

FISCAL SWEETENERS

Did North Carolina Lure Dell Too Much?

In 2004, North Carolina and Virginia were hoping to attract Dell to construct a computer assembly plant within their borders. But there was a stark difference in the incentive packages offered by both states: North Carolina presented Dell with more than \$270 million in tax breaks and other incentives while Virginia put \$37 million on the table. North Carolina eventually won the deal and the plant is now operating in Winston-Salem. But looking back at the large discrepancy in the offers has prompted the Corporation for Enterprise Development and the North Carolina Budget and Tax Center, both nonprofit organizations, to study whether the state is getting its money's worth.

The report says that much of the difference between the two packages was the result of the set of assumptions and the models used to measure the economic impact of the Dell plant. For instance, the state of North Carolina's model relies heavily on a projected sales figure, \$2.3 billion annually, to calculate the factory's impact on Gross State Product (GSP) and state revenues. The authors of the report think that this sales estimate is too high. It implies that each Dell worker would add \$175,000 to the GSP, which is more than twice what the average job in North Carolina contributed in 2004.

Moreover, they feel that a model which is mostly driven by a sales figure might not be appropriate for a multistate firm. While a portion of the plant's revenues that goes toward wages and salaries will likely stay in the state, the profits generated by the factory will probably go back to the head company or be paid out to shareholders who don't necessarily live in North Carolina.

To arrive at what they feel are better estimates of the plant's impact, the authors build various scenarios that adjust some of the assumptions, tweak some of the features of North Carolina's model, and use an alternative one developed by the Iowa Department of Economic Development. They find that the estimated values from this exercise are nowhere near the \$24.5 billion addition to the GSP and the \$707 million net change in state revenues projected by the Commerce Department over the 20-year life of the project. The report's highest estimate shows a mere \$8 billion addition to GSP and a fall in state revenues of \$72 million.

But the authors say that the most obvious omission in the state's economic impact model is the failure to take into account whether firms would have chosen North Carolina even without an incentive package. Such a consideration would call for some downward adjustment in the state's offer, although it may not be easy to find this critical point.

Even if the report casts some doubt on the power of incentives, it does not altogether discourage the use

of subsidies in attracting businesses. It asks policymakers to reconsider the methods and assumptions they use. "What is needed, instead, is for the state of North Carolina to be a savvy investor — for its subsidies to match and ideally surpass its competitors not in largess, but in acumen," says the report. But the Commerce Department stands by its methods. "We think that the model and the numbers we used are accurate," says Deborah Barnes, a spokeswoman for the department.

Matt Martin, a regional economist at the Richmond Fed, says that state officials can make a key mistake when they fail to compare the results of an economic impact model to the next best alternative use of public funds. "We want to make a comparison of what the world looks like with and without this [project], but not compared with nothing," he says.

Martin thinks that another way of gauging whether a state is offering too much is to compare the average salary that these jobs will fetch to the cost per job of the incentives offered by the state. If that cost is a substantial fraction of what a worker stands to receive, then the state may not be getting its money's worth.

— VANESSA SUMO

NO MORE GAS GUZZLERS IN VIRGINIA AND WASHINGTON, D.C.?

Hotbeds of Hybrid Sales

Everyone's talking about hybrid cars, and sales of these electric/gasoline-powered vehicles have increased every year since they were introduced in 2000. Virginia has ranked among the top-five states for hybrid vehicle registrations since 2003, while Washington, D.C., had the fourth-largest number of registrations among metro regions in 2006. Part of that demand may have been due to a perk that hybrid car owners had until last July — they could use high-occupancy vehicle lanes to avoid congestion on Interstates 95 and 395 in Northern Virginia. Also, hybrid owners qualify for a federal tax credit of up to \$3,150, depending on the make and model of the vehicle and when it was purchased.

Could the nationwide popularity of hybrids have something to do with record-high prices at the gas pump? That may seem like a no-brainer. In fact, the relationship between gasoline prices and vehicle preferences isn't that simple. Although gasoline prices rose through August 2006, hybrid growth slowed. Registrations of hybrid vehicles increased 28 percent to 254,545 in 2006, compared with 140 percent year-to-year growth in 2005 and 91 percent growth in 2004, according to data from automotive industry consultant R.L. Polk & Co.

Automakers claim that Americans aren't willing to pay a large price premium for better fuel economy. Michael Allen, director of public affairs for the Virginia Automobile Dealers

Association, says his members have made a similar observation. "Most people are looking for something that is better than what they've got," Allen notes. But new models of traditional cars have been introduced that fare better against hybrid vehicles.

