Prospects for Wisconsin in the Recovery and Beyond

Wisconsin Legislative Symposium

March 4, 2010

Dean Michael M. Knetter
Wisconsin School of Business
UW-Madison
Three Aspects to Wisconsin’s Economic Environment

• The U.S. (and global) recession and recovery
• The structural evolution in the U.S. economy over the last 30 years
  • Globalization and technology change have been main drivers of economic change
  • U.S. industry mix has shifted from manufacturing toward knowledge companies
• Wisconsin’s history and public policy shapes our opportunities
Recent Economic Events

• The U.S. economy experienced its sharpest contraction of post-WWII period:
  – Housing bubble burst, resulting deleveraging led to financial crisis
  – Contraction in spending and employment
  – Massive stimulus to avert Depression has now generated some signs of recovery
  – Now what? Will the private sector begin to grow again?
S&P 500
2007-present
GDP % Change
(quarterly, 2007-present)

Source: U.S. Dept. of Commerce: Bureau of Economic Analysis
Unemployment Rate
1960-Present

Source: Bureau of Labor Statistics
Job Loss Comparison

Source: Bureau of Labor Statistics
Recession’s Impact on Wisconsin

- Wisconsin a bystander with respect to the factors causing the financial crisis—overbuilding and excess lending
- Wisconsin suffered collateral damage from reduced spending by households
- Wisconsin faired reasonably well in the competition for stimulus funds
- Conclusion: We just need to ride out the recession, like everyone else. No special problems, but no magic either
My 2010 Forecast

• Stock market mainly sideways
  – Markets have priced in recovery
  – Downside risks remain

• GDP growth 3%
  – Muted for early recovery
  – Stimulus removal hurts; dollar may help

• Unemployment will end the year near 9%
  – Sluggish recovery
  – Many discouraged workers
U.S. Economic Trends: The Bad

- The common (media?) view today is that pre-recession U.S. growth was built on unsustainable demand:
  - Easy credit
  - Falling personal savings rate
  - Rising consumption relative to GDP
  - Growing federal budget deficits
  - Growing current account deficits—borrowing from abroad
Personal Savings/Disposable Income
1960-Present

Source: U.S. Dept. of Commerce: Bureau of Economic Analysis
Current Account/GDP
1980-Present

Source: Federal Reserve System
U.S. Economic Trends: The Good

• The U.S. economy performed extremely well after 1982-83 recession:
  – Solid real GDP growth
  – Strong underlying growth in productivity
  – Low unemployment rates
  – Robust stock market
  – Rapid rise in the stock of wealth

• U.S. firms capitalized on new opportunities and created “the new economy”:
  – Information technology, telecom, and connectivity
  – Global value creation
Inflation Adjusted S&P 500 Average
1970-Present
Reconciling Positive & Negative Trends

• Income and investment returns grew faster than people expected after 1983:
  – Financial and real estate investments
  – Higher productivity = higher labor income

• Households with higher than expected wealth spend more and save less

• Foreign capital flows in both to capture returns and hold our reserve currency

• Creation of the knowledge economy was real and powered the U.S.
Interpreting Reality

• The 70s and early 80s were difficult:
  – Rising inflation, repeated oil price shocks
  – Loss of competitiveness in key sectors
  – High unemployment
  – High savings rates but erosion of wealth

• The mid to late 80s and 90s were an economic renaissance for the U.S.:
  – Falling inflation, moderate commodity prices
  – Development of new economy
  – High GDP growth, low unemployment
  – Falling savings rates but rapid, albeit uneven, growth in wealth
Interpreting Reality

• The 2000s have been confusing at best:
  – Moderate but rising inflation and commodity prices
  – Internet bubble and 9/11 attacks but continued dominance in new economy
  – Credit-induced housing bubble and bust have wreaked havoc

• How do we interpret this decade?
  – Smart people disagree
My Ten Year Forecast

• Steady state growth in real GDP slows to about 2% per year
  – Labor force growth slows
  – Productivity growth tapers off
  – Capital accumulation challenging

• Human capital and knowledge management are critical to US growth
  – More industries being commoditized
  – Competitive advantages hard to sustain
  – Being smarter and nimbler will be important
The U.S. position in the world has shifted from manufacturing toward knowledge and service economy.

This shift has been beneficial to much of the nation but not as much for Wisconsin.

Wisconsin remains relatively heavy in manufacturing and agriculture and light in knowledge and high end services.

Hence, Wisconsin lags national average growth in income and wealth and our fiscal condition has deteriorated.

Source: Economic Report of the President
Wisconsin Detailed Share of Employment: 1990 vs. 2008

Source: Wisconsin Department of Workplace Development
Historical Per Capita Income for the U.S. and Selected States

Source: U.S. Census Bureau
Structural Impacts on Wisconsin

- Wisconsin is very good at manufacturing, but for reasons beyond our control, manufacturing has become a much more competitive business
  - Pressure on prices and profits
  - Productivity up, but employment down
  - Not unlike mechanization of agriculture
- Wisconsin must defend its strength but enter arenas with greater profits, wages and growth potential--knowledge/tech?
- How do we do that without being all things to all people?
A Diversified Regional Strategy

- Manufacturing: promote in SE up to Fox Cities—proximity to major markets, etc.
- Agriculture: promote move to R&D intensive high-value products
- Knowledge/Services: promote in Dane County (bio/educ) and SE Wisconsin
- Tourism: promote in the north and aim high—we are competing for Chicago $!
- A strategy that promotes business and makes tough choices will take leadership
Questions?