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DOLLAR & SENSE

The geography of prosperity: How to help the areas lagging behind

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(MUSIC)

DOLLAR: Hi, I'm David Dollar, host of the Brookings trade podcast Dollar & Sense. Today my guest is Jay Shambaugh, a Senior Fellow with Brookings and the Director of the Hamilton Project. His team recently put out a study on the geography of economic disparity, why some regions are lagging behind and what we might be able to do to help them. So, that's going to be the theme of today, helping lagging regions. Welcome to the show, Jay.

SHAMBAUGH: Thanks very much for having me.

DOLLAR: I'd like to start with a macro idea and then come down to more micro, which is really what your study's about.

SHAMBAUGH: Sure.

DOLLAR: We have this interesting moment where both Elizabeth Warren and Donald Trump have recently advocated manipulating the value of the dollar down, with the idea of helping U.S. manufacturing, and this would somehow perhaps help the old Rust Belt, other lagging regions.

So, what will we have to do to actually manipulate down the value of the dollar?

SHAMBAUGH: So, I guess I'd say a few things. If a country wanted to really change the value of its currency, the easiest way to do it is with monetary policy, right. So, if the Federal Reserve wanted to run much more lax monetary policy and announce that it was doing it, that probably would make the dollar weaker versus other currencies. But, I don't think that's what we're talking about here, in some sense. We're talking about the executive branch trying to do something.

So, at that point, you could have capital controls and kind of mandate what the value of the currency is, but I don't think anyone's talking about that, either, right. So, then, you're left with basically intervention in the currency, where you go out and sell dollars and buy other currencies to try to make those other currencies worth more relative to the dollar.

And, I think on that front, at least the research I tend to look at suggests is, you know, that can work if it's a signal of future monetary policy, which, again, is not what we're talking about, it's The Fed being separate here. It could work if it's really huge and in your relatively small, traded currency, right.

So, could Vietnam intervene in ways that affects the value of its currency? Yeah, it probably can. Can the dollar or euro get moved by a $5 billion intervention from the U.S. Treasury? I honestly don't think it can. I think the market's just too big and too deep, that unless you're sending signals about the future monetary policy, they're going to look through it.

And, so, otherwise, maybe if the entire G20 intervenes because they think one currency is in a bad place and they all announce they're going to fix it, things like that can do something. But, I think the

U.S. stepping forward and selling a small number of dollars and buying a small number of euros or yen, I don't see that as moving the dollar in a huge amount.

DOLLAR: Right. So, I share your skepticism, but suppose we could push the value of the dollar down by a measurable amount. So, what effect would that have on the U.S. economy? Would this bring back manufacturing jobs?

SHAMBAUGH: So, I think, on average, it would be good for export-oriented firms that currently exist -- to have a weaker dollar would make their goods more competitive around the world. So, you've got that aspect of it. The downside is, of course, any firm that's using imported inputs is going to be paying more for them. Goods are going to cost more to consumers that they import, things like that.

I think you can get some small impacts on manufacturing. I think we did see this in 2015 and '16 when the dollar got stronger. It did seem to coincide with slowing down of manufacturing a bit, although I think a larger part of that was the world economy was slowing. And, so that had a much bigger effect than what was happening to the dollar in particular.

I think you would sorry if we somehow managed to make the dollar weaker but in a way that kind of threw the world economy for a loop. You'd have kind of the competing aspects, right. Sure, it'd make U.S. goods cheaper, but the rest of the world wouldn't be buying.

So, could it help a little bit? Yes. I think a really important part, though, is your question of would it bring the manufacturing jobs back to firms or places that have gotten hurt? And, I think there it's harder to see, right. So, existing firms that are doing well might do a little bit better.

So, some regions that currently do well with manufacturing might do a little bit better, but regions that have really gotten hollowed out, temporary fluctuations in currency aren't going to bring things back when a firm moved out for more structural reasons or long-term cost reasons. And, I think that's especially true with things that people view as any kind of temporary fluctuation.

You'll often see even the buyers for retail firms will say we'll eat the costs for short amounts of time. If we think something's a temporary blip, we're just going to look through it. And, I think anything like this would probably be seen as a temporary blip, and you wouldn't see as much real massive moves on the currency side, but even if you did on the manufacturing side, and then, even if you did, it's not clear to me that that's going to help the struggling regions that much relative to the places that currently are doing reasonably well.

