

# Structural Transformation and Employment Quality in Developing Countries Between Economic Growth and Social Inequality

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## ABSTRACT

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Structural transformation is an important process in the economic development of developing countries, characterized by the shift of labor from the traditional sector to the modern sector. This article analyzes how structural transformation affects the quality of employment, focusing on indicators of work formality, wages, social security, and productivity. Based on panel data from several developing countries between 2000 and 2022, it is found that despite a large shift of labor to the industrial and service sectors, improvements in employment quality do not always follow. Institutional factors, education, and labor policies are key in ensuring that structural transformation yields inclusive benefits.

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## 1. INTRODUCTION

Structural transformation has long been considered the centerpiece of the economic development process, especially in developing countries. Conceptually, structural transformation refers to a shift in the sector composition of the economy, where the contribution of the agricultural sector to gross domestic product (GDP) and employment declines, while the industrial and service sectors experience growth. This shift not only reflects changes in the structure of production, but also has a direct impact on the dynamics of employment, income, and social welfare.

According to the classical theory of development (Lewis, 1954; Kuznets, 1973), structural transformation promotes increased productivity and economic efficiency through the allocation of labor from traditional low-productivity sectors (subsistence agriculture) to modern high-productivity sectors (industry and services). In theory, this process is assumed to create better jobs, improve wages, and reduce poverty. However, in practice, many developing countries face a more complex reality.

Several studies show that while there has been a shift of labor from agriculture to services, most of the new jobs are in the informal sector, which does not provide living wages, social protection, or job security. This phenomenon is known as "structural transformation without industrialization" (Rodrik, 2016), where the growth of the service sector is not accompanied by improvements in the quality of employment. This raises a critical question: does structural transformation actually drive improvements in the quality of employment in developing countries, or does it deepen social inequality and expand the informal sector. The quality of employment is an important dimension in evaluating the success of economic transformation. According to the International Labor Organization (ILO), employment quality is determined not only by the number of jobs available, but also by decent working conditions, including job formality, real wages, access to social security, and opportunities for professional development. Therefore, understanding the relationship between structural transformation and employment quality is crucial for formulating inclusive and sustainable development policies.

Structural transformation in developing countries in the last two decades has seen significant shifts in the employment structure and sector composition of the economy. In general, there has been a downward trend in the share of employment in agriculture, offset by an increase in employment in services and, in some cases, manufacturing. While these shifts indicate structural change, the quality of the transformation varies widely across regions and countries. Data from the World Bank (2000-2022) show that the average contribution of the agricultural sector to total employment in developing countries declines from about 52% in 2000 to about 29% in 2022. This decline is most rapid in East and Southeast Asian countries, such as China, Vietnam and Indonesia, where industrialization and urbanization are taking place rapidly. Meanwhile, countries in Sub-Saharan Africa are experiencing a slower decline, with the agricultural sector still absorbing more than 40% of the workforce in countries such as Ethiopia, Tanzania, and Nigeria.

Most developing countries are experiencing rapid growth in the services sector, which is now the dominant sector in terms of employment. For example, in India, the services sector accounts for more than 50% of GDP and will employ around 30% of the workforce by 2022. However, many jobs in this sector are informal, such as petty trade, domestic services, and informal transportation. Thus, despite the shift from agriculture to services, improvements in productivity and quality of work have not fully taken place. Rodrik (2014) refers to this phenomenon as “premature deindustrialization”, where developing countries experience deindustrialization early-before having the chance to fully utilize the productivity potential of the manufacturing sector. The direct shift from agriculture to services (bypassing manufacturing as a bridge to productive transformation) leads to weak structural transformation in terms of improving labor welfare. In general, structural transformation in developing countries over the past two decades has shown quantitative progress in shifting labor between sectors, but has not always been accompanied by qualitative progress in terms of productivity and job quality. This transformation has been uneven and strongly influenced by the institutional context, industrial policy, workforce education, and the country's capacity to manage urbanization and global integration.

The structural transformation that has taken place in developing countries over the past two decades has had a complex impact on the quality of employment. While there has been an aggregate shift of labor from agriculture to industry and services, improvements in the quality of employment have not been automatic. The impact is strongly influenced by the type of sector that grows, the institutional structure, and the capacity of the country to manage the transformation process. Structural transformation in developing countries has an ambivalent impact on employment quality. On the one hand, the shift from agriculture to industry and services opens up opportunities for job diversification. But on the other hand, without adequate institutional support, this transformation risks expanding the informal sector, maintaining low wage levels, and limiting access to social security. Improving employment quality is not enough to rely on sectoral structural changes. Active labor policies, institutional reforms, and investments in human capital are needed to ensure that economic transformation also means inclusive and equitable social transformation.

