MISSOURI’S COST OF UNEMPLOYMENT

by

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For most of the 1990s the unemployment rate in the state of Missouri (MO) has been noticeably lower than the national unemployment rate (Figure 1). And although it exhibits significant variability, it has averaged well below the national trend. During the latest downturn, however, Missouri experienced a significant increase of unemployment much earlier than the nation as a whole, and it has yet to show signs of recovery. In fact, in June 2002 the state registered the steepest annual drop in employment in the country. Furthermore, since May 2004, MO’s unemployment has not only outpaced the national rate but has also continued to trend upward. What this data suggests is that, although during the 1990s goldilocks economy Missouri workers fared better when compared to those in the U.S. as a whole, they have also suffered disproportionately more from the downturn.
What has this increase in unemployment meant for the state of Missouri and its residents and is it possible to quantify its economic impact? This special report provides one answer to these questions by computing the cost of unemployment.

The Cost of Unemployment

Measures of the impact of unemployment are generally concerned with two types of costs—direct and indirect. The direct costs of unemployment gauge the actuarial costs to the state of paying unemployment insurance (UI) and other welfare benefits to jobless recipients. Of course, an increase in unemployment does not just mean an increase in state outlays in terms of UI and other benefits. It also means real loss of income and output for the economy as a whole. These are generally captured when calculating the indirect costs of unemployment.

Indirect costs are two types: economic and social costs. Measures of the economic costs of unemployment aim to capture the difference between potential and actual output. Had the jobless been gainfully employed, they would have contributed to the production of goods and services in the economy and, therefore, to growth. This loss in output is usually called the economic (or opportunity) cost of unemployment. In addition to the foregone output, the economic indirect costs also include the costs of increased poverty and income inequality.

Loss of output, however, is too narrow a measure of the cost of unemployment, because the unemployed are not simply unutilized factors of production. Unemployment brings numerous other non-pecuniary costs, which are generally called the indirect social costs of unemployment. Unemployment results not just in the loss of income, but also in

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1 See for example the U.S. Department of Labor guidelines for states for determining the reserve adequacy of the unemployment insurance trust fund (1981). See also Kulp (1932-33).
2 The difference between potential and actual output due to changes in the unemployment rate have most famously been summarized by economist Arthur Okun whose empirical work in the 50s and 60s produced a relatively steady relationship between changes in unemployment and gross national product. Okun found that a one percent increase in unemployment generally produced a 3 percent gap in GNP. This steady 1-to-3 elasticity ratio has been termed Okun’s law (Okun, 1962).
3 Winkelmann and Winkelmann report that the non-pecuniary effects of unemployment are in fact much larger than those that stem from the loss of income (1998).
the deterioration of human capital and employability. It is also linked to an increase in certain crimes and health costs. It fosters social antagonism, exclusion, alienation, and stigmatization (Forstater, 2003).

The calculation of the cost of unemployment is a complicated matter for two main reasons. Most importantly, it is difficult (if not impossible) to assign a monetary value to the indirect costs of unemployment (both economic and social). Secondly, while the direct costs are much easier to calculate, they must be interpreted with care, because state payments such as unemployment benefits narrowly represent the costs to the state, while at the same time they correspond to a benefit for the unemployed. Payments for UI have been implemented precisely to offset the high economic costs associated with unemployment. Thus they are both a cost and a benefit.

The C-FEPS measure COU-MO (Cost of Unemployment for Missouri) aims to quantify the economic cost of unemployment in Missouri by suitably dealing with the impact of unemployment insurance payments. In our measure, we will strictly focus on the loss of income to persons and the state of Missouri as a whole. This loss in income includes the personal loss to those who are unemployed but also to all others who would have benefited had this income been spent on goods and services throughout the economy. In other words, firms lose because of foregone sales and profits, individuals and their dependents lose due to the general fall in income, and the state loses due to foregone sales and income tax revenue. Our measure also recognizes that the direct cost to the state in terms of UI payments has a mitigating effect on the loss of income from unemployment.

C-FEPS Measure of the Cost of Unemployment for Missouri (COU-MO)

The present measure of the cost of unemployment for the state of Missouri has two components. First, it includes the opportunity cost of foregone income by employable Missouri residents, who are ready, willing and able to work but cannot find employment. This measure subsumes the forgone (income and sales) tax revenue which the state would have collected had these individuals been gainfully employed. We look
both at the cost to Missouri residents and to the state of Missouri. However, because the state makes unemployment insurance payments to unemployed individuals, these payments and their corresponding multiplier effects have a dampening and countercyclical effect on the state economy. Therefore, our COU-MO measure includes a second component that accounts for UI payments, which we compare to what the cost of unemployment would have been had these payments not been made.

