

## **PED-309: Development Policy Strategy - Fall 2013 -**

### **Syllabus**

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Meet Time:	MW, 11:40-13:00PM in L-280	
Section:	Friday, 8:40-10:00AM in L-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, structural transformation possibilities, 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 section discusses the various determinants of growth and introduces the growth diagnostic framework. The second evaluates in detail structural factors that influence growth; demographics, geography, inequality, structural transformation and institutions. 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 trade-offs of institutional design. The final section concludes.

## Audience

This course is designed for second year MPA/ID students. Other Kennedy School students with excellent backgrounds in graduate-level 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 people 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

The final grade will be based on:

- 3 individual problem sets (25%)
- 3 group problem sets (30%)
- One group presentation in section (10%)
- Final group diagnostic (25%)
- Class participation in lecture and section (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 problem sets - different types of regressions to unveil the returns to education. The group problem sets focus on interpretation and decision making.
- There are three group problem sets during the semester. There will also be a final group diagnostic as well as a smaller group presentation in section during the semester. These exercises are meant to facilitate students' transition 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
- Sections are additional lectures given by the teaching assistant, not reviews of the lectures. They will generally build on the material in class and help students to apply it to real world policies.

### **How have we streamlined the course?**

- 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.
- Group meetings will be more about diagnostics than about new calculations.
- Problem sets are more concentrated at the beginning of the semester, so you may have more time when other courses ask for it.
- Each group will give a brief presentation on an aspect of its country's economy during section at some point during the semester.

## SCHEDULE

Date	Lecture	Assignments
4-Sep	1 Introduction	
9-Sep	2 From asset accumulation to knowledge; what drives growth?	
11-Sep	3 The escape from the Malthusian trap	Pset 1 posted
16-Sep	4 Knowledge and structural transformation I	
18-Sep	5 Knowledge and structural transformation II	
23-Sep	6 Knowledge and structural transformation III	Pset 2 posted
25-Sep	7 The policies of structural transformation	
30-Sep	8 Institutions	
2-Oct	9 Growth diagnostics I	
7-Oct	10 Growth diagnostics II	
9-Oct	11 Growth diagnostics III	Pset 3 posted
14-Oct	<b>Columbus Day</b>	
16-Oct	12 Inequality and labor markets I	
21-Oct	13 Inequality and labor markets II	
23-Oct	14 Inequality and labor markets III	Pset 4 posted
28-Oct	15 Macro I	
30-Oct	16 Macro II	
4-Nov	17 Macro III	
6-Nov	18 Financial markets: problems and policies	Pset 5 posted
11-Nov	19 Volatility I	
13-Nov	20 Volatility II	
18-Nov	21 Fiscal Policy I	
20-Nov	22 Fiscal Policy II	Pset 6 posted
25-Nov	23 Crises	
27-Nov	<b>Thanksgiving recess</b>	
2-Dec	24 From diagnostics to therapeutics	
4-Dec	25 A Policy Making World View	

## LECTURES, REVIEWS AND READINGS

Lecture # 1 Course Introduction: Thinking About Growth

- \*Hausmann Notes (available on course website)

Lecture # 2 From asset accumulation to knowledge; what drives growth?

- \*Jones, Charles and Romer, Paul, “The New Kaldor Facts: Ideas, Institutions, Population, and Human Capital”, *American Economic Journal: Macroeconomics* 2010, 2:1, 224–245

- \*Solow, Robert, “Perspectives on Growth Theory”, *The Journal of Economic Perspectives*, Vol. 8, No. 1. (Winter, 1994), pp. 45-54
- Grossman, Gene and Helpman, Elhanan, “Endogenous Innovation in the Theory of Growth”, *The Journal of Economic Perspectives*, Vol. 8, No. 1 (Winter, 1994), pp. 23-44

### Lecture #3 The escape from the Malthusian trap

- \*Galor, Oded. “Unified Growth Theory,” Princeton University Press, 2011, Chapters 1&2
- Clark, Gregory. “[Human Capital, Fertility and the Industrial Revolution](#)” *Journal of the European Economic Association*, 3 (2-3) (2005): 505-515.
- Kirk, Dudley. “Demographic Transition Theory,” *Population Studies* 50(3) (November, 1996): 361-387.
- O. Galor and D. N. Weil, “The gender gap, fertility, and growth,” *The American Economic Review* 86, no. 3 (1996): 374-387.
- Lucas, Robert. “The Industrial Revolution: Past and Future,” Lecture given at the Centro de Estudios Públicos, Santiago, Chile, 1996. (Available on course website.)

