Labour markets and unemployment in Post Keynesian macroeconomics

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Overview

• PK macro of unemployment
  • Model with effective demand und social conflict
  • Illustrate difference between Post Keynesian and New Keynesian („mainstream“) and Marxian theories of unemployment
  • Using the NAIRU model

1. Theories. basics
2. Theory: a PK NAIRU model
  • A general NAIRU model
  • different closures: demand, NAIRU determination
3. The debate on European unemployment
  • Mainstream: labor market institutions(LMI) vs Keynesian explanation: demand deficiency (monetary pol, accumulation)
  • Stockhammer and Klar (2011)
4. Conclusion & other issues
Post Keynesian Economics

Effective demand

Fundamental uncertainty

Social conflict
## Unemployment and wages in different economic paradigms

<table>
<thead>
<tr>
<th>Paradigm</th>
<th>Unemployment</th>
<th>Distribution: wages, profits</th>
</tr>
</thead>
<tbody>
<tr>
<td>Neoclassical</td>
<td>Imperfection in LR and SR (unempl as <em>disequilibrium</em>)</td>
<td>$W/P = MPL(Y^<em>)$, determined by technology; $R/P = MPK(Y^</em>)$</td>
</tr>
<tr>
<td>New Keynesian</td>
<td>Demand in SR, imperfections in LR (unempl in <em>equilibrium</em>)</td>
<td>Technology +/- rents b/e of imperfections</td>
</tr>
<tr>
<td>Marxist</td>
<td>Reserve army of the unemployed – necessary to maintain work discipline</td>
<td>Degree of exploitation, class struggle</td>
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<td></td>
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<td>Profits based on surplus labour</td>
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<tr>
<td>Keynesian</td>
<td>Lack of demand</td>
<td>$W/P = MPL(Y^{IS})$, but determined by demand; $R/P = MPK(Y^{IS})$</td>
</tr>
<tr>
<td>Post-Keynesian/Kaleckian</td>
<td>Lack of demand</td>
<td>Wage share determined by degree of ‘monopoly power’; $R = I + C_R$</td>
</tr>
</tbody>
</table>
Keynes and Kalecki

- Keynes (GT; Lavoie 2003)
  - Assumes perfect competition (flex prices)
  - Eff D (animal spirits) → $Y^{IS} \rightarrow$ Empl ($E^*$)
  - $W/P = MPL @ E^*$

- Kalecki
  - Assumes mark up pricing
  - Eff D (...) → $Y^{IS} \rightarrow$ Empl ($E^*$)
  - $W \rightarrow P$
  - $W/P \leftarrow$ mark up (for a given productivity; MPL assumed constant)
"mainstream" (?!)

<table>
<thead>
<tr>
<th>Textbooks</th>
<th>Neoclassical = Walrasian</th>
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<tbody>
<tr>
<td>Macroeconomics (academic)</td>
<td>NK (NAIRU) ≠ DSGE</td>
</tr>
<tr>
<td>Economic policy</td>
<td>NAIRU story (lab mkt inflexibility) ≠ Neoliberalism</td>
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## Different theories again

<table>
<thead>
<tr>
<th>Distributional conflict?</th>
<th>Demand problems?</th>
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<tbody>
<tr>
<td></td>
<td><em>Say’s Law</em></td>
</tr>
<tr>
<td><strong>Harmony</strong></td>
<td>Neoclassical (NC) econ</td>
</tr>
<tr>
<td><strong>Conflict</strong></td>
<td>Marxian (Mx) econ</td>
</tr>
</tbody>
</table>
conflict

• Effect on demand (wage-led vs profit-led)
• Effect on inflation (wage and price inflation)
• Effect on economic policy (Kalecki 1943)
• Effect on labour productivity
E.O. Wright (2000) Working-class power, capitalist-class interest and class compromise, AJS

**Figure 10.**—Expanded model of working-class associational power and capitalists’ interests.
Fig. 11.—Working-class associational power, working-class interests, and capitalists’ interests.
Unemployment in Post Keynesian macroeconomics

I. The NAIRU model and different theories of unemployment
Outline

• NAIRU model
  • NAIRU model and NAIRU story
  • NAIRU model: WBC-, PS-curves -> Phillips-Curve
  • Demand closure
  • NAIRU closure: exogenous or endogenous?

• Monetarist NAIRU?

• A New Keynesian (NNKS) NAIRU

• A Post Keynesian (PK) NAIRU

• a Marxist quasi-NAIRU
NAIRU theory—everything clear?

• “the NAIRU is approximately a synonym for the natural rate of unemployment” (Ball and Mankiw 2002, 115)
• “The NAIRU model was developed by Post Keynesian economists.” (de Brunhoff 2005, 216)
• “provide a Post Keynesian explanation of persistent high unemployment rates (...) so that the reader can comprehend why this explanation differs from that of NAIRU proponents” (Davidson 1998, 818)
• “Marx and Kalecki … share a common conclusion with natural rate proponents, in that they would all agree that positive unemployment rates are the outgrowth of class struggle over distribution of income ” (Pollin 1998, 5f)
NAIRU theory vs NAIRU story

• NAIRU theory: theory of the relation between inflation and unemployment.
  • Demand -> unemployment
  • Wage bargaining -> inflation -> feedback on demand?

