UNITED STATES SENATE
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Senator Kyl is Right

UI Extension is an Unlikely Economic Stimulus

> ***Mr. Reid:*** *My good friend from the State of Arizona,* ***Senator Kyl, said that unemployment insurance extension does not create a single job to stimulate the economy.*** *Does the Senator from Minnesota . . . agree with that statement? Or would the Senator agree with the statement from Joeseph Stiglitz, Nobel Prize winner in economics, who says: "... We should extend the duration and magnitude of the benefits we provide to our unemployed. This is not only the fairest proposal, but also the most effective. People who become unemployed cut back on their expenditures. Giving them money will directly increase expenditures." Would the Senator agree with that statement or the one from our friend from Arizona, Senator Kyl, who said unemployment extension does not create a single job to stimulate the economy?*
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> **– *Congressional Record,* February 5, 2002 (emphasis added)**

Republicans support extending unemployment insurance (UI) benefits for those workers dislocated by the recession and the terrorist attacks of September 11. Every stimulus package offered by Republicans, including those supported by the President and passed by the House, included an extension of UI benefits. Last week, the Senate unanimously agreed to adopt just such an extension with Republican support.

That said, Senator Kyl is right. Extending unemployment benefits does not create jobs. In fact, the evidence leans the other way. Extending UI benefits likely increases unemployment and slows economic recoveries. Like much of the Democrat alternative to the President's stimulus package, extending UI benefits increases federal spending and helps dislocated workers pay their bills, but it provides little boost to our economy. The Democrats' focus is on increasing federal benefits with very little concern left over for promoting paychecks. Republicans support provisions to help dislocated workers, but continue to focus on preserving and restoring jobs over promoting higher levels of government spending.

Extending UI Means Extending Unemployment

There is quite a bit of economic evidence that extending UI benefits results in workers staying out of the workforce longer. Here are the abstracts to just two studies that make that point:

✓ "…Overall, we find that the NJEB (New Jersey Extended Benefit) program raised the fraction of UI claimants who exhausted their regular benefits by 1-3 percentage points. More importantly, however, we find that the short-term nature of the benefit extension substantially moderated its effect. For individuals who were receiving UI when the benefit extension was passed, we estimate that the rate of leaving UI fell by about 15 percent. Simulations suggest that if the program had run long enough to affect UI claimants from the first day of their spell, the fraction of recipients exhausting regular benefits would have risen by 7 percentage points, and the average recipient would have collected about one extra week of regular benefits."[1]

David Card – UC Berkeley
Philip Levine – Wellesley College

✓ "This paper examines the impact of the potential duration of unemployment insurance (UI) benefits on unemployment in the United States. First, we use a large sample of household heads to examine differences in the unemployment spell distributions of UI recipients and nonrecipients. Sharp increases in the escape rate from unemployment both through recalls and the new job acceptances are apparent for UI recipients around the time of benefits exhaustion. Such increases are not apparent at similar points of spell duration for nonrecipients. Second, our analysis of accurate administrative data from 12 states indicates that a one week increase in potential benefit duration increases the average duration of the unemployment spells of UI recipients by 0.16 to 0.20 weeks." [2]

L.F Katz – Harvard
B.D. Meyer – NW University

These economists are from such institutions Berkely, Harvard, and Wellesley – not exactly conservative strongholds. What they found, however, is consistent with Senator Kyl's remarks – that extending UI benefits slows job growth and therefore is decidedly unlikely to act as an economic stimulus. Even the Democrats' own witness before the Senate Budget Committee in October argued that extending UI has its costs as well as benefits:

✓ "A traditional government response in a recession is to extend the duration of UI benefits from 26 weeks to 39 or 52 weeks. In a severe, long-lasting recession, extended benefits make a great deal of sense. But research has found that the average duration of unemployment spells rises if benefit duration is expanded, and effort devoted to searching for a new job declines as a result. Relatively short benefit durations is one reason why the unemployment rate is lower in the U.S. than in Europe." [3]

Alan Krueger – Princeton

Another Cost to Extended Unemployment Benefits

Senator Reid cites former Clinton economist and Nobel Prize winner Joseph Stiglitz. Dr. Stiglitz argued for extending UI benefits as part of the economic stimulus bill in the *Washington Post* in the November 11, 2001 Outlook section:

> ". . .America's unemployment insurance system is among the worst in the advanced industrial countries; give money to people who have lost their jobs in this recession, and it would be quickly spent."

