

PED-309: Development Policy Strategy - Fall 2008 -

Syllabus

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Meet Time: M/W 8:40 – 10:00 (Starr)

Review: F 11:30 - 1:00 (Littauer 230)

This is a capstone course that integrates a variety of analytical tools to assess the development challenges faced by countries. The course will develop the tools to diagnose growth constraints, macroeconomic imbalances, fiscal policy, labor market performance, the sources of inequality and volatility, and relate them to policy issues. The course will be applied in the sense that it starts from observations and explores how different theories make sense of the facts. Students will be required to make assessments of these aspects in specific countries all through the course.

Prerequisites:

This course is designed for second year MPA/ID students. It builds on previous core courses, especially PED-101i, API-210i, API-119i and API-120i. Other students will require the consent of the instructor based on their previous exposure to growth theory, open economy macroeconomics and econometrics.

Description

As opposed to the typical academic setting in which theories are presented – normally one at a time - and some implications are derived, policymakers are presented with data and it is up to them to try to interpret it using alternative theories.

This course tries to bridge this gap between the deductive method that characterizes much of academia and the inductive approach, which is typical of the policy world. The course is divided into four sections. The first two sections deal with **growth**. The first section looks at long term determinants such as **demography, geography, institutions and innovation**. The second section will deal with **growth diagnostics** from a more policy-relevant horizon, where we develop tools to identify the potential binding constraints on growth. It also includes a discussion on labor markets and inequality. The third section deals with **the macro stance** of the country. The challenge for the policymaker is to find a coherent diagnostic narrative that can make sense simultaneously of observations about growth, macro balances and social outcomes. We will also **assess fiscal problems**, looking not only at how the fiscal situation affects the macro but also the underlying determinants of the fiscal stance, including debt dynamics, political economy and the budget processes. We will look into the **causes and sources of macroeconomic volatility**, identifying the more structural causes of a country's instability. At every stage, the associated policy issues will be discussed and related to the challenges and tradeoffs of **institutional design**.

Audience

This course is designed for MPA/ID students. Other Kennedy School students with excellent backgrounds in microeconomics, macroeconomics and quantitative methods, and Ph.D. students (in economics, public policy, and PEG) with substantive interests in development policy may also find it useful. The course is designed for persons who will be involved in economic policymaking and analysis in developing countries or in international financial institutions and aid agencies. Persons planning a career in emerging market finance may also find it useful.

Grading (tentative):

The grade will be based on:

- 4 to 6 individual problem sets (30%)
- 3 group problem sets (30%)
- One final group presentation (30%)
- Class participation (10%)

Please note the following:

- The quality of class participation matters for the grade.
- Individual problem sets are usually devoted to performing specific tests and analyses. The output of these problem sets will be analytical inputs for the group problem sets. For example in the group problem sets you may need to discuss if education is a binding constraint. However, students will first run – in individual problems set - different types of regressions to unveil the returns to education. The group problem sets focus on interpretation and decision making.
- Group problem sets, are 3 during the semester. There will also be a final group presentation. These exercises are meant to students to move from analytical tools to coherent policy relevant inference.

Reading Material:

The course does not have a main textbook. It is based mostly on a collection of papers. Papers and materials will be available online and put on reserve.

How is this course different from your first year?

- It is more applied. It is based on analysis that can be carried out in practice
- It will develop methods to diagnose and prioritise
- It will allow students to apply the theory learned in the first year
- It will give students a framework to assess market and government failures in practice

How is this course different from previous years?

- Different (better?) order of lectures
- More continuous work, less stressful peaks before big problem sets
- Short problem sets where we help you "step by step" to develop the basic "tests" for each part of the diagnostics. Later, you will use that information for the group problem sets.
- Then, group meetings will be more about diagnostics than about new calculations.
- Problem sets are more frequent at the beginning of the semester, so you may have more time when other courses ask for it.
- We will have final presentations in December during reading period instead of a final paper due in January.