"A lot of people come to the lot looking at hybrids, [but] when they see the fuel economy of other vehicles [that sell] at a lower cost, they are buying those vehicles instead of the hybrids," Allen explains. Even SUV lovers can find new models with improved mileage, particularly "crossover" vehicles that are built on a car chassis and use a car powertrain.

Also, the demand for gasoline tends to be inelastic in the short run; that is, the quantity consumed doesn't change much when prices change. However, it becomes more elastic in the long run as elevated prices prompt consumers to rethink driving habits. Demand for fuel-efficient cars like hybrids would be expected to follow a similar pattern.

There is evidence of this trend based on the preliminary results of a study by economist Sarah West at Macalester College. West found that if gasoline prices double, sales of minivans, trucks, and SUVs fall. However, the differences weren't statistically significant until she used lagged prices. When someone thinks about buying a car, current fuel costs aren't the only consideration. Changes in prices over time have more influence.

There are other factors that influence buying decisions. George Hoffer, an economist at Virginia Commonwealth University who has studied the automobile industry, says zero-percent financing and other incentives can boost the sales of gas guzzlers even when fuel prices are rising and demand for better mileage increases. SUVs and other light trucks have wider profit margins than other automobiles, giving automakers more room to reduce prices while still making a hefty return.

Car buying decisions have always involved a combination of personal preference and practicality. While hybrids are attracting more interest for their road performance and styling as well as their fuel economy, they still can't compete on price. Only the Toyota Prius is competitive, Allen says, but that's because the company eats the added production costs. General Motors and Ford aren't in the financial position to do the same thing.

— CHARLES GERENA

HURRY UP AND WAIT

Competition at Airports Affects Delays

While airline delays got worse in February 2007, with 33 percent of flights late, performance improved in the spring. Flights were late 26 percent of the time in March; 24 percent in April. For all of 2006, about 25 percent of the nation's flights got in late.

Delays and cancellations frustrate travelers. About 67 percent of flights arrived on time in 2006 at the Columbia, S.C., Metropolitan Airport, compared to the national average of 75 percent. Across the Fifth District, several

smaller airports' punctuality in 2006 was worse than the national average, according to the U.S. Bureau of Transportation Statistics (BTS).

That's bad news for travelers making summer plans, a time when thunderstorms, for example, can wash out flights and spur cancellations. Passenger traffic, according to the BTS, rose by 1.7 percent during the first two months of 2007 over the previous year and continues to grow while airline staffing has declined.

Late arrivals vary from airport to airport. Although nonhub airports generally have fewer delays, Richmond's Richard Byrd International Airport's flights were late 32 percent of the time. (A flight is considered delayed if it arrived at or departed the gate 15 minutes or more after its scheduled time.) Among larger airports, one of the best performances was at Baltimore/Washington International Airport where nearly 80 percent of flights arrived within that 15-minute window.

Reasons for delays are more complicated than they appear. Nicholas Rupp, an economist at East Carolina University in Greenville, N.C., has studied airline on-time performance using a variety of data. People expect smaller airports to be less congested with fewer delays. While that's generally true, he says, when a hub airline services the airport, it can create more congestion.

Competition influences performance, too, with airports served by a large number of carriers with equal market share doing a better job. Airports dominated by a single carrier, like Charlotte with US Airways, or Atlanta with Delta, may not perform as well. Those airports tend to have more frequent and longer delays, Rupp says. He and co-authors Douglas Owens and Wayne Plumly have found evidence of lower service quality on less competitive airline routes.

But airports that service more than one hub airline also can be congested. Since many flights originate from hub airports, that can translate into delayed flights at small airports.

Smaller airports also have higher cancellation rates, "because they're less able to handle adverse circumstances than the big airports. If a bad snowstorm comes through, a big airport is better equipped to handle it. Or a maintenance issue, a big airport has better access to backup crews, planes, parts, and maintenance, whereas small airport don't," says Rupp.

Part of the reason for delays at all airports is simple supply and demand. More carriers are offering more flights, but without a ramp-up in runway capacity. "That is something that we're going to hear more about," he says. "They don't build many new airports."

— BETTY JOYCE NASH

CORRECTION: In the Winter 2007 *Region Focus*, the story "Options on the Outs" incorrectly explained the meaning of "out of the money" employee stock options. Such options have exercise prices above the trading prices, which is why they are worthless to the holders.