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# Ariz.'s choice: Lead or follow

## Lack of urgency to reinvent economy has Phoenix trailing other cities, losing quality of life

**Chad Graham**  
The Arizona Republic  
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The Valley's economy is expected to push through the current real-estate downturn the same way it always has: growth.

At least 100,000 new residents moved in just last year, a growth rate double the national average. A 1,135 percent population growth rate since World War II has made Phoenix the nation's fifth-largest city. But after a remarkable 60-year run, that economic engine shows signs of strain.

According to an *Arizona Republic* analysis of key indicators, metropolitan Phoenix has settled into a trajectory of rising costs and reduced opportunity, riding an economy singularly dependent on the ability to build and sell homes. At risk is the region's ability to compete in the global economy, which in turn threatens the quality of life that drives growth.

This article is the first in a three-part series that will examine where the Phoenix economy falls short and ways other cities have found to build new economies.

Housing accounts for at least \$1 in every \$3 that is generated in metropolitan Phoenix. If real estate begins to pick up as predicted by mid-to-late next year, the Valley's future may again appear secure.

But in the larger world economy, Phoenix is essentially running in place, falling behind cities such as San Diego, Austin and Philadelphia.

These cities have reinvented their economies by moving beyond older manufacturing industries.

Metropolitan Austin, the 39th largest in the country, has become a world center in high-tech manufacturing through sustained investment and marketing.

These cities built "knowledge economies" around research and technology, with the ability to quickly turn new ideas into products and services. Their success attracts more investment, more talented workers and

more leading companies, all critical in global competition. And that success also boosts wages and opportunities across the entire economy.

The Valley has bits and pieces of a knowledge economy. But economists say Phoenix needs to do much more before it can replace housing, manufacturing and tourism as its economic foundation, just as they replaced cattle, farming and copper mining.

Ioanna Morfessis, founding president of the Greater Phoenix Economic Council, has spent 25 years as an economic development expert. She now operates her own consulting firm.

Although progress is being made, she said the question facing Arizona is how to "diversify and create a resilient and competitive economy and make itself less dependent on growth." "Detroit was the fastest growing city in America in 1954, and look at Detroit now."

Part of the answer is to attract more engineers, designers, and scientists whose innovations can drive the economy. Another is to develop a sense of urgency among politicians and business leaders that leads to action.

Warnings about the region's economic base are not new. But the amount of time left to make significant change is running out as the world economy replaces the U.S. economy in determining where Americans work, how much they make and the quality of their lives.

Grady Gammage Jr., a longtime Phoenix attorney and development expert, wrote a book in 1999, *Phoenix in Perspective*, that warned of relying too heavily on growth.

Growth always had been the familiar and reliable solution, Gammage wrote, so there was little incentive to change.

Gammage sees the same mind-set today. "In Phoenix we talk about it, we worry about it, but you know what? Why bother to think about creating a knowledge economy when we can just crank up the machine and sell 30,000 houses each year?"

## **Danger signals**

In a yearlong project with Arizona State University, the *Republic* examined the factors that shape a knowledge economy and, considering those factors, how metropolitan Phoenix compares with nine similar U.S. cities.

Reporters and economists examined decades of data from state and federal sources, universities and businesses. Key indicators were identified for the comparison. Dozens of interviews with economists, business leaders and government officials followed to discuss the findings.

What the analysis found is that Phoenix is slipping. Phoenix is losing ground to other cities in the global economy and experiencing a deteriorating quality of life at home. As the world economy becomes more dominant, Phoenix risks falling further behind.

Two key indicators reflect how much people in Phoenix basically benefit from the current economy.

- **Wages:** Maricopa County ranks last in average weekly wages compared against the nine other most populous counties in the country, according to the Bureau of Labor Statistics. In the first quarter of 2007, the most recent numbers available, workers here made an average \$857 per week compared with \$944 in the Austin area, \$1,038 in the Philadelphia area and \$1,258 in the Atlanta area.

- **Income:** Phoenix's per capita income was \$25,818 last year. That compares to Philadelphia (\$28,436) San Diego (\$28,763) and Denver (\$29,363), according to the U.S. Census Bureau.

