THE ECONOMIC SITUATION

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- **Productivity and the employment mystery. Is the recovery jobless?**
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The Nation Turns the Corner

The latest GDP data offer more than a bit of encouragement. First off, the final estimate for second quarter's growth came in at 3.3%, which is pretty close to the 3.5% long-term trend growth rate. What is more interesting than the number is the fact that the number was revised up from the first and second estimate.

Data used for calculating GDP are obtained from business firms nationwide. The larger business report quickly and systematically. Smaller businesses come in late. An upward revision suggests smaller firms are doing better than larger ones, which is a good sign for the economy. After all, most economic activity is produced by small firms.

The accompanying chart shows real GDP growth with the latest data in place and with projections for the next few quarters. The estimates are based on the median of 30 individual forecasts reported by the Philadelphia Federal Reserve Bank. While the current spotty recovery differs significantly from the 1991 recovery, there is more than a small note of optimism in the 2003-04 estimates.

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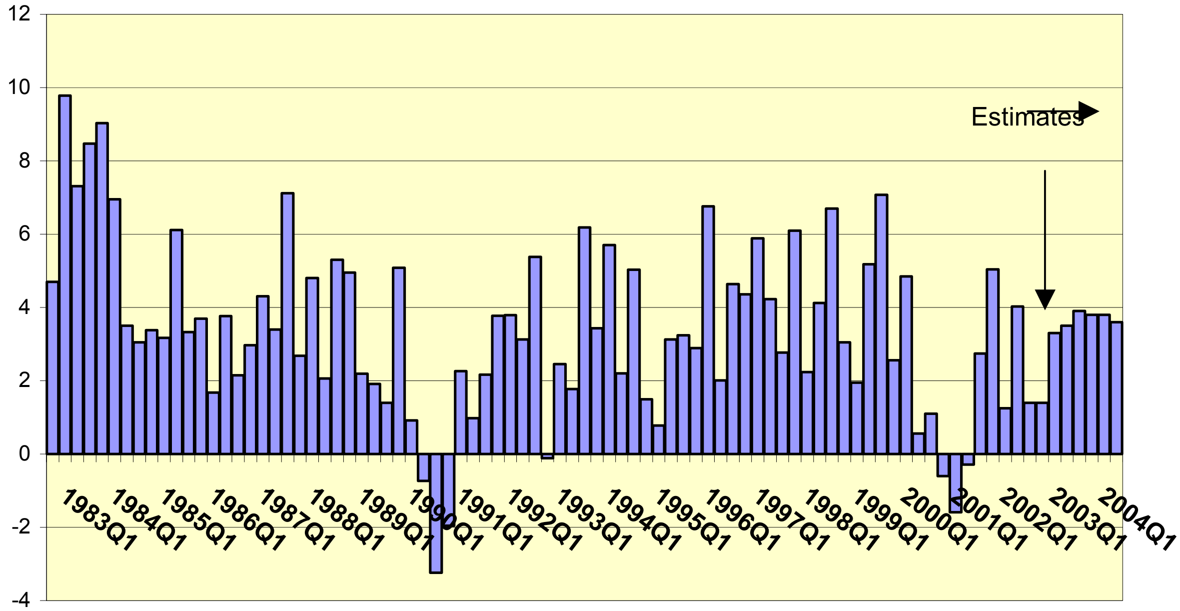
Real GDP Growth: 1983-2003
with estimates to 3Q2004



The Productivity Story

Part of the optimism for 2004 rests on unusually large productivity gains reported for the nation by the Bureau of Labor Statistics (BLS). The BLS divides the total hours worked in the economy for a period of time into the total value of all goods produced during the same period, including capital goods. The chart below shows what has happened in the last 10 years. An inserted trend line makes it easy to see the gain. It should be noted that productivity typically rises during recessions. After all, the least productive workers are among the first released from the workforce. That said, the gains being observed now are still somewhat over the top. They support the optimism seen in the GDP estimates.

