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DEVELOPMENT STRATEGIES IN OPEN DUALISTIC ECONOMIES

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**Final Summary Report to AID
(Contract AID/repas-9)
Development Planning Project
National Planning Association**

August, 1970

FOREWORD

This report is written in accordance with the requirement in contract AID/repas-9 that the National Planning Association submit a final substantive summary of the results of the research work conducted under the contract.

The results are presented in more detail in a larger report ("The Transition in Open, Dualistic Economies") submitted to AID in July, 1970. The reader who wishes to have access to the theory and data behind the present report is referred to that more comprehensive study.

Other more detailed and country-specific results have been submitted to AID in the form of final reports by other staff members and in the form of numerous working papers written during the history of the project. Two of the final reports written by individuals are being published: Alek A. Rozental, Finance and Development in Thailand (New York: Frederick A. Praeger, 1970) and George L. Hicks and Geoffrey McNicoll, Foreign Trade and the Growth of the Dual Economy: A Study of the Philippines, 1950-1966 (in press, Cornell University Press). Two other final studies are available in mimeograph copies: Eliezer B. Ayal, "Manufacturing and Economic Growth: An Application to the Philippines" (NPA, 1969) and Joseph L. Tryon, "The Behavior of Production, Prices and Productivity in Philippine Agriculture, 1949-1964" (NPA, 1968).

Douglas S. Paauw
July, 1970

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INTRODUCTION

This study focusses upon the development process in a common type of contemporary less-developed country (LDC). Interaction between domestic dualism and foreign trade is the most crucial aspect of development in economies where a large foreign trade sector was inherited from colonialism.

The purpose of the study is to understand the contemporary growth and development of these economies by constructing and applying a framework of analysis appropriate to this particular type of economy. The framework is designed to incorporate the significance of openness, emphasizing the relationship between foreign trade and the domestic growth process in LDCs. The ultimate objective of understanding transition growth in open dualistic economies is to provide a basis for more effective formulation of development strategy and policy.

The analytical framework is appropriate for both theoretical and empirical analysis, as well as for policy formulation. The focus is upon the economy as a whole, and standard concepts of aggregate national income accounting are employed. This allows a direct link between analysis and policy, providing a realistic framework of thinking in which development strategy and planning issues may be effectively combined.

The study has been intensively applied to four open dualistic economies in Southeast Asia--China: Taiwan, Malaysia, the Philippines, and Thailand. These case studies have been placed in a broader empirical perspective by evaluating the postwar progress of almost 20 other countries of similar type on the basis of criteria derived from our analytical framework for open dualistic economies. The results assure the applicability of our conclusions to a majority of contemporary less-developed countries.

1. BASIC CONCEPTS

The problem of transition growth in open dualistic economies may be introduced by discussing several basic concepts emphasized in this study. We begin by discussing the concepts of open dualism and the transition. Open dualism refers to the particular type of economy and the transition represents the unique growth process, the two focal points of analysis.

1.1 OPEN DUALISM

The two fundamental characteristics, openness and dualism, mark off the group of LDCs analyzed in this study. Where these characteristics are jointly present, transition growth shares certain

common properties, justifying the identification of these economies as a particular type.

Openness refers to the fact that international trade is an essential aspect of growth. In practice, this characteristic is found where a large part of output is produced for export, as reflected, for example, in a high ratio of exports to gross national (or domestic) product (e.g., at least .10). Among contemporary LDCs, openness in this sense is found in countries of small and medium size (less than 50 million in population) and even in larger countries where an external orientation was inherited from colonialism (e.g., Indonesia). In some large countries having diversified resource bases (e.g., Mainland China, India, and Pakistan), however, growth centers upon the domestic economy rather than foreign trade, and such economies are excluded from our frame of reference.

The term "dualism" has taken on many different meanings in development literature. An exhaustive survey of these meanings will not be attempted. Two uses of the term, however, are relevant to this report, sectoral dualism and technological dualism.

The concept of sectoral dualism is associated with an intersectoral approach to the analysis of economic growth, an approach which is central to our study. In this usage, dualism refers to the dichotomy between two sectors, agriculture and industry, and this dichotomy

is reflected in very different roles assumed by the two sectors during an economy's development.

The concept of technological dualism emphasizes the existence of a technological gulf between a traditional sector, in which techniques of production are backward and unchanging, and a modern sector employing more advanced technology. In this usage, dualism can refer to the economy, as a whole, or to dualism within a particular sector (e.g., between traditional and plantation agriculture).

Dualism in this study is used in the sectoral sense of the coexistence of agriculture and industry. However, technological dualism within agriculture is recognized as an additional complication to enhance the realism of the analysis.

Analysis of open dualism requires a framework which stresses interrelationships between international trade and the two domestic sectors, agriculture and industry. This leads to expanding the two-sector framework of dualism (agriculture and industry) to include a third sector, the foreign sector. This framework accommodates analysis in terms of the triangularity of relationships among agriculture, industry, and the foreign sector. These triangular relationships are essential to understanding transition growth in open dualistic economies.

1.2 THE TRANSITION

The second major concept is the transition from a colonial economy toward a modern growth economy. This concept is essential to understanding the postwar growth processes in open dualistic economies.

All countries of this type share a background of economic colonialism.¹ Although political and economic decolonization began in some countries well before World War II, widespread decolonization occurred in the postwar period. Independence and a general upsurge of economic nationalism caused the breakdown of the colonial economy system throughout the world.

These forces destroyed a system which had existed in LDCs for a long period of time, in many cases for several centuries. Thus, postwar growth experience of these countries is viewed as a period of transition from the long colonial economy epoch toward a new growth epoch. The transition involves a process of comprehensive social change, during which the colonial economy system is displaced by new growth forces.

¹ Economic colonialism was present in open dualistic economies even though formal political colonialism did not occur. This was true, for example, in the cases of Thailand and Liberia.

Successful transition growth is an evolutionary process through which the economy progressively alters the inherited colonial economy system by assuming new growth functions. Evolution toward a modern economy takes place through a series of transition growth phases, with each phase representing greater modification of the inherited colonial system and greater progress toward evolving conditions for modern economic growth.

The transition from colonialism to self-sustained modern growth varies in duration and in the sequence, order, and length of transition phases. We may think of the duration of the transition, as a whole, as covering four or five decades, during which three or four distinct transition phases occur. Empirical observation has been limited to the period since World War II, which we construe to be the first generation of the transition. During this time span, most LDCs have remained in the same growth phase which emerged after decolonization. In a few, however, the initial phase has given way to a more advanced phase of transition growth, and these countries have shown the most impressive growth accomplishments. In Southeast Asia, for example, a first phase of transition growth has persisted throughout the first generation in Malaysia, the Philippines, and Thailand, while China: Taiwan has progressed through a first phase and is well into a second phase.

1.3 DIVERSITY AND FAMILY AFFINITY

Empirical observation reveals considerable diversity of postwar transition growth experience among open dualistic economies--even in the limited geographic area of Southeast Asia. Understanding the causes and nature of this variation is essential to adapting strategy and policy to particular situations. It is important to bear in mind, however, that this diversity occurs within a family of economies of similar type, in which the common features of open dualism, inherited from economic colonialism, are more basic than the differences which have appeared during the first generation of transition growth.

Under colonialism the economy was compartmentalized into a stagnant traditional agricultural sector and a more modern export-oriented enclave which included an agricultural export component and a nonagricultural sector devoted to servicing primary product exports. The two components of the enclave were linked through trade with the foreign sector in a triangular pattern, in which primary product exports provided foreign exchange for imports of consumer and capital goods by nonagriculture, which, in turn, delivered services and imported consumer goods to export agriculture. Growth within this pattern was externally dependent, in the sense that foreign demand for primary products governed whether profits would be used for reinvestment, leading to domestic

expansion, or transferred abroad, producing stagnation. These external forces produced instability in growth and deprived the economy of its own internal growth momentum.

The basic triangular pattern in the colonial economy's mode of operation has profound implications for transition growth. At the time of decolonization, prospects for growth continued to center upon the externally oriented enclave. This enclave is the key to launching transition growth. The nonagricultural (commercial) component of the enclave, whose colonial function was servicing primary product exports, is the foundation upon which a modern industrial sector must be built, while the agricultural export sector offers the resource base and potential market for industrial expansion. These conditions lead to perpetuation of the colonial triangular pattern in the economy's operation as the transition is begun. Primary product exports continue to serve as the source of the economy's profits and savings; imports from the foreign sector continue to provide the producer goods for industrial expansion; and the domestic income generated by primary product exports creates the market for absorbing output from the industrial sector's new productive capacity. Colonialism's heritage of a triangular mode of operation thus engenders a triangular industrialization pattern during the initial stage of the transition.

The economic heritage left by the long history of the colonial epoch accounts for the rise of this common pattern of open dualistic growth as decolonization prods these societies into a transition toward a modern growth system. All share the common heritage of colonialism's fundamental mode of operation, and it is the alteration of this inherited growth system which constitutes the essence of transition growth. The particular processes and sequences by which alteration occurs, however, show considerable variation, as the diversity of postwar transition experience of less-developed countries reminds us. While stressing the similarity in the fundamental economic aspects of open dualistic economies, we must take account of the diversity through which the common inherited feature of triangularism may be expressed in actual growth experience.

The triangular industrialization pattern emphasizes industrial expansion as the key objective of transition growth. Thus, the nature of industrial sector growth is crucial in shaping the course of an economy's transition from colonialism. The precise role of the industrial sector and the extent to which it transmits technological change to the traditional agricultural sector depend upon the industrial sector's growth orientation. Orientation refers to the type of goods that are produced and the sector--agriculture, industry, or foreign--to which industrial output is delivered. In short, the industrial sector's orientation is a matter of its products and markets.

It is important to recognize that industrial orientation is an issue on which the society exercises choice. This choice is of fundamental importance in determining the type of transition growth system that emerges. Industrial orientation is not, therefore, an isolated phenomenon; choice of a particular orientation for industry's growing productive capacity will determine the fundamental nature of the growth process that occurs in the economy as a whole. In Section 2 we investigate alternative transition growth phases which emerge from different industrial sector orientations.

1.4 TIME PERSPECTIVE

Our time perspective of transition growth is necessarily limited to the post-World War II generation (roughly 1950-1970), during which the momentum toward change has become widespread among less-developed countries. This period is the first generation of change, initiating a transition from a long colonial epoch. We are thus concerned with very special growth phenomena, those involving dramatic changes in a short period of time. There are two implications for our approach. First, the analysis must be short-run in nature to capture the essential phenomena involved in progress toward a new growth system. Second, our analysis must be confined to a very specific time horizon, the first

generation of transition experience. In both aspects, our analysis may be distinguished from traditional approaches to growth which are usually relevant to the long run and fail to specify a definite historical period as their time frame.

In confining our analysis to a short-run time horizon, we recognize that the transition growth phenomena under our scrutiny will be affected by short-run exogenous forces--forces which may legitimately be neglected in a long-run growth perspective. Two types of exogenous factors are considered as significant to the course of transition growth. The first are political forces unleashed by decolonization and independence which shape the society's choice of the organizational system under which the transitional economy will operate. This choice will influence the society's capacity for adapting entrepreneurial tasks to the growth functions required for a transition to a modern growth economy.

A second type of exogenous factor pertains to the background economic conditions inherited from the colonial epoch. Of particular significance are differences in factor endowments, the relative supplies and quality of land, labor, and entrepreneurial resources with which the transition is begun. Because of these exogenous forces, a broad historical frame of reference is needed to understand the evolutionary aspects of transition growth. Historical antecedents are emphasized as giving rise

to a particular transition phase at the time of decolonization as well as influencing the later sequencing of transition phases.

1.5 THE ORGANIZATIONAL DIMENSION.

The organizational dimension of transition growth is interpreted to mean the complex of policies and institutions which a society creates to perform its economic functions. In contemporary less-developed countries, the impact of government decisions is particularly relevant in shaping this organizational milieu under which the economy operates. In including this dimension in our study of transition growth in open dualistic economies, we explicitly take account of political forces as expressed through government action. These forces represent a society's response to the particular set of background conditions inherited from the colonial epoch.

In traditional approaches to growth analysis, an organizational framework is typically assumed as given, with little or no effort to take account of organizational factors in the formal analysis. While such an approach may do little violence to growth analysis focussing upon a particular country during a growth epoch in which the institutional milieu remains essentially constant, it cannot be accepted for a study of transition growth. Our scope covers many countries of the open dualistic

type, and empirical observation attests to the fact of considerable diversity in the organizational framework under which transition growth occurs. In fact, organizational change is an important facet of a society's acquisition of changing economic functions associated with transition growth, and each society's response will differ on the basis of its particular historical heritage.

For the study of transition growth, therefore, it is essential to distinguish between the economy's operation (in terms of the basic economic functions performed) and the organizational system a society evolves to carry out these functions. It is only through such a distinction that the interrelationships between the functional and organizational manifestations of transition growth can be analyzed and policy aspects, which bear on organization, placed in a proper perspective. It is precisely in the process of establishing new organizational forms that a society adapts itself to the acquisition of new economic functions during the transition toward modern economic growth. Fundamental decisions on choice of an institutional milieu thus have an important bearing upon the rate and direction of transition growth, as the functions involved in the operation of the inherited colonial economy are abandoned in favor of new functions for post-colonial growth.

Choice among organizational systems for transition growth will be found somewhere in the spectrum between two contrasting alternatives, a controlled system and a free market system. In practice, less-developed countries will exhibit a mixture of the two organizational systems, but analysis of the impact of a society's organization upon the key intersectoral growth functions permits us to apply the appropriate analysis to any particular empirical case.

2. ALTERNATIVE TRANSITION GROWTH TYPES

We have noted that the industrial sector's orientation (in terms of products and markets) is the key to determining the type of transition growth that emerges after decolonization. Using this criterion, three transition growth types may be identified: export promotion, import substitution, and export substitution. In the simplest case, from the viewpoint of continuity with the colonial past, the industrial sector continues to be oriented toward promoting primary product exports. In this case, which is referred to as export promotion, industrial sector "products" are of the servicing and processing variety, essentially inputs (perhaps even modern inputs, such as fertilizer) into the agricultural sector, which provides the market.

