
The State of Working Pennsylvania 2010

Mark Price and **Stephen Herzenberg**



The Keystone Research Center
Harrisburg, Pennsylvania





The Keystone Research Center

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About the Authors

Mark Price, KRC labor economist, holds a PhD in economics from the University of Utah. His dissertation, *State Prevailing Wage Laws and Construction Labor Markets*, was recognized with an Honorable Mention in the 2006 Thomas A. Kochan and Stephen R. Sleigh Best Dissertation Awards Competition sponsored by the Labor and Employment Relations Association.

Stephen Herzenberg is the executive director of the Keystone Research Center and holds a PhD in economics from MIT. He is a coauthor of *Losing Ground in Early Childhood Education*, published in 2005 by the Economic Policy Institute, and *New Rules for a New Economy: Employment and Opportunity in Postindustrial America*, published in 1998 by Cornell/ILR Press.

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Overview

This report, the Keystone Research Center's 15th annual check up on the Pennsylvania economy, makes three simple points.

First, the last 12 months of data on the Pennsylvania and U.S. economies make clear that the extraordinary interventions in the economy by the Federal Reserve, the Bush and Obama administrations, and Congress were effective in forestalling the free fall of the U.S. economy. For Pennsylvania, the simplest indicator of this is the monthly average change in jobs each month. Before the American Recovery and Reinvestment Act (ARRA), Pennsylvania was losing nearly 30,000 jobs per month and this number was growing rapidly. This year, Pennsylvania is gaining jobs each month, on average.

As in the early 1930s, many voices, including within Congress, urged policy makers to do nothing in the face of the collapsing economy. Had this point-of-view prevailed, current unemployment in the United States would be about 15% or 16%.

Second, despite the success of the ARRA, Pennsylvania's economy remains in deep trouble. The state economy would need to add roughly 300,000 jobs to boost employment enough to replace the jobs that have been lost since the recession began, as well as to provide enough employment to match the growth in the working-age population. Even more troubling, the jobs deficit has stopped falling in recent months. Once again policymakers face a choice between intervening forcefully to create more jobs or doing nothing. If they make the second choice, the unemployment rate is likely to remain above 7% until 2014.

Third, there is another "deficit" that underlies the challenges of the U.S. and Pennsylvania economies—the deficit in the buying power of the middle class. This deficit contributed to the emergence of the Great Recession by prompting more families during good economic times to finance their consumption through debt, including risky mortgages or home equity loans that hinged on the unrealistic assumption that rapid increases in housing prices would continue indefinitely.

The deficit in the buying power of the middle class is the result of stagnation in the incomes and wages of working families, evident in trends in hourly wages for Pennsylvania workers since 1995. In the last 15 years during which productivity grew by 43%, the inflation-adjusted hourly wages of both college-educated and high-school educated Pennsylvania workers barely budged.

To gauge the size of the "wage deficit," consider how much more workers would earn today if wages for all workers were distributed as equally as in 1979. In this scenario, workers at all wage levels would have seen the same increases since 1979—as opposed to what actually happened, with wage increases going mostly to high earners. Today, a full-time, year-round Pennsylvania worker earns between \$2,800 and \$3,750 less today in annual income than if the wage distribution had not become more unequal. Middle-class families with two full-time earners would be making between \$5,600 and \$7,500 more per year.

The jobs and wage deficits are far more immediate problems for Pennsylvania families than the accumulated debt or annual federal deficit of the U.S. government. Especially in an election year, voters should ask lawmakers at the federal and state level, "What are you going to do about the jobs deficit?" and "What are you going to do about the wage deficit?"

Page nine at the end of this report briefly outlines our own recommendations for reducing the jobs deficit. The federal government should extend a successful program for creating subsidized jobs. It should also finance extended benefits for jobless workers as long as there are many more unemployed workers than there are available jobs. Beyond this, the federal government should finance a more ambitious jobs program using money saved by not extending the Bush Administration tax cuts for taxpayers earning over \$250,000.¹

¹ For more detailed long-term policy recommendations that would also reduce the wage deficit, see *The State of Working Pennsylvania 2009* (online at http://keystoneresearch.org/sites/keystoneresearch.org/files/SWP2009_2.pdf) and, especially, *The State of Working Pennsylvania 2008* (online at <http://keystoneresearch.org/sites/keystoneresearch.org/files/SWP2008.pdf>).

Go to Page 9 of the report to view our Policy Recommendations.

