Economic Development Planning, Summary 6

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Title: Causes of Varying Economic Performance by State: A Report from the Productivity and Prosperity Project (P3), An Initiative Supported by the Office of the University Economist

Year: 2011

Source: Center for Competitiveness and Prosperity Research, L. William Seidman Research Institute, W.P. Carey School of Business, Arizona State University

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Summary: Arizona has the nation’s second most cyclical economy, reflecting its rapid population growth and heavy reliance on construction and real estate. The key to creating a more consistently high-performing economy is to reduce the reliance on such cyclical industries as construction and real estate, and to increase the relative importance of more stable industries. The goal should be to achieve a
reasonably diverse economy so as to avoid the swinging ups and downs of broadly diverse economies with their highly cyclical industries. That said, Arizona has a relatively diverse economy, ranking 15th among the states. In part, this is due to the state’s size. States with a substantial population tend to be more economically diverse than small states.

**Sectors:** High-tech, construction, real estate, retail, manufacturing, health care and administrative support.

**Geographical impact:** Arizona.

**Key actors:** Arizona governor and Legislature, business community, Arizona Commerce Authority, Greater Phoenix Economic Council, Tucson Regional Economic Opportunities, Greater Phoenix Leadership, Arizona Tax Research Association, Arizona Chamber of Commerce and Industry, Southern Arizona Leadership Council, Science Foundation Arizona, Flagstaff Forty, Arizona Technology Council, Flinn Foundation, Greater Yuma Economic Development Corp., Arizona State University, University of Arizona, Northern Arizona University, among other educational institutions.

**Major challenges:** Arizona’s biggest challenge is its high growth rate. In a fast-growing economy such as Arizona’s that is tied to population growth, efforts to attract high-quality (and presumably stable) jobs can have only a marginal impact because so many other jobs are being created. Achieving a reasonably diverse economy with more stable industries offering higher-paying jobs and fewer highly cyclical industries with lower-paying jobs will be a long-term process, particularly if the population continues to grow rapidly.

**Progress to date:** The Arizona economy is improving, but the state continues to lag the nation in job recovery, having replaced about half of the 300,000 jobs lost in the recession. Passage of the Arizona Competitiveness Package in early 2011 put Arizona on much better footing in competing with other states and countries for higher-value added businesses, and in improving the business climate for existing businesses to add jobs. The legislation provided key building blocks to diversify the state’s economy with the goal of creating higher-paying base industry jobs. In late 2013, *Forbes* magazine and *Moody’s Analytics*
projected that Arizona would lead the nation in job growth over the next five years, averaging 3 percent job growth with annual economic growth of 4.6 percent.

**Major implications:** While many Arizonans still measure success by how many people move to Arizona and how many jobs are created in a year, there is growing recognition that a better measure of progress is what kinds of jobs are being created and whether Arizona is working to build an economy less reliant on highly cyclical industries with low- to average-paying jobs. A more diversified economy with better paying jobs would enable Arizona to better ride out the inevitable economic busts that follow the booms.

**Opportunities for alignment:** The Legislature, in partnership with the Arizona Commerce Authority and other economic development organizations, can continue to craft legislation to create more programs and incentives to make Arizona more attractive to stable industries offering high-wage jobs.

**Background:** Arizona’s volatile, fast-growing economy is fueled by highly cyclical industries such as construction and real estate, which in turn spur retail sales. Construction and real estate make up a disproportionate share of Arizona’s economy and are sensitive to changes in local population growth. When times are good in Arizona, a great numbers of jobs tend to be created. Conversely, during recessions Arizona tends to lose a great number of jobs.

Arizona ranked near the top of states during the economic expansion of 2002-07, but plummeted close to the bottom during the 2008-09 recession as construction and retail sales slumped badly. In contrast, many of the states that underperformed during the expansion experienced a relatively mild recession.

**Economic performance:** The report analyzed nearly 10 years of data pertaining to the economic performance of states. The work was divided into four phases: the recession that occurred in 2001; the expansion from the end of 2001 to the beginning of the 2008-09 recession; the 2008-09 recession; and the recovery so far from the 2008-09 recession.
During the 2001 recession, Arizona’s economy did not decline as much as the national average. Arizona’s economy decreased 1.6 percent versus the national average decline of 2.1 percent. In the West, Washington (-4.3 percent), Colorado (-3.5 percent), California (-3.5 percent) and Nevada (-2.6 percent) were among the hardest-hit states.

The 10 best performing states had losses of 0.5 percent or less and were scattered geographically, except for a cluster around Maryland. During the 2002-07 expansion, Arizona was the fifth-fastest growing state at 27.1 percent. The national average was 14.2 percent growth. The top 10 states exceeded 23 percent growth, led by energy-rich Wyoming (39.6 percent) and North Dakota (38 percent). The weakest growth, 10 percent or less, was largely in the Great Lakes region and in the Northeast.

