

ECON 611  
Spring 2005  
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## ECONOMIC DEVELOPMENT POLICY

### Course Description

Economic Development Policy concerns the nature and consequences of policies designed to promote welfare-augmenting growth and structural change. This requires a micro-analytic perspective that accommodates induced institutional change and a welfare economics suitable for analyzing the static and dynamic consequences of policy reform. Topics include: Specialization and Market Evolution, Economic Justice, Land, Labor, and Credit Policies, the New Institutional Economics, Developing Agriculture and Industry, The Political Economy of Corruption, Sustainable Development, the Asian Miracle and Crisis, the Washington Consensus (before and after Stiglitz) and the Hawaii Synthesis.

A central theme of Econ 611 in 2005 will be contrasting the interventionist Development Economics of Bardhan, Udry, Stiglitz and others with the more fundamental New Institutional Economics and New Classical Microeconomics approaches.

### Recommended texts

Bardhan, Pradhan and Christopher Udry, *Development Microeconomics*, Oxford, 1999  
Bardhan and Udry, *Readings in Development Economics, v. I and v. II.* (2000)

### References

Yang, *Development Economics: Inframarginal vs Marginal Analysis*, Blackwell, 2003  
Ray, *Development Economics, Princeton*, 1998  
World Bank, *World Development Report, 2005: A Better Investment Climate for Everyone*; Oxford, 2004.  
Chenery & Srinivasan, *Handbook of Development Economics, Vol. 3*, Elsevier  
Meier and Rauch, *Leading Issues in Economic Development, 7th ed.*, Oxford, 2000  
Meier and Stiglitz, *Frontiers of Development Economics*, 2001  
Stiglitz, *Whither Socialism and Globalization and Discontents*  
Dixit, *The Making of Economic Policy* (1996)  
Laffont, *The Theory of Incentives* (2002)  
Sen, *Development as Freedom*  
Lucas, *Lectures in the Theory of Economic Growth*, 2002.

Course Outline and Readings (items with \* are optional; additional readings will be designated as the course progresses)

### **I. Introduction: The nature and causes of economic development**

- A. Stylized facts of development. Ray, Ch. 2\*
- B. Roumasset, "Development is Letting Go of Fear"

- C. Krugman, Paul, "The Fall and Rise of Development Economics"  
<http://www.pkarchive.org/theory/dishpan1.html>
- D. Murphy et. al., "Industrialization and the Big Push," ch 7 in *B&U I*\*
- E. Power, "Role of Protection...", *EAER*, 6/72\*
- F. Chenery HB (1961). Comparative advantage and development policy. *American Economic Review*, 51\*
- G. Scitovsky, "Two concepts of external economies," *JPE* 62(2), 1954, pp. 143-151\*

## II. Welfare-theoretic Foundations of Development Policy

- A. "Welfare Economics and the Minimal Role of Government: An Axiomatic Approach," (handout)
- B. Appendices
  1. Arrow, K. (1969), "The Organization of Economic Activity: Issues Pertinent to the Choice of Market versus Non-market Allocation," in the *Analysis and Evaluation of Public Finance: the PPB System*.
  2. Cornwall, R. (1984), *The Use of General Equilibrium Analysis*, Amsterdam, North-Holland. pp. 377-388, 461-471, 484-487, 535-536, 556-560\*
  3. Roumasset, J. (1979), "Sharecropping, Production Externalities, and the Theory of Contracts," *American Journal of Agricultural Economics*, Vol 61, No. 4: 640-647
  4. Roumasset, J. (1990), "Debreu-Scarff Version of the Coase Theorem," (An Appendix to *Exposure Trading*, an East-West Center Working Paper)\*
  5. Samuelson, P. (1969), "Pure Theory of Public Finance and Taxation"\*
- C. Stiglitz, "Some Lessons from the East Asian Miracle," *World Bank Research Observer*, Aug., 1996, esp. pp.160-161; Review of Globalization and its Discontents, <http://www.nybooks.com/articles/15630> ; ch 4 from Stiglitz, *Whither Socialism*
- D. Lucas, lecture 3; also available in Bardhan and Udry I and as Lucas, Robert E. (1993): "[Making a miracle.](#)" *Econometrica*, 61(2):251-272.
- E. Ray, Ch. 5\*

