

## Unemployment: Are Trade Unions and Minimum Wage Laws the Culprits?

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Arne Heise

## Unemployment: Are Trade Unions and Minimum Wage Laws the Culprits?

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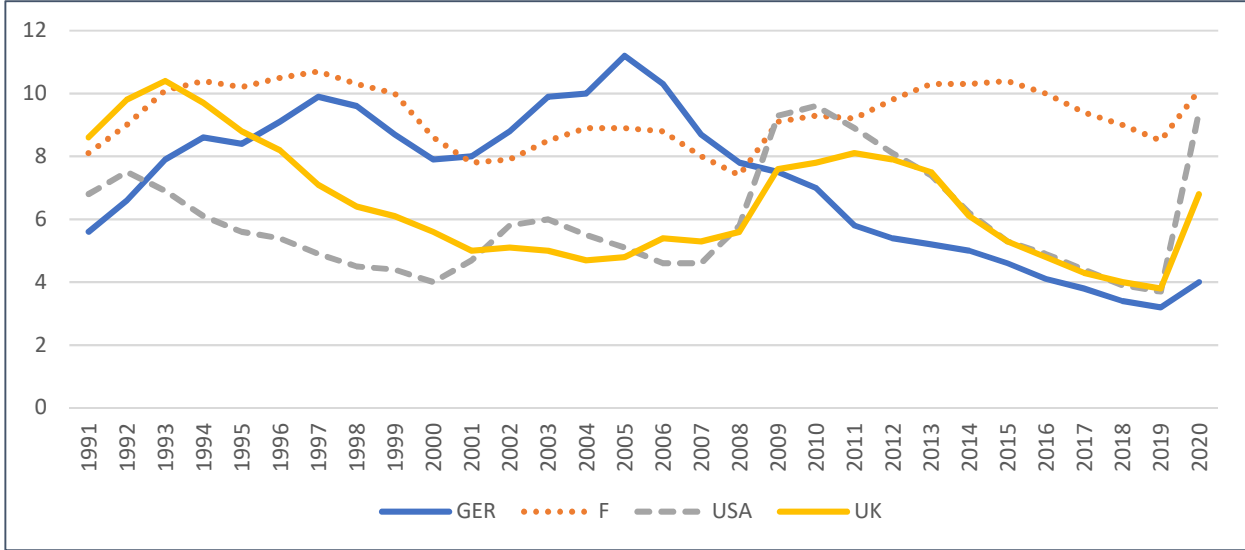
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# Unemployment: Are Trade Unions and Minimum Wage Laws the Culprits?

## 1. Introduction

When unemployment rates reached double-digit levels in many OECD countries at the beginning of the 1990s, fighting unemployment became the prime target of economic policy-making and a major focus of economic research<sup>1</sup>. The OECD (1994) launched a major study – the OECD Jobs Study – which concluded “that the main factor underlying persistent high unemployment has been the inability of the product and labour markets in many OECD economies to adapt to change (...). This inability has been reflected in increased structural unemployment.... The Jobs Study recommended a broad programme of macroeconomic and structural policy reform designed to reduce unemployment sustainably. It stressed that broad and deep structural reforms across a range of markets, including specifically the labour market, are needed to increase the ‘speed limits’ of sustainable economic growth and reduce persistently high structural unemployment” (The Commonwealth Treasury of Australia 1997: 27f.) – the idea of lasting unemployment being strongly related to inflexible, over-regulated labour markets has been termed IMF-OECD consensus and shaped common knowledge about and policies to combat unemployment during the so-called neo-liberal era.

Figure 1: Unemployment in selected OECD countries, 1991 - 2020



Source: European Economy, Statistical Annex, Spring 2020

As can be seen from Fig. 1, unemployment performance in terms of levels as much as developments has been internationally quite diverse. However, peak levels – except for France in this small sample of OECD countries – appear to belong to the past and in some countries there is already talk again of full employment at least during ‘normal’ times of non-crisis.

1 Just to name a few of the many theoretical, empirical and comparative studies on the subject at the time: Barro (1988), Bean (1994), Bean/Layard/Nickell (1986), Blanchard/ Summers (1988), Blinder (1988), Calmfors (1993), Dréze/Bean (1990), Howell (2005), Karanassou/ Snower (1993), Layard/Calmfors (1987), Layard/Nickell/Jackman (1996), Rowthorn/Glyn (1990).

With France often taken as a symbol of an over-regulated ‘coordinated market economy’ (CME) and the UK and the US as effigies of the more market-oriented, flexible ‘liberal market economy’ (LME), divergence in unemployment performance as depicted in Fig. 1 fit the IMF-OECD consensus well. Moreover, Germany – though also often taken an archetype of the ‘coordinated market economy’ - has undergone labour market reform in line with the IMF-OECD consensus in its policy programme called *Agenda 2010* introduced around the beginning of the new century and, therefore, seemed to have been able to reap the fruits of flexibilisation and deregulation in terms of massively falling unemployment from 2005 onwards.

In the following, I will present the theoretical arguments – neoclassical labour market theory - underlying the IMF-OECD consensus and some alternative approaches to challenge it. This is done – despite the empirical picture which superficially corroborates the consensus – on grounds of a skepticism about the accurateness of neoclassical labour market theory that stems from the literature on the impact of minimum wages on employment (see e.g. Heise 2022): neoclassical labour market theory in all its different variants predicts employment losses when minimum wages are established, yet this impact can empirically not be confirmed – Manning (2021) speaks of an ‘ellusive effect’. It will be shown that alternative approaches based on heterodox models may be better suited to understand the determination of unemployment in capitalist economies and may better address the role of institutions, regulations and collective actors.

