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**TESTIMONY OF CHAD STONE**
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**Before the**
**Economic Growth, Job Creation, and Regulatory Affairs Subcommittee**
**of the Committee on Oversight and Government Reform**
**United States House of Representatives**

**Hearing on Unintended Consequences: Is Government Effectively Addressing the Unemployment Crisis?**

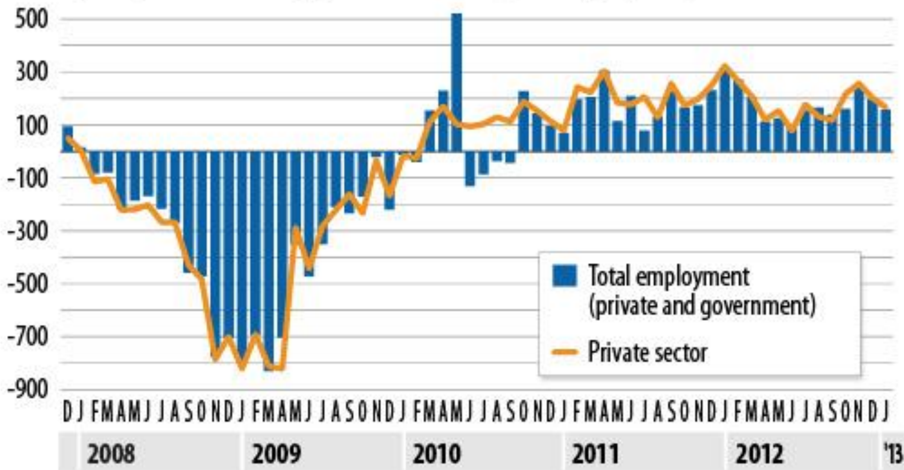
Mr. Chairman and members of the subcommittee, thank you for the opportunity to testify on this important topic. The first half of my testimony focuses on the macroeconomic roots of our current jobs crisis and the second part focuses specifically on unemployment insurance.

There is no doubt that the United States continues to suffer a serious unemployment problem in the wake of the Great Recession. Five years after the onset of the Great Recession and three and a half years after the economy turned around and began growing, there are still 3.2 million fewer jobs on nonfarm payrolls than there were in December 2007. Private payrolls are smaller by 2.7 million, and the unemployment rate hovers near 8 percent.

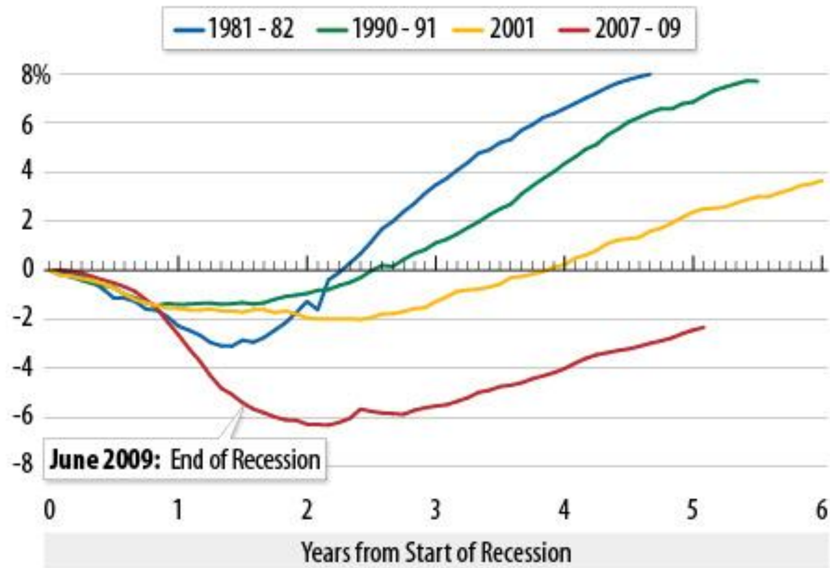
## The Legacy of the Great Recession

To be sure, there was a dramatic turnaround in the jobs picture starting in 2009 when aggressive actions by the Federal Reserve and the financial stabilization and fiscal stimulus policies enacted in late 2008 and early 2009 averted what economists Mark Zandi and Alan Blinder say could have been the "Great Recession 2.0."[1] As the first chart shows, the economy was hemorrhaging jobs at the time but the magnitude of the job losses quickly shrank in 2009 and we've seen 35 straight months of private sector job creation; total nonfarm employment has grown by an average of 157,000 jobs a month.

