1 Key Problems of Economic Development

- Lower per capita income
- Poverty↑ & Inequality↑
- Food crisis
- Environmental degradation
- Internal migration (slums)
- Population Growth (pot. - consequences)

HIV/AIDS and Diseases
- 95% of all HIVs live in DCs
- Affect negatively productivity (wages!)

Population Growth (pot. - consequences)
- Lower per capita income
- Poverty↑
- Inequality↑

Food crisis
- Women attend less to schools
- Lower job opportunities
- Low participation in politics

Environmental degradation
- Soils lose productivity
- Poverty drives environmental degradation
- Environmental degradation caused mainly by IC
- Poor’s livelihood depend on NR

HIV/AIDS and Diseases
- Inappropriate agricultural policies
- Disregard of agricultural development
- Subsidies in IC (unfair competition)
- Bio-Fuel Production (higher food prices)

Poverty and Hunger
- Natural disasters

Education
- Conflicts
Poverty and Inequality

Poverty

Definition
- Pronounced deprivation in well-being
- Command over commodities
- Fullfill need for specific goods
- Generated by capability to function in society

Capabilities
- Set of alternatives a person can achieve with his/her characteristics
- Absolute and not relative!

Dimensions
- Malnutrition, low income, low life expectancy, limited access to education, knowledge, drinking water & health services, shelter, participation in pol, econ, soc. processes

Absolute Poverty
- Rate of people basic needs
- Poverty threshold is arbitrary
- Poverty Line
- Minimum amount that separates poor from rich
- Food-energy intake, cost of basic needs, Subjective poverty lines
- Upper and lower bound for non-food essentials

Problems
- Does not show intensity of poverty
- Correct poverty line?

Relative Poverty
- How poor compared to others
- Poverty is more concentrated in rural areas
- How to compare urban poor

Steps in Measuring Poverty:
1. Define Indicator of Welfare
2. Develop Poverty Line
3. Generate Summary Statistics

Inequality

Lorenz Curve
- From Lorenz Curve
- 0 = Perfect Equality
- 1 = Perfect Inequality
- Gini Coefficient

Importance
- No trickle down effect
- Undermines social stability and solidarity
- Less ppl quality for loans
- Lower S and I
- Marginal Utility gains higher for the poor
- Unequal power distribution (Rent Seeking)

Inequality
- Unequal distribution of income, consumption expenditures, assets and socio-economic factors among households

Lorenz curve
- "Poverty, in this view is not ultimately a matter of incomes at all; it is one of a failure to achieve certain minimum capabilities. The distinction is important since the conversion of real incomes into actual capabilities varies with the social circumstances and personal features" - Amartya Sen

Human Development Index
- Dimensions
- Education
- Health
- Life exp.
- Includes Human Capital
- Advantages
- Multidimensional
- Disadvantages
- Good data availability
- School enrollment ≠ School attendance
- Ecological?
- Relevance of indicators?

Vulnerability
- Exposure to income/health risks in one period and p of exposure to further risks

Steps in Measuring Poverty:
1. Define Indicator of Welfare
2. Develop Poverty Line
3. Generate Summary Statistics

Unequal power distribution (Rent Seeking)
3&4 What is Development and Actors

National Organizations
- Bundesministerium für Wirtschaftliche Zusammenarbeit und Entwicklung (BMZ)
- Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ)
- Deutscher Entwicklungsdienst (DED)
- Kreditanstalt für Wiederaufbau

International Organizations
- World Bank Group
- International Monetary Fund
- Regional Development Banks
- UN organizations
- European Union

50s to 70s: Growth
But not sufficient!

DC definition by WorldBank
Lower&Lower-Middle income countries
5: Non Economic Theories

Geography/climate explain development
- Poorest countries are in the tropics
- Montesquieu: Willingness to work increases as distance from equator increases
- Key to understand changes in economic systems
- Surplus for Winter
- Manufacturing in Winter
- Critique
  - Only one Explanatory factor
  - Today's climate not particularly harmful

Socio-Psychological
- Social dispositions support economic and social development
- Weber (1904): Calvinist ethic pushed development of capitalism
- Traditional societies not fertile for entrepreneurship
- Critique:
  - Little focus on economic development
  - Non-hierachical African societies?
- IC blueprint of Modern Society
- DCs gell behind
- Culture specific concepts?
- Only western style valid?
5.3 Classical Theories 1

2 Structural Change Models

2.1 Classical Dualism

Critique:

Strong Simplification
Insufficient empirical proof
Links between sectors not considered
Industry not necessarily driving force for economic growth

2.2 New Dualism

Modern Sector can’t absorb new Labor Force without more capital

2.3 Balanced Growth

2.4 Unbalanced Growth

Industry vs Agriculture

Investment & Savings

Rostow’s Stages of Growth

IC past “Take off” -- > "Self sustaining Growth"

DCs in "Pre-condition to take off"

1 Linear Stages Theory

Rostow’s

Critique:

Little Explanaotry Power
Deviations?
Poor empirical performance
Disregard of exogenous explanatory variables
5.4 Classical Theories II

2 Structural Change Model

2.1 Classical Dualism

- Subsistence econ --> Modern industrialised econ
- speed depends on investments
- Self sustainable growth until all surplus L is absorbed into Modern Sec.
- Profits -> Investments
- Increased Productivity
- Absorb more labor!

