

EKONOMI KEMISKINAN

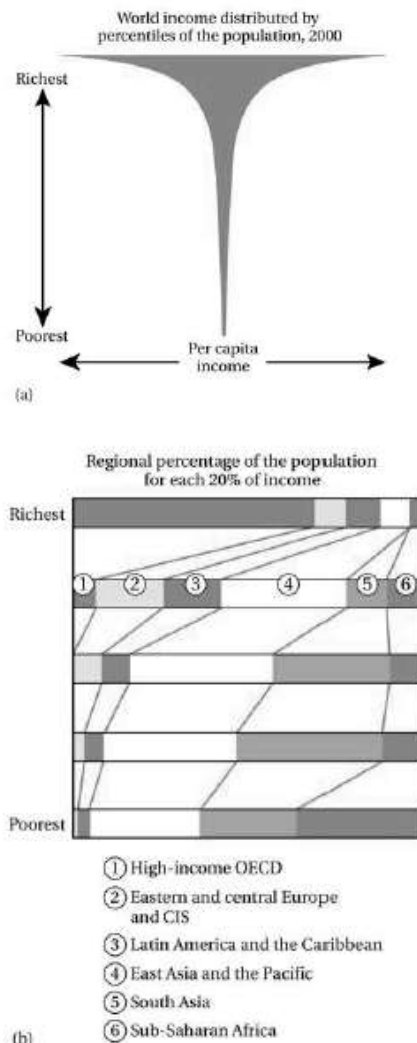
CHAPTER 1

INTRODUCING ECONOMIC DEVELOPMENT : A GLOBAL PERSPECTIVE

The Nature of Development Economics

Greater scope than traditional neoclassical economics and political economy.

Figure 1.1 World Income Distribution



Economies as Social Systems: The Need to Go Beyond Simple Economics
Social Systems : Interdependent relationships between economic and noneconomic factors

Success or failure of development policy
– Importance of taking account of institutional and structural variables along with more traditional economic variables

Traditional Economic Measures
– Gross National Income (GNI)

- Income per capita
- Utility of that income?

The New Economic View of Development

– Leads to improvement in wellbeing, more broadly understood

Amartya Sen's "Capability" Approach

- Functionings as an achievement
- Capabilities as freedoms enjoyed in terms of functionings
- Development and happiness
- Well being in terms of being well and having freedoms of choice
- "Beings and Doings":

Some Key "Capabilities"

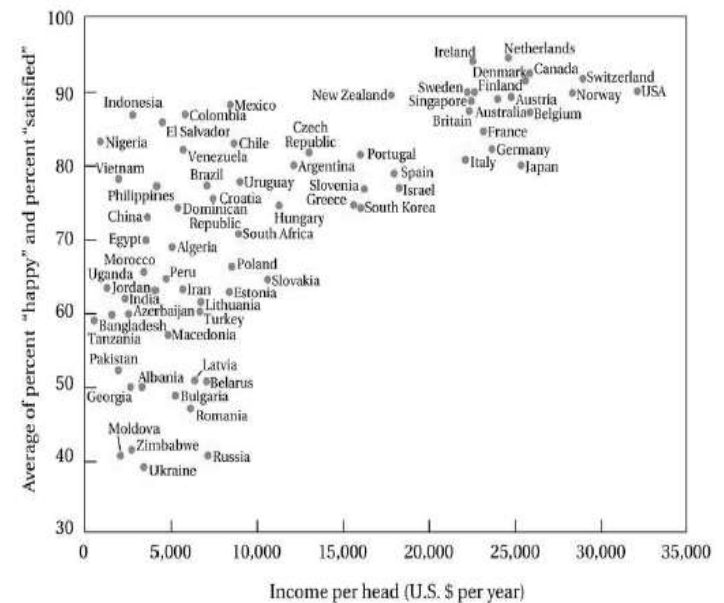
Some Important "Beings" and "Doings" in Capability to Function:

- Being able to live long
- Being well-nourished
- Being healthy
- Being literate
- Being well-clothed
- Being mobile
- Being able to take part in the life of the community
- Being happy – as a state of being - may be valued as a functioning

Three Core Values of Development

1. Sustenance: The Ability to Meet Basic Needs
2. Self-Esteem: To Be a Person
3. Freedom from Servitude: To Be Able to Choose

Figure 1.2 Income and Happiness: Comparing Countries



The Central Role of Women

To make the biggest impact on development, societies must empower and invest in women

The Three Objectives of Development









- Increase availability of life-sustaining goods
- Raise levels of living
- Expand range of economic and social choices

Millennium Development goals (MDGs)

Eight goals adopted by the United Nations in 2000

1. Eradicate extreme poverty and hunger
2. Achieve universal primary education
3. Promote gender equality and empower women
4. Reduce child mortality
5. Improve maternal health
6. Combat HIV/AIDS, malaria, and other diseases
7. Ensure environmental sustainability
8. Develop a global partnership for development

Table 1.1 Millennium Development Goals and Targets for 2015

Goals	Targets
<p>8. Develop a global partnership for development</p> 	<ul style="list-style-type: none"> Develop further an open, rule-based, predictable, nondiscriminatory trading and financial system; includes a commitment to good governance, development, and poverty reduction—both nationally and internationally Address the special needs of the least developed countries; includes tariff and quota free access for least developed countries' exports; enhanced program of debt relief for heavily indebted poor countries (HIPC) and cancellation of official bilateral debt; and more generous official development assistance (ODA) for countries committed to poverty reduction Address the special needs of landlocked countries and small island developing states Deal comprehensively with the debt problems of developing countries through national and international measures in order to make debt sustainable in the long term In cooperation with developing countries, develop and implement strategies for decent and productive work for youth In cooperation with pharmaceutical companies, provide access to affordable essential drugs in developing countries In cooperation with the private sector, make available the benefits of new technologies, especially information and communications
<p>1. Eradicate extreme poverty and hunger</p> 	<ul style="list-style-type: none"> Reduce by half the proportion of people living on less than \$1 a day Reduce by half the proportion of people who suffer from hunger Ensure that all boys and girls complete a full course of primary schooling
<p>2. Achieve universal primary education</p> 	<ul style="list-style-type: none"> Eliminate gender disparity in primary and secondary education, preferably by 2005, and at all levels by 2015
<p>3. Promote gender equality and empower women</p> 	<ul style="list-style-type: none"> Reduce by two-thirds the mortality rate among children under 5
<p>4. Reduce child mortality</p> 	<ul style="list-style-type: none"> Reduce by three-quarters the maternal mortality ratio
<p>5. Improve maternal health</p> 	<ul style="list-style-type: none"> Halt and begin to reverse the spread of HIV/AIDS Halt and begin to reverse the incidence of malaria and other major diseases
<p>6. Combat HIV/AIDS, malaria, and other diseases</p> 	<ul style="list-style-type: none"> Integrate the principles of sustainable development into country policies and programs; reverse loss of environmental resources Reduce by half the proportion of people without sustainable access to safe drinking water Achieve significant improvement in lives of at least 100 million slum dwellers by 2020
<p>7. Ensure environmental sustainability</p> 	

CHAPTER 2

COMPARATIVE ECONOMIC DEVELOPMENT

Common characteristics of developing countries

These features in common are on average and with great diversity, in comparison with developed countries:

- Lower levels of living and productivity
- Lower levels of human capital
- Higher levels of inequality and absolute poverty
- Higher population growth rates
- Greater social fractionalization
- Larger rural population - rapid migration to cities
- Lower levels of industrialization and manufactured exports
- Adverse geography
- Underdeveloped financial and other markets
- Colonial Legacies - poor institutions etc.

Defining the Developing World

World Bank Scheme - ranks countries on GNP/capita
 – LIC, LMC, UMC, OECD (see Table 2.1 and Figure 2.1)

Table 2.1 Classification of Economies by Region and Income, 2010

Country	Code	Class	Country	
East Asia and the Pacific				
American Samoa‡	ASM	UMC	Argentina	
Cambodia*	KHM	LIC	Belize‡	
China	CHN	LMC	Bolivia‡	
Fiji‡	FJI	UMC	Brazil	
Indonesia	IDN	LMC	Chile	
Kiribati*‡	KIR	LMC	Colombia	
Korea, Dem. Rep. (North)	PRK	LIC	Costa Rica	
Lao PDR*†	LAO	LIC	Cuba‡	
Malaysia	MYS	UMC	Dominica‡	
Marshall Islands‡	MHL	LMC	Dominican Republic‡	
Micronesia, Fed. Sts. ‡	FSM	LMC	Ecuador	
Mongolia†	MNG	LMC	El Salvador	
Myanmar*	MMR	LIC	Grenada‡	
Palau‡	PLW	UMC	Guatemala	
Papua New Guinea‡	PNG	LMC	Guyana‡	
Philippines	PHL	LMC	Haiti*‡	
Samoa*‡	WSM	LMC	Honduras	
Solomon Islands*‡	SLB	LMC	Jamaica‡	
Thailand	THA	LMC	Mexico	
Timor-Leste*‡	TLS	LMC	Nicaragua	
Tonga‡	TON	LMC	Panama	
Vanuatu*‡	VUT	LMC	Paraguay†	
Vietnam	VNM	LIC	Peru	
Caribbean				
Sub-Saharan Africa				
ARG	UMC	Angola*	AGO	LMC
BLZ	LMC	Benin*	BEN	LIC
BOL	LMC	Botswana†	BWA	UMC
BRA	UMC	Burkina Faso*†	BFA	LIC
CHL	UMC	Burundi*†	BDI	LIC
COL	UMC	Cameroon	CMR	LMC
CRI	UMC	Cape Verde‡	CPV	LMC
CUB	UMC	Central African Rep.*†	CAF	LIC
DMA	UMC	Chad*†	TCD	LIC
DOM	UMC	Comoros‡	COM	LIC
ECU	LMC	Congo, Dem. Rep.*	COD	LIC
SLV	LMC	Congo, Rep.	COG	LMC
GRD	UMC	Côte d'Ivoire	CIV	LMC
GTM	LMC	Eritrea*	ERI	LIC
GUY	LMC	Ethiopia*†	ETH	LIC
HTI	LIC	Gabon	GAB	UMC
HND	LMC	Gambia, The*	GMB	LIC
JAM	UMC	Ghana	GHA	LIC
MEX	UMC	Guinea*	GIN	LIC
NIC	LMC	Guinea-Bissau*‡	GNB	LIC
PAN	UMC	Kenya	KEN	LIC
PRY	LMC	Lesotho*‡	LSO	LMC
PER	UMC	Liberia*	LBR	LIC

Table 2.1 Classification of Economies by Region and Income, 2010 (continued)

Country	Code	Class	Country
High-Income OECD Countries			
Australia	AUS		Spain
Austria	AUT		Sweden
Belgium	BEL		Switzerland
Canada	CAN		United Kingdom
Czech Rep.	CZE		United States
Denmark	DNK		Other High-Income
Finland	FIN		Andorra
France	FRA		Antigua and Barbuda†
Germany	DEU		Aruba‡
Greece	GRC		Bahamas, The‡
Hungary	HUN		Bahrain‡
Iceland	ISL		Barbados‡
Ireland	IRL		Bermuda
Italy	ITA		Brunei Darussalam
Japan	JPN		Cayman Islands
Korea, Rep. (South)	KOR		Channel Islands
Luxembourg	LUX		Croatia
Netherlands	NLD		Cyprus
New Zealand	NZL		Estonia
Norway	NOR		Equatorial Guinea*
Portugal	PRT		Faeroe Islands
Slovak Republic	SVK		French Polynesia‡
			Greenland

Code	Class	Country	Code	Class
ESP		Guam‡	GUM	
SWE		Hong Kong, China	HRG	
CHE		Isle of Man	IMN	
GBR		Israel	ISR	
USA		Kuwait	KWT	
nomies		Liechtenstein	LIE	
AND		Macao, China	MAC	
ATG		Malta	MLT	
ABW		Monaco	MCO	
BHS		Netherlands Antilles‡	ANT	
BHR		New Caledonia‡	NCL	
BRB		Northern Mariana Islands‡	MNP	
BMU		Oman	OMN	
BRN		Puerto Rico‡	PRI	
CYM		Qatar	QAT	
CHI		San Marino	SMR	
HRV		Saudi Arabia	SAU	
CYP		Singapore‡	SGP	
EST		Slovenia	SVN	
GNQ		Taiwan, China	TWN	
FRO		Trinidad and Tobago‡	TTO	
PYF		United Arab Emirates	ARE	
GRL				

Basic Indicators of Development: Real Income, Health, and Education

1. Gross National Income (GNI)
2. Gross Domestic Product (GDP)
3. PPP method instead of exchange rates as conversion factors (see Figure 2.2)

Figure 2.2 Income Per Capita in Selected Countries (2008)

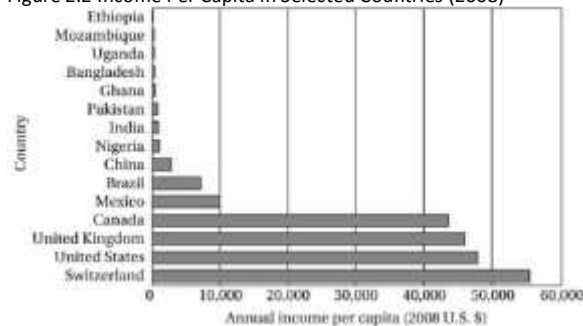


Table 2.2 A Comparison of Per Capita GNI, 2008

Country	GNI Per Capita (U.S. \$)	
	Exchange Rate	Purchasing Power Parity
Argentina	7,190	13,990
Bangladesh	520	1,450
Brazil	7,300	10,070
Burundi	140	380
Cameroon	1,150	2,170
Chile	9,370	13,240
China	2,940	6,010
Costa Rica	6,060	10,950
Ghana	630	1,320
Guatemala	2,680	4,690
India	1,040	2,930
Indonesia	1,880	3,590
Kenya	730	1,550
Malawi	280	810
Malaysia	7,250	13,730
Mexico	9,990	14,340
Nicaragua	1,080	2,620
Sierra Leone	320	770
South Korea	21,530	27,840
Sri Lanka	1,780	4,460
Thailand	3,670	7,760
Uganda	420	1,140
United Kingdom	46,040	36,240
United States	47,930	48,430
Venezuela	9,230	12,840
Zambia	950	1,230

Holistic Measures of Living Levels and Capabilities

- Health
- Life Expectancy
- Education
- HDI as a holistic measure of living levels

$$HDI = \frac{1}{3} (\text{income index}) + \frac{1}{3} (\text{life expectancy index}) + \frac{1}{3} (\text{education index})$$

HDI can be calculated for groups and regions in a country

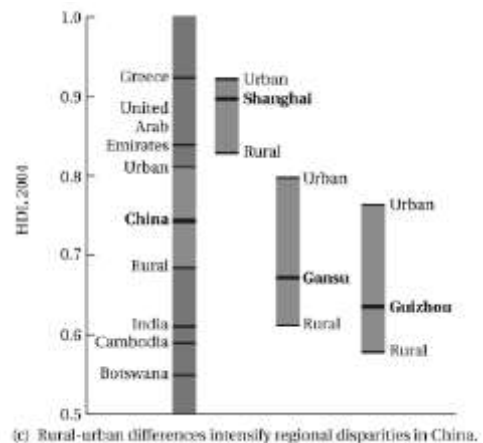
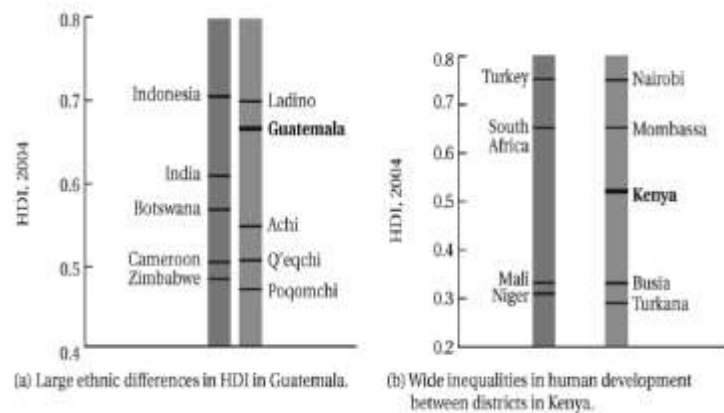
- HDI varies among groups within countries
- HDI varies across regions in a country
- HDI varies between rural and urban areas

Table 2.3 Commonality and Diversity: Some Basic Indicators

Country or Group	2006	2006	2006	Prevalence of Undernourishment* (%)	2007	2008	Adult Literacy ^b	
	Income Per Capita (U.S. \$)	PPP Per Capita (U.S. \$)	Life Expectancy (years)		Under-5 Mortality per 1,000 Live Births	Crude Birth Rate	Male	Female
Income Group								
Low	523	1,354	59	30	118	32	76	63
Lower middle	2,073	4,589	68	15	64	20	87	73
Upper middle	7,852	12,208	71	6	23	17	95	92
High	39,687	37,665	80	5	7	12		
Country								
Den. Rep. Congo (LUC)	150	280	48	75	199	45	78	56
India (LMC)	1,040	2,930	64	22	69	23	75	51
Egypt (LMC)	1,800	3,470	70	<5	25	25	75	58
Brazil (LMC)	7,300	10,070	72	6	22	16	90	90
Malaysia (LMC)	7,250	13,730	74	<5	6	20	99	94
United States (high-income)	47,930	48,430	78	<5	8	14		
Region								
East Asia and the Pacific	2,644	10,461	72	12	29	14	96	90
Latin America and the Caribbean	6,768	10,312	73	9	23	19	92	91
Middle East and North Africa	3,237	7,343	71	7	34	24	82	65
South Asia	963	2,695	64	22	76	24	73	50
Sub-Saharan Africa	1,077	1,949	52	28	144	38	74	57
Europe and Central Asia	7,350	11,953	70	6	22	14	99	97

Source: Data from World Bank, World Development Indicators 2010 (Washington, D.C.: World Bank, 2010), multiple tables.

Figure 2.3 Human Development Disparities within Selected Countries



(c) Rural-urban differences intensify regional disparities in China.

Table 2.4 2009 Human Development Index for 24 Selected Countries (2007 Data)

Country	Relative Ranking	Human Development Index (HDI)	GDP Per Capita (PPP, U.S. \$)	GDP Rank minus HDI Rank	NHDI rank	NHDI Value	Life Expectancy at Birth (years)	Mean Years of Schooling (years)	Expected Years of Schooling (years)	GNI Per Capita (PPP 2008 \$)	GNI Per Capita Rank Minus NHDI Rank	Non-income NHDI Value
Low Human Development												
Niger	182	0.340	627	-6								
Afghanistan	181	0.332	1,054	-17								
Dem. Rep. Congo	176	0.389	298	5								
Ethiopia	171	0.414	779	0								
Rwanda	167	0.460	966	1								
Côte d'Ivoire	163	0.484	1,490	-17								
Malawi	160	0.493	761	12								
Medium Human Development												
Bangladesh	146	0.543	1,241	9								
Pakistan	141	0.572	2,496	-9								
India	134	0.612	2,753	-6								
South Africa	129	0.683	9,757	-51								
Nicaragua	124	0.699	2,570	6								
Gabon	103	0.735	15,367	-49								
China	92	0.772	5,383	10								
Iran	88	0.782	10,955	-17								
Thailand	87	0.783	8,135	-5								
High Human Development												
Saudi Arabia	59	0.843	22,935	-19								
Costa Rica	54	0.854	10,942	19								
Cuba	51	0.863	6,876	44								
Chile	44	0.878	13,880	15								
Very High Human Development												
United Kingdom	21	0.947	35,130	-1								
United States	13	0.956	45,592	-4								
Canada	4	0.966	35,812	14								
Norway	1	0.971	53,433	4								

Country	GDP Per Capita (U.S. \$)	HDI	Rank	Life Expectancy (years)	Adult Literacy (%)	Combined Ratio
GDP Per Capita near PPP \$1,000						
Madagascar	932	0.543	145	59.9	70.7	61.3
Haiti	1,140	0.532	149	61.0	62.1	52.1
Rwanda	866	0.460	167	49.7	64.9	52.2
Mali	1,083	0.371	178	48.1	26.2	46.9
Afghanistan	1,054	0.332	181	43.6	28.0	50.1
GDP Per Capita near PPP \$1,500						
Kenya	1,542	0.541	147	53.6	73.6	59.6
Ghana	1,334	0.526	152	56.5	65.0	56.5
Côte d'Ivoire	1,690	0.484	163	56.8	48.7	37.5
Senegal	1,666	0.464	166	55.4	41.9	41.2
Chad	1,477	0.392	175	48.6	31.8	36.5
GDP Per Capita near PPP \$2,000						
Kyrgyzstan	2,006	0.710	120	67.6	99.3	77.3
Laos	2,165	0.619	133	64.6	72.7	59.6
Cambodia	1,802	0.593	137	60.6	76.3	58.5
Sudan	2,086	0.531	150	57.9	60.9	39.9
Cameroon	2,128	0.523	153	50.9	67.9	52.1
Mauritania	1,927	0.520	154	56.6	55.8	30.6
Nigeria	1,969	0.511	158	47.7	72.0	53.0
GDP Per Capita near PPP \$4,000						
Tonga	3,748	0.768	99	71.7	99.2	78.0
Sri Lanka	4,243	0.759	102	74.0	90.8	68.7
Honduras	3,796	0.732	112	72.0	83.6	74.8
Bolivia	4,206	0.729	113	65.4	90.7	86.0
Guatemala	4,562	0.704	122	70.1	71.2	70.5
Morocco	4,108	0.654	130	71.0	55.6	61.0

Characteristics of the Developing World : Diversity within Commonality

1. Lower levels of living and productivity
2. Lower levels of human capital (health, education, skills)
3. Higher Levels of Inequality and Absolute Poverty
-Absolute Poverty
-World Poverty
4. Higher Population Growth Rates, Crude Birth rates

Figure 2.4 Shares of Global Income, 2008

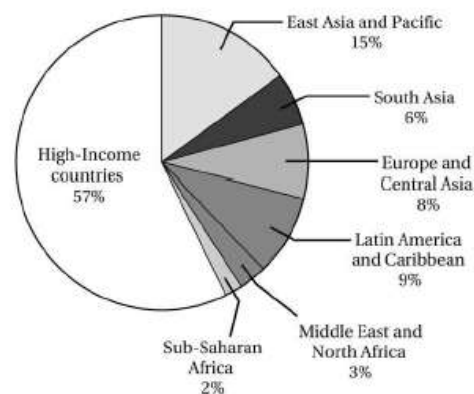


Table 2.7 The 12 Most and Least Populated Countries and Their Per Capita Income, 2008

Most Populous	Population (millions)	GNI Per Capita (U.S. \$)
1. China	1,325	2,940
2. India	1,140	1,040
3. United States	304	47,930
4. Indonesia	227	1,880
5. Brazil	192	7,300
6. Pakistan	166	950
7. Bangladesh	160	520
8. Nigeria	151	1,170
9. Russian Federation	142	9,660
10. Japan	128	38,130
11. Mexico	106	9,990
12. Philippines	90	1,890

Holistic Measures of Living Levels and Capabilities

- The New Human Development Index
- Introduced by UNDP in November 2010

What is new in the New HDI?

