



*We Did Not Know How Bad It Was:*

*Connecticut's Great Recession: a Steeper Hill to Climb*

**The Connecticut Economic Outlook: August 2012**

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*Revised data on the recession's severity and international problems modify CCEA's Outlook and underline necessity for proactive Connecticut recovery policies.*

## Executive Summary

Connecticut's Great Recession was more severe than we previously thought—and Connecticut was still contracting when the rest of the nation was beginning to recovery. We learn this from revised data the federal Bureau of Labor Statistics (BLS) has just released tracking the state's economic output (Connecticut Real Gross Domestic Product or CTRGDP) from 2006 through 2010<sup>1</sup>. These new, lower values change the basis from which CCEA constructs the *Outlook* as well as the dynamic forces driving recovery. Ultimately, BLS's revisions, compounded by international weakness,<sup>2</sup> reveal that Connecticut has an even steeper hill to climb that we had thought. Given that there are fewer jobs in Connecticut now than in 1988—a generation without job creation—and the resulting demographic trajectory holds serious threats to the state's long-term fiscal health, the new understanding of the depths from which we are recovering re-enforces the emphasis in the last *Outlook*<sup>3</sup> of the absolute necessity for Connecticut to pursue aggressive policies and sustained investments to accelerate recovery and job creation.

This *Outlook* begins with a retrospective to understanding the implications of the BLS revisions. It then turns to more encouraging data showing that Connecticut is enjoying a stronger recovery, measured by housing permits, than neighboring states. Even so, the rising level of activity is still well below pre-recession totals and will not translate into sufficient employment gains to bring the state back to the levels of 2008. And finally we consider some of the initiatives that would help the state's economy achieve the range of growth needed to achieve full recovery and—critically—bend the demographic curve.

## Introduction

A brief retrospective outlining the depths of the recession and recovery to date reveals that Connecticut employment bottomed after national and state real incomes were rising—the result of productivity growth outpacing growth in output. And once growth in output began to translate into job creation, through the end of 2011, the state's economy had recovered less than a third of the 120,000 jobs lost since 2008. While recent development initiatives will contribute to extending Connecticut's recovery, the BLS revisions (see Chart 1 below) show the contraction was worse than previously understood and clearly argues for continuing attention to the challenge of driving economic recovery in the state. The Governor's Business Tax Task Force offers one important opportunity to reframe the tax code to strengthen the state's competitiveness and of unleashing nearly \$2.5 billion in stranded tax credits to fund major capital projects in targeted industries.<sup>4</sup> At the same time, the persistence of high unemployment and the large loss of jobs in Connecticut paying under \$40,000 annually argues for continuing expansion of job training and strengthening the education to workforce pipeline.

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<sup>1</sup> BLS press release for update to the 2011 benchmark: <http://www.bls.gov/sae/benchmark2012.pdf>

<sup>2</sup> International weakness continues to grab headlines with EU's difficulties, slowing of Chinese growth, electricity instability in India and a devastating drought in America.

