

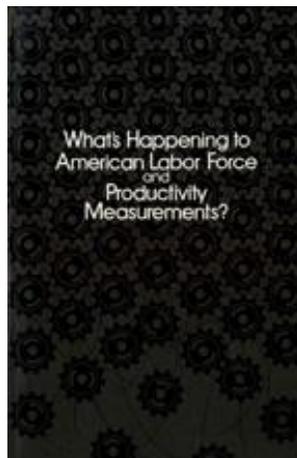
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# Policy Analysis and the Current Population Survey Data

Leon Taub  
*Chase Econometrics*



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# 3

## **Policy Analysis and the Current Population Survey Data**

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### *Introduction*

The Current Population Survey (CPS) provides a wealth of data on labor force and employment conditions within the U.S. economy. Every month its importance is highlighted by one of the most widely quoted U.S. economic statistics—the previous month’s unemployment rate. Expansion of the survey in terms of the number of people covered and the number of questions asked has led to the regular publication of detailed indices of unemployment rates by type of occupation, by major industry and class of worker, by age, sex, and race, by region and by reason of unemployment. The additional information on the labor force has led to the provision of a smorgasbord of unemployment measures based upon varying definitions of unemployment and labor force.

As important as the monthly unemployment rate is, my focus on it thus far may have the effect of understating the breadth of the CPS data for statistical analysis for two important reasons. First, the collection of the sample involves the surveying of the same household for eight months, with an additional eight month break in the middle. Thus the data base contains a significant amount of longitudinal as well as cross-sectional time series information. Second, the supplementary surveys and data, particularly the March ques-

tions on family income, add a wealth of additional information. For these reasons, the CPS data base is one of the most valuable data sources in the United States.

### *The Key Policy Questions*

Each of us has his/her own mental list of key economic policy questions. Some of the major types of questions, presented in an order which relates to my presentation but not meant to imply any judgment of relative importance, are:

#### *Macroeconomic Questions*

- (1) How much national income has been/is being lost due to the incomplete utilization of labor?
- (2) To what extent is “tightness” in the labor markets adding to inflation?

#### *Microeconomic/Programmatic Questions*

- (3) To what extent are labor market imperfections impeding economic growth?
- (4) To what extent do transfer payments reduce employment and job search incentives?
- (5) How many unemployed workers could be aided by alternative programmatic actions?

#### *Sub-national Data Questions*

- (6) What major occupation/skill classifications and regional locations show the greatest job vacancy/unemployed worker imbalances?

#### *Social/Personal Questions*

- (7) What are the social and personal costs of current unemployment levels?

While this list is certainly not exhaustive, it is indicative of the types of important policy questions which can be asked. The first two questions—lost income and inflationary

pressures—reflect the macroeconomic costs of employment changes. The next three questions reflect microeconomic level questions and programmatic issues. Alternative programmatic actions include the traditional questions of direct employment versus training subsidies versus trickle down programs versus public works spending. The issue of personal incentives has already become a key determinant of policy as it affects “rich” people who once faced marginal tax rates of 50 percent to 70 percent. Someday “supply side” economics may be applied to the working poor who face disincentives at rates as high as 60 percent to 100 percent earnings. The question of labor market imperfections, which currently seems to be out of favor as a research topic, may be an extremely important aspect of our current economic situation as I will note later.

The sixth question on the distribution of employment is important because it asks whether the CPS can be an information source which would directly remove some barriers to the efficient use of our nation’s human resources. The answer to this question also has important implications for the optimum distribution of federal resources by type of expenditure and by region. The importance of the final question, which relates to the social and personal hardships faced by Americans under current labor market conditions, is, I hope, obvious to all.

