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Classical Economics of Involuntary Unemployment

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The conventional wisdom has been stated many times, for example, by Solow (1980): "Pigou says the obvious thing first, and I agree that it is the first thing to say: if there is 'thorough-going competition' among workers, then the only possible equilibrium position is at full employment. That is little more than a definition of equilibrium."

Post Keynesians, all too often, are prepared to accept such statements at face value. For example, Davidson (1980) traces the possibility of underemployment equilibrium to the essential properties of money in a modern economy. Thus, for a strictly classical economy in which money is only a *numeraire*, Solow's point is conceded by default.

However, there is no reason whatever to agree with Solow, even under the strictest classical conditions. There is no claim, by Solow or anyone else, that "thorough-going competition" among workers leads to zero unemployment. Rather the argument hinges on whether the unemployment which does exist is to be classified as "voluntary" or "involuntary." We claim that in order to sustain his position, Solow (1980) *must* assert the following: When a robber points a gun at you and asks, "Your money or your life!" the

subsequent transaction is a *voluntary* transfer payment.

If actions forced under the threat of death are classified as involuntary, then involuntary unemployment can exist in strictly classical competitive conditions.

The issue of survival as a precondition for conventional economic reasoning has been raised recently, and quite independently, in an illuminating article by Samuels (1980). Samuels points out that marginalist price theory is predicated upon the prior assumption that the individual consumer is able to survive on his total income. If the consumer's electricity supply is cut off for nonpayment of the bill in the middle of a harsh winter, the resulting "adjustment" is not marginal in nature; nor is it reversible.

This paper differs from Samuels's work in several respects, in the sense of exploring rather different dimensions of the same basic problem. We are concerned with employment and unemployment, not with price formation. Also, we use classical (rather than neoclassical) assumptions, so that marginalism does not enter. But the similarities are probably more important than the differences. In brief, Samuels emphasizes that *dead men do not maximize anything*, whereas we emphasize that *dead men supply no labor*; the similarity consists in the common assertion that *economic man must not be a corpse*.

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The essential logical point can be seen most easily by positing a "strong case" in the sense of Ricardo, that is, by making some extreme assumptions to simplify the argument, assumptions which can be relaxed afterwards. Our assumptions, for now, are:

1. Every worker needs a minimum real wage w_0 in order to maintain himself while working. At any wage w equal to or greater than w_0, he can work and continue to work if he so chooses. At any wage w below w_0, the food he eats does not suffice to provide him with the strength needed for working.

2. A lower level of food consumption, let us say d, suffices to keep a man alive while not working. The society provides a dole payment in the neighborhood of this amount d.

