The Potential Impacts of Recession and Terrorism on U.S. Cities

Alan Berube
The Brookings Institution Center on Urban and Metropolitan Policy

Alice Rivlin
The Brookings Institution Greater Washington Research Program

The Brookings Institution
Center on Urban and Metropolitan Policy

© January 2002

The Potential Impacts of Recession and Terrorism on U.S. Cities

by Alan Berube and Alice Rivlin
The Brookings Institution

I. Summary

Many urban residents and city officials are worried that the combined impact of the recession and ongoing terrorist threats may have a devastating effect on the health of cities. The immediate concern is that cities may be forced to curtail services significantly as they struggle to balance their budgets in the face of declining revenues and rising costs of security. The longer run worries include the possibility that city tax bases may be eroded as residents and businesses relocate to less populous areas they perceive to be less vulnerable to terrorist attack.

This paper attempts to throw some light on these concerns by examining the impact of the last two recessions on employment, finances and poverty in large cities, and by exploring recent trends that may affect the vulnerability of cities in the current recession. The paper makes no estimates as to the absolute impact of this recession on cities, but instead presents evidence on how cities might fare relative to their performance in the last recession. Further, the paper also offers some speculation on the possible longer run affects of terrorism on the viability of cities. Overall, the analysis is relatively reassuring about the short-term prospects for cities, provided the current recession proves to be as short and shallow as now expected by most forecasters.

- **In the serious recession of 1980-82, city economies were negatively affected, but did not fare worse than the rest of the country.** Big city unemployment rates, initially higher than national rates, rose proportionately, and actually recovered faster than the rest of the nation. Many cities suffered revenue declines, especially in l981, but city revenues in the aggregate held up fairly well. This reflected the reliance of cities on property taxes, which are less sensitive to downturns than the sales and income taxes on which state and federal governments rely. Aggregate city expenditures declined markedly in 1981, but otherwise kept pace with inflation throughout the early 1980s.

- **Job loss nationally in the 1990-91 recession, especially in manufacturing and finance, was concentrated in large urban counties.** The briefer, milder recession of 1990-91 showed a similar pattern of proportional increases in city and national unemployment rates. This recession, however, hit cities at a time when they were already losing substantial numbers of jobs to suburbs and outlying areas, especially in manufacturing, and financial services, insurance and real estate (FIRE). Probably because the continuing business and population exodus was hurting city tax bases, the impact of the 1990-91 recession was greater on city revenue and expenditures than one might have expected from a national downturn that was appreciably milder than that of the early 1980s.

- **The current recession finds cities in a much stronger position than either of the last two.** As a group, large cities have experienced a rebound in the last decade, evidenced by rising population, jobs and property values. End-of-year balances in city budgets were at an all-time high last year. If the current recession proves no worse than the 1990-91 recession, as currently predicted, cities will find their budgets constrained, but are unlikely to be forced to enact large cuts in expenditures to balance their budgets.

- **The shift toward a service-oriented economy across all cities, and the dependence of individual cities on different industry sectors, will help to dictate the impact of this recession on city employment.** Market trends and policy changes in cities during the 1990s remind us that past recessions cannot serve as perfect indicators of future experience. The job base in cities as a whole shifted over the past decade from manufacturing to services even faster than the national job base did. While this may insulate cities from large job losses in the cyclical manufacturing sector, urban job growth in the services industry in the 1990s was concentrated in business services, where employment may be just as cyclical as in manufacturing. Cities with higher proportions of government and retail employment may be less likely to suffer than others. On the other hand, some cities may be more vulnerable in this downturn due to increased reliance on revenues from hospitality and tourism – industries that have been hard-hit by fear of terrorist attacks.

- **Recent trends in city finances, and state responses to budget shortfalls, could have important impacts on cites and their lower-income residents.** Factors that may make cities more vulnerable to cyclical downturn during this recession include their somewhat increased reliance on state and federal grants-in-aid, the increasing importance of more cyclical taxes in the local revenue base, and the pressure of welfare reform on city spending as recipients reach time limits and jobs become less available. Unless the recession is long and severe, none of these factors is likely to be critical. Nonetheless, the emerging fiscal crisis in the states, where the current fiscal year budget shortfall is expected to exceed $40 billion, may have especially negative impacts on lower-income families and city economies in the near term.

- **Terrorism is unlikely to play a large role over the long term in the growth and development of U.S. cities.** While it is far too soon to say anything definite about the effects of the recent terrorist attacks in New York and Washington on the future of cities generally, the decisions that people make about where to live and where to locate businesses will continue to be influenced by many factors. Fear of terrorism may, at most, play a small role alongside larger forces such as globalization, immigration, industry consolidation, and technological innovation.

This paper first offers evidence on how the largest U.S. cities fared during the last two national recessions. It then analyzes changes in city economies over the past decade, and their potential implications for city performance this time around. The paper concludes with some thoughts as to how the threat of terrorism combined with the contracting economy may impact cities

in the short run, and whether terrorism fears over the long run might change the economic character of U.S. cities.

II. The Effects of Prior Recessions on U.S. Cities

The Conference Board reported on November 26 that the national economy entered a recession in March 2001, which – at a minimum – will persist through the end of 2001, and most likely into 2002. Most forecasters are predicting a mild recession overall, with recovery in the second half of 2002.

Perhaps the best evidence suggesting how cities may fare during the current economic downturn is their performance during prior periods of slow or negative growth. Of course, the contours of a particular recession – its severity, duration, geography, affected sectors – are unique. Nonetheless, the last two U.S. recessions provide useful examples of how overall city employment and fiscal health may be affected if the coming recession is mild, like the 1990-91 downturn, or more severe, like the early 1980s recession.[1]

A. The Early 1980s

The 1980-82 recession was quite severe, the worst since the Depression of the 1930's. This recession, which followed the stagflation period of the 1970's, was known as the "double dip" recession. The first dip, in 1980, was followed by partial recovery and then a sharper drop in economic activity in 1982. The national unemployment rate climbed throughout 1980 and 1981, and hovered around 10 percent for most of 1982 and 1983.

