

Hearing on "Unemployment in a Volatile Economy: How to Secure Families and Build Opportunity"

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Room 430, Dirksen Senate Office Building

Good morning, Mr. Chairman and distinguished members of the Senate Health, Education, Labor and Pensions Committee. My name is Alan Krueger and I hold the Bendheim professorship in economics and public affairs at Princeton University. I appreciate the opportunity to share my views on unemployment and Unemployment Insurance with you.

In the testimony below I describe some important trends and findings regarding unemployment and job search, and then turn to Unemployment Insurance (UI).

I. UNEMPLOYMENT

According to the Bureau of Labor Statistics' (BLS) definition, "Persons are classified as unemployed if they do not have a job, have actively looked for work in the prior 4 weeks, and are currently available for work."¹ The unemployment rate has been creeping up in recent months, rising from 4.4 percent in March 2007 to 4.9 percent in January 2008 (both seasonally adjusted). It is also worrisome that the average duration of ongoing unemployment spells has been rising for some time, as shown in Figure 1. In January 2001, the average duration of unemployment for an unemployed worker was 12.7 weeks; in January 2008 it was 17.5 weeks. Nearly one in five of those currently unemployed have been unemployed for more than 6 months.

Data from the Gallup Poll indicate that Americans, especially those in middle and higher income groups, are increasingly concerned that it has become more difficult to find a quality job. This trend is displayed in Figure 2. Workers are anxious about the job market, and they are reining in consumption.

Economists have long debated why people are unemployed. Some argue that unemployment is mainly a voluntary affair; people could find work but they choose not to. Others argue that unemployment is involuntary, that there are insufficient jobs available that match the skills of the unemployed. Regardless of the outcome of this debate – and my view is that the truth probably lies somewhere in between -- it is clear that the unemployed are not a happy lot. In a survey of 4,000 Americans that I conducted together with the Gallup Organization in May-August 2006, I found that only 27 percent

¹ Active job search requires that the activity has the potential to result in a job offer without further action on the part of the unemployed. Thus, activities like reading help wanted ads or taking a course are not classified as active job search.

of the unemployed said they were very satisfied with their life while 46 percent of employed people said they were very satisfied with their life. Unemployment also seems to have a lasting effect on people's psychological well-being. A longitudinal study of German workers, for example, found that individuals' life satisfaction dropped in the year they became unemployed and stayed low for at least three years afterwards, even after they found new employment.²

In addition to psychological scars, unemployment has serious economic consequences for the unemployed and the broader population. Jonathan Gruber of MIT, for example, has found that consumption of food, a basic necessity, falls for the unemployed.³ He further finds that the provision of UI benefits reduces the drop in food consumption of the unemployed. And the very existence of unemployment implies that we are not getting the most of our resources, which costs the economy output and tax revenue.

The last two recoveries from recessions could be described as "jobless recoveries". Unemployment lingered and job growth was painfully slow for months after the recessions officially ended. Although no one has a crystal ball -- and it is unclear how long the current slowdown will last, or whether it will be declared a recession by the NBER's Business Cycle Dating Committee -- there are reasons to expect unemployment to linger after the current slowdown ends. In this environment, and in light of available research findings, I think it is particularly appropriate to consider reforms to the UI program, both temporary and permanent.

II. JOB SEARCH INTENSITY

To transition from unemployment into work, the unemployed must search for a job. Economic theory suggests that the unemployed should devote effort searching for a job up to the point that the cost of additional effort is just offset by the expected benefit from that extra effort.⁴ Until recently, job search has been a black box in research on unemployment. How much time and effort do the unemployed devote to job search? How does their search intensity vary with local economic conditions, UI benefits, and personal characteristics? We are now in a position to begin to answer these questions thanks to the availability of the American Time Use Survey (ATUS). The ATUS is a monthly survey conducted by BLS that asks selected individuals who participated in the Current Population Survey (CPS) to report on their activities for a randomly selected day.

For the past several months I have been analyzing data from ATUS on the activities of the unemployed, as part of a study with Andreas Mueller, a visiting graduate student at Princeton University. Specifically, we have pooled together data from all four years of the ATUS, from 2003 to 2006, to assemble a sample of 1,824 unemployed individuals.

² See Andrew Clark, Yannis Georgellis and Peter Sanfey, "Scarring: The Psychological Impact of Past Unemployment," *Economica*, May 2001.

