Policy Brief

west virginia Center on Budget & Policy

www.wvpolicy.org

October 15, 2010

How Federal Action Saved West Virginia Jobs

More government support still needed to close jobs and wage deficits

Sean O'Leary and Ted Boettner

Overview

This past year we have seen slow signs of progress in the national and state economy. A year and a half ago, the United States was suffering through its worst economic downturn since the 1930s, with the international finance system teetering on the edge of collapse. At the time, many feared that the country was poised to fall into a second Great Depression. Yet today, the financial system appears stable, GDP is advancing, and employment is slowly growing.

The recovery of the economy is due in part to the extraordinary response of the Federal Reserve, the Bush and Obama administrations, and Congress in the face of an economic meltdown. Two major components of the response were the Troubled Asset Relief Program (TARP), which was designed to stabilize the financial system by injecting capital into the banking system, and the American Recovery and Reinvestment Act (Recovery Act), which was designed to slow down the recession and restart economic growth. Other actions included slashing interest rates to near-zero levels, rescuing the auto industry, and tackling the collapsing housing market.

The response to the economic downturn was successful in ending the economic free fall and jump-starting the recovery. Had the federal government not stepped in, current unemployment in the United States would be about 16 percent; and above 14 percent in West Virginia. West Virginia would have lost over 80,000 jobs. All together, the federal economic interventions of 2008 and 2009 saved about 56,000 jobs in the Mountain State.

While policy actions like the Recovery Act succeeded in ending the recession, West Virginia's economy has not fully recovered. West Virginia needs to add roughly 30,000 non-farm jobs to replace those lost since the recession began in December 2007. Without action to create more jobs, the unemployment rate will likely remain above 7 percent for several years.

Along with the jobs deficit, most West Virginians have experienced a deficit in their buying power. This deficit is the result of wage stagnation for working families between 1979 and 2009. Only the top 10 percent of wage earners in West Virginia saw a significant increase in real (inflation-adjusted) wages. If all workers experienced the same changes in wages since 1979, then they would be earning between $600 and $2,000 more today in annual income. This lack of wage growth has played a role in both the formation of the financial crisis that led to the recession, and the sluggish growth we have seen since the recession's end.

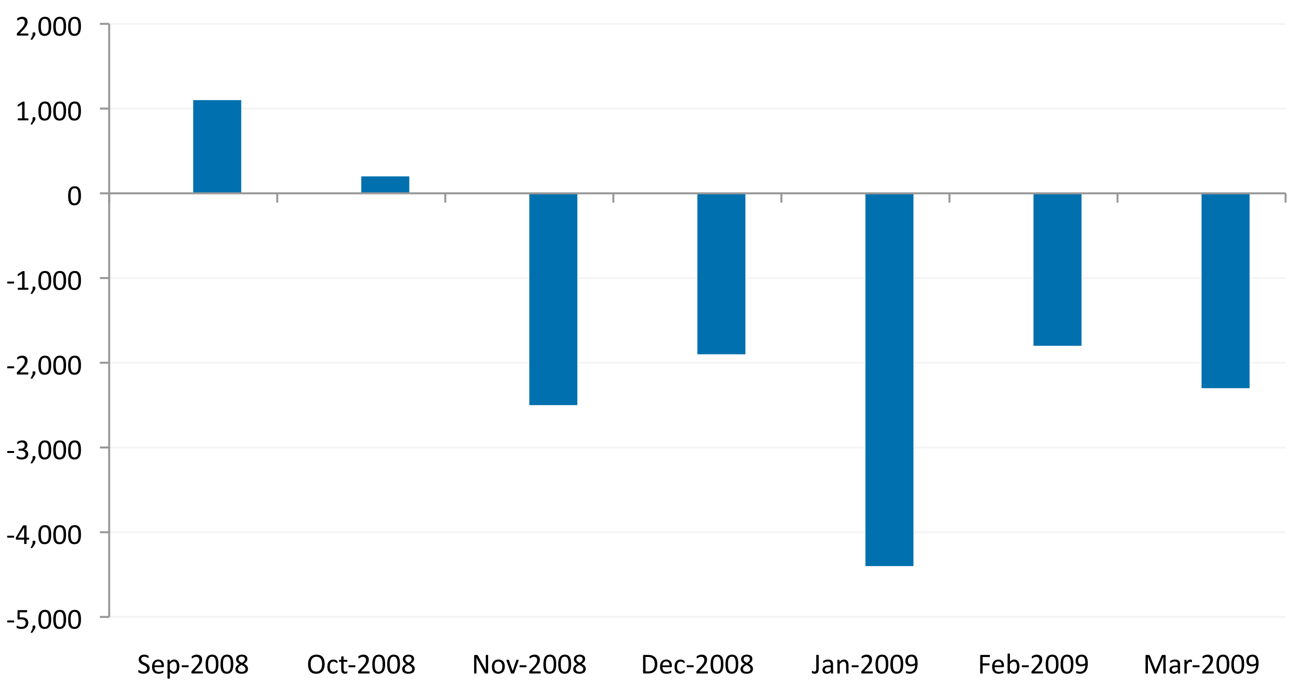
In light of slow economic growth and continued high rates of unemployment, both TARP and the Recovery Act have become unpopular. Critics often mistakenly link these programs as the central drivers of the nation's federal budget deficit and the long-term national debt. However, evidence suggests that the jobs and wage deficits present far more immediate problems for West Virginia. Concerns over the federal deficit, taxes, and spending levels should not overshadow the real problems posed by the jobs and wage deficits. Failure to act on these challenges will keep the economy from fully recovering.

