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Abstract

The question this paper poses relates to the role of economic theories in gaining wider support around political agendas. That is their ability to describe a problem in such a way, so that the "answer" would appear not as a political demand in favor of one class, but as a prerequisite for the general well being. The main argument is that in the context of Keynesian economics, labour cost has been set in the periphery of the theory, allowing labour relations to become a subject of social-political regulation. By contrast, neoclassical economic theory and its successors place the cost of labour at the core of the theory, which in turn means that any attempt to regulate labour relations by non-economic criteria undermines the common wellbeing. Neither the first nor the second theoretical setting predetermines or abolishes class and political conflicts. But they both produce general attitudes with political consequences.

Keywords: employment theory, unemployment theory, political agendas

In 1944 Karl Polanyi (2001 [1944]: 159) wrote that "*class interests offer only a limited explanation of long-run movements in society. The fate of classes is more frequently determined by the needs of society than the fate of society is determined by the needs of classes… the chances of classes in a struggle will depend upon their ability to win support from outside their own membership, which again will depend upon their fulfillment of tasks set by interests wider than their own*". The question this paper poses relates precisely to the role of economic theories in gaining this support. That is their ability to describe a problem in such a way, so that the "answer" would appear not as a political demand in favor of one class, but as a prerequisite for the general well being. To be more precise, in this paper we will try to follow the theoretical shifts that have taken place vis-à-vis the notions of *employment* and *unemployment*, trying to show that despite the fact that these shifts may be purely "theoretical", they nevertheless produce certain kinds of attitudes or political propositions on how to deal with the issue at stake (in our case employment and unemployment).

The main argument is that in the context of Keynesian economics, labour cost have been set in the periphery of the theory, allowing labour relations to become a subject of social-political regulation. By contrast, neoclassical economic theory and its successors (monetarism and the neoclassical synthesis) place the cost of labour at the core of the theory, which in turn means that any attempt to regulate labour relations by non-economic criteria undermines the common wellbeing. Neither the first nor the second theoretical setting predetermines or abolishes class and political conflicts. But they both produce general attitudes with political consequences.

Nevertheless, it is impossible to describe, not to mention to analyze in detail, the main economic theories that are mentioned in this paper. In that sense we had to simplify a lot, keeping only the main characteristics of each theory.

Labour Demand, Wages and Unemployment in Neoclassical Theory

> *A classical economist may sympathize with labor in refusing to accept a cut in its money-wage, but he will admit that it may not be wise to make it to meet conditions which are temporary; but scientific integrity forces him to declare that this refusal is, nevertheless, at the bottom of the trouble*
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> John Maynard Keynes (2008 [1936]: 17)

There are a number of reasons which necessitate a short reference to the neoclassical doctrine as regards the labour market.[1] Firstly, the Keynesian revolution, in regard to employment and unemployment, can be better understood in reference to the previous paradigm. The second reason is related to the fact that the vast majority of textbooks

[1] It has to be noted, that the neoclassical theory in employment and unemployment was formalized after WWII. Until then, there are references to the workings of a number of economists, but only Pigou and Hicks made an attempt to formulate a concrete theory (Dedousopoulos 2004: 213, 228). For an excellent review on the neoclassical tradition in Labour Economics see Boyer and Smith 2001.

used to train the future economists are reproducing the neoclassical theory.[2] The third reason stems from the fact that both the monetarist counter-revolution and the neoclassical synthesis that replaced Keynesianism, drew directly on this theory by reaffirming its main assumptions.

The fundamental idea behind the neoclassical theory on labour market is that labour is a product, just like any other. Consequently, the equilibrium in the labour market will be achieved through the supply and demand mechanism. So the question is what determines labour supply and demand.

In regard to the demand for labour, neoclassical theory maintains that it is determined by the marginal product of labour. The main assumption is that the *"law of decreasing returns"*[3] is valid, which means that, *ceteris paribus*, after a certain point each increases by one unit of input (of production) leads to a proportionally smaller increase of the output. The approach of marginal productivity provides us with the labour demand curve for each enterprise (it is the descending part of the curve of marginal productivity of labour), and the sum of the individual demand curves gives us the total labour demand of the economy. Labour demand in the long-run is dependent on the technology of production, on the economies of scale, on the possibility of swapping labour to capital etc. (those factors form the exact shape of the marginal product of labour curve). In the short-run, when the above mentioned factors are stable, labour demand depends only on the wage-level: the volume of employment a company will use is defined at the point where the wage equals the marginal output of labour (diagram 1). Beyond this point, employing one more worker costs more than the added value this worker produces.

