Lewis Model

- Firm is competitive: MPL = w
- Population is either in urban or in rural areas
- Wu > Wr
- People move from rural to urban
- Rural wages don't increase – underemployment/disguised unemployment
- Until they do because enough people have moved to the urban sector – Lewis turning point
- Ultimately, Wr = Wu
- What can you about inequality across sectors?
- Criticisms:
    - Frictionless process of transition from the rural to the urban sector
    - No unemployment in urban sector
    - Does the demand for agricultural produce increase with higher average wages?

Neoclassical Model

- Both rural and urban sectors are profit maximizing – MPLr = Wr & MPLu = Wu
- Mean income is maximized at the equilibrium
- Can this model explain the existence of unemployment?

Harris Todaro Model

- Urban wage is fixed. (WHY??)
- Wr = Expected urban wage
- Expected urban wage = prob_unemp(W_unemp) + prob_emp(W_emp)
- Do we have inequality in the equilibrium?
- What would happen if the government institutes a mandated wage increase?

Kuznet's Hypothesis

- Originally for across countries: as countries develop, within country inequality first increases, and then falls; one can tolerate some inequality in exchange for growth
- Between sectors:
    - Starting with all the population in the rural sector, when the first worker moves to the urban sector, inequality must increase
    - When the last rural worker leaves, there will be two opposing effects on overall inequality:
        - The <u>between-sector effect</u> is inequality decreasing, as the last (poorer) rural resident becomes urban.
        - But the <u>within-sector effect</u> is inequality increasing (since urban sector has higher inequality).
    - Kuznets assumed that the first component dominates, so inequality falls when the last person leave rural areas
    - If inequality is sufficiently high in the urban sector then there will be no turning point: inequality will continue to rise as development proceeds