With record unemployment filings, federal stimulus will help, but more is needed

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COVID-19 will plunge the United States economy into a recession. Credit: James Yarema on Unsplash

As an economist and director of the California Policy Lab, Till von Wachter is continually spearheading research projects and policy recommendations related to labor and employment as well as homelessness, education and crime.

As the U.S. economy further slows because of how the COVID-19 pandemic has forced so many businesses to close, UCLA Newsroom asked von Wachter, who is also the associate dean of research for the division of social sciences in the UCLA College, to help parse through current employment statistics, why the $2.2 trillion federal stimulus package called the CARES Act—which was signed into law March 27—is so critical and what its immediate and far-reaching effects might be for U.S. workers and the economy.

How do you interpret the unemployment numbers that came out April 2?

The number of new claims to unemployment insurance—6.6 million—was deeply alarming because that number is so much higher than what we've seen in previous recessions. Moreover, these numbers do not capture the many people out of work that are self-employed, have low wages, or for some other reason do not qualify for unemployment insurance. As CNBC noted, even in the worst week of the Great Recession, the number of claims were only 665,000 in March of 2009. The highest since the 1960s was 1,073,500 in the 1982 recession. Having studied unemployment, recessions and the policy responses to them for most of my academic career, I'm deeply concerned that if policymakers don't act quickly, we could see a recession the likes of which our country has never experienced before. It will impact Americans for decades to come. There is still hope that the economy will turn back to normal after the Covid-19 pandemic is contained, but prolonged large-scale unemployment may be hard to reverse.

What will this mean for the U.S. economy and

Americans who could be laid off in the coming weeks?

I have studied a range of situations where workers were hit by a sudden shock in the labor market, such as a job loss when a business suddenly lays off a large number of workers. The key here is to compare people who lost their jobs to a counterfactual of luckier workers who kept their jobs and that otherwise would have looked like them. The result from my research is that a worker with a steady job at a good employer that loses their job during a mass layoff in a recession will die 1.5 years sooner than they would have if they had not been laid off. When you extrapolate that to an expected unemployment rate of 10% (approximately 10 million additional unemployed workers, which given last week's numbers may be a conservative scenario), my back-of-the-envelope calculations suggest a loss of 15 million life years. Beyond increased mortality, in separate research I have found these workers also suffer immediate and permanent earnings losses. Again, if those accrued to 10 million workers, it would amount to over $1 trillion dollars in earnings capacity lost over their lifetimes.

It's also important to keep in mind more than 6 million individuals will graduate high school or obtain a college degree this year, and about 13 million workers age 16-24 are currently in the labor force. Hence about 20 million young individuals are of particularly high risk of exposure to a recession. Existing evidence suggests that unlucky labor market entrants suffer losses in earnings that last 10 to 15 years, depending on the severity of the recession. Yet, it appears their socioeconomic status declines again in middle age, and several studies have found that they experience higher rates of death over the long term. For example, entering the labor market during a large recession appears to reduce life-expectancy of young workers by about half a year. There would be an additional 10 million of life years lost from a prolonged recession.

Will the CARES Act help?

The CARES Act is a good start. It includes significant funding spread out in a variety of ways to help sustain the economy while people practice safe distancing to defeat COVID-19. The additional pandemic unemployment assistance provided to the self-employed and others not covered by unemployment insurance benefits is of course an important aspect of the law. Yet, I argue in a recent proposal that states need to act decisively and creatively to quickly scale up programs included in the CARES Act.

The funding Congress included for several programs that help firms to keep workers on their payroll could be a game-changer. This includes federal funding for "short-time compensation," or STC, programs, sometimes also called work-sharing, as well as short-term emergency loans that include provisions for job stability.

In the same way that we are all "sheltering in place," state employment departments—the agencies that administer unemployment benefits in every state—can use STC programs and equip companies to keep their employees in place. Under STCs, firms are able to reduce the hours of a large group of their employees (instead of laying just a few of them off), and employees can partially make up the difference in pay through receiving unemployment benefits. For a state like California that already has a functioning STC program, these STC benefits will be paid entirely by the federal government. This could lead to substantial saving for the state's finances that will be likely very stretched in other ways.

Even better, the CARES Act also included a substantial subsidy for firms that were impacted by COVID-19 to help pay their workers' wages. A small to mid-size firm that pays average wages could reduce the hours of their workers by 50% through shared-time compensation and have up to half of the remaining 50% of wages paid for by the federal government. This would be an instantaneous reduction of their wage bill by 75% while workers are kept on the job instead of flooding unemployment offices. Some businesses may find it hard to pay for even part of their workforce, perhaps because of large reductions in revenues or substantial fixed costs. The CARES Act also provides struggling businesses with the option to apply for short-term emergency loans through the Small Business Administration that would help them pay rent, wages and other operating costs. The key is that the repayment of these loans can be waived if the firm refrains from laying off their workers. Overall, firms now have a range of options to adjust to the economic conditions without laying off their workers.

How would states use short-time compensation?

Twenty-six states, including California, already have STC programs, meaning about 70% of the U.S. workforce could be covered. There is also funding in the law for the administrative costs of expanding these programs. For those 26 states, the federal government agreed to pay 100% of the benefits under STC programs.

Unfortunately, many employers are not currently aware of the program. Yet, states can be proactive in making the STC more attractive than layoffs to employers. Typically, if a firm lays off workers who receive unemployment insurance benefits, its payroll tax increases to help offset the costs to the unemployment insurance system. Yet, states could choose to pass on some of the cost-savings (from the federal government paying 100% of STC benefits) by committing not to raise the payroll tax for those firms that use STC instead of unemployment insurance. This incentive would help states to make a strong case for employers to use this program.

The key is to dispatch these funds quickly because failure to do so will likely lead to skyrocketing claims for unemployment insurance and serious bottlenecks in processing claims. It can also lead to substantial long-term effects on the income and health of people who are losing their jobs, young labor market entrants and others directly affected by the economic crisis. Unfortunately, many states' STC programs are understaffed, such that there is a concern that bottlenecks may arise. In a recent proposal, I outline a proposal as to how states could quickly enroll thousands of firms despite these issues, such that these problems could also be surmounted.

The CARES Act also included $100 million in start-up grants for states that do not yet have STC programs, and if they do create them, the federal government will fund 50% of the benefits. While this is less than existing programs receive, it is still a great deal for workers, for firms, and for states because it means fewer layoffs, lower payroll taxes, and lower program expenditures, respectively.

More information: A Proposal for Scaling Enrollments in Work Sharing (Short-Time Compensation) Programs During the Covid-19 Crisis: The Case of California: www.econ.ucla.edu/tvwachter/co … _memo_vonWachter.pdf

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