



Building a Future as Bright as Our Past

Introduction

The Federal Reserve Bank of Cleveland has an ongoing interest in understanding developments in the local economy so that these regional issues become a part of the national monetary policymaking process.

But in addition to this policy role, the Bank wears a lot of other hats in our region. We also function as a corporate citizen, a center of economic expertise, a bank supervisor, a payments provider, and a community development advisor. We want to provide a strong voice in the public dialogue that is so important to our continuing economic success as a city and a region.

In my two decades at the Bank, I have witnessed major changes in the regional economy:

- the downsizing of manufacturing industries,
- the global transformation of the auto industry,
- the growth of the health care and polymer industries,
- and a host of start-ups in information technology, bioscience and now even nanotechnology

I wish I could say that all of these experiences have had positive effects for everyone in our region, but as you know, some of these changes have been difficult. We have faced challenges, and we face them still.

This morning, I would like to focus on how we as a city and region can work together to understand what it will take to create the conditions for growth and prosperity that we will need to keep us moving forward in the 21st century.

- First, I will give a bit of history about our region's economic development.
- Then I will review some of the latest thinking on the factors that drive innovation and lead to economic growth and prosperity.
- Finally, I will explore some ideas for how we can work together to create the necessary conditions for innovation right here in Cleveland – to build a future as bright as our past.

Additional Information

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Say Yes! to Cleveland - A Celebration

Intercontinental Hotel and Conference
Center, Cleveland, OH

November 17, 2004

I. History of innovation in Cleveland

Let me begin my remarks by taking you back to a time when the whole world seemed to say Yes! to Cleveland – during the first part of the twentieth century. For this discussion, I will draw heavily on the work of Mike Fogarty, Gasper Garofolo, and David Hammack, who produced an outstanding study on the history of our region for the Center for Regional Economic Issues at Case Western Reserve University.

Cleveland grew steadily from its founding in 1796. It was blessed with a great location– with ready access to timber, iron ore, coal and other raw materials – and a critical infrastructure of that period – first the canals and then the railroads. If Cleveland’s story had ended there, this city would have remained a substantial commercial and manufacturing center based on its transportation links between important resources. But our progress did **not** end there.

Cleveland also benefited tremendously from the knowledge, skill and energy of its citizens and of new people who kept streaming in, drawn by the opportunities our region offered. By the end of the Civil War, Cleveland had developed a healthy concentration of entrepreneurs, firms, and experts who were skilled in metal-working and other technologies.

Working together, people in this community created a major center for industrial innovation, and this enabled Cleveland to really take off.

I am sure that many of you have taken a Lolly the Trolley tour and can name some of the inventions developed in our city: electric streetlights and traffic lights come to mind. But these are just part of the story.

More mundane innovations often created even greater wealth. For example, the process that allowed Rockefeller’s Cleveland oil refinery to remove sulphur from petroleum led to the rise of Standard Oil. The Hulett Ore Unloaders improved the efficiency of the transport of materials across the Great Lakes. This helped make Cleveland a giant in the steel industry.

According to records from the patent office at the turn of the century, Cleveland accounted for 2.6 percent of all “important” patents between 1870 and 1890. This may sound like a small percentage, but it set Cleveland ahead of almost all of the up-and-coming cities of the day.

Innovation remained robust well into the 20th century, and Cleveland’s wealth rose accordingly. We all know the stories behind names like Rockefeller and Carnegie. And we are fortunate to have lasting evidence of that grand era in landmarks like the Terminal Tower.

In 1929, the first passenger train arrived at Union Terminal, and the Terminal Tower complex was dedicated the following year. This was the tallest building outside New York City and gave Cleveland a national presence.

The history of my organization is also tied to this period of vibrancy. The Federal Reserve Bank of Cleveland began operations in 1914 in leased space in the Williamson Building on Public Square, on the land now occupied by the BP Building. We moved into our magnificent pink marble building on East Sixth Street and Superior in 1923, and it continues to inspire visitors, as well as employees, to this day.

One of the great privileges of working for the Federal Reserve is to draw strength from that long history. Our employees have lived

through 17 business cycles and a century of economic transformation. Through it all, our living standard and quality of life have steadily improved from one generation to the next.

