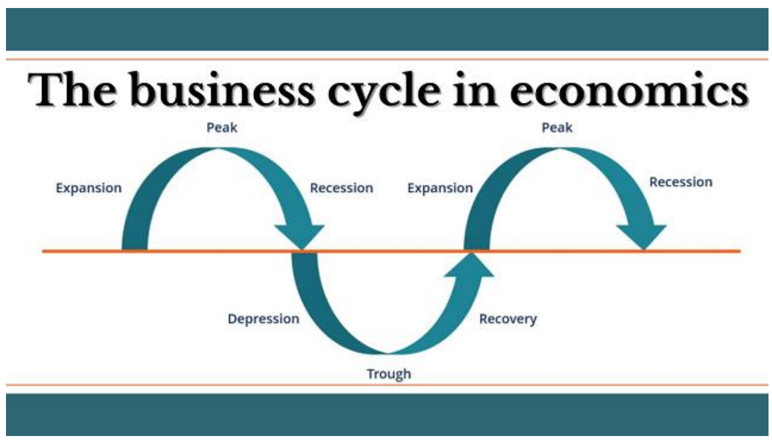
The Social Loss of Unemployment

Unemployment and cyclical instability are regarded as uncontrollable. A completely planned economy may, under certain conditions, experience periods of unemployment and idle resources. However, as one knows the typical operation of the competitive market economy sets the conditions for recurrent periods of depression, and business cycles occur in the absence of extreme income inequalities, excessive credit elasticity, price rigidities declining investment opportunities and economic stability.

The basic approach of these business-cycle theories seeking to explain economic fluctuations is largely based on the theoretical framework of equilibrium economics. But any one-sided emphasis upon such factors as oversaving or price rigidity tends to overlook numerous equally, if not more, basic disequilibrating forces which make for instability under conditions of competitive private enterprise



In order to understand the nature of the social costs of unemployment it is only necessary to elaborate some of the ideas advanced in connection with the discussion of the social costs resulting from the impairment of the human factor of production by occupational diseases and industrial accidents. It was argued that the impairment of the worker's physical and mental health in the course of modern industrial production does not differ fundamentally from the depreciation of nonhuman factors of production. And yet, in contrast with the calculable depreciation of privately owned factors of production, the impairment of the physical and mental capacity of the laborer fails to be reflected in entrepreneurial outlays under the customary wage system of the market economy as long as compulsory legislation does not provide for an adequate system of accident and industrial-health insurance.

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As a matter of fact, the costs of labor are overhead costs in an even more definite sense than are the fixed charges on capital account. Neither the laborer nor the community could escape the burden of these costs even if they wanted to do so.

Under capitalism, these overhead costs of labor are translated into variable costs "in much the same way in which the constant costs of a telephone exchange are translated into a variable charge when the user pays so much per call." In the case of the individual worker, this translation of overhead costs into variable costs is the result of the fact that the laborer under conditions of the present exchange economy is a free person who sells his services by means of a free wage contract. Under this system the burden of all overhead costs of labor is bound to fall upon the individual worker, "he is, under our social system, a free being, responsible for his own continuous support and that of his family; hence his maintenance is his own burden and not an obligation of industry, except so far as he can exact wages that will cover it." This is in marked contrast with the costs of machines and the fixed charges of the borrowed capital which have so be met by industry regardless of business condition.

It is at this point that the social costs of unemployment become apparent. For, once the fixed overhead costs of labor have been converted into variable costs, the entrepreneur is able to disregard the fixed costs of labor completely. A decline of business will be met first by a reduction of the "variable" costs of labor and thus tends to give rise to a wave of unemployment This procedure is not only the most convenient for the entrepreneur, but in view of the fruity of most capital outlays it is the only method of reducing costs of production. Periods of depression will thus give rise to a general shift of the fixed burden of labor to the individual worker, his family or the community.

The same disregard of the fixed overhead costs of labor marks all entrepreneurial decisions concemed with the introduction of technological improvements. In this case, too, entrepreneurial outlays are bound to fall short of the actual total costs, part of which have to be borne by the worker or the community in the form of greater expenditures for relief and unemployment Needless to add, this is not the result of any miscalculation by the entrepreneur but is inherent in the capitalist wage system.

