Hubert H. Humphrey Institute of Public Affairs

UNIVERSITY OF MINNESOTA

2004 Elections Project
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CENTER *for the* STUDY *of* POLITICS

POLICY BRIEF ■ THE ECONOMY

FEBRUARY 2004

ECONOMIC CHALLENGES FACING THE UPPER MIDWEST

Recent reports indicate that the national economy is rebounding, with robust growth in gross domestic product (GDP) and productivity and an energized stock market. GDP grew at 8.2% for the third quarter of 2003 and 4% in the fourth quarter. Even as the country's economy has shown significant improvements overall, the five states in the Upper Midwest (Minnesota, Wisconsin, Iowa, and South and North Dakota) face significant and, in certain respects, unique challenges on several fronts, including job creation and the lack of fiscal stimulus from defense spending. Significant budget constraints have prevented state and local governments from offering much help. These economic and fiscal challenges in the Upper Midwest have contributed to widening economic discrepancies between rural and urban areas.

The jobless recovery

Until the recent recession, the region's job growth closely paralleled the nation's. Between 1992 and 1998, Minnesota and South Dakota outpaced the nation in adding new jobs, while the other states mirrored national job hikes (Table 1). Thereafter, Minnesota and South Dakota quickened their lead modestly while Iowa, Wisconsin, and North Dakota fell behind.

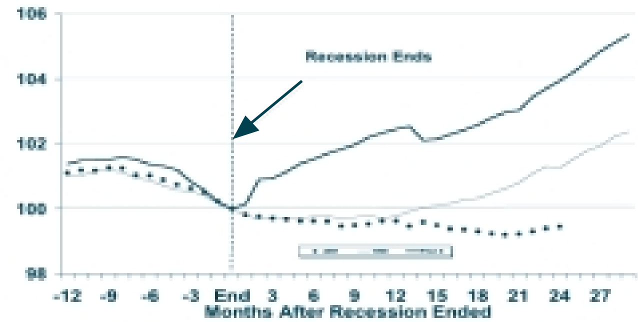
Table 1. Wage and Salary Employment Growth, 1992–2001

	1992=100	1998	2001
Minnesota	100	116	122
Wisconsin	100	114	117
South Dakota	100	116	112
Iowa	100	114	116
North Dakota	100	114	117
United States	100	114	119

Source: Bureau of Economic Analysis, Regional Economic Information System (CA25 Series).

But the big story in the Upper Midwest is the failure of even its most dynamic state—Minnesota—to recover from the recent recession at a rate comparable to that in past cycles. The "jobless recovery" was evident nationally, and Minnesota has lagged slightly behind even this slow rate (Figure 1). In October 2003, the state's total employment was nearly 2% below that of February 2001, while, nationally, the loss was closer to 1.7% (Figure 2). Had Minnesota's employment rebounded at the rate after past recessions, it would have posted job growth of 2%, if compared with the 1990 recession, or 5%, if compared with five previous recessions.

Figure 1. National Payroll Employment Recovery Compared with Past Recessions



Source: Thomas Stinson, Minnesota State Economist, presentation on December 17, 2003.

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Ann Markusen's current research focuses on occupational approaches to regional development and on the arts, high-tech, and defense activities as regional economic stimulants. Before joining the Humphrey Institute, Markusen was State of New Jersey Professor of Urban Planning and Policy Development at Rutgers University. She has held faculty positions at Northwestern University, the University of California at Berkeley, and the University of Colorado. Markusen has been an economic policy fellow with the Brookings Institution and a research economist with the Michigan Speaker of the House's office.

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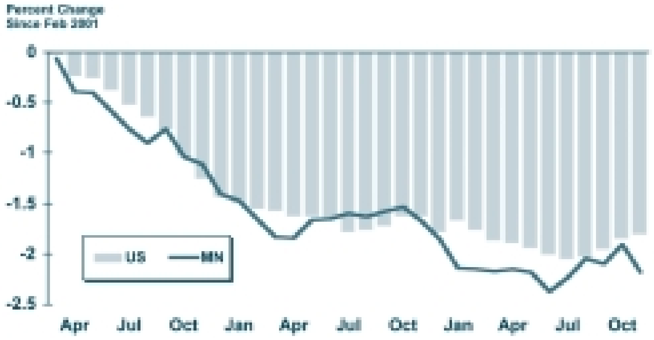
Figure 2. Minnesota versus National Employment Change since February 2001