### Lecture #4 Knowledge and structural transformation I: Economic complexity

- \*Hausmann, Hidalgo et al., “The Atlas of Economic Complexity” (2013), Parts 1 & 2
- Hausmann, R., & Hidalgo, C. (2011). “The network structure of economic output” *Journal of Economic Growth*, 16, 309–342.
- Hidalgo, César and Ricardo Hausmann (2009) “The building blocks of economic complexity”, *Proceedings of the National Academy of Sciences* 106 10570–10575.  
[http://www.chidalgo.com/Papers/HidalgoHausmann\\_PNAS\\_2009\\_PaperAndSM.pdf](http://www.chidalgo.com/Papers/HidalgoHausmann_PNAS_2009_PaperAndSM.pdf)
- Hausmann and Hidalgo, 2010 “Country Diversification, Product Ubiquity and Economic Divergence”
- Hausmann, Hwang and Rodrik (2005) “What You Export Matter”, CID Working Paper #123, available from: <http://www.cid.harvard.edu/cidwp/123.htm>

### Lecture # 5 Knowledge and structural transformation II : Product space

- \*Hidalgo, Klinger, Barabasi and Hausmann “The Product Space Conditions the Development of Nations”, *Science* 317(5837) 482-487.  
<http://www.chidalgo.com/Papers/HidalgoKlingerBarabasiHausmannScience2007.pdf>
- \*Hausmann and Klinger (2006): “Structural Transformation and Patterns of Comparative Advantage in the Product Space”, Mimeo Harvard.
- \*Hausmann and Klinger (2006): “South Africa’s Export Predicament,” CID Working Paper #129. <http://www.cid.harvard.edu/cidwp/pdf/129.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>

### Lecture # 6 Knowledge and structural transformation III : Mechanics of structural transformation

- \*Bahar, D., Hausmann, R., & Hidalgo, C. (2012, April). "International knowledge diffusion and the comparative advantage of nations". Center for International Development.

#### Lecture # 7 The policies of structural transformation

- \*Hausmann Ricardo, "Target of Opportunity: South Africa's Western Cape Seeks a Role in the African Oil Boom" (available on course website)

#### Lecture # 8 Institutions

- \*North, Douglass, "Institutions and Economic Growth: An Historical Introduction," *World Development*, 17(9), 1989, 1319-1332
- \*Hausmann R. 2008 "[The Other Hand: High Bandwidth Development Policy](#)" CID Working Paper No. 179
- Alchian, A. and H. Demsetz, "The Property Rights Paradigm," *The Journal of Economic History* (1973): 16-27.
- Grief, Aver, "Commitment, Coercion, and Markets: The Nature and Dynamics of Institutions Supporting Exchange," *Handbook of New Institutional Economics* (2005): 727-786.
- Engerman and Sokoloff, "Institutional and Non-Institutional Explanations of Economic Differences"
- Djankov, Simeon, Rafael La Porta, Florencio Lopez de-Silanes, and Andrei Shleifer. 2002. "The Regulation of Entry." *Quarterly Journal of Economics*, 117(1): 1-37.