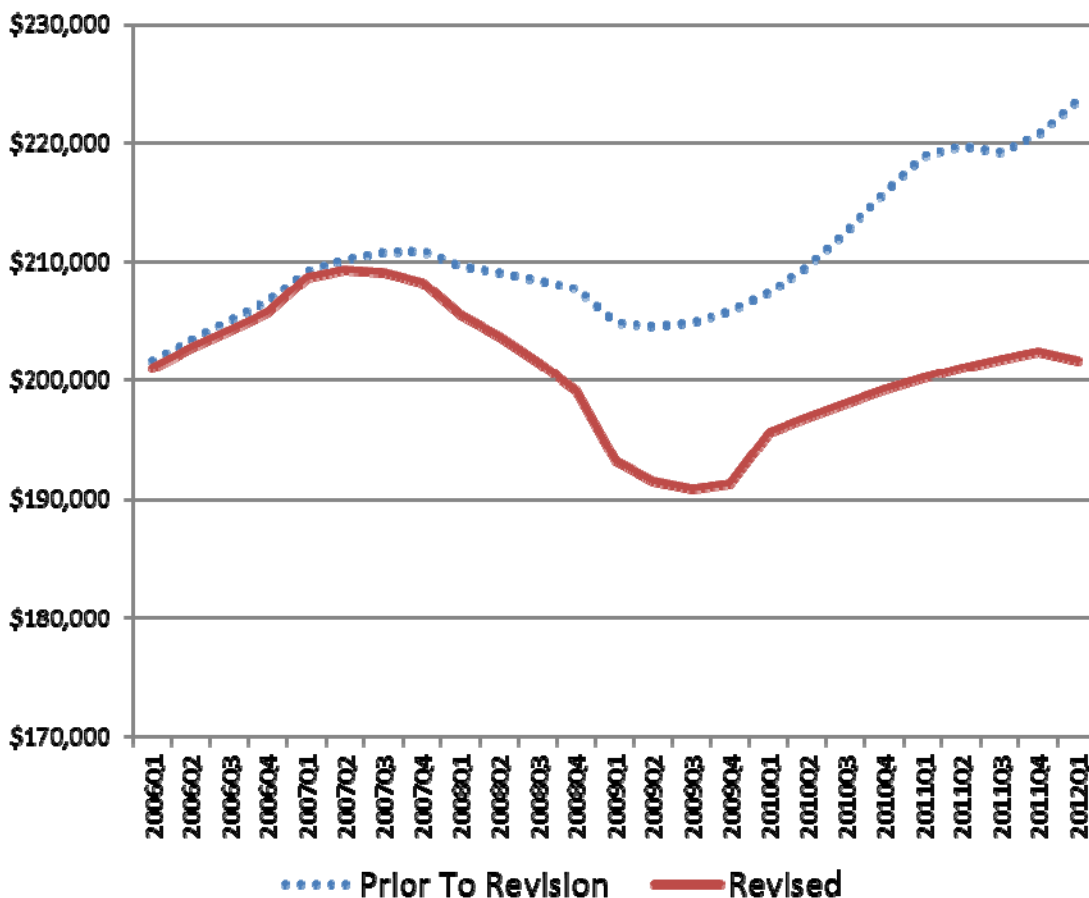
<sup>3</sup> *Recovery Stirring? But will Connecticut be too Old to Compete? CCEA Outlook*, May, 2012. Available at [http://ccea.uconn.edu/forecasts/CTOutlook\\_2012May.pdf](http://ccea.uconn.edu/forecasts/CTOutlook_2012May.pdf)

<sup>4</sup> A CCEA analysis of rededicating stranded tax credits to help fund major capital investments showed that, if fully used, these credits could drive creation of as many as 100,000 new jobs and would be entirely self-financing. See *Driving Recovery: A 2020 Vision for Connecticut*. Available at <http://ccea.uconn.edu/studies/Driving-Recovery-Report.pdf>

## CTRGSP Revisions

The federal Bureau of Labor Statistics sharply lowered its annual seasonally adjusted CTRGDP data for 2006 to 2010 at annual rates as Chart 1 shows. At the extreme, the Bureau's data reveals that in 2009Q4 Connecticut was hit harder by the recession than previous releases indicated, by about \$14.5B down from \$204.5B. Given that reduction, 2010 preliminary figures from the Bureau are well below CCEA's previous forecasts, which relied on BLS data. The impact on this *Outlook's* forecast is to lower the initial point for estimates and to dampen the dynamics underpinning the recovery, as indicated by the flatter growth from 2010Q1 onward. The apparent downward turn in 2012Q1 is also based on BLS's revised personal income data but is partially offset by a slight recovery in the most recent quarter, which Chart 2 shows.

