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1-1-2010

RETURN TO GROWTH

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Business in Nebraska

VOLUME 64 NO. 696 PRESENTED BY THE UNL BUREAU OF BUSINESS RESEARCH (BBR) JANUARY 2010

RETURN TO GROWTH

By the Nebraska Business Forecast Council

U.S. Macroeconomic Outlook

After 18 months of decline, the United States economy returned to growth in mid-2009. Growth was tepid at first, with U.S. gross domestic product rising by just 2.2% in the 3rd quarter. But, growth was much more rapid in the 4th quarter, portending a solid recovery in 2010 and 2011. Economic expansion will be broad-based, with both household consumption and business investment rising, and employment increasing in most industries. The reasons for recovery are typical of other recoveries. Initially, the recovery is powered pent-up consumer demand among households who have retained spending power. Later, there is a rebound in business investment and hiring. This leads to rising employment and income which underpins sustained growth in consumption.

But, this recovery, like the recession which proceeded it, will not be entirely typical. Gross domestic product and employment will not be able to quickly rebound to pre-recession levels. Specifically, several factors will limit the recovery. First, weakness will persist in key sectors such as construction, housing, commercial real estate and banking. In many parts of the United States, the housing sector will be hit by another wave of foreclosures in 2010, which will limit price growth and new construction. An excess supply of commercial real estate will also impact the banking industry and limit construction employment. Recovery in these sectors will be halting during 2010.

Second, pre-recession levels of economic activity, fueled in part by cheap credit and a negative savings rate, were not sustainable. The economy will need time for the underlying productive capacity of labor, capital and technology to expand to support these higher levels of spending. In 2010 then, there can only be a partial recovery to pre-recession levels of gross domestic product and employment.

We expect the U.S. GDP will grow by 3.5% year-over-year in 2010 and by 4.0% in 2011. As indicated above, these rates exceed trend growth rates, as is expected in recovery. But, the rate of growth will not be high enough to snap back to pre-recession levels in 2010. U.S. gross domestic product may only reach pre-recession levels during 2011, and employment may not fully recover until at least 2012. The consumer price index is expected to rise by 2% in 2010 and to 2.5% by 2011. The Federal Reserve will begin raising interest rates later in 2010 and in 2011 in order to combat future increases in inflation rates. The Fed has already begun to phase out emergency measures taken to aid the economy during the financial crisis. The unemployment rate will fall below 9% by late 2010, and to 7% by late 2011.

As in recent years, economic conditions will be relatively strong in Nebraska, since the state begins the year in better shape. Unemployment rates will remain about half the national average, and fall in step with national rates. Nebraska will experience solid job and income growth in 2010, and strong growth in 2011.

Nebraska Outlook

Table 1 provides a summary of the Nebraska economic outlook. The Table shows that a sharp decline in employment in 2009 will be followed by moderate employment and income growth in 2010. Strong employment and income growth are forecast for 2011. Farm incomes fell sharply during 2009, but fell from record highs in 2008. Farm income in 2009 was still above its 10-year average in Nebraska, and is forecast to rise in 2010 and 2011.

Table 1— Key Economic Growth Rates

	Nonfarm Employment	Nonfarm Personal Income (nominal)	Net Farm Income (nominal)
2008	0.8%	3.3%	34.5%
2009	-1.6%	1.5%	-33.4%
2010	1.0%	3.9%	8.2%
2011	1.8%	5.0%	3.4%

Note: Nominal income growth includes inflation.

This outlook was prepared in two phases. First, the UNL Bureau of Business Research and UNO economics faculty member Christopher Decker produced a preliminary economic outlook. Second, the Nebraska Business Forecast Council met to produce a final outlook based on the preliminary outlook, each Council member's research on a key sector of the economy, and the group's overall expertise about the Nebraska economy. A detailed description of the resulting Nebraska outlook is provided below.

Employment

As seen in Table 2, job growth will rebound in Nebraska in 2010, erasing most of the job losses that occurred in 2009. Further, rapid job growth in 2011 implies that Nebraska employment will reach pre-recession levels by mid-2011. Job growth will be broad-based, returning to most sectors in 2010 and others in 2011. Note also that our current forecast is consistent with our last forecast in June 2009.

