John Adams, Professor Emeritus of Geography, Planning and Public Affairs, University of Minnesota

Healthiest metro economies employ creativity, entrepreneurship, hard work

A Civic Caucus Focus on Competitiveness Interview

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Present

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Summary

States don't have economies; metropolitan regions have economies, says John Adams, Professor Emeritus of Geography, Planning and Public Affairs at the University of Minnesota. States have budgets, not economies, he says, while metropolitan areas are economic building blocks of the national economy.

Adams describes three main ways for a metropolitan economy to support itself: (1) the Bernie Madoff, or theft, model, in which cartels act to curtail competition and to charge prices higher than an authentic free-market price; (2) the Steve Jobs, or innovation and production model, which is based on creativity, entrepreneurship and hard work; and (3) the lottery model, based on luck, in which a region sells its unearned wealth in exchange for products and services imported from elsewhere. He says the healthiest regions support themselves with the innovation and production model. The Madoff and lottery models undermine economic health, promote inequality in society and curtail economic growth.

He points out that businesses have both profit and loss statements and balance sheets each year, while governments look only at whether revenues-in match expenditures-out. Without balance sheets,

governments don't account for depreciation or for future liabilities, such as debt or pension obligations.

Adams concludes that a negative trend is that we're moving away from an economy of *earning* money to an economy of *making* money. But a positive trend is an increasing attention to thinking in balance sheet terms about what we do today and its implications for tomorrow.

Background

John S. Adams is Professor Emeritus of Geography, Planning and Public Affairs at the University of Minnesota. His research interests include the American city, regional economic development, intra-urban migration, housing markets, urban transportation and urban development in the U.S., the former USSR and modern Russia. He continues to work closely with the Minnesota Population Center, is working on higher education reform in Minnesota and is president of the University of Minnesota Retirees Association.

Adams served several times as chair of the University's Geography Department. After retiring from the department in 2007, he served as Interim Associate Dean of the Humphrey School of Public Affairs in 2007 and 2008. He directed the University's Urban Studies Program from 1974 through 1979 and served as acting director of the Master of Planning Program from 1971 through 1973.

Adams also taught at Pennsylvania State University; was visiting professor in Poland, in Vienna, at the U.S. Military Academy at West Point and at the University of Washington; and was Fulbright Professor of Geography at Moscow State University. He was a National Science Foundation research fellow at the Institute of Urban and Regional Development at the University of California at Berkeley and economic geographer in residence at the Bank of America world headquarters in San Francisco.

He received his B.A. in economics and mathematics from the University of St. Thomas and his M.A. in economics and statistics and his Ph.D. in economic geography from the University of Minnesota.

Discussion

In a fair and efficient economy, parties are informed, transactions are voluntary and benefits are equal on both sides of the transaction. John Adams, Professor Emeritus of Geography, Planning and Public Affairs at the University of Minnesota, started out saying that each of the tenets in this overlying economic principle must be met for the economy to operate fairly and efficiently.

Adams divided the rest of his remarks into three parts: (1) how metropolitan systems support themselves economically; (2) the pervasiveness of rent seeking and rent capture; and (3) the "Regional Balance Sheet" concept and defects in the Gross Domestic Product (GDP) concept.

Part I. How metro systems support themselves economically.

States don't have economies; metropolitan regions have economies. Adams said states have budgets, not economies. The metro area, on the other hand, is an economic building block of our national economy. What's going on in metro areas is a consequence of very large forces operating on companies, on individuals, on households and on government.

There are three main ways to support a metro system:

(1) The Bernie Madoff, or theft, model. Adams gave the example of the Pittsburgh-Plus steel-pricing cartel in the 1880s and after, which was devised by Andrew Carnegie, J.P. Morgan and others as a way of punishing the South after the Civil War and of preventing competition from potential steel production in Birmingham, Alabama, and elsewhere. The robber barons decided that steel produced anywhere in the U.S. had to be priced equal to that produced in Pittsburgh plus the transportation cost from Pittsburgh to that producer's local market. If the steel producers didn't cooperate, Carnegie and the others would run them out of business. As a result, Pittsburgh's regional economy boomed.

He offered another example: Local real estate brokers who agree that they will all charge a six or seven percent commission are essentially acting as a cartel.

Adams noted that when monopolies and oligopolies act to curtail competition and to charge prices higher than an authentic free-market price, buyers are robbed, receiving few or no benefits in the transaction, and the robbers make lots of money, for a while.

