Trends in Midwestern State Business Incentives

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Saturday, July 13, 2013 at 02:23 PM

Since the Great Recession began, states have faced high levels of unemployment, an increased demand for safety net services and a volatile revenue base. Although the past two years have brought some improvements, the number one question on state policymakers’ minds continues to be this: What can we do to encourage job growth?

Executive Summary

Traditionally, a key policy lever for development and job creation strategies was—and remains—tax and financial incentive programs designed to encourage new firms to start up or existing firms to grow or relocate. This report takes a look at trends in the type and number of incentive programs being used by states in the Midwest, and includes a brief review of economic trends, including an evaluation of employment, unemployment and gross domestic product. A profile for each of the 11 Midwestern states—highlighting certain incentive and development programs, oversight and accountability measures and recent legislative activity—also is provided.

The descriptive information included in each profile was gathered from a review of state economic development agency and division websites and a survey of agency staff.

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Trends in the Use of Tax and Financial Incentives

Over the past three decades, states have developed various incentive programs designed to encourage economic activity in order to create, retain or expand business opportunities. In addition to tax and financial incentives, some states have used customized, company-specific incentives to engage in bidding wars with other states, making interstate competition for industries and businesses increasingly intense.

From the 1970s until the early 1990s, the number of states providing tax and financial incentives to businesses and the types of incentives being offered increased significantly. Over the past 10 years, the number of states offering incentives of varying degrees and types has become relatively stable. In 1977, at least 28 states offered tax concessions or credits to businesses for equipment and machinery, goods in transit, manufacturers’ inventories, raw materials in manufacturing and job creation. In 1998, the number of states offering those incentives had grown to 42—the same number in 2012 offering all of those exemptions.

In the Midwest in 2012, all 11 states provided a tax exemption for goods in transit, manufacturers’ inventory, sales/use tax exemption on new equipment, raw materials in manufacturing, job creation and industrial investment. Ten of the 11 states offered an exemption on corporate income taxes, nine allowed exemptions on personal income taxes and five states offered an excise tax exemption. Ten of the 11 Midwestern states also offered a tax exemption or moratorium on land, capital improvements and equipment or machinery, as well as a tax exemption to encourage research and development and accelerated depreciation of industrial equipment. No states in the region provided tax credits for the use of specified state products, while two offered tax stabilization agreements for specific industries.

The number of states across the country offering financial incentive programs also increased over the past three decades. In 1977, fewer than 20 states offered special low-interest loans for building construction, equipment, machinery, plant expansion and establishment of industrial plants in areas of high unemployment. By 1998, more than 40 states offered those incentives—a number that has remained essentially the same during the next decade and a half.

All 11 Midwestern states in 2012 provided state loans for building construction, equipment or machinery and financing aid for existing plant expansion. Ten states offered incentives for establishing industrial plants in areas of high unemployment, while six offered state loan guarantees for equipment, machinery or building construction.

The Big Picture: Economic Trends in the Midwest

Fiscal and economic recovery remains slow and painful for many states as revenues struggle to get back to pre-recession levels while upward pressures on spending remain. States face additional pressure through decreasing—and increasingly unpredictable—federal spending, especially in the areas of health care and education. Labor trends have improved, but the severity of the recession has left its mark—long-term unemployment rates continue to be elevated, while labor participation rates hit their lowest levels in 30 years.

Unemployment

Unemployment rates remained elevated in 2012, although rates have dropped since the Great
Recession ended. In 2010, the national unemployment rate was 9.6 percent. Throughout 2011, the rate hovered around 9 percent, while the average annual rate in 2012 was 8.1 percent. Nevada had the highest annual average unemployment rate for 2012—11 percent—while North Dakota had the lowest—3.2 percent.

The Midwestern regional average unemployment rate has largely tracked national trends over the past several years, increasing considerably in 2009 and remaining elevated throughout 2010, with small but consistent declines in 2011 and 2012. A few states in the region were hit much harder than others during the recession, with Illinois, Indiana and Michigan each reaching an unemployment rate of more than 10 percent. Michigan had the highest annual unemployment rate in the country in 2009, reaching 13.4 percent—much higher than the national average of 9.3 percent.

Although every state in the region saw its unemployment rates increase during and after the recession, a few states remained significantly below the national average throughout the recession and since, including Iowa—annual rate never got above 6.3 percent; Nebraska—annual rate never got above 4.7 percent; North Dakota—annual rate never got above 4.1 percent; and South Dakota—annual rate never got above 5.2 percent. In addition, the Midwestern average unemployment rate has fallen back toward pre-recession levels more quickly than the national rate, hitting 6.2 percent in 2012, compared to the national rate of 8.1 percent.

