Ten Years of the Connecticut Economy
By Steven P. Lanza

With high hopes and a rock-bottom budget, The Connecticut Economy launched its inaugural issue ten years ago. Our goal then, as now, was to keep an eye on the state's economy and report what we saw, following Yogi Berra's maxim that "you can observe a lot by watching." We've evolved away from a newsletter towards a newsmagazine format, adding new features along the way. But always we've tried to offer readers sound economic analysis in easy-to-follow prose. To mark our anniversary, we take a break from some of our usual routines (including the quarterly roundup normally featured on this page) to serve up a few reflections, from past and present editors, on where we've been and where we may be heading.

Forty issues (and counting) of The Connecticut Economy stacks up to a hefty bundle, so it's fair to ask, "Why shine so much light into such a small corner of the globe?" After all, Connecticut ranks just 29th among U.S. states in population and 3rd from last in land area. Well, it turns out that this tiny state boasts a world-class economy. If Connecticut were a country, it would rank first in per-capita income and 40th in the total size of its economy, ahead of Denmark, Norway, Finland, Israel, and Ireland, ahead even of the oil-rich United Arab Emirates and Kuwait. There's no black gold here—the state's most abundant natural resource is gravel, a heavy though hardly hot commodity—but there's one ingenious population nestled in them thar hills. Connecticut owes its wealth not to natural resources but to the resourcefulness of its people. At the head of the class in education per capita, at the top of the heap in patents per capita, Connecticut is unequalled in worker productivity. And our remarkable inquisitiveness, inventiveness and efficiency, so much a hallmark of the state's history, sustain us still.

Then and Now
When The Connecticut Economy premiered, the state's economy was plumbing the depths of recession. Our labor market was literally decimated, having lost one-tenth of its total jobs in just four short years. Unemployment, at 8.2%, was up sharply from 3.1% in 1989. Manufacturing and financial activities—the state's flagship industries—were bearing the brunt. Declining defense spending at the Cold War's denouement wallowed the state's manufacturers, to the tune of 68,000 jobs or 18.5% of the total. Bad real estate loans, industry restructuring, and tighter regulations pummeled the finance industry, exacting 11,000 jobs. Real gross state product was still stuck below its 1989 peak. Housing demand evaporated, and home prices tanked as young workers left in search of better prospects in the Sunbelt. Median home prices in Hartford and New Haven, which had doubled inside a few years, sank from more than $175,000 in 1989 to less than $160,000 in 1992.

Fast-forward ten years. The state's economy is buffeted by another, albeit much milder, recession. Even so, the job total in 2002 exceeded that of 1992, the differential reflecting sizeable growth in services. Construction is booming again, thanks partly to a rejuvenated housing market. The value of construction contracts, measured by F.W. Dodge, climbed 86% over the decade, and construction jobs were up by a third. Real estate prices are higher now than ever, and with falling interest rates and rising incomes, they are also more affordable. In 1992, following the last housing boom, an average employee could "afford" just 72% of the monthly mortgage for a median home, using the National Association of Realtors' definition. By 2002, the average worker could afford 107% of the median payment. Slow improvements in the economy attracted enough in-migrants that, by 2000, the state posted a small net population gain over the 1990 level. Still, Connecticut has become relatively smaller—as evidenced by its loss of a Congressional

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Yankee Ingenuity

After the wrenching recession of the early 1990s, what enabled Connecticut to rebuild its economy so successfully and weather the current storm so well? The answer, in no small part, lies in the remarkable resourcefulness of Connecticut Yankees. Our workers remain among the most productive in the world, and our advantage has only grown wider. In 1990, the productivity of Connecticut workers exceeded the U.S. average by 22%. Over the ensuing decade, Connecticut’s productivity grew at a 2.0% annual clip, outstripping that of the U.S., at 1.6%, so by 2000 Connecticut’s lead had climbed to 27% (chart p. 3).

The state’s edge reflects, in part, the greater experience and better training of Connecticut workers, who grew both older and wiser over the decade. The state’s median age, 34.4 years in 1990, reached 37.4 years in 2000. (For more on demographics, see pp. 6-7.) We’re better educated today than we were back then: 24.4% of residents age 25 hold at least a bachelor’s degree, up from 20.3% in 1990. But Connecticut’s productivity advantage also reflects the state’s distinctive mix of industries and developments over the past decade.

Nowhere did the state get more productive than in manufacturing—the sector hardest hit by the Great Recession. Connecticut manufacturing productivity growth averaged 4.8% per year in the 1990s (and 6.4% per year after 1993). By contrast, annual U.S. productivity growth in the sector averaged just 4.2%. In 1990, Connecticut manufacturing workers produced 8% more real output than did their U.S. counterparts. By 2000 their advantage had grown to 11.4%. Unlike employment, manufacturing’s share of total state output is growing again—from 18.2% in 1990, down to 15.9% in 1993 but back to 16.9% in 2000.

A big part of the gains can be traced to improved capital stock. Manufacturers’ real capital spending grew at an average annual rate of about 1% in the 1990s, even as jobs shrank by 1.6% per year. And the job cuts, though significant, represented a dramatic slowdown from the previous decade. Between 1992 and 2002, job losses averaged about 400 per month, versus 1,000 per month during the previous ten-year period. In the 1990s, every sub-sector within manufacturing lost jobs except for chemicals, up 3.3%, and (an indication of the growing dominance of health care, discussed below) pharmaceuticals, up 47.2%. In absolute and percentage terms, job losses over the period were especially steep in transportation equipment and aerospace—both casualties of defense cutbacks.

That could change as the U.S. reloads its arsenal. Connecticut will fare well under the recent $400 billion defense authorization bill. Contract awards for 2001, the most recent figure available, totaled $4.3 billion. While still below the $5.0 billion total of ten years ago, it’s much improved from the $2.8 billion average in the intervening years (chart below). The state ranks third in contracts per capita, behind Virginia and Alaska. In the worst year, 2000, our ranking slipped to just ninth.

Financial services, the other key pillar of the Connecticut economy, also suffered debilitating job losses in the early 1990s. But here too the productivity gains have been remarkable. Worker output grew 3.6% annually in the decade, second only to manufacturing. And with average U.S. growth for that sector at just 1.3%, Connecticut’s productivity advantage soared to 40%—the biggest differential for any state sector.

Financial employment held its own during the 1990s, but the composition of jobs shifted away from older, lower-productivity jobs towards newer, higher-productivity ones. Job losses at depository institutions were partially offset by gains at nondepository institutions. Employment in insurance gave way to employment in commodity and financial investment activity, which (despite the extended bear market) has continued to advance. And a vigorous housing market has helped real estate jobs pick up a bit. Like manufacturing, financial services gained output share in Connecticut, with the percentage climbing from 25.8% in 1990 to 29.5% in 2000.

Where the Jobs Are

Manufacturing and financial activities have been the wellspring of productivity growth for the Connecticut economy, but non-financial services have been the richest source of job growth. Virtually the entire net increase of 140,000 jobs in the state between 1992 and 2002 originated in service-producing sectors. Jobs in services are less productive than in manufacturing or finance: output per worker in 2000 (1996 dollars) averaged approximately $50,000 in services, compared with $94,000 in manufacturing and $191,000 in finance. Connecticut workers still hold a sizeable—though declining—productivity edge in non-financial services. Though output per worker grew at an average 1.0% per year in the 1990s compared with 1.3% for the U.S., in 2000 the state still held a 16.6% productivity advantage.

The rise of services, the relentless decline of manufacturing, and the need to harmonize sectoral descriptions with our trading partners recently prompted a switch from the old Standard Industrial Classification (SIC) to the new North American Industrial Classification System (NAICS). The five SIC service-producing industries—transportation, communication and utilities; trade; finance, insur-
achieved, and real estate; services; and government—morphed into eight “supersectors”—information; trade, transportation and utilities (TTU); financial activities; professional and business services; educational and health services; leisure and hospitality; other services; and government. Let’s take a brief tour of the new landscape.

