Prospects for the Nation and the Region

Additional Information

Sandra Pianalto

President and CEO,
Federal Reserve Bank of Cleveland

Medina County Economic Development Corporation

Westfield Center, Ohio

February 28, 2012

I truly benefit by learning directly from business and community leaders like you about what's happening on the front lines in communities across my district, which encompasses Ohio, western Pennsylvania, eastern Kentucky, and the northern panhandle of West Virginia. I take that feedback to Washington with me, when I vote on the Federal Open Market Committee with Chairman Bernanke and my other colleagues.

I am particularly impressed with the initiatives this organization is undertaking to create jobs, support area businesses, and leverage great organizations like Team NEO. Let me say at the outset that I applaud your efforts in bringing hundreds of jobs to the area and your track record of working directly with companies in Medina County to expand their operations.

The reality is this: Here in Northeast Ohio, we must constantly upgrade our businesses and communities to energize and sustain economic growth. That's the centerpiece of my remarks this evening. In my remarks tonight I will cover three topics.

- First, I'll describe economic conditions in the region.
- Second, I'll explain that the keys to our region's long-term growth are education and innovation.
- And finally, I'll close with some comments about the steps the Federal Reserve is taking to support the nation's economic recovery.

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

Let me start with economic conditions in our region. Here in Northeast Ohio, we have weathered the Great Recession better than many other parts of the country. The unemployment rate in Northeast Ohio, which I'm defining as the seven-county area that includes Medina, stood at 7.4 percent as of the most recent reading in December 2011. This is more than a full percentage point lower than the national rate of 8.5 percent that prevailed at that time.

Here in Medina County, conditions have paralleled the performance of Northeast Ohio, although the unemployment rate here is a bit lower, as it is in some of the other suburban counties, such as Geauga and Lake. That said, Medina County is closely linked to Northeast Ohio through both labor markets and supplier networks, so further employment gains here in Medina County will most likely require more progress for the region as a whole. This is all the more reason to think regionally, not locally.

We are also seeing relatively better news in Northeast Ohio in terms of incomes. Income growth in the region outpaced the nation in 2010. Average per capita income in Northeast Ohio rose about 3 percent in 2010 -- the most recent data available -- after falling in 2008 and 2009. A 3 percent increase in income translates to about $3 billion in local spending.

These economic measures are clearly positive news for our region, and are in striking contrast to recoveries from prior recessions. During the harsh recession of the early 1980s, Ohio lost almost a half million jobs, or more than 10 percent of its total employment. Ohio alone accounted for about 20 percent of the entire country's job losses in this difficult period. Unemployment in Ohio peaked near 14 percent in the early 1980s, which was 3 percentage points above the national rate, and remained high for several years. This high unemployment rate was due, in part, to our region's greater share of manufacturing at that time.

During the most recent recession, however, our manufacturing job losses were more in line with those felt by the nation as a whole, reflecting that our regional economy has become more diversified. As a result, manufacturing has not been the lead weight pulling down our economy. Indeed, here in this region, I have been hearing stories of strength and resurgence in manufacturing. In 2011, manufacturing employment increased more than 3.5 percent in Northeast Ohio and about 2 percent nationally. But we shouldn't rely on manufacturing to solve our employment problems. The longer-run trends, like new technologies that have kept manufacturing employment growth low, are likely to continue. Also, it is worth emphasizing that all of the manufacturers I have been talking with expect new hires to come on board with considerably more skills than the workers of the past. In fact, for the past several decades manufacturing employment has grown for those occupations that typically require a college degree, while manufacturing employment in lower skilled occupations has declined.

Despite our region's relatively stronger performance than the nation as a whole during this recovery, we cannot pat ourselves on the back and relax. Many of the structural challenges we faced as a region before the recession are still with us today. That means that we need to take a longer view and focus on the factors that drive sustainable economic growth.