1. Calculating with a geometric mean

Probably most consequential: The index is now computed with a geometric mean, instead of an arithmetic mean. A geometric mean is also used to build up the overall education index from its two components. Traditional HDI added the three components and divided by 3. New HDI takes the cube root of the product of the three component indexes. The traditional HDI calculation assumed one component traded off against another as perfect substitutes, a strong assumption. The reformulation now allows for imperfect substitutability

2. Other key changes:

Gross national income per capita replaces gross domestic product per capita. Revised education components: now using the average actual educational attainment of the whole population, and the expected attainment of today's children. The maximum values in each dimension have been increased to the observed maximum rather than given a predefined cutoff. The lower goalpost for income has been reduced due to new evidence on lower possible income levels

Table 2.6 The 2010 New Human Development Index (NHDI), 2008 Data

Least Populous ^{a)}	Population (thousands)	GNI Per Capita (U.S. \$)
1. Palau	20	8,630
2. St. Kitts and Nevis	49	10,870
3. Marshall Islands	60	3,270
4. Dominica	73	4,750
5. Antigua and Barbuda	87	13,200
6. Seychelles	87	10,220
7. Kiribati	97	2,040
8. Tonga	104	2,690
9. Grenada	104	5,880
10. St. Vincent and the Grenadines	109	5,050
11. Micronesia	110	2,460
12. São Tomé and Príncipe	160	1,030

Figure 2.5 Under-5 Mortality Rates, 1990 and 2005

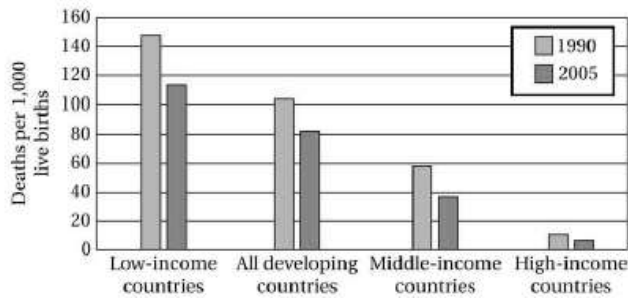


Table 2.8 Primary School Enrollment and Pupil-Teacher Ratios, 2010

Region or Group	Net Primary School Enrollment (%)	Primary Pupil-Teacher Ratio
Income Group		
Low	80	45
Lower Middle	87	23 ^a
Upper Middle	94	22
High	95	15
Region		
East Asia and Pacific	93 ^a	19
Latin America and the Caribbean	94	25
Middle East and North Africa	91	24
South Asia	86	40 ^b
Sub-Saharan Africa	73	49
Europe and Central Asia	92	16

Figure 2.6 Correlation between Under-5 Mortality and Mother's Education

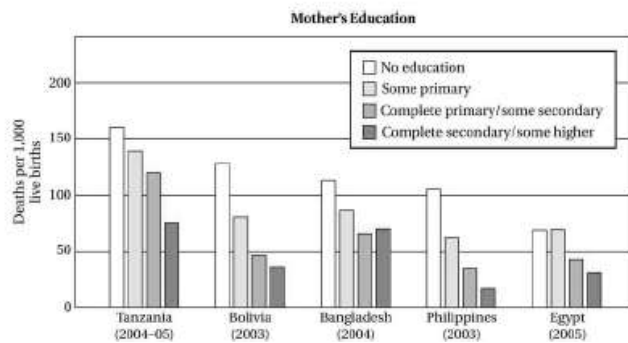
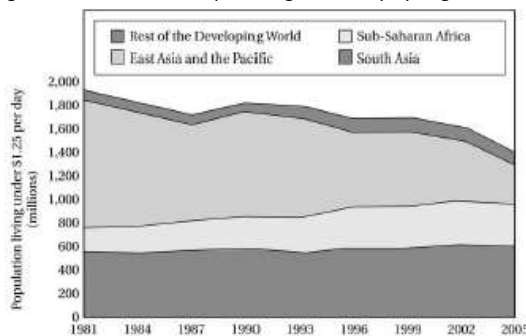


Figure 2.7 Number of People Living in Poverty by Region, 1981-2005



Characteristics of the Developing World : Diversity within Commonality

- 5. Greater Social Fractionalization
- 6. Larger Rural Populations but Rapid Rural-to- Urban Migration
- 7. Lower Levels of Industrialization and Manufactured Exports
- 8. Adverse Geography, Resource endowments

Table 2.10 The Urban Population in Developed Countries and Developing Regions

Region	Population (millions, 2009)	Urban Share (%)
World	6,810	50
More developed countries	1,232	75
Less developed countries	5,578	44
Sub-Saharan Africa	836	35
Northern Africa	205	50
Latin America and the Caribbean	580	77
Western Asia	231	64
South-central Asia	1,726	31
Southeast Asia	597	43
East Asia	1,564	51
Eastern Europe	295	69

Table 2.11 Share of the Population Employed in the Industrial Sector in Selected Countries, 2004-2008 (%)

Region	Services		Industry		Agriculture	
	Share of GDP (2008)	Share of GDP (2008)	Share of GDP (2008)	Share of GDP (2008)	Share of GDP (2008)	Share of GDP (2008)
Africa	49	46	6	13	43	28
Egypt	42	61	17	27	6	12
Ethiopia	37	13	2	5	83	82
Madagascar	67	54	26	36	8	10
Mauritius	63	54	14	35	7	11
South Africa	52	43	13	15	68	42
Asia	37	38	15	21	41	41
Bangladesh	37	51	15	32	10	18
Indonesia	53	41	23	23	20	36
Malaysia	53	39	11	18	24	44
Pakistan	53	60	16	33	8	7
Philippines	44	35	19	22	40	43
South Korea	44	41	19	22	12	7
Thailand	38	23	14	21	60	56
Vietnam	55	51	16	22	6	27
Latin America	75	78	36	36	9	18
Colombia	64	54	13	28	5	18
Costa Rica	59	50	18	31	4	19
Mexico	59	38	18	20	8	19
Nicaragua	51	73	18	20	8	42
Developed Countries	76	66	9	32	1	2
United Kingdom	77	90	9	30	1	2
United States	77	90	9	30	1	2

9. Underdeveloped Financial and Other markets

- Imperfect markets
- Incomplete information

10. Colonial Legacy and External Dependence

- Institutions
- Private property
- Personal taxation
- Taxes in cash rather than in kind

How Low-Income Countries Today Differ from Developed Countries in Their Earlier Stages

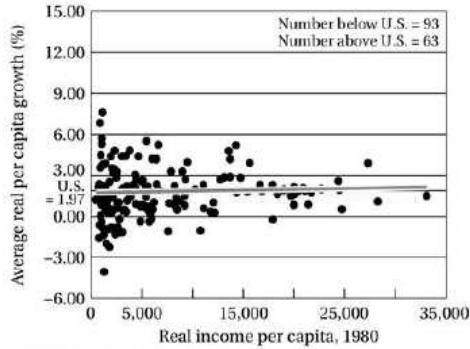
Eight differences

1. Physical and human resource endowments
2. Per capita incomes and levels of GDP in relation to the rest of the world
3. Climate
4. Population size, distribution, and growth
5. Historic role of international migration
6. International trade benefits
7. Basic scientific/technological research and development capabilities
8. Efficacy of domestic institutions

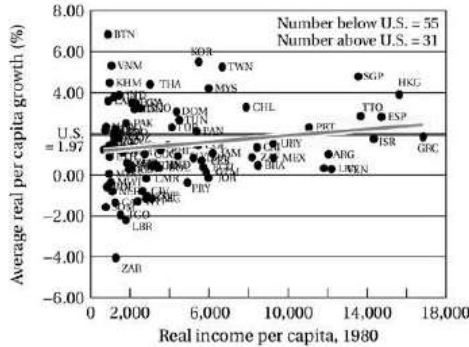
Are Living Standards of Developing and Devolved Nations Converging?

Evidence of unconditional convergence is hard to find. But there is increasing evidence of "per capita income convergence," weighting changes in per capita income by population size

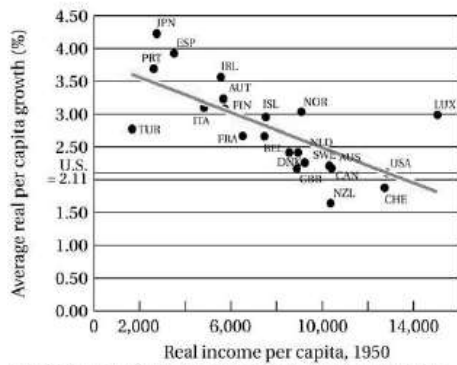
Figure 2.8 Relative Country Convergence: World, Developing Countries, and OECD



(a) Per capita growth 1980–2007 for 157 countries



(b) Per capita growth 1980–2007 for 86 developing countries



(c) Per capita growth 1950–2007 for 22 OECD countries

Figure 2.9 Growth Convergence versus Absolute Income Convergence

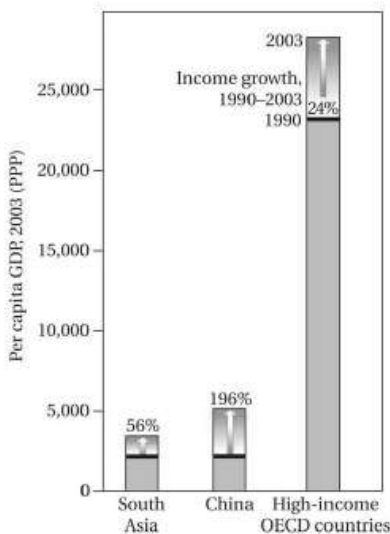
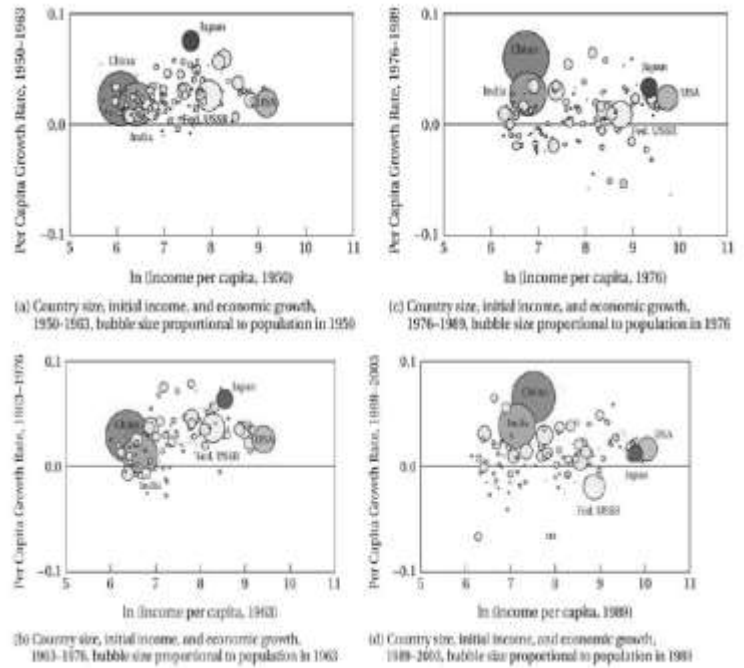


Figure 2.10 Country Size, Initial Income Level, and Economic Growth

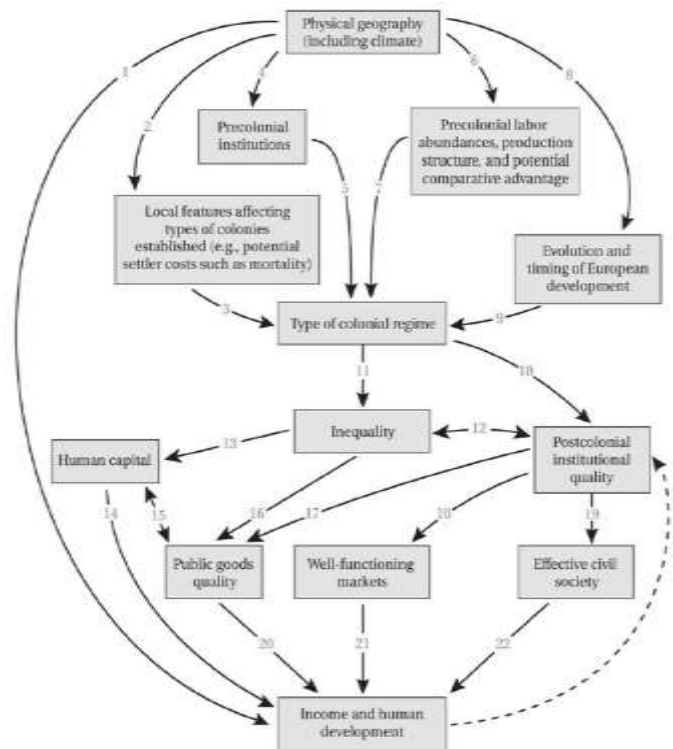


Long-Run Causes of Comparative Development

Schematic Representation

- Geography
- Institutional quality- colonial and post-colonial
- Colonial legacy- pre colonial comparative advantage
- Evolution and timing of European development
- Inequality- human capital
- Type of colonial regime

Figure 2.11 Schematic Representation of Leading Theories of Comparative Development



Nature and Role of Economic Institutions

Institutions provide “rules of the game” of economic life. Provide underpinning of a market economy. Include property rights; contract enforcement. Can work for improving coordination, Restricting coercive, fraudulent and anti-competitive behavior. Providing access to opportunities for the broad population- Constraining the power of elites, and managing conflict. Provision of social insurance. Provision of predictable macroeconomic stability.

CHAPTER 3

CLASSIC THEORIES OF ECONOMIC GROWTH AND DEVELOPMENT

Classic Theories of Economic Development: Four Approaches

1. Linear stages of growth model
2. Theories and Patterns of structural change
3. International-dependence revolution
4. Neoclassical, free market counterrevolution

Development as Growth and Linear- Stages Theories

1. A Classic Statement: Rostow's Stages of Growth
2. Harrod-Domar Growth Model (sometimes referred to as the AK model)

The Harrod-Domar Model

$$S = sY \quad (3.1)$$

$$I = \Delta K \quad (3.2)$$

$$\Delta K = c\Delta Y \quad (3.3)$$

$$S = I \quad (3.4)$$

$$S = sY = c\Delta Y = \Delta K = I \quad (3.5)$$

$$sY = c\Delta Y \quad (3.6)$$

$$\frac{\Delta Y}{Y} = \frac{s}{c} \quad (3.7)$$

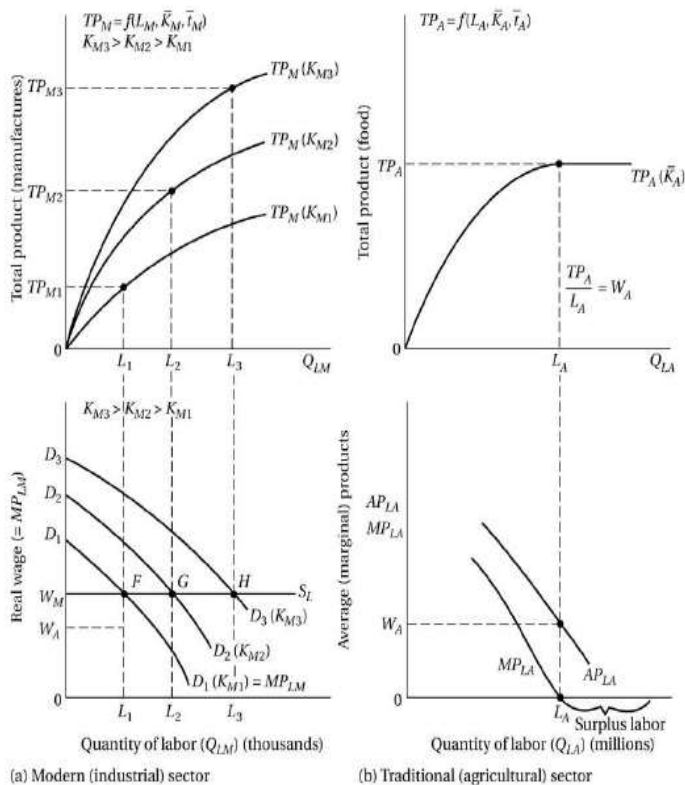
Criticisms of the Stages Model

Necessary versus sufficient conditions

Structural-Change Models

The Lewis two-sector model

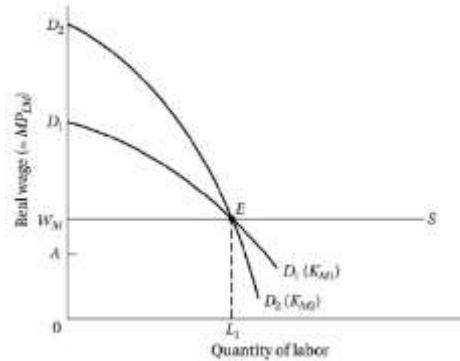
Figure 3.1 The Lewis Model of Modern-Sector Growth in a Two-Sector Surplus-Labor Economy



Criticisms of the Lewis Model

Rate of labor transfer and employment creation may not be proportional to rate of modern-sector capital accumulation. Surplus labor in rural areas and full employment in urban? Institutional factors? Assumption of diminishing returns in modern industrial sector

Figure 3.2 The Lewis Model Modified by Laborsaving Capital Accumulation: Employment Implications



Empirical Patterns of Development - Examples

Switch from agriculture to industry (and services). Rural-urban migration and urbanization. Steady accumulation of physical and human capital. Population growth first increasing and then decreasing with decline in

The International-Dependence Revolution

The neocolonial dependence model
– Legacy of colonialism, Unequal power, Core-periphery

The false-paradigm model

– Pitfalls of using “expert” foreign advisors who misapply developed-country models

The dualistic-development thesis

– Superior and inferior elements can coexist; Prebisch- Singer Hypothesis

Criticisms and limitations

– Does little to show how to achieve development in a positive sense; accumulating counterexamples

The Neoclassical Counterrevolution: Market Fundamentalism

Challenging the Statist Model : Free Markets, Public Choice, and Market-Friendly Approaches

- Free market approach
- Public choice approach
- Market-friendly approach

Main Arguments

- Denies efficiency of intervention
- Points up state owned enterprise failures
- Stresses government failures
- Traditional neoclassical growth theory - with diminishing returns, cannot sustain growth by capital accumulation alone

Classic Theories of Development : Reconciling the Differences

Governments do fail, but so do markets; a balance is needed. Must attend to institutional and political realities in developing world. Development economics has no universally accepted paradigm. Insights and understandings are continually evolving. Each theory has some strengths and some weaknesses

Components of Economic Growth

- Capital Accumulation, investments in physical and human capital, Increase capital stock
- Growth in population and labor force
- Technological progress, Neutral, labor/capital-saving, labor/capital augmenting

Figure A3.1.1 Effect of Increases in Physical and Human Resources on the Production Possibility Frontier

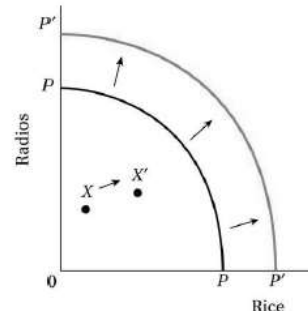


Figure A3.1.2 Effect of Growth of Capital Stock and Land on the Production Possibility Frontier

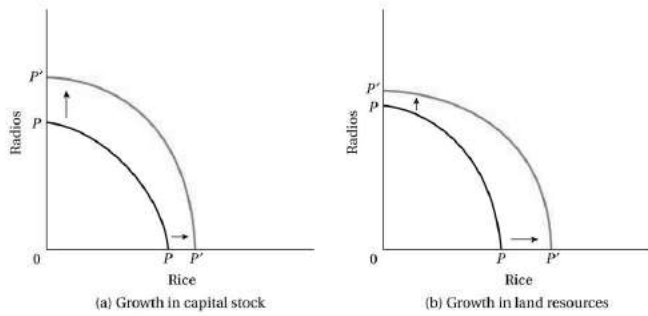


Figure A3.1.3 Effect of Technological Change in the Agricultural Sector on the Production Possibility Frontier

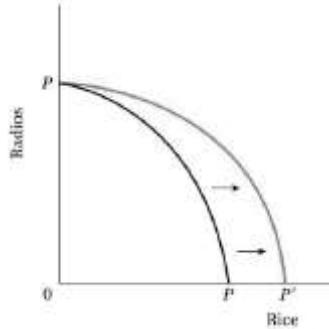


Figure A3.1.4 Effect of Technological Change in the Industrial Sector on the Production Possibility Frontier

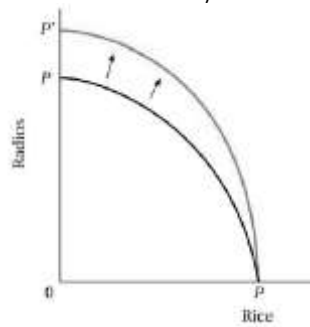


Figure A3.2.1 Equilibrium in the Solow Growth Model

Appendix 3.2: The Solow Neoclassical Growth Model

$$Y(t) = Y(t)^\alpha (A(t)L(t))^{1-\alpha}$$

$$\gamma Y = F(\gamma K, \gamma L)$$

$$Y/L = f(K/L, 1) \text{ or } y = f(k)$$

$$y = Ak^\alpha$$

$$\Delta k = sf(k) - (\delta + n)k$$

$$sf(k^*) = (\delta + n)k^*$$

$$\Delta k = sf(k) - (\delta + n)k \quad (A3.2.4)$$

$$sf(k^*) = (\delta + n)k^* \quad (A3.2.5)$$

Figure A3.2.2 The Long-Run Effect of Changing the Saving Rate in the Solow Model

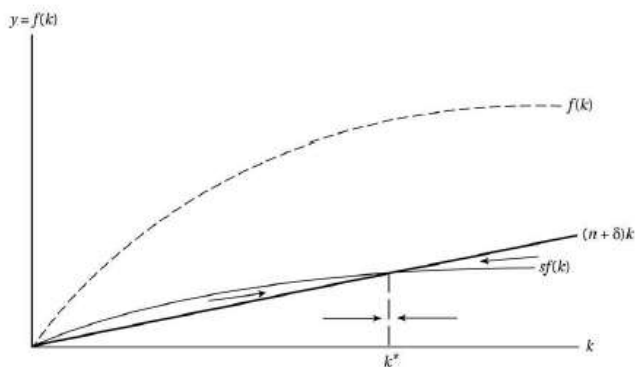
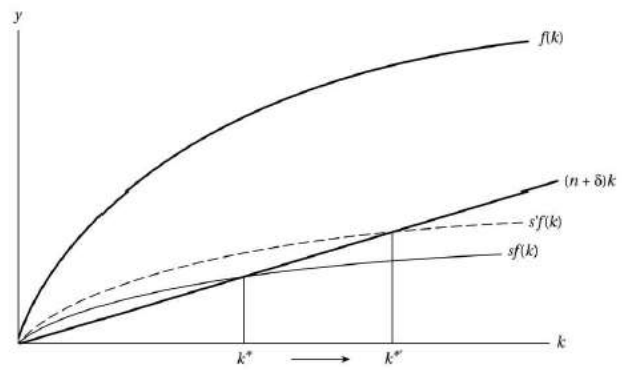


Figure A3.2.2 The Long-Run Effect of Changing the Saving Rate in the Solow Model



Appendix 3.3: Endogenous Growth Theory
 - Motivation for the new growth theory
 - The Romer model

$$Y_t = AK_t^\alpha L_t^{1-\alpha} \bar{K}^\beta$$

$$Y = AK^{\alpha+\beta} L^{1-\alpha}$$

$$g - n = \frac{\beta N}{[1 - \alpha - \beta]}$$

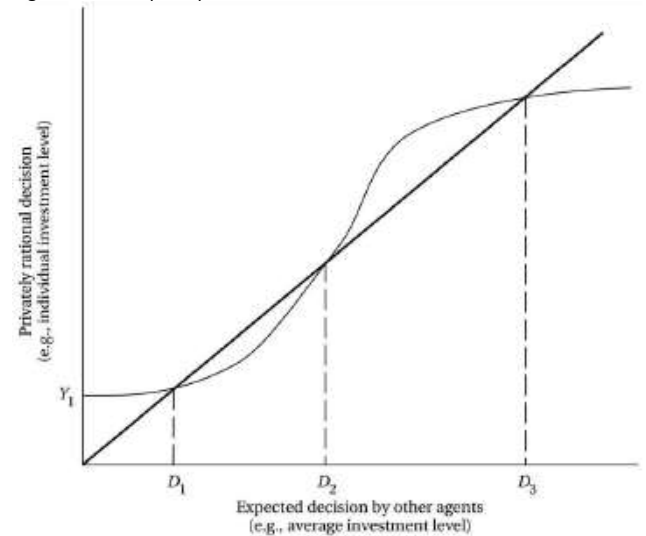
CHAPTER 4
CONTEMPORARY MODELS OF DEVELOPMENT AND UNDERDEVELOPMENT

Underdevelopment as a Coordination Failure
 A newer school of thought on problems of economic development. Coordination failures occur when agents' inability to coordinate their actions leads to an outcome that makes all agents worse off. This can occur when actions are complementary, i.e., Actions taken by one agent reinforces incentives for others to take similar actions

Multiple Equilibria: A Diagrammatic Approach
 Often, these models can be diagrammed by graphing an S-shaped function and the 45° line

Equilibria are
 - Stable: function crosses the 45° line from above
 - Unstable: function crosses the 45° line from below

Figure 4.1 Multiple Equilibria



Starting Economic Development: The Big Push
 Sometimes market failures lead to a need for public policy intervention.

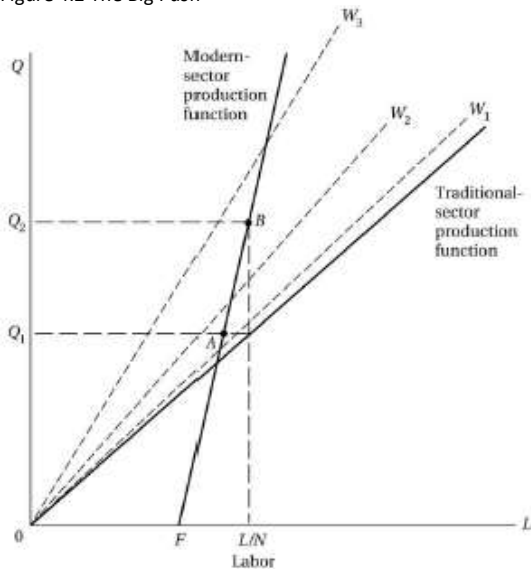
The Big Push: A Graphical Model, 6 assumptions
 - One factor of production
 - Two sectors
 - Same production function for each sector
 - Consumers spend an equal amount on each good

- Closed economy
- Perfect competition with traditional firms operating, limit pricing monopolist with a modern firm operating

Conditions for Multiple Equilibria. A big push may also be necessary when there are:

- Intertemporal effects
- Urbanization effects
- Infrastructure effects
- Training effects

Figure 4.2 The Big Push



Why the Problem Cannot be Solved by a Super-Entrepreneur

- Super Entrepreneur?
- Capital market failures
 - Cost of monitoring managers- Asymmetric Information
 - Communication failures
 - Limits to knowledge
 - Lack of any empirical evidence that would suggest this is possible

In a Nutshell: Big Push Mechanisms

- Raising total demand
- Reducing fixed costs of later entrants
- Redistributing demand to later periods when other industrializing firms sell
- Shifting demand toward manufacturing goods (usually produced in urban areas)
- Help defray costs of essential infrastructure (a similar mechanism can hold when there are costs of training, and other shared intermediate inputs)

Further Problems of Multiple Equilibria

- Inefficient Advantages of Incumbency
- Behavior and Norms
- Linkages
- Inequality, Multiple Equilibria, and Growth

Michael Kremer's O-Ring Theory of Economic Development

- The O-Ring Model
- Production is modeled with strong complementarities among inputs
 - Positive assortative matching in production

Implications of strong complementarities for economic development and the distribution of income across countries

Economic Development as Self- Discovery

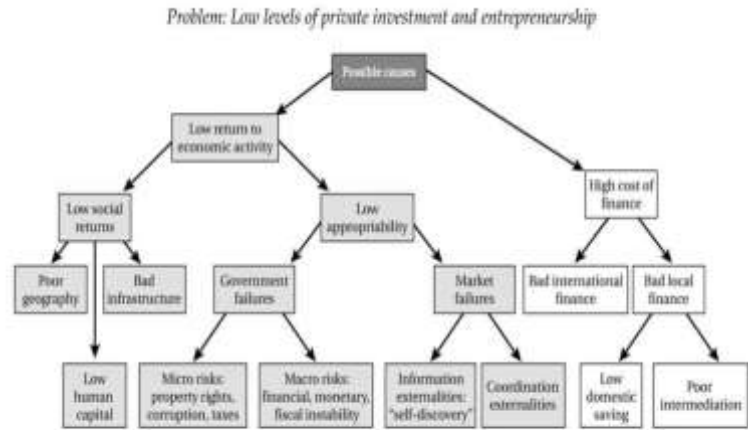
Hausmann and Rodrik: A Problem of Information. Not enough to say developing countries should produce "labor intensive products," because there are thousands of them. Industrial policy may help to identify true direct and indirect domestic costs of potential products to specialize in, by: Encouraging exploration in first stage. Encouraging movement out of inefficient sectors and into more efficient sectors in the second stage

Three building blocks of the theory; and case examples of their reasonableness in practice: Uncertainty about products can produce efficiently (evidence: India's success in information technology was unexpected; reasons for Bangladesh's efficiency in hats vs Pakistan's in bedsheets is not clear). Need for local adaptation (evidence: seen in cases such as shipbuilding in South Korea). Imitation can be rapid (e.g. the spread of cut flower exporting in Colombia)

The Hausmann-Rodrik-Velasco Growth Diagnostics Framework

Focus on a country's most binding. constraints on economic growth. No "one size fits all" in development policy. Requires careful research to determine the most likely binding constraint

Figure 4.3 Hausmann-Rodrik-Velasco Growth Diagnostics Decision Tree



source: Ricardo Hausmann, Dani Rodrik, and Andrés Velasco, "Getting the diagnosis right," *Finance and Development* 3 (2006), available at <http://www.inf.org/external/pubs/ft/fandd/2006/03/hausmann.htm>. Used with permission.

