



Recovery Stirring? But will Connecticut be too Old to Compete?

The Connecticut Economic Outlook: May 2012

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This CCEA Outlook explores strategic reasons and labor force opportunities for accelerating Connecticut's recovery.

Executive Summary

Recovery still is stirring, but without the robustness needed to restore reasonably full employment and household income. And in the longer term, there is little to argue that this pattern will change—but Connecticut has one asset that could vault it to the top of the growth charts and, critically, rescue it from its current bleak demographic trajectory.

Both Connecticut's and the nation's economic performance surpassed expectations during the first quarter of 2012. State seasonally adjusted employment rose to 1.63 million, two thousand higher than the previous *Outlook* forecast. Better than anticipated national real gross domestic product (RGDP) growth during the first quarter has led the majority of forecasters to reverse their downgrading of U.S. growth during the last half of 2011 and to upgrade 2012 projections by 0.2 to 0.3% for the first quarter of 2012.

Also encouraging, residential housing building permits rose throughout the Tri-State area, led by Connecticut's growth at 58% relative to the same time a year ago. Yet permit numbers need to be taken with a grain of salt due to an unusually warm winter and because the value of residential construction permits rose only 16%, signaling plans to build lower cost, smaller housing units.

Despite these modest gains, the *Outlook* sees weak employment growth over the next two years, to the beginning of 2014, with the state adding only 30 to 35,000 additional jobs. This is such a weak jobs recovery that it restores only half of the jobs lost since 2008. And because Connecticut has failed to create net new jobs for more than two decades, leaving it unable to retain many of its own young adults or to attract significant new population, it now confronts a rapidly aging population, with the age 65 and over cohort doubling, its working age population shrinking, and its dependency ratio (the ratio of the working age population to the those under 18 and over 64) soaring. If the state does not change its demographic trajectory, it faces a bleak future.

The challenge therefore is for Connecticut not just to replace all 120,000 jobs lost since 2008, but to drive creation of substantially more—at least 50,000 net new—to retain and attract new workers, to change its demographic future. Current initiatives are a good beginning.¹ Though still in development, (1) the early stages of construction and recruiting at the Connecticut Biosciences complex (“Biosciences Connecticut”), (2) other aspects of UConn's School of Medicine and Dentistry expansion, and (3) creation of the Farmington campus of Jackson Laboratories should boost Connecticut's Real Gross Domestic Product (CTRGDP) growth markedly, adding 0.9% to CTRGDP in 2012 and 1.15% in 2013, above our baseline *Outlook* forecast. Other initiatives to strengthen the small business environment (e.g., the express loan program) and develop a vibrant innovation ecology will also help. But no current policies or initiatives come close to reaching the goal in job creation that Connecticut must reach to address its demographic challenge. This *Outlook* again argues—as the authors have in the past—that the state unleash existing stranded tax credits in a highly targeted program to drive economic growth. If the \$2.5 billion in tax credits currently sitting unused and unusable on balance sheets could be redeemed *ex post* against the cost of major capital projects—effectively converting what is now a liability against state tax revenue into an investment fund—this approach would create nearly 10 million square feet of new advanced manufacturing, pharmaceutical, biomedical and other facilities, creating upwards of 100,000 net new jobs (including multiplier effects). Even more exciting, if the credits were transferable (sold to qualifying enterprises), firms like

¹ The failure to pass Senate Bill #1—the Jobs Bills—is disturbing; that argues the Legislature fails to appreciate the scale of the challenge Connecticut faces.

Genentech might acquire them to build a major facility to co-locate with JAXX or at Yale's West Campus. This aggressive initiative also creates a unique strategic opportunity for Connecticut—given the anemic national labor market and historically low labor force participation rates, the job opportunities it opens up in Connecticut would surely draw in those new workers and younger population the state must attract to secure its economic future.

In sum, unleashing the stranded tax credits—which is ***entirely self-funding***: by the time the credits are redeemed, the new activity and employment flowing from these projects would generate net new tax revenue that first more than covers the cost of redemption and then delivers a revenue bounty—offers the best strategy for changing Connecticut's economic and demographic trajectory!

