

Western New York Economic News

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In many ways Buffalo has failed to keep up economically with its *Rust Belt* cousins. Cleveland, Detroit, Gary, Milwaukee and Toledo have done something that Buffalo has failed to do during the economic restructuring that followed the 1980-82 Great Lakes depression. While employment has grown in Western New York, the wages earned per worker have fallen compared to these other regions. While our last newsletter showed how Buffalo and the other major upstate metropolitan areas have fallen behind the service driven economy in downstate New York; this issue focuses on how Buffalo compares to the resurgent manufacturing based economies of the Great Lakes region. Before we turn to the region we first examine the national economic picture.

The National Economic Outlook

Final figures on third quarter 1999 US real GDP show the US economy growing at an annual rate of 5.7%, after posting gains of 1.9% in the second quarter and 3.7% during the first quarter. Increases in consumer spending, business fixed investment, inventories and exports fueled the economy's growth, while an increase in imports moderated the pace of growth. The Federal Open Market Committee meeting of December 22 failed to produce any policy changes, as the Fed desires to maintain liquidity in the banking system in anticipation of Y2K. The FOMC raised both the discount rate and the federal funds target by 25 basis points at their November 22 meeting. It is widely anticipated that the FED will raise interest rates in the new year, particularly if the economy continues to grow at the heated pace of the third quarter. Consumer inflation, as measured by the Consumer Price Index, has accelerated to a 2.6% annual rate from November 98 to November 99, after reaching a low of 1.4% from August 97 to August 98. This evidence of inflation acceleration will certainly weigh heavily on the FOMC in its next policy setting meeting.

Equity markets have continued their surge as both the Dow-Jones and S&P 500 indexes have risen in excess of 19% since November 98 while the technology laden NASDAQ composite has risen by approximately 78%. US Treasury yields have increased with three month yields increasing by 73 basis points since November 98 and 30-year Treasury yields rising by 122 basis points over the same period.

The national unemployment rate at 4.1% is at a 30 year low and the economy continues to produce approximately 225,000 new jobs each month. The robust technology driven expansion is approaching its ninth year. For the first time in 30 years, the federal budget is approaching a surplus, without the use of the Social Security tax revenues in excess of outlays. A golden age of economic prosperity seems to be upon us. How has the Buffalo region fared so far during this golden age?

The Buffalo Region

US real personal income has grown by 2.3% from September 1998 to September 1999. We expect this moderate growth rate to continue through 2000. Based on our model, our forecast for Buffalo area real personal income growth remains unchanged at 1.03% for 1999 and .55% for 2000.

Nonagricultural civilian employment in the Buffalo MSA increased by an anemic .2% from November 98 to November 99. This compares with a 1.97% growth rate in New York State and 2.13% in the nation. The Buffalo area unemployment rate stood at 4.7% in November 99, up .2% from November 98. While the Buffalo unemployment rate is between the State and National levels, it has risen as the State and National rates have fallen. The local economy, which has not fully participated in the economic boom of the last decade, could face substantial risk when the American economy inevitably enters the downward phase of the economic cycle.

