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## **Unemployment Benefits and Work Incentives: The U.S. Labor Market in the Great Recession**

**David R. Howell and Bert M. Azizoglu\***

In response to rapidly rising long-term unemployment, unemployment insurance (UI) eligibility extensions were enacted that raised the regular 26-week limit to as many as 99 weeks for some workers. As extended program claimants increased to over 6 million, the 'laws of economics' have been invoked to argue that this extended eligibility carries much of the blame for the persistence of the long-term unemployment crisis. Our assessment of this orthodox work disincentive account has three main parts. The first considers what theory suggests: predictions of large work disincentive effects follow from a model that focuses attention on the "value of unemployment" (when benefits replace earned income and workers prefer "leisure" to work); disincentive effects are likely to be much smaller when the focus shifts to the "value of employment" (there are large nonpecuniary benefits to holding a job, and substantial social, psychological and future employment costs to idleness) and to institutional realities of the UI system, which require acceptance of reasonable job offers. The second part reviews the empirical evidence on the timing of the exit of unemployed workers into employment around the time of UI benefit exhaustion, the main evidence used in support of large-scale disincentive effects; we conclude that recent research shows little or no empirical support for such "spikes". The third part explores current evidence of work disincentive effects; we find no support for such labor supply effects in the 2007-10 data on UI claimants, hires, job openings, and labor flows. If the extensions have raised long-term unemployment, it seems most likely due to maintaining labor market participation, not to work disincentives.

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Faced with collapsing employment and rapidly rising long-term unemployment in early 2008, U.S. policy makers responded with an unprecedented series of unemployment insurance (UI) eligibility extensions beyond the standard 26-week limit, with benefits available to some unemployed workers in some high unemployment states for up to 99 weeks.<sup>1</sup> As extended program claimants increased to over 6 million persons, academic economists and the business press responded with warnings that, due to the work disincentives inherent to UI, the extensions themselves had become a leading cause of the long-term unemployment crisis. These challenges helped spur fierce political resistance to continued extensions, resulting in a lapse in payments for 51 days in June and July of 2010 that affected about 1.6 million workers.

Opposition to benefit extensions has been fueled by a widely held belief, especially among economists, that there is always employment available if workers were only willing to take a lower paying, less attractive job. This belief underpins the widespread view among mainstream economists that work disincentive effects are inherent to any UI design.<sup>2</sup> The business press has led the popularization of this case against UI generosity. According to *The Economist* (November 2009), disincentive effects can have large effects even in a deep recession: "It may seem heartless to counsel against too much support for the unemployed but incentives matter even when unemployment is high.... More generous benefits will mean vacancies are filled less quickly, pushing up unemployment." Making these general concerns concrete, Harvard's Robert Barro (2010) published a back-of-the-envelope estimate in the *Wall Street Journal* that some two-thirds of the 6.7 million long-term unemployed would have been employed in the summer of 2010 but for the eligibility extensions.

Such a massive work disincentive effect, as extreme as it seems, is entirely consistent with the orthodox explanation of high European unemployment, in which policy imposed rigidities are held to explain the gap with the U.S. (for a critical assessment, see Howell et al., 2007). In fact, the U.S. unemployment advantage turned out to be short lived, from just the late 1980s to the early 2000s; the latest OECD harmonized figures, for November 2010, show the U.S. unemployment at 9.8 percent, far above the German and Italian rates (6.6% and 8.6%) and about the same as the French rate (9.7%). With the

“American Model” no longer outperforming most European countries, in orthodox circles the culprit is the same. As University of Chicago’s Casey Mulligan (2010b) puts it, “It is no surprise that adopting a European safety net is giving us a European unemployment problem” (for critical assessments of this explanation for high European unemployment, see Howell et al., 2007; Howell and Rehm, 2009).

This paper considers the work incentives case against extended UI benefits on work incentive grounds. Section 1 sets the stage with a discussion of the nature of unemployment shortly before and after the onset of The Great Recession. As recently as 2008, it was widely accepted among leading academic economists that unemployment had become mainly a problem of job finding, not of job destruction, helping define a new era of reduced economic volatility often referred to as The Great Moderation. But the two decades after the mid-1980s now appear as a brief interlude, at best, as The Great Recession has definitively established that large-scale output volatility and job destruction are not just features of a bygone era. The question this paper addresses is whether, in the aftermath of this massive job destruction, extended UI benefits have played a major role in delaying labor market adjustments by reducing job search effort and hindering job finding, and thereby contributing significantly to the persistence of levels of long-term unemployment unprecedented since the Great Depression.

The theoretical case for such labor supply effects rests on a narrow and peculiar vision of worker preferences and choice sets. In standard treatments, workers are assumed to dislike employment (“labour”) in favor of non-work time (“leisure”), so even skimpy UI benefit levels and short durations of benefit eligibility will reduce the costs of unemployment in terms of foregone income and raise the “value of unemployment.” Section 2 considers the plausibility of this underlying vision of the labor market, worker choice sets, and worker preferences, and suggests an alternative, in which nonpecuniary benefits of employment and the social and psychological costs of idleness are substantial. Framed this way, it is not the case that failure to recognize the necessity of large work disincentive effects is tantamount to repealing the “laws of economics” (Mulligan, 2010).

Recent empirical estimates of negative labor supply effects of the 2008-9 UI benefit extensions have relied almost exclusively on extrapolations from particular interpretations of the empirical evidence. Section 3 challenges this interpretation (mainly of the “spike”

evidence – the predicted increase in exit rate out of unemployment at or near the date of benefit exhaustion), and suggests that there ought to be more caution in the use of evidence generated by studies using data from earlier decades, especially since the results from the most recent generation of “spike” studies suggests a strikingly different story (little or no effect of the exit rate into employment at benefit exhaustion). We conclude that many recent “back-of-the-envelope” exercises that estimate sizable UI effects since 2008 fail to stand up to close scrutiny because they rely on old, often quite selective results (supply elasticities).

Section 4 explores current data for evidence of work disincentive effects. We begin by considering the “breakdown” in the Beveridge curve (the relationship between job openings and unemployment) in 2010, which has been cited as evidence that UI extensions may have increased match inefficiency (between workers and jobs). It turns out that the breakdown reflects the recent increases in job openings while job hires have been flat, and there is no evidence that the persistent dismal hires rate is due to the failure of workers on UI to take job offers. In the second part of this section we provide some suggestive evidence on the unemployment duration, benefit exhaustion rates, and job finding rates that offer no clear support for effects from the huge expansion of extended UI beneficiaries. We conclude that the empirical case has yet to be made for the belief that UI work disincentive effects are responsible for much of the current long-term unemployment crisis. Section 5 concludes the paper.

## **1. From the Great Moderation to the Great Recession**

The economic performance of the U.S. between the mid-1980s and the mid-2000s has been hailed as a period of declining economic volatility, illustrated by the relatively minor downturns of 1991 and 2001. Sometimes referred to as “The Great Moderation,” this performance was said to be a consequence of financial deregulation and increased product market flexibility.<sup>3</sup> Some of the clearest evidence for these payoffs from economic liberalization appeared to come from the labour market, since recent research had found that fluctuations in unemployment over the last several decades had been caused mainly by changes in job finding (outflows from unemployment) rather than job destruction (inflows to unemployment) (Shimer, 2005, 2007; for a rather different assessment, see Elsbey et al.,

2009). As Robert Hall (2005) memorably put it, “In the modern US economy, recessions do not begin with a burst of layoffs. Unemployment rises because jobs are hard to find, not because an unusual number of people are thrown into unemployment.’ In the May 2008 issue of the *American Economic Review*, about six months after the formal start of the Great Recession, Steven J. Davis (2008, p. 267) concluded from the recent evidence on trends in job destruction that “At a minimum, the long-term decline in job loss rates calls for some revision to alarmist views about rising economic insecurity for American workers and families.”

If job loss was no longer the main source of employment problems (if it ever was – see the Lucas quote above), the policy implications were straightforward: protective labor market policies like unemployment insurance (UI) needed to be fundamentally rethought, having become as much the cause as the solution to unemployment and economic insecurity (Feldstein, 2005).

With the benefit of hindsight, the recent experience of reduced job destruction rates and two consecutive shallow recessions marked, not the transition to a new stage of low volatility free market capitalism, but a temporary fortunate confluence of increasing reliance on personal, business enterprise and public sector debt with back-to-back technology and housing bubbles. It is now obvious that the long-term decline in the incidence of job loss documented by Davis (2008) took a dramatic U-turn in 2008-9 with an increase in job destruction unmatched since the Great Depression.

Figure 1 shows that the magnitude of the job destruction and collapse in hiring in the Great Recession. Between early 2007 and late 2009, the job loss rate (as a percent of the labour force) rose from about 1 to 4.5, compared to a peak of just over 2 in the aftermath of the 2001 recession. This figure shows that the hires rate (as a percent of employment) tends to fluctuate around 4 and in a single month in early 2003 hit 3.5, fell to 3 in 2009 and has remained around 3.2 since (the large federal government hiring of Census workers was responsible for the uptick in April-June of 2010). As of this writing, in March 2011, neither measure had improved much since the formal end of the recession in May 2009.

