

COMPETITIVE CONSUMPTION AND THE ‘FAIR WAGE’ A POSTKEYNESIAN INSTITUTIONALIST APPROACH

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It is a commonly accepted idea, within the Post Keynesian and *circuitiste* theoretical frameworks, that the unitary money wage is a given, and that the level of the real wage depends on firms’ production decisions (see Graziani, 2003). This argument has recently been enriched in the conviction that wage bargaining is also affected by institutional and ethical factors, thus giving rise to a socially accepted ‘fair wage’ (see Setterfield, 2007), where the ‘fair wage’ is assumed as a given. The aim of this paper is to explore the theoretical links existing between firms’ wage policies and the prevailing ethical codes, and it argues that the ‘fair wage’ is the wage *perceived* as ‘fair’ within given social groups, basically dependent on workers’ comparison with their *relative* levels of consumption, as well as with Veblenian “leisure class” consumption.

JEL: JOO; B29

1 - Introduction

The inverse relation between financial rents and the labour share is demonstrated by a mass of evidence. Palley (2007), in particular, shows that the “rentier share” rose dramatically in the period between the 1970s and the 1990s, and that it generated increasing income inequality and a decline in the rate of growth. OECD reports that the “rentier income share” in the USA rose from about 15% in the 1960s to about 35% in the 1990s, and that it continued to rise from 1995 to 2000 reaching about 45%. As regards real wages and employment, the IMF reports that, in the case of the USA, there was a fall of about 10% from the ‘70s to the ‘90s, 6% of which corresponds to the fall from the ‘80s to the ‘90s. Hein and Truger (in Hein and Truger, eds. 2007, p.225) find that “Moderate wage increases were accompanied by a decline in the labour income share, both in the Euro area and in the USA” and that, in particular, the labour share income in the Euro area passed from about 62% in 1992 to about 57% in 2005, while – in the USA – it started from over 63% to reach 62% in 2005.

Starting from this evidence, this paper aims at finding some basic theoretical nexus between financial rents and real wages. In so doing, a theoretical model will be presented, which moves within the monetary theory of production approach (MTP) and in which some elements of the Institutional theoretical framework will be taken into consideration.

The starting point of the argument proposed here lies on the following observation: it is a commonly accepted idea, within the Post Keynesian theoretical framework, particularly in the variant of the monetary theory of production (or *circuit approach*) (see Fontana, 2003; Fontana and Palacio-Vera, 2007; Fontana and Realfonzo, 2005), that the unitary money wage is a given, and that the level of the real wage depends on firms’ production decisions (see Graziani, 2003). This argument has recently been enriched in the conviction that wage bargaining is also affected by institutional and ethical factors, thus giving rise to a socially accepted ‘fair wage’ (see Setterfield, 2007), where the ‘fair wage’ is assumed as a given.

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The aim of this paper is to explore the theoretical links existing between firms' wage policies and the prevailing ethical codes, by arguing that the 'fair wage' is the wage *perceived* as 'fair' within given social groups, basically dependent on *i*) workers' comparison with their *relative* levels of consumption, *ii*) the comparison between the level of the real wage and the level of rents enjoyed by the "leisure class". Emulation therefore plays a crucial role in wage bargaining, on the basis of comparison *within* social groups and *between* social groups. As will be shown, the first case is explicitly considered by Keynes, while the second one can be found in Veblen's works.

The arguments proposed here fall within the Post Keynesian-Institutional approach, based on the idea that *i*) money is endogenous and demand-driven; *ii*) the Veblenian "leisure class" manages the money market, thus bargaining for the interest rate with industrial firms for the purpose of conspicuous and competitive consumption; *iii*) real wages depend on workers' bargaining power, and their capacity to promote social conflict, as well as on firms' price policies and on the interest rate (see Forges Davanzati and Realfonzo, 2008). The idea that the money supply is endogenous and demand-driven is based on the Keynesian "finance motive" argument (see Keynes 1930, 1937a, 1937b). According to this approach the monetary rate of interest is exogenous and the money supply is generated by the banking system in order to satisfy firms' money demand to finance their production activity¹. At the beginning of every cycle of production, in fact, firms demand a certain amount of money in order to buy materials and to cover the advance payment of wages to their employees. So in order to satisfy these requirements and to finance production, banks create new money through two entries in their balance-sheets: the credit granted to firms on the credit side, and the amount of deposits created in favour of firms on the debit side (see Rossi, 2001). But while it is true that the money supply is demand-driven in the sense just explained, we can also say that the money market is ultimately managed by entrepreneurs and bankers, who in the Veblenian-Institutionalist framework merge into a single class, i.e. the Veblenian "leisure class". The dynamics within the Veblenian "leisure class" are complex, and can be schematically described as follows. On the microeconomic plane, the Veblenian firm is a locus of conflict, involving technicians, whose "instinct of workmanship" leads them to promote and develop production processes (thus expanding the production), and "businessmen", who aim at obtaining profits (via high prices). On the macroeconomic plane, by managing the banking system, the "leisure class" can affect the interest rate for the purpose of conspicuous and competitive consumption. As a result, insofar as high interest rates produce high price levels, the unitary real wage decreases as the interest rate increases: "leisure class" interests are diametrically opposed to the interests of the working class.