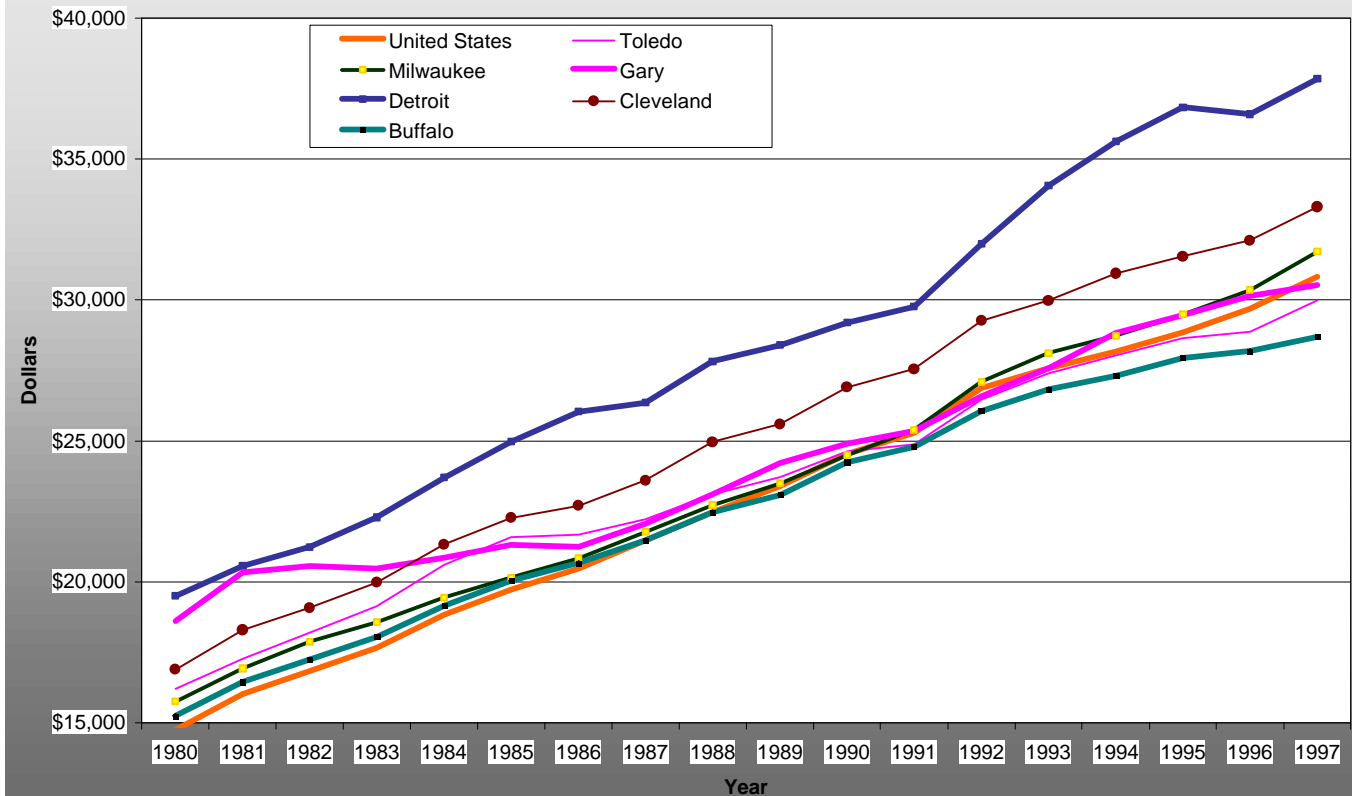
The small increases in total employment mask a fundamental weakness in the regional economy. There has been a shift in the composition of employment. Low wage service sector jobs have been replacing high wage manufacturing jobs since 1980. The long-term decline in manufacturing employment and the resultant reduction in real earnings per worker is the key element in the decline of the regional economy.

Between 1980 and 1997 wage and salary employment increased from 521,792 to 562,259 in the Buffalo-Niagara Falls MSA. At the same time manufacturing employment fell from 136,092 to 91,885. The average earnings per worker in manufacturing were \$48,176 in 1997. The fastest growing employment element the Buffalo workforce, the service sector, increased by almost 76,000 over the same period, and had average earnings per worker in 1997 of only \$24,198. Job growth is clearly not the issue. Replacing almost 45,000 high wage manufacturing jobs with service sector jobs that only pay half as much has had a serious impact on the region's economy. As the trend continues, it will continue to have a profound effect.

Critics of and commentators on the local region focus their attention on the burden of high taxes and government regulation. This ignores the fact there has been substantial employment growth since 1980, of low wage, service sector jobs in the regional economy. Western New York has tax rates that are relatively high, on a per capita basis, when compared to the rest of the nation. They are, however, relatively low when compared to those found in the downstate counties of New York, where the American economic boom of the 1990's is alive and well.

Over the last 20 years the decline in manufacturing employment has been more severe downstate than upstate, but it has been replaced by higher wage service sector jobs, thus over the period real wages per worker have grown dramatically more rapidly downstate than upstate. This is true even though taxes are higher downstate. It should be noted that tax revenues per capita are proxy measures of tax burdens, since they ignore the question of incidence and burden shifting. The key element to the well being of the region is the quality, not quantity of the employment opportunities.