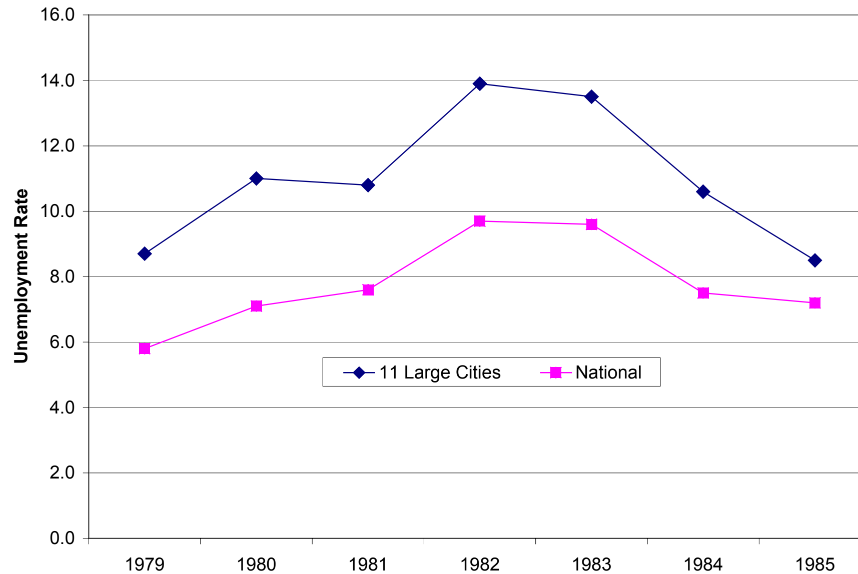
Large cities, like the rest of the country, experienced major increases in unemployment. Limited data are available on unemployment in central cities during the early 1980s recession. The Bureau of Labor Statistics did, however, measure unemployment rates in a select group of 11 central cities throughout the 1980s.[2] Figure 1 shows the median unemployment rate in these 11 cities during the early to mid-1980s, along with the national unemployment rate. Unemployment was higher to begin with in these cities, and tracked the national trend over the six-year period. The "double-dip" of the early 1980s recession was especially evident in the large cities; median unemployment rose over two percentage points between 1979 and 1980, dropped slightly in 1981, then jumped three percentage points between 1981 and 1982. These cities did, however, regain their pre-recession unemployment rates by 1985, ahead of the rest of the country.

---

[1] The bulk of our analysis focuses on the 25 largest cities in the U.S. (and the counties that contain them) as reported in the April 2000 Census. These cities (in descending order of population) are: New York, Los Angeles, Chicago, Houston, Philadelphia, Phoenix, San Diego, Dallas, San Antonio, Detroit, San Jose, Indianapolis, San Francisco, Jacksonville, Columbus, Austin, Baltimore, Memphis, Milwaukee, Boston, Washington, Nashville, El Paso, Seattle and Denver. Only Austin and El Paso were not among the 25 largest cities in 1980. All had population exceeding 550,000 in 2000. About one in eight Americans lived in these cities in 2000.

[2] All were among the largest cities in the U.S. at the time, but older, smaller Midwestern cities were slightly over-represented. Included were Baltimore, Chicago, Cleveland, Dallas, Detroit, Houston, Milwaukee, New York, Philadelphia, St. Louis and Washington, DC.

Figure 1. Median Unemployment Rate in 11 Large Cities versus National Unemployment Rate, 1979-1985



Source: Bureau of Labor Statistics

In addition to rising unemployment, city governments also grappled with weakened budgets during the 1980-82 recession, which hit cities finances fairly hard and forced them to curtail expenditures. Table 2 shows that real tax revenue in the nation's 25 largest cities grew by only 0.1 percent in fiscal year 1981, and that 15 cities actually experienced inflation-adjusted declines in tax revenue. As a result, spending was trimmed significantly in that year, by about 5 percent in real terms. While tax revenues and expenditures recovered in 1982 and 1983, city revenues weakened again in 1984 due to the second "dip" in the economy. That year, eight cities experienced declines in real tax revenue and expenditures, and total real expenditure growth across the largest cities stagnated.

Table 2. Fiscal Conditions in 25 Large Cities, 1980-1984*

Fiscal Year**	Cities w/ Real Tax Revenue Declines	Aggregate Real Tax Revenue Growth	Cities w/ Real Expenditure Declines	Aggregate Real Expenditure Growth
1981	15	0.1%	16	-4.9%
1982	5	2.3%	6	0.8%
1983	2	4.9%	5	5.0%
1984	8	1.9%	8	0.0%

* Aggregate growth figures exclude New York City. Source: US Census Bureau, Statistical Abstract of the US, 1982 through 1987 editions.
** Fiscal year denotes 12 months ending on June 30 (e.g., fiscal year 1980 includes data for cities with fiscal year ending between July 1, 1979 and June 30, 1980).

Poverty also increased substantially in large cities during the early 1980s, as it did in the rest of the nation. Between 1979 and 1983, the number of people living below the poverty line in U.S. central cities increased by over 3 million (see Table 3). The central city poverty rate jumped by over 4 percentage points. Growth in the welfare rolls accompanied this growth in poverty. Over the four-year period, per capita transfers for the AFDC program to the urban counties containing the 25 largest cities increased by almost 17 percent.

Table 3. Poverty and Welfare Spending Trends in Central Cities and Urban Counties, 1979-1983

	1979	1983	Increase
People in poverty (1000s)	9,720	12,872	3,152
Poverty rate	15.7%	19.8%	4.1%
Per capita AFDC payments	$93.20	$108.70	16.6%

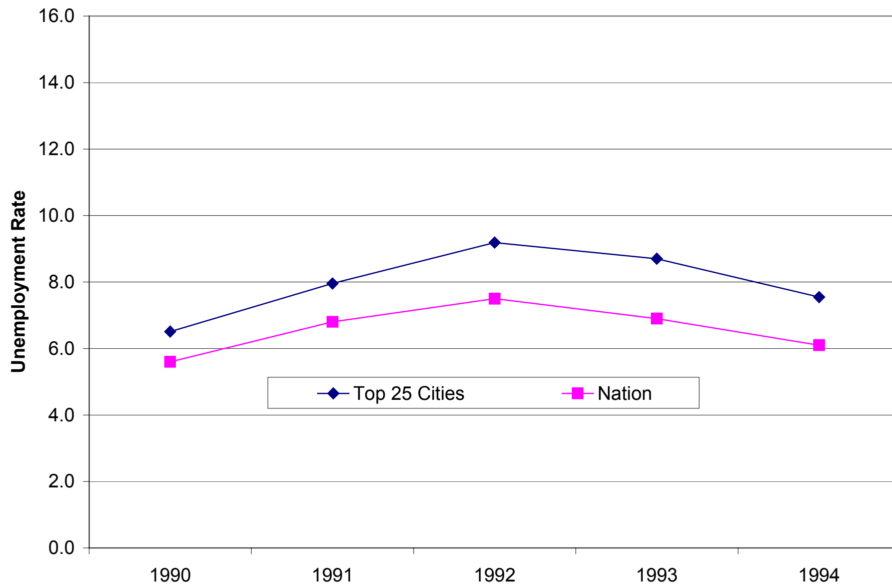
Sources: US Census Bureau, BEA Regional Economic Information System.

