The Theory of Economic Growth
A ‘Classical’ Perspective

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Introduction

Neri Salvadori

Interest in the study of economic growth has experienced remarkable ups and downs in the history of economics. It was central in Classical political economy from Adam Smith to David Ricardo, and then in its `critique` by Karl Marx, but moved to the periphery during the so-called `marginal revolution`. John von Neumann’s growth model and Roy Harrod’s attempt to generalise Keynes’s principle of effective demand to the long run re-ignited interest in growth theory. Following the publication of papers by Robert Solow and Nicholas Kaldor in the mid-1950s, growth theory became one of the central topics of the economics profession until the early 1970s. After a decade of dormancy, since the mid-1980s, economic growth has once again become a central topic in economic theorising. The recent theory is called ‘endogenous growth theory’, since according to it the growth rate is determined from within the model and is not given as an exogenous variable.

This book is the main product of a research group on the theory of growth and the relation between modern growth theory and `Classical’ growth theory. The scholars involved were motivated to this task not only by the emergence at the end of the 1980s and the rapid development of the literature on economic growth, but also by the contributions of Kurz and Salvadori (1998b, 1999) who have shown that the logical structure underlying most of the early models of endogenous growth is very similar to the logical structure of `Classical’ growth models. Put schematically, in the latter a given real wage rate determines (together with the technological data) the rate of profits and thus, through the saving-investment mechanism, the rate of growth; in the modern literature, ‘human capital’ or ‘knowledge’ works in the same way since there is a `technology’ producing them, exactly like the real wage rate ‘produced’ labour in the analyses of the Classical economists. The research group has also investigated the connection between the Classical economists and the modern theories of growth in the analysis of competition, technical change, division of labour economic cycles, environment and financial intermediation.

The readers may ask themselves whether classifying economic ideas in distinct analytical approaches to certain economic problems and even in
different schools of economic thought is a futile enterprise. The title of this book implies that its authors think that it is not. We rather hold the view that there is a theory that may, for good reasons, be called ‘Classical’ economics as distinct from other kinds of economics, in particular ‘Neoclassical’ economics and ‘Keynesian’ economics. This view could immediately be challenged with the indisputable heterogeneity and multi-layeredness of the writings of authors in these groups. Moreover, an author might be classified in one group regarding some aspects, regarding others he or she might be classified in another group. Therefore, I wish to make it clear from the outset that we are not so much concerned with elaborating a classification of authors, which in some cases would be an extremely difficult, if not impossible task. We are rather concerned with classifying various analytical approaches to dealing with certain economic problems. Our interest in these approaches is not dominantly historical; we rather consider them as containing the key to a better explanation of important economic phenomena. Our concern with classical economics is therefore primarily a concern with its analytical potential which in our view has not yet been fully explored.

The book opens with a chapter by Kurz and Salvadori that summarises their previous contributions and clarifies what we mean by ‘Classical’ and ‘Neoclassical’ economics. Chapters 2 and 3 complete this methodological analysis. Antonio D’Agata and Giuseppe Freni insert also ‘Keynesian’ economics into the picture and find some other connections among these schools of thought. Mario Pomini studies the emergence of endogenous growth theory (as opposed to Neoclassical growth theory) from the point of view of Lakatosian categories. These chapters isolate and compare the logical structures and the methodological underpinnings of old and new growth theories. They provide some well-defined guidelines that address the analysis developed in the following chapters.