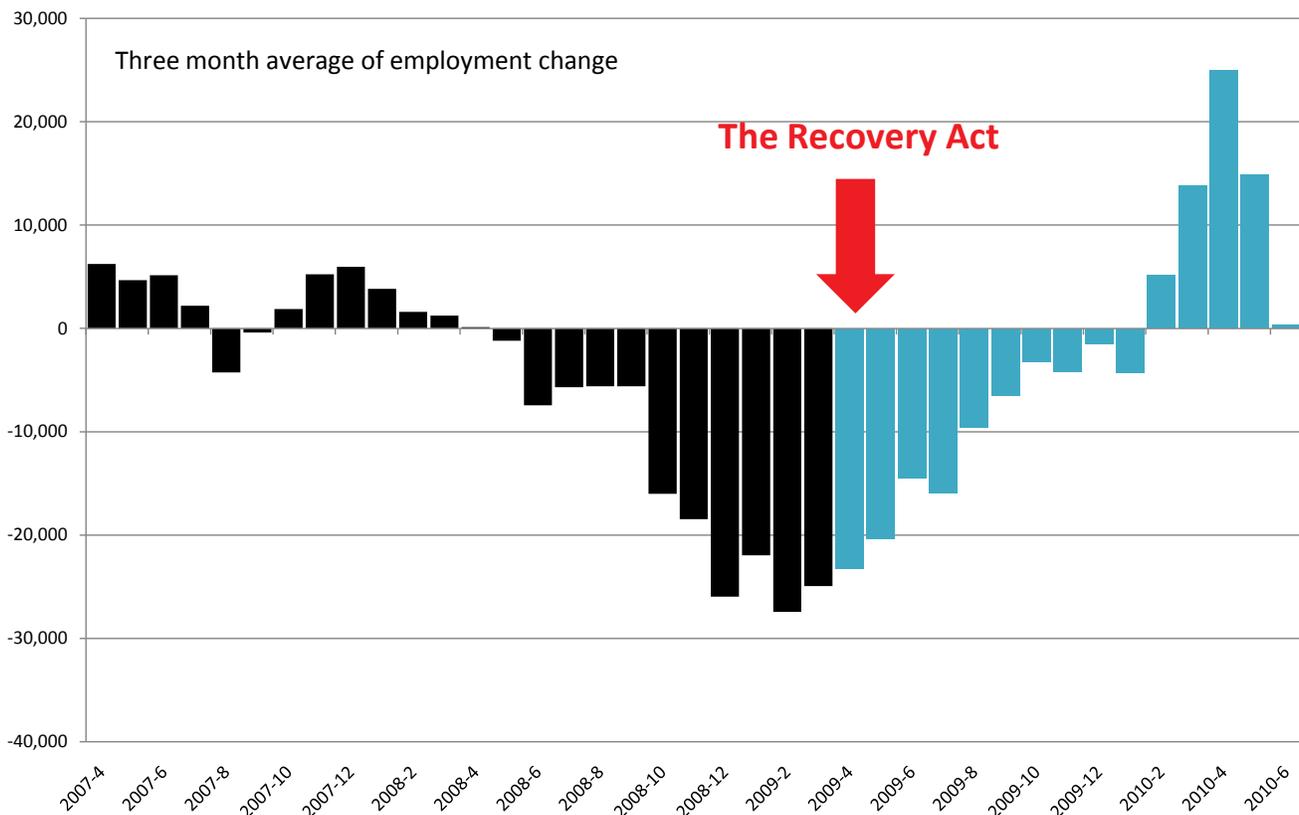
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Government Action Saves The Day

Just two years ago this September 15, the fallout of the collapsing housing bubble forced the investment bank Lehman Brothers to file for bankruptcy. This set off a worldwide financial panic that, within hours, threatened to lead to the collapse of the insurer AIG. The economic concentration and interconnectedness of the largest insurers, investment banks and commercial banks—and their political clout—led the Bush Administration and the Federal Reserve Bank to arrange a bailout of AIG and other financial institutions through the Troubled Asset Relief Program (TARP). The recession, which had already started in December 2007, had just begun to take a toll on the Pennsylvania economy. In the third quarter of 2008, Pennsylvania shed more than 5,000 jobs per month.

The decline in consumer spending and the sharp contraction in business investment caused by the collapsing housing bubble took an escalating toll on Pennsylvania employment in the fourth quarter of 2008, when job losses reached 18,000 per month. By the first quarter of 2009, Pennsylvania lost an average of 27,000 jobs per month. Our national and state economies were in free fall.