B. The Early 1990s

The 1990-91 recession, which followed strong economic growth in the late l980's, was briefer and milder. Officially, the recession lasted only from July 1990 through March 1991. The economy, however, recovered somewhat slowly from the downturn. The state of California, in particular, took longer to recover than the rest of the nation due to heavy aerospace industry layoffs during the early part of the decade. The overall economy's slow recovery is reflected in the fact that unemployment continued to increase through June 1992, when the national unemployment rate peaked at 7.8 percent – up from 5.2 percent in June 1990.

The unemployment trend was similar in the nation's cities. Figure 2 shows that between 1990 and 1992, the unemployment rate in the nation's 25 largest cities in the U.S. increased from 6.5 percent to 9.2 percent – an increase proportional to that in the rest of the nation.

Figure 2. Unemployment Rate in 25 Largest Cities versus Nation, 1990-1994



Source: Bureau of Labor Statistics

But the early 1990's recession was particularly difficult for cities because it coincided with – and probably accelerated – the long-term decentralization of jobs and population occurring in metropolitan areas. From 1980 to 1989, the number of jobs in urban counties containing the largest 25 cities grew by 1.8 percent (4.5 million new jobs), while employment in the rest of the nation grew by 2.3 percent (18.5 million new jobs).[3] During the decade, the population of these cities increased by 5.2 percent, while population in their suburbs swelled by almost 17 percent.

Compounding this trend, job loss during the early 1990s recession was concentrated in large urban counties. Table 4 shows that while the urban counties containing the 25 largest cities lost 890,000 jobs between 1990 and 1992, the rest of the U.S. actually gained about 770,000 jobs.

[3] Data on jobs at the city level are not generally available. We use county-level data on jobs from the Bureau of Economic Analysis Regional Economic Indicators System (REIS). For eight of the 25 counties examined, the city and the county are actually the same jurisdiction – New York, Philadelphia, San Francisco, Indianapolis, Jacksonville, Baltimore, Washington and Denver.

Table 4. Change in Employment 1990-92 & Employment Share by Industry, 1992

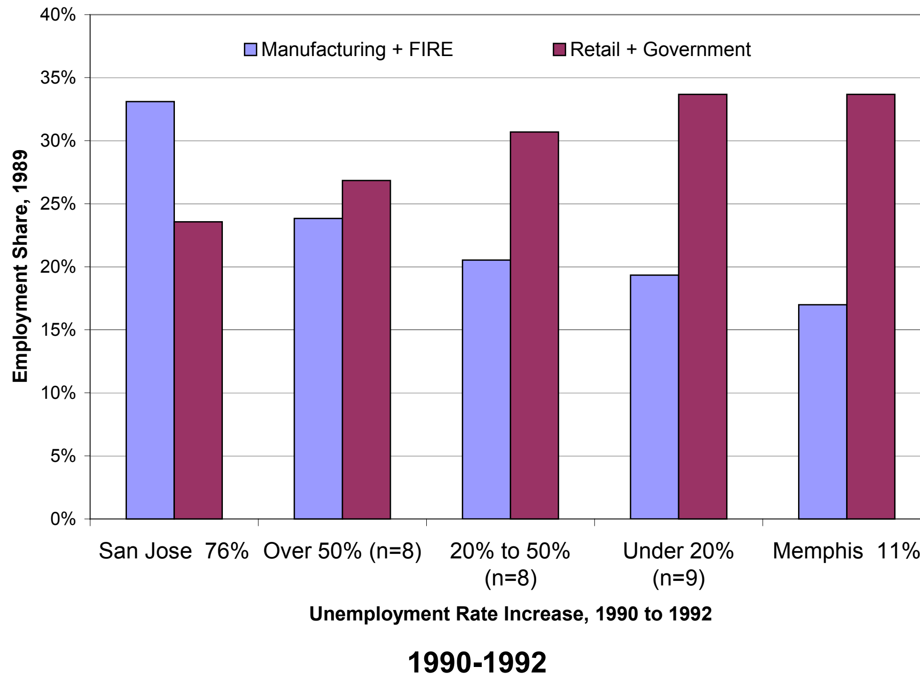
Industry	25 Urban Counties			Rest of U.S.		
	Job Loss/Gain	Percent Change	1992 Share	Job Loss/Gain	Percent Change	1992 Share
Services	+106,000	+ 1.1%	33%	+1,553,000	+ 5.6%	28%
Government	-33,000	- 0.8%	15%	+267,000	+ 1.6%	16%
Retail	-142,000	- 3.3%	14%	+246,000	+ 1.2%	17%
Manufacturing	-340,000	- 9.0%	12%	-648,000	- 4.4%	14%
Finance/Insurance/Real Estate	-215,000	- 6.9%	10%	-206,000	- 3.5%	7%
Wholesale	-89,000	- 5.1%	6%	+60,000	+ 0.9%	5%
Transportation/Utilities	-41,000	- 2.5%	5%	-40,000	- 0.8%	4%
Construction	-131,000	- 10.3%	4%	-304,000	- 5.6%	5%
Other	-5,000	0.0%	1%	-159,000	-2.9%	4%
Total Employment	**-890,000**	**- 2.9%**		**+769,000**	**+ 0.6%**	

Source: Bureau of Economic Analysis, Regional Economic Indicators System (REIS).

This job loss was not spread equally across all industries. Table 4 shows that job loss at the national level was greatest in manufacturing, finance/insurance/real estate (FIRE), and construction. In contrast, during this period there was actually modest growth in services industry employment, and slower decline in the retail and government sectors. In every industry, however, the urban counties containing the largest cities either saw faster job declines than the rest of the U.S., or slower growth (in the case of the services industry).

Cities with higher employment shares in heavily affected industries experienced larger increases in unemployment. Among the largest 25 cities, changes in the unemployment rate between June 1990 and July 1992 varied widely, from an increase of 5.9 percentage points (Los Angeles) to a decrease of 1.4 percentage points (San Antonio). Figure 3 shows that the typical city in which the unemployment rate increased by at least 50 percent between 1990 and 1992 had about a quarter of its jobs in manufacturing and FIRE. This contrasts with the typical city where the unemployment rate increased by less than 20 percent, which had less than a fifth of its jobs in manufacturing and FIRE. Conversely, cities with smaller average increases in unemployment had larger shares of their county workforce in retail and government.