**Chart 1: Revisions to CTRGDP (Millions 2005 \$)**

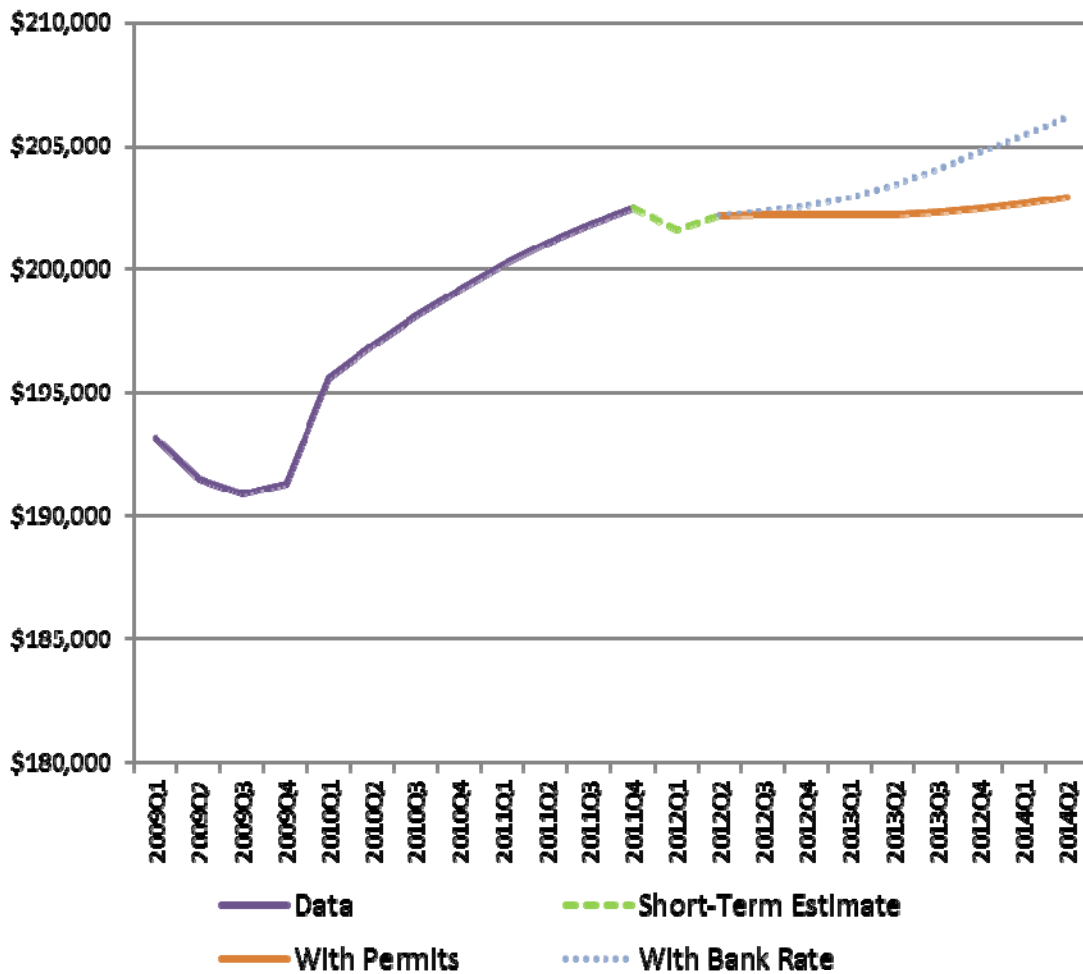


## CTRGDP Outlook

Chart 2 illustrates CCEA's resulting outlook for state output (CTTRGDP). Modeled initially by looking at how, historically, economic factors have interacted, it includes national RGDP, CT employment, real manufacturing earnings, and Connecticut residential housing permits. Despite relatively rapid recovery in Connecticut housing compared with the Tristate region, discussed later, CTRGDP rises slightly by \$875M to

\$203B out to 2014Q2. Using the bank rate instead of housing permits—a substitution CCEA believes appropriate in the current environment—yields higher, more realistic national RGDP and CTRGDP growth. CTRGDP 2012Q2 to 2013Q2 growth rates are at 0.6% followed by 1.3% the following year against a background of 1.3% annually for the nation. The analysis assumes the bank rate will gradually rise by 70 basis points over the eight quarters. Should the Federal Reserve succeed in keeping the bank rate from escalating in this way, there is room for both the national and state economies to reach slightly higher rates of recovery. Another approach is to move from the strictly retrospective view of the forecast modeling into a more proactive approach that includes the impact exceptional major projects (e.g., BioScience Connecticut or the Bridgewater Associates campus development in Stamford), an approach taken later in the employment section.

