Remarks at a Forum on Opportunities and Challenges Facing New England's Smaller Industrial Cities

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It is a pleasure to be with you today in Worcester as we discuss the opportunities and challenges facing New England's smaller industrial cities.[1] At the Federal Reserve Bank of Boston, we are very pleased to be collaborating with our co-sponsors in organizing this forum – the Mosakowski Institute for Public Enterprise, MassINC, and the Rappaport Institute for Greater Boston.

I would like to briefly frame the economic context that prevails as we gather today. I think the economic backdrop only underscores the importance of a practical and constructive forum like this one, and the need for collaboration and leadership – which are themes of particular focus at this event.

I should note, of course, that the views I express today are my own, and not necessarily those of my colleagues on the Federal Reserve's Board of Governors or the Federal Open Market Committee (the FOMC).

The deep recession and slow recovery have had a significant impact on New England's cities. At the same time, we should note that our experience of late in New England has been less severe than that of the nation. The unemployment rate for New England in May, the latest month we have a regional number for, was 7.9 percent – high, but well below the 9.1 percent rate for the nation as a whole in May (a number that climbed to 9.2 percent in June). Many of our cities, particularly in the northern half of New England, have unemployment rates well below the national average. Also, many cities in New England did not experience the extremes of boom and bust in residential real estate that plagued some cities elsewhere in the country.

As the economy continues its slow recovery, there are significant opportunities but also daunting challenges facing our cities. But before discussing those opportunities and challenges, I would like to briefly describe the national economic outlook.

The National Economic Outlook

As we consider the national outlook, I would note that some have referred to the first half of this year as a "slow patch" in the recovery. I am not sure that phrase is quite right, however – the notion of a slow patch suggests strong growth that has been temporarily interrupted by some sort of headwind or shock, like natural disasters or extreme weather that crimps economic activity. I would instead describe the past two years as a consistently weak recovery, interrupted by a period of stronger growth. Let me add that a weak recovery like we have seen is, unfortunately, typical of recoveries after a financial crisis.[2]

Figure 1 shows growth in what we call real final sales, which represents the goods and services produced in the economy, not including inventories. If one assumes that the economy needs to grow faster than 2.5 percent – an estimate of what economists call its potential – to yield much improvement in the unemployment rate, you see that we have had only one strong quarter in this recovery (the fourth quarter of 2010).

Also, **Figure 2** shows that consumers have been particularly tentative during the recovery. The only quarter in which we saw consumption growth in excess of 2.5 percent during this recovery was that same fourth quarter of 2010.

In short, the only quarter of strong economic growth so far in this recovery has been the one containing the holiday season at the end of last year. With housing activity and government spending likely to continue to be unusually weak for a recovery, we need to see consumer and business confidence improve so that consumption and investment can offset the weaker growth in other components of gross domestic product (GDP).

The first half of this year saw the economic recovery impacted by the tragic destruction in Japan, which disrupted manufacturing supply chains, as well as weather issues ranging from severe winter conditions to damaging floods. The result is that growth in the first half of this year is likely to be roughly 2 percent.

As the effects of these problems fade, we do expect a rebound in purchases of consumer durables to yield stronger growth in the third quarter. I expect economic growth over the second half of this year to average somewhere in the range of 3.0 to 3.5 percent. While this represents an improvement from the first half, it is still quite slow given the amount of slack in the economy, and slower than I had expected at the beginning of this year.

While we are seeing some positive economic signs such as equipment and software spending, and growth in exports, the employment report issued last Friday was dismal. The national unemployment rate rose slightly (a tenth of a percent) to 9.2 percent in June. And net job growth was very weak over the last two months – job growth averaged only 21,500 over the two-month period of May and June.[3] The employment-to-population ratio fell to 58.2 percent, matching the 28 year low that we have hit a few times in this recovery.[4]

Not surprisingly, with so much painful slack in the labor market we are not seeing any significant wage pressure – average hourly earnings fell slightly this month and have increased only 1.9 percent over the past year – which is consistent with a continued low inflation rate in the medium term. As **Figures 3** highlights, wages are not likely to place much upward pressure on inflation since compensation is growing only slowly, given weak job markets. In addition, **Figure 4** shows that many commodity prices have stabilized or retreated from their recent highs. These factors give monetary policy the leeway to remain accommodative, so as to provide the monetary conditions for improved economic growth.

In addition, there are significant downside risks associated with an outlook that includes only very slow improvement in the economy. The headlines from Europe continue to remind us of this. With fiscal austerity slowing down economies both here and abroad, it will in my view be important to maintain sufficiently accommodative U.S. monetary policy so that national labor market conditions can improve.

Opportunities and Challenges for New England's Mid-Sized Cities

So the national outlook is for a continued slow recovery, which of course factors into the opportunities and challenges for New England's mid-sized cities we have come together to discuss today.

Also, with widespread pressure for fiscal austerity not only impacting Federal budgets but also budgets at the state and local level, I think we should acknowledge the acute challenges that cities face in prioritizing expenditures to ensure that program cuts do not impair the ability of their communities to prosper over the long term.

As we think about their opportunities and challenges, I think it is useful to highlight some of the trends in New England's mid-sized cities relative to New England as a whole, and the nation. For example, **Figure 5** highlights the differences in the populations of our mid-sized cities and the rest of the region and the country with respect to *age*, at roughly decade intervals. The most recent data suggest that New England as a whole now has a greater portion of people over 65 and a smaller portion of people under 15, and age 15 to 24, than the U.S. However, the residents of the region's small and mid-sized cities are on average younger than the rest of New England – with a smaller share of people over 65 and a larger share of people 15 to 24 than both the region and the nation. As for the portion of people under 15, these cities exceed the region and are basically on par with the nation.

In exploring these trends and characteristics, I would like to offer a few possibilities – in the interest of generating discussion today.

First, it may be that younger workers "just starting out" are especially receptive to training for jobs in a growing sector. So this younger profile of our mid-sized cities, and the fact that they are often the site of medical facilities serving the surrounding communities, together highlight a potential opportunity. Many of the mid-sized cities may be able to build on their medical-services base. While medical employers require highly skilled doctors and nurses, they also hire a variety of other employees in positions that often require only an associate's or bachelor's degree. Indeed, our analysis suggests that the number of jobs in the healthcare industry as a percent of total jobs is much higher for these mid-sized New England cities than it is for the region as a whole, or for the nation.[5]

Worcester is a particularly good example of this, being home to hospitals, the University of Massachusetts medical school, and medical research firms. Other cities in the region have major medical facilities with spillover benefits to the broader community, including Providence (with Brown medical school and partner hospitals), New Haven (with Yale school of medicine and Yale-New Haven Hospital), greater Hartford (with the University of Connecticut Health Center in the Hartford suburb of Farmington), and Springfield (with Baystate Medical Center).