As Theocharakis argues, this approach introduces a strong ethical dimension, as it implies that each worker is paid fairly, exactly as much as he/she offers to the actual production (Theocharakis 2005: 79). Yet, another point to be made is that all of the above mentioned factors are objective and not a product of subjective estimates on behalf of each enterprise. We could say that the company is the entity *calculating* but not *determining* the wage it can pay. It is the all-powerful, abstract economic laws that

[2] for example see Samuelson & Nordhaus 1998, Chacholiades 1990, Dornbusch & Fisher 1993
[3] For a detailed historical analysis on the development of the theory of marginal productivity see. Schumpeter (1954).

define the above, while the company only "announces" the rulings of those laws. All rational entrepreneurs must succumb to their effect.

In regard to labour supply, the theory maintains that each person may choose between leisure and work (=income=consumption), while wage is the offset to the discontent caused by working. Even though it is not possible to predetermine the exact variation of labour supply to a change of wage, the main assumption remains that an increase in real wages causes an increase in labour supply and vice versa. It is easy to show that this point of view makes a series of "courageous" assumptions,[4] namely: no one is obliged to work, each person can choose how many hours he/she will work, work *per se* is the opposite of leisure and it doesn't influence directly the quality of life of individuals, not working is synonymous to leisure which by definition is a positive value regardless of its extent, it is a wage cut that leads to the reduction of labour supply and not the opposite etc. Last, but not least, the main assumption of this point of view, is that the only cost faced by someone who wishes to work is the sacrifice of their leisure, which amounts to the alternative uses he/she would make of their time if he/she will have chosen not to work (Dedousopoulos 2002: 60).

One of the most important issues though, is that, unlike labour demand, the labour supply does not portray an economic necessity, even though it is subjected to an economic rationale (as we seem to be assuming that individuals act rationally aiming at maximising their benefit). Neither the position, nor the slope, of the labour supply curve is subject to insuperable economic laws because labour supply is defined only by subjective criteria (Dedousopoulos 2002: 60) like individual decisions, influenced by social circumstances, consumption models and personal traits etc. So, the shift of the curve in any direction can be either easier or harder, depending on the dominant societal or individual beliefs, but under no circumstances is this shift subject to any law except the one regarding work versus leisure. All this suggests that workers can, at any time, modify their preferences according to economic circumstances. This assumption permutes the weight of adjustment on labour, given the fact that entrepreneurs do not possess the same autonomy on determining their demand for labour. The point where the demand curve intercepts the supply curve for labour is the

[4] For detail criticism on the neo-classical theory of labour supply see Altman (2001), Fleetwood (2006), Harrod (1934), Kaufman (2007), Prasch (2000), Sawyer & Spencer (2010), Spencer (2004, 2005), Sweezy (1934)

equilibrium point that determines simultaneously the real-wage rate and the volume of employment in the economy. Schematically, the curve takes the classic Marshallian X shape.

Three conclusions can be drawn from this analysis. Firstly, if supply and demand are to function without interference it is impossible for unemployment to arise. Point A_1 determines simultaneously the wage rate and the volume of employment. At the same time, this is the point when full employment is reached, meaning that anyone who wishes to work at the given wage rate can find a job.[5] As Keynes (1936:11) argues, within this line of thought there can be only two reasons explaining why unemployment is observed: it is either that this unemployment is *frictional*, which means that it is temporary unemployment stemming from a chronic lag of adjustment of the supply to the demand or due to temporary distortions of equilibrium,[6] or it is *voluntary* unemployment due to the refusal of individuals to work at the given wage rate. However, it is not possible to derive anything similar to the notion of *involuntary unemployment* that is the inability to find work regardless of the willingness to work at the given wage rate.

Secondly, persistently high unemployment rates are to be explained only through the existence of wage rate higher than the equilibrium wage. For example, in diagram 3, if for any reason the wage level is set on W_2, labour demand will be L_2, labour supply will be L_3 and this will cause unemployment equal to the distance between L_2 and L_3. In regard to the reasons for which the wage can "stick" at a higher level to that of full employment, the answers of the '30s are not so much different from the ones of the '70s: strong bargaining position of the Unions, state action establishing minimum rates of pay, inability of the collective bargaining mechanism to take full account of differences in productivity, public beliefs of what constitutes a reasonable living wage etc. All that the above can drag the wage level above the equilibrium point, or can block the adjustment of the nominal wage to the level of prices which creates the

[5] According to Pigou (1968 [1933]: 3): "*a man is only unemployed when he is both not employed and also desires to be employed. Moreover, the notion of desiring to be employed must be interpreted in relation to established facts as regards (1) hours of work per day, (2) rates of wage and (3) a man's state of health*". This is a definition which stands until today.

