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Crossroads

ECONOMIC TRENDS IN THE DESERT SOUTHWEST

El Paso and Texas Border Cities Close the Gap in Per Capita Income

El Paso's per capita income rose to $28,698 in 2010, or 71.9 percent of the U.S. level, marking another year of progress in bringing local per capita income closer to the U.S. average. Between 1969 and 2000, the city's per capita income fell steadily relative to the rest of the country, slowly declining by about half a percentage point per year from 73.1 to 62.0 percent. In 2000, however, this ratio found a bottom, and as seen in Chart 1, most of the losses of previous decades are now restored. Since the national recession began in 2007, El Paso has advanced even more rapidly.

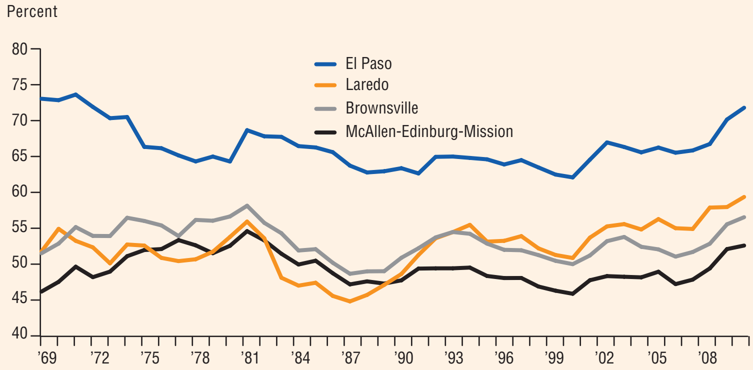
It is tempting to explain this improvement in income levels by simply listing important recent advances in El Paso's economy, such as expanded cross-border trade, the new medical school and the expansion of Fort Bliss. Although we will find some truth in this, other questions arise. Although El Paso has made more progress than other Texas border cities, we see in Chart 1 that the gains are not unique to the city. How have Brownsville, Laredo and McAllen made similar gains? Also, El Paso and other border cities have large poor populations that are highly dependent on Medicaid, unemployment and other income maintenance benefits in the best of times. How much of the post-2007 surge in local income stems from government transfer payments related to poverty or the aftermath of the Great Recession?

This article examines how El Paso has begun to close the large gap in per capita income levels between itself and the U.S. In particular, we ask which local industry sectors drove the recent convergence. At the industry level, the story becomes complex, with important changes under way that include the decline of manufacturing in U.S. border cities, changes in health care policy and the massive expansion of Fort Bliss. Most significant for the long run, however, is a core of industrial strength built around cross-border trade. In particular, we see trade driving the development of higher-order services in information, real estate, finance, professional services, administration and management. This recent growth of quality services is shared by

Chart 1

Per Capita Income in Texas Border Cities

(As share of U.S. per capita income)



SOURCES: Bureau of Economic Analysis; authors' calculations.

all border cities, but El Paso has been the leader.

Describing Per Capita Income Growth

To describe per capita income growth, we use a well-documented methodology employed by the Bureau of Economic Analysis.[1] It divides per capita income into six mutually exclusive and exhaustive categories. When any of these components grows, it promotes income growth. If the component grows faster than its U.S. counterpart, it promotes income convergence, or a closing of the gap between per capita income in these low-income metropolitan areas and the U.S.

The first two components are based on earnings, or a measure of compensation that includes wages, salaries, employer-paid benefits and the income of farmers and small-business owners. Earnings growth can occur due to improved industry mix or greater competitiveness.

• Changes in *industry mix* depend on the compensation rate, or earnings per worker, paid by each industry and the distribution of workers across these industries. If over time, the distribution of jobs improves, in the sense of shifting to higher-compensated industries, then the industry mix improves.

• *Competitiveness* is computed as a residual and reflects all the factors that contribute to the growth of earnings apart from industry mix. These factors might include, for example, a better-trained workforce, better infrastructure, a favorable legal or legislative change or the development of a new industry cluster.

Two components are related to job growth or demographic change.

• The *job ratio* is the number of wage and salary workers, farmers and small-business owners relative to the working-age population, defined as the population age 16 to 65 years. Looked at between points in time, this is a measure of job growth.

