

The southern city welcomes the middle class; heavily regulated and expensive Gotham drives it away.

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New Yorkers are rightly proud of their city's renaissance over the last two decades, but when it comes to growth, Gotham pales beside Houston. Between 2000 and 2007, the New York region grew by just 2.7 percent, while greater Houston—the country's sixth-largest metropolitan area—grew by 19.4 percent, expanding from 4.7 to 5.6 million people. To East Coast urbanites, Houston's appeal must be mysterious: the city isn't all that economically productive—earnings per employee in Manhattan are almost double those in Houston—and its climate is unpleasant, with stultifying humidity and more days with temperatures exceeding 90 degrees than in any other large American city. So if those two major factors in urban growth don't explain Houston's success, what does?

Houston's great advantage, it turns out, is its ability to provide affordable living for middle-income Americans, something that is increasingly hard to achieve in the Big Apple. That Houston is a middle-class city is mirrored in the nature of its economy. Both greater Houston and Manhattan have about 2 million employees. In Manhattan, almost 600,000 of them work in the idea-intensive sectors of finance, insurance, and professional services; only 2 percent are in manufacturing, and fewer than that in construction. Finance increasingly drives New York City's economy as a whole. By contrast, Houston is a manufacturing powerhouse that makes machinery, food products, and electronics, with a retail sector twice

the size of Manhattan's and lots of middle-class jobs.

Housing prices are the most important part of Houston's recipe for middle-class affordability. In Gotham, the extraordinarily high housing costs aren't a problem for the hyper-rich. With enough money, you can live in a spacious aerie overlooking Central Park, shop at Barney's, eat at Le Bernardin, and send your children to Brearley or Dalton. The abundance of poorer immigrant New Yorkers, in turn, tells us that for people simply seeking a lifestyle that beats rural Brazil, the city's many entry-level service-sector jobs, wide array of social services, and extensive public transportation can offset high apartment prices.

But what if, like most Americans, you are neither a partner at Goldman nor a penniless immigrant? Consider an average American family with skills that put them in the middle of the U.S. income distribution—nurses, sales representatives, retail managers—and aspirations to a middle-class lifestyle. What kind of life will such people lead in Houston and New York City, respectively?

For starters, they'll probably earn less in Houston, though not as much less as you might think. In the 2000 U.S. Census, the typical registered nurse made \$50,000 in New York and \$40,000 in Houston. A retail manager earned \$28,000 in New York and \$27,800 in Houston. Let's be generous to New York and assume that our middle-income family would earn \$70,000 there but just \$60,000 in Houston.

If our Houston family's income is lower, however, its housing costs are *much* lower. In 2006,

Houstonians zoom home from work in 27 air-conditioned minutes, . . .



residents of Harris County, the 4-million-person area that includes Houston, told the census that the average owner-occupied housing unit was worth \$126,000. Residents valued about 80 percent of the homes in the county at less than \$200,000. The National Association of Realtors gives \$150,000 as the median price of recent Houston home sales; though NAR figures don't always accurately reflect average home prices, they do capture the prices of newer, often higher-quality, housing.

To understand what kind of houses these are, go house-hunting on the Web. In Houston, you'll find a lot of nice places listing for \$175,000, and they'll probably sell for about 10 percent less, or \$160,000. These are relatively new houses, often with four or more bedrooms. Some have over 3,000 square feet of living space, swimming pools, and plenty of mahogany and leaded glass. Almost all seem to be in pleasant neighborhoods—a few are even in gated communities. The lots tend to be modest, about one-fifth of an acre, but that still leaves plenty of room for the kids to play. For a family that has about \$35,000 available for a down payment, basic housing costs—that is, mortgage payments—would be about \$9,200 a year.

The average home price in New York City is dramatically higher. In 2006, the census put it at \$496,000, and \$787,900 in Manhattan—way out of reach for a family earning \$70,000 a year. There are cheaper options: a perfectly pleasant Staten Island home with three bedrooms and two baths for \$340,000, for instance. These houses don't have the amenities you would find in new Houston houses, but they offer 2,000 square feet of living space. Alternatively, the family might purchase a condominium, with two or three bedrooms, in Queens—say, in Howard Beach or Far Rockaway. Even for the Staten Island option, a family making the same \$35,000 down payment would face basic housing costs of about \$24,000 a year.

