

Unemployment and the dole

By James Alexander

There is a common thread running through most of the arguments put forward to explain the current levels of unemployment. It is that the supply price of labour (the wage level) is too high relative to the level necessary to secure full employment. The major disagreements are over how this situation arose and, the not necessarily linked or obvious, proposals to improve the situation. Just because A causes a harmful effect B, does not mean it is either practicable, necessary, or just, to abolish A. It may well be that there exist further factors that enable A to cause harmful effects. In place of B we have the high unemployment level, in place of A we have the recession, the unions, automation, or the great variety and extent of state interference in the economy and society. But none of these on their own are satisfactory to explain the problem. We have had them all to a greater or lesser extent for the last thirty-five years, so we must look further to find new factors causing the sharp rise in the unemployment level.

Unemployment will always be with us. In Britain last year approximately six million people started new jobs. This was partly derived from the fact that on average about 350,000 people leave the unemployment register each month and an additional 150,000 never register in the first place or were just beginning to work for the first time. If on average each person had spent about one month unemployed this would yield an average yearly unemployment total of 500,000. In fact throughout the 1950's and 1960's the average unemployment was around this level.

The crucial figure in this respect is the average length of time spent searching for a new job. What is it that determines this length of time? Like most courses of action it will depend on a balance of the costs and benefits involved in the action. The cost of

being unemployed will be the income foregone while out of work, or rather the subjective valuation of that income - plus the subjective valuation placed on any other benefits of being in work, such as the social life in work or the respect of the community through being in work. The benefits of being unemployed depend crucially on the level and availability of any income received while out of work. In Britain this means unemployment insurance (the 'Dole') and the plethora of additional supplementary and fringe benefits. It may also include a certain amount of income from tax-free moonlighting.

'INSURANCE' OR DOLE

The usual role for insurance is to reimburse an individual for the costs arising out of an unforeseen and harmful (i.e. costly) situation. Fire insurance is to cover losses occurring after an accidental or criminally caused fire. There is always the risk that over time the valuation of the particular piece of property will change for the worse (and thus the valuation of the insurance for the better), creating the situation in which it may become very beneficial to help cause an 'accident' and so become eligible for damages. This is very widespread in New York where old and rundown property is often 'helped' (in a way that is very difficult for insurers to prove) to catch alight, so enabling property owners to claim the very high values (relative to the actual market values) that they had previously insured the property for in the event of damage.

Today there is little effective difference between unemployment insurance and the other benefits available from the state. They must therefore be considered as the total 'insurance' paid to the unemployed. Unlike other forms of insurance the benefits have become largely unrelated to any amounts paid towards the cost of the 'insurance'. Any link became even more tenuous with the ending of the earnings related supplement to unemployment benefit during the period January to July 1982. Also unlike most insurance the benefits are now available to anyone whether contributions have been paid or not. Although the *de jure* condition for

being registered as unemployed and therefore eligible for benefits is that a person must accept any reasonable offer of a job, the *de facto* position is that a person is either never offered a job or can easily turn it down.

Thus benefits are almost automatic and further, available in perpetuity.

It is often said that many claimants do not know their full entitlements and thus receive less than they should. The figures given out by the Department of Health and Social Security for the average amount collected do not show this to be very widespread. One reason is that the more people there are on benefit the more people learn of their full entitlements. Where there is widespread ignorance of the real levels of benefits is in academic and political discussion of the amounts concerned. The standard amount paid to a typical family of a man and a wife with two children, is as follows: (from January 1982 - weekly payments)

£37.75 -	for a man and wife
£11.90 -	for a child over the age of eleven
£ 7.90 -	for a child under eleven
£16.00 -	rent and rates
£ 3.95 -	heating
-£ 9.50 -	two child benefit allowances
£68.00 -	(ineligible) total payment

To find out whether this 'insurance' makes people in work more likely to become unemployed than they would otherwise have been, and makes people out of work more unwilling to rejoin the work-force, we must show what people are getting paid in work. The average gross figure to work with is the median wage (i.e. the wage level at which half the workforce earns more and half less). This now stands at a gross level of £120 per week. If we take off £35 for Income Tax and National Insurance payments we are left with a rough figure of about £85 per week as the median 'take-home' wage.

The important point is not only that several hundred thousand people earn less than they could get through benefits, but that many millions of people are earning or could only

earn a few pounds more in work than out of it. What the level of benefits does is to cut the effective wage, the wage at which people begin their calculations as to the value of working, to between ten and twenty pounds a week (£85 - £68 = £17). The decision then facing people in this position is whether the unpleasantness of work is worth the relatively small extra sum earned through turning up for a forty hour week. Given that many of the less well paid jobs are generally the unskilled, boring, tedious, repetitive, and foul jobs it is entirely possible that the disincentive effects to work are great. This means that there is an effective floor to the wage structure, provided by the state.