[6] For a number of reason that can create those type of temporal distortions see Hicks (1966[1932]: 42-57)

same outcome (Pigou 1968 [1933]:253-255, also Hicks 1966 [1932], Friedman 1976, Layard et. al. 1991).

Thirdly, if employment is to be increased, a wage cut must take place. Such an action would have a triple effect. Firstly, unemployment will fall because a part of the labour force is going to exit the labour market due to the fact that for some people it "isn't worth working" for a lower wage. Secondly, employment will rise because companies will hire workers due to the fall of labour costs.[7] Finally, this process will be further accelerated through the "Pigou effect". Schematically, a decrease in wages will be followed by a fall of prices. This will signify an increase in demand on behalf of the non-wage earners whose earnings were not affected from the wage cut (actually their real-earnings will increase through the fall of the prises). The increased demand will create more employment.[8] The general conclusion is that a decrease in the level of wages, *ceteris paribus*, will lead to an increase in employment and a decrease in unemployment irrespective of its nature (Rossier 2002: 608).

To sum up, according to the neo-classical theory, the real wage rate is determined through the demand and supply mechanism. The firm has an optimal level of production for every wage rate where profit maximizes. After the wage has been set, the firm determines the volume of employment. In case the volume of employment has to rise, the only available means is through a wage cut. In theory, the wage rate and the volume of employment are determined simultaneously. But given the fact that bargaining is about the wages and not about the volume of employment, the wages remain a priority. According to the above, the arrow of causality goes from the wages to the volume of employment and from there to the final product-output. It looks like that: Level of wages → volume of employment → final output.

[7] The fact that the elasticity of employment to the wage is higher than 1 (Pigou calculated it to be between1.5 and 1.7) a wage cut will lead to a proportionally higher increase in employment (Pigou 1968[1933]:106)

[8] For more on the Pigou effect see. Takami 2010, Rubin 2005

Keynes and his General Theory

"It takes a theory to kill a theory"

Paul Samuelson (1951: 323)

The differences between the Keynesian approach and the neo-classical one is not limited to the treatment of the objects of analysis, or, to the relations each school establishes between those objects. In the Keynesian framework, questions like "what does efficiency mean for the economy" or "which is the fundamental unit-of-account in economics" are answered quite differently.[9] Regarding the issues being discussed here, Keynesian analysis marks a significant shift as regards three aspects.

Firstly, in the foundation of the theory lies the assumption that the success of an economic system depends almost solely on whether it accomplishes full-employment or not. In this sense, unemployment is not just seen as a negative byproduct, but as the main proof of the systems' malfunction. In the final analysis, Keynesian theory is a theory about how to achieve full employment.

Secondly, in the Keynesian universe, employment is not only the final goal of economic policy; it's also the diachronic unit-of-account of the economic system itself. Quantities of money-value and quantities of employment are the only units-of-account to be found in the *General Theory* (Keynes 2008 [1936]: 31)

Thirdly, Keynes showed that the economic system can find itself in equilibrium without achieving full employment. To be precise, he argued that there are endogenous forces within the system, which lead it to such situations. To prevent this, state interventions are demanded. In this sense, Keynes went a step further from just arguing on the necessity to regulate the economy, to proving the need of intervening in its workings.

What determines the total volume of employment in the economy? In contrast to neoclassical theory, where the wage level defines the volume of employment, Keynes argued that the decisions of the companies are governed by their *expectations* about

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[9] For more on the economic philosophy of Keynesianism see Milonakis & Fine (2009: 275-279) and Robinson (1964: 71-74)

the level of demand for their product.[10] In simple words, every entrepreneur is forming expectations about the future level of his/hers sales, and then employ as much labour as he/she needs to produce this product. The introduction of the time aspect in theory (expectations) and the radical uncertainty it created was a revolutionary act capable of separating his theoretical system from the neoclassical one (Psalidopoulos 2001: x, Milonakis & Fine 2009: 272).

In general, following Keynes (2008 [1936]: 25-26) his theory could be briefly described in the following terms:

1. In a given situation of technique, resources and costs, income (both money-income and real income) depends on the volume of employment.

2. The relationship between the community's income and what it can be expected to spend on consumption will depend in its *propensity to consume*. That is to say, consumption will depend on the level of aggregate income and, therefore, on the level of employment, except when there is some change in the propensity to consume.

