
Ag. & Applied Economics 732/Economics 878
Spring 2006
Mon, Wed 11-12:15, B30 Taylor Hall

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Microeconomics of Inequality and Development

[Microeconomics of Agricultural Development/Economic Development: Theory, Statistics and Policy II]

Course Description

Now at last we are setting ourselves seriously to inquire whether it is necessary that there should be any so called “lower classes” at all: that is whether there need be large numbers of people doomed from their birth to hard work in order to provide for others the requisites of a refined and cultured life; while they themselves are prevented by their poverty and toil from any share or part in that life ... the answer depends in a great measure upon facts and inferences, which are within the province of economics; and this is it which gives to economic studies their chief and their highest interest [Alfred Marshall, *Principles of Economics*; cited in Bowles and Gintis, 2000].

Casual observation—as well as some systematic econometric work—suggests that inequality may dampen economic growth. Interestingly, the continuing development of the economics of imperfect information, incomplete markets and endogenous preferences has begun to provide microfoundations for this suggestion, providing rationale for not only why inequality may be economically costly, but why it may tend to perpetuate itself. As controversial as they are important, these empirical and theoretical developments have without a doubt “brought income distribution in from the cold” (as Atkinson, 1996 *Econ Journ* puts it). They also provide a focal point around which to organize this course’s exploration of the rich literature on the microeconomics of development.

The idea that economic performance might be sensitive to the distribution of endowments has deep roots in the theory of agrarian economy. Writing in the early 20th century, the Russian economist A.V. Chayanov argued that farm households with distinct endowments of productive resources would use those resources in different proportions, with different factor productivities. Following an introductory look at different aspects of the inequality-development problem, this course will first examine modern variants of the Chayanovian argument that important household decisions in the sphere of production (and consumption) are inseparable from household wealth endowments. The course will then look more deeply into the economics of the household itself, asking if intra-household distribution similarly matters for factor use and the composition of consumption. We will also explore how socially constructed gender identities may influence economic behavior inside and outside of the household.

The course will then turn to explore theory and empirical evidence concerning the operation of two fundamental factor markets, that for labor and that for capital. The interacting implications of these markets for behavioral differentiation in production, class formation and asset

accumulation will be considered using what might be termed endowment continuum models. The additional complexity introduced by risk, in the presence of incomplete contingency markets, is then considered. Particular attention will be given to the impact of risk on the accumulation of assets, and the possibility that under risk initial endowment inequality may reproduce or deepen itself. Finally, we ask about the degree to which family, friends and non-anonymous social relations can substitute for imperfect and incomplete markets, examining the relatively new (and still somewhat ill-formed) literatures on social capital, social norms and social identity.

Course Prerequisites and Requirements

This course is intended for students with graduate level training in microeconomic theory and econometrics. Please see me with any questions concerning the adequacy of your background preparation.

Readings for the first section of the course are available on the course web page (www.aae.wisc.edu/aae732). If the class wishes, we can arrange for the creation of a xerox reading packet. We will discuss such arrangements during the first class period.

Each student will be required to write a total of three essays. All essays will be equally weighted to calculate the final course grade. Each student will be required to write three essays. The first essay (due **10 March**) will be a critical review of one or two articles that focus on a single, well-defined topic. Topics and articles from which students may choose will be discussed in class. The second essay will be assigned as a take-home exam due on **17 April**. The take-home exam question will require both critical review and extension of the literature. For the third essay, students choose their own topic, and are encouraged to write on a subject close to their research interest. A brief outline of your essay is due **NO LATER** than **14 April**. The essay itself is due the last day of the final exam period, **13 May**.

Scheduling Make-up Classes

Travel commitments may require that we reschedule several classes this term. Likely classes to be rescheduled are 6 March and 22 March. Hopefully we will be able to meet on two Fridays at 11 a.m. to make up for these missed sessions. Should this time not prove convenient for everyone, then we will search for another time that will. In the event that we find ourselves pushed into the evening hours (or the wee early morning hours), I will provide coffee and sweets to ease the burden of these sessions.

Reading List
(*’s indicate required readings)

I. INTRODUCTION: ISSUES IN GROWTH, POVERTY AND INEQUALITY
[18-23 January]

*Bowles, S. and H. Gintis (2000). “Walrasian Economics in Retrospect,” *Quarterly Journal of Economics* CXV(4): 1411-1439. (Not included in the reading packet—available at www.aae.wisc.edu/aae732).

