Where are the Jobs?

Connecticut Struggles to Regain Its Economic Health

The Connecticut Economic Outlook: December 2013

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**Executive Summary**

Slowly, slowly, jobs are returning to Connecticut’s economy. But the superficially encouraging seasonally unadjusted unemployment rate of 7.5% reported for the third quarter of 2013 is misleading. Seasonally adjusted (SA) it jumps to 7.9%. But even the SA figure is a smoke screen covering the true situation. The improving unemployment rate is in large measure an artifact of declining participation in the workforce. If participation were still at the level of the second quarter of 2010 (2010Q2), the unemployment rate would be 10.7%. And, if participation were at its historical high, the unemployment rate would be dramatically higher still. Nearly 65,000 working-age adults simply stopped looking for employment during the last three years. In short, while Connecticut’s sluggish recovery has failed to restore the jobs lost since 2007, the state’s economic malaise has driven many adults out of the workforce.

This Outlook looks closely at the dynamics of the labor market in the context of the larger framework of a future economy with output growing more rapidly. Continuing productivity gains often approaching (or even exceeding) 2% annually translate into no job creation unless the economy grows even faster. Even at the national level, job creation remains modest for this reason. Ironically, Connecticut’s strength in manufacturing, which typically delivers the highest productivity growth, compounds the challenge of job creation.

Connecticut has not created and sustained net new jobs in twenty-five years; current employment remains below the level of 1989. The extraordinary persistence of weak job creation argues powerfully for profound structural weaknesses in the state’s economy, weaknesses that surely pre-date the devastating recession that hammered the state economy at the opening of the 1990s or the financial crisis in 2007-2008. Recent initiatives are intended to reframe the state’s long-term competitiveness and build or expand strategic areas—e.g. the Bioscience Connecticut initiative, the successful attraction of Jackson Labs, the initiatives in digital media, and the effort to build an entrepreneurial ecosystem. Addressing shorter-term challenges, the First Five program, Business Express Loan Program, and manufacturing training initiatives among others work to keep businesses in Connecticut, provide critical working capital, and facilitate expansion in the state. Even so, deeply discouraging budget projections—whether from OFA or OPM—promise a return of large deficits to the state’s operating budget within two years; they reveal how much must still be done.

Previous Outlooks have evaluated how the state could drive significant short-term job creation by accelerating major capital projects whose funding has already been approved or unleashing the large trove of tax-credits companies have earned but not expended to support private sector capital projects. Together these strategies could generate tens of thousands of new jobs in Connecticut within two to four years. The analysis below clearly demonstrates the continuing importance of considering implementation of those strategies to drive short-term job creation even as they strengthen long-term competitiveness and, coincidentally, generate additional revenues to reduce if not eliminate threatened deficits.
Setting the Stage

Connecticut Employment

Connecticut’s seasonally unadjusted state unemployment rate, for 2013Q3, of 7.5% is largely a smoke screen. The seasonally adjusted (SA) unemployment rate, which more accurately reflects the condition of Connecticut’s labor market, is 7.9%. Furthermore, had the level-of-participation in the labor force remained at the height it achieved as recently as 2010Q2, the Connecticut SA unemployment rate would be 10.7%. During the three years from 2010Q2 to 2013Q2, 64,155 left the state’s labor force amidst job losses of 38,341 (based on the household survey). Only in the most recent quarter has seasonally adjusted participation turned up slightly in response to stronger job gains of nearly 10,000 across the state.

Thus far, the recovery has resulted mostly in extending hours of part-time employees, some of whom have moved to full-time employment, as Chart 1 suggests. Full-time equivalents (FTEs) have risen 43,000 over the three years. With gains in FTEs and losses in jobs (the contrast between reported payroll employment and results from the separate household survey), the ratio of FTEs to jobs in Connecticut has risen from 92.4% to 97.6%. Such results give little solace for long-term unemployed and discouraged workers, yet the rising ratio of FTEs to jobs points to further job growth. Despite Connecticut’s aging labor force, the magnitude of recent declines in participation indicates considerable excess capacity in human resources and the need for continuing stimulus and/or risk reduction behavior in Washington to attract investments and facilitate labor force re-entry. From Connecticut’s perspective, the results also underline the risks of premature Federal Reserve Bank (FRB) tightening of the money supply and other restrictive policies based on reported falling unemployment rates rather than labor force capacity underutilization. The very modest federal budget deal, which provides some fiscal stability through 2015, will likely result nationally in benefit cuts to nearly 1.8 million unemployed in the next six months, which will be a further drag on both the national and state economies.

