RELATIVE PRICES AND SECTORAL PRODUCTIVITY

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Abstract
The relative price of services rises with development. A standard interpretation of this fact is that productivity differences across countries are larger in manufacturing than in services. The service sector comprises heterogeneous categories and we document that many disaggregated service categories feature a negative income elasticity of relative prices. We divide service industries into two broad categories based on the income gradient of its relative price: traditional services with positive income elasticities and non-traditional services with negative income elasticities of relative prices. Using an otherwise standard multi-sector development accounting framework extended to include an input-output structure, we find that the cross-country income elasticity of sectoral productivity is large in non-traditional services (1.15), smaller in manufacturing (1.05) and much smaller in traditional services (0.67). Eliminating cross-country productivity differences in non-traditional services reduces aggregate income disparity by 58%, a 7.9-fold reduction in aggregate productivity differences. Heterogeneity between traditional and non-traditional services also has a substantial impact on aggregate productivity. (JEL: O4, O5, O11, O14, E01, E13)

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