### *The CPS and the Macroeconomic Policy Issues*

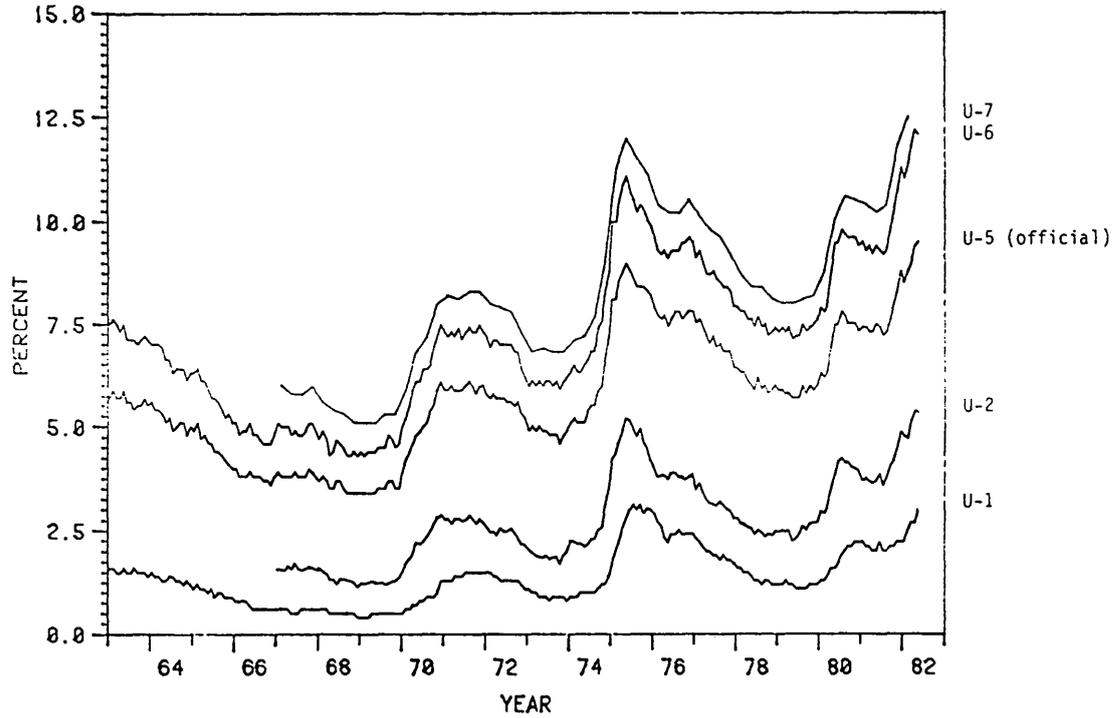
The value of the CPS in answering many of these critical policy issues should not be underestimated. While we can argue about the exact definition of many of the terms in the survey and the alleged biases in both directions, the CPS usually provides unambiguous answers to the two key “macroeconomic” policy questions. Furthermore, any limitations of the “official” key unemployment rate

measure are offset by the availability of supplementary data and the exhaustive analysis of these data which has already been accomplished.

Any uncertainty surrounding the current state of the labor market, as it relates to the macroeconomic issues, does not stem from confusion on the definition of the phrase "hidden unemployment," the phrase "looking for work," or the labor market attachment of teenagers; rather, uncertainty can only occur if people do not understand, or prefer to obfuscate, phrases such as "9.5 percent" (the current unemployment rate), "10.5 million" (the current number of unemployed Americans), "5.9 million," (the number of people who lost their last job) or "50 percent" (the black teenage unemployment rate). Certainly we are utilizing our labor force extremely ineffectively, and labor market "tightness" is providing little, if any, inflationary pressures on wage rates.

Some confusion relating to the macroeconomic issues may arise when the unemployment rate is between 4 percent and 6 percent. However, even in these ranges sufficient supplementary data are provided to obtain good estimates of the macroeconomic impacts of labor force conditions. Furthermore, criticisms of the CPS unemployment rate data usually relate primarily to the definitions employed. Even if the various proposed changes were adopted, the adjustments would primarily affect the reported level rather than reported changes in the unemployment rate. As is shown in Figure 1, fluctuations in the unemployment rate are quite similar, no matter which unemployment rate definition is used. The macroeconomic implications, therefore, would not be severely affected by shifting the definitions of the "official" rate. By contrast, the problem in defining policy usually relates to weighing the relative importance of the two partially contradictory macroeconomic policy issues, a question which data collection cannot hope to resolve.

