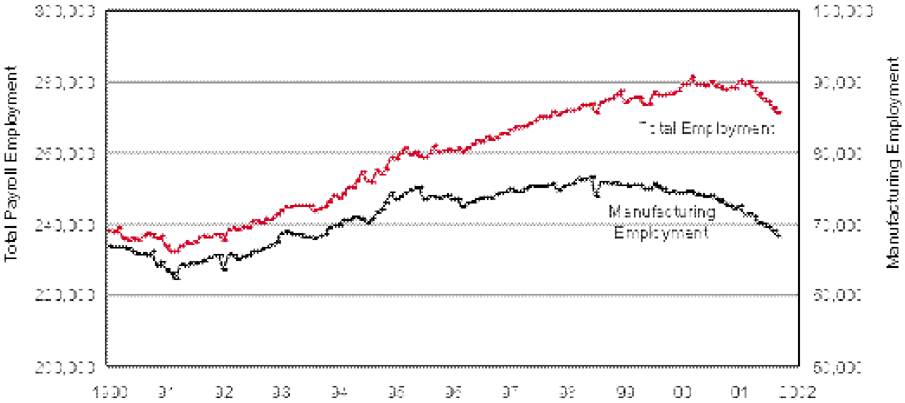
Figure 1
Fort Wayne Total Payroll and Manufacturing Employment



Data seasonally adjusted by Community Research Institute.
Source: U.S. Bureau of Labor Statistics and Indiana Department of Workforce Development

Meanwhile, the U.S. and Fort Wayne area economies are reeling from the initial shock and significant negative multiplier effects of the terrorist bombing. At this juncture, the U.S. and area recessions appear destined to continue through at least the first quarter of 2002.

Furthermore, the Fort Wayne area economy likely will lag behind the U.S. economy in recovery. Typically, the interest sensitive housing and vehicle sectors lead a recovery and the area economy is well represented in those sectors. However, sales in both sectors have held up well this year thanks primarily to the record-setting 2.75 point decline in short term interest rates engineered by the Federal Reserve since the beginning of the year. Compared to all of 2001—not just post September 11th—the upside potential for those two sectors in 2002 is limited.

The Fort Wayne area economy's best hope for significant recovery is a marked increase in capital goods expenditures—e.g., heavy-duty trucks and machinery. But that will not occur until capacity utilization of factories is considerably above the 73.8 percent seen in September and business profits recover. Those will not occur until after the U.S. economy turns—so there will be abundant forewarning. One policy shift that could change the forecasted lag in the area economy's recovery would be passage of a significant but temporary investment tax credit.

In summary, the Fort Wayne area economy is likely to incur a short-run shock to employment of at least another percentage point—3,000 jobs—before beginning a tepid recovery probably in the second quarter of the year. To recover in the second half of 2002 the jobs lost since September 11th will be quite an accomplishment. That will leave the area economy at the end of 2002 still below the last cyclical peak—likely to be identified as January 2001—by approximately 9,000 jobs.

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In 2001, northwest Indiana (Lake and Porter Counties) experienced a noticeable decline in total employment and in manufacturing employment (especially in steel); clearly, the recession that we believe has hit the U.S. economy arrived here some time ago. Before LTV's filing in bankruptcy court, seeking permission to cease steel making operations, it appeared likely that 2002 would bring more of the same, with total employment likely to fall by 1 percent to 1.5 percent (2500 to 3500 jobs), with virtually all the decline coming in manufacturing (with more than half the employment decline in manufacturing coming in steel). If LTV closes, employment may fall by an additional 4,000 to 6,000 jobs, for a total decline in employment of 6,500 to 9,500, transforming a moderate downturn locally into a reasonably severe recession.

Service employment seems likely to continue to rise modestly, as the casinos experience a strong year; however, retail employment may decline modestly, or, at best, remain unchanged. If LTV continues operations, the unemployment rate is likely to rise, peaking at 6.5 percent to 7 percent in 2002; if LTV does close, look for the local unemployment rate to peak at 8.5 percent to 9 percent.

