

Ec 181
Seminar in Economic Development
Final Examination

Prof. S. O'Connell

Fall 2008

Instructions:

- (1) Please put your name on the outside of your bluebooks, and not on the inside.
- (2) Answer question 1 and one question each from Sections B, C and D, for a total of four questions. All questions have the same weight. You have 3 hours for the exam, plus 15 minutes to check your answers (as on an external exam).
- (3) Please note – there are many ways of writing a strong answer, so take time to be thoughtful, and don't get bogged down on any specific part of a question. You can do your selected questions in any order.

Section A (this question is required of all students)

1. In our final seminar we read a pair of papers for each country, one focusing on binding constraints to growth and the other on poverty and income distribution. There is plenty of cross-country evidence that growth reduces poverty. Is poverty or inequality, in turn, a binding constraint on growth? Be specific about the mechanism(s) at work and the policy implications of your answer.
[Appendix 1 shows the Rodrik *et al.* growth diagnostics tree, in case it is of use to you (as you know, it does not have a specific 'node' for poverty or inequality). Feel free to refer to the tree or not, as you prefer.]

Section B (choose 1 of the following 2 questions)

2. Low-income rural households face income risks that can threaten their survival in a bad year. Development economists have argued that a variety of rural 'institutions' (sharecropping, work-sharing, informal credit) survive largely because of their value in coping with risk.
 - 2.1. Choose one of these institutions, and carefully explain its role and its limitations in coping with risk.
 - 2.2. Nobel laureate Douglass North tells us that institutions persist over time. Is the institution you've identified well suited to what development economists call 'the agricultural transformation' – i.e., the modernization of agriculture? Should governments seek to hasten its demise? If so, how?
3. Appendix 2 shows four measures of demographic pressure in Sub-Saharan Africa (SSA) and other developing regions of the world. Notes to help you interpret the variables appear below the table. Discuss the determinants of these four variables, the mechanical/causal linkages between them, and their consequences for economic growth. What considerations will determine how rapidly fertility falls in SSA over the next decade or so?

Section C (choose 1 of the following 2 questions)

4. Nigeria always features prominently in discussions of the natural resource curse. Yet Nigerian policymakers claim to have learned a great deal from the economic debacle of the early 1980s, when declining oil prices left the economy in a shambles. Appendix 3 compares Nigeria during the most recent oil boom (the data cover 2003-2007) with Nigeria during the oil boom of the 1970s. Thoroughly discuss what you see, and what it suggests about the allocation of resources in Nigeria. Is the Nigerian economy in a better position now than it was in the early 1980s to handle a sharp downturn in oil prices?
5. [Buffie 2005] What are the causes of balance of payments crises in developing countries? What combination of policies does the International Monetary Fund typically advocate to eliminate a large payments deficit? Is there any risk that the policies prescribed by the Fund will drive the economy into recession? In answering these questions, draw upon economic theory and relate your analysis to at least one major financial crisis (e.g., the Mexican Peso crisis of 1994, the Asian financial crisis of 1997-98, Brazil 1998, Turkey 2001, or Argentina 2001).

Section D (choose 1 of the following 2 questions)

6. The East Asian Miracle was not anticipated in 1960.
 - 6.1. In hindsight, what common features of economic policy across these countries were fundamentally important in their achieving growth with equity?
 - 6.2. China and India have recently achieved comparable growth miracles, but without the stellar distributional outcomes characteristic of the East Asian miracle economies. In your view, what accounts for this difference?
7. The infant industry argument has a venerable history.
 - 7.1. Policymakers routinely justify infant-industry protection on efficiency grounds. From an economist's viewpoint, under what conditions is infant-industry protection socially efficient?
 - 7.2. "Economists tell us that tariffs and quotas are equivalent. But as policy advisers, economists almost always prefer tariffs, while policymakers very often prefer quotas. Apparently they're not equivalent after all." Explain.
 - 7.3. Infant-industry protection has been employed by export-promoting trade regimes as well as by import-substituting ones. Identify and discuss two key factors that influence whether infant industry protection succeeds.
 - 7.4. Briefly: what do you think of undervalued exchange rates as an alternative to selective intervention, as an instrument of industrial policy?