Table 2— Comparison of Non-Farm Employment Forecasts

	June 2009 Forecast	Current Forecast
2008	0.8%	0.8%
2009	-1.3%	-1.6%
2010	0.9%	1.0%
2011	1.9%	1.8%

Construction and Mining

Nebraska construction activity bottomed in 2009, as an anemic housing market generated few housing starts. A slow recovery is set to begin in 2010 as the economy recovers, credit conditions slowly improve, and pent up demand for new housing leads to an improvement in new home construction. Road construction and other infrastructure projects also should show modest growth in 2010 as Federal stimulus spending supports new projects. But, non-residential construction will weaken in 2010. Several major construction projects in Nebraska wound down in 2009, and a surplus of commercial buildings will limit new construction even as the economy recovers. As a result, there will be no recovery in non-residential activity until 2011.

Overall, in 2010, two segments of the construction sector – residential construction and road building – will experience a modest recovery. By 2011, all three segments of the construction industry will be expanding, and a solid recovery should be underway in new home construction. As a result, we anticipate modest growth in construction employment in 2010, and rapid growth in 2011. As seen in Table 3 on the next page, construction employment fell by 3.0% in 2009, but will grow by 1.0% in 2010 and 4.0% in 2011.

Manufacturing

Total manufacturing activity is beginning to expand again. But, rising industry productivity and related human resources practices suggest that employment growth will return to the industry slowly over time. Specifically, during the early stages of a recession, manufacturers adjust to declining demand by first reducing overtime hours, then cutting back on normal work hours, and lastly by laying off workers. This pattern allows employers to retain highly skilled workers through the early stages of an economic downturn and can reduce the need for time consuming and costly searches to find skilled workers later. When demand does pick up after a long economic downturn, employers first return to normal work hours and then begin offering overtime work. Given current idle capacity, estimates are that manufacturing output could increase about 5% before there is a need to hire new workers.

Table 3—Number of Nonfarm Jobs and Percent Changes by Industry Annual Averages (in thousands of jobs)

	Nonfarm Total	Construction, Mining & Natural Resources	Durables	Non-durables	Wholesale Trade	Retail Trade	Trans-portation and Utilities	Inform-ation	Financial	All Services	Federal Gov't	Local Gov't
1999	893.9	44.1	57.5	55.4	42.3	110.1	44.3	27	60.7	301.1	15.9	135.6
2000	910.7	45	58.7	55.2	41.7	111.2	44.9	26.8	60.3	312.5	16.6	137.9
2001	916.8	45.3	54.7	56.3	42.5	110.5	45.2	25.8	60.2	319.5	16	140.8
2002	908.1	46.1	50.6	55.5	41.5	108.9	44.9	23.2	61.4	317.1	16.3	142.6
2003	910.5	47.4	47.3	55.1	41	107.2	46.4	21.5	62.4	322.6	16.7	142.9
2004	917.7	48.4	47	54	40.8	106.9	48.9	21.1	63.2	327.4	16.5	143.4
2005	930.2	47.8	48.4	52.9	40.6	107.2	52.3	20.2	64.5	335.2	16.3	144.7
2006	941.5	48.4	49.7	51.8	40.8	106.4	53.4	19.5	66.7	342.9	16.2	145.9
2007	957.4	50.5	50	51.4	41.1	107.5	56.2	19.4	68.7	350.3	15.9	146.5
2008	964.7	50	49.5	52.1	41.9	107.5	55.3	18.8	69.1	356.5	16.1	147.8
Forecast Number												
2009	949.7	48.5	43.5	49.6	41.3	105.6	54.2	17.8	69.0	352.3	16.5	151.5
2010	959.1	49.0	42.2	48.9	41.4	105.7	54.9	17.5	69.9	360.1	16.9	152.7
2011	976.4	51.0	43.2	49.0	41.6	106.3	56.9	17.5	71.3	369.8	15.9	153.9
Forecast Number												
2009	-1.6%	-3.0%	-12.1%	-4.8%	-1.5%	-1.8%	-2.0%	-5.5%	-0.2%	-1.2%	2.5%	2.5%
2010	1.0%	1.0%	-3.0%	-1.4%	0.2%	0.1%	1.3%	-1.7%	1.3%	2.2%	2.4%	0.8%
2011	1.8%	4.0%	2.4%	0.2%	0.6%	1.6%	3.6%	0.0%	2.0%	2.7%	-5.9%	0.8%

Source: http://data.bls.gov/cgi-bin/dsrv, 2009

When manufacturers do begin adding new workers, many firms will use temporary workers from employment agencies. These new temporary workers will be counted as employees of the employment agencies (a service sector), not the manufacturing establishments. If demand continues to grow, these temporary workers will eventually become employees of the manufacturing firms and overall manufacturing employment will begin to grow.

