ECONOMIC DEVELOPMENT AND THE DIVISION OF LABOR



with a foreword by Jeffrey D. Sachs



CONTENTS

_15€	OT FIE	ires	X111				
List	of Ta	les	xv				
Fore	eword	by Jeffrey D. Sachs	xvii				
Prei	ace		xxi				
1	Intro	duction	1				
	1.1 1.2	Classical Development Economics and Capitalist Economic Development The Breakdown of the First Global Capitalist System and Neoclassical	1				
		Development Economics	6				
	1.3	A Return to Classical Development Economics	10				
	1.4	The Scientific Approach to Development Economics	15				
	-	Terms and Review	19 19				
	Further Reading						
	-	tions	20				
	Note		31				
Pai	RT ! :	GEOGRAPHY AND MICROECONOMIC MECHANISMS FOR					
		ECONOMIC DEVELOPMENT	35				
2	Geo	graphy and Economic Development	37				
	2.1	Uneven Economic Development in Different Parts of the World	37				
	Que	tions to Ask Yourself when Reading this Chapter	41				
	2.2	Geography and Division of Labor	41				
	2.3	Empirical Linkages of Geography and Economic Development	44				
		2.3.1 Geographical correlates of economic development	44				
		2.3.2 Geography and levels of per capita income	47				
		2.3.3 Geography and growth of per capita income	48				
		2.3.4 Geographical effects on economic policy choices	52				
	Kev	Terms and Review	53				

	Further Reading	54
	Questions	. 54
	Notes	56
3	Driving Force I – Exogenous Comparative Advantage and	
	Trading Efficiency	57
	3.1 Use of the Concept of General Equilibrium to Figure Out	
	Mechanisms for Economic Development	57
	Questions to Ask Yourself when Reading this Chapter	61
	3.2 A Ricardian Model with Exogenous Comparative Technological	
	Advantage and Transaction Costs	61
	3.3 Analysis of Decisions versus Equilibrium Analysis of Development	67
	3.4 Per Capita Real Income, GDP, GNP, and PPP	74
	3.5 Economic Development and Trade Policy	76
	3.6 Comparative Endowment Advantage and Transaction Efficiency	83
	Key Terms and Review	90
	Further Reading	91 91
	Questions Exercises	95
	Exercises	93
4	Driving Force II – Endogenous Comparative Advantage and	
	Trading Efficiency	98
	4.1 Endogenous versus Exogenous Comparative Advantages	98
	Questions to Ask Yourself when Reading this Chapter	100
	4.2 Configurations and Corner Solutions in a Smithian Model	100
	4.3 How the Market Coordinates Division of Labor to Utilize	
	Network Effects and Promote Economic Development	109
	4.4 More Examples	116
	4.5 Pattern of Trade	121
	Key Terms and Review	123
	Further Reading	123
	Questions	124
	Exercises	128
5	Driving Force III – Economies of Scale and Trading Efficiency	131
	5.1 Economies of Scale and Economic Development	131
	Questions to Ask Yourself when Reading this Chapter	132
	5.2 General Equilibrium Models of Economic Development with	
	Trade-offs between Economies of Scale, Consumption Variety,	
	and Transaction Costs	132
	5.3 The Ethier Model with Transaction Costs	138
	5.4 The Murphy-Shleifer-Vishny (MSV) Model of Big-push	د د ډ
	Industrialization	144
	5.5 The Sachs and Yang Model with Economies of Scale, Endogenous	1.47
	Degree of Industrialization, and Transaction Costs	147 151
	Key Terms and Review Further Reading	151
	Questions	152
	Curottom	152

