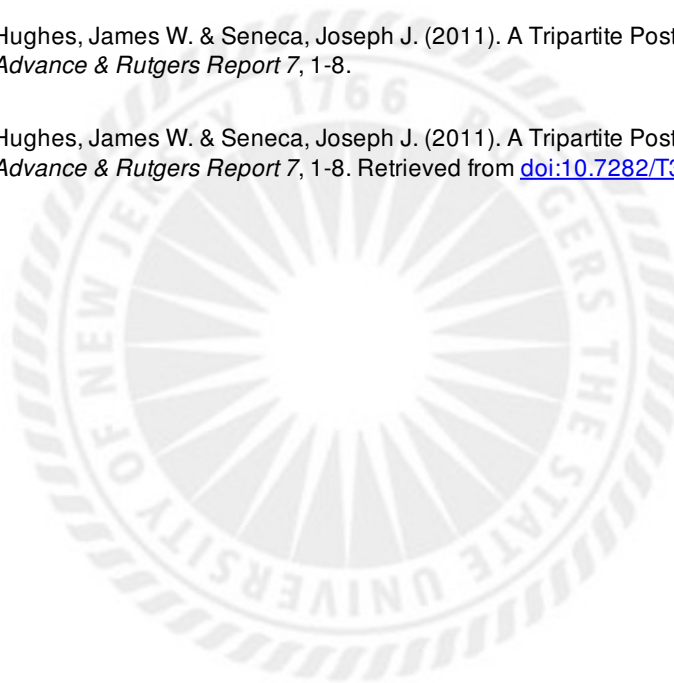


A Tripartite Post-Recession Rebalancing

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ADVANCE & RUTGERS REPORT

Issue Paper Number 7 • November 2011

An Analysis of Economic,
Business & Demographic Trends

A Tripartite Post-Recession Rebalancing

by **James W. Hughes** and **Joseph J. Seneca**

The economic recovery from the worst recession since the Great Depression has been painfully slow.¹ After 45 months (15 quarters) since the Great Recession began, the nation's Gross Domestic Product (GDP) has finally (barely) regained its pre-recession peak (figure 1).² In the previous worst recession since the Great Depression—the 1981–1982 downturn—it took only 21 months (7 quarters) to surpass the pre-recession GDP peak.³ And, 45 months (15 quarters) after the start of the 1981–1982 recession, GDP was 12.7 percent higher than its pre-recession peak. At a minimum, that is where the nation's output should be today. That 12.7



Peter J. Cocozziello

A Message from Advance Realty

by **Peter J. Cocozziello**

In this latest *Advance & Rutgers Report*, entitled “A Tripartite Post-Recession Rebalancing,” Dean James W. Hughes and Professor Joseph J. Seneca deliver an incisive assessment of the current market conditions and obstacles in the path of our economic recovery. They offer a statistical cautionary tale that the private and public sector need to hear and acknowledge in order for the economy to make continued progress.

Hughes and Seneca examine three current major imbalances that are affecting the nation's recovery: housing production, home-



James W. Hughes



Joseph J. Seneca

percent translates into approximately \$1.7 trillion in “missing” GDP, and all the income and employment that would go with such a higher total output level for the nation.

There are many reasons to account for this shortfall. However, this report focuses on those that stem from the imbalances that are present in several key subsectors of the nation's economy. These imbalances are a consequence of unsustainable excesses that led to the Great Recession of 2007–2009 as well as the result of the sheer depth and severity of the downturn.

A painful process of rebalancing is now under way, a process that is severely impairing the potential *(continued on page 2)*

ownership, and public-sector employment. The report stresses that these imbalances were created and expanded during the excesses leading up to the Great Recession, and each will require significant time to press ahead and be resolved. However, the authors assert that this process is already under way and will eventually lead to more stable fiscal foundations and future economic growth.

An *Advance & Rutgers Report* earlier this year offered some welcome economic indicators including the stabilization of job losses after sustained deep declines in addition to the resumption of job growth. We are beginning to see the number of private-sector jobs edge upward, and that's an encouraging sign for the nation.