## III. Development Microeconomics I: Behavior

- A. Household decision-making w/transaction costs
- B. Decision-making among low-income farmers
- C. Readings
  1. Ray, ch. 9\*
  2. Roumasset, J. (1995), *Behavior and Organization in Developing Agriculture, Part I*, Chs. 2, 3; 4\*, 5.
  3. Hutaserani and Roumasset (1991), "Institutional Change and Demographic Transition in Rural Thailand", *EDCC*
  4. de Janvry, Fafchamps, and Sadoulet (1991), "Peasant Household Behavior with missing markets: some paradoxes explained," *Economic Journal* 101: 1400-17 (**Jstor**); or Sadoulet and de Janvry, *Quantitative Development Policy Analysis*, 1995 (Johns Hopkins), ch. 7\*; or Key, Sadoulet, and de Janvry, "Transaction Costs and Agricultural Household Supply Response," *AJAE*, 5/00, 246-59

D. Research topic: Prove conjecture in R'set, ch. 2 and reassess Fafchamps, Key et. al.

#### IV. Development Microeconomics II: Organization

- A. Choice of contracts in space and time
- B. Government intervention in land, labor and credit markets (e.g., land reform, usury laws and insurance)
- C. Induced institutional change
- D. Research topics: Crop insurance revisited; Collateral confusion & the case against land titles
- E. Readings
  1. Ray, Ch. 11-15\*
  2. Bardhan and Udry, chs. 4 and 6-9.
  3. Hoff, K. et. al. (1993) (eds) *The Economics of Rural Organization: Theory, Practice and Policy*, chs. 4-6, Oxford University Press\*
  4. Evenson and Roumasset (1986), "Markets, Institutions and Family Size in Rural Philippine Households," in *Journal of Philippine Development*, Vol 13, No. 23; or Evenson in Quibria\*
  5. Handbook, v. 3 (chapters by Binswanger and on Rural Credit)\*
  6. Roumasset, J. (1995), *Behavior and Organization in Developing Agriculture, Part II*, chs. 4-12.
  7. Roumasset, J. (1995), "The Nature of the Agricultural Firm," JEBO "Agency Costs and the Ag Firm," (w/M. Uy), *Land Econ*, 7/87 (in ch. 7)
  8. Lipton, "Ag. Risk, Rural Credit, and the Inefficiency of Inequality," in R'set et. al., *Risk, Uncertainty, and Ag. Development* (1979).\*
  9. James and Roumasset, "Migration and the Evolution of Tenure Contracts in Newly-Settled Regions," *J.Dev.Econ*, 14 (1984), 147-162.
  10. Stiglitz, "Economic Organization," Handbook, vol. I, 115-124 (section on sharecropping)\*
  11. R'set, "The Welfare Economics of Rural Credit Markets and the Benefits of land Titles," report to the World Bank, 1986 and Review of Floro and Yotopoulos, *Informal credit markets and the new institutional economics: the case of Philippine Agriculture* in JEL, 12/92
  12. Deweaver and R'set, Beyond Stiglitz, A Dynamic Theory of Share Tenancy (see econ department seminar archives and <http://www.economicsbulletin.com/2002/volume15/EB-01O10001A.pdf> ).
  13. Conning on microfinance\* (<http://wso.williams.edu/%7Ejconning/papers.html> )
  14. Besley, "Savings, Credit, and Insurance," Handbook, ch 36\*
  15. Gertler and Gruber, Insuring Consumption against Illness, *AER*, 3/20\*
  16. Townsend, '95 and Murdoch, 2002 (see G&G above)\*
  17. R'set, "Explaining Diversity in Agricultural Organization: An Agency Perspective," U. Minnesota Ec. Dev Bulletin, 94-3. ([http://agecon.lib.umn.edu/cgi-bin/pdf\\_view.pl?paperid=1760](http://agecon.lib.umn.edu/cgi-bin/pdf_view.pl?paperid=1760) )
  18. Research topics

- a) 1<sup>st</sup>-best: formalize Ricardian land-quality, derive implications for family-farm size, and “test” whether rent/yield increases more than enough to compensate for smaller farm size.
- b) 2<sup>nd</sup>-best:
  1. Formalize U-shaped AC curve based on indivisibilities and economies of family supervision.
  2. Develop formal theory to replace four quadrant agency approach (see appendix to nature of ag firm and R’set/Lee critique of Evenson’s labor supervision paper, available on request)

