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Extended UI Payments Do Not Benefit the Economy

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There is no such thing as a free lunch. Congress wants to help the unemployed, but extending the duration of unemployment insurance (UI) benefits slightly harms the economy. Raising benefits to 99 weeks has increased the unemployment rate by 0.5 to 1.5 percentage points.[1]

Extending unemployment benefits again will not stimulate the economy. The only sound arguments for extended unemployment benefits are humanitarian. If Congress decides that these humanitarian benefits outweigh the economic costs, then Congress should pay for this spending with cuts to less important programs.

Extended Benefits Called Stimulus. The government provides unemployment benefits to workers who are involuntarily laid off from work. Since the onset of the recession, Congress has increased the time workers can collect these benefits from 26 weeks to—in some states—99 weeks. These extended benefits expire at the end of the year. If Congress does not act, the maximum duration of UI benefits will return to six months. The average unemployed worker has been without a job for nine months.[2] Many in Congress want to keep benefits at their current level for humanitarian reasons.

Some analysts suggest that doing so will also boost the economy. For example, Mark Zandi, an economist with the Web site Economy.com, argues that each dollar spent on additional UI benefits causes between $1.55 and $1.73 in short-run economic growth.[3] These analysts contend that extended UI benefits are an economic free lunch: Congress can spend money on a program that it wants to support and the economy will grow by more than the amount Congress spends. Unfortunately, this is not the case.

The studies finding that UI benefits boost the economy are based on macroeconomic models that are programmed to show large "multiplier effects" from government spending. Such models assume that each dollar of government spending creates more than a dollar of economic growth. These studies essentially assume their conclusion. Actual empirical evidence shows that UI payments do not benefit the economy.

Extended Benefits Also Prolong Unemployment. One of the most thoroughly established results in labor economics is that extended unemployment benefits cause workers to remain unemployed longer.[4] Even Alan Krueger, President Obama's nominee to chair the Council of Economic Advisors, agrees.[5] Most studies find that increasing UI benefits to 99 weeks increases the time the average worker spends unemployed by five to 11 weeks.

Extended benefits increase unemployment for several reasons. Some workers prefer not to work

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if the government will subsidize their leisure. These workers could look for work but choose not to do so. When benefits run out, the number of unemployed workers finding jobs jumps.[6] However, it is a minority of unemployed workers who game the system like this.[7]

Most of the effect of UI benefits comes from the fact that—by providing additional funds—they reduce the need to find a new job immediately. This enables the unemployed to focus their search on jobs they prefer to find. Often this means looking for jobs near the city, the occupation, and/or salary they had before. As benefits draw down, workers widen their search to jobs they would not previously consider. Krueger finds that the amount of time that workers on UI spend on job hunting triples when their benefits start to run out.[8]

Unfortunately, many of the jobs that unemployed workers would prefer do not exist and will not return. Over half of net employment losses occurred in the manufacturing and construction sectors. The recession hit some states, such as Michigan and Nevada, particularly hard. To find work, many of the unemployed will have to accept jobs that are much less than ideal. Providing two years of benefits slows their transition to these jobs.

Higher Unemployment Rate. Studies conclude that extending benefits to 99 weeks during the recession has raised the unemployment rate by between 0.5 and 1.5 percentage points.[9] This represents between 12 and 37 percent of the overall 4.1 percent increase in the unemployment rate since the recession began. Researchers affiliated with organizations as diverse as the Brookings Institution and the San Francisco Federal Reserve Bank have come to this same conclusion.[10]

Prolonged unemployment has negative economic consequences. Workers do not create wealth during the additional weeks they remain unemployed. They save and consume less. Labor markets become less flexible because it takes more time for workers to transition from one industry or state to another.