Turning to *educational* characteristics in these cities, **Figure 6** shows the percent of the population with a bachelor's degree or higher, and with some college education or an associate's degree – again at roughly decade intervals. New England has a much higher percentage of college graduates than the nation as a whole, but a smaller percentage of people with some college education or an associate's degree. In contrast, the mid-sized cities have a smaller percentage than New England or the U.S of people with a bachelor's degree or higher, or some college education or an associate's degree. The trend is up in these cities, however, over time.

This is particularly significant when we note that the unemployment experience over the past decade has been quite different when segmented by educational attainment, as shown in **Figure 7**. This is particularly true over the past several years, when the unemployment rates by educational attainment have widened significantly from where they were 10 years ago.

All this may suggest that community colleges can and should play a larger role in many of our mid-sized cities. Community colleges in New England have played less of a role in workforce development than in some parts of the country, where there is a very close connection between employers (and potential employers) and the curricula developed and offered at community colleges. As we think about future developments in our mid-sized cities, it is important that leaders at community colleges and local business leaders work together in the ongoing development of specialized curricula that will meet the evolving needs of local employers.

Figure 8 shows that mid-sized cities in New England are increasingly *diverse*. Mid-sized New England cities have a much higher proportion of individuals who were born outside of the U.S. than the rest of New England or the country, and this has intensified over recent decades. These cities also have a much higher percentage of individuals who are not proficient English speakers. This highlights a potential impediment to getting higher education or some jobs.

The availability of English classes remains extremely important, and increasingly so. The same is true for providing greater access to government programs for those with limited English. For example, a working paper by the Bank's Ana Patricia Muñoz shows that small business entrepreneurship programs often do not target Latino populations.[6] State and Federal programs designed to help fund or provide technical assistance to small businesses may need to increasingly tailor some of their programs to fit the needs of local populations.

However, despite these challenges I believe that the diversity in our mid-sized cities can also be a decided advantage. Let me show another chart, **Figure 9**, which instead of foreign born and limited English speakers simply indicates the portion of the population that is Hispanic, and the portion that is African American. You see again that while New England as a whole may be less diverse than the rest of the nation, our mid-sized cities are more diverse -- and increasingly so over the decades. Finding ways for businesses to reach diverse populations is likely to become increasingly important as the country as a whole becomes more diverse, and as technology allows even small companies to reach markets in other countries. A product or service developed by or for a diverse population in Worcester or Hartford or another mid-sized city may be a first step toward accessing diverse markets in the U.S., or even globally.

Moreover, developing successful entrepreneurs within a diverse population could of course be a source of local economic development. The Muñoz paper finds Latino businesses starting up in many of New England's mid-sized cities, and this can be a source of future job growth if some of these businesses can grow.

Finally and importantly, I would observe that while New England has fared better than the rest of the country during the recession and the early stages of the recovery, the same is not true for our mid-sized cities, as shown in **Figure 10.** Unemployment rates are much higher in the mid-sized cities than they are in New England or the country as a whole, in contrast to 10 years ago when the unemployment rates in the region's mid-sized cities were below the national average.

Concluding Observations

In summary and conclusion, our mid-sized cities are on average younger, proportionally less advanced in education, and more diverse than the rest of New England. This provides both opportunities and challenges, as I have noted.

As many of these cities are regional centers, further developing their activities as medical and educational centers will be important, particularly given their younger population compared to New England as a whole.

A theme for this conference is the need to build collaborative leadership. Leaders in government will need to work collaboratively with leaders in education, the sciences, and businesses more generally, and find ways to take advantage of some of the differences we see in our mid-sized cities.

I think we all know this, and the challenge is in finding the best ways to do so, to everyone's benefit. It is our hope that this forum will be one avenue for supporting and advancing that collaboration.

Thank you.

NOTES:

[1] We define mid-sized cities in New England as those with a population ranging from 75,000 to 250,000, excluding "suburb cities" within 20 miles of Boston – specifically, Bridgeport, CT; Danbury, CT; Hartford, CT; New Haven, CT; Norwalk, CT; Stamford, CT; Waterbury, CT; Brockton, MA; Fall River, MA; Lawrence, MA; Lowell, MA; Lynn, MA; New Bedford, MA; Springfield, MA; Worcester, MA; Manchester, NH; Nashua, NH; Cranston, RI; Providence, RI; and Warwick, RI.

[2] As I have discussed in other forums, the following dynamic forms one explanation for why recessions that are accompanied by problems at financial intermediaries tend to be deeper recessions, followed by slower recoveries. Banks experiencing large losses are often reluctant to raise additional capital – either because it could signal financial problems or be perceived as an attempt to avoid diluting existing shareholders. Instead, firms that choose not to raise additional capital often satisfy capital-to-assets requirements *by shrinking their assets*, and more importantly for the real economy, *reducing their willingness to lend* (loans are assets on a bank's balance sheet). If this behavior is widespread, it can significantly reduce credit intermediation. Earlier in my career I studied this dynamic with my colleague Joe Peek, and our research found such behavior during the credit crunch period in the United States during the 1990 recession and during the Japanese banking crisis.

See the following from Peek and Rosengren: "The Capital Crunch: Neither a Borrower nor a Lender Be," Journal of Money, Credit and Banking, vol. 27, no. 3 (August 1995): 625-638. "Bank Regulation and the Credit Crunch," in the Journal of Banking & Finance, Volume 19, Issues 3-4, June 1995, pages 679-692. "The International Transmission of Financial Shocks: The Case of Japan" in the American Economic Review vol. 87, no. 4 (September 1997), pages 495-505. "Collateral Damage: Effects of the Japanese Bank Crisis on Real Activity in the United States" in the American Economic Review, vol. 90, no. 1 (March 2000), pages 30-45. "Unnatural Selection: Perverse Incentives and the Misallocation of Credit in Japan" in the American Economic Review, vol. 95(4), September 2005, pages 1144-1166.

[3] About 18,000 jobs were added in June and the May figure was revised to 25,000. The percent change over the two months is 0.03%. Employment rose by an average of 215,000 jobs per month from February through April but now has averaged 21,500 jobs over the past two months.

[4] The employment-to-population ratio hit 58.2 percent in Dec. 2009, Nov. 2010, and June 2011. It was 58.1 percent in July of 1983.