Rescuing the Economy

In late 2008, the collapsing housing market set off a worldwide financial panic with the bankruptcy and near collapse of several financial institutions. The panic and uncertainty that followed led the Bush Administration and the Federal Reserve to arrange a bailout of AIG and other institutions through the Troubled Asset Relief Program (TARP). The recession, which started December 2007, deepened. In the 4th quarter of 2008, West Virginia lost 4,200 jobs, while the nation experienced job losses totaling over 1.9 million. The economic turmoil continued into 2009, with West Virginia losing 8,500 jobs in the first quarter of 2009, while nationally over 2.2 million jobs were lost.[1]

Figure 1

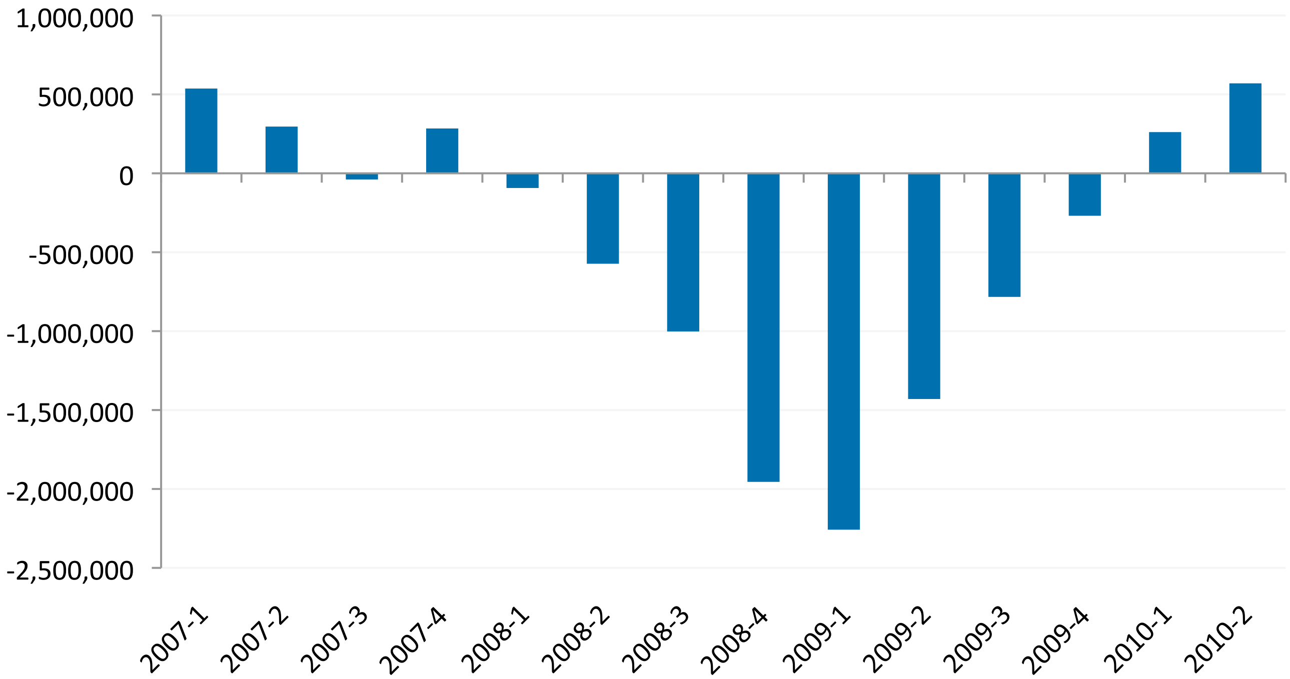
The Recession Hits West Virginia – Monthly Non-Farm Employment Change



Source: WV CBP analysis of Current Employment Statistics

The economy's free fall slowed in the first and second quarters of 2009, as job losses stabilized (Figure 2). Job growth returned to West Virginia in February 2010, and the state's economy has added almost 10,000 jobs since then.[2]