High job destruction and low hires had the predictable consequences for the employment numbers. The employment-to-population rate (EPR) fell from 63.4 percent in March 2007 to just 58.2 percent at the end of 2009, an extraordinary collapse. Neither total

employment nor the EPR improved much in 2010. This employment decline, in turn, had the predictable effects on unemployment and UI claims. Figure 2 shows that the unemployed increased from 7.7 million in December 2007 to 14.8 million in June 2009, nearly reached 16 million in late 2009, and were still at 14.9 million in October 2010. Long-term unemployment increased from 1.3 million to 4.4 million over the course of the official recession; by October 2010 it had risen to 6.2 million.

These employment and unemployment outcomes led to a huge expansion of regular UI program (26 week) claimants, and beginning in May 2008, policy makers responded with a series of expansions of UI duration eligibility to 99 weeks (for some workers in some states). Figure 2 shows that total UI claimants were 8.8 million in October 2010 after peaking at almost 12 million in January 2010, while extended federal program UI claimants rose to 6.6 million in early 2010.

The UI reciprocity rate (total claims as a share of total unemployment) has typically been extremely low by international standards, between 30-40 percent, as Figure 3 shows it was throughout most of 2007. This overall UI reciprocity rate peaked at about 80 percent in early 2010, but by the end of the year had fallen to around 60 percent. Figure 3 indicates that the share of the long-term unemployed receiving extended federal UI program payments rose from about 8 percent to 70 percent between June and August of 2008, and after a substantial decline to just over 40 percent later that fall, peaked at about 95 percent in February 2010. It has since fallen to about 80 percent (October 2010). The long-term (27+ weeks) share of the unemployed is also shown rising from a “normal” rate of under 20 percent to rates of 40-46 percent in 2010. The question this paper asks concerns the causal relationship between these two series: is there good theoretical reason and compelling empirical evidence to support the view that increasing duration of UI benefit eligibility has contributed to the rise in long-term unemployment by reducing job finding incentives?

## **2. UI Benefit and Work Incentives**

“They simply could not understand what was happening to them. They had been brought up to work, and behold! it seemed as if they were never going to have the

chance of working again... Everyone who saw Greenwood's play *Love on the Dole* must remember that dreadful moment when the poor, good, stupid working man beats on the table and cries out, 'O God, send me some work!' This was not dramatic exaggeration, it was a touch from life." (George Orwell, 1958 [1937], p. 86).

"Workers who lose jobs, for whatever reason, typically pass through a period of unemployment instead of taking temporary work on the 'spot' labour market, jobs that are readily available in any economy.... To explain why people allocate time to a particular *activity* – like unemployment – we need to know why they prefer it to *all* other available activities" (Robert Lucas, 1987, italics in the original; quoted by Sawyer, 2010, p. 288).

"The employment and job-search choices of unemployed workers, so far as they have choices, do not seem to be governed simply, or even predominantly, by any simple trade between income and the irksomeness of labor." (Robert Solow, 1990, p. 12)

The broad neoclassical framework for thinking about the labour supply decision relies on the weighing of all costs and benefits, current and future, by a rational worker with reasonably full information. In this case, UI benefits reduce the short-run income cost of unemployment, but whether this compensation acts as a work disincentive must depend on the importance of this reduction in the overall balance of costs and benefits. In contrast, the conventional theoretical application of this framework is a naïve labour-leisure model so narrowly structured that it all but requires substantial work disincentives from the receipt of UI benefits.

In the conventional textbook model of the labor supply decision, workers choose between consumption, which requires income and hence labour - market work and in turn is assumed to be an unsatisfying activity (one that generates disutility) - and non-market time, known as leisure, which is a pleasurable activity. UI benefits offer unemployed workers the option of "leisure" at a lower cost in foregone consumption. This additional pleasurable non-market work time is what is commonly referred to in theoretical discussions as the "value of being unemployed." The more generous the benefit (rate and duration), the greater will be the reduction in search effort and the increase in the reservation wage (what it takes to get workers to take a job). The consequence is longer durations of unemployment and, typically, higher unemployment rates (assuming jobs are available and that the work-leisure choices of those on benefit have no effect on the



probability of job finding by new labor force entrants and re-entrants). This is the moral hazard effect: insurance against unemployment generates behavior that increases it.

The mainstream literature has been nearly exclusively focused on 1) confirming such moral hazard effects, and 2) on minimizing them through the design of optimal UI benefits (e.g., see the overview by Nicholson and Needels, 2006). By framing time allocation as a choice between labor and leisure, any compensated unemployment will reduce what workers do not want to do (“labour”) by subsidizing what they prefer to do (“leisure”). Citing the leading search theorists Mortensen and Pissarides, Pries and Rogerson (2008, p. 822) explain that “It is straightforward to show that an increase in (UI) benefits is identical to an increase in the disutility of work.” While perhaps straightforward in these models, we will argue below that the evidence overwhelmingly shows that in the real world holding a job is typically highly valued independently of the income it generates, and if this is so, changes in UI generosity may have nothing to do with changes in the disutility of work.

Framing the labor supply decision as a tradeoff between unpleasant work time and pleasant non-work time fails to provide a useful way to think clearly about the real-world effects of UI benefits on worker behavior. To begin with, all actual UI systems require a work test – claimants lose benefits if reasonable job offers are turned down.<sup>4</sup> As Holmlund (1998, p. 117) notes, “It is clear that incentive effects will be unimportant if the work test is effective.” In addition, minimal simplicity for a meaningful model of time allocation requires more activities than work and leisure and more attention to which of those activities workers are actually most likely to prefer.

After the universal activities of sleep and basic personal maintenance, workers are confronted with at least four categories to which time can be allocated: 1) *employment*, which can be unattractive and taken only for pay, but is often the most positive utility-generating activity in worker’s lives; 2) *nonmarket labor* (household and caring activities), which can be good or bad, and often is a complicated mix of the two; 3) *idleness*, which, in its standard understanding in the English language is almost always bad, both in its experience and its effects; and 4) *leisure*, which in standard usage consists of time spent at pleasurable activities, not just the time left over when not working for pay. The economist’s dichotomous labor-leisure framework misrepresents employment as simply something to be tolerated only for the sake of the consumption its pay makes possible; it

ignores nonmarket (household) labor, which may or may not be desired; and above all, it fails to recognize idleness, which is fundamental to understanding the disutility (the social and psychological costs) of unemployment stemming from job loss. Thinking clearly and sensibly about the incentives facing unemployed workers cannot be done with the simple labor-leisure dichotomy.

In the conventional account, the cost of unemployment is limited to the loss in income (foregone consumption). UI benefit reduces the cost of unemployment by replacing a portion of the lost income. But this gap between the benefit payment and the potential wage is likely to be a small part of the total cost of unemployment. Rational workers will take into account a wide range of reasonably predictable costs, including 1) the foregone benefits of work that are independent of pay, since many jobs have intrinsic value for workers; 2) the time and hassle costs associated with maintaining UI eligibility; 3) the psychological and social costs of idleness, especially for prime-age workers; and 4) the longer-run scarring effects of unemployment on future employment and wages.

The evidence for the personal costs of unemployment is overwhelming, even controlling for lost income. Citing Winkelmann and Winkelmann (1998), Blanchflower and Oswald (2004) and several others, a recent study by Stavrova et al. (2011, p. 160) nicely summarizes the literature: “Numerous studies have shown that the unemployment effect on life satisfaction and happiness persists even after controlling for income and other socio-demographic characteristics. Furthermore, the results of several studies suggest that non-pecuniary costs of unemployment substantially exceed those caused by income loss.” In addition to status, identity, and “regular contact with peers,” Stavrova et al. argue that among the most critical nonpecuniary benefits of employment is that “working for a living means complying with the social norm to work” (p. 160). The cost of unemployment (measured as “life satisfaction”) is found to vary with the strength of this social norm, but not with the generosity of the welfare state provision for the unemployed (p. 168).

Given the strength of this norm in the U.S., these findings suggest that additional weeks of benefit eligibility would be unlikely to reduce the incentive to get work quickly, especially in light of the clear evidence that both unemployment through job loss and longer unemployment duration has strong scarring effects on future employment and wages (Arulampalam et al., 2001; Farber, 2005; von Wachter et al., 2009).

This conclusion from recent statistical evidence is consistent with the results of classic sociological and ethnographic studies that date back at least to the Great Depression, such as Jahoda et al. (2002) and Bakke (1940). Thomas Cottle's (2001) examination of the individual experiences of unemployed men and their families in 1980s America underscores the intrinsic value of employment:

Although it is often said that we never appreciate something until we lose it, the men whose stories fill this book knew full well how important their jobs were long before they lost them" (p. 2)... If the men whose stories appear in these pages are to be believed, their very perceptions and sensations, the moment by moment working of their conscious minds, their mental representations, their personal and social frames of reference, grew out of their employment, or at least out of their anticipation of working (p. 278).

Similar testimony to the importance of the nonpecuniary benefits of employment for personal well-being and the social and psychological costs of compensated unemployment can be found in recent work by Katherine Newman (1999) and Louis Uchitelle (2007).

