

Ec428: Development and Growth - Lent Term 2009/2010

Lecturer: Prof. Maitreesh Ghatak

Course Outline

In Topic 1 we motivate this part of the course by looking at some aspects of the economic lives of the poor based on household surveys from a set of developing countries. In Topics 2 and 3 we take a macro view and study some theoretical models that in contrast to the neoclassical growth model do not predict convergence. We will see that two economies with identical parameters can converge to very different equilibria depending in initial conditions, or "history". In Topics 4-10 we take a micro view and study financial markets, property rights, agricultural organization, industrial organization, social networks, provision of public goods and services, and time permitting, political economy of institutional change in developing countries. While topics and lectures will hopefully have a rough correspondence (i.e., topic t will be covered at least partly in week t), it will not be exact.

Lecture notes will be posted on the course website. These constitute required reading. Because I update/revise the lecture notes before the lecture, you can access only the previous year's lecture notes *before* the lecture if that topic was taught. The revised version is posted on the web typically within a day or two of the lecture.

There are no textbooks for the course. Debraj Ray's *Development Economics*, Princeton University Press, 1998 provides an excellent introduction to most topics covered in the course.

My office hours: Tuesdays 4 - 5PM Room 530 STICERD, or by appointment.

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Reading List

Topic 1: Introduction

We look at some stylized facts based on micro-level studies as to how the poor live, with special focus on their consumption, income generation, as well as their access to markets and public services. This motivates our theoretical discussion of models of poverty traps (Topics 2 and 3), as well as the microeconomic studies of various markets and institutions that affect development.

*[Lecture Notes](#)

* Abhijit Banerjee and Esther Duflo (2006) "[The Economic Lives of the Poor](#)", April 2006, Journal of Economic Perspectives, Vo. 21(1), pp. 141-167

Abhijit Banerjee and Esther Duflo (2007) "[What is Middle Class about the Middle Classes Around the World?](#)", December 2007

Topic 2: Market Failure and Poverty Traps

We examine some mechanisms of the vicious cycle of poverty. In the presence of transactions costs leading to financial market imperfections, an economy may fail to converge to the efficient steady state, and remain trapped in poverty. The initial wealth distribution may play a crucial role in governing the future trajectory of the economy.

*Lecture Notes

*Maitreesh Ghatak and Nien-Huei Jiang (2002): "[A Simple Model of Inequality, Occupational Choice and Development](#)". *Journal of Development Economics*, Vol. 69, No. 1, October.

Banerjee, A. and A. Newman, (1993): "Occupational choice and process of development" [Journal of Political Economy](#), 101 (2).

Maitreesh Ghatak, Massimo Morelli, Tomas Sjoström (2007) "Entrepreneurial talent, occupational choice, and trickle up policies", *Journal of Economic Theory*.

*Abhijit Banerjee and Sendhil Mullainthan "[Limited Attention and Income Distribution](#)", January 2008

Banerjee, A. (2002): "[Contracting Constraints, Credit Markets and Economic Development](#)", *MIT Dept. of Economics Working Paper No. 02-17*

(*Section 4)

Banerjee, B. and E. Duflo (2004): "[Growth Theory through the Lens of Development Economics](#)" December 2004, forthcoming in *Handbook of Development Economics*.

(* Sections 1-3)

Banerjee, B. and E. Duflo (2003): "Inequality and Growth: What Can the Data Say?" *Journal of Economic Growth*, Vol 8, 267-299.

Topic 3: Coordination and Sorting

We discuss some mechanisms by which history can matter. In the presence of externalities and complementarities in actions of individuals, there can be multiple equilibria. Two identical economies can end up at very different levels of development depending on initial conditions. We also look at issues such as group inequality.

[*Lecture Notes](#)

*Debraj Ray (1998): "History, Expectations and Development", Chapter 5, *Development Economics*, Princeton University Press, 1998.

Murphy, K., A. Shleifer and R. Vishny (1989) : "Industrialization and the Big Push" [Journal of Political Economy](#), pp. 1003-1026.

Fontenay, C. (2004): "The dual role of market power in the Big Push: from Evidence to Theory", *Journal of Development Economics*, Volume 75, Issue 1.

*Sam Bowles, Glenn Loury, and Rajiv Sethi "[Group Inequality](#)" Working Paper, Columbia University.

Donald Davis and David Weinstein (2002): "Bones, Bombs, and Break Points: The Geography of Economic Activity", *American Economic Review*, 92(5).