[5] Using data from the Economic Census, the figure for health care employment in mid-sized cities is almost 30 percent – twice as large a proportion as for the U.S. or New England – but it should be noted that the figures are calculated as a percent of total jobs that are available in the Economic Census, which excludes several job-heavy sectors (like elementary and secondary schools, colleges and universities, public administration and employees in most government owned establishments like public utilities). Using different data sources that include many of these sectors suggests health care is over 22 percent of jobs in mid-sized Massachusetts cities, just under 15 percent in New England, and around 12 percent in the U.S. *Either approach suggests that health care is a very important sector for jobs, in absolute terms and compared to the U.S. and rest of New England.*

[6] Ana Patricia Muñoz, "Small Businesses in Springfield, Massachusetts: A Look at Latino Entrepreneurship", a Federal Reserve Bank of Boston Community Development Discussion paper with Lynn Browne, Sol Carbonell, Prabal Chakrabarti, DeAnna Green, Yolanda K. Kodrzycki, Anna Steiger, Richard Walker, and Bo Zhao (2011). Available on the Bank's public website at the following link: http://www.bostonfed.org/commdev/pcadp/index.htm

Collaboration and Leadership in Smaller Industrial Cities

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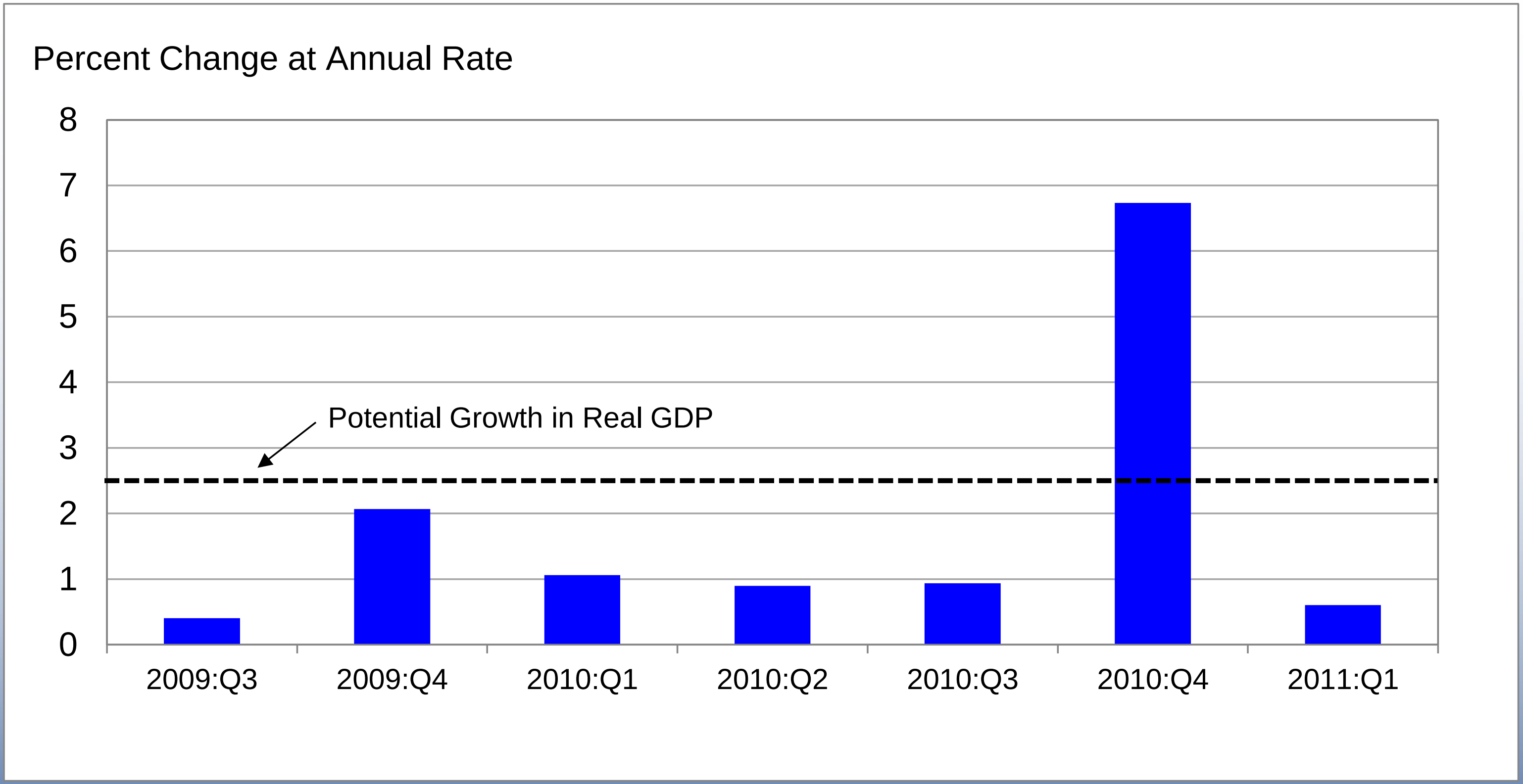
Figure 1
Growth in Real Final Sales