You thus get much more house in Houston and pay a lot less for it. This chasm would be just as big if you compared Houston with Los Angeles, where the average house price is a whopping \$613,000. Small wonder Houston looks so good to middle-class Americans.

It looks even better once you take taxes into account. Federal taxes are roughly equal for the two families: about \$7,000 per year. But under the Texas constitution, to enact a state income tax requires approval by statewide referendum—and two-thirds of the revenues generated by such a tax, if passed, must go toward reducing other taxes. As a result, Texas doesn't have any state income taxes. (Nor, for that matter, does it have any city income taxes.) Houston residents do have to pay property taxes, which come to about \$4,800 for a \$160,000 home. In New York City, not only would a middle-class family have to pay local property taxes, probably about \$3,400; they would also have to pay state and city income taxes—adding another \$4,000 or so to their tax burden, depending on deductions and other factors. State and local levies thus add about \$2,600 to the cost of living in New York.

Ah, but doesn't it cost a lot more to get around sprawling Houston? The Houstonians must have two cars: the poor public-transit system leaves them no other choice. American families earning \$60,000 typically spend about \$8,500 a year on transportation—and sure enough, in Houston, that's sufficient (barely) to cover gas, insurance, and payments on two relatively inexpensive cars. The New Yorkers could save a lot by giving up on cars altogether and relying solely on Gotham's extensive network of buses and subways, but on Staten Island or in outer Queens, that would mean a significant lifestyle cost. Family members would have to walk to the grocery store and rely on taxis for other trips. A more reasonable approach would be to have one car for local trips and use public transit to get to work. With a public-transit bill of \$80 per month, a fair guess is that the New York family will end up spending about \$3,000 less per year than the Houstonians on getting around.

Just as with housing, however, there's a significant difference in the *quality* of transportation in Houston and New York. In Houston, the middle-class breadwinner likely will drive an air-conditioned car from an air-conditioned home to an air-conditioned workplace, and take 27.4 minutes to do it, on average. Commuting via New York public transit is more complicated. If

you live in Queens, the average commute to midtown Manhattan (if that's where you work, as we'll say) is 42 minutes, and longer if you're coming from Far Rockaway. From Staten Island, the average commute is 44 minutes—and often something of a triathlon, with bus, ferry, and subway stages. Our middle-class New York commuter thus spends at least 120 more hours in transit per year than does his Houston counterpart. And except perhaps for the ones spent on the ferry, none of those hours is as agreeable as sitting in an air-conditioned car listening to the radio.

Will rising oil prices eat away Houston's cost advantages? While there's no question that more expensive crude favors dense New York, the impact of paying more at the pump is likely to be modest. If the Houston residents buy 500 more gallons of gas per year than the New Yorkers, and if the price of gas jumps by \$3 a gallon, then the price of Houston living will increase by \$1,500. This is a real cost, but it doesn't come close to evening the playing field. Further, the Houston family could always drive a 50-miles-to-the-gallon hybrid, which would let them buy only 400 gallons of gas to drive 20,000 miles. Big-city boosters may like to think that rising gas prices will end suburban sprawl, but a far more likely response to expensive oil is a large switch to more fuel-efficient cars.

After housing, taxes, and transportation, the New Yorkers have \$26,000 left. The Houston family has \$30,500, and those dollars go a lot further than they would in New York. The American Chamber of Commerce produces local price indexes for various areas, including Houston and Queens (though not Staten Island). The overall price index for Queens is 150, which means that it costs 50 percent more to live there than it does in the average American locale. The price index for Houston is 88. If we exclude the areas that our two families have already paid for (housing and transportation) and average the re-

maining categories in the index (food, utilities, health, and miscellaneous), Queens is 24 percent more expensive than the average American area and Houston is 6 percent less expensive. Thus—again, after housing, taxes, and transportation—the Queens residents' real remainder is a little less than \$21,000; the Houston family's is \$32,200. The Houston family is effectively 53 percent richer and solidly in the middle class, with plenty of money for going out to dinner at Applebee's or taking vacations to San Antonio. The

family on Staten Island or in Queens is straining constantly to make ends meet.