The exposition is organized as follows. Section 2 deals with some basic issues relating to the ethical dimension of the functioning of the labour market, with reference to the neoclassical view; in section 3 a simple theoretical model exploring the links between wage bargaining and the 'fair wage' is provided and section 4 concludes.

2 – Ethics and the labour market: The 'mainstream' view

¹ The contemporary theory of the endogenous money supply follows two different approaches: the 'structuralist' and the 'horizontalist' (or 'accommodationist') one (see Pollin 1991). The first framework considers money above all as a value reserve, so that its supply depends on the liquidity preference of macroeconomic agents and on the behaviour of the central bank, whose decisions are conditioned by political constraints, in order to defend the economic system from financial crisis [see, among others, Chick (1977, 1984), Minsky (1982), Rousseas (1986), Arestis (1997), Dow (1996, 1997), Howells (1995), Palley (1996) Sawyer (1996), Wray (1990)]. On the other hand, the horizontalist approach considers money above all as a means of payment, so that the banking system could theoretically satisfy every demand for money made by firms. See, among others, Kaldor (1970), Weintraub (1978), Moore (1988), Rogers (1989), Smithin (1994). Fontana (2007) has recently analysed the developments in monetary thought, with particular reference to the so-called New Consensus view, and the acceptance – on the part of some mainstream economists – of the endogenous money approach.

The idea that labour is not a good like other goods has recently become a commonly held view, also in the neoclassical theoretical framework (see Solow, 1990). Within the mainstream view, two distinct approaches can be found.

a) *Fair wage and unemployment*. According to the basic model of perfect competition in the labour market, with a negative sloped demand curve and a positive sloped labour supply curve, any increase in the average real wage reduces the level of employment. Wage increases, in turn, may depend on external intervention (namely, by unions and/or the State) whose purpose is to improve workers' standard of living and – apart from other factors – this purpose ultimately rests on ethical considerations, i.e. to guarantee a *decent* income to the 'poor'. Insofar as the decent income – in this theoretical context - is a category which is outside the purely economic realm, economic policies inspired by 'ethical' principles generate a worse allocation of resources, i.e. unemployment in this case. The traditional trade-off between equity and efficiency is thus confirmed.

The main criticism to this view comes from the classical approach, where the idea that wages can be completely flexible is seen as largely unrealistic (see Stirati, 1992), in view of the fact that workers are always paid a wage that reflects a 'subsistence' level, however that is defined.

Moreover, it is emphasised that the neoclassical conclusion rests on the questionable assumption of a labour demand schedule deriving from the marginal productivity theory (see, among others, Zenezini, 1990). One can also note, following Graziani (2003), that the equality between labour marginal productivity and the real wage, which determines the optimum level of employment in the neoclassical approach, implicitly reflects an ethical view, where the *individual* contribution to production (i.e. his/her marginal productivity) is a sign of *merit* and hence it is also a question of *justice* to pay workers according to their merit².

b) *The 'gift exchange' hypothesis*. Akerlof and Yellen (1990) suggest that wage increases determine increases in workers' effort, because workers tend to 'reciprocity'. The initial wage level, the increase of which supposedly determines an increase in workers' effort and thus labour productivity, is the 'market clearing' wage, which, in turn, as in the case below, is not (necessarily) the same as a 'fair wage'. In this model, a 'fair' wage level is considered to be one higher than the market clearing wage, and one that will maximise profits, as well as worker's utility. Compared to the standard neoclassical view, here there is the idea that wage bargaining also reflects ethical variables, at least in the sense that the wage-effort exchange is conceived as a 'gift'.