II. ENDOWMENT SENSITIVITY BETWEEN AND WITHIN HOUSEHOLDS
[23 January – 13 February]

A. The Impact of Endowments on Production and Consumption Decisions

Benjamin, D. (1995). “Can Unobserved Land Quality explain the Inverse Productivity Relationship?” *J of Dev Econ* (February) 46(1):51-84.

Sadoulet, E., A. de Janvry and C. Benjamin (1996). “Household Behavior with Imperfect Labor Markets,” *Industrial-Relations* 37(1):85-108.

*Carter, M.R. and Y. Yao (2002). “Local versus Global Separability in Agricultural Household Models: The Factor Price Equalization Effect of Land Transfer Rights in China,” *Am J of Agri Econs* 84(3):702-715.

Burgess, R. (1997). “Market Incompleteness and Nutritional Status in Rural China,” working paper, London School of Economics.

B. Intra-Household Wealth and Income Distribution

Haddad, L. and R. Kanbur (1990). “How Serious is the Neglect of Intra-Household Inequality?” *Econ Journ* 100(402): 866-881.

*Carter, M. R. and E. Katz (1997). “Separate Spheres and the Conjugal Contract: Understanding Gender-Biased Development,” in L. Haddad , J. Hoddinott and H. Alderman (eds.) *Intrahousehold Resource Allocation in developing Countries: Methods, Models and Policy* (Johns Hopkins).

Thomas, D. (1990). “Intra-Household Resource Allocation: An Inferential Approach,” *J of Hum Resources* 25(4): 635-664.

Barham, Bradford and Takayoshi Kusago (2001). "Preference Heterogeneity , Power and Intrahousehold Decision-Making in Rural Malaysia," *World Development* 29(7):1237-1256.

Doss, Cheryl (2001). "Is Risk Fully Pooled within the Household? Evidence from Ghana," *Econ Dev and Cult Change* 50(1): 101-130.

*Udry, C. (1996). "Gender, Agricultural Production and the Theory of the Household," *J of Polit Econ* 104(5): 1010-1046.

Fafchamps, M. and A. Quisumbing (2003). "Social Roles, human capital and the intrahousehold division of labor: evidence from Pakistan," *Oxford Economic Papers* 55: 36-80.

C. Gender Identities and Intrahousehold Allocation

*Akerloff, George and Rachel Kranton (2000). "Economics and Identity," *Quarterly Journal of Economics* CXV(3):715-754.

Fletschner, Diana and M.R. Carter (2005). "Constructing and Reconstructing Gender: Credit Supply and Women's Demand for Entrepreneurial Capital," working paper.

*Escriche, L., G. Ocina and R. Sanchez (2004). "Gender Discrimination and intergenerational transmission of preferences," *Oxford University Press* 56: 485-511.

III. EFFICIENCY WAGE MODELS OF THE LABOR MARKETS [15-22 February]

A. Nutritional Wage

Bliss, C., and N. Stern (1978). "Productivity, Wages and Nutrition, Parts I and II," *J of Dev Econ* 5:331-97.

Bardhan, P.K., (1979). "Wages and Unemployment in a Poor Agrarian Economy," *J of Polit Econ* 87:479-500.

Dasgupta, P. and D. Ray (1986). "Inequality as a Determinant of Malnutrition and Unemployment: Theory," *Econ Journ* 96: 1011-1034.

Streufert, P. and D. Ray (1990). "On the Perpetuation of Unemployment, Undernourishment and Inequitable Land Ownership in Dynamic General Equilibrium," *Economic Theory* 3:61-85.

Swamy, A. (1997). "A Simple Test of the Nutrition-based Efficiency Wage Model," *J of Dev Econ*.

B. Labor Extraction and Market Segmentation

Bowles, S. (1985). "The Production Process in Competitive Economies: Walrasian, Neo-Hobbesian and Marxian Models," *Amer Econ Rev* 75(1): 16-36.

Frisvold, G.B. (1994). "Does Supervision Matter? Some Hypothesis Tests using Indian Farm-Level Data," *J of Dev Econ* 43: 217-238.

