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RECESSION AND THE NINTH DISTRICT

When half-full feels more like three-quarters

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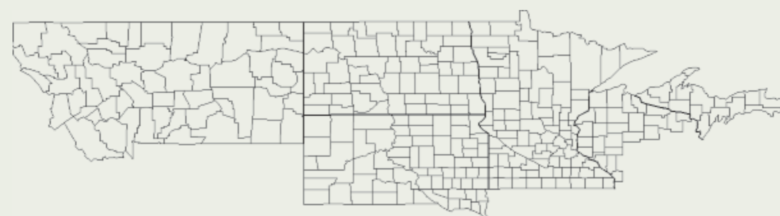


Here's a recession version of the Myers-Briggs personality test: Having lived through one of the worst economic periods in America over the past half-century, are you now economically half-full or half-empty?

That probably depends on with whom or what you compare yourself, whether it be the neighbors next door, people in the state nearby or the people and places nationwide profiled in myriad news articles. Your own circumstances—what life was like a few years ago—likely plays a role in your outlook as well.

But by most of these parameters, Ninth District states should be a generally cheery group. Though they have definitely felt the recession's sting, district states and regions are nonetheless the likely envy of peers nationwide because they have generally suffered less economically.

That "suffering lite" notion might not exactly replace any state mottos ("At least we're not you!") but it's nonetheless a palpable perception in much of the Ninth District. The data say so, in fact. Compared with the country as a whole, unemployment levels were low in district states leading into the recession, and a lower percentage of workers have subsequently lost their jobs. It's hard to pin down exactly why this happened, but some of this "less bad" performance appears to stem from the stabilizing effect of a relatively good farm economy during the recession, and the comparatively moderate pace of housing and general economic growth leading into the recession.

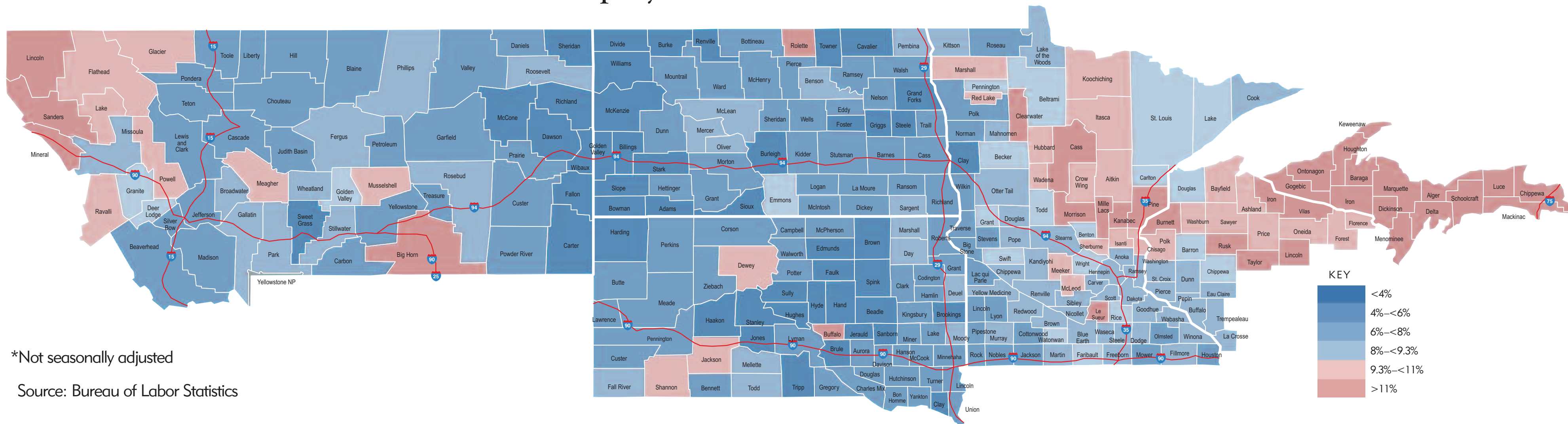
Economists credit an abundance of developable land for helping to restrain the rise in housing prices, while many sources attribute the region's resilience to a conservative culture in the Midwest and Great Plains that forgoes some economic gung-ho in exchange for less economic oh-no.

Supporting what the data say, many people across the district—though not all, of course—acknowledge that their city, region or state is faring better than their peers nationwide. An over-the-shoulder optimism is becoming more noticeable.

"If we were in Florida, I would say, 'Oh my God, we're [still] in a recession,'" said

Continued on page 2

Unemployment rate,* December 2009



*Not seasonally adjusted

Source: Bureau of Labor Statistics

Recession from page 1

The longest recession in generations has left deep economic, emotional and even policy scars. Though district states may have been less brutalized compared with places like California, Florida and Nevada, all have watched unemployment rates rise, businesses go under, foreclosure signs go up and families struggle.

Bob McCoy, president of the Eau Claire (Wis.) Chamber of Commerce. But in Eau Claire, "we don't feel that because we don't have those big swings."

Go west, and you'll bump into Steve Scheel, who knows a little something about recessions. He's the CEO of Scheels, a 23-store sporting goods chain headquartered in Fargo, N.D., with stores in eight states, running from Wisconsin and Nebraska west to Nevada, and including the two largest all-sporting-goods stores in the world. Scheel, the great-grandson of founder Frederick Scheel, has been in the business for 39 years, and despite some missteps recently—like opening a huge new store in recession-shocked Nevada—"we are a stronger force in retail today than we were three years ago."

At the western edge of the Ninth District, things are not exactly exuberant in Helena, Mont., according to Mike Mundt, senior vice president of American Federal Savings Bank. Asked about the regional mood, Mundt said it was merely "slightly upbeat," but he acknowledged that it ranked ahead of many communities. "Most of us recognize that Montana and other mountain states have fared well in comparison to other states nationally. ... I hear people say often, 'We're not as bad off as most.'"

First, the bad news

It must be stressed that this is a positive, "if life gives you lemons" spin on a crushing economic event nationwide.

The Great Recession should no longer need an introduction. It has flipped people, businesses and entire regions on their heads and shaken them for loose change. Led—and intensified—by a collapse in financial markets, the longest recession in generations has left deep economic, emotional and even policy scars. Though district states may have been less brutalized compared with places like California, Florida and Nevada, all have watched unemployment rates rise, businesses go under, foreclosure signs go up and families struggle. (For more information on the comparative depth of this recession, go online to "Recession in Perspective" at minneapolisfed.org.)

Though recessions are often viewed as communal tragedies, they never evenly distribute economic pain and dislocation. That some people and regions relatively close by have experienced less pain is likely cold solace to those directly and harshly affected. Today, many in the Ninth District still don't view their local economy or individual prospects very positively.

Mary Trembley, an investment executive with Raymond James in Anoka, Minn., said by e-mail that her profession allows her to "see how [people] are feeling about the economy and the markets. … General consent seems to be that we are all still struggling." Trembley, also a board member of the Anoka Area Chamber of Commerce, added: "Businesses are still experiencing slow sales. I belong to several business networking groups, and they continue to rise in member numbers because people are still really struggling. They are looking for any alternative to assist them with their business."

The St. Cloud, Minn., region has been publishing a quarterly survey of business conditions since 1998. The most striking part of this recession for St. Cloud has been its breadth and depth; across the board, economic indicators and industrial sectors were much weaker than in the 2001 recession, according to Richard MacDonald, an assistant professor of economics at St. Cloud State University (SCSU), which publishes the survey. "These survey readings suggest a much darker mood of business leaders" regarding the current recession, said MacDonald.

Entire regions in the Ninth District have been trampled by the recession, including the very eastern and western edges (see maps). Michigan is Exhibit A. The state saw its unemployment rate skyrocket from 8.3 percent in 2008 to 13.6 percent last year—both well above the national average. Statistically speaking, nowhere in the Upper Peninsula (the only portion of Michigan that lies within the Ninth District) do conditions look positive. Baraga and Mackinac counties bear unemployment rates topping 27 percent.

On the good side—if you can call it that—its largest county (Marquette) has the lowest unemployment rate in the U.P., and one of the state's lowest. Still, its 11.2 percent rate at the end of last year was higher than the national average and the vast majority of county averages across the Ninth District.

But scratch the surface a little, and you'll start to hear a different story from officials in and around Marquette than the one told by government data. For example, you won't find city of Marquette Mayor John Kivela crying over his luncheon pasties.

"I would say we're pretty optimistic. We have not been hit very hard" by the recession, he said. Housing prices in the city actually rose last year—only 0.4 percent, but that's better than most housing markets. And at a time when commercial real estate markets are reeling, "we've got new construction downtown."

In other words, Marquette just doesn't fit the recession-woe profile that statistics might suggest. "Marquette is kind of an anomaly, not only in the U.P., but the entire state of Michigan," said Kivela.

Tom Nemacheck, head of the Upper Peninsula Travel & Recreation Association, took that notion a step further, at least from a tourism standpoint. "We're pretty optimistic," he said. "Except for a couple of pockets, I don't think the Upper Peninsula has been as hard hit as lower Michigan."

There were a lot of doomsday predictions for tourism, Nemacheck said, but they never really materialized in the U.P.

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One of the Minneapolis Fed's congressionally mandated responsibilities is to gather information on the Ninth District economy. The *fedgazette* is published bimonthly to share that information with the district, which includes Montana, North and South Dakota, Minnesota, northwestern Wisconsin and the Upper Peninsula of Michigan.

The opinions expressed in the *fedgazette* are expressly those of the authors or of attributed sources and are not intended to represent a formal position of this bank or the Federal Reserve System.

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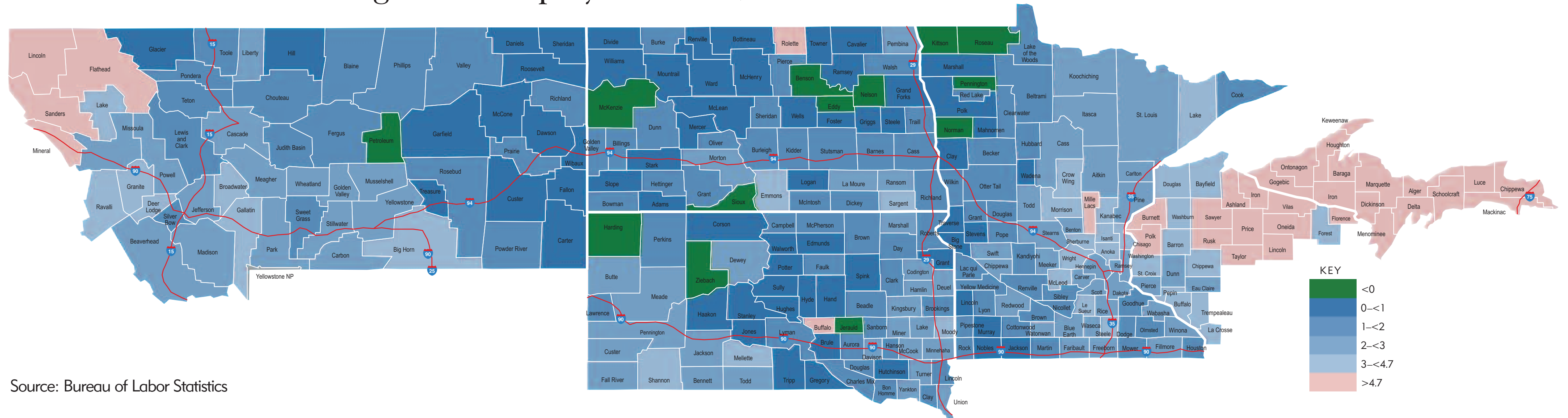
Change in unemployment rate, December 2007 to December 2009



Source: Bureau of Labor Statistics

Lodging revenue was up about 1 percent to 2 percent last year, whereas other regions nationwide saw tourism drop by as much as 15 percent to 20 percent. Though the U.P. is often perceived as the laggard, Nemacheck said, "in this case we kept our head above water, and it feels like the other places took a bigger hit."

You should see the other guy

As it turns out, that "could've been worse" theme runs through most of the Ninth District—not only from sources, but from reams of data. To get a better idea of comparable performance from 2007 through 2009, the *fedgazette* analyzed employment patterns across various geographic jurisdictions (states, counties, metro versus rural) as well as other categorical frameworks, such as industry sectors and against past recessions.

In general, Ninth District states fared relatively well against states nationwide in terms of total job losses and unemployment rates. Though unemployment rates have grown considerably in the past two years, they grew less than the national average in district states over the past two years (see Chart 1). Just as important, unemployment rates in the district were lower to begin with. In December 2009, North Dakota and South Dakota had the two lowest unemployment rates in the nation, with both still under 5 percent. Larger district states—Minnesota and Wisconsin—didn't perform as well, yet they did outperform the nation.

Changes in the number of people with a job (so-called total nonfarm employment) were less favorable in some district states, particularly outside the Dakotas (see Chart 2). And although the employment-population ratio (the proportion of working-age people with jobs) in all district states declined during the recession, it was still considerably higher last year than the national average (see Chart 3).

Big deal? Maybe not before the recession, when such arcane comparisons were the purview of economists and policy wonks. But it's a big deal now, because the recession has focused society's attention back on earned income, the lifeblood of mortgage and car payments, savings and discretionary spending upon which so many businesses rely. And in district states, the ratio of people still earning a paycheck is considerably higher than in the nation as a whole.

In a nutshell, unemployment rates and employment-population ratios both indicate that, at least in terms of employment, district economies entered the recession in better shape, lost a lower proportion of jobs and had a higher percentage of folks still employed. A triple winner—or at least a triple nonloser—which is pretty good under the circumstances.

Superiority complex

An economics history buff might tell you that some of this performance could have been predicted based on past experience. Since 1976, and covering five separate recessions (including 1980 and 1981–82, which many lump together), unemployment rates in district states generally have been less volatile—the spread between their highest and lowest unemployment rates during this period has been narrower than in most states (see Chart 4 on page 4).

Wisconsin and Michigan are the exceptions. Though only portions of each state are in the district, the U.P. and northwestern Wisconsin represent an eastern bookend of counties with the highest unemployment rates and the largest increase in joblessness in the entire district (see maps). Wisconsin's current rates, however, are well below their post-1976 peak.

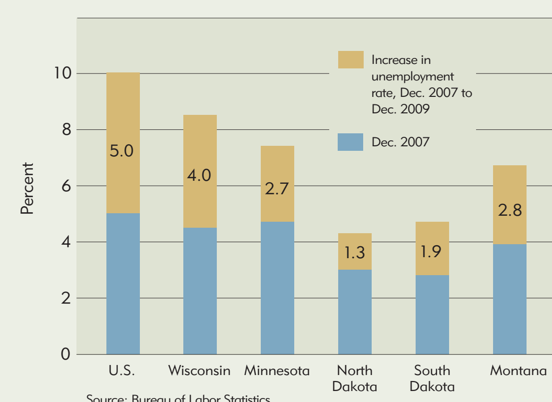
On the other end of the spectrum, the Dakotas and Montana have had much less volatility in their unemployment rates since the mid-1970s. Their current rates are running well below peak levels and are among the lowest in the country right now.

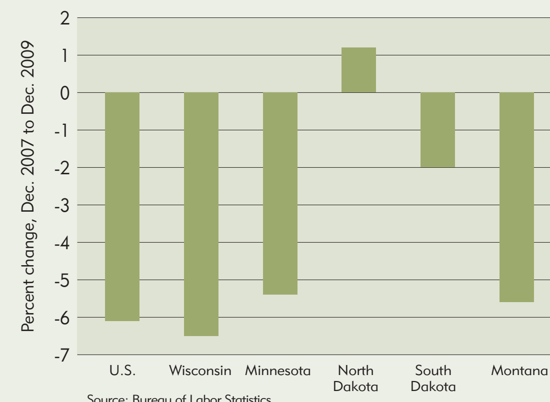
There are likely many reasons for the district's general lack of volatility in joblessness over the past three and a half decades, including the region's relatively well-educated workforce. Other factors are unique and episodic—like the current oil boom in North Dakota, which has made the state an anomaly even within the district (see sidebar on page 6). Perhaps the Midwest work ethic even plays a role—district states tend to have a higher percentage of multiple job holders.

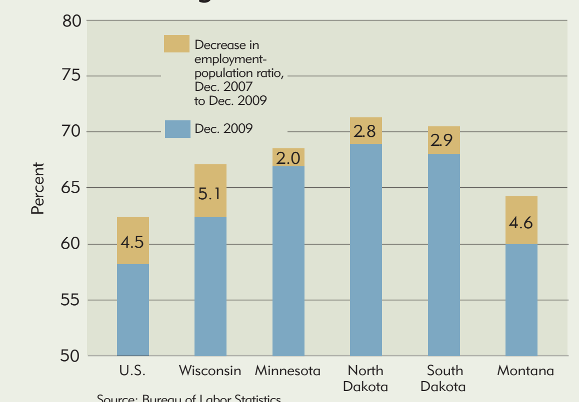
Farming also appears to have played an important role in cushioning the blow of the recession in western states and greater Minnesota (see Chart 5 on page 4). That was particularly the case early in the recession when commodity prices skyrocketed in 2008 and farm income soared. Commodity prices and farm income have since declined—dairy and hog farmers, in particular, have seen tough times. But in general, agriculture has been stable enough to help prop up local and regional economies, especially in counties where farming plays a proportionately larger role (see Chart 6 on page 5).

Another factor appears to be the lack of any disproportionate blight from an industry and geographic standpoint. For example, industry sectors in the district mostly outperformed their peers nationwide. As a useful cross-check, *fedgazette* analysis also found that metro and nonmetro areas in the district outperformed those across the nation (see Chart 7 on page 5)—mostly because

Continued on page 4







Recession from page 3

metro/nonmetro performance among the district states was fairly uniform (see Chart 8). As they say, all for one and one for all, at least for the Ninth District.

There are also historical considerations: In fact, this recession looks much like previous recessions, if on steroids. For example, the job loss pattern in this recession is fairly typical of past recessions: Minnesota and Wisconsin are big, diverse economies that tend to move with U.S. trends; total unemployment and its growth during this recession in these two states reflect that link.

At the other end, the Dakotas and Montana are smaller and historically have tended not to follow the U.S. economy as much because they are more heavily tied to fluctuations in farm and natural resource markets. As in the past, this recession has been more muted in the Dakotas.

Housing: No go boom

Another likely reason that the recession has not been as deep in the district is a comparatively smaller decline in its housing market. Make no mistake, the housing boom paid a visit to the Ninth District, but it didn't move in and change the locks. And while the housing industry has experienced unrivaled decline in some areas—like the Twin Cities, which heavily influences statewide housing trends in Minnesota—the overall decline in the Ninth District pales in comparison to the devastation and ongoing tumult in states like Florida, Nevada, Arizona and California.

Some regions have suffered a housing double whammy from the collapse in construction and real estate, as well as the wood products industry that supplies housing materials. This is how the western edge of Montana got clobbered. From 2002 to 2007, Montana home price appreciation easily outstripped other district states and the national average (see Chart 9 on page 6).

The city of Kalispell and its home county of Flathead in western Montana was the "epicenter of the recession in Montana," according to a research article by Patrick Barkey of the Bureau of Business and Economic Research (BBER) at the University of Montana. Once the fastest-growing region of the state, and subsequently one of its hottest housing markets, the greater Kalispell region saw a collapse in housing and real estate accompanied by a "seemingly endless" series of bad news and reductions in the wood products industry across the northwestern corner of the state, according to Barkey.