In Ohio, there are two structural characteristics that are inhibiting our longer-term prospects for expansion and sustained growth. First, despite some recent increases in income growth regionally, our income growth here has been below the national average for several decades. Second, our population has not grown at the same pace as the rest of the nation. Fifty years ago, Ohio ranked as the fourth most populous state in the country, and our per capita income was much higher than the national average. Today, Ohio has fallen to tenth in population, and our per capita income is about average. These long-term patterns of relative decline have played out even more strongly in this region. So what can we do to reverse this decline?

Economists at my Bank researched the factors that have made states more prosperous over a 75-year period, from 1929 to 2004. The results of their research are clear - the two main drivers of income growth are education and innovation. Their research shows that regions with a more educated workforce and higher rates of innovation saw their incomes grow significantly faster over long periods of time.

Simply put, states that have more "knowledge capital" perform better than states with less. They have a larger pool of highly skilled workers to generate and share new ideas, and to find new ways of doing business. They develop more new products and inventions. They also may be more flexible in adopting new technologies and in responding to the internal and external forces reshaping local economies.

If education and innovation are the key drivers of growth, then how does our region stack up? The percentage of the population with a college degree serves as a good measure for education since so many of today's jobs require post-secondary education. Based on this metric, Ohio ranks 38th out of the 50 states, and we have been in the lower part of the distribution for many decades.

However, this overall statistic might be somewhat misleading in the case of Ohio. Because Ohio has been a slow-population-growth state, we have an older population. People who are 55 and older are less likely to have college or graduate degrees in almost any part of the country. So our researchers dug deeper and focused on younger age groups, ages 25 to 34. Here, Ohio does substantially better. We're in the middle of the pack for college graduation rates—we rank 25th out of the 50 states. And if we look at post-graduate education of 25- to 34-year olds, Ohio does even better -- ranking 17th out of the 50 states. This is not ideal, but it is clearly movement in the right direction.

While these statistics are for Ohio as a whole, we find that Northeast Ohio statistics are consistent with these trends. Our overall educational attainment lags the nation considerably, but our younger residents seem to be doing better. In part, this is a credit to the strength and diversity of the educational institutions here, but we need to attract and create more jobs that require education and skill so that we can retain this knowledge capital, including our young college graduates.

In addition, we need to remember that these comparisons are all within the United States, but our workers and companies increasingly compete with individuals and firms from around the world.

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 in tests of high school students, the United States ranked 14th in reading, 17th in science, and 25th in math. It is not so much that the United States is falling back, but that other countries, like Hong Kong and South Korea, are improving their educational outcomes. In order to remain competitive, the U.S. labor force must become even better educated.

Beyond education, our research also shows that innovative regions experience higher growth. Broadly speaking, I think of innovation as the ability of an economy to generate new ideas and bring these ideas to the market through the creation of new products, services, and production methods. Historically, Ohio has been a relatively innovative state, but over time our advantage has diminished. At one time Ohio ranked sixth in the nation in the number of patents per capita. Today we rank in the middle of the 50 states. How did this happen? It's not that Ohio has not increased patent activity; we just aren't keeping up with the nation. For example, between 2000 and 2010, the number of newly issued patents in Ohio was roughly steady at about 3,000 patents per year. Nationally, the number of new patents issued in 2010 was 27 percent greater than in 2000.

So just how does a region foster innovation? The research on how to generate innovation as a region is not as well developed as it is for educational attainment. But the patent data reveal that an overwhelming share of innovations are generated by companies who are seeking to improve their competitiveness and profitability. Government initiatives can also play key supporting roles. 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. SRI International, a major research institute focused on innovation and technologies, concluded that the early stages of the Third Frontier program have shown considerable success and that the gains should continue to accumulate.[1]

Here in Northeast Ohio, JumpStart is the regional partner for the Third Frontier's entrepreneurial investment program. This organization has a growing portfolio of new businesses in Northeast Ohio that are developing new products and ideas. These endeavors have been successful in attracting significant investments into the region. Moreover, many of the companies that JumpStart invests in are commercializing innovations generated by local research institutions. These investments provide further spillovers back to the research centers as the companies prosper. Therefore, a stronger set of local technology companies makes it more likely that the research from the region's universities and research centers gets commercialized.