CHAPTER 5

POVERTY, INEQUALITY, AND DEVELOPMENT

Distribution and Development: Seven Critical Questions

1. What is the extent of relative inequality, and how is this related to the extent of poverty?
2. Who are the poor?
3. Who benefits from economic growth?
4. Does rapid growth necessarily cause greater income inequality?
5. Do the poor benefit from growth?
6. Are high levels of inequality always bad?
7. What policies can reduce poverty?

Measuring Inequality and Poverty

- Measuring Inequality
- Size distributions (quintiles, deciles)
 - Lorenz curves
 - Gini coefficients and aggregate measures of inequality
 - Functional distributions

Table 5.1 Typical Size Distribution of Personal Income in a Developing Country by Income Shares—Quintiles and Deciles

Individuals	Personal Income (money units)	Share of Total Income (%)	
		Quintiles	Deciles
1	0.8		
2	1.0		1.8
3	1.4		
4	1.8		
5	1.9	5	3.2
6	2.0		
7	2.4		3.9
8	2.7		
9	2.8	9	5.1
10	3.0		
11	3.4		
12	3.8		
13	4.2	13	7.2
14	4.8		
15	5.9		9.0
16	7.1		
17	10.5	22	13.0
18	12.0		
19	13.5		
20	15.0	51	28.5
Total (national income)	100.0	100	100.0

Figure 5.1 The Lorenz Curve

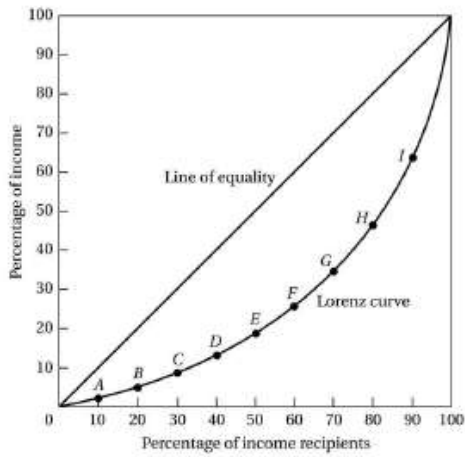


Figure 5.2 The Greater the Curvature of the Lorenz Line, the Greater the Relative Degree of Inequality

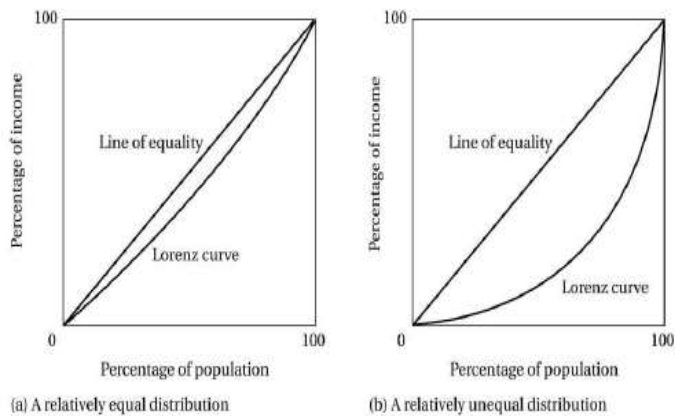


Figure 5.3 Estimating the Gini Coefficient

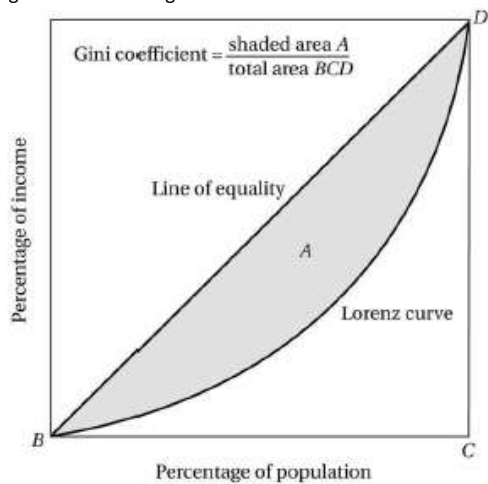


Figure 5.4 Four Possible Lorenz Curves

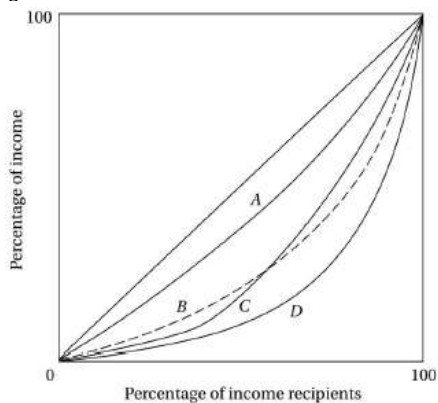
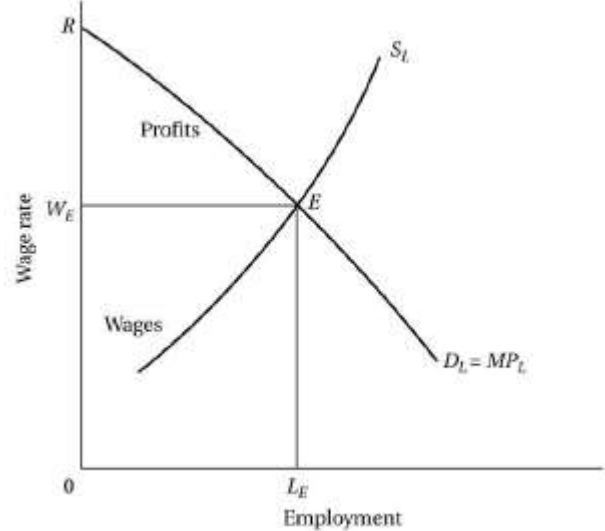


Figure 5.5 Functional Income Distribution in a Market Economy: An Illustration



Measuring Inequality and Poverty

Measuring Absolute Poverty

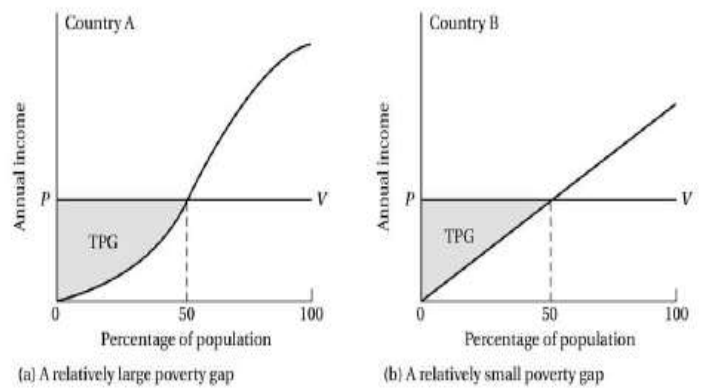
Headcount Index: H/N

Where H is the number of persons who are poor and N is the total number of people in the economy. Total poverty gap:

$$TPG = \sum_{i=1}^H (Y_p - Y_i)$$

Where Y_p is the absolute poverty line; and Y_i the income of the ith poor person

Figure 5.6 Measuring the Total Poverty Gap



Measuring Inequality and Poverty

Measuring Absolute Poverty

Average poverty gap (APG):

$$APG = \frac{TPG}{N}$$

Where N is number of persons in the economy

TPG is total poverty gap

Note: normalized poverty gap, NPG = APG/Y_p

Average income shortfall (AIS):

$$AIS = \frac{TPG}{H}$$

Where H is number of poor persons

TPG is total poverty gap

Note: Normalized income shortfall, NIS =

The Foster-Greer-Thorbecke (FGT) index:

$$P_\alpha = \frac{1}{N} \sum_{i=1}^H \left(\frac{Y_p - Y_i}{Y_p} \right)^\alpha$$

N is the number of persons, H is the number of poor persons, and $\alpha \geq 0$ is a parameter. When $\alpha=0$, we get the headcount index measure. When $\alpha=2$, we get the "P2" measure

The Multidimensional Poverty Index (MPI)

Identification of poverty status through a dual cutoff: First, cutoff levels within each dimension (analogous to falling below a poverty line for example \$1.25 per day for income poverty); Second, cutoff in the number of dimensions in which a person must be deprived (below a line) to be deemed multidimensionally poor. MPI focuses on deprivations in health, education, and standard of living; and each receives equal (that is one-third of the overall total) weight.

MPI Indicators

Health - two indicators with equal weight - whether any child has died in the family, and whether any adult or child in the family is malnourished - weighted equally (each counts as one-sixth toward the maximum deprivation in the MPI)

Education - two indicators with equal weight - whether no household member completed 5 years of schooling, and whether any school-aged child is out of school for grades 1 through 8 (each counts one-sixth toward the MPI).

Standard of Living, equal weight on 6 deprivations (each counts as 1/18 toward the maximum): lack of electricity; insufficiently safe drinking water; inadequate sanitation; inadequate flooring; unimproved cooking fuel; lack of more than one of 5 assets - telephone, radio, TV, bicycle, and motorbike.

Interaction of the deprivations?

Building the index from household measures up to the aggregate measure (rather than using already aggregated statistics), MPI approach takes account of multiplied or interactive harm (complementarity) done when multiple deprivations are experienced by the same individual or family. The MPI approach assumes an individual's lack of capability in one area can only to a degree be made up by other capabilities - capabilities are treated as substitutes up to a point but then as complements.

Computing the MPI

The MPI for the country (or region or group) is then computed. A convenient way to express the resulting value is $H \cdot A$, i.e., The product of the headcount ratio H (the percent of people living in multidimensional poverty), and the average intensity of deprivation A (the percent of weighted indicators for which poor households are deprived on average). The adjusted headcount ratio HA is readily calculated. HA satisfies some desirable properties. Important example - Dimensional monotonicity: If a person already identified as poor becomes deprived in another indicator she is measured as even poorer - not the case using a simple headcount ratio.

Table 5.2 MPI Rankings and Poverty Headcounts for Selected Countries

Country	Year	MPI Value	MPI Rank	Multidimensional Poverty		Income Poverty		Value	Rank	Value	Rank
				H _M (proportion of poor)	A (average intensity of deprivations)	\$1.25 a Day (proportion of poor)	\$2 a Day (proportion of poor)				
Kazakhstan	2006	0.002	7	0.006	0.349	0.001	33	0.172	29		
Thailand	2005	0.006	16	0.015	0.385	0.003	1	0.115	38		
Ecuador	2003	0.009	24	0.022	0.416	0.007	36	0.128	2		
Mexico	2006	0.015	29	0.040	0.389	0.020	1	0.048	39		
Brazil	2003	0.019	39	0.085	0.460	0.052	29	0.127	21		
Colombia	2005	0.041	40	0.092	0.441	0.100	42	0.279	3		
Dominican Republic	2000	0.049	42	0.111	0.433	0.050	28	0.151	2		
China	2003	0.056	44	0.125	0.449	0.159	41	0.363	4		
Viet Nam	2002	0.075	50	0.143	0.525	0.215	30	0.484	51		
Indonesia	2007	0.085	53	0.208	0.459	0.075	31	0.490	52		
Ghana	2008	0.140	57	0.381	0.464	0.300	57	0.536	9		
Zimbabwe	2006	0.174	60	0.385	0.452						
Bolivia	2003	0.175	61	0.363	0.483	0.196	46	0.308	38		
Nicaragua	2001	0.211	64	0.407	0.519	0.158	40	0.318	40		
Lao	2006	0.267	68	0.472	0.565	0.440	46	0.768	71		
Pakistan	2007	0.275	70	0.520	0.540	0.226	53	0.680	59		
Yemen	2006	0.283	71	0.525	0.539	0.175	43	0.666	49		
Bangladesh	2007	0.291	73	0.578	0.504	0.406	71	0.813	60		
India	2005	0.284	74	0.534	0.535	0.416	64	0.756	70		
Kenya	2003	0.302	76	0.604	0.500	0.197	47	0.399	4		
Haiti	2006	0.306	77	0.571	0.533	0.549	76	0.721	67		
Cote d'Ivoire	2005	0.320	78	0.522	0.614	0.213	55	0.468	34		
Nepal	2006	0.360	82	0.647	0.540	0.551	77	0.776	70		
Tanzania	2008	0.367	84	0.663	0.563	0.885	93	0.966	91		
DR Congo	2007	0.393	86	0.712	0.537	0.582	79	0.795	77		
Madagascar	2004	0.413	91	0.705	0.585	0.678	86	0.896	86		
Angola	2001	0.462	95	0.774	0.584	0.543	89	0.900	88		
Ethiopia	2005	0.582	105	0.900	0.647	0.580	62	0.775	71		
Niger	2006	0.642	104	0.927	0.693	0.659	85	0.856	84		

1-126

Multidimensional poverty tells a different story than income poverty

The results showed that knowing income poverty is not enough if our concern is with multidimensional poverty. Multidimensionally, Bangladesh is substantially less poor - ut Pakistan substantially poorer - than would be predicted by income poverty. Ethiopia is far more multidimensionally poor, and Tanzania much less so, than predicted by income poverty. Most Latin American countries e.g. Brazil rank worse on multidimensional poverty than on income poverty; but Colombia's income and MPI poverty ranks are about same.

Poverty, Inequality, and Social Welfare

What's So Bad about Extreme Inequality? Dualistic Development and Shifting Lorenz Curves: Some Stylized Typologies

- Traditional sector enrichment (see Figure 5.7)

- Modern sector enrichment (see Figure 5.8)

- Modern sector enlargement (see Figure 5.9)

Figure 5.7 Improved Income Distribution under the Traditional-Sector Enrichment Growth Typology

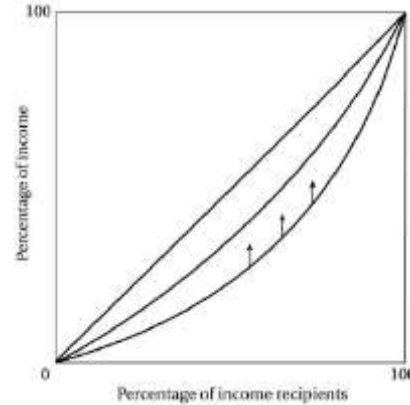


Figure 5.8 Worsened Income Distribution under the Modern-Sector Enrichment Growth Typology

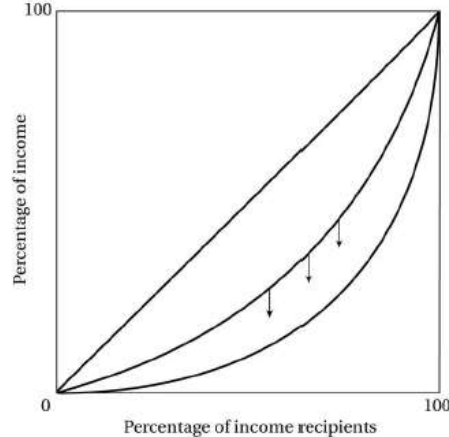
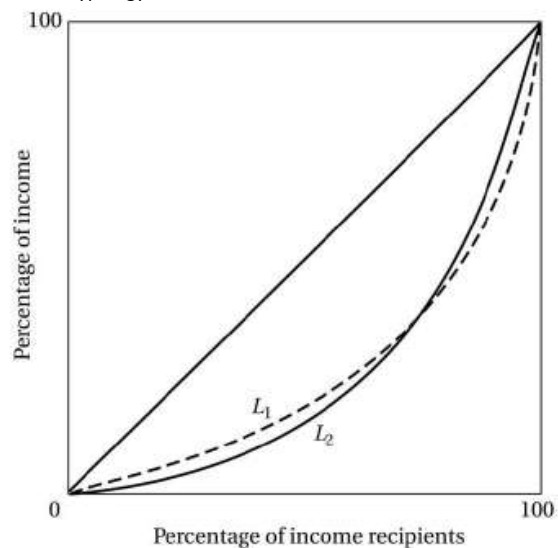


Figure 5.9 Crossing Lorenz Curves in the Modern-Sector Enlargement Growth Typology



Poverty, Inequality, and Social Welfare

Kuznets' Inverted-U Hypothesis

Figure 5.10 The "Inverted-U" Kuznets Curve

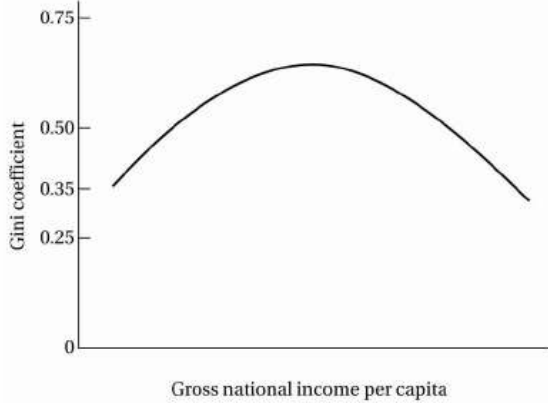


Table 5.3 Selected Income Distribution Estimates

Country	Lowest 10%	Quintile					Highest 10%	Year
		1st	2nd	3rd	4th	5th		
Bangladesh	4.3	9.4	12.6	16.1	21.1	40.8	26.6	2005
Brazil	1.1	3.0	6.9	11.8	19.6	58.7	43.0	2007
China	2.4	5.7	9.8	14.7	22.0	47.8	31.4	2005
Colombia	0.8	2.3	6.0	11.0	19.1	61.6	45.9	2006
Costa Rica	1.6	4.4	8.5	12.7	19.7	54.6	38.6	2007
Guatemala	1.3	3.4	7.2	12.0	19.5	57.8	42.4	2006
Honduras	0.7	2.5	6.7	12.1	20.4	58.4	42.2	2006
India	3.6	8.1	11.3	14.9	20.4	45.3	31.1	2005
Jamaica	2.1	5.2	9.0	13.8	20.9	51.2	35.6	2004
Namibia	0.6	1.5	2.8	5.5	12.0	78.3	65.0	1993
Pakistan	3.9	9.1	12.8	16.3	21.3	40.5	26.5	2005
Peru	1.3	3.6	7.8	13.0	20.8	54.8	38.4	2007
Philippines	2.4	5.6	9.1	13.7	21.2	50.4	33.9	2006
South Africa	1.3	3.1	5.6	9.9	18.8	62.7	44.9	2000
Tanzania	3.1	7.3	11.8	16.3	22.3	42.3	27.0	2001
Zambia	1.3	3.6	7.8	12.8	20.6	55.2	38.9	2005
Japan	4.8	10.6	14.2	17.6	22.0	35.7	21.7	1993
United States	1.9	5.4	10.7	15.7	22.4	45.8	29.9	2000

Table 5.4 Income and Inequality in Selected Countries

Country	Income Per Capita (U.S. \$, 2008)	Gini Coefficient	Survey Year for Gini Calculation
Low Income			
Ethiopia	280	29.8	2005
Mozambique	380	47.1	2003
Nepal	400	47.3	2004
Cambodia	640	40.7	2007
Zambia	950	50.7	2005
Lower Middle Income			
India	1,040	36.8	2005
Cameroon	1,150	44.6	2001
Bolivia	1,460	57.2	2007
Egypt	1,800	32.1	2005
Indonesia	1,880	37.6	2007
Upper Middle Income			
Namibia	4,210	74.3	1993
Bulgaria	5,490	29.2	2003
South Africa	5,820	57.8	2000
Argentina	7,190	48.8	2006
Brazil	7,300	55.0	2007
Mexico	9,990	51.6	2008
Upper Income			
Hungary	12,810	30.0	2004
Spain	31,930	34.7	2000
Germany	42,710	28.3	2000
United States	47,930	40.8	2000
Norway	87,340	25.8	2000

Figure 5.11 Kuznets Curve with Latin American Countries Identified

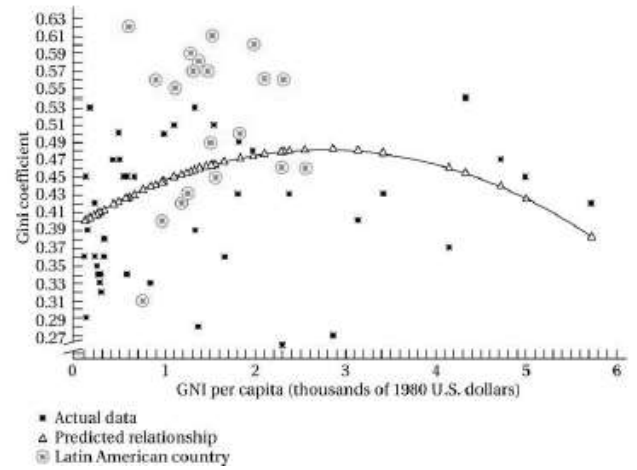
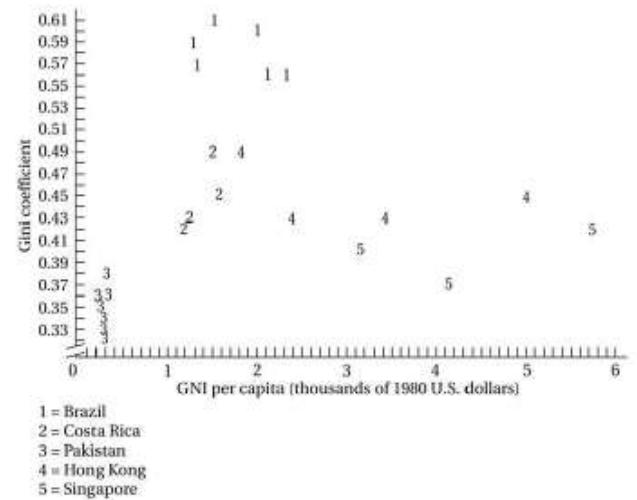


Figure 5.12 Plot of Inequality Data for Selected Countries



5.3 Absolute Poverty: Extent and Magnitude

Progress on Extreme Poverty

- Clear progress on \$1.25-a-day headcount
- Less clear progress on \$2.00-per-day headcount (see Figure 5.14)
- Incidence of extreme poverty is uneven

Relationship between Growth and Poverty

- Association between growth and poverty reduction
- When it is inclusive, growth reduces poverty
- Lower extreme poverty may also lead to higher growth

Figure 5.13 Long-Term Economic Growth and Income Inequality

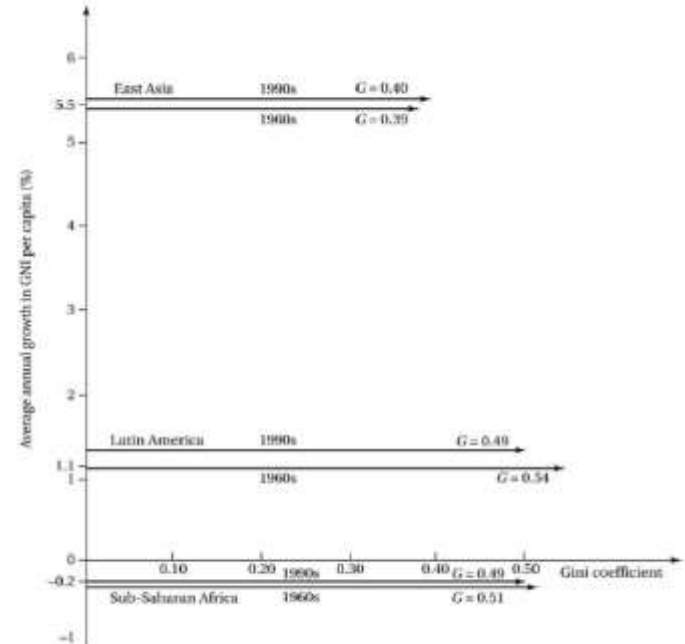
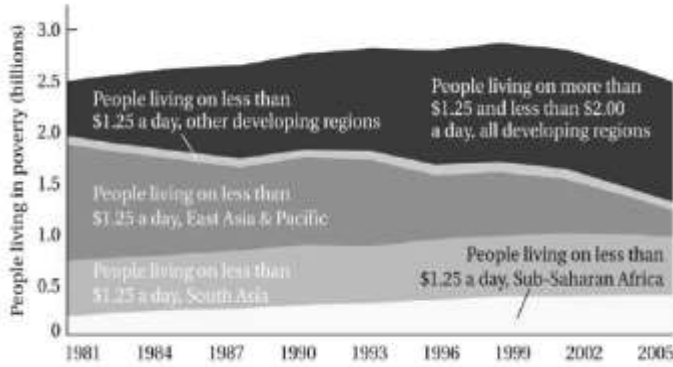


Figure 5.14 Global and Regional Poverty Trends

CHAPTER 6

POPULATION GROWTH AND ECONOMIC DEVELOPMENT : CAUSES, CONSEQUENCES, AND CONTROVERSIES



Economic Characteristics of High-Poverty Groups

- Rural poverty
- Women and poverty
- Ethnic minorities, indigenous populations, and poverty

Policy Options on Income Inequality and Poverty: Some Basic Considerations

Areas of Intervention

- Altering the functional distribution
- Mitigating the size distribution
- Moderating (reducing) the size distribution at upper levels
- Moderating (increasing) the size distribution at lower levels

Policy options

- Changing relative factor prices
- Progressive redistribution of asset ownership
- Progressive taxation
- Transfer payments and public provision of goods and services

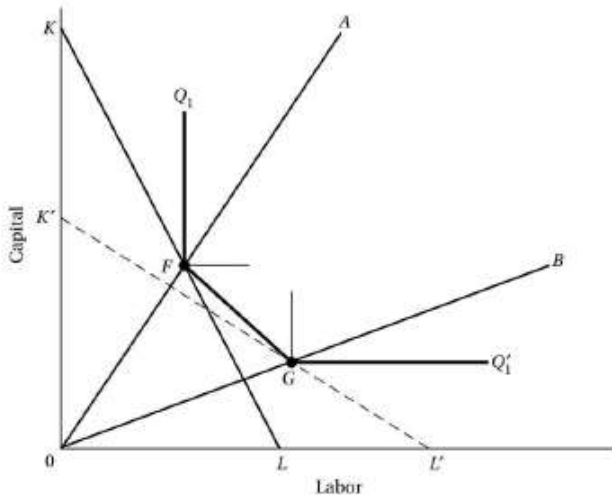
Summary and Conclusions: The Need for a Package of Policies

1. Policies to correct factor price distortions
2. Policies to change the distribution of assets, power, and access to education and associated employment opportunities
3. Policies of progressive taxation and directed transfer payments
4. Policies designed to build capabilities and human and social capital of the poor

Appropriate Technology and Employment Generation: The Price Incentive Model

- Choice of techniques
- Factor Price distortions and appropriate technology
- Possibilities of Labor-Capital substitution

Figure A5.1.1 Choice of Techniques: The Price Incentive Model



The Ahluwalia-Chenery Welfare Index

Constructing poverty-weighted index of social welfare

The Basic Issue: Population Growth and Quality of Life

Six major issues:

1. Will developing countries be able to improve levels of living given anticipated population growth?
2. How will developing countries deal with the vast increases in their labor forces?
3. How will higher population growth rates affect poverty?
4. Will developing countries be able to extend the coverage and improve the quality of health care and education in the face of rapid population growth?
5. Is there a relationship between poverty and family size?
6. How does affluence in the developed world affect the ability of developing countries to provide for their people?

