

The Cost Of Unemployment To The Economy

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Unemployment is universally recognized as a bad thing. While economists and academics make convincing arguments that there is a certain [natural](#) level of unemployment that cannot be erased, elevated unemployment imposes significant costs on the individual, the society and the country. Worse yet, most of the costs are of the dead loss variety where there are no offsetting gains to the costs that everyone must bear. (Depending on how it's measured, the unemployment rate is open to interpretation. Learn how to find the real rate. Check out [The Unemployment Rate: Get Real.](#))

The Costs to the Individual

The costs of unemployment to the individual are not hard to imagine. When a person loses his or her job, there is often an immediate impact to that person's standard of living. Prior to the Great Recession, the average savings rate in the U.S. had been drifting down towards zero (and sometimes below), and there are anecdotal reports that the average person is only a few weeks away from serious financial trouble without a paying job.

Even for those eligible for unemployment benefits and other forms of government assistance (like food assistance), it is often the case that these benefits replace 50% or less of their regular income. That means these people are consuming far less than usual. The economic consequences can go beyond just less consumption, though. Many people will turn to retirement savings in a pinch and draining these savings has long-term ramifications.

Prolonged unemployment can lead to an erosion of skills, basically robbing the economy of otherwise useful talents. At the same time, the experience of unemployment (either direct or indirect) can alter how workers plan for their futures - prolonged unemployment can lead to greater skepticism and pessimism about the value of education and training and lead to workers being less willing to invest in the long years of training some jobs require. On a similar note, the absence of income created by unemployment can force families to deny educational opportunities to their children and deprive the economy of those future skills.

Last but not least, there are other costs to the individual. Studies have shown that prolonged unemployment harms the mental health of workers, and can actually worsen physical health and shorten lifespans.

Costs to Society

The social costs of unemployment are difficult to calculate, but no less real. When unemployment becomes a pervasive problem, there are often increased calls for protectionism and severe restrictions on immigration. Protectionism can not only lead to destructive tit-for-tat retaliation among countries, but reductions in trade harm the economic well-being of all trading partners.

Other social costs include how people interact with each other. Studies have shown that times of elevated unemployment often correlate both with less volunteerism and higher crime. Elevated crime makes sense because absent a wage-paying job people may turn to crime to meet their economic needs or simply to alleviate boredom. The volunteerism decline does not have an obvious explanation, but could perhaps be tied to the negative psychological impacts of being jobless or perhaps even resentment at those who do not have a job.

Costs to the Country

The economic costs of unemployment are probably more obvious when viewed through the lens of the national checkbook. Unemployment leads to higher payments from state and federal governments for unemployment benefits (in excess of \$320 billion through the end of 2010), food assistance, and [Medicaid](#). At the same time, those governments are no longer collecting the same levels of income tax as before - forcing the government to borrow money (which defers the costs and impacts of unemployment into the future) or cut back on other spending (perhaps exacerbating the bad economic situation).

Unemployment is also a dangerous state for the U.S. economy. Over 70% of what the U.S. economy produces goes to [personal consumption](#) and unemployed workers. Even those getting government support cannot spend at prior levels. The production of those workers leaves the economy which reduces the GDP and moves the country away from the efficient allocation of its resources. For those who subscribe to [Jean-Baptiste Say's](#) theory that "products are paid for by products," that is a serious issue.

It is also worth noting that companies pay a price for high unemployment as well. Unemployment benefits are financed largely by taxes assessed on businesses. When unemployment is high, states will often look to replenish their coffers by increasing their taxation on businesses - counter-intuitively discouraging companies from hiring more workers. Not only do companies face less demand for their products, it is also more expensive for them to retain or hire workers.

The Bottom Line

Governments rightly fret about the consequences of inflation, but unemployment is likewise a serious issue. Apart from the social unrest and disgruntlement that unemployment can produce in the electorate, high unemployment can have a self-perpetuating negative impact on businesses and the economic health of the country.

Worse still, some of the worst effects of unemployment are both subtle and very long-lasting - consumer and business confidence are key to economic recoveries and workers must feel confident in their future to invest in developing the skills (and building the savings) that the economy needs to grow in the future. The costs of unemployment go far beyond the accumulated sums handed out as unemployment insurance benefits. (Preparation can help you land on your feet after getting the "old heave-ho." See [Planning For Unemployment](#).)