Productive Consumption Externality in a Two-Sector Model of Economic Development

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Abstract

In low income countries, labor productivity depends crucially on a per capita consumption level that contributes to good nutrition, health and/or education. A higher level of per capita consumption improves each worker's labor productivity. The concept of productive consumption was first introduced into the growth model by Steger (2000a). In this paper, we assume that the average consumption in a society has a positive externality in production and show that the indeterminacy of equilibrium can occur in a two-sector model even without the externality of capital input. This finding explains the growth of developing countries with little or no capital externality and the diversity in the growth rates of per capita real income along the transitional paths of low income developing economies. Each country can choose a different path from an infinite number of equilibrium paths converging to the indeterminate steady state.

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