

# Is Labour Cheapening a Means to Reducing Involuntary (Labour) Unemployment?

---

Tony Aspromourgos\*

---

## 1 The Issue

The question of labour unemployment has long been a difficult and controversial one, both in economic theory and policy. It has also been a pivot for much political controversy – not to say moral and political disasters – in the twentieth century. In the realm of economic theory, Keynes's *General Theory* (1936) has been the centre of gravity of modern debate. Keynes turned the debate around unemployment into a debate around aggregate demand in the product market – at least for a time. But since the 1970s, the centre of gravity of theoretical and policy discussions about unemployment has shifted back in a more traditional direction. The concept of 'the natural rate' of unemployment, first introduced by Friedman (1968; also Friedman 1966, especially pp. 55, 60-1), enabled a sort of reconciliation between an economic theory which said that involuntary unemployment would be an impossibility under conditions of general competition (at least in the long run), and the evident fact of widespread and persistent unemployment, which at least appeared to be involuntary. But how successful, really, is this neat trick perpetrated by the American orthodox core of the contemporary discipline? This is too large a question for us to engage with here. Our purpose below is more modest: to consider a supplementary, or corollary, proposition to that orthodox view concerning unemployment – the idea that a cheapening of labour, in some sense, could be relied upon to increase the demand for labour, and hence lead to a reduction in involuntary labour unemployment, *if the initial position under consideration involves an excess of effective labour supply over labour demand*. Nor will we have anything very original to say. Rather, the purpose is to draw together some important strands from previous research and debates.

By referring directly above to 'effective labour supply' we mean conceptually to *remove* from observed labour supply, that part of it which is 'ineffective' – in the sense that (by way of thought experiment) an increase in labour demand would not enable any element of that part of labour supply to be drawn into employment. This part of observed labour supply is equivalent to what has become known as 'supply-side unemployment', as commonly embodied in the natural rate or, depending upon its precise construction, NAIRU concepts. In fact, the notion of effective labour supply requires one additional thought experiment: not only must we subtract from the observed labour supply, the ineffective part of it, we must also *add* to the observed supply any hidden unemployment involving workers whose labour supply would be effective if it were forthcoming, or 'made itself known' so to speak (including in this, employed workers' desired working hours in excess of their actual working hours). These two adjustments, together, provide an accurate picture of the employment capacity of the economy under consideration.<sup>1</sup> Hence, to suppose, in a thought experiment, that an increase in labour demand would increase employment, amounts to *presupposing* that there is initially some unemployed labour supply, which is unemployed due to a lack of sufficient labour (and hence by inference, product) demand. In other words, this

would be to *assume* the Keynesian view, that in general, competitive capitalist economies exhibit product/labour demand deficiency. It therefore might seem that what needs to be proven – that in a competitive economy there is no spontaneous mechanism for ensuring a balance between effective labour supply and labour demand, *contra* the orthodox view – merely has been assumed. In fact, no such assumption is required for our limited purposes here. The premise of our discussion is rather, that the orthodox notion of a competitive economy as tending to bring about a balancing of labour demand and effective labour supply (so that at least the trend outcomes for the macroeconomy will involve a coincidence of supply-side and actual unemployment) requires the proposition that labour cheapening increases labour demand.

Whether any such increases in labour demand, as labour cheapens, will bring about a rise in employment, obviously depends upon the prior balance between supply and demand, so that under ‘the short-side rule’ – whichever is the smaller, demand or supply, determines quantity – they would fail to do so, if initially effective supply and demand are equal. But if labour cheapening – which we shall understand to mean a decline in the real wage rates of labour – increases labour demand, and if effective labour supply in excess of labour demand induces a cheapening of labour under competitive conditions, then one would conclude, precisely, that a competitive capitalist economy tends towards labour-market clearing. It is just such an informal line of reasoning which seems to have convinced early marginalist economists that labour could be treated like any other flow resource or commodity, in a supply-and-demand framework – *before any solid demonstration of a negative relationship between labour demand and the price of labour had been provided*. In any case, the logic of the argument presented here can now be stated clearly, on the basis of these considerations: *a*) A tendency to labour-market clearing is justifiable upon the basis that a well-behaved demand curve for aggregate labour as an inverse function of real wages –  $L^d(w/P)$  – can be constructed (where  $L^d$ ,  $w$  and  $P$  refer to aggregate labour demand, the money wage per unit of homogeneous labour and the price level of output, respectively). At least this is so, if *b*) labour supply is a non-negative function of the real wage – or, if a negative function of the real wage, labour supply has less (absolute) elasticity with respect to the real wage than labour demand; and *c*) excess effective labour supply places downward pressure upon real wages, via some kind of competitive process, for so long as such excess supply persists. If all this were true or plausible, then the orthodox position would be vindicated. Hence the purpose of our argument is to indicate that *even if propositions b) and c) were sound*, a plausible rejection of the existence of a continuous inverse relation between real wages and aggregate labour demand would suffice to render implausible the orthodox position on unemployment (and, as it happens, the orthodox theory of real wages). Then Keynes’s view would be vindicated, not assumed.<sup>2</sup> That is to say, the appropriate answer to the question in our title would be: ‘In general, no.’

