

- **Business Cycle during Structural Change: Arthur Lewis Theory from a Neoclassical Perspective**

Kjetil Storesletten (University of Oslo), Bo Zhao (Peking University), Fabrizio Zilibotti (Yale University)

Abstract

We provide a unified theory of business cycle and structural change. We document that the nature business cycle evolves over the process of development and structural change. In countries with large declining agricultural sectors, employment is less volatile because agriculture acts as a buffer. During booms, employment in agriculture declines while labor productivity increases in agriculture more than in other sectors. The focal point of the theory is the link between structural change, productivity shocks, and the speed of modernization of an agricultural sector, which comprises a modern and a subsistence labor-intensive subsector. As capital accumulates, modern agriculture becomes increasingly capital intensive while the subsistence agriculture fades away. Structural change accelerates in booms and slows down in recessions. We estimate the model and show that it accounts well for both the structural transformation and key features of the business cycle fluctuations of China.