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# UNEMPLOYMENT, INSTITUTIONS AND THE LIVING STANDARD IN THE CLASSICAL THEORY OF WAGES*

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The interpretation of the theory of wages in classical economic theory, or more specifically in Ricardo, has recently been the subject of much controversy (surveyed in Hollander, 1983, pp. 314–8; Rosselli, 1985; Peach, 1988). Some interpretations have suggested that 'supply' and 'demand' play an important role in Ricardo's wage theory. Accordingly, it has also been suggested that there is a strong continuity between classical and contemporary theories of distribution, as both offer a 'demand and supply' explanation of the wage rate (Hicks and Hollander, 1977, pp. 351–69; Samuelson, 1978, pp. 1415–35; Casarosa, 1978, pp. 38–63; Hollander, 1990, pp. 730–50). By contrast, other interpretations have maintained that in Ricardo (and in classical theory in general) the normal wage level is essentially given at the subsistence consumption of the workers, which is in turn explained by socio-historical factors as well as by biological needs. Classical distribution theory is therefore regarded as quite distinct from contemporary theory (Stigler, 1952, pp. 187–207; Kaldor, 1956, pp. 83–100; Pasinetti, 1960, pp. 78–98; Garegnani, 1984, pp. 291–325; Caravale, 1985). In turn, the attitude towards this distinct character of classical distribution theory differs. Some consider it as a shortcoming of the theory. But others regard the classical analytical framework as a suitable alternative to marginalist distribution theory, the latter encountering both analytical inconsistencies and difficulties in the explanation of real world phenomena.[1]

While closer to the second stream of thought, the view emerging in the present paper enriches and develops it in some important respects. For one thing, it will be maintained that in the classical approach the natural wage rate does not necessarily coincide with subsistence consumption, even when the latter is defined, as it must be, in social/historical terms and not as a biological minimum. As the two do

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[1] See in particular Garegnani, 1990, pp. 118–22. This contribution differs from others in the second stream of interpretation in considering the role of unemployment in classical wage theory. Along similar lines Picchio (1981).

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not coincide, it becomes important to understand what factors, according to the classical economists, determine whether the natural wage settles at the subsistence minimum or a higher level. The following reconstruction contributes to this understanding and highlights the role played not only by institutional factors but also by economic influences, and particularly by the size and trends of unemployment.

The main features of the classical approach to wage determination and labour market analysis will be expounded as follows. Initially, the main concepts entering classical analysis will be defined and some of their mutual relationships discussed (sections I–V). This description of the main 'building blocks' of classical theory will help clarify the differences between it and other explanations of the wage rate. The circumstances that determine the natural wage are subsequently described (section VI). The last two sections discuss two important implications of the classical explanation of the natural wage. The first is that no strict analogy can be drawn between the determination and definition of the natural price of labour and the natural price of any other commodity. The second implication, which is related to the first, is that competition in the labour market is conceived as operating within given boundaries. This view, it will be maintained, is supported by a conception of human behaviour which differs from that prevailing in contemporary economics. In the conclusion I shall briefly return to the implications of the present analysis for the above-mentioned controversy on the interpretation of classical wage theory.

## I. THE NATURAL WAGE RATE

By the term 'natural wage' or 'natural price of labour' Smith and Ricardo usually indicated a quantity expressed in money terms. However the main object of their wage theory is the determination of the 'natural' level of the *real* wage rate. It is this real wage rate which is taken as given, a datum of the theory, when determining the relative prices, the net income or surplus, or when discussing the incidence of taxation. Once the natural prices of the goods on which the wages are usually spent are determined, the value of the natural wage rate in money terms is also known.

In this context, clarification is also needed about the concentration of the classical theory on the explanation of one single rate of remuneration, the natural wage, when observation immediately reveals the existence of a multitude of wage rates in the different employments of labour. Actually, the 'natural wage' of classical economists is explicitly defined as the wage of the 'common labourers' or the 'labourers of the meaner sort'. That is, of male adult workers who did not possess any special qualification or ability, who were at the lowest position in the pay scale (excluding female and child labour), and were regarded as constituting the vast majority of the working population. This simplification of the analysis, however, does not necessarily reflect a lack of perception of, or a lack of interest in pay differentials. It rather follows, and is analytically legitimated by, the view that the

[1] All references to Ricardo are from volumes of his *Works* edited by Sraffa (1951–73). That wage differentials tend to be constant over time has also been suggested by recent empirical studies: see for example Phelps Brown (1955) and Routh (1980).

proportions between the wages of different sorts of labour tend to be very stable over time (Smith, 1776, I.vii.36 and I.X.c.63; Ricardo, I, pp. 20–1).[1] This implies that any change in the wage rate of 'common', unskilled workers will tend to be accompanied by a shift in the entire wage structure, so as to preserve those proportions, which were regarded by Smith as determined by the costs of acquiring certain skills, by the advantages and disadvantages of the various professions, and by institutional and social factors.[1]

It has sometimes been suggested that the 'natural' values of classicial theory were possessed of peculiar meanings, foreign to modern economic theory, i.e. they were regarded by the classical economists as reflecting some natural and harmonious order of divine origin. This attitude, it is also sometimes argued, undermines the scientific value of their theory, for it made it impossible to distinguish between its normative and analytical content (Zamagni, 1987). Others however have remarked that the philosophical belief in an underlying harmonious order did not hinder scientific research either in economics or other fields, and particularly in natural sciences, where fundamental advances were made under that very influence (Taylor, 1929, p. 17; Schumpeter, 1954, p. 111).

Furthermore, despite the influence of natural law philosophy on the classical economists, they would hardly subscribe to the idea that natural economic entities reflect an underlying just and harmonious order. Indeed it has been argued that Smith and his successors actually found many important flaws in the unregulated natural order, and believed that society could attain harmony only through the introduction of a system of moral and legal rules (O'Brien, 1975, p. 24; Taylor, 1929, p. 17).

Remarkably, it is mainly in the sphere of income distribution that the economic analysis of the classical economists tends to highlight the existence of a conflict of interests, rather than harmony, among different social classes. In some instances this was an unintentional result of the analytical developments of the theory. It has been argued for example that the French Physiocrats were embarassed by the fact that their economic theory tended to show potentialities for conflict of interests among social classes, in contrast with their philosophical and political views (Vaggi, 1987, pp. 177–82). By contrast, a harmonious conception of the economic mechanisms appears to have become stronger towards the end of the last century, in the very period that witnessed the abandonment of the classical approach (Taylor, 1929, p. 30–1).

In conclusion, the natural values (wages, prices) of classical economic theory are simply those that reflect the operation of the 'laws' or 'tendencies' underlying the social phenomena under analysis. Indeed, the 'natural' values of the classical economists are in this respect what Marshall defined 'long period normal' values

[1] Concerning the last factor, consider the following passage: 'We trust our health to the physician, our fortune and sometimes our life and reputation to the lawyer and attorney. Such confidence could not safely be reposed in people of a very mean and low condition. Their reward must be such, therefore, as may give them that rank in the society which so important a trust requires' (Smith, 1776, I.x.b. 19).