Figure 6.1 World Population Growth, 1750- 2050

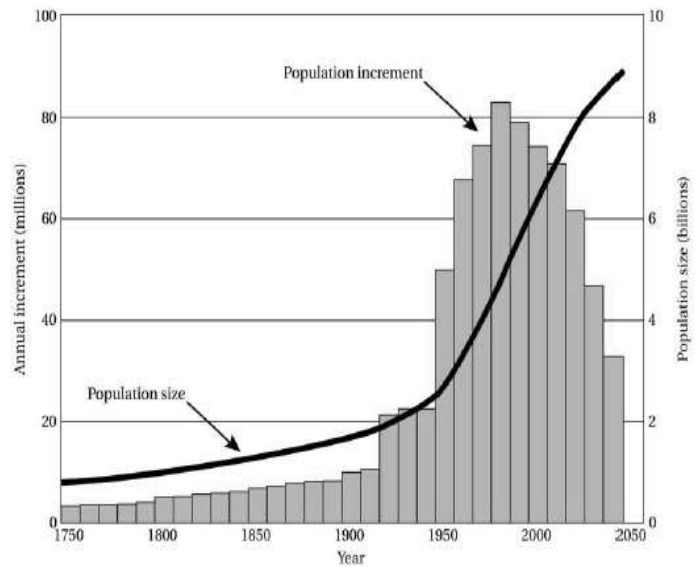
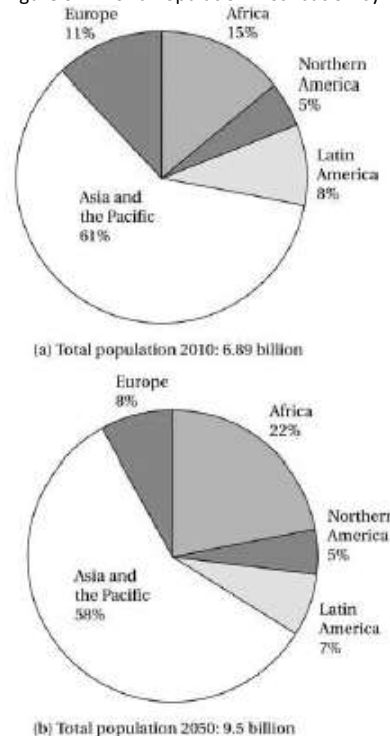


Figure 6.2 World Population Distribution by Region, 2010 and 2050



Population Growth: Past, Present, and Future

- Structure of the world's population
- Geographic region
- Fertility and Mortality Trends
- Rate of population increase
- Birth rates, death rates, Total fertility rates
- Age Structure and dependency burdens

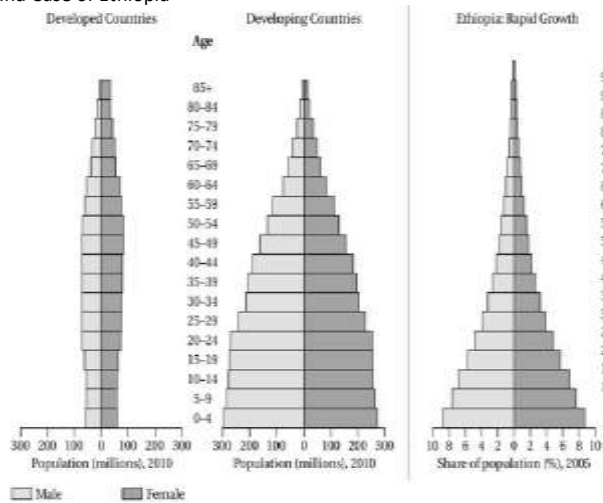
Table 6.3 Fertility Rate for Selected Countries, 1970 and 2009

Country	Total Fertility Rate ^a	
	1970	2009
Bangladesh	7.0	2.3
Colombia	5.3	2.5
Indonesia	5.5	2.4
Jamaica	5.3	2.4
Mexico	4.9	2.3
Thailand	5.5	1.8
Zimbabwe	7.7	3.9

The Hidden Momentum of Population Growth

- High birth rates cannot be altered overnight
- Age structure of developing country populations

Figure 6.4 Population Pyramids: All Developed and Developing Countries and Case of Ethiopia



The Demographic Transition

- Stage I: High birthrates and death rates
- Stage II: Continued high birthrates, declining death rates
- Stage III: Falling birthrates and death rates, eventually stabilizing

Figure 6.5 The Demographic Transition in Western Europe

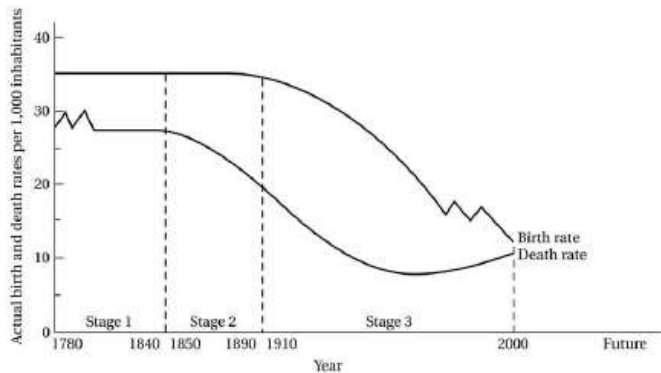
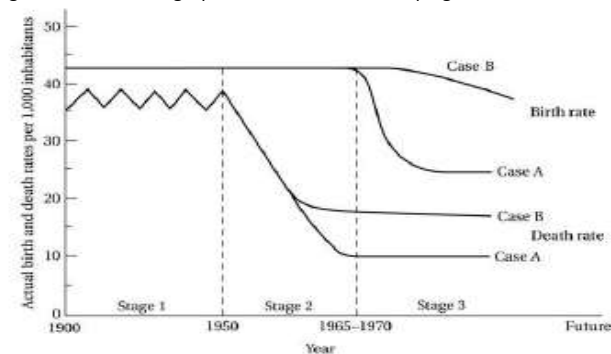


Figure 6.6 The Demographic Transition in Developing Countries

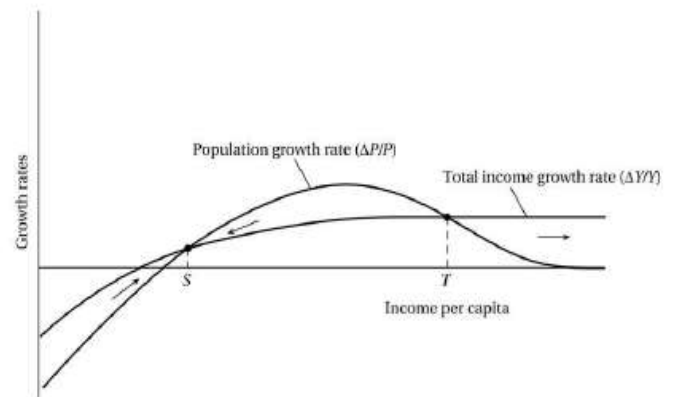


The Causes of High Fertility in Developing Countries: The Malthusian and Household Models

The Malthusian Population Trap

The idea that rising population and diminishing returns to fixed factors result in a low levels of living (population trap)

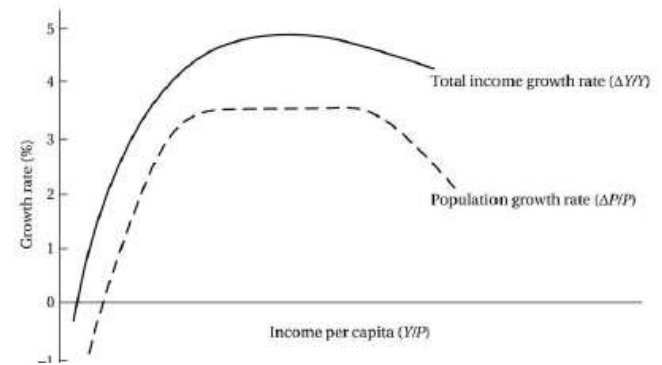
Figure 6.7 The Malthusian Population Trap



Criticisms of the Malthusian Model

- Impact of technological progress
- Currently no positive correlation between population growth and levels of per capita income in the data
- Microeconomics of family size; individual and not aggregate variables

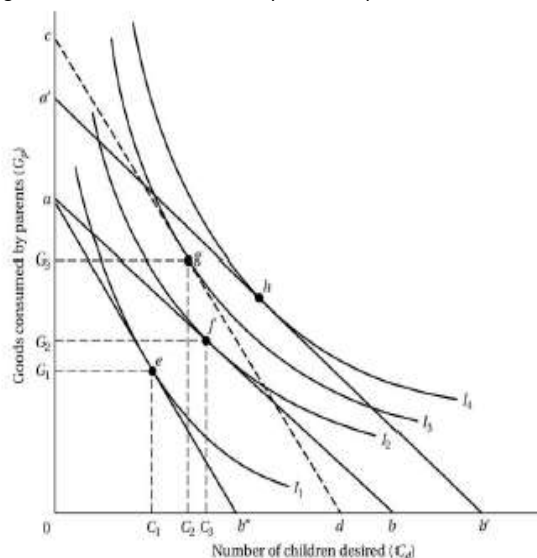
Figure 6.8 How Technological and Social Progress Allows Nations to Avoid the Population Trap



The Microeconomic Household Theory of Fertility. The Demand for Children in Developing Countries

- First two or three as "consumer goods"
- Additional children as "investment goods":
- Work on family farm, microenterprise
- Old age security motivation

Figure 6.9 Microeconomic Theory of Fertility: An Illustration



Demand for Children Equation

$$C_d = f(Y, P_c, P_x, t_x), x = 1, \dots, n$$

Where

- C_d is the demand for surviving children
- Y is the level of household income
- P_c is the "net" price of children
- P_x is price of all other goods
- t_x is the tastes for goods relative to children

Demand for Children Equation

$$C_d = f(Y, P_c, P_x, t_x), x = 1, \dots, n$$

Under neoclassical conditions, we would expect:

$$\frac{\partial C_d}{\partial Y} > 0 \quad \frac{\partial C_d}{\partial P_x} > 0$$

$$\frac{\partial C_d}{\partial P_c} < 0 \quad \frac{\partial C_d}{\partial t_x} < 0$$

Some empirical evidence Implications. Fertility lower if

- Raise women's education, role, and status
- More female nonagricultural wage employment
- Rise in family income levels
- Reduction in infant mortality
- Development of old-age and social security
- Expanded schooling opportunities

The Consequences of High Fertility: Some Conflicting Perspectives

Population growth: "It's Not a Real Problem": The real problem is not population growth but the following,

1. Underdevelopment
2. World resource depletion and environmental destruction
3. Population Distribution
4. Subordination of women

Overpopulation is a Deliberately Contrived False Issue. Population Growth is a Desirable Phenomenon.

"Population Growth Is a Real Problem"

- Extremist arguments
- Theoretical arguments
- Empirical arguments
 1. Lower economic growth
 2. Poverty
 3. Adverse impact on education
 4. Adverse impact on health
 5. Food issues
 6. Impact on the environment
 7. Frictions over international migration

Goals and Objectives: Toward a Consensus

Despite the conflicting opinions, there is some common ground on the following:

- Population is not the primary cause of lower living levels, but may be one factor
- Population growth is more a consequence than a cause of underdevelopment
- It's not numbers but quality of life
- Market failures: potential negative social externalities
- Voluntary decreases in fertility is generally desirable for most developing countries with still-expanding populations

Some Policy Approaches

- Attend to underlying socioeconomic conditions that impact development
- Family planning programs should provide education and technological means to regulate fertility
- Developed countries have responsibilities too

What Developing Countries Can Do

- Persuasion through education
- Family planning programs
- Address incentives and disincentives for having children through the principal variables influencing the demand for children
- Coercion is not a good option
- Raise the socioeconomic status of women
- Increase employment opportunities for women (increases opportunity cost of having more children, as in microeconomic household theory)
- Address resources use inequities
- More open migration policies

How Developed Countries Can Help Developing Countries with Their Population Programs

- Research into technology of fertility control
- Financial assistance for family planning programs

CHAPTER 7

URBANIZATION AND RURAL URBAN MIGRATION : THEORY AND POLICY

The Migration and Urbanization Dilemma

As a pattern of development, the more developed the economy, the more Urbanized . But many argue developing countries are often excessively urbanized or toorapidly urbanizing. This combination suggests the migration and urbanization dilemma. Urbanization: Trends and Projections

Figure 7.1 Urban Population and Per Capita Income across Selected Countries

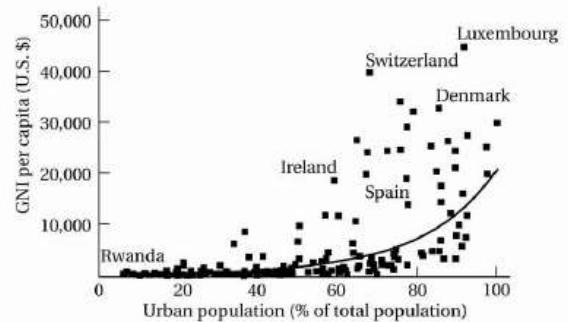


Figure 7.2 Urbanization across Time and Income Levels

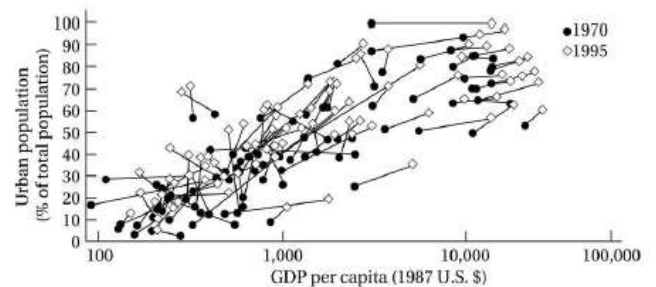


Figure 7.3 Proportion of Urban Population by Region, 1950-2050

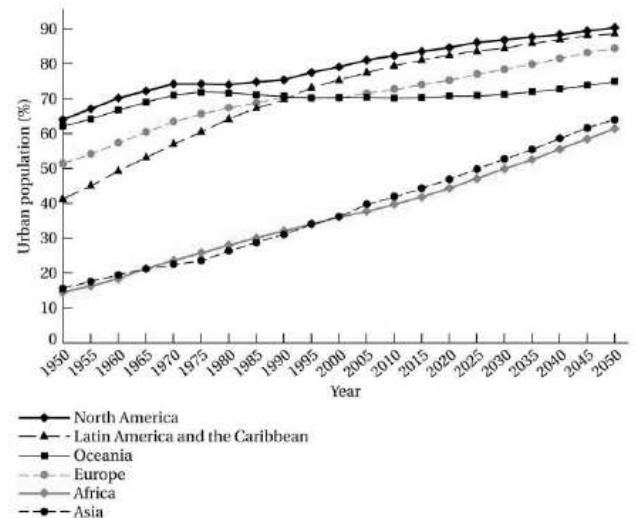
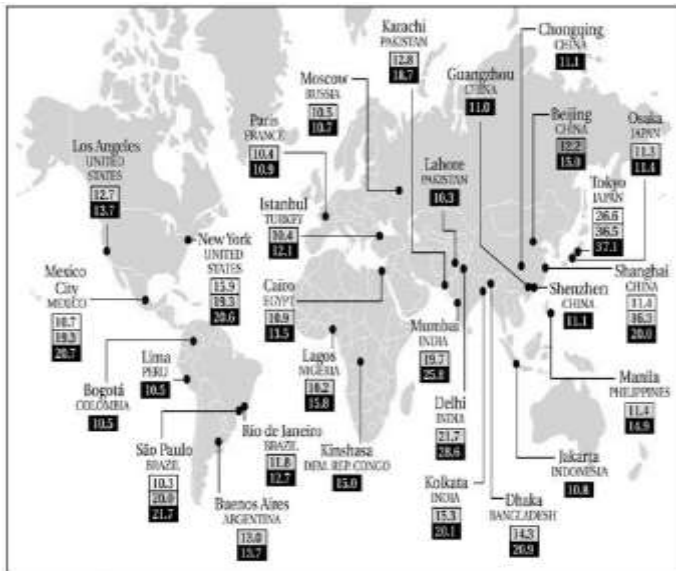


Figure 7.4 Megacities: Cities with Ten Million or More Inhabitants



Population in millions

Figure 7.5 Estimated and Projected Urban and Rural Population of the More and Less Developed Regions, 1950-2050

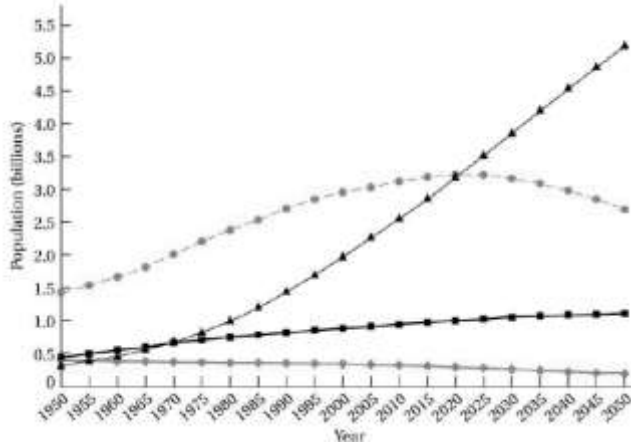
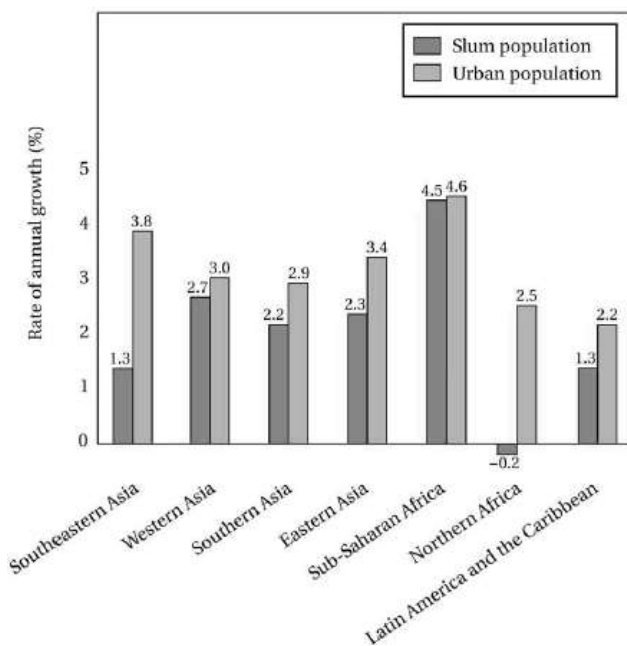


Figure 7.6 Annual Growth of Urban and Slum Populations, 1990-2001



The Role of Cities

Agglomeration economies: Urbanization (general) economies, localization (industry or sector) economies. Saving on firm-to-firm, firm-to-consumer transportation. Firms locating near workers with skills they need. Workers locating near firms that need their skills. Firms benefit from (perhaps specialized) infrastructure. Firms benefit from knowledge spillovers in their and related industries. (Also: consumers may benefit from urban amenities)

Industrial Districts and Clustering

Quality of clusters, or Industrial Districts, is a key to sectoral efficiency. Unfortunately a majority of developing countries have made only limited progress. China: a country that has made huge strides in generating industrial districts over the last decade (Findings Box 7.1)

Urbanization Costs, and Efficient Urban Scale

But, cities also entail "congestion costs". Economically efficient urban scale (from point of view of productive efficiency) found were average costs for industries are lowest. Generally, differing efficient scales for different industrial specializations imply different city sizes. More extensive (expensive) capital, infrastructure required in urban areas. Smaller cities may be expected in labor-intensive developing countries

The Urban Giantism Problem

There may be general urban bias. Cities are capital intensive so may expect large cities commonly located in developed countries. But urbanization in developing countries has taken place at unexpectedly rapid pace. Huge informal sectors in shantytowns, favelas. Large fraction of workers outside formal sector. Much urban growth is in mid-size cities, but urban bias remains a serious issue in many developing countries

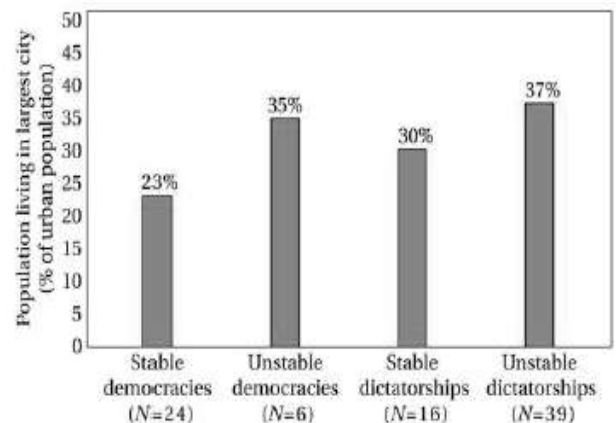
Causes of Urban Giantism:

- Import substitution industrialization: less trade, incentive to concentrate in a single city largely to avoid transportation costs
- "Bread and circuses" to prevent unrest (evidence: stable democracies vs unstable dictatorships)
- Hub and spoke transportation system (rather than web) makes transport costs high for small cities
- Compounding effect of locating the national capital in the largest city

Table 7.1 Population of the Largest and Second- Largest Cities in Selected Countries (millions)

Country	Largest-City Population	Second-Largest-City Population	Ratio
Canada	Toronto, 5.035	Montreal, 3.603	1.40
United States	New York, 18.727	Los Angeles, 12.303	1.52
Argentina	Buenos Aires, 12.551	Cordoba, 1.423	8.82
Brazil	São Paulo, 18.647	Rio de Janeiro, 11.368	1.64
Chile	Santiago, 5.605	Valparaiso, 0.837	6.70
Mexico	Mexico City, 18.735	Guadalajara, 4.057	4.62
Peru	Lima, 8.081	Arequipa, 0.732	11.04

Figure 7.7 Politics and Urban Concentration

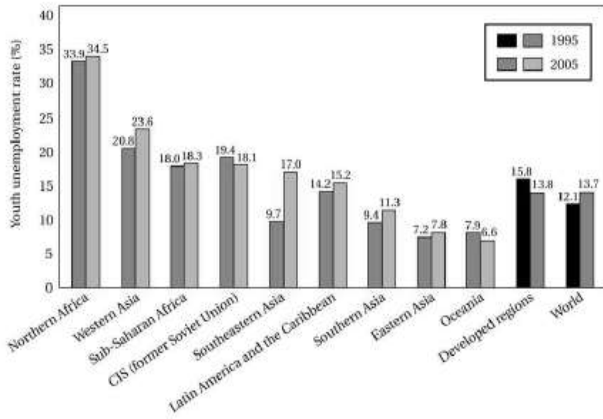


The Urban Informal Sector

Why promote the urban informal sector?

