

Does Unemployment Insurance Inhibit Job Search?

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Representative Carolyn Maloney, Chair

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The principal purpose of the unemployment insurance (UI) program is to provide workers with a safety net in the event that they lose their job. However, some worry that unemployment insurance benefits may inhibit unemployed workers from vigorously looking for or accepting a new job. Those fears are unfounded. The best evidence suggests that during this current economic downturn both the unemployment rate and duration of unemployment were minimally impacted by unemployment insurance benefits and the extensions of benefits. To the extent that the unemployment rate even rises, UI may be providing an enormous social benefit by preventing people not from taking jobs, but from dropping out of the labor force altogether (and often permanently), relying instead on more costly programs like disability benefits.

Unemployment benefits are not particularly generous – average weekly benefits are just 74 percent of the poverty threshold for a family of four.¹ So it is unlikely that extended unemployment benefits inhibit individuals' job search efforts. Simply put, even a low-paying job is likely to provide more support than that offered by UI. Moreover, five unemployed Americans exist for every job opening today, which means that individuals who exhaust benefits are unlikely to find a new job with ease. Those who remain jobless and without unemployment benefits will need some form of social assistance in order to avoid complete destitution, and are likely to turn to alternative social programs at a cost to the federal government.

Extending unemployment insurance benefits is not only a critical form of economic security for American families, but also a key form of fiscal stimulus that has the potential to ease pressure on the labor market by stimulating economic growth.

Unemployment Insurance Does Not Discourage Job Search Behavior

While earlier research suggested that the unemployment insurance program in the 1970s and 1980s had important disincentive effects, the current consensus is that these dated studies overstated the effects of unemployment insurance benefits on job search behavior. The older studies noted a jump in the fraction of workers who found a job just before they exhausted their benefits.² In contrast, in testimony before the Joint Economic Committee, the author of one of the seminal papers in this earlier wave of research, Dr. Lawrence Katz, said that “the most compelling research shows only modest impacts of UI extensions on the search effort and duration of unemployment of unemployment insurance recipients.”³ For example, Katz argued that the large effects found in these earlier studies were mainly due to “firms and industries using temporary layoffs and the sensitivity of recall dates to unemployment insurance benefits,” and suggested that the “layoff-recall process is much less important today than it was in the 1970s and early 1980s.”⁴ Katz pointed out that these studies overstate the overall impact of unemployment insurance benefits on the length of unemployment spells “by ignoring the

spillover effects of shorter unemployment spells for the other unemployed workers not receiving UI benefits.”⁵

Dr. Katz is not the only economist who holds these views. Dr. Till von Wachter, in testimony before the Joint Economic Committee, also shared Katz’s opinion.⁶ “It is likely that in severe recessions, the benefit of extended UI outweighs the costs,” argues von Wachter.⁷ Analyzing data from Germany that was of much higher quality than most other studies on the disincentive effects of unemployment insurance, von Wachter found that “extended UI would lead to a moderate increase in the rate of unemployment.” He also inferred that the increase in the unemployment rate would be smaller in the United States right now because labor market conditions are tight and jobs are scarce.⁸

Another prominent economist who has studied unemployment insurance and other social insurance programs, Dr. Raj Chetty, has reached similar conclusions. In one paper, he and co-authors showed that even though there is a “spike” in exit rates from unemployment insurance at the time of benefit exhaustion, the probability of reemployment doesn’t change significantly.⁹ In other words, many of those who exit the unemployment insurance rolls as their benefits are about to expire are not moving on to another job. Furthermore, Chetty argues that “work disincentive effects” are likely to be small because people are “likely to take any job they can get” in the current economic downturn.¹⁰

Former Chairman of the Federal Reserve Alan Greenspan has also expressed strong support for extending unemployment insurance benefits, and dismisses the argument that unemployment benefits discourage job search behavior. In testimony to the Joint Economic Committee, Chairman Greenspan said, “[U]nemployment benefit insurance here is essentially restrictive because it’s been our perception that we don’t want to create incentives for people not to take jobs. But when you’re in period of job weakness where it is not a choice on the part of people whether or not they’re employed or unemployed, then, obviously, you want to be temporarily generous. And that’s what we’ve done in the past, and I think it’s worked well.”¹¹

While an extension of unemployment insurance benefits will not discourage job search behavior, it may increase the reported unemployment rate by a small amount. This is because the unemployment rate counts only those individuals who are actively seeking work, which is a requirement for receiving unemployment insurance benefits. Jobless individuals who drop out of the labor market entirely are not counted when the Bureau of Labor Statistics calculates the unemployment rate. Because unemployment insurance incentivizes labor force attachment, an extension of these benefits means that more jobless Americans will be counted as unemployed.

The Current Labor Market Provides Few Opportunities for Unemployed Workers

There are currently 5 unemployed workers for every job opening.¹² The slack labor market means that an unemployed worker who loses benefits faces a serious challenge in securing new employment. The jobs are simply not there yet.

