Job Destruction

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by Brian Wesbury, Robert Stein of First Trust Advisors

Normally, we're not big fans of enhanced unemployment benefits. But the current severe economic contraction brought about by the Coronavirus and the government-mandated shutdowns of businesses meant to stop the disease is a completely different animal from a normal recession. It's not just that people are staying away from certain economic activities because of the virus: the government is *requiring* businesses to shut down, magnifying job losses across the country.

Initial jobless claims averaged 216,000 per week in the four weeks ending on March 7, before the shutdowns. That's a total of 863,000, which was very low by historical standards, particularly relative to the size of the labor force. In the four weeks since then, 17.1 million workers have filed claims, blowing away previous records.

Many of these layoffs were the direct result of the government forcing businesses to shut their doors. When people are being deprived of their livelihoods by government fiat it resembles a "taking" under the Fifth Amendment of the US Constitution. In this unique situation, unemployment compensation resembles a "just compensation" for that taking.

The problem is that the boost to unemployment benefits enacted by Congress is over-kill for many workers, leading to perverse incentives. For example, let's take a worker in California earning $46,700 per year. Normally, a layoff would give them six months of unemployment benefits at a rate of $450 per week, which is an annual benefit rate of $23,500, about half of what they were earning when they worked.

But Congress is now throwing in an extra $600 per week for unemployed workers, for four months. That means for four months these workers will get $1,050 in benefits per week, which translates into an annual benefit rate of $54,600, which is even more than they were earning when they were working!

Because the extra $600 is a flat extra benefit, the gap between what unemployed workers can get now versus what they were earning when they worked is even larger for lower-earning workers. And it's not just deep-blue states like California. In Texas, for example, unemployed workers who previously earned up to $58,000 per year will be better off unemployed, at least for the first four months.

Yes, as we've noted the extra benefits only last for four months. But it's hard to believe there won't be enormous political pressure to extend the length of those extra benefits come the summer when they'd otherwise expire. After all, the unemployment rate is still likely to be 10% or more.

Now think of what this means when we re-open the economy. Some workers will go back to work because they might fear their job disappearing if they hold-out. But many won't want to give up the higher payments and businesses will now be competing with government for workers at the same time they'll be digging out of a huge financial hole. In fact, many low margin businesses may not be able to afford those higher wages. Don't get us wrong; we like faster wage growth; what we don't like are government policies that create perverse incentives to avoid work once it becomes more available.

If wages go up because of bad policies that will leave less room for businesses to hire, leading to a more prolonged surge in unemployment and a slower return to the standard of living we had before the virus struck.

Early in the Great Depression, the Hoover Administration urged companies to maintain wages in spite of deflation. The idea was that if wages were kept high workers would have more purchasing power, boosting output. But workers who kept their wages were *already* getting a boost from falling prices. Meanwhile, firms that kept wages high wouldn't hire new workers. It made the Depression worse, not better. By boosting unemployment benefits, the government has put businesses in a position where they have to boost wages, indirectly making the same mistake as President Hoover.

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