## 2 A Point of Departure

One may begin from a simple observation. The aggregate quantity of employment in any economy will be proximately determined by just two sets of phenomena or parameters. In any time period (say, a year) there will be a set of gross outputs produced by the economic system:  $[Q_1 Q_2 Q_3 \dots Q_n]$ , where  $n$  refers to the number of distinct commodities produced in the system (wheat, hamburgers-with-the-lot,

tourist-packages-to-Hayman-Island, a-certain-grade-iron-ore, students-of-a-certain-proficiency, etc.). The money value of this collection of quantities is just the GDP of the economy, for that time period. Each of those various distinct commodities will require input of labour for its production (with labour assumed homogeneous, for simplicity). It will therefore be possible to define the average quantities of labour required to produce a unit of each of these commodities:  $[l_1 l_2 l_3 \dots l_n]$ . Each of these labour terms is just the reciprocal of average labour productivity in each of these  $n$  industries; that is to say,  $1/l_1$ , and so on, is the average output per worker in industry 1, and so on. Hence the total employment generated in the economic system is necessarily expressed as the inner product of these two sets of terms:

$$L = l_1Q_1 + l_2Q_2 + l_3Q_3 \dots l_nQ_n$$

This insight should be the point of departure for any consideration of prospective employment policies. That is to say, any policy which offers itself as a means to systematically reducing unemployment – e.g., reducing wages paid by employers, relative to commodity prices received by employers (which we are calling ‘labour-cheapening’ for short) – should be subjected to the question, *how is it able to systematically increase outputs and/or average labour required per units of outputs?* When so approached, the idea that labour cheapening will systematically reduce unemployment will be revealed for what it is, in general: *a seductive fantasy*.<sup>3</sup>

The utility of proceeding in this manner, by constructing not so much a model as a formal ‘point of departure’, so to speak, is that the latter is likely to be more or less unobjectionable. *Behind* this formalization, more than one model could be built, explaining the behaviour or determination of both gross outputs and technical (in particular, labour) coefficients. This way of proceeding is particularly useful for a consideration of theoretical disagreements or other (for example, policy) controversy, because it enables an *unobjectionable* starting point; whereas if one were to begin from one *particular* kind of (contestable) model, there would be disputation from the beginning, and progress would be more tortuous. Thus our employment equation is not a model; it is a coherent and more or less inescapable point of departure, ‘behind’ which one might build one or other kind of competing model.

Of course, the orthodox marginalist position with respect to unemployment amounts to building behind the above employment equation a model, of one kind or another, which captures the theory that competition, acting particularly (but not exclusively) through ‘factor price’ flexibility, will bring the level of employment represented by that equation into balance with (effective) labour supply ( $L^s$ ):

$$L^s = L^d = l_1Q_1 + l_2Q_2 + \dots + l_nQ_n$$

This *must* mean (taking labour supply as given, for simplicity) that the labour coefficients of production and/or gross outputs must endogenously vary, so as to ensure an adjustment or accommodation of  $L^d$  to  $L^s$ . The introduction of flexible rates of return to ‘factors of production’, together with the availability of alternative methods of production for commodities (each with their own production coefficients), enables ‘factor substitution’ in response to variations in relative ‘factor prices’ to play a role supposedly analogous to substitution in consumption. This is the core meaning of the orthodox idea that demand for resources adjusts to supply (so as to clear ‘factor’ markets), in our context here. One part of the purpose of the debates on capital and choice of technique, in the 1960s and 1970s, was to show that such adjustment could not be generally relied upon, in a setting in which