Figure 2
Quarterly National Non-Farm Employment Change



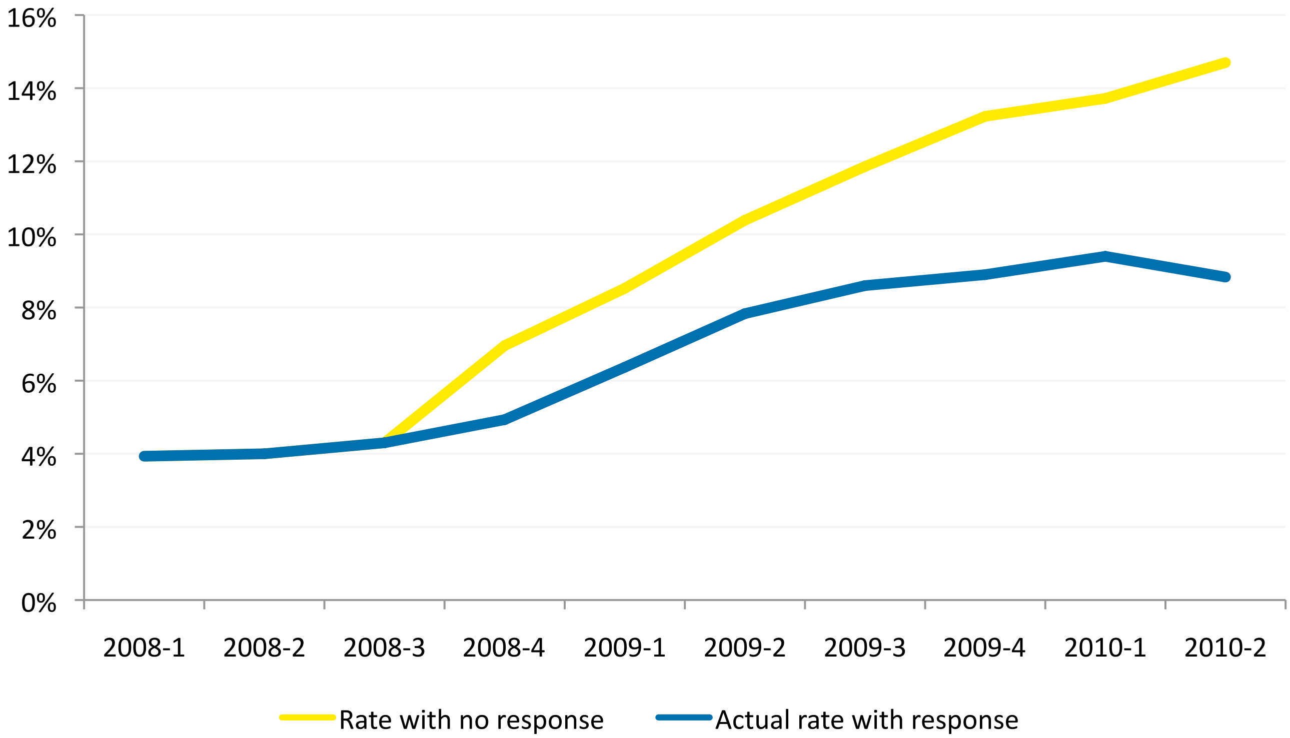
Source: WV CBP analysis of Current Employment Statistics.

The downward slide of the economy in West Virginia and nationwide was stopped in significant part by the decision of the federal government to stimulate the economy with the American Recovery and Reinvestment Act .

The impact of TARP, the Recovery Act, and other policy actions on the economy has been estimated by Princeton economist Alan Blinder and Mark Zandi, an economic advisor to 2008 presidential candidate John McCain. Blinder and Zandi[3] estimate that without actions like TARP and the Recovery Act, the national unemployment rate would now be approaching 16 percent. In the second quarter of 2010 the unemployment rate in West Virginia stood at 8.8 percent. Blinder and Zandi's estimates suggest that, absent government intervention, West Virginia's unemployment rate in 2009 would have been above 14 percent (Figure 3), and would have continued climbing throughout 2010[4].

Figure 3

West Virginia Unemployment Rate With and Without Policy Response



Source: WV CBP estimates based on Alan S. Blinder and Mark Zandi "How the Great Recession was Brought to an End", July 27, 2010.

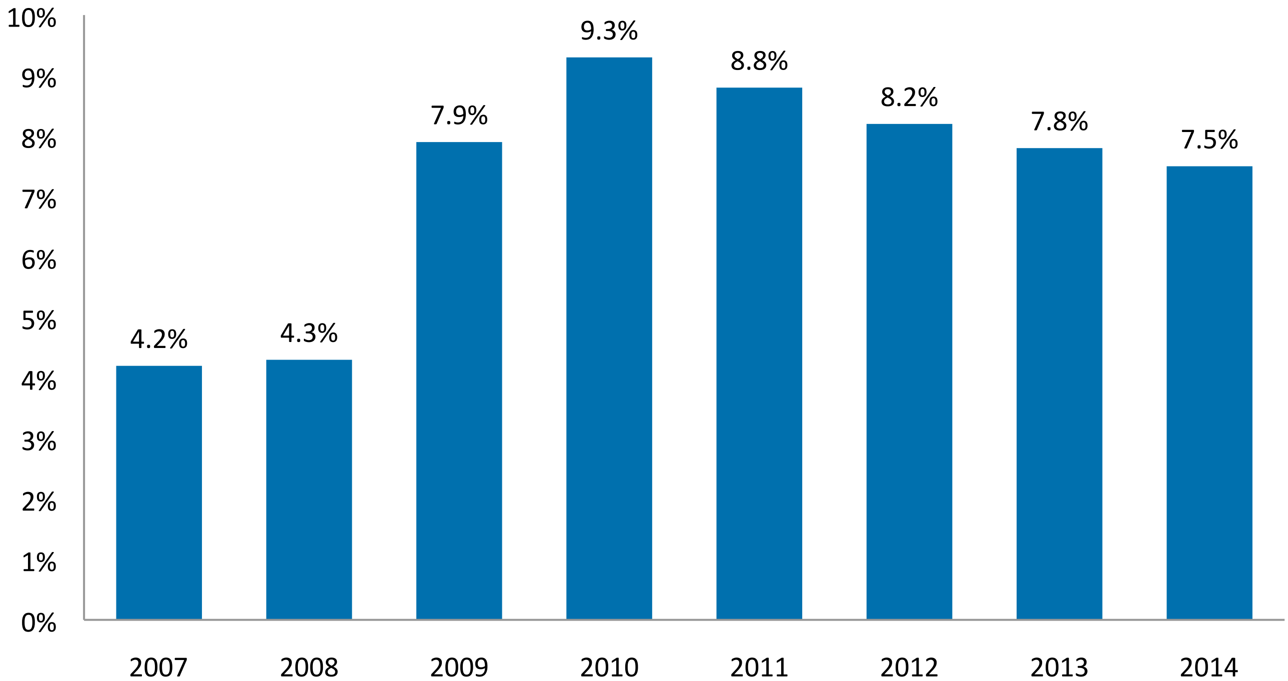
The racial disparity in West Virginia's unemployment rates would have also likely been exacerbated without policy intervention. In 2009, 7.5 percent of white West Virginians were unemployed, while 10.4 percent of African-American West Virginians were unemployed. Without the policy response that kept unemployment from reaching 14 percent, it is possible that the unemployment rate for African-Americans could have been well over 15 percent.[5]