Figure 1. Government Action Saved The Day



Source: Keystone Research Center analysis of Current Employment Statistics

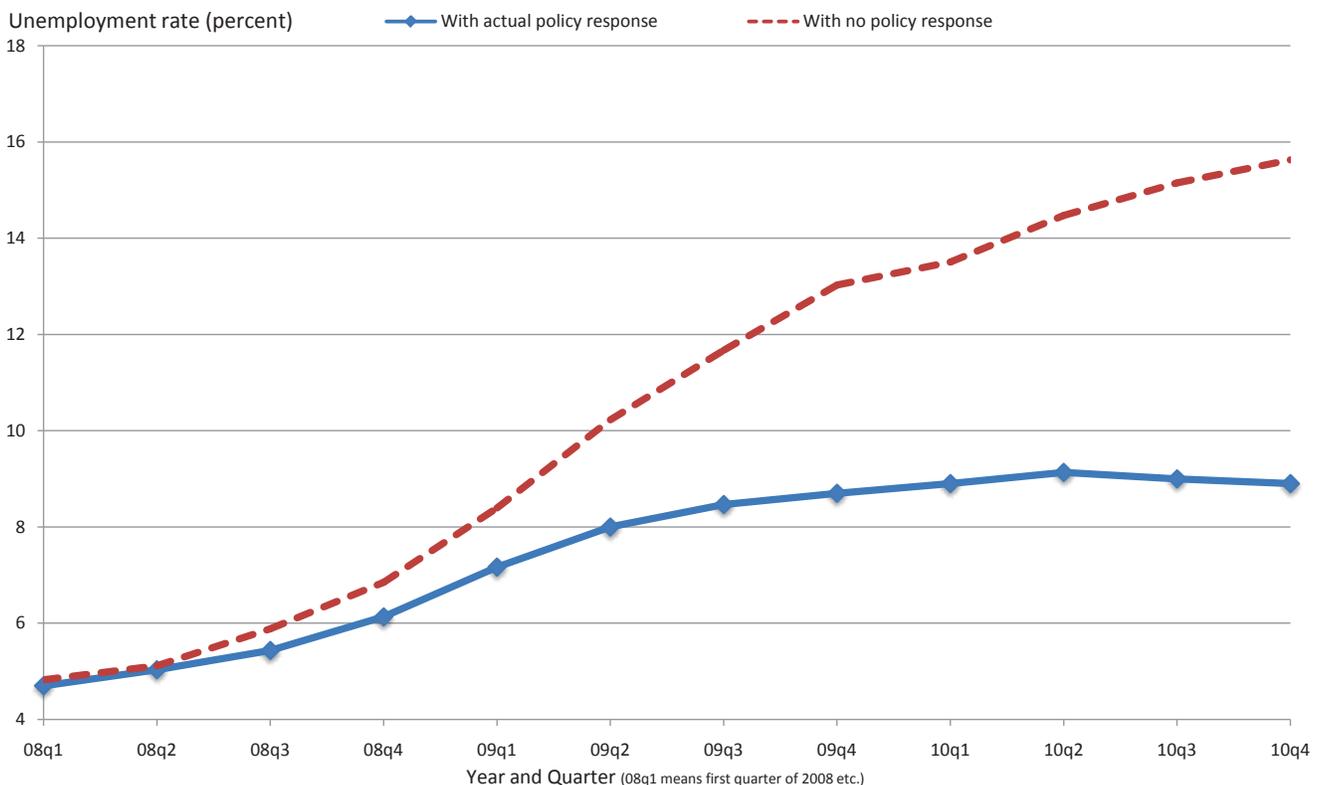
Then, abruptly, the economy's free fall stopped. In the first and second quarter of 2009, job loss per month stabilized (Figure 1). By the third and fourth quarter of 2009, the economy lost fewer and fewer jobs each month. In the first six months of 2010, job growth returned to Pennsylvania, as our economy added more than 7,000 jobs per month.

A visitor from Mars would look at Figure 1 and ask, “What happened in the first and second quarter of 2009 to reverse the accelerating growth of job loss?”

A close observer of economic realities here on earth would answer: what happened was the American Recovery and Reinvestment Act. The federal government, faced with a collapsing private economy, stepped in to inject a critically needed boost. The state of the economy in Pennsylvania and the United States today reflects in significant part the results of conscious policy choices.

The impact of the policy choices of late 2008 and the first part of 2009 have been estimated by Princeton economist Alan Blinder and his coauthor Mark Zandi, an economic advisor to 2008 Presidential candidate John McCain. Blinder and Zandi estimate that, but for the aggressive actions of policy makers at the Federal Reserve, Congress and in the Administration, the unemployment rate would now be approaching 16%.² As we argued last February, Blinder and Zandi confirm that swift policy action likely prevented the second Great Depression.³ In July, the unemployment rate in Pennsylvania climbed to 9.3%, while Blinder and Zandi’s estimates suggest that absent government intervention the unemployment in July would have been above 14% in Pennsylvania (Figure 2). In other words, roughly another 300,000 Pennsylvanians would have been without jobs.

Figure 2. The Recession in Pennsylvania Could Have Been Much Worse
 Pennsylvania’s Actual Unemployment Rate 2008 to 2010 Compared to Estimated Unemployment
 With No Federal Policy Response



Source. Keystone Research Center estimates for Pennsylvania based on Alan S. Blinder and Mark Zandi "How the Great Recession Was Brought to an End," July 27, 2010. Unemployment rates for the third and fourth quarter of 2010 are based on estimates by Global Insight.