rates of profit were equalized across industries (*vide* Harcourt 1972; Pasinetti 1977, Chapter VI; Garegnani 1990a). The idea that demand functions can be constructed for ‘factors of production’, including capital and labour – and associated with this, supply functions for consumable commodities – arose from the idea that a ‘well-behaved’ substitution between capital and labour can be relied upon to operate in response to (notional) variations in relative ‘factor prices’. As the ‘rental price’ of capital (or, we may loosely call it, the rate of interest), for example, rises relative to the real wage rates of labour, this will induce firms or producers in each of the various industries of the economy to switch the proportions in which they combine capital and labour in production, in favour of labour. There would then also follow from this a relative cheapening of labour-intensive consumable commodities, which would favour a shift of consumption in favour of relatively labour-intensive commodities as well.

If the labour/capital substitution mechanism acting through flexibility of real wages<sup>4</sup> is disallowed as a robust mechanism, then consideration of the capacity of real wage reductions to increase labour demand must of necessity fall back upon the capacity of falling real wages to unambiguously increase aggregate product demand – and in a manner more direct than the route via changes in technique of production and relative commodity price variations. In fact, one would be left with an essentially Keynesian approach to the issue as the *only* way of analysing it: how might such wage variations lead to systematic increases in consumption and/or investment, in a closed system without a public sector? There are some *in principle* possibilities here,<sup>5</sup> but none which would appear to offer sufficient generality to support the claim that an inverse relation between real wages and aggregate employment can be entertained as a fundamental theoretical principle. In a monetary framework, with flexible *money* wages the conduit for a competitive system’s resolving of excess effective labour supply, orthodox postwar macroeconomics was obliged to rely upon a real balance effect on outside money holdings (the ‘Pigou’ effect, so called) – and Keynes himself had to wrestle with the impact of falling money wages on interest rates, and thereby aggregate (in particular, investment) expenditure (the Keynes effect) (*vide* Aspromourgos, 1997).

Of course, more realistically, our employment equation should account for the fact that each industry, or commodity produced, uses many different kinds of labour. Properly speaking therefore, we should think of the labour requirements in each industry/commodity as a vector of various kinds of average labour quantities; and then, the final result of the above employment equation would not be a single quantity of aggregate labour, but rather a vector showing the aggregates of all the various kinds of labour used in the system. This labour heterogeneity will be returned to below, briefly.

### **3 Demand-determined Output and Employment**

What then determines the outputs of the system? In a nutshell, demand and profitability. Outputs will be produced so long as: *a*) there is a *demand* for them; and *b*) those demands can be profitably satisfied by firms. The latter raises the vexed question of profitability and employment. This in general points to the fact that required profitability of output supply (or ‘supply price’, to use an old-fashioned term) implies a definite limit to, indeed a definite value of, the real wage. In fact, in the pricing framework which would be preferred by the current writer (the Sraffa or ‘surplus’ approach to pricing and distribution – *vide* Kurz and

Salvadori 1995), once the general rate of profit, or the rates of interest in the financial system, is or are given (subject to certain technological constraints), then the real wage (specified in whatever composite commodity) will be determined, as a negative function of profit or interest rates. The relative commodity prices which are determined simultaneously with real wages, under these circumstances, are just the ‘supply prices’ which guarantee appropriate or ‘normal’ profitability per unit of outputs produced and sold. Furthermore, the determinateness of the real wage under these conditions means that no amount of ‘competition’ between employed and unemployed workers could cause real wages to fall – unless that competition causes rates of return on capital to rise, given the technology of the economy. And the plausibility of such pressure of ‘competition’ upon the real-wage-profit-rate combination is vitiated once the orthodox factor substitution mechanism is repudiated.

As to the former proposition – that demand drives output levels – this is, in the first instance, not ‘unreconstructed Keynesianism’; it is simple common sense: no one in their right mind can doubt that in a market economy outputs will only be produced, so long as those output levels are ‘warranted’ or ‘validated’ by demand levels (and with desired inventories governed by the contours of expected future demand). The point of contention between Keynesian-influenced economists, and those of a more traditional or orthodox persuasion, is whether demand for outputs (and thereby, the ‘derived demand’ for ‘factors of production’) adjusts to autonomous factor supplies – or whether demand for outputs plays a persistent autonomous role in determining the employment of resources (including, most notably, labour).

