The Importance of Infrastructure

Urban Economic Policy Conference
Drexel University
Philadelphia, PA

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Good afternoon. It's a pleasure to be here.

While I'm tempted to launch into the subject of the day immediately, Fed presidents are all but required to give an economic update when we speak. So, with your indulgence, I'll start with a brief overview and outlook for the U.S. economy, and then speak a little about the importance of infrastructure to economic health.

Another requirement of Fed presidents is that we all give the standard disclaimer: The views I express today are mine alone and do not necessarily represent those of anyone else in the Federal Reserve System or my colleagues on the Federal Open Market Committee.

With that out of the way, time for the economic rundown.

Outlook

The advance estimate of GDP growth in the first quarter is 0.7 percent, which pales in comparison to the previous quarter's 2.1 percent. But weak first quarters have been constant enough in the past several years to make them effectively the norm. This year's slowdown was due — as in years past — to a combination of residual seasonality, weather effects, and modest inventory investment. These drags are likely temporary, and I expect a rebound in the second quarter.

Overall, I see growth for 2017 at about 2.3 percent. That's a very slight downward revision of my previous estimate — only 0.1 percentage point, which reflects that slow first quarter growth.

On the inflation side of our mandate, things are looking good. Inflation has been persistently low over the past several years, but it's on track to stabilize at our 2 percent goal by the end of this year.

On the other side, we're looking at the lowest unemployment rate in a decade. We created 211,000 jobs in April, and unemployment is at or below its natural rate at 4.4 percent. Quits are up, and labor force participation is higher than a year ago, despite demographic trends that are pulling in the other direction. All in all, we're looking at a labor market more or less at full health, with very little slack.

I see the unemployment rate falling as low as 4.2 percent at the end of next year and average job growth of about 200,000 a month for 2017. That pace should ease down to about 100,000 jobs a month by the end of 2019.

This isn't a bad thing. In a well-functioning labor market, we don't need the kind of job growth we've seen over the past couple of years. In fact, to sustain a healthy economy, estimates of the ideal number range from about 70,000 to 100,000 a month to keep up with population growth.[1]

So overall, things are looking good. We're essentially at normal now, and based on the strength of the economy, I continue to see two more rate hikes as appropriate this year.

Economic Growth and Mobility

Of course, that's the macro view of the American economy. I'm not blind to the areas that haven't made the same comebacks as their neighbors. I know there are people across our District who feel left behind. One of the benefits to the regional Fed System is that Fed presidents get an on-the-ground view of their local economies. Another is that we have programs to help those communities. We don't invest money or give grants because that's not what we're tasked to do, but we do have education and outreach programs; we get the right people in a room together; and we conduct research — something we are, in my totally unbiased opinion, exceptionally good at.

Research matters. I know we sometimes seem like we're all just fusty old academics, sitting around pondering the minutiae of data and maybe even missing the forest for the trees. But the

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[1] See, for example, Daniel Aaronson, Scott A. Brave, and David Kelley, "Is There Still Slack in the Labor Market," *Chicago Fed Letter*, 359, Federal Reserve Bank of Chicago (2016).

work we do — everyone here — forms the basis of real, demonstrable change. It has the potential to move people and families and towns and cities along the path from poverty to prosperity, and that's powerful. It also allows us to sit around being fusty academics, poring over the minutiae of data, but that's beside the point.

We recently launched an Economic Growth & Mobility Project at the Philadelphia Fed that will take that work to its natural next step. We're establishing research and action labs that will bring together experts and stakeholders to find ways to attack persistent problems at their roots. We're looking at everything from workforce development — like apprenticeships and skills training — to work on the subject we're here for today, urban infrastructure, including affordable housing and equitable transit.

Which is my awkward way of both plugging the excellent work by my Community Development team and pivoting to a new topic: infrastructure, the ebb and flow of urban patterns, and building inclusive economic growth.

Infrastructure

As a Fed president, one of my aims is better economic prospects for the people in the Third District and around the country. One of the ways to accomplish that, of course, is urban revitalization — everything we're talking about today: housing, transportation, competitiveness.

Infrastructure is crucial. Humanity is naturally pulled toward what sustains us, be that practical or amenable. Real infrastructure is essential to modern living, whether that's transportation or housing. So is soft infrastructure that promotes a better quality of life, from entertainment to quality and choice in education.

And all of those are necessary for economic well-being, which I view as the sum of many parts, some of which sound tangential at best to a lot of people. Not anyone here, I'm sure, but to many. Affordable housing, strong education, transportation, and even physical health are all fundamental components of a thriving economy.

If people can't afford to live near jobs — or if there's no transportation to get them there — unemployment becomes a problem. If businesses can't fill positions, they can't expand.

Likewise, the quality of life and ease of access in cities makes them competitive. High-value employees who can go anywhere are guided not just by salary but by amenities. That's part of what compels businesses to establish a presence in one location over another. But if you can't, for instance, fly internationally with ease, the city starts to look less desirable to a company that does business across the globe.

So yes, infrastructure of all kinds plays a central role in any city, region, state, or country's success.

Infrastructure and the Movement of People

Infrastructure, both real and soft, has also played a role in where we live since we first built cities and towns across the colonies. Philadelphia itself is a perfect example.

