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The 'stimulus' for unemployment

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Why did the unemployment rate rise so rapidly -- from 7.2 per cent in January to 10.2 percent in October? It was clearly the administration's "stimulus" bill -- which in February provided $40 billion to greatly extend jobless benefits at no cost to the states.

As Larry Summers, the president's top assistant for economic policy, noted in July, "the unemployment rate over the recession has risen about 1 to 1.5 percentage points more than would normally be attributable to the contraction in GDP." And the rate has moved nearly a percentage point higher since then, even though GDP increased. Countries with much deeper declines in GDP, such as Germany and Sweden, have unemployment rates far below ours.

Summers *knows* why the US rate is so high. He explained it well in a 1995 paper co-authored with James Poterba of MIT: "Unemployment insurance lengthens unemployment spells."

That is: When the government pays people 50 to 60 percent of their previous wage to stay home for a year or more, many of them do just that.

And the stimulus bribed states to extend benefits -- which have now been stretched to an unprecedented *79 weeks* in 28 states and to 46 to 72 weeks in the rest. Before mid-2008, by contrast, only a few states paid jobless benefits for even a *month* beyond the standard 26 weeks.

When you subsidize something, you get more of it. Extending unemployment benefits from 26 to 79 weeks was guaranteed to leave many more people unemployed for many more months.

And longer unemployment translates to higher unemployment rates -- because the relatively small numbers of newly unemployed are added to stubbornly large numbers of those who lost their jobs more than six months ago.

Until benefits are about to run out, many of the long-term unemployed are in no rush to make serious efforts to find another job -- or to accept job offers that may involve a long commute, relocation or disappointing salary and benefits.

(Incidentally, the "mercy" of longer benefits does no long-term favors: The literature is quite clear that a prolonged period on unemployment tends to depress income for years after you finally go back to work.)

The median length of unemployment hovered around 10 weeks for six months before February's "stimulus" plan. Since half the unemployed found jobs within 10 weeks, more than half of those counted among the unemployed in one month would no longer be included three months later. In other words, more frequent turnover among the unemployed held down monthly unemployment.

But after February, with jobless benefits stretched out to 46 to 79 weeks, the median duration of unemployment nearly doubled, reaching 18.7 weeks by October.

The unemployment rate has *not* been rising because of growing numbers of newly jobless people. Indeed, initial claims for unemployment benefits are way *down*. And the number of unfilled *private* job openings *increased* by 9.3 percent from the end of April to the end of September.

The unemployment rate has been rising because unprecedented numbers of those who became unemployed six to 19 months ago are remaining "on the dole" until their benefits are nearly exhausted.

Summers isn't the only administration economist who understands this very well. Assistant Secretary of the Treasury for Economic Policy Alan Krueger co-authored a 2002 survey of the topic with Bruce Meyer of the University of Chicago. They found that "unemployment insurance and worker's compensation insurance . . . tend to increase the length of time employees spend out of work." Last August, Krueger and Andreus Miller of Princeton also found that "job search increases sharply [from 20 minutes a week to 70] in the weeks prior to benefit exhaustion."

Similarly, Meyer found "the probability of leaving unemployment rises dramatically just prior to when benefits lapse." In other words: If you extend benefits to 79 weeks, many people won't find an acceptable job offer until the 76th or 78th week.

Meyer and Lawrence Katz of Harvard estimated that "a one-week increase in potential benefit duration increases the average duration of the unemployment spells . . . by 0.16 to 0.20 weeks." Apply that formula to the 20-to-53-week extension we've seen, and you get an average of three to ten more weeks spent on unemployment. And, sure enough, the average unemployment spell has risen by seven weeks this year -- to nearly 27 weeks by October.

Katz also found that extended benefits, by making it easier for workers to wait and see whether they get their old jobs back, also makes it easier for employers to delay recalling laid-off workers. Just before unemployment benefits run out, Katz found "large positive jumps in both the recall rate and new job finding rate."

The White House recently made the mysterious claim of having "saved" 640,329 jobs, at a cost of only $531,250 per job

($340 billion).

In reality, the evidence is overwhelming that the February stimulus bill has *added at least two percentage points* to the unemployment rate. If Congress and the White House hadn't tried so hard to stimulate long-term unemployment, the US unemployment rate would now be about 8 percent and falling rather than more than 10 percent and -- rising.

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