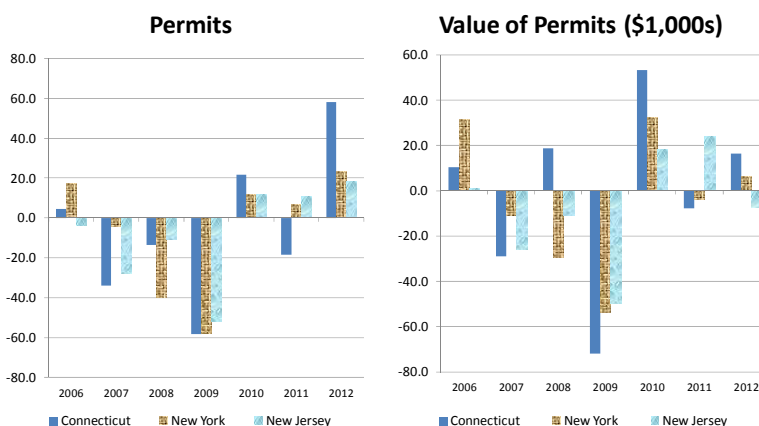
Introduction

Outlook

The historically low interest rates argue in favor of generating the quarterly *CCEA Outlook* forecast with two slightly different approaches. Thus, for this forecast, CCEA shows both the traditional approach and a second one that substitutes the prime bank interest rates for the permits, leaving all other interactive determinants the same (See Chart 2). Arguing in favor of this approach is the unusual pattern with the permit data, which differs significantly from the previous Outlook, but their aggregate value grew much less—and even fell in New Jersey. The permit data, unavailable earlier, in 2012Q1 were 58% higher than a year earlier. As Chart 1 illustrates, changes in the number of house permits far exceeds those of both previous years. While the numbers of permits are up throughout the Tri-State area, values have grown less in both Connecticut and New York and fallen in New Jersey. The paucity of growth in value and the warm spring are ominous indications that first quarter results based on permits may be overly optimistic. And despite the magnitude of these increases, considerable excess capacity remains in Connecticut residential construction due to consecutive years of decline from 2007-2009, followed by minor offsetting adjustments in 2010-2011.

Chart 1:

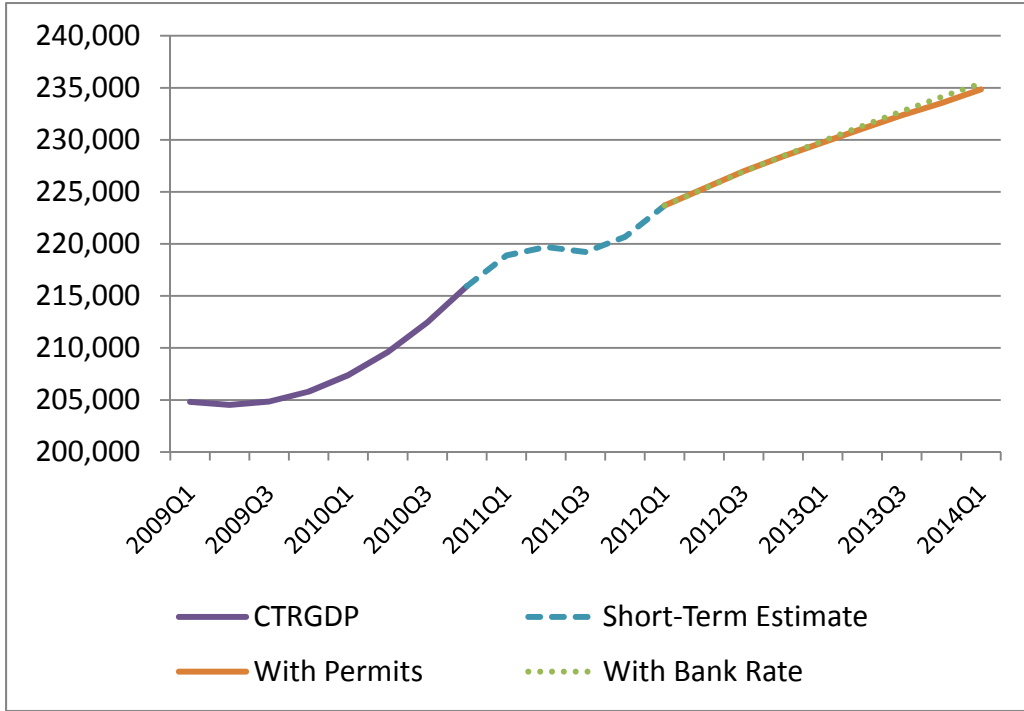
First Quarter Private Residential Housing Permits 2006-2012 (#)



CTRGDP

The forecast for growth in housing permits is quite modest, with additions expanding from 1,100 in 2012Q1 to 1,082 in 2014Q1. The addition of new permits will likely assist modest growth of CTRGDP from an estimated \$223.8 billion in 2012Q1 to between \$234.9 and \$235.4 billion in 2014Q1, as is indicated in Chart 2. Due to the mild winter, and bearing in mind that the permitted units in 2012Q1 have lower average values than usual, the lower of the CTRGDP estimates may be exaggerated.