• NAIRU story: the „mainstream“ NAIRU explanation of European unemployment
  • Actual unemployment is determined by the NAIRU
  • The NAIRU is determined exogenously by labor market institutions (LMI)
  • The rise of unemployment in Europe is due to changes in LMI („overgenerous welfare states)

⇒ Cut unemployment benefits … !

• Note: many PKs equate NAIRU theory and NAIRU story
Standard NAIRU story

Demand (y) (goods markets)

Δp

Actual Unemployment (u)

NAIRU (U_N)

LMI
Keynes

• “The theory can be summed up by saying given the psychology of the public, the level of output and employment as a whole depends on the amount of investment.”
• Keynes 1937 (QJE), 221
Keynes' approach

- Demand (y) (goods markets)
  - Δp
  - WS
  - Actual Unemployment (u)

- Capital accumulation (ΔK)
- Interest rates
- "animal spirits"

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NAIRU: wage bargaining

- Instead of LS there is a wage bargaining curve (WBC)
  - Collective bargaining: bargaining position of unions will depend on unemployment
  - Efficiency wages: at higher employment levels, higher wages are necessary to elicit the same labor effort
- NAIRU unemployment = involuntary unemployment
NAIRU model: labour market

\[ W/P \]

\[ \Delta p \downarrow \Delta w \downarrow \quad \Delta p \uparrow \Delta w \uparrow \]

Note 1: An increase in unemployment benefits will shift the WBC, whereas it would cut off the LS curve.

Note 2: What happens if we're off-equilibrium?

Change in inflation (not employment!)

Adjustment depends on how the goods market reacts!

\[ e_N = 1 - \text{NAIRU} \]
NAIRU model: Actual employment ($e^A \leftarrow Y^{IS}$)
Walrasian labour market

$W/P$

$L^S$: preferences

$L^D = \text{MPL: technology}$

$e^{FE}$

$w/p \uparrow$

$w/p \downarrow$
notional labor demand in NAIRU and Walrasian model
NAIRU model: labour market

- Assume const labor productivity
- Wage claims (WBC):  \((1-\pi)^W = w_0 - w_1u\)
- Profit claims (PS):  \(\pi^R = \pi_0\)
- Actual wage share:  \((1-\pi) = w_0 - w_1u - w_2p^U\)
- Actual profit share:  \(\pi = \pi_0 - \pi_2p^U\)

Note: we assume that
unexpected w infl = unexpected p infl = \(\Delta p\)
NAIRU model: labour market

• Assume const labor productivity
• Wage claims (WBC): \((1-\pi)^W = w_0 - w_1u\)
• Profit claims (PS): \(\pi^R = \pi_0\)
• Actual wage share: \((1-\pi) = w_0 - w_1u - w_2p^U\)
• Actual profit share: \(\pi = \pi_0 - \pi_2p^U\)
• Adaptive expectations: \(p^E = p_{t-1}, p^U = \Delta p\)
• PC: \(\Delta p = (w_0 + \pi_0 - 1)/(\pi_2 + w_2) + w_1/(\pi_2 + w_2).u(y)\)
• \(u = u_N - (\pi_2 + w_2)/w_1 \Delta p\)
• NAIRU: \(u_N = (w_0 + \pi_0 - 1)/w_1\)

Phillips Curve: PC: \(p = p(u, u_N; p_{t-1})\)

Note: “inflation” here is a wage-price spiral
NAIRU model: actual W/P (or WS)

\[ W/P \]

\[ \text{WBC}(.) \]

\[ \text{PS}(.) \]

\[ \text{Actual W/P} \]

\[ e, 1-u \]

\[ e_N \]

\[ e^A \]
PC: $p(u, u_N, p_{t-1})$

- PC will shift upward if inflation is higher than expected
NAIRU model: demand side

• Demand: \( y = y_0 + y_2 p + y_3 \pi \) \[8\]
  \[ y = y_0 + y_2(\Delta p + p_{t-1}) + y_3 \pi \]
• Employment: \( u = n - y \) \[7\]

• \([8]\) in \([7]\): \( u^{\text{IS}} = u(\Delta p, \pi) \)
IS-curve: $u^{IS}=u(p, \pi)$

- $U^{IS}$ denotes the employment level given the equilibrium in the goods market.
- If the IS curve is downward sloping, we’ll get back towards the NAIRU.

