Development Economics

Slides 6–8 Summary

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Summary of Slides 6–8

- **Structural transformation**
  - Main perspective: development rarely balanced across sectors;
  - It generates unevenness, as labor reallocates across sectors.
- Much of the analysis works for any two sectors:
  - agriculture to manufacturing, manufacturing to services, human computation to the IT and digital era, white-collar employment to the rise of AI-based alternatives, manual labor to robotics …
  - we called them **archaic** (a) and **modern** (m).

Summary of Slides 6–8

- But the most important historical transformation gets special treatment:
  - From an **agrarian to an industrial economy**.
  - **Minimum supply of basic goods for work subsistence** needed.
  - Of crucial importance in the closed economy.
  - Relatedly, **non-homothetic preferences** play a special role and impart specific directionality to the transformation.
  - **Dysfunctional structural transformations**: too few employment opportunities in the modern sector might lead to an informal sector based on services.

Summary of Slides 6–8

- We discussed **different frameworks** circling these central issues.
  - **Lewis model:** "economic development with unlimited supplies of labor."
  - Sustained move of labor from archaic to modern sector.
  - Ongoing m-sector capital accumulation provides the fuel for those moves.
  - Under this view, industrial development can proceed without impediment as long as savings rates and modern capital accumulation are high, at least until the surplus-labor phase comes to an end.

Summary of Slides 6–8

- But the Lewis model is **inadequate on two counts**.
  - **First**, it presumes perfect exchangeability of archaic and modern labor.
  - So in surplus labor phase, infinitely elastic labor supply to the modern sector.
- This presumption is discarded in the **Kuznets model**:
  - skill sets are different across the two sectors
  - even in the surplus labor phase, the modern wage initially jumps up
  - The resulting wage differential dies out slowly as individuals acquire human capital.
- Uneven and compensatory phases.

Summary of Slides 6–8

- **Second**, the Lewis model de-emphasizes work subsistence — basic needs for productive employment — over and above survival subsistence.
  - The **Kalecki-Rao constraint**.
  - Particularly salient in a closed economy.
- The constraint illustrates **a fundamental tension**:
  - Industrialists like low food prices because that ensures a low wage bill.
  - But that disincentivizes agriculture and can strangle industrial development in the longer run.
  - Associated policy questions.

Summary of Slides 6–8

- The growth of an informal sector could be a dysfunctional consequence of labor migrations to a formal sector with inadequate job opportunities.
  - **Harris-Todaro model**
  - Migration choices form a “lottery equilibrium.”
- **Policies:**
  - Paradox of job creation
  - Migration restrictions
  - Wage subsidies
  - Combinations