In Stiglitz' view, the economy right now has excess capacity, and therefore deficient demand. Giving money to people with a high propensity to consume encourages consumption, raises demand, and fills the void of excess capacity. During debate, Senator Reid referenced a Congressional Budget Office (CBO) report in support of Dr. Stiglitz' views. But the CBO study's focus was, by the office's own admission, extremely narrow in its scope:

> "In evaluating the economic impact of proposed changes in tax policy, CBO has restricted its analysis to an option's usefulness in raising overall demand in the short term. Therefore, that assessment should not be taken as indicating how the proposal would affect growth and efficiency in the long term. [4]

The CBO report goes on to illustrate both the limitations of this approach *and* identifies an additional cost to extending UI benefits:

> For example, in the short run, if slack capacity exists (that is, if the economy is underemployed), an effective stimulus would be one that increased consumption and decreased saving. Yet a decline in saving as a long-term policy would tend to slow economic growth because it would reduce capital accumulation and growth of the economy's capacity to produce.

So now we have a second downside to extending UI benefits. Not only does it slow the repatriation of dislocated workers into the workforce, it could also shift resources away from savings and investment. In Stiglitz' view apparently, that's okay since our main problem is deficient demand. Even for those who endorse such Keynesian policies, other economists have noted that consumer demand and confidence has held up remarkably well during this downturn. Nominal retail sales in the fourth quarter of last year were up a remarkable 5 percent from the previous fourth quarter. That's not a sign of weak demand.

If Stiglitz is wrong, then the CBO is using the wrong indicator to measure which stimulus package is "good" and which is "bad," which means that the benefits of raising overall demand are overstated, and all we're left with is the shifting of resources away from savings and investment. As the CBO report notes, in the long-term, savings and investment are where job growth and higher wages originate.

Senator Kyl Is Right

Paying people not to work does not stimulate the economy. It helps reduce economic dislocation. It enables unemployed workers to keep their homes and pay for health insurance. It is an important part of our overall safety-net for people who lose their jobs. It should not, however, be oversold as a fix for slow economic growth. To the contrary, studies show that extending unemployment benefits slows the return of the unemployed to the workforce and retards the overall increase in employment rates following a recession.

The centrist stimulus package blocked by Senator Daschle last week balanced the need to invest in our safety net through UI benefits and health insurance tax credits with policies designed to stimulate economic growth and job creation, both now and in years to come. It included both demand and supply incentives to protect households and restore economic growth. Republicans continue to believe this sort of economic package will help people find new jobs or keep their current ones, and hope Senator Daschle will return, once again, to consider the centrist stimulus package.

Written by RPC Deputy Staff Director Brian Reardon, 224-2946

Endnotes:

[1] Card, David, and Phillip B. Levin, "Extended Benefits and the Duration of UI Spells: Evidence from the New Jersey Extended Benefit Program," NBER Working Paper No. w6714*.

[2] Katz, Lawrence, and Bruce D. Meyer, "The Impact of the Potential Duration of Unemployment Benefits on the Duration of Unemployment," *Journal of Public Economics,* Vol. 41, Issue 1 (1990).

[3] Krueger, Alan B., Princeton University, Prepared Statement for the Senate Budget Committee, October 2, 2001

[4] CBO Paper: "Economic Stimulus: Evaluating Proposed Changes in Tax Policy," January 2002.