Other indicators reflect how well the current economy is doing and the potential for success as a knowledge economy. These indicators reflect both past performance and prospects for the future.

- **Educational attainment:** One key indicator of a region's economic potential is the number of people with college degrees. About one quarter of Valley workers over the age of 25 hold at least a bachelor's degree, compared with 33 percent of Atlanta and 33 percent in San Diego.

Experts say Phoenix is not producing or attracting enough educated workers to compete.

- **Affordable housing:** Inexpensive housing has long been Phoenix's key to steady growth. But in the past two years the median home price has soared from \$169,400 in 2004 to \$268,200 in 2006. Even with the current housing crunch, experts tend to agree that the median price won't fall back to the level of three years ago.

- **Venture capital:** Venture capital refers to public or private money invested in new ideas, products or companies. The amount of venture capital a region generates or receives reflects both its current level of innovative activity and potential for future success. In 2005, Arizona businesses received \$165 million in venture capital, compared with California's \$10 billion, Washington's \$791 million and Colorado's \$652 million.

- **Patents:** Patents granted in a region are considered a reliable indicator of innovation. Between 1996 and 2006, Arizona inventors were granted 16,212 patents. Texas, in comparison, was granted 62,186. Pennsylvania had 34,461.

- **Opportunity:** Want to apply for a job at one of the 500 fastest-growing companies in the U.S.? Arizona had one, JLT Mobile Computers of Chandler, but it was bought earlier this year by a Florida-based company. Compare that with Texas' 45, Pennsylvania's 23 and Washington's 14.

Fast-growing companies tend to be those that rely on innovation and attract educated workers. They are a strong indicator of both a region's accomplishments and future potential.

When it comes to established Fortune 500 companies, Arizona has just four: Avnet Inc., Phelps Dodge (now known as Freeport-McMoran Cooper & Gold Inc.), U.S. Airways and Allied Waste Industries Inc.

Job creation is often cited as an Arizona success story. Arizona has impressive numbers. But there is a difference between quantity and quality of jobs.

From 2005-2006, for example, Arizona added nearly 135,000 jobs for a growth rate of more than 5 percent, compared with about 2 percent nationally.

But the largest segment of the state's workforce - nearly 20 percent (or 526,600 people) - work in trade, transportation and utilities, according to the Arizona Department of Economic Security, jobs largely outside the category of "knowledge workers" needed to transform the economy.

Many new jobs are service jobs to meet the daily needs of all the people moving to the region. Construction, the industry most affected by growth, increased its number of jobs from 219,500 in 2005 to 245,500 in 2006.

But the real-estate slump will lower that number to 231,000 by 2008, according to the Arizona Department of Economic Security.

Data on wages, investment and career opportunity show an economy that is turning but not gaining traction.

## **Growth works**

Cities that have transformed their economies did so with a sense of urgency. Something bad happened. Someone put forth a compelling vision. Change seemed the only option.

There is little sense of urgency in Phoenix, longtime analysts say, because growth has always worked.

Infusions of federal money helped secure the water needed for a desert city to grow, from dams along the Salt River to the canals carrying Colorado River water for the Central Arizona Project. And military bases built from Kingman to Yuma during World War II brought more money and people.

Phoenix took off after World War II with the introduction of residential air-conditioning and a housing industry that mastered economies of scale in an area with vast expanses of cheap land.

Developer John F. Long devised a construction system back in the 1950s that cut costs and allowed him to complete 25 homes a day. Long's assembly-line style of building laid the foundation for the Valley home industry and the Phoenix economy.

From 1940 to 1970, the population of Phoenix soared from 65,414 to 581,562.

By the 1970s, along with a booming housing industry, the region had landed a number of corporate divisions of such companies as Motorola Corp. to headquarters like Greyhound Corp. They helped expand the Valley's role as a low-cost business center and brought more families as well as retirees to the area.

From 1970 to 2000, Phoenix grew from 581,562 to 1.3 million people.