Recent survey evidence lends still more support to the view that the conventional labour-leisure tradeoff view misrepresents the nature of the labour supply decision and worker preferences. According to Freeman and Schettkat (2002), in a 1997 survey, only 23 percent of male and 25 percent of female workers agreed that "job is just a way to make money", while 60 percent of both men and women agreed that they "would take job even if money not needed" (table 8). Krueger and Mueller (2008) find that the unemployed spend much more time in housework and "leisure" activities than the employed, but 201 of the 343 minutes of "leisure" time on an average weekday was spent by the unemployed watching TV (table 3), and that happened to be the activity during which unemployed workers felt "saddest" (table 5). The "leisure" was evidently "idleness" and the distinction is vital for any serious discussion of unemployment, work incentives, and happiness.

On the benefits side, UI benefits can promote efficiency in job-worker matching. The nature of unemployment changes over the course of the business cycle, from one of matching frictions in booms to job rationing in recessions (Landais, Michailat, and Saez, 2010). In times of job rationing, any increase in unemployment duration caused by receipt of UI benefit is likely to be less a moral hazard effect (using benefits to avoid work) than a liquidity one, in which workers without the resources to conduct a job search long enough

to produce a good match are able to do so (Chetty, 2008). In this case, workers take advantage of UI benefits to extend unemployment duration to find an appropriate job match. And it should be noted that extended unemployment duration may result in substitution of unpaid for paid work, as unemployed workers, faced with only very poorly paid jobs, find it better to do household work rather than pay for it out of a much smaller paycheck.

In sum, within the conventional economic framework in which unemployed workers on benefit are assumed to rationally weigh the benefits and costs of taking a job, this calculation should include a wide range of costs and benefits, and not just the loss reflected by the replacement rate. The case for substantial work disincentives is weaker the greater the job rationing, the greater the social norm to work, the greater the nonpecuniary benefits of holding a job, the greater the psychological and social costs of unemployment, the greater the time, hassle and humiliation of maintaining benefit eligibility, and the greater the expected scarring effects on future employment and wages. This suggests to us that we should not expect to observe much evidence of moral hazard related to benefit receipt in the U.S. in the Great Recession.

### **3. UI and Work Incentives: The Use of Pre-Great Recession Evidence**

Much of the empirical case for a substantial causal effect of the 2008-9 UI extensions on work incentives, labor supply, and the persistence of high long-term unemployment has relied on interpretations of what the “spike” evidence shows: that there is a sharp increase in the exit rate from the UI system near the the end of benefit eligibility, implying strategic behavior to avoid work by the unemployed. The first part of this section reviews this evidence; the second part examines the use of this evidence in recent “back-of-the-envelope” estimates of the unemployment-increasing effects of the recent UI extensions.

#### *3.1. UI and the Exit from Unemployment*

The most common approach to identifying work disincentive effects is to determine whether there is a “spike” at the point of UI benefit exhaustion. Such a spike would suggest that many workers wait until the end of benefit eligibility before returning to work. There

are a number of reasons to be cautious about the use of some of this evidence for explaining high rates of long-term unemployment.

First, much of the spike evidence cited in the current policy debate over the effects of extensions on work incentives was published in the late 1980s and early 1990s with data from 1970s and 1980s. These data often included large numbers of workers on temporary layoff – firms would effectively use the UI system to help subsidize keeping employees on call during economic downturns (Katz, 2010). Obviously, “spikes” of this sort have nothing to do with workers choosing not to work in response to the availability of generous UI benefits.

Second, the benefit exhaustion spike often fails to distinguish those leaving for employment from those who drop out of the labor force. If there are very few job opportunities in a severe economic downturn, the “spike” simply shows that the long-term unemployed collected all the benefits for which they were eligible. For the spike to demonstrate a UI work disincentive, it would have to be limited to those entering employment at the time of benefit exhaustion.

A third consideration is the interpretation of spikes as evidence of strategic work avoidance. As Chetty (2008) has argued, a spike into employment may reflect mainly “liquidity”, not moral hazard effects. Given imperfect private insurance markets, it is well known that one of the benefits of UI benefit is that it helps smooth consumption over periods of joblessness. Chetty has shown that those who have the resources to do this smoothing do not change their search behavior, and those whose behavior is sensitive to benefit levels and duration tend to have low liquidity (“cash-in-hand”). Without UI benefits, these low-liquidity unemployed workers would be pressed to return to work at jobs of lower quality or offering a poorer skill-task match, with long-run cost efficiency and well-being consequences.

Fourth, even if there is a spike and it reflects a re-employment hazard caused by strategic behavior, the magnitude of the effect as estimated in the literature ranges from small to trivial. As Schmieder et al. (2009, p. 1) put it, citing two important early studies (Katz and Meyer, 1990; Hunt, 1995), “... the magnitude of existing estimates does not imply substantial increases in unemployment as a result of longer UI durations....”.

Finally, it seems straightforward that if there is strategic behavior, rational workers would be most likely to display it in good times, when jobs are flush and employers struggling to fill vacancies. Conversely, strategic work avoidance is surely most risky in deep recessions, when unemployment is by severe job rationing (see Landais et al., 2010). With some five unemployed workers per job opening and hiring at record low levels for three years, there should be some caution extrapolating from results several decades old and generated under labor market considerably less severe.

Despite these reasons for caution, nearly all the evidence used to support the view that increases in the duration of UI eligibility can be expected to increased long-term unemployment comes from a narrow set of studies that rely on data many decades old. For example, in his Presidential address, Feldstein (2005, p. 13) states: “UI benefits raise the unemployment rate in a variety of ways that economists have now analyzed and measured.” The only supportive evidence Feldstein offers is the Katz and Meyer (1990) paper, which Feldstein says “showed that the probability that an unemployed person takes a job rises dramatically in the few weeks just before their benefits would expire”(p. 13). As noted above, Katz has testified that these early 1980s results have limited utility for assessing current UI effects, and in any case the Katz and Meyer referred only to the average duration of unemployment, not the unemployment rate.<sup>5</sup>

Card, Chetty, and Weber’s (2007) survey of the literature on the effects of benefit exhaustion on the re-employment rate indicates that the strongest evidence of spikes appears in very early literature (Moffitt, 1985; Meyer, 1990; and Katz and Meyer, 1990a and 1990b). The often-cited Card and Levine (2000) study concludes with an elasticity estimate of .08, half or less than some of the most quoted studies just mentioned. But since their study covered a New Jersey labor market that “remained robust throughout the period,” it was a time in which strategic behavior would be expected to carry the least risk. As noted above, in a deep recession, the costs of such behavior are surely much greater, so the Card-Levine estimates might reasonably be interpreted as being at the high end of the range.<sup>6</sup>

As for their own work, Card et al. (2007, p. 15), they find little evidence of a disincentive effect using recent data from Austria, widely recognized to offer the best

quasi-experimental test. We reproduce a key result in Figure 4, which shows an exit spike, but not a re-employment spike.

We conclude that most job seekers in Austria are not waiting to return to work until their UI benefits are exhausted. Rather, a large fraction simply leave the unemployment registry once their benefits end and they are no longer required to register to maintain their eligibility for benefits (p. 1)... This modest spike (in exiting into employment) implies that fewer than 1% of jobless spells have an ending date that is manipulated to coincide with the end of UI benefits. The difference in spikes between the two measures arises because many individuals leave the unemployment registry once their benefits expire without returning to work (Card et al., 2007, p. 15).

Even more recent evidence also suggests small or negligible work disincentive effects. Schmieder et al. (2009) use administrative data from Germany and the U.S.: “We find that increases in UI have small to modest effects on non-employment rates, a result robust over various measures of the business cycle and across groups. Thus, large expansions of UI during recessions do not lead to lasting increases in unemployment duration, nor can they explain differences in unemployment durations across countries.”

Curiously, recent discussions that cite spike evidence in support of strong work disincentive effects rarely consider this new evidence. For example, in the latest edition of his text, Jonathan Gruber (2010) underscores the importance of moral hazard effects by reproducing a dramatic spike figure from a single study (Meyer, 1990), concluding that “this pattern suggests that UI benefits are a key factor in a person’s decision about when to return to work.” In addition to reliance on just one study that used data from three decades ago, Meyer’s spike shows just the exit rate, not the exit rate into employment. Figure 4 illustrates how big a difference this can make.

Similarly, in support of his argument that workers respond to the strong work disincentives inherent to UI systems even in times of high unemployment, Mulligan (2010) cites just one study, by Jurajda and Tannery (2003). But two-thirds of the spike they find (for workers in Pittsburgh in the early 1980s) was accounted for by recalls by employers, which has nothing to do with work disincentive effects. It is also notable that this paper is relatively obscure in the professional literature, at least in part because of questions about the reliability of the findings.<sup>7</sup> Most recently, Nakajima (2011, p. 3) relies on estimates taken mainly from studies using data from the 1970s and 1980s, but cites Card and Levine

(2000) as the “smallest estimate.” No mention is made of either Card et al. (2007) or Schmieder et al. (2009). The implicit assumption in this literature seems to be that the largest and most dated estimates should be preferred.

