

## **Rent, State and the Market: The Political Economy of the Transition to Self-sustained Capitalism**

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In opposition to the now generalised critique of rent-seeking the following contribution establishes the inevitable character of the emergence of a rent problem in nearly any transition to capitalism from pre-capitalist relations of production. The only possibility of avoiding this possibility would be a rapid demographic decline or an equally rapid increase in availability of productive land. This rent problem in underdeveloped countries is aggravated by the existence of technically more advanced economies. Integration into the world economy can contribute to the management of this rent problem, but does not abolish it. The topic of development economics is, therefore, the combination of market regulation with non-market regulation in order to move the respective underdeveloped economy to a state where rent can be abolished by the extension of the market mechanism. In contrast to the recommendations of the Bretton Woods Institution, the mere reinforcement of market regulation and the withdrawal of the state from economic regulation cannot be considered as sufficient for moving underdeveloped economies to self-sustained growth which allows market regulation.

The contribution is based on Keynesian economics. Market regulation depends on the possibility that decentralised owners of means of production perceive perspectives of earning profit from additional (net) investment. For the individual entrepreneur, these perspectives seem to depend on his efficiency in producing marketable goods with at least state-of-the-art processes. On the macro-economic level, net profit depends however on the net production of investment goods where incomes are paid to workers and capitalists, who do not add directly (through the production of consumption goods) or indirectly (through the production of inputs and replacement of investment goods) to the actual supply of consumption goods. Favourable perspectives of the entrepreneurs may induce them to proceed to employment creating investment, which will contribute to increasing demand. As

any efficient technology reduces unit costs at least in the middle term, investment in itself however, is not sufficient to make consumptive capacity match productive capacity. The continuation of the investment process requires increasing consumption. If this consumption comes only from the higher income strata, the social and economic bases of competition are threatened. Increased consumption in a capitalist economy, therefore, has to come from the poorer households—the average working population—, and hence implies a structure of distribution of bargaining power within the society, which favours labour in its various forms. This can be the result of organisations of the working population, but also of simple scarcity of labour due to the development of marginal productivity. If, however, labour cannot stand in such bargaining relations due to low marginal productivity and/or a weak political position, the process of accumulation within the framework of self-sustained growth can be started only with difficulties. This aspect seems to characterise the structures in underdeveloped economies and the mechanisms they trigger off are the topic of this article.

In a first step, the necessary emergence of marginality and rent is established. Both are closely interconnected. In a second step, it is shown that technical progress and enforcement of market regulation cannot abolish marginality and, therefore, neither rent. From a stylised description of underdevelopment as characterised by rent and marginality, an explanation of well-known and often criticised political structures in underdeveloped economies is offered. From this, the limits to a self-propelling capitalist spurt are discussed.

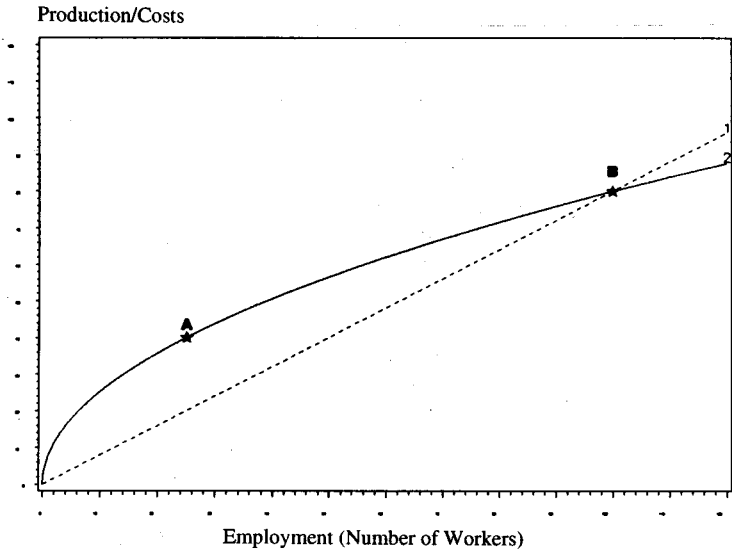
It is then argued that the described rent-trap is reinforced by the mere existence of an international economy in which relative prices and demand are largely determined by technically more advanced and richer market-regulated economies due to new options available for those in control of the surplus as well as due to the typical distribution of comparative advantage as well as price and income elasticities of demand in the world economy.

From this analysis, the conditions for management of rent in order to move the economy to a state are discussed, where market regulation and self-sustained growth with withdrawal of the state from the day-to-day operations of the economy are possible. It is shown that there is not only one blueprint to be followed, but that there are some general rules, which can guide the use of the non-market economy in order to allow the extension of the market-regulated sector.

## **1. THE INEVITABLE EMERGENCE OF MARGINALITY AND RENT IN A PROCESS OF TRANSITION TO CAPITALISM**

An underdeveloped economy is characterised by a low level of technical

development.<sup>1</sup> Due to limited technical possibilities, the law of diminishing returns is operating. In this case it cannot be avoided that at some level of employment additional available workers will produce less in agriculture than they need for the subsistence of themselves and their families (subsistence income). Obviously, it is only in agriculture that marginality can be observed, as only in agriculture physically identical inputs can be compared to outputs without referring to prices of inputs and outputs. The following chart describes the emergence of marginality:



The parabolic curve (1)  $Y_{agr} = \alpha \cdot L_{agr}^\epsilon$ , where  $0 < \epsilon < 1$  of the type of  $Y_{agr} = \alpha \sqrt[\epsilon]{L_{agr}}$  describes agricultural production as a function of the quantity of employment in agriculture  $L_{agr}$ . The costs of production (no capital costs, no inputs, all costs are labour costs ( $L \cdot \lambda$ ); all workers receive only subsistence incomes ( $\lambda_s$ ), which do not increase with a rise in the level of employment) are the costs of labour

$$W_{agr} = \lambda \cdot L \quad \dots \quad \dots \quad \dots \quad \dots \quad \dots \quad \dots \quad (2)$$

No society can exist beyond the point B, where  $W_{agr}$ , and  $Y_{agr}$  intersect. This level of employment will not be reached, if society is divided into two classes, one of which is constituted by the owners of the land, the other one by propertyless labour. If employment increases beyond point A, the surplus of agriculture defined

<sup>1</sup>Georgescu-Roegen, Nicholas: "Economic Theory and Agrarian Economics", in: *Oxford Economic Papers*, 12, 1 (1960); pp. 1-40. Similar: Chao, Kang: *Man and Land in Chinese History* (Stanford, Calif.: Stanford University Press, 1986); p. 6ff. Moo-Ki, Bai: "The Turning Point in the Korean Economy", in: *The Developing Economies*, 20, 1 (1982); pp. 117-140.

as the difference between production and the wage cost in agriculture diminishes.<sup>2</sup> This point may be called threshold of marginality. Additional labour consumes more than it produces and is, therefore, marginal. It cannot be employed in agriculture and, if it should be so, due to pre-capitalists obligations of the landowners, it has to be shed off—at the latest—if capitalist competition is imposed on the landowners.

In a closed economy, and if landowners and labour are separated, maximum employment is determined by the number of those whose marginal production in agriculture is at least equal to their subsistence costs (which also includes the demand for non-agricultural goods and services), and the number of those who can be fed from the surplus of agriculture, which is produced at this level of employment. Whether the non-agricultural labour, which can be fed from this surplus, is really employed depends on the spending behaviour those in control of the surplus.

The owners of land or those in control of the surplus are best served, if the volume of population reaches the level of the sum of productively employed labour in agriculture (including those required for the non-agricultural wage-goods production for agricultural labour)<sup>3</sup> and of those who can be fed from the corresponding

<sup>2</sup>A distinction has to be drawn between the concepts of surplus of agriculture and agricultural surplus. Agricultural surplus is defined as the excedent of food production above food requirements of the productively employed labour in agriculture. Labour, which is employed in agriculture, consumes also non-food items. Up to the amount of this expenditure of agriculturally employed labour for non-food items, there is an offer of food on the market, which is not at the disposal of the landowners or the state as surplus of agriculture. This food is exchanged for non-food items with the non-agricultural economy; the agriculturally employed labour purchases non-food items. This offer of food and the surplus of agriculture add up to the agricultural surplus defined as the total quantity of food which is not consumed by the agriculturally employed labour. The surplus of agriculture can be used for feeding labour which produces goods and services for the landowners and other privileged ones. The difference between the surplus of agriculture and the agricultural surplus, however, is used for feeding those workers who produce non-food goods and services for labour employed in agriculture.

<sup>3</sup>Maximum employment in agriculture is defined by  $Y'_{agr} = \lambda_s$ , so that

$$L_{agrmax} = (\lambda_s / \alpha \cdot \epsilon)^{\frac{1}{\epsilon - 1}} \dots \dots \dots \dots \dots \dots \dots \dots \dots \dots \dots \dots \dots \dots \dots \dots (39)$$

Non-agricultural wage-good employment for agricultural and non-agricultural workers consumption depends on spending  $\mu$  of wage-earners in agriculture on non-agricultural wage-goods and the non-agricultural consumption of workers employed in this activity. Employment in non-food wage-goods production for the agricultural workers and those non-agricultural workers who work for their supply in non-agricultural wage-goods is  $L_{big}$  (where *big* stand for basic industrial goods):

$$L_{big} = ((\mu / \lambda_s) + (\mu / \lambda_s)^2 \dots + (\mu / \lambda_s)^n) (L_{agrmax}) \dots \dots \dots \dots (40)$$

$$= \left( \frac{1}{1 - (\mu / \lambda_s)} - 1 \right) \cdot (L_{agrmax}) \dots \dots \dots \dots (41)$$



Such a politico-economic structure should be considered as rather stable for two main reasons: First, as it is shown in periods of turmoil, a decline in spending capacity of the rich will reduce all those to abject poverty who are neither agriculturally productive nor in the non-agricultural wage-goods production. They lose all entitlements to income. As agricultural surplus is still there, they will engage in looting and other disorderly activities for gaining access to food. Both, the agriculturally employed and the shed-off population, therefore develop an interest in maintaining the existing system of exploitation provided that it keeps the rate of exploitation within tolerable limits. The cyclical movement of such societies from the breakdown of the system of exploitation to its re-establishment under the leadership of an at least initially more benign dynasty, as it is described by the theory of the "dynastic cycle" in Chinese history or with reference to the Islamic world by Ibn Khaldûn, corresponds, therefore, to the economic interests of both parts of the underprivileged population, namely those in agriculture and those in luxury production.

