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Post-Keynesian Perspectives on Economic Development and Growth

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ABSTRACT

As history, institutions, social and political forces specific to any economy have a profound effect on that economy's dynamics, it is important to understand how these have evolved with the development of capitalism. The classical economists analysed economies with labour surpluses, which kept wages at subsistence levels, encouraging profits and therefore economic growth. Lewis extended this model to developing economies, with the labour surplus coming from the agricultural sector. With growth and development, the labour surplus becomes absorbed into the labour force, eventually leading to upward pressure on wages This is associated with the Keynesian era, where the level of effective demand becomes an important determinant of employment and growth. As a result of further development, competitive capitalist economies have evolved to the monopoly capital stage, where oligopolistic corporations influence the dynamics of the economy. More recently, we have seen the increased prominence of the financial sector, which has both led to and been influenced by globalisation.

Key words: economic development, history of economic thought, Post-Keynesian, economic history, industrialisation, monopoly capitalism

JEL Classification: B00, N00, O10, O14

> [T]he institutional framework of a social system is a basic element of its economic dynamics. Kalecki (1970) p.111

Introduction

The fundamental feature of the Post-Keynesian understanding of economic development and growth is that the history, institutions, social and political forces specific to any economy have a profound effect on that economy. As a result, "institutions and political forces are important in shaping economic events". (Holt 2007, 93)

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Each economic system, in fact, each economy, will have different institutional frameworks, which manifest themselves in differences in meditating economic behaviour. Obviously these institutions will have profound effects on the economies concerned. As a result, most Post-Keynesians deny the usefulness of general, universal theories to describe actual economies. They do not subscribe to a general theory with modifications to allow some role for institutions and social phenomena[2], but instead incorporate these into the essence of their models. It is therefore no surprise to learn that the Post-Keynesian analyses of capitalist, socialist and developing economies fundamentally differ from each other (and from mainstream analyses) on the grounds that each reflects differing institutional frameworks, as well as other differentiating characteristics. This may be contrasted to modern neoclassical theory, where the same general economic theory is used to analyze developed and developing economies and is also utilized to analyse "non-economic" aspects of social life[3].

As the economy develops, so will its underlying structures and these will both influence and be influenced by the underlying economic relations. A major development which has profoundly influenced the institutional structure of economies has been the evolution of capitalism from its early phase through to its current manifestation. Clearly it is still evolving, and many fundamental economic relations are still changing. However, Post-Keynesians have identified some fundamental changes, particularly to the factors which determine employment and the level of output, as a result of the development of the economy from early capitalism to the later stage, sometimes called monopoly or mature capitalism. In other words, less developed economies and early capitalist ones

[2] . Institutions include not only the economic institutions associated with, for example, finance and banking and with property rights, but also political, cultural and other social institutions. They include class structure, race relations, religion, family, the nature of government and cultural factors . Clearly all of these will have extremely important roles in the development process, and will themselves evolve during it. Although this paper will concentrate on economic institutions, the others play important roles during development.

[3] See also Harcourt (1978)

behave, for a variety of reasons, in a number of important respects quite differently from the more developed capitalist economies.

It is important to realise that what we now call developing economies are often in the early stages of capitalist development, and share similar characteristics to the early stages of development of the now advanced capitalist economies, and are also entering into the phase of multi-national oligopolistic capitalism, although the international economic environment is fundamentally different, in particular influencing inter-country trade, capital flows and technological transfers. As a result, the important problems faced by developing economies have some similarities to those faced by early capitalist ones, although the current international environment requires different industrial structures.

The Role of the Surplus

The emergence of a surplus is a necessary, though not sufficient condition, for an economy to grow and develop. In the case of an economy which is producing at subsistence level, it is just producing enough to reproduce itself, to survive. Such an economy cannot grow by definition, as it has nothing which will enable it to provide resources to expand, to invest in such a way as to increase productive capacity. In order to grow, it needs to produce a "surplus" or "net product", that is, a physical excess of goods produced over the goods which have to go back into the production process in the next period, including replacement of the means of production, in other words, the surplus over subsistence. This concept of a surplus was developed in the work of the physiocrats, the classical Political Economists and Marx, and later, especially explored by Piero Sraffa, and has taken an important role in the work of Post-Keynesian economists. The concept of “the surplus” was derived from the idea that if an economic system is to reproduce itself, a part of output has to be put back into production. This includes the necessary replacement of the means of production as well as the subsistence consumption of workers.

