

# Brief Contents

Chapter 1	<b>The Development Gap</b>	1
Chapter 2	<b>Poverty and Inequality</b>	27
Chapter 3	<b>Population Growth</b>	55
Chapter 4	<b>Economic Growth</b>	82
Chapter 5	<b>Structural Change and Development Strategies</b>	113
Chapter 6	<b>International Trade and Exchange Rates</b>	145
Chapter 7	<b>Institutions and Economic Development</b>	175
Chapter 8	<b>Markets and Hierarchies</b>	203
Chapter 9	<b>Political Institutions</b>	232
Chapter 10	<b>Legal and Fiscal Institutions</b>	264
Chapter 11	<b>Culture</b>	288
Chapter 12	<b>Rural Land Rights and Contracts</b>	312
Chapter 13	<b>Property Rights and Efficiency in Urban Areas</b>	340
Chapter 14	<b>Market Development</b>	366
Chapter 15	<b>The Role of Credit Markets in Development</b>	394
Chapter 16	<b>Health Care Delivery in Developing Countries</b>	422
Chapter 17	<b>Delivering Education in Developing Countries</b>	455
Chapter 18	<b>Delivering Infrastructure in Developing Countries</b>	485
Chapter 19	<b>Corruption</b>	508
Chapter 20	<b>Conflict</b>	537
Appendix	<b>Econometric Appendix</b>	561
	<b>Glossary</b>	581
	<b>Index</b>	593

# Contents

## Chapter 1 The Development Gap 1

### Facts about the Development Gap 4

- The Income Gap 4
- The Poverty Gap 6
- The Health Gap 7
- The Education Gap 10
- The Urbanization Gap 11
- Why Is There a Development Gap? 13

### The Evolving Development Gap 13

- Differences in Economic Growth 14
- Population Growth 16

### Stories of Economic Catch-Up and Decline 17

- The Historical Catch-Up of Japan and Germany 18
- Economic Decline 21
- Important Questions 24

Chapter Summary 25 • Key Terms 25 •  
Review Questions 25

## Chapter 2 Poverty and Inequality 27

### Poverty Measurement and Comparisons 28

- Measuring Poverty 28
- How to Compare Poverty Levels 33
- Poverty Rates in Practice 36

### Measurements and Comparisons of Income Inequality 38

- Measuring Income Inequality 38

### Economic Determinants of Inequality 44

- Education and Income Inequality 44
- Land Ownership and Income Inequality 45

### Inequality, Growth, and Development 46

- The Kuznets Hypothesis 46
- Income Inequality and Economic Growth 49
- Inequality over Time 50

Chapter Summary 53 • Key Terms 53 •  
Review Questions 54

## Chapter 3 Population Growth 55

### Population over Time and the Demographic Transition 56

- An Exponentially Growing Population 56
- The Evolution of Population Growth Rates 58

### The Determinants of Population Growth 60

- Fertility, Mortality, and Birth and Death Rates 60
- Age Distribution 61

### The Determinants of Fertility Rates 63

- The Economics of Fertility Choices 63
- Fertility Choices and Institutions 69
- Fertility Choices and the Demographic Transition 73

### Family Planning and Population Growth 77

- Family Planning Policies 77
- Externalities and the Economics of Family Planning 78

Chapter Summary 79 • Key Terms 80 •  
Review Questions 80

## Chapter 4 Economic Growth 82

### Growth and Factors of Production 83

- Factors of Production 83
- The Production Function 84
- Factor Productivity 85
- Factor Shares 86
- Growth Accounting 87

### The Neoclassical Solow Growth Model 88

- Constant Returns to Scale and Diminishing Marginal Products 89
- Equilibrium in the Solow Model 90
- The Steady State in the Solow Growth Model 91
- Growth Inside and Outside the Steady State 92
- Technological Progress and the Steady State 93
- The Effect of Different Savings Rates 94
- Differences in Human Capital 95
- Income Convergence 96

### Endogenous Growth Theory 97

- Boundless Knowledge-Based Growth 97
- Knowledge as a Non-Rival Good 98
- Basic Equations of the Romer Model 100
- The Romer Model versus the Solow Model 100
- Intellectual Property Rights and Technology Transfers 101