• The *working-age ratio* is the working-age population divided by the total population. Shifts that occur over time toward a higher share of workers, and a lower fraction of dependents, promote per capita income growth.

Finally, there are two components of unearned income.

• *Property income* is rent, interest and dividends.

• Personal *transfer payments* are primarily government payments to individuals. In 2010, for example, 97 percent of U.S. transfer payments were government payments, mainly for pensions, medical services, income maintenance, unemployment benefits, education and training, and veterans benefits. The remainder is government payments to not-for-profit institutions and business transfers to individuals.

Border Cities Catching Up

Table 1 shows the growth rates of per capita income in El Paso and other Texas border cities from 2001 through 2010, as well as the percentage-point contributions of the six components described above.[2] El Paso shows a 4.0 percent growth rate, with the largest contribution to growth being 2.6 percentage points from improved industry mix. Transfers are the second-biggest component of growth, adding 1.2 percentage points, followed by better job growth (0.3 percentage points) and growth in the working-age population (0.2).

The other border cities show a similar growth rate near 4.0 percent and component contributions much like El Paso. We will find differences among border cities in the factors that drive income convergence to U.S. levels, especially when we look at the key industries that drive local growth. But the similarities are striking at this level, and we discuss the reasons for this commonality below.

Throughout 2001–2010, the largest contributions to U.S. income growth come from improved industry mix and the growth of transfer payments, but the U.S. grows more than 1 percent per year more slowly than any of the border cities. To illustrate how these border cities have converged to U.S. per capita income levels, the bottom of Table 1 shows the difference between border-city and U.S. growth rates. For El Paso, convergence averages 1.2 percent per year, and the chief factors working to close the gap with the U.S. are better job growth, growth in transfer payments and improving industry mix. Only about one-third of convergence since 2001 can be attributed to growth of transfer payments. Once again, the pattern of factors driving convergence is shared across all the border metropolitan areas.

Table 2 shows similar results, except focused only on the recession and partial recovery period of 2007–10. Per capita income growth in El Paso falls to 3.3 percent during these years, and industry mix and growth in transfer payments account for most of the growth. Other border cities are similar, but Laredo and McAllen show a better than 1 percent contribution to growth from increased competitiveness.[3] El Paso is the only city where job growth makes a positive contribution to per capita income growth. With the recession and weak recovery, transfer payments surge in the U.S. and all border cities.

Texas border cities made big gains relative to the U.S. from 2007 through 2010, as U.S. per capita income growth averaged only 0.4 percent. This growth was driven by a significant shift to higher-wage jobs and growth in transfer payments. However, the gains are largely offset by a weak job market that subtracts 1.9 percentage points per year.

In El Paso, a stronger job market accounts for 2.2 percentage points of a 2.9 percent annual pace of convergence to U.S. levels. Another 0.9 percentage points come from earnings growth, primarily from a 0.7 percent contribution by industry mix. Only 0.5 percentage points of convergence comes from growth in transfer payments. Losses in working-age population and property income offset some of the gains.

Brownsville shows a similar and strong convergence, built

Table 1

Growth of Per Capita Income, 2001–10: U.S. and Texas Border Cities Compared

Percentage-point contributions to per capita income growth: 2001–2010

	Brownsville	El Paso	Laredo	McAllen	U.S.
Per capita income	3.9	4.0	3.9	3.8	2.8
Industry mix	2.5	2.6	2.4	2.5	2.3
Competitiveness	0.1	0.0	–0.2	–0.1	0.0
Jobs in working-age population	0.0	0.3	–0.1	0.2	–0.5
Working-age population/population	0.1	0.2	0.4	0.6	0.1
Property income	–0.3	–0.2	0.0	–0.4	0.0
Transfer payments	1.6	1.2	1.4	1.1	0.8

Convergence: Border city minus U.S. growth rate

	Brownsville	El Paso	Laredo	McAllen	U.S.
Per capita income	1.1	1.2	1.1	1.1	0.0
Industry mix	0.2	0.3	0.1	0.2	0.0
Competitiveness	0.1	0.0	–0.2	–0.1	0.0
Jobs in working-age population	0.5	0.8	0.4	0.7	0.0
Working-age population/population	0.0	0.0	0.3	0.4	0.0
Property income	–0.4	–0.3	0.0	–0.4	0.0
Transfer payments	0.7	0.4	0.6	0.3	0.0

NOTE: Differences due to rounding.

