CONGRESSIONAL BUDGET OFFICE
U.S. Congress
Washington, DC 20515

Phillip L. Swagel, Director

June 4, 2020

Honorable Charles Grassley
Chairman
Committee on Finance
United States Senate
Washington, DC 20510

Re: Economic Effects of Additional Unemployment Benefits of $600 per Week

Dear Mr. Chairman:

At the request of your staff, the Congressional Budget Office has examined the economic effects of extending the temporary increase of $600 per week in the benefit amount provided by unemployment programs. Under the Coronavirus Aid, Relief, and Economic Security (CARES) Act, that increase in unemployment benefits is in place through July 31, 2020.[1] CBO estimates that extending that increase for six months through January 31, 2021, would have the following effects:

- Roughly five of every six recipients would receive benefits that exceeded the weekly amounts they could expect to earn from work during those six months.

- The amount, on average, that recipients spent on food, housing, and other goods and services would be closer to what they spent when employed than it would be if the increase in unemployment benefits was not extended.

[1] See Congressional Budget Office, cost estimate for H.R. 748, the CARES Act, Public Law 116-136 (April 16, 2020, revised April 27, 2020), www.cbo.gov/publication/56334; and Julie M. Whittaker and Katelin P. Isaacs, *Unemployment Insurance: Legislative Issues in the 116th Congress*, Report R45478, version 10 (Congressional Research Service, April 10, 2020), https://go.usa.gov/xwCCP.

- The nation’s economic output would probably be *greater* in the second half of 2020 than it would be without the extension of the increase; in calendar year 2021, however, output would be *lower* than it would be without the extension.

- Employment would probably be *lower* in the second half of 2020 than it would be if the increase in unemployment benefits was not extended; in calendar year 2021, employment would be *lower* than it would be without the extension.

The estimated effects on output and employment are the net results of two opposing factors. An extension of the additional benefits would boost the overall demand for goods and services, which would tend to increase output and employment. That extension would also weaken incentives to work as people compared the benefits available during unemployment to their potential earnings, and those weakened incentives would in turn tend to decrease output and employment.

In the second half of 2020, CBO estimates, the signs of the effects would probably be opposite: Output would be greater and employment lower—because workers employed as a result of the boost in demand would have higher average earnings (and contribute more to output) than the people who were not employed (because of the extension’s effect on work incentives) would have had if they were employed. The following simplified illustration shows how output could increase while employment fell: As a result of the extension of the additional benefits, a group of workers with average earnings became employed, and a group twice as large whose earnings would have been less than half the average amount were not employed.

In calendar year 2021, both output and employment would be lower than they would be if the increase in unemployment benefits was not extended. That would occur mainly because the effect of the reduced labor supply would, in CBO’s assessment, last longer than the effect of increased overall demand.

To respond rapidly to your questions, in this letter CBO discusses the direction of the effects of additional unemployment benefits but not the magnitude of those effects. The agency is continuing to develop its capacity to quantify the effects of changes in different types of unemployment benefits.

Background

In CBO's projections, the number of unemployed people remains high after the $600 per week benefit expires at the end of July. In the third quarter of 2020, an average of 25 million jobless people per week are available for work and are either seeking work or expecting to be recalled from a temporary layoff, and the unemployment rate is 16 percent.

Unemployment benefits are provided through a partnership between the federal government and state governments that provides a weekly payment to qualifying unemployed workers. To qualify for unemployment benefits through the unemployment insurance system, most workers must have lost their job through no fault of their own. In addition, the CARES Act created Pandemic Unemployment Assistance (PUA) to provide benefits to the self-employed and others who are working less or not at all for reasons related to the 2020 coronavirus pandemic.

Almost all current recipients of unemployment benefits can receive them through at least December 31, 2020, and depending on the circumstances, many may continue to receive benefits after that date. For example, workers in most states in which the unemployment rate is high enough are eligible for up to an additional 13 weeks of benefits.

Each state administers its unemployment insurance program within guidelines established by federal law. The number of weeks that a person can receive unemployment insurance benefits varies from state to state. PUA benefits are available for up to 39 weeks. The amount of weekly benefits depends on the minimum benefit and an individual's prior earnings. The minimum unemployment insurance benefit amount varies by state. The minimum PUA benefit equals half of the state's average weekly benefit from regular unemployment insurance in four recent quarters. Higher earners receive larger benefits, up to a maximum amount. Maximum regular benefits per week for a single person, for example, range from $235 in Mississippi to $823 in Massachusetts.

