

# Philadelphia's Economy in the National Setting

By Anthony M. Rufolo\*

When policymakers have looked at national economic issues, the accent usually has been on aggregate indicators, such as Gross National Product, and on national trends in business activity. Recently, however, it has become widely acknowledged that national initiatives affect different regions in different ways—that the Philadelphia region, for instance, may be influenced by Federal policies in a way quite different from any of the Sunbelt cities.

While basic economic forces account for much of Philadelphia's relative economic decline over the years, Federal programs

also have worked against the region. Removing the negative effects of these programs, which were largely unintended, probably would not have any fundamental impact on the long-term trend in the region, though it is likely to help at the margin. The region might benefit significantly, however, from programs aimed at altering the distributional effect of national business cycles, because the region's response to these cycles makes it particularly sensitive to aggregate national policies.

## MYTHS AND REALITIES: PHILADELPHIA'S ECONOMIC DECLINE

What is and what is not happening to cause differences in regional economic growth?

Contrary to the popular image, it is not true that industries in large numbers are fleeing the Northeast—New England and the Middle Atlantic—for the Sunbelt. All studies which

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have addressed this question find that migration accounts for only a tiny fraction of the differences in interregional employment growth. Figure 1, which breaks out the causes of changes in employment levels, shows that these changes are explained primarily by rates of birth, growth, decline, and death of business firms. The next to last number in the shaded band shows that from 1969 to 1974, the Middle Atlantic lost less than one-third of one percent of its employment because of

the migration of firms out of the region. The third number in the band shows that over 21 percent of the jobs in this region were lost because of firm closings over the same time period. These figures suggest that the Northeast's difficulty is not the attractiveness of sunnier climes but low or declining profitability. And if this is correct, the items to focus on are those that alter the region's relative profitability.