SOURCES: Bureau of Economic Analysis; authors' calculations.

Table 2

Growth of Per Capita Income, 2007–10: U.S. and Texas Border Cities Compared

Percentage-point contributions to per capita income growth: 2007–2010

	Brownsville	El Paso	Laredo	McAllen	U.S.
Per capita income	3.4	3.3	3.0	3.6	0.4
Industry mix	1.8	2.0	1.5	1.4	1.3
Competitiveness	0.5	0.2	1.3	1.5	0.0
Jobs in working-age population	–0.5	0.2	–2.3	–1.8	–1.9
Working-age population/population	–0.3	–0.6	0.3	0.4	–0.1
Property income	–0.5	–0.6	0.0	–0.2	–0.4
Transfer payments	2.4	2.1	2.2	2.3	1.6

Convergence: Border city minus U.S. growth rate

	Brownsville	El Paso	Laredo	McAllen	U.S.
Per capita income	3.0	2.9	2.6	3.2	0.0
Industry mix	0.5	0.7	0.2	0.1	0.0
Competitiveness	0.5	0.2	1.3	1.5	0.0
Jobs in working-age population	1.4	2.2	–0.4	0.2	0.0
Working-age population/population	–0.2	–0.5	0.4	0.5	0.0
Property income	–0.1	–0.2	0.4	0.3	0.0
Transfer payments	0.9	0.5	0.6	0.7	0.0

NOTE: Differences due to rounding.

SOURCES: Bureau of Economic Analysis; authors' calculations.

on a pattern much like El Paso's. Laredo and McAllen have weaker contributions from the job market, but this is offset by strong earnings growth from improved competitiveness, as well as growth in the working-age population and property income.

Despite the loss of manufacturing activity, Texas border cities continued to respond strongly to industrial growth in their neighboring Mexican cities.

Common Features of Border Cities

The common pattern of income growth in Texas border cities is dictated largely by geography and proximity to Mexico.[4] These cities all have a large transportation and distribution sector to support cross-border trade; a retail sector inflated by serving large numbers of Mexican shoppers; and a government sector swollen by border enforcement and public programs that address high poverty rates.

In addition, the modern border city has been characterized as an emerging service center for cross-border trade.[5] Mexican manufacturing has grown rapidly in northern Mexico since the 1960s, mainly driven by the maquiladora industry. The maquiladora began as a jobs program to alleviate poverty in the north of Mexico, allowing duty-free transfer of parts to Mexico for assembly, with tariffs paid only on the value added when the final product returned to the United States. Capital-intensive production remained on the U.S. side of the border, with Mexico providing low-wage, low-skill assembly.

In the past decade, the maquiladora—and all Mexican manufacturing—has been transformed in the face of competition from China and other low-wage countries.[6] Textiles, apparel, leather, toys and other low-skill industries have been replaced by modern factories producing autos, appliances, aircraft and medical instruments. The initial concept of the Mexican maquiladora as an employment program has evolved into advanced manufacturing, taking advantage of Mexico's now-skilled and experienced workforce and delivering high levels of production to the large, neighboring U.S. market.

U.S. border cities initially manufactured many of the parts to be assembled by the maquiladora, as well as organizing cross-border customs, transportation, finance and warehousing. However, in recent years, the advent of modern supply chains and just-in-time inventory requirements has worked to push much of this border-city manufacturing into Mexico. Tighter border security following the 2001 terror attacks has accelerated the trend. As a result, border-city manufacturing has fallen, even as the production of goods has continued to grow strongly in Mexico, resulting in rising demand for cross-border services.