With regard to the labour coefficients of production – which together with the gross output levels determine aggregate employment in an equilibrium – it would be widely accepted, across otherwise contending schools, that under conditions of general competition these would emerge as part of the solution to the problem of choice of profit-maximizing methods of production by firms. These coefficients, being reciprocals of average labour required per unit of each commodity produced, for any of them to rise would imply *a decline in average labour productivity*. That is to say, a rise in labour required to produce any given vector of gross outputs would be required. Is anyone seriously entertaining this as an appropriate means of increasing employment? I don’t think so.<sup>6</sup> Nevertheless, in the orthodox factor-substitution framework, a rise in labour intensities so understood is precisely what is implied by substitution in response to excess effective labour supply. For example, suppose a labour supply shock (say, an exogenous shift in labour-leisure preferences, away from leisure) to an initially fully employed economy. This would be supposed to induce a decline in real wages and, as a consequence of that, a shift towards more labour-intensive methods of production (and a relative cheapening of labour intensive commodities).

To sum up the issue of the determination of quantities marketed, in a Keynesian world wherein (at least some components of) commodity demand play an autonomous role, all commodities – whether used as inputs in production processes, or exclusively as final consumption goods – may be subdivided into reproducible and primary resources. It is obvious enough, in the case of reproducible commodities or resources, how their production will adjust to demand conditions: given sufficient time for adjustment to occur, firms will bring their activity and capacity levels into line with average demand conditions. From the system standpoint, this process of adjustment will involve a complex of multipliers.

For example, in general a contraction in bread production will itself reduce the use of, and hence the demand for, those commodities used as inputs in bread production (e.g., flour), thus contracting activity levels (and perhaps capital stock capacity, if the fall in demand for bread is regarded as persistent) in the industries supplying inputs to bread, such as the flour industry. This in turn will contract the use of and demand for the commodities used as inputs in the production of inputs for bread (e.g., the tractor industry), and so on. But however complex in practice, this kind of process can be shown to be quite analytically tractable (*vide* Kurz 1985).

Apart from labour, other primary and non-reproducible commodities will exist as stocks (e.g., iron ore), to be drawn down or extracted as demand and profitability jointly dictate. The notion of an '(un)employment rate' for such resources is not really meaningful: they will simply have rates of depletion, optimal or otherwise. (In fact, properly understood, labour is more akin to a reproducible commodity than a nonrenewable stock.) Hence in the Keynesian, autonomous-demand approach, *we are left with just one resource or 'commodity', for which it is impossible that the supply or 'production' adjusts to the demand for it: labour*. Or at least, there is no straightforward sense in which labour supply can adjust to labour demand. There are some mechanisms on the labour supply side, in response to an insufficiency of demand, which can meliorate an excess effective supply. The so-called Malthusian mechanism whereby reproduction of the workforce eventually contracts in the face of excess labour supply was widely endorsed in classical economics, for so long as workers could be construed, in the production process, as being little different to cattle. The large-scale global emigrations of the nineteenth and twentieth centuries were in part labour supply responses to employment opportunities. Furthermore, family structures have commonly acted as a kind of private social security system: collectively, a 'buffer' absorbing involuntary unemployment and 'carrying' some of the individuals so affected. These several forces can act to give a *semblance* of balance to labour demand and supply (*vide* Garegnani 1990b). But there are strong limits to the operation of such forces, and the existence of (hard-won) public support systems for the unemployed – income support, social security, retraining schemes, and so on – have the effect of giving the involuntarily unemployed an incentive to disclose their existence.<sup>7</sup> Hence the one commodity for which an excess supply can be observed to persist is human labour, even though there are means to somewhat alter perceptions of unemployment, driving it 'underground' by making it unattractive, or even punishing, for involuntarily unemployed human beings to disclose themselves.

#### **4 Real Wages and Employment**

To return to our central question – can labour cheapening favour higher employment? – we do not wish to give an overwhelmingly emphatic negative answer to this. But we do wish to stress that what should be asked is how such a policy might increase the inner product of labour and output quantities which enter into aggregate employment. If rising labour coefficients can be ignored as a general possibility, then we are left with the role of labour-cheapening in increasing demand for outputs. This offers no very clear prospects. The most obvious exception to this is foreign trade, with wage rates in the rest of the world given. But all countries or economic systems can cut wages; and it seems unlikely that any subset or subsystem of countries in the global economy would prove persistently capable of prosecuting wage reductions or labour cheapening more successfully

than the rest of the global system. In any case, from the ‘higher’ (global) standpoint, this route to increasing employment evaporates. It is globally incoherent. That is to say, it cannot plausibly generate a rise in global employment: even if successful for a subset of countries, it will amount to ‘importing employment’ from elsewhere.