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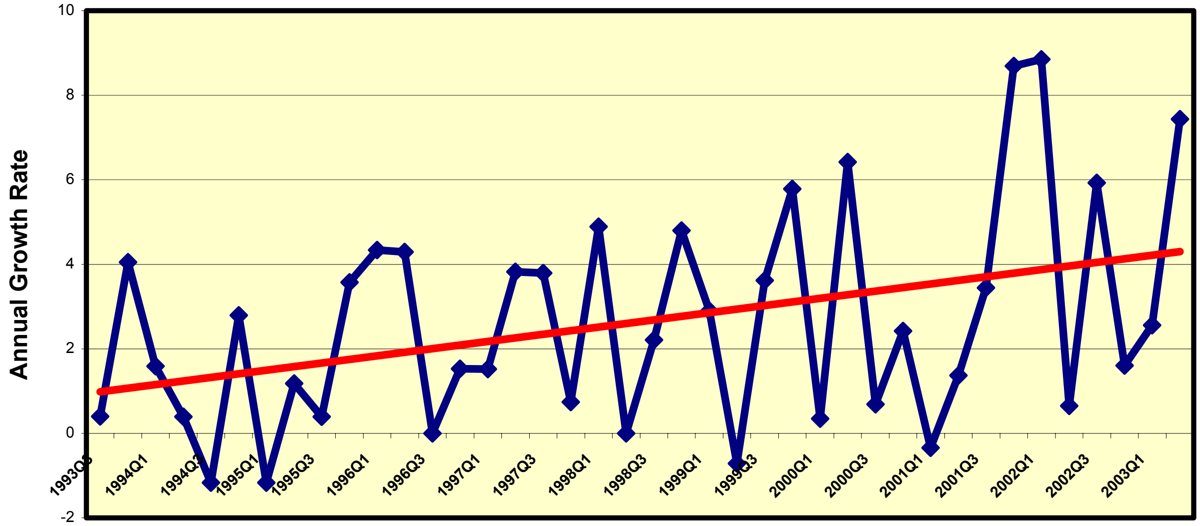
Output Per Hour of Work
1993-2003



The Employment Mystery

Is this a jobless recovery or not? There are always unresolved mysteries lurking in economic data. This recovery's hobgoblin is employment. There are two measures of national employment, both produced by the Bureau of Labor Statistics. One results from a survey of businesses, the so-called payroll survey. The other is the household survey. Generally speaking, the two surveys provide similar findings. Job losses reported by one correspond fairly well to job losses reported by the other. Not so this time. Since November 2001, there has been a loss of 1.1 million payroll survey jobs. Since November 2001, there has been a **gain** of 1.4 million household survey jobs. That's right. A gain. The gap of 2.5 million between the two is the largest on record.

What's going on? Could it be that the more optimistic household numbers help to explain the high level of retail sales reported in the economy?