LECTURES, REVIEWS AND READINGS**Mon, Sep-08** - Lecture # 0 - . Shopping day

- No readings for shopping day

Wed, Sep-10 - Lecture # 1 - . Unified growth theory

- * Galor, O. (2004) From Stagnation to Growth: "Unified Growth Theory" in P. Aghion and S. Durlauf (Eds.) Handbook of Economic Growth
- Hansen, G. and Prescott E. (1998) "Malthus to Solow", NBER WP# 6858. Available from: <http://papers.nber.org/papers/W6858.pdf>

Fri, Sep-12 – RODRIGO'S LECTURE - . Review of demography and growth.**Mon, Sep-15** - Lecture # 2 - . Demography & Population

- * Bloom, D.E., Williamson, J.G. 1997. "Demographic Transitions and Economic Miracles in Emerging Asia." NBER Working Paper No. W6268, November.
- Inter-American Development Bank. 2000. "Demography, Threat or Opportunity." Development beyond Economics: Economic and Social Progress Report, Chapter 2. Washington, DC.
- Behrman, J. R.; Duryea, S.; Székely, M. 1999. "Decomposing Fertility Differences Across World Regions and Over Time: Is Improved Health More Important than Women's Schooling?" IDB WP-406.
- Attanasio, O.P. and Szekely, M. 2000 "Household saving in Developing Countries – Inequality, demographics and all that: How different are Latin America and South East Asia?", IDB WP 427.

Wed, Sep-17 - Lecture # 3 - . Geography

- Gallup, J. and J. Sachs. 1998. "Geography and Economic Development," ; Annual World Bank Conference on Development Economics 1998, Available: <http://www2.cid.harvard.edu/cidwp/001.pdf>
- Inter-American Development Bank. 2000. "Development beyond Economics," Economic and Social Progress Report, Washington. DC, Chapter 3. http://www.iadb.org/res/publications/pubfiles/pubB-2000_4027.pdf
- Braun, Hausmann & Pritchett. 2002. Disintegration and the Proliferation of Sovereigns: Are There Lessons for Integration? www.anderson.ucla.edu/faculty/matias.braun/Braun_Hausmann_Pritchett_2002.pdf

**Fri, Sep-19 – RODRIGO'S LECTURE Describing Economic Growth: Towards a Narrative.
Due individual problem set 1.****Mon, Sep-22- Lecture # 4 - . Institutions I: Consequences**

- Acemoglu, Daron, Simon Johnson, and James A. Robinson, "The Colonial Origins of Comparative Development: An Empirical Investigation," American Economic Review, 91(5), December 2001, 1369-1401. (Also NBER working paper: <http://papers.nber.org/w7771>)
- Rodrik, Dani, Arvind Subramanian, and Francesco Trebbi, "Institutions Rule: The Primacy of Institutions over Geography and Integration in Economic Development" August 2002. <http://ksghome.harvard.edu/~drodrik.academic.ksg/papers.html>
- Knack, Stephen and Philip Keefer (1997) "Why don't poor countries catch up? A cross national test of an institutional explanation" Economic Inquiry 35.
- Robert Hall and Charles I. Jones "Why Do Some Countries Produce So Much More Output per Worker than Others?" The Quarterly Journal of Economics, vol. 114, no. 1, pp. 83-116, February 1999. Available also as NBER Working Paper No. W6564 (<http://papers.nber.org/papers/W6564.pdf>.)

Wed, Sep-24 - Lecture # 5 - . Institutions II: Market failures and institutional design

- Greif, Avner. 2005. Commitment, Coercion and Markets: The Nature and Dynamics of Institutions Supporting Exchange . In C. Menard and M. Shirley (eds.), Handbook of New Institutional Economics. Springer. 727–786. Available at http://www-econ.stanford.edu/faculty/Greif_Papers/Commitment_Coercion_Markets.pdf
- Sabel, C. Learning by Monitoring: The Institutions of Economic Development, in Handbook of Economic Sociology, edited by N. Smelser and R. Swedberg. Princeton: Princeton University Press and Russell Sage Foundation, 1994, 137-65.
- Rodrik, D. 2000 "Institutions for High-Quality Growth: What They are and How to Acquire Them", NBER Working Paper No. W7540. Available at <http://papers.nber.org/papers/W7540.pdf>.

