



The Keys to Regional Growth

I am proud to have grown up in Akron, and I still live in the Akron area, so it's an honor to speak to you about our regional economy—including all of its strengths and possibilities. I believe that by focusing on our strengths, we can unlock the possibilities that will get our area thriving again.

The Summa Hospital System is certainly one of Akron's strengths, and I commend all of the volunteers in this room who work so tirelessly to support it—with your service and your fundraising.

That's the kind of dedication we need as our region and our nation gradually recover from a harsh recession. We continue to live in challenging times, but we also have great opportunities ahead of us. The choices we make today will be critical to the well-being of future generations who will live and grow in our communities.

As president of the Federal Reserve Bank of Cleveland, I look at a lot of data on how the economy is doing at the local, regional and national levels. My Bank's territory includes all of Ohio, western Pennsylvania, eastern Kentucky, and the northern panhandle of West Virginia. It's a very diverse region, which makes it a good barometer of the national economy.

I also participate in the Federal Open Market Committee, the committee that sets monetary policy for the country. At each committee meeting, I bring information about my region and my outlook for the national economy. To help me prepare for these meetings, the economists at my Bank conduct extensive research and analysis of our regional and national economy. I also benefit from the insights I receive from our Bank's directors and from frequent meetings with commercial bankers, business people, and community leaders across my District. I would like to recognize one of our Bank's directors here today—Tim Brown, from New Horizons Baking Company in Norwalk. Thanks for all you do to benefit our Bank and our region, Tim.

In my talk today, I will focus on three topics important to our region's outlook. First, I will talk about how the recession and recovery have unfolded in both the nation and our region. Next, I will look at the importance of productivity in driving long-term economic growth. Finally, I will discuss how two factors—education and innovation—work together to improve our prosperity.

As always, the views I express today are mine alone and do not necessarily reflect those of my colleagues in the Federal Reserve System.

Recession and Recovery in the Nation and

Additional Information

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Region

So let's begin with the recession and recovery. As I am sure you know, our nation has emerged from the deepest and longest-lasting recession since the Great Depression. The shocks that set off the "Great Recession" from late 2007 through the middle of 2009 had national and international repercussions. The downward spiral began with the housing crisis, which led to a severe financial crisis. Financial markets froze up, production collapsed, and employment plummeted.

At the Federal Reserve, our response to the recession was aggressive. First, we cut our short-term interest rate target to near zero, and that is where it remains today. Second, we created new lending facilities to help specific areas of the markets, where credit had effectively dried up. Third, we purchased significant amounts of assets, including mortgage-backed securities and government securities.

In each case, our goal was to restore normal market functioning by improving liquidity in financial markets and generally easing credit conditions. Basically, our aim was to restore the lifeblood of the market economy—that is, the lending and borrowing that help fuel investments, run factories, and improve our infrastructure.

When I look back on what we've been through over the past few years, I believe the actions that the Federal Reserve took were both necessary and successful. We were able to forestall a broader economic collapse and restore stability to the credit markets.

As a policymaker who was involved in many of these decisions, I was also mindful of the problems faced by millions of Americans. During the "Great Recession," the U.S. economy shed almost 9 million jobs. I am sure many of you here today have family members and friends who have faced unemployment as a result of the recession. Job loss creates enormous challenges for families and communities.

It is important to remember that this recession was much deeper and lasted longer than previous recessions, and we have a long way to climb back. Unemployment rates have declined a bit recently, but job creation remains anemic, as businesses have been cautious in expanding their payrolls. Simply put, it will take a long time to recover the many millions of jobs we have lost. I realize that is small comfort to those who are still on the sidelines.

Yet we are seeing signs that the overall economy is gradually improving. Manufacturing continues to expand, export activity has risen, and companies are investing in equipment again. Consumer spending also finished on a positive note last year. But we are still facing some headwinds. In particular, the housing market remains depressed, which weakens household balance sheets. Also, income growth is likely to be constrained by high unemployment rates, and credit conditions remain tight, especially for some small businesses. Keeping these factors in mind, I expect that the pace of economic growth for this year will continue to be moderate.

But the focus of my speech today is Ohio and this region. Ohio's employment loss during the recession was somewhat more pronounced than in the nation as a whole. This weaker labor-market performance partly reflects Ohio's greater share of manufacturing employment, which fell sharply throughout the country during the recession.

Still, compared to the recessions of the early 1980s, which is the last period that our economy experienced double-digit unemployment, Ohio's relative performance has been better. During the harsh recessions of the early 1980s, Ohio lost more than 10 percent of its

jobs, and this loss accounted for about 20 percent of the entire country's job losses. Unemployment in Ohio peaked near 14 percent in the early 1980s, which was three percentage points above the national rate, and remained high for several years.