In times of depression these direct costs tend to be shifted backward all along the line along which goods move toward the consumer. As soon as business conditions begin to

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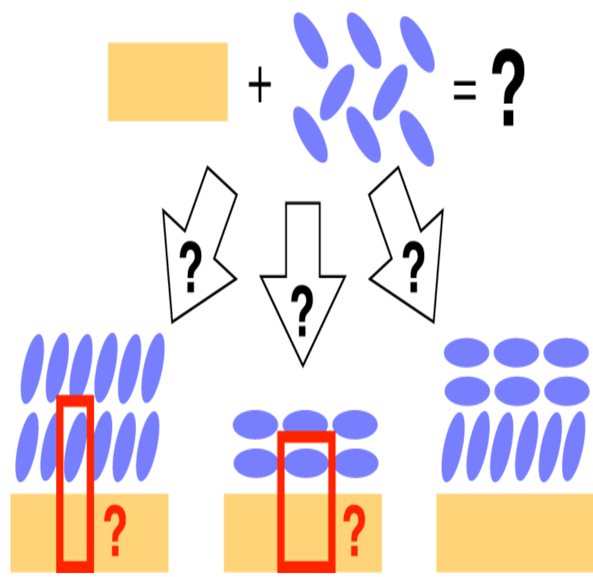
deteriorate, each individual firm reduces its variable expenditures by curtailing as far as possible its purchases of raw materials, semifinished articles, tools and other producers' goods. However, the overhead costs involved in the production of these intermediate goods remain substantially the same. Since their fixed costs have to be borne by a smaller volume of output and sales, unit costs are inevitably increased. It is this increase of costs resulting from any contraction of the demand for intermediate goods by producers closer to the consumer, which is not considered entirely in private business decisions and cost calculations. And inversely, in deciding the question whether or not it is worthwhile to resume production at full capacity, instead of keeping part of his plant idle, the individual entrepreneur can only disregard the entire series of savings which would accrue in all intermediate stages of production as a result of the fact that with increased production the fixed overhead costs in these industries could again be distributed over a larger total output. This is merely another way of saying that for the economy as a whole the difference in costs involved in partial utilization of available plant equipment as against those involved in full utilization is relatively small-so small, indeed, that as long as the additional products have any want-satisfying power there is a presumption that their production is worthwhile in terms of total costs and total returns. In other words, the cost calculations of the individual firm fail to record both the social costs resulting from enforced idleness and the economies obtainable from full utilization of productive resources.



It is this "atomistic" method of accounting which tends to distort the economic calculations of the market economy and accounts for the obviously absurd fact that no production and complete idleness are preferred to at least some output and partial utilization of available resources. Another reason for this absurdity, according to which while millions of persons are unable to satisfy their most elementary needs... nothing seems to be preferable to at least something, is that during the initial stages of the depression many cost prices reflect what the productive resources were worth in the past and not what they are worth under existing conditions. In other words, "a wage rate of three dollars per day for making shoes ought to mean that there are other opportunities for using this labor to produce something worth three dollars per day. If the worker stands idle because he is not worth three dollars per day at making shoes, that means that the three-dollar alternative does not exist or at least is not available within the limits of existing knowledge. Under these conditions, to act on the assumption that shoes are not worth producing unless they will cover the three-dollar wage is false social accounting, flying in the face of the elementary fact that anything produced is that much more than nothing. It stands in the way of our

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making the best available use of out productive resources, whatever that use may be, by insisting that they shall not be used at all unless their use will cover 'costs' which changed conditions may have rendered, for this purpose, arbitrary and misleading" The same applies to interest and rent. They too represent what capital and land were worth in the past in times of prosperity and not what they are worth under the new conditions after business has declined. It is, therefore, "inevitable that productive resources should go to waste, with the further result that they create no purchasing power to buy the products of other productive resources."

Estimates of Social Losses Caused by Unemployment

Various attempts have been made to measure the social costs of depressions in terms of the potential real national income lost due to the decline of output and employment. Using this approach, WC Mitchell and W.1. King placed the loss of income from depression in one bad year (1914) at nearly 3,500,000,000 prewar dollars— not quite one tenth of the national income. These authors also calculated on the basis of a rough approximation that "the worst years (in a cycle period) run something like 15 to 20 per cent behind the best, and something like 8 to 12 per cent behind the moderately good years." This was before the Great Depression.