### *3.2. Counterfactuals and Back-of-the-Envelope Estimates*

With the passage of legislation authorizing UI benefit extensions in the summer of 2008, many back-of-the-envelope exercises have been published to highlight the perverse effects these extensions are likely to have on long-term unemployment. Some are thought experiments using a variety of assumptions (e.g., Barro, 2010; Fujita, 2010). Others rely on results from the older spike-at-benefit-exhaustion literature to estimate possible effects (Elsby et al., 2010; Aaronson et al., 2010).

Robert Barro’s back-of-the-envelope estimates, published in the *Wall Street Journal*, illustrate a simple textbook vision in which idleness (leisure) is preferred to work and employment is available as long as reservation wages are sufficiently downwardly flexible. Concerned with explaining the expansion of the long-term unemployed to over 46% of all those unemployed in June 2010 (it peaked at 24.5% in the worst previous recession in the postwar era), Barro writes that “The dramatic expansion of unemployment-insurance eligibility to 99 weeks is almost surely the culprit.... My calculations suggest the jobless rate could be as low as 6.8% instead of 9.5%, if jobless benefits hadn’t been extended to 99 weeks.” Assuming the July 1983 long-term unemployment rate (24.5%), he has long-term unemployment dropping from 6.7 to 2.5 million. To get the 6.8% unemployment rate, he explicitly assumes an unchanged labor force, which requires that all 4.2 million workers who are no longer long-term unemployed would have been employed but for the UI extensions, presumably by lowering their reservation wage.

A very different sort of counterfactual exercise appears in Fujita (2010). He compares unemployment-to-employment (UE) and unemployment-to-nonparticipation (UN) flows for workers in different unemployment duration groups (from less than 4 to more than 97 weeks of unemployment) for 2004-7 and 2009-10: “It is assumed that in the absence of the benefit extensions, the shapes of the UE and UN transition rate functions are the same as those estimated for 2004-2007” (p. 12). He finds a “hump” rather than a spike at 25-28 weeks (around the 26 week benefit exhaustion point) in 2004-2007 but not in



2009-10. This difference is attributed to the extensions in the latter period, and this produces an estimate that the extensions “raised male workers’ unemployment rate by .9-1.7 percentage points.” This exercise assumes that the ability of workers to act strategically in the timing of re-employment would be no different in a labor market with 5 percent unemployment (2004-7) than in one with a 9.6-10 percent unemployment rate (2009-10). It also assumes a direct translation from average unemployment duration to the aggregate unemployment rate (see endnote #4).

Both Elsby et al. (2010) and Aaronson et al. (2010) estimate the likely effects of the Great Recession UI extensions on unemployment by using a range of elasticity estimates from the “spike” literature. Both use Katz and Meyer (1990) for the high estimate (.2) and Card and Levine (2000) for the low estimate (.08). In the Elsby et al. calculation, the extensions account for 15-40 percent of the increase in unemployment duration, which “corresponds to between .7 and 1.8 percentage points of the 5.5 percentage point rise in the unemployment rate witnessed in the current recession.” Aaronson et al’s estimates are a bit lower, with the extensions increasing unemployment duration by 10-25 percent. In the concluding section of the paper, this duration increase is translated directly into a 10-25 percent increase in long-term unemployment (p. 46).

Both studies emphasize that these are only back-of-the-envelope estimations. But it should be underscored that they rely on a set of quite dated and selective elasticity estimates. A proper interpretation of the Card-Levine (2000) “good times” estimate, the Card et al. (2007) survey of the literature and their results using Austrian data, and the findings of the Schmieder et al. (2010), would together suggest a more reasonable range of zero to .08 rather than .08 -.2.

In sum, like the selective reference to “spike” results noted in the first part of this section, recent “back-of-the-envelope” estimates have tended to ignore recent – and seemingly far superior – supply elasticity estimates in favor of much older (and larger) ones.

#### **4. Evidence from the Great Recession**

As of this writing it has been just over three years since the start of the 2007-09 recession, an elapse of time sufficient to begin to explore some data series for suggestive

evidence on the possible effects of the UI extensions on the job finding behavior of the unemployed. We begin with evidence from the apparent “breakdown” of the Beveridge curve – the relationship between job openings (labor demand) and unemployment (labor supply). We then report some published evidence that compares the duration of unemployment for job losers (generally eligible for UI) and new entrants or re-entrants (generally not eligible). The third part of this section explores labor flow data (e.g., from unemployment to employment and nonparticipation) to see if there is any evidence of effects on the behavior of the unemployed as the share of the long-term unemployed on extended benefits rose from close to zero in the spring of 2008 to as high as 95 percent in the spring of 2010.

#### *4.1 Beveridge Curve Evidence*

By showing the relationship between job openings (or vacancies) and the excess supply of workers available to fill them (unemployment), the Beveridge Curve has become a standard reference for assessing the efficiency of job matching in the labor market. There tends to be a tradeoff, shown by a negative slope, between vacancies and unemployment: lots of job vacancies indicate that employers are having trouble getting the workers they need, while a low vacancy rate suggests job rationing and high unemployment. The best measure of vacancies is the job openings rate (JOR) from the Bureau of Labor Statistics JOLTS program (Job Openings and Labor Turnover Survey), available monthly since December 2000.

If policy interventions have reduced the efficiency of job matching, the Beveridge Curve should move outwards, and can be interpreted as a decline in match efficiency. It has been common to cite the recent breakdown in the Beveridge Curve as evidence for considerable work disincentive effects of the UI benefit extensions (e.g., Elsby et al., 2010; Barnichon et al., 2010). Figure 5 shows the expected downward slope between December 2000 (a JOR of 3.7 and unemployment rate of 3.9 percent) and April 2009 (JOR of 1.8 and unemployment above 8.9 percent), with considerable flattening after September 2008. Between the formal end of the recession in June 2009 and December 2010 the relationship is either flat or moves upward - the JOR ranges from 1.7 to 2.5 and unemployment

between 9.4 and 10 percent). Should this flattening followed by an uptick in mid-2010 be interpreted as a breakdown in the Beveridge Curve likely caused by the UI extensions?

As Barnichon et al. (2010, pp. 13-14) point out, there are three main sources of match inefficiency: mismatches by skill (e.g., by industry or occupation) and geographic area (jobs and workers are in different places); a shortfall in hires per vacancy (e.g., low recruiting intensity by employers); or inadequate search intensity by workers (e.g., due to UI benefits). While the authors point to some evidence that suggests skill mismatch is an unlikely culprit, they leave open the question of the relative importance of employer hiring versus worker search intensity. While there is no doubt that hiring has been flat at an extremely low levels since early 2008 (see Figure 1), what has changed is the job openings rate (JOR), from about 1.8 in mid-2009 to as high as 2.5 in late 2010 (see Figure 5).

A closer look at changes in job openings and hires raises questions about the meaningfulness of short run fluctuations in job openings as a reliable indicator of changes in effective labor demand. Table 1 reports the numbers and rates of job openings, hires and separations by economic sector for December 2009 and November 2010, the period of the Beveridge curve “breakdown”. The first row shows the increase in the aggregate JOR that appears in Figure 5, from 1.9 in December 2009 to 2.4 in November 2010, which reflects an increase of 671,000 openings (column 3). The second row shows the figures for the private sector only: the vacancy rate increases from 2 to 2.6, an increase of 758,000 openings. This sounds quite impressive, but it took place alongside hardly any increase in hires: the aggregate hires rate increased from just 3.1 to 3.2 (an increase of 217,000), and the private sector hires rate rose from 3.5 to 3.6 (192,000).

While there were increases in the JOR in each large industry sector shown on the table except education and health, the increase in the aggregate JOR was driven largely by Professional and Business Services (from a rate of 2.7 to 4.0; 298,000 openings). But hires in this sector increased much less strongly (from a rate of 4.0 to 4.6; 125,000 hires), and this was substantially offset by the increase in separations (from a rate of 3.9 to 4.3; 72,000 more separations). It is also notable that increasing reliance on temporary help in the aftermath of the recession has had a large effect on these three indicators in this sector. According to the BLS (2011, p. 13), “Since September 2009, employment growth in professional and business services has been driven primarily by temporary help services.”

So temporary help jobs drove hiring in professional and business services, and this sector was responsible for a large share of the economy-wide increase job openings. The problem is that the hires and openings numbers generated from this temporary help sector may not be reliable, and in any case may fail to reflect meaningful widespread changes in aggregate labor demand.<sup>8</sup> A better understanding of the effects of mismeasurement, especially regarding the temporary help sector, is necessary, but enough is known to suggest that there ought to be much more care taken before interpreting the modest uptick in the JOR that appears in Figure 5 as evidence of growing job match inefficiency due to the moral hazard effects of extended UI.

