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St. Cloud Area Quarterly Business Report

Spring 2003

Inside This Issue:

Executive Summary	page 1
Leading Indicators	page 2
Overall Outlook	page 3
Outlook Survey	page 7
Special Questions	page 10 - 11

Volume 5, Number 2

Central Minnesota Economy Still Struggles —Awaits U.S. Recovery

Executive Summary

General economic weakness and persistent struggles at some of the area's largest manufacturing enterprises continue to plague the St. Cloud area economy. Overall employment in the St. Cloud area fell over the most recent year, with job losses heavily concentrated in retail, government, and manufacturing sectors. Continuing job gains in the financial and construction industries are among the few bright spots. Results from the **St. Cloud Index of Leading Economic Indicators** suggest economic conditions will remain flat into the late summer of this year. Responses to the **St. Cloud Area Business Outlook Survey**, although somewhat more upbeat than the indicators index, also indicate a great deal of uncertainty with regard to the pace and timing of the local economic recovery. The next few months is likely to be a period in which most area businesses cautiously await signs that economic uncertainty has become less severe and broad-based recovery has begun.

Area employment fell by 1.6 percent over the year ending February 2003, making the St. Cloud economy the worst performer of all neighboring metropolitan areas. In addition, recently revised employment figures indicate recent local employment declines have been more severe than originally thought. Predictions of the **St. Cloud Index of Leading Economic Indicators** are mixed. Signs of strength in the local index can be found in increases in new residential electrical hookups and in the number of local business start-ups, while a slight reduction in the length of the average workweek of area manufacturing pro-

duction workers and a fall in the U.S. Index of Leading Economic Indicators has served as a drag on the local index.

Thirty-seven percent of the fifty-three firms responding to the **St. Cloud Area Business Outlook Survey** experienced a decrease in business activity over the past three months. Twenty-eight percent of surveyed firms report an increase in business activity over the past quarter. Area labor market conditions remained soft as the number of companies reducing employment exceeded those that added workers. In addition, the length of the workweek appears to have declined for many area firms and businesses are, on balance, finding it less difficult to attract qualified workers. Area firms are more upbeat about the future however. Sixty-six percent of survey respondents anticipate an increase in the level of business activity for their company over the next six months compared to only 13 percent who expect conditions to worsen. This expectation is, of course, reasonably conditioned on the fact that the war in Iraq is not extended over many months, that oil prices stabilize, and that national economic conditions improve.

A special question in the March 2003 **St. Cloud Area Business Outlook Survey** asked area businesses to indicate the extent to which they agreed with Governor Pawlenty's budget proposal for education spending. Forty-seven percent of responding firms indicate agreement with the governor's proposal, while 19% say he should have found another way to balance the budget. Fifteen percent of those surveyed think both K-12 and higher education spending

Pace & timing
of local
recovery is
uncertain

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should be cut to balance the budget. These results indicate a much greater degree of support by St. Cloud area business leaders for the governor's education spending proposal than was reported by the *Star Tribune* in its Minnesota Poll of the same question in late February. A second special question asked area businesses to indicate the extent to which they supported the lifting of the current legislative ban on new hospital construction. Fifty-six percent of the 43 businesses responding to this question indicated they were either "strongly in favor" or "mildly in favor" of lifting the ban. By contrast, 28% of surveyed businesses are either "strongly opposed" or "mildly opposed" to lifting the ban. Written comments suggest a wide variation of differences in opinion on the desirability of lifting this ban. Many respondents suggest more research is needed to make an informed judgment on this highly visible local issue.

St. Cloud Index of Leading Economic Indicators

The February 2003 **St. Cloud Index of Leading Economic Indicators** projects that the St. Cloud area economy will show no clear trend through late Summer 2003. The index is designed to forecast local economic activity four to six months in the future.