It s important to note that the disposal of the surplus does not influence the survival of society. Once a society produces at least its subsistence, it will survive, regardless of what it does with its surplus. However, its distribution between competing claims, only some of which will use the surplus in productive activities, influences the ability of an economy to grow and develop. If the surplus is used for productive purposes, such as for investment (accumulation) , it will allow the economy to grow. However, if it is used for unproductive purposes, such as consumption by landlords, to finance wars etc. the economy will stagnate. An economy needs to produce a surplus in order to grow, but, whether or not it actually grows depends on what happens to that surplus. In history, many countries have stagnated because the surplus has not been used productively.(Baran 1957 p. 21, Meek 1977 p.160 and Walsh and Gram 1980, especially chapter 1)

The manner in which the surplus is distributed will depend on the social institutions within that particular country. These will vary, often dramatically, between countries with different social, political and economic histories, and within counties at different stages of their history[4]. This indicates an important reason why Post-Keynesian economists believe that there cannot be a unique theory of economic development. While many countries have been able to produce a surplus, some have not been able to grow and develop beyond that stage due to the manner in which that surplus was distributed. Importantly, then, a country's level of development is closely tied to the existence and disposal of the surplus. This explains the focus of the classical economists, and Marx, on the question of distribution[5].

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[4] . Economic sociologists and anthropologists, like Weber and Polanyi , look at the emergence of capitalism in term of the interrelation of economic forms with state and cultural forms. In particular, a strong state or church may levy the surplus, preventing it from being used productively and postponing the development of capitalism.

[5] See, for example, Ricardo's famous statement to this effect in the Preface to his Principles of Political Economy (Ricardo 1817, p.5)

Stages of development

Once the surplus is generated, and the growth process kick started, an important question is: what is the difference between the causes of growth in developing economies and in developed capitalist economies? The distinct problem of developing economies is the shortage of productive capacity, rather than its underutilization. There are not enough capital goods to fully employ the labour force. To increase employment as well as to improve the standard of living requires a high level of investment which will accelerate growth in productive capacity as well as in national income.

Kaldor and Kalecki, amongst other Post-Keynesian economists, identify important differences in the stages of development, which they explore by utilising Keynesian and Kaleckian economics. They argue that developed economies behave fundamentally differently to less developed ones in the earlier stages of capitalist development. In the more developed stage, the factors determining output, growth and employment are different to the factors which determine these in the earlier phases of capitalist development.

According to Kalecki:

> The problem of unemployment in underdeveloped countries differs fundamentally from that in developed economies. In the latter, unemployment arises on account of inadequacy of effective demand. During periods of depression unemployed labour coexists with underutilized equipment. The situation may, therefore, be tackled by measures designed to stimulate effective demand, such as loan financed government expenditure.
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> Unemployment and underemployment in underdeveloped countries are of an entirely different nature. They result from the shortage of capital equipment rather than from deficiency of effective demand. Kalecki (1960) p 3
>
> This is not to deny that in an underdeveloped economy there may be a deficiency of effective demand. There are many instances of countries whose capital equipment, meagre though it is, will nevertheless be underutilized. However, as contrasted with developed economies, even if this equipment is fully utilized, it is still not capable of absorbing all available labour, as a result of which the standard of living is very low.... the main problem here being the deficiency of productive capacity rather than the anomaly of its underutilization..... The crucial problem facing the underdeveloped countries is thus to increase investment considerably, not for the sake of generating

> effective demand, as was the case in an underemployed developed economy, but for the sake of accelerating the expansion of productive capacity indispensable for the rapid growth of the national income. Kalecki 1966 pp. 15-16

This last quote, in particular, highlights the important difference, for Kalecki, between advanced capitalism and underdevelopment. For advanced capitalist economies, investment is a double-edged sword. In the short run it increases effective demand, which is important in reducing today's unemployment, but, at the same time it increases capacity, which can increase tomorrow's unemployment. In contrast, as Kalecki indicates, insufficient effective demand in developing economies is less of a problem, so the effect of investment is unambiguously positive in its ability to increase capacity, and by increasing the size of the stock of capital, enable it to employ more workers.

