How Would America Look Without the Coasts?

Wide Geographic Disparities in the New Policy Paradigm

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In the new policy paradigm we're in, disparities within the economy become much more important to examine. The persistent undershoot of inflation relative to the Fed's target over the past decade has provided the Fed latitude to remain easier and has led the Fed to redefine its full employment mandate as "broad-based and inclusive" and that seeks to address "shortfalls" from maximum employment. Additionally, the MP3 policy paradigm—where expansionary fiscal policy is paired with stimulative monetary policy—allows room for more targeted support where it's needed most in the economy.

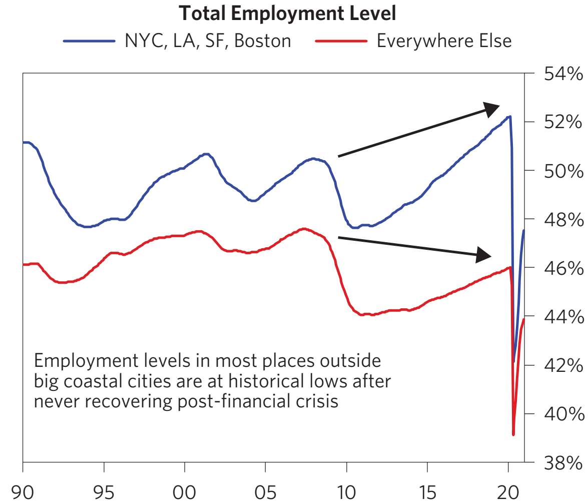
There are many types of disparities in the economy (e.g., race, gender, education level), and in this research, we focus on geographic disparities, which are at highs given historically low domestic migration rates. While there is nothing magical about geographic disparities, we find them to be a good way to illustrate how different pockets of the economy have performed over the recent expansion. **By excluding the booming coastal cities from the rest of the US, it is easier to see just how large the "shortfalls" from maximum employment are in the bulk of the country.** This dynamic adds to the Fed's (and other policy makers') skew toward lagging the economy and permitting inflation to rise.

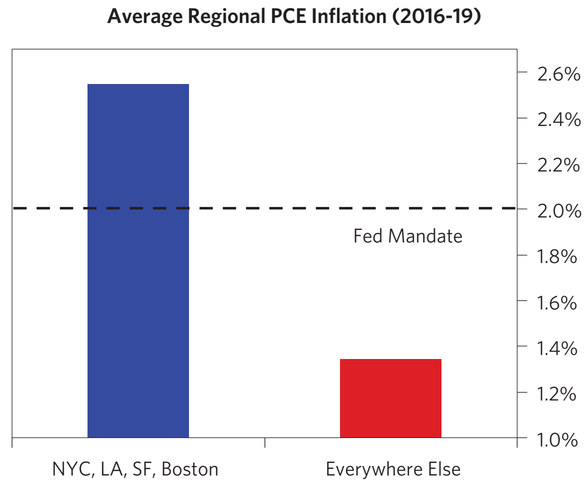
To delve into this question, we started with a thought experiment: what if we split the large coastal cities off from the rest of the country?

- Zooming in on New York, Los Angeles, San Francisco, and Boston, these four cities make up about 14% of the labor force. If they made up the whole economy, there would be considerably more pressure on the Fed to tighten; employment levels were at historical highs pre-COVID and have already rebounded to normal levels, and with a roaring labor market, inflation rates in these cities were "overshooting" the Fed's target prior to COVID.

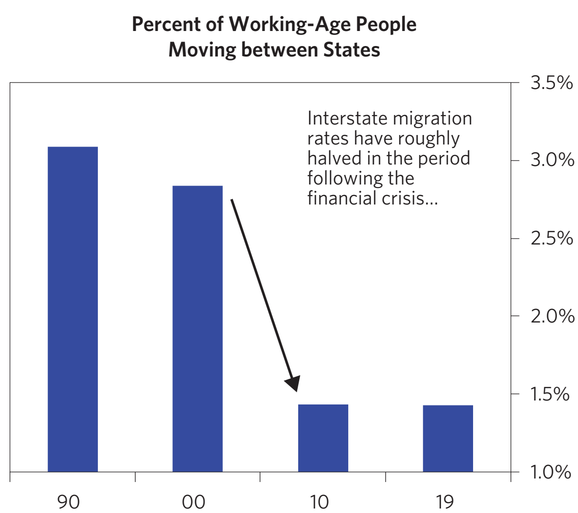
- When you exclude just these four cities from the US, the level of employment is at historical lows—largely a consequence of record low and falling participation in the labor force—and inflation has been running well below the Fed's target. In other words, without the coasts, it is easier to see just how large the "shortfalls" from maximum employment are in the bulk of the country.