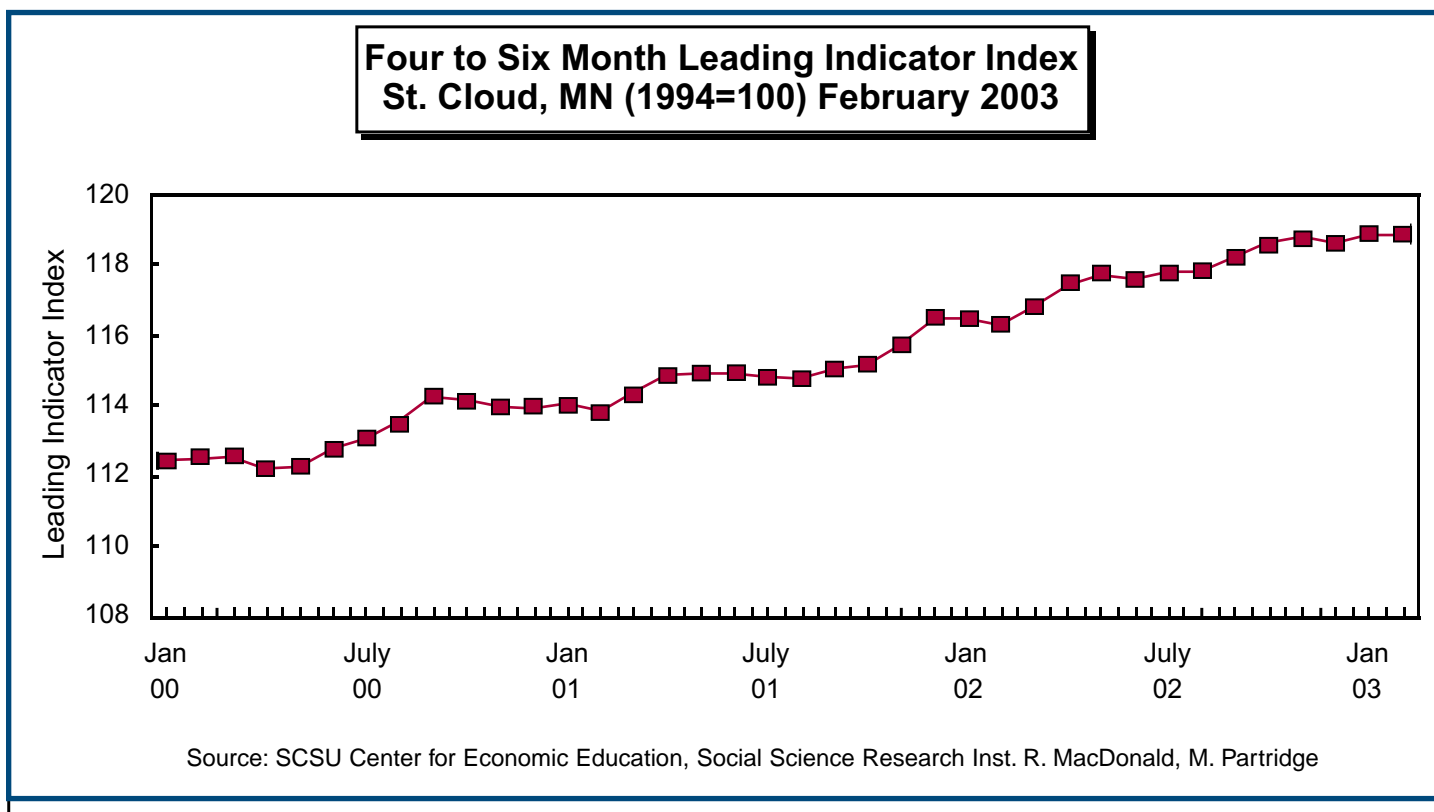
Indicators index shows no clear trend

Figure 1 shows that the index has been flat since November of last year. The local index has been boosted by steady increases in the number of new St.

Cloud area residential electric hookups and in the number of new local business start-ups as suggested by new registrants with the Minnesota Office of the Secretary of State. A recent decline in the U.S. Index of

Leading Economic Indicators and a slight fall in the area average manufacturing workweek have had a depressing impact on the local index. Readers are once again reminded that the economic shock of the 2002 Fingerhut shutdown challenges the predictive capabilities of the statistical model used to derive the index. Forecasting models use past trends to help predict future events and they are less reliable when one-time events (such as the Fingerhut shutdown or the events surrounding 9-11 at the national level) affect the economy. For example, new business start-ups are usually viewed as a sign of bullish confidence in future economic conditions. Yet, in the current lengthy downturn, new business start-ups may instead reflect a lack of alternative job opportunities. As a rule of thumb, three consecutive positive changes in the **St. Cloud Index of Leading Economic Indicators** suggest an expanding economy, while three consecu-

Figure 1 — St. Cloud Index of Leading Economic Indicators (February 2003)



tive decreases suggest a contracting economy and/or a slowing of economic growth.

The St. Cloud Area Overall Outlook

Table 1 shows non-farm employment data for the St. Cloud Metropolitan Area (MSA), Minneapolis-St. Paul (MSA), and Minnesota. As indicated, February 2003 St. Cloud MSA employment was 1.6 percent below that of a year earlier. This table reports different industry groupings than in the past to reflect the federal government's changeover to the North American Industrial Classification System (NAICS) from the old Standard Industrial Classification (SIC) (for more details, see the U.S. Department of Labor website <http://www.bls.gov/bls/naics.htm>). The reclassification produces many changes such as shifting eating and drinking establishments from the retail category to the leisure and hospitality category. This new reporting scheme means that (at least for the next few months) it will be more difficult to use past patterns of local economic data to predict future movements in activity. These concerns will, of course, gradually ease, as more is understood about the effect of the reclassification on the path of indicators of local economic activity.

One change with the new figures is that the St. Cloud MSA's economic performance was stronger in 2000 than previously reported. This is noteworthy because downsizing at Fingerhut was already well underway at that time. Likewise, 2001 and

Area economy in late 2002 was weaker than originally believed

early 2002 were a little stronger than initially reported. It was originally thought that the St. Cloud economy dipped into recession in July 2001. Recently revised data now suggest the local recession began in December 2001--some nine months after the national economy officially entered recession. The downside of this rebenchmarking is that the new figures

suggest area economic performance was somewhat weaker in late 2002 than was originally believed. For example, November 2002 non-farm employment in the St. Cloud MSA was about 2 percent below what it had been one year earlier. These new data revisions, in combination with survey results reported in Table 3 below, call into question whether or not the local economy has yet hit bottom. A broad-based local recovery appears to have not yet begun. To be sure, some pockets of the local economy are experiencing moderate to strong growth, but others (including several highly visible large employers in the area manufacturing sector) are contracting. Any area recovery has been, to date, very uneven.

St. Cloud's 1.6 percent employment decline in the year ending February 2003 trails the 0.2 percent decline in both the state and nation. Likewise, St. Cloud lags corresponding rates in Duluth-Superior, Minneapolis-St. Paul, and Rochester (respectively, 1.9%, -0.3%, and 0.5%). Interestingly, the modest economic recovery currently occurring in Duluth illustrates that it sunk into recession well before the rest of the state, with its recovery also beginning a little earlier. Considering metropolitan areas near the Minnesota border (Grand Forks, Fargo-Moorhead, Sioux Falls, Sioux City, Des Moines, La Crosse, Eau Claire), only La Crosse is currently experiencing an economic slump as severe as St. Cloud. The general weakness felt in the St. Cloud area reflects continuing fallout from the Fingerhut shutdown in early 2002 as well as more severe weakness in the local manufacturing sector than previously thought (although strict comparisons to old manufacturing data is problematic due to the data reclassification referenced above). Sharp declines in St. Cloud MSA state government employment are also aggravating the local situation.

The biggest hindrance to broad-based local recovery is the uneven and uncertain performance of the national economy.

Although no official pronouncement has been given, it appears the national recession that began in March 2001 ended later that year. However, many analysts point to continuing job losses to argue that the U.S. is in the midst of a jobless recovery. Even more worrisome is that some national forecasters now contend that another recession is possible in the near future. A jobless recovery and low consumer confidence does not bode well for consumer durable purchases (and for the household sector in general). This sector accounts for two-thirds of expenditures, and it has remained remarkably strong through months of continuing uncertainty. Events that cause consumers to sit on the sidelines will certainly have an adverse effect on the economy at all levels. Indeed, it is nearly impossible to imagine any broad economic recovery in which household spending is weak.

To be sure, interest rates remain at low levels, but given that a significant share of consumer durable purchases and new home construction has already been pushed into the last 18 months, it is hard to imagine that a widespread economic recovery will be triggered by any further reductions in interest rates. Despite the fiscal stimulus package that is being debated in Washington, it seems quite unlikely that any economic boost will arise from economic policy actions. The Federal Reserve is limited in scope on how much further it can attempt to stimulate economic activity and the tax cuts being discussed by Congress are unlikely to provide immediate economic stimulus. Sustained recovery, it seems, will only occur when households and businesses become less uncertain about future U.S. involvement in Iraq--both in terms of a military presence and in reconstruction--and more convinced that geopolitical conditions have stabilized.

