GPiD Global Poverty & Inequality Dynamics Research Network

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Researching structural change & inclusive growth

GPID Briefing Paper 2

WHAT IS STRUCTURAL TRANSFORMATION?

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SUMMARY

This brief discusses the concept of 'structural transformation'. In doing so questions arise of what is meant by structural transformation and the possibility of transitions beyond that of the structural transformation from a 'traditional' or agriculture or rural society to a 'modern', manufacturing or urban society.

It is argued that common approaches to defining structural transformation have generated understandings based largely on sectoral shares of GDP and employment. Yet, the broader set of structures related to factors of production, the composition of growth, labour productivity, and international trade are as important to garner a deeper understanding of structural transformation.

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About the GPID research network:

The ESRC Global Poverty and Inequality Dynamics (GPID) research network is an international network of academics, civil society organisations, and policymakers. It was launched in 2017 and is funded by the ESRC's Global Challenges Research Fund.

The objective of the ESRC GPID Research Network is to build a new research programme that focuses on the relationship between structural change and inclusive growth.

See: www.gpidnetwork.org

THE DEVELOPER'S DILEMMA

The ESRC Global Poverty and Inequality Dynamics (GPID) research network is concerned with what we have called 'the developer's dilemma'.

This dilemma is a trade-off between two objectives that developing countries are pursuing. Specifically:

1. Economic development via structural transformation and productivity growth based on the intra- and inter-sectoral reallocation of economic activity.
2. Inclusive growth which is typically defined as broad-based economic growth benefiting the poorer in society in particular.

Structural transformation, the former has been thought to push up inequality. Whereas the latter, inclusive growth implies a need for steady or even falling inequality to spread the benefits of growth widely. The 'developer's dilemma' is thus a distribution tension at the heart of economic development.

What is structural transformation and why does it matter?

Structural transformation (ST)—in the first instance meaning the reallocation of economic activity not only between, but also within, 'sectors' towards higher productivity activities—has been neglected with reference to developing countries.

Although the importance of the shift to higher productivity is not disputed in neoclassical economics, a one-sector model of economic growth has become standard in macroeconomics (Herrendorf et al. 2013). In this one-sector model of economic growth one abstracts, meaning does not take account of, the process of inter-sectoral reallocation of economic activity or structural transformation. This is because in the neoclassical growth model (of Solow 1956) growth is driven by incentives to save, accumulate physical and human capital, and innovate.

However, ST in itself can be an important driver of growth because of often dramatically differing productivity levels between and even within sectors. McMillan and Rodrik (2011, 1), taking sectoral and aggregate labour productivity data, empirically show that the transfer of labour and other inputs to more productive activity is a driver of economic development as Arthur Lewis (1954) originally hypothesized. They note:

> *The countries that manage to pull out of poverty and get richer are those that are able to diversify away from agriculture and other traditional products. As labour and other resources move from agriculture into modern economic activities, overall productivity rises and incomes expand. The speed with which this structural transformation takes place is the key factor that differentiates successful countries from unsuccessful ones.*

However, as McMillan and Rodrik note, ST can be *growth-enhancing* or *growth-reducing* depending on the reallocation of labour. They show how ST had been growth-enhancing in Asia because labour has transferred from low to higher productivity sectors. However, the converse is the case for sub-Saharan Africa and Latin America because labour has been transferred from higher to lower productivity sectors.

Types of structural transformation

Arthur Lewis (1954) provided one of the best-known and most optimistic models of economic development through structural transformation. The model, although sixty years old in its earliest iteration, remains relevant today to developing countries (see for discussion, Gollin 2014).

Lewis argued that the driver of economic development was a movement of the factor of production abundant in developing countries, labour, which transfers from the 'traditional' or 'non-capitalist' sector (of low productivity, low wage, and widespread disguised unemployment) to the 'modern' or 'capitalist' sector (of higher productivity and higher wages).

Lewis focused on a two-sector economy model and the transfer from the traditional to the modern sector. He did not intend traditional to be synonymous with agriculture nor modern to be synonymous with manufacturing although for simplicity this is often how the model has been used.

This raises the question of the definitional scope of structural transformation or structural change of what, between what and in what direction.

In terms of the ‘what’ Seers (1963, 81–3) again writing some time ago identified the following list to demonstrate how one might differentiate developed nations from developing nations: *by factors of production* (e.g. a literate and mobile labour force who are mostly in employment; substantial quantities of skilled labours); *by sectors of the economy* (e.g. manufacturing diversified and much larger than either agriculture or mining); *by public finance* (e.g. reliance on direct taxes; outlays on social security); *by foreign trade* (e.g. exports that have a large internal market and are sold to many countries with high price and income elasticities); *by household consumption* (e.g. very few people below subsistence level and a moderately equal distribution of income post-tax); *by savings and investment* (e.g. well-developed financial intermediaries; high investment) and *by ‘dynamic influences’* (no chronic tendency to deficits; slow population growth and high urbanization).

Contemporary structural transformation

A contemporary concept of ST has three discernible aspects. These are: sectoral, factoral, and integrative.

The first, the sectoral aspects of structural transformation, is about the inter- and intra-reallocation of sectoral activity towards higher productivity. This includes the traditional measures of structural transformation, notably shares of GDP and employment.

The second, the factoral aspects of structural transformation, is about the composition or drivers of economic growth in terms of factors of production and productivity. Underlying this are questions of demography.

Third, there is integrative aspect to structural transformation. This relates to the characteristics of global integration in terms of trade and investment patterns.

This brief is based on Sumner (2017).

References

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