

Econ 490A_ Summer 2016

Course: MW 10:50-1:00, Savery 264

Office Hours: MW 10:00-10:50 and by appointment, Office: Savery 332

Course web page: <https://catalyst.uw.edu/workspace/thornj/44002>

Governance and Misgovernance

The goal of this course is to investigate how institutional arrangements impact the ability of the members of a society to better their lives and to achieve rising economic welfare. We look at the efficiency of economies, the process of growth, and the resulting welfare of their people, seeking to bring the tools of economic analysis to bear in understanding how state capacity and institutional change impacts economic incentives and economic growth. Students will apply the tools of economics to the analysis of real world cases.

We analyze the impacts of economic policies on growth and welfare using micro-economic theory. Students whose use of price theory is weak should review the underlying theory in Jeffrey Perloff's *Microeconomics* (any edition.) Applying microeconomics and simple growth models to real world cases, we ask how economic policies influence the incentives and economic behavior of individuals and firms, exploring how households and producers respond to changes in the opportunities and constraints that they face and how they interact in markets and in administrative systems. We use microeconomics as a problem-solving tool to ask questions and to set up and solve qualitative and quantitative problems. .

Most of the economic policies reviewed in these case studies were intended to achieve social stability and economic growth, rising productivity, and improved well-being. However, some governmental policies intended to provide stability hindered economic growth. Since the lessons to be learned from mistakes are clearer than stories of success, in Section 1 we follow the lead of development economists, Robert Hall and Charles Jones (1999) in "Why Do Some Countries Produce So Much More Output Per Worker Than Others?" exploring the role that institutions play in fostering innovation and technical change. Reading Daron Acemoglu, Simon Johnson, James Robinson "The Rise of Europe: Atlantic Trade, Institutional Change, Economic Growth," we look at the economic environments in which entrepreneurs in England and Western Europe could apply scientific discoveries and commercial innovations to reap the benefits of trade with the New World. On the flip side, Elsa V. Artadi and Xavier Sala-i-Martin "The Economic Tragedy of the XXth Century: Growth in Africa," seeks to identify the forces that led to absolute declines in per capita income in the Sub-Saharan African countries with their emergence from colonial rule. In many cases, the evidence of problems—war, poverty, health crises, inflation, crime, and corruption—suggest hypotheses about the determinants of good performance and the sources of poor performance.

Section I asks "Why are some countries rich and others poor? Do Western economists understand enough about the sources of economic growth to assist policy-makers in low-income countries? Can countries jump from poverty to modernity or are slow processes of change common in historical experience? Do institutional changes and economic changes tend to evolve together and, if so, why might economic changes and institutional changes evolve simultaneously?"

Section 2 introduces *In the Shadow of Violence* by North, Wallis, Webb, and Weingast (abbreviated as N-W.) North and Weingast identify some countries in which people live in fourteenth-century conditions, facing violence, plague, starvation, and ignorance. They survey the features that the world's poorest countries have in common: civil war, a "resource curse," lack of access to global markets, and fragile governments with growth-killing policies. These scholars use case studies to explore how governments may choose the institutions of a Limited Access Order (LAOs), based on control and allocation of economic rents as a device to avoid violent conflict and achieve social stability. Yet, they argue, Limited Access Orders often impede societies from achieving the institutional foundations of an Open Access Order that allows emergence of private property rights, economic and political competition, and checks and balances on the powers of government authorities. Hall and Jones argue that differences in capital accumulation, productivity, and output per worker are fundamentally related to differences in *social infrastructure* across countries. A social infrastructure favorable to high levels of output per worker provides an environment that supports productive activities and encourages capital accumulation, skill acquisition, invention, and technology transfer. With the strong social infrastructure of an Open Access Order, individuals capture the social returns to their actions as private returns. Social

institutions to protect the output of individual productive units from diversion are an essential component of a social infrastructure favorable to high levels of output per worker.

Sections 3, 4, and 5 apply some of the lessons that emerge from comparing countries that are achieving high levels of per capita income and welfare with countries that appear to be caught in a low-income trap.

LAOs sometime evolve toward the doorstep conditions supporting secure property rights, rule of law, and competitive markets, called an open access order. Sometimes they do not. In Section 3, the case of China challenges the N-W hypothesis of a double balance between economic and political change in that high economic growth spurred by the rise of a dynamic sector of private firms has occurred while the governmental structures remain relatively authoritarian. In section 4 we look at the contrast between North and South Korea, two governments dividing a people with a common culture, a common language, and a common geography. Today, South Korea ranks near the top in economic performance with high per capita income, high levels of investment, good health outcomes and a participatory polity.

