HOUSTON BUSINESS BRIEFS

Should Houston Become the Next Dallas?

As you look across the American system of cities, you can divide the largest cities into two groups. Cities such as Atlanta, St. Louis and Indianapolis serve as diversified financial, distribution and transportation centers for a surrounding region. Alternatively, some cities are identified strongly with a single large industry, such as automobiles in Detroit or financial services in New York City. In the Southwestern United States, Dallas fills the role of a large regional financial and distribution center. Houston, only 250 miles to the south, is the nation's preeminent center for oil services, refining and petrochemicals.

With the onset of the oil-based recession that struck Houston in 1981–82, diversification of the economic base became an economic priority for the city. The problem, of course, is that in many key industries the niche to be filled by a diversified metropolitan community is already filled by Dallas. Must Houston really beat Dallas at its own game to achieve diversification? Couched in these terms, do Houstonians really want their city to be the next Dallas?

This article presents a close examination of the economic role that these two cities play, including a discussion of how—despite the intense rivalry between them—both have thrived for 150 years. Diversification is occurring in Houston, but not really at the expense of Dallas' strength in trade and distribution. Many of Houston's recent gains in medical services, aerospace and construction engineering stem from the deep technical skills of the city, skills that owe much to Houston's role on the national stage as a petroleum center.

Fortune 500 Firms

Fortune magazine annually compiles lists of the largest industrial and service firms in the United States. The tables on pages two and three list the largest Fortune 500 firms located in the Houston area and in the Dallas–Fort Worth Metroplex. Industrial firms appear at the top of the tables, and service firms are at the bottom. The companies are ranked by the size of their assets, with the smallest ones at the top of the lists.

On the industrial list, we find 16 Houston firms to Dallas–Fort Worth's 15. Both cities show a strong base in petroleum and chemical companies. In Houston, 11 of the 16 firms are oil, gas or chemical companies, as are seven of the 15 firms in the Metroplex.

It is in services that we see the marked difference between the cities. Dallas–Fort Worth has 17 Fortune 500 service companies, in contrast to Houston's 11. The Dallas area is particularly well represented in retailing (J.C. Penney, Southland and Tandy) and transportation

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(AMR, Greyhound, Southwest Airlines and Burlington Northern). Except for Texas Air, Houston's large transportation firms are pipeline companies. If petroleum-based industry is removed from the service list, the count of firms becomes 15 to seven in favor of the Dallas–Fort Worth Metroplex.

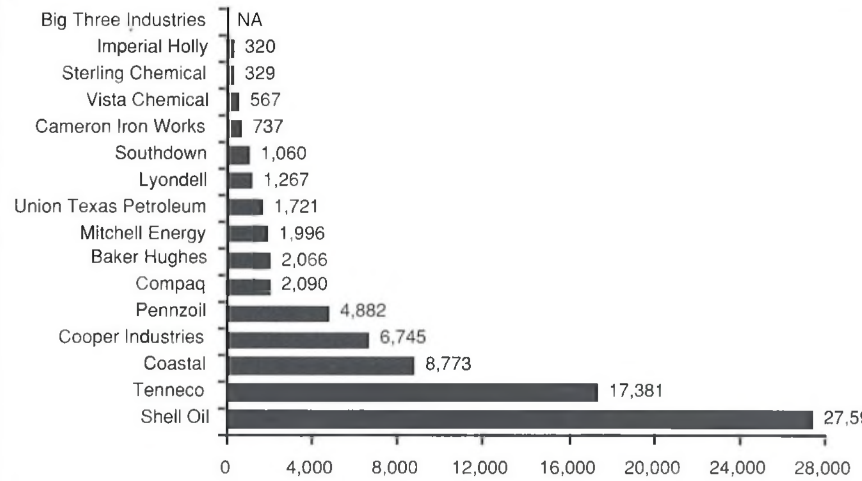
It might be argued (and with good cause) that the number of large headquarters in a city is not always a good indicator of more fundamental trends in the local economy. In this case, however, these numbers effectively make a point. Other data point to similar conclusions. For example, I looked at the pattern of earnings in all the metropolitan areas of the United States that have a population of a million or more. (See the July 1990 issue of the Federal Reserve Bank of Dallas *Economic Review* for details.) Once more, Houston's role as an oil center was strongly evident.