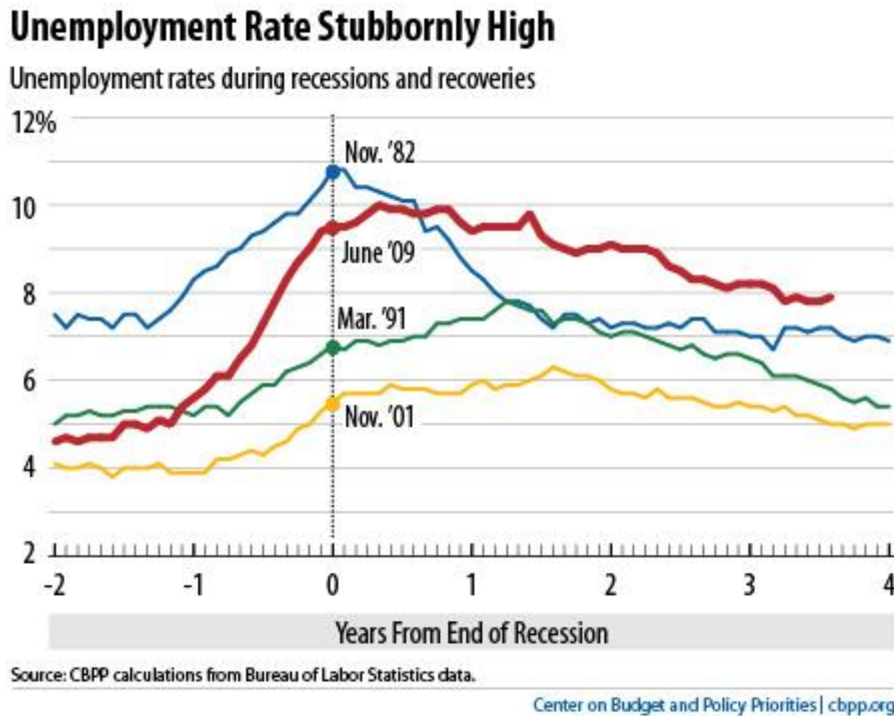
[1] Alan S. Blinder and Mark Zandi, "How the Great Recession Was Brought to an End," July 27, 2010, available online at http://www.economy.com/mark-zandi/documents/end-of-great-recession.pdf



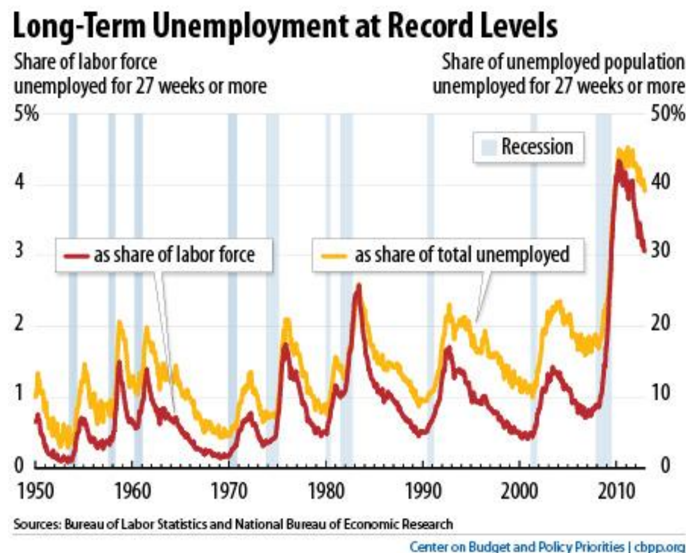

The problem is that the Great Recession created a jobs deficit much larger than any we have seen since the 1930s and we still have a long way to go to erase it, catch up with population growth over the intervening years, and get back to full employment. The next chart illustrates how deep the job losses were compared with recent recessions. It also shows that the rate of job growth since early 2010 has not been that different from the last recovery, but we started from a much deeper hole.