The Jobs Deficit

While the Recovery Act helped the nation avoid a depression, the unemployment rate in West Virginia remains high, and job growth has been slow. Projections from the economic forecast in the 2011 West Virginia Executive Budget show that unemployment will remain high for years. Absent additional policy action, the unemployment rate in West Virginia is projected to be 7.5 percent in 2014, well above pre-recession levels (Figure 4).

Figure 4

Projected Unemployment Rate for West Virginia



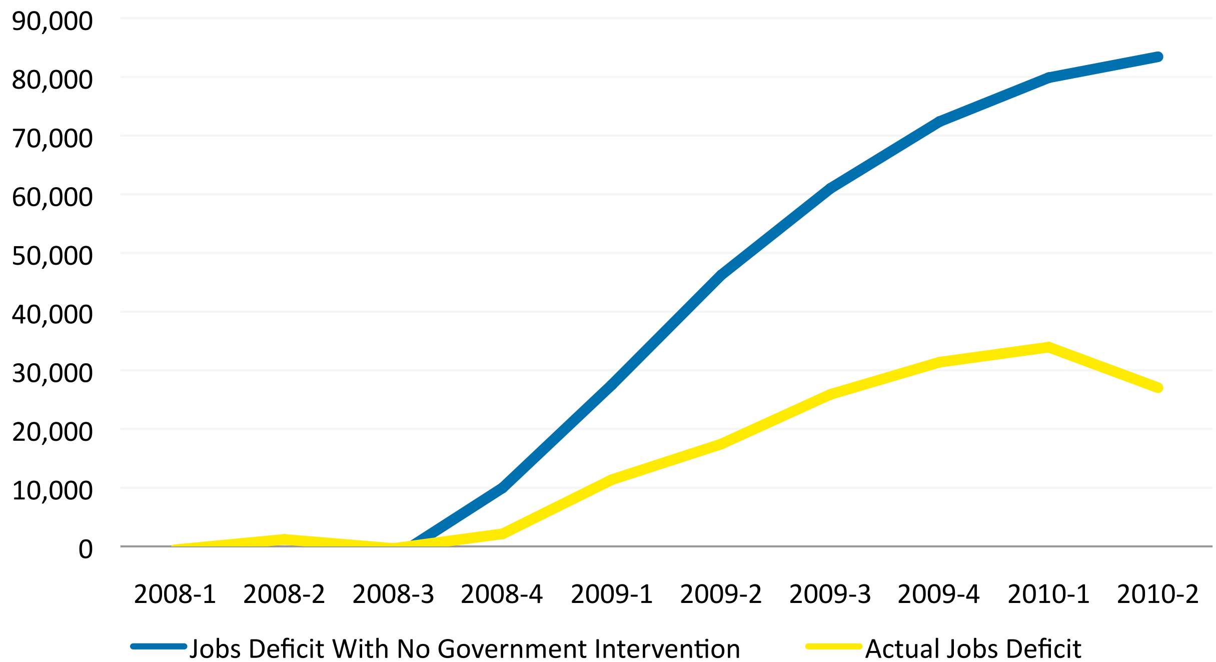
Source: State of West Virginia Executive Budget FY 2011 Economic Forecast

Even with projections of high unemployment for years to come, public concern has shifted from job creation to reining in the federal deficit. This focus ignores the work that is still needed to fully recover from the recession. Figure 5 shows the "jobs deficit" for West Virginia. The jobs deficit is the number of non-farm jobs needed to return the state to its pre-recession level of jobs. In the second quarter of 2010, West Virginia had a deficit of over 27,000 jobs.

