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Disguised Unemployment

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DISGUISED UNEMPLOYMENT

AN economy consisting of self-supporting families each working their own land must always enjoy full employment, since each individual is free to work as long as he considers the real reward he obtains a sufficient inducement for his efforts.

In any economy in which there is specialisation and exchange the principle of effective demand comes into play, and unemployment may occur. If, however, there are no debts, no form of money and no negotiable capital instruments,¹ the output of the community will be in neutral equilibrium. Saving can only be done by means of adding to the stock of durable goods (an increased amount of seed corn may be saved from the year's harvest so as to extend next year's crop). An increase of thriftiness is therefore necessarily accompanied by an increase of investment, and an increased desire to invest necessarily entails an increase in thrift. A communist economy without private saving is of this type.

Any community with an exchange economy and negotiable capital exhibits the main features of our own system, and in such a system there is no reason to expect that full employment will be the normal state.² On the contrary, full employment is only likely to occur in periods of abnormally rapid expansion, when inventions and discoveries are giving constantly renewed stimulus to investment. In a relatively stagnant state of society we should expect under-employment to be the rule. Yet unemployment, as we know it, is specifically the disease of an advanced industrial community. How can we account for the fact that, over the whole range of human history, unemployment in the modern sense is, comparatively speaking, a rare and local phenomenon?

The answer is to be found in the existence of disguised unemployment. In a society in which there is no regular system of unemployment benefit, and in which poor relief is either non-existent or "less eligible" than almost any alternative short of suicide, a man who is thrown out of work must scratch up a living somehow or other by means of his own efforts. And under any system in which complete idleness is not a statutory condition for

¹ See Keynes, *General Theory of Employment, Interest and Money*, p. 239.

² See Keynes, *op. cit.*, p. 347.

drawing the dole,¹ a man who cannot find a regular job will naturally employ his time as usefully as he may. Thus, except under peculiar conditions, a decline in effective demand which reduces the amount of employment offered in the general run of industries will not lead to "unemployment" in the sense of complete idleness, but will rather drive workers into a number of occupations—selling match-boxes in the Strand, cutting brush-wood in the jungles, digging potatoes on allotments—which are still open to them. A decline in one sort of employment leads to an increase of another sort, and at first sight it may appear that, in such a case, a decline in effective demand does not cause unemployment at all. But the matter must be more closely examined. In all those occupations which the dismissed workers take up, their productivity is less than in the occupations that they have left. For if it were not so they would have engaged in them already. The wage received by a man who remains in employment in a particular industry measures the marginal physical productivity of a similar man who has been dismissed from it,² and if the latter could find an occupation yielding him a better return, he would not have waited for dismissal to take it up. Thus a decline in demand for the product of the general run of industries leads to a diversion of labour from occupations in which productivity is higher to others where it is lower.³ The cause of this diversion, a decline in effective demand, is exactly the same as the cause of unemployment in the ordinary sense, and it is natural to describe the adoption of inferior occupations by dismissed workers as *disguised unemployment*.

In this connection it is convenient to make use of an alternative definition of "voluntary unemployment." According to Mr. Keynes' definition,⁴ voluntary unemployment exists when more labour than is actually being performed would be willingly offered at a real wage slightly lower than that which actually rules. It follows that, when *full employment* obtains, an increase in the output of investment goods can only occur if there is a decline in the output of consumption goods (any reasonable arbitrary division being made between the two classes). On the other hand, when less than full employment obtains, an increase in

¹ The "dole" is here used to mean any kind of relief payments.

² This is upon the assumption of perfect competition in the industry, but the existence of any degree of monopoly merely adds an *a fortiori* consideration.

³ We are here confronted with the formal difficulty of distinguishing a divergence of marginal products of similar workers which is due to a decline in demand from one which is due to ignorance, inertia or bad management. But the test is simple, for the first would disappear and the second would not if a revival of effective demand were to occur.

⁴ *Op. cit.*, p. 15.

investment will normally lead to an increase in consumption, and a decline in thriftiness will normally lead to an increase in investment as well as in consumption. Thus we may say that *unemployment* is present when an increase in the output of capital goods (not offset by an increase in thriftiness) would lead to an increase in the output of consumption goods.

