



2006: Our Economy in Transition

By Andrew Brod
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Another year has come to an end. Let's get right to a list of the biggest economic stories of 2006. First, on the local and regional scene:

- **Incentive follies:** No one like fiscal incentives for businesses, not even their defenders, who admit that they're a necessary evil. In June the Guilford County commissioners declared a moratorium on such incentives. Then in September they lifted the moratorium. Were the commissioners indecisive? Had they lost their nerve?

It appears that the commissioners just needed some breathing room, to allow them to learn some of the painful realities of the incentives game. Economic developers told them that continuing the moratorium would damage the county's reputation among corporations and site consultants. Site consultants agreed.

So the commissioners reluctantly reinstated their incentives program, but by zigging and then zagging they might well have broadcast a strategically important signal. Guilford County will play the incentives game, but it will do so in a hard-nosed fashion.

The city of High Point sent a different signal in 2006. Generally speaking, High Point has been more aggressive than Greensboro and the county in granting incentives, but in November the city set a new standard. It granted \$600,000 in incentives to La-Z-Boy to relocate a divisional headquarters... from Greensboro!

It's one thing to compete with one's neighbors to attract a new business from outside the region. But it's another thing to lure an existing business from next door, and High Point's beggar-thy-neighbor gambit drew deserved criticism. So much for regionalism?

- **Education lottery pays off?:** The North Carolina lottery started selling tickets this spring, and the first audit of the program just came out. According to the audit, the lottery made gross ticket sales of \$230 million in its first three months and paid out \$119 million in prizes. Of the remainder, \$63.5 million was dedicated to education programs in the state.

Critics charged that \$63.5 million amounted to a 28 percent payout to education, not the 35 percent mandated by state law. But even so, \$63.5 million is very nice... for now. As has been seen in numerous other states with lotteries, the flow of lottery dollars into education programs creates significant unspoken pressure to reduce formal state allocations to education. Rarely do state lotteries actually increase education funding. Will North Carolina be the exception or the rule?

• **North Carolina's gasoline tax is capped:** In January the tax set an all-time high of 29.9 cents per gallon, generating furious opposition in some quarters, ostensibly because the tax depends in part on the average wholesale price of gasoline in the state. When gasoline prices rise, so does the tax, and this angered many people (though they didn't mind in the past when the formula caused the tax to fall). But were opponents really angry about the way the tax was set, or the fact that it was so high? After all, the sales tax we pay on food, also a necessity, rises when food prices rise.

State lawmakers diffused some of the anger by capping the tax at 29.9 cents for fiscal year 2006-07. (Users also pay an additional .25 cent inspection fee on each gallon of gas.) As a result, higher prices didn't raise the tax when it was recalculated for July 2006, nor will it rise tomorrow in spite of record-high prices earlier this year. Of course, the tax won't fall tomorrow either, and it's unlikely to fall in July unless prices fall further. We may be stuck at 29.9 cents per gallon for some time.

• **Mergers are in the air:** First, US Airways announced its plan to acquire Delta. Then United and Continental began to discuss a merger. The mergers present potential benefits to the airlines, which have been in and out of bankruptcy protection for years. But the effect on consumers, especially in the Southeast, is likely to be higher airfares. In some markets, a combined US Airways-Delta airline would have greater than 50 percent market share. The two airlines' market share at Piedmont Triad International Airport is currently about 60 percent (United and Continental account for another 23 percent).

Delta has rejected the hostile takeover by US Airways, claiming that the merged airline would carry the largest debt load in history. Delta hopes to emerge from bankruptcy next year as a single airline. But if its shareholders end up approving the acquisition, the move is unlikely to be stopped by the Bush administration, which has tended to let the market, rather than government oversight, sort out such mergers.

• **A problem with one of the three R's?:** The developers of the Bellemeade Village residential development called a time-out this fall. Some have wondered if this is the end of downtown's residential boom, but the more likely outlook is steady growth with occasional fits and starts like this.

The "three R's" of downtown development are residential, retail, and restaurants, with offices thrown in for good measure. Office development can grow without much residential or retail growth, as can restaurants (and entertainment more broadly). But the remaining two R's, residential and retail, tend to grow roughly in tandem. We've seen a number of years of strong residential growth in downtown Greensboro, but the retail infrastructure is just starting to catch up. Once we see grocery stores, dry cleaners, and other small retailers coming downtown to serve a residential clientele, we'll start seeing condominium and apartment construction start back up again. My colleague, real-estate economist Don Jud, believes that downtown Greensboro is well below its residential capacity. The only real issue is the pace of its growth.

- **“Suburban” poverty:** This month a report by the Brookings Institution showed that between 1999 and 2005, poverty rates have grown significantly in suburban areas as well as in central cities. Even worse, the Brookings report put the “suburban area” around Greensboro near the top (or bottom?) of the list. In 2005, only eight metro areas (out of the 100 largest metros covered in the study) had higher rates of poverty in their suburbs. And between 1999 and 2005, only two other metro areas saw suburban poverty rise faster than it did around Greensboro.

But the Brookings report defines a “suburban area” as the entire metropolitan area excluding the central city. The Greensboro-High Point metro area is made up of Guilford, Rockingham, and Randolph counties, and therefore the report takes Greensboro’s suburban area to be these three counties excluding Greensboro proper. Not only are Eden and Asheboro seen as part of Greensboro’s suburban area, but so is High Point.