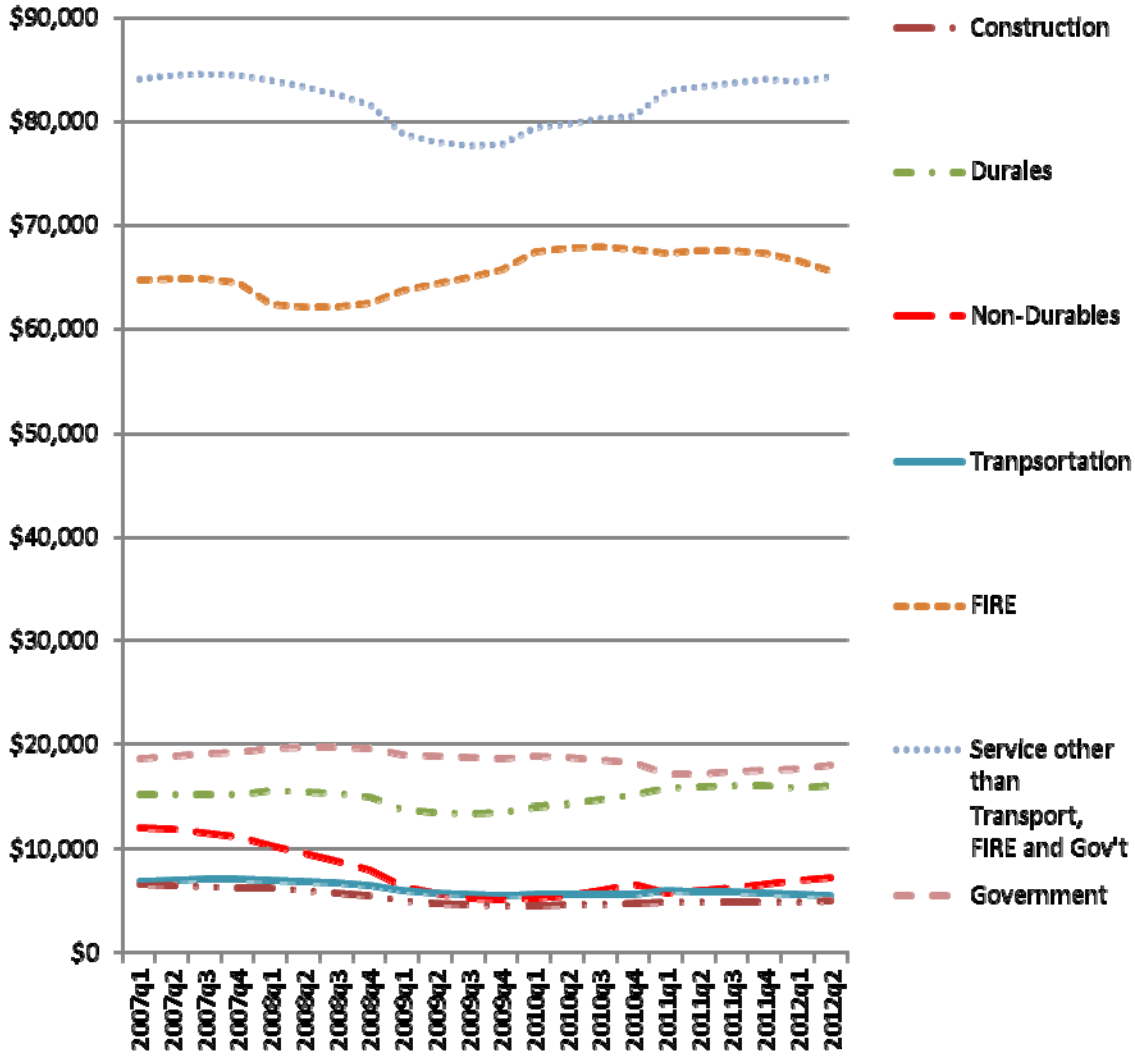
**Chart 2: CTRGDP Outlook (Millions 2005 \$)**



