

# Chicago Fed Letter

## Emerging urban markets in the Midwest

Midwest cities began to turn around their fortunes in the 1990s, not through outside assistance but by building on their inherent advantages and by virtue of favorable trends. In the first quarter 2000, the Federal Reserve Bank of Chicago held a series of conferences on the potential of emerging inner-city markets. Conference participants represented a wide range of stakeholders, including private business organizations, public and nonprofit agencies, and academics. This *Fed Letter* summarizes the discussions and highlights the issues presented during these conferences.

### Hidden market potential

Lynn Reilly Whiteside, chief executive of Social Compact, along with other staff members, presented a description of the group's Emerging Neighborhood Markets Initiative project. Social Compact is a Washington, DC, based nonprofit organization whose goal is to foster business investment in low-income areas. The Emerging Neighborhood Markets Initiative is an effort to promote the development of data and indicators of inner-city market potential for commercial development. The project's initial work includes a case study of the neighborhoods of Little Village and Pilsen on Chicago's West Side.

Current research on the market potential of inner-city neighborhoods has been hampered by the lack of dependable statistics from official sources on inner-city markets. In particular, measures of household income are underreported due to the use of means-based criteria in qualifying for various aid programs and from underground

economic activity. So too, measures of household spending are not available at a fine enough resolution to assess inner-city markets, and customary imputations from national data are typically more accurate for middle- and upper-income areas, which represent a larger portion of the national samples. Even so, from national data, we know that households that earned less than \$30,000 collectively accounted for \$898 billion (29%) of consumer spending.

In light of these data limitations, the Social Compact is fostering the adoption of a different type of model of inner-city retail market potential. Indicators can be compiled to better represent the economic situation in city neighborhoods. These include measures of wealth in the form of home equity, declining crime rates at the beat versus district level, and growth measures in terms of existing to potential sales. Social Compact's model draws on data from public and private sources, as well as from the proprietary data of Social Compact's corporate partners. Such partners include large corporations such as State Farm Insurance, Commonwealth Edison, SBC/Ameritech, Walgreens, Harris Bank, Home Depot, and Blockbuster Video.

Social Compact uses a four-tier process. The first tier assembles the available information on market characteristics such as income, population, home-ownership, crime incidence, and retail sales. The next tier constructs data gathered by "intercepts," which is a technique that uses local people to perform market surveys. The third tier assembles the proprietary data and market experiences of Social Compact's corporate partners. The final tier analyzes all the different data and provides estimates of market size and potential. Using such data

techniques, Social Compact arrives at substantially higher estimates of aggregate income, population density and growth, and stability than those from conventional sources.

During the session, several Federal Reserve Bank staff members commented on methodology and presentation. Ed Green suggested using the more conservative drill-down estimates, instead of those in the mid-range, to enhance the project's perceived credibility. Meanwhile, Lori Woos cautioned against using mortgage data to determine owner-occupancy since, in her experience, many families in Little Village split mortgages for multifamily homes. Woos also suggested comparing Little Village and Pilsen with other high-growth areas, such as the Clybourn Corridor, that may have different demographic characteristics. Dan Aaronson inquired as to Social Compact's stance on the accuracy of the Census, and Leslie McGranahan suggested using the intercept technique after the 2000 census to determine if people in the neighborhood had been accurately counted.

Other attendees questioned the direction of the effort and the choice of Little Village as a case study. Can the extent to which these neighborhoods are underserved by retail establishments be better documented? Although the community is not served by large, name-brand retailers, Little Village is a vibrant market composed of small independent stores and is adjacent to a commercial corridor on 26th Street. Bill Testa also questioned the study's focus on "big box" retailers such as Home Depot and Blockbuster, since smaller businesses may be better suited for the Little Village market. The focus on large retailers was defended as a means to raise public

awareness of the issues through the name recognition of big box chains. In response to the special features of Little Village, Social Compact is widening its examination to include the neighborhoods of Roseland and Bronzeville on Chicago's South Side.

### Investment spillovers

During the second conference of the series, Geoffrey Hewings of the University of Illinois at Urbana-Champaign and the Regional Economics Application Laboratory (REAL) presented findings from his research on the economic interaction within the Chicago metropolitan area. The project, funded by Chicago United and the MacArthur Foundation, demonstrates that potential investments in the less-developed areas of metropolitan Chicago—the South and West sides of the city—can have beneficial ripple effects for other areas in the metropolis.

Hewings' work, entitled "Creating and expanding trade partnerships: Economic interaction within the Chicago metropolitan region," uses input-output data on 53 sectors to create a model of the interdependence of areas in the Chicago economy. The study delineates four sub-areas of the six county metropolitan region: 1) the North Side and Loop area; 2) the South Side; 3) the West Side; and 4) the suburbs.

