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# Introduction and Overview

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# Why Study Development (Micro) Economics?

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## Astonishing Differences between Countries:

- **World Development Report (2009):**

- A threshold of \$11,455 per capita in 2007 to distinguish between ‘High-Income Countries’ and ‘Low- and Middle-Income Countries’.

	Population (Millions) 2007	GNP per capita (US \$) 2007
Low Income	1,296	578
Middle Income	4,260	2,872
Low and Middle Income	5,556	2,337
High Income	1,056	37,566
World	6,612	7,958

- Despite many caveats and qualifications, the ubiquitous fact of these astonishing disparities remains.

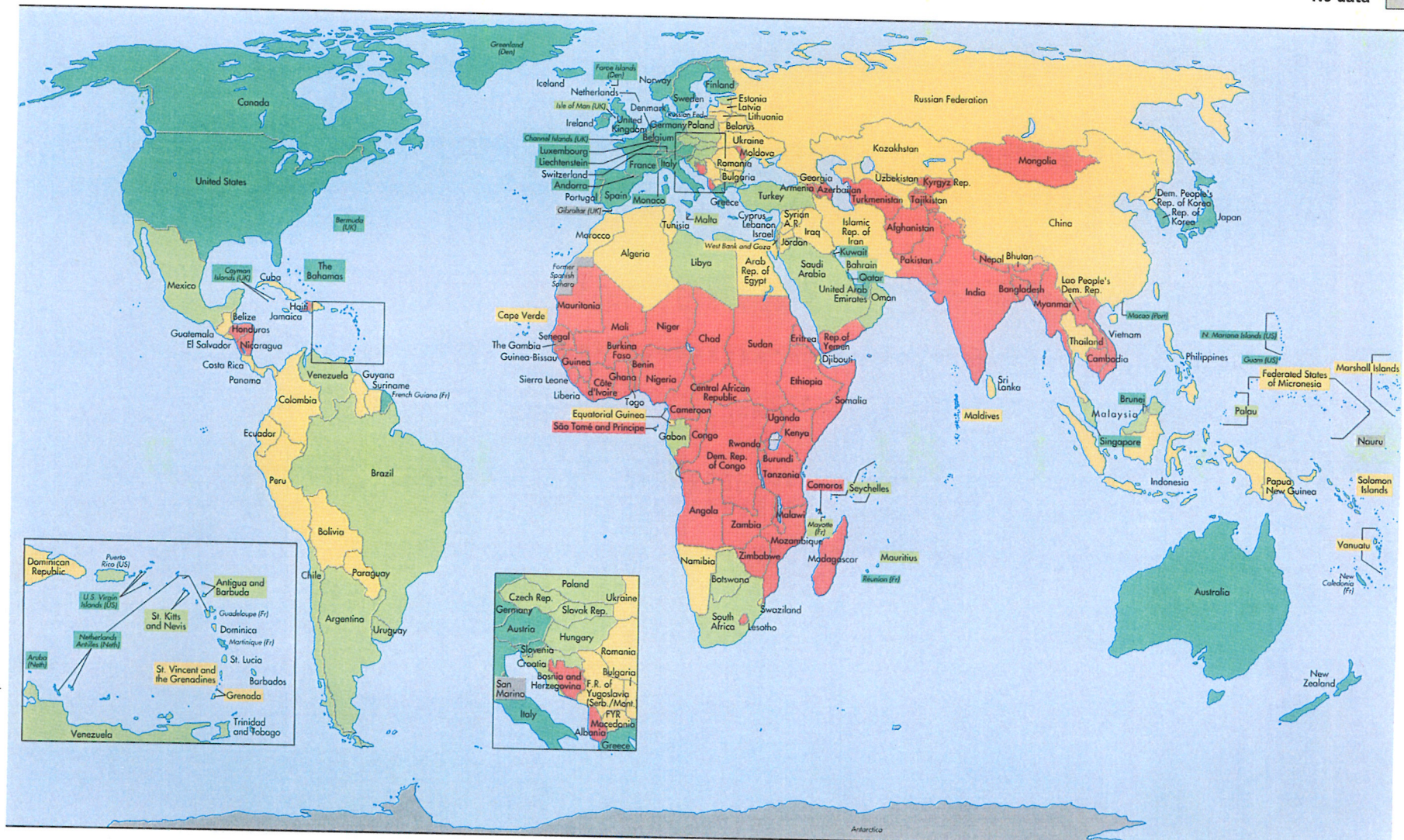
- **World Development Report (2009):**

- World Production: \$52.6 trillion of output in 2007.
  - 24.7% of this came from the low- and middle-income developing countries
    - a pittance when we see that these countries house 84% of world's population.
  - Norway, the world's richest country, enjoyed a per capita income (\$76,450) that was 695 times the per capita income of Burundi (\$110), the world's poorest.
  - Switzerland: \$59,880; USA: \$46,040.
- An index of income that controls for purchasing power (Purchasing Power Parity, PPP) would place these numbers far closer together:
    - World Production: \$66.6 trillion
    - High income countries: \$35.6 trillion
    - Low and middle income countries: \$31 trillion
  - The per-capita disparities are enormous, and no amount of fine-tuning in measurement method can get rid of the stark inequalities that we live with.