The 2008-09 recession was long and deep, with Arizona suffering the fifth-largest decline at 9.2 percent. Three other states in the West (California, Nevada and Idaho) had losses of more than 7.5 percent. The District of Columbia and states in the South Atlantic region tended to fare better.

With the 2010 recovery, the average rate of growth was 2.1 percent over a period of four quarters. Six of the 10 slowest-recovering states were in the West, including Arizona (0.7 percent). The other Western states were Hawaii (0.3 percent), Colorado (0.5 percent), Utah (0.6 percent), Washington (1.0 percent), and New Mexico (1.3 percent).

**Performance across periods:** Few states posted consistently strong growth across all four time periods. Alaska, New Mexico and District of Columbia had the most consistently strong performance, followed by Wyoming and Louisiana. Similarly, not many states consistently lagged behind, though Michigan and Indiana were among the bottom 10 states in each of the first three time periods.

Arizona’s relatively strong aggregate economic growth from 2000 to 2006 was simply the result of population and employment growth that greatly exceeded the national average. It was not the result of solid growth in measures of prosperity and productivity, such as per capita personal income or earnings per employee. Even during the economic
expansion, growth in per capita income and earnings per employee were barely faster than the national average.

**Diversity of the economy and job quality:** Neither job quality nor the diversity of the economy explain very much of the differences in economic performances across states or over time. This suggests that variations in economic growth by sector are the main cause of the overall differences in growth rates.

**Varying sectoral performance:** Some sectors, such as construction, are quite volatile, showing strong growth during expansions, but posting large losses during recessions. States with a disproportionate share of these highly cyclical sectors have the most volatile economies. Since many of these industries, such as construction and real estate, are highly tied to population growth, Arizona and other fast-growing states in the Sunbelt and West have the most volatile economies.

The analysis looked at the change in annual average employment by sector to identify those economic activities responsible for causing the variation in overall growth rates across states. Also examined was regional shift to explain differences in growth rates across states or time periods (in each sector, state employment in the prior period was multiplied by the difference in the sectoral growth rate between the nation and the state).

**2001 Recession.** Between 2000 and 2001, total employment in Arizona grew by 27,682 jobs, a gain of 1 percent compared to 0.1 percent nationally. Had Arizona performed identical to the national average, it would have added only 2,357 jobs. Arizona’s industrial mix accounted for the creation of 2,158 jobs and the regional shift for the remaining 23,167 jobs. Only four of the 20 sectors experienced a job loss in Arizona during this period. Government, finance and insurance, and agriculture stood out.

**2002-07 Expansion.** Total employment in Arizona rose by 631,088 jobs. The state’s growth rate of 22.4 percent compared to 8.7 percent nationally. Had Arizona performed to the national average, it would have added 245,267 jobs. The state’s industrial mix accounted for 36,573 new jobs, and the regional shift component accounted for the
additional 349,248 jobs. Manufacturing and information were the only sectors that didn’t expand, largely reflecting the national weakness in these two sectors. Most sectors in Arizona expanded considerably, notably health care; construction; government; professional, scientific and technical services; administrative support; and real estate.

**2008-09 Recession.** Arizona lost jobs at a greater rate than the national average (-7.1 percent versus -3.4 percent). In all, the state lost 244,615 jobs. Had the state performed at the national average, it would have lost 116,635 jobs. The industrial mix, including construction, manufacturing and administrative support, accounted for 10,152 lost jobs. The regional shift was responsible for 117,828 lost jobs. Nearly half the jobs lost in the regional shift were in construction.

**2009-10 Recovery.** Arizona’s economic recovery has trailed most of the nation, with 15 of 20 sectors in the regional shift component negative.

**Conclusion:** Job quality and economic diversity are laudable goals for economic development, but they do not guarantee a consistently high-performing economy. Arizona’s job quality is below the national average, but the state ranks just above the median state. Arizona’s economy is the nation’s second cyclical. The state should strive to reduce the significance of cyclical industries and increase the relative importance of more stable industries.

In a rapidly growing state such as Arizona, efforts to attract high-quality jobs can have only a marginal impact. When Intel’s new Fab facility comes online in 2013 or 2014, its few thousand jobs will be overshadowed by job growth tied to population gains. In those years, job growth will likely be around 100,000 a year.

If in-migration to Arizona came to a halt, the state would need to create only about 25,000 jobs per year to meet the demands of young adults entering the workforce net of retiring workers. In that scenario, the growth of high-wage operations like Intel would have a telling impact on the economy. It may be many years before Arizona reaches a state of little, if any, net in-migration.