2.2 New Dualism

- Capital Flight
- High unemploy in industry (praxis)
- Constant wages?
- Profits are reinvested in labor saving tech
- Income is for owners!

2.3 Vicious Circle (Myrdal)

- High Savings --> High I
- Expansion!
- Low S -> Low I
- Underdevelopment!
- Call for active role of State

2.5 Balanced Growth

- Keynes
- Too much confidence in State
- Hayek (Information Problem)
- Disregard of Price as regulating mechanism
- State investment can hardly suffice for self-sustaining growth

2.6 Unbalanced Growth

- Disequilibria by active policy triggers entrepr.
- Profit motive
- Competition maximizes consumer welfare

Critique:
- Behavioral assumptions
- No perfect substitution of factors
- Natural law?
- How to break circle?

Critique:
- Rational Entre. and Bureaucrats
- Optimal magnitude of Disequilibrium?
- May cause dualistic economies
- little attention to division of labor

New dualism
5.5 Classical Growth Theories: Foreign Trade Theories

- **Terms of Trade (ToT) - Prebisch-Singer**
  - Prebisch-Singer Hypothesis: Low Income Elasticity for Primary Commodities vs. High Income Elasticity for Manufactured Commodities
  - Falling ToT leads to Transfer from DCs to ICs
  - Critique: Hypothesis does not hold! No consistent empirical pattern

- **Immizerizing Growth (Bhagwati)**
  - Growth -> Net Exports for imports from ICs
  - Negative ToT crowds out positive growth effect
  - Gains of growth transferred to ICs
  - Critique: Extreme circumstances assumed

- **Import Substitution**
  - Substitute Imports with domestics
  - Critique: Low Competition, Low Quality -> Die in International Market

- **Export Promotion**
  - Abolish Regulations of Foreign Trade
  - Asian Tigers: Countries with high export growth also have overall growth
  - Causality?
5.6 Growth Theories

1. Harrod-Domar (Post-Keynesian)
   - Growth if I > Depreciation
   - Easy Formula
   - + Correlation btw. I and Growth
   - Influenced countries with Central Planning

   Critique:
   - S and P.G assumed exogenous
   - I necessary but not sufficient!
   - No diminishing marginal returns

2. Solow (NeoClassical)
   - Most influential growth model
   - Diminishing marginal returns
   - Convergence
   - Technological Progress
   - Innovation/Human Capital as growth engine

3. Endogenous Growth Theories
   - Technological Progress
   - Innovation/Human Capital as growth engine

   Critique of endogenous growth theories
   - Neoclassic assumption inappropriate for DCs
   - Structural change not modelled
   - Imperfect markets? Institutions?
   - Limited support of empirical studies
   - Different growth rates of knowledge IC/DCs

4. Human Capital Model
   - Increasing marginal returns of HC
   - Invest in Education!
   - Technological Spill over

5. Romer
   - Technological Spill over
   - Growth endogenous due to +externalities
   - Different growth rates of knowledge IC/DCs

   Critique of endogenous growth theories
   - Neoclassic assumption inappropriate for DCs
   - Structural change not modelled
   - Imperfect markets? Institutions?
   - Limited support of empirical studies
   - Different growth rates of knowledge IC/DCs

Behavior by X -> Behavior by Y
Models of EconDev complementarities
No D without S, no S without D
Policy intervention to achieve best Equilibrium
5.7 Growth

Washington Consensus

- 1 Fiscal Discipline
- 2 Reordering Public Expenditure priorities
- 3 Tax reform
- 4 Liberalization of interest rates
- 5 Competitive exchange rates
- 6 Trade liberalization
- 7 Liberalization of FDI
- 8 Privatization
- 9 Deregulation
- 10 Secure PR

Other Factors (e.g., Oil Shock)
- Failure?
- Slowdown in g by IC
- Rise in world interest rates
- Incomplete implementation
- Inequality reduction?
- Elimination of absolute poverty

Critique
- China?
- South Corea?

Limits of Growth

- Peak Oil
- Declining environmental quality
- Overuse of Resources in IC -> Costs in DC
- Crisis of non-renewable resources
- Scenario 1
- Crisis of environmental degradation and pollution
- Scenario 2

"Anyone who believes exponential growth can go on forever on a finite planet is either a madman or an economist." Kenneth Boulding, 1986
"Institutions are humanly devised constraints that shape human interaction." North 1990

"The inability of societies to develop effective, low-cost enforcement of contracts is the most important source of both historical stagnation and contemporary underdevelopment in the Third World." North

“Implications of property rights”

- Formal Law
- Informal Tradition

- PR determined by Inst. (legal st. & norms)
- PR ensure that Inv. today = Inv tomorrow
- Clear defined PR help prevent conflict
- PR prevent externalities (Tragedy of Commons)
- PR inst important for g
- PR influence size and efficiency of Inv.
- PR and Econ. C

- Bundles of Rights
- Property Rights

- NIE & PR

- Bundle of Rights
- PR determined by Inst. (legal st. & norms)
- PR ensure that Inv. today = Inv tomorrow
- Clear defined PR help prevent conflict
- PR prevent externalities (Tragedy of Commons)
- PR inst important for g
- PR influence size and efficiency of Inv.