- Generates surplus despite hostile environment
- Creating jobs due to low capital intensity
- Access to (informal) training, and apprenticeships
- Creates demand for less- or un- skilled workers
- Uses appropriate technologies, local resources
- Recycling of waste materials
- More benefits to poor, especially women who are concentrated in the informal sector

Figure 7.8 Importance of Informal Employment in Selected Cities



Migration and Development

Rural-to-urban migration was viewed positively until recently. The current view is that this migration is greater than the urban areas' abilities to

- Create jobs
- Provide social services

Toward an Economic Theory of Rural-Urban Migration

A Verbal Description of the Todaro Model

- Migration is a rational decision
- The decision depends on expected rather than actual wage differentials
- The probability of obtaining a city job is inversely related to the urban unemployment rate
- High rates of migration are outcomes of rural urban imbalances

A Diagrammatic Presentation

Figure 7.11 Schematic Framework for Analyzing the Rural-to-Urban Migration Decision



Figure 7.10 Components of Migration in Selected Countries

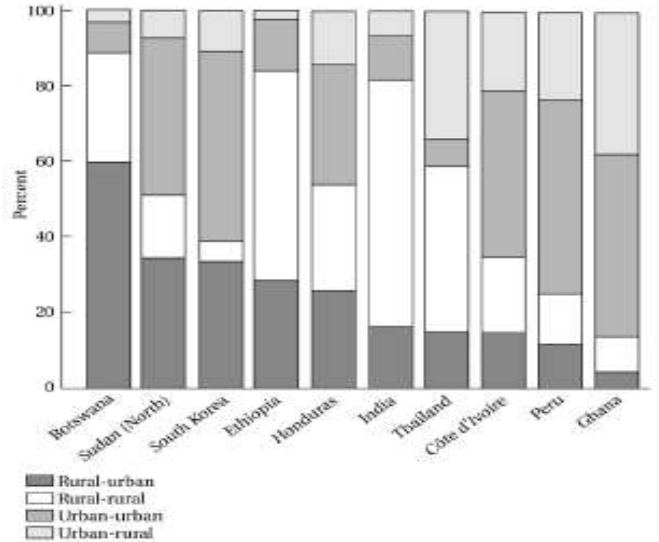
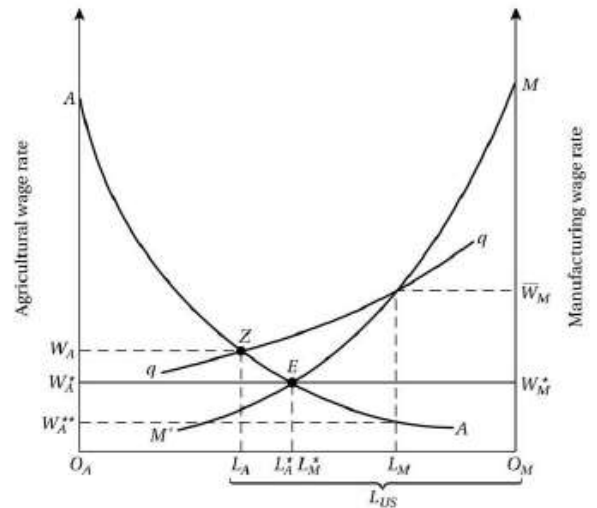


Figure 7.12 The Harris-Todaro Migration Model



Toward an Economic Theory of Rural- Urban Migration

$$W_A = \frac{L_M}{L_{US}} (\bar{W}_M)$$

Where

- W_A is agricultural income.
- L_M is employment in manufacturing
- L_{US} is total urban labor pool
- \bar{W}_M is the urban minimum wage

Five Policy Implications

1. Reduction of urban bias
2. Imbalances in expected income opportunities is crucial
3. Indiscriminate educational expansion fosters increased migration and unemployment
4. Wage subsidies and scarcity factor pricing can be counterproductive
5. Programs of integrated rural development should be encouraged

Summary and Conclusions: A Comprehensive Migration and Employment Strategy

1. Create a urban-rural balance
2. Expand small-scale, labor intensive industries
3. Eliminate factor price distortions
4. Choose appropriate labor-intensive technologies of production
5. Modify the linkage between education and employment
6. Reduce population growth
7. Decentralize authority to cities and neighborhoods

CHAPTER 8

HUMAN CAPITAL : EDUCATION AND HEALTH IN ECONOMIC DEVELOPMENT

The Central Roles of Education and Health

Health and education are important objectives of development, as reflected in Amartya Sen's capability approach, and in the core values of economic development. Health and education are also important components of growth and development – inputs in the aggregate production function

Education and Health as Joint Investments for Development

These are investments in the same individual. Greater health capital may improve the returns to investments in education

- Health is a factor in school attendance
- Healthier students learn more effectively
- A longer life raises the rate of return to education
- Healthier people have lower depreciation of education capital

Greater education capital may improve the returns to investments in health

- Public health programs need knowledge learned in school
- Basic hygiene and sanitation may be taught in school
- Education needed in training of health personnel

Improving Health and Education: Why Increasing Incomes Is Not Sufficient

Increases in income often do not lead to substantial increases in investment in children's education and health. But better educated mothers tend to have healthier children at any income level. Significant market failures in education and health require policy action

Investing in Education and Health: The Human Capital Approach

Initial investments in health or education lead to a stream of higher future income. The present discounted value of this stream of future income is compared to the costs of the investment. Private returns to education are high, and may be higher than social returns, especially at higher educational levels

Figure 8.1 Age-Earnings Profiles by Level of Education: Venezuela

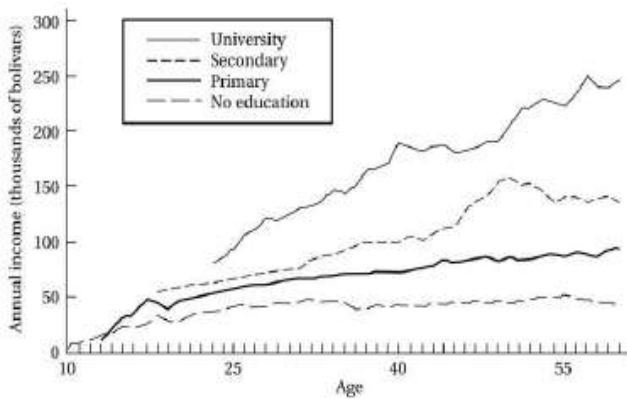


Figure 8.2 Financial Trade-Offs in the Decision to Continue in School

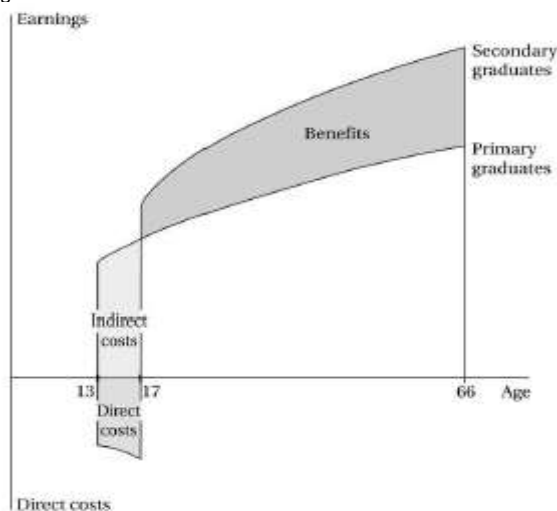


Table 8.1 Sample Rates of Return to Investment in Education by Level of Education, Country, Type, and Region

Country Type and Region	Social Rate of Return (%)			Private Rate of Return (%)		
	Primary	Secondary	Higher	Primary	Secondary	Higher
Developing						
Sub-Saharan Africa	24	18	11	41	27	28
Asia	20	13	12	39	19	20
Latin America	18	13	12	26	17	20
Developed	14	10	9	22	12	12

Child Labor

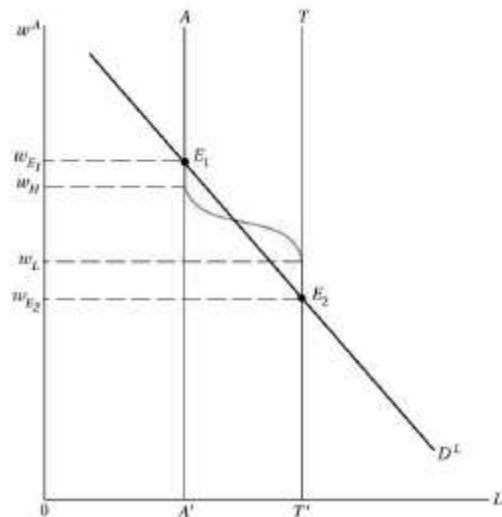
Child labor is a widespread phenomenon. The problem may be modeled using the "multiple equilibria" approach. Government intervention may be called for to move to a 'better' equilibrium. Sometimes this shift can be self-enforcing, so active intervention is only needed at first.

Assumptions of the Child Labor Multiple Equilibria Model

- Luxury Axiom: A household with sufficiently high income would not send its children to work.
- Substitution Axiom: Adult and child labor are substitutes (perfect substitutes in this model), in which the quantity of output by a child is a given fraction of that of an adult:

$$QC = \gamma QA, 0 < \gamma < 1.$$

Figure 8.3 Child Labor as a Bad Equilibrium



Other approaches to child labor policy

1. Get more children into school (as in Millennium Development Goals), e.g. new village schools; and enrollment incentives for parents such as in Progresa/ Oportunidades
2. Consider child labor an expression of poverty, so emphasize ending poverty generally (a traditional World Bank approach, now modified)
3. If child labor is inevitable in the short run, regulate it to prevent abuse and provide support services for working children (UNICEF approach)
4. Ban child labor; or if impossible, ban child labor in its most abusive forms (ILO strategy; "Worst Forms of Child Labor Convention")
5. Activist approach: trade sanctions. Concerns: could backfire when children shift to informal sector; and if modern sector growth slows

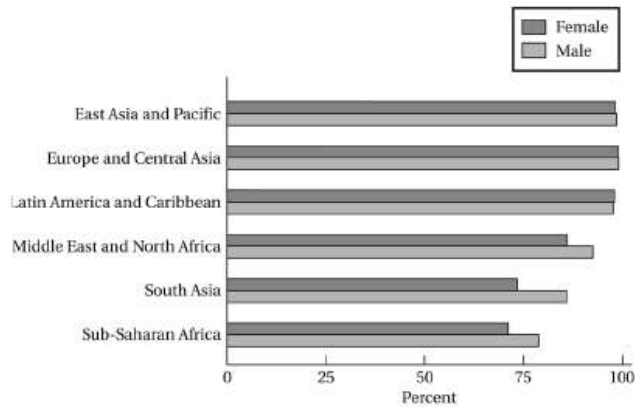
The Gender Gap: Discrimination in Education and Health

Young females receive less education than young males in nearly every low and lower-middle income developing country

Closing the educational gender gap is important because:

- The social rate of return on women's education is higher than that of men in developing countries
- Education for women increases productivity, lowers fertility
- Educated mothers have a multiplier impact on future generations
- Education can break the vicious cycle of poverty and inadequate schooling for women
- Good news: Millennium Development Goals on parity being approached, progress in every developing region

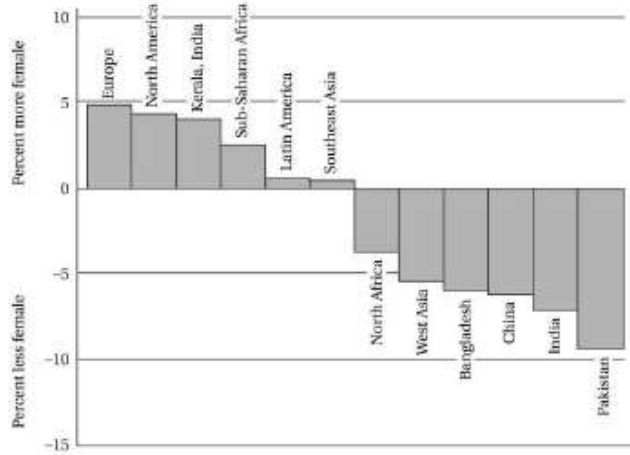
Figure 8.4 Youth Literacy Rate, 2008



Consequences of gender bias in health and education
 – Economic incentives and their cultural setting
 – “Missing Women” mystery in Asia

Increase in family income does not always lead to better health and education

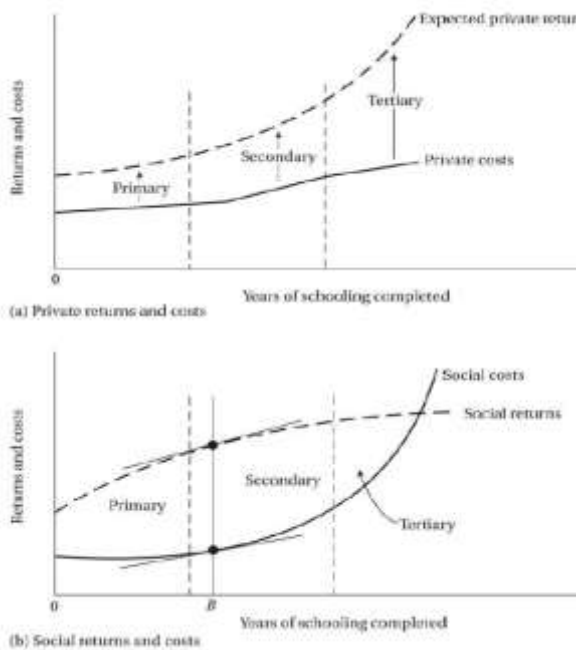
Figure 8.5 Female-Male Ratios in Total Population in Selected Communities



Educational Systems and Development

The Political Economy of Educational Supply and Demand: The Relationship between Employment Opportunities and Educational Demands. Social versus Private Benefits and Costs

Figure 8.6 Private versus Social Benefits and Costs of Education: An Illustration



Educational Systems and Development

Distribution of Education, Lorenz curves for the distribution of education. Education, Inequality, and Poverty

Figure 8.7 Lorenz Curves for Education in India and South Korea

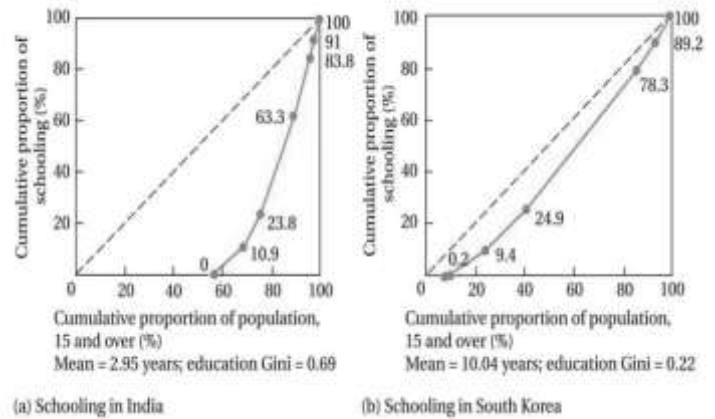
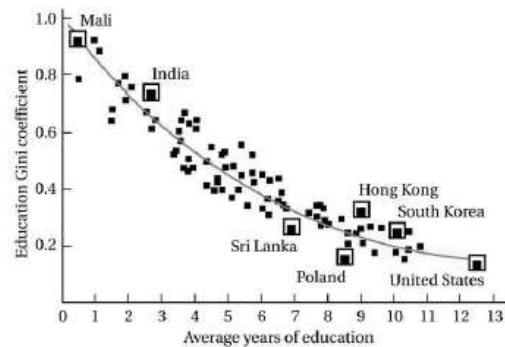


Figure 8.8 Gini Coefficients for Education in 85 Countries



Educational supply and demand: the relationship between employment opportunities and educational demands.

- Social versus private benefits and costs
- Distribution of education
- Education, inequality, and poverty
- Education, Internal Migration, and the Brain Drain

Health Measurement and Distribution

World Health Organization (WHO): The key United Nations agency concerned with global health matters.

Figure 8.9 Life Expectancy in Various World Regions

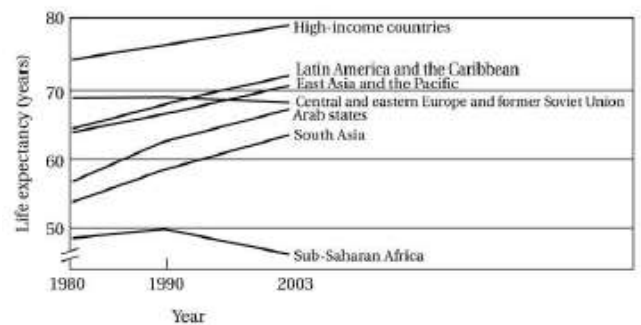


Figure 8.10 Under-5 Mortality Rates in Various World Regions

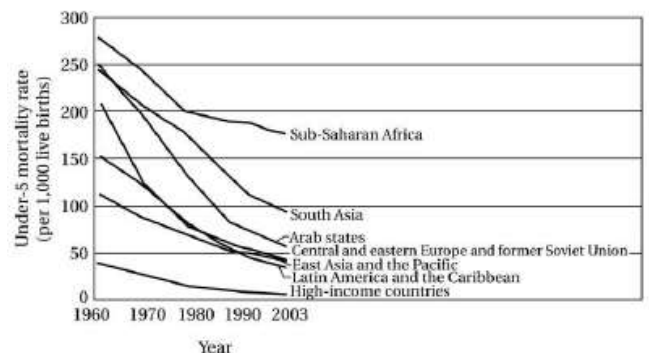


Figure 8.11 Deaths of Children under Age 5

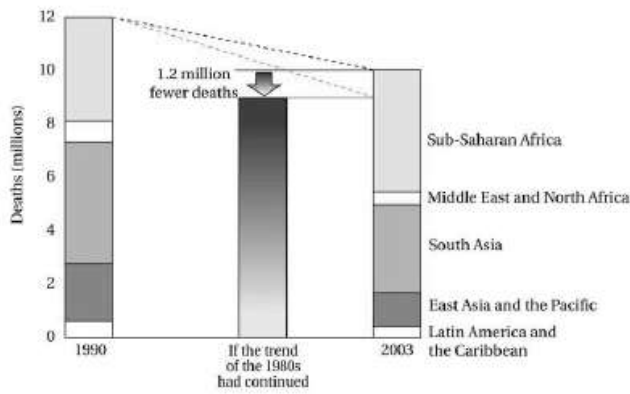


Figure 8.12A Children's Likelihood to Die in Selected Countries

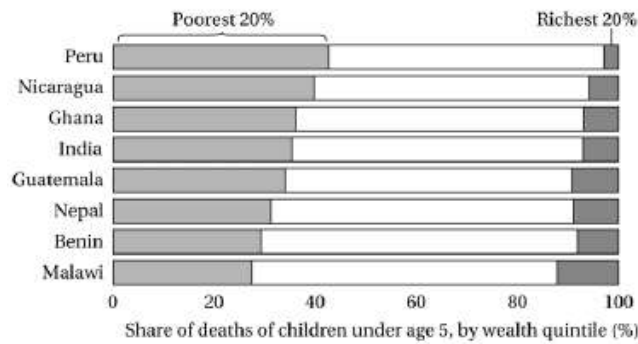
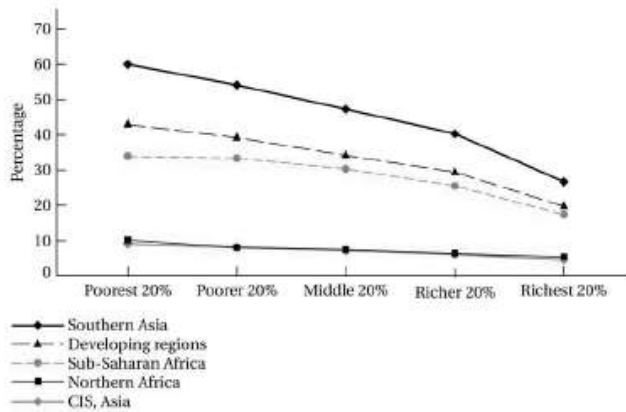


Figure 8.12B Proportion of Under-Five Children Who Are Underweight, by Household Wealth, around 2008



Disease Burden

1. HIV/AIDS
2. Malaria
3. Parasitic Worms and Other "Neglected Tropical Diseases"

Figure 8.13 Proportion of Children under 5 Who Are Underweight, 1990 and 2005

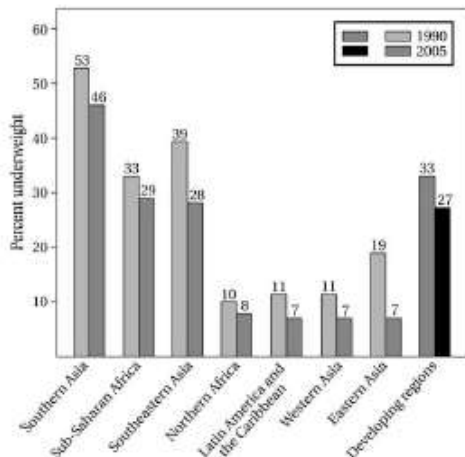


Table 8.2 Regional HIV and AIDS Statistics, 2009

Region	Adults and Children Living with HIV	Adults and Children Newly Infected with HIV	Adult and Child Deaths Due to AIDS
Sub-Saharan Africa	22.4 million	1.9 million	1.4 million
Middle East and North Africa	310,000	35,000	20,000
South and Southeast Asia	3.8 million	280,000	270,000
East Asia	850,000	75,000	50,000
Oceania	59,000	3,900	2,000
Latin America	2 million	170,000	77,000
Caribbean	240,000	20,000	12,000
Eastern Europe and Central Asia	1.5 million	110,000	87,000
Western and Central Europe	850,000	30,000	13,000
North America	1.4 million	55,000	25,000
Total	33.4 million	2.7 million	2 million

Table 8.3 The Major Neglected Tropical Diseases, Ranked by Prevalence

Disease	Global Prevalence (millions)	Population at Risk	Regions of Highest Prevalence
Ascariasis	807	4.2 billion	East Asia and Pacific Islands, sub-Saharan Africa, India, South Asia, China, Latin America and Caribbean
Trichuriasis	604	3.2 billion	Sub-Saharan Africa, East Asia and Pacific Islands, Latin America and Caribbean, India, South Asia
Hookworm infection	576	3.2 billion	Sub-Saharan Africa, East Asia and Pacific Islands, India, South Asia, Latin America and Caribbean
Schistosomiasis	207	779 million	Sub-Saharan Africa, Latin America and Caribbean
Lymphatic filariasis	120	1.3 billion	India, South Asia, East Asia and Pacific Islands, sub-Saharan Africa
Trachoma	84	590 million	Sub-Saharan Africa, Middle East and North Africa
Onchocerciasis	37	90 million	Sub-Saharan Africa, Latin America and Caribbean
Leishmaniasis	12	350 million	India, South Asia, sub-Saharan Africa, Latin America and Caribbean
Chagas' disease	8-9	25 million	Latin America and Caribbean
Leprosy	0.4	N.D.	India, sub-Saharan Africa, Latin America and Caribbean
Human African trypanosomiasis	0.3	60 million	Sub-Saharan Africa
Dracunculiasis	0.01	N.D.	Sub-Saharan Africa
Buruli ulcer	N.D.	N.D.	Sub-Saharan Africa

Health, Productivity, and Policy

Productivity : Is there a connection?

Health Systems Policy : Great variability in the performance of health systems at each income level

Figure 8.14 Wages, Education, and Height of Males in Brazil and the United States

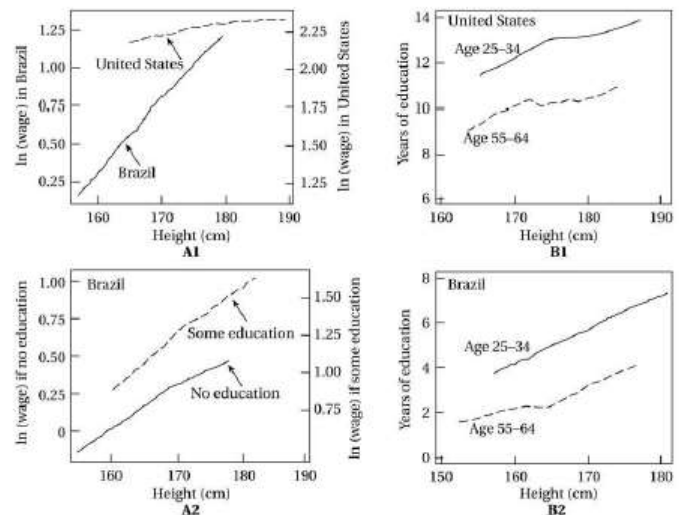
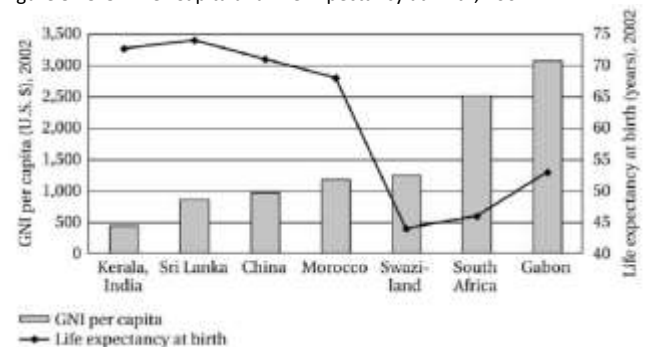


Figure 8.15 GNI Per Capita and Life Expectancy at Birth, 2002



CHAPTER 8

HUMAN CAPITAL : EDUCATION AND HEALTH IN ECONOMIC DEVELOPMENT

The Imperative of Agricultural Progress and Rural Development

The heavy emphasis in the past on rapid industrialization may have been misplaced. Agricultural development is now seen as an important part of any development strategy. Three complementary elements of an agriculture and employment-based strategy

- Accelerated output growth
- Rising domestic demand for agricultural output
- Non-agricultural rural labor intensive rural development activities that are supported by the farming community

Agricultural Growth: Past Progress and Current Challenges

Although agriculture employs the majority of the developing country labor force, it accounts for a much lower share of total output. Agricultural production is rising but unevenly

Figure 9.1 As Countries Develop, the Shares of GDP and Labor in Agriculture Tend to Decline, but with Many Idiosyncrasies

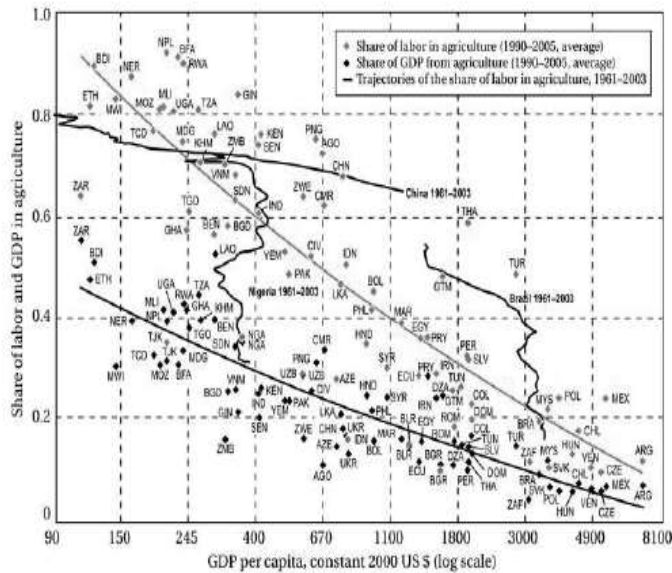
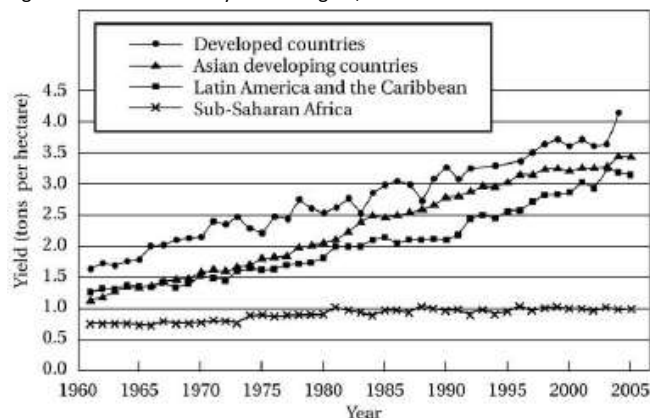