A second industrial orientation represents more of a break with the colonial past, with the industrial sector oriented toward producing manufactured consumer goods for the domestic market. Since this orientation leads to continuous replacement of previously imported consumer goods by domestic production, the growth type is known as import substitution. The third case represents an even sharper break with the past, as the industrial sector becomes oriented toward producing finished manufactured goods for export to the foreign sector. This orientation leads to an export substitution growth type, as the previous primary product exports are gradually replaced by industrial products.

2.1 MAJOR FEATURES OF ALTERNATIVE GROWTH TYPES

Two of the three alternative transition growth types, export promotion and import substitution, are sufficiently close to the colonial economy's mode of operation that either may represent a feasible system for launching transition growth from the colonial economy heritage. Continuity with colonialism is seen from the fact that both maintain the basic triangular pattern of commodity flows, in which primary product exports provide the means for industrial sector expansion. Moreover, in both cases the industrial sector is oriented toward the domestic market and,

hence, the primary product export base also continues to serve as the basic market stimulant for industrial expansion.

Though in both export promotion and import substitution the industrial sector has a domestic market orientation, their product orientation shows a fundamental difference. In export promotion growth, the industrial sector continues the colonial precedent of providing inputs to accommodate and promote export growth through the production of industrial intermediate goods and services for the agricultural export sector. In the transition context, this orientation may be broadened to emphasize primary product export diversification. By contrast, in import substitution growth, the industrial sector breaks away from this historical orientation, producing consumer goods for the market created by primary product export earnings. Although a ready market exists in the form of the existing imports of industrial consumer goods, domestic production to supply this market represents a modest break with the typical colonial heritage.

Export substitution represents a much sharper break from the colonial economy system, as the industrial sector displaces agriculture from its historical role as the dominant source of the economy's exports. This growth type, therefore, involves not only diversification of industrial products but also industrial penetration into new markets beyond the

domestic economy. These tasks impose high standards of efficiency and adaptability upon industrial entrepreneurs as they enter the arena of world competition. For this reason, export substitution is unlikely to occur immediately after decolonization. Indigenous entrepreneurs must be offered an initial period of experience in the less competitive domestic market if they are to compete successfully in international markets.

In the export promotion growth type, the economy as a whole is export-oriented, with the industrial sector indirectly promoting primary product exports; while under export substitution the industrial sector is directly involved in export expansion. Import substitution growth differs from these types by being exclusively focussed upon the domestic market. Import substitution growth tends, therefore, to reduce the economy's openness as the industrial sector's growth replaces previously imported commodities. This emphasis produces built-in stagnation tendencies since, with relatively constant exports, the volume of imports to be substituted remains constant. Under this condition, successful import substitution automatically diminishes future opportunities for expansion. These inherent tendencies toward termination of import substitution growth are a basic cause of emergence of pressures toward a new growth phase.

Both export promotion and export substitution growth, by contrast, are expansionary in nature. However, export promotion growth

continues colonial-type reliance upon land-based primary product exports. This implies that export promotion can serve as a viable growth system only so long as a land-surplus condition exists. Indeed, only a handful of presently developed countries relied upon this growth system for a relatively long period of time,² and the land-surplus condition is uncommon among contemporary less-developed countries. In the case of export substitution growth, where the industrial sector no longer serves primary product exports, no such land supply constraints hamper long-term growth. Hence, export substitution growth may be viewed as possessing greater potentiality and longer term viability than export promotion.

2.2 EMERGENCE OF CONTRASTING TRANSITION SYSTEMS

Even within the limited sample of open dualistic economies in Southeast Asia, postwar transition experience confirms the fact of diversity of growth patterns. To understand the nature of this transition growth experience, therefore, we must go beyond one general theory of open dualistic growth. Recognizing this implication of diversity, it is a

²"Agricultural export economies," such as Denmark and New Zealand, have progressively increased the industrial value added component in both output and exports.

central thesis of this study that different growth types must be identified and analyzed within a common analytical framework.

Exogenous background conditions, inherited from colonialism, affect transition growth by influencing political choice between alternative organizational systems. Particular combinations of background conditions and the political response they induce can obviously produce a wide variety of specific transition growth systems. This problem of diverse reality may be simplified by identifying two contrasting organizational systems, neo-colonialism and economic nationalism. Empirically, all early transition growth systems can be interpreted, with appropriate modifications, to fall into one or the other of these modal systems.

The terms neo-colonialism and economic nationalism will be given special connotations in our usage, in each case representing a synthesis of the exogenous background conditions and the society's political response. The political response is interpreted in terms of the resultant choice of economic organization, construed as a particular mix of free markets and controls, for achieving the basic objectives of a particular growth strategy. This choice determines the nature of the growth system under which the transition will be launched. Thus, neo-colonialism is associated with export promotion growth and economic nationalism, with import substitution growth. To facilitate our exposition, Table I summarizes the major features associated with the two systems.

TABLE 1

MAJOR FEATURES OF NEO-COLONIALISM AND ECONOMIC NATIONALISM

Major Features	Growth Type	Neo-Colonialism (Export promotion growth)	Economic Nationalism (Import substitution growth)
I. Relationship to historical background		Continuity with colonialism	Sharp break from colonialism
II. Industrial orientation		Servicing and accommodating primary product exports	Production for domestic consumer goods market
III. Economic organization		<ol style="list-style-type: none"> 1. Free market system in allocation and investment decisions 2. Import competition 3. Free international capital movements 	<ol style="list-style-type: none"> 1. Controlled market system 2. Protection from import competition 3. Control of international capital movements
IV. Background conditions		<ol style="list-style-type: none"> 1. Land surplus 2. Large modern enclave and small traditional agricultural sector 3. Scarcity of indigenous entrepreneurship 	<ol style="list-style-type: none"> 1. Land scarcity 2. Small modern enclave and large traditional agricultural sector 3. Minimum supplies of indigenous entrepreneurship

The first row in Table 1 shows the relationship of the alternative systems to colonialism. Neo-colonialism maintains continuity with the colonial past by relying upon primary product export-led growth, while economic nationalism seeks a new basis for the economy's growth. This general characteristic is reflected in different orientations of the industrial sector, shown in the second row. Neo-colonialism retains the colonial precedent of the industrial sector's orientation toward promoting primary product exports. Transition growth may involve broadening this orientation beyond mere accommodation and servicing to include introduction of modern inputs and processing, but the fundamental role of the industrial sector remains unchanged. In economic nationalism, by contrast, the industrial sector abandons its traditional role, becoming re-oriented toward production of consumer goods for the domestic market, gradually replacing imports of these goods by domestic production.

The organizational features of the two systems are shown in Row III. These features must be consistent with the industrial sector's orientation, which (as we have emphasized earlier) determines the nature of the growth type as a whole. Neo-colonialism requires an organizational system conducive to effective competition in export markets and inducements to industrial sector promotion of primary product exports. Specifically, this involves reliance upon the free market for allocating

resources and guiding investment decisions, assuring import competition and free international capital movements. In short, because of its continuation of an export orientation, neo-colonialism involves an organizational system dominated by competitive market forces, both externally and internally. These organizational features, in general, were inherited from colonialism.

In emphasizing a new basis for growth by re-orienting the industrial sector toward the domestic consumer goods market, economic nationalism requires substantial modification of the organizational system inherited from colonialism. The dominant organizational characteristic is the use of economic controls to achieve the new functions of import substitution growth. A major objective in this connection is the encouragement of indigenous entrepreneurship to assume industrial roles unfamiliar in the previous colonial economy. Entrepreneurial inducements typically take the form of market intervention to transfer export profits to industrialists, to provide protection from import competition, and to prevent the economy's savings from being transferred abroad. The control system tends to be mainly concerned with foreign trade flows since exports are initially the major source of the economy's surplus.

The emergence of one or the other of these contrasting organizational systems is traced to the background conditions confronting

societies at the beginning of transition growth (Row IV of Table 1). The impact of these exogenous factors is properly viewed in a historical perspective because decolonization leads to a political emphasis upon national development--embracing the economy as a whole.³ Decolonization almost universally prompts a political quest for a growth system potentially capable of promoting the modernization of the entire economy, a goal very different from that of colonialism.

The first background condition, which distinguishes between land surplus or land scarcity, is fundamental in determining whether a land-based primary product export growth system will be a viable basis for achieving national development. The specific issue concerns whether the natural resource base is adequate, during the early transition years, to support growth and modernization throughout the economy from primary product exports--rather than merely supporting the growth of the enclave and profits to alien investors, as in the past. Where a significant land-surplus condition was left by colonialism, primary product export expansion can be relied upon to provide widespread economic improvement and, with proper policies, these gains can be disseminated throughout the

³ This is borne out by the widespread initiation of national development plans in newly-independent countries--under both neo-colonialism and economic nationalism.

society. In contrast, where colonialism left severe population pressure upon land resources, land-based primary product exports will not grow rapidly enough to serve as the basis for national development, and the society is induced to seek a new basis for transition growth.

The significance of the second background condition, the relative size of the enclave and traditional agricultural sectors, clearly reinforces the first. Where the enclave sector is large in scope, involving the majority of the society's population, reliance upon primary product exports is more feasible for development of the entire economy-- if a land-surplus condition also exists. A part of the primary product export surplus may then be employed, through appropriate public policy, for the uplift of the relatively small, but backward, traditional agricultural sector. If, by contrast, a small enclave sector coexists with a large and backward traditional agricultural sector, even a land-surplus condition may not enable overall development from the primary product export base. If land scarcity accompanies the dichotomy between a small enclave and a large traditional sector, reliance upon primary product export growth for national development is obviously unrealistic.

Choice between the two systems is also subject to constraints imposed by the supply of indigenous entrepreneurship, the third background condition. Two critical aspects of entrepreneurship must be emphasized.

On the one hand, the continuation of a land-based export system imposes more severe requirements upon a society's entrepreneurial capacities than the alternative. This is precisely because the primary product export orientation involves competition in external markets. On the other hand, economic nationalism, in posing a sharp break with colonialism, requires a new class of entrepreneurs who must perform functions uncommon in the operation of the colonial economy. Economic nationalism provides a climate of protection from competition and a control system to assure profits, enabling inexperienced entrepreneurs to assume the new functions.

In Southeast Asia, and perhaps elsewhere, the colonial heritage poses the special problem of supplies of alien versus indigenous entrepreneurs. This problem is prevalent in Southeast Asia because colonial enterprise shared the entrepreneurial and managerial roles with Chinese and other resident minority groups, in some cases to the virtual exclusion of indigenous peoples. Where this condition is present and the background resource conditions promote emergence of a neo-colonial system, a compromise with alien entrepreneurship is required since indigenous agents are unable to operate the competitive export economy. Although growth under economic nationalism imposes less demanding entrepreneurial requirements, the system transfers vast amounts of resources to industrial entrepreneurs. These transfers are likely to be

politically palatable only where an adequate supply of potential indigenous entrepreneurs is available. Where both land supply and entrepreneurial conditions are unfavorable--and where a compromise with alien entrepreneurs is politically infeasible--economic nationalism is likely to lead to chaotic early transition growth.

3. CONCLUSIONS FROM COUNTRY ANALYSIS

Four country case studies were undertaken to provide a firm empirical basis for analyzing postwar transition growth in open dualistic economies. These country studies reveal quite different patterns of development during the first generation of the transition. The postwar experience in two countries (Thailand and Malaysia) is characterized as neo-colonial export promotion growth, while in one country (Philippines) import substitution growth under economic nationalism dominated postwar experience. Finally, in China: Taiwan the unique phenomenon of a sequence of two contrasting phases, import substitution and export substitution, occurred within the brief 20-year period, 1950-1970.

In this section we briefly summarize the major conclusions from these country studies as background for the policy discussion in the next

section. Detailed analysis and empirical verification behind the assertions in this section are found in our study, "The Transition in Open Dualistic Economies."⁴

3.1 EXPORT PROMOTION GROWTH: THAILAND AND MALAYSIA

Thailand

Thailand's postwar transition growth has been based upon promotion of primary product exports, emphasizing diversification through expansion of unprocessed agricultural exports. The presence of a land surplus has facilitated this growth process as land brought under cultivation was devoted to production of new export crops, such as maize, kenaf, and cassava. During the period 1950-1966, land under cultivation increased by 63 per cent, while that devoted to the major traditional export crop, rice, increased by only 26 per cent.

Though Thailand escaped overt political colonization, the economy of prewar Thailand shared all of the common properties of a colonial economy. Thailand's traditional economy was converted into an

⁴Douglas S. Paauw and John C. H. Fei, "The Transition in Open Dualistic Economies" (Washington, D. C.: Center for Development Planning, National Planning Association, July, 1970), mimeographed.

open colonial-type economy in the second half of the nineteenth century. Under the force of treaties with Western powers, a colonial pattern of foreign trade was introduced, eventually becoming the major growth force in the economy. To operate the rice and tin trade which became dominant in Thailand, Chinese immigrants became established as the society's entrepreneurs and middlemen. Thus, by the twentieth century, the Thai economy exhibited both a structure and mode of operation very similar to that of Thailand's colonial neighbors.

Thai society showed the ethnic specialization characteristic of Southeast Asian colonial economies. While political control remained in indigenous hands, alien and minority groups controlled economic functions in the enclave (export servicing, including rice milling), with traditional agriculture remaining as the preserve of indigenous Thais. A major, and rather unique, feature of the Thai colonial economy, however, was the extensive involvement of the traditional sector with the enclave, reflecting the monetization caused by the dominant position of rice in Thailand's exports. Throughout the century after 1850, rice accounted for more than half of Thailand's export earnings. Production of other exports (e. g., tin) was largely controlled by aliens, Chinese or European.

The superior position of aliens and minority groups in the economy, in control of export activities, eventually induced an interest

among Thai leadership in economic decolonization and a transition to a domestically oriented growth system. These nationalistic stirrings began to appear during the 1930s, precipitating in Thailand a first effort toward modernization through industrialization. A highly nationalistic political regime came to power, conspicuously oriented toward transferring the export base to indigenous control and using the export surplus for industrial development.⁵ A first step in this direction was the final repudiation of the unequal treaties between Thailand and the Western powers.

Forced industrialization in Thailand, beginning in the late 1930s and continuing until the 1950 decade, assumed a very special character. In view of the lack of indigenous private entrepreneurship, the government promoted industrial development by transferring resources to public officials, resulting in a pattern which might be termed "bureaucratic industrialization." These industrial undertakings were largely of an import-substitution variety, eventually covering several industrial activities. The motivation behind this bureaucratic industrialization effort was clearly a nationalistic political desire to promote indigenous control of modern industry vis-a-vis the Chinese minority.

