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State's Ability to Stave off Recession May be Nearing End

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Here is the case for optimism: The Texas economy's diversified industry base has helped the state weather the worst of the national downturn.

But there also is a case for caution: Employment growth has slowed, and the state will probably be pulled into the national recession.

Those were among the conclusions reached by The Dallas Morning News Board of Economists, who met recently to discuss a range of pocketbook issues facing the state. The group of nine analysts found themselves still trying to understand all the implications that the national recession and the Sept. 11 terrorist attacks will have on Texas.

"It's not even clear that Texas is in a recession," said Harvey Rosenblum, a senior vice president and director of research at the Federal Reserve Bank of Dallas. "We continued to grow right up until a couple of months ago." Even so, Mr. Rosenblum and the other economists said Texas remains vulnerable to unpredictable trends - many of which are difficult to read because of the uncertainty created by last year's terrorist attacks.

The state's economic health depends on the continued attraction of new

residents and stable energy prices. And a combination of shocks has so weakened the economy that a statewide recession appears likely unless the national economy stages an unexpectedly sharp rebound.

"We are likely to enter a recession later than the rest of the country," said Mr. Rosenblum, who is also president of the National Association for Business Economics. "It looks from a particular set of indicators that it would be hard to avoid."

A year ago, the panel of economists predicted that the Texas economy would experience a slowdown but avoid recession because of a diversified economy, its proximity to Mexico and a growing, consumption-minded population. The forecast was on target until the Sept. 11 terrorist attacks. "We continued to grow right up until a couple of months ago," Mr. Rosenblum said.

Texas has been hit with many shocks: The technology bust, the direct effects of the terrorist attacks on airlines and transportation, floods in Houston, and psychological blows from the bankruptcy of Enron Corp., which epitomized the state's transition from its oil-dependent past to a technology-driven future.

And the atmosphere of uncertainty created by the terrorist attacks also makes it difficult for businesses to make long-term decisions. Unknown are the additional security costs to industry, as well as the built-in inefficiencies that new airline security procedures will place on the

movement of people and goods.

"It's no longer a particular event, it's a metaphor for all the unexpected turns that can affect us," said Thomas Kim, an economics professor at Hardin-Simmons University in Abilene. "Our vulnerability is much more exposed than it has ever been."

In the short term, the terrorist attacks have slowed the movement of people and goods, whether it is at major airports or across the Texas-Mexico border. Disruptions have caused not only inconvenience, but have also piled on costs.

For the long term, companies have new worries about protecting employees and facilities. The problems will demand brainpower. New technologies are needed to protect supply chains from disruptions without accumulating excess inventories.

"There's a real drag on efficiency," said Ray Perryman, president of The Perryman Group, an economic research and consulting firm in Waco. "It's a measurable effect that we're going to have to overcome in the future."

Labor's loss

Recession and terrorism hit the state labor market quickly. After several years of the tightest job market on record, some cities, including Dallas and Austin, had a reversal of fortune, with the jobless rate jumping by more

than 2 percentage points in a single year.

Last year, the jobless rate in Dallas soared faster than in any other city in the nation, noted Bernard Weinstein, director of the Center for Economic Development and Research at the University of North Texas in Denton.

During the 12 months leading up to November, the city's unemployment rate rose 3 percentage points to 5.8 percent. The latest data show that the jobless rate in December dropped two-tenths of a percentage point to 5.6 percent.

"This has been a very, very dramatic turnaround in the Dallas metro area, to see the pendulum move that far in a relatively short period of time," Mr. Weinstein said.

Still, the economists point out that Texas employment only stopped growing a few months ago - well after other regions of the country reported job losses. The state unemployment rate stood at 5.7 percent in December, a hair's breadth from the national average of 5.8 percent. Overall state employment will not rebound right away, the economists said.

"Folks went through a really horrendous process to cut people loose and, with that, people are losing a lot of wealth and stock options," Mr. Perryman said. "Employers are going to bleed every ounce of productivity they can get out of the existing workforce before they start rehiring in

large numbers."

In the meantime, workers will have to consider other fields. Just ask Cindy K. George about the personal drama of a changing economy. When the technology sector hit hard times last July, the 44-year-old Richardson resident hit the streets. Ms. George lost her \$100,000-plus job as a business software job recruiter. At first, she found it hard to accept that the information technology boom had gone bust. For four months she scoured websites, job fairs and classified ads for another job as a technology recruiter.

