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The Stimulus: Extending Unemployment Insurance Is Unnecessary

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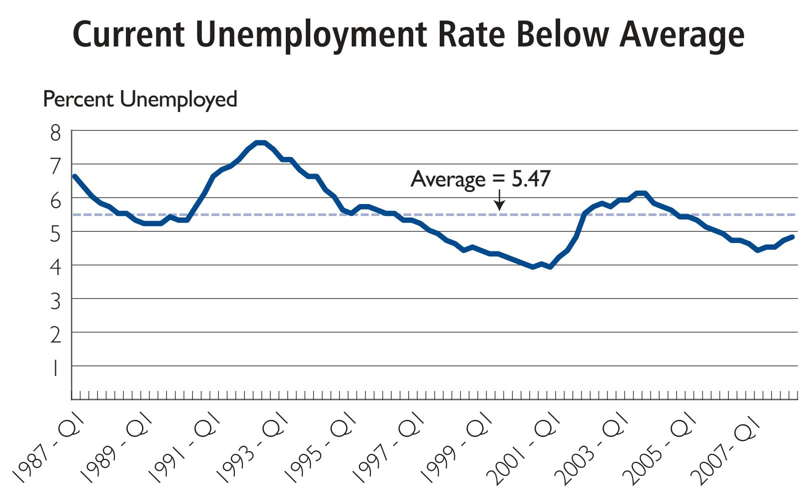
Senate Finance Committee Chairman Max Baucus's (D–MT) stimulus proposal would extend unemployment insurance (UI) benefits to 39 weeks in an attempt to stimulate the economy.[1] Workers have no economic need for a longer period of unemployment benefits. Congress should not extend the duration of UI benefits for the following reasons:

- Unemployment is low, and the number of new UI claims is falling, not rising;
- Long-term unemployment has been stable over the past 2 years; and
- Little evidence suggests that extending UI benefits improves the economy.

Chart 1 WM 1787



Source: U.S. Department of Labor, Bureau of Labor Statistics Employment and Training Administration, Office of Workforce Security, UI Weekly Claims, at *http://ows.doleta.gov/unemploy/claims_arch.asp.*

Unemployment Historically Low. In most cases, workers can collect unemployment insurance benefits for 26 weeks. This limit discourages employees from using the system to collect benefits instead of working. In fact, substantial numbers of workers find jobs immediately after their benefits expire.[2] Congress has allowed workers to collect more than 6 months worth of benefits during times of high unemployment, when it is more difficult to find a new job. This last occurred after the 2001 recession, and Congress allowed the extended benefits to expire in 2004.

Currently, however, unemployment is well below average levels. In December, the unemployment rate stood at 5 percent. Unemployment has been above this rate 65 percent of the time over the past 20 years—a period that includes the tech bubble.[3]

This paper, in its entirety, can be found at:
www.heritage.org/Research/Labor/wm1787.cfm

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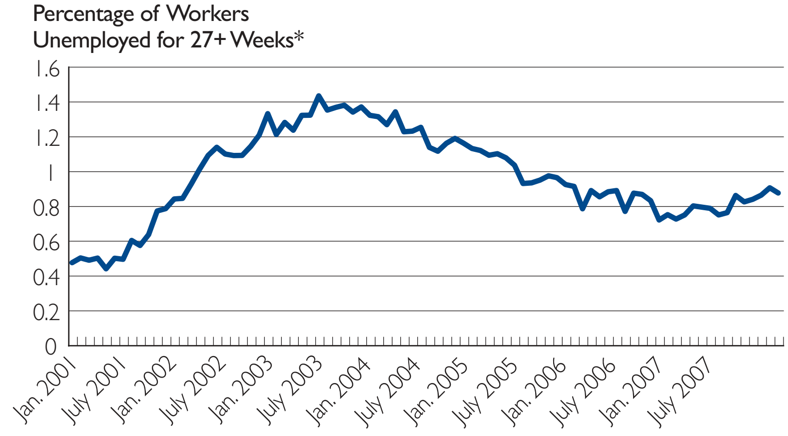
Extending UI benefits in the current economic environment makes little sense. Workers are not having an unusually difficult time finding new jobs. Few diligent workers would use the additional benefits.

