ECONOMIC PERFORMANCE AND INCOME

Economic Performance and Per Capita Income: The Inside Story

Have you ever wondered why per capita income in Hampton Roads has lagged the rest of the United States for more than a decade? Interestingly enough, it is not because those who work in Hampton Roads earn lower than average wages and salaries. Instead, it is because they own fewer assets, don't earn nearly as much as others do from businesses they own, and aren't receiving as much in the way of transfer payments (such as welfare) as individuals in other regions of the country. That's the surprising finding we report in this chapter.

But, First, A Look At The Growth Rate Of The Regional Economy

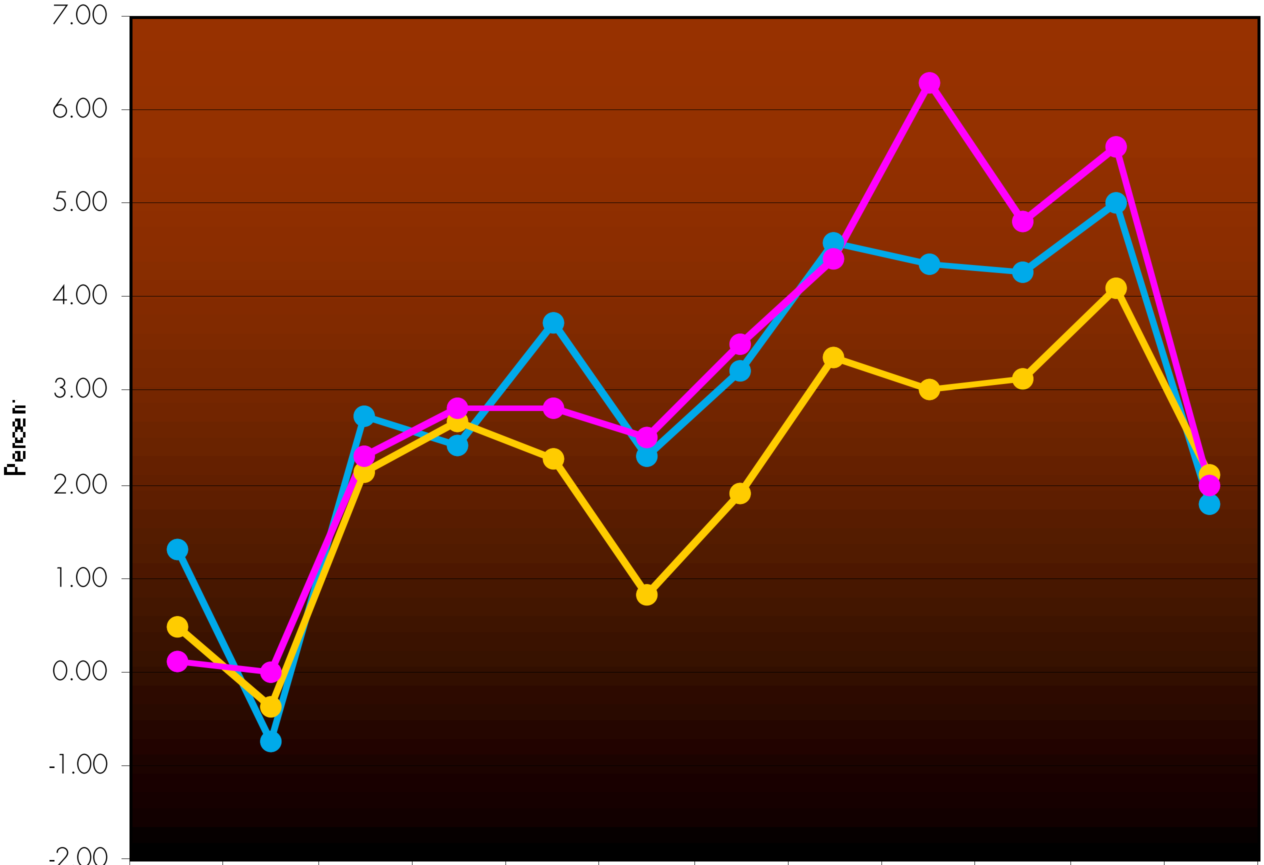
In 2000, the Hampton Roads economy did rather well, at least compared to the past few years. The region's economy grew by 4.1 percent, which was its largest regional economic growth rate since 1987. Nonetheless, despite this rapid increase in 2000 Gross Regional Product (GRP), Hampton Roads' economic growth rate continued to lag behind that of both the United States and Virginia. As shown in Graph 1, since 1990, the economic growth rate of Hampton Roads has trailed both the Commonwealth and the nation as a whole.

Defense spending reductions are the primary reason why Hampton Roads' economic growth has trailed the rest of the country. Fortunately, this situation is expected to change in 2001 as the region's economic growth rate is expected to exceed that of both the United States and Virginia. Why? Because defense expenditures will increase by 7 percent or more and the rest of the country is going through economic recession. Defense expenditures tend to stabilize the Hampton Roads economy. Hampton Roads grows less rapidly than other regions during prosperous times, but it also contracts less rapidly when the American economy is in recession.

There is additional good news. The nondefense sector of the Hampton Roads economy grew at an estimated 5.6 percent in 2000, well above the high GRP regional growth rate. Lest we ignore the significance of this development, it means the civilian economy in Hampton Roads recorded a banner year in 2000. This bodes well for the region's future, for it suggests the region has been creating lots of private jobs. The region's unemployment rate sank to about 3 percent, its lowest regional yearly unemployment rate in more than 30 years.

2000 defense spending, hampered by the loss of nearly 300 relatively highly paid federal civilian employees, expanded at an estimated "real" (inflation adjusted) rate of only 1.8 percent, well below the regional nondefense and GRP economic growth rates. This dragged the GRP growth rate down to the overall level of 4.1 percent. The defense sector's slower growth rate in 2000 resulted in further decline in the defense-dependent portion of the region's economy. As a proportion of GRP, the defense-dependent sector fell from a high of nearly 42 percent in 1990 to an estimated 28 percent in 2000. The opposite side of the coin is this: the nondefense sector now accounts for 72 percent of GRP.

GRAPH 1
YEAR-TO-YEAR REAL GROWTH RATES
HAMPTON ROADS, VIRGINIA AND THE U.S.
1990 - 2001



	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001est
U.S.	1.30	-0.75	2.73	2.41	3.73	2.31	3.22	4.59	4.34	4.26	5.00	1.8
Hampton Roads	0.47	-0.37	2.12	2.66	2.27	0.82	1.90	3.35	3.01	3.13	4.10	2.1
Virginia	0.10	-0.02	2.30	2.80	2.80	2.50	3.50	4.40	6.30	4.80	5.60	2