One element in the profit equation that

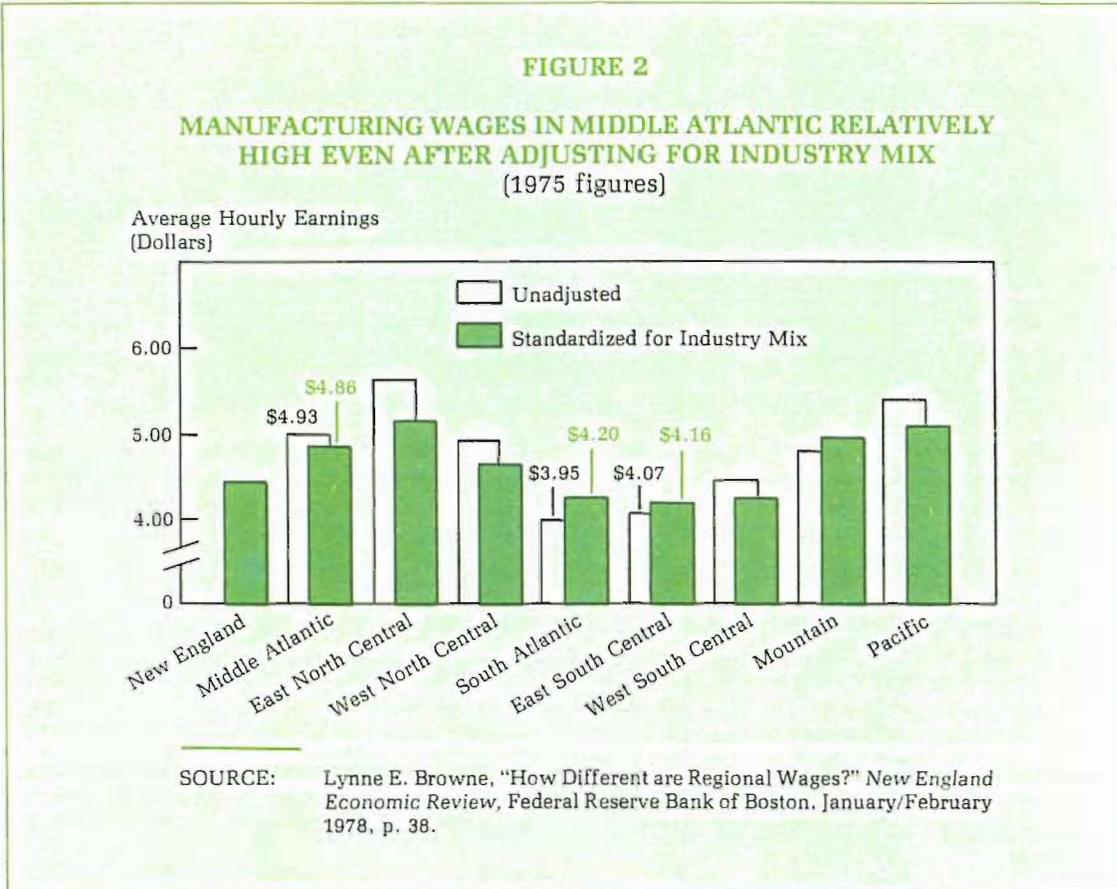
**FIGURE 1**

**MIGRATION OF FIRMS NOT THE MAIN CAUSE OF NORTHERN EMPLOYMENT LOSS  
1969-1974**

Region	Total Job Opportunities 1969	Percent Change 1969-1974	Composition of Percent Change*				
			Closure of Firms	Birth of Firms	Expansion/Contraction	Migration out of Region	Migration into Region
North	20,718,094	- 5.8	- 20.5	8.9	5.6	-0.21	0.06
New England	2,897,583	- 7.4	-21.9	9.4	4.5	-0.11	0.03
Middle Atlantic	8,731,946	-11.1	-21.7	8.6	2.0	-0.27	0.06
East North Central	9,088,565	- 0.3	-18.9	9.1	9.5	-0.18	0.08
South	10,983,550	11.6	-21.7	17.1	15.7	-0.16	0.61
South Atlantic	5,766,036	10.4	-21.4	18.2	12.8	-0.08	0.86
East South Central	2,165,189	7.1	-21.1	13.9	14.2	-0.13	0.29
West South Central	3,052,325	17.1	-22.6	17.4	22.3	-0.34	0.35

\*Sum of five columns may not equal Percent Change because of incomplete coverage of firms.

SOURCE: Carol L. Jusenius, "Documenting the 'Decline' of the North and the 'Rise' of the South (or Vice Versa)." U.S. Department of Commerce, Report EDA-OER-77-035, 1977.



receives a lot of attention is wages. But here too the popular image may call for reexamination. Wages in the Northeast may not be so much higher than elsewhere. Figure 2 illustrates that, adjusted for the skill levels of the work force, wages in the Middle Atlantic are closer to those in the rest of the nation than at first might appear. This adjustment is called for because the industries that are concentrated here use a higher percentage of skilled workers than other industries do. Simply comparing average wages from region to region is like comparing apples to oranges. The plain fact is that skilled workers earn more than unskilled workers.

The adjustment is made by looking at what

the average regional wage would be if the region had the same percentage of each industry as the nation does. For our region, this procedure lowers the weight given to the high-wage, high-skill industries which are concentrated in the Middle Atlantic, and it raises the weight placed on the low-wage industries which are not as well represented here. Adjusted along these lines, wages in the Middle Atlantic fall from \$4.93 per hour to \$4.86 per hour while those in the South Atlantic region rise from \$3.95 per hour to \$4.20 per hour.

