The Jerome Levy Economics Institute of Bard College

Public Policy Brief

HIGHLIGHTS

No. 36A, October 1997

Dangerous Metaphor: The Fiction of the Labor Market

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An intellectual dichotomy underlies the way most economists are taught to think: Macro is macro, and structure is microeconomics. This conventional view leads to the common ground on policy that has come to permeate economics from the liberal center to the far right. According to this common ground, one set of instruments defines macroeconomic parameters, while another assures that "markets work," for example, by providing training and infrastructure, by removing distortions in pecuniary incentives, and by removing barriers to the efficient adjustment of prices. The deep constraints on the economic policies of the Clinton administration illustrate the consequences of these ideas. Modern market-oriented liberals can favor labor training, education, adjustment assistance, and other programs that help workers move from one job to the next. They can favor a wider distribution of education and skills because equalizing initial chances in the labor market will supposedly work to equalize final outcomes. They can support public investments in infrastructure because these are said to contribute to the international competitiveness of the economy. On the same ground, they can support research and development assistance to advanced enterprises and efforts to open foreign markets to American products.

These are supply-side measures. Their purpose is to improve the long-term performance of the economy. The thought is that a more productive economy will generate higher average living standards. The further thought, that these higher standards will "trickle down" to low-paid production and service workers, is left as an assumption. It is an assumption that has so far proved unfounded, for such supply-side policies have so far achieved nothing to reduce economic inequality; either the dose is too weak or the remedy itself is ineffective. Yet liberals have no other recourse, as long as they remain wedded to the theoretical construct of the "labor market" and are therefore obliged to leave that market's choices about employment and pay fundamentally beyond the direct reach of public action.

Nor can macroeconomic policy come to the rescue, for it is a peculiar feature of modern macroeconomics that in the conservative limit, it disappears. That is, if all of the canons of the new classical economics hold--monetarism, rational expectations, and market clearing--macroeconomics ceases to exist except as a blown-up version of micro. Aggregate supply and demand models behave exactly as micro supply and demand models, yielding an aggregate labor market that clears at the natural rate of unemployment and without disturbing the income distribution decided by efficient micro markets. The message to the policymaker is "Hands off."

To be sure, even conservative policymakers do not completely abandon macro responsibility and historical experience. Partly this is contact with reality--one might say gut instinct--and partly it is the influence of ideas, such as those concerning rigidities, externalities, and public goods, that compromise the purist position, violating one assumption or another in a quest for a context within which limited macroeconomic action becomes possible. So an asymmetric debate over macroeconomic policy lives on in practice--asymmetric because those advocating intervention must acknowledge that their grounds are *ad hoc* , impure, theoretically

problematic, a matter of coarse pragmatism at best. Acceptance of the broader conservative theoretical structure reduces macroeconomic policy to a fringe role, that of large-scale intervention only in deep and lasting recessions. In all other circumstances, the macro authorities are warned off and the active pursuit of full employment disappears from the list of respectable policy goals.

My dissent does not labor under these policy constraints, either macro or micro, for I have come to reject the macro-structure dichotomy on theoretical grounds. To acknowledge the full extent of my heresy, I have come to believe that the core analytical categories of microeconomics--supply, demand, price, and quantity in flow markets for current inputs and outputs--have little bearing on the most important policy questions and that many policy measures directed at improving the performance of such markets are misconceived. The markets that truly matter are either asset markets, for which the rules are quite different, or, as in the case of the "labor market," not markets at all but a set of social relations, a social matrix, that we may call the *job structure* . And the policies that truly matter, both for aggregate performance and for distribution, are mainly macroeconomic.

The "Labor Market"

The concept of the labor market completely colors thought and argument on the relationship between employment, unemployment, wages, and inflation. But what is the labor market? What does it mean in principle to say that the labor market is tight or slack or in equilibrium? These notions rest on the familiar underpinnings of supply and demand, which enable us to make fast and intuitive connections between quantities and the movement of prices. For instance, a slack labor market is one in which labor is in excess supply (there is unemployment), and, therefore, there is downward pressure on the real value or purchasing power of the money wage. A tight labor market is one in which labor is in excess demand, and, therefore, real wages are rising. The problem is that these connections, fast and intuitive though they are, are theoretically unfounded and empirically wrong.

