WebMemo
Published by The Heritage Foundation

No. 1934
May 20, 2008

Congress Should Not Attach Extended UI Benefits to Troop Funding

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The U.S. House of Representatives recently voted to attach a provision extending unemployment insurance (UI) benefits to H.R. 2642, the Military Construction and Veterans Affairs Appropriations Act of 2008. The legislation now moves to the Senate, which will consider it along with the supplemental funding for the wars in Iraq and Afghanistan.

Attaching extended UI benefits to troop funding is a mistake. Both the unemployment rate and the long-term unemployment rate are below the levels they had reached when Congress ended previous extended benefit programs. Unemployment insurance, moreover, does not stimulate the economy. Congress should not use the American people's desire to support the troops to extend UI benefits.

Extended Benefits. Unemployment insurance provides temporary income to workers who lose their jobs through no fault of their own. Unemployed workers receive a portion of their paychecks for up to 26 weeks (six months) after they lose their job. The program insures workers against the risk of unexpected job loss and is intended to provide temporary support while workers look for a new job. It is not a permanent entitlement or a general unemployment benefit. Some in Congress want to extend the current 26 weeks of benefits to 39 weeks—nine months. This will not help the economy.

UI Does Not Stimulate. Congress never designed or intended the program to stimulate the economy. However, a 2004 study by Mark Zandi concluded that extending UI benefits provides more "bang for the buck" than other policy proposals.[1] On the basis of this study, many Members of Congress now support extending UI benefits to stimulate the economy.

This study suffers from two serious flaws. First, it inaccurately assumes that UI recipients spend every dollar of additional 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.[2] The other 50 cents finances consumption that households would have made otherwise, either by spouses working longer hours or by drawing from savings.[3]

Second, the Zandi study 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 else. When the government taxes incomes to finance new UI benefits, the individuals who paid the taxes have less money to spend or invest elsewhere in the economy, which offsets the stimulus. Government spending does not

This paper, in its entirety, can be found at:
www.heritage.org/Research/Labor/wm1934.cfm

Produced by the Center for Data Analysis

Published by The Heritage Foundation
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have a multiplier effect so much as it redirects economic activity toward the activities that government spends money on. Dollar for dollar, government spending does less for the overall economy than private spending. Even if the government "borrows" the funds by selling Treasury notes, the same economic inefficiency occurs—and taxes must pay for this borrowing.

Given these flawed assumptions, it is not surprising that the 2004 study concluded that extending UI benefits is an economic panacea. Empirical studies of the actual effect of increased UI spending come to the opposite conclusion. Many states, such as California and Michigan, have had large variations in the amount they spend on UI because their unemployment rates have risen and fallen sharply in recent decades. If additional spending on UI stimulates the economy the way the Zandi study projects, then this effect would appear in these states' economies. It does not.[4] Congress should recognize that extending UI benefits to nine months will not stimulate the economy.

Unemployment and Long Term Unemployment Low. Labor market conditions do not justify extending UI benefits. Six months of taxpayer support is enough time for most workers to find new jobs. The UI system is not intended or designed to support low-income workers in times of economic stress. Other state and federal programs fill that role. The only reason to extend UI benefits to nine months is if a high percentage of unemployed workers are having difficulty finding new jobs.

Despite the troubles in the housing and financial markets, this is not the case. The unemployment rate remains historically low at 5 percent. Economists estimate that full employment in the United States occurs at between 4 percent and 6 percent unemployment.[5] Workers are not having difficulty finding new jobs. Chart 1 shows the unemployment rate and the long-term unemployment rate for the past 35 years. The unemployment rate is significantly lower now than when Congress ended the last three extended unemployment insurance programs.

Some analysts argue that though overall unemployment is low, long-term unemployment—the number of workers unemployed for more than the 26 weeks of UI eligibility—has risen.[6] They believe that though fewer workers lack jobs, the unemployed now have greater difficulty finding work than in the past. They contend that nine months of benefits are now necessary to give workers time to find jobs.