Let us apply this criterion to disguised unemployment. If a revival of investment were to occur, dismissed workers would be called back from the hedgerows and the street-curbs into their normal occupations. The wages they now receive represent a command over consumption goods which they prefer to the product of their former hand-to-mouth efforts. The output of consumption goods, as evaluated by consumers, has therefore increased. Hence, according to our definition, unemployment existed before the revival of investment took place, even though every individual worker was busy all day long. There has been no increase in employment reckoned by heads, but there has been an increase in employment reckoned in terms of output, because efficient methods of production have been substituted for inefficient methods.

The level of consumption corresponding to a given level of effective demand will be higher the better are the opportunities of the unemployed for self-help (assuming that dole payments are in any case out of the question), for the product of their efforts, the equivalent of which they consume themselves, is a clear addition to the output of the regular industries. The increase in consumption brought about by re-employing them is therefore less the smaller is the difference between their productivity in regular industry and their productivity in hand-to-mouth occupations.

In some cases this difference may be slight. When there is an open frontier, with free access for all comers to good cultivable land, the difference in productivity between a man in employment and a man in disguised unemployment may be small. In the limiting case, where there is no difference in productivity, unemployment can never occur, for a man dismissed from industry can then take up an alternative occupation without any loss in real earnings,¹ and an increase in investment could only take place if consumption were to decline.

On the other hand, the less productive are the hand-to-mouth occupations, the nearer will the unemployed be to starvation,

¹ This approximates to the case of a community of self-supporting families, for this condition can only be fulfilled when no increase in productivity results from employment under entrepreneurs in specialised industries.

and the stronger will be the pressure upon society to institute some kind of dole system. The attitude of mind, prevalent even now in certain quarters, that unemployment is the result of a vicious idleness of disposition in the unemployed individuals, pandered to by the dole, is largely an anachronism which had some plausibility in an epoch when there was open access to the land, so that any active and laborious individual could make a livelihood, when he fell out of employment, not glaringly different from what he had obtained in his former trade.

The existence of disguised unemployment introduces a complication into the formal scheme of the General Theory of Employment. When it is possible for unemployment to become disguised, there is not a unique function relating total consumption to total investment, since a given rate of investment will be accompanied by a greater rate of consumption the more unemployment is disguised. In the normal way an increase in output is accompanied (in the short period) by a fall in real wages and an increase in real profits, in respect to the output which is already being produced. The increase in profits leads to an increase in saving, and it is for this reason that, even when there is no dole, an increase in output, in the normal way, can only come about if there is an increase in investment. But when unemployment becomes disguised there is an increase in output unaccompanied by an increase in saving. Some workers have found an occupation in which real earnings are low without there being any increase in profits and output expands without there being any increase in saving.¹

¹ From a certain point of view the phenomenon of disguised unemployment may be regarded as a special case of a change in relative wages. In general, when money wages are falling, for any reason, they are likely to fall unevenly, those workers who are in a relatively weak bargaining position suffering a relatively larger cut in money wages. There will thus be a fall in the real wages of some workers and a rise in the real wages of others. A change in relative wages will alter the distribution of profits between different groups of employers, output expanding and real profits rising where relative wages fall, and output contracting and profits falling where relative wages rise. This will have a reaction upon the thriftiness of the community as a whole which may be in either direction and may, consequently, lead either to an increase or to a decrease in employment. Assuming for simplicity that all wage incomes are spent, the condition for a decline in thriftiness (and an increase in employment) is that saving out of profits declines by more in the contracting industries than it increases in the expanding industries (assuming that the savings of consumers are unaffected by changes in relative prices). This condition will be fulfilled in so far as (a) the entrepreneurs in the expanding industries are poorer, and therefore less inclined to save, than the entrepreneurs in the contracting industries, and (b) the short-period elasticity of supply is greater in the expanding industries, so that profits in them increase by less than profits in the contracting industries decline. There is no particular reason to suppose that this condition will in general be fulfilled, except, perhaps,

The notion of disguised unemployment has some relevance even at the present day. Its effects may most conveniently be examined in two stages. We will consider what happens when an individual who is out of work takes up some hand-to-mouth occupation, first when he has no right to any form of relief, and, second, when having been drawing the dole (which is taken to stand for all forms of relief) he is now disallowed benefit.