Structural transformation will only have a positive impact on the world of work if it is supported by a combination of mutually reinforcing factors: targeted industrial policy, investment in human capital, strong labor market institutions, inclusive infrastructure, and fair governance of urbanization. Conversely, the absence of these factors not only hinders the creation of decent jobs, but also deepens inequality and expands the informality of work.

## 2. RESEARCH METHOD

This research method uses a qualitative-descriptive approach with the support of secondary quantitative data to analyze the impact of structural transformation on the quality of employment in developing countries. Data were collected through a systematic literature review that included reports from international institutions such as the World Bank, ILO, and UNDP, as well as relevant scholarly articles. Data analysis was conducted using thematic content analysis to identify key patterns in the relationship between economic sectors, labor formality, wages, and social security. In addition, a cross-country comparative analysis was conducted to explore differences in the impact of structural transformation across contexts. Although the study utilizes secondary data, which limits the analysis to micro dynamics and worker perceptions, this approach allows for a broader understanding of macro trends in economic transformation and work quality.

### 3. RESULTS AND DISCUSSIONS

#### 3.1 Transformasi Struktural Ketenagakerjaan di Negara Berkembang

Structural transformation of employment is a long-term process characterized by a shift in the sector composition of the economy, from the dominance of agriculture to industry and services. In developed countries, this transformation has been underway since the Industrial Revolution, but in developing countries this process shows a more complex and not always linear pattern. In the last two decades, the trend of structural transformation in developing countries has shown new dynamics, influenced by factors of globalization, technology, national policies, and demographic characteristics of each country.

In general, developing countries experienced a decline in the proportion of labor in the agricultural sector. However, there is not always a proportional increase in the industrial sector: Premature deindustrialization is a common phenomenon. Many countries such as Nigeria, Pakistan and most Sub-Saharan African countries began to experience a decline in the industrial sector's contribution to GDP before the sector reached its peak contribution. In contrast, the services sector is growing fast and absorbing massive labor, but mostly in the form of informal and low-productivity jobs (such as street trading, domestic services, and informal transportation). Some countries such as Vietnam, Bangladesh and Ethiopia are exceptions, where the manufacturing sector is growing rapidly due to integration in global supply chains (GVCs), especially in textiles and electronics.

Structural transformation is ideally characterized by a shift of labor to higher productivity sectors. However, trends in developing countries often show a mismatch between labor composition and sector contribution to GDP: The services sector accounts for up to 50-60% of GDP, but many services sub-sectors (especially informal ones) contribute little to national productivity. In many African and South Asian countries, more than 40% of the workforce is still in agriculture, even though the sector's contribution to GDP is less than 20%, suggesting a 'low productivity trap'. In countries such as India and Indonesia, there is growth in the modern services sector (information technology, finance, and logistics), but it absorbs only a fraction of the total workforce due to high skills barriers.

Structural transformation is also reflected in rapid urbanization processes: Developing countries experience massive urbanization without balanced industrialization. This has led to the growth of large cities without adequate formal job creation. Economic concentration occurs in metropolitan centers, while rural and peripheral areas remain trapped in agriculture or informal services. This reinforces regional inequality and rural-urban migration that is not productively accommodated.

Integration in global value chains (GVCs) has changed the landscape of structural transformation: Countries that are able to attract foreign direct investment (FDI) and develop manufacturing export sectors show positive results, such as Vietnam and Cambodia. However, many countries are merely suppliers of cheap labor, with low value-added and little technology transfer. Dependence on external demand and the volatility of global markets make structural transformation vulnerable to crises (e.g. the impact of COVID-19 on the export sector in Bangladesh). Despite economic growth in many developing countries, structural transformation is often not inclusive: Income inequality is increasing, especially between skilled and unskilled workers, and between developed and lagging regions. Women and youth are increasingly absorbed into the informal sector and low-wage jobs. Many countries have failed to develop skills training (TVET) systems capable of preparing the workforce for the changing structure of the economy.

The structural transformation of employment in developing countries in the last two decades has shown non-linear, fragmented and highly contextualized dynamics. Many countries experienced a direct transition from agriculture to services without going through a full industrialization phase, thus failing to create broadly productive jobs. Although the services sector grew, its informal character and low productivity posed serious challenges to the quality of employment. Therefore, structural transformation in developing countries requires more strategic, pro-poor, and labor capacity building-based policy interventions in order to generate inclusive and sustainable economic growth.

