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Strategies for improving the Midwest work force

by Richard Mattoon, senior economist

Work force issues are critical to regional economic development. The Midwest faces a number of challenges in attracting and retaining skilled workers, training new entrants to the work force, and retraining displaced workers for a successful transition to new employment. How the region should respond to these challenges was the subject of a recent Chicago Fed conference.

As physical capital plays a less important role in economic growth, human capital grows in importance as an economic input.

Critical issues facing the Midwest work force formed the theme of a one-day conference sponsored by the Federal Reserve Bank of Chicago and the Gerald R. Ford School of Public Policy at the University of Michigan on November 21, 2002. The conference brought together academics, policymakers, and business people to assess the current status of the region's work force and identify strategies to help attract, retain, and develop the best human capital.[1]

In opening remarks, Curt Hunter, senior vice president and director of research at the Chicago Fed, noted that the Bank's 1997 study assessing the turnaround in the Midwest economy found that regional work force development and education strategies would be critical to sustaining economic health. The study suggested that as physical capital played a less important role in economic growth, human capital would grow in importance as an economic input.

Next, William Testa, vice president and director of regional programs at the Chicago Fed, provided an overview of the Midwest work force. Testa described the region's work force as marginally high income, with an above the national average concentration in manufacturing jobs. The work force tends to have moderate educational attainment with a higher than average percentage of workers having a high school or slightly better level of education and a lower percentage having a college or college plus level. Other features of the region's work force include a tendency for out-migration to be led by younger and more educated individuals, a difficulty in attracting domestic in-migration, and a below the national average ability to attract international immigrants, with the exception of Chicago.

Testa concluded that the lack of an available work force in the late 1990s most likely constrained the region's growth. He also suggested that much of the region's strong performance in the 1990s came from fully employing its work force rather than from significant gains in wages.

Midwest work force quality

Dan Sullivan, vice president and director of microeconomics at the Chicago Fed, presented joint work with Dan Aaronson, senior economist and economic advisor at the Chicago Fed, on regional differences in worker quality. Worker quality is one of several factors that support labor productivity growth, and it is one factor that can be influenced by public policy. Sullivan defined worker quality as a composite of attributes, such as years of education and experience, sex, and other factors, that are related to relative wage levels at a point in time. Research on worker quality assumes differences in relative wages reflect corresponding differences in worker productivity. Thus, changes over time in the distribution of such characteristics should lead to changes in average productivity levels. Sullivan and Aaronson's research suggests that labor quality growth has varied over time. During the late 1980s and early 1990s, labor quality grew relatively rapidly, averaging about 0.5% per year. Recently, growth has slowed to half that, and Sullivan projects growth to slow even further because of slower growth in education levels (due to demographic shifts) and the aging of the baby boom generation.

Comparing the Midwest to the U.S. as a whole, Sullivan said that the Midwest is perhaps the "most average" region. It has caught up to the U.S. in education, has somewhat better levels of worker experience, and modestly faster worker quality growth over the last 20 years. As for the U.S. as a whole, much of this has to do with the changing demographics of the work force—in particular, a decline in the share of prime-age workers as baby boomers pass their peak earnings and productivity years and head toward retirement.

Work force issues I—Immigration, ex-offenders, brain drain

Barry Chiswick, a professor from the University of Illinois at Chicago, discussed immigration. Chiswick noted that where immigrants settle tends to be determined by the location of ports of entry, family and friends, and jobs. Thus, immigration tends to be concentrated in a handful of locations. For example, 26.5% of immigrants in 2000 landed in California and 12.5% in New York; only 10% of immigrants ended up in the Midwest, and the majority in large metropolitan areas. Where immigrants come from has changed significantly in the last 40 years. From 1951 to 1960, 68% of immigrants came from Europe or Canada. By 2000, the leading region of origin was Asia with 30%. Other major countries/regions of origin for immigrants in 2000 were Mexico (20%), other Latin American nations (24%), and Europe/Canada (18%).

Chiswick next turned to the trend in skills—a case of the "disappearing middle." Immigrants today tend to fall into either very low or very high skill levels. He suggested some possible avenues for improving immigrant absorption policy. First would be to reduce barriers for transferring skills. Licensing practices can often prevent skilled immigrants from working in their profession even when they are fully qualified. A second policy would emphasize retraining for immigrants with country-specific professional skills that might not be applicable in the U.S. For example, lawyers and other legal professionals often have country-specific knowledge and would need retraining for the U.S. labor market. Finally, improvement in English language skills and speeding up the "Americanization" process can help smooth assimilation.

Kristin Butcher, an economist at the Chicago Fed, next discussed issues facing ex-offenders in the labor market. Butcher noted that we should care about what happens to ex-offenders for two simple reasons—first, there are a significant number of inmates in the country; and second, 95% of them will be released at some point. In the Midwest, the prison population had grown from around 60,000 in 1977 to over 220,000 by 1998. In 1998, over 100,000 sentenced prisoners were released in the Midwest.