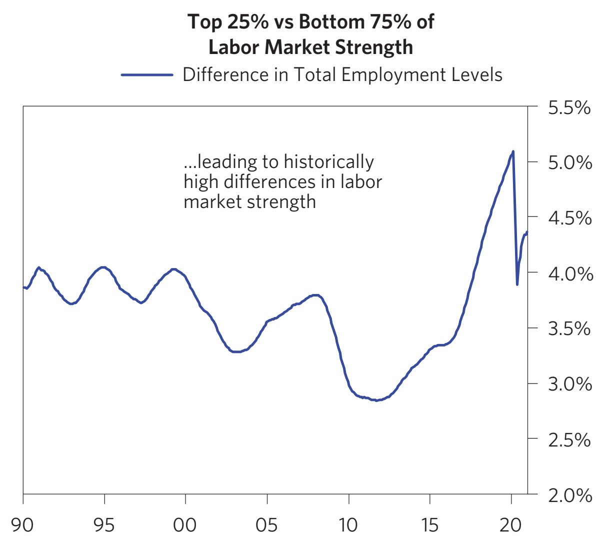
There have always been divergences within the US. But after a decade where social conditions have increasingly diverged from traditional measures of economic performance, these divergences are wider than ever—and in the new policy paradigm, there is more room for such disparities both to influence policy makers' choices and to potentially be addressed through more targeted MP3 policy measures.



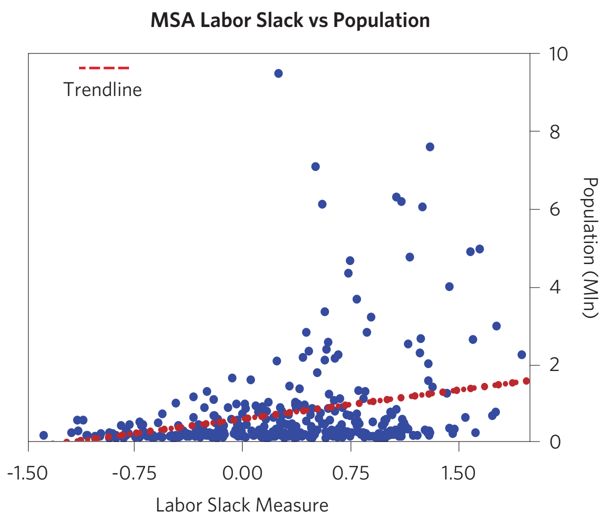


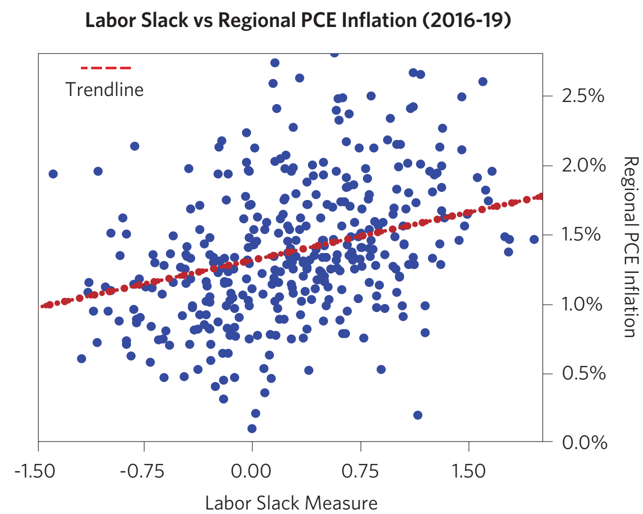
Geographic disparities within one country really shouldn't matter much. Without internal borders or language barriers, Americans are free to pick up and move to wherever there is opportunity, and work is increasingly more remote and therefore more accessible from anywhere. But in practice, migration within the US is down significantly. As the barriers to entry for many places where opportunity exists have become restrictively high, people have become more likely to stay put and just stop looking for work, dropping out of the labor force and returning only if and when local conditions eventually improve. **As a result, geographic divergences in labor markets are running at historically high levels.**