*M. Kremer (1993): "The O-Ring Theory of Economic Development", *Quarterly Journal of Economics*, August.

R. Fernandez (2001): "[Sorting, Education and Inequality](#)", NBER Working Paper No. 8101.

Topic 4: Financial Markets in Developing Countries: Theory & Evidence

Financial markets play a crucial role in economic development by allowing those who have talents and skills but not money, to undertake investments by using the surplus savings of others. If this market is subject to frictions, then worthwhile projects may not be undertaken for lack of money, thereby depressing national income below its potential. We study theoretical models of frictions in financial markets, empirical evidence on their importance, and innovative policy interventions in response to financial market imperfections, with special emphasis on micro-finance

[*Lecture Notes](#)

Parikshit Ghosh, Dilip Mookherjee and Debraj Ray: "[Credit Rationing in Developing Countries: An Overview of the Theory](#)", by, Chapter 11 in *Readings in the Theory of Economic Development*, edited by D. Mookherjee and D. Ray, London: Blackwell, 2000, pages 383--301.

Raghuram Rajan and Luigi Zingales (1998): "Financial Dependence and Growth", *American Economic Review*, 88(3).

*Abhijit Banerjee, Esther Duflo and Kaivan Munshi (2003): "[The \(mis\)-allocation of capital](#)" *Journal of the European Economic Association*, Papers and Proceedings.

Abhijit Banerjee, Esther Duflo (2008) "[Do Firms Want to Borrow More? Testing Credit Constraints Using a Directed Lending Program](#)" Mimeo, MIT

*Karlan, D. and J. Zinman (2008): "[Observing Unobservables: Identifying Information Asymmetries with a Consumer Credit Field Experiment](#)", Working Paper, Yale

Marianne Bertrand, Dean Karlan, Sendhil Mullainathan, Eldar Shafir, Jonathan Zinman (2005) "What's Psychology Worth? A Field Experiment in the Consumer Credit Market" NBER Working Paper 11892.

Robin Burgess and Rohini Pande (2005): "Do Rural Banks Matter? Evidence from the Indian Social Banking Experiment", *American Economic Review*, 95(3).

David McKenzie and Christopher Woodruff (2007): [Experimental Evidence on Returns to Capital and Access to Finance in Mexico](#)

*Suresh de Mel, David McKenzie and Christopher Woodruff (2008): [Returns to Capital in Microenterprises: Evidence from a field experiment](#), forthcoming *Quarterly Journal of Economics*.

Topic 5: Micro Finance

Microfinance needs no introduction as one of the key elements of development policy. We look at theoretical models of how microfinance works as a mechanism, and also empirical studies of its impact.

*Lecture Notes

*Ghatak, Maitreesh and Timothy W. Guinnane: "[The Economics of Lending with Joint Liability : Theory and Practice](#)" *Journal of Development Economics*, Vol.60, No.1, October 1999.

Karlan, Dean (2002), "[Social Capital and Group Banking](#)", Mimeo. Princeton.

Morduch, Jonathan (1998): "Does Microfinance Really Help the Poor? New Evidence from Flagship Programs in Bangladesh", Working Paper, New York University.

*Xavier Giné and Dean Karlan (2008) "[Peer Monitoring and Enforcement: Long Term Evidence from Microcredit Lending Groups with and without Group Liability](#)", Mimeo. Yale.

Prabal Roy Chowdhury (2005): "Group-lending: Sequential financing, lender monitoring and joint liability" [Journal of Development Economics Volume 77, Issue 2](#), August 2005, Pages 415-439

Rocco Macchiavello and Mikhail Drugov (2008): "[Learning and Microlending](#)", Mimeo. Oxford University.

Topic 6: Property Rights

Property rights are at the heart of a market economy and some trace the problem of underdevelopment as a problem of imperfect property rights. In this lecture we examine various mechanisms through which property rights affect economic efficiency and also look at empirical studies that study the impact of them in the context of some reform.

*Lecture Notes

*Besley, T. (1995): "Property Rights and Investment Incentives: Theory and Evidence from Ghana." *Journal of Political Economy*, 103, 5, p. 903-937.

*Besley, T. and M. Ghatak (2008): "[Property Rights and Economic Development](#)", Forthcoming in D. Rodrik and M. Rosenzweig (ed.s) *Handbook of Development Economics V*, North Holland, 2009.

Besley, T. and M. Ghatak (2008): "[Creating Collateral: The de Soto Effect and the Political Economy of Legal Reform](#)", Mimeo. LSE.