Despite the loss of manufacturing activity, Texas border cities continued to respond strongly to industrial growth in their neighboring Mexican cities. For example, for every 10 percent increase in production in neighboring Ciudad Juárez, El Paso employment grows 3 percent. For other border cities, the comparable job growth is 3.6 percent in Laredo, 1.9 percent in Brownsville and 5.9 percent in McAllen. As the cross-border linkages have shifted away from manufacturing, Texas cities have been increasingly drawn to transportation, wholesale and retail trade, finance, real estate and personal and business services.[7]

Growth of Earnings

Earnings are wages, salaries and employer-paid benefits and make up 64 percent, or the largest share, of U.S. personal income. The share in Texas border cities ranges from 56 percent in Brownsville to 64 percent in El Paso. Earnings are reported by industry and allow us to trace the role of particular industry sectors in per capita income growth. Table 3 shows the percentage-point contribution to earnings growth of several industries between 2001 and 2010. Total earnings growth is divided into that derived from earnings per worker and that from jobs. In the U.S., the dominant factor in generating earnings is higher compensation rates. In the border cities, job growth assumes a larger role, except in El Paso, where earnings per worker contributed 2.6 percentage points to growth and jobs 1.8 percentage points.

The industries in Table 3 draw on our description of border-city industrial structure, selected on the basis of being common to all border cities and collectively likely to deliver the observed pattern of similar growth among border cities. The industries are manufacturing, health care, retail trade, transportation, civilian federal government and six selected service sectors. The six service sectors, chosen for their role in providing good jobs related to cross-border trade, are information, finance, real estate, professional services, management of companies and administrative services.

These border-related industries show a number of trends working at cross purposes. Manufacturing declines in all Texas border cities, with a –10.3 percent annual rate in El Paso being the highest. Laredo has the slowest rate of decline at –0.8 percent per year. El Paso is the only Texas border city that prior to the passage of the North American Free Trade Agreement (NAFTA) in 1994 had a large manufacturing sector unrelated to maquiladora supply. This large apparel sector specialized in blue jeans and men's slacks, and quickly entered a period of sustained decline. The rapid loss of manufacturing earnings in El Paso is attributable to the loss of apparel and other low-wage industry, as well as to the response seen in other cities related to improved supply chains and higher levels of border security.

With the opening of a new medical school in El Paso and the expansion of associated patient care and research, the slow growth of health care in El Paso seems contrary to expectations. However, these data do not allow us to separate out growth resulting from the medical school. Further, the growth of medical care in border cities has historically been driven primarily by Medicare, Medicaid and other government transfer programs. El Paso and McAllen, in particular, have found themselves at the center of a controversy over the use (and possible abuse) of Medicare and Medicaid. Researchers and journalists have looked at the differences in the growth rates of government payments for health care in El Paso versus cities such as McAllen and Brownsville to see if there have been systematic efforts by the medical community of the Rio Grande Valley to "maximize revenues," even if not strictly breaking the rules.[8] Why does El Paso—another border city with similar demographics and low income— stand out as having markedly lower levels of and slower growth in health care expenditures? Whatever the reasons for this slow growth in local health care earnings, it has been a longstanding trend in El Paso.

Both retail and transportation make relatively weak con-

Table 3

Percentage-Point Contribution to Earnings Growth by Industry Sector, 2001–10

Total earnings	**Brownsville**	**El Paso**	**Laredo**	**McAllen**	**U.S.**
Manufacturing	–6.9	–10.3	–0.8	–4.4	–7.3
Health care	8.8	2.7	5.3	11.2	4.6
Retail trade	–0.3	–1.2	–1.2	0.2	–1.6
Cross-border trade	6.5	7.8	1.5	5.6	5.2
Transportation	0.1	0.3	–2.5	0.7	–0.2
Six service sectors*	6.0	6.5	2.7	4.8	5.1
Civilian federal government	0.4	1.1	1.3	0.1	0.3
Total	5.0	4.4	4.9	6.8	2.7
Earnings per worker	**Brownsville**	**El Paso**	**Laredo**	**McAllen**	**U.S.**
Manufacturing	–1.7	–2.4	–0.2	–1.1	–1.2
Health care	2.4	0.7	1.3	2.5	1.1
Retail trade	0.2	–0.1	–0.1	0.1	–0.1
Cross-border trade	1.7	2.0	0.6	1.4	1.2
Transportation	0.0	0.0	–0.4	0.2	0.0
Six service sectors*	1.5	1.6	0.5	1.1	1.1
Civilian federal government	0.2	0.4	0.5	0.1	0.1
Total	2.5	2.6	2.2	2.4	2.3
Jobs	**Brownsville**	**El Paso**	**Laredo**	**McAllen**	**U.S.**
Manufacturing	–5.3	–7.9	–0.6	–3.4	–6.2
Health care	6.4	2.0	4.0	8.7	3.5
Retail trade	–0.4	–1.1	–1.1	0.1	–1.5
Cross-border trade	4.9	5.9	0.9	4.2	4.0
Transportation	0.1	0.2	–2.1	0.5	–0.2
Six service sectors*	4.6	4.9	2.2	3.7	4.0
Civilian federal government	0.2	0.7	0.8	0.1	0.2
Total	2.5	1.8	2.7	4.4	0.4

* The six service sectors are information, finance, real estate, professional services, management of companies and administrative services.

