January 4, 2004

The Joyless Recovery

By EDMUND L. ANDREWS

ROCKFORD, Ill.

The stock market is surging and the economy appears to be booming, but Judith Pike is getting out of business. "I'm finished; I'm out of here," said Mrs. Pike, owner of Acme Grinding, whose customers have been vanishing and whose work force has shrunk from 40 to 4. Two days before Christmas, Mrs. Pike sold her business and more than 40 machines used to grind and finish metal parts. "It will be for pennies on the dollar," she said. "Less than what it cost to buy just one of these machines."

Considering that nearly every scrap of data suggests that the American economy has finally climbed out of the doldrums and is humming at its fastest pace in at least four years, Mrs. Pike's timing may seem unfortunate. But here in Rockford, and in the nation as a whole, factory owners like her have seen their worlds turned upside down. And their struggle goes a long way toward explaining why this continues to be such a joyless recovery.

More than 11,000 jobs have disappeared in and around Rockford in the last three years, and many of those are not expected to return. Motorola shut down a big repair plant not far from Mrs. Pike's company last year, eliminating more than 1,000 jobs, even as it invested $1.9 billion in a new electronics factory in China. Textron is closing several factories that make metal fasteners. And industrial parks are swimming in "for sale" and "for lease" signs.

"We've been through downturns before, but this time it's different," said Malcolm Anderberg, owner of Dial Machine Inc., which does contract manufacturing. "This time, the work is leaving the country, and it's not coming back."

In part, this is an old story - and one not unique to Rockford. Manufacturers have been shedding jobs in the United States for decades, moving plants to low-wage countries or squeezing ever more production from fewer workers at home. But the process accelerated recently, with manufacturers trimming a whopping 2.8 million jobs over the last three years alone. A study published in August by the Federal Reserve Bank of New York concluded that more than half of those job losses stemmed from structural changes and were likely permanent.

History leaves little doubt that new jobs will eventually replace the old, and that workers' incomes can still rise. But the outlook for the short and medium term remains grim. This is the second "jobless recovery," the first having occurred after the slowdown in 1990 and 1991. Before then, factories in cyclical industries had tended to be the biggest source of employment gains once the economy began to revive. Now the bounce has to come from other areas. And this time, even those sectors have been less than gung-ho about hiring.

Still, Rockford has become a case study of how an industrial area can respond to a shifting economic landscape. This city has long been synonymous with manufacturing. It has scores of automobile suppliers, tool-and-die makers, machine-tool producers and small companies that provide contract manufacturing services. The
unemployment rate is nearly 11 percent in the city and about 8 percent in the surrounding Rock River Valley, much higher than the national average of 5.9 percent.

But the news is not all bleak. Confronted with the choice between adapting or dying off, Rockford has tried to reinvent itself. "We are in a global economy, and we are in the throes of a major transformation," said Robert Levin, executive director of the Council of 100, a business-promotion group here.

Rockford's sprawling airport, which has almost no passenger traffic, has become a fast-growing cargo handling center. United Parcel Service employs 1,500 people there, making the airport its second-largest hub, after Louisville, Ky. All told, 3,000 people work at the airport, which handled 1.4 billion pounds of freight last year.

Telephone call centers just outside town employ about 5,000 people, mostly part-time workers who earn about $10 an hour. The pay is lower than in most factories, and many people worry that even these jobs will be pulled away to the fast-growing call centers of India or the Philippines. But MCI, the long-distance carrier, has built a center with more than 1,000 workers and is still hiring.

Rockford is also becoming a bedroom community. New housing developments are attracting people from Chicago's western suburbs, about 70 miles away. (The prospect of four-bedroom homes for $169,000 seems to make the commute more tolerable.) Reflecting the influx, Wal-Mart, which already owns one big store outside town, is building two more in the area. Target and Home Depot are each opening a second store in the area as well.

So far, none of this has come close to filling the void left by the loss of manufacturing jobs. The big question is whether the remaining industries also transform themselves or move away entirely. The answer could determine the shape of the economic expansion in the months and years ahead.

