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The Puzzling Differences Between Michigan and Indiana in This Recession

By Michael Hicks and Kevin Kuhlman

Summary

Indiana has fared much better than Michigan during the economic downturn of the last few years. A new study looks at why.

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(Editor's note: This is an edited version of a commentary that appeared in Michigan Capitol Confidential on Nov. 15, 2011.)

Two of the nation's leading manufacturing states, Indiana and Michigan, have and still continue to feel the pain of this recession. Yet Michigan, which is less dependent on manufacturing, has had a much deeper and longer downturn than Indiana. This is a great puzzle. We have recently authored a study that attempts to frame the issues more clearly, "The Puzzle of Indiana's Economy Through the Great Recession," for the Sagamore Institute.

In the wake of this recession, the livelihoods and dreams of many in the Midwest have been impacted by high levels of joblessness and persistent unemployment. Unemployment peaked in Indiana at 10.8 percent, but rose to 14.9 percent in Michigan. Any economic model would predict either state would have had unemployment rates in the 13 to 15 percent range. Our study tries to explain this difference in outcomes between the two states.

Indiana Gov. Mitch Daniels delivered the keynote address at "An Evening with the Mackinac Center" on Nov. 14, 2011, in Lansing. You can watch a replay of the event and hear his advice on what Michigan needs to better at www.mackinac.org/16031.

First, it is pretty clear that the unemployment rate differences cannot be wholly explained by the structure of manufacturing. Indiana is more manufacturing intensive than Michigan, and the sharp drops in auto sales such as those seen in 2008 and 2009 are not correlated with increased volatility in Michigan's unemployment rate. Of course, the auto industry matters. Indiana saw just one Big Three plant closing during the recession, while Michigan lost seven GM plants over the same time period. Indiana is also home to Honda, Toyota and Subaru plants. In 2010, Indiana was site of a large announced investment by GM. Granted, the life cycle of a particular plant will impact closing and opening dates, so plant closings can be affected by such things as a discontinued product line or aging equipment. In the end, plant closings are heavily influenced by underlying economic factors, both local and national.

Unsurprisingly for anyone who has lived through the past five years in Indiana or Michigan, tax policy plays a role. At the beginning of the recession, Indiana was debating property tax reform. The legislation passed before the deepest economic declines, beginning a three-year tax cut in the state.

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The same time frame saw Michigan pass a new business tax and then slap on a surcharge before the new Michigan business tax had a chance to become law. This action did not improve Michigan's reputation for poor fiscal management.

At the same time, the foreclosure rate in Michigan was about five times that of Indiana. Average weekly wages in Indiana rose by $3.51 from 2007 to 2009, but dropped by $22.93 in Michigan.

The American Recovery and Reinvestment Act apparently didn't help. While Michigan received a significantly higher share of the so-called stimulus money, it took some $559,457 to create a job in Michigan, compared to $489,274 in Indiana (according to White House estimates). These estimates suggest a frighteningly ineffective stimulus, but if it required some $70,000 extra to create a job in Michigan than Indiana when the unemployment rate in Michigan was almost 40 percent higher, deeper problems plague Michigan.

Most worrisome is our finding on debt between the two states. Indiana's bond debt is about one-third that of Michigan on a per capita basis. Michigan also has a significantly higher public-sector unfunded pension liability than Indiana. This raises the specter of much higher future taxes and is a big signal to business that without better political leadership in Michigan, taxes will necessarily rise.

Such a policy decision would not help matters. According to the Tax Foundation, Indiana ranked 21st in the nation in 2011 on the Index for Corporate Taxes, while Michigan was 48th. Indiana also ranked 10th nationally for favorable business climate, while Michigan was 17th.

Moving forward, Michigan should continue to decrease the burden public-sector wages and benefits place on taxpayers, pass right-to-work legislation and reform the state's regulatory regime.

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