Figure 3. Industrial Makeup of 25 Urban Counties by City Unemployment Rate Increase



1990-1992

Sources: Bureau of Labor Statistics; Bureau of Economic Analysis, Regional Economic Indicators System (REIS).

The experiences of San Jose and Memphis, also displayed in Figure 3, offer an example. The differing industrial makeup of these two cities may have accounted for some of the disparity in their unemployment rate increases in the early 1990s (76 percent in San Jose versus 11 percent in Memphis). The counties containing these two cities (Santa Clara, CA and Shelby County, TN) lost manufacturing and FIRE jobs at about the same rate in the early 1990s. However, with one-third of its employment in these sectors, San Jose lost 25,000 more jobs in manufacturing and FIRE than Memphis, where only 17 percent of jobs were in these industries. In contrast, Memphis had about one-third of its jobs in the government and retail sectors, compared to less than one-quarter in San Jose. Because the rate of job loss in the government and retail sectors was much lower than in manufacturing and FIRE, Memphis lost only about 1,000 more government/retail jobs than San Jose, and overall unemployment rose much less sharply.

The flow of jobs and people out of cities during the early 1990s had a negative impact on city tax bases. The fiscal impact of the recession was actually more severe than that of the deeper recession ten years earlier. Table 5 shows that real tax revenues for the largest cities declined in three of the years, and real expenditures in two of the years, between 1990 and 1994. In city fiscal years ending between July 1993 and June 1994 – two years after the national recession had ended – 16 cities experienced declines in real tax revenue.[4]

[4] This 1993-94 decline reflects a large drop in property tax revenues that year, collections of which lag economic conditions due to the delay in property assessments.

Table 5. Fiscal Conditions in 25 Large Cities, 1990-1994*

Fiscal Year	Cities w/ Real Tax Revenue Declines	Aggregate Real Tax Revenue Growth	Cities w/ Real Expenditure Declines	Aggregate Real Expenditure Growth
1991	14	-0.2%	11	-1.0%
1992	11	-1.2%	7	3.7%
1993	11	0.2%	13	-0.2%
1994	16	-2.3%	8	1.6%

* Aggregate growth figures exclude New York City. Figures for 1994 are for 22 of the 25 largest cities. Source: US Census Bureau, Statistical Abstract of the United States, 1992 through 1997 editions.

In many cities, government employment fell victim to the expenditure cuts precipitated by the early 1990s recession. Nine of the top 25 cities shrank their workforce by at least 1,000 full-time workers between 1990 and 1993, and total city government employment shrank by 10,000 full-time equivalents during these years.[5] Cities also cut back on expenditures by reducing salaries; in ten of the top 25 cities, real average pay for city workers declined over the three-year period. While extensive, expenditure cuts were not as deep in any of these years as the 5 percent real decline in 1981.

The increases in unemployment that accompanied the early 1990s recession caused welfare rolls nationwide to increase – from 3.8 million cases in 1989 to almost 5 million cases in 1993. Table 6 shows that in 23 large urban counties for which Brookings obtained historical data, caseloads jumped 27 percent between 1990 and 1993.[6] Some urban counties experienced much larger increases – Los Angeles County's caseload jumped by 41 percent, and Nashville's grew by nearly 54 percent. Increased need, however, was widespread; each of these 23 urban counties had a larger caseload in 1993 than in 1990.

Since the population exodus from the cities during the 1990s was heavily middle-class, poverty rates in cities were higher in the early 1990's than a decade earlier, although the impact of the recession on city poverty rates was somewhat less. The central city poverty rate increased from 18 percent in 1989 to 21.5 percent in 1993. As in the early 1980s, over 3 million more city residents were poor after the recession versus before.

[5] This figure excludes New York, where city government employment was 20 times as large as the average city among the top 25.
6 These counties include those containing the largest 25 cities, with the exception of Baltimore and Jacksonville, for which data were unavailable.

Table 6. Poverty and Welfare Caseload Trends in Central Cities and Urban Counties, 1989-1993

	1989	1993	Increase
People in poverty (1000s)	13,592	16,805	3,213
Poverty rate	18.1%	21.5%	3.5%
Welfare caseload (1000s)	1,087	1,379	26.9%

Source: US Census Bureau; Brookings survey data.

III. How Might Cities Fare in the Current Recession?

The depth and length of the downturn of 2001 is still unknown. Before September 11, it seemed likely that the economy would pull out of the sharp slowdown that followed the extraordinary growth of the late 1990's without falling into recession. The terrorist attacks, however, were a strong negative shock and caused both consumers and investors to put many spending plans on hold. Most forecasters now predict that the economy will post a moderate recovery in the second half of 2002, but the recession could turn out to be worse. The events of September 11 and its aftermath have focused the sharpest drops in spending on travel and tourism, and shifted both public and private spending toward security.

The evidence from the prior two recessions indicates, not surprisingly, that: (a) some cities will be affected more than others; (b) a city's industrial makeup will likely have some bearing on its economic performance during the downturn; (c) cities will experience a heightened degree of fiscal stress; and (d) cities will see increases in poverty and declines in income.

Many cities, however, experienced substantial revitalization in the fast growth period of the late 1990's and are in better financial shape to withstand recession than ten or 20 years ago. The urban counties containing the 25 largest cities added 4.4 million jobs between 1992 and 1999. The population of these cities grew at an 8.9 percent rate during the 1990s, versus 5.2 percent in the 1980s. The central city poverty rate reported by the Census Bureau was at a 20-year low in 2000. These positive trends were accompanied by economic and policy changes that may also affect how cities perform during this recession. We discuss these changes here, and offer thoughts as to their implications for the economic performance of cities over the coming months.

A. Services Grow in Importance

The decline in the U.S. manufacturing job base, and the parallel rise of services sector – which includes both high-wage "knowledge-based" services and lower wage personal services – over the last two decades is well-documented. Nowhere is this transition more apparent than in large U.S. cities. Table 7 shows growth in employment shares in major U.S. industries for large urban counties versus the rest of the U.S. between 1979 and 1999.