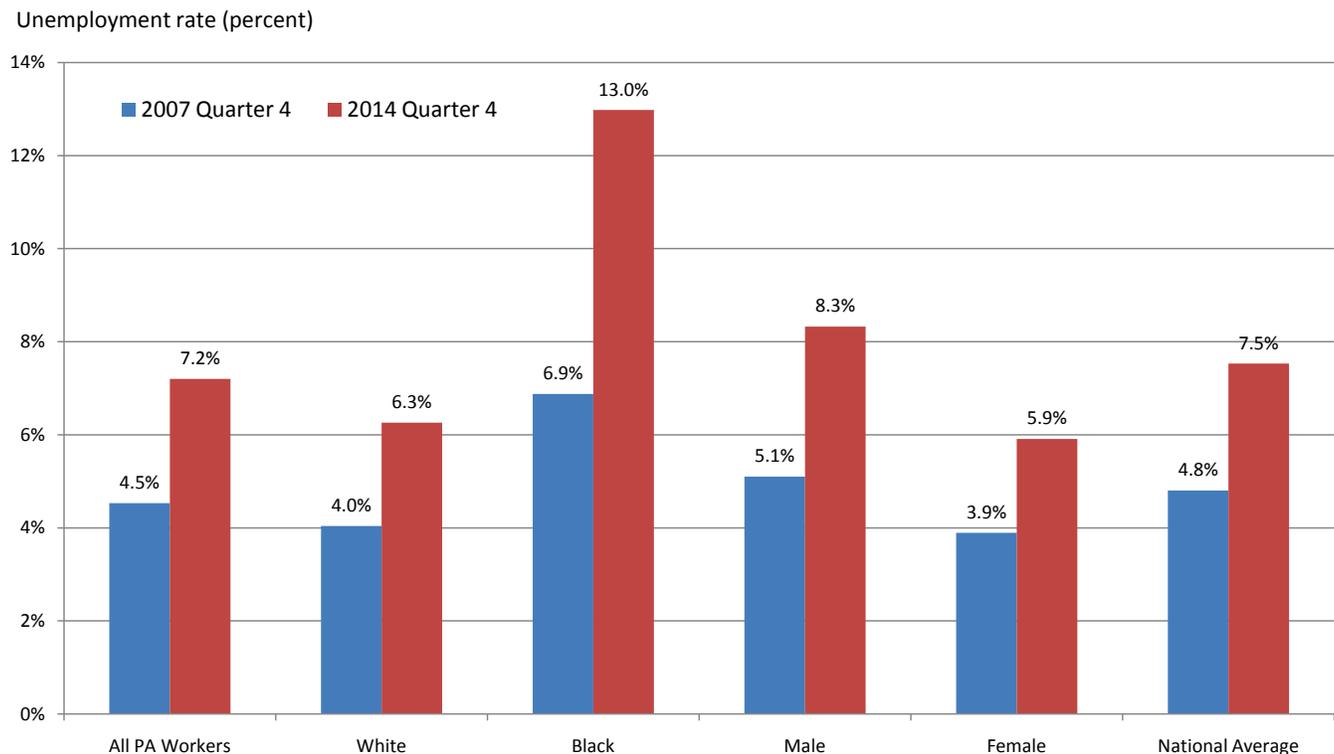
2 The Keystone Research Center’s estimate, made roughly six months before Blinder and Zandi’s, was that without the Recovery Act, unemployment in February 2010, “could easily be 12 percent to 15 percent—and on its way to 20 percent.” Stephen Herzenberg, “How the Stimulus Rescued America,” *The Philadelphia Inquirer*, February 17, 2010.

3 Blinder and Zandi estimate that the unemployment rate without the stimulus alone—but with Federal Reserve action and the TARP—would have been 12%.

A Growing Jobs Deficit

While a depression has been averted, the 9.3% July unemployment rate in Pennsylvania signals that our job market remains extremely sluggish. Current projections suggest that unemployment will remain high for years. Absent major policy action, the unemployment rate in Pennsylvania is projected to be 7.2% more than four years from now, in the fourth quarter of 2014 (Figure 3).

**Figure 3. Seven Years After the Start of the 'Great Recession'
Unemployment in Pennsylvania Is Projected to Remain Well Above
Normal**