In the most recent recession, Ohio's unemployment rate rose to 11 percent, slightly above the 10 percent peak rate experienced by the nation. So far, Ohio's unemployment rate has been declining at a pace similar to the nation's. By any stretch, this was a difficult recession for workers in the region. However, Ohio's path through this recession looks similar to the nation as a whole, and this highlights the fact that our regional economy has become more diversified.

The recent shocks that hit our regional economy were national and international in scope, and they called for national policy responses. The problems that Ohio experienced during the recession were similar to those in other regions of the country, and our path in the recovery will largely follow the path of the national economy.

Even so, many of the economic challenges we faced in our region before the recession are still with us today. In particular, our region has experienced relatively slow per-capita income growth, especially over the past decade. If that slow pace of income growth continues, it will greatly affect our quality of life going forward. So we need to look beyond the current cycle and focus on the factors that drive sustainable economic growth.

Productivity and Long-term Growth

When we look at the factors that drive economic growth over the long run, one stands out above the rest—the productivity of the workforce. As productivity improves, incomes grow, increasing the demand for goods and services throughout the economy. Over time, this process will also increase the demand for labor.

In the United States, productivity has risen significantly in the past generation, to the point that an hour of labor in 2010 produced twice as much as it did in 1975. This rise in productivity led to a rise in incomes. Adjusted for inflation, per capita incomes rose by 90 percent over this period. Today, the U.S. economy remains one of the most productive in the world and also has one of the highest standards of living.

How did labor become so much more productive over the past generation? Workers improved their skills through formal education and on-the-job training, and they received better tools to do their jobs as technology advanced. Companies and employees designed better ways to do their work.

Productivity also grew from the natural shift of labor and resources, such as plants, equipment and technology, toward new activities that generate greater profits and increased wages. This process is often referred to as creative destruction. It reflects the forces of competition, entrepreneurship, and technological change. Creative destruction reshapes industries and regions.

In our region, we have seen these transformative forces at work over the past few decades. I'm sure many of you remember the smell of rubber that was always in the air in Akron long ago—I remember smelling it when I was a child. The rubber factories are now gone, of course, but the Akron economy has undergone a remarkable transformation. The region built on its expertise in materials chemistry and developed a cutting-edge industry in polymer sciences. It's no accident that Goodyear decided to keep its R&D center and headquarters here, even though it manufactures most of its products

elsewhere. But at the same time, there has been new growth, as well, in the fields of biomedical sciences and education. Most of you in this room are familiar with the growth seen in the health care industry throughout the region.

However, we also need to realize that this transformation of our economy is a work in progress and that quite a lot remains to be done. So, like all of you, I want to know what will best position our region for future growth.

Education and Innovation--the Drivers of Prosperity

Economists at my bank have been looking at this question. The results of their analysis are clear—the two main drivers of income growth in a region are education and innovation. States with a more educated workforce, and states with high rates of innovation, saw their incomes grow significantly faster over long periods of time.

In other words, states that have more “knowledge capital” perform better than other states. They develop more new products and inventions. They also may be more flexible in adopting new technologies and in responding to the forces of creative destruction. They have a larger pool of highly skilled workers to generate and share new ideas, and to find new ways of doing business. These capabilities increase overall productivity, which leads to higher incomes. Research suggests that pursuing policies to expand a region’s knowledge capital is an effective economic development strategy.

If education and innovation are the key drivers of growth, then how does our region stack up? In terms of the percentage of its population with college degrees, Ohio ranks somewhat low—we rank 38th out of the 50 states. Northeast Ohio’s metropolitan areas do somewhat better: Akron is ranked in the middle of the pack of the 100 largest metropolitan areas.

These comparisons are all within the United States, but we know that workers and firms in the region increasingly compete with individuals from around the globe. Back in 1995, the United States had the second-highest college graduation rate in the world, but by 2008, we had slipped to thirteenth. In a recent comparison of 34 developed countries, the United States is ranked 14th in reading, 17th in science and 25th in math.¹ It is not so much that the United States is falling back, but that other countries, like Hong Kong and Korea, are improving their educational outcomes, and we should applaud their improvement.

However, it does suggest that international competition is having an increasingly stronger effect on our labor markets. In the past, skilled workers had been relatively insulated from this competition, but this is less true today. The number of skilled workers in other countries who will compete with workers in some middle- and higher-skilled occupations in the United States is growing.