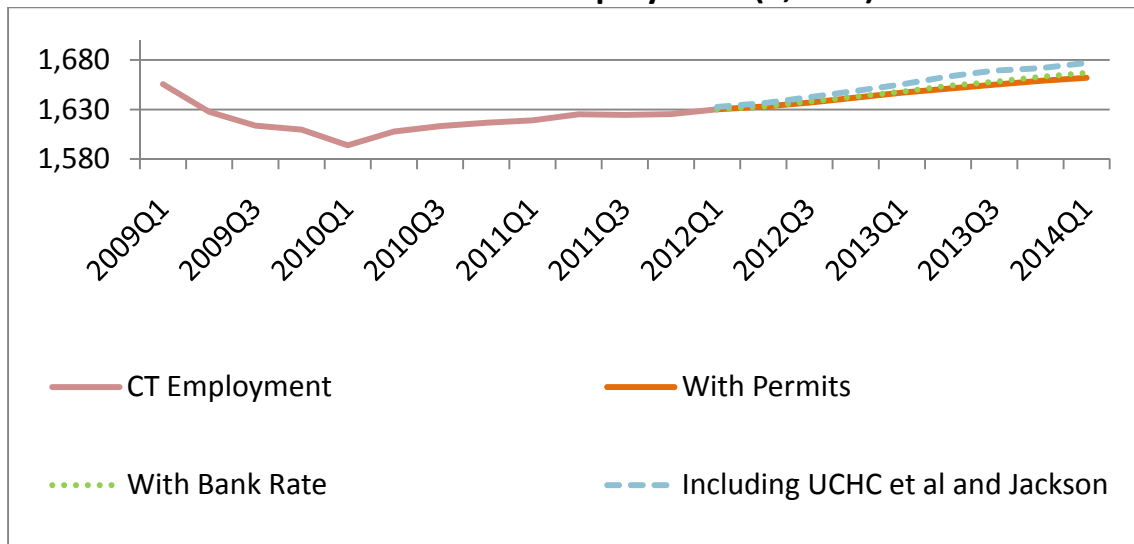
**Chart 2: Connecticut Real Gross State Product: Seasonally Adjusted (CTR GDP)
(Millions \$)**



Employment

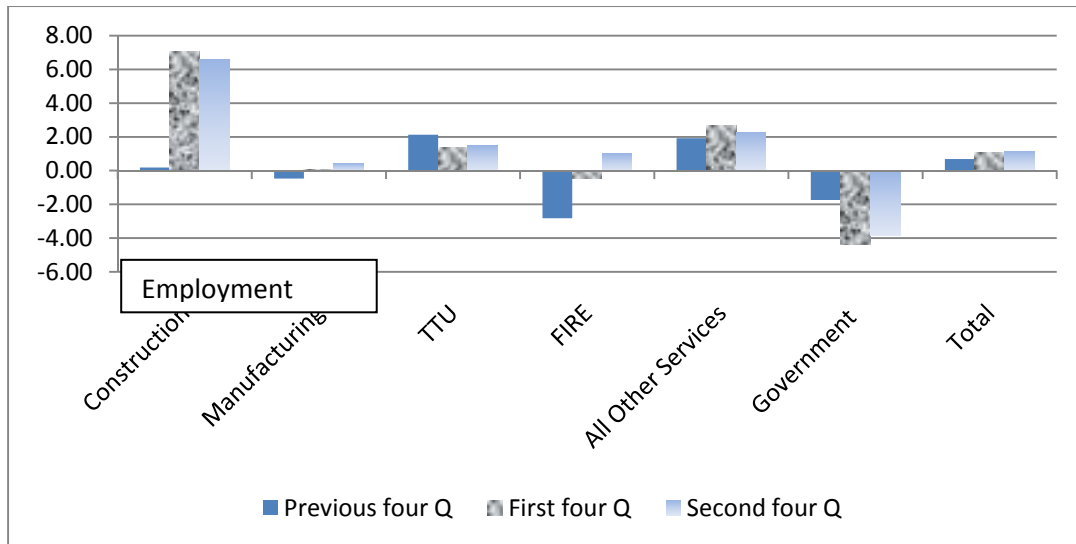
Using permits in the modeling framework results in a forecast of only 32,000 new jobs by 2014Q1, to a total of 1,662,000 jobs. But using the bank rate, including a 69 basis point gain over the two-year period, improves expected employment gains by 5,000. To this we can add another 10,000 new jobs flowing from construction and early staffing of UConn Health Center’s Biosciences Center accompanied by major investments in Jackson Laboratories.