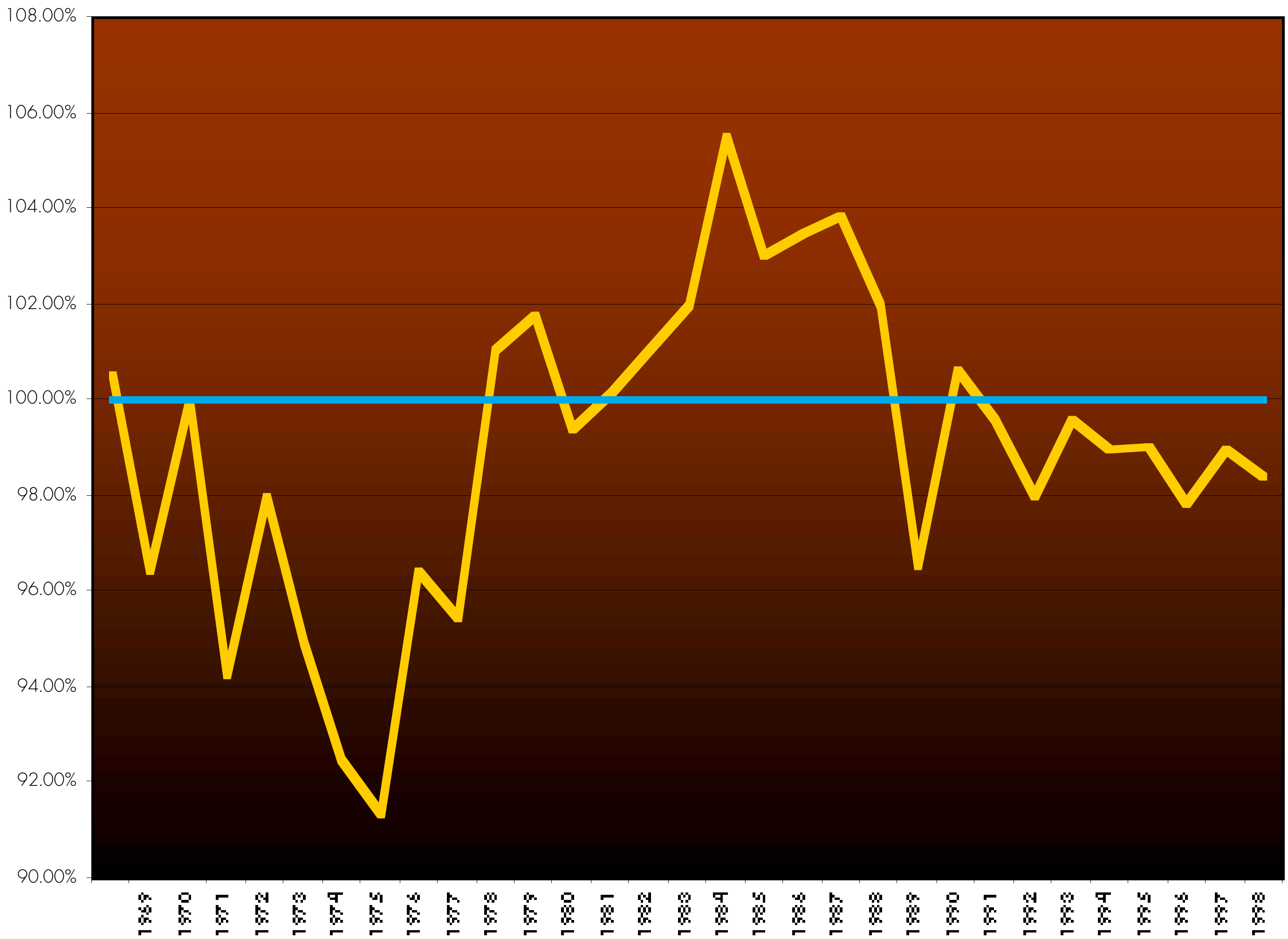
Source: Old Dominion University Economic Forecasting Project

Per Capita Income And Standard Of Living

An important measure of Hampton Roads' economic standard of living is the personal income generated in the region relative to its population – per capita income, or income per person. Many individuals focus only on "money" per capita income – that is, income that is not adjusted for the cost of living. However, an accurate comparison of Hampton Roads' economic standard of living relative to other metropolitan areas (MSAs) requires adjusting for price differences between it and the other MSAs. Graph 2 shows a "real," price-adjusted percentage comparison between Hampton Roads' per capita income and that of the United States from 1969 to 1999. A value of 100 implies equality, or parity, between U.S. "real," price-adjusted per capita income and that of Hampton Roads. Values above the parity line represent years in which Hampton Roads' "real," price-adjusted per capita income exceeded that of the nation, while values below the line indicate the opposite.

It is evident in Graph 2 that "real," price-adjusted per capita income in Hampton Roads generally was below the national average during most of the 1970s, above the average throughout most of the 1980s and modestly below the average during most of the 1990s. As we will demonstrate in a moment, defense expenditures explain most of these trends.

GRAPH 2
HAMPTON ROADS PRICE-ADJUSTED PER CAPITA INCOME
AS A PERCENT OF U.S. PRICE-ADJUSTED PER CAPITA INCOME
1969 - 1999



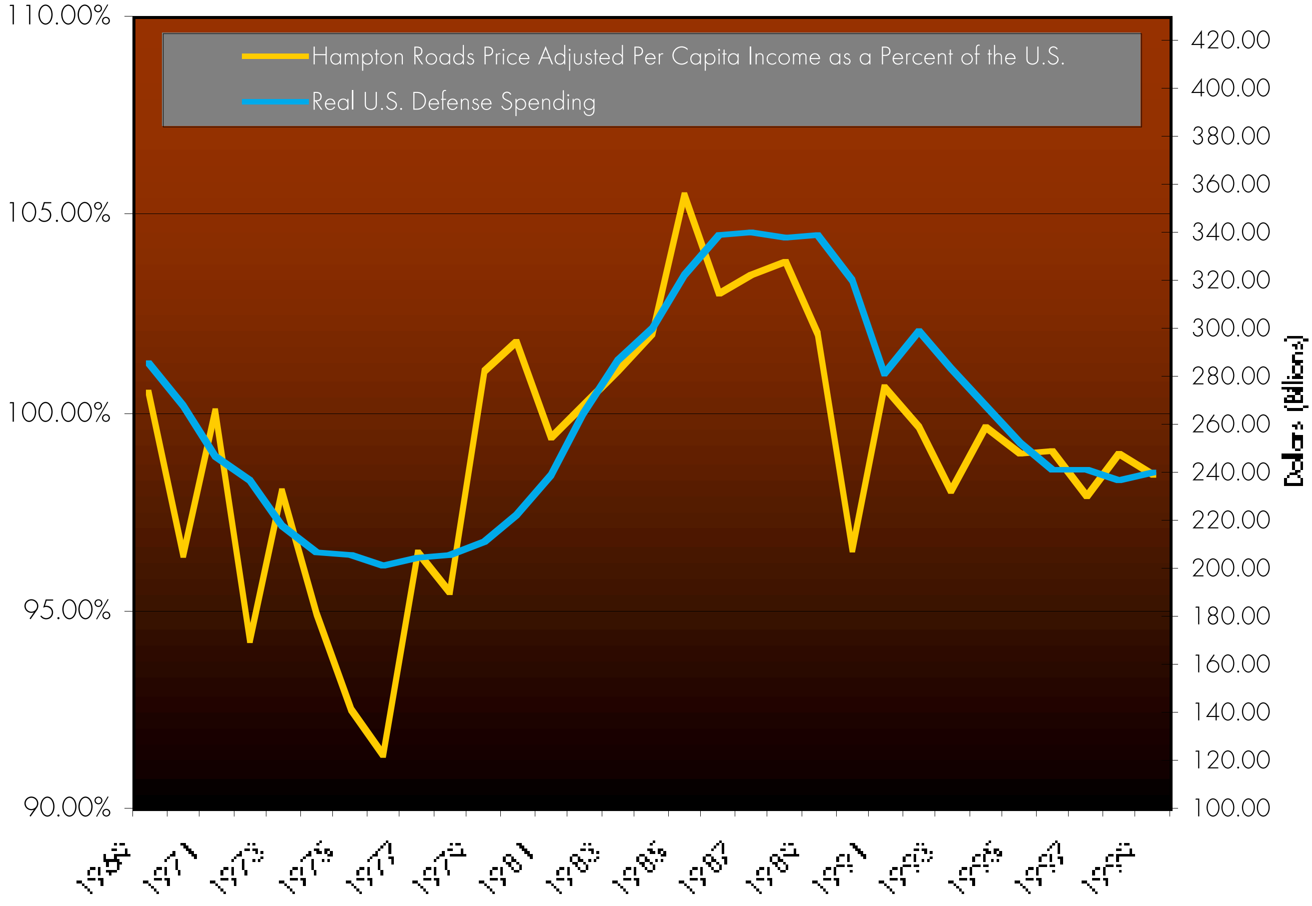
Sources: U.S. Department of Commerce and Old Dominion University Economic Forecasting Project

From an economic development perspective, Graph 2 immediately begs two questions. First, since 1969, what has caused the fluctuations in Hampton Roads' relative economic standard of living, especially the more recent decline of more than seven percentage points from a high of 105.5 in 1985 to its current 98.4 percent? Second, why can't Hampton Roads break away from its seeming 30-year reversion to the U.S. mean?

