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A misinterpretation of Keynes's concept of involuntary unemployment

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Abstract

Research background: One of the principal contributions of Maynard Keynes's General Theory was identification of the phenomenon of involuntary unemployment, due (on account of adverse expectations and confidence on the part of potential buyers) to a want of demand for the quantity of output which a fully-employed labour force was capable of producing. Such unemployment, he insisted — contrary to conventional opinion — was not due to workers pricing themselves out of work by demanding wages higher than employers could afford. Far from unemployed workers being themselves responsible for their plight, they were, in reality, victims of circumstances beyond their control. Keynes's understanding was, for many years, widely accepted by academics, policy-makers and the general public. In recent times, however, mainstream macroeconomic theory has shown a regrettable tendency to return to old modes of thinking. Blame for unemployment is again put on the workforce, whose alleged misunderstanding or slow response to change are said to imply seeking employment on unrealistic terms. A more extreme view is that worklessness may reflect a deliberate choice of leisure. To anyone sceptical of the validity of such analyses there is a clear need to recover the Keynesian understanding of the possibility not just of frictional or voluntary, but also of involuntary unemployment.

Purpose of the article: Ezra Davar, recognising that it is important not to lose sight of the idea of involuntary unemployment, has recently attempted in this Journal to explain Keynes's concept. Unfortunately, however, he fails to recognise that Keynes accounted for involuntary unemployment as resulting from deficiency of aggregate demand for output, not as the consequence of any supply-side factor. In attributing involuntary unemployment

a peculiarity in the labour supply function Davar quite misses Keynes's point, and in fact identifies as involuntary unemployment a situation of what Keynes would have described as "voluntary" employment. The objective of the present note is to clear up this misunderstanding.

Introduction

In a paper recently published in this journal, Ezra Davar (2016, pp. 605–629) claims to be presenting a clarification of the concept of involuntary unemployment, resolving what he describes as "the confusion" created by Keynes's allegedly "vague and incomplete" definition.¹ Davar's proposed elucidation consists of an interpretation of Keynes's theory of involuntary unemployment as a derivation from Walras's account of *voluntary* unemployment. According to Davar, Keynes achieved this "by changing Walras's assumptions" regarding conditions of labour supply.² Responding to that rather surprising suggestion, this note makes the point that while Davar seems to understand well enough what Walras meant by "voluntary unemployment," it is evident that he does not have the ghost of an idea of what Keynes was getting at in the *General Theory* with the notion of "involuntary unemployment". Our purpose therefore in this paper is to bring out the true nature of Keynes's concept of involuntary unemployment, contrasting it with the very different state of affairs which Davar chooses to describe as "involuntary unemployment". We believe that Davar's suggestion as to the source and character of involuntary unemployment is in fact highly misleading and likely to cause confusion as to what Keynes understood by "involuntary unemployment". As the issue is one of both theoretical and practical importance, correction of Davar's misunderstanding is desirable.

Davar on voluntary and involuntary unemployment

Let us briefly review Davar's interpretation of voluntary and involuntary unemployment and then set Keynes's explanation of involuntary unemployment against that of Davar.

¹ While not accepting Davar's description of Keynes's definition of involuntary unemployment as "vague and incomplete", we do agree with him that Keynes's concept of involuntary unemployment is a unique and important contribution, and that it is deplorable that it has disappeared from much of the modern literature. In our opinion, however, Davar's attempt to explain involuntary unemployment fails to achieve its objective.

² The mere suggestion that Keynes found inspiration from Walras is implausible: it was not Keynes's wont to approach theoretical issues from a Walrasian perspective.

Davar correctly shows Walras's treatment of employment and unemployment (Walras, 1874), which covers both *voluntary* unemployment and *forced* unemployment, to be of a characteristically neoclassical character. Employment is represented as determined within the labour market at the point of intersection of the "labour demand" (marginal product of labour) and labour supply schedules (both are functions of the real wage) [See Figure 1(a)]. Note that, from this point of view, if employment is to change in the short term, the labour supply curve must shift (for the reason that in the short run the "labour demand" function is fixed in position by the given technology in use).