A troublesome fact is that the rate of growth of skilled workers in this country has slowed. Perhaps surprisingly, this overall slowdown is largely due to a decline in the rate of men who complete college. For example, between 1970 and 2008, college attainment rates for young men between the ages of 25 to 34, rose only modestly, while rates for young women nearly tripled.²

Of course, there were great changes in the labor market for women that explain some of these differences. But focusing on the most recent data, we see an 8 percentage point difference between the

college attainment rate for young men and young women. The share of young women with a college degree stood at 35 percent, but for young men it was only 27 percent. Similar patterns can be found in our region. In Ohio, the difference in college attainment rates currently stands at 6 percentage points, or 32 percent for young women versus 26 percent for young men.

It is hard to overemphasize the economic importance of education. Adjusted for inflation, the hourly wages for individuals with only a high school diploma have fallen over the past 30 years. At the same time, the difference in wages between college and high school graduates, also known as the college premium, has expanded sharply. The economic incentives to get a college degree have been, and continue to be, very strong.

Not surprisingly, a common conclusion that many analysts have drawn from both the international rankings and U.S. labor market patterns is that we must do a better job in K-through-12 education, especially for our young men. This is a conclusion I agree with wholeheartedly. The United States has a world-class higher education system, but we are just not getting enough students to that system or through that system. And it is critical for us to do so, because if these trends continue, they will have a profound effect on the ability of our workers and firms to compete in a highly globalized marketplace.

Beyond education, our research also shows that innovation is another key driver of income growth for a region. More innovative states experience higher growth. Historically, Ohio has been a relatively innovative state, as measured by patent activity, but over time our advantage has diminished. Other states have seen more rapid patent growth. It's interesting to note that Akron still ranks relatively high—23rd out of the top 100 metro areas, based on patent activity for the 2001 through 2008 period.³

So just how does a region foster innovative activity? Innovation is driven largely by firms, workers, and research institutions acting in their own interests. It is not typically in the hands of the government, especially at the regional level, but there are always exceptions. Ohio has made significant investments to support research and commercialization in targeted areas—such as alternative energy and biomedical sciences—through the Third Frontier program. Many analysts have viewed the early stages of this program as showing success.⁴

However, there are a large number of smaller-scale research collaborations being fostered throughout the region, combining public and private investments. For example, the University of Akron has invested heavily in fundamental research in materials science and polymers, and has also developed an innovative technology transfer program to commercialize the results of its science. Commercialization is important if you want to reap the full economic benefits of new technology.

Summa Health System is also engaged in innovative research as one of five partners in BioEnterprise, which focuses on growing bioscience and healthcare companies, as well as the commercialization of bioscience technologies in Northeast Ohio. Since 2003, BioEnterprise has helped 100 companies raise more than \$1 billion in venture funding.

These endeavors have had real results in developing new start-up companies and in attracting significant investments into the region. They are driven by the right incentives: Universities or hospitals benefit from increased private funding; firms benefit from access to world-class research; and consumers benefit from the development of

new products and new therapies.

Although their scope is somewhat limited, regional policymakers and elected officials can also work to help create environments that are attractive to highly talented innovators. The competition is fierce for innovative individuals and firms. Local governments need to make investments in amenities, schools, and infrastructure that will attract and retain this talent.

Businesses and people respond quickly when times get tough, and if they see a better environment and opportunities elsewhere, they will move there. As a resident of Northeast Ohio, I'd like to see them stay right here and use their knowledge to enrich our region.

Conclusion

In closing, I see a moderate recovery path continuing for both the nation and our region, and I am optimistic about our economic future. The key to our long-term prosperity is to increase productivity. This will lead to both higher incomes and a greater standard of living. Research at my Bank shows that education and innovation are fundamental drivers of this process.

I believe that our region has taken steps in the right direction. We are becoming more innovative, and we are focused on bringing those innovations to the market, ultimately creating new businesses and new jobs. But I also believe that we have some work to do as well. Our educational attainment in particular is clearly lagging.

To make improvements, it all comes down to the choices that we make. We all know that we do not have unlimited resources. We have to make the best use of our available resources to invest in those activities and institutions that will do the most for our economy. If we make wise choices, we will build sustainable long-term growth for the generations to come.

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 3. Bradley, J., Istrate, E., and Rothwell, J. "Exports in the Great Lakes: How Great Lakes Metros Can Build on Exports and Boost Competitiveness," Brookings Institution, July 2010.
 4. "Making an Impact; Assessing the Benefits of Ohio's Investment in Technology-Based Economic Development Programs," SRI International, September 2009.