

Labor and the Economy

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The American University

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/ Preface

For many years I have been dissatisfied with the existing textbooks in labor economics. Students in my classes have had difficulty with the several books I have used through the years. Economic theory did not seem to be integrated directly with economic policy. The theories never seemed to be exposed to adequate empirical tests. Usually only one theory in economics was presented, and I would have to supplement this material in class with the rich and exciting debate among competing schools of thought in labor economics.

Students respond better to economic theory if they know the reason they are asked to study economic theory. They also are reassured if they know that the theory will not simply be left as a set of unverified hypotheses but will be

subjected to careful and critical empirical scrutiny. And they want to know how theory relates to programs for making the economy function more efficiently and improving the lives of those who work in the economy.

So I decided to write a book that would integrate economic theory, empirical studies of the labor force, and public policies that flow from the theories and empirical studies. Moreover, I decided to pursue this objective by putting the debate among supporters of competing models into a format that would enable students to see several different approaches to each problem. For example, unemployment problems and the consequent debate about minimum wages are examined through the Keynesian, neoclassical, structural, and dual-labor-market theories. For each theory, empirical studies are presented, and the conclusions from these studies are the basis for evaluating a public policy proposal—for example, a youth subminimum wage to stimulate employment among young people in the labor force.

The book I have written is set in the 1980s—not an inconsiderable advantage, since two of the major textbooks in this field were originally written in the 1940s and 1960s. The legacy of labor economics from the 1950s, 1960s, and 1970s forms an important backdrop for a consideration of the problems of the labor force in the 1980s. Trade unions and their impact on the economy were of paramount interest in the 1950s, and material on those subjects is integrated into the discussion of wage determination in this text. In the 1960s such Great Society issues as poverty, income inequality, and discrimination came to the fore, and these questions are integrated into the debate over theoretical models in the discussion of “Labor and Individual Incomes” in Part I of the book. Interest in human capital models in the early part of the 1970s gave way by the end of the decade to concern over stagflation. The problems we face in the labor force in the 1980s must be understood in this historical context so that we can prepare to enter the 1990s with the appropriate labor market policies. My hope is that this book will contribute to an understanding of what public policies are needed to overcome our present difficulties in the labor force.

I start with the definition of a problem, and then I present theory, empirical studies, and policy application. In too many textbooks the authors jump right in to examine economic theory and do not prepare the student adequately for the use of the theory in policy. A topic is stated and then theory is developed. My approach is different. A foundation is prepared by a thorough discussion of the problem first. Then theory is developed and tested and applied to economic policy. For example, in Part II of the book, a chapter on measuring unemployment and the labor force is presented first, followed by a chapter on employment theory and public policy. This method helps students understand the context of theory better and provides them some motivation for grappling with difficult theoretical material.

Since 1969 I have been teaching labor economics at both the graduate level and the undergraduate level at The American University. Interaction with the students in those classes through the years has provided me with a pedagogical laboratory to experiment with my approach to the study of labor economics. It

works for me. I hope I have translated my classroom method into this text effectively. If I have, I know students will appreciate its scope and approach. Teachers will delight in having students responsive to the material of the course.

Acknowledgments

In acknowledging colleagues who helped with the writing of this book, I add the usual caveat: They are in no way implicated, and I take full responsibility for the content of the book!

While I was studying at the University of Michigan in the late 1960s, two teachers were important models for me in approaching the study of labor economics: Harold Levinson of the Department of Economics and Lou Ferman of the Institute of Labor and Industrial Relations. Throughout the 1970s, I prospered from my association with Barry Bluestone (now of Boston College), Bennett Harrison (now of M.I.T.), and Michael Reich (now of the University of California, Berkeley). We were all writing in similar ways about similar subjects, and that work as a whole influenced my approach to the study of labor economics. My coauthor for several of the articles I wrote during that period was Charles Betsey, and to him goes an equal share of the credit for those articles.

In writing this text, I have benefited from a score of readers' comments. Since many of these were anonymous, I do not know whom to thank for all of them. Readers I do know who have contributed substantially to the manuscript are Charles Craypo, Jon Wisman, Deb Figart, Michael Reich, Carol O'Cleireacain, Arne Anderson, Billy Dickens, Charles Betsey, Neil Garston, Naomi Davidson, and Lafayette G. Harter, Jr. Billy Dickens prepared the study questions. Nancy Smith was my excellent typist. A special note of appreciation goes to Ann Colowick of Academic Press, who guided the book through copy editing and production.

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1 / Labor and the Economy

Toward the end of the 1970s a new refrain was heard from the American people: "Why doesn't the economy work the way it used to?" In one form or another, this is the question citizens are asking. The question is posed to politicians. It is asked of business people and union leaders. And it is also directed at economists. Do we have adequate answers? What are these answers? Can they be successfully translated into policies and programs?

Aims of the Book

This is what this book is about—trying to find answers to the most perplexing problems we face in our economy in the 1980s. Inflation, wages, unemployment, poverty, and robotization are but a few of the important issues we look at in this

book. In one way, this book is about the issues that are the substance of political campaigns and the basis for newspaper headlines. But in another sense, this is also a comprehensive textbook in an important branch of economics. In this capacity *Labor and the Economy* takes you through economic theory, economic statistics, empirical methodology, institutional frameworks, and public policy debates—all for the purpose of helping you understand contemporary economic and policy matters.

The focus of this book is on economic issues and debates. Starting with a definition of the problem, we apply the tools of labor economics in our analysis. Economic theories are used, empirical studies are examined, and public policy conclusions are reached.

There are few, if any, settled questions in labor economics. This is particularly true today because the economic upheavals of the late 1970s caused a breach in what had previously been a consensus on some issues. For this reason several alternative theories and points of view are introduced in this book in connection with each economic problem.

The problems of our economy in the past ten years have created an explosion of new ideas, theories, and empirical studies. There has probably been as much new material produced in labor economics in the last 15 years as in the previous 50. These new approaches to the study of labor economics form the core of many of the sections and chapters of this book.

Labor is an integral part of the economy. What labor does affects the economy and what happens in the economy affects labor. These interactions form a theme that runs through this book. Trade union wage settlements influence prices, other wages, and the general standard of living. Fiscal and monetary policies, on the other hand, affect unemployment, which in turn influences the activities of labor. Labor and the economy form a whole, and they must be looked at together.

In another sense labor is something different from the abstractions that textbooks use. We say we “work for a living,” but that phrase is deceptive. Work is a means toward the end of consumption, as “working for a living” implies. But work is also tied up with living itself and cannot easily be disentangled from the roots of our existence. Our identities as human beings are defined in a significant way by our work. This fact makes the study of labor economics more difficult and complex, and at the same time richer and more challenging.

Recent History of Labor Economics

Labor economics today is at a juncture in the evolution of economic ideas. The complacency of the 1960s, when it appeared that economic problems could be managed by Keynesian fine tuning, has given way to sharp debate over what to do with an economy that seems to be unresponsive to the policies of an earlier era. Students wonder what has gone wrong with the economy; where definitive solutions are not immediately available, they seek clear alternatives based on careful reasoning.