Certainly, I found Houston to have a strong claim to the title of national energy center. A look at the other major metropolitan areas that might make similar claims—Dallas, Fort Worth, New Orleans or Denver—showed no real challenger. Compared to the typical large city in the United States, the share of earnings from oil and gas operations was 16 times larger in Houston. New Orleans came in second with a share nearly 10 times that of typical large cities. However, the absolute size of New Orleans' earnings in 1987 (the latest year available) was only $631 million, or 20 percent of Houston's $3.1 billion. In fact, Dallas came closest to Houston in the dollar value of earnings from oil and gas mining, with $1 billion.

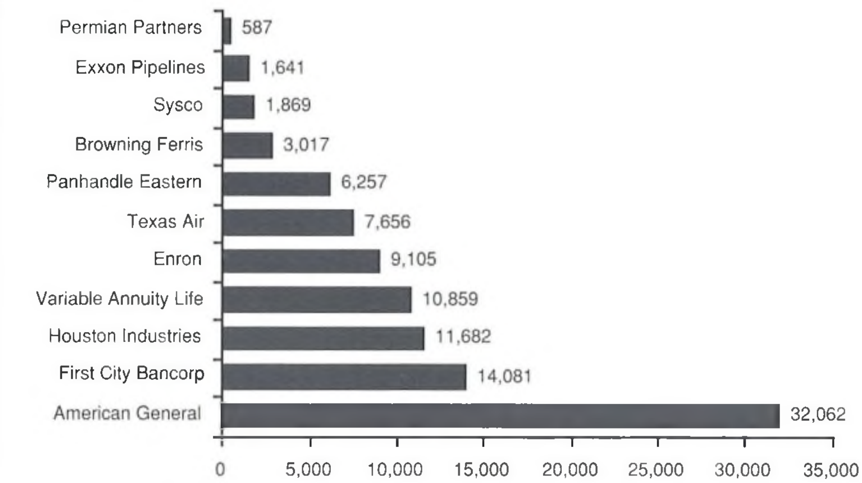
Houston easily took the title of national energy capital when I factored in the city's extensive refining and petrochemical operations and the fact that no major metropolitan area in the nation rivals its pipeline operations.

On the other hand, Dallas emerged as the trade, distribution and financial center for much of the Southwest, exporting these services widely to other major cities. Dallas' only major metropolitan rivals that lie between the Mississippi River and California and that have a strong Southwestern orientation would be Houston, Denver, Phoenix, New Orleans and Salt Lake City. All these cities show some strength in retailing, distribution and finance, but none show the widespread strength and diversity of the Dallas economy. Dallas can be accurately called the regional economic capital of the Southwest.

Assets of Houston Fortune 500 Industrial Companies
(In Millions of Dollars)



Assets of Houston Fortune 500 Service Companies
(In Millions of Dollars)