Kaldor, in a number of places, makes a similar distinction, between what he calls Marxian and Keynesian unemployment. For Marx, the market always generates an excess supply of labour, which he called the "reserve army of the unemployed " and which continually exerted downward pressure on wages. In the early stages of the development of capitalism, competition forces capitalists to reinvest most of their profits, as otherwise they would lose out in the competitive struggle - they have no choice if they wish to survive. As Marx stated, "Accumulate, accumulate! That is Moses and the prophets!" (Marx 1867, 1990 p. 141) At this stage of development, employment depends on capital accumulation. As capitalism develops, both the demand for and supply of labour grow. As the pace of accumulation increases, so the demand for labour grows at a faster rate than its supply, eventually "extinguishing" the reserve army. Labour becomes scarce. When this happens, downward pressure on (real) wages is halted, and they rise causing the share of profits to fall. This reduces growth and demand. According to Kaldor, this happens in the later stages of capitalism, when the Keynesian explanation of unemployment comes into its own.

As a result of capital accumulation outpacing the growth in the labour force, excess capacity becomes built into the economy, becoming a major factor within the further development of capitalism. According to Kalecki and Kaldor capitalist economies have reached a stage of capital accumulation where the existing stock of capital goods is more than sufficient to employ all the economy's labour, and this has changed the nature of underlying economic relations. Unemployment in this stage is associated with unused capacity resulting from insufficient effective demand. For both Keynes and Kalecki the major problem with advanced capitalist economies is the underutilization of capital. The solution to the problem is to increase effective demand via some exogenous means, such as government expenditure, investment, or exports etc. In contrast, developing economies have not reached that stage of capital accumulation. The size of the capital stock is not sufficient to employ all the labour. In other words, even if there was no excess capacity, there would not be full employment of labour. Their crucial problem is the shortage of productive capacity.

Joan Robinson reached the same conclusion when she compared Marx and Keynes on the causes of unemployment, although she was not as explicit in acknowledging that their difference related to different stages in the development of capitalism.

> For in Marx’s system … [c]ompetition and technical progress set up an urge to accumulate, for each capitalist fears to fall behind in the race if he does not continuously invest in new capital equipment embodying the latest developments. Thus the problem of effective demand does not arise. … In his view, the amount of employment offered by capitalists depends upon the amount of capital in existence, and there is unemployment because there is insufficient capital to employ all potentially available labour. .. Now, unemployment of this type, in the world at large, is a phenomenon of the greatest importance. It exists in the backward, over-populated countries of the east, and, indeed, everywhere except amongst the most developed industrial nations.Robinson 1948 140-1[6]

[6] She also notes that this type of unemployment may have been be relevant for Europe in the immediate aftermath of World War 2, as a result of the destruction of much productive capacity. Interestingly, in discussions with Kalecki, Robinson tried to use the argument of the imperative to invest to justify the importance of “animal spirits” as a determinant of investment, despite Kalecki always regarding them as “irrational”, see, for example Robinson, 1977, 196.

This discussion highlights the fact that for Post-Keynesian economists, differences in their economic structure and institutions means that developed economies behave in many significant ways differently from less developed ones. In the early stages of development, the imperative on capitalists to invest is strong, and so, as noted, there is a strong tendency for profits to be reinvested. As capitalism develops to a more mature stage, the problem of effective demand becomes prominent, and the factors acting on capitalist change, for a number of reasons discussed below, so that they no longer have the same compulsion to invest .

Chakravarty used this as a means of distinguishing between developed and developing economies:

> But more precisely, what we mean by a developing economy is one where the following conditions hold: (i) it is 'capital stock' rather than available labour that sets the upper limit to output and employment in those sectors wherever the concept of capacity output can be defined, even if in a rough way; (ii) while the economy is capable of generating some 'surplus' over 'current consumption', output per head is not significantly in excess of subsistence consumption; (iii) where wage employment exists, wage bargain is conducted in money terms and (iv) there are no savings out of wage income. Chakravarty 1979 p. 17

As a result, Chakravarty argues that Keynes's major insights are "largely … inapplicable to such situations" [Chakravarty 1979 p. 17] although because demand and investment decisions are important in developing countries, there is some role for Keynesian analysis. A similar conclusion was reached by A. K. Dasgupta:

> "The limiting factor in the growth of employment in [a developing] economy … is not so much a shortage of money as a shortage of real capacity. With the existing capital equipment, even if we have 'full employment' in the Keynesian sense, a large volume of unemployment will still remain in a physical sense. … [This] is a phenomenon which is not connected in any way with a fall in effective demand, nor does it go along with excess capacity in capital resources. It is there because the maximum capacity of capital equipment is inadequate to fully employ the available labour…. In Keynes's model surplus labour is accompanied by excess capacity in capital equipment; in underdeveloped economies reserve capacities are deficient, if not nonexistent. … In underdeveloped economies … the current real rate of wages even in the urban sector, not to speak of the rural sector, is about the minimum necessary for physical existence." (Dasgupta 1954 pp. 308-09)

This distinction helps explain why, in many less developed economies, extreme poverty coexists with low levels of unemployment- it is the employed who are poor. This is due to the fact that the value of what they produce must be extremely low. This is related to low levels of skill and low productivity, caused by the shortage of capital in the capitalist sector, side by side with employment in the “traditional” sector which is not capitalist employment in the sense that it is not for wages, but, rather for subsistence produce and services. This is reinforced by multinational activities in the capitalist sectors of most developing economies, which leads to further duality within the capitalist sector with multinational firms operating with relatively high capital-labour ratios; compared to domestic firms.

“In the rural sector, there is surplus labour pressing on a limited stock of land. And since the mode of production is family-oriented and pre-capitalistic, the labourer enjoys a living which is set by average productivity, even though the marginal productivity may turn out to be zero.” (Daspgupta 1958 p. 337)

The Path of Economic growth

An important question relates to the path the economy takes in moving from the early capitalist/less developed stage to that of a mature capitalist economy. The analysis of the classical economists and of Marx in describing the growth path of early capitalist economies is of great relevance and has been used as the basis of more recent growth models. For all of these economists, the “iron law of wages” according to which wages tended towards subsistence levels, was an important aspect of capitalist economies, though the reason for that tendency varied substantially between them.

In Ricardo’s model of capitalist growth, net output is distributed to workers, in the form of the subsistence wage and to capitalists and landlords who share in the surplus. Capitalists invest their profits, which provide the engine of growth and accumulation. Due to diminishing returns in agriculture, the share of the surplus accruing to capitalists falls, while the share accruing to landlords increases. This eventually leads to a rate of profits so low that there is no further accumulation and the economy reaches a stationary state. Of course, as Ricardo admitted, technical progress can postpone the stationary state by increasing the productivity of agriculture and, therefore, reducing the proportion of the surplus accruing to the landlord. (Harcourt 2006 p. 94)

Marx's analysis of capitalism is more relevant to the contemporary circumstances than that of Ricardo. Marx changed the focus of analysis from the agricultural sector being centre stage to the manufacturing sector being the engine of growth. As a result, the role of the landlord was minimised, with most of the surplus in Marx's analysis accruing to the capitalist as profits and being used to generate growth and accumulation. Although Marxian analysis is relevant in describing the early stages, it needs to be modified to throw insight on the transition path. For Marx, the reserve army of the unemployed put downward pressure on wages, keeping them near subsistence. This allowed capital accumulation without pressure on profits which were then automatically invested due to competitive pressures.

In the early stages of the development of capitalism, as in Ricardo's analysis, the agricultural sector dominates. This is true both historically and in contemporary times. This has led to a new understanding of the Marxian process associated with the idea of "dual" labour markets, which emphasizes the difference between conditions in agriculture and in manufacturing, ie. between pre-capitalist and capitalist modes of production.

The modern version of this model is most associated with Arthur Lewis in his classic paper, "Economic development with unlimited supplies of labour" (Lewis 1954) which extended the classical model to incorporate problems associated with modern economic development.

His analysis was based on a dual economy model, where the economy consists of a 'noncapitalist' or traditional/subsistence sector, usually agriculture, and a modern 'capitalist' sector "that part of the economy which uses reproducible capital, and pays capitalists for the use thereof." (Lewis 1954 p. 407) . The capitalistic sector, usually manufacturing, operates under a system of wage employment, producing an output which is sold for a profit. The subsistence/traditional sector has little, if any, access to reproducible capital and maintains production and consumption in pre-capitalist social institutions. There are no labour markets, labour tends to work for food, so there is a only a very limited form of markets for output, and the sector is not capitalistic. This sector is regarded as “traditional” because of the way in which production in it is organised (Bhaduri 2003 p. 222) The traditional sector is well described by the classical model of labour surplus in the agricultural sector, that is, with the marginal product of labour near zero, while wages tend towards subsistence. In this case, labour can move out of the agricultural sector into manufacturing with little or no loss of output in the former. So when the capitalist sector expands, it can draw on the labour reservoir from the traditional sector, with the labour supply infinitely elastic at the existing wage, just enough above the subsistence wage to induce labour to move. This is analytically the same as Marx’s analysis of the reserve army of the unemployed which also keeps wages at subsistence and labour supply infinitely elastic. However, because Marx was analysing a “pure” model of the capitalist mode of production, with no remnant of feudalism, his main difference from the Lewis’s model, is that, for the latter, labour comes from another (traditional) sector rather than from the unemployed.