$e_N = 1 - \text{NAIRU}$
NAIRU model: IS-curve

• A priori the slope of the curve can be positive or negative
  • Negative: (standard) real balance effect
  • Positive: real debt effect

\[ \text{PC}_0, \text{PC}_1 \]

\[ \text{PC}_1 \]

\[ u^{IS}() \]

\[ \text{P} \]

\[ e, 1-u \]

\[ e_N, e_1, e_2 \]
NAIRU model with upward-sloping IS-curve

• A priori the slope of the curve can be positive or negative
  • Negative: (standard) real balance effect
  • Positive: real debt effect

\[ P = u_{IS}(\cdot) \]

\[ PC_0 \]

\[ e_N, e_1, e_2 \]
NAIRU model: NAIRU endogeneity („hysteresis“)

- Even if the IS curve is well behave...
- The NAIRU itself may shift due to the temporarily high level of employment

\[ P, \quad PC_2, \quad PC_0, \quad u^{IS}(\cdot), \quad e, \quad 1-u, \quad e_{N1}, \quad e_{N2}, \quad e_1 \]
NAIRU model closures

• What demand function is assumed? $u^{IS} = u(p, \pi)$
  • How does $\Delta p$ affect demand?
  • How does $\Delta \pi$ affect demand?
• What does $u_N$ depend on?
  • Is it exogenous or endogenous?
  • NAIRU: $\hat{u}_N = \lambda(u-u_N)$. $\lambda = 0$?
• What are the policy conclusions?
### NK, PK and Mx closures

<table>
<thead>
<tr>
<th>Demand closure</th>
<th>NAIRU closure</th>
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<tbody>
<tr>
<td>$y_1 (=dY/dp)$</td>
<td>$y_2 (=dY/dWS)$</td>
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<td><strong>NK</strong></td>
<td>Negative (b/e of CB?)</td>
</tr>
<tr>
<td><strong>PK</strong></td>
<td>Positive (wage-led D)</td>
</tr>
<tr>
<td><strong>Mx</strong></td>
<td>Negative (profit-led D)</td>
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</table>
Monetarist NRU ≠ NAIRU (?)

- **Demand**: \( y = y_0 + y_2(m-p) \)
  - Real balance effect provides automatic stability
  - No conflict inflation, but misperceptions

- **NAIRU**: \( u_{NRU} = u(LMI, \text{demographics}); \lambda = 0 \)

- Natural Rate (Friedman) = voluntary unemployment

- … but policy conclusions of NAIRU story similar to Monetarist policies: cut unemployment benefits

…
New Keynesian NAIRU closures

- **Demand closure**: \( y^{IS} = y_0 + y_2(i-p); \ y_1 < 0 \)
  - Exogenous money supply (Layard, Nickell & Jackman 1991)
  - **or**
  - CB reaction function (Taylor Rule) \( i^{CB} = i_0 + i_2(p-t) \)
    - *No economic automatism!*
  - Only works if inflation is non-trivially positive
    - \( Y^{IS-CB} = y_0 + y_1(i_0 + i_2(p-t_p) - p); \ y_1 < 0; \ dy/dp < 0 \)
- **NAIRU closure**
  - Hysteresis: different wage elasticities for short-term unemployed and long-term unemployed (\( u^{LT} \))
  - *(if \( u^{LT} = u_{t-1} \)) effectively a partial adjustment process with endogenous short-run NAIRU and exogenous long-run NAIRU*
  - Quasi-exogenous NAIRU
New Keynesian NAIRU

- There is a private-sector $u^{IS}$.
- And an $u^{IS-CB}$ that includes the central bank reaction function.
New Keynesian NAIRU

• In SR fiscal or monetary policy can manipulate output and employment, but only at the cost of unexpected inflation.
  • If $u \neq \text{NAIRU}$ gov’t can *speed up* adjustment
• In LR inflation will erode demand and $u$ goes back to NAIRU.
  • NAIRU a strong attractor in the long run
• What has caused increased unemployment empirically?
  • Disagreement: LMI (Nickell et al 2005, IMF 2003, OECD 2006) or policy (Ball 1999)
Standard NAIRU story

Demand ($y$) (goods markets)

$\Delta p$

Actual Unemployment ($u$)

NAIRU ($U_N$)

LMI
NK: persistence vs hysteresis

• See Nickell (1998)
• Long-term unemployed have weaker effect on wages than short-term unemployed
• Hysteresis: special case where long-term unemployed have no effect on wages
NK persistence

• Short-term and long-term unemployed have different effect on $W$

• $(1-\pi)^W = w_0 - w_1 \Delta u_t - w_1(1-h).u_{t-1}$

• $(1-\pi)^W = w_0 - w_1(u_t - h.u_{t-1})$

• Long run effect only if $h=1$ = “NK hysteresis”

• $(1-\pi)^W = w_0 - w_1 \Delta u_t$

• If $h < 1$:

  • $u_t = (w_0 + \pi_0 -1) + w_2.h/w_1.u_{t-1} - w_2/w_1 \Delta \pi$
  • $u_t = (w_0 + \pi_0 -1)/w_1 - (\pi_2 + w_2)/w_1 \Delta \pi + h.u_{t-1}$
  • LR: $u_t = u_{t-1}$ and $\Delta \pi=0$
  • $u = (w_0 + \pi_0 -1) + w_2.h/w_1.u_{t-1} - w_2/w_1 \Delta \pi$
  • $u_{LR-NAIRU} = (w_0 + \pi_0 -1)/(w_1.(1-h))$
NK unemployment persistence
New Keynesian policy