THOUGH more extreme than in some other parts of the country, Rockford's unemployment problems fit in with a broader national trend. Like their counterparts elsewhere, many executives here are increasingly confident that business is picking up, but they are also reluctant to hire extra workers. Companies are either convinced that they can extract more productivity from the employees they already have or are worried that they will be overstaffed if the expansion turns out to be another false start.

Most evidence suggests that the economy is moving into high gear after one of the feeblest recoveries in history. Economic growth soared at an annual rate of 8.2 percent in the third quarter of 2003, and economists say they think it will climb nearly 4 percent this year.

Business spending, the weakest component of the economy more than a year after the recession officially ended, is now growing rapidly. Orders for new equipment shot up at the fastest pace in 20 years in December, rising for the sixth month in a row, according to a survey by the Institute for Supply Management that was released on Friday. Industrial production jumped 0.9 percent in November, the third increase in a row and the biggest in four years, according to the Federal Reserve. Perhaps most encouraging, the increases were spread across most sectors of industry.

Despite all the good news, employment continues to climb much more slowly than in previous recoveries. Many people took heart when the Labor Department reported that the economy added a total of 236,000 jobs in September and October. But just 57,000 jobs were created in November, and most employers remain cautious about expanding their payrolls.

Given the growth of the working-age population, the nation needs to add around 250,000 jobs a month to
achieve a significant decline in unemployment before the November election. Economists are skeptical that job creation will hit that pace, in part because companies of all types have been getting ever more work out of the same number of workers.

Productivity climbed at an annual rate of 9.4 percent in the third quarter of 2003, and it has risen at an annual rate of 5 percent for the last several quarters. If the pace continues at anywhere near that level, the economy would have to grow by far more than 4 percent a year to bring down the jobless rate.

China is the other big factor. Lobbyists for manufacturers attribute many of their woes to that nation, which is running a trade surplus with the United States of roughly $125 billion. But a large percentage of Chinese imports come from subcontractors of American manufacturers, which are themselves trying to take advantage of China's low costs.

Whether jobs are being lost to China or merely to higher productivity, many companies remain nervous about hiring even if business is picking up. "It's busier for us than it has been for the past four years," said Eric Anderberg, general manager of Dial Machine and the son of the founder. "The problem is, there's nothing that gives me the sense of a sustained recovery."

FOUNDED in 1890 at the dawn of the automotive era, Rockford Powertrain, a maker of transmission equipment for heavy-duty trucks, is still profitable and exports its products all over the world. But these days, it does little manufacturing. Its main business is logistics.

"We want to stay in Rockford," said Thomas M. Corcoran, the company's president. "We just don't want to manufacture here."

Over the past decade, Rockford Powertrain has stopped producing most of its components at home and started buying almost all of them abroad - from South Korea, Poland, Germany and, most of all, China. The number of employees in Rockford has dropped from 800 in 1988 to 250, and the work is limited largely to assembly, quality control and management.

In October, Mr. Corcoran took his international plans further, selling what he called a "substantial minority stake" in the company to the Wanxiang Group, one of China's largest auto parts suppliers. The deal, he said, will give him more reliable access to a major Chinese supplier and to the booming Chinese market.

There may be more deals like that to come. Given the globalization of both suppliers and customers, he said he could imagine selling off additional stakes to investors in India, Germany and other countries.

Rockford Powertrain still occupies a 625,000-square-foot factory here, but that, too, is changing. Two weeks ago, Mr. Corcoran agreed to sell the plant and lease back about half the space until he can move the company to a smaller and more appropriate location. "The plant was designed for a different business model," Mr. Corcoran said. "We don't need that much space today."

Rockford Powertrain is but one example of a broader shift away from domestic manufacturing, a trend that appears to have accelerated sharply since the economic downturn in 2001. Intense global competition is expected to force factories to keep squeezing their work forces and to focus tightly on areas where they have a special technological edge or can offer highly customized services. Even if some manufacturing companies remain vibrant, they are not expected to supply many new jobs, and the real economic growth will continue to come from services.
"The relative decline in manufacturing employment is real, as is the decline in the manufacturing share of national income," said N. Gregory Mankiw, chairman of the White House Council of Economic Advisers, in a speech last month.

Mr. Mankiw compared the trend in manufacturing to that in farming over the last century. Farm production has increased, but the proportion of people working in agriculture has dropped from 40 percent a century ago to 2 percent now.

"Both job creation and job destruction are part of the process by which countries gain from trade," he said. "Free trade encourages each country to specialize in what it does best. It thereby raises national incomes both at home and abroad."

In Rockford, industry is far from dead. But business has been transformed, often with great pain. One of the few thriving metalworking industries here is the business of scrap metal - mainly because of voracious demand from Chinese steel mills. Some of the metal is discarded industrial machinery from factories that have closed.

"China has a need for a tremendous amount of raw material," said Bill Day, chief financial officer at Joseph Behr & Sons, a large trader in scrap metal here.

Generally, production at home is becoming less important than logistics and shipping. Companies that once sold easy-to-replicate products to nearby car companies are being bypassed by distant rivals in China. "We have lost our technological edge, our pricing edge and in many cases our quality advantage," said Eric Anderberg of Dial Machine, testifying before a recent panel on manufacturing that was convened by the Commerce Department.

Carl Bradberry, owner of a small machining shop near Rockford called S&B Jig Grinding, produces machine parts engineered to a precision of less than the diameter of a human hair. Mr. Bradberry took out a second mortgage on his vacation cabin to keep the company going, and in November he saw his first profit in nearly four years. But even now, many of his machines are idle.

Increasingly, the companies that survive are those that function like boutiques. They offer specialized products with unusual craftsmanship, and they deliver on short notice.

North American Tool, which makes precision tool parts, was able to retain its 100 employees over the last three years and is now beginning to have a solid pickup in demand. But it specializes in customized parts ordered by the dozens rather than the thousands, and it has shrunk its delivery time on most orders to just one day. Even with all that, company executives say they must constantly look for new market niches or the next idea.

"The good old days are gone for good," said Roger K. Taylor, the chief executive. "I don't know what our company will be doing in two years, but it will almost certainly be different from what it looks like today."

Here is Robert O'Brien's next big idea: nonstop passenger flights between Rockford and Budapest. As in Hungary.

Far-fetched? Not necessarily. As executive director of the Northwest Chicagoland Regional Airport, Rockford's sprawling but underused airport, Mr. O'Brien is confident that this region is on the verge of becoming a major logistical center.

Though it is big enough to handle Boeing 747's and military transport planes, the airport has become so overshadowed by O'Hare International in Chicago that it has had virtually no passenger air service for more than
a decade.

But rather than go out of business, the Rockford airport has turned itself into a busy cargo center. In addition to the U.P.S. hub, the airport also houses some operations of BAX Global and DHL, two other big shipping concerns.

That transformation mirrors a strategic shift for the Rock River Valley area. Manufacturing is either stagnant or in decline, but transportation and logistics are booming. In the town of Rochelle, 30 miles to the south, the Union Pacific Corporation has built a new "intermodal" transportation center that it hopes will become a major transfer point for truck and rail cargo.

Local officials say they have a big opportunity to steal cargo business from Chicago. "I think we're sitting on top of a gold mine," said Mr. O'Brien, the airport executive.

BUT even with the increase in cargo traffic, he said the airport was still operating at less than 10 percent of its capacity. So he and other local leaders want to resurrect passenger air service.

Knowing they had no chance to compete against O'Hare on flights to most American cities, they decided to focus on specialty routes and little-known airlines. In August, TransMeridian Airlines, a small charter company, started regular flights to Las Vegas and Orlando, Fla. The service has carried about 11,000 passengers so far, Mr. O'Brien said.

Now he is pushing a deal with Malev, the Hungarian airline, to offer regular nonstop flights between Rockford and Budapest. Demand for that route may seem limited, but Rockford officials say Malev would attract tens of thousands of American travelers who would use Budapest as a low-cost jumping-off point to the rest of Europe.

Mr. O'Brien envisions Rockford playing host to an array of low-cost airlines, domestic and international, that would offer travelers low prices in exchange for destinations that are slightly less convenient.

Last month, Rockford officials welcomed Hungary's ambassador to the United States and executives from Malev. The Hungarians said they were intrigued, but they have not yet bought into the idea.

If they do not, Mr. O'Brien says, he has other deals in the works.