It might appear that a fall in real wages, in increasing the general profitability of capital (with given technology), might induce a rise in product demand by inducing higher investment demand (or capital accumulation, dynamically speaking). But there seems very little warrant for such a view. A general rise in the profitability of capital assets creates no inducement for wealth-holders to prefer any particular investment or asset over any other. Hence, the only ‘inducement’ which could come into play as the general profitability of capital rises is an inducement for wealth-holders to shift away from consumption in general, towards accumulation. Even if one ignores the evident great difficulty (rightly stressed by Keynes), of translating a rise of saving into an equivalent rise of investment demand, it would not be at all clear that the net employment effect of such a switch in favour of investment would be positive. And, at the end of the day, one would want to know how a rise in profitability, in and of itself, could induce a rise in expected future demand for final consumption – the only genuine and ultimate rationale for firms or entrepreneurs to expand productive capacity (i.e., accumulate capital), so long as the required profitability of output supply is satisfied.

There are some other, more minor possibilities which should be acknowledged. If we go down to the disaggregated level of heterogeneous labour and consider how altered wage differentials might influence employment, the following may be allowed: if wage regulations which oblige a uniform wage rate across distinct sub-groups of workers with economically relevant *different* characteristics are relaxed, then this may well alter the *relative* employment prospects between these sub-groups. For example, if workers with one year’s experience in a particular activity are paid the same wage as workers with five years’ experience in the same activity, this might favour employment of the latter (in a demand-rated labour market) – and a change to a lower relative wage for the less experienced workers might shift employment in their favour. But, even if so, whether this would improve the employment prospects *of workers as a whole* would lead us back to the inner product above, albeit suitably augmented to account for heterogeneous labour.

It may be added that even if a general fall in money and real wages increased employment, if the elasticity of employment with respect to the money and real wage were less than unity (that is to say, if an  $x$  percent fall in the money or real wage led to a less than  $x$  percent increase in employment), then *wage earners as a whole would still be worse off as a result of such a wage cut*. That is to say, total wages earned (wage rate times total employment) would fall. Hence the workers employed at the previous wage levels could ‘bribe’ at least sufficient of the unemployed workers not to work, and one or both parties would be better off, at the previous wage levels. In other words, even if one were to assume the conventional (negative) elasticity of aggregate employment with respect to the rate of (money or real) wages, the absolute magnitude of that elasticity should crucially condition one’s attitude to the ‘welfare significance’ of reducing real wages in order to increase employment. This is so because an elasticity of absolute magnitude less than or equal to unity would entail that an increase in employment resulting from a

fall of real wages would not increase the real income of labour as whole. This argument assumes that work is not intrinsically desirable to individuals, which is probably largely false; but it is the basis upon which the conventional (utilitarian) style of analysis of labour supply usually proceeds.

In conclusion, the notion of an inverse relation between wages and employment in fact arose, not from any common sense, but from a kind of utilitarian conviction that labour could be treated as if its demand were like the consumer demand for apples or oranges. One could suppose that if apples were cheapened (at least relative to substitutes such as oranges) then the consumer demand for apples, relative to the demand for substitutes, would rise. It was thought that the demand for labour could be similarly treated. This was an error. The analogy is in fact false. One may say that the analogy from a switch by a representative consumer towards a relatively cheapening commodity, as between substitutes (say apples and oranges), to a switch by a representative firm or entrepreneur or producer towards labour as it cheapens, relative to supposedly substitutable 'capital' (aggregated), is in fact itself the core of the seductive delusion referred to in section 2 above.

