Economic upheaval in the Midwest

George Cloos and Philip Cummins

The Midwestern heartland, with the Seventh Federal Reserve District at its center, has entered its sixth year of adversity. Economic recovery in this region in 1983 was concentrated in the motor vehicle industry and certain smaller sectors such as household appliances. The gap in the region's economic performance relative to the rest of the nation, a gap that began to open in 1979, widened further in 1983.

Signs point to a broader improvement in the Midwest in 1984. Further gains are expected in motor vehicles and there are glimmerings of revival in the region's badly depressed capital goods industries. Suppliers to the farm sector are almost certain to rebound from their worst slump since the 1930s.

In general, confidence is firming. However, the best-case scenario for 1984 will still leave the Midwest economy far below its high-water mark of the late 1970s. The restructuring of what has been labeled the "Rust Belt," with its ailing "smokestack" industries, will require years of painful adjustment.

This article examines the causes of the current plight of the Midwest, and considers the policies, public and private, that could point the way to a return to economic health.

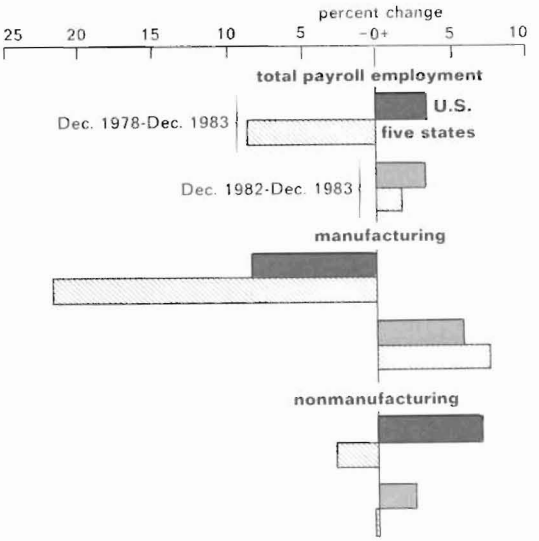
Hard times—1979-84

Prior to 1979, economic conditions in the Midwest were basically sound and prosperous. Business recessions since World War II hit the region with varying intensity, but output and employment always recovered lost ground and reached new highs in subsequent expansions. Business and consumer confidence remained unshaken in the expectation that good times would return.

Although trouble had been brewing for years, the present problems of the Midwest were touched off by the huge increases in petroleum prices associated with the Iranian oil embargo, and the soaring interest rates of 1979, that sent the booming motor vehicle industry into a sharp decline. The region's important machinery and equipment industries were badly mauled in the 1981-82 recession. Steel output dropped below 50 percent of capacity. Setbacks to industry were reinforced by a three-year recession in the Cornbelt, the nation's largest area of productive farmland, which covers major portions of Indiana, Illinois, and Iowa.

In December 1983, nonfarm payroll employment nationally was 3.5 percent above the year-earlier level, while the increase was 2 percent for the five-state area. However, compared to December 1978, U.S. employment was up 3 percent while the five-state area was *down* 8 percent. Manufacturing employment in December was 6 percent above last year nationally, and up 8 percent in the five-state area, which was helped by a 13 percent rise in Michigan. Compared to December 1978, manufacturing employment was

District employment remains well below prosperous levels



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Defining the Midwest

There is no official definition of "the Midwest," a flexible term often applied to the entire area north of the Ohio River from the Appalachians to the Rockies. It may be equated with the U.S. Census Bureau's North Central Region, divided by the Mississippi River into two sub-regions—the East North Central (five states) and the West North Central (seven states). The Seventh Federal Reserve District, served by the Federal Reserve Bank of Chicago, encompasses a large portion of this region—all of Iowa and most of Illinois, Indiana, Michigan, and Wisconsin. This article concentrates on that five-state area, which has experienced economic trauma that began in the late 1970s and continues in the 1980s. Similar problems have afflicted Ohio and Pennsylvania to the east and the Plains states to the west.

still down 8 percent nationally and down 22 percent in the five-state area. Manufacturing employment was 23 percent less than in 1978 for Illinois, Indiana, and Michigan, despite the motor state's recovery in the previous 12 months.

Five years of weak job markets in the goods producing industries of the Midwest have reverberated in other sectors—services and construction. State and local governments, which continued to add staff even in recession years prior to the 1970s, have been forced by financial stringencies to freeze hirings or reduce staff. The cumulative effect of hard times has taken a toll of public confidence, causing investment decisions of businesses and individuals to be postponed or cancelled, thereby intensifying the problems. Population growth has slowed and many once-prosperous communities have reported net outmigration.

