

How Well Does Unemployment Explain the Low Levels of Consumer Confidence?

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“There is a deep-seated concern out there, which I must say to you I have not seen in my lifetime.”

—Alan Greenspan, December, 1991

Associated with the continuing weakness in the U.S. economy are very low levels of consumer confidence. For example, the Consumer Confidence Index, published by the Conference Board, was 46.3 in February 1992, its lowest since December 1974 when it was 43.2 (1985=100).¹ This recent figure reflects a sharp decline from 102.4 in June 1990.

The lack of consumer confidence is puzzling because many of the factors likely to affect it, such as inflation, interest and unemployment rates, are not at levels that many feel would cause such low levels of consumer confidence. Inflation, at least in the near future, is not perceived as a problem. In fact, the low level of inflation is used by many to justify additional expansion of the

¹ The empirical evidence relating consumer confidence to economic activity is mixed. C. Alan Garner found that confidence indexes are not reliable for predicting durable goods purchases and add little when used with other variables in forecasting “Forecasting Consumer Spending: Should Economists Pay Attention to Consumer Confidence Surveys?” Federal Reserve Bank of Kansas City Economic Review, (May/June 1991), pp. 57-71). On the other hand, Adrian Throop found that the indexes were useful for forecasting total consumption expenditures and GNP (“Consumer Sentiment and the Economic

money supply. Short-term interest rates are at their lowest levels in years. The average yield on three-month Treasury bills in January 1992 was 3.8 percent, the lowest average since May 1972. Current unemployment rates near 7 percent nationally and regionally, however, make unemployment a concern.² Nevertheless, current unemployment rates are substantially below their double-digit rates of the early 1980s.

This article takes a closer look at the unemployment rate. It begins with a review of how the official unemployment rate is calculated. Some have suggested that official employment rates are inadequate because of the existence of “discouraged workers.” Thus, the article examines the consequences of adjusting the unemployment rate for discouraged workers to see if the official numbers might be a misleading indicator of the depth of the current unemployment problems. If so, this might partially explain the low levels of consumer confidence. The article then returns to the consumer confidence level to explore some of the issues surrounding the recent declines.

Unemployment Rates

Downturn,” Federal Reserve Bank of San Francisco *Weekly Letter*, (March 1, 1991)).

² For the purposes of this article, the Eighth District will be represented by the states of Arkansas, Kentucky, Missouri and Tennessee because their economies account for the bulk of District activity.

An individual must meet a strict set of criteria before being considered officially unemployed. Basically, an unemployed person does not have a job *and* is actively looking for one. Receiving unemployment insurance compensation is not a criterion for classifying an individual as unemployed. Owning a business, performing any work for pay or at least 15 hours without pay in a family-owned business is sufficient to classify an individual as having a job and, therefore, being employment.

The sum of all people who are either employed or unemployed is the *labor force*. The *unemployed rate* is simply the percentage of the labor force that is officially unemployed. Therefore, every individual in the population is either “in the labor force” (employed or unemployed) or “out of the labor force.”³

Official data are gathered to determine who “in” the labor force. Anyone qualifying as “in” automatically qualifies as “out.” For example, suppose Mary worked as a financial analyst for a St. Louis firm before losing her job. She has tried to find other work compatible with her skills and experiences but has been unable to do so. If she gives up her job search, Mary will be officially considered “out of the work force.” Thus, she will not be counted in the statistic even though she would accept a financial analyst’s position if one were offered to her.

Mary’s action of abandoning her job search results in the official unemployment rate *falling* because the total number of unemployed persons has fallen by one *and* the total labor force has fallen by one. Mary is known as a *discouraged worker*. The

³ For determining employment rates, the population is restricted to those civilian individuals who are at least 16 years of age and who are not presently institutionalized (nursing homes, prison, psychiatric wards, etc.)

existence of discouraged workers is one reason why unemployment figures can be understated. For example, imagine an economy with a labor force of 10 people, three of whom are officially unemployed and seven of whom are officially employed. The unemployment rate is then 30 percent $\{(3/(3+7))\cdot 100\}$. If one of the unemployed persons becomes discouraged and stops looking for a job, the total labor force is reduced to nine people, two of whom are unemployed and seven of whom are employed. The official unemployment rate is now 22 percent $\{(2/(2+7))\cdot 100\}$ even though 30 percent might better reflect the true circumstance. Consequently, differences in the numbers of discouraged workers may make comparisons of unemployment rates over time less reliable as indicators of the strength/weakness of the labor market.

Eighth District Unemployment

Table 1 shows quarterly unemployment rates for periods encompassing the recessions of the early 1980s (January-July 1980 and July 1981-November 1982) and the most recent recession (July 1990-) whose end has not been officially declared. During the early 1980s, national unemployment rates peaked at 10.7 percent in the last quarter of 1982, while the District's unemployment rate peaked at 11.2 percent in the first quarter of 1983. Despite being roughly comparable in early 1980, the District unemployment rate exceeded the national unemployment rate by at least 0.3 percentage points in every quarter from the fourth quarter of 1980 through the end of 1983.

Currently, the unemployment rate of approximately 7 percent for both the nation and the District is far below the double-digit levels of the early 1980s. In addition, the relative performance of the District and national economies in 1990 and

1991 is roughly comparable, and their unemployment rates have risen by similar amounts during the last two years. One difference, however, is that for much of 1991 the national rate held constant, while the District rate steadily increased.