NOTE: Differences due to rounding.

SOURCES: Bureau of Economic Analysis; authors' calculations.

Construction spending at Fort Bliss between 2007 and 2010 kept El Paso's recession from being as deep as that experienced by the rest of the country.

tributions to border-city growth, as shown in Table 3. Transportation does generally outperform the U.S. and contribute solidly to convergence, although Laredo is an exception. Both border-city retail and transportation were badly hurt by the recession, and the U.S. outperformed them from 2007 through 2010. If we focus on the expansion from 2001 through 2007, however, all border cities outperformed the U.S. by a percentage point or more, indicating a strong cyclical component unique to the border. Federal civilian government makes particularly strong gains in El Paso and Laredo. El Paso's gains were likely helped by the Fort Bliss expansion, but the common gains along the border suggest that there was an important role for strengthened border enforcement.

El Paso and Brownsville show strong gains in the six selected service sectors, and in El Paso they contribute 1.4 percentage points per year to convergence. Although job growth is the largest contributor to earnings growth in these service sectors, compensation rates rise in all border cities.

Expansion of Fort Bliss

Fort Bliss has been El Paso's largest employer for many years, and the ongoing expansion of the Army base will double the number of military personnel to near 40,000. Counting only the new military personnel and their dependents scheduled to arrive by 2013, the population of El Paso will increase by 37,000, or 4.7 percent. With a construction budget of over $5 billion, this project is likely the largest single economic event in the history of El Paso. Construction is spread over the years 2007–13, and annual spending peaked at $1.5 billion in 2009, just at the height of the financial crisis. Between 2007 and 2010, $3.6 billion was spent; this timely spending kept El Paso's recession from being as deep as that experienced by the rest of the country.

Table 4 shows the percentage-point contributions to earnings growth from construction and military sectors in El Paso and the

Table 4

Construction and Military Sectors Contribute to Earnings Growth

(Percentage-point changes)

	2001–2007			2007–2010		
	El Paso	U.S.	Convergence	El Paso	U.S.	Convergence
Total earnings						
Construction	2.8	1.8	1.0	0.3	–8.8	9.0
Military	1.1	–0.2	1.4	9.1	0.5	8.5
Total	4.8	4.1	0.7	3.6	–0.2	3.8
Earnings per worker						
Construction	0.8	0.4	0.4	0.4	–1.6	2.0
Military	0.9	0.0	0.8	2.8	0.2	2.6
Total	2.8	2.8	0.0	2.2	1.3	0.9
Jobs						
Construction	2.0	1.3	0.7	–0.1	–7.2	7.1
Military	0.3	–0.3	0.5	6.3	0.4	5.9
Total	2.0	1.3	0.7	1.4	–1.5	2.9

SOURCES: Bureau of Economic Analysis; authors' calculations.

U.S. The contributions are divided into those from earnings per worker and those from a growing number of jobs. From 2001 through 2007, construction added about 2.8 percentage points to El Paso's earnings, more than the U.S. construction sector even while it was propelled by the housing bubble. The military sector in El Paso annually added 1.1 percentage points, but subtracted 0.2 percent in the U.S.

During 2007–10, a period marked by financial crisis, a credit crunch and the nationwide collapse of construction, Fort Bliss kept construction's contribution to El Paso's earnings slightly positive at 0.3 percent per year. Meanwhile, construction was subtracting 8.8 percentage points from U.S. earnings growth. If we look at the differences between the performance of El Paso and U.S. earnings growth, they are remarkable. Construction contributed 9.0 percentage points to convergence each year, and federal military government contributed another 8.5 percent. This combined 17.5 percentage point advantage offset recession-driven losses in many other local industries and, after 2007, kept El Paso earnings growing 3.8 percent per year faster than in the U.S. overall. Job growth was about three times more important than rising wages and salaries in driving convergence during 2007–10; in 2001–07, job growth and earnings per worker made about equal contributions.

