

Development and Income Distribution

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Outline

- 1) The nature of development
- 2) The Lewis model
- 3) Harrod-Domar
- 4) The pattern of consumption and disarticulation
- 5) Relation to post-Keynesianism

The development challenge

- Long-run growth
 - Growth over several decades
 - But also: the time horizon where the capital stock & agents can adjust
- Structural transformation (sectoral changes)
- ‘Unlimited’ supplies of labour/hidden unemployment
- Income distribution as an outcome
- Polarized consumption structure

Development
as structural
change

Manufacturing, value added (% of GDP) - Korea, Rep., Singapore, Malaysia, Indonesia, Thailand

World Bank national accounts data, and OECD National Accounts data files.

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Lewis model: Significance

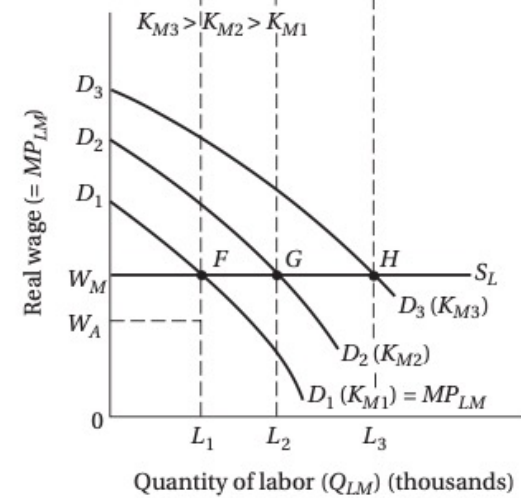
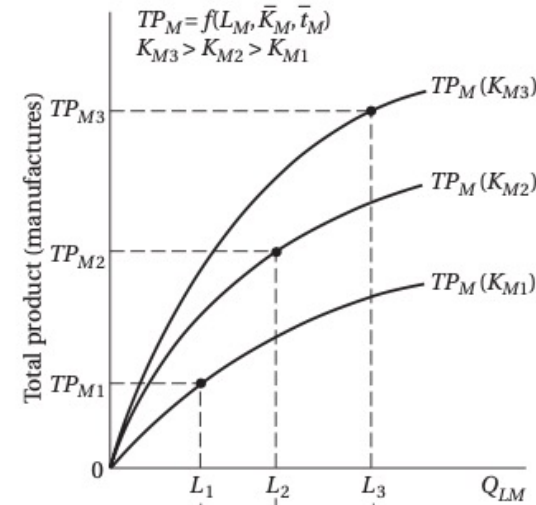
- Originates contemporary development economics
- Sectorally unbalanced growth
- Interesting paper from history of thought perspective
- Two key messages:
 - Unlimited labour at subsistence wages;
 - Centrality of capital accumulation
- Criticism of the Keynesian schema
 - GT → Unlimited labour assumption *but also* unlimited capital stock

Lewis model: Key messages

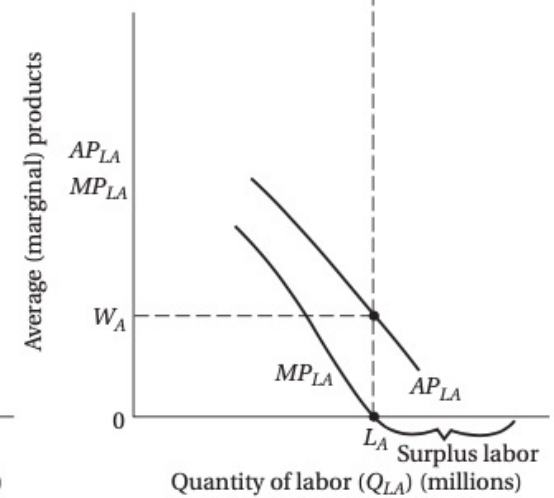
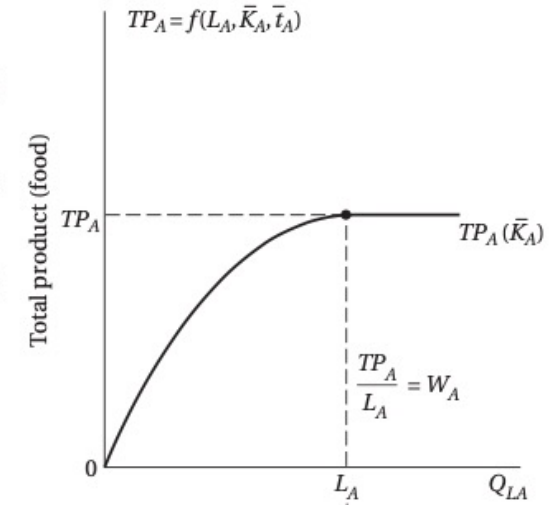
- Unlimited labour supply → MPL is low, zero, or negative
- Wage determination → APL in traditional sector
 - Plus a premium in the modern sector
- Expansion driven by capital accumulation
 - Capital accumulation driven by profits
- Capital and labour are complements
- Conclusions regarding the saving rate
- Conclusions regarding income distribution

Lewis model: graphically

- Surplus labour population
- Capital stock and modern sector production
- Profits and capital accumulation
- Elasticity of labour supply
- Reinvestment
- Lewisian turning point



(a) Modern (industrial) sector



(b) Traditional (agricultural) sector

Lewis model: criticisms

- Profits and capital accumulation
 - Capital flight
 - Luxury consumption
- Wage determination
 - Bit hand-wavy...
 - Subsistence, convention, or APL?
- Dual sector distinction
 - Perhaps not so neat in reality
 - Stark divide or spectrum?

