



n° 36, novembre 2014

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**When Taiwan's Fate Changed Dramatically in the 1940s:  
The Price of War, the Nationalists' Game, and the Vagaries of International Politics**

In the course of its history, Taiwan's destiny has often been linked to the policies carried out by the leading global powers, Asian or Western – that were eager to protect their political and economic interests in the region.<sup>1</sup> This was particularly the case between the late 1930s and the early 1950s, when, within the space of only a few years, Japan, China and the USA all, in varying degrees, made their influence felt on Taiwan. As a Japanese colony, Formosa was first forcibly involved in the war against China (1937) and, subsequently, against the United States (1941). In 1945, as a former Chinese province, the island was handed over by the Allies to the Republic of China (ROC), and its relations with Japan were temporarily interrupted. Later still, whereas the conflict between

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<sup>1</sup> During the 17<sup>th</sup> century, Formosa opened itself to the world mainly through the impetus given by the Dutch, who colonized Formosa from 1624 to 1662 (the Spanish who landed on Taiwan in 1626 controlled the North of the island until the Dutch expelled them in 1642). They developed agriculture on the island and made it the core of their international trade. Whether as an exporter of local products, such as cane sugar or camphor, or as a point of transit for foreign goods, Formosa developed economic relations with Japan, China, Southeast Asia and even Europe. The takeover of Taiwan by the Zheng family in 1662, and subsequently by the Qing dynasty in 1683 (the Ming dynasty's loyalist Zheng Chenggong (鄭成功) – also called Koxinga – expelled the Dutch from Taiwan in 1662, his son Zheng Jing (鄭經) controlled the island until 1683, and his grandson Zheng Keshuang (鄭克塽) recognized the Qing dynasty the same year) saw these multilateral economic exchanges steadily contract as the island became closer to Mainland China. From the early 18<sup>th</sup> to the mid 19<sup>th</sup> century, trade across the Strait flourished either officially through the ports of Luerhmen (*Lu'ermen* 鹿耳門), Lukang (*Lugang* 鹿港), Palipen (*Baliben* 八里坌), Wushih (*Wushi* 烏石) or unofficially through a throng of other small ports along Formosa's Western coast. Following the signing of the Treaty of Tianjin (June 1858), English merchants extended the island's external trade as far as North America (Los Angeles, New York, Boston) for tea, Australia, New Zealand and Japan for sugar, Germany, England and India for camphor. Cf. LIN, Manhong, *Sì bai nian lai de liang'an fenhe – Yi ge jingmao shi de huigu* (400 Years of Exchanges Between Taiwan and Mainland China – An Historical Overview of the Trade Across the Taiwan Strait), Taipei, Zili wanbao wenhua, Taiwan lishi da xi, 1994, pp. 10-32.

the Chinese Communists and the Nationalists isolated Taiwan from the Mainland (1949), the Korean War drove it to the American side as well as its former colonizer, Japan (from 1950 onwards).

Throughout the 1940s, Taiwan was in some ways a hostage of others' ambitions. Japan's ambition to expand southwards had brought war to Formosa. After 1945, led by their own ambition to capture power, the Nationalists siphoned off the island's resources to the sole benefit of the Chinese Mainland. The Formosans could do little about this except grin and bear it, for what they expected to be a long period of domination. In the event, however, the vagaries of international politics reshuffled all the cards. Chiang Kai-shek's (*Jiang Jieshi* 蔣介石) defeat on the Mainland, soon afterwards followed by the Korean War, led to a marriage of convenience between the Nationalists, the United States and Japan that would eventually benefit Taiwan, at least in economic terms. Although the Nationalist government's ambition remained unchanged, its behavior changed completely. Acknowledging that he was likely to be confined in Formosa for some time, Chiang Kai-shek began to carry out a policy designed to strengthen Taiwan's economy. The Americans for their part were extremely worried about the expansion of communism in Asia, and their main ambition – even obsession – was to contain it at any price. This led the United States not only to draw closer to the Nationalists who had taken refuge in Formosa, but also to provide them with substantial military and economic aid. As for the Japanese government, it was highly dependent on the US for the preservation of its security, while Japan's economy remained very weak. There was a clear political and economic logic in joining the safety zone Washington was building up in East Asia.

The purpose of this article is to review these years of transition, during which the Island of Formosa gave up its status as a Japanese colony – and even in some ways as a Chinese province – to follow its own path within the constraints imposed by the interaction of political and economic forces at the time. We seek to address the following questions: To what extent was Taiwan affected by WW2? What part did political factors play in the economic crisis that hit the island in the immediate aftermath of this war? How did political and economic factors influence the position in the region taken by the US, as well as that of the Nationalists? What was the effect on Formosa's economic recovery?

The first part of this article will assess the scale and impact of the political and economic watersheds experienced by Taiwan during the 1940s: i.e., the war (physical damage, human losses), the economic slump (declining domestic production, surging prices) and the "228 Incident" (tension

between “Mainlanders”<sup>2</sup> and “native Taiwanese”<sup>3</sup> who were victims of political repression). It will not only analyze the impact of goods and capital (public and/or private) flows across the Taiwan Strait, but will also assess the extent to which the Nationalist government exacerbated the situation.

The second part will examine the influence of the split between the Chinese Communist Party and the Nationalist Party (Kuomintang or KMT) across the Strait on the American government’s policy towards Taiwan on the one hand, and the Nationalist government’s policy towards Japan on the other hand. It will highlight the dilemmas faced by these governments when they had to arbitrate between political and geo-strategic/economic interests. It will also underline other conflicts of interests, such as those between Chinese and foreign merchants, or Central and Provincial governments.

Finally, there are some concluding remarks which examine the significance of this period in terms of the island’s postwar economic and political developments.

## **Trapped in the War**

At the end of the 19<sup>th</sup> century, Taiwan became a Japanese colony through the Treaty of Shimonoseki (April 1895). While gradually becoming the island’s main trading partner, the new colonizer also made a major economic contribution by developing Formosa’s infrastructure, educating its population and modernizing its economy.<sup>4</sup> However, Japan also brought war to the island as, from the 1940s onwards, the island was transformed into a military base in order to support Japan’s expansionist policy in Asia. This was the beginning of a dark decade for the Taiwanese people: not only did Japan mobilize them for war purposes, but the island was also bombed by the Allied Forces, inflicting many casualties and causing much destruction.

From September 1937 onwards, the colonial government started to requisition young men aged between twenty and thirty as “military workers” (*junfu* 軍伕).<sup>5</sup> The first group (450 men) was sent to Mainland China to help Japanese soldiers transport weapons and ammunition. Subsequently, others were forced to work as laborers (construction of bridges, farming), cooks, physicians,

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<sup>2</sup> “Mainlanders” (*waishengren* 外省人) refers to Chinese originally from the Mainland who migrated to Taiwan after 1945.

<sup>3</sup> “Native Taiwanese” (*benshengren* 本省人), also called “Formosans”, refers to Chinese originally from the Mainland who migrated to Taiwan before 1945.

<sup>4</sup> A description of Japan’s legacy in Taiwan can be found in LI, Xiaofeng, LIN, Chengrong, *Taiwan shi* (*History of Taiwan*), Taipei, Hualitushu, 2004, pp. 175-187 [Chapter 8, “Ribendi guo tongzhi shiqi de Taiwan” (“Taiwan Under the Rule of Imperial Japan”)].

<sup>5</sup> They were later called “*junshu*” (軍屬). This term, translated as “soldier’s dependent” or “army man’s family (member)”, was used in an attempt not to instil fear among a population that had been shocked by the first roundup of “military workers” carried out by the Japanese.

interprets, etc<sup>6</sup> in Japanese garrisons stationed on the Mainland, in Southeast Asia (Philippines, Malaysia, Indonesia, Burma, Singapore) and even in New Guinea. From the early 1940s onwards, so-called “volunteers” were recruited as “soldiers” (*junren* 軍人) in both the army and navy. From late 1943, Japanese authorities began to provide military training to Taiwanese males in anticipation of an American attack.<sup>7</sup> On 22<sup>nd</sup> August 1944, a state of war was officially declared on the island. On 1<sup>st</sup> September 1944, the “conscription system for Taiwanese’s mobilization” (*Taimin zhengbing zhidu* 臺民徵兵制度), intended to provide for the defense of Formosa, came into force. Finally, from 9<sup>th</sup> January 1945, the colonial government began to undertake the physical examination of every mobilized conscript.<sup>8</sup> Overall, of the 200,000 or so Taiwanese enrolled either as “military workers” or “soldiers” between 1937 and 1945, about thirty thousand died.<sup>9</sup>

The Allied Forces carried out air raids against Taiwan. The island suffered its first air attack on 25<sup>th</sup> November 1943, when aircrafts targeted the airport of Hsinchu (*Xinzhu* 新竹).<sup>10</sup> Afterwards, the Americans bombed intensively Formosa between 12<sup>th</sup> October 1944 and 10<sup>th</sup> August 1945.<sup>11</sup> On 9<sup>th</sup> March 1945, Taiwan’s main power plant, located near Sun Moon Lake (*Ri yue tan* 日月潭), was completely destroyed.<sup>12</sup> On 31<sup>st</sup> May 1945, the governor-general’s office in Taipei was also destroyed.<sup>13</sup> According to statistics published by the “colonial government’s police headquarters” (*zongdufu jingwuju* 總督府警務局), the final toll of these ten months of bombing was about 6,500 people reported dead or missing (92% Taiwanese, 8% Japanese) and 14,300 wounded (60% Taiwanese, 40% Japanese).<sup>14</sup> Physical damage was also heavy. British sources reported that at the end of 1945 between 10% and 50% of housing in main cities had been destroyed.<sup>15</sup> For its part, the colonial government indicated that bombing and/or related fires had partially or completely

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<sup>6</sup> There were also girls known as “comfort women” (*wei’an fu* 慰安婦) who went overseas initially to work in Japanese garrisons, but were then forced to work as prostitutes for soldiers. Statistics based on the number of passports issued by mayors in Taiwan’s main cities during 1938-41 point to at least 350 such cases, although the true number is probably far higher. Cf. ZHU, Delan, *Taiwan wei’an fu* (Taiwan’s “Comfort Women”), Taipei, Wunan tushu, 2009, pp. 19-20 and 317-326.

<sup>7</sup> Cf. ZHENG, Liling, *Taiwan ren Riben bing de zhanzheng jingyan* (The War Experience of Taiwanese as Japanese Soldiers), Taipei, Xianli wenhua zhongxin, 1995, pp. 1-7.

<sup>8</sup> Cf. YANG, Bichuan, *Taiwan lishi nianbiao* (A Chronology of Taiwan’s History), Taipei, Zili wanbao, 1988, p. 176 and 178.

<sup>9</sup> This relatively low rate of deaths can probably be explained by the fact that the great majority of “recruits” were “military workers” and not “soldiers”. Cf. Zheng, *Taiwan ren Riben bing de zhanzheng jingyan*, op. cit., p. 1.