Many economists have been seriously misled in their tests of the theory that benefits are a disincentive to work by concentrating on the behaviour of the ratio of benefits while out of work to the average income while in work. It may well be that the ratio has remained the same over the last thirty years. But this entirely misses the major factor influencing any individual's decision to work, or to go onto (or stay on) benefit.

Say at today's prices the value of benefit for an individual was only twenty pounds and the possible income from work thirty pounds. The extra ten pounds gained through working would enable him (assuming he is independent of any other income and has to pay his rent) to live in a bedsit and eat. Whereas on twenty pounds a week one of these expenses would have to be seriously cut back. So he would be very likely to choose work rather than go on benefit. If we now hold the ratio constant but increase the real values of both the benefit and the income from work to forty and sixty pounds respectively, the individual faces a very different situation. Although the extra income to be gained through working has risen to twenty pounds (from ten) many of his most immediate needs will have been satisfied.

The value of the goods and services bought with the extra twenty pounds will have fallen, and for many people it will have fallen below the value of the original extra ten pounds gained through working.

There is a further reinforcement of this change in valuations that it is particularly important to the argument. Because his most immediate needs have now been satisfied he will value the leisure time while not working a lot more than when he was only getting a basic twenty or thirty pounds a week. So when he now chooses between taking a job and staying unemployed, his valuation of the sacrifice in time through doing a forty hour per week job will have risen.

So not only will he value the extra income gained through working less than in the previous situation, his valuation of the sacrifice in time involved through working will have risen. These two effects mean it is much less likely he will choose to work when both benefit and income are high than when they are both low.

The evidence for the behaviour of real income and real benefit is that they have both risen continuously since the war and both rose especially fast in the sixties and early seventies. In fact benefits were either linked to the price level or the average wage level, and when they differed benefits were often raised by the higher figure of the two. Thus the ratio means nothing to any individual decision-maker and can shed no light on the problems of unemployment.

The trend of the average level of unemployment since the mid-sixties has been upwards. The level during boom years has been getting higher and the level during years of slump has also been increasing. It is this upward trend that can be explained only by the upward trend in the level of real benefit. The recent doubling of the last recession level of unemployment (1976-77) and trebling of the level from the one before that (1971-72) can now be understood. The recession would also appear to be a harsher one than the 1976-7 Labour Government-induced recession. This has led to a greater shake-out of inefficiency and slack, which in turn should mean a greater labour turnover than has previously occurred. This has the inevitable result of leading to a wider dispersion of information about the level of benefit and a consequent rise in the effects of their relatively high real level.

As everything is linked together in an economy through the (government-distorted) price system the higher levels of unemployment are bound to effect the rest of the economic system. The result (for society) of having to subsidise an increasingly large army of unproductive people will inevitably be an adverse one. The failure of the wage structure to adjust to the new realities of the economy (i.e. through a temporary lowering of wages) can only prolong the recession.

STATE CONTROLS

There are many other things in processes of society and in a constantly developing economy that temporarily lead to people having to leave and change jobs. The effect of a high level of benefits will be to make the completion of these adjustments take far longer than they otherwise would have taken. It is very similar to the way other forms of state interference in the economy make re-adjustments to changes in market conditions much more drawn out and therefore damaging.

The general movement away from manufacturing in western economies has been seriously hampered by government attempts to hold back the effects of a worldwide economic development. This has meant that the societies with rapidly evolving market structures have become relatively more efficient in the production of goods using relatively unskilled labour. This should have meant that the western economies with large investments in human capital (through the result of previously accumulated and constantly renewed levels of education and health care) moved into the production of goods and, especially, services that used this advantage more intensively than the developing nations. But states in the west have continually subsidised and protected (unskilled, labour intensive) industries such as textiles, shipbuilding and farming in the face of more efficient (i.e. cheaper) foreign competition.

There are several more general state interventions that have had disastrous results in preventing the efficient re-allocation of resources. They have benefited a section of the population in the short run, but in the

long run have only led to all round immiserization.

Wage Councils covering two and a half million workers have led to the establishment of an effective minimum wage. In the industries concerned this has had the predictable effect of pricing many potential workers out of a job. The councils tend to cover the unskilled and more informal sectors of the economy such as the retail trade. This has led to a particular exclusion of unskilled immigrants, young people, and women from employment opportunities even when they wished to work.

In the 1930's when growth was occurring in the south of England there was a movement of workers to the south. But this sort of movement to where the demand for labour is highest is now seriously frustrated by the operation of strict rent and tenure control in favour of tenants. The result has been the virtual drying up of rented accommodation as landlords find the risks involved in renting out rooms and flats far too high relative to the returns available. This has the effect of hampering movement of workers to the areas of high demand and consequently higher wages. Further hampering this flow is the existence of state owned council houses. The fact that they cannot effectively be rented out or sold by anyone other than the council has meant that this hardly ever happens. This not only ties up a large proportion of the housing stock, it also ties the tenants to the house and the area where it is situated.

