Jobs Crisis

Most economists agree states can do a few things, though not a lot, to help create jobs.

BY LOUIS JACOBSON

Everyone who's been paying attention to national politics knows how polarized the fight over job creation has become.

Last fall, President Obama and congressional Republicans continued to slug it out over who has the best vision for the economy.

The president proposed the American Jobs Act—a mix of targeted tax cuts, funds to keep state and local workers on the payroll and to build infrastructure projects, and an extension of unemployment insurance—only to see it stall in Congress. The president then took to the hustings to decry inequities in the tax code between the super-rich and the middle class.

Republicans attacked Obama's proposed tax hikes on wealthier Americans, describing them as an all-out assault on the nation's job creators.

Where the economy, taxes and the budget are concerned, the two sides today are on different planets, a split that is echoed in legislatures across the country.

"The president's plan is the best one I've heard so far," says Assemblywoman Maggie Carlton, a Democrat from the economically hard-hit Las Vegas area. Her state is staggering under an unemployment rate that was at 13.4 percent in October, the highest in the nation. "We need to get very serious in Nevada, where unemployment in the construction trades is over 50 percent."

But Republican Senator Paul G. Campbell Jr. of South Carolina argues temporary tax cuts aren't the best way to help businesses. Decisions on "shovel ready" projects risk being made for political reasons, not economic ones, he says. "The president's proposal doesn't make a bit of sense."

With the federal government paralyzed over how best to spur job growth, what can states do? A range of economists who specialize in economic development agree there are things states can do to improve the nation's jobs outlook, but there are plenty of pitfalls, too.

Most experts agree the states' role in job creation is limited because they have less capacity to jolt the economy than the federal government and they're facing severe fiscal constraints.

Promoting job creation "is really a task for the federal government," says Jeffrey A. Frankel, a professor of capital formation and growth at the Harvard University Kennedy School of Government. Only the federal government has the tools to increase consumer demand and the availability of credit on a large scale, says Roger Noll, an emeritus economics professor at Stanford University.

In addition, states historically have devoted a big chunk of their economic development efforts to luring factories and other types of businesses to relocate within their borders, sometimes with lavish tax breaks and other incentives. Always controversial, such efforts not only have become more spendthrift than ever before, but are also damaging to the national economy since they merely shift employment and do nothing to create new jobs for the nation as a whole.

States are still "trying to attract jobs from other states," says Jon Shure, director of state fiscal strategies for the Washington, D.C.-based Center on Budget and Policy Priorities. "Many states still feel that, by offering lower taxes and higher subsidies, they can grow their economies. It is not a long term-strategy, but states still do it. And companies still play states off against each other, asking for the best deal and then leaving when they get a better one someplace else. It's a sucker's game for states, but no one wants to unilaterally disarm."

Investments vs. Incentives

In Connecticut, efforts are underway to take a different course. Governor Dannel P. Malloy received bipartisan backing from the legislature on two measures aimed at creating new jobs, not just poaching them from other states.

The first, Bioscience Connecticut, calls for investments in the

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state's flagship public university and its health center to promote high-tech investment nearby, providing—in the estimates of its sponsors—3,000 jobs annually between 2012 and 2018.

"We need to find what can be our future, and moving aggressively into biotech and research can be that future," Senate Majority Leader Martin Looney said when the bill was passed. "It requires us to make this investment today because this is the specific opportunity that has presented itself in this time frame and now is the time to do it."

The second measure is a $626 million economic development package that includes cuts in regulations favored by GOP lawmakers and supports worker training advocated by Democrats. There are financial incentives for each job created and even larger benefits for companies that hire veterans, disabled people and the unemployed.

"States are recognizing the importance of organic growth," says Martin Shields, a regional economist at Colorado State University. "Fostering entrepreneurship is increasingly recognized as an important source of growth. The importance of innovation and creativity, and the supporting role that institutions can play in this, is evident in policy initiatives, such as clean energy, biopharmaceuticals and the like."

Yet, Shields acknowledges the limits to such policies, especially the possibility that governments will create a revenue-wasting "industrial policy" rather than letting the free market work its magic.