Absent federal policy interventions, as shown by the dark blue line in Figure 5, the state would be in worse shape, with a jobs deficit over 83,000.[6] This means the economic interventions of 2008 and 2009 saved West Virginia about 56,000 jobs. While the Recovery Act and other interventions kept the jobs deficit from growing rapidly, more action is still necessary to see the jobs deficit close.

Figure 5

The Jobs Deficit in West Virginia, Non-farm Employment, 2008-2010



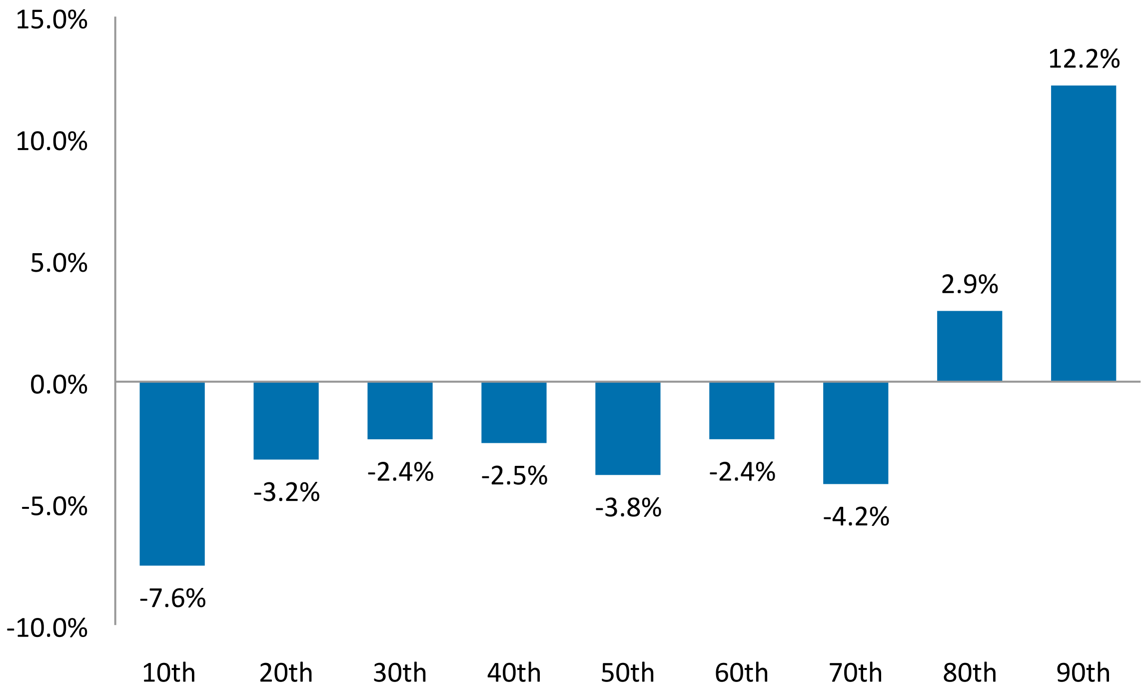
Source: WV CBP estimates based on Alan S. Blinder and Mark Zandi "How the Great Recession was Brought to an End", July 27, 2010, and Current Employment Statistics data.

The Wage Deficit

One reason job creation and economic growth have remained sluggish is the growing wage deficit. Middle class wages have been stagnating for decades. Real (adjusted for inflation) median wages in West Virginia have actually declined by more than 3 percent between 1979 and 2009. In fact, only the top 10 percent of wage earners in West Virginia have seen any substantial real wage growth from 1979 to 2009 (Figure 6 and Table 1). Although the total economic pie, driven by rising productivity, has grown, most of the increase has been captured by the highest-income households.

Figure 6

Change in Real Wages for West Virginia by Deciles, 1979-2008



Source: Economic Policy Institute analysis of Current Population Survey.