Ultimately, the public sector can learn much from the lessons of the private sector. Specifically, corporations today are positioning themselves strongly for the future by evaluating all assets—including real estate—in order to maximize value, functionality, and sustainability. As an owner of real estate in New Jersey for more *(continued on page 7)*

James W. Hughes and
Joseph J. Seneca, Editors

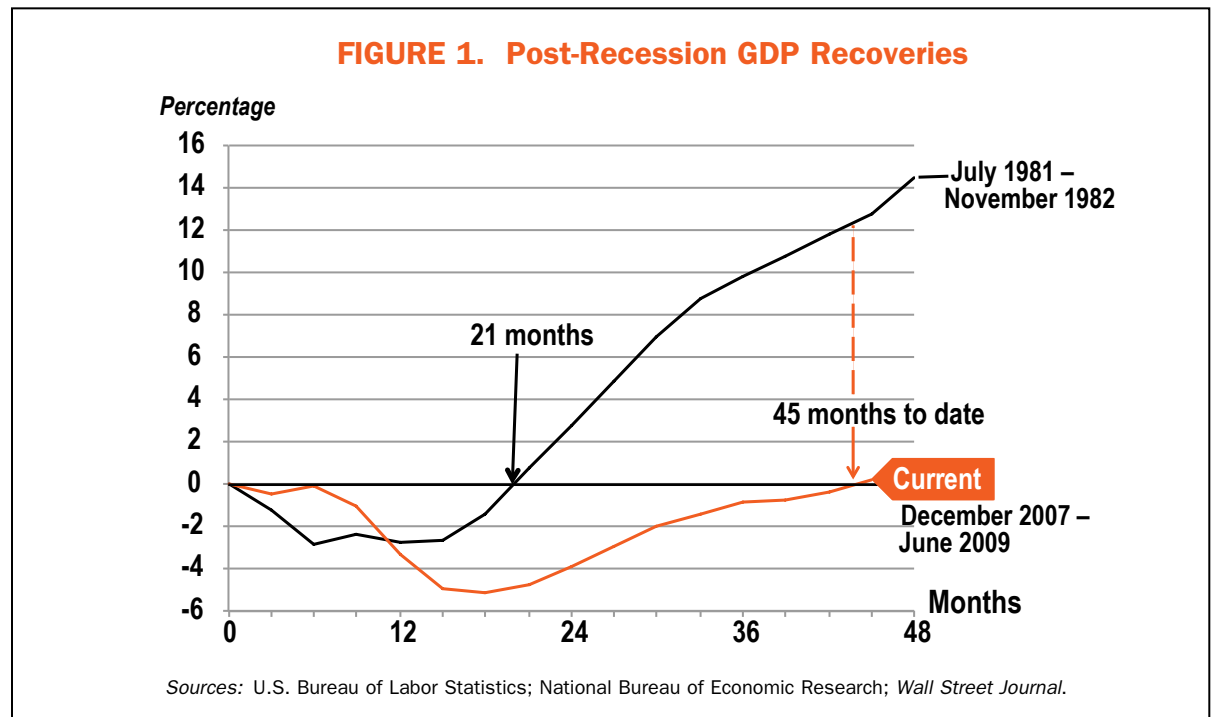


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Post-Recession Rebalancing, continued



strength of the economic recovery, and one that will also take considerably more time to work through. This report examines three dimensions of this ongoing readjustment.

- The Great Recession produced two record private-sector job-loss years (2008 and 2009). During this time, public-sector employment remained unscathed. The nation lost an unprecedented 8,771,000 private-sector jobs in the two years but managed to add a net total of 108,000 public-sector jobs (table 1). This enormous imbalance is now being addressed. Public-sector jobs are

1. According to the Business Cycle Dating Committee of the National Bureau of Economic Research, the recession began in December 2007 and ended in June 2009. Its 18-month length was the longest since the Great Depression. This surpassed the 16-month-long recessions of 1974–1975 and 1981–1982.

2. This time period is measured from the fourth quarter of 2007 to the third quarter of 2011.

3. GDP declined by 5.1 percent in the 2007–2009 recession. This compares with 2.5 percent in the 1981–1982 recession.

now contracting as private-sector employment grows. This ongoing rebalancing will continue to constrain overall employment growth for some time to come.

