

**AMERICAN UNIVERSITY**  
*Department of Economics*

Comprehensive Examination  
Econ Development Economics

June 2009

**Directions:** Answer two (2) questions from each of the two parts for a total of four (4) questions.

**PART 1: Development Microeconomics**

Answer *one* question from Section A and *one* question from Section B. **Read the questions carefully, and make sure to answer what is asked. Answers are judged on clarity of exposition and intuition, command of the relevant literature, and accuracy and depth of technical detail.**

**Section A: Answer one question:**

1.
  - a. Discuss carefully the analytical and empirical reasons why development microeconomists in recent years have rejected both: i) the simple model of the (agricultural) household (AHM), and ii) the standard (Walrasian) labor market model particularly as theoretical bases for empirical research. Demonstrate your arguments for each of these models by i) critically discussing the main assumptions that underlie these models which development economists find problematic, and ii) supporting your arguments with the findings of an empirical study on the subject.
  - b. Recent models of household decision-making show that intra-household decision-making such as household budgeting and expenditure allocation are far more complicated than the simple agricultural model of the household (AHM). Explain how the selection of the household model affect the predictions and expected outcomes and hence influence the outcomes of policy evaluation? Demonstrate your arguments by giving example(s) using empirical studies.
2.
  - a. What are the main factors that likely affect bargaining power within the household? Discuss each one carefully.
  - b. To what extent are these similar or different to those that affect bargaining power in the market? Explain.
  - c. If you were to conduct an empirical analysis, what indicators or measures would you use to capture bargaining power? Justify your answer and discuss the merits and disadvantages of each measure.
  - d. From a methodological standpoint, why are intrahousehold dynamics difficult to capture in a quantitative analysis? Demonstrate your answer using any of the empirical studies in the literature.

3.
  - a. Why do informal markets continue thrive in developing countries? Explain carefully how the presence of market imperfections and transaction costs create a situation in which outcomes can be non-Pareto optimal. Use economic reasoning and empirical evidence from the literature to illustrate your points.
  - b. Is sharecropping efficient or not? Critically discuss the Marshallian response to this question. Be sure to label your graph (s). What then explains the continued persistence of sharecropping? Explain your answer carefully.
  - c. Carefully discuss the difference between the entitlement approach and the availability of food approach towards understanding famines. To what extent can policies cause or exacerbate famines? Give examples to illustrate your point.

**Section B: Answer one question:**

1. Facing high unemployment especially in the rural areas, the Nigerian government decided to embark on a policy of creating new jobs by allowing rural wages to decline.
  - a. By means of graphs, demonstrate carefully the interrelation between poverty, nutrition and labor markets. In your answer, discuss how an individual's work capacity affects his/her income in labor markets and how individual income affects work capacity as summarized in the so-called capacity curve. Then demonstrate that there will be involuntary unemployment in labor market equilibrium.
  - b. Supposed that the policy has also brought about rapid-rural urban migration. Give an economic explanation of this phenomenon as a result of the decline in rural wages, using the Harris-Todaro migration model. Illustrate this by means of diagram. Are there likely any gender dimensions in term of the decision to migrate to the cities? Explain your answer carefully.
  - c. From a methodological standpoint, what makes the empirical test of migration decisions and outcomes challenging? How are these econometric concerns dealt with in empirical research? Give a concrete example to illustrate your point.
2.
  - a. What role does risk play in understanding poverty? Are poverty and vulnerability synonymous? Why or why not?
  - b. Discuss the role of kinship and social networks in livelihood and coping strategies in both rural and urban areas of the developing world. What are the limitations of such insurance schemes?
  - c. Explain at least two livelihood and coping strategies employed by farmers (wealthy or poor) and discuss their medium and longer-term impacts on their welfare. Discuss in particular the distributional consequences of such strategies and the "Micawber threshold" that may likely occur.