Bardhan, P.K. (1983). "Labor-tying in a Poor Agrarian Economy: A Theoretical and Empirical Analysis," *QJE* 98 (August):501-14.

*Eswaran, M., and A. Kotwal (1985). "A Theory of Two-Tier Labor Markets in Agrarian Economies," *Amer Econ Rev* 75 (March):162-77.

*Anderson-Schaffner, J. (1995). "Attached Farm Labor, Limited Horizons and Servility," *J of Dev Econ* (August) 47(2): 241-270.

Hanchate, Amresh (2000). "Timeliness of Farming Operations as a Determinant of Equilibrium Wages with Excess Labor Supply: A Strategic Bargaining Approach," *Review of Development Economics* 4(1): 51-69.

Genicot, G. (2002). "Bonded Labor and Serfdom: A Paradox of Voluntary Choice," *J of Dev Econ* 67(1):101-128.

Stanley, Denise (2002). "Efficiency and Equity Tradeoffs: Incentive-compatible Contracts Revisited," *J of Dev Econ* 67(2):309-331.

Basu, A. (2002). "Persistence of Tied Labor Contracts," *Am J of Agri Econs* 84(2):438-453.

IV. ACCESS TO CAPITAL AND MULTIPLE MARKET FAILURES MODELS OF DIFFERENTIATION AND CLASS

[27 February – 29 March]

A. Theoretical Perspectives on Credit Rationing and Market Segmentation

Hoff, K. and J. E. Stiglitz (1993). "Imperfect Information and Rural Credit Markets: Puzzles and Policy Perspectives," in Hoff, Braverman and Stiglitz (eds.) *The*

Economics of Rural Organization: Theory, Practice, and Policy (Oxford University Press).

*Boucher, Stephen and M.R. Carter and C. Guirkingner (2005). "Risk Rationing and Wealth Effects in Credit Markets," working paper.

Jain, Sanjay (1999). "Symbiosis versus crowding out: the interaction of formal and informal credit markets in developing countries," *Journal of Development Economics* 59(2): 419-444.

*Bell, Clive and G. Clemenz (2006). "The Desire for Land: Strategic Lending with Adverse Selection," *Journal of Development Economics* 79(1):1-25.

Basu, K. (1983). "The Emergence of Isolation and Interlinkage in Rural Markets," *Oxford Econ Pap* 35:262-80.

Braverman, A., and J. Stiglitz (1982). "Sharecropping and the Interlinkage of Agrarian Markets," *Amer Econ Rev* 72:695-715.

B. Econometrics of Credit Markets

*Kochar, A. (1998). "An Empirical Investigation of Rationing Constraints in Rural Markets in India," *J of Dev Econ* 53(2): 339-372.

Mushinski, D. (1998). "An Analysis of Loan Offer Functions of Banks and Credit Unions," working paper, Department of Economics, Colorado State University.

Bell, C., T.N. Srinivasan and C. Udry (1997). "Rationing, Spillover and Interlinking in Credit Markets: The Case of Rural Punjab," *Oxford Econ Pap* 49: 557-585.

*Bannerjee, A. and E. Dufflo (2002). "Do Firms Want to Borrow More? Testing Credit Constraints using a Directed Credit Program," MIT Working Paper.

C. Micro-credit and Group Lending

*Karlan, D. (2002). "Social Capital and Group Banking," working paper, Princeton University.

Amin, S. A.S. Rai and G. Topa (2003). "Does Microcredit Reach the Poor and Vulnerable: Evidence from Northern Bangladesh," *J of Development Economics* 70:59-82.

Ghatak, M. (2000). "Screening by the Company You Keep: Joint Liability Lending and the Peer Selection Effect," *Econ Journal* 100:601-631.

Besley, T. and S. Coate (1995). "Group Lending, Repayment Incentives and Social Collateral," *J of Development Economics* 46:1-18.

*McIntosh, C. and B. Wydick (2005). "Competition and Microfinance," *Journal of Development Economics* 78: 271-298.

McIntosh, C., E. Sadoulet and A. de Janvry (2004). "How rising competition among microfinance institutions affects incumbent lenders," *Economic Journal* 115: 987-1004.

D. Multiple Market Failures Models of Asset Distribution, Productivity and Class

*Eswaran, M., and A. Kotwal, (1984). "Access to Capital and Agrarian Production Organization," *Econ Journ* 96:482-498.