But we all recognize that the glory days of our regional prominence have faded. Today, we are more likely to hear stories about our region's problems than about its promises. Over the past couple of decades, we have been struggling to come to terms with a structural shift in both the regional and the national economy – including more global trade, greater innovation, changing technology, the shrinking share of manufacturing jobs, and a growing wage differential between high school and college graduates.

As painful as these short-term adjustments may be, we know that we must keep pace with the changes around us if we are to move forward. We need to continue to identify the factors that will drive economic growth and prosperity for our citizens. And in fact, our economists at the Federal Reserve Bank of Cleveland have begun to focus their research efforts on economic transformation.

II. What factors drive innovation?

So let's consider exactly what these experts have to say on the factors that drive regional growth and prosperity.

In our Bank's 2003 Annual Report, we discuss our research findings in this area. We propose that **innovation** is the true engine of economic prosperity, and we argue that our greatest strength will be our ability to embrace change, from integrating new technologies to welcoming new people. If we hope to remain vital as a region, then flexibility is likely to be our most valuable asset.

Indeed, the key to maintaining a region's economic vibrancy is its ability to sustain a community of innovators. Some of the factors that may help an economy nurture growth and innovation are a skilled labor force, access to natural resources, commitment to the rule of law, and openness to trade with the rest of the world. But perhaps even more important is an openness to new ideas and different perspectives. We simply cannot survive on our past successes.

As you know, an entrepreneurial spirit is a critical driving force for innovation. We are glad to hear that some new industries are emerging in greater Cleveland. The Plain Dealer recently reported a study by the BioEnterprise Corporation. This study found that we already have a surprisingly solid base in the bioscience industry, with 362 companies and about 15,000 employees. And I was very pleased to read about last month's conference on nanotechnology here in Cleveland. This is a fascinating new industry, and most of it is driven by entrepreneurs.

It is really no exaggeration to say that the American psyche is hard-wired for entrepreneurship. My friend and colleague Bill Poole, president of the Federal Reserve Bank of St. Louis, recently co-wrote a research article on this subject with Howard Wall. They note that Americans are more than twice as willing to become entrepreneurs than are people in western Europe and Japan. They emphasize that in order for this American entrepreneurial spirit to lead to success, it must be accompanied by an environment that allows it to thrive. Entrepreneurship does not usually come from without – it is likely to be home-grown and based on experiences within a community.

So what are some of the environmental factors that promote entrepreneurship? Again I will draw on the findings of one of my colleagues, Randy Eberts, who was an economist at the Federal Reserve Bank of Cleveland and is now executive director of the Upjohn Institute for Employment Research.

Earlier this year, Randy made a presentation to the Harvard Business Club of Northeast Ohio. In his remarks, he cited the results of a survey on the four essential ingredients in fostering an entrepreneurial culture:

- First, entrepreneurs need **access to people** – they need a critical mass of highly educated and open-minded people of all varieties, such as scientists, educators, managers and workers.
- Second, entrepreneurs need **access to seed capital or venture funds**.
- Third, they need **access to information and infrastructure**. This includes public education, universities, businesses, and transportation and communication networks. It also includes some intangibles like entrepreneurial attitudes and leadership.
- Finally, they need **government to play a proper role** – a role that gives entrepreneurs the space and opportunity to innovate and that manages taxes, investments and regulations wisely.

III. Creating the conditions for innovation, growth and prosperity in Greater Cleveland

So now let's bring this discussion back around to the question that we all really want to address today – what can we do to create the conditions for innovation, growth and prosperity here in Cleveland?

Please keep in mind that I am a Federal Reserve Bank president and a monetary policymaker. I am not an elected official or an economic development director, so I am not proposing specific policies or projects.

What I can do today is tell you what I have learned from the work of my research staff and from many of the organizations that I am a part of, such as the Cleveland Foundation, the Greater Cleveland Partnership, the Northeast Ohio Council on Higher Education, and Leadership Cleveland. All of these groups feature outstanding people who have expressed some great ideas for moving this region forward. I will borrow from some of these ideas and share with you what I consider to be our strengths and opportunities in building a regional culture of innovation.