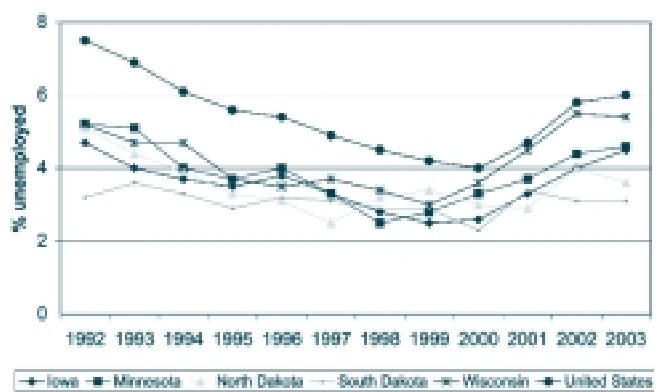


Source: Thomas Stinson, Minnesota State Economist, presentation on December 17, 2003.

The failure to regenerate jobs is the result of significant changes in the dynamics of the region's economy. After hunkering down during the recent recession, fewer firms and agencies than ever chose to re-open or re-hire after the recession ended. Several factors are at work. Significant cuts in state and local spending—the product of state tax cuts followed by large deficits—have pounded local government jobs and to, a lesser extent, jobs in education. Part of the added income from tax cuts may have dissipated into purchase of imported goods and services rather than fueling business investment or job creation in the region. Growing import competition is eroding manufacturing. Given the states' low share of federal military spending, their economies are benefiting only marginally from this largest new stimulus in the economy. Finally, a rapid increase in Latino workers may be associated with a shift of low-paying jobs into the informal, uncounted portion of the economy, especially in the Twin Cities.

The failure of the region's economy to rebound has closed the gap between its historically low unemployment rate and the nation's (Figure 3). In 1992, the unemployment rates in Upper Midwestern states were at least two percentage points below the nation's jobless rate of more than 7%. Today, the Midwest has lost its edge. Since the late 1990s, Wisconsin's jobless rate has converged with that of the country as a whole, while those of the other Midwestern states have narrowed. Wisconsin remains by far the most manufacturing-intensive of the five states, and heavy industrial job loss could be driving this convergence.

Figure 3. Unemployment Rate, 1992–2002



Source: Bureau of Labor Statistics, Local Unemployment Statistics.

The farm economy, where livelihoods are generated principally through proprietary income, has been reeling from the recession as well. Following a huge shakeout in the early- to mid-1980s during which many family farms failed, farm income growth for those remaining in that sector of the economy began to slow in the late 1980s and turned negative in the 1990s in all states but Iowa (Table 2). Since 1994, farm income has plummeted throughout the five-state region.

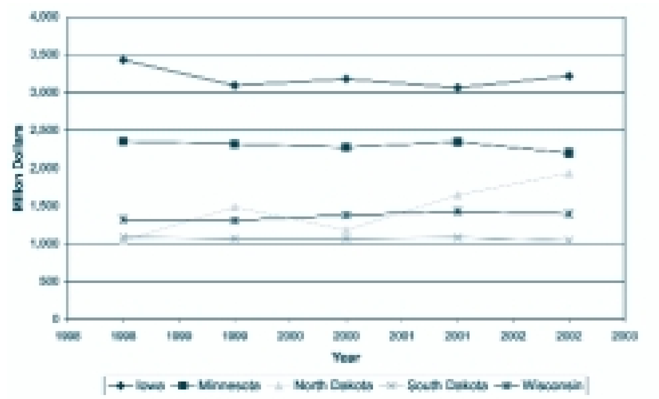
Table 2. Farm Income, 1980–2002 (current dollars)

	1980–85	1986–90	1991–95	1996–02
Iowa	73%	13%	20%	-143%
Minnesota	28%	18%	-53%	-338%
North Dakota	134%	16%	-6%	-112%
South Dakota	60%	38%	-23%	-194%
Wisconsin	-59%	-1%	-4%	-100%

Source: United States Department of Agriculture, Economic Research Service. For information, contact Roger Strickland at rogers@ers.usda.gov.

As farm income losses have ballooned since 1996, the value of agricultural exports has remained relatively constant, except in North Dakota where exports have risen substantially without generating additional income (Figure 2). These losses have occurred despite the vigorous pursuit of free trade by the Clinton and Bush administrations, which was presented as a boost to the relatively competitive American farm economy. The Upper Midwest states do not appear to have shared in agricultural gains to trade.

