Some Elements About the Classical Employment Theory and the Keynesian Perspective

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Abstract

The fundamental aim of this paper is to lay out essential elements concerning classical economic theory about employment, and compare them with the Keynesian approach. In other words, this document shows a comparative-contrasting study of the classical and more modern theoretical claims, concerning employment. Since employment is a crucial variable related to economic growth and development, this paper is focused on a revision of conceptual issues concerning such a critical indicator. The approach presented here is important not only for professional economists but also for other social scientists. One of the major conclusions of this study is referred to the evidence that the Keynesian "General Theory" is not precisely the most completed and updated theoretical approach to solve problems of employment, but it has a particular richness in its contents that is important to rescue; in fact that theory was extremely useful to undertake unemployment and economic growth problems during the Great Recession in the United States.

Keywords: *Classical Theories, Employment, Employment Supply, Employment Demand.*

A. INTRODUCTION

The purpose of this article is to present some elements about the theory of classical economists in relation to employment and compare their ideas with what within economic thought has been called the Modern Theory of Employment: The Keynesian Version (Rowthorn, 2020; Gali, 2018). In other words, it is intended to retake some of the arguments of the classical authors regarding the theory of employment, trying above all to establish the similarities and differences between these theories and the Keynesian conception, without any pretense of originality of my own part, but rather with the purpose of reflecting on the issue of employment, so pertinent and at the same time worrying, not only for economists, but for professionals from different disciplines (Gali, 2018; Lavoie, 2019).

The article refers to the main foundations that define the labor market and the problem of unemployment, presenting a contrast between the orthodox current of thought and the Keynesian theory (Marshall & Rochon, 2019; Stockhammer & Ali, 2018). It is concluded that the General Theory is not the only or the most complete argumentation of unemployment as it appears in the economy today, but it has the merit of having provided an explanation and alternative solutions to the scourge of unemployment experienced in United States in the thirties of the last century (Eichengreen, 2020; Fazzari, 2020).

There are many economic theories to explain the phenomenon of unemployment, considered a serious scourge in the labor market. In this article a comparison is made between the theory of employment formulated by classical economists and the modern theory of employment formulated by Keynes (Aksakal, 2019; Guizzo, 2020). It is necessary to clarify that the denomination "Classical Economists" will be used in the strict sense in which John Maynard Keynes worked it in his work "The General Theory of Employment, Interest and Money"; that is, alluding to the economists prior to Keynes, founders of a theory that culminated in Ricardo:

The classical economists was a name invented by Marx to refer to Ricardo, James Mill and their predecessors, that is, to the founders of the theory that culminated in Ricardo. I have become accustomed, perhaps committing a solecism, to include in the "classical school" the followers of Ricardo, that is, those who adopted and perfected Ricardian economic theory, including, for example, J. S. Mill, Marshall, Edgeworth and the pro- Professor Pigou.

The article addresses in the first part the analysis of the Classical Theory of Employment and reviews the concept of the labor market of the classics from the functions of demand and supply and its main theoretical postulates; the determination of equilibrium, the problem of unemployment and the notion of voluntary unemployment based on the explanation that economists proposed in 1930 in the face of the massive increase in unemployment. In the second part, the Keynesian version of the theory of employment is presented, where the classical model is restated under certain restrictions that leave the orthodox theory without foundation, giving rise to the need to formulate a new explanation that is contained in chapter II of the book, Book I of Keynes's General Theory (King, 2022; Dimand, 2020).

This is not to say that Keynes was the first economist to refute classical employment theory, nor is he the last to do so. What stands out is the fact that Keynesian arguments were stronger than those of their predecessors in challenging orthodox employment theory and that their contribution was so significant that even today economics faculties review their postulates.