The omnibus TTU sector still ranks first in employment, though its relative importance has diminished over time. Despite the addition of 20,000 jobs over the decade, principally in retailing, the sector’s share of total jobs slipped from 19.0% in 1992 to 18.6% in 2002. Retail jobs shifted markedly from general toward specialized merchandising, particularly big-box retailing. The emergence of Home Depot and Lowes, for example, coincided with a flurry of new employment in the building material/garden subsector which went from 10,600 to 15,900 jobs. Output per TTU worker increased 2.7% annually in the 1990s, but since sector productivity grew 3.0% per year nationally, Connecticut’s productivity advantage declined from 18.1% in 1990 to 15.5% in 2000.

TTU may be the state’s biggest employer, but the best sector for job growth has been the old SIC “services” sector, now captured most closely by health-and-education services and professional-and-business services. Job gains in the former came chiefly in health. As more patients were treated in HMOs, jobs in outpatient services climbed 13,400 or 23.7%, while growth in hospital or inpatient care was just 6.7%. Partly due to our aging population, nursing and residential care also posted double-digit job growth (up 29.1%), as did social assistance (up 66.5%). During the 1990s, Connecticut’s productivity advantage over the U.S. held steady at an average of 30% in education and 14% in health care.

Professional and business services, however, are a different story. The state’s productivity there grew 2.4% annually compared with 2.2% for the U.S., and now stands 35% above the nation’s. Between 1992 and 2002, state jobs in the sector climbed by 38,000 or 23.4%. Growth in business services reflects a decade of outsourcing and reclassification of manufacturing tasks as service activities: business services once performed in-house by manufacturing firms are increasingly performed by outside service contractors. Scientific and technical jobs have doubled. Jobs in administrative support services leapt by double digits, as they have in “temp” services, reflecting the shift to just-in-time inventory and production methods.

For glitz and glitter, nothing can match the splash that casino gaming has made in the state. Foxwoods opened its doors in February 1992, and Mohegan Sun followed in October 1996. Today the two establishments account for some 20,000 jobs. Measuring their impact is not easy, because even under NAICS, tribal employment is counted in the state’s government sector rather than more sensibly as part of the leisure and hospitality industry.

As for Connecticut’s public sector, it only grew leaner during the 1990s. Output per worker inched up 0.2% per year. And by 2000, state and local government activity in Connecticut accounted for 6.3% of total output versus 7.7% ten years earlier. Although many other states also devoted a declining fraction of output to government services over the period, Connecticut managed to preserve its rank as the second most frugal state in the union, after New Hampshire.

Curiously, a look back across the decade through the lens of NAICS reveals that the state’s smallest sector, information, showed little job growth. So much for all the hullabaloo about the information economy! And it wasn’t just because the new NAICS sector incorporates the “old-economy” function of publishing. Information also includes the “new” telecommunications industry. At its peak in 2000, employment in telecommunications was only 2,700 or 18.5% higher than in 1992, and with the carnage in technology since then, total jobs were back to the 1992 level by 2002. Of course, not all segments of the information economy are classified here. For instance, NAICS sweeps the growing computer services business under the rug of business services.

The Challenges Ahead

It’s been a challenging decade for Connecticut, but the state has again demonstrated its talent for productively mobilizing human energy. Our state’s ability to retain and even widen its productivity advantages means that it continues to boast a world-class economy. No one can do more with less than can Connecticut workers. But there are warning signs to heed.

Productivity growth has largely occurred in sectors where jobs have been flat or falling, while jobs are growing where our productivity advantage is slipping. Demographic changes will also challenge the state’s ability to keep its productivity engine humming. The supply of young workers entering the labor force will struggle to keep pace with the number of older workers leaving it (see pp. 6-7). Finally, amid signs that inequalities across the state are widening rather than narrowing (see pp. 7-8), it’s clear that Connecticut’s success in solving the production problem has not been matched in solving the distribution problem. Research in these pages and elsewhere suggests that worsening inequalities can hinder economic growth.

The challenges are daunting. But if the past is any guide, Nutmeggers will prove equal to the test.