QUESTION 1: A Ministers Speech

You have been asked by the minister in a developing country to comment on the following broad proposal made in a speech:

"Our country is climatically very divers and we will therefore divide all rural areas into specific agricultural zones. Within each of these zones, we will only allow one common agricultural product to be produced commercially. By specializing agricultural production into one common agricultural output within each zone we enhance both agricultural innovation, learning spillovers, and efficiency. As most land within each agricultural zone is owned by a few landlords, a land reform initiative only allowing share-cropping arrangements will be implemented. To facilitate this agricultural transition, local credit and insurance institutions are set up in each of the agricultural zones. Each of these local credit and insurance institutions will have expert knowledge about the specific crop grown in the zone where it is located. In order to reduce risk all of the formal credit and insurance institutions are made independent of each other. All these initiatives will in turn also reduce production risk and vulnerability among especially the poorest farmers."

The minister would like your advice (**no more than 2 normal pages**) regarding the above proposal. You should highlight what the minister has to be specifically aware off when designing the policies, and are there any analyses you would recommend before implementing such policies. If you have many suggestions, you should focus on the topics that you find most critical.

A very good answer would structure the speech into at least three broad areas that needs to be analysed more thoroughly. A very good answer will always refer to relevant references from the curriculum, when criticising the statements made in the speech. The three broad areas include:

1. Agricultural specialization
2. Land ownership and share cropping arrangements
3. Independent local credit and insurance institutions

The very good answer will remember to focus on the last statement in the speech "All these initiatives will in turn also reduce production risk and vulnerability among especially the poorest farmers" within all three broad areas.

Within the first category "agricultural specialization" it is important that the student link specialization to the inverse land-productivity relationship discussed in the curriculum (agriculture

lecture and AHM model). Moreover, the very good answer will also discuss the problems of specialisation for reducing production risk and vulnerability of poor landless farmers (remember that most land is owned by a few large landlords) also referred to in the curriculum (land lecture). In addition, the very good answer will also discuss the importance of creating non-ag jobs locally, as efficiency increases due to specialization. Surplus labour needs to be absorbed by other local initiatives (doing business lecture) or policies for facilitating better mobility for the vulnerable and poor needs to be set in place (jobs and migration lecture). Finally, the success of re-directing agricultural production within each agricultural zone to a potential new crop will depend on the homogeneity of the society in which the change is taking place. Diffusion of technologies will depend on this, and the student should discuss that the characteristics and diversity of each society in terms of ethnicity and religion will matter for the diffusion and innovation of the introducing a potential new technology to enhance efficiency (social networks lecture).

Similarly within the land ownership situation. In the speech, it is highlighted that land is currently owned by a few landlords and that they will force share-cropping arrangements. Here it is important that the student highlight under which conditions share cropping arrangements are superior to pure fixed rate contracts and formal wage contracts (land lecture). Moreover, the very good answer will also discuss innovation and investment probabilities in the context and situation where ownership remains on the hands of a relative few number of landlords. Basically, discussing the specifics of whether share-cropping arrangements can efficiently substitute for actual ownership of the land (will we ever have sufficient information such that the efficient sharing rule can be established?).

Finally, the third question is related to the credit and risk lectures and here the good answer will highlight that risk pooling will not be possible under the scheme suggested as farmers will face increased correlated risk due to the specialization. Moreover, the very good answer will also discuss whether an introduction of more formal insurance mechanisms will harm informal insurance mechanisms and again discuss that this will be dependent on the degree of homogeneity in the different societies and the level of remittances as share of total income (credit, risk and social network lectures). Finally, the excellent answer will discuss production versus income risk in the context of the increased specialization.