As well, at low levels of specialisation, which can reasonably be assumed for such predominantly agrarian societies, skills are rather evenly distributed among labour at least for the larger part of productive activities. Those who do not find a possibility to be engaged in agriculture or non-agricultural wage-goods production are kept out of gainful employment not because of their lack of skills, but because of the sheer size of numbers. They cannot obtain employment on the basis of better skills, which would produce a higher surplus for a potential employer. Therefore, they will try to offer other services of non-material character, for example loyalty or devotion or even political support. They will try to establish relations with the gatekeepers for access to employment and food. Solidarity will not develop between large groups characterised by an identical position in the process of production, as anyone among them can be substituted by somebody else. Unlike a class of workers in a capitalist society, which is entirely composed of surplus producing labour, they cannot opt for strike. As the access to surplus depends on political mechanisms, locally powerful ones can maintain their position only, if they achieve protection by more powerful ones. These more powerful ones derive their situation from their capacity to combine the resources of a number of locally powerful ones against any attempt to overthrow the existing order, should it occur. Vertically structured networks of political support emerge, which have at their apex the central ruler. There may be cleavages and rivalries within this political structure, but these controversies will lead to capitalist competition only, if profit can emerge. This depends not only on decentralisation as will be discussed below. The prevalence of vertical ties of patron-client relations over horizontal solidarity beyond the very limited range of small groups, such as family and kinship group, is the result of the ever present danger of marginality at the bottom of society.

Mainstream economics have always supposed that labour is at least as productive as to yield some surplus at a sufficiently low wage. From the above demonstration it seems that underdevelopment can be defined by the absence of this condition. If underdevelopment is not only backwardness, but a specific economic, social and political structure, which requires a specific theory, then the existence of marginality is the essential criterion. Marginality goes with the existence of a surplus which at this point of the argument, I have assumed as appropriated on the basis of power and not on the basis of efficiency on the market. The existence of marginality has two implications: There can be no wage drift which raises real wages in case of productivity increases in some even "isolated" sectors of the economy where unqualified labour can be employed and, hence, become scarce (and, therefore, valuable also in other sectors). Neither, due to patron-client relations, can powerful organisations emerge which unite the social forces on horizontal lines, as it is the case if society is organised on the basis of common socio-economic criteria derived from the position of the various individuals in the process of production.

## **2. PROBLEMS OF CAPITALIST TRANSFORMATION BASED ON TECHNICAL PROGRESS, ACCUMULATION AND COMPETITION**

The simultaneous existence of surplus and marginality is the basis of the idea widely shared in development politics and development economics that the main problem is to find individuals or institutions (and mostly a combination of the two) that are able to transform surplus into productive investment. A variety of solutions is proposed. The development state was one of them. Its decline due to inefficiency is at the basis of what is presently called the crisis of development theory, which leads to a renewed interest in the market.

On the basis of my argument about the most probable simultaneous existence of surplus and marginality, this challenging question can be narrowed down to the following problematic: A continuous re-investment of profit depends on expanding demand from whatever source, as additions to capital stock increase capacity of production. There are three categories of economic subjects, which can provide this additional demand: These are labour, which may increase its demand because of either rising employment or increasing real wages, the non-capitalist landowners, who may increase their demand for products of the capitalist entrepreneurs, or the capitalist entrepreneurs themselves, who increase their demand for labour due to their tendency to accumulate.

The impact of technical progress on the surplus-plus-marginality syndrome

varies according to the category of products in the elaboration of which technical progress occurs. Productivity increases in the production of luxury goods do not influence the costs of the agriculturally employed. They do not change the threshold of marginality. As well, they do not increase the surplus of agriculture.

Productivity increases in wage goods production do have an influence on the threshold of marginality. The slope of  $W_{agr}$  decreases depending on the rate of increase in productivity in non-agricultural wage goods production and on the share of food in consumption of the agriculturally employed labour. With decreasing shares of non-food items in subsistence spending, maximum surplus of agriculture approaches the level of employment where maximum agricultural surplus (cf. footnote 2) is achieved, where  $\lambda_s$  equals  $\phi$ , the spending for the amount of food necessary for subsistence per agricultural worker household.<sup>5</sup>

The main effect of an increase in wage goods productivity are declining terms of trade for industry and finally a decrease in employment in wage goods production as increasing productivity at only slowly growing physical demand (increases are only to be expected from increases in employment) will result in decreasing labour requirements. Productivity increases in wage goods production can support an expansion of industrial production only, if the assumption of stagnant mass incomes is dropped. This requires an end to the influence of marginality on the labour market either by increasing marginal productivity in agriculture or by

<sup>5</sup>Take the definition of footnote (4), Equations (39) and (44)

$$L_{Basic} = L_{agrmax} + L_{big} = \frac{\lambda_s}{\phi} \cdot \left(\frac{\phi + \mu}{\alpha \cdot \epsilon}\right)^{\frac{1}{\epsilon-1}} \dots \dots \dots \dots \quad (45)$$

If productivity in non-agricultural wage goods production increases,  $1/\phi$  and  $1/(\alpha \cdot \epsilon)^{\frac{1}{\epsilon-1}}$  are constant.

So,

$$L_{Basic} = (\phi + \mu) \cdot ((\phi + \mu)^{\frac{1}{\epsilon-1}}) \cdot constant \dots \dots \dots \dots \quad (46)$$

If productivity in non-agricultural wage goods production increases at the rate of technical progress  $\theta$ , the cost of an identical quantity of  $\mu$  decreases and is defined as  $\mu/\theta$ . From (46):

$$L_{Basic} = \left(\phi + \frac{\mu}{\theta}\right)^{\frac{1}{\epsilon-1} + 1} \cdot constant = (\phi/\alpha \cdot \epsilon)^{\frac{1}{\epsilon-1}} \dots \dots \dots \dots \quad (47)$$

With increasing  $\theta$ ,  $\mu/\theta$  tends to zero and  $L_{Basic}$  decreases, reaching its limit at  $(\phi/\alpha \cdot \epsilon)^{\frac{1}{\epsilon-1}}$ , where the wage-earners have a consumption of non-agricultural goods of zero, so that  $\lambda_s = \phi$  and hence  $L_{Big} = 0$  and  $L_{Basic} = L_{agrmax}$ .



redistributive measures in case of an increasing surplus in agriculture.

Technical progress in agriculture can have two results, which in the case of any particular innovation may be achieved to different degrees. Progress may increase the surplus of agriculture by shifting the production curve or increase marginal productivity per worker employed. If it increases only the surplus, the possible change in employment depends on patterns of spending behaviour of those in control of the surplus. Additional surplus from agriculture increases the precarious employment, but not the number of those whose marginal product is higher than their subsistence costs. New inputs may even contribute to higher yields with decreasing employment. If technical progress in agriculture increases marginal productivity, employment in agricultural and non-agricultural wage good production increases.

From the various types of technical progress I conclude that technical progress can contribute to the eradication of marginality in agriculture only to a limited degree. The question of entitlement remains as long as marginality pockets continue to exist.

### 3. THE LIMITS TO A SELF-PROPELLING SPURT OF CAPITAL ACCUMULATION

Whether the capitalist sector is capable of bringing about growth without increasing wages is a question which has been debated for a long time, especially in the controversies about late 19th century Russia and imperialism. Various solutions have been proposed. The Schumpeterian<sup>6</sup> vision is based on dynamic entrepreneurs. As any new technology reduces unit costs (otherwise it would not be competitive with the existing ones), available resources for investment continuously increase, if real wages are constant. It is the existence of dynamic entrepreneurs who just invest as they see new technologies. By this way they raise the spending on capital from period to period. A specification of the relations between capital stock, investment, profit and production (see Appendix 1) shows that such a system will not run into the problem of a decline in the profit rate only, if capital productivity will not decrease despite continuous capital deepening. This condition requires, however, a continual increase of the rate of growth of production and hence also of labour productivity until the share of labour in total incomes tends to zero. If the condition of continuously increasing rates of growth of labour productivity is dropped, we arrive at the solution Lenin seems to have proposed in his analysis of the develop-

<sup>6</sup>Schumpeter, Joseph Alois: *Konjunkturzyklen* (Göttingen: Vandenhoeck and Ruprecht, 1961); p. 110ff. Schumpeter, Joseph Alois: *Theorie der wirtschaftlichen Entwicklung* (Berlin: Duncker and Humblot, 1934); p. 111ff.

ment of capitalism in Russia.<sup>7</sup> In that case, the rate of growth of capital increases for a series of periods without pulling production to a same rhythm of growth. The capital-output ratio rises. In such a model, high, but from period to period declining rates of growth of profit allow to keep the rate of profit and the rate of capital expansion even on the rise, but not indefinitely. The effect of the decline of the rate of growth of profit<sup>8</sup> and the effect of the increase in the rate of growth of capital accumulation above the rate of growth of income will inevitably lead to a situation where the rate of growth of accumulation and the rate of profit have to fall. The fall in the rate of profit will not occur in unrealistic areas of the model where the share of wages in net income is near zero, and depends on the initial capital-output ratio, the initial share of profit in net income and the exogenously determined rate of technical progress, which is also the rate of growth of labour productivity.

Capitalists may react against the (after some periods) inevitably threatening fall of the profit rate by reducing the rate of accumulation per employed worker and woo away labour from other capitalists. This would imply their readiness to accept a perhaps less important fall in their individual profit rate due to rising wages.

Tugan-Baranowski, has suggested a model, in which the system grows only by ploughing back profits into employment creation without capital deepening and without increases in labour productivity.<sup>9</sup> This seems to have been the solution suggested in the models proposed by modernisation theory, where increasing volumes of surplus were used for the creation of jobs in the modern sector, until the labour surplus in agriculture was absorbed, which was expected to exist due to marginal productivity below subsistence (and in some models even at zero). This solution does not lead to any tension between capital accumulation, profit rate and rate of growth as long as labour productivity does not increase. If, however, the implied assumption is rejected that capitalists do not improve on technologies, the rates of growth of total product increase from period to period. Explosive growth takes now the form of a continuous increase in the rate of growth of employment creation, which unhappily we have not yet been able to observe in the really existing capitalist system.

There are conditions for the employment of new labour, especially if the entrepreneurs operate in another society or if labour from another society has to be employed. As it is implied that real wages have not yet risen beyond subsistence,

<sup>7</sup> Lenin, Vladimir Il'ich: *The Development of Capitalism in Russia* (Moscow: Progress Publishers, 1956); pp. 54, 283, 556. Lenin, Vladimir Il'ich: *A Characterisation of Economic Romanticism* (Moscow: Progress Publishers, 1967); p. 32.

<sup>8</sup> Obviously, this is not any support to the Marxian law of the tendential fall of the rate of profit. If real wages increase and keep the rate of accumulation down to the rate of productivity increase, the problem will not emerge. The problem in the transition to capitalism is, however, that the increase in labour productivity is not translated into wage increases as long as marginal labour exists.

<sup>9</sup> Tugan-Baranowski, Michael von: *Studien zur Geschichte der Handelskrisen in England* (Jena: G. Fischer, 1901); pp. 21–25.

these new workers can be employed only if they reach very rapidly the levels of productivity of the already employed ones, as they cannot out-compete employed workers with lower wages. Whether this is possible depends on the sources of growth in labour productivity. If technical progress is embodied only in the machinery and hence, at least in principle, mobile, such an extension of employment seems not to be problematic. If, however, technical progress depends on a residual factor or human capital or any non-visible and non-measurable transformation of the environment for production, which is not mobile, the extension of employment would require rising wages for the already employed workers.

