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THE INTERACTION BETWEEN RESEARCH AND PUBLIC POLICY: THE CASE OF UNEMPLOYMENT INSURANCE

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ABSTRACT

This essay examines the role of economic research in affecting the recommendations of the National Commission of Unemployment Compensation, and the likely impacts of that Commission and economists' research findings on policy. Using a questionnaire addressed to Commission members, I find that most became quite aware of the results of research on the labor-market effects of unemployment insurance, with the degree of recognition proportional to the strength of the consensus among economists on a particular result; that the members had little awareness of the identity of particular economists who had done the research; and that, though the members claimed their recommendations were influenced importantly by research, that influence is difficult to detect in the Commission's Report. Because that Report goes against the tenor of current labor-market policy, its short-run impact will likely be small; and, because the focus of interest in policy will change over time, its long-term influence may not be great. Economic research, though, is shown to have had an immediate impact in three specific cases; and its long-run effect, by conditioning the policy discussion, has been and will like be substantial.

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Unlike politicians, economists do not take opinion polls on their performance. But we are prone to occasional self-examination, asking whether all the articles, books and testimony in areas related to public policy have done more than gain tenure and higher salaries for their authors. Views on this issue have ranged from the remarkably optimistic (Walter Heller on macro policy in the early 1960s); to the modest (George Stigler on a benefit-cost analysis of economics); to the very negative (John Dunlop on labor economics). The self-examination here deals with only one specific program, unemployment insurance. By providing quantitative evidence linking research results with the perceptions of them by their consumers and their impact on policy, we can use this small program to illuminate the broader issue of the utility of economics.

Unemployment insurance (UI) is particularly well-suited for our purposes. Empirical research on UI has clearly been one of the growth stocks in labor economics since the early 1970s. This explosion coincided with (and may have been caused by) the persistent high unemployment during this period and some major changes in UI policy. With the Amendments of 1970 (P.L. 91-373), a permanent program of extended benefits (covering weeks 27-39 of unemployment), to be triggered when unemployment is temporarily high, became effective; coverage of wage and salary workers became nearly universal with the 1976 Amendments (P.L. 94-566); for the first time, Federal benefit standards (regulating receipt of UI benefits and retirement income, and proscribing payments to teachers on summer vacation) were instituted; and in 1979 some UI benefits became taxable as ordinary income under P.L. 95-600. (See Daniel Hamermesh, 1977, for a discussion of these changes and of the program's operating details.)

The 1976 Amendments also provided for a National Commission on Unemployment Compensation (NCUC) to study the program and make recommendations for change. Its 13 members were appointed in 1977 and 1978 by the President, the Speaker of the House and the President Pro Tempore of the Senate, and included trade union, business and public representatives. A large minority had a backround dealing with issues in UI. The NCUC held over 100 days of meetings and hearings, and issued a final report in Fall 1980.

Let us consider what economists have contributed to our knowledge of the effects of UI, and then try to answer several questions: To what extent were the NCUC's deliberations influenced by economic research, both that funded by the NCUC and other work? What determined the direction of the NCUC's recommendations? How will they and the economic research affect policy in the 1980s -- in short, what will be the net impact of the NCUC and of our own work?

I. What Are the Economic Effects of UI?

The burgeoning interest in UI has generated impressive theoretical and empirical results. Nonetheless, the major accretions to our knowledge result from measuring impacts that were envisioned as long ago as the 1930s, when the Federal mandate for state UI programs was first imposed. In decreasing order of precision, the empirical findings (see Alan Gustman for a recent summary) are:

1) The median UI recipient faces a replacement rate that is about half of his after-tax earnings; and a substantial fraction, especially low-wage and secondary workers, face net replacement rates in excess of three-fourths.

2) Higher net replacement rates induce longer spells of unemployment. The nearly two dozen studies of this issue indicate fairly consistently that a 20 percent increase in UI benefits induces between one half and one extra week of measured unemployment (3 to 6 percent), other things equal. The

NCUC funded some research projects that confirmed earlier results on this point.