**Figure 1. Alternative Unemployment Rate Measures**



SOURCE: U.S. Department of Labor.

Returning to the present situation for a moment, I would like to pose the question: “If the answers to the macroeconomic policy questions are perfectly obvious, why don’t we do something about the current unemployment situation?” Four possible answers spring to mind immediately. First, we do not possess either the necessary policy tools or the knowledge of how to use them. Second, we may value even small reductions in inflation more than income gains. Third, the CPS data may not present the answers to these questions clearly enough for noneconomists to understand. Fourth, we may believe the present situation represents a temporary but necessary adjustment, which will allow us to eventually reach a period of relative price stability and high employment levels.

Since we cannot delve into the minds of policymakers, none of these possibilities can be dismissed out-of-hand. However, the evidence that we can control the economy through monetary and fiscal policies is overwhelming. Therefore the first answer is not likely to provide the most important explanation.

The second answer is even less likely to be the primary driver behind current policy actions. It is well known that as unemployment rises, the costs rise in at least a linear fashion, while the inflation reducing impact rises at an ever diminishing rate. Public opinion polls indicating that most Americans are not even aware of the extent of recent inflation reductions, when combined with this asymmetry of costs and benefits, must mean that 9.5 percent unemployment is not the rate preferred by most Americans.

One can argue that economists have been poor in communicating information on these policy options or the costs of unemployment to policymakers. That view leads directly to the third point. Perhaps current data, including the CPS data, do not adequately address the macroeconomic policy

issues and relationships. Certainly, by combining compensation data (perhaps from the March CPS) with the monthly regional and skill unemployment and underemployment data, one could calculate an “income gap” measure. This measure would address the “income lost” question more directly. The loss in income could then be compared with either a zero baseline or perhaps more appropriately some arbitrary unemployment rate, or perhaps to a time when labor market conditions for a given percentage of the economy were defined as “tight.” (While the latter measure is of course subjective, the same criticism could be leveled as with other commonly used indices, such as capacity utilization or the timing of NBER reference cycles.)

The same goal—emphasizing the “income gap” consequences of high unemployment could also be addressed by changing the definition of the “official measure” of unemployment. Unfortunately, this would reduce the usefulness of the data for estimating labor market induced inflationary pressures. However, there are several reasons for suggesting that the official measure of the unemployment rate should concentrate on the “income gap” question rather than the inflation question. First, most empirical studies of the U.S. economy, including econometric models, Phillips-curve analysis, and anecdotal reports, have found that the relationship between unemployment and inflationary pressures are variable. Thus we may be giving up a useful direct indicator of income lost for a less useful indirect measure of inflationary pressures. Second, for unemployment rates above 5 percent, which means for 10 of the last 11 years, the changes in national income from changes in the unemployment rate are almost certainly more important than the changes in the job market pressures on wage rates from changes in the unemployment rate.

Third, recent evidence by Medoff and Abraham (NBER Working Paper 781) suggests that labor market indicators

which measure unsatisfied demand are better for measuring the inflationary pressures in the economy than the unemployment rate. If these indices, which include the quit rate from the CPS, do in fact perform this function equally well or better than the published unemployment rate, it is clear we should use the unemployment rate to measure the loss in income and output, and these other measures to estimate labor market inflationary pressures.

Thus a change in the focus of the official unemployment rate to a measure which includes workers discouraged for economic reasons and those working part time for economic reasons would seem to be warranted. The collection of job vacancy data, as a supplement to the CPS would aid in assessing of labor market inflationary pressures, and would more than compensate for the change in focus of the official unemployment rate.