Chapters 4–9 analyse in greater detail the above-mentioned schools of thought: Classical, Keynesian, Neoclassical. Chapter 10, by Santangelo, surveys the evolutionary point of view on growth and thus complements Chapters 4–9. Chapter 4, by Giuseppe Freni, Fausto Gozzi, and Neri Salvadori, can be read as an analysis of the problems that the extension to a multi-sector economy poses for endogenous growth theorists, but it can also be read both as a restatement of some solutions proposed by the theory of production of ‘Classical’ orientation (see Kurz and Salvadori, 1995) and as a complement to this theory when the growth rate is negative and depreciation is by evaporation. Chapter 5, by Davide Fiaschi and Rodolfo Signorino, investigates a problem concerning the ‘Classical’ growth model that has rarely been on the agenda of scholars interested in modern developments of the ‘Classical’ school (but see Pasinetti, 1981, pp. 69–70; 1993); the problem of consumption patterns. Chapter 6 is a broad survey on ‘Keynesian’ theories
of growth. Pasquale Commendatore, Salvatore D’Acunto, Carlo Panico, and Antonio Pinto have gone to great lengths to produce a comprehensive analysis of all the literature on the issue. Chapter 7 on Say’s law, by Fabio Petri, complements this analysis. As is argued in the first chapter of this book, the fact that the endowments of all resources – including capital and labour – are among the data of neoclassical theory imposes that this theory can consider growth only as exogenously directed. However, some sort of alternative exists; it consists in complementing neoclassical theory with a theory modelling the evolution of some endowments. Chapters 8 and 9 perform this task. Piero Manfredi and Luciano Fanti provide an analysis of the dynamics of the working population within the Solovian model. Maria Rosaria Carillo studies the changes in the efficiency of work connected with social factors, as opposed to economic factors.

Thus Chapters 3–10 are mainly devoted to a ‘vertical’ or in-depth analysis of four schools of thought, the ‘Classical’, the ‘Keynesian’, the ‘Neoclassical’ and the ‘Evolutionary’ School. By contrast, the remaining chapters of the book are devoted to a ‘horizontal’ analysis of a number of items connected with growth. Chapter 11, by Antonio D’Agata, explores the problem of legal barriers to entry and rent-seeking in Smith and in the modern theory of growth. Chapters 12 and 13 investigate the problem of technical change: Mauro Caminati proposes an ingenious method to classify the modern literature whereas Maria Daniela Giammanco compares recent results with some features that characterise the analysis of technical change proposed by Marx. Chapter 14, by Andrea Mario Lavezzi, compares the modern contributions on the division of labour with the old literature, mainly Adam Smith and Allyn Young. Chapters 15 and 16 analyse the connection between growth and cycles: Serena Sordi surveys the macrodynamic models whereas Davide Fiaschi and Serena Sordi survey the more recent literature on this topic. Tommaso Luzzati, in Chapter 17, is concerned with the questions that the environment poses for growth theorists. Finally, Chapter 18, by Salvatore Capasso, investigates the problems connected with the existence of financial intermediation.
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The theory of growth, as stated by the classical economists (Smith, Malthus, and Ricardo) can be described in a simple way: According to labour theories of value, wages will be paid to each worker according to the level of subsistence and surplus. The capitalists will accumulate surplus—the difference between total products and total consumption. The surplus is assumed to be equivalent of total wage bills.

The Malthusian theory of population growth has been proved to be misleading in the light of the experience of economic growth of the advanced countries. The Malthusian arguments that whenever wages are above the level of subsistence, people like to have more baby rather than bicycles, radios, televisions or cars seems to be invalid both logically and empirically. Economic growth is an increase in the production of economic goods and services, compared from one period of time to another. It can be measured in nominal or real (adjusted for inflation) terms. Traditionally, aggregate economic growth is measured in terms of gross national product (GNP) or gross domestic product (GDP), although alternative metrics are sometimes used. Key Takeaways. Economic growth is an increase in the production of goods and services in an economy. Increases in capital goods, labor force, technology, and human capital can all contribute to economic growth. Economic growth is one can define economic growth as the increase in the inflation-adjusted market value of the goods and services produced by an economy over time. Statisticians conventionally measure such growth as the percent rate of increase in real gross domestic product, or real GDP. Growth is usually calculated in real terms, i.e., inflation-adjusted terms to eliminate the distorting effect of inflation on the prices of goods produced. Measurement of economic growth uses national income accounting. Since all theory depends on assumptions which are not quite true. That is what makes it theory. The art of successful theorizing is to make the inevitable simplifying assumptions in such a way that the final results are not very sensitive. A "crucial" assumption is one on which the conclusions do depend sensitively, and it is important that crucial assumptions be reasonably realistic.

1 wish to argue that something like this is true of the Harrod-Domar model of economic growth. The characteristic and powerful conclusion of the Harrod-Domar line of thought is that even for the long run the economic system is at best balanced on a knife-edge of equilibrium growth.