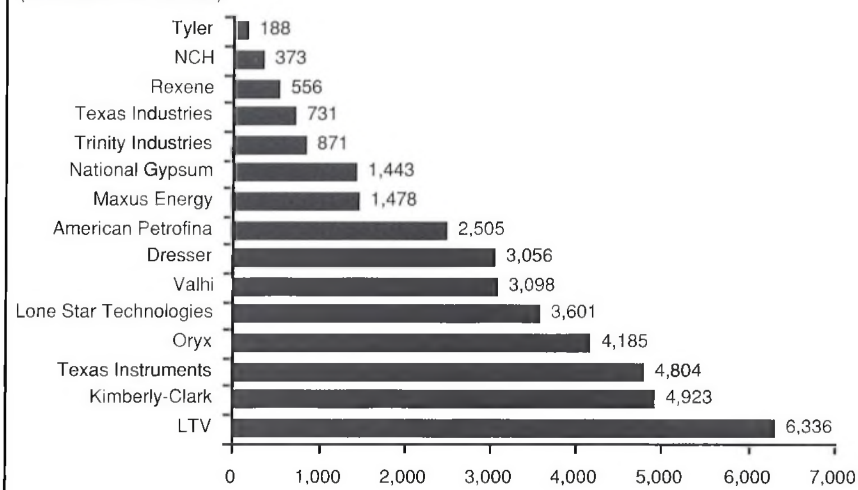
Conclusions

The rivalry between Houston and Dallas is long and intense, and I will not try to decide here whether it is better to be the nation's energy capital or the regional economic center of the Southwest. But this perspective on the two cities provides insight into their role in the Southwest economy. Both cities have an extremely powerful economic base that, despite the rivalry, is threatened only tangentially by the other city. There is overlap in economic functions, of course. The role of Dallas in the oil and gas industry is apparent from the discussion above. And Houston has diligently sought diversification from oil and gas in recent years. However, it is unlikely that two major metropolitan areas the size of Houston and Dallas could coexist for 150 years and only 250 miles apart if they represented a fundamental threat to the other's basic industry.

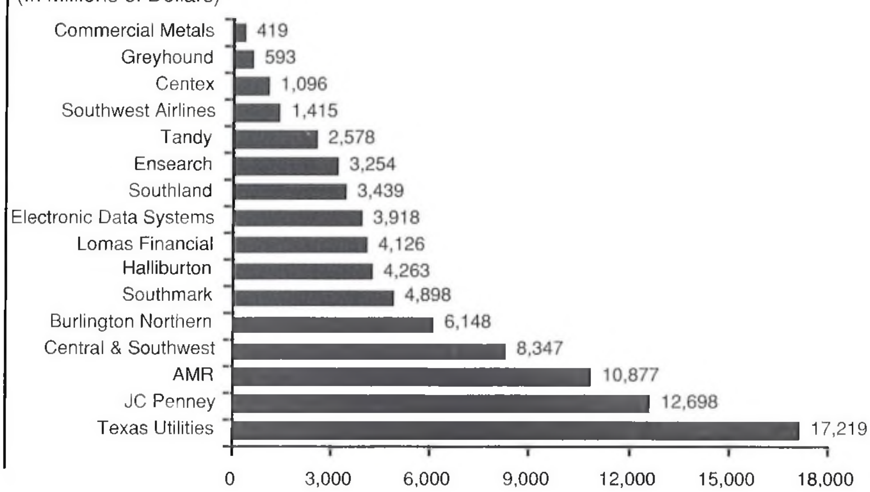
Finally, diversification in Houston in recent years does not follow the Dallas model. Instead, Houston's new jobs and industry have drawn on the deep technical and engineering base of the city that originated in petroleum operations. Houston's new jobs since the local economic recovery began in 1987 can be tied to several sources: engineering construction firms that are building petrochemical and other plants around the world, NASA and the contractors that have grown around it, new aerospace firms and the Texas Medical Center. The common element here is engineering and technical skills involved in the application of technology. It is diversification in the sense that the pattern differs mightily from the early 1980s when tens of thousands of jobs mushroomed in oil exploration and services. This diversification does not overlap much with Dallas' strength in regional services.

