Approved: 1-25-93
Date

MINUTES OF THE HOUSE COMMITTEE ON ECONOMIC DEVELOPMENT.

The meeting was called to order by Chairperson Wanda Fuller at 3:30 p.m. on January 14, 1993 in Room 423-S of the Capitol.

All members were present except: Representative Gary Haulmark
Representative Carol Sader

Committee staff present: Lynne Holt, Legislative Research Department
Bob Nugent, Revisor of Statutes
Ellie Luthye, Committee Secretary

Conferees appearing before the committee:
Dr. Norman Clifford, University of Kansas

Others attending: See attached list.

The Chair introduced Dr. Norman Clifford from the Institute for Public Policy and Business Research at the University of Kansas. Dr. Clifford presented testimony on "U.S. and Kansas Economic Forecasts for 1993", January, 1993 (Attachment 1) and "U.S. and Kansas Economic Forecasts for 1993", January 14, 1993 (Attachment 2). He also provided maps showing the six economic regions in Kansas (Attachment 3) and testimony on "The Outlook for the Kansas Economy Through 1997". (Attachment 4)

Following a period of questions, the meeting was adjourned at 4:30 p.m.

The next meeting of the House Economic Development Committee will be Tuesday, January 19th, Room 423-S.

GUEST LIST

COMMITTEE: Economic Development DATE: 1-14-93

NAME (PLEASE PRINT)	ADDRESS	COMPANY/ORGANIZATION
[illegible]	1915 Alabama St	IPPBR - KU
Don Steffes		
Dennis Tietze	Topeka KS	Dv of [illegible]
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ALAN SPICER	TOPEKA	KDOT
Art Brown	Topeka	KS [illegible] Dealers Assn
[illegible]	Wichita	WIBA
U. L. "Kip" Gooch	Wichita	Committee
Larry Mathews	Newton	City of Newton
Jim Heinicke	NEWTON	City of Newton
HENRY SCHWALLER		KANSAS, INC.

Institute for Public Policy and Business Research
The University of Kansas

U.S. AND KANSAS ECONOMIC FORECASTS FOR 1993

by
Norman Clifford
Associate Scientist
Director of Forecasting

Mohamed El-Hodiri
Professor of Economics
Director of Economic Research

Anthony Redwood
Professor of Business, and
Executive Director

Funding for the Kansas Economic Modeling Program at the Institute is provided by the state of Kansas

January 1993

January 14, 1993
Economic Development
Attachment 1

Introduction

A continuation of moderate recovery is expected for the U.S. economy in 1993: anchored by moderate growth in real consumer spending, U.S. real output should grow about 2.0 percent. Consumer spending will be supported by a 2.3 percent growth in real personal income, although increases in personal tax revenues will weaken the effect somewhat, allowing real disposable personal income to grow only about 1.5 percent. Additional strength will be found in investment spending by firms in 1993. The stimuli in this sector will come from spending on new plant and equipment as well as spending to replenish inventories that were depleted during the recession. Increases in residential investment spending will also help sustain output in 1993. Although the value of the dollar will be relatively low, export growth will be moderate because of slow growth of our major trading partners. On the other hand, the weak dollar will contribute to slow import growth, so that the trade deficit should remain relatively stable. Declines in real federal government purchases of goods and services will continue to be a drag on the national economy in 1993.

On the positive side, the lower rate of inflation brought about by the recession will continue throughout the coming year, with the Consumer Price Index increasing about 3.3 percent. Employment growth, on the other hand, will probably be meager, so that the U.S. unemployment rate in 1993 should average about 7.3 percent, about the same as it did 1992. Short-run interest rates will probably bottom out during the fourth quarter of 1992, and then increase very gradually during 1993. Long-run rates, on the other hand, should decline slightly throughout 1993 as inflationary expectations continue to wane.

The forecast is a little more rosy for Kansas than for the nation as a whole. Measured by the performance of employment growth, Kansas has consistently outperformed the U.S. during and after the recession, and should continue to do so during 1993. The rate of employment growth should keep the Kansas unemployment rate at about 4.1 percent, well below the predicted U.S. rate. Nominal personal income should grow 5 percent; its 2.1 percent rate of growth after correcting for inflation is a sign of the strength of our forecast for the state.

The National Outlook

The national forecast presented below is based on the following major assumptions[1]:

1. In spite of the Fed's obviously expansionary interest reductions during 1992, the M2 measure of the money supply has grown very slowly. Although the Fed has made reserves available to the banking system at a very low cost, banks, with an apparently increased aversion to risk, have failed to make large amounts of new credit available. Additionally, it appears that there has been some portfolio reallocation away from the low rates available on certificates of deposit and savings accounts. The forecast assumes that this trend will ease somewhat in 1993, with M2 growing 4.6 percent, up from its 2.8 percent growth rate in 1992.

2. We assume that there will be only slight changes in federal fiscal policy over the forecast period. Our forecast includes a 5.6 percent decline in real federal defense spending in 1993. Total real federal spending is expected to grow 1.3 percent in 1993. The federal government's budget deficit is expected to jump to about the $322 billion (NIPA basis)[2] level. The forecast assumes that some increases in state and local tax rates will be needed to reduce deficits in state and local operating budgets.

3. The trade weighted average of the exchange rate is expected to remain low (at about 89 on an index in which the 1973 level equals 100) throughout 1993. Nevertheless, our forecast takes the rather pessimistic view that real exports will grow at about a 4 percent annual rate over that same period. This assumption comes from a belief that economic growth among the U.S.'s major trading partners will be weak over the next year or so.

4. The forecast assumes that imported oil prices will remain fairly stable through the end of 1993, growing at about a 1 percent annual rate.

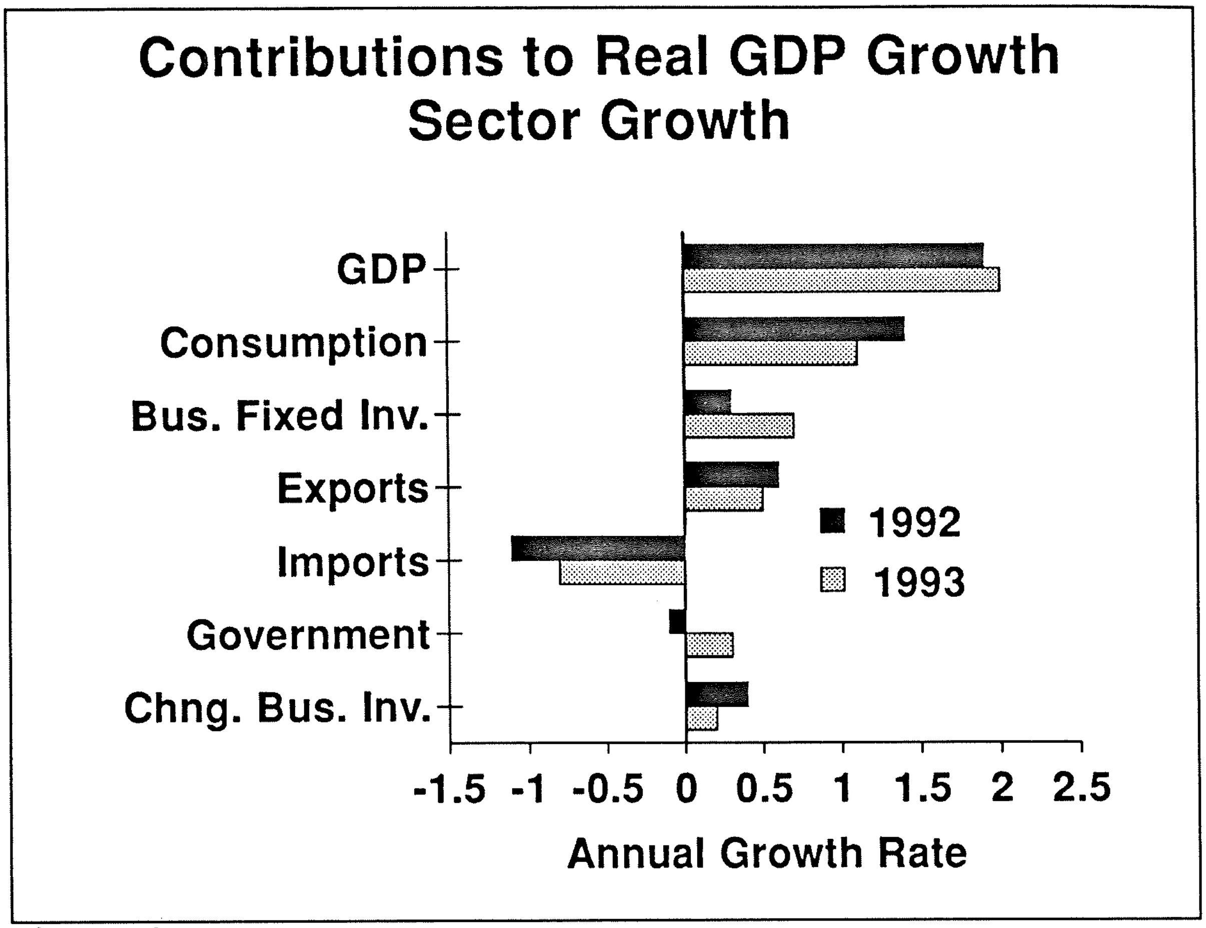


Figure 1

Given these assumptions, the national forecast is for the recovery to continue at a more or less moderate pace. U.S. output, measured by real GDP, should grow about 1.9 percent in 1992, and 2.0 percent in 1993. A summary of the contributions of the various sectors of aggregate demand to the overall growth rate of GDP is presented graphically in Figure 1. As the figure illustrates, 1993 should very much resemble 1992, with slightly weaker performance by the consumption and export sectors offset by stronger investment spending and reduced growth of spending on imports. Some of the details of these movements are presented below.

The quarterly pattern of forecasted GDP growth is illustrated in Figure 2. Although real GDP grew 3.9 percent during the third quarter of 1992, the increase was driven by a big jump in real consumption spending (3.7 percent). This growth in consumption spending, however, was not induced

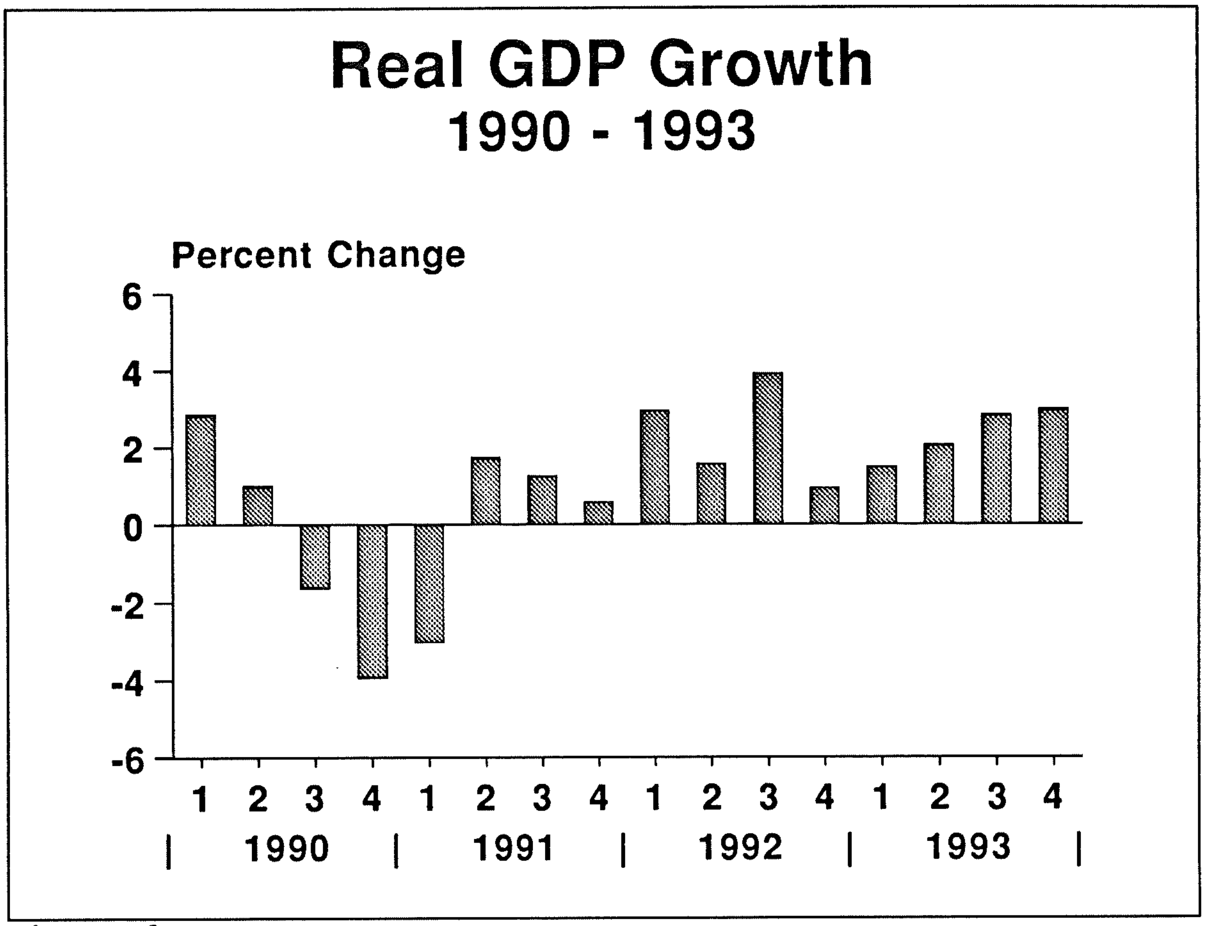


Figure 2

by growth in real disposable income, which grew only 0.4 percent. Thus, the rather robust consumption spending that occurred in the third quarter would be unlikely to persist, and in fact real consumption growth is expected to be significantly weaker throughout the rest of the forecast.

The modest growth in personal consumption expenditures forecasted for 1993 is a result of an equally modest forecast for personal income growth and an even less lively growth in disposable personal income. Nominal personal income is expected to grow only about 5.0 percent in 1993, slightly more than it did in 1992. Growth in wage and salary disbursements, which make up nearly 60 percent of personal income, is expected to be only 4.5 percent, due to weak employment growth and small wage increases. On the other hand, property income (dividends, interest, and rents) is expected to grow 3.3 percent, after declining 1.5 percent in 1992 and increasing a mere 0.6 percent in 1991.

Proprietors' income is expected to grow 3.9 percent, while transfer payments are forecasted to increase 9.0 percent. Although the 5.0 percent expected growth in personal income is modest, the forecast for personal disposable income growth is even less encouraging at only 4.4 percent, due to a forecasted increase of more than 9.7 percent in personal tax and nontax payments to both the federal and state and local governments.

If we adjust the personal income and disposable personal income forecasts for inflation, we get a forecasted increase of 2.2 percent in real personal income, and 1.5 percent in real disposable income. Given these income forecasts real consumption spending is expected to grow 1.6 percent in 1993. Since consumption spending is about two-thirds of gross domestic product, this growth in consumption spending alone almost guarantees some growth in real output, while simultaneously indicating that output growth will be at best moderate.

Most of the increase in real consumer spending for 1993 will come from spending on services, which will increase 2.2 percent following a 2.1 percent increase in 1992. Consumer spending on durable goods, on the other hand, will grow about 2.4 percent after growing 5.3 percent in 1992. One notable indication of the slowness of the recovery is this still weak behavior of consumer spending on durable goods. Because consumer spending on durables declined 0.3 percent in 1990 and a further 5.6 percent in 1991, the forecasted growth in 1992 and 1993 still leaves the level of consumer spending on durable just above its 1989 level. One bright spot in the forecast for consumer spending on durable goods is new automobiles: the forecast is for this category of consumer spending to increase 4.4 percent after growing 4.0 percent in 1992. Once again, however, this forecast puts the level of consumer spending on new autos in 1993 well below its pre-recession level. In fact, spending on new autos was above the 1993 forecasted level in every year from 1984 through 1990.

Consumer spending on nondurable goods is expected to grow about 0.4 percent in 1993, about half as its 0.8 percent growth in 1992. Although the growth rate of consumer spending on nondurables did not fall as dramatically as the growth rate of spending on durables (real spending on nondurable goods grew 0.5 percent in 1990 and declined 1.3 percent in 1991), these forecasted growth rates are much lower than the ones for durable goods for 1992 and 1993. Nevertheless, the forecasted level of consumer spending on nondurable goods in 1993 is about the same as its level in 1990, its previous highest year. Thus, our forecast can be characterized as presenting a slightly stronger market for consumer nondurables than consumer durables in 1993. Consumer spending on food will grow 0.4 percent, spending on clothing and shoes is expected to grow 1.6 percent, while spending on gasoline and oil will increase 1.7 percent.