			Contents	vii
	Exerc			154
	Notes			156
6		istence of Endogenous and Exogenous Comparative Advantage: atterns of Development and Trade	s	157
		•		
		Underdevelopment and a Dual Structure with Underemployment		157
	-	ions to Ask Yourself when Reading this Chapter A Smithian Model with a Dual Structure in the Transitional Stage		158
		of Economic Development		159
		General Equilibrium and its Inframarginal Comparative Statics		162
		Trade Pattern in the Presence of Both Endogenous and Exogenous		
		Comparative Advantages, and the Relationship between Income		
		Distribution and Development		167
	6.5	Development Strategies and Trade Patterns		169
		6.5.1 A consumer's decision		170
		6.5.2 Possible trade structures		170
		6.5.3 Production of agricultural good z		171
		6.5.4 Production of final manufactured good y		171
		6.5.5 Production of intermediate goods		172
		6.5.6 Local equilibrium in structure A		172 173
		6.5.7 Local equilibrium in structure C 6.5.8 Local equilibrium in structure D		173
		6.5.9 Local equilibrium in structure E		176
		6.5.10 Local equilibrium in structure F		176
		General Equilibrium and Inframarginal Comparative Statics		177
		A Comparison with the Conventional Wisdom based on Models wit	h CRS	179
		Terms and Review		183
	Furth	ner Reading		184
	Quest			184
	Exerc			188
	Notes	3		192
7	Struc	tural Changes, Trade, and Economic Development		193
	7.1	Endogenous Trade Theory and an Endogenous Number of		
		Consumer Goods		193
	-	tions to Ask Yourself when Reading this Chapter		195
	7.2	A Model of Economic Development with Fixed Learning Costs		195
	7.3	How Are Demand and Supply Functions Determined by Individu	als'	100
	7.4	Levels of Specialization?		198
	7. 4 7.5	Inframarginal Comparative Statics of Optimum Decisions		201
	1.3	How is the Level of Division of Labor in Society Determined in the Market?		201
	7.6	Inframarginal Comparative Statics of General Equilibrium and Ma	nv	401
	, .0	Concurrent Development Phenomena	.i.y	204
	7.7	Emergence of International Trade from Domestic Trade		209
	7.8	Co-movement of Division of Labor and Consumption Variety		210
	7.9	The Emergence of Professional Middlemen and Trade Patterns		214
	7.10	The Trade-off between Economies of Specialization and		
		Coordination Costs		216

viii Conten	TC

	Furt	•	217 218 218 223 225
Par	т II:	THE INSTITUTION OF THE FIRM, ENDOGENOUS TRANSACTION COSTS, AND ECONOMIC DEVELOPMENT	227
8	Econ	omic Development, the Institution of the Firm, and Entrepreneurship	229
	8.1	What is the Institution of the Firm?	229
		what is the histitution of the Firm: tions to Ask Yourself when Reading this Chapter Why are Claims to Residual Rights of the Firm Essential for Nurturing	231
		Entrepreneurship? - The Story behind the Model	231
	8.3	The Emergence of the Firm from the Evolution of Division of Labor	233
		8.3.1 Economies of roundabout production	234
		8.3.2 The corner equilibria in four structures	235
	8.4	8.3.3 General equilibrium structure of transactions and residual rights The Distinction between ex ante and ex post Production Functions,	239
		and the Role of the Institution of the Firm in Economic Development	241
	8.5	The Coase Theorem and Other Theories of the Firm	242
		Terms and Review	245
		her Reading	245
	Exer	ctions	246 251
	Exci	CISES	231
9	End	ogenous Transaction Costs, Contracts, and Economic Development	254
	9.1	Endogenous Transaction Costs and Economic Development	254
	_	stions to Ask Yourself when Reading this Chapter	257
	9.2	Endogenous Transaction Costs Caused by Moral Hazard	257
	9.3	Game Models and Endogenous Transaction Costs	270
		9.3.1 Game models	270
		9.3.2 Nash equilibrium	270
		9.3.3 Subgame perfect equilibrium 9.3.4 Bayes equilibrium	272 274
		9.3.4 Bayes equilibrium 9.3.5 Sequential equilibrium	274
	9.4	The Role of Nash Bargaining Games in Reducing Endogenous	213
	7.1	Transaction Costs caused by Trade Conflict	278
	9.5	Endogenous Transaction Costs caused by Information Asymmetry	2,0
	, ,,	and Holding Up	281
		9.5.1 Economic development and endogenous transaction costs caused	
		by adverse selection	281
		9.5.2 An alternating-offer bargaining game in a model of endogenous	
		specialization	283
		9.5.3 Economic development and endogenous transaction costs caused	
		by holding up	285
		9.5.4 How can endogenous transaction costs be eliminated by	
	0.1	consideration of reputation?	287
	9.6	The Grossman-Hart-Moore Incomplete Contract Model	288