Chart 3: Connecticut Employment (1,000s) SA



Using bank rates for modeling, illustrated in Chart 4, sector patterns suggest strong growth rates in construction and a slight recovery of manufacturing employment, as well as somewhat stronger growth in all other private sector employment amidst ongoing fiscal conservatism leading to continuing declines in government employment. The “First Four Q” marker represents the 2012Q1 to 2013Q1 rates; the “Second Four Q” from 2013Q1 to 2014Q1.

Chart 4: Sector Employment Growth Rates for Q1



Employment Retrospective

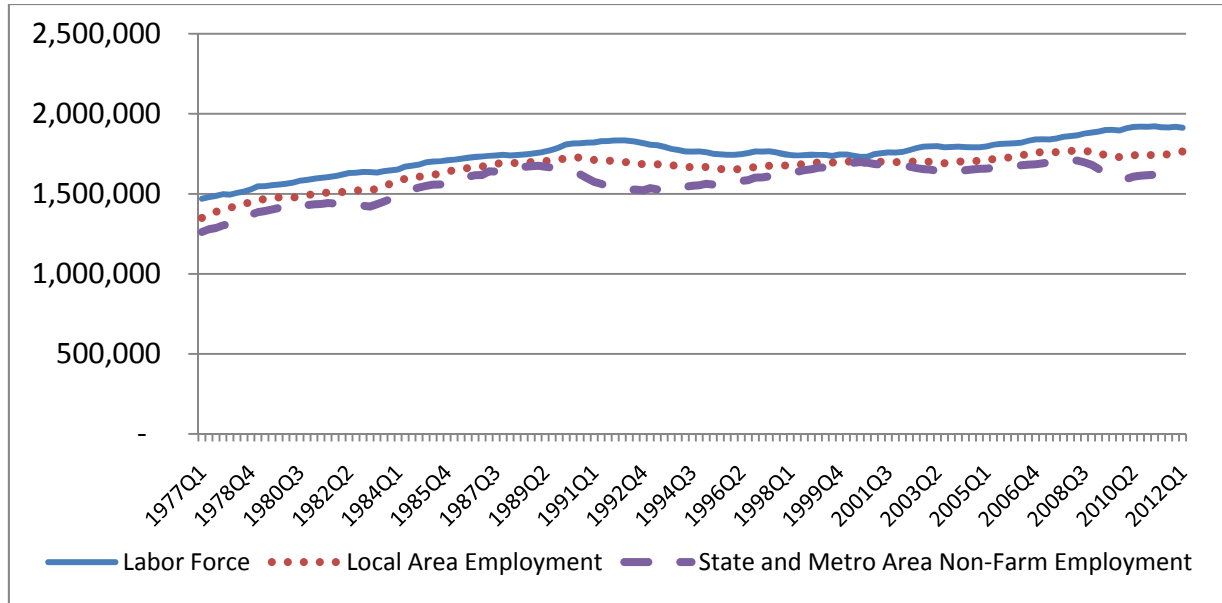
This section addresses the long-term employment trends in Connecticut since 1977, and then proceeds to a more in-depth look at American demographic changes. Benchmarking employment against previous peak employment assumes that demographics projections will not change significantly. With the aging of Connecticut’s labor force – like the nation’s – and the tendency for older-age cohort participation rates to be lower than other groups, status quo assumptions may be problematic. The national American context is relevant not just for parallels that CT data will likely follow, but also because freedom to migrate within the United States provides a human capital resource pool on which Connecticut could draw, attracting young workers and families to offset the current projection of rapidly growing dependency ratio and heavy fiscal burdens.