Table 7. Job Share by Major Industry, 25 Urban Counties versus Rest of U.S., 1979-1999

	County 1979 (%)	County 1989 (%)	County 1999 (%)	Rest of US 79 (%)	Rest of US 89 (%)	Rest of US 99 (%)
Manufacturing	18	13	10	19	15	12
Retail Trade	14	15	14	16	17	17
FIRE	10	10	10	7	7	7
Services	**26**	**32**	**36**	**20**	**26**	**30**
Government	15	14	13	17	15	14
Other	16	15	16	21	20	20

Source: Bureau of Economic Analysis Regional Economic Indicators System (REIS)

The services industry accounted for more than one in three jobs in urban counties in 1999, up from one in four in 1979. This mirrored the trend in the rest of the U.S. over the same period, where the share of all jobs in the services industry increased from 20 percent to 30 percent over the two decades. Still, urban counties maintain a significant edge over the rest of the U.S. in services employment. Large urban counties also experienced slightly steeper declines in manufacturing employment than other places in the nation.

The services industry encompasses a wide array of employment sub-sectors that experienced very different rates of growth in the 1990s. Personal income data (representing the total amount of salaries and wages derived by place of employment) reveals that services industry growth in the cities was not consistent across sub-sectors, however. Table 8 shows that in the 25 large urban counties, gains in the share of income derived from "business services" (3.5 percentage point increase) accounted for nearly all of the increase in the share of income attributable to the services industry (4.1 percentage point increase) in the 1990s.

Like the services industry as a whole, business services itself includes jobs from across the pay spectrum – computer programming, advertising and graphic design at the high-paying end; and janitorial services, temp employment and security services at the low-paying end. The other sub-sector to account for a significantly greater share of wages and salaries at the end of the 1990s was engineering/management, due largely to employment and pay growth in the management consulting and accounting industries.

Table 8. Share of Total Wages and Salaries by Services Industry Sub-Category, 25 Urban Counties versus Rest of US, 1989 and 1999

Category	Counties 1989	Counties 1999	Rest of US 1989	Rest of US 1999
Services	*29.4*	*33.5*	*23.0*	*27.5*
Hotels/lodging	0.8	0.8	0.8	0.9
Personal services	0.8	0.7	0.9	0.9
Business services	**5.3**	**8.8**	**4.0**	**6.6**
Auto repair/services/parking	0.8	0.7	0.9	0.9
Amusement/recreation	0.9	1.2	0.6	0.9
Motion pictures	1.1	1.3	0.2	0.2
Health services	7.2	7.0	7.6	8.2
Legal services	3.9	3.7	1.5	1.4
Educational services	1.3	1.5	0.9	1.0
Social services	0.8	1.0	0.7	1.0
Membership organizations	1.0	0.9	0.9	1.0
Engineering/management	4.3	5.0	3.0	3.5
Other	1.2	0.9	1.0	1.0

Source: Bureau of Economic Analysis Regional Economic Indicators System (REIS)

What does the trend toward a services-oriented economy suggest about the vulnerability of city employment in this recession? To the extent that services jobs "replaced" manufacturing jobs in cities over the last decade, cities may in fact be more insulated from this recession than the past two. Cities, and the U.S. as a whole, tended to lose manufacturing jobs much faster during the early 1980s and early 1990s than throughout the rest of the decade. In contrast, services industry growth during the two recessionary periods was muted, but still positive.

On the other hand, to the extent that services industry employment growth in cities during the 1990s was concentrated in highly cyclical sub-sectors like temp employment, cities in general may be more exposed to this recession than previous ones. Job data from the past few months suggests this heightened exposure. Between September and December, the business services sub-sector alone lost nearly 240,000 jobs, one-quarter of the entire net national job loss over that period.

B. Emerging City "Specialties" May Influence Exposure to Recession

Earlier we documented that between 1990 and 1992, the manufacturing and FIRE industries suffered the largest percentage declines in total jobs. Cities that experienced the largest increases in unemployment had higher concentrations of jobs in these industries. Cities with concentrations in government and retail employment, on the other hand, tended to fare better than other cities. While this exact pattern may not hold in this recession, it is worth exploring whether these industries have become more or less important in certain cities over the last ten years, and how those cities have responded thus far to the current slowdown.

As discussed previously, the share of jobs in manufacturing in cities declined significantly during the 1990s. In 24 of the 25 largest cities, urban county employment share in manufacturing

dropped between 1989 and 1999. In general, the share of urban county employment in the other three sectors (FIRE, retail, government) decreased slightly, as the service industry boomed. Still, certain cities stand out as having *gained* or *lost* significant employment share in these industries over the decade. Table 9 displays the cities with the largest changes in employment share in these four industries during the 1990s, and the leaders in employment share in those industries in 1999.

Table 9. Changes in Industry Concentration in Large Cities 1989-1999, and Industry Share Leaders, 1999

Industry	Top Gainer	Gain in Share	Top Loser	Loss in Share	Leaders	
Manufacturing	Austin	1.1%	San Jose	-6.0%	San Jose	21%
					Detroit	18%
					Milwaukee	15%
FIRE	Jacksonville	1.7%	Philadelphia	-2.1%	Boston	15%
					New York	14%
					San Francisco	13%
Retail Trade	Denver New York	0.4%	Baltimore	-3.0%	Columbus	19%
					San Antonio	18%
					Nashville	17%
Government	Baltimore	1.5%	Austin	-7.1%	Washington	33%
					El Paso	20%
					Baltimore	19%

- **Manufacturing**. Only one city – Austin – posted a gain in manufacturing employment share during the 1990s, due in large part to job growth at Dell Computer Corporation. The city has already lost many of those jobs as part of the broader technology sector decline, and unemployment in Austin increased from 2.0 percent in October 2000 to 5.0 percent in October 2001.[7] San Jose, while losing significant employment share in manufacturing during the 1990s, still remained highly dependent on high-tech manufacturing in the late 1990s. Like Austin, the city has suffered from tech sector layoffs, and unemployment there was 7.5 percent in October, up dramatically from 1.9 percent a year prior.

- **FIRE**. Only six of the top 25 cities actually gained share in FIRE employment during the 1990s. Boston, New York and San Francisco remain the leaders in total employment share in this sector. With a significant gain in the 1990s, though, Jacksonville's share of jobs in FIRE was similar to the traditional "finance cities" in 1999. Over the same period, banking industry consolidation led Philadelphia to lose 24,000 FIRE jobs. Finance cities may remain somewhat more susceptible to the recession than other cities; the unemployment rate in Boston, for instance, increased 1.9 percent between October 2000 and October 2001, compared to 1.5 percent nationally.

