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OVERVIEW OF ECONOMIC AND POLICY OUTLOOK FOR 2014 AND BEYOND

Outlook for the general economy

Outlook for Michigan local governments

Outlook for health care and economic development

Conclusions
OVERVIEW OF ECONOMIC AND POLICY OUTLOOK FOR 2013

Outlook for the general economy

• This is not your father’s recession
• The threat of inflation and the “tapering” issue
2-Year Yields “Core” And “Semi Core” Converge To 0%
The technical definition of recession: A significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in production, employment, real income, and other indicators.

A recession begins when the economy reaches a peak of activity and ends when the economy reaches its trough.
Second-Quarter GDP, the First Reading

Quarterly change at an annual rate, inflation-adjusted

Previous estimate (◻️)  Revised (◆)

2nd qtr.: Up 1.7%

2008  '09  '10  '11  '12  '13

Note: Seasonally adjusted  Source: Commerce Dept.  The Wall Street Journal
Why the Economy Grew

How much each part of the economy contributed to the quarterly change in GDP, in percentage points; measured at an annual rate.

**CONSUMERS**
- Housing and construction
- Consumer spending
- Imports

**BUSINESS**
- Exports
- Business investment excluding intellectual property
- Intellectual property products

**GOVERNMENT**
- State and local
- Federal

Note: Data are adjusted for inflation and the seasons. Source: Commerce Department.
The key part of the definition: A recession begins when the economy reaches a peak of activity and ends when the economy reaches its trough.

–Is it over yet?
  • Peak of economic activity: 4Q of 2007.
  • Trough of economic activity: 3Q of 2009.
  • So is the recession over? Technically, yes.
  • But why doesn’t it feel like it?
Chart 1

The Bounceback Effect in GDP

Deviation from long-run trend (percent)

NOTE: Shaded bars indicate U.S. recessions.

SOURCES: Bureau of Economic Analysis; author’s calculations.
The Evolution of the Jobs Gap To Date and in the Future Under Different Rates of Job Creation (Through July 2013)

- - - - Average monthly job creation for best year in 2000s (208,000 jobs per month in 2005)
- - - - Average monthly job creation for best year in 1990s (321,000 jobs per month in 1994)
- - - - Maximum number of jobs created in a month in 2000s (471,000 jobs in one month)

THE HAMILTON PROJECT
Chart 1. Number of unemployed persons per job opening
Seasonally adjusted


Note: Shaded area represents recession as determined by the National Bureau of Economic Research (NBER).
Median Household Income Index (HII) and Percent Unemployed, Marginally Attached, or Working Part-time for Economic Reasons by Month, January 2000 to June 2013
But we are not now and never have been in a recession.
We are in a banking crisis.

And banking crises are much longer and much deeper than recessions and do not respond to the policy tools that work in a recession.
Recession: A significant decline in economic activity… lasting more than a few months.

Banking crisis: A country’s corporate and financial sectors experience a large number of defaults… great difficulties repaying contracts… non-performing loans increase sharply and all or most of the aggregate banking system capital is exhausted. This situation may be accompanied by depressed asset prices… on the heels of run-ups before the crisis (see Laeven and Valencia).
THIS IS NOT YOUR FATHER’S RECESSION

▪ **Recession:**
  – Bank stress/failures **follow** the beginning of the recession.
  – Bank capital remains adequate to maintain banking system liquidity, does not pose systemic threat to banking system.

▪ **Banking crisis:**
  – Bank stress/failures and a credit crisis **precede** the recession.
  – Bank capital is inadequate to maintain banking system liquidity, creating a systemic threat to banking system.
  – Bank lending/economic growth are affected **for a much longer period of time**.
Chart 2
GDP Falls Below Trend After Banking Crises

NOTE: Shaded area is the 90 percent confidence interval for the mean.