In this standard labour market diagram [Figure 1(a)], with labour available for employment measured along the horizontal axis, whatever quantity of labour lies to right of the point corresponding to the intersection of the demand and supply curves is deemed (a la Walras) to be "voluntarily unemployed". A person is voluntarily unemployed, Davar explains, "because the wage he or she requires to be employed is higher than the equilibrium wage." In the situation shown in Figure 1(a) — given the tacit assumption that demand for output can be relied upon to accommodate itself to whatever quantity of output is produced — if employment is to increase in the short run, a downward shift of the labour supply curve is sufficient to permit equilibrium with more employment.

It may be mentioned that Davar, following Walras, describes as "forced unemployment" any unemployment which results from the fixing of a minimum wage too high to permit full employment [Figure 1(b)]. That may be so if an external agency is involved, but unemployment resulting from an attempt by labour itself to set an unrealistically high rate of wages, Keynes would consider as voluntary: he remarked (1936, p. 15), "Nor should we regard as "involuntary" unemployment the withdrawal of their labour by a body of workers because they do not chose to work for less than a certain real reward." Keynes makes the point that a collective decision not to work for an offered real wage, just as much as an individual one, implies voluntary unemployment (the workforce has control over the situation).

Before moving on to what Davar has to say about Keynes's theory, note his observations concerning the Walrasian labour supply curve (Davar, 2016, p. 607). He remarks that the type of unemployment depends on the character of that aggregate supply curve. Thus,

When it is a strongly increasing function, as in Walras's approach [Figure 1(a)], there might be only voluntary unemployment. . . . [If on the other hand,] the supply curve of labour is a weakly increasing one, which means that the supply function [has] a horizontal segment, then there might be involuntary un-

employment if the equilibrium point is located between the boundary points of the horizontal segment.

Davar's conception — call it his “quasi-Walrasian” model — is illustrated in Figure 2. The diagram shows a situation with (what Davar describes as) involuntary unemployment.

Given that the intersection of the labour demand (MPN) and supply curves in Figure 2 does occur on the horizontal section of the supply curve, Davar's point is that workers who would accept the market determined going wage may nevertheless find themselves unemployed. Thus Davar (2016, p. 626): “So, in such a case, an individual is involuntarily unemployed against his own wishes, because an equilibrium wage defined by free competition is equal to the wage which he requires.” In Figure 2 workers, indicated by the number N_2 — N_1 , are willing to work at the going real wage, but no work is on offer. That rate of wages has attracted more people into employment than can profitably be employed; some are inevitably disappointed (to Davar, they are “involuntarily unemployed”). We are, presumably, meant to set this situation against that identified above as “voluntary unemployment” which occurs when the going rate of wages is insufficient to induce (some) labour to offer its services for employment.

According to Davar, therefore, the critical issue distinguishing involuntary from voluntary unemployment is whether or not labour is willing to work for the wages on offer. This seems to us too narrow a view; apparently it does it not matter whether or not the wage rate which labour has decided as acceptable is realistic or not? What doesn't seem to count with Davar is the fact that, in the situation depicted, more members of the labour force than actually are employed could not profitably be employed at the chosen rate of wages. Furthermore, in terms of the neoclassical model of the labour market (with which Davar seems to have no problem) the “involuntarily” unemployed could find employment if they were to accept a sufficient wage reduction (see Figure 2); a solution is therefore in their own hands.

Is it meaningful for Davar to describe this as “involuntary unemployment”? It is certainly not involuntary unemployment as understood by Keynes. To Keynes, involuntary unemployment occurs because of a lack of demand for output and consequently want of demand for labour — nothing to do with supply-side conditions. We take the view that the situation described by Davar as one of “involuntary unemployment” is nothing of the sort. The hard fact of the matter is that the unemployed workers in question *are seeking a wage which exceeds the value of their services*. If, as in the Davar scenario, labour is asking for a wage in excess of its marginal productivity, but at the same time, could secure a job by accepting a lower

rate of pay, that state of affairs ought not to be described as one of involuntary unemployment. We suggest that this is nothing more than a case of voluntary withholding of labour (because the desired real wage exceeds that which employers are prepared to pay). Contrary to Davar's contention, the existence of a horizontal section of the labour supply curve in his "quasi-Walrasian" model, does not give us an instance of what Keynes would describe as involuntary unemployment: Davar's "quasi-Walrasian model" has nothing at all to say about the problem of involuntary unemployment as *Keynes envisaged it*.

At this point in the discussion we may take note of the existence of another analysis of unemployment which features a horizontal labour supply curve, an analysis overlooked by Davar. Apparently Davar has not realised that Professor Pigou in his 1933 *Theory of Unemployment* actually envisaged a reverse-L-shaped labour supply curve, *horizontal over its whole length*, as descriptive of the contemporary state of the labour market (see Keynes, 1973, p. 54 and Figure 3 above).

