

**Economic Research note**

**US: jobless benefits leaving a big mark on the macro data**

- Lengthened availability of jobless benefits has raised the unemployment rate by 1.5%-pts
- This added availability has increased the average duration of unemployment spells by over a month
- The resulting constraint on supply and lift to demand may explain recent phenomenal productivity growth

The Senate recently passed a bill to extend the emergency unemployment benefits program through the end of the year. These benefits have been available since July 2008—with about a one-month exception this February—and have significantly increased the length of time that unemployed persons can receive unemployment compensation. While emergency benefits have been made available in all recent recessions, the terms of the current emergency benefits program have by far been the most generous, and have most likely had the largest impact on the macroeconomy.

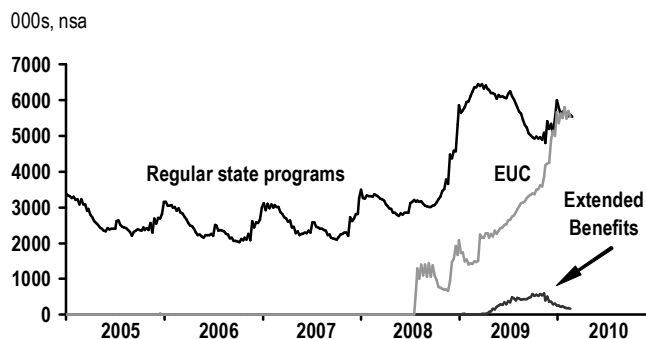
In particular, the availability of these benefits has almost certainly played a significant role in the record rise in the average duration of unemployment. Consequently, they have also had a role in the stunning rise in the unemployment rate over the last two years. Finally, and more conjecturally, the program’s support to consumption and restraint on forming employment matches may have a role in explaining the good growth/great productivity/bad labor market nexus that has characterized the recovery so far.

Note: In the analysis that follows, we attempt only to discern the impact of emergency benefits on the economic data. We make no recommendation or claim about the appropriateness of alternative unemployment compensation policies. Such an analysis would require a much more thorough consideration of other factors, such as equity and moral hazard, which are not addressed here.

**Benefits expanded significantly, in steps**

The “regular” unemployment insurance system is operated at the state level, and so rules vary across states. In the majority of states, regular benefits last for 26 weeks. The number of recipients of these regular benefits is what is counted in the weekly continuing claims data. There are two additional, broad categories of benefits: Extended Benefits, and what are usually referred to as emergency benefits (the names can get a little confusing). Extended Ben-

**Persons receiving unemployment compensation**



**Emergency benefits programs**

Program name	Dates in effect	Benefit weeks available	Total benefits (inf adj, \$2009 bn)	First pymt (\$ mn)
FSB	1Q75-4Q77	13 to 26	23.5	6.1
FSC	3Q82-1Q85	8 to 12	20.3	7.6
EUC	4Q91-2Q94	7 to 27	42.7	9.2
TEUC	2Q02-1Q04	13 to 20	27.0	7.5
EUC	3Q08-	34 to 53	56.1 <sup>1</sup>	9.6 <sup>1</sup>

1. Through August 2009.

efits have been in place since 1971 and are available to unemployed persons in states in which the labor market is particularly weak (by a variety of metrics). Extended Benefits have generally entailed an additional 13 weeks of unemployment compensation, though in the recent downturn that has been increased to 20 weeks. Currently, Extended Benefits are only paid after emergency benefits have been exhausted.

Unlike Extended Benefits, emergency benefits are not a permanent feature of unemployment insurance law, but instead are enacted by Congress on an ad hoc basis during recessions. In every recession since 1970 (except the short, one-quarter recession in 1980), Congress has authorized emergency benefits of one form or another, though the terms have varied significantly. In the recent downturn, emergency benefits were first enacted in mid-2008, adding another 13 weeks of benefit availability in all states. In late 2008, that was further increased to 20 weeks. Late last year, emergency benefits were increased another 14 weeks (bringing the total to 34 weeks), and two additional tiers were created that added 13 more weeks of benefits in states with bad labor markets and six more on top of that for states with very bad labor markets. The threshold for the additional 13 weeks was low enough that the majority of the population resides in states where that tier of benefits was available. All told, the maximum available duration of benefits has increased from 39 weeks before the recession to 99 weeks now.