The good news

The good news is that we already have a lot going right for us here in Greater Cleveland.

We have outstanding health care facilities and public and private universities.

- We have a concentration of first-rate legal and financial enterprises.
- We have a set of established companies that want to remain here, and some exciting emerging technology sectors, as I mentioned earlier.
- We have begun bringing early-stage investment to local entrepreneurs through the excellent efforts of organizations like JumpStart.
- Our region also has a small-town feel, an affordable lifestyle, and big-city cultural amenities. These assets sustain our residents and provide a huge draw for newcomers to our area.

The not-so-good news

Of course, there are also many things we need to do better if we are to regain a truly vibrant regional economy like the one we enjoyed a century ago.

- First, we need to focus on improving educational attainment.
 - Evidence shows that the Cleveland-Akron area lags behind other regions in levels of educational attainment. In an economy that increasingly runs on brainpower, we must invest in our most important asset – our people.
 - Education and workforce development must be broad-based, and we must be realistic about the level of change that is needed. Ohio's manufacturing tradition once gave many people a path to high earnings without the need for higher education. We all know that day is over. Service-sector jobs typically require more education than do manufacturing jobs to reach the same levels of income.
 - Our Bank is already at work on the education front. On November 18-19, we are sponsoring a two-day conference on the role of education in economic development. I am confident that the discussions with hold with prominent academics, civic leaders and educational policymakers will bear fruit in additional research and policy directions.
- Second, we must find a way to stem the loss of young people from our community.
 - We can draw on the programs we already have in place – internships for young people and organizations like Say Yes! To Cleveland, Leadership Cleveland, and Bridge Builders – to keep people engaged and energized to stay here.
 - But we also need to think about new ways to tell the story about why our region is a great place to build a personal and professional future.
- Third, if state and local regulations and taxes are hampering regional investment, we must find a way to ease these burdens.
 - Some reports indicate that not enough public dollars are being invested in economic development that could bring tax relief for our consumers and businesses. We also need to find new sources of public and private revenue for investment without imposing greater burdens on our already stretched tax base.
- Fourth, we need to do more to attract venture capital in our region.
 - We know the rate of job creation from business startups

or expansions is slower in the Midwest than in other parts of the country. Entrepreneurs are telling us that it can still be difficult to get early-stage capital for new ventures.

- At our Bank, we are preparing to investigate the financing climate, along with several other Reserve Banks and with Scott Shane, a professor from the Weatherhead School of Management at Case Western Reserve University. Each of these Reserve Banks will convene a panel of so-called “angel investors” and ask them a common set of questions to learn how and where they invest, and what kinds of business ventures they are looking for. We hope to identify some next steps to promote better access to capital for small businesses.

- Finally, we need to take an honest look at the role of government in promoting innovation and growth.
 - Recent efforts to cooperate at a regional level might lead to a better business climate, and we should urge government leaders to engage in that conversation.

What I think we should not do is to dictate the brand of innovation or the industries we “think” we might need. We need to let the marketplace define those specifics.

On a broader level, we also need to let go of what might have worked well for us in the past. Innovation, by its very nature, requires us to be open to change. Think of the steady, upward march of our economic prosperity as climbing a ladder, where each rung is a new stage of our economic development. Until we are willing to release our grasp on the rung we’re holding and reach for the next one, we cannot hope to reach greater heights.

Conclusion

All of us have a vested interest in our region’s economic growth. We all have a role to play, and that includes those of us at the Federal Reserve Bank of Cleveland. We will continue to conduct research on issues that are important to our region, and we have begun partnering with universities, foundations, and business groups that are engaged in economic growth and development.

The Cleveland area has seen industries and fortunes rise and fall over the past century, and today we are in a long transition toward a more service-oriented economy. Let us work together to create the conditions for innovation, growth and prosperity that will bring the new entrepreneurs and energies of the 21st century to our city. Let us also find the way to help our citizens prepare themselves for this future with better education and training.

Say Yes! to Cleveland provides an important voice in building the partnerships we need to move forward as a city and region. We all want to build a future that is as bright, or even brighter, than our past. Working together, we will make the difference.

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