The various solutions proposed to overcome the tensions, which emerge if capitalist accumulation proceeds with constant real wages, can even be combined and lead to multistage models of growth with changing "regimes of accumulation" of the type the French regulation school has proposed.<sup>10</sup>

Most, not all models of this type come to dynamic steady states when the share of labour in total income tends to zero, because obviously now all remaining aggregates can have identical growth rates. This long-term solution is not interesting as it is an unrealistic one. What comes out from these models is that growth without expansion of final consumption based exclusively and even primarily on increases in capital formation and so-called productive consumption is a precarious one and limited in time. If the volume of marginal labour is low, such a spurt may lead to full employment and labour scarcity, in this way bringing the economy on the rails of self-sustained capitalist development. However, where the amount of marginal labour is important such a result is improbable.

For the success of such a spurt, the development of capital productivity is important. Machinery can be used, if identical products can be produced. An increase in employment of machinery requires an increase in the consumption of homogeneous products. A demand from high income households is more diversified and will lead to fewer opportunities to use machinery in relation to a same amount of demand from lower-income households. As well, an improvement in machinery performance in relation to costs, hence in the productivity of machinery production, depends on the specification of the machines, i.e. on the development of single-purpose machinery. This can only be achieved, if homogeneity in output increases, as was experienced by German machinery production in the 1920s.

If we integrate the capitalist sector into the rentier economy, which it is expected to transform, the stated dependence of capital productivity on homogeneity of demand has an important consequence. The pre-capitalist class, which controls the surplus from agriculture, has a diversified import-intensive demand. It therefore limits the rise in capital productivity and hence the impact of the Schumpeterian

<sup>10</sup>Boyer, Robert: *La théorie de la régulation* (Paris: La découverte, 1986); p. 100.

solution. It is possible that the capitalists will be able to take over the whole industrial production and become the only suppliers of industrial goods to the pre-capitalist class. In that case, they will orient their production to luxury goods and they will experience low rates of increases of productivity. Sombart's<sup>11</sup> vision of capitalist growth being dependent on luxury consumption has an area of applicability, but its impacts for transformation of the economies is limited. The argument admits an increasing importance of the "capitalist" sector in the satisfaction of the demand of luxuries but at decreasing possibilities for mechanisation. The 19th century cases of Britain and France are instructive, with France being specialised on luxury products, experiencing high profits and also a high productivity, if measured in export prices, but where technical transformation was much slower than in England.<sup>12</sup>

Suppose now that the pre-capitalist class remains in control of the surplus of agriculture with its pre-capitalists habits on which we may base the assumption that productivity in agriculture will not increase. With this, the terms of trade between agriculture and the still only industrial capitalist sector have to move in favour of agriculture. The surplus, which the pre-capitalist class draws from agriculture, becomes more and more valuable in relation to the assets the capitalist can acquire. In addition, as the capitalists become richer, they will make investment decisions not only on the basis of the rates of return on assets which are supposed to decline, but also on the basis of the probability with which these future returns will occur. As the surplus of agriculture is certain and its value increasing, the capitalist class will tend to buy assets held by the pre-capitalist class and transform itself into a part of such a pre-capitalist class instead of transforming the "traditional" economy.

But, in the absence of lavish spendings of the pre-capitalist class, the capitalists can force the owners of land to sell or change the methods of production in agriculture only, if the capitalists rise the labour costs for the pre-capitalist class in providing above-subsistence incomes for labour outside agriculture and hence by raising the real wages in the capitalist sector. This, in turn, the capitalist sector is able to do only, if marginal labour does no longer exist or is supported by redistributive measures.<sup>13</sup> The continued behaviour of capitalists as innovators and the trans-

<sup>11</sup>Sombart, Werner: *Luxus und Kapitalismus* (Munich/Berlin: Duncker and Humblot, 1913); p. 114ff.

<sup>12</sup>O'Brien, Patrick Karl/Keyder, Çağlar: *Economic Growth in Britain and France 1780-1914. Two Paths to the Twentieth Century* (London: Allen and Unwin, 1978); p. 162. Crafts, N. F. R.: "Economic Growth in France and Britain, 1830-1910: A Review of the Evidences", in: *Journal of Economic History*, 44, 1 (1984); pp. 49-67.

<sup>13</sup>Obviously, one can construct models, where the push of the capitalist sector based on an increase in the rate of capital accumulation is sufficient to absorb all marginal labour and to push the economy to a state, where the wage drift operates. This is even easier, if the pre-capitalist class for one reason or other engages in heavy spending, for example for overhead capital, transport construction and so on. On the other side, the larger the volume of population, which is marginal, the less it is probable that such a push of the capitalist sector is sufficient to transform the economy.

formation of the pre-capitalist class into a capitalist one depend on the eradication of marginality which, under favourable conditions, may be achieved by a capitalist spurt. This, however, is the less probable the greater the amount of marginal population, which has to be absorbed. As long as this breakthrough is not achieved, capitalists and the pre-capitalist ruling class will co-exist. As the capitalists depend on the consumption of the pre-capitalist ruling class, they will tend to entertain good relations with the pre-capitalist ruling class. In case of conflict, the members of the pre-capitalist ruling class can always reduce their market orientation and consume services and goods, which are supplied by labour on their "estates". If the capitalists should try to upset this order, for example by reducing the surplus which goes to the pre-capitalist class, through taxes or foreign competition, the pre-capitalist class can invest in military services. In order to defend themselves against such strategies, the capitalists also have to spend money either on political services (buying support from the non-capitalist sector) or even by establishing own private armies.

The implications of the rent-cum-marginality syndrome can hence be summarised as follows: A capitalist push based on technical innovation is of limited impact, if real wages do not rise, as long as unrealistic increases in the rate of growth of labour-productivity are excluded, as capitalist accumulation has to be expected to outrun the rate of increase in labour productivity. If such high increases in labour productivity are, however, possible, it is still not certain whether the entrepreneurs will realise these possibilities. Hicks with a declining marginal efficiency of capital and Harrod<sup>14</sup> with a breakdown of expectations of capitalists describe the two types of blockages, which I mention here.

The system tends to revert to non-capitalist structures for economic and political reasons as long as the marginality trap is not overcome. It is not only food production, which has to increase if the capitalists should be enabled to increase employment beyond the threshold of marginality and the employment, which the agricultural surplus at this level of agricultural employment supports, but also entitlement. A capitalist spurt can contribute to such entitlement on the basis of employment creation, but only to a limited extent. The contribution of the internal final and even intermediate demand becomes even more limited in the case of such an economy being integrated into a world economy, in which technically more advanced countries are dominant. Exports may or may not compensate.

#### **4. THE REINFORCEMENT OF THE MARGINALITY TRAP BY THE OPENING OF A BACKWARD ECONOMY TO THE WORLD MARKET**

The opening up of such a backward economy to a world economy dominated

<sup>14</sup>Hicks, John: *Money, Interest and Wages: Collected Essays on Economic Theory* (Oxford: Basil Blackwell, 1982); p. 41. Harrod, Roy Forbes: *Economic Essays* (London: Macmillan, 1952); p. 273.

by more advanced economies entails the danger that those fed from the surplus of agriculture will be shed off from employment. In the closed surplus-cum-marginality economy, those in control of the surplus cannot use this surplus for other purposes than employing local labour. This labour is not employed, because it produces itself a surplus in agriculture. The surplus out of which it is fed, is already produced by other workers. This labour transforms the surplus from agriculture which is already available, in exchange of the additional costs of its own non-agricultural consumption which those in control of the surplus have to accept. If there are no capitalists the only possibility of transformation of the surplus from agriculture into surplus appropriated for the ruling class is its use for purposes which are not profit-based investments: The pre-capitalist class will use this remaining surplus for purposes which are not characterised by clear expectations about future yields in additional income. Such uses may be luxury consumption. But it is not excluded, that such uses may be considered as "investments", i.e. changes in the physical environment of production which may contribute to increases in productivity. Orientations of the pre-capitalist classes with respect to their spending behaviour are not irrelevant for the possibilities of transition to capitalism.

If that this economy is opened to the world market dominated by technically more advanced economies (either by quantity or quality imported luxury products exceed the volume of luxury goods those in control of the surplus can produce with the local labour they until now had fed from the surplus of agriculture) there is no barrier against exchanging the whole surplus from agriculture against imports. The security net which was provided by the absence of alternative uses of surplus and which brought the society back to its employment-maximising pre-capitalist mechanisms of operation is now abolished. Because of the existence of a more advanced surrounding world economy, the pre-capitalist class is no longer forced to use the locally available surplus of agriculture for local employment.

In addition, those in control of the surplus in the less advanced economies with limited investment possibilities may transform themselves into "capitalist" holders of assets by buying revenue-yielding property in the advanced countries if the latter allow capital-imports. They do not become truly innovative capitalists, but continue be rentiers in the sociological use of the term, living just of their estates. Due to the obstacles against rising mass incomes in the backward economy this latter should normally be expected to become a "capital"-exporting economy; surplus is no longer ploughed back into local employment (and more so not into investment), because there are now revenue-yielding opportunities outside the backward economy.

Suppose that this economy has however no comparative advantage in any non-food production as is assumed in the specification of the model, the shed off labour outside agriculture cannot be employed for additional food exports as its

marginal product in agriculture is less than its subsistence costs and its "value-added" in food production is negative. Thus, specialisation is no complete substitute for factor mobility if agricultural productivity in the respective economy is so low that agriculture cannot function also an employer of last resort and if industrial productivity is high only in branches where world market demand is characterised by very low price elasticity of the demand.

This impossibility of using the labour fed out of the surplus of agriculture for exports despite the possibility of using it for nonagricultural works and services inside the economy before specialisation points to very different linkages between the non-market economy and a growing capitalist sector in the period of transition according to the time when the start to capitalism occurs. If the pre-capitalist class uses this labour for the production of nontradeables inside the economy, it can contribute to employment and hence also to mass demand for the capitalist sector in the process of transition. In the case of 19th century Europe, the pre-capitalist classes engaged in government spending for public works and military purposes in order to maintain their power position within the framework of the rivalries between contending political powers, quite independently from the rate of return on these "investments". The construction of railways was an important source of employment in all major industrialising countries in the 19th century with very little import content. Arms production and large armies had an incidence on the internal labour markets. On the contrary, infrastructural investments in today's Third World are more specific due to technical developments. The share of local production in transport systems is nowadays lower, and the share of imports in military spending has increased due to the greater importance of sophisticated technology as compared to the sheer number of military manpower.