⁵These tendencies were reinforced by the decline in world demand for primary export products during the depression.

While these control policies interfered with export performance, the industrialization efforts failed to shift the economy's operation to a domestic center of gravity. Eventually the failure of this nationalistic drive was recognized, and a compromise with Chinese entrepreneurs emerged. Liberalization policies, adopted in 1955, effectively ended the earlier restrictive measures and provided the basis for a period of vigorous primary product export-led growth. This led to explicit policy emphasis upon primary product export expansion under a free market system, with the government actively participating in rural infrastructure development for agricultural export diversification.

This reversal in Thailand eventually had dramatic repercussions upon transition growth of the economy. The effects, in terms of accelerating growth of exports and domestic output, were not clearly apparent, however, until approximately 1958--suggesting a significant time lag between the reorientation of development strategy and response of major growth phenomena. While both export and output growth lagged during the years after the export boom of the early 1950s (from 1950 to 1958), a period of satisfactory and steady export-led growth began in 1958.

Since 1958, export growth has been almost completely dominated by rapid expansion of new unprocessed agricultural exports (e. g., maize,

kenaf, and cassava).⁶ Success at diversification and growth of exports during this period has been accompanied by acceleration of growth in both industry and agriculture, at significantly higher rates than during the pre-1958 period.⁷ An important feature of output, and particularly of productivity growth, since 1958 has been its balance by sector. After 1956, falling labor productivity growth rates in both sectors were reversed and dramatic improvements were shown.

Given an adequate natural resource base and an appropriate organizational system, export-led growth provides a viable pattern of early transition growth. This result has clearly been achieved in Thailand since the liberalization policies of the mid-1950s. Transition growth of this type, however, emphasizes the development of nonagricultural (industrial) sector activities which are oriented toward servicing primary product exports. In particular, this growth system is not conducive to industrial development catering to the domestic market for consumer goods. This

⁶Since 1965 "service" type exports have become the most rapidly growing component, as we mention later.

⁷In the period 1951-1958, exports grew by an annual rate of 4.5 per cent, compared to 10.9 per cent in the 1958-1965 period. Growth of gross national product rose from 3.8 per cent to 7.9 per cent; industrial value added, from 3.8 per cent to 9.6 per cent; and agricultural value added, from 3.7 per cent to 5.7 per cent. All are in constant (1962) prices.

feature of growth led by primary product exports poses a political threat to its long-run viability as a transition growth system, since it maintains the external dependence inherited from colonialism.

Import substitution, which normally begins at the consumer goods level, has made little headway during the postwar period in Thailand. The ratio of imported industrial consumer goods to total consumer expenditures on nonagricultural goods has risen consistently over the period 1951-1965. Similarly, the ratio of imported consumer goods to total imports remained almost constant. This contrasts to very rapid import substitution of manufactured consumer goods in both the Philippines and Taiwan, as well as in many other LDCs which have emphasized import substitution growth during the first phase of the transition.

Although Thailand's economic growth has been led by expansion and diversification of primary product exports during the decade and a half since the organizational reforms of the mid-1950s, one cannot ignore the emerging tendencies toward change which have become conspicuous in recent years. Chief among these tendencies is the growing emphasis upon supplementing primary product exports by service exports (particularly tourism) and the shift of domestic investment toward promotion of these

exports.⁸ While this tendency is partly associated with the growing U. S. involvement in Thailand for mutual defense reasons, the export of Thailand's urban labor surplus through service-intensive tourist trade must be emphasized as the underlying economic basis for the shift. The significance of this emerging shift in exports is that it represents a tendency toward labor-intensive exports, supplementing the traditional export of land-intensive primary export products.

One may only speculate on the extent to which Thailand's rapid progress in expanding service exports is attributable to the growth of U. S. expenditures in Thailand and the likelihood of continued success at this type of export promotion after the inevitable reduction in official U. S. expenditures in Thailand. This issue has important implications for Thailand's future transition growth since service exports have strengthened the export-led growth system, as primary product diversification has begun to confront depleting land frontiers.

⁸The importance of this shift may be seen in the growth of service exports and their contribution to total exports. In 1965 service exports comprised 16 per cent of the total, rising to 28 per cent in 1969. From 1965 to 1969 service exports increased by 166 per cent, compared to 47 per cent for commodity exports. Data are taken from National Economic Development Board, Annual Plan, 1971, p. 30.

A second threat to the continuation of primary product export-led growth is raised by the emergence of national interest in industrialization with an orientation beyond the scope of mere agricultural processing, a development which may lead to the eventual resurgence of an import substitution emphasis in national policy. There is undoubtedly considerable scope for a more aggressive import substitution program in Thailand. A labor surplus appears to be emerging in urban areas, providing the labor condition for import-substitution growth. As Thailand's early transition experience emphasizes, however, successful import substitution is crucially dependent upon indigenous entrepreneurial capabilities. If Thailand's present organizational framework for export promotion growth, necessarily emphasizing efficiency and competitiveness, can be maintained with appropriate inducements for investment in consumer goods manufacturing and the society's minority group entrepreneurial talent responds positively, a labor surplus-based growth system may indeed prove as viable in Thailand as it has in Taiwan. A reversion to a highly controlled import-substitution system, particularly one with the previous nationalistic overtones, would, however, run the risk of choking off the economy's growing supply of entrepreneurship, still largely in alien hands.

Malaysia

Malaysia's transition experience represents a classic case of export promotion under a neo-colonial organizational system. The colonial pattern of "modern" primary export products (e.g., rubber), involving a substantial amount of domestic nonagricultural processing, has been maintained, with modest progress toward diversification. As in the case of Thailand, a land-surplus condition has been fundamental to expansion of primary product exports. During the first nine years after independence (1957-1966), land under export crop cultivation in West Malaysia⁹ was expanded by 18 per cent, and even more rapidly in East Malaysia.

Peaceful transfer of sovereignty from the British to the new Malaysian government offered a climate for an effective compromise between several contending power groups--the former British colonial masters, the Chinese and Indian minorities who dominated the economic roles in the enclave, and the indigenous Malays to whom political power was transferred. The compromise was instrumental in preventing experimentation with a

⁹ **Malaysia includes West Malaysia (previously known as the Federation of Malaya) and East Malaysia (Sabah and Sarawak). West Malaysia contains 85 per cent of Malaysia's estimated 1967 population of 10 million but only 39 per cent of the country's total land area.**

nationalistic control system, which marked decolonization in many newly-independent countries. Thus, Malaysia's export promotion growth system did not require a period of decontrol and liberalization for its launching; it was rather a natural continuation of the colonial system, with some modifications associated with independence.

The industrial sector retained the colonial orientation of primary product export promotion. Unlike the Thailand case, however, the industrial sector has been oriented toward increasing the flow of modern inputs into primary product exports rather than merely providing accommodating services for a larger volume of crude primary product exports. Though some diversification of exports has occurred, the major emphases have been upon raising productivity in primary product export production and increasing the industrial processing component in these exports.

The retention of the primary product export base for growth has been accompanied by efforts to improve conditions in the lagging traditional agricultural sector. The chief economic impact of independence, therefore, has been the use of government policy to redirect a part of the economy's export surplus to foster the development of traditional agriculture through both infrastructure programs and provision of modern inputs. Given the large size of the export-oriented enclave, the economy

had historically been able to support a persistent food deficit without difficulty. The emphasis on modernizing traditional agriculture had stemmed not so much from the existence of a food deficit as from the political necessity to improve the welfare of the Malay component in the population, which is predominantly involved in subsistence food-crop agriculture. This program has reduced the economy's food deficiency, thus bolstering export promotion growth.

Malaysia's export promotion system is based upon an economy with an unusually large export-oriented enclave. At the time of Malaysian independence (1957), 78 per cent of land under cultivation was devoted exclusively to export crops and 69 per cent to the economy's major export, rubber; these percentages remained unchanged throughout the first decade of independence. In addition, tin and other extractive exports (e.g., timber, iron ore) from the natural resource base grew rapidly during this period. Similarly, approximately three-fourths of the economy's employed labor force is absorbed by occupations in the enclave, giving Malaysia an atypically small traditional agricultural sector. This feature has not only produced a high per capita level of real income but also

provides conditions favorable to improving productivity in traditional agriculture.¹⁰

The basic economic factors in the colonial heritage--land surplus and a large, prosperous enclave--were accompanied by a third factor which was important in explaining the emergence of neo-colonialism, the exclusion of Malays from entrepreneurial and managerial roles in the colonial enclave. The one exception was British tutelage of indigenous Malays for positions in the government bureaucracy. This preparation of Malays for government service enabled the British to relinquish political power to the Malays, which set the stage for a compromise solution in regard to the economy's organization. The compromise maintained a continued British role in the economy and encouraged open competition between Western and minority group (Chinese) participation in the lucrative enclave sector of the economy. This free market emphasis was accompanied by policies to elevate the political and economic status of the indigenous Malay population.

¹⁰Per capita income of approximately U.S. \$200 is, however, unequally distributed among the Malays and minority groups, with Malay per capita income being about U.S. \$120 and Chinese, \$280.

Malaysia's transition growth under this compromise system has been led by primary product exports of the processed variety (e. g. , rubber and tin).¹¹ Exports in real terms (constant prices) have grown at approximately the same rate as gross product (about 6 per cent per year), maintaining the export ratio near 45 per cent for Malaysia as a whole. Malaysian growth has been plagued, however, by fluctuating and generally deteriorating terms of trade, particularly in the case of West Malaysia, which contributes about four-fifths of the economy's export earnings.

Despite export instability, export-led growth in Malaysia has provided satisfactory and balanced growth of real output. In West Malaysia (1957-1967), real GDP has grown at an average annual rate of 5.8 per cent, with the nonagricultural component growing by 6.4 per cent and the agricultural component, by 5 per cent. Labor productivity (total productivity per employed laborer) in the two sectors has shown balanced growth, near 4 per cent per year in both. This reflects close linkage between the growth performance of agriculture and nonagriculture since primary product export growth is dependent upon inputs from the nonagricultural sector.

¹¹Processed agricultural products and minerals have consistently contributed approximately 90 per cent to West Malaysia's total exports, but a smaller percentage in East Malaysia.

The orientation of nonagriculture toward primary product export promotion is apparent for all nonagricultural activities. Manufacturing, which plays a critical role in all transition growth systems, is dominated by export processing activities. Less than one-fourth of manufacturing output is devoted to consumer goods production, with the remainder consisting of intermediate goods for export-oriented activities. This emphasis precluded any significant development of consumer good import substitution industries during the first phase of the transition. The industrial consumer good component of total imports has remained essentially constant since Malaysia's independence.

Malaysia's future transition growth prospects appear to be dependent upon emergence of patterns of specialization between West and East Malaysia. Although West Malaysia contains the majority of Malaysia's population (about 85 per cent), it nevertheless shows a relatively low density of population. A surplus of potentially cultivable land appears to exist. The experience of the first decade of independence suggests, however, that this land surplus will be taken up more to expand domestic food output than to expand primary product exports. The government's orientation toward raising the economic position of Malays in the traditional sector supports this prognostication. Moreover, the government's export expansion efforts in West Malaysia have not led to

significant progress in diversifying West Malaysia's exports. As a result, West Malaysia has suffered from deteriorating terms of trade. In this situation, continued reduction of West Malaysia's food deficit by expansion of food output is likely to prove to be the emphasis in absorbing the region's land surplus.

Since the mid-1960s West Malaysia's deteriorating export fortunes have also induced a clear tendency toward import substitution. Whether the free market character of this process will be eroded in the future by an aggressive program of controls to foster rapid import substitution is a major growth issue now confronting Malaysia.

Recent developments in East Malaysia contrast sharply with the transition experience in West Malaysia. The primary product export emphasis remains strong, and food deficits have continued to grow--in 1966 representing about one-fourth of Malaysia's total food deficit. Given the large and diversified, but sparsely populated, resource base, however, East Malaysia's future primary product export prospects look bright. In contrast to West Malaysia, considerable diversification of exports has occurred, and conditions are favorable for future growth of a diversified pattern of primary product exports. In both Sabah and Sarawak, timber exports have grown rapidly and exports of other indigenous products have been successfully expanded during the past five years.

These evolutionary transition forces, contrasting between East and West Malaysia, point to the possibility of a new phase of transition growth, based upon geographical specialization. The striking land-surplus condition in East Malaysia places that region in a natural position as the primary product export base for a new growth phase. As West Malaysia's export enclave becomes increasingly circumscribed by emphasis upon food crops and import substitution, East Malaysia may be expected to become the export base for West Malaysia's industrialization.

Such a geographically specialized pattern of import substitution growth is one which Indonesia pursued without success during the first decade of Indonesian independence. A clear lesson from this experience is that the employment of one region's export surplus to promote industrialization of a second region evokes very serious political tensions. The basic reason for failure in the Indonesia case, however, was the absence of an entrepreneurial response by indigenous Indonesians. In the Malaysian case, where entrepreneurship is dominated by the Chinese minority, these political and entrepreneurial threats may be expected to be particularly volatile. Thus, although the economic basis may be judged to be relatively sound, there are serious questions about the political viability of the transition phase which is appearing to evolve in Malaysia.

3.2 PROLONGED IMPORT SUBSTITUTION: THE PHILIPPINES

Postwar transition growth experience in the Philippines has reflected the perpetuation of a system created to foster consumer good import substitution. A system of foreign trade and domestic controls, favoring the development of import substitution industries, was introduced in the early 1950s. The controls were employed to transfer profits from the primary product export sector to industrial entrepreneurs. Although consumer goods manufacturing industries grew rapidly during the 1950s, both primary product exports and traditional agriculture suffered under the impact of the control system.

Philippine manufacturing development has a relatively long history. During the four decades prior to World War II substantial development occurred, and by 1938 manufacturing contributed approximately 17 per cent of net output. However, manufacturing during the prewar period was clearly oriented toward processing primary products, particularly food, for export. This prewar status of manufacturing is precisely what we would expect in a primary product export colonial economy.

In the postwar period the Philippines clearly opted for encouraging import substitution through reliance upon transfer of export profits to private entrepreneurs. Industrial development, through import

substitution led by private entrepreneurs, became a dominant national goal early in the post-World War II period. As executed in practice, preference was overwhelmingly given to promotion of manufacturing for the home market at the expense of exports. This emphasis is apparent in both the government's official regulations and the structure of incentives resulting from the entire organizational milieu.