<sup>10</sup> Cf. YE, Rongzhong, *Ri ju xia Taiwan da shi nianbiao* (A Chronology of Major Events in Colonial Taiwan), 1895-1945, Taichung, Chengxing, Taiwan lishi guan, 17, 2000, p. 374.

<sup>11</sup> Cf. QI, Jialin, *Taiwan shi* (A History of Taiwan), Taipei, Haixia xueshu, 2008, p. 432.

<sup>12</sup> Cf. Ye, *Ri ju xia Taiwan da shi nianbiao*, op. cit., p. 384.

<sup>13</sup> Cf. Yuanliu, *Taiwan shi xiao shidian* (Concise Chronological Dictionary of Taiwan History), Taipei, Yuanliu, Renshi Taiwan shidian xilie, 2002, p. 159.

<sup>14</sup> Cf. Qi, *Taiwan shi*, op. cit., pp. 432-434.

<sup>15</sup> 10% in Taichung (Taizhong 臺中), 20% in Taipei (Taibei 臺北), 40% in Hsinchu, Tainan (臺南), Kaohsiung (Gaoxiong 高雄), 50% in Keelung (Jilong 基隆). Cf. Report written by the British Consul in post in Fuzhou following a tour of Formosa between 24th October and 14th November, 1945, in Robert L. JARMAN (ed.), *Taiwan – Political and Economic Reports, 1861-1960, 8 (1945-1949)*, Slough, UK, Archive Editions, 1997, p. 127.

destroyed around 46,300 houses and left some 277,400 people homeless. As for the railway network, 1,400 engines / (freight) cars were destroyed (48% of the engines and 20% of the (freight) cars), as well as 1,500 buildings (stations, hangars, etc.) located along the railways. Nor were production facilities spared, as with 200 or more factories demolished by war damage.<sup>16</sup>

## Economic Recession

The end of the Pacific War signaled Taiwan's return to China's political and economic sphere.<sup>17</sup> However, far from bringing relief to the Formosans, the return of the island to Chinese rule led to new hardship. The heavy damage inflicted on the island's infrastructure during the war had already caused a sharp fall in production levels: by 52.3% in the agricultural sector, and by 63% in the industrial sector (1937-45).<sup>18</sup> In terms of some key products, the output decline was even more dramatic: in 1945, rice production was just 41.7% (0.58 million MT (Metric Tons)) of its pre-war peak (1.39 million MT in 1938); for cane the corresponding figure was 32.4% (4.16 million MT, compared with 12.84 million MT in 1939); and for refined sugar it was a mere 23.2% (0.33 million MT, compared with 1.42 million MT in 1939).<sup>19</sup>

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<sup>16</sup> Cf. Qi, *Taiwan shi*, *op. cit.*, pp. 432-434.

<sup>17</sup> It had been agreed as early as December 1943 at the Cairo Conference by Franklin D. Roosevelt, Winston Churchill and Chiang Kai-shek, later accepted by Stalin, and officially confirmed at the Potsdam Conference in July 1945, that at the end of the war all former "Chinese" territories considered as having been occupied by Japanese – including Taiwan – would be returned to China, meaning the Republic of China founded by Sun Yat-sen (*Sun Yixian* 孫逸仙) on 1<sup>st</sup> January 1912.

<sup>18</sup> In value terms. Cf. WU, Ruoyu, *Zhan hou Taiwan gongying shiye zhi zheng jing fenxi* (*Political and Economic Analysis of Taiwan's Postwar Public Enterprises*), Taipei, Yejiang, Zhang Yongfa jijinhui, Guojia zhengce yanjiu zhongxin, 1992, p. 56. The agricultural sector suffered from a lack of fertilizers (phosphorus fertilizers: 400 MT in 1945 versus 24,768 MT in 1937; nitrogenous fertilizers: "nil" in 1945 versus 12,778 MT in 1942) [a], and from the reduction of cultivated land turned over to military use (cultivated land area: 816,017 hectares in 1945 compared with 860,439 hectares in 1940) [b]. The industrial sector for its part suffered a sharp fall in the production of electric power following the destruction of the Sun Moon Lake power plant (electric power: 0.36 billion KWH in 1945; 1.17 billion KWH in 1943) [c]. Sources: [a] Cf. (1945) Chinese American Joint Commission on Rural Reconstruction, "Taiwan Agricultural Statistics, 1901-1965", *Economic Digest Series*, 18, December 1966, p. 257; "(1937, 1942) Taiwan sheng xingzheng zhangguan gongshu tongjishi", *Taiwan sheng tongji yaolan*, 1, October 1946, p. 89; [b] Cf. Chinese American Joint Commission on Rural Reconstruction, "Taiwan Agricultural Statistics, 1901-1965", art. cited, p. 11; [c] Cf. "Taiwan sheng xingzheng zhangguan gongshu tongjishi", *Taiwan sheng tongji yaolan*, 1, October 1946, p. 89.

<sup>19</sup> Cf. (1945) Chinese American Joint Commission on Rural Reconstruction, "Taiwan Agricultural Statistics, 1901-1965", art. cited, p. 23 and p. 47.

From late 1945, not only did domestic production only slowly begin to recover<sup>20</sup>, but prices on the island also began to soar<sup>21</sup>: by 21.6% per month on average between January and May 1946.<sup>22</sup> Although the creation, on 22<sup>nd</sup> May, 1946, by the Nationalist authorities of a new currency called “taibi” (臺幣) or “Taiwan dollar” (T.W.\$)<sup>23</sup> slowed down the inflation rate for a few months (+ 2.6% per month on average between May and September 1946), the upward trend was resumed in the last quarter of the year (rising by 7.4% per month on average between September and December 1946), and accelerating during the following years: (average monthly rate) by 19.3% between January and December 1947; 26.8% between January and December 1948; and by 52.6% between January and June 1949.<sup>24</sup>

At a first glance, this runaway inflation can be explained by conventional factors. Firstly, with overall production already below those of pre-war levels, massive immigration from Mainland China led to excess demand in domestic markets, generating demand-pull inflation. After the return of the island to the ROC, Formosa’s population increased by about one quarter in just a few years: by 23% between June 1946 (6,013,719) and December 1949 (7,398,200), according to official statistics<sup>25</sup>; and by 28.4% if we include the military troops stationed in Formosa (324,150 in 1949)<sup>26</sup>, taking the total population to 7,722,350 inhabitants.<sup>27</sup> Secondly, the exponential growth of the money supply in Formosa during the 1940s induced a depreciation of the Taiwanese currency,

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<sup>20</sup> In early 1946, the British Consul in Fuzhou underlined the slow pace of reconstruction works: “No effort appeared yet to have been made by the government to proceed with the repair or cleaning up of bombed areas. (...) No repairs have been made on bombed factories and, in consequence the steady deterioration of plant owing to action of wind and weather continues”. Cf. British Report (16<sup>th</sup> February-4<sup>th</sup> March, 1946), in Jarman (ed.), *Taiwan – Political and Economic Reports, 1861-1960*, 8 (1945-1949), *op. cit.*, p. 226. In 1949, if a few products, i.e. fertilizers, had already recovered their pre-war production levels (31,830 MT for phosphorus fertilizers and 14,010 MT for nitrogenous fertilizers) [a], most of them had still to do so: 72.6% (0.85 billion KWH) of pre-war record for electric power [b]; 87.1% (1.21 million MT) for rice; 48.2% (6.19 million MT) for cane; 45.8% (0.65 million MT) for sugar [c]. Source: [a] Cf. Chinese American Joint Commission on Rural Reconstruction, “Taiwan Agricultural Statistics, 1901-1965”, art. cited, p. 257; [b] Cf. *Industry of Free China IV* (6), December 1955, p. 56; [c] Cf. Chinese American Joint Commission on Rural Reconstruction, “Taiwan Agricultural Statistics, 1901-1965”, art. cited, p. 23 and p. 47.

<sup>21</sup> Actually, the price of foodstuffs started to increase from August 1945 onwards as the price-control legislation put in force by the Japanese was breaking down. Cf. British Report (24<sup>th</sup> October-14<sup>th</sup> November, 1945), in Jarman (ed.), *Taiwan – Political and Economic Reports, 1861-1960*, 8 (1945-1949), *op. cit.*, p. 126.

<sup>22</sup> Calculated by the author from the monthly wholesale price index in Taipei reported in YUAN, Yingsheng, *Guangfu qianhou de Taiwan jingji (Taiwan’s Economy Before and After the “Retrocession”)*, Taipei, Lianjing, Zhonghua minguo jingji fazhan celüe congshu, 1998, p. 191.

<sup>23</sup> The purpose was to prevent inflation to spread from the Mainland to Taiwan. During the war, prices had already soared in Mainland China where the currency in use since 4<sup>th</sup> November 1935 was the “fabi” (法幣). Cf. CHANG, Kia-NGau, *The Inflationary Spiral – The Experience in China, 1939-1950*, London, Chapman and Hall, The Massachusetts Institute of Technology, 1958, pp. 34-58.

<sup>24</sup> Calculated by the author from the monthly wholesale price index in Taipei reported in Yuan, *Guangfu qianhou de Taiwan jingji*, *op. cit.*, p. 191. Finally, the “T.W.\$” was replaced by the “New Taiwan Dollar” (NT\$) – “xin taibi” (新臺幣) – in June 1949 (NT\$1 = T.W.\$40,000).

<sup>25</sup> + 83,398 in 1946, + 400,617 in 1947, + 309,867 in 1948, + 590,599 in 1949. Cf. “Taiwan sheng xingzheng zhangguan gongshu tongjishi”, *Taiwan sheng tongji yaolan*, 9, 1949, p. 8.

<sup>26</sup> Cf. WU, Congmin, *1945-1949 nian guomin zhengfu dui Taiwan de jingji zhengce (National Government’s Economic Policy in Taiwan between 1945 and 1949)*, Taipei, Xingzhengyuan guojia kexue weiyuanhui, Zhuanti yanjiu jihua chengguo baogao, Taida jingji xi, 12<sup>th</sup> June, 1997, p. 26.