Kevane, M. (1996). "Agrarian Structure and Agricultural Practice in Western Sudan," *Am J of Ag Econ* 78(1):236-245.

Carter, M.R. and F. Zimmerman (2000). "The Dynamic Cost and Persistence of Asset Inequality in an Agrarian Economy," *Journal of Development Economics*.

Mookherjee, Dilip and Debraj Ray (2000). "Contractual Structure and Wealth Accumulation," *American Economic Review* 92(4):818-49.

Ghattak, M. and N. Nien-Huei Jiang(2002). "A Simple Model of Inequality, Occupational Choice and Development," *Journal of Development Economics* 69:205-226.

V. RISK, SAVINGS AND ACCUMULATION **[3 – 24 April]**

A. Risk and Consumption Smoothing

Carter, M.R. (1997). "Technology, Environment and the Social Construction of Risk in West African Agriculture," *Econ Dev and Cult Change* 45(3).

*Deaton, A. (1991). "Savings and Liquidity Constraints," *Econometrica* 59(5):1221-1248.

B. Income Smoothing and Asset Smoothing

- *Zimmerman, F. and M. Carter (2003). “Dynamic Portfolio Management under Risk and Subsistence Constraints in Developing Countries” *J of Dev Econ*.
- *Rosenzweig, M. and H. Binswanger (1993). “Wealth, Weather Risk and the Composition and Profitability of Agricultural Investments,” *Economic Journal* (January).
- *Fafchamps, Marcel, Chris Udry and Katherine Czukas (1998). “Drought and saving in West Africa: are livestock a buffer stock?” *Journal of Development Economics* 55:273-305.
- *McPeak, John (2004). “Contrasting income shocks with asset shocks: livestock sales in northern Kenya,” *Oxford Economic Papers* 56: 263-284.
- *Hoddinott, John (2006). “Shocks and their consequences across and within households in rural Zimbabwe,” *Journal of Development Studies* 42(2): 301-321.

C. Asset Dynamics and Poverty Traps

- *Buera, Francisco (2005). “A Dynamic Model of Entrepreneurship with Borrowing Constraints,” working paper, Northwestern University.
- *Lybbert, T., C. Barrett, S. Desta and D.L. Coppock (2004). “Stochastic Wealth Dynamics and Risk Management among a Poor Population.” *Economic Journal*.
- *Adato, M., Carter, M. and J. May (2006). “Exploring Poverty Traps and Social Exclusion in South Africa using Quantitative and Qualitative Data,” *Journal of Development Studies* 42(2): 226-247.

VI. BEYOND THE ANONYMOUS MARKET: FAMILY, FRIENDS, NORMS AND SOCIAL CAPITAL

[26 April – 3 May]

A. Social Capital

- Durlauf, S. and M. Fafchamps (forthcoming). “Social Capital,” in *Handbook of Economic Growth*.

- Narayan, D. and L. Pritchard, (1999). "Cents and Sociability: Household Income and Social Capital in Rural Tanzania," *Econ Dev and Cult Change* 47(4): 871-898.
- *Maluccio, J., J. May and L. Haddad (2000). "Social Capital and Household Welfare in South Africa," *Journal of Development Studies*.
- Fafchamps, M. and B. Minten (forthcoming). "Returns to Social Network Capital among Traders," *Oxford Economics Papers*.
- Karlan, D. (2002). "Using Experimental Economics to Measure Social Capital and Predict Financial Decisions," Working Paper, Princeton University.
- Durlauf, S. (2001). "On the Empirics of Social Capital," *Economic Journal*..
- *Carter, Michael and Marco Castillo (2006). "An Experimental Approach to Social Capital in South Africa," working paper.

B. Social Identity and Social Capital

- *Mogues, T. and M.R. Carter (2004). "Social Capital and the Reproduction of Economic Inequality in Polarized Societies," *Journal of Economic Inequality* 3(1): 193-217.
- Oxoby, R.J. (2004). "Cognitive Dissonance, Status and Growth of the Underclass," *Economic Journal*, vol. 114, no. 498, October 2004, pp. 727-49
- Austen-Smith, and R. Fryer (2005). "An Economic Analysis of Acting White," *Quarterly Journal of Economics* 120(2):551-584.