DOLLAR: Right. So, in my 20 years in the World Bank, Jay, people are always saying can't you find a macroeconomic policy package that not only is good for growth but also has redistribution effects. Can't you help the poor or help the lagging part? I actually worked on Vietnam for years, so we were worried about the lagging parts of Vietnam, and I made a lot of enemies by basically arguing that it's not really rational to use macro policy for those distributional goals. There are, in fact, micro and distributional policies.

So, now we're going to shift gears, go down to the micro level, talk about your study on place-based policies for shared growth. First, let's just start with a general question from your study. What do you find about these lagging regions or these differences in economic geography? Why are regions behind?

SHAMBAUGH: So, I'd say a few things. First, I think it's just important to always remind people just how big the differences are. If you look at the top quintile of counties, the top 20 percent versus the bottom 20 percent, household income is literally a factor of two. The richest counties are at over 80,000. The poorest counties are at 40,000.

The one that's really hits, I think, macroeconomists hard is when you see that the prime age population, the 25 to 54, the people we think that are all out there working, the number of them that are working in the top-performing counties is 83 percent. In the bottom-performing counties, it's 67. And, when we think, like, during the recession, that might have fallen about five points nationally, and we all thought it was the greatest catastrophe in macroeconomics.

Here, you're talking about three great recession-level shocks from top to bottom. So, I think it is important, incidentally, these places are doing radically differently in terms of economic outcomes. And, so I do understand, like, people are casting about trying to figure out ways how would we help these places, because the gaps are really big.

I think you said, you know, why are they different? There, I think it is harder, although one that's really important is to note how persistent it is.

So, we used to see in the United States the poor regions actually growing faster, so you had convergence within the country. And, you also had a lot more mobility.

And, so if you were a policymaker 30, 40 years ago and you said what should we do about lagging regions, one tempting response would have been, well, look, they're catching up faster already, and, if people don't want to be there they can move, and they are moving. And, those two things might make you say I'm not going to try to tilt resources in some way that might be inefficient. Whereas today, since 1980, the convergence has stopped, the poorer regions have stayed poor, and mobility is down.

And, so I think at that point it becomes much more incumbent on policymakers to say is there something we can do for these struggling regions, because they're not getting better on their own and people aren't moving as much.

DOLLAR: One thing I like about your study, Jay, is you note that there's a long history of trying to help lagging regions, --

SHAMBAUGH: Yes.

DOLLAR: -- and it's a history that's mostly one full of failure.

SHAMBAUGH: Yes.

DOLLAR: I mean, it's not easy. So, you've got some interesting policy ideas, some research-based suggestions. One of those is to subsidize employment in areas of extreme policy. So, let's look at some of the possible interventions.

SHAMBAUGH: Sure. And, on this particular policy, we reached out to an author actually who had written many of the studies saying all those previous policies failed. And, we went to him and said, look, you know a lot about this. This is David Neumark who is an economist. We said, if you were to design it yourself, could you do better.

And, so one of the concerns people always had in the past was, you know, you do these policies that gave us subsidy for firms in a particular location. It often wound up helping the landowners in those places more than it helped the poor people. And, so the policy that we've put out here is to say you give subsidies to hire people in high-poverty areas where there's just really weak labor demand, these places where you don't have enough prime-age people working.

And, in particular, though, it's thinking there are two issues going on -- one, you don't just give them subsidies to hire anybody, because then again, you get people moving in right around the edges of where you drew the boundary, and it doesn't help the poor people in the poor places. And, instead you say, people who are currently poor in the currently poor places, we will subsidize them being hired.

The other, I thought, interesting twist that David Neumark came up with was to say the other problem in these places is often the public goods are in terrible condition, right. They're tax base is eroded, the parks are falling apart, the schools aren't in good shape, there aren't really good community health centers.

So, what you do is you subsidize people to work to improve the public good. So, you pay nonprofits to hire people for 18 months to do things that would improve the area, and that gives those people job skills and job training and a wage, importantly. And, then, over time you switch that subsidy to paying 50 percent for private firms to hire them, and you basically try to glide people back from being out of the labor force into being employed by private firms.

DOLLAR: Economics has all these powerful theorems. That's one of the things I love about it.