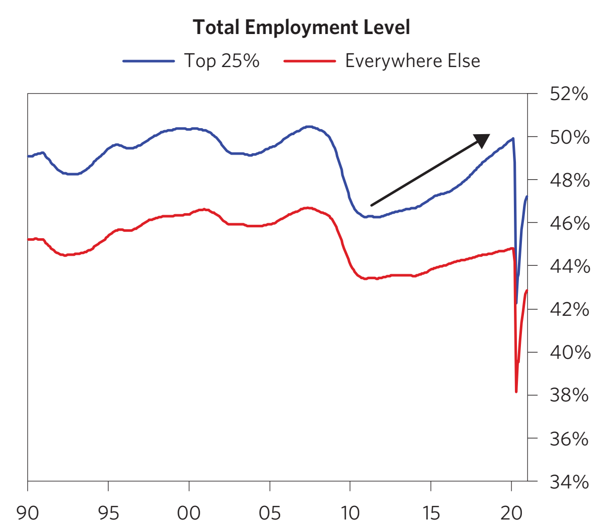


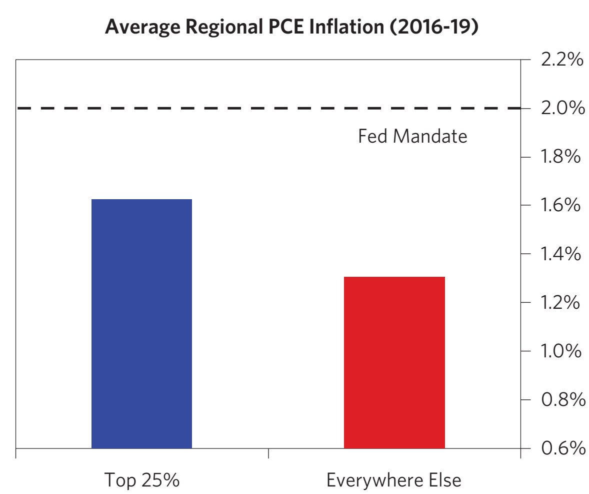
These divergences aren't just about an idiosyncratic difference between a few coastal cities and the rest of the country; they hold true broadly. To get a better sense of geographic divergences across the US, we created a measure of regional labor slack that looks at the total percentage of people employed (both the level and change) as well as overall job growth across ~380 metropolitan statistical areas (MSAs), covering about 87% of the US labor force. We chose to use a more holistic measure of labor slack because narrow measures like headline unemployment obscure important information about those who have simply left the workforce altogether (only those who are actively looking for work are categorized as unemployed). In the context of record-low domestic migration rates, each MSA can increasingly be thought of as an individual labor market. As the below scatter chart on the left shows, labor markets are generally stronger in the largest cities. And as the chart on the right shows, in general, **where labor markets are stronger, inflation is running at higher levels**; in most cities, it has been running well below the Fed's mandate (inflation is shown over the 2016-19 period, the last few years of the expansion when parts of the economy were starting to bump against capacity constraints).