In both variants of the mainstream approach, the fair wage is linked to individual merits and, more importantly, social conflict cannot be justified on either moral or economic grounds. This is because, under the assumption of a downward labour demand schedule, insofar as it generates an increase in the average real wage, social conflict produces unemployment, thus having a negative effect on the well-being of the working class as a whole. Moreover, since - on methodological grounds - the rational choice paradigm (as well as methodological individualism) holds, *the fair wage is settled independently of historical, institutional and social conditions*. The basic distinction between this view and those of Post Keynesians and Institutionalists basically lies in this latter point. Methodological individualism, in fact, according to both its operationalist version (Samuelson, 1947) and its structuralist version (Friedman, 1953), operates with a consequential approach, the main effect of which is to lead to a theoretical known, based on a core of axioms and on a set of hypotheses consistent with the axioms. This leads to the construction of models that, in a logical time-frame, are closed both inwardly and outwardly (Lawson 1985, 1988, 1997). In this way, the only achievable results possible are those which derive consequentially from the initial set of axioms and hypotheses, cutting out all the other possible results that might emerge if institutional elements were also considered and if a historical time-frame were adopted (Dow, 1993). In terms of the labour market, this means that, under the rational axiom about worker and entrepreneur behav-

² On this issue, Costabile (2007) remarks that the marginal distributive rule does not necessarily ensure a "reasonable amount of substantial freedom", insofar as "a poorly endowed agent would not be safe from poverty and deprivation in a pure competitive world, if her initial endowments were very limited".

our³, and with a set of hypotheses on workers' utility function, worker productivity, entrepreneurs' production and cost functions (just to consider a few), the "fair wage", both according to the standard neoclassical framework and to its developments like that of Akerlof and Yellen, depends exclusively on workers' merit, so that no social conflict can be justified, either on moral or on economic grounds. However, by opening the model internally and outwardly, and introducing institutional and historical elements in the analysis, it will be possible to achieve results otherwise not accessible⁴. Again with respect to the labour market, in fact, if we consider that agents' behaviour is also driven by other forces, such as their *animal spirit*, in the sense of their degree of faith in rational calculus (see Keynes, 1930; Khan, 1972), and their emulative tendency, the "fair wage" will depend also on historical, institutional and social conditions, so that social conflict finds its own justification, for example, in terms of working class reaction to a standard of living considered not decent compared to that enjoyed by other social classes. Accordingly, in this theoretical context, 'ethical behaviour' is conceived as cooperative behaviour, i.e. a condition where agents do not voluntarily damage others, given the constraints they face⁵.

3 – Relative wages and social conflict: A theoretical model

Within the Post Keynesian theoretical framework, it is maintained that the unitary wage is a given, depending on the relative bargaining powers of firms and workers. Setterfield (2007), among others, suggests that it is also dependent on variables belonging to the institutional setting and to workers' perception of a "decent" standard of living⁶. Setterfield and Lovejoy (2006) also find that that workers' aspiration gap can be a relevant factor in explaining the path of unemployment and inflation. Post Keynesian scholars stress the role of wage relativities in industrial relations. In her seminal contribution, Joan Robinson (1962, p.70) points out that "the cause of movements in money-wages are bound up with the competition of different groups of workers to maintain or improve their relative position". Wiles (1973, p.379) observes that "the communication revolution [...] making everyone instantly aware of everything, has sharply increased the amount of envy and imitation in the world". Rowthorn (1977) considers that wages are a function of the level of unemployment – due to the 'industrial reserve army' effect – and of the consumption on the part of high-paid workers, so that if the general wage level is expected to rise, each group of workers will demand wage increases so as to preserve their relative position in the wage hierarchy⁷. Lavoie (1992, pp. 379 ff.) remarks that the "core of a Post Keynesian explanation of price and wage inflation [is] based on the notion of equity" and that equity, in turn, is strictly linked to the "normative pressures of relative fair wages and the need to preserve one's status within the pecking order of labour hierarchy"⁸. The starting point of this approach to the determination of the 'fair wage' lies in the idea that the wages of a given group of workers are considered 'fair' insofar as they compare them with what other reference groups obtain.

³ Which says that these agents maximize their objective utility and profit functions under the constraint of poor resources.

⁴ On this issue see among others: Narcross (1990); Frazier (1994); Howard-Snyder F., (1997); Lenman J., (2000); Dale M.E., (2003).

⁵ Forges Davanzati (2006) provides a reconstruction of the debate on the ethical foundation of income distribution within the Neoclassical and the Institutional theoretical framework.

⁶ The role of ethical factors in affecting the dynamics of income distribution, within an Institutionalist theoretical framework, is explored by Forges Davanzati (2006).