"At the end of the day, it's very hard to plan economic development," Shields says. "It's hard to pick winners. It's hard to identify and seed 'the next big thing.' "

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>
> *Martin Shields, Colorado State University.*

Is Green Great?

The recent implosion of Solyndra—a politically well-connected solar energy equipment company that received $535 million in federal stimulus money from the Obama administration—has only fueled criticism of efforts to "pick winners," whether it's at the federal or state level.

Joel Kotkin, an author and fellow at Chapman University in southern California who specializes in the future of urban areas, says there may be valid reasons to support "green" industries, but job creation isn't one of them. The jobs created, he said, simply cost too much in taxpayer money to represent a good investment.

"The idea that going green would be economical in the short- to medium-term is off," he says. "It's one thing to say we need to do this for other reasons, but to pretend it's an economic policy is disingenuous."

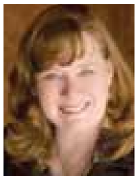
When Michigan tackled changes to its tax code earlier this year, the governor and Legislature took a broader approach. They reduced taxes on an entire class of businesses—limited-liability corporations, many of which are smaller—from 23 percent to 6 percent while also simplifying the rules for deductions.

"We call it economic gardening," says Representative Mark Ouimet, who represents a portion of Ann Arbor. Even though Michigan is best known as the headquarters of the Big Three automakers, "we feel it will be small business that will lead us out of the economic challenge we're in," he says.

Plethora of Policies

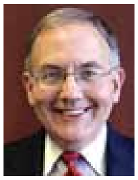
Policies that help create jobs, some targeted and some more holistic, can help states pull out of the prolonged labor slump, experts say.

Efforts to improve workers' skills and advise companies on everything from how to expand locally to how to break into foreign markets are beneficial, as long as the programs are well run, says Ryan Sharp, director of the Center for Strategic Economic Research in Sacramento, Calif.



Assemblywoman Maggie Carlton Nevada

Senator Paul G. Campbell South Carolina



Senator Martin Looney Connecticut

Representative Mark Ouimet Michigan

Making the Top 10

Each year, several organizations compile rankings to compare business climates in the states. While the rankings rely on different criteria, some states have managed consistently to top several lists for the past few years.

North Carolina, Texas and Virginia consistently finish in the top five of at least four business climate rankings. Texas and Virginia have topped CNBC's list every year since it started ranking states in 2007. North Carolina has ranked No. 2 on Chief Executive Magazine's "Best/Worst States for Business" since 2009, edged out only by Texas.

What keeps these states on top?

Those who compile the lists often cite these states' success in categories such as economic growth, unemployment, workforce quality, costs of doing business, tax and regulatory environment, and quality of life. Although every organization evaluates states differently, scoring near the top of several different subcategories may often earn states a top spot in the overall rankings. For example, in CNBC's "America's Top States for Business" rankings in 2011, Virginia was in the top 10 for half of the evaluation categories, helping it earn the top spot overall.

Other states that regularly appear in business climate rankings top 10 lists are Georgia, Florida, South Carolina, Tennessee and Utah. Utah claimed the top spot on Forbes' 2010 "Best States for Business and Careers" list (after Virginia topped the list for four years), and Business Facilities Magazine's "Best Business Climate" list in 2011, largely because of recent economic growth. A states' perceived potential for future growth also can help it make the top 10.

Business Facilities Magazine stresses that the difference between top ranking states is often small. States that appear in the top 10 are all experiencing success in developing their economies, and many of these states consistently finish in the top 10 on more than one list.

—Erica Michel, NCSL

Ernie P. Goss, a regional economist at the Creighton University College of Business in Omaha, Neb., urged quicker processing of payments to state vendors and expediting state and local projects that may be on hold because of a lengthy approval process. "And pray for favorable factors, such as good weather and no natural disasters," he says.

Another option for states are work-sharing programs that allow employers to reduce a worker's hours so those employees then can receive partial unemployment insurance benefits while continuing to work part time, says Dean Baker, an economist and co-director of the Center for Economic and Policy Research in Washington, D.C. The federal government lets states run such programs even when the employee has exceeded the 26 weeks of state unemployment and is tapping into extended benefits during which the federal government pays a larger share.

