THE GROWTH PONZI SCHEME, PART 1

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The underpinnings of the current financial crisis lie in a living arrangement -- the American pattern of development -- that does not financially suppport itself. The great experiment of suburbanization that America embarked on following World War II has no precedent in human history. As it enters its third generation, the flawed assumptions that were overlooked are now coming back to bite us in a cruel way. Like any Ponzi scheme, there is only one way this ends.

The Growth Ponzi scheme is a major part of our Curbside Chat presentation, in which we go out to communities across the country for a discussion on the future of America's cities, towns and neighborhoods. Please visit the Strong Towns website if you are interested in hosting a Curbside Chat, contributing to the creation of a Chat video or supporting the Cubside chat program.

In the great American experiment of suburbanization following World War II, we redirected our county's extensive resources into a living arrangement unseen at any point in human history. We abandoned thousands of years of history, knowledge and tradition in building cities and towns in order to try this new -- and completely untested -- approach.

In a way, this was an odd thing for such a pragmatic generation, having been conditioned on financial depression, scarcity and war, to undertake. I don't think they ever saw it that way, however. The Great Depression had cut short efforts to improve the industrial city. With the automobile offering the promise of mobility for all, it was seemingly within our grasp for each

American family to one day live the life of European royalty, complete with a country estate outfitted with all the modern trappings. America's ascendancy and absolutely financial domination worldwide made this dream appear possible. We likely never stopped to think it through.

What is more puzzling -- at least to those that think about it -- is how there has been so little questioning of the logic behind this arrangement. American suburbanization is a grand experiment, but one where the hypothesis -- suburban development provides prosperity -- is never really tested. It is basically a law, not a theory, that has crept into our ethos. It is only the collapse of the housing market, along with the much less talked about but even more consequential collapse of the commercial real-estate market, that has allowed critics of suburbanization to avoid the label "kook".

Suburban development has become equated with the American dream. It's continual propagation is nearly unquestioned. Even those who think we are in a deep financial hole that will take years to correct ultimately envision "recovery" to include a return to building more and more of this same pattern. But is that even possible?

Following World War II, there are four ways that American cities have grown (we call these the Mechanisms of Growth). They are:

1. Government Transfer Payments
2. Transportation Spending
3. Debt
4. The Growth Ponzi Scheme

Focusing initially on the first three, they all share two things in common. First, the initial cost to the local government for new growth is minimal. If the state or federal government provides a grant or low-interest loan to subsidize a project -- for example, the extension of a sewer or water line -- the local government may have to pay something, but it is nowhere near the total cost. Where the DOT comes in and builds a highway, widens a road, puts in a signal, builds an overpass, etc... there may be some local funds contributed, but again, the vast overwhelming majority of the money is spent by the DOT. When a developer comes into a community and uses leverage to finance a development project, and then when families or business owners come in and take on mortgages and real estate loans to acquire a property within the development, the local government spends little or nothing to make this happen.

That is the first characteristic these growth mechanisms share: a low initial cost of entry for cities. Even though the city gets local tax revenue from the new growth, it usually doesn't cost them much up front.

The second characteristic they share is that, with each increment of new growth, the city assumes the long-term liability of maintaining all improvements deemed "public". This typically includes sewer and water systems as well as roads and streets, but will also include treatment systems, pumps, water towers, meters and even storm water ponds. All of this stuff ages, degrades, breaks and ultimately needs to be replaced.

Put these two characteristics together and you have a key insight; **Cities routinely trade near-term cash advantages associated with new growth for long-term financial obligations associated with maintenance of infrastructure.**

To financially sustain itself then, a city or town utilizing the American suburban development pattern and making this tradeoff must believe one of the following two assumptions to be true:

1. The amount of financial return generated by the new growth exceeds the long-term maintenance and replacement cost of infrastructure the public is now obligated to maintain, OR
2. The city will always grow in ever-accelerating amounts so as to generate the cash flow necessary to cover long-term obligations.

Of course, with the suburban model, it is physically impossible for a city of finite dimension to grow indefinitely, let alone at amounts that accelerate forever. Even realtors are now starting to acknowledge that assumption #2 is not true. Later this week we'll show how assumption #1 is also not true, and by extension, why our pattern of development is a classic Ponzi scheme, one that we cannot fix or "recover" from.

Additional Reading

- The Small Town Ponzi Scheme (February 2, 2009)
- Growth. I love you, I need you, I want you. (June 29, 2010)
- If you are not growing, you are dying (April 10, 2010)
- In a different world... (April 21, 2010)
- Costs and Benefits, Part 5 (November 11, 2010) - Read the comment
- If it creates jobs, then it must be good, right? (January 10, 2011)