A feast or famine economy: the Bay State’s robust but imbalanced economic recovery

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A Feast or Famine Economy:
The Bay State’s Robust but Imbalanced Economic Recovery

MASSACHUSETTS’ REBOUND FROM THE RECESSION HAS OUTPACED THE NATION, BUT THE BAY STATE’S RECOVERY HAS BEEN SKewed. IT HAS BEEN BUSINESS-LED, WHITE COLLAR, AND REGIONALLY IMBALANCED.

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A Robust Economic Recovery

By a number of different measures, the state’s economic recovery from the “Great Recession” has been a robust one throughout 2010. The growth in overall economic activity has significantly exceeded that of the U.S. in each of the first three quarters of the year, employment has been expanding at a pace not seen since the mid-1980s, export growth has been strong and state tax revenues have been coming in above forecast.

However, for many across Massachusetts, it doesn’t much feel like a strong recovery is underway. Statewide, consumer and business confidence remain weak, high levels of joblessness in key industries and major regions of the state persist, and the housing slump is entering its sixth year.

Part of the explanation for the disconnect between the undeniably strong macroeconomic performance of the state economy and the “lived experience” of this recovery in many sectors of the economy and regions of the state is revealed by a closer look at the areas of the economy and of the state that have been benefitting from this recovery and those that have not. In a number of important respects, this has been a business-led, white collar and regionally imbalanced recovery.

A Business-Led Recovery

As measured by the MassBenchmarks Current Economic Index (CEI), the state economy emerged from recession in the summer of 2009 and has grown steadily since.

In a number of important respects, this has been a business-led, white collar and regionally imbalanced recovery.

Throughout 2010 the pace of the Commonwealth’s economic expansion has consistently outpaced the U.S., frequently by a substantial margin.

As can be seen in Figure 1, Massachusetts grew at nearly twice the rate of the U.S. in the first and third quarters and nearly three times as fast in the second quarter.

The Commonwealth’s “growth premium” appears to be largely a function of the strength of the Massachusetts innovation economy that, unlike in recent recessions, helped buffer Massachusetts from the “Great Recession” and has been a growth driver during the recovery period.

Specifically, Massachusetts has benefitted significantly and disproportionately from the choices that consumers, firms and investors have been making in how they spend and invest the trillions of dollars in capital that have been injected into the national economy as the result of federal
monetary and fiscal policy choices. According to the U.S. Bureau of Economic Analysis, as of the second quarter of 2010, corporate profits had nearly regained their prerecession peak.

To date, while federal stimulus efforts have had a demonstrable and positive impact on the national economy,1 they have not succeeded in improving the national jobs picture sufficiently to induce a recovery in consumer spending, a prerequisite for more robust national growth in economic activity and job creation.

While weak consumer demand is understandable in light of the nation’s high unemployment rate and uncertain economic outlook, weak demand, along with the current low interest rate environment, helps to explain why businesses have been in a cost-cutting mode, have been reluctant to hire, and have been making significant investments in their future capacity to grow both through spending on inventory replenishment and investment in productivity-enhancing technology products and processes.

According to the most recent U.S. GDP report, investment in equipment and software — a reasonable proxy for investment in innovation and technology sectors — grew by 12 percent between the second and third quarters of 2010, dwarfing the more modest 2.6 percent rise in personal consumption expenditures and a 0.5 percent growth in disposable personal income during the same period.

As can be seen in Figure 3, investments in equipment and software declined precipitously in the last half of 2008 but have recovered rapidly since. While the pace

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**Figure 2. Corporate profits before tax with inventory valuation and capital consumption adjustments**  
(Seasonally Adjusted Annual Rate, Billions of Dollars)

![Figure 2](source)

**Figure 3. Business investment is driving current economic growth in Massachusetts**

![Figure 3](source)
of growth has slowed of late, this pattern helps to explain why the innovation-intensive Massachusetts economy has been expanding significantly faster than the more consumer-dependent national economy.

**A Largely White Collar Recovery**

While the pace of job growth appears to have slowed in the late summer, through September job growth during 2010 has been strong in both absolute and relative terms. During the second quarter of 2010, payroll employment in Massachusetts expanded at a 4.5 percent annual rate — over twice as fast as the nation’s during that period, the fastest quarterly growth in the past 25 years.

The strong job growth during the first three quarters of 2010 has had a significant impact on unemployment. On a seasonally adjusted basis, the state unemployment rate began the year at 9.5 percent (January) and by September had fallen to 8.4 percent. Since the state’s labor force has grown throughout 2010, it is clear that this improvement is largely the result of workers finding jobs rather than leaving the labor force.