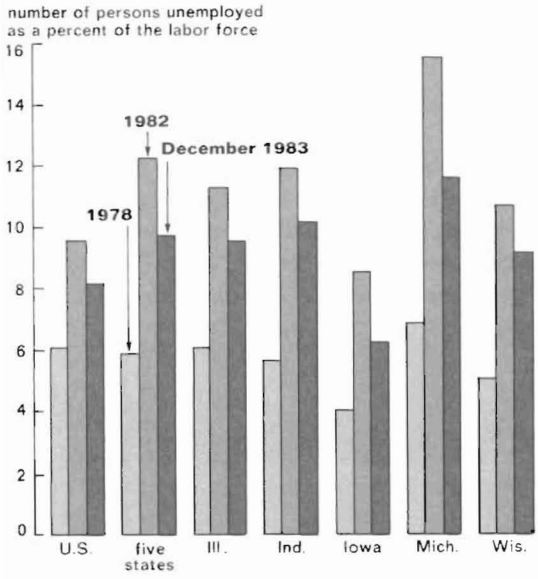
Results: Higher unemployment in the Midwest...

In much of the 1960s and 1970s unemployment was less of a problem in the industrial states of the Midwest than in the nation generally. In 1969, for example, at the end of a nine-year upswing in general activity, there were significant labor shortages in some of the region's major industrial centers.

In 1978, the jobless rate averaged 6.1 percent nationally. In the five-state area the rate averaged 5.9 percent, ranging from 4 percent in Iowa to 6.9 percent in Michigan. In 1982, the worst year for unemployment since 1940, the rate for the U.S. averaged 9.7 percent. But in the five-state area it was 12.2 percent, with Michigan at 15.5 percent.

During 1983, job markets improved steadily. By December, the national jobless rate was down to 8.2 percent. The five-state average was 9.8 percent, with Michigan at 11.6 percent. In contrast to the national situation, most of the decline in unemployment in the Midwest in 1983 resulted from net withdrawals from the labor force rather than increased employment. Jobs in the region remained relatively scarce. Knowledge that a company was adding workers often produced mob scenes with eager applicants far exceeding the number of openings.

Despite sharp decline in unemployment in 1983, District rates remain high



...and a halt in population growth

The five-state area's population has been growing less rapidly than in the nation for several decades. Until recently, however, the difference was modest. In 1930, the area had 17.1 percent of the nation's population. By 1970, this ratio had dropped to 16 percent. In the 1970s the drop accelerated. By 1980 the five states had only 14.9 percent of the nation's population, and by 1982 14.6 percent.

From 1960 to 1970, the U.S. population rose 13.4 percent while population in the five states rose 10.8 percent. In 1970-80, growth was 11.4 percent for the U.S., and 4.2 percent for the five states. From 1980 to 1982 U.S. population rose 2.2 percent, while the five-state area *declined* by 0.3 percent. Indiana, Iowa, and Michigan lost population in 1980-82. The reduction or reversal of population growth reflects, in large part, migration of job seekers to the South and West.

Until 1960, the number of people taking residence in the five-state area from outside exceeded the number that departed. Only Iowa had reported net outmigration, because of the decline of the farm population. Net outmigration from the five-state area reached 200,000 in the 1960s, and 840,000 in the 1970s, when only Wisconsin reported a small plus.

The latest available data for the 1980-82 period shows net outmigration from the five-state area of 650,000, more than 70 percent of the number in the previous *decade*. Michigan, which attracted many newcomers in the 1940s and 1950s, led the other states in outmigration in 1980-82, losing more than 300,000 persons. The bulk of those leaving headed for Texas, Florida, and California—areas of rapid growth.

Population loss is associated with reduced job opportunities in virtually all fields. Fewer people means less need for all consumer goods and services, including housing. Fewer workers are required to supply these needs when popula-

Decline in Midwest's share of U.S. population accelerated in 1970s

	United States	Five States	Illinois	Indiana	Iowa	Michigan	Wisconsin
				(percent of United States)			
1960	100.0	16.3	5.6	2.6	1.5	4.4	2.2
1970	100.0	16.0	5.5	2.6	1.4	4.4	2.2
1980	100.0	14.9	5.0	2.4	1.3	4.1	2.1
1982	100.0	14.6	4.9	2.4	1.3	3.9	2.1
				(percent change)			
1960 to 1970	+13.4	+10.8	+10.2	+11.4	+2.5	+13.5	+11.8
1970 to 1980	+11.4	+ 4.2	+ 2.8	+ 5.7	+3.1	+ 4.3	+ 6.5
1980 to 1982	+ 2.2	- 0.3	+ 0.2	- 0.4	-0.3	- 1.7	+ 1.3
				(millions)			
1982	231.5	33.7	11.4	5.5	2.9	9.1	4.8

tion declines or grows at a slower pace.