#### Lecture # 9 Growth Diagnostics I: Old Style vs. New Approach

- \*Hausmann, Rodrik and Velasco (2004) "Growth diagnostics" available at <http://ksghome.harvard.edu/~rhausma/new/growthdiag.pdf>
- Rodrik, Dani 2005 "Why we learn nothing from regressing growth on policies", mimeo Harvard available at <http://www.hks.harvard.edu/fs/drodrik/Research%20papers/policy%20regressions.pdf>
- Barro, R & Sala--Martin, X. Growth accounting (chapter) in the book "Economic Growth".
- Hausmann Ricardo, Klinger Bailey, Wagner Rodrigo 2008 "[Doing Growth Diagnostics in Practice: A 'Mindbook'](#)" *CID Working Papers Series No. 177*

#### Lecture # 10 Growth Diagnostics II: A Different Approach

- Hausmann Ricardo, Klinger Bailey, Wagner Rodrigo 2008 "[Doing Growth Diagnostics in Practice: A 'Mindbook'](#)" *CID Working Papers Series No. 177*
- Dixit, A. "Evaluating Recipes for Development Success." *World Bank Research Observer*, 22(2), 2007, pp. 131-157.
- Hausmann, Ricardo, and Dani Rodrik. "Self-Discovery in a Development Strategy for El Salvador." *Economía: Journal of the Latin American and Caribbean* Fall 2005. Critiques can be found at: [http://frrodriguez.web.wesleyan.edu/docs/academic\\_english/comments\\_hausmann\\_rodrik.pdf](http://frrodriguez.web.wesleyan.edu/docs/academic_english/comments_hausmann_rodrik.pdf)

- Heckman, J. L. Lochner and P. Todd (2003) "Fifty years of Mincer earnings regressions", NBER WP #9732 <http://www.nber.org/papers/w9732>

#### Lecture # 11 Growth Diagnostics III: Case Study -- Brazil

- Hausmann, Ricardo "In Search of the Chains that Hold Brazil Back," prepared for the Brazil Center for Public Leadership. (Available on course website.)

#### Lecture # 12 Inequality and labor markets I

- Kremer M. and Maskin E., "Globalisation and Inequality", *WCFIA Working Paper*, 2006 <http://www.wcfia.harvard.edu/node/2745>
- Aghion P., Caroli E. and García-Peñalosa C., "Inequality and Economic Growth: The Perspective of the New Growth Theories", *Journal of Economic Literature*, Vol. 37, No. 4 (Dec., 1999)
- 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/external/default/main?pagePK=64165259&theSitePK=478060&piPK=64165421&menuPK=64166093&entityID=000112742\\_20050920110826](http://econ.worldbank.org/external/default/main?pagePK=64165259&theSitePK=478060&piPK=64165421&menuPK=64166093&entityID=000112742_20050920110826)
- 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. <http://wber.oxfordjournals.org/content/11/1/33.abstract>

#### Lecture # 13 Inequality and labor markets II

- \*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.
- 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

#### Lecture # 14 Inequality and labor markets III

- Heckman, James and Carmen Pages-Serra, The Cost of Job Security Regulation: Evidence from the Latin American Labor markets. Available at <http://www.iadb.org/res/publications/pubfiles/pubWP-430.pdf>
- 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
- Harris, John; Michael Todaro. "Migration, Unemployment and Development: A Two-Sector Analysis," American Economic Review, Vol 60, No 1 (1970), pp. 126-142.

#### Lecture # 15 Macro I

- United Nations. 2004. "National Accounts: A Practical Introduction" *Handbook of National Accounting*, New York.  
<http://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&ved=0CC8QFjAA&url=http%3A%2F%2Funstats.un.org%2Funsd%2FEconStatKB%2FAttachment35.aspx&ei=nfT6UdiiF9W14AOAy4Fw&usg=AFQjCNH2H6WncREpJYxyXEL7k05cxqAaJg&sig2=cyX4OxviTbAEiNSXrbMA6w&bvm=bv.50165853,d.dmg&cad=rja>
- International Monetary Fund. 1996. *Balance of Payments Textbook*, Washington, DC.  
<http://www.imf.org/external/np/sta/bop/BOPtex.pdf>
- International Monetary Fund. 2000. *Monetary and Financial Statistics Manual*, Washington, DC.  
<http://www.imf.org/external/pubs/ft/mfs/manual/index.htm>

#### Lecture # 16 Macro II

- Dornbusch, Rudiger, (1980) *Open Economy Macroeconomics*, Chapter 6.
- Rigobon, Roberto (2004) Notes on the BBNN model.