And, one of the basic theorems is, if you have something you care about, you want to target, like you think poor people don't have enough employment opportunities in a location, the optimal policy is always to directly subsidize that. And, everything else is incredibly indirect. So, if we use import protection, --

SHAMBAUGH: Yep.

DOLLAR: -- costs a million dollars to create a steelworker job. We try to talk down the value of the dollar. That's not likely to have any effect. So, if you're really worried about this issue, then the smart this is to just go indirectly with subsidies.

SHAMBAUGH: Yeah, and that's, basically, -- the logic of the plan is to say, at a fairly local level, where you know there's a really high concentration of poverty and just not enough labor demand, you go into those places, partner with the nonprofits, subsidize them to improve the public goods, and then over time subsidize the private firms to hire them. And, hopefully, as you say, you've targeted the real specific concern you have, which is that poor people don't have jobs and, therefore, don't have incomes. Well, good, let's turn around and fix that specifically.

DOLLAR: So, do we have any historical examples of this in any country? Is anyone using a policy similar to this?

SHAMBAUGH: I wouldn't say exactly like this. I think we've seen policies with wage subsidies. The Earned Income Tax Credit is a really broad-based national wage subsidy, aimed at poor people, so that you do have some examples. And, that's one where you see people think it can be quite effective, but that's certainly not geographically targeted in any way. So, this would be basically saying let's go in and target a specific location.

Again, as I mentioned, we've had previous policies that have tried to subsidize hiring in these places, but often doing so, or even more subsidized business investment in these types of places, and the concern you have often is, it seems like they in some cases were effective, in some cases weren't effective, and often were most effective at helping capital or landowners in those areas. And, so, this is trying to switch it a little bit and really target poor individuals.

DOLLAR: So, another chapter in your study looks at the issue of government grants. You hear a lot of complaining of the U.S. nowadays that we're broke, we don't have money to do anything, which is ridiculous, because we're still the richest country in the world.

And, I saw in your study that we have about $700 billion per year in essentially transfers from the central government to local governments.

SHAMBAUGH: Right.

DOLLAR: How could we use that more effectively to help these lagging regions?

SHAMBAUGH: Yeah. And, this was a study by Tracy Gordon, where she said people are trying to come up with all these new solutions, of new programs or new subsidies or things like that. And, she said not to criticize those other ones, but before we create brand new programs, we should also just remember we sent out a lot of money, right, like $700 billion going around the country. And, you could just try to send it out with, in all honesty, a greater eye to poverty.

In many of these cases, these things have formulas already, whether it's the money that goes out to help states pay for Medicaid, whether it's money that's going to education and to poor schools, you can change those formulas and make them more sensitive to the poverty, both the poverty rates and the overall poverty of an area. And, if you do that, you could try to make sure that poorer places are getting more money from the federal government to help deal with this fact that they don't have much of a tax base to provide public goods themselves.

And, so, that's the idea she had, was to try to come up with ways you could look at the specific spots where we're giving out a lot of money. And, Medicaid and education are the two biggest cases. But, there's a broader array that you can look at and just kind of go through them and put a greater emphasis on the poverty in the region as one way to do it.

I will admit this is not the easiest thing to do, right, because you already have the complaints from states that pay more in taxes than they get back. They consider themselves donor states. They get very upset at the idea that money that they're giving out that they're sending in to the federal government would not be coming back to them.

And, so, people tend to think that the taxes they pay for gasoline will come back to them, to their state for their highways. And, the more you do to tilt the funding towards the poorer places, the bigger you're going to push on those kind of regional complaints you get around this. But, I think the fact remains, if you're worried about these lagging regions, one thing you can do is try to improve their health care and improve their schools through the money we're already sending out through the federal government.

DOLLAR: You're right that our existing system redistributes money toward the poor to some extent, but if you compare the U.S. to other countries, like Germany, for example, there's much more redistribution within the German system than there is within the U.S. system.

SHAMBAUGH: Yeah, absolutely. The point of Tracy's paper was to demonstrate the extent to which we are not particularly income-sensitive in how we distribute the money right now. And, a lot of it is the formulas are based on trying to give money back to the places it came from. And, so, the idea is, if we want to care more about regional inequality, one way to deal with it is to adjust those formulas a little bit.