The capitalist sector is relatively competitive, so that profits on capital tend to be equalised. Due to the availability of finance and greater information, almost all investment will be in the capitalist sector, which means that “inevitably what one gets are very heavily developed patches of the economy surrounded by economic darkness.” (Lewis 1954 p. 409)

Accumulation occurs through the reinvestment of the surplus in the capitalist sector, fuelling its expansion. This expansion is associated with the movement of labour from the traditional sector to the capitalist sector, with little if any effect on wages in the latter sector. With an elastic supply of labour to the capitalist sector, this process will continue, at the same time increasing the surplus, until the labour surplus in the traditional sector disappears.

Lewis follows the classical economists in assuming that, since wages are at subsistence, workers' saving is trivial, while most of profits are reinvested and go into accumulation, so that "the major source of savings is profits". (Lewis 1954 p. 417) With wages given at subsistence, capital accumulation is associated with a higher proportion of national income accruing to profits: "The model says, in effect, that if unlimited supplies of labour are available at a constant real wage, and if any part of profits is reinvested in productive capacity, profits will grow continuously relatively to national income, and capital formation will also grow relatively to national income." (Lewis 1954 p. 418)

As a result of his analysis, Lewis concludes that the main factor determining the growth and development of less developed countries is the size of their capitalist sector, as this is the source of profits, and therefore the source of investment and accumulation. In addition, he acknowledges the importance of "the sociological problem of the emergence of a capitalist class, that is to say of a group of men who think in terms of investing capitals productively." (Lewis 1954 p. 420)

The process described by Lewis naturally ends when "capital accumulation has caught up with population, so that there is no longer surplus labour." (Lewis 1954 p. 431) Once this happens, the process of accumulation and growth changes to that which the writers discussed above call Keynesian. However, Lewis argues that the process may be terminated while there is still surplus labour if real wages increase so as to reduce profits significantly. In general, it is only when the supply of surplus labour is exhausted, or nearly so, that there is no longer a reserve army effect and wages rise above subsistence.

With wages at subsistence, workers consume all their wages, so saving can only come from capitalists. If productivity is increasing along with growth, then a constant real wage allows capitalists to generate reasonable and increasing profits in the manufacturing sector, which would be reinvested. In other words, during this process, effective demand (realisation) is not a problem. Again, this depends on the distribution of the surplus, and the behaviour of capitalists who are assumed to save and invest rather than consume. The rate of growth of the capitalist sector will equal the rate of profit in that sector, multiplied by the capitalists' saving ratio. The share of profits in national income is, therefore, of great importance. The agricultural sector is not assumed to grow, so the economy will become increasingly more capitalistic. Eventually, the capitalistic sector will have exhausted all the surplus labour from the agricultural sector, leading to labour shortages. This will cause rising wages, which will reduce the share of profits and, therefore the growth rate. In other words, capital accumulation will have caught up with the excess supply of labour.

The model can be explained in terms of the Kalecki/Kaldor distinction between Marxian and Keynesian unemployment. Recall that for Marxian unemployment, there is a reserve army of the unemployed which is absorbed as capital accumulates, and which exerts downward pressure on wages. In the Lewis model, agricultural labour takes over the role of the reserve army. Now, the unemployed labour is in the agricultural sector, where, instead of being unemployed, it is underemployed. If the marginal product of these labourers is near zero, then they are effectively unemployed. The accumulation of capital absorbs them. Eventually, when the dual nature of the economy is overcome, and these labourers are absorbed, we are in the Keynesian regime, as now the capital stock is fully able to employ all the labour[7]. So, the Lewis model is closely related to that of Kaldor and Kalecki.