In addition to these concerns, shifts in national monetary policy hold significant risks for Connecticut. While the FRB continues to pursue its large-scale asset purchase (LSAP) initiatives – more commonly referred to as “quantitative easing” – in concert with maintaining low discount rates, at some point the Federal Open Market Committee (FOMC) will begin to tighten the money supply. Should the removal of monetary stimulus be implemented prematurely, Connecticut’s unemployment situation would suffer, as higher interest rates would likely hamper business investment, housing starts, and, ultimately,

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1 The unemployment rate is calculated by dividing the number unemployed workers (those people who are not working, but actively seeking employment) by the total number labor force, and multiplying the result by 100. Both the numerator and the denominator can change, thereby affecting the rate. The participation rate is important because it impacts both the numerator and denominator of the unemployment rate. Someone who is unemployed dropping out of the labor force causes decreases in both parts of the unemployment rate but because the number unemployed is smaller than is the labor force, that dropout has a larger proportional impact on the numerator than the denominator causing the unemployment rate to fall; thereby resulting in a lower unemployment rate.

2 This ratio is unapt to exceed 100%, indicative of overtime. In addition, those working part time jobs may be working longer in each job and therefore needing to work fewer multiple jobs each.

3 A discouraged worker is an individual who is able to work, but it no longer considered part of the labor force.
growth. In this *Outlook* we examine the forecasted impact of mild tightening by modeling the likely outcome of slightly higher rates on the state’s economy, especially on its labor force.

**Chart 1: Connecticut Job and Employment Trends**

![Chart 1: Connecticut Job and Employment Trends](image)


**National Employment**

While Connecticut faces challenges unique to the state, continuing weaknesses in the national economy compound these hurdles. Recent analysis presented at the University of Michigan’s Regional Seminar on Quantitative Economics (RSQE) underscore the weakness of U.S. growth and reasons for that malaise. Per capita national income gains have been zero over the last two years, with higher income shares generally going to individuals in the top-earning third of the population. The U.S. economy is now 56 months—nearly five years—into a recovery that is simply the weakest since World War II.

In comparison with recovery rates of nine post-war recoveries at the same stage:

- Nonfarm payroll employment gains in the current recovery are the worst aside from the recovery at the turn of the century;
- Employment recovery has been the slowest of the nine recoveries;

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5 This change can be seen by analyzing the Gini Coefficient, which is a measure of economic disparity; that is, the difference between the highest earners and the lowest. In his most recent book, *The Map and the Territory*, Alan Greenspan focuses on the increasing income and wealth gaps in the U.S., and the detrimental impact that has accompanied this change. (See, in particular, Chapter 11 of Greenspan’s book, “The Onset of Globalization, Income Inequality, and the Rise of the Gini and the Crony.”)
• The unemployment rate apparently has recovered relatively well but mostly for the wrong reasons due to discouraged workers rather than job growth;
• National housing starts have only recuperated sufficiently over the last year to be a jonnie-come-lately driving force;\(^6\) and
• In contrast with other recoveries, government cutbacks in payroll employment led by local governments have been a drag on the economy.\(^7\)

National labor force participation rates have fallen from a turn-of-the-century peak of 67.3% to under 63% and the national employment ratio among those of labor force age has declined from 64.7% to 58.3%.\(^8\) While the percentage of employed men and women over 55 years of age has risen, an increasing number of younger members of the labor force participation rate has fallen to 47% for both men and women under 25 and to only 81.5% for men aged 25-34 and 68% for women of the same age.\(^9\) In addition to the short-term penalties this decline imposes on younger members of the labor force, it has the more pernicious longer-term outcome, preventing these dropouts gaining the skills and experience needed to be fully productive lifetime workers, despite achieving higher levels of education.