- Housing production soared to unsustainable levels during the 2000–2007 housing bubble: Housing starts were far in excess of household growth and inventory losses (figure 2). This yielded a production overhang of substantial proportions. Record-low levels of housing starts are now correcting this situation. But the overhang is significantly large such that the housing construction industry is destined to remain in deep recession for several more years. Housing has usually been a key locomotive in post-recession economic bounce backs. It is now the caboose on the recovery train.
- Homeownership rates rose far above historical norms during the pre-recession housing bubble, reaching record levels in 2004, 2005, and 2006 (figure 3). As a result of the bursting of the

shelter bubble, they are now trending back toward more realistic and sustainable levels. Many households became homeowners that probably should not have become homeowners in the first place. This is now forcing painful readjustments in the housing market.

The process of correcting deep excesses and wide imbalances is long-term in nature and is not susceptible to any short-term accelerants. An effective, fast, economic adrenaline boost for these imbalances simply does not exist. Thus, the rebalancing process will continue to impede a stronger general economic bounce back.

I. Private- Versus Public-Sector Job Losses

According to the Business Cycle Dating Committee of the National Bureau of Economic Research (NBER), the Great Recession began in December 2007. During its first year (measured from December 2007 to December 2008), the nation lost 3,784,000 private-sector jobs (table 1). At that time, this was the largest annual loss of private-sector jobs since payroll employment statistics were first compiled in 1939. However, during the very same period, total public-sector employment increased by 184,000 jobs. Of this increase, 108,000 jobs were added by local governments. So, private-sector labor markets bore the entire brunt of the recession in 2008.

Again, according to the NBER, the Great Recession technically ended in June 2009, making it the longest recession (18 months) since the Great Depression (1929–1933), which lasted 43 months. Thus, for the first six months of 2009, the nation was in recession; during the last six months of 2009, the nation was in recovery. Nonetheless, the employment losses in 2009 (-4,987,000 private-sector jobs)

significantly surpassed those in 2008 (-3,784,000 private-sector jobs), and 2009 became the worst employment-loss year since the federal government began counting. In addition, the recession's impact finally spread to public-sector employment (-76,000 jobs), but just barely. Federal government employment continued to grow (+56,000 jobs), but contractions in state (-41,000 jobs) and local (-91,000 jobs) governments outweighed the gains in federal jobs.

For the two years combined (December 2007 to December 2009), the nation lost an unprecedented 8,771,000 private-sector jobs but managed to add a net total of 108,000 public-sector jobs. While private-sector employment declined by 7.6 percent, public-sector jobs increased by 0.5 percent. Another way of looking at it is by monthly metrics for the 24-month period. While the private sector was losing an astounding 365,458 jobs per month, the public sector expanded by 4,500 jobs per month. This pattern of decline and growth across the two sectors was not sustainable and was destined to change.

In 2010, America's employment hemorrhage finally ceased as total employment growth resumed. However, this growth was solely concentrated in the private sector, as the nation started to emerge from a deep employment hole. And there was a similar, but opposite, change in the public sector, whose job losses increased as the negative echo effects of the recession on tax revenues were widely felt by almost every state and local government. The nation added 1,173,000 private-sector jobs in 2010 while public-sector losses totaled 233,000 jobs. The decline in employment in local government alone (-239,000 jobs) was greater than the total government loss because federal government growth (+16,000 jobs) was greater than moderate state government losses (-10,000 jobs).

Private-sector employment recovery continued in 2011. For the first ten months of the year (through October), the United States gained 1,529,000 private-sector jobs, 356,000 greater than the total for all 12 months of 2010

TABLE 1
United States Employment Change, 2008–2011
(in thousands)

	2008	2009	2010	2011 YTD	Total 2008–2011	
					Absolute	Percentage
Total Nonfarm	-3,600	-5,063	940	1,256	-6,467	-4.7
Total Private Sector	-3,784	-4,987	1,173	1,529	-6,069	-5.2
Total Government	184	-76	-233	-273	-398	-1.8
Federal	24	56	16	-41	55	2.0
State	52	-41	-10	-82	-81	-1.6
Local	108	-91	-239	-150	-372	-2.6

Note: Data are seasonally adjusted. Employment changes for 2008, 2009, and 2010 are measured from December to December. Employment change in 2011 is measured from December 2010 through October 2011.

Source: U.S. Bureau of Labor Statistics.