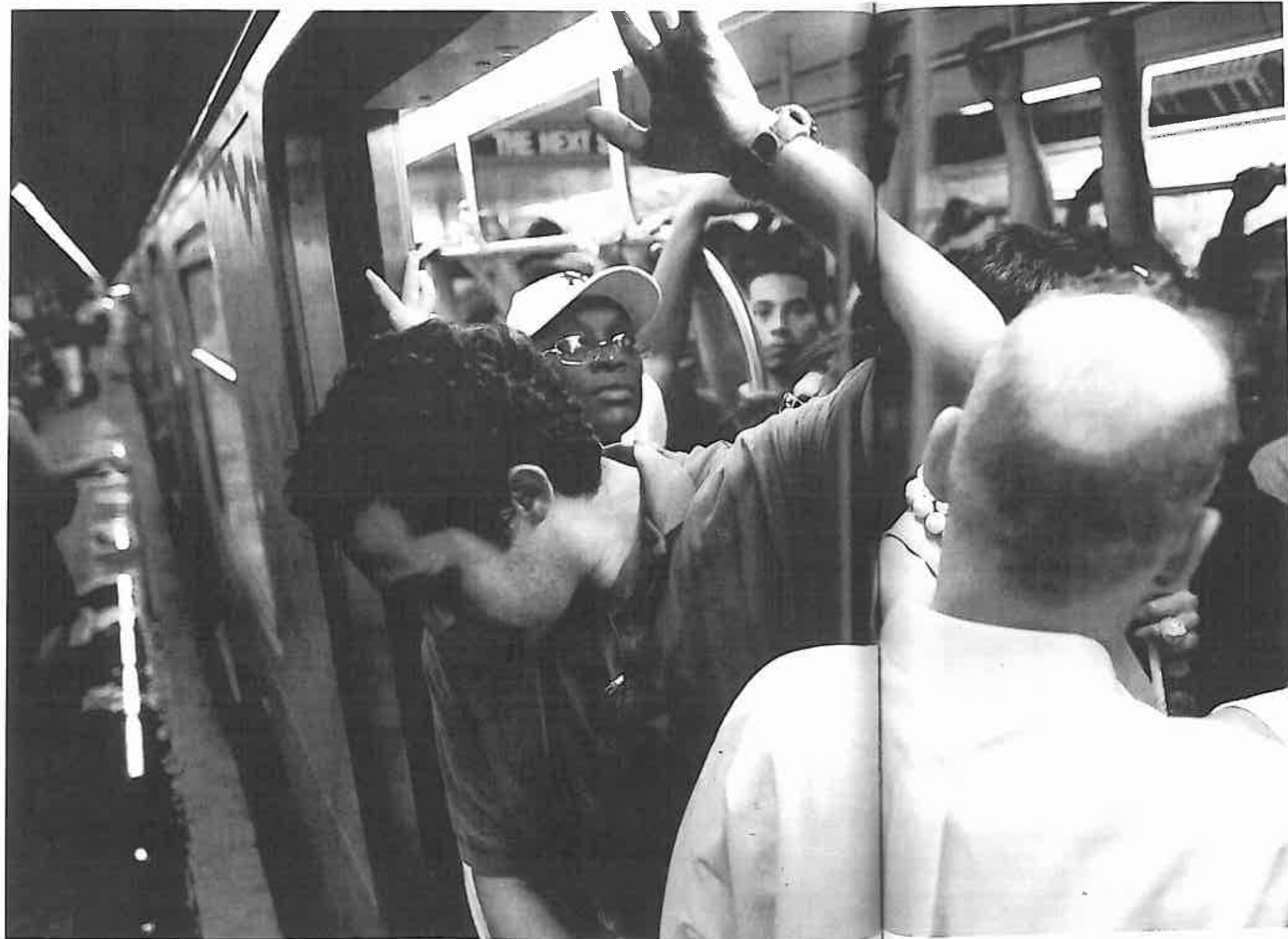
“Living in Houston on \$60,000 a year means a high-quality, spacious home, low local taxes, and education options.”