⁷ Wage relativities are sometimes used to explain the determination of the 'fair wage', under the conviction that the notions of equity and justice are a relevant part of non-hortodox economics in comparison with the mainstream view (Lavoie, 1992, pp.379 ff.).

⁸ He adds that to "follow the opinion of the majority" is one of the basic strategy in order to face uncertainty, in a Keynesian world. Moreover, imitative behaviour constitutes an helpful guidance to decisions and tend to become a norm: these norms, in turn, represent "focal point" since they are generated by the opinions of the most powerful and respected groups.

In the *General Theory*, in dealing with the dynamics of wage bargaining, Keynes (1973 [1936]) emphasises the following points.

a) Workers are interested in preserving their *relative* wages, compared to the wages obtained by individuals belonging to a given reference group, in a behaviour that can be labelled “horizontal emulative behaviour”: «Since there is imperfect mobility of labour, and wages do not tend to an exact equality of net advantage in different occupations, any individual or groups of individuals, who consent to a reduction of money-wages relative to others, will suffer a *relative* reduction in real wages, which is a sufficient justification for them to resist it» (p.14). Moreover, “the struggle about money-wages primarily affects the *distribution* of the aggregate real wage between different labour-groups... The effect of combination on the part of a group is to protect their *relative* real wages” (p.14).

b) When this condition is violated, workers tend to react via social conflict: in fact, “the reduction in wages disturbs political confidence by causing popular discontent” (Keynes, 1973 [1936], p.264), and: “On the other hand it would be impracticable to resist every reduction of real wages... and in fact reductions of real wages arising in this way are not as a rule resisted unless they proceed to *an extreme degree*” (p.14, italics added).

Note that a significant inequality of income distribution may give rise to social conflict, particularly in the form of a growing crime rate. As a result, the decline of wages below their ‘fair’ is likely to produce an increase in the demand for ‘unproductive’ workers and, therefore, to reduce the potential output. This argument has recently been developed by Bowles and Jayadev (2005), who have shown that crime and guard-labour increase when income distribution becomes more unequal.

Similarly, according to Veblen, wages are considered ‘fair’ by workers where they give them the possibility to approach the consumption level of the “leisure class” as nearly as possible, in a behaviour that can be labelled ‘vertical emulative behaviour’. Bowles and Park point out that «consumption is motivated by a desire for social standing as well as for the enjoyment of the goods and services *per se*» (Bowles and Park 2005, p. 398), and conclude that – due to emulation – working hours increase as the leisure class income increases. However, note that this is not the only possible reaction of workers aiming at «liv[ing] up [to] the conventional standard of decency» (Veblen, 1934, p. 81). In particular, when workers observe a growing gap between their standard of living and that of the “leisure class”, social conflict is likely to occur.

Moreover, it is assumed that firms are not homogeneous. In particular, type-B firms are bigger and with a higher level of unionization than type-A firms and furthermore, on this basis, type-B firms enjoy a higher bargaining power in the money market than type-A firms. It may follow that – because of their small size and hence of their low bargaining power in the money market – small firms face problems of credit rationing. Moreover, following Graziani (1987, 1988, 2003), banks can decide not to finance firms, particularly in the event that their level of debt is considered too high by banks: this can be conceived as a further reason why the credit supply to small firms – insofar as their production is highly dependent on external finance - is rationed^{9,10}. By contrast, insofar as big firms can more easily threaten to relocate production abroad, big firms enjoy a superior bargaining power with respect to the banking system and, therefore, they can obtain more credit and/or low money interest rates.

Starting from these assumptions, the aim of this section is to find the conditions which allow the equality of the actual real wages (w/p_o) and the ‘fair’ or desired real wage (w/p^*). Let us assume that

⁹ The mainstream view supports the idea that credit rationing emerges as logical response to increased moral hazard and adverse selection (Stiglitz and Weiss, 1981). However, apart from these points, other factors can be taken into consideration. Bhattacharya and Thakor (1993) show that credit history of the individual firm as well as its collaterals (thus its size) are a significant variable in explaining bank-firm relationships. For the sake of the arguments presented here, it is assumed that as a firm's size increases, the risk of bankruptcy decreases and, as a result, banks can find it convenient to increase the initial finance (and/or reduce the interest rate). This is to say that type-A firms face a highly elastic money supply curve, while type-B firms face a less elastic money supply curve.