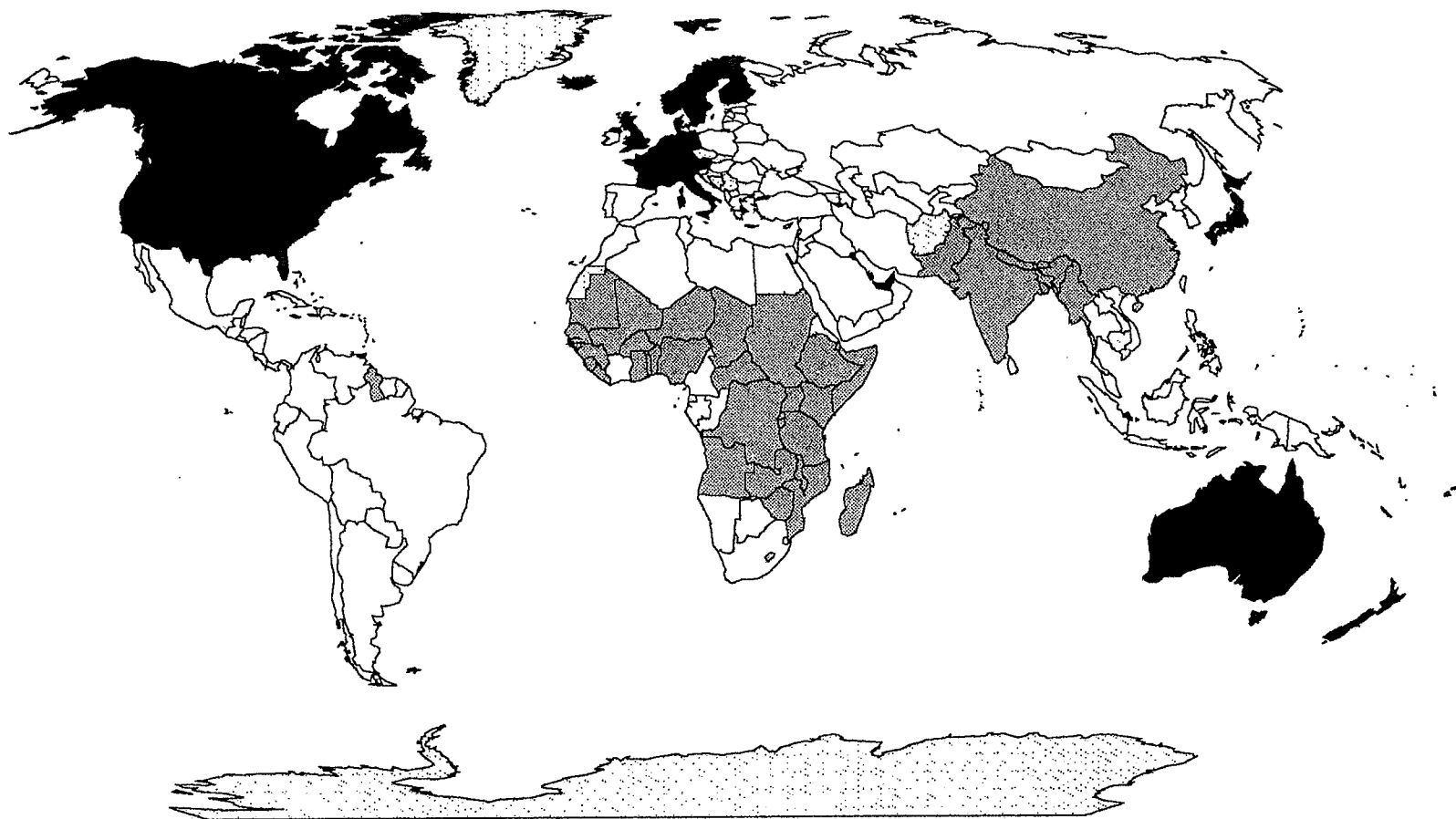
## The World by Income

This map presents economies classified according to World Bank estimates of 1997 GNP per capita. Not shown on the map due to space constraints are: American Samoa (upper middle income); Fiji, Kiribati, Samoa, Tonga (lower middle income); French Polynesia (high income); Tuvalu (no data).

**Low** \$785 or less  
**Lower middle** \$786 to \$3,125  
**Upper middle** \$3,126 to \$9,655  
**High** \$9,656 or more  
**No data**



MAP 1. The Rich and the Poor



The countries in black contain 15 percent of world population but produce 50 percent of world GDP. The countries in gray contain 50 percent of world population but produce 14 percent of world GDP.



