

Norwich Finance Committee Report of Current Economic Conditions and Recommendations

Current Conditions, August 2011

National: While the United States has indeed come out of the “Great Recession” in the last 24 months, the effects of the financial crisis are still being felt, and in many cases revisited. An estimated \$7.8 trillion of home equity has been lost to the American public in the last 4 years, a startling figure that figures to weigh on our economy for years to come. At the start of 2011, the consensus forecast for U.S. GDP growth was in the 3.5-4.0% range, based largely on the idea that the country had firmly established that it was out of the recession and that the jobs picture would improve. Unfortunately neither economic nor job growth has occurred. The jobs picture has stagnated, with national unemployment hovering at 9.1% in the most recent data. U.S. GDP growth for the first half of the year has been recently revised down, with 1st quarter growth at 0.3%, and 2nd quarter growth at 1.4%. U.S. productivity *fell* at a 0.3% annual rate in the second quarter as the economic recovery remained tepid and labor costs continued to rise. Consumer spending also dropped in June for the first time in two years. Additionally, other factors have contributed to a particularly weak year. Inflationary pressures, in the form of higher food and energy costs, have cut into household budgets. The U.S., being a consumer-driven economy, is extremely sensitive to changes in consumer costs. Cotton, sugar, and grain prices are also at or near all-time highs, creating higher costs for almost all consumer staples. These factors have contributed to a much more muted growth rate than was forecast- somewhere in the 1.2% range for 2011, with many analysts now pegging the potential for another recession between 30 and 50 percent. Compounding fears is the sovereign debt crisis that has engulfed Greece, Ireland, Spain, Portugal, and Italy in the last year. While the U.S. bank exposure to European defaults is low, the potential “spillover” from a severe sovereign debt crisis has become a harsh reality (particularly counterparty risk). The recent severe selloff in the equity markets is indicative of the lack of faith that investors put in the government to deal appropriately with the deteriorating economic situation. This view was hardened during the two-week standoff in Washington over the deal to raise the debt ceiling, which resulted in the historic decision by Standard and Poor’s to Lower the United States credit rating (a decision that they claim was based largely on the dysfunctional situation in Washington). On August 9, 2011, the Federal Reserve issued a statement in which they said that “The Committee now expects a somewhat slower pace of recovery over coming quarters than it did at the time of the previous meeting and anticipates that the unemployment rate will decline only gradually.....and that the downside risks to the economic outlook have increased. The Committee will maintain exceptionally low levels for the federal funds rate.....at least through mid- 2013”. For an organization that prefers to remain nimble and be able to react quickly to changing conditions, this long-term dour outlook is particularly discouraging.

Regional: The northeast was not hit as hard as some other parts of the country in the recession, at least as far as jobs and housing are concerned. The unemployment rate in New Hampshire only reached 6.8% at its highest point in 2009, and currently stands at 5.2%. Similarly, Vermont has a 5.5% unemployment rate. The housing market is stable but presents a muddled picture, with median prices rising 2.2% to

4.1% regionally year-over-year, but with a 3.8% drop in the number of homes sold. Despite record low interest rates, mortgage companies are seeing a decline in overall demand, indicating that buyers are looking for real bargains, and sellers either cannot sell at depressed levels, or simply will not. State governments are being pressured to cut budgets, as we are seeing the trickle-down effect of too much debt at the national level. There is a growing feeling that underfunding of pension funds and other entitlements for state workers will continue to put budget pressure on state governments.

Local: Here in the Upper Valley, we have a “muted” picture of the national and regional economies. Housing prices locally have fallen, particularly on the high-end, but remain in line with surrounding communities. The overall volume of real estate transactions has slowed recently, as sellers seem to be riding out the recent decline. The local jobs picture is solid yet unspectacular; however, there is a growing concern that there will be future cuts at DHMC and Alice Peck Day as the state is cutting funding to hospitals and is reducing Medicaid reimbursements. Approximately 725 DHMC employees have been offered an early retirement package recently due to the reduction in those payments. This could directly affect households in Norwich. While locally unemployment is not a huge problem, it’s safe to say that people do not feel quite as secure in their jobs as they did 4 or 5 years ago. Workers are being asked to work longer hours, for similar pay, and generally less benefits. As taxes have risen in Norwich in the last 3 years, people are being forced to make do with less on a weekly, monthly, and annual basis, generally speaking. Perhaps the most concerning data locally comes from the 2010 U.S. Census, which shows an overall decline in the Norwich population from 2000, and a recent report on the Upper Valley from the Nielsen company projects growth over the next 5 years at 0.5%, i.e. virtually none. This contributes to the idea that while the Upper Valley is still a desirable place to live and raise children, it is not the growth center it once was. The average age of the local population is 41.5, compared to 37.8 nationally, with that difference expected to grow by .5 years over the next five years (Nielsen). This aging population is consistent with the area’s weak growth outlook. A positive sign for Norwich is that (along with Hanover) it is a haven for those with advanced degrees. By most accounts, the employment/wage gap between those with a high school education and those with an advanced degree is going to grow at an even much greater rate than what has occurred historically.