But wages in the Middle Atlantic still are among the highest in the country, and they may not capture all the differential labor

**FIGURE 3**  
**NORTHEAST LEADS NATION IN MUNICIPAL WORKER FRINGE BENEFITS**  
**(Benefits as percentage of pay for hours worked)**

	Police	Fire	Sanitation	All Others
Northeast	37%	39%	38%	37%
North Central	36	41	34	30
South	29	30	28	25
West	36	36	33	29

SOURCE: "Second National Survey of Employee Benefits For Full-Time Personnel of U.S. Municipalities," Labor-Management Relations Service of the National League of Cities, United States Conference of Mayors, National Association of Counties (1974).

costs. Wages are only part of total compensation; benefits count, too. And Figure 3 illustrates that workers in the Northeast overall still may hold a strong edge in fringe benefits over their counterparts elsewhere. The top line of Figure 3 shows, for example, that municipalities in the Northeast on average give their workers fringe benefits equal to about 38 percent of their pay—higher than anywhere else in the country. This relation of benefits to wages is likely to hold also for nonmunicipal workers in the region. Other employer costs, such as contributions to unemployment funds, also may be higher in the Northeast.

In addition, work rules in our region may make labor costs much higher than wages alone would indicate. Unionization is more prevalent in the Northeast than in other parts of the country; and it is argued that some unions may not only protect workers from arbitrary changes in work procedures but also inhibit management from introducing new technology or making other changes which increase efficiency. Thus while unadjusted wage differences may overstate the wage disadvantages of the Middle Atlantic, wages still appear to be higher here than in many other regions, and other features of the labor-management relationship which are harder to quantify also may work against the region.

On net, then, the Middle Atlantic appears

to be a relatively high-cost, low-profit place to do business. And the cost differentials appear to offer one important explanation for Philadelphia's relative economic decline. Many firms and people stay here because of established business and personal ties and because of fixed investments. But the region seems to suffer with respect to new and growing businesses, and low profits are a drag on business development. To a large extent, this situation can be explained by ordinary economic forces, but it appears that Federal programs and policies inadvertently may have enhanced these economic forces.

#### THE EFFECTS OF FEDERAL SPENDING

It's widely believed that the Federal government affects regional economies mainly through direct expenditures. Many people point, for example, to the effects that the space program had on Houston. Local economies can become oriented toward supporting a large Federal agency or Federal supplier. And the injection of Federal salaries and purchases into an area can have an impact on total income and employment which is larger than the original amount spent. Workers spend wages, firms buy inputs from other firms, and all pay taxes into the local economy. To the extent that this happens, favored areas can benefit while, relatively, others lose out.

Are Federal policies biased against the

Northeast? It has been said that the U.S. returns only 87 cents to Pennsylvania for every tax dollar it takes out.<sup>1</sup> But Federal spending patterns may tell a misleading story. For one thing, a corporation that maintains its headquarters in New York but operates all over the country may have its entire Federal tax payment credited to New York. On the other side of the ledger, a firm in California may be credited with a large Defense Department purchase, even though many of the items it uses to fulfill the contract may be bought from firms in other parts of the country. So the dollar value of the contract may overstate the benefit to California.

Furthermore, it does not appear that Federal expenditures could be reallocated so as to have much of an impact on a large number of cities. This is partly because direct Federal purchases make up less than 8 percent of GNP. But, more importantly, only small amounts of this spending can in fact be reallocated. Government can buy petroleum, for example, only in the states that produce it. Thus changes in direct Federal expenditures are likely to have only a marginal impact on regional economic development.

At the same time, some Federal programs do appear to be biased against the Northeast and to have had a negative impact on the relative economic development of the Philadelphia region. And they may have a bigger impact on the regional economy than their dollar amounts alone show.

#### **FEDERAL POLICIES HAVE NEGATIVE IMPACT**

Federal transportation policies appear to have created a real bias against older, higher density areas. And they probably have had more significant negative effects than any other Federal policies. The Federal highway program, for example, receives no net subsidies from general revenue, but its method

of financing has resulted in a redistribution of wealth from high-density to low-density areas.

