CONFERENCE ON MANUFACTURING PROSPECTS AND MIDWEST PUBLIC POLICY
FEDERAL RESERVE BANK OF CHICAGO

Chicago, Illinois
April 27, 2004

## Welcoming Remarks

Good morning. It is my pleasure to welcome each of you to the Chicago Fed.

Before I begin my remarks, I'd like to acknowledge one of our Board of Directors who is here today: Mark Gaffney, president of the Michigan AFL-CIO.

Today's meeting is the third in a series of conferences that are part of our Midwest Manufacturing Project. We initiated this project in order to improve our understanding of recent trends in the manufacturing sector, both nationwide and in the Midwest. Is manufacturing at a "crossroads", or merely experiencing a "bump in the road?" That is, are recent weaknesses in performance attributable to transitory, cyclical factors? Or, for example, does the growth of low wage economies overseas presage a structural change where domestic production activities will accelerate their migration overseas? The implications for the Midwest's income and population will differ under the alternative scenarios.

The first meeting in our series, held last September, addressed these broad questions and more. The second meeting focused on the developments in the auto industry. And while today's meeting will certainly revisit many of these issues, the primary objective is to consider them in the context of what they imply for the region's policies and programs.

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. We produce disproportionate amounts of steel and farm machinery. But, our greatest contribution is in the auto industry: we produce 40 percent of the nation's motor vehicles and related equipment.

It goes without saying that recent trends in manufacturing have not been favorable. National manufacturing employment has ended each of the past five years lower than the previous year, and it has declined in 43 of the past 44 months. The Midwest preceded the nation into the 2001 recession, 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 fashioning appropriate policies.

During episodes of economic sluggishness like we have seen in recent years, it is typical for manufacturing to experience a steeper decline than other sectors. Consumers re-align their spending with diminished prospects for employment and income growth, which contributes to a sharp reaction in the purchases and production of durable goods. Similarly, businesses cut back investment spending on capital goods as they face production overcapacity, or lower expectations for sales in the months ahead. To a certain degree, this process accounts for what has happened to manufacturing in the past few years.

Yet, some believe that structural changes are taking place that could affect American manufacturing and the Midwest economy. Among those with this belief, a large portion claim that our manufacturing and production activities can no longer compete internationally as the rise of low-labor cost economies has shifted the terms of trade permanently away from the U.S.

However, this phenomenon is not new and our country has successfully met challenges like this before. Over the past 50 years, we have heard concerns about job losses attributed to competition from Japan, the Asian Tigers, Mexico, and, now, China and India, At the same though, the U.S. economy generated 80 million jobs and real manufacturing output continued to grow robustly.

To some, the increased foreign competition and other developments all portend a gloomy future for the Midwest. But, given our experience in the past 15-20 years, I am hopeful. The Midwest pulled off a heroic turnaround 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 impact. Competition from abroad penetrated the region's mainstay industries. Landmark companies folded or shrank to a shadow of their former selves. Others lost their identity and regional presence through mergers and acquisitions. And one in five manufacturing jobs disappeared in the region from 1979 to 1983.

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 before the District re-attained its former share of the nation's manufacturing jobs. And dislocations of workers and households go hand-in-hand with the shifting and churning of jobs and businesses that take place as we undergo such transitions. The human costs are significant and compelling. And 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.

Today, there are those who say that—owing to changing terms of trade throughout the world—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, I think we must be careful not to throw away or easily cede any industry or manufacturing activity without considering efforts to eliminate inefficiencies in our region‚Äôs infrastructure. For our afternoon discussion, we have assembled a panel to lead us all in a discussion of what can and what should Midwest policymakers and communities do to support its manufacturing industries.

However, before we can decide what policies and practices are appropriate in the current context, we must continue to try and understand what exactly the current context is. With that in mind, we put together the rest of today's agenda.

To start things off today, Bill Testa—our director of regional programs—will explore whether we are measuring manufacturing trends accurately. The structure of manufacturing is more complex today, and how we think about this sector needs to reflect the complexity of its composition. Many old-line manufacturers, such as GE and GM, have become as much service providers as they are goods producers. At the same time, manufacturing companies have been outsourcing a greater portion of service activities like accounting, management, and transportation. These activities have not necessarily been outsourced overseas—though some of them have—but largely to U.S. service companies. And so, it bears asking whether the manufacturing jobs that appear to be "lost" are not still here, but only categorized differently.

Following Bill Testa's presentation, we will hear a trio of panelists that examine employment growth closely for signs of structural change in the U.S. economy—especially structural change that would indicate that economic trends have shifted away from manufacturing. All of these panelists are from the Federal Reserve System—Erica Groshen from New York, Mark Schweitzer from Cleveland, and Ellen Rissman from Chicago.

The morning's concluding session addresses prospects for Midwest manufacturing in light of current international developments. Nagi Palle will share his observations of the expansion of vehicle assembly and parts production in China, and what that might mean for production here at home in coming years. Josh Bivens from the Economic Policy Institute will analyze the extent that manufacturing job losses have stemmed from changing trade patterns as opposed to productivity and shifts in consumer demand. And Michael Knetter from the University of Wisconsin will discuss the recent changes in the dollar and how much might be passed through in prices and output in the U.S.

After lunch, we'll hear about the near-term manufacturing outlook from Bruce Braker, from the Tooling & Manufacturing Association of Chicago, a 79 year-old trade association composed of 600 members from area metalworking and plastics companies. And then we will carry these front-line experiences into this afternoon's regional policy discussion.

In closing, the current downturn in manufacturing is just one in a long line of challenges that the Midwest has faced in its economic history. But, by putting our heads together and by working both hard and smarter, the region has sustained its prosperity through the changes of recent decades. Today, I look forward to joining you in uncovering a better understanding of our current situation and the prospects for manufacturing in the years ahead.