B. LITERATURE REVIEW

In Keynes's General Theory, chapter II, book I The Postulates of Classical Economics, the author refers to the fact that orthodox economists exhaustively worked on the origin and distribution of wealth through remuneration to the different owners of the factors of production, the amount of available resources that are scarce and the problems in their allocation in the face of unlimited needs, the limits of natural wealth and the accumulated production equipment, among other economic issues; However, the factors that determine the real occupation of the available resources in an economy have been studied very little (Farmer & Nicolo, 2018; Comert, 2019).

Perhaps, says Keynes, that this gap exists because the occupation was not an obvious problem that concentrated the attention of economists in the time before the world crisis of 1930, the year in which the massive and uncontrollable increase in unemployment of the factors of production, but mainly of the labor force, led the analysts of that time to notice this phenomenon, since the classical explanations of the theory of employment, although very logical in their foundations, failed when applied to the real world (Zhao & Drechsler, 2018). As stated above, Keynes warns that his work is not the first approach to an explanatory theory of employment, because the author recognizes arguments that, although simple, analyzed the labor market situation systematically and almost without having been objected to at the time, giving them full validity until the time of the world crisis:

But the explanation of what determines the actual occupation of the available resources has rarely been carefully examined in pure theory. To say that it has not been considered at all would of course be absurd; because every study on the ups and downs of the occupation, which have been many, has had to do with the subject. I do not mean to say that it has been overlooked, but rather that the fundamental theory on which it rests has been believed to be so simple and self-evident that there was almost no point in mentioning it (Hein & Lavoie, 2019).

In this way, the orthodox theory of employment is presented in a significantly logical way, based on principles and postulates that are sustained depending on each other, that is, when one of them collapses, the entire edifice of classical thought would collapse, and this was precisely what happened in 1930 when the logic of classical thought was unable to explain reality (Marcuzzo, 2018).

Of all these postulates, perhaps the most complete, systematic and logical regarding the theory of occupation are contained in the conceptions of Professor Pigou, which are analyzed in more detail, because they became a real challenge for Keynes, all the more so when we know in advance that Keynes was a disciple of Pigou. Based on these considerations, classical theory defends the fundamental premise that the flexible price system would inevitably lead to full employment (Palley, 2019). If the price paid for the use of labor power is the wage, then a flexible wage system would ensure the ideal situation of full employment, barring occasional disturbances in the labor market (Prates, 2020).

In this order of ideas, in a situation of perfect competition, full employment would be reached spontaneously, that is, if there was unemployment, wages would tend to fall, because there would be workers willing to join the market for lower wages and in these circumstances the companies would be able to increase the demand for the labor factor, thus generating a situation of full employment.

C. METHOD

This research uses qualitative research with descriptive analysis approach about Keynesian theory from the perspective of classical economic theory based on Keynesian perspective. Sources of data used in this study is secondary data. The presentation of data in this study uses a qualitative approach.

D. RESULT AND DISCUSSION

It starts from considering that orthodox theorists assign a fundamental role to the market, since they consider it the quintessential regulator of the economy and of course the best distributor of resources.

In the microeconomic approach, the free market forces based on the assumption of laissez-faire would inevitably lead economies to the ideal equilibrium situation, where optimization of all scarce resources and the privileged position of the full employment of the factors of production, or at least a very high level of employment. In the labor market, also guided by laissez-faire, the classics analyze the curves of demand and supply of employment, in the following way:

1. Employment Demand Curve

The employment demand curve is represented by the companies, that is, these production units are the ones that demand labor to operate the equipment and machinery that allows them to produce.

To study the demand for employment, the classics start by considering that the salary is equal to the marginal productivity of labor, which corresponds to the value that would be lost if the occupation were reduced by one unit, and therefore, this is fully known by the employer and based on the law of diminishing marginal returns (the marginal productivity of labor) decreases as employment increases.