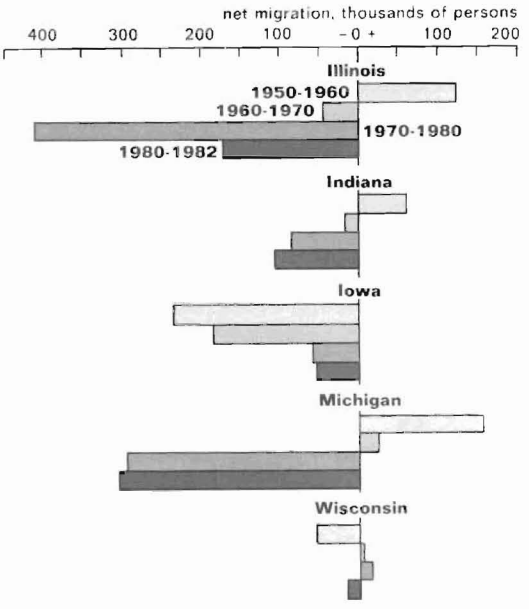
Population data clearly depict the decline of the great cities of the Midwest. Most large central cities have been losing population for about 25 years, while suburban areas have continued to grow. And in the 1970s even some metropolitan areas, including Detroit and Milwaukee, lost population as growth in the suburbs failed to match the exodus from the city.

Between 1970 and 1980, the population of the city of Detroit declined 21 percent. Chicago and Milwaukee each lost 11 percent of its people, Indianapolis and Des Moines 5 percent. Jobs in the core cities have declined faster than population. Unemployment rates there are exceptionally high.

Even as cities have been losing population, their racial mix has been changing rapidly. By 1980, 63 percent of Detroit's residents were black and 2 percent Hispanic. Chicago was 40 percent black and 14 percent Hispanic.

Blacks and Hispanics have increased in the big cities, both through net inmigration and high birth rates. These populations tend to be less well equipped with academic and job skills than the whites they replace. Pressure on employers to provide affirmative action programs based on the cities' population mix may have adversely affected the total number of jobs available.

Midwest population trends reflect outmigration



A troubled sector: durables

In the late 1800s and early 1900s, the Midwest increasingly turned from agriculture to the production of durable manufactured goods. Detroit and other Michigan cities became centers of motor vehicle manufacturing. The steel producers of south Chicago and northern Indiana started the expansion that would eventually seize the lead in steel production from Pittsburgh. Chicago continued to expand its place as the region's financial, trading, and financial hub. Milwaukee became prominent in heavy machinery. Other centers emphasized farm equipment, machine tools, construction equipment, freight cars, engines and other components. In large part the economic problems of the Midwest since the late 1970s reflect the declines in output and sales of such industries.

In 1978, when business activity in the Midwest was still robust, the five-state area accounted for 15.7 percent of the nation's nonfarm payroll employment, somewhat more than its 15 percent share of the population. These states accounted for 19.3 percent of the nation's employment in manufacturing, and 23.4 percent in durable goods manufacturing. Within durable goods, they accounted for 31 percent of employment in steel, 55 percent in engines and turbines, 56 percent in farm machinery, 35 percent in construction machinery, 35 percent in metalworking machinery, and 54 percent in motor vehicles. The five states accounted for a very high proportion of the nation's employment—ranging up to 70-80 percent—in farm tractors, heavy earthmoving equipment, industrial cranes, diesel engines, recreational vehicles, and outboard motors.

In December 1982, at the low point of the recession, total U.S. payroll employment was only about 1 percent below the 1979 average. Employment in durable goods manufacturing, however, was 17 percent less than in 1979 and average work weeks were sharply lower. Employ-

Midwest takes a big share of jobs in durable goods manufacturing

	United States	Five States	Illinois	Indiana	Iowa	Michigan	Wisconsin
			(percent of United States, 1978)				
Total nonfarm payroll employment	100.0	15.7	5.5	2.6	1.3	4.1	2.2
Manufacturing	100.0	19.3	6.1	3.6	1.2	5.6	2.8
Durable goods	100.0	23.4	6.8	4.7	1.3	7.6	3.0
Primary iron and steel	100.0	31.1	8.7	10.7	0.4	8.7	2.5
Engines and turbines	100.0	54.9	15.8	9.0	0.8	9.8	19.5
Farm machinery	100.0	55.6	21.0	3.1	16.0	4.3	11.1
Construction and related machinery	100.0	34.5	17.6	1.6	5.7	4.1	5.4
Metalworking machinery	100.0	35.0	10.2	3.5	0.3	17.8	3.2
Motor vehicles and equipment	100.0	53.7	2.8	6.9	0.9	39.8	3.4

ment in motor vehicles was down 36 percent; steel, 45 percent; farm equipment, 40 percent; construction equipment, 36 percent; metalworking, 22 percent; and railroad equipment, 38 percent.