The firm espousal of economic nationalism, expressed in import substitution growth under political aegis, represents a political response to the background conditions inherited from colonialism. Colonialism left the Philippines with a large and rapidly growing population, beginning to press upon the society's land resources. Alien groups had dominated the entrepreneurial functions in the society, and the real welfare of Filipinos had remained relatively stable under colonialism. Contemporary Filipino scholars view the pursuit of forced industrialization as a conscious response to these conditions:

"One should appreciate that the main raison d'etre of the import substitution was that in the postwar period the structure of the economy had to be altered. The prewar economy based on primary production and exports, while it did achieve for Filipinos high living standards, was no longer sufficient for a nation with a vastly increased

population, a disappearing frontier area and diminishing uncultivated land, and rising expectations. The import substitution drive during the control period of 1950-65 was necessary to effect the change in structure. "¹²

As the theory of import substitution growth predicts,¹³ however, the growth regime created by the Filipino control system eventually ran out of steam (1956-1958); and several symptoms of distress (idle productive capacity, balance of payments disequilibrium, and capital flight) appeared. These inherent difficulties of import substitution growth were aggravated by the lagging agricultural sector. On the one hand, agricultural exports remained stagnant, limiting the expansion of markets for the growing output of consumer good manufacturers. The effects of stagnant agricultural exports, however, were mitigated by a fortuitous growth of extractive exports, particularly lumber and minerals. On the other hand, stagnation in traditional agriculture eventually produced growing food deficits, necessitating the diversion of foreign exchange earnings from producer goods imports to food imports.

¹² Amado A. Castro, "Import Substitution and Export Promotion: Trade and Development," University of the Philippines, School of Economics, Discussion Paper No. 69-10, June 27, 1969, p. 15 (mimeographed).

¹³ See Douglas S. Paauw and John C. H. Fei, op. cit., Chapters 4 and 9.

These joint problems of agricultural stagnation under the discriminatory control system eventually caused sharp retardation of import substitution growth in the industrial sector. Retardation throughout the economy became serious during the latter part of the 1950 decade, and the distress symptoms induced government action. Political awareness of the exhaustion of import substitution growth¹⁴ gave rise to efforts to mitigate the deleterious effects of the control system on primary product export growth in an effort to stimulate revival. The effect of these efforts was to prolong import substitution growth, accompanied by the emergence of a serious food deficit.

Decontrol and associated measures, introduced after 1959, were accompanied by continuation of protection for import substitution industries. These measures, however, continued the economy's basic orientation toward import substitution growth. They resulted in a temporary revival of modest rates of industrial sector expansion but failed to induce industrial entrepreneurs to engage in agricultural

¹⁴For example, this perception was clearly stated by President Macapagal: "The country has fully exhausted the potentialities for growth offered by the complement of policies ruling over the decade of the 1950s.... It has become obvious that the impetus to investments which exchange controls and various incentives provide has worked itself out." Quoted by Amado A. Castro, op. cit., p. 16.

modernization or the expansion of their market horizons from domestic to foreign.¹⁵ Hence, the export promotion features of the new policies had the effect of merely prolonging the import substitution growth phase rather than leading to the evolution of a new transition growth phase. The policy reversals near the end of the 1950 decade, therefore, produced two subphases in the Philippines' postwar transition: (1) a period of pure import substitution, roughly coterminous with the 1950 decade and (2) a period of prolongation of import substitution growth (after 1960), during which the system of controls came to be modified by export promotion policies.

While import substitution continued as the economy's dominant growth regime under the changed policies during the second phase, the evidence suggests that even the moderate reduction of protection and profit transfers from the 1950 levels posed serious problems of adjustment for the "new and necessary" industries. Both rates of utilization of capacity and profit rates retreated from their 1950 levels, and the society was forced to allocate an increasingly large share of its export earnings to cover a growing food deficit. The progressive decline

¹⁵ These conditions are essential to further evolution of transition growth, as demonstrated by our review of the Taiwan case in the next section.

of the system, notwithstanding the major export promotion policies of 1960-1965, induced a search for more basic solutions, beginning in the 1966-1969 period. These gropings toward a new basis for Philippine transition growth focussed upon coming to grips with the problem of stagnant traditional agriculture. By the late 1960s the economy's food deficit had been eliminated, but agricultural modernization had failed to progress sufficiently, and the necessary organizational change had not been accomplished, for abandoning import substitution and the emergence of an export substitution growth phase.

The organizational changes of the 1960s were inadequate to break the pattern of faltering import substitution growth. Concessions to import substitution industries were continued, though the profit transfer mechanisms employed were less potent than those in existence during the 1950s. The moderate relaxation of discrimination against the export sector produced an upsurge of growth of primary product exports. Even manufactured exports with a high domestic natural resource component showed a significant response. The major weakness of the organizational changes was that they failed to remove serious obstacles to the growth of exports of manufactures which do not have a high natural resource comparative advantage. The continuation of high levels of protection for consumer goods manufactures, through tariffs, discouraged entrepreneurs

in these industries from making the efficiency adjustments required for penetration of foreign markets.

Import substitution of consumer goods manufactures, under a high wall of protection, offers entrepreneurs a first training ground for undertaking new modes of production. The artificial atmosphere of assured high domestic prices for their output and artificially low input costs are not, however, conducive to the growth of efficiency required for breaking into highly competitive export markets. The difficulties experienced by industrial firms during the period of moderate reductions in profit transfers and protection cause grave concern about the future of Philippine manufacturing growth. Prolonged import substitution offers only modest expansion opportunities, circumscribed by the growth of primary product exports. The significant avenues for a new wave of rapid industrial growth lie in export substitution. The organizational milieu prevailing during the 1960s, in prolonging import substitution growth, did not offer a climate in which industrial entrepreneurs could progress toward assimilating the new tasks required for export substitution growth.

3.3 EVOLUTIONARY TRANSITION GROWTH: TAIWAN

China: Taiwan is one of few LDCs which have progressed from an initial phase of transition growth to a more advanced phase during the first generation of the transition from colonialism.¹⁶ The significance of Taiwan's postwar experience lies in this evolutionary nature of its transition growth. In addition to providing rapid growth of output, evolutionary transition growth in Taiwan produced dramatic changes in the economy's structure and in its mode of operation. These changes occurred as the economy traversed a relatively brief import substitution phase (1950-59), which provided a first departure from colonialism, and entered a phase of export substitution growth in approximately 1960.

In a historical view of the transition process, the phenomenon of rapid succession of growth phases assumes very special significance. Two aspects deserve emphasis: (i) the rapidity of growth which accompanies this sequencing and (ii) progress in each phase in the sequence toward inculcating in the society more advanced functional attributes of modern economic growth. From the experience of such growth

¹⁶ Among Asian countries, Taiwan shares this unique experience only with South Korea. Elsewhere, Israel and possibly Mexico may be cited as among rare examples.

accomplishments within the short time span of one generation of the transition, we may learn about the evolutionary process involved in successful transition growth experience.

An unusually favorable supply of human resources is basic to understanding Taiwan's successful transition experience. The withdrawal of Japanese entrepreneurship during the decolonization process was offset by a wave of immigration of skilled manpower from Mainland China in the late 1940s. Prominent among the immigrants were Chinese with a long history of commercial and industrial experience in China's coastal provinces, and these immigrants assumed the entrepreneurial roles required for transition growth. This supply of industrial leaders was matched by an abundant and literate labor force, capable of quickly acquiring industrial labor skills. These human resource advantages enabled the society to terminate controls and protection after a brief period of import substitution, as entrepreneurs quickly learned to function in more competitive free markets.

The second special background factor stems from the preconditions for modernization of agriculture which were established during the half century (1895-1945) of Japanese control in Taiwan. During this period, Taiwan was developed into an agricultural complement to Japan's industrializing economy. Taiwan became the beneficiary of Japan's own

modernization as agricultural improvement was emphasized. Productivity gains in both the traditional and export subsectors were encouraged by investment in rural infrastructure, by an educational system which reached into traditional agriculture--improving literacy and adaptability to technical change--and by the formation of cooperatives for promoting both dissemination of improved methods and wider access to markets. Through these programs, technological dualism was gradually eliminated, providing the basis for rapid modernization of agriculture, as a whole, during the postwar transition period.

Taiwan's preconditioning for agricultural modernization was indeed unique. Japanese industrial growth required rapid expansion of food and raw materials from her colony, and Japanese experience was freely transferred to raise agricultural productivity across the entire agricultural sector. This background contrasts sharply with other Southeast Asian countries, where technical change and modernization were confined to small enclaves within the massive traditional agricultural sector and growth effects upon traditional agriculture were more accidental than intentional. Thus, Taiwan's task of agricultural modernization during the transition was facilitated by a long period of conditioning, an advantage rarely found in other countries embarking upon transition growth.

Special features in Taiwan's postwar situation enabled the society to turn its attention quickly to building upon these favorable preconditions for agricultural modernization. The Kuomintang government was amenable to institutional reform in agriculture because of its preceding history on the mainland. This orientation was reinforced by access to foreign assistance--both financial and technical--to pursue agricultural programs at an early stage of the postwar transition. This effort was epitomized in the Joint Commission for Rural Reconstruction which provided American assistance for creating institutional conditions (particularly "land reform") conducive to rapid agricultural modernization. The significance of this effective program is apparent from comparison with the Philippine case, where agricultural stagnation became the major barrier to smooth and rapid transition growth after the initial momentum of import substitution growth had been exhausted.

In summary, Taiwan's unique success is explained by particularly favorable background conditions affecting the two most crucial aspects of transition growth--entrepreneurship and agricultural development. These favorable conditions were a joint product of Japanese colonialism and the historical accident of the transfer of entrepreneurial and labor skills from the mainland. With the additional benefit of access to large-scale external assistance, Taiwan was strategically suited to

launching transition growth by a brief and effective import substitution phase and quickly achieving conditions for even more rapid growth under export substitution--all within a brief 15-year period.

The Import Substitution Phase

Taiwan's transition toward a modern economy was launched by an aggressive import substitution program which built directly upon the triangular pattern of resource utilization inherited from the colonial past. The primary product export base was employed as the means to modify the colonial economy by rapid development of a consumer goods manufacturing sector. Primary product export earnings were increasingly redirected from consumer goods imports to producer goods to foster the growth of domestic manufacturing capacity. A cumulative process ensued in which growth of domestic capacity released a growing share of foreign exchange earnings for producer goods imports. This process was manifested in rapid growth of industrial consumer goods output, replacement of imported consumer goods by domestic supply, and a marked shift in the structure of imports from consumer to producer goods.

Organizationally, the import substitution phase resembled the controlled economy milieu of economic nationalism. Foreign trade controls were emphasized since primary product exports remained the

basic source of both foreign exchange and savings required for industrial sector growth. There was a clear protectionist strain in foreign trade policies, strengthening the inducements offered by profit transfers to industrial entrepreneurs. Behind this controlled organizational system lay a rationale of forced industrial growth from the surplus generated by primary product exports.

This organizational milieu provided rapid industrial expansion for several years of import substitution growth. However, deceleration began to appear by the mid-1950s, conforming to the inherent exhaustion tendency predicted by our theory. When this termination effect appears, growth of the industrial sector will continue to lag unless a new market orientation is found.¹⁷ Taiwan's outstanding success during the first generation of the transition was based upon the society's ability to adopt a new orientation for industrial sector growth when these inherent termination forces appeared.

¹⁷When a new industrial orientation is not found, or mere prolongation occurs, symptoms of lagging import substitution growth will appear. These include the appearance of unutilized industrial capacity, capital flight, terms of trade shifting against the industrial sector, a declining rate of return to industrial capital. These symptoms appeared in the Philippines and continued over a period of several years--in contrast to Taiwan, where they were quickly overcome.

During the second half of the 1950 decade, the industrial sector responded by beginning to turn to the market offered by acceleration of modernization of agriculture. Encouraged by government agricultural infrastructure programs and an easing of the import substitution phase policies discriminatory to the agricultural sector, industrialists began to shift to production of modern inputs for agriculture.

Agricultural modernization is a natural consequence of the import substitution phase. When retardation of import substitution growth occurs, there is an inherent tendency for industrial entrepreneurs to seek new investment outlets in the domestic economy, rather than venturing into the more uncertain and demanding arena of foreign markets. The organizational system accompanying import substitution, in discriminating against agriculture, tends to starve that sector in terms of investment, resulting in gradual accumulation of investment opportunities. The industrial know-how gained during the import substitution phase is relevant to producing modern inputs for agriculture as well as for diversifying agricultural exports through introduction of new products and greater domestic industrial processing.

The feasibility of exploiting new opportunities in the agricultural sector, however, depends upon several crucial preconditions. Perhaps most critical is a history of raising agricultural productivity through

introduction of modern inputs during the preceding colonial history. The existence of nascent distributive channels for dissemination of modern inputs and the acceptability of new technology in the agricultural sector are important features of such a colonial heritage. A second prerequisite is the maintenance of domestic political stability to attract investment into raising agricultural productivity. Finally, reorientation of industrial sector output toward new markets is likely to be associated with positive public measures encouraging a shift to agricultural modernization.¹⁸

We have noted earlier Taiwan's favorable agricultural background inherited from Japanese colonialism, while the other essential conditions appeared to converge in Taiwan during the mid-1950s.

The shift to agricultural modernization during the latter part of the import substitution phase is crucial for understanding the evolutionary nature of successful transition growth in Taiwan. Reorientation of industry from the domestic market focus of the import substitution phase to foreign markets is the essence of moving on to an export substitution phase. This reorientation stems directly from modernization of the traditional agricultural sector.

¹⁸Institutional conditions in the agricultural sector, such as patterns of land utilization and ownership, may tend to obstruct modernization, and these obstacles can only be removed by government policies; e.g., "land reform."

Conditions Leading to a New Growth Phase

The emergence of an export substitution phase after an initial period of transition growth in open dualistic economies is fundamentally a matter of supply and demand conditions affecting the rise of a disciplined industrial labor force. The underlying factors operating on the supply of labor are found in the traditional agricultural sector, where modernization has been proceeding. On the demand side, the major factor is the quality of industrial entrepreneurship, which has been gradually oriented toward market criteria of efficiency, encouraged by easing of the control policies of the import substitution phase. Availability of a cheap and efficient labor force and its employment to provide a new export base to replace the traditional natural resources base are sine qua non for evolution of export substitution.