### TABLE: The Cost of Unemployment in Missouri, 2004

<table>
<thead>
<tr>
<th></th>
<th>Not accounting for UI payments</th>
<th>After accounting for UI payments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Income Lost</td>
<td>$ 6,736,539,855</td>
<td>$ 5,676,101,577</td>
</tr>
<tr>
<td>Total State Income Lost</td>
<td>$ 534,263,187</td>
<td>$ 1,049,439,187</td>
</tr>
<tr>
<td>Total Income Lost (per unemployed individual)</td>
<td>$ 37,003</td>
<td>$ 31,178</td>
</tr>
<tr>
<td>Total State Income Lost (per unemployed individual)</td>
<td>$ 2,935</td>
<td>$ 5,764</td>
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</tbody>
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The cost of unemployment in terms of total income lost in the state of Missouri during 2004 was a whopping $5.676 billion. If the state had not made unemployment insurance payments, it would have been much higher – over $6.7 billion. Since these figures represent the income lost due to unemployment, they also subsume the lost tax revenue to the state, which amounts to over $534 million. If we add the direct cost of unemployment insurance to the foregone state tax revenue, we see that the cost to the state rises to over $1.049 billion.

The table also shows the total income lost to MO’s economy per unemployed individual. This figure should not be interpreted to mean that, if a jobless individual were employed, he or she would have earned $37,000 in wages. Rather the figure...
calculates both the foregone individual wages and their foregone multiplier effects. This is because when an individual is unemployed, she or he would lose not only the earnings but also the benefits that come from buoying economic activity as a result of spending these earnings. After accounting for UI, the number drops to $31,178 because UI offsets the loss of income by the amount of the UI payment and its multiplier effect.

Finally the table shows that the cost to the state per unemployed individual is $5,764, which includes the direct cost of paying unemployment insurance and the opportunity cost of foregoing $2,935 in income and sales tax revenue.

Figures 2 and 3 show the historical data for these measures since 1998 (the first year for which adequate state UI data is available). If we look at the trend since 1998 in Figure 2 we see a sharp increase in the cost of unemployment during the latest economic downturn. Irrespective of which measure we consider (with or without UI payments) the cost of unemployment (unadjusted for inflation) has more than doubled in a matter of six years from its trough in 1999.
Figure 3 shows a small decline in 2004 in the measure of state costs, which includes unemployment insurance payments. There is little cause for cheer, however. In March of 2003 Missouri’s unemployment insurance trust fund went bankrupt forcing the state to borrow money from the U.S. Treasury in order to pay benefits to eligible claimants. This in turn prompted reforms to MO’s unemployment compensation system to restore solvency. Some of the changes included increases in employer contribution rates and the taxable wage base. But the reform also established conservative caps on weekly benefits and a series of ever more punitive means test for eligibility. In sum, in the face of still rising unemployment in Missouri (see Figure 1) and falling state unemployment insurance payments, the safety net which the state provides is being eroded. Coupled with the aggressive budget cuts on other social spending, the countercyclical effect of state spending will continue to diminish. We should thus expect that, because the state is strapped for cash to relieve the loss in income from unemployment, the cost of unemployment in Missouri would continue to rise in 2005.
State Budgets and the Cost of Unemployment

Since Nixon’s Presidency revenue-sharing programs aimed to send federal funds to states for various social programs. This led to increased state responsibility for program decision-making, and soon thereafter increased responsibility for funding these programs. The era of devolution resulted in greater burdens on states to provide social
States are not always able to deal with the financial burden for social programs, especially in recessions. Unlike the Federal government, they are constitutionally and operationally constrained in their spending.

As we have seen over the last two years the state of Missouri could not deal with the budget crisis on its own. To meet UI payments it had to turn to the Federal government to borrow; it also slashed spending and increased taxation. In April 2005, Missouri implemented aggressive spending cuts in Medicaid which benefits the low-income families and people, will become ineligible for Medicaid. Thousands more will have to pay for part of their medical bills, and for others, eligibility requirements will become more stringent.

What does all of this mean for the state of Missouri? Quite possibly, it means that the state will be at the end, and not at the beginning, of the economic recovery. The AFL-CIO reports that since 2001 Missouri has experienced heavy job losses in industries, which generally offer high wages and benefits. Between January 2001 and October 2004, Missouri lost 33,400 jobs in manufacturing and 9,800 in information technology. Outsourcing too has worsened Missouri’s job picture. One estimate is that 14,677 jobs have moved south of the border as a result of NAFTA (AFL-CIO, October 2004). This job loss has put downward pressure on wages. Average wages in Missouri’s growing industries are 32% lower than in Missouri’s shrinking industries. At the same time health coverage steadily disappears from many compensation packages. In 2003, 620,000 residents of Missouri were uninsured, which is an increase of 18.3% over just 3 years. Finally, the AFL-CIO reports that in 2003, 602,000 Missourians were poor, an increase of 16% since 2000, and that personal bankruptcies have increased 46%.
The Missouri job market has become increasingly more precarious. Jobs are leaving the state, wages and benefits are falling and more and more people cannot rely on state and federal benefits for basic support. During the first nine months in 2004 nearly 57,000 people in Missouri exhausted their eligibility for UI before finding employment. The cost of unemployment in terms of lost income in 2004 was $5.676 billion. But behind the numbers stands a more fundamental job crisis.

REFERENCES:


