

**The Pennsylvania State University  
Department of Economics**

**Economics 570  
Development**

**Professor Barry W. Ickes  
Spring 2002**

This is the first half of the Development Economics sequence. In this part we focus on some aspects of development economics and on the economics of transition. With regard to development economics we will focus primarily on macroeconomic aspects of development, and on the role of organization in economic development. We will also study some aspects of stabilization and financial crises in developing countries. We will then turn to the economics of transition.

A good reference for anyone planning to take the comprehensive exam in development are the Handbooks of Development Economics:

H. Chenery and T.N. Srinivasan, eds., *Handbook of Development Economics*, vols. 1 and 2 (Amsterdam: North-Holland, 1988 and 1989).

J. Behrman and T.N. Srinivasan, eds., *Handbook of Development Economics*, vols. 3A and 3B. (Amsterdam: North-Holland, 1995).

In addition the following books may be useful:

Debraj Ray, *Development Economics*, Princeton University Press, 1998.  
Kaushik Basu, *Analytical Development Economics*, MIT Press, 1997.

With regard to transition economics we have a new text which we will use, and is in the bookstore.

Gerard Roland, *Transition and Economics*. MIT Press, 2000. (GR)

### *Grading*

There will be a midterm and a final exam. In addition, you will be required to submit a term paper of length 15-20 pages which either presents your own empirical work or reviews the literature on a certain issue. The midterm will count for 20% of the grade. The paper and final will each count for 35% of your grade. The remainder of your grade will be determined by class participation and presentations. You should meet with me early in the semester to discuss your paper.

The discussion may resemble the following outline. Some papers are available on the web, and are marked WEB. Materials for this course can be found on my website: <http://econ.la.psu.edu/~bickes/>

## **1. Introduction to Development and Transition Economics**

What is Development Economics about and how does it relate to Transition Economics? Are the problems of emerging economies from poverty similar to those of economies emerging from socialism? How should we think about this subject.

Ofer, Gur, "Development and Transition: Emerging, but Merging?" November 2000, mimeo, WEB.  
Ickes, B.W., Lecture Note: Introduction to Development and Transition. WEB

## **2. Stylized Facts of Economic Growth and Explanations of Divergence**

The most important stylized fact of economic growth is the large divergence in output levels since the early 19<sup>th</sup> century. What accounts for these differences? What are the systematic factors that inhibit growth in much of the world?

- Maddison, Angus, *The World Economy: A Millennial Perspective*. Paris, OECD, 2001.
- Easterly, William, and Ross Levine, "It's Not Factor Accumulation: Stylized Facts and Growth Models," World Bank, 2001. WEB
- Hall, R.E., and C.I. Jones, "Why Do Some Countries Produce So Much More Output Per Worker Than Others?" NBER Working Paper, 6564, June 1999. WEB:
- Zak, P., and S. Knack, "Trust and Growth," *Economic Journal*, April 2001.
- Quah, Danny, "Cross-Country Growth Comparison: Theory to Empirics, mimeo, LSE, January 2000. WEB.
- Galor, Oded and Omer Moav, "Natural Selection and the Origin of Economic Growth," mimeo, Hebrew University, January 2002. WEB
- Jones, Charles, "Was an Industrial Revolution Inevitable? Economic Growth Over the Very Long Run," *Advances in Macroeconomics*, Volume 1, Number 2 2001.
- Parente, S., and E. Prescott, *Barriers to Riches*, MIT Press, 2000.

### **3. Institutions, Organization and Economic Development**

What role do institutions, and institutional innovation, play in economic development? How do economic organizations differ in developing and developed countries? The economics of organization explains the development of economic institutions as means of economizing on transactions costs. Are their specific problems faced by developing countries that inhibit the development of economic institutions? How does this impact on economic development? A theory of economic organization is crucial for development economics because of the wide variety of experiences observed.