Funding for the highway program comes largely from a tax on gasoline. Cars use the roads more heavily in high-density areas, so more tax dollars are collected per mile of road in these areas. In addition, many developed areas already had a highway network when the Federal highway program was started, and so relatively few new roads were constructed in these areas. Thus many of the benefits of the system went to low-density areas. Suburbs were helped to prosper at the expense of cities, and growing regions at the expense of developed ones. The highway program is credited also with influencing where people live, and some economists now are arguing that jobs are more likely to follow people than vice versa. Thus the highway program may have encouraged certain businesses to relocate out of urban centers toward residential suburbs or regions with better climates.

Other transportation policies also seem to be biased against the Northeast. Federal freight rate regulations, for example, tend to subsidize low-density areas; and they appear to favor trucks over railroads by setting rail rates at uncompetitive levels. Railroads are most efficient in high-density areas such as the Northeast, and the Northeast already has an extensive rail network in place. But the higher rates that railroads must charge give shippers an incentive to use trucks instead. Finally, recent waterway construction, which has been concentrated in the South, has encouraged development there rather than in the Northeast.

Transportation is not the only department in which Federal policies have put the Northeast at a relative disadvantage. The Federal tax system is progressive in rates, so it should be expected that the relatively wealthy Northeast would pay more in taxes. Most Federal transfer programs are designed to shift wealth from the rich to the poor, and these programs have accelerated growth in

<sup>1</sup>*National Journal*, June 26, 1976, pp. 821-824. Reprinted in U.S. Department of Commerce, *Statistical Abstract of the United States: 1977*, p. 257.

low-income areas while slowing it down in high-income areas. This shifting of wealth was the intention of such programs, but Federal retirement and welfare programs also may have reduced the labor force participation rate of low-income households and thus have hurt older central cities by cutting the supply of low-skilled labor. And it may be that minimum wage laws have made it more difficult for low-skilled workers who want jobs to find them.

Federal regulations also may have hindered economic growth in Philadelphia and the rest of the Northeast. Price controls on natural gas may have forced many firms to move South to get assured supplies. Pollution control and new safety standards are more costly to meet in the Northeast's older plants. Also, banking regulations that tend to encourage lower risk loans may work against older, central cities, where risks have been thought to be relatively high.

Further, policy changes currently under consideration at the Federal level are not likely to alter these trends significantly. They may indeed stop assisting the trends and thus slow down the changes. And there are signs that many of the differences which favored decentralization and new areas are becoming less pronounced. Wages are becoming more similar across regions, for example, and higher energy prices may make centralized concentrations of residential and business activity more desirable. But the basic economic forces are not likely to be reversed, and many of the Federal policies which contributed to unequal regional economic development patterns are essentially irreversible. After all, who is going to advocate tearing up the interstate highway system?

Nevertheless, Federal policies could be changed to ease some of the negative impact on this region. While the region is likely to continue to grow at less than the national rate, it almost certainly will continue to grow; and removing these negative effects would further improve its outlook.

