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What Development Economics Is All About

Malawi is one of the poorest countries in the world. The average person living there had an annual income of \$330 in 2010. That is not even a dollar a day. Even when we adjust for a low cost of living, the average Malawian lived off what in the United States would be the equivalent of around \$850 per year.¹

What is the solution to Malawi's pervasive poverty?

Like other less-developed countries (LDCs), Malawi has tried a number of different strategies to stimulate development and raise the welfare of its people. It made the growth of smallholder production a cornerstone of its development and poverty-alleviation strategy, by focusing on improving smallholders' access to agricultural input and output markets. Eighty-one percent of Malawi's population is rural, and smallholders make up about 90% of the poor. Food production is a major source of livelihood for most rural households. Productivity and, in particular, fertilizer use are low. Only 67% of agricultural households used fertilizer in 2004.²

Before 1998, Malawi relied on market price supports to transfer income to farm households. (Next door in Zambia, where per-capita income was \$1,400 in 2010, the government continues paying farmers prices well above market levels for their maize.³) In recent years, fertilizer subsidies were the primary method of transferring income to rural Malawi households. Government payments for farmers' inputs is expen-

sive and controversial. More than 50% of the Ministry of Agriculture's budget has gone toward paying for these subsidies.⁴

Most recently, the country has taken a new line of attack by introducing a Social Cash Transfer Scheme (SCTS) that targets ultra-poor households (those living on less than \$0.10 per day) whose members are unable to work due to disability, age, illness or a high dependency ratio (too many people to take care of at home). Rather than specifically targeting agricultural production like the price supports or fertilizer subsidies, cash transfers raise incomes directly, allowing households to increase consumption or to invest in production activities. The government and researchers hope these transfers will stimulate production in other ways, while creating positive spillovers that benefit other households in the economy.

Studies to test the effectiveness of the SCTS are in the field. Similar programs are being implemented throughout the continent, in Ethiopia, Ghana, Kenya, Zambia, Zimbabwe, Lesotho, and other poor countries. The United Nations (UNICEF and the Food and Agricultural Organization-FAO), in conjunction with several universities and agencies, have launched an ambitious project to document the impacts of these transfer programs on a range of outcomes, from crop production to AIDS prevention.⁵

Development economists are on the front line of this effort, helping to design and evaluate SCT programs. On a micro level, this is a good example of the sorts of things development economists do. A whole chapter later in this book (Chapter 11: What Works and What Doesn't?) is dedicated to project impact evaluation.

Development Economics involves much more than this, though.

What Is Development Economics?

Usually, a development economics class is a potpourri of special topics. It's hard for it not to be, because economic development involves so many different things:

- It's income growth. How can we have development without growth in countries whose per-capita incomes now hover around \$1-2 per day?
- It's welfare economics, including the study of poverty and inequality.
- It's agricultural economics. How to make agriculture more productive is a big question in countries where most of the population is rural and agricultural.
- It's economic demography, the study of population growth in a world with more than 7 billion people, and population distribution in a world with more than a quarter of a billion international migrants and many more internal ones. (China will have about that many internal migrants in the near future, if it doesn't already.)
- It's labor economics: education, health, conditions in the workplace.
- It's the study of markets for goods, services, inputs, outputs, credit, insurance, without which whole economies can grind to a standstill.
- It's public economics, including the provision of public goods from roads and communications to utilities and waste treatment, and it's about managing the macro economy, too.
- Development is about natural resources and the environment: energy, water, deforestation, pollution, climate change, sustainability.

What is economic development *not* about, you might ask?

Lurking behind this question is another one, which lies at the heart of why I wrote this book: Why is there a field of development economics? After all, most economics departments have courses in each one of the above areas—and more.

Wikipedia defines development economics as “a branch of economics which deals with economic aspects of the development process in low-income countries.” This implies that there must be something different about studying economics in low-income countries.

Clearly there is. Economic development entails far-reaching changes in the structure of economies, technologies, societies, and political systems. Development economics is the study of economies that do not fit many of the basic assumptions underpinning economic analysis in high-income countries, including well-functioning markets, perfect information, and low transaction costs. When these assumptions break down, so do the most basic welfare and policy conclusions of economics.

This book, like other development economics texts, touches on many different topics. However, its focus is on the fundamental things that distinguish rich and poor countries and the methods we use to analyze critical development economics issues. After reading and studying it, you should have both a tool kit for doing economic development research and an idea set to help you understand why poor countries are different and what this means for the theory and practice of development economics.