Fluctuations In Relative Per Capita Income

The most important cause of the fluctuations in the region's real, price-adjusted per capita income relative to that of the nation over the last 30 years is year-to-year variation in national defense expenditures. Graph 3 supports this assertion by comparing the Hampton Roads per capita income parity percentage of Graph 2 with real national defense expenditures. The left side, or vertical axis, of Graph 3 represents Hampton Roads' real, price-adjusted per capita income relative to that of the United States. The right side, or horizontal axis, measures real national defense expenditures. One can easily see that fluctuations in Hampton Roads' relative per capita income over the last 30 years have closely tracked that of real national defense expenditures.

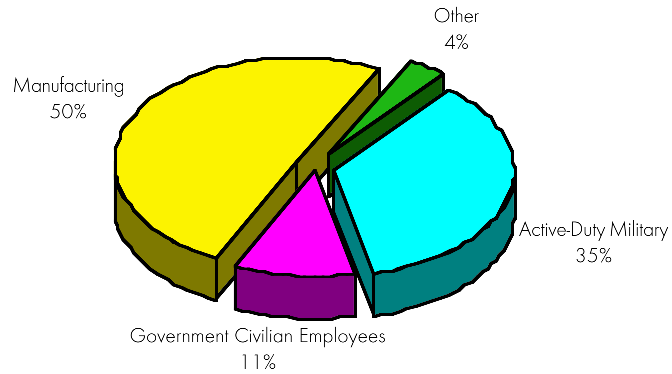
GRAPH 3
HAMPTON ROADS PRICE-ADJUSTED PER CAPITA INCOME AS A PERCENT OF U.S. PRICE-ADJUSTED PER CAPITA INCOME AND U.S. REAL DEFENSE SPENDING (1992 = 100)
1969-1999



Sources: U.S. Department of Commerce, Old Dominion University Economic Forecasting Project, and U.S. Department of Defense

Thus, the fall in the area's relative economic standard of living in the 1970s resulted from winding down the Vietnam War, while the rising regional prosperity of the 1980s rise resulted from the Reagan administration's military buildup. Likewise, the decline in real, price-adjusted per capita income, from 105.5 percent in 1985 to 98.4 percent in 1999, can be attributed to the end of the Cold War and the subsequent decline in defense expenditures during the Clinton administration. This decline in the region's real, price-adjusted per capita income (7.5 percent between 1985 and 1999) can be traced largely to employment and consequent income declines within the specific categories displayed in Graph 4. Shrinkage (at least relatively) in the region's manufacturing base accounted for roughly one-half of this fall in per capita income. Manufacturing job and income losses were largely concentrated in the area's civilian shipyards. The decline in active-duty military personnel and the decade-long decline nationally in the ratio of military to civilian wages were responsible for more than a third of the 7.1 percent decline. That is, the region lost active-duty military personnel and those who remained were not paid as well (relatively speaking) as in the past. Finally, the reduction in civilian federal workers, the majority of whom worked at the Norfolk Naval Shipyard and the Naval Air Rework Facility, accounted for slightly more than 10 percent of the drop in Hampton Roads' relative per capita income.

GRAPH 4
SOURCES OF THE DECLINE IN HAMPTON ROADS' PER CAPITA INCOME RELATIVE TO THE U.S.
1985 - 2000



Source: Old Dominion University Economic Forecasting Project

But, here's the most important point. **Fluctuations of Hampton Roads' relative economic standard of living over the past 30 years, as measured by real, price-adjusted per capita income, do not appear to be the product of any inherent problem or defect within the region's economy. Rather, these fluctuations, including the most recent decline, were a result of deliberate national policy decisions to change the level of national defense spending. The bottom line is this: Hampton Roads' regional economy is not sick, but it continues to be highly dependent upon military expenditures.**

The national defense policy-induced cycles displayed in Graphs 2 and 3 are likely to be repeated in the future. The region is about to go through an upward turn in its relative per capita income similar to, though not as extensive as, the 1980s. The upward movement in the region's relative price-adjusted per capita income will initially be prompted by the Bush administration's supplements to the current defense budget. These will cause an increase in the military to civilian wage ratio and supply additional spending for both ship maintenance and construction. Federal fiscal year 2002 military spending will be particularly important to the region, as national defense spending is projected to rise by 7 percent, even after adjusting for inflation. This will stimulate real, price-adjusted per capita income in the region and will push the area's economic standard of living to roughly one percentage point above parity with the nation. That is, Hampton Roads is likely to move from 98.5 percent of the national average real, price-adjusted per capita income to approximately 101 percent.

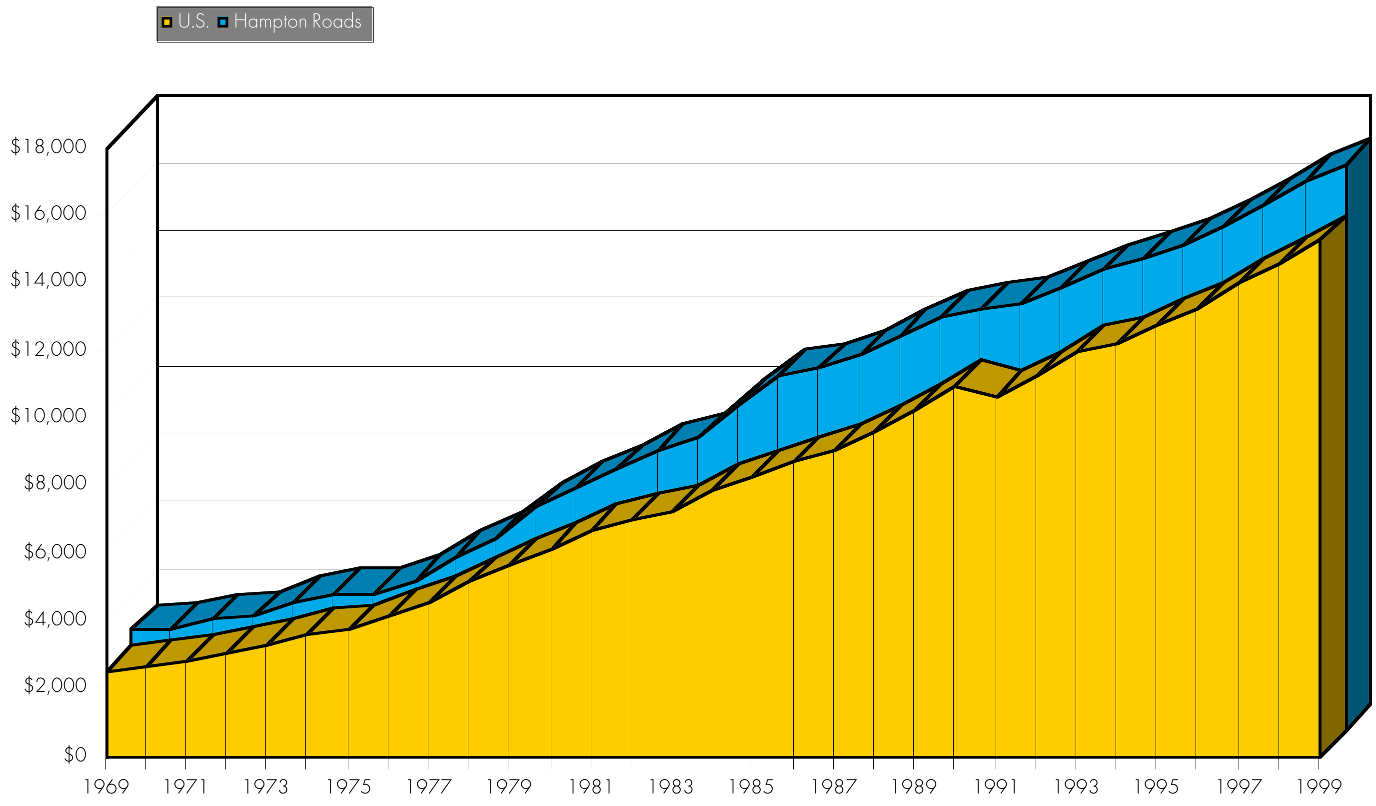
A Closer Examination Of Per Capita Income In Hampton Roads

Per capita income generally is broken down into four major parts: (1) wages, salaries and fringe benefits; (2) property income; (3) business income; and (4) transfer payments (unearned income). Let's look at each of these, for they provide some surprising information.