¹⁰ On the formal plane, this means that money supply is elastic for big firms, while small firms cannot increase their demand for money over a given amount.

firms fix the price level by adding a mark-up (including the interest rate) to the average costs. If $p=(w/\pi)[(1+r)(1+i)]$ is the price level, the actual real wage can be written as:

$$[1] \quad \frac{w}{p_0} = \frac{\pi}{(1+r) \cdot (1+i)},$$

Where r is the rate of profits, i the money interest rate, p labour productivity, w the unitary money wage and p_0 the current price level. According to the arguments above, considering an economy where two types of macro-agents exist – the working class and the leisure class - and where the working class is, in turn, divided into two groups – type- a workers and type- b workers - where – as by assumption - the first group consists of workers employed in small firms with a low – or nil – level of unionisation (type-A firm) and the second group consists of workers employed in highly unionised firms and/or in firms of large size (type-B firm), the ‘target wage’ for *type-A* workers can be written as:

$$[2] \quad \frac{w^*}{p} = \frac{\beta w_b + \theta R'}{p},$$

where β is an index of ‘horizontal emulation’, w_b is the wage perceived by workers employed in big firms, θ is the coefficient of emulation between workers and the “leisure class” and R' is the average level of rent gained by the leisure class. Of course, emulative effects are such that the desired wage is higher than (or, in the extreme case where emulation does not occur, equal to) the actual real wage, i.e. $w^*/p \geq w/p_0$. Moreover, because – as stated above - conflict translates into reductions of labour productivity, labour productivity increases as the real wage increases, due to the decrease in social conflict within the firm as long as the unitary wage is equal to the “just wage” (see Forges Davanzati, 1999):

$$[3] \quad \pi = c + d \left(\frac{w}{p} \right),$$

where d expresses the exogenous propensity to cooperate¹¹. It is assumed that the increase in wage determines a higher increase of labour productivity both for type-A firms and for type-B firms. By substituting [3] into [2], one obtains:

$$[4] \quad \pi = c + d \cdot \frac{\beta w_b + \theta R'}{p},$$

which is the maximum level of labour productivity, resulting from the equality between the actual real wage and the ‘fair wage’, i.e. the wage level desired by workers. With respect to equation [4] it is worth noting that the higher the emulation coefficients and/or the higher the wages of the reference group workers (w_b) and/or the leisure class rents (R), the higher the value of labour productivity.

The “no conflict” condition which ensures that the unitary real wage is fixed at the just level, is obtained by equalizing equation [1] with equation [2], that is:

¹¹ The fact that wage reduction implies a decline in labour productivity can produce an increase in labour costs in a two-sided scenario. First, if social conflict occurs *inside the firm* (for instance, by means of strikes or voluntary reduction of labour intensity), this can happen because a decline in wages, insofar as it reduces the intensity of labour, can force firms to increase the costs of surveillance. As a result, while the individual firm aims at obtaining higher profits by means of wage cutting, the rising costs of hiring ‘unproductive workers’ can determine an increase in total production costs. Second, in the event social conflict is *outside the firm* (for instance, in the form of an increasing crime rate), ‘unproductive workers’ must be paid via public expenditure and/or taxation. If this implies an increase in public debt and/or higher taxation (at least in part) at the expense of firms, a ‘lack of coordination’ problem results: while the individual firm finds it profitable to reduce wages, so as to increase profits, on the macroeconomic plane this results in additional costs for firms.

$$[5] \quad \frac{\pi}{(1+r) \cdot (1+i)} = \frac{\beta w_b + \theta R'}{p}.$$

Now, in view of equation [5], it is possible to analyse the effects of a possible gap between *relative* wages, by considering that it can derive from financial market deregulation. As recent studies demonstrate, when financial deregulation occurs, barriers to entry are reduced¹². This produces an increase in the number of individuals belonging to the *rentier* class, with a consequent increase in the desired level of consumption of luxury goods on the part of the leisure class¹³. Since the rent of the leisure class is generated within the money market, insofar as the banking system supplies firms with their initial finance - $F \equiv wN$, applying a money interest rate (i), financial rents are:

$$[6] \quad R = iF = iwN.$$

In the event F is rigid enough, the leisure class is in the position to increase its rents (and, therefore, its conspicuous consumption) via the increase in the interest rate¹⁴.

As a result, workers' desired real wage grows, according to their 'vertical emulative behaviour', with a consequent increase in the wage level demanded.

