

Involuntary unemployment, macroeconomic policy, and a behavioral model of the firm: Why high real wages need not cause high unemployment

Morris Altman

Department of Economics, University of Saskatchewan, 9 Campus Drive, Saskatoon, SK, Canada S7N 5A5

Received 9 February 2005; accepted 14 March 2006

Abstract

The perspective of modern macroeconomic theory, be it new classical or old and new Keynesian, is that unemployment can be reduced only if real wages are cut. The modern Keynesians, basing themselves upon the microfoundations of efficiency wage theory, argue that real wages cannot and will not be cut by firms for efficiency wage reasons. This generates involuntary unemployment based on a market coordination problem. A behavioral model that contrasts with efficiency wage theory is presented here which suggests that reducing real wages need not affect the marginal cost of labor and, therefore, the number of individuals employed. In the behavioral model, wherein there exists some linearity in the relationship between real wages and working conditions and labor productivity, a lower real wage rate is not a necessary condition for reducing the unemployment rate nor is a higher real wage an obstacle to reducing it. In this scenario, unemployment, to the extent that it is demand-side induced, is not related to movements in real wages. Therefore, restoring full employment after a negative demand shock becomes a matter for demand management, not demand management that must be coordinated with measures designed to reduce real wages.

© 2006 University of Venice. Published by Elsevier Ltd. All rights reserved.

JEL classification: B4; D2; E2; E6; H5

Keywords: Unemployment; X-efficiency theory; Efficiency wages; Demand management; Behavioral economics

1. Introduction

A common denominator running through the spectrum of modern macroeconomic theory, be it the new classical or old and new Keynesian, is that unemployment can be reduced only if real wages are cut and that relatively high rates of unemployment are a function of relatively high real wage rates. The key philosophical distinction between the new classical and Keynesian economics is that for the new classicals unemployment is voluntary whereas for the new Keynesians it is largely involuntary.¹ The new Keynesian theorists, basing themselves on Keynes' own foundation

E-mail address: altman@sask.usask.ca

¹ See Mankiw (1993) for a summary of the new Keynesian literature. See Greenwald and Stiglitz (1993); Tobin (1993) for a critical review of the same. See Blinder (1997); Solow (1980), Tobin (1972, 1992, 1993) representations of traditional Keynesian perspective. For a post-Keynesian critique of the latter see, for example, Brothwell (1997); Darity (1987–1988); Darity and Horn (1982–1983); Darity and Young (1995), Davidson (1983b, 1998). The new classical position that unemployment, whatever its measured rate, is typically voluntary is presented, for example, in Friedman (1968) and Lucas (1977, 1981).

contribution to the literature, argue that real wages must be cut in the short run (plant size and technology are held constant) for unemployment to fall. A reduction in real wages is a necessary condition for increasing the level of employment and, thereby, the rate of unemployment. This can be done most efficaciously through a mild inflationary process and such cuts would be acceptable to workers at large in a world where prices are sticky downwards (Akerlof, 2002; Akerlof et al., 1996, 2000; Fortin, 2001). Thus, for the new Keynesians, a key explanatory variable to persistent high rates of unemployment and to increasing unemployment rates, is the downward stickiness of real wages. The post Keynesians, on the other hand, focus on increasing aggregate demand, *implicitly* assuming that real wages will fall, as need be, in the process of demand-side expansion—the dynamics of necessary real wage adjustments are largely ignored in this discourse. The new classical economists reject the assumption that workers would accept any such real wage cuts, thereby maintaining, voluntarily, the prevailing macroeconomic rate of unemployment.

A behavioral model presented in this article suggests that changing real wages need not affect the marginal cost of output over a range of wage rates through its effect upon effort inputs and, in the longer term, upon technical change. The behavioral model, therefore, suggests that the production function is not determined independent of real wages or working conditions in the firm, as it is in its traditional rendering. In this scenario, reducing real wages is not a necessary condition for increasing employment. Nor need increasing real wages be a supply side obstacle to increasing employment. In this scenario, unemployment, to the extent that it is demand-side driven, need not be related to movements in real wages. Therefore, restoring full employment after a negative demand shock becomes a matter for demand management, not demand management that must be coordinated with measures designed to reduce real wages. Moreover, in this scenario, maintaining an adequate level of aggregate demand becomes a necessary condition for maintaining low levels of unemployment. Demand management is also modeled as a corollary to increasing the efficiency of labor. In other words, a dynamic dialectical relationship is established between increasing and high real wages, increasing and high levels of economic efficiency, demand management and the rate of unemployment. From this perspective, on the supply side, more attention need be placed on increasing the level of economic efficiency as opposed to reducing real wages. On the other hand, increasing efficiency, without corresponding increases in aggregate demand will generate increasing rates of unemployment.²

Which economic theory is used to design macroeconomic policy is critically important. Measured unemployment remains high and is, indeed, now much higher than it was on average in the first decades following the Second World War. Table 1 presents unemployment rate estimates for 20 advanced market economies for the 1950–2003 time-frame. Average unemployment has increased from 3% in the 1950–1973 period (pre-oil shock), to 5.5% in the 1974–1983 period, to 8% in the 1984–1993 time-frame. At least for the first few years of the new millennium the unemployment rate was 6.2%. From the mid-1970s, governments in these economies by and large pursued relatively tight macroeconomic policy being largely concerned in the post-1973 period with inflationary pressures as opposed to unemployment, with the underlying belief that real wage inflexibility played and continues to play a pre-eminent role in maintaining the relatively high rates of unemployment (Eatwell, 1997; Lombard, 2000; Maddison, 1984, ch. 6; Michie and Wilkinson, 1994; Tarling and Wilkinson, 1997).

The gist of this paper is to improve the standard modeling of the causes of involuntary unemployment by introducing alternative assumptions contained in a behavior model presented here, that wages and working conditions impact upon the production function. The framework for this discussion is the macroeconomic demand model contained in the standard IS-LM framework and in the post-Keynesian rendition of Keynes' work and the macroeconomic supply model contained in the neoclassical production function parlayed into the labor market. Particular attention is paid to the importance of supply side factors in these models, specifically real wages, as a constraint to demand side efforts to reduce the rate of unemployment.

2. Keynes and the real wage rate

Since Keynes provided the foundational work for active and effective demand side management of the economy as it relates to determining the level of employment, for the many varieties of Keynesian economics that

² We are not concerned here with the important issue of wage flexibility as it pertains to shifts in the demand for labor across an economy's many labor markets due to structural change or changes in consumer tastes. In this case, wage flexibility relates to movements in wages about some average to accommodate relative shifts in supply and demand across product markets. This is not the same wage flexibility issue addressed in the macroeconomic discourse on the average flexibility of real wages to accommodate changes in aggregate demand across all labor and product markets.

متن کامل مقاله

دریافت فوری ←

ISIArticles

مرجع مقالات تخصصی ایران

- ✓ امکان دانلود نسخه تمام متن مقالات انگلیسی
- ✓ امکان دانلود نسخه ترجمه شده مقالات
- ✓ پذیرش سفارش ترجمه تخصصی
- ✓ امکان جستجو در آرشیو جامعی از صدها موضوع و هزاران مقاله
- ✓ امکان دانلود رایگان ۲ صفحه اول هر مقاله
- ✓ امکان پرداخت اینترنتی با کلیه کارت های عضو شتاب
- ✓ دانلود فوری مقاله پس از پرداخت آنلاین
- ✓ پشتیبانی کامل خرید با بهره مندی از سیستم هوشمند رهگیری سفارشات