## 5. MARGINALITY AND THE DIVISION OF LABOUR

From what was said about the condition for the introduction of a new technology, i.e. that it reduces unit costs, it follows that any new technology which is economically efficient is self-financing. Its introduction may require an efficient banking system but does not need any transfer of financial resources neither from outside nor from other economic sectors. This is the reason why capitalist economies, when kept on full employment, outperform the ones euphemistically called real-socialist, which for long periods had higher shares of investment in GNP with unchecked declines in capital productivity.<sup>15</sup> The only non-capitalist sector

<sup>15</sup>Cf. the literature quoted in Elsenhans, Hartmut: *Abhängiger Kapitalismus oder bürokratische Entwicklungsgesellschaft. Versuch über den Staat in der Dritten Welt* (Frankfurt am Main: Campus, 1981); pp. 90–91. English translation forthcoming: Elsenhans, Hartmut: *State, Class and Development* (New Delhi: Radiant, 1994).

which, in establishing a monopoly price, does not abolish the mechanism of competition between those in control of surplus is unskilled labour, which by enforcing real wage increases in line with productivity increases keeps the rate of growth within the range of technical progress and provides new opportunities for producing goods with capitalist methods of production and hence increases the rate of technical progress.

Real wages in a capitalist economy increase in line with average productivity. Branch-wise or production line-wise productivity increases diverge from average productivity due to technical conditions. These differences in productivity never depend on the rate of growth of fixed capital in the respective branches or production lines, as it is shown by high capital-output ratios in declining industries (coal, steel) and very low capital-output ratios in rising industries (e.g. office machine production), and especially in machine-tool production.

If real wages increase in line with average productivity, those production lines with below average productivity will experience rising unit costs. As well, production lines with above average productivity increases will experience declining unit costs of production. This entails shifts in labour allocation and, by increases and reductions of production, changes in relative prices.

Technically less advanced economies will experience permanent shifts in their comparative advantage, even if there is no technology transfer. As productivity increases in the technically advanced economies differ according to production lines, the lags in productivity of technically backward economies scatter over the various production lines and the differences in relation to the advanced economies vary over a wide spectrum. Backward economies will be competitive already at a relatively high international price of their local labour power in only a few production lines. They will increase the volume of their exports if the international price of their labour decreases. At what level of international price of labour they can achieve full employment for their agriculturally marginal labour depends on the price elasticities of the demand for those products where competitiveness is achieved at a rather high level of international price of their labour, and the scattering of its lags in productivity with respect to the technically leading countries whose comparative prices influence and even determine relative prices on the world market for a wide spectrum of products.

At declining exchange rates, new activities (exports and also activities which substitute imported goods) will become competitive. As well, lower exchange rates will lead to lower international prices for the products exported and hence possibly to more employment in these production lines. Hence, the impact of a declining exchange rate on export earnings will depend on the price elasticity of the demand for those goods, were relative backwardness of the underdeveloped economy and the scattering of the productivity lags are low.



From the history of international specialisation, the theory of the product-cycle<sup>16</sup> and the theories about income elasticity and skill requirements associated with new products,<sup>17</sup> we may reasonably deduce that relative productivity of backward countries is rather high in raw materials production, in traditional mostly labour-intensive products, as well as in mature products which may be produced with capital-intensive methods of production.<sup>18</sup>

It may be reasonably assumed, that price elasticity for labour in technically backward economies is less than unity for a large range of possible states of specialisation with the result that export earnings will decline with intensified specialisation; at least the increase in export earnings may be lower than the increase in the local cost of local content so that intensified specialisation goes with a decline in available financial resources for investment. This has been the topic of the discussion about the declining terms of trade of Third World countries, which was at the basis of the development of state intervention in the process of allocation of financial resources and in the external economic relations of Third World countries.<sup>19</sup>

Suppose that the government wants to combine high export earnings with high employment growth. It can use devaluation in order to render competitive new export and import substituting production lines and combine this devaluation with export taxes on those products which are already competitive at high international prices of local labour, the famous solution of devaluation-cum-export tax.<sup>20</sup> This is nothing else than the appropriation of a rent by the government. If the rent was invested in the rent-yielding activity, production would go up and the rent would decline due to declining prices. Rent appropriation therefore requires its channelling into uses, where the individual profit rate is less than the rent cum profit rate in the rent generating sector. This can be achieved only if the government sets appropriate data, normally if the government itself allocates the rent. This is one (albeit not the only) economic basis of the development state. Rent appropriation will be efficient

<sup>16</sup>Vernon, Raymond: "International Investment and International Trade in the Product Cycle", in: *Quarterly Journal of Economics*, 80, 1 (1966); pp. 190-207.

<sup>17</sup>Kindleberger, Charles: "Anciens et nouveaux produits en commerce international", in: *Economie appliquée*, 7, 3 (1954); pp. 281-297.

<sup>18</sup>Although this has been discussed at length with respect to raw materials from underdeveloped countries, it also applies to manufactured goods as it was shown by the declining terms of trade of the newly industrialising countries of East Asia in the last decade. Sarkar, Parbirjit/Singer, H. W.: "Manufactured Export of Developing Countries and their Terms of Trade Since 1965", in: *World Development*, 19, 4 (1991); p. 339.

<sup>19</sup>Both facts were influential for the emergence of development economics since the 1930s, when the colonial export economies went into crisis due to the world economic depression of that period, Elsenhans, Hartmut: "The Great Depression of the 1930s and the Third World", in: *International Studies*, 28, 3 (1991); pp. 273-290. Elsenhans, Hartmut: "Decolonisation: From the Failure of the Colonial Export Economies to the Decline of Westernised State Classes", in: *Maghreb Review*, (1994); forthcoming.

<sup>20</sup>Kaldor, Nicholas: "Dual Exchange Rates and Economic Development", in: *Economic Bulletin for Latin America*, 9, 2 (1964); p. 220.

as long as the increase in investible resources through rent appropriation will be higher than the decline in capital productivity in comparison to the percentage increase of available resources.<sup>21</sup> The development state of the Third World did not run into decline, because its state bureaucrats were less efficient than capitalist entrepreneurs, but because this degree of inefficiency in managing investible resources was so much bigger than the increases in the amount of investible resources though rent appropriation.

Falling terms-of-trade were an important element of the industrial transformation for the first industrial country. Increasing terms-of-trade provide disincentives for economic transformation as already mentioned by H. W. Singer in his seminal contribution on the deteriorating terms-of-trade in 1950.<sup>22</sup> The voluminous literature on the so-called Dutch disease establishes that even an industrialised and diversified economy may experience difficulties in maintaining industrial competitiveness, if terms-of-trade are good. This applies even for foreign aid.<sup>23</sup> As well the difficulties, which the old industrial countries experience in their competitiveness with newly industrialising countries (especially of Asia) cannot be explained by too high costs of labour in these economies, but by the good prices they earn on the basis of the exports of their traditional industries, where their advances in productivity are much higher than in the new industries, where technical innovativeness does no longer depend on learning and skills acquired in the older industries.<sup>24</sup> In the 1980s, the wage restraint of German labour has been regularly cancelled by continuous evaluations of the Deutschmark due to high competitiveness of Germany in some older industries with the result of continuously improving terms-of-trade of Germany.<sup>25</sup>

The decisive question then is not the development of the terms-of-trade and

<sup>21</sup>Let be  $R$ =rent,  $P$ =profit realised under capitalist competition,  $b_g = (R + P)/Y$ , capital productivity under government regulation, and  $b_c = P/Y$ , capital productivity under perfect competition, the growth rates are  $y_g Y = (R + P) \cdot b_g$  and  $y_c Y = P \cdot b_c$  and  $y_g / y_c = \frac{(R + P)}{P} / \frac{b_c}{b_g}$ . If the relative increase in investible resources is higher than the relative decline in capital productivity, the growth rate goes up, despite the inefficiency of the state planners.

<sup>22</sup>Singer, Hans W.: "U.S. Foreign Investment in Underdeveloped Areas. The Distribution of Gains between Investing and Borrowing Countries", in: *American Economic Review*, 40, 2 (1950); pp. 482.

<sup>23</sup>Younger, Stephen D.: "Aid and the Dutch Disease: Macroeconomic Management When Everybody Loves You", in: *World Development*, 20, 11 (1992); pp. 1587-1597. Elsenhans, Hartmut: "Political Obstacles to Private Sector Development", in: Bennett, James G., (ed): *Private Sector Development in Bangladesh* (Oase: Cologne, 1991); pp. 205-245.

<sup>24</sup>Elsenhans, Hartmut: "State, Economy and Power, and the Future of the International System", in: *Europe India: New Perspectives in Changing Power Structures in the International System* (New Delhi: Friedrich Ebert Foundation, 1993); p. 26.

<sup>25</sup>One example among many: *Handelsblatt*, 5/6.11.1993; p. 3. cf. already: Courcier, Michel/Malsot, Jean; *La spécialisation internationale des industries à l'horizon 1985* (Paris: La documentation française, 1978); p. 241, who pointed to technology rents of German industry which will delay German economic modernisation.

the earnings achieved from exports but the capacity of the export sector to transform the economy. Specialisation on products with different technical characteristics despite declining export earnings, may have different results for the long-term growth of an economy depending on the implications, which exports products may have for improving technical proficiency and innovativeness.

From what was said about the absence of capital-deepening in technical improvement, the necessarily higher rate of growth in productivity in machine-building in relation to average growth of productivity can be deduced. An innovating machine producer can introduce a new machine, if it reduces unit costs (or improves the quality of the product in relation to costs). The performance-cost ratio between these savings and the cost of the machinery is a measure of productivity in machine production. If there is competition, even in case of a high degree of specialisation of most machine producers, a longer-lasting exceptionally high rate of profit due to innovation in a machine production plant will induce other machine producers to enter the market with similar solutions. When prices for the new machine decrease due to competition, the user of the machinery will experience an increase in productivity. The total sum of savings and quality improvements is related to the costs of production of the machinery, if the performance-cost ratio in machinery production is referred to, as opposed to total costs of production of the economy if average productivity is calculated: the increase in physical productivity in machinery production is always higher than the increase in average productivity of an economy, which determines real wages.

The increase in productivity for the user of a machinery can always be achieved by any user of the machinery, provided that he operates it at standard speeds. This may often be the case if the operation of the machine does not require special skills. The more a technology is mature and hence capital-intensive, the lower the skill requirements and the more productivity is independent of the technical skills in its economic environment. Especially capital-intensive mature technology (like a passenger car) can therefore be used in the Third World with levels of productivity quite comparable to the ones achieved in technically more advanced economies. The underdeveloped economies will hence participate in productivity increases in the machinery-employing production lines without participating in the upgrading of skills in the machine-producing production lines. A decrease in costs due to the use of imported machinery will even displace locally produced machinery, leading to the loss of skills, which otherwise would have been developed. Innovation in the machinery production of the advanced economy will lead to a shift of comparative advantage of the backward country against local technology production, and this being not due to factor proportions, but to differences in growth of productivity between machinery-employing and machinery-producing production lines. The contention does not hold when completely new technologies are discov-

ered, where achievement does not depend on proficiency in existing ones, as debated in the theories about long-term waves of capitalist growth.<sup>26</sup>

Obviously, this formulation of the development of comparative advantage challenges conventional theory of international specialisation according to factor endowments, which are here considered as quite irrelevant, as technical advance does not depend on the degree of capital intensity achieved. Capital is less important than brains.<sup>27</sup>

Due to this difference between average productivity increase and productivity increase in machine building in the technically advanced countries, the production of less performing machinery in the technically backward economy on the basis of low wages becomes unprofitable, if there are no additional sources of learning (for example copying) and if the exchange rate reflects average productivity differences. Complete specialisation makes the backward country dependent on technology imports without opening up an avenue for catching up in productivity in machine building and hence in technical proficiency. This has an important implication on the applicability of market regulation for global demand management, the normal instruments of state interventionism in a market economy.

