

Challenges and Opportunities: Indiana's future

MANUFACTURING AND THE 2001 RECESSION

The 2001 recession exposed the disadvantages of dependence on the manufacturing sector of the economy to Indiana and its neighbors in the Midwest. Following a sharp downturn in corporate investment spending following the boom years of the late 1990s, manufacturing cutbacks began in earnest in the second half of 2000, and together with the collapse of the dot-com bubble sent the US economy into recession in 2001. Significant job losses hit the nation in the 2nd quarter of 2001, but by then manufacturing was declining for the fourth consecutive quarter. And those losses were accelerating, from an annual rate of -2% in the fourth quarter of 2000 to -4% in the first quarter of 2001, to -6% in the second quarter, ultimately peaking at -8% in the fourth quarter. These losses, moreover, have continued through the first half of 2003, at an annual rate in excess of 3%.

Indiana, consequently, began losing jobs in the third quarter of 2000, and hence entered the recession at least six months ahead of the US. The severity of the fall in manufacturing also accentuated the overall job loss in Indiana. In 2001, while US payrolls fell by 0.14%, Indiana payrolls shrunk by 2.22%. And, given the continued slump in manufacturing, the state continued to suffer more than the nation. In 2002, job levels in Indiana declined by 1.47%, well above the US rate of 0.96%. Manufacturing losses accounted for 73% of the 2001 decline, and 63% of those in 2002. The rate of decline in the manufacturing sector was very similar for Indiana and the US, but it was the state's far greater dependence on these jobs that deepened its recession.

It is hard to overstate the degree to which manufacturing dominates the Indiana economy. The share of all state economic activity which manufacturing represents is well ahead of that in all other states. Indiana manufacturing accounts for 20.2% of all state jobs—down from 22.2% at the start of the recession—and 27.2% of Gross State Product. The next most manufacturing-dependent state is Michigan, where the job share is 16.6% and the GSP share is 23.1%. The US average dependence is 12.8% for jobs and 14.0% for GSP. Indiana almost doubles these shares.

As the US economy has become increasingly more oriented to the service sector, manufacturing has been in long-term decline. Manufacturing's share of US employment has declined from over 30% in 1966, to under 20% by 1985, to less than 13% today. Global Insight projects that this share will dip under 11% over the next ten years. The Indiana economy is 20 years behind this trend, with a manufacturing share of the economy similar to the US in the early 1980s.

THE MANUFACTURING RECESSION AND INDIANA METRO AREAS

Amongst the 318 largest US metro areas the median share of manufacturing in total metro employment was 11.9% in 2002. Not surprisingly, all of Indiana's metros have a manufacturing intensity greater than the median. Elkhart ranks number one among all US metros, with a manufacturing job share of 46.1%. Kokomo, at 30.4%, and Lafayette, with 29.2%, are also ranked in the top five. (Hickory NC, and Sheboygan WI, are the other two). Table 5 below details this dependence and the performance of manufacturing in the metros since the 2000 recession.

TABLE 5: MANUFACTURING IN INDIANA METROS

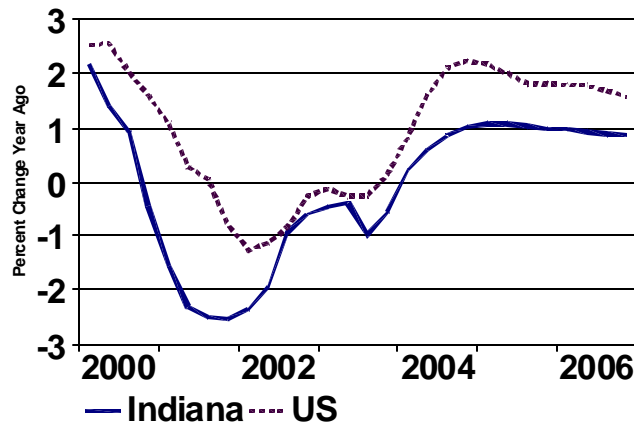
	RANK OF 319 US MSAs	SHARE OF TOTAL EMPLOYMENT	MFG LOSSES SINCE 2000
Elkhart	1	46.1%	4,500
Kokomo	4	30.4%	3,500
Lafayette	5	29.2%	3,200
Fort Wayne	23	22.5%	15,100
Evansville	48	19.5%	3,800
Muncie	57	18.0%	1,700
Bloomington	76	16.9%	1,800
Terre Haute	88	16.0%	2,000
Gary	98	15.2%	9,700
South Bend	106	14.4%	3,100
Indianapolis	155	12.2%	12,100