(Marshall, 1920, pp. 314–5). Like these they are determined on the one hand by neglecting the temporary and accidental phenomena which at any moment disturb the operation of the more persistent underlying tendencies (Schumpeter, 1954, p. 112, n. 5); on the other hand they are determined under the provisional assumption that no changes are taking place in the relevant data. As Marshall writes: '[the] doctrine of Adam Smith and other economists [is] that the normal or "natural" value of a commodity is that which economic forces would bring about if the general conditions of life were stationary enough to enable them all to work out their full effect' (Marshall, 1920, p. 289). Changes in the data of the theory associated with the accumulation process and structural change (innovations, variations of 'tastes') determine what Marshall defined as 'very gradual, or *secular* movements' of the normal values (*ibid.*, p. 315).

The theory of wages of the classical economists therefore has for its object the indication of the circumstances that determine the natural wage rate in any given normal, or 'long run', position of the economic system (Garegnani, 1976). Changes in these circumstances (caused, as will be seen below, by the accumulation process, demographic and institutional changes, etc) will give rise to the 'secular movements' of the natural wage.

## II. SUBSISTENCE

In classical economics the notions of the natural wage and 'subsistence' consumption are closely intertwined. Contrary to what is often believed, however, the two did not coincide.

'Subsistence' comprises 'the quantity of food, necessaries and conveniences become essential to [the labourer] from habit' (Ricardo, I, p. 93). Or as Smith writes 'not only the commodities which are indispensably necessary for the support of life, but whatever the custom of the country renders it indecent for creditable people, even of the lowest order, to be without' (Smith, 1976, Vol. ii.k.3). Subsistence consumption is not therefore biologically, but historically and socially determined,[1] and was regarded as a minimum, below which the real wage rate cannot persistently fall. It is, according to Smith, the 'rate below which it seems impossible to reduce, for any considerable time, the ordinary wages even of the lowest species of labour' (*ibid.*, I.viii.14); or, as Turgot writes: 'Pour le salaire de l'ouvrier, le prix fondamental est ce que coûte à l'ouvrier sa subsistance [...] il est un minimum au-dessous duquel [la valeur courante] ne peut baisser' (Turgot, 1767, II, p. 663).[2]

It was generally maintained by the classical economists that the natural wage rate had a tendency to coincide with this social minimum. However, this tendency was

[1] On the classical definition of the subsistence minimum and its continuing validity under present-day conditions see Sen (1985).

[2] 'As far as the wage of the workman is concerned, the fundamental price is the cost of his subsistence [...] it is a minimum below which [the current value] cannot fall'.

regarded as the consequence of specific circumstances, which tended to prevail in the historical context they were observing. Smith describes such circumstances in some well-known passages in *The Wealth of Nations* where the bargaining advantage of the masters is attributed to the urgency of workers' need to obtain employment, to legislation hostile to their 'combinations', and to the existence of unemployment.[1] Should these circumstances change in a direction favourable to the workers (as it happens, according to Smith, in rapidly growing economies) their bargaining position would improve and the natural wage rate would be established at a rate higher than subsistence.

Conceptually therefore subsistence is the minimum possible level of the natural wage. The latter is the central or average wage rate, around which the actual (market) wage rate may continually fluctuate because of continuously occurring temporary and accidental disturbances of the economy. The natural wage rate does not *necessarily* coincide with subsistence and may be above it if circumstances are favourable to the workers.

There is yet a further aspect to the relation between the natural wage rate and subsistence consumption. The latter, as we have seen, is a historical and social minimum, determined by 'habit and custom'. Because of this it cannot be supposed to be entirely unrelated to workers' usual incomes. A change in the natural wage rate, if sufficiently persistent, may therefore gradually induce a change in the habitual consumption levels, and lead to enlargement or improvement in the set of commodities which 'the custom of the country renders it indecent, for creditable people, to be without'. In other words, a 'ratchet effect' will tend to take place, which will tend to move the 'subsistence' social minimum upwards as a consequence of a sufficiently persistent rise of the natural wage above its previous minimum level. This relationship is described particularly well by Sir James Steuart:

> the workmen, having long enjoied them [higher incomes] will have bettered their way of living; and as they are many, and live uniformly, anything which obliges them to retrench a part of their habitual expence, is supposed to deprive them of necessaries (Steuart, 1766B, Vol. III, p. 11; see also 1766A, pp. 192–3).

## III. DEMAND FOR LABOUR

The influence of what have become the habitual modes of thought has led to the belief that the classical economists conceived labour demand as an inverse function of the wage rate, albeit perhaps still in a rough and approximate way (Blaug, 1985, p. 44, among others).

Actually, in classical economic theory the term 'demand for labour' indicates a given quantity (the number of workers employers want to hire). It is the employment level in the capitalist or market sector of the economy[2] and not a

[1] Smith, I.viii.12; I.viii.24–26. These points will be developed below, section VI.

[2] By the term 'demand for labour' Ricardo indicated only the workers demanded in the 'productive', capitalist sector of the economy. Smith also included the servants hired at a wage.

schedule representing the alternative equilibrium employment levels for the employers at varying wage rates, as in marginalist theory. In any normal position of the economy, the demand for labour in the sense just explained is determined by the existing productive capacity, the size and composition of which has been determined by the previous history of accumulation. The full utilisation of this capacity (Say's law is assumed to hold),[1] given output composition and the production techniques in use, will uniquely determine a corresponding level of the demand for labour.

In support of this interpretation one can think of the analogy with the 'demand' or 'effectual demand' of a commodity. Effectual demand is the quantity of the commodity that consumers are willing to purchase at the normal price.[2] The notion of a decreasing demand for labour with respect to the wage rate has been attributed to the classical economists on two (complementary or alternative) bases: the wage-fund doctrine on the one hand and on the other substitution mechanisms in production and/or consumption similar to those constituting the foundations of the decreasing demand schedules for factors in modern marginalist theory.

However, wage-fund theory was fully developed only after Ricardo's death. Its two main features: (a) the notion of a pre-determined wage fund, given before and independently of income distribution, and (b), that of an inverse relation between the wage rate and the employment level, are not only absent from the writings of Ricardo and his predecessors, but were explicitly criticised by the former, when

[1] Classical wage theory, however, is fully compatible with the abandonment of Say's law. See Eatwell, (1983); Mongiovi (1991).

[2] Smith, 1776, I.vii.7–8; Ricardo, I, p. 91. On this point see Garegnani (1983); Id., 1987, pp. 563–6 and Roncaglia (1982); despite his different interpretation of classical demand theory Hollander himself (1987, pp. 66–7) admits that in the key passages of *The Wealth of Nations* the 'proportion' between 'the quantity brought to market' and 'the demand' is actually the ratio between two given quantities, and that there is no reference to demand schedules in the text. By contrast, Benetti (1981) has interpreted 'effectual demand' as a given *sum* equal to the natural price of the commodity times the quantity bought at that price. This sum is given in the sense that it is always spent (no more and no less) in the purchase of the commodity, whatever the quantity actually 'brought to market'. It follows then from this interpretation that the market price is determined by the ratio of 'effectual demand' (so defined) to the 'quantity brought to market', and that there is always market clearing. This, however, is incompatible with Smith's discussion of the subject. He writes for example that 'the market price will sink more or less below the natural price [ . . . ] according as it happens to be more or less important to [the sellers] to get immediately rid of the commodity. The same excess in the importation of a perishable will occasion a much greater competition than in that of durable commodities' (Smith, 1776, I. vii. 10). This obviously implies that the excess supply of the commodity is not necessarily entirely sold, and that the market price is not necessarily 'market clearing'. In addition, Smith argues that when there is shortage of a commodity, the market price will rise more or less not only according to the 'greatness of the deficiency' but also according to the 'wealth and wanton luxury of the competitors' and 'as the acquisition of the commodity appears to be of more or less importance to them. Hence the exorbitant price of the necessaries of life during the blockade of a town or in a famine' (*ibid.*, I.vii. 9). Several factors that do not come into Benetti's explanation therefore influence the market price. The last remark about blockades and famines in particular forces one to doubt the legitimacy of regarding the sum each consumer will spend in any commodity as given. It seems indeed much more likely that consumers will be ready, for example, to sacrifice the consumption of some commodities in order to acquire those that are most necessary or useful.