Among the nation's 49 metro regions with at least 1 million people, the Twin Cities saw the smallest unemployment increase (2.8 percentage points) from January 2008 to January 2010, according to the U.S. Department of Labor.

Flathead County saw housing starts last year decline by 41 percent, and they are down 73 percent from their peak earlier in the decade, according to BBER research. The drop-off has hammered the local job market; by the end of 2009, Flathead County's unemployment rate had reached 10.9 percent, up from just 5.3 percent two years earlier. In contrast, rates in Gallatin and Missoula counties—both of which have larger, more diversified economies—were 6.5 percent or lower, even though housing starts had fallen at a similar rate as in Flathead.

Sources elsewhere cited the inverse—a lack of a housing frenzy—as a central reason that many Ninth District regions were digging out of a smaller hole than most. For example, the Eau Claire area didn't experience a big run-up in land and housing prices like other regions did—much to the chagrin of area residents at the time.

"We were discouraged when housing and land prices were really going up everywhere" except Eau Claire, said McCoy, from the local chamber. But that's turned out to be a blessing in disguise. McCoy credited that lack of a boom for the region's tentative optimism now. "We didn't crash like everywhere else. … [Housing prices] went down a little, but they are coming back now."

The unemployment rate in the Eau Claire region has risen by almost 90 percent, but that's deceiving. Unemployment stood at just 3.4 percent in 2007, and its 6.1 percent rate in 2009 is significantly lower than the state's average. "We haven't seen the big job losses" from major employers in the region, McCoy said. "There have been no big dips. … We're kind of just bumping along."

He acknowledged that things aren't perfect—retail sales have been up and down, and the banks are stable, "but they all [got] a few houses back" through foreclosure. The annual number of new homes went from about 100 to only about 35 last year. But the area also saw two new firms announce they were coming to town—a software company planning to add 30 to 50 people, and the other a computer support firm planning to hire three times that number. Local construction employment has been growing strongly in Eau Claire in early 2010, thanks to a new Luther Midelfort Mayo hospital and new Nestlé manufacturing plant.

Is it gone yet?

None of this should minimize or ignore the immense dislocation caused by the recession, or give the impression that the economy has regained its rose tint. It cannot be overstated that district states have a long way to go to get back to prerecession normal. Forecasters predict that it could take several years for unemployment rates to come down.

Asked this past spring by a St. Paul reporter whether the recession was over, Dan McElroy, commissioner of the Minnesota Department of Employment and Economic Development, replied, "Only to an economist."

But signs of comparative health are hard to ignore. Among the nation's 49 metro regions with at least 1 million people, the Twin Cities saw the smallest unemployment increase (2.8 percentage points) from January 2008 to January 2010, according to the U.S. Department of Labor. When it registered 7.7 percent in February, the Twin Cities became the only large metro to post a decrease (0.3 percent) over a year earlier.

More notable still, the Twin Cities would be considered a laggard among district metros. Bismarck and Fargo, N.D., along with Sioux Falls, S.D., boast unemployment rates below 5 percent, while Billings, Mont., and Rapid City, S.D., are just a tick off that pace.

Optimism tends to be contagious. Surveys of consumers and businesses in Minnesota and Wisconsin—which absorbed the biggest hits in this recession among district states—suggest more optimism than is generally found nationwide. For example, a fourth quarter 2009 survey by the Saint Paul Area Chamber of Commerce found that hiring expectations were positive, with 27 percent of members expecting to hire more workers compared with 9 percent expecting to lay off workers. Respondents were even more positive about business prospects, with 58 percent expecting growth in 2010 compared with just 8 percent forecasting a drop in business.

Even manufacturing is upbeat. Despite the beating the sector took in Minnesota over the past two years—employment dropped by 15 percent—manufacturers see more sunshine in the forecast: According to a survey of 500 manufacturing firms by Enterprise Minnesota, 34 percent of executives expected profits to increase, while 17 percent were bracing for a drop in profits—a virtual flip-flop from one year ago.

Manufacturing in the west-central part of Minnesota "is picking up again, and some of our local manufacturers are actually in growth mode with new divisions," according to Coni McKay, executive director of the Alexandria Lakes Area Chamber of Commerce, via e-mail. The region's tourism and retail business also have been good. "I can't speak for everyone here in the

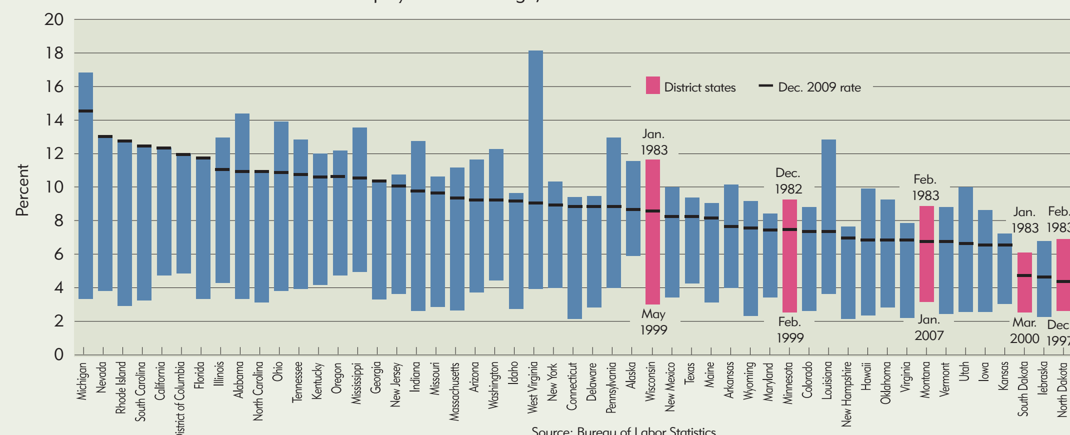


CHART 4
District states fare better historically

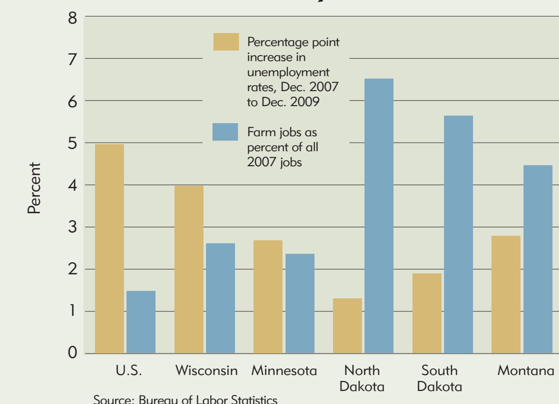


CHART 5
Large farm sectors led to lower job losses

Alexandria Lakes Area, but I believe the outlook here is positive and optimistic."

King Banaian, chair of the economics department at St. Cloud State, and co-author with MacDonald of the regional quarterly business report, noted via e-mail that the mood of local business leaders is "always more positive in the beginning of a year. But this year they are more positive than usual."

Even investment sentiment around publicly traded firms in the district is beating national benchmarks. The Federal Reserve Bank of Minneapolis created a stock index of 27 mid-cap companies in 2004, and for several years the index tracked the S&P MidCap 400 very closely. But the two indexes parted ways beginning in 2008, and the local one saw a much shorter and briefer retreat through the heart of the recession (see Chart 10 on page 6).

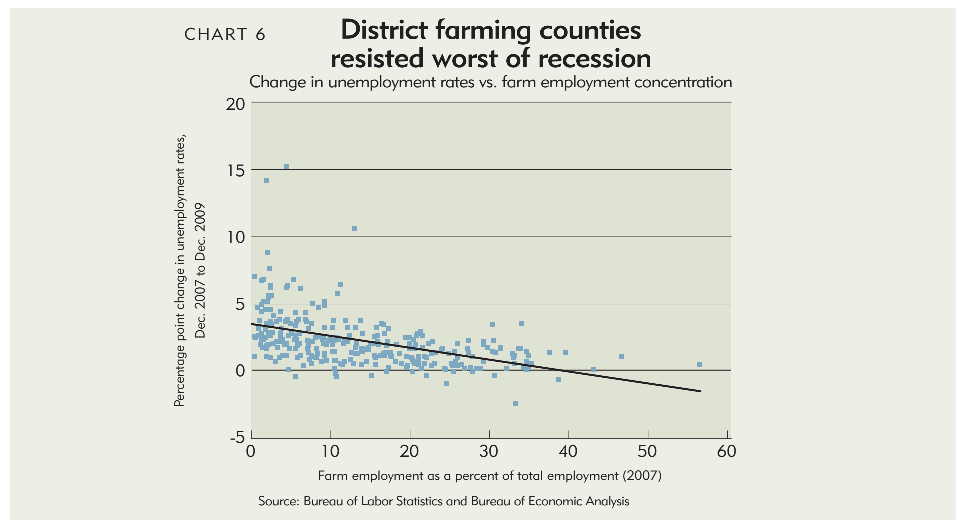
The way we were?

But don't mistake optimism for over-confidence, at least not yet. For most sources, the mood is guarded, much like the day after a serious storm: Folks are happy to see daylight, but there is some serious cleanup ahead before things get back to normal. Said McKay, "While we all would love to believe the recession is over, we all know that it will take three to five years for our overall economic vibrancy in the state or nation to return."

In spite of outward optimism, businesses and consumers understand that economic forecasts call for modest growth in the immediate future and weak increases in employment—creating a self-reinforcing mechanism. Dick Granchalek, president of the La Crosse (Wis.) Area Chamber of Commerce, sees area businesses taking a "wait and see" attitude. "What we're seeing is many people being cautious and holding back," even if they have the resources to expand and hire," he said. "They are saving for a rainy day and waiting for a clearer future."

The good and bad news is that during the recession and the fragile recovery, businesses have discovered their resiliency, becoming more productive

During the recession and the fragile recovery, businesses have discovered their resiliency, becoming more productive and finding out along the way that maybe they don't need so many workers. As a result, many are taking a cautious approach to hiring.



and finding out along the way that maybe they don't need so many workers. As a result, many are taking a cautious approach to hiring, according to Minneapolis Fed business contacts.

SCSU's MacDonald has been hearing similar stories in St. Cloud through the quarterly survey. Firms are rethinking their workforce size, average hours and wages "in ways that go beyond a pure cyclical adjustment. … [T]hey are emerging from this downturn as leaner [and] more efficient." According to MacDonald, one executive with a large regional firm "says that his business will never again be the same. … Demand for his firm's product would have to expand by an order of magnitude in order for him to increase the scale of employment to what it once was."

The sheer scale of worker dislocation brings additional obstacles to a quick recovery in employment. "The problem is that recessions are wrenching experiences that leave behind some collateral damage," said SCSU's Banaian. For example, recessions shake out businesses and entire industries that were inefficient or did not have a comparative advantage. This weeding out process improves economic health, but often casts aside workers with skills that might not transfer to new opportunities in a changed marketplace.

"I can't make the machinist who worked at the now-closed plant into a bio-scientist. I have to lure bio-scientists to this area and find a way for the machinist to move to a job elsewhere," said Banaian. "That just doesn't always work well."

Upheaval in Washington, D.C., has also made businesses cautious, sources said. McCoy, from Eau Claire, said that firms have expressed interest in hiring, but are reluctant to do so "because they don't know what's going to happen in Washington" with health insurance, tax rates and other federal policies that affect business. "People here are a little more cautious," McCoy said. "I don't think anyone's wanting to go springboard" headlong into the recovery.

Tim Hennessy, the regional president for U.S. Bank in western North Dakota, said via e-mail that clients tell him that "the uncertainty in the financial markets, and especially the uncertainty of what to expect out of Washington, has caused many businesses—and consumers for that matter—to take a 'hunker down' attitude."

An ode to flyover country

Whatever the trepidation about prospects for recovery, that anxiety is likely more acute elsewhere, because most other places are trying to climb out of a deeper hole.

Some district businesses see opportunity because they made shrewd moves during the recession and maybe had some good fortune along the way. Scheel has been in the sporting goods business for almost four decades and has watched his company rebound from previous recessions. "Periods such as this are the perfect time to separate your business from the competition," he said. "The best in each industry or category seem to do well and come out of the recessions even stronger. Mediocre or poorly run businesses struggle."

While many retailers cut inventories and salaries, Scheels took advantage of low interest rates and construction costs to expand retail space and grow his company's labor force—including at the corporate headquarters in Fargo—each of the last three years.

Scheels has benefited from a concentration of retail outlets along Interstate 29 from Grand Forks, N.D., to Omaha, Neb.—all located in states least affected by the recession. But the company is not immune to mistakes. For example, as mentioned earlier, the company opened the largest all-sporting-goods store in the United States—300,000 square feet—in Reno, Nev., in 2008. "Great timing," Scheel noted sarcastically. The Reno store is the only one "that is not performing close to the level we would like. … Nevada is an economic mess by every measure, and the attitude in Reno and Nevada is poor. You can feel the defeat in the media every day."

In other places, resiliency and optimism likely flow from being battle tested—further testimony to the idea that if something doesn't kill you, it just might make you stronger. That's the feeling

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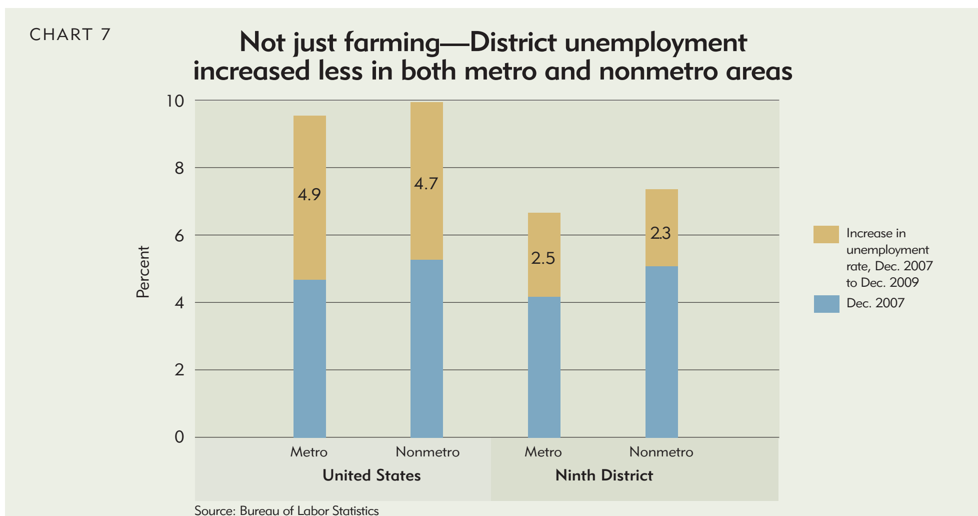


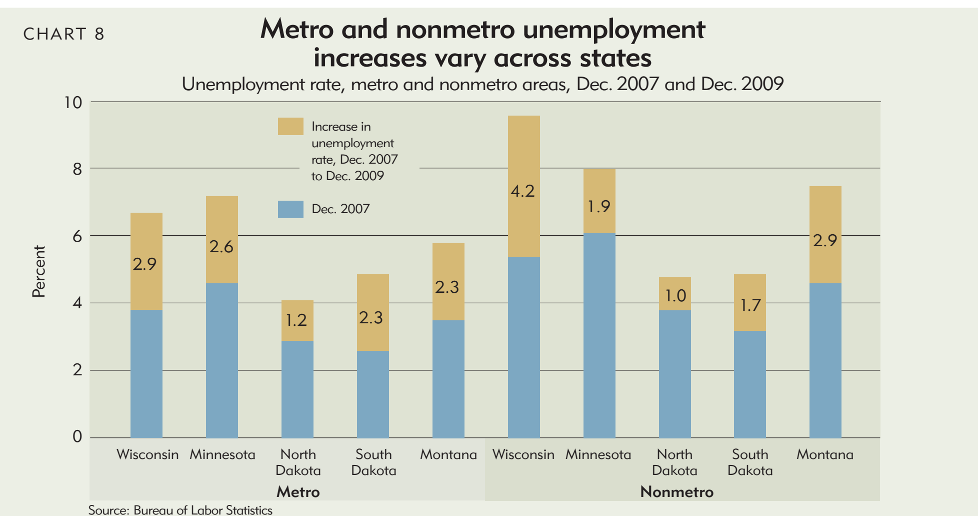
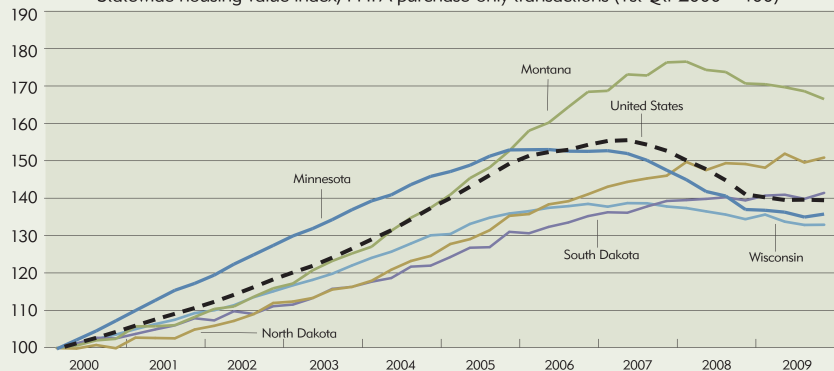


CHART 9

Housing price boom and bust missed much of the district

Statewide housing value index, FHFA purchase-only transactions (1st Qtr 2000 = 100)

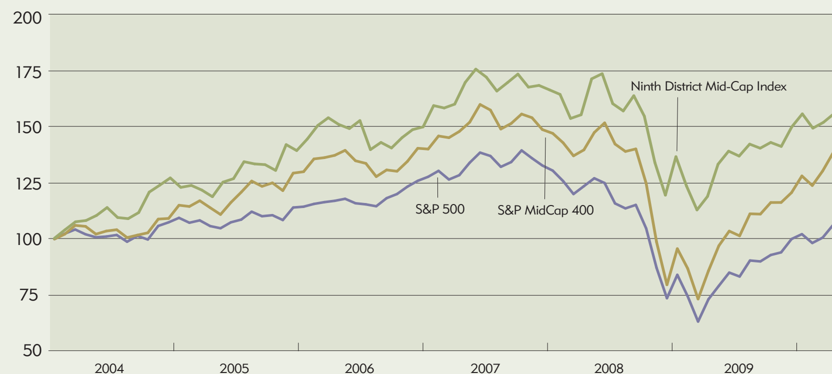


Source: Federal Housing Finance Agency

CHART 10

District stocks performed better than the nation

Mid-cap stock price indexes (Jan. 2004=100)



Source: Federal Reserve Bank of Minneapolis, Standard & Poors

Recession from page 5

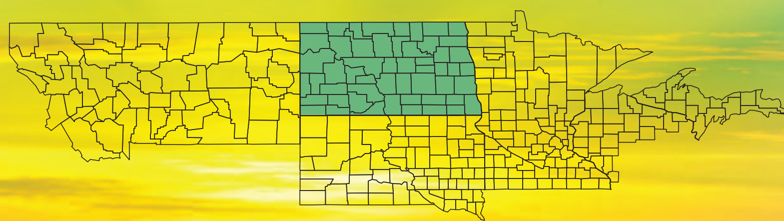
for many in the Marquette region in the Upper Peninsula. In 1995, while the rest of the country boomed, the greater Marquette region had to endure the closing of the K.I. Sawyer Air Force Base. That was "a crisis far worse in our community than [this] recession," said Amy Clickner, CEO of the Lake Superior Community Partnership, a regional economic development group. "That was a community of 10,000 people basically gone."