In his introduction, Hewings discussed the "new economic geography" theories that underlie his work and attempted to explain the spatial dimension of economic activity. Some applications of this school of thought analyze trade flows both within and between countries and regions. To illustrate, Hewings showed that the volume of trade between Illinois and its largest export markets—Canada, Japan, and Mexico—is dwarfed by the amount of trade with its neighbors—Michigan, Ohio, Indiana, and Wisconsin—which amounts to over \$400 billion a year.

The volume of trade within the Chicago metropolitan area is also hefty, registering \$114 billion. However, Hewings estimates that trade with the South and West sides accounts for a much smaller percentage of the total metropolitan

area trade than the size of the populations of these areas might suggest. Drawing a parallel with international trade topics, Hewings asserted that while there are no "tariffs" inhibiting trade with the South and West sides of Chicago, there may be significant non-tariff barriers, such as transportation, culture, and information.

Hewings' examination of the interdependencies among the four sub-regions yielded a set of multipliers that can be used to estimate the ripple effects of an increase in economic activity in one sub-region on the others. While the magnitudes vary by industry, overall, an investment in one of the relatively less-developed sub-regions yields more benefits for the other sub-regions than would an investment in one of the relatively more developed sub-regions. For example, if \$1 million is spent on a construction project on the (less-developed) South Side, the suburbs capture \$130,000, \$50,000 goes to the Loop/North Side, and \$10,000 is captured by the West Side. By comparison, for a similar investment in the Loop/North Side, \$110,000 accrues to the suburbs, only \$10,000 to the South Side, and less than \$10,000 to the West Side.

Hewings next considered the income flows as a consequence of Chicagoans' journey to work patterns. Since many people do not work in the same sub-region in which they live and shop, income earned in one sub-region causes positive "ripples" in the other regions. The income multipliers make an even stronger case that investment in the less-developed sub-regions can benefit the more developed ones. For example, for every new dollar of income earned on the South or West sides, the suburbs earn 50 cents or more. In fact, the largest total impact of this ripple effect comes from income earned on the South Side, with almost two dollars in total spending resulting from one dollar of new income. Finally, in an attempt to gain more precision in his estimates, Hewings discussed ongoing research improvements using "journey to shop" data to determine interregional purchasing patterns and resulting income flows.

Several points were brought up for discussion. Ed Green and Leslie McGranahan of the Federal Reserve Bank of Chicago inquired as to the policy implications of the study. Hewings observed that removing potential barriers to trade, travel, and development among and within Chicago's neighborhoods benefits every Chicagoan because of these income flows and spillovers.

Jim Lewis of Roosevelt University inquired about the industries that have the largest ripple effects outside of their neighborhood. Hewings responded that medical services, banking, and consumer nondurables appear to have the highest multipliers. Curt Hunter of the Chicago Fed asked whether there are programs such as tax increment financing (TIF) districts or enterprise and empowerment zones on the South and West sides and how effective they have been at stimulating investment in these areas. Charles Brown of Chicago United responded that there are about 50 TIF districts as well as both enterprise and empowerment zones in these areas. Brown's opinion was that these subsidies are generally working, but that there also needs to be a change in investors' mindset. In his view, the non-tariff barriers that Hewings mentioned are stigmas associated with issues of safety and race. He further posed the question why, given that the South and West sides are markets as large as or larger than our North America Free Trade Agreement partners, do developments there not receive much media attention. To this Heather Steans of the Civic Committee of Chicago suggested that Hewings' findings should be translated into examples of potential business decisions in order to make stronger impressions on that audience. She also proposed that the model should be adapted to analyze the impact of specific programs.

### Competitive advantages of the inner city

In the final conference of the series, Elisabeth Reynolds and Alen Amerkhanian of the Initiative for a Competitive Inner City (ICIC) presented an

overview of the research methodology they have developed to assess the business environment and growth prospects of inner cities. Founded in 1994, ICIC is a nonprofit organization whose mission is to foster healthy economies in America's inner cities. The organization has applied its methodology to inner cities in Boston, Chicago, and St. Louis, among others. Although their presentation drew primarily from their study of St. Louis, the speakers also brought in experiences from their Chicago study.

ICIC's methodology centers around the ideas expressed by Michael Porter, the organization's founder, in the article, "The competitive advantage of the inner city."<sup>1</sup> This theory involves shifting the focus of economic development efforts from being public sector driven, emphasizing subsidies and social services, toward a private sector orientation, concentrating on business development investment and market opportunities. ICIC's research framework involves identifying an inner city's competitive advantages and strengthening the linkages of the inner city economy to its "regional business clusters." These initiatives thereby establish a strategy for inner-city growth based on private sector engagement, rather than government aid and subsidies.