Preliminary (partial) data for 2009 suggest a 12.1% decline in the durable goods manufacturing jobs. In 2009, lower farm incomes reduced demand for the farm machinery, equipment manufacturing, and the fabricated metal products manufacturing industries. Nationally, the recession and credit conditions reduced employment in other durable goods sectors and these reductions will continue through much of 2010. Durable goods employment is expected to fall another 3.0% in 2010 before an increase of 2.4% in 2011. The outlook for farm equipment is beginning to brighten as some agricultural commodity prices, especially corn and soybeans have shown signs of strength.

In the case of nondurable manufacturing, preliminary data for 2009 suggest a 4.8% decline in employment. Employment is forecast to decline through 2010, with a loss of 1.4%. During 2010, increases in international demand for meat products are expected to have a positive impact on food processing, the key nondurable goods sector in Nebraska. In 2011, employment growth will return with job growth up 0.2%.

Transportation and Utilities

The national recession slowed Nebraska's rapidly growing transportation sector in 2009. Trucking, rail, and warehousing experienced a 2.0% job loss in 2009, continuing a decline that began in 2008.

National economic recovery will mean a recovery in the Nebraska transportation sector. Net hiring should begin by mid-2010, and perhaps earlier in both the trucking and rail sectors in response to the cyclical upturn. Further, long-term trends continue to favor Nebraska's transportation sector. Nebraska's central location, advantages of the I-80 corridor, low entry costs, educational training programs, and favorable

demographics all underpin above average growth in the industry in the long-run.

With normal growth rates returning during 2010, transportation and utility employment will grow by 1.3% this year. Growth will accelerate to 3.6% in 2011 as all segments of the industry expand.

Wholesale Trade

Wholesale trade employment has changed little over the last decade. Employment drifted both up and down during the period but never by more than a few hundred jobs from year to year. Trends also have not always followed the overall Nebraska economy. Trends in the industry may be hard to identify because many wholesale businesses are tied to wider regional markets as well as the local markets within the state. In particular, many wholesale operations serve multi-state markets and compete with businesses based in other states. This means growth in industry activity from year to year will depend on the ability of Nebraska businesses to maintain and gain customers from their competitors. At the same time, rising productivity keeps a cap on total industry employment, so there is no long-term trend of job growth.

But, the industry does respond to strong economic trends as is evident by the 1.5% decline in wholesale trade employment in 2009. The industry is expected to experience very modest growth as the economy recovers. Wholesale trade employment is expected to grow by 0.2% in 2010 and 0.6% in 2011.

Retail Trade

The year 2009 was difficult for the retail trade industry. With weak consumer demand, retail employment fell by 1.8% in 2009. Industry sales will recover as the economy recovers in 2010 and 2011. But, employment growth will be modest in both years. Several factors will account for this modest employment growth. As with wholesale trade, productivity is rising in retail trade businesses, particularly as larger ‘big box” stores gain a larger share of the sector. Slow growth of the labor force due to an aging baby boom population also encourages more efficient use of labor in retail businesses. Finally, there are increased sales by on-line and other nontraditional retailers, many of which are located in other states. Retail employment is expected to grow by 0.1% in 2010 and 0.6% in 2011.

Information

The information industry contains a diverse group of industries including newspapers, media outlets, sound studios, and technology-oriented industries such as telecommunications, data processing, web site development, and web publishing. Most of these industries are cyclically sensitive, and portions of the industry such as media are under substantial long-term pressure as advertising revenues have dropped both due to the recession and due to a shift of advertising to on-line and wireless platforms. There also have been very substantial increases in labor productivity in areas such as telecommunications and publishing. These factors point to both a long-term decline in employment and sharp declines in the current recession. Preliminary data suggest a 5.5% decline (1,000 jobs) in 2009. A further decline of 1.7% is expected in 2010 and employment will be flat in 2011.

