

Economics 404W
Lecture 1
January 10, 2006

Tuesdays/Thursdays, 104 RACKLEY

I. Course Mechanics

- **Coordinates:** 517 Kern Bldg., jtybout@psu.edu, 865-4259
- **Office hours:** Wednesdays and Thursdays, 4-5 PM
- **Pre-requisite:**

ECON 302 (INTERMEDIATE MICROECONOMIC ANALYSIS) **or**
ECON 304 (INTERMEDIATE MACROECONOMIC ANALYSIS)

- **2 midterms (25% each), term project 25%**, 3 homework assignments, 2 interim writing assignments and class participation 25%. **No final. No make-ups.**
- **The writing assignments and class participation**

After several lectures you will sign up for a country team. You'll be responsible for researching characteristics of that country and coming to class ready to discuss them.

As you learn about your country, you will write about it. You will submit a 2-3 page report Feb. 14 addressing the topics distributed in advance. You will submit a second report on March 30 that addresses an additional set of issues. Finally, you do some additional research and combine these reports into an 8 page country report that is due during the last week of class. The final country report should reflect the comments on your writing you have received during the semester.

We're going for quality, not quantity. I am looking for well-honed documents that reflect the principals of professional writing as laid out by Bruce Ross-Larson. Clarity, organization, ease of reading.

- **Collaboration:** Homeworks are to be done individually. You can, of course, collaborate on researching your country, but *not* on writing.
- Two **books** to buy; some other **materials on reserve or accessible on the web.**

Be reading:

Smith and Todaro—chapters 1 and 2

Ross-Larsen, pp. 1-39.

For a feel for LDCs, Kaplan, chap 1

II. Distinguishing Features of LDCs

International comparisons of living standards are problematic:

- under-report income (tax collection not well enforced)
- non-comparable goods
- non-market goods (big rural pop.),
- relative price differences (because of imperfect tradeability)

Nonetheless, they give us a crude sense for material well-being.

(overhead 1)

The overwhelming majority of people live in **poor** countries (income per capita below \$3,125 per annum). **Low income countries (<\$785) account for 2.4 B of world's 6 B population.** These countries are concentrated in S. Asia, E. Asia, Sub-Saharan Africa.

- Low income is associated with **shorter life expectancies (col. 4)**; the **proximate causes** are:
 1. Low **health expenditures** per capita (*col 6*)
 2. low **caloric** intake (*col. 5*)
 3. poor **sanitation**
- The **low quality of life is exacerbated by**
 4. **squalid living** conditions
 5. **low education** levels
 6. adverse **working conditions**,
 7. **vulnerability to earnings shocks** (agric., sickness, macro stabilization)

Looking at country-wide or region-wide statistics masks heterogeneity

Define the poverty line to be \$370 per annum (1993 US dollars). Although per capita income in Latin America far exceeds that in E. Asia and Pacific (\$3,940 versus \$970), about 15 percent of the population was below this poverty line in both regions. Note also 46 percent of Sub-Saharan African households were below the poverty line and 40 percent in S. Asia.

This reflects relatively unequal income distribution in Latin America, making many households there much worse off than the “average” Latin American household. Unequal income distributions combine with very low per capita income levels in Sub-Saharan Africa and South Asia. You can see the consequences in the social indicators.

We call countries characterized by low per capita income and/or large percentages of their population in poverty 3rd world, or developing, or less developed.

In the WB taxonomy, this **includes “low income,” “middle income,” and sometimes the high income oil exporting countries** (Oman, Libya, Saudi Arabia, Kuwait, UAR).

Why the oil exporters? Although per capita income is high in these countries, they look like LDCs in terms of their life expectancy, literacy, and other features that characterize LDCs. Income and wealth are not spread evenly.

Not only does the 3rd world easily dominate in terms of population, but its population is expanding at a relatively rapid rate. (col 2).

Excluding China and India, population growth has been fastest among the poorest countries. (Look at Sub-Saharan Africa!)

Only a short-sighted fool would ignore the importance of the LDCs or cling to the hope that they will soon become “like us”

III. Why don't these economies do better?

Various observers have suggested:

a) Characteristics of the labor force

- Just too many people, or
- inability to attain skills and education because of collateral trap, or
- cycle of low education, high birth rates as optimal choice.

b) Insufficient incentives to invest

- misguided government controls
 1. choke the financial system
 2. tax capital formation excessively
 3. discourage or disallow FDI
- cycle of subsistence and high dependency rates prevents savings
- to be profitable, K projects must be done in right environment:
 4. need critical mass of other investment projects (coordination failure)
 5. need infrastructure
 6. need enforceable property rights

c) Problems of Interaction with the world economy

- not reaping benefits of foreign capital inflows
- not reaping the benefits of trade:
 - comparative advantage

x-efficiency
technology transfer
monopoly behavior

- trade has driven country away from goods with learning potential
- adverse external shocks: T/T, protectionism in ROW

d) Inadequate resource endowment

- Saharan Africa,
- Parts of Asia (e.g., Bangladesh)
- Jared Diamond: climate and topography are destiny

10,000 years ago, Fertile crescent was endowed with large animals that could be domesticated, and grains/fruits that could be cultivated. These spread east-west through Europe/Asia, but not south to Africa because of climate and topography

Cultivation freed up people to think about other things (weapons, conquests), bred disease living in close quarters with animals and each other. Both led to dominance of the W. European culture in S. America, S. Asia and Africa.

e) Historical Accident

- Once minimum efficient scale is reached in one country, it dominates
 - learning-by-doing (pool of local knowledge),
 - infrastructure-based scale economies

f) Exploitation by the 1st World and its legacy

- prevented the emergence of an entrepreneurial class
- extracted wealth (essentially primary products)
- collusion of external powers with established power brokers prevented the emergence of industry
- Drew unnatural borders that created tribal feuds.

We'll explore all of these possibilities except the last one (which I leave for your professors of history and government)

IV. Structure of the Course (turn to syllabus):

1. First, document the patterns of development that have emerged

Transformations in

- structure of production
- characteristics of population
- nature of the public sector
- investment patterns
- trade and capital flows

2. Next, consider models of growth process, old and new:

Develop a preliminary sense for the basic forces at work:

- Labor force growth,
- saving and investment,
- productivity growth,
- externalities.

3. A key feature of development is industrialization—we'll study models that explain why this occurs (or fails to)

- Poverty traps?
- A role for history: coordination failures and externalities?

4. The demographic transition

- How and why does population change with development?
 1. location (urban/rural)
 2. age structure
 3. education and skills
- Is rapid population growth the cause or consequence of under-development?
- Can government efforts to change population growth rates improve welfare?

5. Inequality, human capital and development

- How does inequality affect growth?
- What about education?
- Are there self-sustaining cycles of inequality?
- What role might government play?

7. Trade and development

- Openness and development in competitive models
- Other aspects of openness and economic performance (tech. diffusion, market structure and efficiency effects)
- Ways that LDCs attempt to manipulate trade flows
- The WTO and the LDCs

9. Multinationals and International capital flows

- How do multinational investments affect LDCs?
- LDC policies and consequences
- Child labor/sweat shops

10. Macro Management

- Foreign aid
- Fiscal management and the political economy of policy formation

- balance of payments crises

Many things are missing in this course. A limited sample includes:

Rural markets—insurance, tenancy/sharecropping, agricultural performance

Marxist arguments

Project evaluation in developing countries