Recovery on the Horizon?

Strategic investments and policy choices will decide.

The Connecticut Economic Outlook: February 2011

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Overview

This Outlook delivered worrisome results, with weak Connecticut employment growing faster than growth in total output—suggesting declining productivity and creation primarily of low-wage jobs. To test this, CCEA analyzed how the state's economic sectors were evolving, an analysis that confirmed the initial forecast—without significant policy changes, Connecticut's growth will come in lower wage jobs. This is not where the state should be heading.

Assuming that the state implements aggressive policies to drive creation of jobs in high valued added industries, this CCEA Outlook reallocated the expected employment growth to more productive jobs; then using the dynamic model of the state's economy (REMI), CCEA assessed the growth impacts of a shift in employment on both real gross domestic state output (CTGDP) and employment by sector.

The result of the analysis is that job creation and CTRGDP growth improve significantly, moving the state towards acceptable rates of expansion. Higher productivity and better paying jobs generally create more indirect and induced spin-offs than do less productive ones. High-end development projects like Yale's West Campus and the proposed collaborative expansion of UConn's Dempsey Hospital, with creation of the Institute for Translational and Clinic Sciences, in Farmington, drive creation of exactly the desired types of jobs. Unleashing the moribund R&D ITC's to underwrite major capital projects in advanced manufacturing, research centers, and other areas would also contribute significant growth. A comprehensive analysis of such initiatives—these noted above are capable of delivering upwards of net new 60,000 jobs over the next several years—makes clear how critical state leadership will be in changing the future course of the state's economy.

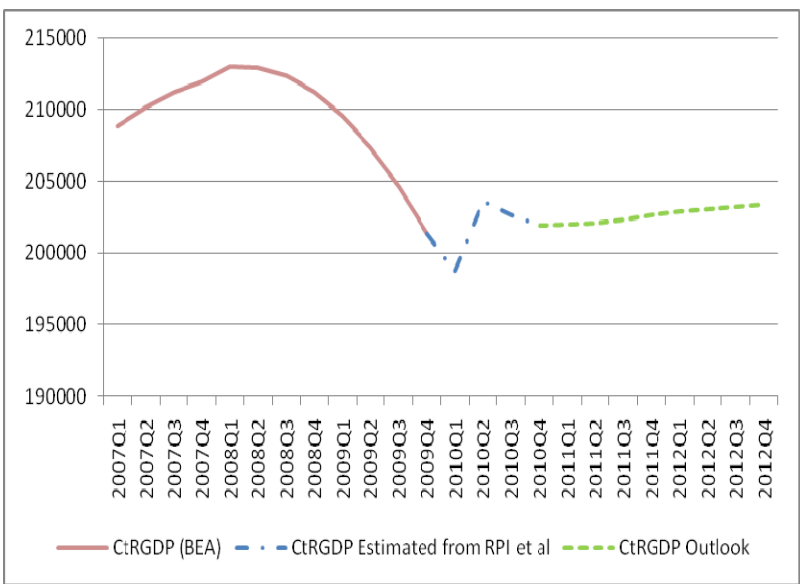
Outlook

Buoyed by pent-up national demand for consumer durables and continuing vigorous growth in emerging economies pulling in American exports, the national economy is showing signs of modest recovery. But layoffs and contractions in state and local government pulled 2010 fourth quarter growth down by fully a half percentage point and continuing fiscal challenges at the state level will impose additional future constraints. In addition, Goldman Sachs projects that the proposed spending reductions at the federal level could shave as much as a third off of future national growth. Given this environment, this Outlook used a growth projection for National Real Gross Domestic Product (RGDP) for this year of 2.18%, falling to 1.35% in 2012.

Connecticut State Output

The initial perspective for CTRGDP is for continuing mild growth from now through the end of 2012; the result is that CTRGDP does not approach levels reached prior to the downturn. Using the rebased government data, Connecticut's economy contracted 3.1% in 2009, and CCEA projects that it declined a further 1.9% in 2010. Expansion did begin in the final two quarters of 2010, but it was too weak to delivery recovery for the full year. By the end of 2012, Connecticut's economy will only recover to less than 96% of the 2008 level.[1]

Chart 1: CT RGDP (Millions 2005$ Seasonally Adjusted)



[1] The Bureau of the Census has readjusted the year basis for real GDP data, from 2000 to 2005. Valued at the earlier 2000 base, 2009 CTRGDP was $207.7 billion. At the new 2005 base, the same year's CTRGDP is $212.4 billion. Based in 2005 dollars it declined in 2009 to $205.7 billion or by -3.1%. Relying largely on personal income data, CCEA's estimate of CTRGDP declined in 2010 by a further 1.9% despite showing signs of recovery during the last two quarters. From $201.9 billion (2000 basis?) in 2010Q4 it is expected to grow to $203.4 billion in 2012Q4.