#### *4.2 Suggestive Evidence on Unemployment Duration, Benefit Exhaustion, and Job Finding Rates*

Did unemployed job losers, most of whom are eligible for UI benefits, exhibit longer spells of unemployment than other unemployed workers less likely to be getting benefits? Are job finding rates significantly different for these two groups of unemployed workers? Did workers who received regular UI benefits increasingly exhaust their benefits at 26 weeks in order to qualify for extended benefits as the long-term unemployment claimant share of all long-term unemployed workers reached nearly 100 percent? Did job finding rates (UE flows) fall as the extended UI claimant numbers rose to nearly six million and the extended UI claimant rate rose to nearly 100 percent? This sub-section explores each of these questions.

A recent Federal Reserve Bank of San Francisco study explored the effects of extended unemployment benefits on the duration of unemployment by comparing unemployment duration for two populations, job losers and quits/new entrants (Valletta and Kuang, 2010). Since very few of the people who quit or newly enter the labor force are eligible for unemployment benefits, it is the job losers who would be affected by the receipt of benefits. If benefits had substantial effects on the duration of unemployment, job losers should show longer durations, especially after the benefit extensions (otherwise they would drop out of the data as they drop out of the labor force). But Valletta and Kuang found that the durations for job losers (UI claimants) and new entrants and re-entrants (non UI claimants) were nearly identical.

As of the fourth quarter of 2009, the expected duration of unemployment had risen about 18.7 weeks for job losers and about 17.2 weeks for leavers and entrants, using the years 2006-2007 as a baseline. The differential increase of 1.6 weeks for job losers is the presumed impact of extended UI benefits on unemployment duration.... It is not surprising that the disincentive effects of UI would loom small in the midst of the most severe labor market downturn since the Great Depression (p. 4).

Barnichon and Figura (2011) adopted the same means of identifying UI recipients, distinguishing job losers from unemployed new entrants and re-entrants. But instead of looking at effects of the UI extensions on unemployment duration, they test for job finding probability: "We find that EEB (emergency unemployment benefits) has little effect on job finding probabilities" (p. 17).

We can also look for evidence of strategic behavior in the exhaustion rates of regular UI recipients as they reach the 26-week maximum. In an orthodox world, one might reasonably expect that if workers really vastly prefer "leisure" to work, work only for income (see Section 2), and have easy access to extended UI benefits for up to an additional 73 weeks, would exploit the regular UI system to the 26 week limit, especially in an epic labor market collapse. But Figure 6 shows that the regular UI exhaustion rate reached only about 55 percent by end of 2009 and has since declined slightly, even as the extended UI claimant rate fluctuated between 70 to 95 percent. This 50-55 percent level was only modestly higher than the 45 percent exhaustion rate reached in 2003, despite a much greater potential duration of benefits (73 weeks compared to just 26 weeks in 2003).

This evidence is hardly definitive, but there is little suggestion here that the high extended UI reciprocity rate and unprecedented duration of benefits available in 2010 led to an epidemic of moral hazard: hardly more than half of all regular UI recipients exhausted their benefits at the height of the downturn. Support for this interpretation comes from a large-scale weekly survey of UI recipients in New Jersey in the Fall-Spring of 2009-10. According to Krueger and Mueller (2011, p. 29), one clear finding was that "workers do not seach more or lower their reservation wage in periods when their UI benefits have lapsed or been exhausted, suggesting that EUC (the benefit extensions) did not provide a serious disincentive to finding a job."

Finally, the labor flows data also fails to show clear evidence of strategic work avoiding behavior. Figure 7 reports the monthly flows of workers from unemployment to employment (U to E) and to nonparticipation (U to NILF) for the long-term unemployed (27+ weeks) as well as the number of extended UI claimants for January 2007 through December 2010. Both U to E and U to NILF flows increase steadily as the stock of long-term unemployment increases, as would be expected. The important point this figure highlights is that flow behavior out of unemployment shows no observable change in trend in response to the massive increase in claimants, from nearly zero in early 2008 to almost 6 million in the spring of 2010, or to the drop of nearly 1.4 million extended UI recipients between March 2010 and the end of the year.

Figure 8 shows these same U to E and U to NILF flows for the long-term unemployed as rates: each is divided by the previous month's stock of long-term unemployment. Similarly, extended UI program claimants are shown as a share of total long-term unemployment. If the increase in availability of extended benefits has large negative effects on job finding by the unemployed, we should see a decline in the long-term U to E rate as the extended UI reciprocity rate increases, especially with eligibility extending to as many as 73 weeks. But Figure 8 shows that the UE27+ series has been almost perfectly flat since the passage of the first extension, in May 2008, when it was about 10 percent. This stability persisted despite an extended UI reciprocity rate that hit 70 percent almost immediately (July 2008) and has ranged from 70-95 percent since the formal end of the recession in June 2009.

## **5. Conclusions**

“Perhaps the single most important policy-related insight in economics is that changes in policies lead to behavioral responses” (Glaeser, 2010). It is instructive that Glaeser's first example is UI benefits and that the effects are unconditional: “More generous unemployment insurance leads to longer spells of unemployment.” It follows that the unprecedented expansion of UI benefits from 26 to as many as 99 weeks should be a leading cause of the extraordinary 2008-9 increases in U.S. long-term unemployment. This is, indeed, the view of many leading economists, exemplified by Robert Barro's back-of-the-

envelope estimate that as many as two-thirds of the long-term unemployed would be working but for the increased generosity of the UI system (Barro, 2010).

This paper takes a critical look at this work incentive perspective and assesses the evidence for it in the U.S. Great Recession. Section 2 considered the conditions under which UI compensation is likely to generate meaningful work disincentives. The conventional approach consists of a narrowly framed model of the labour supply decision in which employment is valued only for the income it generates, all activities apart from paid labour are “leisure”, non-income related costs of unemployment are ignored, and there is no risk of benefit loss if workers refuse to accept job offers. Under these conditions, UI benefit should be viewed as a subsidy for leisure and we should observe a pronounced spike out of unemployment into employment at the point of benefit exhaustion.

In contrast, a useful framework for thinking about real labor supply decisions requires that all important costs and benefits should be counted and that the basic institutional features of the UI system are recognized, which include requirements to search for and accept reasonable job offers. A particularly serious omission in the conventional account is the failure to recognize that for most workers there are considerable nonpecuniary benefits to employment. The statistical and qualitative evidence is overwhelming that job loss is typically a major source of the unhappiness - even trauma - and these effects persist independently of income loss: for most, there is an intrinsic value to holding a job. The evidence also points to other substantial social and psychological costs of unemployment, and in addition to these, a rational worker must account for the probable future scarring effects on future wages and employment of additional weeks on the dole. In short, the orthodox belief that UI benefits necessarily cause unemployment, and do so substantially even in a deep employment downturn, is rooted in a naïve model inappropriate for the assessment of the real-world incentive effects of labor market policies.

Section 3 assessed the evidence commonly relied upon to support the presence of substantial work disincentive effects. The focus of much of this research has been on the time pattern of the exit rate out of unemployment. Grounded in the narrow vision just summarized, search theory predicts a spike into employment at benefit exhaustion. Our review of this literature suggests that nearly all the references relied upon to support the

prediction of large current work disincentive effects rely on data from the 1970-80s. Apart from the appropriateness of extrapolating from statistical relationships that are 3-4 decades old to predict behavior in the worst labor market downturn since the 1930s, recent estimates of sizable work disincentive effects have ignored recent research that has used much more recent data and arguably much superior statistical methodologies. It is notable that this recent “spike” evidence finds much smaller and even negligible UI labor supply effects.

Section 4 offers some recent evidence from U.S. labor market indicators for 2007-10. It has been argued that the flattening of the curve (rising unemployment at the same level of vacancies), especially for long-term unemployment, and the uptick in the months since mid-2010 (same unemployment despite more vacancies), reflects a policy-induced breakdown of the Beveridge curve. Although the story remains unclear, we suggest that it may be important to recognize that the modest increase in the job openings rate in 2010 was driven in large part by the increasing employer demand for temporary workers. Under these conditions, short-term movements in the JOLTS data may not be entirely reliable, and in any case, may not accurately reflect shifts in aggregate labor demand. The hiring freeze that has kept hiring rates at record low levels since early 2008 (see figure 1) appears to reflect an interest in taking productivity gains combined with a continuing lack of confidence in consumer demand by employers. In short, we need more information before establishing that shifts in the Beveridge curve reflects rising match inefficiencies, much less that they have been caused by the UI extensions.

Other evidence from 2007-10 raises considerable doubt about the work disincentive account. Two recent studies have explored the effects of the UI extensions by comparing outcomes for job losers (who are mostly eligible for UI benefits) and unemployed new entrants and re-entrants (who are not generally eligible) on unemployment duration (Valletta and Kuang, 2010) and job finding probability (Barnichon and Figura, 2011); neither finds much difference. Nor does the benefit exhaustion data (either from the trends for regular UI exhaustion rates or from the Krueger and Mueller survey) suggest that the extensions provided a disincentive for job finding. We also explore job finding probabilities using Current Population Survey flow data for the long-term unemployed. If extended UI eligibility has substantial work disincentive effects, the unprecedented increase in



extended UI benefit claimants between 2008 and 2010 should show some observable effects on the outflow of workers from unemployment to employment. We find no evidence of any relationship between these flows and changes in UI claimants in the aggregate or by duration of unemployment, in numbers or in rates.