"This would encourage employers to cut workers' hours rather than lay them off," Baker says. "Twenty states already have work-sharing programs, but the take-up rates are very low. This is because most employers don't even know about it, and because the program tends to be overly bureaucratic. However, if a state could get more widespread use of work sharing, it could be an effective way to bring down its unemployment rate."

"Do No Harm"

Of course, the easiest way for states to prevent job losses is to refrain from cutting state workers. Nationally, private sector payrolls have been increasing, at least modestly, for the past year and a half. It's been government payrolls that have held back employment growth overall. State governments have shed 125,000 jobs since 2008, and local governments have cut another 525,000 over the same period, according to Bureau of Labor Statistics. That's both an enormous drag on the monthly employment numbers and a wallop to the larger economy from lost wages and lower consumer spending.

"One of the best things states can do is not lay off public sector workers," says Shure of the Center on Budget and Policy Priorities. "I'd say, 'first, do no harm.' "

Low interest rates are the silver lining for states in the current economy, Shure says. They allow states to borrow for infrastructure repairs and maintenance that can put people to work.

But the most important strategy may be the least hands-on—that is, just providing the kinds of fundamental conditions that allow businesses to thrive.

"In general, the key to job creation is understanding that governments don't create jobs," says Michael Pakko, an economic forecaster at the Institute for Economic Advancement at the University of Arkansas at Little Rock. "They only provide an environment that is conducive—or not—to job growth."

Both Sides Bring Value

The good news for those craving bipartisan solutions to the jobs crisis, economists agree, is that both liberal and conservative ideas have something to offer. Liberals can take comfort that smart investments in education, research and general infrastructure are important. Conservatives can relish that efforts to eliminate needless regulations and counterproductive tax policies can help.

"What it comes down to is doing things to make sure the environment is positive for business growth," says Mark Schill, vice president for the Praxis Strategy Group.

"We understand certain regulations are for the public good. We don't want to have no regulation. But you need timely answers, more streamlined processes, agencies not competing with each other," he says. "We call it fighting 'DURT'—delays, uncertainty, regulation and taxes."

"Policymakers should ensure that their [state's] tax system is competitive with that of its neighbors," says Creighton's Goss. "This means the tax code should not be cluttered with special cutouts and incentives for a narrow slice of firms and individuals. For long-term, sustained development, policymakers should reduce tax rates at the same time they widen the tax base. Special incentives do the opposite."

Even the most business-friendly environment, however, won't help if your state skimps on shelling out for basic amenities. Carlton, the Nevada legislator, notes her state ranks high nationally for business friendliness but low in education spending. In fact, an Education Week comparison published in 2009 found Nevada ranked third from the bottom of the 50 states in expenditures per pupil when adjusted for local costs.

Carlton says when courting prospective employers, falling short in education "is one of the first things that gets you taken off the list. We really found that out when the recession hit."

Schill emphasizes any solution has to be balanced. "You can neither cut nor spend your way there," he says.

With educational attainment increasingly important for securing good jobs, "focusing so much on cuts is not healthy," Schill says. "It doesn't mean you just throw more money at the problem, but you have to have adequate levels of investment in your workforce."

One of the biggest challenges of enacting a balanced approach to job creation is the nature of politics itself. One obstacle is overindulgence to entrenched interests. Kotkin emphasizes a promising agenda is impossible to accomplish if it bends too much to powerful interest groups, whether they be unions, environmentalists or real estate developers.

Another obstacle is deeply ingrained partisanship. Vicious fights over a few fundamental issues lead to demonization of the other side, which, in turn, makes cooperation on more mundane—and historically bipartisan—issues that much more difficult. "State officials often get caught up in the national debate, whether by choice or not," says Colorado's Shields.

Ultimately, however, voters cannot escape blame entirely, says Noll of Stanford. "Most pundits blame it on weak leadership, but I think that is a cop-out," he says. "We elect them, probably because we like strong personalities and simple, home-spun solutions to complex problems."

"The problem with 'growing your own' jobs," Goss says, "is that it takes longer, and thus is less politically viable for elected officials who have very short time horizons."

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Inching Toward Recovery

The nation's economy is gaining strength, and even employment should start picking up this year.