³ See Jonathan Gruber, "The Consumption Smoothing Benefits of Unemployment Insurance," *The American Economic Review*, March 1997.

⁴ This observation was first made by George Stigler in "Information in the Labor Market," *Journal of Political Economy*, Supplement, October 1962.

This sample provides unique information on the activities that unemployed Americans engage in, including job search. Job search activities include preparing and sending out a resume, interviewing for a job, traveling to an interview, and submitting a job application.⁵ We can also compare the time devoted to job search by unemployed Americans to that of unemployed individuals in 13 other countries, using time-use data originally collected by those countries' government statistical agencies. Our results shed new light on the nature of unemployment. Let me summarize seven of our main findings.

First, unemployed Americans devote much more time to searching for a new job than do the unemployed in each of the other countries that we have studied. On the average day (including weekends), 20 percent of unemployed American workers devoted part of their day to searching for a job. For the 13 other countries for which we have comparable data, 10 percent of the unemployed made an effort to look for work on any given day, on average. (The 13 countries are: Austria, Belgium, Bulgaria, Canada, Finland, France, Germany, Italy, Poland, Slovenia, Spain, Sweden and the U.K.) Furthermore, the average unemployed American who spent some time looking for work devoted 2 hours and 40 minutes to job search activities, compared with 1 hour and 40 minutes in the average of the other countries. Of the 13 countries, Canada comes closest to the U.S. in terms of the amount of time the unemployed spend searching for work.

Second, we have found little relationship between UI benefit generosity and time spent searching for a job across countries. One reason why the unemployed spend more time searching for work in the U.S. than in other countries is that the variability in wages, fringe benefits and working conditions across jobs is greater in the U.S. than in other countries. When all jobs are alike, there is little to be gained from devoting more effort to try to find a better job. But when there is wide dispersion in wages and working conditions, the payoff from additional job search is likely to be greater. Another reason why the U.S. (and Canada) has high job search intensity is that average education is relatively high in the U.S., and higher educated individuals devote more time to job search.

Third, within the U.S., those who appear eligible for UI benefits tend to search more than those who are not eligible (because they are new entrants, reentrants or part-time workers). On the average weekday, 33 percent of those who appear eligible for UI and are not on temporary layoff made an effort to search for work, and the average amount of time spent looking for work by those who searched was 170 minutes. For those who are not eligible for benefits, 23 percent searched for work, for an average of 156 minutes. Given that the BLS definition of unemployment only requires active job search at some time in a 4 week period, these figures are notably high.

Fourth, those classified as unemployed by the BLS definition spend considerably more time searching for work than do those who are classified as out of the labor force. Even if we compare those currently unemployed to those who were categorized as unemployed when last interviewed in the CPS but as out of the labor force in ATUS, those currently classified as unemployed are much more likely to search for work on any given day.

⁵ Job training and education are classified separately in ATUS and not included in job search.

These findings suggest that the BLS categories of unemployed and out of the labor force represent distinctly different labor market states.⁶

Fifth, for the period that they are eligible for UI benefits, job search intensity tends to rise the longer that workers are unemployed. Figure 3 summarizes some of our findings in this regard.⁷ The horizontal axis indicates the number of weeks that a worker has been unemployed as of the ATUS survey. (Unfortunately, we can only identify the duration of unemployment for those who are unemployed at least 13 weeks.) The vertical axis shows the average amount of time devoted to searching for a job in minutes per day, counting those who spent no time searching as 0. The solid line refers to those unemployed who are eligible for UI and the dashed line to the ineligible. Search intensity tends to rise for the eligible unemployed as benefits are closer to running out, probably because they are desperate to find any job offer.

Sixth, those on temporary layoff devote very little time to searching for a job, just 12 minutes on the average day. Evidently, workers who are on temporary layoff and expecting to be recalled to their job have little to gain by searching for a new job and consequently spend little time engaged in job searching. This finding is not surprising and adds to the face validity of the data.

Seventh, about 7 percent of the unemployed spend some time engaged in job training or education related activities on the average day. This is almost double the percentage for employed workers. As a group, unemployed workers spend about one third more time in job search related activities than in training or education related activities. The relatively low participation in job training is not surprising given the sharp decline in federal funding of training programs since the early 1980s.

This evidence provides a new window on the activities of the unemployed. It is only possible because of the accumulation of data from the ATUS. The ATUS can and has been used to study many other questions as well, such as how much time is spent caring for children, how much housework do men and women do at home, who cares for elderly adults and how much time do they spend. Given the varied uses of the ATUS and the fact that no other survey collects comparable information, it is most unfortunate in my view that the President's FY 2009 budget eliminates funding for ATUS. The value of the information yielded by the survey for policymakers, researchers, businesses and families vastly outweighs its \$4.3 million cost.