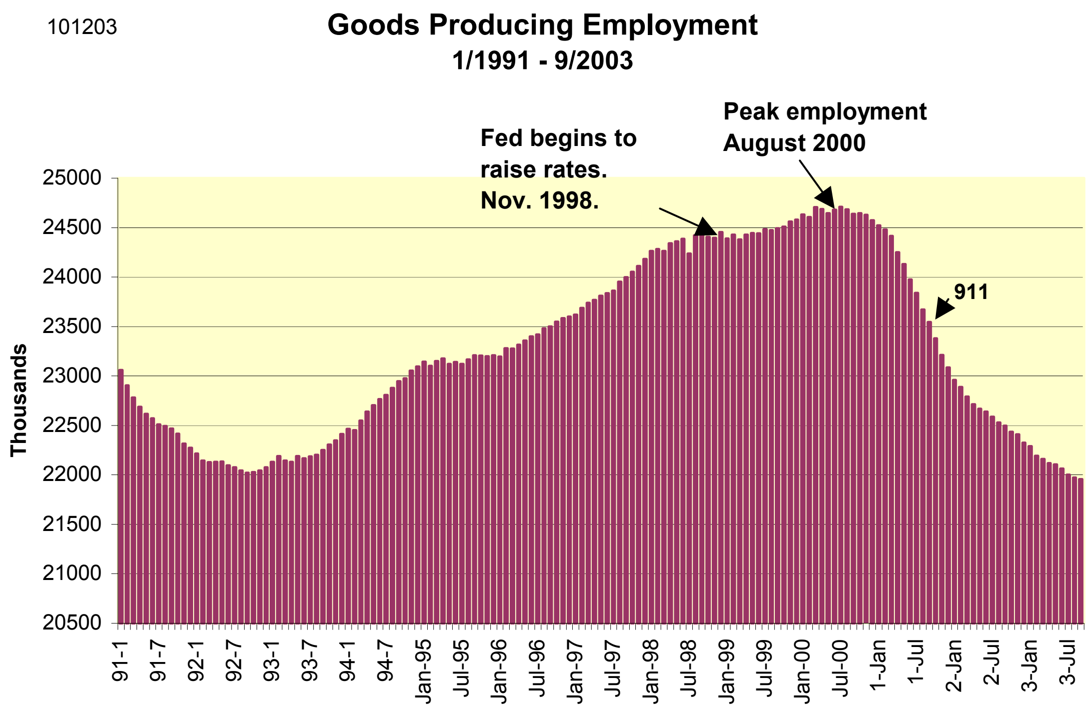
One explanation relates to entrepreneurship. When layoffs occur and big businesses practically shut down major headquarters departments, necessity becomes the mother of invention. Lots of small businesses get started. Indeed, there was an unprecedented surge of new business formations that followed the 1990 recession. Firms maybe reporting a sharp decline in payroll employment, but the household survey reports a gain in employment. People who operate small business will understand. In many cases, they are working out of their homes, and they are surely not unemployed.

It is possible that both numbers are correct after all.

South Carolina's Economy

All this entrepreneurship may be well and good, but it doesn't speak to the very real decline in manufacturing employment and what that means to the Palmetto economy. A quick look at total U.S. employment in manufacturing over the last few years provides a pretty powerful introduction to what has happened to the South Carolina manufacturing economy.

The chart here begins in 1991 and ends with data for September 2003. The rather sharp and sudden drop off in total employment begins about 10 months after the Federal Reserve Board decided to slow the U.S. economy. Starting in November 1998, the Fed raised interest rates seven times. The dollar strengthened; foreign goods became cheaper in dollar terms; U.S. manufacturing went in the tank, along with the rest of the economy. The chart here gives the national manufacturing employment picture that resulted.



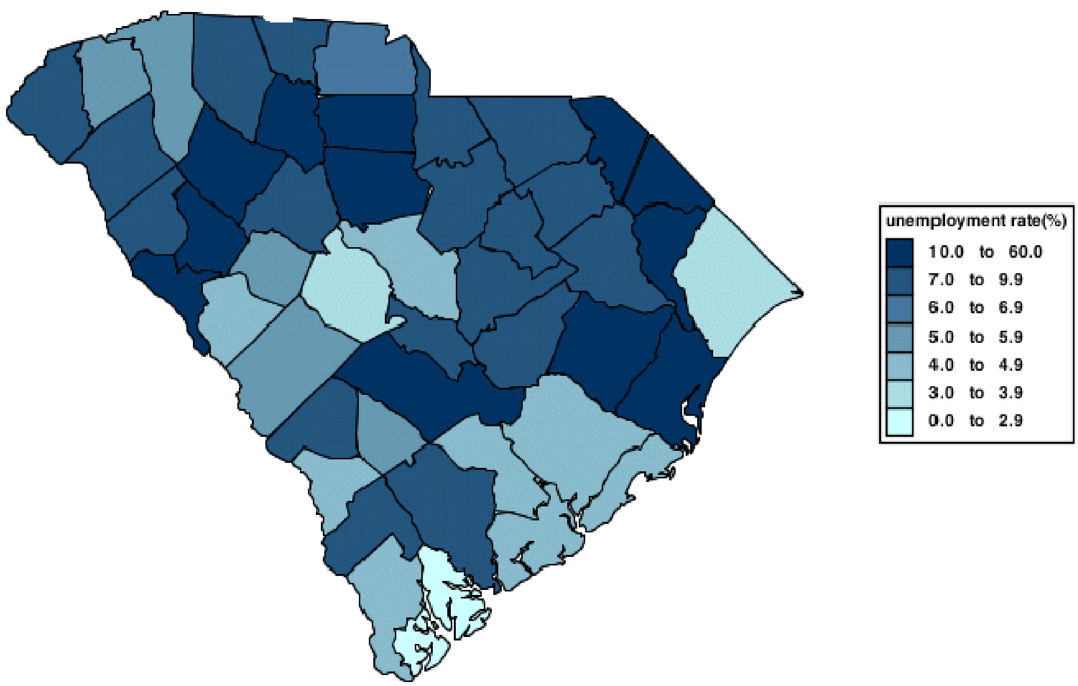
We should keep in mind that a large decline in manufacturing employment does not necessarily mean that manufacturing is a disappearing national enterprise. Of course, there is a linkage, but consider the numbers below. Manufacturing's contribution to Gross Domestic Product has fallen since 1987, but not by nearly as much as employment has fallen. In 1987, the share of GDP contributed by goods producers was 18.7%. In 1997, 10 years later, the share was 16.6%, a decline of about 10%. In 2001, the latest available data, the share was 14.1%.

