

Decolonization and Development

Lecture Summary

- Empires dismantled after 1945. Why?
 - International factors
 - Changes in the int'l distribution of power, military and economic
 - Effects of World War II
 - Domestic factors
- Former colonies - and most other developing nations - choose economic nationalism
 - Import Substitution Industrialization (ISI)
 - Key features of ISI
 - Explanations of ISI's adoption
 - Effects of ISI, positive and negative

Decolonization: International Factors

Situation in 1945 (Figures 1-2). Why decolonization?

International factors

1. Changes in the global distribution of power

- Military changes
 - U.S. conventional and nuclear umbrella provided security for West; GB, Ger., and France no longer needed colonies for military/strategic purposes
 - As a former colony, U.S. was deeply unsympathetic to colonialism
- Economic changes
 - U.S. dominant economically; dislikes empires because closed to American business (e.g. “Imperial Preferences”)

2. Effects of World War II

- U.S. supports independence movements as part of the war effort
- *de facto* independence of some colonies (those of empires that were defeated and occupied)

Decolonization: Domestic factors within colonial powers

1. Decline in economic motivation for colonialism

- Interests: Business interests in rich countries trade mostly within OECD; raw materials not as essential to modern, knowledge-intensive industries
- Interests: Rich-country manufacturing MNCs less concerned with nationalistic trade policies in poor countries. Could skirt protectionist barriers via foreign direct investment: “tariff jumping FDI”
- Interests: Manufacturing MNCs less concerned with being seized by nationalistic governments. Unlike extractive MNCs (oil, minerals), host govts could not capture profit stream

2. But the value of colony varied from case to case and affected the timing of decolonization

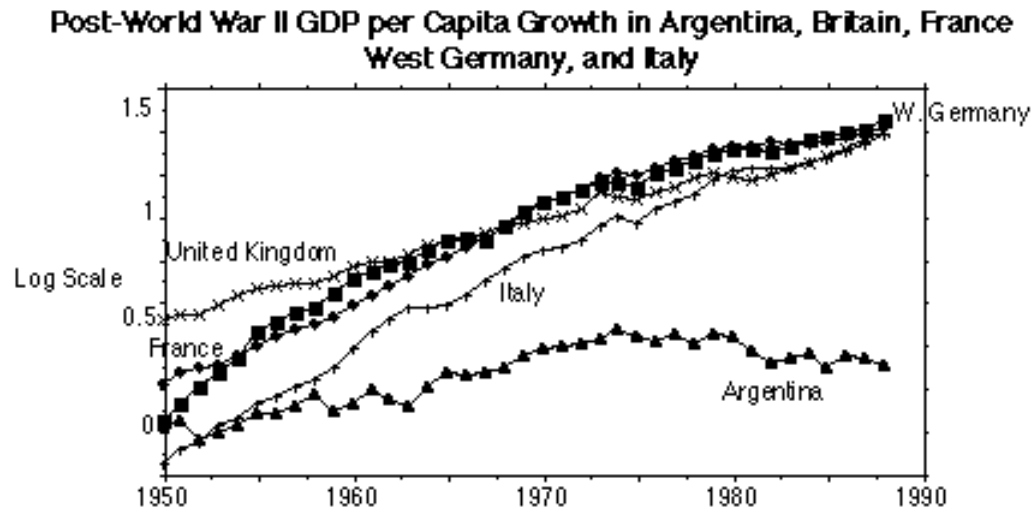
- Generally, settlement colonies (those with large numbers of white expatriates) were the last to get independence
 - e.g. French in Algeria to 1962; Portuguese in Angola to 1975

Decolonization: Domestic factors within colonies

1. Independence movements strengthened by WWII
(see above)
2. Local developments
 - Proto-nationalist elite, often trained in colonial power, seek reform
 - Rise of urban middle class, with new leaders (Nehru, Sukarno). Leaders were first of all nationalists, but also middle class and educated in Europe
 - Nationalist movements attract mass following (India, Indonesia)

Consequences of Decolonization

- Economic: despite industrialization, period from 1945-1980s a near catastrophe for many newly independent countries. Same holds for long-independent countries of Latin America, e.g., Argentina...



Source: Robert Summers and Alan Heston, *Fern World Table V*.

Import Substitution Industrialization

- ISI defined:
 - Deliberate effort to replace major consumer imports by promoting the emergence and expansion of domestic industries (e.g. textiles, shoes, household appliances), using high tariffs to protect these new “infant industries.”
 - Figure 3 for tariff levels during ISI
- Rationale for ISI:
 - Developing countries sought to break away from “unfair” economic order, based upon comparative advantage, where developing nations specialized in primary products (agricultural, mineral, forest) and imported the manufactured goods they consumed from the “North.”

What was wrong with specializing in primary products?