<sup>27</sup> Note that 284,220 Japanese left Taiwan between February and August 1946. Cf. “Taiwan sheng xingzheng zhangguan gongshu tongjishi”, *Taiwan sheng tongji yaolan*, 1, October 1946, p. 39.

generating a rise in prices (monetary inflation). Taiwan suffered a serious lack of capital. Japanese capital had disappeared, Western capital had not yet arrived, and Chinese capital was insufficient to meet Taiwan's needs. In order to "kick-start" the island's economy, as well as to finance its war against the Chinese Communists, the Nationalist government – now in control of virtually all Taiwan's production facilities – could not help but to turn to the Bank of Taiwan (*Taiwan yinhang* 臺灣銀行) for credit. As a result, the Bank issued excessive amounts of money. Huge inflows of capital further exacerbated the growth of the money supply. As the Civil War intensified in Mainland China, private capital began to pour into Formosa, where conditions seemed safer and more stable than in the Mainland. When the Nationalists faced obvious defeat, public capital was too remitted from the Mainland to Taiwan to prevent it from falling into the hands of the Communists.<sup>28</sup>

However, these conventional explanations do not capture the entire story. In particular, they omit the fact that mishandling of the situation, or even trafficking, by the Nationalist government made inflationary pressures even more severe. Firstly, the politically-motivated decision to keep a fixed exchange rate between the "taibi" in Taiwan and the "fabi" on the Mainland<sup>29</sup> offset, if not nullified, the positive effects of the creation of an "independent" currency in Taiwan, and thereby encouraged the diffusion of inflation through imports of goods from the Mainland.<sup>30</sup> On the one hand, since the island was now part of China, it was hard for Chiang Kai-shek to accept a floating rate of exchange between the Taiwanese currency and the "fabi". On the other hand, since the Mainland imported a lot of products from Taiwan, the Nationalist Party sought to control prices on the island. Secondly, the shortage of rice that fuelled price inflation<sup>31</sup> was due less to insufficient local production than to bad management of the stocks and smuggling activities. At this point in time, average per capita rice consumption in Formosa was 250 lbs (113.5 kg) per year. Based on this estimate, only 0.88 million MT of rice a year should have been required to feed the entire population of Taiwan (7,722,350 in 1949) – i.e., less than the island's total rice production (1.21 million MT in 1949).<sup>32</sup> In fact, the Nationalist government appropriated large quantities of rice produced locally, whether by taking control of stocks<sup>33</sup> or by compelling farmers to sell all or part of their output to

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<sup>28</sup> The inflation process is well described in PAN, Zhiqi, *Guangfu chuqi Taiwan tonghuo pengzhang de fenxi* (Analysis of the Inflationary Phenomenon in Taiwan during the Early "Retrocession" Period), Taipei, Lianjing, 1980, pp. 43-78.

<sup>29</sup> This policy of fixed exchange rates prevailed until 15<sup>th</sup> January 1948.

<sup>30</sup> Raw materials and other necessities that had previously been imported from Japan were henceforth shipped from the Mainland.

<sup>31</sup> For instance, the price of rice increased from T.W.\$5,200 to T.W.\$9,700 a "picul" (*dan* 擔 = 60.5 kg) between January and June 1948. Cf. British Report entitled "Summary of Events in Formosa during the First Six Months of 1948" (24<sup>th</sup> July, 1948), in Jarman (ed.), *Taiwan – Political and Economic Reports, 1861-1960*, 8 (1945-1949), *op. cit.*, p. 323.

<sup>32</sup> Calculated by the author on the basis of the home consumption estimate reported in the British Report entitled "A Survey of Present Conditions in Formosa" (12<sup>th</sup> January-5<sup>th</sup> February, 1946) taken from Jarman (ed.), *Taiwan – Political and Economic Reports, 1861-1960*, 8 (1945-1949), *op. cit.*, p. 170.

<sup>33</sup> This was done through the "Taiwan Province Provisional Regulation for the Management of Foodstuffs" (*Taiwan sheng guanli liangshi linshi banfa* 臺灣省管理糧食臨時辦法) implemented from 31<sup>st</sup> October 1945 to 11<sup>th</sup> January 1946. Cf. Wu, *1945-1949 nian guomin zhengfu dui Taiwan de jingji zhengce*, *op. cit.*, pp. 10-12.

them at a very low price.<sup>34</sup> Most of this rice was either exported to the military for use in Northern China and Manchuria or smuggled (trade exports of rice was officially prohibited) to the Mainland where prices were much higher offering substantial profits to the authorities.<sup>35</sup> Some rice was also smuggled by unscrupulous merchants who bought it from farmers resentful of the controlled price fixed by the government.<sup>36</sup> Thirdly, the lack of foreign exchange that led to wide-scale resort to credit is largely explained by the fact that the Central government was operating serious drain on the island's export's resources. Take, for example the Taiwan Sugar Company (TSC) (*Taiwan tangye gongsi* 臺灣糖業公司), a public enterprise based on the merger of private sugar firms operating in Taiwan in the early 1940s, which saw its revenues melt away after the handover. Although it had the control of all the sugar produced on the island, the TSC was compelled to give up its sugar stocks without compensation (in March 1946, the Nationalist government requisitioned the stocks dating from the colonial period as well as output from 1945-46)<sup>37</sup>, or to sell them in Shanghai at a price far below the world market price. Moreover, in the latter case, the Shanghai office of the Bank of Taiwan did not even secure the proceeds of the sales, since the Central government instead negotiated a new loan with the island's Bank of Taiwan.<sup>38</sup> Thus, the TSC, which had to advance the production costs (seeds, fertilizers, etc.) to farmers for the growing of cane, had no alternative but to borrow these funds from the Bank of Taiwan.

### From Disillusion to Anger

According to British representatives in Taiwan, the Formosans were initially happy to see the departure of the Japanese and the arrival of the Chinese:

“The Formosan appeared to have (...) no regret for the Japanese regime. Wherever I went I heard voluble complaints of Japanese discrimination against Formosan and unwarrantable interference in their way of life” (British Report, 24th October-14th November, 1945).<sup>39</sup>

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<sup>34</sup> The government also obtained rice by swapping it for fertilizers or by collecting land taxes in the form of rice. Cf. Wu, *Zhan hou Taiwan gongying shiye zhi zheng jing fenxi*, *op. cit.*, pp. 68-70.

<sup>35</sup> Cf. British Report entitled “Formosan News Summary for January and February 1948” (10<sup>th</sup> March, 1948), in Jarman (ed.), *Taiwan – Political and Economic Reports, 1861-1960, 8 (1945-1949)*, *op. cit.*, p. 309.

<sup>36</sup> Cf. British Report (16<sup>th</sup> February-4<sup>th</sup> March, 1946), in Jarman (ed.), *Taiwan – Political and Economic Reports, 1861-1960, 8 (1945-1949)*, *op. cit.*, p. 227.

<sup>37</sup> Cf. WU, Congmin, “Taiwan changqi zong chanchu zhi biandong yu jingji jiegou bianqian” (“Taiwan’s Long-Term Global Output Fluctuations and Economic Structure Evolution”), in Taiwan sheng wenxian weiyuanhui, *Taiwan jindai shi – jingji bian* (*Taiwan’s Modern History – Economy*), Nantou, Taiwan sheng wenxian weiyuanhui, 1995, pp. 621-623.

<sup>38</sup> Cf. British Report about the situation in Formosa after fifteen months of Chinese control, 12<sup>th</sup> February, 1947, in Jarman (ed.), *Taiwan – Political and Economic Reports, 1861-1960, 8 (1945-1949)*, *op. cit.*, p. 235.

<sup>39</sup> Cf. Jarman (ed.), *Taiwan – Political and Economic Reports, 1861-1960, 8 (1945-1949)*, *op. cit.*, p. 125.



“[The Taiwanese]’ enthusiasm for China at the conclusion of the Pacific War was strong and sincere (...)” (British Report, 12th February, 1947).<sup>40</sup>

However, it did not take long before they changed their minds. The rapid deterioration of living standards caused by the economic slump brought great disillusion. Corrupt practices and political discrimination turned disillusion into discontent. A police blunder transformed discontent into anger.

The decline in the standard of living mainly reflects the sharp rise in the prices of most staple foodstuffs, which was underway as early as late 1945 (+ 4.45% per month for groundnut oil, + 8.97% for pork, + 44.34% for vegetables, + 51.47% for rice between November 1945 and January 1946)<sup>41</sup> and continued into early 1946 (+ 2.60% per month for pork, + 17.70% for groundnut oil, + 22.47% for vegetables, + 26.50% for eggs, + 71.98% for rice between January and March 1946).<sup>42</sup> Such price rises were a new experience for the Formosans (the Japanese had enacted price-control legislation that kept prices stable),<sup>43</sup> and they felt that the Chinese authorities, either through mishandling or trafficking, were responsible for it. Worse, the new masters who took over most production facilities on the island rapidly appeared in Formosans’ eyes to be not only incompetent, but also corrupt. This was underlined by both British and American representatives on the ground:

“There is little doubt that the majority of Formosans disliked Japanese rule (...), [but] since the [Chinese] civil administration began to ‘function’ however, there have been grave disappointment, and the inability of the Chinese to deal with the situation and the many corrupt practices which have appeared have not gone un-noticed” (British Lieutenant Commander Max Berman, 1946).<sup>44</sup>

“The people anticipated sincerely and enthusiastically deliverance from the Japanese joke. However, Chen Yi and his henchmen ruthlessly, corruptly and avariciously imposed their regime upon a happy and amenable population” (American General Wedemeyer, 1947).<sup>45</sup>

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<sup>40</sup> Cf. *ibid.*, p. 238.

<sup>41</sup> Groundnut oil: from ¥176 to ¥192 (per 4 kg); pork: from ¥320 to ¥380 (per 5 kg); vegetables: from ¥144 to ¥300 (per 60 kg); rice: from ¥350 to ¥803 (per 75 kg). Eggs were an exception as their prices decreased from ¥375 to ¥300 (per 150 pcs) during the same period. Cf. British Report (16<sup>th</sup> February-4<sup>th</sup> March, 1946), in Jarman (ed.), *Taiwan – Political and Economic Reports, 1861-1960*, 8 (1945-1949), *op. cit.*, p. 227.

<sup>42</sup> Pork: from ¥380 to ¥400; groundnut oil: from ¥192 to ¥266; vegetables: from ¥300 to ¥450; eggs: from ¥300 to ¥480; rice: from ¥803 to ¥2375. Cf. *ibid.*

<sup>43</sup> Cf. British Report (24<sup>th</sup> October-14<sup>th</sup> November, 1945), in Jarman (ed.), *Taiwan – Political and Economic Reports, 1861-1960*, 8 (1945-1949), *op. cit.*, p. 126.

<sup>44</sup> Cf. British Report entitled “A Survey of Present Conditions in Formosa” (12<sup>th</sup> January-5<sup>th</sup> February, 1946), in Jarman (ed.), *Taiwan – Political and Economic Reports, 1861-1960*, 8 (1945-1949), *op. cit.*, p. 218.

<sup>45</sup> Report by General Wedemeyer to the Secretary of State following a mission to China, August 17, 1947. Cf. Lyman P. VAN SLYKE, *The China White Paper – August 1949*, Stanford, Stanford University Press, 1967, p. 309. This “paper” was originally issued as *United States Relations with China (with Special Reference to the Period 1945-1949)* by the American Department of State.