The Evolution of Development Economics

Economics classes rarely spend much time on history. But the brief history of development economics is instructive. Studying the process economists have gone through to discover what economic development is helps *us* understand the various approaches people have taken over time and how we got to the ideas that are popular now. What we *thought* development meant at the beginnings of our field's history is quite different from the way we see it today.

The origins of modern development economics are not found in low-income countries, but rather in relatively developed countries devastated by war. In the aftermath of World War II, there was a need for economic theories and policies to support the rebuilding of war-torn Europe and Japan. The United States adopted the Marshall Plan to help rebuild European economies. This was a massive program: \$13 billion over four years was a lot of money back then!

In the 1950s and 1960s, economists turned their attention from Europe to the economic problems of Africa, Asia and Latin America. Lessons learned in Europe did not transfer easily to those settings; it quickly became clear that poor countries faced fundamentally different challenges.

Early development economists focused on growth, often blurring the lines between growth and development. In poor countries, major structural transformations were needed to achieve growth. By comparing different countries' growth experiences (including the past experiences of the more developed countries), economists tried to uncover the conditions that determine successful development and economic growth.

Taking Off

Seminal work during this early period of development economics includes Walter Rostow's treatise on the stages of economic growth: the traditional society, the pre-conditions for take-off, the take-off, the drive to maturity, and the age of high mass-consumption.⁶ Nobel laureate Simon Kuznets (whom we shall revisit later in this chapter) countered this simplistic view that all countries go through a similar linear set of stages in their economic history. He argued instead that key characteristics of today's poor countries are fundamentally different from those of high-income countries before they developed.

The Anatomy of Growth

Economists recognized the need to understand how the growth process works. Growth is so important that we will devote a whole chapter to it in this book. There, we'll focus on modern growth theory, but growth models have played an important role since the start of development economics.

A simple aggregate growth model developed by Sir Roy F. Harrod and Evsey Domar became part of the basic creed of development economists in the 1950s and 1960s.⁷ The Harrod–Domar model's main implication

was that investment is the key driver of economic growth. It focused economists' and policy makers' attention on generating the savings required to support higher growth rates in poor countries. Although simplistic, this was a precursor to models used to analyze economic growth in developing countries today.

Nobel Laureate W. Arthur Lewis viewed growth through a higher-resolution lens. His famed work, *Economic Development with Unlimited Supplies of Labor*, shifted attention from aggregate growth to structural transformation.⁸ Lewis introduced the dual sector model, demonstrating that the expansion of the modern (industrial or capitalist) sector depends on drawing labor from the traditional (agricultural or subsistence) sector. He focused on poor, labor-rich countries, in which a labor surplus in the subsistence sector could be a valuable resource for industrial growth: industry could expand without putting upward pressure on wages. Implicit in the Lewis model is a simple, demand-driven model of migration: as urban industry expands, people move off the farm to fill the new jobs. Whether or not workers really can be moved out of agriculture without losing crop production is an empirical question that some economists still try to answer today.

Lewis was criticized for largely ignoring agriculture. His work was extended and formalized by Gustav Ranis and John Fei, who demonstrated that industrial growth depends on agricultural growth as well as industrial profits.⁹ If agricultural production does not keep up, food prices rise, and this forces urban wages up, squeezing profits and investment in industry. The growth of industry, then, depends on agriculture. Recognition that different sectors of the economy are linked in critical ways was an important contribution of dual-economy models and is a basis for more sophisticated economy-wide models today.

The assumption that there is surplus labor in the traditional sector (that is, that the marginal product of labor there is zero) was questioned by another Nobel laureate, Theodore Schultz.¹⁰ He pointed out evidence of labor shortages during peak harvest periods even in economies like India and China, where a labor surplus existed at other

times of the year. Thus, he argued, one cannot assume that countries can move labor out of agriculture without suffering a drop in crop production—unless they adopt new agricultural technologies. Schultz emphasized the importance of technological innovation and revolutionized economists' thinking by putting forth the thesis that farmers in less-developed countries are "efficient but poor." That is, while they might appear to be inefficient (compared, say, to commercial farmers in rich countries), poor farmers optimize given the severe resource constraints they face, including traditional technologies and limited human capital. The efficient-but-poor hypothesis continues to shape the way development economists think about and model poor rural economies. Nevertheless, recent work questions whether production, land tenancy (e.g., sharecropping), and other institutions in poor countries really are efficient in an economic sense.

The burgeoning early development economics literature produced far too many works to catalogue here, but two others deserve special mention because of the far-reaching impact they had on economic thinking and, more importantly, policies.

