Diversifying the Economy

By Patty Silverstein | Posted: Wednesday, September 21, 2011 9:10 pm

The Brookings Institution recently released a study suggesting that the economic recovery in some of the 100 largest metropolitan areas will lag due to a mismatch in the supply of and demand for educated workers. The report categorized the Denver metropolitan statistical area as a region with a favorable education match, but an unfavorable industry composition. Many communities that Metro Denver often competes with for company expansions were included in the same category, including Chicago, Kansas City, Portland, Raleigh, Salt Lake City, San Jose and Seattle. According to the study, "these economies are more heavily concentrated in declining or more vulnerable industries. ... These metros are not well positioned to recover unless national demand for what their industries produce rebounds significantly, or they diversify into faster growing industries like healthcare, professional services, and clean energy."

Really? Metro Denver has strong employment concentrations in healthcare, professional services, and clean energy. Indeed, the Metro Denver region ranks seventh out of the 50 largest metropolitan areas in employment concentration in the cleantech industry. So, what is it about our industry base that is causing the region to lag in the economic recovery, or is Metro Denver truly lagging?

The 11-county Metro Denver area -- a region that combines the Boulder MSA and the Denver-Aurora-Broomfield MSA -- ranks as No. 16 of the 50 largest metro areas as measured by total employment. Looking at annual average employment data from 2007 to 2010, a time that encompasses the 18-month Great Recession that lasted from December 2007 to June 2009, reveals that Metro Denver's average annual growth rate of -1.4 percent for this period ranks as 17th best. During this time, only three metro areas achieved an average annual growth rate that falls in positive territory: Austin (+0.4%), New Orleans (+0.3%), and San Antonio (+0.3%). Twenty-four of the 50 largest metro areas fell below the national average annual growth rate of -1.9 percent, with Las Vegas posting an average annual loss of 4.8% per year.

While it would certainly be desirable to add jobs back more quickly, I believe that Metro Denver's recent economic performance reflects the diversity of its economy.

A specialized economy may be extremely volatile, subject to booms and busts in the industries in which it specializes. A diversified economy, on the other hand, is better able to absorb employment shocks and should exhibit more stable economic performance. Therefore, one goal of a sound economic development strategy is to diversify the economy to achieve an ideal industry mix.

The ideal industry mix will vary from place to place depending on an area's comparative advantages: that is, attributes such as geographic location, natural resource availability, and worker skill sets play a major role in determining an area's optimum industry mix. In addition, economic diversification must also fit into the design and "flavor" of the community.

What is the best measure of economic diversity? If we assume that the national industry mix reflects the comparative advantages of all parts of the country, the national industry composition provides a benchmark with which to compare a region's industry structure. The goal of a region, however, should not be to duplicate precisely the industrial mix of the United States, as each area should allow geographic and regional nuances to prevail.

There are two main methods for comparing the local industrial structure to that of the U.S. One method compares the employment mix by industry and the other compares state gross domestic product (GDP) by industry, or the value of all goods and service produced, with national GDP. This article focuses on the employment by industry measure.

All business entities in the U.S. are classified into one of 20 sectors through the North American Industry Classification System (NAICS). For ease of analysis, these 20 sectors are combined into 11 "supersectors," or combinations of sectors. As shown in the following table, the percentage of employment by supersector at both the U.S. and Metro Denver level shifted between 2000 and 2010. At the national level, the employment share increased in financial activities, professional &business services, education & health services, leisure & hospitality, other services, and government. Metro Denver employment mirrored this trend, except that the percentage of employment in the financial activities sector decreased slightly. More importantly, the difference between the percentage of employment in each supersector in Metro Denver compared with the U.S. got smaller over the decade, indicating an increase in diversity, with three exceptions: professional & business services, education & health services, and leisure & hospitality. Metro Denver has a strong concentration of professional & business services employment, and that concentration increased over the decade. While Metro Denver's share of education & health services has increased, its increase was slightly less than that which occurred at the national level. Finally, Metro Denver strengthened its share of leisure & hospitality employment, which is not surprising given the importance of tourism to the state and regional economies.

Percentage of Nonfarm Employment by Supersector

	Annual 2000			Annual 2010		
	U.S.	Metro Denver	Difference	U.S.	Metro Denver	Difference
Total Nonfarm	100.0%	100.0%		100.0%	100.0%	
Natural Resources & Construction	5.6%	7.5%	1.9	4.8%	5.5%	0.7
Manufacturing	13.1%	8.1%	-5.0	8.9%	5.6%	-3.2
Wholesale & Retail Trade	16.1%	15.7%	-0.4	15.3%	15.0%	-0.3
Transportation, Warehousing & Utilities	3.8%	4.0%	0.2	3.6%	3.5%	-0.1
Information	2.8%	6.1%	3.4	2.1%	3.9%	1.8
Financial Activities	5.8%	7.5%	1.7	5.9%	7.2%	1.4
Professional & Business Services	12.6%	16.3%	3.7	12.9%	17.1%	4.2
Education & Health Services	11.5%	8.5%	-2.9	15.1%	12.0%	-3.0
Leisure & Hospitality	9.0%	9.5%	0.5	10.0%	10.7%	0.6
Other Services	3.9%	3.5%	-0.4	4.1%	3.9%	-0.2
Government	15.8%	13.2%	-2.6	17.3%	15.5%	-1.8

Source: U.S. Bureau of Labor Statistics, Current Employment Statistics.

How do you know when an area reaches an optimal level of diversification? Actually, the best industry mix will probably never be achieved. Instead, the mix changes constantly, adjusting with technological innovations and consumer demand patterns. While there is no way to insulate an area completely from business cycles, diversification helps to maintain stability in the overall economy.