Armchair Economics

Perspectives from an economic everyman

The Little Engine That Could

September 2013

Detroit, Michigan has filed for bankruptcy. We have all heard the reasons for Detroit's demise. Unions caused the cost of labor to rise too high. Foreign competitors started making better vehicles. Free trade destroyed domestic production. Regional government became too fat and happy, if not outright corrupt. White-collar workers and jobs moved to the suburbs. The social safety net rose too high, swaying people away from productive activity.

One thing is for sure, when population contracts, and Detroit's has by roughly 50% over the last couple of generations, keeping economic heads above water for any municipality is a losing battle. A great deal of every municipality's revenue comes from its citizens, and if the number of people in any area contracts, then so do the tax receipts that pay for government. But as we see every day, government by its nature is very hard to contract.

Since most everyone today is focused on the reasons for Detroit's demise, why don't we take a different perspective? Instead of belaboring all the mistakes made and pointing fingers at scapegoats, let's consider the reason Detroit became so great in the first place. What was behind Detroit's rise to its original economic success? Are there lessons we might learn from understanding the catalyst behind Detroit's previous glory?

Not long ago, I made a road trip through the upper Midwest with my youngest son. Seeking a glimpse of this region beyond its urban and interstate infrastructure, we made our way through the state highways of Illinois, Indiana, Ohio, Michigan, Wisconsin, Minnesota and Iowa. As we passed through numerous communities, one question kept surfacing, "Why is this town even here?" The answer to this question, for just about any town and any city, is pretty simple: At a point in time, that particular geography was needed to support some part of an economic infrastructure.

In Detroit's case, the city and surrounding upper Midwest region were in the obvious migratory path as New Englanders stretched themselves west. But there has to be something more powerful than regional proximity to inspire people to leave behind their legacy lives and risk moving to an unknown place.

The something that has always impelled people to move is the perception of greater personal economic opportunity. This had to be a factor at play for New Englanders and new immigrants to leave their communities and relocate to Detroit and the Great Lakes region in larger and larger numbers from the mid 1800s on. But what was the source of this hope for greater economic prosperity?

The region possessed the same thing that has caused people throughout history to move, the historical catalyst to the great majority of economic opportunity, the very foundation to economy and civilization. That catalyst is abundant natural resources.

Anyone who has been to the Great Lakes region can see that timber is in enormous supply. In early American history, this timber was harvested, processed, shipped around the region and exported to the east, supporting the growth of an emerging country. The area was and still remains quite fertile, providing the local population with ample food and further exports to the east and south.

But neither timber nor agriculture was the primary catalyst behind Detroit's original rise to prominence. Those natural resources certainly helped establish the upper Midwest's economic viability, but even more important to the area's prosperity was the enormous amount of iron ore discovered around 1844.

Iron ore is the key ingredient for steel. Where there is iron ore, there can be steel. Other natural resources in the area helped make it all happen. Ohio and Pennsylvania were blessed with ample deposits of coal, the fuel needed to process that iron ore into steel. And the Great Lakes waterways provided a cost effective transportation infrastructure to get the iron ore to the steel plants and the finished steel to where it was needed.

That steel initially went into building out the country's early commercial infrastructure including railroad tracks, locomotives, rail cars, bridges, commercial boats and the first skyscrapers. It eventually found its way into many consumer products including cars, washing machines, stoves, ovens and refrigerators. And it made its way into the military hardware we build and operate today that no other country in the world can match.

On the back of abundant natural resources, a rising economic tide lifted all ships from Minnesota to New England. Agriculture helped the upper Midwest become part of the Breadbasket of America, while iron ore made this region our Industrial Heartland.

Duluth, Green Bay, Milwaukee, Chicago, Detroit, Cleveland and Buffalo. All of these Great Lakes port cities grew up supporting the commerce that originated with timber and agriculture, exploding as iron ore fueled an industrial renaissance.

Chicago became the commercial center, balancing the region's enormous natural resources with the needed capital and services. A stone’s throw away, Gary, Indiana became an enormous iron ore port and steel-processing center. Detroit, Pittsburgh, Cleveland, and Toledo grew as industrial centers. They were all connected to the east by the Great Lakes waterways, the port city of Buffalo and inland transportation and commercial hubs in Rochester and Syracuse.

As the United States grew, the upper Midwest grew. As the upper Midwest grew, the United States grew. Growth fueled growth. Population grew, so economy grew. Immigration grew, so economy grew. Productivity grew, so economy grew.

These natural resources created a waterfall economic effect. Infrastructure had to be built to support the process of turning iron ore into steel and steel into numerous commercial and consumer goods. And as jobs were created all along this industrial food chain, further infrastructure had to be built to support a growing population.

One might even conclude that Great Lakes’ iron ore was the primary catalyst behind the creation of the world’s first seemingly sustainable middle class.

Natural growth continued until virtually every American family had a car, washing machine, dryer, stove and oven. By then, we had also substantially built out our interstate highway system, our seaports, a large part of our air travel infrastructure and enormous urban centers.

Armchair Economic Perspective
The Little Engine That Could
September 2013

Eventually the great majority of our infrastructure was mature, and families had more than one of many appliances. Soon the United States economy would become referred to as a developed market. We were no longer emerging, no longer growing our middle class.

Once our country's growth matured, our natural resource needs from the upper Midwest region leveled off. At the same time, other regions of the country grew their own competitive industrial infrastructures, and global markets developed other supplies of iron ore, steel and many of the products the upper Midwest previously produced.

Today's rapid growth economies are no longer in the Upper Midwest or New England, nor are they across the ocean from New England, in Europe. Today's rapid growth markets are in China, India, Brazil, Asia, South America and Africa. The growth gene has moved to other geographies around the world. Situated in the middle of the US, Detroit is a long way from these markets.

What are the lessons to learn from Detroit's rise and fall? Well certainly we must be careful of projecting perpetual economic growth. There are huge differences between emerging and developed economies. Because the growth gene moves around, we must be more prudent when good fortune comes our way. We must develop and maintain a nimble economic ecosystem. And we must always focus on developing systems, infrastructure and products that serve the next growth markets.

Today we are watching a similar story unfold. Innovation has unlocked an enormous new supply of oil and natural gas. New infrastructure is now needed to support this growing supply of natural resources. Pipelines and other transportations systems must be constructed. Storage facilities must be developed. Industrial plants that process oil and natural gas must be expanded or built from scratch. Looking out even further, we could see investment grow in plants that turn processed hydrocarbons into finished goods like paint, building materials, fertilizer, textiles and a myriad of plastic products.

Developing out the needed infrastructure to support our expanding supply of oil and gas will require hundreds of billions of dollars invested in new assets. It has and will continue to be a huge job growth driver. Our new natural resource boom is creating wealth, increasing tax receipts and providing new vitality to many parts of the sagging US economy. It's economic déjà vu.

What we are starting to witness today is the same sort of economic activity that created the once great cities of the upper Midwest. Like Detroit, they all rose up behind the growth in natural resource production. This story makes it easier to understand the economic position today of the Gulf Coast region. And it provides a sliver of hope that our national economy has a worthwhile future beyond the Federal Reserve playing games with Monopoly money and the federal government pretending it's the Wizard of Oz.

Doug

Douglas A. Leyendecker
713-862-3030
doug@armchaireco.com