Then, the classics affirm that the lower the occupation, the higher the marginal productivity of work, for which a higher salary would correspond, but this would also lead to the employer being able to hire fewer workers and if the occupation increases the marginal productivity of the work decreases. Therefore, the salary would be lower and as a logical consequence it would lead to an increase in the demand for workers. An inversely proportional relationship is established between the level of salary and the level of employment, thus:

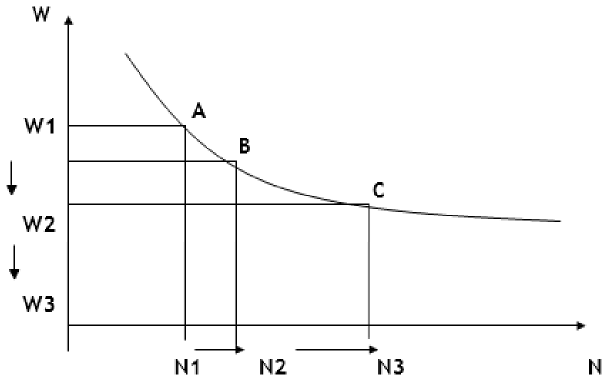

Figure 1. Employment Demand Curve

Real wages and employment for the classics are closely related, an increase in employment is linked to lower real wage rates, so a decrease in wages increases employment levels and therefore an increase in wages decreases employment levels, also presenting an inversely proportional relationship between the real wage and the level of employment, as shown in figure 1. Under conditions of perfect competition there will always be a strong tendency for wage rates to relate to demand in such a way that all find employment. The implication is that such unemployment as it exists at any time is due entirely to the fact that demand conditions are continually changing and that frictional resistances prevent appropriate adjustments in wages from being made instantaneously a completely flexible wage policy would abolish fluctuations in employment altogether.

2. Employment Supply Curve

The offer of employment within a labor market is carried out by the workers who are the people who make their workforce available to the companies, that is, their physical and intellectual capacities. The classics begin by making the assumption that Salary Utility must be at least equal to the marginal disutility of the volume of employment.

Salary Utility = Marginal Employment Volume Disutility

The utility of the salary is related to the benefit that the amount of the payment for the work grants to the employee, considering that the employee establishes an indifference curve taking into account the daily distribution of his time between the utility that being busy provides him represented in his wages and utility provided by leisure. As the indifference curve establishes the same level of utility, the individual is willing to sacrifice hours of leisure for hours of work depending on the salary offered.

Then the classical economists consider that the Salary Utility must be at least equal to the Marginal Disutility of the Employment Volume, but preferably, the Salary Utility should be greater than the Marginal Employment Volume Disutility, such that The higher the Salary, the higher the Employment Offer, since a higher salary allows better satisfying the needs of the workers and, therefore, would be an attraction for the workers to offer employment.

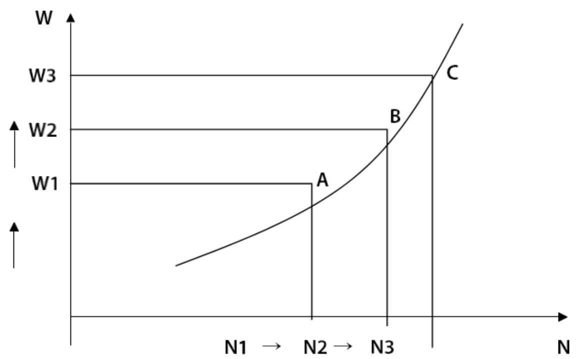

Figure 2. Employment Supply Curve

The marginal disutility of the volume of employment refers to any reason that induces a man or group of men to refrain from working rather than accept a salary that represents for them a utility below a certain limit.

3. Work Market

From the determination of the supply and demand functions, the labor market can be illustrated from the perspective of classical economists. The graph illustrates the demand for employment as a function of the marginal productivity of work according to the classical postulates and, on the other hand, the supply of employment as a function of the marginal disutility of the volume of employment.

When the marginal disutility of the volume of employment exceeds the marginal productivity of work, a situation of imbalance occurs within the labor market that is known as unemployment and that in other words represents an excess of supply compared to the demand for labor job. Similarly, when the marginal productivity of labor exceeds the marginal disutility of the volume of employment, a situation of imbalance occurs in the labor market that translates into an excess of demand compared to the supply of employment.