WAGES, SALARIES, AND FRINGE BENEFITS

The most important determinant of the level of a region's per capita income is how much the region's workers receive in wages, salaries and fringe benefits. In Hampton Roads, wages, salaries and fringe benefits constitute roughly 70.8 percent of personal income per capita. As seen in Graph 5, since 1978, when compared to the entire United States, this portion of Hampton Roads' personal income, measured on a per capita basis and adjusted for prices, actually exceeded that of the nation. **In 1999 the region's per capita wages, salaries and fringe benefits stood at 109.5 percent of, or 9.5 percent above, the national average. Hampton Roads typically earns total wages, salaries and fringe benefits somewhat above the national average, something many people do not believe is true.**

GRAPH 5
PRICE-ADJUSTED WAGES, SALARIES AND EMPLOYEE BENEFITS PER CAPITA
HAMPTON ROADS AND U.S.
1969 - 1999



Sources: U.S. Department of Commerce and Old Dominion University Economic Forecasting Project

Of course, one can gain additional income either by earning a higher wage rate, or holding more jobs or by working more hours in the jobs one holds. As we will see in a section below, a much higher proportion of Hampton Roads residents actually hold jobs than is true in the rest of the country. This is one of the reasons why the region's per capita wage, salary and fringe benefit income is above the national average.

But, these data do provoke an obvious question. If the total of what people are paid in wages, salaries and fringe benefits in Hampton Roads exceeded the national average in 1999, then why is it that the region's per capita income was only 98.4 percent, or 1.6 percent below the national average (see Graph 2)? The answer to this question lies with the nature of the nonlabor income received by households. Generally defined, nonlabor personal income comes in three forms: the return to ownership of property, business income and transfer payments.

NONLABOR INCOME: OWNERSHIP OF PROPERTY

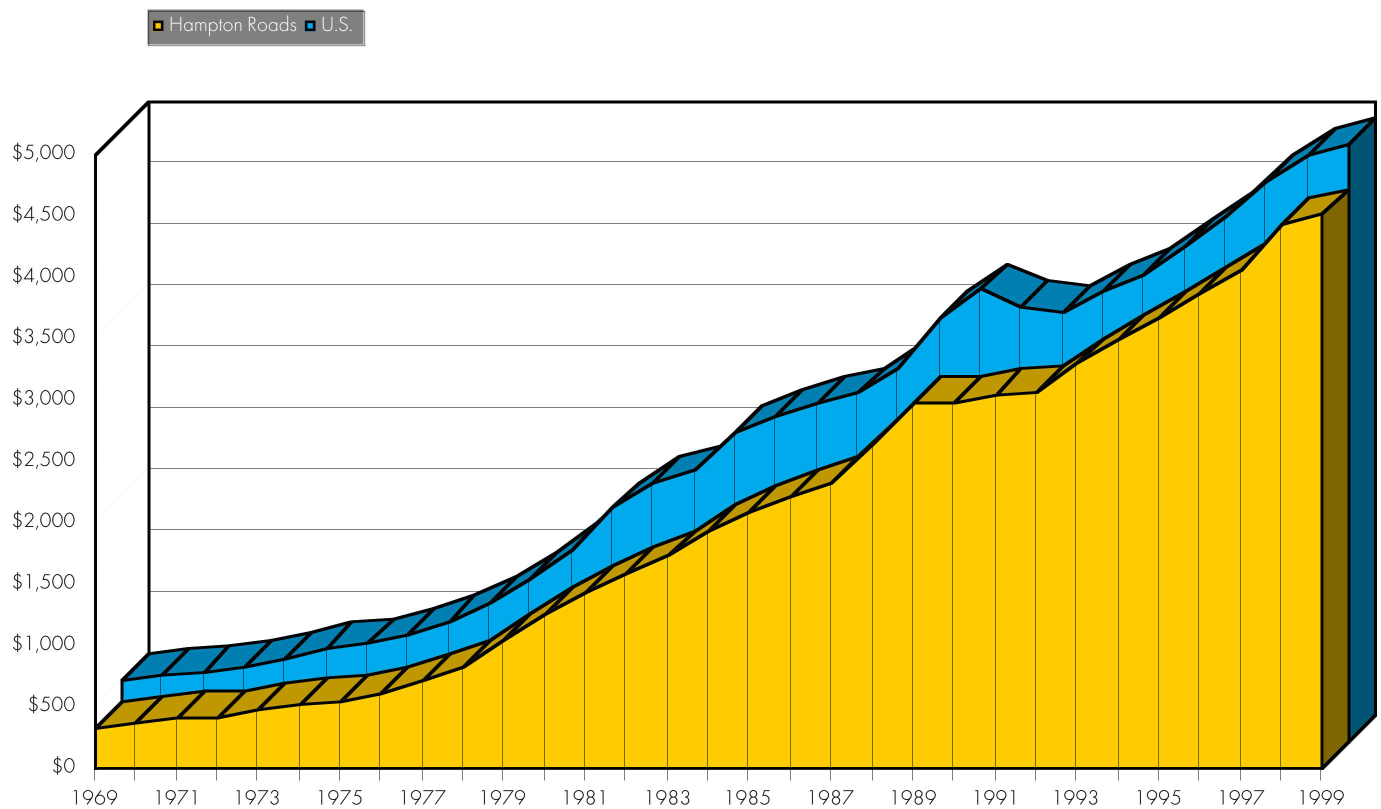
Household income from ownership of property is the return from financial, real estate and solely owned or partnership business assets. Economists say the income generated from these assets is "the return to capital." Returns from these assets are often overlooked in popular thinking about per capita income because such returns are not widely spread across households. In fact, they are highly concentrated among households – so much so, that in 1998, the top 1 percent of U.S. household income earners owned almost 50 percent of all assets, while the top 10 percent owned 80 percent of all financial assets in 1998.

Despite the obvious, heavy concentration of these returns to ownership among a very limited number of households, the size of these returns plays a critical role in the determination of a metropolitan area's level of per capita income. Consider two fascinating examples of how important these returns are to Hampton Roads' level of per capita income.

- In 1999, West Palm Beach, Fla. was the highest price-adjusted per capita income metropolitan area in the U.S. If Hampton Roads simply swapped its return to financial and real estate assets with West Palm Beach, then Hampton Roads would become the highest per capita income metropolitan area in the U.S. and West Palm Beach's ranking would drop to 105, very close to Hampton Roads' actual 1999 rank.

- Seattle's per capita income is one-third larger than Hampton Roads. Bill Gates, Paul Allen and Steve Ballmer, the founders of Microsoft, all reside in the Seattle metropolitan area. In1999, they had an aggregated net worth of $116 billion, according to Forbes. If only these three people moved from Seattle to Hampton Roads, then the yearly income generated from their assets would push Hampton Roads' per capita income to approximately that of Seattle. Microsoft's wealth does make a difference!