More recently, from March 2012 to March 2013, 39 states reported declines—although only 11 were statistically significant—in their unemployment rates. Nationally, Nevada saw the biggest decline for the second year in a row, dropping 1.9 percentage points; followed by Rhode Island with a drop of 1.5 percentage points; and Florida, which reported a decline of 1.4 percentage points. Over this same time period, three states reported no change in their unemployment rates, while eight reported an increase, although those increases were all 0.7 percentage points or less.

From March 2012 to March 2013, seven states in the Midwestern region reported a decline in unemployment rates, while four states reported increases. The declines were modest, with Iowa (0.5 percentage points) and Michigan (0.5 percentage points) dropping the most in the region. Illinois (0.7 percentage points) and Indiana (0.5 percentage points) each saw the largest increases—both regionally and nationally—to their unemployment rates over this period.

Long-term Unemployed

While unemployment rates continue to improve, characteristics of the unemployed remain fundamentally altered due to the recession. For example, the number of long-term unemployed—defined as those unemployed for 27 weeks or more—skyrocketed throughout the economic downturn. Nationally in 2011, the percentage of unemployed workers considered long-term unemployed increased significantly, hitting 44.6 percent in September—the highest percentage since the U.S. Department of Labor began calculating the rate in 1948. By 2012, the long-term unemployed rate stabilized and began decreasing slightly, hitting 39.1 percent in December. Individuals received unemployment benefits an average of 38.1 weeks in December 2012—more than double the average duration of unemployment when the recession began in December 2007.

Labor Force Participation

Labor force participation rates—the proportion of the working age, civilian noninstitutionalized population that either has a job or is actively looking for one—hit 63.3 percent in April 2013, the lowest rate since February 1979. Participation rates, however, vary significantly by state. West Virginia, with a labor force participation rate of 54.2 percent, had the lowest rate in the country in April 2013, followed by Alabama at 57.9 percent and Mississippi at 58.4 percent. Nebraska had the
highest rate in the nation at 72.9 percent, followed by North Dakota at 72 percent and Minnesota at 70.9 percent.\(^4\)

In the Midwestern region, Michigan had the lowest labor force participation rate in April 2013 at 59.8 percent, followed by Indiana at 62.5 percent and Ohio at 63.5 percent. Nebraska had the highest labor force participation rate in the region at 72.9 percent, followed by North Dakota at 72 percent and Minnesota at 70.9 percent. All but two states in the region—Michigan and Indiana—had participation rates higher than the national rate.

The change in labor force participation rates since the recession began also varies by state. From November 2007 to April 2013, the national labor participation rate fell from 66 percent to 63.3 percent—a drop of 2.7 percentage points. Hawaii had the biggest drop in its participation rate of any state nationally over this period, falling by 5.7 percentage points. Utah (4.9 percentage points) and Michigan (4.7 percentage points) were close behind. Kentucky (0.2 percentage points) and Texas (0.3 percentage points) saw the smallest decreases in participation rates. No state over this period experienced an increase in labor force participation rates.

In the Midwestern region, the drop in participation rates from November 2007 to April 2013 ranged from a low of 0.5 percentage points in Nebraska and 1.2 percentage points in Minnesota to a high of 4.7 percentage points in Michigan and 4.2 percentage points in Indiana.

**Gross Domestic Product**

Nationally, real gross domestic product\(^5\) increased 2.2 percent in 2012 compared with an increase of 1.8 percent in 2011. Personal consumption expenditures, nonresidential fixed investment, exports, residential fixed investment and private inventory investment contributed the most to the increase in real GDP in 2012, gains that were offset somewhat by negative contributions from public (federal, state and local) spending.

On a state-by-state basis, 43 states and the District of Columbia saw an increase in real GDP in 2011, a modest slowdown compared to 2010. Each region performed differently, with several states posting more than a 4 percent gain and one state—North Dakota—posting a 7.6 percent gain. Most states fell between a 0.03 percent and a 3.3 percent growth rate from 2010 to 2011.\(^6\) Seven states—Alabama, Hawaii, Maine, Mississippi, Montana, New Jersey and Wyoming—experienced a drop in year-over-year real GDP, each decreasing by less than 0.78 percent. Oregon, North Dakota and West Virginia each experienced big gains in GDP, all growing by 4.5 percent or more, with North Dakota posting a 7.6 percent increase over 2010.

On a per capita basis, nominal GDP for the U.S. was $48,079 in 2011, while states nationally ranged from a high of $72,487 in Delaware to a low of $32,839 in Mississippi. For the 11 Midwestern states, the 2011 growth rate for real GDP ranged from a low of 0.1 percent in Nebraska to 7.6 percent in North Dakota.

