

# Consumption-led Industrial Upgrading



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### **ABSTRACT:**

This paper develops a macro development model for understanding the mechanisms behind industrial upgrading in a catching-up economy. Our model features hierarchical demand for consumption goods and inter-industry technology spillovers. When the market of new consumption varieties emerges, the rising demand drives the incentives of domestic innovation, resulting in technology progress and cost reduction. The cost reduction of existing varieties in turn leads to "surplus" of aggregate capital, which seeks opportunities in next new industries that produce new varieties. The dynamic feedback of "capital-push new market" and "demand-pull innovation" moves the domestic technology frontier and the consumption frontier in an upward spiral, and in this process the dual-sector economic structure - the co-existence of domestic technology-mature industries and domestic technology-immature industries - evolves endogenously. A hump-shaped behavior of the savings rate arises in our model with the endogenous aggregate production function. Because of the presence of dynamic externality, the laissez-faire equilibrium is inefficient and the optimal development policy involves two-sided interventions: suppressing consumption and enhancing capital accumulation in the early stage of development while reversing the sign to stimulate consumption in a later stage.

### **BIOGRAPHY:**

Prof. Sichuang Xu is an Assistant Professor of Economics in The Chinese University of Hong Kong, Shenzhen. He received his B.A in Finance from Sun Yat-sen University and his Ph.D. from Hong Kong University of Science and Technology. His research interests are macroeconomics, financial economics and international economics.

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