Starting again from a situation in which firms have their profits at the maximum level, the increase in R , according to equation [5], can lead to a decrease in the firms' profits, because of a reduction in their workers' productivity level, resulting from their conflictual reaction to the gap between their desired wage level and the wage level really earned. In fact, when R increases, also workers' desired wages (w^*/p) increase, because their perception of the standard of decency improves. Specifically, their "vertical emulative behaviour" towards consumption pushes them to ask for a new wage level - w^*/p - to enable them to enjoy a higher standard of living, consistent with the new idea of a decent standard of living, perceived by workers as a consequence of the observed increase in the variable R' . However, if the wage is kept at a lower level than desired, workers will react via conflict by reducing their labour productivity, thus causing a reduction in firms' profits. By inserting equation [2] into the profit function, we obtain:

$$[7] \quad P = RT - CT = \pi \left(\frac{w^*}{p} \right) \cdot N - \frac{w^*}{p} \cdot N = \pi \left(\frac{\beta w_b + \theta R'}{p} \right) \cdot N - \left(\frac{\beta w_b + \theta R'}{p} \right) \cdot N,$$

Equation 7 expresses the total gross real profits, insofar as net profits are given by $(P-iF)/p$. Note that - since labour productivity is assumed to grow faster than wages - the increase in wages determines an increase in profits. The increase in the interest rate - insofar as it determines an increase in rents - generates an increase in the 'fair wage', for a given coefficient of emulation.

¹² On this point see, among others, Laeven (2003) and Abiad A. Mody (2005). In particular, in their paper, Abiad and Mody study the financial liberalizations made in the period between 1973 and 1996 in 36 countries, belonging to the areas of East Asia, South Asia, Latin America, Africa and the Middle East and OECD and demonstrate that there is a significant correlation between the categories of "financial market regulation" and "entry barriers". In fact, the correlation index constructed on these two categories shows that the degree of correlation between entry barriers respect and financial market regulation is around 58% (see table n. 1, p. 69).

¹³ On the relation between financial deregulation and consumption see, among others, Zeldes (1989); Bayoumi and Penelopi (1990); Blundell-Wignal A. Brown and Cavaglia (1991); Bayoumi and August (1993a); Bayoumi (1993b).

¹⁴ Of course, one can consider that banks compete in the money market by lowering the money interest rate. In this case, the continuous reduction of interest rates by individual banks is likely to stop when the interest rate equals the operative cost of production. Note that rents can also increase in this case if the demand for money expressed by firms is elastic enough.

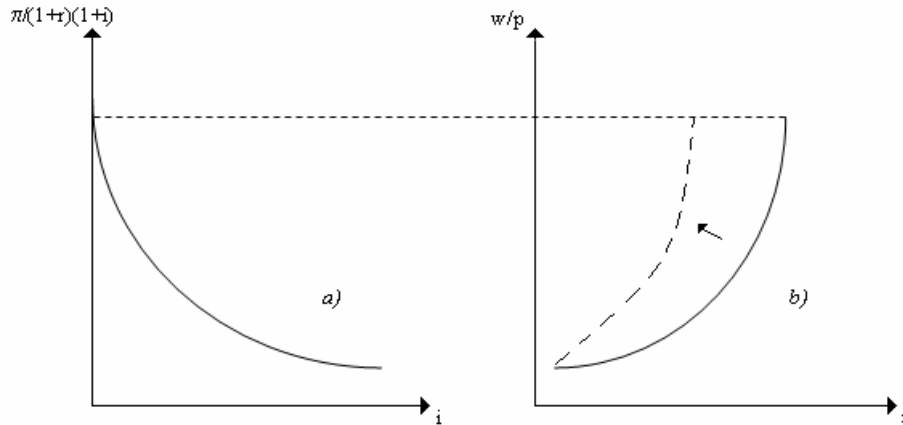


Figure 1 Interest rate and the fair wage

Figure 1 shows the inverse relation between the interest rate (and thus financial rents), the real wage and labour productivity, and the direct relation between the wage rate and the profit rate (r). In panel *a*) the first effect is described. Under the assumption that labour productivity never reaches a value equal to zero, the increase in the interest rate reduces the average real wage for a double reason. First, *for a given value of π* , and by assuming r as a constant, the increase in the interest rate reduces the share of social product which workers can obtain. Second, by determining an increase in financial rents (if money demand is rigid), and for a given value of θ , the rise in the interest rate increases the difference between the ‘fair wage’ and the actual wage, thus reducing labour productivity. If firms react to the decrease of π by increasing wages (panel *b*)¹⁵, this results in a shift upward on the left of the w/p - r curve, because r is a π direct function, with an increase in its slope, which coincides with the variable π .