## The Magnitude of the Problem:

- Poor countries are very poor indeed.
  - 61.2% of the population in Mali in the 2001 lived on less than \$1.25 a day at 2005 PPP prices and 86.4% in Nigeria lived under \$2 a day in 1996-1997.
- This translates into
  - 30% of the children under 5 in Mali in 2000-2007 had measurable signs of malnutrition (44% in India, 0 in Sweden);
  - Under 5 mortality rate in Mali was 217/1000 in 2006 (270 in Sierra Leone, 4 in Norway);
  - Life expectancy at birth for males was 52 years in Mali (41 years in Sierra Leone, 79 in Sweden);
  - 76% of adults were illiterate in Mali in 2005 (61% in Niger, 0 in Sweden).

- The *Poverty Line* in India is 16 rupees per person and per day.
  - This is also the average poverty line for the 50 countries where most of the poor live.
- 16 rupees is 36 cents (US). . . . But life is cheap in India, so if we correct for world prices, it corresponds to 99 cents (this is what we mean when we talk about “life under a dollar a day”):
  - The poverty line in the US is 14 dollars per day.
  - Average GDP per capita in the US is \$47,400, implying \$130 per person per day!
- **865 million people in the world live with less than 99 cents per day in 2005.**

- Poverty is not only lack of income, but also
  - Poor health:
    - 9 million children every year die under the age of 5, mainly of diseases that could have been prevented;
      - 6.5 million children die every year before their first birthday;
    - 27 million children every year do not get the essential vaccinations.
  - Poor education: 50% of children enrolled in schools in India cannot read a simple paragraph.
  - Poor quality of life: hours collecting water instead of playing, working, learning.
  - Difficulty to realize your ambition: Get a loan for a business; be insured for the risk of your farm.
- **Amartya Sen: Development as Freedom.**



## The Story of Abu

- From *A Quiet Violence*, by Betsy Hartman and James Boyce, 1983.
  - A quasi-journalistic account by two economists of life in rural Bangladesh, in 1975.
    - These were the worst years in the history of Bangladesh. Things have gone much better since.
  - This is the story of one peasant family.
- The First Visit:
  - Abu is sick. He has not been able to work for the last three weeks.
  - His children are hungry.
  - His oldest daughter, who is still a child, is the only earner in the family. She gets 1/4 kilo of rice for husking rice all day.
  - Abu cannot afford the Rs. 100 that he needs to pay a doctor.

- The Past:

- Abu used to have enough land to live on, but he needed money to take care of his mother who was sick, and sold some of the land.
  - She died any way.
- They had a number of children and the land they had was no longer enough to feed everyone.
- When there was no food, they borrowed from the money lender at very high rates, which ate into their future income.
- Abu started working for a landlord who gives one meal and 1.25 kilos of rice a day.
- He could sharecrop and get to keep half of what he grows but he gets it after the harvest and in the meanwhile they starve.
  - Also renting a plough-team costs 2 days labor/day.
  - He had to mortgage more land to his landlord.

- The Future:
  - At the first visit they are still optimistic.
    - Abu had planted a jackfruit tree four years ago.
    - In a couple of years it will yield fruits that can be sold and bring in good money.
- The Second Visit:
  - Abu has sold land to pay the doctor.
  - His wife has no work.
  - In the lean season he cannot find work either, so they are starving.
  - Abu cuts down a jackfruit tree and sells the wood for 25 takas.
    - It never got a chance to bear fruit.

## **Is the vicious circle completely closed?**

- Should you take away from the story of Abu that there is no need to take this course: as long as people are poor they will be sick and as long as they are sick they will be poor?
  - In fact, there are many examples where the vicious circle can be broken: many interventions could durably help Abu and others.
  - Development economics is largely about this question: how do vicious circles emerge and what can we do about them?

# Topics to be Covered in this Course

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- **Introduction:**

- We look at some stylized facts based on micro-level studies as to how the poor live.
  - Special focus on their consumption, income generation, as well as their access to markets and public services.
- This motivates our theoretical discussion of the microeconomic studies of various markets and institutions that affect development.

- **Agricultural Organization and Productivity in Developing Countries:**

- Agriculture occupies a central place in less developed economies. We study
  - 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,
  - strategies for successful agrarian reform,
  - empirical determinants of organizational and contractual form,
    - and the effect of these on agricultural productivity.

- **Credit Markets in Developing Countries: Theory and Evidence:**

- Credit 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.

- **Micro Finance:**

- Microfinance is 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.



- **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.
- 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.

- **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.

- **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.

# The Game Plan

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- This semester is about building blocks.
  - Household behavior (nutrition, health, education);
  - Markets (land; credit; savings; insurance);
  - Institutions (formal and informal).
- In the Development Macroeconomics course next semester we will incorporate these building blocks in good models to answer the “big questions”.