• If $u_N = f(LMI)$, then NAIRU story (cut unemployment benefits …) (Nickell)
• If hysteresis: economic policy becomes very effective (Ball)
• Empirical issue whether LMI did in fact „worsen“
PK reactions to NAIRU

• Reactions divided
• *Rejection*: NAIRU is pre-Keynesian, because WS function assumes $MP_L$ (Davidson 1998)
• *Extending* the NAIRU model: similar to conflict inflation (Arestis & Co)
• Conflict inflation
  • $\Delta p = (w_0 - w_1 u + \pi_0 + \pi_1 z - 1)/w_2$
  • Inflation as result of unresolved distributional conflict
    • No presumption that distributional aspirations are exogenous or stable
  • Little empirical work (Setterfield and Lovejoy)
  • Mostly interpreted as theory of inflation, not of unemployment
A PK NAIRU model

• So what’s the difference?
• Labour demand need not be downward sloping in W/P (wage-led demand)
• Aggr D need not be negative in P (debt deflation)
• → NAIRU not a strong attractor (unstable equi)
• NAIRU is endogenous
PK demand closure

- **Demand closure**: $y^{IS} = y_0 + y_3\pi + y_4(\text{Debt}-p); y_3 < 0$
  - Feedback from inflation to demand not negative
  - Distribution affects demand: wage-led demand (Kalecki)
- **NAIRU equilibrium is likely to be private-sector unstable.**
- **With CB reaction function**
  - $y^{IS-CB} = y_0 + y_2(i^{CB}-p) + y_3\pi + y_4(\text{Debt}-p)$
  - CB ability to stabilize is asymmetric because of lower bound of nominal interest rates!
Stable and unstable PK NAIRUs
Post Keynesian NAIRU

- Under deflationary conditions
- $u^{IS}$ determines demand

Diagram labels and axes:
- $P$: Price
- $e, 1-u$: Employment
- $PC_0, PC_1$: Phillips Curves
- $u^{IS}, u^{IS-CB}$: Output gaps
- $e_{N1}$: Employment level

Graphical representation:
- Points A, B, C indicating different economic states
- Arrows illustrating changes in employment and prices

Institution logo: Kingston University London
PK NAIRU closure: NAIRU endogenous

- Endogenous wage aspirations: workers (and the unemployed) regard wage of other workers as „normal“ and/or get used to current wage level
  \[ \hat{w}_0 = v.[(1-\pi) - (1-\pi)^w] \Rightarrow u_N = f(u_{t-1}) \]
- Difference to NK persistence: Not weak wage effects of long-term unemployed, but a shift of the reference wages („normal wage“, social wage norms) (Skott 2005)
- Capital stock: imperfect substitution
- Capital stock: increased K (for given Y) reduces price setting power of firms (Rowthorn)
- Profit claims / mark up depends on (long-term) interest rate
  \[ \pi^R = \pi_0(i-p) \] (Hein 2008)
PK NAIRU endogeneity due to wage norms
A Post Keynesian NAIRU?

• At any point in time there is a NAIRU (= a short-term Phillips curve)
• … but it is neither exogenous
• … nor is it strong attractor
• NAIRU: as much an outcome as a determinant of macroeconomic performance.
A Post-Keynesian NAIRU

Demand (y) (goods markets)

Δp

WS

Actual Unemployment (u)

NAIRU (Uₙ)

Interest rates (i^{CB})

Capital accumulation (ΔK)

LMI

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A Marxian NAIRU?

• Not *one* Marxian theory, here: profit squeeze crisis
• While few Marxists have discussed the NAIRU model explicitly, there are striking parallels
  • Wages as outcome of a bargaining process/class struggle
  • Unemployment as a workers’ discipline device
• stress on class struggle rather than LMI
• cyclical movements of actual unemployment rather than a stable NAIRU (Goodwin cycle)
• **Demand closure**: $\Delta y = y_0 + y_2 \Delta \pi$, with $y_2 > 0$
  • The profit share affects demand positively (profit-led growth)
• NAIRU = equilibrium ”RAU”? , endogenous?
NAIRU model closures

• NAIRU *model*: wage bargaining and Phillips curve
• NAIRU *story*:
  • Exogenous NAIRU
  • Actual $u$ is determined by NAIRU
  • $E u$ driven by LMI
• NAIRU model needs closures
• What demand function is assumed?
  • How does $\Delta p$ affect demand?
  • How does $\Delta \pi$ affect demand?
• What does $u_{\text{NAIRU}}$ depend on?
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NK, PK and Mx closures

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AMECO’s NAWRU (Oct 2013)
Open Q & what’s missing?

• Problems of the NAIRU model
  • pro-cyc wage share ...