The only equilibrium situation in the labor market occurs when the marginal productivity of labor becomes exactly equal to the marginal disutility of the volume of employment, that is, when demand becomes exactly equal to supply in the labor market. In other words, Supply becomes exactly equal to Demand at the wage level W0 where the Marginal Productivity of Labor must exactly offset the Marginal Disutility of the Volume of Employment.

For the classical approach, so linked to equilibrium and so confident in the perfect self-regulating automatism of market economies, the adjustment between labor supply and demand depended entirely on the flexibility of wages that would lead to the existence of full employment. . In this way, any reason that leads to disturbing the free functioning of labor market forces would be responsible for the existence of imbalances in the labor market and particularly unemployment, a serious scourge of the economy.

All this approach, theoretically so well founded, collapses at the time of the great world crisis of the thirties, where multiple phenomena appear, among them unemployment, which could not be explained under these postulates that turned out to be too limited. to account for what was happening in this period, and what is worse, they did not serve to solve these problems that threatened to become permanent.

In the year 1929 there were approximately 1,550,000 unemployed in the United States; The explanation of classical economics for the massive and apparently permanent increase in unemployment consisted of the proposition that it was in a certain way voluntary on the part of the workers, arguing that they did not want to work because: a) They were owners of other factors of production and therefore live on the income provided by their land, or the interest on their capital, and/or the profits of their companies; b) These people are not interested in working for low wages; and c) They were people who are not willing to move from their places of origin.

In short, there were a number of unemployed people in the environment, but their leisure situation was voluntarily accepted. Faced with the criticism raised by some detractors of the classical school, in the sense that this was not evident at the level of each individual and that in addition by the year 1933 the United States already had 14,000,000 unemployed in its streets, which were by no means voluntary, the classics found it necessary to seek much more logical and convincing arguments and defended themselves by proposing the following:

Voluntary unemployment was caused by the resistance of the workers to accept lower real wages, who in this way and coordinated through the union organizations prevented the excess supply of labor force over its demand from being translated into a reduction. of the price of labor power, that is, in a reduction of his Real salary.

Since the real wage could not be reduced because the unions prevented it, then; the market mechanism to reduce the excess supply, which would be the price reduction, was unable to operate. In this way, it was concluded that union action hindered the free functioning of the market, interfering with its mechanism to eliminate excess supply and ending up perpetuating it; that is, by perpetuating unemployment.

The workers, with their concerted and organized action through the unions, would have created their own unemployment, for which this would be "voluntary" at the group level, although this would not be evident at the level of each individual. Until the crisis of 1930, this theory had the great advantage of having logic, but also the disadvantage of being unable to understand reality, which is why it was subjected to serious doubts that gradually affected the foundations of this logic of thought until that finally the economic world not only needed but demanded an explanation and what is better a solution to the terrible scourge of unemployment.

4. Modern Employment Theory: The Keynesian Version

Keynes, with his revolutionary thought confirmed in the countless works published before the General Theory, had given convincing signs of his permanent doubts regarding the automatic adjustment on which the orthodox thought of the time was based. In his General Theory he exposes and attacks Say's Law, principally, the role played by wages in making the automatic adjustment towards full employment.

The collapse of Say's Law implied that all other postulates of classical orthodoxy would begin to falter, which is why the principle of effective demand, an argument that refutes Say's law exposed in Keynes's work, is the point of departure of the modern theory of the use and is contemplated in the Book I chapter III. If Say's Law in its simplest theoretical notation can be expressed as that every supply automatically creates its own demand, this led to the assumption that there would be no obstacle to the increase in production and therefore to the increase in employment within an economic system, since demand does not become a hindrance to it.