## A big effect on labor market outcomes

Jobless benefits have the potential to increase the unemployment rate through two channels. First, by softening the blow of losing a job, they allow unemployed persons to become more selective in what job offer they accept, thereby raising the average duration of unemployment and increasing the unemployment rate. Second, they may encourage people who would otherwise drop out of the labor force to be counted as jobseekers and therefore in the labor force. The magnitude of these effects has been the subject of a vast amount of econometric investigation. The variable most studied is the degree to which unemployment duration increases for a given change in the maximum available duration of jobless benefits. Most estimates of this elasticity have centered on a finding that an increase of one week in the availability of benefits raises the average duration of unemployment by 0.2 week.<sup>1</sup>

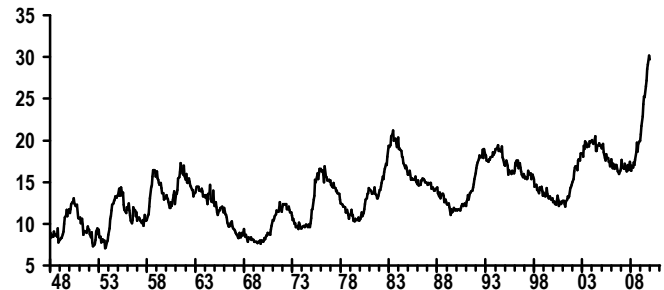
To use this estimate to understand how much the unemployment rate has been increased by the enactment of emergency benefits, we first need a figure for how many added weeks of benefits are now available. For all states, an additional 34 weeks of benefits are now available. On top of that, another 13 weeks are available in states where the three-month average unemployment rate is above 6%, a threshold that includes over 90% of the population. So we'll use a figure of 47 weeks of additional benefits as our baseline. (Since an additional six weeks of benefits are available in states where the three-month average unemployment rate is above 8.5%, and since Extended Benefits have been increased another seven weeks, our 47 weeks figure could be thought of as near a lower bound.)

Based on the widely accepted 0.2 estimate of the responsiveness of average duration to the length of benefit availability, the 47 extra weeks of benefits could be expected to increase average unemployment spells by 9.4 weeks. Since only about half of the unemployed are eligible to receive unemployment benefits (the other half generally have not met the requirements for sufficient prior employment or lost their jobs through layoffs), the total average unemployment duration would be expected to increase by 4.7 weeks.

Starting from an average duration of around 16.5 weeks, this would imply about a 30% increase in the length of unemployment spells. If the generosity of unemployment benefits does not have a major influence on the rate at which firms lay off workers—which seems a reasonable working

## Average duration of unemployment

Weeks, sa



assumption—this would imply a 30% increase in the unemployment rate. Starting from an unemployment rate before the recession of roughly 5%, this means that increased benefits can account for 1.5%-pt of the subsequent increase in the unemployment rate.

While a 1.5%-pt increase in the unemployment rate from longer benefits appears to be a large figure, this could actually understate the degree to which policy has lifted the unemployment rate. As mentioned earlier, in many states the maximum benefit duration has increased by more than 47 weeks. In addition, the increased subsidy for COBRA benefits has provided a shadow increase in unemployment compensation. The stimulus package also added a \$25/week bonus to unemployment checks, but using standard estimates, this probably increased average durations by only about 0.2 of a week). Because some of this effect may come through sustaining higher labor force participation, the absence of these benefits would not necessarily mean that employment would be 1.5% higher, only that unemployment, as measured, would be 1.5% lower.

## Mixed supply, demand impact

To the extent increased jobless benefits restrain the aggregate amount of labor employed in productive activities, they could in fact lower the amount of output produced. This conclusion runs somewhat counter to another perceived effect of jobless benefits. By increasing the funds available to be spent by the unemployed, higher benefits should stimulate aggregate demand. This logic has been advanced as one of the rationales for increasing unemployment compensation. The differing supply and demand implications could be rationalized by higher productivity, which, from the data, is precisely what has occurred.

1. See the references in "Unemployment Insurance: Strengthening the Relationship between Theory and Policy," Waler Nicholson and Karen Needels, *Journal of Economic Perspectives*, 2006, Vol 20, No 3.

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