## **2. Determination of employment in mainstream and heterodox perspective**

My approach will be to paradigmatically contrast different ways of explaining the causes for unemployment. Of course, I will have, first of all, to elaborate on the different forms of unemployment and to restrict my analysis. We can distinguish between temporary and permanent, between equilibrium and disequilibrium, voluntary and involuntary unemployment which are all partly overlapping. We will not be concerned here with temporary or voluntary unemployment due to seasonal or cyclical fluctuations, regional or qualificational mismatch or technological, labour-saving innovations but only with a permanent excess supply of labour that is willing to work at the existing wage rate. This includes the acceptance of the Beveridge definition of full employment which holds that a situation of coexistence of a number of unemployed labourers with the same number of job vacancies would still be called full employment although this kind of frictional unemployment may also be involuntary and certainly may last considerable time.

### *Unemployment in the Walrasian paradigm*

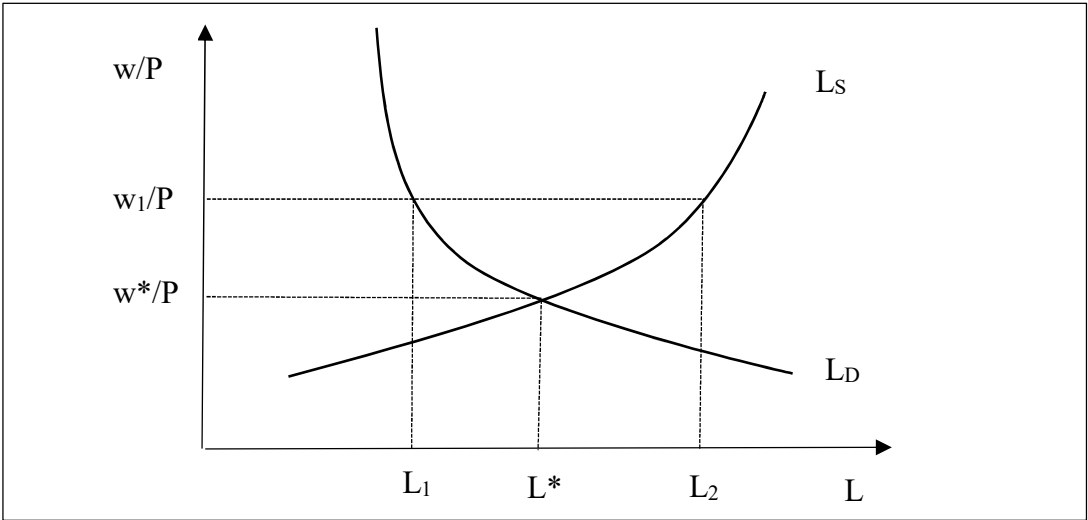
The dominant Walrasian paradigm<sup>2</sup> struggles with explaining any kind of equilibrium unemployment. Ontologically modelling capitalist economic activity principally as intertemporal exchange, the orientation of Walrasian economics is allocative: markets serve as the places where supply and demand of goods and services – including factors of

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2 I include all such theories which accept the validity of Walras’ law. The acceptance of Walras’ law is a device for testing rigorousness and consistency of model-building within the Walrasian paradigm (see Heise 2017).

production – meet according to the principles of optimisation. At the market-clearing price, all supplied goods and services will be demanded. The labour market (see Fig. 2) is – analytically – no exception and allocates labour along the lines of utility (supply  $L_S$ ) and profit maximisation (demand  $L_D$ ). Under complete market conditions, i.e. perfect competition, perfect information and foresight, no transaction cost and some technical requirements<sup>3</sup> – involuntary, equilibrium unemployment would be impossible or, put differently, any existing unemployment would have to be either voluntary ( $L_2 - L^*$  in Fig. 2) in the sense that the unemployed are simply not willing to work at the market-clearing wage rate  $w^*/P$  or transitory in nature ( $L^* - L_1$ ).