Figure 9.2 Cereal Yields by World Region, 1960-2005



Malnutrition and famine inspire calls for a new green revolution focused on Africa. Food price spike of 2007-2008 partly due to short term factors but long term factors may herald return to persistently higher food prices in the years ahead. New upward spike of prices by early 2011. The presence of market failures - and poverty alleviation goals - create need for constructive government role in agriculture

Roles for Government in Agricultural Development

1. Environmental externalities
2. Agricultural research and extension services
3. Economies of scale in marketing
4. Informational asymmetries in product quality
5. Providing institutions and infrastructure
6. Ensure shared growth in agriculture sector
7. Addressing poverty traps

The Structure of Agrarian Systems in the Developing World

Three systems of agriculture

Agriculture based countries, often subsistence, but agriculture makes up large part of growth. Transforming countries, most of world's rural people, large % of poverty incidence found there, low contribution of agriculture to growth. Urbanized countries, half or more even of the poor found in urban areas. The trend is from agriculture-based, to transforming, to urbanized economies as illustrated with the cases of India, China, Indonesia, and Brazil in Fig. 9.3

Figure 9.3 Agriculture's Contribution to Growth and the Rural Share in Poverty in Three Types of Countries

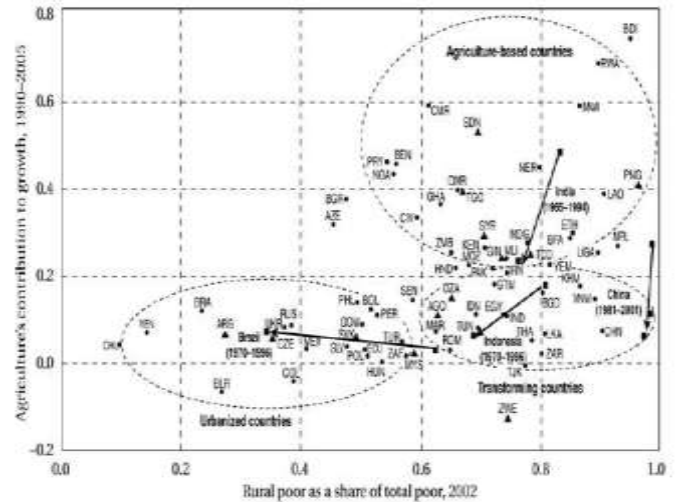


Table 9.1 Land Productivity in Developed and Developing Countries

Country	Agricultural Productivity (value added per worker, U.S. \$ 2005-2007)	Average Grain Yield (kilograms per hectare, 2006-2008)	Population (millions), 2008
Developed			
United States	45,015	6,578	304
Japan	39,388	5,977	128
United Kingdom	28,065	7,110	61
Developing			
Brazil	3,315	3,531	192
Mexico	3,022	3,341	106
Russian Federation	2,914	2,092	142
Sudan	844	800	41
Indonesia	657	4,508	227
India	480	2,574	1,140
Bangladesh	387	3,896	160
Kenya	367	1,621	39
Dem. Rep. of Congo	162	772	64

Peasant Agriculture in Latin America, Asia, and Africa

- Latin America and Asia: similarities and differences
- The Latifundio-Minifundio dualistic pattern in Latin America
- The fragmented and heavily congested dwarf land holdings in Asia
- Africa: extensive cultivation patterns

Table 9.2 Distribution of Farms and Farmland by Operational Farm Size and Land Tenure Status In Selected Developing Countries in Asia and Latin America

Country	Average Operational Farm Size (hectares)	Percentage of Farms and Farmland				Gini Coefficient of Land Concentration	Percentage of Tenanted Area in Total Farmland		Percentage of Share-Tenancy in Tenanted Land ^b
		Below 5 Hectares	Above 50 Hectares	Farms	Area		Pure Tenancy	Total ^a	
Asia									
Bangladesh	1.6	90.6	67.6	N.A.	N.A.	0.42	N.A.	20.9	91.0
India	2.3	88.7	46.7	0.1	3.7	0.62	2.4	8.5	48.0
Indonesia	1.1	97.9	68.7	0.0	13.6	0.56	2.1	23.6	60.0
Nepal	1.0	97.2	72.1	0.0	0.8	0.56	1.5	13.2	48.3
Philippines	3.6	84.8	47.8	0.2	13.9	0.51	21.4	32.8	79.3
Thailand	3.7	72.3	39.4	0.0	0.9	0.45	6.0	15.5	29.0
Latin America									
Brazil	59.7	36.8	1.3	16.3	84.6	0.84	6.1	10.2	N.A.
Costa Rica	38.1	48.9	1.9	14.5	79.7	0.82	1.2	9.0	9.4
Colombia	26.3	59.6	3.7	8.4	77.7	0.86	5.3	11.5	49.4
Peru	16.9	78.0	8.9	1.9	79.1	0.91	4.5	13.6	0.0
Uruguay	214.1	14.3	0.2	37.6	95.8	0.82	19.1	46.3	4.7
Venezuela	91.9	43.8	0.9	13.6	92.5	0.91	4.5	2.4	N.A.

Table 9.3 Changes in Farm Size and Land Distribution

Country	Period	Land Distribution Gini (percent)		Average Farm Size (hectares)		Change (%)		Farm Size Definition Used
		Start	End	Start	End	Total Number of Farms	Total Area	
Smaller farm size, more inequality								
Bangladesh	1977-1986	43.1	48.3	1.4	0.6	105	-13	Total land area
Pakistan	1990-2000	53.5	54.0	3.6	3.1	31	6	Total land area
Thailand	1978-1983	43.5	46.7	3.8	3.4	42	27	Total land area
Ecuador	1974-2000	69.3	71.2	15.4	14.7	63	56	Total land area
Smaller farm size, less inequality								
India	1990-1995	46.6	44.8	1.6	1.4	8	-5	Total land area
Egypt	1990-2000	48.5	37.8	1.0	0.8	31	5	Total land area
Malawi	1981-1993	34.4	33.2 ^a	1.2	0.8	37	-8	Cultivated crop area
Tanzania	1971-1996	40.5	37.6	1.3	1.0	64	26	Cultivated crop area
Chile	1975-1997	60.7	58.2	10.7	7.0	6	-31	Arable land area
Panama	1990-2001	77.1	74.5	13.8	11.7	11	-6	Total land area
Larger farm size, more inequality								
Botswana	1982-1993	39.3	40.5	3.3	4.8	-1	43	Cultivated crop area
Brazil	1985-1996	76.5	76.6	64.6	72.8	-16	-6	Total land area
Larger farm size, less inequality								
Togo	1983-1996	47.8	42.1	1.6	2.0	64	165	Cultivated crop area
Algeria	1973-2001	64.9	60.2	5.8	8.3	14	63	Arable land area

Transforming Economies: Problems of Fragmentation and Subdivision of Peasant Land in Asia

Impact of colonial rule in strengthening land tenure systems of private property rights and the consequent rise of moneylenders. Contemporary landlordism in India and Pakistan involves absentee landlordism and persistence of sharecroppers and tenant farmers. Rapid population growth resulted in more fragmentation and peasant impoverishment

Agrarian Patterns in Latin America: Progress and Remaining Poverty Challenges

Apart from latifundios (large holdings) and minifundios (small farms) much production occurs on family farms and medium sized farms. Latifundios (traditional ones, especially) are relatively inefficient; landlords/owners are sometimes less focused on the business of farming; and large farms typically entail higher transaction costs. Overall the agricultural sector seems to be doing well in many Latin American countries. Two prominent examples: Chile (diversification), and Brazil (biofuels). Extreme rural inequalities still persist.

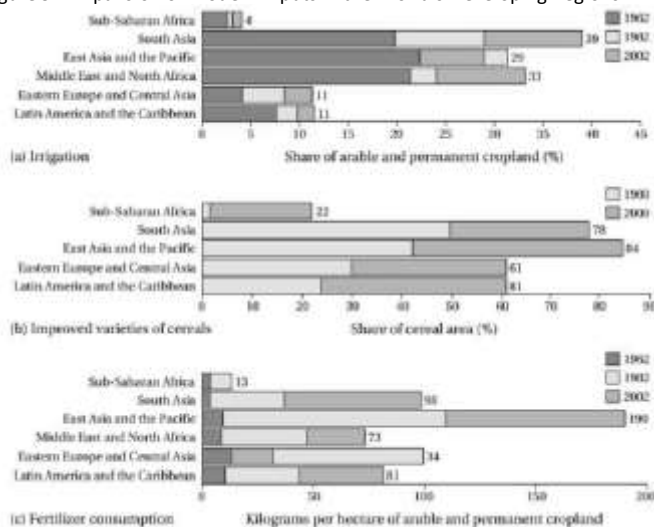
Subsistence Agriculture and Extensive Cultivation in Africa

- Low productivity due to lack of technology
- Shifting Cultivation
- Seasonal demand for labor depending on rainy season
- High dependence on unimproved seeds sown on unfertilized, rain-fed fields
- Relatively high fraction of underutilized land
- High concern about climate change impact
- Need for an African new green revolution, there are hopeful signs that it is getting underway

The Important Role of Women

Women provide 60% to 80% of agricultural labor in Africa and Asia, and 40% in Latin America. Women work longer hours than men. Government assistance programs tend to reach men, not women

Figure 9.4 Expansion of Modern Inputs in the World's Developing Regions



The Microeconomics of Farmer Behavior and Agricultural Development
Subsistence farming: risk aversion, uncertainty, and survival

Traditional neoclassical model of profit maximization with certainty is not adequate. Price, weather, and other uncertainty, along with limited access to credit and insurance (and even savings vehicles), largely explains the extent of risk-averse behaviors observed. Risk-averse subsistence farmers (often not irrationally) can prefer technologies that combine low mean-perhectare with low variance to alternative high yielding but higher risk technologies. Efforts to minimize risk and remove commercial and institutional obstacles to small farmer innovation are necessary

Figure 9.5 Small-Farmer Attitudes toward Risk: Why It Is Sometimes Rational to Resist Innovation and Change

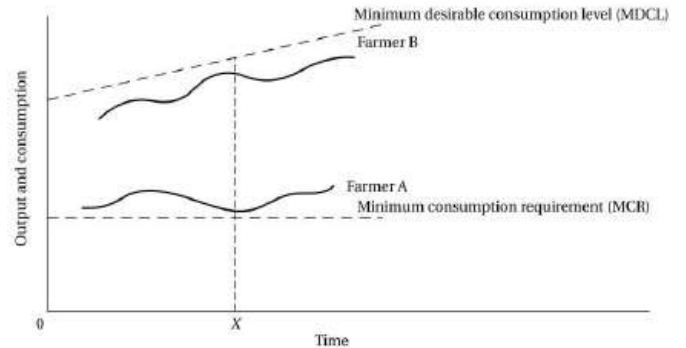


Figure 9.6 Crop Yield Probability Densities of Two Different Farming Techniques

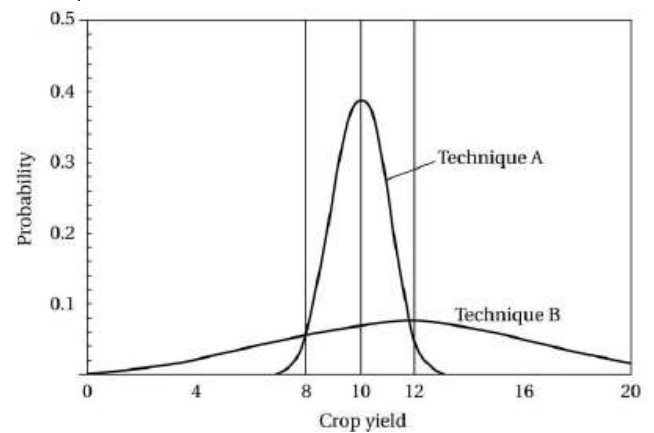
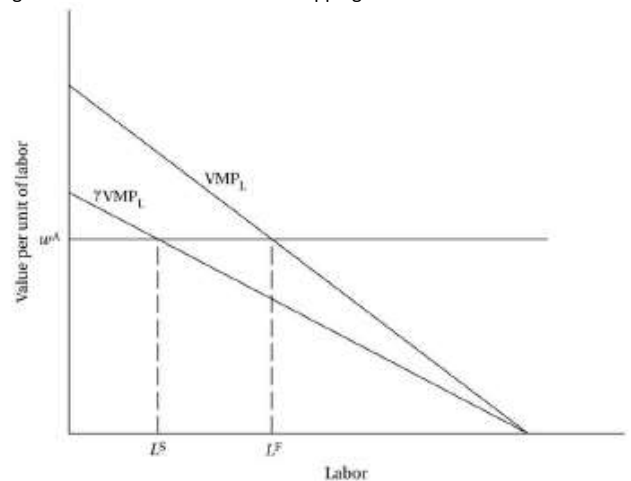


Figure 9.7 Incentives under Sharecropping



Issues in sharecropping: a long debate

- Intrinsically inefficient due to poor incentives (Marshall)
- Monitoring approach (Cheung)
- Compromise between two types of risk (Stiglitz, others)
- Screening argument (if high ability then take pure rental)
- Empirical evidence for inefficiency from Ali Shaban (comparing same farmer, controlling for soil)
- Giving sharecroppers a larger share of the produce and security of tenure on land can increase efficiency
- Issues in interlocking factor markets
- The Transition to Mixed and Diversified Farming
- From Divergence to Specialization: Modern Commercial Farming

Core Requirements of a Strategy of Agricultural and Rural Development
Improving Small-Scale Agriculture

- Technology and innovation
- Institutional and pricing policies: Providing necessary economic incentives
- Adapting to new opportunities and New Constraints

Conditions for Rural Development
 - Land Reform
 - Supportive policies
 - Integrated Development Objectives

CHAPTER 10

THE ENVIRONMENT AND DEVELOPMENT

Environment and Development: The Basic Issues

Environmental issues affect, and are affected by, economic development. Classic market failures lead to too much environmental degradation. Poverty and lack of education may also lead to non-sustainable use of environmental resources. Global warming and attendant climate change is a growing concern in developing countries.. Sustainable development and environmental accounting

Sustainable development has been defined as “meeting the needs of present generation without compromising the wellbeing of future generations”. So, running down the capital stock is not consistent with the idea of sustainability . Environmental and other forms of capital are substitutes only to a degree; eventually they likely act as complements. In developing countries, environmental capital is generally a larger fraction of total capital. To know whether environmental capital is increasing or decreasing, we need environmental accounting

Sustainable net national product is:

$$NNI^* = GNI - D_m - D_n$$

Where

NNI* is sustainable national income
 GNI is Gross national income
 Dm is the depreciation of manufactured capital assets
 Dn is the depreciation of environmental capital

More expansively, sustainable net national product is:

$$NNI^{**} = GNI - D_m - D_n - R - A$$

Where

NNI** is the revised NNI calculation
 GNI, Dm, and Dn are defined as before
 R is expenditure needed to restore environmental capital
 A is expenditure required to avert destruction of environmental capital

(Note: R and A are components of GNI but not NNI**)

The poor as both agents and victims of environmental degradation

Victims:

- The poor live in environmentally degraded lands which are less expensive because the rich avoid them
- People living in poverty have less political clout to reduce pollution where they live
- Living in less productive polluted lands gives the poor less opportunity to work their way out of poverty

Agents:

- The high fertility rate of people living in poverty
- Short time horizon of the poor (by necessity)
- Land tenure insecurity;
- Incentives for rainforest resettlement

Environment and Development: The Basic Issues

1. Sustainable development and environmental accounting
2. Population, resources, and the environment
3. Poverty and the environment
4. Growth versus the environment
5. Rural development and the environment
6. Urban development and the environment
7. The global environment and economy
8. Nature and pace of Greenhouse Gas- Induced Climate change
9. Natural Resource-Based Livelihoods as a pathway out of poverty: Promise and Limitations

Natural Resource Based Livelihoods: Pathways Out of Poverty?

In low income countries, high dependence on natural resources: agriculture; animal husbandry, fishing, forestry, hunting, foraging But

access to the benefits of resources often very inequitable. Poor losing control of natural resource commons areas. Many poor lack farmland, forests, cattle, boats and equipment. Common village lands may be “spontaneously” privatized. Governments may overlook companies logging, fishing, and mining, without regard to local people or traditional rights. Governments designate lands “protected,” banning livelihoods, while corruption remains; no incentive to take part in protection. A solution: “pro-poor governance” – empowerment of the poor

The Scope of Domestic-Origin Environmental Degradation: An Overview

Environmental problems have consequences both for health and productivity

- Loss of agricultural productivity
- Prevalence of unsanitary conditions created by lack of clean water and sanitation
- Dependence on biomass fuels and pollution
- Airborne pollutants

Rural Development and the Environment: A Tale of Two Villages

Representative African village

- Desertification
- Low opportunity cost of women’s time encourages waste

Representative South American village

- Soil erosion
- deforestation

Global Warming and Climate Change: Scope, Migration, and Adaptation

The benchmark 2007 IPCC report paints a dire picture for developing economies. Recent reports amplify: Summary in World Bank 2009 World Development Report. Using data not yet available to IPCC report, the 2010 U.S. NOAA study found evidence of global warming due to greenhouse gases on all 11 indicators examined. Impact of global warming likely hardest on the poorest. Agriculture harmed in tropical and subtropical areas. Resultant conflicts over natural resources may grow. Range of adverse health impacts

Some impacts of climate change in Developing Countries identified by IPCC

- prolonged droughts, expanded desertification
- increased severity of storms with heavy flooding and erosion
- longer and more severe heat waves
- reduced summer river flow and water shortages
- decreased grain yields
- climate-induced spreading ranges of pests and disease
- lost and contaminated groundwater
- deteriorated freshwater lakes, coastal fisheries, mangroves, coral reefs
- coastal flooding
- loss of essential species such as pollinators and soil organisms, forest and crop fires

Global Warming and Climate Change: Scope, Mitigation, and Adaptation

Problem primarily but not exclusively caused by developed countries
 - Rapid industrial growth especially in Asia
 - Deforestation in developing countries

Strategies for mitigation

- Taxes on carbons
- Caps on greenhouse gases (with “carbon markets”)
- Subsidies to encourage technological progress

Types of adaptation

- Planned (or “policy”) adaptation
- Autonomous adaptation (some types are reviewed in Box 10.1)

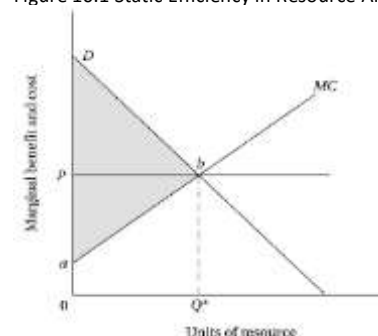
Economic Models of Environment Issues

1. Privately owned resources
2. Inefficiencies result from imperfections in property rights

Perfect property rights are characterized by

- Universality
- Exclusivity or Excludability
- Transferability
- Enforceability

Figure 10.1 Static Efficiency in Resource Allocation

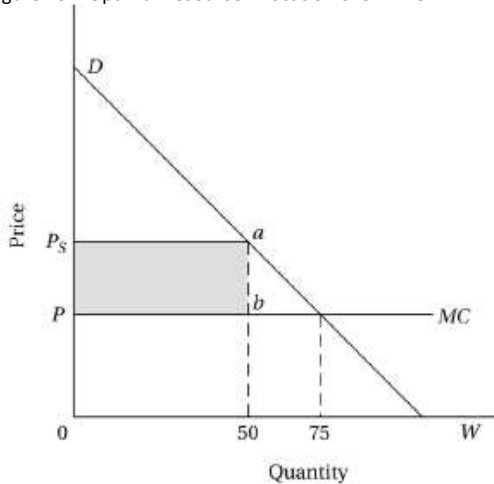


Allocational efficiency

Equate PV of marginal net benefits of last unit consumed in each period. That is, for allocational efficiency, consumer must be indifferent between

consuming last unit in this period or in another period

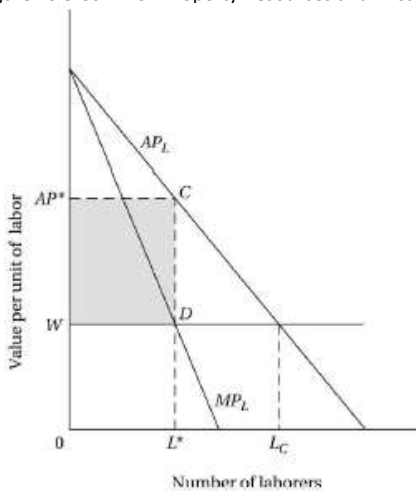
Figure 10.2 Optimal Resource Allocation over Time



Common property resources

- Inefficiencies may arise because resource is not privately owned
- Traditional models do not concern themselves with equity and income distribution
- Family farmers can benefit from extended tenancy or ownership
- Who should buy publicly owned land

Figure 10.3 Common Property Resources and Misallocation



Understanding the tragedy of the Commons

Users fail to take account of an externality: that as each uses more of the common resource the average return is lowered for other users. Traditional societies have sometimes responded effectively with social enforcement mechanisms.

Elinor Ostrom's Common Property Design Principles Derived from Empirical Studies

Clearly Defined Boundaries of the resource system. Proportional equivalence between benefits and costs for users. Collective-choice arrangements including those affected. Monitoring, with those who audit accountable to users. Graduated Sanctions. Conflict-resolution mechanisms. Recognition of rights to organize. Nested enterprises when resources are parts of larger systems

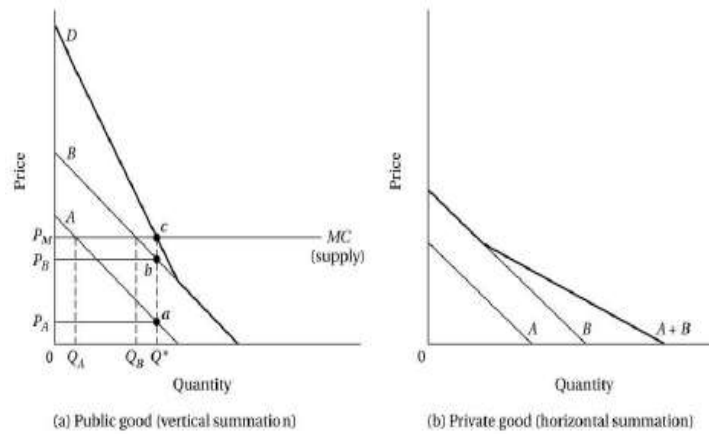
Public goods and bads: regional environmental degradation and the freerider problem

- Internalization of externalities is not easy
- Free rider problems

Limitations of the public goods framework

- Pricing mechanism

Figure 10.4 Public Goods, Private Goods, and the Free-Rider Problem



Urban Development and the Environment

Environmental Problems of Urban Slums

- Health threatening pollutants
- Unsanitary environmental conditions
- Serious impact on poor

Industrialization and urban air pollution

- Environmental Kuznets curve
- Pollution tax
- Absorptive capacity of the environment
- Severity of industrial pollution- impact on health

Figure 10.5 Pollution Externalities: Private versus Social Costs and the Role of Taxation

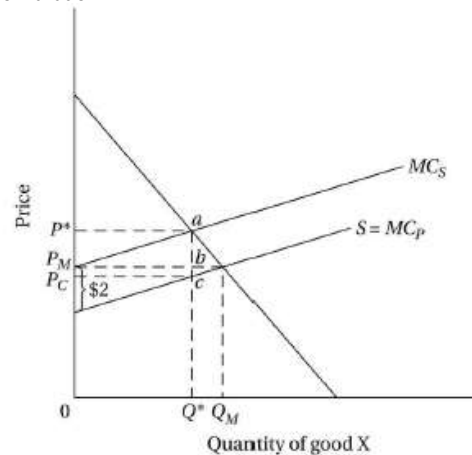
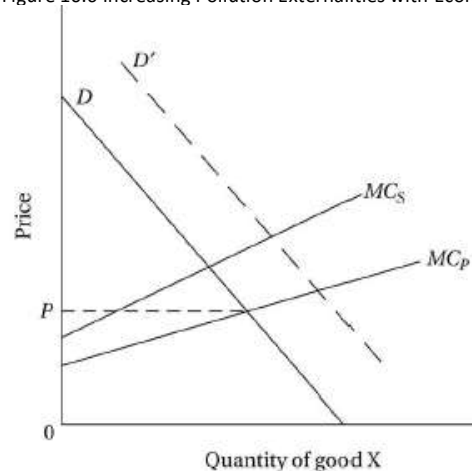


Figure 10.6 Increasing Pollution Externalities with Economic Growth



Problems of congestion, Clean water, and Sanitation

- High health and economic costs associated
- Drag on development
- Impact on poor
- Private wells have led to land subsidence and flooding
- Impact on export earnings

The Local and Global Costs of Rain Forest Destruction

Rainforest loss contributes to global warming. Loss of biodiversity. Loss of livelihoods for people living in poverty who depend upon them. Much waste in the process of forest clearing. Thus, rainforest preservation (and restoration) is a global public good - a restorative mechanism for the environment. Sustainable management of rain forests is a priority. Provide funds, debt relief to help enhance biodiversity. In addition, support for forest preservation as climate change mitigation

Policy Options in Developing and Developed Countries

- What Developing Countries can do
1. Proper resource pricing
 2. Community involvement
 3. Clearer property rights and resource ownership
 4. Improved economic alternatives for the poor
 5. Improved economic status of women
 6. Investments that yield returns regardless of the shape of climate change, such as a better road network
 7. Industrial emissions abatement policies
 8. Proactive stance toward adapting to climate change

How developed countries can help developing countries

1. Lower developing country costs for environmental preservation
2. Trade policies: reduce barriers, subsidies
3. Debt relief and debt for nature swaps
4. Development assistance

What developed countries can do for the global environment

1. Emissions controls, including greenhouse gases
2. Research and Development on green technology and pollution control
3. Transfer of technology to developing countries
4. Restrictions on unsustainable production