⁶ Corroborating evidence from job finding rates is in Christopher Flinn and James Heckman, "Are unemployment and out of the labor force behaviorally distinct states?" *Journal of Labor Economics*, 1983.

⁷ Be aware that a statistical artifact known as "length-based sampling" affects the trends in the graph. Individuals are only included in the sample if they are unemployed. The less people search for work, the longer they are likely to remain unemployed. Thus, the composition of the sample changes with the duration of unemployment. Those who have a proclivity to search very little are likely to be over represented among the long-term unemployed, which will depress the average search time.

III. REFORMS TO UNEMPLOYMENT INSURANCE

The main goal of UI is to provide insured unemployed individuals with cash assistance to tide them and their families over until they can find an appropriate job. As such, the UI program helps recipients stay out of poverty. Another role that UI serves is as an automatic stabilizer. When the economy turns down in a region, UI benefits are automatically paid out, which stimulates the economy.

As with all insurance programs, tradeoffs are involved. Paying benefits to the unemployed could induce some people to stay unemployed longer than they otherwise would.⁸ Economists have long noted that reducing the burden of unemployment increases the opportunity cost of work, leading some unemployed workers to delay their return to work.⁹ Such an incentive effect, however, is not a sign of failure. It simply means that the unintended consequences must be weighed against the desired effects of the program, and an appropriate balance struck. In addition, recent research by Raj Chetty of the University of California, Berkeley, argues that it is desirable from society's perspective to provide job seekers who have inadequate savings sufficiently generous UI benefits to enable them to stay out of work longer and search for an appropriate job.¹⁰ Longer spells of unemployment, to the extent they occur, are not necessarily undesirable if they enable workers to find jobs that fully utilize their skills. Thus, longer unemployment spells are not always an unintended consequence of UI. In a downturn when good jobs are harder to find and spells of unemployment are longer, I would also argue that the balance of intended and unintended consequences shifts, and we should worry more about cushioning the blow of unemployment.

Reforms could make UI a more efficient and more effective program. Here I highlight four reforms that I would recommend considering.

First, the automatic triggers that temporarily turn on extended benefits without Congressional action are not set at realistic levels. The state triggers are connected to the insured unemployment rate; that is, the fraction of covered workers who receive benefits. The insured unemployment rate must exceed 5 percent for extended benefits to be provided, and must be 120 percent above the rate in the corresponding period in each of the prior two calendar years. Because insured unemployment has drifted down relative to the BLS's unemployment rate (which includes all unemployed workers, insured and ineligible), and because the natural rate of unemployment has declined, it is very unlikely

⁸ It should also be noted that those unemployed who are not eligible for UI have a stronger incentive to search for and accept a job if UI benefits are more generous because, in the event that they find a job and are subsequently laid off from it, they will qualify for more generous benefits. For some evidence on this effect, see Phillip Levine, "Spillover Effects Between the Insured and Uninsured Unemployed," *Industrial and Labor Relations Review*, October 1993, pp. 73-86.

⁹ See Alan Krueger and Bruce Meyer, "Labor supply effects of social insurance," *Handbook of Public Economics*, A. J. Auerbach & M. Feldstein (eds.), 2002, for a survey.

¹⁰ See Raj Chetty, "Moral Hazard vs. Liquidity and Optimal Unemployment Insurance," unpublished working paper, University of California, Berkeley, February 2008. Recognizing the competing effects of UI benefits, Chetty provides evidence suggesting that the optimal benefit level exceeds 50 percent of a worker's pre-layoff wage.

that a state will automatically trigger extended benefits. In practice, the automatic triggers have become irrelevant.

In March 2002 I testified before the Senate Banking committee and recommended reforming the automatic triggers for extended benefits. The triggers have not been modernized. If more reasonable automatic triggers are not put in place, I would encourage the passage of a temporary measure to extend the maximum duration of benefits in the current economic slowdown, especially in those areas with higher unemployment. Extended benefits are well targeted to a population that is very much in need of assistance, and that population is growing.