To simplify the argument we will assume that the dole is financed entirely by borrowing, so that a reduction in dole payments is equivalent to a reduction in the central or local budget deficit—that is, to a decline in dis-saving. When this condition is not fulfilled, the dole being financed from rates and taxes, the situation is unaltered for at least one financial year; if, after a time, a decline in dole payments leads to a reduction in taxation, some part of the increased net income of taxpayers will be devoted to consumption, so that less than the whole of any reduction in dole payments represents an increase of saving. This alters the magnitude, but not the direction, of the effect upon employment of changes in the amount of the dole. Our assumption that the whole of the dole represents dis-saving simplifies exposition without introducing any difference of principle.¹ We will further assume that an unemployed man has no saleable wealth, no relations to help him, and no credit with his tradesmen.

In the first case, the individual we are considering has no source of expenditure at all and is faced by starvation. He takes up some occupation—planting potatoes if he can get an allotment,

in so far as workers are likely to be least strongly organised where employers are poorest; and haphazard changes in relative wages are as likely to reduce total employment as to increase it.

The condition for the increase in employment in the industries where relative wages fall to be offset by *no* decline in employment in other industries is that there should be no increase at all in saving out of profits in the expanding industries. This will occur only if the entrepreneurs engaged in those industries are too poor to save in the first instance and if the elasticity of supply is so great that their profits do not increase up to the point at which saving begins. It is clearly unlikely that this more stringent condition should be fulfilled by any ordinary change in relative money wages. But when we are discussing disguised unemployment we are supposing that unemployed individuals are restrained by loyalty, or by the strength of trade union organisation, from competing for jobs in regular industry by offering themselves at cut wage rates, and that they take up occupations in which they are able to employ themselves. In such a case the entrepreneurs in the expanding industries, *i.e.* the unemployed men themselves, are extremely likely to be so poor as to spend the whole of their receipts. It is for this reason that the expansion of their output is not accompanied by any contraction in the output of regular industry.

¹ Cf. Kahn, "Home Investment and Unemployment," *ECONOMIC JOURNAL*, June 1931, p. 176.

selling match-boxes in the Strand, hanging round railway stations to carry bags to hotels. Anything that he earns, in kind or in cash, he devotes to immediate consumption. Whatever he succeeds in producing is a clear addition to the total of output. As a first approximation we may say that from the point of view of the rest of society, taken as a whole, his activities make no difference to output, one way or the other. It may be that particular producers suffer from his competition. The tobacconists will complain if he sells matches. But the money which he attracts from the customers of the tobacconists is spent at the grocer's. The total output of match-selling is not increased by his efforts, but the total output of society is increased by a value exactly equal to what he spends. He adds to demand exactly what he adds to supply, the grocers gain from his addition to demand just what the tobacconists lose from his addition to supply, and the output of society, excluding himself, is neither increased nor diminished. The dole-less individual, who is too poor to save, is a little world to which Say's Law applies with full force.

It is to be observed that it makes no difference to the argument whether the unemployed man eats up his own produce or sells it to others. If he sells matches and buys potatoes, the tobacconist loses what the greengrocer gains, and if he grows his own potatoes, neither is affected at all. In either case, the output of the rest of society is, on balance, unaffected by his activities.

This is a first approximation. There are certain ways in which his activities may alter the output of the rest of society, but their effect, as we shall see, is likely to be slight. First, it may be that the ordinary traders with whom he comes into rivalry are more disposed to saving than those on whom he spends his earnings. If a decline in the profits of tobacconists reduces saving by more than an increase in the profits of grocers promotes it, then a transfer of custom (via the street seller) from one to the other will reduce thriftiness and increase output for the rest of society. But there is no *a priori* reason to expect that this effect will tell in one direction rather than another.¹ Second, charitable persons

¹ The unemployed man may be obliged to purchase raw materials from the regular industries, but he can only do so from the proceeds of his sales. He cannot buy seed potatoes and eat the crop himself, since he has no resources to dis-save. The increase in demand, represented by his purchases of raw materials and consumption goods together, is offset by the increase in supply represented by the output which he places on the market. If a large part of the match-seller's earnings are devoted to paying rent, then, since a landlord is likely to save more than a tobacconist, it is probable that the effect of the match-seller's efforts will be to reduce the output of the rest of society.

may feel inclined to buy more matches when they are offered on the curb than when they are sold only in the shops, or commodities which are unobtainable in better times, such as the services of an outside porter, may attract expenditure from consumers on goods which they would otherwise forgo. If, but only if, this expenditure is not offset by economising on other lines of consumption, a decline in thriftiness is induced by the hand-to-mouth efforts of the unemployed man. On the other hand, the outside porter may save the traveller from taking a taxi, and this economy may not lead him to an equivalent expenditure on something else.¹ It appears that the net reaction of the efforts of the unemployed man upon the thriftiness of the rest of the community can hardly be very great. Our first approximation is a good one, and these complications may legitimately be neglected in what follows.