Effects on the Ratio of Benefits to Potential Earnings

Before the pandemic, the ratio of unemployment insurance benefits to prior earnings generally ranged from 30 percent to 50 percent. Workers with higher earnings were at the lower end of that range, in part because of the cap on weekly benefits. Prior earnings are a strong predictor of the potential earnings any given person would have if he or she was reemployed. However, it is the ratio of benefits to *potential* earnings that is key to understanding incentives to work.

Potential earnings in 2020 and 2021 for people who have permanently lost jobs are lower, on average, than their prior earnings, primarily because some knowledge that has value only to the previous employer is no longer productive. People who are expecting to be recalled from a temporary layoff also have lower potential earnings than their prior earnings, on average, mainly because some of them will not end up returning to their previous job.

If the benefit of $600 per week was extended through January 2021, benefits would exceed 100 percent of potential earnings for roughly five of every six recipients of unemployment benefits from August 2020 to January 2021, CBO projects. For example, a single worker would have a ratio of benefits to potential earnings of 100 percent if his or her potential earnings were $21 per hour for 40 hours a week in Mississippi or $30 per hour for 40 hours a week in Massachusetts. For people with much lower potential earnings, that ratio is much higher.

If the benefit of $600 per week was extended, fewer than one in thirty recipients would receive benefits—generally the maximum amount in their state—that were less than 50 percent of their potential earnings, CBO projects. For example, for the ratio to be 50 percent for a worker in Mississippi, the worker's potential earnings would have to be about $42 per hour for 40 hours a week; the potential earnings of a worker in Massachusetts with that same ratio would be about $71 per hour for 40 hours a week.

Effects on Consumption

When people become unemployed, they generally consume fewer goods and services. To pay for food, housing, and other living expenses while unemployed, people can draw on their savings, borrow money, sell assets (such as cars or jewelry), or use funds received from other people or the government. Many unemployed people have little or no savings and would face high interest rates on loans. Some people could draw on retirement savings: The CARES Act allows people affected by the pandemic to withdraw from tax-preferred retirement savings accounts without incurring a tax penalty.

The additional $600 per week in unemployment benefits under current law allows people to continue to consume goods and services that they might otherwise be unable to afford and to save for future contingencies. The average amount that recipients spend on food, housing, and other goods and services is, in CBO's assessment, closer to what they spent when employed than it would be without those additional benefits. CBO anticipates that if the additional $600 per week was extended to the end of January 2021, that pattern would continue—in part, because the extension would allow people to make more payments on loans and therefore have greater access to credit in the future than they would have otherwise.

Funding the additional unemployment benefits would, however, increase the federal budget deficit. In CBO's assessment, larger deficits tend to slow the growth of the economy in the long term, thereby reducing overall income and the consumption of goods and services in the future.

Effects on Output

Output is affected by both the overall demand for goods and services and the supply of labor. In the short term, unemployment benefits boost the former and reduce the latter.

Spending of unemployment benefits on consumption spurs demand for goods and services and, as a result, boosts production. Most of that effect occurs near the time that the benefits are received. The effect is stronger, CBO estimates, when the economy is weak and the Federal Reserve does not act to reduce potential inflation by dampening the effect of fiscal policy on the economy.

Because businesses' decisions about investing and hiring depend on the demand for their products, increased demand and production leads to more investment and hiring. In the short term, the increased spending from the additional benefits would have a much larger effect on output than would the increased deficits; in the longer term, those deficits would drive interest rates up—lowering investment and the economy's maximum sustainable output.

Receipt of unemployment benefits also weakens the incentives of recipients to search for and take jobs and the incentives of firms to quickly recall workers from a temporary layoff, especially when benefits exceed a recipient's potential earnings and when going to work increases risks to a recipient's health. A reduction in the supply of labor causes some machinery and equipment to be underused and some people to be in jobs that are not as well-matched to their skills—making it more costly for businesses to produce goods and provide services. As a result, some businesses set wages higher than they would have without the benefits. Some businesses reduce their output and raise their prices above what they would otherwise have been, and others close. Over the longer term, some businesses begin to use machinery and equipment that allows them to use less labor.