confronted with their first appearance in the writings of some of his contemporaries, Malthus among them (Ricardo, I, pp. 406–7; II, pp. 135–6; VIII, pp. 236–7, 255–8, 273). Ricardo and his precursors thought that the quantity of each commodity produced was determined by 'effectual demand' for that commodity. Wage goods were no exception to this general economic principle. Accordingly, the amount of such goods produced in the economy (the wage fund in real terms) could not be regarded as independent of income distribution, the real wage level evidently playing a crucial role in the determination of the 'effectual demand' for those goods. In other words, the 'wage fund' could not determine the real wage rate, but was determined by it (Stirati, 1991, pp. 180–90).

Concerning the presence in classical theory of substitution mechanisms similar to those of contemporary marginalist theory, it should be clear that the issue is *not* whether classical economists conceived the production coefficients or the composition of consumption as absolutely fixed and unchangeable; or whether or not they would admit that changes in income distribution or in relative (natural) prices might affect them. Much more specifically, the question is whether they conceived the relationships of a *systematic* and *general* nature that constitute the necessary analytical foundations of the decreasing demand schedule for labour in contemporary theory. In other words, whether it can be said that the classical economists: (a) thought that a change in income distribution would *systematically* determine a shift in production methods such that a rise of the wage rate would induce the use of less labour-intensive techniques (and vice versa); and/or (b) thought that the increase of the relative price of 'labour-intensive' commodities following an increase of the wage rate would *in general* determine a change in consumption patterns such as to reduce the demand for relatively more labour-intensive commodities (and vice versa).

Such a systematic relation between the natural price and the consumption of a commodity is clearly denied by several passages in Ricardo's writing (I, pp. 237, n., 325–6, 385). Besides, it has been argued that the instances of influence of changes in the natural price on the quantity demanded can be more consistently analysed (and were in fact analysed) within the classical framework by other means than demand schedules (Garegnani, 1987, pp. 564–5).[1]

[1] Demand schedules are often attributed to the classical economists on the basis of their discussion of market prices, the main argument being they acknowledged that a rise in the market price of a commodity would induce a reduction in its consumption (and vice versa). But market prices in Smith and Ricardo are not equilibrium prices. In the sense, for example, that they do not necessarily equalise supply and demand: in cases of excess supply there are indications that both Smith and Ricardo thought that the commodity would not necessarily be entirely sold (Smith, 1776, I.vii.10; Ricardo, I, pp. 297–98); in cases of excess demand on the other hand, the diminished consumption is the unavoidable consequence of the (temporary) scarcity of the commodity and not the result of consumers' substitution in their consumption baskets as relative prices change. Market prices are the actual, observed prices which temporarily deviate from the natural ones in consequence of accidental mismatching between the quantity supplied and that in demand. Their adjustment towards the natural price does not require the notion of a decreasing demand schedule (see Roncaglia, 1982A, pp. 354–5, 1982B, p. 374; Garegnani, 1983, and 1987, pp. 565–6).

Concerning direct substitution between labour and other inputs, it is fairly widely recognised that such a mechanism was not envisaged by the classical economists, for techniques tended to be regarded as given in any normal position of the economy, and gradually changing with the accumulation process as a consequence of innovations and returns to scale.[1]

Ricardo (and before him Barton, 1817) discussed the possibility of substitution of machinery for labour in his famous chapter *On Machinery*. Although he was clearly concerned with technical innovation (i.e. 'the *discovery* and use of machinery': Ricardo, I, pp. 390, 391, 392), rather than with choice among already known alternatives, as is the case with modern economic theory, he maintained that the introduction of machinery could be stimulated by changes in the wage rate (*ibid.*, p. 395), a view that might seem suggestive of later neo-classical developments. His analysis however appears to be lacking some of the essential features of contemporary marginalist theory. The decrease of the employment level following the introduction of machinery (possibly stimulated by a higher wage rate) is argued to be possible in principle. In practice, however, according to Ricardo, machinery would often be introduced not through the 'diversion' of existing capital from its previous employments, but by investing the additional savings in its acquisition. Thus its introduction would usually affect the rate of growth of employment, but not its level, as would instead be required for the construction of a decreasing demand schedule for labour. The latter also requires reversibility of change, and this is not contemplated in Ricardo's (nor in Barton's) treatment. He did not envisage the possibility that unemployment following the introduction of machinery would induce a reduction of the wage rate and, consequently, a rise of the employment level until full employment was reached again. This, by the way, is precisely the aspect of Ricardo's discussion that has puzzled many contemporary economists, leading them to attribute peculiar errors and inconsistencies to his treatment of machinery.[2]

Changes in the composition of final demand were mostly associated by the classical economists with the rising income levels accompanying accumulation (Engel's law). 'Tastes' and their changes (taken as exogenous data in marginalist theory) were sometimes also analysed in sociological terms, stressing the importance of factors such as social imitation, the ambition to move upwards in social consideration and desire to preserve the achieved social status.[3]

[1] On the fact that techniques tended to be regarded as given by the classical economists see for example Blaug (1987, p. 441) and Schumpeter, who argues that they conceived of technical change as resulting only from innovation or scale economies, and not substitution (1982, p. 679, n. 94); Hollander himself (1973, p. 219) states that for Smith technical change was due to progress and innovation and not to changes in production methods following changes in distribution.

[2] Wicksell, 1934, I, p. 137; Schumpeter, 1954, p. 683; Blaug, 1985, p. 185, among others. Montani (1985) has by contrast shown how the conclusions reached by Ricardo are the consistent result of his theory, which differs from that of Wicksell (the marginalist approach).

[3] J. Steuart writes for example: 'The moment a person begins to live by his industry, let his livelihood be ever so poor, he immediately forms little objects of ambition, compares his situation with that of his fellows who are a degree above him, and considers a shade more of ease, as I may call it, as an advancement not of his happiness only, but also of his *rank*' (1766A, p. 272, see also *ibid.*, pp. 270–1).

Changes in distribution affect the output composition in a given normal position of the economy because of differences in the consumption patterns of the classes receiving different types of income. This of course may affect the employment level. For example, it may increase as the wage rises if the production of 'corn' consumed by the working classes requires (directly and indirectly) more labour inputs than that of 'luxuries' consumed by the capitalists (or vice versa). Such effects, however, can go in either direction according to circumstances, and have nothing in common with the change in output composition which, according to modern economic theory, would follow a change in distribution because of relative price variations and substitution among consumption goods.

Despite the recent revival of interpretations following the original example of Marshall, that tend to emphasise the similarity of the classical and contemporary approach (Hollander, 1973, 1979, 1987; Samuelson, 1978; Rankin, 1980), many scholars have denied the existence of those notions in the body of classical economic theory.[1] Indeed, even those who emphasise similarity often admit that substitution mechanisms were not really formulated by classical economists, but rather that their theory would benefit from being integrated and 'rationalised' by the introduction of such mechanisms (Hollander, 1983, p. 370; Id., 1979, p. 276; Barkai, 1967, p. 75 and 1986, pp. 609, 611–2).