We have seen that the self-help of a man who in any case does not draw the dole makes no appreciable difference to the rest of the community taken as a whole, though he may damage some sections and help others. The case of a man who is disallowed benefit is not the same. For, as we have seen, whatever he may now do for a livelihood adds to supply exactly what it adds to demand; thus whether he starves, grows potatoes, or sells matches, whether he now earns more² or less than he received as dole, it makes no difference. Demand for the output of the rest of society is reduced by the amount of dole that he was formerly spending. Thus, when he is disallowed from benefit, the output of the rest of the community will decline.³ The effect of discontinuing the dole to an unemployed man, and driving him to self-help, is to increase the total of unemployment, while causing a part of it to become disguised.

It is now plain that the institution of a dole where none was before cannot lead to a decrease of employment, according to our definition. If a dole is instituted, for which complete idleness

¹ To put the same point in a formal manner: the efforts of the unemployed alter the composition of the aggregate of goods offered to consumers, and so may alter the eligibility of consuming rather than saving.

² This is not inconceivable. If self-help methods provide a better income than the dole, the unemployed man may forgo benefit voluntarily, and the effect of this is exactly the same as though he were disallowed. A more plausible case is one in which a man prefers the dole, so long as he is eligible, to an onerous or undignified line of life which earns him more money.

³ In the limiting case, where no decline in saving accompanies a decline in output except the increase on dis-saving due to dole payments, one more man, receiving dole, must be thrown out of work for every unemployed man disallowed benefit.

is a qualification, the result will be an increase of employment and output in regular industries, combined with a decrease of disguised unemployment. It will cause unemployment to throw off the disguise, but the amount of unemployment will be reduced.

It is true, of course, that the institution of a dole system (or, for that matter, an increase in the opportunities for self-help) may reduce the amount of work corresponding to full employment. For the real wage which will be rejected as inadequate will be raised by any influence which makes the situation of the unemployed less desperate. Thus the institution of a dole may be held to increase the amount of *voluntary* unemployment. But since dole payments are only introduced in communities where involuntary unemployment is frequent and extensive, this consideration is of a highly academic nature.

It should be conceded, however, that the introduction of the dole system must increase the amount of enforced idleness, of which there is none when all unemployment is busily disguised, and may, if efficiency in the occupations which disguise it is sufficiently high, lead to a decrease in the total of output. Thus, in some circumstances, it is possible to make out a case against the institution of a dole for which idleness is a qualification, though not in a country like our own, where the opportunities for self-help are exceedingly meagre and efficiency outside ordinary industry is very low.

But a dole for which idleness is not a qualification is an un-mixed benefit. An example of such a system is to be found in self-help schemes such as that instituted at Upholland. Here a community of unemployed men work at various trades for their own benefit. They continue to draw the dole to which they were entitled when they became unemployed, and with this imports into the community are paid for. Their own produce is not exported (*i.e.* sold to the outside world), but is divided up and consumed within the community. Our analysis enables us to see that the output of the rest of the world is unaffected by the existence of such a community, because the dole of an unemployed man who enters Upholland continues to be spent upon the output of the outside world, while the whole produce of the workers within the scheme is a clear addition to the output of society. Further, we have seen that the distinction, rigidly drawn at Upholland, between working for home consumption and working for sale is somewhat artificial. Entrepreneurs engaged in the particular lines of production, for instance market gardening, developed at Upholland suffer from increased competition, for

without Upholland a larger part of the dole would be spent upon vegetables. If exports from Upholland were allowed this effect would be intensified and no doubt the outcry that would be raised by the employers (and perhaps the workers also) in these trades and the abusive references to prison labour that they would permit themselves, would create so much unpleasantness that it is scarcely practical politics to advocate exports from Upholland.¹ But the fact remains that, so long as all receipts from exports were currently spent upon imports from the outside world into Upholland, the outside world as a whole would be no worse off. Certain trades would suffer from increased competition, and certain other trades would gain from increased demand. On balance, Upholland would gain from increased variety of consumption, and the rest of the world would be no worse off.