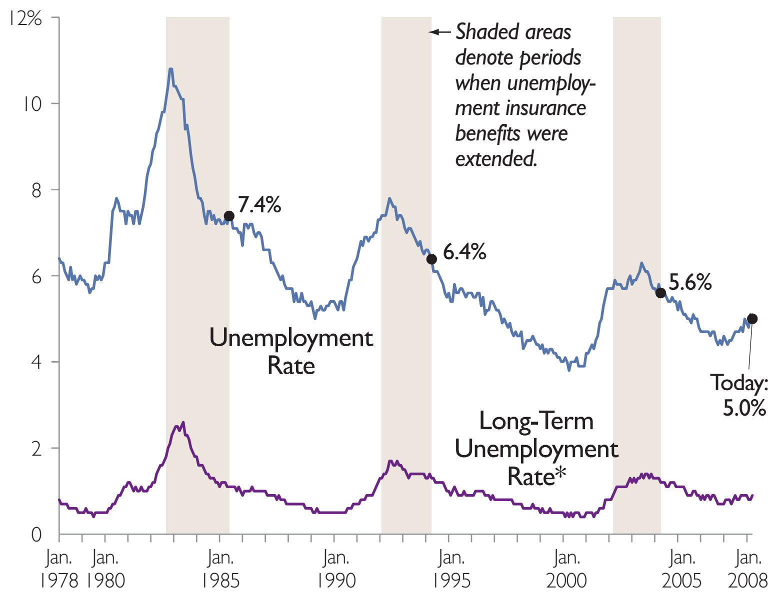
This is untrue. Chart 1 shows the historical long term unemployment rate, currently at 0.9 percent. Though the long-term unemployment rate has

1. Mark Zandi, "Assessing President Bush's Fiscal Policies," Economy.com Inc., July 2004, at *www.economy.com/dismal/economycom_bushfiscalpolicy.pdf*.
2. 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.
3. 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. 546–572; Eric M. Engen and Jonathan Gruber, "Unemployment Insurance and Precautionary Saving," *Journal of Monetary Economics*, Vol. 47 (June 2001), pp. 545–579.
4. 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, No. 3, (April 1976), pp. 363–376.
5. Organisation for Economic Co-operation and Development, "Revised OECD Measures of Structural Unemployment," *OECD Economic Outlook* No. 68, December 2000, at *http://www.oecd.org/dataoecd/44/50/2086120.pdf*.
6. Robert Samuelson, "Sensible Stimulus," *The Washington Post*, May 7, 2008, p. A21, at *http://www.washingtonpost.com/wp-dyn/content/article/2008/05/06/AR2008050602444.html*.

risen since the peak of the tech bubble in the late 1990s, it is still much lower than when Congress ended the previous extended benefit programs. The long term unemployment rate was 1.2 percent in April 2004, 1.3 percent in April 1994, and 1.1 percent in June 1985. Long term unemployment is 21 percent to 34 percent lower now than when Congress previously believed the labor market sufficiently strong that extended UI benefits were unnecessary.

Unemployment Rate and Insurance Benefits

Today's unemployment rate is lower than it was at the end of each of three periods during which Congress extended unemployment insurance benefits.



* The long-term unemployment rate is defined as the percent of workers in the labor force unemployed for more than 26 weeks.

Source: Heritage Foundation calculations based on data from the Department of Labor, Bureau of Labor Statistics / Haver Analytics.

Chart 1 • WM 1934 heritage.org

Conclusion. Extending UI benefits will not stimulate the economy and is not justified by economic conditions. Congress has not passed this policy as stand-alone legislation for good reason. Congress did not pass extended benefits in the stimulus bill that sent tax rebates to most American households, despite intense lobbying to do so. Now the House of Representatives has attached extended benefits to the Military Construction and Veterans Affairs Appropriations Act of 2008, and the Senate may attach it to the supplemental bill that will provide funding to the troops in Afghanistan and Iraq. Congress should not use the American people's desire to support the troops as political cover to enact a policy that is not justified on the merits.

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