De Soto, Hernando, [2000], *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else*, New York: Basic Books and London: Bantam Press/Random House.

De Soto, Hernando, [2001], "The Mystery of Capital," *Finance and Development*, IMF, available at: <http://www.imf.org/external/pubs/ft/fandd/2001/03/desoto.htm>.

Field, Erica and Maximo Torero, [2004], "[Do Property Titles Increase Credit Access Among the Urban Poor? Evidence from a Nationwide Titling Program](#)," Mimeo. Harvard.

S. Galiani and E. Schargrotsky "[Property Rights for the Poor: Effects of Land Titling](#)" Mimeo. Universidad Torcuato Di Tella Business School.

Shing-Yi Wang (2008) "[Credit Constraints, Job Mobility and Entrepreneurship: Evidence from a Property Reform in China](#)," Mimeo. NYU.

Hornbeck, Richard (2008): "[Good Fences Make Good Neighbors: Evidence on the Effects of Property Rights](#)", Mimeo. MIT.

Topic 7: Agricultural Organization & Productivity in Developing Countries

Agriculture occupies a central place in less developed economies. We study (a) features of agricultural organization in these economies, such as sharecropping tenancy and

interlinked contracts, as optimal second-best responses to missing markets and transactions costs (b) strategies for successful agrarian reform (c) empirical determinants of organizational and contractual form, and the effect of these on agricultural productivity

*[Lecture Notes](#)

*Banerjee, A.V., P. Gertler and M. Ghatak (2002) : "[Empowerment and Efficiency - Tenancy Reform in West Bengal](#)", *Journal of Political Economy*.

Mukesh Eswaran and Ashok Kotwal (1985): "[A Theory of Contractual Structure in Agriculture](#)", *American Economic Review*, Vol. 75, No. 3, p. 352-367.

Akerberg, D. and M. Botticini (2002): "[Endogenous Matching and Empirical Determinants of Contractual Form](#)", *Journal of Political Economy*.

*Shaban, R. (1987): "[Testing between alternative models of sharecropping](#)", *Journal of Political Economy*, v.95.

Jacoby, H., R. Murgai, and S. Rehman (2003): "Monopoly Power and Distribution in Fragmented Markets: The Case of Groundwater", Forthcoming, *Review of Economic Studies*.

Conning , Jonathan H. and James A. Robinson (2005): "Property Rights and the Political Organization of Agriculture" Forthcoming, *Journal of Development Economics*.

Jean-Marie Baland and James A Robinson (2003) "[Land and Power](#)", CEPR Discussion Paper

Markus Goldstein, and Christopher Udry (2008): "[The Profits of Power: Land Rights and Agricultural Investment in Ghana](#)", *Journal of Political Economy*, 116 (2).

Topic 8: Industrial Organization in Developing Countries

Two commonly cited problems for low levels of industrial investment in developing countries is costly contracting and uncertainty. We study how industrial organization in developing countries respond to these problem, focussing on the importance of reputation and subcontracting and the potential role of cooperatives.

*[Lecture Notes](#)

*Banerjee, Abhijit and Esther Duflo, "[Reputation Effects and the Limits of Contracting: A study of the Indian Software Industry](#)," *Quarterly Journal of Economics*, Vol. 115 (3), pp. 989-1017, 2000.

*Tahir Andrabi, Maitreesh Ghatak, and Asim Ijaz Khwaja: "[Subcontractors for Tractors -](#)

[Theory and Evidence on Flexible Specialization, Supplier Selection, and Contracting](#)", Working Paper, LSE, October 2002.

Timothy Besley and Robin Burgess, 2004. "[Can Labor Regulation Hinder Economic Performance? Evidence from India](#)," *The Quarterly Journal of Economics*, MIT Press, vol. 119(1), pages 91-134

Sanghmitra Das and Dilip Mookherjee. 2004. "[Ownership Form and Contractual Efficiency: Comparing Performance of Cooperatives and Private Factories in the Indian Sugar Industry](#)." Mimeo. Boston University.

Rocco Machiavello (2005): "Contractual Imperfections, Credit markets and Vertical Integration: Theory and Cross-Country Evidence" Mimeo. LSE

Asim Khwaja et al (2008) "[The Value of Business Networks](#)", Mimeo KSG Harvard

Rachel Kranton and Anand Swamy (2008) "[Contracts, Hold-Up and Exports: Textiles and Opium in Colonial India](#)," *American Economic Review*.