3. The amount of labor, which entrepreneurs will decide to employ, depends on the sum of two quantities, namely the amount which the community is expected to spend on consumption, and, the amount which is expected to devote to new investment. This sum is called *effective demand.*

4. Hence, the volume of employment in equilibrium depends on (i) the aggregate supply function, (ii) the propensity to consume, and (iii) the volume of investment.

…

[10] He writes: "it follows that in a given situation of technique, recourses and factor cost per unit of employment, the amount of employment, both in each individual firm and industry and in the aggregate, depends on the amount of the proceeds which the entrepreneurs expect to receive from the corresponding output. For entrepreneurs will endeavor to fix the amount of employment at the level which they expect to maximize the excess of the proceeds over the factor cost" (Keynes 2008 [1936]: 22-23).

Those expectations are of two kinds. There are the short-term expectations concerning mainly the price of the product. These expectations define the volume of employment. Namely, the firm will employ as much labor, until the marginal product of labor will equalize not the expected price of the product it produces. Secondly, there are the long-term expectations concerning mainly the future profits of an investment. Reaching full employment is mainly linked with these kinds of expectations. In general, changes in expectations are neither violent nor sudden, but based mainly on recent experience.

8. So, when employment increases, consumption will increase because real income has increased. But the increase of consumption will not be as much as the increase of real income (due to saving). Here lies the heart of (but also the key to) the problem. There should be a quantity to fill the gap between the increase of income and consumption. This can be done only by investment spending. If the volume of investment is not sufficient in order to fill the gap, the economic system may find itself in stable equilibrium with a level of employment below full employment. An insufficiency of effective demand may bring employment to a standstill before the level of full employment has been reached. In this case we will have *involuntary unemployment*, meaning people who want to work in the given wage level cannot find a job

Following the above, the key to the problem lies in investment which, in brief, is dependent on the interest rate and the rate of capital return. From the inquiry on the factors affecting interest rate and capital return rate derives the Keynesian theory on interest and money.

So, in Keynes' analysis, product, labor and financial markets are interdependent systems and the equilibrium in the labor market cannot be defined solely with reference to its internal relations (Dedousopoulos 2000: 284). Keynes accepts that the real wages are defined by the marginal productivity of labour, but he argues that real wages do not equal money ones (except when full employment has been reached).[11] This permits him to not only to develop his own theory, but also to subordinate the neo-classical theory as a mere "special condition" of his own.

The consequences are grave. Firstly, within Keynes' analysis, the arrow of causality has changed direction, to the one the neoclassical school follows. In his theory, aggregate demand defines production, production defines employment, and that volume of employment corresponds to a certain wage rate. In the Keynesian universe,

[11] Actually, the acceptance by Keynes that real wage equals the marginal disutility of labour, has been criticized by his student Joan Robinson who argued that "is a piece of Marshallian luggage that Keynes thoughtlessly carried with him (Robinson 1964: 87). Screpanti & Zamagni (2004b: 101) also note that the Keynes acceptance that real wage equals the marginal productivity of labour is due to his "incomplete" departure from the restrains of the orthodox theory. Nevertheless, as Dedousopoulos notes (2004: 209), Keynes was relieved when Hughes and Perlman informed him that their empirical research does not support this belief.

causality goes as follows: Aggregate demand → product → volume of employment & level of wage.

Secondly, by demolishing the equation of real wages with the money ones, the neoclassical argument suggests that full employment can be reached through changes on the relative prices of the factors of production lose its value (Screpanti και Zamagni 2004b: 101). A cut on the money wage cannot result in full employment. Actually, the results of such a cut cannot be predicted. A reduction of money-wages will create employment only in one of two cases (Keynes 1936: 165-166): (a) if the reduction is relative to money-wages abroad, so exports will rise if the advantages are not going to be offset by a change in tariffs, quotas etc., or (b) if the reduction is to be so severe, that further changes are expected to be only in the upward direction.[12] But in this case, the political instability this might create could offset any possible advantages. On the other hand, curbing money-wages might have negative effects on the volume of employment. As Keynes argues (1936: 165), a reduction of money-wages will reduce prices somewhat. It will therefore involve some redistribution of real income from wage-earners to other factors entering the marginal prime cost whose remuneration had not been reduced, and from entrepreneurs to rentiers to whom a certain income fixed in terms of money has been guaranteed. In the community as a whole, this wage-cut will decrease the propensity to consume since this propensity is lower to the richest members of society. So unemployment will rise. In one respect, the more equitable the distribution of income is, the smaller the intervention will need to be due to the fact that lower income groups are characterised by a higher propensity to consume. In this framework, the expansion of the welfare state satisfies not only social, but also economic goals.