Some interpretations attribute a particular kind of decreasing 'demand schedule' for labour to the classical economists (Levi, 1976, pp. 235–52; Hicks and Hollander, 1977; Casarosa, 1978; Samuelson, 1978; see also Schumpeter, 1954, p. 667, n. 50). This is based on the positive relation between the accumulation rate (hence the rate of growth of employment) and the profit rate. Given the inverse relation between the wage and profit rates, the employment growth rate is represented as a negative function of the wage rate. The function therefore does not concern the level of employment in a given normal position of the economy (that is, with no accumulation or decumulation taking place) as when demand schedules are drawn in marginalist theory.

This peculiar 'demand curve' can be regarded as a somewhat misleading representation of classical thought. It is true that Say's law was generally believed to hold, so that growth did depend on the rate of saving/investment, and the latter was indeed regarded as essentially coming out of profit income. Yet Smith believed that the propensity to invest, and hence the rate of growth of the economy, would not depend on the rate of profit.[2] Ricardo emphasised that the fall of the profit rate, by diminishing the income potentially available for investments, would slow down the accumulation process. But he did not believe that a once and for all diminution of

[1] See for example Cannan, 1893, pp. 200–206 and 382; Knight, 1956, p. 75. Hutchison (1952) denies that Ricardo provided any contribution to neoclassical economics, and lists a large number of neoclassical authorities who 'explicitly rejected the Ricardian theory of value and distribution in the bluntest terms' (p. 76). He also includes Smith in this negative appreciation of the classical contribution to subsequent developments (p. 78). On Smith's distribution theory see also Schumpeter, 1954, pp. 268, 557–61, 566–7.

[2] For note 2, see next page.

the profit rate would necessarily cause a fall in investment. For example he thought that taxes on profit incomes were most likely to affect capitalists' consumption, leaving their investments unaltered (I, 152–3; see also II, p. 319, n. 39). Thus it is to be doubted that the classical economists conceived of the relation between the wage rate and employment growth as a generally valid, stable function of known parameters, as suggested by some modern interpretations.

## IV. LABOUR SUPPLY

In current economic language the labour supply (or the labour force of statistical surveys) is the number of workers (or number of working hours) offered at the current wage rate. This in turn is given by the employed workers plus people out of employment who are *actively* seeking it. In modern economic theory the labour supply out of a given population is regarded as a function of the real wage rate. It is also generally thought that this function is a positively sloped curve, at least for some interval of the values assumed by the wage rate.

In the writings of the classical economists, labour supply is identified with the population belonging to the social classes that can obtain the income necessary for their survival only by selling their labour. Of course there is always a section of the working class population that will be unable to work, like very young children and invalids. The classical economists were certainly aware of this, but it did not prevent them from considering the size of the working class population as an appropriate, albeit somewhat approximate measure of labour supply. Indeed, there is nothing wrong with this, provided that the share of the population who are not, so to speak, able-bodied, remains fairly stable in time, so that population and labour supply do actually change in the same direction and at roughly the same rate. There is one instance however in the analysis of the classics in which it is important to keep in mind the difference between the changes in population size or in its growth rate and those of labour supply, meaning by the latter the able-bodied, adult population. This is the case when classical economists discuss the effect of changes in the wage rate on population, and of variations of the latter, in turn, on the wage rate. Since population changes mainly result from variations in child mortality and in fertility, it will take time before they are actually felt on the labour market: the time required for the additional children to become labourers. The fact that, as a consequence, labour supply responds only slowly to changes in the wage rate was very clear to the classical

[2] 'The demand for labour increases with the increase of stock whatever be its profits; and after these are diminished, stock may not only continue to increase, but to increase much faster than before' (Smith, 1976, I.ix.11). Bowley (1976) thus comments this passage: 'This seems to have been a common view also during the eighteenth century. Saving appears to have been regarded as dependent on the habits and outlook of society, on his thriftiness arising from an attitude of mind and on the desire of certain sections to better themselves' (p. 194).

economists.[1] This is why changes in population in response to changes in the wage rate were not regarded as concerning the adjustment of the labour market in a given normal position of the economy, unlike the movements along the labour supply function of modern economic theory. Changes in population (or its rate of growth) were rather regarded as affecting the 'secular' movements of the economic system and of the natural wage rate.

Therefore, although an influence of the wage rate on population was generally recognised, the labour supply was regarded as a given quantity in any normal position of the economy, and quite independent of changes in the wage rate. It should be remarked that the fact that labour supply is given, does not imply that the labour actually available to the employers cannot adjust to changes in demand. The adjustment is made possible by the movements in and out of employment (and in and out of 'labour supply' as defined in modern economic language) of some sections of the population. Here we can follow Turgot's description of what happens in response to increased production and employment opportunities:

> Si cette offre d'ouvrages proposés à la classe des ouvriers de toute espèce n'augmente pas les salaires, c'est une epreuve qu'il se presente pour le faire une foule des bras inoccupés [ . . . ] voila [ . . . ] abstraction faite de toute augmentation du prix des salaires, une augmentation d'asisance pour le peuple, en ce qu'il a de l'ouvrage lorsqu'il n'en avait pas; en ce que tel qui ne trouvait à s'occuper et à gagner de l'argent que pendent les deux tiers ou les troi quarts de l'année, pourra trouver à en gagner tours les jours; en ce que les femmes, les enfants, trouveront à s'occuper d'ouvrages proportionnés à leur forces, et qui était auparavant exécutés par des hommes (Turgot, 1770, III, p. 320).[2]

There are under-employed workers that can supply more working hours, as well as some previously unemployed sections of the population that enter the labour market when there is demand for their services.

The above arguments suggest that, contrary to what is often maintained, population movements cannot be the mechanism ensuring the gravitation of the actual

[1] As is well known, child labour was very widespread at the time; yet children of extremely young age would not be regarded as potential workers. Besides, children, even when working, would not directly compete with the (male) adult workers whose wage was the main object of analysis. Thus in fact classical economists thought that a quite long period of time would elapse before the effect of improved income on population was felt on the labour market, affecting in turn the normal wage rate. Turgot (1770, III, p. 321) mentions a period of 20 years; a similar length of time is suggested by Malthus, with no objections from Ricardo (Ricardo, II, p. 225; also quoted in Roncaglia, 1982A, p. 349). Indeed Ricardo explicitly states in *The Principles* that the adjustment of population is much slower than that of any other commodity (I, pp. 165 and 220). Smith (1776, I.viii.23, n. 17) remarks that in areas where there are high opportunities for child labour, children begin to earn their subsistence at the age of six or seven.

[2] 'If these jobs offered to the class of workmen of all sorts do not raise wages, it is a proof that a crowd of unemployed apply to obtain them [ . . . ] here we have, abstracting from any increase in the price of wages, an increased comfort for the people, as there is employment where it was wanted; as those who could find an employment and earn money only for two thirds or three fourths of the year can now find it every day; as women and children will be able to find employments proportioned to their forces, which were earlier performed by men'.

