At Last, A Modern Theory of Wage Determination

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A great deal of wage determination, especially that practiced in large, bureaucratic firms, is constrained in ways that did not emerge until the 20th century. As a result, the elegant, durably mainstream modeling of the great 19th-century neoclassical theorists, especially their description of labor supply, inadequately captures the present-day behavior of labor pricing. Playing by the consensus rules of contemporary macro thinking, especially the insistence on model coherence, this paper reconstructs labor-pricing theory. The renovation builds on the pathbreaking work of Ronald Coase (1937) on the proper boundaries between firms and markets as well as A.W. Phillips (1958) on the stabilization centrality of labor-price adjustment to market conditions. The goal is to accommodate vast changes in the global production landscape since the Second Industrial Revolution, a game that turns out to be worth the candle. Once enriched with the modern theory of wages, macroeconomics can be both coherent and stabilization relevant.

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