Under these assumptions real wages below w_0 are impossible. At such wages workers cannot supply labor. It is not that they are unwilling; rather, they are unable. Thus the labor supply curve takes the form shown schematically in Figure 1. It is a smoothly
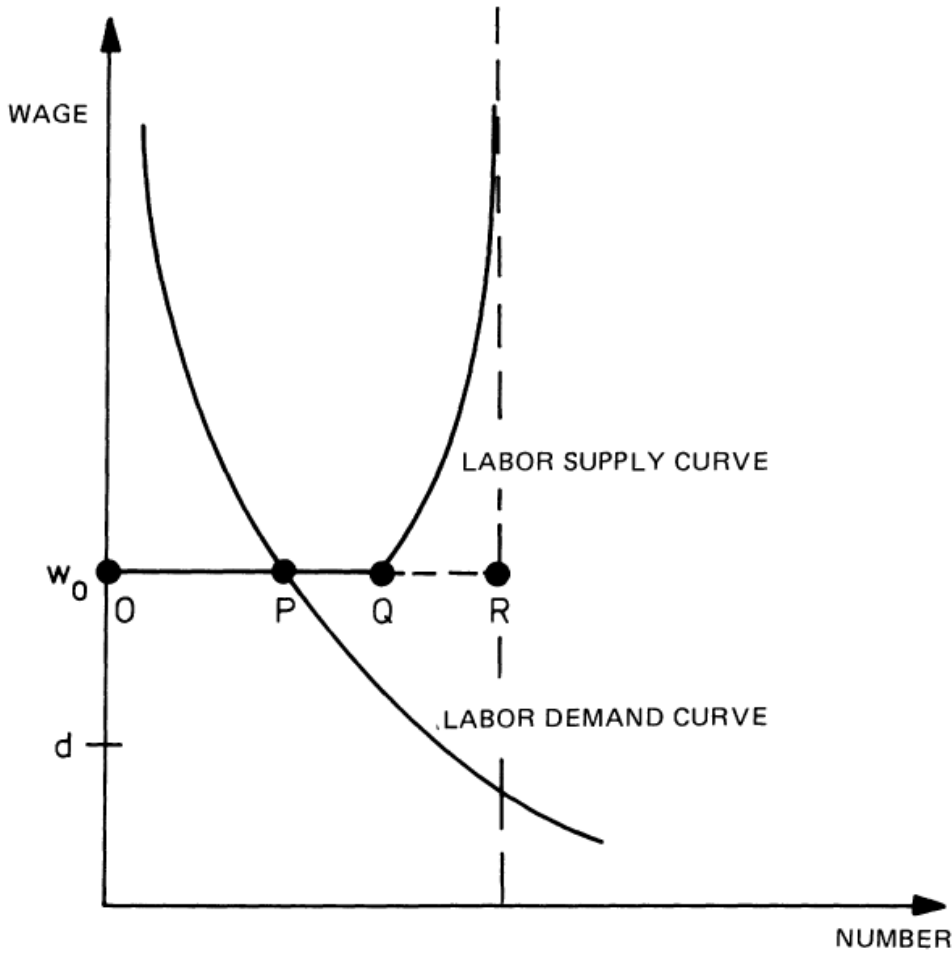
Figure 1

Labor supply cannot occur below the physical minimum subsistence wage w_0 for a man who is working. A lower income, d, suffices to keep an unemployed man alive. The dole is near to, but not necessarily equal to, d. If the supply and demand curves cross at point P, as shown, then the subgroup corresponding to the line segment PQ is unemployed involuntarily.

rising curve for wages above w_0. But it drops sharply to zero at $w = w_0$.

If the demand for labor is such that the supply and demand curves cross at a wage w in excess of w_0, good and fine. Some workers remain unemployed at such a wage, but economists classify this unemployment as being voluntary. This equilibrium position is therefore at full employment.

However, consider what happens when the demand curve lies farther to the left, so that its position is as shown in Figure 1. The

two curves cross at a wage precisely equal to w_0, at point P in the figure. This situation corresponds to the classical "iron law of wages," of course.

In this situation the population divides into three groups, not two. The group represented by the line segment OP is employed. The group represented by the line segment QR is classified as voluntarily unemployed. But the third group, represented by the line segment PQ, must be regarded as being unemployed involuntarily. These people are quite prepared to accept a job at the going wage $w = w_0$. But no such job is being offered. They *cannot* offer to work at a lower wage, because at any lower wage they cannot maintain life.

These people are *forced* onto the dole. They have no choice. There is nothing "voluntary" about their "decision," any more than there is when a robber demands, "Your money or your life."

Note that the minimum, and actual, wage w_0 in this situation is *not* equal to the dole payment. A person can subsist on less food while unemployed than while working. Furthermore the dole need not be precisely equal to the minimum requirements of an unemployed person. It may be slightly higher, or (all too often in history) may be rather lower, leading to slow starvation. Even this is preferable to rapid death from overwork on insufficient food. The "choice" is still entirely forced, not voluntary.

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In this model the function of the dole is *not* to put a floor under wages. There is such a floor, but it arises independently of the dole and exists even if there is no dole. In this section we address ourselves briefly to the question of the dole: How did the dole arise, and what is its primary function?