Topic 9: Social Networks and Informal Institutions

Even though formal institutions of enforcing property rights and contracts are weak or non-existent in developing countries, informal institutions based on repeated interactions have emerged in response. We draw on theoretical work on the benefits and costs of informal institutions and complement it with empirical work drawing on economic history, as well as contemporary developing countries.

[*Lecture Notes](#)

*Greif, A. (1993): "Contract enforceability and economic institutions in early trade: the Maghribi Trader's coalitions", *American Economic Review*.

Arnott R. and J. Stiglitz (1991): "[Moral Hazard and Non-market institutions: Disfunctional Crowding-out or Peer Monitoring?](#)" *American Economic Review*

Banerjee A and A. Newman (1998): "Information, the Dual Economy, and Development", *Review of Economic Studies*

Narayan, D. and L. Pritchett (1997): "[Cents and Sociability: Household Income and Social Capital in Rural Tanzania](#)" World Bank working paper

Knack S. and P. Keefer (1997) "[Does Social Capital have an Economic Payoff? A Cross-Country Investigation](#)" *Quarterly Journal of Economics*

*Kaivan Munshi (2003): Networks in the Modern Economy: Mexican Migrants in the U. S. Labor Market, *Quarterly Journal of Economics*, Volume: 118 Number: 2

Steven Durlauf and Marcel Fafchamps (2004): "[Social Capital](#)" Mimeo. University of Wisconsin, Madison & University of Oxford.

*Benjamin Olken (2008) "[Do Television and radio Destroy Social Capital?](#)", Harvard University, Mimeo

Kaivan Munshi (2008) "[The Birth of a Business Community: Historical Disadvantage and Contemporary Mobility in India](#)"

Dean Karlan, Markus Mobius, Tanya Rosenblat and Adam Szeidl (2008) "[Trust and Social Collateral](#)" *Quarterly Journal of Economics*, forthcoming.

Topic 10: Organization Design for Public Goods Provision

Effective provision of public goods is a key determinant of quality of life. Conventional approaches to poverty measurement look only at private goods, but this view is too narrow. Public policy debates mostly revolve around the question .how much., i.e., how much money should the government spend on particular types of public goods. In the light of compelling evidence of government failure, the key question to ask is .how., i.e., designing effective mechanisms for the delivery of public goods.

*Lecture Notes

Tim Besley and Maitreesh Ghatak (2004): "[Competition and Incentives with Motivated Agents](#)" Forthcoming, *American Economic Review*.

*Tim Besley and Maitreesh Ghatak (2004): "[Public Goods and Economic Development](#)" forthcoming in *What Have We Leant About Poverty*, (A. Banerjee, R. Benabou, D. Mookherjee, eds.), Oxford University Press.

Tim Besley and Maitreesh Ghatak (2001): "[Government versus Private Ownership of Public Goods](#)" *Quarterly Journal of Economics*, Vol. 116, No. 4, p.1343 - 1372.

Oliver Hart, Andrei Shleifer, and Robert Vishny (1997): "The Proper Scope of Government: Theory and an Application to Prisons", *Quarterly Journal of Economics*, November

World Development Report 2004: Making Services Work For Poor People

*Sebatian Galiani, Paul Gertler and Ernesto Schargrotsky (2002) "[Water for Life: The Impact of the Privatization of Water Services on Child Mortality in Argentina](#)" Forthcoming, *Journal of Political Economy*.

Sebatian Galiani, Paul Gertler and Ernesto Schargrotsky (2005) "School Decentralization: Helping the Good Get Better, but Leaving the Poor Behind", Mimeo UC Berkeley.

*Esther Duflo, Rema Hanna and Stephen Ryan (2007) "[Monitoring Works: Getting Teachers to Come to School](#)", Mimeo, MIT.

Michael Kremer and Paul Glewee (2003): "[Teacher Incentives](#)," Mimeo. Harvard.

Victor Lavy (2003): "[Paying for Performance: The Effect of Teachers' Incentives on Students' Scholastic Outcomes](#)". BREAD Working Paper No. 22.

Jakob Svensson (2005): "Eight Questions about Corruption", Journal of Economic Perspectives, 19(3).

Ben Olken (2006): "[Monitoring Corruption: Evidence from a Field Experiment in Indonesia](#)" Mimeo. NBER.

Ben Olken and Patrick Barron (2007): "[The Simple Economics of Extortion: Evidence from Trucking in Aceh](#)" Mimeo. NBER

Jakob Svensson and Ritva Reinikka (2006) "[The power of information: Evidence from a newspaper campaign to reduce capture](#)", Mimeo. Stockholm IIES.