Under the 2000 RGDP basis, the CCEA Outlook for Connecticut includes miniscule growth of 0.26% this year and 0.44% in 2012. This finding supports IHS Global Insight's forecast of close to no job growth in Connecticut—ranking last among the fifty states—out through the next five years.

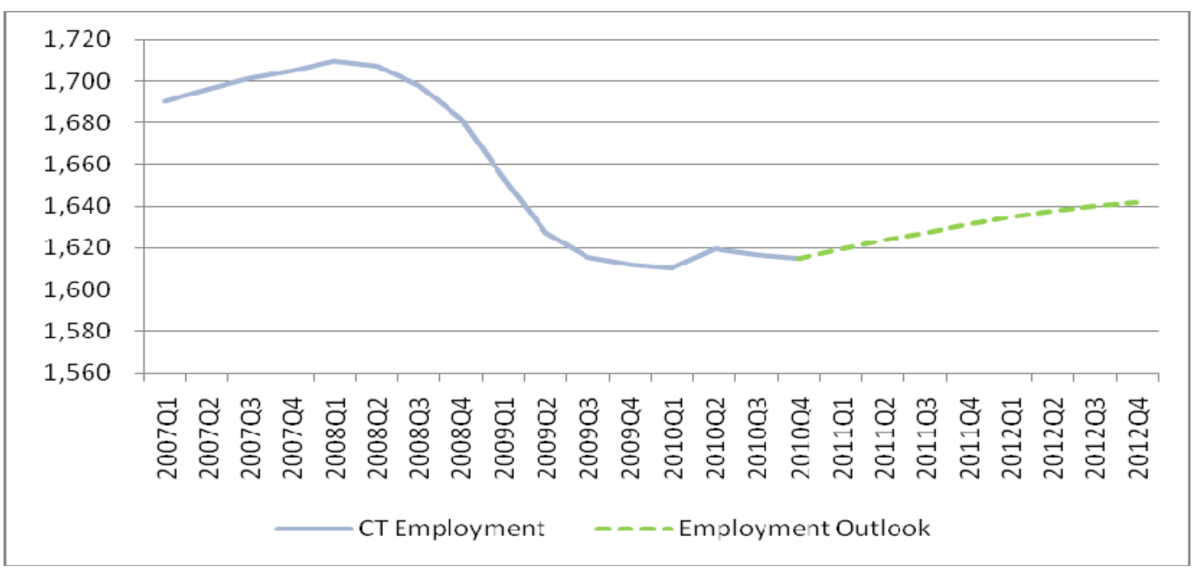
The February 16 State budget provided measures to expand growth in the State. Combined with federal initiatives, several provisions allow room for some optimism:

- Federal initiatives to rapidly expand U.S. exports;
- The Federal Reserve intent to maintain relatively low interest rates;
- Governor Malloy's initiative to streamline State government to eliminate bureaucratic log jams inhibiting development;
- A "First Five" initiative to induce companies to add 200 or more jobs in Connecticut;
- Uncapping R&D tax credits to reward job creation;
- Expansion of other programs to incentivize firm retention and job growth.

Employment

Contrary to earlier Outlooks, this one foresees slightly higher employment growth than expected from the rate of projected CTRGDP growth. After declining by 0.7% in 2010, employment begins to turnaround, growing 0.6% in 2011 and 0.8% in 2012. Given on-going productivity gains, this growth occurs when the labor force shifts proportionately into less productive service sectors, other than Finance, Insurance and Real Estate (FIRE). Even within FIRE there are significant differences between expansions among financial houses in contrast to real estate brokers and agents, particularly in today's competitive markets. Chart 2 reveals this anemic growth. From 2010Q4 to 2012Q4 seasonally adjusted employment is expected to grow from 1,615,000 1,642,000, by just 27,000 jobs.