Manufacturing's Share of GDP

1987	18.7%	1995	17.4
1988	19.2	1996	16.8
1989	18.5	1997	16.6
1990	17.9	1998	16.3
1991	17.4	1999	16.0
1992	17.1	2000	15.5
1993	17.0	2001	14.1
1994	17.3		

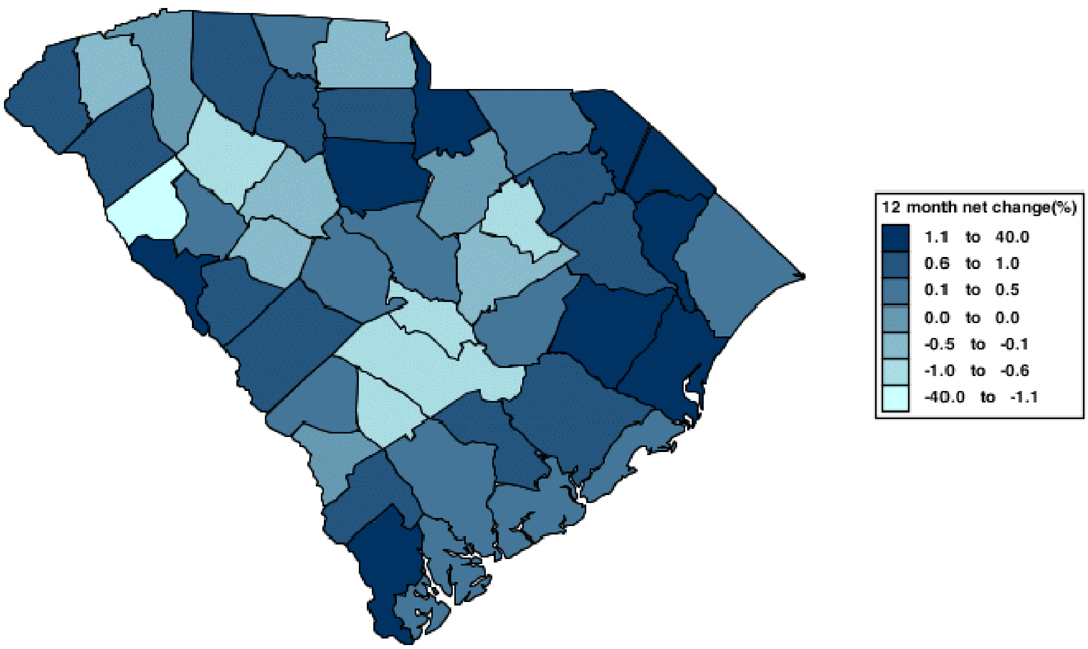
The trend is obvious, and so is the magnitude. The United States is a gigantic goods producer, but the services sector is where growth is occurring.

