Development Economics

Slides 6

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Structural Transformation

- **A systematic shift of labor and output share** from one sector to another.
  - Economic growth is fundamentally uneven:

    Agriculture $\longrightarrow$ industry, manufacturing $\longrightarrow$ services, IT, AI …

    Recent examples: call centers, diagnostics, new monitoring and enforcement technologies, digital financial transactions, the rise of ClaudeCode …
  - Unbalanced growth $\longrightarrow$ compensatory process

    disequalization-equalization cycle
  - A focus on aggregate output downplays importance of such change.

Sources of Structural Transformation

I. Technology:

- In its broadest form, just meeting the same set of needs differently:
- communication, or information, or companionship, or exchange.
- E.g., travel: walking $\rightarrow$ bullock cart $\rightarrow$ bicycle $\rightarrow$ car.
- Technological revolutions:
- the steam engine, electricity, the telegraph, the computer, AI ...

Sources of Structural Transformation

II. Shifting patterns of trade:

- Could be high-tech, intermediate, or an expansion of something traditional.

  garments, machine tools, software, chips

  even food

  service-based items (call centers, diagnostics, typesetting, financial products).
- E.g., liberalization:

  moves resources from traditional sector to an export-oriented sector.

Sources of Structural Transformation

III. Human preferences:

- Homothetic and non-homothetic preferences.
  - Homothetic: demand for good x (relative to income y) does not change with y at fixed prices.
  - Non-homothetic: as $y \uparrow$, some goods become relatively more important:

    - E.g., first food, then clothing, then shelter, then other manufactured goods …

    - a bicycle, a car, a TV, a computer, a washing machine or a music system …

    - services: financial transactions, travel by train or air, eating out …
  - Economic development: **sectoral changes that mirror these natural shifts**.

Sources of Structural Transformation

IV. Institutions:

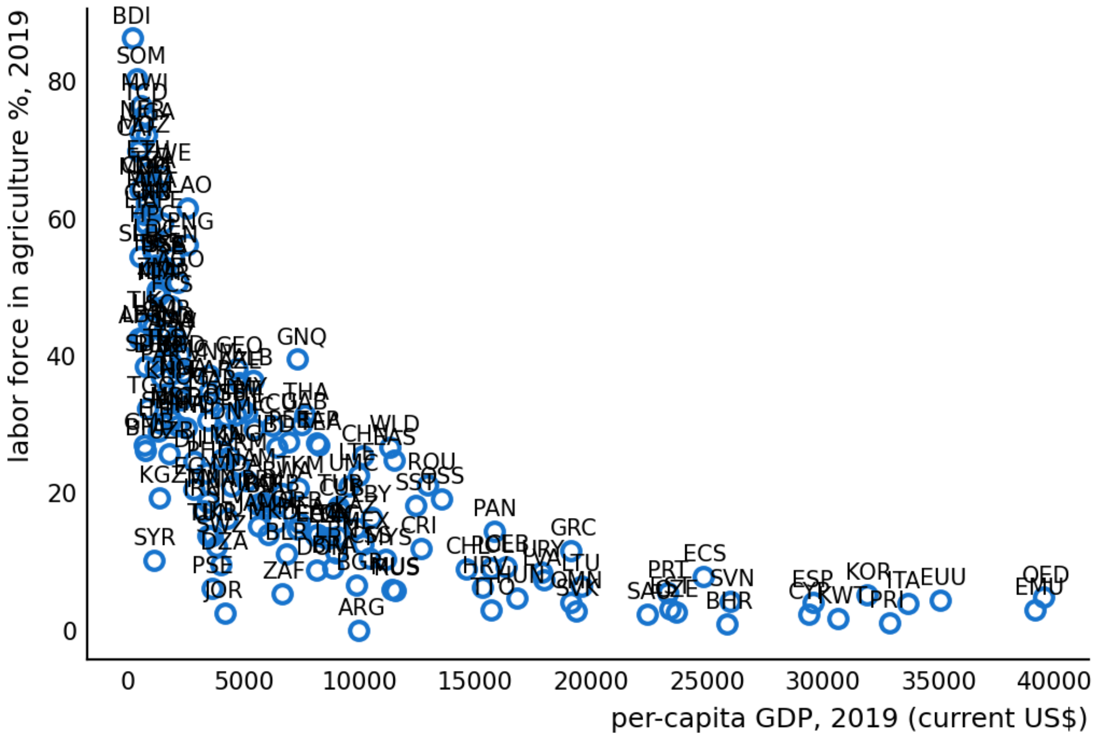
- "Formal" and "Informal" sectors.
- Formal: institutional umbrella of rules and regulations
- Access to benefits that their informal counterparts lack