Conclusions: While locally we seem to be slightly better off than most other parts of the country, the best way to assess the overall economic picture is “fragile”. It is true that the Hanover/Norwich community is generally “higher-end”, but that does not make us exempt from problems surrounding the national economy, such as protracted high unemployment, ever-growing deficits, and a growing problem with consumer costs. Additionally, with many baby boomers approaching retirement age, the underwhelming performance of 401ks and IRAs over the past 4 years will force many people to make difficult choices in the coming years. Looking out to next year, we look toward what promises to be a heated presidential election, with the economy and governmental gridlock looming as major issues.

More and more, it seems like the country and the region must adapt to what we will refer to as “the New Normal”, where housing prices will remain soft for an extended period of time; the government will provide less and less help to municipalities and individuals; the cost of goods for both the consumer

(food, energy) and the school (teacher salaries and benefits) are on a steady rise; and where global events can affect the economies of even the most isolated small towns. Unemployment is the key component of the New Normal, as many economists believe it will not get better and, very well, will get worse for a number of reasons. One, the unintended consequences of technology have eliminated forever many jobs and will continue to do so. Two, the availability of cheap foreign labor is too attractive to the bottom line. Three, businesses have learned they can operate in a leaner, more efficient manner while coping with the recession. Moreover, the slow demise of labor unions is and will continue to impact wages.

Recommendations

The NFC feels the problems outlined above will extend well beyond any quick fix and will take years to remedy, in particular, the stagnant unemployment rate and any significant appreciation in the real estate market. In consideration of ongoing distress in the economy, we ask the Norwich School Board to consider these points when formulating future budgets, when considering teacher hires and classroom sizes, and in communicating an effective and informative message to the public during a budget process that we anticipate will find fewer dollars available to fund our school's needs.

* The New Normal means less government support and a greater burden placed on local tax revenue to fund town and school services. The Board should be prepared to receive less revenue and should be proactive in identifying budget items where reductions are possible. The goal should be to know what budget changes would have the greatest impact.

*The Committee is concerned about the recent operating deficits by the school district and whether future operating expenditures will be cut back to eliminate this deficit and avoid future deficits. Consideration must be given to a review of the classroom size policy and any other policies affecting school expenditures.

*The Board should consider the impact of any expense on the cost per pupil calculation. NSD finances are a function of cost per pupil, which can be improved by lower costs or increasing pupils at an improved economy of scale. The committee would like to develop a model on the relative effectiveness of each measure, to wit:

1. To what extent does lowering the standard of education drive away customers?
2. To what extent does adding students increase costs?

*The committee is concerned by the recent staffing and enrollment issues that ultimately resulted in the hiring of an additional third grade teacher. While the outright cost of the teacher appears to have been mitigated to a large degree, the process was certainly less than ideal. Obtaining accurate enrollment projections at the earliest possible date would help the board to make sound decisions for its students, and to be able to communicate those decisions to parents so that they can make informed choices for their children. Additionally, exit surveys could be conducted both with families leaving the district and

those who inquire (but ultimately do not come) as to the reasons for their decisions. This data would be invaluable to both the Board and the Finance committee as it would provide data points as to how people make decisions for their children's education in relation to both the quality of the product and the costs associated with it.

*The use of the current reserve funds is problematic. Reserve funds have historically been used to address budget shortfalls. The Committee would like the School District to clearly define each reserve fund as to its specific need, use, and appropriate balance.

* Formulating future budgets should acknowledge the low level of interest rates and growing level of inflation in our economy. We urge that future budget discussions recognize that at or above market increases in pay and benefits cannot be offset in an atmosphere of declining revenues and fund balances earning low rates of return.

*Upon consideration of a new teacher hire or other large expense, the Committee would like to formalize the process of a meeting with relevant parties (Principal, School Board members, NFC) to put the expense in the context of school priorities, discuss funding proposals, and create a spreadsheet or report that summarizes the true cost of the proposed item.

Norwich Finance Committee

August, 2011