Since 2010Q3, the number of participants in the United States labor force has increased by 874,000 but remains 4,430,000\(^10\) below the number needed to equal the participation rate of three years ago. Because the 2010Q3 participation rate itself was short-term blip, still well below historical peak of 66.5% in 2003Q2, the 4.4 million participant shortfall is a modest measure of US excess labor force capacity. The good news for the nation is that jobs over the same period grew by 4.5 million and FTEs by at least 4.0 million,\(^11\) about half those needed to utilize excess labor capacity and facilitate recovery by those most adversely impacted by the recession. From a monetary policy perspective, the national results begin to support mild monetary tightening; the continuing weakness in Connecticut’s labor market suggests that the state would be differentially injured if that tightening were to begin too soon.

**Income Growth Data and Negative National Consumer Sentiment**

Given the situation with America’s labor market, it should come as no surprise that consumer sentiment is mainly negative:

• Relative to 1966, where the index is set equal to 100, from 1952 to the present, the annual consumer sentiment index that US would be able to sustain gains averaged 86.8 indicating mild pessimism is the norm, but it is currently at just 72.6 (more than 16% below the long-term average);
• Since 1960, more Americans have been pessimistic rather than optimistic about the five-year outlook of the national economy, with an annual average index of 93 where 100 would indicate

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\(^6\) Allen Sinai, Economic Policy and the Economic Outlook: Help or Hindrance, Nov. 21, 2013.
\(^7\) Op cit. Daniil Manaenkov and Mathew G. Hall.
\(^8\) Richard T. Curtin, Director of Surveys, Surveys of Consumers, Thomson Reuters University of Michigan, Nov. 21, 2013. The employment ratio is employed/labor force.
\(^9\) Ibid. In 2000, participation rates for this age group were 90% for males and 73% for females.
\(^11\) Ibid. Unlike its household survey, BLS’s Survey of Employers puts this number at 6.1 million.
an even split – that index currently stands currently at 73 (over 21% below the long-term average);

- The U.S. Federal Government is increasingly being viewed as the problem not the solution – by about 18% of respondents during the debt ceiling debacle, 22% going over the fiscal cliff, and 33% during the recent shutdown;
- 57% of the population has lost confidence in Obama’s economic policies – the lowest that figure has been since his inauguration in 2009; and,
- Income growth is not expected to keep pace with inflation\(^\text{12}\) and real monthly earnings (SA) have been declining from $455 to $386 over the last three years.\(^\text{13}\) More broadly, household income is well below its peak level in the late 1990s.

Nevertheless at the national level, there are some positive signs, such as improvements in the housing market – with home builder confidence index rising from 7.5 in January 2009 to 56 currently\(^\text{14}\) -- and light vehicle sales increasing by 1.1 million units in 2013 as compared to 2012.\(^\text{15}\)

**Connecticut Indicators of Recovery: Mixed Signals**

From September to October nationally one in every 978 housing units received a foreclosure notice. Connecticut had the ninth worst ranking among states at one foreclosure for every 752 housing units.\(^\text{16}\) Reintroducing that level of uncertainty into Connecticut’s housing market will further dampen this sector’s recovery of the last year and three quarters as noted in Chart 2.

While Connecticut housing permits recovered sharply in 2012, their growth has been more muted this year relative to New York and New Jersey, and will likely be further dampened by Connecticut’s above-average foreclosure rates. In addition, Connecticut manufacturing is not closely linked to light vehicle parts and assembly and is therefore not positioned to take advantage of the pent-up demand underpinning light vehicle growth.