Even when the economy stalled during the savings-and-loan crisis and real-estate crash of the late 1980s,

growth quickly brought investors and buyers back. Through the 1990s, the Valley's population soared as housing developments pushed farther out into the county.

In 2005, metropolitan Phoenix passed Atlanta as the largest home-building market in the U.S. Phoenix's population rose to 1,469,794, pushing past Philadelphia as the fifth-largest U.S. city.

That year, Robert McLeod of Newland Communities expressed what many developers felt about a possible housing bubble.

"Phoenix is unique. The growth won't stop," he said at the time. "Will it slow a little? Will we see a little dip? Will some prices go down 5 percent maybe? Sure. But it has nothing to do with the continuing growth in this Valley in residential real estate."

## Optimism

Growth was such a powerful economic force it was hard to see the downside.

Longtime Phoenix attorney Bill Stephens served as majority leader in the Legislature in 1961 and 1962. Business leaders and politicians "were not foresighted," he said. "They did not see what was coming. They didn't recognize the need for a high-performing educational system. They didn't recognize the need for a road system."

But by the mid-1980s, some leaders did begin to worry how long it could last. Air pollution was worse. Traffic was a mess. Growth in the suburbs was eroding the city's retail sales tax base. And for all the region's success, Phoenix still wasn't able to attract a good number of high-paying white-collar jobs.

When the Valley's population topped the 1.5 million mark, there was no comprehensive growth plan looking toward the future. Freeway construction did not begin until 1985.

Concerns about relying on growth spawned committees and reports in the years since. A few examples:

**1986:** Phoenix Economic Growth Corp., the first private-public partnership for economic development in the state, released "Phoenix: A Blueprint For Growth," calling for a diversification of the economic base with new kinds of industries.

**1988:** In the wake of the real-estate crisis, a negative article in Barron's wondered if boomtown Phoenix had gone bust. Then-mayor Terry Goddard held an "emergency summit," which determined that "increasing economic development competition at all geographic levels means that Phoenix can no longer take continued rapid growth . . . for granted." The summit led to a call for a unified economic development effort.

**1990:** Arizona remained one of only seven states without an overall economic development plan. Public and private groups kicked off a volunteer effort called Arizona Strategic Planning for Economic Development (ASPED) to grow new kinds of companies.

**1991:** An ASPED report determined that "competing in the new world economy simply on the basis of cost - low cost labor, low taxes and low land costs - will not be successful in the long run." The report recommended that Arizona develop economic "clusters" of interdependent companies across several industries.

**1992:** ASPED launched an "Arizona's Economy Is Everyone's Business" campaign and held Town Hall meetings and numerous public forums across Arizona and then disbanded. Gov. Fife Symington formed the Governor's Strategic Partnership for Economic Development (GSPED) committee to attract companies.

**1999:** Gov. Jane Hull formed the Arizona Partnership for the New Economy to assess Arizona's economy.

**2001:** Hull signed a bill allocating \$3 million to strengthen Arizona's infrastructure and give the state a leadership role in the New Economy.

"Phoenix has a history of having great plans," said Naaman Nickell, a former longtime *Arizona Republic* business columnist. "There were all kinds of studies and calls to action that were pretty soundly based, but there was never the leadership to actually move them from planning to action."

Recently there has been some action.

ASU, the University of Arizona and the Translational Genomics Research Institute anchor downtown Phoenix's biomedical campus. And earlier this month the new Science Foundation Arizona secured \$25 million in state money through a matching donation from philanthropist Jerry Bisgrove.

Supporters say these are examples of how to combine public and private funds to help build a research-based economy. But they are small steps compared with what is happening in many other cities.

"This is Arizona playing catch-up to the rest of the world," said Barry Broome, president and CEO of the Greater Phoenix Economic Council. Broome credits ASU President Michael Crow for pushing state leaders to think globally, but he added that it is still hard in Arizona "to get people to think and operate differently."

## Uncertain future

Phoenix, like the rest of the country, has become permanently entwined with the global economy. Cities around the world are connected through outsourced jobs, international investment, immigration and the rise of China. All of it affects life in Phoenix.

Phoenix's economy will rise or fall, experts say, based on its connection to the world economy.

