

New England's Economy: The Current Outlook and Challenges Ahead

**by Cathy E. Minehan, President & Chief Executive Officer
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Good afternoon. It's a pleasure to be here with you today, and to enjoy, if only for a short while, the beauty of the Connecticut River Valley. I'd like to thank Congressman Neal for his invitation to share some perspectives on where things are right now and the broad challenges going forward.

I will focus most of my remarks on the New England economy, but a few thoughts on the national scene can act as a useful backdrop. Overall domestic trends are undoubtedly positive. The remarkable combination of solid growth, low unemployment, quiescent inflation, and a declining federal budget deficit provide a solid basis for economic progress in New England and in the rest of the U.S. as well. Signals of capacity constraint in the face of above-trend growth could point to higher rates of inflation in the future. But as yet, there are almost no signs of increasing price pressures. In fact, one has to look back to the 1960s to find such an extended period of low unemployment and inflation.

As for the view ahead, domestic fundamentals continue to look positive. Job growth and personal income are strong, and these are the primary drivers of consumption. While the full impact of the Asian crisis has yet to unfold, for now most businesses are in good shape, with investment spending by firms one of the principal stars of this business cycle expansion. To a central banker, however, there are always reasons to be cautious, vigilant, and forward-thinking, and I certainly would not want to break from that mold.

Here in New England, the economy is performing remarkably well. The unemployment rate -- 3.9% in December, and 4.1% in the Springfield area for November-- is lower than the unemployment rate for the nation as a whole. Given the steep downturn experienced at the end of the 1980s, the fact that we as a region are now operating above the level of our pre-recession job high in 1989 is a cause of great satisfaction to me.

In evaluating our current situation, it helps to recall the characteristics of the '80s boom. Then, as now, New England enjoyed a low unemployment rate. But the two periods are also fundamentally different. While New England in the '80s grew in ways that were with hindsight overheated and unbalanced, the region's current prosperity stands on a firmer footing, for several reasons.

First, while the region's current unemployment rate is lower than that for the country as a whole, most of our labor markets are not significantly tighter. The demographics of our workforce tend to produce an unemployment rate somewhat below the national average, all other things being equal. And wages of manufacturing production workers in New England have been rising at roughly the same rate as they have nationally. This stands in contrast to the '80s, when wages here increased much faster than nationally.

The last recession hit New England earlier and much harder than it did the nation as a whole. As a result, as I mentioned before, we are now just back to the employment peak reached in the late '80s. And some areas have not yet fully recovered. Springfield's employment level is still about 6 percent lower than its peak, despite the low unemployment rate I mentioned earlier. This juxtaposition of unemployment rates versus job growth can be confusing. How can New England have such low unemployment rates and yet just be getting back to where its employment level was in the late '80s?

The answer is that, in the early '90s, New England's labor force declined, as potential workers stopped looking for work

or moved out of the region in search of better opportunities, while the national labor force grew substantially. The reduced pool of workers in New England helped drive down our unemployment rate early in the expansion. More recently, our labor force has grown, as improved conditions induced more people to return to work, and attracted workers to the region.

A second reason for the improvement in the regional outlook is the widespread perception that the New England states generally, and the Commonwealth, in particular, have become more hospitable to business growth and hiring. As examples in Massachusetts, rates of taxation have moderated over the past decade, workers' compensation rates are more in line with other states, and some permitting processes have become more streamlined. New England remains a high-cost area in which to do business, but changes aimed at improving this picture are being pursued in every state.

A final difference lies in the broad-based nature of the current recovery. In the past, New England tended to be more dependent on particular industries than on a broad, diversified base: shipping and textiles generations ago, or mini-computers and defense more recently. Today, however, the recovery in Massachusetts and New England has been led by a diverse set of companies. High-skill educational services, financial services such as mutual funds, health services including biotech research, and engineering, management, and legal services make up a large and growing fraction of our regional employment.

Construction employment growth has also been strong, but construction activity is still well short of its level toward the end of the '80s boom. The speculative excesses and overbuilding that contributed to the severity of New England's recession have not resurfaced--at least, so far--though I must admit that when I'm in a worrying mode, I do worry about the potential for excesses here, especially in hotel and office construction. Overall, however, it seems to me that the current expansion continues to be more balanced and sustainable than were the '80s.

Looking forward, the New England Economic Project, a nonprofit forecasting group with which the Boston Fed is involved, expects continued solid job growth in the region, roughly in line with national job growth. Unemployment is forecast to be in the low-to-mid 4% range through the year 2001. Among industries, we expect a continuation of the expansion's patterns to date. Services will account for the great bulk of new jobs, with growth especially strong in business services. While that category includes a variety of jobs, in Massachusetts business services are dominated by software programming and other computer-related work. And the average job in this growing business service sector pays significantly more than the average overall for the Commonwealth.

Which brings me to the central challenge facing us today and over the next few generations -- the challenge of improving public education. Our region's prosperity hinges on having a well educated and skilled workforce. For example, the jobs in financial services here are, by and large, high-wage, high-value-added positions. That wasn't always so, but restructuring within financial services firms, and the advent and importance of technology has placed a premium on higher skills. The earnings of Massachusetts workers in financial services have risen sharply, relative to the nation, since the early '80s. It is demand for such skills that raises their price, a trend that highlights the importance of human capital in Massachusetts and New England.

The region has always lacked abundant natural resources such as iron or coal or oil, and we have long celebrated the essential role that higher education plays in our economic life. Our great universities, public and private, draw the brightest from the entire world to their graduate programs, and a fair percentage of the graduates stay in our region, fueling our prosperity.

But in the new economy, we have come to understand that first-rate college graduates are not enough to ensure regional prosperity. Accelerated technology, changes in organization, and relentless competition have put a premium on a broader range of skills for all workers, not just professional staff. Hence the importance of high-quality public schools.

The business leaders throughout Massachusetts who pushed for state education reform understood the need to raise academic standards, then measure and reward progress toward them. Challenging new statewide tests, starting this spring, will raise the stakes by setting a benchmark that communities can use to improve their schools. I know that Springfield has joined 14 other urban and suburban districts to form the Massachusetts Coalition for Higher Standards. Your community is in the vanguard of planning for the more rigorous standards, by sharing best practices and educating parents and the public.

Keep at it. This effort is not easy or inexpensive, but we have a great stake in making sure that state and local money is well spent. I urge you to participate in helping your school officials decide where to target resources. Improving the schools is not just good business: It is also a means by which we can raise the standard of living for all the Commonwealth's citizens.

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