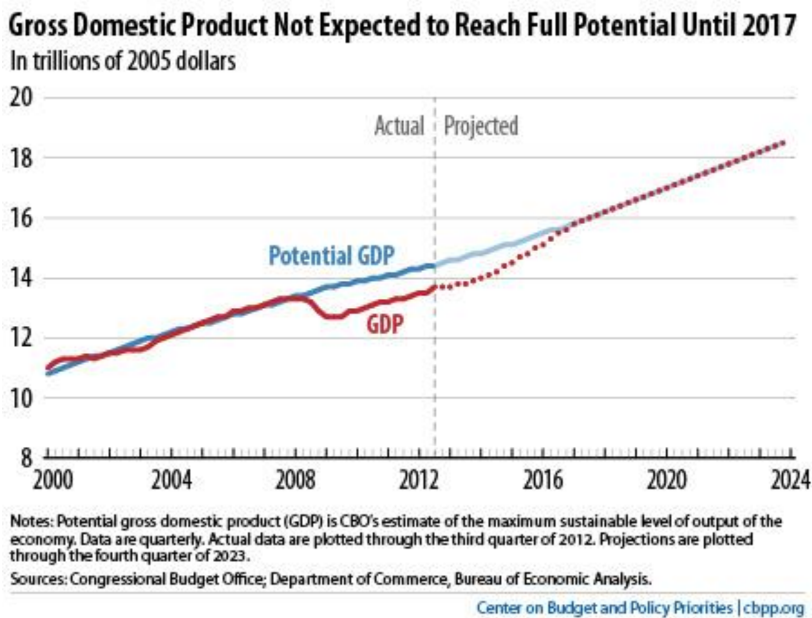
The next chart illustrates how the pattern of unemployment has combined the worst features of the past three business cycles. The unemployment rate shot up even faster than it did in the deep 1981-82 recession (though not quite as high) but it kept rising and has come down only slowly after the formal end of the recession in June 2009, matching the pattern of slow jobs recoveries in the previous two recessions.




A final disturbing feature is the extent of long-term unemployment. The percentage of the labor force and the share of the unemployed who are unemployed for 27 weeks or more rose to unprecedented levels in the Great Recession and, while they have come down, they remain higher than their previous peaks in any prior recession in the post-World War II era.



CBO estimates that the economy will grow just 1.4 percent this year and the unemployment rate will remain near 8 percent through the year.[2] That means another year of enormous economic waste and high unemployment. CBO estimates that gross domestic product in 2013 will fall short of the economy's full potential by $1 trillion (see chart). It projects that the gap won't close and we won't see a high level of employment until 2017. That will require sustained economic growth at a faster pace than we have seen thus far in the recovery — and much faster than we will likely see this year under current law.




There is tremendous economic waste and human hardship in an economy that is operating well below full capacity. The goods and services that are not produced, the wages and business income that is not earned, and the revenues not received are lost forever. Potential GDP is effectively a ceiling on sustainable production, so periods of severe economic slack such as we are currently experiencing are not offset in the future by periods when actual GDP exceeds potential by a comparable amount.

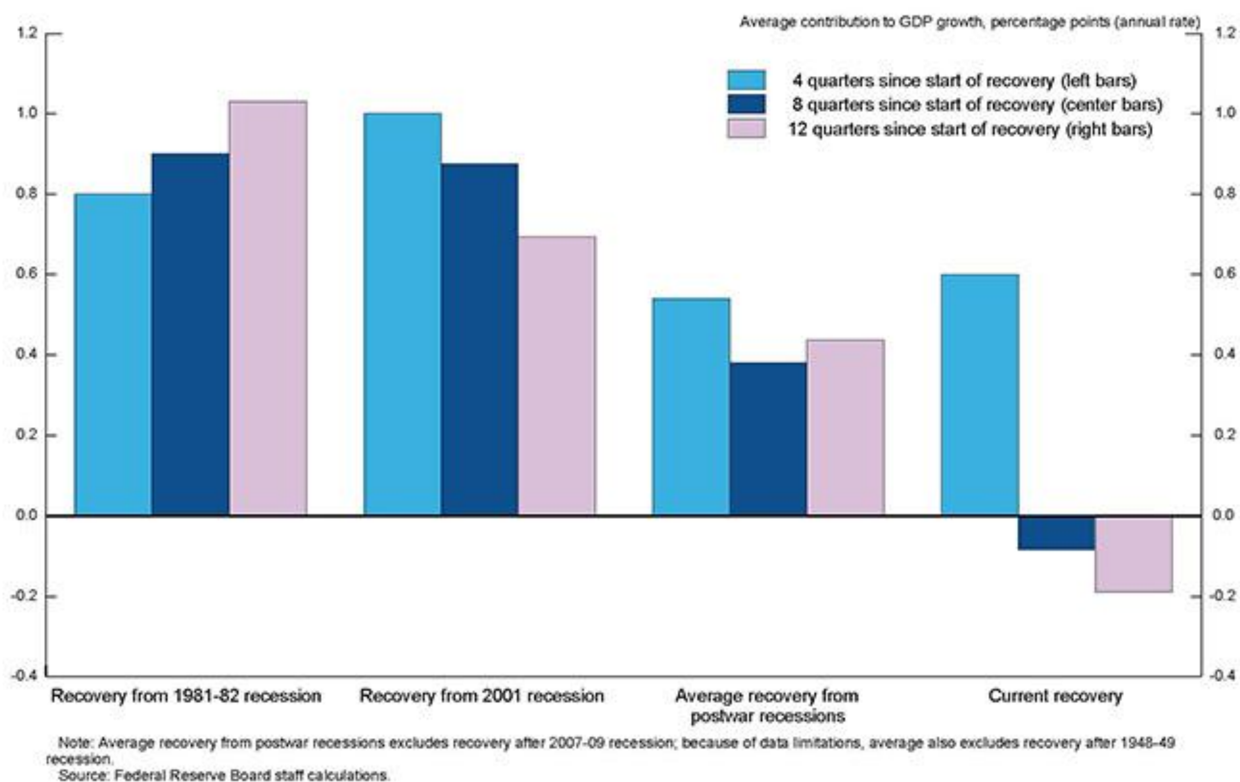
CBO —and I would venture to say a majority of economists—believe that this large output gap stems mainly from inadequate demand for goods and services, not a lack of incentives for businesses to supply goods and services or an unwillingness of workers to offer their labor services. The cure for most of our current unemployment problem is faster economic growth to close the output gap more quickly. The Federal Reserve has gone to extraordinary lengths within its powers to encourage greater growth, but since 2009 fiscal policy has been a drag on growth.