Table 1

Real Hourly Wages (2009 dollars) for West Virginia by Deciles, 1979 and 2009

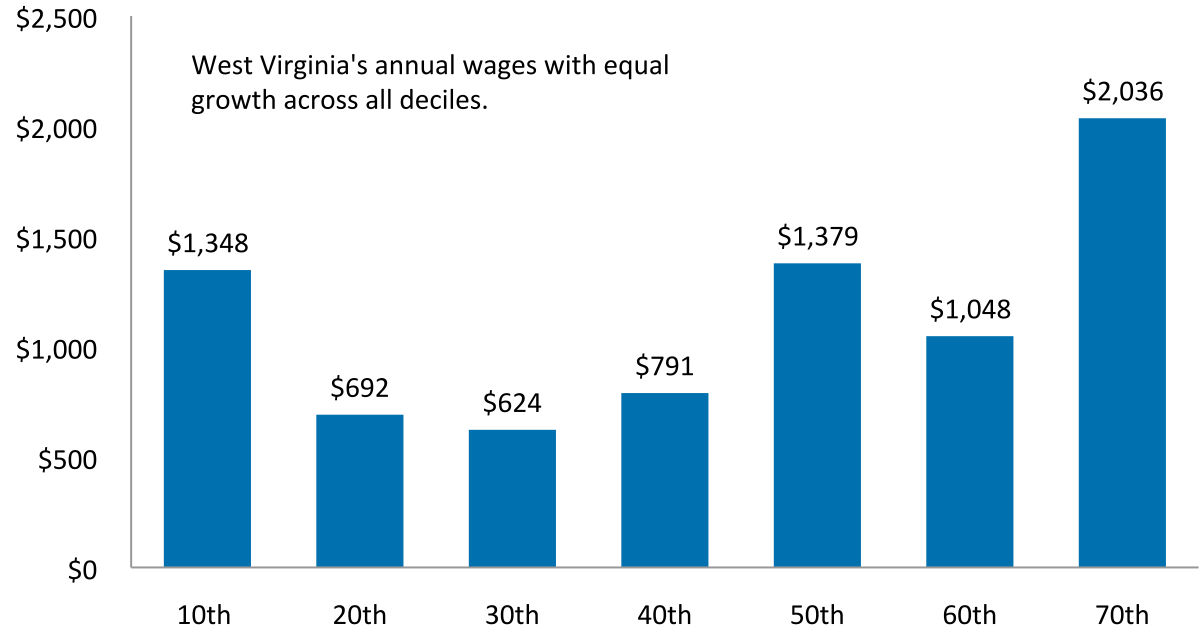
Decile	1979 Wages	2009 Wages
10th	$8.10	$7.46
20th	$9.10	$8.77
30th	$10.60	$10.31
40th	$12.74	$12.37
50th	$15.45	$14.80
60th	$17.83	$17.34
70th	$21.00	$20.04
80th	$23.84	$24.43
90th	$27.71	$30.97

Source: Economic Policy Institute analysis of Current Population Survey.

One way to estimate the wage deficit is to examine how much more workers would earn if the distribution of wages was the same today as it was in 1979. To do this we apply the change in average wages from 1979 to 2009 to wages at each decile. Applying the average change to all wages determines what earnings would be if wage increases had occurred equally, rather than concentrated at the top. Figure 7 shows how much higher wages would be at each wage level with a more equal wage distribution.

Figure 7

The Wage Deficit



Source: Economic Policy Institute analysis of Current Population Survey and WV CBP analysis of Bureau of Economic Analysis.

For the median West Virginia wage earner - the wage earner in the middle of the wage distribution (50th decile) - the wage deficit measured this way is $0.66 per hour. For a full-time employee who works 2,080 hours per year, this translates into $1,379 per year. For a middle class family with two full-time median wage earners, this totals $2,740 per year.

This estimate for a single median wage earner is more than what is paid in state and local income and property taxes.[7] This indicates that the wage deficit, not taxes, is the primary reason for the erosion in the buying power of working families.

Debt-Financed Consumption

The explosion in the housing market bubble is tied directly to the wage deficit. Even though wages stagnated, consumption spending was fueling economic growth. In fact, unemployment rates approached historic lows in 2007. But wages were not the source of the spending that fueled the economy. Instead, as the buying power of wages fell, many began to finance their spending through debt, particularly with mortgages and home equity loans. According to the Federal Reserve, total mortgage debt grew from $2.3 trillion in 1999 to over $9 trillion in 2008.[8]

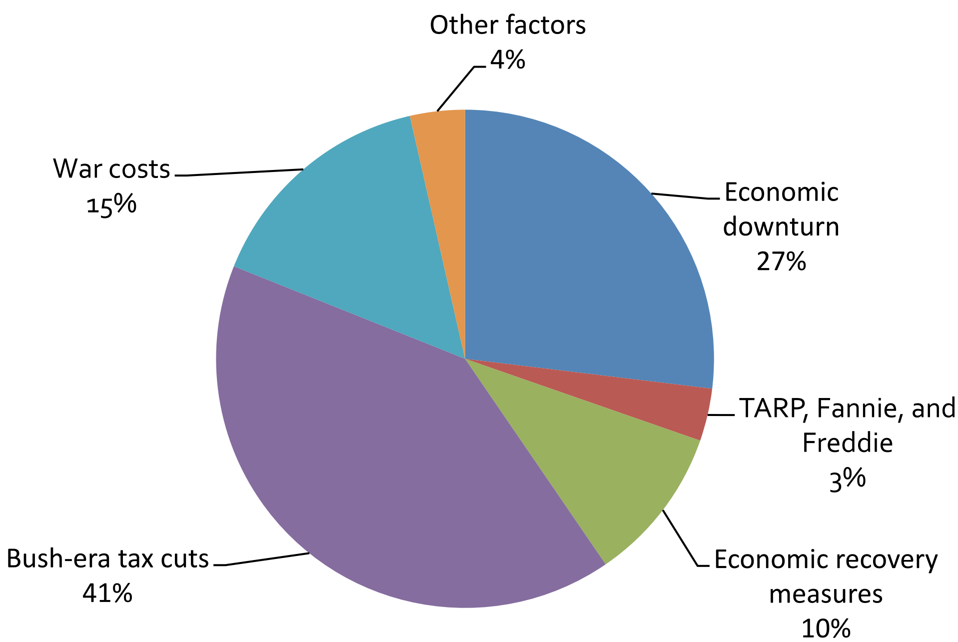
This debt led to a rapid expansion in the housing market that artificially inflated home prices. When the housing bubble collapsed, household wealth was reduced by $8 trillion, reducing consumption, and plunging the nation into a recession.[9] The job losses caused by the recession led to further declines in consumption and lower economic output by $1.4 trillion in 2009 and a projected $1.6 trillion in 2010.[10] A return to economic growth and job creation will require broad-based and sustainable consumer spending.