3) UI benefits accrue disproportionately to households in the third through ninth (next to lowest) deciles of the income distribution; on net they reduce the Gini coefficient on after-tax incomes.

4) By providing incentives to stabilize employment fluctuations, reduced experience rating of UI taxes (narrower rate structures on tax schedules, and a lower taxable base) increases layoff rates and thus the number of spells of unemployment. Here too, the NCUC supported research that strengthened this conclusion. The size of the impact is unclear; estimates of the effect of instituting a tax structure like that in the state with the most complete experience rating range from a one percent to a 33 percent reduction in the layoff rate in manufacturing.

5) Longer potential duration of benefits induces workers to stay unemployed longer, other things equal, though less so in recessions. The estimates, including one from a project funded by the NCUC, extend up to one extra week of actual unemployment for each week of extra potential duration.

6) Perhaps one half of benefits accrues to persons whose consumption would not be reduced in the absence of those benefits (see, eg., Daniel Hamermesh, 1982). Since the program's major goal is the maintenance of a standard of living, this suggests the benefits are not completely target efficient.

7) Broadened coverage, eased eligibility and higher weekly benefits and potential duration induce workers to spend more time in the labor force. This increases total market production, partly offsetting the lost production implicit in points (2) and (5) above, though perhaps increasing the loss in welfare.

II. Awareness and Use of Economic Research

How did these findings, which include some of the most concrete results in labor economics (or applied economics generally!) impinge upon the NCUC? To examine this I distributed a short questionnaire to the 12 Commission members who participated in the NCUC's work; nine responses were made (anonymously). The answers on questions about awareness of research findings, of producers of research, and of effects of policy changes represent, to my knowledge, the first set of responses by such a group to specific questions of this type.

On a scale from 4 ("Have seen summaries of the results and have a good grasp of findings") down to 1 ("Am unfamiliar with research in this area") the Commission members were asked to indicate their familiarity with research on the effects of: 1) Longer potential duration and higher weekly benefits on unemployment duration; 2) Experience-rated payroll taxes on employment fluctuations; and 3) UI benefits on the distribution of after-tax income. The respondents' claims of familiarity with research results correspond remarkably closely to the degree of concreteness I attached in the previous section to the results. On the first question the average score was 3.7; on the second and third the scores were 2.7 and 2.6 respectively. If we can believe their claims, it appears that Commission members were most aware of findings in those areas that have received the most attention from economists.

The NCUC members were able to convert their familiarity with research findings into an appreciation of the likely impact of some hypothetical changes in UI policy on the labor market: 1) Raise potential duration to 65 weeks; 2) Tax all UI benefits; 3) Abolish experience rating of payroll taxes. A question on the impact of UI benefits on the distribution of income was also asked. On the policy questions the Commissioners were asked to indicate what effects, between -1.5 and +1.5 percentage points, the change would have on the aggregate unemployment rate. The averages of their responses about the likely impact of the three changes were +.6, -.2 amd +.3 percentage points respectively. Eight of the nine respondents stated that UI benefits make the income distribution "somewhat more equal"; the other stated they had no effect. Though one might quibble about these magnitudes, they seem remarkably close to what a careful reading of research results would lead one to expect. Whether the "accuracy" of these responses stems from the Commissioners' general acuity or from the careful reading of research findings is unclear. However, the lack of previous familiarity of many Commissioners with the UI program, coupled with their responses to the first set of questions, suggests that they did become knowledgable about the latest economic research on the impact of the program they were reviewing.

The Commissioners' familiarity with the results of economic research did not extend to the recognition of the economists responsible for the research results. Seven persons who had published two or more articles or books on UI were listed in the questionnaire. The respondents were asked to check whether or not they "were familiar with (had seen a reference to or summary of) their work on UI." Also included were James Braunfeld and Michael Hart, fictitious persons whose names (which are dissimilar to those of any practicing labor economist I know of) I constructed. One Commissioner was aware of Braunfeld's work; three were familiar with Hart's work. Only three of the seven real economists achieved more recognition than Hart. (Included among the four who did not was one person who completed a project under contract to the NCUC.) One must conclude that only three of the seven were really familiar to the Commissioners. (As a partial check on this analysis, nine graduate students and recent doctorates in economics were given this part of the questionnaire. The majority were not acquainted with the work of two of the seven real persons, but none expressed familiarity with Braunfeld's or Hart's work.) Sic transit gloria doctorum: Our works may we known, we often we are not!