Import-substitution Industrialization

In 1950, Raul Prebisch and Hans Singer independently observed that the terms-of-trade, or the ratio of prices, between primary (agricultural, resource extraction) and manufactured products erodes over time.¹¹ As people's income increases, the share of income they spend on manufactures increases, while the share spent on primary goods falls. This happens globally as well as locally. Prebisch and Singer argued that this drives up the prices of manufactured goods relative to primary goods. Poor countries that continue to specialize in primary-goods production lose out compared to countries that protect and promote their industries.

Prebisch and Singer's work was enormously influential in promoting protectionist trade policies, shielding infant industries in poor countries from international competition. Its policy prescriptions ran soundly against the doctrine that countries should follow their com-

parative advantage in trade. In retrospect, countries that followed this advice did not fare as well as countries like the “Asian Tigers” (Hong Kong, Singapore, South Korea and Taiwan) that followed more outward (trade)-oriented development models.

Linkages

Albert Hirschman, another early pioneer in development economics, put forth the interesting and influential argument that imbalances between demand and supply in less-developed economies can be good: they create pressures that stimulate economic growth. Hirschman was instrumental in creating a focus on economic linkages, which pervade economy-wide modeling, a staple of development policy analysis today. By promoting investments in industries with many linkages to other firms, governments can have a multiplier effect on economic growth; the effects of a policy spread to industries linked to the targeted industry. Backward linkages transmit growth effects from an input-demanding activity (e.g., textiles) to input suppliers (cotton mills or wool producers). Forward linkages stimulate the growth of activities ahead of firms, as when investment in an electricity generator facilitates the growth of electricity-using industries.

Hirschman argued that agriculture generated few linkages with the rest of the economy. This, particularly when combined with the Prebisch-Singer hypothesis, contributed to the sense among policy makers that agriculture is unimportant and countries ought to use their scarce resources to promote industrial, not agricultural, growth. John Mellor countered this argument in his seminal work, *The New Economics of Growth*, which documented the importance of consumption linkages between rural households and urban industries. If most of a country’s population is rural, where will the demand for new industrial production be if not in rural households? Rising agricultural incomes, then, provide a critical market for manufactures, thereby stimulating industrial growth.

Development economists had begun to take more of a systems view of poor economies, recognizing the linkages among production sectors and between firms and households that are important in shaping economic growth. They would soon rethink their emphasis on growth, though.

Rethinking Growth: Inequality and Poverty

The United Nations declared the 1960s to be the decade of development. In 1961, it:

“...called on all member states to intensify their efforts to mobilize support for measures required to accelerate progress toward self-sustaining economic growth and social advancement in the developing countries.”

Each developing country set its own target, but the overall goal was to achieve a minimum annual growth rate of 5% in aggregate national income by the end of the decade.¹² The world came close to realizing the UN’s goal. Less-developed countries achieved an average annual growth rate of 4.6% from 1960-1967. However, their population also increased. As a result, their per capita gross product (income divided by population) rose only about 2%.

When the UN Development Decade ended in 1970, the gap between rich and poor countries had widened: two-thirds of the world’s population had less than one-sixth of the world’s income. This raised new questions about the meaning of development. Evidently, a tide of rising world income did not lift all—or even most—boats. The U.N. General Assembly concluded that one of the reasons for the slow progress was the absence of a clear international development strategy.

The problem of rising inequality made development economists rethink their focus on growth. Before then, the key work linking growth and inequality was Simon Kuznets’ “inverted U” hypothesis. It stated that economic growth decreases inequality in rich countries but increases it

in poor countries.¹⁴ It tended to create a sense of complacency about inequality: sure, inequality increases for awhile as poor countries grow, but eventually countries “outgrow” it and become more equal. At least, that’s what Kuznets saw when he used cross-section data to compare rich and poor countries. (Cross section data are data on different countries at the same point in time. It would have been nice to track the same countries over time to see if inequality first increases then decreases as economies grow, but we didn’t have the data to do that back when Kuznets put forth his novel theory.)

As panel data became available to track individual countries’ growth and inequality, the inverted-U theory has been challenged repeatedly in the development economics literature, though it seems to fit some countries well. (Panel data provide information on the same units (here, countries) over time.) Today, China is growing fast, and inequality there is increasing. Brazil and Mexico have much higher per-capita incomes than China, and inequality there is going down. Then there’s the United States, where inequality fell through the 1970s but is rising again now.