## Sector CTRGDP

At the sector level, the Connecticut anatomy of the recession becomes a little more transparent. Chart 3 dissects trends in Connecticut sector RGDP. It is clear that the downturn in Finance Insurance and Real Estate (FIRE) was a precursor of the recession. Further the most seriously impacted sectors were non-durable manufacturers and services other than FIRE and transportation and utilities. Durable manufacturers were less seriously impacted than their non-durable counterparts. There has been a relatively strong recovery in durables and other services, inclusive of health, but the recovery in FIRE appears to be fizzling out. Recent market recoveries could ameliorate the likelihood of a future decline in that sector, but the impact of Dodd-Frank and other regulatory interventions may mean that this weakness is a precursor of further difficulties. CTRGDP generated in government fell to \$17.2B in 2011Q2, but has since recovered to \$18.0B at annual rates. Future CTRGDP generated by government depends very much on pending election results.

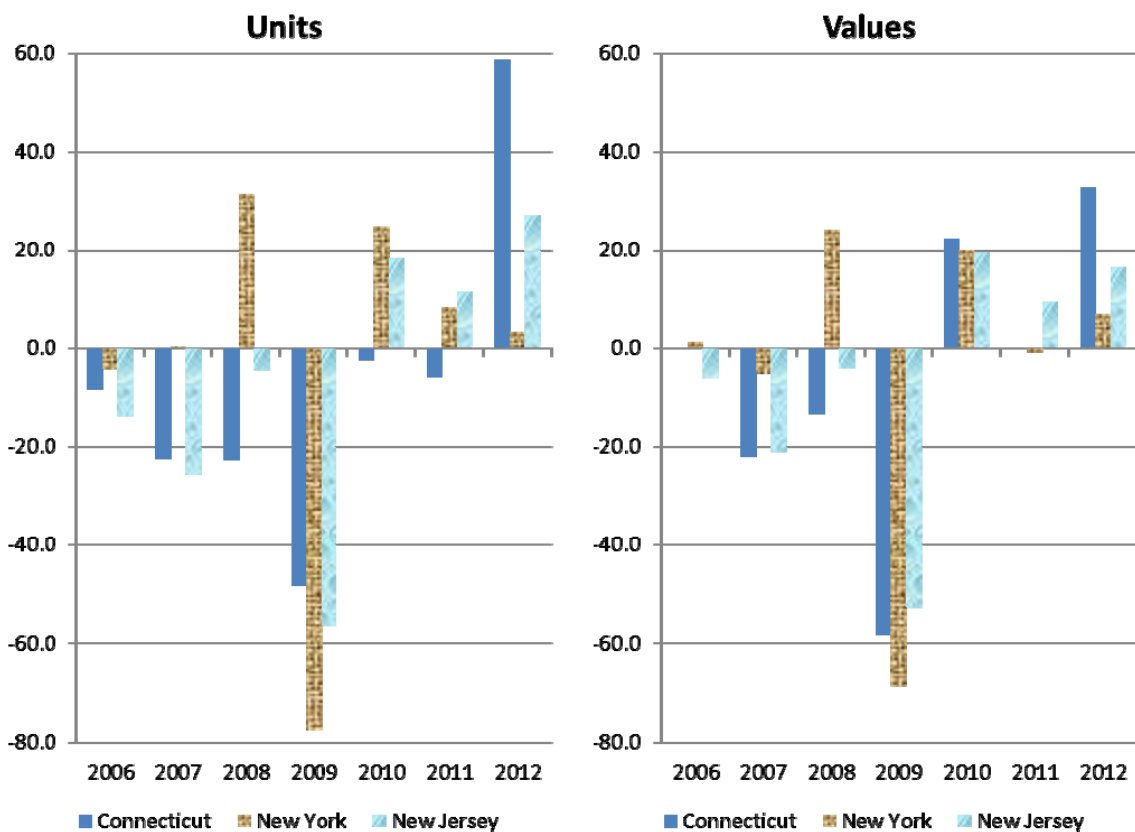
**Chart 3: CTRGDP by Sector (Millions 2005 \$)**