I know it sounds strange to people used to talking about "out-of-control" government spending, but changes in combined federal and state and local spending on goods and services have made a negative contribution to economic growth since 2009 — not because government spending has

[2] Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2013 to 2023*, February 2013, p. 43

been growing, but because it has not, as shown in the following chart from a recent speech by Federal Reserve Vice Chair Janet Yellen.[3]

**Exhibit 3: Estimated Effect of Discretionary Fiscal Policy on the Economy during Recoveries**




This chart shows the contribution of federal, state, and local government purchases of goods and services to economic growth one year, two years, and three years after the end of the recession for the current recovery, the average of past recoveries, and the recoveries from the 1981-82 and 2001 recessions. In the first year, the contribution of government spending to growth was about the same as the average of past recoveries but nowhere near what it was in the Reagan and Bush recoveries. And in the two subsequent years, government spending was a drag on growth.

We do have to take steps to stabilize our long-run budget situation, and our macroeconomic policies have not been as disastrous as those of Great Britain or the EUC, but our pursuit of too much budget austerity, too soon has not done the economic recovery any favors.

CBO estimates that the fiscal restraint still in effect after the fiscal cliff deal will subtract 1½ percentage points from economic growth this year. Three things account for the bulk of that restraint: the automatic cuts in federal spending ("sequestration") due to kick in March 1, the

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[3] Vice Chair Janet L. Yellen, "A Painfully Slow Recovery for America's Workers: Causes, Implications, and the Federal Reserve's Response," February 11, 2013, available online at http://www.federalreserve.gov/newsevents/speech/yellen20130211a.htm

expiration of the 2009 payroll tax cut, and expiration of some of President Bush's tax cuts for wealthy taxpayers.

Although sequestration does the least of these three policies to cut the budget deficit this year, dollar-for-dollar it restrains growth and job creation the most. In fact, CBO estimates that it accounts for roughly the same overall drag on growth as the combined tax changes. Moreover, most of the drag from the tax changes arises from the 2 percentage point increase in the payroll tax; dollar-for-dollar, higher tax rates on the very affluent do little to hamper the economic recovery.

Policymakers missed an opportunity in the "fiscal cliff" negotiations to resolve the sequestration issue by replacing the across-the-board cuts with policies that achieved equivalent budget savings but that were more balanced between taxes and spending and that did not take effect until the economy was stronger. They missed an opportunity to boost the recovery and brighten jobless workers' job prospects when they failed to extend the payroll tax cut. And they missed an opportunity to achieve more deficit reduction that didn't threaten the recovery when they did not end Bush-era tax cuts for more very well-to-do Americans.