## 5 Some Comments on Wages, Competition, and Labour Supply

One proposition which we accepted for the sake of argument above (proposition *c*), in section 1) was that excess effective labour supply would induce a decline of real wages via 'some kind of' competitive process. This of course can be disputed. Indeed, Keynes himself disputed it, in various ways, especially in Chapter Two of *The General Theory*. What may be emphasized here is that such arguments for disputing the existence of a tendency towards zero involuntary unemployment are necessarily limited to *i*) some kind of justification for real wage 'stickiness' in non-monetary economies; or *ii*) the idea that the monetary character of actually existing economies (wherein agents contract in nominal or monetary terms, not real terms) somehow or other impedes the adjustment of real wages in the presence of excess labour supply. The latter is the route essentially taken by Keynes.<sup>8</sup> There is one further possibility: *iii*) that in a monetary economy in which money-wage flexibility *would* lead to real wages moving in the same (appropriate) direction, money wages are sticky. Well, the idea of 'sticky' prices of some kind (in this illustration, the nominal and real prices of labour) impeding the orthodox tendency towards zero effective excess labour supply – so far from being a critique of orthodoxy – is a quite direct corollary of the orthodox position. If price flexibility is understood as the means via which competition would remove involuntary unemployment, then impediments to price flexibility immediately suggest themselves as a reason for observed unemployment (whether or not those impediments are attributable to impediments to competition). To that extent, the only difference between the 'old (orthodox) Keynesianism' derived from Hicks's IS-LM interpretation of Keynes, and the so-called 'New' Keynesianism, is that the latter can find some bases for price rigidities in rational optimizing behaviour – 'rational stickiness', we might call it. This is consistent with the orthodox position.

With regard to labour supply, it was entertained above (proposition *b*) in section 1) that labour supply could have a negative elasticity with respect to real wages. Probably this is not worth taking very seriously, certainly at the level of *aggregate* supply behaviour. It arises in modern marginalist choice theory from labour/leisure preferences and the possibility that 'perverse' income effects may

more than offset the substitution effect of a notional (say, hourly) real wage change. Perhaps a more plausible example is workers at or near subsistence wages (notably, in Third World economies) who will wish to increase labour-time worked (and perhaps also overthrow the State) as real wages fall, merely to survive. In any case, for a modern economy both possibilities seem to be little more than ‘theoretical toys’.

## 6 Conclusion

Where does this argument leave the issue of employment policy? The short answer is, in a more difficult position than the orthodox view of the labour market would be prepared to admit. Once we understand and acknowledge that there is a more or less chronic tendency towards an excess of labour supply with respect to existing labour demand, then the capacity of orthodox policies to address mass unemployment becomes greatly limited: if there is no mechanism, via the spurious connection between labour cheapness and labour utilization, for spontaneously bringing labour supply and demand into balance (with a little help in practice from labour-market deregulation policies), then employment levels have actively to be managed. The comforting delusion that actual unemployment tends to equality with supply-side or (quasi-)voluntary unemployment must be dispensed with. And with it would go the comforting politico-ethical self-delusion, or prejudice, particularly popular in the United States, that the unemployed (like the poor in general) are unemployed (or poor) because they *want* to be, or because they *deserve* to be. The ‘surprise’ with which many economists greeted the decline in U.S. observed unemployment at the turn of the just completed century is entirely a result of their false belief that actual unemployment tends to approximate ‘natural’ unemployment. This comforting belief implies that dramatic falls in unemployment will not occur, since the forces regulating supply-side unemployment, by their very nature, are only susceptible to slow and gradual change. That is to say, sudden or dramatic falls in unemployment tell *against* the view that observed unemployment is (quasi-)voluntary. It is almost unnecessary to add that, if actual unemployment is in large measure involuntary, then there is no reason why a substantial improvement in the growth of labour demand should not lead to a sudden and dramatic improvement in the unemployment rate. Similar delusion concerning the relationship between actual and natural unemployment is evident in the proceedings of the Reserve Bank of Australia’s recent conference on unemployment (Debelle and Borland 1998).