Financial Services

The financial services industry comprises a diverse group of related industries including finance, insurance, and real estate. The trend in these industries is for strong, stable growth as the need for financial and insurance services grows in our increasingly complex, service-oriented economy. Nebraska is also a national leader in the insurance industry, and has a number of strong, growing regional banks.

The industry, however, has been impacted by current weakness in the housing sector. Housing related industry segments such as real estate, loan activity, and mortgage brokers were weak in 2009 and may only begin to recover with the housing market in 2010. Preliminary data suggest that industry employment was down by -0.2% in 2009. Employment growth will return as the economy and housing sector recover. Employment growth of 1.3% is anticipated for 2010, with job growth accelerating to 2.0% in 2011.

Services

The services sector accounts for 37% of employment in the Nebraska economy and contains a diverse group of industries. Services includes some of the fastest growing parts of the economy such as professional, scientific and technical services and other types of business services, as well as the largest industries in the economy such as health care. Services also includes the hospitality industry, encompassing lodging, food

services, drinking places, and arts, entertainment, and recreation businesses.

During an economic expansion, service sector employment expands at a healthy pace. Demand for services from both people and business grow quickly. In a typical year, service sector employment will grow by 2% to 2.5%.

Portions of the industry such as health care also grow steadily, largely avoiding cyclical patterns. However, portions of the industry closely follow the business cycle, expanding rapidly when the economy expands and declining when the economy is in recession. These cyclical portions of the industry such as business services shed employment during 2009. Preliminary data indicate a 1.2% decline in services industry employment in 2009.

Job growth will return to the industry as the economy recovers in 2010 and 2011. Growth will be broad-based including the hospitality industry and education services. Very rapid job growth is expected for business services industries such as professional, scientific, and technical services, administrative and support services, and management of companies, especially in 2011. Overall service sector job growth will reach 2.2% in 2010 and 2.7% in 2011.

Government

Federal government employment grew in 2009 and is expected to grow in 2010 due to the decennial Census. Workers were hired in 2009 in preparation for the Census and will be hired in 2010 to carry-out the Census. In the past the cumulative impact of the Census was to increase Federal employment in Nebraska by approximately 5%. We anticipate a roughly 2.5% increase in employment in both 2009 and 2010. Those jobs will be shed by 2011.

Stimulus funding and an expansion of state funding for local schools helped underpin strong job growth in state and local government employment during 2009. Preliminary data suggest a 2.5% increase in state and local government employment in Nebraska in 2009. Most of that increase was in local government employment, which includes schools. Growth will return to the trend rate of 0.8% in both 2010 and 2011.

Personal Income

Declining employment in 2009 led to slow growth in nominal income (income growth which includes inflation) during the year. As seen in Table 4, nonfarm income grew by just 1.5% in 2009. Income growth, however, will reach normal levels as employment growth returns to Nebraska in 2010, and accelerate to strong growth in 2011. Farm income declined in 2009 compared to record breaking levels in 2008. However, 2009 farm income is above its 10-year average and there will be modest growth in farm incomes in 2010 and 2011.

Table 4— Comparison of Forecasts for Nominal Income

Nonfarm Income

	June 2009 Forecast	Current Forecast
2008	4.4%	3.3%
2009	2.5%	1.5%
2010	4.8%	3.9%
2011	5.1%	5.0%

Farm Income

	June 2009 Forecast	Current Forecast
2008	19.0%	34.5%
2009	-24.5%	-33.4%
2010	1.6%	8.2%
2011	9.7%	3.4%

Note: Nominal income growth includes inflation.

Nonfarm Personal Income

Nonfarm personal income growth slowed to just 1.5% in 2009 with recession conditions hurting wage and salary income, and especially proprietor and dividend, interest, and rent income. As seen in Table 4, nonfarm personal income growth will improve to 3.9% as employment growth returns in 2010, and grow by 5.0% in 2011.

As seen in Table 5, nonfarm wage and salary income will grow by 4.4% in 2010 and 5.1% in 2011. Growth in employee benefits (other labor income) will match growth rates in wage and salary income. Thus, employer contributions to worker benefits, including health insurance, will rise at a moderate rate throughout the period. As a result, workers will be responsible for paying a significant share of the increase in health care costs. Non-farm proprietor income will contract in 2009, but snap back sharply as the economy improves in 2010 and 2011. Proprietor income is typically very pro-cyclical.