Appendix 1. The Rodrik et al. growth diagnostics tree

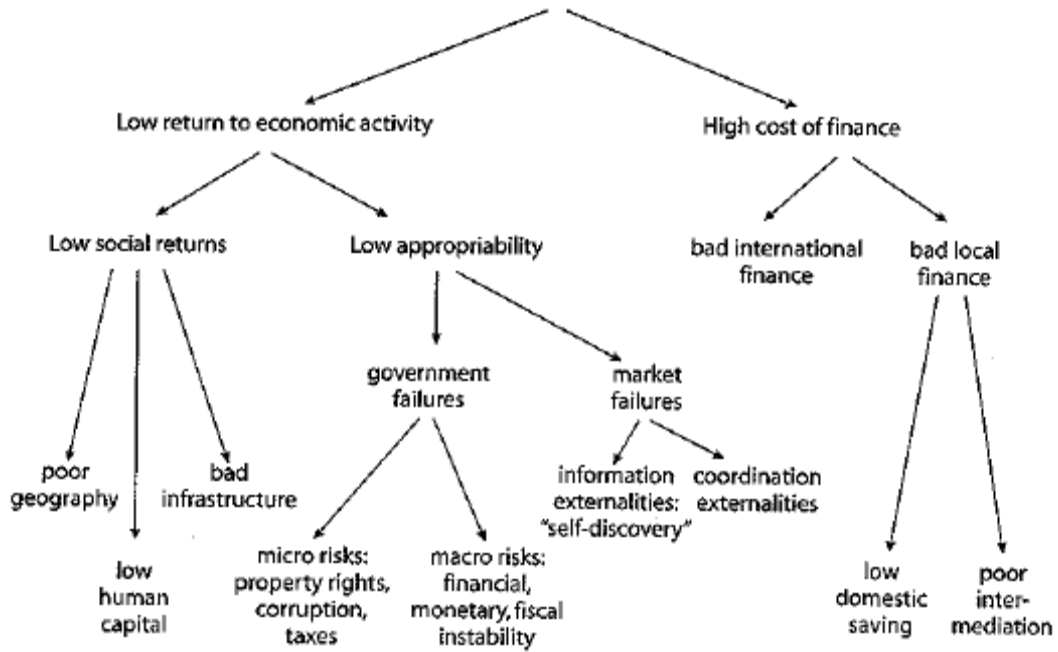


Fig. 2.1. Growth diagnostics

Source: Rodrik, D. (2007), *One Economics, Many Recipes* (Princeton, Princeton University Press), p. 66.

Appendix 2. Demographic pressures, SSA versus Other developing regions, 1960-2000.