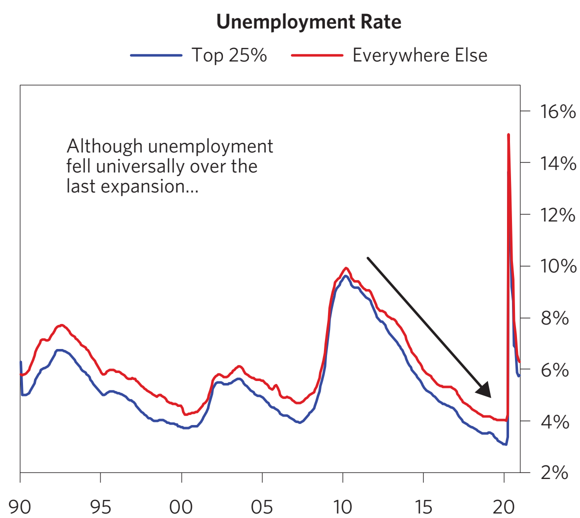


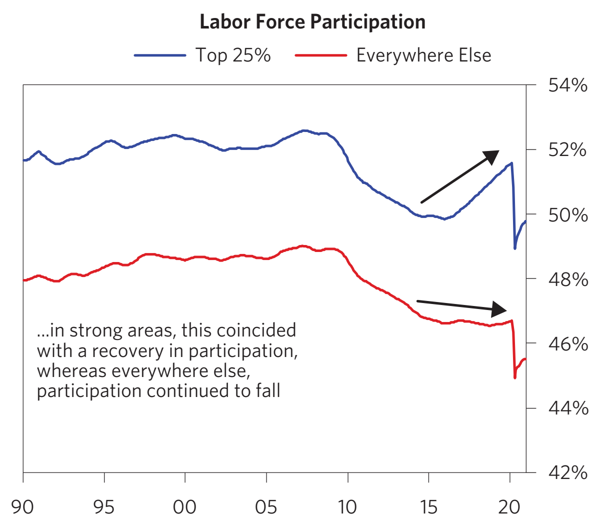
Expanding from just the four large cities described above, we looked at the top 25% of MSAs in terms of labor market strength. This group of 95 metro areas (see the list in the Appendix) makes up approximately 40% of the US labor force. The total level of employment across this top quartile of MSAs was close to historical highs pre-COVID and has already almost normalized; **for the rest of the country, the level of employment barely recovered over the course of the last expansion** and currently sits at historical lows because of the pandemic. Inflation in these top cities ran about 30bps higher than in the rest of the country prior to COVID.





The fact that employment levels were largely stagnant over the last expansion is a result of steadily declining labor force participation rates. The level of employment can be broken into 1) participation in the labor market and 2) the unemployment rate of participants. While unemployment rates fell universally over the course of the expansion (see left chart below, a chart we are used to seeing), the means by which unemployment fell differed between the areas with stronger labor markets and everywhere else. In the stronger regions, unemployment fell as jobs were added to the economy, with the strength of the labor market even drawing people back into the labor force; conversely, **in most other areas, the fall in unemployment was largely a function of people giving up on looking for work and dropping out of the labor force**, as is evidenced by a steadily declining participation rate, which currently sits at record lows due to the impacts of COVID.





Disparities within the economy are not new—although they are more extreme today than they have been in past decades, they have always existed. **What is different today is that we are in a new policy paradigm**, with the end of preemptive inflation fighting and the shift to MP3—the fusion of monetary and fiscal policy—as the primary policy tool. **This policy paradigm is one that explicitly considers such disparities in the economy in setting policy objectives.** The Fed's latest "Statement on Longer-Run Goals and Monetary Policy Strategy" defines its full employment mandate as "broad-based and inclusive" and as deliberately targeting economic performance that is strong enough to eliminate "shortfalls" from its maximum level. As Fed Chair Jerome Powell noted in a recent speech titled "Getting Back to a Strong Labor Market":

> *"A strong labor market that is sustained for an extended period can deliver substantial economic and social benefits, including higher employment and income levels, improved and expanded job opportunities, narrower economic disparities, and healing of the entrenched damage inflicted by past recessions."*

And in a speech given late last year titled "Achieving a Broad-Based and Inclusive Recovery," Fed Governor Lael Brainard also specifically called out the Fed's focus on closing long-standing labor market gaps, stating:

> *"In the years before the pandemic, I was encouraged to see prime-age individuals in all demographic groups drawn into the strong labor market, reversing the previous decline in participation and boosting the productive capacity of the economy. Persistent spells out of employment risk harming not only the prospects of these individuals, but also the economy's potential growth rate."*

Additionally, in the new policy paradigm, fiscal policy is playing a bigger role than ever before in our lifetimes and is distributional by nature, with the ability to target support where it's needed most in the economy ("picking winners and losers"). Later this year, we expect to see the first expansionary fiscal package centered around pursuing long-term social, environmental, and competitiveness policy goals—consistent with the increased comfort we see with policies intended to shape the economy more proactively.