When the housing bubble collapsed, households no longer had the power to drive long-term growth. The housing boom was, in part, fueled by new mortgage products that were used by consumers to supplement their wages with debt. However, this proved to be unsustainable, and in the wake of the housing market's collapse, the struggle to recover has exposed damage caused by the wage deficit. Creating long-term sustainable growth will require consumer spending that is fueled by broadly shared wage growth. Taking action to close the wage deficit will create widespread increases in household wealth, which will spur consumption and job creation, and put West Virginia and the country on the path to sustainable economic growth.

Economic Downturn and Tax Cuts Are Increasing the Federal Budget Deficit

Critics of federal stimulus spending often cite the growing federal budget deficit and the growing national debt as why more federal spending should not be pursued, however this the nation's deficit in recent years is a direct result of the economic recession, which has left millions of Americans, and thousands of West Virginians, unemployed. This has reduced tax receipts and required increased safety net spending. In fact, together with the economic downturn, the Bush-era tax cuts and the wars in Afghanistan and Iraq explain virtually the *entire* deficit over the next ten years (Figure 8).

Figure 8
Drivers of the Federal Deficit, 2009-2018



Source: Center on Budget and Policy Priorities analysis of Congressional Budget Office estimates.

Further, the Recovery Act and other economic interventions account for about 13 percent of the federal deficit over the next ten years. By 2018, the Congressional Budget Office projects that these programs will account for less than 6 percent of the federal budget deficit. By putting more people to work today, they will create more revenue in the future and reduce the long-term debt faster than cutting spending.

More Action is Still Needed

While the Recovery Act and other actions stopped the recession from becoming a depression, the meager growth has begun to stall. With high unemployment and the continuing jobs and wage deficits, the debate over the federal deficit and national debt should not overshadow the country's immediate problems. The job losses created by the collapse of the housing market cannot be made up solely by consumer spending.

The stagnation of wages for 30 years has made it impossible for consumer spending to spur enough activity. Instead, it is necessary for the government to offset the loss consumption through spending. With huge losses in demand and output, and interest rates at near-zero levels, increases in government borrowing to finance spending will not crowd out other components of GDP, nor will additional borrowing impose a substantial interest burden on the country in future years.[11] According to the Federal Reserve, U.S. corporations are sitting idle with $1.84 trillion in total liquid assets. [12] The last time American companies stockpiled this much cash was in 1964, nearly 50 years ago. Rather than investing these cash reserves in equipment, machinery, and the hiring of workers, businesses have opted to sit out the economic recovery process. The only solution is for government to stimulate demand.

Allowing deficit concerns to justify spending cuts will result in the continued growth of the jobs deficit and a deepened unemployment crisis. Policy actions, like Congress's recent approval of $26 billion of assistance to the states, are critical to preserving jobs and keeping the economic recovery on track. Other policy actions at the state and federal level that can help close the jobs and wage deficits should include:

- **Create long-term investment in infrastructure**. 39 percent of West Virginia's bridges are structurally deficient or functionally obsolete, 37 percent of West Virginia's major roads are in poor or mediocre condition, and 30 percent of West Virginia's 360 dams are in need of rehabilitation to meet applicable state dam safety standards. According to the American Society of Civil Engineers, West Virginia has over $3 billion in drinking and wastewater infrastructure needs alone. Infrastructure investments at the federal and state level not only have a short-term impact on job creation, they also lower the cost of doing business and increase the state's productive capacity. According to Moody's Analytics, a $1 increase in infrastructure spending will increase total economic activity by $1.57. This is a higher multiplier than almost any type of tax cut as a fiscal stimulus measure.[13]

- **Enact a work-sharing program.** Work-sharing is an alternative to collecting unemployment, where unemployment insurance is used to subsidize a worker's pay during a downturn, rather than the worker being laid off. This keeps workers in the workforce, instead of collecting unemployment insurance as their skills deteriorate. Employers also avoid the costs of rehiring and retraining when their business begins to pick back up. Work-sharing programs do not cost much, as the subsidy otherwise would have been paid out as an unemployment insurance benefit. And since work-sharing keeps people active in the economy, it has a strong stimulus effect. $1 spent financing a work-sharing program during a downturn can increase economic activity by $1.69.[14]

- **Modernize and extend unemployment benefits**. As long as the unemployment rate remains abnormally high, then unemployment benefits should be extended. Earlier this year, over 13,000 West Virginians benefited from an extension of unemployment benefits. These benefits are often what keep families from slipping into poverty when jobs are lost and new jobs are scarce. The benefits also keep money flowing in a sputtering economy. West Virginia could also modernize its unemployment insurance system by including part-time workers and those who are unemployed for compelling family reasons. This would inject $22 million in federal Recovery Act funds into the state's Unemployment Insurance Trust Fund. When benefits are exhausted, not only do recipients lose a source of income, they also lose an incentive to find work, leave the workforce, stop spending, and become a drag on a struggling economy. Every dollar spent on extending unemployment benefits can increase economic activity by $1.61.[15]