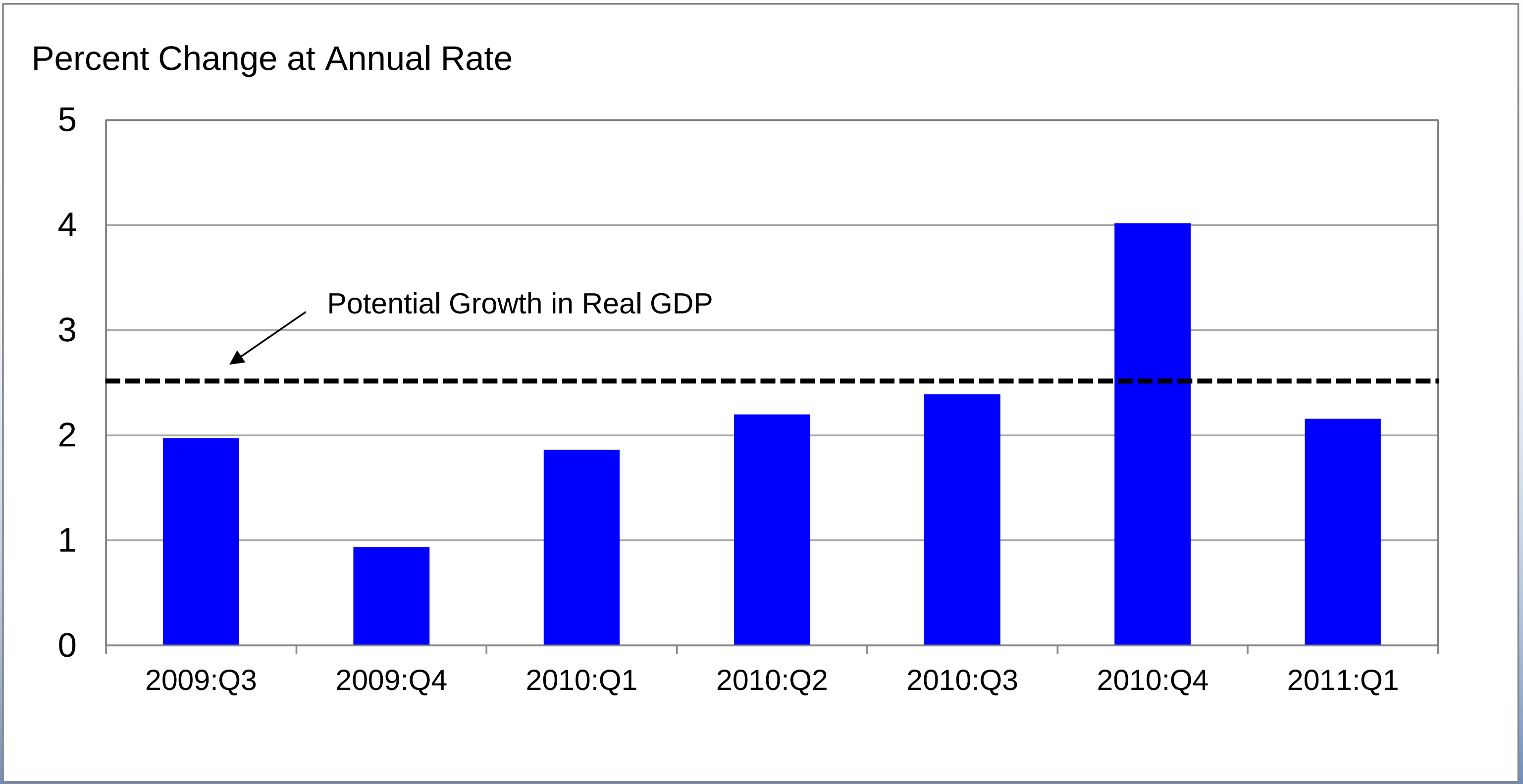
2009:Q3 - 2011:Q1



Source: BEA / Haver Analytics

Figure 2
Growth in Real Consumption

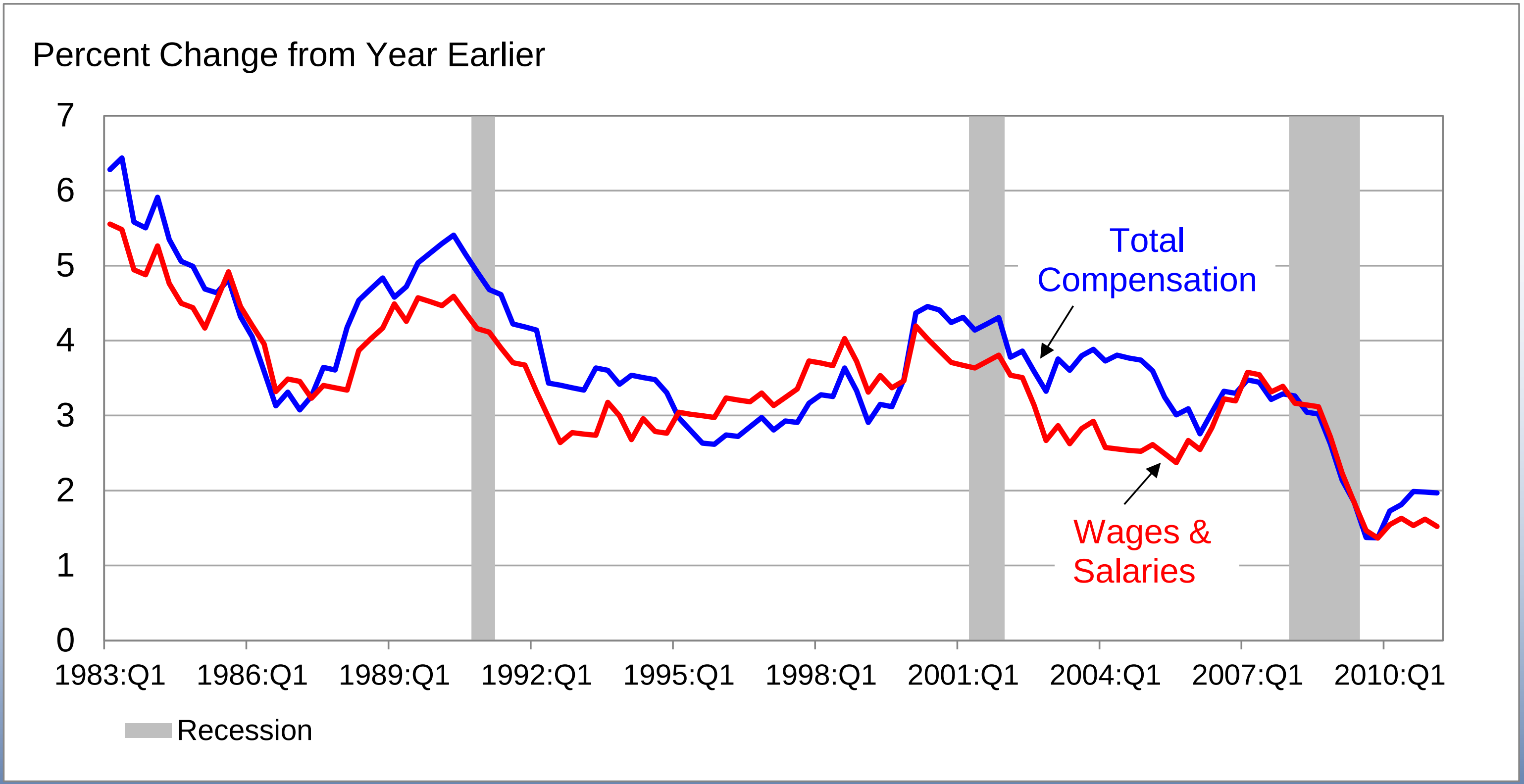
2009:Q3 - 2011:Q1



Source: BEA / Haver Analytics

Figure 3