Figure 2: Employment and unemployment in a standard labour market model

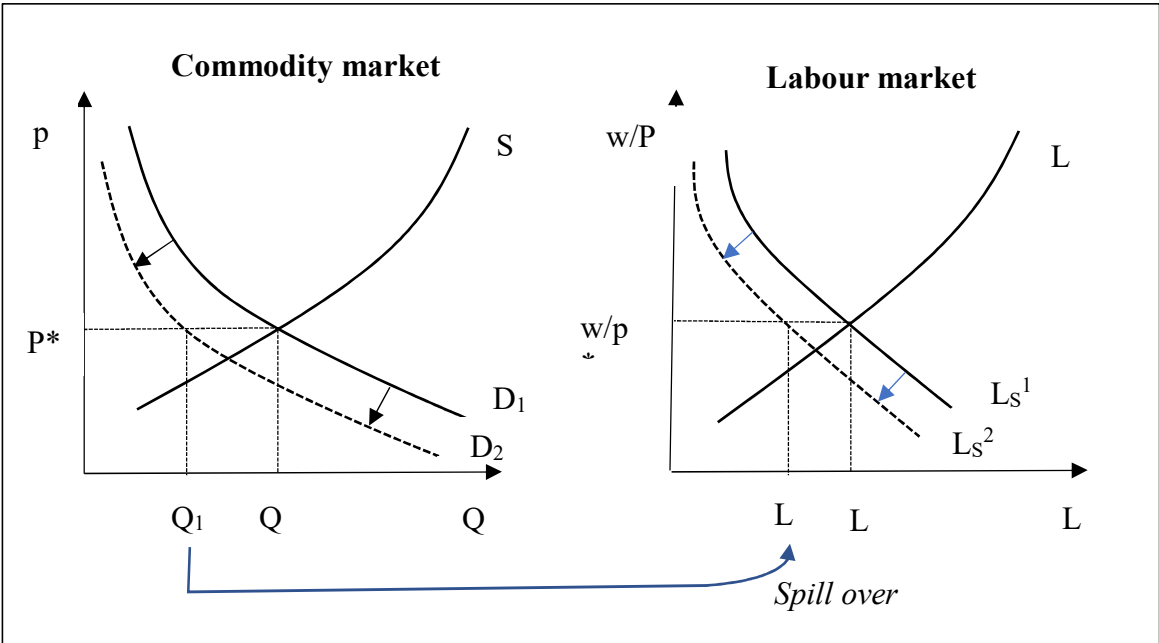


Of course, real-world markets – and particularly real-world labour markets – are not complete markets but characterised by all kinds of regulations (e.g. unfair dismissal legislation, minimum wages), social security systems which to some extent de-commodify labour (by introducing reservation wages allowing them not to sell their service at any price) and collective bargaining systems and labour market institutions which undermine competition of individual market actors. In myriads of theoretical approaches – e.g. monopoly union models, efficiency wage models, insider-outsider models<sup>4</sup> – it has been demonstrated that the real wage rate  $w_1/P$  will settle above the market-clearing level  $w^*/P$  resulting in what has been termed ‘natural’ unemployment by Milton Friedman. In this reading, unemployment is the result of rent-seeking behaviour of market actors (trade unions or insiders), a disciplining device under conditions of incomplete contracting to avoid shirking or simply the – perhaps unintended – result of political action in order to maximise votes in median-voter models<sup>5</sup>.

3 In order to rule instability problems out, the price-elasticity of demand must be higher than the price-elasticity of supply.  
 4 Just to name a few: Akerlof (1984), Akerlof/Yellen (1986), Layard/Nickell/Jackman (1991), Layard/Snowder (1988), Pissarides (2000), Shapiro/Stiglitz (1984).  
 5 It can be seen as ‘involuntary’ only because it cannot directly be influenced by the individual labourer.

This kind of ‘natural unemployment’ differs from country to country according to the degree of labour market regulation, collective bargaining systems and the endowment of social security systems and it cannot be reduced by stabilisation policies without endangering price stability. Instead, employment enhancing policies must be directed towards the determinants of natural unemployment, i.e. must increase competition on the labour market by decentralising collective bargaining systems and deregulating labour markets and must reduce de-commodification by retrenching the social security system – something which has been dubbed ‘active labour market policies’ or ‘activating welfare state’<sup>6</sup> and fits the OECD Jobs Study recommendations cited above quite well. Macroeconomic measures in this setting are basically tailored to create price stability and budgetary neutrality, i.e. monetary policy must provide a rule-based money-supply and fiscal policy is orientated towards balanced budgets.

Figure 3: Employment and unemployment in a ‘rationing’ model



However, Walrasian economics also comprises ‘Keynesian-look-alike’<sup>7</sup> models that are likewise based on the exchange ontology of capitalism, yet try to explain unemployment not as allocative malfunction but as the result of a lack of effective demand. Demand shocks (depicted by a shift in demand curve  $D_1$  to  $D_2$  in Fig. 3) due to abrupt external (e.g. a collapse of exports) or internal changes (e.g. a breakdown of profit expectations of firms or a drastic increase in the savings

6 See e.g. Peck/Theodore (2000),Walters (1996: 207ff.). These labels were mostly used by social democratic parties to euphemise the supply-side character of the policies.

7 I refer to these theories as ‘Keynesian-look-alike’ models not because of disrespect but merely because they are not based on Keynes’s original thinking as N. Gregory Mankiw (1992: 560) declares quite ostentatively: „Since Keynesian economics is derived, by definition, from the work of John Maynard Keynes, one might suppose that reading Keynes is an important part of Keynesian theorizing. In fact, quite the opposite is the case. Few young economists - Keynesian or otherwise - concern themselves with question of what ‘Keynes really meant’. New Keynesians view their work as following in the broad tradition that evolved from Keynes, but their goal is to explain the world, not to clarify the views of one particular man. If new Keynesian economics is not a true representation of Keynes’s views,then so much the worse for Keynes.“



propensity of households) on the one hand or a trading at false (i.e. non-market clearing) prices on the other hand will spill over from the affected commodity markets to the labour market and, thus, ration the supply of labour (from  $L^*$  to  $L_I$  in Fig. 3). The first type of demand-constrained unemployment is presented by ‘standard Keynesian’ ISLM modelling while the latter type refers to what has been called ‘rationing’ or ‘reconstituted reductionist’ approach (see Coddington 1976).

