Counting the Costs of Unemployment Insurance

As part of the backroom deal to extend the Bush tax cuts for another two years, the GOP gave the progressives an extension of one of their favorite welfare-state building blocks: unemployment insurance — which will undoubtedly add to the long lines of suffering Americans in our country.

Otto von Bismarck, the "Iron Chancellor" of Germany in the 1880s, first introduced the concept of state-mandated unemployment insurance. It was then forcibly introduced in the United States during the Great Depression under the Roosevelt administration and has been expanded regularly ever since. In fact, the proposed extension would be the sixth such expansion since June of 2008.

As a classic example of economist Frederic Bastiat's "broken window" fallacy, it is worth exploring to see just who benefits from such largesse, and who ultimately winds up paying for it.

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The justification, on the surface, seems simple enough: These people are out of work, and something needs to be done. Since the free market has put these people out of work and is unconcerned with their welfare, the safety net of the government (state, federal, or both) must be provided to keep them from living on the streets. It's the charitable and honorable thing to do. Besides, it's only a temporary hand up until they can get back on their feet and begin to contribute to society economically once again.

And there you have it: neat, plausible, and wrong, as H. L. Mencken used to say. It appeals to the heart. These people are hurting. Something must be done. And no one seems able to do anything about it. We just can't let them starve.

But this is a case where the business principle deemed KISS (Keep it simple, stupid) doesn't apply. Simplicity, in this case, allows only for an emotional reaction to a *perceived crisis*, which neatly avoids any thinking at all. The moment thinking gets involved, however, things begin to get complicated — but then the truth comes out.

For example, how is it that a certain, specific individual is out of work in the first place? Was his job eliminated? If so, was that elimination a result of cutting expenses, or replacement by a higher level of technology? If it was a result of cutting expenses, why was his particular position selected? Were there personnel-management reasons for the termination (poor attitude, inability to complete tasks, etc.)? Or was the position no longer viable for the company as it adjusted to changes in the market place? If so, was the company simply trying to position itself to maximize its returns on invested capital by adjusting to changes in its customers' needs and demands?

Let's broaden it a bit. Were company managers simply being greedy and trying to make more profit by laying off the employee, or were they looking out for the best interests of the majority of their workers and their jobs? Does the individual worker who was laid off have any responsibility in the matter? Did the knowledge that if he is laid off he will “qualify” for unemployment benefits impact his own job performance in some way? And wouldn’t it seem likely that, in his own self-interest, an employee might set aside some of his own earnings to offset the possibility of being laid off if such unemployment benefits were unavailable? Might he not also invest in additional skills to make himself more valuable to the company, or to a competitor?

And if a need for an “insurance fund” is perceived as socially useful, couldn’t that be provided by private insurance companies whose purpose is to offset individual risks such as unemployment through pooled risk-sharing among those interested in insuring against such risks? Wouldn’t a business owner offer this as an additional incentive to keep his employees happy and contented and efficient?

Let’s push the discussion a little further. What if a worker is laid off, and there is no private unemployment insurance, and he has no resources of his own on which to rely? What then? Isn’t this where charity comes in? Isn’t this the calling of churches and other eleemosynary humanitarian organizations? What about families and friends?

The progressives’ answer is always, “But what if that isn’t enough? Won’t there always be someone who slips through the cracks? What about them? Aren’t they important? What kind of society is this that would even allow a chance of this happening?”

This is the siren song of socialism, all dressed up to look like charity and helpfulness, but charity done that way way can’t stand scrutiny past the level of an emotional response either.

First, someone has to pay. Ayn Rand’s eternal question to the interventionist has always been, “At whose expense?” Since government has no resources of its own, but only the power to loot, how does unemployment insurance get funded?

Estimates vary, but the anticipated cost of the extension could exceed $50 billion. Who gets to pay for that?

The obvious answer — one of several correct responses — is that the employers get to pay! And indeed, they are paying. In the microcosm of the real world, just down the street here in Colorado Springs is a very nice popular restaurant, McCabe’s Tavern. Greg Howard, the proprietor, was reviewing his payroll costs and was astonished to discover that his bill for unemployment insurance had *increased six times!* Other examples abound: a painting contractor whose unemployment insurance (UI) quarterlies have jumped from $1,000 to over $6,500 in the last three years; a printing supply company that has had to cut its payroll in order to pay its unemployment insurance. And so on. (Note, less profits means less new hires and less raises for current workers even as inflation creeps upward — or even the closure of businesses altogether.)

Who else pays? Since payroll taxes fail to meet the “needs” of the current unemployment programs (in April, an unemployment tax specialist testified before the Senate that 35 states had UI shortfalls totaling nearly $40 billion), the the government must borrow to meet its spending. And this borrowing needs some analysis as well: “From whom will we borrow? For how long? How will the lenders be paid back? At what rate of interest? What is the borrower’s credit rating and is the additional borrowing going to lower the credit rating? And *isn’t this just another way of shifting the current bills to another time and another generation*?” Yes, our children get to pay in the future because the unemployment benefits are being extended now.

Who else pays? Everyone who buys anything pays — literally. Since payroll taxes aren't sufficient to pay unemployment benefits, and borrowing through standard markets has its limits, there is always the lender of last resort: the Federal Reserve System. The Fed prints money and services government debt. The creation of new money is inflation, and the cost of goods rising is a result of inflation.

Up until recently, the Fed's ability to create new money out of nothing was considered magical, and beyond a worker's ability to understand or even part of his concern. With Rep. Ron Paul's ascension to chair of the House subcommittee that oversees the Fed, exposure of that "magic" is going to make for some very interesting conversations with Fed Chair Ben Bernanke. As Gary North put it, "It's going to be fun."

What's about to be exposed is that inflation of the currency, the Fed's only tool, reduces the purchasing power of every piece of currency in circulation. This is another way of saying, if there is any shortfall in contributions to unemployment insurance programs, everyone holding currency gets to pay for it through a reduction in their own purchasing power.

Beyond the loss of jobs and personal wealth that always go hand in hand with unemployment insurance, there are other consequences of letting government in where it doesn't belong and letting it begin to pervert and twist the system: citizens reduced to cattle, expected to do their daily job, receive their daily bread, and be happy about it. The spirit of independence, self-reliance, and individual responsibility becomes replaced with a firm reliance on the government: "The government will take care of me." "After all, I paid into the system all these years." "Don't cut me, don't cut thee, cut that man behind the tree!" and so forth.

The broken window fallacy is now seen to be clear in all its dreariness: Government cannot provide a benefit without first arranging to pay for it out of the pockets of others, which in turn hurts those who are vulnerable even more in the long run. But the vested interest of the noisy minority far exceeds any resistance to such looting by those who pay.

For the progressives and those who are building the cattle pens for Americans, unemployment insurance is just one instrument used in that building. Present benefits to a noisy few, supported by those who have other motives in mind, continually find extensions of such benefits not only inviting but positively irresistible.

This article was modified slightly in response to a faithful reader's correction.

Photo: AP Images