Should Unemployment Benefits be Extended?  
An Economic Framework and Empirical Evidence

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Is extending benefits a “good” policy choice?

Would extending benefits increase total economic welfare?

Economic theory shows that answer depends on tradeoff between two central factors

- Benefits for the unemployed via higher consumption
- Costs of providing benefits by reducing incentives to find a job

Economists have made significant advances in measuring the benefits and costs over the past few years

Can now provide a reasonably scientific answer to the policy question
Three potential benefits of providing UI benefits

1. [Micro] Consumption-smoothing: higher consumption in a time when income is very valuable

2. [Macro] Fiscal stimulus: unemployed spend most of the money they receive → good tool to stimulate aggregate spending

3. [Job matching] UI benefits may lead individuals to find better jobs (e.g., engineer who settles for service industry job to put food on the table)
Benefits of UI: Evidence

- Consumption-smoothing benefit of providing UI large because unemployed families are cash-constrained

- Median unemployed person has less than $250 in net savings prior to job loss and cannot borrow

- Moreover, most families have many “commitments” that they cannot adjust
  - Ex: have to pay home mortgage, utilities, tuition bills, etc.

- Therefore forced to cut back on items such as food, clothing, medicines
  - Serious consequences for health (von Wachter and Sullivan 2009) and children
  - UI benefits can be very valuable in mitigating consumption drop
FIGURE 1
Effect of Unemployment on Food and Housing Consumption

Source: Chetty and Szeidl 2007
Extending UI benefits reduces incentives to find job by reducing net pay of work

- If benefits are $250 per week and worker earns $400 per week, net gain of only $150 by finding a job

People may search for jobs less intensively because of this work disincentive (or “moral hazard”) effect

- Could lead to higher unemployment rate and lower GDP
Two methods of measuring size of work disincentive effects

Method 1: Do people to take a longer time to find jobs when UI benefits are increased?

Evaluate using variation in UI benefit levels across states in the U.S.
FIGURE 2a
Effect of UI Benefits on Unemployment Durations: Liquid Wealth < -$2,000

Mean benefit rate = 53% of wage

Mean benefit rate = 48%

Source: Chetty 2008
Effect of UI Benefits on Durations: Liq. Wealth Between -$2,000 and $200

Mean benefit rate = 48%

Mean benefit rate = 53%

Source: Chetty 2008
FIGURE 2c
Effect of UI Benefits on Durations: Liq. Wealth Between $200 and $22,000

Source: Chetty 2008
FIGURE 2d
Effect of UI Benefits on Durations: Liquid Wealth > $22,000

Source: Chetty 2008
Are Longer Durations Caused by Work Disincentives?

- UI benefits lead to longer unemployment durations, but pattern is not consistent with work disincentives.

- Work disincentive effect should occur among higher-wealth households as well.

- Alternative explanation for why UI benefits raise durations: cash-on-hand (or “liquidity”) effect.

- Consider a single-earner household with children and no savings.

- Without any income (i.e. without UI benefits), parent forced to make inefficient choices to put food on the table and pay bills.

  - May be forced to spend little time with children or skip medical appointment to devote all her time to job search.
Work Disincentive vs. Cash-on-Hand Effects

- For this parent, increase in UI benefits will increase duration
  - She will rationally choose to spend more time with children and search more efficiently and patiently for a good job
- But this increase in duration is not a negative effect generated by distorted work incentives
- Rather, it is a benefit of having more cash on hand
  - With more resources (UI or any source of income), parent can spend some time with children even while unemployed
- How much of the effect of UI benefits on duration is a beneficial cash-on-hand effect rather than a harmful work disincentive effect?
- Turn to a natural experiment in Austria to answer this
FIGURE 3
Effect of Severance Payments on Unemployment Durations in Austria

Source: Card, Chetty, and Weber 2007a
Similar findings in U.S. with lower quality data

Conclusion: 2/3 of the effect of UI benefits on increased durations is a beneficial “liquidity” effect rather than a harmful work disincentive effect
Measuring Work Disincentives: Benefit Exhaustion

- Second method of assessing work disincentives: do people wait to exhaust benefits before finding a job?

- Traditional finding: spike in rate of exiting unemployment at time of benefit exhaustion

- Problem: old studies estimated probability of exiting UI system, not finding a new job

- Recent evidence again suggests that work disincentive effects are much smaller than implied by previous evidence
FIGURE 4
Unemployment Exit Rate Relative to Date of Benefit Exhaustion

Source: Meyer 1990
FIGURE 5
Job Finding vs. Exiting Unemployment System in Austria: 20 Week UI

Weekly Rates

Weeks Unemployed
Fraction Finding Jobs
Fraction Exiting Unemp System

Source: Card, Chetty, Weber 2007b
FIGURE 6
Job Finding vs. Exiting Unemployment System: 30 Week UI

Weeks Unemployed

Fraction Finding Jobs

Fraction Exiting Unemp System

Source: Card, Chetty, Weber 2007b
FIGURE 7
Effect of Benefit Expiration on Job Finding vs. Exiting UI System

Source: Card, Chetty, Weber 2007b
Should We Extend UI Benefits Now?

- Evidence shows that even in normal times, benefits of UI are large relative to work disincentive costs.

- Benefits of UI likely to be larger in this deep, long recession.
  - Especially for long-term unemployed because of depleted assets, collapse of credit markets, and risk of foreclosure.

- And work disincentive effects likely to be smaller than usual now.
  - People likely to take any job they can get.

- Weighing costs against benefits, extending benefits further in current economy would significantly increase economic welfare.
References