(2) The Steve Jobs, or innovation and production, model. It's based mainly on creativity, entrepreneurship and hard work.

Adams offered the example of Minneapolis flour milling after 1870. Local companies pioneered in figuring out how to grind hard spring wheat grown in Minnesota and the Dakotas and then to separate the pieces of brittle bran from the white flour. That turned the nutritious spring wheat into the premium bread ingredient, which the millers sold at higher prices all over the world for several decades. The millers also replaced the traditional stone mill wheels with porcelain and steel rollers, which cut costs and improved quality. This led to the large milling fortunes here.

(3) The lottery model. In this model, which is based on luck, a region sells its unearned wealth in exchange for products and services imported from elsewhere. As an example, Adams noted that the economic boom in the Williston oil basin in North Dakota is caused by the sale of unearned wealth in oil and gas. The lottery model involves making money (transferring wealth), rather than earning money (by creating new wealth).

This is known as "economic rent." Economic rent is any unearned income that arises from conditions of exclusivity or scarcity. (Economic rent should not be confused with the more common term "rent," which refers to a payment made for temporary use of an asset or property, such as paying rent to a landlord in order to live in an apartment.)

For example, economic rent is reflected in the huge salaries made by star athletes, who are scarce, versus an average person. It also explains the high value of assets like patents and permits, which lead to scarcity or exclusivity.

The healthiest regional economies support themselves by the innovation and production model, in which something new and valuable is produced. Most regional economies, though, are mixes of all three models.

Part II. The pervasiveness of rent seeking and rent capture.

The Madoff model and the lottery model are based on rent seeking. Special interests engage in rent seeking when they figure out how to get benefits for themselves, usually through the political arena, without giving something equal back to the system. They typically do so by getting a subsidy or a tariff for a good they produce or by getting a special regulation that hampers their competitors. These activities don't create any benefit for society, thus violating the equal-benefits-to-both-sides-of-a transaction tenet of a fair and efficient economy; they just redistribute resources from taxpayers to the special-interest group.

Adams gave the following examples of rent seeking and rent capture: when certain interest groups, through pressure and lobbying, that is, rent seeking, convince the rest of us to give something away (like grazing rights or water from an aquifer) or to legislate subsidies (such as for federal flood insurance) or to grant restrictions (like sugar restrictions). We then allow the groups to make money off these actions, that is, to capture the economic rent that has been created. The narrow group of people who receive the benefit are very successful in convincing the rest of us that it's in the public's interest to allow things to operate this way.

He pointed out, though, that some restrictions can be positive. Patents and copyrights, he said, are a good way of rewarding people for a certain period of years for inventing new things.

Rent seeking and rent capture undermine economic health, promote inequality in society and curtail economic growth. Adams said if economic rents were taxed, they wouldn't disappear altogether, but the reduced size of the rents would help redirect the use of capital elsewhere and improve the economy's efficiency and productivity. Rent seeking and rent capture in so many parts of our economy divert resources into places that promote additional rent capture, rather than focusing them into a place that's really productive and that allows healthy economic expansion and promotes equality.

Part III. The "Regional Balance Sheet" concept and defects in the Gross Domestic Product (GDP) concept.

Some people believe that the concept of the GDP is defective, because it's steering us in directions that are helping the GDP, but eroding the national balance sheet. The GDP was defined in the 1930s as a set of economic flows: essentially, *consumption spending* per year + *new investment* put in place each year + *government spending* each year. Adams said the country had a very strong balance sheet in the early Depression years, but we were experiencing a slowdown in investment, credit tightening by the banks and a drop in consumer expenditures.

Assets in each region included human capital, natural resources, the built environment, and local institutions, such as governments, laws, traditions, schools, colleges and universities, human service professions, churches, etc. We took those assets for granted and accepted the advice of people like John Maynard Keynes, who said the flows were inadequate and that we needed to step up the flows to get people working again.

The policy response from the Roosevelt Administration was to promote more spending by consumers, businesses and government. The consequence, Adams said, is that we've been thinking that way ever since. But in 2013, that line of thinking has serious flaws, he said. According to the GDP concept, $1 spent on prisons is just as valuable as $1 spent on preschool education. Governments act as though it shouldn't make any difference, as long as the flows are enhanced. Or policymakers believe a "cash for clunkers" program, that is, destroying assets to stimulate cash flow, is a good idea.

