Migration and the wage and unemployment gaps between urban and non-urban sectors: A dynamic general equilibrium reinterpretation of the Harris–Todaro equilibrium

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Abstract

This paper offers a dynamic general equilibrium reinterpretation of the static partial migration equilibrium by Harris and Todaro [Harris, J., Todaro, M., 1970. Migration, unemployment and development; a two-sector analysis. American Economic Review 60, 126–142], under (i) flexible urban and rural wages and (ii) free mobility of workers and free entry of firms. The proposed model accounts for the set of stylized facts in developing countries: rural to urban migration and higher urban wages and unemployment.

The model allows us to view the wage gap as a compensating differential for the negative amenities associated with job destruction and subsequent costly search on the consumption side, which can also be seen as a match-specific premium based on a sectoral productivity differential on the production side. Our model predicts the comovements among urban and non-urban wages and migration flows to the urban sector, an empirical regularity observed over the urbanization process of developing economies. Finally, we also conduct a welfare analysis.

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1. Introduction

Three salient stylized facts that characterize the economic development process are: (i) workers migrate from the rural to the urban sector, (ii) wages in the urban sector exceed those in the rural sector, and (iii) urban unemployment exceeds that in the rural sector. While these phenomena are common across developing economies, it has been difficult to obtain a cogent theoretical explanation. The early seminal papers by Harris and Todaro (1970) (henceforth, HT) and Todaro (1969) took some important strides toward providing an explanation. In its simplest form, HT’s model postulates that migration proceeds in response to differences in urban and rural “expected” wages, and the HT equilibrium holds when the expected wages are equalized. Nevertheless, a caveat to their approach is that migration is considered in a partial equilibrium setting with urban wages given exogenously. Moreover, the equilibrium is defined based on ex ante expected value calculations. But given the differences in job-finding and -destruction rates in the usual job-matching process entailing costly and time-consuming search, such ex ante HT migration decisions are not supported by the ex post decisions in a dynamic general equilibrium setting. This point therefore implies that migratory flows in the traditional HT models are not an ongoing equilibrium phenomenon.

While many important studies have extended or improved the HT migration equilibrium (see the literature survey in footnote 4), what separates this study from previous studies lies in the following three points. First, this paper builds a dynamic general equilibrium model of migratory flows that is consistent with the set of stylized facts. The proposed model provides a coherent framework that permits: (i) both urban and rural wages to be fully flexible, (ii) both labor mobility and firm entry to be free across
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