Thirdly, state intervention not only does not create distortions, but on the contrary it is demanded. Capitalism is not characterised by an inherent tendency towards stability and intervention is needed in order for the main goal of economic policy (full employment) to be achieved. The latter also means that unemployment is not seen as just one more evil but as the main symptom of economic malfunction.

[12] If the expectation is for further reduction, this will harm the investment thus produce more unemployment

Finally, the unemployed are not unemployed by choice and unemployment has only marginal relation with wages. Full employment and the rate of unemployment are not dependent on the labor market relations, but they are heavily dependent on the interdependence of all the basic characteristics of the economy. A wage cut during recession will not solve the unemployment problem; in fact, such a policy will probably further exacerbate the problem.

Milton Friedman and the "natural rate of unemployment"

Only surprises matter

Milton Friedman (1976: 271)

Three years after the General Theory was published, efforts began to integrate Keynes into the neoclassical corpus and make his theory compatible to the neoclassical paradigm. The result was the so-called "neoclassical synthesis" (or "neo-Keynesianism"), which became the core of orthodox analysis after the Second World War (Screpanti, Zamagni 2004: 196), dominating economic policy up until the mid-70's and the monetarist counter-revolution.[13]

An important part of the above mentioned synthesis was the Phillips curve, which meant to provide the battleground among neo-Keynesians and monetarists during the mid '70s (Dedousopoulos 2004: 300). The Phillips curve is based on an empirical observation made by Phillips (1958), that there is a negative correlation between the rate of unemployment and the rate of inflation. This observation allowed the government to tolerate a certain level of inflation in order to achieve lower rates of unemployment, or even to evoke inflation in order to reduce unemployment. The problems began during the late '60s when economists started to observe rising rates both of unemployment and inflation (stagflation).

[13] It should be noted, that this particular reading of Keynes was not the only one. For example Joan Robinson, Piedro Sraffa και Michael Kaletcki, argued that the "neoclassical synthesis" stripped Keynes' theory from its most innovative elements transforming into a mere sub-case of the neoclassical theory. Robinson, Sraffa, Kaletcki and others became the founders of another tradition, (post-Keynesianism) which is characterized by far more radical suggestions. For more on the history of Post Keynesian Economics see King 2002 and Harcourt 2006

By that time, Friedman and Phelps were arguing that fiscal policy does not influence the level of employment due to the fact that in the long-run the Phillips curve is vertical (Friedman 1968, Phelps 1968).[14] Starting from the neoclassical assumption that only real wages matter Friedman claimed that an inflationary pressure would have positive results on employment only if the increase in demand (inflation) were to be unexpected. However, even in this case the positive outcomes would be temporary.

The mechanism works something like this: Let us assume that there is an inflation-demand boost caused by the government. The entrepreneurs will be willing to raise nominal wages in order to employ more workers, but this increase will be lower than the increase in prices. That is to say nominal wages will go up, but real ones will fall. So in the short-run, employment will increase because inflation diminishes real wages (which is the typical neoclassical mechanism). During this first stage, workers fail to realize the fall of their real wage due to their incomplete knowledge on the general level of prices. By contrast, they will conceive the nominal increase in wages as a real one.

However, this situation is only temporary. As time goes by and prices keep rising, workers will adjust their wage claims to the real level of inflation. So after some time, real wages, employment and unemployment will return to the previous levels, and the only change in the newfound balance will be that inflation will be higher (Friedman 1976: 271-272). The bottom line is that, if the relationship implied by the Phillips curve is valid only in the short run, the dilemma is not between higher inflation and lower unemployment, but between a fixed rate of unemployment (the "natural" one) and lower or higher inflation (Dedousopoulos 2000: 377-378).