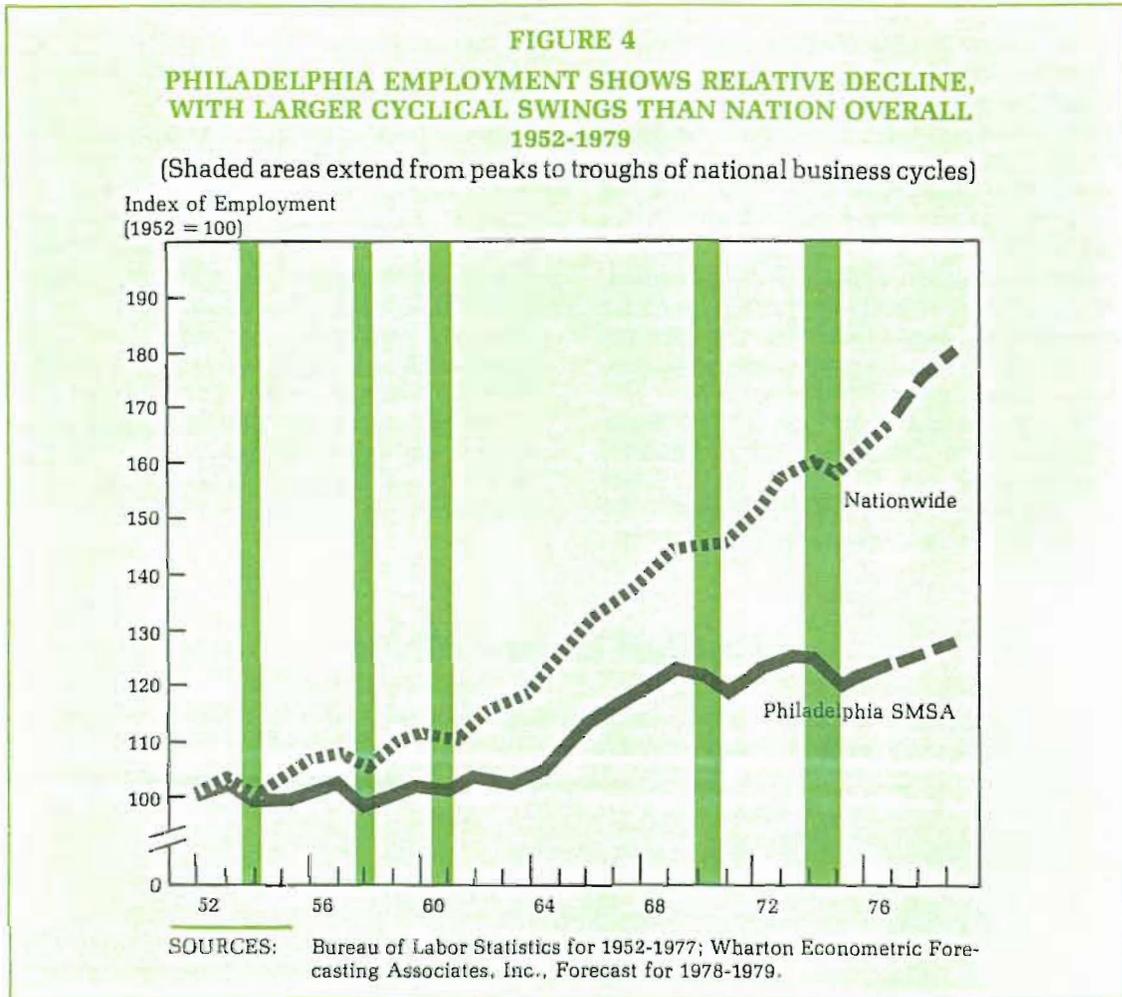
#### **PHILADELPHIA'S SENSITIVITY TO NATIONAL BUSINESS CYCLES**

Federal policy responses to national business cycles could have more significance for Philadelphia's economy than the widely publicized spending and urban impact considerations. National business cycles affect different regions quite differently. But these differential effects seldom have been taken into account when national countercyclical policies were being framed.

Figure 4 shows indices of regional and national employment from 1952 to 1977, with projections through 1979. As appears from this figure, the net regional growth path has been slower for Philadelphia than for the nation as a whole, and the region has suffered more severe downturns than the nation at large. The region did relatively well during the 1960s, but the two most recent recessions clearly had a disproportionate negative impact. Philadelphia has been declining relative to the nation almost from the time it was founded, so the trend is nothing to worry about. But the downturns are.

It is well known that the Northeast and North Central areas, and their older central cities in particular, have relatively heavy concentrations of durable goods industries like electrical machinery and that these industries are very sensitive to national business cycles. Yet Federal countercyclical aid is noted for going to construction projects that are easy to start up, and this direction tends to favor newer, growing areas. Thus it is not surprising that our region has more severe downturns than the nation as a whole.