### Empirical Analysis of Economic Growth 102

- Geography and Growth 104
- Institutions and Growth 105

Chapter Summary 111 • Key Terms 111 •  
Review Questions 112

## Chapter 5 **Structural Change and Development Strategies** 113

- Structural Change** 114
  - From an Agricultural to an Industrial Economy 114
  - From an Industrial to a Service Economy 114
  - Structural Change across Industrial Sectors 115
- The Lewis Model of Structural Change** 116
  - The Traditional and Modern Sectors 116
  - Transfer of Labor from the Traditional to the Modern Sector 118
  - The Lewis Model in Practice 120
  - The Role of Institutions 122
- The Harris-Todaro Model of Rural to Urban Migration** 123
  - The Harris-Todaro Model and the Migration Equilibrium 123
  - The Implications of the Harris-Todaro Model 126
- Development Strategies: Sectoral Growth** 128
  - Balanced and Unbalanced Growth 128
  - Big Push Theories 130
- Development Strategies: Import Substitution versus Export Promotion** 132
  - Import Substitution and the Prebisch-Singer Hypothesis 133
  - Industrialization and the Protection of Infant Industries 134
  - Export Promotion and the Asian Miracle 135
- The Foreign Aid Controversy** 139
  - Sachs and the Argument for Foreign Aid 140
  - Easterly and the Skeptics' View 140
  - What Conclusions Should We Draw about Foreign Aid? 141
- Chapter Summary 142 • Key Terms 143 • Review Questions 143

## Chapter 6 **International Trade and Exchange Rates** 145

- World Trade Evolution and Developing Countries** 145
  - The Increased Openness of Developed and Developing Economies 146
  - A Diverse Trade Performance across Regions 147
  - The Evolution of Trade Specialization in Developing Countries 148
- The Theory of Comparative Advantage** 148
  - The Benefits of Exchange and Specialization 150

- Japanese DVD Players and Chinese Shirts: Comparative Advantage in Action 151
- Factor Endowments and Comparative Advantage 152
- Comparative Advantage and Patterns of Trade 154
- Trade Specialization and Export Price Risk 154
- The Politics of Trade** 156
  - Winners and Losers in International Trade 156
  - Collective Action Failure 157
  - "Give and Take" 157
- The Costs of Trade Barriers** 158
  - Protectionism and Tariffs 158
  - Nontariff Barriers 159
- Trade Institutions: Bilateral versus Multilateral** 161
  - Multilateral Trade Avoids Trade Diversion 161
  - Multilateral Trade Agreements Are Politically Easier to Achieve 162
  - The World Trade Organization 163
- Exchange-Rate Policies in Developing Countries** 165
  - Degrees of Convertibility 166
  - Fixed and Floating Exchange-Rate Regimes 168
- Chapter Summary 172 • Key Terms 172 • Review Questions 173

## Chapter 7 **Institutions and Economic Development** 175

- What Are Institutions?** 176
  - Formal Institutions 176
  - Informal Institutions 177
  - Interactions between Institutions 178
- What Do Institutions Do?** 178
  - Informational Problems 179
  - The Hold-Up Problem 185
  - The Commitment Problem 187
  - The Cooperation Problem 190
  - The Coordination Problem 195
- The Persistence of Inefficient Institutions** 198
  - The Functionalist Fallacy 198
- Chapter Summary 200 • Key Terms 201 • Review Questions 202

## Chapter 8 **Markets and Hierarchies** 203

- The Central Planning Debate** 204
  - The Theoretical Argument against Central Planning 205
  - Lange's Rebuttal 206
  - Hayek's Fundamental Criticism 207

<b>The Central Planning Experiment</b>	208
Managerial Incentives under Central Planning	208
Central Planning and Shortage	213
Economic Behavior under Shortage	215
Worker Behavior	220
Complexity, Coordination, and the Slow Demise of Central Planning	222

<b>Prices versus Quantities</b>	224
Coordination Mistakes Using Price and Quantity Signals	224

<b>Institutions and the Boundaries of the Firm</b>	228
The Trade-Off between Efficiency and Holdup	229
Less Vertical Integration with Better Institutions	229

Chapter Summary	230	•	Key Terms	230	•
Review Questions	231				

## Chapter 9 Political Institutions 232

### Political Regimes 233

<b>Economic Effects of an Autocracy versus a Democracy</b>	235
The Theory of Autocracy	236
The Theory of Democracy	238
Autocracy and Democracy Compared	240

<b>Political Institutions in a Democracy</b>	244
Presidential and Parliamentary Democracies	244
Electoral Rules	245
The Economic Effects of Democratic Institutions	246

<b>Political Institutions in an Autocracy</b>	249
Communist Regimes	249
Nazism and Fascism	250

### Waves of Democratization 251

<b>Theories of Democratization</b>	254
Income and Democracy	254
Education and Democracy	255
Inequality, Social Conflict, and Democracy	257

Chapter Summary	262	•	Key Terms	263	•
Review Questions	263				

## Chapter 10 Legal and Fiscal Institutions 264

<b>Legal Institutions</b>	264
Differences between the Common-Law and Civil-Law Systems	265

The Economic Effects of Different Legal Systems	268
Controversies over the Importance of Common and Civil Law	272

<b>Fiscal Institutions</b>	275
Taxation in Developing Countries	275
Determinants of Tax Structure	280
Why Does Taxation Differ between Developed and Developing Countries?	283