On a more mundane level, I should note that one recurring problem with the CPS data is the lack of reliability of the monthly unemployment estimates. Macroeconomists often find themselves "explaining away" the unemployment data for a given month because of sampling and seasonality problems. It may be that some policymakers, after hearing that "this month's data are poor" too many times, begin to believe the data set itself is useless. A larger sample would help to remedy these problems. An even more important, and less costly, improvement would be to stagger the CPS surveys during the month. This would reduce the number of distortions which arise as a result of extremely poor weather in a given week during the winter, the variability of school recesses in the spring, and the randomness of holidays throughout the year. In essence, the unemployment rate would be a true monthly series instead of a weekly series gathered only 12 times a year.

### *Why Does the Current Recession Exist?*

Returning to the dilemma posed earlier, perhaps current employment rates are tolerated, not because we lack the knowledge to do better, but rather because there is a belief that it is necessary to endure an admittedly painful but presumably temporary adjustment period to arrive at conditions which will be substantially better in the future. This explanation, I believe, should not be denigrated as either implausible or as stemming from “latent Puritanism.” First, I have run out of alternative hypotheses. Second, this rationale is often cited by policymakers when describing the current situation. Third, I believe there is some evidence that the current recession is having a significant impact upon American society in a way which augers well for the long-run health of the nation.

The data I am referring to are, for the most part, scattered and anecdotal. It may be that when collected and evaluated they would be found insignificant. However, we have all heard the charge that recessions are “necessary” to remove excessive expectations from the system. It is hardly radical to suggest that this view should be the subject of investigation.

Indeed, it does appear that the current economic environment is substantially reducing expectations of income gains in some sales. For example, until recently, it appeared that a serious and growing imbalance was developing between the compensation rates of workers in some industries, primarily those with industrywide collective bargaining agreements, and those of other workers. Casual empiricism would suggest that the current recession is rectifying some of these imbalances. Furthermore, it may be that a less severe recession, even if coupled with the same import problems, would not have served this end.

The current recession has clearly lowered the expectations of most Americans in terms of expected standard of living increases. If these lowered expectations persist even after the economy begins to recover, it will be much easier for the economy to satisfy these expectations without inflation. Presumably this means less inflation through a "better" (i.e., lower) rate of consumption (assuming the validity of the permanent income hypothesis). It also may mean lower demands for transfer payments and hence lower taxes, and increased incentives for low income workers to stay in the labor force and accept low paying jobs and lower minimum wage gains.

A third example seems evident when one talks to business leaders who appear to be placing renewed emphasis on curbing inventories, cutting overhead staffs, increasing line worker productivity, and improving quality control. Until last year, productivity growth seemed to be a national goal rather than a business imperative. However, the preliminary GNP and employment data indicate that productivity, using the BLS measure, rose last quarter despite a falling GNP. The last time that occurred was in the fourth quarter of 1957. Certainly one quarter's data can always reflect a coincidence. Many more months of data will be needed before a structural trend could clearly be discerned. Nevertheless, it may be that a profit squeeze as disastrous as the squeeze experienced in recent months was necessary, given the structure of our economy, to restore productivity growth to an elevated role in American business decisions.

Perhaps these reorientations of expectations and goals would have occurred without a recession as serious as the one we are experiencing. Perhaps the changed views of the world will fail to persist. Perhaps the change is quantitatively unimportant. However, in the current evidence vacuum it is difficult to counter the charge that recessions are useful in this regard.

### *The Key Microeconomic Policy Issues*

The purpose of presenting this hypothesis; or perhaps more correctly, this series of conjectures, is not to argue that pain can be good for you—even if one does feel better when it stops. Rather it is to suggest that some of the major economic problems in the United States may be microeconomic rather than macroeconomic in nature. (This may seem like an unusual position for a macroeconomist to take. However, I remind you that it is common for members of the Fed to discuss fiscal policy—leaving the monetary policy discussions for the Congress.)

In a situation in which competitive markets exist, one should not need severe recessions to change expectations and restore primacy to questions of marginal cost and marginal productivity. For example, in a competitive environment, it would not be necessary to destroy or seriously weaken every company in an industry, or every worker in an industry, in order to convince them to act efficiently. The market should “discipline” companies and individuals who fail to follow these precepts one at a time.