In the mid-18th century, when we were a major trading center, not to mention the New World's financial capital,[2] everything was located by the river. On the commercial side, obviously anything related to shipping was drawn to the banks of the Delaware. But so were businesses that relied on trade, from tanneries to carriage shops to breweries.[3] With that kind of concentration, it made sense for financial services to set up shop nearby.[4]

Transportation options were limited, so most people lived within a few blocks of the river. Sure, the wealthy had country estates, but in the city, even they lived in the center of the action. Ultimately, people of all statuses lived in the central port area because of the concentration of industry and the high cost — and limited means — of travel.

In the 19th century, things started to change. New York usurped our role as the country's financial capital, and manufacturing became Philadelphia's economic engine. Factories were built farther west, toward Broad Street and Manayunk. Newer, faster modes of transportation

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[2] Joseph Gyourko et al., "Looking Back to Look Forward: Learning from Philadelphia's 350 Years of Urban Development," *Brookings-Wharton Papers on Urban Affairs* (2005), pp. 1–58. Gary Burtless and Janet Rothenberg Pack, eds., *Brookings-Wharton Papers on Urban Affairs* (2005) as cited in Jeffrey Lin, "Understanding Gentrification's Causes," Federal Reserve Bank of Philadelphia *Economic Insights*, forthcoming.

[3] Theodore Thayer, in *Philadelphia: A 300-Year History*, Russell F. Weigley, ed. New York: W.W. Norton & Company (1982), pp. 75–76.

[4] Gyourko.

were developed, and people started to live farther away from work, in the more comfortable — and quieter — suburbs.

In the 20th century, of course, the same kinds of forces affected migration. Transportation evolved even further, became even cheaper, and got people farther in less time. People owned cars, and we invested in the Interstate Highway System; research shows that highways caused a full 25 percent decline in central city living across the U.S. from 1950 to 1990.[5] The suburbs offered more space and amenities at the same time that diminishing public financing and city services made urban Philadelphia less inviting.[6] Manufacturing jobs also started to move out of the city.

Now, of course, we're witnessing the reversal of the mid-20th century suburbanization trend. This time, it's partly motivated by the preference of higher-income households for conveniences like restaurants and theaters.[7] Amenities have improved, and crime has gone down. As any Philadelphian can tell you, the city looks a lot different now than even 10 years ago, much less 20 or 30.

So, what does all this mean?

For one, it means that infrastructure plays a central role in where and how we choose to live.

More importantly, it means we have to think not just about how to equip our cities to handle the demands of a changing population but how to essentially reengineer the infrastructure that supported the needs of a different time. How, for instance, do we modernize commuter systems to serve changing commuting patterns?

And finally, it means that we have to look more broadly at how regions — not just cities and states — work together to make systems more effective.

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[5] Nathaniel Baum-Snow, "Did Highways Cause Suburbanization?" *The Quarterly Journal of Economics*, 122:2 (2007), pp. 775–805. Jeffrey Brinkman, "Making Sense of Urban Patterns," Federal Reserve Bank of Philadelphia *Economic Insights*, First Quarter 2017.

[6] Gyourko. Robert Inman, "How to Have a Fiscal Crisis: Lessons from Philadelphia," *American Economic Review Papers and Proceedings*, 85:2 (1995), pp. 378–383.

[7] Victor Couture and Jessie Handbury, "Urban Revival in America, 2000 to 2010," University of Pennsylvania Working Paper (2016).

Building an Inclusive Economy

The Third District is the smallest in the Fed System. We cover about two-thirds of Pennsylvania, starting around Johnstown and going east; Delaware; and southern New Jersey. But it's really a microcosm of America: We have urban centers, suburban expanse, postindustrial towns, and rural areas.

Which means I can see the effect and influence of infrastructure on pretty much every economic profile.

There are three points I think are important when we talk about economic revitalization. First, that it should be inclusive. Second, that it can't be one-size-fits-all. Third, that our neighbors' fates are tied to our own.

Taking those in turn:

First, while economic strength and sustainability are important, we need to ensure they're inclusive. That means balancing the risks of growth, particularly the displacement of a city's long-term residents when good economic fortune sweeps in.

We've been watching and talking about gentrification for a long time. We know the patterns, and we know a lot about what drives movement into one neighborhood or another. With so many examples of booming cities across the country, cities should be able to plan ahead, whether that's ensuring mixed-income housing or transit-oriented development.

Second, we have to acknowledge that the needs of Allentown aren't the same as the needs of Philadelphia. My Community Development team is working with the city of Scranton on equitable transit, and we'll have a summit in October to share some of the findings that can be adopted by other small cities around the country. Infrastructure — real and soft — is an issue for big cities, but it's also important to smaller cities and towns, although they're obviously addressing different concerns.

Finally, as the president of a District that encompasses parts of three states, we have got to start seeing beyond traditional borders. I-95 doesn't stop at the Philadelphia city limits. We're a region as well as individual states and cities; working together on infrastructure projects is in everyone's interest.

Conclusion

I realize that I've made these proclamations as though fixes are easily found. As ever, just because we have the data or the experience doesn't mean we have the solutions. If solving problems of economic expansion and sustainability were easy; if infrastructure came in an IKEA-like flat-pack, ready to be assembled; or if working across bureaucratic lines were simple, we'd have done it already. And a lot of economists would be out of jobs.

It takes work, I understand that. And much of that work has to be done outside the scope of my own professional reach.

What we can do, however, is contribute to the body of research and offer ideas. That's what we're hoping to accomplish at the Philadelphia Fed, and that's what conferences like this, and research like you're undertaking, can help deliver as well.

Thank you.