GRAPH 6
PRICE-ADJUSTED PER CAPITA RETURNS TO FINANCIAL AND REAL ESTATE ASSETS
HAMPTON ROADS AND U.S.
1969 - 1999



Sources: U.S. Department of Commerce and Old Dominion University Economic Forecasting Project

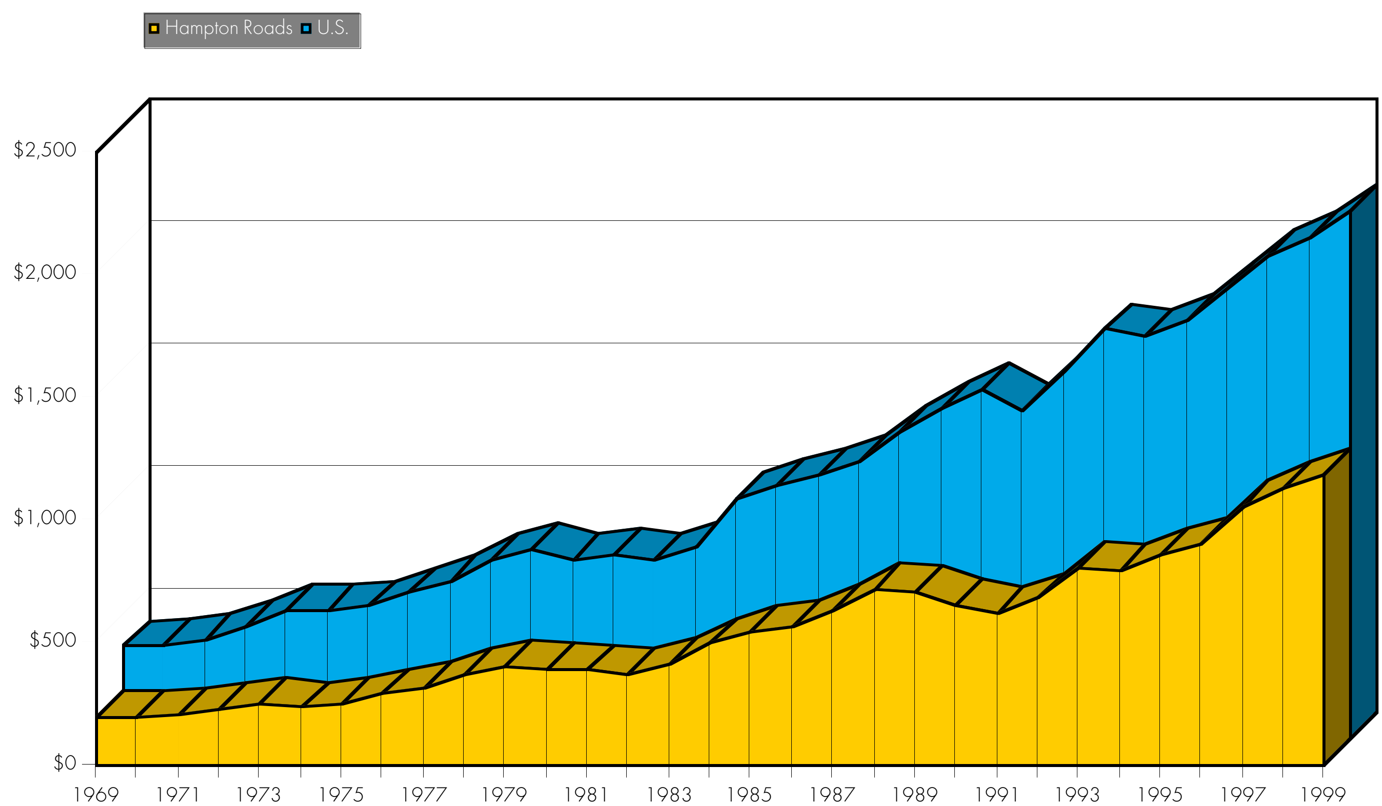
As illustrated in Graph 6, for the past 30 years Hampton Roads has lagged behind the national average in the returns it has earned from its ownership of financial and real estate assets.

Adjusted for prices, the region's return to ownership of these assets has been roughly 10 percent below the national average. Further, given the concentration of these assets in other high-income MSAs, Hampton Roads' per capita return to ownership of financial and real estate assets was only one-third that of the top 10 per capita income metropolitan areas in the United States. What this boils down to is: **Hampton Roads has wealthy people, but not nearly as many as other regions, and its wealthy residents are not as rich as those in the highest income metropolitan areas in the United States. You may already have known this, but most people have not considered its impact upon the region's per capita income.**

BUSINESS INCOME

Hampton Roads also trails the nation where business income is concerned. Business income is assumed to come to individuals who own a business, either as a sole proprietor, or as a partner. As seen in Graph 7, in 1999, Hampton Roads' real, price-adjusted return to personal business ownership was only 55 percent of the U.S. average. This alone accounts for an almost

GRAPH 7
PRICE-ADJUSTED PER CAPITA BUSINESS OWNERSHIP INCOME
HAMPTON ROADS AND THE U.S.
1969 - 1999



Sources: U.S. Department of Commerce and Old Dominion University Economic Forecasting Project

$1,000 difference in annual per capita income. The region's relative lack of business income reflects the dearth of small to medium-sized businesses in the region. Nationally, in a typical metropolitan area, there are roughly 21 people in the work force for each business. In Hampton Roads, however, there are roughly 26 people per business. That is, the region simply doesn't have as many of these types of businesses. As seen in Table 1, when Hampton Roads is compared to a selected group of some of the highest per capita income regions in the both the United states and the South, it has approximately one-quarter more workers per business.

Hampton Roads' relative lack of personal ownership of small and medium-sized businesses (and the income generated by them) has been a serious impediment to increasing the region's level of per capita income. Small to medium-sized businesses tend to incubate entrepreneurs and their subsequent "spin-off" businesses. Specifically, in many cases, existing businesses develop employees who learn the lessons necessary and acquire the experience to start new firms.

Given the "Catch-22" nature of the spread of new firms in a region (it takes existing businesses and the learning they generate to help start new businesses), public policy designed to stimulate and make life easier for small and medium-sized business development would be helpful. For example, it might make sense to focus more of the region's economic development efforts on small and medium-sized businesses, and smaller startup businesses that are generated by the research and development activities

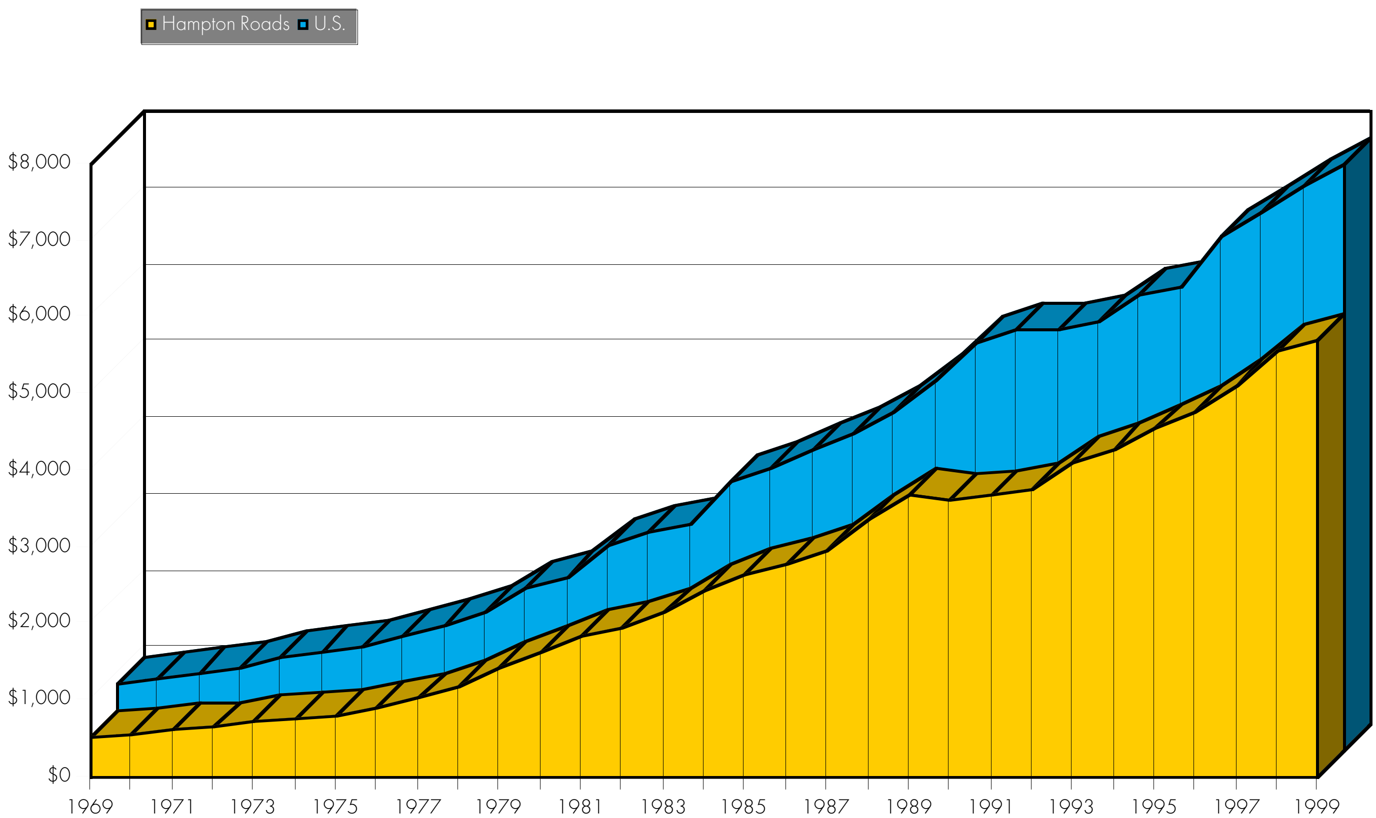
TABLE 1 Employed Workers per Business Selected MSAs 1995	
Selected MSAs	**Employees per Business**
Gloucester County	54.8
Raleigh-Durham-Chapel Hill, NC	20.8
Richmond-Petersburg, VA	19.8
Seattle-Bellevue-Everett, WA	18.4
Denver, CO	18.3
Charlotte-Gastonia-Rock Hill, NC-SC	20.4
Atlanta, GA	20.4
Baltimore, MD	22.1
Norfolk-Virginia Beach-Newport News, VA-NC	**25.7**
U.S. Average	21.2