Chart 2: CT Employment Alternative Pathways (1,000s)



Sectoral Shifts

Chart 3 below shows the employment outcomes for two scenarios. The first, which the textured bar shows, comes directly from the current Outlook. Employment is expected to fall in construction (-2.7 thousand), in trade, transport and utilities (TTU) (-3,200), FIRE (-6,200) and manufacturing (-8,200). Employment rises in government (8,900)[2] and other services (38,200).

These outcomes run contrary to the announced public measures intended to stimulate the economy and recognize the need to tighten-up management of other private and public services, including local governments. Utility infrastructure adjustments are expected to increase the service demands for electric vehicles. Also, trade is likely to pick-up with increased expansion. In spite of multiple failures to do so in the past, governments claim to be renewing attempts to curtail their workforces as part of their budget cutting exercises. In addition, the President has taken an aggressive step toward expanding trade and moving to rectify exchange rate issues, both of which would stimulate manufacturing.

Given this background, CCEA developed a second employment forecast. This Employment Productivity Outlook assumes only that the above policies achieve a simple shift in incremental direct employment from the initial outlook to more productive sectors. The modeling exercise then estimates and adds in any additional indirect and induced impacts arising from the direct expansion occurring in these more productive industries. The resulting indirect and induced incomes deliver a marginally more optimistic forecast, shown in the solid bars in Chart 3. Reflective of the recovery in financial markets, FIRE grows 2.5%. Should federal trade policies work earlier than expected, the manufacturing decline could be sliced in half. As part of the exercise, employment growth in Other Services has slowed to keep total initial employment the same. The underlying difference between the two cases is the distribution of employment to more rather than less productive and income generating industries. The differences in the outcomes indicate the importance of development strategies that impact positively on highly productive industries. And, in a limited way, this second scenario responds to the question, “How effective are these initiatives for extracting Connecticut from the post recession quagmire?” The answer is, a little, but not much.

Alternative Sector Shifts

Chart 4 builds on the previous analysis to illustrate possible sector employment impacts if economic policies drive growth in higher value-added and wage sectors. The multicolored (or shaded) bars illustrate the total impacts of industrial strategies the attract growth in these area. Using REMI to estimate the impacts of shifting initial employment growth into these high value sectors yields significant improvement in state output, which would be higher by an additional $3.5 billion in 2011 and $3.8 billion in 2012. This alternative nearly quintuples Connecticut’s growth performance to 1.5% in 2011—still below what would deliver significant job growth, but vastly healthier that the current trend.

Over and above the modest growth in the initial case, employment is higher by 22,000 in 2011 and 23,200 in 2012; total employment would thus grow 45,000, rather than the anticipated 27,000.

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[2] This result of the modeling exercise will not happened in reality; government employment at both the state and local level will contract in 2011 and 2012, perhaps significantly.

Chart 3: Shifts in Sector Shares of CT Employment 2010Q4 and 2012Q4 (1,000s Employed)

