MAINE ECONOMIC OUTLOOK

Maine has finally entered a period of relatively sustained employment and economic growth, though the pace is still well behind that of the U.S. as a whole. The state has recovered about two thirds of the jobs lost in the Great Recession and is on track in this forecast to complete the process by mid-2016s. The Great Recession will not have been the longest downturn in Maine's recent history but it will be the slowest recovery. Three sectors will lead the way in job creation: professional & business services, education & health, and leisure & hospitality. Manufacturing will more or less stabilize in terms of jobs, while growing at the national level.

Maine's long-standing problem with demographics is now beginning to become a factor in the potential for economic growth. A combination of no population growth and a smaller and smaller entry-level work force is transforming Maine into a labor shortage rather than a labor surplus environment, reducing the available workforce and increasing its price. While rising wages will be positive, the effects on competitiveness and on the substitution of capital for labor are unknown.

Maine obsesses over economic development every election. Three candidates for Governor agree on more than they might admit, but also differ significantly in their views of the role of government in the economy. But the economic development debate bears little resemblance to the real Maine economy and how the next administration will respond to the new Maine economy is very uncertain.

1. Finally Finding Recovery Road

The significant lag in job growth during the recovery from the Great Recession of 2008-2009 has nowhere been more apparent than in Maine, a small economy that relies almost entirely on national economic growth to generate new economic activity. The old saying "As Maine goes, so goes the Nation", a largely apocryphal description of Presidential elections when Maine voted in September ahead of the rest of country, has been reversed in the case of the economy: As goes the Nation, so goes Maine. Except more slowly.

A lagging recovery from the recession has been common for Maine. There has been a recession-recovery-expansion cycle in each of the last four decades. In the 1980s and 2000s, Maine's recovery to pre-recession employment levels took fewer quarters than the U.S., but in the 1990s Maine's recovery was ten quarters longer than the U.S. employment recovery, and the current period is also forecast to be longer by a full year than the U.S.

This pattern is clearly being repeated in the current period, which is accurately described as the Not So Great Recovery from the Great Recession. As measured by employment losses, Maine entered the recession about two quarters after the recession officially began in December 2007 in the U.S. Through mid 2010 when jobs finally stopped falling, Maine lost 4.7% of its wage & salary employment. At that point, U.S. wage & salary jobs had declined by 5.7%. By the second quarter of 2014, the U.S. was back above pre-recession employment levels, while Maine remained 1.7%, or about 10,000 jobs, below pre-recession levels. In this forecast, Maine does not recover to pre-recession levels of about 620,000 pre-recession jobs until the second quarter of 2016.

But there is actually much good news in this forecast. The rate of job growth in Maine has picked up appreciably in the last year. At 1.3% (seasonally adjusted at annual rates) from 2013Q3 to 2014Q3, the job growth rate is more than double the 0.5% average growth rate from the beginning of the recovery. At 1.3%, Maine now is just behind the U.S. growth average employment growth rate of 1.5%; unfortunately the U.S. has been averaging that rate since mid 2010, while Maine has gotten to growth rates over 1% only over the past year.

This overall picture masks, however, an important element of the Maine economy which is the much more dramatic effects on manufacturing sectors in recessions. In 1960, one of every three jobs in Maine was in manufacturing, with the largest sectors being shoe, clothing, and textiles. Today it is less than one in six. Manufacturing jobs have shrunk by more than half in the last forty years. While the decline has been characterized by a continuous stream of small losses here and there, in recessions the flood gates of job losses in manufacturing open and the rates of job losses double or triple.

In general, the decline in Maine's manufacturing employment has been significantly greater than in the U.S. as a whole. Much of this occurred in the 1980s and 1990s when the last remnants of shoe and clothing manufacturing left for foreign shores. But there was also a significant decline in the 2000s, particularly in pulp and paper industry. By the Great Recession so much of the manufacturing sector had been cleaned out, that Maine's job losses were relatively mild compared with the U.S. The other side of this is that Maine has little potential for growth; while U.S. manufacturing employment will recover somewhat, Maine's is forecast to continue a modest decline.