Indianapolis is the metro most representative of the US. Indeed, in the Global Insight measure of structural diversity of metro areas in the US, it ranks number two, behind Portland, OR. Kokomo and Elkhart both rank in the bottom ten by that measure.

FUTURE PROSPECTS

Not only are Indiana metros heavily dependent upon manufacturing, they are also heavily dependent upon durable goods manufacturing, its most cyclical component. This is primarily due to the transportation equipment industry, as myriad Indiana facilities provide parts and supplies for automobiles and truck assembly (The exception is Gary, where the steel industry accounts for the bulk of jobs and job losses). This sector has lost 16,900 jobs across the state since 2000, despite very robust vehicle sales throughout the recession. The combination of a reduction in North American vehicle production from recent high levels and a movement of market share to new plants constructed in the South Central part of the country, primarily by the Japanese manufacturers, will further erode these payrolls, as will emergent competition from overseas suppliers, particularly in China. Global Insight projects that transportation equipment manufacturing job levels in Indiana will stagnate through the rest of the decade, never recovering the recent recession losses. On the other hand, non-durable sectors such as pharmaceuticals and medical products will grow strongly over the next decade. Indianapolis is well-positioned to benefit from this trend, owing to the leadership and presence of Eli Lilly and Roche Diagnostics, as are, to a lesser extent, Terre Haute and Lafayette. Table 6 illustrates the results of these trends as it contrasts the Global Insight forecasts for the state and the nation. Indiana will experience a muted 2004 recovery relative to the US, and its longer-term growth rate will be less than 60% of US growth. By 2006 gross state product would be 3.7% higher if Indiana were able to grow at the US rate. The cumulative impact of this difference represents \$22 billion in lost output for the state through 2006.

TABLE 6 INDIANA JOB GROWTH WILL TRAIL THE NATION



DEVELOPMENT INITIATIVES

A comprehensive state tax plan in 2002 cut business taxes, thereby reducing business property taxes, the corporate gross income tax, and an inventory tax. The research and development tax credit was doubled to 10%, and the apportionment formula was reformed.

The Governor's Energize Indiana initiative is targeting the industry clusters of information technology, 21st century logistics, advanced manufacturing, and the life sciences. A 30% investment tax credit was added, as was a venture capital tax credit. It includes certified technology park legislation, which requires an area to show significant support from a local college. Important university linkages can be developed in Fort Wayne with IUPUI Fort Wayne, and in West Lafayette with Purdue, particularly in biosciences.

PRESCRIPTION FOR THE FUTURE

Interest in metropolitan areas as growth engines was heightened during the 1990s boom. It became clear that it was metro area agglomerations of activity that provided the largest boost to the state and national economies. Silicon Valley, or San Jose CA, most exemplified this dynamism. We have found the following factors to be crucial determinants of metro area growth. These factors characterize the high-growth metros of the past decade:

- - Highly skilled labor, and knowledge and creative workers
- - High quality of life
- - Access to and utilization of emerging, productive technologies
- - Availability of capital, especially venture capital
- - Efficient, competitively-priced infrastructure
- - Supportive regulatory environment, and moderate tax burdens
- - Location advantages, proximity to suppliers or markets
- - Public-private partnerships, especially with universities.

