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Federal Reserve: Stimulus Increased Unemployment

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With a “jobs bill” speeding through Congress this week that may end up totaling $154 billion, and a new Congressional Budget Office analysis claiming that last year’s $862 billion stimulus bill saved the country from 11 percent unemployment, the most powerful economic agency in the government is inconspicuously taking a very different view.

Buried near the end of the minutes of last month’s Federal Reserve Open Market Committee meeting was this observation: “The several extensions of emergency unemployment insurance benefits appeared to have raised the measured unemployment rate, relative to levels recorded in past downturns … some estimates suggested it could account for 1 percentage point or more of the increase in the unemployment rate during this recession.”

Allowing the states to cut lots more unemployment checks was a big part of the stimulus, and the economy did indeed grew strongly in the fourth quarter of 2009.

The non-partisan economic analytical arm of Congress, “using evidence about the effects of previous similar policies on the economy and using various mathematical models that represent the workings of the economy” estimated “that in the fourth quarter of calendar year 2009” the stimulus “added between 1 million and 2.1 million to the number of workers employed in the United States, and it increased the number of full-time-equivalent jobs by between 1.4 million and 3.0 million.”

But with only $200 billion of last year’s stimulus spent last year, and with Medicaid, Social Security, state and local grants, student aid, and unemployment benefits making up most of that, how could the CBO’s claims be correct?

Pro-free market economists charge that the economists now running U.S. government policy know very well that extending unemployment insurance actually boosts unemployment.

White House National Economic Council head Lawrence Summers “explained it well in a 1995 paper co-authored with James Poterba of MIT: ‘Unemployment insurance lengthens unemployment spells,’” Cato Institute senior fellow Alan Reynolds wrote in the New York Post in November.

Assistant Secretary of the Treasury for Economic Policy Alan Krueger was another such economist who recognized the negative effects of extending unemployment benefits. In a 2002 analysis with the University of Chicago’s Bruce Meyer, Krueger found that unemployment and worker’s compensation insurance “tend to increase the length of time employees spend out of work.”

The Fed’s minutes, in contrast to the CBO’s claims, describe a job situation that is far from rosy. “The unemployment rate was essentially unchanged from October through December,” they noted. “The labor force participation rate, however, had declined steeply since the spring, likely reflecting, at least in part, adverse labor market conditions. Moreover, hiring remained weak, the total number of individuals receiving unemployment insurance – including extended and emergency benefits – continued to climb, the average length of ongoing unemployment spells rose steeply, and

joblessness became increasingly concentrated among the long- term unemployed."

The CBO conceded in its report on last year's stimulus released this week that "substantial government spending can cause a shift in resources (including employees) away from production in other firms and sectors to government-funded projects."

It added, "That indirect crowding-out effect could cause growth in employment among recipients" of stimulus funds "to be offset by declines in employment elsewhere in the economy." Additionally, last year's stimulus "could also reduce production elsewhere in the economy if they used scarce materials or workers with specific skills, creating bottlenecks that hindered other activities."

But the CBO considered that effect to be smaller than usual last year "because of the high unemployment rate and large amount of unused resources" and because of "the diversity of activities" funded by the stimulus.

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