The Medicaid one is a good example in that it already does have poverty in it, right. So, we've already acknowledged we should give states with high poverty rates, help them with their Medicaid costs more than other states. There is nothing to say we've hit the golden medium perfectly, right. Like, maybe the answer is, as regional inequality has seemed worse and more persistent, that we need to tweak that formula and help out the states that are poorest and the counties that are poorest with their educational costs.

DOLLAR: Right. It certainly makes sense, given what's happened with income distribution in the U.S. It makes sense for us to do more redistribution. When, in fact, if you look at the whole system, including taxes, we're actually doing less redistribution than we were just a few years ago. So, we're going backwards.

SHAMBAUGH: Yeah, especially regionally. I think there's an argument that you look at and you say these places aren't getting better on their own. And, if we thought they were before, we should be adjusting our policies.

DOLLAR: So, there's also a chapter about the role of universities, which I found quite interesting. I know you're also a university professor --

SHAMBAUGH: That's right.

DOLLAR: I apologize. I forgot to introduce you as a university professor as well as a Brookings fellow. Nice idea that having a university near a poor community is potentially a benefit. But, I took the point of your chapter that it doesn't just happen automatically, or maybe some benefits just spill over automatically. But, there are things that can proactively create linkages between universities and nearby communities.

SHAMBAUGH: Yeah. This, for me, was a really interesting project to work with these authors on, because two of the authors were initial professors at the University of California-Merced, when it was dropped effectively in the middle of nowhere, and the university seemed to do well. So, the way it affects poor communities is to drop a university in them. And, I think their response to that was you've got to be a little more careful than that.

And, first of all, to remind us that Johns Hopkins is a world-class research university. Baltimore has really struggled at times over the last few decades. Yes, there are other areas that have universities that have done better, but that doesn't mean it's automatic. It's also really expensive, right. Building a new university -- and not just a university but a big research university that's going to have all these spillovers -- is a really costly endeavor.

When we had this event, we had Becky Blank, who's the chancellor of the University of Wisconsin, on the panel, and she was quite bemused by the idea that we were going to go out and build a lot more universities. Sitting there is someone who is fighting for every dollar she can get from her state to keep what she has, and the idea that we're just going to go build a ton more is far-fetched.

And, so, what these authors were thinking was, well, can we use what we've got better, can we better connect universities to the struggling places, either if the university is in one, -- or, for that matter, their world-class universities in Massachusetts, they're not all located in the areas of Massachusetts that are struggling. But, can we do more to connect them to those regions?

And, so, their goal was to say we've already seen this in the past, whether it's the kind of agricultural extension -- and now more recently the manufacturing extension -- programs that try to get knowledge out of the university into the communities, into the businesses. It's a, really, model off that manufacturing extension partnership program that the U.S. already has, and tried to kind of build it up in a more robust way, in particular if a university is partnering with a community in one of these places that has higher poverty rates or lower employment-to-population rates and say, hey, these are areas that are struggling, these are areas where, in particular, their point was it's not just the supply of high-skill individuals that fixes everything.

Cornell produces a lot of high-skill people. They don't all stay in upstate New York. And, so, instead, with the emphasis being the goal is to create demand for high-skill workers. You need the firms. You need to help the firms grow to hire the high-skill workers. That's what gets people to stay in communities.

And, so, their goal is, if you partner with the universities and kind of get, whether it's the management knowledge, the scientific knowledge, the marketing knowledge, these things that universities are good at creating, get those into the firms and partner with the firms, that you could actually help firms grow in those areas, and that would create demand for high-skilled workers and kind of raise the incomes and the labor demand in those areas.

DOLLAR: So, do we have any sense of universities that are doing a particularly good job with this?

SHAMBAUGH: There are universities that do a good job. And, so, we've certainly seen over really long histories -- you know, the research triangle down in North Carolina didn't used to be what it is today, and those schools have created an area that is now seen as kind of one of the leading areas in the United States. So, you certainly can see it happen over long stretches of time.

In the chapter, they talk through a few others schools. State University of New York and Buffalo is one where you get the community coming together. In some cases it's mayors partnering with local business leaders partnering with universities to say, hey, we're struggling as an area, what can we do to utilize this one big resource we have.

And, so, I think in cases like that you have seen some steps where we've been able to get more partnerships going with the firms and kind of get some of that knowledge out into the community. Some of the University of Florida schools have done a really good job as well is my recollection.