Significantly, the underemployment rate for Massachusetts, the U-6 rate, which includes discouraged workers and those working part-time who wanted full-time work, has fallen significantly in recent months according to an analysis by MassBenchmarks Senior Contributing Editor Alan Clayton-Matthews. As can be seen in Figure 4, the U-6 underemployment rate for Massachusetts fell (on a seasonally adjusted basis) from 16.8 percent in December of last year to 11.8 percent in September. During this same period, the U.S. rate declined only slightly (from 17.3 percent in December to 17.1 percent in September).

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Even though job growth appears to have come down to earth in recent months, the Commonwealth has continued to add jobs at a respectable clip. For the year ending in September 2010, Massachusetts added an estimated 23,400 net new jobs, an annual growth rate of 0.7%.

Not surprisingly, those sectors of the economy that benefit most from federal spending and private investments in innovation and technology have experienced the most robust job growth during the past year. In the year ending in September 2010, the following super-sectors added jobs at a faster rate than the state overall: Professional and Business Services (3.0%), Construction (2.0%), Information (1.1%), and Education and Health Services (1.6%).

While construction employment has been expanding at a relatively rapid clip in the past year, employment in this sector remains well below prerecession levels. In the fourth quarter of 2007, Massachusetts was home to an

![Figure 4. Underemployment Rate (U-6 Definition)](source: U.S. Bureau of Labor Statistics, CPS. Seasonally Adjusted. The Massachusetts underemployment rate is seasonally adjusted by NUE.)
estimated 137,500 employed construction workers. As of September 2010 employment in this sector was 108,100, a decline of 22 percent. So while recent growth in construction employment is very welcome, this critical sector remains years away from a full recovery, even if one assumes that the current pace of job creation is sustainable.

A Regionally Imbalanced Recovery
The divide between the labor market outcomes of so-called blue collar and white collar workers is explored in more detail elsewhere in this issue (see Sum et al., page 12 of this issue). However, before concluding our discussion of the state of the state labor market, we briefly note that the disparities in the economic experiences of different workers and different industries also manifest regionally.

The so-called innovation economy has been a major growth driver for the Commonwealth in recent decades and during the current recovery. Massachusetts is home to world-class research universities and research and development institutions that are a magnet for public and private investment and have helped the Bay State to incubate and grow a wide variety of technology and knowledge-intensive enterprises in a wide variety of areas. These include information technology, life sciences, and a wide variety of advanced manufacturing sectors that contribute to and benefit from a robust industrial and economic ecosystem that has made Massachusetts a world leader in a wide variety of advanced technology fields.

This ecosystem and the lion’s share of the benefits of Massachusetts’ innovation economy remain concentrated in the Greater Boston and Northeast regions of the state. As can be seen in Figure 5, the unemployment rates in the Commonwealth’s older industrial cities have been consistently higher, often significantly higher, than the overall state rate. While many significant efforts are underway to extend these opportunities and benefits to the rest of the state, these efforts have not yet made a significant impact on a number of the state’s regional economies and urban areas. Consequently, the benefits of the business-led and largely white collar recovery described above have been regionally as well as industrially and occupationally imbalanced.

Those firms, regions and households that have been left behind during the recovery have had a far different experience than might have been expected given the relatively robust state recovery to date. For many households beyond the Route 495 belt, and those working in the construction, manufacturing, and consumer sensitive sectors statewide, it continues to look and feel like a recession.

The Housing Market Slump: Five Years and Counting
At the conclusion of the third quarter, the Commonwealth’s residential housing entered the sixth year of its slump as measured by the S&P/Case-Shiller Home Price Indices for the Metro Boston market. As of August 2010, overall housing prices have fallen an estimated 13.7 percent from their peak in the third quarter of 2005, effectively returning to 2003 levels. These declines pale in comparison with those in other regions of the nation, several of which have experienced declines of over 50 percent during the same period.

These price declines have taken their toll on home equity and have pushed an estimated 15 percent of Massachusetts homeowners with a mortgage underwater (into a negative equity position). While price declines have yet to visibly improve housing affordability due to continued unemployment challenges and stagnant wage growth, they help to explain why foreclosure deeds in the first nine months of 2010 are up over 58 percent from a year earlier (from 6,796 to 10,777).