- International factors
 - Depression and WWII: developing countries could not buy manufactured goods from the North during the depression and WWII (or only at very high prices). They realized their vulnerability to shortages and high prices
 - Deteriorating Terms of Trade (TOT): Long-term trend of declining prices for primary commodities after World War II. (Figure 4)
 - Declining TOT meant that low income countries specializing in primary commodity production received less and less “foreign exchange” through trade, and therefore had to pay relatively more for the manufactured goods they imported from industrialized countries.
- Domestic factors
 - Interests: Dominance of a populist coalition of urban labor and domestic capitalists
 - E.g., Juan Peron in Argentina

Was ISI Successful?

- Depends on your metric
 - If it is the share of industry in GDP, then yes. Massive industrialization in the South during ISI
 - If it is social welfare, the answer is no. Very slow rates of growth in ISI countries: ISI countries did not “catch up” or converge on the income levels of developed countries.
 - Countries that *did* catch up used other policies (EOI in South-East Asia)

What went wrong with ISI? A long list:

- Anti-market philosophy promotes expansive regulation and corruption
- Under cover of high protective barriers, domestic firms (and MNCs) have little incentive to be efficient
- Anti-export bias leads to BOP problems
- ISI *raised* dependence on imports; foreign exchange shortages
- Protection created vested interests; hard to keep it temporary
- Small domestic markets lead to inefficient scale of production
- Distribution of income deteriorates as capital intensive sector expands
- Due to anti-export bias, ISI process became highly dependent on foreign capital (FDI and bank loans)

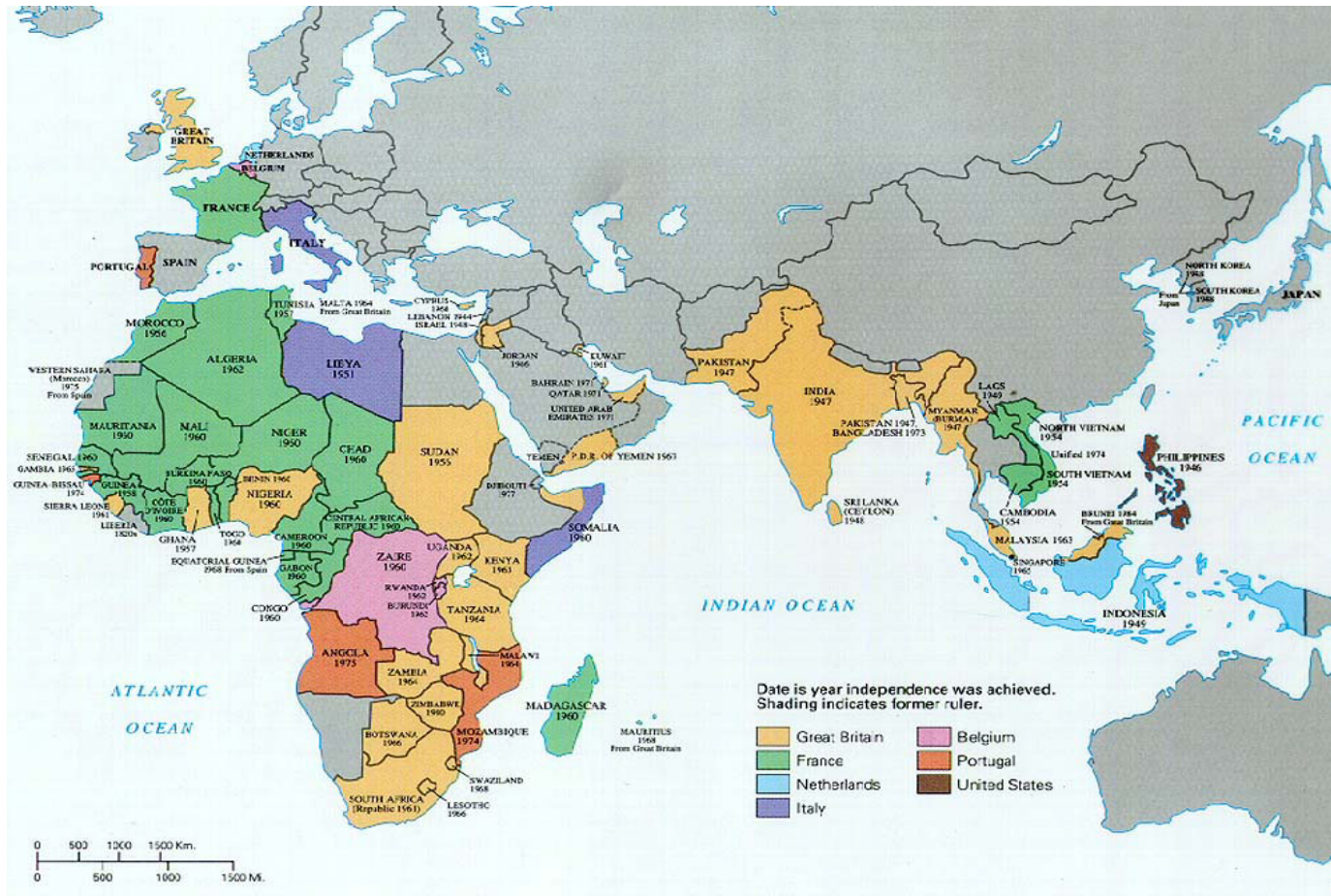
Figure 1: Extent of Colonialism, 1945

	Great Britain	France	Belgium	Netherlands	Germany (1914)
Area in Square Miles	94,000	212,600	11,800	13,200	210,000
Population	45,500,100	42,000,000	8,300,000	8,500,000	67,500,000
Area of Colonies	13,100,000	4,300,000	940,000	790,000	1,100,000
Population of Colonies	470,000,000	65,000,000	13,000,000	66,000,000	13,000,000