Connecticut

A long term view of national and state labor markets illustrates both their current state and the potential for Connecticut, with adoption of the right policies, to take advantage of that state. Chart 5 distinguishes between non-farm state and metro employment, modeled throughout the *Outlook’s* history. Civilian labor force is also measured with the local area data. As the Chart illustrates, Connecticut has reached full employment only (briefly) twice in the last 35 years – once in late 1988, and again at the turn of the century. Additionally, Chart 6 shows that non-farm state and metro employment has only exceeded its

1988Q3 peak of 1,698 thousand in 2000Q2 to 2000Q4. Even more troubling, Chart 6 highlights that employment is now 45,000 below a peak reached in 1989Q1 and is still 80,000 below the latest peak. Over the 34 year period (to 2011Q1), Connecticut's labor force grew by 453,000, followed by a decline of 10,000 over the last year. This reveals in stark numbers why Connecticut has such a rapidly aging population and rising unemployment—its working age population grew in the absence of job creation. Current projections now anticipate that the working age population will begin shrinking—and may already be shrinking.

Chart 5: Long-Term Trends in Connecticut Employment 1977Q1 to 2012Q1



National Labor Force

Chart 6 illustrates the evolution on the national work force and the aging of the American population of civilian labor force age. The demographic impacts of the post-WWII baby boom and subsequent migration into the United States of post-war families is obvious from the initial peaking of the various age cohorts in successive decades – 16-24 year olds in 1980, 25-34 year olds in 1990, 35-44 year olds in 2000, 45-54 year olds in 2010 and the ascendancy of 55-64 year olds towards 2020. Given current trends and barring plagues and pestilence, Chart 6 argues that in 2020 the two largest age cohorts for the American population of civilian labor force age will be aged 54-65 and 65 and older.

The rise in the youngest age group since the mid 1990s can be attributed to the postwar baby echo and immigration policy. Barring any further foreign sustained military excursions, it will bump up as demobilization of military personnel accelerates. Among all age cohorts in the civilian population of labor force age there are more women than men due lower death rates and the greater share of men in uniform.

In addition to underlying population trends and withdrawals by citizens from the civilian labor force to serve in the military, participation rates among age cohorts also impact on the size and shifts in composition of the civilian labor force. In particular, population growth in the youngest age cohort is ameliorated by falling civilian labor force participation rates by that cohort in juxtaposition to rising participation rates in other age cohorts, particularly among females.

Chart 6: Aging of the American Population of Civilian Labor Force Age (1,000s)