III. Research and Recommendations

The Commission made recommendations on all facets of the Federal-state UI program. While economic research has nothing to say about many of these issues, it carries some clear implications for others. Most radical (and costly) of these was a set of recommendations that the Congress impose standards on state programs' average and maximum benefits. These standards were opposed by only two to five members, nearly all of whom could be called business representatives. Together these would, if implemented, increase program costs by at least 15 percent ($1.3 billion if the changes had been applied in fiscal year 1979), and would result in higher replacement rates and some increase in unemployment. Despite their clear awareness of the research results linking higher replacement rates and longer duration of unemployment, and the evidence that many recipients do not "need" the income, five of the nine Commissioners responding claimed research played a major role or some useful role in determining the recommendations on these benefit standards. The other four respondents stated research had no effect. In light of the clear contradiction between the recommendations and the research findings, this appraisal by the majority of the respondents seems strange indeed. Comparing the recommendations to the research, most observors would conclude that the latter had no impact, though it may have restrained still more generous recommendations.

With three business and one state government representative dissenting the Commission recommended that a permanent triggered (by state or national unemployment rates) program of benefits for weeks 40 through 65 of potential duration be established. (This would make permanent the most generous extension enacted during the 1974-75 recession.) Though the Commissioners indicated that a nontriggered extension would raise aggregate unemployment by .6 percentage points (see above), and though they were aware of the evidence on this issue, only one of the nine respondents felt research did not affect this recommendation. (One claimed it had a major role, two that it served some useful role, and five that it had a slight role.) Here again there is a sharp contradiction among Commissioners awareness of research results, their perceptions of how research affected their recommendations, and those recommendations themselves.

The Commission's views on experience rating are somewhat mixed. It recommended that minimum tax rates exceed zero, clearly reducing the scope for experience rating; it also urged that maximum rates be sufficiently high that the "vast majority of benefit payments are effectively charged." Also, the Commission endorsed increases in the annual amount of wages subject to taxation, which would also increase the extent of experience rating. Five of the nine respondents felt research played a major role in affecting this recommendation. However, these recommendations were aimed at infusing revenue into the program; and the research referred to may have been work showing revenue projections rather than the program's labor-markets impact. While we thus cannot claim too close a link between economic research and the NCUC's recommendations, at least some claim can be made that the NCUC's direction is consistent with economists' findings.

The NCUC urged unanimously that Congress repeal the taxation of UI benefits. Since benefits are only taxable if a family's taxable income well exceeds the median, repeal would surely decrease the income-equalizing effect of the program. The Commissioners were, as we saw, aware of the program's effects in this context; either they could not or would not make the jump to recognizing the disequalizing impact of their recommendation, or they did so but subordinated their interest in equalizing incomes to some other goal. In this case, though, six of nine did respond that research results had no impact on the recommendation, a response which seems quite consistent with the facts.

Though Commission members had a reasonable knowledge of what economists as a group (but not individually) have found, economic research seems to have had little effect on the actual recommendations of the NCUC. This, despite the Commissioners' implied belief to the contrary. Rather, one may conclude that the NCUC's recommendations on those issues which economists have studied were highly political, with the union and most of the public representatives aligned against most of the Commission's business members. In most of these cases the majority's position supported changes that would exacerbate the negative side effects that UI produces on the labor market.

The Report can be summarized the same way Samuel Gompers summarized the goals of organized labor -- MORE: Higher replacement rates, longer potential duration of benefits, and easier eligibility for benefits. Regardless of one's views on the appropriateness of these recommendations, it is difficult to imagine a set of prescriptions that would be in more conflict with the massive amounts of research on the labor-market impact of UI that economists have produced in the past ten years. Despite their recognition of these effects, the Commissioners may implicitly have viewed other factors, perhaps income maintenance and macro stabilization, to be of greater importance. If they did, their emphasis contradicts in part the evidence (point 6 in Section I) on the program's target efficiency, and its necessity as an automatic stabilizer (see Martin Feldstein). So too, they may at least in part have acted out perceived roles as representatives of groups with fixed positions on the issues. (This seems to have happened in other commissions; see Robert Kilroy-Silk.)

