

Assessment guidelines SØK2007 fall 2017

The compulsory readings are chosen chapters from the textbook “Economic Development” by Todaro and Smith, as well as four articles and lecture notes.

Question 1 (40%)

a) The Human Development index ranks countries on a scale from 0 to 1 based on three components: health, education, and income. Each component should be explained (see chapter 2 in the textbook).

b) Private return to education: Higher future income. Private costs of education: Direct costs (tuition fees, books, uniforms etc.) and indirect costs (alternative cost, loss of labor income). Social return to education: Spillovers, growth effects, externalities etc. Social costs of education: School buildings, equipment, teacher salaries etc.

c) The Gini coefficient lies between 0 and 1 and is a measure of income inequality. The Lorenz curve can be used as a starting point to explain the Gini coefficient. The advantage of the Gini in the case where two Lorenz curves cross each other should be mentioned.

d) The difference between absolute and relative poverty measures should be explained. Main measures of poverty include the head count index and the total poverty gap. Good answers also mention the Multidimensional Poverty Index (MPI) as an example of a non-monetary measure of poverty.

e) Main arguments: Motivation behind the allocation of foreign aid, emergency aid, long-run vs. short-run effect, micro-macro paradox, and the Samaritan’s dilemma. The discussion can also be related to the empirical analysis of Easterly (1999) and Burnside and Dollar (2000).

f) The price elasticity gives the percentage change in demand or supply as a response to 1% increase in the price. The price elasticity in demand for primary goods is low because primary goods (like food) are typically necessary goods, and the demand will not change much even if prices increase. The price elasticity in supply of primary goods is low because farmers are not able to adjust the crop or quantity produced immediately (seasonal harvest). Low price elasticities imply steep demand and supply curves, and economic shocks cause large and volatile price fluctuations (should be illustrated graphically and compared to the case with high price elasticities). Since developing countries typically export primary goods, this can lead to instability in export earnings.

Question 2 (30%)

a) The Harrod-Domar model and the Solow model are explained in chapter 3 of the textbook. The main difference between the two models is that the Harrod-Domar model assumes constant returns to capital, while the Solow model assumes decreasing returns to capital. Both models should be presented, both graphically and analytically.

b) The effect of increased savings must be illustrated graphically for both models. In the Harrod-Domar model, higher savings rate leads to permanently higher growth rate. In the Solow model, higher savings rate increases the growth rate temporarily, while the long run growth rate is exogenously given. The income level is higher in the long run.

Question 3 (30%)

Static gains from trade due to specialization in production can be explained based on the theory of comparative advantage. The gains should be illustrated numerically and graphically. The discussion of trade policies can be related to how specialization according to its comparative advantage might lead to 'wrong' specialization. Specialization in the production of primary goods might lead to export earnings instability and falling terms of trade, which gives an argument for import substitution policies to build up comparative advantage in new activities (the infant industry argument). Problems with this strategy should be discussed (loss of dynamic gains from trade, challenge to keep the protection temporary, unproductive firms kept alive, need large domestic market).