Involuntary Unemployment: The Elusive Quest for a Theory

By Michel De Vroey, Routledge (Frontiers of Political Economy), 2004, ISBN 0-415-08074-6

The main aim of this book is to evaluate whether economic theory has provided coherent theoretical explanations for involuntary unemployment. To many laypersons involuntary unemployment is undoubtedly an important fact of reality, and they are probably surprised that this book has not already been written. Many trained economists will probably be less exited by the agenda. They would argue that a good theoretical question has a well-defined meaning, and that a well-established, precise definition of *involuntary* unemployment fails to exist. For example, Layard, Nickell and Jackman (1993, p. 41) concludes that it is fruitless to ask the question of whether unemployment is voluntary or involuntary.

As indicated above, I did not have high expectations when starting to read the book. Fortunately, the book surprised me. De Vroey is well aware that the main question he raises is uninteresting unless he provides some clear conceptual definitions. Thus, the first part of the book is devoted to conceptual prerequisites. Two chapters provide an overview and a very thorough discussion of the different definitions of involuntary unemployment applied in the literature. Surprisingly, many text books in Labour Economics have a much more superficial discussion – if any – of the involuntary unemployment concept, despite that many students probably take courses on labour market theory in order to understand involuntary unemployment (in the laypersons view).

De Vroey endorses the reservation wage definition of involuntary unemployment. In this definition, involuntary unemployment occurs if individuals are without a job despite the fact that the prevailing market wage exceeds their reservation wage. This definition comes in two versions. A narrow version called the ‘individual disequilibrium’ definition, and a broader version named the ‘frustration definition’.

An individual equilibrium exists if the optimal plan of the individual, prior to trading, is realized when trading takes place. Individual disequilibrium refers to the case where this is untrue. Unemployment in the individual disequilibrium sense may, for example, arise if the government (for some reason) dictates a wage which is higher than the equilibrium wage determined by supply and demand. If, on the other hand, the high wage is set by a utilitarian trade union, unemployment would fail to be involuntary in the individual disequilibrium definition. The reason is that the trade union chooses a wage level that maximizes the expected utility of each member. Whether an individual is employed or not is determined by a lottery, but since it is optimal for all individuals to enter the lottery, the (ex ante) optimization plan is realized for both the employed and the unemployed. After the lottery has taken place, the losers are jealous of those who won, and union wage-setting therefore generates involuntary unemployment in the frustration definition.

After the chapters on conceptual issues, the book critically examines the views on involuntary unemployment offered by different economic theories and their creators. The book follows a historical thread. It starts, naturally, with Keynes and *The General Theory*, then turns to IS-LM macroeconomics a la Hicks, Modigliani and Tobin, the disequilibrium/fix-price approach pioneered by Patinkin, Barro, Grossman, Drèze, Benassy, Malinvaud and others, the anti-Keynesian offensive by Friedman, Lucas and collaborators, and finally the New-Keynesian counter-attack featuring implicit contract theory, efficiency wage theory, insider-outsider theory, coordination failure models and imperfectly competitive general equilibrium models.

Since it all started with Keynes, and because many subsequent contributions claimed to be Keynesian, the book also tries to access whether Keynes' research programme has been met with success. That is, do we have coherent theories that explain involuntary unemployment in the individual disequilibrium meaning within a perfectly competitive general equilibrium setting, and at the same time demonstrating that wage rigidity may be exonerated as the cause, while demand stimulation may solve the problem? In short, the answer is 'no'. Many theories feature Keynesian elements but no one fully succeeds in achieving Keynes' programme. The author concludes, and I agree, that the most likely explanation is that the programme is unfeasible.

Some theories claim to explain involuntary unemployment, but turn out to fail its mission if we apply the reservation wage definition of involuntary unemployment. This is even the case when considering the broad version, i.e., the frustration definition. When considering the more narrow individual disequilibrium definition, De Vroey finds only little theoretical support for the presence of involuntary unemployment. An exception is the mal-nutrition version of the efficiency wage idea (Dasgupta and Ray, 1986). However, this model is hardly appropriate if the goal is to give a theoretical foundation for the presence of massive involuntary unemployment in Europe.

What lessons should be drawn from these conclusions? In his epilogue, De Vroey writes (p. 247) that he believes that a significant fraction of unemployed people can be classified as involuntarily unemployed in the reservation wage definition, and if so, that facts of life and economic theory would be on a collision course.

This is a strong verdict over the existing economic theory and, in my opinion, it is unwarranted. First, De Vroey is not very precise when talking about involuntary unemployment in the real world:

“One might, for example, interview people on the dole and suggest to them a job they are qualified for at the existing, or a slightly lower, wage. If they accept, they could be considered as involuntary unemployed.” (p. 247). This type of questioning does not distinguish between the two types of involuntary unemployment. Thus, those individuals who accept may ‘only’ be unemployed in the frustration definition, and we still have more than one theory explaining this type of unemployment.

Secondly, De Vroey has chosen to disregard equilibrium search theory, although it is a workhouse in labour market theory. His argument is that it is underpinned by alternative assumptions about the organisation of trade (that is, unlike the remaining theories it cannot be classified as belonging to a Walrasian or a Marshallian approach). Therefore, it does not fit into his survey and, more importantly, the involuntary modifier becomes trivialised. These arguments are rather weak. The best description of the organisation of trade in the labour market seems to be provided by the search-matching framework. In this framework, unemployed individuals would see themselves as involuntarily unemployed, if asked in the way De Vroey suggests. Wage bargaining, efficiency wages etc. may be embedded in the matching framework, and we therefore have many explanations for a high involuntary unemployment in the real world. Thus, economic theory is in accordance with the ‘facts of life’. Moreover, the fact that the involuntary modifier becomes trivial in the matching framework should not be seen as a weakness of the framework. If anything, this may indicate that the involuntary unemployment concept is not so interesting after all.

Finally, let me emphasise that, although I do not agree with his final conclusions, I think De Vroey has made an important contribution to our understanding of involuntary unemployment. The book should be of great interest to researchers and graduate students interested in Labour Economics, Macroeconomics and the Political Economy of Employment and Unemployment.

References

Dasgupta, P. and Ray, D., 1986. Inequality as a determinant of malnutrition and unemployment theory. Economic Journal 96, 1011-1034.

Layard, R., Nickell, S. and Jackman, R., 1993. Unemployment. Oxford University Press, Oxford.

Claus Thustrup Kreiner

Institute of Economics

University of Copenhagen

1455 Copenhagen K, Denmark

E-mail address: ctk@econ.ku.dk