My colleagues at the Center on Budget and Policy Priorities' recent analysis shows that $1.5 trillion in additional deficit reduction would stabilize the debt over the next ten years.[4] Moreover, it shows that deficit reduction should be designed carefully to avoid further slowing the recovery, and it should be phased in over coming years. Preferably, policymakers would couple those permanent deficit-reduction measures with some targeted temporary fiscal measures to accelerate growth and job creation now.

A good place to start would be to replace sequestration with a balanced package of tax and spending measures that do not exert such a sharp, immediate drag on the recovery.

## Unemployment Insurance

Policymakers acted with uncharacteristic speed to enact emergency unemployment compensation (EUC) in mid-2008 and to expand it in late 2008 when the severity of the job losses became evident. The 2009 Recovery Act added full federal funding for the joint federal-state Extended Benefits (EB) program, and added a federal benefit of $25 per week. While the maximum number of weeks of unemployment insurance (UI) available in the typical state in normal times is 26, the combined number of weeks of regular UI, EUC, and EB eventually available in states with particularly high unemployment was 99 from late 2009 to early 2012.

The maximum number of weeks was reduced by changes in the law in February 2012, and as the number of unemployed workers drops and state economies improve, federal emergency UI spending will diminish. Congress has enacted emergency federal UI in every major recession since the 1950s, and it has always allowed the program to expire once the labor market is strong enough that workers can be expected to find a job in a reasonable period of time. However, the highest unemployment rate at which previous programs were allowed to expire was 7.2 percent — a rate

[4] Richard Kogan, Robert Greenstein, and Joel Friedman, " $1.5 Trillion in Deficit Savings Would Stabilize the Debt Over the Coming Decade," Center on Budget and Policy Priorities, February 11, 2013, available online at http://www.cbpp.org/files/2-11-13bud.pdf

CBO does not expect the economy to reach this year or next under its baseline assumption that current laws continue to govern taxes and spending.

Clearly, federal emergency UI was a larger program in the Great Recession and its aftermath than it was in previous recessions, but as I hope I have shown, the unemployment problem was much larger this time as well.

Finally, I want to address the question of whether emergency unemployment insurance discourages unemployed workers from looking for work and could be a significant contributor to the high levels of unemployment in the Great Recession and its aftermath. CBO provides a useful discussion[5] of the variety of ways providing additional weeks of unemployment insurance might affect the incentives of workers receiving UI to search for a job and accept a job if offered. Importantly, CBO also distinguishes between such effects in a strong labor market versus one with substantial unemployment.

Opponents of continuing emergency unemployment benefits often assert that UI discourages people from looking for work and that ending these benefits would speed a return to full employment. Though research from earlier periods showed that additional weeks of unemployment insurance have an impact in lengthening unemployment spells, the most careful recent research indicates that these effects are much smaller in a weak economy.

Additional weeks of UI benefits have three distinct effects on the duration of unemployment spells. First, unemployment insurance has the beneficial effect of allowing an otherwise financially strapped unemployed worker to search more efficiently for an appropriate job (rather than having to accept the first job offered, whether or not it is a good match for his or her skills). Second, since unemployed workers are required to seek work in order to qualify for UI benefits, additional weeks of UI benefits keep unemployed workers attached to the labor force and looking for jobs for longer than they might have without those benefits. Finally, UI may create disincentives to look hard for a job.

One study released in early 2010 offers the "back of the envelope calculation," based on the relevant research, that weeks of benefits added through EUC could account for "between 0.7 and 1.8 percentage points of the 5.5-percentage-point rise in the unemployment rate."[6] But it also suggested that "the true effect of extended UI benefits on unemployment duration is likely to be at the lower end of these estimates."

Indeed, a careful study of recent evidence by economist Jesse Rothstein found that federal extensions of UI in the past few years likely had an *even smaller* effect than this. Rothstein found that the unemployment rate in December 2010 would have been only about 0.2 percentage points lower without the extension of unemployment compensation.[7] Moreover, Rothstein also found that at least half of this 0.2 percentage-

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[5] Congressional Budget Office, "Unemployment Insurance in the Wake of the Recent Recession," November 2012.

[6] Michael Elsby, Bart Hobijn, and Aysegul Sahin, "The Labor Market in the Great Recession," Brookings Institution Papers on Economic Activity, Spring 2010, http://www.brookings.edu/~/media/Files/Programs/ES/BPEA/2010_spring_bpea_papers/2010a_bpea_eslby.pdf

[7] Jesse Rothstein, "Unemployment Insurance and Job Search in the Great Recession," University of California, Berkley, October 16, 2011, http://gsppi.berkeley.edu/faculty/jrothstein/workingpapers/Rothstein-UI-Oct2011.pdf. For a concise summary of this paper, please see Heidi Shierholz, "What's UI got to do with it?" Economic Policy Institute, September 22, 2011, http://www.epi.org/blog/unemployment-insurance-benefits/.

point increase could be from increasing labor force attachment — i.e. keeping UI recipients actively searching for work rather than dropping out of the labor force. Most other studies of the disincentive effect of UI in the current downturn have also found relatively small effects.