Under a labor-surplus condition (which characterizes societies opting for beginning the transition by an import substitution phase), the source of labor supply lies in the traditional agricultural sector. Given the initial condition of a large and stagnant traditional sector, migration from traditional agriculture tends to occur early in the transition. Migration alone is not adequate, however, to assure a labor supply for export substitution growth. Modernization of traditional agriculture is needed to provide simultaneous release of labor and the food supply

required for their maintenance. In this sense, effective labor transfers for industrial growth are contingent upon expansion of agricultural productivity, providing the basis for delivery of growing quantities of food (and raw materials) from traditional agriculture to the industrial sector.

If this condition is met, an assured supply of "cheap" labor becomes available to meet demand for its utilization in manufacture of labor-intensive export goods. While domestic natural resources may still be required as inputs, the conspicuous and important aspect of the new export orientation is its reliance upon the comparative advantage of cheap labor services, rather than land services, as in the preceding history of the economy.

Successful export substitution requires diversification of outputs and markets. Industrial entrepreneurs must become increasingly sensitive to market changes and alert to innovation possibilities on the technological front. This very diversification thrust of export substitution will eventually begin to free the open dualistic economy from its historical difficulties of fluctuating terms of trade and unstable foreign demand for a few primary product exports.

The assumption of these new growth functions associated with adopting an external orientation for industrial output is contingent upon the

development of entrepreneurial capabilities. Entrepreneurial development is fundamentally a matter of gaining productive efficiency to enable exploitation of the economy's labor surplus comparative advantage in competitive export markets. An essential condition for utilization of this comparative advantage is entrepreneurial capacity to adopt labor-using techniques of production. In practice, this requires the ability to adapt imported capital goods (embodying capital-intensive technology) to the economy's labor-surplus condition. This involves a major change in entrepreneurial behavior from the import substitution phase, when the control system tended to discourage modification of capital-intensive imported technology.¹⁹ Hence, organizational change must accompany the evolution of entrepreneurial capabilities to encourage the shift to effective competition in export markets.

To summarize, there are two major prerequisites for the emergence of successful export substitution: (i) modernization of agriculture must raise productivity to enable the traditional agricultural sector to release labor, food, and raw materials to the industrial sector

¹⁹In the climate of controls and protection during the import substitution phase, entrepreneurs are assured high profits by merely importing producer goods embodying capital-intensive technology and employing these goods without modification.

and (ii) indigenous entrepreneurs must be capable of penetrating new markets through growing competitiveness, and they must also learn to modify imported technology to produce industrial exports which fully exploit the advantage of a cheap labor supply. A society's capacity to meet these preconditions depends upon accomplishments during the import substitution phase.²⁰

The Export Substitution Phase

The export substitution phase of transition growth represents a relatively advanced growth type among open dualistic economies. The operation of the economy, in terms of our intersectoral framework, is more complex than the other growth types discussed (import substitution and export promotion). Part of the complexity is explained by the persistence of vestiges of these earlier growth phases, reflecting the fact that export substitution naturally evolves from both the operational and organizational features of import substitution (which, in turn, evolved from the triangularism of colonial export promotion growth).

²⁰Where these conditions are not met, as in the Philippines, prolonged import substitution occurs.

The more complex growth under export substitution involves three major changes from previous growth experience. First, the economy for the first time abandons its colonial triangular mode of operation. This results from the external orientation of the industrial sector which increasingly becomes the major source of the economy's export earnings. Second, internal integration between agriculture and industry is strengthened by the growing flows of food and raw materials from agriculture to industry (accommodating the rapid transfer of labor). Third, the industrial sector becomes the source of its own industrial investment, contrasting with the prior pattern based upon the agricultural export surplus.

Throughout the import substitution phase, primary products continued to dominate Taiwan's export earnings. This characteristic began to be reversed in approximately 1960, the date marking the beginning of the export substitution phase. Substitution of industrial for primary product exports proceeded rapidly, so that by 1969 80 per cent of total exports were of industrial origin (compared to 6 per cent in 1952 and 42 per cent in 1960). This feature is the major empirical measure of the occurrence of export substitution growth.

This remarkable shift in the composition of Taiwan's exports was based upon the industrial sector's rapidly expanding labor-intensive exports.

This accomplishment was associated with acceleration of the reallocation of labor from agriculture to industry, in turn enabled by rapid gains in agricultural productivity. Agricultural productivity gains showed rapid improvement, beginning in the late 1950s, as a result of the shift to agricultural modernization during the latter years of the import substitution phase.

The export substitution phase brought even more rapid growth throughout the economy than during the successful import substitution phase. All performance indicators showed marked acceleration. Growth of exports was sharply raised by the diversification resulting from introduction of manufactured consumer goods and processed agricultural products. This enabled the economy to sustain a rising rate of growth of industrial producer goods imports and to terminate earlier large-scale foreign capital inflow. By 1964 Taiwan had become independent of foreign economic assistance, a direct result of outstanding success under export substitution growth.

Per capita real GDP showed marked acceleration during the export substitution phase (from an average rate of growth of 3.6 per cent to 6.2 per cent). This resulted from the higher gains of labor productivity in industry than in agriculture and the rapid reallocation of labor from agriculture to industry. Throughout the export substitution phase, labor

productivity in industry was 3-4 times as great as in agriculture, even though labor productivity in agriculture was growing significantly. Moreover, a marked acceleration of labor transfer occurred, with the ratio of industrial to agricultural employment rising from .78 in 1960 to 1.02 in 1967. Thus, growing maturity of industrial entrepreneurship accounted mainly for Taiwan's rapid growth under export substitution, reflected in both rapid gains in industrial productivity and the provision of growing employment opportunities in the industrial sector.

Prognostication about Taiwan's future transition growth is somewhat hazardous because contemporary empirical examples of post export substitution growth are lacking. Some tendencies, however, are apparent, and these point toward future patterns of the economy's evolution. On the one hand, increasing backward linkage toward domestic sources of intermediate goods has appeared, strengthening domestic integration between industry and agriculture. Increasingly, export substitution has involved the agricultural sector, as industry has evoked supplies of new agricultural raw materials for processing and export. On the other hand, nascent tendencies toward backward linkage of capital goods import substitution have also appeared, suggesting that domestic production and export of capital goods may offer opportunities for a new growth phase. This pattern of evolution is consistent with Japanese

transition growth, the one historical example of an open dualistic economy which evolved to a modern economy in the twentieth century.

Taiwan's successful transition growth has important implications for transition growth generally in contemporary open dualistic economies. We have noted that the two growth phases from which the transition has begun in these economies, import substitution and export promotion, must eventually terminate. Though the order and duration of transition phases may be expected to vary, successful transition must eventually lead through an export substitution phase. Taiwan's experience offers guidance about the entrepreneurial, agricultural modernization, and organizational preconditions essential for the emergence of an export substitution phase.

4. DEVELOPMENT POLICY AND STRATEGY CONCLUSIONS

The analysis of the transition in open dualistic economies has important policy and strategy implications for a large number of contemporary LDCs. We consider these implications by raising three types of policy questions: (i) the general approach to development policy and strategy; (ii) its relationship to conventional development planning; and (iii) the transferability of the results of this study, including its foreign assistance recommendations.

4.1 GENERAL POLICY ORIENTATION

Recognition of Diversity: A Typological Approach

Our analysis has shown that contrasting growth types arise at the outset of the transition from the colonial economy and that these differences among countries persist as the transition proceeds. This phenomenon of diversity has profound implications for transition growth policy. The fundamental lesson is that development policy during the transition must be adapted to the particular conditions of individual countries.

The nature of the type of transition growth that occurs in a particular country at a specific point in time is determined by the orientation of the industrial sector; i. e. , its products and the market for which its goods are destined. At the time of decolonization a country chooses a particular orientation because of its particular response to its colonial heritage, though this does not necessarily mean that this political choice will be most conducive to initiating effective transition

growth. In other words, the transition growth system that emerges from political conditions may not be consistent with a country's economic heritage from colonialism.²¹

After the initial system is chosen to launch transition growth at the time of decolonization, there is a further issue in the duration of the initial phase. We have seen from the Taiwan case that successful transition growth, by its very nature, leads to a sequence of growth phases. Here, we merely wish to emphasize that some industrial orientations (e.g., toward sale of manufactured goods in foreign markets) are not feasible at the outset of the transition. More advanced transition phases require gradual acquisition of new functions by the society during prior transition growth phases.

We have emphasized that open dualistic economies--the general and common type on which this study focusses--share common features of transition growth. These common features are summarized in the triangular industrialization pattern inherited from colonialism. The continued openness of these economies offers a natural mode for initial

²¹This is apparent, for example, from Indonesian experience. Pursuit of an import substitution strategy under nationalistic controls after independence failed to launch satisfactory transition growth because the entrepreneurial preconditions for success were absent.

transition growth through redirecting the primary product export surplus from colonial purposes (i. e. , profit repatriation) to fostering domestic economic growth. This involves the conversion of foreign exchange earnings and savings from this export base into producer goods imports for expansion of the industrial sector. The industrial sector thus becomes the key to the economy's transition growth, its orientation determining the type of output and market as well as the extent to which it transmits modern technology imported in the form of producer goods to other sectors of the domestic economy.

We have seen that three alternative industrial sector orientations may appear during the first generation of the transition: (i) continuation of the colonial precedent of producing intermediate goods and services for primary product exports, (ii) producing finished consumer goods for the domestic market, and (iii) producing finished manufactures for the export market. The first orientation leads to export promotion transition growth; the second, to import substitution; and the third, to export substitution. Export substitution, however, is not feasible at the outset of the transition since it imposes stringent efficiency requirements upon industrial entrepreneurs.

A major policy issue is the extent to which the economy's organizational framework and its background economic conditions

are consistent with the type of industrial orientation adopted by the society. Transition growth will falter where either consistency condition is not met. In Southeast Asia, at least moderate success in beginning the transition was made during the postwar period in all four countries studied (Thailand, Malaysia, the Philippines, and Taiwan). In both Thailand and Malaysia, the industrial sector continued to be oriented toward primary product export expansion and their land-surplus condition was consistent with this emphasis. Moreover, the free market organizational requirements for export promotion growth were adopted by these countries. By contrast, the Philippines and Taiwan began the transition by a controlled system of import substitution which effectively generated a first wave of industrial entrepreneurship--under background conditions no longer conducive to an export promotion system since land scarcity was apparent. Thailand's earlier (1935-1954) attempt at a controlled economy system of import substitution (redirecting the industrial sector's orientation from primary product export promotion to the domestic market) is instructive in showing failure because background conditions were unfavorable to rapid development of indigenous entrepreneurs.

Many other cases of failure at initiating transition growth have been recorded during the first (postwar) generation of the transition. Two

cases--Burma and Indonesia--stand out in Southeast Asia. In both, a new industrial sector orientation was sought through forced industrialization for the home market under a system of foreign trade-oriented controls. Failure to launch transition growth resulted from the lack of response of indigenous entrepreneurs to the opportunities offered by the control system. In both countries, the colonial heritage had failed to offer opportunities for development of indigenous entrepreneurs, and a more gradualistic transition approach to their development--or reliance upon minority group entrepreneurship--was called for. However, the control policies were inimical to continuation of primary product export growth which could have allowed a period of transition growth to solve the key problem of entrepreneurship.

Transition Growth as an Evolutionary Process

We have just emphasized that differing problems of transition growth confront individual countries because contrasting growth types emerge after decolonization. An even more important emphasis for transition policy and strategy is the conception of the transition as an evolutionary process from the colonial economy toward a modern growth economy. This emphasis implies that development strategy during the transition must focus upon initiating and maintaining a society's progress

in terms of growth accomplishments for more advanced economic functions. The progressive acquisition of new functions is implied in the very concept of the transition. The economy's mode of operation inherited from the previous colonial epoch is gradually modified, and the transition ends only when the society has acquired all of the essential conditions for self-sustained modern growth.

The economy's evolution in this sense occurs through a sequence of transition growth phases, each phase allowing human agents to assume new growth functions. Our typological orientation reminds us, however, that different countries may pass through different sequences, in respect to both the order of growth phases and their duration. These differences stem from variations in inherited background conditions, including economic geography, the quality of human resources, and the relative development of the two dualistic sectors, agriculture and industry. Thus, the historical facts of each particular situation must be carefully analyzed for proper formulation of development strategy and policy.

A first implication of the evolutionary approach to transition growth is that qualitative growth accomplishments are essential to allow the economy to progress from one transition growth phase to one more advanced. This qualitative change is essentially a matter of human resource development. In one particular sequence, exhibited in Taiwan,

the first transition growth phase of import substitution was devoted to creation of a growing cadre of indigenous industrial entrepreneurs, while also creating preconditions for the emergence of a more advanced growth phase. These preconditions consisted of the society's mobilization of both public and private entrepreneurs for attacking the problem of modernizing agriculture and their further cooperation in removing controls and protection to encourage adoption of market criteria of productive efficiency. Thus, in both public and private sectors, human agent development progressed adequately to enable the economy to shift from an import substitution to an export substitution focus.

A corollary of this cardinal principle of qualitative change is that development policy must focus upon these qualitative transition goals rather than quantitative growth. It is entirely conceivable that satisfactory quantitative growth (as measured, for example, by the rate of growth of real GDP) may not be accompanied by qualitative change conducive to the rise of more advanced transition growth phases. This danger is particularly germane to export promotion systems, which continue the colonial pattern of land-based exports (e.g., petroleum) without encouraging the development of indigenous human resources for new transition growth functions. Contemporary LDCs showing this crucial failure of transition growth while achieving an adequate rate of expansion

include such oil-dependent export economies as Kuwait, Iraq, and Venezuela.

The failure is even more striking, however, in the case of countries which have suffered prolonged import substitution growth during the first generation of the transition. This has occurred in the Philippines and several Latin American countries. Our analysis demonstrates that import substitution and the controlled organizational system which maintain it persist where conditions for export substitution are not created through entrepreneurial development in both the public and private sectors. Without organizational reform, particularly the abandonment of controls, and without agricultural modernization to provide productivity increases, labor-intensive industrial exports cannot displace the traditional primary product export orientation. Thus, the rise of the more advanced phase of export substitution is clearly dependent upon qualitative growth accomplishments during the prior phase.