So you might understand the Yooper optimism coming out of this recession, despite what the jobless rate might imply. For one thing, the region is seeing a mini revival in mining. Cliffs Natural Resources announced major investments in local iron ore mines in mid-2008 that will keep them running much longer than thought just a few years earlier. A subsidiary of Rio Tinto received approval earlier this year from the state of Michigan to open a copper and nickel mine about a half-hour from Marquette. Though fiercely opposed by some, others welcome the hundreds of construction and mining jobs that are projected to follow.

Clickner said she's not convinced that Marquette is out of the economic woods yet, because trends tend to lag in the U.P., and Michigan's state budget crisis will hurt given the large government sector in the county. Still, she said, "we are seeing and hearing many positives from business."

Nemacheck, from the U.P. tourism group, said he keeps in touch with many bankers, and has a couple of them on his board. "They're saying things aren't that bad, and there's a feel of a bounce, as gentle as it is," he said during an April interview. In terms of tourism, "every indication is that the [tourism] traffic is starting to look pretty good. … We're feeling good about the upcoming summer." f

North Dakota: The little economic engine that could



By RONALD A. WIRTZ
Editor

What a difference a decade has made for North Dakota.

Roughly that long ago, the national media were coming to the state to throw dirt on it, curious about what was going on in a state whose population barely grew during the roaring 1990s. The following decade didn't start much better: Through the first half, it was one of only two states to lose population—the other being Louisiana, which had Hurricane Katrina to blame.

Fast-forward to 2010, and there's now a bit of reverse Julius Caesar going on: People come not to bury North Dakota, but to praise it. That's because the state's economy sticks out like a diamond in a bowl of cherry pits. While North Dakota hasn't escaped the national recession completely unscathed, in the big picture it has posted top-of-the-class numbers in unemployment, income growth and other enviable economic categories.

Many point to the oil boom that has gushed money, business and general optimism into the state. But sources say the state's success goes deeper than an oil well.

Nice view from here

The state's repositioning on the economic totem pole is dramatic. A decade ago, the state's per capita personal income ranked 39th in the country; at $23,500, it was about 83 percent of the national average, according to the federal Bureau of Economic Analysis.

Over the next 10 years, annual personal income grew by 5.3 percent—two full percentage points better than the national average. By 2009, personal income in the Peace Garden state had leapt to $39,500—slightly above the national average and good for 19th highest.

For much of the decade, that growth went overlooked—indeed, dismissed—as the rest of the country strolled along with the housing boom. But when the country fell into recession, North Dakota gained more attention for its ability to continue swimming against an outgoing economic tide. While job loss has been rampant across the United States and the Ninth District, North Dakota actually added jobs from 2007 through the end of 2009 (see Chart 2 on page 3). With 4.9 percent unemployment in March (seasonally unadjusted), North Dakota had easily the lowest unemployment rate in the country—a fraction of the nation's rate of 9.7 percent and well ahead of second-place South Dakota (5.3 percent).

Without doubt, there are still struggles in North Dakota. Some rural areas continue to lose population, and many small towns are caught in an economic death spiral—few economic opportuni-

ties, forcing young workers and families to look elsewhere—with no obvious means of reversing the trend. But North Dakota is hardly unique in that regard. Nor has the state been completely immune to the recession's effects. The state's manufacturing base has been hit hard with major manufacturers laying off hundreds; Bobcat, the homegrown maker of skid-steer loaders, closed its Bismarck plant because of the national and international downturn. In all, the state lost 11 percent of its manufacturing job base from 2007 through 2009, as well as 3 percent of jobs in professional and business services.

But that's where many economic similarities end as far as national and most state trends go. In four other major industrial categories—trade and transportation; leisure and hospitality; information and financial activities; and mining, logging and construction—North Dakota achieved net job increases over the past two years. No other district state saw a net increase in any of these categories (see the accompanying table). Even in manufacturing and professional and business services, losses in North Dakota were the lowest of any district state and well below the national average.

PERCENT CHANGE IN NONFARM EMPLOYMENT BY INDUSTRY*
Dec. 2007 to Dec. 2009

	Total Nonfarm Employment	Trade, Transportation and Utilities	Government	Education and Health Services	Professional and Business Services	Manufacturing	Leisure and Hospitality	Information and Financial Activities	Mining, Logging and Construction
Minnesota	-5.4	-7.9	.4	4.8	-6.5	-14.7	-5.4	-5.1	-24.8
Montana	-5.5	-5.3	1.1	3.9	-7.8	-15.2	-4.6	-4.1	-29.1
North Dakota	1.2	0.3	2.9	4.9	-3.0	-11.1	3.6	1.5	5.6
South Dakota	-2.0	-1.0	2.2	5.6	-7.9	-11.7	-1.6	-4.7	-11.5
Wisconsin	-6.5	-7.8	2.1	4.2	-12.7	-16.0	-5.5	-4.5	-22.3
U.S.	-6.1	-7.7	0.5	4.3	-8.7	-16.0	-4.0	-7.5	-22.6

*Industries are sorted by U.S. employment size
Source: Bureau of Labor Statistics

Fuel for the North Dakota fire

There are both obvious and subtle reasons for this success. Most people, for example, are quick to credit the shale oil boom in the western part of the state—the so-called Bakken play.

Though oil prices have been up and down a lot over the past two years (see the September 2009 *fedgazette* and a Web-exclusive June update), the oil-producing portion of the state has been surging with the rebound in crude prices. Last year, the state pumped 80 million barrels of oil—up almost 25 percent from 2008. Since 2004, crude oil production in the state has grown an average of 17 percent per year. The state is now the fourth-largest oil producer in the United States, behind only Alaska, Texas and California.

The success and impact of the oil industry shows immediately in employment data (see "Mining, Logging & Construction" in the table). Because this category includes construction jobs, most states saw numbers plunge—even more than in manufacturing—because of the collapse in housing. But not North Dakota, which saw sector employment rise by 5.6 percent on the heels of strong growth in the oil patch, a healthy coal market (the state is the nation's 10th-largest producer of coal) and a more stable housing market.

Cole Carley is about as far from the oil patch as a North Dakotan can get as the president and CEO of the Fargo-Moorhead Convention & Visitors Bureau. Despite being on the opposite side of the state, Carley understands the spillover effects of oil production on the broader state economy.

"The oil-gas-coal patch certainly deserves a bunch of credit. It's filling pockets, restaurants and hotel rooms all over the western part of the state," said Carley. He pointed out that North Dakota was the only state to see an increase in hotel rates and occupancy last year, and oil and other energy production "is a large part of that."

Richard Rathge, director of the North Dakota State Data Center, noted via e-mail that the oil exported out of the region brings an even more important import: people. The state had been seeing population loss virtually everywhere except Fargo and Bismarck. But oil production has reversed that: According to Rathge, 20 of 53 counties saw population growth last year, and 15 of those were in the western part of the state. Rathge, the state's demographer for more than 25 years, said that "this is one of the very few times I can recall that the vast majority of growing counties are on or west of the Missouri [River]."

But the state's enviable economic position is not just about oil and mining, Rathge and others pointed out. Agriculture, for example, has been healthy for the past half-decade, particularly in crop sectors where the state is strong, and has helped stabilize local economies in North Dakota and across the Ninth District (see cover article for more discussion).

Stark County lies in an oil-producing region. While oil drilling and production bring additional economic activity to the county, "ag is the historical bedrock," according to Vaune Cripe, senior vice president of American Bank Center in Dickinson, the county seat. "The energy industry has been a thick frosting on the cake."

Michael Solberg, president of State Bank & Trust in Fargo, agreed that the state's success "is more than oil." Despite having no oil production to speak of, the Fargo region's unemployment rate was lower than the state average (that's also the case in Bismarck and Grand Forks, the state's other two metro areas).

Solberg credited Fargo's economic good fortune to the stabilizing presence of three colleges, Great Plains Software (owned by Microsoft), high health care employment and the headquarters of Scheels, a major purveyor of high-end sporting goods. But Solberg also acknowledged that these economic elements are hardly unique to Fargo. One factor for Fargo and the entire state is likely "the housing market never [getting] out of whack here." Solberg said his bank has branches in Minneapolis, "and we see the pain that goes on where housing falls off a cliff."

Jerry Youngberg is a real estate agent with Dakota Commercial & Development in Grand Forks, and has been in the real estate business for 26 years. He believes real estate sales "are a pretty good indicator of the economic health of an area." The Grand Forks multiple listing service, which covers much of northeastern North Dakota and northwestern Minnesota, had its best years in 2006 and 2007, like the rest of the country, according to Youngberg. But 2008 was the third-best year on record—until 2009 beat it, and the outlook for this year is more of the same.

Outlook: A slice of humble pie

When it comes to the state's good fortune, current economic conditions and the road ahead, most sources across the state exhibit a farmer's mindset—modest, perpetually optimistic, yet conservative.

Brad Schlossman, CEO of West Acres Shopping Center in Fargo, for example, said that "our agricultural-based culture keeps us aware that next year's crop has yet to be harvested."

And Youngberg, from Grand Forks, added, "Our conservative nature inhibits us from tooting our own horn very loudly. But we are working on overcoming that to some degree."

Carley, from the Fargo-Moorhead Convention & Visitors Bureau, was asked about North Dakota's silver spoon, and he replied, "People up here would never use that slogan because Scandinavians never claim to look good or [to be] doing really well. It's got something to do with knowing or being related to farmers … [who] almost never talk positively about their crops because they think it's bad luck."

In other words, many North Dakotans seem to understand that they are doing comparatively well, but also that things can change in a hurry—just as "a good hailstorm or tornado can wipe out a crop in minutes," said Carley. "I think that everyone here is aware that we're better off than many others, but they don't say much about it. It's like being the tallest kid in a short class."

At times the North Dakota vibe can border on fatalistic. Said one source at the University of North Dakota: "I think we are almost at a point of suspicion that others will try to emulate North Dakota and rob us of what made us successful."

Economic performance, it seems, is a matter of perspective. North Dakota might look like the king of the hill right now, but that position is like the adage about a sunny day in these parts—enjoy it, but don't be surprised when the clouds roll in. Schlossman pointed out that the state's lack of boom or bust cycles makes for smaller recessions, "but soon you will see our job growth lag" as the rest of the country rebounds and returns to historical growth patterns. "The comparative prosperity we may enjoy today is only relative."

It's hard to imagine things in North Dakota unraveling too much, particularly in the short term, though a large and extended drop in oil prices would likely cause anxiety. But issues of real economic concern elsewhere—like a serious downturn in commercial real estate and yawning state budget deficits—are non-issues in North Dakota. And if North Dakota does see its fortunes turn for the worse, one doesn't get the impression that there will be a lot of related angst.

Solberg points to "a steady mind frame" among residents when it comes to economic difficulties. "There is a quiet confidence. Our region knows when times are tough, we're going to do better than most." f

Sing sweetly (please), employment canary

Survey of staffing firms suggests some—slow—recovery in the jobs market

By RONALD A. WIRTZ
Editor

Before the recession, employment growth was not a matter many paid particularly close attention to. But with deep, scarring job losses across the country, job growth has become a closely watched, slow-motion race.

Through the first half of this year, employment levels appear to have at least found stable ground again. Some increases in employment are forecast through the remainder of this year and into next year. (See the most recent forecast from the Federal Reserve Bank of Minneapolis on page 21.)

Many policymakers, unemployed workers and others look to the temporary employment market (also referred to by the industry as staffing services) as a leading indicator for traditional employment. Said one official with a Minnesota staffing company, which operates six offices in Minnesota and Wisconsin, "We are the first to start the recovery" as business and industry get more comfortable with permanent hiring. Many firms "are unwilling to add [jobs] until they are more assured of long-term recovery. We are the way (in) to work and have been for the last 10 years."

So with the help of statewide associations in three states, the *fedgazette* surveyed staffing services firms in Minnesota, North Dakota and Wisconsin to see how their businesses were faring coming out of the recession, what trends could be gleaned from recent activity and what the future holds for the traditional employment market.

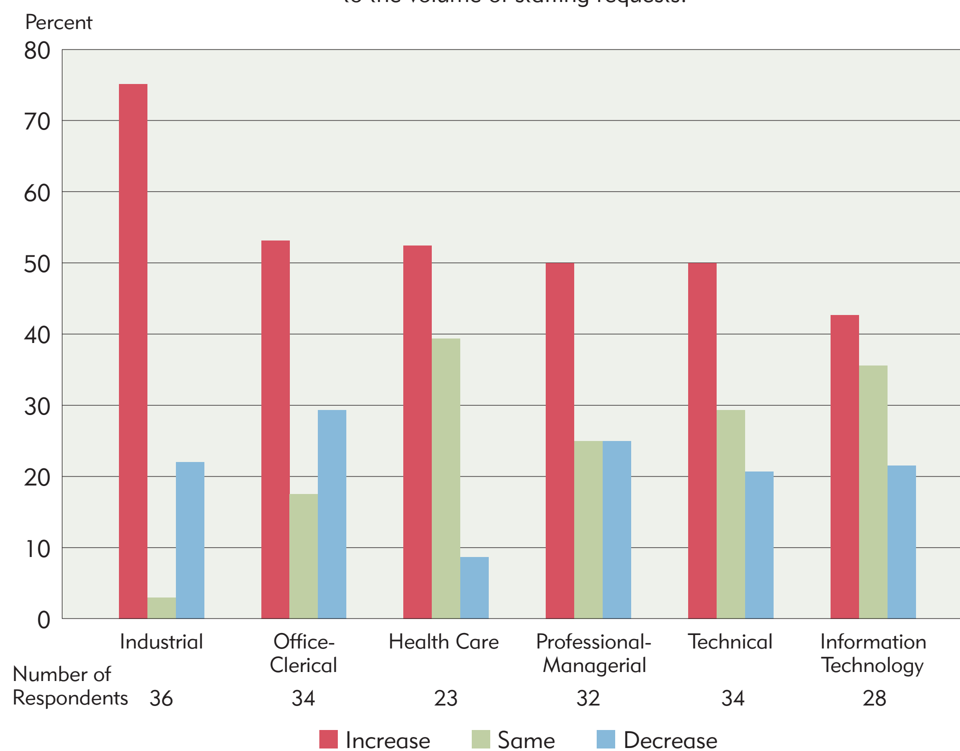
The survey suggests both positive and not-so-positive news. Staffing services firms report that their business is picking up—aggressively in some cases. Business has been up across most sectors in the economy served by these firms. The unpleasant news is that with an ample supply of available workers, client firms are picky about whom they choose to accept for temporary work, and pay rates generally have been flat, or worse. As for prospects for growth in traditional employment in the near term, opinions vary widely.

Tweet, tweet

The good news, especially if you're in the staffing services sector, is that business is looking up—way up for some. Among 42 responding firms, those seeing a year-to-date increase in clients over the same period last year outnumbered all other responses by a 3-to-1 margin (see Chart 1); close to half of respondents said client volumes grew by at least 10 percent.

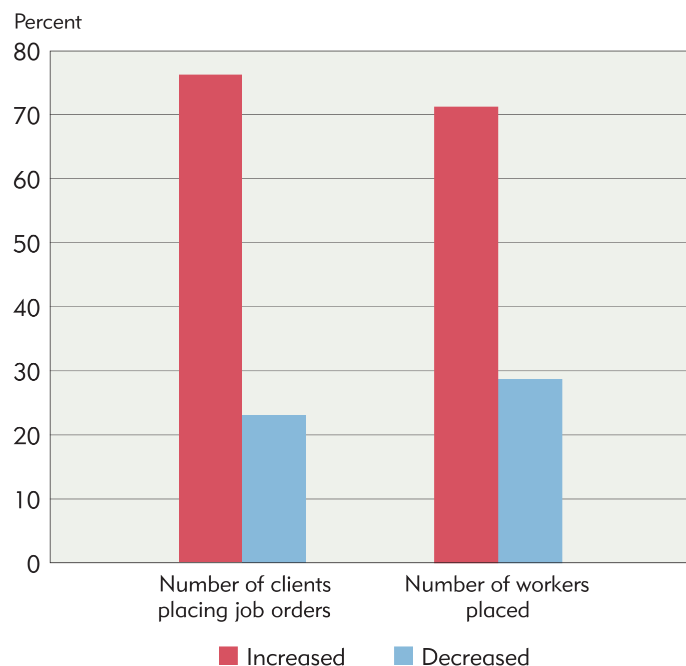
More clients generally mean more contract workers: As a group, a large majority of firms saw an increase in the number of workers placed with clients (see Chart 1), and close to half said total assigned workers grew by 10 percent or more. This finding also matches government data that suggest—after a steep decline—that temporary and contract employment may be on the rebound in three district states.

CHART 2 **Temp requests up across sectors**
Survey question: Compared with last year, what's happened to the volume of staffing requests?



Source: Federal Reserve Bank of Minneapolis survey of temporary employment firms in Minnesota, North Dakota and Wisconsin

CHART 1 **More temp workers sought, placed**
Survey question: What's happened to business this year compared with the same period last year?



Source: Federal Reserve Bank of Minneapolis survey of temporary employment firms in Minnesota, North Dakota and Wisconsin

Those gains were spread fairly evenly among the employment sectors served by temporary staffing firms. Respondents reported net gains in staffing requests in every area of temporary employment, led by the industrial sector (see Chart 2).

Though more openings appear available, not everything is bright for workers. It probably comes as no surprise, but respondents said the supply of virtually all types of workers had risen, including those with higher skills.

That appears to have affected pay rates, as slightly more staffing firms reported a net decline (rather than an increase) in pay rates over the same period last year. A medium-sized staffing agency in Wisconsin commented that office and administrative professionals used to earn between $12 and $14 per hour, but "now, $10 with no flex." Reported increases in pay rates were typically small; reported decreases were typically larger (5 percent of more).

An ample labor supply also gives clients the pick of the litter so to speak, and they are being choosier; respondents reported that client companies were asking for more educated, skilled and experienced workers. Worker standards, said one Wisconsin firm, "are much higher by the employer. [Clients] want more employee for less money."

One might think a tough employment market would make job hunters more pliant and eager to please. But job-related expectations range widely among temporary or contract workers. Some workers are very cooperative and eager, staffing firms reported. One Wisconsin company said, "There has definitely been an increase to not only accept temporary assignments, but there has also been an increase in our assignment retention. The employee pool is less likely to walk off or quit a job than they previously had been."

But other firms reported that some workers remained demanding. A different Wisconsin agency said, "We are amazed at how many unemployed applicants will not budge on shift or wage, as if the economy was robust."

There's some evidence that extended unemployment benefits have made low-

wage workers choosy. When unemployment checks rival what economists call the reservation wage—the lowest wage that a worker will accept to take a job—finding employment can seem less urgent. A medium-sized staffing agency in North Dakota reported that entry-level temporary or seasonal positions were a "challenge" to fill because job and unemployment income were similar. A medium-sized agency in the Twin Cities commented, "We do see a lot of people that just want to say they are applying for a job, but they really do not want it. They just want to collect their unemployment."

