

14.75: Political Economy and Economic Development

Introduction

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Some basic facts about the world

- Income dispersion between rich and poor countries
- What is GDP per capita?
 - US GDP per capita in 2009 is? \$49,900
 - Mexico? \$8,143
 - Kenya? \$738
 - Niger? \$352
- These are all in actual US dollars. Adjusting for purchasing power differences makes some difference, but not much.

- Even worse if you look over past 140 years
 - USA vs. poorest countries was a factor of 10-1 in 1870
 - USA vs. poorest countries was a factor of 45-1 in 1990

Why could this be?

- Gap between richest and poorest countries is enormous, and the gap is growing
- Why could this be? What's different between these countries?
- Let's make a list:
- Some hypotheses:
 - Geography: temperature, disease burden
 - Human capital: education
 - Physical capital
 - Institutions: democracy, corruption, etc
- What does the data say? Let's start by looking just at some cross-sectional graphs

What do we learn from all these graphs?

- Rich countries seem to be better on all of these dimensions
 - Geography
 - Human capital
 - Institutions
- These graphs don't necessarily tell us that these factors cause the income differences. Why not?

This course

- This course is going to explore the role of politics and institutions in developing countries
- We'll explore both whether political institutions matters for development, and if so, how to analyze political institutions in developing countries
- Let me give a preview of where we're going

Does political economy matter? And how do we know?

- The cross-sectional graphs we showed suggests that there is a correlation between political institutions and economic development
- But do politics actually affect development?
- Many countries have become wealthy without having democracy (e.g., China, Singapore) and some countries became wealthy first, and then became democratic (e.g., Korea)
- How do we know if political institutions actually affects development?
- We'll study several recent empirical studies that explore whether there really is a link
 - Do political leaders matter? Does it matter who the President is?
 - Do historical institutions matter? 50 years after the end of colonialization, do colonial institutions still matter for development? Do even older institutions still make a difference?

Voting and Policy Determination in Democracies

- How to think about elections:
 - The benchmark is called the "Median Voter Theorem." The basic idea is that you win elections if you get $> 50\%$ of the vote. This says that if candidates compete, then policies should express the preferences of the median voter.
- Does this hold in practice? Why or why not?
 - Maybe politician's identity matters (e.g., women, minorities, etc)
 - Maybe people vote based on what happened in the past, not the future
 - Maybe people vote for good politicians, not just whatever policy they most prefer
 - Maybe people just vote for whoever will bribe them the most
 - Maybe with more than 2 choices, things get a bit more complicated than the median voter theorem suggests
- Common theme we'll explore: how does the way that voting takes place in developing countries influence the policies that governments actually put in place and ultimate development outcomes

Dictatorship and Democracy

- Does democracy become more likely with income?
- Can dictators do whatever they want? Why or why not?
- Why are there often elections in dictatorships?

Collective Action

- Not all public goods are provided by the state. In many case, people do it themselves.
- This is true in the US to some degree (from PTAs to citizen initiatives) but even moreso in developing countries
- Topics we'll discuss:
 - The benchmark in economics is the free-rider problem – why should I pay when someone else will?
 - Is this problem worse in ethnically diverse settings?
 - What are the implications for monitoring officials to make sure they do their job?

- Wars are a challenge to the state, either from outside or within
- One view is that wars shouldn't happen in equilibrium
 - They are very costly
 - So both sides should figure out who would win the war, and have transfers from the would-be loser to the would-be winner and avoid all the costs
- Yet they do happen
 - Why? Why might the logic I just outlined break down?
 - We'll then spend 2 lectures looking at civil wars, trying to understand what makes them more or less likely and how one can recover from civil wars

- Corruption can undermine the state's authority in many ways
 - Government officials can create hassles to get you to pay bribes
 - Bribes allow law breakers to pay their way out of breaking the law – which can undermine the government's ability to crack down on lawbreakers
 - Theft from government projects can mean that government can't execute projects it would like to
 - etc.
- We'll ask four basic questions about corruption
 - What are the impacts of corruption? Is corruption inefficient?
 - How do corrupt officials respond to incentives?
 - Can we think about corrupt politicians using the economics of firms?
 - How do politicians use their influence to channel rents to favored friends and firms?

Pre-requisites

- I will expect you have taken the pre-reqs:
 - 14.01 (introductory micro)
 - 14.30 (statistics for economists)
 - or the equivalent
- If you have already taken 14.32 (econometrics), that's will be helpful. However, we will not assume this material.
- If you're not an MIT undergrad, or if you have questions, see me after class.

- Grading and assignments
 - Problem sets (30%). There will be 5-6 problem sets, so one approximately every two weeks. These will be a mix of theoretical exercises and empirical exercises. You will need to use Stata to complete the problem sets. You must do these individually.
 - In-class midterm (30%). March 22.
 - Final exam (40%).
 - Class participation is expected, and will be taken into account in marginal cases.

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