Development economics shifted its attention from income growth to income inequality. In 1974, Hollis Chenery, head of the World Bank’s economic research department, published an influential book called *Redistribution with Growth*. It demonstrated that when assets (such as land) are distributed unequally, economic growth creates an unequal distribution of benefits. Around the same time (1973), Irma Adelman and Cynthia Taft Morris published a book called *Economic Growth and Social Equity in Developing Countries*. They found that as incomes grew, not only did inequality increase, but the *absolute* position of the poor *worsened*. At the early stages of a country’s economic growth, the poorest segment of society may be harmed, as traditional economic relationships in subsistence economies are displaced by emerging commercial ones. Growth was more equitable in countries that redistributed assets, like land and human capital (education), *before* the growth happened.

Robert McNamara, the World Bank’s president, presented Chenery’s findings at a 1972 UN Conference in Santiago, Chile. The new position of

the World Bank and development economics profession was that growth is not enough. McNamara and many development economists recommended redistribution before growth; for example, land reforms and other measures to raise the productivity of small farmers and widespread rural education programs.

The development economics mantra had shifted from “growth” to “inequality,” “poverty,” “basic needs,” and “broad-based economic growth.” National planning offices cropped up around the world, often with “five-year plans” inspired by the Soviet Union’s planning models but not necessarily socialistic in nature. While I was an undergraduate student I worked for a year with the National Planning Office in Costa Rica, which hardly was a communist state! This period saw the advent of economy-wide models as a tool for development planning and policy. These models were designed to simulate the complex impacts that policies have on whole economies as well as on particular social groups. They continue to be a staple of development economics research and policy design.

The 1970s marked the beginning of what has become an ongoing friction between direct government involvement in the development process and market-led development. The traditional neoclassical economic view, inspired by Adam Smith’s “invisible hand,” is that individuals and firms, in the pursuit of their self-interest, are led as if by an invisible hand to economic efficiency. For example, competition among profit-maximizing firms drives down prices for selfish, utility-maximizing consumers. However, the invisible hand does not typically lead to fair outcomes, so government intervention can often play a role in promoting social objectives other than efficiency, such as equality or protection of domestic industries.

The 1960s and 1970s witnessed increasing government involvement in markets: setting prices, controlling trade, and creating “para-statal” enterprises that did everything from buying and selling crops to drilling for oil. Much of the focus of these efforts was on stimulating industrial growth; however, most of the population in poor countries—especially

the very poor—depended heavily on agriculture. In many countries, import-substitution industrialization policies created severe biases against agriculture, in three ways:

- “Cheap food policies” directly harmed agriculture while helping to keep urban wages low.
- Steep tariffs and quotas on imported industrial goods and direct subsidies were used to promote industrialization. This increased the profitability of industrial compared to agricultural production.
- Macroeconomic policies like over-valued exchange rates made imported industrial inputs and technologies (as well as food) cheaper. This created yet another bias against agriculture, by making traded goods (food) less profitable than non-traded goods (manufactures, which were protected from trade competition).

Trusting Markets

The 1980s saw the beginning of a backlash against too much state involvement in the economy. This was the era of Ronald Reagan and Margaret Thatcher, in which we recognized the inefficiencies of state-planned economic systems like in the Soviet Union and China compared with the more *laissez-fair* political systems in the west. Meanwhile, it became clear that the countries that were experiencing the most rapid and broad-based growth were *not* the inward-oriented countries following import-substitution industrialization, like Kenya, Mexico and Brazil. Instead, they were the outward (export)-oriented economies, particularly the Asian Tigers. In those countries, governments were involved, sometimes heavily, in the economy, but opening up to market competition made it possible to become competitive on a world scale.

In the 1970s and 1980s, the world economy went into a recession as oil prices soared. Debt crises struck many LDCs (particularly in Latin America), forcing them to rethink their development policies—often as part of “structural adjustment” programs required by the International Monetary Fund (IMF) as a condition for restructuring their debt.

The World Bank's 1984 *World Development Report* was somewhat of a watershed. It called for removing distortions created by governments' over-involvement in agricultural markets. Almost overnight, governments began to withdraw from markets, dismantling import-substitution industrialization policies and opening up to trade. Less-developed countries around the world entered into free-trade agreements (see box, "Major Free-trade Agreements").