3.
  - a. Using the imperfect information framework of analysis, explain the underlying reason(s) for the variation in interest rates observed in rural credit markets. In what way do interest rates serve as a mechanism for reducing rate of loan default?
  - b. Discuss some of the methods and devices employed by informal lender in order to mitigate screening, incentive and enforcement problems. Explain why these mechanisms appear to work in situations of underdeveloped and imperfect markets.
  - c. Does the exclusion of poor households from formal financial services justify government intervention? Why or why not?
  - d. Discuss at least two types of policies that you would recommend. What are the likely outcomes of such interventions?

## **PART 2. Development Macroeconomics**

**Answer *one* question from Section C and *one* question from Section D. Read the questions carefully and make sure to answer what is asked. Answers are judged on clarity of exposition and intuition, command of the relevant literature, and accuracy and depth of technical detail.**

### **Section C: Answer one question.**

1. The Solow model.
  - a. Explain the basic assumptions of the Solow growth model and provide the key equilibrium condition. Be sure to show in your answer the dynamic properties of capital and why the equilibrium is stable.
  - b. Now endogenize the savings rate by having it depend on the rate of return to capital. Restate the equilibrium condition and then show how a decrease in the savings rate affects equilibrium capital to output and growth.
  - c. Compare and contrast the Solow growth model with the endogenous growth models. What are the key differences?
  - d. Acemoglu et al focus on institutions as a key determinant of growth. How do they define ‘good economic institutions’ and what empirical evidence do they draw upon to support their hypothesis regarding the influence of institutions on growth?
2. Real exchange rates.
  - a. Define the real exchange rate and the equilibrium real exchange rate. Be sure to lay out your assumptions underlying the definitions you have given.

- b. Consider the three approaches to assessing the appropriateness of the real exchange rate:
  - i) In the single equation estimation approach applied to a low-income, natural resource-based economy, say Sierra Leone, indicate what variables you would use as fundamentals and what would be the expected empirical findings with regard to their relationship to the real exchange rate.
  - ii) Contrast for Sierra Leone how you would apply the macroeconomic balance and external sustainability approaches.
- c. Given that Sierra Leone has a floating exchange rate, if it is found that Sierra Leone has an overly appreciated real exchange rate, what policy options are available to it to address this? Would it make sense for Sierra Leone to join the common currency of the francophone West African countries namely, the cfa franc? Explain why or why not, using the optimal exchanges regime evaluation criteria.

### Section D: Answer one question

#### 1. Capital account liberalization, capital flows, and currency crises.

- a. What are some of the benefits and drawbacks of financial integration?
- b. Explain the difference between *de jure* and *de facto* financial integration and suggest both some price and quantity-based measures of *de facto* integration.
- c. Explain how countries cope with a destabilizing decrease in capital inflows in the instance where they have both a fixed and a floating exchange rate and the different types of policy interventions that can be used.
- d. Explain how high capital mobility affects the ability of a country to sustain a fixed peg.

#### 2. Current account sustainability

- a. What does the literature suggest as a good rule of thumb for a sustainable current account deficit? Explain why this is reasonable and what economic factors affect current account sustainability.
- b. Demonstrate mathematically that the current account is equal to the difference between domestic saving and national investment.
- c. Consider a small economy with a fixed exchange rate and a weak tax base in which the central bank has frequently been called upon to finance government. Explain the applicability of Krugman's first generation model of currency crises to this country. What would be early warning indicators of a currency crisis?
- d. Consider a larger emerging market with a floating exchange rate and a diversified economic basis. Explain the applicability of second generation models of currency crises to this country. What would be early warning indicators of a currency crisis?

3. Foreign Aid

- a. Explain carefully the main macroeconomic challenges that a poor country faces in absorbing a scaled up level of aid. In your response, consider the impact on a) growth, b) inflation, c) real exchange rate, d) interest, e) the government budget, and f) the balance of payments.
- b. How do your assumptions about the efficiency of aid alter your results?
- c. What does the empirical work suggest on the efficacy of aid in benefiting countries?