• Omissions
  • exogenous productivity (Storm)
  • Workers aspire to be fully compensated for inflation (.Setterfield)

• Production function?
  • Keynes (GT): yes
  • Neorcardian critique, other criticisms (team work)
  • Kaleckian pragmatism: const MPL until max output

• Demand or conflict?
  • No theory of production
  • Mark up pricing or bargaining?

• Political contradictions of full employment
Unemployment in Post Keynesian macroeconomics

II. The debate on European unemployment
structure

• Some stylized facts on Eu unemployment
• Mainstream NAIRU story
• Keynesian (empirical) explanations
• Stockhammer & Klar (2011)
Why?

• “broad movements in unemployment across the OECD can be explained by shifts in labour market institutions” (Nickell et al EJ 2005, 1).

• “high unemployment in many industrial nations is an unintended byproduct of their redistributionist welfare states“ (Krugman 1994, 51)
Standard NAIRU story

Demand \((y)\)  
(goods markets)

\(\Delta p\)

Actual Unemployment \((u)\)

NAIRU \((u_N)\)

LMI

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NAIRU story: high u and high W/P

\[ e_N = 1 - \text{NAIRU} \]
Stylized facts: high u and low W/P
Mainstream analyses of European unemployment

• (marginally) changing targets of the mainstream
  • In 80s: unions too strong & wages too high
  • 90s: labor market rigidities
  • wage spread too low, flexicurity, PMR interactions

• empirical work on the NAIRU:
  • (ex post) reconstructing the NAIRU via Kalman filter
  • (ex ante) explaining actual unemployment by NAIRU determinants controlling for changes in inflation: panel $u=f(LMI, MS)$
    • OECD 1994: Jobs Study
    • IMF 2003, EC
    • OECD Employment Outlook 2006
    • Variations: interactions Blanchard & Wolfers 2000
    • Skilled vs unskilled workers’ share (EC 2007)
<table>
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<tr>
<th></th>
<th>OECD unweighted average</th>
<th>High employment outcomes</th>
<th>Low employment outcomes</th>
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<tbody>
<tr>
<td></td>
<td></td>
<td>English-speaking countries, mainly</td>
<td>North European countries, mainly</td>
</tr>
<tr>
<td>Employment protection legislation</td>
<td>2.01</td>
<td>1.38</td>
<td>2.13</td>
</tr>
<tr>
<td>Generosity of unemployment benefit system</td>
<td>27.81</td>
<td>18.23</td>
<td>39.86</td>
</tr>
<tr>
<td>Active labour market programmes</td>
<td>29.25</td>
<td>15.76</td>
<td>64.14</td>
</tr>
<tr>
<td>Tax wedge</td>
<td>27.10</td>
<td>18.54</td>
<td>27.42</td>
</tr>
<tr>
<td>Union coverage</td>
<td>59.96</td>
<td>30.75</td>
<td>83.33</td>
</tr>
<tr>
<td>Union co-ordination</td>
<td>2.88</td>
<td>1.88</td>
<td>3.92</td>
</tr>
<tr>
<td>Product market regulation</td>
<td>1.42</td>
<td>1.20</td>
<td>1.28</td>
</tr>
<tr>
<td>Employment rate</td>
<td>67.11</td>
<td>70.92</td>
<td>71.91</td>
</tr>
<tr>
<td>Unemployment rate</td>
<td>7.47</td>
<td>5.90</td>
<td>4.79</td>
</tr>
<tr>
<td>Total LMP expenditures</td>
<td>1.86</td>
<td>0.98</td>
<td>2.68</td>
</tr>
<tr>
<td>of which: ALMP expenditures</td>
<td>0.76</td>
<td>0.39</td>
<td>1.31</td>
</tr>
<tr>
<td>Income inequalities (Gini Index)</td>
<td>29.35</td>
<td>31.50</td>
<td>25.58</td>
</tr>
<tr>
<td>Relative poverty rate</td>
<td>9.64</td>
<td>11.78</td>
<td>7.77</td>
</tr>
</tbody>
</table>

a) This country classification is derived from a Principal Component Analysis (see Annex 6.A1), a simple statistical technique which helps to identify existing combinations of policy settings and to highlight similarities and differences across countries. However, some countries are barely representative of the group of countries to which they belong, being close to the frontier between two regimes of labour market functioning. This is for instance the case for Austria, Finland, Germany, Ireland, Japan, Korea, Portugal, Sweden and Switzerland, as shown in the Annex 6.A1.

b) This group of countries includes Australia, Canada, Japan, Korea, New Zealand, Switzerland, the United Kingdom and the United States.

c) This group of countries includes Austria, Denmark, Ireland, the Netherlands, Norway and Sweden.

d) This group of countries includes Belgium, Finland, France, Germany, Italy, Portugal and Spain.

e) This group of countries includes the Czech Republic, Poland and the Slovak Republic.
• “on average, extremely different degrees of “interventionism” in almost each selected policy area (with the exception of product market regulation) may lead to very similar employment and unemployment rates. This suggests that there is not a single road for achieving good employment performance.” 192
• ... And then they give the standard policy recommendations
A. Set appropriate macroeconomic policy