Global demand management of a capitalist economy primarily is oriented to influence the profit rate, hence the demand for investment goods, which are expected to be produced locally, at least to a high proportion, and through investment activity also the demand for labour and the development of wages. Monetary policy operates through the rate of interest and, in case of an expansion of money supply, allows the launching of investment projects, which until then had been postponed as their internal rate of return was lower than the interest rate. In turn, if the interest rate rises, some projects, which were still profitable, have to be postponed. These mechanisms can influence global demand only, if the share of local production in investment goods is high. Otherwise, it is only the balance of trade and not the internal level of activity, which is influenced. As well, the objects of fiscal policy in

<sup>26</sup>Implications are discussed in: Elsenhans, Hartmut: "Appropriate Technology and the Entry into Most Modern Technology", in: *The Utkal Journal of Sociology*, 1, 1 (1989); pp. 89–107.

<sup>27</sup>Aukrust, Odd: "Factors of Economic Development: A Review of Recent Research", in: *Weltwirtschaftliches Archiv*, 93–1; p. 42. If the assumption is removed the argument of Lal crumbles. Lal maintains that most capital goods are produced in a labour intensive way, what I do not contradict, and are produced therefore in the Third World, what seems less obvious to me. cf. Lal, Deepak: *The Poverty of Development Economics* (Lancing, West Sussex: The Institute of Economic Affairs, 1983); p. 81. My presentation conforms, however, to the Leontief paradoxon. Its empirical validity is now so well established that mainstream economics masked the fact that there are differences in productivity, which are not explained by richness in capital endowment by inventing a new factor of production, the so-called human capital. The argument had to be abandoned at the practical level when UNCTAD based on it a Third World's claim to reimbursement for losses in human capital due to outmigration of skilled labour from the Third World to the First World (especially physicians). UNCTAD: *Preliminary Outline of a Set of Guidelines on the Reverse Transfer of Technology* (Geneva: UNCTAD, 1985); pp. 10–11. UNCTAD: *The Feasibility of Measuring International Flows of Human Resources* (Geneva: UNCTAD, 1982); p. 5.

launching deficient or stifling excess demand by deficits or surpluses in government spending become extremely difficult to achieve, if changes in public spending are not amplified by multiplying and accelerating effects. Structures of budgets are normally not malleable to a degree, at which only the deficit or surplus of the government can compensate for deficits or excesses in global demand. If investment goods production is external to the economy, the multiplier effect is largely compensated by the import propensity, which operates just as the saving propensity. The accelerator also is decreased in value, if the import propensity for investment goods is high. Excess spending from government in case of investment goods dependence will not lead to an increase of the level of activity of the economy, but to a deficit of the balance of trade, as experienced in the debt-ridden countries of Latin America. In addition, in all budgets it is especially the investment part, which can be changed with undue delays, where the share of investment goods in spending is normally high.<sup>28</sup>

The most important barrier created by an absence of local equipment production lies, however, in the basic features of the relations between social classes and the autonomy of a capitalist economy from permanent detailistic state interventionism. Suppose a diversified capitalist economy, which operates near full employment. Some innovation occurs in this economy. The profit rate rises in the respective production line. An investment-based boom will be initiated. When this investment spurt peters out, nominal wages will be defended by the workers. As investment declines, profit will also decline, as well as prices, at least under the conditions of competitive capitalism as we can observe it until the end of the 19th century. Prices go down more rapidly than wages. Important elements of demand are preserved despite rising unemployment. At some time, installed investment is worn out or has become economically obsolete. Innovation and physical replacement trigger off a herd-like concentration of investment decisions, which brings the economy back to a full-employed path, if unemployment has been limited in the crisis.<sup>29</sup> It is in these periods of rising demand for labour that the reformist organisations of labour were able to increase their organisational strength and their bargain-

<sup>28</sup>The constraint of investment goods dependence on global demand management is also visible in case of the use of the mechanism of devaluation for global demand management. If additional export capacity requires additional imported investment goods, devaluation must be comparatively high in order to launch the economy via exports, especially if price elasticity of exports is low. cf. Buffie, Edward F.: "Devaluation, Investment and Growth in LDCs", in: *Journal of Development Economics*, 20, 2 (1986); p. 376 cf. on "perverse" effects of devaluation: Cooper, Richard N.: *Currency Devaluation in Developing Countries. Essays in International Finance No. 86* (Princeton, NJ: Princeton University, 1971); p. 13. Diaz Alejandro, Carlos F.: *Exchange Rate Devaluation in a Semi-Industrialised Country: The Experience of Argentina 1955-1961* (Cambridge, Mass./London: MIT Press, 1965); p. 63.

<sup>29</sup>This lead a genuinely liberal author to his theory of secondary crisis when demand has too much fallen during the recession. Roepke, Wilhelm: *Crises and Cycles* (London et al.: William Hodge, 1936); p. 119 ff.

ing power vis à vis capital.<sup>30</sup>

It is obvious that due to the same obstacles, the autonomy of civil society is greatly reduced, if there is no local equipment production because the elaboration of a compromise between labour and capital on the basis of their most selfish strategies will become politicised and state-mediated, if investment decisions of the capitalists are not employment-promoting and if increasing consumption of labour is not supporting net investment on the basis of locally produced investment goods and hence net profit.<sup>31</sup> By pursuing their selfish interests without any coordination or government mediation, capitalists empower labour through their demand for investment goods, if these are produced locally, and labour, as well, empowers capital by increasing its consumption, which cannot be satisfied by the capitalists without additional capacities of production, hence additional investment goods, the cost of which they can earn by an investment-induced increase in the share of profits in net income of the economy.

A pattern of specialisation, which creates disincentives for local equipment production, is hence in opposition to the stated attempt of the Bretton Woods Institutions to get the economies of the Third World more market-regulated by devaluation and more international specialisation. In that case, the export sector performs the role of a quasi-investment-goods sector. But whereas the value of additional exports is mediated through the exchange rate, additional local investment goods production directly creates profits (if the usual assumptions are made that workers do not save out of their wages).

It can be objected to the above analysis that after a prolonged period of integration into the international division of labour even limited learning effects, which result from the use of imported technology, combined with ever decreasing international values of local labour may lead to avenues of technical learning, which bring the economy to a normal capitalist structure. The existence of marginality in agriculture creates, however, limits to such complete specialisation. Suppose an economy, which tries to achieve full employment via a declining international value of its local labour. When the amount of marginal labour in agriculture is large and additional workers employed have to be supplied with basic goods from imports, the process of devaluation has to come to a stop when the international price of labour becomes lower than the international price of the basket of wage goods to be consumed by the workers in the export sector. Appendix 2 shows that the higher the surplus from agriculture, the higher the possible rate of devaluation and the greater

<sup>30</sup>Geary, Dick: *European Labour Protest* (London: Croom Helm, 1981); p. 38.

<sup>31</sup>Elsenhans, Hartmut: "Economie sous-développée et société civile: Surcharge du système politique et possibilités de pluralisme politique", in: CERES, (ed): *Actes du Colloque: Pluralisme Social, Pluralisme Politique et Démocratie*. Cahier du CERES, Série Sociologie No. 19 (Tunis: Université de Tunis, Centre d'Etudes et de Recherches Economiques et Sociales, 1991); pp. 24-40.

the possibilities for pursuing growth via export orientation. There is a nearly identical importance of agriculture for an outward-looking and for an inward-looking strategy. In the first case, agriculture provides a surplus, which allows workers' consumption to remain largely independent of export earnings, so that the economy can be moved to full employment with export earnings declining in relation to local costs of production, whereas such a surplus in an inward-looking strategy is the basis for government-promoted employment.

There is no necessity for comparative advantage for technically backward countries in agriculture. Even if productivity increases in agriculture in capitalist developed countries may have been lower than productivity increases in industry (although productivity increases in agriculture have been quite substantial),<sup>32</sup> the cost of the transfer of productivity increasing innovation in industry can be considered as considerably lower than in agriculture. It is therefore safe to conclude that comparative advantage resides with industrial production based on cheap local labour and imported technology.

On the other hand, local agriculture operates with a declining elasticity of production in relation to food prices. In the area of low elasticity of agricultural production in relation to prices, a decline in local food prices, which results from evaluation of the local currency, will lead to a low decline of production, which comes under competition from cheaper food imports. In a situation of a low price elasticity for exports and a low price elasticity of local agricultural production, total availability of basic goods may increase with a rising exchange rate.

In an economy characterised by the surplus-cum-marginality syndrome, integration into an international economy, which is dominated by technically more advanced economies, exacerbates the rent problem, which exists in any transition to capitalism where land supply is not unlimited. The safeguard, which in the closed economy is provided by the impossibility of using the surplus of agriculture for anything else but labour is removed. Employment will go down. Non-capitalist spending on improvements becomes import-intensive. Complete specialisation on low-price elasticity products may result in declining export earnings and the dynamising effects of complete specialisation may be limited due to low local equipment production and a low surplus in agriculture.

The problematique of development economics is hence determined by the exacerbated character of the inevitable emergence of rent in the transition to capitalist self-sustained growth. A theory of such transition cannot limit itself to a critique of rent-seeking and other "pre-"capitalist techniques or resource appropriation, but

<sup>32</sup>The point has been made very long ago by: Elliott, William: *The Political Economy of American Foreign Policy: Its Concepts, Strategy and Limits. Report of a Study Group Sponsored by the Woodrow Wilson Foundation and the National Planning Association* (New York: Henry Holt, 1955); p. 44.

has to look into an appropriate combination between the market-regulated and the non-market regulated sectors of the economy, which has to be moved from a state where marginality exists to a state where marginality is eradicated.

The difficulties for developing a coherent concept of development economics as this section of economics, which deals with the combination of non-market and market sectors at low levels of average productivity, stems from the fact that such a theory obviously has to be eclectic in character. The non-market appropriation and allocation of surplus allows the increase of surplus available possibly for investment, but entails state failure, which is due to lack of automaticity in accountability of decision-makers. This, in turn, is not only a problem of the design of administrative institutions.