Say's Law was interpreted by Keynes as the identity of the supply and demand functions, which was considered by this author as the fundamental false assumption of the orthodox theory, which can be better explained through the following graph:

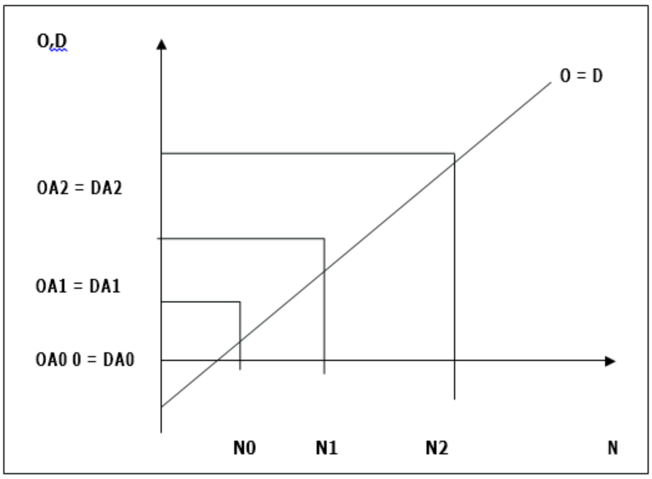

Figure 3. Say's Law Representation

If the quantities or volume of employment (N) are measured on the horizontal axis X in terms of man-hours of work per unit of time, it can be seen that by increasing the volume of employment N, the aggregate supply increases, that is the aggregate supply is a growing function of the level of employment, in this way to the level of employment N0 corresponds a level of aggregate supply OA0, when the level of employment increases to N1, the aggregate supply also grows, locating itself in OA1, corresponding to each level of employment a level of aggregate supply.

As Say's Law states that all aggregate supply is identical to an aggregate demand that allows productive units to sell their entire production at profitable prices, then the aggregate supply OA0 would be identical to an aggregate demand DA0, the aggregate supply OA1, will be identical to the equivalent aggregate demand DA1, and so on, for all possible aggregate supply, an identical aggregate demand would correspond. For this reason, the aggregate demand function would be exactly superimposed on the aggregate supply function or, in other words, would be totally confused with it, turning the two functions into the same function.

Therefore, the demand would not establish any obstacle to reach the desired level of employment N and this would increase to its maximum limit, that is; until the availability of labor force that exists in the market is exhausted. In this way, compliance with Say's Law would guarantee that the economy always reaches the Full Employment level. The classical doctrine that used to be expressed categorically by the statement "supply creates its own demand" and which remains the mainstay of all orthodox theory, implies a special assumption regarding the relationship between these two functions; because "supply creates its own demand" must mean that f(N) and ◎(N) are the same for all values of N, that is, for any volume of production and employment; and that when there is an increase in Z (= N) corresponding to another N, D (=f N) necessarily grows by the same amount as Z. The classical theory assumes, in other words, that the demand price price (or product of sales) always adjusts itself to the price of the global offer, in such a way that whatever the value of N, the product D acquires a value equal to the price of the global offer Z corresponding to N. That is to say, that effective demand, instead of having a single equilibrium value, is an infinite scale of values, all of them equally admissible, and that the volume of employment is indeterminate, except to the extent that disutility of work set an upper limit.

Keynes, for his part, affirms that the aggregate supply and demand functions are not identical, therefore, it is not true that the economy automatically tends towards the level of full employment because aggregate demand becomes an obstacle to achieving this level objective. The basic argument of Keynes's General Theory consists in proposing that Say's Law does not hold, that is; that the aggregate supply and demand functions are different.

Both functions have a positive slope, but the aggregate supply function has a greater slope than the aggregate demand function. Supply has a slope equal to one and demand has a slope less than one, due to the fundamental psychological law of economics, which states that as a general rule and on average, individuals tend to increase consumption each time their level increases income but the increase in income is always greater than the increase in consumption.

That is, by increasing the level of employment N, Keynes argues that aggregate supply increases and aggregate demand also increases, but it increases less than aggregate supply increases, so aggregate demand also has a positive slope, but this slope is less than that of the aggregate supply, which is what the Fundamental Psychological Law represents. In this way, aggregate demand grows more slowly, becoming an obstacle to the increase in production and the corresponding jobs.