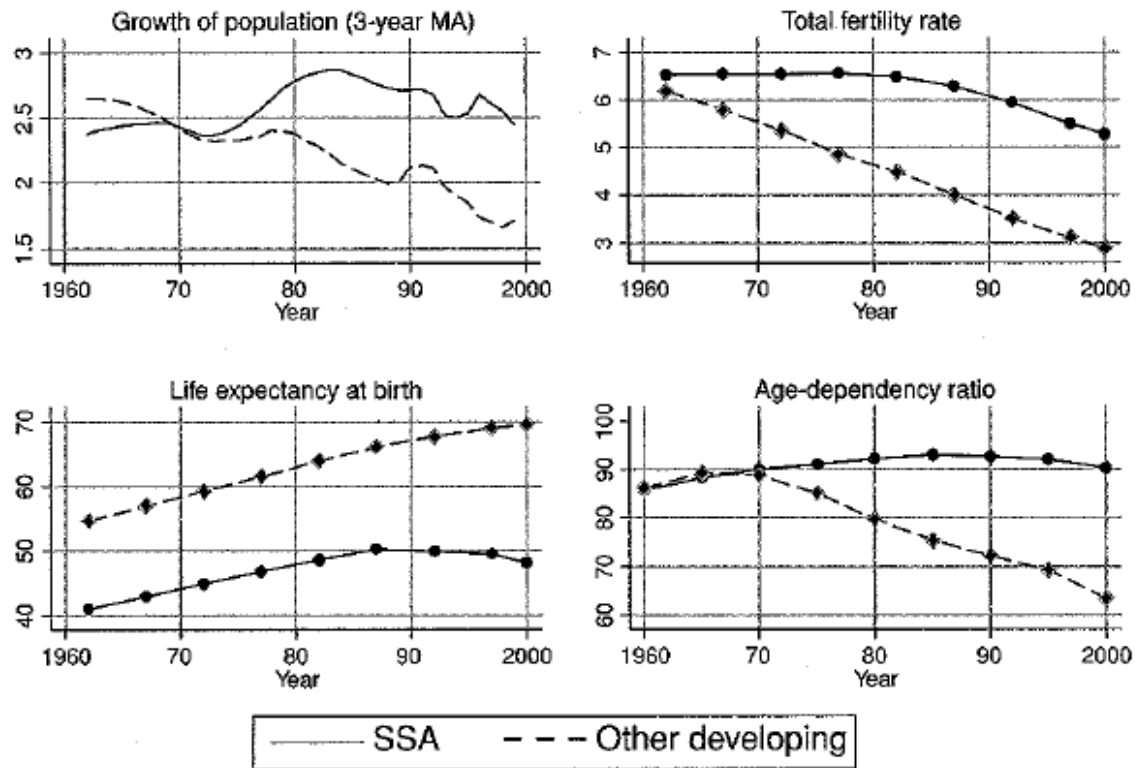


Figure 1.6 Demographic pressures, SSA versus Other developing regions, 1960–2000. Source: World Bank, World Development Indicators 2005. The figures show simple averages of country observations, for all countries with continuously available observations.

Notes on these variables:

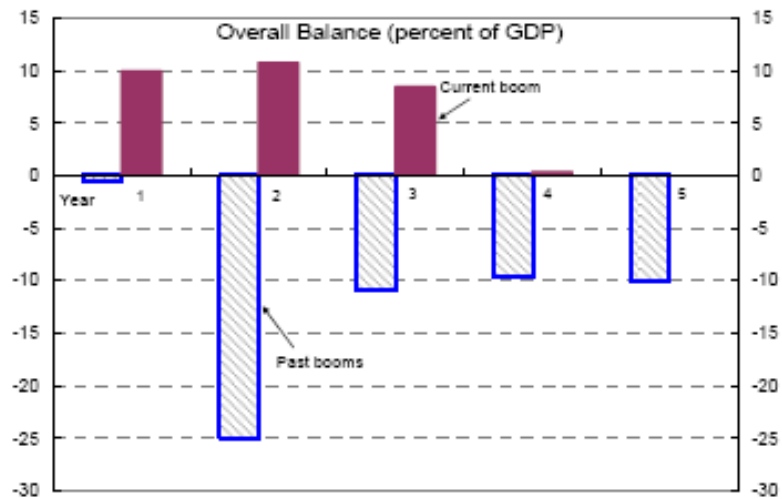
- The *growth of population* (%) looks smooth in the diagram because it is calculated as a 3-year moving average, i.e., for year t it is calculated as $n = (1/3) * [n(t-1) + n(t) + n(t+1)]$.
- The *total fertility rate* is the number of live births per female over her childbearing years.
- *Life expectancy at birth* (years) is a projection based on current age-specific mortality rates. The decline in SSA during the 1990s is primarily due to HIV/AIDS.
- The *age dependency ratio* (%) is the share of very young (ages 1-15) and very old persons (ages 65 or older) in the total population.

Source: Ndulu, B. J. and S. A. O’Connell (2007), “Policy plus: African growth performance, 1960-2000,” in B. J. Ndulu *et al.*, eds, *The Political Economy of Economic Growth in Africa, 1960-2000, volume 1* (Cambridge: Cambridge University Press).

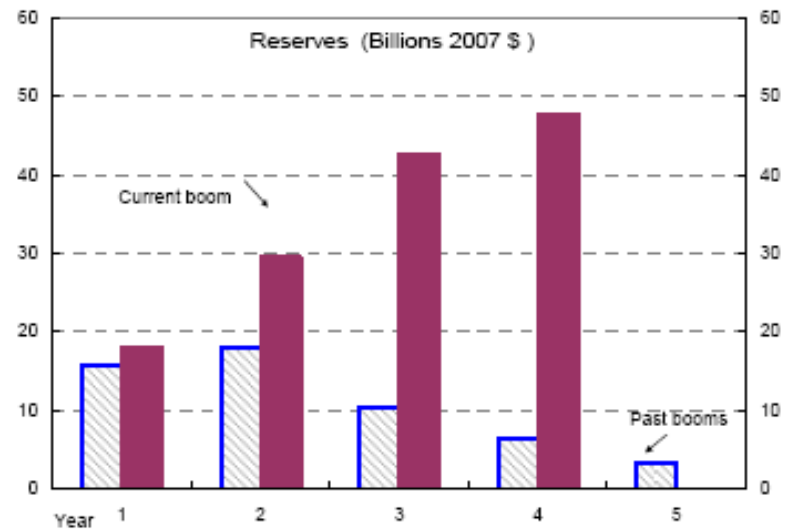
Appendix 3. Nigeria during oil booms: 1970s versus 2000s.