**Fri, Sep-26 – RODRIGO'S LECTURE - .How are firms organized ?
Due: Group Problem Set on Growth Description****Mon, Sep-29 - Lecture # 6 - . Diagnostics: Old style versus New approach**

- Rodrik, Dani 2005 "Why we learn nothing from regressing growth on policies", mimeo Harvard available at <http://ksghome.harvard.edu/~drodrik.academic.ksg/papers.html>
- * Barro, R & Sala-i-Martin, X. Growth accounting (chapter) in the book "Economic Growth".
- Hausmann, Klingler and Wagner 2008. Handbook of Growth Diagnostics. Mimeo Harvard University

Wed, Oct-1 - Lecture # 7 - . Diagnostics: A different approach I

- Hausmann, Klinger and Wagner 2008. Handbook of Growth Diagnostics. Mimeo Harvard University
- * Hausmann, Rodrik and Velasco (2004) "Growth diagnostics" available at <http://ksghome.harvard.edu/~rhausma/new/growthdiag.pdf>
- Dixit, A. "Evaluating recipes for development success", The World Bank Research Observer Advance Access published online on June 23, 2007
- * Hausmann, Ricardo, and Dani Rodrik. "Self-Discovery in a Development Strategy for El Salvador." *Economía: Journal of the Latin American and Caribbean* Fall 2005.

* Include critiques to the paper in the following page...frodriquez.web.wesleyan.edu/docs/academic_english/comments_hausmann_rodrik.pdf

Fri, Oct-3 - Rodrigo's Lecture . Doing Growth Diagnostics in Practice

Mon, Oct-6 – Rodrigo's Lecture What game has an equilibrium like the story you tell ?
Introducing basic Models of Political Economy or Spatial Economics

Wed, Oct-8 - Lecture # 8 - . From growth diagnostics to growth therapeutics

- Hausmann, Klinger and Wagner 2008. Handbook of Growth Diagnostics. Mimeo Harvard University

Fri, Oct-10 - Lecture # 9 - Catch up Friday # 1. Macro Balance

- Dornbusch, Rudiger, (1980) Open Economy Macroeconomics, Chapter 6.
- Rigobon, Roberto (2004) Notes on the BBNN model. <http://web.mit.edu/rigobon/www/Pdfs/bb-nn.pdf>

Mon, Oct-13 - # - No Class: Columbus day

Wed, Oct-15 - Lecture # 10 - . Is it finance I

- Easterly, W. and Levine, R. 2000. "It's Not Factor Accumulation: Stylized Facts and Growth Models." World Bank, Development Research Group, available from: http://www.cgdev.org/doc/expert%20pages/easterly/easterly_factwber.pdf
- Rodrik, Dani, "Saving Transitions", Drafts, J.F.K. School of Government, Cambridge, 1998., available at <http://ksghome.harvard.edu/~drodrik.academic.ksg/savpaper.pdf>.
- Dornbusch, Rudiger (1987) Dollars, debts and deficits, Ch. 4
- Hausmann, Ricardo; Gavin, Michael; Talvi, Ernesto, "Saving Behavior in Latin America: Overview and Policy Issues. WP-346, May. 1997, available at www.iadb.org/OCE/pdf/346.pdf.
- Agenor, Pierre-Richard and Peter Montiel (1999) Development Macroeconomics, Princeton University Press, Chapter 2

Fri, Oct-17 - Lecture # 11 - . Is it finance II

- * Thorsten Beck, Ross Levine, and Norman Loayza, 1999 “Finance and the Sources of Growth” , WB Working Paper No. 2057, available at <http://econ.worldbank.org/view.php?type=5&id=286>.
- * Inter-American Development Bank 1999. Facing Up to Inequality in Latin America, Chapter 7: Financial Market Policies to Reduce Income Inequality.
- * Mishkin, F. “Prudential supervision: Why is it important and what are the issues?” <http://www.nber.org/papers/w7926>
- * Barth, Caprio and Levine (2002) “Bank regulation and supervision: what works best?” <http://www.nber.org/papers/w9323>
- Rajan, R and Zingales, L. 1997. Financial Dependence and Growth. American Economic Review. 88(3), 559–86