In general terms, a market is defined by the plausible presence of demand and supply curves, which is to say, of schedules of price and quantity, of bids and offers, on both sides of the transaction. It is this, and only this, that makes possible systematic statements about the effects of change (such as "a decrease in price will raise the quantity demanded"). Such statements are plausible in the case of, for example, apples (even though there are many varieties and grades of apples) and fish (though an even wider variety exists) because in the aggregate different apples, or different fish, are reasonably close substitutes for one another. Therefore, we can plausibly imagine prices adjusting in response to shortages and surpluses or changes of consumer mood. The labor market--especially when considered as an aggregative entity covering an entire region or country--has never been a market in this sense. Each individual worker brings a complex package of characteristics, skills, job history, and reputation to each possible job match. Jobs themselves are, perhaps, not so complex as the people who hold them, but they, too, are highly differentiated. Neither individuals nor jobs are close substitutes for one another.

The idea that people can readily be switched from one line of work to another would appear to stem from the idea that labor time is a commodity with a coherent meaning, and this notion is an extension of nineteenth-century abstractions about labor that have lost their slight purchase in real world conditions over the course of the present century. The manual worker with general skills hired out by the day for odd jobs at a negotiable wage is a fringe case. Everybody else is linked to a social network that dictates within broad bands terms of employment specific to his or her skills and background. The small actions that lend intuitive plausibility at the micro level to the concept of a market for fish ("Atlantic Salmon $5.99! Special Today!") are never observed in the so-called market for labor. Wages are not set in response to the short-term variations of supply and demand, but rather by a complex process of relevant comparisons, within and across occupations, industries, and the characteristics and qualifications of the worker.

The Job Structure

What is the job structure? It is a historically, socially, and politically specific set of status and pay relationships in the economy, within and between firms, within and across industries. I assert that a job structure always

exists, and has to exist, in every society. Otherwise, relative pay would be wholly underdetermined--market forces being insufficient to do the job of setting wage rates and job characteristics--and chaos would prevail. I also assert that elements of the job structure are familiar to almost every worker, for one need only analyze the components of one's own pay--occupation, industry, seniority, performance--to see a part of it. The analytical challenge is to come up with a coherent description of the whole thing, a task that is not so straightforward.

Job structures may be more or less flexible at different moments of time. They are obviously not immune to pressures from markets or the fluctuations of the business cycle. But they have the effect of distributing those pressures across themselves (like shock waves hitting a building). Occasionally a structure may collapse under pressure, but for the most part the effect of having structure is to slow down changes and to distribute them in ways that may not appear predictable to those focused intently on market characteristics. Yet because structures are well understood by the people within them, their existence lends coherence and legitimacy to the economic world. Indeed, a stable and accepted structure of wages is one thing that distinguishes a politically stable society from an unstable and disordered one.

The Job Structure and Policy

What then is the meaning of the job structure for economic policy? As the job structure replaces the labor market, the received wisdom about natural rates and barriers to full employment fades away and with it the excuse for ducking the basic task of reaching and holding full employment. Subsidies to education, training, infrastructure, and scientific research must be designed and evaluated on their social and political merits; it becomes inadequate to justify them on a blanket supply-side assertion that they will help productivity or competitiveness and indefensible to assert that they alone can take care of the larger problems of growth, employment, and inequality.

Equally fundamentally, the issue of the appropriate differentials between groups returns to the political context. What should garment workers be paid relative to auto workers (or to lawyers)? What should secretaries be paid relative to their bosses? How much is it acceptable for a chief executive officer to earn, not just in terms of the health of the company he works for, but in terms of the health of society? More broadly, what should be the distribution of incomes? How much range should there be between the bottom and the top? Between high risk - high return and low risk - low return? Between capital and labor? Between skill and no skill? If these are not market questions, they are and must be political questions that should be faced squarely despite the immensely difficult ethical questions that they inevitably raise.

Political issues have to be resolved by political means. Collective bargaining is one such means, income and wealth taxation is another, and minimum wages are a third. If these are not available, something else has to be devised. The Keynesian guidepost policies of the 1960s were an explicit effort to influence wage structures, and despite the oblivion into which they have since disappeared, it may be that they were a critical element in the huge comparative macroeconomic success of those years.

A structural approach to relative wages also has implications for antiinflation policy, as long understood by the older generation of labor economists in the United States and by trade unions who established coordinated or solidaristic wage bargains in Japan and Europe in the postwar period.

A key question concerns *adjustment* of the wage structure. By what principle should real wages change? Surely, on average, at the rate of productivity growth, but should productivity gains be distributed to the individual, to the industry, or to the economy as a whole?

A structural perspective points to a general preference for structural stability, once (if!) a reasonable consensus about appropriate differentials has been reached. It is probably better to distribute productivity gains as broadly as possible, to make them largely social rather than industrial or individual. It is clearly better to avoid arbitrary perturbations to the structure, such as arise when there are shocks to the general price level and some groups are better indexed than others. A discretionary, prospective indexation scheme could prove a useful tool in keeping the structure stable.