Pigou's theory calls into question the validity of Davar's proposition regarding the relationship between a horizontal labour supply curve and involuntary unemployment. Contrary to what Davar might have expected given the form of Pigou's labour supply curve, Pigou certainly did not characterise the unemployment of the time as "involuntary". Quite the contrary: to Pigou the unemployment in question was, in effect, essentially voluntary (even if that was not the terminology he used): he believed it to be the fault of the workforce in holding out for wages too high to be compatible with full employment. We conclude that Davar, focusing on the shape of the labour supply curve in his attempt to elucidate the Keynes theory of involuntary unemployment, has actually taken us back to something very different, with a model which approximates to Professor Pigou's representation of the labour market; but Pigou's analysis leads not to a theory of involuntary unemployment — in fact to the opposite — to a conception which Keynes described as being one of voluntary unemployment.

Keynes, for his part, did, of course, reject Pigou's explanation of the contemporary unemployment as voluntary (wage-constrained) and diagnosed it as being of an involuntary character — *but that diagnosis had nothing whatever to do with the shape of the labour supply curve*. Whether Pigou's labour supply curve was horizontal or not, was quite irrelevant to Keynes's explanation of involuntary unemployment. Keynes, recognising that the demand for labour is derived demand, came to the conclusion that a general collapse of demand for output was responsible for the contemporary want of demand for the services of labour. As Keynes saw the situation, the root of the unemployment problem lay with an insufficiency of

demand for output, not with the conditions of labour supply. We shall come back to the Keynesian explanation of involuntary unemployment.

To return to Davar's attempt to clarify Keynes's account of involuntary unemployment: we note that having introduced the notion of a labour supply curve with a horizontal section, Davar believes he has found the key to the Keynes theory of involuntary unemployment. It would appear that he connects Keynes with his hypothetical Walrasian partially horizontal supply curve construction by way of contributions by Lange (1944) and Patinkin (1965), particularly the former (see Davar, 2016, pp. 615–621). Davar wishes to find in Keynes the account of (so-called) involuntary unemployment as presented via his (Davar's) "quasi-Walrasian" horizontal labour supply curve model. And he thinks he finds it. Let us now see what Davar has to say about Keynes's handling of the issue of involuntary unemployment; we will then come back to the question of how Davar may have arrived at his particular interpretation of Keynes.

With respect to the Keynes theory, Davar tells us (2016, p. 615) that, we may conclude that Keynes, by supposing that the total labour supply function is "weakly", not "strongly "increasing", as Walras had assumed — changed Walras's assumptions. The function could therefore feature a horizontal segment (as is the case with Davar's "quasi-Walrasian" labour supply curve depicted in Figure 2).

To emphasise the point. Davar is attributing to Keynes the assumption of a (partly) horizontal labour supply curve, which he (Davar) believes is the necessary condition for the occurrence of what he describes as involuntary unemployment. Davar asserts that "*in the equilibrium state there might be involuntary unemployment if the equilibrium point is located on the horizontal segment.*" From this perspective, he concludes: "*So, Keynes stated that voluntary unemployment is characterised by the rigid-wage phenomenon, . . . Thus, in the absence of rigid wages, there is also no involuntary unemployment.*" Davar makes it clear that, as he understands the issue, whether unemployment is voluntary or involuntary, depends on the shape of the labour supply curve. He sums up: "*. . . in the framework of free competition, the kind of unemployment, if it exists, depends on the character of the assumptions, i.e., on the form of the supply curve of labour.*" [Emphasis added] *This understanding is evidently what Davar is presenting as his clarification of Keynes's theory of involuntary unemployment.*

There we have it. That is what Davar thinks of as the Keynes theory and the meaning of involuntary unemployment. In other words, as Davar stated in the opening statement of his paper, "Keynes's involuntary unemployment derived from Walras's voluntary unemployment by means of changing the characteristic of the aggregate supply curve (function) of labour."

The crux of the matter, according to Davar, is that Keynes introduced into his model a horizontal section of the labour supply curve the presence of which he deemed a necessary condition for the occurrence of (what he called) involuntary unemployment. To that allegation is added, we may note, the old charge of Keynes assuming wage rigidity. It is clearly to the supply side of the labour market that Davar directs our attention if we are to understand how involuntary unemployment comes about.