  e.g., infrastructural facilities to foreign exchange quotas to bank credit.
- Informal: a mix of (usually small-scale) businesses or individuals:
- they escape the cover of many of these regulations, but
- they do not receive access to privileged facilities.

- With $\uparrow$ development and $\uparrow$ government capacity, **informal $\rightarrow$ formal transition**.

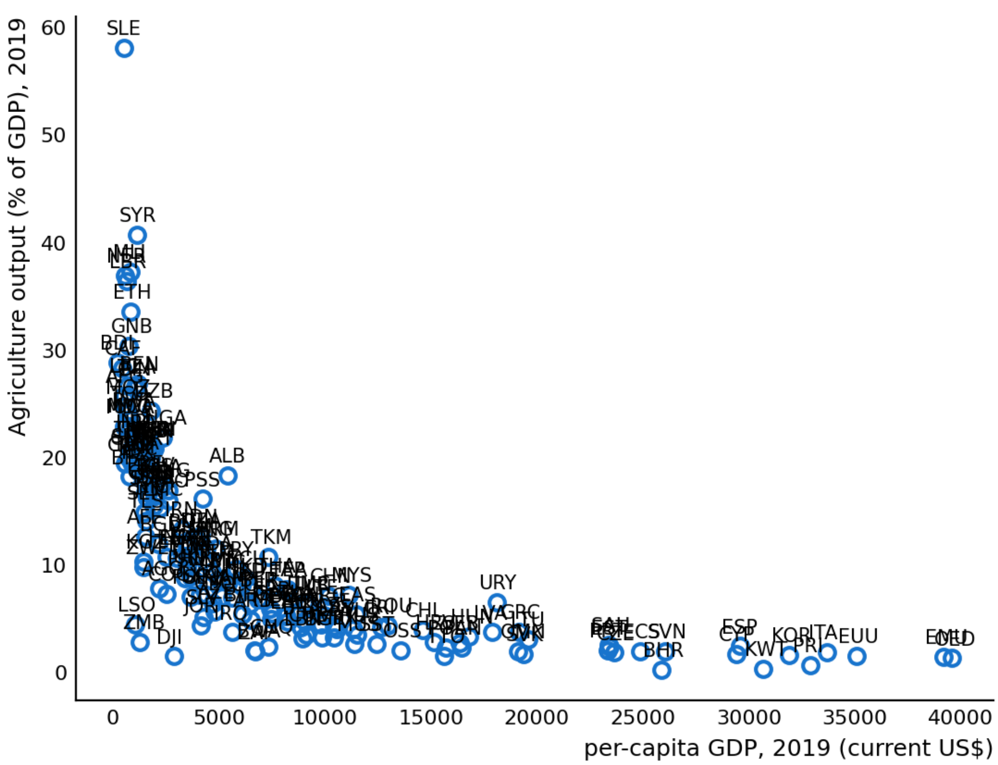
The Agriculture-Industry Transformation

- Labor share in agriculture:



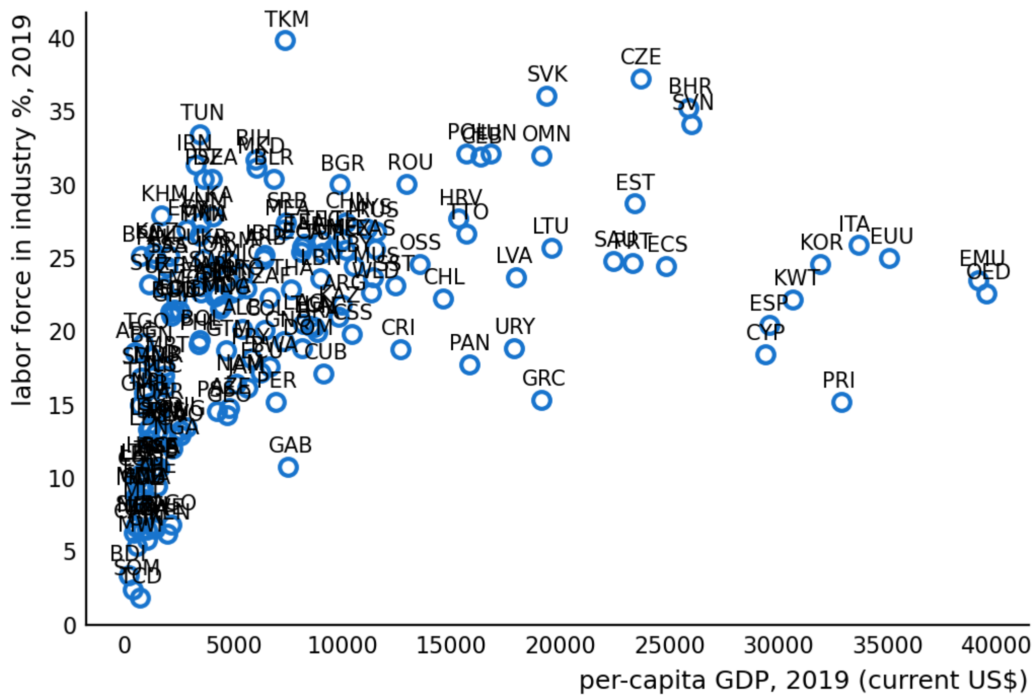
The Agriculture-Industry Transformation

- Output share in agriculture:



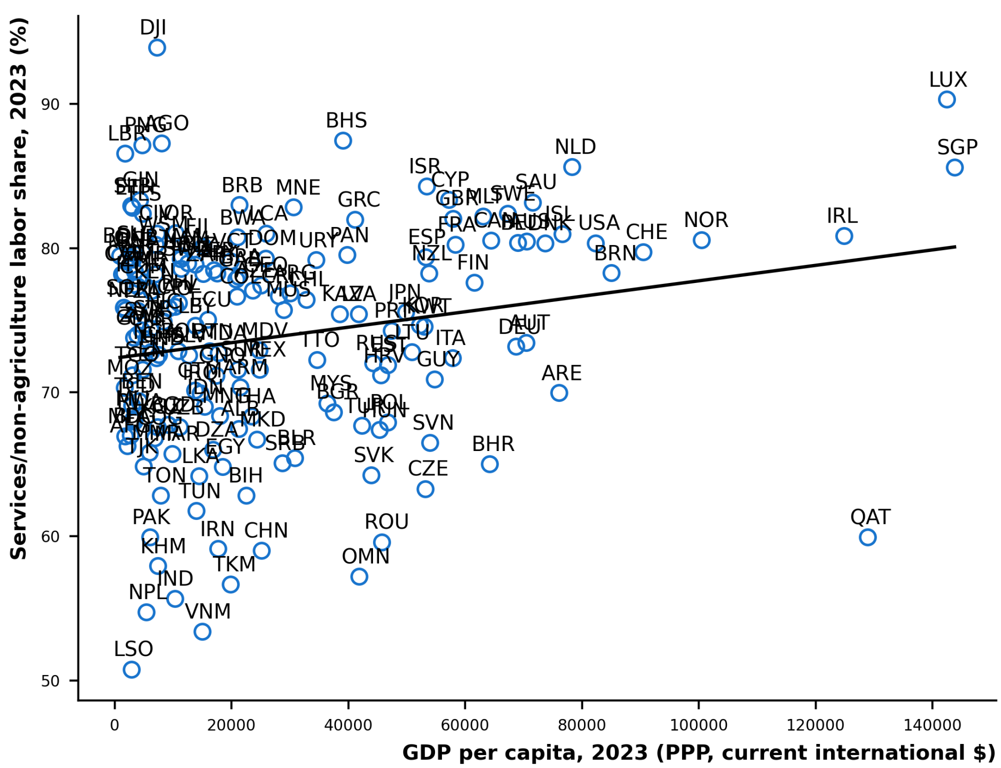
The Agriculture-Industry Transformation

- Labor share in industry:



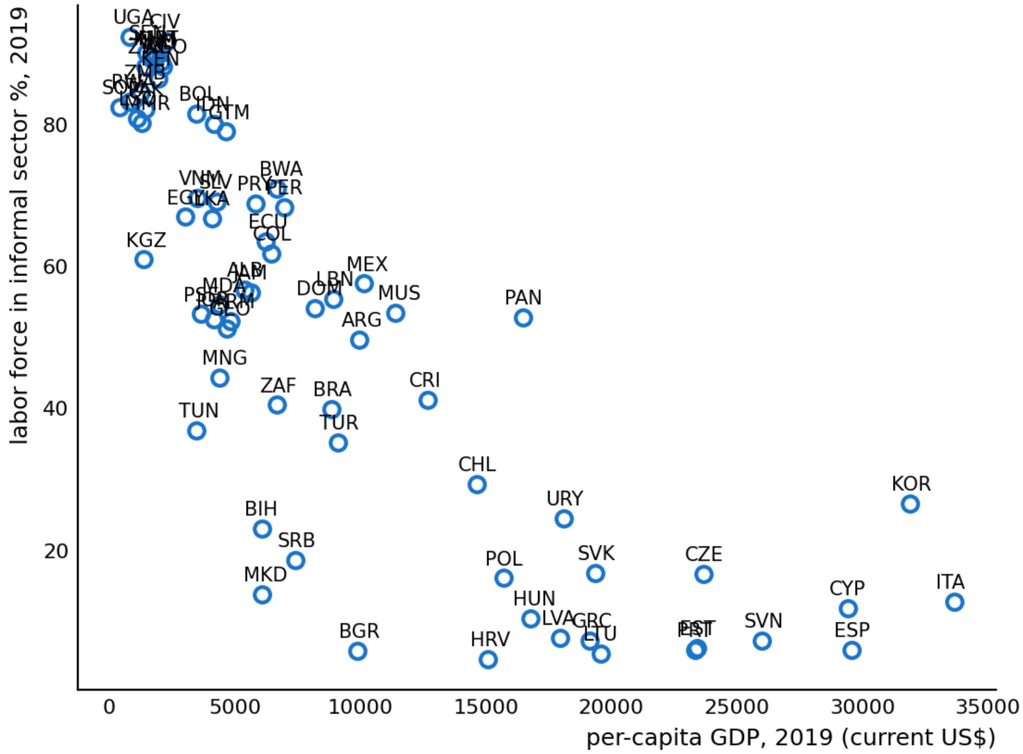
The Industry-Services Transformation

- Labor share in services as a fraction of *non-agricultural employment*:



The Informal-Formal Transformation

- Labor share in the informal sector:



Some Remarks

1. The agrarian transformation happened/is happening in almost every country.

- Countries like India still dominantly agrarian.
- Countries like Singapore or regions like Hong Kong never were.

2. The twin flows:

- Labor
- Agrarian surplus
- These need to match in a closed economy, though not in an open economy.

3. Services:

- The industry-services transformation is muddled by the parallel informal-formal transition.