Recall now that 17% of South Carolina employment is in manufacturing as compared with 11.3% for the nation. The manufacturing recession's uneven effects on South Carolina counties are seen in the next two charts. The first shows the August 2003 county unemployment rate. The darker shaded counties are those with the highest rates. One darker swath includes Chester, Greenwood, Laurens, and McCormick in what might be called the state's old textile belt. These have unemployment rates greater than 10 percent. Joining the double-digit group are Dillon, Fairfield, Georgetown, Marion, and Marlboro. The manufacturing slows put a mark on some of these counties too, though the slowdown was not textile related.



S.C. County Unemployment Rate
August 2003

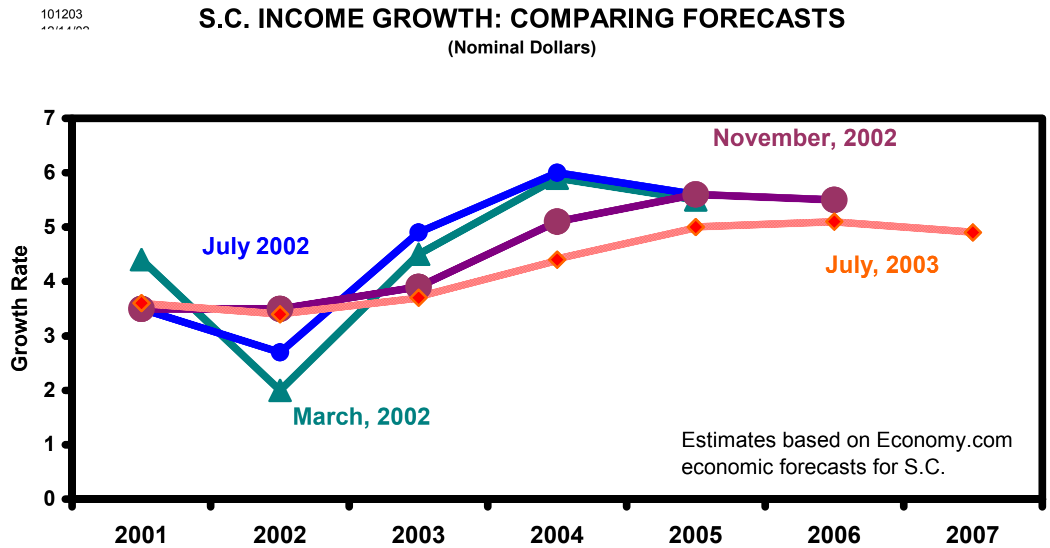
The next chart shows the change in the county unemployment rate since August 2002. Again, the darker the hue the higher the unemployment rate at the end of the period. It is noteworthy that the textile belt counties generally show improvement, while the coastal counties have weakened.



Change in County Unemployment Rate
August 2002-2003

The Latest S.C. Forecast

Economy.com provides periodic forecasts for states, regions, and United States. To illustrate how events and changing facts affect assessments of future fortunes, four Economy,com forecasts, each with its own date, are shown in the next chart. The most recent forecast, which is based on slower than anticipated growth in employment, shows a decidedly weaker growth path for the next few years.



Final Thoughts

Pawing through piles of old data in search of signals about the future reminds one of Mark Twain's statement about history. As he put it, history might not exactly repeat its self but it does rhyme. South Carolina and the nation are in a deep transition from the economy that existed in 1998 to a new economy based more than ever on information and other technical services and less on the large scale production of goods that can be routinely built anywhere in the world.

An examination of these trends reinforces the notion that we should not be planning for the past. Our future will not be built on the strength of industrial capitalism. Those who build industrial parks in the hopes of filling them with clean versions of the old smokestack industries will likely be disappointed. Yes, South Carolina, more than the nation, will continue to be a strong manufacturing economy. History does rhyme. But our future growth will be led by a sophisticated services sector, by growing eco-tourism, and by an information economy that will link itself to the growing world economy.