We find it very difficult to recognise Keynes's theory of unemployment from the above description offered by Davar. The "rigid-wage phenomenon", "the supply curve of labour with a horizontal segment" — where do these come from? This is not the *General Theory* as we know it. What is clear, however, is that Davar is attempting to foist on Keynes the account of what he (Davar) calls involuntary unemployment — as developed via his "quasi-Walrasian" model. But his is not an account of involuntary unemployment as understood by Keynes, and seems to bear no relation to anything said in the *General Theory*. The question is — how did Davar arrive at his particular reading of the Keynes Theory?

We think we have the answer to that question. As mentioned above Davar has evidently given particular attention to Oskar Lange's 1944 study, *Price Flexibility and Full Employment*. He comments that "Lange was one of the first economists to define involuntary unemployment graphically, that is, close to its genuine meaning in the economics literature". We suggest that Davar has been misled in his understanding of Keynes's work by Lange's unsatisfactory exposition — including his diagrammatic treatment. We need therefore to examine Lange's handling of the issue of involuntary unemployment. Accordingly, Lange's labour market diagram is reproduced below (Figure 4):

Davar's "quasi-Walrasian" model, when compared with Lange's account, is seen to bear a suspiciously close resemblance to what Lange thought to be the characteristics of Keynes's conception of the labour market (see Lange, 1944, p. 6 and Davar, p. 616). Lange's model shows the conventional neoclassical determination of employment by the intersection of the labour demand and supply curves. The labour supply curve has — presumably, for Davar, the critical feature of the model — a horizontal section such that its intersection with the labour demand curve is above and to the left of what would have been the intersection of the labour demand curve with a normal, positively-sloped labour supply curve. The situation is described by Lange in the following words:

“Underemployment” is the excess supply $AB (=PQ)$, while Keynes considers the line D is the demand curve and S the supply curve of the factor. In our treatment CQS as the supply curve, P an equilibrium point and $PQ (=AB)$ involuntary unemployment.

“Involuntary unemployment” in the Keynesian sense is . . . an equilibrium position obtained by intersection of a demand and supply curve, the supply curve of labour, however, being infinitely elastic over a wide range with respect to money wages, the point of intersection being to the left of the region where elasticity of the supply of labour to money wages becomes infinite.”

Davar comments that “by Lange’s definition involuntary unemployment only exists if the labour supply curve includes a horizontal segment (implying wage rigidity)”. It looks very much as if Davar got the key element of his model — the horizontal labour supply curve — from Lange’s (incorrect) representation of Keynes (he certainly didn’t get it directly from Keynes). The trouble, though, on our understanding, is that Lange’s model (and Davar’s model apparently derived from it) has nothing to do with Keynes’s interpretation of the nature of involuntary unemployment. As a guide to Keynes, it is misconceived and irrelevant.

Use by Lange and Davar of the standard neoclassical representation of the labour market, which explains employment as determined at the point of intersection of the (conventional) labour demand and labour supply curves, reveals that these authors have failed to grasp an essential element of Keynes’s (revolutionary) conception — namely, that demand for labour is derived demand. As demand for labour depends on demand for the output that labour will produce, labour demand ought not to be shown diagrammatically as dependent simply on the rate of real wages sought by the workforce. In offering employment employers are interested not only in the productivity of labour, but also, crucially, in the prospects for the sale of the output that labour will produce. We will deal with this point more fully below when we come to examine Keynes model of the labour market.

Furthermore, Keynes certainly did not suppose the labour supply curve to be horizontal — and rigid — at some level of real wages incompatible with full employment (as shown in Lange’s diagram). Wage rigidity is not a cause of unemployment in Keynes’s theory (he even thought it could be a beneficial source of stability). *The essential point of the Keynes theory of unemployment is that the problem was not one of too high wages but of want of demand for the output of labour.* In the Keynes analysis, far from employment being constrained by a labour supply curve fixed “in the wrong position” as suggested by the Lange model, labour is “off its supply curve” (diagrammatically) in a position determined by effective demand for output, somewhere to the left of the point on the labour supply curve which

indicates labour's preferred position. Contrary to Davar's contention labour cannot be involuntarily unemployed if it is on its supply curve — though it may be voluntarily unemployed.