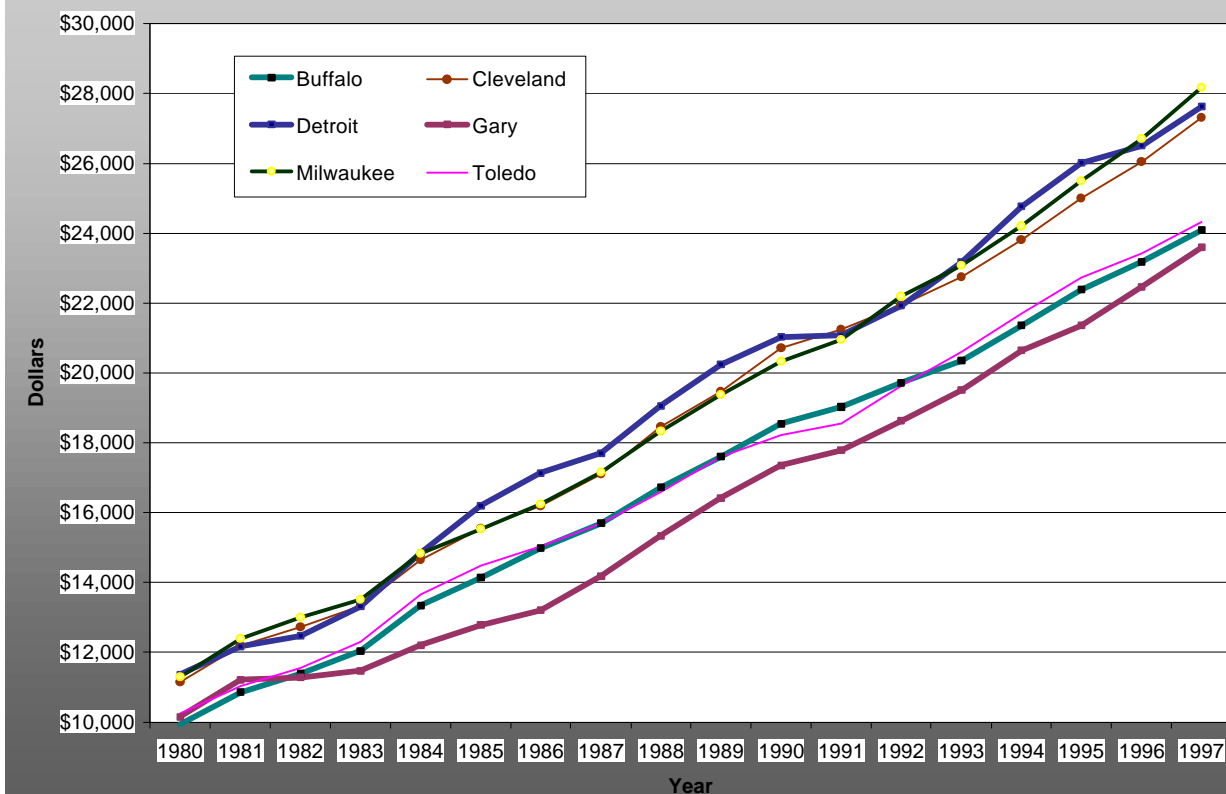
Figure 1 Earnings Per Job



We have continuously stressed the importance of income, since it is a principal determinant of the demand for goods and services. When combined with a declining population, decreases in real income over substantial periods of time have led to reduced levels of economic activity locally. These reductions manifest themselves in the form of falling housing values, declining or vacated retail establishments, and limited employment opportunities, especially for young and displaced workers. The expectation is for this decline to continue and spill into the public sector in the form of reduced assessed valuations, tighter governmental budgets, and increased tax rates or decreased levels of public service. Income levels, and changes in those levels, are good indicators of the present and the future well being of the region. The decline in real income has been most closely associated with the replacement of high wage with lower wage jobs.

Figure 1 compares the relative earnings per worker from 1980 to 1997 in the Buffalo, Cleveland, Detroit, Gary, Milwaukee and Toledo metropolitan areas. Comparing Buffalo to these areas, as well as the U.S. average, reveals several important trends. In 1980, all six areas were above the national average. By 1997, Buffalo, Toledo and Gary had fallen below the national average. In 1980, earnings per worker were clustered between \$15,200 in Buffalo and \$19,400 in Detroit. By 1997, both the level and the range had expanded, from a low of \$28,700 in Buffalo to a high of \$37,800 per Detroit worker. The other *Rust Belt* areas have done better than Buffalo in the economic restructuring of the last two decades, at least by the measure of earnings per worker. We should remember, though, that they were already better than Buffalo at the beginning of the period in question.