CHAPTER 11
DEVELOPMENT POLICYMAKING AND THE ROLES OF MARKET, STATE, AND CIVIL SOCIETY

A Question of Balance

Roles and Limitations of State, Market, and the Citizen Sector/NGOs in Achieving Economic Development and Poverty Reduction

Development Planning: Concepts and Rationale

The Planning Mystique

In the past, few doubted the importance and usefulness of national economic plans. Recently, however, disillusionment has set in – But a comprehensive development policy framework can play an important role in accelerating growth and reducing poverty

Development Planning: Concepts and Rationale

The nature of development planning resource mobilization for public investment. Economic policy to control private economic activity according to social objectives formulated by government. Planning in mixed developing economies. Private sector in mixed economies comprises

- The subsistence sector
 - Small scale businesses
 - Medium size enterprises
 - Larger domestic firms
 - Large joint or foreign owned enterprises
- 1-318

The Rationale for Development Planning

- Market failure
- Resource mobilization and allocation
- Attitudinal or psychological impact
- Requirement to receive foreign aid

Three General Forms of Market Failure

The market cannot function properly or no market exists. The market exists but implies inefficient resource allocation. More expansively: the market produces undesirable results as measured by social objectives other than the allocation of resources. Other items such as more equal income distribution, and “merit goods” such as health, are treated as separate rationales for policy, outside of economic efficiency

Market Failure

Market failures can occur when social costs or benefits differ from private costs or benefits of firms or consumers. Market power (monopolistic, monopsonistic)

- Public goods: free riders cannot be excluded except possibly at high cost
- Externalities: agents do not have to pay all costs of their activities, or are unable to receive all the benefits

Prisoners’ Dilemmas occur when agents better off if others cooperate but individual agents better off “defecting”. Coordination failures can occur

when coordination is costly; e.g. with Big Push problems (Chapter 4). Capital markets are particularly prone to failure

Market and Government Failure: Broader Arguments

Government failure: in many cases, politicians and bureaucrats can be considered utility maximizers, not public interest maximizers. So can’t jump to conclusion that if economic theory says policy can fix market failures that it will do so in practice. Analysis of incentives for government failure guides reform, e.g. civil service reform, constitution design. Developing countries tend to have both high market failure and high government failures

The Development Planning Process: Some Basic Models

Characteristics of the planning process

Planning in stages: basic models

- Aggregate growth models
- Multisector input-output, social accounting, and CGE models

Three stages of planning

- Aggregate
- Sectoral
- Project

Aggregate Growth Models: Projecting Macro Variables

$$K(t) = cY(t) \tag{11.1}$$

Where

$K(t)$ is capital stock at time t
 $Y(t)$ is output at time t
 c is the average and marginal capital-output ratio

$$I(t) = K(t+1) - K(t) + \delta K(t) = sY = S(t) \tag{11.2}$$

Where

$I(t)$ is gross investment at time t
 s is the savings rate
 S is national savings
 δ is the depreciation rate

If g is the targeted rate of output growth, then

$$g = \frac{Y(t+1) - Y(t)}{Y(t)} = \frac{\Delta Y(t)}{Y(t)} \tag{11.3}$$

$$\frac{\Delta K}{K} = \frac{c\Delta K}{K} = \frac{(K/Y)\Delta Y}{K} = \frac{\Delta Y}{Y} \tag{11.4}$$

$$g = \frac{sY - \delta K}{K} = \frac{s}{c} - \delta \tag{11.5}$$

$$n + p = \frac{s}{c} - \delta \tag{11.6}$$

$$W + \pi = Y \tag{11.7}$$

Where W and π are wage and profit incomes

$$s_{\pi}\pi + s_W W = I \tag{11.8}$$

Where s_{π} and s_W are the marginal propensities to save from wage income and profit

$$c(g + \delta) = (s_{\pi} - s_W)\left(\frac{\pi}{Y}\right) + s_W \tag{11.9}$$

The Development Planning Process: Some Basic Models

1. Multisector Models and Sectoral Projections
2. Interindustry or input-output models

Can be extended in 2 ways

– SAM models where data from national accounts, BOP, and flow-of-funds databases is supplemented with household survey data.

– CGE models where utility and production functions are estimated and impacts of policies are simulated.

Project Appraisal and Social Cost-Benefit Analysis

Basic concepts and methodology

- Specify objective function
- Compute social measures (shadow prices)
- Establish decision criterion

Computing shadow prices and social discount rates
 – Calculating the social rate of discount or social time preference

Net present value, or NPV is given by

$$NPV = \sum_t \frac{B_t - C_t}{(1+r)^t} \quad (11.10)$$

Where

- B_t is the expected benefit at time t
- C_t is the expected cost at time t
- r is the social rate of discount used

Choosing projects: some decision criteria
 – NPV rule
 – Compare the internal rate of return with an interest rate

Conclusions: planning models and plan consistency

Government Failure and Preferences for Markets over Planning

- The 1980s policy shift toward free markets
- Problems of Plan Implementation and Plan Failure
- Theory versus practice
- Deficiencies in the plans and their implementation
- Insufficient and/or unreliable data
- Unanticipated economic disturbances, external and internal
- Institutional weaknesses
- Lack of political will
- Conflict, post-conflict, and fragile states

Potential problems of government intervention in developing countries

- Individuals know more about their preferences, circumstances
- Government may increase risks by pointing all in same direction
- Government may be more rigid and inflexible in decision making
- Governments lack capabilities to administer detailed plans
- Bureaucratic obstacles may block private sector initiative
- Hard to replicate market incentive system within governments
- Different parts of government may be poorly coordinated
- Black markets place constraints on government Controls create incentives for rent seeking
- Planning may be manipulated by narrow, privileged groups

The Market Economy

- Well functioning market economy requires
- Clear property rights
 - Laws and courts
 - Freedom to establish business
 - Stable currency
 - Public supervision of natural monopolies
 - Provision of adequate information
 - Autonomous tastes
 - Public management of externalities
 - Stable monetary and fiscal policy instruments
 - Safety nets
 - Encouragement of innovation

The “Washington Consensus” on the Role of the State in Development and its Limitations. The consensus reflected a free market approach to development espoused by the IMF, the World bank, and key U.S. government agencies

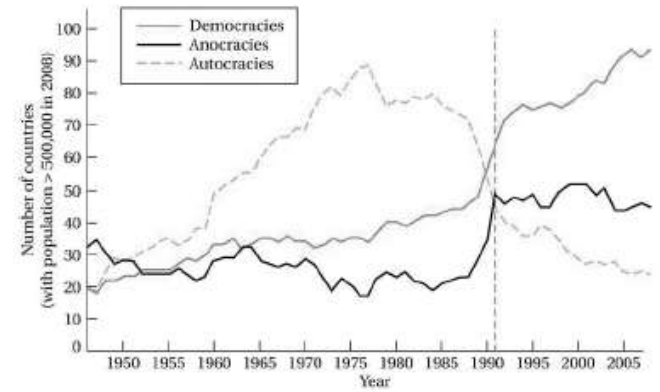
The Washington Consensus on the Role of the State in Development and Its Subsequent Evolution

- Toward a new consensus
- New emphasis on government’s responsibility toward poverty alleviation and inclusive growth
 - Provision of fundamental public goods
 - Importance of health and education
 - A recognition that markets can fail
 - Governments can help secure conditions for an effective market based economy

Development Political Economy: Theories of Policy Formulation and Reform

- Understanding voting patterns on policy reform
- Institutions and path dependency
- Democracy versus autocracy: which facilitates faster growth?
- Role of NGOs in development and the broader citizen sector

Figure 11.1 Global Trends in Governance, 1946-2008



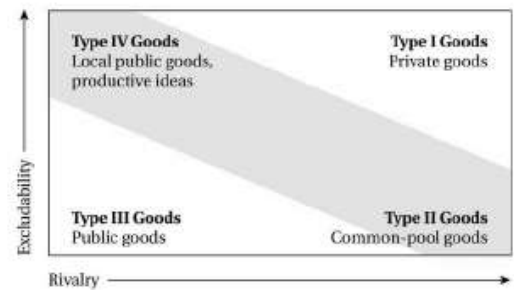
Development Roles of NGOs and the Broader Citizen Sector

- Potentially important roles in:
- Common property resource management
 - Local public goods
 - Economic and productive ideas

Possibly other activities that are either:

- Excludable but not rival
- Rival but not excludable
- Partly excludable and partly rival

Figure 11.2 Typology of Goods



The shaded diagonal indicates the area of primary NGO comparative advantage in dimensions of rivalry and excludability. When, based on local conditions (such as government failure), NGOs are in a position to supply public or private goods at a lower price or higher quality, they may be found expanding into these nonshaded areas as well (Type I and Type III goods).

Development Roles of NGOs and the Broader Citizen Sector

- Other potential comparative advantages of NGOs
- Innovative design and implementation
 - Program flexibility
 - Specialized technical knowledge
 - Provision of targeted local public goods
 - Common-property resource management design and implementation
 - Trust and Credibility
 - Representation and advocacy

Other limitations: “voluntary failure” – NGOs may be...

- Insignificant, owing to small scale and reach.
- Lacking necessary local knowledge to develop and implement an appropriate mix of programs to address relevant problems
- Selective and exclusionary, elitist, and or ineffective
- Lacking adequate incentives to ensure effectiveness
- Captured by goals of funders rather than intended beneficiaries; may change priorities one year to the next
- Giving too little attention to means, preventing needed scale...
- Or, find that means—such as fundraising—can become ends in themselves
- Lacking immediate feedback (as private firms get in markets, or elected governments receive at the polls); this can let the weaknesses go on for some time before being corrected

Trends in Governance and Reform

Tackling the problem of corruption, Abuse of public trust for private gain. Good governance enhances capability to function. Effects of corruption fall disproportionately on the poor. Good governance is broader than simply an absence of corruption. Tackling the problem of Corruption. Decentralization. Development participation- alternate interpretations.– Genuine participation and role of NGOs

Figure 11.3 Corruption as a Regressive Tax: The Case of Ecuador

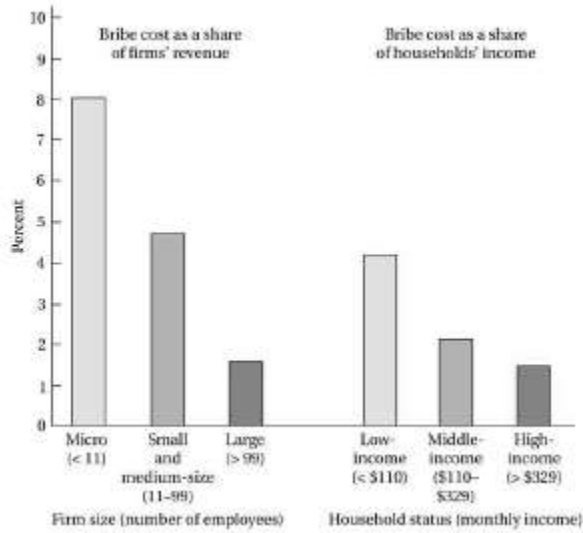
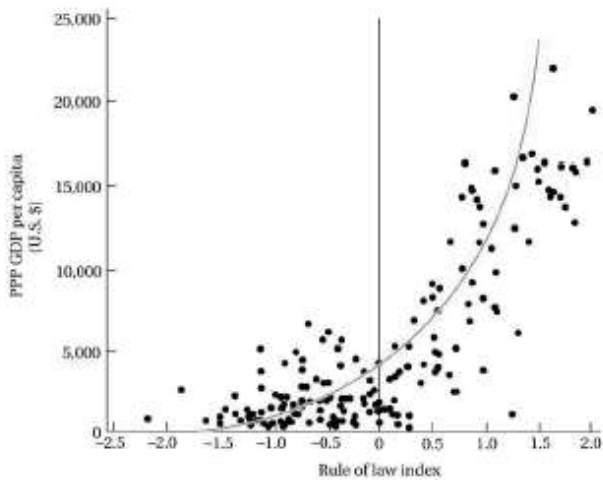


Figure 11.4 The Association between Rule of Law and Per Capita Income



Country Name	Merchandise Exports (current millions of U.S. \$)	GDP (current millions of U.S. \$)	Merchandise Exports as a Share of GDP (%)	Manufactures Exports (% of merchandise exports)
Developing countries				
Malaysia	199,516	221,773	90	54
Nigeria	81,900	207,118	40	5
China	1,428,488	4,326,996	33	93
Venezuela	93,542	314,150	30	4
Philippines	49,025	166,909	29	83
Indonesia	139,281	510,730	27	39
Mexico	291,807	1,088,128	27	74
Sri Lanka	8,370	40,565	21	67
Kenya	4,972	30,355	16	37
Jamaica	2,400	14,614	16	61
Niger	820	5,354	15	7
India	179,073	1,158,171	15	63
Brazil	197,942	1,575,151	13	45
Developed countries				
United Kingdom	457,983	2,674,057	17	70
Japan	782,337	4,910,840	16	89
United States	1,300,532	14,591,381	9	74

Demand Elasticities and Export Earning Instability

Other low price elasticity of demand for agricultural commodities but supply shocks. Other low price elasticity of supply for basic commodities but demand shocks. Result can be export earnings instability; risks to income. Also, low income elasticity of demand for primary products:

The Terms of Trade and the Prebisch-Singer Hypothesis

Total export earnings depend upon:
 - Total volume of exports sold; and,
 - Price paid for exports

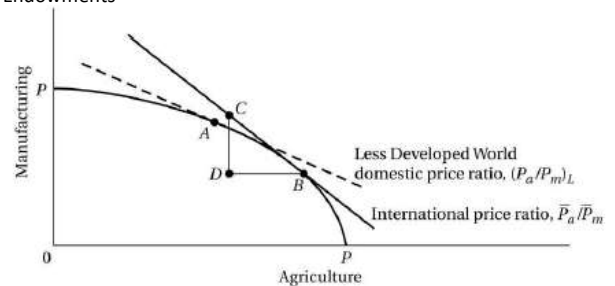
Prebisch and Singer argued commodity export prices fall over time, so developing countries lose revenue unless they can continually increase export volumes. They concluded that developing countries need to avoid dependence on primary exports. Some evidence relative prices within manufactures are also diverging with falling prices for low-skill products

The Traditional Theory of International Trade

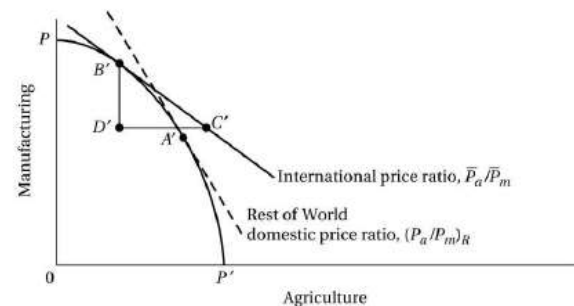
Comparative advantage, specialization. Relative factor endowments and international specialization: the Neoclassical model
 - Ricardo and Mill (static model)
 - Heckscher and Ohlin (factor endowment theory)

Different products require productive factors in different ratios. Countries have different endowments of factors of production

Figure 12.1 Trade with Variable Factor Proportions and Different Factor Endowments



(a) Less Developed World (without trade, production and consumption occur at A; with trade, production is at B, consumption is at C; exports = BD; imports = DC)



(b) Rest of World (without trade, production and consumption occur at A'; with trade, production is at B', consumption is at C'; exports = B'D'; imports = D'C')

Main conclusion of the neoclassical model is that all countries gain from trade. World output increases with trade. Countries will tend to specialize in products that use their abundant resources intensively. International wage rates and capital costs will gradually tend toward equalization

CHAPTER 12
INTERNATIONAL TRADE THEORY AND DEVELOPMENT STRATEGY

Economic Globalization: An Introduction

Globalization- many interpretations. Core economic meaning- the increased openness of economies to international trade, financial flows, and foreign direct investment. Concerns with globalization center around the unevenness of the process, and risks

International Trade: Some Key Issues

Many developing countries rely heavily on exports of primary products with attendant risks and uncertainty. Many developing countries also rely heavily on imports (typically of machinery, capital goods, intermediate producer goods, and consumer products). Many developing countries have chronic deficits on current and capital accounts which depletes their reserves, causes currency instability, and may slow economic growth. Recently many developing countries sought to promote exports and accumulate large foreign exchange reserves to cushion against crises - spurring new policy debates

Five Basic Questions about Trade and Development

1. How does international trade affect economic growth?
2. How does trade alter the distribution of income?
3. How can trade promote development?
4. Can developing countries determine how much they trade?
5. Is an outward-looking or an inward-looking trade policy best?

The Importance of Exports to Different Developing Nations. Importance of exports to developing nations. Exports of developing countries are generally less diversified than those of developed countries. Merchandise exports as a share of GDP are often higher for developing countries

Table 12.1 Merchandise Exports in Perspective: Selected Countries, 2008

Returns to owners of abundant resources will rise relatively. Trade will stimulate economic growth

Trade theory and Development: The Traditional Arguments

- Trade stimulates economic growth
- Trade promotes international and domestic equality
- Trade promotes and rewards sectors of comparative advantage
- International prices and costs of production determine trading volumes
- Outward-looking international policy is superior to isolation

Critique of Traditional Free-Trade Theory, in the Context of Developing-Country Experience

The following assumptions of the basic Neoclassical model have been scrutinized:

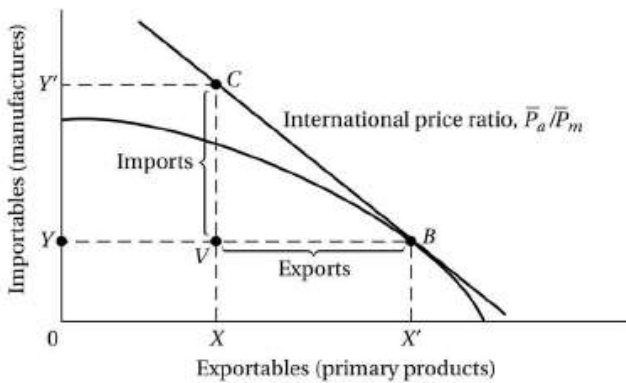
Fixed resources, full employment, international factor immobility And fixed, freely available technology and consumer sovereignty vs product cycle, ongoing development of synthetic substitutes for developing countries exports, and opportunities for dynamic gains in leading sectors. Internal factor mobility vs different types of structural rigidities; and perfect competition vs pervasive market power. Governmental non-interference in trade vs active trade policies . Balanced trade and international price adjustments vs instability. Trade gains accruing to nationals vs export enclaves with foreign ownership; distinction between GDP and GNI becomes important

Fixed Resources, Full Employment, and the International Immobility of Capital and Skilled Labor. Challenged by North-South trade models Porter's "Competitive Advantage" theory: Traditional trade theory applies only to basic factors (unskilled labor, physical resources), But creation of advanced factors (knowledge resources, specialized infrastructure) is the first priority . Central task to "escape from the straightjacket of factordriven national advantage"

The Critique of Traditional Free-TradeTheory in the Context of Developing-Country Experience

1. Alternative Theories
2. Vent for Surplus theory

Figure 12.2 The Vent-for-Surplus Theory of Trade



Fixed, Freely Available Technology and Consumer Sovereignty
 - Challenged by the Product Cycle theory
 - Development of synthetic substitutes for developing country exports

International Factor Mobility, Perfect Competition, and Uncertainty: Increasing Returns, Imperfect Competition, and Issues in Specialization

- Structural realities in developing countries
- Increasing returns and exercise of monopolistic control over world markets
- Risk and uncertainty inherent in international trading arrangements

The Absence of National Governments in Trading Relations

- Definite role for State
- Industrial policy is crated by governments
- Commercial policies instruments (tariffs, quotas) are state constructs
- International policies can result in uneven distribution of gains from trade

Balanced Trade and International Price Adjustments
 - Unrealistic (example: impact of oil price hikes of the 1970s)

Trade gains accruing to nationals
 - Enclave economies are promoted by trade
 - Difference between GDP and GNI becomes important

Some Conclusions on Trade Theory and Economic Development Strategy

- Trade can lead to rapid economic growth under some circumstances
- Trade seems to reinforce existing income inequalities
- Trade can benefit developing countries if they can extract trade concessions from developed countries

- Developing countries generally must trade
- Regional cooperation may help developing countries

Traditional Trade Strategies for Development: Export Promotion versus Import Substitution

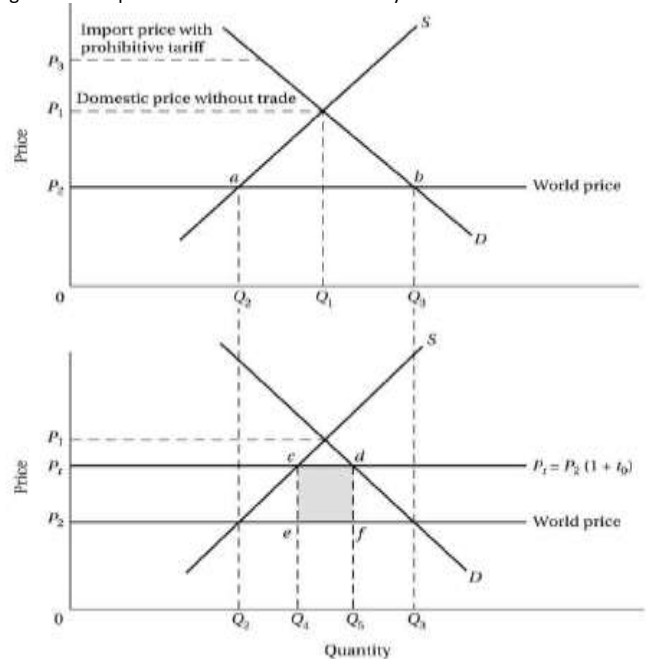
Export promotion: looking outward and seeing trade barriers, Primary-commodity export expansion, limited demand

- Low income elasticities
- Low population growth rates in developing economies
- Decline in prices implies low revenue (some periods of price spikes, including recent years, but very long-run trend has been downward)
- Lack of success with international commodity agreements
- Development of synthetic substitutes
- Agricultural subsidies
- Primary-commodity export expansion, supply rigidities

Expanding Exports of manufactured goods: Greater successes, particularly China; unevenly distributed across the developing world

Import substitution: looking inward but still paying outward
 - Tariffs, infant industries, and the theory of protection

Figure 12.3 Import Substitution and the Theory of Protection



The import substitution (IS) industrialization strategy and results

- Protected industries get inefficient and costly
- Foreign firms often benefit more
- Subsidization of imports of capital goods tilts pattern of industrialization and contributes to balance of payments (BOP) problems
- Overvalued exchange rates hurt exports
- Does not stimulate self-reliant integrated industrialization

Tariff Structure and Effective Protection

- Nominal rate of protection
- Effective rate of protection

The nominal tariff rate, t, is

$$t = \frac{p' - p}{p} \quad (12.1)$$

Where

- p' is the tariff-inclusive price
- p is the free trade price

Tariff Structures and Effective Protection

The effective tariff is

$$\rho = \frac{v' - v}{v} \quad (12.2)$$

Where

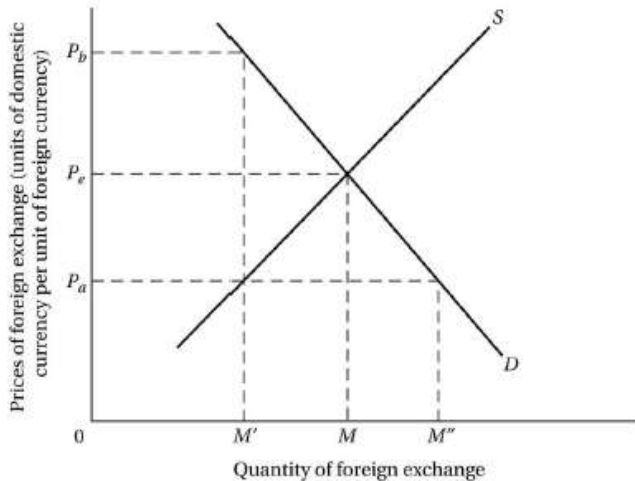
- v' is the value added per unit of output, inclusive of the tariff
- v is the value added per unit of output under free trade

- Standard argument for tariff protection
- Sources of revenue
 - Response to chronic BOP problems
 - Help foster industrial self-reliance (general IS)
 - Greater control over economic destinies

Must be applied selectively and wisely. Infant industry protection argument. Many examples of perceived failures, but some success in East Asia

- Foreign-exchange rates, exchange controls, and the devaluation decision**
- Developing country currencies have often been overvalued (excess of local demand over available exchange)
 - A developing country can devalue currency, or
 - Can run down reserves
 - Can curtail excess demand through taxes, tariffs, dual exchange rates
 - Can use exchange controls
 - Can switch to freely convertible foreign exchange

Figure 12.4 Free-Market and Controlled Rates of Foreign Exchange



- Chronic payments deficits can be ameliorated by a currency devaluation
- Difference between depreciation and devaluation
 - Higher import prices result in an inflationary wage-price spiral
 - Distributional effects

Trade Optimists and Trade Pessimists: Summarizing the Traditional Debate
Trade pessimist arguments

- Limited growth of world demand for primary exports
- Secular deterioration in terms of trade
- Specializing in comparative advantage inhibits industrialization, skills accumulation, and entrepreneurship
- Rise of "new protectionism"; WTO benefits limited in practice

Trade optimist arguments - trade liberalization:

- Promotes competition and efficiency
- Generates pressure for product improvement
- Accelerates overall growth
- Attracts foreign capital and expertise, which are in scarce supply in most developing countries
- Generates foreign exchange to use for food imports if agricultural sector lags behind or suffers natural catastrophes
- Eliminates distortions caused by government interventions including corruption and rent-seeking activities
- Promotes equal access to scarce resources,
- Enables developing countries to take full advantage of reforms under the WTO

Export-Oriented Industrialization Strategy: Some arguments in the literature on why, in principle, it could be effective:

There are market failures in transfer of innovations. Coordination failures may make industrialization problematic. Export expansion may facilitate technology transfer through contacts with foreign firms, industry spillovers, scale economies. There may be learning by doing (or "watching") effects in manufacturing sectors. Performance is rigorously tested when firms attempt to export. Export targets more visible; focus on manageable problems. Hausmann, Hwang, and Rodrik: exporting a mix of goods more typical for higher-income countries predicts higher growth. Thus, export oriented industrial policy may help overcome market failures in the process of technological progress

