

Ec 81 Economic Development
Final Examination

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Instructions: Choose any 4 of the following 7 questions and respond briefly and clearly to all parts of the question. Please answer only 4 questions; each question is worth 25 points, for a total of 100 points. The questions are designed to take a bit over 20 minutes each, i.e., these are supposed to be *short essays*. The whole exam is designed to something like 1 ½ hours, although you have 3 hours to complete it.

1. In the late 1980s, World Bank economist Alan Gelb edited a celebrated book entitled *Oil Windfalls: Blessing or Curse?*, reflecting the varied legacy of the 1970s oil booms among major oil exporters. We are now undergoing a global oil boom.
 - 1.1. [14 points] The dutch disease is often cited among the down-side risks associated with a commodity boom. What is this phenomenon? Identify two policies you would advocate for avoiding the adverse effects of the disease, and briefly explain how they would accomplish this.
 - 1.2. [11 points] While acknowledging the dutch disease, Collier argues instead that “[t]he heart of the resource curse is that resource rents make democracy malfunction.” We looked carefully at the case of Venezuela, a major oil exporter. Briefly, does Venezuela illustrate Collier’s argument? [update: while I was in Tanzania and you were recovering from writing your paper, the Venezuelan public narrowly rejected a referendum that would have altered the constitution to eliminate Presidential term limits and a variety of other constitutional restraints on executive power.]

2. The statistical evidence compiled by Collier and other researchers suggests that civil war is a development disaster – other things equal, it lowers the rate of economic growth by more than 2 percentage points per year. In his book, however, Collier goes further and calls conflict a development *trap*.
 - 2.1. [14 points] Explain clearly what Collier means by calling conflict a development trap.
 - 2.2. [11 points] Briefly, what important policy insights flow from construing conflict as a trap rather than ‘merely’ a disaster?

3. W. Arthur Lewis argued in 1954 that the traditional sector in some poor economies harbored an economic *surplus* that could become a source of economic growth and modernization.
 - 3.1. [13 points] How does economic growth get started in the Lewis model? What sustains it, and what ultimately stops it?
 - 3.2. [12 points] Many countries taxed agriculture heavily and starved it of public investment between the 1960s and 1990s, in an effort to push the pace of industrialization. Yet the countries that industrialized most successfully, both in Asia and in other regions, were careful not to discriminate against agriculture. Briefly, can a case for investing in agricultural productivity be made within the Lewis model?

4. Economists tend to ask two questions in a bilateral contracting situation: Is the outcome efficient? How are the gains distributed?
 - 4.1. [14 points] Suppose that landlords and tenants care only about the expected or average gain from the contract, and not about risk. Comparing a sharecropping contract to a fixed-rent contract: which of these is efficient? Briefly explain.
 - 4.2. [11 points] Now suppose (realistically) that tenants lack assets and do not have access to insurance or credit markets. They are therefore in a poor position to bear risk. Can this help explain the persistence of sharecropping contracts? Briefly explain.
5. Classical economists thought that fertility would rise with increases in household income, up to some maximal number of births per woman over the reproductive cycle, at which point fertility would stabilize.
 - 5.1. [11 points] Is the global evidence on fertility behavior consistent with the classical model?
 - 5.2. [14 points] How does the modern neoclassical theory of fertility differ from the classical theory, in predicting how fertility responds to household income? Briefly explain the key predictions of the neoclassical approach and how they are obtained.
6. Group lending was the most striking innovation of the Grameen Bank, and it has been widely imitated by other microfinance initiatives.
 - 6.1. [14 points] How does group lending address the problems that limit the supply of credit to poor households from traditional formal-sector lenders (e.g., banks)?
 - 6.2. [11 points] A careful study of the operations of the Grameen Bank in the early 1990s concluded that each dollar of lending increased the consumption expenditures of borrowing households by 17 cents relative to what they would have been without the loan (repayment rates were almost 100% so this was net of repayment). Loans were very costly to administer, however, and at the interest rate charged on the loans, the Grameen Bank required a subsidy of 22 cents on every dollar of lending to remain sustainable. In your view, does this look like an effective use of public funds? Would it be better, for example, to reduce the subsidy (i.e., increase the commercial viability of the operation) by charging a higher interest rate?
7. At one point in his book, Collier argues that in coastal economies with abundant labor, growth opportunities are favorable enough that the government just needs to deliver core functions reasonably well: 'exporters simply need an environment of moderate taxation, macroeconomic stability, and a few transport facilities' (p. 65). But later he argues that while this minimalist prescription would have sufficed for securing entry into world markets for manufactured goods in the early 1980s, it is no longer sufficient.
 - 7.1. [10 points] According to Collier, what has changed?
 - 7.2. [15 points] Drawing on Collier and/or other readings, where would you go beyond the minimalist prescription to promote export diversification in a coastal, labor-abundant least-developed country?