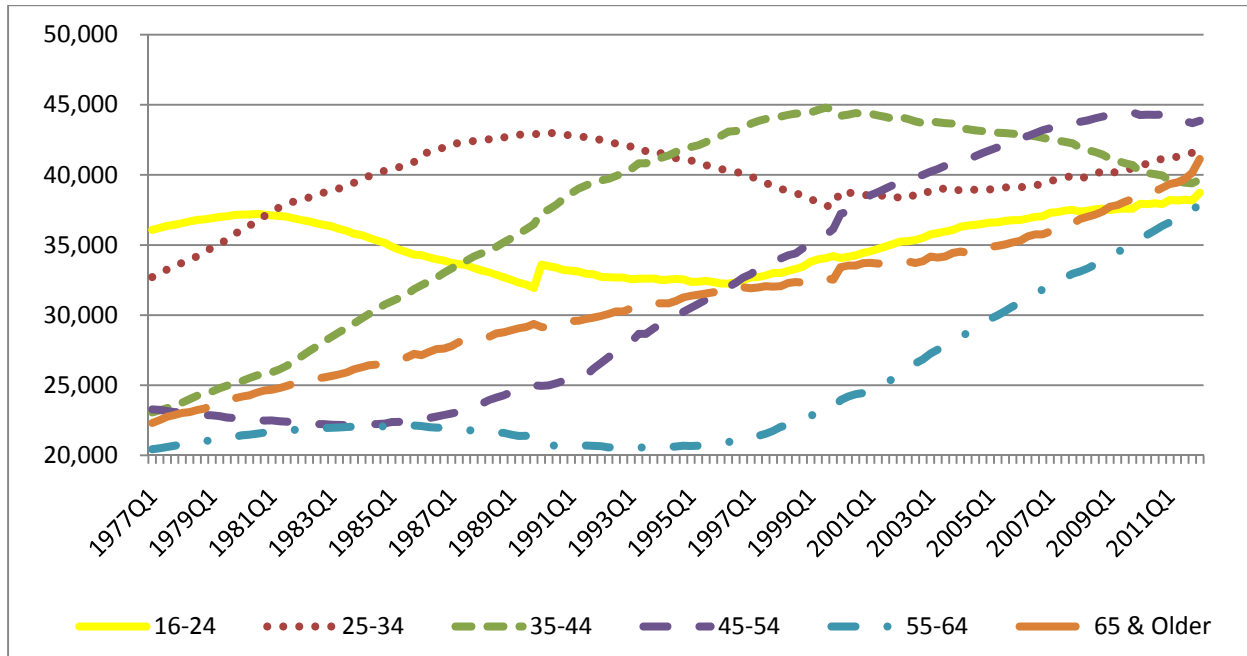


Chart 7 presents male participation rates in the civilian labor force by age cohort. Among prime aged males, participation rates have fallen from the mid 90s to 90% or a little less. There is some minor withdrawal from the labor force when males reach the ages of 45-54, and considerably more for each successive cohort. Among all age cohorts, except those 65 and older, male participation rates have been consistently declining, suggesting discouraged-worker impacts. Such impacts are strongest among the youngest working cohort, where participation rates have fallen sharply, from 73.5% in 1977Q1 to 56.1% in 2012Q1. There is the potential for this outcome to be more sinister and prolonged than meets the eye. Our colleague at UConn, Professor Merrill Singer, has illustrated the symbiotic relationship between poverty and drug use among America's poor, and has shown the lasting, debilitating effects of this pernicious trend.² Professor Singer's research adds urgency to redressing the problem.

As is illustrated in Chart 8, contraction in labor force participation rates among females aged 16-24 has been less severe than among males, with a female decline from 58.8% to 53.2% for the entire period. Female participation rates among all other age cohorts have been growing at rates that outpace male rates of change, particularly in the 65 and older cohort. Labor force participation rate growth of about 50% over the period among 55-64 year-old females suggests that returning to or continuing to participate in the labor force after or while raising a family has become the norm rather than the exception. The more-than-doubling of participation rates among women 65 and older from 1987 onward demonstrates that returning to the labor force is more permanent for many more than it has been. Among all age cohorts, female

² Merrill Singer, *Drugging the Poor Legal and Illegal Drugs and Social Inequity*, Waveland Press Inc. 2008.

participation rates remain lower than male ones, though differences between the sexes have shrunk in all age cohorts.³

Chart 7: Male Participation Rates in U.S. Civilian Labor Force by Age Cohort 1977Q1-2012Q1 (%)