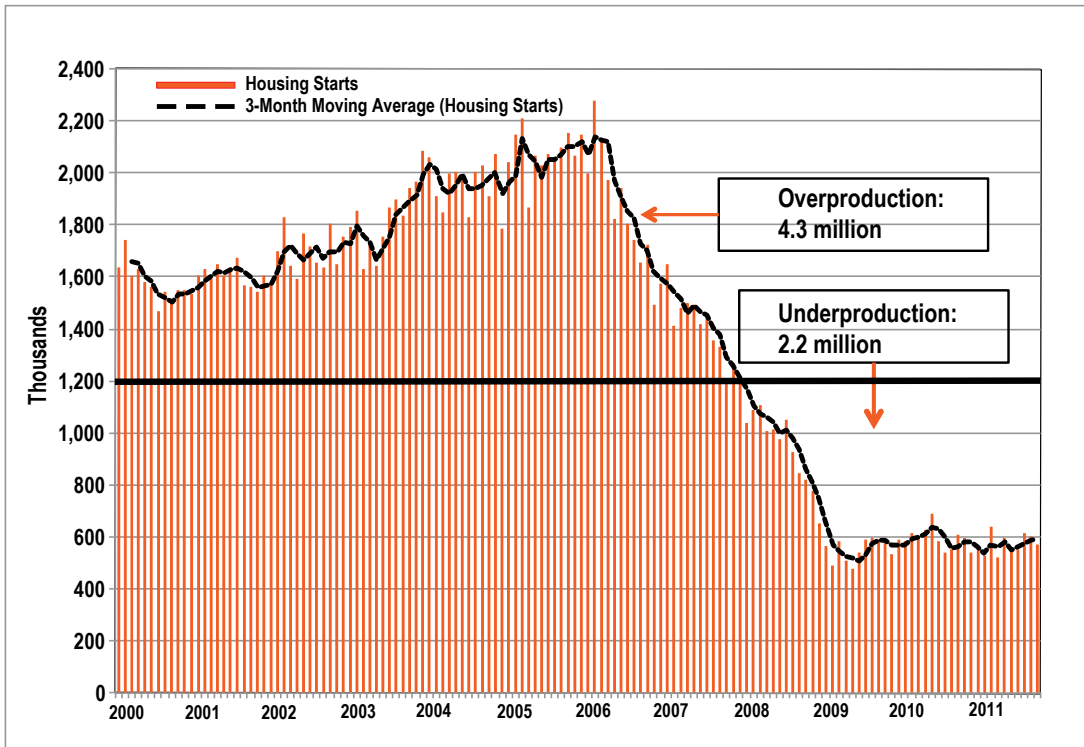
(+1,173,000 jobs). At the same time, public-sector job losses (-273,000 jobs) had already surpassed those of all of 2010 (-233,000 jobs) since federal government employment also joined the loss column (-41,000 jobs), while state (-82,000 jobs) and local employment (-150,000 jobs) continued to contract. So the rebalancing of jobs among the sectors is gaining momentum.

The next-to-last column in table 1 presents the employment change from the start of the recession (December 2007) to October 2011 (46 months). Overall, the nation is still 6,467,000 jobs below the pre-recession peak. The bulk of this is accounted for by the private sector (-6,069,000 jobs). Even though the public-sector losses are starting to accumulate (-398,000 jobs), particularly at the local level (-372,000 jobs), the disparities are still quite substantial. The private sector's decline (-5.2 percent) over the 46 months since the start of the downturn was nearly triple that of the public sector (-1.8 percent). In absolute terms, for every

government job that was lost since December 2007, the private sector lost over 15.

Another way of examining the balance sheet of job losses is to look at the changes in the share of employment between the two sectors at the start of the recession and currently. In December 2007, the private sector accounted for 83.8 percent of total employment and the public sector for the remaining 16.2 percent. In October 2011, the private-sector job share had fallen to 83.3 percent while the public-sector share increased to 16.7 percent. That 0.5 percentage-point shift represents the rebalancing problem.

The recession has been incredibly harsh and its job impacts long-lasting. As painful as the recent public-sector job losses have been, the data clearly reveal that the private sector has borne the brunt of the Great Recession and its aftermath. Given the slow growth in the national economy, state and local fiscal constraints are likely to continue, causing further rebalancing of public-sector employment.