In short, the situation portrayed in the Lange model which seems to have determined Davar's conception, corresponds not to Keynes account in the *General Theory* but has more resemblance to Pigou's picture of wage-constrained employment — that is to say, in Keynes's terms, to a case of voluntary unemployment.

Once we have developed our account of the Keynes theory of involuntary unemployment (which we do immediately below) we shall be in a position better to explain, with the aid of a diagram which properly illustrates the Keynes conception, how the Lange — Davar models fail to capture Keynes's understanding. It looks as if Davar got the key element of his model — the horizontal labour supply curve — from Lange's misrepresentation of Keynes (he certainly didn't get it from Keynes) Davar has missed the essential insight of Keynes's theory of involuntary unemployment, namely that deficiency of demand for output is the factor responsible for involuntary unemployment of labour. It is the (derived) demand for labour, not wages or anything else (such as the shape of the labour supply curve) that matters.

Keynes on involuntary unemployment³

To appreciate how far off the mark Davar's interpretation of Keynes is, we now turn directly to Keynes's explanation of the origin and nature of involuntary unemployment.

The essential and original feature of Keynes's theory of involuntary unemployment is its recognition that the level of employment depends not only on conditions within the labour market, but, crucially also, on conditions outwith the labour market — that is, on the state of demand for output in the commodities markets. In other words, demand for labour is derived demand, derived from the expected demand for the output that labour would produce if employed.

Davar apparently does not appreciate that Keynes understood the demand for labour to be derived demand; this lack of understanding is in fact characteristic of the conventional neoclassical treatment of the functioning of the labour market. In terms of the standard model the marginal product of labour function is invariably described as the "labour demand function", which is incorrect — that description ignores the fact that whatever the

³ This section draws heavily on Grieve (2017).

marginal product of labour may be, it cannot be profitable to employ and pay labour according to the notional value of its diminishing marginal product if that product cannot actually find a market. If we maintain, neo-classical fashion, the idea of diminishing marginal returns to labour in the short run, the reality (not properly recognised by the conventional theory) is that if employment is to increase, it is necessary not only that the going wage falls as the marginal product of labour diminishes, but it is essential also that any increase in employment offered must be accompanied by a sufficient increase in demand for output to justify that extra employment. In other words, with respect to the labour market diagram, it is an increase in demand and output that justifies additional employment, with the wage reduction being an automatic (accommodating) accompaniment of the increased employment. The MPN curve should therefore be read as a real wage function, with the real wage (the dependent variable) depending on the volume of labour employed, not vice versa.

As demand for labour depends crucially on conditions beyond the labour market, on the state of expected demand for output, we may, in order to depict the impact of demand for output on the labour market, impose on the conventional labour market diagram a vertical line indicating how much labour (corresponding to demand for output) is actually demanded in the labour market. This link between the markets we call the “derived demand for labour function” (DDR). See Figure 5 which indicates how the demand for labour in the labour market derives directly from effective demand for output in the commodities market.

With demand for labour thus determined quite independently of labour supply, demand for labour may equal, exceed or fall short of the available supply. With insufficient demand relative to that required for full employment, a corresponding “gap” exists in the labour market between the quantity of labour offered for employment, and the quantity demanded by employers. This gap, reflecting the “derived” nature of the demand for labour, indicates the difference between the demand for labour as dependent on the volume of expected demand for the output of that labour, and the quantity of labour available for employment on realistic terms. A situation of involuntary unemployment is illustrated in Figure 6(c).

Note Keynes’s formal definition of involuntary unemployment:

“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.”

This definition takes the form of a test to confirm that involuntary unemployment was present. If the specified condition is met, it must be the case that such a gap between labour demanded and labour supply did indeed exist.⁴

If we trace through the sequence of events depicted by this three-part diagram, the nature of Keynes's involuntary unemployment as demand-deficient employment should become clear. We consider first Keynes's 1936 account as presented in the *General Theory*. We then describe the simplified, but in basic principle identical, account advanced by Keynes in 1939.

Start with the 45 degree line ("Keynesian cross") diagram in figure 5(a). We suppose that initially the aggregate demand function (AD1) lies in a position corresponding to full employment (income and output equal to Y_1). The position of the "derived demand for labour" curve (DDN1) in diagram 5(b) indicates, via the production function, that level of output requires for its production the volume of employment N_1 (corresponding to full employment) in Figure 5(c).