Lewis's model of the dual economy was utilized by many economists, including Kalecki, to stress the structural problems associated with development, that is, the problems resulting from intersectoral relations, ie. the structural relations between different sectors. As a country develops, it will move from a Marxian regime, where employment is limited by the size of the capital stock, to a Keynesian one. The process requires an expansion of the "productive capacity of the capital-

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[7] . Lewis assumed that at this point the neoclassical model, rather than the Keynesian one, took over. Harcourt 1984 p. 33

goods sector". This means that as the process of development continues, we have to move beyond the simple two sector model, à la Lewis, and look at a three sector model which separates the manufacturing sector into consumption goods and capital goods sectors. At this stage, it is no longer simply the size of investment which is important, but also its composition. That is where the analysis takes off.

So, what we see is the importance of structure and institutions for the development process. Development is associated with changes in the structure of economies, as they become more capitalistic and begin to develop capital goods sectors. However, the main features which will determine the ability of an economy to develop are its institutional framework. In particular, the property/land ownership arrangement will have important implications for the potential for the surplus generated in the agricultural sector to be used for expansion of the manufacturing sector. So, for example, if this increased surplus accrues “to landlords, merchants, or money lenders, then … [it] will not be spent at all, or will be spent on luxuries.” (Kalecki 1954 p. 29) Associated with this is the development of the financial institutions required to facilitate such transfers as well as to mediate between capitalist saving and investment decisions. In addition, there needs to be a range of institutions to allow the increased surplus generated in the agricultural sector to be used to pay the wage demands of the newly emerging manufacturing sector, as well as institutions which give the agricultural sector some access to the manufacturing output. Of course, underlying all of this are the institutions which determine the distribution of the surplus between productive and unproductive uses.

The importance of institutional changes helps explain Kalecki’s scepticism with respect to the ability of markets to solve developmental problems in an acceptable way. Problems with generating sufficient investment, with structural imbalance causing inflation and with the general need for change to the financial and land tenure institutions, could not be achieved by markets except at great social costs.

"In general, then, the development of agriculture requires government intervention to overcome institutional obstacles. The measures by government range from land reform and cheap bank credit for peasants to improvements in the method of cultivation, small scale irrigation and cheap fertilizers," [Sawyer 1985 p. 218]

"The constraints on development posed by the existing social and political order were seen as particularly severe in the rural sectors. As well as the problems of simply providing material resources for the development of agriculture, there are still fundamental social and political constraints, already referred to in the nature of semi-feudal land relations and the domination of merchants and money lenders. These vested interests represent powerful restrictions on development which would have to be removed for the development process to proceed. However, it is clear that overcoming the resistance to such institutional change by the privileged classes is a much more difficult problem than curing the problem of insufficient effective demand in developed economies." [Sawyer 1985 p. 221]

Mature capitalism?

Once the development process has reached the stage at which the labour surplus has been absorbed, economic growth and development proceed along the lines suggested by Kalecki and Kaldor discussed above. Keynesian/Kaleckian unemployment becomes important, with effective demand the main determinant of the levels of output and employment and therefore, of the growth rate. With the development of the productive sectors of the economy, there is an associated development of the financial and credit institutions. It is the development of these institutions which frees private sector investment from the requirement of an existing stock of loanable funds (savings), and allows investment to generate the saving necessary to finance it. In other words, as both Keynes and Kalecki have shown, with the development of the financial system, it is no longer increased saving which causes increased investment, rather the causality runs from investment to saving. (see Chick 1983 chapter 9)

With the development of capitalism, and the increased importance of investment comes the advent of large-scale capital. The effect of these are to expand considerably output while increasing the productivity of labour. However, with downward pressure on wages, demand may not increase sufficiently to purchase the increased output. This leads to a new structure of capitalism, reinforcing problems associated with insufficient aggregate demand.

Post-Keynesian economists have identified further structural transformations which occur with the subsequent development of capitalism influencing both the dynamics of competition and of accumulation. In particular, the role of investment changes from being a purely benign generator of increased capital with which to employ the labour force, to having the dual role identified by Kalecki. In later capitalism, the role of investment in generating sufficient demand to fully employ the labour force is paramount. However, at the same time, increased investment increases both productive capacity and productivity, requiring even higher levels of aggregate demand in the future to maintain full employment. "The tragedy of investment is that it causes crisis because it is useful. Doubtless many people will consider this paradoxical. But it is not the theory which is paradoxical, but its subject –the capitalist economy." Kalecki 1937 p. 318[8]

This expansion of capacity also influences the nature of competition. The competitive phase of capitalism, as has been so cogently analysed in Rothschild (1947), Steindl (1952), Sylos-Labini (1962) and Galbraith (1967), has within it the seeds of its own destruction. The competitive process leads to the emergence of large corporations and to what is often referred to as the monopoly capitalism phase of the economy. This, in most mature capitalist economies is associated with excess capacity, oligopolistic market structures and problems with aggregate demand. This phase in the development of capitalism has its own logic of competition and growth as has been well analysed, *inter alia*, by Kalecki, Steindl, J. K. Galbraith, Hymer and Baran and Sweezy.