Chapter Summary	285	•	Key Terms	286	•
Review Questions	286				

## Chapter 11 Culture 288

<b>Measuring Culture</b>	289
The World Values Survey	289
Schwartz's Cultural Mappings	293
Hofstede's Index of Individualism and Collectivism	294

<b>Culture's Effect on Institutions</b>	297
Culture and the Quality of Democracy	297
Culture and Norms of Governance	300
Culture and Contract Enforcement	301

<b>Cultural Obstacles to Economic Development</b>	303
Egalitarian Norms and Development	303
Religious Taboos on Interest	304
Islam and Inheritance Laws	305

<b>The Effects of Culture</b>	307
Religiosity and Growth	307
Religious Beliefs and Trust	308
Culture and Thrift	308
Pitfalls to Avoid in Research on Culture	309

Chapter Summary	310	•	Key Terms	311	•
Review Questions	311				

## Chapter 12 Rural Land Rights and Contracts 312

### Worldwide Land Distribution and Land Contracts 313

<b>Properties of Land Contracts</b>	316
Farmer Ownership	317
Communal Ownership	318
Fixed Land Rental	318
Sharecropping	320
Labor Contracts	320

<b>Economic Effects of Land Contracts</b>	323
Communal and Private Ownership	324
Sharecropping Compared to Privately Owned Farms	326
Sharecropping Compared to Fixed Rental Contracts	327

- Plantations and Slave Labor 327
- Plantations and Privately Owned Family Farms 328
- Institutions and Patterns of Land Inequality and Land Contracts 329

#### **Land Reform 330**

- The Experience of Land Reform 330
- Obstacles to Land Reform 333
- Effects of Land Reform 335

Chapter Summary 338 • Key Terms 338 •  
Review Questions 339

### **Chapter 13 Property Rights and Efficiency in Urban Areas 340**

#### **Property Rights and the Informal Sector 341**

- The High Transaction Costs in the Informal Sector 342
- Institutional Obstacles to Entry in the Formal Sector 343
- The Economic Effects of Titling 345

#### **Institutions and Property Rights Protection: Lessons from Transition Economies 347**

- The Informal Sector and Institutional Quality 347
- Property Rights, Investment, and Market Development 349

#### **Privatization 352**

- From Nationalization to Privatization 352
- Privatization Goals and Problems 353
- Methods of Privatization in Developing Countries 356
- Privatization Outcomes 357

Chapter Summary 364 • Key Terms 364 •  
Review Questions 364

### **Chapter 14 Market Development 366**

#### **Institutions and Market Development 367**

- Taking Markets for Granted 367
- Specific Problems of Market Development in Poor Countries 368
- Business Networks in Development 370

#### **The Emergence of Markets in Transition Countries 371**

- The Output Fall in Central and Eastern Europe 372
- China and the Dual-Track System 374
- Lessons from the Effects of Transition on Market Development 376

#### **Rural Markets and the Monopsony Problem 376**

- Monopsony and the Hold-Up Problem 377
- Monopsonies in Developing Countries 378
- Possible Solutions to the Monopsony Problem 379

#### **Market Integration 381**

- Communication Obstacles to Market Integration 382
- Transportation Obstacles to Market Integration 384
- Regulatory Obstacles to Market Integration 386

#### **Famines 388**

- Amartya Sen's Analysis of Famine 388
- Famines and Democracy 390

Chapter Summary 391 • Key Terms 392 •  
Review Questions 392

### **Chapter 15 The Role of Credit Markets in Development 394**

#### **The Demand for Credit in Developing Economies 395**

#### **The Theory of Credit Markets in Development 396**

- Financing an Entrepreneur in Mumbai 396
- Adverse Selection and Credit Rationing 398
- Moral Hazard and Collateral 400
- Moral Hazard and Monitoring 401
- Monitoring and Variation in Interest Rates 402
- Dealing with Default 403

#### **Credit Constraints in Developing Countries 404**

- The Difficulty of Measuring Credit Constraints 404
- Exploiting the Indian Priority Lending Reform 405

#### **Microfinance 409**

- How Does Microcredit Work? 409
- Incentive Properties of Microcredit 410
- Other Forms of Microfinance 413
- Is Microfinance Profitable? 415
- Evaluating Microfinance 418

Chapter Summary 419 • Key Terms 419 •  
Review Questions 420

### **Chapter 16 Health Care Delivery in Developing Countries 422**

#### **A Historical Perspective: The Epidemiological Transition 423**

#### **Measuring Health 424**

- Self-Reported Health Status 424
- Self-Reported Symptoms 425
- Reporting Daily Activities 425
- Nutrient Intake 425
- Anthropometric Measures 426
- Disability Adjusted Life Year (DALY) 427