1. This represents between 765,000 and 2.3 million workers.
2. U.S. Department of Labor, Bureau of Labor Statistics, "The Employment Situation—August 2011," Table A-12, September 2, 2011.
3. Mark M. Zandi, "Assessing President Bush's Fiscal Policies," Economy.com, July 2004, Table 4, at *http://www.pbs.org/wsw/opinion/zandionbush.pdf* (September 7, 2011); Mark Zandi, "Global Policy Prescriptions: How Another Recession Can Be Avoided," Moody's Analytics, August 26, 2011, at *http://www.economy.com/mark-zandi/documents/Policy-Prescriptions-20110826.pdf?src=slideshow* (September 7, 2011).
4. See David Card and Phillip B. Levine, "Extended Benefits and the Duration of UI Spells: Evidence from the New Jersey Extended Benefit Program," *Journal of Public Economics*, Vol. 78 (October 2000), pp. 107–38; Lawrence Katz and Bruce Meyer, "The Impact of the Potential Duration of Unemployment Benefits on the Duration of Unemployment," *Journal of Public Economics*, Vol. 41, No. 1 (1990), pp. 45–72; Stepan Jurajda, "Estimating the Effect of Unemployment Insurance Compensation on the Labor Market Histories of Displaced Workers," *Journal of Econometrics*, Vol. 108, No. 2 (2002), pp. 227–52; John T. Addison and Pedro Portugal, "How Does the Unemployment Insurance System Shape the Time Profile of Jobless Duration?," *Economics Letters*, Vol. 85, No. 2 (November 2004), pp. 229–34; Rafael Lalive, Jan Van Ours, and Josef Zweimüller, "How Changes in Financial Incentives Affect the Duration of Unemployment," *Review of Economic Studies*, Vol. 73, No. 4 (October 2006), pp. 1009–38.
5. Alan B. Krueger and Bruce D. Meyer, "Labor Supply Effects of Social Insurance," in *Handbook of Public Economics*, ed. A. J. Auerbach and M. Feldstein, 1st ed., Vol. 4 (2002), pp. 2327–2392.
6. Stepan Jurajda and Frederick J Tannery, "Unemployment Duration and Extended Unemployment Benefits in Local Labor Markets," *Industrial and Labor Relations Review*, Vol. 56, No. 2 (January 2003), pp. 332–34.
7. Raj Chetty, "Moral Hazard versus Liquidity and Optimal Unemployment Insurance," *Journal of Political Economy*, Vol. 116, No. 2 (2008), pp. 173–234. See also Jurajda and Tannery, "Unemployment Duration and Extended Unemployment Benefits in Local Labor Markets." They find that about one-third of unemployed workers who have not yet found jobs find work the week after benefits run out. This represents a minority of all unemployed workers finding jobs when benefits expire.
8. Alan Krueger and Andreas Mueller, "Job Search and Unemployment Insurance: New Evidence from Time Use Data," *Journal of Public Economics*, Vol. 94, Nos. 3–4 (2010), pp. 298–307.

The welfare benefits of extended UI come with an economic cost.

Consumption Increases Modest. The theory behind UI-as-stimulus is that the government should transfer money to workers who will immediately spend it. This is supposed to increase aggregate demand and stimulate the economy. This theory is a recycled version of Keynesian economic theories that economists and policymakers rejected after they failed during the 1970s.

Even if policymakers accept Keynesian theories, however, microeconomic research shows that UI spending only modestly changes consumption. Each dollar spent on UI benefits increases total household consumption by just $0.55.[11] This happens because unemployment benefits change household behavior. The spouses of unemployed workers with UI benefits work less than those without benefits. For married men, each dollar of benefits reduces their wives' earnings by between 36 and 73 cents.[12] The fall in spousal income partly offsets the increase in UI benefits. Workers also spend more of their savings without UI, so UI benefits indirectly fund some saving, not consumption. Extended UI benefits provide alternative financing for much consumption that would nonetheless take place.

No Economic Boost. The Heritage Foundation modeled the effect of extended unemployment benefits accounting for these factors.[13] The simulations showed that extending benefits from 26 weeks to 39 weeks boosted GDP in the short run but by well less than the amount spent. Extensions beyond 39 weeks slightly reduced the size of the economy. Models that account for how benefits affect workers' behavior find that UI payments do not stimulate the economy.

Empirical research comes to the same conclusion. States that increase UI spending see little economic boost.[14] Recent history shows the same thing.