Harrod-Domar

- Extending static Keynesian model to dynamic long-run. Particularly used for development planning.

$$Y = uK \quad (1)$$

$$\dot{K} = I \quad (2)$$

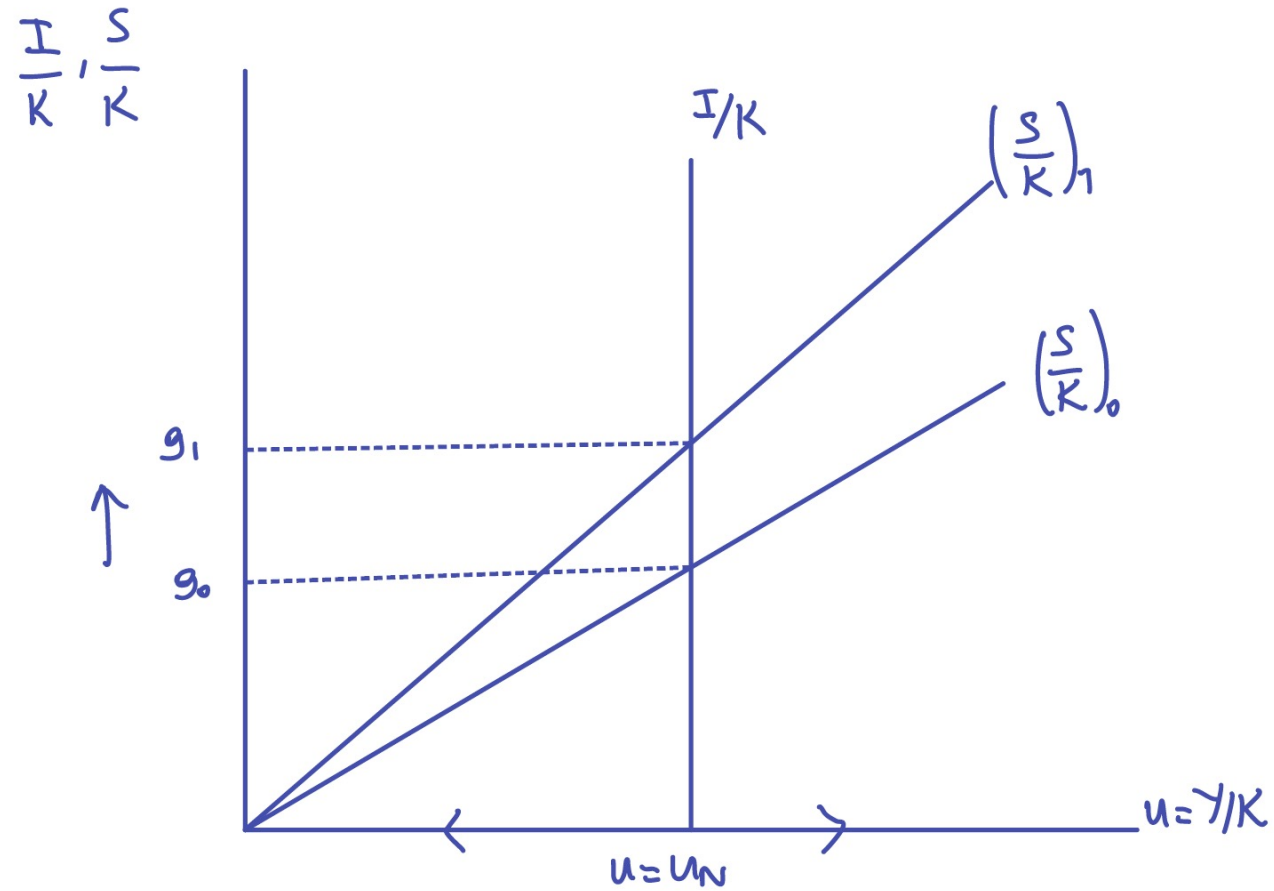
$$S = sY \quad (3)$$

$$I/K = S/K \quad (4)$$

$$\hat{Y} = \hat{K} = \frac{\dot{K}}{K} = su \quad (5)$$

- A higher 'warranted growth rate' (the growth rate corresponding to goods market equilibrium) requires a higher saving rate
- If your structural unemployment requires raising the rate of investment, you need a higher saving rate? Development problems are more classical than Keynesian?