BY CHRISTOPHER THORNBERG AND ASHA SHEPARD

Many pundits say the United States has yet to pull out of the recession that began in December 2007, and they point to ongoing high unemployment as first-hand evidence.

It's true U.S. employment numbers are grim. The slow pace of job creation resembles the jobless recoveries following the 2001 and 1990 recessions. The job losses in this past recession were much larger as a share of the labor force than those that occurred in the two earlier downturns. The net result is that unemployment in still uncomfortably high at 8.6 percent as of November.

In addition, many workers have simply dropped out of the labor force and are not even counted among the unemployed. Millions have been out of work for more than a year, and with each passing day it grows more difficult for these people to find a new job with pay comparable to what they lost.

Those who say the economy is still in a recession and that a lack of jobs is the problem, however, are confusing cause and effect. First, the U.S. economy is not in a recession. A recession is largely characterized by a decline in aggregate output—in other words, when you are producing fewer goods and services this year as compared to last year. The last quarter of negative growth in the United States was in the second quarter of 2009. Since then, the nation has had nine straight quarters of positive growth, and all indications were that the fourth quarter of 2011 would be positive as well.

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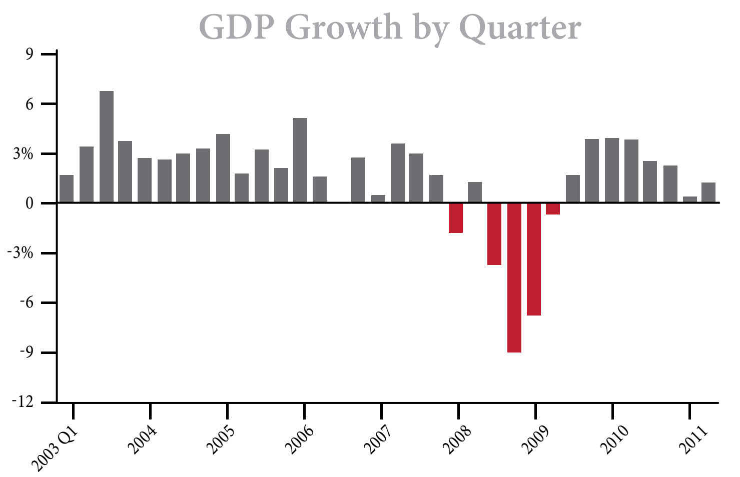

Source: U.S. Bureau of Economic Analysis

Not all the news is grim. Since reaching its lowest point in 2010, total nonfarm employment in the United States as of October had risen by 1.6 percent, or by 2 million jobs. Also, from its peak in 2009 of 10.1 percent, the national unemployment rate had fallen to 8.6 percent in November—still well above historical norms, but an improvement nonetheless. And incomes are rising. Those who have jobs earned more last year than they did in 2010. The number of job openings also continues to rise. Job openings in the United States have been above 3 million for the last three months of data, the best reading since before the recession began, according to the Bureau of Labor Statistics.

That's the good news. Now for some bad news. Many families continue to struggle, and 14 million people who want to work can't find jobs.

So what is wrong with the labor markets? There are really two main problems. The first is the output gap and the nature of the economic recovery itself. The second is something more fundamental: technological change and the growing skills gap.

The Output Gap

The problem isn't that the United States is not growing, it's just not growing fast enough. Looking back at the two major downturns in the mid-1970s and early 1980s, the U.S. economy averaged more than 6 percent growth for the two years after the recession ended. After these growth spurts, the nation's economy had "caught up" with long-run growth trends. The excess growth made up for the steep decline in output that occurred during the recessions. This suggests the labor markets also healed quite rapidly.

This time around, the story has been much different. During the recent recession, the U.S. economy contracted by roughly 5 percent, when normally it should have grown, but for the recession, by roughly 4 percent. This adds up to an output gap of 9 percent. With GDP growth averaging less than the 3 percent since the second quarter of 2009, slightly less than average, the nation cannot close the output gap with a growth spurt. As a result, the labor markets remain weak.

The output gap is one reason there are continued calls for more fiscal stimulus. Unfortunately, many of the stimulus strategies miss their mark because they focus on the consumer. It is true that growth in consumer spending was a large part of the catch-up that occurred in the last two major downturns. But this was because consumer spending had fallen to lower than long run levels during the recession itself.