In many Midwestern localities the situation was worse than the data above suggest. Plants closed for months on end, only to reopen with minimal staff. Others closed permanently and operations were abandoned or shifted to new, up-to-date plants in the South or abroad where labor costs were much lower.

Causes—complex and varied

The factors that have combined to produce the present relative decline in the Midwest are varied in nature and in severity. Some are economic, some political, and some social. Some factors are long-term results of "natural" economic evolution, such as the aging of the Midwest's heavy industrial plant. Others, such as the high interest rates of recent years, may be only temporary dislocations. If the causes differ in kind and degree, so do the potential remedies. While some problems may best be left to the economic market place for solution, including adjustments by management and labor, others may call for close regional cooperation on the political front, or sensitive intervention in social areas by government agencies.

A high wage area

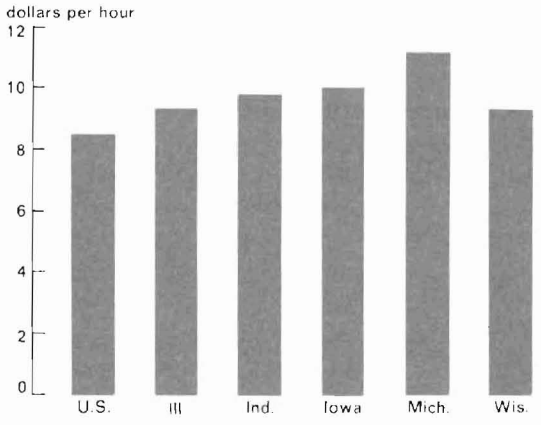
Until the successful CIO organization drives of the late 1930s (aided by the National Labor Relations Act of 1935) the great durable goods industries of the Midwest were largely nonunion. Most prominent among the new "industrial unions," as opposed to the AFL's craft unions for specific trades, were the United Automobile Workers (UAW) and the United Steelworkers (USW). The UAW eventually organized the farm and construction equipment factories, and has often set the pace for demands of other unions.

Successive industrial union contracts from 1946 through 1980, sometimes agreed to after

Motor vehicles, machinery, and other durables dominate Midwest manufacturing

	United States	Five States	Illinois	Indiana	Iowa	Michigan	Wisconsin
			(percent of manufacturing employment, 1978)				
Manufacturing	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Durable goods	59.8	72.3	66.9	77.0	62.4	80.4	65.7
Primary iron and steel	3.9	6.2	5.6	11.5	1.2	6.0	3.6
Engines and turbines	0.7	1.9	1.7	1.6	0.4	1.1	4.6
Farm machinery	0.8	2.3	2.7	0.7	10.4	0.6	3.2
Construction and related machinery	1.9	3.4	5.5	0.8	8.8	1.4	3.7
Metalworking machinery	1.7	3.0	2.8	1.6	0.4	5.3	2.0
Motor vehicles and equipment	4.8	13.3	2.2	9.1	3.6	33.7	5.9

Earnings of District factory workers far exceed U.S. average



extended work stoppages, brought substantial increases in wages and benefits, and changes in "work rules" desired by organized labor. In addition to annual, "basic" wage increases, contracts called for cost-of-living increases and generous benefit packages—vacations, pensions, medical and dental insurance, workers' compensation, and supplementary unemployment insurance. Important benefits also were provided for retired workers. As a result, total compensation rates in these industries tended to outrun compensation per hour in other industries by a widening margin.

Despite concessions in the past year, total cost per hour of employed production workers in the major unionized durable goods industries including steel and autos is $20-24 per hour ($40,000 to $50,000 per year), almost double the average for manufacturing workers in the U.S. and several times foreign labor costs. Nonunion compensation in highly organized states such as Michigan also tends to be higher than in the nation generally.

Average wage rates in the five-state area have exceeded the national average for many years. Wages typically are highest in Michigan, where average hourly earnings of all production workers in manufacturing in 1982 were one-third higher than for the nation. Average wage rates in other District states exceeded the national average by 10 percent to 18 percent.

Labor costs per hour in the Japanese auto industry, high by world standards, are said to be about $12 per hour. In addition, labor productivity is higher than in the U.S., in part because of strict worker discipline, absence of strikes, and low absenteeism. Compensation elsewhere in the Far East and in Mexico and other parts of Latin America is generally much lower than in Japan.

