

# 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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*The editor in charge of this paper was Dirk Krueger.*

Acknowledgments: We thank the editor, four anonymous referees, Giuseppe Berlingieri, Paco Buera, Rui Castro, Pedro Cavalcanti Ferreira, Doug Gollin, Berthold Herrendorf, David Lagakos, Alessio Moro, Delfim Neto, Rachel Ngai, Markus Poschke, Andrés Rodríguez-Clare, Todd Schoellman, Yoyee Wang, Xiaodong Zhu, and seminar participants at several institutions for useful comments and suggestions. All errors are our own. Both authors gratefully acknowledge the support from the Social Sciences and Humanities Research Council of Canada. Restuccia thanks the support from the Canada Research Chairs program. Restuccia is an NBER Research Associate

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