Local recovery depends on national economy

Many have argued that a long-term U.S. presence in Iraq may create an Arab backlash that produces more terrorism and more uncertain and expensive oil supplies. Even without Middle East conflict, oil supplies are clearly adversely affected by events in Venezuela and Nigeria. A reduction in geopolitical uncertainty would help mitigate some of the significant volatility that has been observed in financial markets in recent weeks. Capital equipment purchases by the business sector have been weak for nearly two years. The obsoles-

cence of plant and equipment suggests that business investment will soon take off once economic growth resumes and uncertainty moderates. We therefore expect a pick-up in business capital expenditures to be an important leading indicator that recovery has begun.

The St. Cloud economy is, of course, not immune to national and global events. In addition to the uncertainty arising from military conflict in Iraq, there is a sense that the local economy is vulnerable in

ways that we have never before seen. Several area businesses report that they are experiencing fierce competition with imported goods from China. Steel tariffs have also made it more costly for area steel fabricating businesses to compete. Some of these businesses are among the St. Cloud area's largest employers. The market for paper products has also slipped, leaving several area employers at risk of weakening business conditions. In short, there is a sense of unease among many area firms and their employees that they have been

Table 1 — Employment Trends

	St. Cloud Employment Trends in Percent			Minnesota Employment Trends in Percent			Twin Cities Employment Trends in Percent		
	1990-2003 Long Term Trend Growth Rate	Feb 02-03 Growth Rate	Feb. 03 Employment Share	1990-2003 Long Term Trend Growth Rate	Feb 02-03 Growth Rate	Feb. 03 Employment Share	1990-2003 Long Term Trend Growth Rate	Feb 02-03 Growth Rate	Feb. 03 Employment Share
Total Nonagricultural	2.4%	-1.6%	100.0%	1.7%	-0.2%	100.0%	1.7%	-0.3%	100.0%
Total Private	2.7%	-1.2%	100.0%	1.8%	-0.5%	100.0%	1.6%	-0.3%	100.0%
GOODS PRODUCING	3.0%	-0.1%	21.8%	0.8%	-2.9%	17.4%	0.4%	-4.8%	16.0%
Construction/Nat. Res.	4.3%	4.1%	4.3%	3.3%	-1.1%	4.2%	3.6%	-5.8%	4.0%
Manufacturing	2.7%	-1.1%	17.5%	0.2%	-3.4%	13.2%	-0.5%	-4.4%	12.0%
SERVICE PRODUCING	2.2%	-2.0%	78.2%	1.9%	0.4%	82.6%	1.9%	0.6%	84.0%
Trade/Transportation/Utilities	1.0%	-5.2%	22.2%	1.2%	-1.1%	19.7%	1.1%	-0.3%	19.6%
Wholesale Trade	3.0%	-0.5%	4.6%	1.5%	-0.8%	4.8%	1.3%	-1.1%	4.9%
Retail Trade	0.3%	-7.7%	14.4%	1.2%	-0.8%	11.3%	1.2%	1.0%	10.9%
Trans./Warehouse/Utilities	1.9%	-0.2%	3.1%	0.8%	-2.4%	3.6%	0.4%	-2.8%	3.9%
Information	4.6%	3.1%	1.9%	1.6%	-2.4%	2.5%	1.9%	-2.2%	2.9%
Financial Activities	4.3%	9.1%	4.3%	2.1%	-0.9%	6.4%	2.3%	1.6%	8.0%
Prof. & Business Service	3.9%	-5.0%	6.6%	2.4%	-1.4%	11.0%	2.1%	-2.0%	14.0%
Educational & Health	4.2%	-0.9%	15.4%	3.3%	3.6%	14.1%	3.1%	4.5%	12.2%
Leisure & Hospitality	2.7%	1.4%	8.4%	2.0%	1.1%	8.3%	2.3%	3.9%	8.7%
Other Services (Excl. Gvt)	2.5%	3.2%	4.8%	2.0%	-0.3%	4.5%	1.6%	-0.8%	4.3%
Government	0.9%	-3.6%	14.7%	1.5%	1.3%	16.1%	1.7%	-0.5%	14.3%
Federal Government	-0.3%	-0.2%	1.7%	-0.1%	2.9%	1.3%	0.1%	4.1%	1.3%
State Government	-1.2%	-11.5%	4.1%	0.5%	1.6%	3.6%	1.5%	2.4%	4.0%
Local Government	0.3%	-0.1%	9.0%	2.1%	1.1%	11.2%	2.5%	-2.3%	9.0%

Note: Long term trend growth rate is the compounded average employment growth rate in the specified period. St. Cloud and Twin Cities represent the St. Cloud and Minneapolis-St. Paul MSAs, respectively.
SOURCE: MN Workforce Center

just able to "hang on" through tough times in recent months. An extended period in which conditions remain slack for these companies could prove grave indeed. While we have always felt that Fingerhut's closure would cause a severe blow, we still thought that St. Cloud could avoid a prolonged slump if the national economy displayed enough strength to give the local economy a bump. Unfortunately, the national economy has failed to give the local economy this needed lift. Thus, we are increasingly concerned that our original "pessimistic" forecast of a late Spring 2003 recovery now appears to be overly optimistic. With the continued sluggish national economy and an uncertain future U.S. involvement in Iraq, it is increasingly apparent that the U.S. economy will not improve measurably for several months. Hence, a sustained local recovery is unlikely until later this year.

The St. Cloud Area Sectoral Outlook

Table 1 shows sectoral employment performance. Even in the midst of the local downturn, there are sectors that are holding their own. For example, revised figures show that area construction employment has been steadily rising since early 1999 with employment rising another 4.1 percent in the year ending February 2003. This surprising strong trend likely reflects the strength of the local residential housing market, although commercial construction is apparently lagging. Table 2 shows that the valuation of residential building permits declined 5.5 percent in the December-February quarter compared to year-earlier levels. While this may suggest a slight slowdown in the early spring, building permits continue at a rather strong pace compared to historical norms.

Construction and financial industries have been bright spots

The financial industry (the old FIRE sector) continues its local expansion with growing firms such as ING Direct producing a 9.1 percent job

growth in the year ending February 2003. Likewise, the low interest rate environment has lifted real estate and the related mortgage and refinance components of banking. Other growing sectors include information (mostly publishing, broadcasters, telecommunication, and internet providers), leisure and hospitality (e.g., hotels and eating & drinking establishments), and other services (e.g., repair shops, cleaners, religious and civic organizations).