An inner city's potential competitive advantages arise from four characteristics. An inner city can often be characterized by a large local market underserved by large retailers, a strategic location near regional transportation infrastructure, an underutilized workforce, and untapped linkages to other regional industries. Assessing these potential advantages is one of the services ICIC provides to client cities; others include strategy training, economic mapping, cluster profiling, and workshops.

A typical competitiveness assessment by ICIC entails four stages—background research, business-base portfolio analysis, in-depth analysis, and strategy development. Each stage of the process is performed with the final implementation of the strategy in mind so that the process remains focused and practicable. The background research

stage defines the inner-city study area and assembles its general demographic characteristics, as well as reviewing all prior studies of the city. In St. Louis, poverty, median household income, and unemployment were compared at the zip code level against the metropolitan statistical area (MSA) as a whole to delineate the inner city.

The second phase entails profiling the business base that exists in the inner city. In St. Louis, for example, the businesses located in the inner city represented 13% of the MSA's employment and revenue. To examine this business base, ICIC used two approaches, the business clusters and the business environment approaches. The business clusters approach groups local establishments by similar resource needs, products, and trade linkages with each other. Further, clusters are identified as to those that produce traded versus locally consumed goods and services. The identified industry clusters are ranked according to their share of regional employment, their growth in employment from 1993 to 1998, and their potential for high growth. They are then prioritized by their "fit" with the inner city's competitive advantages, such as whether they provide job opportunities that match the skill levels of residents, or whether they exploit their proximity to transportation nodes. Once the business clusters are targeted, in the third phase ICIC conducts in-depth interviews with companies in the clusters to assess the business environment they face. In Chicago, for example, of 24 formerly inner-city-based manufacturing firms interviewed, 14 respondents said that they had moved their companies due to the inability to expand their facilities in the inner city. Another six indicated "lost space" or "modernization" as their reason for leaving. These responses indicate that land use issues are a constraint in the business environment of inner-city Chicago. In the St. Louis study, one of the industries that appears potentially more competitive for the inner city is automotive supplies. While Missouri is home to the

largest concentration of light vehicle assembly plants outside of Detroit, relatively few of the auto components are sourced locally. ICIC believes that there may be some types of components that would benefit from just-in-time delivery or transportation-cost advantages if produced in St. Louis' inner city.

After identifying the business clusters and business environment issues to target, ICIC develops a strategy for business retention and expansion. For St. Louis, the strategy addresses land use barriers and makes it easier for businesses to assemble and remediate land, as well as providing better data to companies that would like to expand in the inner city. A working group comprising both private and public actors would then implement the strategy. In Chicago, the strategy is being implemented by the Chicago Partnership for Economic Development, which is a public/private cooperative that acts as an intermediary point of entry and facilitation.

During the presentation, seminar participants contributed insightful comments. Robert Weissbourd of Shorebank questioned the categorization of industries into local and tradable sectors. Bill Testa of the Federal Reserve Bank of Chicago suggested identifying the business clusters up from the local level rather

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than from the national level in order to see if there are any clusters that may be specific to certain locations. Other participants, including Dan Aaronson and Leslie McGranahan of the Chicago Fed, discussed the finding that manufacturers left Chicago due to site-related constraints. Heather Steans of the Civic Committee of Chicago commented that, in her experience, businesses have difficulty assembling adequate parcels of land and face difficulties with city administrative processes and politics. Drawing on his research on the auto industry, Thomas Klier, also of the Chicago Fed, noted that the lack of automotive component manufacturers in St. Louis could be due to historical factors that have shaped the geographic choices of the auto industry and therefore could be difficult to undo.

### Conclusion

Inner-city neighborhoods have struggled against a tide of suburbanization in recent decades. Countermeasures such as intergovernmental aid and tax

favoritism have proven little more than stopgaps. In response, new directions try to build on the underlying strengths of inner cities at a time when such strengths are being magnified by general economic growth, favorable demographics, and a shrinking of available market opportunities elsewhere. These new directions are as yet untested and unproven, but city leaders believe that they are headed in the right direction. In a recent survey by the U.S. Conference of Mayors, 81% of respondents indicated that their cities' neighborhoods have significant untapped markets.<sup>2</sup> Researchers hope to lend a strong foundation to market-based development efforts through better general documentation of inner city business opportunities and by identifying specific avenues and approaches to growth and development.

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<sup>1</sup>Michael A. Porter, 1995, "The competitive advantage of the inner city," *Harvard Business Review*, May-June, pp. 55-71.

<sup>2</sup>U.S. Conference of Mayors, 1999, "Seizing economic opportunities in the new millennium," September, available on the Internet at [www.usmayors.org/uscm/news/press\\_releases/untappedsummary.htm](http://www.usmayors.org/uscm/news/press_releases/untappedsummary.htm).

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