

Pigou's Wage Policy Approach to Unemployment in the 1920s: A Neglected Contribution

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The purpose of this paper is to reexamine the significance for wage policy and theory of *The Theory of Unemployment* (1933). A.C. Pigou (1877-1959) began to study unemployment problems before World War I. He often advocated “direct state action” to lessen unemployment by increasing government expenditure. After the war, however, increasingly he viewed direct action by government as something to be exercised selectively and with caution. According to Pigou, the causes of unemployment in the 1920s were to be found not in a shortage of aggregate labor demand but primarily in the high wage-rates of some industries.

In other words, he shifted the approach to unemployment from the labor demand side to the labor supply side. That change in analytical starting point shows up clearly in Pigou's “Wage Policy and Unemployment” (1927). In that article he maintains, “If it is correct – if, that is to say, post-war wage policy is in fact responsible for adding some

5 per cent to the volume of unemployment which is normally brought about by other factors – the country is confronted with a problem of a type which pre-war economics never found itself called upon study.” Pigou's study of unemployment in relation to wage policies crystallized in 1933 into *The Theory of Unemployment*, in which his chief objective was to shed light on unemployment as an outcome of causative factors originating in the labor supply side.

My main conclusions are three: (1) Pigou's theory of unemployment developed and changed through at least two stages; (2) In the late 1920s Pigou began to emphasize the importance of wage policy as a dominant cause of the unemployment at that time; and (3) *The Theory of Unemployment* contained some arguments similar to the natural unemployment-rate hypothesis, which was popular in the 1970s.

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