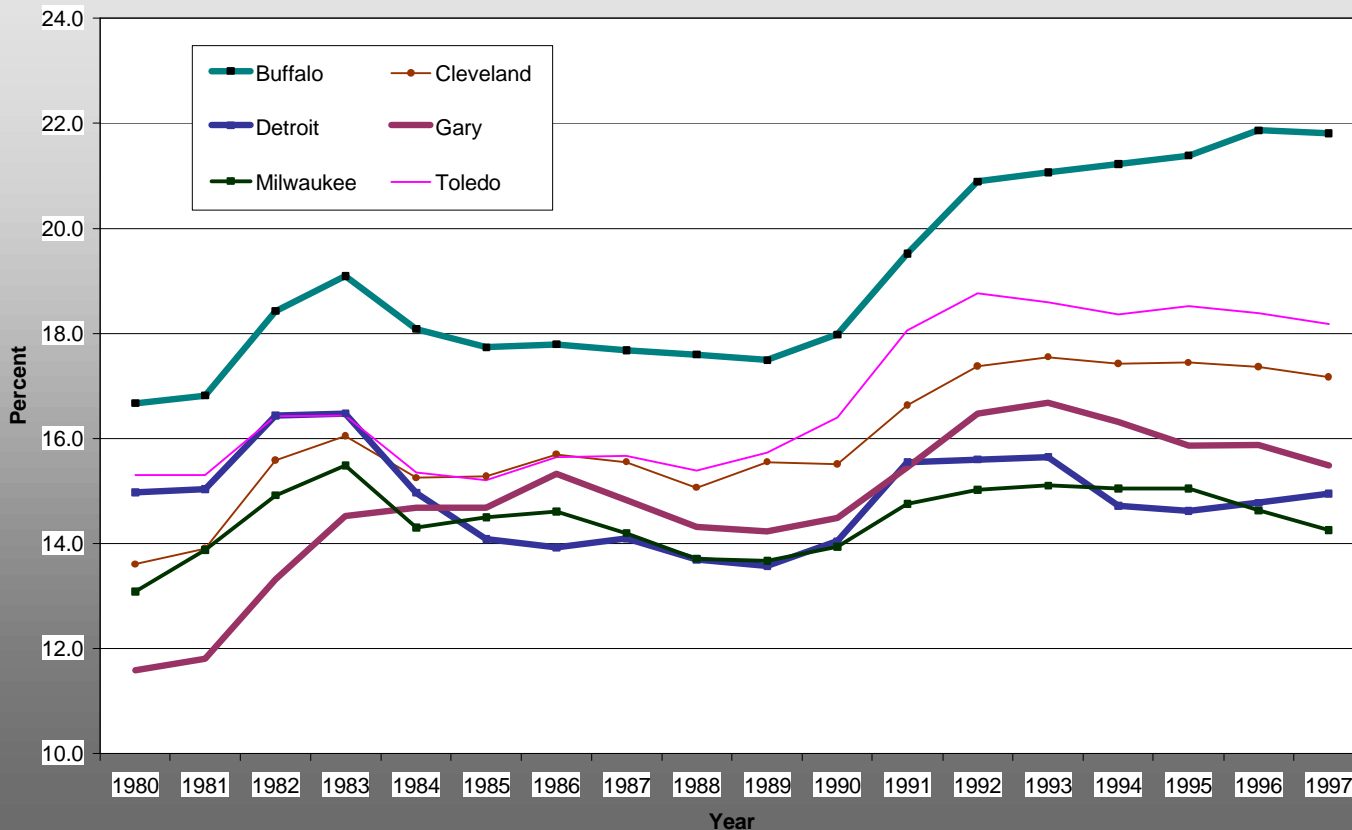
Figure 2 Personal Income Per Capita 1980-1997



Income measures differ from earnings since they generally include rent, dividends, interest, as well as transfer payments. Figure 2 shows the personal income per capita for the same set of Great Lakes metropolitan areas. Note the divergence between the lower and upper income groups over the 17-year period, similar to what was seen for earnings per worker in Figure 1. Again, Buffalo, Toledo and Gary are in a group distinctly below the other three areas.

Transfer payments, principally in the form of Social Security benefits and welfare, affect the level of income in an area. There is a considerable degree of variation among the Great Lakes metropolitan areas. As shown in Figure 3, the Buffalo – Niagara Falls MSA has the highest percentage of its personal income in the form of transfer payments, approximately 22%, while Detroit and Milwaukee have the lowest at 14.9 and 14.3 percent respectively. These percentages reflect both the greater numbers of transfer recipients in Buffalo, as well as the lower earnings per worker. But, regardless of the reason, Buffalo is more dependent on Federal income maintenance programs than are the other areas in the Great Lakes region. This was also true, although at much lower levels, in 1980.