Productivity lags

High labor compensation need not lead to high prices or low profits if output per hour, or labor productivity, is also high. Throughout much of the postwar era, labor productivity in nonfarm business nationally rose more than 2 percent a year on average. In 1977-82, however, there was no rise in productivity on balance. In 1983, productivity rose 3 percent and a further gain is probable in 1984. After severe cutbacks in both blue-collar and white-collar staffing, including many middle managers, Midwest employers are limiting increases in hiring. Some positions eliminated during the recession will not be refilled, and productivity, presumably, will gain as a result.

In some Midwest industries, productivity has been limited by labor problems. Strikes, absenteeism, and restrictive work rules regarding job assignments, overtime, and discipline have lowered labor efficiency.

Another factor inhibiting labor productivity in the Midwest is the aging of important facilities. Existing plants here are generally among the nation's older plants. These factories compete with more modern plants in other regions or abroad which incorporate more advanced technology. In recent years, some producers have shifted production to newer plants in the South that originally had supplemented output of older facilities in the North.

The greater age of the Midwestern industrial plant has another adverse effect. Regulations controlling industrial emissions—air, water, and solid wastes—have had a large impact on the Midwest. Emission controls can be incorporated at lower cost in newly constructed facilities. Deadlines for meeting emission standards im-

posed on older plants may sometimes be satisfied most easily by closing the plants. Often closings have been the answer, especially for foundries. Such decisions have been encouraged by the income tax code. Many Midwest plants, once locally owned, have been acquired by conglomerates whose owners may benefit from tax write-offs when older facilities are shut down.

Foreign competition grows

In the past several years, Midwest producers of durable goods have encountered increasingly severe foreign competition. Imports have taken a growing share of domestic markets while their exports have declined.

Last year, imports accounted for 20 percent of U.S. steel consumption, 30 percent of passenger car sales, 40 percent of machine tool sales, and almost all small farm tractor sales. In addition, a growing share of equipment components are imported. Exports of equipment, steel, and autos have dropped—to a trickle in some cases. Construction machinery producers, some of whom used to export over half of their output, reported a drop in foreign sales of almost 70 percent from 1981 to 1983, largely because of a near-collapse in world markets, but also because of increased foreign competition.

The reasons for adverse trends in the durables trade balance are several. Foreign producers have narrowed or eliminated the technological leads formerly enjoyed by U.S. companies. In part, this has reflected investments of U.S. companies abroad and licensing of U.S. patents and processes. In some cases, e.g., small cars, American consumers have preferred imports to domestic models. Quality of some U.S. goods has been compared unfavorably with imports. Then there is the matter of price. Costs of production are lower abroad than in the U.S., mainly because of lower labor costs.

In recent years the increase in the value of the dollar has been an important factor in the relative prices of U.S. and foreign goods. This development enables foreigners to sell more cheaply here while it raises prices of U.S. goods abroad. Since 1980 the "trade weighted dollar" has risen 50 percent relative to other industrialized countries.

U.S. producers have complained that foreign competitors have been aided by governments that subsidize exports, and impose barriers on imports. Subsidies can take many forms, including low cost financing. In addition, value added taxes, common abroad, are refunded on exported items.

Interest rates hit hard

Most of the durable goods produced in the Midwest, both for business and consumers, involve relatively large outlays, which often require the use of credit. When credit is costly and lenders are cautious, sales of durables will be affected adversely. Purchases of most machinery and equipment, and most big-ticket consumer goods such as autos, appliances, RVs, and boats, are postponable. In depressed times outlays on such items typically decline more than total spending. Businesses have less need for equipment when they are operating below capacity. Consumers may choose to make do with what they have, or do without. In recent years the slump in the durables industries has been reinforced by the highest interest rates in modern times.

In 1980-82, yields on high-grade corporate bonds averaged 13.3 percent and the prime business loan rate averaged 16.4 percent. In 1976-78, when the Midwest was relatively prosperous, high-grade bonds averaged 8.4 percent and the prime rate averaged 7.6 percent. Although high relative to the early 1960s when both the bond rate and the prime rate were at about 4.5 percent, the rates of 1976-78 were not too high to prevent expanding use of credit for purchases.

Interest rates on consumer installment loans historically have been higher than rates on business loans because of the additional costs of administration and servicing. A decade ago effective annual rates on new car loans were around 11-12 percent and other consumer loan rates ranged to more than 20 percent. In recent years of tight money, rates on consumer loans rose to new highs, pricing some borrowers out of the market. Moreover, usury ceilings in various states prevented rates from rising to competitive

levels and caused some lenders to halt new loan applications. Even apart from usury problems, financial conditions of recent years have caused some banks and finance companies to de-emphasize or completely withdraw from "retail" (consumer) lending.