### 3.2 Labor Quality Doesn't Always Improve in Developing Countries

Structural transformation is often associated with increased productivity and labor welfare. However, in the context of developing countries, changes in economic structure are not always accompanied by improvements in labor quality. Despite the shift of labor from the agricultural sector to the industrial and service sectors, many of the new jobs created are in the informal sector with low productivity levels, minimal wages, and minimal social protection. This phenomenon shows that there is a disconnection between economic growth and improvement in the quality of work.

One of the key indicators of employment quality is the formality of employment. In many developing countries, structural transformation has led to the expansion of the informal sector, especially in urban areas. For example, rural migrants who move to cities do not enter the formal manufacturing sector, but instead work in the informal sector such as street vendors, online motorcycle taxi drivers, day laborers, or domestic assistants. ILO studies show that in some African and South Asian countries, more than 70% of the workforce is in the informal sector, even after two decades of relatively high economic growth. Despite the increase in employment opportunities, the real wages received by workers are still stagnant or even declining in some cases. This is due to the high supply of labor that is not accompanied by increased productivity and skills. In the informal services sector, workers often face poor working conditions with long hours and no guarantee of a stable income. Even in export industries, such as textiles and electronics, wage practices often do not meet decent work standards, especially in countries with weak labor regulations.

Access to social protection and employment security remains a major issue. Many workers in the informal sector do not have access to health insurance, pensions, or accident protection. In developing countries with low social security coverage, structural transformation increases workers' vulnerability to economic risks, especially during economic crises or pandemics. This reinforces social inequality as only a small proportion of formal workers enjoy state protection. Quality of work issues are also closely linked to gender and age inequalities. Women and youth workers are often pushed into informal, low-wage jobs without legal protection. In some cases, they also face discrimination in access to formal employment due to cultural barriers, double burden, or lack of digital skills. Structural transformation without an inclusive approach exacerbates these inequalities and creates a dualistic labor market: formal for the few, informal for the majority.

Spatially, regional disparities in employment quality are striking. In countries such as Indonesia, India and Nigeria, most quality jobs are concentrated in large cities and certain industrial areas. Meanwhile, underdeveloped regions remain dependent on subsistence agriculture or low-productivity informal services. This inequality makes structural transformation uneven and has the potential to generate social tensions and reinforce cycles of unproductive internal migration. It should be noted that limitations in labor training and vocational education policies contribute to the low quality of employment. Many developing countries do not have training systems that are responsive to the needs of modern industry. As a result, there is a mismatch between the skills of job seekers and the needs of the market. Without state intervention to strengthen skills development, structural transformation will not be able to produce a workforce ready to face the challenges of the digital and green economy.

Thus, while structural transformation brings opportunities for economic growth and modernization of the production sector, employment quality does not automatically improve in developing countries. Without strong public policy support, structured labor markets, and inclusive social protection, this transformation risks widening inequality and reinforcing informality in the labor market. Therefore, the labor reform agenda must go hand in hand with the economic transformation strategy so that the benefits can be felt equally by all levels of society.

### 3.3 Factors that Strengthen or Hinder the Positive Impact of Structural Transformation and Employment Quality

Structural transformation in developing countries should have a positive impact on the quality of employment, such as increased wages, improved working conditions, and the creation of more

productive and sustainable jobs. However, this is not always the case. Various factors, both internal and external, can strengthen or hinder the positive impact of structural transformation on the quality of employment. The following are the key factors that affect the outcomes of structural transformation in developing countries.

Government policies play a central role in determining the direction and quality of structural transformation. Developing countries with progressive economic and labor policies tend to be more successful in creating good quality formal jobs. Policies that strengthen the protection of workers' rights, increase access to skills training, and promote minimum wage increases play an important role in improving the quality of employment. However, in countries with weaknesses in law enforcement, existing regulations are often ineffective in protecting workers. For example, while many countries have laws governing worker protection and minimum wages, wage practices in the informal sector and light industry remain often far from the established standards. Corruption, politicking and political instability can worsen the implementation of policies aimed at improving the quality of employment.

Globalization and the integration of developing countries into global value chains (GVCs) can accelerate structural transformation, especially in the manufacturing and services sectors. Countries that successfully attract Foreign Direct Investment (FDI) and become part of GVCs experience an increase in formal sector employment, especially in export-driven sectors such as textiles, electronics, and automotive. These investments often bring technology transfer, skills upgrading, as well as access to wider global markets. Globalization also has a downside, especially for developing countries that are merely suppliers of cheap labour in GVCs. This can lead to worker exploitation, low wages, and poor working standards. Most of the jobs created in this process are low-wage, unstable, and often not protected by adequate social security systems.