With Fingerhut's closing, it is not surprising that the weakest St. Cloud MSA sector is retail, where employment fell 7.6 percent over the period. While there have been some encouraging signs such as Fingerhut recently signing a contract with union workers, any future large-scale operations by the renewed Fingerhut appears to be well down the road. Overall retail employment is down about 1,100 over the year ending February 2003, which is perhaps less than might have been expected given last year's large-scale lay-offs at Fingerhut. Along with modest growth in the new leisure and hospitality category, this suggests that the indirect fallout from Fingerhut is starting to dissipate for other local retailers. However, the area's professional and business service providers (e.g., consultants, accountants, legal, etc.) continue to struggle with employment falling a sharp 5 percent in the February 2002-February 2003 period.

Government employment has also declined by 3.6 percent during the period, with losses occurring at all levels of government. State government employment fell a staggering 11.5 percent, although caution must be exercised in interpreting St. Cloud MSA government employment figures because the employment estimates are quite volatile on a month-to-month basis. Even so, the estimated 3,777 area state government employees is the lowest February state figure since 1992. With impending state budget cuts, further declines in state government employment are inevitable (along with a related cutback in local government hires). Given St.

Cloud's relatively high share of state government employees, these workforce reductions may be a drain on the local economy.

The 1.1 percent decline in St. Cloud MSA manufacturing employment is discouraging because previous figures had suggested that local manufacturers were faring better. Yet, the local figure exceeds the corresponding state and U.S. declines of -3.4 and -3.0 percent. Even more telling is the performance of St.

Area labor market remains soft

Cloud manufacturers over the five-year span ending in February 2003. St. Cloud manufacturers added about 1.1 percent more jobs, but state and national manufacturers respectively shed 11.9 and 13.1 percent of their workforce. In this context, the St. Cloud performance doesn't appear so dim. Nonetheless, it is quite discouraging that some large area manufacturers (including SPX Valves, Electrolux, and International Paper) have announced lay-offs in recent months. The economic health of the area manufacturing sector is thus an ongoing concern. As discussed above, sluggish national economic conditions and fierce foreign competition have weighed heavily on manufacturing firms. Unfortunately, the national economy shows few signs of an immediate pickup. While the declining value of the U.S. dollar should eventually help some area manufacturers, it is unlikely to improve trade conditions with China-where competition has been particularly fierce. Since China fixes the foreign exchange value of the yuan to the U.S. dollar, the declining value of the U.S. dollar provides little relief for firms who compete against Chinese products. For these reasons, we remain pessimistic that the health of local manufacturers will show dramatic improvement in the near future.

St. Cloud Area Labor Market Conditions

The general weakness of the labor market is further demonstrated in Table 2. The February St. Cloud MSA unemployment rate was 5.6 percent, modestly above the 5.3 percent rate recorded one year earlier. However, the unemployment rate conceals general weakness in the labor market with both local employment and the labor force respectively falling 1.0 and 0.7. The big question is whether the declining labor force reflects a negative out-migration from the area, or people dropping out of the labor force. While this will not be known until the U.S. Census Bureau releases population estimates in a couple of years, continuing increases in new residential electric hookups suggest that a general out-migration from the St. Cloud area has not taken place. Fortunately, the unemployment rate in both the state and the

Twin Cities has shown a small improvement over the last year, suggesting some stabilization in their economies.

Additional evidence of softness in the local labor market includes a steep 24.8 percent reduction in help-wanted ad linage in the *St. Cloud Times* in the December-February quarter compared to the corresponding period one year earlier. A 25 percent decline is quite telling, but we caution that some of the decline reflects the ongoing migration of help-wanted ads to the internet. New unemployment insurance claims were up over 42 percent during the period (they were up 47 percent for the state over this same period). However, this is likely caused by a fluke in the unemployment insurance program in December 2002. In January and February, new unemployment

insurance claims at the St. Cloud office were running at almost the same levels as 2002. It is heartening that new area claims are stabilizing, although they remain about 28 percent above the corresponding levels of January and February 2000.

Firms responding to the **St. Cloud Area Business Outlook Survey** concur with the view that the St. Cloud labor market is a "buyers market." Twenty-five percent of surveyed firms indicate it was easier to find qualified workers in March 2003 than it was three months earlier (which was itself a soft period). Only 4% of surveyed firms found it more difficult to find qualified workers over the last three months and 15% think it will be less difficult to find qualified workers six months from now. Figure 2 indicates that the area labor mar-

Table 2-Other Economic Indicators

	2003	2002	Percent Change
St. Cloud MSA Labor Force Feb. (MN Workforce Center)	105,895	106,654	-0.7%
St. Cloud MSA Civilian Employment# Feb. (MN Workforce Center)	99,998	101,025	-1.0%
St. Cloud MSA Unemployment Rate* Feb. (MN Workforce Center)	5.6%	5.3%	NA
Minnesota Unemployment Rate* Feb. (MN Workforce Center)	4.9%	5.1%	NA
Mpls-St. Paul/MSA Unemployment Rate* Feb. (MN Workforce Center)	4.4%	4.6%	NA
St. Cloud Area New Unemployment Insurance Claims Dec-Feb Average (MN Workforce Center)	1,132	795	42.3%
St. Cloud Times Help Wanted Ad Linage Dec-Feb Average	2,980	3,961	-24.8%
St. Cloud MSA Residential Building Permit Valuation (\$1,000) Dec-Feb Average (U.S. Dept. of Commerce)	5,739	6,072	-5.5%
St. Cloud Index of Leading Economic Indicators Feb. (SCSU)	118.9	116.3	NA

#- The employment numbers here are based on resident estimates, not the employer payroll estimate in Table 1.
*- Not Seasonally Adjusted
NA- Not Applicable

ket has remained soft for an extended period. The last time a larger percentage of area businesses reported *increased* difficulty attracting qualified workers than reported *decreased* difficulty was the survey of December 2000--twenty seven months ago!