SOURCE: World Economic Outlook, International Monetary Fund, October 2009.
Chart 3
U.S. Postcrisis GDP Resembles Average Experience

A. Selecting 2007 as first year of the crisis in the U.S.

B. Selecting 2008 as first year of the crisis in the U.S.
WEAKEST RECOVERIES SINCE 1970 EACH RESULTED FROM A BANKING CRISIS.
OCTOBER 23, 2013, 6:17 PM

Jury Finds Bank of America Liable in Mortgage Case

By LANDON THOMAS JR.

Updated, 9:20 p.m. | Bank of America, one of the nation’s largest banks, was found liable on Wednesday of having sold defective mortgages, a jury decision that will be seen as a victory for the government in its aggressive effort to hold banks accountable for their role in the housing crisis.

Moreover, the jury also found a top manager at Bank of America’s Countrywide Financial unit liable, pinning some — if not all — of the responsibility for the bad acts on an individual.

During the trial, federal prosecutors accused Rebecca Mairone, a top manager at Countrywide at the time, of having opted for quantity over quality in its mortgage-writing program, which resulted in the bank’s churning out to unqualified buyers housing loans that were destined to fail.

Federal lawyers claimed that Ms. Mairone, who now works at JPMorgan Chase, led a program nicknamed the “hustle,” derived from the initialism HSSL, or the “high-speed swim lane.” The program linked bonuses to how fast bankers could
Regulators are expected to hit J.P. Morgan Chase & Co. with at least $700 million in penalties as part of a settlement related to the bank's handling of the London Whale trading loss. Colin Barr reports on the News Hub. Photo: AP.

WASHINGTON—J.P. Morgan Chase & Co. is expected to take a big step toward resolving the "London whale" trading fiasco, agreeing to pay at least $800 million in penalties and admit wrongdoing as part of a broad regulatory settlement over its handling of the matter, according to people familiar with the situation.

Regulators in the U.S. and U.K. are expected to fault J.P. Morgan for deficient internal controls and disclosing incorrect information related to the 2012 trades, the people said. The trades resulted in more than $6 billion in losses at the largest U.S. bank.
Of the $13 billion, JPMorgan Chase & Co.’s record $13 billion deal to end U.S. probes of its mortgage-bond sales would free the nation’s largest bank from mounting civil disputes with the government while leaving a criminal inquiry unresolved.

The tentative pact with the Department of Justice increased from an $11 billion proposal last month and would mark the largest amount paid by a financial firm in a settlement with the U.S. The deal wouldn’t release the bank from potential criminal liability, at the insistence of U.S. Attorney General Eric Holder, according to terms described by a person familiar with the talks, who asked not to be named because they were private.

“To not get the waiver from criminal prosecution is not good,” said Nancy Bush, a bank analyst who founded NAB Research LLC in New Jersey. “What we’re looking for in a settlement of this size is certainty from things like the criminal prosecution of a company. The Street wants certainty.”

JPMorgan Chief Executive Officer Jamie Dimon, 57, personally discussed the deal with Holder after markets closed Oct. 18 as the banker sought to end probes that have beset his firm and resulted in its first quarterly loss under his watch. The agreement, which isn’t yet final, includes $4 billion in relief for unspecified consumers and $9 billion in payments and fines, according to another person briefed on the terms.

The payouts would cover a $4 billion accord with the Federal Housing Finance Agency over the bank’s sale of mortgage-backed securities, that person said. The deal, which may be announced in the coming week, also resolves pending inquiries by New York Attorney General Eric Schneiderman, the people said.

### Dwarling Pay

The settlement would amount to more than half of JPMorgan’s record $21.3 billion profit last year, or 1.5 times what the firm’s corporate and investment bank set aside to pay employees during this year’s first nine months. Only seven companies in the Dow Jones Industrial Average earned more than $13 billion in 2012, according to data compiled by Bloomberg. Some portions of the deal, such as relief to homeowners, would probably be tax deductible for JPMorgan.

