Nice places grow faster

By MICHAEL HICKS

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I think by now most people understand that differences in population growth, and therefore economic growth, between regions are because of differences in amenities such as schools, parks, the cityscape and natural attractions. While the link between economic performance and local schools is self-evident, I am often asked to explain why having more and better local amenities matters to job creation. It is a simple concept, really.

Households (aka families) make choices about where to live based upon a variety of factors. Among them are the presence of things such as playgrounds, safe and attractive neighborhoods and recreational activities.

Abundant research also reveals that workers in these households are willing to sacrifice to obtain these things. They are willing to commute long distances and even forgo higher wages to live in nice places. We economists call these sacrifices "compensating differentials" and this will be important later in this column.

Businesses like to locate in places where they can be more profitable, not just where costs are lower. The nicer places that households favor also possess higher land costs and typically higher tax rates. This will weigh heavily on profitability for some firms.

However, these places pack in more people and thus they boost profitability for businesses that need local consumers. They also reduce hiring costs and let businesses take advantage of the well-known productivity increase in urban areas (we economists call this agglomeration).

The interaction between the location choices of businesses and households would seem to be a complex dance among these factors; however, there are a couple of matters that bring amenities to the forefront.

First, the fastest growing businesses in the nation, those that do the most hiring and pay the best wages, care little about land costs. It is people that matter. The high land costs and property tax costs figure only modestly in their location calculus. This gives a growing edge to places that can attract lots of people, but there is an even bigger factor at play.

The thirst for amenities is whetted by wealth. Unsurprisingly, higher income households are willing and able to spend more to live in nicer places. These higher income households are not so by accident, but rather because of more education and skills. Workers from these households are more prized by businesses, which is why they are paid better.

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Now remember that these are the same households willing to accept a higher "compensating differential" to live in a nicer place. This means that they will take lower wages and pay higher home prices to live, work and shop in a higher quality community. That boosts business profits and can more than offset land prices and higher taxes. This creates a virtuous cycle where nice places grow and not-so-nice places shrink.

The implications of this are pretty clear: Nicer places are going to see an increasing share of household and business location. Places with below average schools, crummy neighborhoods and limited recreational opportunities will watch as people and businesses leave. This is Indiana's greatest economic challenge.

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