LABOR MARKETS AND UNEMPLOYMENT:
THE TARGETS AND INSTRUMENTS FRAMEWORK

Thomas I. Palley

Chung-cheng Lin has written an interesting paper that constructively explores my "targets and instruments" approach [Palley, 1988] to understanding unemployment and the operation of labor markets. My one criticism is that he sets up a false opposition between the targets and instruments characterization and the efficiency wage explanation of unemployment. The latter is nested within the former.

The targets and instruments characterization is intended as a meta-framework for understanding the problem of unemployment. Firms have several goals (targets) — finding workers, purchasing hours from those workers, and extracting effort from them. But they have a limited number of instruments (the wage) for reaching these goals. In this sense, they have more targets than instruments. From an economy-wide stance, the result is that some dimension of labor markets—jobs, hours, or effort—does not clear.

Such an approach can be contrasted with the conventional "rigidities" approach which sees unemployment as the result of labor market rigidities — downward nominal wage rigidity, downward real wage rigidity, long-term contracts, etc. In the rigidity view there are enough instruments, but some are rusty and cannot do their job.

The targets and instruments meta-framework encapsulates the efficiency wage problem. In the standard representation the firm desires employment and effort (two targets) but has only one instrument (the wage). From a market-wide perspective, the result is that outcomes end up on the effort supply schedule and off the labor supply schedule.

The reason for this outcome is similar to Tobin's [1990] "common funnel" theorem regarding the Phillips curve. The Phillips curve forces a trade-off between inflation and unemployment. Macroeconomic policy controls aggregate demand (the common funnel) and is bound by this trade off. If monetary policy is used to lower unemployment and fiscal policy is used to lower inflation, the two get mixed in the common funnel and offset each other. In the standard efficiency wage model there is a trade-off between effort and unemployment, and the wage is the common funnel. Raising wage payments increases effort, but it also increases unemployment by lowering labor demand and increasing labor supply.
AN INTERVIEW WITH PAUL DAVIDSON

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Paul Davidson, Holly Chair of Excellence at the University of Tennessee, has been a leader in heterodox economics for over 40 years. I first met Paul at the initial Post Keynesian seminars at Rutgers and Columbia back in the 1970s. I have followed his work, with admiration, since that time. His contributions to economics are multitudinous—almost 30 books and hundreds of articles. (A bibliography is presented at the end of this interview.) His focus on true uncertainty (we live in a non-ergodic world) as the appropriate framework for Keynes and all economic thinking, has provided many of us with a sense that there was much more to Keynes than could be found in the textbooks. His insistence that Keynes must be seen as a Marshallian is now generally accepted, and his proposals for international monetary reform are playing significant roles in current policy debates.

Paul’s knowledge of Keynes’ work is legendary; in discussions he will often cite chapter and page number where arguments are to be found. His work on aggregate supply and demand, now mostly forgotten by the profession, is still far closer to correct than that presented in the current texts.

But going through his writings alone is insufficient to convey a full sense of his contribution to heterodox economics. Through discussion and organizing activities he has encouraged an entire generation of young economists to question the models they are being taught, and to approach economics with a critical eye. He is a regular on the PK Net, and he spends an enormous amount of time patiently, and sometimes not so patiently, explaining the logic of his position to newcomers.

His wife, Louise, has been a constant companion and co-organizer throughout his career. In her role as managing editor, and in his role as editor, of the Journal of Post Keynesian Economics, they have guided the Post Keynesian movement, and kept it in the public eye.

The interview was conducted with Paul and Louise at the University of Tennessee in his office in 1997. I specifically asked that Louise be at the interview because of the central role she has played in guiding Paul, and thereby in guiding the Post Keynesian movement.

REFERENCES