The outline of the tentative accord was reached during a telephone call between Holder, Dimon, JPMorgan General Counsel Stephen Cutler and Associate U.S. Attorney General Tony West, said the person. The settlement’s statement of facts is still being negotiated.
Number of Institutions By Asset Size

September 30, 2013

- Less than $100 Million: 2,117 Institutions (30.7%)
- Greater than $10 Billion: 107 Institutions (1.6%)
- $1 Billion to $10 Billion: 561 Institutions (8.1%)
- $100 Million to $1 Billion: 4,106 Institutions (59.6%)
Industry Assets By Asset Size
September 30, 2013
($ Billions)

- $1 Billion to $10 Billion: $1,453 (10.0%)
- $100 Million to $1 Billion: $1,245 (8.5%)
- Less than $100 Million: $124 (0.8%)
- Greater than $10 Billion: $11,774 (80.6%)
Adjusted and Required Reserves

Billions of dollars

Adjusted

Required

96 97 98 99 00 01 02 03 04 05 06 07 08 09 10 11 12 13
WHERE ARE WE NOW? UNDERSTANDING THE INFLATION ISSUE AND “TAPERING”

The fundamental equation of monetary economics

\[ M \times V = P \times Y, \text{ where:} \]

- \( M \) = Monetary base
- \( V \) = Velocity of money
- \( P \) = Price level
- \( Y \) = Output of goods and services in the economy

If \( V \) and \( Y \) are constant (\( Y \) at full employment), then an increase in \( M \) will result in an increase in \( P \) (inflation).
WHERE ARE WE NOW? UNDERSTANDING THE INFLATION ISSUE AND “TAPERING”

The fundamental equation of monetary economics

\[ M \times V = P \times Y, \text{ where:} \]

- \( M \) = Monetary base
- \( V \) = Velocity of money
- \( P \) = Price level
- \( Y \) = Output of goods and services in the economy

But what if \( V \) is not constant (decreases)? Then \( P \) will decrease if the \( M \) does not increase.

What determines \( V \)? Two factors: (1) Firm/consumer cash holding habits and (2) bank lending practices.
WHERE ARE WE NOW? UNDERSTANDING THE INFLATION ISSUE AND "TAPERING"

The fundamental equation of monetary economics

\[ M \times V = P \times Y, \text{ where:} \]

- \( M \) = Monetary base
- \( V \) = Velocity of money
- \( P \) = Price level
- \( Y \) = Real output of goods and services

But if \( Y \) (output) is not at full capacity, then \( P \) will not increase if the \( M \) increases.

What is happening with \( Y \) relative to capacity?
CHART 4: TREMENDOUS EXCESS CAPACITY IN THE U.S. ECONOMY

United States: Real GDP and Real Potential GDP
($ billion, 2005)
## Yawning

Output gap* as % of potential GDP, forecast

<table>
<thead>
<tr>
<th>Country</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>7</td>
<td>6</td>
</tr>
<tr>
<td>Germany</td>
<td>6</td>
<td>5</td>
</tr>
<tr>
<td>France</td>
<td>4</td>
<td>3</td>
</tr>
<tr>
<td>United States</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>OECD</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>Canada</td>
<td>3</td>
<td>2</td>
</tr>
<tr>
<td>Italy</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Spain</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Britain</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

*Difference between actual and potential GDP

Source: OECD
WHERE ARE WE NOW? UNDERSTANDING THE INFLATION ISSUE AND “TAPERING”

The fundamental equation of monetary economics

\[ M \times V = P \times Y, \] where:

- \( M \) = Monetary base
- \( V \) = Velocity of money
- \( P \) = Price level
- \( Y \) = Real output of goods and services

Summary:

- \( V \) is DECREASING.
- \( Y \) is BELOW CAPACITY.