Course Goals:

1. Applied Goals: The goal of the course is to survey the historical experience of a sample of developed and developing economies undergoing rapid economic change. We apply microeconomic principles and the theory of production to an understanding of the choices and constraints individuals face in changing economic environments.

Explore how economic institutions and policies impact economic growth, productivity, and welfare and how economic performance influences formation of institutions.

Understand how individuals and firms make choices subject to market and administrative constraints.

Understand how government policies affect the allocation of resources, productivity, and growth.

Understand how prices in a market system inform the decisions about what to produce, how to produce it, and who gets it.

Explore how administrative decision-makers make resource allocation decisions in the absence of market competition.

2. Problem-Solving Goals

Apply microeconomics and growth theory to an understanding of the role of institutions and policies in economic performance.

Understand how economic arrangements influence the behavior of decision-makers, focusing on incentives, constraints, and sources of uncertainty.

Understand how institutional constraints and incentives impact the economic environment faced by individuals.

Use the theory of risk to understand how individuals respond to uncertain economic outcomes.

Understand how market structure and regulatory policies influence the allocation of resources.

Course Requirements

Class lectures and discussions follow the syllabus, below. Grades are based on three exams, each of which receives 25% of the weight. There are also three short quizzes, each of which receives 8% of the weight. Exams and quizzes involve both solution of economic problems relevant to the real-world cases in the readings and a brief essay, exploring how policy choices impact the behavior of individuals. Quizzes and exams are scheduled for the first class hour on Wednesdays. I will hand out frequent practice problems. Students are encouraged to do these practice problems as homework jointly with other members of the class. You do not need to hand in practice problems, since you will have similar in-class problems sets in the quizzes and exams. You will want to get together with other members of the class to critique your readings and to apply your analytical tools to real world cases.

Academic Integrity:

Academic integrity is the cornerstone of the Department's rules for student conduct and evaluation of student learning. Students accused of academic misconduct will be referred directly to the Office of Community Standards and Student Conduct for disciplinary action pursuant to the Student Conduct Code and, if found guilty, will be subject to sanctions. Sanctions range from a disciplinary

warning, to academic probation, to immediate dismissal from the Department and the University, depending on the seriousness of the misconduct. Dismissal can be, and has been, applied even for first offenses. Moreover, a grade of zero can be assigned by the instructor for the course.

Texts:

North, Douglass, John Wallis, Steven Webb, and Barry Weingast. *In the Shadow of Violence*. New York: Cambridge University Press, 2013.

Lardy, Nicholas. *Markets Over Mao*. Peterson Institute for International Relations, 2014

Jang Jin-Sung. *Dear Leader*. New York: Atria Books, 2014 (First half only.)

Optional Reference:

Perloff, Jeffrey. *Microeconomics* (any edition). Boston: Pearson/Addison-Wesley. (All the Perloff references are optional. They are recommended for students who want to review the incentive effects of policy regulations. You may supplement the course readings with material from sources such as:

US Department of State: *Country Background Reports* <http://www.state.gov/r/pa/ei/bgn/>

Economist Intelligence Unit, *Country Report*, *Country Commerce*, *ViewsWire*

(http://www.eiu.com.offcampus.lib.washington.edu/site_info.asp?info_name=corporate_landing_University_of_Washington&rf=0)

World Bank, *Doing Business* <http://www.doingbusiness.org/> and World Bank Country Reports.

United Nations Development Program, *Human Development Report*. <http://hdr.undp.org/en/>

Reading List

Section 1a: Why are Some Countries Rich and Others Poor?

Performance measures

“Goals” on website

Sources of economic growth; lessons from economic history

Robert Hall and Charles Jones (1999) “Why Do Some Countries Produce So Much More Output Per Worker Than Others?” *Quarterly Journal of Economics*, February, 83-116.

Daron Acemoglu, Simon Johnson, James Robinson “The Rise of Europe: Atlantic Trade, Institutional Change, Economic Growth,” *American Economic Review* June 2005.

Section 1b: Barriers to Growth in a Limited Access Order

Elsa V. Artadi and Xavier Sala-i-Martin “The Economic Tragedy of the XXth Century: Growth in Africa,” NBER Working Paper No. 9865 July 2003

Section 2: The Evolution from Limited Access Order to Open Access Order

Limited versus open access political and economic systems

North, et. al. Ch 1 What is a limited access order?