In 1939, the National Resources committee estimated that the loss of national income caused by the depression years of 1929 to 1937 amounted to over 200 billion dollars. "The significance of this figure... is hard to grasp, but some idea can be obtained by considering what 200 billion dollars would mean in terms of concrete goods. If all the idle men and machines could have been employed in making houses, the extra income would have been enough to provide a new $6,000 house for every family in the country. If, instead, the lost income had been used to build railroads, the entire railroad system of the country could have been scrapped and rebuilt at least five times over. Of such is the magnitude of the depression loss in income through failure to use available resources. It meant a lower standard of living for practically every group in the community."

With a national income running at 180 billion dollars, the average annual losses of a depression (of equal severity to that of 1929) would be roughly 45 billion dollars in current prices. (This figure is arrived at by estimating that the loss of 200 billion dollars from 1929 to 1937 represents roughly 25 per cent of the potential income during these years) Estimates of this nature raise, however, a number of statistical problems related to trend analysis and the forecasting of the national product with which we cannot concern ourselves in this study.

It is clear that these estimates of the losses of depressions in terms of national income foregone fail to take account of certain less tangible consequences of recurrent disruptions of the productive process. It will probably never be possible to visualize fully, and even less to appraise adequately, the psychological effects of economic fluctuations which result from general insecurity and the frustration of the hopes of millions of

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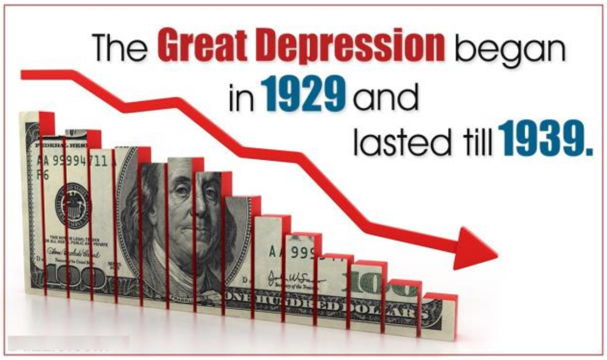
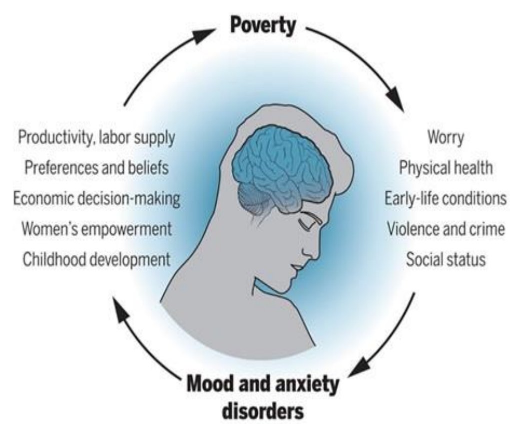
individuals. The foregoing figures also omit the social costs of depressions which are evidenced in a general deterioration of the state of public health, higher mortality,



greater incidence of crime, increased alcoholism, and lower marriage and birth rates. The political consequences of depressions are likewise beyond the measuring rod of national income. Suffice it to say that a major depression in the United States might lead not only to a cessation of foreign lending (as it did in 1929) but also to a contraction of American imports, both these developments would have the effect (as they did after 1929) of transmitting the depression to the rest of the world. The existing "dollar shortage would be accentuated and the process of reconstruction would be brought to a halt in all countries dependent upon American markets and supplies. It is not difficult now, as it was perhaps in 1929, to visualize the political upheavals that would follow in the various countries in the path of the depression.

Even if these broader social and political consequences of depressions are left out of account, it is safe to assert that the social losses of depressions are by far the most important social costs bound up with the operation of the private enterprise economy. They were seen to be reflected in a general shift of the overhead costs of labor to the unemployed and the community, as well as in the higher unit costs which result from the peculiar manner in which "variable" entrepreneurial outlays can be shifted backward to intermediate and primary stages of production. As soon as the demand for its own products begins to



fall off, each concern finds it possible and convenient to curtail its enders and "variable" costs, irrespective of the effects which such action is likely to have upon costs and employment in the preceding stages of production. In other words, instead of contributing his "share" to the fullest utilization of available productive equipment and factors of production, the individual entrepreneur finds it more profitable, or rather less expensive, to stop producing altogether. By the same token, the private firm can only disregard the economies that would accrue, in the form of lower costs in all intermediate stages of production from any resumption of production at full capacity, owing to the fact that fixed overhead charges could again be distributed over a larger total output and turnover. In this way, private outlays tend to distort and to magnify the actual costs of production in times of depression.

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