Table 5—Nonfarm Personal Income and Selected Components and Net Farm Income (USDA) ($ millions)

	Consumer Price Index	Nonfarm Personal Income	Dividends, Interest, & Rent	Total Personal Current Transfer Receipts	Nonfarm Wages & Salaries (Wages & Salaries — Farm Wages)	Other Labor Income	Contributions to Social Insurance	Residential Adjustment	Nonfarm Proprietor Income	Net Farm Income (USDA)
Millions of Dollars										
1999	166.6	$44,484	$9,288	$5,802	$25,144	$5,179	$4,043	-$783	$3,896	$1,707
2000	172.2	$47,557	$10,108	$6,088	$26,649	$5,546	$4,225	-$854	$4,243	$1,453
2001	177.1	$49,569	$10,086	$6,693	$27,573	$5,981	$4,411	-$871	$4,518	$1,914
2002	179.9	$51,247	$10,095	$7,127	$28,474	$6,538	$4,553	-$902	$4,468	$867
2003	184.0	$53,071	$10,101	$7,424	$29,458	$7,136	$4,716	-$956	$4,624	$2,762
2004	188.9	$55,068	$9,926	$7,783	$30,857	$7,399	$4,924	-$971	$4,998	$3,587
2005	195.3	$57,190	$10,177	$8,210	$32,095	$7,836	$5,187	-$991	$5,051	$2,973
2006	201.6	$61,125	$11,471	$8,833	$33,905	$8,144	$5,595	-$960	$5,327	$2,020
2007	207.3	$64,289	$12,354	$9,982	$35,817	$8,383	$5,793	-$1,064	$5,209	$2,994
2008	215.3	$66,383	$12,426	$10,076	$37,010	$8,654	$5,984	-$1,081	$5,283	$4,026
Forecast Number										
2009	214.6	$67,390	$11,950	$10,650	$37,935	$8,897	$6,194	-$1,105	$5,257	$2,680
2010	218.9	$70,051	$12,129	$11,179	$39,601	$9,297	$6,536	-$1,131	$5,510	$2,900
2011	224.4	$73,532	$12,479	$11,762	$41,632	$9,715	$6,849	-$1,157	$5,951	$3,000
Forecast % (nominal growth)										
2009	-0.3%	1.5%	-3.8%	5.7%	2.5%	2.8%	3.5%	2.1%	-0.5%	-33.4%
2010	2.0%	3.9%	1.5%	5.0%	4.4%	4.5%	5.5%	2.4%	4.8%	8.2%
2011	2.5%	5.0%	2.9%	5.2%	5.1%	4.5%	4.8%	2.3%	8.0%	3.4%

Source: http://www.bea.gov, 2009

Note: Nominal income growth includes inflation.

As is often the case, transfer income will grow fastest during recession. Transfer income will grow by 5.7% in 2009, before falling back to 5.0% growth in 2010 and 5.2% growth in 2011. All of these growth rates in 2010 and 2011 are above the expected rate of inflation.

Farm Income

As is evident in Table 5, there has been substantial volatility in farm incomes in recent years. These fluctuations have been due to external factors beyond the producers' control – the dollar exchange rate, the price of oil on world markets, consumer shifts in diet under financial constraints, and global agricultural production levels. The sharp decline in Nebraska farm incomes in 2009 (after hitting record levels in 2008) align with USDA forecasts for the entire U.S. farm sector. In 2009, crop commodity prices fell from their high levels in 2008, while both crop and livestock producers faced higher input costs going into 2009.

Income conditions are highly diverse in agriculture. While crop producers have experienced a generally favorable year in 2009 despite high fertilizer input costs and lower crop prices, livestock producers have struggled to break even. In fact, with weak meat and dairy prices, many livestock producers have seen continued losses in 2009, and in some cases, financial stress threatening their long-term economic survival.

Looking forward to 2010 and beyond, there are forces in place which suggest some optimism for future farm income levels. Fertilizer prices have fallen by more than 50% from a year earlier. The dollar decline against other currencies, if it holds, will encourage more agricultural exports of both crops and livestock/meat. Further, the population base of global demand continues to grow at a rate of 78 million additional persons per year, which also will encourage exports. Finally, the falling dollar, by increasing the price of oil, also lifts ethanol prices. Ethanol plants that were shut down or running at less than full capacity have now come back on line, which should help support corn prices. We anticipate that farm income will rise to $2.9 billion in 2010, or an 8.2% increase. Farm income will rise another 3.4% to $3.0 billion in 2011.