St. Cloud Area Business Outlook Survey
The St. Cloud Area Business Outlook Survey is a survey of current business conditions and area firms' future outlook. It is administered quarterly with the cooperation of the St. Cloud Area Economic Development Partnership. Survey results reported in Tables 3 through 6 reflect the responses of 53 area business firms who returned the recent mailing. Participating firms are representative of the collection of diverse business interests in the St. Cloud area. They include retail, manufacturing, construction, financial, and government enterprises of sizes ranging from small to large. Survey responses are strictly confidential. Written and oral comments have not been attributed to individual firms.

Table 3 reports survey results of area business leaders' evaluation of business conditions for their company in March 2003 ver-

sus three months earlier. Results from Table 3 are weaker than in the December 2002 survey. Many area firms experienced weaker business activity over the past three months. For example, the diffusion index (representing the percentage of respondents indicating an increase minus the percentage indicating a decrease in any given category) for the level of business activity decreased from 7.8 to -9.4 in the current period. This represents yet another decline in this index which is now at its lowest point since the December 2000 survey. Thirty-eight percent of surveyed firms report a decrease in business activity in this most recent quarter while 28% note an increase. Two firms report seasonal effects noting "seasonal business weighted heavily toward summer" and "we are cyclical-now is our busiest time with numerous seasonal employees-we plan for growth in number of employees and business volume six months from now based on the same period last year." Another firm notes that "interest rates drive real estate and continue to soften." One respondent is concerned about the "lack of sufficient North-South and East-West roads throughout the regional area." Finally, several area firms are concerned about the effect of war

on the local economy. Note that the survey was distributed about one week prior to the invasion of Iraq, so some responses were returned prior to the beginning of the military conflict. One firm remarks that "the impending war is causing customers to delay their purchase decisions. It is extremely unfortunate that the U.S. is becoming a global aggressor. We should be (and have been in the past) a global peace keeper." Another firm writes "very edgy times in a very conservative St. Cloud market-even in good times. Market and war have people very 'edgy'." Finally, a local retailer notes "responses may be affected if war in Iraq takes place."

The diffusion index for number of payroll employees is the lowest it has been since December 2001. The index declined slightly to -1.8 from a value of 0 three months ago. Further confirming weakness of the area labor market is a decline in the diffusion index on length of the workweek as well as a decline in firms' difficulty attracting qualified workers. It is worth noting that area firms may be experiencing more cost and price pressures. The diffusion index on employee compensation increased from 24 to 38 over the past three

Figure 2-Diffusion Index for Question 8: Difficulty Attracting Qualified Workers
Percent Increase Minus Percent Decrease

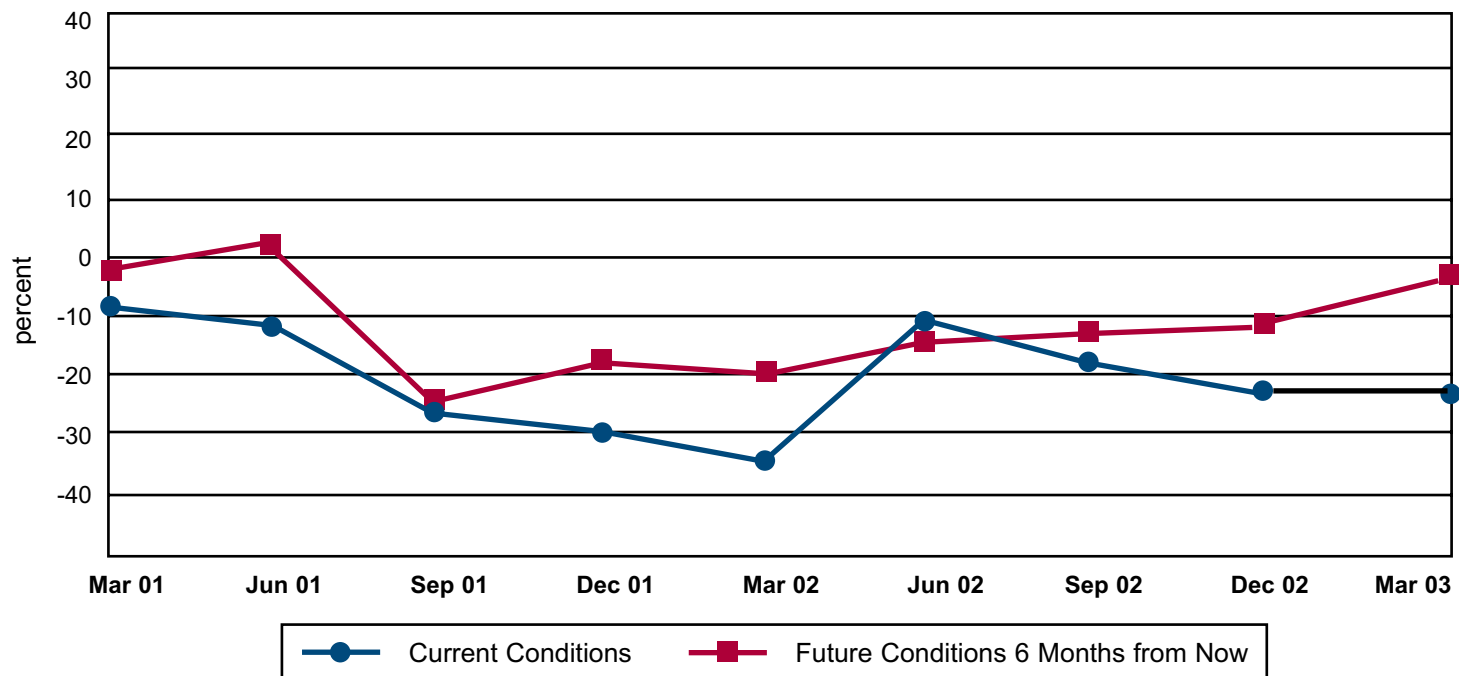


Table 3--Current Business Conditions*

ST. CLOUD AREA BUSINESS OUTLOOK SURVEY Summary March 2003 <i>What is your evaluation of:</i>	March 2003 vs. Three Months Ago				December 2002 Diffusion Index ³
	Decrease (%)	No Change (%)	Increase (%)	Diffusion Index ³	
Level of business activity for your company	37.7	34.0	28.3	-9.4	7.8
Number of employees on your company's payroll	22.6	56.6	20.8	-1.8	0
Length of workweek for your employees	17.0	75.5	7.5	-9.5	0
Capital expenditures (equipment, machinery, structures, etc.) by your company	9.4	66.0	24.5	15.1	13.7
Employee compensation (wages and benefits) by your company	3.8	54.7	41.5	37.7	23.5
Prices received for your company's products	15.1	58.8	22.6	7.5	-5.9
National business activity	34.0	39.6	17.0	-17.0	-11.8
Your company's difficulty attracting qualified workers	24.5	71.1	3.8	-20.7	-11.8
Notes: (1) reported numbers are percentages of businesses surveyed. (2) rows may not sum to 100 because of "not applicable" and omitted responses. (3) diffusion indexes represent the percentage of respondents indicating an increase minus the percentage indicating a decrease. A positive diffusion index is generally consistent with economic expansion. * SOURCE: SCSU Center for Economic Education, Social Science Research Institute, and Department of Economics					