- Ray, chapters 5, 12.
- Basu, chapters 1-2.
- Stiglitz, J. E., "Economic Organization, Information, and Development," *Handbook of Development Economics*, vol. 1, 1989.
- Lin, J.Y., "Collectivization and China's Agricultural Crisis in 1959-1961," *Journal of Political Economy*, 98, 6, December 1990: 1228-1249.
- Acemoglu, Daron, Simon Johnson, and James Robinson, "Reversal of Fortune: Geography and Institutions in the Making of the Modern World Income Distribution," NBER Working Paper, 8460, September 2001. WEB
- Greif, Avner, "Contract Enforceability and Economic Institutions in Early Trade: The Maghribi Traders Coalition," *American Economic Review*, vol. 83, 3, June 1993.
- Greif, A., P. Milgrom, and B.R. Weingast, "Coordination, Commitment, and Enforcement: The Case of the Merchant Guild," *Journal of Political Economy*, 102, 4, August 1994.
- Greif, A., "Cultural Beliefs and the Organization of Society: A Historical and Theoretical Reflection on Collectivist and Individual Societies," *Journal of Political Economy*, 102, 5, October 1994.
- Kremer, M., "The O-Ring Theory of Economic Development," *Quarterly Journal of Economics*, CVIII, 3, August 1993: 551-575.
- Caballero, R., and M. Hammour, "Creative Destruction and Development: Institutions, Crises, and Restructuring," World Bank, ABCDE Conference, 2000. Web.

### **4. Political Economy and Policy Reform**

Policy reform is a key issue for developing economies. How reforms are implemented is often as important as what reforms are implemented. This is especially important as it related to corruption. A critical question for development economics is whether or not corruption is a deterrent or a spur to growth.

- Shelifer, A. and R. Vishny, "Corruption," *Quarterly Journal of Economics*, CVIII, 3, August 1993: 5599-617.
- Mauro, P., "Corruption and Growth," *QJE*, CX, 3, August 1995.
- Bardhan, Pranab, "Corruption and Development," *Journal of Economic Literature*, Vol. XXXV, September 1997: 1320-1346.
- Basu, Susanto, and David Li, "Corruption and Reform," *Davidson Institute Working Paper*, June 1996.
- Krueger, Anne O., *Political Economy of Policy Reform in Developing Countries*. MIT Press, 1993.
- Tornell, Aaron, "Economic Growth and Decline with Endogenous Property Rights," Harvard University Discussion Paper, 1739, September 1995.
- Alesina, A., and R. Perotti, "Income Distribution, Political Instability, and Investment," *European Economic Review*, 40, 1996: 1203-1228.
- Rodrik, D., "Understanding Economic Policy Reform," *Journal of Economic Literature*, XXXIV, March 1996: 9-41.
- Fernandez, Raquel, and Dani Rodrik, "Resistance to Reform: Status Quo Bias in the Precence of Individual-Specific Uncertainty," *American Economic Review*, December 1991, 81, 5, 1146-1155.
- Alesina, Alberto and Alan Drazen, "Why are Stabilizations Delayed?" *American Economic Review*, December 1991, 81, 5, 1170-1188.
- Mussa, Michael, "Government Policy and the Adjustment Process, in J. Bhagwati, ed., *Import Competition and Response*, University of Chicago Press, 1992.

## **5. Structural Adjustment, Liberalization, and Financial Crises**

A primary problem that faces developing countries is macroeconomic imbalance. The IMF inspired structural adjustment policy mix has been applied in many cases. Similar notions underlay the "shock therapy" as applied in Poland and Russia. An important question has been how applicable are such policies to developing and transition economies. Recently, concern has shifted to financial instability. Globalization and capital mobility has led to financial instability in emerging market economies. Capital inflows are important to developing countries, but this also presents risks associated with financial instability. The problems in Asia and Russia and the potential for spread to Latin America make this an important issue which we will focus on.

- Levine, Ross, "Financial Development and Economic Growth: Views and Agenda," *Journal of Economic Literature*, vol. XXV, June 1997, 688-726.
- Rajan, R., and L. Zingales, "Financial Dependence and Growth," *AER*, vol. 88, 3, June 1998: 559-586.
- Bekaert, G., C. Harvey, and C. Lundblad, "Does Financial Liberalization Spur Growth?" *NBER Working Paper*, 8245, April 2001.
- Edwards, S., and S. van Wijnbergen, "Disequilibrium and Structural Adjustment," *Handbook of Development Economics*, vol 2, 1989.
- Khan, Mohsin, "The Macroeconomic Effects of IMF-Supported Adjustment Programs: An Empirical Assessment," *IMF Staff Papers*, June 1990: 195-231.
- Sachs, Jeffrey, Aaron Tornell, and Andre Velasco, "Financial Crises in Emerging Markets: Lessons from 1995," *Brookings Papers on Economic Activity*, 1, 1996.
- Eichengreen, Rose and Wyplosz, "Contagious Currency Crises," NBER 5681, July 1996.
- Calvo, G., L. Leiderman, and C.M. Reinhart, "Inflows of Capital to Developing Countries in the 1990's," *Journal of Economic Perspectives*, 10, 2, Spring 1996: 123-139.