According to the previous analysis, it is reasonable to imagine that after an increase in the rent level of the leisure class, the bigger and/or more unionised firms (the type-B firms) will increase the actual real wage paid to their employees in order to prevent them from reacting via conflict by reducing their labour productivity and thus causing a drop in profits. If workers’ bargaining power increases, this leads to wage rises in highly unionised firms. As a result, for a given unitary wage on the part of type-A firms (due to credit rationing), profits of type-A firms decrease due to social conflict within the firm and the consequent reduction of labour productivity.

In fact, when w_b/p increases, also the desired wage of type-A firm workers (w_a^*/p) increases. Driven by their horizontal emulative behaviour towards consumption, the type-A firm workers ask for a wage w_a^*/p at least equal to the new wage level earned by their colleagues employed in type-B firms. But owing to their lower unionisation and/or their smaller size, type-A firms are not able to pay a wage as high as the new wage level earned by the type-B firm workers. As a result, type-A firm workers will react via conflict by reducing their labour productivity¹⁶, thus causing a reduction in the **gross** profits of type-A firms:

$$[8] \quad P_a = RT_a - CT_a = \pi_a \left(\frac{\beta w_b + \theta R'}{p} \right) N_a - \left(\frac{\beta w_b + \theta R'}{p} \right) \cdot N_a,$$

The higher wages on the part of type-B firms should force type-A firms to increase wages. However, since type-A firms face a financial constraint due to credit rationing, the real wage of workers

¹⁵ For the aim of maintaining a normal rate of profit (or increasing it), the increase of the unitary wage must be lower than (or equal to) the drop in labour productivity

¹⁶ Conflict within the firm can also imply a reduction in working hours. For the sake of simplicity, this case is not considered here.

employed by firm *A* becomes lower than the real wage of workers employed by firm *B*. Accordingly, profits of type-A firms decrease.

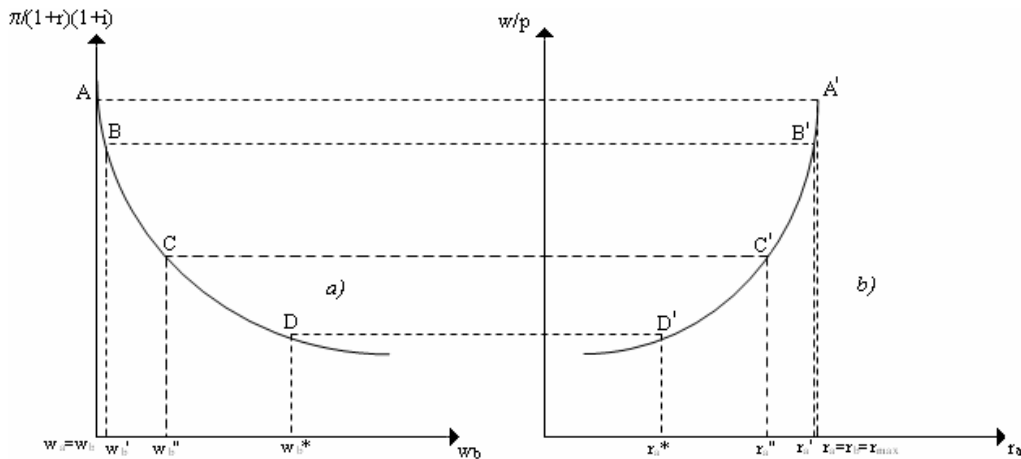


Figure 2 Wage differentials and the fair wage

Figure 2 shows the relation between wage differentials, labour productivity and the rate of profit for type-A firms. Starting from the initial condition that profits of type-A firms are lower than those of type-B firms, in panel *a*), at the origin of axes $w_a = w_b$, and - in view of equation 5 - labour productivity in type-A firms is at a maximum (point A), point A' - in panel *b* - represents the rate of profits corresponding to the maximum labour productivity. This is a case where $r_a = r_b$. When w_b increases - for a given w_a (due to credit rationing) - labour productivity in type-A firms falls, due to the increasing gap between the desired and the actual real wage of type-A workers (i.e. points B and C). As a result, as shown in panel *b*), the increase in the aspiration gap generates a decline in the rate of profits for type-A firms (i.e. points B', C'). Since, for credit rationing, small firms are unable to increase wages, a 'crowding out effect' occurs, due to the negative externalities generated by type-B firms' wage policy (say w_b^*). The 'crowding out' effect is measured by the difference of r_{max} and the declining rate of profits for type-A firms. Note that the more unionised and/or the bigger type-B firms are, the greater this difference is, i.e. the wage differentials among firms is higher. This means that the presence of a large and highly unionised typology of firms, able to increase the wage level of their employees, tends to produce a drop in profits of the small firms, which face credit rationing. Note that since by assumption, when labour productivity grows faster than the unitary wage, small firms would find it convenient to increase wages but they are unable to do so since they face a budget constraint resulting from their low bargaining power in the money market (which can result in credit rationing). Hence, F_a cannot increase, or cannot increase to the same degree as the profitable increase in w^{17} . Accordingly, the behaviour of the banking system contributes to generating profit differentials (as well as wage differentials) between big and small firms. By inserting equation [3] into the profit function, we obtain:

$$[8'] \quad Pa = \pi Na - (w/p)Na < [a + d(w/p)]Nb - wNb$$

and, hence, for a given stock of capital K , $r_a = P_a/K < r_b P_b/K$. Equation 8' derives from credit rationing and, as a result, $dw/p = 0$ for type-A firms. A further possible outcome of this dynamic concerns the increase in the industrial concentration: wage differentials ratio - due, in turn, to different sizes of firms, different levels of internal unionisation, different relationships with the banking system - which generates a different rate of profits, hence the possibility of bigger firms taking over small firms. As a result, financial market deregulation: *i) increases the degree of segmentation of the labour market; and ii) favours industrial concentration.*

¹⁷ The variation of F_a ultimately depends on the degree of credit rationing. In the extreme case, adopted here, F_a is fixed. On credit rationing in the Post Keynesian approach see Docherty (2005).

Emulative behaviour can also affect the level of employment (N). Consider that N is settled on the basis of fixed technical coefficients (λ), in both small and large firms, i.e. $N=K/\lambda$, where K is a given stock of fixed capital, higher in large firms. The level of employment also depends on the amount of initial finance, that is:

$$[9] \quad F = w(K / \lambda)$$

Therefore, $N=K/\lambda=F/w$. While big firms can increase the unitary wage without reducing N , small firms face a given F , so that the increase in the unitary money wage determines a decrease (of the same size) of workers employed. As a result, an increase w by type-A firms results in unemployment and capital underutilization. The increase in w will increase profits in the event that the consequent increase in output (due to the increase of labour productivity) is higher than the loss of output due to the drop in employment. Note that, in this case, low labour demand ultimately depends on:

i) high rents and/or high wages on the part of large firms. This occurs because – for given emulation coefficients – the rent increase and/or the increase in w_b can push type-A firms to raise the unitary wage and – since F is a given – cause a reduction in N . Accordingly, employment reductions mainly derive from the small firm sector¹⁸.

ii) Credit rationing. Since small firms face a given F , the level of employment in these firms decreases as the unitary wage increases. By contrast, provided that money supply is perfectly elastic for large firms, the increase in unitary money wage does not affect N_b . For type-B firms the increase in rents determines an increase in the money interest bill, due to the necessity of paying high money wages in order to keep labour productivity (and, thus, profits) at the maximum level¹⁹.

4 – Concluding remarks

This paper dealt with how emulation in consumption – both between different groups of workers and between workers and the “leisure class” – is related to the real wage level. A theoretical model has been presented in order to show that emulation plays a crucial role in setting what workers perceive as a ‘fair wage’. The ‘fair wage’, in turn, is conceived here as the wage level which allows the non-conflict condition, thus generating the maximum work intensity and therefore the maximum labour productivity. In particular, it has been shown that *i)* the increase in rents produces a reduction of labour productivity in the event that firms are not in the position to increase money wages to a level corresponding to the (higher) level of the ‘fair wage’; *ii)* the increase in wages on the part of some firms (in particular large firms with a strong internal union and/or public firms) generates negative externalities – i.e. reduction of productivity – at the expense of smaller firms with no internal unions. This can give rise to take-over processes and, as a result, to the increase in the industrial concentration ratio. Finally, it has been shown that *low wages and low profits on the part of small firms are due to the behaviour of banks, in particular to credit rationing, and that, in this context, a negative relation between financial rents and labour share is evident.*

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¹⁸ Otherwise, small firms find it easier to fire workers at least because of low internal unionisation.

¹⁹ Note that if output increases more when labour productivity rises more than when employment grows, even large firms may find it convenient to fire workers, insofar as the interest rate is too high.

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