

Does imperfect competition foster capital accumulation in a developing economy?

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Abstract

We analyze the relationship between imperfect competition and capital accumulation in a dual economy, with traditional and modern sectors and two types of agents (workers and capitalists). Workers allocate their time endowment between the two sectors. Capitalists accumulate wealth in the modern sector. The economy is open to capital flows, but capitalists face borrowing constraints. Non-competitive behavior of capitalists results in a rent, which is extracted from the workers and lowers employment in the modern sector. In the long-run, if capitalists are unconstrained, imperfect competition is beneficial for capital accumulation and growth, while it is detrimental in the converse case. Moreover, not-binding borrowing constraints lead to higher employment and wages. This can motivate the introduction of a subsidy on bequests which allows the economy to reach the unconstrained regime, and is welfare-enhancing for workers.

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[✉] The core of the paper was written with Philippe and we have completed the text after his sudden death. We want to express our deep sorrow for the loss of a close friend and an excellent economist, from whom we had learned much over the years.

1. Introduction

Does imperfect competition foster capital accumulation in a developing economy? This paper is an attempt to answer this question. We explore the relationship between imperfect competition and capital accumulation, in a dual economy. Considering an economy with two sectors, a traditional agricultural sector and a modern capitalistic one, we assume a non-competitive behavior of capitalists in the modern sector. Capitalists take into account the effect of their labor demand on the equilibrium wage. This behavior results in an extra rent for them, but introduces a distortion in factor prices. We aim at evaluating its effect on capital accumulation.

Since Lewis' (1954) contribution (developed through a formal model in Ranis and Fei, 1961), numerous articles have explored issues relating to the migration of workers from a traditional sector to a modern one. Development is viewed as an unbalanced growth process, in which labor shifts toward the manufacturing sector. Capital accumulation in this sector increases labor productivity and results in higher wages, attracting more and more workers. The article by Kongsamut et al. (2001) can be viewed as a modern reformulation of the argument, which deals with three sectors of activity (agriculture, manufacturing and services), and shows how such models are consistent with historical stylized facts.

As is apparent in Lewis' model, a direct consequence of the dual production structure is that the two sectors have conflicting interests. Capitalists in the modern sector can hire more workers at lower costs if the labor productivity in the traditional sector is low enough. The mechanism would be reinforced if the capitalists had a non-competitive behavior taking account of the effect of their decisions on the traditional sector. Worsening the situation in the traditional sector by such a behavior could favor a quicker development of the modern sector. Typically, by strategically reducing their labor demand, capitalists can maintain lower wages.

In order to formulate this idea, we consider a framework that retains the main ideas of Lewis (1954) and Ranis and Fei (1961) models. We use a model with successive generations of workers and capitalists. Workers are identical within a generation and consume their whole revenue at each period. Capitalists are altruistic and leave as a bequest a stock of wealth to their descendants. Thus, our model is close to Mankiw's (2000) model with savers and non-savers agents.

We consider a dual economy with two production sectors, a traditional agricultural sector and a modern capitalist one. The traditional sector employs labor as the only input, when the modern one uses capital and labor. Workers must allocate their time endowment between the two activities. The optimal allocation of workers time determines labor supply for the modern sector.

We assume that capitalists behave non-competitively. They maximize their profit taking into account the impact of their labor demand on the equilibrium wage. Under this assumption, they tend to demand less labor than in the competitive case, in order to decrease the equilibrium wage. The equilibrium concept is in the line of the Cournot–Walras equilibrium (cf. Gabszewicz and Vial, 1972; Codognato and Gabszewicz, 1993; Gabszewicz and Michel, 1997): some agents, called strategic agents, take into account the influence of their choice on the Walrassian equilibrium and play between them a game of the Cournot–Nash type. In our framework, strategic agents are the capitalists, who consider the effect of their labor demand on the Walrassian equilibrium wage.

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