Mon, Oct-20 - Lecture # 12 - Human Capital

- Heckman, J. L. Lochner and P. Todd (2003) “Fifty years of Mincer earnings regressions”, NBER WP #9732 <http://www.nber.org/papers/w9732>
- Pritchett, Lant. 1996. “Where Has All the Education Gone?” World Bank, Policy Research Department, Working Paper # 1581.
- Blundell, Richard, Lorraine Dearden, Elissa Goodman and Howard Reed, 2000, “The Returns To Higher Education in Britain: Evidence from a British Cohort”, The Economic Journal, Vol. 110, F82-F99.
- Inter-American Development Bank (1996) Making social services work. Part 3, Chapters 1-3, pp. 235-274.
- World Bank (2004) Making Services Work for Poor People. Chapter 3.
- Angrist and Krueger (1999) “Empirical strategies in labor economics” The Handbook of labor economics vol.III cap 23

Wed, Oct-22 - Rodrigo’s Lecture: Working with Household Surveys I

- Deaton, Angus The analysis of household surveys. A microeconomic approach to development policy. World Bank; Johns Hopkins University Press. Baltimore, MD, USA. 1997. 479 p

Fri, Oct-24 - Rodrigo’s Lecture Working with Household Surveys II**Mon, Oct-27 - Lecture # 14 - . Inequality**

Inequality: measurement and micro analysis

- Ravallion, M. (1994), “Poverty Comparisons” Harwood Academic Publishers. Switzerland.
- Cowell, F. (1995). “Measuring Inequality”, Prentice Hall, London. Chapter 4 and Appendix.
- World Bank (2006) World Development Report: Equity and Development, available from <http://econ.worldbank.org/WBSITE/EXTERNAL/EXTDEC/EXTRESEARCH/EXTWDRS/EXTWDR2006/0,,contentMDK:20375456~menuPK:897405~pagePK:64167689~piPK:64167673~theSitePK:477642,00.html>
- Murphy, Kevin M. and Lawrence F. Katz, 1992, “Changes in Relative Wages, Supply and Demand Factors”, Quarterly Journal of Economics 107, February, 35-78

The Macro dimension of Inequality

- Wood, Adrian, 1997, “Openness and wage inequality in developing countries: The Latin American challenge to East Asian conventional wisdom”. The World Bank Economic Review 11:1 (January), 33-58.

- Hausmann, R. and Gavin, M. 1998. "Nature, Development, and Distribution in Latin America. Evidence on the Role of Geography, Climate, and Natural Resources", WP-378, August.
- Inter-American Development Bank, "Facing up to inequality in Latin America", Economic and Social Progress in Latin America. 1998-1999 report, Washington D.C. Chapter 4. (The Role of Economic Environment)

Wed, Oct-29 - Lecture # 15 - . Labor Markets

- Labor markets
- * Blanchard, O. and Katz, L. (1997) "What we Know and Do Not Know About the Natural Rate of Unemployment" Journal of Economic Perspectives -Vol.11 Number 1. Winter.
- Inter-American Development Bank (2004) Good Jobs Wanted: Labor Markets in Latin America, Economic and Social Progress Report, Chapters 1-2.
- Blanchard, O and Jimeno, Juan F. "Structural Unemployment: Spain versus Portugal" American Economic Review v85, n2 (May 1995): 212-18
- Agenor, P.R . " The Labor Market and Economic Adjustment" International Monetary Fund Staff Papers v43, n2 (June 1996): 261-335

Fri, Oct 31 - Rodrigo's Lecture Formal models of labor market. / Decomposing income