And, so, I think it's something that we've got good models at the local level, and we've got some models at the national level with this manufacturing extension partnership, that this is not one that's some bizarro new idea we've never done before. There are real models on the ground we could do to tweak and take steps forward. It's not going to save every struggling community, because there's some that really have no firms to begin with or not many firms to partner with and things like that.

So, there are some places this isn't kind of the idea that would save them. But, especially for communities that are a little bit closer to good universities, that you could think of some of these upstate New York places looking around at, whether it's the Syracuse or Rochester or Cornells of the world, and thinking there are a lot of people spending a lot of federal research dollars here. How can I link up with some of that knowledge, in ways that might keep some of the firms and labor demand in those areas?

DOLLAR: So, the last topic I want to take up, Jay, is, toward the end of the short summary of your study you say you draw some lessons from developing countries about how aid to infrastructure, education, and health can help jumpstart growth and development. So, I'm curious about what these lessons are.

SHAMBAUGH: Stephen Smith, who's a colleague of mine at George Washington University, and I had spoken about this a long time ago. And, so, when we were doing this book, I asked him if he would write this chapter where we basically think -- if you look at the development economics literature, you know, over the last 30 years it's just been an amazing amount of really high-quality, empirical work going in and testing what works, what doesn't work, relying on going in and running experiments or looking at what's working in different states in India, or all sorts of things where we've been able to say we know a little bit more about how economics in a struggling region works today than we did 30 or 40 years ago.

But, a lot of those literatures are a little bit segmented from, say, the literatures in advanced economies where people are looking sometimes at similar questions. And, so, I'd say some of the key lessons revolved around education and really focusing on how do you get people through high school.

And, one of the things, I think, that was striking in the work we were doing at the Hamilton Project, just on which areas were struggling, which weren't, was just -- if you threw a bunch of stuff in a regression to try to predict which areas weren't doing well, far and away the easiest measure was areas with a high less than high school population. The areas that were doing well had a lot of college graduates. But, the areas separate from that effect, the areas that were distinctly struggling were ones where people aren't graduating from high school.

And, so, some of the lessons you see in the developing world is around whether it's raising the school age, whether it's providing tutors to families that are struggling, whether it's doing a lot more information aimed at families, to try to make sure they understand the value of education and getting people through a high school degree, that there's a whole range of types of programs -- You can go out and look at specific choices countries have made where you see programs have worked. So, I think some is in education.

One that I find interesting and actually is relevant in the U.S. context is health policy. And, that's this idea that -- occasionally where I've talked to a mayor from an area that has a lot of poverty and say what's the easiest thing we could do -- this may sound silly, but the easiest thing they can do is make sure every single person in their area is signed up for all of the health and federal benefits they're eligible for, because there are a lot of places where people aren't getting Medicaid. They're not getting SNAP or what used to be called food stamps.

All sorts of programs that the research shows us are incredible impactful on people's lives, on kids' lives, on people doing better, staying in school, getting jobs eventually. And, making sure people are actually signed up for these programs that already exist is almost the biggest no-brainer that we have, in that sense.

And, that's another one that actually kind of comes out of the developing country context, where trying to get everyone signed up for health benefits, trying to make sure everyone who is eligible for going to school on a scholarship is, in fact, going to school on that scholarship, and getting the information out to people that these benefits exist for them, to try to help them kind of get out of the poverty traps they're in at an individual level. That winds up helping areas that have a lot of poverty, too.

DOLLAR: So, I've been talking to Jay Schambaugh about Place-Based Policies for Shared Economic Growth, which is a publication of the Hamilton Project at Brookings. You can find the study on the Brookings website. The basic message I take away, Jay, is, there are a lot of interesting ideas that intervene at the community level or even the individual level, a lot of interesting ideas about how to help poor people in lagging regions.

Sounds like a lot of hard work, and some of these ideas about let's just put up import barriers or let's devalue the dollar, this is rather cheap thinking, that this is going to have the same kind of effect as some of this hard work at the micro level.

SHAMBAUGH: I think that's very fair to say that there's a lot that can be done. It's not always easy, but there's a lot we know about how to do it in the right way, and I think there are a lot of opportunities there.

DEWS: Okay. Thank you very much, Jay.

SHAMBAUGH: Thank you.

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