Note: the following 5 charts show the fiscal balance, international reserves, external debt, growth of the non-oil economy, and the inflation rate for Nigeria, comparing the oil booms of the 1970s with the most recent boom (the data cover 2003-2006). The solid bars refer to the current boom and the hatched bars refer to the booms of the 1970s. On the *x*-axis, 'year' refers to the timing of the boom, so that year 1 is the first year of the boom, year 2 is the second, etc.

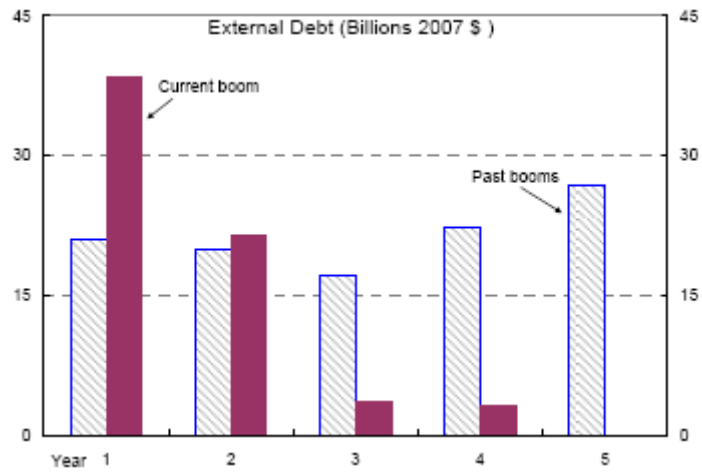
1. Fiscal balance (+ = surplus) as share of GDP:



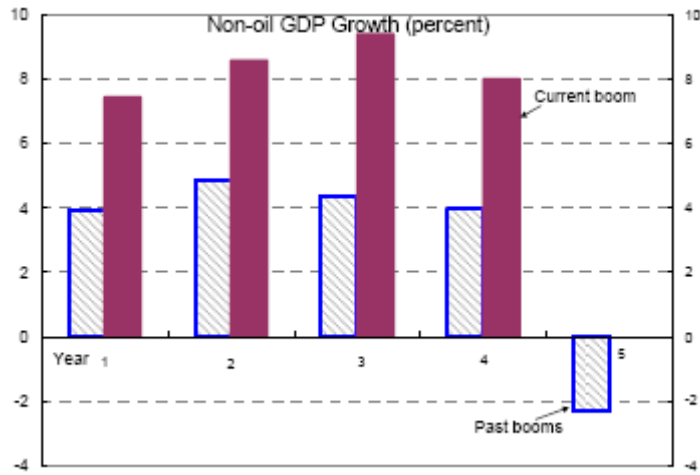
2. International reserves (billions of 2007 \$)



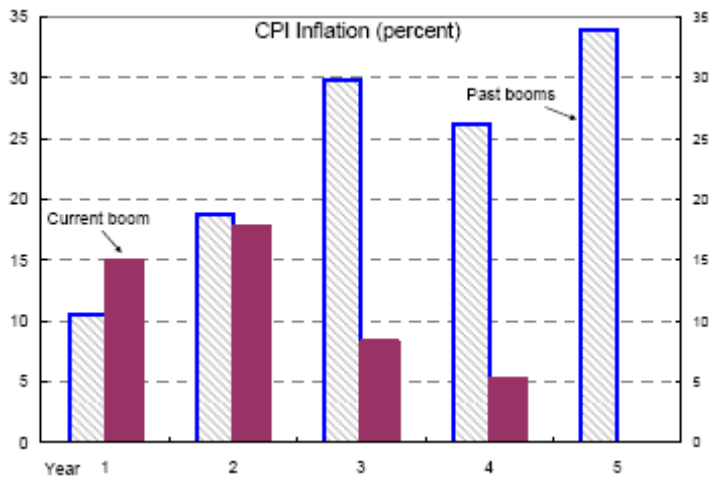
3. External debt (billions of 2007 \$)



4. Growth rate of the non-oil economy (%)



5. Inflation rate (%)



Source: International Monetary Fund (2007), *Nigeria: Fourth Review Under the Policy Support Instrument—Staff Report; Staff Statement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Nigeria*, October. (<http://www.imf.org/external/pubs/cat/longres.cfm?sk=21414.0>).