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Dual Economy

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## **Dual Economy**

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Dual economy models arose as a reaction against single sector models. A half-century ago, theoretical modeling of economic growth was dominated by single sector models such as that of Nobel Prize winner Robert Solow. Other analysts, though, felt that economies would better be characterized as having multiple sectors, which they stylized into dual economy models. Foremost among the early dual economy modelers were two other Nobel Prize winners, W. Arthur Lewis and Simon Kuznets. The dual economy models posited a relatively advanced sector and a relatively backward sector. These have alternatively been called capitalist and subsistence, formal and informal, modern and traditional, industry and agriculture, urban and rural, primary and secondary, and good-jobs and bad-jobs.

For both Lewis and Kuznets, the two sectors differed in terms of the goods produced, the nature of the growth process, and conditions in labor markets. Lewis specified a capitalist sector producing industrial goods and a subsistence sector producing agricultural goods, services, and commercial activities. Kuznets distinguished an agricultural sector from all others, primarily industry. For Lewis, capital accumulation took place in the capitalist sector only, and so this sector was the engine of growth. For Kuznets, the essence of modern economic growth was the gradual shift of production from lower-income to higher-income sectors. For both, the advanced sector offered higher real wages to those who worked there than the backward sector did.

This co-existence of high wage and low wage sectors is the defining feature of labor market dualism, the generalization of which is labor market segmentation. Besides real

wages being higher in the good jobs, dualism and segmentation require that access to the good-job segments be restricted in the sense that not all who want to work in those segments are able to. As summarized by Michael Wachter, the dual labor market model advances four hypotheses:

First, it is useful to dichotomize the economy into a primary and a secondary sector. Second, the wage and employment mechanisms in the secondary sector are distinct from those in the primary sector. Third, economic mobility between these two sectors is sharply limited, and hence workers in the secondary sector are essentially trapped there. Finally, the secondary sector is marked by pervasive underemployment because workers who could be trained for skilled jobs at no more than the usual cost are confined to unskilled jobs.

Some of the subsequent writings on labor market dualism took on board human capital theory, as developed in the Nobel Prize-winning work of T.W. Schultz and Gary Becker and also in the work of Jacob Mincer. Human capital theory maintains that workers with more education and training have higher skills, which the labor market rewards. Thus, it is not enough for labor market dualism that workers in some sectors earn systematically more than another; it must be that workers with the same skills do better in one sector than in another. Ample research has demonstrated empirical evidence that wages are systematically higher for observationally equivalent workers in some economic sectors than in others. Many observers take this as evidence of labor market dualism, though some dismiss it as merely indicating the existence of unmeasured skills and abilities.

The works reviewed thus far have in common that all available workers are employed either in the advanced sector or in the backward sector; unemployment is absent. Later

models such as that of John Harris and Michael Todaro specified two types of employment (industrial and agricultural) plus unemployment.

One feature that could not be ignored was the duality within the urban economy, some jobs being desirable and others quite miserable. This observation led me to develop a model with three types of employment - an urban formal sector, an urban informal sector, and a rural agricultural sector – plus unemployment.

More recently, one more need has become apparent. This is to give due recognition to the fundamental duality to be found within the informal sector. On the one hand, the informal sector has free-entry activities such as street-vending and small scale services that enable those who do such work to eke out a meager existence, which they do because it is better for them than being unemployed. On the other hand, the informal sector also has restricted entry activities that people who could be working formally choose to take up instead. Some current segmented labor market models include both the “free entry” part of the informal sector and the “upper tier” of the informal sector.

Today, dual economy and multi-sector models dominate both academic research and applied policy work. Analysts routinely utilize models with many economic sectors and many labor market states. The sectors at minimum include industry and agriculture; other sectors, such as commerce and services, may also play a role. As for the labor market, workers might be employed (be it in wage employment or self-employment) in one of four sectors: the formal sector, the free entry part of the urban informal sector, the upper tier of the urban informal sector, and rural agriculture. They might also be unemployed. Models assuming that the economy has only a single sector or that all employed workers earn the same amount seem hopelessly unrealistic today.



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