I am very encouraged by recent efforts and initiatives arising from regional development groups in Northeast Ohio that are coalescing around an agenda focused on educational attainment and innovation. These drivers of economic growth are closely linked. Innovative environments typically have a strong educational infrastructure and attract a large concentration of people with high human capital. Ultimately, our efforts in these areas can't be slogans or advertising, or short-term fixes. We need to work together and remind ourselves that we are involved in a marathon, not a sprint.

Let me wrap up with some comments on how the Federal Reserve is working to support economic growth across the country. One of the Federal Reserve's most important responsibilities is setting monetary policy. The Federal Reserve's monetary policymaking group is the Federal Open Market Committee, or FOMC. This year, I am a voting member of the Committee.

The Committee generally meets eight times a year in Washington to review economic and financial developments and to determine the appropriate stance for monetary policy. The FOMC is focused on achieving the dual mandate given to us by Congress: to maintain stable prices and promote maximum employment.

Needless to say, the last few years have been very challenging for monetary policymakers. As you are painfully aware, the economy has been through its worst recession since the Great Depression in the 1930s and the Federal Reserve has responded aggressively and creatively to the financial and economic crisis. In September of 2007, the Federal Reserve began to ease monetary conditions by lowering our target for the interest rate that banks charge each other for short-term loans, known as the federal funds rate. You and I can't borrow at the federal funds rate, but the rates we pay for consumer and business loans do respond to changes in the federal funds rate. By the end of 2008, we reduced the federal funds rate to nearly zero, and it has remained there ever since. Once the rate fell that low, we had to employ some different techniques to ease monetary conditions further. Think of it as taking the back roads when the freeway is shut down; it may not be as efficient, but the new route can still get you to your original destination.

The new techniques that we used included purchasing large quantities of U.S. Treasury securities and federally guaranteed mortgage-backed securities. Our balance sheet grew from $900 billion prior to the crisis to close to $3 trillion. Our objective in taking these alternative routes is to push down medium- and longer-term interest rates for consumers and businesses, and we have been successful in doing that.

Even though we have introduced some new techniques, we are still operating to achieve our dual mandate of stable prices and maximum employment. We still have to make policy decisions based on forecasts, and we still have to wait for the effects of monetary policy to work their way through the economy.

The recovery from the recent financial and economic crisis has been frustratingly slow. A number of headwinds are holding back growth. Housing markets continue to be depressed. The government sector has been reducing spending and employment. Add to the mix the situation in Europe, which could negatively impact our exports. Given these numerous headwinds, I am expecting the economic recovery to remain moderate and for the economy to grow around 2-1/2 percent this year and about 3 percent next year. Given this outlook for economic growth, it could take as long as four to five years to achieve maximum employment, which I estimate to be consistent with an unemployment rate of about 6 percent.

The outlook for inflation is a little more encouraging. Both headline and core inflation slowed significantly from the first half of last year to the second half, and I expect inflation to remain close to 2 percent for the next few years. Still, the recent increases in oil prices and housing rents could complicate the inflation picture if they persist.

We are, as I mentioned earlier, in a challenging environment for monetary policymakers. We do not have a good deal of concrete history for monetary policy to fit our current circumstances, but I am confident the Federal Reserve is making the most of its tools to move the economy in the right direction. I think monetary policy is appropriately positioned to maintain stable prices and to support economic growth that will keep us on a path toward achieving maximum employment.

Locally, we can take some comfort in the knowledge that we are performing far better in this recovery than we typically have done. But we cannot sit back and relax. We still have much work to do. Specifically, we need to boost educational outcomes and innovation in order to make our region more prosperous.

In closing, let me again underscore the important work of the Medina County Economic Development Corporation. I urge each of you here this evening to continue to look for opportunities to leverage relationships throughout this region. Together we can build a more prosperous region by producing and retaining a more highly educated workforce and by encouraging innovation.

1. SRI International, “Making an Impact: Assessing the Benefits of Ohio's Investment in Technology-Based Economic Development Programs,” 2009.