Major Free-Trade Agreements by Year

- ASEAN Free Trade Area (AFTA), 1992
- Asia-Pacific Trade Agreement (APTA), 1975
- Central American Integration System (SICA), 1993
- Central European Free Trade Agreement (CEFTA), 2006
- Common Market for Eastern and Southern Africa (COMESA), 1994
- G-3 Free Trade Agreement (G-3), 1995
- Greater Arab Free Trade Area (GAFTA), 1957
- Gulf Cooperation Council (GCC), 1981
- North American Free Trade Agreement (NAFTA), 1995
- South Asia Free Trade Agreement (SAFTA), 2004
- Southern African Development Community (SADC), 1992
- Southern Common Market (MERCOSUR), 1991
- Trans-Pacific Strategic Economic Partnership (TPP), 2005
- U.S.-Central American Free-Trade Agreement (CAFTA), 2006

Not (Quite) Trusting Markets

The market liberalization movement continued into the 1990s; however, the enthusiasm for free trade became tempered by a realization that market liberalization does not necessarily improve people's economic welfare if markets do not work properly. This produced a surge of research documenting market failures in LDCs as well as their underlying causes. (Markets and market failures are the subject of Chapter 9.)

Joseph Stiglitz, who received the 2001 Nobel Prize in Economics, along with other economists, demonstrated that markets are rarely efficient. He attributed this largely to imperfect information, which creates high transaction costs that lead to widespread market failures, particularly in poor countries. When markets do not work well, government involvement in the economy can often improve welfare. Development economists have been careful to warn that market failures do not necessarily warrant broad state intervention in the economy: there are government failures as well as market failures. However, the scope for the state to raise welfare by intervening in markets, it seems, is much larger than previously thought.

The Experimental Revolution

Today, much of the focus of development economics has shifted to the micro, project-evaluation level. Increasingly, development economics research involves using experiments to learn about people's economic behavior and evaluate the impacts of policy interventions on welfare outcomes. When experiments are not possible, economists use other methods, including econometrics and simulation modeling, to try to identify the impacts of policies and programs. The social cash transfer programs mentioned at the start of this chapter are an example. Today, if you work for an NGO, international development agency, or even LDC government, there is a good chance you'll be dealing with experimental

economics. Experiments have become such an important part of development economics that we devote an entire chapter (Chapter 11: “What Works and What Doesn’t?”) to them in this book.

What Is Economic Development, Then?

Economic development has different meanings in different contexts. In rich countries, it is pretty much equated with growth. Picture the urban developer who makes skyscrapers sprout from vacant lots in a blighted city core. Politically, development projects in high-income countries often are motivated by some of the same goals that inspire development projects in poor countries, particularly the creation of new jobs, incomes, and tax revenues. Their ultimate aim, however, is likely to be growth.

Most development economists today would say that economic development is not equivalent to growth, although it is difficult to achieve development goals without growth. Development projects around the world focus on concrete outcomes related to poverty, malnutrition, inequality, and health. Development is about satisfaction of basic physical needs like nutrition, shelter, and clothing, and about the development of the mind (and of course people’s earnings potential), through education. Projects also focus on the environment, conservation, and sustainable resource use; on human rights, gender and ethnic equity, and even government corruption.

All of these questions can be vital not only to determining who reaps the benefits of economic growth, but also to growth itself. Herein lies a fundamental difference in the way we tend to look at economics and politics in rich and poor countries. In high-income countries (not to mention our micro-economic courses!), economic efficiency and equity tend to be viewed as separate questions. The efficient allocation of resources is critical to ensure that economies produce the biggest possible economic pie, given the constraints they face (i.e., limited resources and technolo-

gies). Efficiency is the primary focus of the vast majority of our economics classes.

What about equity? How the pie gets distributed usually is an afterthought. It is sometimes thought of as being more the domain of politics than economics. Think about the economics courses you've taken. The textbook view is that efficiency and equity are sequential, or recursive, problems: First grow the pie, and once that's done, think about how it gets distributed (or step back and let the market decide).

Clearly, there's an important separability assumption here: that efficiency can be achieved regardless of how income is distributed. Is this a reasonable assumption? In a competitive market equilibrium, there will be different outcomes depending upon what the initial distribution of wealth looks like. But provided the basic assumptions of the competitive model (which you learned in your introductory economics courses) hold, all will be efficient in the Pareto sense: you cannot make anyone better off without making someone else worse off. If you ever studied an Edgeworth Box, you've seen how economists show this.

The separability of equity and efficiency was reinforced by the Nobel Laureate Ronald Coase, who argued that bargaining will lead to an efficient outcome regardless of the initial allocation of property rights, even in the case of externalities (a cost or benefit not reflected in prices, like pollution). According to Coase it doesn't matter whether you have the right to smoke or I have the right to breath clean air. Once we have finished bargaining with each other, the amount of smoke in the air will be the same. This view has achieved the status of a theorem: Coase's Theorem.

If efficiency and equity are truly separate issues, then there is not much room for economic policy, nor much reason for efficiency-minded economists to worry about equity. (Of course, even economists might worry about equity for other (i.e., humanitarian) reasons.)