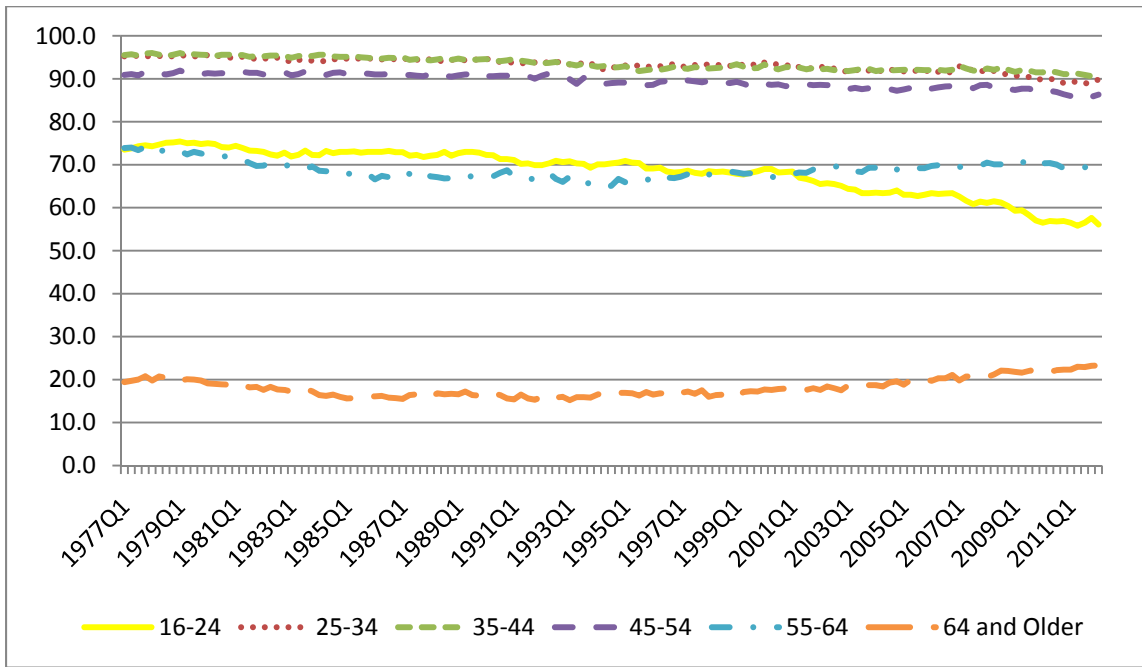
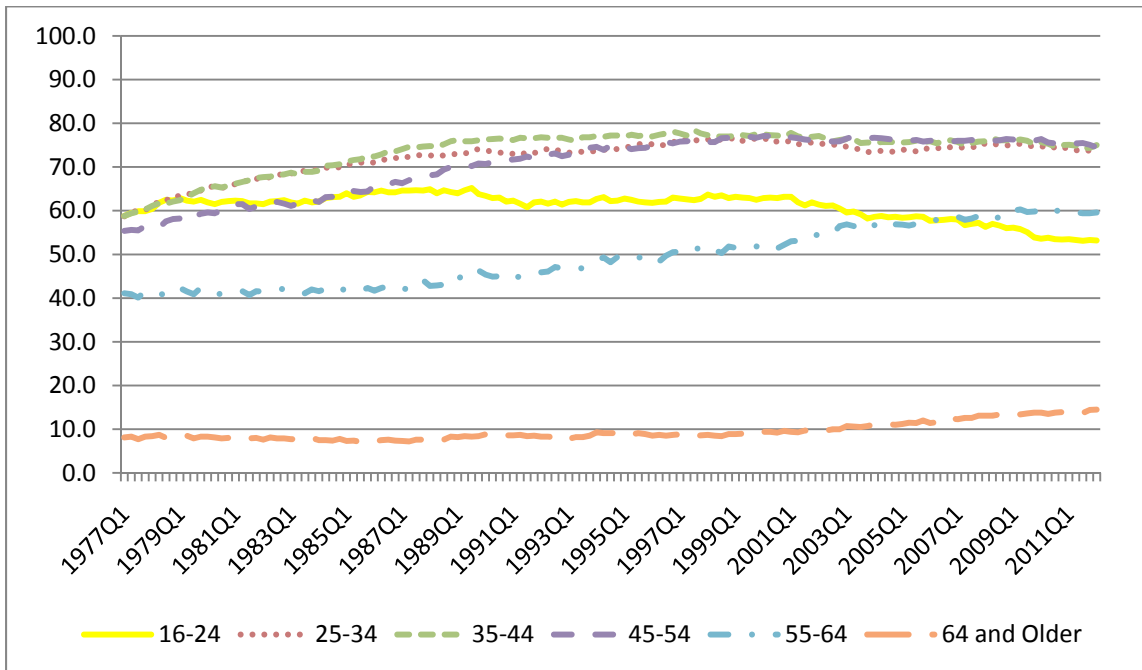


Chart 8: Female Participation Rates in U.S. Civilian Labor Force by Age Cohort 1977Q1-2012Q1 (%)