(or 'market'), wage rate around its natural level in a given normal position. An example is the tendency of the real wage to adjust rapidly towards the natural level after deviations from that level have been caused by the taxation of wage goods, or by a rise in their natural price (due for example to increased production costs in the agricultural sector). Such adjustment was regarded as taking place very rapidly, so that in their theories of the incidence of taxation and distribution, economists such as Turgot, Smith and Ricardo could regard the wage rate as given in real terms at its natural level. Deviations from that level could be overlooked because of their temporary nature. Such an attitude would be inconsistent with the slow (and uncertain, see below) nature of changes in the labour supply following changes in population. The rapid adjustment of the actual real wage rate in the circumstances described, relies not on population adjustment but on the same circumstances that determine the level (in real terms) of the natural wage rate. These, as will be explained below (section VI), can be summarised in the social norms fixing the minimum subsistence wage and in the bargaining position of the workers *vis à vis* the employers. As neither are modified by taxation, they will soon re-establish the real wage level at its previous natural level.[1]

Like the influence of the wage rate on accumulation, the 'secular' relationship between the wage rate and population growth should not be regarded as a mathematical function (a particular 'supply curve') of known and stable parameters, as in some interpretations of the classics (Levi, 1976; Hicks and Hollander, 1977; Casarosa, 1978; Samuelson, 1978; see also Schumpeter, 1954, p. 667, n. 50). As mentioned above, in addition to being 'slow' in its effects, the influence of the wage rate on population was not regarded as certain, and was definitely not conceived as a mathematical relation. Quite the opposite; the classical economists generally thought that changes in the wage rate could affect population in different degrees and even directions, according to circumstances. For example a relatively high natural wage rate might determine an improvement in the worker's habitual living standard and the development of a taste for more 'conveniences' and 'luxuries' rather than an increase in the number of children per marriage (Ricardo, VIII, p. 169; II, p. 115; I, 406–7; Smith, 1776, V.ii.k.7; see also Spengler, 1959, pp. 6–7; Hollander, 1973, p. 162).

The classical economists' view according to which demographic changes are the main factor explaining the secular evolution of labour supply may appear unsatisfactory in the light of subsequent analytical developments and historical experience.

Marx for example criticised this view, setting against it his conception of the continual creation of a 'surplus population' or 'reserve army of labour' in the course

[1] Smith, 1776, V.ii.i.1; Turgot, 1770, III, p. 288; Id., 1767, II, 664; Ricardo, I, pp. 161–6. For the interpretation of why wages adjust rapidly to changes in direct or indirect taxation see Garegnani (1985); Stirati, 1991, pp. 94–107 and 186–90. The fact that the conclusion reached by classical economists about the effects of a tax on wage goods or on wage income differs from the one that would be reached by marginalist theory (that is, within the demand/supply schedule apparatus) confirms the existence of profound differences between the two theories of distribution. In marginalist theory, with a given labour supply (a vertical line in the usual diagram), the burden of taxation would entirely fall on the workers.

of accumulation as a consequence of capital accumulation itself. This, according to Marx, causes continual displacement of workers through both the expansion of capitalist modes of production in previously non-capitalist sectors of the economy and the introduction of technical innovations.

Historical experience has also shown the importance of other factors, particularly social and institutional changes (in family, schooling, welfare provisions, etc) in determining the working behaviour of certain sections of the population, particularly women, youth and the elderly, and hence the size of labour supply out of a given population.[1]

Both Marx's contribution and the role of social and institutional factors in affecting labour supply are however fully consistent with, and can be easily integrated into, the classical analysis. Furthermore, as the latter does not imply a tendency to the full employment of labour, it allows full appreciation of the influence of actual employment opportunities on the labour supply and on the evolution of the institutions and social behaviours affecting it.

Certainly there were historical reasons behind the tendency of the classical economists to identify the labour supply with the population belonging to the working classes. At the time when classical economics was developed, low incomes and widespread poverty as well as social customs were such that the people belonging to these classes, women, children and the elderly included, were generally ready to take up employment that could help support themselves and their households.

Yet the choice of the size of the working class population as an (approximate) measure of labour supply might also be regarded as a reflection of the distinctive analytical structure of the classical approach. As we shall argue in the next paragraph, once the notion of a constant tendency of the economic system towards full employment equilibria is abandoned, the current definition of labour supply appears inadequate. Namely, it becomes immediately evident that there may be difficulties in regarding it as determined independently of the actual opportunities to find a job.

## V. UNEMPLOYMENT

The unemployed, as currently defined, are people out of work and actively seeking it. The unemployment rate is the ratio of the unemployed to the labour force.

Within the classical approach, as we have seen, there is no tendency to full employment: there is no decreasing demand schedule to ensure it on the 'demand

[1] Actually, some of these changes could be described according to Marxian analysis as the result of the expansion of capitalist modes of production in non-capitalist sectors. This is particularly the case for the increase in female labour force participation, reflecting to some extent the declining importance of family-based production of goods and services (destined both for self-consumption and the market). See for example Braverman, 1974, chap. 6; Simeral (1978); Humphries (1983).

side' nor can a rapid adjustment be expected on the 'supply side'. The possibility of unemployment was therefore contemplated by the theory, and unemployment certainly existed in the real world of the day. The word unemployment, however, was not then in common use, and other words or circumlocutions were often used instead (Garraty, 1978, p. 4): the idle (as opposed to the industrious, but without the moral implications nowadays implicit in the words), or the people who 'want' employment and are unable to find it. These people included those actually seeking jobs and underemployed labourers wanting to work more days or hours than they actually could, but also those who had become vagrants, beggars and criminals. They also included sections of the population such as women and children, who may or may not be actively seeking a job, but would be ready to offer their labour services as soon as the opportunity materialised. Although not 'unemployed' according to the current definition, these people were regarded as 'wanting employment' and as part of the labour supply. The problem here is not simply one of changed historical conditions.

The issue is evidently the one we mentioned at the end of the last section. Unemployment (or the unemployment rate) as currently defined can be considered a satisfactory indicator of labour market conditions (i.e. of the existence of an excess supply) only if it can be supposed that the number of people actively seeking employment is independent from the actual opportunities to find it. Such an assumption is legitimate only in so far as it is possible to suppose, as it follows from contemporary marginalist theory, that the economic system tends to be at full employment or around it, and that unemployment is always of a frictional or of a temporary nature. By contrast, in a world in which such a tendency does not exist (as in the world of classical economic theory), it must be supposed that a persistent difficulty in finding employment will discourage at least some sections of the population from actively seeking it.

In such circumstances the possibility of 'disguised' or 'latent' unemployment, in the form of begging, low productivity self-employment in non-capitalist sectors and, at higher income levels, prolonged and undesired permanence in the condition of housewife, student, retired person would render inadequate the current definitions of labour supply and unemployment. In this context, the size of the (working age) population appears a suitable approximation for *potential* labour supply; while the variations in the ratio of the employed in the market sector of the economy to the population provide, along with the unemployment rate as currently defined, a further useful indication of labour market conditions, and of the changes in the size of both explicit *and* disguised unemployment.

'The proportion of demand to supply' of labour (or other similar expressions) is often mentioned in the writings of Ricardo and other classical economists as a major factor affecting the wage rate. It actually means the 'relative sizes' or the 'ratio' between demand (that is, the employment level) and supply (that is, population) and was regarded by these economists as an indicator of labour market conditions, along with the number of unemployed in a stricter sense.

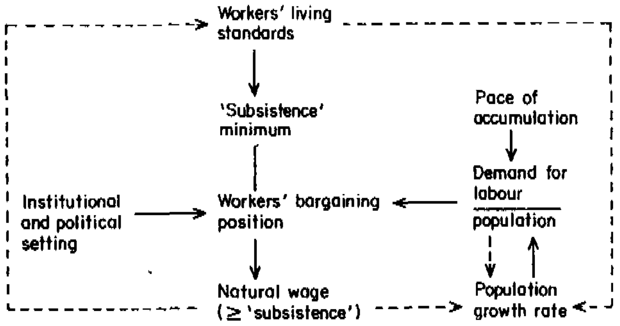


Figure 1.