Figure 4. Total Farm Exports by State (current dollars)



Source: United States Department of Agriculture, Economic Research Service, Total Agricultural Exports by State.

Table 3. Index of Military Prime Contract Awards per Capita to U.S. Norm

State	1970	1980	1990	2002
District of Columbia	275	298	496	770
Virginia	124	196	228	452
Connecticut	297	424	321	296
Alaska	197	213	189	257
Arizona	113	102	164	223
Maryland	121	146	177	217
Hawaii	98	136	111	209
Missouri	133	239	250	184
Massachusetts	154	214	273	139
Georgia	124	56	59	123
California	195	193	161	123
United States	**100**	**100**	**100**	**100**
North Dakota	100	39	37	59
Minnesota	100	83	82	55
South Dakota	9	15	22	46
Wisconsin	52	31	42	36
Iowa	45	32	33	34

Source: Jennifer Ebert, Pingkang Yu, and Ann Markusen, Project on Regional and Industrial Economics, Humphrey Institute of Public Affairs, University of Minnesota, from data from "Military Prime Awards by Region and State," U.S. Department of Defense. Calculations based on constant 2004 dollars.

Missing out on the military stimulus

The impact of federal tax cuts have not yet generated jobs nationally or in the Upper Midwest at the rate anticipated and new deficit-financed federal spending on the military, which is helping in some parts of the country, is not a positive factor in this region. Since 1998, Presidents Clinton and Bush and the Congress have reversed a decade-long downsizing of the military. The acceleration in security spending after the 9/11 terrorist attacks has not stimulated the economy in the Upper Midwest because the region has low levels of military production and fewer military bases than other parts of the country.

After the Cold War, military spending fell 36% from $462 billion in 1985—near the Reagan-era peak—to $295 billion in 1998 in real terms (2003 dollars). The Upper Midwest economy was better insulated from military cuts than the New England, West Coast, and Intermountain West regions, the post-World War II "gunbelt."

When military spending rose 29% to $389 billion in 2003 (with an additional rise to $410 billion expected by 2007), the Upper Midwest missed out on much of the associated stimulus. Each of the five Upper Midwest states receive less than 60% of the national average per capita prime contracts (Table 3). These differentials are quite large. In 2002, Minnesota businesses won military prime contracts awards of just over $300 per capita, while Virginia firms won eight-fold more (nearly $2,500 per capita).

State and local governments can't offer much help

The national government has not offered much help to the Upper Midwest through increased defense spending, and state and local governments have not been able to do much either. Extraordinarily constrained budgets have tied the hands of states for the past two years.

Because important state revenues are tied to federal tax structure and the Bush administration's tax cuts most benefited those in the highest income brackets, the tax reductions hit states like Minnesota—which had a progressive income tax structure— particularly hard. In addition, governors and state legislatures in some states, most notably Minnesota, had chosen to return the surpluses of the late 1990s to citizens in the form of tax cuts they were not willing to reverse. When the recession hit, these states were poorly positioned to absorb the large revenue losses in sales and income tax receipts. These losses were made worse with sharp declines in the stock market and the whittling down of the inheritance tax and other federal taxes. Worst hit in the region was Wisconsin, where revenues lagged expenditures by 2.6% during the 2003 fiscal year.

Federal government initiatives not only helped to drain revenues from state government coffers, but they also added new burdens on states that fell especially hard on the Upper Midwest. Over the years, the burden for Medicaid, poverty programs, education, childcare, and job training has shifted increasingly to the states. The Medicaid burden is particularly onerous, resulting in a proposal by a coalition of states for a one-time $110 billion aid infusion; in the fiscal year 2004 budget, they got just $20 billion spread over two years. This is a particular problem in the Upper Midwest because of the disproportionately high share of people over 65 in four of its five states (Minnesota being the exception).

How did the states respond? Nationally, states cut between $20 and $40 billion dollars in spending over the past two years, contributing negatively to the economy's growth rate. Upper Midwest states cut spending in step with the nation. In 2003, Minnesota slashed most state agency budgets by 15%. South Dakota and Iowa were able to rely on rainy day funds, at least in 2003. Minnesota and Wisconsin also froze hiring and laid off workers or imposed furloughs. Some states chose to protect certain expenditure categories: Minnesota and North Dakota exempted K–12 education from across-the-board cuts, while Wisconsin protected most health and public safety programs. Minnesota, Wisconsin, and Iowa also increased public college tuitions by double-digit amounts—sometimes as high as 18.5%—in both 2002–03 and 2003–04. These state government cuts were complemented by sometimes even deeper cuts by local governments. Continued battles over spending and taxation can be expected throughout the election year.