The Formosans were also deprived of their political rights. Firstly, the Mainlanders, behaving more like conquerors than liberators, excluded native Taiwanese from positions of administrative responsibility. The background of personnel in the nine departments of the Governor's office in July 1946 bears this out: out of 1,275 total employees, two-thirds (850) were Mainlanders, and one third (425) were native Taiwanese. The imbalance was even more striking for the most senior positions: the posts of governor (1), secretary-general (1) and commissioners (8) were all held by Mainland Chinese; out of 355 vice-commissioner and technical expert positions, 93% (330) were held by Mainlanders. Only at the lowest levels in the hierarchy was there greater parity: out of 910 posts of clerks, 44% (400) were held by Formosans.<sup>46</sup> Secondly, the Chinese authorities decided not to enact in full the new constitution of the Republic of China (promulgated in January 1947) in Formosa. For example, they permitted the election by popular vote of the heads of the villages and small towns in December 1947, but postponed the election of the mayors and county heads until 1948 – and that of higher officials until 1949.<sup>47</sup>

While anger against the Mainlanders was growing amongst the Formosans, a police blunder precipitated a major incident that was to have lasting implications. On 27<sup>th</sup> February 1947, a local resident was killed following the arrest by the police of a woman trafficking in the street in Taipei.<sup>48</sup> The following day, around two thousand people protested outside the Governor's office, demanding that disciplinary action be taken against the policeman responsible for the shooting. Guards opened fire on the crowd, killing several people.<sup>49</sup> From 1<sup>st</sup> March onwards, strikes and riots broke out in Taipei and all over the island, as Formosans hunted down Mainland Chinese in the streets. The situation became so critical that on 4<sup>th</sup> March the Governor, Chen Yi (陳儀), asked Chiang Kai-shek to dispatch troops from the Mainland. On the morning of 8<sup>th</sup> March, more than 8,000 soldiers sailed from Shanghai for Formosa.<sup>50</sup> The same day in the afternoon, another ship from Fuzhou disembarked 2,000 soldiers in the port of Keelung.<sup>51</sup> On 18<sup>th</sup> March, the entire island was under the control of the army.<sup>52</sup> To the profound anger and distress of the indigenous Taiwanese population,

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<sup>46</sup> Cf. British Report (12<sup>th</sup> February, 1947), in Jarman (ed.), *Taiwan – Political and Economic Reports, 1861-1960*, 8 (1945-1949), *op. cit.*, p. 234.

<sup>47</sup> This decision was taken at the conference on administration in Formosa, held in January 1947 under the aegis of – among others – the governor of Taiwan and the chairman of KMT's provincial headquarters. Cf. *ibid.*, p. 235.

<sup>48</sup> Officials of the Tobacco Monopoly Bureau and police in Taipei detained a woman selling smuggled cigarettes. When she refused to hand over her takings, one of the policemen hit her over the head with the butt of his pistol. Bystanders witnessing the scene closed in on the police, and when the police fired some shots to make their escape, a bystander was killed.

<sup>49</sup> A chronology of the events can be found in Guo shi guan, *Er er ba shijian cidian (Dictionary of the 228 Incident)*, Taipei, Guo shi guan, er er ba shijian jinian jijinhui, 2008, pp. 761-776.

<sup>50</sup> Cf. LIN, Delong, *Er er ba guanfang jimi shiliao (Official Confidential Historical Data of the 228 Incident)*, Taipei, Zili wanbao, 1992, p. 146.

<sup>51</sup> Cf. Letter sent by the British Consulate in Tamsui to the British Ambassador in Nanking on 10<sup>th</sup> March 1947, in Jarman (ed.), *Taiwan – Political and Economic Reports, 1861-1960*, 8 (1945-1949), *op. cit.*, p. 259.

<sup>52</sup> About 16,000 soldiers were probably involved in the 228 incident: 3,444 soldiers already stationed on the island + 12,500 soldiers dispatched from the Mainland. Cf. ZENG, Qingguo, *Er er ba xianchang (shang) – Dang'an zhi ji (The 228 Incident on the Spot (Vol. 1) – Direct Evidence Gathered from Archives)*, Taipei, Taiwan shufang, 2008, pp. 13-29.

this rebellion was crushed by the Nationalist government with violence and bloodshed, making thousands of victims.<sup>53</sup>

This rebellion known in Chinese as the “228 Incident” (*er er ba shijian* 二二八事件) left profound aftermath and had a great impact on relations between Mainlanders and native Taiwanese.<sup>54</sup> It was followed by a period of political repression against opponents of the Kuomintang – known as the “White Terror” (*baise kongbu* 白色恐怖) period – that was to last almost fifteen years during which two thousand people were reported to have been shot dead and eight thousand put in jail.<sup>55</sup> Many opponents also fled to Japan where they were given political asylum.<sup>56</sup>

### Division Across the Strait

The turn of history reversed the island’s destiny when in late 1949 the war between the Nationalists and the Communists in Mainland China divided the two countries on the two sides of the Taiwan Strait. While Mao Zedong (毛澤東) was proclaiming the People’s Republic of China on the Mainland in October, Chiang Kai-shek fled to Taiwan where in December he officially re-established the Republic of China.<sup>57</sup> As the Civil War between the Communists and the Nationalists intensified, it had become increasingly dangerous to travel across the Strait. The Nationalist leader had imposed martial law in May 1949, forbidding all contacts with the enemy (the Communists), with offenders facing a charge of high treason. All this delivered a serious blow to maritime transport across the Strait: many merchant ships were taken out of commission and many coastal businesses

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<sup>53</sup> There is no accurate figure of the total number of dead, and published data reveal major discrepancies: from 240 (an official figure announced by the Chinese authorities in Taiwan through the channel of the garrison headquarters) to more than 100,000 (an estimate based on the number of people taken out of the island’s domiciliary registers after being classified as “whereabouts unknown” following the 1953 census of the population, most of these being considered as victims of the 228 incident). A more sensible figure may be around 20,000 victims, an estimate based on the death rate recorded in 1947, which appears to be much higher than the death rates observed in 1946, 1948, 1949 and 1950. Cf. ZENG, Qingguo, *Er er ba xianchang (xia) – Jie hou yusheng (The 228 Incident on the Spot (Vol. 2) – Surviving after the Disaster)*, Taipei, Taiwan shufang, 2008, pp. 195-206. Further analysis of the figures can be found in Xingzheng yuan yanjiu 228 shijian xiaozu, *228 shijian yanjiu baogao (Study Report on the 228 Incident)*, Taipei, Shibao wenhua, 1994, pp. 261-363.

<sup>54</sup> The victims had to wait almost fifty years (28<sup>th</sup> February 1995) before Lee Teng-hui, as Chairman of the Kuomintang as well as President of the Republic of China in Taiwan, officially apologized to them and unveiled a memorial dedicated to their memory. On 23<sup>rd</sup> March 1995, Taiwan’s Legislative Council (*Lifa yuan* 立法院) passed a law awarding compensation to “228 Incident”’s victims (*er er ba shijian chuli ji buchang tiaoli* 二二八事件處理及補償條例). The statutory order was published by the Presidency on 7<sup>th</sup> April, and the law came into force on 7<sup>th</sup> October. The same year, the “228 Incident” was for the first time referred to in the island’s textbooks. Cf. *Er er ba shijian cidian*, *op. cit.*, pp. 785-786.

<sup>55</sup> For details about this period, see CHEN, Zhengmao, LIN, Baozong, LIN, Shizong, *Xin bian Taiwan shi (The History of Taiwan: A Contemporary Introduction)*, Zhonghe, Xinwenjing kaifa, 2008, pp. 364-376.

<sup>56</sup> In the mid 1960s, there were about 2,500 Taiwanese political refugees living in Japan belonging to or at least inclined towards Taiwan independence groups. Cf. Douglas H. MENDEL, Jr., “Japan’s Taiwan Tangle”, *Asian Survey* IV (10), October 1964, pp. 1075-1076.

<sup>57</sup> From that time onwards, Formosa (Taiwan) was identified with the Republic of China, and Mainland China became the People’s Republic of China.

went bankrupt.<sup>58</sup> This was especially harmful to the island's economy since about four fifths of Taiwan's total external trade<sup>59</sup> was at that time with the Mainland.<sup>60</sup>

Trade between the two sides of the Strait fell dramatically during 1949.<sup>61</sup> It continued on a very small scale and under military control through Canton and other southern Chinese ports after the Communists took Shanghai (May 1949), and through the Chusan Islands (*Zhoushan dao* 舟山島) off the Hangzhou Bay after the fall of Canton (October 1949).<sup>62</sup> But smuggling activities also have to be taken into account. Often in collusion with local authorities, Taiwanese ships went to the Mainland where they stocked up with foodstuffs and other daily consumption goods, as well as timber for construction. Chinese ships involved in illegal trade would usually set a course other than for Taiwan, but then change direction and make for the island to take on board supplies of cane sugar, coal or Western medicine.<sup>63</sup> Large quantities of produce originating from North China, especially bean cakes (*doubing* 豆餅) for feeding animals, and groundnuts for cooking oil were also imported through Hong Kong.<sup>64</sup> Such illegal trade went on until the early 1950s<sup>65</sup>, when heightened cross-Strait tensions put a stop to it.

On 3<sup>rd</sup> September 1954, the Communists demanded the "liberation of Taiwan" and shelled the Quemoy (*Jinmen* 金門) archipelago.<sup>66</sup> This led the United States to sign a mutual defense treaty with the Nationalist government, which committed it to intervene militarily should the communist forces launch a major attack on Taiwan.<sup>67</sup> This treaty notwithstanding, four years later (on 23<sup>rd</sup> August 1958) the Communists resumed shelling Quemoy for a period of 44 days during which 80 Taiwanese military personnel were killed.<sup>68</sup> The KMT administration's response was to urge

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<sup>58</sup> Cf. Lin, *Si bai nian lai de liang'an fenhe...*, *op. cit.*, p. 46.

<sup>59</sup> Such trade had been under the control of the Chinese authorities since December 1945 (when trade between the two sides of the Strait was "reorganized" through the setting up of the "Taiwan Province Trading Company" (*Taiwan sheng maoyi gongsi* 臺灣省貿易公司) that was renamed "Taiwan Province Trading Bureau" (*Taiwan sheng maoyi ju* 臺灣省貿易局)) in February 1946.

<sup>60</sup> Mainland China's part of Taiwan's trade was 94.1% in 1946, 90.8% in 1947 and 86.5% in 1948. Cf. *Taiwan Trade Statistics for the Last Fifty-Three Years (Taiwan maoyi wushisan nian biao) (1896-1948)*, Bureau of Accounting and Statistics, Provincial Government of Taiwan, China (*Taiwan sheng zhengfu zhujichu*) (date of edition invisible), p. 4.

<sup>61</sup> No official statistics are available for 1949 concerning the structure of Taiwan's trade by countries, although some estimates are available in British sources (see note 105).

<sup>62</sup> Cf. Formosa Economic Notes (British Report) (15<sup>th</sup> May, 1949-15<sup>th</sup> January, 1950), in Jarman (ed.), *Taiwan – Political and Economic Reports, 1861-1960*, 8 (1945-1949), *op. cit.*, p. 576.