The Great Recession in the U.S. now looks much like previous deep recessions, only a lot deeper: massive job destruction followed by an extended period in which the hiring rate has been much too low to reduce long-term unemployment. Under these conditions, with approximately five unemployed workers for each job opening, a theoretical framework that counts the full range of costs and benefits of continued joblessness for unemployed workers would not suggest that much of current U.S. long-term unemployment can be explained by UI-related low job finding efforts and high job offer rejection rates. Consistent with this expectation, we find no compelling evidence for any UI-related work disincentive effects either in the recent literature or in the 2007-10 data.

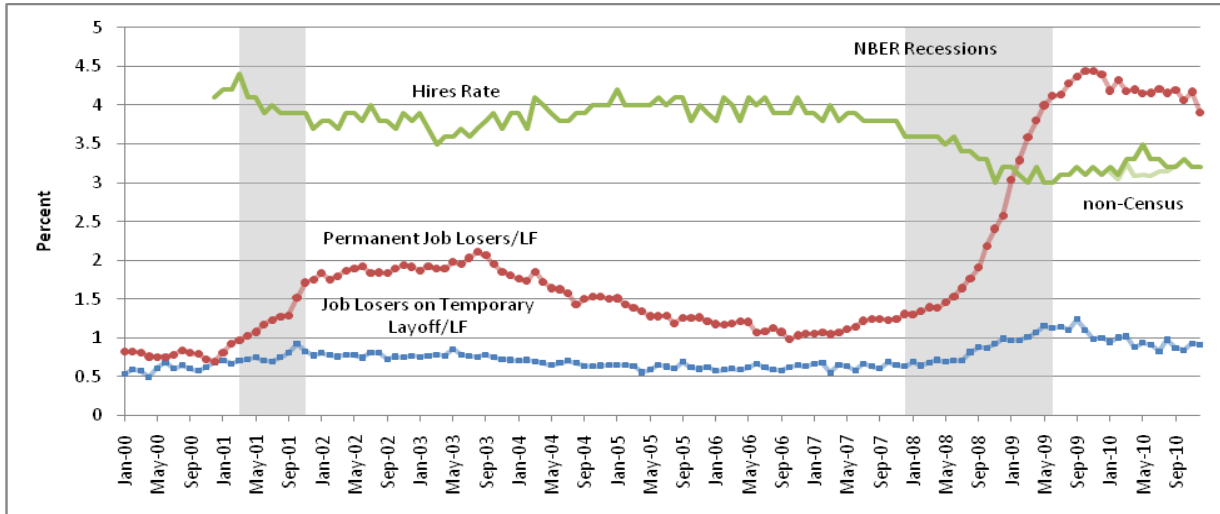
Table 1: Changes in Job Openings, Hires and Separations (in thousands and as rates\*),  
December 2009 to November 2010

	Job Openings			Hires			Separations		
	Dec. '09	Nov. '10	Chg	Dec. '09	Nov. '10	Chg	Dec. '09	Nov. '10	Chg
Total (rate)	2531 (1.9)	3202 (2.4)	671	3997 (3.1)	4214 (3.2)	217	4195 (3.2)	4154 (3.2)	-41
Total Pvt.	2130 (2.0)	2888 (2.6)	758	3715 (3.5)	3907 (3.6)	192	3884 (3.6)	3834 (3.5)	-50
Construction	67 (1.2)	91 (1.6)	24	335 (5.9)	347 (6.2)	12	382 (6.7)	363 (6.5)	-19
Manufacturing	171 (1.5)	214 (1.8)	43	244 (2.1)	274 (2.3)	30	273 (2.4)	293 (2.5)	20
Trade, transp, utilities	378 (1.5)	461 (1.8)	83	849 (3.4)	855 (3.4)	6	901 (3.7)	832 (3.3)	-69
<i>Prof. and Bus Services</i>	404 (2.4)	702 (4.0)	298	652 (4.0)	777 (4.6)	125	649 (3.9)	721 (4.3)	72
Education and Health	545 (2.7)	558 (2.7)	13	496 (2.6)	524 (2.7)	28	486 (2.5)	487 (2.5)	1
Leisure and hospitality	227 (1.7)	306 (2.3)	79	657 (5.1)	656 (5.0)	-1	688 (5.3)	646 (4.9)	-42
Government	401 (1.8)	314 (1.4)	-87	282 (1.3)	308 (1.4)	26	311 (1.4)	319 (1.4)	8

Source: "Job Openings and Labor Turnover Survey Highlights, December 2010," Bureau of Labor Statistics, February 8, 2011, Table A.

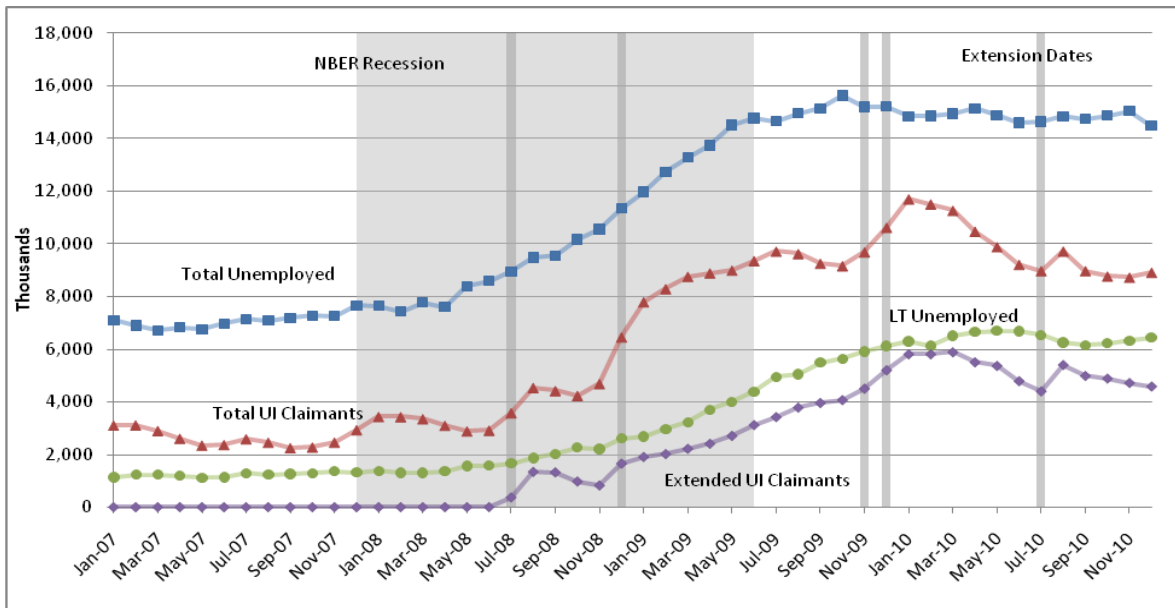
\* The job openings rate is the number of job openings on the last business day of the month as a percent of total employment plus job openings. The hires and separation rates are calculated as a percent of total employment.

Figure1: Hires and Job Loss Rates, January 2000 to December 2010



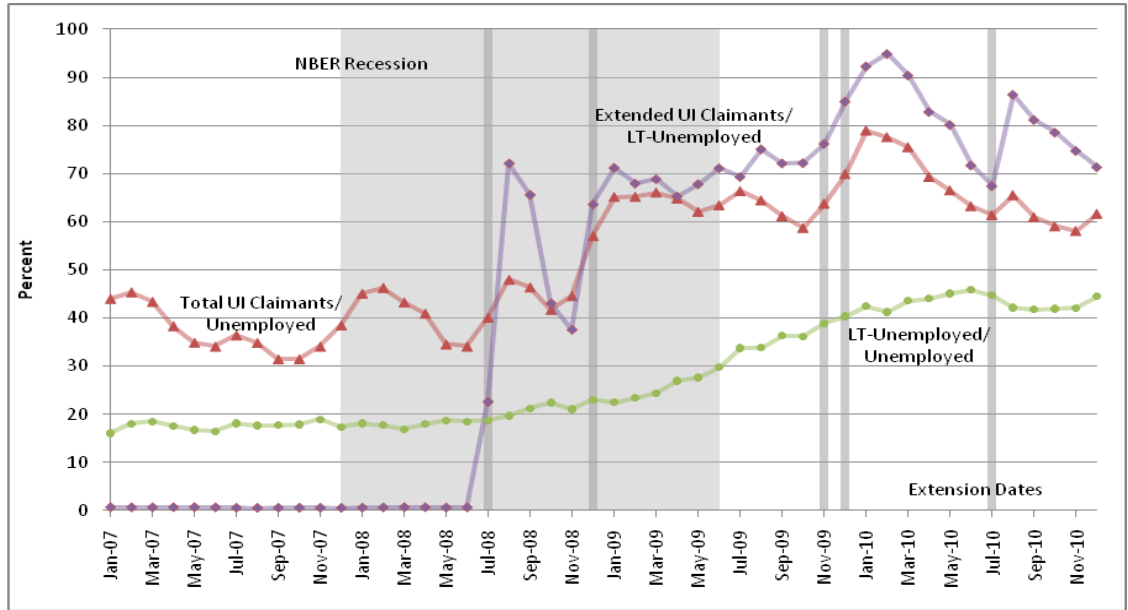
Sources: the hires rate is from the Job Openings and Labor Turnover Survey (JOLTS), Bureau of Labor Statistics (<http://www.bls.gov/jlt/>); adjustment by authors for large temporary Census Bureau hiring Census 2010 in April-June 2010 uses employment data from US Census Bureau (<http://2010.census.gov/news/releases/jobs/temp-workers.html>); job loss rates are calculated by the authors with numbers of permanent job losers, job losers on temporary layoff and labor force data from the Current Population Survey (<http://www.bls.gov/cps/>).

