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## **DISCUSSION PAPER N°1**

*Towards a Reflection on Political Economy:  
Employment Theory*

**Executive Summary**

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# CONTENT

## **Executive summary and policy implications**

As suggested by Keynes in 1934, there seems to be a gulf separating two fundamental views in economic theory. They have their analytical continuations in the field of employment theory and therefore policy practices. Some economists think that the economic system is self-adjusting in the long-run, “though with creaks and groans and jerks, and interrupted by time-lags, outside interference, and mistakes”. Others see the economic system as intrinsically unstable; unstable in its capacity to tend towards a full employment equilibrium. This work belongs to the second school of thought.

These two economic interpretations of the functioning of the capitalist system have their extensions for employment policy-making. If, in the long-run, the economic system is self-adjusting towards a full-employment equilibrium level, only external rigidities i.e. those external to the economic system, can be sources of involuntary unemployment. In the long-run, the crossing of supply and demand curves for labour should determine the full-employment equilibrium, a level of employment for which those who do not work, given their preferences and the price system, choose not to work. In this respect, for this school of thought, an employment policy is a policy directed towards more flexibility and less external intervention in the economic system.

This view has been challenged by Keynes, demonstrating that the economic system can reach a stable state with involuntary unemployment. This result is the consequence of the fact that, for Keynes, the level of employment is not determined on the labour market, which, by definition, does not exist taking into account the absence of a labour supply curve. An employment policy is therefore not a labour market orientated policy, but more a policy directed towards what is considered to be the cause of involuntary unemployment, the lack of demand, resulting from a lack of investment and consumption.

However, when considering that the fundamental cause of involuntary unemployment lies in the lack of investment, one has to analyse consequences of a rise in investment on the whole economic system. In other words, one can wonder if an employment policy aiming at raising investment could be a source of instability and crisis during the adjustment process. In this respect, one can question the intrinsic tendency of the economy to gravitate around or tend towards a full-employment equilibrium. Indeed, modifications in the level and the quality of investment can be destabilising both through capitalists’ reactions to changes in monetary and real variables, and through its impact on relative magnitudes i.e. prices, quantities, stocks..., and technical change. The adjustment process can exhibit instability coming both from capitalists’ reactions to signals sent by the markets and financial institutions and from perverse relative price variations through the techniques of production used i.e. from the established quasi-dogma of political economists stating that competition always produces stability. The first set of questions is mainly related to Keynesian and post-Keynesian research, the second one refers to Classical economics.

The lack of investment and demand being the cause of involuntary unemployment, a rise in investment for a rise in employment can be destabilising from a quantitative as well as from qualitative point of view.

The first part of this work will be devoted to the analysis of the main Keynesian conclusion of the possibility for the economy to reach a stable state with involuntary unemployment. It will be seen that the attempt to integrate the Keynesian message into the dominant theoretical corpus led in fact to conclusions alien to the Keynesian project. In this respect it will be possible to show that the main criticism against Keynesian recommendations, namely the rise in the general price level, has found responses in post-Keynesian literature. However, this will imply an analysis of the tendency, for the economy, to tend towards a full-employment equilibrium in a multisectoral model.

The second part of this research focuses on the critique of one of the most discerning adversaries of Keynes, Hayek. A critical analysis of his masterpiece, written in 1931, will allow to go deeper in the understandings of an economy out-of-equilibrium, through the analysis of the interaction of sectors of production in a multisectoral production economy. This will permit to suggest that a rise in investment could be destabilising from another point of view, concerning the structural allocation of capital in the economy.

Finally, it will be seen that if a rise of investment could be destabilising, a sound employment policy must take into account the dynamics of the economy concerning price formation, relative price variations, capitalists' reactions to profit rate differentials, the techniques of production used, and their interactions, thus revealing the relative sectoral interdependencies.

The main conclusions, in terms of economic policy, are the following ones:

1. For the dominant theory, it is worthless to speak about a proper employment policy. The only problem which could prevent the establishment of full-employment lies outside the economy, from political considerations.
2. For Keynes, the economy can reach a stable state with involuntary unemployment and every economic policy aiming at a decrease in the rate of unemployment must be associated to an action on effective demand.
3. The integration of the Keynesian conclusion of the possibility of involuntary unemployment in the orthodox theoretical corpus, makes the cause of unemployment lie either in the rigidity of real wages or in the behaviours of workers.
4. Keynesian policies have been challenged on the ground that they would be sources of inflation, but it will be seen that this is only the case when investment in production capacities is not taken into account.
5. A pro-active employment policy can be destabilising in dimension i.e. in the global level of activity, creating ground for external intervention both as initiator of an economic policy and as regulator during the adjustment process.
6. A monetary policy that encourages a rise in investment and employment could also be destabilising considering the interactions of sectors of production in the adjustment process, and therefore the techniques of production used.

7. An employment policy which encourage an increase in consumption or in investment, will create new investment opportunities and, therefore, new allocation of capital. This follows the need for capitalists to invest their capital in the most rentable way.
8. Depending on the techniques of production used in the different sectors of production, it is not insured that competition will always produce stability i.e. in proportion, revealed by the structural allocation of capital in the economy and preventing the reproduction of the economy at the next period.
9. Investments must therefore be orientated in order to raise employment but also in order to allow a more stable accumulation path.
10. A sound employment policy is therefore a sound monetary, budgetary and fiscal policy but it must be accompanied by an industrial policy. This would seems necessary in order to choose the sectors of production which would be the most suited to raise employment and to insure a stable accumulation path.

# PLAN

## Introduction

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## Conclusion

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