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STRUCTURAL TRANSFORMATION AND INCOME INEQUALITY, REVISITED

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Abstract

This study analyzes the mechanism of structural transformation, defined as the reallocation of economic activity from high-productivity tradable sectors (agriculture and manufacturing) to low-productivity service sectors, and its implications for changes in the overall distribution of income within an economy. The focus is on the observed fact of development that the service sector's employment share tends to increase at a faster rate than does the sector's value-added share. An empirical analysis indicates that the different rates of changes in employment and value-added shares account for a stagnant increase in per capita income in the service sector, resulting in interpersonal income inequality as economic development progresses and the service sector's share increases. Next, we present a simple static model to analyze the difference between employment and value-added shares and determine that the change in the relative capital intensity of the tradable sector versus that of the service sector is a key factor in causing the difference.

Keywords: Structural transformation; income distribution; value-added and employment shares of services; capital intensity

JEL Classification: C23; D31; O14; O15; O41

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