Table 4--Future Business Conditions*

ST. CLOUD AREA BUSINESS OUTLOOK SURVEY Summary March 2003 <i>What is your evaluation of:</i>	Six Months from Now vs. March 2003				December 2002 Diffusion Index ³
	Decrease (%)	No Change (%)	Increase (%)	Diffusion Index ³	
Level of business activity for your company	13.2	18.9	66.0	52.8	56.9
Number of employees on your company's payroll	7.5	47.2	43.4	35.9	27.5
Length of workweek for your employees	1.9	71.7	24.5	22.6	13.8
Capital expenditures (equipment, machinery, structures, etc.) by your company	9.4	56.6	30.2	20.8	29.5
Employee compensation (wages and benefits) by your company	1.9	43.4	52.8	50.9	56.8
Prices received for your company's products	7.5	56.6	30.2	22.7	27.5
National business activity	9.4	47.2	30.2	20.8	11.8
Your company's difficulty attracting qualified workers	15.1	71.7	11.3	-3.8	-1.9
Notes: (1) reported numbers are percentages of businesses surveyed. (2) rows may not sum to 100 because of "not applicable" and omitted responses. (3) diffusion indexes represent the percentage of respondents indicating an increase minus the percentage indicating a decrease. A positive diffusion index is generally consistent with economic expansion. * SOURCE: SCSU Center for Economic Education, Social Science Research Institute, and Department of Economics					

months. Forty-two percent of responding businesses increased employee compensation over the most recent quarter while only 4% reduced wages and benefits. Twenty-three percent of firms report receiving higher prices over three months ago, while 15% note that prices were lower. It is unclear if this means profit margins are improving or that cost increases (perhaps because of rising energy prices) are pushing up the prices area firms are charging. Local capital spending remained weak last quarter. Only twenty-five percent of responding firms increased capital expenditures last quarter while 9 percent cut back on capital purchases. Contrast this to three years ago when 32 percent of firms were increasing capital purchases despite markedly higher interest rates. Finally, survey respondents acknowledge the weakness of national business conditions, with more than one-third of responding firms indicating national business activity had weakened over the past three months. It is hard to envision a sustained local recovery

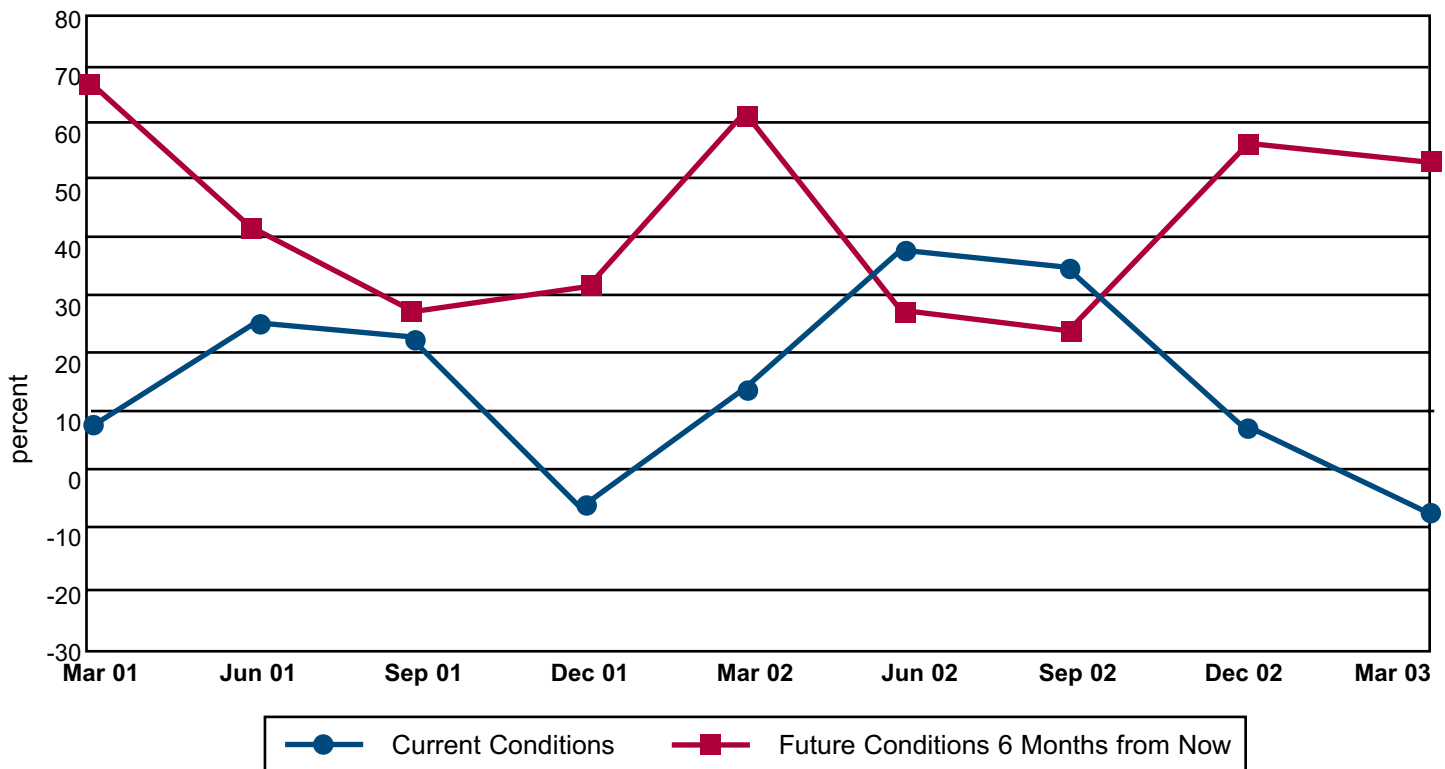
until national conditions improve and business capital spending picks up.