Finally, she accepted a career change - and a \$50,000 pay cut. Now Ms. George works as an admissions officer at The Art Institute of Dallas, where she screens applicants who want to be executive chefs.

"I started beating the pavement and interviewing and sending out resumes. It was pretty bleak," said Ms. George, saying headhunters were no longer willing to pay recruiters both salary and commissions.

Reflecting on her experience, she advises other job seekers that they may have to modify their expectations to find new work.

"When it got down to the point of four months and nothing had really moved, I had to take another approach and take another direction," Ms. George said.

"You have to have an open mind, and you have to think of everything that you

have possibly done in the past and that you could possibly do in the future."

For workers like Ms. George, a recession can mean scrambling to survive. For industry, the current environment requires managers to face not only short-term adjustments but also vulnerabilities exposed by the terrorist attacks.

Prior to Sept. 11, many companies were using technology to manage the flow of supplies and parts to their factories. The idea was to save money by keeping the smallest amount of parts and finished inventory on hand. In particular, North Texas' telecommunications companies have learned just how important efficient supply chains can be in a downturn, said Michael Granfield, an economist with the Ernst & Young accounting firm. "The penalty for not having an efficient supply chain management is going to be much more severe in the future than it has been in the past," he said.

But the terrorist attacks showed that such just-in-time inventory systems were vulnerable to costly disruptions. When the airline industry was shut down for two days, a key component of the distribution system was grounded, leaving factories without integral supplies.

New challenge

Now, The News' Board of Economists said, companies will demand new technologies that emphasize the efficiencies of the just-in-time inventory

systems but also offer protection from the costly disruptions of a catastrophe.

"We've created an incredible incentive for people to discover ways to break through and become more efficient," Mr. Perryman said. "There is a Bill Gates level of wealth waiting for the folks who are able to design the processes and systems that allow that to happen."

Donald Hicks, a professor of political economy at the University of Texas at Dallas, noted that crises often produce advances in technology. For instance, he noted that the spike in oil and gas prices during the 1970s forced big energy users to quickly find more efficient production processes.

Mr. Hicks said similar advances will come from the fallout of the terrorist hijackings. He predicted that companies will become increasingly sophisticated about using the Internet to solicit bids, order supplies and manage inventories.<p>

"That's a new generation, a new breed of responsiveness for these new technologies that will move us to a different place," Mr. Hicks said. "That is one of the lessons we are about to learn."

Some of the other economists said Sept. 11 would create political impetus for other changes.

They noted that the backup in truck traffic at the Texas-Mexico border has become intolerable because of added security measures.

"We're going to see deep challenges at our international borders and how the government is going to deal with security measures," said Pia Orrenius, a senior economist at the Federal Reserve Bank of Dallas.

For now, the analysts are focused on how long the Texas economy will be down and what will spark the recovery. The answer is predictable: the same diversification and migration of new residents that served as a buffer during the national recession.

New residents boost housing, construction and retail. And a diversified economy means an ailing sector such as telecommunications doesn't wreak as much havoc as energy and real estate did in the 1980s.

Tech recovery vital

But the economists said the state also needs energy prices to remain stable and a recovery to take place in the technology sector.

North Texas' technology companies - which Mr. Rosenblum said were on the verge of recovery just before the Sept. 11 attacks - will eventually rebound. And the region's technology prowess will help sprout cutting-edge industries, such as biotechnology.

"Some places are going to be the next high-tech centers in biotechnological applications in health care, in electronics," said Mr. Perryman. "Dallas has an opportunity to do that, but it's by no means a certainty."

One factor in favor of Dallas includes the "nice synergy" of its telecommunications, electronics and avionics companies, he said. But he pointed out that Houston, which has a mature and strong medical center, could have a leg up.

But researchers in Austin and Dallas are trying to keep pace. DPR Construction Inc., which just wrapped up construction on a research laboratory in the Stemmons corridor, specializes in what it calls technically demanding projects and has experienced strong demand in all three cities.

Texas as a whole has a lot at stake in attracting biotechnology, the economists said.

"Biotech is a small sector, but in terms of percentage growth, it's phenomenal," Mr. Perryman said. "It's the next train that's going to leave the station."