It might surprise you, then, that a great deal of development economists' effort goes into discovering how equity and efficiency are inter-

twined, especially in poor countries. How assets are distributed clearly affects efficiency if:

- Banks are unwilling to loan money to small farmers
- Poor people cannot get insurance to protect themselves against crop loss or sickness
- Poverty and malnutrition prevent kids from growing up to become productive adults
- Access to markets for the stuff people produce, the inputs they use, and the goods they demand is different for the poor and rich
- The ability to get a job depends on who you are, not on how productive you are

In these and many other cases, the separability of equity and efficiency breaks down. A person's capacity to produce (or even consume) efficiently depends upon how wealth is distributed to start out with because the basic assumptions of competitive markets often don't hold for the poorest members of society. A rich farmer can produce where the market price equals the marginal cost of producing corn, the basic requirement for profit maximization and efficiency. But if a poor farmer lacks the cash to buy fertilizer, and no bank will lend to her, she will not be able to produce as efficiently as the large farmer. Efficiency then depends on how income is distributed to begin with.

The conditions under which equity affects efficiency are many, and they permeate the economies and societies of poor countries. Development economics, more than anything else perhaps, is the study of economies in which equity and efficiency are closely interrelated. This opens up a whole realm of possibilities for policy and project interventions to increase economic efficiency as well as equity. More often than not, equity and efficiency are not only complementary; they are inseparable.

The Millennium Development Goals (MDGs)

Eradicating extreme poverty continues to be one of the main challenges of our time, and is a major concern of the international community. Ending this scourge will require the combined efforts of all, governments, civil society organizations and the private sector, in the context of a stronger and more effective global partnership for development. The Millennium Development Goals set timebound targets, by which progress in reducing income poverty, hunger, disease, lack of adequate shelter and exclusion—while promoting gender equality, health, education and environmental sustainability—can be measured. They also embody basic human rights—the rights of each person on the planet to health, education, shelter and security. The Goals are ambitious but feasible and, together with the comprehensive United Nations development agenda, set the course for the world's efforts to alleviate extreme poverty by 2015.

—United Nations Secretary-General BAN Ki-moon

In September 2000 189 nations came together at United Nations Headquarters in New York and adopted the United Nations Millennium Declaration. In it, they committed to creating a new global partnership to reduce extreme poverty and achieve a set of specific development targets by 2015. These targets (see Appendix at the end of this chapter), which range from health to environment to gender equality, have become known as the Millennium Development Goals (MDGs).¹⁴ Setting goals like these and monitoring our progress towards achieving them requires tremendous amounts of data, measurement methods, and above all, commitment.

If you attend almost any international development meeting, you almost certainly will hear the MDGs come up. The MDGs are often used by governments and international development agencies to motivate

and justify specific development projects. They have galvanized efforts to meet the needs of people in the world's poorest countries.

The UN Secretary General explains the
Millennium Development Goals.



The Organization of this Book

This book was written to provide students with the essential tools and concepts of development economics. Most development texts are written around topics: money, labor, population, and so on. The chapters in this book are less about topics than providing a window into how developing economies are different and what this means for the way we study them. Most of the cutting-edge research by economists is found in journal articles that are beyond the reach of most undergraduate students. Text boxes scattered throughout the book try to make this research available, summarizing the questions it asks, the methods it uses, key findings, and why they are important. By the end of this book, our hope is that students will have a new understanding of what economists bring to development research and policy and be conversant in many of the approaches they employ.

The rest of this book is all about seeking answers to big questions.

Chapters 2 through 5 are about understanding, measuring, and analyzing the four key elements of economic development: Income (Chapter 2), Poverty (Chapter 3), Inequality (Chapter 4), and Human Development (Chapter 5).

A theme that emerges from the first five chapters is that income growth is an important, though by no means sufficient, condition for achieving economic development. How can countries, regions, and households make their incomes grow? Chapter 6 (“Growth”) gives an introduction to aggregate (national) growth theory and concludes by

asking whether poor countries, regions, and households are “catching up,” and whether income growth alone will enable countries to reach the Millennium Development Goals.

Agriculture still dominates the economies of many countries in terms of income and employment. Chapter 7 (“Agriculture”) presents the key tools economists have come up with to analyze agricultural economies, with an eye towards understanding a wide array of impacts, from agricultural policies to trade and climate change. This chapter begins with the agricultural household model, the staple of microeconomic analysis of agricultural and rural economies. It concludes with village and rural economy-wide models, which let us see how households are connected with each other and transmit impacts of policy, market, and environmental shocks.

