

the new industrial sector. Thereafter, additional workers can be withdrawn from the agricultural sector only at a higher cost of lost food production because the declining labor-to-land ratio means that the marginal product of rural labor is no longer zero. Thus the labor supply curve becomes positively sloped as modern-sector wages and employment continue to grow. The structural transformation of the economy will have taken place, with the balance of economic activity shifting from traditional rural agriculture to modern urban industry.

Criticisms of the Lewis Model

Although the Lewis two-sector development model is simple and roughly reflects the historical experience of economic growth in the West, four of its key assumptions do not fit the institutional and economic realities of most contemporary developing countries.

First, the model implicitly assumes that the rate of labor transfer and employment creation in the modern sector is proportional to the rate of modern-sector capital accumulation. The faster the rate of capital accumulation, the higher the growth rate of the modern sector and the faster the rate of new job creation. But what if capitalist profits are reinvested in more sophisticated laborsaving capital equipment rather than just duplicating the existing capital as is implicitly assumed in the Lewis model? (We are, of course, here accepting the debatable assumption that capitalist profits are in fact reinvested in the local economy and not sent abroad as a form of "capital flight" to be added to the deposits of Western banks.) Figure 4.2 reproduces the lower, modern-sector diagram of Figure 4.1a, only this time the labor demand curves do not shift uniformly outward but in fact cross. Demand curve $D_2(K_{M2})$ has a greater negative slope than $D_2(K_M)$ to reflect the fact that additions to the capital stock embody laborsaving technical progress—that is, K_{M2} technology requires much less labor per unit of output than K_M technology does.

We see that even though total output has grown substantially (i.e., OD_2EL_V is significantly greater than OD_1LJ), total wages (OW_MEL_V) and employment (L_V) remain unchanged. All of the extra output accrues to capitalists in the form of profits. Figure 4.2 therefore provides an illustration of what some might call "antidevelopmental" economic growth—the extra income and output growth are distributed to the few owners of capital, while income and employment levels for the masses of workers remain largely unchanged. Although total GNP would rise, there would be little or no improvement in aggregate social welfare measured, say, in terms of more widely distributed gains in income and employment.

The second questionable assumption of the Lewis model is the notion that surplus labor exists in rural areas while there is full employment in the urban areas.