

# **Unemployment**

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## UNEMPLOYMENT\*

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In capitalist economies, individuals and families are largely responsible for providing for their own well-being. In all industrialized and many developing economies, most workers do not have the means of production to provide for their own subsistence, but rather must obtain the means of purchase and means of payment (money) necessary for buying the means of subsistence by selling their labour-power in the market. In addition, the requirement that taxes be paid in government currency means that even those possessing the means of production to provide for their own subsistence nevertheless must usually enter the labour market to obtain that which is necessary to settle their tax obligations.

Unemployment, the failure to obtain employment that earns wages or salaries paid in money, thus has a dire impact on the jobless, and is also associated with tremendous social and economic costs for society as a whole. Whereas in neoclassical economics, market systems possess an inherent tendency to full employment, in Post Keynesian economics unemployment is seen as a normal feature of capitalist economies. The *effective demand problem* means that capitalist economies have trouble *attaining* full employment, while the *structural change problem* means that capitalist economies have trouble *maintaining* full employment, even if it could be attained. In addition, some Post Keynesians—echoing Marx—have identified the *functionality* of unemployment, which presents obstacles to Post Keynesian economic policies to eliminate unemployment. Nevertheless, Post Keynesian economics does suggest policies that might assist capitalist

economies in attaining and maintaining full employment, without resulting in other macroeconomic problems, such as inflation.

Unemployment has tremendous social and economic costs (see, e.g., Piachaud, 1997). Unemployment causes permanent losses of output of goods and services. The unemployed are faced with financial insecurity, resulting in poverty and indebtedness. Certain kinds of criminal activity are directly related to unemployment. Many studies have linked unemployment to family disruption, suicide, ill health (physical and mental), drug addiction, homelessness, malnutrition, poor prenatal care, school dropouts, racial and ethnic antagonism, and other social problems (see, e.g., Jahoda, 1982).

Unemployment also differentially affects certain sectors of the population, so that disadvantaged minorities, those with little education, and youth, e.g., can suffer from rates of unemployment two to ten times the overall rate.

Unemployment also can destabilize business expectations, as fears of low demand cool private investment. Related to this, unemployment can also lead to technological stagnation. If, as Marx and others suggest, high levels of employment stimulate technical innovation, unemployment would be associated with less innovation. Firms with high and stable levels of demand have the resources and the incentive to support going high tech; with high unemployment and thus cheap labour, firms lack the resources and the incentive to retool. It has also been shown that unemployment leads to deterioration in labour skills. All of this suggests that unemployment may lead to lower productivity growth.

Unemployment is the direct and indirect cause of many social and economic problems. It can also lead to political instability. Since Keynes, Post Keynesians have

dedicated significant attention to the problems of unemployment. Since unemployment is the cause of so much social and human misery, it is of great interest whether capitalist economies tend to full employment or whether unemployment is a normal feature of capitalism, and thus a target for government intervention.

In neoclassical economics, market systems tend to utilize all resources fully, including labour. Perfectly flexible wages, prices, and interest rates constitute the self-adjusting mechanism that will tend to eliminate unemployed resources in the long run. In the neoclassical version of Say's Law, if there is unemployment wages will adjust to increase labour demand, and interest rates will adjust to ensure that the excess of aggregate income over aggregate consumption at the full employment level of output will be invested. There is no *involuntary* unemployment in the long run, unless there are market imperfections such as 'sticky' wages, government interference, or other institutional rigidities (e.g., unions). For neoclassical economics, if there is unemployment, government should stay out and let the market correct itself; if there are market imperfections, government may promote conditions under which the self-adjusting mechanism works most smoothly, e.g., deregulation, anti-trust, etc.

In *The General Theory of Employment, Interest, and Money*, Keynes overthrew Say's law and demonstrated the possibility and the likelihood that market systems do not tend to fully utilize resources, even under competitive conditions, due to insufficient effective demand. Keynes criticized the neoclassical theory of saving and investment, arguing that traditional loanable funds theory holds income constant when looking at savings and abstracts from expectations when analyzing investment. If aggregate saving is primarily a function of income, not interest rates, and investment is determined by the

expected profitability of investors and lending institutions, then saving does not determine investment through variations in the rate of interest, and the economy does not automatically tend to full employment. Instead private investment determines savings through changes in income, but there is no reason to expect that the full employment level of investment will always be undertaken. Keynes's analysis takes place in historical rather than notional (or logical time). The past is unchangeable and the future is unknown and unknowable. Money must be understood as an institution for dealing with radical uncertainty. The result is that capitalist economies tend to operate with excess capacity and unemployment. It is therefore unlikely for a capitalist economy, on its own, to attain full employment.