Sources: U.S. Census, U.S. Department of Commerce and Old Dominion University Economic Forecasting Project

of universities and medical schools. Such businesses often start small, and sometimes struggle, but they frequently are the seed corn of future economic development. Their rapid growth – when they succeed – has led economic growth guru David Birch to label them "gazelles." The evidence suggests Hampton Roads falls short here. Further, perhaps more economic development focus should be placed upon attracting and retaining small businesses to the region. The Hampton Roads Economic Development Authority and the Virginia Peninsula Alliance for Economic Development tend to concentrate their efforts upon attracting medium- to large-sized businesses to the region. Such successes are highly touted when they occur (an illustration being a firm such as John Deere). However, the per capita income data we have introduced here imply that Hampton Roads might be better off if it focused its efforts on attracting and retaining many small firms. The publicity might not be as attention-getting, but the long-term results in economic development might be much better.

Hampton Roads' relative lack of ownership income, whether from business or real estate and financial assets, is evident not just in comparisons to the highest income-earning MSAs but also to those of similar population. As seen in Graph 8,

GRAPH 8
PRICE-ADJUSTED PER CAPITA OWNERSHIP INCOME
HAMPTON ROADS AND MSAs WITH 1 TO 2 MILLION PEOPLE
1969 - 1999



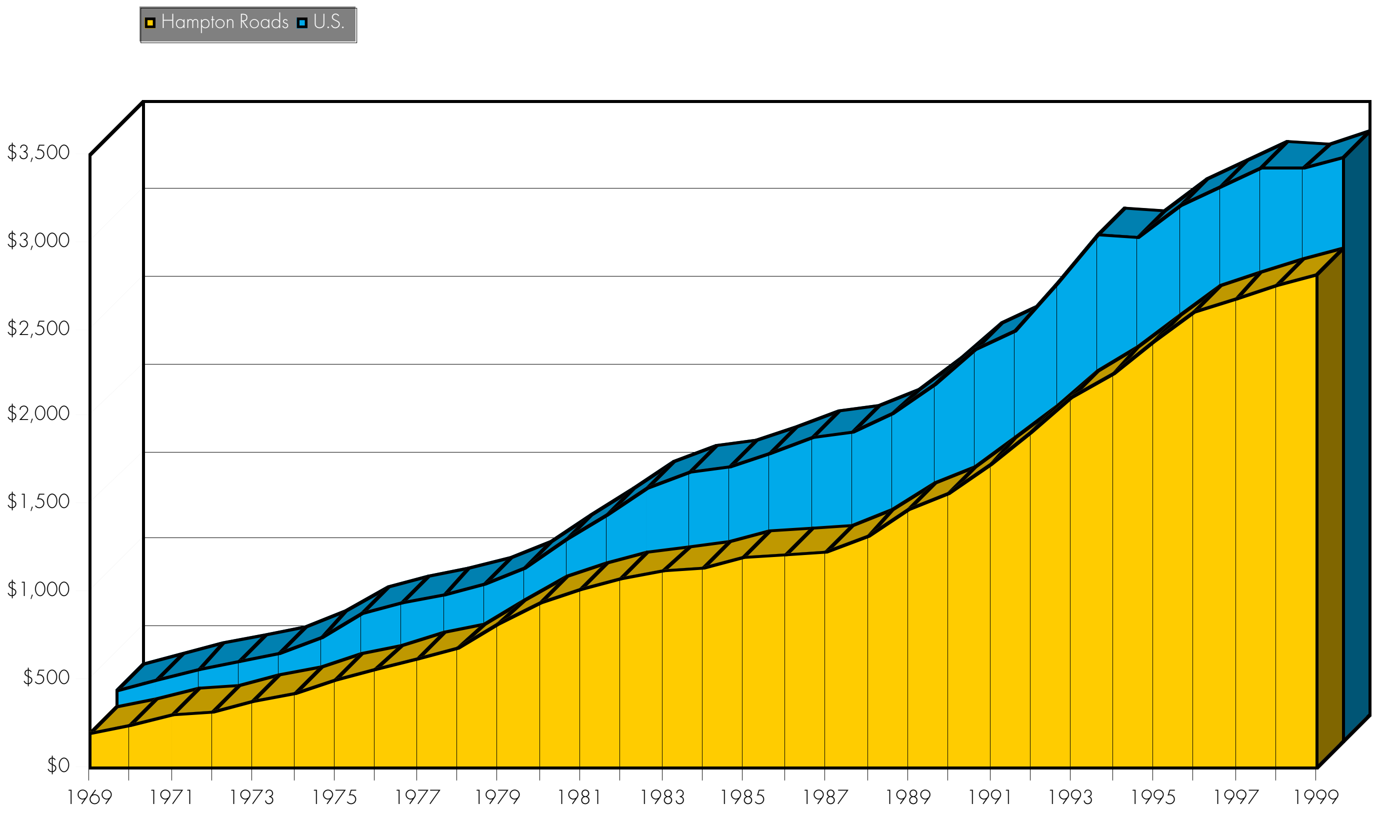
Sources: U.S. Department of Commerce and Old Dominion University Economic Forecasting Project

Hampton Roads has, over the past 30 years, been consistently and substantially below its population peers in the accumulation of ownership income. In 1999, Hampton Roads per capita ownership income was 75 percent of the average of its population peers.