Individually, the Eighth District states experienced the recessions to varying degrees. In the 80s' recessions, Arkansas and Missouri moved as the nation did; however, Kentucky and Tennessee ultimately reached levels of unemployment greater than 12 percent. Today, Missouri still reflects the national averages in its movements. Tennessee has performed relatively better than the nation, while Kentucky seems to have weakened substantially during the last half of 1991. Arkansas is not repeating its 1980-82 performance and has experienced small increases in unemployment relative to the nation and other District states. Overall, though, Eighth District states are not experiencing rates of unemployment comparable to those of 10 years ago.

Discouraged Workers

Even though present unemployment rates are substantially below the levels of the early 1980s, it is possible that larger numbers of discouraged workers exist currently than in the early 1980s. If true, this might explain the recent low levels of consumer confidence. The Bureau of Labor Statistics identifies discouraged workers by their responses to particular questions. These individuals must “*want* a job but are *not* searching for employment because they feel that no jobs are available” (italics original).⁴ The Bureau further explains that discouraged workers are not counted among the unemployed because “classification of

⁴ U.S. Department of Labor, Bureau of Labor Statistics, *Questions and Answers on Popular Labor Force Topics*, Report 522, (1978), p. 7.

an individual is primarily based on a person's actions rather than on his or her desires."⁵

Table 2 shows the number of discouraged workers nationally. Unfortunately, data are not available for the District or the individual states. What we observe, however, is that the current weakness has produced far fewer discouraged workers than the two previous recessions. The highest number of discouraged workers during the last recession occurred in the fourth quarter of 1982 when close to 1.8 million people were classified nationally as discouraged. During the current weakness, this figure did not exceed one million until the third quarter of 1991 when approximately 1.1 million were classified as discouraged.

To illustrate the impact of discouraged workers on official unemployment statistics, the national unemployment rates are adjusted to include discouraged workers. The best we can do for the District is *approximate* the numbers based on national data. These estimates, especially the national ones, present a more realistic picture of how many people are jobless and willing to work if they could find a reasonable job.

We find that, adjusting for discouraged workers, the 1990 U.S. employment rate (see table 1) would increase about 0.63 percentage points. For the same period, the District's unemployment rate would increase about 0.65 percentage points. Adjusting for 1991 add about 0.77 percentage points to the national unemployment rate and 0.76 percentage points to the District's rate.

Performing the same analysis for the early 1980s, the U.S. official unemployment rates would have gradually increased from as little as 0.82 additional percentage points in 1980 to as many as 1.3 additional percentage points in 1982 and 1983. The District,

⁵ Ibid, p. 8.

though, would have shown more of an abrupt change than the nation with increases over the official data as small as 0.9 percentage points in 1980 and 1981, and as large as 1.3 percentage points in 1982 and 1983.

The above estimates show that the current unemployment rates adjusted for discouraged workers are still lower than the official unemployment rates from 10 years ago (see table 1). In other words, the adjusted rates of unemployment (including discouraged workers) we are currently experiencing are much lower than the official rates of unemployment (*not* including discouraged workers) we experienced 10 years ago. In the District, approximately 204,000 additional people would have to become unemployed or discouraged for our estimates of unemployment rates with discouraged workers to approximate the official unemployment rates of the early 1980s.

Consumer Confidence Levels

The preceding analysis of unemployment rates and discouraged workers does little to resolve the issue of what explains the low levels of consumer confidence. While it is true that we are experiencing almost record low levels of consumer confidence it is not true to suggest that levels of consumer confidence today are lower than they were during previous recessions. In fact, the lowest level of consumer confidence was achieved during the recession of 1973-75.

Several points may partially explain the recent general impression of very poor consumer confidence. First, between July and August 1990, the index fell 17 points. Then, between September and October 1990, the index fell an additional 23 points. These represent the largest single declines in confidence since the beginning of the recession of 1973, when confidence fell

36.7 points between October and December 1973. In each of the above instances, however, there was a significant development influencing opinions: Iraq's invasion of Kuwait in August 1990, troop buildups in Saudi Arabia and the potential for extended conflict in September 1990, and OPEC's cutback in oil production in the fourth quarter of 1973. These occurrences made the actual declines more dramatic. For comparison, the consumer confidence level was 90.7 entering the recession of 1980, falling 4.8 points the month the recession began.

The second possible explanation for the emphasis currently placed on the consumer confidence level is that those factors listed at the beginning of the article as affecting confidence are not in bad shape. We have already seen that rates of interest and inflation are at low levels and not of much concern. Unemployment, too, while rising, is not at an alarmingly high level. Thus, the plunge in consumer confidence is more noticeable. Nonetheless, on average, 1991 had a higher level of consumer confidence (68.4) than 1982 (59.6).

Conclusions

Contrary to our hypothesis, unemployment rates are not understating conditions by enough to account for the lack of and decline in consumer confidence. While the number of discouraged workers is higher than in expansionary periods, it is not large enough to justify the conspicuous decline in consumer confidence. In addition, the current levels of discouraged workers are lower than the levels experienced during the recessions in the early 1980s.

The question of what explains the low levels of consumer confidence remains. Many hypotheses have been proposed: the rapid growth of the public and private debt in the 1980s, increased

job uncertainty and the trend of declining U.S. growth since the late 1980s. Such hypotheses, however, have yet to be tested.