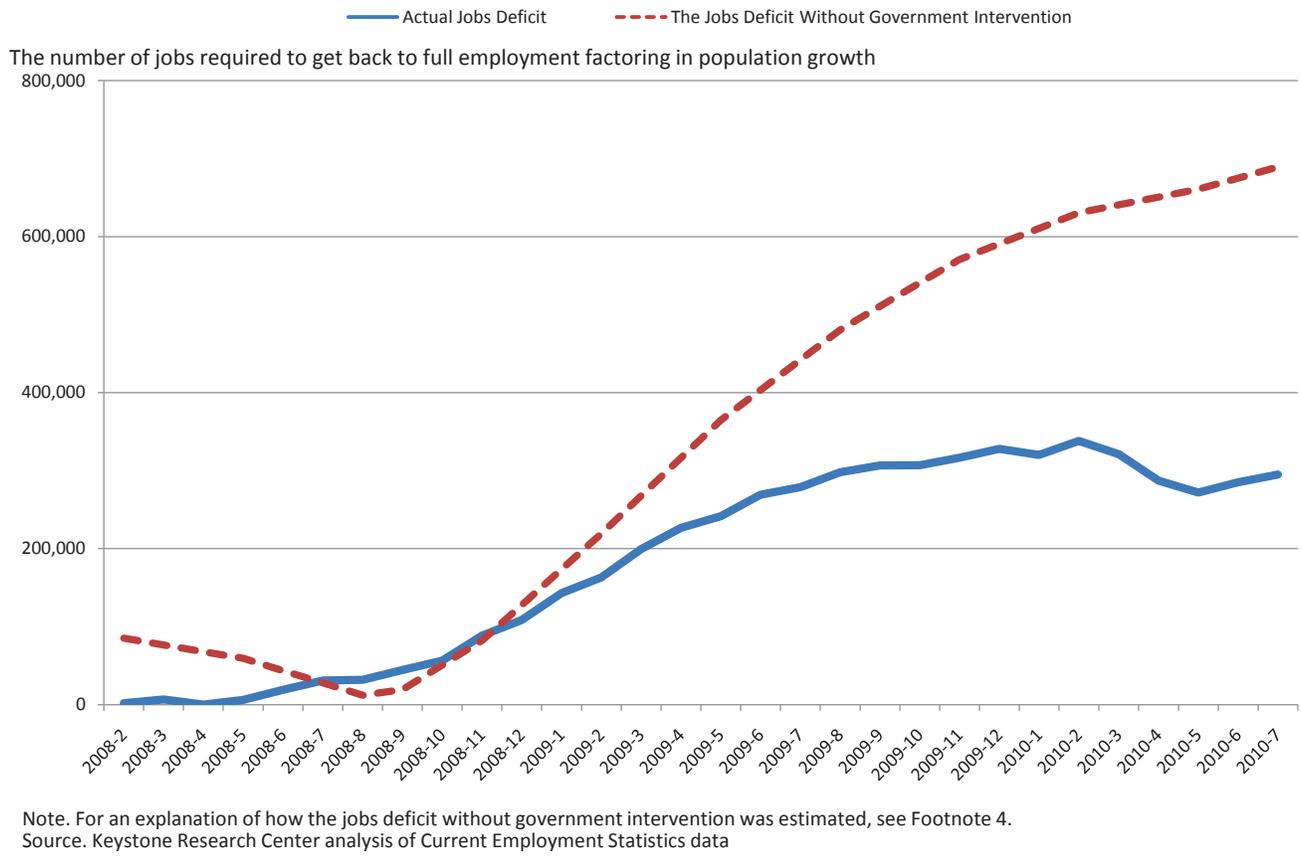


Source: Economic Policy Institute

Despite projections of high unemployment for years to come, the debate in Washington D.C. has shifted from concern over boosting the economy to reining in the federal deficit. Figure 4 raises a simple question: why? Figure 4 shows the Pennsylvania “jobs deficit,” defined as the number of jobs needed to return the state to its pre-recession ratio of jobs to working-age Pennsylvanians. As of July, Pennsylvania had a deficit of almost 300,000 jobs. Absent policy intervention, as shown by the dashed line in Figure 4, we would be in much worse shape with a jobs deficit approaching 690,000.⁴ The jobs deficit stopped growing rapidly as a result of the Recovery Act, but it has not yet started to fall consistently. To close the jobs deficit within five years from now, the Pennsylvania economy would have to produce 7,900 jobs a month. This is a rate of job growth more than three times larger than the average job growth that occurred during the last economic expansion.

⁴ Blinder and Zandi estimate that absent any policy response U.S. payroll employment would have been 122.3 million in the second quarter of 2010. With total nonfarm employment in Pennsylvania averaging 4.28% of total U.S. employment since 2000, we estimate that in the second quarter of 2010 absent any policy response total employment would have been 5.2 million in the Commonwealth. Adjusting for working age population growth of 1.5% since December 2007 yields a jobs deficit just shy of 690,000 jobs.