And a third agency serving a small market in Wisconsin said that "workers are more selective in accepting positions if they are receiving [unemployment] benefits."

A traditional outlook

Many economy watchers are interested in what trends in temporary and contract employment might mean for permanent employment in the near and intermediate future. Here the news is mixed; indeed, it might be more accurate to say it's on hold.

For example, staffing firms overall reported a slight increase in the ratio of assignments becoming permanent compared with the previous year. A small placement firm in the Twin Cities said it "sees an upward trend—very slow, but upward" for the traditional employment market.

However, despite the pickup in their own business, staffing companies said their clients are still taking a wait-and-see approach to full-time permanent hiring, preferring to stay as lean and flexible as possible by depending on temporary and contract workers for long periods. According to one large Wisconsin staffing firm located in a major metro region, "Customers are looking for long-term employees, but making few commitments to hiring the employees."

That's good news for staffing firms, and many anticipate continued growth. A Wisconsin firm said it sees healthy business ahead in an improving economy, and also because clients are trying to avoid health care and other rising labor costs by sticking with contract workers. Another firm in that state was seeing more companies use workers "on a per-project basis and utilizing temporary staffing to remain flexible" in an unstable economy.

One staffing company in the Twin Cities reported that business was up 200 percent over the same period a year earlier. "We've started to see some permanent business for higher-level positions happening. I do feel that there won't be a great improvement in permanent placements until next year providing the economy doesn't stall out. Many of our customers have said that they intend to keep people on as temporaries for longer terms than they used to." f

Methodology: This survey was conducted with the assistance of the Minnesota Recruiting & Staffing Association, the North Dakota Staffing Association and the Wisconsin Association of Staffing Services. An e-mail alert was sent to about 400 contacts identified by these three organizations. The e-mail informed members about the survey, its intent and where it could be taken online. The survey was conducted from April 21 through April 30. A total of 42 responses were received. The three organizations have a combined membership of 121, but their contact lists included nonmember firms as well as multiple contacts at a single firm.

Short sales stand tall

More sellers—and mortgage holders—of "underwater" homes are taking what they can get

By JOE MAHON
Staff Writer

When one of Blaise Johnson's clients fell behind on his mortgage last year, things looked dire. The Fargo, N.D., homeowner needed to sell, but in a real estate slump, his house was worth less than the amount he still owed the bank. If it had gone into foreclosure, he not only would have lost his home, but he also would have had difficulty buying another for years to come because of a poor credit record.

In the end, the client staved off foreclosure, thereby doing less damage to his credit standing. Johnson, director of lending for Gate City Bank in Fargo, worked out a deal in which the homeowner sold his house for what he could get and agreed to make up the $3,000 shortfall—the difference between the sale price and the balance owed on the mortgage—out of his own pocket.

This transaction is a simple example of a short sale, in which the homeowner sells for less than the mortgage amount, often making some arrangement to pay all or part of the outstanding balance. Short sales have become an increasingly popular escape hatch for financially distressed homeowners who need to sell in a still-hurting housing market.

Market survey data indicate that, nationwide and in the Ninth District, short sales are growing, although the rate of growth varies, typically in sync with the underlying health of a region's housing market.

In March, roughly one in 10 homes sold in the Twin Cities metro area was a short sale, according to the Minneapolis Area Association of Realtors (MAAR); in 2006, that statistic was closer to one in 100.

Data on short sales aren't available for many smaller markets in the district, but interviews with real estate sources suggest that they've become more prevalent. "We've seen a lot of activity with short sales, and a lot of interest from first-time home buyers," said Brint Wahlberg, a real estate broker in Missoula, Mont.

Given the state of the housing market—sagging values and large inventories of foreclosed homes in many parts of the district—it's not surprising that short sales have caught on. Although they can be complicated and time consuming, in a down market, short sales often work to the advantage of all parties—seller, buyer and lender.

But the surge in short-sale activity is unlikely to last for more than a year or two. Short sales will likely decline when housing prices rebound, allowing home sellers to once again pay off the bank on closing day.

Treading water

Until recently, real estate short sales (not to be confused with short selling in the stock market) were rare. "I couldn't even spell short sale three years ago," said Bill Malkasian, president of the Wisconsin Realtors Association.

There isn't much opportunity to sell a home short when prices are rising, as they were over much of the past 15 years in virtually every district market. For a homeowner struggling to make mortgage payments, the standard solution in a robust market is foreclosure, where the lender takes possession of the home (which has typically appreciated) and sells it to cover remaining debt.

For short sales to occur, it takes two needy parties to tango, and banks aren't accustomed to accepting losses on their loans. Just a few years ago, most short-sale offers (about 90 percent, according to Wahlberg) were rejected. Lenders usually preferred to foreclose, resorting to short sales only in instances where they had little hope of recovering the value of the home, typically due to fire, flood or some other disaster.

All that has changed with the drop in housing values in many parts of the country and the district. The number of "underwater" homes—those whose owners owe more on their mortgage than the market value of their house—has risen sharply over the past three years. Foreclosures and tighter appraisal standards in the secondary mortgage market have further lowered home values in many areas, driving more properties underwater.

In the first quarter of this year, about 17 percent of Minnesota homes with a mortgage outstanding had negative equity, according to a report by research firm CoreLogic. Even in relatively pros-

Continued on page 10

Short sales from page 9

perous North Dakota, 11 percent of mortgages were underwater, or close to it (see Chart 1).

Coming up short

In this troubled market, short sales have gained traction as an alternative to foreclosure. In the nation and in the district, short sales have increased in numbers and as a proportion of both total housing sales and distressed sales (those where the owner is compelled to sell).

Nationwide, short sales grew from less than 13 percent of total transactions last July to 18 percent in April, according to a survey conducted by Campbell Communications for the trade publication *Inside Mortgage Finance*. Short sales' share of distressed transactions increased even more over the same period, from 25 percent to 38 percent (see Chart 2).

In the district, where the housing crash hasn't been as severe, short sales make up a smaller proportion of total sales. But short selling has increased dramatically over the past year. The *Inside Mortgage Finance* survey found that in district states (excluding portions of Michigan and Wisconsin within the district), short sales increased from 9 percent of transactions last summer to 16 percent in April. District short sales as a share of distressed sales increased even more over the same period and outpaced national gains.

The Twin Cities saw a big jump in short sales in 2009, and that trend continued this spring, although at a slower pace. As of March, the number of short sales in the Twin Cities area had risen 52 percent from a year earlier, according to Multiple Listing Service (MLS) data compiled by MAAR.

As short sales have increased to account for over 10 percent of all home sales in the Twin Cities, foreclosures have declined. From early 2009 to early 2010, "lender-owned" sales fell 38 percent in the metro area. MLS data are less informative for other metro areas in the district. Several realty associations, including those in western Montana, South Dakota and northwestern Wisconsin, didn't begin tracking short sales until 2009, in response to signs that activity was increasing.

But real estate sources provide further evidence of an increase in short sales. In Sioux Falls, S.D., First Dakota Title handles the details of housing transactions around the state, including payments to mortgage holders. Vice President of Business Development Mark Wahlstrom said he's seen more short sales over the past 12 to 18 months than over the past decade.

Lemonade from lemons

In many ways, short sales are advantageous—or at least the lesser evil—for everybody involved in the sale of a home whose value has been battered by the market.

For the lender, short sales offer a way to avoid the often costly and lengthy process of taking possession of a house and trying to sell it in a slow market. By agreeing to negotiate with the owner—in many cases accepting less than the full value of the mortgage—a bank or secondary mortgage holder may recover more of its investment than it would by pursuing foreclosure. Also, holding illiquid assets on the books looks bad to investors and may imperil a bank's standing with regulators.

For homeowners who are looking to get out from under a mortgage, taking what they can get in the market can be preferable to letting their home slip into foreclosure. While selling short blemishes the homeowner's credit record, the credit damage often is less severe compared with foreclosure. (The extent to which a short sale impairs a homeowner's credit depends on several factors—previous credit history, whether the mortgage is delinquent, how many payments have been missed and so on.)

"The credit implications of a short sale versus a foreclosure are better for the homeowner, so there is incentive to short sell, instead of just to walk away," Wahlberg, of Missoula, said.

And for first-time home buyers and other bargain hunters, short sales offer greater peace of mind than foreclosed properties. Homeowners selling their own houses, rather than turning them over to lenders, are more likely to keep them in good shape.

However, not every short sale is as cut and dried as the one Johnson arranged for his client. The bigger the difference between the sale price and the balance owed on the mortgage, the more leery of the deal the lender becomes. Further, many home sellers who take the short-sale route have second mortgages or home equity loans that they still must pay off. This can complicate and drag out a potential short sale, making it less attractive to both seller and buyer. "It isn't always the best process, and people do get frustrated," said South Dakota's Wahlstrom.

The new normal?

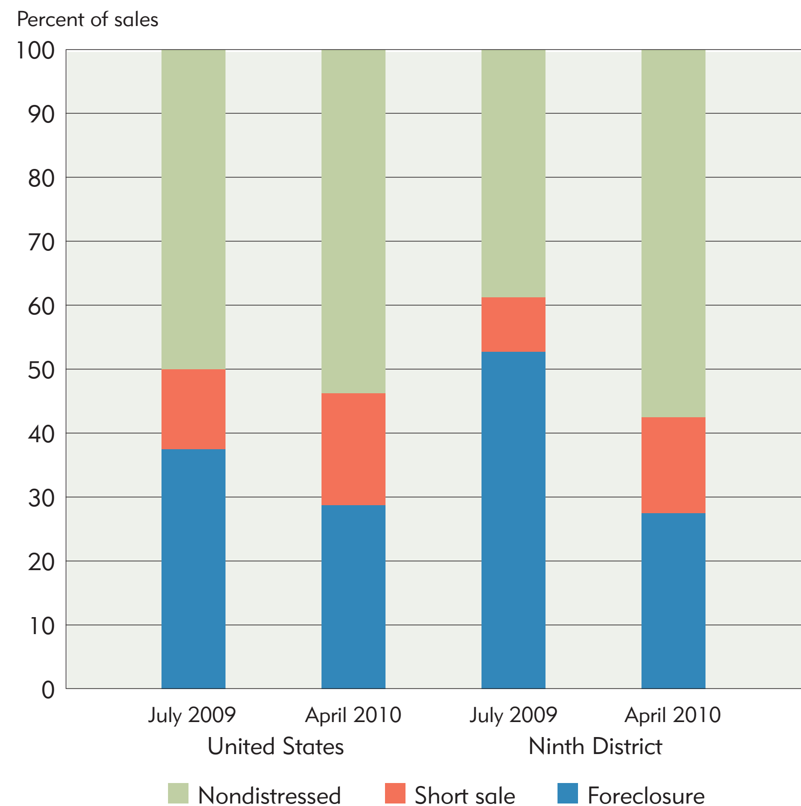
Short sales are a lagging indicator of the downturn in the housing market rather than a new trend in home financing. The short-sale tide may continue to rise for a while; respondents to the April Inside Mortgage Finance survey indicated that the supply of district homes on the market listed as short sales was growing faster than stocks of foreclosed properties and traditional, nondistressed houses.

But since short sales only make sense for underwater homes, they are expected to decline when housing prices start climbing again. When that will happen is anyone's guess.

Malkasian noted that as long as a huge inventory of distressed, unsold homes exists, homeowners and banks will resort to short sales to find buyers. "I still think we have, in Wisconsin, another couple years to go before we unwind all of this," he said.

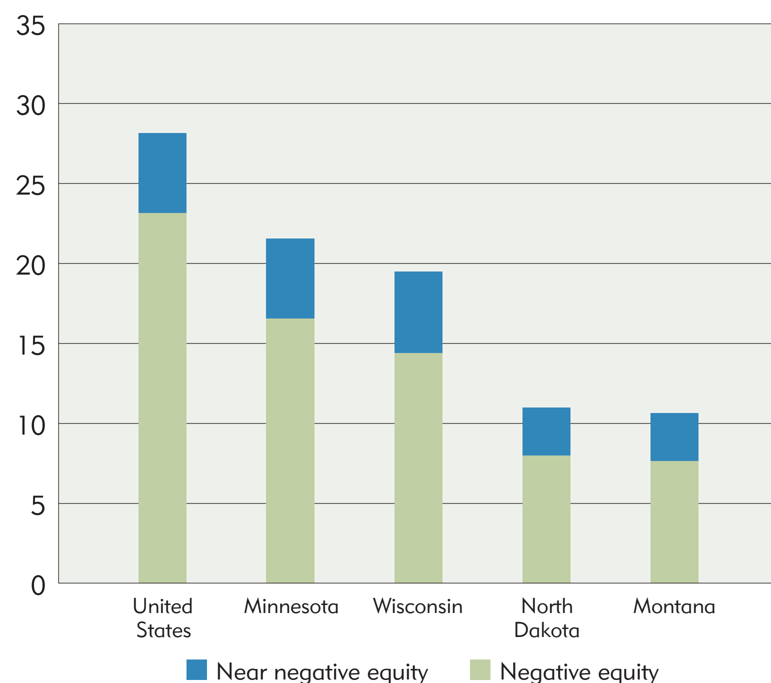
Wahlberg isn't sure when housing prices in Montana will return to normal—whatever that means, considering the peaks and valleys the market has seen in recent years. "You could say that right now is going to be the new normal for the next couple of years," he said. ■

CHART 2 **Short sales account for a larger portion of national and district home sales**
Real estate transactions by type, July 2009 vs. April 2010



Source: Campbell Surveys for Inside Mortgage Finance Publications, Inc.

CHART 1 **Large share of homes are "underwater"**
Percent of properties with an outstanding mortgage that have negative equity or within 5 percent
First quarter 2010*



*South Dakota data not available
Source: CoreLogic Inc.

PHOTOGRAPH BY SUE PROM

Money to burn

Fighting wildfires—in the forest and in back yards—has become costlier in recent years

The 2007 Ham Lake fire in northern Minnesota was the biggest in the state in 90 years, scorching 36,000 acres and more than100 homes and cabins.

By PHIL DAVIES
Senior Writer

It's high wildfire season in Montana and much of western and central South Dakota. The sun has sucked moisture from forests and grasslands, making them yearn to burn. Crews of firefighters and millions of dollars worth of equipment—fire engines, bulldozers, helicopters, airplanes—stand at the ready to attack blazes ignited by lightning, sparks from trains or careless campers.

This summer could turn out to be a mild fire season like last year, when just a few big wildfires inflicted relatively little damage on natural resources and private property. Or it could develop into a rerun of 2006 and 2007, record wildfire years in the region, when several large fires raged, consuming timber, homes and tens of millions of dollars in suppression costs. There was the Alabaugh Canyon fire, which destroyed 32 homes near Hot Springs, S.D., in July 2007, and the Jocko Lakes fire that broke out near Seeley Lake, Mont., later that summer, burning through 36,000 acres and over $37 million in public funds before it was put out.

Over the past decade, severe wildfire seasons have outnumbered the mild ones, in the nation and in the Ninth District. The cost of fighting wildfires has risen with the flames, taxing the resources of government agencies charged with putting out fires. Last year, the U.S. Forest Service alone spent over $1 billion fighting wildfires, mostly in the western part of the country.

In the district, the intensity of recent fire years and the resulting costs are most evident in fire-prone Montana. Over most of the past decade, state government incurred average annual fire suppression costs of over $20 million—just a fraction of total firefighting costs in the state. Costs peaked at $65 million in the 2007 fire season, requiring a special legislative session to cover a budget shortfall. "What we've seen is a really substantial escalation in the number of fire seasons where we burn a lot of acres, and a lot of those acres are threatening communities, so we tend to spend a lot of money," said State Forester Bob Harrington.

Experts have ascribed the increased expense of wildfires in western states and the district to a hotter and drier climate, the accumulation of deadwood and other fuels in forests, and increased development in fire-prone areas. Growth in the wildland-urban interface, or WUI—areas where structures intermingle with public forest and grassland—has attracted special scrutiny; studies have linked homes in the line of fire to higher firefighting costs.

Strategies for tamping down fire activity and escalating suppression costs face numerous obstacles; some are the equivalent of fighting a house fire with a garden hose. For example, fuels reduction—mechanical removal and prescribed burning to reduce the intensity and duration of wildfires—may prove a losing battle, given the vast acreage yet to be treated.

In the WUI, state and federal taxpayers heavily subsidize risk-taking by people living in fire-prone areas. Because local governments bear a small share of firefighting costs, they haven't done much to regulate development in the WUI or imposed taxes and fees on residents who benefit from fire protection but pay nowhere near its full cost.

"Something has to happen, because the local governments just aren't taking enough responsibility for reducing firefighting cost," said Jeff Gies, a fire manager with the Forest Service in the Black Hills of South Dakota.

However, local officials and landowners are starting to feel the heat from the rising costs of wildfires. The state of Montana and some fire-prone counties in the district are edging toward regu-

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lating development on the wildland fringe. And some insurers are requiring policyholders in fire-prone areas to take steps to reduce their fire risk, on pain of losing their insurance.

Smoke gets in your eyes

It may come as a surprise to some, but wildfires are commonplace in the district, as much a part of the natural order during warm weather as bugs and backyard grilling. National fire data show that Montana accounts for the bulk of wildfire activity in the region (see Chart 1). Huge swaths of public timberland and grassland in the state become highly flammable after snowmelt. The Black Hills, an oasis of conifers on the semiarid Great Plains, is another hot spot.

But every district state has its share of wildfires. During droughts, North Dakota sees numerous rangeland fires that are usually extinguished quickly by rural fire departments. In relatively wet Minnesota, over 1,000 wildfires break out each year, only a few of which wreak sufficient havoc to make the news. One such blaze was the Ham Lake fire in northern Minnesota three years ago—the biggest in the state in 90 years, scorching 36,000 acres of forest and more than 100 homes and cabins.

The source of fires varies. In Montana, lightning starts about half of wildfires; the rest are ignited by human activity—arson, smoking, bonfires, sparks from vehicles. In the eastern part of the district, the overwhelming majority of fires are caused by people.

Typically, big fires provoke a multipronged assault from local fire departments and firefighting crews from state departments of natural resources (DNRs) and federal agencies such as the Forest Service. State and federal units supply the heavy, expensive weaponry often deployed to stop or slow an advancing wildfire: bulldozers to clear fire breaks, helicopters with water-scooping buckets, air tankers that dump water or fire retardant.

After the fire, the various agencies share suppression costs, usually based on acres burned in each jurisdiction. Cost-share agreements differ from state to state and from fire to fire, with other factors such as resources expended and structure protection taken into account, and different cost splits for federal versus state agencies. The Federal Emergency Management Agency often helps pay for large, dangerous—and expensive—fires that threaten communities or subdivisions. For FEMA-declared fires like the Alabaugh Canyon fire and last year's Eagle Mount fire near Columbus, Mont., the federal government pays up to 75 percent of firefighting costs.

After all costs are allocated, the federal government ends up paying the lion's share of fire suppression costs in the district, with state legislatures responsible for most of the remainder. In 2009, the state of Montana was responsible for less than one-quarter of the total cost of putting out fires, according to state and national fire data. (Minnesota, with a smaller proportion of federal land, paid a larger share of overall suppression costs.)

