

# Chapter 7

## The Stages of Economic Development: Commercial, Industrial, and Innovative

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## The Stages of Economic Development

- ❑ **Excess profits** (the source of economic growth) emerge from **differences**
- ❑ The Stages of Economic Development: The main question is where do differences come from?
  1. **Commercial Economy**, which exploits price differences between markets
  2. **Industrial Economy**, which exploits wage differences between farmers in locals and factory workers in cities
  3. **Innovative Economy** (Post-Industrial Economy or Knowledge Economy), which exploits productivity differences between old and new innovation in production, technology, organization, and management

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## Stage 1: Commercial Economy

- **Excess profits** come from **price differences** between different markets by means of an **arbitrage** trading or buying cheap in one market and sell high in another market
- **Commerce** (market trading and exchanges) becomes the main dimension of the economy
- But this commerce economy will stop growing as different markets are integrated and thus price differences disappear
- The commerce (arbitrage) economy contains a cause of its own destruction: Arbitrage profits from exploiting price differences, which will reduce the price differences

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## Stage 2: Industrial Economy

- **Excess profits** come from **productivity-wage differences**: that is, between a high productivity-wage of factory workers and a low productivity-wage of farmers so long as an excess labor supply exists in local agricultural areas
- However, the **excess supply of labor** in the primary industry will be exhausted sooner or later
- Then the economy have to transform itself from an industrial economy to a **post-industrial** innovative economy
- Japan seems to have failed to transform its catching-up industrial economy (the 1940 system) to a leading-the-way innovative society during the 1970s and 1980s

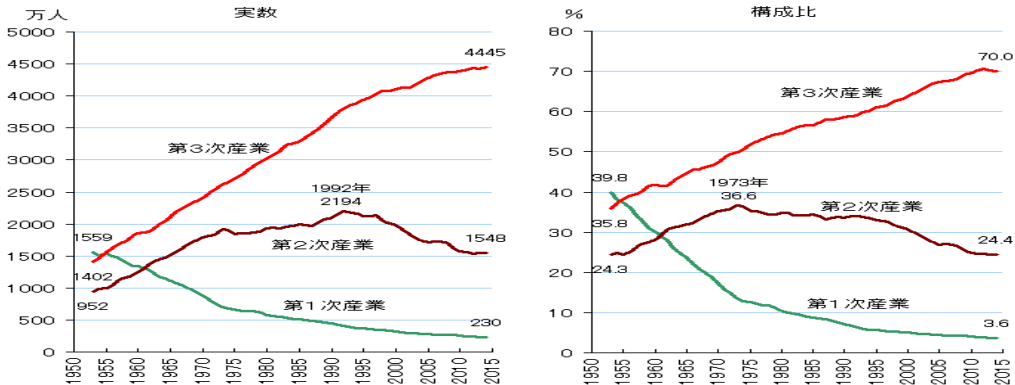
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## Workers by Industry

— primary industry — secondary industry — tertiary industry

産業別就業者数の推移



(注)1953～2014年の各年データ。産業不詳の就業者があるため構成比の合計は必ずしも100となっていない。  
(資料)労働力調査

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## Stage 3: Innovative Society

- **Excess profits** come from **productivity differences** between old and new **innovation** in technology, production, organization, management, and finance
- Joseph Schumpeter's "**creative destruction**," which means that new innovation makes old innovation obsolete: that is, new innovation is destructive for old innovation
- **Innovation** becomes the most important factor that determines not only the success and failure of a firm, but also the long-run growth of an economy in the post-industrial stage
- **Education** and **cooperation** become the critical elements of an **innovative society** because it is the actions and interactions of creative individuals that will bring about new innovations

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## Appendix 1: The “Middle Income Trap”

- **Middle Income Trap**: The middle income trap is a theorized economic development situation, where a country which attains a certain income level (US\$10,000) will get stuck at that level because of rising wages, failure to produce high-value-added products, and the lack of innovations (Examples: South Africa and Brazil)
- The biggest challenge is moving from resource-driven growth that is dependent on cheap labor and capital to **growth based on high productivity and innovation**
- Japan passed the test of the middle income trap around 1980

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## Appendix 2: Schumpeter’s “Creative Destruction”

- According to Joseph Schumpeter, "**creative destruction**" describes the process of industrial mutation that revolutionizes the economic structure from within, destroying the old one, creating a new one
- **Innovation** is a source of **temporary market power** : creative destruction can explain the dynamics of industrial change from a competitive to a monopolistic market, and back again
- However, Schumpeter was pessimistic about the sustainability of this process, seeing it as leading eventually to the undermining of capitalism's own system (see his book “Capitalism, Socialism and Democracy”)

[https://en.wikipedia.org/wiki/Creative\\_destruction](https://en.wikipedia.org/wiki/Creative_destruction)

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## Appendix 3: The Innovator's Dilemma: When New Technologies Cause Great Firms to Fail (1)

- Clayton Christensen's idea of "**Innovator's Dilemma**": Successful companies can put too much emphasis on customers' current needs, and fail to adopt new technology or business models that will meet their customers' future needs.
- Such companies will eventually fall behind
- The anticipation of future needs are called "**disruptive innovation**"

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## Appendix 3: The Innovator's Dilemma: When New Technologies Cause Great Firms to Fail (2)

- Businesses or organizations will reject innovations based on the fact that customers cannot currently use them, thus allowing these ideas with great potential to go to waste

[https://en.wikipedia.org/wiki/The\\_Innovator%27s\\_Dilemma](https://en.wikipedia.org/wiki/The_Innovator%27s_Dilemma)

<http://jhqedu.com:1042/upload/books/Book1010/20140311115729871.pdf>

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