This difficulty has received considerable attention in recent development policy literature.²² There is a tendency in existing literature

²²See, for example, Albert O. Hirschman, "The Political Economy of Import Substituting Industrialization in Latin America," Quarterly Journal of Economics, Vol. LXXXII, No. 1 (February, 1968), pp. 1-32; and Harry G. Johnson, Economic Policies Toward Less Developed Countries (Washington, D. C.: The Brookings Institution, 1967), pp. 71-78.

to view import substitution and export substitution as alternative opportunities for growth in LDCs. Typically, import substitution systems are castigated while export substitution is praised, and policy changes (from foreign trade controls to laissez-faire) for initiating export substitution are recommended. Our analysis, however, points to a quite different policy lesson. The basic obstacles to emergence of export substitution are the society's failure to achieve the growth prerequisites for rapid growth of industrial exports. Human agents must be developed to assume the crucial growth tasks associated with the rise of the new growth phase, and their development must precede the required organizational change.

To summarize, we learn from the study of transition growth in open dualistic economies that growth accomplishments needed for progress toward a modern growth economy are achieved through a sequence of transition phases. Each phase leads naturally toward a more advanced phase unless the sequence is interrupted by serious growth bottlenecks. Where these bottlenecks exist, development policy must be specifically focussed upon overcoming them rather than encouraging diffusion of the society's efforts through an across-the-board development program. Lack of focus on the crucial transition growth bottlenecks is a common characteristic of national development plans in contemporary LDCs.

Crucial bottlenecks to transition growth sequencing vary according to the growth phase existing in particular countries. Thus, there is no general strategy which can be proposed to facilitate rapid transition growth sequencing in all transition economies. The general lesson is that the nature of transition growth must be analyzed for each case, with historical antecedents given due emphasis. This does not imply the need for a case-by-case approach. Our analysis identifies a limited number of transition growth phases, and in all there are common characteristics of open dualistic growth patterns.

Country-Specific Policy Implications

This general policy orientation may now be applied to the Southeast Asian countries on which this study has focussed. A marked sequence of phases related to progress has appeared only in Taiwan, where an import substitution phase of one decade (1950-1960) provided the basis for the emergence of an export substitution phase characterized by rapid expansion of labor-intensive manufactured exports. During the export substitution phase, Taiwan has shown a high rate of economic progress, substantially more rapid than in the other countries. Moreover, the outstanding export performance after 1960 enabled the economy to achieve independence from large-scale foreign assistance. Export

substitution, therefore, represents a major landmark from the viewpoint of self-help. Rapid expansion of industrial exports during the export substitution phase enabled the economy to meet, from its own resources, both the savings and foreign exchange requirements for growth. Thus, Taiwan's transition experience teaches that progress toward export substitution in an economy beginning from an import substitution phase is an important factor in applying self-help criteria in foreign assistance.

Taiwan's transition during the postwar period, thus, provides guidelines as a success case among open dualistic economies, offering a perspective to evaluate transition strategy in other LDCs of this type. A first conclusion from Taiwan's experience reiterates a lesson from the economic history of advanced countries whose growth was export oriented.²³ Successful export-led growth requires a continuous process of dynamic adjustment to world market conditions, implying that export development involves continuous change in the composition of exports. Taiwan and a handful of other countries (e.g., Korea, Israel) have demonstrated that developing countries in transition can successfully penetrate world markets for labor-intensive manufactured goods.

²³ Japan, Denmark, New Zealand, Netherlands, Great Britain, and many other countries may be cited as examples.

Their export accomplishment should dispel the common defeatism about export diversification through introducing manufactures.

The strategic implication is that export development must be given emphasis throughout the transition. Even during the phase of import substitution, in which an industrial base is created for supplying consumer goods to the home market, an autarkic orientation should be avoided. Control policies needed to launch that phase must be tempered by an emphasis upon competitiveness as entrepreneurial cadres are created by the easy profit opportunities associated with profit transfers. Once indigenous industrial entrepreneurs have been created, controls and protection must be relaxed to induce entrepreneurs to look beyond the limited domestic market horizons. Government leadership in encouraging an external orientation should, however, go beyond mere removal of controls. In Taiwan, assistance was offered through many promotional and incentive devices; e.g., marketing assistance and duty-free industrial processing zones.

In short, over-zealous concentration upon import substitution is not conducive to shifting from land-based primary export products to labor-intensive manufactured exports, a shift which lies at the heart of successful transition growth in open dualistic economies. Taiwan's experience suggests that this shift is initiated by the rapid growth of

industrial processing of primary products and that, once industrial involvement in exports is begun, it proceeds rapidly toward labor-intensive manufactured exports. For this progression to occur, modernization of agriculture is essential to permit, in the early stages, rapid diversification of agricultural output to accommodate introduction of new processed exports. As this leads toward fully manufactured goods exports, agriculture's role shifts more to supplying growing labor transfers. At this point, rapid increases in food supplied to the industrial sector are needed to maintain cheap wages to enable competitiveness in the world market for labor-intensive manufactured goods. For both conditions, productivity growth and diversification in agriculture are essential. In Taiwan, a firm historical basis for agricultural development was inherited from Japanese colonialism, but even more dramatic change in agriculture was initiated under government leadership during the import substitution phase.

In countries where the agricultural modernization problem is more intractable than in the special case of Taiwan (and this appears to be generally true in LDCs), transition strategy must be oriented toward agricultural development from the outset. In these cases, therefore, an initial phase of import substitution may present serious obstacles to smooth transition growth because the society's organization for import substitution

growth necessarily discriminates against both export and traditional agriculture. The Philippines represents a case in which transition growth has been continuously plagued by a backward and neglected agricultural sector.²⁴

In two countries, Thailand and Malaysia, postwar growth experience has been dominated by promotion of primary product exports as the basis for launching the transition from the colonial economy. The evolutionary conception of transition growth has important implications for understanding these growth regimes as well as for growth strategy. We briefly consider the sequencing aspect for the two countries.

Phasing during the postwar transition period in Thailand has been apparent, and the important strategy issue is the tendency toward emergence of a new growth system. From 1950-55 the economy's basic source of growth continued to be traditional primary product exports (rice and rubber), and this export base was employed to encourage industrialization under government aegis. This was followed by a phase of approximately a decade (1956-65), during which diversification of agricultural exports came to the fore as the major source of growth and

²⁴This remains true in spite of the Philippine success in eliminating the rice deficit through a crash program in the late 1980s.

the export surplus was primarily employed to enhance the further diversification and improvement of this growth base. By the late 1960s, however, this growth emphasis began to be overshadowed by the emergence of service exports as the most rapidly growing source of the economy's growth. This tendency was accompanied by a marked shift in the use of the economy's export surplus as it came to be used for investment in expanding the service export sector (e. g., facilities for tourism). From the transition viewpoint, this new departure represents a tendency toward exporting the economy's surplus labor (in the form of labor-intensive service exports) which should be viewed as an important departure from Thailand's previous land-based growth.

Simultaneous with the evolution of service exports as a major growth force, a marked shift toward a political interest in import substitution has appeared. Hence, the major transition strategy issue now confronting Thailand is the problem of combining these two new tendencies into a viable transition growth system. The policy dilemma is posed in terms of the need to maintain a free market efficiency orientation for increasing industrial sector exports (service as well as manufactured goods) versus protection for domestic entrepreneurs for encouraging more rapid substitution of industrial consumer goods imports. Moderate protection policies may be effective in inducing a domestic

entrepreneurial response in import substitution if minority group entrepreneurial talent is not disadvantaged in favor of indigenous Thai nationals (as was true in the pre-1955 experience). The important policy goal should be to maintain an adequate efficiency orientation through moderate and brief protection to ensure the eventual shift from producing exclusively for the domestic market to producing for export. Prompt withdrawal of protection is essential to encourage industrial entrepreneurs gradually to gain the production and marketing skills for penetrating competitive foreign markets.

Though Malaysia has followed the same general pattern of primary product export-based growth as Thailand throughout the two decades since 1950, the strategy question of future growth sequences is posed in somewhat different terms. Malaysia's transition experience reflects the facts of the new political and economic conditions resulting from the formation of the merger between West Malaysia (previously the Federation of Malaya) and East Malaysia (Sabah and Sarawak) in 1963.

West Malaysia has a large modern export product (rubber, tin, palm oil) enclave inherited from colonialism, and postwar policy has focussed upon improving productivity in this enclave while also emphasizing the development of the lagging food-producing traditional agricultural sector. The productivity emphasis upon the export sector,

largely in the hands of Chinese and other minority groups, was necessitated by continued reliance upon primary product export growth, while political pressures dictated the orientation toward uplift of the Malay-dominated traditional agricultural sector. The deterioration of terms of trade for West Malaysia's traditional exports and slow progress toward diversification, however, have placed this dual agricultural development policy in jeopardy. Specifically, these difficulties have created rising pressures for a shift in industry's orientation from export promotion to import substitution.

East Malaysia has low population density, and this land-surplus condition offers opportunities for rather easy expansion of primary product exports. Food production has been neglected because the comparative advantage clearly lies in primary product export production. As mentioned earlier, these very different conditions between West and East Malaysia raise the significant issues of Malaysia's future transition growth. In particular, the strategic question concerns the nature of the transition phase which is emerging from the natural regional division of labor, now apparent.

In possessing a large and skilled Chinese minority with considerable experience in trade and enclave industry, Malaysia appears to have the entrepreneurial resources necessary for the emerging

transition phase. This phase is foreseen as comprising three elements: (i) the development of import substitution industry in West Malaysia under moderate protection, (ii) the continuation of expansion of food production in West Malaysia's traditional sector, and (iii) emphasis on primary product diversification and growth in the land-surplus area of East Malaysia. In addition to the policy dilemma between protection and free market efficiency orientation, however, Malaysia must overcome serious ethnic and regional problems if the emerging phase is to develop into a viable transition growth system. Chinese entrepreneurs must be relied upon to forge the import substitution base under carefully devised protection systems. The squeeze upon primary product exports must be modest to avoid regional dissidence and to promote export growth in East Malaysia, where opportunities for primary product expansion are best. Emphasis on modernization of traditional agriculture must be continued, both for political reasons and to encourage the eventual rise of an export substitution system. Finally, conditions conducive to an external orientation of the promoted import substitution industries must be built into the protection system needed for their initial development.

The Philippines' case represents a very different type of transition experience from the three cases just reviewed, but it is a type of experience common to contemporary LDCs in transition. We have

described the Philippine case as prolonged import substitution growth, signifying that the initial import substitution system has persisted without leading to a more advanced type of transition growth system. From the transition sequencing viewpoint, the Philippine case reveals that the subphases which have occurred are a response to the problems of prolonged import substitution growth rather than a natural progression toward a more advanced modern economy (as in the case of Taiwan).

Import substitution growth has been emphasized by the organizational system in the Philippines throughout the postwar period. After six or seven years of effective growth under this system (1950-56), serious problems were encountered. By the late 1950s, lagging primary product export growth was clearly interfering with further industrial expansion. The society's response to these difficulties took the form of easing the system of import controls which necessarily discriminated against exports. These measures resulted in a new spurt of import substitution growth (1960-64), but a new problem of food deficits emerged to plague the economy's progress. The society responded by a priority program to emphasize expansion of rice production. Success was achieved in eliminating the country's food deficit, but the crash rice program was not accompanied by a thoroughgoing program for modernization of agriculture.

In short, Philippines' transition policy has been oriented toward correcting problems arising from prolonged import substitution growth rather than toward promoting the evolution of a new transition growth phase. As Philippine economists are well aware,²⁵ the major bottleneck impeding effective transition growth is the failure of the industrial sector to penetrate export markets. The consumer goods import substitution market has been largely exhausted, and industrial sector growth will remain sluggish until wider market horizons are opened up and successfully exploited. Thus, the key issue of contemporary Philippine transition growth is export substitution; i. e., rapid growth of industrial exports to replace the traditional primary product export base.

Since the late 1950s the Philippines' growth has been stalled at the near exhaustion of import substitution. Neither the emphasis on reviving primary product export promotion nor the rice production program has contributed to solving this basic problem, though they did serve as palliatives to take the edge off emerging crises. The strategic issue continues, therefore, to be the creation of conditions from which a phase of export substitution can be successfully launched.

²⁵See, for example, Gerardo P. Sicat, "A Design for Export-Oriented Industrial Development," School of Economics, University of the Philippines, Discussion Paper No. 67-5, June 20, 1967 (mimeographed).

Three major policy areas are involved in moving toward a solution of this basic problem of Philippine transition growth. First, and most basic, at both the public and private levels a major reorientation toward productive efficiency in the industrial sector is needed to promote competitiveness in international markets. Specifically, this means that Philippine industrial entrepreneurs must learn to dispense with the high levels of protection and subsidization that have marked the postwar era of industrial development. In this connection, public leadership is needed to encourage the reorientation toward international standards of efficiency and competitiveness and the search for external market outlets.

Second, emphasis upon general agricultural modernization is needed to provide the basis for cheap labor supply and domestic raw materials for exports of manufactured goods. This effort, too, imposes requirements upon both the public sector and private entrepreneurs. The public sector must provide infrastructure for agricultural modernization (e.g., irrigation, marketing facilities, land reform, and improved transport), while the private industrial sector must participate by introducing new products, new productive methods, and intermediate goods.

Third, the society's entire development and planning apparatus should be geared to overcoming the present bottlenecks to emergence of

export substitution as the next phase of Philippine transition growth. At present, these activities are not only relatively ineffective but also are spread over a large range of development objectives. What is needed is the concentration of the society's planning and fiscal resources on inducing the industrial sector to penetrate foreign markets. With adoption of this goal as the highest priority in development strategy, many specific policies conducive to this goal may be devised and phased over a three to five-year time horizon.

4.2 RELATIONSHIP TO CONVENTIONAL DEVELOPMENT PLANNING

The analysis of transition growth in open dualistic economies offers a new perspective for applying conventional development planning methodology, a practice which has attained widespread vogue in LDCs. Conclusions from our study provide a basis for strategy and policy guidelines which are frequently absent in national development planning. To understand the relevance of our contributions, we begin by briefly reviewing the essential nature of contemporary development planning.

The Scope of Development Planning

The scope of development planning is defined by the methodology in current usage and the spirit with which it is applied. At the level of overall national planning, development plans are formulated within a national income accounting framework. Such a framework may be adapted to various levels of aggregation, from a highly aggregated (e. g., Keynesian type) model to a rather detailed level of disaggregation (e. g., input-output models).