<sup>63</sup> Cf. Lin, *Si bai nian lai de liang'an fenhe...*, *op. cit.*, p. 46.

<sup>64</sup> Cf. Formosa Economic Notes (15<sup>th</sup> May, 1949-15<sup>th</sup> January, 1950), in Jarman (ed.), *Taiwan – Political and Economic Reports, 1861-1960*, 8 (1945-1949), *op. cit.*, p. 576.

<sup>65</sup> It is difficult to estimate the scale of these activities. Since trade between Taiwan and the Mainland was forbidden, no figure appears in official statistics. There is a strong presumption that part of the island's imports from Hong Kong (18.3% in 1950, 12.9% in 1952, 5% in 1954) and part of the island's exports to Hong Kong (17.1% in 1950, 7.7% in 1952, 8.1% in 1954) in fact includes trade with Mainland China. Cf. *Industry of Free China* III (6), June 1955, p. 82.

<sup>66</sup> The archipelago, then under the control of the Nationalists, is located less than 3 kilometers from the Mainland. Today, Taiwan's authorities exert their sovereignty over Taiwan, Penghu (澎湖), Quemoy and Matsu.

<sup>67</sup> Nevertheless, in order to minimize the possibility of its military becoming involved in a conflict, the U.S. government deliberately excluded Quemoy and Matsu from this treaty. Cf. LIAO, Yifan, *Tuijie Taiwan shi (An Illustrated History of Taiwan)*, Taipei, Yiboshi chubun, Yice tongxiao, 2005, p. 207.

<sup>68</sup> Cf. *Taiwan shi xiao shidian*, *op. cit.*, p. 177.

Washington to provide the “offshore” islands, i.e. Quemoy and Matsu (*Mazu* 馬祖), with necessary supplies and military equipment.<sup>69</sup> Eventually, on 25<sup>th</sup> October 1958 the People’s Republic of China’s authorities adopted a new strategy, whereby the shelling of Quemoy took place every other day.<sup>70</sup> That put a brake on any form of trade across the Strait.

Paradoxically, the splitting of the Strait also marked a new start for Formosa. The 1940s had witnessed a dramatic deterioration in economic conditions on the island. By 1950, Taiwan’s national income (US\$730 m.) was far below that of Japan (c. \$10,233 m.), let alone that of the United States (c. \$240,632 m.)<sup>71</sup>, as was its average per capita income (US\$89.5, compared with \$123 for Japan and \$1,596.8 for the United States).<sup>72</sup> Its exports also lagged far behind those of Japan and the USA (US\$72 m., compared with \$820 m. (Japan) and \$10,149 m. (United States))<sup>73</sup> and even its per capita export ratio.<sup>74</sup> However, new opportunities were about to emerge that would soon dramatically raise Taiwan’s international economic profile.

## Washington to the Rescue

In the early 1950s, Chiang Kai-shek faced a difficult dilemma. He needed to maintain adequate military defense capabilities in case the island was invaded by Chinese communist forces.<sup>75</sup> He had to provide for the subsistence needs of Mainland civil servants and soldiers who had followed him to Taiwan. He needed too to begin the task of rehabilitating the island’s economy (e.g., to restore transport infrastructure and production facilities) in order to maintain economic and social stability. However, there was a desperate shortage of funds to finance such activities. At the end of 1950,

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<sup>69</sup> Cf. Nancy BERNKOPF TUCKER, *Taiwan, Hong Kong and the United States, 1945-1992*, New York, Twayne Publishers, Twayne’s International History Series, 1994, p. 43.

<sup>70</sup> Cf. *Taiwan shi xiao shidian*, *op. cit.*, p. 177.

<sup>71</sup> Taiwan, cf. *Industry of Free China* IX (6), June 1958, p. 38; Japan, United States, cf. *UN Statistical Yearbook*, 1953, New York, United Nations, p. 419.

<sup>72</sup> Taiwan, cf. *Industry of Free China* IX (6), June 1958, p. 38; Japan, United States, calculated by the author by dividing the national income by population figures (83,199,637 for Japan ; 150,697,361 for the United States), cf. *UN Statistical Yearbook*, 1953, *op. cit.*, p. 24 and p. 27.

<sup>73</sup> Cf. *ibid.*, p. 371 and p. 373.

<sup>74</sup> US\$9.3 versus US\$9.9 for Japan and US\$67.3 for the United States. Calculated by the author by dividing the export volume by population figures (7,722,350 for Taiwan), cf. (Taiwan) notes 25, 26 and 27; (Japan, United States) note 72. Japan’s national income was originally ¥3,683,700 million. We used the exchange rate of US\$0.002778 for ¥1 to obtain the value in US\$. Taiwan’s national income and per capita income were originally respectively NT\$6,106 million and NT\$749. We used the exchange rate of US\$0.1195 for NT\$1 (an average of the selling rate of US\$0.1134 and the buying rate of US\$0.1255) to obtain the values in US\$. Cf. *Industry of Free China* III (6), June 1955, pp. 104-105.

<sup>75</sup> Actually, the Nationalist leader had also in mind the recapture of the Mainland.

Taipei's gold and foreign exchange reserves were a mere US\$15 million<sup>76</sup>, insufficient to cover imports even for two months.<sup>77</sup>

Against the background of deficient foreign exchange, American aid was providential, even if initially it was not as self-evident as it seemed.<sup>78</sup> Certainly, US financial support for Chiang Kai-shek was not new. In the early 1930s, for example, Washington provided assistance to the Chinese leader in his struggle against both the Japanese and the Communists. After the Japanese attack on Pearl Harbor, American support for the Generalissimo increased significantly. Even so, relations between Chiang and Washington were always tense. Although Chiang Kai-shek had his supporters in the US Congress, both President Roosevelt and President Truman seemed to have no great liking for him. Chiang refused to give President Roosevelt's military representative to the Chinese government (General Joe Stilwell) unrestricted command of all Chinese forces (1944)<sup>79</sup>, and in a subsequent (1949) White Paper published by President Truman's Secretary of State (Dean Acheson), reference was made to the Generalissimo's military ineptitude.<sup>80</sup>

American support to the Nationalist government was, in fact, driven by pragmatism. Above all, it sought to defend and strengthen the United States' geo-strategic interests in the region. After the failure to achieve the hoped-for reconciliation between Communists and Nationalists, Washington even considered abandoning Chiang Kai-shek and recognizing the Communist regime in Peking. But any such eventuality was overtaken by the Korean War and the subsequent Cold War, when a new priority – that of preventing the expansion of communism in Asia – came to the fore. In short, Washington had no choice but to assist the Nationalist regime as an ally in the struggle against communism.

Greater economic independence and stability for Taiwan, as well as strengthened defense capabilities were seen as necessary conditions for a successful outcome in this struggle.<sup>81</sup>

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<sup>76</sup> Cf. Maurice SCOTT, "Foreign Trade", in Walter GALENSON (ed.), *Economic Growth and Structural Change in Taiwan – The Postwar Experience of the Republic of China*, Ithaca/London, Cornell University Press, 1979, p. 314.

<sup>77</sup> Taiwan's total imports (1950): US\$116.5 million (NT\$974.5 million X 0.1195) [US aid imports included]. Cf. (imports) *Statistical Abstract of Taiwan Province, ROC (Taiwan sheng tongji tiyao) (1946-1967)*, Bureau of Accounting and Statistics, Taiwan Provincial Government (*Taiwan sheng zhengfu zhujichu*), October 1971, p. 432; (exchange rate) *Industry of Free China* III (6), June 1955, pp. 104-105.

<sup>78</sup> The following description is based mainly on Bernkopf Tucker, *Taiwan, Hong Kong and the United States, 1945-1992*, *op. cit.*, pp. 8-51.

<sup>79</sup> In fact, Stilwell and Chiang Kai-shek had divergent opinion on the way to wage the war against the Japanese. Cf. Barbara W. TUCHMAN, *Stilwell and the American Experience in China, 1911-1945*, New York, The MacMillan Company, 1971, pp. 483-509.

<sup>80</sup> The "military debacle [of the Nationalist forces] (...) can all be attributed to the worst leadership (...). The complete ineptness of high military leaders and the widespread corruption and dishonesty throughout the Armed Forces, could, in some measure, have been controlled and directed had the above authority and facilities been available" (Report by General Barr to the Department of the Army, November 16, 1948), cf. Van Slyke, *The China White Paper – August 1949*, *op. cit.*, p. 358.

<sup>81</sup> Cf. Neil H. JACOBY, *An Evaluation of U.S. Economic Aid to Free China, 1951-1965*, Washington, Department of State, Agency for International Development, A.I.D. Discussion Paper No. 11, January 1966, p. 5.

Accordingly, the USA provided Taipei with substantial military and non-military assistance that was to contribute significantly to the island's economic growth. Firstly, between 1950 and 1970, the United States delivered commodities (mainly raw materials, but also capital and consumption goods)<sup>82</sup> worth US\$1.34 billion to Taiwan. This commodity aid covered a significant share of the cost of the island's annual imports: more than 40% from 1952 to 1957 (49.8% in 1956), more than 30% from 1958 to 1961 (36.4% in 1958), and more than 20% from 1962 to 1963 (26.3% in 1962).<sup>83</sup> This aid in kind spared the Nationalist government the temptation of cutting back the island's trade deficit earlier by using floating exchange rates or reducing the volume of imports.<sup>84</sup>

Secondly, in addition to these deliveries, the Nationalist government also received some US\$1.48 billion of economic aid from the Americans (on average, US\$82.2 m. per year between 1951 and 1968).<sup>85</sup> This financial support was all the more useful in helping the island's economic recovery since during the same period direct foreign and overseas Chinese investment on the island was limited, totalling US\$310.9 m., or averaging \$17.3 million per year.<sup>86</sup>

Finally, although Washington's assistance to Taiwan was mainly motivated by wishing to defend US national security interests<sup>87</sup>, there was also an economic agenda. As early as 1946, the United States established a Public Relations Office in Taipei which, as a British representative in Formosa noted, held out the promise of significant future benefits for US involvement with Taiwan:

"In true American fashion they have gone the 'whole hog', taken over an entire three storey building, fitted it out with all the necessary equipment, and provided an adequate staff of civilian experts. This organization pours out a flood of information on the U.S.A., its way of life, its industry, and its products. (...) The benefits which will accrue to the U.S.A., as a result of all this propaganda, are plain to see" (British Lieutenant Commander Max Berman, 1946).<sup>88</sup>

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<sup>82</sup> Cf. *Taiwan Statistical Data Book*, 1997, Council for Economic Planning and Development, Taipei, ROC, p. 234.

<sup>83</sup> US aid imports: (1956) US\$96.5 million, (1958) US\$82.3 million, (1962) US\$80.1 million; total imports: (1956) US\$193.7 million, (1958) US\$226.2 million, (1962) US\$304.1 million. The proportion fell to around 10% in 1964-1965, and less than 5% afterwards. Calculated by the author from *Taiwan Statistical Data Book*, 1988, p. 240 (total imports) and *Taiwan Statistical Data Book*, 1997, *op. cit.*, p. 234 (US aid imports).