What of employment? If structure stabilizes relative wages and neutralizes wage pressures percolating backward from growth sectors, there is no longer any inflationary labor market barrier to full employment. The reserve army of the unemployed loses its function, both because the wage structure remains stable without it and because the stabilization of the income structure removes the incentive for employers to maintain a climate of fear. The issue is therefore not how many jobs but who to employ and on what and for how many hours? The issue of who to train and for what function may have some importance, but much experience holds that people train themselves when they have an incentive (such as good conditions and decent pay) to stay on the job. At present the economy is short of jobs, not of skills.

Stabilization of private investment demand would remain a central macroeconomic issue related to employment. Countercyclical public investment is a possibility, using revolving funds as a finance facility for states and localities. The Swedes used to accomplish the trick with private business through tax policy, allowing tax-free deposits of profits into blocked accounts during booms, to be released for tax-free investment in slumps. This seems more reasonable than countercyclical profits taxes, which might do the stabilizing trick at investment levels too low to assure full employment. Progressive taxation of distributions and realized capital gains--a consumption tax aimed at the rich--seems worth exploring despite the obvious tendency of today's politics to go in the other direction. Given ratchet effects and leakages to imports, countercyclical consumption boosters, like general income tax cuts, seem the wrong way to go.

Alongside stabilization of investment demand one has to think of technological renewal. It makes sense to shut down progressively the back end of the capital stock, for environmental, safety, and competitive reasons. Properly designed regulation can help. At the same time, a flatter wage structure and bigger safety net would reduce the cost of job loss and the resistance from affected workers.

In a world of structural policy, interest rates should lose their present macroeconomic function. They should serve instead to arbitrate the distribution of income between debtors and creditors, capital and entrepreneurship. They should therefore be stable and low. Real rates of return on money should be zero. There is also no reason why long-term rates of interest in real terms should exceed the long-term real growth rate of the economy; indeed, they should lie below the growth rate, effecting a gradual redistribution of wealth away from the creditor and toward the debtor class and a long-term stabilization of household and company balance sheets. Speculation in fixed asset markets, an ancillary risk, should be heavily taxed.

If nominal wages rise in line with productivity, average prices will be stable outside of shocks to nonwage elements of cost. Commodity stockpiles could help curb the shocks. If debt creation is well regulated in the aggregate, there is no harm in relying on low nominal interest rates to keep the class structure in order. Difficulties in the debt structure can be weathered through a modest upward tilt in nominal prices and wages. As Congressman Henry B. Gonzalez has well said, zero inflation is for the graveyard.

Trade bears watching under structuralism, particularly as persistent deficits in the current account can undermine the political commitment to full employment. I am reluctant to impose barriers to trade, for technological reasons: too much structure, too little creative destruction, and one ends like the Soviet Union. On the other hand, industrial development strategies clearly matter. The more advanced industries are, the fewer production workers they need, the more service workers the economy can afford, and the higher the national standard of living relative to the world. Equally, the more public goods consumption relative to private goods, the fewer imports are needed for a given living standard and the fewer exports one is obliged to do. A high-technology, high-export development path requires attention to stabilizing aggregate demand in overseas markets, and particularly in the developing world, where there has been catastrophic indifference to this problem in the past 25 years.

All of this is not to denigrate the traditional liberal emphasis on education, infrastructure, and the environment; it is only to question whether these goals can be usefully pursued by dressing them up as a substitute for economic pol-icy. Indeed unless accompanied by a successful economic policy that produces full employment and strong growth in government revenues, it seems certain that these causes will continue to lose the budget battles, as well as fail to achieve the larger economic results that their advocates sometimes promise.

It may seem unrealistic to propose these policies now, but the point is that there is no good in thinking

half-thoughts or agreeing to half-measures from the outset. The liberal microeconomic supply-side can perhaps make itself useful by getting a little money into education, training, infrastructure. But the point is to raise living standards, increase security and leisure, provide jobs that are worth having. And one cannot do that while the grand viziers of macroeconomic policy are left free to disrupt output and employment and to redistribute income from working people to the rich.

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Galbraith's new book, *Created Unequal: The Rise of Wage Inequality in America*, is sponsored by the Twentieth Century Fund and will be published in 1998 by the Free Press. Among his publications are *Balancing Acts: Technology, Finance and the American Future* (Basic Books, 1989), *Macroeconomics*, with William Darity Jr. (Houghton Mifflin, 1992), and many articles in such journals as *Cambridge Journal of Economics, Journal of Economic Perspectives*, and *The American Prospect*.

The full text of this paper is published as Levy Institute Public Policy Brief No. 36.

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ISSN 1094-5237
ISBN 0-941276-35-X