Where is the inflationary threat from \( M \)?
CPI Inflation and 1-Year-Ahead CPI Inflation Expectations

The shaded region shows the Humphrey-Hawkins CPI inflation range. Beginning in January 2000, the Humphrey-Hawkins inflation range was reported using the PCE price index and therefore is not shown on this graph.
Outlook for the general economy

• This is not your father’s recession – income growth will remain slow
• Employment growth is will remain slow
• We remain focused on the wrong issue (inflation being right around the corner)
• This is a global phenomenon
OVERVIEW OF ECONOMIC AND POLICY OUTLOOK FOR 2014 AND BEYOND

Outlook for the general economy

Outlook for Michigan local governments
Figure 3. Continued Growth In Personal Income and Sales Tax Collections

Year-Over-Year Real Change in Major State-Local Taxes
Percent Change of Four-Quarter Average

Sources: U.S. Census Bureau, Quarterly Summary of State & Local Government Tax Revenue and Bureau of Economic Analysis (GDP).
Notes: (1) 4-quarter average of percent change in real tax revenue; (2) No adjustments for legislative changes.
Figure 9. State Tax Revenue Recovery Is Weak and Slow

State Tax Revenue Since the Start of the Recession
Four-Quarter Moving Average, Adjusted for Inflation

Cumulative % change since start of recession vs. Quarters since start of recession

Sources: U.S. Census Bureau, Quarterly Summary of State & Local Government Tax Revenue and Bureau of Economic Analysis (GDP).
Notes: (1) 4-quarter average of inflation-adjusted tax revenue; (2) No adjustments for legislative changes.
Figure 13. Local Government Property Tax Revenues Are Weak Compared to Past Two Recoveries

Local Government Property Tax Revenue Since the Start of the Recession
Four-Quarter Moving Average, Adjusted for Inflation

Sources: U.S. Census Bureau, Quarterly Summary of State & Local Government Tax Revenue and Bureau of Economic Analysis (GDP).
OVERVIEW OF ECONOMIC AND POLICY OUTLOOK FOR 2014 AND BEYOND

Outlook for the general economy

Outlook for Michigan local governments

• Once again, this is not your father’s recession – state and local tax revenue growth will remain slow
OVERVIEW OF ECONOMIC AND POLICY OUTLOOK FOR 2014 AND BEYOND

Outlook for the general economy

Outlook for Michigan local governments

Outlook for health care and economic development
HEALTH CARE AND STATE/Local ECONOMIC DEVELOPMENT

Health care will become a source of competitive advantage among states just as much as taxes, utility costs, work force quality, etc.

Forces driving the issue of health care and economic development will be stronger ideological preferences

- Health Insurance Marketplaces (Exchanges), transparency, and business recruitment
- “Job lock”, the entrepreneur, and business development
- Provisions of the ACA
### Employment Size of Firms

Table 2a. Employment Size of Employer and Nonemployer Firms, 2008

*Introductory text* includes scope and methodology. These data are also available by industry and state. Table includes both establishments with payroll and nonemployers. For descriptions of column headings and rows (industries), click on the appropriate underlined element in the table.