Local governments pay a relatively small portion of firefighting costs, especially for big fires that threaten private property. Figures on local cost share in district states are unavailable, but Harrington estimates that Montana counties pay less than 10 percent of the cost of fighting large fires on county and private land. The state assumes the costs of such fires when county or municipal fire chiefs ask for help.

In South Dakota, the state pays all costs of fires that occur on nonfederal land in the Black Hills. County governments in the region pay nothing (although counties in the rest of the state help pay for fighting grass fires). "The counties have very little skin in the game when it comes to a forest fire in South Dakota," said Jim Strain, assistant chief of the state's Wildland Fire Suppression unit.

Many wildfire experts point to home construction in the WUI as a contributor to escalating firefighting costs—one that is likely to become more significant in some parts of the district.

Flaming budgets

Firefighting by the Forest Service, state DNRs and other public agencies promotes the general welfare by protecting resources such as timber, wildlife habitat and homes that would otherwise be destroyed. If tax dollars were not spent suppressing fires, society would suffer far greater economic losses (see "Counting the full cost of wildfires" on page 14). But over the past 10 or 15 years, the cost of keeping wildfires in check has risen markedly, along with the amount of land ravaged by fire. After staying fairly constant for 30 years, acreage scorched by wildfires across the country almost doubled in the 2000s, according to the National Interagency Fire Center, a clearinghouse for fire data. Costs also soared: In the 1990s, federal agencies spent an average of about $400 million annually in today's dollars fighting wildfires; since 2000, they have burned through at least $1 billion annually.

Comprehensive, long-run data on the cost of fires aren't available for district states. But NIFC statistics show that the region has experienced a rash of severe fire seasons during the past decade. Fire activity spiked in 2003, and again in 2006 and 2007, when over a million acres—an area the size of Minnesota's Boundary Waters Canoe Area—burned each year in district states, excluding the Upper Peninsula of Michigan. In 2006, over 1 million acres burned in Montana alone.

An analysis of separate NIFC wildfire cost figures—data that capture the biggest and most expensive fires—shows that total fire suppression costs in Montana, Minnesota and the Dakotas surpassed $375 million between 2005 and 2009.

Historic fire-cost data are available for Montana. State records of fire activity on nonfederal land since 1981 show that as the average number of acres burned annually has increased, inflation-adjusted costs have risen even more sharply over the past 30 years, more than doubling between 1991 and 2009 (see Chart 2).

At the national level, escalating firefighting costs have strained the budget of the Forest Service, which does the bulk of firefighting on federal lands. In the early 1990s, fire suppression accounted for about 13 percent of Forest Service expenses; by 2009, it consumed about half of the agency's budget. Last year, Congress created reserve accounts to cover firefighting costs in severe fire seasons when the annual budgets of the Forest Service and the Department of the Interior are exhausted.

In the district, states feel the financial impact of fighting wildfires in differing degrees. Minnesota spent about $15.5 million on fire suppression in 2009—a minuscule piece of roughly $25 billion in state spending that year. In Montana, a state with one-fifth the budget of Minnesota, record fire expenses in 2007 required $39 million in special appropriations. From 2006 to 2008, South Dakota's governor sought $2.4 million in emergency funding to douse prairie fires in the western and central parts of the state.

Waiting for a spark

Probably the single biggest reason for the increase in wildfire activity and suppression costs in the region is a shift in weather patterns. Government and academic research has linked higher-intensity, longer fire seasons since the 1980s to earlier snowmelt and warmer, drier summers, possibly caused by oceanic cycles or global warming. When parts of the district suffer drought—in 2003, 2006 and 2007, for example—the number and severity of wildfires invariably spikes.

Another factor behind the upswing in fire activity and costs is a decades-long buildup of woodland fuels that increase the likelihood of fires burning out of control. Ironically, over a century of successful fire suppression by federal and state agencies has contributed to this buildup; following Smokey Bear's advice has stifled countless small wildfires that otherwise would consume deadwood, brush and leaf litter. In Montana in the summertime, hot weather and a surplus of dried vegetation are an explosive mixture just waiting for a spark, said Harrington, the state forester. "With some fire starts, the conditions are so extreme that by the time you know that fire is there, it is already 100 acres and rolling," he said.

The chances that a wildfire will roll toward a house or subdivision have increased in recent years. Many wildfire experts point to home construction in the WUI as a contributor to escalating firefighting costs—one that is likely to become more significant in some parts of the district.

Over the past 25 years, development has blossomed on the wilderness boundary, particularly in tourist and retirement areas such as western Montana, the Black Hills and the North Woods of Minnesota and Wisconsin. Forestry researchers estimated in 2005 that 60 percent of the homes built in this country in the 1990s were built in WUI areas. In 2000, about 40 percent of all homes in Montana were located within a mile and a half of forestland.

More development means more cabins, houses and other structures that are defended from wildfire, often at considerable expense. (The presence of humans also increases the number of wildfire starts, but not necessarily costs because most wildfires are quickly extinguished.)

The WUI effect is most pronounced in the western part of the district, where fire danger within or adjacent to public forests can be extreme. Firefighting officials in the region see a connection between rising suppression costs and development in the WUI. "That has absolutely been a cost driver for wildfires" in Montana, Harrington said. In the Black Hills, Strain said, increased development "does indeed drive up our fire costs over time. Once you put primary residential houses and structures in a forest setting, it's more expensive to fight the fire."

Nationally and in the district, fire suppression costs per acre burned haven't increased over the years—an indication that, for all fires, cost increases have more do with weather patterns and the accumulation of fuel than woodland sprawl. However, a number of recent studies have linked WUI devel-

At the 2007 Jocko Lakes fire near Seeley Lake, Mont., a firefighter supervisor drives through flames that jumped the road.

opment to higher suppression costs for *large* wildfires.

Headwaters Economics, a research group based in Bozeman, Mont., analyzed daily fire suppression costs for 18 large wildfires that burned in Montana during 2006 and 2007. The study found that each additional house within one mile of a wildfire was associated with a $7,900 increase in suppression costs. For conflagrations in areas with relatively dense development, about 30 percent of the cost of fighting those fires was related to structure protection. Another study of large wildfires fought by the U.S. Forest Service found that as total home values within 20 miles of a fire ignition increase, so do firefighting costs.

Protecting "values at risk" from an advancing wildfire is expensive because it typically involves heavy concentrations of firefighters and equipment. A rule of thumb in defending houses or subdivisions calls for one fire engine and crew to be assigned to each structure. Determined to save lives and property, fire chiefs often summon costly reinforcements—large structural engines, bulldozers, tanker airplanes. Aircraft are particularly pricey, accounting for about one-third of total firefighting costs on a big blaze.

Denny Gorton, fire coordinator for Pennington County in the Black Hills, has battled several big wildfires that imperiled houses, including a 2006 fire that grew quickly and marched toward 200 homes on a ridge near Rapid City, S.D. "When you get that type of fire and you have that many homes being threatened, you pull out all the stops," he said. "You start requesting lots and lots of resources—local, county, state, federal." Putting out the East Ridge fire, which burned seven homes, cost taxpayers about $2 million.

Slash and burn

If hotter and drier conditions are mainly responsible for the upsurge in wildfire activity and suppression costs, there's not much that can be done about that, at least in the short term. However, public policy and private markets can mitigate the harmful effects of natural phenomena such as floods, tornadoes and wildfires. It may be possible to reduce the number of large, raging fires—and the tax dollars burned putting them out.

Most efforts to tame wildfire risk over the past decade have focused on fuels reduction on public land—thinning tree stands and eliminating brush and forest litter to prevent large, intense fires that rip uncontrolled through forestland. Fuels treatment includes prescribed burning and letting smaller wildfires burn within predetermined boundaries.

Such treatment has increased over

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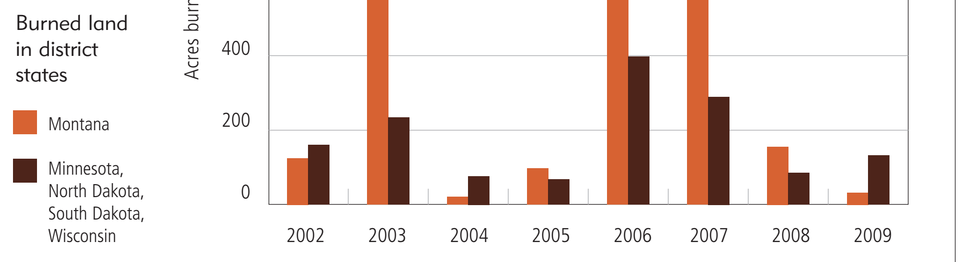
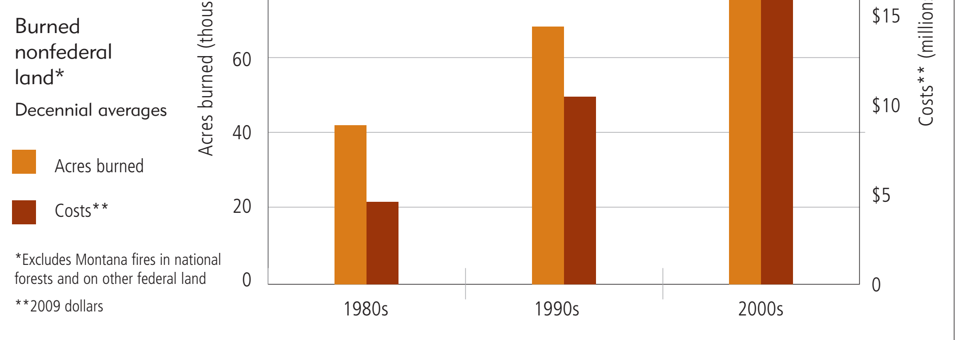


Source: National Interagency Fire Center



Source: Montana Department of Natural Resources and Conservation

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PHOTOGRAPH BY SUE PROM

A firefighting crew gathers at the Ham Lake fire in Minnesota in 2007.

Counting the full cost of wildfires

Firefighting costs, the focus of this article, amount to a small portion of the economic costs of wildfires. This is especially true for big wildfires that rage out of control, consuming vast expanses of forest and burning private property. Estimates of the total cost of large wildfires to landowners, investors and taxpayers range from 10 to 50 times the cost of fire suppression. Wildfire experts and economists generally divide actual wildfire costs into three categories:

Direct costs. These are values directly consumed by flame or related to controlling and managing fires. They include suppression expenditures, damage to homes, public infrastructure and personal property, burned timber, lost business revenues, and the expense of evacuating residents and treating the injured.

Indirect costs. These are typically unaccounted for in government audits and media reports. Examples are firefighting readiness expenses such as crew training and equipment maintenance, fire insurance premiums (paid in anticipation of fire), lost investments in reforestation and other natural resource management, and degraded recreational value.

Post-fire costs. Long-term damage to the economy and the environment may not become apparent for years. Lingering effects of wildfires include declines in the capital value of timberland, reduced property tax revenue, chronic illness due to smoke exposure, increased soil erosion, and ongoing salvage, repair and rehabilitation costs.

When all of these costs are added up, the economic toll exacted by wildfires can be staggering. The Ham Lake fire in Minnesota in 2007 cost about $11 million to extinguish. Assuming conservatively that suppression expense amounted to roughly 10 percent of total costs, the full cost of that blaze—just one of thousands that burned in the district that year—likely will exceed $100 million over time.

—Phil Davies

the past decade, both nationally and in the district. In Montana, the Forest Service, Bureau of Land Management and other federal agencies cut and burned about 114,000 acres last year, more than double the acreage treated in 2003. Minnesota saw a comparable jump in treated federal land, much of it in the Boundary Waters, where a 1999 windstorm had leveled millions of trees.

District states and local governments have received federal dollars to reduce fuels in areas identified in Community Wildfire Protection Plans. About 4,000 communities across the west, including Rapid City, S.D., and Missoula, Mont., have adopted such plans. "We're seeing a sizable amount of acres getting worked up in fuel reduction activities," Strain said. "Whether it's made a difference or not, time will tell."

It's not clear that such activity is moving fast enough, and ultimately it may prove futile. Studies have shown that the Forest Service and other federal agencies would have to treat between 10 million and 12 million acres nationwide each year to significantly reduce wildfire risk—more than double the current pace of fuels reduction. At Montana's accelerated 2009 pace, treating all the federally owned forest in the state would take more than a century—by which time much of the purged biomass would have grown back.

Moreover, a struggling timber industry in Montana and other western states has removed a major source of demand for logs from selective cutting of trees on public land.

Homeland defense

The one element of wildfire suppression cost that is completely under human control is development near wildlands. If protecting private property in the WUI drives up firefighting costs, then perhaps the conditions that contribute to higher costs—government policies that encourage disregard for fire risk, for example—can be changed.

Wildfire research has shown that the best way to protect structures from wildfire—and avoid heroic firefighting efforts—is for owners to create "defensible space" by removing surrounding trees, undergrowth, pine needles and other flammable materials. "The biggest fire risk out here is that people aren't doing enough to treat their own land," said Gies of the Forest Service. Using fire-resistant construction materials on roofs and decks can also prevent house fires started by embers carried on the wind from nearby wildfires.

But there's a major obstacle to making builders and property owners responsible for keeping the flames at bay: a disconnect between who benefits from construction in the WUI and who pays when those structures are threatened by fire.

Because local governments pay little or none of the cost of defending homes or subdivisions from wildfires, they have scant incentive to reduce fire risk by restricting development in hazardous areas or requiring defensible space and fire-wise construction methods. Some local officials reject the notion that WUI development increases suppression costs, arguing that if federal and state agencies were more diligent in treating fuels on public land, fewer fires would invade private land and endanger homes.

For their part, property owners generally don't give much thought to wildfire peril, trusting firefighters to come to the rescue or, in the worst case scenario, insurance or federal disaster assistance to cover their losses and let them build anew—often somewhere else near the forest. "You get a lot of people with the attitude that if the forest is all black around my house, I might as well let my house burn down because I don't want to live here anymore," said Tim Eggers, fire chief of Lead, S.D.

Curbing development in the WUI—by banning home building in hazardous areas, for example—is probably infeasible, both economically and politically. The desire to live in scenic, wooded areas of the district is strong, and local governments covet increases in property tax revenue that development brings. After a lull due to the national recession, growth in the WUI, especially in western states, is projected to continue apace in a recovering economy.

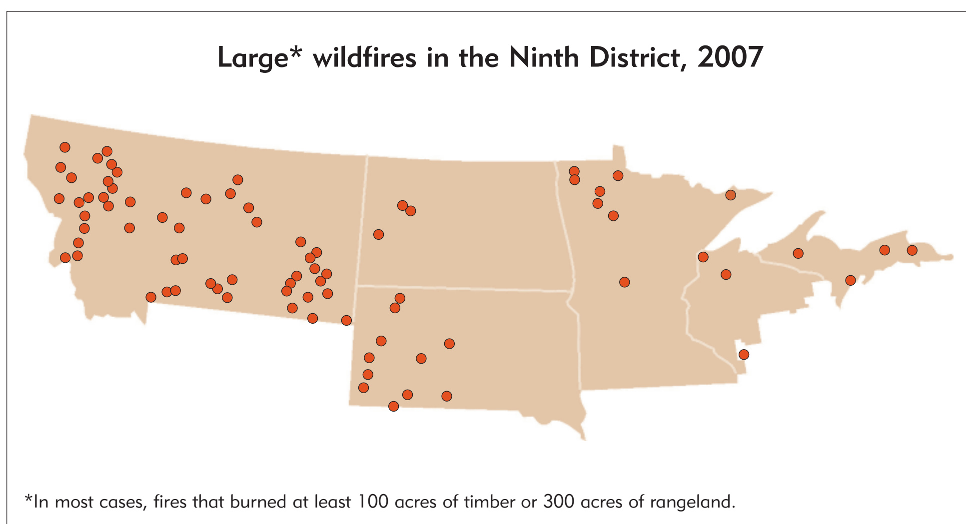
But it's an economic axiom that those who benefit from a good or service should bear its costs, and this rule should also apply to wildfire protection on the forest fringe. Noting that federal agencies don't have power to regulate local development, a 2006 report by the U.S. Department of Agriculture's Office of Inspector General recommended that state and local governments accept more financial responsibility for firefighting in the WUI.

Such a shift "should provide an incentive for a behavior change, such as changing zoning rules or building codes," noted Krista Gebert, a Forest Service economist based in Missoula who co-authored the cost study of large wildfires fought by the agency. In particular, tapping city and county governments for a greater share of firefighting costs would put pressure on them to try to reduce wildfire risk to private property. (Alternatively, they could raise property taxes or levy special fire protection fees on homeowners in hazardous areas.)

Responding to the high costs of recent fire seasons, the state of Montana and some counties in the district have taken halting steps toward making development in hazardous areas more resistant to fire. In Montana, legislation enacted in 2007 encourages local government to follow state guidelines on the use of fire-resistant building materials in the WUI, in return for aid to local fire departments drawn from federal fuels-reduction dollars.

In the northern Black Hills, Lawrence County started requiring wildfire hazard inspections of new subdivisions last year. Developers must comply if inspectors order them to trim vegetation, improve road access and take other action to mitigate fire danger. Although the measure doesn't address building codes (the county has no building inspector) or existing subdivisions, Eggers said that it will make firefighting easier as more clusters of houses sprout among combustible pines. "It was just a recognition by the county that with the amount of growth that was going on, something needed to be done," he said.

Smoke billows at the 2006 Red Eagle wildfire in Glacier National Park.



Large* wildfires in the Ninth District, 2007

*In most cases, fires that burned at least 100 acres of timber or 300 acres of rangeland.

Source: National Interagency Fire Center

Insurance to the rescue?

Insurance markets offer another approach to cutting fire risk and suppression costs in the WUI. If insurance companies raised fire insurance premiums, some prospective home buyers might forgo a place in the woods, resulting in fewer houses to defend in the event of a wildfire. Existing homeowners, in order to lower their rates—or qualify for coverage at any price—might carve out defensible space, replace shingle roofs and take other steps to reduce the chances of disaster.

Historically, insurance firms haven't worried much about wildfire losses because they make up a small proportion of payouts; according to the Insurance Information Institute, catastrophic fires account for about 2 percent of U.S. insurance losses, compared with 26 percent for tornadoes and 46 percent for hurricanes and tropical storms. But devastating wildfires in California over the past 15 years have alerted the industry to the potential for huge property losses. "It's been on our radar for a long time," said Carole Walker, executive director of the Rocky Mountain Insurance Information Association in Denver.