In the light of the previous discussion, the term unemployment will henceforth be used in a wider meaning than usual, indicating also people who, although not actively seeking a job, would take up employment, or work more hours, if they had the opportunity to do so.

## VI. THE DETERMINATION OF THE NATURAL WAGE RATE IN THE CLASSICAL APPROACH

Having defined some of the main concepts in the analysis of the labour market, we can now pull the threads together, and turn to the discussion of how the natural or normal wage rate is determined within the classical approach.

The natural wage rate can be regarded as the result of two sets of circumstances. On one hand at any time there are inherited social habits and conventions resulting, to a large extent, from the past history of bargaining and conflict between social classes. These may be embodied in largely accepted social behaviour and norms or in particular institutions. The obvious examples are the existence of a widespread notion of the minimum, socially acceptable and 'fair' wage; and the existence of legal rules fixing it. Such inheritance is the starting point for the bargaining over the wage rate, and establishes its minimum possible level. On the other hand there are all the circumstances that influence the bargaining position of workers with respect to employers in a given period and place.

The main factors entering the determination of the natural wage rate are summarised in Fig. 1. The living standards of the workers determine the minimum subsistence level of the natural wage rate. As explained above, this minimum can gradually change over time, but is the reference/starting point for bargaining in a given period. The circumstances that affect the bargaining position of the workers in turn can be grouped under two main headings.

The first is what I have labelled the 'institutional and political setting'. This includes what was regarded as an essential feature of an economic system based on wage labour: the fact that the workers can obtain the income they need for their support only by selling their labour, and are therefore under constant pressure to obtain employment. This is always recalled in the discussion of wage determination by the classical economists. One of the causes of the masters' advantage in bargaining over the wage rate is, according to Smith, the fact that 'Many workmen could not subsist a week, few could subsist a month, and scarce any a year without employment' (Smith, 1776, I.viii.12). Turgot, in his *Reflections*, affirmed that 'The simple workman, who possesses only his hands and his industry, has nothing except in so far as he succeeds in selling his toil to others' (1766, p. 122) as a premise to the statement that the wage rate will always tend to be limited to what is necessary for subsistence. Necker attributed the tendency of the wage rate to subsistence to the power the employers (*propriétaires*) had over the workers and saw this power as depending upon:

> la prodigeuse inégalité qu'il y a entre les hommes qui vendent leur travail pour vivre aujoud'hui, et ceux qui l'achètent pour augmenter simplement leur luxe ou leurs comodités: les uns sont pressés par l'instant, les autres ne le sont point; les uns donneront toujours la loi, les autres seront toujours contraints de la reçevoir (Necker, 1775, I, p. 137).[1]

Along with this fundamental feature, the 'institutional and political setting' also includes other factors, more specific to a given place or historical period. Smith attributed great importance in determining the masters' bargaining advantage to the legislation of his country concerning workers' combinations (1776, I.viii.12). Hume also attributed an important role both to the ability of the workers to combine and to the 'form of government' existing in the country:

> The poverty of the common people is a natural, if not an infallible effect of absolute monarchy; though I doubt, whether it will be always true, on the other hand, that their riches are an infallible result of liberty. Liberty must be attended with particular accidents, and a certain turn of thinking, in order to produce that effect. Where the labourers and artisans are accustomed to work for low wages, and to retain but a small part of the fruits of their labour, it is difficult for them, even in a free government, to better their condition, or conspire among themselves to heighten their wages (Hume, 1752, p. 16).

Necker, too, thought that the 'form of government' had an important role in affecting the conditions of the working classes:

[1] 'The terrible inequality between those who sell their labour in order to be able to meet the subsistence needs of the day on the one hand, and those who only buy this labour in order to increase their luxury and comforts on the other hand: the first are always under the pressure of immediate need, the others are altogether not affected by it; the latter will always succeed in imposing their conditions, and the former will be obliged to accept them'. Elsewhere Necker stated that the remuneration of labour depends upon the 'degrés respectifs de besoin et de pouvoir qui existent entre les propriétaires qui se font servir et les hommes sans propriété qui les servent' (1775, I, p. 68) ['the relative degree of need and power existing between the proprietors who take others in their service and the men without property who serve them'] and also that 'La classe de la société dont le sort se trouve comme fixé par l'effet des lois sociales, est composée de tous ceux qui, vivant du travail de leur mains, reçoivent impérieusement la loi des propriétaires, et sont forcés de se contenter d'un salaire proportionné aux simples nécessités de la vie: leur concurrence et l'urgence de leurs besoins constitutent leur état de dépendence' (1785, V, 323). ['The class of society whose fate is as fixed by the effects of social laws, is composed of all those who, living by their hands and industry, are forced to submit to the conditions imposed by the proprietors, and must content themselves with a wage proportioned to the mere necessities of life: their competition and the urgency of their needs constitute their state of dependence'.]

Il n'y a d'adoucissement à cette espèce d'esclavage, que dans le petit nombre d'états où la forme du governement laisse entre les mains due peuple quelque droit politique, dont la jouissance influe sur sa considération; et lui procure quelque moyen de résistence (Necker, 1785, V, p. 323).
L'Angleterre est le pays du monde où la condition du peuple paroît la meilleure, [ . . . ] il faut plutôt en chercher la cause dans la nature du governement qui donne au peuple un degré de force et de résistence qui influe sur le prix de ses salaires (Id., 1775, I, p. 313).[1]

Even Ricardo, who was less prone in his published writings to discuss the role of institutional and political factors, did make statements in his correspondence that show he too believed such factors as workers' combinations (VII, p. 203) and the political system (IX, pp. 49–50) could have a role in determining persistent changes in income distribution.

The other main circumstance affecting the bargaining position of the workers, along with the 'institutional and political setting', is the situation of the labour market, i.e. the size of both explicit and latent, or disguised, unemployment. In this respect however it is important to distinguish between the temporary fluctuations of output and employment and changes of a more persistent nature. The former, which typically resulted from the vagaries of agricultural yields, were regarded as a possible cause of temporary oscillations of the actual or market wage rate, but not of changes in the natural or normal wage rate. This was viewed as being affected by the 'average' size of unemployment which is the result of the trend rates of growth of employment and labour supply experienced by the economy.

The role played by the existence of unemployment in classical wage theory has seldom been recognised. Yet in his discussion of a stationary economy Smith clearly referred to the multiplication of hands 'beyond their employment' and to the 'constant scarcity of employment' as the reason why the natural wage rate tends to 'the lowest rate consistent with common humanity', i.e. the rate just 'sufficient to maintain the labourer, and to enable him to bring up a family' (1776, I.viii.24). Similarly, in a declining economy it is the competition among many workers unable to find employment that establishes the wage at its subsistence minimum. By contrast, in thriving economies it is the persistent 'scarcity of hands' that, causing 'competition among masters', gives an advantage to the workers and enables them to raise their wages above subsistence (*ibid.*, I.viii.16–7; 23).