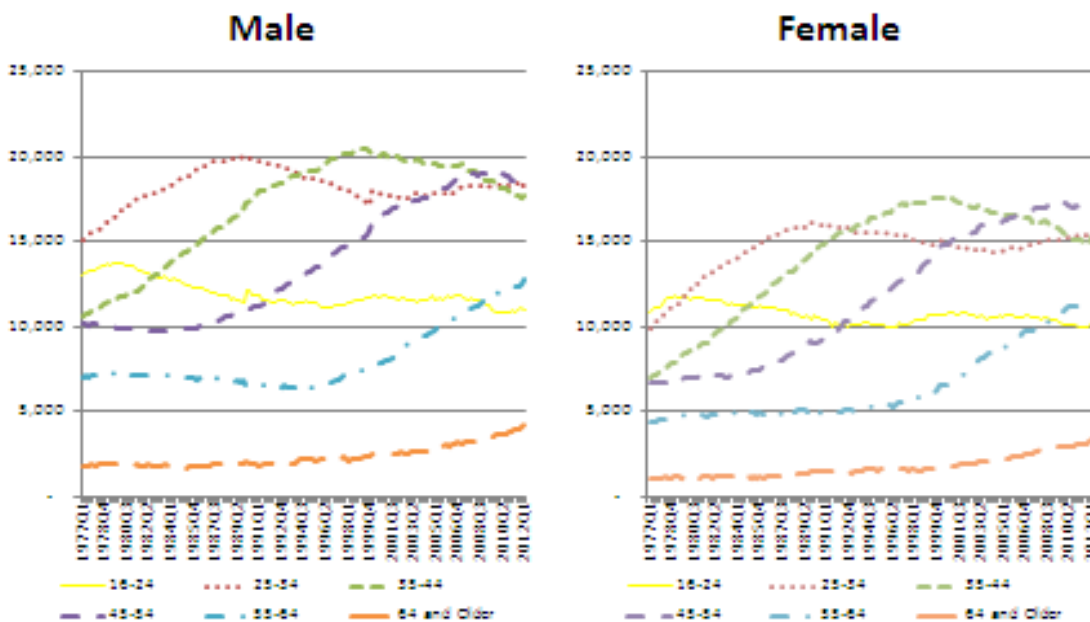


³ Rising participation rates among seniors of both genders may be related to better health and/or financial necessity in the wake of losses on family home prices and capital markets.

Particularly among the youngest cohort, the expanding population accompanied by declining participation rates begs the question of whether or not labor force participation is rising or falling for each gender. Chart 9 argues that participation in the civilian labor force for both genders is declining for the youngest age cohort, suggesting that the discouraged worker impacts are felt by both genders. End-point-to-end-point comparisons between genders among the same-aged cohorts also illustrate that as females mature they are becoming an increasing share of the civilian labor force.

Chart 9:

U.S. Civilian Labor Force (1,000s)



As the comparative frames in Chart 9 illustrate, participation rates trend downward as the population ages. As a result, pressures to reduce the labor force will continue to be present. Likewise, in the short-term, there will likely be increasing numbers of young workers who may be attracted back into the labor force as the recovery takes hold, which could serve as a potential offsetting factor. Barring large waves of immigration, that supply of new labor force participants is limited. In Connecticut, current projections see the under 18 cohort shrinking--probably by 90,000 in the next decade or so.

Implications for Connecticut's Development Strategy

From the perspective of the Connecticut's economic development strategy, there are important insights to be drawn from the above. Overcoming the discouraged-worker impacts can not only increase the supply of labor within the state, but also accelerate expansion of jobs, making Connecticut a more appealing place to remain or as a destination for American migrants – one benefit of Americans' capacity to move freely from

state to state. Increasingly, females are playing an larger role in America's labor force, a trend that is changing the fundamental social and economic fabric of the country. Development strategies need to take attracting females increasingly into account, particularly among active seniors where rates of growth within labor force cohorts are the highest. However the way to grow the State's human capital—and therefore to sustain increased numbers of seniors in retirement – is to expand employment among the younger age cohorts. As illustrated by Connecticut's history of occasionally moving to full employment, the window of opportunity to reverse the discouraged worker impacts will close in the long-term. It is therefore vitally important to exceed the job creation needed to retain Connecticut's own youth at increasing participation rates by attracting American migrants to build the Connecticut's future tax base.

Beyond America, the deterioration of the European Union, ill-suited to making the fundamental adjustments needed to its economy,⁴ is likely to provide an alternative source of potential English-speaking migrants.

Conclusion

On current trend, despite recent initiatives, Connecticut faces a dismal future, with its 65 and over population doubling, its working age population shrinking while its quality deteriorates, and its under-18 cohort contracts. The anemic national jobs recovery will not itself change the state's trajectory—but Connecticut has the capacity itself to meet this challenge and change the direction of its economy. Given current labor force patterns and participation rates, with an aggressive expansion policy, Connecticut could effectively compete both to retain its own educated youth and to pull in thousands of new workers, significantly exceeding its previous employment level. In the longer term, together with the initiatives in place, aggressive use of the stranded tax credits would launch Connecticut on a long-term dynamic path that would continue expanding employment opportunities for two or more decades.

⁴ Despite the European partial financial union, barriers to internal migration within it include, language, lack of flexibility in transfer payments and remnants of migration laws.