The reversion to pre-Keynesian thinking which has occurred in the discipline can also be seen from the vantage point of one particular (though representative), and particularly blunt, recent elementary textbook, by a distinguished member of the profession. One is struck by a kind of epilogue (entitled ‘The Core’) which appears at the end of the text proper (Blanchard 1997, pp. 620–21). It defines what the author conceives of as five basic sets of propositions about which there is apparently no disagreement in macroeconomics. That is to say, all (legitimate?) disagreements are understood to occur *within* the framework of these principles. As Blanchard (1997, p. 621) himself points out, the remaining possible (allowable?) disagreements pertain to two issues: ‘the length of the “short run”’; and ‘the role of policy’.<sup>9</sup> In fact, on the basis of our above argument, one could only at all endorse the first two of these propositions – and the second is in fact little more than an empty formalism. For those familiar with

conventional macroeconomics, these five principles may be described as ‘the usual suspects’. Briefly quoted they are:

- (i) ‘In the short run, shifts in aggregate demand affect output.’
- (ii) ‘Expectations play a major role in determining the behavior of the economy. How people ... respond to ... policy determines ... the economy’s response to the [policy] change.’
- (iii) ‘In the long run, output returns to its natural level ... [which] depends on the natural rate of unemployment .. the size of the labor force ... the capital stock, and ... the state of technology.’
- (iv) ‘Monetary policy affects output in the short and medium run, but not in the long run ...[:] money growth eventually translates one for one into ... inflation.’
- (v) ‘Fiscal policy has ... short- and long-run effects on output ... [but higher] deficits are likely to increase activity in the short run ... [and] decrease capital accumulation and output in the long run.’

In the accompanying summary of this last chapter of the book, this core is further reduced, quite reasonably, to two principles: ‘In the short run, shifts in aggregate demand affect output. In the long run, output returns to its natural level’ (Blanchard 1997, p. 621). The latter three of the five propositions should be rejected; and those three propositions, and the rejection of them, hinge upon the same singular issue: the question of whether there exists some ‘natural’ tendency for a market economy to tend towards a ‘market-clearing’ outcome in which involuntary or demand-deficient unemployment is impossible.

If there were a strong political and social commitment to addressing the *real* problem of mass and involuntary unemployment, then one could expect to see a more *direct* policy approach than merely policies intended somehow or other to ‘massage’ the level of GDP growth up towards rates which would bring employment growth into the neighbourhood of the growth of labour supply. In the limit, government might be expected to employ all effective excess labour supply itself.<sup>10</sup> It could hardly be supposed that there would be insufficient desirable activities for such publicly employed labour to undertake, for a good length of time at least: after ten to fifteen years of conservative economic policies, in Australia as well as elsewhere, public and social infrastructure, and public services, are a long way from being satiated with resources.

In a sense, our Keynesian argument and conclusions above can be seen as a restoration or confirmation of common sense. The idea that falling wages, nominal or real, would necessarily induce an unambiguous rise in the demand for the outputs produced by labour is not intuitive. On the other hand, this idea of the repudiation of marginalism as a restoring of common sense should be handled with care, and might be dangerous. If economic truth were no more than common sense, there would be no function for an economic *science*. And, in truth, the (false) idea that a cheapening of labour would increase its use (or that a fall in the relative price of labour as an input would induce an increase in its utilization) *has* had intuitive appeal, at least among theorists influenced by utilitarianism. But, of course, utilitarianism itself is a doctrine built upon a supposed substance (‘utility’) *which could not be observed even in principle*. This is a vacuous basis for both science and common sense.

---

\* Associate Professor of Economics, School of Economics & Political Science, University of Sydney, NSW 2006, Australia. Email: T.Aspromourgos@econ.usyd.edu.au. I am indebted to R. Leeson and an anonymous referee for comments, without thereby implicating them in the final product.

## Notes

1 The possibility of hidden involuntary unemployment has not been of much theoretical interest to orthodox economics. This is attributable to the fact that if one is working from a framework in which labour demand spontaneously adjusts to the capacity of the economy implied by labour supply, then ‘discouraged’ workers (which is the primary rationale for hidden involuntary unemployment) would appear as nothing more than a temporary or cyclical phenomenon. In a world in which labour demand accommodates itself to labour supply, at least in the long run, there would be no *persistent* reason for ‘discouragement’.

2 To be more precise, Keynes’s *negative proposition*, that labour demand does not tend to equality with labour supply, would be vindicated. But this by itself would not demonstrate his *positive proposition*, concerning a tendency for labour demand to be deficient with respect to labour supply. For Keynes, the latter was a contingent fact, not a logical necessity under capitalism. See especially Chapter Eighteen of *The General Theory*.

3 Something similar to this approach was pursued in Asproumorgos (1987), following Pasinetti (1974).

4 And therefore also, necessarily, acting through flexibility of the general rate of profit upon capital, since, with given technology, real wages cannot fall without the profit rate rising. In a competitive economy, in which profit rates on capital in the production system and yields on financial instruments are arbitrated to some kind of equi-profitable balance, this also necessarily requires flexibility of interest rates in money markets.

