

Why States Grow
Continued from “Why Countries Grow”
by:
Elliott D. Pollack

In the article entitled, “Why Countries Grow” we explored current research into why some countries grow and prosper while others stagnate or decline. The conclusion was that discrepancies in income levels exist not because of a lack of education or natural resources, but instead are primarily the result of country specific political and economic policies. These policies result in constraints on work practices, production methods and, ultimately, profitability at the firm level.

The next question to ask is if this theory can be extended to individual political subdivisions within the U.S. In other words, can we use this theory to identify what makes Arizona and Greater Phoenix grow? To answer this question, we must first more specifically discuss what causes growth at the local level. Once we fully understand why we grow, we can identify what policies need to be implemented to allow us to maintain or even improve our economic condition.

Why Do We Grow?

Why do some places within the United States grow and others do not? Some areas grow over long periods of time, as measured in multiple decades for our purposes. It is that group, those that grow consistently over time, that we are interested in examining.

The discussion begins with two basic tests. You don’t get to progress to the second test unless you pass the first. The first test is simple. Do the people want to live in that area? This covers a list of things. Is the climate nice? Is the area livable in terms of political environment? Does it have a social infrastructure conducive to growth (i.e. is it a meritocracy)? The quality of life factor is important to consider. But, like beauty, it is in the eye of the beholder. Fortunately, there is an objective measure to consider. The real answer is that people vote with their feet. The places that continually enjoy rapid population growth can be assumed to make the first cut. People want to be there. The first cut also partly explains why areas of the country that supposedly have great business climates, South Dakota for example, do not enjoy rapid population growth. Simply put, if an area does not make the first cut, it simply will not have rapid growth for any sustained period of time.

The second cut is more complex and more related to the previously discussed book Barriers to Riches. Is the business and political climate of a local area conducive to business expansion relative to the area’s competitors? Just as with nations, the basic questions must be asked. Are there specific local policies that result in constraints on work practices and the application of better production methods? Can firms operate profitably relative to alternative locations? Does the area embrace business expansion and competition?

Arizona

For many places in Arizona, the answer to the first question has been a resounding yes. People want to live here. Fortunately, the environment and social climate of the southwest remains appealing to individuals.

The focus, therefore, has to be on the second question. Boiled down it asks, is government getting in the way? We have direct control over the extent that our government encourages or discourages business expansion. In the end, the more competitive we are, the better will be the quality of our expansion. Just as at the national level, specific local policies can result in constraints in work practices and the ability of individual firms to earn a normal profit. This is where we will focus.

All Jobs are Not the Same

If “policies that result in constraints on work practices and on the application of better production methods at the firm level” affect decisions at the international level, they certainly could at the state or metropolitan area level. That is especially true when it is applied to base (or export) jobs as opposed to domestic sector jobs. Export sector jobs, generally higher paying jobs, are jobs that are created because a company’s product is sold primarily outside of the local area. These companies could locate in other states if they so desired because they don’t serve the local market. On the other hand, domestic sector companies serve local markets so they have to locate locally. A domestic sector company; a retailer, insurance agency, title company, lawyer, or barber; are chasing local income. From an economist’s standpoint, these are someone else’s ripple effect. Think of it this way. The ghost towns of the old west became ghost towns because their reason for existence ended. For example, the mine petered out, there was a drought and agriculture moved away, or the rail head moved.

The reason Greater Phoenix exists, for the most part, is its manufacturing, tourism and export service base, not its retail base. Thus, the ability to attract those base jobs is key to an area’s growth and wealth. In that regard, why these base industry companies locate in Greater Phoenix or Tucson or Flagstaff, as opposed to another city in another state, is primarily due to the same factors described by Prescott and Parente in their book Barriers to Riches. The ability to implement the latest technologies and make a reasonable profit without a great deal of costly government interference is key. Yes, there are other factors in some cases such as proximity to markets. But, generally, the important point is, can we attract sufficient labor at a reasonable cost (do people want to live here) and can we make money (policies that result in constraints including red tape, work practices and taxes)?

Where Should We Focus?

There are different options when it comes to modifying public policy. Some options have a cost to the government while others are cost free. Modifying the State’s tax structure could have a cost to the government if it results in a net decrease in revenues. Obvious examples include various reductions in the State and local tax rates. No cost proposals could include the shifting of tax burden that results in economic efficiencies and increases output and income. Implementation of needed infrastructure is also a

necessary government function. The efficient spending of these funds is critical. Reductions in regulation also improve efficiency at a relatively low or no cost. The key to positively affecting the local economy is to direct the public policy changes to where they will do the most good. Thus, focus on base rather than domestic sector industries.

The attraction of base industry operations is not complicated. If a government limits constraints on work practices (i.e. right to work state), minimizes taxes while providing needed services, limits inefficient red tape, and limits the extent that monopolies are protected, good things will come. The simplicity of this analysis does not take away from the work being done by our economic development professionals. In fact, these individuals are vital in the analysis and distribution of proper economic information.

It is also important to note that change, whether it be increases in wages or increases in efficiencies, sometimes come slowly even if we utilize the best of public policy. This is the subject of a later discussion. During the next year, we will intermittently look at how Greater Phoenix looks on some of the key competitive issues. This will help to answer question two from above. While we are not sure what we will end up with, we at least now have a framework from which to judge what to look at.