There are some positive signs in Maine manufacturing. Ship and boat building, now Maine's largest manufacturing industry, looks to be stable or growing for some time because of a good recovery in boat building and continued success by Bath Iron Works in winning contracts from the Navy. In a victory more symbolic than substantial, the maker of Lincoln Logs has decided to move production from China to Maine beginning next year.

One of the consequences of this shift away from manufacturing is to place most of the job creation burden on sectors in which Maine has relatively little inherent competitive advantage and which are driven far more by national economic performance than internal Maine conditions.

In some ways the patterns of the past are replicated in this period. Goods-related industries like manufacturing, natural resources, and construction had most of the job losses and will see little in the way of job growth in the recovery, though construction will see some growth. At the same time professional & business services, education & health services and leisure & hospitality services saw little or no job losses, and they have and will provide much of the job growth.

Of these three sectors, only leisure & hospitality services is connected to a recognizably "Maine" industry. Health services, the major job creator over the past decade, is now undergoing profound shifts driven by changes at the national level. And while Maine has vibrant professional & business services industries, other than an attractive quality of life, Maine has no particular competitive advantage in this sector.

Two sectors stand out from the pattern. One is trade, transportation & utilities, the vast majority of which is retail trade. There were about 6,500 jobs lost in retail trade during the recession and there will be only about half that many recovered in the forecast. With nearly 80,000 jobs in Maine (about 14% of the total), retail is a key employment sector, but the recovery of jobs in this sector, normally an important part of recovery phases, is not in the cards, and the long run growth potential in Maine and elsewhere in retail seems to be limited by changes in the sector such as online shopping. But the limited population growth in Maine is also an important factor; there are simply not enough new people in Maine to generate a large expansion of bricks and mortar retail establishments.

The other sector that stands out is government, where job loses exceeded 4,000. These losses primarily occurred from 2010 on when state budget cuts began to flow through to local governments in significant ways. Nearly half of state revenues are returned to local governments, with the largest share going to education, and education employees have seen the brunt of the job losses. Although the General Fund has returned to pre-recession nominal levels, almost all of the revenue growth has gone to covering cost increases rather than restoring services.

This structural pattern of change in the Maine economy as it emerges from the Great Recession has implications beyond the pace of recovery. The first is the increasing dependence of the Maine economy on its human resources; the dominance of service industries implies a much greater emphasis on human capital compared with physical capital. This will come at a time when that human capital is becoming scarcer. The second implication is on the relationship between economic development efforts and the actual economy they purport to affect.

2. The Demographic Dilemma

"Maine is the oldest state in the nation" is probably the most commonly quoted demographic fact about the state. The "fact" is based on the median age, which at 42.7 is indeed the oldest of any state on this measure. The "oldest state" implies that "senior citizens" dominate the state, and indeed the "graying" of Maine (and New England) is a major issue. But the more profound and troubling demographic factor is not what is happening in the older population but what is happening in the working age population.

Maine's working age population as a proportion of the population peaked around 1990 and has been steadily declining; the growing share has been those over 65. The older working age population is now the largest share of the population in Maine, and both older and younger working age people have barely shifted their proportions. In contrast, the U.S. working age population is much younger and has been since the early 2000s, with the younger working age significant larger than in Maine.

What this portends is an extended period, probably two decades, in which new entrants will be relatively plentiful to the U.S. workforce and very scarce in Maine. This will upend the dominant feature of the Maine economy since the middle of the 19th century: that it is a labor surplus economy, with the population larger than the available supply of jobs. For the next twenty years, Maine will be a labor short economy; there will not be enough people to fill the jobs available.

This is already beginning to affect a number of industries. Metals fabricating and related manufacturing industries have complained for more than a decade that they cannot get enough younger workers to fill their needs. Information technology companies now cooperate in recruiting and hiring candidates outside of Maine, often in the Boston area. And in perhaps the most telling manifestation of this change, the logging industry, one of the truly iconic Maine industries, is now desperate for workers, pleading with the high schools and community colleges to find ways to increase enrollments in forest harvesting related skills.