**Personal Income**

State personal income\(^7\) continued to increase in 2012, growing by 3.5 percent over 2011. That growth rate was slower, however, than in 2011, when income grew by 5.2 percent over 2010. Personal income grew the most in North Dakota in 2012—by an impressive 12.4 percent—while personal income fell slightly in South Dakota—the only state to have negative growth over the period—falling by 0.2 percent.
On a per capita basis, personal income was $42,693 in 2012, an increase of 2.7 percent over the per capita rate in 2011 of $41,560. Nationally in 2012, Connecticut had the highest per capita personal income at $58,908, while Mississippi had the lowest at $33,073. Growth rates in per capita personal income from 2011 to 2012 also varied significantly across states. Only South Dakota posted a negative growth rate over this period, while other states’ growth rates ranged from a low of 1.07 percent in Nevada to a high of 9.9 percent in North Dakota.

Across all 11 states in the Midwestern region, personal income grew 3.3 percent in 2012, slightly less than the national growth rate of 3.5 percent. 2012 per capita personal income in the region ranged from a low of $36,902 in Indiana to a high of $51,893 in North Dakota. In 2012, the Midwestern region included the state with the highest per capita personal income growth—North Dakota with an increase of 9.9 percent—and the only state to see declines in per capita personal income over the period—South Dakota, with a decline of 0.2 percent.

North Dakota claimed the fastest personal income growth rate of any state for the fifth time in six years, due primarily to a steep increase in oil and gas extraction in the state. Since 2006, personal income in North Dakota has grown at a compound annual rate of 9.2 percent, more than three times the 2.9 percent growth rate of the other 49 states. In 2012, mining—which includes oil and gas extraction—and construction accounted for 43 percent of private nonfarm earnings growth in North Dakota.

The Bureau of Economic Analysis explains that South Dakota’s decline in personal income was due to the effects of a drought on farm income. The same drought also affected personal income in three other states in the region: Nebraska, Kansas and Iowa, each of which had below average total personal income growth in 2012. The drought also helps to explain a relatively low growth rate for the regional average.

**Earnings and Median Income**

The average hourly earnings for all employees nationally on private nonfarm payrolls reached $23.87 in April 2013, an increase of 45 cents—or 1.9 percent—over April 2012. In 2012, average annual hourly earnings differed considerably across states, ranging from $18.57 in Arkansas to $28.14 in Connecticut. In the Midwestern region, annual hourly earnings in 2012 ranged from a low of $19.42 in South Dakota to a high of $24.95 in Minnesota.

Another measure of income is median household income. Real median household income fell between 2010 and 2011 by 1.5 percent—the second consecutive annual drop—landing at $50,054 in 2011. Nevada saw the biggest drop from 2010 to 2011 in real median household income—10.9 percent—while Oklahoma saw the biggest year over year increase—9 percent. Median household income in 2011 ranged from a low of $39,856 in Kentucky to a high of $68,876 in Maryland. From 2010 to 2011, 28 states experienced a decrease in real median household income while 21 states saw an increase and one state—North Carolina—saw no year-over-year change.

When compared to prerecession income levels in 2007, real household median income has declined by 8.1 percent and remains 8.9 percent shy of the peak that occurred in 1999. Nevada also saw the sharpest decline in real median household income from 2007 to 2011, falling 19.8 percent, while North Dakota’s income grew the most—10.1 percent. Over this period, 44 states saw a decline in real median household income, while Mississippi, Nebraska, North Dakota, Oklahoma, Vermont and Wyoming were the only states to see an increase in income.

Among states in the Midwestern region, Indiana had the lowest median household income in 2011 at $44,445, while Minnesota had the highest, at $57,820. From 2010 to 2011, five of the 11 states in
the region saw a drop in real median household income. Indiana saw the biggest drop—6.6 percent—while Minnesota and North Dakota saw the biggest gains to income, each growing by 7.1 percent year-over-year. The average regional percent change over this period was 0.3 percent, a more positive change than the national average of -1.5 percent. From 2007 to 2011, all but two states in the region—Nebraska and North Dakota—saw a drop in real median household income, with Ohio seeing the largest decline at 16.2 percent. The average regional percent change over this period was -6.8 percent.

Appendix A: GDP and Personal Income, PDF [15] or Excel [16]
Appendix B: Unemployment and Labor Force Participation, PDF [17] or Excel [18]
Appendix C: State Tax Incentives, PDF [19] or Excel [20]
Appendix D: State Financial Incentives, PDF [21] or Excel [22]

5 Based on chained 2005 dollars, U.S. Bureau of Economic Analysis, National Real Gross Domestic Product, www.bea.gov [27]
6 Based on chained 2005 dollars, U.S. Bureau of Economic Analysis, State Real Gross Domestic
Product, www.bea.gov [27]

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