Employment Cost Indexes for Civilian Workers

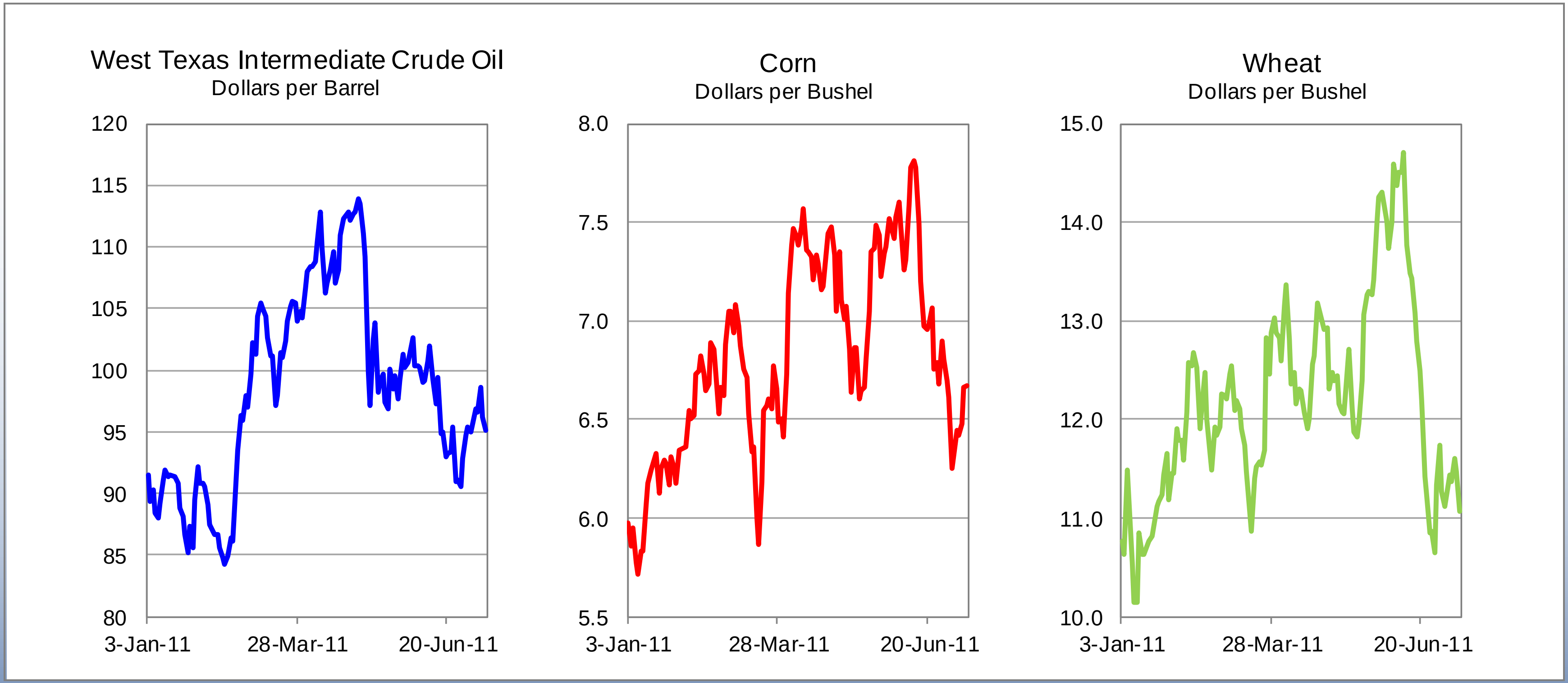
1983:Q1 - 2011:Q1



Source: BLS, NBER / Haver Analytics

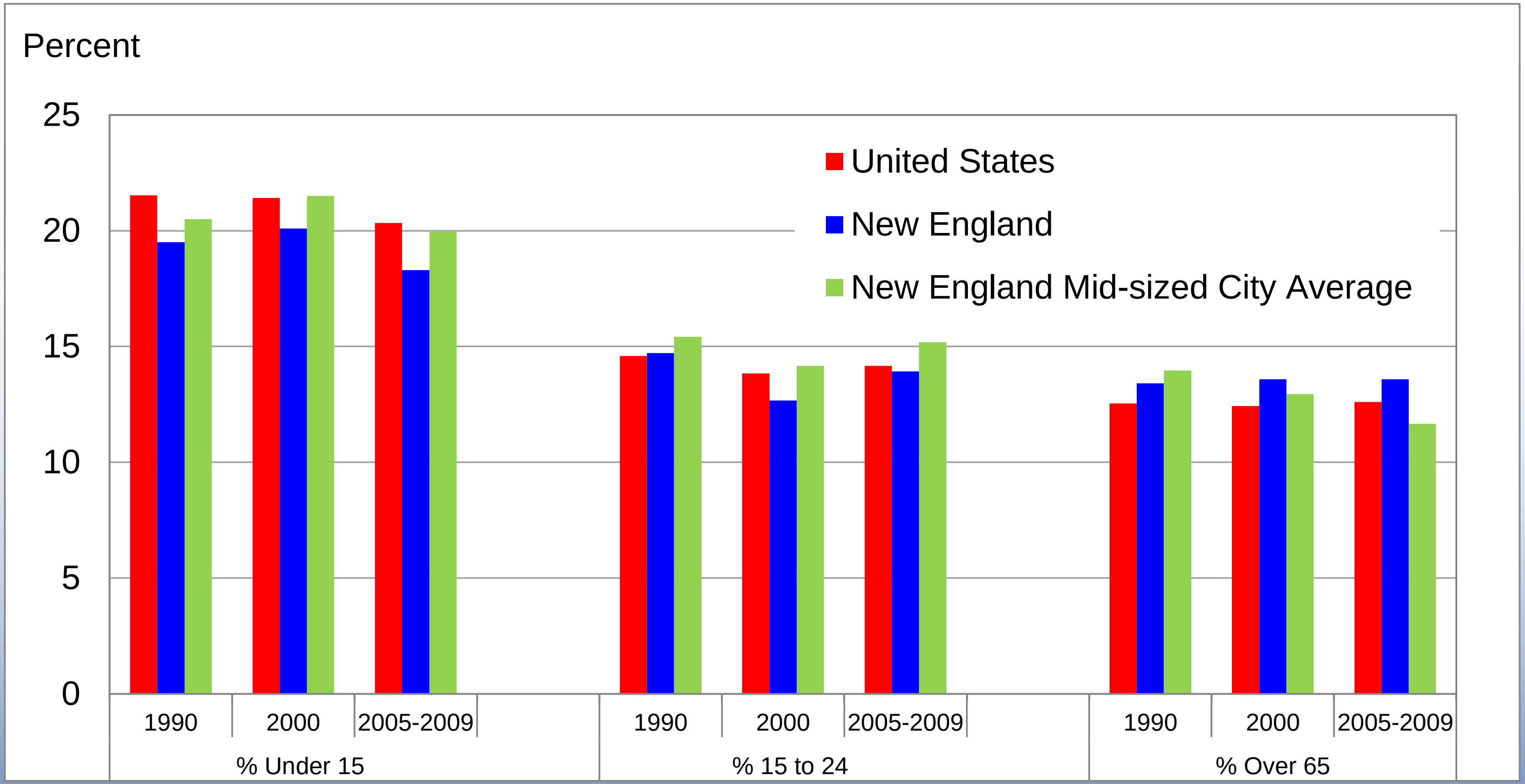
Figure 4
Commodity Prices

January 3, 2011 - July 11, 2011



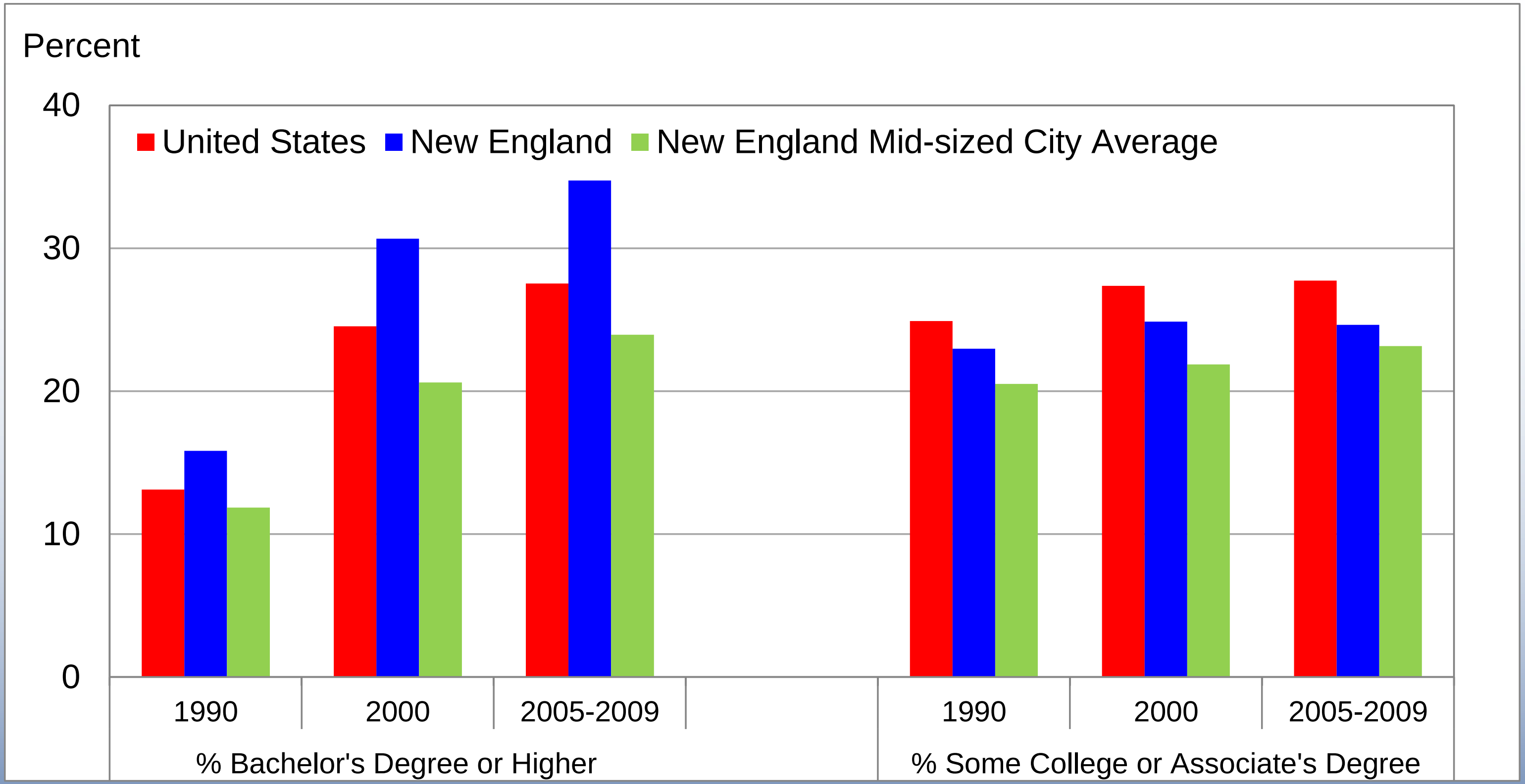