The effects of the emerging labor shortage are being masked by the slow recovery. The slow pace of housing construction in Maine and the northeast and declines in demand for paper means that demand for timber harvesting remains low, so the problems today may be better described as annoying rather than critical. But this will not last as more and more of the older workforce begins to retire over the rest of this decade.

Overall the slow recovery is also masking the most important sign of a labor short environment: rising costs of the resource in short supply, in this case manifested as average wages. With recovery to pre-recession employment still two years away, average wages remain more or less stuck.

These examples point to the two paths that will be taken in the labor short environment. The first is to increase the productivity of the workforce that is available. This is clearly seen in the fabricated metals and timber harvesting sectors where technology has substituted for labor for many decades, substantially reducing the demand for labor. But this substitution has its limits. Huge productivity gains were made possible by numerically controlled fabricating tools and CAD/CAM technologies and by feller-bunchers and skidders in woods harvesting. Three people can now cut and deliver the wood that a generation ago took 10 people and three generations ago took 20-30 people. But the existing technologies in these and other industries are have clearly hit or are beyond the point of diminishing marginal returns. Increasing output now requires actually increasing the number of people using the technologies, not just substitution of technology for labor.

These trends in manufacturing and natural resource harvesting are beginning to show up in service industries, where information technology has increasingly provided the productivity gains that Baumol's "cost disease of the services sector"[1] hypothesized could not be obtained in the services industries. While the full impact of information technology on productivity almost certainly still lies in the future, for Maine and other labor short economies, the central question is whether the gains in productivity can outpace the declines in labor supply and resulting increases in labor costs. This is a race that will be visible in the Maine economy beyond the current forecasting horizon.

Increasing productivity to get more output from the existing supply of labor is one path for a labor-short economy. The other is increasing the supply of labor by bringing in more working age population from outside of Maine. Net outmigration is characteristic of recessionary periods, but in other years, Maine is characterized by in-migration.

The forecast shows a significant recovery in the rate of net in-migration over the forecast horizon from the slow pace of the last several years. In fact, Maine's population has barely grown since the onset of the recession, and with deaths now exceeding births in almost all of the state, population growth is now determined entirely be migration trends.

In this forecast, the net migration estimates produced by the model reflect the need for the economy to bring in more people to solve the model's equations for growth in Maine relative to the U.S., and this migration has not been significantly modified. Essentially, the forecast assumes that in order for Maine to really take advantage of the accelerating national economy that more people will have to move to Maine- far more in fact than recent history suggests likely.

The demographic dilemma is a phenomenon being experienced throughout Maine, but Maine, like the rest of the northern New England states it plays out differently within the state. The urban regions, particularly Portland in Maine, are increasingly the center of economic activity. Most of the job losses during the recession were in the rest of Maine as opposed to the Portland metropolitan area, while most of the job gains, at least through 2012, were in the Portland area.

[1] William Baumol hypothesized in the 1970s that because productivity increasing technologies did not exist in service industries, the only way output could be expanded was by hiring more and more people at increasing wages, meaning that as the economy became more and more dependent on services productivity gains would become more difficult.

The urban regions are where the jobs are located and are more likely to be attractive to in-migrants. Housing prices in Portland are high for Maine but low for the rest of New England. There is a wide variety of attractive features in terms of life styles, schools, crime, etc. although for specialized occupations Portland will never offer the density of labor markets that are a key attractant to migrants.

But the other side of these advantages are the disadvantages in smaller metro areas like Lewiston-Auburn and Bangor and even more so in the non-metropolitan area where the rural regions are suffering the most from the declines in the natural resources and manufacturing sectors. In these areas, unless they are grounded in the natural resource industries, including tourism, the economies will increasingly be transfer payment economies dominated by the elderly.