The Upholland scheme is not in itself a remedy for unemployment. It is no substitute for measures calculated to increase effective demand. But it provides a peculiarly efficient method of reducing the ill effects of unemployment, for it allows the advantages of hand-to-mouth production, under unusually favourable conditions, to be obtained without imposing, upon the unemployed and the rest of society alike, the evils of cutting off the dole.

Under ideal conditions, the widespread institution of such schemes could remove the ill effects of unemployment altogether, and could produce the level of consumption corresponding to full employment, or even improve upon it. Suppose that the entrepreneurship, provided by well-wishers of the unemployed, does not compare unfavourably with the efficiency of the ordinary run of entrepreneurship produced by the pursuit of profit, and suppose that the schemes are run on a large enough scale to approximate to the most efficient technical methods of industry. Then the productivity of a man in an Upholland community would not be much less than that of a man in ordinary industry. The level of consumption corresponding to full employment would be attained, provided that everyone thrown out of ordinary industry entered an Upholland community, if efficiency inside bore such a relation to efficiency outside that earnings within the

¹ In such cases, the interests of those who suffer by competition are more concentrated, and therefore more vocal, than the interests of those who gain by increased expenditure. If the firms who would gain by exporting to Upholland could be taught to cry as loudly as the firms who lose by the competition of exports from it, the necessity of an embargo on exports from Upholland would disappear.

community exactly made up the difference between the dole and an ordinary wage. A man who lost his job would then enjoy the same standard of life as a man who retained it, and an increase in investment would, at best, lead to no increase in the total of consumption.¹ If productivity in Upholland stood in a higher ratio to productivity in ordinary industry than the ratio of wage *minus* dole to wage, then the total of consumption would necessarily increase as ordinary employment declined, and the workers would actually gain by a decline in effective demand. This apparent paradox is merely due to the fact that workers are imagined to be drawing the dole on top of earnings not much less than those obtained in ordinary industry.

All this is far away from the conditions of Upholland as it actually exists. But our cloud-castle supplies an important warning which must not be neglected in the actual situation. As the scope of a scheme such as that at Upholland expands and its managers gain in experience, the efficiency with which its output is produced will increase. A day may not be far distant when, taking account both of the standard of consumption and the general amenities, the life of an unemployed man in Upholland may appear preferable to the life of an employed man outside. If things ever came to this pass, it is easy to imagine the protests that would be made against continuing dole payments to men who were actually finding unemployment tolerable. But if the dole were discontinued, the whole merit, from the point of view of outside industry, of the Upholland scheme would disappear. The increase in efficiency which we have presumed to occur might be great enough to compensate the men within the scheme for the loss of dole payments which we have imagined to be the consequence. But there is nothing to compensate the outside

¹ This is true in the limiting case, where no change in saving or dis-saving accompanies a change in the output of industry except the change in dole payments. Take, by way of illustration, the dole equal to one-third of the wage. Now suppose that a man is called out of Upholland and set to work in an investment industry. His total consumption is unaltered, but whereas formerly only one-third of it was drawn from the consumption industries outside Upholland, now the whole of it is drawn from them. The multiplier for the outside world is equal to 3, and two men are put into work in the consumption industries, an increase in investment equal to one man's wage leading to a decrease in dis-saving of three men's dole. Now three men have been withdrawn from the production of consumption goods in Upholland, and, of these, two are producing consumption goods outside. Thus if their efficiency in Upholland was two-thirds of their efficiency outside the total of consumption is unchanged. Investment could then continue to increase, without a decline in consumption, up to the point at which all workers are re-absorbed from Upholland into ordinary industry. Full employment is then reached, and any further increase in investment would only be possible if consumption declined.

industries for the loss of their export trade to Upholland. Unemployment outside would increase,¹ and profits decline. The case of Upholland without the dole is parallel with the case, examined above, of the man who was disallowed benefit and took to selling matches. The men in Upholland are less wretched than the match-seller. But this is no comfort to employers in the outside industries who suffer from the shrinkage of demand.