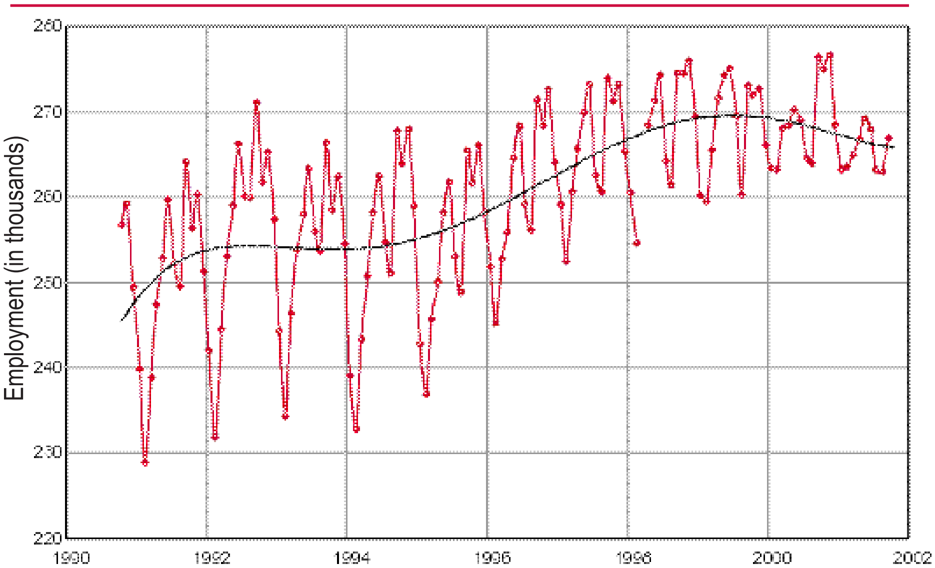
The causes for continued difficult economic times in northwest Indiana are not hard to identify. National forecasts suggest declining automobile and truck sales (down from about 16 million in 2001 to around 15 million in 2002—and the 2001 sales already mark a decline from 2000). The continued reliance of Northwest Indiana on steel suggests that this will translate into declining output and employment locally. A national recession, if it extends into the second half of 2002, is likely to reduce the demand for gasoline and other fuels, also with predictable local results. Even if the national economy recovers more quickly, or more strongly, the local economy's recovery is likely to depend on developments in the steel industry. If LTV ceases operations and the property is not acquired and operated by another steel producer, then the local economy is likely to recover slowly, if at all, during 2002.

Total Employment and Unemployment

Total establishment employment has declined since late 1999 by about 1.5 percent, a loss of about 4,000 jobs (see **Figure 1**). That decline has come entirely in manufacturing (where about 4,400 jobs have been lost); more than 80 percent of the decline in manufacturing jobs (about 3,600) has occurred in the steel mills. The year-to-year change in total employment actually slowed somewhat in 2001 compared with 2000, falling by 0.5 percent to 1 percent in the first half of 2001 compared with year-earlier data. (Household employment data show smaller declines. The distinction is important, since establishment employment is an estimate of the number of jobs available at northwest Indiana employers. Household employment includes northwest Indiana residents working outside Lake and Porter counties, mostly in Chicago.)

While local unemployment rates are notoriously unreliable measures of local economic activity, the unemployment rate estimated for Lake and Porter counties has also begun an upward trend, to about 4.6 percent recently. (This follows declining unemployment rate estimates for most of 2000—from about 5.6 percent to less than 3 percent—a decline that seems somewhat at variance with the observable changes in employment during 2000).

Figure 1
Total Employment



The northwest Indiana economy remains more heavily concentrated in manufacturing (about 17 percent of total employment is in manufacturing locally, compared with less than 16 percent nationwide) and especially in steel (now about 9 percent of local employment, but around 0.1 percent of national employment). As a result, a national recession, which will most likely affect durable goods manufacturing more strongly than other sectors, will have a disproportionate effect on this region. It seems likely that total employment will continue to decline, by 1 percent to 3.5 percent over the next year, a loss of another 2,500-9,500 jobs. The continued job losses locally, coupled with a national recession that will likely make finding jobs in the Chicago area more difficult as well, suggest that the unemployment rate will continue to rise well into 2002, probably reaching as high as 6.5 percent to 9 percent, depending on what happens with LTV.

Manufacturing

Manufacturing employment continues to decline in northwest Indiana (see **Figure 2**). In 1991, the region had about 57,000 manufacturing jobs out of a total of about 258,000 (22 percent). By the middle of 2001, manufacturing employment had declined to about 44,000 out of 263,000 total jobs (17 percent). The declines over the past 4-5 years have been steady and consistent, and so it is reasonable to suggest they will continue, with manufacturing employment falling to perhaps 41,000 by the end of 2002.