Now suppose a fall occurs in aggregate demand, from AD1 to AD2. In response, with unsold inventories piling up, firms cut production and employment, so that output falls to Y_2 and employment to N_2 . DDN shifts to position DDN2. In the labour market a gap emerges ($N_1 - N_2$) indicating the extent to which the contraction of final demand for output has brought about a decline in the demand for labour. This is demand-deficient unemployment; it is also involuntary unemployment in that workers hitherto in employment have lost their jobs through no action or fault of their own. There has occurred no change either in the technological conditions of production and employment, nor in the terms on which labour is seeking employment: all that has happened is that conditions in the output markets have deteriorated, so that only a proportion of the previous volume of output can be sold.

But what is happening with wages? If demand for labour has fallen and unemployment has emerged, the above model shows that real wages will have risen (W_1 to W_2). But Keynes in the *General Theory* makes the emphatic point that any such increase in real wages is the consequence, not the cause, of the rise in unemployment. What has happened is that, with

⁴ If we compare the Keynes model of the labour market — see Figure 5(c) — with the conventional neoclassical model, the "labour demand" (MPN) schedule of the latter implies that demand for output will match employment corresponding to any value of the real wage. It is the real wage, not demand for output that is the effective constraint on employment. On the other hand, introducing DDN specifies a specific volume of demand for labour, and a demand constraint, which is independent of current labour supply. See Figure 5(c); also Kerr and Harcourt (2009, diagram p. 31).

demand for output falling, firms have moved down their short run supply curves reducing output and employment (DDN moves to position DDN2) and implying, even with no alteration of money wages, a fall in commodity prices — and so some fall in the cost of living. In the face of falling demand, the workforce has certainly not pushed for an increase in money wages. The rise in real wages is simply an incidental result of the contraction of activity, a consequence, not the cause of the fall in demand and production.

Moreover, a reduction in money or in real wages may not be helpful in stimulating increased aggregate demand. Neither falling prices — with expectations of further deflation — nor falling real incomes can be expected to induce more spending.

Consider the opposite case — of a rise in aggregate demand — from AD2 to AD1. Output and employment increase, back, say, to Y1. DDN shifts from DDN2 to DDN1 and N from N2 to N1. As output and employment rise, so does the cost of living, with prices rising (slightly) against unchanging money wages. Thus, real wages fall permitting movement down the MPN function, but that movement is initiated by, and occurs only with the rightward movement of the DDN curve. What do we make of this fact that real wages have fallen (W2 to W1)? Again, as in the equivalent case of a decrease in output and employment, the change in wages is the consequence, not the cause of the change in demand and employment. Keynes's reasoning here was that, when employment is increasing, even if the cost of living is rising a little, workers will not risk missing out on increased employment by insisting on higher money wages.

We have, however, a further step to take before we complete our exposition of Keynes's theory of effective demand and involuntary unemployment. What remains to be noticed is that, shortly after publication of the *General Theory Keynes* (1939) simplified the story offered the General Theory regarding wages and employment. On the basis of newly gathered empirical evidence he concluded that in reality (contrary to the standard neoclassical prediction) real wages did not fall as employment increased. In fact, on the evidence, no systematic short-term relationship appeared to exist between employment and real wages. Keynes now considered it appropriate to treat the MPN (real wage) schedule as horizontal, meaning that, in the short run, output and employment could be understood to increase or decrease without any accompanying changes in real wages occurring. (See Figure 6.)

Figure 6 presents essentially the same understanding as does Figure 5 of how the situation in the labour market depends on the state of demand in the product markets. The labour supply curve (NS) shows how much labour is available at the going (real) wage W1. For simplicity (and possibly real-

ism) we have borrowed Pigou's right-angled labour supply function. It is understood that that wage corresponds to the (invariant marginal) value placed by employers on all labour available for employment (maximum labour supply, N_f). The vertical lines DDN1 and DDN2 show the derived demand for labour according to the levels of aggregate demand for output. The quantity of employment offered is determined at the point of intersection of the relevant DDN curve with the labour supply function. DDN moves rightwards or leftwards according to whether aggregate demand for output is rising or falling. Any gap which exists between the equilibrium level of employment thus indicated (N_1 or N_2) and the level of full employment (N_f) represents demand-deficient unemployment, which, by its nature, is involuntary unemployment. From this representation of the labour market, which no longer makes reference to a downward-sloping MPN function, it is absolutely clear that the going level of employment is determined without reference to the current rate of real wages.