Source: WSJ / Haver Analytics

Figure 5
Selected Age Groups as a Share of Total Population



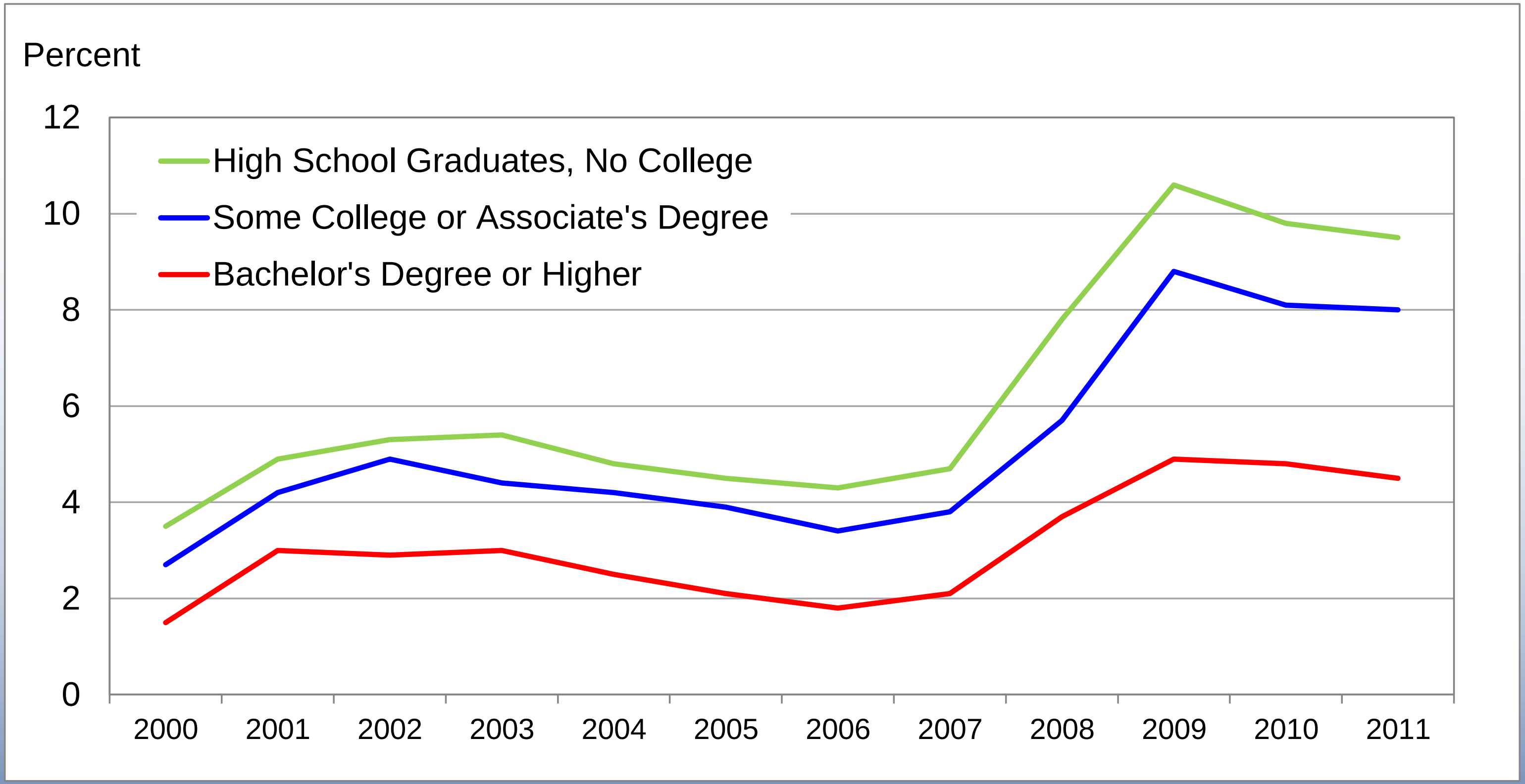
Source: Census Bureau (1990 and 2000), American Community Survey (2005-2009, 5-Year Estimates)