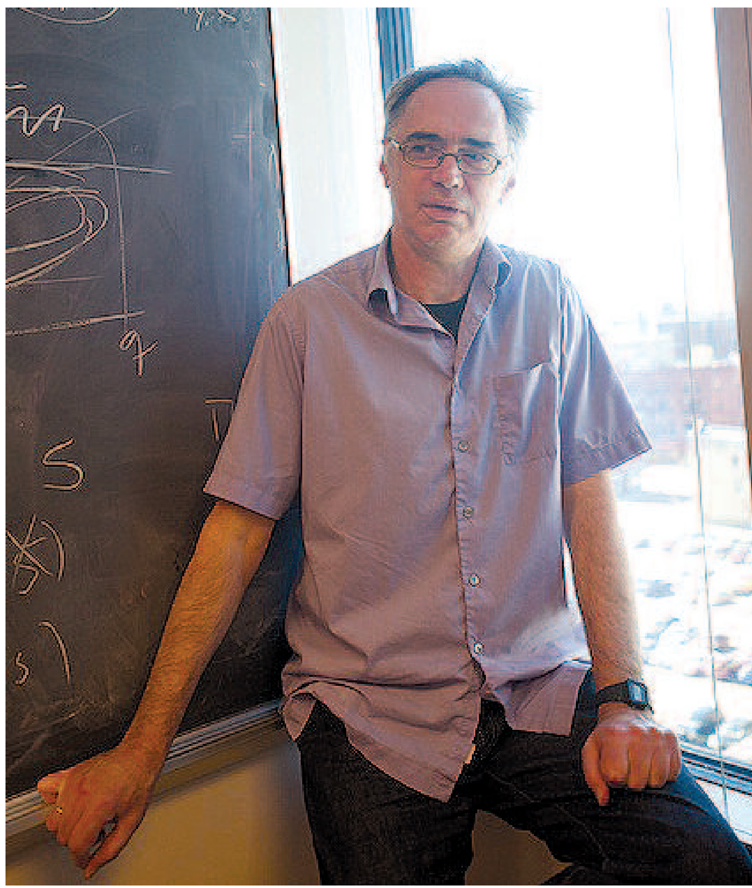
Some insurers have tightened their requirements for wildfire coverage, usually sold as part of a home or commercial property policy. State Farm Insurance introduced a wildfire hazard inspection program in 2003 and has since expanded it to 13 states, including Montana. Landowners must show inspectors that they've cut brush, moved log piles, installed wildfire sprinkler systems and taken other action to enhance fire safety. Those who don't comply risk cancellation of their policy. "The financial incentive for people to do the right thing and protect their property is motivated by keeping your insurance," Walker said. Allstate Insurance Co. and USAA have similar inspection programs.

In most WUI areas, fire insurance is available and relatively inexpensive compared with other types of insurance. For all their concern about curbing wildfire risk, State Farm and other insurers have not appreciably raised rates, and they have canceled only a tiny percentage of policies. This forbearance is understandable; public policy sends a clear signal that the government will shield private property from wildfire, even in high-risk areas. In setting their rates, insurers factor in local firefighting capacity—what firefighting resources are in the vicinity and how quickly they can arrive at the scene of an approaching wildfire.

For premiums to accurately reflect wildfire risk, firefighting agencies would have to abandon their practice of protecting private property at all costs—an unlikely scenario, observed Montana State Sen. Bob Hawks, who sponsored last year's WUI wildfire legislation. "If we just considered all territory to be equal in our [firefighting] response, then homeowners would pay an increased insurance cost … which is the way the market should work. But our sense of protecting people and property is high."

There's the rub with wildfires, and not just blazes threatening homes and other buildings in the WUI. When fire rages across the landscape, federal and state agencies and local fire departments respond aggressively, dispatching fire crews and expensive equipment to battle the flames. Very few fires are left to burn themselves out; in Montana, 96 percent of fires on state land are put out before they exceed 10 acres in size.

If more hot, dry summers lie in store for the district's forests and grasslands, the cost of suppressing wildfires will rise with the columns of smoke. Everybody—people who live in cities and relatively wet areas at little risk from wildfire as well those squarely in the fire zone—will foot the bill. f


PHOTOGRAPHS BY MARC NORBERG

Sweet productivity

An interview with Minneapolis Fed economist James Schmitz

James Schmitz is a senior economist at the Federal Reserve Bank of Minneapolis and a visiting professor at the University of Minnesota. His research focuses on the sources of innovation and economic growth, often through historical case studies. In a recent staff report (SR 437 online at minneapolisfed.org), he looked at sugar beet production and sugar refining, while in an earlier published paper, he studied iron ore mining, both of which are important industries in the Ninth District. Staff Writer Joe Mahon sat down with him to talk about his research.

fedgazette: What made you want to study the sugar business?

James Schmitz: Well, a big part of my research is thinking about the impact of competition, particularly its effects on productivity. And an interesting era for competition in U.S. history is the Depression era, because the U.S. government allowed manufacturing industries to cartelize, and I'm interested in the effect of that.

Now, in most industries, the cartels didn't last very long, but some cartels lasted a long time, like the sugar cartel, which lasted 40 years—from 1934 to 1974. That was the main thing that got me interested in the industry. It was a long period of time and there was a lot of data, from archives and other sources.

fedgazette: When you say "cartel," many people will think of drug cartels. But the sugar cartel was actually a legal cartel, set up by the government. Could you go over briefly how it worked, how exactly the cartel was structured?

Schmitz: It was run through the Department of Agriculture; they set up sales quotas every year for each firm. And they gave farmers quotas every year, tied to precartel acreage. Some of the years it wasn't binding; after the Cuban Revolution, for example, [farmers] were allowed to grow whatever amount of beets they wanted for a few years.

Anyway, it was a pretty complicated system. I don't think we said it in the paper, but in one of the archives (at the University of Colorado, Boulder: the Great Western Sugar Company collection), I found this huge handbook of how the cartel was administered. A lot of it was done at the county level by farmers and representatives of the government. But it's a huge book, hundreds of pages. Through the handbook and other sources, we were able to figure out pretty well how the cartel worked.

fedgazette: By necessity, the quotas were supposed to keep out competitors. Were they successful in doing that?

Schmitz: Yes. Literally, I don't think any new firms entered, and the firms abided by their sales quotas.

fedgazette: You found that the cartel prevented production from moving geographically. How?

Schmitz: By giving quotas to farmers based on pre-existing acreage, the cartel locked beet production in place. The provisions for firms didn't preclude them from closing a factory in one state and moving to another, but it wouldn't make sense to move somewhere with no beets to process.

fedgazette: There's now a lot of sugar production in the Ninth District, particularly in the Red River Valley, but there wasn't as much during the cartel years. Why was it that after this 40-year period, it became advantageous to produce sugar in the Midwest?

Schmitz: Well, the productivity of making sugar in North Dakota went up faster than in, say, California over the 40-year period. Let's make it very simple: Suppose the only input into making sugar was land, and it took one unit of land to make one unit of sugar in California and in North Dakota. And suppose in 1934 the price of a unit of land was the same in California as in North Dakota. So the physical productivity was the same, and the input price was the same. Now suppose in California the value of the land goes up faster than the value of the land in North Dakota. The opportunity cost—the alternative use of land—that's what's really determining its price. Well, California wasn't a very big economy in '34. But over the 40-year period, a lot of stuff happened in California. A lot of cities were growing; a lot of agricultural land was becoming nonagricultural. And so the value of the land was going up faster than in North Dakota.

So in '74, you're still using one unit of land in California and North Dakota. But the cost of land was much higher in California. So if you get rid of this cartel, production moves from California to North Dakota. Productivity goes up in the sense that the cost of your inputs is going down.

fedgazette: There was also this tax-subsidy scheme, which you argue in the paper played a big role in distorting productivity. Can you explain how that worked?

Schmitz: The purported motivation for the subsidy was that since farmers are going to voluntarily abide by these quotas, we're going to give them a bonus, some subsidy. Now, Congress wanted that to be revenue-neutral, and that was part of the law actually. So they taxed the sugar coming out of factories—regardless of where the sugar was grown—to pay for those subsidies to farmers. The good news for the beet sugar industry was that a lot of taxes were paid by the sugar factories in New York, Baltimore and so on that processed raw cane sugar from Cuba

and other smaller foreign sources.

The subsidy to farmers, in turn, was based on the amount of sugar that they had in their crops. You measure that by taking the tons of beets and multiplying that by the percentage of sugar in an average ton. In the paper, we called it "sugar in the crop."

The best way to think about it for the industry as a whole, when you consider the factories and the farms together, is that before the cartel, the only source of revenue to the industry came from processed sugar. Now there's some revenue going to the industry based on how much sugar they had in their crops before extraction, and that's going to affect the way they produce beets; it's going to distort their decisions.

fedgazette: How were their decisions changed?

Schmitz: You can farm beets in such a way that you increase the tonnage of beets and the total amount of sugar in a crop, but at the same time, decrease the percentage of sugar in each beet. That's what the industry did, and the quality of beets—their percentage of sugar—fell.

fedgazette: So that's a theoretical story about how incentives changed for the industry. What evidence can you point to that the cartel did, in fact, distort decisions?

Schmitz: What's interesting is you can see it in the national level; beet quality starts falling in '34 when the cartel starts. I don't know exactly how many factories there were back in 1934, on the order of 100. It turned out that we found information on a lot of these factories in archives all around the country.

Now, as an economist you ask, "Well, is quality falling in every factory?" And, in fact, it was happening at most factories. There were regional differences, and that's one of the key things too.

You can drive up sugar in the crop, driving down beet quality in the process, by watering and fertilizing heavily in a certain part of the growing cycle, but restricting water closer to harvest, when more rainfall would just pump up the beets with water. It was easiest to manipulate quality in areas that were arid and had access to irrigation, such as California. And certainly in those areas you saw beet quality falling right away in all of the factories. In the Midwest, you have more difficulty manipulating quality since you don't have control over the rain, and you don't have irrigation either. So quality fell less in the Midwest. In the Chaska [Minn.] factory, I don't think it fell at all.

Switching over to new technologies or management practices can be costly to firms. If the transition disrupts production, say, if there's a steep learning curve or a strike, the lost production can be costly. What's the cost of that? Well, the cost is tied to lost sales revenue. You're not going to do this during a period where prices are high; you'll do it in a period where prices are pretty weak. Competition lowers prices, and so it lowers the opportunity cost of changing practices. That's one idea.

fedgazette: The sugar cartel is over now, but there are import quotas and tariffs. Do you have any thoughts on how these contemporary protectionist measures might be affecting productivity in the industry?

Schmitz: The first thing I want to say is that I really focus on the period of the cartel which ended in 1974. But clearly, everything else equal, if you had more competition, productivity probably would go up. There's still a little bit of sugar production in California, and if import quotas and tariffs were eliminated, that would probably go away. The sugar producers in our region I'm guessing are the most productive in the country. And so these other producers outside our region would have the hardest time.

I think we would knock the socks off the Europeans if we had to compete with them. There's no North Dakota in Holland, when it comes to land values, and there's no North Dakota in France. They're using very valuable land for growing beets there. Europe actually makes tons of beet sugar, and they export tons of it. But we would knock their socks off because North Dakota is a much more productive place to make sugar than the Netherlands, just given the land alone.

fedgazette: I want to talk about another industry you've studied that's very important in the Ninth District, and that's iron ore mining. Your research was on the historical productivity of this industry, but instead of cartelization, you looked at foreign competition. So what was your interest in the iron ore industry?

Schmitz: Well, in the 1980s, there had been a threat of competition from Brazil, and the industry increased its productivity pretty dramatically. And I was just simply trying to understand how it happened—how did they raise their productivity? So that's sort of a classic question, I guess. We saw competition, and we saw productivity go up. Why?

A little esoteric point is that there really wasn't a lot of increase in imports into the region during this period. In the models economists work with, the gains from trade are closely tied to how many imports come in. So these models completely miss the effect that you don't have to have imports come in to see the benefits of competition. Some people lost their jobs, and that's obviously not a benefit to those people. But in terms of the industry's productivity, there were benefits.

We had the mine-level data in Minnesota, so we were able to ask whether industry productivity went up because they closed the least-productive mines. And that really was not a big factor. They only closed a couple mines, and one of those opened up again. It was just that they sort of reorganized work in the mines. They were able to increase their productivity a lot through changing their work rules.

fedgazette: What do you mean by work rules?

Schmitz: Well, for example, you might have a certain repair classification, and if you had that classification, you weren't able to work on certain types of machines or certain other types of jobs, even if you might have been quite capable of doing the repair work. And a rule like that leads to lower productivity. Let's say machines go down for some reason. You want to get them back up operating as quickly as possible, but if you have to wait to get the correct classification of worker there, the machine is down longer than it has to be.

There's actually a great example of a change in work rules in the paper—when the mines went to eyeball-to-eyeball crew relief.

fedgazette: What's that?

Schmitz: When you had crew relief before the Brazilian threat, you brought small vans around to pick people up on their blasting equipment and ore-hauling trucks, and you brought them back to a central location. And then you filled up the vans with new people, and you took them out to the equipment. So the equipment is idle as you're changing shifts.

Now, suppose you took the new crew out to the machines in the same vans and dropped them off as you picked up the old crew. The crews pass eyeball-to-eyeball. Before the threat of foreign competition, some of the mines were not eyeball-to-eyeball, and they changed in response. Very little has changed in the mine itself, you're just getting more output.

fedgazette: How is it that just the mere threat would have initiated these changes in management practices?

Schmitz: There are some ideas that Tom Holmes and David Levine and I had. Switching over to new technologies or management practices can be costly to firms. If the transition disrupts production, say, if there's a steep learning curve or a strike, the lost production can be costly. What's the cost of that? Well, the cost is tied to lost sales revenue. You're not going to do this during a period where prices are high; you'll do it in a period where prices are pretty weak. Competition lowers prices, and so it lowers the opportunity cost of changing practices. That's one idea.

But it still doesn't get into why management and workers couldn't agree to things like eyeball-to-eyeball crew relief in the first place.

fedgazette: So the puzzle is if there were these potential gains to productivity, why were they not being exploited?

Schmitz: Yes. Obviously, management, employees and the union could not reach agreements to achieve these productivity gains. The puzzle is why not, and there's no good answer for that.

fedgazette: Thanks for talking with us, Jim.

—Joe Mahon

Manufacturers turn the page on poor 2009 exports

Exports slump across states and sectors

By ROB GRUNEWALD
Associate Economist

WONHO CHUNG
Research Assistant

A global recession and small appreciation of the U.S. dollar led to the largest annual decrease in exports at both the district and the national level since export data first became available in 1997.

Last year, district and U.S. manufactured exports dropped 18 percent to $33.7 billion and $916.7 billion, respectively (see Chart 1). The bloodletting was widespread, affecting virtually all export destinations and product sectors.

For example, all district states saw decreases in exports to Canada and Europe, the district's largest export destinations, which account for over half of all manufactured exports. While GDP growth was still positive during 2009 in some developing countries, including China and India, district exports decreased to almost all of these destinations as well.

There were a few bright spots. Minnesota exports to China rose by 5 percent, and North Dakota saw a 60 percent increase in exports to Mexico, primarily from shipments of food and kindred products. Exports to South America also increased slightly from Wisconsin due to relatively hefty increases in machinery sent to Chile and Peru.

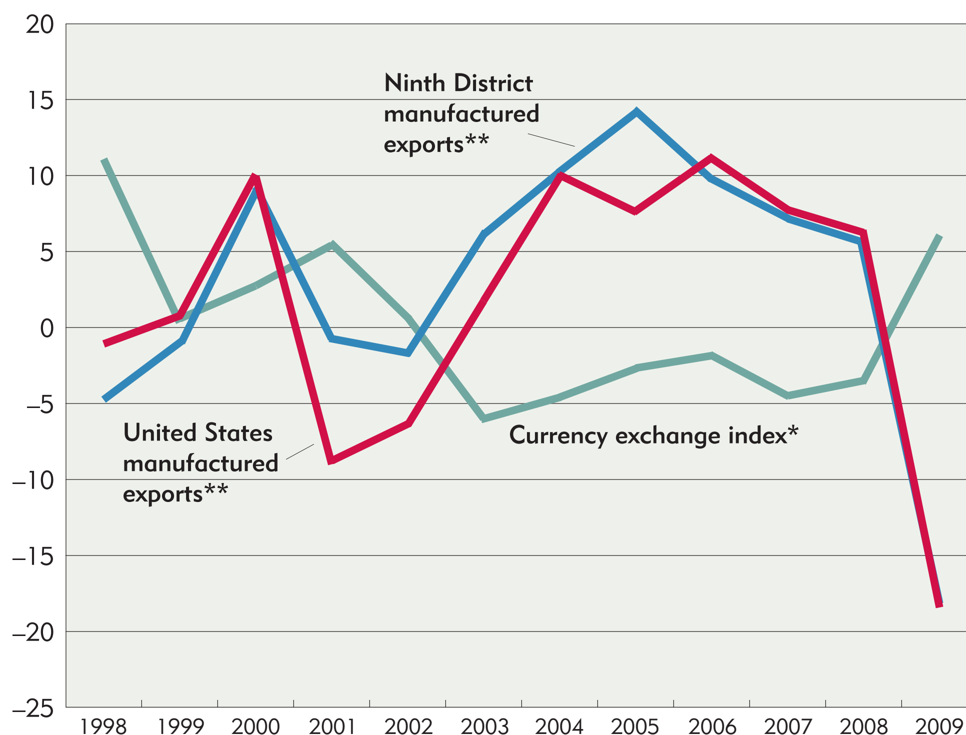
However, steep declines were more the rule. Exports to Canada decreased by 20 percent or more from all district states, except North Dakota, where exports dropped by a more modest 7 percent. Exports to Europe were down across the board, but off the most from North Dakota, at 45 percent. South Dakota, which had the steepest overall export decline of 38 percent, posted a combined decrease of more than 70 percent to Hong Kong, Singapore, South Korea and Taiwan.

U.S. dollar stronger in 2009

The average value of the U.S. dollar relative to the Canadian dollar and the euro increased by 7 percent and 6 percent, respectively, during 2009 compared with the previous year, which increased the cost of district exports abroad. A broader measure of the value of the U.S. dollar relative to the currencies of 26 major trading partners increased 6 percent (see Chart 1).

