

Gas prices choke \$5 bil. out of local economy

By Paul Merrion
Aug. 07, 2006

Gasoline prices are pumping \$5 billion from the Chicago-area economy, a hit that could cost the region roughly 62,000 jobs if prices stay above \$3 for the remainder of the year, according to a new study prepared for *Crain's*.

And if gas hits \$4 a gallon — as some predict could happen soon — the economic drag reaches more than \$8.5 billion and means 102,000 fewer jobs than the area otherwise would have seen.

That's because as consumers spend more on gas, many are spending less on dining out, going to a show or updating their wardrobes — decisions that are beginning to have a direct effect on restaurants and retailers, but are eventually expected to ripple out to almost all sectors of the local economy.

"At some point, if gas prices continue to go up, it will start to bite," says Geoffrey Hewings, director of the University of Illinois' Regional Economics Applications Laboratory (REAL), a joint venture with the Federal Reserve Bank of Chicago. REAL conducted the study for *Crain's*. The state had two consecutive months of job losses in May and June, he notes; it added 67,000 jobs in the 12 months ended in June.

Beyond the consumer spending patterns that REAL is measuring, the total economic impact of rising petroleum prices could be even greater, as local businesses ranging from plastics molders to logistics companies contend with rising raw material and transportation costs.

Anecdotally, there already are signs a slowdown has begun.

Richard Melman's Lettuce Entertain You Enterprises Inc. had a "spectacular" January, when gas prices were last below \$2.40 a gallon in the Chicago area. But sales were noticeably off across Lettuce's 68 restaurants from March through June, as gas climbed up to \$3 and beyond.

"I can't tell you unequivocally it was gas, but I believe it has some impact," says Mr. Melman, Lettuce's chairman. "I don't know if (people) stop eating out or trade down" to less expensive restaurants, he says.

Marc Stolfe believes they do go downscale. His Connie's Pizza chain, which will have 13 local outlets by yearend, is a low-priced alternative to home cooking and normally does better when the economy slows. He has not seen a drop in sales this year, even though people are ordering fewer high-ticket items from the menu. But gas prices are squeezing his profit margin, forcing him to keep a lid on overtime and rethink next year's expansion plans.

"I can't think of anything that comes in without a freight surcharge now," says Mr. Stolfe, president and owner of Connie's Restaurants LLC in Carol Stream. "And our pizza delivery fee now covers less than half the cost. If I doubled my delivery charge, sales would plummet."

Higher gas prices are causing myriad shifts in spending by consumers and businesses alike. When a fill-up costs \$50 or more, a driver may not stop for a double latte or rent a video on the way home. And when its costs go up, a business like Connie's Pizza or a large manufacturer buys less equipment and leases less space, and avoids overtime and hiring as much as possible.

"It's kind of like getting slammed in four ways," says Tom Pasqualini, executive vice-president of operations and supply chain for Chicago's Solo Cup Co. Higher energy prices are raising Solo's costs of manufacturing, shipping, paper and — biggest by far — plastic raw materials derived from petroleum. In the last few months, Solo announced it was cutting 400 jobs, partly in the wake of a merger, but energy costs are also "a big part of the reason," Mr. Pasqualini adds.

Gauging the impact of higher gas prices is not an exact science, given higher interest rates and other fundamentals driving the economy. The U of I study attempts to isolate just one factor — consumer spending — to show what happens when households spend a little more each week on gasoline and a little less on everything else.

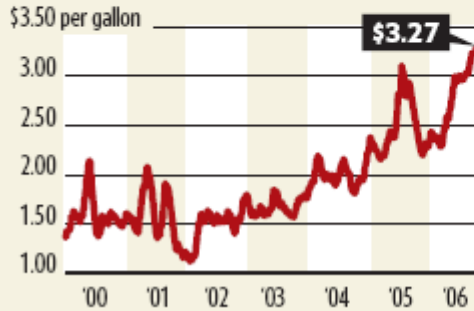
Even if total consumer spending stays the same, higher gas prices mean more dollars flow out of the region, eventually to oil companies and producers in the Middle East, Texas or elsewhere. Likewise, dollars spent on other goods and services have a greater tendency to recirculate and produce more goods and services in the Chicago region.

ECONOMY SUFFERS AS GAS PRICES ESCALATE

As consumers spend more on gasoline, they're expected to spend less on other goods and services, taking a toll on the local economy.

AVERAGE CHICAGO GAS PRICE

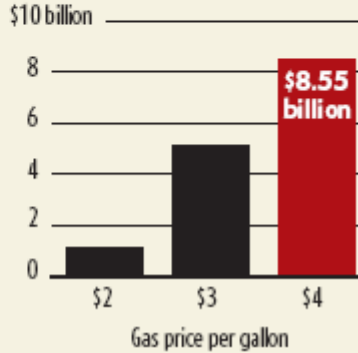
Per regular gallon, 1/1/00 to 8/02/06



Sources: Oil Price Information Service, University of Illinois

ECONOMIC LOSSES

Cumulative drain on local economy



\$15 HERE, \$15 THERE

REAL assumed that the typical Chicago household is now spending \$15 a week more on gasoline than last year, and \$15 less on everything else. With nearly 3 million households in the six-county region, that adds up to \$2.3 billion more spent on gas over a year, and a corresponding drop in other local retail sales.

"Fifteen dollars doesn't sound like a lot of money," says Mr. Hewings, but "just taking a small amount of money (out) has an enormous impact on the economy."

At Chicago-based Sam's Wines & Spirits, customers are happy to pay a \$5 delivery fee if it saves a trip to the store. Sam's second-quarter sales were flat, but "since gas prices spiked, our delivery business is up 14%," says Chief Operating Officer Brian Rosen.

Altogether, higher gas prices have a nearly \$2.5-billion direct impact on the local economy, plus indirect effects of nearly \$2.7 billion, according to REAL. That doesn't mean the region's recent economic growth will turn into a decline, but it will grow \$5.2 billion less than it would have if gas prices had stayed at the early 2005 level. Similarly, the study says 62,000 jobs would be affected, but that would be a combination of jobs lost, fewer hours worked or people not hired because of higher gas prices.

The economic drag would be partly offset by increased government spending, resulting from increased tax revenues as the price of gas goes up, according to the study. The higher tax revenue would result in a small uptick in construction. More significantly, the petroleum sector in Illinois would gain nearly \$1.9 billion in economic output and more than 1,500 jobs.

It may not be much, compared with what the state consumes, but Illinois produces about 32,000 barrels of light, sweet crude oil a day from thousands of stripper wells, mostly far Downstate.

"It forms a substantial part of many local economies," says Brad Richards, executive vice-president of the Illinois Oil and Gas Assn. But some well owners live in the Chicago area and "a lot of investment money comes out of Chicago," he adds. At today's prices, every drilling rig in the state is looking for more oil and "rigs are being added, people are being hired."

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