Although consumer spending will not be a particularly strong sector of aggregate demand in 1993, business spending on plant and equipment is expected to perform rather well. In real terms, such purchases declined slightly in 1990 and then fell 7.1 percent in 1991 before rebounding modestly with a 2.5 percent increase forecast for 1992. For 1993, real spending by firms on new plant and equipment is expected to increase a healthy 6.3 percent. Once again, however, the weakness of the recovery over the last two years is illustrated by the fact that even strong growth in 1993 will bring firm spending on new plant and equipment to only about the same level that it was in 1989. Most of the forecasted increase in new plant and equipment comes from an expected 9.1 percent increase in spending on equipment, even better than the 6.9 percent increase in this category in 1992. However, spending on structures is expected to grow 0.6 percent, following its 12.2 percent, and 7.1 percent declines in 1991 and 1992. The level of spending on new structures will be well below its 1990 peak. Indeed, one of the most important and long-lasting effects of the recession and weak recovery will be that the long period during which the level of investment spending was low will lead to less capital stock and lower productivity in the future.

Residential investment spending will also exhibit strong growth in both 1992 and 1993, with increases of 11.8 percent and 2.4 percent respectively. As Figure 3 illustrates, residential investment

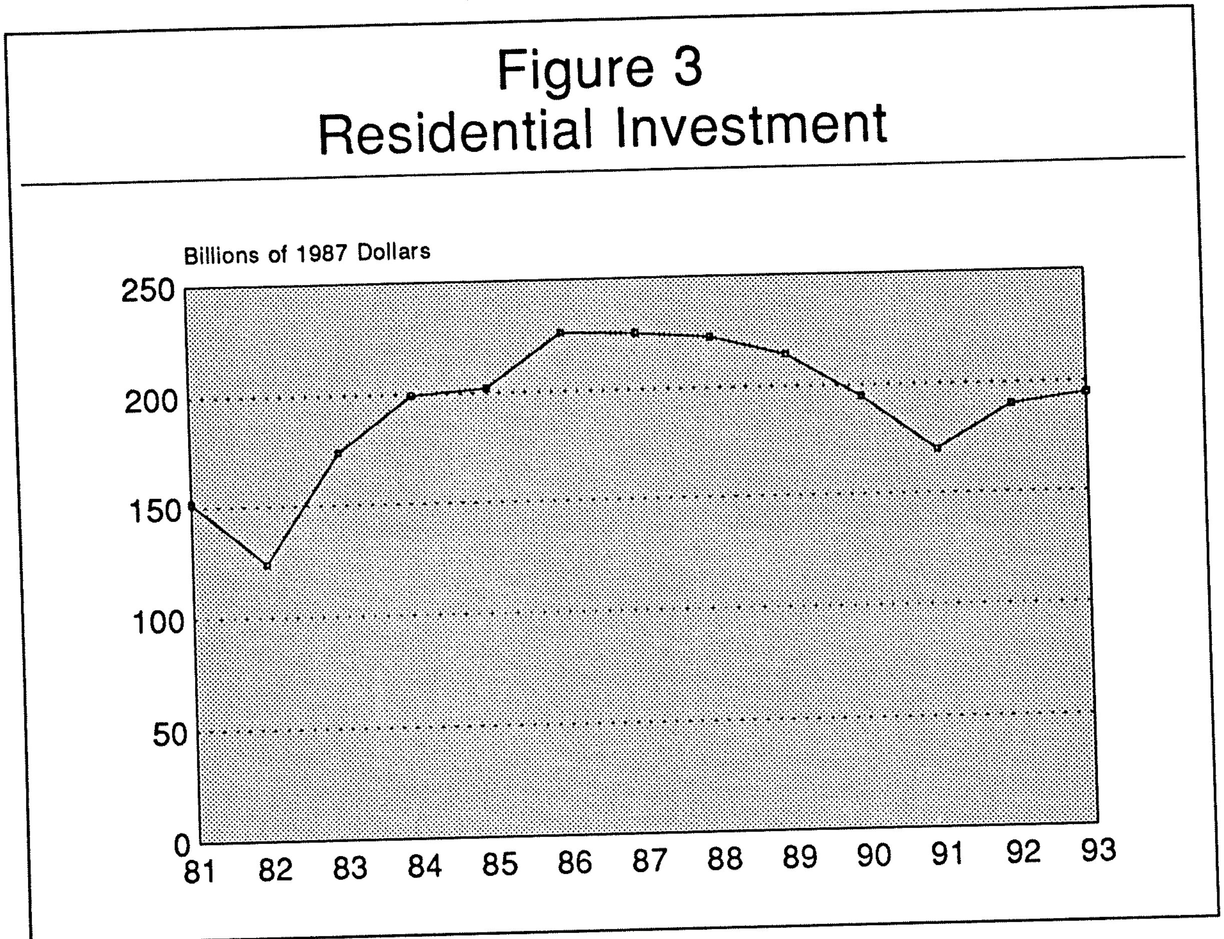


Figure 3

reached its peak level in 1986, and then declined for the next 5 years, with near double digit drops occurring in 1990 and 1991. Thus, we once again see that although the strong growth predicted for 1993 should contribute significantly an increase in aggregate demand, the level of real residential investment spending in 1993 will be well below the 1986 peak.

The final category of investment spending, firms additions to inventories, should also exhibit a significant increase in 1993. As Figure 4 illustrates, firms began to draw down their inventory stocks in the last quarter of 1990 and had not significantly reversed that process by the third quarter of 1992. The forecast is for firms to finally begin to replenish their inventory stocks in the fourth quarter of 1992, and to continue that process through 1993. At the forecasted rate of increase, firms real inventories should return to their pre-recession level sometime in the second quarter of 1993. These

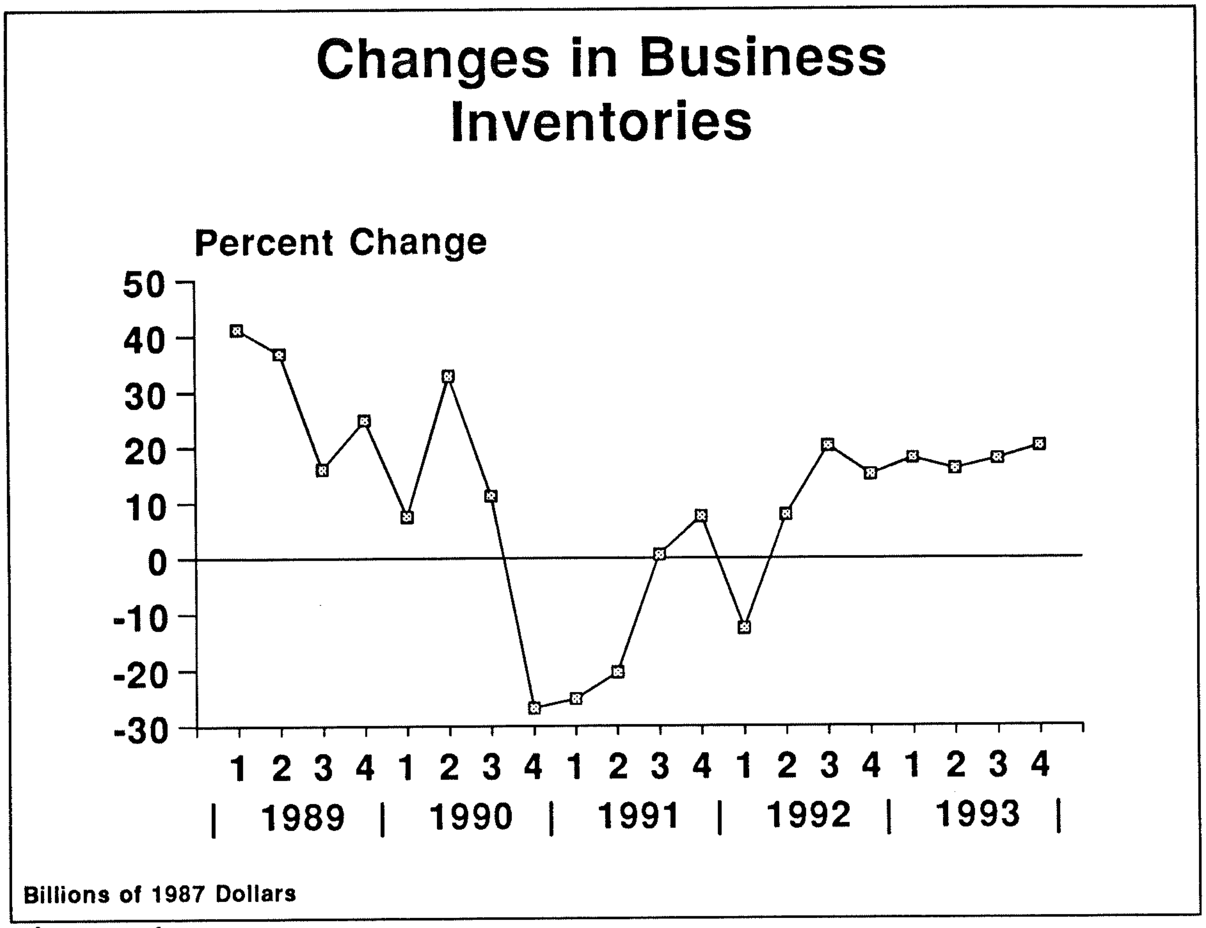


Figure 4

additions to inventories by firms should contribute somewhat to GDP growth during 1993.

Import and export growth are expected to slow somewhat in 1993. Although the value[3] of the dollar is relatively low at the time of the forecast and is expected to increase only slightly over the forecast period, suggesting that U.S. goods will be attractively priced overseas, the forecast is for very modest export growth in 1993, based on a somewhat pessimistic view of the prospects for growth among the nation's major trading partners. On the other hand, the rate of import growth is expected to slow as well, as the weak dollar means that imported goods will be relatively expensive in the U.S. Thus, at least some of the negative effect of decreased export growth will be offset by a slower rate of increase in imports. According to this forecast, the trade balance will remain relatively stable. The forecasted growth of imports and exports is illustrated in Figure 5.

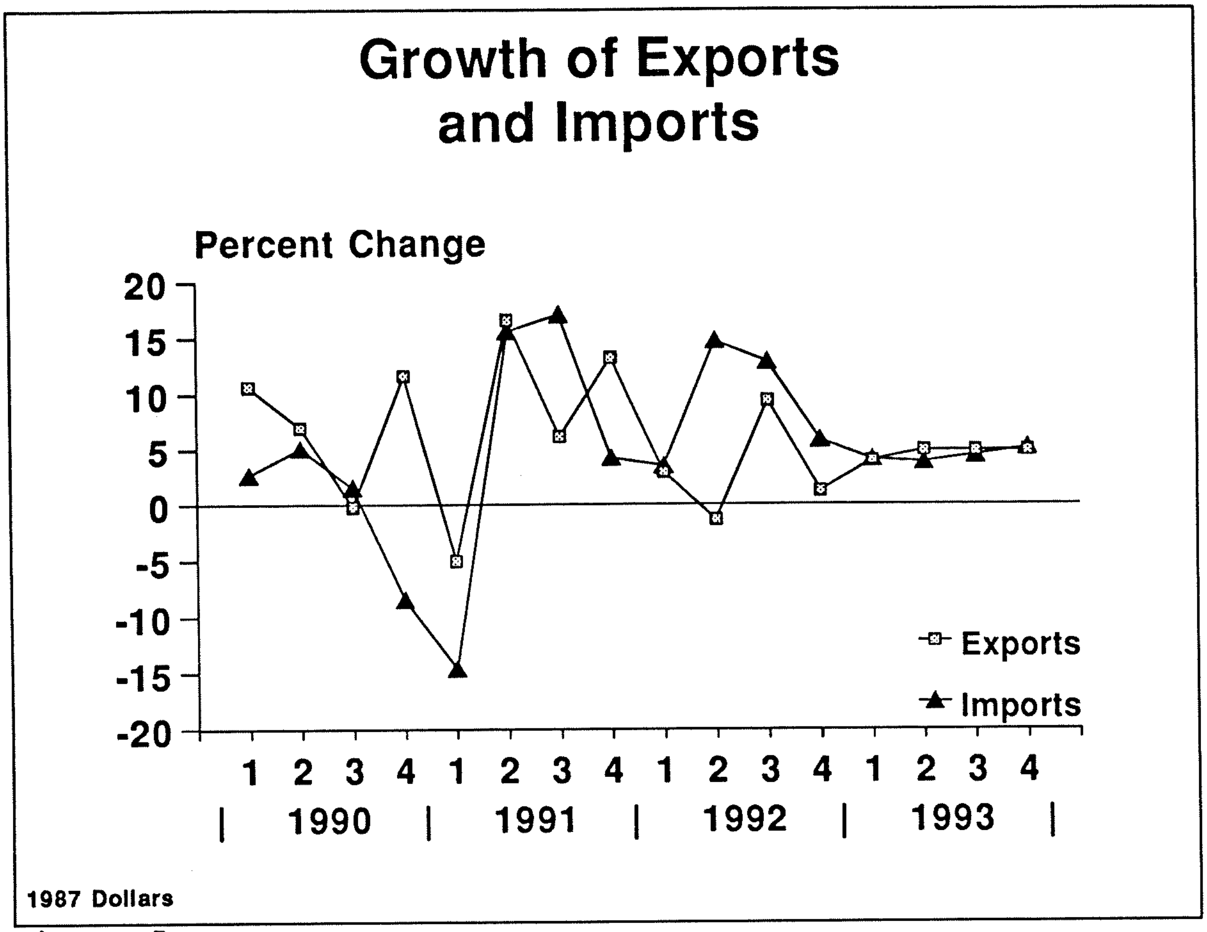


Figure 5

The final category of aggregate demand, government purchases of goods and services, will grow 1.4 percent in 1993, after declining 0.3 percent in 1992. Federal defense spending has fallen in every year but one since 1987, declining at an average rate of 2.2 percent per year over the period, and it is forecasted to decline an additional 5.6 percent in 1993. Federal nondefense purchases have increased an average of 3.7 percent per year since 1987: they are forecasted to increase 17.6 percent in 1993. Total federal purchases of goods and services have declined at an average rate of 0.6 percent per year since 1987 and are forecasted to fall increase only 1.3 percent in 1993. In contrast to this declining trend in federal purchases, state and local purchases of goods and services have grown an average of 2.5 percent per year since 1987, and they are expected to increase 1.5 percent in 1993. Aggregating these federal and state and local trends yields a growth rate of 1.1 percent in total government purchases of goods and services since 1987; aggregating the forecasts yields an expected 1.4 percent decline in total government purchases of goods and services.

One of the salient features of the federal budgets of recent years is the seemingly inexorable climb in the federal budget deficit. This has occurred in spite of the fact, observed in the preceding paragraph, that total federal purchases, adjusted for inflation, have declined slightly over the period. On average, federal tax collections over the 1987-1992 period have increased about a half of a percentage point faster per year than federal government purchases, and total federal government receipts (which includes contributions for social insurance) have increased nearly 2 percentage points per year faster than federal government purchases. However, federal government outlays other than expenditures, which include transfer payments, grants-in-aid to state and local governments, and net interest payments, have grown more than 3 percent faster per year than federal government receipts, accounting for the rapid increase in federal government budget deficits. Over the 1987-1992 period, grants-in-aid to state and local governments have grown fastest, averaging 11.2 percent per year in current dollars, while transfers have grown at an average rate of 8.6 percent per year and net interest payments have grown at an average rate of 6.6 percent per year. A large part of the growth in transfer payments is due to a nearly 19 percent increase in 1992, a rate of increase that presumably will not persist in coming years. On the other hand, net interest payments increased only 0.6 percent in 1992, and will probably increase significantly when interest rates go up, as they are likely to do sometime in 1993. Thus, some of the reduced growth of transfer payments in 1993 should be offset by an increase in net interest, and there will be little change in the federal government's budget deficit.