If no dole is offered, then *ceteris paribus* the unemployed starve to death. Considered purely in the abstract, this is indeed a "mechanism for clearing the labor market." It ensures full employment for the survivors of the exercise.

Very few, if any, practitioners of the dismal science have gone that far in their policy recommendations. Why not? One possible, but unlikely, explanation is their natural humanity and kindness. One hesitates to attribute excessive amounts of these qualities to people who are cold-hearted enough to classify a man as being "voluntarily unemployed" when he refuses to let himself and his

family be ground down to the absolute bare minimum physical subsistence level. Fortunately there is no need to turn to such implausible hypotheses. A more coldly rational, strictly economic reason can be given for the dole.

The demand curve for labor is by no means fixed and immutable. Immediately after a panic the demand for labor is low. It increases during the subsequent recovery and reaches high levels in the boom, just before the next panic. If the unemployed starve to death during the slump, where will the extra labor come from subsequently? The much wanted boom may never materialize if labor supply is so tight that any incipient recovery runs up immediately against a shortage of labor and consequent bidding up of wages. We conclude that on direct economic grounds, an (adequately meager) dole is quite cost-efficient in the intermediate run.

This may appear to be a plausible economic reason for the dole. However, this explanation is unacceptable because it runs afoul of historical facts, in particular, of the *time* when the dole was introduced. Many people, when asked when this happened, can only guess, and their usual guess is the late nineteenth century. The truth, for England, is the late *sixteenth* century, under Queen Elizabeth I! The economic reasoning given above does not apply to this period at all. We must look elsewhere.

At that time large tracts of land were being "enclosed" by their aristocratic owners. The former feudal tenants were driven out, to become "paupers" on the roads and in the towns of England. In earlier times paupers had been left to charity, either private charity or, more usually, the charity of the Church. But now the problem had grown too large for this, particularly since the Church had been despoiled so recently by Henry VIII and was much in need of charity herself. The huge number of paupers, without relief and without hope, presented a social problem, a problem of law and order. The government had to step in with legislation, else desperate men might turn to revolt, as many of them had already turned to robbery under arms.

This is the true origin of the dole. It has nothing to do with benevolence, charity, labor unions, or even capitalism; it was instituted, in spite of the "Protestant ethic," by a strongly Protestant government. The truth is, quite simply, that an organized system of subsistence payments to paupers is necessary for the very survival of *any* society which generates a significant number of paupers. Under the usual, very narrow, definition of "economics," the
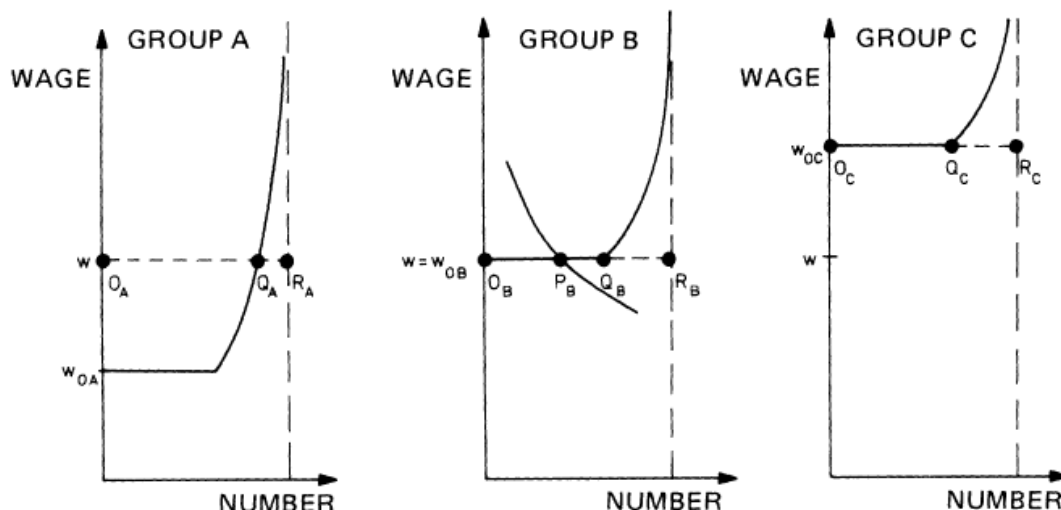
Figure 2