Favoring Connecticut growth is recovery in financial markets combined with expectations that international trading pressures and burgeoning hydrocarbon supplies from the Bakken, Marcellus Shale\(^\text{17}\) and other major U.S. finds. These pressures are expected to subdued expectations for inflation, subdue pressures on the greenback, and facilitate low interest rates for many months if not years.\(^\text{18}\) This view is supported by relatively low inflation rates at 1.5%, well below FRB upper limits of 2%\(^\text{19}\) and rebalancing of FRB objectives toward labor utilization rather than just controlling prices.

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\(^\text{12}\) Op cit. Curtain.
\(^\text{13}\) BLS Labor Force Statistics. SA average weekly manufacturing earnings fell from $965 to $880.
\(^\text{14}\) Ibid.
\(^\text{16}\) http://www.bankrate.com/finance/real-estate/foreclosures-by-state/
\(^\text{17}\) Patrick M. Barkey, The Boom that Hasn’t Gone Bust: Maturation of Bakken Oil Production, Nov. 22, 2013. Gas export markets for the U.S. will continue to be limited for a decade by lack of U.S. liquid natural gas (LNG) plants.
\(^\text{18}\) Op cit. Crary et al.
\(^\text{19}\) Ibid.
Confounding both the national and state outlooks are continuing policies which retarded 2013 growth.\textsuperscript{20} Included in these are: (a) the two-percentage-point increase in payroll taxes at the year’s outset; (b) the eventual expiration of the Bush tax cuts; (c) sequestration of the federal budget which the recent budget agreement hardly touches; (d) rising long-term government yields; (e) the October government shutdown; and (f) the ongoing threat to eliminate extended unemployment benefits rather than phasing in reduced payout periods. Connecticut has been directly impacted by budget cuts through decreases in SNAP (food stamps) and layoffs by private sector firms due to the October furloughing of federal personnel including inspectors of private sector output.\textsuperscript{21} Going forward, the abrupt loss of long-term unemployment benefits—which seems likely given their exclusion from the budget agreement—will further undermine both national and state recovery.

During 2013Q3 extraordinary inventory growth contributed 0.8% to RGDP. Those inventories are expected to be reduced during 2013Q4 to offset curtailed inspection capabilities during the furloughs.

\textsuperscript{20} Included in these are the two-percentage-point increase in payroll taxes at the year’s outset, the eventual expiration of the Bush tax cuts, sequestration of the federal budget, rising long-term government yields, and the October government shutdown. SNAP cuts have had direct economic impacts. According to a Center for Budget and Policy Priorities study, Connecticut will receive $44 million less a year in public benefits. The cuts will decrease the disposable income of many families, creating a ripple effect on local retailers and businesses.

\textsuperscript{21} SNAP cuts have had direct economic impacts. According to a Center for Budget and Policy Priorities study, Connecticut will receive $44 million less a year in public benefits. The cuts will decrease the disposable income of many families, creating a ripple effect on local retailers and businesses. Due to the lack of inspectors UTC laid off 3,000 personnel. Those decreases in income are expected to impact adversely on demand in the near future.
While other inventories may have been accumulated there were also lay-offs due to the lack of inspection services. By eliminating 2013Q3 inventory growth nationally and in the state over the year\textsuperscript{22} from RGDP and CTRGSP, this \textit{Outlook} adjusts for some of the private sector 2013Q4 disruptions attributable to government closures.\textsuperscript{23}

**The Connecticut Outlook**

Underpinning the Connecticut forecast are two national series. Given the adjustments noted above, CCEA projects RDGP growth to average 3.1\% annually 2013Q3-2015Q3, slightly faster than RSQE’s outlook (+2.8\%)\textsuperscript{24} due to different estimating process. The anticipated interest rate creep from the current prime rate of 3.25\% is a little less than in the previous \textit{Outlook}, reaching 4.11\% at the end of the period.

**CTRGDP**

At the time the forecast was undertaken, the Bureau of Economic Research has revised its data on CTRGDP downwards indicating a slight decline from 2010Q1 to 2012Q4, as noted in the nearly flat line in Chart 3. In contrast, the methods used by CCEA to estimate recent CTGDP suggest some recovery during the first three quarters of this year. Views about the future of Connecticut’s economic trajectory differ, of course, depending on the assumptions forecasters make and the models they use. The results from a scenario that includes only modest creep in the bank rate indicates accelerated growth to 5.1\% percent annually. This rate-of-growth should definitely be viewed as optimistic because it does not take into account Connecticut’s relatively high level of foreclosures that are likely to continue to be a drag on residential construction.

