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# INTEREST-DETERMINED AND GROWTH-DETERMINED RATE OF PROFITS: AN UNNECESSARY EXERCISE IN RECONCILIATION

The purpose of this paper is to discuss Kaldor's idea (elegantly reformulated by Carlo Panico in some recent works) that an excess of the rate of interest (or rather of the interest-determined rate of return on shares) over the rate of profits resulting from the rate of growth of the economy can (and, indeed, should) be taken care of by fiscal policy. A proper amount of government-generated extra-demand, it is argued, will cause the rate of profits to rise (and the real wage to fall) to the extent required to bring it into line with the rate of interest.

As a first step in my argument I shall focus on the consequences of the assumption, underlying the above exercise in reconciliation, that plant is continuously run at its normal degree of capacity utilisation. As soon as we impose the condition that output ($Y$) is equal to normal-capacity output ($Y^*$), investment turns out to be equal to normal-capacity saving ($I = sY^*$) and the economy is placed on a steady-state path, along which it grows at the 'warranted' rate

$$\frac{I}{K} = \frac{sY^*}{K} = \frac{s}{v} = g_w$$

where $K$ is the amount of (everlasting) capital employed in the economy and $v = K/Y^*$.

Let us consider now what J. Robinson calls the 'realised' rate of profits ($\pi$), namely, the ratio of overall profits ($P$) to overall capital. Under 'classical' saving assumptions

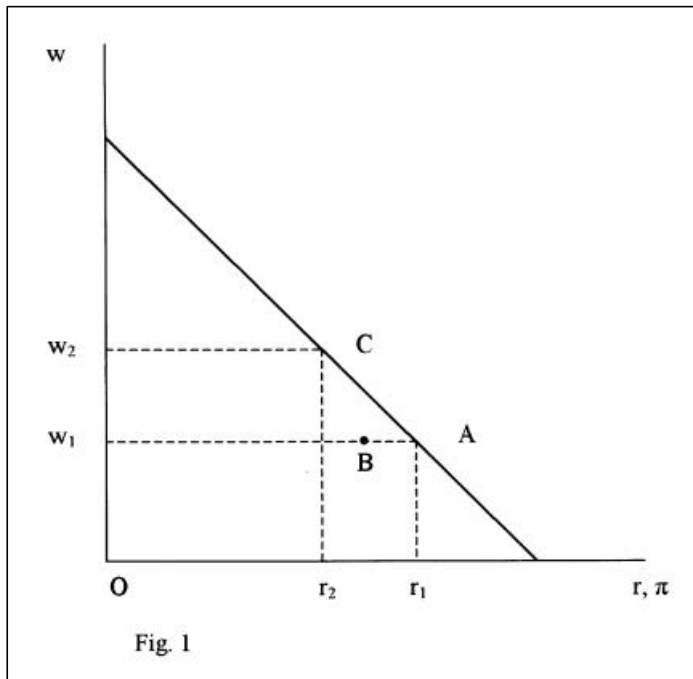$$\boldsymbol{p} = \frac{P}{K} = \frac{1}{s_c}\frac{I}{K} = \frac{1}{s_c}g$$

If plant is run at its normal degree of capacity utilisation, then the realised rate of profits is equal to the normal rate of profits ($\pi = r$). The realised rate of profits corresponding to the wage $w_1$ in Fig. 1 is then equal to $r_1$, as shown by point $A$ on the $w$-$r$ frontier. If, instead, effective demand is insufficient to absorb the normal-capacity output, productive capacity turns out to be under-utilised and the realised rate of profits is lower than the normal one ($\pi < r$), as shown by point $B$ in Fig. 1, which lies inside the $w$-$r$ frontier.

To write the 'Cambridge equation' $\qquad r = \frac{1}{s_c}g$

is tantamount to impose the condition that $\pi = r$, namely, that plants are continuously run at the normal degree of capacity utilisation. This is what I call the *full-adjustment constraint*, which oblige the economy to grow at the warranted rate ($s/v$). The only choice we are left with is among different warranted rates, each of which is characterised by a different propensity to save; which under classical savings assumptions means a different income distribution. Thus, if we consider two economies growing at different speeds, the lower-growing one must necessarily have a higher wage and a lower normal rate of profits (say, $w_2$ and $r_2$ in Fig. 1) than the faster-growing one ($w_1$ and $r_1$).

Why in the world should it be so? The reason can be stated quite simply. In the slower-growing economy the ratio of $I$ to $K$ is by definition lower than in the faster-growing one. As the productive capacity installed in the investment-good sector is assumed to be utilised normally in

both economies, the portion of *K* installed in the consumer-good sector must be larger in the slower-growing economy than in the faster-growing one. But in order to enable the productive capacity installed in the consumer-good sector, too, to be normally utilised, the wage must be higher in the slower-growing economy than it is in the faster-growing one. This is how the link between the rate of growth of the economy and the normal rate of profits comes to be established. And this is also how the incompatibility arises between the allegedly growth-determined normal rate of profits and the rate of interest (whenever the latter is higher than the former).



Fig. 1

An entirely different story can, however, be told as soon as we drop the full-adjustment constraint. Suppose that the normal rate of profits is determined by the rate of interest. And suppose further that the inducement to invest is insufficient to keep the economy growing along the steady-state path corresponding to the existing, interest-determined normal rate of profits. Productive capacity will be underutilised and the realised rate of profits will be lower than the normal one. This is likely to further slow down the growth of the productive capacity installed, which will tend to adjust to the pace of growth of output (to the extent that this will occur, the realised rate of profits will come nearer to the normal one). These developments are fully compatible with the permanence of the same wage and the same normal rate of profits.

This means that the normal rate of profits can be thought to be determined by the rate of interest without any need for a fiscally-induced reconciliation of the above determination with the idea that the normal rate of profits is determined by the rate of growth. We are in no need to reconcile a statement about the real-world normal rate of profits (the normal rate of profits is determined by the long-term rate of interest) with a link between the normal rate of profits and the rate of growth which is not a statement about the real-world rate of profits, but about the value the normal (and realised) rate of profits should assume in order to make it possible for the economy to grow in steady-state conditions with plant permanently run at its normal degree of capacity utilisation.