SOURCE: Mary E. Townsend, *European Colonial Expansion Since 1871* (Chicago: J.P. Lippincott, 1941).

- In 1945, 700 million people, or 1/3 of world's population, lived under colonial rule (not self-governed).

Figure 2: Decolonization, 1945-1970s



•By 1970, less than 2 million people remained colonial subjects...in a few small, island nations that were generally not interested in formal independence.

Figure 3: Tariff Levels during ISI

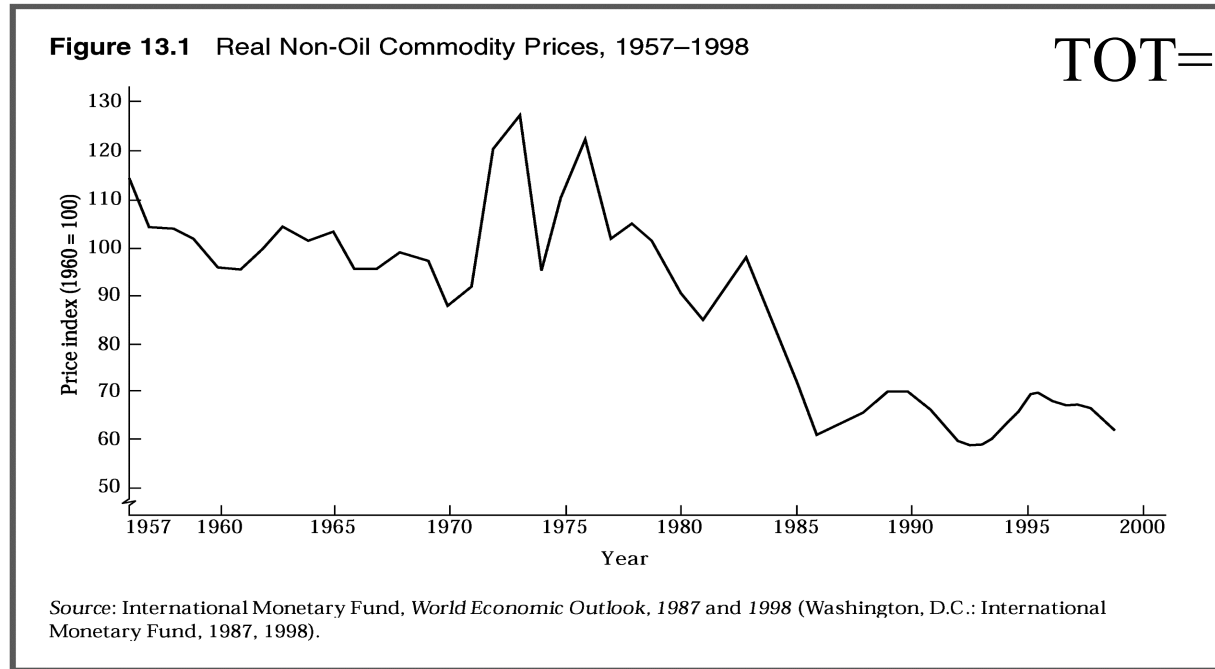
Table 13.2 Effective Protection Rate in Selected Third World Countries

Country	Average Effective Protection Rate (%)
Uruguay	384
Pakistan	356
India	69
Brazil	63
Ivory Coast	41
Thailand	27
Singapore	22
Colombia	19
South Korea	-1

Source: David Greenaway and Chris Milner, "Trade theory and the less developed countries," in Norman Gernmell (ed.), *Surveys in Development Economics* (Oxford: Blackwell, 1987), tab. 1.5.

In Uruguay, for example, prices of imported manufactured goods were 384% higher than world market prices.

Figure 4: Terms of Trade (TOT) for Primary Products



$$\text{TOT} = \frac{\text{Price of Exports}}{\text{Price of Imports}}$$

Why did the TOT deteriorate? Two main factors:

(1) Engel's Law: with rising incomes, the share of expenditures for food (and, by extension, other primary) products declines. So, as the world got richer, the demand for food products fell relative to the demand for manufactured products. [Ernst Engel was a 19th cen. German statistician].

(2) Power of unions and oligopolies to raise prices for manufactured goods vs. competitive forces in primary goods markets.