In contrast, the value of the U.S. dollar relative to the Japanese yen decreased by 9 percent during 2009, making district goods relatively less expensive in Japan and a likely reason

CHART 1 **Manufactured exports tumbled in 2009**
Percent change from a year earlier



*Trade Weighted Exchange Index: Broad. A weighted average of the foreign exchange value of the U.S. dollar against the currencies of a broad group of major U.S. trading partners.
**2009 dollars
Source: WISERTrade International Trade Database, Holyoke Community College

Minnesota Manufactured Exports

	Total Exports 2009 (millions of dollars)	Annual Percent Change 2008–2009
Top Five Destinations		
Europe	4,224.8	–18.4
Canada	3,805.2	–20.7
Asian NIEs*	1,478.3	–2.3
Southeast Asia	1,037.5	–23.3
China	955.4	4.9
Total Manufactured Exports	14,613.7	–15.5

	Total Exports 2009 (millions of dollars)	Annual Percent Change 2008–2009
Top Five Industries		
Computer and Electronic Products	3,378.3	–19.5
Machinery, Except Electrical	2,445.3	–16.4
Miscellaneous Manufactured Commodities	1,935.3	–1.2
Transportation Equipment	1,652.9	–18.5
Food and Kindred Products	1,231.2	–13.3
Total Manufactured Exports	14,613.7	–15.5

Montana Manufactured Exports

	Total Exports 2009 (millions of dollars)	Annual Percent Change 2008–2009
Top Five Destinations		
Canada	335.8	–28.6
Europe	136.7	–13.8
Asian NIEs*	135.7	–20.7
Japan	129.2	–1.2
China	59.2	–2.7
Total Manufactured Exports	875.9	–19.7

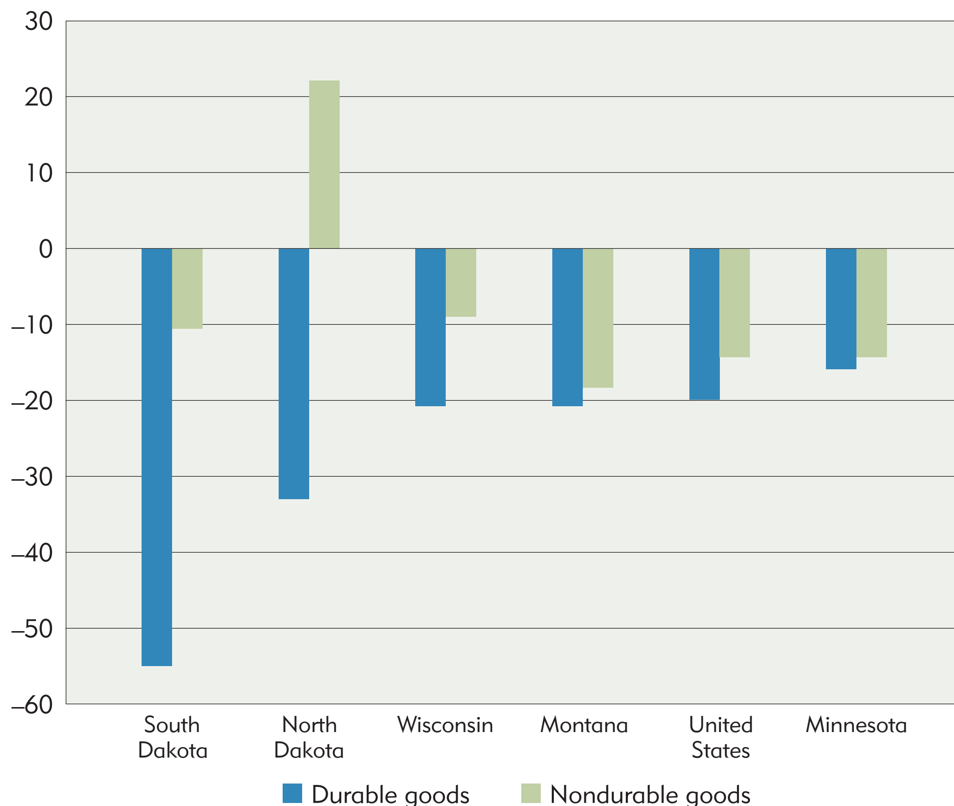
	Total Exports 2009 (millions of dollars)	Annual Percent Change 2008–2009
Top Five Industries		
Chemicals	303.0	–14.2
Machinery, Except Electrical	156.6	–15.2
Primary Metal Manufacturing	121.5	5.7
Transportation Equipment	76.7	–48.8
Nonmetallic Mineral Products	39.2	–10.1
Total Manufactured Exports	875.9	–19.7

North Dakota Manufactured Exports

	Total Exports 2009 (millions of dollars)	Annual Percent Change 2008–2009
Top Five Destinations		
Canada	825.7	–6.8
Europe	170.0	–45.4
Mexico	145.8	59.6
Pacific Islands	103.4	13.6
Former Soviet Republics	84.7	–68.8
Total Manufactured Exports	1,474.8	–22.2

*Asian NIEs (newly industrialized economies) include Hong Kong, Singapore, South Korea and Taiwan.

CHART 2 **Durable goods fell harder than nondurables**
Percent change in manufactured exports 2008 to 2009



Source: WISERTrade International Trade Database, Holyoke Community College

that district exports there saw a smaller overall decrease (6 percent).

A silver lining in the data is that while the level of manufactured exports was down substantially last year, quarterly data show gradual improvement over the course of the year. By the fourth quarter 2009, exports were down only 9 percent from a year earlier, compared with a decline of more than 20 percent for the first three quarters. If modest improvement continues through this year, 2010 will likely pull ahead of 2009's dismal performance. However, it may take longer to top 2008's level of $41.1 billion in total exports.

Durable goods lead decline in export products

Exports of durable manufactured goods (products with a useful life of more than three years) make up the three largest export categories in the district: machinery, computer and electronic products, and transportation equipment. Their steep declines were a central factor in the overall drop in manufactured exports as global demand for durable goods fell sharply during the recession (see Chart 2). Nondurable goods tended to decrease at a more modest pace, such as the district's fourth-largest export industry, food and kindred products, which decreased by 8 percent.

Trends by particular industry include a drop in transportation equipment by more than 40 percent from Wisconsin and Montana and a decrease in chemicals by 49 percent from North Dakota. Steep declines were also noted in South Dakota, where machinery decreased 41 percent and computer and electronic products decreased 74 percent. Exceptions include a 6 percent increase in exports of primary metal products from Montana, which were largely sent to Japan. Meanwhile, exports of food and kindred products were up 49 percent from North Dakota.

Exports to Iraq and Afghanistan increase

The presence of U.S. military operations coincided with increases in district manufactured exports to Iraq and Afghanistan from practically zero early in the decade to over $20 million to each country in 2009. Nevertheless, these levels represent only a tiny fraction of total district exports.

Iraq received $24 million in district exports in 2009, an 8 percent increase from a year earlier. About 85 percent of the exports included machinery and transportation equipment.

Exports to Afghanistan increased 73 percent in 2009 to $20 million. Over half of these exports were transportation equipment, with machinery, food and kindred products, and electrical equipment, appliances, and components making up most of the remainder. f

North Dakota (continued)

	Total Exports 2009 (millions of dollars)	Annual Percent Change 2008–2009
Top Five Industries		
Machinery, Except Electrical	801.8	–32.2
Food and Kindred Products	322.1	48.5
Transportation Equipment	144.1	–37.5
Chemicals	43.6	–49.0
Beverages and Tobacco Products	32.9	34.5
Total Manufactured Exports	1,474.8	–22.2

South Dakota Manufactured Exports

	Total Exports 2009 (millions of dollars)	Annual Percent Change 2008–2009
Top Five Destinations		
Canada	322.6	–33.2
Mexico	232.8	–17.9
Europe	135.2	–29.1
Southeast Asia	63.3	–70.6
Asian NIEs*	51.8	–71.4
Total Manufactured Exports	927.1	–38.4

	Total Exports 2009 (millions of dollars)	Annual Percent Change 2008–2009
Top Five Industries		
Food and Kindred Products	312.3	–9.9
Machinery, Except Electrical	151.9	–41.4
Computer and Electronic Products	131.2	–74.2
Beverages and Tobacco Products	85.8	–27.8
Transportation Equipment	66.9	–29.3
Total Manufactured Exports	927.1	–38.4

Wisconsin Manufactured Exports

	Total Exports 2009 (millions of dollars)	Annual Percent Change 2008–2009
Top Five Destinations		
Canada	4,516.2	–25.0
Europe	3,282.6	–19.3
Mexico	1,481.8	–1.8
South America	1,186.5	0.7
China	1,009.0	–8.6
Total Manufactured Exports	15,777.1	–18.2

	Total Exports 2009 (millions of dollars)	Annual Percent Change 2008–2009
Top Five Industries		
Machinery, Except Electrical	4,889.6	–21.6
Computer and Electronic Products	2,895.1	–7.0
Transportation Equipment	1,475.4	–43.2
Food and Kindred Products	1,092.7	–10.2
Electrical Equipment, Appliances and Components	977.5	–12.4
Total Manufactured Exports	15,777.1	–18.2

*Asian NIEs (newly industrialized economies) include Hong Kong, Singapore, South Korea and Taiwan.

Source: WISERTrade International Trade Database, Holyoke Community College

Professional services firms expect rebound over the next year

By TOBIAS MADDEN
Regional Economist

Accountants, architects, engineers, market researchers and other professional services firms experienced a significant decline in business over the past year, according to results of an annual May survey conducted by the Federal Reserve Bank of Minneapolis and the Minnesota Department of Employment and Economic Development.

Widespread decreases in prices, employment and sales revenue were reported by survey respondents. Coupled with a significant increase in input costs, those decreases resulted in plunging profits. In addition, office space usage was flat, exports were stable and productivity did not change (see chart). Some firms noted a continued tightening of credit conditions. Looking ahead to the next four quarters, firms expect orders to pick up and plan to handle demand through greater productivity rather than additional workers. Respondents expect input costs to increase and profits to rise slightly. The firms see a rebound in their state economies, with higher employment and consumer spending.

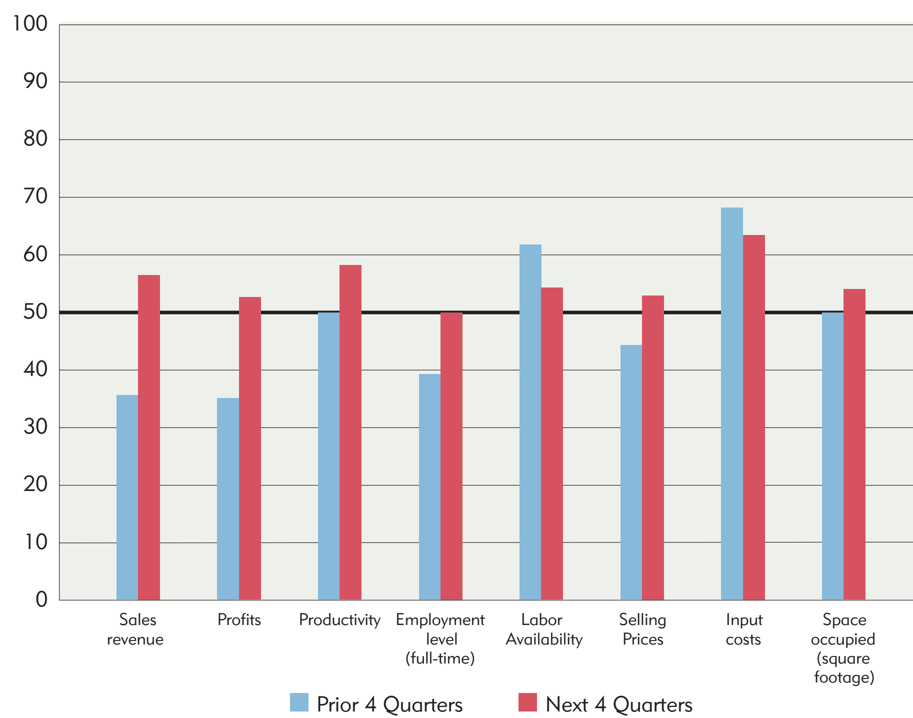
"Business is tough," commented a small Montana accounting firm. Sales revenue slid, with 53 percent of firms reporting decreases and 26 percent reporting increases. Both sales volume and selling prices fell. Input costs rose, as 42 percent of firms reported higher input costs and only 5 percent reported lower input costs. Wages grew an average of 2 percent, and benefits per worker rose 1.6 percent. Profits for firms fell significantly, as only 26 percent of firms noted an increase in profits, and 56 percent noted a decrease. Employment levels fell, with 32 percent of firms reporting lower employment and 11 percent reporting higher employment. Obtaining credit is still a problem; 23 percent of respondents found that access to bank credit had deteriorated over the past three months compared with only 3 percent reporting improved credit conditions.

Professional business services firms are somewhat optimistic about the next four quarters. Sales revenue is expected to rise, according to 36 percent of the respondents, compared with 24 percent expecting lower revenues. The use of space will increase, according to 15 percent of respondents, while only 6 percent see a decrease. A small North Dakota environmental consulting firm said it used Small Business Administration loans to finance a new building "in anticipation of a rebound." Firms expect employment and profits to stay roughly constant and productivity to increase.

Respondents' outlook for their state economy is somewhat positive. They expect employment and consumer spending to increase slightly. Flat corporate profits are expected. However, "inflation will increase in the future," commented a respondent from a small Minnesota services firm. Many other respondents agreed, with over half expecting higher inflation and only 2 percent expecting lower inflation over the next four quarters.

Go online to minneapolisfed.org for complete survey results.

An uptick in activity is expected at professional business service firms
(Above 50 indicates expansion; below 50 indicates contraction)



Sources: Federal Reserve Bank of Minneapolis and Minnesota Department of Employment and Economic Development

The *fedgazette* has moved to a quarterly schedule (January, April, July and October) to bring more focus and resources to the *fedgazette* online. Look to **www.minneapolisfed.org** for enhanced coverage and analysis, including new types of information and ways to stay informed about the Ninth District economy.

Despite uncertainty, moderate economic growth expected

By ROB GRUNEWALD
Associate Economist

TOBIAS MADDEN
Regional Economist

Despite continued economic uncertainty, including issues regarding government debt levels in Europe and the oil spill in the Gulf of Mexico, indicators show that the Ninth District economy is strengthening at a moderate pace. The Minneapolis forecast models show that this gradual improvement should continue through 2010 and into 2011.

District employment levels have increased moderately, and consumer spending is up. The manufacturing sector has increased output, and home construction has started to pick up. The forecast models predict that these trends will continue into next year. In the agriculture sector, the spring planting and calving season benefited from mild weather. Crop prices are expected to remain level, while some increases are predicted for cattle, hog and milk prices.

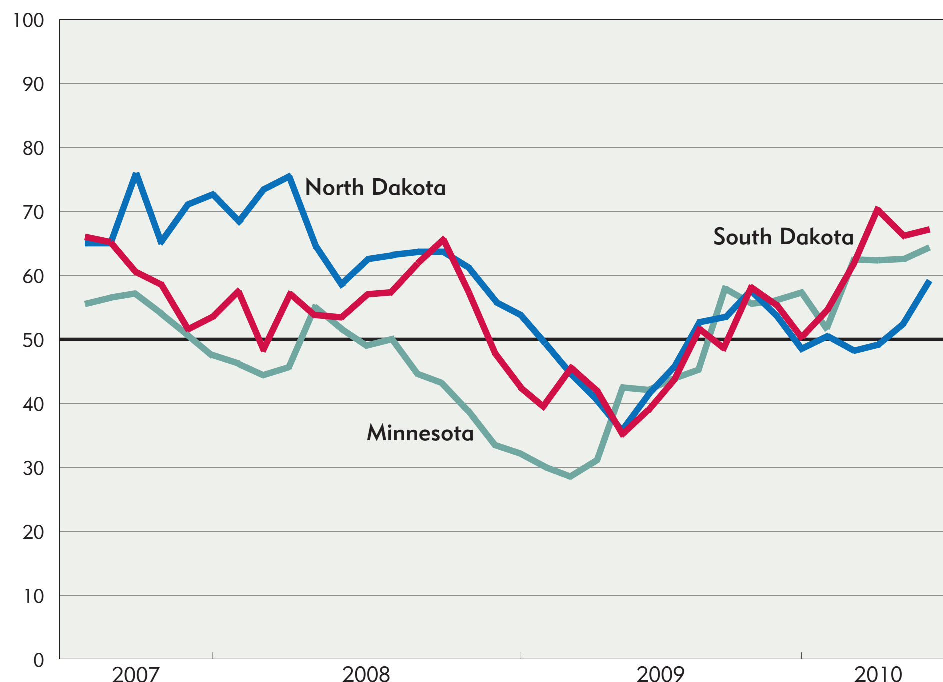
Moderate employment growth under way

The economic recovery, which likely started by the third quarter of last year (July through September), has been characterized as one observed in data, but not on Main Street. With relatively high unemployment rates, 9.7 percent nationally and 7.4 percent in the district, the thousands of unemployed workers who are looking for jobs probably don't consider this a recovery as such. However, since employment in the district hit bottom in December of last year, the picture has improved. Since the beginning of the year, the district has gained more than 65,000 jobs.

In April, district nonfarm employment was down 1 percent compared with a year ago. Construction posted the largest decrease in employment from a year ago (–5.1 percent), followed by manufacturing (–3.1 percent) and information and financial activities (–2.5 percent). However, not all sectors decreased; modest growth was tallied in professional and business services (0.1 percent), government (0.5 percent) and education and health services (1.2 percent) (see Chart 1). As hiring continues to improve, the recovery will likely become more tangible.

While manufacturing employment was down from a year ago, output turned positive during 2010 in Minnesota and the Dakotas, as shown in survey results released by Creighton University (see Chart 2). The improvement in manufacturing is also made evident by the increase in the number of hours worked by manufacturing employees. Since April 2009, hours worked increased in all district states except Montana (see Chart 3 on page 23). The data suggest that manufacturers are boosting output through longer hours instead of hiring new workers. A similar trend is beginning to appear among nonfarm workers nationally.

CHART 2 **Conditions for manufacturing firms improving**
Business conditions index*



*Index numbers above 50 indicate expansion; below 50 indicate contraction.
Source: Creighton University

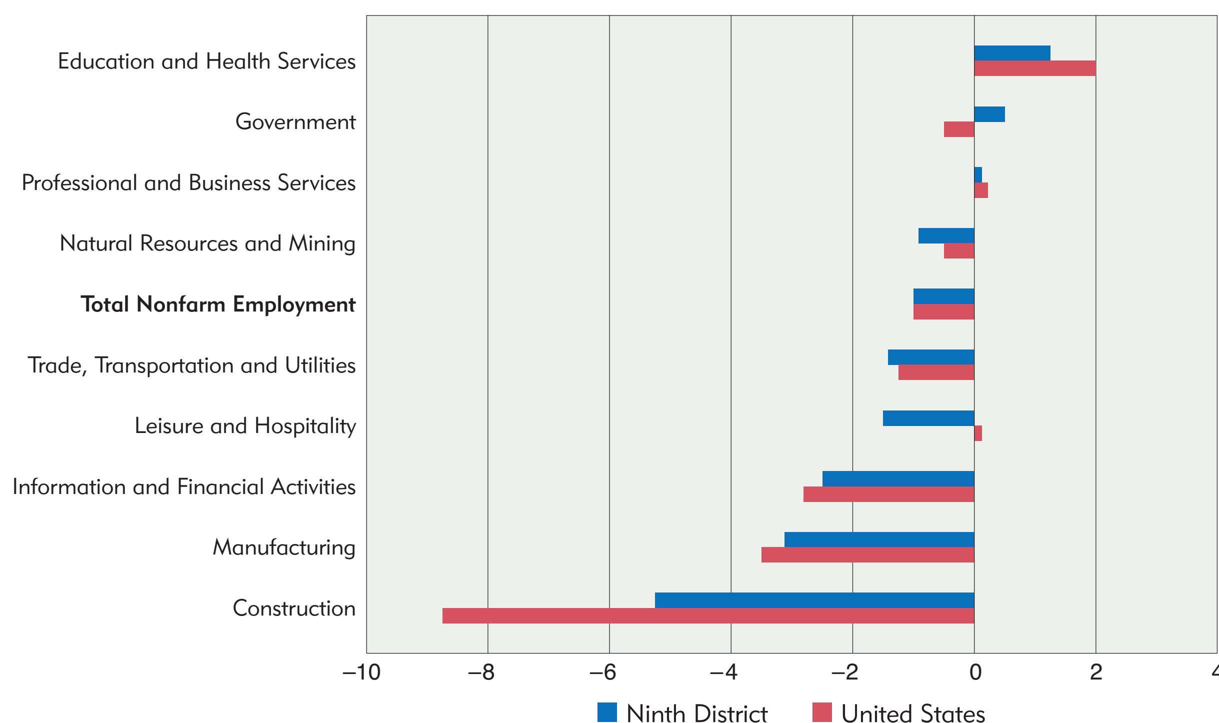
Not only are staff working more hours per week, but they are producing more per hour worked. During the first quarter of 2010, national productivity levels for nonfarm employees increased more than 6 percent compared with a year earlier, the largest gain since 2002. These trends, longer hours combined with productivity gains, are often observed during an economic recovery. That is, companies respond to increases in demand by stretching their current resources while waiting for economic conditions to become stable before making commitments to add staff.