Conclusions

Looking to the future of income growth in El Paso, there are conflicting trends. The expansion of Fort Bliss is a one-time event that is increasingly behind us; manufacturing has been a significant drag on growth; and health care has provided a smaller stimulus than in the U.S. or other border cities. The future of Fort Bliss and health care are going to be determined largely by public policy and not economics, entailing events and decisions currently too complex to project over coming years. But as wars wind down and health care policy is debated and implemented, this article clearly illustrates the important role these decisions can and will play in local income growth. Since 2001, El Paso manufacturing employment has fallen by half to 17,400 workers, but today is showing clear signs of reaching a bottom. In the future, manufacturing will at least move from a negative to neutral factor in local growth.

This leaves us with perhaps the most important long-term trend for El Paso and other border cities—the growth of service sectors related to cross-border trade. In El Paso, the six sectors we selected contributed 6.5 percentage points to earnings growth each year for 2001–10, the largest contribution among border cities. The bulk of these new jobs are in finance, professional services, management and administration, and they mark the emergence of higher-order and well-paid services along the U.S.–Mexico border. In El Paso and Brownsville, they have become strong contributors to raising border incomes to U.S. levels.

The growth of these services is supported by the continued integration of U.S. and Mexican industrial production, by the increased competitiveness of Mexican manufacturing and by the growing volume of goods crossing the U.S.–Mexico border. They provide a firm foundation for future income growth in El Paso. The promise offered by NAFTA in 1994 may finally be fulfilled: El Paso and other border cities are no longer at the edge of the U.S., but at strategic locations in an emerging North American market. For El Paso, the loss of a large apparel industry meant that the first years following NAFTA's implementation brought significant pain. The city became the largest recipient

El Paso and other border cities are no longer at the edge of the U.S., but at strategic locations in an emerging North American market.

of NAFTA-related compensation and worker-retraining funds. After 2000, however, as the initial shock passed, we see per capita income rising in El Paso and throughout the border region, converging rapidly to U.S. levels, and with firm evidence that growing trade with Mexico is at the heart of this recent economic progress.

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Notes

[1] "Accounting for Regional Differences in Per Capita Personal Income: An Update and Extension," by Daniel H. Garnick, *Survey of Current Business*, vol. 70, January 1990, pp. 29–40.

[2] The choice of dates is dictated by the annual metropolitan personal income data provided by the Bureau of Economic Analysis. We begin in 2001 when the U.S. National Income Accounts began reporting under a new industrial classification system. Unlike many other data series, these personal income reports were not revised for prior years to reflect the new classification. The 2010 end-point is the latest information available, first reported in April 2012.

[3] The biggest gains in competitiveness by industry come from transportation and real estate in Laredo and from construction, other services and transportation in McAllen.

[4] "Texas Border Cities: An Income Growth Perspective," by Robert W. Gilmer, Matthew Gurch and Thomas Wang, *The Border Economy*, Federal Reserve Bank of Dallas, June 2001.

[5] "The Impact of the Maquiladora on U.S. Border Cities," by Jesús Cañas, Roberto Coronado, Robert W. Gilmer and Eduardo Saucedo, in *Growth and Change* (forthcoming); a summary appears in "From the Fed: Maquilas and the El Paso Economy," by Robert W. Gilmer and Roberto Coronado, *El Paso Inc.*, April 22, 2012.

[6] "Maquiladora Recovery: Lessons for the Future," by Jesús Cañas, Roberto Coronado and Robert W. Gilmer, Federal Reserve Bank of Dallas *Southwest Economy*, March/April 2007.

[7] In *Growth and Change*, Cañas et al. provide an extensive econometric analysis of cross-border impacts by city and by industry. See note 5.

[8] "The Cost Conundrum: What a Texas Town Can Teach Us About Health Care," by Atul Gawande, *New Yorker*, June 1, 2009; "McAllen and El Paso Revisited: Medicare Variations Not Always Reflected in the Under-Sixty-Five Population," by Luisa Franzini, Osama I. Mikhail and Jonathan S. Skinner, *Health Affairs*, vol. 29, no. 12, 2010, pp. 2302–09.

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