Renewing our Regional Economy

Introduction

Tonight, I will talk about a subject that I am sure is on all of our minds - renewing our region's economy. I will comment on the economic transitions we are facing in Northeast Ohio, and I will discuss the critical role that education can play in reinvigorating our region.

Please note that the opinions I express today are mine alone. I do not presume to speak for any of my colleagues in the Federal Reserve System.

Additional Information

Sandr Pianalto

President and CEO,
Federal Reserve Bank of Cleveland

Cuyahoga Valley Communities Council

Brecksville, OH

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The Role of the Federal Reserve System

Before I turn to economic renewal, I want to give you some background on the organization that I am part of - the Federal Reserve System - and the role we play in the economy. The Federal Reserve has been getting a lot of media attention lately. Our new chairman, Ben Bernanke, gave his first economic report to Congress this week, and I know that a lot of people are following the actions of the Federal Open Market Committee, which has raised its target federal funds rate at 14 consecutive meetings. Because of this attention, I have been getting a lot of questions about what we do at the Federal Reserve and how we are structured. It appears that the Federal Reserve is somewhat of an enigma.

The Federal Reserve System is our nation's central bank. Our mission is to preserve price stability, to foster maximum sustainable growth in output and employment, and to promote a stable and efficient financial system.

The Federal Reserve was created by an Act of Congress in 1913. At that time, there was a debate in Congress over whether the Federal Reserve should be a public institution that would report to the U.S. Treasury or whether is it should be a private institution that would be owned and operated by commercial banks. The legislation ended in a compromise - drawing on both the public and private sectors to create a unique, decentralized structure.

The Board of Governors in Washington is the public aspect of the system. Each of the seven governors who serves on the Board of Governors is appointed by the President of the United States to a 14-year term. These long terms were intended to insulate the Federal Reserve from political pressures.

The 12 Reserve Banks across the country are the private aspect of the System, meaning that they operate somewhat independently, with their own charters and boards of directors, but under the general oversight of the Board of Governors in Washington.

I head the Federal Reserve Bank of Cleveland. My district - the Fourth District - includes all of Ohio, western Pennsylvania, eastern Kentucky, and the panhandle of West Virginia. Our main office is in Cleveland, and we have branch offices in Pittsburgh and Cincinnati.

Like the other 11 Reserve Banks, the Federal Reserve Bank of Cleveland conducts economic research, provides financial services, and supervises banks.

An important function of the Federal Reserve is monetary policy. And just what do I mean by "monetary policy?" In a nutshell, this is how the Federal Reserve manages the nation's supply of money and credit. Monetary policy is conducted by the Federal Open Market Committee, commonly known as the FOMC. The FOMC brings together the twelve Reserve Bank presidents and the seven governors.

We meet eight times a year in Washington to determine the course of monetary policy. When the news media speak of interest rate decisions by "the Fed," they are really referring to decisions made by the FOMC.

Our monetary policy task is straightforward - but it is certainly not simple. Our goals are to maintain price stability and promote maximum sustainable economic growth. You might think that these two goals are at odds, but in fact they go hand in hand. The only way that the Federal Reserve can promote maximum sustainable economic growth is by maintaining price stability.

Our policies are informed by the careful monitoring of economic developments. My colleagues and I constantly review the latest national and international economic statistics. We have several hundred economists throughout the System who pore over the data, conduct research, and create models to project economic activity.

I also rely on the input of people who are closely in tune with the day-to-day pace of business on Main Street. These are my Bank's directors, members of my business advisory councils, and people like you, in communities throughout the District. This input provides me with reliable information "in real time" about how the economy is performing, and it offers me a glimpse into economic trends long before the national statistics are released.

The main monetary policy tool we use is targeting the federal funds rate - the interest rate that banks charge each other for overnight loans. Changes in this rate, in turn, affect a host of other short-term interest rates and economic variables.

Those are the basics of the Federal Reserve and monetary policy. I want to emphasize that although monetary policy is national in scope - meaning that the FOMC takes policy actions based on what is best for the country as a whole - we are well aware that different regions of the country face their own special circumstances and challenges.

As we saw last year, some regions, like the Gulf Coast, can face sudden and catastrophic changes, while others, like our region, are in the process of responding to longer-term structural changes.

Economic Transition in Northeast Ohio

Let me now turn to the economic challenges that we are currently facing in Northeast Ohio. More than four million people live in the 15 counties that make up Northeast Ohio. Compared with the rest of the country, we are still a region that manufactures, coats, polishes, and extracts.

After a century of relying on the heaviest types of traditional industry - coal, steel, autos, rubber, and electrical equipment - we have been deeply affected by global trends, including rapidly changing technology and increased international trade.

Deep currents of change have swept over our industrial landscape. Economists call this process "creative destruction." Creative destruction is a natural, and indeed a necessary, part of our economic development. As familiar industries of the past are replaced by the innovative technologies that will shape our future, resources are redirected to wherever they are most productive. Capital and creative energy will flow toward the new goods, services, and processes that will deliver the greatest value, and the jobs will eventually follow.

Of course, creative destruction can be an uncomfortable process; but in reality, it is the absence of this ebb and flow that should concern us. There is some evidence to suggest that a weak level of creative destruction can help explain why employment and economic growth have been less robust in our region than in other parts of the country.

For example, I think there is a common perception that Ohio has had a higher-than-normal share of job losses due to plant contractions and closings over the past few decades. But, in fact, until very recently Ohio's rate of job destruction has been less than the nation's. This might sound promising at first, but as I have suggested, it actually points to a less dynamic economic environment.