IV. Impact, Impact, Who Has an Impact?

The picture in the previous section may appear bleak to those who seek an immediate impact of economic research on the formulation of policy. Yet economists' research findings have often had an immediate impact on policy, one that the NCUC Report is not likely to obtain. Similarly, the long-run effects of the economic research of the 1970s on the UI program seems likely to exceed that of the Report in those areas where the latter deals with economic issues.

In three areas the Congressional staff personnel I interviewed, none of whom had formal training in economics, indicated that economic research provided part of the impetus for changing the UI program. The taxation of benefits received by high-income families resulted partly from some examples of high net replacement rates that were shown for some secondary workers who are UI recipients. The demonstration that these reduced work incentives produce longer spells of unemployment was also important. Similarly, the final extension of Federal Supplemental Benefits (FSB) (P.L. 95-19) included the first Federal requirement defining suitable work (jobs that UI recipients must accept or face a cut-off of benefits) more broadly than its definition for recipients of regular and Extended (weeks 1-39) benefits. This stipulation stemmed in part from evidence produced in an analysis of the job-search behavior of persons who had exhausted FSB payments. Finally, a study of the disqualification of claimants of regular UI benefits led to Federal legislation disqualifying them from receiving Extended Benefit payments. Even beyond its use to buttress proposed legislation, economic research has had a direct effect on those areas where Federal policy affects UI programs.

This role stands in sharp contrast to the likely immediate impact of the recommendations of the NCUC. The NCUC members were appointed by a Democratic President, Speaker and President Pro Tempore; the Report was filed just before a Republican President and President Pro Tempore assumed power. Examination of recent legislation (P.L. 97-35) and discussions with staff persons in both the executive and legislative branches indicate that the Commission's recommendations in the areas where economists have provided evidence of the program's impact will be ignored at least through 1984. (In other areas, such as providing for states with large deficits in their UI accounts, where program requirements dictate legislative action be taken, the NCUC's proposals may well have a major effect.) Indeed, the current Administration's proposals run counter to those presented by the Report. For example, imposing a Federal standard requiring UI recipients to have worked at least 20 weeks in the base period to receive benefits beyond 13 weeks of unemployment (97th Cong., S. 983) represents an extreme interpretation of studies of UI and unemployment duration. Ideology and political influence dominate most proposals that have been made in the last ten years for UI policy, as one should expect in a program that affects directly so many employers and workers.

The long-run impact of the NCUC Report obviously cannot be foretold. Nonetheless, the role that previous reports in other areas have played suggests that, should conditions arise after 1984 that spur changes in the program, the politics will be such as to dictate a different mix of influences, and thus a different political outcome, from those that generated this Report. It seems unlikely, in the crucial areas of benefit standards, policy on potential duration, taxation of benefits, etc., that the Report's long-term impact will exceed the short-run effects.

This stands in sharp contrast to the likely future effects of the research on UI that economists have done since 1973, including that funded by the NCUC. Examination of the three cases cited above where research directly affected changes in policy suggests one should not expect future policy changes to arise directly out of past research: To affect changes in policy, research results must be recent. However, the increased certainty about the impact of UI on the economy that has been provided by this spurt of research findings will, as it has to some extent already, condition the debate over any future changes in the program. One may reasonably conclude that the NCUC's major legacy, in terms of its eventual impact on policy, may be the aid it gave to the accretion of knowledge about the program. This conclusion and the contrast between the short-run effects of prior economic research and the Commission's recommendations suggest strongly that we economists should feel our contributions in this area have been and will continue to be important. Whether the same fairly optimistic inference can be drawn about economic research on other topics is unclear. At the very least, though, the case of unemployment insurance should provide some insight into the circumstances necessary for that research to have an impact on policy.

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