Mon, Nov-3 - Lecture # 16 - . Labor Policies

- * Heckman, James and Carmen Pages-Serra, The Cost of Job Security Regulation: Evidence form the Latin American Labor markets. Available at <http://www.iadb.org/res/publications/pubfiles/pubWP-430.pdf>
- Inter-American Development Bank (2004) Good Jobs Wanted: Labor Markets in Latin America ,.
- Marquez, Gustavo; Pagés-Serra, Carmen. Ties that Bind: Employment Protection and Labor Market Outcomes in Latin America, Inter-American Development Bank, WP-373, Mar 1998 available from <http://www.iadb.org/res/publications/pubfiles/pubWP-373.pdf>
- Cortazar, R. "Sharing Risk in Volatile Labor Markets" in Hausmann, R. and Reisen, H. Securing Stability and Growth in Latin America , OECD: Development Center, pp. 215-241.
- Peter Khun (1998) "Unions and the Economy: What we Know; What we should Know" Canadian Journal of Economics. Vol. 31 no.5 November

Wed, Nov-5 - Lecture # 17 - . Structural transformation 1

- Hausmann, Hwang and Rodrik (2005) "What You Export Matter", CID Working Paper #123, available from: <http://www.cid.harvard.edu/cidwp/123.htm>
- Hausmann and Klinger (2006): "Structural Transformation and Patterns of Comparative Advantage in the Product Space", Mimeo Harvard.
- Hausmann and Rodrik (2004) "Economic Development as Self-Discovery" <http://ksghome.harvard.edu/~rhausma/paper/selfdiscovery.pdf>
- Hausmann, Rodriguez-Clare and Rodrik (2005) "Towards a strategy for economic growth in Uruguay" available at <http://ksghome.harvard.edu/~rhausma/new/uruguay05.pdf>

- Rodríguez-Clare, “Positive Feedback Mechanisms in Economic Development” in Development Strategy and Management of the Market Economy, Volume II, edited by Szekely and Sabot, Clarendon Press Oxford, 1997
- Rodríguez-Clare, A. (2005) “Identifying R&D shortfalls in LDCs”, Mimeo Inter-American Development Bank.

Fri, Nov-7 – Rodrigo’s Lecture Using Firm level Microdata (carefully).

Mon, Nov-10- Lecture # 18 - . Industrial Policy

- Hausmann & Rodrik - Doomed to Choose: Industrial policy as predicament. First draft. See <http://ksghome.harvard.edu/~drodrik/doomed.pdf>
- Ricardo Hausmann, Dani Rodrik, and Charles F. Sabel. 2007 (Draft) . Reconfiguring Industrial Policy

Wed, Nov-12 - Lecture # 19 - . Fiscal Policy

- Barro, Robert (1979) “On the determination of public debt”, Journal of Political Economy, pp.941-971.
- Agenor, Pierre-Richard and Peter Montiel (1999) Development Macroeconomics, Princeton University Press, Chapter 4.
- Hausmann, R., Talvi, E., Gavin, M., Perotti, R. 1996. " Managing Fiscal Policy in Latin America and the Caribbean: Volatility, Procyclicality, and Limited Creditworthiness." IDB WP-326.
- Velasco, Andrés and Camila Rodríguez (2003) “El Salvador: Fiscal Performance, Prospects and Policy Options”.
- Supplementary readings:
- Barth and Hemphil. “Financial Programming and Policy: The Case of Turkey”, Chapter 6.
- Aizenman, J., Michael Gavin and Ricardo Hausmann (1996) “Optimal Fiscal Policy with Endogenously Imperfect Creditworthiness”, WP-NBER No. 5558. <http://papers.nber.org/papers/W5558.pdf>
- Talvi, E., Vegh, C.A. 2000. "Tax Base Variability and Procyclical Fiscal Policy." NBER Working Paper No. W7499. January. Available at <http://papers.nber.org/papers/W7499.pdf>.

Fri, Nov-14 – Rodrigo’s Lecture Fundamentals of Taxation and Redistribution

Mon, Nov-17 - Lecture # 20 - . Fiscal Institutions

- Main readings:
- Alesina, A., Perotti, R. 1996. " Budget Deficits and Budget Institutions." NBER W5556, May. Available at <http://papers.nber.org/papers/W5556.pdf>
- * Hausmann, 1998. Fiscal Institutions for decentralising democracies: which way to go ? In Fukasaku and Hausmann (Eds) Democracy, Decentralization and deficits in Latin America. OECD
- Inter-American Development Bank 1997. Latin America After a Decade of Reforms, Economic and Social Progress in Latin America, Part Three.
- Hallemberg, M and von Hagen J. "Electoral Institutions and the Budget Process" in Democracy, Decentralization and Deficits , edited by Fukasaku K. and Hausmann, R. OECD Development Center.