• A1. Macroeconomic policy should aim at price stability and sustainable public finances so as to keep interest rates low and encourage investment and labour productivity

• A2. Macroeconomic policy should be used to help stabilise the economy in order to reduce the risk that transitory increases in unemployment
  • Monetary policy should pursue medium-term price stability by reacting to both inflationary and disinflationary shocks
  • Fiscal policy should aim to restore and maintain sound public finances so that automatic stabilisers can be allowed to operate, supplemented as required and feasible by discretionary policy. This is particularly important in countries that cannot employ monetary policy for that purpose.
B. Remove impediments to labour market participation as well as job-search

• B1. Unemployment benefit replacement rates and duration, as well as social assistance benefits provided to individuals who can work, should be set at levels that do not discourage job search excessively

• Make other non-employment benefits more work-oriented (B4-B5)

• B6. Family-friendly policies, including childcare support, as well as working-time arrangements

• Adjust taxes and other transfer programmes to make work pay (B7)
C. Tackle labour- and product-market obstacles to labour demand

• *Ensure that wages and labour costs respond to labour market developments (C1-C3)*
  • C1. Ensure that minimum wages are set at levels that do not harm job creation significantly for low-productivity workers.

• *Enhance competition in product markets (C4-C5)*

• *Make sure that employment protection legislation helps labour-market dynamism and provides security to workers (C7-C8)*

• *Promote transitions to formal employment*
  • C9. Transitions to formal employment should be promoted through: lower taxes on low-paid employment going hand-in-hand with better compliance of other taxes (notably on small businesses);

• D. Facilitate the development of labour force skills and competencies
Keynesian explanations

- Criticism of explanatory power of LMI-story
- Demand deficiency
  - Fiscal policy
  - Monetary policy (EMU)
  - Capital accumulation (taken to be quasi-exogenous)
It’s not labor market institutions!

"While labor market institutions can potentially explain cross country differences today, they do not appear able to explain the general evolution of unemployment over time."

• Blanchard & Wolfers 2000, EJ, p. 2
"the Layard and Nickell model seems unable to explain the increase in European unemployment"

• Madsen 1998, Economic Journal, p. 862
"Simple, cross-country comparisons suggest that EPL has little or no effect on overall unemployment."

• OECD Employment Outlook 1999, 50
“labor market policies are not important causes of the unemployment successes and failures since 1985."

• Ball 1999, Brookings Papers .., 191
LMI, cont’d

• “no meaningful relationship between [the] OECD measure of labor market deregulation and shifts in the NAIRU.”
• Baker et al 2005, 107

• „We find no systematic support for the deregulatory view. Indeed, employment protection, benefit replacement rates, and tax wedge do not seem to have a significant impact on unemployment. At the same time, we find a robust positive association between union density and unemployment.“
• Baccaro and Rei 2007, 563
Fiscal policy

• There is surprisingly little on the effects of fiscal policy
• Until crisis mainstream hasn’t done research on the multiplier any more
  • Hemming et al (2002): exp multiplier close to 1
  • Recent OECD Economic Outlook: close to 1
• Since crisis it’s being rediscovered
  • Various IMF; De Long & Summers 2012 BPEA; Eggertson & Krugman 2012 QJE
    • normal times and ZLB (or ‘liquidity trap‘ or debt overhang)
• Not many estimates by Post Keynesians
  • Hein and Truger (2005): PDR on GDP growth 0.24
• None of these calculates or estimates effects on employment
Monetary policy

• If you look carefully, it’s in the mainstream studies (e.g. IMF 2003),
  • but it’s ignored when discussing policy

• Baccaro & Rei, Baker et al
• Ball 1994, 1997: episode analysis of effects of monetary policy during recession on unemployment and OECD-NAWRU 5 years later (update: Stockhammer & Sturn 2012)
Capacity utilization and unemployment (Bean 1994 JEL)

Figure 7. Capacity Utilization and Unemployment
Capital accumulation

- Almost entirely ignored by mainstream (now, not in 1980s!)
- Alexiou and Pitelis 2003: panel of 13 OECD countries, annual data, various macro variables and K
- Stockhammer 2004: 5 OECD countries, annual data, time series analysis, some LMI, K
- Arestis & Co 2007: VECMs for 9 OECD countries, quarterly data, unemployment and wage equations, UB, strike, K
- Stockhammer and Klär 2011 CJE
Review of the empirical literature

• **Large mainstream literature on LMI and unemployment**

• **Two principal Keynesian criticisms:**
  • LMI explanation does not actually work empirically (Howell et al 2007), Baccaro and Rei (2007)
    • Demand (and hysteresis)
    • Limited substitutability (Rowthorn 1999)

• **Usually not both elements in the same study**
  • But: time-series = only limited LMI set, small range of countries
## Classification of the empirical [econometric] literature explaining unemployment