Responses found in Table 4 are notably more optimistic. These results are, on balance, similar to the relatively upbeat assessment of future business conditions that was found in the December 2002 *St. Cloud Area Quarterly Business Report*. Summary results from questions related to survey respondents' expectations of business conditions six months from now versus March 2003 are reported in this table. The diffusion index for the question that asks about the level of future business activity for area companies is 52.8. This is similar to last quarter's survey, but is up sharply from a value of 22.6 reported six months ago. Six months ago, respondents anticipated relatively weak business conditions in March 2003, so it is not entirely surprising that the Current Business Conditions survey results found in Table 3 indicate relative weakness. To some extent, this weakness was expected six

months ago. Going forward, area businesses are for the most part relatively optimistic. It should be noted once again that at the time these surveys were distributed, the war in Iraq had not yet begun. About two-thirds of surveyed businesses expect improved business conditions over the next six months and only 13% expect conditions to worsen.

When compared to the results of the December 2002 survey, business respondents expect a slightly stronger labor market over the next six months. For example, the index on the survey item which asks about anticipated payroll employment is up from 27.5 to 35.9. Forty-three percent of survey respondents expect to increase hiring over the next six months (the corresponding number was 25% in June 2002). The diffusion index on length of the workweek is also improved from 13.8 to 22.6 as 25% of responding firms anticipate the workweek to lengthen by September 2003. It should also be noted that 51 percent of

Figure 3-Diffusion Index for Question 1: Level of Business Activity
Percent Increase Minus Percent Decrease



Special Question #1: Support for the Governor's Budget Proposal for Education Spending

A February 26, 2003 Star Tribune Minnesota Poll question asked Minnesotans about their attitudes regarding Governor Pawlenty's budget proposal for education spending over the 2004-05 biennium. The same question was asked of St. Cloud area business leaders. The results indicate that area business leaders are more supportive of the proposed cuts than was found in the Minnesota Poll. Forty-seven percent of the 53 businesses responding to this special question believe "the governor did the right thing" in his budget proposal. This is sharply higher than the 31% of respondents who gave the similar answer in the Star Tribune poll. Only 19% of respondents to the St. Cloud Area Business Outlook Survey believe the governor "should have found some way to balance the budget without cutting any education funding." By contrast, the Minnesota Poll reported that fifty-six percent of respondents felt the governor should not have proposed to cut education funding. Finally, fifteen percent of responding businesses believe both K-12 and higher education funding spending should be cut. This is somewhat higher than the 10% response that was found in the Star Tribune.

It is clear from the responses to this special question that a disproportionate share of survey participants feel cuts to the higher education budgets of public colleges and universities are warranted. It has been well publicized that the proposed cuts will lead to a mix of higher tuition, program cutbacks, and a reduction of access to public higher education. This comes at a time when the earnings gap between those with four-year college degrees and those who are only high school graduates has almost doubled since the late 1970s. While this growing earnings gap is an argument for education, others contend that individuals should shoulder more of the burden of their college costs since they will be able to recover these costs over their work life. Even so, should program cuts and increased tuition reduce access to higher education, this earnings gap is likely to grow. In addition, a frequently heard complaint during much of the late 1990s was a lack of a highly qualified, skilled workforce—which an investment in higher education helps produce. In written comments, several business leaders remark that it is now time for the education industry to re-invent itself. Certainly many of the productivity gains and efficiency improvements that have been so visible in other sectors have proved elusive in the education sector. Future issues of the St. Cloud Area Quarterly Business Report will further explore business leaders' views on how the education industry should proceed during such tough times.

TABLE 5—Special Question 1—SUPPORT FOR THE GOVERNOR'S BUDGET PROPOSAL FOR EDUCATION SPENDING

The 2/26/03 Star Tribune Minnesota Poll asked Minnesotans about their attitudes regarding Governor Pawlenty's budget proposal for education spending over the 2004-05 biennium. This special question is the same as that which was used in the Star Tribune Minnesota Poll:

Governor Pawlenty proposes reducing state college and university funding, which will cause large increases in tuition. He also proposes keeping kindergarten through 12th grade classroom funding about the same as it has been. When it comes to education funding, which of the following comes closest to your opinion?*

He should have found some way to balance the budget without cutting any education funding	The governor did the right thing	Funding for both higher education and K-12 education should be reduced to help the state's budget problems	Don't Know	Other
18.9	47.2	15.1	9.4	1.9

* reported results are percent of surveyed businesses.

Selected Survey Responses

Business leaders were asked to comment on the governor's budget proposal for education spending. These comments include:

- It's time for all governmental spending, except K-12 education to be reduced. A reduction in college spending should not result in an increase in tuition.
- There is a lot of "waste" that goes undetected. Those who think they cannot cut have no idea of tiny details and are out of touch.
- Higher education at state colleges and universities is still a "good deal." Our students will need to make a little more investment in themselves.
- Education is very important. But all units of government should help with (the) deficit. The government funding method for education is severely flawed.
- None of these cutbacks are easy. We are impacted in our businesses, home lives, etc. Kid's 1-12 need an education today. College can still be optional, albeit desirable. I support education strongly but when there's not enough money to go around, advanced education (may) for now be available to those who pay higher tuition.
- We need to hold education accountable. When I see administrative cuts made...I'll know then education is serious. St. Cloud—2800 administrators, 800 teachers. They want to cut teachers—education thinks. The cash cow—government must end.
- I don't see the link between more funding and better education.
- His campaign pledge was absurd. Do some cutting, raise some taxes, and fund K-12.
- School levy issues continue to fail, open enrollment is a benefit to parents who no longer want to send to District 742 and schools in outlying areas benefit from open enrollment (by) getting more government dollars while District 742 and others suffer from open enrollment and continue to have failed levies and decreasing enrollment.
- Schools need to be accountable. However, it appears cutting funds puts the burden elsewhere instead of purely holding state taxes.
- Education needs to look at cutting expenses before raising fees.
- Everyone is affected by the economy, therefore everyone should "feel the pain." All other sectors are feeling the effects, why shouldn't education??
- Every budget needs to be reviewed. However, some areas to include education should be spared more than others.