One of the most significant factors in determining the impact of structural transformation on the quality of employment is the level of education and skill development of the workforce. Countries that have a strong education system and can produce a skilled workforce will be better equipped to adapt to structural change. Educated and skilled workers tend to shift more easily from agriculture to more productive industries and services, and can access better-paying jobs. In many developing countries, the skills gap is a major constraint. Many workers lack the skills required by the modern industrial and service sectors. In addition, unequal access to education between urban and rural areas, as well as a mismatch between education curricula and labor market needs, exacerbate the quality of the workforce in developing countries.

Adequate infrastructure, such as internet access, transportation, and energy, is essential to support the structural transformation process. Developing countries with better infrastructure can support the growth of more productive industrial and service sectors. Access to technology, especially information and communication technology (ICT), enables workers to adapt to changes in the digital and global economy. Many developing countries still face infrastructure limitations, especially in rural areas. Difficulties with internet access and poor transportation in these areas limit workers' mobility and their ability to access quality formal employment. These inequalities in infrastructure also create regional disparities, which hinder the equitable distribution of the positive impacts of structural transformation.

The informal sector is an important aspect of employment in many developing countries. On the one hand, the informal sector can serve as a labor absorber for those who cannot access formal employment, providing opportunities for income despite inadequate working conditions. It provides opportunities for women, youth, and migrants to earn an income. The informal sector is also often a major obstacle in improving the quality of employment. Jobs in this sector often have no social protection, unstable pay and poor working conditions. Without policy support to address problems in the informal sector, such as improvements in wages, social security, and job security, the positive impact of structural transformation on labor quality will be limited.

Economic stability and sound macroeconomic policies play an important role in ensuring that structural transformation can take place smoothly and have a positive impact on the quality of employment. Countries with stable economies and sound fiscal policies are better able to attract investment and create sustainable employment. In addition, economic stability also supports more effective labor policies and the provision of broader social security. Conversely, economic crises, global market fluctuations and high inflation can hinder the process of structural transformation. Developing countries that rely heavily on commodity exports or have economies that are vulnerable to external shocks will find it more difficult to create quality jobs and improve the quality of employment in the long run.

Social and political inequalities in developing countries also affect the outcomes of structural transformation on labor quality. Inequalities in access to education, health services and economic opportunities hinder the achievement of better employment quality for marginalized groups, such as women, the poor, minorities and young workers. Without interventions that address social justice and resource distribution, structural transformation risks benefiting only a few in society. In addition, political instability and social conflict can hinder the creation of an environment conducive to more inclusive economic reforms. Political and social tensions can reduce investor confidence, influence labor policies, and even undermine the informal sector, which is an economic lifeline for many families.

#### 4. CONCLUSION

The structural transformation taking place in developing countries, characterized by a shift in economic sectors from agriculture towards industry and services, does not always lead to improvements in employment quality. While developing countries are experiencing significant economic growth, the results of this transformation are often unevenly distributed, with many of the new jobs created being in the informal sector where wages are low and working conditions are poor. A large proportion of the labor force that shifts to industry and services is often trapped in informal jobs that do not offer social security, job security, or decent wages, which hinders improvements in the quality of employment.

The informal sector, which has grown rapidly in response to structural transformation, does not provide sufficient social protection and may even exacerbate social inequality. Although these sectors are capable of absorbing a lot of labor, the quality of jobs in the informal sector tends to stagnate and risks exacerbating income inequality. The role of the informal sector is therefore often seen as an economic savior, but at the same time an obstacle to improving workers' welfare.

Globalization and integration in global value chains (GVCs) can drive faster structural transformation in developing countries. However, many countries are merely suppliers of cheap labor, without significantly benefiting from technology or skills upgrading. For example, while export sectors in developing countries are growing rapidly, workers in these sectors often face low wages and insecure work due to the dominance of foreign investment that emphasizes low labor costs. Globalization often worsens employment conditions as many developing countries are unprepared for the impact of the digital and green economies. One of the main inhibiting factors is the skills gap between the available workforce and the needs of modern labor markets. Many developing countries do not yet have an education system that can produce a workforce that is skilled and adaptive to the changes taking place in the global economy.

Without policies that encourage technical and vocational education, the mismatch between skills and jobs remains a major obstacle in improving the quality of employment. Poor infrastructure, limited access to technology, and a lack of skills training systems are other major challenges. Workers in areas not covered by basic infrastructure or modern technology tend to be trapped in informal or subsistence sector jobs with low productivity. Infrastructure inequality between urban and rural areas exacerbates inequalities in access to formal employment and higher wages. On the other hand, government policies play a very important role in regulating the quality of employment. Countries with inclusive policies, which encourage the development of broader social security systems and increases in minimum wages, have been more successful in creating better employment in the formal sector.

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