Figure 2: Numbers of Unemployed, UI Claimants, Long-term Unemployed (27+ weeks), and Extended UI Claimants (27+ weeks), January 2007 to December 2010



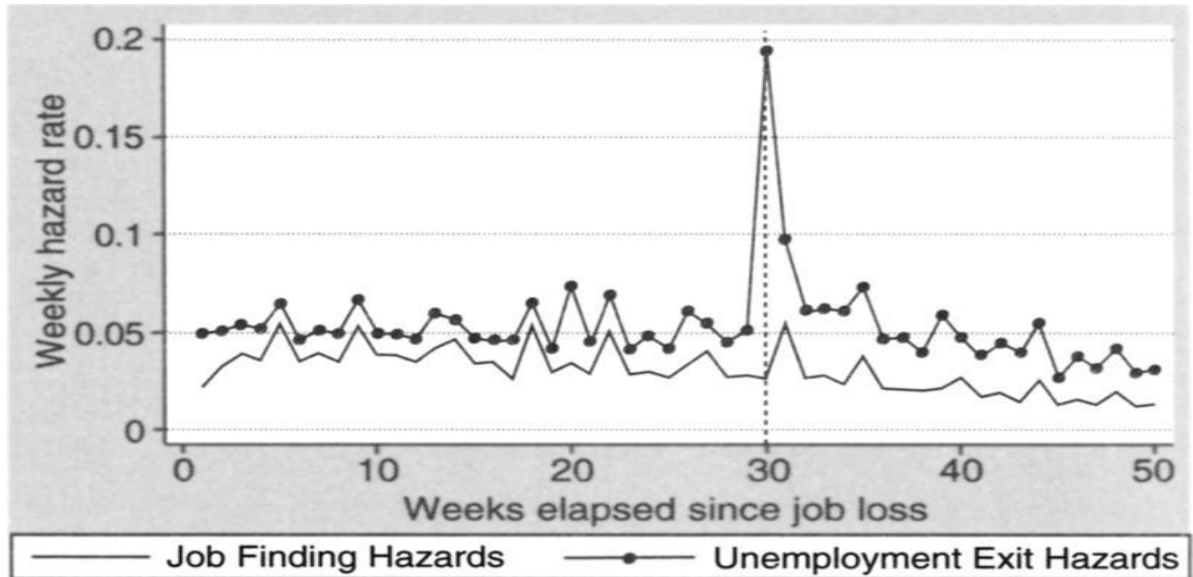
Sources: The number of total unemployed and long-term unemployed are from the Bureau of Labor Statistics (<http://www.bls.gov/cps/>); the number of total UI claimants and extended UI claimants are from Department of Labor, Employment and Training Administration <http://www.ows.doleta.gov/unemploy/finance.asp>.

Figure 3: Total UI Claimant, Extended UI Claimant, and Long-Term Unemployment Rates, January 2007 to December 2010



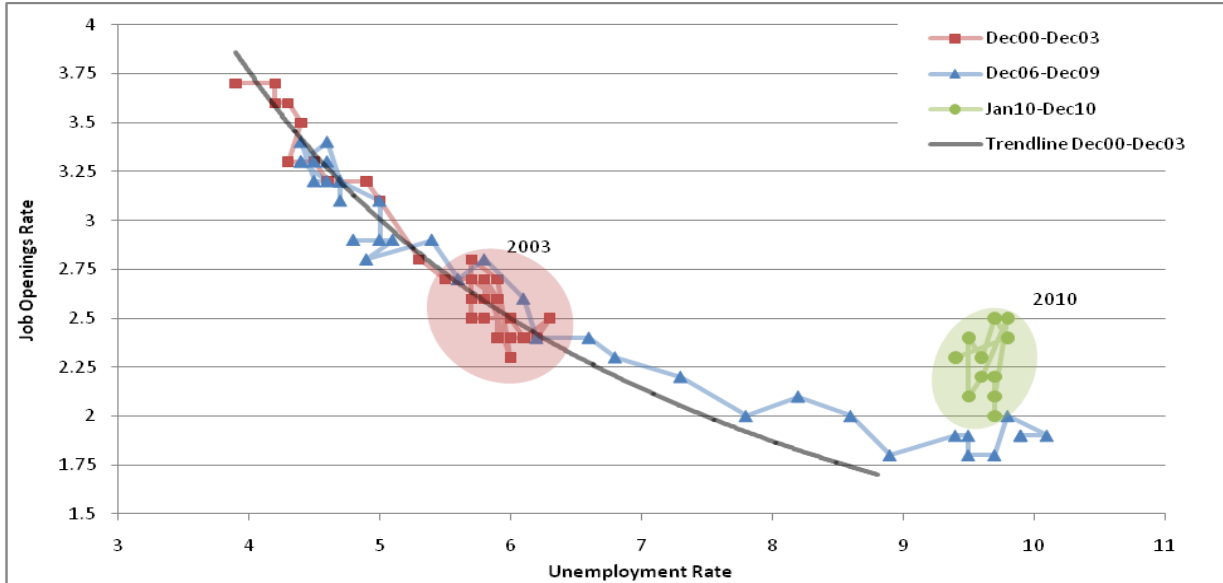
Sources: author's calculations: the number of unemployed and long-term unemployed is from the Bureau of Labor Statistics (<http://www.bls.gov/cps/>); total UI claimants and extended UI claimants are from the Department of Labor (<http://www.ows.doleta.gov/unemploy/finance.asp>).

Figure 4: The Overall Exit Rate and the Exit Rate into Employment for Austrian Workers With 30 Weeks of Benefit Eligibility, 1981 to 2001



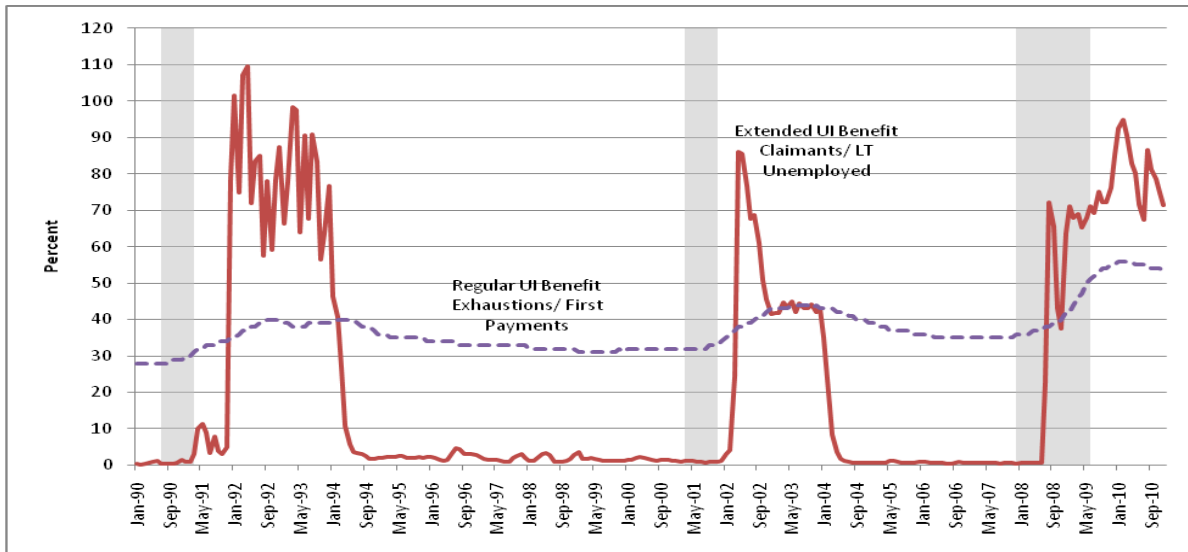
Source: Card, Chetty, Weber (2007), p.115