The rate at which unemployment will be once again stabilized is the "natural rate of unemployment". According to Friedman (1968: 10) the natural rate of unemployment is by one part frictional unemployment, and by another unemployment arising from institutions-practices that inhibit the flexibility of real wages. Friedman claimed (1976: 273) that developments like the inclusion of women and young people in the labour market in conjunction with the higher mobility of these groups, has increased

[14] Forder (2010: 508) has argued that the main points of Friedman's and Phelps criticism on the Philips Curve had been known long before either of them put them forward in their infamous articles. The main reason why it dominated was not theoretical at all but was connected to the general historical circumstances: the abandonment of the Keynesian policies was not based solely on theoretical reasons.

the time of job-seeking and thus frictional unemployment has also increased; at the same time, the welfare state's expansion has permitted the unemployed to extend the time they expend to search for a job, thus causing a further increase of frictional unemployment. Other institutions, like collective agreements on minimum wages, union power etc. also hamper wage flexibility. Following the above, the natural rate of unemployment is related to the structural characteristics of the labour market and can change over time in relation to the changes of those characteristics.[15]

Moreover, in contrast to Keynes, Friedman did not consider a high rate of unemployment as an indicative measure of economic malfunction or that full employment should not be the aim of economic policy. As he characteristically writes: "*there is a tendency to take it for granted that a high level of recorded unemployment is evidence of inefficient use of resources and conversely. This view is seriously in error. A low level of unemployment may be a sign of a forced-draft economy that is using its resources inefficiently and is inducing workers to sacrifice leisure for goods that they value less highly than the leisure under the mistaken belief that their real wages will be higher than they prove to be. Or a low natural rate of unemployment may reflect institutional arrangements that inhibit change. A highly static rigid economy may have a fixed place for everyone whereas a dynamic, highly progressive economy, which offers ever-changing opportunities and fosters flexibility, may have a high natural rate of unemployment*" (Friedman 1976: 273).

At any rate, Friedman's influence in Europe (considering employment policy), has been limited and selective. Monetarist analysis dominated the area of monetary policy, but the policies of enhancing labour market flexibility had been relatively limited until the mid-90's. During the 80's and early 90's the main focus was on the containment of wages and not so much on enhancing labour market flexibility. This made the European Commission conclude that until the mid '90s, there was no such thing as a common version of labour market deregulation (European Commission 1993: 314). Essential components of the neoliberal agenda, like the promotion of flexibility of the labour market and privatizations, acquired a strong standing after the mid 90s. The "paradox" here is that at the same time, most European countries had

[15] There is a footnote to this. Friedman maintained that a boost in demand would have no long-term effect on employment. However when he was asked to define how much time is needed in order for the long-term equilibrium to occur, he gave a number between 10 and 20 years (Friedman 1968: 11).

social-democratic parties in government. In order for the new phase of neoliberal expansion to take place, a combination of political, economic and theoretical developments were to happen: the political and economic development was the creation of EMU, the theoretical one was the birth of the NAIRU models.

The NAIRU: Keynesian in the short term and neoclassical in the long term[16]

Worldly wisdom teaches that it is better for reputation to fail conventionally than to succeed unconventionally

John Maynard Keynes (2008 [1936]: 102)

The main problem with the monetarist approach on labour market was that it actually revived the neoclassical analysis without solving any of its main issues or contradictions. Moreover, arguing that unemployment of 8%-10% was "natural" or frictional sounded unconvincing. The answer came from the NAIRU (Non Accelerating Inflation Rate of Unemployment) approaches that emerged in the beginning of the 90's. The main differences of this approach in relation to Friedman's natural rate of unemployment are twofold: on the one hand, the NAIRU does not assume full competition; on the other hand, it allows for a notion of involuntary unemployment (Stockhammer 2008: 484).[17] In this respect, the NAIRU approach is definitely more elegant than the neoclassical one (Stockhammer 2004: 14). Eventually the NAIRU dominated as a tool of interpreting unemployment as well as an employment policy "counselor".

Any discussion about NAIRU should take into consideration two facts. Firstly, NAIRU does not measure actual/observed unemployment and so it can never be observed by itself (Sawyer 1997: 2). What NAIRU does, is pointing to a rate of unemployment that will not accelerate inflation. The real/observed rate of unemployment may be higher or lower from NAIRU estimations. Secondly, NAIRU is the result of a system of mathematic equations with numerous variables whose exact number depends upon the specific model one uses. Consequently, the more variables introduced the more relative the importance of each one becomes. This also

[16] Stockhammer 2008: 450
[17] See also Layard, Nickell και Jackman 1991: 20-21

means that there are numerous NAIRU models depending on the variables used and the relation established among these variables.[18]

Despite the high mathematical expression of the theory, the governing principle is simple: wages are formed through a bargaining process between workers and firms. The core element that determines the claims of capital and labour is the expected level of inflation. Like in any bargaining process, the equilibrium point is the one where the claims of workers match those of capital. In most cases, the wage finally formed is higher than the equilibrium one, thus producing unemployment. This unemployment is to an extent "structural" in the sense that there are structural characteristics of the labour market that affect the bargaining power of each actor (labor and capital). The inflation expectation is central. Each factor that raises inflation expectations also raises the point of equilibrium. Accordingly, each factor that increases the flexibility of wages or prices (in effect lowering inflationary expectations) reduces the point of equilibrium. If labour and capital inflation expectations converge, then inflation remains stable.