## Housing Permits

Connecticut housing permits recovered strongly during the first and second quarters of this year, particularly encouraging given the nation's leading rate of decline in housing prices.<sup>5</sup> While the first quarter recovery was thought to result from the unusually warm winter, sustaining that recovery at nearly 60% into the second quarter, accompanied by increases in the average value of the permits issued, argues that the recovery may be taking hold. The value of Connecticut housing permits increased at 32.8% over the first six months, twice the rate achieved in the first quarter. As Chart 4 shows, for the Tri-State area, first half 2012 growth in both number of units and the value of Connecticut housing permits has far outpaced those in the states of New York and New Jersey. In all jurisdictions but New York, the smaller percentage change in values relative to permits suggests a shift in construction to more modest homes, including multi-family rental units.

**Chart 4: 2012 First Half CT Housing Permit Changes (%)**

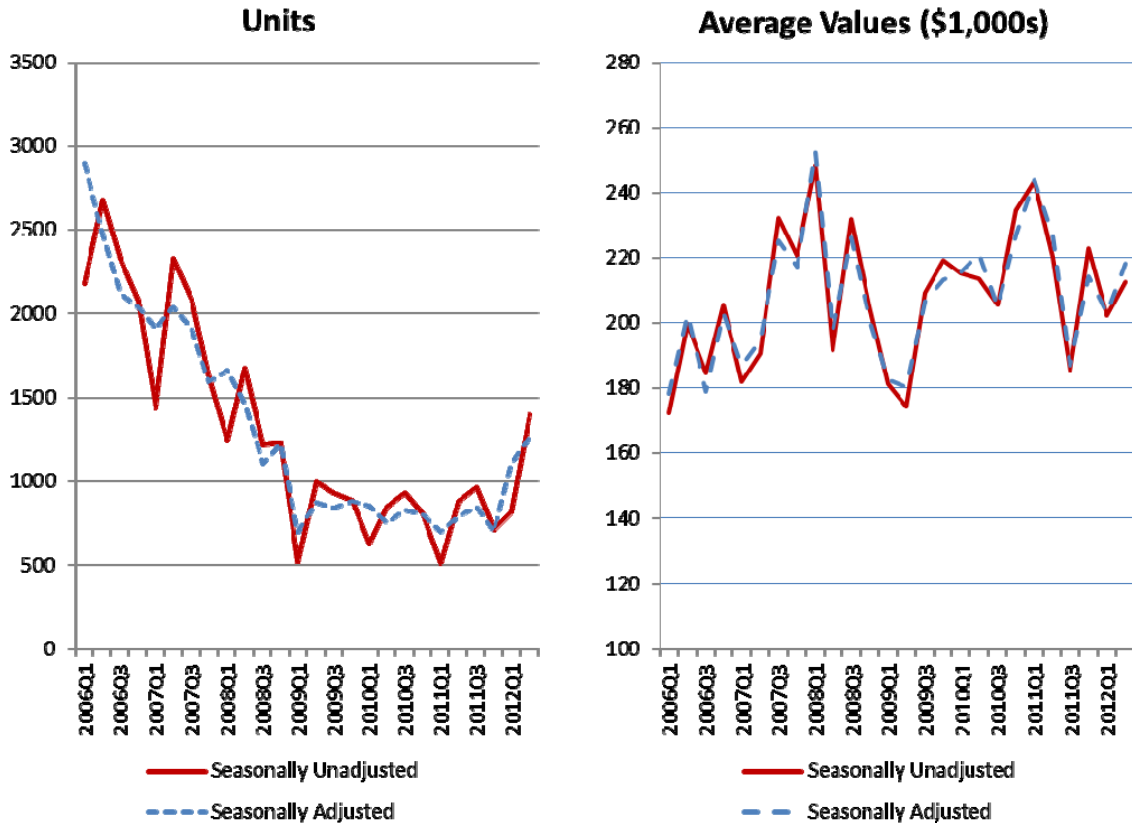


2012 gains come after the grueling decline in the number of units permitted over the previous six years, a contraction that predated the recession, and falling values in all but one of those years. As noted in Chart 5, these gains are insufficient to make up the entire shortfall. At half the level before the recession, there is a long way to go before fully righting the ship. Average values of permits also indicate modest recovery, but remain below the peaks achieved at the outset of 2008, after which average permit values fell to three