As the local economy has weakened, average weekly hours in manufacturing have declined from 42.9 hours per week in August 2000 to 41.3 hours per week in August 2001. As scheduled overtime has diminished, average hourly earnings have declined, by about 2 percent, from $21.40 in August 2000 to $20.93 in August 2001. Average weekly earnings fell by nearly 6 percent as a result both of declining hours and of declining hourly wages. (Hourly and weekly earnings are in 2001 dollars (see **Table 1**)).

Combining the 5 percent decline in employment in manufacturing with the additional 3.7 percent decline in hours suggests that the total use of labor in manufacturing declined by about 8 percent. The 3 percent decline in hourly earnings suggests that total incomes in manufacturing fell by nearly 11 percent from August 2000 to August 2001. By itself, the income declines in manufacturing suggest that total local income fell by at least 2 percent between August 2000 and August 2001.

Figure 2
Manufacturing Employment

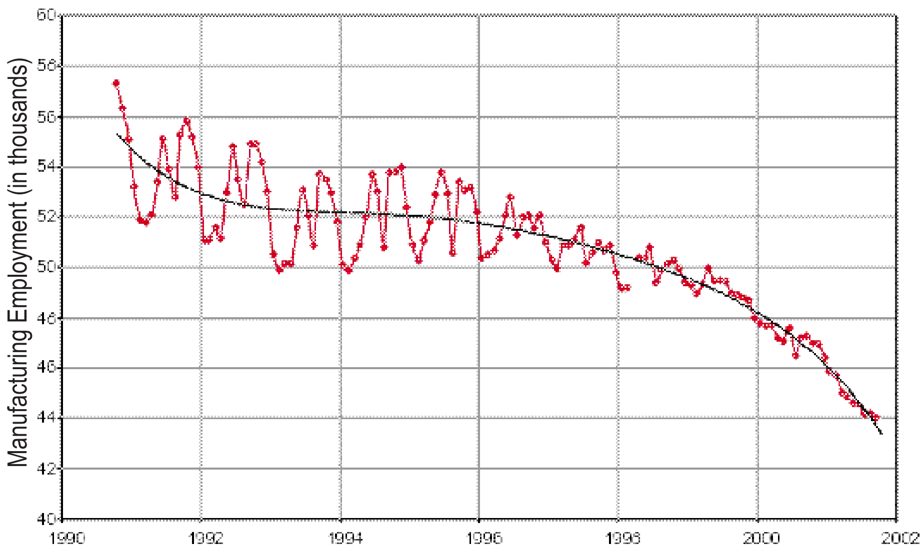


Table 1
Average Weekly Earnings, Average Hourly Earnings, and Average Hours Per Week

Industry	Weekly Earnings August 2001	Weekly Earnings August 2000	Percent Change in Weekly Earnings
Manufacturing	$864	$918	-5.8%
Durable Goods	$880	$943	-6.7%
Primary Metals	$967	$1,047	-8.2%
Steel	$982	$1,070	-8.4%
Industrial Machinery	$700	$764	-0.3%
Non-Durable Goods	$793	$796	-3.0%
Chemicals	$636	$700	-9.2%

Industry	Hourly Earnings August 2001	Hourly Earnings August 2000	Percent Change in Hourly Earnings
Manufacturing	$20.93	$21.40	-2.2%
Durable Goods	$21.93	$21.93	-2.9%
Primary Metals	$23.19	$24.02	-3.4%
Steel	$23.56	$24.38	-3.3%
Industrial Machinery	$17.76	$17.52	+1.3%
Non-Durable Goods	$19.30	$18.90	+2.1%
Chemicals	$18.48	$18.15	+1.8%

Industry	Weekly Hours August 2001	Weekly Hours August 2000	Percent Change in Weekly Hours
Manufacturing	41.3	42.9	-3.7%
Durable Goods	41.3	43.0	-4.0%
Primary Metals	41.7	43.6	-4.4%
Steel	41.7	43.9	-5.0%
Industrial Machinery	39.4	43.6	-9.6%
Non-Durable Goods	41.1	42.1	-2.4%
Chemicals	34.4	38.8	-11.3%

Depending on the resolution of the LTV bankruptcy petition, manufacturing employment will probably decline by at least 5 percent. Hours will decline over the next year as well, but at a slower rate than in the past year. Income earned in manufacturing will likely decline over the next year, probably by between 5 percent and 10 percent.