An alternative scenario that takes into account residential housing permits rising at about 10\% annually, but excluding the bank rate, predicts average annual growth of 2.5\%. However, the 2.5\% rate may prove to be overly pessimistic depending on FRB monetary and state fiscal policy decisions and the simulative impact those could provide.

**Employment**

The performance of the economy relative to the two above scenarios impacts the CCEA’s employment outlook. Chart 4 illustrates forecast FTE growth relative to each scenario. As one would expect, more robust CTRGDP calls forth significantly higher employment, and continues the momentum in the direction forged in the most recent quarter. The slower rate of CTRGDP growth fails to generate sufficient increases in Connecticut employment, and does little to attract previously discouraged workers, as most of the more modest CTRGDP expansion is likely to be met with increased productivity and by more fully utilizing those currently employed.

\textsuperscript{22} This is the same process as followed by the University of Michigan. See Manaenkof et al op cit.

\textsuperscript{23} These disruptions are not apt to be well captured in official data. The BLS decided to keep its survey period to about Oct 11, deployed prior to the impacts of furloughing, rather than continue with its question concerning employment status a week prior to applying its questionnaire administered post-furloughing, thereby obscuring private sector impacts of furloughing in favor of consistency in timing of survey data.

\textsuperscript{24} Op cit. Manaenkof Table 2.
Based on past employment performance, a third model of employment growth by sector yields results consistent with the model based on the bank rate. All the employment growth occurs in the private sector with governments continuing to curtail their direct employment.

**Chart 4: Connecticut Employment Outlook (1,000s)**
Conclusion
The available data argue that a significant share of growth in full-time employment in Connecticut flows from part-timers moving to full-time, reversing some of the part-time arrangements made during the downturn. Thus relatively few of the unemployed are securing positions. Even so, the slowly improving employment picture has very recently begun to bring significant numbers of discouraged workers back into the labor force. If participation rates do reverse, expanding labor force participation, the measured unemployment rate will be increasingly unlikely to decline—the stronger the recovery, the more likely that rate will rise. The case for tempering FRB implementation of monetary tightening, given the historically low levels of labor force participation, is clearly stronger when tied to excess capacity in the labor force rather than the (mis-measured) percentage unemployed, particularly from Connecticut’s perspective when compared to the national one. The expansionary scenario this Outlook presented underlines the importance to Connecticut of extending monetary easing into 2015 to facilitate reentry into the labor force by those most severely impacted by the recession.

Beyond national policies that partially frame the opportunities and challenges for Connecticut, the state itself has substantial ability to shape its own economic future. And for this state, it is absolutely imperative to “bend the curve” as its current trajectory remains quite troublesome. As noted in the Executive Summary, previous Outlooks have offered careful assessments of two potentially powerful strategies that would drive short-term job creation, enhance state revenues, and build long-term competitive strength: these are dramatically accelerating public sector capital projects whose funding has already been approved (now exceeding $6.5 billion) and unleashing the trove of accumulated tax credits to fund private sector capital projects. Together these strategies have the potential to create tens of thousands of new jobs in Connecticut within the next two to four years, bringing employment to an all-time high.

Further, Americans’ loss of confidence in government needs to be reversed by a stable policy environment rather than hop-scotching from crisis to crisis. As Alan Greenspan notes, “... we seem to have lost our legislative ability to reach across the aisle to find common ground for solutions. At risk is the status the American economy has held as the preeminent world economic power for more than a century.” Abnormal policy-imposed risks are adding to uncertainties among both investors and consumers, retarding growth. For both Connecticut and the country to recover fully from the aftermath of the 2007-2008 financial tsunami and ensuing recession, state and national political leaders must continue to work to decrease uncertainty to facilitate economic growth.