---

[7] We cite year-to-year unemployment changes in this section, as figures from the Bureau of Labor Statistics' Local Area Unemployment Series are not seasonally adjusted.

- **Retail**. With widespread employment growth in the services sector, only five of the top 25 cities experienced a net gain in retail sector employment share. Denver and New York topped the list with modest 0.4 percent increases in share, joined by other "amenity" cities like Seattle and San Francisco. Table 9 shows that Columbus, San Antonio and Nashville continue to rely on this sector to a greater degree than other cities. Perhaps as a result, each has experienced unemployment rate increases below the national average over the past year (Nashville's unemployment rate actually remained unchanged between October 2000 and 2001). On the other end, Baltimore lost significant retail employment share in the 1990s, and 23,000 retail jobs overall.

- **Government**. In part compensating for its retail sector job losses, Baltimore posted the strongest gain in government sector employment share in the 1990s. However, it did so only as a result of losing jobs in this sector *more slowly* than in other sectors. It is now among the cities most dependent on government employment.[8] Still, Baltimore's heavy reliance on government employment may help to account for the fact that its unemployment rate has risen only 0.2 percentage points since last October. In contrast, Austin – despite actually gaining 11,600 government jobs in the 1990s – saw the greatest decline in employment share in this sector, due to rapid growth in all other sectors of its economy. Washington, D.C. remains by far the leader in government sector employment, with a third of its job base in government positions. Despite being one of the targets of the September terrorist attacks, the city's unemployment rate was 6.2 percent in October, up only slightly from 5.9 percent a year earlier.

Do city "specialties" dictate how they will perform in a recession? Will the manufacturing/FIRE cities listed in Table 9 take a beating, while retail/government cities escape unscathed? It is impossible to say with certainty whether employment in these sectors will respond the same way as it did in the last recession. Layoff data from the past few months, however, suggest that manufacturing and FIRE remain cyclical sectors; government positions, in contrast, are still probably among the safest to occupy during a downturn.

C. Hospitality and Tourism-Dependent Cities May Suffer

One industry area that has already suffered – and will likely continue to suffer – during this downturn is hospitality and tourism. The September terrorist attacks exacerbated job losses in an industry that was arguably quite susceptible to economic conditions in the first place. The dependence of large cities overall on these industries did not change much in the last decade, though. In both 1989 and 1999, only about 2 percent of total wages/salaries earned in the 25 large urban counties were in the hotel/lodging and amusement/recreation sectors.

Despite the small share of city employment in these sectors, recent surveys indicate that significant numbers of cities and counties had, at least until September, relied on tourism as an

---

8 The only urban county that posted an absolute gain and gain in share in government employment was Los Angeles, which added 16,000 new government jobs in the 1990s.

engine of economic growth. A 1999 International City/County Management Association (ICCMA) survey found that tourism and hospitality was a focus of 54 percent of central city economic development programs in 1999; 15 percent of cities surveyed in 1999 reported that tourism/hospitality accounts for most of their current economic development prospects, up from 4 percent in 1994.[9]

A few cities saw strong growth in these sectors during the past decade. While total wages and salaries earned in Nashville grew by 86 percent between 1989 and 1999, wages and salaries earned in hotels and recreation grew by 217 percent. Philadelphia and Los Angeles experienced similar increases. To the extent that these cities now depend more on tourism for local employment and taxes, they may be more exposed to this recession than the last one.

Like the hospitality/tourism sub-sector, certain retail sub-sectors may also be sensitive to declining economic conditions and the after-effects of the terrorist attacks. Overall retail employment experienced smaller declines in the last recession than other industries, due in part to the fact that sub-sectors like food retailing are relatively inelastic. Restaurant employment, in contrast, may turn sharply downward as reductions in disposable income cause families to eat out less, and as business travel declines in response to airport delays and fears of terrorism. Unlike retail generally, restaurant retail was a growth sector in urban economies in the 1990s. In 15 of the 25 large urban counties, the share of total wages and salaries earned in restaurants was greater in 1999 than in 1989, although the overall change was not dramatic. As with hospitality and tourism, Philadelphia and Nashville were among the leaders in growing these retail sub-sectors, and may be somewhat more susceptible to this downturn as a result.

D. Healthy City Fiscal Conditions Provide Buffer Against Cyclical Decline, But State Spending "Squeeze" Looms

Cities approach this recession arguably better prepared than they were for either of the last two recessions. On the heels of several years of strong economic growth, end-of-year balances in fiscal 2001 were at all-time highs. The National League of Cities reports that in fiscal year 2001, ending balances in 30 of the largest cities (population exceeding 300,000) averaged nearly $78 million, about two and a half times their average "ending balance goal" of $31 million. In even a protracted recession, this level of surplus balances should allow cities to avoid some of the more painful fiscal choices they faced in the early 1990s. Nevertheless, in addition to employing surplus balances, cities are likely to once again use a combination of targeted spending cuts, tax increases, and one-time spending or revenue "shifts" (to the extent they were reversed since the last time they were used) to weather the current economic storm.

Because the severity of this downturn is yet unknown, we can predict little about how city revenues will respond. However, a few trends in city finances during the 1990s are worth noting.

---

[9] Lisa Mulligan, "Economic Development Trends in Local Government," The Municipal Year Book 2001, International City/County Management Association; Adam Prager et al., "Local Economic Development: Trends and Prospects," The Municipal Yearbook 1995, International City/County Management Association.

First, large cities relied on state and federal transfers to a slightly greater extent in the late 1990s than in the late 1980s. Table 10 shows that the percentage of general revenues derived from federal, state and local intergovernmental transfers rose from 28.1 percent in 1988 to 30.3 percent in 1996. While this does not constitute a seismic shift, intergovernmental transfers clearly continue to represent an important part of city budgets.

Table 10. Revenue Characteristics for Cities, 1988 and 1996

Year	Share of Total General Revenues				Share of Total Taxes		
	Taxes	*Other Own-Source*	*State/ Local*	*Federal*	*Property*	*Sales/Gross Receipts*	*Other*
1988	45.4%	26.5%	19.1%	9.0%	42.9%	28.8%	28.3%
1996	41.1%	28.7%	20.2%	10.1%	41.6%	32.4%	26.0%

Source: Statistical Abstract of the US, 1991 and 2000 editions. Figures are for 25 largest cities in 2000, excluding New York City.