Don't forget education. Ordinary public schools would be comparable in Houston and on Staten Island, with average

SAT scores of about 950. The Houston family, though, has the option of moving to a slightly more expensive school district, like Spring Branch, which has an average SAT score of 1070, better than that in many New York suburbs. The family could buy a decent home there for \$200,000—a modest stretch. Finding a similarly better school in New York—unless the child in question were brilliant and got in to a really great place like Staten Island Technical School, where the SAT average is 1280—would require relocating to a distant and very expensive suburb.

True, New York boasts fantastic cultural advantages, hip downtown neighborhoods, and pleasures you can enjoy even if you don't have much cash in your pocket—museums, parks, architecture. But the fact remains that living in Houston on \$60,000 a year means a high-quality, spacious home, an air-conditioned commute, low local taxes, education options, and a decent amount of spending money left over. Living in New York City on \$70,000 a year means a smaller, older home, a long and arduous commute, higher local taxes, fewer educational alternatives, and scrimping every day. For many

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middle-class families, at least those with kids, the amenities will be no substitute for a more comfortable life. In a sense, the real surprise isn't that so many middle-income families are putting down roots in Houston (and in other fast-growing cities with similar characteristics, such as Atlanta and Phoenix); it's that any of them remain in New York.

Low taxes, decent schools, and a comfortable commute are important, but if the key factor making Houston a middle-class magnet is its plentiful and inexpensive housing, that raises the question: Why is it so cheap? The low cost of homes reflects the low cost of supplying homes in Texas. Building an "economy" 2,000-square-foot house in Houston costs about \$120,000, and a slightly larger "standard" one about \$150,000. Add a developer's profit and land costs, and you can figure that supplying a new middle-class home costs between \$140,000 and \$190,000. Since housing depreciates over time, it's possible to buy older houses below construction costs, and that's exactly what middle-class families are doing. Supplying housing in New York City costs much, much more—for a 1,500-square-foot apartment, well over \$500,000 in construction costs alone.

Why is it so much more expensive in New York? Part of the reason is admittedly geographic: an old port on a narrow island can't grow outward, as Houston has, and the costs of building up—New York's fate, especially in Manhattan—will always be higher than those of building out. Yet there are places in the U.S. that look geographically like Houston but are as unaffordable as Manhattan—San José, California, for instance. And there are places that look more like Manhattan but are priced more like Houston: high-rise Chicago is a lot more affordable for middle-income people than is high-rise New York. These gaps tell us that housing prices mirror government policies as well as natural geography.

... while outer-borough New Yorkers heading to midtown Manhattan sweat through an average commute of three-quarters of an hour.

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And the unavoidable fact is that New York makes it harder to build housing than Chicago does—and a lot harder than Houston does. The permitting process in Manhattan is an arduous, unpredictable, multiyear odyssey involving a dizzying array of regulations, environmental and otherwise, and a host of agencies. Then developers must deal with neighborhood activists and historical preservationists. Any effort to build in one of New York's more attractive, older communities would almost certainly face strong opposition from the Landmarks Preservation Commission.

A further obstacle: rent control. When other municipalities dropped rent control after World War II, New York clung to it, despite the fact that artificially reduced rents discourage people from building new housing. As New York owners converted rental units into coops to escape the price controls, the city then turned to public housing to solve the problem of housing the poor. The city's strange policy remains to try to increase the (modest) number of subsidized apartments rather than opening the market to more development, which would significantly increase the overall supply of housing at all price levels.