Figure 4. The Jobs Deficit in Pennsylvania Is Almost Three Hundred Thousand Jobs



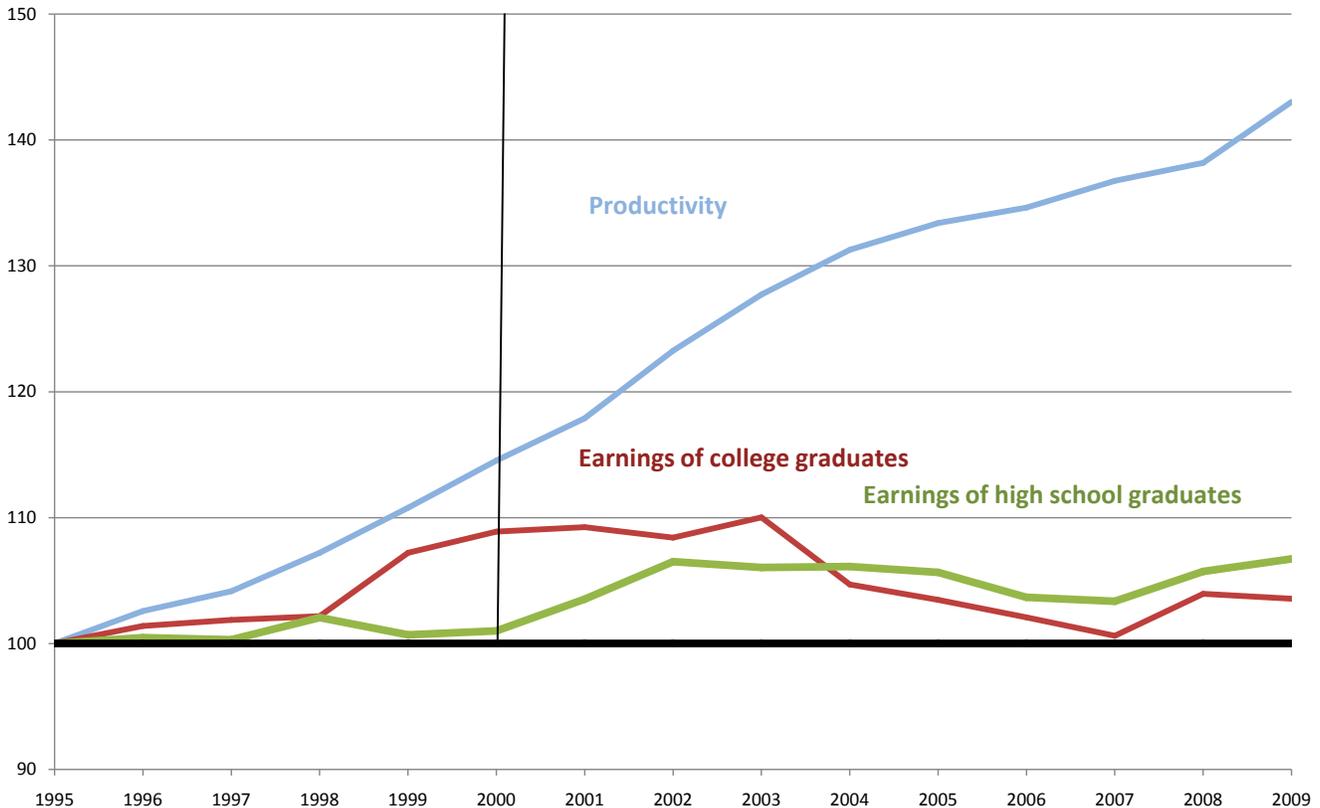
A Growing Wage Deficit

The business cycle that ended in December 2007 is the only one on record in which the typical U.S. working family had less income at the end of the cycle (usually the peak in incomes) than they had at the beginning. In Pennsylvania, median household incomes in 2007 were \$2,400 lower than in 2000.

The stagnation of household incomes reflected the fact that both college and high school graduates experienced stagnant or falling wages over the previous business cycle, while productivity growth surged (Figure 5).

Figure 5. Productivity and Median Hourly Earnings, 1995-2009

Inflation-adjusted productivity and earnings indexed to 1995 = 100



Source: Keystone Research Center analysis of Bureau of Labor Statistics and Bureau of Economic Analysis data

Despite the absence of wage growth, unemployment rates approached historic lows in 2007. The economy was able to reach full employment thanks to a rise in consumption spending fed by rapidly rising home prices and an explosion of unconventional mortgage products designed to sever the connection between income and creditworthiness.

The subsequent collapse of the housing bubble has reduced household wealth by \$8 trillion and left a gaping hole in the Pennsylvania labor market. A return to sustainable growth will require consumption spending fueled by broadly shared wage growth.