Net Taxable Retail Sales

In Table 6, data on net taxable retail sales are divided into motor vehicle sales and non-motor vehicle sales. The distinction is important. Motor vehicle net taxable sales are growing over time, but from year to year follow a cyclical pattern. Non-motor vehicle taxable sales rise steadily, but are affected by business cycles and periodic changes to Nebraska's sales tax base. During the outlook period, we do not anticipate changes in the sales tax base, but the economic recession and recovery will influence taxable sales.

With a weak economy in 2009, non-motor vehicle taxable sales declined by 2.8%. This decline was reinforced by a small decline in the consumer price index in 2009. With the economy recovering, non-motor vehicle taxable sales growth will increase to 3.2% in 2010 and 4.1% in 2011. Both growth rates will exceed inflation rates, and are consistent with growth in retail sector employment, and with improved growth in hospitality industry activity, much of which is subject to state sales tax.

Motor vehicle net taxable sales, always very cyclical, began a sharp turn-around in 2007, growing by 9% and by 1.4% in 2008 after years of decline. Given the often discussed collapse of auto sales in the United States in 2009, there was a 6.0% decline in Nebraska motor vehicle sales in that year. Motor vehicle sales in Nebraska will improve in 2010, and especially 2011, as the economy and automobile sales improve across the nation. An increase of 5.7% is anticipated for 2010, and growth of 11.4% is expected in 2011.

Overall net taxable sales (from both sources) declined by 3.2% in 2009. This substantial decline is consistent with downward revisions in overall Nebraska state tax revenue during the year. Growth will return during 2010, with growth in total taxable sales of 3.5% as the Nebraska economy rebounds. Growth will be strong in 2011, due to improving non-motor vehicle taxable sales and a sharp increase in motor vehicle sales. Growth will reach 4.9% in 2011. Both growth rates will exceed the rate of inflation.

Table 6—Net Taxable Retail Sales, Annual Totals ($ millions)

	Consumer Price Index	Total Net Taxable Sales	Motor Vehicle Net Taxable Sales	Non Motor Vehicle Net Taxable Retail Sales
Millions of Dollars				
1999	166.6	$19,806	$2,520	$17,286
2000	172.2	$20,443	$2,605	$17,838
2001	177.1	$21,057	$2,897	$18,160
2002	179.9	$21,426	$2,926	$18,500
2003	184.0	$22,092	$2,894	$19,199
2004	188.9	$23,618	$2,885	$20,733
2005	195.3	$24,443	$2,751	$21,691
2006	201.6	$24,978	$2,661	$22,317
2007	207.3	$26,237	$2,902	$23,335
2008	215.3	$26,664	$2,943	$23,721
Forecast Number				
2009	214.6	$25,823	$2,767	$23,057
2010	218.9	$26,719	$2,924	$24,795
2011	224.4	$28,028	$3,258	$24,770
Forecast % (nominal growth)				
2009	-0.3%	-3.2%	-6.0%	-2.8%
2010	2.0%	3.5%	5.7%	3.2%
2011	2.5%	4.9%	11.4%	4.1%

Source: Nebraska Department of Revenue, 2009
Note: Nominal taxable sales growth includes inflation.

Our Thanks …

The Bureau of Business Research is grateful for the help of the Nebraska Business Forecast Council. Serving this session were

- John Austin, Department of Economics, UNL;
- Chris Decker, Department of Economics, UNO;
- Tom Doering, Nebraska Department of Economic Development;
- Ernie Goss, Department of Economics, Creighton University;
- Bruce Johnson, Department of Agricultural Economics, UNL;
- Ken Lemke, Nebraska Public Power District;
- Bill Lock, Nebraska Legislative Council;
- Shannon Ramaeker, Nebraska Department of Labor;
- Franz Schwarz, Nebraska Department of Revenue;
- Scott Strain, Greater Omaha Chamber of Commerce;
- Eric Thompson, Bureau of Business Research, UNL;
- Keith Turner, Department of Economics, UNO (emeritus)

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