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Arguments Against Extending Unemployment Benefits

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The topic of the newest *U.S. News and World Report* ”Debate Club” is whether Congress should extend federal unemployment benefits. On the “yes” side, we get arguments ranging from “It would be cruel not to” to “Unemployment benefits create economic growth.” The emotional argument is understandable: If you ignore what is unseen, there is no doubt that failing to extend UI would be painful for many current beneficiaries. That being said, it’s one thing to acknowledge the emotional aspect of UI and quite another to claim UI creates jobs. First, there is little to no evidence that this is the case. There is some evidence that the opposite is true — that, past a certain point, the negative effects of extending these benefits outweigh the positive effects. (I wrote about this here). The entry from the Cato Institute’s Chris Edwards makes this point:

> With respect to the economy, some analysts claim that more UI spending will be stimulative, even though Congress already has $1 trillion of deficit spending in the pipeline for next year. Rather than stimulating anything, such huge deficits are destabilizing financial markets and damaging business confidence.
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> Furthermore, any stimulus from UI benefits will be counteracted by the anti-stimulus of the higher taxes needed to pay for them. Many states have been raising their UI taxes on businesses in order to replenish their unemployment funds, and these tax increases are surely harming job creation.
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> Another negative effect of UI benefits is that they increase unemployment because they reduce the incentive for people to find work. Higher UI benefits delay the need for people to make tough choices about their careers, such as switching industries, taking lower pay, or moving to a different city. It’s a basic rule that when the government subsidizes something, we get more of it.

Fiscal experts Martin Feldstein and Daniel Altman found that the "most thoroughly researched effect of the existing UI system on unemployment is the increase in the duration of the unemployment spells. By reducing the cost of remaining unemployed, UI benefits induce individuals to have longer spells." Similarly, Larry Summers, a former top economist to Presidents Clinton and Obama, concluded in his academic work that unemployment benefits contribute to long-term unemployment.

Our UI system causes other problems. It suppresses personal savings because people expect the government to care for them when they are unemployed. That is harmful because personal savings are a key source of economic growth—savings get channeled into capital investment, which ultimately raises productivity and wages.

Edwards's bottom line: There is no free lunch in subsidy programs.

Along these lines, a new paper by University of Chicago economist Casey Mulligan finds the same result for *all* safety-net programs, not just UI:

Inflation-adjusted spending on means-tested subsidies have increased sharply since 2007, and most of this growth was due to changes in eligibility rules, and increases in subsidies per eligible person, rather than increases in the number of people who would have been eligible under pre-recession subsidy rules. The non-elderly parts of the safety net have increased from about $10,000 per year of non- or under-employment by non-elderly household heads and spouses in 2007 to almost $15,000 per year in 2010, adjusted for inflation. From 2007 to 2010, inflation-adjusted safety net spending increased $35,000 for every added year of non-employment or under-employment. As a result, the average private returns to employment are substantially less than they were in 2007.

This data goes against the claim that the recent increase in income-security spending is attributable solely to the recession — Mulligan finds that "only a small fraction of that growth is due to the recession, the rest because of legislation making the programs more generous." Incentives matter, which means that we should think about the effect an extension might have on long-term unemployment numbers. (Thanks to Matt Mitchell for the pointer.)