Figure 6
Educational Attainment of Population 25 Years and Older



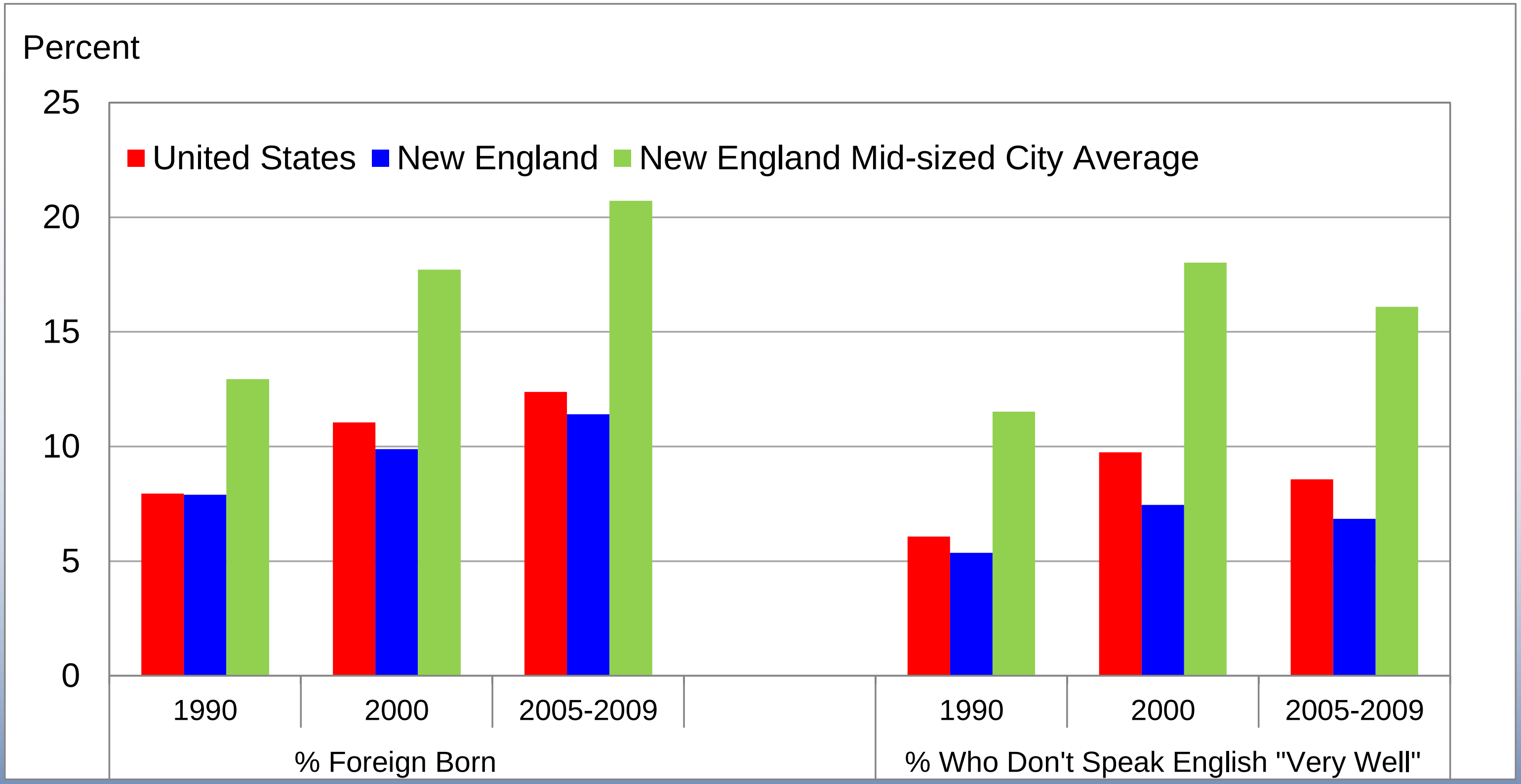
Source: Census Bureau (1990 and 2000), American Community Survey (2005-2009, 5-Year Estimates)