When the level of employment increases and goes from NE to N1, a gulf (AB) opens between the aggregate supply and the aggregate demand that will continue to grow if the level of employment continues to increase. The indefinite increase in this gap means that entrepreneurs cannot sell all their production in the market at profitable prices, then unwanted inventories appear or that production begins to be sold at prices lower than those that allow obtaining the normal profit. . In this way, entrepreneurs adjust supply to real demand, existing in the market, reducing production, and therefore employment.

If the reduction were significant up to any point to the left of NE, such as N2, then the opposite would occur, the aggregate demand becomes greater than the aggregate supply, which would imply for the productive units an increase in their sales, a decrease in their unwanted inventories, increased prices, increased profits, stimulated production, increased production, and increased employment.

This leads to the economic system being automatically located at NE = Equilibrium Employment Level. At the equilibrium level of employment, the aggregate supply is equal to the aggregate demand and this aggregate demand is exactly sufficient to absorb the current production of the companies, yielding the normal profit. E: is the only common point between the aggregate supply and demand functions. This point is called by Keynes Effective Demand.

Let Z be the global supply price of the production resulting from the employment of N men, and the relationship between both symbols Z =◎ (N), which can be called a function of global supply. Let us call D the amount of the product that employers expect to receive with the employment of N men, and the corresponding relation, D f (N), which we will designate as a function of global demand. Now, if for a certain value of N the amount that is expected to be received is greater than the global supply price, that is, if D is greater than Z, there will be a stimulus for entrepreneurs in the sense of increasing employment above N and, if necessary, raise the costs by competing with each other for the factors of production, up to the value of N where Z is equal to D. Thus the volume of employment is determined by the intersection of the function of the global demand and the global supply function, because it is at that point where the entrepreneur's profit expectations reach the maximum. The value of D at the point of intersection of the global demand function with the global supply function will be called the effective demand.

From this argument, three main conclusions can be drawn: 1) Effective Demand is that level of aggregate demand capable of exactly absorbing the aggregate supply or the current level of production, yielding the profit expected by businessmen, that is, , without excess supply, or excess demand; 2) The level of employment is determined by the effective demand, since the economic system always tends automatically towards the level at which the Aggregate Demand becomes equal to the Aggregate Supply (Book I Chapter III of the General Theory); and 3) NE: It is the Equilibrium Employment level, but it is not the Full Employment level, because the limit to the Full Employment level is given by the availability of the labor force and not by the level of effective demand.

In this way, the economy operating through the free game of supply and demand leads to placing the economic system at a level of equilibrium employment that is generally below the level of full employment. Therefore, the free operation of market forces does not guarantee the long-awaited full employment, but on the contrary, there will always be levels of involuntary or forced unemployment within economic systems, even when they are in a state of equilibrium.

E. CONCLUSION

The Keynesian theory of employment provides an argument that is much more compatible with the characteristics of unemployment in the world crisis of the 1930s and had the enormous privilege of providing not only an explanation for this phenomenon, but also, of course, alternative solutions that led to that the General Theory becomes one of the most important works during the first half of the 20th century, baptizing it with the name of the Keynesian revolution. However, unemployment is the serious scourge of economies worldwide and one of the phenomena that persists the most, becoming the stone in the shoe of the macroeconomic performance of all countries regardless of their level of economic growth, which is why the theory economy as a whole has fallen short when it comes to proposing a logical explanation for this serious problem accompanied by a practical solution that leads to celebrating the end of this disease that is so overwhelming for economic systems, fundamentally for those with difficulties in their macroeconomic performance as is the case of several nations. It is precisely this reflection in light of the situation in Latin America in general and in Colombia in particular that will motivate my reflection in the future, contrasting this case in particular, which deserves an interesting study, with the classical and Keynesian theoretical positions.

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