Is there a relationship between having a criminal record and labor market outcomes? Butcher suggested three approaches to thinking about this question. First, there may be no link. These are people who would have had bad job prospects even without a criminal record due to other attributes. Second, a criminal record acts as a red flag to potential employers who think anyone with a criminal record would be a poor employee. Third, being incarcerated degrades human and social capital, making an individual less able to succeed in the workplace. Butcher noted that the literature has yet to resolve this question, but has established a reasonable case for the impact of incarceration on earnings.

Butcher analyzed policy options, including "second chance" policies that would expunge or redact a prison record for a period of time and the federal bonding program that issues bonds for people deemed "unbondable" under private insurance. This program protects an employer against theft by an employee. Another option would be to improve prison programs to better develop human and social capital.

Yolanda Kodrycki, assistant vice president at the Federal Reserve Bank of Boston, presented her research on the "brain drain." Increasingly, states are concerned about retaining or attracting college graduates. Kodrycki's research examines why some regions have higher proportions of college graduates than others. She cited four factors that help determine where college grads locate—quality and accessibility of educational institutions, availability of jobs that make use of advanced skills, cost of living, and amenities.

Kodrycki identified two strategies for attracting college students. The dominant strategy is to grow and retain your own. The probability that a person who went to high school and college in the same state will stay in that state is significantly higher than for a person who leaves their home state for schooling. This is particularly true for the Midwest where the percentage of home-grown 31 to 41 year-olds with bachelor's degrees is slightly above the U.S. average at roughly 18%. However, the Midwest falls short on the second strategy—attracting college-educated workers into the region. Kodrycki cited statistics that show that the East North Central region lost roughly 26% of its college graduates from 1979 to 1991 to other regions. The U.S. average is 23.5%. However, the percentage of college graduates East North Central gained via in-migration was only 9.8% versus a U.S. average of 23.5%. Kodrycki suggested that factors that tend to cause college graduates to leave their state include: a history of prior moves and poor economic conditions in the home state (including low employment growth, a high unemployment rate, or low pay for college graduates). Interestingly, people from seacoast states are less likely to move, suggesting this is a highly valued amenity. Finally, housing costs seem to be insignificant to the location decision of recent college graduates.

In conclusion, Kodrycki said that the Midwest should continue to pay attention to "grow your own" strategies through educational opportunities. In addition, the region should continue to develop attractive job opportunities for college students. Finally, the region should better promote its benefits and opportunities to attract graduates from other areas.

Work force opportunities for low-skilled workers

In the keynote address, Rebecca Blank, dean of the Gerald R. Ford School of Public Policy, discussed her research on work force opportunities for low-skilled workers in Michigan, Illinois, and Ohio. She noted that in the late 1970s workers without a high school education in these states tended to earn relatively high wages in comparison to the nation. However, this advantage quickly eroded and today, low-skilled workers in the region have wages on par with their national peers. Since wages for low-skilled workers have declined nationally since the 1970s, this means wages have declined at an even faster rate among low-skilled workers in the Midwest.

Blank next turned to policies to improve the prospects of low-skilled workers. The most important policy in the long run is to continue to improve the current K–12 education system and to improve graduation rates. However, for those low-skilled workers already in the labor market, Blank suggested that subsidizing wages has proven to have significant benefits. Research shows that recent increases in the minimum wage have not displaced workers and the earned income tax credit provides a significant incentive to work for low-skilled workers. A third strategy would target non-job work support. In particular, this would include support for child care, health insurance, transit, and English language training.

In addition, Blank noted that traditional job training may provide some benefits, although evidence suggests that many programs have not worked. The one exception has been training designed for women in the welfare population. Finally, policies that affect the macroeconomy also matter. Low unemployment rates clearly improve the job prospects of low-skilled workers. Recent declines in wages among low-skilled workers have been linked to macro trends in globalization, changing technology in the workplace, and de-unionization.

Work force issues II—Strategies for central Illinois, displaced workers, spatial mismatch, employment and training support

Richard Judy, president of Workforce Associates, reviewed work force challenges facing a five-county region in central Illinois. Judy noted that the region's economic growth (measured by gross product) had significantly lagged both the U.S. and Illinois. He attributed this to the region's difficulty in making the transition from its traditional base of agriculture, food processing, and heavy manufacturing to other types of industries. In particular, Judy said it was critical for the region to develop new and stronger export-oriented industries. It has several factors in its favor, including good schools and infrastructure, fair taxes, regional cooperation, and good public services. Judy noted that a challenge to the region's attempt to develop more knowledge-based industries (such as bioscience) would be a potential lack of workers. To address this, the region would need to explore ways of augmenting work force growth and raising worker productivity and work force quality. In general, Judy said that strategies that would position the region as a "learning community" with affordable and accessible education available throughout one's lifetime could serve as a key to renewed economic growth.