Appendix: Top 95 Metro Areas in Terms of Labor Market Strength (2016-19)

Abilene, TX MSA	Gainesville, GA MSA	Port St. Lucie, FL MSA
Ann Arbor, MI MSA	Grand Junction, CO MSA	Portland-Vancouver-Hillsboro, OR-WA MSA
Asheville, NC MSA	Greeley, CO MSA	Provo-Orem, UT MSA
Atlanta-Sandy Springs-Roswell, GA MSA	Harrisonburg, VA MSA	Raleigh, NC MSA
Auburn-Opelika, AL MSA	Huntsville, AL MSA	Reno, NV MSA
Austin-Round Rock, TX MSA	Idaho Falls, ID MSA	Richmond, VA MSA
Baltimore-Columbia-Towson, MD MSA	Jacksonville, FL MSA	Riverside-San Bernardino-Ontario, CA MSA
Barnstable Town, MA Met NECTA*	Jonesboro, AR MSA	Rochester, MN MSA
Bend-Redmond, OR MSA	Kalamazoo-Portage, MI MSA	Salinas, CA MSA
Birmingham-Hoover, AL MSA	Kankakee, IL MSA	Salt Lake City, UT MSA
Boise City, ID MSA	Kennewick-Richland, WA MSA	San Francisco-Oakland-Hayward, CA MSA
Boston-Cambridge-Nashua, MA-NH Met NECTA	Lake Havasu City-Kingman, AZ MSA	San Jose-Sunnyvale-Santa Clara, CA MSA
Boulder, CO MSA	Las Vegas-Henderson-Paradise, NV MSA	Santa Rosa, CA MSA
Bremerton-Silverdale, WA MSA	Logan, UT-ID MSA	Savannah, GA MSA
California-Lexington Park, MD MSA	Los Angeles-Long Beach-Anaheim, CA MSA	Seattle-Tacoma-Bellevue, WA MSA
Carson City, NV MSA	Louisville-Jefferson County, KY-IN MSA	Sioux Falls, SD MSA
Charleston-North Charleston, SC MSA	Mankato-North Mankato, MN MSA	Spartanburg, SC MSA
Charlotte-Concord-Gastonia, NC-SC MSA	Miami-Fort Lauderdale-West Palm Beach, FL MSA	Spokane-Spokane Valley, WA MSA
Charlottesville, VA MSA	Midland, TX MSA	St. George, UT MSA
Chattanooga, TN-GA MSA	Minneapolis-St. Paul-Bloomington, MN-WI MSA	Tallahassee, FL MSA
Coeur d'Alene, ID MSA	Morgantown, WV MSA	Tampa-St. Petersburg-Clearwater, FL MSA
College Station-Bryan, TX MSA	Mount Vernon-Anacortes, WA MSA	Trenton, NJ MSA
Colorado Springs, CO MSA	Napa, CA MSA	Tuscaloosa, AL MSA
Dallas-Fort Worth-Arlington, TX MSA	Naples-Immokalee-Marco Island, FL MSA	Walla Walla, WA MSA
Daphne-Fairhope-Foley, AL MSA	Nashville-Davidson-Murfreesboro-Franklin, TN MSA	Warner Robins, GA MSA
Decatur, AL MSA	Odessa, TX MSA	Washington-Arlington-Alexandria, DC-VA-MD-WV MSA
Denver-Aurora-Lakewood, CO MSA	Ogden-Clearfield, UT MSA	Wenatchee, WA MSA
Des Moines-West Des Moines, IA MSA	Olympia-Tumwater, WA MSA	Wilmington, NC MSA
Dubuque, IA MSA	Orlando-Kissimmee-Sanford, FL MSA	Winchester, VA-WV MSA
Elkhart-Goshen, IN MSA	Palm Bay-Melbourne-Titusville, FL MSA	Yakima, WA MSA
Fayetteville-Springdale-Rogers, AR-MO MSA	Pensacola-Ferry Pass-Brent, FL MSA	
Florence, SC MSA	Phoenix-Mesa-Scottsdale, AZ MSA	
Fort Collins, CO MSA		

*New England City and Town Area