When companies start to add resources, they first turn to temporary employees and contract workers. In a recent Minneapolis Fed survey of temporary staff firms in Minnesota, North Dakota and Wisconsin, a large majority of respondents noted that client volumes and workers placed with clients increased during 2010 compared with the same period last year (see related story on page 8).

With temporary hires picking up, will the hiring floodgates open? According to the Minneapolis Fed's forecast models, employment will end 2010 above

Continued on page 22

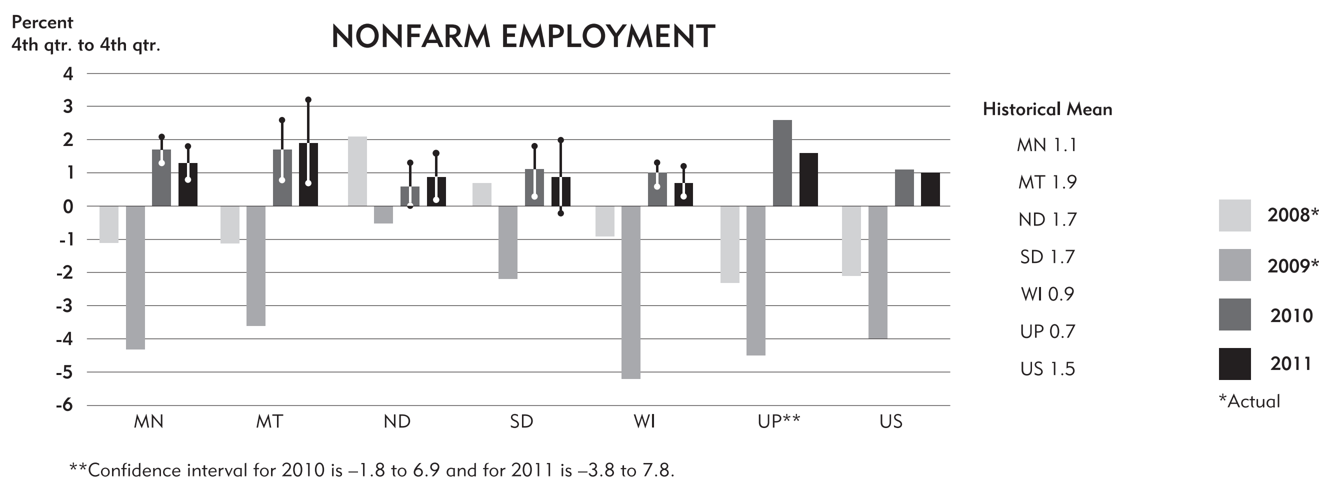
CHART 1 **U.S. and district employment down from last year**
Percent change in nonfarm employment compared with a year earlier, April 2010



Source: Bureau of Labor Statistics

District Forecast

After steep declines in all areas during 2009, nonfarm employment is expected to grow modestly during 2010. Growth rates in 2010 are expected to exceed historical average rates in Minnesota, Wisconsin and the Upper Peninsula, and remain below historical averages in Montana and the Dakotas. In 2011, gains in employment are predicted to continue in all areas, with rates at or above historical averages in Minnesota, Montana and the Upper Peninsula.



**Confidence interval for 2010 is –1.8 to 6.9 and for 2011 is –3.8 to 7.8.

2008*

2009*

2010

2011

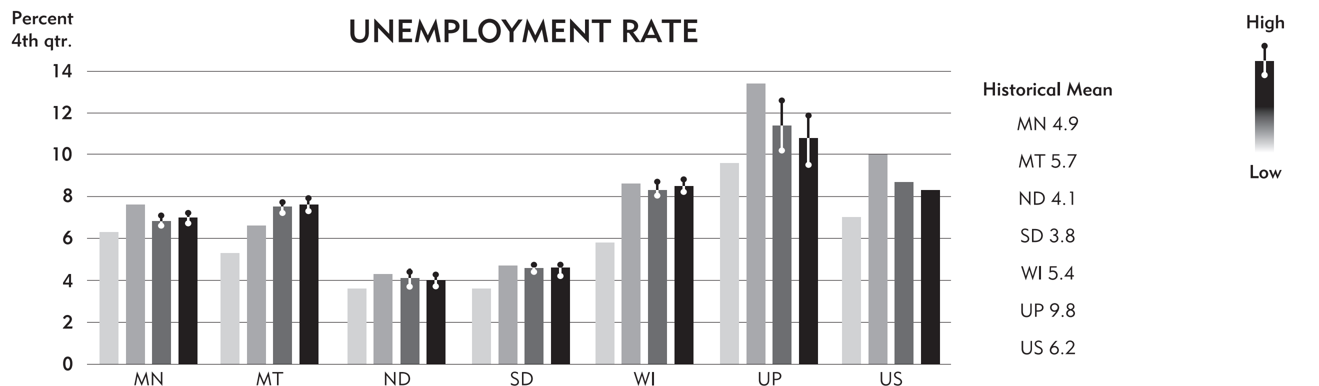
*Actual

FORECAST

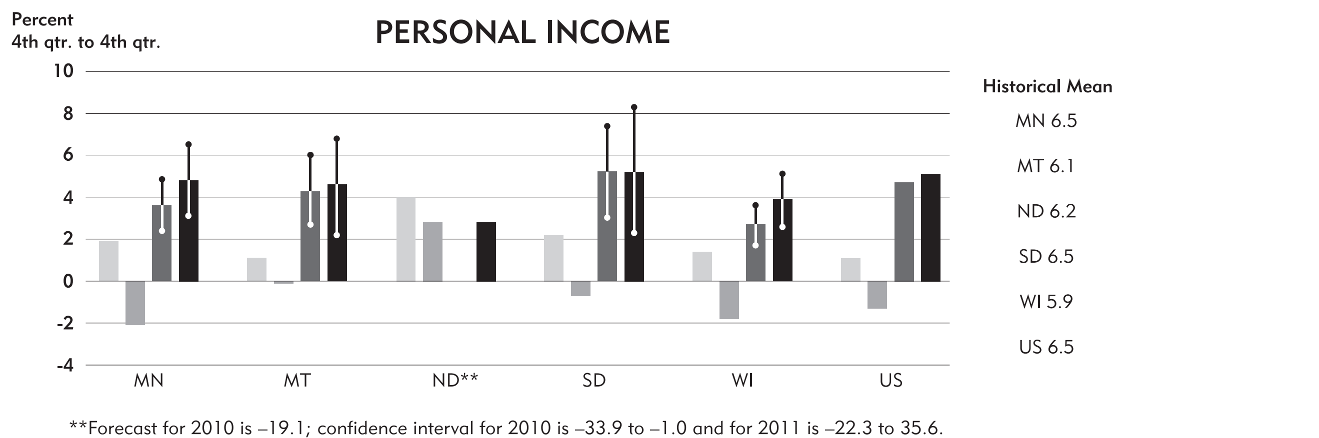
High

Low

Unemployment rates are expected to step down from their high points in 2009 in all areas, except Montana, where higher rates are anticipated during 2010. However, all unemployment rates in 2010 will remain at or above historical averages. In 2011, unemployment rates are forecast to stay about the same, with slight increases in Minnesota, Montana and Wisconsin and slight decreases in the Upper Peninsula and the Dakotas.

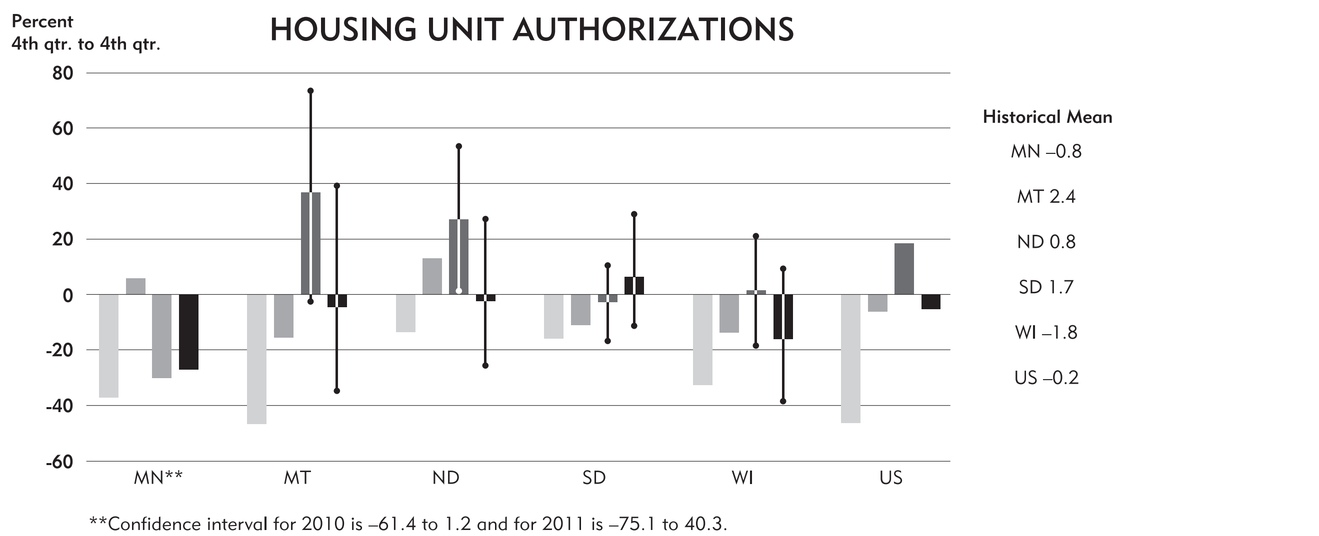


During 2010, personal income is expected to grow in all areas, except North Dakota, where a decrease is forecast. However, this predicted decrease possibly reflects changes in farm income, which tends to be volatile. Last year, North Dakota was the only district state to post an increase in personal income. In 2011, personal income growth is expected to pick up somewhat in all states, except South Dakota, where the pace of personal income growth is expected to remain the same.



**Forecast for 2010 is –19.1; confidence interval for 2010 is –33.9 to –1.0 and for 2011 is –22.3 to 35.6.

Prospects for housing units authorized are mixed. Authorizations are expected to increase in Montana and North Dakota and decrease slightly in South Dakota and Wisconsin during 2010. After posting an increase in Minnesota in 2009, authorizations are forecast to turn negative again in 2010. In 2011, housing units authorized will increase in South Dakota and decrease slightly in Montana and North Dakota. Meanwhile, the forecasting model shows authorizations dropping steeply in Minnesota and Wisconsin, but these predicted decreases are likely due to the unusual behavior in current data combined with the statistical properties of the forecasting model. In Minnesota and Wisconsin, housing units authorized have not only dropped sharply during the past few years, but they are also below levels observed over 30 years ago. Since forecasting models typically rely on long-term and recent trends, it is not surprising that the model points to a continued drop. At some point, population and market pressures will likely spur a more sustained demand for housing, but the Minneapolis Fed's model, as with forecasting models generally, will have difficulty predicting when that turning point will occur.



**Confidence interval for 2010 is –61.4 to 1.2 and for 2011 is –75.1 to 40.3.

Outlook from page 21

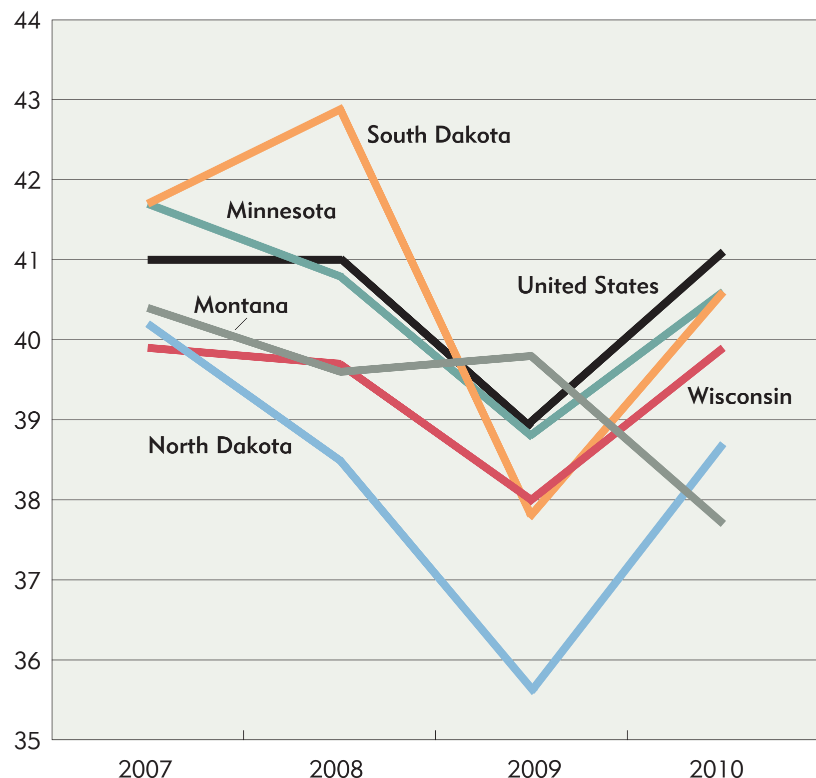
year earlier levels. However, the pace of hiring will hardly seem like a flood, but certainly more than a trickle. In Minnesota, Wisconsin and the Upper Peninsula of Michigan, growth rates will exceed historical averages. In 2011, employment will continue to grow across the district, but employment levels will not reach prerecession peaks until 2013 or beyond, with the exception of North Dakota, which is expected to return to peak levels by 2011. North Dakota's economy has been supported by an expansion in oil drilling activity and a relatively healthy agriculture sector.

Long-term unemploment levels high

Nationally, the number of long-term unemployed workers and discouraged workers has increased over the past year. The percentage of unemployed who are out of work 27 weeks or more increased from 27 percent in May 2009 to 46 percent in May 2010. The list expanded as declining employment levels persisted through the relatively long recession. Those who are unemployed for a long period risk losing skills due to their absence from the workplace, making it more difficult to land a job once hiring picks up.

CHART 3 **Hours worked make a comeback**

Average weekly hours for manufacturing workers
April 2007–2010



Source: Bureau of Labor Statistics

The number of discouraged workers, those who would like a job but are currently not looking for work because they believe no jobs are available for them, increased 36 percent nationally in May compared with a year earlier. Because discouraged workers are not considered part of the labor force, they are not counted as unemployed. However, once they do start looking for a job, they are counted as unemployed and place upward pressure on the unemployment rate. Even as hiring picks up, as discouraged workers enter the workforce, unemployment rates may stay relatively high for a few years.

According to the Minneapolis Fed's forecasting models, unemployment rates in the district are expected to edge lower but remain above historical averages for awhile, with the exception, again, of North Dakota, which is expected to return to its historical average by next year.

Consumer spending growing

Growth in consumer spending during 2010 has helped keep the economy moving forward. Auto sales that were anemic a year ago are finding a spark once again in 2010. New car registrations increased more than 80 percent in Montana and North Dakota in April from a year earlier, while registrations were up about 15 percent to 20 percent in northwestern Wisconsin and the Upper Peninsula.

Sales nationally at major retailers were softer during April and May compared with stronger growth earlier in the year, but still positive. The International Council of Shopping Centers reported that revenue growth at stores open at least a year slowed in April (0.8 percent) and May (2.6 percent).

Meanwhile, district tourism businesses have expressed cautious optimism for the summer travel season. For example, the number of nonresident visitors to Montana is expected to increase 2 percent compared with 2009, when visitor numbers were flat, according to state tourism officials.

Consumers continue to face tame price increases. The April consumer price index was only 2.2 percent higher than a year earlier. Once prices for food and energy, which tend to be relatively volatile, are removed, the core index increased 0.9 percent, the smallest year-over-year increase since January 1966.

Future consumer spending will benefit from gains in personal income. After decreasing in 2009, district personal income is expected to grow in 2010 and into 2011. According to a survey of professional services firms (see page 20), 35 percent of respondents expect higher consumer spending over the next 12 months, while 27 percent predict declines.

Outlook for residential construction and real estate mixed

District housing units authorized for the first four months of 2009 were 43 percent higher than in the same period last year. Most of the gains were for authorizations of multifamily units; single-family home permits were flat. While results from the forecast models are mixed, the increase in authorizations suggests that home building is no longer scraping bottom.

Residential real estate has picked up. Existing home sales in district states increased 10 percent during the first quarter compared with a year ago. Sales continued to grow into April. However, it seems likely that the expiring home buyer tax credit is driving most of the recent gains. It remains unclear how the housing market will perform post tax credit.

Home prices have been soft, with many sales considered distressed (see related story on page 9). However, first quarter prices were moderately higher in some district cities, with the exception of Minneapolis-St. Paul, where prices were 7 percent lower than a year ago.

2010 looking up for animal producers

After several good years, 2009 was mediocre for agriculture as a wet fall caused the harvest to spill into 2010, and dairy and livestock producers battled low prices and high input costs. The first half of 2010 brought new life to agriculture; mild weather allowed early planting and a good calving season. Meanwhile, 2010 prices for the major district crops softened, but prices for livestock and dairy rebounded (see table).

Every quarter, the Minneapolis Fed surveys agricultural lenders to get views on how their customers are performing financially. Results from surveys last year showed increased concern about profits. This trend continued in the first quarter (April 2010) agricultural credit conditions survey, with half of the respondents seeing decreased agricultural income. Lenders were less pessimistic about farm profits in the second quarter of 2010, with 42 percent expecting lower income and 14 percent expecting higher income.

Ranchers and farmers enjoyed a mild spring in 2010. Many ranchers across the district reported a good calving season. The warm spring allowed a smooth completion of the delayed 2009 harvest and early planting across most of the district. Many district crops have emerged from the ground earlier than last year and earlier than the five-year average. Crops are also in good condition. This increases the odds of a bountiful harvest. In addition, decent soil moisture levels are evident across most of the crop-growing regions of the district. However, drought conditions intensified in northern Wisconsin.

After crop prices dropped last year, the U.S. Department of Agriculture expects corn, soybean and wheat prices to be relatively stable through 2011. This stability, combined with a potentially large harvest, could mean higher farm revenues. Meanwhile, cattle prices have jumped from 2009 levels and are expected to rise even further in 2011. Hog prices also rose in 2010 and are expected to remain at those levels into 2011. Milk prices increased from 2009, but are still below 2008 levels. Expected 2011 milk prices show an uptick from 2010. The increase in output prices and softening of input prices should bode well for livestock and dairy producers. ■

Cattle and hog prices rise

Average farm prices

	2007/2008	2008/2009	Estimated 2009/2010	Projected 2010/2011
(Current $ per bushel)				
Corn	4.20	4.06	3.45–3.65	3.30–3.90
Soybeans	10.10	9.97	9.50	8.00–9.50
Wheat	6.48	6.78	4.85	4.00–4.80
	2008	**2009**	**Estimated 2010**	**Projected 2011**
(Current $ per cwt)				
All Milk	18.29	12.84	15.75–16.15	15.80–16.80
Choice Steers	92.27	83.25	92.00–96.00	95.00–102.00
Barrows & Gilts	47.84	41.24	54.00–57.00	53.00–57.00

Source: U.S. Department of Agriculture, estimates as of June 2010

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