We end this section on Keynes's treatment of unemployment with a short resumé. We have observed that in the Keynes theory employment is not set by the intersection of the marginal product of labour and labour supply schedules as it is in the neoclassical model of the labour market, but by the position of the DDN curve which indicates the current extent of demand-deficient involuntary unemployment. The volume of demand for output and so for labour is what matters — not the rate of wages. The difference in employment, N_1 minus N_2 , indicates the consequent effect on employment of a deficiency of demand for output. Cutting wages cannot be of direct help — as is shown by the position of DDN: there are presently no further employment opportunities available. Real wage reduction would be more likely to reduce than stimulate demand for output. Neither is deflation, occurring via falling money wages and prices a promising route to increased expenditure. Under conditions of deficient demand for output there is in fact little possibility of the workforce being able to remedy the situation through its own efforts.

Conclusions

We arrive at the conclusion that neither Ezra Davar, nor his presumed guide to these matters, Oskar Lange, have got anywhere near to understanding, far less elucidating, Keynes's theory of involuntary unemployment. As already discussed, what Davar identifies as "involuntary unemployment" is nothing of the sort. What he describes is the voluntary withholding of labour from employment because potential employees are unwilling to work on terms on which employment is available. These unemployed workers

may think themselves unlucky in that others have been able to find employment at a wage for which they would have been happy to work, but in the situation envisaged by Davar and Lange the going wage is too high to allow who would accept these terms to find employment.

Neither Lange nor Davar have succeeded, conceptually or diagrammatically, in capturing what Keynes meant by “involuntary unemployment”. Both focus on the supply side — neither recognise the essential insight of the Keynes theory that the problem originates on the side of demand. Yet Keynes’s thesis is straightforward — involuntary unemployment occurs when workers, willing to work on realistic terms compatible with their employment, are without employment because the quantity of employment on offer falls short of the quantity of labour available.

Davar and Lange both chose to stay with the conventional neoclassical model of the labour market, fatally flawed by its failure to take account of the fact that demand for labour is derived demand. The MPN — so-called “labour demand schedule” is read as indicating that demand for labour is a function of wages, so that, according to this diagram, the only constraint on employment is the position of the labour supply curve. As regards demand for labour there is no way, in terms of the neoclassical diagram, of showing that employment may be limited by a constraint on the side of demand. The traditional (pre-Keynesian) theory was unable properly to take into account and represent the impact of changes in the demand for output on the labour market. To demonstrate that employment may indeed be limited by demand, given the supply of labour on offer, a more satisfactory representation of the demand side (other than calling the MPN schedule the labour demand curve) of the labour market is needed. That is what our DDN (derived demand for labour curve) provides by linking directly demand for output in the goods markets with (derived) demand for labour in the labour market.

With demand for output and labour and the supply of labour determined independently of each other it becomes possible to advance beyond the limitations of the neoclassical analysis and conceive of a situation in which the supply of labour available for employment and the demand for labour services from employers are not equal; while they can be in balance, the issue here is that they may, more commonly, be out of line with each other: that for the reason pointed out by Keynes — demand for output is an independent and unstable determining factor which cannot be guaranteed always to be such as to induce employers to take on all the labour on offer to them would be produced through their employment.

This note demonstrates that Ezra Davar (2016) quite misses Keynes’s point concerning the nature of much observed unemployment. His account altogether fails to recognise how fundamentally different Keynes’s under-

standing was from that of the neoclassical school. Instead of identifying the sharp contrast which exists between the views of Keynes, and his orthodox predecessors (and successors!), Davar actually attempts to subsume the Keynes theory into the neoclassical mode of thinking, representing it as a variant of the Walrasian treatment of the labour market. That misreading of Keynes's theory of involuntary unemployment should not be allowed to pass without comment.

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Annex

Figure 1. From Davar: Walrasian “voluntary” (and forced”) unemployment”