		CONTENTS	IX
	9.7 Noncredible Commitment and Soft Budget Constraint		291
	Key Terms and Review		293
	Further Reading		293
	Questions		294
	Exercises .		298
10	Transaction Risk, Property Rights, Insurance, and Economic Development		302
	10.1 Uncertainties in Transactions and the Economics of Property Right	te	302
	Questions to Ask Yourself when Reading this Chapter	.5	306
	10.2 Economic Development and the Trade-off between Economies of		300
	Division of Labor and Coordination Reliability		307
	10.3 Endogenization of Coordination Reliability in Each Transaction and	1	00,
	Substitution between Competition and Better Enforced Property R		310
	10.4 Why Can Insurance Promote Economic Development?	U	319
	10.5 Economic Development and Endogenous Transaction Costs Caused	đ	
	by Moral Hazard		324
	Key Terms and Review		331
	Further Reading		332
	Questions		332
	Exercises		336
PAR	RT III: URBANIZATION AND INDUSTRIALIZATION		339
11	Urbanization, Structural Duality between Urban and Rural Areas,		
	and Economic Development		341
	11.1 Why and How Cities Emerge from the Division of Labor		341
	Questions to Ask Yourself when Reading this Chapter .		343
	11.2 The Fujita-Krugman Model of Urbanization based on a Trade-off		
	between Economies of Scale and Transaction Costs		344
	11.3 Emergence of a Structural Duality of Urban and Rural Areas from		
	the Division of Labor		346
	11.4 Why Can the Geographical Concentration of Transactions Improve	ĉ	
	Transaction Efficiency?		349
	11.5 Simultaneous Endogenization of Level of Division of Labor,		
	Location Pattern of Residences, Geographical Pattern of Transaction	ons,	255
	and Land Prices		355
	Key Terms and Review		366
	Further Reading Questions		366 367
	Exercises		368
	Notes		369
	1000		307
12	Industrialization, Structural Changes, Economic Development,		
	and Division of Labor in Roundabout Production		370
	12.1 The Features of Industrialization		370
	Questions to Ask Yourself when Reading this Chapter		375
	12.2 Industrialization and the Evolution of Division of Labor in		
	Roundabout Production		375

X	CONTENTS

	12.3	Corner Equilibria and the Emergence of New Industry	377
	12.4	General Equilibrium, Industrialization, and Structural Changes	379
		12.4.1 Changes in the employment shares of the industrial and	
		agricultural sectors	381
		12.4.2 The number of possible structures of transactions increases more	
		than proportionally as division of labor evolves in roundabout	
		production	383
	12.5	Evolution in the Number of Producer Goods and Economic Developmen	t 386
		Terms and Review	391
		ner Reading	391
	Quest		391
	Exerc		396
	Notes		398
PΔR	т IV:	DYNAMIC MECHANISMS FOR ECONOMIC DEVELOPMENT	399
13		classical Models of Economic Growth	401
13	INCOL	lassical Models of Economic Growth	701
	13.1	Exogenous versus Endogenous Growth	401
	Ques	tions to Ask Yourself when Reading this Chapter	403
	13.2	The Ramsey and AK Models	403
	13.3	R&D-based Endogenous Growth Models	410
	Key '	Terms and Review	416
		ner Reading	416
	Ques		417
	Exerc		418
	Note	s · ·	420
14	Econ	omic Development Generated by Endogenous Evolution of	
		sion of Labor	421
	14.1	Economies of Specialized Learning by Doing and Endogenous	
		Evolution in Division of Labor	421
	Ques	tions to Ask Yourself when Reading this Chapter	423
	14.2	A Smith-Young Dynamic Model with Learning by Doing	424
	14.3	Optimum Speed of Learning by Doing and Evolution of	
		Endogenous Comparative Advantage	425
		14.3.1 The function of contracts	425
		14.3.2 An individual's dynamic decision problem	426
		14.3.3 Dynamic equilibrium	427
	14.4	Endogenous Evolution of the Extent of the Market, Trade	
		Dependence, Endogenous Comparative Advantages, and	
		Economic Structure	437
	14.5	Empirical Evidence and Rethinking Endogenous Growth Theory	438
		endix 14.1: The Relationship between the Control Theory and	
	F F	Calculus of Variations	444
	Kev	Terms and Review	445
	•	her Reading	445
		stions	446
		cises	447
	Note		448