According to many NAIRU analyses, the equilibrium that is reached does not necessarily clear the market (full employment). On the contrary, the economy will always be characterized by a rate of unemployment, which is in effect neoclassical (caused by the existence of a real wage higher than the equilibrium one). This rate will always be there, even in the case where companies could set the wage level by their own (it has been argued that companies are willing to pay higher wages – efficiency wage– in order to maintain peace in the workplace and enhance the productivity of their workforce).

In regard with the nature of unemployment, Layard, Nickell και Jackman (1991: 41-44) maintain that it can be simultaneously voluntary and involuntary. The basic idea is that labor market is characterized by a duality: there is the primary market where wages and terms of employment are better and there is a secondary market where wages and terms of employment are worse. Even in the case of high unemployment, one could look for work in the secondary market but most of the times one does not.

[18] Following a comment by Karamesini (2005: 95-98) the mathematical form of NAIRU is used to give a technocratic-objectivity tone to the discussion on unemployment. On the other hand, its obscurity and the various results of the different versions has worked for its benefit instead of against it.

In effect, people are voluntarily and involuntarily unemployed at the same time: they are willing to work with the existing wage in the primary market but they cannot, and at the same time refuse to work in the secondary market where jobs are available.

Another element of the theory is that the unemployed have a key role in the formation of NAIRU. The intensity of their job-search influences the wage claims of the already employed; if the unemployed are sufficiently "active" the wage claims of the unions will be lower and the level of unemployment lower. So, one way of lowering the NAIRU is to address the reasons that make an unemployed person "passive": unemployment benefits should be limited in level and duration, active policies of convergence of demand and supply of labour should be enhanced, long-term unemployment should be combated, the industrial relations should become more flexible, etc (Layard, Nickell και Jackman 1991: 61-74). The bottom line is that the vast majority of NAIRU models are characterized by a conservative reservation regarding the role of unions due to the fundamental neoclassical view that trade-unions manage somehow to set the real-wage to a higher level than that of the equilibrium one.

In any case, today there is an open debate about the nature of NAIRU. Some economists argue that this thing simply does not exist (Davidson 1998, Karanassou & Snower 1997), while others argue that it is not real unemployment that fluctuates around NAIRU but the other way around (Stockhammer 2008). If this is true, then wage flexibility does not stabilize the system but destabilizes it further and eventually NAIRU becomes a political phenomenon and not an economic one (Stockhammer 2008: 494-501).

Regarding actual employment policies, NAIRU dominated both on the level of political analysis and that of policy suggestions. The most typical example of its dominance is to be found in the European Employment Strategy (EES) that was introduced in 1997 and since 2000 was incorporated in the Lisbon Strategy (LS). The impressive element here is the comprehensive and integrated way that both the EES and the employment dimension of the LS have incorporated policy directives stemming from the NAIRU analysis: strengthening professional and geographical mobility of the labour force, focusing on "active" policies versus "passive" ones, activate the social protection system in order to encourage job-search, encouragement of professional training and education, etc.

<u>Discussion</u>

The moral problem is a conflict that can never be settled. Social life will always present mankind with a choice of evils. No metaphysical solution that can ever be formulated will seem satisfactory for long. The economists were no less delusory than those of the theologians that they displaced

Joan Robinson (1964: 137)

For the larger part of the industrialized world, the years between 1971 and 1983 have been marked as a period of great economic and societal transformations. For the economists, the crisis of 1973 was a turning point. Even though it did not cause the transformation as such, it can be seen as the fuse that sparked the acceleration of processes that had already begun since the '60s. Jessop (2002) formulates graphically what this economic transition meant for the social organization and the general economic setting of advanced capitalist economies, when he refers to the move from the Keynesian Welfare National State to the Schumpeterian Competition State. In the new framework, new polarities have arisen to replace old ones: *stability* was transformed into *rigidness* in order to be countered by *flexibility*; *equality* was to become *homogenization* in order to be countered by *diversity*, economic justice was seen as the opposite of effectiveness (Wagner 2000: 41). The causes of this paradigm shift are not solely or even mainly theoretical. As Hobsbawm (1994: 409) puts it: "*the battle between Keynesians and neo-liberals was neither a purely technical confrontation between professional economists, nor a search for ways of dealing with novel and troubling economic problems. It was a war of incompatible ideologies. Both sides put forward economic arguments… Yet economics in both cases rationalized an ideological commitment, an a priori view of human society*".