[8] . This dual relationship played important roles in the work of both Harrod (see Harrod 1939, 1948) and Domar (Domar 1948) and underlies their famous growth models.

Essentially, the analysis of all of these writers demonstrates that “monopoly capitalism is characterized not only by ‘normal’ business cycles but also by a powerful tendency to secular stagnation” (Sweezy 1971a p.8). As a result, monopoly capitalism requires continuous exogenous shocks, such as innovation (associated with Schumpeter’s creative destruction), sales promotion or increased state intervention (sometimes in the form of military expenditure) in order to avoid stagnation. “It can be concluded that semi-exogenous factors, such as innovations, enable the capitalist system to break the impasse of the stationary state and to expand at a rate dependent on the importance of these factors” Kalecki 1962 p. 430)

The important change is not in the degree of competition, but, as Sweezy notes, in its nature: “what is at issue in the transition from competitive to monopoly capitalism, therefore, is not at all the *elimination* of competition, but rather a change in the *forms* and *methods* of competition. In the earlier period when each individual firm supplied only a small share of the market, the main weapons of competition were lowering costs and improving quality. … competition was perceived as coming from all other firms in the industry . …. As concentration and centralization proceeded, however, this situation changed. The number of firms in industry after industry .. declined to the point where each one supplied a considerable share of the market.” (Sweezy 1981 pp. 61-62 emphasis in original) “[C]ompetition inevitably gives way to monopoly via the concentration and centralization of capital, and monopoly retards the accumulation process giving rise to ever more powerful tendencies to stagnation.” (Sweezy 1971 p. 42) Clearly, this discussion applies not only to the manufacturing sector, but also to much of the service sector which exhibits the same monopolistic tendencies. In addition, globalisation is associated with the internationalisation of these tendencies. (Hymer 1972)

“[T]he *normal* state of the monopoly capital economy is stagnation …. This means chronic under-utilization of available human and material resources … Left to itself - that is to say in the absence of the counteracting forces, which are no part of what may be called the ‘elementary logic’ of the system – monopoly capitalism would sink deeper and deeper into a bog of chronic depression.” (Baran and Sweezy 1966 pp. 113-114) “Under monopoly capitalism … the normal condition is less than capacity production. The system simply does not generate enough ‘effective demand’ (to use the Keynesian term) to ensure full utilization of either labour or productive facilities.” (Baran and Sweezy 1966 . 146)

Firms in these concentrated oligopolistic industries, from practical experience, realised that price-cutting is not a successful strategy, and rely increasingly on non-price competition, which changes the nature of the competitive process:

“[M]onopoly capitalism represents a particular historical phase of capitalist society which is a phenomenon unique to that stage, and requires a ‘new’ explanation. There emerge, for example, new forms of competition which may counteract any tendency towards uniformity in rates of profit, the earlier importance of price competition breaks down, with nonprice the norm.” (Halevi and Kriesler 1991 p. 81)

These new forms of competition are associated with the emergence of strong barriers to entry which inhibit the mobility of capital and allow firms to make profits even in the long run.

The idea that competitive capitalism has within it the seeds of its own destruction, has been analysed by a number of Post-Keynesian authors. Of particular importance are Steindl’s *Maturity and Stagnation in American Capitalism*, and Sylos-Labini’s *Oligopoly and Technical Progress,* which both show how the competitive process operates so as to reduce the number of firms within an industry, increasing concentration with the result being a tendency to stagnation.