As Figure 6 shows, probably the best news in the forecast is the continuation of relatively low rates of inflation. Inflation decreased significantly in 1991, when the rate of inflation, as measured by the change in the Consumer Price Index, fell from 5.4 percent to 4.2 percent. The inflation rate fell again in 1992, running at just above 3 percent for the year, and should again be less than 3 percent in

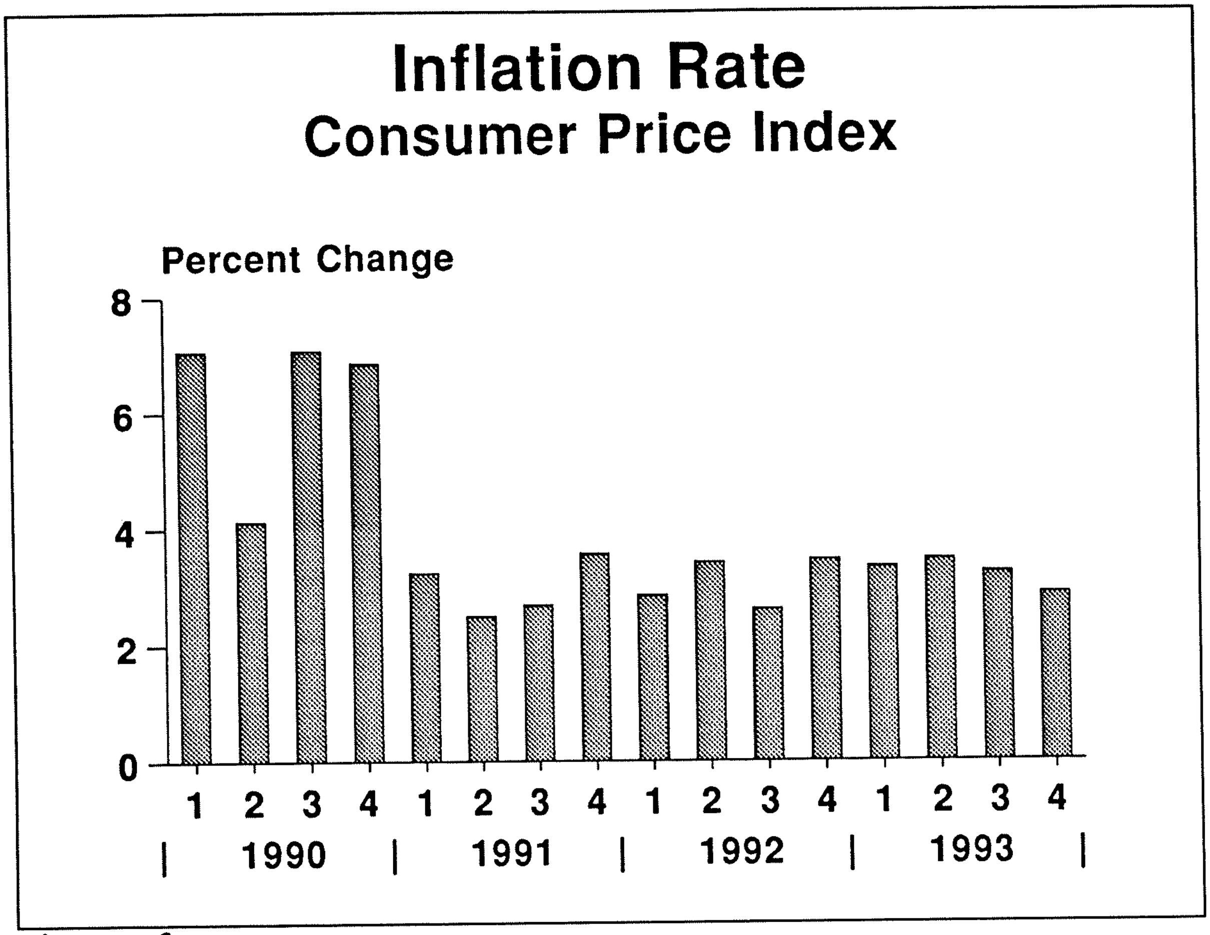


Figure 6

1993. Just as in 1992, food and beverage prices should show very modest increases, growing 2.0 percent in 1993 following a 1.4 percent increase in the previous year. Housing costs will increase at 3.5 percent, close to the overall rate of inflation and up just slightly from 1992's 3.0 percent rate of increase. Transportation costs will increase 2.6 percent in 1993, up from their 2.1 percent increase in 1992 but still in line with the overall inflation rate. New car prices are expected to increase only about 1.9 percent in 1993, down about 0.6 of a percentage point from the previous year's increase, but this decrease will be offset by a 2.4 percent increase in motor fuel prices, which declined 1.3 percent in 1992. Increases in the costs of medical care will occur above the overall rate of inflation at 5.9 percent, but will be much less than the 8.7 and 7.4 percent increases of 1991 and 1992.

A less bright picture appears when we turn to employment. The forecast for employment and

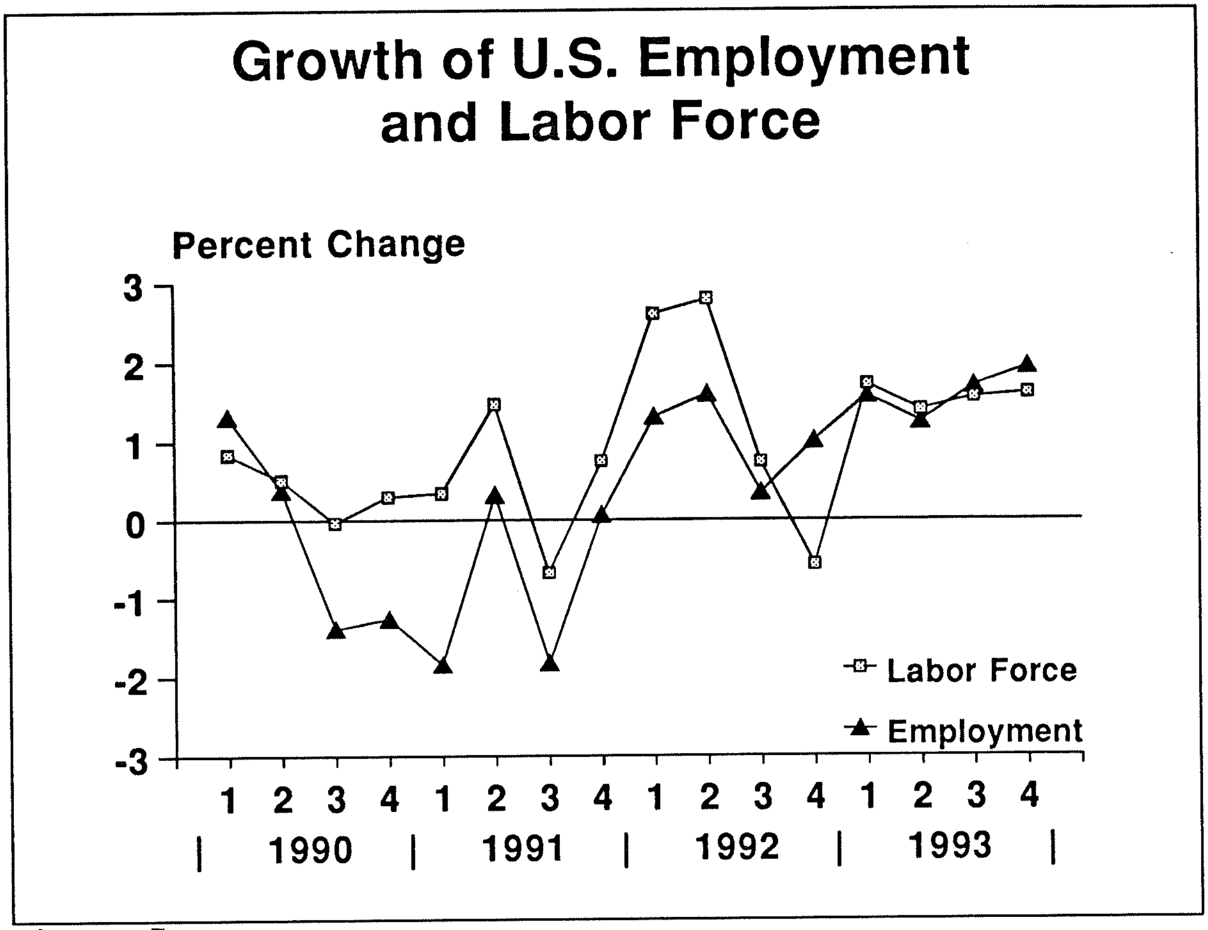


Figure 7

the civilian labor force is illustrated in Figure 7. An important feature is that the forecasted rate of output growth leads to a rate of employment growth that barely exceeds the rate of growth of the civilian labor force; thus the forecast is for the unemployment rate to barely decline from 7.4 percent in 1992 to 7.3 percent in 1993, again a sign of the lack of vigor in the recovery.

In some ways, the unemployment rate may understate the seriousness of the economic situation, since there is some reason to believe that poor economic conditions tend to reduce the size of the labor force: people who would actively seek work if the prospects were better might be inclined to choose alternative actions (pursue further training, for example) when the outlook is unpromising. There appears to be some evidence for this in the behavior of the civilian labor force over the last several years. During the three years from 1987 to 1989, civilian labor force growth averaged 1.7

percent per year. However, during the three years from 1990 through 1992, civilian labor force growth averaged just 0.8 percent per year. Of course, we cannot attribute all of the reduction in labor force growth to the recession and slow recovery, but just to give some idea of the magnitudes that we are talking about, if, during the three years 1990 to 1992, the civilian labor force had grown at the annual 1.7 percent that it averaged during the previous 10 years, instead of the historical average rate of 0.8 percent, and if employment had grown at its historical rate, then the 1992 unemployment rate would be 9.7 percent instead of 7.4 percent. This figure in some sense represents an upper bound on the amount of understatement represented by the published unemployment rate.

The interest rate forecasts are shown in Figure 8. As the figure illustrates, short-term rates, as

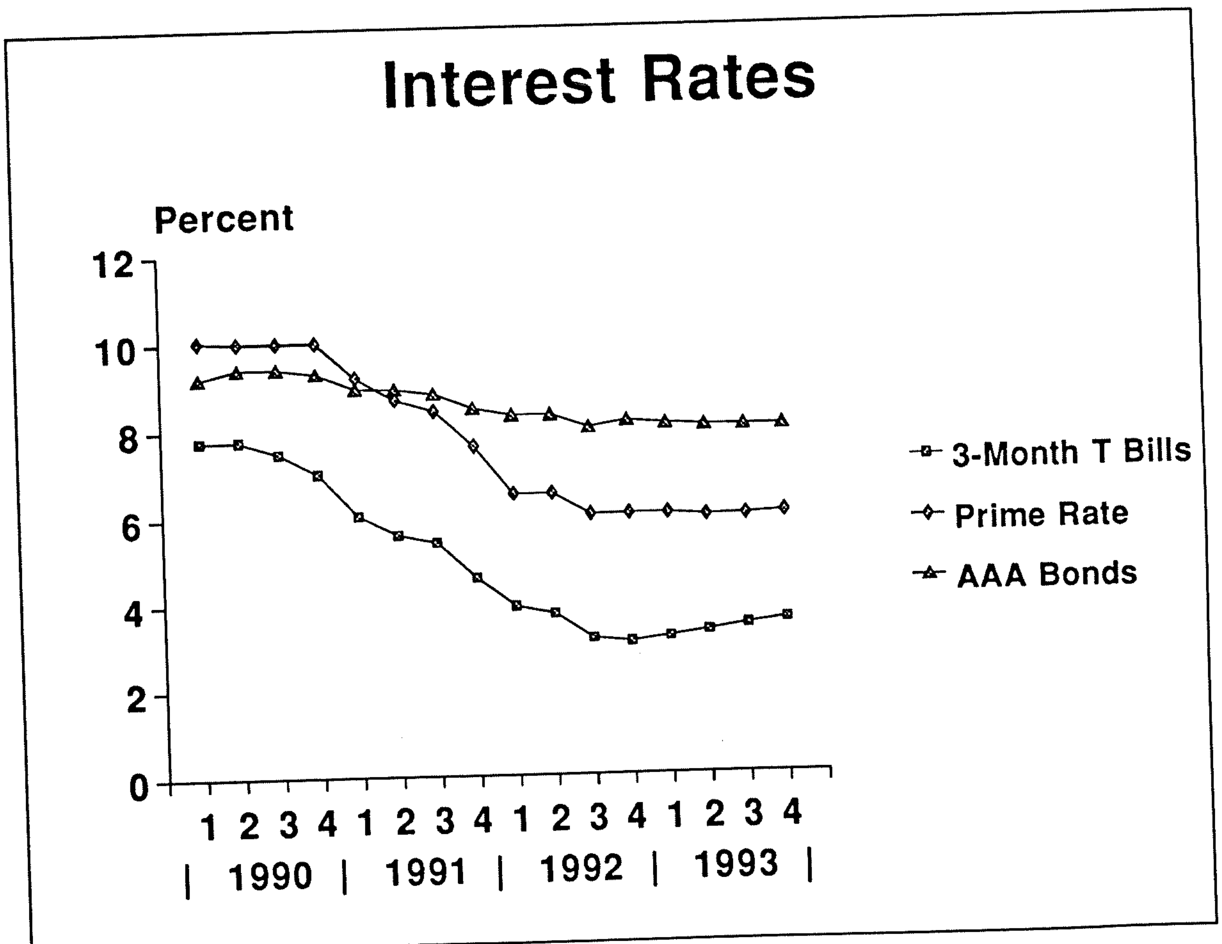


Figure 8

represented by the three month Treasury bill rate, have declined rather steadily since the beginning of 1990, and have been followed rather closely by the prime rate charged by banks to their best customers. As the graph also illustrates, long-run rates, as represented by the Moody's AAA bond rate, have also declined over the period, although at a slower pace than short-run rates. This is a good illustration of the inertia present in long-run rates due to the fact that they in part reflect inflationary expectations.

The forecast is for short-run rates to reach their lowest point sometime during the fourth quarter of 1992, when rates achieve a level at which the Fed believes that further reductions will not provide any useful stimulus to aggregate demand. In our forecast, that point corresponds to a three month Treasury bill rate of just over 3 percent, which is then expected to increase gradually throughout 1993, reaching above 3.5 percent by the end of the year. The prime rate charged by banks will similarly reach a trough in the fourth quarter of 1992, at about 6.0 percent, and will remain at that level throughout the year. Long-run rates, however, will continue to decline slightly throughout 1993, reflecting a continued reduction in inflationary expectations.

Kansas Forecast

During both the recession and the recovery period, the Kansas economy appears to have significantly outperformed that of the U.S. Figures 9, 10, and 11 compare the recent history of the Kansas and U.S. economies, as well as the forecasts for 1993. Figure 9 illustrates nonfarm wage and salary employment[4] growth for Kansas and the U.S. As the figure rather strikingly shows, during the period from 1981 to 1987, U.S. employment grew faster than Kansas employment in every year. During the 1982 recession, Kansas employment was hit much harder than U.S. employment, declining 3 percent while U.S. employment declined 1.8 percent; furthermore, in 1983 U.S. employment began to recover, while Kansas employment remained flat. During the whole period, U.S. employment grew at an average rate of 1.8 percent per year, while Kansas employment grew at an average annual rate of

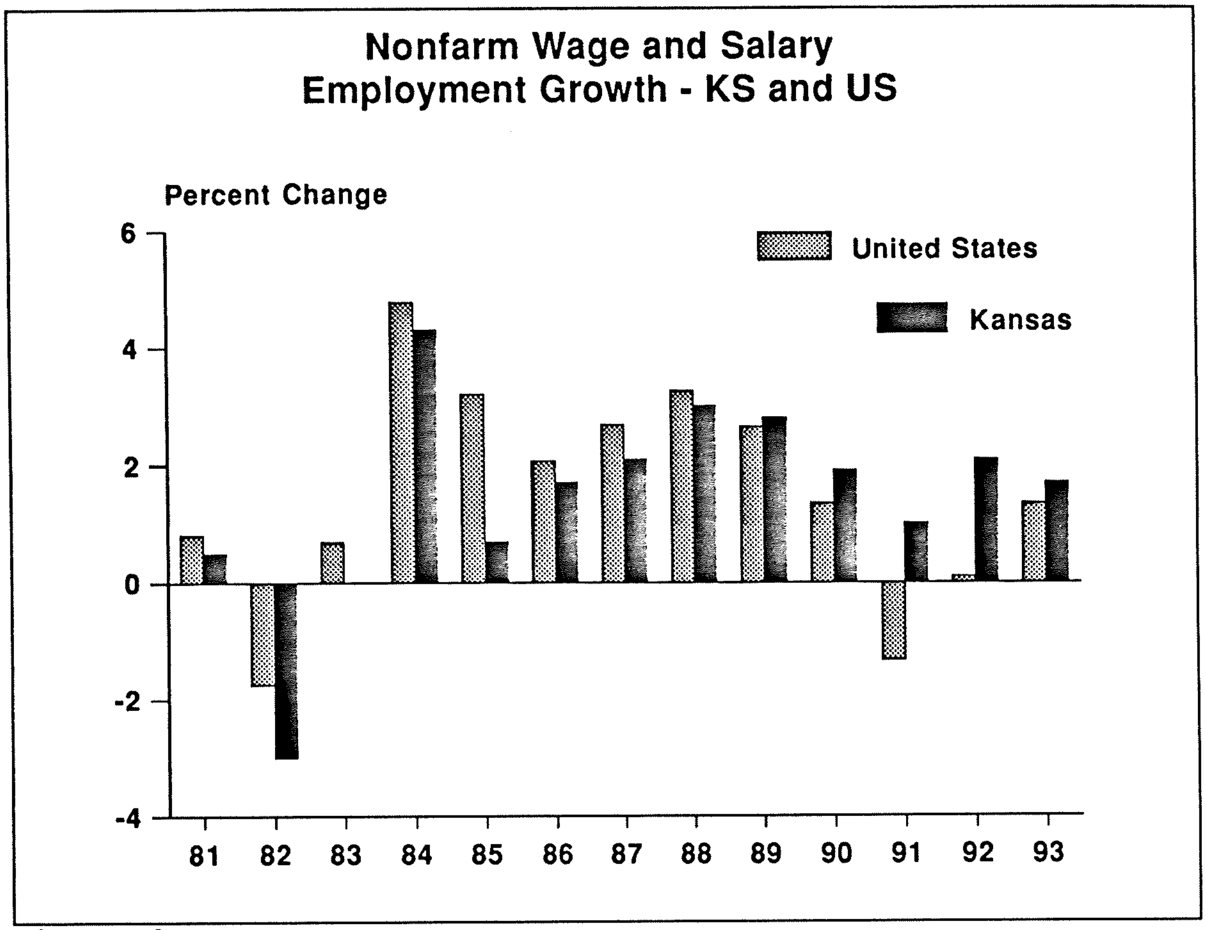


Figure 9

0.9 percent, only half the U.S. average. As the figure also shows, this pattern is absent during the 1988-1989 period. In fact, both economies averaged 2.9 percent employment growth over that period. During the 1990-1993 recession and recovery period, the 1981-1987 pattern appears to have been dramatically reversed. During 1991, U.S. employment fell 1.3 percent as a result of the recession, while at the same time Kansas employment grew 1 percent. During 1992, preliminary data suggest that U.S. employment will grow only about 0.1 percent, while Kansas employment increases 2.2 percent. Over the four year period 1990-1993, historical data and our forecasts suggest that U.S. employment growth will average 0.3 percent per year, while Kansas employment growth will average 1.7 percent. From the point of view of employment, Kansas appears to have come through the recession and its immediate aftermath much better than the U.S.

