The Service-Sector Recovery in Cleveland
by Robert H. Schnorbus and Lorie D. Jackson

A popular belief in urban development is that the service sector provides a perpetual source of employment growth. Service-sector industries include transportation and public utilities, wholesale and retail trade, government, finance, insurance, real estate, and other consumer and business services. Except for an occasional quarter or two of employment loss during recessions, service-sector employment has increased steadily nationwide. Service-sector employment is especially important to the Fourth District to replace jobs lost in the shrinking local manufacturing sector. In many areas of the Fourth District, however, rates of service-sector growth often have been among the lowest in the nation. Moreover, in five of the first six quarters of the current national recovery, employment in Cleveland’s service sector declined (see chart 1). Indeed, service-sector employment has been on a downward trend since 1980.

The views stated herein are those of the authors and not necessarily those of the Federal Reserve Bank of Cleveland or of the Board of Governors of the Federal Reserve System.

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Service-Sector Recovery—Past and Present
Since World War II, the service sector nationwide has rarely experienced employment declines. Over the business cycle, service-sector employment typically slows its rate of growth during recession and accelerates during recovery. In the 1981-82 recession (the deepest in postwar experience), however, nationwide service-sector employment declined 0.3 percent (or 174,000 jobs), mostly in service-related industries. In the current recovery, service-sector employment expanded 4.6 percent (or 3.1 million jobs) between the cycle trough in 1982:IVQ and 1984:IVQ. This performance was generally consistent with the 1971-72 and 1975-76 recovery experiences nationwide.

In contrast, Cleveland’s service sector frequently loses employment, both in recessions and in the early stages of recovery. Over the current business cycle Cleveland’s service-sector employment declined throughout the 1981-82 recession, losing over 1.7 percent of its employment (or 10,400 jobs) and continuing to lose employment in nearly every quarter since the recovery began nationwide. Indeed, local service-sector employment in 1984:IIQ, six quarters into the recovery, was 0.3 percent (or 1,600 jobs) below its level when the recovery began nationally (see chart 2).

In many ways, the current local recession has been similar to recent recoveries. In both the 1970-71 and 1975-76 recoveries, local service-sector employment dropped about

Chart 1 Manufacturing and Services-Sector Employment Index

Chart 2 Local Service-Sector Recoveries Index

1. The Fourth Federal Reserve District includes the entire state of Ohio, northern and eastern Kentucky, western Pennsylvania, and the northern panhandle of West Virginia.

Another factor in the slowdown could be the rising prices of services compared with goods. If productivity in services has grown at a slower rate than in manufacturing, as is generally assumed, then unit costs of services should be rising faster than the price of goods. If the demand for services becomes price responsive to price changes, continued increases in service prices would reduce the quantity of services demanded by more than the price increase. In producer services with emerging economies of scale, the price effect might be overshadowed by productivity improvements associated with the introduction of new technologies.

**Linkages between Manufacturing and Services**

Although service-sector expenditures have grown faster than manufacturing expenditures over the postwar period, service-sector performance has not been completely independent of the manufacturing sector. The demand for services is linked directly and indirectly to manufacturing activity. A direct link is created by producer services that provide services, essentially "invisible" inputs into the manufacturing process. An indirect link is created by consumers' demand for services in that many consumers' incomes depend on employment in the manufacturing sector. This growth in the service sector has been concentrated in mature economies, such as Cleveland's, where economic growth has been below the national average. There are several reasons, related to structural changes in the local economy, why the Cleveland service sector might have experienced disproportionately slow service employment growth over the postwar period. First, the link between the manufacturing and services sectors is long-term as well as cyclical effects. Structural decline within the local manufacturing sector is likely to spill over into the service sector. Second, the loss of local population and income would be expected to slow the growth of services demanded by consumers. Third, the extent to which structural decline has occurred throughout the Fourth District, there may also have been a decline in the portion of service-sector employment in Cleveland devoted to the export of services to surrounding metropolitan areas.

**Shifts in Composition**

Over the last decade, Cleveland's service sector has been emerging, fostered by new technologies, most notably computers. New producer services (e.g., computer services, computer consulting, and nonprofit services (e.g., technological advances in diagnostic medicine) have been increasing as a share of total services, while the more traditional government and distributive services have managed to hold their own. This trend is likely to continue in the changing distribution of service-sector employment (see chart 5). In 1973, for example, the share of services employed in the nation were in either state or local governments or in the distribution of services (e.g., retail trade), with employment in producer and nonprofit services. By 1983, 64 percent of service jobs were in government and distributive services, and 36 percent were in producer and nonprofit services. (Consumer services, which include the current service sector that normally would be expected to grow more rapidly than the nation as a whole.)

**Trends in Service-Sector Expenditures**

Several underlying trends, both nationally and locally, might explain the slowing of service-sector employment growth in the Cleveland area. If Cleveland were experiencing service-sector employment gains comparable with those in the 1975-76 recovery, it would have gained about 29,000 more service-sector jobs by the sixth quarter of the current recovery than it actually did. In addition, to the declining performance of Cleveland's service sector, the gains made locally were less than those made nationally. In Cleveland, the service sector's share of producer-service employment was 7 percent greater than in the nation, by 1983, the local share had dropped by only 1 percent, in the nation. Because Cleveland has become less specialized in producer services relative to the nation than it was ten years ago, the cyclical contribution of this industry to the total service sector has become more like the nationwide contribution. The net effect of less specialization in producer services has likely been a dampening of the local relative employment growth even less cyclically sensitive services (i.e., nonprofit services) have taken off. Among other types of services, nonprofit services increased their share of Cleveland's service-sector employment by nearly 10 percent more than the national average in 1973 to nearly 30 percent in 1983. While reflecting long-term growth, the construction and finance sectors, which represent a large part of Cleveland's service industries, employment declines since 1980 were greater than in overall service-sector employment. Employment gains in these industries did not offset the overall service cyclical recovery than in the past (assuming service-sector industries follow a typical recovery pattern).

**Service-Sector Trends**

While the broad-based weak recovery in employment in Cleveland's service sector since 1980, employment nationwide has been accelerating in response to improvements in performance and consumer demand. However, the slower growth in service-sector employment since 1980 is that the last two recessions (1980 and 1981-82) were particularly severe for Cleveland's manufacturing industries. Manufacturing employment dropped a total of 29,000 jobs between 1970 and 1982, with about one-third of the job losses occurring between 1980 and 1982. Adjustments in the local sector to manufacturing losses appear to have continued into the current recovery. A lagging structural adjustments have detracted from the employment gains in the service sector that normally would be expected to come with recovery in the business cycle.

Although there are a few bright spots, the performance of all service groups bears some evidence of the local impact of structural decline (see chart 4). In contrast to past recoveries, cyclically sensitive government and distributive services have performed poorly in the current recovery. While education, health, and social services have not been affected as severely in the current recovery as in the past, they continue to be relatively more cyclically sensitive than services. (i.e., nonprofit services) have taken off. Among other types of services, nonprofit services increased their share of Cleveland's service-sector employment by nearly 10 percent more than the national average in 1973 to nearly 30 percent in 1983. While reflecting long-term growth, the construction and finance sectors, which represent a large part of Cleveland's service industries, employment declines since 1980 were greater than in overall service-sector employment. Employment gains in these industries did not offset the overall service cyclical recovery than in the past (assuming service-sector industries follow a typical recovery pattern).