Figure 7
United States Unemployment Rate by Educational Attainment



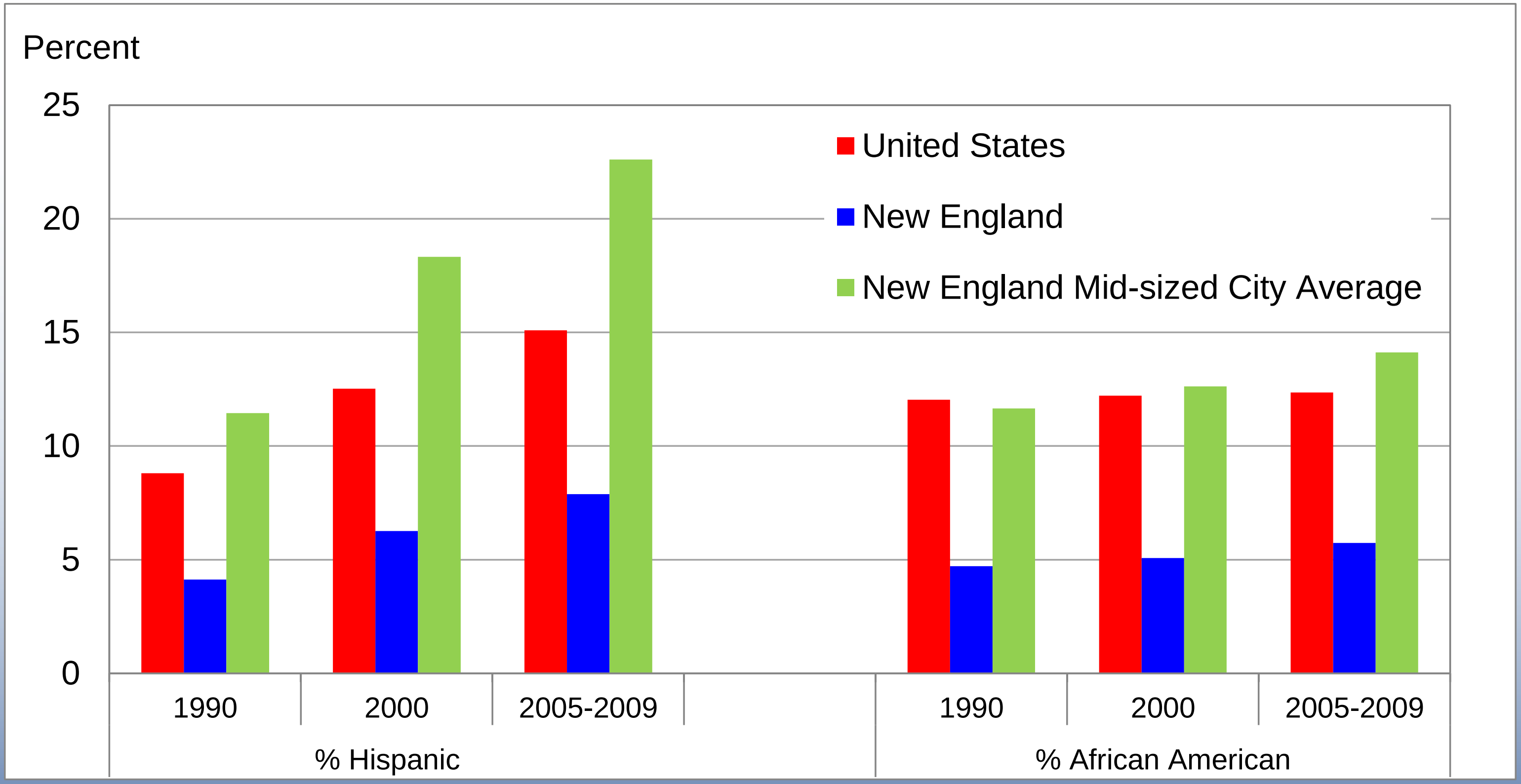
Note: Figures are for December of each year from 2000-2010 and for May 2011 and for population 25 years and over
Source: Census Bureau and BLS, Current Population Survey

Figure 8
Foreign Born and Limited English Shares of Total Population



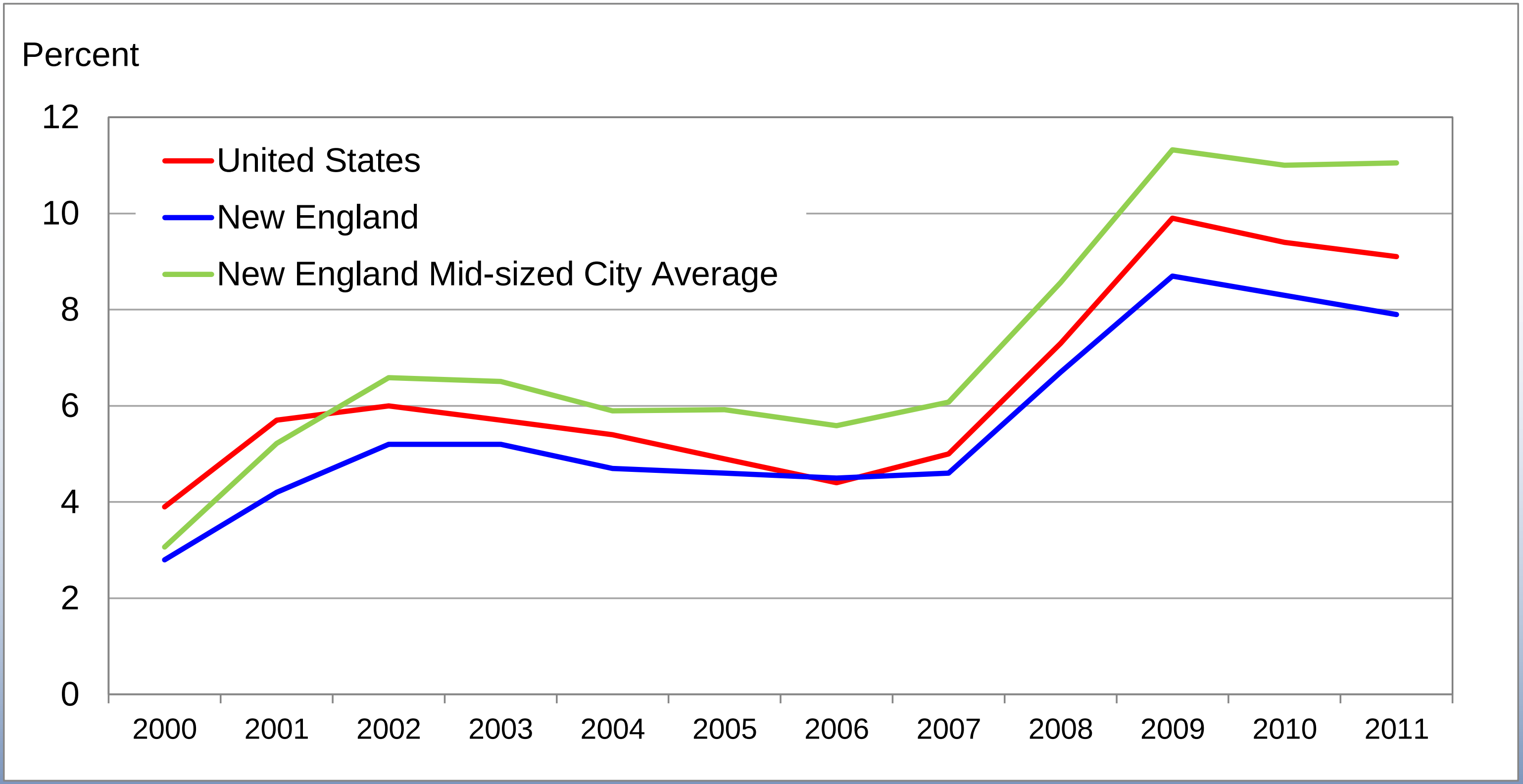
Source: Census Bureau (1990 and 2000), American Community Survey (2005-2009, 5-Year Estimates)

Figure 9
Hispanic and African American Shares of Total Population



Note: A small number of persons self-identified as both African American and Hispanic are included in both shares
Source: Census Bureau (1990 and 2000), American Community Survey (2005-2009, 5-Year Estimates)

Figure 10
Unemployment Rate for the United States, New England, and New England Mid-sized Cities



Note: Figures are for December of each year from 2000-2010 and for May 2011
Source: Census Bureau and BLS, Current Population Survey / Haver Analytics