Second, the financing of UI could do more to stabilize the economy and discourage layoffs. The federal government sets minimum standards for state unemployment insurance programs and has a history of encouraging experience rating. Experience rating is the practice of charging a higher UI contribution rate from employers with a worse history of laying off workers. This is a unique feature of the American system of UI, and may in part help to account for the relatively low unemployment in the U.S. compared with other economically advanced countries.

Unfortunately, the degree of experience rating has severely lapsed. Better experience rating could be accomplished by increasing the 5.4 percent maximum tax rate on high-layoff employers, and by requiring the states to have at least five different rates and to spread employers among the rates. Some states have only two rates. In addition, I would recommend that the per employee taxable earnings cap – which range from \$7,000 to \$10,000 in half of the states – be raised, which would allow better experience rating at lower tax rates and make the financing of the program less regressive. Raising the caps and lowering the rates would also increase demand for less skilled workers. Improved experience rating would discourage employers from laying off workers, and help to internalize the externalities layoffs impose on society. These changes could be made in a way that is revenue neutral, so the tax on employers as a group would not change.

A study by Phillip B. Levine of Wellesley and David Card of U.C. Berkeley estimates that the unemployment rate would decline by six-tenths of a percentage point if industries were fully experience rated – that is, if employers in an industry were required to pay the full additional costs of unemployment benefits for layoffs in that industry.¹¹

Third, unemployed workers who are otherwise eligible for UI but are searching for a part-time job (e.g., because of family obligations) are ineligible for benefits in most states. These workers pay into the system, but are prevented from receiving benefits when they and their families need them. States could be required to expand eligibility. Workers who would be made eligible for UI benefits as a result of this reform would be primarily single-parent, female, and low-income workers.

¹¹ See David Card and Phillip B. Levine. "Unemployment Insurance Taxes and the Cyclical and Seasonal Properties of Unemployment." *Journal of Public Economics*, January 1994.

Last, but not least, it seems to me that the credit crunch that the economy is currently experiencing presents a unique situation in which a temporary increase in the level of UI benefits may be particularly timely. Unemployment benefits help the unemployed maintain a level of consumption when their income drops. Benefits replace 50 percent of lost earnings, but the replacement rate is often less than that because benefits are capped, often at less than \$400 a week. The average weekly UI benefit as a percent of the average weekly wage of covered workers was only 34.5 percent in the third quarter of 2007 according to Labor Department data. Even with UI benefits, many of the unemployed are forced to borrow to pay their bills. Borrowing is difficult in the current credit crisis. In addition, many adjustable rate mortgages are resetting, requiring higher monthly payments. It seems to me that even the short-term unemployed will face pressure meeting mortgage payments. A temporary increase in UI benefits can help to forestall mortgage foreclosures for a vulnerable population. Reforming UI more generally, as well as temporarily boosting benefits and extending benefits, would help stabilize the economy and dampen the economic slowdown.

Thank you for your attention and I am happy to answer any questions you might have.

Figure 1. Average Duration of Ongoing Unemployment Spells, 1948-2008 (seasonally adjusted). (Source: BLS.)

Weeks of Unemployment

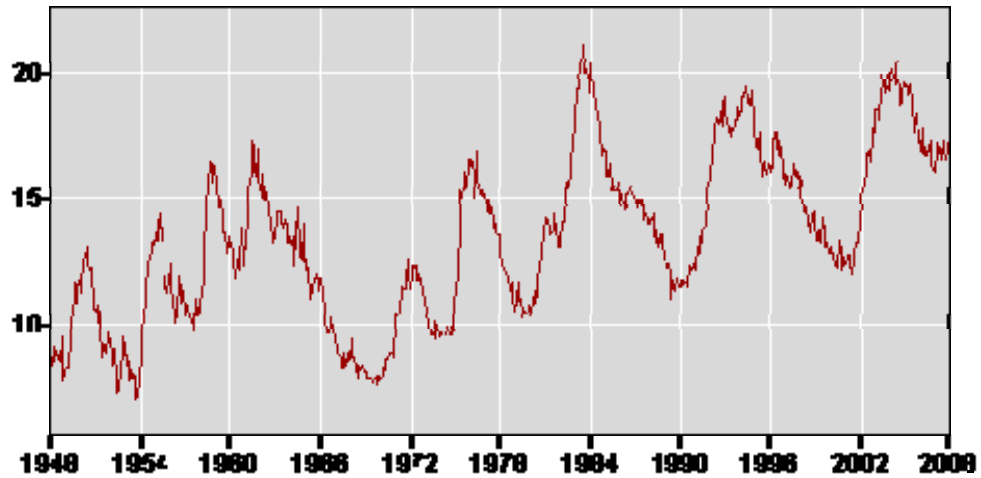
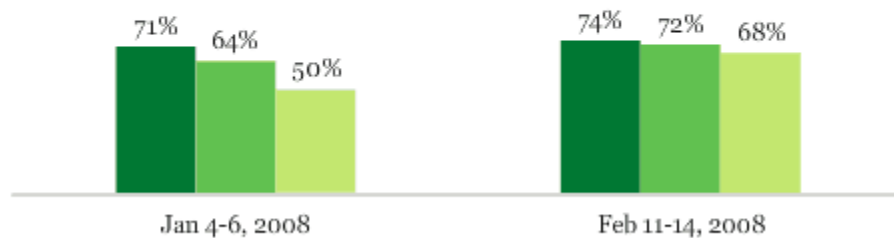