<sup>84</sup> Cf. LIN, Ching-yuan, *Industrialization in Taiwan, 1946-1972 – Trade and Import-Substitution Policies for Developing Countries*, New York/London, Praeger Publishers, 1973, p. 70.

<sup>85</sup> Between 1951 and 1965, average annual aid disbursements were even higher, i.e. US\$96 million (US\$1.44 billion in 15 years). Cf. *Taiwan Statistical Data Book*, 1997, *op. cit.*, p. 225.

<sup>86</sup> Between 1951 and 1965, annual direct foreign and overseas Chinese investment averaged even less, i.e. US\$9 million (US\$134.7 million in 15 years). Cf. *Statistics on Overseas Chinese and Foreign Investment, Outward Investment, Mainland Investment*, Investment Commission, Ministry of Economic Affairs, Taipei, ROC (various issues).

<sup>87</sup> This motivation is reflected in the statutory sources of aid funds voted by the American Congress: (1951-1968) 67.4% (US\$999.3 million) for "defense support" and "direct forces support", 26.1% (US\$387 million) for "surplus agricultural commodities" under the "food for peace" program, 6.5% (\$95.9 million) for "development loans/grants" and "technical cooperation". Cf. *Taiwan Statistical Data Book*, 1997, *op. cit.*, p. 227.

<sup>88</sup> Cf. British Report entitled "A Survey of Present Conditions in Formosa" (12<sup>th</sup> January-5<sup>th</sup> February, 1946), in Jarman (ed.), *Taiwan – Political and Economic Reports, 1861-1960, 8 (1945-1949)*, *op. cit.*, p. 221.

Clearly, neither Washington nor London was impervious to the major business opportunities offered by Taiwan. Moreover, in their capacity as advisors to the Chinese administration, the privileged position of Americans offered them the best opportunity to take full advantage of the resumption of international trade.<sup>89</sup>

### **Necessity Knows no Law**

Useful though it was, American aid could not meet Formosa's entire needs, nor was it sufficient to finance the island's long-term development. It was therefore essential for Taiwan to renew commercial partnerships as soon as possible. Cut off from the Chinese Mainland, the Nationalist government now turned to what was to become one of its most important trading partner – Japan.

The return of Formosa's recent colonizer to the island's economic sphere could not have been wholly predicted, since Chiang Kai-shek had actively sought to remove all Japanese influence from Taiwanese society. Firstly, the Nationalist government had confiscated most of the Japanese properties on the island, including government and privately-owned property, as well as the funds of religious institutions, social welfare agencies and Japanese civilians. This was carried out in the face of strong opposition from US representatives in Formosa (i.e. the Formosa Liaison Group of the United States Army), which denounced the action as having no legal basis (no legal instrument transferring Formosa to China had yet been implemented, and no compensation was given to make up for it).<sup>90</sup> Secondly, despite the findings of an investigation conducted by Japanese officials in October 1945 that showed that 43.6% of Japanese living in Taiwan wished to remain there, it was decided that all Japanese citizens, must be repatriated.<sup>91</sup> Thirdly, in order to win over the hearts of Formosans who had been subject to the influence of their Japanese colonizers for half a century, the Nationalist government actively promoted the use of Mandarin. In April 1946, they set up the "Commission for the Promotion of the National Language" (*guoyu tuixing weiyuanhui* 國語推行委員會), whose responsibilities included opening "national language promotion schools" (*guoyu tuixing suo* 國語推行所) in every district and district level's city. From July 1951, it became strictly

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<sup>89</sup> *Ibid.*

<sup>90</sup> Cf. *ibid.*, pp. 197-198.

<sup>91</sup> Out of 323,269 included in the investigation, 141,009 wished to remain in Taiwan. The total number of Japanese living in Formosa at the time was estimated to be 526,674 (including 130,000 prisoners of war). Cf. *ibid.*, pp. 143-144.



forbidden to use any language other than Mandarin in any school (primary or secondary) or university on the island.<sup>92</sup>

But necessity knows no law, particularly when economic interests are at stake. Under the Japanese administration, Taiwan had developed an exceptionally close commercial relationship with Japan. During the 1930s, Japan was the main – if not exclusive – source of Taiwan’s imports (89.4% in 1938), as well as the main market for Taiwan’s exports (93.2% in 1937).<sup>93</sup> Indeed, under Japanese rule, Formosa’s economy was shaped to meet Japan’s needs: Japan provided raw materials and manufactured consumer goods, which were paid for with food products. It is noteworthy too that Japan also acted as a “middle-man” between Formosa and the rest of the world. Many goods imported by Taiwan from Japan were re-exports, while many goods shipped from Taiwan to Japan were subsequently re-exported to other countries.<sup>94</sup> In 1935, Taiwan’s main exports were sugar (43.2% of the total) and rice (30.1%) – far ahead of bananas (2.9%), tea (2.7%), pineapples (2.3%), alcohol (2.1%) and camphor (1.3%). Most of these products were destined for Japan: 99.9% of rice exports, 96.3% (sugar), 92.5% (bananas), 90.5% (pineapples) and 93.5% (alcohol). In the same year, the island’s main imports were fertilizers (16.5%), textiles (13%), metal products (8.3%), timber (4.3%), tobacco, alcohol, opium (6.2%) and tires (3.6%). Only 52.4% of fertilizer imports came from Japan, but for other products the figure was much higher: 88.9% for textiles, 95.1% for metal products, 90.4% for timber, 98.5% for tobacco, alcohol, opium’s imports, and 99.7% for tires.<sup>95</sup>

The last years of the Pacific War saw a decline in Japan’s share of Taiwan’s trade (in 1944 and 1945 Japan accounted for 73.6% and 74.9% of the island’s imports, and 69.3% and 59.3% of its exports).<sup>96</sup> In the year after Japan’s surrender, trade between the two territories came to a virtual standstill, although it was not long time before economic exchanges were resumed, albeit initially on a tiny scale. In 1947 and 1948, for example, just 3.1% and 7.9% of the island’s exports were shipped to Japan.<sup>97</sup> The revival would have been more significant if trade had not been hampered by conflicts of interest. Initially, for example, the Chinese Shipping Guild exerted pressure to exclude

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<sup>92</sup> Hitherto “Japanese”, as well as “minnan” (*minnanhua* 閩南語), “hakka” (*kejiahua* 客家話) and all aboriginal languages had been the most common mother tongues of Formosans. Cf. LI, Xiaofeng, *Taiwan shi 100 jian dashi (xia) (100 Important Events in Taiwan’s History* (Vol. 2)), Taipei, Yushan she, 1999, pp. 14-16.

<sup>93</sup> Imports (1938): (total) T.W.\$366.7 million, (Japan) T.W.\$328 million; exports (1937): (total) T.W.\$440.2 million, (Japan) T.W.\$410.3 million. Cf. *Taiwan Trade Statistics for the Last Fifty-Three Years (1896-1948)*, *op. cit.*, pp. 1-3.

<sup>94</sup> Cf. British Report entitled “A Survey of Present Conditions in Formosa” (12<sup>th</sup> January-5<sup>th</sup> February 1946), in Jarman (ed.), *Taiwan – Political and Economic Reports, 1861-1960, 8 (1945-1949)*, *op. cit.*, p. 192.

<sup>95</sup> Cf. TU, Zhaoyan, *Riben diguo zhuyi xia de Taiwan (Taiwan Under Imperial Japan)*, Taipei, Renjian, Renjian Taiwan zhengzhi jingji congkan, di yi juan, 1993), pp. 159-160.

<sup>96</sup> Imports (1944): (total) T.W.\$164.7 million, (Japan) T.W.\$121.3 million; exports (1944): (total) T.W.\$311.2 million, (Japan) T.W.\$215.7 million; imports (1945): (total) T.W.\$22.3 million, (Japan) T.W.\$16.7 million; exports (1945): (total) T.W.\$24.1 million, (Japan) T.W.\$14.3 million. Note that the figures concerning the year 1945 are up to the end of August only. Cf. *Taiwan Trade Statistics for the Last Fifty-Three Years (1896-1948)*, *op. cit.*, p. 4.

<sup>97</sup> Exports (1947): (total) T.W.\$36.14 billion, (Japan) T.W.\$1.11 billion; exports (1948): (total) T.W.\$226.27 billion, (Japan) T.W.\$18.09 billion. Japan’s share in Taiwan’s imports was even smaller: 0.8% in 1947; 0.1% in 1948. Cf. *ibid.*

foreign shipping from trade with Japan, despite severe shortages of Chinese maritime shipping. This obstacle was eventually overcome, with most freight cargo being carried by British ships.<sup>98</sup> Secondly, the Central government in Mainland China endeavored to maintain strict control over all trade with Japan. They insisted that all commercial transactions should take the form of “barter trade”,<sup>99</sup> exclusively conducted through the Central Trust (*zhongyang xintuo ju* 中央信託局)<sup>100</sup>, but with Japanese goods received in exchange for Taiwanese products being shipped to the Mainland rather than to Formosa.<sup>101</sup> The Provincial Government tried to circumvent this obstacle, most obviously through the use of Hong Kong as an entrepot.<sup>102</sup>

In the wake of defeat at the hands of the Communists and the consequent loss of the Chinese Mainland market, the expansion of economic exchanges with Japan became even more urgent. In April 1949, the Taipei Chamber of Commerce demanded that the Central Government give Formosa the right to deal directly with Japan, with commercial trade officers of the Provincial Government being permanently stationed in Tokyo. The same month saw the signature of the first commercial contract between Formosan and Japanese private traders since the return of the island to Chinese rule in the form of an exchange of Taiwanese derrick and bananas for Japanese fishing nets, gas pipes, motors, trucks, artificial silk and other products. The total value of the deal was US\$111,000.<sup>103</sup> In July the Provincial Government obtained the agreement of the Central Government to reduce customs duties on cotton cloth (from 60% to 20%), cotton yarn (from 50% to 5%) and fertilizer and scrap iron (from 20% to 5%).<sup>104</sup> In October the Director of the Taiwan Camphor Bureau visited Japan and signed an agreement for the sale of 80% of Formosa’s output of fragrant oil. In early December the first shipment of Taiwanese coal to Japan since the handover was made. All these initiatives helped boost Taiwan’s trade with Japan, so that by 1949 Japan accounted for no less than 27.3% of the island’s exports and 26.7% of its imports.<sup>105</sup>

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<sup>98</sup> Cf. British Report entitled “Summary of Events in Formosa during the First Six Months of 1948” (24<sup>th</sup> July, 1948), in Jarman (ed.), *Taiwan – Political and Economic Reports, 1861-1960, 8 (1945-1949)*, *op. cit.*, pp. 325-329.

