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Deficit reduction fever: Why the Clinton budget will not reduce the deficit

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The recent announcement by a financially healthy Proctor and Gamble to eliminate 13,000 jobs captures the crux of the current economic malaise in Maine and across the country. At this point in the economic cycle, employers would typically be adding jobs. But Maine and U.S. companies are now eliminating many good jobs and replacing them with fewer, lower wage jobs. The absence of a macroeconomic stimulus is accelerating the process of industrial restructuring in a way that harms the long-term economic health of Maine and the United States and will generate persistent underemployment and government budget deficits.

The recession that began in 1990 has put many people out of work. In Maine, 40,000 jobs were lost between 1989 and 1992. Of these, 70 percent were in industries that pay higher than average wages and offer full-time employment and benefits. These include 11,100 manufacturing jobs (primarily transportation equipment, metals and electronics), 11,400 construction jobs, 3,000 wholesale and banking jobs, and 2,500 federal civilian jobs. In effect, the recession has added 28,000 people to the unemployment rolls in Maine, who were earning between $23,000 (in the banking industry) to $38,000 (in the paper industry). These are in addition to the 8,400 retail jobs lost during the period.

In a typical recovery, many of these workers would have returned to work by now. Some permanent losses would occur as companies eliminate inefficient or excess production, but job levels would return to something approximating pre-recession levels. The process of adjustment would continue, but at a more gradual pace and in the context of an expanding economy. At-risk workers would, at least, be employed and have the economic and social supports needed to make adjustments to new job requirements. However, this "recovery" continues to be especially anemic. Seasonally adjusted employment levels in June 1993 were roughly equivalent to the low reached in 1992. Job growth in Maine is expected to be just over one percent during 1993 and to remain at this weak pace through the decade. National Gross Domestic Product (GDP) has been growing at annual rate of well below the three percent level required to generate new job demand.

Persistent weak demand and weak employment and income growth prevent companies from raising prices. The only avenue to higher profits is to reduce costs. This is achieved by adopting more efficient production techniques and, especially, by closing down production that was once marginally profitable. Consequently, firms have fewer jobs and the remaining jobs have a new array of requirements.

The protracted recession that began in 1990 is accelerating the process of industrial restructuring in a way that will be harmful to the long-term economic health of Maine and the U.S. We are eliminating medium-skilled/moderate-to-high wage jobs from the U.S. and Maine economies at an unprecedented pace. This accelerated adjustment is resulting in a large and growing number of unemployed and underemployed workers. This "correction," in the quaint vernacular of economists, may be good for company bottom lines, but it has a high and lasting economic cost to society. Many of the former manufacturing and construction workers who could once make a living wage with modest education and training will remain unemployable in this environment, except in very low-wage jobs. Even the low-wage retail and service jobs will not be growing very rapidly, because consumer demand will remain weak. These 28,000 middle-class households, whose primary wage earner will remain underemployed for a considerable period of time, will not be able to pay mortgages, health insurance, or other elements of the secure lifestyle to which they had grown accustomed. They will, instead, join other underemployed households who sustain a very heavy demand on publicly-financed social services.

In a typical recovery, these people would have had more time to adjust to this change, and they would have done so in an environment of general economic expansion. This adjustment may have been supported by their employer, and at least with the support of a paycheck, and the housing, food, healthcare and self-esteem it buys. Instead, they will be struggling to bolster their education and training while they are unemployed and burdened by the cost of training and education, and the need to house, clothe and feed their families.

The fiscal impact of this dynamic is obvious. Slow job growth will generate weak revenues while prolonged underemployment will increase government costs, a formula for deficits. Ironically, this effect will be directly attributed to federal deficit reduction policies.

This is not a typical recovery. The principal difference between this and the recoveries of the past is the absence of economic stimuli. The federal government refused to offer meaningful economic stimulus because of a political interest in reducing the deficit. Instead, in the interest of reducing the deficit, the federal government has committed to reduce aggregate demand by roughly $200 billion per year. The result of this political decision will be to prolong the current economic stagnation and to risk a long-term cycle of tax increases and social service cuts. In the face of federal fiscal contraction, the number of employed persons will not increase and wages will certainly not increase, con-straining federal revenue growth. At the same time, the demand for social support for formerly middle-class families and the long-term poor alike will expand. This will, ironically and inevitably, increase the deficit. The rising deficit will fuel a cycle of demands to reduce social spending further and the need to raise taxes further.

In sum, the refusal to stimulate an economic recovery has left millions of workers jobless for a protracted period of time, has expedited the process of eliminating medium-skill/medium-to-high wage jobs, and has created an exceptionally large unemployed labor pool to compete for a shrinking number of decent jobs. Companies that survive this recession may be somewhat more competitive in the short term. But Maine citizens and businesses will pay a great cost in a higher and prolonged demand for social support and even higher cost in human suffering and community disruption.

Policy issues for Maine

Maine has directed its limited tools on this economic malaise. The $80 million Jobs Bond in 1992 was designed to counter sagging construction employment and to provide capital to businesses suffering from the "credit crunch." Similarly, efforts to improve the disposable income of businesses and individuals motivated the elimination of temporary income taxes. Unfortunately, in a state as small as Maine, these approaches can offer only marginal stimulus to Maine's $25 billion economy. In this environment, Maine government will have to strengthen its capacity to assist workers to adjust to the rapidly changing economic environment. Of particular importance will be:

- Re-doubling efforts to provide help in matching workers to jobs. The economy will produce replacement jobs (openings resulting from retirements and relocations) and the modest re-hiring that will occur. However, public job placement services need to increase greatly their connections to private job openings.
- Rationalizing Maine's all-too- fragmented job training, development, and placement services "network." The current system is not well-designed to serve the large number of skilled and semi-skilled workers seeking employment assistance.
- Anticipating continued upward pressures on costly social support systems in combination with weak state revenues.

Meaningful improvements in the Maine economy can only come from more active macroeconomic intervention by the federal government or some other unforeseen economic stimulus. However, the current national politics have produced the counter-Keynesian policy of reducing aggregate demand during economic recession and has relegated the U.S. and Maine economies to protracted stagnation and larger federal deficits.

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