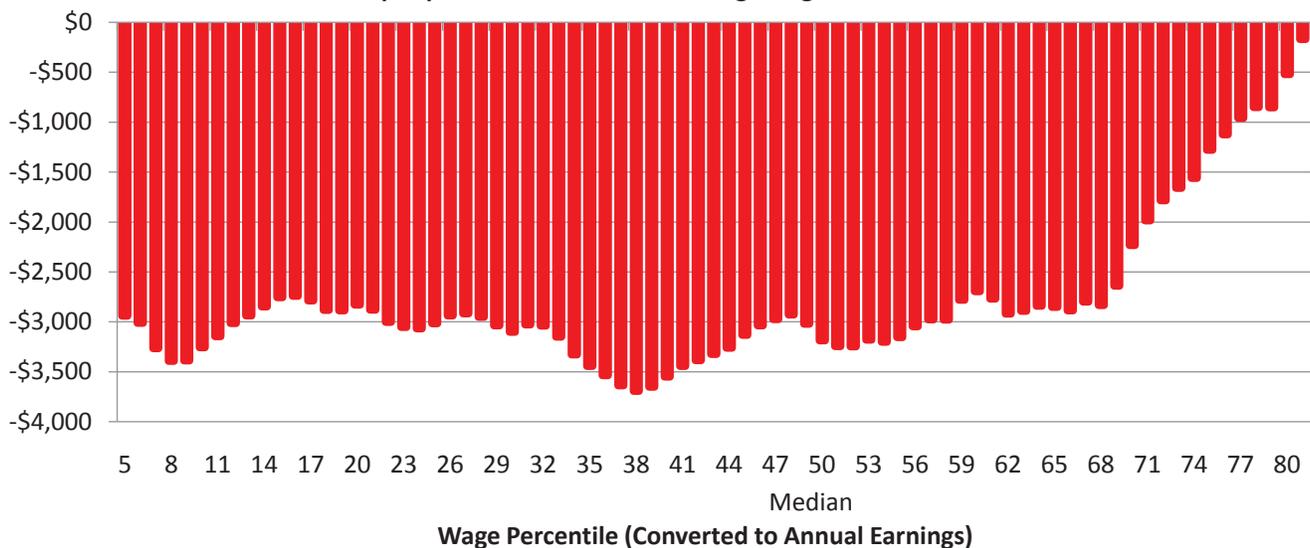
Currently households do not possess the buying power to drive long-term growth because an unprecedented “wage deficit” has opened up for the bottom two-thirds wage earners over the past three decades. Although the total economic pie, driven by rising productivity growth, has increased in size, most of the increase has been captured by the highest-income households. One way to measure the “wage deficit” is to estimate how much less workers earn because the distribution of wages is less equal today than it was in 1979. To calculate this amount, we first estimate what hourly wages would be today at each wage percentile if all earners had received an equal wage increase for the period 1979 to 2009. (In this calculation the total increase in the wages of all earners is kept the same.) We then subtract our estimate of hourly wages at each percentile (assuming wage increases had been equal across the board) from actual hourly wage increase at each percentile. This difference is usually negative because workers below the top 20 percent of the distribution all earn less than they would have with equal wage increases. We multiply this hourly wage deficit by 2080 to compute the annual wage deficit for someone who works full-time, full-year. Figure 6 shows the result—how much workers have lost in annual earnings because of the wage deficit.

For two-thirds of Pennsylvania workers, the wage deficit measured this way is between \$1.30 and \$1.80 per hour. For a full-time employee who works 2,080 hours per year, this translates into between \$2,800 and \$3,750 per year. For a middle-class family with two full-time earners, this adds up to between \$5,600 and \$7,500 per year.

Our estimates of the “wage deficit” are conservative because some of the erosion in the distribution of income since the 1970s resulted from an increase in profits relative to wages. (Our estimates are also conservative because our data source caps reported earnings at the top end.)

Figure 6. The Wage Deficit

This figure shows, at each wage percentile, how much lower Pennsylvania annual earnings are because wages for most workers have not kept up with the increase in average wages.



Note. Definition of percentile: the n th percentile wage earner makes a higher hourly wage than n percent of workers and less than $(100-n)$ percent of workers; for example, the 20th percentile earner makes more than 20 percent of workers and less than 80 percent. The wage deficit was calculated by, first, assuming that workers at all wage percentiles received the increase in the Pennsylvania inflation-adjusted average hourly wage from 1979 to 2009; second, computing at each wage percentile the “hourly wage deficit”—i.e., the difference between our calculated wage for 2009 and the actual inflation-adjusted wage at that percentile; and, third, multiplying this hourly wage deficit by 2080 to estimate the annual wage deficit for a full-time, full-year worker.

Source. Keystone Research Center analysis of CPS data

5 Data contained in the Institute for Taxation and Economic Policy’s report, *Who Pays 2007?*, indicate that average state plus local taxes paid by Pennsylvania families equal \$5,771.

Conclusion: The Need for Additional Action on Jobs

While some ARRA spending continues to hold up GDP, economic growth has stalled again in recent months. Meanwhile, high unemployment has meant continued weakness of state and local tax collections leading to cuts in state and local government spending all across the country.

Economists with Goldman Sachs have raised concerns about the negative impact of state and local budget cuts on the economic recovery. In late 2009, the firm wrote that state and local revenue gaps—and the cuts used to close them—“will exert a persistent drag on US economic growth.”⁶ More recently, Zandi has raised this concern, saying: “The budget cutting that is dead ahead will be a significant impediment to economic growth later this year into 2011.”