#### Lecture # 17 Macro III

#### Lecture # 18 Financial markets: problems and policies

- \* 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>
- \* Inter-American Development Bank 1999. *Facing Up to Inequality in Latin America*, Chapter 7: Financial Market Policies to Reduce Income Inequality.  
<http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=35129835>
- Thorsten Beck, Ross Levine, and Norman Loayza, 1999 "Finance and the Sources of Growth" , WB Working Paper No. 2057, available at  
<http://www.sciencedirect.com/science/article/pii/S0304405X00000726>
- 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](http://www.cgdev.org/doc/expert%20pages/easterly/easterly_factwber.pdf)

- Rajan, R and Zingales, L. 1997. Financial Dependence and Growth. *American Economic Review*. 88(3), 559–86

### Lecture # 19 Volatility I

- 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://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=788134>
- 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://web.mit.edu.ezp-prod1.hul.harvard.edu/rigobon/www/Robertos\\_Web\\_Page/policy\\_IS\\_files/is.pdf](http://web.mit.edu.ezp-prod1.hul.harvard.edu/rigobon/www/Robertos_Web_Page/policy_IS_files/is.pdf)
- Hausmann, Ricardo (1999) “Managing terms of trade volatility”, World Bank PREM Note No. 18, available from <http://www1.worldbank.org/prem/PREMNotes/premnote18.pdf>

### Lecture # 20 Volatility II

- Hausmann, Ricardo, Barry Eichengreen and Ugo Panizza. “Original Sin: The Pain, The Mystery, and the Road to Redemption”. November 2002. Paper prepared for the conference “Currency and Maturity Matchmaking: Redeeming Debt from Original Sin”. Inter American Development Bank, Washington D.C. November 21-22, 2002. [http://www.hks.harvard.edu/fs/rhausma/paper/pain\\_mystery02.pdf](http://www.hks.harvard.edu/fs/rhausma/paper/pain_mystery02.pdf)
- Eichengreen, Hausmann and Panizza “Currency mismatches, debt intolerance and original sin”, NBER WP # 10036. <http://www.nber.org/papers/w10036>

### Lecture # 21 Fiscal policy I

- Barro, Robert (1979) “On the determination of public debt”, *Journal of Political Economy*, pp.941-971.
- 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 Rodriguez (2003) “El Salvador: Fiscal Performance, Prospects and Policy Options”.
- Supplementary reading: 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>

### Lecture # 22 Fiscal policy II

- Alesina, A., Perotti, R. 1996. " Budget Deficits and Budget Institutions." NBER W5556, May. Available at <http://papers.nber.org/papers/W5556.pdf>

- Hausmann, Ricardo, Alesina Alberto, Stein Ernesto and Hommes Rudolf. "Budget institutions and fiscal performance in Latin America." *Journal of Development Economics* (59)2, 1999: 253-273. <http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=788213>
- 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 Fukusaku K. and Hausmann, R. OECD Development Center.

#### 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 [http://www.iadb.org/res/includes/pub\\_hits.cfm?pub\\_id=WP-306&pub\\_file\\_name=pubWP-306.pdf](http://www.iadb.org/res/includes/pub_hits.cfm?pub_id=WP-306&pub_file_name=pubWP-306.pdf)
- Hausmann and Velasco (2003) "Hard Money's soft underbelly: Understanding the Argentine Crisis" [http://ksghome.harvard.edu/~rhausma/paper/btf02\\_hard\\_money.pdf](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 <http://www.cid.harvard.edu/cidwp/136.htm>

#### Lecture # 24 From Diagnostics to Therapeutics

- Dixit, Avinash (2007): "Evaluating Recipes for Development Success". *The World Bank Research Observer*, Vol. 22, No. 2, pp. 131-157.

#### Lecture # 25 A Policy Making World View