

January 27, 2009

## TEMPORARILY INCREASING UNEMPLOYMENT BENEFITS IS BETTER TARGETED AND MORE STIMULATIVE THAN SUSPENDING TAXATION OF UNEMPLOYMENT BENEFITS

By Sharon Parrott

Both the House and Senate recovery packages include a \$25 per week temporary increase in unemployment insurance benefits. Economists, including Mark Zandi of Moody's Economy.com, routinely rate increased unemployment benefits as among the most stimulative provisions under consideration. Zandi estimates that every dollar spent on increased unemployment benefits increases economic activity by \$1.63.

The Senate package also would temporarily suspend taxation of up to \$2,400 in unemployment benefits. The suspension of taxation is projected to cost \$4.7 billion in 2009. Using that money to fund a larger temporary increase in unemployment benefits would likely have stronger stimulative effects.

Providing a temporary, across-the board, increase in unemployment benefits is likely to be more stimulative than suspending taxation on jobless benefits because the across-the-board benefit increase would target more of the benefits on lower-income unemployed workers, who are more likely to spend (rather than save) the additional money, thereby boosting economic activity.

- *Suspending taxation of UI benefits provides no help to jobless workers with incomes too low to owe federal income taxes.* Many jobless workers have already been out of work more than six months, and the labor market forecasts are bleak. Unemployed workers who do not have enough earnings, unemployment benefits, or other taxable income to owe federal income tax will get no additional money to spend from a suspension of taxation. A couple with two children needs at least \$26,000 in taxable income to owe federal income taxes in 2009.
- *Among those who have incomes high enough to owe federal income taxes, suspending taxation of UI benefits provides significantly larger benefits for higher-income households than for moderate-income households.* The Tax Policy Center analyzed a proposal to suspend taxation on all unemployment benefits (not limited to the first \$2,400). Under this proposal, the typical taxpayer in the lowest income quintile who benefited from the suspension of taxation would receive a tax cut of \$184 while the typical taxpayer in the highest quintile benefiting from the suspension of taxation would receive an average tax cut of \$1,019. This disparity occurs for two reasons. First, higher-

income individuals qualify for higher unemployment benefits, since benefit levels are based in part on prior earnings. Second, higher-income taxpayers are in higher tax brackets.

- *If the suspension of taxation is limited to the first \$2,400 in unemployment benefits, high income households would still benefit substantially more than lower-income households.* A household in the 10 percent tax bracket would receive a \$240 benefit from the suspension of taxation, if the household has at least \$2,400 in unemployment benefits. A household in the 28 percent tax bracket receives a \$672 benefit.
- *Lower-income unemployed workers are more likely to spend rather than save additional benefits.* Targeting additional benefits to lower income households produces a larger increase in consumer expenditures and a bigger boost to the economy.
- *Suspending taxation of unemployment benefits in 2009 will provide virtually no stimulus until 2010.* According to the Joint Committee on Taxation analysis, 80 percent of the benefit from this provision will come in 2010 and only 20 percent will come in 2009. By contrast, a temporary increase in unemployment benefits can start to go out in 2009.