Wed, Nov-19 - Lecture # 21 - . Fiscal sustainability & Bonds

- Hausmann, Ricardo (2002) "Good credit ratios, bad credit ratings: the role of debt denomination" available at <http://ksghome.harvard.edu/~rhausma/paper/GCRBCR-3.2003.pdf>
- Alberto Ades et al, Goldman Sachs, "Introducing GS-ESS: A New Framework for Assessing Fair Value in Emerging Markets Hard-Currency Debt"

Mon, Nov-24 - Lecture # 22 - . Volatility: Real and financial

- Aghion, Angeletos, Banerjee, and Manova "Volatility and Growth: Credit Constraints and Productivity-Enhancing Investments", NBER WP#11349, available at <http://papers.nber.org/papers/W11349.pdf>
- Hausmann, R., Gavin, M. 1996. "Securing Stability and Growth in a Shock Prone Region: The Policy Challenge for Latin America Inter-American Development Bank WP-315, Jan. 1996." WP-315. <http://ksghome.harvard.edu/~rhausma.cid.ksg/WP/pubWP-315.pdf>
- Eichengreen, Hausmann and Panizza "Currency mismatches, debt intolerance and original sin", NBER WP # 10036. <http://www.nber.org/papers/w10036>
- Hausmann, Ricardo (1999) "Managing terms of trade volatility", World Bank PREM Note No. 18, available from <http://ksghome.harvard.edu/~rhausma/paper/PREMnote18.pdf>
- Caballero, Ricardo J. Macroeconomic Volatility in Latin America: A View and Three Case Studies NBER Working Paper No. W7782, available at <http://papers.nber.org/papers/W7782.pdf>.
- Hausmann, Ricardo and Roberto Rigobon (2002) "An alternative interpretation of the resource curse: theory and policy implications" available at <http://ksghome.harvard.edu/~rhausma/NBER/NBERWP9424.pdf>
- Hausmann, R. (1999) "Managing terms of trade volatility", World Bank PREM Note No. 18 <http://ksghome.harvard.edu/~rhausma/paper/PREMnote18.pdf>

Wed, Nov-26- Lecture # 23 - . Crises

- Dornbusch, Rudi (2001) "A Primer on Emerging Market Crises", NBER Working Paper No. w8326, available from <http://papers.nber.org/papers/w8326>
- Calvo, G, "Varieties of capital-market crises" available at www.bsos.umd.edu/econ/ciecrp3.pdf
- Hausmann and Velasco (2003) "Hard Money's soft underbelly: Understanding the Argentine Crisis" http://ksghome.harvard.edu/~rhausma/paper/btf02_hard_money.pdf
- Kaminsky, Lizondo, Reinhart, "Leading indicators of currency crises" IMF Working Paper, WP/97/79
- Gavin and Hausmann, R. "Roots of banking crises: The Macroeconomic Context", WP-318, Jan 1996.
- Hausmann, Ricardo, Rodriguez, Francisco R. and Wagner, Rodrigo, "Growth Collapses" (October 2006). KSG Working Paper No. RWP06-046

Fri, Nov-28 - No Class: Thanksgiving**Mon, Dec-1** - Lecture # 24 - . Case studies

- South Africa / El Salvador / Peru / Paraguay /

Wed, Dec-3 - Lecture # 25 - . Case studies

Fri, Dec-5 - --Rodrigo's Lecture Presentation Checklist.

Groups should already have all the basic components of the diagnostic by this date.

Some groups may present a preliminary version of their Growth Diagnostics

Mon, 08 Dec Lecture # 26 - Policymaker's world view

Dec-10 / Dec 12 - - Group Presentations of growth diagnostics exercise.