- Rules of law: “reflects the degree to which citizens of a country are willing to accept the established institutions to make and implement laws and adjudicate disputes”

- ICRG Index

- Expropriation Risk and Rule of Law
- Repudiation of contract by govt
- Corruption in Govt and Bureauc. quality

- PR Inst important for g
- PR influence size and efficiency of Inv.

- Functions
- Define choice set
- Reduce uncertainty

- Framework for invisible hand

- Transaction Costs
- Costs of using the markets (Coase)

- Bound rationality

- Trade off
- Returns of Spec. and TC

- Poor Transport / Underdeveloped Markets
- Inefficient Public Administration
- Poor education

- DCs and TCs
- Contracts

- Risks

- Agency Problems
- Inf. Asymmetries between P and A (due to TC)

- Design incentives to reduce PA Problem!

- P. Govt: A. Bureaucrats

- Powerful players take advantage of poor informed farmers

- Lack of collateral -> Underdev. Financ. Markets

- Agency Problems

- Reputation & Trust

- Family Enterprises

- Self-Enforcing contracts (Ostrom)

- Collective Action

- Solution to Commons Problems

- Open Access (Tragedy of commons)

- TR

- TR

- Common property (community)

- State property

- Non-excludability -> Free riding

- to overcome it, INST to be considered

- TR

- PR

- Privatization

- Prisoners Dilemma

- Trust can lead to pareto efficient field of

- Collective Action
7 Population Growth and Economic Development

Demographic Transition: Falling Death & Birth rate

Malthusianism (1798)

- Population growth geometrical
- Resource growth arithmetical
- CRISIS!
- Proved wrong

New Tech

Malthus

Stage 3
- Case A: strongly falling death and birth rates → parts of Asia and Latin America
- Case B: initially diminishing death and birth rates, but later stagnation caused by poverty, poor living standards and HIV/AIDS → parts of Africa and the Middle East
Environment and Development

Environ. Res Important for DCs
- Rural livelihoods depend on it
  - Agriculture, hunting, fishing...

DCs & Environmental degradation
- Self perpetuating process
  - Poverty -> Overuse of resources
  - Overuse of resources -> Poverty!
  - Econ. growth influenced by environ. degradation

Population & econ. growth -> environ. degradation
- More area for food production
- Deforestation

ICs most responsible for climate change. But Climate change hurts specially DCs
- Ecological Footprint
  - WWF & Global Footprint Network
  - Indicator for sustainability
  - Human consumption vs Regenerative capacity

Conflicting views
- Anthropocentric
  - Human as center
  - Utilitarian
  - Nature as resource

- Biocentric
  - Nature as center
  - Protectionist
  - Nature as conservation-worthy

Not compatible with today’s exploitation
- Humans must integrate
  - Biocentric

WWF & Global Footprint Network
- Indicator for sustainability
- Ecological Footprint
- Human consumption vs Regenerative capacity

Rationing over time
- Scarcity Rent
- Dynamic Efficiency
- Static Efficiency
- max \( \sum PR + CR \)

Sustainability
- Sustainable Dev. path
- Future growth and quality of life depend on environment

Problems
- Economic growth vs environmental preservation
- Sust. growth possible
- \( \downarrow \) Production costs
- \( \uparrow \) Tourism and Agriculture
- Market failure
- Poverty
- Reasons for unsustainable growth

"[...] meeting the needs of the present generation without compromising the needs of future generations" Todaro, Smith 2009
Trust and Economic Performance

Relevance

Trust: “Willingness of a party to be vulnerable to the actions of another party based on the expectation that the other will perform a particular action important to the trustor, irrespective of the ability to monitor or control that other party.” Mayer et al 1995

“Virtually every commercial transaction has within itself an element of trust, certainly any transaction conducted over a period of time. It can be plausibly argued that much of the economic backwardness in the world can be explained by the lack of mutual confidence.” Arrow 1972

Lowers agency cost if Trust actors use social contacts & network for business

Examples

Agency (difficulty to monitor)

One party has opportunity to take advantage

T0: Good; T1: payment

Peasant doesn’t feed mule

I & S. banks & govts. will not expropriate

From Nash Equilibrium to Pareto Efficient Optimum

Trust & Econ. performance

High T → spending on protection ↓

Written contracts less needed

Litigation less frequent

Less dependence on formal INST

In formal credit markets depend on T

Govt credibility (Central banks)

More appropriate horizons (LR > SR)

Access to credit↑ → more enrollment↑

Trust & Human Cap

T↑ Performance of govt INST↑

T→Enforcement of contracts→↑ Returns on ed

Low T→ Hiring based on net. →↓ Returns on ED

Higher returns on HC if high T

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