Figure 3 Transfer Payments as a Percent of Personal Income



The movement of skilled labor out of Buffalo has increased the proportion of the population comprised of the elderly and other people dependent upon Federally determined transfer payments. When this trend is combined with the continued replacement of high wage manufacturing jobs with low wage service jobs, the effect is an increase in the share of total income accounted for by transfer payments. Thus, the high level of transfer payments reflects the loss of working age people from the region, as well as lower earnings per remaining worker.

Table 1 summarizes the transition that has occurred in the Great Lakes MSA economies since 1980, using a crude Location Quotient (LQ) measure of specialization. On an MSA basis, an LQ compares the proportion of total economic activity in an industry to that industry's share of total economic activity. Using earnings as the measure of economic activity, the LQ's in Table 1 represent how many times greater than the national norm is the concentration of each industry in its metropolitan area. A ratio of 1.0 suggests a concentration no greater than the national average.

Table 1
Number of Times the Metropolitan Average of the Following Categories:

		Earnings From Employment by Industry Group:					
MSA	Per Capita Income	Durable Goods	Primary Metal	Auto	Chemicals	Government	Services
US MSA Average = 1.0							
Buffalo							
1980	0.932	1.63	3.23	4.11	4.46	0.95	0.86
1997	0.898	1.46	1.56	4.90	1.27	1.18	0.89
Cleveland							
1980	1.045	1.74	2.79	2.64	1.48	0.65	0.91
1997	1.018	1.77	4.75	2.54	4.29	0.78	0.99
Detroit							
1980	1.066	2.15	1.68	11.97	0.52	0.75	0.88
1997	1.029	2.60	1.35	13.64	0.39	0.70	0.88
Gary							
1980	0.952	2.77	d	0.16	0.84	0.50	0.59
1997	0.879	2.41	28.95	0.05	1.07	0.78	0.80
Milwaukee							
1980	1.060	1.80	1.18	1.20	0.36	0.66	0.92
1997	1.050	1.82	1.71	0.98	0.50	0.72	0.92
Toledo							
1980	0.961	1.61	0.97	4.26	0.61	0.74	0.90
1997	0.906	2.07	1.85	5.39	0.51	0.92	0.83

A concentration greater than 1.0 suggests specialization in that activity and production for a global or national market. In a sense the region is exporting those goods and services for which the LQ is greater than 1.0. The national average is for all metropolitan areas.

Table 1 compares these measures of concentration and specialization for the Great Lakes MSAs for 1980 and 1997. Additionally there is a column for the ratio of regional to national per capita income. The ratios in the **durable goods** column indicate that all of these metropolitan areas were goods producers in 1980. Only Buffalo and Gary had lower levels of specialization in this category in 1997 than in 1980. For these two metropolitan areas, the income generated in the production of **primary metals** was a significant component of their respective economies in 1980. That is still true only in Gary. While the exact extent of the change in Gary can not be determined due to disclosure rules, the decline in the relative share of durable goods generated income over the period suggests that there have been declines in primary metals in Gary as well.

Perhaps of equal interest, but certainly less frequently discussed, is the change in the **chemical industry** in the Buffalo – Niagara Falls MSA. In 1980, earnings from the chemical industry were almost four and one-half times higher than the national average. In 1997, it is less than one and one-half times the norm. Where has the chemical industry gone? For the Cleveland PMSA, 1980 earnings from the **chemical industry** were less than one and one-half times the national average. By 1997 they had increased to 4.3 times the national average. While this does not necessarily imply that specific jobs in Buffalo went to Cleveland, it does mean that the chemical industry that was an important part of the Western New York economy in 1980, is now in Cleveland.

In the last of Buffalo's big three industrial sectors in 1980, **automobile production**, Buffalo increased from slightly more than four times the national average to slightly less than five times the national average. Thus, the Buffalo economy has become more dependent on the cyclically sensitive automobile industry. It is, however, much less important here than in Detroit or Toledo. In Cleveland, at two and one-half times the national average, automobile production is not inconsequential. Since 1980 Buffalo has lost two of its three **economic legs**, Cleveland has had substantial growth in two of its three main sectors and Detroit has benefited from its dominant position in the automobile industry. Buffalo now looks more like Gary and Toledo, dependent on one sector in its economic base.