Special Question #2: The Extent to Which Your Business Supports the Lifting of the Legislative Ban on New Hospital Construction

A second special question asked area firms to consider the extent to which they supported Abbot Northwestern's recent efforts to have the legislative ban on new hospital construction lifted. At issue is Abbot's desire to construct a 95-bed hospital facility in Sartell. This issue has seen wide publicity in recent weeks and, while it appears to have not received the requisite support by area legislators during this year's legislative session, this is not likely to be an issue that will permanently go away. CentraCare Health System, operators of the St. Cloud Hospital (and the area's largest employer), has raised concerns about their ability to deliver critical health care services to the St. Cloud area should a new hospital facility compromise scale economies that currently exist. For its part, Abbot asserts that they wish to offer a health care alternative in the growing St. Cloud market. The majority of the forty-three businesses who replied to this special question are in favor of lifting the ban on new hospital construction. The typical written response is that competition leads to stronger service and more favorable pricing. But it is not clear that a simple competitive model is the best way to analyze the St. Cloud area health-care industry. Instead, it is quite possible that the level of investment in sophisticated medical instruments and in highly specialized personnel that must be made in order to provide health care services means that only one provider can efficiently serve a market of St. Cloud's size. Draining resources from the existing health care provider may end up leaving Central Minnesota health care consumers with fewer options, particularly in specialized care services. In any event, public discussion will certainly continue as additional study is undertaken to analyze this highly visible local issue. Results of the special question are reported in Table 6 and selected survey responses can be found below the table.

TABLE 6—Special Question 2— THE EXTENT TO WHICH YOUR BUSINESS SUPPORTS THE LIFTING OF THE LEGISLATIVE BAN ON NEW HOSPITAL CONSTRUCTION

Abbot Northwestern is presently seeking legislative support to overturn a statewide ban on hospital building that has been in place for nearly 19 years. If this ban were lifted, Abbot Northwestern has plans to build a 95-bed hospital facility in Sartell. This issue has generated a great deal of public discussion in the St. Cloud area in recent weeks. To what extent does your business support the lifting of the legislative ban on new hospital construction for the purpose of Abbot's desire to build a new hospital in Sartell?*

Strongly opposed to lifting the ban	Mildly opposed to lifting the ban	Neither in favor nor opposed	Mildly in favor of lifting the ban	Strongly in favor of lifting the ban
9.3	18.6	14.0	23.6	32.6

* reported results are percent of surveyed businesses.

Selected Survey Responses

Business leaders were asked to comment on their responses. These responses include:

- I have mixed feelings. I strongly oppose government controlling business growth. Also, competition is usually good—but St. Cloud Hospital has expanded and is meeting the needs of the community.
- St. Cloud Hospital isn't fully utilized. It takes its job of securing health for us seriously. It gets updated equipment, recruits specialists so we don't have to go to the [Twin] Cities. [There is] already a shortage of doctors and nurses. Having another hospital, inadequately staffed, could compromise care at both hospitals.
- More competition promotes better pricing and service.
- Competition is good for business.
- We would be in favor if it would reduce the cost of hospitalization (health care) in this area. With that being said, I don't really believe that the cost will ever come down with the addition of competition in this area.
- In favor if it's lifted across the state. Competition and jobs will be great asset to the area.
- Competition breeds better service and pricing. Monopoly doesn't.
- Non-profit hospital does not need competition since pricing is competitive now. Reduction of traffic to St. Cloud Hospital will result in specialized local care going to Twin Cities.
- Great for the local economy and our business!
- The community is better off when there is healthy competition for services.
- I'm torn between the value of competition in the medical community and the fact that the St. Cloud Hospital is heavily involved in public programs that probably are at no charge to the consumer who is unable to pay.
- Why do we need another hospital in town?
- This would cost St. Cloud area very valuable health services that would be lost as the market cannot support a second hospital at this time!
- I would tend to strongly favor if I could confirm some issues but I am in favor of competition relating to more and better service for the consumer at cheaper prices.
- Competition is always good, it brings out the best in services.
- Competition generally improves services. However, I think the St. Cloud Hospital is an excellent provider and facility. Not sure I understand all the pros and cons well enough to feel strongly either way.
- Most knowledgeable "experts" agree that a second hospital will increase costs to the consumer.
- I would be for the new hospital if it didn't take the profitability away from the St. Cloud Hospital...i.e. take the profitable business and leave the losing business lines [Medicare] to St. Cloud Hospital.
- If Abbot Northwestern can provide enough information to convince legislators of the need then so be it.
- An objective study should be conducted to determine the needs of the community both now and for the future. This study should also attempt to determine the economic impact to the greater St. Cloud community if a second hospital was to be built.
- Need to study before I make comments.

surveyed firms expect to increase employee compensation over the next six months and only one firm expects compensation to decline. Area firms continue to expect little trouble finding qualified workers. The diffusion index on this item is little changed from its December value. It seems that the area economy could begin a recovery by fall were it not for some of the uncertainties mentioned earlier in this report.

The survey item asking firms about their future capital spending plans is less optimistic than was found in last quarter's survey. The value of the diffusion index on this item is 20.8, almost one - third lower than it was in December. Thirty percent of surveyed firms expect to increase capital purchases over the next six months while 9% expect to cut back. Firms also expect to be able to pass on higher prices by September. While the diffusion index on this item fell from its value three months

ago, 30% of area firms still expect to receive higher prices in six months time. Only 8% of responding firms expect lower future prices. Finally, area firms expect an improvement in national business conditions by the fall. Thirty percent of those responding expect national business activity to increase and only 9% expect a deterioration. It will be very interesting to see how the war in Iraq effects this item in the upcoming June 2003 survey.

An historical view of the evolution of the diffusion indexes on current and future business conditions over the past several quarters is presented in Figure 3. This shows a continued decline in the diffusion index on current business activity over the past three months. This index is now at -9.4 (its record high of 67.8 was recorded in June 1999, while its low of -19.3 occurred in December 2000). This period's future business activity diffusion index is little

changed from last period's reported value. This index is well above its all-time low of 19.7 recorded in June 2000, and is only slightly below its value of 61.2 in March of last year. It should be noted that some of this represents a normal seasonal pattern of business activity that has now been observed over the five years that the survey has been conducted.

Participating businesses can look for the next survey at the beginning of June and the accompanying **St. Cloud Area Quarterly Business Report** (including the **St. Cloud Index of Leading Economic Indicators** and the **St. Cloud Area Business Outlook Survey**) in late July. Area businesses who wish to participate in the quarterly survey can call the SCSU Center for Economic Education at 320-255-2157. All survey participants will receive a free copy of the **St. Cloud Area Quarterly Business Report** on a preferred