Harvard economist Lawrence Katz has also observed that traditional estimates of the relationship between UI and the length of unemployment spells ignore other effects, such as "the macroeconomic stimulus impacts of increased consumption expenditures by the unemployed … as well as the gains from keeping more of the long-term unemployed attached to the labor market rather than moving onto disability programs."[8]

Arguments that emergency UI benefits are an important contributor to high unemployment in today's economy have cause and effect backwards. We have a temporary federal program *because* unemployment is so high and jobs are so hard to find.

In assessing the economic effects of extending UI, CBO concluded that "the various effects of extending additional unemployment benefits, apart from the effect on the overall demand for goods and services would, on balance, make little difference to overall output or the number of people employed" under weak economic conditions. CBO has, however, found UI to be one of the most cost-effective ways of stimulating output and employment in a weak economy.

The impact on unemployment is more complicated. People who have dropped out of the labor force are not counted as unemployed, and some of the stimulative effect on *em*ployment could come from bringing people back into the labor force. At the same time, if UI has a strong enough effect keeping recipients in the labor force looking for work rather than dropping out, a longer duration of emergency UI could also increase *un*employment. But once again, keeping people looking for work is a desirable outcome not a problem with the program.

## Concluding Observations

The United States continues to have an unemployment problem. That problem is a legacy of the Great Recession and the subsequent slow recovery. Part of the reason for the slow recovery and persistently high unemployment is that policymakers have pursued budget austerity during a period of economic weakness. Ideally, policymakers would have chosen a better mix of policies between those with high job-creating bang-for-the-buck in the early years combined with those that would achieve significant deficit reduction but only in the later years when the economy is stronger. Policymakers should apply that approach in their upcoming decisions about sequestration.

With the economy still weak, programs like emergency unemployment insurance, which put money in the hands of people likely to spend it, not only meet their primary goal of providing help to people in need but also provide valuable support to the economic recovery by boosting demand for goods and services. These programs do not add significantly to long-term deficits and debt because they shrink automatically as the economy improves, and emergency measures expire.

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[8] Lawrence F. Katz, "Long-Term Unemployment in the Great Recession," testimony before the Joint Economic Committee, U.S. Congress, April 29, 2010, pp. 4-5, http://jec.senate.gov/public/index.cfm?a=Files.Serve&File_id=e1cc2c23-dc6f-4871-a26a-fda9bd32fb7e. For a concise summary of this testimony and other recent research, see Joint Economic Committee, "Does Unemployment Insurance Inhibit Job Search?" July 2010, http://jec.senate.gov/public/?a=Files.Serve&File_id=935ec1e7-45a0-461f-a265-bbba6d6d11de.

Chad Stone is Chief Economist at the Center on Budget and Policy Priorities, where he specializes in the economic analysis of budget and policy issues.

He was the acting executive director of the Joint Economic Committee of the Congress in 2007 and before that staff director and chief economist for the Democratic staff of the committee from 2002 to 2006. He was chief economist for the Senate Budget Committee in 2001-02 and a senior economist and then chief economist at the President's Council of Economic Advisers from 1996 to 2001.

Stone has been a senior researcher at the Urban Institute and taught for several years at Swarthmore College. His other congressional experience includes two previous stints with the Joint Economic Committee and a year as chief economist at the House Science Committee. He has also worked at the Federal Trade Commission, the Federal Communications Commission, and the Office of Management and Budget. Stone is co-author, with Isabel Sawhill, of Economic Policy in the Reagan Years. He holds a B.A. from Swarthmore College and a Ph.D. in economics from Yale University.

**Committee on Oversight and Government Reform**
**Witness Disclosure Requirement – "Truth in Testimony"**
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Name: Chad Stone

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1. Please list any federal grants or contracts (including subgrants or subcontracts) you have received since October 1, 2010. Include the source and amount of each grant or contract.

none

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2. Please list any entity you are testifying on behalf of and briefly describe your relationship with these entities.

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Chief Economist

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*I certify that the above information is true and correct.*

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Date: 2/13/13