How economists view the US debate on extending jobless benefits

Experts discuss the trade-offs between work incentives and income support; whether top-ups should be reduced, and how economics and public health might determine federal contribution levels, writes **Romesh Vaitilingam**.

Despite the latest GDP figures showing that the US economy had contracted nearly 10% in the second quarter and with unemployment numbers continuing to rise, there is still no resolution in Washington on whether the enhanced federal benefits for the jobless that expired Friday, 31 July, will be extended in some form.

We recently invited our panel to express their views on the possible trade-off between work incentives and the income support provided by the unemployment insurance supplements, whether the top-ups should be reduced or ended, and how the economic and public health conditions in each state might determine the level of federal UI contributions.

We asked the experts whether they agreed or disagreed with three statements, and, if so, how strongly and with what degree of confidence.

Of our 43 US experts, 38 participated in this survey and the balance of opinion on the three statements is summarised below. More details on the experts' views come through in the short comments that they are able to make when they participate in the survey.

Statement 1: Employment growth is currently constrained more by firms' lack of interest in hiring than people's willingness to work at prevailing wages.

A majority of the panel agreed that it is more an issue of labour demand than labour supply. Weighted by each expert's confidence in their response, 29% of the panel strongly agree, 55% agree, 16% are uncertain, and none disagree.

Among the comments by those who agree, Anil Kashyap at Chicago says that: 'Especially once the unemployment top-up rolls off, with lockdowns resuming, businesses will remain cautious and consumers reluctant too.' Barry Eichengreen at Berkeley adds: 'There is also some understandable reluctance to work (at any wages) owing to safety concerns. Still, I agree.'

Panelists who say that they are uncertain see a role for both demand and supply. Caroline Hoxby at Stanford comments: 'These two phenomena are not mutually exclusive: Employers can have little demand for labour and workers can be unwilling to work at prevailing wages.' Robert Shimer at Chicago notes: 'Both matter. Job openings have only fallen modestly and are at more than double their 2009 levels.' And Robert Hall at Stanford warns: 'The big issue currently is the high volume of workers who are not working now but expect to be recalled to their existing jobs.'

Pete Klenow at Stanford, who strongly agrees with the statement, points to an April study of data on job vacancies and UI claims, which found that nearly all industries and occupations saw contraction in postings and spikes in UI claims, regardless of whether they are deemed essential and whether they have work-from-home capability.

Statement 2: Reducing supplemental levels of unemployment benefits so that no workers receive more than a 100% replacement rate would be a more effective way to balance incentives and income support than simply stopping the supplement at the end of this month.

There is strong majority in agreement. Again weighted by each expert's confidence in their response, 40% of the panel strongly agree, 54% agree; 6% are uncertain, and none disagree.

Among the comments, Robert Shimer states: ‘There is no reason for replacement rates above 100%. Optimal level is unclear, but probably higher than in normal times due to disease risk. Caroline Hoxby emphasises that: ‘Since there are costs associated with employment (work clothes, meals outside home, commuting) even 100% replacement rate would discourage work.’ And Bengt Holmstrom at MIT suggests: ‘UI creates allocational distortions, but no reason to stop it entirely. Go down to 60% to strike a compromise.’

Others are more wary about a big reduction. Richard Schmalensee at MIT replies: ‘More efficient, of course, but also harder to get right in a hurry.’ Larry Samuelson at Yale concurs: ‘Bringing replacement rates below 100% would help incentives, but the economy is too fragile for an abrupt end.’ And Barry Eichengreen, who says that he is uncertain, remarks: ‘Would strengthen incentive to work for some but remove adequate income support for some. So there are trade-offs.’

Joseph Altonji at Yale, who notes that ‘Labour demand is weak, so insurance is needed’, provides links to a co-authored study of his, which finds no evidence that more generous benefits disincentivised work either at the onset of the benefits extensions or as firms looked to return to business over time. He also references summaries of two Brookings Papers on the US labour market during the pandemic, while Pete Klenow reminds us of the study of UI replacement rates during the pandemic that finds a median rate of 134% for UI benefits under the CARES Act.

Statement 3: A well-designed unemployment insurance system would tie federal contributions to states on the basis of each state’s economic and public health conditions.

There is another majority in agreement. Weighted by each expert’s confidence in their response, 21% of the panel strongly agree, 60% agree; 20% are uncertain, and none disagree.

Among those who agree, Anil Kashyap argues that: ‘The current system that uses the “special” tailoring of saying everywhere is the same – even a poor rule would beat that.’ Richard Schmalensee responds: ‘We also need unrestricted aid to states based on their conditions – despite the waste this would entail.’ And Robert Shimer says: ‘I strongly agree with the connection to public health conditions. The argument for extending benefits in recessions is weaker.’

Others mention the potential impact on the incentives for states. Daron Acemoglu at MIT points out: ‘One might have to worry about state moral hazard, but in the current environment, this is not the first order concern.’ Bengt Holmstrom adds: ‘One concern is moral hazard. In COVID situation, very small. In general, bigger.’ And Caroline Hoxby, who responds that she is uncertain, comments: ‘Would agree if could identify EXOGENOUS part of states’ conditions. Should not give states incentives, though, to be irresponsible.’

Among the other panelists who are uncertain, Michael Greenstone at Chicago says: 'Implementing public health component would need some careful thought… unclear that it would be an improvement.' Robert Hall states: 'There's no particular reason for both levels of government to be involved.' And Kenneth Judd at Stanford concludes: 'Let's not make the UI system too complicated. The purpose is to help people get through unemployment. Let's focus on that.'

- *All comments made by the experts are in the full survey results.*
- *This blog post is based on the IGM Forum survey, of The University of Chicago Booth School of Business and appeared originally at LSE Business Review.*
- *Featured image by Andy Feliciotti on Unsplash*

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Note: The post gives the views of its authors, not the position USAPP– American Politics and Policy, nor of the London School of Economics.

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About the author

Romesh Vaitilingam
Romesh Vaitilingam is a writer and media consultant, and the editor of CentrePiece, the magazine of LSE's Centre for Economic Performance. He is also a member of the editorial board of VoxEu. Romesh is the author of numerous articles and several successful books, including The Financial Times Guide to Using the Financial Pages (FT-Prentice Hall), now in its sixth edition (2011). As a specialist in translating economic and financial concepts into everyday language, Romesh has advised a number of institutions, including the Royal Economic Society, the Centre for Economic Performance at LSE and the Centre for Economic Policy Research. In 2003, he was awarded an MBE for services to economic and social science. He tweets at @econromesh.