Unfortunately, both lines of reasoning can only explain temporary unemployment based on prices rigidities – particularly the wage rate – and interrupted adjustment processes which, once these rigidities are removed, will take place. Rationing or reconstituted reductionist models are based on the insight that lasting, equilibrium unemployment can only be made plausible when Walras’ law is refuted. Based on Clower’s ‘dual decision hypothesis’, a distinction is made between Walrasian disequilibrium – a situation of false-price trading of unrationed quantities ( $p^*Q^*$  in Fig. 3<sup>8</sup>) – and non-Walrasian disequilibrium – a situation of false-price trading of rationed quantities ( $p^*Q_I$ ).<sup>9</sup> While reconstituted reductionists defend the validity of Walras’ law for situations of Walrasian equilibrium, they claim to have refuted Walras’ law in situations of non-Walrasian disequilibrium. This however, has not been accepted by most heterodox economists who argue that Walras’ law must always hold as long as the budget constraint is derived from the exchange of initial endowments<sup>10</sup>.

Although unemployment explained in ‘Keynesian-look-alike’ models is, thus, only transitory in nature and, therefore, might not need to be addressed by particular measures if the outlook is directed to the long-run, typical Keynesian stabilisation policies – i.e. expansionary monetary and fiscal policies – can be recommended when the long-run is assessed as too long (‘in the long run we are all dead’). Moreover stabilisation policy measures must be gauged and timed in a sufficiently effective way to directly counter-balance the initial demand-shock – something which has been questioned against polity (instrumental and administrative time-lacks) and politics (different rationalities between the political and the economic arena) backgrounds.

### *Unemployment in a heterodox paradigm*

Although the term ‘heterodox economics’ is anything but clearly defined (see Mearman/Berger/Guizzo 2019), I venture to argue – as I have done in more detail elsewhere (Heise 2014, Heise/Thieme 2017) – that a paradigm which claims to be heterodox must reject some (or all) of the core assumptions (axioms) of the orthodoxy and, thus, be based on a different ontology resulting in different postulates that must be accepted. As argued above, the approval of Walras’ law is a heuristic device – postulate – that needs to be accepted if a theory claims to be part of orthodoxy or, the other way round, theories assuming to be

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8  $p^*$  would be a ‘false price’ in this situation as the market-clearing price would have dropped to a level  $p_I$  below  $p^*$ .

9 Both disequilibria have been termed ‘temporary equilibrium’. However, this only makes sense when disequilibrium refers to an inequality of supply and demand and a temporary equilibrium is characterised by a temporary (depending on the duration of rigidities) position of rest.

10 It must be admitted that critical voices remain (see e.g. Túñez Arena 2014, Túñez Arena 2016). However, even one of the champions of Walrasian economics declares: „In brief, a sufficient condition for the validity of Walras’ Law is that the individual’s demand and supply functions on which it is ultimately based are all derived from the same budget constraint, whether quantity-constrained or not“ (Hahn 1977: 13); see also Palley (1998), Rhodes (1984).

heterodox ought to reject the validity of Walras' law and must be based on a different ontological foundation. As far as I am aware, there is only one school of thought that is explicit about its refutation of Walras' law and its ontological basis: fundamentalist or monetary Keynesianism (see Coddington 1976, Davidson 1998, Heise 2017a)<sup>11</sup>. In the following, I will present the determination of unemployment as equilibrium phenomenon in this particular variant of Post Keynesian economics.

Fundamentalist or monetary Keynesianism or, as Keynes himself dubbed it, monetary production economics is based on an ontology which takes capitalism as a system of nominal obligations. The basic constituents are not – as in the orthodox paradigm – market exchange but creditor-debtor-relationships denominated in money, making it the most liquid asset being the 'standard of deferred payments'. The interest rate on parting with money – i.e. providing finance for productive or speculative purposes – "rules the roost" (Keynes 1936: 223) as it sets all other rewards a lower limit and, thus, determines production and employment in the short period and accumulation and growth in the long period and orients towards social provisioning ('management of resources') instead of allocation ('control of resources'). In this setting, employment is determined as the result of entrepreneurial decisions under fundamental uncertainty about future profits, political actions, technological change on the one hand, the need of households to sell their labour at a fixed nominal wage without prior knowledge of the purchasing power of that nominal wage rate and the state of confidence of wealth owners. Equilibrium employment in a monetary production economy is not determined by setting a market-clearing real wage rate simply because no operating labour market exist that equilibrates demand and supply at a pre-determined real wage rate. This kind of labour market is no more than an analytical tool to prove the invalidity of Walras' law and to explain what 'involuntary unemployment' means (see below). Equilibrium employment in a monetary production economy is, therefore, that level of employment which is established when firms' profit expectations are fulfilled and, thus, they have no reason for any change in future action and the employment system shows a certain degree of inertia irrespective of the employment level.

