Lecture 10: Trade and Development

Homework 2 is due now.
Today’s Plan

• Housekeeping
• Reading quiz
• Midterm expectations
• Trade and Development
Housekeeping

• Midterm is next Thursday (October 2)
• Midterm Study Guide Part II will be posted tomorrow.
Reading Quiz (1)

• What kinds of trade problems do developing nations face in accessing international markets?
  • A. Having their exports concentrated in only one or a few primary products.
  • B. Agricultural export subsidies of advanced nations.
  • C. Customs delays and inefficient ports
  • D. A and C
  • E All of the above
Reading Quiz (2)

- If advanced nation’s wages are forced down by competition from countries with lower labor costs and abusive labor conditions, this is called
  - A. Elasticity of Labor
  - B. Cost and Demand Differences
  - C. Social dumping
  - D. Labor subsidization
  - E. Labor darwinism
The Midterm Exam

• Key Terms, Short Answer, Mini-Essay
• Key terms:
  • Definition: 1 sentence.
  • Relevance: 1-3 sentences
  • Example: 1-3 sentences
• Short Answer: 1 sentence is all it takes, sometimes just 1 word.
• Mini-Essay: 3-6 Sentences.
  • There will be multiple points we’re looking for
Recommendations

• Study in groups
  • Divide questions - write up correct answers to every question
• Attend to cognitive diversity
Colonial Legacies

- Many of today's poor countries are former colonies
  - But not all former colonies are poor

- It matters **who** you were colonized by and **how** you were colonized
  - Economic institutions
  - Political institutions
  - Infrastructure
  - Human capital
The Colonial Archetype

- Colonial government:
  - Low investment in infrastructure or human capital
  - Produce raw materials (mining, agriculture)
  - Trade exclusively with colonial metropole on unfavorable terms (mercantilism)
Legacies of Colonialism

• Colonies were governed better where the colonists actually resided themselves
  • Less malaria -> less colonists dying -> more colonists staying

• US, Canada, Australia (genocide) and South Africa (Apartheid)

• Colonists continued to rule after colonial ties ended.
If nothing else, hope that you were colonized by the Brits

- The Brits hired locals into their civil service
  - Developed local capacity & human capital
  - When they left, this civil service persisted
  - India is a prominent example:
    - Hundreds of languages, 30 of which have at least 1 million speakers, several major religions, huge regional economic imbalances
    - Picture ruling all the Americas as a single country -- only harder
  - Also, the common-law system and English
If nothing else, hope that you were colonized by the Brits

• The core questions:
  • Was there investment in education and infrastructure?
  • Were there efficient courts, rule of law, etc?
    • Did the protection of these courts extend to locals, or just colonizers?
    • Did these institutions survive when the colonizers exited?
Development after Decolonization

• Developing countries export raw materials, import manufactured goods

• “Terms of trade” favor rich countries: at the time, raw materials (commodities) were becoming cheaper relative to manufactured goods.

• Powerful MNCs often struck deals with poor-country governments that were not good for the developing country.

• Decolonization was an economic disappointment
Development after Decolonization

- Neocolonialism
- Dependency Theory:
  - “Core” wealthy states enrich themselves at the expense of “peripheral” states
  - International division of labor with unskilled labor at the periphery and skilled labor at the core
  - Peripheral states cannot develop due to their place in the “World System”
    - System is static and peripheral states cannot join the core
    - Poverty at the periphery is necessary to sustain wealth at the core
- Recommendation: Poor states should withdraw from the global economy
  - Import-substituting industrialization (ISI)
Dependency Theory over Time

- Dependency theory is Marxist in origin
- Like Marxism more generally, it provided a compelling explanation for a set of facts at one time
  - But made bad predictions going forward

- Empirical problems for dependency theory
  - Peripheral states can grow wealthy (and have)
  - The poor countries that have developed most successfully have been primarily trade-dependent
  - Import-substituting industrialization failed (by most measures)
Import-Substituting Industrialization

- Core prescriptions:
  - Tax agriculture and subsidize key industries
  - Protect those industries with high tariffs
  - Aim for economic self-sufficiency (i.e. autarky)

- Rapid industrialization: By 1970s many developing countries are self-sufficient in manufacturing

- Costs:
  - These industries are inefficient, produce low quality goods
  - Temporary subsidies become permanent
  - No gains from trade!!!!
Export-Oriented Industrialization

• Similar in many ways to ISI:
  • Tax agriculture (also keep wages low), subsidize key industries
  • But subsidize exports in particular
  • “National Champions” model
  • South Korea is the archetypical case

• Cheap labor provides the key competitive advantage
  • Government investment helps develop higher value-added industries.
  • But government intervention has its risks...
ISI didn’t die easily

- Theories don’t die just because the facts become inconvenient
  - Entrenched domestic political interests

- The 1980s debt crisis sealed the deal
  - The IMF essentially forced countries off of ISI
  - Conditional loans:
    - We’ll bail you out, but only if you adopt the policies we prescribe
The Washington Consensus

- Neoliberal economic policy
  - Liberalize trade
  - Privatize state-owned assets
  - Fiscal austerity to fix current account deficits
  - Open up to foreign capital and foreign investment

- Turns out, this hurts a lot
  - Taking away the government safety-net in poor countries has high human costs
  - “bitter medicine” that may not even work
    - Economic pain = political instability