Congress’ recent approval of \$26 billion in additional federal assistance to the states will help reduce the impact on jobs of state and local budget cuts this year. The federal legislation included extension of the enhanced Federal Medical Assistance Percentages (FMAP) to the states and additional school funding to preserve teacher jobs. For Pennsylvania, this amounted to \$600 million in additional FMAP funding and \$388 million to keep teachers in the classroom.

About half of the jobs that will be preserved through continued state spending are in the private sector, including contractors and local vendors across the Commonwealth.

Yet even with some additional help for states, the private sector is not ready to drive the economy. Ominously, private sector payroll growth in the last three months in Pennsylvania has slowed to an average of just over 1,300 jobs a month.

We have reached a moment of truth, anything less than stellar employment growth over the next several years will be an unmitigated disaster for hundreds of thousands of Pennsylvania families. A further expansion of the jobs deficit could further dampen wage growth, possibly exacerbating inequality and the size of the wage deficit. Thousands of unemployed men and women with a decade, if not more, of gainful employment risk becoming permanently detached from the labor market as their skills atrophy over long spells of unemployment.

Action on jobs is urgently required. Whatever course chosen by the Federal Reserve, Congress, and the White House, the state of our economy a year from now—and four years from now—will reflect their policy choices.

6 Ed McKelvey, “State and Local Update: The Drag Persists,” US Economics Analyst, Goldman Sachs Global Economics, Commodities and Strategy Research, December 11, 2009. <http://www.scribd.com/doc/24003585/Goldman-Sachs-Research-State-and-Loa...>

Policy Recommendations

In the near future, a number of key policy choices will determine whether jobs deficit of 300,000 in Pennsylvania grows or shrinks.

Before the end of this year, the federal government needs to take the following steps.

- Extend the federal program which provides resources to state-subsidized job-creation through Pennsylvanian's "Way to Work" program. This program will have created an estimated 21,000 jobs by the end of September, including 13,000 for adults and 8,000 for summer youth. Without Congressional action, the Way to Work program will expire September 30.⁷
- Continue to extend unemployment insurance benefits as long as unemployment remains so high that it is impossible for many jobless workers to find jobs. The extension of unemployment insurance benefits by the federal government currently allows unemployed workers to receive benefits for 99 weeks instead of the normal 26. The most recent extension of federal unemployment insurance benefits phases out at the end of November.

By the first part of next year, the federal government should also allow the Bush tax breaks for families earning over \$250,000 to expire. Over the next decade,

extending these cuts would cost a trillion dollars.⁸ For the first two years, these tax cuts should be repurposed to spending and tax cuts that have a bigger "bang for the buck" when it comes to creating jobs. Near the top of the list of alternative uses of money saved by not extending the Bush tax cuts for the rich should be:

- Additional revenue sharing with states and localities;
- A jobs bill that includes investment in infrastructure, renewable energy and energy efficiency, and clean manufacturing; and
- Targeted tax cuts for businesses that help ensure that small businesses do not become the victims of the current slow economy. For example, the Congressional Budget Office (CBO) estimates that cutting payroll taxes for employers that hire more workers would create four to eight times as many jobs per dollar of cost as extending the high-end tax cuts.

Beyond the early part of next year, policies are also needed to eliminate the "wage deficit" by lifting the wages and incomes of middle-class families.⁹ That will allow middle-class consumption to once again drive the expansion of our economy, eliminating the need for government to run large deficits.

7 For basic information on the Pennsylvania Way to Work program, see http://www.paworkforce.state.pa.us/portal/server.pt/community/way_to_work/19161. On the need to extend the federal program that supports Pennsylvania's Way to Work program, see Liz Schott and LaDonna Pavetti, "Walking Away From a Win-Win-Win: Subsidized Jobs Slated to End Soon Are Helping Families, Businesses, and Communities Weather the Recession," Center on Budget and Policy Priorities, <http://www.cbpp.org/cms/index.cfm?fa=view&id=3274>. For testimony for a Pennsylvania employee and employer on the value of Pennsylvania's Way to Work program, see <http://www.cbpp.org/cms/index.cfm?fa=view&id=3276>.

8 Chuck Marr and Gillian Brunet, "Extension of High-Income Tax Cuts Would Benefit Few Small Businesses; Jobs Tax Credit Would Be Better," online at <http://www.cbpp.org/cms/index.cfm?fa=view&id=3251>.

9 For more detailed policy recommendations on how to reduce the wage deficit long term, see the *State of Working Pennsylvania 2009* (http://keystoneresearch.org/sites/keystoneresearch.org/files/SWP2009_2.pdf) and, especially, *The State of Working Pennsylvania 2008* (<http://keystoneresearch.org/sites/keystoneresearch.org/files/SWP2008.pdf>).