Energy prices and the Midwest

Despite declines since the 1981 peak, world crude oil prices are about 10 times the level of 1972, with OPEC still keeping a lid on output. Prices of other fuels, such as natural gas and coal, also have increased sharply. By comparison, the general price level has only slightly more than doubled since 1972. Soaring energy costs have had profound effects on national economies throughout the world.

Nowhere in the U.S. has the impact been more adverse than in the Midwest. The most direct effect has been on the motor vehicle industry. Customers initially curtailed purchases of cars and trucks, especially the larger, more powerful U.S. models. Imports of small Japanese cars and trucks rose rapidly, until growth was limited by quotas and taxes. Sales of motor homes, other recreational vehicles, and outboard motors, a substantial proportion of which are made in the Midwest, also suffered precipitous declines. Demand for capital equipment made here was curtailed because of the severe recession, which resulted partly from the large increases in energy prices, and because of the massive shift of investment funds to energy exploration and development. The equipment needed for such work is produced and serviced mainly in the oil and gas producing areas in the South and West.

Higher energy prices, coupled with some unusually severe winters here, encouraged the growth of industry and population in warmer climates. Overall, per capita energy usage is not much different in the Midwest than in the nation. However, space heating requirements are much greater here than in warmer areas. This is offset, in part, by lesser use of energy for air conditioning. On average, per capita *residential* energy use in the five-state area exceeded the national average by 16 percent in 1981.

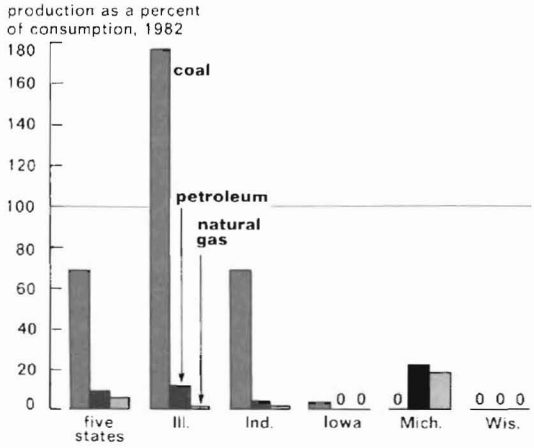
The price of fuel in the Midwest includes not only the cost at the production site, or at U.S. ports, but also transportation charges to this region. Costs to District users are further raised by severance taxes levied by energy-producing states. In some major oil, gas and coal exporting states, severance taxes in 1981 accounted for 20 percent to 50 percent of total tax revenue.

A very large share of the energy consumed in the five-state area is imported from other regions or abroad. Some oil is produced in Illinois, Indiana, and Michigan, but only a small fraction of their consumption. Iowa and Wisconsin produce none at all. Taken as a group, the five-states produce only 10 percent as much oil as they consume.

Some natural gas is produced in Michigan, but less than 20 percent of its consumption. Taken together, the five states produce only 5 percent of the natural gas they consume.

The Midwest fares somewhat better in coal production than in gas or oil. Coal reserves underground in Illinois account for 14 percent of the U.S. total, but coal mined in the state accounts for only 6 percent of U.S. output. Illinois coal is high in sulfur, and many utilities are required to burn low sulfur coal which is commonly supplied by mines in the Rocky Mountain states. Indiana also produces a substantial amount of coal, about 3 percent of the U.S. total. Production of coal in Iowa is small, and none is pro-

Midwest must import costly energy



duced in Michigan and Wisconsin. As a group, the five states produce about 70 percent as much coal as they consume.

Federal outlays low here

The five Seventh District states contribute a much higher proportion of the federal government's revenues than they receive in federal disbursements. This is especially true in the case of national defense spending. This disparity tends to reinforce other factors adversely affecting economic activity in the region.

The five states generate about 15 percent of the nation's personal income. Their contribution to federal revenues is probably similar. These states receive a much smaller share of federal outlays disbursed in the United States—only 10.7 percent of the total and only 5.1 percent of the outlays for defense. (These data exclude interest paid and certain other items not allocable by state.)

Midwest states do not share equitably in federal spending

	Federal outlays, fiscal year 1982			
	Total	Defense	Total	Defense
	(billions)		*(percent)*	
United States	$603.6	$178.8	100.0	100.0
Illinois	22.4	2.8	3.7	1.5
Indiana	10.1	2.6	1.7	1.4
Iowa	5.2	.5	.9	.3
Michigan	18.0	2.2	3.0	1.2
Wisconsin	8.9	1.1	1.5	0.6
Five States	64.5	9.1	10.7	5.1

	Per capita federal outlays			
	Relative to U.S. average		State rank	
	Total	Defense	Total	Defense
	(percent)			
United States	100	100		
Illinois	75	31	46	44
Indiana	71	62	49	34
Iowa	69	22	50	49
Michigan	76	31	45	45
Wisconsin	72	30	48	47
Five States	73	35		

SOURCE: Federal Expenditures by State for Fiscal Year 1982, Bureau of Census.