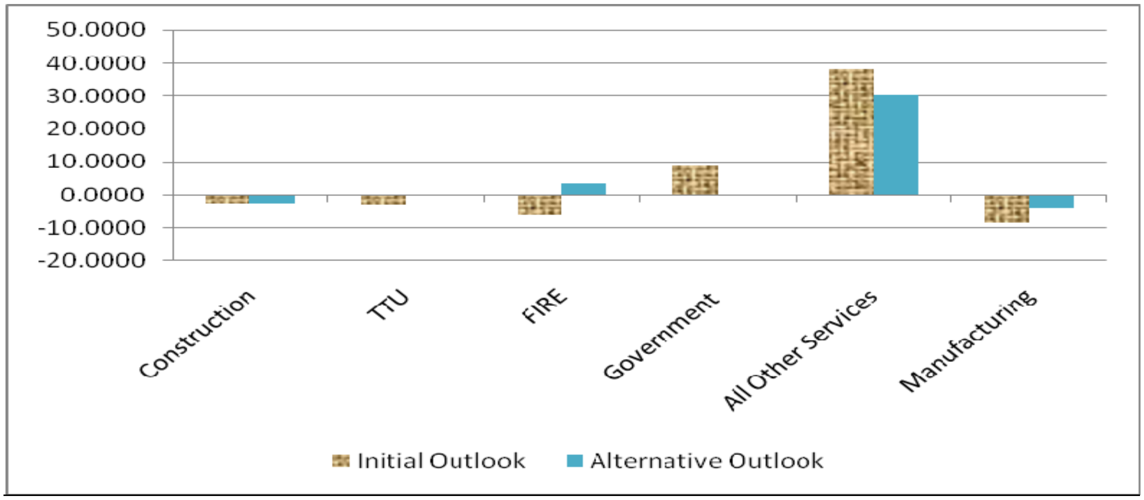
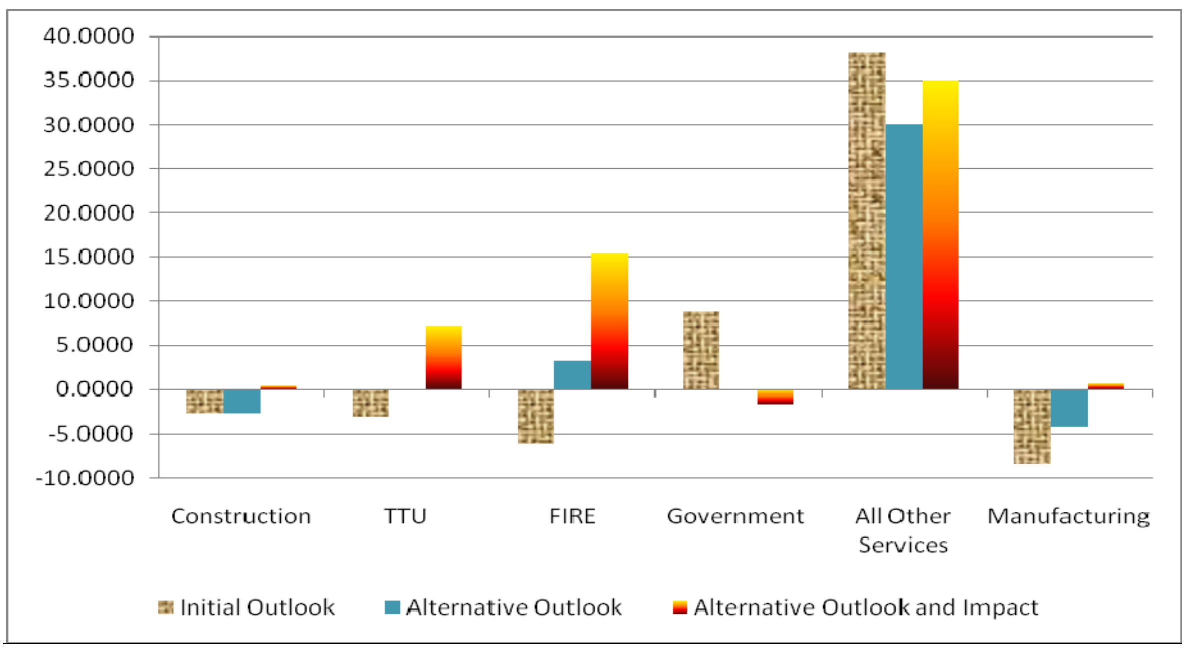


Chart 4: Shifts in Sector Shares of CT Employment 2010Q4 and 2012Q4 for Policies Targeted at Relatively Highly Productive Sectors (1000s Employed)



Note that when growth flows primarily from relatively productive sectors, even construction employment manages slight gains. Private sector companies employ more persons while government employment shrinks further.

Conclusions and Perspective

Connecticut faces a long road to recovery. Retaining and encouraging expansion of highly productive businesses and attracting new firms are central to generating a strong recovery. This Outlook underlines emphatically why it is critical to focus on those jobs with higher productivity and better pay: they create significantly more indirect and induced spin-offs than do less productive ones.

This exercise demonstrates why it is crucial for Connecticut to develop policies and initiatives that facilitate the rapid growth of projects such as expansion that underpins Yale's West Campus, creation of the Institute for Translational and Clinical Science in conjunction with the renovation of UConn's Dempsey Hospital, and the effective utilization of currently moribund tax credits. Not only would each of these initiatives be fully self-financing, they would deliver a significant fiscal bonus to the state and create tens of thousands of new, high-quality jobs. The course that Connecticut's economy charts in the next few years depends critically and overwhelmingly on the policy choices and strategic investments to which the state commits itself in the next few months.