But capitalist economies have problems maintaining full employment, even if it could be attained, due to ongoing structural and technological change, such as changes in labour supply and the supply of natural resources, labour- and capital-displacing technical change, and changes in the composition of final demand. An economy running at full capacity and full employment would be unable to respond to such changes, and sectoral imbalance is here added to aggregate imbalance as a further cause of unemployment. Bottlenecks and rigidities mean that full employment is likely to be inflationary. Structural change will soon result in unemployment, as technology displaces workers in one sector and fails to absorb them in another, the formation of real capital fails to keep up with the pace of a growing labour supply, or declining demand in one sector fails to be offset by demand for new products. Work such as Pasinetti's (1981) and Lowe's (1976) offers structural models that demonstrate the great unlikelihood of capitalist economies maintaining full employment, even if it could be attained.

The effective demand problem and the structural change problem are economic causes of unemployment. But Post Keynesians such as Kalecki have noted that there may also be political obstacles to full employment. Since unemployment in Keynes is a negative by-product of capitalism, it is viewed as serving no purpose in the capitalist system and so is clearly undesirable for all. Kalecki, Steindl, and others, however, have highlighted that unemployment may be functional in capitalism, an insight that is drawn from Marx's analysis of the reserve army of labour.

In Marx, unemployment serves several functions. First, it provides the system with a pool of available labour from which to draw when the pace of accumulation increases. Second, unemployment serves to discipline workers, who may not fear being laid off in an environment of full employment. Third, unemployment holds down wages, since one of the ways in which unemployment disciplines workers is to decrease their bargaining power and thus keep wages from rising. Thus, in this view, unemployment is not only a natural by-product of capitalism, it is essential to its smooth operation.

Marx postulated a number of different components of the reserve army of labour. The 'latent reserve' includes those currently outside of the market system, either performing unpaid household labour or eking out a meager subsistence in the periphery of Third World economies. The 'stagnant reserve' includes those who are almost never employed, boom or bust. Members of the 'floating reserve' alternate between employment and unemployment, with the ups and downs of the business cycle. 'Paupers' is the term Marx used to identify those who are now often referred to as the 'underclass.' Recently, it has been suggested that changes in global capitalism have rendered some of these components no longer functional. And this has resulted in an

environment conducive to policies that may promote the elimination of the emerging ‘surplus population’ with scary, genocidal, and racist connotations (Darity, 1998).

Policies to address unemployment must recognize both the effective demand problem and the structural change problem, as well as the functionality of unemployment and the emergence of a hard-core, ‘unemployable’ sector no longer functioning as a reserve army. Traditional Keynesian policies initially attempted to stimulate aggregate demand through fiscal and monetary policies. Stimulating the private sector to full employment may address the aggregate demand problem but not the structural change problem. In fact, since the structural change problem emerges most forcefully at higher levels of capacity utilization and employment, stimulating private sector demand may increase the structural change problem. Some Post Keynesians would utilize incomes policies to deal with some of the symptoms. Other routes would include promoting public works and the ‘socialization of investment.’ These latter approaches, if designed correctly, may be more effective than conventional fiscal stimulus in dealing with the structural change problem. In the framework of a capitalist economy full employment requires a policy—or a set of policies—that can increase effective demand without bringing on structural rigidity and that can eliminate unemployment while finding some institutional mechanism for dealing with the functionality question.

Recently Post Keynesians have suggested that such a policy is available in the form of a kind of permanent Works Progress Administration (Wray, 1998). Hyman Minsky (1986) referred to this as government as ‘employer of last resort.’ Under such a policy, the government would provide a Public Service Employment (PSE) job to anyone ready and willing to work. As the economy expands (contracts), the private sector

demand for labour would increase (decrease), and the PSE sector would shrink (grow). PSE workers would be employed in all kinds of social and public services that would benefit the community. Elimination of long periods of unemployment would preserve and potentially enhance labour productivity. The social and economic costs of unemployment due to income insecurity and poverty would decline, and society would experience a significant benefit in the form of less crime and other social problems associated with unemployment. The effective demand problem would be solved by maintaining aggregate income at high levels, but the PSE approach, unlike traditional demand stimulus, would address the structural change problem as well (Forstater, 1998). Instead of workers alternating between employment and unemployment, sectoral and aggregate change would only alter the proportion of private and public sector employment. PSE also can address environmental problems. Stimulating the private sector to full employment would surely result in greater pollution and exhaustible resource utilization, while PSE activities may be designed to pollute less and use less fossil fuels.

Unemployment is at the root of many of the economic and social problems of capitalism. Some would argue that, instead of tinkering with capitalism, a new economic system should be sought in which the right to a job as put forward in the United Nations Universal Declaration of Human Rights is realized. Perhaps in a post-capitalist society the employment-money link will be severed and a new mode of social and economic organization will make unemployment extinct and irrelevant. Until such a time, however, there is no reason not to go immediately to full employment with a guaranteed public service job for anyone ready and willing to work.



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