Figure 10 compares the U.S. and Kansas in terms of personal income growth. Once again, it appears that Kansas performance relative to the U.S. has been better in recent years, although the contrast is not as sharp for personal income as it is for employment. During the 1981-1989 period,

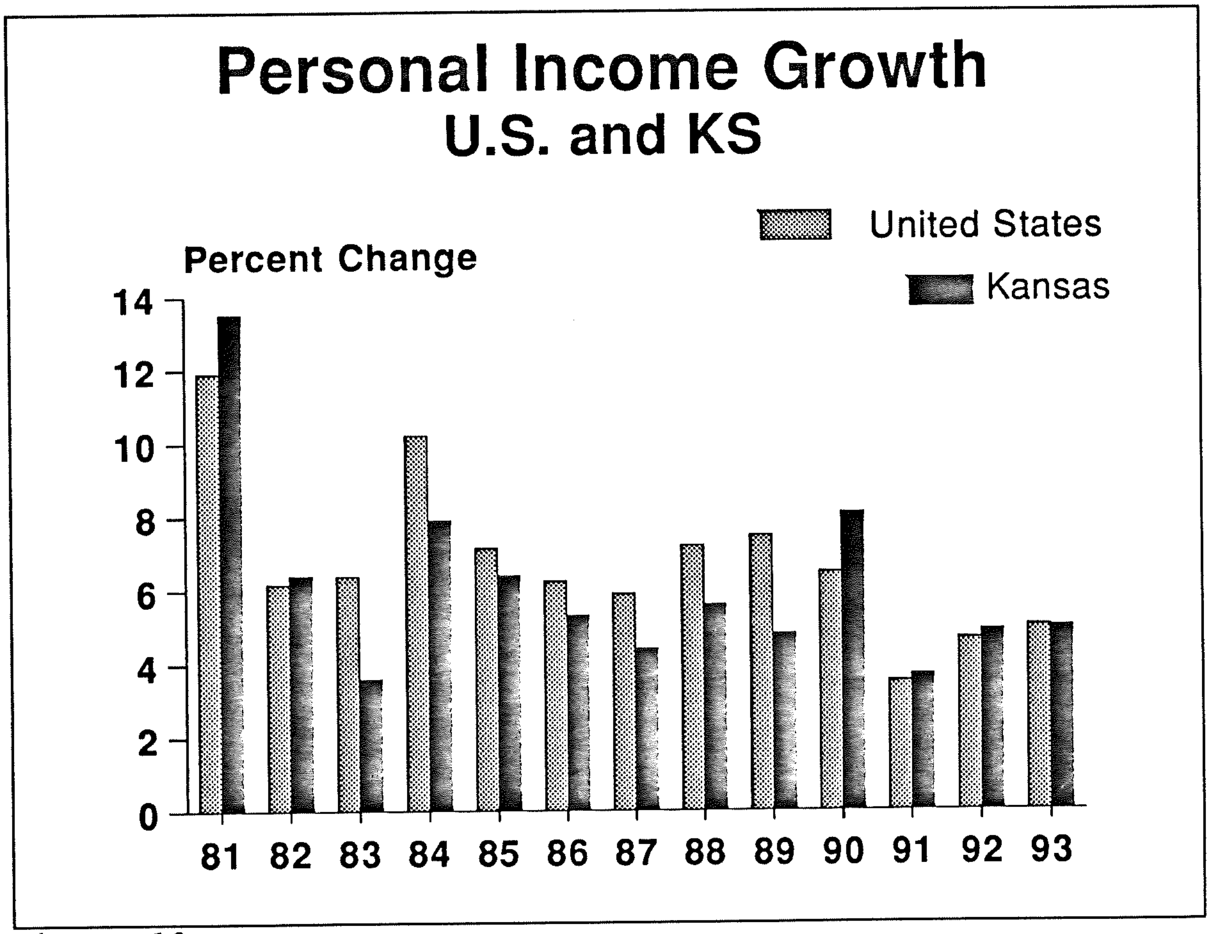


Figure 10

U.S. personal income growth averaged 7.6 percent per year, while in Kansas it averaged 6.6 percent. During the 1990 -1993 period, historical evidence plus our forecasts suggests that U.S personal income growth will average 4.6 percent per year, while Kansas personal income growth will average 4.9 percent.

As Figure 11 illustrates, the behavior of the U.S. and Kansas unemployment rates also strongly supports the thesis that the Kansas economy has been performing better relative to the nation in recent

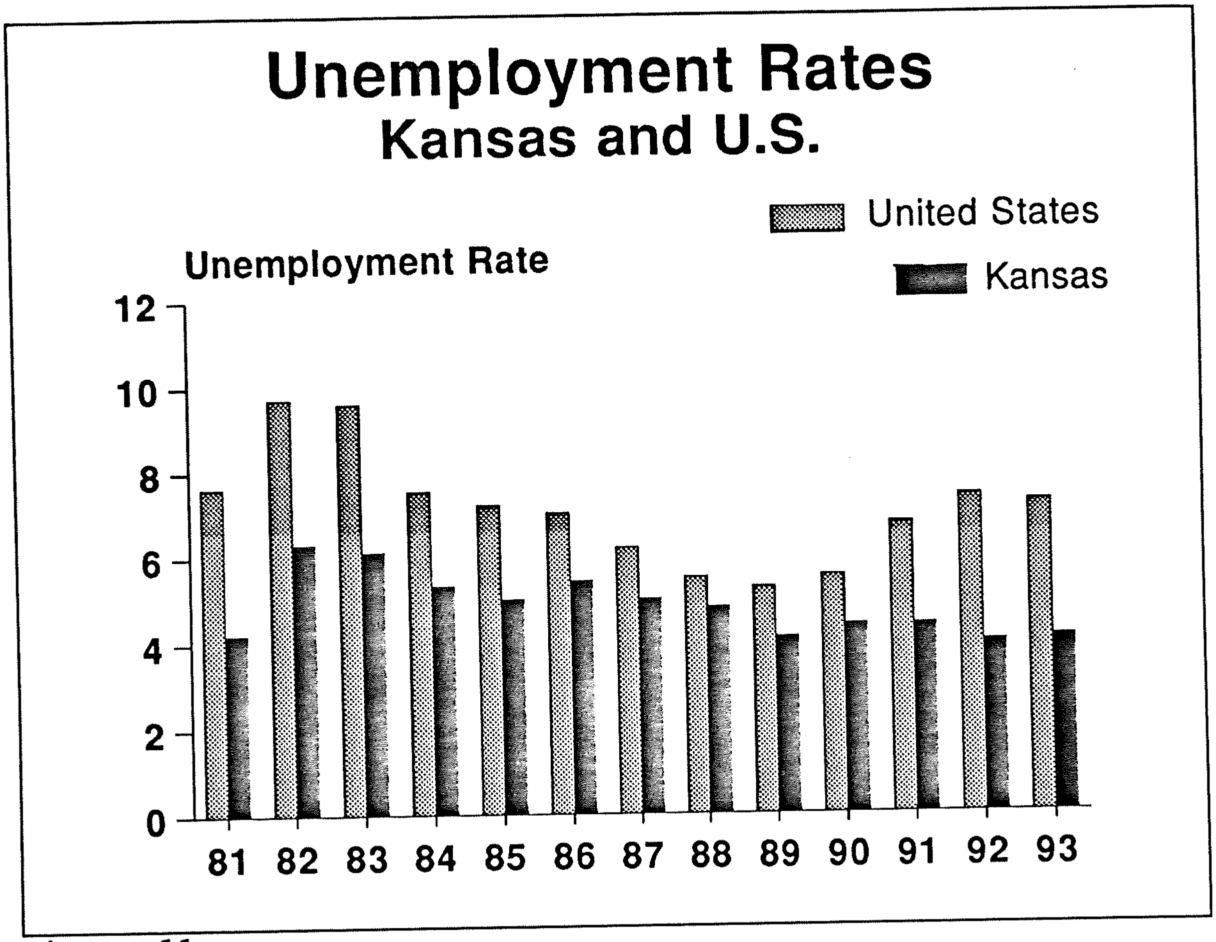


Figure 11

years. Heading into a recession during the 1981-1982 period, the unemployment rate in the U.S. averaged 8.7 percent, and the Kansas unemployment rate averaged 5.3 percent. a difference of 3.4 percentage points. As the recession developed and the Kansas recovery, in particular, was very sluggish, the gap between the U.S. and Kansas unemployment rates closed, until by the 1988-1989 period the U.S. unemployment rate averaged 5.4 percent and the Kansas unemployment rate averaged 4.4 percent, a difference of only 1 percentage point. Beginning in 1990, however, the gap began to widen once again, as Kansas performance relative to the nation improved. Historical data and our forecasts suggest that for the 1992-1993 period, the U.S. unemployment rate will average 7.4 percent, while the Kansas unemployment rate will average 4.1 percent, a difference of 3.3 percentage points. Even more striking is that during the 1990- 1993 period, the Kansas unemployment rate is falling slightly, while the U.S. unemployment rate is increasing rather sharply.

Provided with some perspective about Kansas economic performance relative to the U.S., we turn now to some details of the Kansas forecast for 1993. In general, the forecast for Kansas is moderately good. Total Kansas employment is forecasted to increase 1.4 percent in 1993, down slightly from its 2.6 percent increase in 1992. This coupled with an equal 1.5 percent growth in the labor force, leads to a projection of a 1993 unemployment rate of 4.1 percent, about the same as its 1992 4.0 percent average. Nominal personal income is expected to grow 5.0 percent in 1993, up just slightly from its 1992 growth rate of 4.9 percent. Adjusted for inflation, personal income growth is expected to improve from 1.9 percent in 1992 to 2.1 percent in 1993, in contrast to a real income decline in 1991 of 1.4 percent.

The forecasts of growth rates of employment in several major sectors of the Kansas economy are given in Table 1. Since 1990, when mining employment, which in Kansas is mostly employment

Table 1

Kansas Employment Breakdown
Growth Rates

	1991	1992	1993
Mining	-1.3	-2.7	0.3
Construction	0.4	9.8	2.4
Nondurable Goods	0.0	1.2	1.3
Durable Goods	-1.4	-2.2	-1.6
Transp. & Public Util.	-2.3	-0.5	1.0
Wholesale & Retail Trade	0.6	1.2	1.6
Finance, Ins., & Real Est.	0.4	0.1	0.8
Services	2.8	4.1	4.7
Farm	-0.2	-2.9	-0.7
Government	2.2	3.6	0.7

in oil and gas extraction, grew 5.5 percent, mining employment has been shrinking. The major factor in this decline has been the stabilizing of world oil prices at a relatively low level. Although imported oil prices rose sharply during the latter half of 1990, they fell to nearly their early 1990 level by the beginning of 1991 and continued to decline slightly for the rest of the year. They then fell steeply again during the first quarter of 1992, and slight increases through the rest of the year were not of sufficient magnitude to stimulate oil and gas activity in Kansas. The expected 1 percent increase in oil prices in 1993 will also not be sufficient to stimulate new activity, hence the forecast of essentially no employment growth in this sector in 1993.

Probably the most prominent single entry in Table 1 is the 9.8 percent growth in construction employment in 1992. Although this increase is significant, it should be put in perspective by noting that such an increase restores construction employment to about its 1987 level; after peaking in that year, construction employment fell 8.2 percent in 1988, and a further 3.6 percent in 1989, before leveling off in 1990 and 1991. Thus, even with a 2.4 percent forecasted growth in 1993, construction employment in Kansas will still be at a somewhat moderate level.

A further look at Table 1 reveals that in terms of manufacturing, the outlook, as well as recent history, is better for nondurable goods manufacturing than for durable goods manufacturing. The forecasted 1.3 percent growth rate for 1993 in nondurable goods manufacturing employment is driven by a forecast of 2.6 percent growth in employment in the food and kindred products sector. More modest increases of 1.4 percent and 1.3 percent are predicted for the printing/publishing and petroleum/coal products sectors, respectively. Small declines in employment are forecasted for the apparel and chemical and allied products sectors.

The forecasted 1.6 percent employment decline in durable goods manufacturing in 1993 is in line with the 1991 and 1992 decreases in that sector. Employment in this sector grew robustly in 1988 and 1989, averaging nearly 3 percent per year, but leveled off in 1990 with the onset of the recession, actually beginning its decline during the second half of that year. The forecasted 1993 decline in the sector is quite general, including decreases of 7.8 percent in fabricated metals, 1.2 percent in machinery (including electrical), and 1.4 percent in the important transportation equipment sector. Only the very small primary metals sector appears headed for an employment increase (1.1 percent).

Within the transportation and public utilities sector, the forecast is for another decline in railroad employment (employment in this sector last increased in 1984, and the 1993 forecasted level is just over half of the 1984 level), to be offset by an increase in employment in trucking and warehousing. Employment in electric, gas, and sanitary services is also expected to increase slightly. The predicted employment growth in wholesale and retail trade includes a 1.0 percent increase in wholesale trade, a 0.6 percent decrease in merchandise stores, a 1.0 percent increase in food stores, a small decline in auto dealers/gas stations, and a small increase in apparel/accessory stores. The 0.8 percent increase in employment in finance, insurance, and real estate sector includes a 0.8 percent decline in banking employment and a 1.0 percent increase in employment in insurance.

A not uncommon feature of the Kansas economy in recent years has been an above average increase in employment in the services sector, and the forecast for 1993 is unexceptional in this respect. The forecast includes a 4.1 percent increase in employment in hotels and lodging, and a 4.0 percent increase in employment in personal services. An unusual feature of service sector growth in Kansas, relative to the rest of the nation, has been the large portion of this growth that has occurred in the high paying business services area.

The predicted 0.7 percent decline in farm employment is in line with recent history. The average annual rate of decline in farm employment from 1980 through 1991 has been 2.4 percent. Finally, the 1.0 percent increase in government employment is comprised of a 2.6 percent decline in federal government employment in the state, and a 1.1 percent increase in state and local government employment.

The breakdown for the Kansas personal income forecast is shown in Table 2. Although many

Table 2

Kansas Personal Income Breakdown
Growth Rate

	1991	1992	1993
Personal Income	3.7	4.9	5.0
Wages and Salaries	4.1	5.1	4.4
Nonfarm Proprietors	0.6	9.3	4.7
Dividends, Int., & Rents	4.4	-1.4	2.8
Pers. Cont. to Soc. Ins.	7.8	6.1	6.9
Transfer Payments	10.2	11.2	8.8
Other Labor Income	8.0	6.3	5.1
Farm Proprietors' Income	-35.4	-4.3	22.2

of the categories show 1993 increases that are below their 1992 increases, it is important to keep in mind that the rates of increase are not corrected for inflation. If we adjust for inflation, which is expected to be low again in 1993, we find that real personal income is expected to grow 2.1 percent, compared to 1.9 percent in 1992. The category of personal income whose growth is expected to change most drastically between 1992 and 1993, is dividends, interest, and rents. Because of the end of the decline in interest rates and therefore the end of the decline in interest income, income in that category is forecasted to increase 2.8 percent in nominal terms, after falling in both 1991 and 1992.