<table>
<thead>
<tr>
<th>Employment size of enterprise</th>
<th>Firms</th>
<th>Establishments</th>
<th>Paid employees</th>
<th>Annual payroll ($1,000)</th>
<th>Sales or Receipts ($1,000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>All firms</td>
<td>27,281,452</td>
<td>28,952,489</td>
<td>120,903,551</td>
<td>5,130,509,178</td>
<td>n/a</td>
</tr>
<tr>
<td>Nonemployer firms</td>
<td>21,351,320</td>
<td>21,351,320</td>
<td>n/a</td>
<td>n/a</td>
<td>962,791,527</td>
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<tr>
<td>Employer firms</td>
<td>5,930,132</td>
<td>7,601,169</td>
<td>120,903,551</td>
<td>5,130,509,178</td>
<td>n/a</td>
</tr>
<tr>
<td>Firms with 1 to 4 employees (or with no employees as of Mar 12)</td>
<td>3,617,764</td>
<td>3,624,614</td>
<td>6,086,291</td>
<td>232,062,907</td>
<td>n/a</td>
</tr>
<tr>
<td>Firms with 5 to 9 employees</td>
<td>1,044,065</td>
<td>1,056,947</td>
<td>6,878,051</td>
<td>222,504,912</td>
<td>n/a</td>
</tr>
<tr>
<td>Firms with 10 to 19 employees</td>
<td>633,141</td>
<td>667,463</td>
<td>8,497,391</td>
<td>293,534,352</td>
<td>n/a</td>
</tr>
<tr>
<td>Firms with 20 to 99 employees</td>
<td>526,307</td>
<td>705,430</td>
<td>20,684,691</td>
<td>774,589,335</td>
<td>n/a</td>
</tr>
<tr>
<td>Firms with 100 to 499 employees</td>
<td>90,386</td>
<td>359,902</td>
<td>17,547,567</td>
<td>706,476,683</td>
<td>n/a</td>
</tr>
<tr>
<td>Firms with 500 employees or more</td>
<td>18,469</td>
<td>1,186,813</td>
<td>61,209,560</td>
<td>2,901,340,979</td>
<td>n/a</td>
</tr>
<tr>
<td>Firms with 500 to 749 employees</td>
<td>6,060</td>
<td>72,676</td>
<td>3,681,760</td>
<td>156,491,764</td>
<td>n/a</td>
</tr>
<tr>
<td>Firms with 750 to 999 employees</td>
<td>3,038</td>
<td>48,005</td>
<td>2,617,087</td>
<td>114,635,897</td>
<td>n/a</td>
</tr>
<tr>
<td>Firms with 1,000 to 1,499 employees</td>
<td>3,044</td>
<td>64,556</td>
<td>3,720,654</td>
<td>167,658,791</td>
<td>n/a</td>
</tr>
<tr>
<td>Firms with 1,500 to 1,999 employees</td>
<td>1,533</td>
<td>45,062</td>
<td>2,653,392</td>
<td>121,800,728</td>
<td>n/a</td>
</tr>
<tr>
<td>Firms with 2,000 to 2,499 employees</td>
<td>904</td>
<td>36,081</td>
<td>2,011,244</td>
<td>94,406,916</td>
<td>n/a</td>
</tr>
<tr>
<td>Firms with 2,500 to 4,999 employees</td>
<td>1,934</td>
<td>120,416</td>
<td>6,726,611</td>
<td>329,188,349</td>
<td>n/a</td>
</tr>
<tr>
<td>Firms with 5,000 employees or more</td>
<td>1,956</td>
<td>800,017</td>
<td>39,798,812</td>
<td>1,917,158,534</td>
<td>n/a</td>
</tr>
<tr>
<td>Firms with 5,000 to 9,999 employees</td>
<td>975</td>
<td>121,835</td>
<td>6,773,466</td>
<td>337,598,036</td>
<td>n/a</td>
</tr>
<tr>
<td>Firms with 10,000 employees or more</td>
<td>981</td>
<td>678,182</td>
<td>33,025,346</td>
<td>1,579,560,498</td>
<td>n/a</td>
</tr>
</tbody>
</table>

n/a - Receipts data are available for employers only for the years for which an economic census is taken (2007, 2002, 1997).
### Exhibit 2.2
Percentage of Firms Offering Health Benefits, by Firm Size, 1999-2013