The central purpose of applying planning models (at any level of aggregation) is to project through time a consistent pattern of resource allocation for the economy as a whole. In this resource allocation focus, the national income accounting framework is employed to assure consistency, while particular models can be built projecting the economy's operation on the basis of behavioral assumptions.

If there is any development strategy component implicit in development planning methodology, it is the preoccupation with maximizing capital formation. This orientation leads to a mechanistic view of the growth process, in which emphasis is placed upon augmenting the economy's capital resources while abstracting from development of human resources to assume new growth functions. In fact, even the application

of planning techniques to human resources is pervaded by a quantitative, rather than a qualitative, orientation.

In short, development planning is an exercise in projecting the growth and allocation of the economy's resources through time. In this orientation, planning ignores the crucial problems of growth accomplishments in a transition perspective. For this reason, planning methods fail to discriminate between transition growth phases, and strategy guidance, to the extent it occurs, is intuitive and haphazard in nature.

The objectives of resource allocation planning must necessarily be quantitative in nature. Plan targets are typically formulated in terms of projected increases in aggregate and sector outputs. Behavioral assumptions appropriate to achieving these targets (e. g., the capital-output ratio) are ordinarily taken from the economy's historical experience or that of other countries. Changes in the economy's mode of operation among transition growth phases and the assumption of new growth tasks by the society's economic agents lie outside the scope of formal development planning methodology.

Planning and the Transition Perspective

Transition growth analysis points to quite different directions for a society's major growth targets during the several generations of transition from the colonial economy epoch. While quantitative output goals may be consistent with other growth objectives, the major focus of transition strategy is the gradual evolution of human agents to assume qualitatively new growth functions as the economy moves through progressively more advanced phases of transition growth. These tasks include the creation of a class of indigenous industrial entrepreneurs, the gradual growth of their technological sophistication and productive efficiency, the penetration of export markets, expansion of employment opportunities for a disciplined and market-oriented labor force, the promotion of modern agricultural enterprise, and the evolution of a progressive, development-oriented public bureaucracy. These major human development tasks must be accomplished in sequence, and this leads to the appearance of phases. The order of sequencing in this social learning process, however, may be expected to vary on the basis of inherited background conditions.

Since no common sequencing of transition growth accomplishments can be formulated, transition strategy must be evolved on the basis of the unique conditions in each country. Yet there are general principles

applicable to all open dualistic economies undergoing the transition process, and these general principles are important for providing guidance for application of conventional planning techniques.

The first application of transition strategy to planning involves the overall view of the economy within which planning techniques are utilized. All development policy must be based upon evidence, especially statistical data. Empirical evidence must be collected within a framework that provides both internal consistency and relevance to the society's crucial transition problems. For development strategy concerned with the transition in open dualistic economies, the appropriate empirical framework is a national income accounting system emphasizing intersectoral flows. Since interrelationships among industry, agriculture, government, the foreign sector, and the finance sector are crucial to growth during all transition phases, relationships among these sectors on production and income disposition account must constitute the focus of strategy and planning.

Such a national income accounting framework is presented in the appendix. The estimation of flows within the framework provides the data basis for transition planning, as guided by the strategy of sequencing of phases to enable the economy to move to more advanced growth phases. This data framework has been applied to the four countries studied

intensively (China: Taiwan, Malaysia, the Philippines, and Taiwan).

Time series estimates for the postwar period have been used as the basis for identifying the transition phases occurring in these economies.

Alterations in the economy's mode of operation, essential to identifying transition phases, are clearly demonstrated by time series data collected within the framework. This is apparent from the changes in intersectoral flows involving such key variables as output, inputs, exports, imports, savings, investment, and consumption. These applications attest to the feasibility of generating data necessary for formulation of strategy and for planning activities at the level of aggregation shown in the diagram in the appendix.²⁶

The second major implication for conventional planning relates to the time perspective. The important consideration in this connection is the concept of the transition perspective. This suggests that development strategy should have a long-run time frame of reference embracing the transition as a whole--from the inherited colonial economy to a modern economy. This notion conforms to the idea of perspective planning which is current in contemporary planning literature.

²⁶Estimation and other data problems confronted in applying the intersectoral framework to the Philippines are discussed in Douglas S. Paauw, "The Philippines: Estimates of Flows in the Open, Dualistic Economy Framework, 1949-1965" [Washington, D. C. : Center for Development Planning, National Planning Association, February, 1968 (mimeographed)].

The primary significance of the transition perspective is that it imbues planning with a sequencing content, explicitly recognizing that major growth tasks to be accomplished during the transition must be achieved in specific phases of the economy's growth. The chief advantage of the transition outlook is that it offers a basis for coordinating development strategy and conventional planning activities. This general principle must necessarily be applied in the context of each country's unique conditions. Two major focusses of planning during each transition growth phase emerge from the transition strategy perspective. On the one hand, a concrete dominant objective may be defined as the focal point for planning within each phase. On the other hand, the sequencing strategy implies a second focus, the preparation for the next phase of transition growth by gestation policy.

This important implication of the transition perspective may be given more concrete meaning by considering an example. In an economy in which the land-surplus condition for continuation of colonial-type export growth is not present, an eventual shift to an industrial base requires a first phase of creation of indigenous industrial entrepreneurs. The analysis of transition growth teaches us, however, that mere creation of industrial entrepreneurs under a highly protective system and a domestic market orientation must be followed by additional tasks if the

transition toward a modern economy is to proceed. Thus, planning during the first phase must emphasize the balancing of two objectives, the creation of industrial entrepreneurship and the achievement of preconditions for a subsequent phase of growth in which entrepreneurs assume new growth tasks (i. e. , beyond producing for the protected domestic market).

The major contribution of this perspective for guiding planning in each phase is that it permits concentration upon the predominant growth mission of that phase while simultaneously seeking to avoid undue prolongation of that phase. These twin focusses give specific orientations to the society's planners by identifying the critical bottlenecks which must be placed at the center of the society's development planning. It is precisely this type of priority formulation that has been lacking in most planning activities in LDCs, causing diffusion of resources among many competing objectives.

Policy Planning

The adaptation of conventional resource planning to specific growth tasks during transition phases also has an important policy planning dimension, which is given little recognition in current development planning practice. In this connection, it is important to recognize that the scope of conventional development planning is largely confined to direct

public sector resource allocation and that the allocation of a much larger body of resources is affected (and often controlled) by government policy, frequently quite independently of formal planning objectives and actions.

Our analysis of transition growth demonstrates that the government's impact upon the economy's organization--which is the essence of public policy--is a crucial determinant of the emergence and duration of transition growth phases. It is this arena of government activity which must be more fully integrated with resource allocation planning of the conventional type. In other words, the most critical aspects of planning for transition growth in open dualistic economies lie in the area of exchange rate policy, tariff policy, inflation, domestic trade controls, and similar policies which impinge upon the key intersectoral flows. Unless these policies are consistent with the objectives of resource allocation through public sector planning activities, conventional development planning activities are likely to fail in their objectives. It is discrepancy between the two which largely accounts for the dismal record of development planning in most contemporary LDCs. This discrepancy, for example, stands out clearly in the Philippine case since the late 1950s, and we suspect that is also true for many Latin American countries where prolonged import substitution growth has dominated postwar transition experience.

4.3 TRANSFERABILITY OF RESULTS

Prevalence of Open Dualism

The transferability of the analytical and policy results of this study to LDCs, other than those used as empirical examples, hinges upon the prevalence of open dualistic economies. The concept of the transition from a colonial-type economy to a modern economy is applicable to virtually all LDCs since all entered the postwar development era from a primary product export base, regardless of whether they had been colonies in the political sense.

Dualism may also be accepted as a common feature of all LDCs. Though the relative size of the two dualistic domestic sectors, agriculture and industry, varies, this dichotomy between a backward traditional agricultural sector and a more modern nonagricultural sector is universally found in LDCs.

Openness shows significant interaction with dualism during the course of the transition where foreign trade is a large component of the economy's output. This characteristic is found in the majority of LDCs. Kuznets has shown that small LDCs (less than 10 million population), which are the most numerous, are inevitably heavily involved in foreign

trade.²⁷ In addition, most medium-size countries (10-50 million in population) show significantly high export ratios (above 10 per cent). In Latin America, for example, where country size varies from very small (e.g., Guyana) to large (e.g., Brazil), no country shows an export ratio below 10 per cent. Thus, open dualistic patterns of transition growth are the most common exhibited among contemporary LDCs.

Identification of Variants of Open Dualistic Transition Growth

Our analysis suggests that three major types of open dualistic transition growth have occurred during the first generation of the transition. Where the industrial sector continues the colonial orientation of promoting primary product exports, transition growth is described as export promotion. Import substitution is found where the industrial sector growth is dominated by the substitution of domestic manufactured consumer goods for imports. Export substitution occurs where the industrial sector's major orientation is toward producing manufactured goods for exports, causing the composition of exports to shift from primary products to manufactures.

²⁷ Simon Kuznets, Six Lectures on Economic Growth (Glencoe, Illinois: The Free Press, 1959), pp. 89-107.

Each variant of open dualistic growth is reflected in distinct operational and organizational features. Our empirical applications to Southeast Asian countries have demonstrated the feasibility of identifying transition phases (variants) from empirical indicators related to these features. These indicators, combined with performance measures, provide a basis for transferability of our policy conclusions to all open dualistic economies in transition. Thus, criteria of successful and unsuccessful transition growth may be formulated to provide guidance for both domestic transition strategy and foreign assistance policy.

Transferability of Foreign Assistance Conclusions

A primary objective of this study has been an analysis of contemporary transition growth in a common type of LDC to provide a firmer basis for foreign assistance. In this final section we attempt to demonstrate the general applicability of our results to this specific policy focus.

Having identified the large group of open dualistic economies as our typological focus, the essential problem is further discrimination among countries in this group to distill appropriate foreign assistance criteria. In the transition perspective which has been emphasized in our study, a first classification relates to the degree of success achieved in the process of transition growth.

Success at transition growth is a matter of altering the inherited colonial economy system toward a modern growth economy by traversing a number of successively advanced growth phases. In each phase new growth functions are mastered by the society, as a whole, and conditions for more advanced phases are created. Thus, the essence of successful transition growth is dynamic change in the economy's overall mode of operation and the creation of conditions to enhance smooth evolution from one transition growth phase to another. Failure in this sense consists of an economy's remaining stalled in an initial transition growth phase or retaining an essentially colonial economy without creating conditions leading away from colonial-type primary product export-led growth.

The transition is initiated by one of two possible alternative growth systems, continued reliance upon primary product export promotion or a redirection toward domestic industrialization through import substitution. Early transition experience in all countries characterized by open dualism can be categorized as one or the other, as we have done for the countries used as our empirical cases.

Once the system used to initiate the transition has been identified, criteria relevant to foreign assistance can be formulated in concrete terms. The important implication from recognizing the contrasting systems is that the growth problems confronted in the two systems are

fundamentally different; and, hence, the specific objectives of foreign assistance in facilitating domestic growth will also differ.

The export promotion growth system, as an initial phase of the transition, is commonly found in countries where a land surplus exists and continuity with the colonial organizational system is politically acceptable. While we do not seek to present an exhaustive list of countries beginning the transition with this system, several examples (in addition to Thailand and Malaysia) may be cited to demonstrate that this method of transition genesis is a common phenomenon. In Latin America, such countries as Guyana, Jamaica, Panama, Peru, and Venezuela have clearly fallen into the export promotion type of transition genesis, while in Africa the examples include Kenya, Libya, Malawi, Rhodesia, Tanzania, Tunisia, Uganda, and Zambia.

The crucial question in export promotion transition growth systems is whether the primary product export surplus is employed to modernize the economy as a whole. Practically, this question revolves around whether the growth impetus from primary product exports is confined to the export-oriented enclave or whether modernization of the traditional subsistence agricultural sector is begun. A second issue concerns the extent to which indigenous entrepreneurial development is being encouraged since the emergence of a more advanced growth type

(in the sense of progress from the colonial toward a modern economy) is contingent upon creation of a class of domestic industrial entrepreneurs.

In an export promotion system, where primary product exports are growing satisfactorily, foreign assistance requirements for transition growth are likely to involve technical assistance rather than foreign capital. Technical assistance is required to promote the formation of preconditions for more advanced transition growth. Foremost in this regard is the modernization of traditional agriculture. Where a country undergoing export promotion as an initial transition phase emphasizes productivity improvements in non-export agriculture (as in the case of Malaysia), a clear self-help condition for foreign technical assistance is present. If traditional agriculture is neglected and there is no domestic political commitment to move toward agricultural modernization, there is little basis for foreign assistance, either technical or capital.

In order to launch industrial diversification from the export promotion orientation of the enclave (frequently dominated by aliens), the society must emphasize development of indigenous economic agents for both private and public sector roles. As demonstrated by the experience of Malaysia, this task requires gradual acquisition of skills through both education and learning-by-doing training opportunities. Technical assistance may play a valuable role in this process, but it

must be directed at very specific targets in the educational and training fields to promote the evolution of talent appropriate to the industrial tasks that will emerge from broadening the scope of industrial sector activities.

These developmental focusses (i. e., agricultural modernization and development of human agents) for achieving more advanced phases of transition growth should be accorded high priority in national development planning efforts. It follows that foreign technical assistance may make a significant contribution to furthering transition growth in neo-colonial economies by stressing the necessity to focus planning objectives specifically on these problems and offering technical advice for their solution. These principles continue to deserve emphasis in both Thailand and Malaysia, the two examples of export promotion transition growth among our case studies, and it appears that this is similarly true of neo-colonial export promotion countries generally.

The import substitution variant for initiating transition growth is also commonly found in LDCs. In Latin America, for example, it is so prevalent that many writers appear to regard it as the major postwar growth phenomenon in that area.²⁸ (An advantage of our approach,

²⁸ See Albert O. Hirschman, "The Political Economy of Import-Substituting Industrialization in Latin America," The Quarterly Journal of Economics, Vol. LXXXII, No. 1 (February, 1968), pp. 1-32--in which the tenor of discussion conveys the generality of import substitution throughout the region.

therefore, is the capability of distinguishing alternative growth regimes, as we have seen from the Southeast Asian case studies.) The difficulties confronting prolonged import substitution growth (inflation, underutilized industrial capacity, and food deficits) are so pronounced that much literature on Latin American economies has been devoted to these symptoms of transition failure through stalling at the initial import substitution phase. Among other countries, these characteristics have been found in Brazil, Chile, Columbia, Costa Rica, and Guatemala.