Graphic representation



Development as structural transformation pt. 2

Imbs and Wacziarg (2003)

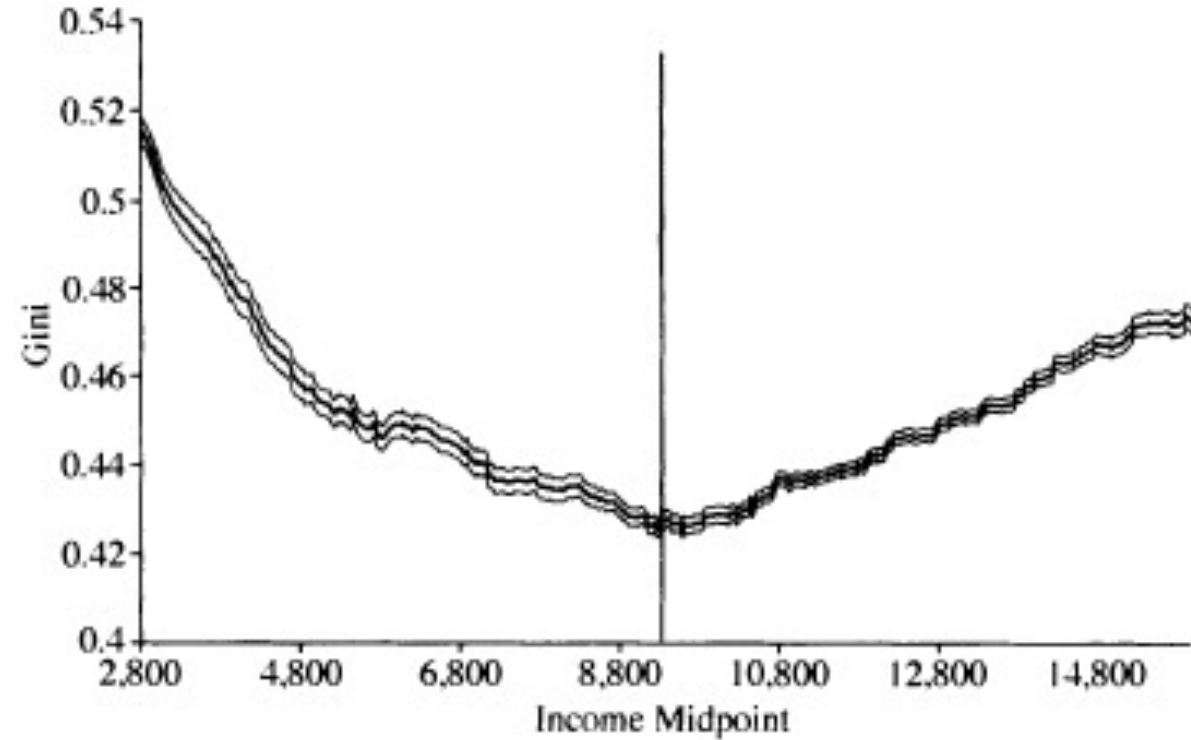


FIGURE 1. ESTIMATED CURVE (NONPARAMETRIC)—GINI INDEX—ILO 1-DIGIT EMPLOYMENT DATA

Engel's Law and effects of redistribution pt. 1

- Three classes: workers, capitalists, landlords
- Two sectors: modern/manufacturing & traditional/agricultural
- Capital/investment only in the modern sector
- The pattern of consumption and Engel's Law
 - No imported consumption goods
 - Workers consume traditional good
 - Elites split income between modern sector and traditional sector good
- Capacity adjusts – we are in the SR
- Investment: determined by capacity utilization & profitability

Engel's Law and effects of redistribution pt. 2

- Key question: how does structure of consumer preferences influence consequences of redistribution?
- Intuition?
- Relaxing the fixed capacity utilisation assumption insufficient to derive compatibility of redistribution with development



“The problem of unemployment in underdeveloped countries differs fundamentally from that in developed economies. In the latter, unemployment arises on account of inadequacy of effective demand. During periods of depression unemployed labor coexists with underutilized equipment. The situation may, therefore, be tackled by measures designed to stimulate effective demand, such as loan financed government expenditure. Unemployment and underemployment in underdeveloped countries are of an entirely different nature. They result from the shortage of capital equipment rather than from deficiency of effective demand.”

(Kalecki 1960: 3)



“Keynesian remedies can be effective as a solution to a problem of under-utilization of capacity, but it is evident that they cannot create a capacity that doesn’t already exist”

(Joan Robinson, quoted from Lavoie 2014: 278)

Concluding thoughts and key questions

- Is development a one-size fits all Keynesian aggregate demand problem?
 - Insights for policy from a PK perspective/differences from mainstream
- Is income distribution predominantly the cause or effect of growth in the development process?
 - What role does surplus labor play in determining distributive outcomes?
- How does the consumption-investment trade-off relate to development?
- What role for the state in development?