NONLABOR INCOME: TRANSFER PAYMENTS

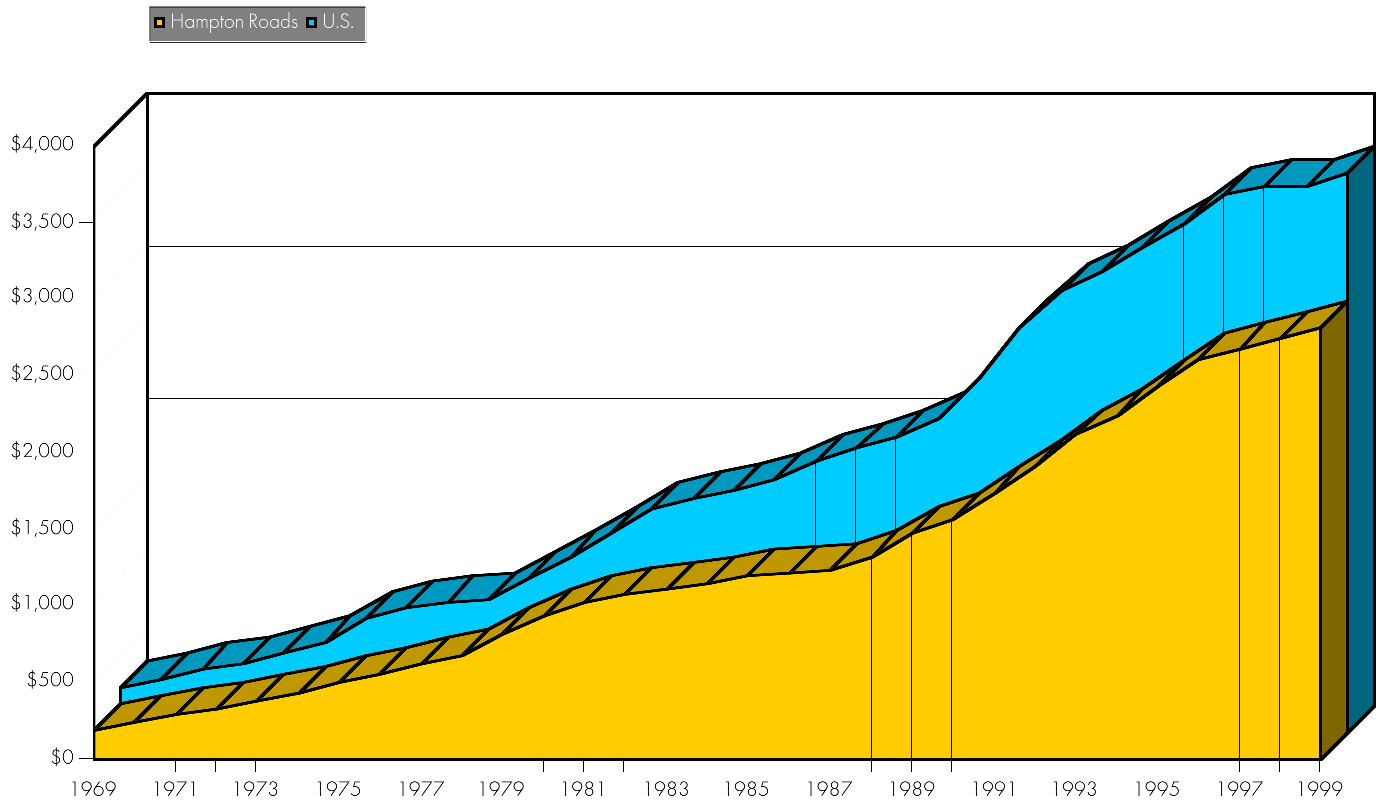
In addition to its lack of ownership income, Hampton Roads receives a smaller share of transfer payments relative to other metropolitan areas. Transfer payments include payments for welfare, unemployment compensation and Social Security. As might be expected, they are paid largely to those households at the lower end of a region's income distribution. Adjusted for prices, in 1999 Hampton Roads received only 84.5 percent per capita of the national average of transfer payments. As shown in Graph 9, the area has, over the past 30 years, consistently received fewer transfer payments per capita than the national average. Further, when compared to its population peers, as Graph 10 demonstrates, Hampton Roads received significantly fewer transfer payments per capita. For example, in 1999 the area received 77 percent of its population peer group average of per capita transfer payments.

GRAPH 9
PRICE-ADJUSTED PER CAPITA TRANSFER PAYMENTS
HAMPTON ROADS AND THE U.S.
1969 - 1999



Sources: U.S. Department of Commerce and Old Dominion University Economic Forecasting Project

GRAPH 10
PRICE-ADJUSTED PER CAPITA TRANSFER PAYMENTS
HAMPTON ROADS AND MSAs WITH 1 TO 2 MILLION PEOPLE
1969 - 1999

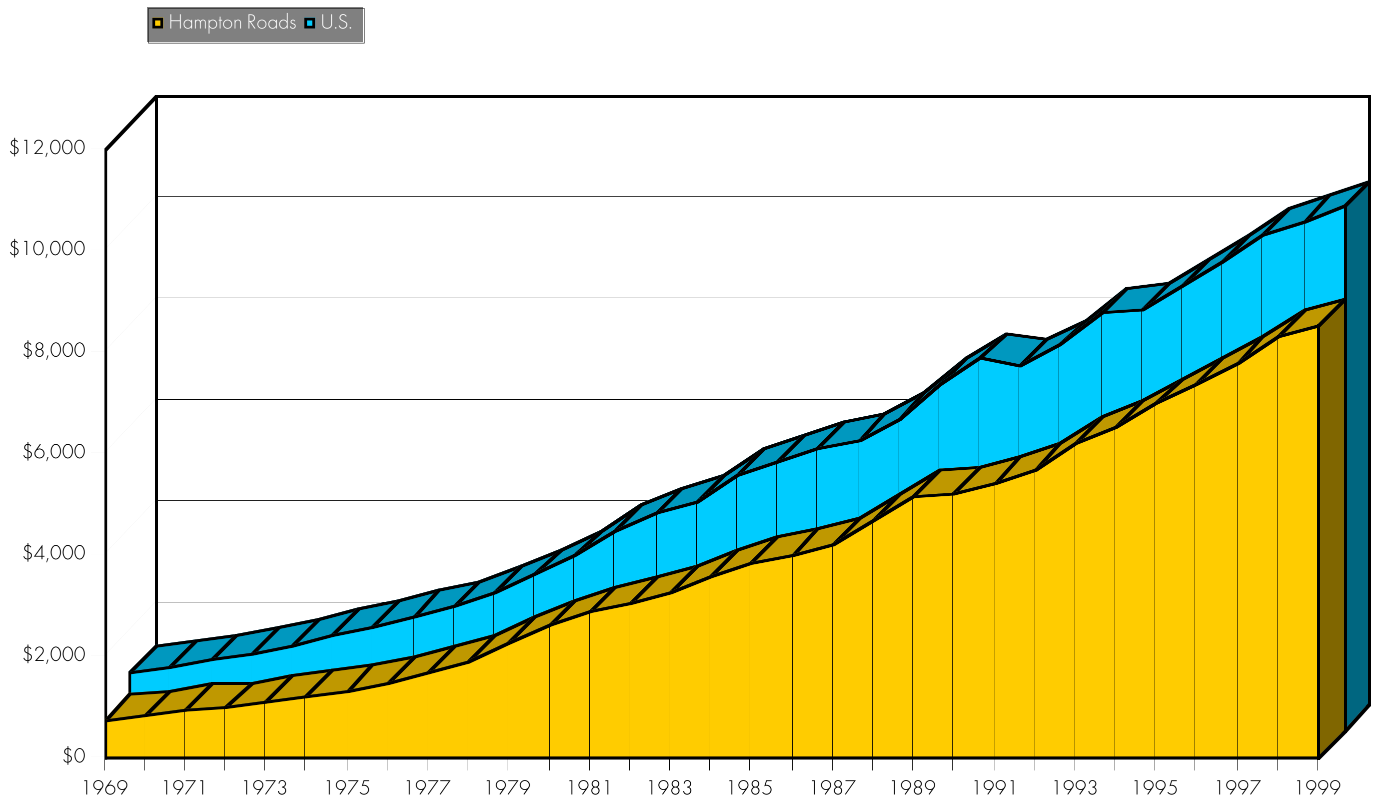


Sources: U.S. Department of Commerce and Old Dominion University Economic Forecasting Project

ADDING UP THE THREE SOURCES OF NONLABOR PER CAPITA INCOME

Graph 11 depicts the sum of all of the nonlabor per capita income in Hampton Roads. It is the total of the income generated by the ownership of assets, business income and transfer payments. Graph 11 compares Hampton Roads to the United States for the year 1999. In 1999, Hampton Roads' real, price-adjusted nonlabor per capita income was only 82.1 percent of that of the rest of the country, or 17.9 percent below the national average. On the other hand, as we already have seen, Hampton Roads' labor income, or the wages, salaries and fringe benefits discussed above, were 9.5 percent above the national average. Thus, there is a 27 percent gap between per capita labor income and nonlabor income in Hampton Roads.