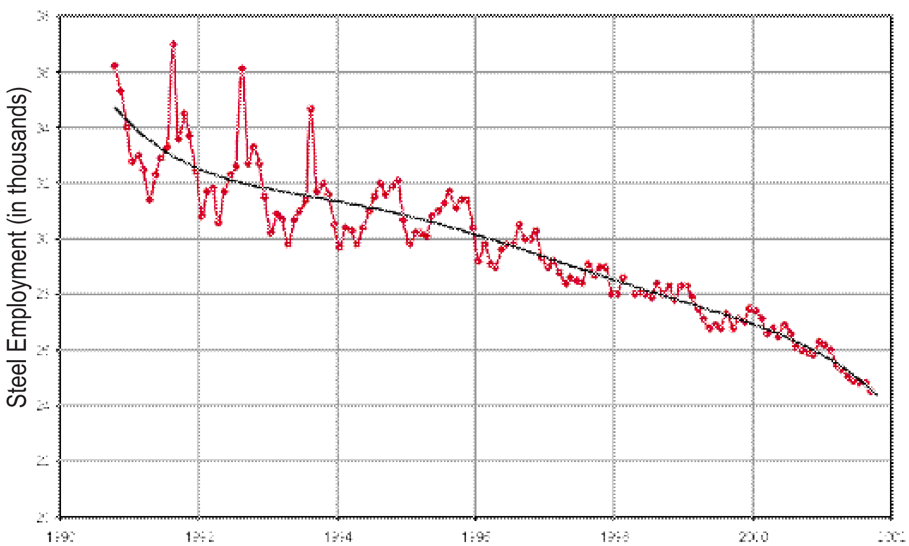
Steel

Steel continues to be of special importance in northwest Indiana. As a result of productivity increases and relatively modest increases in local steel output between 1997 and mid-2001, steel mill employment declined from around 29,000 in early 1997 to around 24,500 by mid-2001 (see **Figure 3**). Local steel output declined in the last half of 2000 and recovered somewhat in the first half of 2001. The International Trade Commission (ITC) has recently ruled that the domestic steel industry has been damaged by imports and is now completing hearings designed to result in recommendations for protection for the steel industry. Such protection is likely to provide short-term benefits to local steel output and employment. However, it is also likely to lead to increased imports of such products as automobiles, trucks and appliances. Any benefits to northwest Indiana are likely to be offset in Indiana by reduced output and employment in steel-using industries.

In addition, data from the American Iron and Steel Institute on domestic production and imports suggest that steel imports rise during periods of rising domestic steel output—the correlation between domestic steel output and steel imports is 0.33—small, but positive and significant. In addition, the ratio of imports to domestic production *falls* as domestic output rises (the correlation between them is –0.35)—imports rise more slowly than domestic production (and, when domestic production is falling, imports fall more slowly as well). This is not consistent with the notion that imports displace domestic production, but rather with the conclusion that both domestic production and imports rise as domestic demand for steel rises, and fall as domestic demand falls.

With or without protection, output in the steel industry is likely to rise if the economy recovers rapidly and fall if it does not. Employment is likely to continue to fall as productivity continues to rise—unless steel output increases quite rapidly. Locally, steel output is likely to remain roughly constant, so employment will probably continue to fall at about the same rate as productivity increases (roughly 5

Figure 3
Steel Mill Employment



percent per year). Steel mill employment fell by about 2,000 jobs in 2000 and has declined by almost 1,300 jobs so far in 2001. It is reasonable to expect employment in steel mills will continue to decline over the next year, perhaps by another 1,200 jobs, to around 23,000, even in the absence of changes attributable to Bethlehem Steel and LTV.

For northwest Indiana, the bankruptcy filings by Bethlehem Steel and LTV pose additional concerns. Despite Bethlehem's having relatively new, modern and productive facilities, the continued operation of those facilities is not certain. Either a recovery to profitability or the purchase of the company by another steel producer in a stronger financial position seems necessary for Bethlehem's continued existence. Some observers, writing in *Business Week*, attribute the bankruptcy in part to cheap imports, but it seems clear that the other factors also cited by *Business Week*—"anemic demand, and a $3 billion tab for health-care liabilities it owes retirees and their families"—are of greater importance.[1]

The losses Bethlehem Steel has suffered have come during a period of declining domestic output and declining imports, so weak demand has clearly had a major impact. When this is coupled with a very inflexible cost structure—the retiree health-care costs are totally unrelated to, and thus totally unresponsive to, changes in output—Bethlehem would have faced a difficult position in any event. Imports have probably played a fairly minor role in Bethlehem's difficulties, and import restrictions are likely to play a fairly minor role in its return to profitability.

