

## Sensorveiledning, econ1910 spring 2018

Consider a household whose income depends on its work capacity and where the work capacity depends on the income.

1. How would you explain the two relationships?
2. What is a poverty trap?
3. Discuss how the two relationships in (1.) has to be shaped in order to get a poverty trap.
4. Discuss how policies that directly increase income may affect the economic situation of the household.
5. How could free education, social insurance, and free health care affect the situation of the household?

The problem set is at the core of the course. Poverty traps based on productivity are covered in the lecture notes <http://folk.uio.no/hmehlum/1910s18/MMecon1910s18.pdf>. (section 10). A candidate that cover the issues addressed in that section has provided a good essay. Other supplementing arguments are also valuable.

1. in short: income depends on work capacity if you are self employed or if your employer pays higher wage to more productive workers. Work capacity depends on income due to nutrition and health. But also (in the longer run) education.

2. A person (country) is poor because she/it is poor. It often describes a situation where one equilibrium is good and the other bad. Then the process of going to the good equilibrium is a virtuous circle while going to the bad equilibrium is a vicious circle. It is important when describing such a process that stability is addressed. Stability depends on the exact dynamics assumed. It is never obvious. (That leads to q 3)

3. They have to be shaped as in the lecture notes. They need to cross twice with an unstable point that is better than the poverty trap.

4. The increase in income can be cash grant, pension, higher wage, lower tax etc etc. it increase income for all productivity levels and small changes in general give small effects but small changes may remove the poverty trap all together.

5 This question is a roundabout way of asking the same as above, but now for higher productivity for each level of income.

In 4 and 5 it is important to distinguish between what first happens to income/productivity and then what processes that are following as a result.

The questions goes to the core of the course and to the core of development economics. The technicalities should be within reach for all. If the candidate also are able to link the discussion to relevant policy debates it should give a good grade.

A good grade could also be given to innovative and creative analytical discussions.