- Calvo, G., and E. Mendoza, "Mexico's Balance of Payments Crisis: A Chronicle of Death Foretold," *Journal of International Economics*, vol. 41, 3-4, November 1996: 235-264.
- Sachs, Jeffrey, Aaron Tornell, and Andre Velasco, "The Mexican Peso Crisis: Sudden Death or Death Foretold," *Journal of International Economics*, vol. 41, 3-4, November 1996: 265-284.
- Agenor, P-R., and P. Montiel, *Development Macroeconomics*, Princeton, New Jersey, Princeton University Press, 1996: chapters 8, 10, 14, 16.
- Boone, Peter, "Politics and the Effectiveness of Foreign Aid," *European Economic Review*, 40, 1996: 289-329.
- Krugman, Paul, "What Happened to Asia?" mimeo, January 1998. WEB: <http://www.stern.nyu.edu/~nrubini/asia/AsiaHomepage.html#intro1>
- Radelet, S. and J. Sachs, "The East Asian Financial Crisis: Diagnosis, Remedies, Prospects," *Brookings Papers on Economic Activity*, 1, 1998: 1-74.
- Chang, R., and A. Velasco, "Financial Crises in Emerging Markets: A Canonical Model," NBER Working Paper, #6606, June 1998. WEB: <http://www.nber.org/new.html#latest>.
- Corsetti, G., P. Pesenti, and N. Roubini, "Paper Tigers? A Preliminary Assessment of the Asian Crisis," June 1998. WEB: <http://www.stern.nyu.edu/~nrubini/asia/AsiaHomepage.html#intro1>
- Burnside, C., M. Eichenbaum and S. Rebelo, 2001, "Prospective Deficits and the Asian Currency Crisis", *Journal of Political Economy*, December 2001.
- Caballero, R., and A. Krishnamurthy, "Smoothing Sudden Stops," NBER Working Paper 8427, August 2001. WEB

## **6. Transition**

The transition from central planning to a market economy creates questions of special importance to development economics. Transition economies are underdeveloped, but in ways different from LDC's. They have industry and they have already undergone the rural-urban transition that is part of development, but they lack the institutions of markets. How important are these institutional gaps?

This section is divided into subsections, as it comprises a subject in and of itself. The first section provides background into the system from which the transition starts.

A recent report by the World Bank documents 10 years of transition and is a useful source of information. It is available at:  
[http://lnweb18.worldbank.org/ECA/eca.nsf/Attachments/Transition1/\\$File/complete.pdf](http://lnweb18.worldbank.org/ECA/eca.nsf/Attachments/Transition1/$File/complete.pdf)

### *1. Background*

- Ericson, Richard, "The Classical Soviet-Type Economy: Nature of the System and Implications for Reform," *Journal of Economic Perspectives*, Fall, 1991.  
GR, chapter 1.
- Ickes, Barry W., "Dimensions of Transition in Russia" in *The Russian Economy in the 1990's*, B. Granville and P. Oppenheimer, eds., Oxford University Press, 2001. WEB: <http://econ.la.psu.edu/~bickes/granv.pdf>
- Hewett, Ed A., *Reforming the Soviet Economy: Equity and Efficiency*, Brookings, 1990.
- Ofer, Gur, "Soviet Economic Growth: 1928-1985," *Journal of Economic Literature*, December 1987.
- Murrell, Peter "Evolution in Economics and in the Economic Reform of the Centrally Planned Economies." in Clague, Christopher and Gordon C. Rausser, eds. *Emergence of Market Economies in Eastern Europe*, Blackwell Publishers, 1992.
- Litwack, John, "Legality and Market Reform in Soviet Type Economies," *Journal of Economic Perspectives*, Fall, 1991.