_								
(O	N	T	F	N	т	ς	

хi

15		Experiments and the Evolution of Knowledge of	140
		elopment	449
	15.1	How Does Organizational Knowledge Acquired by Society	
	_	Determine Economic Development?	449
	_	tions to Ask Yourself when Reading this Chapter	453
	15.2	A Static Model with a Roundabout Production Chain of	
		Endogenous Length and an Endogenous Division of Labor	454
	15.3	Interactions between Dynamic Decisions and Evolution in	4-6
	15.4	Organizational Information	456
	15.4	Walrasian Sequential Equilibrium and Concurrent Evolution in	450
	12	Organizational Information and Division of Labor	459
		Terms and Review	468
		ner Reading	468
	Ques Exer		468
•	Exer	AISES	470
PA 16	RT V:	THE MACROECONOMICS OF DEVELOPMENT	473
. 16	Inve	stment, Saving, and Economic Development	475
	16.1	Classical Theory of Investment and Saving	475
Ġ.		stions to Ask Yourself when Reading this Chapter	478
Ň.	16.2	Neoclassical General Equilibrium Models of Self-saving and	
		Interpersonal Loans	478
Ė	16.3	The Smith-Young Theory of Investment and Savings	482
		16.3.1 The model	482
		16.3.2 Configuration and structure sequences	483
		16.3.3 Dynamic corner equilibria in 16 structure sequences	485
8	16.4	, 1	488
		16.4.1 Dynamic general equilibrium	489
Ā.		16.4.2 Nontopological properties of economic growth and the sudden	400
	•	decline of interest rates	492
: i,		16.4.3 An endogenous decision horizon and effect of liberalization	40.4
	12.	on opportunities for lucrative investment	494
		Terms and Review	495 495
		ther Reading	495 496
្ទីរប	= -	rcises	497
7 0	No.		497
.!.			
4	Ma Mc	ney, Division of Labor, and Economic Development	498
	₩ 17.		498
		estions to Ask Yourself when Reading this Chapter	501
	17.		701
		Economic Development	501
	1.17.	5 6	503
		y Terms and Review	509
		rther Reading	510
		estions ércises	510 511
		oreises	511
	TAY.	rear and a second secon	914

Index

18	Endogenous Business Cycles, Cyclical Unemployment, and					
	Endogenous Long-run Growth					
	18.1 Rethinking Macroeconomic Phenomena in Economic Development	513				
	Questions to Ask Yourself when Reading this Chapter	519				
	18.2 Long-run Regular Efficient Business Cycles, Cyclical Unemployment,					
	Long-run Economic Growth, and Division of Labor in Producing					
	Durable Goods ,	519				
	18.3 A Smithian Dynamic Equilibrium Model of Business Cycles,					
	Unemployment, and Economic Development	523				
	18.4 Cyclical and Noncyclical Corner Equilibria	525				
	18.4.1 Regime specification, configurations, and market structures	525				
	18.4.2 The dynamic corner equilibrium in autarky	526				
	18.4.3 Market structure C 18.4.4 Market structure P	527 529				
	18.4.5 Welfare and policy implications of the model	531				
	18.5 General Price Level, Business Cycles, and the Unemployment Rate	531				
	18.6 The Emergence of Firms and Fiat Money from the Division of Labor	534				
	Key Terms and Review	536				
	Further Reading	537				
	Questions	537				
	Exercises	539				
	Note	543				
19	Economic Transition	544				
	19.1 Understanding Economic Transition	544				
	Questions to Ask Yourself when Reading this Chapter	546				
	19.2 The Socialist System and Evolution in Division of Labor	547				
	19.3 Driving Mechanisms for Transition	555				
	19.4 Market-oriented Reforms Associated with the Transition of					
	Constitutional Rules	557				
	19.5 Market-oriented Reforms in the Absence of Constitutional Order	561				
	19.6 Trade-offs between Reliability and the Positive Network Effects					
	of Division of Labor, and between Incentive Provision and Stability	572				
	Key Terms and Review	577				
	Further Reading	578				
	Questions	578 500				
	Exercises	582				
	Notes	583				
D.	ferences	586				
ne.	TOTOTICES	300				

617