FIGURE 2. U.S. Housing Starts, 2000–2011*(seasonally adjusted at annual rates)*

Source: U.S. Census Bureau.

II. Housing Production Overhang

Due to unsustainably high levels of new-shelter construction during the credit-bubble years, a significant housing overhang now afflicts America. This has driven down production to unprecedentedly low levels. The year 1959 was the first year that data on housing-unit starts was compiled. In the 52 years of this data series, 2009 and 2010 had by far the worst housing-production record. Both years had fewer than 600,000 starts (figure 2). And 2011 is destined to replicate these dismal levels. To put this performance in perspective, average annual

starts between 1959 and 2009 were approximately 1.5 million units per year. Housing is not simply in recession—it is in a sustained depression.

This has had profound implications for America's economy. Housing is usually a key locomotive in post-recession economic bounce backs. It is now the caboose on the recovery train. The inventory overhang that currently exists suggests that it will be the caboose at least until 2015. This is demonstrated by housing starts data of the past 11 years. Based on annual new household formations and yearly

losses from the housing inventory, America needs to add about 1.2 million housing units per year. This is indicated by the solid black line in figure 2. That line can be viewed generally as the level of sustainable, trend, housing production.⁴

However, as is evident from figure 2, national housing production entered the last decade at a robust 1.6 million housing starts per year. A true housing bubble then began in 2002 as starts trended upward. They exceeded 2.1 million at the peak in 2005–2006. Then the bubble burst. The steep downward slide in starts between 2006 and 2009—an economic statistic in virtual “free fall”—represented an unprecedented contraction in America’s housing industry.

Despite this tumble, there is still a significant inventory overhang. Between 2000 and 2008, the total overproduction—that is, the annual production over 1.2 million units—was 4.3 million units. That is the area in figure 2 above the heavy black line up to the dotted black line. Production is now hovering at around 600,000 starts per year—near record-low levels. Since 2008, the under-trend production has totaled 2.2 million units. That is the area in figure 2 below the heavy black line down to the dotted black line. Thus, there are still 2.1 million units to be worked off—4.3 million minus 2.2 million—before the inventory overhang is eliminated.

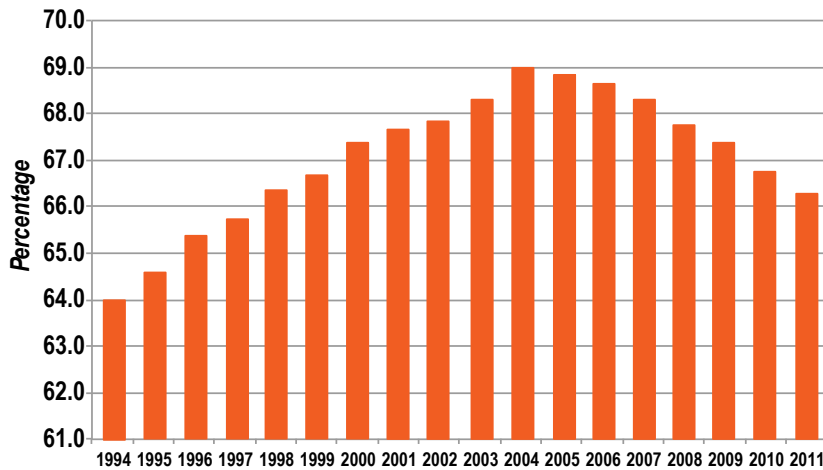
So, it is no surprise that housing has not been a post-recession jackrabbit as in previous economic recoveries. It is likely to remain far more the tortoise than the hare for some time to come. America will need approximately three and a half more years, or until 2015, of subdued production at 600,000 units

per year to achieve rebalancing. Then the market may be able to finally ramp back up to the 1.2 million-unit-per-year production level.