As is evident from the table with an LQ less than 1.0 Buffalo is not participating in a substantial way in the booming national service economy. The growing service sector has not benefited Buffalo to the same extent as it has the nation as a whole, or the downstate counties in New York. The increase in service sector employment in the Buffalo region has been substantial, but the low wages in the service sector employment that has grown in the Buffalo region has diminished the economic importance of this growth.

A cautionary lesson from this might well be that those involved in economic development should talk less about jobs being brought to the region, and more about the earnings associated with this new employment. The Buffalo region needs to replace its earning power. Other *Rust Belt* areas did it by increasing the presence of the big three manufacturing employers. Downstate counties did it by replacing manufacturing wages with high-wage service sector jobs. If Buffalo's future economy follows either of these models, it could reverse its trend of long term decline. If it follows its current path, it will continue to devolve into a low wage, low skill region highly dependent on governmental transfers.

The full text and supporting documents of the newsletter appear on the internet under the address <http://www.canisius.edu/wnyeconomicnews>.

The Wehle School of Business at Canisius College publishes the *Western New York Economic News* as a public service to the Western New York business community with research and analysis performed by the following faculty from the Department of Economics & Finance:

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NATIONAL, STATE & LOCAL BUSINESS INDICATORS

NATIONAL INDICATORS	98:III	99:I	99:II	99:III	%change 98:III – 99:III
Real GDP (billions of chained 1992\$) (1)(a)	8,536.0	8,737.9	8,778.6	8,897.7-	4.2
US Personal Income (billions of \$)	7,413.6	7,630.2	7,732.6	7,825.9	5.6
	Nov 98	Sep 99	Oct 99	Nov 99	%change Nov 98 - Nov 99
Leading Indicators Index (1992=100) (1)(a)*	106.2	107.9	107.9		2.08
Consumer Price Index (1982-84=100) (2)	164.0	167.9	168.2	168.3	2.62
Exchange Rate Canadian/US \$ (3) (b)	65.23	68.12	67.98	67.86	4.03
30 Year Treasury Bond Yield (%) (3) (b)	5.07	6.05	6.16	6.29	1.22
3 Month Treasury Bill Yield (%) (3) (b)	4.41	4.71	4.95	5.14	0.73
S&P 500 Stock Index (3) (b)	1163.6	1282.7	1362.9	1388.9	19.36
Dow-Jones Industrial Average (3) (b)	9116.695	10337.0	10729.9	10877.8	19.32
LABOR MARKET TRENDS (2)					
Nonag Civilian Employment					
US (1000's) (a)	126841	129048	129311	129545	2.13
NY State (1000's) (a)	8293.1	8420.3	8443.6	8456.6	1.97
WNY (1000's)	551.1	548.5	554.5	555.2	0.20
Unemployment Rate (%)					
US (a)	4.4	4.2	4.1	4.1	-0.30
NY State (a)	5.5	5.3	5.2	5.0	-0.50
WNY	4.5	4.9	4.6	4.7	0.20
Ave. Wkly. Hours in Mfg. WNY	42.8	43.9	43.8	44.8	4.67
Ave. Wkly. Earnings in Mfg. WNY (\$)	727.17	801.08	798.04	810.43	11.45
Ave. Wkly. Hours in Mfg. US	42.2	41.7	42.0	42.1	-0.24
Ave. Wkly. Earnings in Mfg. US (\$)	573.92	588.40	589.30	591.90	3.13
WNY EMPLOYMENT (1000's) (2)					
Construction and Mining	21.7	22.4	22.0	21.1	-2.76
Manufacturing	89.3	87.9	87.8	87.7	-1.79
Transportation and Public Utilities	26.5	27.0	27.2	26.9	1.51
Wholesale and Retail Trade	133.4	131.0	131.8	134.3	0.67
Finance, Insurance and Real Estate	29.3	29.7	29.6	29.5	0.68
Services	164.2	165.0	167.4	166.5	1.40
Government	88.8	85.5	88.7	89.2	.45
OTHER LOCAL ECONOMIC INDICATORS					
Construction Contracts (\$millions) (4)*	35.3	80.6	139.8		104.39

(1) US Dept. of Commerce

(2) US Dept. of Labor

(3) Wall Street Journal

(4) FW Dodge Division of McGraw-Hill, Inc.

(a) Seasonally Adjusted

(b) End of month data

*Oct 98 - Oct 99 % change