## 6. ON THE COMBINATION BETWEEN THE MANAGEMENT OF RENT AND SOME WITHDRAWAL OF THE STATE FROM THE ECONOMY

An eclectic theory of development economics as the skillful combination of non-market and market regulation has a set of rules by which a maximum of market regulation is used in order to overcome marginality and by which an optimum of state intervention/non-market intervention is applied which maintains the non-market sector within limits in which accountability can be imposed. Such a theory has at least two major elements. A political science element would have to deal with the tendencies of the non-capitalist surplus controlling class to transform the management of the surplus to a political power game between segments—clans—cliques who are oriented primarily to increasing their power, prestige and income.<sup>33</sup> This theory has to extend even to the problem of the structure of communication and the viscosity of information in societies characterised by an important rent element in total surplus.<sup>34</sup> For the economist the interesting question of such a theory of transition concentrates on how to use the non-market economy for overcoming marginality in order to limit state interventionism.

Some solutions available to the “whites” in the 19th century are no longer there. The destruction of the North American Indian communities and the forced transfer of their property rights to North American settlers has resulted in North American contributions to the problem of the transition to capitalism completely ignoring the problem of marginality which—in the case of the North American development—was solved on the back of the former inhabitants of this continent. Each

<sup>33</sup>I will not deal with this aspect in this contribution, as I have devoted several publications to it. cf. Elsenhans, 1981, *op. cit.* fn 15.

<sup>34</sup>Elsenhans, Hartmut: “Dependencia, Underdevelopment and the Third World State”, in: *Law and State*, 36 (1987); pp. 83–86.



settler established on new lands, contributed to employment not only by the job created on his homestead, but also by the volume of agricultural surplus he was ready to exchange for industrial products. The fertile soils today available for such colonisation are extremely limited and they may be under the control of Western countries, which obviously are very reluctant to admit a migration of marginal labour, say from overpopulated regions of India to the American Middle West.<sup>35</sup> As well the reduction in population which occurred in Europe during the 14th century (great plague) and which led to an increased bargaining position of labour, cannot be reasonably advocated for solving the problem of marginality today.

As well from what was said about price elasticity of demand for industrial products from the Third World, a solution to marginality by increasing exports to the world market can be reasonably expected only if world income distribution changes. If, however, important regions of today's Third World realised their transition to capitalism by eradicating marginality, this option may become available for the less successful ones. The reallocation of production from East and Southeast Asia's newly industrialising countries to lower-wage countries of the region is an example for such an outcome. It shows that success in development efforts need not be generalised but it would be sufficient if the major part of the Third World could be drawn into a state of self-sustained growth.

If there is no political basis for the productive use of rent, its simple distribution among the poorest would be an instrument for increasing consumption of low-price low quality products for which local technologies are available.<sup>36</sup> In cases as Sub-Saharan Africa or Bangladesh, where the share of foreign aid approaches or exceeds even by a large margin the share of the lowest quintile in national income, the use of aid for increasing the incomes of the poorest households would in most cases have the result of eradicating marginality.

Without external resources, changes in income distribution can be a powerful instrument for dealing with marginality. The English Poor Laws are a case in

<sup>35</sup>Krishna, Raj: *The Inequity of the International Economic Order. Some Explanations and Policy Implications* (New Delhi: Research and Information System of the Non-aligned and Other Developing Countries, 1985); p. 30.

<sup>36</sup>One can imagine that the donors declare that they would buy useless stones which are however difficult to collect with the result that an artificial labour-intensive resource industry would emerge. Perhaps they use helicopters dropping commodity moneys in remote areas which they exchange at a rate which just covers subsistence needs of the collecting workers including the cost of transport to the exchange office, so that more productive labour does not engage in this activity. Marginal labour can stand on the labour market, because it produces an income, no middleman can take away from it, as it has to satisfy its subsistence needs in order to be able to collect this money. The additional demand goes to labour-intensively produced industrial products and food and will trigger off eventually an investment process in agriculture by those, who have a slightly higher productivity in agriculture. cf. Elsenhans, Hartmut: "Problems Central to Economic Policy Deregulation in Bangladesh", in: *Internationales Asien Forum*, 22, 3-4 (1991); pp. 281-293.

point.<sup>37</sup> The abled-bodied poor were forced to work at wage rates below subsistence in exchange for these subsidies which were financed by the parishes. Obviously Malthus<sup>38</sup> is right when he points to the fact that the parishes could not pay these subsidies to the poor without reducing the surplus which capitalist or pre-capitalist owners of assets drew from the employment of surplus-producing workers. But as the cost of marginal labour is now reduced for the employers (which may be the same entrepreneurs who have to pay the tax), in the surplus cum marginality model, employment and agricultural production increase; the slopes of the production curve do not vary in case of a lump sum tax raised independently from the volume of production whereas the slope of wage cost curve can be lowered by a subsidy.<sup>39</sup> From what was said about the difficulties in using available surplus as long as demand for goods produced with investment goods is low due to mass poverty, a decline in surplus in the wake of such a redistribution does not exclude that profit increases. Profit is only that part of the surplus which entrepreneurs appropriate on the market as the result of consumers' incomes spent on investment-related consumption goods.

An agrarian reform which consists of the redistribution of land has the same results as the English Poor Laws on income distribution and employment,<sup>40</sup> perhaps not on innovation. By distributing land rather equally, marginal labour time is internalised in the small farm as shown by the microfundia-latifundia complex. Despite the Green Revolution yields are still higher on small farms in most countries. The farmer cannot dispense with labour which brings him less than average production for his labour time as long as he has no access to more rewarding opportunities. He will spend the surplus generating labour time in the first hours of his working day. Because his labour may not be sufficient for his and his families' needs, he will expend more labour even if additional returns decrease. The distinction between

<sup>37</sup>Elsenhans, Hartmut: "Englisches Poor Law und egalitäre Agrarreform in der Dritten Welt. Einige Aspekte der Theorie, daß Wachstum historisch die Erweiterung des Massenmarktes erforderte und heute die Erweiterung der Massenmarktes erfordert", in: *Verfassung und Recht in Übersee*, 13, 4 (April 1980); pp. 283–292. English in Elsenhans, Hartmut: *Equality and Development* (Dhaka: Centre of Social Studies, 1992); pp. 130–163.

<sup>38</sup>Malthus, Thomas Robert: *An Essay on Population* (London/New York: Dent and Sons Dutton, 1914); p. 57f.

<sup>39</sup>Suppose  $Y_{agr} = 8 \cdot \sqrt{L_{agr}}$ ,  $\lambda = 0.8$ . Maximum employment is 25, maximum production is 40. A tax of 8 is imposed. Then maximum surplus is reached when  $\sqrt{L_{agr}} - 20 = 0.8 \cdot L_{agr} - 8$ ;  $L_{agr} = 66.6$ ;  $W_{agr} = 53.8$ ;  $Y_{agr} = 65.36$  and surplus of agriculture 12.8 or 18.8 percent of production, which is probably more easy to manage for investment than a surplus of 50 percent. Total employment increases by 77 percent.

<sup>40</sup>Cf. recently Dutt, Amitava Krishna: "Stagnation, Income Distribution and the Agrarian Constraint: A Note", in: *Cambridge Journal of Economics*, 15, 3 (1991); p. 348. Elsenhans, Hartmut: "Agraverfassung, Akkumulationsprozeß, Demokratisierung", in: Elsenhans, Hartmut (ed): *Agrarreform in der Dritten Welt* (Frankfurt/New York: Campus, 1979); p. 552–562.

surplus generating production workers and subsidised workers in the English Poor Laws which still require the continuous intervention of the parishes, is replaced by the distinction between the surplus generating hours of work and no longer surplus increasing hours, the additional product of which is however required for subsistence. The redistribution is unconsciously realised by the households and does not require any intervention of the non-market economy.

It is quite improbable that the redistribution of surplus in favour of mass incomes is on the agenda in the years to come. The crisis of the Third World development state has led to an estrangement between those sectors of Third World societies which are referred to as middle classes, petty bourgeoisie, or intelligentsia. The exhaustion of financial resources has led to an end of the growth of state employment and hence of coaptation of members of these sectors of society into what I have defined as state classes and their organic clientele in bureaucratic development societies.<sup>41</sup> Against a state which withdraws from providing patronage, these members of middle strata of the society develop a new consciousness, hence constitute themselves as a class, which employs a vision of society opposed to the westernised state in all its ideological coatings (revolution, nationalism, statism, socialism, etc.) and opt for economic liberalisation. Against the rapacious fisc, as which the state appears to them, they need a vision of society which enables them to mobilise popular support. The turn to traditional values which to the difference of western ideals of change and progress are not yet discredited. Religion is among them and presents two advantages.<sup>42</sup> It appears attractive to disappointed poor which are extremely heterogeneous with respect to their role in production and cannot be organised on the basis of their material interests in the production process as was the case with "proletarians" in societies where wage labour had become generalised. As well, all major religions have been revealed in times when peasant communities and market-oriented producers were striving against discretionary exploitation of ruling classes of the so-called tributary modes of production. Property rights were important.

The solution open to such economies in which the political structures are against the state appropriation of surplus or its redistribution is obviously increased exports. Under the condition of a low price elasticity for the products these small and medium enterprises of so-called newly emerging middle classes can produce, the success of such endeavours once more depends on the solution of the problem of agricultural productivity. From the limits of devaluation which are based on low agricultural surplus, we can develop a scenario which assumes that surplus in agriculture can be increased (see Appendix 3). When marginal earnings from exports are still positive, but lower than marginal costs of the exports, a decrease in locally

<sup>41</sup>Elsenhans, 1981, *op. cit.*, fn. 15, pp. 118ff.

<sup>42</sup>Elsenhans, Hartmut: *Global Change and Implications for India* (New Delhi: Lancer, 1992), pp. 29–33.

available surplus will allow an expansion of employment in exports. Total employment decreases only, when marginal earnings from exports become negative. Small additions to total earnings from exports, even if lower than the cost of additionally employed labour, will contribute to overall employment, provided that the surplus in agriculture is increasingly used for feeding labour in the export sector. According to this model there is no fundamental difference between an inward-looking strategy of development and an outward-looking strategy of development with respect to the central importance of agriculture. If the surplus of agriculture is used for subsidising employment in the export sector total employment increases, as long as marginal export earnings are positive. This is the same mechanism as the poor laws: Labour, which earns less than its subsistence, here due to declining export prices, is subsidised out of the productive labour in agriculture.

The question then is not whether an inward-looking or an outward-looking strategy is preferable, but how the employment effects and the learning effects can be maximised by a combination of the two. Suppose that the learning effects in the export sector are limited. Restrictions on quantities exported will increase the surplus over costs of production. This surplus can be used for training programmes. Singapore has taxed its low-skill labour-intensive export sector and financed from this supplementary tax a skill-upgrading programme for workers in production lines, where international competitiveness was not yet achieved. In a similar manner, South Korea has—after its textile industry became extremely competitive on the basis of very low-paid labour—blocked its market for imported textile machinery. Textile producers had to promote the local production of textile machinery. As this textile machinery was initially expensive in relation to performance, costs of production in the export sector increased. At a low price elasticity of demand for these exports additional costs could be shifted to the (First-World) customers. Financial resources from the export sector were channelled into the high-skill/high-learning sector of textile machinery production, which was subsidised unvoluntarily by the textile exporters. The administrative mechanism of this subsidy is different from the administrative mechanism, which is applied when an oil-exporting government subsidises enterprises out of the oil rent, from which it expects the further transformation of its economy. The economic mechanism, however, is identical: The export sector, which faces low price elasticity of demand, is burdened by an additional charge, a rent, which is used, against the rules of complete specialisation, to support a not yet competitive, but innovative sector, where learning for future innovation can be maximised. The question, therefore, is once more not whether the rent could be eliminated, but how it could be used best.