Shorter Unemployment Spells. Extended UI benefits are intended to help the long-term unemployed—those out of work for longer than the six-month limit for collecting UI benefits. However, the long-term unemployment rate has been stable for the past two years and is well below its peak following the 2001 recession.

Chart 2 WM 1787

Long-Term Unemployment Has Remained Fairly Stable for Last Two and a Half Years



*The ratio is the number of workers unemployed for 27 weeks or longer divided by the total civilian labor force 16 years of age or older.

Source: Heritage Foundation calculations based on data from Haver Analytics / Department of Labor, Bureau of Labor Statistics, "The Employment Situation," Press Release Table A-9.

Chart 2 shows the number of workers who have been unemployed for more than 6 months as a percentage of the total labor force. The long-term unemployment rate has been fairly stable over the past two and a half years, fluctuating between 0.7 and 1 percent. Substantially fewer workers are experiencing long-term unemployment now than when extended UI benefits expired in early 2004.

Furthermore, few unemployed workers stay unemployed for the 26 weeks necessary to begin collecting extended UI benefits. The typical unemployment spell now lasts 16.6 weeks, nine weeks less than the maximum length of time workers can collect benefits.[4] Most workers do not need more than the 6 months of unemployment benefits the law currently provides.

Initial UI Claims Falling. If larger numbers of workers were losing their jobs and they had greater need to rely on UI benefits, the number of initial claims for unemployment benefits would rise. This also has not happened. Instead, the number of weekly initial unemployment benefit claims has been fairly stable, between 291,000 to 342,000 per month since October 2005.[5] This is much lower than the levels immediately following the 2001 recession.

1. Jonathan Weisman, "Senate to Offer Own Stimulus Package: Almost All Would Get $500 Rebate," *The Washington Post*, January 29, 2008, page A1, at *www.washingtonpost.com/wp-dyn/content/article/2008/01/28/AR2008012802431.html?hpid=topnews*.
2. James Sherk and Patrick Tyrrell, "Unemployment Insurance Does Not Stimulate the Economy," Heritage Foundation *WebMemo* No. 1777, January 18, 2008, at *www.heritage.org/Research/Economy/wm1777.cfm*.
3. Heritage Foundation calculations based on U.S. Department of Labor, Bureau of Labor Statistics, Labor Force Statistics From the Current Population Survey, (SEAS) Unemployment Rate, at *http://data.bls.gov/PDQ/servlet/SurveyOutputServlet?series_id=LNS14000000*.
4. Haver Analytics / Department of Labor, Bureau of Labor Statistics, "The Employment Situation," Press Release Table A-9.
5. Seasonally adjusted monthly average of new UI claims per week. Center for Data Analysis calculations based on data from Haver Analytics / U.S. Department of Labor, Employment and Training Administration, Unemployment Insurance Services Division, unpublished data.

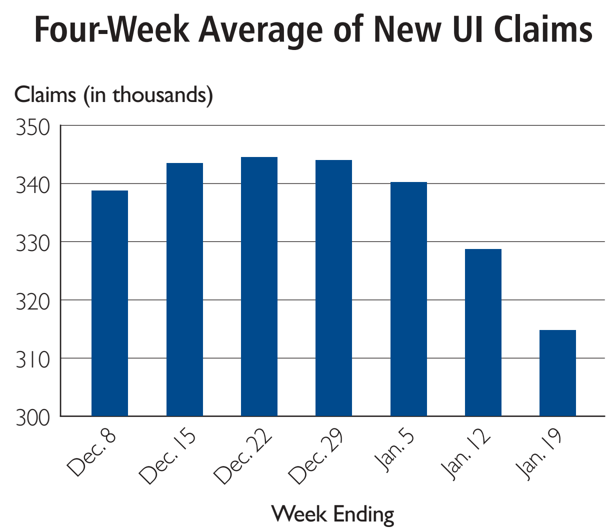
New UI claims have also decreased—not increased—in recent weeks. Chart 3 shows the four-week moving average of new UI claims. It has fallen steadily throughout January 2008.