How changes in incentives to work affect output varies over time and depends on economic conditions. In April 2020, at the peak of social distancing across the country, the weaker incentives for the unemployed to work probably had little effect on output because so many businesses were closed. When a large number of job seekers who do not receive unemployment benefits (including people who had recently been out of the labor force) are available for every open job, the effect of unemployment benefits on output also tends to be small. CBO expects that for every open job in the second half of 2020, the number of job seekers who are not receiving unemployment benefits will be small, on average, making the effect of those benefits on output larger. If the $600 per week increase in benefits ended in January 2021, it would nonetheless continue to affect the supply of labor afterward because it would take time for recipients of those benefits to find work.

Whether additional unemployment benefits increase or decrease output depends on the relative size of the effects on the demand for goods and services and on the supply of labor. In the second half of 2020, the increase in demand from the additional $600 per week in unemployment benefits would, in CBO's assessment, probably boost output more than the reduction in the supply of labor stemming from those benefits would reduce it. In calendar year 2021, the net effect of the additional benefits would be to reduce output, CBO estimates.

Effects on Employment

The main factors affecting employment in CBO's analysis are the same as those affecting output: overall demand for goods and services and incentives to work. In CBO's assessment, a boost in overall demand from the additional unemployment benefits increases employment of people who, on average, have higher potential earnings than the people who would not be working because of the weaker work incentives stemming from those benefits. Also, the effects on the supply of labor from weaker work incentives differ according to workers' potential earnings. The additional $600 per week in benefits decreases the incentive to work more for people who expect to have lower earnings than it does for people who expect to have higher earnings because that additional amount is a larger percentage of lower-earning workers' potential earnings.

The effects on employment of extending the additional benefits are measured in numbers of people, and each worker is weighted equally. The effects on output are measured in dollars, and each worker's supply of labor is weighted by his or her contribution to that output. Because the reductions in employment stemming from weaker incentives to work would come from people who, on average, had lower potential earnings than the people who became employed as a result of the boost in demand for goods and services, the direction of the total effect on employment could differ from the direction of the total effect on output.

In CBO's assessment, the extension of the additional $600 per week would probably reduce employment in the second half of 2020, and it would reduce employment in calendar year 2021. The effects from reduced incentives to work would be larger than the boost to employment from increased overall demand for goods and services.

Comparison With CBO's Previous Estimates

Per dollar, CBO estimates, the effects on output and employment of an additional $600 per week of unemployment benefits would not be as large and positive as the agency previously estimated they would be for a dollar of unemployment insurance benefits when, in 2012, it analyzed the effects of extending the period for which workers could receive benefits.[2] A comparison of this analysis with that previous analysis of additional outlays for unemployment benefits indicates that, on a per-dollar basis, increasing benefit amounts would reduce the supply of labor by more than would extending the length of time that a worker could receive benefits—especially when benefits exceed the estimated amount that a worker would earn if he or she was employed. Also, the reduction in the supply of labor is greater when a larger fraction of potential workers are receiving unemployment benefits, as is the case now compared with the previous analysis. In addition, the estimated effects on overall demand per dollar of benefits are smaller than they were in the previous analysis because the possibility of social distancing and concerns about the pandemic increase savings and reduce spending on goods and services.

Effects of Other Types of Increases in Unemployment Benefits

The effects of increasing unemployment benefits could differ if the added benefits were structured in some other way. If, for instance, the addition to unemployment benefits was proportional to previous earnings up to some

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[2] See Congressional Budget Office, *Unemployment Insurance in the Wake of the Recent Recession* (November 2012), www.cbo.gov/publication/43734.

maximum amount rather than a fixed dollar amount, CBO expects that for a given dollar of outlays on unemployment benefits, less support for consumption would be provided to people who previously had low earnings. Also, the effects on output and employment would probably be more positive because a proportional benefit would not create especially weak incentives to work for people with low potential earnings.

Some states might have difficulty implementing such a proportional change. Also, states generally do not have consistent data about the prior earnings of self-employed people and many others receiving PUA benefits, which would be necessary to apply a proportional change for those people. States that could implement a proportional change could also combine it with a fixed additional amount. CBO has not examined the economic effects of such approaches in detail.

Further Questions

I hope this information is helpful to you. If you have further questions, please contact me directly.

Sincerely,

Phillip L. Swagel
Director

cc: Honorable Ron Wyden
Ranking Member