How so? Well, the fastest-growing areas of the country tend to exhibit the greatest rates of job destruction. As this happens, old jobs are replaced with newer, more productive and more innovative activities. And it is precisely the creative part of creative destruction that is less evident in Ohio. We have not only had a lower rate of plant contractions and closures than the nation, but also a lower rate of plant openings and expansions.

During the past few years, Ohio's rate of job destruction has been moving much closer to the national average, while job creation is still sub-par. This combination has actually worsened Ohio's relative position nationally in job creation. Clearly, our state's economy is less dynamic than it should be to sustain healthy growth.

We can see the results of this trend during the so-called "boom" years of the 1990s. During that decade, our region struggled to keep pace with the nation in many labor market measures. For instance, in the 1990s, growth in employment nationwide was about 21 percent; but in Northeast Ohio, our employment growth was only half that much - about 11 and a half percent. Wages followed a similar pattern: The increase in average annual wages nationwide was more than 51 percent, but in our region, wages increased only three-quarters of that amount - just under 38 percent.

Although declines in manufacturing employment are a part of the story, they aren't the whole story. In fact, the region's relatively weak job growth is fairly broad based, and it affects industries across both the manufacturing and service sectors. From 1990 to 2003, two-thirds of Ohio's industries saw slower employment growth than their national counterparts. If you combine these trends with those related to plant openings and closings, you might presume that our region has a generally less favorable and less fertile business environment.

That does not have to be the picture for the long term, however. Looking ahead, we can foresee economic change that opens the way toward a future every bit as prosperous as our past - but only if we prepare for it, plan for it, and summon the resolve to embrace new opportunities.

We have many strengths that provide a solid foundation for future growth:

- We have a wealth of established companies and a promising array of emerging technology firms.

- We have a large concentration of financial expertise and legal talent.

- We have fine public and private universities, and an outstanding health care sector.

- We have outstanding natural resources, such as the Cuyahoga Valley National Park.

- Most important, we have talented, committed people who enjoy living and working here.

Because of this, I am confident about the potential for renewal in Northeast Ohio.

Take a look at some of our country's currently successful areas, and you will see that they also went through difficult transitions. For example, a famous billboard from 1971 asked, "Will the last person leaving Seattle turn out the lights?" At that time, the decline of aerospace and timber seemed to spell doom for that city. Now, of course, Seattle is known as a major center for software and the coffee trade - businesses that the city hardly even dreamt of in 1971. Also think of North Carolina's Piedmont region. This area faced steady declines in its core industries - tobacco, textiles, and furniture - before becoming the "Research Triangle" and a major banking center today.

What made these successes possible, and what can we do to emulate them?

Why Education Matters

This brings me to the last topic I would like to discuss tonight: education. There is no magic formula, but a growing body of research seems to suggest that education is a critical component of an area's economic growth prospects. Indeed, Seattle shows up as the U.S. city with the highest proportion of bachelor's degree holders, and Raleigh, North Carolina - one corner of the Research Triangle - ranks third.

What about areas of the country that are older, colder and formerly industrial? Regions in the Northeast and Midwest that have prospered during the past 25 years have also tended to have high levels of educational attainment. A number of studies suggest that levels of educational attainment are strongly correlated with economic growth over time. This is not hard to believe, especially in a global economy, which seems to put an increasing premium on highly skilled workers.

What is perhaps surprising, however, is that this is not a recent phenomenon or an outgrowth of the computer age. As a matter of fact, economists at the Federal Reserve Bank of Cleveland are discovering that a state's so-called "stock of productive knowledge," as measured by levels of educational attainment and patents, has been the best predictor of its relative income level since at least the 1940s.

Back then, differences in high school graduation rates were a key driver of differences in income levels across the states, and Ohio ranked 19th in the country in graduation rates. We also tended to produce significantly more patents per person than the national average - about one and a half times more. Since the 1960s, however, Ohio's patents per person have declined to about the national average.

Ohio also does not fare very well in the measure of educational attainment that matters most today - college graduation rates. In this category, Ohio ranks 39th out of the 50 states in the share of its residents who have earned baccalaureate degrees. Not surprisingly, just as Ohio's patent production and educational attainment have failed to keep pace with most of the country, Ohio's per capita income - which was once above the national average - has not kept pace with the national average for more than two decades now.

We all want to build a sound foundation for future economic prosperity. I believe that one of the most promising ways to do that is to create a civic culture that supports education. I am proud to be a part of a statewide group - the Ohio Business Alliance for Higher Education and the Economy - that is working to increase the strategic role of our colleges and universities in contributing to Ohio's economic growth.

As we look ahead, our prospects will depend critically on our commitment to invest in intellectual capital. The knowledge base of our students and the technological skills of our workers will be critical for the future prosperity of our region. I am convinced that the investments we make in education today - if other conditions are right - will serve as a springboard for economic growth tomorrow.

Conclusion

I have enjoyed sharing my perspectives on economic renewal in our region. I believe that together, we can create and nurture a civic culture that promotes economic creativity, encourages investment in new technologies, and champions education.

The late Lew Platt, the former head of Hewlett-Packard, once advised business leaders that "Formerly successful companies did not make gigantic mistakes.the only real mistake they made was to keep doing whatever it was that had made them successful for a little too long."

So it is for our region. Instead of resisting change, we must prepare for new opportunities. In this effort, I know that we can remain confident in our region's resourcefulness, and that we will remain committed to building an economic future that will be as enriching as our past.