Efforts to target countercyclical aid to Philadelphia would have their difficulties. Local cycles often can't be identified far enough in advance to let policymakers offset them. Economic projections are notoriously bad at picking turning points in the economy. Yet waiting for the actual data to come in means that the turning point may not be recognized for some time after it occurs. And even when the turning point has been recognized, lags in decisionmaking and implementation slow



down the response. Thus when Federal countercyclical programs have been enacted, they have tended to focus on public works projects that could be implemented quickly. This focus usually favored growing areas with plans for sewers and other infrastructure already drawn up.

But there remain a few things that policymakers can do. Local officials in the Northeast can develop plans for replacing outdated or deteriorating streets, bridges, and sanitary systems, for example, when funds become available. And at the national level, programs

can be targeted more toward soft public works, such as refurbishing parks and painting and repairing old transit cars. This approach could shorten time lags for public works programs and improve the local infrastructure of the entire area. All in all, such a response to the differential regional impact of national business cycles may offer the most promising form of Federal aid to Philadelphia's economy.

**THE OUTLOOK**

Regional employment is growing again,

and Wharton Econometric Forecasting Associates, Incorporated, predicts that the real Gross Regional Product will rise at a rate of about three percent per year for the next few years, while employment grows at between one and two percent per year. Output is expected to increase in all sectors, with the employment gains concentrated in the service sector. The city itself probably will stabilize and may even grow slightly over this period. But this forecast hinges on there being no new national recession over the forecast horizon. And it does not presuppose any new Federal urban policy in the region.

Thus the short-run outlook is moderately optimistic. Over the longer haul, recognition of the distributional effects of Federal policies may lead to changes which will benefit the region. But these changes will not alter the

outlook drastically. And changing Federal spending patterns or programs probably will not alter the region's relative economic strength either.

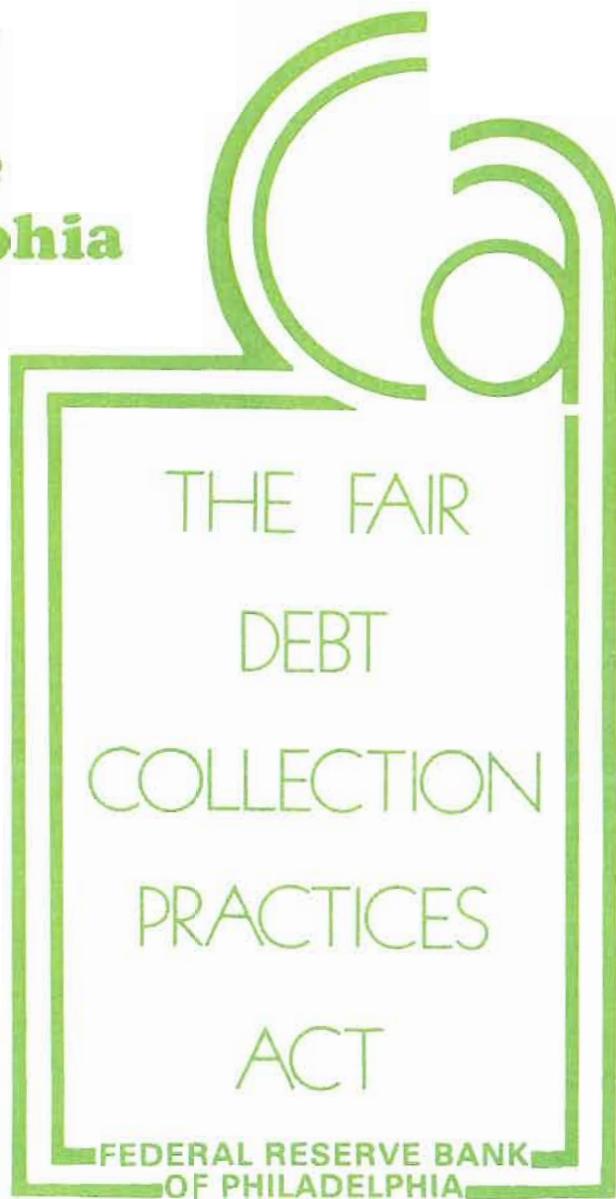
In the past, the region has shown itself to be very sensitive to national business cycles, but it appears to have gotten relatively little Federal help, in the way of accelerated public works programs, for example, during the business downturns. While the current moderately optimistic outlook for Philadelphia makes Federal countercyclical assistance in the near future unlikely, it remains true that more targeting of programs to help offset the region's cyclical difficulties may be the most effective initiative that the Federal government could take to improve the region's long-term outlook.