Turgot explained the tendency of the wage rate to the subsistence minimum in his *Reflections* (1766, p. 122) by the fact that the employer can choose among a large number of workers forced to compete with one another and thus lowering the wage rate. The reference to the 'large number' of workers and to the competition among them suggests the existence of an excess supply of workers (Stirati, 1991,

[1] 'There is no relief from this sort of slavery except in the small number of countries where the form of government leaves some political rights in the hands of the people. These influence the consideration the people enjoy, and give them some means of resistance'.
'England is the country in the world where the conditions of the people appears to be the best, [ . . . ] the cause of this must be sought in the form of government, which gives the people a degree of force and resistance that affects their wages'.

pp. 65–68). This is confirmed by Turgot's admission, elsewhere, of the possibility of unemployment (see the passage quoted in section V above and Turgot, 1770, III, p. 321), and also by the fact he considered an increase in the employment level to be a factor that could raise the wage rate:

l'augmentation du revenu des propriétaires [ ... ] les a mis en état de faire travailler davantage, et l'augmentation du travail a fait hausser les salaires. La construction des plusierus grands édifices à Limoges et le parti que j'ai pris depuis plusieurs années de supprimer les corvées et de faire les chemins à prix d'argent, y ont aussi eu quelque part (1770, III, p. 343).[1]

This positive impact of an increase in employment on the wage rate is elsewhere attributed, as in Smith's discussion, to 'la concurrence des cultivateurs et des propriétaires qui enchériront les uns sur les autres pour attirer les travailleurs (*ibid.*, p. 321).[2]

In Fig. 1 the situation of the labour market is indicated, as was often done by Ricardo, by the ratio of labour demand (that is, the employment level) to the population. This ratio cannot by itself determine the rate of wage but 'regulates' its level in a given historical and social context. It is evident, for example, that according to the classical economists, two countries experiencing the same 'proportion' of demand to supply (that is, the same unemployment) would not in general exhibit the same natural wage rate if their institutions, political situation and workers' usual living standards (in turn related to the previous history of accumulation and class relations) differed.

It can be noted in passing that besides affecting the bargaining position of the workers and their ability to obtain a higher wage, this 'employment ratio' also immediately affects the average per capita income of the population belonging to the working class, since it represents the share of its members who have access to an income. Accordingly, an increase in the ratio of the employed to the population may affect the rate of growth of population even at a given wage rate. This is why some economists explained changes in population as the direct result of changes in the employment level, rather than in the wage rate (Cantillon, 1755, pp. 23–5, 63–5, 95; Hume, 1750, pp. 111–2; Necker, 1775, pp. 28, 35–40; Barton, 1817, p. 22).

The bargaining power of the workers, determined by the factors just described, will establish the natural wage rate at its historically determined minimum subsistence level or above it. In turn, a relatively high natural wage level may affect: (i) population growth, and hence, when its effects on labour supply are felt on the labour market, the bargaining position of the workers and the natural wage rate (for a given rate of growth of employment); (ii) the habitual living standards of the

[1] 'The increase in the revenue of the proprietors [ ... ] has given them the possibility of employing more work, and the increase in employment has raised the wages. The building of several large edifices in Limoges and the party I have taken several years ago to abolish the *corvées* and to pay for the making of the streets also had some role in this rise'.

[2] 'Competition among cultivators and proprietors who will raise wages against one another in order to attract labourers'.

workers, thus producing a 'ratchet effect' that increases the consumption level socially regarded as the 'subsistence' minimum. This will tend to keep the natural wage rate at higher levels in future periods.

For two reasons both these effects have been indicated in the figure by a dotted line. First, they take place in a long time, and may affect the evolution of the natural wage rate over time, i.e. its 'secular' movements, but not its level in a given normal position. Second, they are not certain. For example the improvement of living standards following a rise in the natural wage rate may entirely prevent its effects on population growth, or vice versa.

## VII. NATURAL PRICE OF LABOUR AND NATURAL PRICE OF A COMMODITY

The absence of a demand schedule for labour in the traditional sense in the analysis of the classical economists means that an excess supply of labour is not corrected on the demand side by a fall in the wage rate. It excludes therefore the possibility that wage flexibility will ensure a tendency to the full employment of labour.

On the other hand, the adjustment on the supply side is, in the case of labour, slow and uncertain, for the reasons already discussed. This implies that disequilibria in the labour market, particularly the existence of unemployment, are not rapidly and necessarily corrected on either the demand or supply side, and can therefore be sufficiently persistent to affect the natural or normal price of labour.

This introduces a difference in the way the natural price of labour is determined and defined with respect to the natural price of any other commodity. In the case of a produced commodity, excess demand or excess supply phenomena will tend to be corrected by the adjustment of supply following a temporary rise or fall of the market price of the commodity. Not only can this adjustment generally take place more rapidly for a commodity than for population, but it also relies upon a certain mechanism: the interest of the capitalists to produce the quantity on demand (no less and no more) in order to maximise their profits and avoid losses.

The classical economists tend to regard labour as a commodity that like any other is bought and sold on the market, and the production of which is regulated by demand. Yet the fact that the 'production' of labour in response to changes in demand depends, in the classical framework, on demographic factors makes a difference. This is reflected in the fact that while the price of a commodity coincides with the natural price when 'the quantity brought to market is just sufficient to supply the effectual demand and no more' (Smith, 1776, I.vii.11), and disproportions between these quantities only determine temporary deviations of the actual (market) price from the natural price (*ibid.*, 13–6), it is not so for the natural price of labour. This is defined by Smith as the 'ordinary and average rate of wages' (*ibid.*, 1), with no reference to equality between quantity supplied and demanded, and is said to vary according to the 'circumstances of society', that is to its 'advancing, stationary, or declining condition' (*ibid.*, 1; 34). The discussion in the chapter *On Wages* highlights that such different conditions of society affect the natural wage rate because of their consequences for the labour market, as a stationary economy (not to speak of a declining one) will feature 'constant scarcity of employment'; while persistent 'scarcity of hands' is what improves the natural wage rate in a progressive economy, where employment opportunities grow faster than population (see section VI above).

This difference between the natural price of labour, affected by persistent 'disproportions' between demand and supply, and the natural price of a commodity, which is the price obtained when the rate of profit is normal and there are no 'disproportions' in the market, did sometimes occasion ambiguities and difficulties in the writings of the classics. This is particularly so for Ricardo, who attempted to provide a definition of the natural price of labour strictly analogous to that of the natural price of a commodity in his chapter *On Wages*. Yet, he was well aware of the differences in the adjustment process of labour supply as opposed to the supply of other commodities (section IV above), and in some parts of his *Principles* (particularly, his discussion of the incidence of taxation) followed the Smithian approach in regarding the *natural* price of labour as affected by changes in the proportion of demand to supply due to a difference in the relative rates of growth of employment and population (Stirati, 1991, pp. 195–201).

## VIII. COMPETITION AND NORMS IN THE LABOUR MARKET

The absence of any automatic mechanisms of correction of disequilibria in the labour market renders entirely possible phenomena of persistent unemployment, which, as explained above, have a role in determining the normal wage rate. If in this analytical context the wage rate were perfectly flexible, given the absence of any necessary adjustment mechanisms following changes in the wage rate, the unrealistic situation of a wage rate that falls to zero (or keeps rising indefinitely) without correcting unemployment (or excess demand) would be theoretically possible.

By contrast, the classical economists thought that unemployment would tend to bring the natural wage rate to its historical/social minimum but not below it, and a tight labour market would tend to cause a definite increase in the natural wage rate above that minimum, rather than an indefinite rise. Competition among workers when there is unemployment (or among employers, when there is scarcity of hands) does not lead to a continuous fall (rise) in the wage rate for as long as the 'disproportion' persists.