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>3-9 Workers</td>
<td>55%</td>
<td>57%</td>
<td>58%</td>
<td>58%</td>
<td>55%</td>
<td>52%</td>
<td>47%</td>
<td>49%</td>
<td>45%</td>
<td>47%</td>
<td>59%*</td>
<td>48%*</td>
<td>50%</td>
<td>45%</td>
<td></td>
</tr>
<tr>
<td>10-24 Workers</td>
<td>74%</td>
<td>80%</td>
<td>77%</td>
<td>70%*</td>
<td>76%</td>
<td>74%</td>
<td>72%</td>
<td>73%</td>
<td>76%</td>
<td>78%</td>
<td>72%</td>
<td>76%</td>
<td>71%</td>
<td>73%</td>
<td>68%</td>
</tr>
<tr>
<td>25-49 Workers</td>
<td>88%</td>
<td>91%</td>
<td>90%</td>
<td>87%</td>
<td>84%</td>
<td>87%</td>
<td>87%</td>
<td>83%</td>
<td>90%*</td>
<td>87%</td>
<td>92%</td>
<td>85%*</td>
<td>87%</td>
<td>85%</td>
<td></td>
</tr>
<tr>
<td>50-199 Workers</td>
<td>97%</td>
<td>97%</td>
<td>96%</td>
<td>95%</td>
<td>95%</td>
<td>92%</td>
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<td>95%</td>
<td>95%</td>
<td>93%</td>
<td>94%</td>
<td>91%</td>
</tr>
<tr>
<td>All Small Firms (3-199 Workers)</td>
<td>65%</td>
<td>68%</td>
<td>67%</td>
<td>65%</td>
<td>65%</td>
<td>62%</td>
<td>59%</td>
<td>60%</td>
<td>59%</td>
<td>62%</td>
<td>68%*</td>
<td>59%*</td>
<td>61%</td>
<td>57%</td>
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</tr>
<tr>
<td>All Large Firms (200 or More Workers)</td>
<td>99%</td>
<td>99%</td>
<td>99%</td>
<td>98%</td>
<td>97%</td>
<td>98%</td>
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<td>63%</td>
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<td>59%</td>
<td>63%</td>
<td>69%*</td>
<td>60%*</td>
<td>61%</td>
<td>57%</td>
<td></td>
</tr>
</tbody>
</table>

* Estimate is statistically different from estimate for the previous year shown (p<.05).

Note: As noted in the Survey Design and Methods section, estimates presented in this exhibit are based on the sample of both firms that completed the entire survey and those that answered just one question about whether they offer health benefits.
Adjoining states face differences with health care law

Donovan Slack, Gannett Washington Bureau 5:44 a.m. EST November 10, 2013

Minnesota has signed up far more people at lower rates on its state-run health insurance exchange than neighboring Wisconsin, which has struggled with the troubled federal government site.

WASHINGTON -- When Joe Atkins hunkered down to draft legislation outlining how Minnesota would implement the Affordable Care Act, he had no idea the results would be so dramatic.

The Gopher State is now enrolling individuals through its health-insurance exchange by the thousands and at premium rates that are among the lowest in the country.
HEALTH CARE AND STATE/LOCAL ECONOMIC DEVELOPMENT

Health care will become a source of competitive advantage among states just as much as taxes, utility costs, work force quality, etc.

Forces driving the issue of health care and economic development will be stronger ideological preferences

- Health Insurance Marketplaces (Exchanges), transparency, and business recruitment
- “Job lock”, the entrepreneur, and business development
- Provisions of the ACA
Will Work For Health Insurance: The 'Job Lock' Conundrum

By TODD BOOKMAN

Richard Polonsky is an organizational consultant, and can, if prompted, easily talk like one.

"Being an outsider to an organization, I think people tend to listen to you more than when you are part of the organizational structure," says Polonsky.

Based in Bedford, he has spent a career advising companies and non-profits on how to be more effective.
HEALTH CARE AND STATE/LOCAL ECONOMIC DEVELOPMENT

Health care will become a source of competitive advantage among states just as much as taxes, utility costs, work force quality, etc.

Forces driving the issue of health care and economic development will be stronger ideological preferences:

- Health Insurance Marketplaces (Exchanges), transparency, and business recruitment
- “Job lock”, the entrepreneur, and business development
- Provisions of the ACA
HEALTH CARE AND STATE/LOCAL ECONOMIC DEVELOPMENT

Provisions of the ACA that will affect the economic development issue among states

- **Small Business Options Program (SHOP)**
  - Employers with less than 50 employees can purchase group insurance on the Health Insurance Marketplace in 2014
  - SHOP open to employers with less than 100 employees in 2016
  - States’ option to open SHOP for all employers after 2016
- **2017:** States have option of multistate compacts
Slow economic growth is likely to continue and exacerbate federal, state and local government budget issues.

Tax revenue growth at state and local levels is likely to continue to be limited.

The health care issue will continue to affect state and local governments as employers and as competitors in the economic development game.