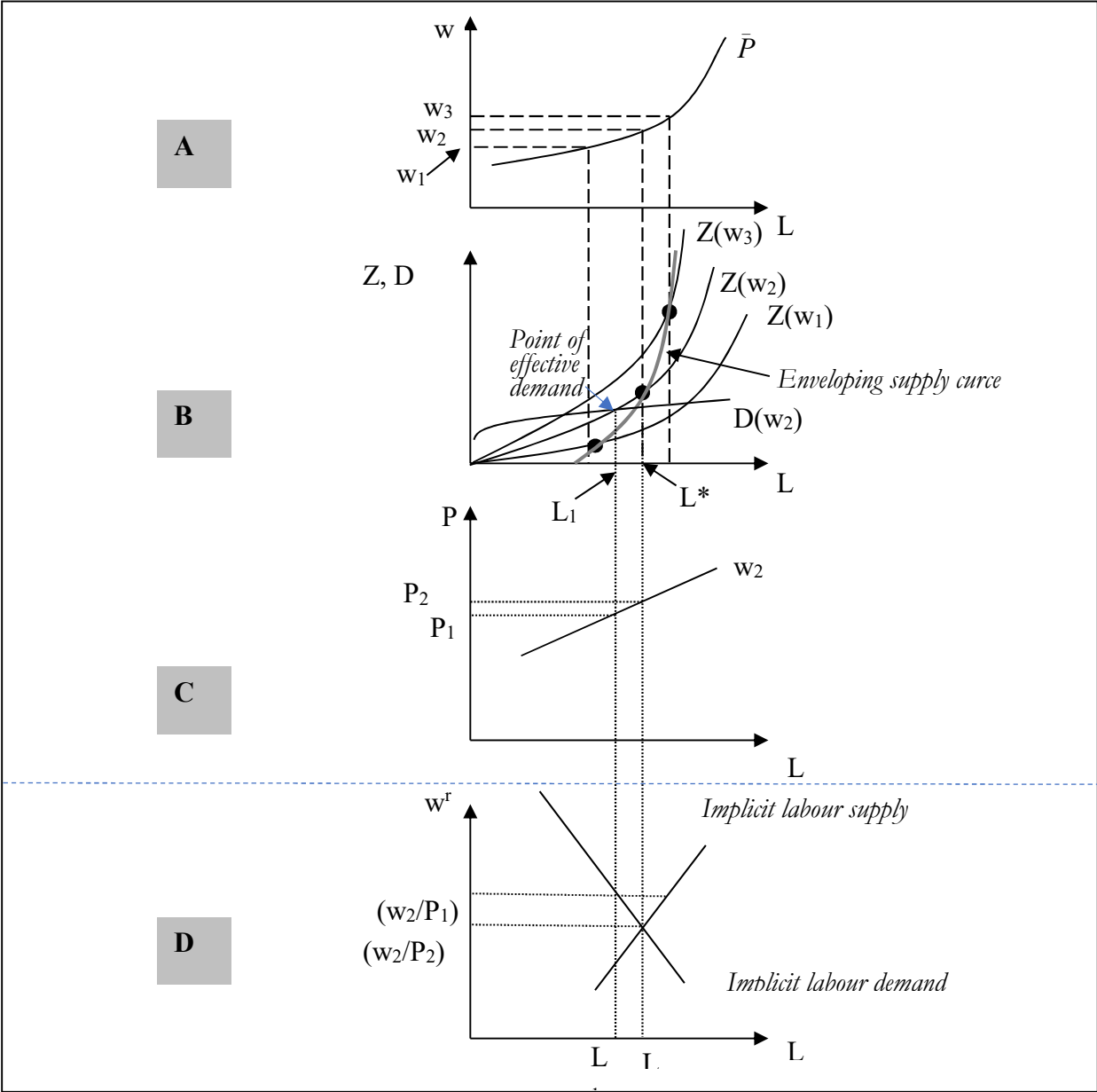
Fig. 4 tries to capture the determination of equilibrium employment in this variant of Post Keynesianism: The upper part A of Fig. 4 depicts the supply of labour as a positive function of the nominal wage rate  $w$  on the assumption of an expected price level  $\bar{P}$ . Part B portrays the aggregate supply curve  $Z$  as explained in Chap. 3 of Keynes's *General Theory* (and well elaborated in Chick 1983) with different nominal wage rates  $w_1 < w_2 < w_3$ . The enveloping supply curve replaces the ordinary assumption in Post Keynesian models of a given amount of labour services supplied (measured in hours or number of labourers) by an endogenous labour supply positively related to the expected real wage rate. It also depicts the point of effective demand where the aggregate demand curve  $D$  (portraying expected proceeds) just equalises the aggregate supply curve. The perspective taken here is that of the firms' and the resulting level of employment  $L_1$  must not necessarily and in most circumstances will not

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11 There are other Post Keynesian models such as Kaleckian 'conflicting claims', Post Keynesian NAIRU and neo-Marxian 'extraction' approaches (see e.g. Badhuri/Marglin 1990, Marglin/Schor 1991, Pollin 1999, Stockhammer 2008). However, they also argue on the backcloth of a real-wage driven labour market without ostentatiously invalidating Walras' law and demonstrating an alternative ontology. Therefore, I rather build my exposition on fundamentalist or monetary Keynesianism, although being entirely aware about some reservations against this approach by proponents of other Post Keynesian schools of thought.

match the labour supply at the existing (given) nominal wage rate  $w_2$ . In part C the price level  $P$  is determined based on the simple assumption of mark-up pricing relating the nominal wage rate ( $w_2$  in this case) positively to the price level. This gives us – in part D – an implicit labour supply curve  $L_S$  and, constructed in a similar way, an implicit labour demand curve  $L_D$ . Part D is separated from parts A – C by a dotted line indicating that this real-wage driven labour market is not an operating market but merely an explanatory analytical tool: It explains, for instance, that, *ceteris paribus*, any increase in employment must be accompanied by a reduction of the real wage rate – however, that does not mean that the real wage can be reduced easily to increase employment.