5 For example, that a redistribution towards nonwage income – at some initial, given level of aggregate employment – might favour higher aggregate employment, if consumption out of nonwage income sufficiently favours relatively more labour-intensive commodities, than does consumption out of wage income, after taking into account also (likely) differential saving ratios.

6 The only serious exception is the idea of job sharing, which involves sharing the *same* labour hours, but among more *persons*: so the number of *persons* per unit of output rises, though not the number of hours worked. Reductions in the length of the working week are in effect a variant of such job sharing.

7 In this respect the common view that such support systems *cause* observed unemployment, by increasing the relative attractiveness of unemployment versus employment, can be given a different twist: those systems cause (more of) the unemployed to come out ‘into the open’, so to speak. For this reason alone, it would not be surprising if higher levels of observed unemployment were witnessed in countries with more attractive public options for the unemployed.

8 The central Keynes argument is that money wage reductions will only cause real wages to fall, to the extent that money wage falls cause employment to rise first. That is to say, the level of real wages is an *effect* of the level employment, not a cause. Keynes then sought to show, in Chapter Nineteen of *The General Theory* in particular, that falling money wages would *not* induce an expansion in output and employment. On this proposition, orthodox Keynesians (old and ‘New’) part company with Keynes.

9 The general public might think that economists disagree about everything; but they can take relief in the knowledge that in fact all this noise occurs within the safe confines of a unified set of common beliefs.

10 The issues pertaining to this proposal are canvassed in more detail in Aspromourgos (2000).

## References

- Aspromourgos, T. (1987) 'Unemployment, economic theory and labour-market deregulation', *Australian Economic Papers*, 26 (June): 130–44; repr. (abridged) in J.E. King (ed.) (1992) *Readings in Australian Labour Economics*, South Melbourne: Macmillan.
- Aspromourgos, T. (1997) 'Keynes on wage flexibility and the Australian wages system', *Australian Economic Papers*, 36 (June): 114–26.
- Aspromourgos, T. (2000) 'Is an employer-of-last-resort policy sustainable? A review article', *Review of Political Economy*, 12 (2): 141–55.
- Blanchard, O.J. (1997) *Macroeconomics*, New Jersey: Prentice-Hall.
- Debelle, G. and J. Borland (eds) (1998) *Unemployment and the Australian Labour Market*, Sydney and Canberra: Reserve Bank of Australia (Economic Group) and Australian National University (Centre for Economic Policy Research).
- Friedman, M. (1966) 'Comments', in G.P. Shultz and R.Z. Aliber (eds) *Guidelines, Informal Controls and the Market Place: Policy Choices in a Full Employment Economy*, Chicago: Chicago University Press.
- Friedman, M. (1968) 'The role of monetary policy', *American Economic Review*, 58 (1): 1–17.
- Garegnani, P. (1990a) 'Quantity of capital', in J. Eatwell, M. Milgate and P. Newman (eds) *Capital Theory*, New York: Norton.
- Garegnani, P. (1990b) 'Sraffa: classical versus marginalist analysis', in K. Bharadwaj and B. Schefold (eds) *Essays on Piero Sraffa: Critical Perspectives on the Revival of Classical Theory*, London: Unwin Hyman.
- Harcourt, G.C. (1972) *Some Cambridge Controversies in the Theory of Capital*, Cambridge: Cambridge University Press.
- Keynes, J.M. (1936) *The General Theory of Employment, Interest and Money*, London: Macmillan.
- Kurz, H.D. (1985) 'Effective demand in a "classical" model of value and distribution: the multiplier in a Sraffian framework', *Manchester School*, 53 (2): 121–37; repr. in H.D. Kurz (1990) *Capital, Distribution and Effective Demand: Studies in the 'Classical' Approach to Economic Theory*, Cambridge: Polity.
- Kurz, H.D. and N. Salvadori (1995) *Theory of Production: A Long-Period Analysis*, Cambridge, Cambridge University Press.
- Pasinetti, L.L. (1974) 'The economics of effective demand', in Pasinetti, *Growth and Income Distribution*, Cambridge: Cambridge University Press.
- Pasinetti, L.L. (1977) *Lectures on the Theory of Production*, New York: Columbia University Press.