The rivalry between the two cities is such that any accomplishment by one city is often seen as a setback to the other. However, as scarce resources are allocated by government for infrastructure, education and job training, the unique role of each city needs to be brought into focus. Longer runways in Dallas or a new biotechnology center in Houston may make perfect sense, but perhaps not if the proposal is turned around geographically. The idea that Houston or Dallas must have or do everything that the other city has or does is simply wasteful. A clear focus on the unique and important role of both cities is crucial as resources are divided between them.❖

Assets of Dallas Fortune 500 Industrial Companies
(In Millions of Dollars)



Assets of Dallas Fortune 500 Service Companies
(In Millions of Dollars)



Houston Beige Book
June 1990 Results

The Houston expansion has slowed in early 1990 compared to a year earlier, but growth remains robust. Year-over-year, changes in total employment have slipped from annual rates of 4.5 percent in Spring 1989 to only 3 percent this spring. Both construction and services (the narrow, one-digit definition) have year-over-year growth rates that exceed 6 percent. Manufacturing, on the other hand, saw employment growth rates near 4 percent last spring decline to almost 1 percent in recent months. This manufacturing slowdown mirrors the U.S. business cycle to some extent.

Houston's growth, though slower now than in recent history, remains strong. The May unemployment rate was 5.5 percent, up slightly from April's excellent 4.9-percent figure. Beige Book respondents reported strong activity in all phases of the oil industry. Weaker levels of activity in paper and lumber and softer prices in some key chemicals reflect the U.S. slowdown. A summary of comments from Beige Book respondents follows.

Oil Services

A combination of stable oil prices, horizontal drilling in the Austin Chalk and increased foreign demand have helped oil service respondents push sales to levels 30-percent above where they were a year ago. The Texas rig count is up by 31 percent from last year, and more than half of this increase has come in Railroad Commission District 1, where horizontal drilling activity is centered.

Oil service firms report a firming of their prices in recent months as demand has risen. These firms report no labor shortages, but activity in the field has led to reported shortages of drilling crews.

Chemicals

Demand is reported as strong, with Gulf Coast plants continuing to operate at a high level. Prices for some products have softened (chlorine, spot ethylene), while others remain stable (propylene, styrene, benzene). No extraordinary increases in general input prices or wages were noted. The cost of a few specific regulations, such as taxes on freon and new hazardous waste requirements, were adding significantly to the cost of operations.

Refining

With the prices of crude oil down and prices of gasoline up, margins are reported to have been very healthy for the past few months. These margins should remain strong through the summer. Gasoline inventories are reported to be adequate heading into the summer driving season; summer driving may increase 10 percent or more compared to last year.

Paper and Wood Products

Demand for bleached products is down, in part due to strong customer demand for recyclables in disposable food products. Pulp markets remain very soft, and prices continue to fall. Container board exhibits strong domestic demand, but exports are down; prices are considerably softer than last quarter.

Rain has hurt the East Texas lumber industry, as wet weather continues to make it difficult to get logs out of the woods. Demand is weak, and market prices are falling because of the slowdown in housing starts in Texas and across the nation. Lumber sales to California have cooled sharply. Houston is the only bright spot for construction in the region.

Real Estate

Office rents in downtown Houston continue to improve and have risen 25 to 30 percent over the past 12 months. Current rents still average only \$15–\$17 per square foot, below the \$22–\$24 needed to justify new construction. Rents in the Galleria area trail downtown slightly at \$13–\$14 per square foot.

Apartment rents continue to rise sharply, and the market for new single-family homes in the \$120,000–\$150,000 price range remains very strong. The market for starter homes (\$60,000–\$80,000) may finally be reviving. Foreclosures on quality properties are disappearing, and there are reported sales of developed lots and other infrastructure built in these neighborhoods in the early 1980s.

Retail Sales

Warm weather always pushes up retail sales, and this year has been no exception. Big stores in Houston uniformly report double-digit increases in sales compared to this time last year. Other than normal promotional activities, the heavy discounting that was prevalent last fall and winter has disappeared.

April was a poor month for auto sales in Houston, and May ran only 4 percent ahead of last May. However, strong February and March sales still leave retail sales in Houston 7 percent ahead of 1989 on a year-to-date basis.❖

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