Growth in the post World War II US economy has been strikingly defined by movement from the Northeast and Midwest to the Sun Belt. The dual dynamic of jobs following people and people following jobs has resulted in the relative declines in older industrial regions such as Indiana. The most current indicator of such flows and relative performance is data on the internal migration of people among the US counties. The state of Indiana lost 15,657 residents to other states from 2000 to 2002. The only metro with an inflow was Indianapolis, and it garnered over half of the state's 28,172 immigrants during that period.

Retention rates for college graduates in Indiana are notoriously low. Lack of sufficient high-tech job opportunities for professional and technically qualified graduates have been the leading factor. While Indiana has over the years successfully lured first-rate manufacturing plants with high paying jobs, it has lagged behind other states in attracting highly paid managerial, professional, and high-tech jobs.

Moreover, it has become clear that young, highly educated workers in the high tech and financial sectors prefer metropolitan areas that can provide quality of life amenities. From the Lake Michigan waterfront to the downtowns of its older cities, Indiana needs to provide an attractive vibrant image to reverse the brain drain of college graduates.

Gary's proximity to Chicago, the third largest metro in the nation, represents significant investment opportunity for the state. The future redevelopment of the Lake Michigan waterfront and the deployment of its airport as a vital part of a Chicago-Gary air transportation hub could yield significant growth for the region. The Buffington Harbor mixed use entertainment, residential, and commercial development project is a prime example of the former. And Boeing's recent relocation of its corporate fleet at the Gary airport is an example of the latter. Its strategic location extends to the rail and trucking networks as well. The airport is poised to become a significant inter-modal transportation facility for cargo and passengers.

The Energize Indiana initiative is correct to focus on the industries for which the Indiana metros have a comparative advantage. The automobile industry is one of the leading users and developers of advanced high technology manufacturing processes and components. Indiana possesses both the demand for, and the availability of, skilled labor to leverage. Life sciences such as biotechnology are at the center of many state development agendas. Indiana has both the corporate and university research presence to compete in these fields. But it must develop some of the entrepreneurial risk-taking culture that attracts and exploits big ideas. A venture capital presence is also sorely missing. The emphasis on logistics is well placed, as Indiana is in a geographically ideal position for US distribution, one that is becoming more prominent as population trends move the resident center of the country further west.

A legacy of the manufacturing economy and a significant part of the business development problems in the Rust Belt are the presence of brownfields. These abandoned facilities litter the landscape of Indiana's old manufacturing cities, contributing to a depressed image and standing in stark contrast to the inviting greenfield locations in the South and West. It is vitally important for Indiana to join with the business community in cleaning and re-using these areas. Notable advances in redevelopment have occurred recently at the Studebaker plant in South Bend and by TJX in Indianapolis. Strong efforts are also being made at the Bayer Diagnostics facility in Elkhart, and with Buffington Harbor in Gary.

Two types of infrastructure are vital to Indiana's future growth potential. One, the old economy standard, is maintenance of its highway and freight networks, including its ports. The intrastate highway system crisscrosses Indiana, opening its metro areas to supplier and

market corridors in all directions. In addition, a new extension for I-69 is planned, to extend it past Indianapolis to Bloomington and south to I-64, dramatically improving access to Evansville in the southwest corner of the state. Second, though, are the information technology networks required for high speed access to networks around the world.

In short, the State should develop a specific growth strategy for each metro area, the engines of the state economy. Without such a strategy Indiana risks future economic decline due to its excessive dependence on an industry, manufacturing, that will see its impact on the US economy continue to decline. This metro strategy should aim for the development of a 21st century economy based on the unique assets of diverse metros that attract workers and companies with a vibrant, high quality of life. The state's strategy should acknowledge that its economy is first and foremost reliant on the economic performance of these metros, and that these metros need to embrace additional diverse sectors such as technology, services, entertainment, and education. Indiana's metro economies must be prepared to compete in a global marketplace in order to ensure its future prosperity.