Both Steindl and Sylos-Labini build on Kalecki’s analysis by examining the relationships between profit margins, excess capacity, investment and industrial concentration. Their starting point is with the recognition of the existence of cost differentials between firms, due to technological differences in production methods. Lower cost firms have greater profit margins which allows them to invest in the latest plant and equipment, increasing industry capacity and further lowering their costs. This gives them cumulative advantages over the high cost firms in the industry. If the growth in industry capacity exceeds growth in demand then unplanned excess capacity will emerge. In this case, the lower cost firms may attempt to secure a greater share of the market at the expense of other firms. This can be achieved either by reducing price and, therefore profit margins or by increasing expenditures on sales efforts. In both cases, smaller, less advantageously placed firms may be forced to leave the industry, leading to an increase in industrial concentration. As this process continues, industries will become dominated by a few large producers. Due to the cost of price wars in concentrated industries, firms will turn to other forms of competition. If accumulation in these industries is faster than the growth of sales then the degree of excess capacity will increase- so industrial concentration and excess capacity are the outcomes of the process of competition between capitalists (of which investment is one aspect).

This process is also associated with social and political change. The emergence of large corporations is related to their power to influence the environment in which they operate through a number of means, including political.

"[M]onopoly capitalism signals that stage of development where capitalism, once progressive, has become retrograde due to its immanent inability to realise the potential surplus output of the economy. Hence the growing tendencies towards unproductive, but not necessarily socially useful activities, including the hypertrophic development of the financial superstructure." (Halevi 1985 p. 112)

Further shifts in the nature of capitalism are apparent, with the rise of the financial sector and of financial capital often at the expense of the manufacturing sector.

Various Post-Keynesian authors have attempted to describe the current developments in capitalism. James Galbraith has written of the peculiarly American phenomena of the "predator state", where the state actively intervenes in the economic realm to increase the space for large corporations. Whereas his analysis concentrates on the developments of the state in America, it is clear that elsewhere the state's role has evolved in different ways, as is evident by comparing America with northern Europe or Asia. In each of these areas, institutional differences have led to very different relationships between the state and the economy. Other Post-Keynesians have documented the increased importance of the financial sector, and the related phenomena of globalization especially of finance and of corporate power. Others have highlighted the dominance of domestic markets and governments by multinational oligopolies in the current situation.

Chick (1986) discussed "the evolution of the banking system". Importantly, in the latter stages of this evolution, "banks develop 'liability management'" where they react to increased financial competition by actively seeking both deposits and "lending outlets". (p. 198) Since the breakup of Bretton Woods and the associated deregulation of international and national financial systems, there have been further developments to the world system. The deregulation of both domestic and international capital, in addition to the general push for financial liberalisation, have resulted in increased volatility in financial prices, particularly interest rates, share prices, and exchange rates. There have been substantial movements of large holdings of funds into positions outside the banking system as a result of "the rise of managed money'". (Wray 2011 p. 8). This refers to the placing of private savings, such as pension and insurance funds, with professional managers. There has been a resultant blurring of the distinction between banking and non-banking activities (the rise of "shadow banks" Wray 2011 p. 9), as well as substantial increases in cross-border financial dealings and "the internationalization of financial business." (Studart 2002 p. 73) Associated with these changes has been substantial growth in capital markets of all types, including derivative markets. These have provided increased "sources for funding for corporate investors", with the downside being increased financial fragility. (Studart 2002 p. 74)

The net impact of this has been to substantially increase the proportion of economic activity related to the financial sector and unrelated to real activity. This, in turn, has increased the divergence of the interests of financial capital from those of real capital, and led to the former dominating not only the economies of the developed world, but also both domestic and international policy.

Conclusion

The discussion in this chapter has been in terms of some general representations of variables and concepts which have been relevant for the development of capitalism, although it should also be noted that many developing countries are taking a different route[9].

Capitalism has developed as an economic and social system from its earliest stages until the present. It continues to develop and evolve, with the current domination of international policy by financial capital a symptom of the latest stage of capitalist development.. The importance of this for Post-Keynesian economic theory is that underlying economic relations are constantly evolving, so that the analysis most appropriate for a particular stage in the development of capitalism may cease to be a relevant consideration as the economy develops. Far from there being a general theory of economic behaviour, economic theory itself has to constantly be changing and evolving in order to maintain its relevance- it is a “houses for courses” discipline! This carries through to the policy area, where simple policy rules must be rejected, in favour of examining the particular problems facing economies at a particular point of time and taking into consideration the current international economic environment.

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[9] An important example of this is India, where the role of service sector in the growth of the economy has been at least as important as the role of manufacturing, and promises to continue to be so, both in terms of its impact on economic growth and of its importance in providing employment. (Government of India 2009, Balakrishnan 2010 and Eichengreen and Gupta 2011)

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