(Optional Perloff Chs 8 and 11, competitive markets and monopoly)

Fragile limited access orders; “In the Shadow of Violence”

North, Ch 2,3, or 4 (Choose one)

(Optional Perloff, Ch 17 uncertainty; why does institutional change increase uncertainty)

Basic limited access orders; obstacles to growth and productivity

North, Ch 5, 6, or 7 (Choose one)

Week 2: Quiz 1; Describe and Evaluate a Fragile or Basic LAO State (one page) Compare competitive and monopoly outcomes
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Mature limited access orders; can they evolve into open, competitive institutions?

North, Ch 8 or 9 (Choose one)

Lessons in the Shadow of Violence

North, Ch 10

(Perloff Ch 9 Competitive Model; what are the sources and consequences of competition?)

Week 3: Exam 1, Limited and Open Access Orders

Section 3: China: Market versus Mao

State versus Market

Lardy Ch 1

Notes on the Socialist Economy (On the class web page) How did China's communes differ from the household responsibility system?

Reform of State Owned Enterprise

1978: Break-up of the communes, emergence of town-and-village-enterprises, opening to trade

What was the role of China's TVEs in post-1978 growth?

Lardy Ch 2

Notes on Reform in the 1980s and 1990s (On the class web page)

Week 5: Quiz 2: Institutional change and economic growth in China (Perloff Ch 6, firms and production, Ch 13 oligopoly)

Rise of the Private Sector

Lardy Ch3

Notes on Growth and Trade (On the class web page)

Implementing the Reform Agenda

Lardy Ch 4

Notes on Fiscal and Exchange Rate Policy, Macroeconomic Structure (On the class web page)

What is the future of China's growth?

Week 6: Exam 2: Lessons from China's Growth

Week 7: Section 4: Prospects for Reforming North Korea

North Korean History and Administration

Jang Dear Leader Ch I-1 and I-2

North Korean Economic Performance

Jang Ch I-3 through I-5

Data from The Bank of Korea (on the class web page)

North Korean Economic Welfare

Jang Ch 2-1 and 2-2

Compare the institutions and economic growth of South and North Korea. (N-W, South Korean case study.)

Notes on Lankov, "The Real North Korea"

Week 8: Quiz 3 Compare N Korean and S Korean Economic Performance (one page)

What is the role of the informal economy in the welfare of North Korean people?

How does a government retain political power in the face of poor economic performance?

Section 5: What Should Be Done? Can North Korea learn from the examples of China and South Korea?

Recent Developments in North Korea

North Korea; Witness to Transformation (blogs. piie.com/NK)

Week 9: Exam 3: Summarize lessons from North-Weingast and case studies. Review price theory tools—labor-leisure choice, production, decision analysis, uncertainty, oligopoly, and simple game theory. How can a country increase their economic growth?

Schedule and Readings	
Week 1: Monday Goals of economic systems "Goals" on web	Wednesday Institutional Sources of Growth Hall and Jones; Acemoglu
Week 2: Fragile States N-W, Ch 1, choose 2,3,or 4 Perloff Chs 8 and 11 Competition and Monopoly	Basic LAO States Evaluate an LAO state N-W, choose Ch 5,6, or 7 Quiz 1
Week 3: Evaluate a LAO State Perloff Monopoly and Monopsony	From Limited to Open Access North, choose 8 or 9, Ch 10 Exam 1
Week 4: China Lardy, Ch 1 State vs Market Perloff Ch 6 Firms and Production	China Notes on Chinese Reform in 1980s and 1990 Perloff Ch 7 Costs
Week 5: Lardy Ch 2 Reform State-owned Firms	Lardy Ch 3 Rise of Private Sector Notes on Chinese Growth and Trade Quiz 2
Week 6: Lardy Ch 4 Reform Agenda Notes on Chinese Fiscal and Exchange Rate Policies Perloff Ch 17 Uncertainty	The Future of Chinese Growth Exam 2
Week 7: North Korea Notes on North Korean History Perloff Ch 13 Oligopoly	Jang Ch 1-1 and 1-2 N Korean Administration
Week 8: Jang Ch 1-3 My Hometown Perloff Ch Game Theory	Jang Ch 1-4 and 1-5 Farewell Quiz 3
Week 9: Comparing North and South Korea Jang 1-6 Leaving Jang 2-3 and 2-4 Perloff Ch 14 Game Theory	Lessons from Africa, China and South Korea for North Korea Exam 3