The growing economic divide

The gap in the per capita income (PCI) between Upper Midwestern metropolitan areas and their non-metropolitan neighbors has widened over the past decade (Table 4).

Table 4. Growing Intra-regional Gaps in per Capita Personal Income, 1992–2001

	PCI as % US PCI			Metro/ Non-Metro	
	1992	1998	2001	1992	2001
Iowa	90	91	90	117	122
Cedar Rapids	102	108	107		
Des Moines	108	110	108		
Iowa City	96	100	103		
Iowa Non-metro	84	84	81		
Minnesota	103	108	109	141	148
Duluth-Superior	86	89	88		
Minneapolis-St. Paul	118	124	125		
Rochester	116	112	115		
St. Cloud	81	84	82		
Minnesota Non-metro	80	83	81		
North Dakota	84	84	85	113	119
Bismarck	88	87	90		
Fargo-Moorhead	89	93	93		
Grand Forks	83	84	83		
North Dakota Non-metro	80	79	78		
South Dakota	85	87	87	124	125
Rapid City	92	89	89		
Sioux Falls	102	106	106		
South Dakota Non-metro	79	81	80		
Wisconsin	94	97	96	128	132
Green Bay	98	102	100		
Janesville-Beloit	92	91	85		
Madison	112	116	119		
Milwaukee-Waukesha	108	112	111		
Wausau	88	92	93		
Wisconsin Non-metro	79	81	79		

Source: Bureau of Economic Analysis, Regional Economic Information System.

Growth in income, especially in better-paying "high road" jobs, has been concentrated in a few metropolitan areas. Table 4 shows that Minnesota's pre-eminence is tied entirely to the Twin Cities region (125%) and its "medical alley," Rochester (115%). Madison, home of Wisconsin's state's capitol and flagship public university campus, is the only other metro area in this range (119%). The economic vitality of the these three metros has pulled talent from smaller communities and other states; the weaker economic performance of Iowa and the Dakotas has contributed to more than one in five single, college-educated residents aged 25 to 39 years old leaving these states in 2000. A few other metros in the region have managed to increase their per capita incomes—Milwaukee, Sioux Falls, Cedar Rapids, and Iowa City.

Most troubling is the growing per capita income gap between metro and non-metropolitan areas of all five states. Table 4 reveals that this gap has widened over the past decade in all five states in the Upper Midwest. In Minnesota, metro per capita income is almost 50% higher than in non-metro areas; South Dakota has the smallest gap, with metro per capita income 20% higher. Differences in the costs of living narrow the gaps a bit but still leave substantial discrepancies. Job gains that some rural areas had achieved in the 1990s have evaporated in the recent downturn, and rural farm communities have been hit harder than non-farm rural areas.

The recession and ineffectiveness of the recovery in generating significant new jobs have hurt not only rural areas but also lower-paid workers. When unemployment was relatively low during the 1990s, workers who were less well-educated and were not highly skilled saw their wages rise. These gains are now fading. Compensation for workers with less education is stagnating or even declining, especially as the costs of health care coverage are shifted from employers to employees. The erosion of the real value of the minimum wage, which has not increased in the region since the federal increase to $5.15 in 1997, has prompted campaigns to raise it to between $6.50 and $7.00 in Wisconsin and Minnesota, following the successful hike to $6.50 in Illinois in the summer of 2003. In addition, an increasingly hostile federal environment toward unionization blunts this route to higher pay and benefits. Low-income parents facing a double onslaught of decreased government assistance and stagnant wages are finding it increasingly difficult to meet a basic needs budget.

Economic recovery in the Upper Midwest

National economic recovery has not boosted job growth and income in the Upper Midwest as it has in the past. Many of the economic development and employment security tools that worked well in the 1990s—job training, displaced workers' programs, manufacturing extension services, and safety net programs—have been defunded at both national and state levels. Voters in the Upper Midwest, whether rural or urban, will be paying close attention in the coming months to candidates' track records and proposals for jobs and wages.

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• 2004 Elections Project •

The 2004 Elections Project at the Humphrey Institute's Center for the Study of Politics provides relevant, non-partisan information about the 2004 elections on such topics as voter attitudes and characteristics, campaign spending, and the impact of third parties. The project focuses on policy issues of importance in the Upper Midwestern states of Minnesota, Iowa, Wisconsin, and South Dakota, which have emerged as critical swing states in the 2004 national election.

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