

# Inching Toward Recovery

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 over-indulgence 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.”

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



BY CHRISTOPHER THORNBERG AND ASHA SHEPARD

**M**any 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 is 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.

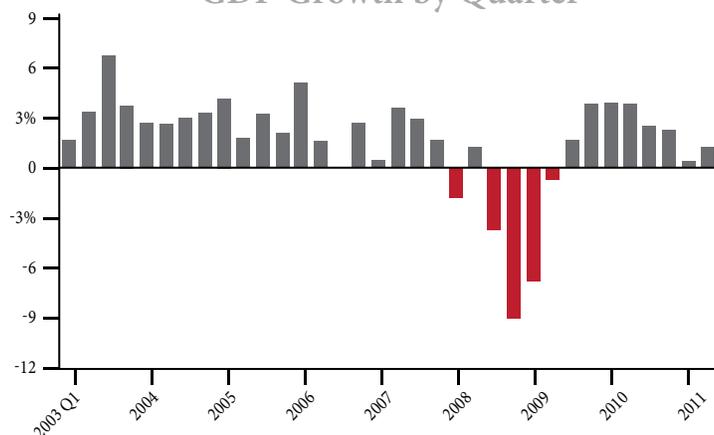
Those who say the economy is still in a recession and that a lack of jobs is the problem, however, are confusing cause and effect. First, the U.S. economy is not in a recession. A recession is largely characterized by a decline in aggregate output—in other words, when you are producing fewer goods and 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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## GDP Growth by Quarter



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.

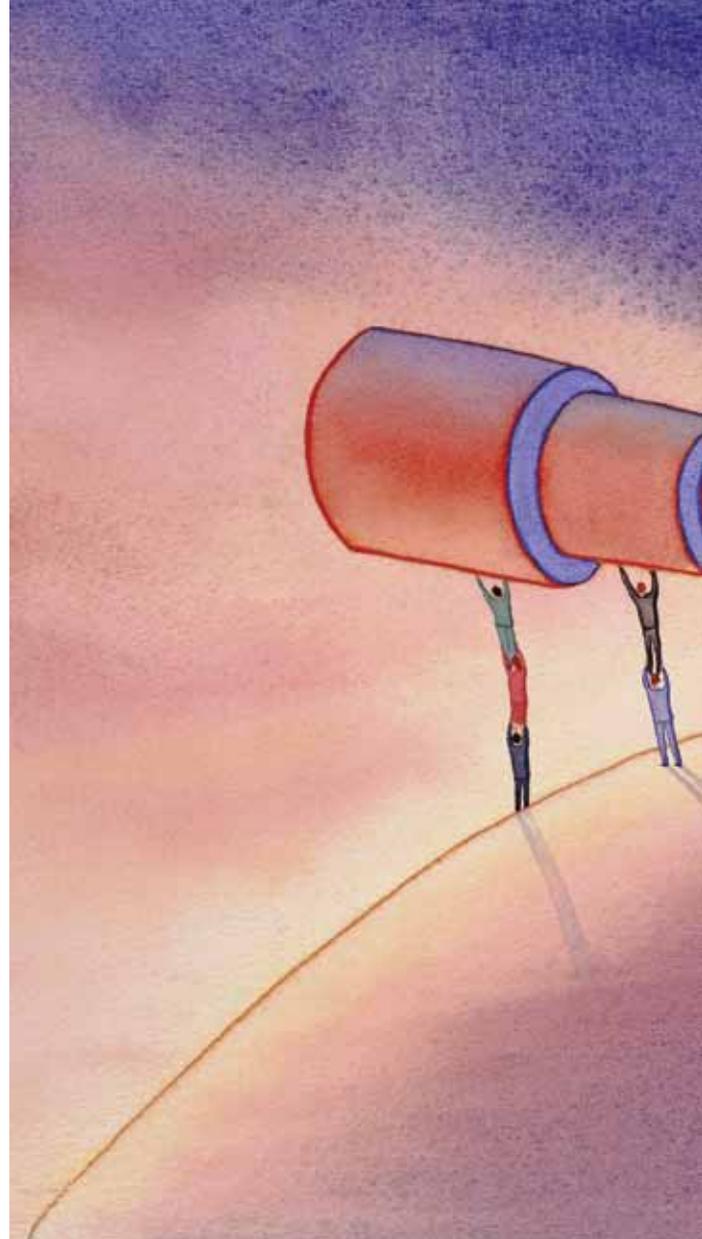
So what is wrong with the labor markets? There are really two main problems. The first is the output gap and the nature of the economic recovery itself. The second is something more fundamental: technological change and the growing skills gap.

### 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.