The relatively low participation of the District in federal outlays stands out dramatically in comparisons with other states on a per capita basis. The five states have five of the six bottom slots among the 50 states in per capita total federal spending and four of the lowest seven positions in defense spending. Indiana ranks highest in the District in defense, but is still only 34th in the nation. The District's role both as prime contractor and as supplier of raw materials and semifinished parts to the rapidly expanding production of military equipment remains relatively small.

State and local governments

Until the late 1970s, state and local government employment in the District had tended to offset periodic declines in private employment, rising even in recession years. In the past few years, state and local governments throughout the District have been grappling with serious financial problems. Revenue shortfalls have reflected both the recession's effect on tax revenues and cutbacks of federal aid. Meanwhile, requirements for social programs and welfare outlays have increased.

State and local governments in the Midwest are dealing with their financial problems by (1) curtailing programs (often reducing employment), and (2) raising taxes. While these steps are necessary to achieve financial solvency, they exert a dampening effect on economic activity.

Farm economy still weak

In some periods in the past when durable goods manufacturing was curtailed, the farm economy of the District was relatively prosperous. In the past three years, declining farm income has coincided with and reinforced the contraction in manufacturing. Many smaller communities are dependent on sales of equipment, supplies, and services to farmers.

Data on agriculturally related employment

are sparse, rendering precise characterizations of the situation difficult. Yet, there is no doubt that rural communities and the industries serving agriculture have suffered extensively in the economic downturn of recent years. There are signs that the farm sector is beginning to recover. But any recovery in agriculturally related employment, in the Midwest and nationwide, is likely to be slow.

Acreage removed from production under government programs in 1983 was about 16 percent of the area planted to principal crops in 1982—the largest such removal ever. The decline in acreage helped to place the farm sector on a stronger financial footing. But industries that furnish inputs and services to farms experienced weak sales in 1983. Sales of seeds, fuels, fertilizer, and pesticides declined 10 to 15 percent, and purchases of grain storage facilities were reduced. Unit sales of farm equipment, down 50 percent from the levels of the late 1970s, remained at very depressed levels. In 1984, the replanting of most of the acreage idled last year will reverse these trends but many firms supplying the farm sector will remain under considerable stress.

Government aids for industries

The shift of industry to the South and West has not merely reflected advantages of climate. Right-to-work laws that hamper organizational efforts of unions also are factors. In addition, powerful incentives are offered to induce businesses to locate new facilities in these states.

Some state and local aids to business are noncontroversial. These include informational services on local resources, labor, transportation, and utilities. Training of potential workers in courses tailored to the needs of particular companies also meets with little criticism. However, the use of financial subsidies can lead to destructive competition among the states and municipalities. Some states and municipalities offer property tax exemptions on new facilities which place additional burdens on other taxpayers, including other businesses. Some offer free land, below-market-rate loans, and aid for construction of access roads or utility extensions. The widespread use of tax-free industrial revenue bonds has inflated the volume of municipal offerings and raised borrowing costs for all state and local governments.

The *Commercial Club Project*

The "City that works" looks for work

In mid-1983, the Federal Reserve Bank of Chicago joined with the Commercial Club of Chicago, a long-established group of business leaders, in a project to create an economic plan for the Chicago metropolitan area. The plan is envisioned as a strategic road map for the Chicago area over the next twenty years, with an emphasis on retaining, creating, and attracting jobs.

As part of this effort, the Chicago Fed is developing a data base of economic information on the metropolitan area. Employment figures and trends, comparative data for other metropolitan areas, and other economic data are being collected and analyzed. The bank will maintain and update the data for the future.

Preparation of the economic plan involves analysis of the Chicago area's strengths and weaknesses and the identification of economic pitfalls and opportunities. Representatives of industry, labor, government, and education are working on industrial sector and individual issue "resource committees" covering such areas as manufacturing, agribusiness, transportation, emerging businesses, research and education, and changing job skills. Resource committees will report to the project's "Road Map" committee.

The recommendations of the resource committees will serve as the basis for detailed proposals to better Chicago's economic and employment position. Some ideas being considered include establishment of public-private partnerships to give technical assistance to small and emerging businesses; tax, zoning, and regulatory changes to encourage retention of business; closer cooperation between the business and education communities to provide appropriate technical support for new enterprises as well as career training for new and displaced workers; and promotional campaigns to improve the Chicagoland image as one of the world's great metropolitan centers. Final project recommendations are scheduled to be completed by August 1984.

