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The Great Debate: Do Unemployment Benefits Boost the Economy?

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Although the Obama administration no longer uses the phrase "stimulus," it does support spending $35.5 billion to extend benefits for the nation's unemployed and $50 billion to aid states hoping to avoid "massive layoffs of teachers, police and firefighters." From an economic perspective, is this really a good way to stimulate the economy and avoid the chances of a double-dip recession?

This is a hotly debated topic among economists right now. Augustine Faucher, director of macroeconomics at Moody's economy.com, says economic growth will soften in the second half of the year and that the chances of falling into recession again by year-end have risen to about 25%.

Faucher believes the government should spend between $80 billion and $100 billion on a second stimulus package to get the economy past these obstacles.

"The two most useful forms would be extended unemployment insurance benefits and aid to state governments," Faucher says, "because these would both be effective from a bang-for-the-buck perspective. You get a lot of stimulus dollars spent, and the money also gets into the economy quickly."

Deficit Worries, Infrastructure Opportunities

However, both proposals have been blocked by Republicans in Congress, who argue that the additional spending won't be offset by new revenues and would add to the deficit, which is another hot-button issue in this election year.

Faucher maintains that spending a dollar on extending unemployment benefits or aid to state governments produces more of an increase in GDP than the same dollar spent on tax cuts. If state employees like teachers are laid off, Faucher says, "they cut back on their spending, and that weighs on economic growth."

But Andrew Samwick, a professor of economics at Dartmouth College, says the proposed stimulus of about $80 billion is too small to do much good. He adds that unemployment benefits aren't the most efficient way to stimulate the economy.

"You're giving them money, but they're not giving you anything in return," Samwick says, rejecting the argument that unemployment benefits are usually spent immediately and thereby sustain the economy. "There's no virtue in spending money -- the government could do that directly," he says.

Samwick says he'd like the government to commit to a long-term spending plan costing hundreds of billions or even trillions of dollars to address the country's infrastructure needs, such as developing a smart grid for electricity distribution.

"All of those things use material that has to be produced, which means it creates jobs, or it creates new opportunities for people, where it creates employment as well," Samwick says. "Why is that not better than just giving the money to the states to compensate them for their own budget challenges or the unemployed?"

Recovery May Begin at Home

Karen Dynan, vice president and co-director of the economic studies program at the Brookings Institution in Washington, D.C., says such large stimulus programs would be hard to justify, given the size of the budget gap and the deficit's upward trajectory. Some estimates project the federal debt will hit more than $20 trillion by 2020.

Dynan says by extending unemployment insurance benefits, the government would be not only help the households that have been the hardest hit by the recession, but would also sustain their level of spending.

"Many people have had to cut their spending, sometimes drastically, because of the loss of income," Dynan says. "If they can sustain their spending, that that will benefit the economy, because you'd stimulate overall demand for goods and services."

Dynan acknowledges that there are downsides to unemployment benefits, including the possibility that some people will be less motivated to look for work. But because the current labor market remains poor -- unemployment is at 9.5% -- even if some individuals are less inclined to seek work, plenty of others would be willing to fill empty jobs, she says.

Uncle Sam vs. The Private Sector

Tad DeHaven, a budget analyst at the libertarian Cato Institute, says the idea of spending government funds to promote economic growth is a flawed idea. "The fundamental question is: Do you think that the private sector would do a better job of fostering economic growth and job creation, or do you think politicians and bureaucrats would do that?"

DeHaven says that continuing to finance state sector jobs like teachers diverts resources away from the private sector, which would use the money more efficiently and ultimately create more job opportunities.

And, of course, a dispute continues among economists about whether the first Obama stimulus actually had an economic benefit and created worthwhile jobs. "I think the entire history of trying to buy jobs with government spending has largely been a failure," says John Antos, a scholar at the American Enterprise Institute.

But Faucher of economy.com disagrees. "I think the situation would be much, much worse without the first stimulus," he says. "We'd be talking about an unemployment rate of 11%-12%. It has been effective."

"Large, Positive Multipliers"

One of the most definitive studies of the $800 billion stimulus was provided in a paper from the Federal Reserve Bank of San Francisco. Economist Daniel J. Wilson said Obama's stimulus program had created or saved 800,000 jobs as of May, 2010. But he said if the cutoff date had been three months earlier, the stimulus would have created 2 million jobs, but many of those jobs, especially in construction, weren't long-lasting.

Said Wilson: "The results strongly suggest that infrastructure and other general spending efforts have large, positive multipliers while spending on safety-net type of programs may actually reduce employment."

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