<sup>99</sup> In such a trade, goods are exchanged for other goods instead of being sold for money. The problem lies in the fact that most firms in the Far East were specialized in one particular line of products and had no experience in dealing with any other. Cf. British Report (16<sup>th</sup> February-4<sup>th</sup> March, 1946), in Jarman (ed.), *Taiwan – Political and Economic Reports, 1861-1960, 8 (1945-1949)*, *op. cit.*, p. 229.

<sup>100</sup> This organism was set up in 1935 with the purpose of handling the Republic of China’s external trade.

<sup>101</sup> Cf. British Report entitled “Summary of Events in Formosa in September 1948” (12<sup>th</sup> October, 1948), in Jarman (ed.), *Taiwan – Political and Economic Reports, 1861-1960, 8 (1945-1949)*, *op. cit.*, p. 360.

<sup>102</sup> The Director of the Department of Supply, Trade and Industry of the Hong Kong Government visited Formosa in September 1948 at the invitation of the Provincial Government to discuss the sale of coal to Hong Kong. Cf. *ibid.*

<sup>103</sup> Cf. Formosan Economic Notes (British Report) (15<sup>th</sup> April-15<sup>th</sup> May 1949), in Jarman (ed.), *Taiwan – Political and Economic Reports, 1861-1960, 8 (1945-1949)*, *op. cit.*, pp. 560-561.

<sup>104</sup> High customs duties had been imposed to protect Mainland China’s industries. Trade restrictions between Taiwan and Japan reflected the policies of both the Chinese authorities and the S.C.A.P. (Supreme Commander for the Allied Powers – the US administration that assumed power in Japan after the surrender). Cf. *ibid.*, pp. 572-575.

<sup>105</sup> These percentages must be considered to be minimum values. There is no official figure for the structure of Taiwan’s trade by countries in 1949, although British sources give “different” estimates: a) (from July to December 1949) Taiwan’s imports from Japan = US\$15 million, Taiwan’s exports to Japan = US\$12.3 million; b) (1949) Taiwan’s total imports =

## Moving Towards Normalization

Taiwan's economic needs were not the only factor that encouraged normalisation of relations with Japan. A significant political factor was the imminent signing up of both territories to the security zone which Washington was establishing in the Far East.<sup>106</sup> In addition, Japan's own economic interests were at stake.<sup>107</sup> Formosa was in a position to help alleviate Japan's food shortages (Japan's population had increased by 12.7% between 1944 and 1950)<sup>108</sup> through the provision of sugar, rice, bananas, etc. It also had the means to help Tokyo kick-start the Japanese industry through the supply of raw materials, such as coal, salt, copper, aluminum and paper pulp. As the main energy source, coal was especially important for Japan's economy, the sharp decline in domestic output having hindered the recovery of industrial production.<sup>109</sup> Lastly, the island might help Japan recover overseas markets lost after the surrender, not only in Taiwan itself, but also in Southeast Asia, where strong anti-Japanese sentiment made it hard to market Japanese goods. Cooperation between Japanese businessmen and their Taiwanese counterparts would enable them to develop products that could be sold under a "made in Taiwan" label, and Japan could also use Taiwanese firms as go-betweens in helping build up business relations with overseas Chinese living in the region.<sup>110</sup>

On 6<sup>th</sup> September 1950, less than a year after the transfer of the Central Government to Taipei (8<sup>th</sup> December 1949)<sup>111</sup>, a trading agreement was signed between Taiwan and Japan<sup>112</sup>, designed to

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US\$26 million / US\$56.3 million (figure taking into account the depreciation of the "old" Taiwan dollar in the first half of 1949); Taiwan's total exports = 33.9 million / 37 million (figure taking into account the depreciation of the old Taiwan dollar in the first half of 1949) / 45 million (figure based on the foreign exchange sold by the Bank of Taiwan). Cf. Formosa Economic Notes (British Report) (16<sup>th</sup> January-15 February, 1950), pp. 203-204; (16<sup>th</sup> February-15 March, 1950), pp. 214-215; (16<sup>th</sup> August-15 September, 1950), p. 296, in Robert L. JARMAN (ed.), *Taiwan – Political and Economic Reports, 1861-1960, 9 (1950-1951)*, Slough, UK, Archive Editions, 1997.

<sup>106</sup> The Japan-US Security Pact was signed on 8<sup>th</sup> September 1951, and the Taiwan-US Security Pact on 2<sup>nd</sup> December 1954. Cf. François JOYAUX, *Géopolitique de l'Extrême-Orient* [Tome II, Frontières et stratégies], Bruxelles, Editions Complexe, 1993, pp. 181-186.

<sup>107</sup> Cf. LIAO, Hongqi, *Maoyi yu zhengzhi: Tai Ri jian de maoyi waijiao (Trade and Politics: Trade Diplomacy between Taiwan and Japan) (1950-1961)*, Banqiao, Daoxiang, 1895 xilie, 2005, pp. 43-60.

<sup>108</sup> From 73.8 m. in 1944 to 83.2 m. in 1950. This rise was largely attributable to the return of many Japanese expatriates to their homeland. Figures are taken from TAKAFUSA, Nakamura, *A History of Showa Japan, 1926-1989*, Tokyo, Tokyo University Press, 1998, p. 352.

<sup>109</sup> Cf. *ibid.*, pp. 293-294.

<sup>110</sup> Taiwanese businessmen who were culturally close to Fujian immigrants in Southeast Asian countries (especially Indonesia) had long played an active role in trade between Japan, China and Southeast Asia – especially in the tea trade between Taiwan and Southeast Asia during the period of Japanese rule in Formosa. This includes native islanders as well as Taiwan *sekimin* (席民), i.e., Taiwan registered people, some of them even adopting multiple nationalities (Chinese, Japanese, Dutch, etc.) in order to take advantage of this trade. Cf. LIN, Man-Houng, "Taiwanese Merchants, Overseas Chinese Merchants, and the Japanese Government in the Economic Relations Between Taiwan and Japan, 1895-1945", *Journal of Asia-Pacific Studies* (Waseda University) 4, March 2002, p. 7, and "Overseas Chinese Merchants and Multiple Nationality: A Means for Reducing Commercial Risk (1895-1935)", *Modern Asian Studies* 35 (4), 2001, pp. 997-1005.

<sup>111</sup> The same month, KMT's headquarters and the head office of the Central Bank and the Central Trust were also transferred to Taipei.

<sup>112</sup> This agreement was signed between Yin Zhongrong, adviser to the Ministry of Economic Affairs in the Nationalist Government, and A.J. Keche, the United-States' representative to the Allied forces' HQ. Cf. Qinxu, *Taiwan quan jilu (Chronicle of Taiwan)* – 15000 B.C. ~ 1989 A.D, Taipei, Qinxu, 1990, p. 316.

facilitate closer trade relations between the two territories. “Barter trade” arrangements were abandoned, items were added to the lists of permitted imports and exports, and private merchants were allowed to handle most trade transactions. Even so, the degree of trade liberalization remained limited: bilateral trade was capped at US\$100 million per year (this figure was later raised), all transactions had to be made through a special bank account, and private merchants were excluded from international trade in products such as rice, sugar, salt and fertilizers.<sup>113</sup> Two months later (December 1950) the Provincial Government resumed rice exports to Japan (40,000 tons).<sup>114</sup> Between 1950 and 1951 Japan’s share in Taiwan’s total exports increased from 36.1% to 48.3%. Its import share too rose, albeit less sharply, reaching 26% in 1950, and 34% in 1951.<sup>115</sup>

The “Taiwan-Japan Trading Agreement”, originally intended to last for one year (1<sup>st</sup> July 1950 ~ 30<sup>th</sup> June 1951), was renewed on an annual basis until the end of the decade. In the early 1950s, Taiwan’s authorities embarked on infrastructure construction<sup>116</sup> for industrial development within a policy framework of import-substitution.<sup>117</sup> External trade was severely restricted, foreign exchange was strictly controlled, and a multi-exchange rate system was adopted in order to encourage domestic production of manufactured goods that had previously been imported, while discouraging consumption (all this in a context in which capital was in short supply and private savings were insufficient to finance domestic investment).<sup>118</sup> Meanwhile, the take-off of Japan’s economic growth<sup>119</sup> generated a dramatic increase in its demand for industrial raw materials. Anxious to expand their overseas sales and aware that Taiwan’s familiarity with machinery using Japanese technology might facilitate the penetration of the island’s market, Japanese multinationals

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<sup>113</sup> Cf. Formosa Economic Notes (British Report) (16<sup>th</sup> August-15<sup>th</sup> September 1950), p. 296; (16<sup>th</sup> September-15<sup>th</sup> October 1950), pp. 308-309, in Jarman (ed.), *Taiwan – Political and Economic Reports, 1861-1960, 9 (1950-1951)*, op. cit. A detailed presentation of the “Taiwan-Japan Trading Agreement” (*Tai Ri maoyi xieding* 臺日貿易協定) followed by the “China-Japan Trading Regulations” (*Zhong Ri maoyi banfa* 中日貿易辦法) can be found in Liao, *Maoyi yu zhengzhi...*, op. cit., pp. 12-43.

<sup>114</sup> Cf. Formosa Economic Notes (British Report) (16<sup>th</sup> November-15<sup>th</sup> December 1950), in Jarman (ed.), *Taiwan – Political and Economic Reports, 1861-1960, 9 (1950-1951)*, op. cit., p. 334.

<sup>115</sup> Cf. *Industry of Free China* III (6), June 1955, p. 82.

<sup>116</sup> Actually, the Japanese had already begun to develop infrastructural facilities in Formosa. For instance, Taiwan’s first hydroelectric power station, located in Shenkeng (深坑) near Taipei, and named “Guishan hydroelectric powerhouse” (*Guishan shuili fadiansuo* 龜山水力發電所), was operational as early as 1905. Subsequently, other small and medium-sized power stations were built all over the island. In July 1919, these were all merged to form the “Taiwan Power Ltd Company” (*Taiwan dianli zhushi hui* 臺灣電力株式會社). In the same year, construction of a large-scale power plant got under way in Sun Moon Lake the first phase of which was completed in June 1934, and the second phase in July 1937. The increasing capacity in power supply gave an impetus to the island’s industrialization. Cf. Li, Lin, *Taiwan shi*, op. cit., pp. 181-182; *Taiwan shi xiao shidian*, op. cit., p. 147.

<sup>117</sup> It could be argued that Taiwan had already embarked on import-substituting industrialization under Japanese rule, although on a small scale and driven by wartime contingencies. Cf. HSIAO, Frank S.T., HSIAO, Mei-Chu W., “Taiwan in the Global Economy – Past, Present and Future”, in Peter C.Y. CHOW, (ed.), *Taiwan in the Global Economy – From an Agrarian Economy to an Exporter of High-Tech Products*, Westport, London, Praeger Publishers, 2002, pp. 182-184.

<sup>118</sup> Cf. Joseph S. LEE, “The Role of State in Economic Restructuring and Development: The Case of Taiwan”, *Occasional Paper Series* (CIER) 9403, April 1994, pp. 3-11.