Don Reynolds is an internationally known economist who founded 21st Century Forecasting, a Texas research company focused on long-term economic trends.

He said that during the next five years developing markets like China and India will average a 7.5 percent growth rate compared with a 2 percent growth rate for developed markets like the U.S. and Europe.

In addition, "the GDP of the emerging markets is going to be approximately 30 percent of the global economy, and the United States is going to be 28 percent," he said. "This is the first time that the emerging markets are now a larger part of the global economy than the U.S."

For the Valley to compete in this changing environment, it must move beyond the housing industry as the basis of the economy and develop the pool of people and companies required for a knowledge economy. The effects of running in place economically are beginning to show in metropolitan Phoenix's economic trends and quality of life measures. Income levels are at best running in place according to the Bureau of Economic Analysis.

In 1980, Arizona's per capita income was 94 percent of the national average and 28th in the country. By 1990, per capita income was 87 percent of the national average, 35th in the country. In 2000, it was 86 percent of the national average, 37th in the country.

In 2005, it was 88 percent of the national average and ranked 38th in the country.

If that trend continues, parents may not be able to anticipate a better life for their children for the first time in the state's 95-year history.

Jack August, director of the Arizona Historical Foundation at ASU, said: "Maybe we need to have some balanced, healthy, apolitical debate about 'what does this mean?' Why are we this huge city, but when you scratch the surface, we're poor in a lot of ways?"

Without a solid economic core, other parts of the community lose footing.

"You're not going to have great museums, you're not going to have great medical research, you're not going to have a great highway system," said Bill Harris, president and CEO of Science Foundation Arizona. The larger, long-term value of innovative companies at the heart of a knowledge economy, Harris said, is that they require other layers of small businesses to support them. Incubate those companies "and you've got a real ecosystem."

Nurturing those kinds of companies raises wages and incomes across the economy.

And it will take time. Some experts predict it could take at least two decades to transform the economy.

"It all comes down to leadership and your ability to execute," said Joe Snell, president and CEO of Tucson Regional Economic Opportunities Inc.

"We have got some challenges, and realistically we can't accomplish all of them at the same time. We're going to have to prioritize who does what and do a much better job at leveraging our money. With that said, it all does come down to rolling up your sleeves and just implementing."

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When we run out of desert and forest land, what then yo??

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In my opinion, the economy of greater Phoenix is tied in many ways to the statewide economy of Arizona as a whole. If Phoenix is a success, that draws attention to the entire state, since Phoenix is the largest and capital city in this state.

The educational system, simply put, must continue to take steps to produce educated and competent workers, who have the ability to go into existing businesses as employees and also have the tools to create businesses of their own as entrepreneurs. Scientists and engineers need to be encouraged to start companies of their own that can develop new and innovative products that can improve conditions for humanity and society.

In California, there was a recognized need to support a booming population after WWII, and to be competitive in the face of the Cold War. The California Master Plan for Higher Education, along with increased investment in elementary and secondary education, established a framework that made California not just a national but an international economic power within a generation.

It would be an excellent idea for Arizona to reorganize our institutions of higher learning on the California model, where the three universities (UA, ASU, NAU) accept the top 10-12% of Arizona HS grads. These universities would be the only ones allowed to grant doctoral degrees. A middle tier of state universities (call it the Arizona A&M University system), made up of the 4-6 largest existing community colleges including Mesa CC, Western Arizona College, at least one campus of Pima CC, etc., be charged with granting 4-year bachelor degrees (and a limited number of masters') to the top 1/3 of Arizona HS grads, and the remaining community colleges continue to accept all students who can benefit with an emphasis on transfer competence to the 4-year schools.

Such an allocation and definition of resources can channel funding (from state, Federal and private sources) in the most effective and appropriate manner.

Such a system will not work without continued support and improvement of elementary and secondary education. Schools need to continue to be held to high standards so their students are ready to continue their education and not drop out and be limited to low-skilled service industry work, which in the long run hurts our economy rather than help it. This is critical in areas of Phoenix and the Valley that have become economically disadvantaged; neighborhood revitalization and the reduction of crime depends on



a population base that feels as though they have a chance to succeed in life and not hindered by lack of a good education or lack of an ability to have a good-paying job or start a business.