- Kornai, J. "The Hungarian Reform Process: Visions, Hopes, and Reality," *Journal of Economic Literature*, Dec., 1986: 1687-1737.
- Murphy, Kevin, Andrei Shleifer, and Robert Vishny, "The Transition to a Market Economy: Pitfalls of Partial Reform," *Quarterly Journal of Economics*, August 1992.

## 2. Sequencing

- McKinnon, R., *The Order of Economic Liberalization: Financial Control in the Transition to a Market Economy*, Johns Hopkins Press, 1991, chapter 2.
- GR, chapters 2-3.
- Dewatripont, M., and G. Roland, "Transition as a Process of Large-Scale Institutional Change," *Economics of Transition*, 4, 1, 1996: 1-30.
- Dewatripont, M. and G. Roland, "The Design of Reform Packages under Uncertainty," *American Economic Review*, 85,5, December 1995.
- Dewatripont, M. and Roland, G. "The Virtues of Gradualism and Legitimacy in the transition to a Market Economy," *Economic Policy*, March 1992.
- McMillan, John, "Markets in Transition," in D. Kreps and K. Wallis, eds., *Advances in Economics And Econometrics: Theory and Applications*. Cambridge University Press, 1996.
- Ofer, Gur, "Stabilizing and Restructuring the Soviet Economy: Big Bang or Gradual Sequencing?" in M. Keren, and G. Ofer, eds., *Trials of Transition: Economic Reform in the Former Communist Bloc*. Boulder, CO; Westview Press, 1992.
- Aghion, Phillipe and Olivier Blanchard, "On the Speed of Transition in Central Europe," *NBER Macroeconomics Annual*. Cambridge, MA, 1994: 283-320.
- Alexeev, Michael and Michael Kaganovich, "Dynamics of Privatization Under a Subsistence Constraint," *Journal of Comparative Economics*, 29, 2000: 417-447.

## 3. The Output Fall and Stabilization

- Blanchard, O., and M. Kremer, "Disorganization," *Quarterly Journal of Economics*, CXII, 4, November 1997.
- Calvo, G., and F. Coricelli, "Output Collapse in Eastern Europe: The Role of Credit," *International Monetary Fund Staff Papers*, 40, 1, March 1993.
- Cochrane, J.H., and B.W. Ickes, "Macroeconomics in Russia," in E. Lazear, ed., *Economic Transition in Eastern Europe and Russia: Realities of Reform*. Hoover Institution Press, 1995.
- Ericson, Richard E., "The Structural Barrier to Transition Hidden in Input-Output Tables of Centrally Planned Economies," *Economic Systems*, V.23, 3, September 1999, pp. 199-224.
- Ickes, B.W., and Randi Ryterman, "The Interenterprise Arrears Crisis in Russia," *Post-Soviet Affairs (formerly Soviet Economy)*, 8: 4, October-December, 1992: 331-61.
- Ickes, B.W., and Randi Ryterman, "Roadblock to Economic Reform: The Interenterprise Arrears Crisis in Russia," *Post-Soviet Affairs (formerly Soviet Economy)*, 9, 3, July-September, 1993.
- Ickes, B.W., and Randi Ryterman, "Financial Underdevelopment and Macroeconomic Stabilization in Russia," in G. Caprio, D. Folkerts-Landau, and T. Lane, eds., *Building Sound Finance in Emerging Market Economies*, World Bank-IMF, 1994.
- Berg, A., and J. Sachs, "Structural Adjustment and International Trade in Eastern Europe: The Case of Poland," *Economic Policy*, No. 14, April 1992, pp. 118-173.
- Fischer, Stanley, Ratna Sahay, and Carlos Vegh, "Stabilization and Growth in Transition Economies: Early Experience." *Journal of Economic Perspectives*, Spring 1996.
- Ickes, Barry W., Peter Murrell and Randi Ryterman, "End of the Tunnel? The Effects of Financial Stabilization in Russia," *Post-Soviet Affairs (formerly Soviet Economy)*, vol. 13, 2, April-June, 1997.

- Roland, G., and T. Verdier, "Transition and the Output Fall," Davidson Institute Working Paper, March 1997.
- Fischer, Stanley, and Ratna Sahay, "The Transition Economies After Ten Years," IMF Working Paper, February 2000.
- GR, chapter 7.