For the classics as for contemporary economists competition implies that the process of wage determination is impersonal and unintentional, and that there is a tendency to uniform remuneration of labour units with the same characteristics; but it does not entail, in contrast to the view that dominates contemporary economics, a continuously falling wage rate when there is unemployment. This must mean that, when there is unemployment, the workers will not offer to work at pay rates below the socio-historic 'subsistence' minimum, nor will employers try to force them to accept such low rates. Similarly, if there is an excess demand, the employers will not compete to get the labour force they require at any price, offering ever higher wages in order to procure it.

### *What is the basis of this view?*

The writings of the classical economists suggest that precisely those norms and social conventions, the role of which is recalled in the definition of the 'subsistence' minimum, also play a role in preventing the wage rate from falling below this level. This happens because such generally accepted norms, although they do not prevent or substitute competition, establish the boundaries within which the latter operates in a given social environment. Such a view is particularly explicit in Smith's chapter *On Wages*, where the minimum, subsistence wage rate is defined several times as the minimum consistent with 'common humanity'. It is in turn related to a view of human behaviour somewhat different from the individualistic conception which is prevailing nowadays in economics. The individual's pursuit of self-interest and competitive behaviour appear to have been regarded as limited by the conventions and norms prevailing in society at large and particular social groups.

Actually, in his *Theory of Moral Sentiments*, Smith developed a non-utilitarian view of human behaviour, explained as the result of a multiplicity of motives which cannot all be reduced to self-interest. Above all, it is regarded as determined by the individual's interaction with the social community, and by his/her desire for approval (Smith, 1759, III. 2. 6). This leads the individual to accept and respect generally held norms and behaviours.[1] This view of human behaviour agrees well with the interpretation suggested, according to which competition in the labour market was conceived as operating within boundaries defined by widely accepted conventions and norms.

Such views should not be too surprising or unacceptable today, as a growing number of economists recognise, and attempt to explain, the role of social norms and notions of 'fairness' in the functioning of the labour market (Akerlof, 1982,

[1] Consider the following passages from Smith (1759): 'It is chiefly from this regard to the sentiments of mankind, that we pursue riches and avoid poverty. For to what purpose is all the toil and bustle of this world? What is the end of avarice and ambition, of the pursuit of wealth, of power, and pre-heminence? [ . . . ] what are the advantages we propose by that great purpose of human life which we call bettering our condition? To be observed, to be attended to, to be taken notice of with simpathy, complacency, and approbation, are the advantages which we can propose to derive from it (I.iii.2.1)'.
'In the race for wealth, and honours, and preferments . . . [he] may run as hard as he can, and strain every nerve and every muscle, in order to outstrip all his competitors. But if he should justle, or throw down any of them, the indulgence of the spectators is entirely at an end. It is a violation of fair play, which they cannot admit of' (II.ii.2.1).
Interpretations of Smith's view of human behaviour that support our argument can be found in Anspach, 1972; Coase, 1976, pp. 529 and 545; Raphael and Macfie, 1976, pp. 15–20; Sen, 1987, pp. 22–8; Skinner, 1979, p. 60–5, among others.

pp. 543–60; Blinder and Choi, 1990, 1002–15; Solow, 1990). One point, however, needs to be emphasised. In contemporary discussion, the 'stickiness' of the wage rate, whether explained by social norms or otherwise, in turn accounts for the possibility of unemployment. But in the classical approach it is not so, and the causal connection between the two phenomena, if any, might be reversed. According to this approach, unemployment is possible simply because there are no necessary and automatic economic mechanisms to prevent it, nor would there be if the real wage rate were completely flexible. Changes in the latter might only gradually affect the size of unemployment through possible (but not necessary) influence on the accumulation rate or population growth.

In this context, the existence of limits to competition and to the fall of wages appears inconsistent with purely individualistic behaviour on the part of the worker who, if unemployed, would still gain from taking someone else's job at a lower wage. Yet the existence of these limits would indeed benefit workers as a group and, in some respects, society as a whole. Since it would not ensure (unlike in contemporary economics) a decrease in the unemployment level, a fall of the wage rate could in general *only* result in lower incomes for the working class. Accordingly, the existence of limits to the flexibility of wages appears to favour the stability and viability of the social and economic system.

Economists who hold that social norms and institutions have an important rôle in the working of the economic system seem to believe that economists ought to be able to say something about how and why they emerge (Solow, 1990, is an authoritative attempt in this direction). The above suggest that, as far as the labour market is concerned, such an explanation may be more satisfactorily attained within the analytical framework of classical economics.

## IX. CONCLUSIONS

The controversy about the interpretation of wage theory in Ricardo, the implications of which may be extended to the interpretation of classical wage theory in general, has been described as the opposition between a 'fix wage' and a 'variable wage' interpretation (Hollander, 1983), or between interpretations attributing a central analytical role to the natural wage rate rather than the market wage rate (Caravale, 1985). Actually, the question debated may be summarised as follows. Is the wage rate an exogenously given variable determined by non-economic factors, or is it an endogenous variable of the system determined by market forces of supply and demand, and therefore (according to the proponents of this interpretation) determined as in contemporary distribution theory?

In the light of the interpretation suggested in this paper, it emerges that the question has been posed in somewhat misleading terms, which postulate a conflict between admitting the influence of labour market conditions on the (normal) wage rate[1] and the possibility of regarding the wage rate as a given variable in the classical theory of value and distribution. However they are not inconsistent, provided that the role of 'demand' and 'supply' in the classical theory of wages is correctly understood. The ratio between the employment level (demand) and population (supply) is an indicator of both explicit and disguised unemployment. As it affects the bargaining position of the workers, it has an influence on the natural, or normal, wage rate. It is essentially determined by the respective trends of employment and population growth experienced by the economic system, which in turn can very well be regarded as known when analysing a given normal position of the economy. Accordingly, recognising its influence on the natural or normal wage rate is not in contrast with taking this as given when determining the relative prices and the net income or surplus. Changes in the trend rates of growth of population or employment affect the 'secular' movements of the natural wage, and with it, the relative prices and net income.

Thus it is true that 'demand' and 'supply' of labour play a role in the classical theory of wages, but in a way quite distinct from that attributed to demand and supply in contemporary economic theory. In the latter the interaction between demand and supply schedules determines the wage rate as a full employment equilibrium price, an indicator of the relative scarcity of labour. In the classical approach it is the difference between the amount of labour demanded and the available supply — a difference that can be very persistent — that enters, along with other factors, into the determination of the normal wage rate.

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[1] Here we are neglecting the debate on the respective roles of the market and the natural wage rate in classical economic theory. This deserves some explanation. The so-called 'variable wage' or 'market wage' interpretations consider the natural wage rate — identified with the subsistence wage — as prevailing only in the stationary state. The normal positions along the growth path of the economy are characterised by a wage rate different from subsistence which is called 'market wage' but which must be still considered as the 'long period normal' wage rate according to the Marshallian definition provided in section I above. The term 'market wage', in other words, changes in meaning. What was regarded as the actual wage and not a theoretical variable by the classical economists, in turn becomes a 'normal' or 'equilibrium' theoretical variable in these modern interpretations. We have argued however that there is no difference between the concepts of natural and normal wage rate in the classical approach, and that this can differ from subsistence. The question we are concerned with here is therefore how this normal wage rate is determined in the classical approach, and whether this has distinctive features with respect to the contemporary demand and supply explanation of distribution.

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