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9. Bhash Mazumder, "How Did Unemployment Insurance Extensions Affect the Unemployment Rate in 2008–10?," Federal Reserve Bank of Chicago, April 2011, at *http://www.chicagofed.org/digital_assets/publications/chicago_fed_letter/2011/cflapril2011_285.pdf* (September 7, 2011); Shigeru Fujita, "Effects of Extended Unemployment Insurance Benefits: Evidence from the Monthly CPS," Federal Reserve Bank of Philadelphia, revised January 2011, at *http://www.chicagofed.org/digital_assets/publications/chicago_fed_letter/2011/cflapril2011_285.pdf* (September 7, 2011); Makoto Nakajima, "A Quantitative Analysis of Unemployment Benefit Extensions," Federal Reserve Bank of Philadelphia, revised February 2011, at *http://www.philadelphiafed.org/research-and-data/publications/working-papers/2011/wp11-8.pdf* (September 7, 2011); Daniel Aaronson, Bhashkar Mazumder, and Shani Schechter, "What Is Behind the Rise in Long-Term Employment?," Federal Reserve Bank of Chicago, *Economic Perspectives*, Vol. 34 (2010), pp. 28–51, at *http://www.chicagofed.org/digital_assets/publications/economic_perspectives/2010/2qtr2010_part1_aaronson_mazumder_schechter.pdf* (September 7, 2011).
10. M. Elsby, B. Hobjin, and A. Sahin, "The Labor Market in the Great Recession," Brookings Institution, March 8, 2010, at *http://www.brookings.edu/~/media/Files/Programs/ES/BPEA/2010_spring_bpea_papers/spring2010_elsby.pdf* (September 7, 2011); Rob Valletta and Katherine Kuang, "Extended Unemployment and UI Benefits," Federal Reserve Bank of San Francisco, April 19, 2010, at *http://www.frbsf.org/publications/economics/letter/2010/el2010-12.html* (September 7, 2011).
11. Jonathan Gruber, "The Consumption Smoothing Benefits of Unemployment Insurance," *American Economic Review*, Vol. 87 (March 1997), p. 195. Note that a 10 percent increase in the replacement rate (representing a 10 percent increase in individual income) reduces the fall in individual consumption by 2.65 percent. Footnote 9 of this paper notes that the average recipient obtains 48 cents out of every additional dollar of which he or she is eligible because not all workers eligible for benefits receive them. So when UI raises incomes by 4.8 percent, consumption rises by 2.65 percent. Each dollar spent on UI raises consumption by approximately 55 cents.
12. J. B. Cullen and J. Gruber, "Spousal Labor Supply as Insurance: Does Unemployment Insurance Crowd Out the Added Worker Effect?," *Journal of Labor Economics*, Vol. 18, No. 3 (2000), pp. 546–72.
13. James Sherk and Karen Campell, "Extended Unemployment Insurance—No Economic Stimulus," Heritage Foundation *Center for Data Analysis Report* No. 08-13, November 18, 2008, at *http://www.heritage.org/Research/Reports/2008/11/Extended-Unemployment-Insurance-No-Economic-Stimulus*. The simulation accounted for both the effect of extended benefits on unemployment duration and the fact that each dollar spent increased total consumption by only $0.55.
14. Kyung Won Lee, James R. Schmidt, and George E. Rejda, "Unemployment Insurance and State Economic Activity," *International Economic Journal*, Vol. 13, No. 3 (Autumn 1999), pp. 77–95.

Since January 2009, the government has spent over $300 billion on unemployment benefits.[15] The unemployment rate remains stuck above 9 percent—well above the Administration's forecasts. Massive stimulus spending, including on extended unemployment benefits, has not discernibly improved the economy.

Prioritize Spending. Congress understandably wants to help unemployed workers, but this spending comes at a cost to the economy. Congress should not imagine that spending more on unemployment benefits will end the recession. Instead, Congress should weigh the economic costs of extending unemployment benefits against the humanitarian benefits they provide.

Congress may decide that extended unemployment insurance provides important benefits and should be maintained. However, current federal spending is unsustainable, and the debt poses a threat to America's future. Congress should pay for any extension of benefits by reducing spending on less beneficial programs. Experimental evaluations show that many well-intentioned federal programs do not improve the lives of those they intend to help.[16] Cutting or eliminating these programs would cover the 10-year cost of another UI extension. Congress should not add extended UI benefits to the national debt.

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15. Heritage Foundation calculations using data for the U.S. Department of Commerce, Bureau of Economic Analysis, "Personal Income and Outlays," Table 1.
16. Peter Z. Schochet, Sheena McConnell, and John Burghardt, *National Job Corps Study: Findings Using Administrative Earnings Records Data: Final Report* (Princeton, N.J.: Mathematica Policy Research, October 2003); U.S. Department of Health and Human Services, Administration for Children and Families, "Head Start Impact Study: Final Report," January 2010, at *http://www.acf.hhs.gov/programs/opre/hs/impact_study/reports/impact_study/hs_impact_study_final.pdf* (September 7, 2011).