Figure 4: Employment and unemployment in a monetary production economy



It can also be shown what involuntary equilibrium unemployment means in this setting: Let's assume that wage earners expected the price level to be  $P_2$  at the nominal wage rate  $w_2$  when they made their labour supply offers. After the firms – maximising their expected profits –

demanded a quantity of  $L_1$ , the price level turned out to be  $P_1$  increasing the endogenously determined real wage rate to  $w_2/P_1 > w_2/P_2$ . As the expectations of the wage earners have been disappointed, there would be room for future action – potentially a reduction of nominal wages as their labour supply has been restricted by a lack of effective demand. To call such a situation an equilibrium only can be approved when there will be, despite unfulfilled expectations and a quantitative mismatch between labour supply and labour demand, no change in future actions. And this may be the case, when collective bargaining institutions and relative wage considerations introduce some inertia as Keynes noted: “...any individual or group of individuals, who consent to a reduction of money-wages relatively to others, will suffer a relative reduction in real wages, which is sufficient justification for them to resist it” (Keynes 1936: 14). However, when – for whatever reason – the level of aggregate demand rises and the point of effective demand will be shifted towards the full-employment level  $L^*$ , the price level will rise to  $P_2$  and the real wage rate will fall accordingly to  $w_2/P_2$ . As this is what wage earners had only expected anyway, there is no reason not to accept the upcoming job offers – which means that those additional labourers employed after the increase in aggregate demand must have been involuntarily unemployed before. This matches Keynes’s definition: “*Men are involuntarily unemployed if, in the event of a small rise in the price of wage-goods relatively to the money-wage, both the aggregate supply of labour willing to work for the current money-wage and the aggregate demand for it at that wage would be greater than the existing volume of employment*” (Keynes 1936: 15; italics in original)

There is one omission we have to remove: Although it is quite plausible not to assume that the point of effective demand will just come to lie at full employment – otherwise, this would assume away the very problem – we will have to consider whether there is a mechanism of self-adjustment if only the inertia described above could be rectified: The common idea would be to reduce the real wage rate as long as unemployment still exists. However, we have argued that the real wage rate is no policy variable available to labour market actors but will be determined endogenously. Yet, the nominal wage rate could be entrusted with doing the job instead. In the long Chap. 19 of the *General Theory*, Keynes discusses this adjustment mechanism only to discard it at the end: “It follows, therefore, that if labour were to respond to conditions of gradually diminishing employment by offering its services at a gradually diminishing money-wage, this would not, as a rule, have the effect of reducing real wages and might even have the effect of increasing them, through its adverse influence on the volume of output. ... To suppose that a flexible wage policy is a right and proper adjunct of a system which on the whole is one of *laissez-faire*, is the opposite of the truth” (Keynes 1936: 269, italics in original). Simply put, nominal wages impact on the price level (via mark-up pricing) but not on real wages and employment (see also Davidson 1998: 821ff.). Moreover, the real-balance effect of falling prices only work under the assumption of an exogenously fixed money supply – an assumption rejected by all variants of Post Keynesianism.

Although the explanation is quite different, the remedy for unemployment in a monetary production economy is similar to Keynesian look-alike approaches as both are based on deficient aggregate demand. However, limits to stabilisation policies emphasised by monetary Keynesianism – due to fiscal sustainability requirements and lack of teleocratic policy control (see Heise 2006) – appear to request stronger demands for macroeconomic policy coordination and to prefer rule-based policies more than Keynesian look-alike approaches would suggest.

### 3. What role for institutions?

Institutions are omnipresent. They may be formal (e.g. laws, contracts) or informal (e.g. customs, ethics, norms) – in any case, they help making decisions by reducing the number of options available and giving incentives to act in a certain way. However, institutions also involve costs forcing the economist to draw a balance when evaluating particular institutions. In an allocative orientation, however, institutions are systematically under suspicion of harming welfare because they will insert discontinuities into the process of resource allocation and, hence, will have to be justified.<sup>12</sup> In an orientation of social provisioning, on the other hand, institutions may not only negatively affect allocative efficiency but also positively productive efficiency in the sense that they increase the quantity of deployed factors of production. Surely, institutions in this setting may also be harmful on balance, yet there is systematically more room for a beneficial implementation.

The labour market is a good example to demonstrate the different impact of institutions on overall economic welfare in both paradigms: In the market paradigm of orthodoxy, labour market institutions such as unfair dismissal regulations, minimum wage laws or social reservation wages may reflect the interest of the majority of the people, yet they will distort the labour market outcome as described above: the real wage will be determined at a level too high for full employment causing persistent unemployment or labour market dynamics will be hampered causing frictional unemployment. Moreover, collective bargaining systems will – as part of their nature – reduce wage competition of individual labour market actors and cause either the real wage to be set above the market-clearing level or, in case of external shocks or structural change, introduce a downward rigidity into wage-setting which will hamper the adjustment process towards full employment. Therefore, in the logic of price-centered (or, more precisely, wage-centered) standard labour market theory, trade unions, minimum wage legislation and social security systems are the culprits of, at least, permanent unemployment producing an efficiency-equality trade off.