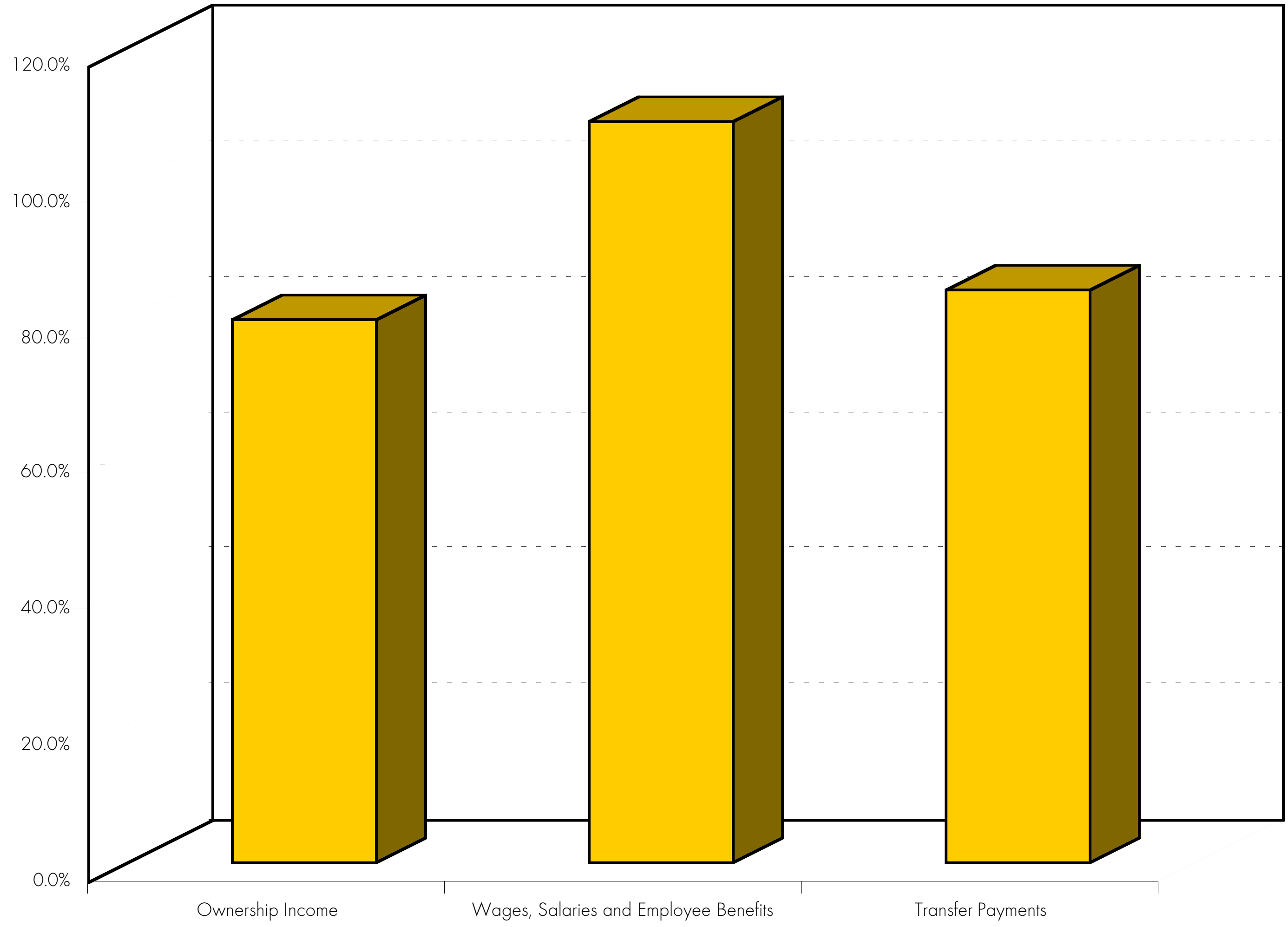
GRAPH 11
PRICE-ADJUSTED PER CAPITA NONLABOR INCOME
HAMPTON ROADS AND THE U.S.
1969 - 1999



Sources: U.S. Department of Commerce and Old Dominion University Economic Forecasting Project

What does this mean? First, ownership income (which is derived from the ownership of assets and the ownership of businesses) tends to be associated with the upper end of a metropolitan area's income distribution, while transfer payments are associated with the lower end of the distribution. On the other hand, wage earner or labor income is apt to be representative of those in the middle of a region's income distribution. Graph 12 compares these per capita income sources in Hampton Roads. **Compared to other metropolitan areas, Hampton Roads' income distribution is more concentrated in the middle-income categories as opposed to the upper- and lower-income extremes. This means the region has fewer very rich people and fewer very poor people than the typical metropolitan area. Hampton Roads is "exceedingly average" insofar as its distribution of income is concerned. But, there is also another interesting implication in Graph 12. Since wage and salary income goes primarily to middle-income individuals, and Hampton Roads' wage and salary income is more than 109 percent of the national average, this means the standard of living of its middle class is higher than that of the rest of the country.** That is, the region's middle class is larger than most and it is doing rather well, economically speaking. Once again, Hampton Roads tends not to have the extreme differences in incomes one sees in the typical metropolitan area nationally. The region may not have thought about itself in these terms, but Hampton Roads is a more egalitarian area than most others in the country.

GRAPH 12
HAMPTON ROADS LABOR AND NON-LABOR PRICE-ADJUSTED PER CAPITA INCOME AS A PERCENT OF THE U.S.
1999



Sources: U.S. Department of Commerce and Old Dominion University Economic Forecasting Project

Hampton Roads' relative lack of ownership income and its lack of wealth (asset) concentration have interesting consequences other than their effects on per capita income. For example, they help explain why the region has a limited number of high-end retail establishments and why it does back flips when a retailer such as Nordstrom's agrees to locate here. (Of course, it also explains why it is so difficult to get them to come in the first place.) These data also help explain why fund-raisers may find the region a bit tougher than wealthier areas to mine for donations. Hampton Roads simply doesn't have the large number of upper-income residents one finds in Richmond and Northern Virginia. This also contributes to diminished political clout for the area, especially in competition with Northern Virginia, as Hampton Roads has fewer large contributions to statewide political candidates and its own lobbyists are likely to be less well funded. Finally, the relative absence of high-income individuals, and a regional lack of privately owned small to medium-sized, and highly profitable, businesses, are important reasons why major league sports teams find the region less attractive. They anticipate they will be unable to sell a sufficient number of expensive reserved-seating areas and sky boxes.

There is a potential good side to all of this, however. Hampton Roads has an appreciably smaller concentration of lower income people, especially when compared to the largest American cities. This reflects both the nature of the jobs available here and an apparently strong regional commitment to the work ethic. This commitment is reflected in the labor force participation characteristics of the region. In 1999, 73.3 percent of all people over the age of 16 in Hampton Roads actively participated in the region's work force. However, in the United States, during the same year, only 68.1 percent were in the labor force. Hence, a significantly larger proportion of Hampton Roads' adult citizens work than is the case in the rest of the country. One can put a positive spin on this and interpret it as a statement about the work ethic of the citizenry. The possible negative spin to these data is that one might simply conclude Hampton Roads has no choice because it takes more jobs for families here to generate the same income as in the rest of the United States.

Final Words

Opinion surveys of Hampton Roads residents, including the one reported in the *State of the Region, 2000,* consistently indicate Hampton Roads residents believe the region pays below-average wages and salaries. They believe this is why the area's per capita income is below the national average. However, the data presented here demonstrate this is not necessarily true. **The primary reason why per capita income in Hampton Roads trails other regions is that this area doesn't own as many income-producing assets, doesn't earn as much business income and doesn't receive as many transfer payments as individuals living in other regions.**

The data also reveal that Hampton Roads is a rather egalitarian place. It has fewer very high-income individuals and fewer very low-income individuals than the typical metropolitan region in the United States.

Finally, the data presented here once again underline the key role of defense expenditures in the region's economic welfare. True, defense-related expenditures now account for only 28 percent of the region's economy, as opposed to 42 percent a decade ago. Nonetheless, regional prosperity continues to be tied closely to the ups and downs of Department of Defense expenditures. The good news is these expenditures are going up, and this shot in the arm, by itself, probably will move real, price-adjusted per capita income in Hampton Roads above the national average next year.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