Nevertheless, in the region around Greensboro, the poverty rate has increased dramatically, and whether this is a suburban or rural phenomenon, it’s sobering news. The report talks about the decline of manufacturing around the country, but that discussion is focused on the Northeast and Upper Midwest. For suburban areas, the report talks about “the changing location of the poor” and the role of Latino immigration.

But around here, the “suburban” story is very much about manufacturing, or rather the particular manufacturing industry on which this region has relied for decades. Textile and apparel manufacturing has declined much more than other manufacturing industries, and rural areas in North Carolina are struggling to find new paths for growth and employment.

Regardless of the specific news in 2006, the biggest economic story continues to be the transformation from Old to New Economy, from physical capital to human capital. The situation in North Carolina’s cities isn’t as dire as in its rural areas, but communities throughout the state will continue to cope with economic transformation throughout 2007 and beyond.

On the national scene in 2006:

- **Burst bubbles:** The end of the housing boom, which has been predicted repeatedly for some time now, finally happened in 2006. For most of the country, the end meant slower growth in home prices or no growth at all. Only in formerly red-hot housing markets in the Northeast, California, and in many coastal areas have home prices fallen significantly.

But even slow growth is a significant change. Strongly rising home prices increased homeowners’ wealth and fueled spending. Consumer spending in the second half of this year has slowed somewhat, and most forecasters see further slowing in 2007. Few experts see a crash, but the fat years of very low interest rates and easy real-estate profits are most likely behind us for a while.

- **Economic nationalism?:** In the November elections, Democrats broke through and took both houses of Congress away from the Republicans. Voters appeared to care mostly

about Iraq and Katrina and corruption, but the change in power has implications for U.S. economic policy as well. We can expect a bill to increase the federal minimum wage (as was done in North Carolina in 2006), and some of the president's tax cuts will probably be in jeopardy.

But it goes beyond that, as Jacob Weisberg recently noted in *Slate* magazine. This fall's Democratic winners ran against free trade, globalization, moderate immigration policy, and so on. Weisberg calls them the "Lou Dobbs Democrats," after the CNN commentator who has devoted so much airtime and anger to issues like outsourcing and immigration.

Economic populism, the call to defend working people from ravages inflicted upon them by corporations and rich people, is usually a winning political strategy. The Lou Dobbs Democrats may take this one step further and promote an economic nationalism, which is sort of like economic populism on steroids. Instead of blaming the rich here, economic nationalism blames the poor in other countries. I hope President Bush doesn't expect Congress to support more free-trade agreements. As Mark Twain said, free-traders win the arguments but protectionists win the votes.

- **Immigration economics:** This spring the debate over U.S. immigration policy hit a fever pitch. Opponents of the Bush administration, in both parties, wanted stricter enforcement and more secure borders. Many blamed our economic problems on immigrants. And yet the evidence to support the economic argument is slim.

Immigration does indeed increase the supply of labor and thereby exerts downward pressure on wages, but it also increases the demand for labor and thereby exerts an upward pressure on wages as well. Economic studies show repeatedly that these opposing forces approximately cancel each other out. Immigration, legal or illegal, has little or no effect on wages in the U.S.

Other voices decried the money sent by immigrants back to their home countries, but the evidence is that such "repatriation" is smaller than most people believe, on the order of 15 to 20 percent of earnings. Still others complain about the burden placed on government budgets by illegal immigrants, but those burdens are also relatively small on average, and in any case the picture can be complicated. For example, undocumented workers, through their use of falsified Social Security numbers, are projected to contribute hundreds of billions of dollars *more* into the Social Security system than they'll ever collect in benefits.

There may be many justifications for stricter immigration policies, but it's hard to make an honest case for economic justifications.

- **Oil and gasoline prices don't rise:** In the first part of 2006, it seemed that oil and gasoline prices would never fall again. Economic growth around the world fueled a surge that pushed prices above \$75 per barrel in July and early August. But by November, prices had fallen 20 percent, and though they have risen gradually since then, they have not returned to their mid-2006 heights. The amnesiac American public responded predictably,

and SUV sales, depressed when gasoline reached its record levels, regained some vigor near the end of the year.

Has the trend of the last few years ended? Temporarily yes, as economic growth around the world is expected to slow in 2007. But the main reasons for the price surge are still in place. The world demand for oil is driven now by emerging economies like India and China as well as developed economies like the U.S. Don't look for consistent price reductions until new technologies spurred by high prices kick in. And that might take a few years.

- **The yield curve inverts:** The yield curve is a relationship between interest rates at different maturities. The typical shape of the curve is upward-sloping, because long-term rates (say for a 10-year T-bill) are typically higher than short-term rates (say for a 1-year CD). It's risky to lock up your investment for years on end, and long-term rates generally reflect that. But when long-term rates fall below short-term rates, the yield curve slopes downward and is said to be inverted.

Inversions happen for a variety of reasons, such as when investors anticipate a future recession, or when short-term rates have increased too quickly for long-term rates to catch up. The effect is that investment dollars are diverted away from long-term capital formation.

Historically, inversions are strong indicators of coming recessions. The last time the yield curve for U.S. Treasury bonds inverted was in 2000, right before the 2001 recession. And now, since August, the yield curve has inverted again. It's not a good sign for the economy in 2007, but many forecasters believe we'll avoid a full-fledged recession.

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