There is no economic justification for extending unemployment benefits beyond 26 weeks. Unemployment is low, few workers are experiencing long-term unemployment, and new claims for unemployment insurance are falling.

UI Is No Stimulus. Extending UI benefits does not help the economy. The UI system was designed to provide workers with insurance against the risk of involuntary job loss, not to stimulate the economy. Paying workers to stay unemployed longer does little to promote economic growth.

Supporters of extended UI benefits point to a 2004 study concluding that this approach provides the most "bang for the buck" because each $1 spent on additional UI benefits would increase GDP by $1.73.[6] However, that study is flawed. It relies entirely on the theoretical assumption that government spending has a "multiplier effect" on the economy and that the key to economic growth is greater government and consumer spending, not saving or investing. In the actual economy, money the government spends comes from somewhere. When the government borrows money to finance new UI benefits, the individuals it borrows from have less money to spend or invest elsewhere in the economy, which offsets the stimulus. Government spending does not have a multiplier effect so much as it redirects economic activity toward the activities that government spends money on. Additionally, the government must eventually repay the loan, which requires spending reductions or higher taxes in the future.

Chart 3 WM 1787



Source: U.S. Department of Labor, Bureau of Labor Statistics Employment and Training Administration, Office of Workforce Security, UI Weekly Claims, at *http://ows.doleta.gov/unemploy/claims_arch.asp.*

The 2004 study also erroneously assumed that recipients spend every dollar of additional UI benefits. In fact, households respond to more generous benefits by changing their behavior. Only 50 cents of every dollar in UI benefits finances new consumption.[7] The other 50 cents finances consumption that households would have made otherwise, either by spouses working longer hours or by spending savings.[8]

Given these flawed assumptions, the study's conclusion is not surprising. Real-world studies of the effect of UI spending on the economy come to the opposite conclusion. Empirical research finds little

6. Mark Zandi, "Assessing President Bush's Fiscal Policies," Economy.com Inc, July 2004, at *www.economy.com/dismal/economycom_bushfiscalpolicy.pdf*.

7. 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 notes that the average recipient gets 48 cents out of every additional dollar he or she is eligible for, because not all workers eligible for benefits receive them. Thus, when UI raises incomes by 4.8 percent, consumption rises by 2.65 percent. Consumption is less than household income, so each dollar spent on UI raises consumption by roughly 50 cents.

8. B. Cullen and J. Gruber, "Spousal Labor Supply as Insurance: Does Unemployment Insurance Crowd Out the Added Worker Effect?" *Journal of Labor Economics*, 18(3) (2000), pp. 546–572; Eric M. Engen and Jonathan Gruber, "Unemployment Insurance and Precautionary Saving," *Journal of Monetary Economics*, Vol. 47 (June 2001), pp. 545–579.

to no evidence that increasing UI benefits boosts the economy.[9]

Conclusion. Congress has no economic or policy reasons to extend unemployment benefits beyond the current maximum of six months. Economic conditions do not justify providing additional unemployment benefits. The unemployment rate is low, and unemployed workers are not having unusual difficulty finding new jobs. New claims for unemployment insurance are dropping, not rising. Also, paying workers not to work does not encourage economic growth. Empirical studies find little evidence that unemployment insurance boosts the economy or provides much "bang for the buck." Congress should leave extended UI benefits out of any stimulus package.

—James Sherk is Bradley Fellow in Labor Policy, and Patrick Tyrrell is a Research Assistant, in the Center for Data Analysis at The Heritage Foundation.

9. 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; George M. Von Furstenberg, "Stabilization Characteristics of Unemployment Insurance," *Industrial and Labor Relations Review*, Cornell University, Vol. 29 (3), (April 1976), pp. 363–376.