In the alternative paradigm of a monetary production economy, fundamental uncertainty about future behaviour of economic agents and, hence, the development of economic variables which economic actors need to take into consideration when deciding is so prevalent, that institutions become crucial in order to make informed choices possible in the first place and will help increase the state of confidence of economic actors. In the labour market<sup>13</sup>, institutions such as collective bargaining systems or minimum wages are needed to form a basis for price-setting and the formation of price expectation or, as Keynes wrote: “For if competition between unemployed workers always led to a very great reduction of the money-wage, there would be a violent instability in the price-level. Moreover, there might be no position of stable equilibrium except in conditions consistent with full employment; ... In the light of these considerations I am now of the opinion that the maintenance of a stable

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12 One could argue that institutions will only come into existence when their benefits surpass their cost – otherwise their creation would be economically nonsense (the endogenous institutions view). However, most institutions are created in order to serve individual interests not overall welfare (exogenous institutions view) and, therefore, are suspected *grosso modo* of being harmful .

13 I am reluctant to speak of the labour market in connection with a monetary production economy because the notion of a labour market is strongly related to the orthodox idea of a real-wage driven market which, as emphasised above, is not accepted within the alternative paradigm. Lacking any better term, I nevertheless keep the ‘labour market’ notion with strong reservations.

general level of money-wages is, on the balance of considerations, the most advisable policy for a closed system” (Keynes 1936: 253ff.). And although labour protection legislation may introduce external inflexibilities into the employment system which may cause frictional unemployment, they will help stabilising spending patterns and, thus, aggregate demand and, additionally, induce internal flexibility which all may improve productive efficiency (see e.g. Tüselmann 1996, McDonald/Tüselmann 1997).

An instructive comparison of the different role of institutions in orthodox and heterodox labour market theorising is offered by the introduction of minimum wages as occurred, for instance, in Germany in 2015. The vast majority of studies published in the run-up to the enactment of an economy-wide minimum wage were based on orthodox ideas and they all – without exception – warned about massive ensuing unemployment particularly of the low-qualified labourers particularly in branches which were especially affected by the minimum wage (see e.g. Bruttel/Baumann/Dütsch 2018, Bruttel 2019, Heise 2022) – a potential improvement for the group of low-wage earners, it was predicted, will be off-set by job-losses of the same group. The very few heterodox studies<sup>14</sup>, in contrast, predicted complex effects on relative prices and some structural change (from more exposed branches to less exposed branches), but no significant employment reduction and, therefore, no trade-off between efficiency and equality.

#### **4. The empirical picture**

If two scientific paradigms, as in this case, offer entirely different analytical explanations of one of the most pressing social problems of capitalist economies – unemployment – and, additionally, policy proposals also differ substantially, we surely have to somehow discriminate between the two. According to economic methodology, this should be done along the lines of verisimilitude: assuming that both competing paradigms cannot sensibly be claiming to be a correct explanation of reality<sup>15</sup>, we could try to empirically falsify any one of the two paradigms. Unfortunately, in non-experimental sciences such as the economic discipline empirical falsification of entire paradigms is impossible (the so called Duhem-Quine thesis). However, partial theoretical proposals can be empirically tested and such tests ought to have consequences for the tested section of the paradigm – the labour market in this case.

It must be admitted first, that there is a strong publication bias: we have, in total, many more studies testing the orthodox approach than the heterodox approach and, moreover, we have many more studies of heterodox authors testing the orthodox approach than orthodox

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14 An almost complete list comprises Heise/Pusch (2020), Herr/Kazandziska/Proprotnik (2009), Herr et al. (2017), Palley (1995).

15 We have learnt that there are two different approaches to the determination of employment and unemployment within the orthodox exchange paradigm: the traditional allocative approach and the ‚Keynesian look-alike‘ approach based on effective demand. Attempts have been made to reconcile both approaches by attributing some part of existing unemployment to a lack of effective demand (‚Keynesian unemployment‘) and some part to non-market-clearing wages (‚Classical unemployment‘). Following this line, we would have to distinguish between permanent (‚structural‘) and temporary (‚cyclical‘) unemployment and allow both to occur at the same time. Although this definitely is an appropriate description of reality, we are only concerned with the explanation of permanent, involuntary unemployment.

authors testing the heterodox approach. While the former is simply due to the quantitative proportion of orthodox to heterodox (labour) economists, the latter reflects the fact that orthodox economists do not respect and consider the work of their heterodox colleagues (see Kapeller 2010). We have to keep these qualifications in mind.

There are, of course, many empirical studies that appear to support the allocative approach to persistent, equilibrium unemployment<sup>16</sup> – otherwise, this approach ought to have been consigned to the history of economic thought long ago (that is, at least, what one should expect). However, the overall empirical picture is, to say the least, ambiguous: Several meta-studies concerning the impact of labour market regulations on unemployment<sup>17</sup> are in line with the results of the most comprehensive and contemporary study of Brancaccio/De Cristofaro/Giammetti (2020: 13): “Among 53 academic papers published between 1990 and 2019 and contained in the Web of Science, only 28 per cent support the consensus view while the remaining 72 per cent report results that are ambiguous (21 per cent) or contrary to the consensus (51 per cent)” defining the consensus view similar to what we have called the ‘IMF-OECD consensus’: “labour deregulations aimed to reduce EPL (Employment Protection Legislation; A.H.) indexes, improve the efficiency of labour markets, and thereby contribute to increased employment and lower unemployment rates” (Brancaccio/De Cristofaro/Giammetti 2020: 5). Such weak empirical support even made those institutions more cautious in their reasoning and policy prescriptions that lend the consensus its name: the IMF and the OECD (see IMF 2016, OECD 1999, OECD 2018).