Conclusion

Several factors appear to be contributing to the rather slow recovery of the U.S. economy. Consumer spending is dampened not only by slow personal income growth but also by consumers' actions to reduce somewhat their level of indebtedness. Whether this is a short-run phenomenon related to consumer confidence or a longer-run attitude, based upon the aging of the population bulge known as the baby boom generation, is not clear. In addition, large government deficits and a change in the world political climate have made government spending a drag on, rather than a stimulus to, the recovery. Finally, a weak world economy has caused the expansionary effects of a relatively weak dollar to be less than one might have hoped. A stronger world economy than the one that we have conjectured for 1993 could lead to a stronger performance than indicated in our forecast.

The Kansas economy, especially relative to the U.S., seems to have made a dramatic turnaround between the early and mid-1980's, on the one hand, and the early 1990's on the other. A good balance among manufacturing, agriculture, oil and gas extraction, and business services appears to be an important factor in this performance. The growth in high quality service jobs seems to have been an especially notable influence. Whether or not this turn around is a long-run phenomenon will depend upon the ability of the manufacturing sector, especially the durable goods manufacturing subsector, to remain a viable area of growth, and whether the effects of the creation of business services jobs will be felt sufficiently throughout the state.

Notes

1. The forecasts for the national economy are produced by the Econometric Model of the United States developed at the Center for Econometric Model Research at the University of Indiana, using assumptions generated at the Institute. The directors of the CEMR are R. Jeffery Green and Morton J. Marcus. The Kansas forecasts are produced by the Kansas Econometric Model, which is a product of the Institute for Public Policy and Business Research.

2. National Income and Product Accounts basis.

3. Trade weighted average of the dollar's exchange rate.

4. Employment refers to total number of Kansas residents employed in civilian (including nonmilitary government) jobs. Nonfarm wage and salary employment refers to total nonfarm civilian (including nonmilitary government) jobs in Kansas. Thus, to go from nonfarm wage and salary employment to employment, one must correct for farm employment, Kansans who have more than one job, Kansans who work out of state, and non-Kansas residents who work in Kansas.

Institute for Public Policy and Business Research
The University of Kansas

U.S. AND KANSAS ECONOMIC FORECASTS FOR 1993

Testimony to the Senate and House Economic Development Committees

by
Norman Clifford
Associate Scientist
Director of Forecasting

Mohamed El-Hodiri
Professor of Economics
Director of Economic Research

Anthony Redwood
Professor of Business, and
Executive Director

Funding for the Kansas Economic Modeling Program at the Institute is provided by the state of Kansas

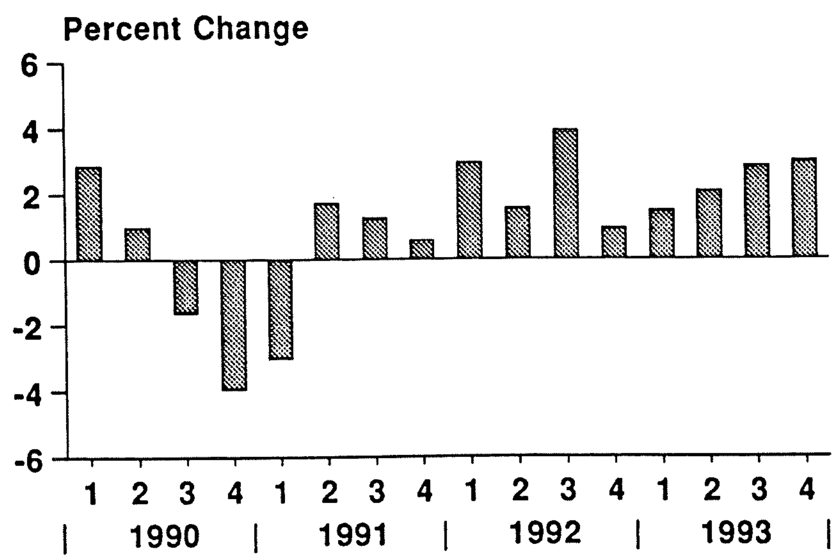
January 14, 1993

January 14, 1993
Economic Development
Attachment 2

U S Forecast Summary

	1991	1992	1993
Real GDP Growth	-1.2	1.9	2.0
Rate of Inflation	4.2	3.1	3.3
Unemployment Rate	6.8	7.4	7.3
3-Month Treasury Bill Rate	5.4	3.5	3.4
Nominal Personal Income Growth	3.5	4.7	5.0

Real GDP Growth
1990 - 1993



Contributions to Real GDP Growth
Sector Growth

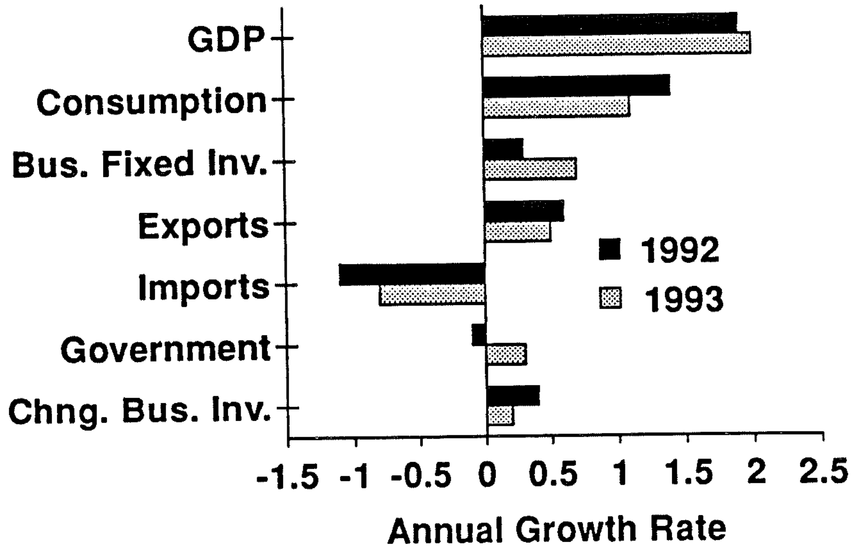
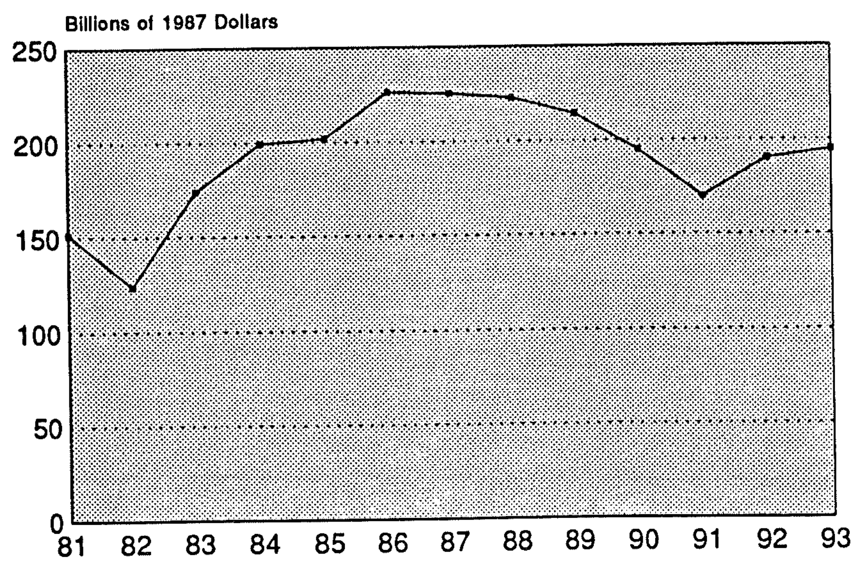
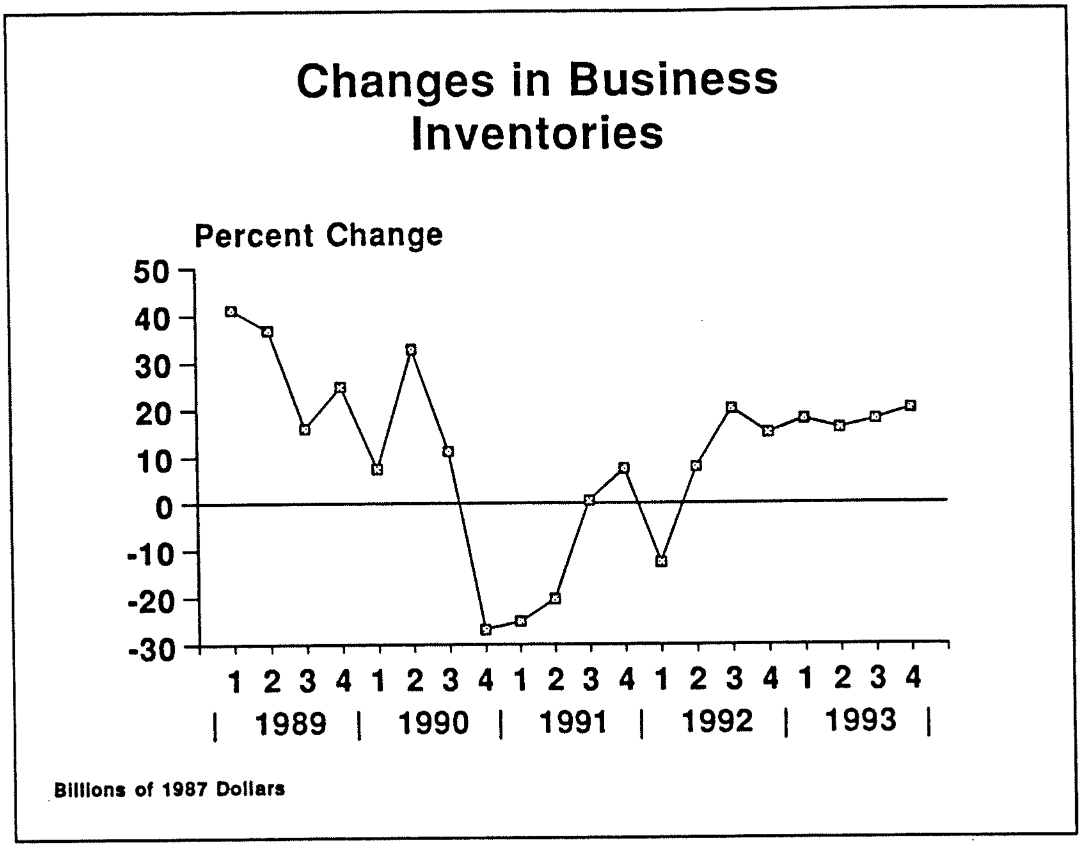
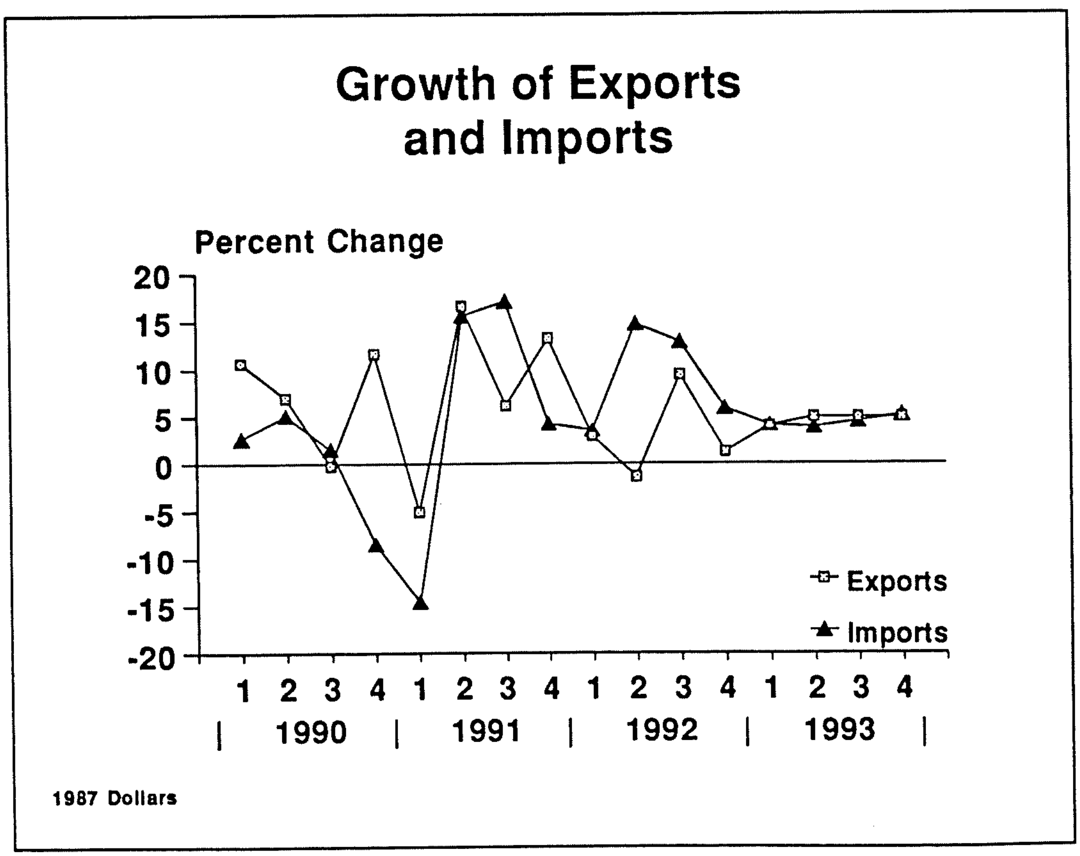
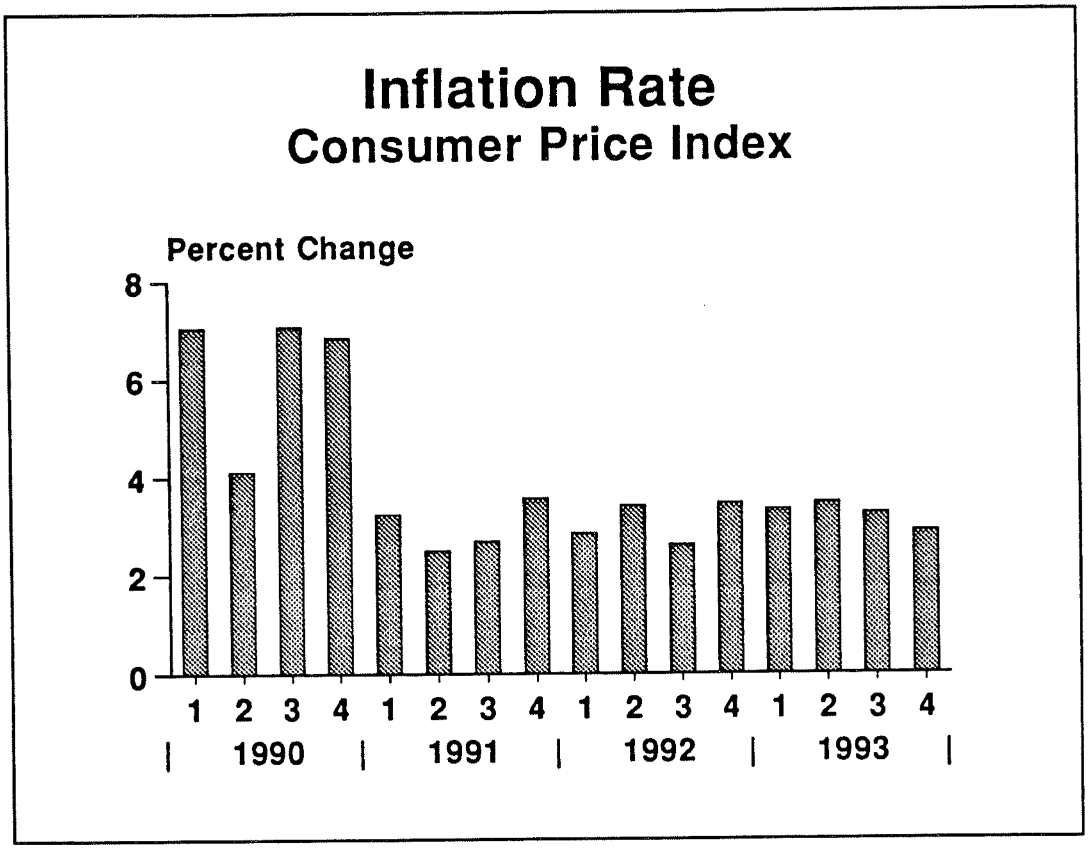