III. Rebalancing Homeownership

The overproduction was not evenly spread over all housing segments. It was particularly concentrated in the ownership market and was linked to dramatic increases in the rate of homeownership. In 1994, the homeownership rate in the United States was approximately 64 percent, as shown in figure 3. It had first reached the 64 percent threshold 20 years earlier in the mid-1970s, and then hovered in that vicinity until 1995, when it began a long, steady rise. By 2000, it had eclipsed the 67 percent level. But, by 2004, it had soared to 69 percent; 2004, 2005, and 2006 had the highest levels of homeownership in America’s history, aided by high-risk lending and cheap, easy credit. This was not sustainable and was a key factor in America’s housing bubble and overproduction. Many of the households that participated in that rate increase probably should not have become homeowners in the first place. This is now being corrected—a painful process. The rate tumbled to just over 66 percent during the first half of 2011, and the retreat is likely to continue. It is not surprising that the rental housing market has become much more robust.

4. Household growth in the decade of the 2000s averaged about 1.1 million per year. However, it varied annually based on the stage of the economic cycle. For example, between 2001 and 2007, years of economic expansion and the housing bubble, there were 1.3 million household formations annually. Between 2007 and 2010—the Great Recession and its aftermath—formations tumbled to approximately 500,000 per year. Going forward, 1.1 million formations per year may be optimistic.

FIGURE 3. U.S. Homeownership Rates, 1994–2011

Notes: Annual rates calculated as averages of quarterly rates. Data for 2011 are through the second quarter.

Source: U.S. Census Bureau.

Conclusion

The three imbalances described here are formidable obstacles to the economic recovery. They were created and expanded during the consumer and financial excesses leading up to the Great Recession. Each is large in scope and fundamental to the economy—housing production, homeownership, and public-sector employment—and especially, local public-sector employment.

Each of these imbalances grew over a considerable period of time, creating conditions that were not sustainable, and also creating powerful self-interest, economic, and political forces that increasingly exacerbated the imbalances. It is not surprising that the corrections for each imbalance have been painful, lengthy, and felt across the nation. Even more unfortunately, each imbalance requires significant time going forward to be fully resolved. Nevertheless, the process has begun in each case and will lead to a sounder economic and fiscal foundation for future economic growth. ■

The authors thank Will Irving for statistical assistance, Arlene Pashman for editorial and production support, and Marcia Hannigan for distribution assistance.

A Message from Advance, continued

than 30 years, I see significant opportunities for the public sector to take a cue from this trend by assessing their real estate holdings as a prudent approach to finding and unlocking hidden value and spurring economic growth.

Governor Chris Christie's recently announced State Strategic Job Growth Plan establishes a practical framework for the future of development and economic growth in the state and focuses on creating so-called "Vibrant Regions" to grow and promote our diverse communities. We agree with the state's approach to development that promotes communities with access to mass transit and quality infrastructure. Advance Realty is leading the way with the Riverbend District and Willow 14—mixed-use, transit-oriented projects under development in Harrison and Hoboken, respectively. We are proud to be on track with this plan and fervently believe these projects serve a dual purpose of creating jobs and improving communities.

As always, we thank the faculty and staff at Rutgers for their astute work in helping us better understand the market forces at work. ■

Peter J. Coccoziello is President and CEO of Advance Realty.

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ADVANCE & RUTGERS REPORT

The **Edward J. Bloustein School of Planning and Public Policy** is one of the nation's key centers for the theory and practice of planning and public policy scholarship and analysis. The school was established in 1992 by the Rutgers University Board of Governors to provide a focus for all of Rutgers' initiatives and programs of instruction, research, and service in planning and public policy. The Bloustein School was ranked No. 3 in the United States in the latest survey of the nation's top graduate programs in urban planning by Planetizen, a Los Angeles-based planning and development network.

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March 2012 will mark the twentieth anniversary of the establishment of the Edward J. Bloustein School of Planning and Public Policy. A series of events from fall 2011 through spring 2012 is planned to commemorate this achievement. Festivities will include presentations on Bloustein School faculty and staff research, several major lectures, and a two-day symposium on healthy cities, health policy, transportation security, and international planning. Events will highlight the best of the school's work in urban planning, public policy, and public health. They began in September 2011 with the construction of the Rutgers and NJIT completely solar-powered ENJOY house on the Washington Mall in the District of Columbia as part of the U.S. Department of Energy's Solar Decathlon, and will culminate in the two-day symposium.

For additional information about the Bloustein School, its academic programs, upcoming events, and affiliated research centers, visit the school's website: <http://www.policy.rutgers.edu>. Check the website frequently for calendar updates on special Twentieth Anniversary events. ■

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