The picture looks quite different when we consider heterodox views on unemployment. Admittedly, the number of studies empirically testing Post Keynesian theories of unemployment in general and monetary Keynesianism in particular are much more rare than their orthodox counterparts<sup>18</sup> and, in some cases, empirically less sophisticated (using mainly descriptive methods and simple correlations) – the reason may be that Post Keynesians often show a critical distance to econometrics on the one hand and that Post Keynesian modelling is of macroeconomic orientation based on critical elements (e.g. uncertainty, expectations, liquidity preference) which are difficult to measure, operationalise and predict (see Downward 2002, Gerrard 2002). However, the Post Keynesian proposition that employment and unemployment are demand-driven (with particular relevance for investment demand based on expected returns as in Fig. 4, part B) not only in the short but also the long period and, thus, quite independent of actual wage-setting, has empirically not been contested (see e.g. Smith/Zoega 2008, Smith/Zoega 2009) and has even been accepted by some orthodox (Keynesian look-alike) economists such as Nobel Laureat Franco Modigliani (2000). Yet those orthodox economists such as Olivier Blanchard (2000: 29) who

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16 Just to name a few: Lazear (1990); Addison/Grosso (1996); Scarpetta (1996); Elmeskov/Martin/Scarpetta (1998); Blanchard/Wolfers (2000).

17 See e.g. Boeri/van Ours (2008), Heimberger (2020), Kemper (2016), Skedinger (2010). A very similar – i.e. inconclusive – picture can be found when the impact of the generosity of the welfare system on unemployment is tested; see Kim (2011). Moreover, result depends on the design of the empirical study undermining their robustness and giving rise to concerns about scientific integrity: „Our survey is motivated by a concern that empirical research on the determinants of high unemployment in the developed world has been, to a disturbing degree, driven by efforts to verify, or confirm, orthodox theory, rather than by efforts to critically test it“ (Howell et al. 2007).

18 See e.g. Arestis (1989), Davidson (1998), Heise (2008a), Smith/Zoega (2009) Stockhammer (2004), Stockhammer (2008).

cling to the IMF-OECD consensus coined the term 'Modigliani puzzle', indicating their acceptance of the empirical evidence on the one hand and their unwillingness to approve any other paradigmatic orientation on the other hand<sup>19</sup>.

Even more telling is the empirical evidence on the introduction of minimum wages. Despite considerable efforts to extend and supplement the orthodox labour market model (introducing frictions and imperfections), predictions of considerable employment losses could not be amended or avoided – predictions that are falsified by myriads of empirical studies from different countries, different historical and institutional settings and different levels of minimum wages (see Heise 2022). On the other hand, even rather crude (in terms of model specifications) Post Keynesian modelling can be made easily consistent with the empirical evidence of no significant employment effects, but some structural change (see Heise/Pusch 2020).

## 5. Conclusion

Economics ought to be a pluralistic discipline. Therefore, we must accept that different paradigms compete for a more accurate understanding of economic reality. However, that does not mean that every theoretical reasoning can claim to be taken seriously in its attempt to produce knowledge – this would defend a relativism which must undermine the discipline's authority as science. Hence, the scientific community of economists has long ago accepted to share the common methodology of fallibilist positivism as quality control device. This does neither, as argued above, allow us to falsify entire economic paradigms nor only to discriminate beyond reasonable doubt between competing sub-theories – yet, it helps evaluating their verisimilitude.

As we have seen there are alternative approaches to the determination of employment and unemployment based on different paradigms taking different orientations. The orthodox exchange paradigm cannot explain persistent, equilibrium unemployment without reverting to labour market institutions that cause market failures – the empirical evidence, however, is too faint not to be skeptical about this approach. In contrast to that, the heterodox monetary production paradigm in rejecting Walras' law not only explains persistent unemployment as a systematic lack of effective demand which cannot be cured by built-in self-stabilising processes (i.e. wage adjustments). Moreover, empirical evidence corroborates this approach.

The consequences are obvious: supply-side labour market policies of the IMF-OECD consensus, which have been pursued almost comprehensively in the Western world during the neo-liberal era, not only prevented to tackle mass unemployment more effectively, but caused a retrenchment of social security systems, a weakening of labour market institutions – particularly trade unions and centralised collective bargaining systems - , a shift towards irregular employment and a huge increase in wage and overall income inequality. Whereas these developments can be explained on politico-economic grounds focussing on the vested

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19 As Blanchard admits: „Modigliani's interpretation of this relation is in terms of aggregate demand, with investment demand determining demand, output, and by implication, unemployment. Given that the relation seems to hold at low frequency as well, I feel another explanation is needed. The question is whether it comes naturally out of the model sketched in this lecture“ (Blanchard 2000: 29).



(distributional) interests of the dominant meritocracy (see e.g. Heise 2008b), it is more difficult to understand the resilience of a paradigm which scores so badly on its verisimilitude.

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