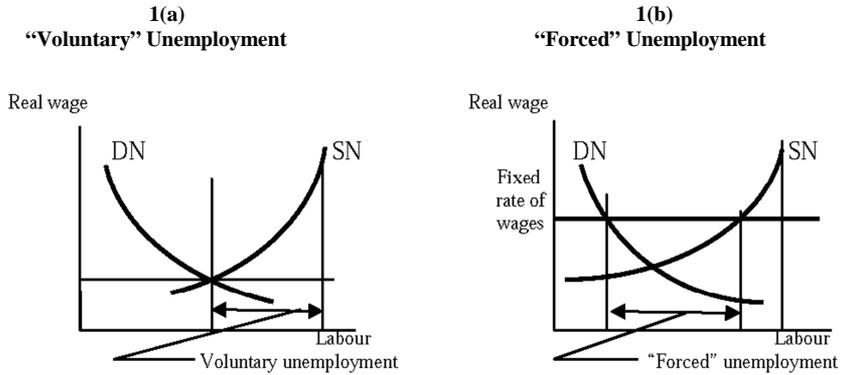


Figure 2. Davar’s “weakly increasing” aggregate supply curve of labour

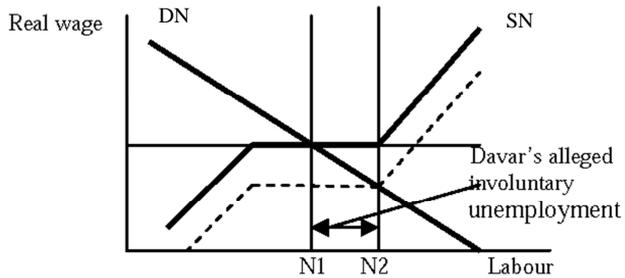


Figure 3. Pigou’s aggregate supply curve of labour

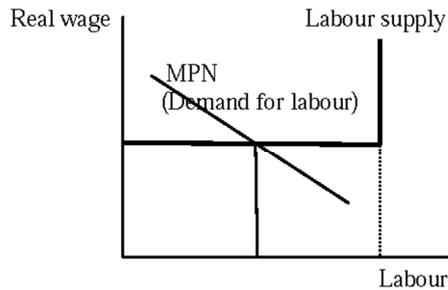
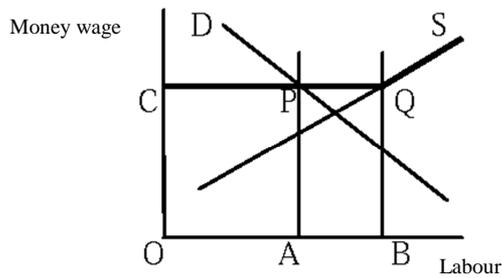


Figure 4. Lange's representation of involuntary unemployment



Source: Lange (1944, p. 6), Davar (2016, p. 616).

Figure 5. The derived demand for labour function (DDN) – (shown - - - -) and involuntary unemployment.

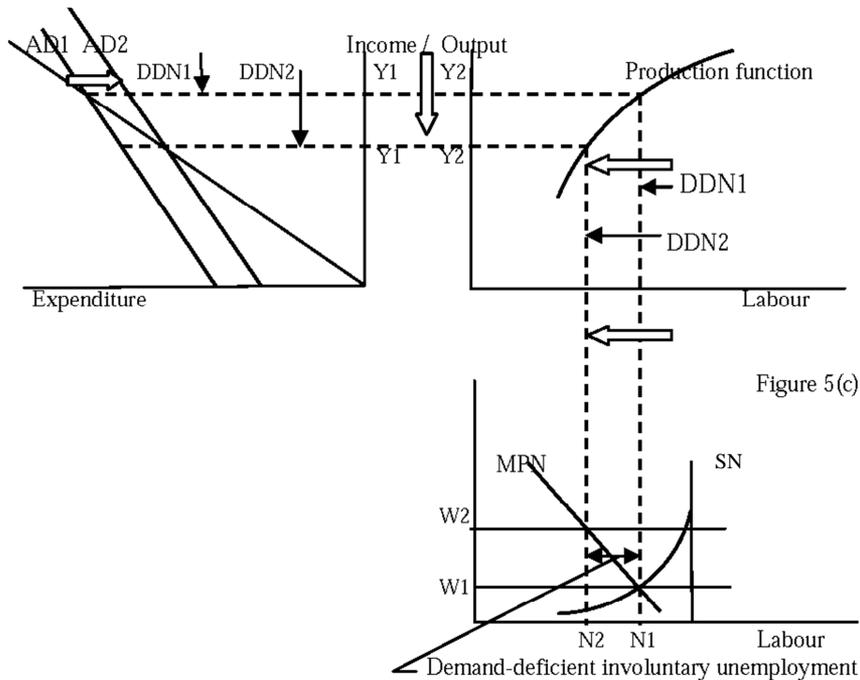


Figure 5(c)

Figure 6. A representation of Keynes's 1939 model of the labour market