This line of thought suggests that the key to solving our current economic problems and to avoiding severe recessions in the future (other than those stemming from energy “shocks,” from crises, or from past policy errors) does not require only that we be better informed on the macroeconomic causes and consequences of policy actions; rather it requires us also to look at some microeconomic data and microeconomic solutions. While the CPS appears to be designed primarily to explore macroeconomic issues, it may be that the CPS data can be helpful in providing information on the microeconomic issues as well. If so, it will require great ingenuity by researchers in blending the CPS data with full longitudinal and other microeconomic data bases. Furthermore, there may be areas in which it is extremely impor-

tant to add to the current CPS survey, either on an annual or on a more frequent basis.

The types of microeconomic questions which could use more study include: (1) the extent to which industrywide collective bargaining has provided monopoly gains to workers in those industries and consequent losses to others; (2) the extent to which transfer payments affect work disincentives (for example, combining the results of the Seattle-Denver experiment, particularly comparing the differences in the three-year and the five-year program impacts with CPS-based data on the impact of unemployment compensation differences); and (3) the magnitude and types of barriers to employees changing their occupation and/or place of residence. These questions and other microeconomic-oriented questions are important not just because they would improve our understanding of the economy and help devise specific programs which would benefit many potential workers. The answers to these questions might also lead to direct program actions which would not only immediately improve the performance of the economy on a macroeconomic basis, but might also obviate the rationale for putting the economy through recessionary conditions as severe as those we are presently experiencing.

I recognize the limitations of the CPS as a microeconomic data source. Examples are: (1) followup after 16 months is nonexistent; (2) the following of workers to other locations is not attempted; (3) the sample size is too small for many cross-sectional applications. This argues for supplementing the data where possible from other studies, providing results which are admittedly preliminary and tentative, and for trying to convince the government to improve the data base.

### ***The CPS and Occupation/Skill and Regional Data***

In the area of data collection, the recession and government policies have certainly caused economists to experience the phenomenon of “lowered expectations.” However the cost of data collection is hardly a legitimate objection when economic policies are based upon the data. If microeconomic policies could be used to accomplish goals presently accomplished with macroeconomic policy, the net average increase in GNP and federal revenues would be in the billions. Collecting data is clearly cheaper than executing policies in ignorance.

Without belaboring the point, it is clear that additional data on occupation and skill classifications, on regional employment conditions and on demographic detail would be useful to policymakers. The need for a consistent comparable job vacancy index was noted earlier. Its usefulness on a regional level would be even greater than on a national level. When critical policy decisions—on the state, local and federal levels—are based upon poor information, or when billions of dollars in federal funds are distributed suboptimally because proper data do not exist, or when executive offices spend millions to “create” labor force estimates because the primary data are unreliable or nonexistent, no one gains. Information is a public good. If we underproduce it, we all suffer.

### ***The Social/Personal Costs of Labor Conditions***

As I noted in the beginning, the ordering of the policy questions was designed for expositional ease rather than to denote importance. Indeed, the last issue, the social/personal costs of unemployment, is perhaps the most important of all. I have saved it for last because I believe the CPS can

be utilized as a source of information on this issue only if a major amount of specific supplementary data are gathered.

Certainly the CPS provides a crude but useful measure of the costs of unemployment. If the official measure of the unemployment rates is modified as I suggested earlier to reflect the “income gap” aspect of unemployment, the social/personal costs of unemployment would be shown even more dramatically. However, this measurement of these costs is far from precise. Unemployment compensation reduces the costs of short-run unemployment; but how can this be quantified? A simple measure like the unemployment rate will not even capture the direction of change in social/personal costs which result when benefits are increased. Clearly unemployment in a one-worker family is more serious than the unemployment of one worker in a multi-worker family; but how much? Clearly, full-time employment in an occupation which uses a worker’s abilities only partially is a cost; but how is the concept to be defined?