#### **Diseases and Development 428**

- HIV 429

Diarrheal Diseases	432
Malaria	433
Worms	437
Tuberculosis	440
<b>Cheap Drugs and Development</b>	441
Why Pharmaceutical Companies Spend So Little on Developing Countries	442
An Advance Market Commitment	442
The Costs of Vaccine Commitments for Developing Countries	443
<b>Health and Income</b>	444
Does Better Health Lead to Higher Incomes?	444
Does More Income Improve Health?	446
<b>Institutions and the Provision of Health Care</b>	447
Variable Quality of Health Care Systems	447
Corruption in the Health Care Sector	448
Chapter Summary	452 • Key Terms 453 • Review Questions 454

## Chapter 17 Delivering Education in Developing Countries 455

<b>Measuring the Education Gap</b>	456
The Primary School Gap	456
The Secondary-School Gap	458
The Educational Gender Gap	458
Educational Achievements	459
The Issue of Education Quality	462
<b>The Returns to Education in Developing Countries</b>	464
Externalities of Education	465
The Role of Government in Education	466
Empirical Estimates of the Returns to Education	467
<b>Institutions and Education in Developing Countries</b>	470
Why Is There Child Labor and Should It Be Banned?	470
The Indian Caste System and Educational Choices	473
<b>What Reforms Can Improve Education?</b>	476
Fighting Teacher Absenteeism	476
Are Incentives for Teachers Effective?	477
Decentralization	478
Vouchers	479
Reducing Education Costs	480
Reducing the Educational Gender Gap	481
Chapter Summary	482 • Key Terms 483 • Review Questions 484

## Chapter 18 Delivering Infrastructure in Developing Countries 485

<b>The State of Infrastructure in Developing Countries</b>	486
Inequality of Access to Infrastructure	486
Institutions for Infrastructure Provision	488
<b>Development Effects of Infrastructure Investment</b>	489
The Effect of Infrastructure Investment on Growth	490
The Benefits of Transportation Infrastructure	491
The Costs and Benefits of Dams	494
White Elephants	497
<b>Investment Risk and the Cost of Capital in Infrastructure</b>	498
The Cost of Capital	499
Estimates of the Cost of Infrastructure Investment	500
<b>Geography and Infrastructure</b>	501
<b>Institutional Aspects of Infrastructure</b>	502
Regulatory Reform	502
Decentralization	503
Fighting Corruption in Road Construction	504
Chapter Summary	505 • Key Terms 506 • Review Questions 507

## Chapter 19 Corruption 508

<b>What Is Corruption?</b>	509
<b>Measuring Corruption</b>	510
Objective Measures of Corruption	511
Subjective Measures of Corruption	513
<b>Greasing the Wheels or Rotting the Fruit Basket?</b>	515
<b>Corruption and Growth</b>	517
<b>Why Are Some Countries More Corrupt than Others?</b>	518
Development and Corruption	519
Political Institutions and Corruption	520
Legal Institutions and Corruption	522
Natural Resources, Trade, and Corruption	522
<b>Culture and Corruption</b>	523
Different Cultures, Their Various Social Norms, and Corruption	523
Disentangling Culture from Other Institutional Causes of Corruption	525
<b>The Difficulty of Fighting Corruption</b>	527
Few Success Stories, but Can We Generalize?	527

Higher Pay for Civil Servants: Does It Work?	528
Why Is Fighting Corruption So Difficult?	529
Chapter Summary	530 • Key Term 530 •
Review Questions	531 • Appendix 532
<b>Chapter 20 Conflict</b>	<b>537</b>
<b>Theoretical Explanations of Conflict</b>	<b>538</b>
Misjudging Your Rival	539
Deals That Aren't Worth the Paper on Which They Are Written	540
<b>The Empirical Determinants of Conflict</b>	<b>541</b>
Why Do Civil Wars Start?	542
Greed versus Grievance	545
What Is the Causal Link between Conflict and Development?	550
<b>The Economic Effects of Conflict</b>	<b>551</b>
The Long-Term Effects of War	552
The Long-Term Effect of Hiroshima and Nagasaki	553
The Long-Term Effects of Bombing Vietnam	554
Sierra Leone's Civil War	556
Chapter Summary	559 • Key Terms 559 •
Review Questions	559
<b>Appendix Econometric Appendix</b>	<b>561</b>
<b>Some Basic Statistical Concepts</b>	<b>562</b>
Mean, Variance, and Standard Deviation	562
Covariation between Two Variables	564
Bivariate Regression Analysis	565
<b>Causal Inference</b>	<b>567</b>
The Treatment Effect and Selection Bias	568
Randomized Evaluations	569
Ordinary Least Squares and Causal Inference	569
Bias from Omitted Variables	570
Panel Regressions	571
Fixed Effects and Difference-in-Differences Estimation	572
Instrumental Variables	574
A Regressions Table	577
<b>Glossary</b>	<b>581</b>
<b>Index</b>	<b>593</b>