<sup>119</sup> The United States stimulated Japan’s economic growth through the system of “special procurements”, e.g., purchasing goods for use by US military in the Korean War and sub-contracting US exports to Japanese manufacturers. Cf. Takafusa, *A History of Showa Japan, 1926-1989*, op. cit., pp. 304-307.

began to set up operations in Formosa: Toyota (*Fengtian* 豐田) (exclusive distributor) in 1949, Hitachi (*Rili* 日立) (representative office) in 1953, Sanyo Electric (*Sanyang dianqi* 三洋電器) (joint venture) in 1955.<sup>120</sup> Taking advantage of connections nurtured during the period of Japanese colonization, in March 1953 Matsushita Electric (*Songxia dianqi* 松下電器) had formed a partnership with Hong Jianquan (洪建全), a Taiwanese businessman whose family had acquired wealth during the colonial period, to sell Matsushita's electrical appliances under the brand name "National" (*Guoji pai* 國際牌).<sup>121</sup>

Until the mid 1950s, these economic developments gave a boost to trade between Taiwan and Japan. Thus, in 1955 Japan accounted for 59.5% of Taiwan's exports and 30.5% of its imports.<sup>122</sup> Subsequently, however, the trend was reversed.<sup>123</sup> Although the share of Japanese goods in Taiwan's imports remained buoyant (35.3% in 1960), as a destination for Taiwan's exports, Japan's significance fell sharply (to 37.7% in 1960).<sup>124</sup> In any case, in 1961 the "Taiwan-Japan Trading Agreement" was ended – an event that marked the normalization of economic relations between the two territories.

## Conclusion

From the late 1930s to the early 1950s, the Formosans were trapped in a political game over which they had no control. At first, they seemed to be dogged by ill fortune. After suffering exploitation by the Japanese colonial authorities, their resources were commandeered by the Chinese in order to supply the Nationalist troops fighting the Communists on the Mainland, – and to enrich corrupt officials. The cost of the Pacific war and the "228 Incident" were further serious setbacks. Yet following a decade or more of such misfortunes, the political game was to turn to Formosa's

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<sup>120</sup> Information gathered by the author directly from Toyota (20<sup>th</sup> September 2000), Hitachi (28<sup>th</sup> September 2000) and Sanyo (20<sup>th</sup> October 2000).

<sup>121</sup> At this point Matsushita Electric's only other brand name was "Panasonic". In November 1946, Hong Jianquan had set up a shop called "Jianlong" (*Jianlong hang* 建隆行), which specialized in the assembly and sales of electrical products. "Jianlong" later changed name for "Jianlong Electric" (*Jianlong dianqi dian* 建隆電氣店). Cf. Information gathered by the author directly from Matsushita (13<sup>th</sup> October 2000).

<sup>122</sup> Cf. *Taiwan Statistical Data Book*, 1997, *op. cit.*, p. 199 and p. 201.

<sup>123</sup> Notice that this reflected a change in the structure of Taiwan's external trade. Imports of durable consumer goods dropped sharply: "textiles" represented 14.2% of Taiwan's total imports in 1952, but only 1.9% in 1960. Conversely, imports of production goods and raw materials surged: while the part of "machinery" increased from 6% (1952) to 15.4% (1960), those of "iron and steel" and "cotton" rose respectively from 2.3% (1952) to 9.5% (1960), and from 0.5% (1952) to 7.3% (1960). Meanwhile, "sugar", "rice", "tea", "bananas", "canned food" and "fishery products" continued collectively to account for the lion's share of the island's exports, though on a declining trend (59.4% in 1960 versus 87.1% in 1952). Meanwhile, Formosa's textile industry saw a remarkable increase in its share of the island's exports (14.2% in 1960 versus 0.7% in 1952). Calculated by the author from *Taiwan Statistical Data Book*, 1988, *op. cit.*, pp. 228-229 and pp. 240-241.

<sup>124</sup> Cf. *Taiwan Statistical Data Book*, 1997, *op. cit.*, p. 199 and p. 201.

advantage. Indeed, far from being a new blow to its economy, the division across the Strait and the loss of its main trading partner (Mainland China) proved to offer a lifeline to the island.

Firstly, for example, the severing of cross-Strait relations protected Taiwan from the Great Leap Forward and the Cultural Revolution – events that were to cause severe economic dislocation in China for many years. Secondly, it put Taiwan under Washington's protection. The United States' military umbrella, together with the provision of American raw materials, consumption goods and public capital contributed greatly to economic development and political stability on the island at a time when recovery was still ongoing. Thirdly, it forced Formosa to resume economic relations with Japan far more rapidly than might have been expected. This made it possible to compensate, within a very short period of time, for the loss of Chinese market: both in terms of exports (thanks to shipments of Taiwanese goods and minerals to Japan) and also of imports (thanks to Taiwan's purchases of Japanese fertilizers, machinery and textiles). In addition, Japanese firms were able to establish strong and lasting relations with Taiwanese businessmen that subsequently helped shape the island's economic future.

Indeed, the special relationships Taiwan built up with the United States and Japan in the late 1940s paved the way for the island's post-war economic development. More than half of foreign direct investment (FDI) in Formosa between 1966 and 1979<sup>125</sup> originated in the United States (32.3%) or Japan (18.8%).<sup>126</sup> Many American and Japanese firms went into partnership with local private companies, whether by signing Original Equipment Manufacturing (OEM) contracts or setting up joint ventures, providing technologies and overseas sales networks while taking advantage of Taiwan's cheap and well educated labor force, as well as gaining access to its expanding domestic market. This enabled the island's small and medium-sized enterprises (SMEs) to nurture an important intangible asset – namely, a flexible organizational framework that could respond rapidly to market *stimuli* and satisfy client demands in terms of price, quality and delivery deadlines.<sup>127</sup> American and Japanese corporations undoubtedly contributed a great deal to the outstanding growth Formosa experienced for more than three decades (average annual growth of 8.8% for national income, and 6.3% for per capita income, 1955-1987)<sup>128</sup> by facilitating industrial upgrading and helping drive the island's export boom. By 1987, per capita exports in Taiwan (US\$2,744) were

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<sup>125</sup> According to Taiwan's balance of payment's figures, FDI totalled US\$798 million between 1966 and 1979. Cf. *Zhonghua minguo tongji yuebao*, Statistical Bureau, Executive Yuan, Taiwan, 109, January 1975, pp. 101-102; *Balance of Payments ROC*, The Central Bank of China, Taiwan District (various issues).

<sup>126</sup> These percentages are based on the overseas Chinese and foreign investment "projects" approved by the Taiwanese authorities the total amount of which is higher than the balance of payments' figures: (US\$ million) 2,117.7 (USA: 683.5; Japan: 398.9). Cf. *Statistics on Overseas Chinese ...*, *op. cit.*

<sup>127</sup> See for instance HSING, You-tian, *Making Capitalism in China: The Taiwan Connection*, New York, Oxford, Oxford University Press, 1998; CHEN, Tain-Jy (ed.), *Taiwanese Firms in Southeast Asia – Networking Across Borders*, Cheltenham, UK, Northampton, MA, US, Edward Elgar, New Horizons in International Business, 1998.

<sup>128</sup> Constant 1991 prices in NT\$. Calculated by the author from *Taiwan Statistical Data Book*, 1997, *op. cit.*, pp. 33-34.

higher than the corresponding figure for both the United States (US\$1,033.3) and Japan (US\$1,894)<sup>129</sup>, and its foreign exchange reserves had reached US\$76,7 billion.<sup>130</sup>

Nevertheless, while presenting Taiwan with new economic opportunities, the division across the Strait also incurred a political cost. Under the authoritarian rule of the Kuomintang, the island experienced many years of political dictatorship.<sup>131</sup> Separation from the Mainland was also at the heart of a highly sensitive issue, that of the so-called “two Chinas”. Still unresolved in 2014, this question continues to jeopardize relations between Taipei and Peking and remains a source of concern for the United States and the wider international community.

Paradoxically, political differences did not prevent the resumption of economic exchanges between the two sides. Indeed, both the island’s businessmen and government authorities had little option but to adapt to the changes that had begun to affect Taiwan’s macroeconomic environment. Deng Xiaoping’s policy of economic openness offered such potentially favourable business opportunities that Taiwanese SMEs soon came to regard investment in China as a way of circumventing rising production costs at home. In the 1970s and early 1980s, when martial law remained in force, smuggling activities increased in scale despite the risks incurred in breaking the law. But eventually the government in Taipei was forced, part at least, to fulfil private sector expectations by authorizing “indirect” trading operations (July 1985) and investment (October 1990) on the Mainland.<sup>132</sup> So it was the movement towards trade and investment liberalization across the Strait that got under way.<sup>133</sup> Some thirty years after the normalization of economic relations with Japan, the island’s authorities once again acknowledged that necessity knew no law, even though such economic pragmatism offered no guarantee that the political impasse would be resolved.

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<sup>129</sup> Taiwan, cf. *Taiwan Statistical Data Book*, 1997, *op. cit.*, p. 189; Japan, United States, calculated by the author by dividing the export volume (US\$229,224 million for Japan; US\$254,122 million for the United States) by population figures (121,023,579 for Japan; 245,920,994 for the United States). Population figures for Japan and the United States are from United Nations Statistics Division, UNSD Statistical Databases, National Accounts Main Aggregates Database, <http://unstats.un.org/unsd/snaama/resQuery.asp>, 20<sup>th</sup> June 2013; export volume for Japan and the United States is from Department of Economic and Social Development (Statistical Office), *1992 International Trade Statistics Yearbook*, 1, Trade by Country, United Nations, New York, 1993, p. 488 and p. 982 (United Nations Statistics Division, UNSD Statistical Databases, UN Comtrade, Annual Totals Table for Imports and Exports, Tables published in the International Trade Statistics Yearbook, Previous Editions, <http://comtrade.un.org/pb/first.aspx>, 20<sup>th</sup> June 2013).

<sup>130</sup> Cf. *Taiwan Statistical Data Book*, 1997, *op. cit.*, p. 4 and p. 189.

<sup>131</sup> Martial law remained in force in Taiwan from May 1949 to July 1987.

<sup>132</sup> “Goods” had to transit through Hong Kong or Macao, while “capital” had to be routed through a front company registered in a third territory.

<sup>133</sup> More details concerning the development of economic exchanges between Taiwan and China can be found among others in Philippe CHEVALERIAS, “Taiwan-Chine: priorité aux échanges économiques”, *Politique internationale* 119, Spring 2008, pp. 365-377, and “The Taiwanese Economy After the Miracle: An Industry in Restructuration, Structural Weaknesses and the Challenge of China”, *China Perspective* 83, 2010/3, pp. 35-44; Françoise MENGIN, *Fragments d’une guerre inachevée. Les entrepreneurs taiwanais et la partition de la Chine*, Paris, Karthala, 2013.