The business environment issue

Business groups complain of "unfavorable business climates" in the industrial states of the Midwest. Costs of unemployment insurance and workers' compensation are relatively high in this region, especially in Illinois and Michigan. These costs reflect both the size of payments and the ease of establishing claims. Other complaints involve high costs of waste disposal, large medical insurance premiums, excessive taxes on business, burdensome state pollution controls, restrictions on cutoffs of utility services, and laws affecting hiring and personnel practices.

In 1983, Alexander Grant and Co. published its fourth study of general manufacturing business climates in the 48 contiguous states. States were assigned over-all rankings for 1982. Florida, Texas, and North Carolina took the top three spots. Indiana was 29, Iowa 35, Wisconsin 36, Illinois 42, and Michigan 48. Among the factors considered:

- Costs of fuel and electricity. Costs in the Great Lakes states were 41 percent greater than in the South Central Region, and 4 percent more than the national average.
- Wage costs. Michigan had the highest wage costs of any state. The average for the Great Lakes states was 40 percent higher than for the Southeastern states, and 18 percent above the national average.
- Unionization. In the Great Lakes states 31 percent of nonfarm workers were organized, compared to less than 10 percent in the Carolinas.
- Taxes. Total taxes in the Great Lakes states on individuals and businesses, relative to incomes, was about equal to the national average, but higher than in the Southeastern states.

Business financial stress

Some large District companies that were in excellent financial condition a decade ago have been operating under severe stress in recent years. Their problems usually are a result of several factors—sales falling below expectations, intense competition, rising costs of labor and other inputs, and heavy debts incurred at high interest rates. Some of these firms are operating under special agreements with creditors who could force them into bankruptcy under contractual agreements.

Many hard-pressed firms, especially in the auto industry, have substantially improved their financial positions in the past year and further gains are expected in 1984. However, erosion of executive morale and confidence over the past several years will not be corrected in a year or two. Until financial strength is solidly reestablished and the general economy is clearly in a new growth trend, business caution will restrain commitments for capital spending, inventory investment, and hirings.

The outlook—a warming trend

The Midwest retains the assets that supported growth and prosperity in the past. These include central location, productive farmland, good transportation, ready access to materials and markets, ample fresh water, and a well-educated work force under vigorous management. The economy of the region should improve significantly in 1984 with gains in output of motor vehicles, capital goods, and agricultural supplies. However, a number of steps to correct the problems and inequities that have contributed to the post-1978 malaise must be taken if full economic health is to be regained. Some progress was made in 1983, but much remains to be done. Management, labor, and government have vital roles to play.

Many of the factories closed in recent years will never reopen. Probably, durable goods will never be as large a factor in the region's economy as in the past. But service industries, including scientific research, law, consulting, finance, communications, and futures trading are growing. The continued expansion of office space, especially in Chicago, largely reflects the rise of services. An atmosphere conducive to further growth of these sectors should be maintained. In particular, tax initiatives that might drive such businesses elsewhere should be avoided.

But manufacturing will continue to provide more jobs in the Midwest than will these sophisticated service industries. Its vitality will depend

on efficient, low-cost operations. Labor-management agreements to bring worker compensation more in line with competition and to reduce or eliminate counter-productive work rules are essential. In reaching agreements, long, destructive strikes should be avoided.

State and local governments are aware that the "economic climate" of the region is widely viewed as unfavorable to business. Excessively burdensome business taxes, programs for workers' and unemployment compensation, and regulatory policies should be adjusted to "level the playing field" with other regions.

The federal government should take various measures to aid the Midwest. This does not mean special financial help as has been directed, at times, toward Appalachia, and other depressed regions. Rather, the gross inequity of the underdistribution of federal outlays in this region should be ameliorated. Other measures could include action against (1) high severance taxes that force Midwest residents to finance governments in fuel producing states; (2) sales of tax writeoffs that encourage closings of older plants; and (3) subsidies and other unfair practices of foreign governments that encourage their exports and discourage our exports.

The federal government responds to pressure from many groups according to the size of their constituencies. The Midwest states have common problems that require national attention. An organization of state governments of the region, presenting a united front, and cooperation among District congressional delegations could provide effective instruments for constructive change.

The whole nation is adjusting to new economic realities and relationships. That the adjustment should affect most deeply the established industrial base of the Midwest was inevitable. Minimizing the pains of change and maximizing the benefits will require application of the Midwestern traits that created the achievements of decades past: competitive spirit, adaptability, intelligence, technical proficiency, and hard work.