Figure 5: The Beveridge Curve, December 2000 to December 2010



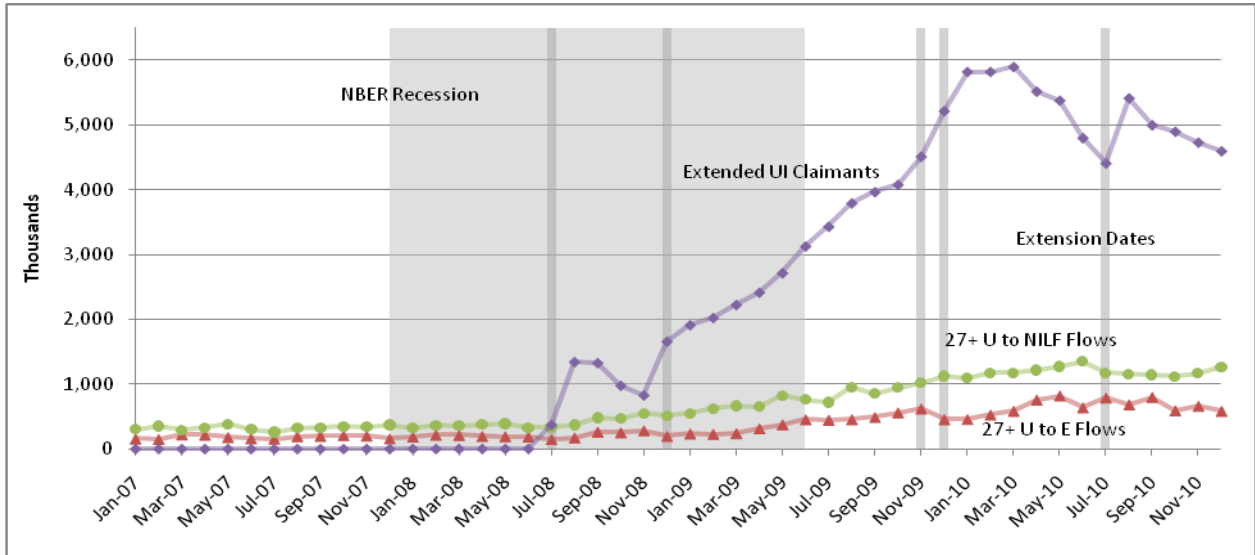
Sources: The job openings rate (openings as a percent of openings plus employment) is from the BLS' Job Openings and Labor Turnover Survey (<http://www.bls.gov/jlt/>); the unemployment rate is taken from the CPS (<http://www.bls.gov/cps/>).

Figure 6: The Regular (26 week) UI Benefit Exhaustion Rate and the Extended UI Claimant Rate, January 2000 to December 2010



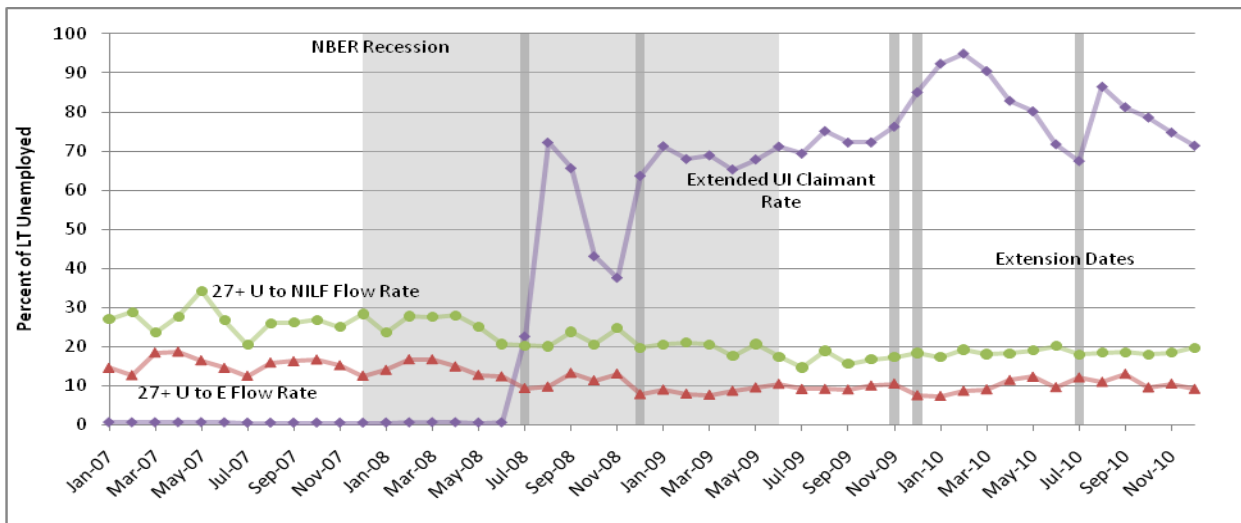
Sources: For the extended UI benefits rate, see Figure 3; the exhaustion rate is from the Department of Labor (<http://www.ows.doleta.gov/unemploy/finance.asp>).

Figure 7: Extended UI Claimants and Outflows from Long-Term Unemployment to Nonparticipation (NILF) and Employment, January 2007 to December 2010



Sources: Long-term unemployment flows data from the Bureau of Labor Statistics, Current Population Survey Labor Force Status Flows Research Series (unpublished data generously provided by Randy Ilg of the BLS); extended UI claimants data from the Department of Labor, ETA Program Statistics (<http://www.ows.doleta.gov/unemploy/finance.asp>).

Figure 8: Extended UI Claimant and Long-term Unemployment Outflow Rates, January 2000 to December 2010



Sources: Authors' calculations using flow data (see sources for Figure 7) and long-term unemployment (see sources for Figure 3).

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<sup>1</sup> Under the federal Extended Benefits program, enacted in 1970, “emergency benefits” were already available for additional 13-20 weeks, depending on the state’s unemployment rate. On top of these extensions, additional weeks of benefits were funded by Congress in 2008 under the Emergency Unemployment Compensation program (EUC08) in four “tiers”: the first two are available to all states for up to 34 weeks (20 and 14) and the 3<sup>rd</sup> and 4<sup>th</sup> for an additional 20 weeks (13 and 6); the latter were limited to high unemployment states. The EUC was legislated to expire at the end of 2009, at which time new long-term unemployed workers would not be eligible to claim EUC benefits and existing EUC recipients would only be able to complete their current tier. But there have been a number of extensions since late 2009 (see Shaw and Stone, 2010).

<sup>2</sup> For example, Martin Feldstein (2005, p. 1) asserts in the introduction to his Presidential Address to the American Economic Association that “Unemployment insurance (UI) programs raise unemployment” and has testified before Congress (September 2009) that extending benefit eligibility would “create undesirable incentives for individuals to delay returning to work” (cited by Gruber, 2010, p. 390); Casey B. Mulligan (2010) has noted that there is support “even among economists” for UI benefit extensions “despite the fact that the program would raise unemployment rates and reduce both employment and economic output;” Gregory Mankiw (2010), in reference to his “ambivalence” about whether UI benefit extensions should be reauthorized states - with no mention of evidence - that “UI reduces the job search efforts of the unemployed.”

<sup>3</sup> Similar views were widely accepted in the UK, as illustrated by speeches in 2007 by Gordon Brown and A. Darling (quoted by Sawyer, 2010, p. 286)

<sup>4</sup> For example, according to the eligibility rules in Connecticut, one of the most generous states: “You must be physically and mentally able to work during each week for which you claim benefits. You must be able to work and available for work as defined by law, during each week for which you are claiming benefits. This means that you must be ready, willing, and able to accept any suitable work. You must make reasonable efforts to find employment each week” (downloaded September 6, 2010 from <http://www.ctdol.state.ct.us/progsupt/unemplt/uceligb.htm#Weekly%20Requirements>).

<sup>5</sup> Longer unemployment duration does not necessarily translate directly into higher unemployment rates due to both composition and entitlement effects. On composition (or externality) effects, “cross-section results on the importance of unemployment compensation for the likelihood of finding a job do not translate directly into implications for aggregate unemployment because less availability by some workers will raise the probability of job finding by others” (Blanchard and Diamond, 1990, p. 163). “Entitlement effects” are also possible: since eligibility for benefits always depends on prior work experience, higher replacement rates and longer durations of benefits can induce new entrants and the unemployed not on benefit to take jobs with little job security and poor wages in order to qualify for UI benefits in the future, which complicates the relationship

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between benefits, unemployment duration and unemployment rates (Blondal and Pearson, 1995, pp. 137-9; Holmlund, 1998, p. 116).

<sup>6</sup> Notably, they also “found a similar spike in exit rates in the 25<sup>th</sup> week of benefit receipt for people who were eligible for 26 or 39 weeks, perhaps reflecting a tendency to return to work after exactly 6 months, irrespective of UI benefits” (Card et al. (2007, p. 4).

<sup>7</sup> Card, Chetty and Weber (2007) explain that “We have not included in our summary table a study by Jurajda and Tannery (2003) .... A re-examination of their data shows a coding error that leads to some overstatement of the spike at exhaustion, so the true magnitude is unclear” (fn #3, p. 5).

<sup>8</sup> According to a BLS report on improving the JOLTS methodology, the JOLTS data systematically fails to accurately track the employment estimates from BLS’s Current Employment Statistics (CES) program. Much of the problem has been traced to the Employment Services Industry, where “businesses have a difficult time reporting hires and separations of temporary help workers” (BLS, “Improving JOLTS Methodology”, p. 3: [www.bls.gov/jlt/methodologyimprovement.htm](http://www.bls.gov/jlt/methodologyimprovement.htm), downloaded 3/10/2011).