November 16, 2011 Policy Brief: Volume 11, Number 58

Debunking Fallacy Filled Economic Analysis

How to speed job growth in Pennsylvania? According to the latest offering from the Keystone Research Center (KRC), the Commonwealth and local tax levying bodies should raise taxes and hire more employees. They don't directly say "raise taxes" but how else can the state, school districts and municipalities already facing budget deficits afford to keep all their employees—never mind hiring more? Unlike the Federal government that has the ability to borrow money to fund current expenses, the state and local governmental entities do not have that luxury.

KRC recently issued a report asserting that the recent reductions in state and local government jobs are slowing private sector employment gains in the state, claiming the cuts in government jobs had pushed Pennsylvania to 47th in overall employment growth over the period April to September 2011. Conclusion? State and local governments should begin hiring more people.

There are several problems with KRC's claim. The fact that the loss of government jobs happened concurrently with the slowing in the growth of private sector jobs is not sufficient to demonstrate causality. Second, the selection of the April to September time frame amounts to data cherry picking. April's nonfarm jobs number was clearly a suspiciously high number as it was well above both the March and May employee counts. Third, the alleged slowdown in private job gains over the period was limited to a few sectors with much of the slowdown in the summer months and growth had resumed in most by September.

The essential relationship between movements in public sector employment at the state and local level and changes in private sector jobs is not complicated. A moment's reflection tells us why. When the state and local economies and incomes are growing and throwing off rising revenue, public employment can grow or remain stable without increasing the relative burden on taxpayers. On the other hand, when economies slide into a serious downturn, tax revenues will also drop substantially. When tax revenues suffer a major drop off, state and local governments have limited choices—use up reserves, raise tax rates, levy a new tax, or make significant spending cuts. And since employee compensation makes up a very large share of total expenditures, it is a virtual certainty that large spending reductions will necessitate layoffs.

Thus, finding that government spending and job reductions and slipping private sector jobs often go hand in hand should come as no surprise, and the causality is clear. It is the weak private sector that is forcing public sector job cuts. KRC would have us believe that the causality runs in the other direction. And they raise the weakest of arguments to make their case by using the April to September employment changes that purportedly show a softening private sector jobs picture concurrently happening with layoffs of teachers and state workers.

During the January to September period of 2011 private sector jobs were up by 39,000. Over the same period in 2010, private jobs rose by 49,000 which would suggest a modest slowing. But looked at over a yearly time frame the picture is quite different. For example, private jobs in September 2011 were 70,000 higher than in September 2010. By comparison, private jobs in September 2010 were 54,000 greater than September 2009 suggesting that some longer term momentum is still in place.

Bear in mind too that manufacturing employment has posted gains throughout 2011, faster even than the 2010 increases. Private education continues to add workers at an impressive pace, completely unfazed by the public sector job cuts. Mining and logging, driven by gas drilling, is still climbing although at a slower pace than in 2010 when the industry was getting into high gear across the state. Accommodation and food services have boosted employment in 2011 at a quicker pace than in 2010. And after a hiccup in the June to July period, health care employment has resumed growing. Meanwhile, arts and entertainment have seen a drop off and construction jobs are down very slightly.

All in all, the improving numbers for many categories in September, after a pause over the summer, suggest that Pennsylvania's overall jobs picture is holding up. Nonetheless, it is certainly nothing to brag about given the 200,000 plus nonfarm employment loss between late 2007 and late 2009.

Many of the private sectors showing some softening in employment over the summer have little immediate connection with public sector cuts—gas drilling, construction, and entertainment for example. Likewise, the sectors showing strength such as manufacturing are independent of short term changes in public employment. In short, the evidence presented and the studies cited by the KRC report do not make the case they are attempting to sell. Thus, their advocacy of more government spending and public sector hiring as a way to boost the economy is fallacy filled on several levels. Increased spending and hiring would mean higher taxes. Higher taxes are not a growth enhancer when the economy is already weak. It will not stimulate private sector hiring or business expansion and very likely will make matters worse.

This effort by KRC must be seen for what it is: an attempted justification for putting union workers back to work, especially teachers.

Part of the confusion for KRC arises from three key factors that affected Pennsylvania during the recession. One, Pennsylvania did not have the housing boom and subprime bubble as did states such as Nevada, Arizona, Florida, California and several other faster growing sunbelt states. Thus, the housing market did not get hit as hard in Pennsylvania as the nation as a whole. Housing and non-residential construction were not massively overheated so that the construction job losses were much smaller, foreclosures were fewer and price hits not as dramatic.

Two, the Federal stimulus funds enabled the state and local governments to hold off making layoffs and helped school districts delay the reductions in staff they would otherwise have faced. Indeed, between late 2007 and late 2009, not only were layoffs forestalled but government payrolls in Pennsylvania climbed by 14,000, setting up the need for even bigger employee cuts later. Six thousand teachers and other school employees were hired in 2008 and 2009 in the vain hope that the economy would turn around quickly or that Federal funds would continue indefinitely. Neither happened and the inevitable bullet biting had to occur.

Third, the advent of the Marcellus Shale gas drilling and production surge in 2009 and 2010 helped stanch the loss of private sector employment and generate net gains by creating thousands of direct industry related jobs along with additional thousands of transportation and other indirectly supported jobs such as hotel employees and restaurant workers among others.

Overall, it is important to bear in mind some job creation basics. In its latest Keystone Business Climate Survey, the Lincoln Institute found that business hiring is stagnating as worries over uncertainty spawned by the Federal government's inability to rein in spending and borrowing and the threat of tax hikes. Countless other surveys point to business concerns over the unending flow of debilitating regulations as reasons to postpone hiring and expanding.

If KRC is truly desirous of seeing the private sector start hiring it should forget promoting government hiring and more taxes and work for changes in the business climate such as reforming labor and environmental regulations and advocate lower business taxes. When the private economy is strong and growing, everybody wins including government. When the private sector is being progressively weakened, the long term outlook for the economy is not good and government payrolls will be under continuous attack. Someone has to pay the taxes that pay the salaries of government workers. That would seem to be an easy to understand premise.

Jake Haulk, Ph.D., President

Policy Briefs may be reprinted as long as proper attribution is given.
For more information about this and other topics, please visit our website:
www.alleghenyinstitute.org

Allegheny Institute for Public Policy
305 Mt. Lebanon Blvd.* Suite 208* Pittsburgh PA 15234
Phone (412) 440-0079 * Fax (412) 440-0085
E-mail: aipp@alleghenyinstitute.org