This time, the consumer was not affected by some external negative shock. Rather, the consumer was the problem. Consumer spending had surged to unsustainable levels in the middle part of the last decade in large part because of a false sense of wealth driven by the massive asset bubble—first in terms of equity prices during the dot.com bubble in the late 1990s and then during the home price bubble of the mid-2000s. This could have created a nice fiscal stimulus for the U.S. economy, but instead our nation simply opened a vast trade gap—our overspending consumers helped China's economy grow more than our own. Since the 1980s, consumer spending went from roughly 74 percent of all income to more than 84 percent by mid-2005. Over the same time, the trade deficit grew from roughly 0 percent of real GDP to nearly 6 percent—showing that much of the expansion in spending accrued to the rest of the world.

So what is the true problem behind the economic recovery and the output gap? It boils down to trade, housing and business spending. True, continued efforts to stimulate consumer spending in the U.S. economy through tax cuts has helped keep

spending from falling as far as it might have, but it also has kept demand for imports very high. The trade deficit is running at 3.5 percent of GDP, or more than one-third of the output gap. Slow down consumer spending for imported products and some of this gap will be erased, which would actually help the United States. The continued decline in the U.S. dollar also will help fill the gap.

As for housing, the problem here is the tyranny of the huge inventory. Over the course of the housing bubble, the United States produced close to 3.5 million housing units that simply weren't needed given the pace of population growth. As a result, new home construction is at its lowest level ever, accounting for close to one-third of the output gap. The good news is that these excess units are dwindling away over time, and the nation should start to see a slow increase in the pace of construction this year, which will start to fill in some of the gap.

Finally, there is the lack of business investment. This explains the last one-third of the output gap. Some of the slow pace of business investment can be linked to the trade deficit itself. If the United States exports more and imports less, businesses will beef up capacity. Using direct incentives such as tax credits could help, too, as would federal spending on infrastructure projects instead of tax cuts.

The Skills Gap

The second problem with the labor markets, and one that is more profound, is a persistent and growing skills gap. The pain of the recession has fallen largely on those with the fewest skills. According to the U.S. Census Bureau, in 2010, those who had a bachelor's degree or higher had the lowest unemployment rate, at 4.3 percent, among all educational attainment levels. This matches the other trend, which is the long-term gap in income between high- and low-skilled workers.

In terms of the slow recovery, the skills mismatch is playing a significant role: There are simply not enough qualified applicants for the types of jobs that are becoming available. The professional/scientific/technical and health and education sectors currently are leading the jobs recovery, but these industries largely employ workers with high levels of education.

Two of the slower post-recessionary growing sectors have been construction and retail, which generally employ more low-skilled workers. Retail can't grow quickly because people already are spending more than they can afford. Construction is being hampered by the excess inventory of housing. And, while manufacturing used to be able to absorb these workers, it is not happening this time. Manufacturing output in the United States is certainly growing and exports are a large source of new profits for these firms, but the sector is not creating many new jobs because information technology is filling the roles that low-skilled workers used to take. This increased technological efficiency is true in many parts of the economy outside of manufacturing.

Cautious Optimism

The forecast is for slow, yet sustained growth for the U.S. labor market. GDP growth has grown at an average rate of 2.4 percent after the end of the recession, which lags the historical trend of post-recessionary growth in economic output. After the recessions of the mid-1970s and early 1980s, GDP grew at a much faster than average pace the two years following their economic troughs. The two post-recessionary years after this recent recession have actually been slower than average, which has led to the painfully slow recovery in the labor market.

By the second half of 2012, GDP growth should exceed 3 percent, which will help speed up the job recovery process. Given that increase in economic output, expect the unemployment rate to fall below 8 percent by 2013, and for total nonfarm employment to increase by 4.2 million jobs over the same period.

Despite what you might read in the media, the U.S. economy continues to recover from the Great Recession. While the pace of job growth so far has left much to be desired, there is ample evidence the recovery process is gaining steam. This has positive implications for job growth over the next few years. Clearly times remain tough for many Americans and the recovery is fragile, but we're headed in the right direction.