LEWIS MODEL

→ a theoretical framework that describes development/growth in a very simplified economic setting. Here, Development is essentially characterized by structural transformation – i.e. resources (which is labor) moves out of the "traditional Sector" to fuel the growth of a "modern sector".

THE PREMISE OF THE MODEL

DUAL ECONOMY

Traditional / Agricultural Sector

- ✓ supplier of labor
- ✓ large surplus of labor that can be removed at little or no potential cost.
  - ↳ this situation is termed "Surplus labor".

Labor

Modern / Industrial Sector.

- ✓ Soak up the supply of labor from traditional sector.
- ✓ not all the surplus labor are soaked up at one go, because it is limited by the supply of capital. Hence, Capital Accumulation.

contd.

Traditional

Why Surplus labor exist?

↳ it's the fallout of the nature of economic organization that prevail in the traditional sector. [Under normal state of affairs in a capitalist organisation, this situation cannot persist where one is paid a positive wage for a zero marginal product of labor].

↳ Typically, traditional forms of organization are characterized by income sharing, (or payment according to average product), and this allows family farms to pay positive "wages" even when the marginal product of labor is close to zero.

Modern

becomes the engine of development.

✓ More Capital → labor dd↑
↓
rural-urban migration ↑

✓ As development ↑
↓
TOT gradually turn against industry
↓
food prices will rise
⇓
pushes the industrial wage up
↓
So, the pace of development is driven by accumulation of capital, but is limited by the ability of the economy to produce a surplus of food.

Mechanism of the model :

~~Phase 1:~~ Now, we will integrate the traditional and modern sectors into one interactive model and analyse how it works out. The model will be classified into three phases:

1. Surplus - labor Phase / "Unlimited Supply of labor" phase.
2. Disguised Unemployment Phase.
3. Commercialization Phase.

[• "Supply Curve" of labor is represented by the minimum cost of hiring].

Phase I [Surplus - labor Phase].

✓ Unlimited Supply of labor → movement of labor doesn't push the output level down as the marginal product of labor is almost 0 in this phase.

✓ Wage in agriculture sector does not rise.

↓

Industry can hire all the transferred labor at a constant wage rate or simply put it, supply curve of labor is flat at a constant wage w^* in this phase.

Phase ii: [Disguised Unemployment Phase].

- ✓ Disguised Unemployment [where the marginal product of labor is positive, but less than the existing wage rate].
- ✓ Agricultural output will start to fall as labor migrates to the modern sector. So, food prices will rise → industrial wage will also go up. So, Supply Curve of labor will start to slope upward.

Phase iii: [Commercialization of Agriculture].

→ Marginal Product of labor begins to exceed the traditionally given wage rate.

↓

profitable to ~~bid~~ actively bid for labor.

↓

Wage in agriculture sector will rise.

↓

Now, the industry should not only compensate for a movement of terms of trade against industry, but it must now compensate workers for a higher income foregone in the agricultural sector.

Bottomline:

Development proceeds via the joint transfer of labor and agricultural surplus from the "traditional" agricultural sector to the "modern" industrial sector. ~~The ability~~ The diagrams below give a pictorial representation of The Lewis - Ranis - fei Model.