*Answer all questions. All sub-questions carry equal weight*

**I. Short questions (weight 1/3)**

1) Explain briefly why political favoritism is negative for economic performance. How can we go forth to detect the presence and extent of economic favoritism empirically?
   Covered in Fisman (2001) and Hodler and Raschky. Should have some theoretical considerations, e.g. allocation of resources to different areas inefficient. Should cover at least ne of the two empirical approaches, both mentioned for good grade.
2) What do Besley and Persson[1] (2009) mean by "state capacity" and why does it matter economically? Explain why rulers may choose to *not* invest in extending state capacity in some cases.
   Should explain basics of the model, state has fiscal and legal capacity which limits how high taxes, how strong contract can be enforced. If a group fears losing power, may not invest in fiscal capacity as it can be used to tax them heavily in the future.

**II. Long question: Culture and economic performance (weight 2/3)**

1) How is the concept "culture" defined in economics? Why do we believe it matters for economic performance?
   Be a precise as you can. Presenting a small model may be useful.
   Mostly covered in Tabellini, modelling arguments can draw on Greif as well. Main definition is through trust or playing cooperatively in games. Can set up simple trust game, good outcomes can be sustained in repeated setting but only if agents start cooperatively. Generally, this makes the economy smoother, makes more complicated market transactions possible.
   Could also mention Gorodnichenko and Roland's culture as individualism.
2) What are the empirical challenges in studying the effect of culture on economic performance? Explain how Algan and Cahuc[2] (2010) attempt to solve these challenges using data on US immigrants. Discuss the credibility of their approach.
   Reverse causality and omitted variables. Instruments not trivial (may mention instruments in Tabellini). A&C uses immigration to US to get measurement of trust level at two points in time, can use differences to estimate a FE type regression. Avoids omitted variables problems, some reverse causality problems (but not all).
3) Nunn and Wantchekon[3] (2011) argue that the slave trade reduced levels of trust in Africa. Explain this argument, and describe how they substantiate it empirically. Their Table 1 is reproduced below. Interpret the findings in the Table.
   They relate slave trade by ethic group*country to trust measured in Afrobarometer, find negative effect. Argue that fear of being sold as slave by neighbors reduces trust in neigbors, mis-trust survives multiple generations. Could also menation this is an explanation for negative

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[1] Besley, Timothy and Torsten Persson 2009. "The Origins of State Capacity: Property Rights, Taxation and Politics", *American Economic Review*, 99(4): 1218-44

[2] Algan, Yann, and Pierre Cahuc, 2010. "Inherited Trust and Growth", 2010. *American Economic Review*, 100(5): 2060-92.

[3] Nunn, Nathan, and Leonard Wantchekon, 2011. "The Slave Trade and the Origins of Mistrust in Africa." *American Economic Review*, 101(7): 3221-52.

economic effect on slave trade. Good answer should explain properly what the estiamtion in Tab 1 is, what numbers mean and mention how se calculated.

4) What is the difference between culture and institutions? Which of the two are most important for understanding economic performance?
   Culture is deeper in people's mindset, institutions working of government and other organizational features. Both found to matter, hard to disentangle which is most important as they are correlated. Gorodnichenko and Roland find that individualism stronger than institutions, but conclusion not very clear.