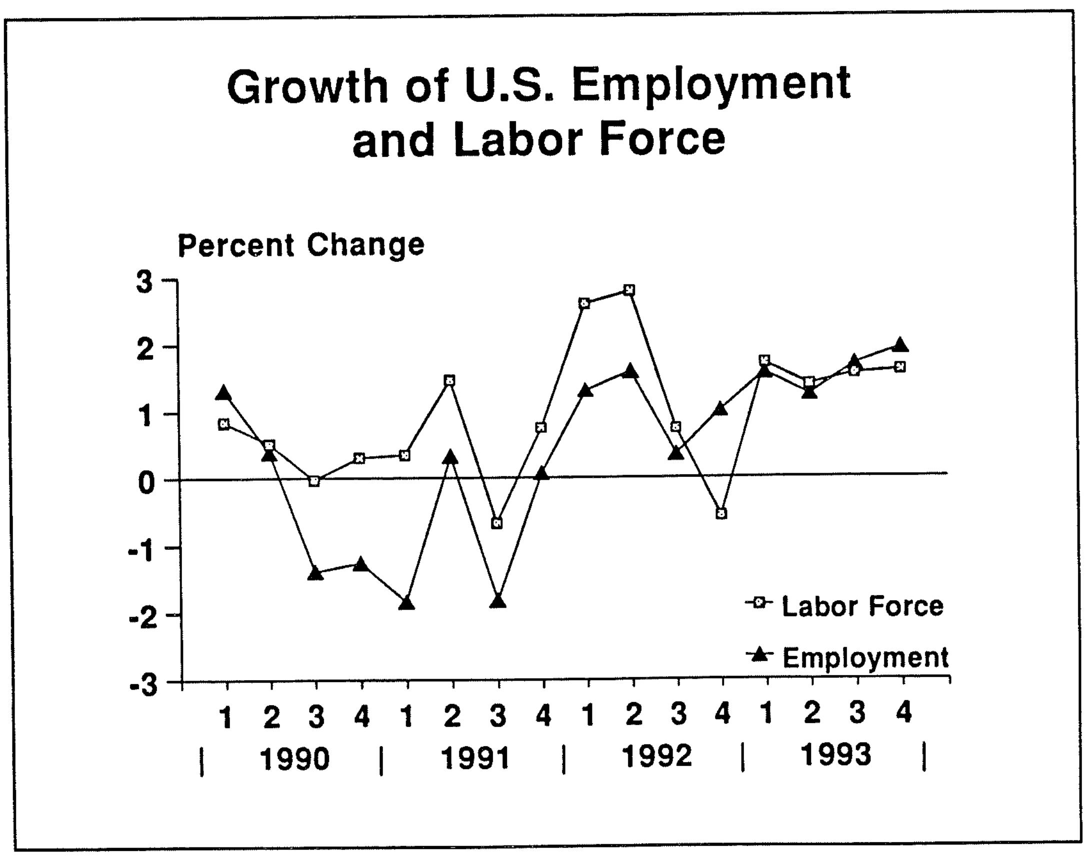
Figure 3
Residential Investment



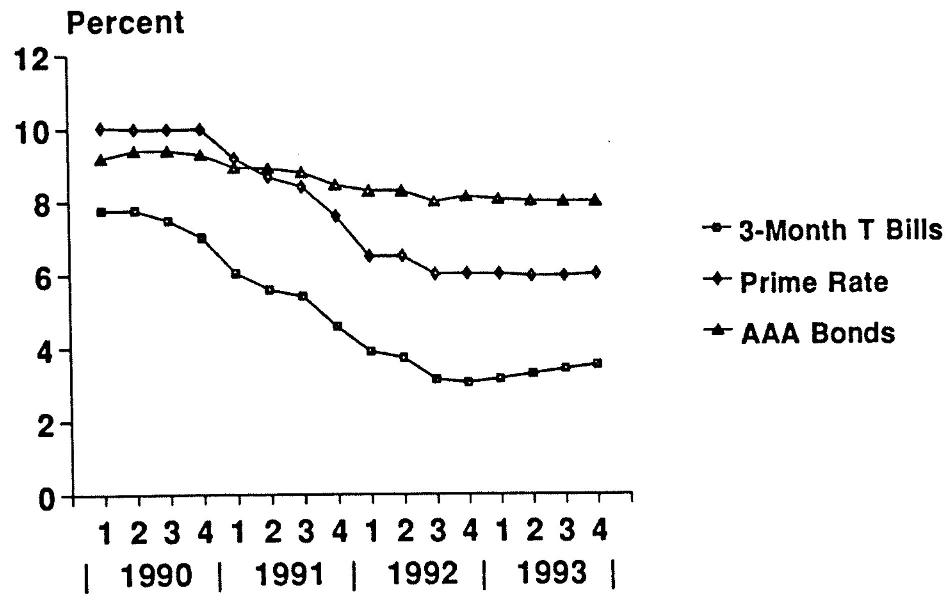

Changes in Business
Inventories
Percent Change
50
40
30
20
10
0
-10
-20
-30
1 2 3 4 1 2 3 4 1 2 3 4 1 2 3 4 1 2 3 4
1989
1990
1991
1992
1993
Billions of 1987 Dollars


Growth of Exports
and Imports
Percent Change
20
15
10
5
0
-5
-10
-15
-20
Exports
Imports
1 2 3 4 1 2 3 4 1 2 3 4 1 2 3 4
1990
1991
1992
1993
1987 Dollars


Inflation Rate
Consumer Price Index
Percent Change
8
6
4
2
0
1 2 3 4 1 2 3 4 1 2 3 4 1 2 3 4
1990
1991
1992
1993


Growth of U.S. Employment
and Labor Force
Percent Change
3
2
1
0
-1
-2
-3
Labor Force
Employment
1 2 3 4 1 2 3 4 1 2 3 4 1 2 3 4
1990
1991
1992
1993

Interest Rates



Kansas Forecast Summary

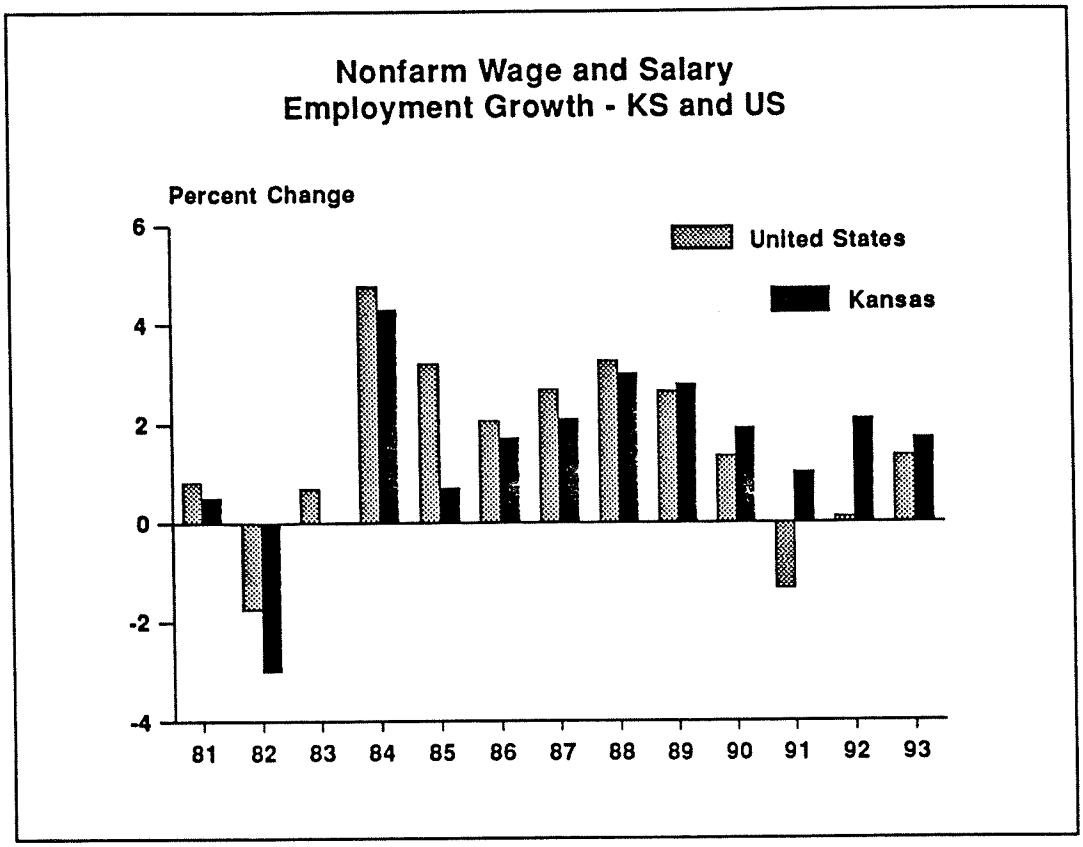
	1991	1992	1993
Labor Force Growth	-0.4	2.2	1.5
Employment Growth	-0.4	2.6	1.4
Unemployment Rate	4.4	4.0	4.1
Nonfarm Wage & Salary Employment Growth	1.0	2.1	1.7
Nominal Personal Income Growth	3.7	4.9	5.0

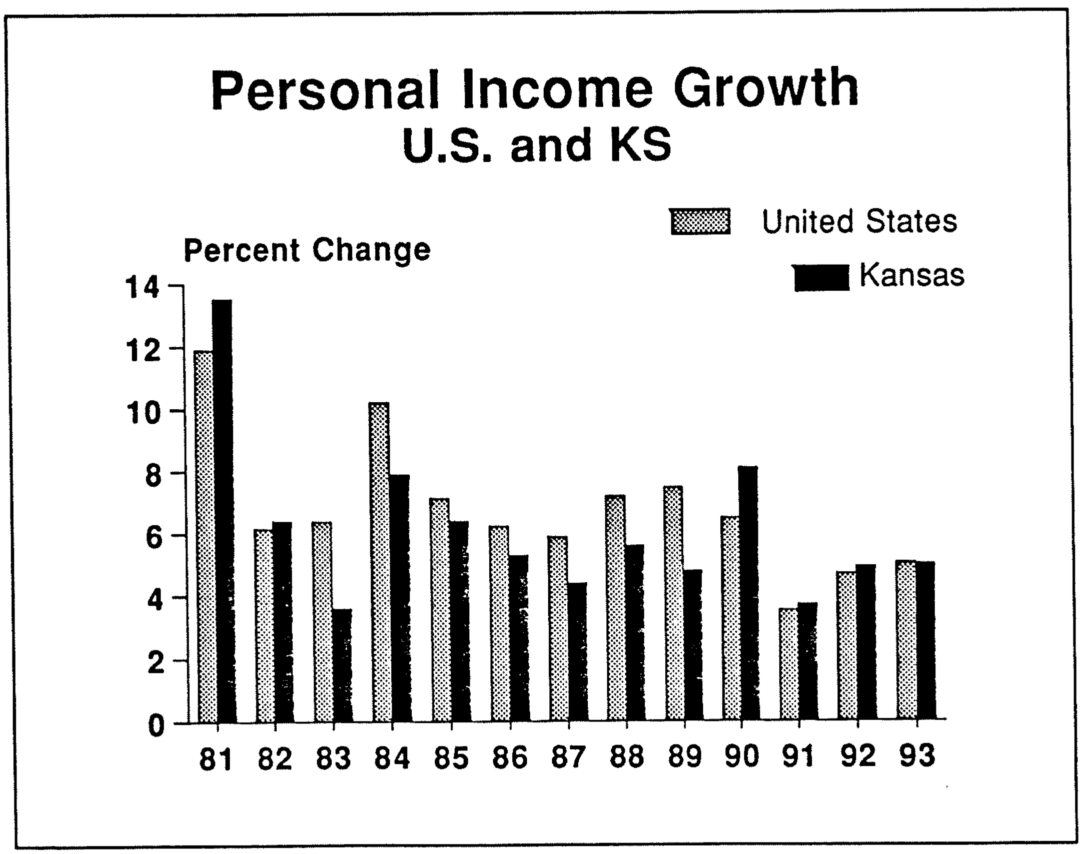
Kansas Employment Breakdown
Growth Rates

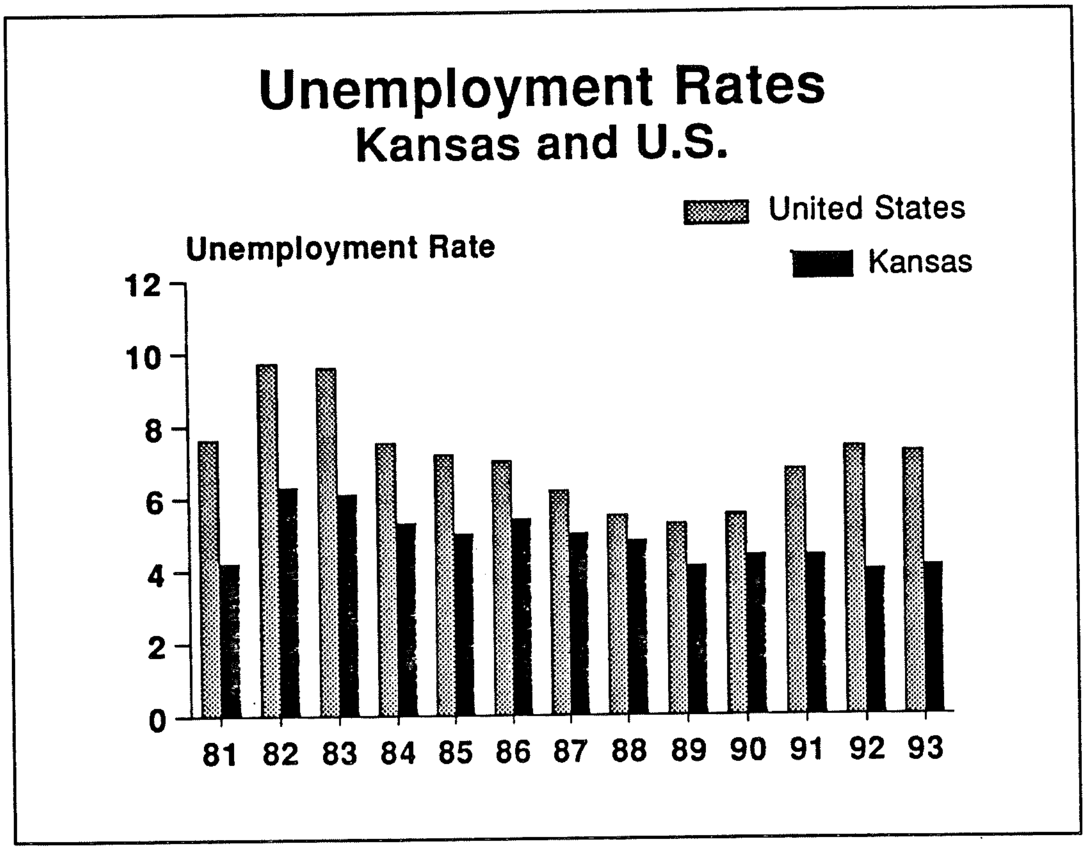
	1991	1992	1993
Mining	-1.3	-2.7	0.3
Construction	0.4	9.8	2.4
Nondurable Goods	0.0	1.2	1.3
Durable Goods	-1.4	-2.2	-1.6
Transp. & Public Util.	-2.3	-0.5	1.0
Wholesale & Retail Trade	0.6	1.2	1.6
Finance, Ins., & Real Est.	0.4	0.1	0.8
Services	2.8	4.1	4.7
Farm	-0.2	-2.9	-0.7
Government	2.2	3.6	0.7