Next, Robert LaLonde, a professor at the University of Chicago, presented research on programs designed to help displaced workers. LaLonde's work has focused on the effectiveness of retraining programs in improving employment and wage outcomes. He discussed two broad findings. First, retraining displaced workers is a productive investment for society and workers; and second, retraining does not substantially reduce the costs to displaced workers of losing their job. LaLonde's work defines displaced workers as those with three or more years of tenure with their employer. Workers with longer tenure have usually developed some firm-specific skill or attribute that often can't be easily transferred to another firm. LaLonde characterized the pattern of earnings loss for displaced workers as declining sharply after initial job loss and never fully recovering, even after reemployment. New jobs found by displaced workers often pay only 75% of former earnings.

Because displaced workers have firm-specific knowledge, they often require retraining to find new work. Retraining services vary. They can include simple reemployment services, such as job search assistance, or formal retraining, ranging from specialized programs for the displaced, existing courses at community colleges and technical schools, to on-the job training with private employers. Research on both experimental and non-experimental programs finds modest earnings effects. In an experimental case, the Texas Worker Readjustment Demonstration project, the first year impact on men's wages was $800, or 5%. For women, the result was far better, raising earnings by

Michael H. Moskow, *President;* William C. Hunter, *Senior Vice President and Director of Research;* Douglas Evanoff, *Vice President, financial studies;* Charles Evans, *Vice President, macroeconomic policy research;* Daniel Sullivan, *Vice President, microeconomic policy research;* William Testa, *Vice President, regional programs and Economics Editor;* Helen O'D. Koshy, *Editor;* Kathryn Moran, *Associate Editor.*

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$1,675, or 28%. LaLonde's non-experimental work with Sullivan and Jacobson in Washington state found long-term earnings effects of 7% for men and 8% for women. Workers appeared to have higher earnings gains when their coursework focused on technical/quantitative subjects. Again, while these results suggest positive gains, the impacts are modest compared with workers' likely earnings prior to displacement. LaLonde concluded that to get a $7,000 gain in earnings for a displaced worker, roughly $70,000 in retraining expenditures would be needed.

Then, Dan McMillen from the economics department at the University of Illinois Chicago presented evidence of spatial mismatch in the Chicago metro area. McMillen explained that spatial mismatch research came to the fore in the 1960s, when John Kain began examining the movement of manufacturing from the cities to the suburbs. The problem was that low-skilled urban populations that had held manufacturing jobs now found themselves either unable to find transportation to suburban job centers or to find low-cost housing. McMillen presented evidence that suggests that in Chicago the mismatch may be more a product of race, opportunity, and discrimination than other factors.

McMillen provided maps showing that low-cost housing does exist in suburban Chicago. Further, when examining the location patterns of specific ethnic groups, it is clear that Hispanics have been more willing (and perhaps have had more opportunity) to move to suburban locations and have found housing. In contrast, blacks remain far more segregated on the south side of the city. Using a dissimilarity index for whites and blacks, McMillen reported that midwestern cities are particularly segregated. Of the top ten most segregated cities in the nation, Gary, IN, ranked 1; Detroit, 2; Milwaukee, 3; Chicago, 5; Flint, MI, 7; Cleveland, 9; and Saginaw-Bay City-Midland, MI, 10.

Kelly DeRango, a research fellow at the W. E. Upjohn Institute, next discussed the Georgia Frontline Decision Support System (FDSS), a pilot project of Upjohn, the U.S. Department of Labor, and the state of Georgia to create an integrated, coordinated, and comprehensive employment service delivery system. The system is designed to bring together information for both customers and staff that will improve decisions regarding job prospects and service referrals. It uses client information and existing state data to help workers to find work and to identify which service programs are most likely to help an individual client based on the experience of prior clients with a similar profile. It relies on statistical methods to relate customer characteristics, labor market information, past work history, and service participation to employment outcomes.

The FDSS helps users address such key concerns as: the probability of returning to work in the same industry, estimating reemployment earnings, identifying related occupations, and searching for targeted information about specific jobs. It also can rank job services and training opportunities by effectiveness with regard to employment outcomes. Clients enter their information and the system provides a customized profile of each individual's employment prospects.

Conclusion

This fourth conference in the Chicago Fed's Midwest Infrastructure Program series helped identify the current condition of the region's work force and strategies that can help enhance regional human capital. It is clear that work force development remains a critical component of any economic development strategy for the Midwest.

[1] This conference was the fourth in the Chicago Fed's *Midwest Infrastructure Program* conference series. An expanded version of this article, to be published only on the Internet, will be available later this month. To access it, follow the Research Publications link to *Chicago Fed Letter*, 2003, February (Midwest Infrastructure Issue) from the Bank's homepage, www.chicagofed.org.