#### 4. Privatization

- Boycko, M., A. Shleifer and R.W. Vishny, "Privatizing Russia," *Brookings Papers on Economic Activity*, 2:1993: 139-181.
- GR, chapters 4, 10.
- Ickes, B.W., and Randi Ryterman, "From Enterprise to Firm: Notes For a Theory of the Enterprise in Transition," in R.W. Campbell ed., *The Postcommunist Economic Transformation: Essays in Honor of Gregory Grossman*, Westview Press, 1994: 83-104.
- Katz, B., and J. Owen, "Privatization: Choosing the Optimal Time Path," *Journal of Comparative Economics*, 17: 715-736.
- Laban, Raul and Holger Wolf, "Large-Scale Privatization in Transition Economies," *American Economic Review*, 83, 5, December 1993.
- Murrell, P., and Y. Wang, "When Privatization Should be Delayed: The Effect of Communist Legacies on Organizational and Institutional Reforms," *Journal of Comparative Economics*, 17: 385-406.
- Roland, G. and T. Verdier, "Privatization in Eastern Europe: Irreversibility and Critical Mass Effects," *Journal of Public Economics*, 54, 1994: 161-183.
- Rutland, Peter, "Privatization in Russia: One Step Forward: Two Steps Back?" *Europe-Asia Studies (formerly Soviet Studies)*, 46, 7, 1994: 1109-1132.
- Shleifer, A., and R. Vishny, "Politicians and Firms," *Quarterly Journal of Economics*, CIX, 4, November 1994: 995-1025.

#### 5. Empirical Studies

- Meggison and Netter, From State to Market: A Survey of Empirical Studies on Privatization, *Journal of Economic Literature*, Vol. 39, No. 2, June 2001.
- Djankov, Simeon D. and Peter Murrell, "Enterprise Restructuring in Transition: A Quantitative Survey" mimeo, WEB.
- Berg, Andrew ; Borensztein, Eduardo R ; Sahay, Ratna, and Jeromin Zettelmeyer, "The Evolution of Output in Transition Economies - Explaining the Differences," IMF Working Paper, No. 99/73, January 1999, WEB.
- Campos, Nauro F., and F. Coricelli, "Growth in Transition: What We Know, What We Don't, and What We Should" Global Development Network, November 2000, WEB.
- Guriev, Sergei, and Barry W. Ickes, "Microeconomic Aspects of Economic Growth in Eastern Europe and the Former Soviet Union, 1950-2000," Global Development Network, September 2001, WEB.
- Frydman, R., Gray, Cheryl, Marek Hessel, and Andrzej Rapaczynski (1999). "When Does Privatization Work? The Impact of Private Ownership on Corporate Performance in Transition Economies," *Quarterly Journal of Economics*, 114(4).
- Jones, D., "The Economic Effects of Privatization: Evidence from a Russian Panel," *CES*, XXXX, 2, Summer 1998: 75-102.
- Linz, S., and G. Krueger, "Enterprise Restructuring in Russia's Transition Economy: Formal and Informal Mechanisms," *CES*, XXXX, 2, Summer 1998: 5-52.
- Zettelmeyer, Jeromin (1998). "The Uzbek Growth Puzzle," *IMF Working Paper* 98.