<table>
<thead>
<tr>
<th></th>
<th>Econometric approach</th>
<th>LMI controlled for</th>
<th>Macro shocks controlled for</th>
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<tr>
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<td>Dyn.P</td>
<td>Sta.P</td>
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<tr>
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<td>Blanchard &amp; Wolfers 2000</td>
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<td>Bassanini &amp; Duval 2006</td>
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<td>Baccaro &amp; Rei 2007</td>
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<td>Arestis et al 2007</td>
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</table>
Stockhammer & Klar 2011

\[ \Delta p \]

Actual Unemployment \((u)\)

NAIRU \((U_N)\)

Interest rates \((i^{CB})\)

Capital accumulation \((\Delta K)\)

LMI

Kingston University London
Econometric Model & Data

• \( u_{NAIRU} = f(LMI, MS, \Delta K) \)
• panel least squares regression

• DATA
  • Bassanini & Duval 1982-2003
    • most up-to-date OECD dataset
    • Basis of OECD Empl Outlook 2006
  • Baker, Glyn, Howell, Schmitt 1960-99
    • Updated and revised version of Nickell & Nunziata LMI-DB
  • \( u, K, CPI \): EU AMECO
    • Capital stock or investment?
  • 20 Countries (all Western OECD and JP, without LU and GR)

• All data transformed into non-overlapping 5-yr-avgs
## Regression results (BD 83-03 dataset)

<table>
<thead>
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<td>LMI + MS + ACCU</td>
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<td>(in differences)</td>
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White period standard errors & covariance (d.f. corrected); no weights (except variant 4: cross section weights). *, **, *** denote significance at the 10, 5, and 1% level, respectively.
Regression results based on Baker et al dataset (1960-99)

<table>
<thead>
<tr>
<th>LMI + MS + ACCU</th>
<th>LMI + MS + ACCU</th>
<th>LMI + MS + ACCU</th>
<th>LMI + MS + ACCU</th>
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<td>R² (adj.)</td>
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<td>n</td>
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<tr>
<td>DW</td>
<td>0.92</td>
<td>1.13</td>
<td>0.92</td>
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</table>

Table 2: Unemployment effects of Institutions, macro shocks, and capital accumulation

Baker et al dataset (1960-1999)
Findings I

- **LMI do play a role, but a minor one**
  - Few are consistently statistically significant, many display perverse signs
  - Only Union Density (UD) statistically significant (and with the expected sign) across data sets and different specifications
  - In line with Baccaro and Rei (2007), Howell et al (2005)

- **Demand shocks do play an important role**
  - Strong (and significant) effect of real interest rates
    - +1%-pt. real interest rate $\rightarrow$ +0.5%-pts. unemployment rate
  - Strong (and significant) effect of ACCU
    - +1% ACCU $\rightarrow$ -0.9%-pts. unemployment rate

- **Supply shocks play some (minor) role**
  - TOT, LD have effects, particularly in the short (BD) sample
Contributions to unemployment in %pts relative to 1960-64 for 'mean country' (BGHS dataset)
Findings II

• Economic relevance over time
  • Early 70s: INT and ACCU lower unemployment, from 80s on strong positive effects: high real interest rates and diminished ACCU raise unemployment
  • 70s and 80s: UD contributes to unemployment, in 90s the effect is negative
  • From mid 80s on, TW contributes to unemployment (however typically insignificant in our study, as opposed to B&D 2006)
Summary / conclusion

• The degree of capital accumulation has a strong impact on unemployment in the medium run

• Real interest rate shocks play a significant role even when ACCU is simultaneously controlled for

• The effects of LMI are relatively modest and unrobust
  • Only Union Density delivers consistent (positive) effect
  • Counteracted by COORD (or CBC)
  • Some role for TW; ‘perverse‘ results for EPL, UB

• Investment (flow) seems to play a larger role (as a demand shock) than the capital stock (as a supply variable)

• Policy conclusions:
  • focus on LMI as explanations for persistent unemployment is misguided – labour market reforms will not cure unemployment
  • Encourage investment / capital accumulation
Why did accumulation slow down?

Financialization

- Shareholder value orientation
- Interest rates ($i_{CB}$)
- Financial uncertainty & volatility

Capital accumulation ($\Delta K$)

- Demand ($y$) (goods markets)
- WS

Liberal fiscal policy regimes

"animal spirits"
Conclusion and some loose ends

• Distribution
• Loose ends
• Policy conclusions
Determinants of income distribution

- Dramatic changes in (functional as well as personal) income distribution in past three decades
- Until recently ignored by mainstream
  - Then a lot on personal distribution
  - And some on personal (IMF 2007, EC 2007): it’s technological change
  - Critical mainstream (Rodrik) highlights globalisation
- Little by PK
  - Some on financialization and distribution (Argitis & Pitelis 2006 CPE: UK, USA)
  - Jayadev (2007 CJE) on financial globalisation
  - Little that brings together changes in labour relations and changes in finance
Stockhammer (2013 ILO)
Determinants of income distribution

- Technological change
- Globalisation
- Financialisation
- Welfare state retrenchment