Most of the world’s poverty is in rural areas. Rural economies, though, are becoming less agricultural over time, as households get an increasing share of their income from non-agricultural activities. For a growing number of people, getting out of poverty means moving off the farm. Chapter 8 (“Transformation”) looks at the far-reaching transformations of rural and national economies that accompany economic growth and what this means for how we do economic analysis and design development policies.

Markets and trade are vital for countries to grow and spread the benefits of this growth across a broad population. However, markets fail for many people, and others find themselves unable to compete in an increasingly global economy. In Chapters 9 (“Markets, Information, and Trade”) and 10 (“Credit and Risk”), we see why economists think markets are so important to economic development, why markets fail for many people, how globalization creates both winners and losers, and what this all means for development policies.

As households and individuals seek out livelihoods in increasingly complex and global economies, governments, international development agencies, and development banks carry out a wide diversity of development projects. Evaluating the impacts of these programs is the focus of a new generation of development economists, inspired by experimental methods. Chapter 11 (“What Works and What Doesn’t”) looks at why economists do experiments, what the limitations of experiments are, and how projects and policies affect non-beneficiaries as well as beneficiaries.

Appendix

The Eight Millennium Development Goals

MDG 1: End poverty and hunger

Target 1.A: Halve, between 1990 and 2015, the proportion of people whose income is less than \$1 a day

Target 1.B: Achieve full and productive employment and decent work for all, including women and young people

Target 1.C: Halve, between 1990 and 2015, the proportion of people who suffer from hunger

MDG 2: Universal Education

Ensure that, by 2015, children everywhere, boys and girls alike, will be able to complete a full course of primary schooling

MDG 3: Gender Equity

Eliminate gender disparity in primary and secondary education, preferably by 2005, and in all levels of education no later than 2015

MDG 4: Child Health

Reduce by two thirds, between 1990 and 2015, the under-five mortality rate

MDG 5: Maternal Health

Target 5.A:

Reduce by three quarters the maternal mortality ratio

Target 5.B:

Achieve universal access to reproductive health

MDG 6: Combat HIV/AIDS

Target 6.A:

Have halted by 2015 and begun to reverse the spread of HIV/AIDS

Target 6.B:

Achieve, by 2010, universal access to treatment for HIV/AIDS for all those who need it

Target 6.C:

Have halted by 2015 and begun to reverse the incidence of malaria and other major diseases

MDG 7: Environmental Sustainability

Target 7.A:

Integrate the principles of sustainable development into country policies and programmes and reverse the loss of environmental resources

Target 7.B:

Reduce biodiversity loss, achieving, by 2010, a significant reduction in the rate of loss

Target 7.C:

Halve, by 2015, the proportion of the population without sustainable access to safe drinking water and basic sanitation

Target 7.D:

By 2020, to have achieved a significant improvement in the lives of at least 100 million slum dwellers

MDG 8: Develop a Global Partnership for Development

Target 8.A:

Develop further an open, rule-based, predictable, non-discriminatory trading and financial system

Target 8.B:

Address the special needs of least developed countries

Target 8.C:

Address the special needs of landlocked developing countries and small island developing States

Target 8.D:

Deal comprehensively with the debt problems of developing countries

Target 8.E:

In cooperation with pharmaceutical companies, provide access to affordable essential drugs in developing countries

Target 8.F:

In cooperation with the private sector, make available benefits of new technologies, especially information and communications

Learn more about the Millennium Development Goals at: <http://www.un.org/millenniumgoals/bkgd.shtml>

Additional Reading

Each year, The World Bank publishes its World Development Report with its own special topic (not to mention a great source of data on an array of development indicators). As you can see, they cover an enormous array of topics. These reports are available online.¹⁵

World Development Reports, 2000-2012

WDR 2012: Gender Equality and Development The 2012 World Development Report on Gender Equality and Development finds that women's lives around the world have improved dramatically, but gaps remain in many areas. The authors use a conceptual framework to examine progress to date, and then recommend policy actions.

WDR 2011: Conflict, Security, and Development Conflict causes human misery, destroys communities and infrastructure, and can cripple economic prospects. The goal of this World Development Report is to contribute concrete, practical suggestions to the debate on how to address and overcome violent conflict and fragility.

WDR 2010: Development and Climate Change The main message of the report is that a "climate-smart" world is possible if we act now, act together, and act differently.

WDR 2009: Reshaping Economic Geography Places do well when they promote transformations along the dimensions of economic geography: higher densities as cities grow; shorter distances as workers and businesses migrate closer to density; and fewer divisions as nations lower their economic borders and enter world markets to take advantage of scale and trade in specialized products. WDR 2009 concludes that the transformations along these three dimensions of density, distance, and division are essential for development and should be encouraged.