Separate labor supply curves are drawn for three groups, A, B, and C, of workers, with different minimum subsistence wages. Equilibrium is assumed to occur at wage $w = w_{0B}$, with subgroups $O_A Q_A$ and $O_B P_B$ employed, the rest unemployed. We classify as "voluntary" unemployed the subgroups $Q_A R_A$, $Q_B R_B$, and $Q_C R_C$, and as "involuntary" unemployed the subgroups $P_B Q_B$ and $O_C Q_C$.

dole is not economic at all but belongs to "political science" instead.

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Let us now remove the extreme simplification of section 2, that workers require the same wage w_0 for minimum subsistence. The essentials of the argument can be seen already when there are only three distinct groups of workers, A, B, and C. The workers in group A need a minimum subsistence wage of w_{0A}, those in group B need w_{0B}, those in group C, w_{0C}. We assume $w_{0A} < w_{0B} < w_{0C}$. In Figure 2 we have drawn labor supply curves for these three groups, separately.

Let us suppose that the total demand for labor is such that the going wage is $w = w_{0B}$ and that, at this wage, some but not all of the willing labor in group B is actually employed. Naturally, at this wage no worker in group C is employed.

How are we to classify the various subgroups in these three groups of workers? We shall present our classification first, the reasoning afterwards:

Group A: $O_A Q_A$ are employed, $Q_A R_A$ are voluntarily unemployed.

Group B: $O_B P_B$ are employed, $P_B Q_B$ are involuntarily unemployed, $Q_B R_B$ are voluntarily unemployed.

Group C: $O_C Q_C$ are involuntarily unemployed, $Q_C R_C$ are voluntarily unemployed.

Our classification is conventional for group A. For group B the classification has been motivated in section 2. The new points arise in connection with group C. If every person not prepared to work for the going wage is "voluntarily" unemployed, then the entire group C is voluntarily unemployed. If every person not able to work at the going wage is "involuntarily" unemployed, then the entire group C is involuntarily unemployed. Our proposed classification is between these extremes. We classify subgroup $Q_C R_C$ as "voluntary," since this subgroup would remain outside the labor force even at a wage slightly in excess of w_{0C}, their minimum subsistence wage. But workers in subgroup $O_C Q_C$ *cannot* offer to work for the going wage $w = w_{0B}$ for the same reason that they cannot do so at *any* wage below w_{0C}. They cannot sustain life at such a wage. There is nothing whatever "voluntary" about their plight, any more than there is when a robber demands, "Your money or your life."

We conclude that the extreme simplification of the same physical minimum subsistence wage for all workers is *not* necessary for the existence of truly involuntary unemployment. In particular, in the limit of very many groups, each with its own minimum subsistence wage, there still can be involuntary unemployment. This is true even though the labor supply curve has no visible kinks left in it.

It is *not* permissible to classify workers as being voluntarily unemployed merely because they do not line up for work at the going wage. Rather each unemployed man must be asked the following questions:

1. Is your physical minimum subsistence wage below the going wage rate?

   If the answer is yes, classify him as voluntarily unemployed. Else ask:

2. Would you be prepared to accept a job at a wage equal to your physical minimum subsistence level?

   If the answer is no, classify him as voluntarily unemployed; else his unemployment is involuntary.

None of this is intended to deny, or minimize, the practical importance of the factors stressed by Keynes and post Keynesian economists. The point is one of pure theory. One should not accept, directly or by default, invalid reasoning on the part of any economist of whatever school.

The "obvious thing" which is "the first thing to say," according to Solow, has turned out to be a *wrong* thing. It is not only a logical error in theory but is also a vicious error in its practical consequences.

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