In the absence of unemployment benefits, job seekers need some form of assistance in order to avoid further economic crisis. Private savings are not the answer, as the vast majority of unemployed Americans have minimal savings on which to draw upon during jobless spells. Indeed, economist Raj Chetty finds that nearly half of job losers in the United States report zero liquid wealth at the time of job loss, suggesting that many households simply do not have the resources to continue to pay their bills and put food on the table in the absence of unemployment insurance benefits.¹³

In the absence of unemployment insurance benefits or private savings, these workers will need an alternative source of income until they find employment. In the wake of the financial crisis, banks have tightened lending requirements, which constrains access to credit cards and home equity lines for economically-vulnerable Americans.¹⁴ Many are likely to turn to another social assistance program that may be even more expensive than unemployment insurance. For instance, the Joint Economic Committee estimates that the cost of failure to extend unemployment benefits would result in \$24.2 billion in additional spending on Disability Insurance benefits.¹⁵ Other programs, including Temporary Assistance to Needy Families and food stamps (now SNAP), are likely to see a spike as well.

Unemployment Insurance as Effective Fiscal Stimulus

Workers receiving unemployment insurance payments are typically cash-strapped and will spend their benefits quickly. This quick spending generates a “multiplier” for the economy as a whole. Every dollar of unemployment benefits that a recipient spends can generate a cascade of spending by others, providing a significant jolt to the nation’s economy in terms of both economic activity and employment. Therefore, extending unemployment insurance benefits not only helps struggling households, but can also spur the creation of job opportunities.

Indeed, the President’s Council of Economic Advisers estimates that every dollar spent on unemployment insurance benefits raises gross domestic product (GDP) by \$1.60.¹⁶ The nonpartisan Congressional Budget Office recently reported that increasing aid to the unemployed is more cost-effective in terms of boosting economic growth and employment than a variety of other policies under consideration.¹⁷ Given forecasts of tepid growth through the rest of 2010 and 2011, additional targeted stimulus should be discussed in Congress.

¹ Joint Economic Committee calculations using data from the Congressional Research Service and the Department of Health and Human Services. See Whittaker, Julie, et. al. May 28, 2010. "Unemployment Insurance: Unemployment Benefits and Legislative Activity."

<http://crs.gov/Pages/Reports.aspx?Source=search&ProdCode=RL33362>; United States Department of Health and Human Services Assistant Secretary for Planning and Evaluation, 2009 Federal Poverty Guidelines, <http://aspe.hhs.gov/poverty/09poverty.shtml>.

² Katz, Lawrence F. and Bruce D. Meyer. "The Impact of the Potential Duration of Unemployment Benefits on the Duration of Unemployment," *Journal of Public Economics* (1990), pp. 45-72.

³ Joint Economic Committee testimony of Dr. Lawrence Katz (April 29, 2010).

⁴ *Ibid.*

⁵ *Ibid.*

⁶ Joint Economic Committee testimony of Dr. Till von Wachter (April 29, 2010).

⁷ *Ibid.* In testimony before the House Committee on Ways and Means, "Responding to Long-Term Unemployment," June 10, 2010, Dr. von Wachter further testified that "As a typical measure, extensions of unemployment insurance have been shown to prevent large consumption declines of laid off workers; thereby, they provide a degree of demand stabilization; they are also likely to prevent entry into more costly government programs such as disability insurance; and – at least in recessions – extensions of the duration of unemployment insurance benefits are unlikely to be associated with significant reductions in employment in the short or the long run."

⁸ *Ibid.*

⁹ Card, David, Raj Chetty, and Andrea Weber. "The Spike at Benefit Exhaustion: Leaving the Unemployment System or Starting a New Job?" August 2007 NBER working paper.

¹⁰ From Dr. Raj Chetty's May 28, 2010 presentation before the Economic Policy Institute on "Should Unemployment Benefits Be Extended: An Economic Framework and Empirical Evidence." His presentation can be found at http://epi.3cdn.net/d5a99f04921083739f_t7m6bxpa7.pdf.

¹¹ Testimony of the Honorable Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System, Joint Economic Committee (May 21, 2003).

¹² Joint Economic Committee calculation using data from the Bureau of Labor Statistics Job Openings and Labor Turnover Survey and the Bureau of Labor Statistics Household Survey.

¹³ Chetty, Raj. Moral Hazard vs. Liquidity and Optimal Unemployment Insurance.

http://www.econ.berkeley.edu/~chetty/papers/mh_liq_ui_jpe.pdf.

¹⁴ Board of Governors of the Federal Reserve System. May 3, 2010. "The April 2010 Senior Loan Officer Opinion Survey on Bank Lending Practices."

<http://www.federalreserve.gov/boarddocs/SnLoanSurvey/201005/fullreport.pdf>

¹⁵ Joint Economic Committee. May 2010. Extending Unemployment Insurance Benefits: The Cost of Inaction for Disabled Workers. http://jec.senate.gov/public/?a=Files.Serve&File_id=d5003466-eb78-4a91-b5b1-eb99c2982166.

¹⁶ Statement of Jane Oates, Assistant Secretary for Employment and Training, U.S. Department of Labor, Senate Finance Committee (April 14, 2010).

¹⁷ Congressional Budget Office, Policies for Increasing Economic Growth and Employment in 2010 and 2011.

January 2010. <http://www.cbo.gov/ftpdocs/108xx/doc10803/01-14-Employment.pdf>.