Actual tendencies of the international system do not favour a better use of the rent. Industrial countries are reluctant to open their markets for manufactured products of the South in order to protect their employment. Export-oriented manufactur-

ing, which could have been a sector in which capitalist competition is realised with the possible result of slowly reducing the realm of political management of resources has become itself—by export quotas and other non-tariff barriers in the West—a politically managed sector where quota rents are appropriated.<sup>43</sup>

The condition for an opening of the industrialised countries' markets—at least in the long run—would be that marginality in the new exporting countries disappears so that export surpluses will be translated into real wage increases.<sup>44</sup> In the name of the priority of capital accumulation and the automaticity of the transition to a market economy, the social reforms, e.g. agrarian reforms, are prevented. The growth of internal markets is neglected, although all empirical evidence shows that growth did not depend on the trade regime<sup>45</sup> (export orientation or not), but on the growth of markets where external markets can only complement but not replace internal markets. The privileged are always supply-siders. It was nearly 200 years ago that another privileged class, the Russian gentry, considered itself as equal in efficiency, because equal in surplus to the English gentry, and argued that if it would force its peasants to work harder and to increase the surplus, it would economically catch up with Britain.<sup>46</sup> So many rentiers mix up capitalism with something else because they concentrate on financial resources, and not on competition and its preconditions in the social system. I have shown elsewhere that these rentiers have good chances to prevail in the world economy because they may be able to destroy the internal preconditions of capitalism in the North.<sup>47</sup>

<sup>43</sup>Kostecki, Michael M.: "Marketing Strategies and Voluntary Export Restraints", in: *Journal of World Trade*, 25, 4 (1991); pp. 87–100. Takacs, Wendy E.: "Economic Aspects of Quota Licensing Auctions", in: *Journal of World Trade*, 22, 5 (1988); pp. 39–51. Khanna, Sushil: "Market Sharing Under Multifiber Arrangement: Consequences of Non-Tariff-Barriers in the Textile Traders", in: *Journal of World Trade*, 24, 1 (1990); p. 71–104.

<sup>44</sup>The point was made in: Elsenhans, Hartmut: "Social Consequences of the NIEO. Structural Change in the Periphery as Precondition for Continual Reforms in the Centre", in: Jahn, Egbert/Sakamoto, Yoshikazu, (eds): *Elements of World Instability: Armaments, Communication, Food, International Division of Labour*. Proceedings of the International Peace Research Association. Eighth General Conference (Frankfurt: Campus, 1981); pp. 86–94.

<sup>45</sup>Example: Adelman, Irma: "Beyond Export-led Growth", in: *World Development*, 12, 9 (1984); pp. 938–944. Mathur, Ashok: "The Interface of Agriculture and Industrial Growth in the Development Process: Some Facts of the Indian Experience", in: *Development and Change*, 21, 2 (1990); p. 276. Gray, Patricia/Singer, Hans W.: "Trade Policy and Growth of Developing Countries: Some New Data", in: *World Development*, 16, 3 (1988); p. 403. Hwa, Erh-Cheng: "The Contribution of Agriculture to Economic Growth: Some Empirical Evidence", in: *World Development*, 16, 11 (1988); p. 1337. Oshima, Harry T.: "'Labour-Force Explosion' and the Labour Intensive Sector in Asian Growth", in: *Economic Development and Cultural Change*, 19, 2 (1971); p. 170.

<sup>46</sup>Kingston-Mann, Esther: "The Light and Shadow of the West: The Impact of Western Economics in Pre-Emancipated Russia", in: *Comparative Studies in Society and History*, 33, 1 (1991); p. 92.

<sup>47</sup>Elsenhans, Hartmut: "The Logic of Profit and the Logic of Rent: Risks in the Transition to a New International System", in: *Voice of Peace and Integration*, 1, 1 (1992); pp. 36–39.

## DEFINITIONS AND LIST OF SYMBOLS

$C$	capital (monetary)
$Co_x$	cost of exports (monetary)
$I$	labour in exports (quantity)
$L$	labour (quantity)
$L_{agr}$	labour in agriculture (quantity)
$L_e$	labour in exports (quantity)
$P$	profit
$W$	wages (monetary)
$W_{agr}$	wages in agriculture (monetary)
$X$	exports
$X_q$	exports (quantity)
$X_e$	exports earnings (monetary)
$X_w$	retained earnings from exports (monetary)
$Y$	net national product
$Y_{agr}$	agricultural production
$b$	capital productivity $Y/C$
$i$	rate of growth of capital per worker
$l$	growth of net employment
$p$	growth rate of profits
$pr$	price
$q$	rate of growth of investment funds for new employment
$y$	growth rate of net national product
$\alpha$	parameter for $Y_{agr}$
$\varepsilon$	parameter for $Y_{agr}$
$\theta$	rate of technical progress/rate of growth of labour productivity
$\lambda$	wage rate
$\lambda_s$	subsistence wage rate
$\mu$	non-food spending out of subsistence wage
$\pi$	profit rate
$\tau$	labour coefficient for export goods
$\phi$	food spending out of subsistence wage
$\varphi$	parameter for export demand
$\chi$	parameter for export demand
$\omega$	import content of exports

APPENDIX 1

Let be (3)  $Y_t = P_t + W_t = \pi_t \cdot C_t + W_t = b_t \cdot C_{t-1}$  where  $Y$  net production,  $P$  net profit,  $C$  value of fixed capital,  $W$  costs of labour,  $\pi$  the rate of profit and  $b$  capital productivity.  $Y_t$  is the result of fixed capital of the period  $t-1$ , which is operated in the period  $t$  with the capital productivity  $b_t$ . Hence  $P_t$  is also related to  $C_{t-1}$ , the value of capital when the production period starts. As the economy is considered to be characterised by the existence of marginal labour whose product in agriculture is less than subsistence, there is at least initially an unlimited supply of unskilled labour at the subsistence wage  $\lambda = \lambda_s$ . Investment  $I$  is always defined as net investment. It is assumed that all profits are reinvested. The consumption of the capitalists is assumed to be financed out of their "wage" for managerial activities and is part of the wage bill. We run the model first on the basis of a constant volume of labour  $L$ , so that  $W = \lambda_s L_o = \text{constant}$ . Under this condition  $y = 0$ . Then, the rate of profit and capital productivity  $b$  are defined by

$$\pi_t = P_t / C_{t-1}, \text{ and (5) } b_t = Y_t / C_{t-1} \quad \dots \quad \dots \quad \dots \quad (4, 5)$$

By simple transformation of (3) we obtain the general relationship  $W/C = b - \pi$ , or

$$\frac{W_t}{C_{t-1}} = b_t - \pi_t (1 + \pi_{t-1}). \quad \dots \quad \dots \quad \dots \quad \dots \quad \dots \quad (6)$$

If the wage bill remains constant and capital accumulation continues,  $W_0 / C_t$  tends to zero. The condition (6) can be fulfilled only if either  $\pi$  rises or  $b$  declines, or both.

The rate of growth of production is:

$$y_t = (1 + \pi_{t-1})(1 + b'_t) - 1; 1 + \pi_{t-1} = \frac{1 + y_t}{1 + b'_t}; \pi_{t-1} = \frac{1 + y_t}{1 + b'_t} - 1. \quad \dots \quad (8)$$

The growth rate of profits  $p$  is:

$$y_t \cdot Y_t = p_t \cdot P_t; p_t = \frac{Y_t}{P_t} \cdot y_t; y_t = \frac{P_t}{Y_t} \cdot p_t \quad \dots \quad \dots \quad \dots \quad (9)$$

Profits in the period  $t$  are:

$$P_t = (1 + p_{t-1}) P_{t-1}. \quad \dots \quad \dots \quad \dots \quad \dots \quad \dots \quad (10)$$

The rate of profit in the period  $t$  is:

$$\pi_t = \frac{(1 + p_{t-1})P_{t-1}}{(1 + \pi_{t-2})C_{t-2}} = \frac{1 + p_{t-1}}{1 + \pi_{t-2}} \pi_{t-1} \dots \dots \dots \dots \dots (11)$$

According to (11), the rate of profit will not fall as long as:

$$p_t \geq \pi_{t-1}; (1 + p_t) \geq (1 + \pi_{t-1}). \dots \dots \dots \dots \dots (12)$$

The condition (12) can be rewritten by inserting (8) and (9).

$$\frac{Y_t}{P_t} \cdot y_t \geq \frac{1 + y_t}{1 + b'_t} - 1. \dots \dots \dots \dots \dots (13)$$

With  $W = \text{constant}$ , the share of profit in net income rises.  $Y/P$  runs from  $\infty$  to 1. Whether the condition (13) is fulfilled depends on the development of capital productivity and the rate of growth of profits. As  $Y/P$  tends to 1, the left-hand side of (13) is dependent on the rate of growth of net income  $y$ .

At a constant capital productivity, we obtain:

$$b = f(C); b' = 0 \dots \dots \dots \dots \dots (14)$$

If capital productivity remains constant, condition (13) is always fulfilled. Because of (8) and (9), condition (15) has to be fulfilled:

$$p_t > y_t = \pi_{t-1}. \dots \dots \dots \dots \dots (15)$$

Because of (11) and (15), which implies  $p_t > \pi_{t-1}$ , follows:

$$\pi_t = \frac{1 + p_t}{1 + \pi_{t-1}} \cdot \pi_{t-1}; \pi_t > \pi_{t-1} \dots \dots \dots \dots \dots (16)$$

If  $b$  is constant, condition (15) can hold only, if

$$\pi_t > \pi_{t-1} > \pi_{t-2} \text{ etc.} \dots \dots \dots \dots \dots (17)$$

As under (8) and (14)  $y_t$  equals  $\pi_{t-1}$ , (15) can hold only, if

$$y_t > y_{t-1} > y_{t-2} \text{ etc.} \dots \dots \dots \dots \dots (18)$$



At a constant capital productivity,  $y$  has to grow and hence also  $\pi$  until the share of profits in net income becomes 100 percent.