These costs are both cyclical and secular. Secular costs are even more difficult to define than cyclical costs. “Poverty” in the United States is defined using income levels which would denote affluence in other nations. Indeed, to the extent that “poverty” is relative, winning the war on “poverty” can be accomplished only by equalizing all incomes. Indeed, the definition of secular social/personal costs is, I believe, impossible.

If we accept the concept of costs in a cyclical rather than a secular framework, it may be possible to quantify the social/personal costs of a given level of economic performance. My suggestion for accomplishing this goal is to measure changes in consumption patterns rather than changes in income patterns. One could, using surveys, measure the changes in the consumption behavior of individuals. Shifts in consumption patterns away from “lux-

uries” toward “necessities” would represent personal distress. The changes associated with unemployment would therefore be included in this measure. In addition, other causes of hardship would also be included. A forced wage cut, the absence of overtime or of full-time employment, underemployment, or an oil price “shock” may all lead to personal costs which would be reflected in a consumption based index.

This approach would have several additional advantages. It solves the problem of newly unemployed workers facing different levels of distress as a result of different asset holdings. It also solves the problem of adjusting the distress of unemployment for the existence of income replacement programs in any particular year. Finally it also enables one to deal with people’s ability to change their style of social organization in response to unemployment changes. (If a teenager loses his/her job, he/she may be forced to move back with his/her parents. The teenager may be distressed, but the consumption pattern may indicate a minimal social cost.)

The concept, as I have presented it, is obviously extremely rough. Not only have I made no effort to refine it, but the efforts would have been unsuccessful even if I had. Years of gathering primary data, trying to construct an index, and finally observing the index would be required to develop a good measure of personal social distress. However, I do believe that such an indicator is presently lacking and its addition to our list of economic indicators would substantially add to our understanding of the economy, thereby leading to better policy decisions. Without the addition of consumption-oriented data, it may not be possible to create a satisfactory index of the personal costs of unemployment.

Unfortunately, the costs of gathering these data and performing the theoretical and empirical work necessary to con-

struct an index are not small. The decision on whether or not to proceed will not be easy. However, it seems to make little sense to debate social program changes involving billions of dollars in a vacuum because the data necessary to evaluate the social/personal impacts have simply not been collected.

### *Conclusions*

Four types of key policy questions which relate to the CPS have been identified. With respect to the first type—the macroeconomic questions—several suggestions have been presented. First, the focus of the official measure of unemployment should be shifted from industry labor market tightness to quantifying the loss in national income due to unemployment. This could be accomplished either by constructing a direct income gap measure, or by including workers who are either discouraged or working part time for economic reasons in the official unemployment measure. A job vacancy index, or existing CPS data such as the “quit rate” should be used to measure the inflationary pressures resulting from labor market conditions. Second, the amount of monthly randomness of the data should be improved by staggering the survey weeks to create a true monthly (rather than recurring weekly) unemployment index. Expanding the sample would also help in this regard.

The second type of question—the microeconomic/programmatic questions—is often viewed as relating to narrow issues. This view may well be incorrect. Indeed, our failure to deal successfully with the microeconomic inefficiencies in our economy may be a major factor leading to our present sub-par macroeconomic performance. Although the CPS is not well-equipped to deal with these issues by itself, it can make a major contribution to our understanding of these issues if combined with longitudinal, experimental, and other supplemental data.

With respect to the sub-national data questions, both the usefulness and the deficiencies of the CPS are well-known. Extra data gathering efforts in this area would, I believe, be extremely cost efficient in terms of improving our economic performance, improving the effectiveness of federal, state and local policy decisions, and better targeting federal spending programs. In addition to expanding the sample, a separate effort to collect job vacancy indices as a supplement to the CPS data would be helpful.

The final type of question—the personal/social costs of labor conditions—is extremely difficult to answer. In order to address these questions properly, I believe it may be necessary to restrict the question to cyclic rather than long term costs. Even so, it is probably necessary to supplement the CPS data with consumption-oriented survey data and a new index based upon changes in family consumption patterns. Thus the costs of collecting the data and constructing the index will be high. However, the value of the additional information is also likely to be great.

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