Second, changes in the composition of city revenues could leave cities more exposed to an economic downturn than they were in the early 1990s. In 1996, cities depended on the more elastic sales tax to a greater extent than in 1988, before the last recession began. The largest 25 cities (excluding New York) derived nearly 34 percent of their tax revenues from the sales tax in 1996, up from about 29 percent in 1990. Cities may thus experience somewhat larger shocks to their budgets during this recession, although their continued reliance on the less-elastic property tax may serve to insulate them from severe fiscal strain. Cities that levy income taxes, including New York, Philadelphia, Detroit, Columbus and Baltimore, may experience larger-than-average dips in revenue given the cyclical nature of this tax.

Third, hospitality and tourism are important not only for city employment, but also are significant sources of revenue for many city budgets. Cities generally levy occupancy taxes on top of state sales/use taxes on hotel rooms, and use the revenues to promote tourism, fund special projects like convention centers and stadia, and support general expenditures. In 1999, state and local taxes on hotel occupancy in the 25 largest cities averaged 13.3 percent, compared to averages in their states of around 10.4 percent.[10] In San Francisco, the hotel room tax was projected to generate $200 million in revenue in fiscal year 2001-2002, over half of which was budgeted for general expenditures. Special restaurant taxes and airport concessions also represent important, but tourism-sensitive, revenue sources in a number of cities. These revenues are likely to be more cyclical than others during a typical recession, as consumers and businesses cut back on nonessential travel and entertainment expenditures; this cyclicality is probably heightened by the decline in air travel precipitated by the terrorist attacks.

On the whole, city revenues may be somewhat more susceptible to the current recession than the early 1990s recession. Despite these factors, however, the healthy balances that cities

[10] "State Tax Percentage Rates," US General Services Administration, online at http://policyworks.gov/org/main/mt/homepage/mtt/perdiem/taxesa-c.htm.

enjoyed at the end of fiscal year 2001, and the overall economic momentum they built at the end of the 1990s, place them on solid footing as they face the current downturn.

As noted above, though, the economic health of cities and their residents will rely in part on the fiscal health of their states. In this arena, the outlook is less reassuring. The National Governor's Association estimates that total state budget deficits nationwide this fiscal year will exceed $40 billion, or about 10 percent of state spending.[11] The situation is more severe now than in the last recession; state budget shortfalls peaked at $19.5 billion in 1992, or about 6.5 percent of expenditures that year. As a result, many states are cutting back on programs that directly benefit low-income families, a disproportionate share of whom live in cities. For instance, in Illinois, the governor cut $90 million in spending for Medicaid "safety net" hospitals, many of which are located in inner-city Chicago and its inner suburbs.[12] Those cuts are likely to have serious impacts in Chicago on access to care and health care employment. The Massachusetts legislature sliced $11 million from after-school program spending that supported 38,000 students, many of whom live in the greater Boston area.[13] This will put the squeeze on low-income working parents who cannot afford paid after-school care for their children. State cuts in programs that benefit low-income families not only increase pressures on services at the city level, but also reduce the amount of economic activity in cities and make it harder for them to recover from the downturn.

E. Welfare Reform Could Leave Cities in Difficult Place During Recession

While states have traditionally pulled the purse strings for many programs targeted to low-income families, the 1996 reform of the federal welfare law could have especially significant implications for city expenditures during this recession. The law converted the federal entitlement to cash benefits into a block grant to states, effectively ending the countercyclical nature of welfare aid. Under the new law, each state has a great deal of discretion regarding the allocation of its block grant funds, application and diversion procedures for potential clients, time limits on receipt of aid, and sanctions policies.

Welfare reform presents particular issues for cities during this economic downturn for several reasons. First, the largest cities are now home to disproportionate shares of the nation's welfare clients. In 2000, the counties containing the 25 largest cities were home to 19 percent of the nation's population, but 33 percent of the nation's welfare caseload. This represented an increase from 1994, when these counties contained 30 percent of the nation's caseload. Second, many cities have been slow in moving their welfare clients into the workforce. City residents who have made the transition from welfare to work are thus likely to have less labor market experience than their suburban counterparts, and may now be at greater risk of losing their jobs. Third, evidence from a number of cities – particularly older, more segregated cities like Milwaukee, Chicago, Washington, Detroit and Philadelphia – indicates that urban TANF participants are more disadvantaged than

---

[11] National Governors Association, "States Face Unprecedented Budget Shortfalls," December 10, 2001.
12 "Ryan eases hospital cuts; Millions in Medicaid funding restored for hardest-hit providers," Chicago Tribune, January 9, 2002.
13 "After School Programs in Jeaopardy," The Boston Globe, December 9, 2001.

welfare recipients elsewhere. In general, recipients in cities appear to have lower levels of education, less work experience, are less likely to be able to read, and have larger households to manage – including more children with disabilities.

Experience suggests that cash assistance programs are quite likely to come "under the knife" in the current downturn. In fiscal years 1992 and 1993, over 40 states froze or reduced their basic benefits for AFDC. Now, states have a larger number of fiscal levers they might pull to constrain spending, and greater motivation to do so in the absence of a federal match.[14] As states seek welfare savings this time around, some may not only cut benefit levels, but also apply sanctions and diversion policies more liberally to avoid adding to their rolls, and seek to terminate assistance altogether for families who have exceeded their lifetime limit on benefits. Some states, such as New York, Michigan and California, have already made commitments to serve families who have exceeded their benefit time limits, or to serve the children of parents who have been sanctioned. Still, other states may aggressively seek savings in their welfare budgets; as they do, the pressure may grow on cities to provide for these families financially.

If cities are disproportionately affected by state welfare spending or eligibility cuts, how many families are likely to be affected? There is reason to believe that the need for cash assistance may grow more sharply in cities during this recession than in previous ones. Blank finds that a 1 percentage point rise in the national unemployment rate has historically increased the nation's welfare rolls by 3 to 5 percent. In the previous two recessions, urban caseloads grew rapidly, but no more rapidly than caseloads in the rest of the nation. By increasing labor force participation among single mothers, however, welfare reform has likely made welfare caseloads in cities more cyclical. Between 1992 and 1997, labor force participation among female headed households increased by 16 percent in central cities – compared to 9 percent in suburban areas and 6 percent in rural areas.

While recent changes in the welfare system may not bode well for cities during a recession, the federal safety net for the *working* poor – most notably a greatly expanded Earned Income Tax Credit, and nearly universal health insurance for low-income children – is much stronger than it was ten years ago. This may serve to stimulate local economies, and relieve stress on public hospital budgets, to a greater degree than in the last recession.