Stepped up cash flow is not the same as economic development. If you really believe in the GDP concept and forget about the balance sheet notion, Adams said, there should be a law that as soon as your car is seven years old, you should have to run it off a cliff. That way you'd have to buy a new car and that would be good for the economy. "But that overlooks the fact that you've destroyed one of your assets," he said.

Governments don't have balance sheets; they have budgets. They figure if revenues-in equal expenditures-out, then the budget is balanced.

Businesses have profit and loss statements and balance sheets. Adams noted that a balance sheet is a financial statement prepared at the end of the year, listing assets, liabilities and the net worth of a household or business. The goal is to have a better balance sheet this year than last year.

In a business, depreciation is treated as a cost. For example, if a machine should last five years, then a business depreciates it every year for five years and treats that as a cost against the business's revenue. The value of the asset diminishes.

Governments don't take depreciation into account. "Their annual budgets are misleading and I think they're downright dishonest," Adams said. "If a business failed to depreciate its machines, it would overstate its profits and it would look healthier than it really is. But that's what governments do."

If a business has an account payable or an employee pension obligation, it goes on the balance sheet as a liability.

Governments don't do that with pensions and other obligations, so we can't tell if we're better off or worse off at the end of the year.

A negative trend is that we're moving away from an economy of earning money to an economy of making money. But a positive trend is an increasing attention to thinking in balance sheet terms about what we do today and its implications for tomorrow.

Adams said we must make sure that as individuals, families, communities, states and a nation:

1. We pay full price for what we get, with no subsidies and no rents; and

2. We make no overpayments: no graft, no sweetheart contracts, no excessive pay or

benefits, which is another form of rent capture.

The large forces that have been building up for the past 40 years include the rampant spread of rent seeking and rent capture. Individuals and organizations try to put themselves in a protected position (through monopoly, cartels, patents, political action, government rules and regulations, occupational licensing), so they will be compensated well for their work, without regard to the value to society of what they produce.

These practices ensure three outcomes: (1) increasing inequality in economic circumstances; (2) increasing stagnation of the economy; and (3) increasing polarization in politics that keeps the one percent strong, while using their resources to convince the 99 percent that what's happening is in their interest.

As long as we allow rent seeking and rent capture to proceed, it'll create huge incentives for people to do exactly that. In response to a question, Adams said that when we're talking about how the metro economy is working today and how it should work down the road to make us effective and competitive, we must look at the sources of income today. How much is based on rent seeking and how much on creativity and ingenuity?

Entrepreneurs are limited in what they can do, because we're not investing early enough to create the entrepreneurs of tomorrow. He said the Washington, D.C., economy has flourished by the growing presence of special interests seeking rent capture. "That's not a productivity business," he said. "It leaves behind an underinvestment in young people to create the entrepreneurs, the business leaders and the productivity of tomorrow."

More and more people feel entitled to what they're getting, rather than feeling that what they get has to be earned. An interviewer noted that people now seem to feel less discomfort with collecting a paycheck whether or not they've earned it. Adams said managers and leaders must tell people that being a public employee is a public trust: it's your obligation to deliver equal to what's being given to you. "When public employees become a major political block, voting to ensure that what they get continues on their terms," he said, "the system has become corrupted."

Smaller cities in Minnesota have their own economies. Adams said the Rochester region, the Marshall region, the Duluth region and the Roseau region are all smaller versions of the Twin Cities, with their own economies. He noted that Rochester, for example, has an economy, but he asked how much of that economy is based on quality research that's improving the effectiveness and efficiency of health care down the road and how much is based on doing routine, overpriced medical procedures.

Governments could be required to have balance sheets. Adams said the Government Accounting Standards Board is "inching" into that in the transportation area. He said it's important to think in balance sheet terms: is it improving or declining? "If it's improving because we're doing a better job of competing with the rest of the world by supporting ourselves in honest ways, that's good," he said. "If we're competing because we've learned how to rip off the rest of the world, that's bad. It's not long-term competitiveness."

Agriculture is one of Minnesota's major industries. Adams said when it's done well, that is, with the agricultural producers absorbing the full costs of their production, it's a big part of the economy. "They're doing great if they're not polluting, if they're not leaving toxic things behind and if they're not creating too much monoculture, so that we create a bad situation down the road," he said.