- **Add labor demand incentives**. Job incentive programs provide wage subsidies for employers who hire unemployed workers referred by local workforce agencies for newly created positions. Such programs can be designed to match employers who are willing to offer good job experiences with unemployed workers who are ready to work. If subsidies are only offered for newly created positions, the program can increase total employment rather than substitute subsidized workers for other workers. Minnesota successfully used such a program in the 1980s, and there have been recent efforts to revive it in Minnesota and at the national level. Studies have shown that if disadvantaged workers, with little education or obsolete job skills, can be hired for entry level jobs and stay employed for six months, they gain valuable labor market experience and a better reputation with employers, which increases their long-term employability and earnings.

- **Establish a Training Benefit program.** Training Benefit programs allows eligible unemployment insurance claimants to receive unemployment benefits while attending an approved training program. Training Benefit programs change the role of unemployment insurance from a partial wage replacement while an individual looks for work to assistance in returning to the workforce with better skills and more earning power.

- **Take full advantage of federal TANF funds**. The federal government allows states to use Temporary Assistance for Needy Families funds toward a refundable portion of a State Earned Income Tax Credit and as unemployment insurance for low-income workers. The EITC reduces the burden of Social Security taxes on low-income workers and can help close the wage deficit. TANF funds can also be used to fund a supplemental unemployment insurance program for unemployed workers in needy families who are not eligible for benefits under West Virginia's regular unemployment insurance program.

- **Refrain from unnecessary budget cuts**. Cutting spending may help close the budget deficit, but it does nothing to address the jobs and wage deficits, and may do more harm than good. Unnecessary budget cuts hamper the state's ability to address our economic challenges, and usually lead to job cuts, particularly in education and health care.

Acknowledgements

The authors thank Mark Price and Stephen Herzenberg of the Keystone Research Center and the Economic Policy Institute for their assistance.

Endnotes

[1] U.S. Census Bureau, Bureau of Labor Statistics, Current Employment Statistics, seasonally adjusted.

[2] Ibid.

[3] Blinder, Alan S. and Zandi, Mark, (2010). *How the Great Recession was Brought to an End.* Economy.com.

[4] Estimates for the unemployment rate in West Virginia with no policy response were derived from Zandi's and Blinder's analysis of the national unemployment rate. West Virginia's rate was determined by assuming the relationship between the national unemployment rate and the West Virginia unemployment rate over the period of 2000 to 2010 would have been maintained in a downturn predicted by Zandi and Blinder. Between 2000 and 2010, the West Virginia unemployment rate averaged to be 98% of the national unemployment rate. Applying that average to the national rate with no policy response predicted by Zandi and Blinder gives the results shown in Figure 2.

[5] US Census Bureau 2009 American Community Survey.

[6] Blinder and Zandi estimate that absent any policy responses, U.S. payroll employment would have been 122.3 million in the second quarter of 2010. With total non-farm employment in West Virginia averaging 0.56 percent 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 684,000 in West Virginia. Adjusting for working age population growth of 1.0 percent since December 2007 yields a jobs deficit of just over 83,000.

[7] Data contained in the Institution for Taxation and Economic Policy's report, *Who Pays 2007?*, indicate that a single full-time median wage earner paid $1,231 in state and local income and property taxes.

[8] Federal Reserve Bank of New York, Quarterly Report on Household Debt and Credit August 2010.

[9] Baker, Dean. (2010). *Feel No Pain: Why a Deficit In Times of High Unemployment Is Not a Burden*. Washington, D.C.: Center for Economic Policy and Research

[10] Baker, Dean. (2009). *CBO Predicts More Severe Downturn*. Washington, D.C.: Center for Economic Policy and Research.

[11] Baker, Dean. (2010). *Feel No Pain: Why a Deficit In Times of High Unemployment Is Not a Burden*. Washington, D.C.: Center for Economic Policy and Research.

[12] U.S. Federal Reserve's Z.1, Flow of Funds Account of the U.S., Total Assets from line 1, Table B.102 and Total Liquid Assets from line 41, Table L.102.

[13] Testimony of Mark Zandi, Chief Economist, Moody's Analytics, Before the House Budget Committee, *Perspectives on the Economy*, July 1, 2010.

[14] Ibid.

[15] Testimony of Mark Zandi, Chief Economist, Moody's Analytics, Before the House Budget Committee, *Perspectives on the Economy*, July 1, 2010.

Our Mission

- Research and analyze tax and budget issues for fairness and adequacy and examine overall budget priorities.

- Educate policymakers on the effects of budget and tax policies and economic trends.

- Inform public debate and ensure that complex tax and budget issues are accessible to a varied audience of state and local officials, journalists, nonprofits, other interested parties, and the general public.

- Make research available to state and community-based groups and organizations and assure that they are consulted in the process of setting priorities for research and analysis.

Find this and other reports online at
www.wvpolicy.org