Wage councils and their minimum wages should be immediately abolished. Council houses and flats should be immediately given away to the existing tenants.

More difficult to assess is the effect the trade unions have on raising the unemployment levels. Insofar as they manage to gain higher than the market valuation for their member's labour, and insofar as they are able to frustrate the establishment of non-union enterprises in their industry, they will raise the wage level for their members. But the numbers employed in that industry will fall due to the artificial raising of costs, and some workers will be forced to move to areas of work where they will receive less high wages

than they would have done had the unions not succeeded in restricting employment and output. In an economy without a high level of benefits this would have normally resulted in a general lowering of the wage level, but now it may lead many workers forced out in this way onto benefit.

Something similar to the unions in that it induces a reallocation of jobs and thus brings about temporary (frictional) unemployment is automation. But like the unions it is not a cause of increased unemployment. As with the unions, it can through its introduction have side effects that when combined with a high level of real benefits will cause a marginal rise in the average level of unemployment. Nevertheless automation is much more likely to cause an increase in the overall level of employment.

Fear of automation is based on a blind ignorance of the lessons of history. Automation, the substituting of labour by labour-saving devices, is one of the chief reasons why people all over the world are living far healthier and richer lives than those of their ancestors. Automation enabled many tasks to be accomplished, that previously were left unattended through lack of time. Far more goods and services could now be enjoyed. Instead of having to work all hours of the day to keep body and soul together, the many hours saved through getting machines to do the work could be spent in leisure.

Automation then, may occasionally force a firm to lay off workers who may then decide to stay on benefit longer than they otherwise would have done and so raise the level of unemployment. But rather more likely is that any individual firm gaining in productivity through the introduction of new machinery will expand output as it is now able to sell more goods through a reduction in prices or an improvement in quality. Instead of laying off workers it is more likely to either pay its existing ones more and/or take more workers on so raising the general level of wages and the general standard of living.

Abolition of minimum wage controls, council houses, rent controls, employers' National Insurance contributions (a tax directly on employment), ending state

subsidisation of unprofitable industries (by giving them away to the employees), and the adoption of unilateral free trade, will all go some way to reducing the level of unemployment. But as long as unemployment 'insurance' is provided by the state there is always the danger that it will repeat the same mistake in allowing the real level of benefit to rise so high as to create a large *volunteer* army of unemployed people. As a start to getting back to full employment the benefits should be kept at the same nominal level so that given the continuation of rising prices the real value will fall. In the longer run, responsibility for unemployment insurance should shift to the individual, through the extension of existing private insurance and perhaps through the unions taking a greater responsibility for their members by introducing their own schemes for insurance.

AN UNEMPLOYMENT READING LIST

Articles

1. D K Benjamin and L A Kochin "An explanation of unemployment in Interwar Britain" *Journal of Political Economy*, March 1979 (For a similar view of unemployment in the thirties).

Yale Brozen: "Automation" The Retreating Catastrophe" *The Libertarian Alternative* (ed. T. Machan) Nelson, New York (Also see Brozen on minimum wage rates in the same book)

Background

1. Armen Alchian and W R Allan *University Economics*, Prentice /Hall 1974

2. H G Grubel and M A Walker (editors), *Unemployment Insurance*, The Fraser Institute, 1978

3. *Priced Out!* published by The National Federation of Self-Employed and Small Businesses, 1981

4. Edwin Cannan, 'The Problem of Unemployment', *Economic Journal*, March 1930

5. C.G. Hanson, "Welfare before the Welfare State" *IEA Readings No 9*, 1974.- (Gives some indication of how friendly societies used to provide private insurance for workers when they became unemployed or sick).

Thoughts on the sieve method

When I was doing farm work in the countryside, I used to select seed for planting. Two people, facing each other, hold a large sieve between them and shake energetically. The small, hollow grains are discarded and the full grains remain in the sieve.

After experiencing the ten years of internal unrest, I have come to a new understanding of the 'sieve method'.

The production responsibility system and fixing production quotas for the households had been called 'capitalist restoration' and 'retrogression'. No efforts were spared to sift these practices out of the countryside. However, facts have proved them effective in bringing good harvests. What really got sifted out are Leftist mistakes in the rural areas.

It had been called a good way to 'abolish bourgeois right on the medical front' to have doctors mop the floors, nurses write the prescriptions and hospital workers do the operations. That practice almost cost the lives of the patients. And the result? A quick end to that experiment and the keeping of the rational division of labour in hospitals.

Practice is the sieve. It is the criterion by which truth is known from falsehood. Everything that goes against objective laws and the people's interest, no matter how much one wishes and tries to keep it, is bound to be discarded through the sieve of practice.

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