3. Economic Development in Maine

With the economy barely recovering from the worst U.S. recession in more than a half century, the economy remains a hot topic for the current election season. Three things can be said about Maine's, or for that matter, any state's economic development policies:

1. There are very few major innovations in economic development polices, though different periods emphasize different aspects of the economy. For the most part differences over economic development are matters of degree and emphasis rather than fundamentally different approaches.
2. Economic development policies are always expressed in language about the future, but they remain grounded in a vision of the economy dictated by the past.
3. The ability of state and local governments to shape the economy during the term of office is extremely small; the ability to shape the economy beyond the term of office can be quite significant.

To illustrate these points, there are three major candidates for governor in Maine this year, a Republican, a Democrat, and an Independent. As expected, the Republican Paul Le Page emphasizes cutting taxes, regulatory reform, and being "friendly to business". The Democrat, Mike Michaud emphasizes manufacturing as the focus of policy development, not surprising given his background as a mill worker in the now-defunct Great Northern Paper Company in Millinockett. The Independent in the race, Eliot Cutler, who also ran in 2010 and came within a hair's breadth of beating Paul LePage, borrows a little bit from both. He emphasizes taxes, but focuses on the property tax rather than the income tax. He and Mike Michaud emphasize infrastructure, "farms and fisheries" along with renewable energy development.

Like Paul LePage, Cutler also focuses on regulatory reform (though without the "red tape" language). All three candidates put some emphasis on the workforce, with LePage emphasizing improvements to the functioning of the job market through regional job fairs, while both Michaud and Cutler speak more to "workforce development". Only Cutler includes access to higher education as an economic development issue. Only Michaud mentions "shipping" as point of focus.

None of the candidates could be said to oppose the positions of the others. No one is arguing for higher taxes or more regulation. No one is against education or "workforce development" (whatever that is). Everyone wants to help the farming and fisheries industries to one degree or another, and certainly everyone will do what they can to support new manufacturing jobs. But there are some differences. Paul LePage has been fairly outspoken in his opposition to renewable energy development in Maine as he has seen renewables as inevitably costing more than fossil fuels. His emphasis is on the cost of electricity and energy relative to other regions. The other candidates see renewable energy as a development opportunity on its own merits, and emphasize security of supply and long term price stability over short term increases in price.

The most profound difference lies not in the specific policies, but in the overall stance of state government relative to the economy. For Paul LePage and much of the Republican Party in Maine, the path to economic growth lies in a steady and significant reduction in the size of state and local government through reductions in taxes and spending, particularly on dependent populations. Their "model" of economic development is the simple one of cost minimization by government in order to support the profitability of private investments, which will, it is assumed, always be directed to the lowest cost operating environment. Both Michaud and Cutler see a more active role for government in investments in infrastructure and workforce, in support for particular sectors that seem to define Maine. In their "models" the state is both active supporter and investor and cost minimizer to the extent practical.

But none of the candidates really touches at all on the Maine economy that exists today and that will continue to exist for the foreseeable future. None of the candidates address in any way the needs of the professional and business services sector or the health care sector, which will add most of the new high paying jobs. Tourism is not even mentioned, relegated as it is in the popular imagination to "low paying seasonal" jobs. There is no discussion of the housing sector or construction other than in the form of public infrastructure investments.

There is a general sense of the importance of investing in the workforce, but this is mostly to help people to transition from jobs lost, but no sense at all of how the demographics of Maine will profoundly alter the competitive position and potential of the state's economy. The real future is largely ignored in order to stay with safe and well-understood concepts of the economy.

Instead, the state is in the process of a historic downsizing of the public university system, little investment in the community college system, and utter confusion with what to do about K-12 education, particularly in the areas of the state with the sharpest enrollment declines. Under the current school funding law, the state captures all of the benefits of declining enrollment in K-12 schools, leaving the local tax payers to cover all of the fixed costs of providing local schools.

The interesting question is not, therefore, about what the candidates and parties are saying in the election process, but what will be the result when the expectations and promises of candidates and electorate collide head on with a Maine economy that is changing in ways both substantial and subtle.

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