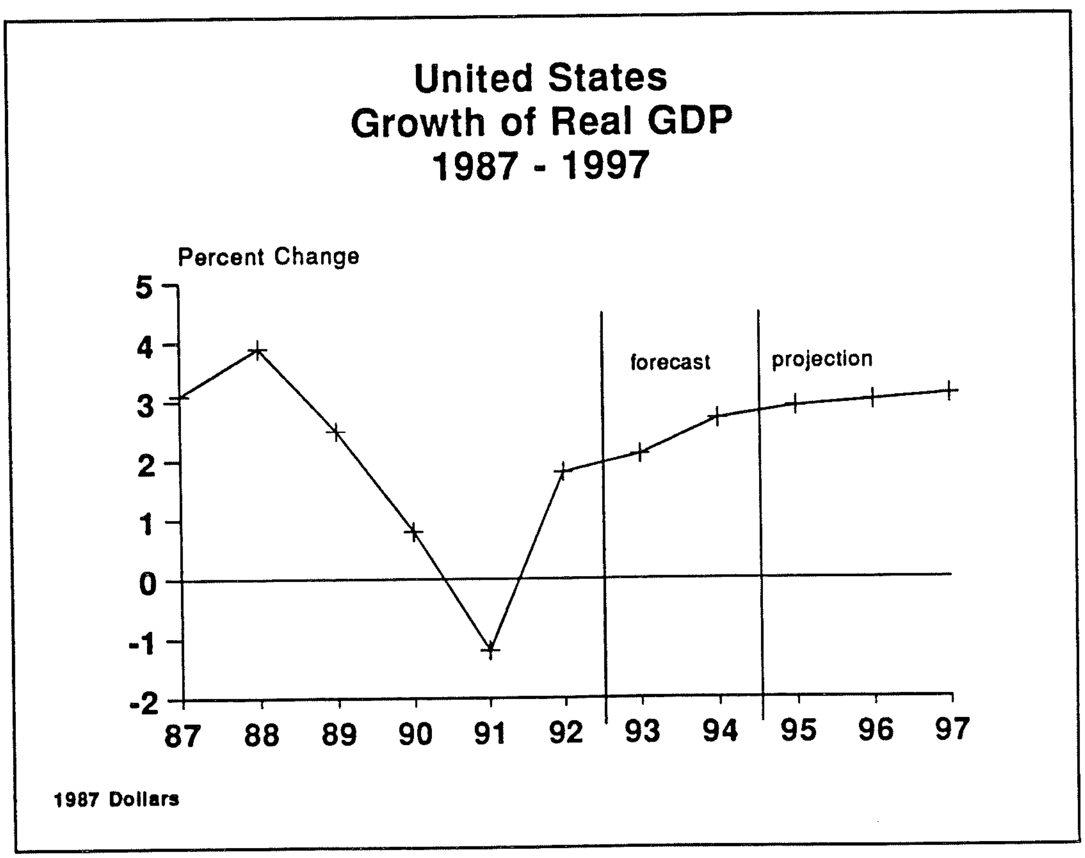
Kansas Personal Income Breakdown
Growth Rate

	1991	1992	1993
Personal Income	3.7	4.9	5.0
Wages and Salaries	4.1	5.1	4.4
Nonfarm Proprietors	0.6	9.3	4.7
Dividends, Int., & Rents	4.4	-1.4	2.8
Pers. Cont. to Soc. Ins.	7.8	6.1	6.9
Transfer Payments	10.2	11.2	8.8
Other Labor Income	8.0	6.3	5.1
Farm Proprietors' Income	-35.4	-4.3	22.2

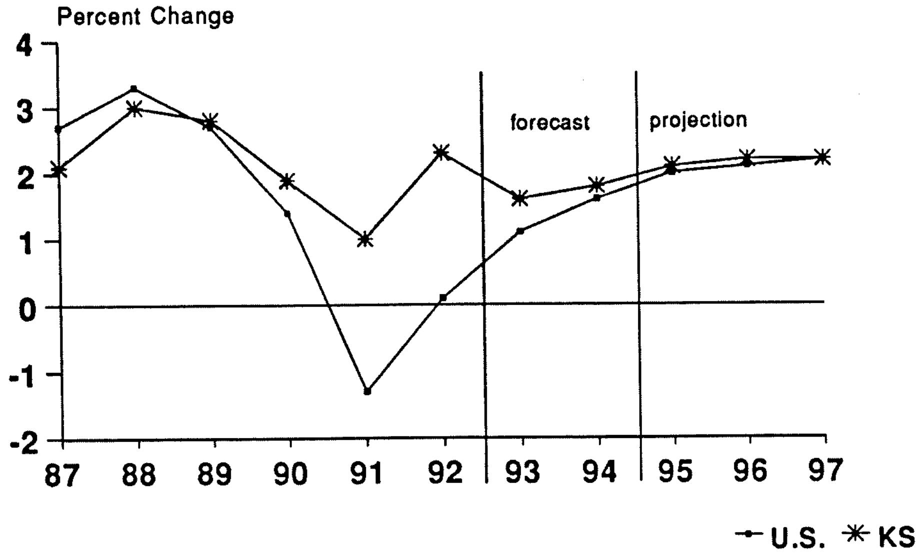

Nonfarm Wage and Salary
Employment Growth - KS and US
Percent Change
United States
Kansas
6
4
2
0
-2
-4
81
82
83
84
85
86
87
88
89
90
91
92
93


Personal Income Growth
U.S. and KS
Percent Change
United States
Kansas
14
12
10
8
6
4
2
0
81
82
83
84
85
86
87
88
89
90
91
92
93

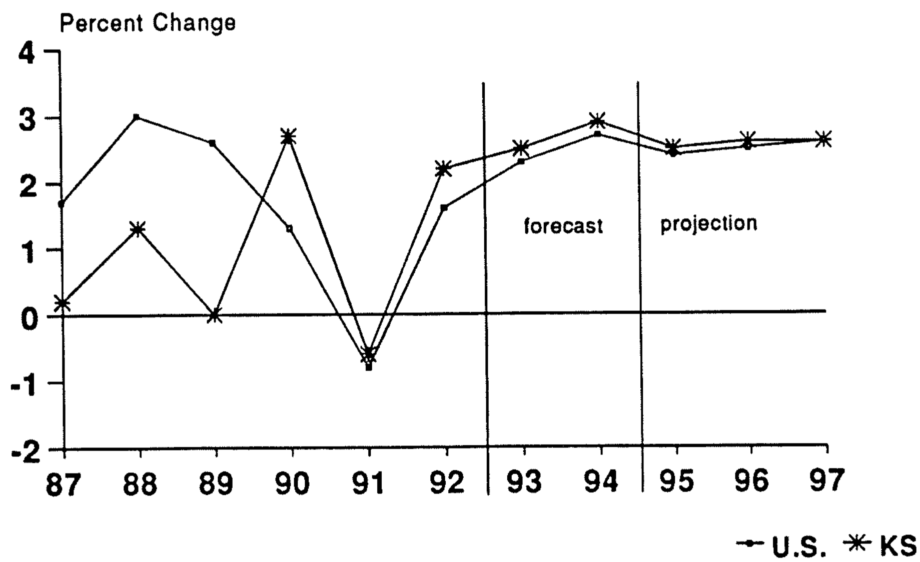

Unemployment Rates
Kansas and U.S.
United States
Kansas
Unemployment Rate
12
10
8
6
4
2
0
81 82 83 84 85 86 87 88 89 90 91 92 93


United States
Growth of Real GDP
1987 - 1997
Percent Change
5
4
3
2
1
0
-1
-2
forecast
projection
87 88 89 90 91 92 93 94 95 96 97
1987 Dollars

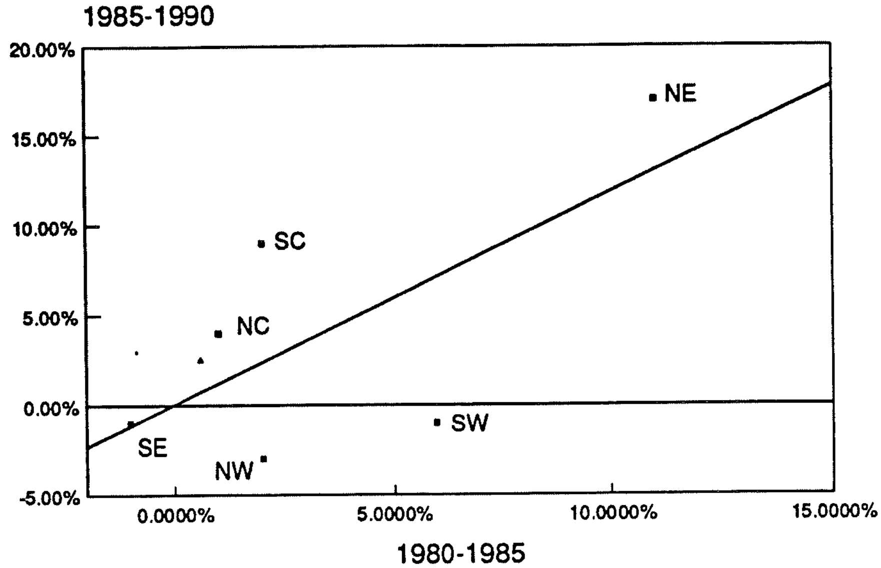
United States and Kansas Nonfarm Establishment Employment Growth 1987 - 1997



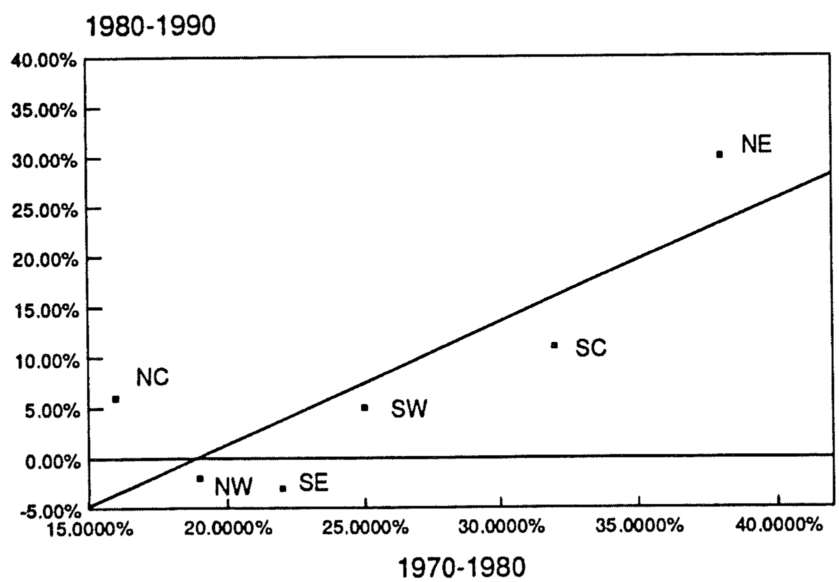
United States and Kansas Real Personal Income Growth 1987 - 1997



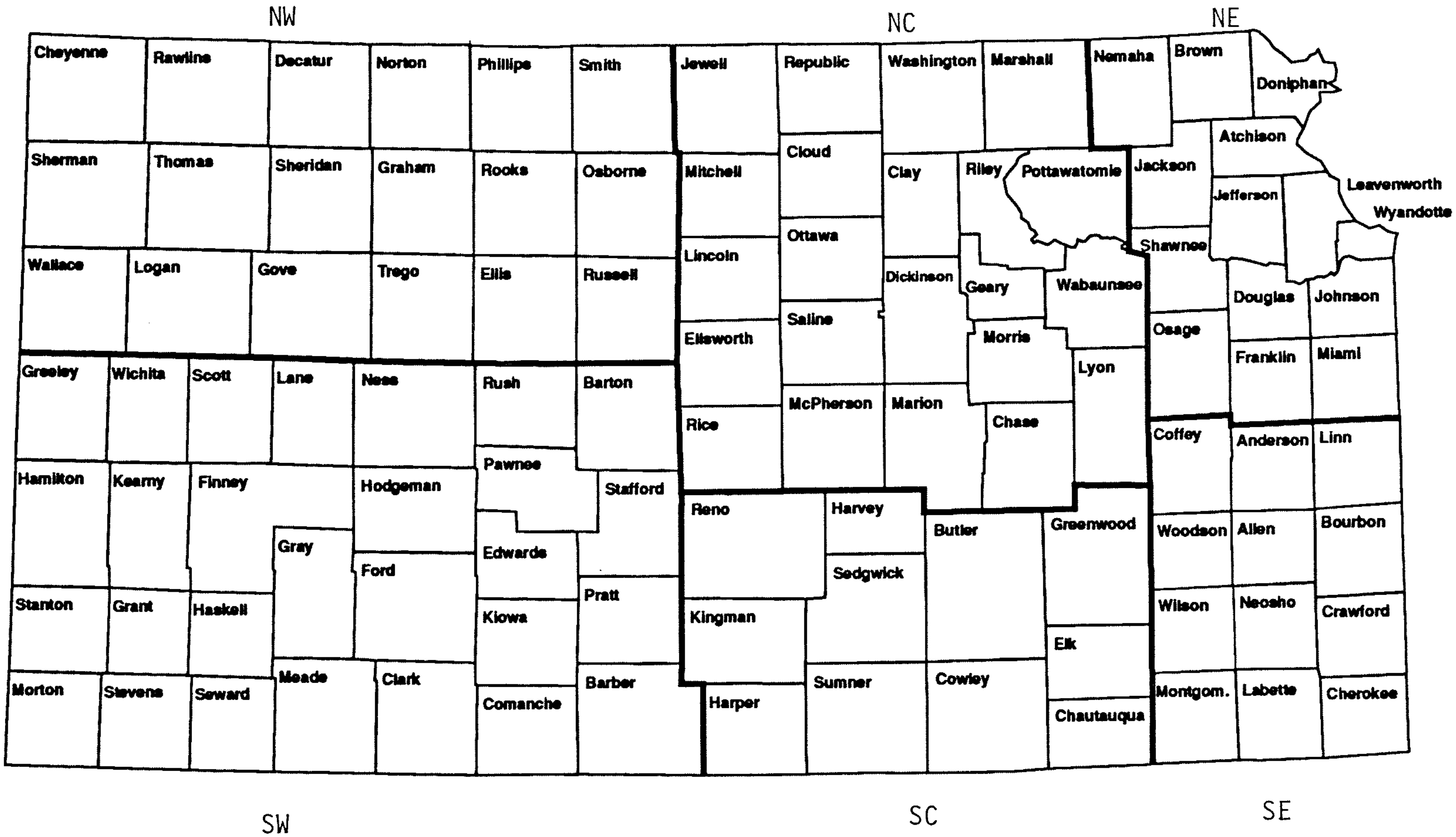
Employment Growth of Kansas Regions 1980 -1990



Employment Growth of Kansas Regions 1970 -1990



Kansas Regions



January 14, 1993
Economic Development
Attachment 3

The Outlook for the Kansas Economy Through 1997

by

Norman Clifford and Robert Glass

Institute for Public Policy and Business Research

University of Kansas

The purpose of this note is to characterize the expected performance of the Kansas economy over the next five years. In the first part of the note we provide formal projections. In making these projections, we take note of the fact that the Kansas economy depends in part on the national economy; in fact it is sometimes useful to think of Kansas as a small "country" whose level of economic activity is partially determined by the quantity of goods and services that it can export to the rest of the "world", where the most important customer is the rest of the United States. Thus, in projecting the Kansas economy, we must project the national economy. These projections are done in two parts; the performance of the national and state economies over the period 1993-1994 are forecasted using formal econometric models of the two economies.[1] However, since two and a half years out is pushing the limits of reliability of these models, the projections for the period 1995-1997 have been made from an assessment of where we are in the business cycle and a consideration of the long-run trend rate of growth. In the second part of this note, we discuss some particular sectors of the Kansas economy and point out specific areas of uncertainty about the future.

Projections

In general, the history of the national economy can be viewed as a sequence of fluctuations (the business cycle) around a trend of steady economic growth, although over extended periods, the long-run trend rate of growth may vary somewhat. Figure 1 shows the behavior of output growth during the most recent of these cycles. Unfortunately for those who wish to predict future behavior, the cycles vary significantly in both amplitude and frequency, so that knowledge of historical business cycles is only a very rough guide to predicting the future.[2] One way in which the current business cycle has been different from other postwar cycles is that the recovery that has apparently been proceeding for a year and a half has exhibited below average rates of growth. In the early phase of the recovery from most earlier recessions, the economy has experienced at least brief periods during

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[1] The National economy is forecasted using the Econometric Model of the United States produced at the Center for Econometric Model Research at the University of Indiana, R. Jeffery Green and Morton J. Marcus, directors. The Kansas economy is forecasted using the Kansas Econometric Model which is an ongoing project of the Institute for Public Policy and Business Research at the University of Kansas.

[2] This is evidenced by the recent lively debate about whether or not the recent recession would exhibit a "double dip".