It appears that despite historically low mortgage interest rates, high inventory levels suggest slow growth is the most likely near-term outlook for the housing market in Massachusetts.
Figure 5. Unemployment Rates in the Gateway Cities
(Not Seasonally Adjusted)


Note: Unemployment rates are not seasonally adjusted to allow for a direct comparison between statewide and urban rates.
Massachusetts. According to the Massachusetts Association of Realtors, in July 2010 there were over 43,000 active listings. While the large number of listings may in fact represent evidence of a housing market gaining strength — as homeowners feel more confident about the outlook and put their homes on the market — given current levels of sales activity, this represents approximately nine months of supply and a considerable inventory overhang to be worked off. While the housing market is clearly struggling, there are some positive signs. “Time on the market” data show that houses are taking about the same time to sell as last year, when the homebuyer credit was still in effect. Further, a recent Mass Insight® consumer confidence survey reported that 75 percent of respondents thought it was a good time to buy rather than rent a home.

**THE OUTLOOK FOR 2011**

The national economy appears to be in for a long, slow recovery from the recession. Recessions arising out of financial crises are especially difficult to break out of, as cleaning up both household and business balance sheets saps the potential for pent-up demand in these sectors. Protracted recovery with sustained high unemployment is the norm in the aftermath of a deep financial crisis. This is the situation that continues to weigh heavily on the national economy, and while the Commonwealth has been experiencing faster than national growth, it will prove unsustainable if the national economy does not begin to grow more quickly.

The short-term prospects for national growth, absent further stimulus from the federal government, are modest at best. Consumers and businesses are being cautious in their spending, the housing market remains quite weak and there are a number of global risks that could affect domestic growth. Under the circumstances, this suggests that the highest probability near-term growth outlook for the Commonwealth will involve slower, albeit positive, growth in the state economy.

A slower rate of growth in overall economic activity can be expected to, in turn, slow the rate of state employment growth. In addition to these significant cyclical employment challenges, the Massachusetts labor market faces substantial structural problems as well. The construction and manufacturing sectors have lost a multitude of jobs, many of which are unlikely to return to prerecession levels anytime soon. This creates profound challenges for workers who have lost these jobs and a crucial workforce development challenge for state and regional education and training policymakers.

**Another Difficult Year Ahead for State and Local Government Finances**

In recent months the state has experienced stronger than expected growth in tax revenues, which, along with the defeat of ballot Question 3 (which would have cut the state sales tax from 6.25 to 3 percent), has put the state in a more solid fiscal position than many observers had expected earlier this year.

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In October of 2010, the state’s Department of Revenue reported that revenues are 9.5 percent higher than they were a year earlier (in October 2009). This represents $413 million dollars above expected levels for the first four months of FY 2011. Despite this welcome and not altogether expected growth in state revenue, the Commonwealth continues to face a large structural deficit that will present the governor and legislature with some very difficult decisions as they develop the FY 2012 state budget.

In the year ahead, Massachusetts budget writers will not have the luxury of relying on one-time revenues such as the federal stimulus and rainy-day funds to close the budget gap as they have in recent years. The Massachusetts Taxpayer’s Foundation has estimated that the state faces a $2+ billion dollar budget gap. In the absence of additional federal stimulus funds, closing it will require some very hard choices.
CONCLUDING THOUGHTS

The relatively robust recovery of the Massachusetts economy in the aftermath of the “Great Recession” is a welcome change from the lagging performance of the Bay State during the recessions of the early 1990s and 2001–2003.

The most vexing problem facing the state, and perhaps the nation as well, is the uneven benefits of economic growth. The state’s traditional path to middle class status has largely been through blue collar sectors, many of which have suffered disproportionately in recent years. In addition to sectorally imbalanced job growth, regional inequality remains a major challenge. Beyond metropolitan Boston, the prospects of robust economic growth are not bright, and the Commonwealth’s challenges go well beyond the problems presented by the current business cycle. Many of these communities and regions are in a state of long-term stagnation, from which there seems little prospect of escape. Our imbalanced recovery underscores that in 21st century Massachusetts, the benefits of economic growth and the substantial incomes generated by our world-class innovation economy largely accrue to workers and regions with the necessary brainpower and physical, technological and intellectual infrastructure to compete at a high level in an increasingly competitive and global economy. Ensuring that a broader array of the state’s regions and working families have the opportunity to reap the benefits of expected periods of future prosperity may be the most important and challenging issue facing both the political and business leaders of our Commonwealth.

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ENDNOTES


3.) First American Core Logic, Negative Equity report, Q2 2010.


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