The transferability of policy implications from our analysis of the import substitution variant must be considered by distinguishing successful from unsuccessful cases. In the successful case, exemplified by Taiwan and Korea, the initial transition phase of import substitution is brief, and the phase is devoted to introducing entrepreneurs to manufacturing for the home market under protection. Simultaneously, however, agricultural modernization is emphasized, promoting backward supply linkages by the emerging industrial sector. Where these conditions exist, progress toward more advanced transition growth is being achieved; and foreign assistance policy should take cognizance of these achievements. During such a growth phase, capital requirements are at a maximum since both industrialization and modernization of agriculture are in progress. Thus, a successful import substitution phase presents

a good case for external capital assistance. Moreover, technical assistance in both sectors is likely to be needed to promote effective use of investment resources, as was demonstrated by Taiwan's experience (particularly JCRR in agriculture). Finally, at the planning and policy level, technical assistance should be oriented toward inducing prompt change in the control system to enhance the competitiveness of evolving industry. This latter feature was apparent in the case of large-scale U. S. assistance to Taiwan.²⁹

In the unsuccessful case where an initial phase of import substitution leads to prolongation without engendering the rise of a new transition phase, guidelines for foreign assistance are very different. Such a case may be identified early in transition growth experience by lagging traditional agriculture, reflected in the necessity to import growing quantities of food. (Thus, agricultural productivity is a major empirical measure for distinguishing the successful and unsuccessful cases.) Other symptoms, perhaps emerging somewhat later in the phase, include underutilization of industrial capacity, balance of payments difficulties and capital flight, and flagging investment.

²⁹ See Neil H. Jacoby, U. S. Aid to Taiwan (New York: Frederick A. Praeger, 1966), especially Chapter 10.

In such an unsuccessful case of import substitution, there is a prima facie case for confining foreign assistance to technical assistance bearing upon organizational change in the society. Capital assistance should be used sparingly, if at all, since the major investment outlet in the economy remains expansion of consumer goods output rather than export expansion or agricultural modernization. Effective policy barriers to these potential investment outlets are, in fact, a major cause of prolongation of import substitution.

The solutions to the stagnation of transition growth during the import substitution phase lie in modernization of agriculture and industrial sector penetration of export markets through competitiveness in these markets. The first requires a redirection of public sector priorities, leading to stimulation of agricultural modernization. In some cases, this may involve deep-rooted institutional change (e.g., land reform) supplemented by investment in agricultural infrastructure. The second solution--enhanced world market competitiveness of industry--requires organizational change to remove excessive levels of protection and profit transfer to import substituting industry.

Without change in the society's national policies in regard to these basic conditions for terminating prolonged import substitution growth, foreign assistance is likely to be futile in promoting the evolution

of a new growth phase. This suggests that technical assistance be limited to the type that will have an effect in inducing these basic changes. This leaves room for planning assistance and training programs aimed at broadening the perspectives of policy-making government officials.

The transition cases which have been discussed thus far from the policy viewpoint are all cases in which a transition toward modern growth was, in fact, initiated during the postwar period. For these cases, we have defined success at transition growth with reference to progress from the initial phase to more advanced phases. These cases should be distinguished from the case of failure in a different sense, where no clear transition growth system appeared and modification of the colonial economy produced retrogression in terms of the economy's performance indicators (e. g., per capita real income). This phenomenon of failure to initiate transition growth is common enough to have significance for foreign assistance policy. Burma and Indonesia are examples in Southeast Asia.

Failure to initiate transition growth occurs where the export promotion system inherited from colonialism is not continued and an import substitution phase fails to take hold. Without undertaking a detailed analysis of causation of this phenomenon, it may be said that this occurs where inherited background factors are particularly adverse.

In the Indonesian case, for example, severe population pressure on land was accompanied by a serious shortage of indigenous entrepreneurs and political tensions between Indonesians and both the Dutch and minority group entrepreneurs who dominated the export enclave.

Where a viable transition phase does not emerge after decolonization, both domestic and foreign assistance policy must focus upon modifying the colonial economy system to create preconditions for transition growth. The postwar experience of economies in transition provides guidance about the preconditions needed to launch transition growth. These may be subsumed under two general prerequisites, economic stabilization and political infrastructure. In the countries (China: Taiwan, Malaysia, Philippines, and Thailand) used as empirical case studies, transition growth was preceded by a period when these preconditions were created. Relatively favorable background conditions and external assistance contributed to brevity of this initial preconditioning phase.

Economic stabilization is needed to maintain proper functioning of the export base, inherited from colonialism, since all transition growth must be launched from this base. Decolonization--in the sense of transferring ownership and control of enclave production from foreign to indigenous agents--must be tempered in order to avoid falling export

earnings. Domestic inflation must also be restrained sufficiently to prevent serious export disincentive effects, and exchange rate policy must be geared to export expansion. Decolonization itself, particularly in the aftermath of World War II, produced tendencies in the opposite direction.

Political infrastructure development is an equally important prerequisite for launching transition growth. Its major transition significance lies in creating a policy framework in which transition growth can proceed. In this sense, it is basic to achieving the task of economic stabilization, just discussed.

Political infrastructure for transition growth is thus equivalent to creating a new and independent public sector, oriented toward encouraging a transition from the colonial economy toward modern economy growth. Where the colonial heritage failed to prepare indigenous agents for this function (as in Indonesia), the first requirement is the development of human agents to assume new public functions for launching transition growth. This precondition, thus, is fundamentally a matter of human resource development, the most important aspect being an orientation toward national economic development as a primary social goal.

Where transition growth has not yet been effectively begun after a generation of transition growth, foreign assistance policy must

focus squarely upon progress toward achieving these preconditions. The primary emphasis lies in strengthening the purpose and capabilities of human agents in the public sector, with the first specific goal being stabilization to revive an effectively functioning export sector.

The important policy lesson is that technical assistance has a large role in promoting human resource development before capital assistance can be effective, even in promoting economic stabilization. More ambitious assistance programs of a project nature must be reserved for a later phase when conditions for launching either import substitution or export promotion growth have been achieved. It is only at this later point that the transition phase policies, previously discussed, become relevant. A crucial aspect of strategy (and one frequently neglected) is the conscious choice of an initial transition phase, once the first prerequisites for transition growth are attained. It may be noted that Indonesia is now approaching this basic transition strategy issue, after two decades of struggling to create the initial conditions for launching transition growth.

APPENDIX

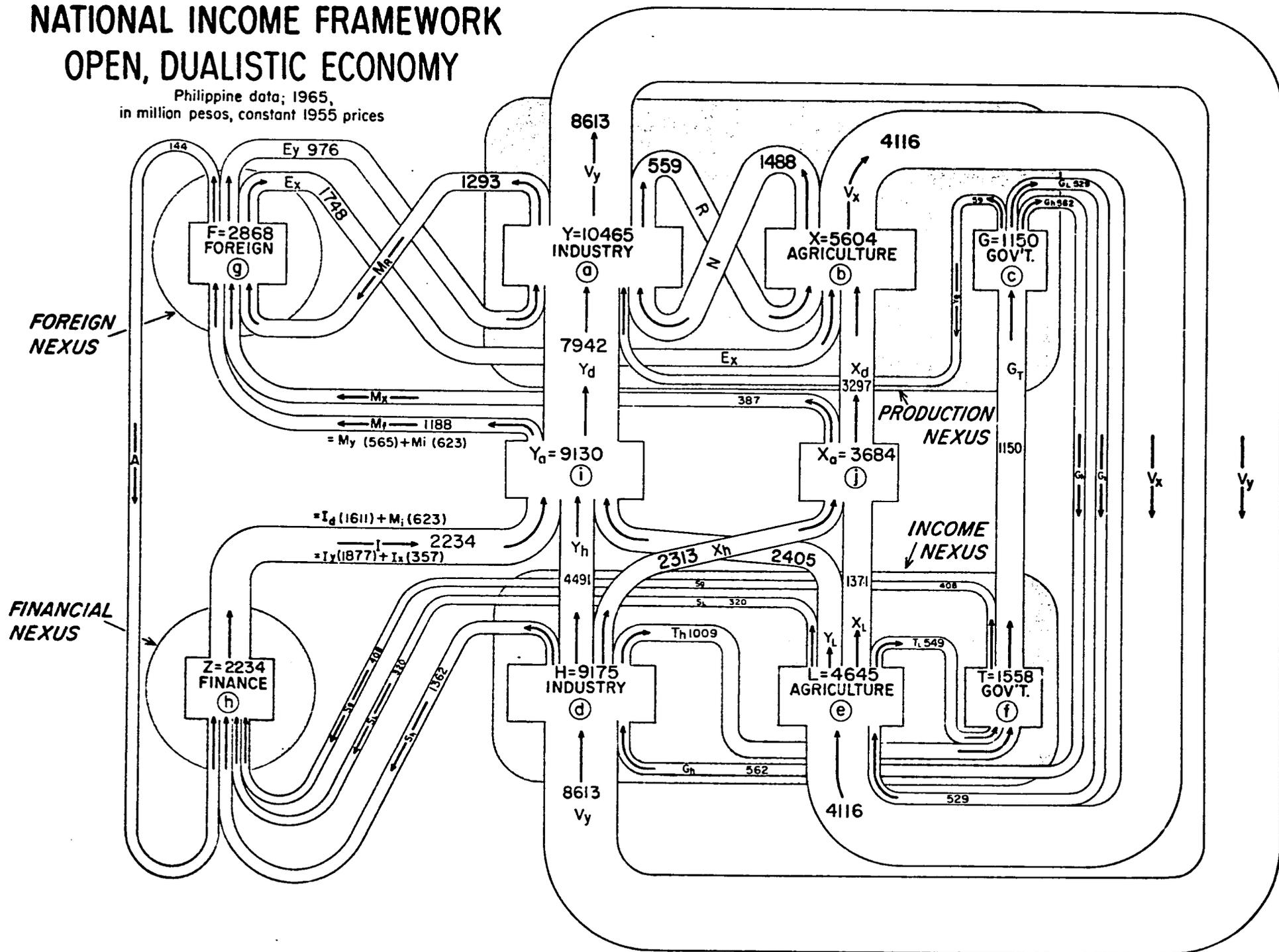
NATIONAL INCOME ACCOUNTING SYSTEM FOR OPEN DUALISTIC ECONOMIES

The accompanying diagram shows the national income accounting system for open dualistic economies. The magnitudes of the accounting concepts are represented by the directed monetary flows in the pipes.³⁰ These flows form a connected pattern through the vertices denoting the economic sectors. There are ten vertices, (a) (j), representing the production and income disposition relationships among the economic sectors. These relationships are summarized in the table on Page A3. The table shows the various components of the total monetary inflows for each vertex. The accounting system is a consistent framework in that, at each vertex, the total inflows equal total outflows. This is illustrated by the actual numerical data for the Philippine economy for the year 1965.

³⁰ There are thus 10 accounting equations linking 26 national income accounting concepts. However, one accounting equation can be deduced from the rest so that there are 9 independent accounting equations.

NATIONAL INCOME FRAMEWORK OPEN, DUALISTIC ECONOMY

Philippine data; 1965,
in million pesos, constant 1955 prices



MONETARY INFLOWS AT VERTICES IN NATIONAL INCOME ACCOUNTING FRAMEWORK

Sector	Production	Income Disposition	Availability
Industry	(a) $(E_y + Y_d + Y_g + N)$	(d) $(V_y + G_h)$	(i) $(I + Y_h + Y_L)$
Agriculture	(b) $(R + E_x + X_d)$	(e) $(V_x + G_L)$	(j) $(X_h + X_L)$
Government	(c) (G_T)	(f) $(T_h + T_L)$	-
Foreign	(g) $(M_R + M_x + M_f)$	-	-
Finance	-	(h) $(A + S_h + S_L + S_g)$	-

For the production relationship, the demand for total industrial output ($Y = 10465$) at (a) is the sum of exports ($E_y = 976$), domestic consumption demand ($Y_d = 7942$), government demand ($Y_g = 59$), and agricultural sector intermediate goods demand ($N = 1488$). The demand for total output of agricultural goods ($X = 5604$) at (b) is the sum of exports ($E_x = 1748$), demand for intermediate goods by the industrial sector ($R = 559$), and domestic consumption demand ($X_d = 3297$). The demand for government output ($G_T = 1150$) at (c) is simply total government expenditures ($G = 1150$). In addition to these domestic production relations, the demand for total imports ($F = 2868$) from the foreign sector at (g) is the sum of imports of raw materials by the industrial sector ($M_R = 1293$), imported agricultural goods for consumption ($M_x = 387$), and imported finished industrial goods on current and capital account ($M_f = 1188$).³¹ The total availability of industrial goods for domestic final demand ($Y_a = 9130$) is shown at vertex (i), while that for agricultural goods ($X_a = 3684$) is shown at (j).

³¹ Imported finished industrial goods, M_f , include consumer goods ($M_y = 565$) and capital goods ($M_i = 623$).

For income disposition relationships, total industrial income ($H = 9175$) at vertex (d) is the sum of factor payments to the industrial sector ($V_y = 8613$) and government transfer payments to industry ($G_h = 562$). Total agricultural income ($L = 4645$) at vertex (e) is the sum of factor payments to agriculture ($V_x = 4116$) and government transfer payments ($G_L = 529$). Total government income ($T = 1558$) at vertex (f) is the sum of tax payments by industrial households ($T_h = 1009$) and tax payments by agricultural households ($T_L = 549$). Total final demand for industrial goods ($Y_a = 9130$) at vertex (i) is the sum of investment demand ($I = 2234$) and consumption demand by industrial households ($Y_h = 4491$) and agricultural households ($Y_L = 2405$). Total final demand for agricultural goods ($X_a = 3684$) at vertex (j) is the sum of consumption demand of industrial households ($X_h = 2313$) and agricultural households ($X_L = 1371$). The economy's total savings fund ($Z = 2234$) at vertex (h) is the sum of industrial household saving ($S_h = 1362$), agricultural household saving ($S_L = 320$), government savings ($S_g = 408$), and foreign capital inflow or import surplus ($A = 144$). This completes the description of the national income accounting framework.