Bargaining power of labour

Functional distribution of income
Overview baseline variables

\[ WS = f(\text{fin}, \text{tech}, \text{wfst}, \text{glob}) \]

<table>
<thead>
<tr>
<th>ALL/DVP</th>
<th>ADV</th>
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<tr>
<td>financialisation</td>
<td>FINGLOB</td>
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<tr>
<td>globalisation</td>
<td>OPEN</td>
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<td></td>
<td></td>
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<tr>
<td>Welfare state</td>
<td>CG</td>
</tr>
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<td></td>
<td>UNION</td>
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<tr>
<td>Technological change</td>
<td>GDPpw IND AG</td>
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Baseline specification (ADV)

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<td>TOT</td>
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<td>-2.57**</td>
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<td>CG</td>
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<td>UNION</td>
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<td>LOG(KL_KLEMS)</td>
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</tr>
<tr>
<td>dw</td>
<td>1.81</td>
<td></td>
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</table>
Contributions to the change in the wage share, advanced countries 1980/84-2000/04
Production in Mx and PK theories

• Marxian:
  • production as a labour process - *exploitation*
  • Class struggle at point of production, work organisation ... (labour process debate)
  • Social theory of productivity growth in SSA: positive effect of W, cost of job loss, unemployment

• Post Keynesian
  • Productivity determined by demand (Kaldor)
  • (empirically oriented): high wages, labour market institutions can contribute to productivity growth
    • Storm and Naastepad (2009): ‘rigid’ LMI lead to higher productivity growth
    • Hein and Tarassow (2010): higher profit share has neg effect on pdy growth
    • Vergeer and Kleinknecht (2011): wage, LMI pdy growth
  • How does this go together with class conflict in production?
    • Note: Arestis & Biefang-Mariscal have effect of unemployment (cost of job loss) on effort
Some other loose ends

- Labour market segmentation
  - Skilled/unskilled labour
  - Gender inequality and growth (Seguino 2000, Blecker & Seguino 2002; Freeman & Schettkat 2005)
  - Political Economy of Race
  - Youth unemployment?
- Working time
- Uncertainty and class struggle
  - distributional struggles around the distribution of uncertainty - ‘job insecurity’ as uncertainty experience by workers (Stockhammer & Ramskogler 2008 JEI)
- Labour supply
  - Spencer 2004, Spencer and Sawyer 2011
- Standard labour demand and accounting identities
Economic policy conclusions

• Full employment as policy goal: demand policy
• Wage policy can’t cure unemployment:
  • wage cuts are counterproductive: Danger of deflationary spiral
  • consumption propensity out of wages is higher than out of profits.
• NAIRU endogenous
• Capital accumulation/animal spirits as key variable to explain variations in unemployment
• Fiscal policy as key tool for stabilization
Net Effects: $\Delta Y/\Delta WS$

<table>
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<tr>
<th>Effects on private excess demand</th>
<th>EU 12 (openness 15%)</th>
<th>Austria (openn. 50%)</th>
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<td>Consumption</td>
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<td>Investment</td>
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<td>Domestic sector</td>
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<td>Net exports</td>
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<tr>
<td>Total effect</td>
<td>0.21</td>
<td>-0.18</td>
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Financialization

Demand (y) (goods markets)

WS

financialization

Interest rates ($i^{CB}$)

Capital accumulation ($\Delta K$)
Shareholder value orientation

• "profoundly altered patterns of managerial power and behaviour." (Baker and Smith 1998, 3)

• "Among the manifestations of this lack of control over management were the pursuit of market share and growth at the expense of profitability (...)." (OECD 1998, 17; emphasis added)

• management adopts owners' priorities: $\text{UM} = U(g, r)$
Extended NAIRU model

\[ e[y(p, WS, \Delta K, i)] \]

\[ WBC(LMI, (w/p)_{t-1}) \]

\[ PS(i, K, ..) \]

\[ 1-u, e \]
A Keynesian explanation, part 1

\[ WBC(LMI, (w/p)_{t-1}) \]

\[ PS(i, K, ..) \]

\[ 1-u, e \]

\[ W/P \]

\[ y(\ldots) \]
A Keynesian explanation, part 2

\[
W/P \quad y(\ldots) \quad 1-u, e
\]

\[
WBC(LMI, w/p_{t-1})
\]

\[
PS(i, K, \ldots)
\]
NAIRU model: different closures

- Simple NAIRU model
- Wage setting (WBC) and price setting (PS) function
  - Implied a NAIRU
  - Give a reduced form (expectations-augmented) Phillips Curve (PC)
- Employment determined by demand
  - Demand function: \( y = y_1.p + y_2.WS \)
    - How does \( \Delta p \) affect demand?
    - How does \( \Delta WS \) affect demand?
- Determination of the NAIRU (\( u_N \))
  - Is it exogenous (LMI) or endogenous ("hysteresis")?
  - NAIRU: \( \dot{u}_N = \lambda(u-u_N) \). \( \lambda=0 \)?
  - Or: \( y(x) \) and \( u_N(x) \)