<sup>5</sup>The Federal Housing Finance Authority index released this month showed Connecticut among only eight states with falling housing prices, year-on-year, and had the largest contraction, at more than 4%.

quarters of that high. The seasonally adjusted indicate that the strength in average values may be stronger than indicated by the unadjusted data, while the retrospective CTRGDP outlook cautions about putting too much faith in residential housing permit recovery as a driver of Connecticut's economy.

**Chart 5: Quarterly CT Housing Permits and Values 2006-12Q2**



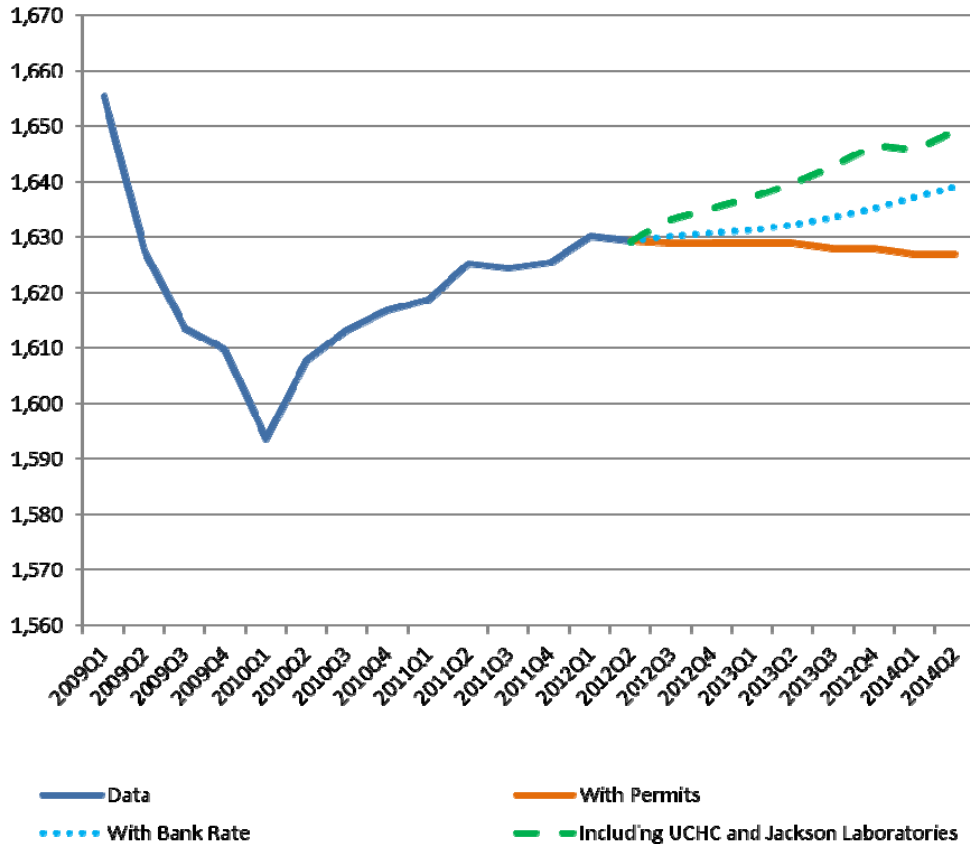
### Employment Outlooks

Slower CTRGSP growth translates into lower employment growth than previously forecast. Because the employment data come from Bureau of Labor surveys, rather than the BLS, historical data to 2012Q2 have not been readjusted in line with lowered state output. The interrelationships among the data included in modeling of the *Outlook* have however been impacted. CCEA now regularly supplements its conventional employment forecast, based on its retrospective approach, with the expected impacts of new major projects, including the \$840 million expansion of the UConn Health Center (BioScience Connecticut) and the development of Jackson Laboratories, captured in Chart 6. Adding the upturn in residential housing permits prevents the employment forecast from dipping further than a couple of thousand over the eight quarters.