LTV's request for permission to cease operations creates additional concerns. If a buyer for the assets does not emerge, then the local economy will lose about 3,000 jobs fairly quickly, with additional losses in industries serving the steel industry of up to another 3,000 jobs. Sale and continued operations of the facilities would, of course, mitigate these job losses.

Services

Services employment has been the continuing strength of the Northwest Indiana economy, rising by about 20 percent over the past decade and about 2 percent during the past year. The period of fastest growth in services employment corresponded to the opening of the casinos and rapid growth in employment in that sector. Even if a national recession continues into 2002, services employment will almost certainly continue to rise.

Services employment has displayed substantial seasonal fluctuation, rising rapidly in the first half of the year, declining at mid-year, then rising again toward the end of the year. (In part, the mid-year decline stems from declining employment in public schools.) This pattern is likely to continue in early 2002, providing a boost to local employment at a time when it is likely to be badly needed.

In addition, in the next six months, activity at the casinos is likely to rise faster than usual, as people travel less and substitute local entertainment for vacations. In the short-run, then, casino employment is likely to rise.

The seasonal patterns in retail employment are even more pronounced. Following a fairly sharp decline at the end of the year, retail employment tends to rise through the year. During the first part of 2001, however, retail employment rose more slowly than usual, driven almost certainly by a slowing local economy. Slower growth in the retail sector will continue so long as local and national economies are in a recession. The retail sector is unlikely to provide any noticeable support for the local economy in the next six to nine months; current trends suggest a small decline in employment in retail trade over the next year.

State and local government employment are also unlikely to rise rapidly. The continuing budget difficulties of state government and the uncertainties surrounding local government budgets related to property tax reassessments are likely to prevent any expansions in government services. The relatively limited importance of federal government activities in northwest Indiana makes it unlikely that even expanded federal government activity will provide any direct local economic stimulus.

Tax Restructuring

The state seems poised to enact a comprehensive restructuring of its tax system, a restructuring that will involve not just funding for state government, but also, by reducing local government reliance on property taxes, funding for local government units. A key provision here is the assumption by the state of additional funding responsibilities for local schools. The restructuring plan is complex, and already a number of industry groups have identified aspects of it that may lead to higher business taxes (while, it seems, ignoring the parts of the plan that will reduce business taxes). Overall, the plan will apparently shift the tax burden from business to individuals. It will also shift taxes from property taxes to tax sources that are more responsive to changes in economic conditions.

Of major importance for northwest Indiana is the proposed replacement of the inventory tax by other sources of revenue and the assumption of local (township) welfare costs by the state. Both of these changes will reduce business tax burdens.

Among the unanswered questions in the proposed restructuring plan are the formulas to be used to increase state funding of local schools and the mechanism by which local welfare expenditures are to become the responsibility of the state.

Conclusion

The northwest Indiana economy will continue in recession during the next six to nine months. Total employment will decline by 1 percent to 3.5 percent, primarily as a result of declining manufacturing employment, and the resolution of LTV's bankruptcy filing. Declining weekly hours in manufacturing will contribute to declining local incomes as well. Even continued increases in services employment will not be sufficient to prevent the local economy from continuing in a recession, which will have a total duration (from its beginning in late 1999) of more than two years. Unemployment will rise, with the unemployment rate peaking between 6.5 percent and 9 percent. As the national economy recovers (probably in the second quarter of 2002), the local recession is likely to end as well. In the longer-term, the tax restructuring may have substantial consequences for businesses, and therefore for business activity.

Finally, we need to remain aware of the potential vulnerability of the economic infrastructure to continued terrorist acts. While in countries in which there is an extended history of such acts (Israel, Ireland, the Basque region of Spain) most of the attacks have not targeted the economic infrastructure, that is by no means a guarantee for the future.

Notes and References

1. *Business Week*, October 29th, p. 40.

A note on data sources. Local employment and unemployment data are drawn from the Labor Market Letters for Lake and Porter counties issued by the Indiana Department of Workforce Development. Data on steel output and imports comes from data on the web site of the American Iron and Steel Institute (www.asisi.org).

Indianapolis

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As of the week of September 11th, Indianapolis employment was still running ahead of the same month a year earlier (see **Figure 1**). More recent data are not available as we go to press.

The nine county metro area had 8,500 more jobs in September 2001 than in 2000. This was a shallow 0.9 percent increase over a year earlier and ranked 100th among the nation's 275 metro areas. But in a Midwestern perspective, the Indianapolis metro area looked far better, ranking 17th of 75 metro areas, with only one larger metro area doing better (Kansas City ranked 6th).