6. *Corporate Governance and Corruption*

- Shleifer, A. and R. Vishny, "A Survey of Corporate Governance," *Journal of Finance*, 52, June 1997:737-783.
- Aoki, M., "Controlling Insider Control: Issues of Corporate Governance in Transition Economies," in M. Aoki and H Kim, eds., *Corporate Governance in Transitional Economies*. The World Bank, 1995.
- Claessens, S., "Corporate Governance and Equity Prices: Evidence from the Czech and Slovak Republics," *Journal of Finance*, 52, 4, September 1997: 1641-1658.
- Frydman, R., C. Gray, and A. Rapaczynski, eds., *Corporate Governance in Central Europe and Russia*. CEU Press, 1996.
- GR, chapter 8.
- Brada, J., "Corporate Governance in Eastern Europe: Findings from Case Studies," *Post-Soviet Geography and Economics*, 37, 10, December 1996: 580-614.
- Hellman, J., G. Jones, and D. Kaufmann, "Seize the State, Seize the Day" State Capture, Corruption, and Influence in Transition," World Bank Discussion Policy Research Working Paper, 2444, September 2000. WEB
- Wei, Shang-Jin, and Yi Wu, "Negative Alchemy? Corruption, Composition of Capital Flows, and Currency Crises," Brookings, February 2001, WEB.
- Johnson, S., D. Kaufmann, and A. Shleifer, "The Unofficial Economy in Transition," *Brookings Papers on Economic Activity*, 2, 1997.
- Greif, Avner, and Eugene Kandel, "Contract Enforcement Institutions: Historical Perspective and Current Status in Russia, in Edward Lazear, ed., *Economic Transition in Eastern Europe and Russia*, Hoover Institution Press, 1995.

7. *Restructuring*

- Aghion, P., and O. Blanchard, "On the Speed of Transition in Central Europe," in S. Fischer and J. Rotemberg, eds., *NBER Macroeconomics Annual 1994*, MIT Press.
- Ericson, Richard E., "Cost Tradeoffs in Activity Shutdowns: A Note on Economic Restructuring During the Transition," in Robert Campbell ed., *The Postcommunist Economic Transformation: Essays in Honor of Gregory Grossman*, Westview Press, 1994
- Ericson, R., "Restructuring Investment in Transition: A Model of the Enterprise Decision," Davidson Institute Working Paper, January 1998.
- Blanchard, O., *The Economics of Post-Communist Transition*. Oxford University Press, 1997.
- Ickes, B.W., Randi Ryterman, and Stoyan Tenev, "On Your Marx, Get Set, Go: The Role of Competition in Enterprise Adjustment," World Bank Discussion Paper, May 1995.
- Pinto, Brian, Marek Belka and Stefan Krajewski, "Transforming State Enterprises in Poland: Evidence on Adjustment by Manufacturing Firms," *Brookings Papers on Economic Activity*, 1993 (1), pp. 213-270.
- GR, chapter 5.
- Gaddy, Clifford and Barry W. Ickes, "To Restructure or Not to Restructure: Informal Activities and Enterprise Behavior in Transition." Davidson Institute Working Paper, April 1998, WEB: <http://econ.la.psu.edu/~bickes/ickres.htm>.
- Ericson, R.E., and Barry W. Ickes, "A Model of Russia's Virtual Economy," *Review of Economic Design*, vol. 6, 2, September 2001.
- Guriev, Sergei and Barry W. Ickes, "Barter in Russia," in Paul Seabright, (ed.) *The Vanishing Ruble Barter and Currency Substitution in Post-Soviet Societies*, Cambridge: Cambridge University Press, 2001.

8. *China versus Russia*

McMillan, John, and Barry Naughton, "How to Reform a Communist Economy: Lessons from China," *Oxford Review of Economic Policy*, 8. 1. Spring 1992.

Sachs, Jeffrey and Wing T. Woo, "Structural Factors in the Economic Reforms of China, Eastern Europe, and the Former Soviet Union," *Economic Policy*, 18, April 1994: 102-145.

Qian, Yingyi, "How Reform Worked in China," mimeo, September 2001, WEB.

Lau, L., Y. Qian, and G. Roland, "Reform without Losers: An Interpretation of China's Dual-Track Approach to Reforms," *JPE*, vol. 108, 1, 2000: 120-163.

GR, chapter 6.

Young, Alwyn, "Gold into Base Metals: Productivity Growth in the People's Republic of China During the Reform Period," NBER Working Paper, 7856, August 2000.

Young, Alwyn, "The Razor's Edge: Distortions and Incremental Reform in the People's Republic of China," NBER Working Paper, 7828, August 2000.

9. *The Transition Process*

Roland, Gerard, "The Political Economy of Transition," William Davidson Working Paper Number 413, December 2001 WEB.

Berglof, Erik, and Patrick Bolton, "The Great Divide and Beyond: Financial Architecture in Transition," William Davidson Working Paper Number 414, December 2001 WEB.

GR, chapter 13.

Stiglitz, Joseph, "Whither Reform? Ten Years of the Transition," ABCDE Conference, 1999. WEB