This factor takes into account the immigrant situation that is a powder keg of emotions in this state on both sides of the debate. We have to realize that people from Mexico and Latin America, rightly or wrongly, still see the United States as the ONLY place where they can realize their goals to provide a better life for themselves and their children and achieve the middle-class status largely denied to them at home. We MUST find a way to get a win-win situation on the immigration problem. Will it take pressure on Mexico and Latin America to get their economies in order and take steps to provide opportunity for THEIR own people? Will it take a second civil rights movement among the immigrant community to achieve acceptance for the people who have come here and proven themselves to be worthy of being called Americans and joining our honored tradition of the melting pot? (you're not going to just deport millions of people, that is impractical). Or do we just continue to build our stronger borders and keep people out of this country using military force to do so, as we are beginning to do now? The immigrant situation will be half of the battle to make Arizona competitive in the next 20 years.

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And another thing, I am in support of the DREAM act to provide a path to citizenship to the children of immigrants who want to become a part of this country (and in many cases to serve in our military and protect our freedom) and already feel as though they are Americans. I feel that it's not fair to penalize the kids for the decisions of the parents. That being said, why are so many people coming here illegally in the first place? We need to look at the root causes and put pressure on Mexico and other Latin American countries to get their economies in order and provide opportunities for their people (outside of the drug trade) so there is less of a demand to migrate in the first place. Expand the middle class in Latin America which seems to now be an "elite" group in which the masses are not welcome.

Arizona needs to be a state which is known for giving opportunity to all people. The immigration issue needs to be handled by the federal government. Right now the feds don't seem to want to do anything about our border or about the root causes for immigration, and that will hurt Arizona's competitiveness to a degree - not totally, but it will be somewhat of a burden unless we change our attitudes on immigrants and start doing a better job of accepting and integrating them into Arizona's society. Some Arizonans will never come to that point.

- UncleAlbert
- Posted: Oct 28, 2007 at 7:15 AM
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#### Economists & Manipulating numbers?

First of all wages have not kept up with growth and yet housing has sky rocketed. Article states housing will probably never drop where it was, with out increases in wages this right here should be a great indicator of the future of AZ, No accounting for the shadow economy of illegals that deplete our low wages even more. Think Mr. August has it right by stating "scratch the surface, were poor in alot of ways". Until we Stop the anti union mentality of this state which would benefit everyone. People who believe Unions are bad then you can continue to allow these CEO'S to continue to rape the payrolls and leave the frontline employees with the scraps. Aero-Space drove us through 60's 70's & part of 80's..Computer industry took it from there and now has peaked. Maybe next are solutions and engineering to save this already strained Planet. Yea we could be the Mecca for alternative fuels & Energy...

We already live under a false economy with much of it manipulated. Inflation calculations that don't account for fuel, food & energy increases...All these numbers are to jumbled to make good sense of

them for the average trying to balance their check book person.

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We knew there was a problem long ago, so I guess my question is why people haven't opened their eyes to it? We already see the issues with the roads and job security.

If the freeway can't accomodate the vehicles now traveling within our cities, how can we expect a stagnant lifestyle and work environment to accomodate? It just seems obvious.

A large number of the issues listed in this article feed on each other to form a vicious cycle. People don't come here with higher educations because there's no motivation for them - lower wages for their education, and little chance of landing a proper job in their field.

The top companies don't pick Arizona and Phoenix as sites for business because there aren't enough qualified people to fill the positions of a "knowledge economy" zone.

The schools don't offer many programs because there's not enough interest in them since there's no job opportunity in the area for those fields.

The housing prices are increasing and our wages/salaries are remaining virtually stagnant, making owning a home difficult for even long-time Arizonans, let alone newcomers who are used to higher salaries.

It IS a mess, and we know it... the question to be answered is what can we be expected to reasonably do as a community to rectify the situation? People are loathe to change much, so it must be a simple solution or it won't happen...

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