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Economic Development
Attachment 4

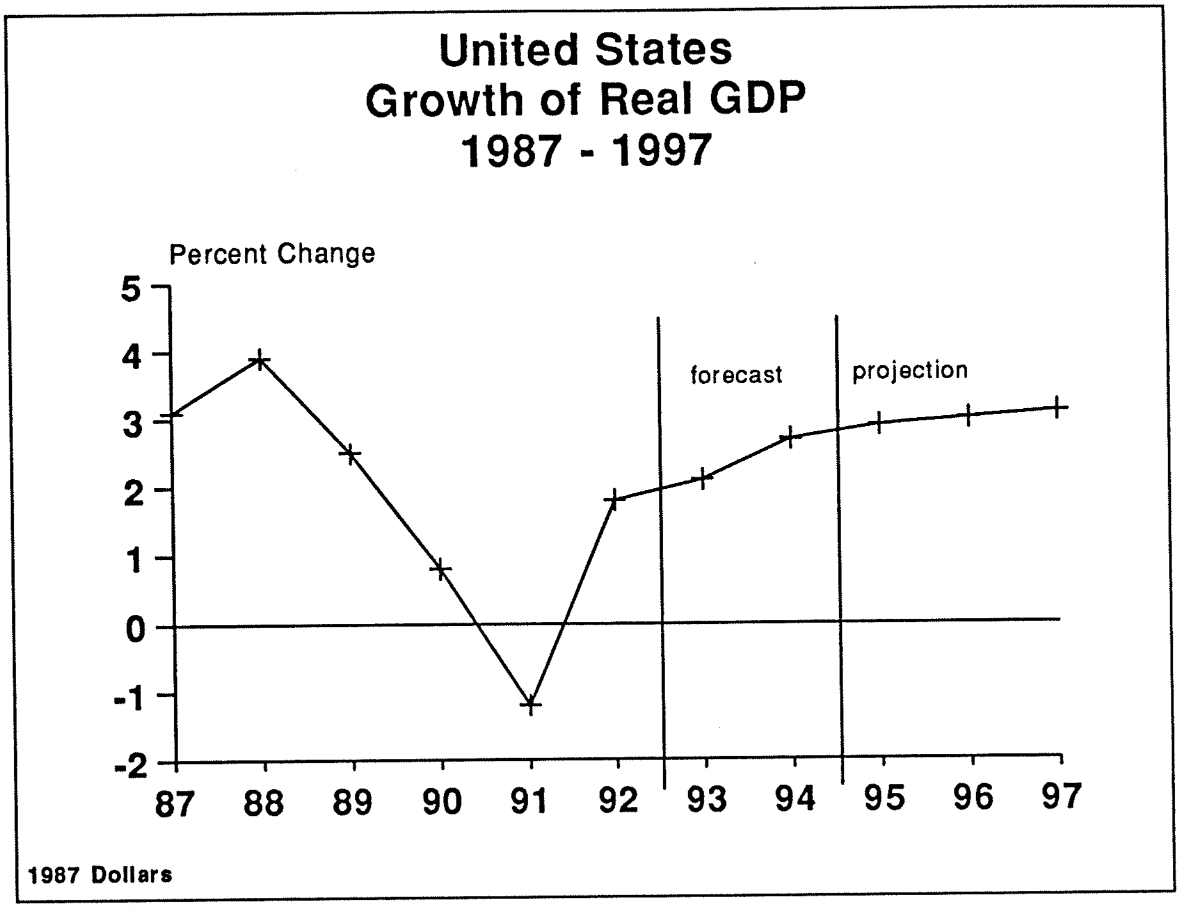

Figure 1

which the growth rate was well above the long-run trend rate of growth of just under 3 percent. During the recent recovery, on the other hand we have had an above trend rate of growth of Gross Domestic Product only in the most recent quarter (the third quarter of 1992) at 3.9 percent. Since most of that growth was due to a big increase in consumer spending, which was not supported by a corresponding increase in personal income, it seems most unlikely that such rates will persist.

The forecasts from our econometric models are consistent with the view that the current expansion will proceed at fairly moderate rates; as illustrated in Figure 1, we forecast GDP to grow 2.1 percent in 1993, and 2.7 percent in 1994. As for the 1995-1997 period, we believe that the modest pace of the current recovery suggests that we are most likely in the midst of a long, mild upswing rather than a period large ups and downs. Thus, we believe that a reasonable projection for the 1995-1997 period growth at or slightly above the current trend rate of growth, which we place at about 2.7 percent. This is illustrated in Figure 1, with growth rates of GDP in the 2.7 to 3 percent range for the period.

With this projection of the national economy as a foundation, we turn now to the projections

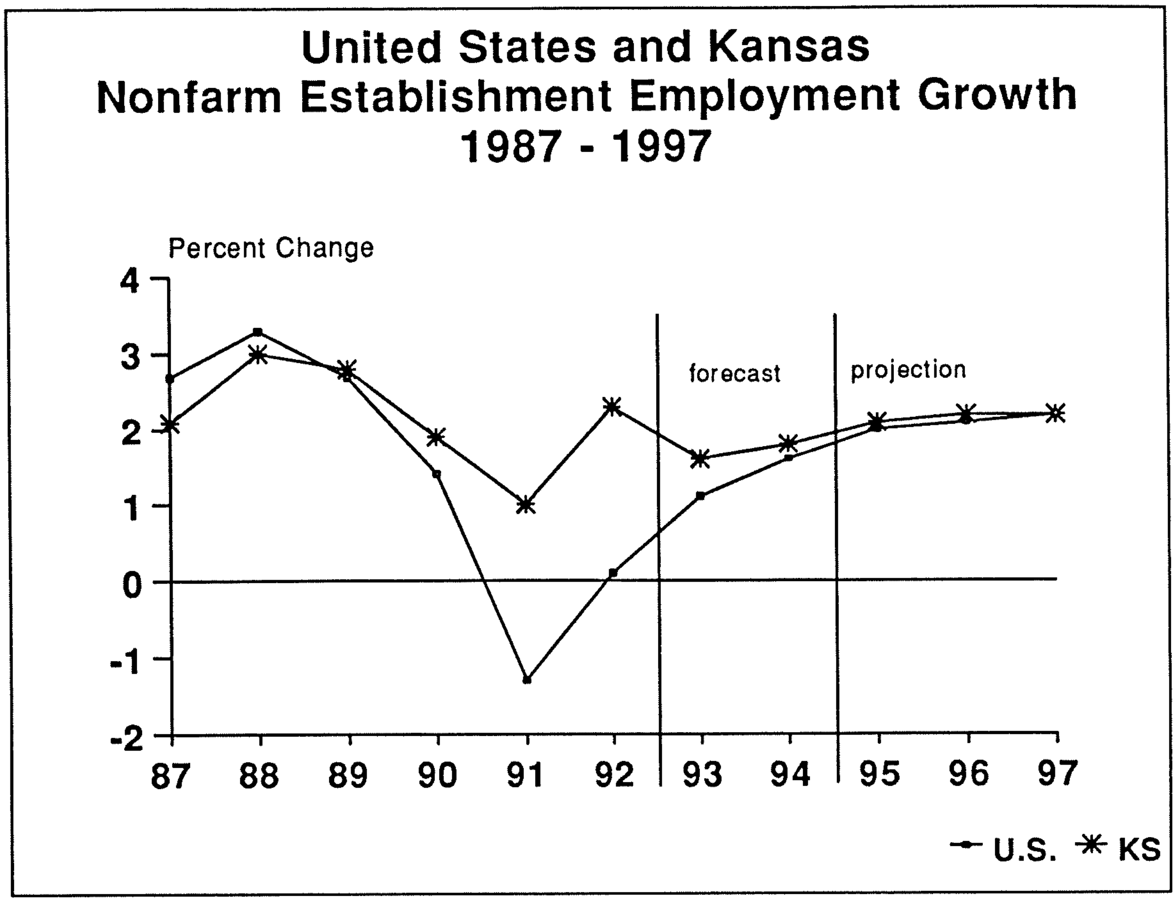

Figure 2

for Kansas. Because of data limitations, the projections for the state economy must be in terms of employment and personal income, rather than output. The recent history and projections of employment growth for Kansas and the U.S. are shown in Figure 2. A salient feature of that figure is the 1990-1992 period, during which Kansas employment growth significantly exceeded national employment growth; indeed, in 1991 U.S. employment fell 1.3 percent while Kansas employment grew 1 percent. This is in stark contrast to the early 1980's; from 1981 through 1987, the average annual rate of employment growth in Kansas was 0.9 percent, while U.S. employment grew at an average annual rate of 1.8 percent. Our forecast indicates that Kansas will continue to outperform the nation in employment growth in 1993 and by a lesser amount in 1994. As the U.S. recovery continues through the 1995-1997 period, we expect that the Kansas and U.S. employment growth rates will converge.

The recent history of personal income in Kansas is similar to that of employment. In every year from 1983 to 1989, real (adjusted for inflation) personal income grew faster in the nation than it did in the U.S. On the other hand, in 1990, 1991, and 1992, personal income in Kansas grew faster

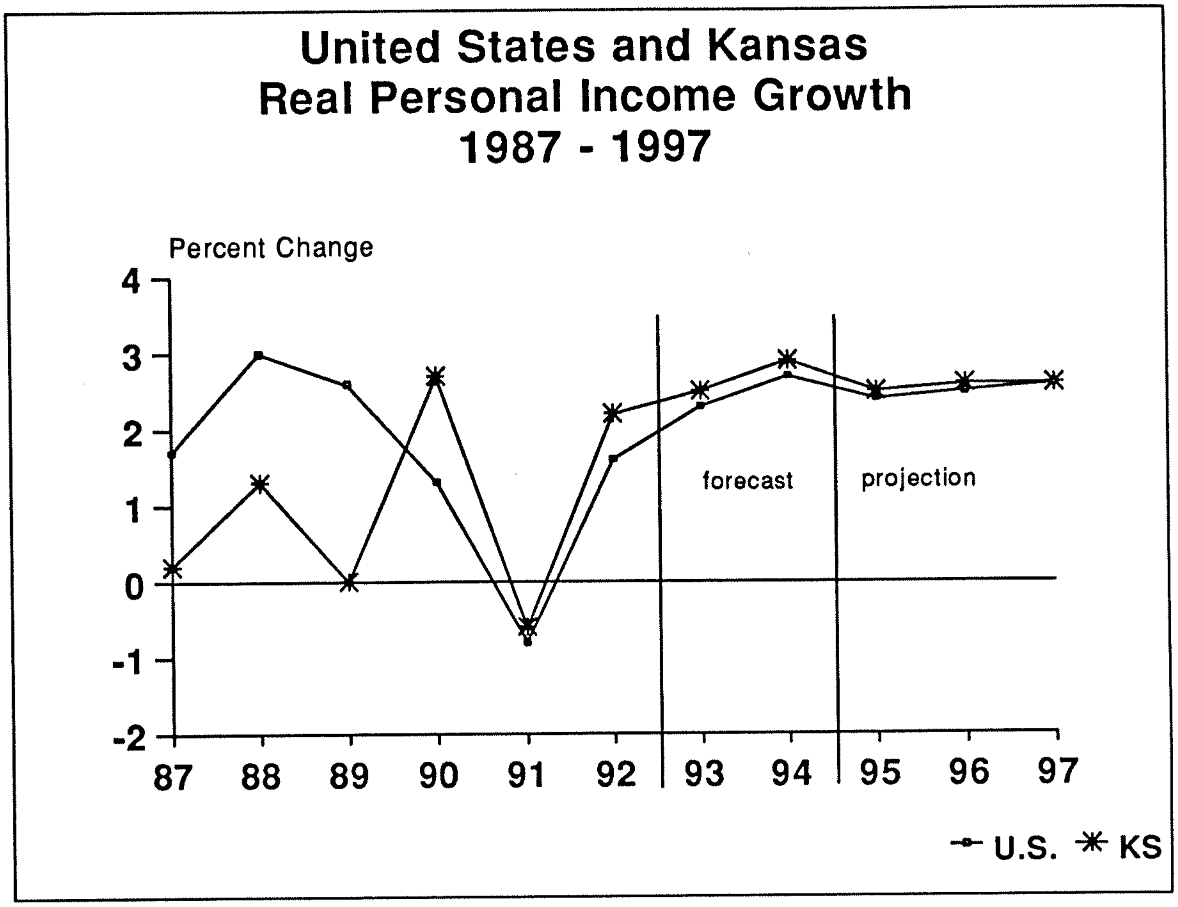

Figure 3

than U.S. personal income, although as Figure 3 shows, the difference between Kansas and the U.S. growth rates is less pronounced for personal income than for employment. Once again, we expect that Kansas and U.S. growth rates will converge as the U.S. recovery continues.

In summary, the Kansas economy has been much stronger in recent years, relative both to the national economy and to Kansas in the early 1980's. Our projections can be characterized as the Kansas economy continuing to be stronger over the next five years than it was in the early eighties, and roughly matching U.S. performance as the nation continues a prolonged but moderate expansion.

Major Sectors

The performance of Kansas agricultural sector in 1993 is expected to be somewhat weaker than in 1992, but still better than the late 1980's — assuming normal weather. A slight decline in net farm income should occur with both the crops and the livestock sectors. For the longer run, most of the manageable uncertainty (as apposed to something like another drought) for the agriculture is trade related. The current dispute with the French over oilseed subsidies by the EC threatens the GATT negotiations. If a new GATT agreement could be reached which lowers European subsidies, then American grain producers would be in a better competitive position internationally. In addition to the GATT negotiations, the passage of the NAFTA agreement with Mexico also has important implications for American farmers. This year, wheat and sorghum exports to Mexico appear to have increased sharply, indicating that if the NAFTA agreement is not signed, that Kansas farmers might face future market contraction. Along similar lines is the current debate over the trade status of Mainland China. If China does not retain most favored nation status, then another grain export market might be closed. Finally, the question of the status of the economy and agricultural production of the former Soviet Union also plays a role in the long run outlook for agricultural exports.

Another important sector of the Kansas economy which has faced increased uncertainty over the past two decades is the oil and gas industry. This industry has been partially deregulated, subjected to erratic swings in the prices of its products, and faced increased taxes. Because of the mature nature of most of the oil industry in Kansas, unless prices should increase substantially over an extended period, this industry appears to be a declining industry with declining tax revenues. The gas industry in Southwestern Kansas appears stronger, but with the same caveat; it does not look like a strong growth industry in the near future.

In terms of employment, the manufacturing sector has been a declining sector both nationally, and, to a lesser extent, in Kansas. While employment in the manufacturing sector fell 5.1 percent nationally from 1980 to 1990, Kansas manufacturing employment, over the same period, fell only 3.0 percent. Also, the performance of Kansas non-metropolitan manufacturing over the last decade was worse than Kansas metropolitan manufacturing. The future for non-metropolitan manufacturing could become worse. Meat packing has been a notable growth sector for the western, non-metropolitan areas of Kansas over the past 20 years. However, several factors could result in some of the meat packing industry moving out-of-state. Two of these factors are the expiration of tax incentives in some of the cities where the plants are located, and the lack of water in western Kansas while Nebraska has a surplus of water. Other types of non-metropolitan manufacturing might be hurt by the NAFTA agreement if it is approved.

The largest metropolitan manufacturing industry in Kansas is aviation which over the past few years has had a small decline in employment. In particular, Boeing, the largest manufacturer in the state, has been gradually laying off workers since 1990 with more planned for 1993. The decline in future orders for airplanes is an indication that this trend could continue beyond 1993. Two major reasons seem to exist for the declining future orders: the end of the cold war and consequent reduction in defense spending, and the glut of used commercial aircraft on the market. For these reasons, the next few years should not resemble the boom in aircraft production of the mid and late 1970's, but because of the commercial character of most of the aircraft production in Wichita, it should also not experience an economic crisis like it did in the late 1960's through 1971.

The service sector is the fastest growing sector in both the national economy and the Kansas economy, although it has grown faster nationally (45 percent) than in Kansas (35 percent) during the decade of the 1980's. Over the same time period, the service sector was the fastest growing sector of both the metropolitan (51.3 percent) and non-metropolitan (19.1 percent) economies of Kansas. Service sector growth has been responsible for substantial structural change in the U.S. and Kansas economies. Even when a narrow definition of services is employed, services now comprise about 32 percent of the Kansas economy and 36 percent of the national economy. Because service sector jobs have traditionally paid less than manufacturing jobs, the transition to a service economy has created concerns about a lowered standard of living for workers. To further aggravate the problem, service sector wages and salaries in Kansas lag behind their national counterparts to a greater extent than do manufacturing wages, even though the Kansas share of high wage services slightly exceeds the national average.

On a more optimistic note, the last decade has seen a surge of well-paying services jobs, particularly business services, which have become part of the export base of Kansas (industries that sell outside of the state). These jobs are primarily located in metropolitan areas, particularly Johnson County. Services contribute about 1 out of every 5 export related jobs in Kansas, but almost 1 out of every 2 export jobs in Johnson County. Two trends threaten the continued growth of these well-paying business services jobs. First, most of these services are an input to manufacturing. As manufacturing declines, the demand for business services might also decline. Second, the 1986 reclassification amendment created a tradeoff between higher assessment ratios for business property and removal of inventories from the property tax base. Since services have almost no inventories, they were clearly adversely affected by the change in the tax assessment.

Conclusion

The Kansas economy is stronger and will continue to be stronger over the next five years than it was in the early 1980's. In the near future, it should continue to outperform the nation, especially in terms of employment growth, but not by as much as it has done in the last three years as the U.S. recovery strengthens somewhat. Over the longer run, the rates of growth of Kansas and the U.S. should converge, as the U.S. continues through an extended period of moderate expansion. On the other hand, for each of the four major strength areas of the Kansas economy, agriculture, oil and gas, manufacturing, and services, there are concerns and uncertainties about the future. In addition, the assessment of these four sectors suggests that the geographical distribution of economic growth will be uneven: the rural economy of Kansas appears to be headed for more decline. Most growth in Kansas will likely take place in the metropolitan areas.