### SUGGESTED READINGS

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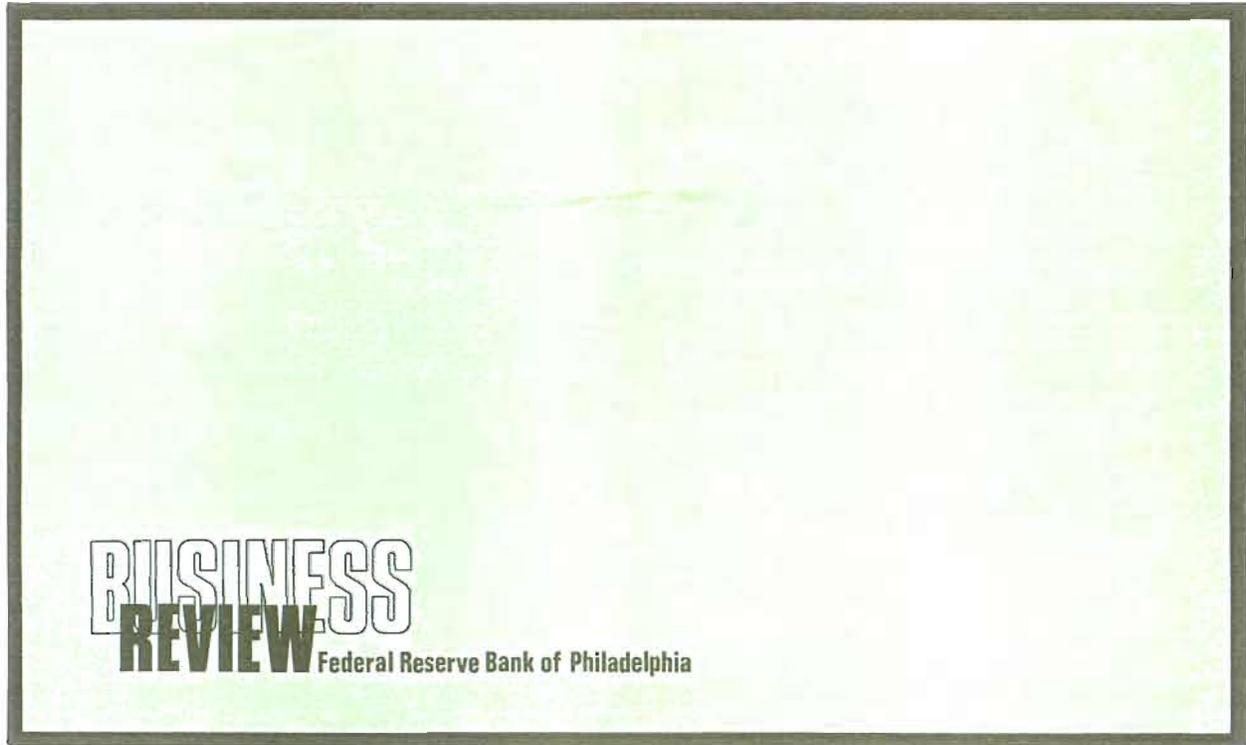
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