The main concept that runs through this presentation is that the development of economic theory had a strong impact on politics, not only through the "immediate" policy conclusions it seemed to suggest, but mainly through the *political* *tendencies/correlations* that these theories established. According to this line of thought, we can look at economic theories as "regulated ways of practicing the possibilities of a discourse" (Foucault 1987 [1969]: 109). Paraphrasing Foucault, it is possible to argue that the emergence and adoption of different theoretical paradigms on the issue of employment cannot be separated from the "preferences and illusions" (Foucault 1987 [1969]: 110) of a social class, but, that these theories cannot be viewed as mere ideological mechanisms working towards the establishment of that class: ideology does not rule out science (Foucault 1987 [1969]: 208).

In the theoretical field, the shift of the dominant paradigm has sparked concomitant shifts of meaning from the core of the theory to its periphery and vice versa (at this point, the approach follows Lakatos (1978) theory on scientific programs). Here, the main question concerns the exact place of labour costs within the theoretical architecture of each theory.

The Keynesian revolution was to place the cost of labour at the periphery of the theory. In the Keynesian universe, the wage level is the *result* of causal relationships within the economy, not their starting point. The emphasis is to be given to the demand function; the rate of unemployment becomes a measure to evaluate an economic system; full employment becomes an end in economic policy and it is achieved through macroeconomic policies and not through the labour market itself. In such a framework there is no theoretical necessity that predetermines the employment contract and so the adjustment of the employment relationship becomes an issue of social regulation heavily influenced by social criteria and society's notion of justice. In a society where the vast majority is wage-earners, this necessitates corporatism, strong unions and extensive legal protection of employment. Based on Keynesian analysis one could argue that social justice and economic development are two sides of the same coin, or even better, that social justice is a prerequisite of economic development (Ioakeimoglou1998: 124-125, Glyn 1995: 110).[19] Keynesian theoretical

[19] The above, of course, does not rule out the class character of capitalism. Kaletcki was arguing since 1943, that "discipline in the factories and political stability are more appreciated than profits by business leaders" (Kaletcki 1943: 3). Some years after, Joan Robinson (1969: xi) noted "once the duty to maintain full employment is accepted, the whole moral and political basis of the argument changes. If we are to be guaranteed full employment in any case, the question to be discussed is what the employment should be for… These deep, divisive questions are smoothed over by making employment an end in itself. Since Keynes (meaning Keynesian economics) became orthodox, full employment had become a conservative slogan".

architecture permitted –to some extent– working class interests to be seen as the interests of society as a whole and of the economic system as such; and it also legalized state intervention in the economic sphere as having an immediate consequence on the "entrance" of policy into economy.

On the other hand, the monetarist counter-revolution reestablished the cost of labour in the core of the theory by putting the emphasis is on the supply side. In this framework, the flexibility of wages and labour markets arises as an "objective" economic necessity, not just as a political demand of the capital, but as a theoretical precondition for prosperity. Monetarist arguments supported the exact opposite views: "national interest" was seen as synonymous to low wages and the dismantling of the welfare state, and state intervention was reduced to the level of regulation. In the final analysis, economic policy remains a *policy*, meaning that it remains subject to struggles, pressures, conflicts and compromises. That is to say, just like there was never such a thing as "pure Keynesianism" (in terms of economic policy), there was never such a thing as "pure neoliberalism". The real relation of the two has been one of hierarchy (Gravaris 2003: 344).

So even though the aforementioned shifts on the notion of employment are strictly theoretical, they have had major consequences, due to the fact that they defined the way in which the problem of unemployment is to be described, which, conjecturally led to the predetermination of its solution (Breslau 1997: 872). These developments, even though they did not provide "clean-cut" solutions (due to the policy factor), they nevertheless created an intellectual and political tendency towards ways of dealing with unemployment. That is to say, that even though labour market deregulation did not come about immediately as a consequence of theoretical shifts, developments in theory had a definitive role to play. These "regulated means of mobilizing logos" (Foucault 1987[1969]: 109), regardless of the fact that they remain to some extent open, are in fact circumscribed; they live and are nurtured in a confined political and ideological space. The possibilities for different approaches or readings remain significant but the space seems to be clearly carved out: "they didn't say everything they could, but they could not say anything".

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