IS MIDWEST MANUFACTURING AT A CROSSROADS? FEDERAL RESERVE BANK OF CHICAGO

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Opening Remarks

Good morning. It is my pleasure to welcome each of you to our workshop concerning the future performance of manufacturing in the Midwest. Today's meeting is the first in a series of events that we are hosting to help us understand the dynamics of change in Midwest manufacturing. I hope that you will be able to join us for our next workshop, scheduled for November 3 in Detroit, which will focus on the auto industry. And I hope you can attend the additional programs we will host next year.

I am especially attentive to the issues addressed in this series, because, as you look around the U.S. you'll find few, if any, regions that are as tied to manufacturing as our own. States in the Seventh Federal Reserve District produce 18 percent of U.S. manufacturing output with only 13 percent of the country's population.

Durable goods production is even more concentrated here, with 20 percent of the U.S. durable goods output made in our states. We produce, for example, 40 percent of the nation's motor vehicles, 35 percent of its steel, and nearly half of its farm equipment.

As Midwesterners, our paychecks are more closely tied to manufacturing activities than the rest of the country. By one measure of this-personal income received by people according to where they live-the Midwest is 44 percent more dependent on manufacturing than the rest of the nation. And this is before we consider the transportation, wholesaling, and business services activities attendant to manufacturing that create additional jobs and income. The region's wealth of manufacturing firm headquarters here-just over a quarter of the nation's largest-suggests the extent to which our business service sector is closely linked with manufacturing.

The performance and behavior of manufacturing and durable goods production is especially important to me as a central banker analyzing the nation's economy. Typically, during episodes of economic sluggishness, purchases and production of durables tend to react much more sharply as consumers re-align their spending with dimin-

ished prospects for employment and income growth. Similarly, businesses cut back investment spending on capital goods as they face production over-capacity, or lower expectations for sales in the months ahead.

To some degree, this is what has happened to manufacturing in the past few years. By the official benchmarks, our national recession ended in November 2001-some two years ago. Yet, national manufacturing employment has ended each of the past five years lower than the previous year and has declined for 37 consecutive months. The Midwest preceded the nation into this downturn and manufacturing employment here has been falling longer.

Distinguishing whether this decline in manufacturing is simply related to near-term fluctuations in the business cycle or part of a larger structural change can be difficult. But doing so is essential to setting appropriate policy. For example, in recent years, technological advances in inventory control have seemingly dampened the historic production volatility in the auto industry and other durable goods sectors. Out-sourcing and supply chain management of both production and service activities have become more prevalent and geographically widespread.

Many old-line manufacturers, such as GE and GM, have become as much service providers as they are goods producers. The structure of manufacturing is more complex today and how we think about this sector needs to reflect the complexity of its composition.

Another dimension to the question of structural adjustment, is that shrinking employment may reflect rising productivity. In the manufacturing sector, we are experiencing a robust, though not unprecedented, productivity acceleration that was sorely missed for many years of the 1970s and 1980s. Over the long term, such growth means higher living standards for American households. With rising productivity, workers are ultimately able to command higher real wages; that is to say, their wages ultimately buy more products at local shops and stores.

But there are dislocations of workers and households that go hand-in-hand with the shifting and churning of jobs and businesses that take place as we achieve greater productivity. Some people win, some lose. Some lose at first, but eventually adjust to new opportunities for employment. Whatever the impetus behind their dislocation-be it overseas competition or technological progress at home-we must always strive to ease the transition for these workers and their families.

While much of what we will discuss today is applicable at the national level, it is the regional dimension that brings us here today. We wonder: What is the future of manufacturing in the Midwest? The experience of the past 15-20 years makes me hopeful in this regard. During my tenure at the Bank and the private sector before that, I have witnessed a heroic turnaround which the Midwest pulled off following the dismal years of the early 1980s. At that time, many of the issues, and experiences were much the same as today-though more severe in their effect on the region. One in five manufacturing jobs disappeared in the region from 1979 to 1983. Competition from abroad penetrated the region's mainstay industries. Landmark companies folded or shrank to a shadow of their former selves, while others lost their identity and regional presence through mergers and acquisitions.

To their credit, the remaining workers and businesses began to rebuild and restructure during the late 1980s. Old firms and their plants demonstrated that age was no impediment to adapting new technologies such as just-in-time and lean manufacturing, or wholly new organizational strategies and business models. The region's workers showed that they, too, had the mettle to retrain and shift their focus toward global standards of performance.

This is not to say that the adjustment was easy, or that we want to do it again. Much was lost and many suffered in the transition, and the process took quite some time. It was 15 years, for example, before the District re-

attained its former share of the nation's manufacturing jobs.

Today, there are those who say that-owing to changing terms of trade throughout the world and the emergence of nations with abundant low-cost labor-the Midwest can no longer compete in manufacturing. But even with the facts before us, and with careful analysis and deliberation, we cannot and will not know whether this is the case for quite some time and through further experience. And so, we must be careful, I think, not to throw away or easily cede any industry or manufacturing activity without considering efforts to eliminate inefficiencies in our region's infrastructure.

There are many pillars by which manufacturing can remain competitive. One is the extent and composition of our public capital stock and infrastructure. How well can our roadways, rail, air, energy delivery, and communications systems coordinate and deliver goods to their sources of final demand? We have recently completed a series of conferences here at the Bank that produced some directions in which we should proceed with respect to public infrastructure. For example, as demonstrated by recent events, the country's level of investment in the transmission grid for electricity and the grid's organizational framework are sorely in need of review.

Second is education and training. How skilled, adaptable, and creative are our workers versus those in competing locales? Manufacturing trades and skills confront several unique circumstance in assuring an adequate workforce. One is an aging workforce that will need replacing in certain occupations and skills. However, due to job uncertainty in the sector, young people are often loathe to choose manufacturing programs as an investment in their training. In addition, many of the educational programs centered on the skilled trades have faded and disappeared.

Third is the creation, transfer, and embodiment of new technologies into our products and into our production processes. For many industries, new technology can often lead to production activity near the location of innovation or research and development facilities. Can we refresh our existing industries and maintain their Midwest location through efforts to become a center of innovation? Michigan's initiatives to develop the next generation of automotive locomotion-through viable fuel cells-is one example. Looking to the far future, the research base of so-called nano-technologies-by which we manipulate materials at the molecular level-shows prodigious presence in our region's universities and industrial laboratories. The scientific base is here: our researchers have published disproportionately in nano-technology.

And so before we give our manufacturing selves away, let's consider giving the same efforts toward renewal that we mustered in the 1980s and 1990s.

First, however, we must know what we are facing before we can decide in which directions we should proceed. At our first conference here today, we will largely look at the basic question: How much of our problem is related to the business cycle, and how much is structural and expectedly long-lived?

Beyond that, we hope that today's workshop will help sharpen the questions and focus of the current debate, and perhaps set some directions of research and inquiry in the months ahead. The answers are important to us here in the Bank, but especially important to workers and businesses in our District. I look forward to joining you for much of today's discussion.

The views presented here are my own, and are not necessarily those of the Federal Open Market Committee or the Federal Reserve System.