IV. TERRORISM AND LARGE CITIES

In the immediate aftermath of the attack on the World Trade Center some people predicted that fear of terrorism would devastate big cities. Speculations abounded that people would abandon densely populated urban places and seek safety in small towns and rural communities. At that moment, terrorism was so closely associated with the collapse of the Twin Towers that tall urban office buildings suddenly seemed like risky places to work. As time passes, however, it is becoming

---

[14] Governors in California, Kentucky and Michigan, among others, have already proposed cuts to TANF spending in fiscal year 2002. Kevin Carey and Iris J. Lav, "States Are Cutting Low-Income Programs in Response to Fiscal Crisis: Less Counter-Productive Options Are Available." Center on Budget and Policy Priorities, January 17, 2002.

clearer that terrorism may take many forms, and the ultimate impact of terrorism on our society is likely to be quite complex. The implications for cities are still unpredictable and will probably remain so for some time to come. Only a few speculative thoughts can be offered at this time:

- The physical impact of the World Trade Center attack was horrific, and the effort required to restore the site will be lengthy, complex and expensive. Nevertheless, the damage was confined to a small area, as was the damage from the attack on the Pentagon. Cities have a long history of rebuilding and reviving after natural and manmade disasters – London after the blitz, Los Angeles and San Francisco after the earthquakes, Miami and Charleston after the hurricanes. If there is a long term impact of the recent terrorist attacks, it will be the result of attitudinal changes, not physical destruction.

- The World Trade Center is unlikely to be replaced with towers of comparable height, and there will probably be very few buildings of 50 or more stories erected in American cities for decades to come. The reasons are not just fear of another attack, although that plays a role. The World Trade Center was more than 30 years old and not considered a commercial or esthetic success. The spectacular towers were heavily subsidized and did not attract enough commercial tenants to make them financially viable until the bull market and financial services boom of the late 1990's made Lower Manhattan a hot real estate market. Moreover, the World Trade Center complex was considered by many a sterile workplace, which was cut off from the rest of the city and formed a huge barrier to traffic circulation in the surrounding area. Planning for the reconstruction of the site is still in progress, but there appears to be a consensus that the future of the Lower Manhattan lies in office buildings of more moderate height, with more mixing of residential, cultural and commercial uses, and greater access to and from the surrounding areas. Downtown building in other cities also seems likely to emphasize mixed uses and a more human scale.

- The attack on the World Trade Center, which destroyed part of the New York subway system, as well as a crucial transit link between Manhattan and northern New Jersey, dramatized the importance of mass transit and of having redundant systems in an emergency. There is hope that the rebuilding of Lower Manhattan will not only restore the transit links, but significantly improve them. The experience may also push other cities toward upgrading their transit systems and making them more secure.

- One of the lessons that large companies doubtless learned from the attacks was that concentrating key personnel in one location is risky. Headquarters of large organizations may be more decentralized in the future, but the trend may not actually affect many workers. Nor will it necessarily mean that corporations move key personnel out of cities. Corporations may instead split them among different cities.

- Another lesson was that having back-up computer systems in diverse locations pays off in an emergency. Indeed, the disruption of financial markets after the attack on the World Trade Center was far less serious than it would have been if financial services companies had not

put so much effort into building redundant systems in preparation for the Y2K episode. Fear of terrorism will likely accelerate investment in back-up systems, but this investment was already heavy.

- Many companies had been moving their back-office functions out of cities in recent years to take advantage of cheaper rents and lower wages in less densely populated areas. Indeed, the information revolution makes it possible for workers in widely separated locations to work together easily and for routine operations like data processing to be carried on wherever the costs are lowest. Fear of terrorism may provide an additional or reinforcing reason for such moves, but the primary motivation will continue to be cost reduction.

- Terrorism-induced aversion to air travel – combined with rapidly improving technology for Internet communication and video-conferencing – may slow the rate of growth of business travel and reduce the demand for business conference facilities, even after the economy recovers from recession. Such a trend would be harmful to both public and private revenues in cities that have traditionally attracted large numbers of business travelers and convention-goers and cities that are major airline hubs. Terrorism fears might also provide an additional incentive for telecommuting, which would reduce congestion on commuter routes, but might shift additional retail revenues from cities to suburbs--although such effects seem likely to be marginal at most.

- Private and public decision-makers are facing up to living in a world in which many kinds of terrorism – biological, chemical, nuclear – pose real threats. The costs of preventing and dealing with these threats will impose serious burdens on both the public and private sectors. But it is not obvious that coping with diverse threats will prompt an exodus from cities. Some people may feel safer in remote areas, which they believe will be less likely terrorist targets. Others may feel more vulnerable if they are farther from population centers and from the resources – such as expert medical care, highly trained police, fire and other public safety personnel – that might protect them in a city.

The decisions that people make about where to live and where to locate businesses are complex and influenced by many factors. Fears clearly play a role. Some people may not live in San Francisco or Los Angeles because they fear earthquakes or in South Florida because they fear hurricanes. High crime rates deter many from living in cities. Fears of being hit by a crashing plane – as well as distaste for noise pollution – may deter some from living near airports.

However, terrorism is just one of many possible fears that might influence location decisions, and probably not a major one, since terrorist attacks are rare and unpredictable. Repeated terrorist attacks by the Irish Republican Army over the years have not apparently deterred many people from living and working in London. Indeed, the threat of a common danger may bring people together and cause them to value their surroundings more highly. Polls in both New York and Washington taken after September 11 found evidence of increasing attachment to each city.

In sum, it is far too soon to say anything definite about the effect of the recent terrorist attacks on cities. In the end, however, it seems likely that their effects will be marginal. The growth and development of cities will continue to be shaped by complex economic, social and technological forces, among which terrorism plays a very minor role.

V. Conclusion

The economic and financial vitality that large cities enjoyed in the late 1990s seems to have left them better-prepared for the current national recession than they were for either of the previous two recessions. If the economy recovers in the second half of 2002, as leading economists predict, cities overall should weather the storm well. Should the downturn persist, the effects on city employment, budgets, and vulnerable families could be more serious. Regardless of the length and severity of the recession, different cities will fare differently, depending on the composition of their job bases, their reliance on revenues of varying sensitivity, and state spending decisions on programs for lower-income families. Some trends from the 1990s described in this paper, though not dramatic, highlight areas of potential concern for cities over the next couple of years. Over the longer term, fears of terrorism may have, at most, a marginal economic impact on cities. Larger market trends such as globalization, immigration, industry consolidation, and evolving technologies will continue to dictate more about the future of cities than terrorism alone.