At a falling capital productivity (13) can be rewritten:

$$(1 + p_t) \geq \frac{(1 + y_t)}{(1 + b'_t)} \quad \dots \quad \dots \quad \dots \quad \dots \quad \dots \quad (19)$$

As  $p_t$  tends to  $y_t$  when  $Y/P$  tends to 1, (19) can only be fulfilled, if  $b'$  tends to zero, so that  $b'' < 0$  and this requires, when  $p$  tends to  $y$ , that  $\pi_t < \pi_{t-1} < \pi_{t-2}$  despite  $\pi_t > y_t = \text{constant}$  etc. As accumulation proceeds, the right side will rise to the level of the left side, i.e. the rising profit rate will equal the declining growth rate of profits. If  $y$  is constant, the profit rate has to fall beyond this  $\pi_t = \text{max}$ . The rate of accumulation and the rate of profit fall until they reach  $y$ , when  $Y = P$ . If  $\pi_t < \pi_{t-1}$  is to be excluded, then  $y$  has to rise beyond  $\pi_t = \text{max}$ , whatever the rate of growth of technical progress had been before. This can occur at declining capital productivity until the whole system gets stabilised with identical growth rates for profits, capital stock and net income when  $Y = P$ . The rate of growth of all elements would have to be the maximum rate of profit, which is achieved after the ascending phase of  $\pi$  and before the influence of the declining growth rate of profits is felt on  $\pi$ . At which level of the profit rate this state will be reached and which then has to be the obviously rising growth rate of net income depends on the initial parameters of  $P/Y$ ,  $C/Y$  and the exogenously determined rate of technical progress.

Now we drop the assumption that the capitalist sector cannot increase its employment.

The growth rate of net income  $y$  is then the product of the growth of employment  $l$  and labour productivity  $\theta$ . According to (8) we obtain:

$$(1 + l_t)(1 + \theta_t) = (1 + \pi_{t-1})(1 + b'_t) \quad \dots \quad \dots \quad \dots \quad \dots \quad (20)$$

According to (9) we obtain:

$$(1 + p_t) = (1 + l_t)(1 + \theta_t) \frac{Y_t}{P_t} \quad \dots \quad \dots \quad \dots \quad \dots \quad (21)$$

The condition (12) has to be fulfilled. The condition is now rewritten:

$$(1 + l_t)(1 + \theta_t) \frac{Y_t}{P_t} \geq \frac{(1 + l_t)(1 + \theta_t)}{(1 + b'_t)} \quad \dots \quad \dots \quad \dots \quad (22)$$

If capital productivity is constant, we achieve an explosive growth of employ-

ment until  $Y/P = 1$ . If capital productivity declines, the capitalists are forced to reduce the rate of accumulation per worker to the rate of growth of profit per worker, which declines after  $i_t = \max$  in analogy to the interpretation of (19), so that  $i_t < i_{t-1} < i_{t-2}$ .

The rate of growth of profit per worker is:

$$(1 + i_t) = \frac{(1 + p_t)}{(1 + l_t)} \quad \dots \quad \dots \quad \dots \quad \dots \quad \dots \quad \dots \quad (23)$$

where, according to (19), at a declining capital productivity per worker the rate of growth of capital per worker falls more rapidly than the rate of growth of profit, so that from (23) follows:

$$\frac{i_t}{i_{t+1}} > \frac{p_t}{p_{t-1}}, \text{ and } l > 0. \quad \dots \quad \dots \quad \dots \quad \dots \quad \dots \quad (24)$$

Profits, which are available for new jobs, grow with  $q$ :

$$q = (1 + \pi - i), \quad \dots \quad \dots \quad \dots \quad \dots \quad \dots \quad \dots \quad (25)$$

where due to  $\pi_t \leq \pi_{t+1} \leq \pi_{t+2}$  and  $i_t > i_{t+1} > i_{t+2}$ :

$$q_t < q_{t+1} < q_{t+2}. \quad \dots \quad \dots \quad \dots \quad \dots \quad \dots \quad \dots \quad (26)$$

The rate of growth of employment is then  $l = q/i$  and according to (26).

$$l = \frac{q}{i} \text{ and } l_1 = \frac{q_1}{i_1} < l_2 = \frac{q_2}{i_2} < l_3 = \frac{q_3}{i_3}, \text{ etc. ;} \quad \dots \quad \dots \quad (27)$$

From (22) we also see that this explosive growth can be avoided, if there is no increase in labour productivity and no change in capital productivity as well as no change in  $Y/P$ . Explosive growth can be avoided, if the entrepreneurs are using just the same technology and ploughing back all profits, which they get from production, into the creation of new jobs, where they employ exactly the same technology as before, without any change in capital productivity nor any change in labour productivity.

APPENDIX 2

Suppose an inelastic demand for the industrial exports. The quantity exported  $X_q$  is a function of the unit price  $pr$ . Then:

$$X_q = f(pr); X'_q < 0 \quad \dots \quad \dots \quad \dots \quad \dots \quad \dots \quad \dots \quad (28)$$

and described by a function of the type, where  $\chi$  and  $\phi$  are parameters for describing the price elasticity of demand:

$$X_q = (\chi - \phi pr); \chi > 1, 0 < \phi < 1. \quad \dots \quad \dots \quad \dots \quad \dots \quad (29)$$

There is only one production technology and no returns to scale. Export earnings are a function of exported quantities and price. Then export earnings  $X_e$  are:

$$X_e = X_q \cdot pr \quad \dots \quad \dots \quad \dots \quad \dots \quad \dots \quad \dots \quad (30)$$

and

$$X_e = (\chi - \phi pr)pr = \chi pr - \phi pr^2; X'_e = \chi - 2\phi pr \dots \quad \dots \quad \dots \quad (31)$$

The costs of capital and imported inputs  $Co_x$  per unit are considered as a fixed proportion  $\omega$  of quantities produced, so that:

$$Co_x = \omega X_q = \omega(\chi - \phi pr), \text{ where } \omega < pr. \quad \dots \quad \dots \quad \dots \quad (32)$$

We suppose that the demand of the country for imported food has no influence on the international price of food. Export proceeds available for food imports (in this model for wages) are the difference between export earnings ( $X_e$ ) and costs of imported inputs and investment goods ( $Co_x$ ), so that the retained earnings, which are available for labour, are  $X_w$ :

$$X_w = \chi \cdot pr - \phi \cdot pr^2 + \omega \phi pr - \omega \chi; X'_w = \chi - 2\phi pr + \omega \phi. \quad \dots \quad (33)$$

Maximum earnings  $X_e = \max$  are achieved where:

$$X'_e = 0; \chi - 2\phi pr. \quad \dots \quad \dots \quad \dots \quad \dots \quad \dots \quad \dots \quad (34)$$

Maximum excess earnings over imports are achieved where:

$$X'_w = 0; \chi = 2\phi pr - \omega\phi. \quad \dots \quad \dots \quad \dots \quad \dots \quad \dots \quad (35)$$

For  $X'_w > 0$  retained earnings and hence the potential for additions to local wage goods availability and to local food availability increases, for  $X'_w < 0$  it decreases.

### APPENDIX 3

Then from Equations (1), (2), and (31) total production and costs of agriculture and the export sector we get the condition for rent-financed export orientation:

$$(\chi - \phi pr)pr + \alpha L_{agr}^e \geq (\chi - \phi pr)\tau\lambda_s + \lambda_s L_{agr} \quad \dots \quad \dots \quad \dots \quad (36)$$

where  $\tau$  is the labour coefficient for export goods and

$$(\chi - \phi pr)\tau = L_e, \quad \dots \quad \dots \quad \dots \quad \dots \quad \dots \quad (37)$$

the volume of labour in the export sector.

If the country is specialised on high technology products with high prices on the world market where  $pr > \tau\lambda$ , marginal productivity and surplus of agriculture are without relevance for total employment, as employment can go up indefinitely in the export sector. If, however, increasing employment in exports has to be achieved with products, which face a low price elasticity of demand on the world market, employment promotion via export orientation is facilitated, if the surplus of agriculture is high, as exports can be subsidised out of the surplus of agriculture. With increasing rates of devaluation, the following condition, however, has still to be fulfilled:

$$(\chi + \phi pr_1)pr_1 \leq (\chi + \phi pr_2)pr_2. \quad \dots \quad \dots \quad \dots \quad \dots \quad (38)$$

Marginal earnings from exports have to be positive, but can fall below the increase in the wage bill, as long as there is a surplus from agriculture.

**Comments on**  
**“Rent, State and the Market:**  
**The Political Economy of the Transition**  
**to Self-sustained Capitalism”**

This rather longish paper is written in the political economy tradition, but without a coherent analytical framework. The author has drawn from the works of Marx (the pre-capitalist or rentier society), Schumpeter (entrepreneurship), and Keynes (role of aggregate demand). Following the title of the paper, I was expecting an explanation of the process of transition—and its major actors and institutions—from a pre-capitalist (rentier) economy to a full-blown capitalist economy. My major disappointment is that the author has used concepts which are either ill-defined or defined in ways contrary to their standard definitions. Let me turn to some of these problems.

How is the concept of a rentier society any different from the classical dual economy model used by Arthur Lewis? The state of “marginality”—which is not well defined in the paper—is simply another way of defining surplus labour with zero marginal product. If landlord maximises the rent, what keeps the real wage constant? What determines the reproduction process or marginal population?

In a rentier society, who starts technical progress and why? What brings investment in a zero-investment model? Why and how does the rentier class start investing? Why can't marginality be eradicated by technical progress?

The author seems to suggest that the market relations and an open economy adversely affect the employment level. Market relations turn the unemployment problem from the disguised to open state. What about the “vent-for-surplus” argument in opening the economy to international trade?

I have also serious problems with the notion—again not well defined—of a “development state”? How does it come into existence and how does it facilitate the transformation of a rent-based to a profit-based economy?

Finally, what is meant by self-sustained capitalist growth? Do the market-forces of demand and supply, comparative advantage, etc.—not determine the growth process?

The analysis in the paper does not help us at all in understanding the complex process of development. On the contrary, it makes the task of comprehension far more difficult than it needs to be. Too many ideas have been thrown at the reader without a coherent theory or analytical framework.

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the Export Oriented Industrialisation Strategy and argues that there is no distinction between the two policies. He points out that the two strategies should be examined in the context of an enlargement of the markets. Since export oriented industrialisation enlarges the market, one prefers it over the import substitution industrialisation. However, Professor Elsenhans suggests that a strategy which apportions the rent to the poor, would promote growth and employment as the poorer sections of the society tend to consume labour-intensive products. Therefore, protection to such activities would result in higher output and productivity would improve through learning by doing. No doubt, learning by doing is very important, yet it is a function of cumulative output and investment. Obviously, if the domestic market is rather limited, the learning coefficient would also be smaller. The natural choice, therefore, is to explore the export market. Moreover, import substitution industrialisation breeds both the allocative as well as x-inefficiencies and how these can be avoided, the paper does not throw any light.

Professor Elsenhans argues that shifts in the comparative advantage are due to growth in factor productivity rather than factor endowments. Obviously, if the productivity increases more rapidly in a particular sector relative to others, the comparative advantage would shift to that product. But that in no way implies that the country has not specialised in accordance with comparative advantage.

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