Where America is headed

by Claude Gruen

For more than 100 years, the movement of workers from poorer to richer states has pulled up the per capita incomes of both richer and poorer regions and lessened inter-regional income inequalities. A Harvard University paper titled *Why Has Regional Convergence in the U.S. Stopped?* shows this connection between rich and poorer regions has been severed since the 1970s. The paper defines the historic relationship whereby the economic prosperity of some regions increased income growth in all regions as "income convergence." Consider an example of income convergence before and after the disconnect. In 1940, the per capita income in Connecticut was 4.37 times larger than per capita income in Mississippi. By 1960, that multiple had fallen to 2.28. In 1980, the multiple had fallen to 1.76. But, 30 years later in 2010, the multiple between the per capita incomes of these two states stood at 1.77.

The paper offers statistically backed mathematical proofs of this disconnect in the long-time macroeconomic interactions between regions. The adoption of constrictive housing supply policies by successful regions is identified as cutting historical labor mobility connections between U.S. regions. Their data analysis concluded that:

1. Housing prices in the richest regions of the United States climb faster than incomes, so in these regions housing is taking a bigger share of incomes. "Housing prices now capitalize a greater fraction of the income differences across places," the report says.
2. As historic patterns of internal migration change, higher housing prices in the most economically successful regions are too expensive for relatively unskilled workers. Wealthier regions are attracting a less economically diverse, highly skilled population, while less affluent regions are attracting a higher proportion of the less skilled. Or, as the paper reads: "A reduction in the elasticity of housing supply in rich areas shifts the economy from one in which labor markets clear through net migration to one in which labor markets clear through skill sorting."

The urban economy is born

Since colonial times, urban places were conceived from the eggs of rural settlements by the relationship between entrepreneurial settlers, would-be settlers, land speculators and governmental entities. Typically, the government provided the funding and organization to develop some naturally occurring geographic feature, most often a transportation link between the rural place to distant markets or nearby mineral resources. The purpose of the relationship was to give birth to economic growth. It succeeded as private-sector actors exploited the comparative economic advantages provided by

the improvements to create one or more basic economic activities that exported goods or services outside the new urban place. "Non-basic" business then began to evolve, as some of the proceeds earned from the export activity were spent inside the community.

Once the baby of an urban economy was born, the governmental parent stayed in the relationship to encourage the further growth and, from time to time, necessary reinventions of the basic and non-basic elements of the regional economy, to keep it healthy and in tune with changing market, technological and demographic conditions. This required all levels of government to support further improvements to the region's physical and social infrastructure, such as educational institutions. Most importantly, the federal and state governments established and enforced laws that would encourage easy transactions and private developments. Not surprisingly, in the United States, where many of the founding fathers were businessmen, planters, developers and land speculators, laws granted the owners of property significant rights that could not be subverted by any branch of government, except when such subversion was necessary for the general health and welfare of the citizenry.

For about 200 years, the U.S. Constitution continued to be interpreted as allowing property owners broad discretion as to what they could do with their property. Safeguards to these rights were codified in state constitutions. At least as importantly, throughout that long history the consensus of U.S. public opinion continued to support the legal concept of strong property rights.

But in the 1960s, large gaps began to appear in that consensus, and by the 1970s major reinterpretations of federal and state constitutions devolved property rights from private owners to neighborhood communities and protectors of the natural and existing built environment. That resulting shift in what the law would allow enabled many urban regions to begin stifling the ability of private property owners to respond to the increased demand for residential and workplace development generated by the growth of urban economies.

Control land use, control values

In 2011, Brian Jansen and Edwin Mills wrote an article titled *Distortions Resulting from Residential Land Use Controls in Metropolitan Areas* in the *Journal of Real Estate Finance and Economics,* after analyzing data reported in several earlier studies. They found a strong correlation between the increase of land use–restricting policies, housing price increases, and lowered real incomes, employment and population growth. At the conclusion of their paper, they wrote: "A final comment is that there appears to be no interest in any level of government, or among the articulate population, in reducing the stringency of land use controls. Indeed, recent trends are in the opposite direction."

For more than 200 years, the U.S. Constitution has been interpreted as allowing property owners broad discretion over land use.

That comment leads me to believe the shift away from income convergence between regions in the United States is unlikely to be reversed. Except for those strong economies, such as Houston and Austin, that do not constrict supply additions as their economies grow, U.S regions will be relatively disconnected in the future. Most U.S. regional economies will be similar to the distinctly separate enclaves of Europe. As the cost of living and working in these regions continues to climb, the rate of growth in the strongest and largest regions will decline, encouraging the growth of some strong new economies that maintain more supply-friendly land use policies.

The macroeconomic effect of slower rates of growth within housing-constrained enclaves will be to lessen the growth rate of the United States by putting a drag on the growth of exports and import substitutes. Skills and incomes will become more diverse between regions and increasingly more homogeneous within regions than they have been historically, while incomes across the country will be less equal than they would have been before the demise of convergence. The economic, social and political ramifications of this new trend are complex and of concern. ❖

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