#### IV. Development Microeconomics III: Specialization, Intensification, and the Evolution of Markets

- A. Yang, *Development Economics* (introduction by Sachs), esp chs 1,3, 9, 14.
- B. See also Sachs, Yang, and Zhang, Globalization, Dual Economy, and Economic Development; “Endogenous Transaction Costs and Division of Labor” and other papers on agglomeration economies, division of labor, specialization, exogenous vs. endogenous comp. advantage at <http://ceiba.cc.ntu.edu.tw/cnc/article/yang-list.htm>)\*
- C. Roumasset et. al., Specialization and the Co-Evolution of Agricultural Markets, IRIS WP, U. of Maryland, 1998\*
- D. Foley, Stabilization of human population through increasing returns, *Economics Letters* 68 (2000) 309-317\*
- E. Day, The Rise and Fall of Manoralism\*
- F. James and R’set, “How to Facilitate or Stifle Economic Development: The Role of Agriculture in Indonesia and the Philippines,” *Southeast Asian Journal of Agricultural Economics*, Vol. 1, No. 2, (December 1992)\*
- G. R’set, “Microeconomics of Agricultural Development in the Philippines” (2000).
- H. World Dev Report, 2001/2002: Building Institutions for Markets\*
- I. North, <http://ideas.repec.org/e/pno11.html>\*
- J. Research topics: combine A and C; do same for evolution of financial mkt.

#### VI. Poverty-alleviation policies

- A. Lipton, M. and Ravallion, M. (1995), from *Handbook IIIB*\*
- B. Ray, ch. 7&8\*
- C. *World Dev. Report*, 2000/2001: Attacking Poverty, chs. 1-5, 8\*
- D. Fabella, R., ch. 4 in Balisacan, Arsenio and Shigeaki Fujisaki, eds. *Causes of Poverty: Myths, Facts and Policies: A Philippine Study*, U. of the Philippines Press;\* and Roumasset, review of same, *APEL* 5/2001.
- E. B&U, ch. 11.\*
- F. Conning on safety nets, <http://wso.williams.edu/%7Ejconning/papers.html>
- G. The cases for safety nets and community participation; food stabilization policies\*

## VII. Sustainable growth and development

- A. Weitzman, in *QJE*, 1976, 65-94\*
- B. Endress, Roumasset, and Tzou, A Koopmans approach to sustainable development (<http://www2.soc.hawaii.edu/econ/workingpapers/WP%2002-4.pdf>) or Sustainable Growth w/o Constraints (<http://www2.soc.hawaii.edu/econ/workingpapers/009abstract.html>)
- C. Endress and Roumasset, *J. of the Asia Pacific Economy*
- D. Dasgupta, & Maler (1993), "Poverty, Institutions, and the Environmental-Resource Base," *Hndbk, Vol. 3*\*
- E. B&U, ch. 13\*
- F. Rset, review of Opschoor, J(Hans). B., Kenneth Button, and Peter Nijkamp, eds. *Environmental Economics and Development, Environment and Economic Development*, 2001
- G. Krautkraemer, J., (1994), "Population growth, soil fertility, and agricultural intensification," *J. Dev. Econ.*, 44, 403-428.
- H. *World Dev Report*, 2003, selected chapters\*
- I. Research topic: Combine B and G

## VIII. (1<sup>st</sup>) Second-Best Policy Analysis

- A. Benefit cost analysis
- B. Applied general equilibrium approaches to policy analysis
- C. Infrastructure and pricing policies
- D. Spatial and Temporal Consequences of Intervention
- E. Research topics: Replicate F5 or F6
- F. Readings
  1. Squire, L. (1989), "Project Evaluation in Theory and Practice," in Chenery and Srinivasan (eds), *Handbook of Development Economics Vol II*, Amsterdam, North-Holland.\*
  2. Roumasset, J. and Setboonsarng, S. (1988), "Second-Best Agricultural Policy: Getting the Price of Thai Rice Right," *Journal of Development Economics*, Vol. 28, pp. 323-340.
  3. Clarete, R. and Roumasset, J. (1987), "A Shoven-Whalley Model of a Small Open Economy," *Journal of Public Economics*, Vol. 32, pp. 247-261.
  4. Clarete, R. and Roumasset, J. (1990), "The Relative Welfare Cost of Industrial and Agricultural Policy Distortions: A Philippine Illustration," *Oxford Economic Papers*, Vol. 42, pp. 462-472\*
  5. Fujimura, M., Roumasset, J. and Russo (1995), "Shadow Exchange Rates, Conversion Factors, and the Equivalent Variation Foundations of Project Evaluation"\*
  6. Kratz and Roumasset, "Trade Diversion, Excess Storage, and State-Trading Enterprises: Rice Policy in the Philippines," (pdf, 2000)\*

