

Econ N171 Economic Development
Homework Assignment #5

Atanu Dey

Due in Class on Tue August 9th

1. The World Development Report of 2009, “Reshaping Economic Geography,” notes that “As economies grow from low to high income, production becomes more concentrated spatially.”

a. Explain in your own words the virtuous circle that location confers in economic development.

Answer: For an individual, the country of birth is the most important determinant of the person’s welfare. Prosperity is not evenly distributed at the individual level. So also, it is not at the level of the collective. Some areas lag while other areas prosper. As a country develops, location becomes less important at the level of the family but is still important at the level of the firm. The virtuous circle of prosperity allows prosperous areas to attract more people that increase the development of those areas.

b. What are the policy implications of the three attributes of development – geographic unevenness, circular causation, and neighbourhood effects?

Answer: Geographic unevenness implies that governments cannot simultaneously achieve economic growth and ensure that the benefits of growth are spread evenly. The policy implication is that governments should not attempt to even out the unevenness that accompanies growth. As Easterly put it, “Development is uneven; get over it.”

The policy implication of circular causation is that policymakers should attempt to concentrate the population into well-planned urban areas to allow market forces of agglomeration and migration to yield a concentration of economic production and a convergence of living standards.

Neighborhood effects require policies that promote economic integration. As the World Development Report notes, “Economic integration is an effective and the most realistic way to harness the immediate benefits from concentration to achieve the long-term benefits of convergence.”

c. Justify the proposition “Cities are the engines of growth.”

Answer: Cities are the engines of growth because they produce more output per capita than rural areas, as is empirically true. This is analytically true also because cities afford agglomeration economies that are absent in rural areas. For instance, manufacturing requires a variety of inputs – including skilled labor – that are only available in urban areas.

Cities also produce a disproportionate number of innovations and patents.

d. State and briefly explain economies of scale, scope, urbanization. Also, distinguish between three types of agglomeration economies by giving example of such from your general knowledge of the subject.

Answer: Scale economies arise when the average cost of production is inversely proportional to the volume of production. Scope economies are those that arise when joint production of related goods costs less than if they were produced separately. Urbanization economies arise from the production of goods and services in areas of high population diversity and density such as are found in urban areas.

There are three types of agglomeration economies. **Urbanization economies.** Arise from common infrastructure, the diversity of labour and market size.

Industrialization economies. Arise from clustering of industrial activities, such as being their respective suppliers or customers.

Localization economies. Arise from clustering of activities near a specific facility, such as a transport terminal, a big market or a large university.

2. “Subsistence, Trade and Exchange: Understanding Developing Economies,” Peter Bauer argues for the importance of internal trade for development.

a. Why is internal trade important? In other words, what are the linkages between economic growth and internal trade?

Answer: Please refer to the lecture notes of Mon 1st Aug – the slide on “Importance of internal trade.”

Distribution is link between production and consumption; Efficiency in distribution releases resources for other productive purposes; Even two centuries ago, the present day developed economies were largely exchange economies – production was not subsistence,

unlike contemporary poor countries; Internal trade is an engine of growth – it created commercial institutions and increased human capital

b. What is his argument against the existence of the “vicious cycle of poverty”?

Answer: Bauer argues that the vicious cycle of poverty is a myth. The rich countries were poor once upon a time, and yet they developed – evidently without external help. If VCP was indeed true, then we’d still be stuck in the Stone Ages.

3. We discussed Joseph Stiglitz’s critique of the Washington Concensus.

a. What are the main components of the Washington Concensus?

Answer: The WC is a set of policy directives which include fiscal discipline, tax reforms, trade liberalization, privatization, deregulation, secure property rights, flexible labor markets, anti-corruption, and other aspects of economic liberalization.

b. What is Stiglitz’s conception of development and in what ways does it differ from the Washington Concensus?

Answer: Stiglitz considers development as the transformation of society, as in a change from traditional ways of thinking and doing to a more modern way. The associated changes “provide individuals and societies with more control over their own destiny.”

The WC view of the world seeks to reduce the role of the government in the economy. The WC is about a greater reliance on markets and less on government intervention. Stiglitz argues that the government must have an active role in the transformation.

c. How does it compare with the concept of development that is discussed by James Dorn in his article, “Sustainable development: a market-liberal vision.”

Answer: The market-liberal vision of development is the expansion of choices open to individuals. Government planning and intervention in the economy denies fundamental right to liberty and property, according to people like Peter Bauer. They consider the suppression of economic and personal freedom to be against development.

d. If you were advising the government of a currently very poor developing country, would you recommend that they seek the assistance of Stiglitz or would you ask them to consult Dorn? Justify your advice briefly.

Answer: I would advise them to consult Dorn. Stiglitz is correct in his view that development is transformation from traditional ways of doing and thinking to more modern ways. The matter then is how that transformation is brought about. I consider comprehensive freedom – economic, personal, social, political – to be a modern way of doing things. Therefore, the transformation has to be brought about through the enlarging of freedom, and not by increasing government power relative to the individual.