WDR 2008: Agriculture for Development In the 21st century, agriculture continues to be a fundamental instrument for sustainable development and poverty reduction. WDR 2008 concludes that agriculture alone will not be enough to massively reduce poverty, but it is an essential component of effective development strategies for most developing countries.

WDR 2007: Development and the Next Generation Developing countries which invest in better education, healthcare, and job train-

ing for their record numbers of young people between the ages of 12 and 24 years of age, could produce surging economic growth and sharply reduced poverty, according to this report.

WDR 2006: *Equity and Development Inequality of opportunity*, both within and among nations, sustains extreme deprivation, results in wasted human potential and often weakens prospects for overall prosperity and economic growth, concludes this report.

WDR 2005: *A Better Investment Climate for Everyone Accelerating growth and poverty reduction* requires governments to reduce the policy risks, costs, and barriers to competition facing firms of all types—from farmers and micro-entrepreneurs to local manufacturing companies and multinationals—concludes this report.

WDR 2004: *Making Services Work for Poor People* This report warns that broad improvements in human welfare will not occur unless poor people receive wider access to affordable, better quality services in health, education, water, sanitation, and electricity. Without such improvements, freedom from illness and from illiteracy—two of the most important ways poor people can escape poverty—will remain elusive to many.

WDR 2003: *Sustainable Development in a Dynamic World* Without better policies and institutions, social and environmental strains may derail development progress, leading to higher poverty levels and a decline in the quality of life for everybody, according to this report.

WDR 2002: *Building Institutions for Markets* Weak institutions--tangled laws, corrupt courts, deeply biased credit systems, and elaborate business registration requirements--hurt poor people and hinder development, according to this report.

WDR 2000-2001: *Attacking Poverty* This report focuses on the dimensions of poverty, and how to create a better world, free of poverty. The analysis explores the nature, and evolution of poverty, and its causes, to present a framework for action.

Chapter One Notes

1. The true cost of living is difficult to compare across countries. Here we use the purchasing power parity method. Even income can be hard to measure in a country where most crop production is for home consumption. These issues will be addressed later in this book.
2. Mateusz Filipiński and J. Edward Taylor. 2012. "A Simulation Impact Evaluation of Rural Income Transfers in Malawi and Ghana." *Journal of Development Effectiveness*, Vol. 4, Issue 1, pp. 109-129.
3. Chewe Nkonde, Nicole M. Mason, Nicholas J. Sitko and T.S. Jayne. "Who Gained and Who Lost from Zambia's 2010 Maize Marketing Policies?" Working Paper No. 49, Food Security Research Project, Lusaka, Zambia, January 2011 (<http://www.aec.msu.edu/fs2/zambia/wp49.pdf>).
4. <http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/AFRICAEXT/MALAWIEXTN/0,,contentMDK:21575335~pagePK:141137~piPK:141127~theSitePK:355870,00.html>
5. You can read about some of these programs at the Transfer Project website, housed at the University of North Carolina, Chapel Hill; <http://www.cpc.unc.edu/projects/transfer>.
6. Walter W. Rostow, *The Stages of Economic Growth: A Non-Communist Manifesto*, Cambridge: Cambridge University Press, 1960.
7. Roy F. Harrod, 'An Essay in Dynamic Theory' (1939), *Economic Journal* 49:14–33.
8. Lewis, W. Arthur (1954). "Economic Development with Unlimited Supplies of Labor," *Manchester School of Economic and Social Studies*, Vol. 22, pp. 139-91.
9. Gustav Ranis and John C. Fei. 1961. "A Theory of Economic Development." *American Economic Review* (September) 51:533-58.
10. Theodore W. Schultz. 1964. *Transforming Traditional Agriculture*. New Haven: Yale University Press.
11. Raúl Prebisch, "Commercial Policy in the Underdeveloped Countries," *American Economic Review* 49 (May 1959): 251–273.

12. United Nations, Encyclopedia of the Nations. <http://www.nationsencyclopedia.com/United-Nations/Economic-and-Social-Development-FIRST-UN-DEVELOPMENT-DECADE.html>
13. Kuznets, Simon. 1955. Economic Growth and Income Inequality. *American Economic Review* 45 (March): 1-28
14. See <http://www.un.org/millenniumgoals/bkgd.shtml>
15. <http://econ.worldbank.org/WBSITE/EXTERNAL/EXTDEC/EXTRESEARCH/EXTWDRS/0,,contentMDK:20227703~pagePK:478093~piPK:477627~theSitePK:477624,00.html>