- X. Trade Promotion, Asian Miracles/Debacles, Globalization, and 3<sup>rd</sup> best policy reform**
- A. Ray, chs. 16-18\*
  - B. Rodrik, D. (1995), "Trade and Industrial Policy Reform," *Handbook* and/or "Paradoxes of the successful state" *European Econ Rev* 41 (1997) 411-442\*
  - C. World Bank, *East-Asian Miracle*, 1993\*
  - D. Krugman, "The Myth of Asia's Miracle," *Foreign Affairs*, Nov/Dec, 1994\*
  - E. Stiglitz and Yusuf, ch. 13 or IIC above.\*
  - F. Roumasset, Ch. 1 in Roumasset and Barr, *The Economics of Cooperation: East Asian Development and the Case for Pro-Market Intervention*, 1992\*
  - G. Harley, "A Review of O'Rourke and Williamson's *Globalization and History*," *JEL*, 12/00 or review of three Williamson papers in *The Economist*, 4/20/96.\*
  - H. Power, "Role of Protection...", *EAER*, 6/72
  - H. Roumasset, "The Political Economy of Corruption"
  - I. Excerpts from Dixit and Laffont\*
  - J. Balisacan&R'set\* and B&O, ch. 11
  - K. World Dev Report 2002, chs. 5&7\*
  - L. Easterly, *Quest for Econ Growth*, ch on econ of scale, matching, and circles\*
  - M. Research topic: combine I and J.

#### Grading

Midterm (3/11)	24%
Paper <sup>1</sup>	24%
Final	36%
Homework+citizenship	16%

#### Office hrs.

Wed, 1:30-3 and by appt.

#### Topics and tentative schedule

Weeks 1-3: Stylized facts of development. Market failure, govt. failure and the role of govt. in econ dev (theorems 1-5, justice, three levels of abstraction, positive and normative, tech and pec externalities). Coasean paradigm of economic development.

Jan 11: Theorem 1. Homework: stylized facts of development.

Jan 13: Neoclassical, modernism, post-modernism; Critiques of SWF (Arrow, no consensus, MAAN, premature sacrifice of efficiency without doing LE for basic needs). Alternatives (new-new welfare econ; Aristotle/Wicksell). Theorem 2. Krugman (history, methodology, Murphy).

Jan 18: Thm 3 (Coase).

Jan 20: Stiglitz, dynamic pecuniary externalities; coordination of interdependent investments; begin thm 4. Homework: solve for voluntary provision of a public good with naïve conjectures.

Jan 25: Prove theorems 4a, 4b. Lucas on productivity miracles.

While there are difficulties with measuring the contribution of learning to productivity growth, the evidence that learning on individual products is bounded is robust. A macroeconomic model of long-run

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<sup>1</sup> Two-page (max) typed proposal due Feb 17. Paper due on date of penultimate class.

growth therefore has to account for the microeconomic restriction on learning possibilities. The natural way to do this is to combine new product introduction with bounded learning.

Lucas (1993) is a beautifully-written paper applying LBD to the question of aggregate economic growth and development (it is largely inspired by earlier work by Nancy Stokey and Alwyn Young, cited in the supplementary readings). His model combines the boundedness of new learning on new products with knowledge spillovers to new products, and contains a valuable message about how firms can experience growth miracles if they open themselves to new ideas.

Krugman's paper is an entertaining series of mini essays illustrating how learning by doing can cause temporary policies to have permanent consequences. We will focus on the section on what Krugman called the narrow moving bound, a parable about how temporary government interventions can make miracles.

### **Background reading for Lucas (not required)**

Arrow, Kenneth J. (1962): "[The economic implications of learning by doing.](#)" *Review of Economic Studies*, **29**:155-73.

Parente, Stephen (1994): "Technology adoption, learning by doing, and economic growth." *Journal of Economic Theory*, **63**:346-369.

Stokey, Nancy L. (1988): "[Learning by doing and the introduction of new goods.](#)" *Journal of Political Economy*, **96**:701-717.

Young, Alwyn (1991): "[Learning by doing and the dynamic effects of international trade.](#)" *Quarterly Journal of Economics*, **106**:369-405.

Young, Alwyn (1993): "[Invention and bounded learning by doing.](#)" *Journal of Political Economy*, **101**:443-472.

Krugman, Paul M. (1987): "The narrow moving band, the dutch disease and the economic consequences of Mrs. Thatcher. Notes on trade in the presence of dynamic scale economies." *Journal of Development Economics*, **27**:41-55.

Jan 27: Wedge model

Feb 1: Development microeconomics I (continued)