Figure 2. People increasingly believe it is a bad time to search for a good job. (Source: Gallup Poll.)

Thinking about the job situation in America today, would you say that it is now a good time or a bad time to find a quality job?

Percentage saying "bad time," by annual household income

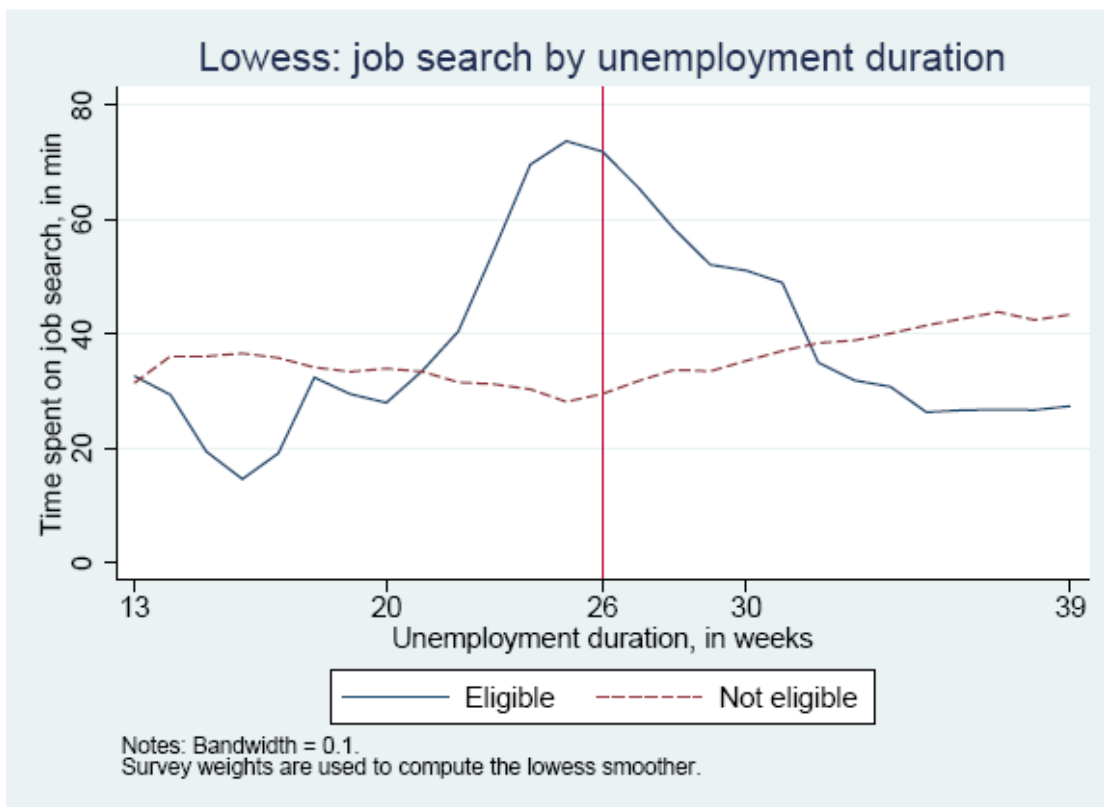
■ Less than \$30,000 ■ \$30,000 to <\$75,000 ■ \$75,000 or more



GALLUP POLL

Figure 3: Smoothed graphs of amount of time spent searching for work per day by duration of unemployment for eligible and ineligible unemployed job seekers

(Source: Krueger and Mueller, based on ATUS)



Note: The sample includes weekends as well as weekdays. Time spent searching for a job is measured in minutes per day.