

The Competitiveness of Inner Cities

BY LISA KENNEY

“Are America’s Inner Cities Competitive? Evidence from the 2000s,” Daniel A. Hartley, Nikhil Kaza, and T. William Lester, Federal Reserve Bank of Cleveland Working Paper No. 15-03, March 2015.

Are the majority of inner cities experiencing a renaissance thanks to rapid gentrification, or is growth limited to a small number of high-technology regions, resulting in inequality among metropolitan areas? These two narratives are at the center of new research from the Cleveland Fed, which looks at whether inner cities have become more competitive — that is, whether they have had net positive employment growth and an increase in the share of jobs located there.

The authors conclude that while there has been nationwide job growth in inner cities, it has not been enough to declare a renaissance in inner city America.

In their research, the authors look at three measures of employment. First, census tract level data from the Local Origin-Destination Employment Statistics program showed that inner city tracts added 1.8 million jobs between 2002 and 2011. This job growth was found in nearly all census divisions, and the inner city rate of growth nearly matched suburban tracts’ rate of growth, 6.1 percent to 6.9 percent, respectively.

Inner cities also increased their share of metropolitan employment in 120 of the 281 metropolitan statistical areas studied — in addition to having positive employment growth — showing that competitive inner cities may not be uncommon, but they are not yet universal.

Finally, the authors look at the pattern of job growth within the inner cities. Job growth tended to occur faster in census tracts closer to downtown, with nearby population increases and recent residential construction. And even within competitive inner cities, the tracts with higher poverty levels had lower job growth than the tracts with lower poverty levels.

“Competing for Jobs: Local Taxes and Incentives,” Daniel J. Wilson, Federal Reserve Bank of San Francisco *Economic Letter* 2015-06, Feb. 23, 2015.

There has been a debate about whether or not localities should use tax incentives to persuade businesses to relocate to certain areas. State and local governments across the country, including in the Fifth District — where, for example, South Carolina lured Boeing with a multimillion-dollar incentive package — have used these tools to increase the economic development in their regions.

These incentives can be broken into two categories: Discretionary incentives are created specifically for individual companies, while nondiscretionary incentives are

available to all qualifying businesses.

In a recent *Economic Letter*, a San Francisco Fed researcher asks whether these incentive situations are a zero-sum game. That is, has economic activity simply been moving from one area to another? According to past research that the author reviews, the answer is mostly yes.

Past research has found that when tax incentives bring a company to a new locality, the move has an adverse effect on the old location. This means there is no net gain for the national economy.

The *Economic Letter* finds that local tax policy does influence the location decisions of companies, but that there is no consistent way to measure whether the benefits of these incentive policies outweigh the costs of lost tax revenue.

One large policy question is whether these tax incentives should be banned, as they are in most of the European Union. Standard economic theory suggests it may not be optimal for local governments to set tax policies because they do not factor in the negative effects their decisions will have on other areas; the central government may be better suited for this role. But the Tiebout model, posited by economist Charles Tiebout in 1956, says that competition for individuals and businesses forces local governments to be as efficient as possible in order to charge the lowest possible tax rate.

The author concludes that policy must “weigh the benefits of local choice ... against the cost of how changes in one area might negatively affect competing jurisdictions.”

“How Cyclical Is Bank Capital?” Joseph G. Haubrich, Federal Reserve Bank of Cleveland Working Paper No. 15-04, March 2015.

The idea that bank capital is cyclical has been cited by some as one reason for the 2008-2009 financial crisis. But economist Joseph Haubrich of the Cleveland Fed wondered if bank capital was really cyclical at all. He finds that the answer depended on several factors, including time period, definition of capital ratio, and bank size.

Haubrich used both quarterly and annual data. The first quarterly dataset shows the ratio of total equity capital to total assets from fourth quarter 1959 to fourth quarter 2013; the second set shows the ratio of Tier 1 capital to risk-weighted assets from first quarter 1996 to fourth quarter 2013. There are also two sets of annual data, one from 1834 to 1980 and the other from 1875 to 1946. In the quarterly data, Tier 1 capital to risk-weighted assets is found to be moderately procyclical, while the quarterly equity to assets ratio does not show any cyclicity.

Small banks were the most procyclical, while the largest categories of banks showed more counter-cyclicity. **EF**