The model deploying the continuing low bank rate works better because the bank rate influences national RGDP, which in turn positively impacts CTRGDP and employment. Retrospective modeling anticipates

modest growth in employment of 10,000 over the next two years—insufficient to return total employment to anything approaching the level of 2008, let alone the higher level need to change the demographic trajectory. There is the potential for major projects, inclusive of the UCHC, Jackson Laboratories, the Hartford-New Britain busway, and other planned initiatives, at least to double job growth, as shown by the higher projection. The remaining gap between expected and the level of 2008 however will still remain close to 70,000.

**Chart 6: CT Employment Outlook (1,000s)**



Closing this gap will require more than just job creation. It requires policies to recover the pride and the employability of persons who have suffered from long-term unemployment. Connecticut has successful organizations with considerable experience in such activities, including the Mashantucket Pequot initiatives and Platform to Employment in Stamford. The Mashantucket-Pequot has a long and proud history of rehabilitating individuals drawn from the slums of New England, gradually bringing them back into the labor force. Platform to Employment is a joint private public sector venture that runs five-week courses to reorient those who have exhausted employment benefits back into the labor force.<sup>6</sup> It has a 70% success rate. Such organizations constitute building blocks on which to reconstruct both the lives and livelihoods of those who are being slighted by job advertisements that indicate only those currently employed should apply. To this the State has expanded training programs in advanced manufacturing and other areas at its public colleges.

<sup>6</sup> Reuters August 3, 2012 and CBS 60 Minutes, August 12, 2012.



## Conclusions

CCEA projects the Connecticut economy's real output and employment will continue to grow more modestly than anticipated by the previous *Outlook*,<sup>7</sup> even inclusive of significant added growth in CTRGDP and employment flowing from development of the biomedical cluster in Farmington and other major projects.

Developing the biosciences cluster, with the twin anchors of the UConn Health complex and Jackson Laboratories, establishes a leading-edge industry that should contribute to the health and wealth of Americans for generations to come. Connecticut is now establishing the required elements to create the industry synergy that emerged at North Carolina's Research Triangle and along Route 128 in the Boston area. This health complex can deliver strong growth to the state for decades. Thus, beyond the forecasting period, as the biosciences complex builds out and becomes fully operational, the impacts on Connecticut growth will continue to expand.

The remaining challenge is to articulate policies and programs that build on this initial success. The most obvious example is high precision manufacturing, in which Connecticut is both very competitive in absolute terms and has improved its competitive position strikingly in the past decade. More broadly, as with the biosciences, Connecticut is deeply engaged in research and development activities. Addressing the poorly conceived policies that limit the use of accumulated but now stranded tax credits and that prevent conversion of this enormous fund of nearly \$2.5 billion—there is no other pool of funds comparable to these credits—from a liability to an asset is clearly the most important policy challenge the state confronts, one critical to its future competitiveness<sup>8</sup> in growing strong, high-value sectors in the state's economy.

Successful public/private initiatives designed to recover capable persons from the ranks of the long-term unemployed need to complement fiscal and investment stimuli. Built on Connecticut expertise, employment recovery needs to focus on the positive aspects of being employed as well as retaining and refocusing on employment opportunities that are available.

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<sup>7</sup> Realistically, the only option to the policies adopted would have been dramatic budget reductions, which CCEA projected could have much larger negative impacts on both employment and output.

<sup>8</sup> Major firms have accumulated nearly \$2.5 billion in tax credits whose use is highly restricted because, as constituted, they are a liability on current revenue. Converted to underwrite major capital projects, these credits become a major asset, driving extensive new construction and job creation. For a thorough analysis, see "Driving Recovery" on the CCEA website: <http://ccea.uconn.edu/studies/Driving-Recovery-Report.pdf>.