

# SPECIALIZATION, ECONOMIC DEVELOPMENT AND INEQUALITY

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One of the central questions in economic growth and development is why disparities in income and development across countries are large and persistent. After decades of research, however, the question continues to puzzle the profession. Most of the difference in income across countries is attributed to differences in productivity which, in words of Moses Abramovitz, is a measure of our ignorance. At the same time, as Adam Smith pointed out in his famous “pin factory” example in *The Wealth of Nations*, specialization and division of labor can lead to large gains in productivity and, consequently, output. Hence, there are three questions to be addressed in this project. First, do we observe a systematic relationship between specialization and the level of income (and productivity)? Second, can we link the degree of specialization to fundamental factors such as strength of institutions, culture, etc. Third, what are the implications of increased specialization for the distribution of income?

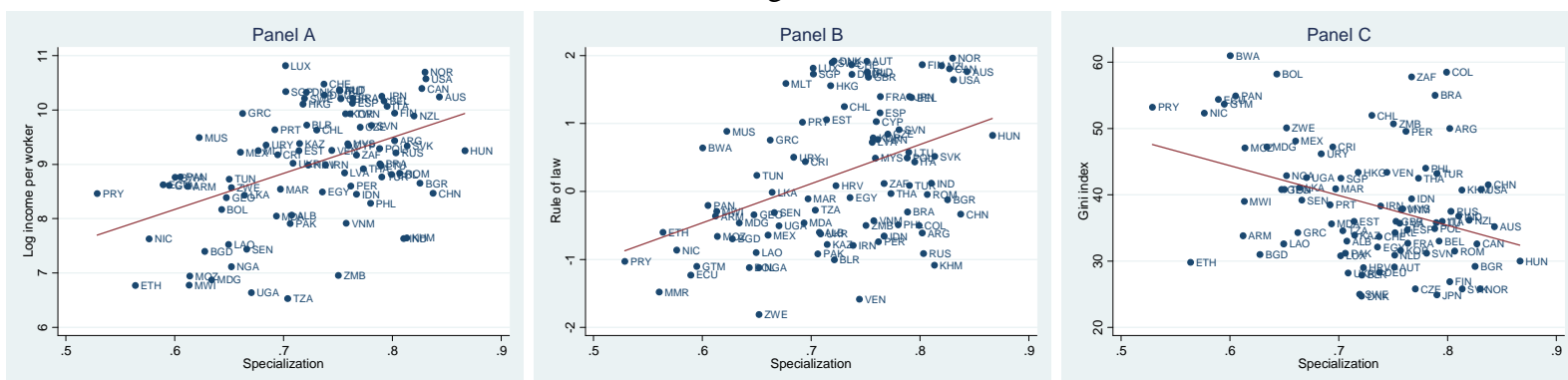
As the US economy developed, specialization according to various measures grew and the decline of Henry Ford’s *Rouge Factory* in Dearborn, MI clearly embodies this trend. This pattern however appears to be more general. Preliminary results (Panel A in Figure 1) show a very strong correlation between the level of income per worker and a measure of specialization. Thus, we observe both time-series and cross-sectional positive correlation between specialization.

Preliminary results (Panel B) also suggest that the degree of specialization is strongly correlated with the rule of law, which is an index variable measuring contract enforcement, protection of property rights, etc. This tentative result with respect to the second question points to important policy prescriptions.

Finally, increased specialization tends to be correlated with more evenly spread income (see Panel C) which can capture that idea that greater specialization spreads ownership of means of production and dilutes economic power. This developmental pattern has key policy implications for facilitating equitable growth.

These preliminary results suggest that this project can help address the key questions about sources of productivity gains and mechanisms of income distribution. Further theoretical and empirical work will explore these issues more deeply.

Figure 1



Note: Each point represents a country. All data are for year 2005. A higher value of *Specialization* corresponds to a higher degree of specialization.