The Industrialization Strategy Approach to Export Policy

Focus on government interventions to encourage exports, especially those with higher skill and technology content (industrial policy) - Problem: without proper attention to incentives, industrial policies may be counterproductive too. WTO rules and industrial policies - gray areas remain. Problem: level of competence and political authority of governments to carry out policies effectively

Economic Integration: Theory and Practice

- The growth of trade among developing countries.
- Integration encourages rational division of labor among a group of countries and increases market size
- Provides opportunities for a coordinated industrial strategy to exploit economies of scale
- Trade creation
- Trade diversion

Regional trading blocs and the globalization of trade

- NAFTA
- MERCOSUR
- SADC
- ASEAN
- Local conditions matter
- Still not fully answered: Do blocs promote growth or retard the progress of globalization

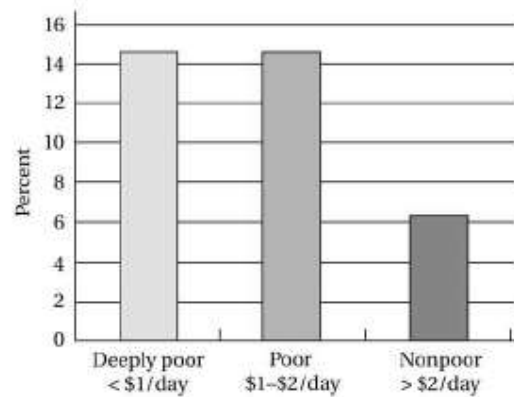
Trade Policies of Developed Countries: The Need for Reform and Resistance to New Protectionist Pressures

Rich-nation economic and commercial policies matter for developing countries

- Tariff and non-tariff barriers to developing country exports
- Adjustment assistance for displaced workers
- General impact of economic policy

World Trade Organization, Despite 8 liberalization rounds over 50 years, trade barriers remain in place in agriculture; and, through various mechanisms, to a degree in other sectors. Doha Development Round begun 2001 tilted the nominal focus to needs of developing world; but talks remained stalled through the end of 2010, a self-imposed deadline

Figure 12.5 Effective Tariff Faced by Income Groups, 1997-1998



CHAPTER 13

BALANCE OF PAYMENTS, DEBT, FINANCIAL CRISES, AND STABILIZATION PROCESS

International Finance and Investment: Key Issues
How major debt crises emerged during the 1980s

The Balance of Payments Account

General considerations:

1. Balance of Payments (BOP)
2. Current Account
3. Surplus and Deficit
4. Capital Account

Table 13.1 A Schematic Balance of Payments Account

Exports of goods and services	A
Imports of goods and services	B
Investment income	C
Debt service payments	D
Net remittances and transfers	E
Total current account balance (A - B + C - D + E)	F
Direct private investment	G
Foreign loans (private and public), minus amortization	H
Increase in foreign assets of the domestic banking system	I
Resident capital outflow	J
Total capital account balance (G + H - I - J)	K
Increase (or decrease) in cash reserve account	L
Errors and omissions (L - F - K)	M

Cash Account or International Reserve Account

Three forms:

1. Hard currency
2. Gold
3. Deposits with IMF

Table 13.5 Developing Country Payments Balances on Current Account, 1980–2009 (billions of dollars)

	1980	1981	1982	1983	1984	1985	1986	1987
All developing economies	43.203	-17.934	-43.535	-40.573	-19.798	-27.544	-56.07	-23.168
Developing Asia	-7.604	-12.295	-13.898	-17.372	-10.751	-20.124	-16.382	-6.22
Middle East and North Africa	79.623	61.314	23.835	-10.585	-9.128	-2.164	-17.117	-8.23
Sub-Saharan Africa	0.612	-17.405	-16.347	-8.687	-4.319	0.14	-4.673	-1.836
Developing Western Hemisphere	-27.677	-43.789	-42.287	-7.501	-1.266	-1.97	-17.089	-10.959
	1988	1989	1990	1991	1992	1993	1994	1995
All developing economies	-41.458	-38.121	-32.15	-95.512	-81.619	-120.442	-79.1	-92.015
Developing Asia	-14.931	-19.715	-11.261	-8.954	-9.166	-31.691	-16.711	-36.916
Middle East and North Africa	-9.303	-4.362	3.225	-66.499	-25.704	-21.744	-10.471	-1.208
Sub-Saharan Africa	-6.818	-3.823	-2.314	-4.876	-6.382	-5.766	-5.923	-9.864
Developing Western Hemisphere	-9.322	-4.977	-1.087	-17.413	-34.821	-45.853	-51.931	-37.451
	1996	1997	1998	1999	2000	2001	2002	2003
All developing economies	-68.881	-69.83	-105.755	-15.457	92.923	47.897	80.48	148.978
Developing Asia	-35.981	11.08	50.156	39.801	41.651	39.285	66.937	85.011
Middle East and North Africa	18.038	15.028	-26.183	13.502	78.232	45.814	31.417	63.895
Sub-Saharan Africa	-4.692	-6.813	-15.516	-12.168	1.985	-4.891	-12.638	-12.702
Developing Western Hemisphere	-39.137	-66.266	-90.539	-56.513	-48.569	-53.88	-16.153	9.245
	2004	2005	2006	2007	2008	2009		
All developing economies	222.251	449.74	665.562	657.93	709.16	321.748		
Developing Asia	92.904	167.489	289.244	414.67	424.059	319.003		
Middle East and North Africa	106.152	219.225	286.385	279.219	347.809	34.81		
Sub-Saharan Africa	-8.484	-2.713	30.985	10.074	8.582	-18.149		
Developing Western Hemisphere	21.37	36.66	49.822	14.825	-26.687	-18.612		

Table 13.2 Credits and Debits in the Balance of Payments Account

"Positive" Effects (Credits)	
1. Any sale of goods or services abroad (export)	
2. Any earning on an investment in a foreign country	
3. Any receipt of foreign money	
4. Any gift or aid from a foreign country	
5. Any foreign sale of stocks or bonds	

"Negative" Effects (Debits)	
1. Any purchase of goods and services abroad (import)	
2. Any investment in a foreign country	
3. Any payment to a foreign country	
4. Any gift or aid given abroad	
5. Any purchase of stocks or bonds from abroad	

A hypothetical illustration: deficits and debts

- Current Account
- Capital Account
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Table 13.3 A Hypothetical Balance of Payments Table for a Developing Nation

Item	Amounts (millions of dollars)
Current account	
Commodity exports	135
Primary products	125
Manufactured goods	110
Commodity imports	245
Primary products	210
Manufactured goods	235
Services (e.g., shipping costs)	25
Investment income	11
Debt service payments	215
Net remittances and transfers	12
Balance on current account	227
Capital account	
Private direct foreign investment	13
Private loans and portfolio investments	14
Government and multilateral flows (net)	13
Loans	19
Debt amortization	26
Resident capital outflow	28
Balance on capital account	12
Balance on current and capital accounts	225
Cash account	
Net decrease in official monetary reserves	125
Balance on cash account	125

Table 13.4 Before and After the 1980s Debt Crisis: Current Account Balances and Capital Account Net Financial Transfers of Developing Countries, 1978-1990 (billions of dollars)

Year	Current Account	Capital Account Net Financial Transfers
1978	-32.1	33.2
1979	+10.0	31.2
1980	+30.6	29.5
1981	-48.6	35.9
1982	-86.9	20.1
1983	-64.0	3.7
1984	-31.7	-10.2
1985	-24.9	-20.5
1986	-46.4	-23.6
1987	-4.4	-34.0
1988	-22.4	-35.2
1989	-18.4	-29.6
1990	-3.0	-22.5

A hypothetical illustration: deficits and debts

- Inflow
- Outflow
- Amortization

The Issue of Payment Deficits

- Some initial policy issues
- International reserves

Restrictive fiscal and monetary policies:

1. Structural adjustment
2. Stabilization policies

Special drawing rights (SDRs)

Trends in the Balance of Payments

Accumulation of Debt and Emergence of the Debt Crisis

Background and analysis

- External debt
- Debt service
- Basic transfer

Net capital inflow, F_N , is

$$F_N = dD \quad (13.1)$$

Basic transfer, BT, is

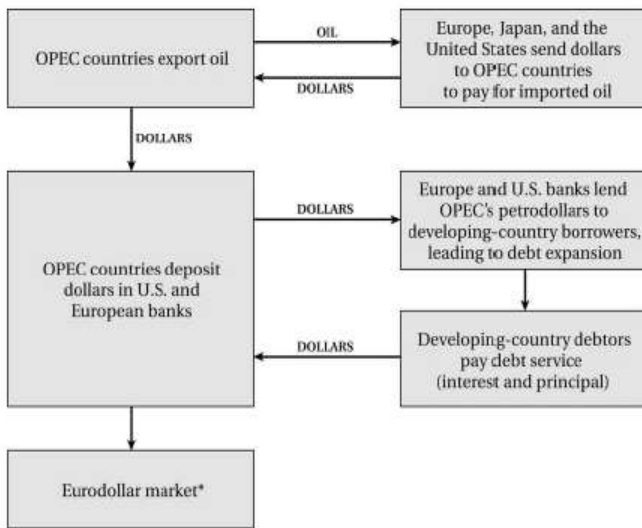
$$BT = dD - rD = (d - r)D \quad (13.2)$$

Where d is percent increase in total debt
 D is total debt
 r is the average interest rate

Origins of the 1980s Debt Crisis

- OPEC oil price increase
- Increased borrowing
- Excess of imports
- Lagging exports

Figure 13.1 The Mechanics of Petrodollar Recycling



4. Developing-country stock markets
5. Aid
6. Distribution of influence among developing countries
7. Worker remittances
8. Poverty
9. Health and education
10. General policy framework

Differing impacts across developing regions
 – China and the exchange rates controversy
 – East Asia and Southeast Asia except China
 – India
 – Latin America
 – Africa

CHAPTER 14

**FOREIGN FINANCE, INVESTMENT, AND AID :
 CONTROVERSIES AND OPPORTUNITIES**

Origins of the Debt Crisis
 – Debt-servicing obligations
 – Debt-service payments
 – Debt-servicing difficulty
 – Oil shocks

Developing countries' two options:
 1. Curtail imports and restrictive fiscal and monetary measures
 2. More external borrowing

Attempts at Alleviation: Macroeconomic Instability, Classic IMF Stabilization Policies, and Their Critics
 The IMF stabilization program
 – Macroeconomic instability
 – Stabilization policies

Four basic components of IMF stabilization program:
 1. Liberalization of foreign exchange and imports control
 2. Devaluation of the official exchange rate
 3. Stringent domestic anti-inflation program
 4. Opening up of the economy to international commerce

Such policies can be politically unpopular because they hurt the lower- and middle-income groups. Less radical observers view the IMF as neither a developmental nor an antidevelopmental institution.

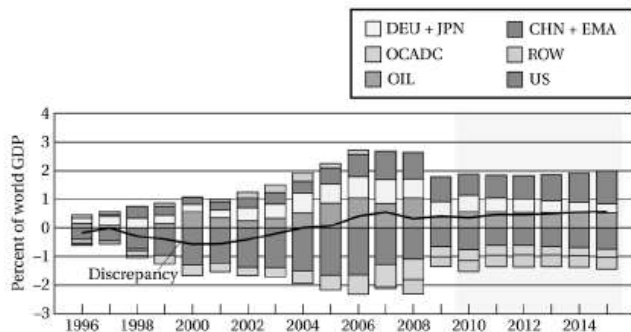
Tactics for debt relief:
 1. Debtors' cartel
 2. Restructuring
 3. Brady Plan
 4. Debt for equity swaps
 5. Debt for nature swaps
 6. Debt repudiation

"Odious Debt" and Its Prevention
 What is odious debt?

Sovereign debt used by an undemocratic government in a manner contrary to the interests of its people should be deemed invalid

Resolution of 1980s-1990s Debt Crises and Continued Vulnerabilities
 – Highly indebted poor countries (HIPCs)
 – Some progress but vulnerabilities remain

Figure 13.2 Global Imbalances



The Global Financial Crisis and the Developing Countries
 Causes of the crisis and challenges to lasting recovery. Economic impacts on developing countries

1. Economic growth
2. Exports
3. Foreign investment inflows

The International Flow of Financial Resources

Three sources:
 – Private direct and portfolio investment
 – Remittances of earnings by international migrants
 – Public and private development assistance
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Private Foreign Direct Investment and the Multinational Corporation

Multinational Corporation (MNC)
 – Recent growth of foreign direct investment (FDI)

Figure 14.1 FDI Inflows, 1980–2008

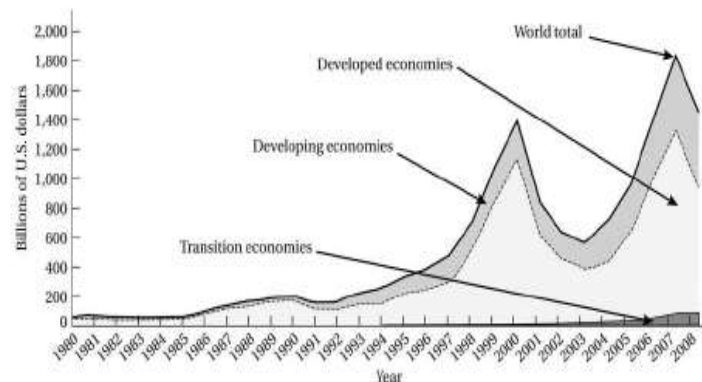
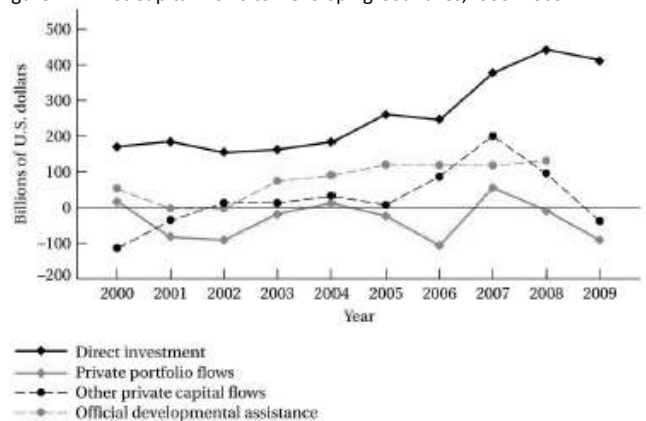


Figure 14.2 Net Capital Flows to Developing Countries, 2000–2009



Private Foreign Direct Investment and the Multinational Corporation

Private Foreign Investment: Pros and Cons for Development. Traditional arguments in support of private investment: Filling savings, foreign exchange, revenue, and management gaps, Four main arguments. Two main perspectives of the arguments: Economic and ideological, transfer pricing. Reconciling pros and cons

Private Portfolio Investment: Benefits and Risks?

What is portfolio investment?
 Emerging-country stock markets

The Role and Growth of Remittances

1. Wage differences

- 2. "Brain Drain"
- 3. Uneven flow of remittances

Figure 14.3 Sources of External Financing for Developing Countries, 1990–2008

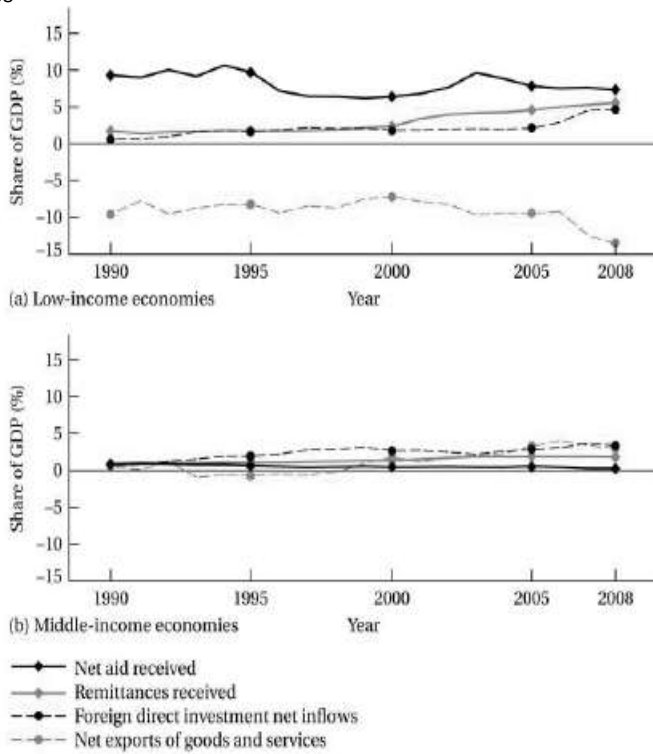


Table 14.1 Major Remittance-Receiving Developing Countries, by Level and GDP Share, 2008

	Inflow of Migrants' Remittances (millions of U.S. dollars)	Annual Change (%)	Share of Remittances in GDP (%)
Ranked by volume			
India	45,000	27.8	3.7
China	34,490	5.0	0.8
Mexico	26,212	3.4	2.4
Philippines	18,268	12.1	10.8
Nigeria	9,979	8.2	4.7
Egypt	9,476	23.8	5.8
Bangladesh	8,979	38.8	11.0
Pakistan	7,025	17.1	4.2
Morocco	6,730	0.0	7.6
Indonesia	6,500	5.3	1.3
Lebanon	6,000	4.0	20.7
Vietnam	5,500	0.0	6.1
Ukraine	5,000	11.0	2.8
Colombia	4,523	0.0	1.9
Russian Federation	4,500	9.7	0.3
Ranked by share of GDP			
Tajikistan	1,750	3.5	34.1
Lesotho	443	0.0	27.4
Moldova	1,550	3.5	25.3
Guyana	278	0.0	24.0
Lebanon	6,000	4.0	20.7
Honduras	2,801	6.7	19.8
Haiti	1,300	6.4	18.0
Nepal	2,254	30.0	17.8
Jordan	3,434	0.0	17.1
Jamaica	2,214	3.3	17.1
El Salvador	3,804	2.5	17.0
Kyrgyzstan	715	0.0	14.2
Nicaragua	771	4.2	11.5
Guatemala	4,440	4.4	11.2
Bangladesh	5,979	36.8	11.0

Foreign Aid: The Development Assistance Debate

Conceptual and measurement problems. Amounts and allocations: public aid, Official development assistance (ODA).

Table 14.2 Official Development Assistance Net Disbursements from Major Donor Countries, 1985, 2002, and 2008

Donor Country	1985		2002		2008	
	Billions of U.S. Dollars	Percentage of GNI	Billions of U.S. Dollars	Percentage of GNI	Billions of U.S. Dollars	Percentage of GNI
Canada	1.6	0.49	2.0	0.28	4.8	0.33
Denmark	—	—	1.6	0.96	2.8	0.87
France	4.0	0.78	5.5	0.38	10.9	0.40
Germany	2.9	0.47	5.3	0.27	14.0	0.40
Italy	1.1	0.26	2.3	0.20	4.9	0.23
Japan	3.8	0.29	9.3	0.23	9.6	0.20
Netherlands	1.1	0.91	3.3	0.81	7.0	0.86
Sweden	—	—	2.0	0.83	4.7	1.00
United Kingdom	1.5	0.33	4.9	0.31	11.5	0.40
United States	9.4	0.24	13.3	0.13	8.0	0.18
Total (22 countries)	29.4	0.35	58.3	0.23	121.5	0.45

Table 14.3 Official Development Assistance (ODA) by Region, 2008

Region	ODA Per Capita (U.S. \$)	GNI Per Capita (U.S. \$)	ODA as a Share of GNI (%)
Middle East and North Africa	73	3,237	1.9
Sub-Saharan Africa	49	1,077	4.3
Latin America and the Caribbean	16	6,768	0.2
East Asia and the Pacific	5	2,644	0.2
South Asia	8	963	0.8
Europe and Central Asia	19	7,350	0.2

Foreign Aid: The Development Assistance Debate

- Why donors give aid
 - Political motivations
 - Economic motivations: two-gap models and other criteria
 1. Foreign exchange constraints
 2. Growth and savings
 3. Technical assistance
 4. Absorptive capacity
 5. Economic motivations and self-interest

The two-gap model : savings constraint

$$I < F + sY \quad (14.1)$$

Where

- I is domestic investment
- F is the amount of capital inflows
- s is the savings rate
- Y is national income

The two-gap model : foreign-exchange constraint

Where

- I is domestic investment
- F is the amount of capital inflows
- E is the level of exports
- Y is national income
- m1 is the marginal import share
- m2 is the marginal propensity to import

Why recipient countries accept aid. The role of nongovernmental organizations in aid (NGOs). The effects of aid

Conflict and Development

The scope of violent conflict and conflict risks. The consequences of armed conflict

- Health
- Destruction of wealth
- Worsening hunger and poverty
- Loss of education
- A torn social fabric

Figure 14.4 Global Trends in Armed Conflict, 1946-2008



The causes of armed conflict and risk factors for conflict
 - Horizontal inequalities

- Natural resources for basic needs
- Struggle to control exportable natural resources

- The resolution and prevention of armed conflict
- Importance of institutions; e.g. addressing commitment problems
 - Global actors
 - Regional actors: an Africa-wide approach
 - National actors
 - Focus on education
 - Local, "community-driven" economic development

CHAPTER 15
FINANCE AND FISCAL POLICY FOR DEVELOPMENT

The Role of the Financial System in Economic Development

Six major functions of the financial system

1. Providing payment services
2. Matching savers and investors
3. Generating/distributing information
4. Allocating credit efficiently
5. Pricing, pooling, and trading risks
6. Increasing asset liquidity

Differences between developed and developing-country financial systems

The Role of Central Banks and Alternative Arrangements

Functions of a full-fledged central bank

- Issuer of currency and manager of foreign reserves
- Banker to the government
- Banker to domestic commercial banks
- Regulator of domestic financial institutions
- Operator of monetary and credit policy

Table 15.1 Central Banking Institutions

Institution	Function					
	Issuer of Currency	Banker to Government	Banker to Commercial Banks	Regulator of Financial Institutions	Operator of Monetary Policy	Promoter of Financial Development
Full-fledged central bank	3	3	3	3	3G	1
Supranational central bank	3E	2E	2	2	2E	2
Open-economy central banking institution	3C	2C	2	3	1	3
Transitional central banking institution	3CG	2C	2	1	2G	3
Currency enclave central banking institution	1, 2CE	2CE	2	1	1	3
Currency board	3C	1	1	1	1	1

Currency boards

Form of central bank that issues domestic currency for foreign-exchange at a fixed exchange rate

Alternatives to central banks :

- Transitional central banking institution
- Supranational central bank
- Currency enclave
- Open-economy central banking institution

The role of development banking

Development banks are specialized public and private financial intermediaries that provide medium- and long-term credit for development projects.

Informal Finance and the Rise of Microfinance

Traditional informal finance, Microfinance institutions (MFIs)

- Microfinance provides financial services to people otherwise with no access or only with very unfavorable terms.
- Includes microcredit, microsavings, and microinsurance
- Primary focus: very small loans for microenterprises
- Microcredit often uses group lending schemes (joint liability)
- Provides "collateral of peer pressure" to jointly repay
- An alternative without joint liability: "dynamic incentives," in which loan sizes steadily increase when loans are repaid
- Other alternatives to joint liability

MFIs: three current policy debates

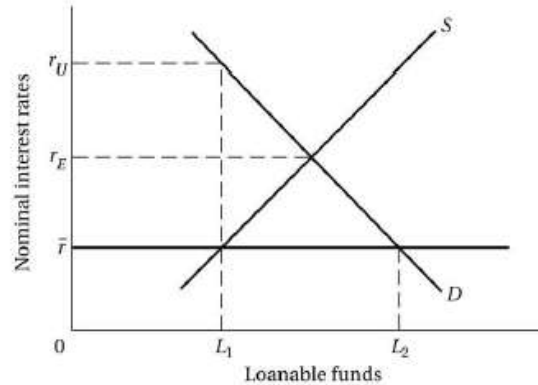
- Microfinance schism--Are subsidies appropriate?
- Should credit be integrated with education, health, or other programs?
- Should MFIs undergo commercialization, whereby an NGO providing microfinance is converted into a for-profit bank?

Potential limitations of microfinance as a development strategy. Microfinance is a powerful tool, but it needs to be complemented with other development and poverty policies

Reforming Financial Systems

- Financial liberalization, real interest rates, savings, and investment
- Rationing
- Financial repression

Figure 15.1 The Effects of Interest-Rate Ceilings on Credit Allocation



Financial policy and the role of the state

Stiglitz: seven financial market failures:

1. The "public good" nature of monitoring financial institutions
2. Externalities of monitoring, selection, and lending
3. Externalities of financial disruption
4. Missing and incomplete markets
5. Imperfect competition
6. Inefficiency of competitive markets in the financial sector
7. Uninformed investors

Debate on the role of stock markets

Fiscal Policy for Development

Macro-stability and resource mobilization. Taxation: direct and indirect.

Five factors of the taxation potential of a country

1. Level of per capita real income
2. Degree of inequality in the distribution of that income
3. Industrial structure of the economy and the importance of different types of economic activity
4. Social, political, and institutional setting and the relative power of different groups
5. Administrative competence, honesty, and integrity of the tax-gathering branches of government

Table 15.2 Comparative Average Levels of Tax Revenue, 1985–1997, as a Percentage of GDP

Country Groups	1985–1987	1995–1997
OECD countries	36.6	37.9
America	30.6	32.6
Pacific	30.7	31.6
Europe	38.2	39.4
Developing countries	17.5	18.2
Africa	19.6	19.8
Asia	16.1	17.4
Middle East	16.5	18.1
Western hemisphere	17.6	18.0

Fiscal Policy for Development

1. Personal income and property taxes
2. Corporate income taxes
3. Indirect taxes on commodities
4. Problems of tax administration

State-Owned Enterprise and Privatization

State-owned enterprises (SOEs)—public corporations and parastatal agencies owned and operated by the government. Improving the performance of SOEs.

Privatization: theory and experience

Public Administration: The Scarcest Resource

Administrative capability is a scarce public resource in the developing world. The administrative component of economic development should not be underestimated