Houston, by contrast, has always been gung ho about development. Its founders, back in the 1830s, were two real-estate developers from upstate New York, Augustus and John Allen. Using \$5,000 that Augustus's wife, Charlotte, had inherited, the brothers bought 6,600 acres that they hoped to turn into a "great city of government and commerce." They named the city after the hero of San Jacinto and promised prospective settlers (nonexistent) waterfalls.

Harvey Molotch and Joshua Logan's 1988 classic, *Urban Fortunes*, described the "urban growth machine": a collection of local business interests that unite to push economic expansion. Over 150 years, just such a machine, led by the Houston Chamber of Commerce, has worked tirelessly to turn Houston into an urban giant. It has made sure, above all, that nothing gets in the way of building. Indeed, the city is unique in America in not having a zoning code. Many

deeds include land-use restrictions of various kinds, true, but these are voluntarily chosen by developers, not decided on high by government bureaucrats. Occasionally, groups rally to try to institute zoning regulations, but the growth machine invariably beats them back, often supported by some of the poorest people in the city. Houston's builders have managed—better than in any other American city—to make the case to the public that restrictions on development will make the city less affordable to the less successful.

Houston's development isn't costless. Like most growing places, it must struggle with water issues, sanitation, and congestion. For environmentalists who worry about carbon dioxide emissions and global warming, Houston's rapid growth is particularly worrisome, since Houstonians are among the biggest carbon emitters in the country—all those humid 90-degree days mean a lot of electricity to cool off, and all that driving gobbles plenty of gas. (Ironically, Houston's energy-consuming growth owes its success, in part, to the environmentalists themselves. By helping shut down new construction in denser places with mild climates, such as the San Francisco Bay, the activists ensure that new development will move to less dense places with harsher climates. People have to live somewhere.)

But Houston's success shows that a relatively deregulated free-market city, with a powerful urban growth machine, can do a much better job of taking care of middle-income Americans than the more "progressive" big governments of the Northeast and the West Coast. Still, it's a bad thing for the country that so much growth is heading to Houston and Sunbelt sister cities Dallas and Atlanta. These places aren't as economically vibrant or as nourishing of human capital as New York, or Silicon Valley. When Americans move from New York to Houston, the national economy simply becomes less productive.

However, the right response to Houston's growth is not to stymie it through regulation that would make the city less affordable. It's for other areas, New York included, to cut construction costs and start beating the Sunbelt at its own game.

Mayor Bloomberg needs to prepare the city for the crash of the Wall Street gravy train.

Nicole Gelinis

New York City, dependent on Wall Street for a quarter-century, has gotten used to harsh cyclical economic downturns, including the lending contraction in the early nineties and the bursting technology bubble in 2000. But today's turmoil may be not a cyclical downturn for Wall Street but instead the beginning of an era of sharply lower profits as it rethinks its entire business model. If so, it will produce the biggest economic adjustment and fiscal challenge that New York has confronted in more than three decades. If the city's leaders don't recognize this challenge and move quickly to meet it, New York could soon face an acute fiscal crisis rivaling its near-bankruptcy in the mid-seventies.

Such a fate—almost unthinkable to a city that has grown complacent about its world-class standing—could set Gotham back in the colossal strides that it has made over the past two decades in restoring its citizens' quality of life. As Mayor Michael Bloomberg said in May, we must "pray that Wall Street does well." But we'd better have a plan if it doesn't.

Wall Street bankrolled New York's long recovery from the seventies because New York, through its long economic, fiscal, and social deterioration, managed to keep its position as the nation's financial capital just as finance was about to take off. In the early eighties, the nation's financial industry—particularly Wall Street—was feeling its way toward a sweet spot where it would stay for two decades. As Federal Reserve chief Paul Volcker brought inflation under control, creating a stable environment for financial innovation and a stable currency for the world's savings, baby boomers and international investors flocked to U.S. markets. The Dow Jones Industrial Average tripled between 1982 and 1990, despite the '87 crash, while the assets of securities brokers and dealers more than doubled as a share of America's financial assets. The financial industry also saw a huge opportunity in Americans' increasing love of debt, creatively packaging it into everything from mortgage-backed securities to