We may now consider, in the light of Upholland, the effects of the regulations surrounding eligibility for unemployment benefit. We have seen that, *provided he does not sacrifice his right to the dole*, an unemployed man does himself good, and on balance does others no harm, by occupying himself as usefully as he can. Yet the regulations surrounding the receipt of the dole militate strongly against useful occupation. Until recently an unemployed man was compelled to fill his time in keeping up the appearance of Genuinely Seeking Work. If he fulfilled this obligation conscientiously he had little time or energy for any other activity. Even now he cannot embark upon any occupation which commits him to spending a certain period of time in any definite way, for he is obliged to hold himself ready to accept a job, should one chance to offer, at a moment's notice. But there is another consideration which is by far the most important. The unemployed man is hedged in by restrictions on his daily activity which are due to fear of losing his right to benefit. The restrictions, in the nature of the case, are highly arbitrary. Under the regulations at present in force ² a man may pursue a subsidiary occupation, provided that (a) it is not his usual trade, (b) it does not occupy what would be his working hours if he had work and (c) it does not bring in an income of more than three shillings and fourpence a day. Thus an unemployed waiter is allowed to accept an odd job in the morning, and an unemployed shop assistant may work after six-thirty (provided that neither accepts three and fivepence for his services), but during normal working hours they must sit at home doing their best to appear "capable of and available for" the work that they cannot find in their normal trades.³ Such regulations restrict the disguising of unemploy-

¹ In the limiting case one additional man would become unemployed for every one who lost benefit by entering Upholland (see p. 231 note above). If this condition were fulfilled at all levels of output, the result would be that ordinary industry would come to a standstill while the whole working population was employed in Upholland communities.

² Unemployment Insurance Act, 1935, Section 35 (5).

³ The concession is made that the subsidiary occupation may actually be carried out during normal working hours provided that it *could* be performed outside

ment within narrow limits. Moreover the extreme complexity of the rules and the Gilbertian situations to which they give rise have a strong effect in discouraging any efforts at self-help, for the unemployed man, bewildered by the intricacy of the regulations with which he is faced, and discouraged by the prospect of "coming up for trial" before the Court of Referees, is naturally inclined to pursue a policy of Safety First and to sit at home making sure of his right to benefit.

Yet, as we have seen, the situation of the rest of the community is in no way impaired if an unemployed man succeeds in earning some money, whether less or more than three and fourpence. Anything, in kind or in cash,¹ that he may be able to secure is a pure gain to himself and no loss to others, provided that he does not sacrifice his right to the dole. It follows that regulations calculated to prevent him from doing himself any kind of good are harmful to him and not beneficial to the rest of society, while regulations that deprive him of the dole on a slight pretext are deleterious to the rest of society as well as to himself. The administrative complications involved, the strong moral objection to scroungers, felt by workers as well as by taxpayers, and the difficulty of preventing employers from obtaining an illicit subsidy, may be regarded as sufficient justification for such regulations. But their economic effects can only be harmful.

The notion of disguised unemployment throws light on an interesting, though highly academic, problem. It has always been felt that the definition of "employment" was arbitrary, and that a man when he is shaving himself, or a woman when she is scrubbing her own floor, is "producing utilities" just as much as when he is mining coal or she is serving at a counter. Wicksteed carried this line of argument to its logical conclusion, and held that we are producing utilities for ourselves even when we are lying in bed. On his view, everyone is "employed" for twenty-four hours every day.

them. Emmerson and Lascelles, *Guide to the Unemployment Insurance Acts*, p. 55.

¹ It must be recalled that we are assuming throughout that an unemployed man spends all he earns. In practice some part of his cash earnings may be devoted to paying off debts. In that case the increase in supply, represented by what he sells, is not offset by an equal increase in demand. The grocers, to return to our first example, do not gain as much as the tobaccoists lose. This consideration introduces a difference between the case where he earns cash and where he works for his own consumption. But it would be hard to defend the regulations at present in force on the ground that they compel the unemployed to incur the maximum amount of debts.

The analysis of disguised unemployment makes it clear that while everyone is *occupied* for twenty-four hours a day, so that the total amount of occupation can never be increased, yet *employment* can be said to increase when part of a man's time is transferred from an occupation in which its productivity is lower to one where it is higher.

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