Danville Works
New IKEA Factory Hums

One manufacturer decided to swim against the outsourcing current and situate a factory close to its market.

IKEA's Swedwood manufacturing plant in Danville, Va., specializes in wood-based furniture such as bookcases and side tables.

PHOTOGRAPHY: DANIEL BROOKS

Swedwood, the manufacturing unit for IKEA, opened its first U.S.-based manufacturing facility in Danville, Va. By the time the factory opened in May of 2008, there were more than 175 employees at the 930,000 square-foot plant. Swedwood expects to hire another 625 workers by 2013.

For Southside Virginia, the new factory brought relief. Here the economic blues are nothing new. Danville, home to 48,411 residents, according to the 2000 Census, has struggled with high unemployment and a stagnant economy for a decade. In the current recession, Danville's unemployment jumped to 13.9 percent in January 2009, well above the 7.6 percent nationwide unemployment rate. By October, the rate had fallen to 11.2 percent, much higher than Virginia's 6.3 percent rate.

Manufacturers have generally left Danville for the cheaper labor found overseas. For example, textile manufacturer Dan River Inc. was facing overseas competition and steadily decreased its production. The textile mill once employed as many as 15,000. By 2008, only a handful of workers remained when the company filed Chapter 11 bankruptcy. The departure of the textile mill and smaller manufacturers crippled the economy. For a city where about 15 percent of jobs were in the manufacturing sector (compared to the 7 percent Virginia average), the decline of manufacturing was particularly devastating.

For some manufacturers, transportation makes up a large percentage of total costs. This is especially true for IKEA, known for low-priced furniture. Two years prior to IKEA's 2006 announcement that they would open the Danville plant, crude oil had more than doubled in price, from about $30 a barrel in 2004 to $70 a barrel by August of 2006.

The Danville facility produces wood-based products such as bookshelves, and coffee and side tables. According to Jorgen Lindquist, vice president of Swedwood in North America, "this kind of lightweight furniture is cheap to make, so transportation is a huge part of the overall cost." Having to ship goods from factories in Eastern Europe all but wiped out the benefits of manufacturing in such low-wage economies.

Now IKEA's products can be shipped to East Coast distribution centers in Georgia, Maryland, and New Jersey. Proximity to those centers was one reason why Danville was chosen. A manufacturer also needs skilled labor, and Danville had plenty who were eager for employment.

The Danville Office of Economic Development especially welcomed the arrival of Swedwood. After the tobacco settlement in 1999, in which states received $206 billion over 25 years from tobacco companies, millions of dollars went to aid Danville's weakening economy. The city and its home county, Pittsylvania, used that money to attract industry and built the 900-acre joint industrial park Swedwood now occupies.

Swedwood was also lured by the industrial park's communications capacity. Using money from the tobacco settlement, the state initiated the Mid-Atlantic Broadband Cooperative (MBC) to construct a fiber-optic network covering a large section of southern Virginia. This enables Swedwood to connect to its home office in Sweden. According to Tad Derisa, general manager of MBC, it cost less for Swedwood to buy connectivity to Sweden through the cooperative than other carriers.

Because IKEA is not publicly traded, it is difficult to gauge the impact of its manufacturing move to the United States. With the value of the dollar declining and the rise in oil prices at the time, other manufacturers were reviewing the United States for possible sites. The outsourcing trend is unlikely to reverse, even with a sharp increase in oil prices. But in some cases, these high transportation costs may provide some employment relief for small towns like Danville.

—DANIEL BROOKS

Troubled Asset Relief

Bank of America Repays Government Loans

Bank of America in December repaid the $45 billion it borrowed from the government's Troubled Asset Relief Program (TARP). Bank officials said in a press release that the repayment clears a "significant hurdle" and demonstrates the company's strength following the nationwide financial crisis.

More than half of the repayment came from cash, with more than $19 billion coming from a new issuance of stock. Bank of America is the nation's largest bank-holding company by assets and received the second-biggest chunk of TARP money behind Citigroup.

Most banks want to repay the money, in part to be free of government influence over executive pay and other operational issues. But it's not easy. Banks must prove they're out of financially tumultuous waters before using resources to pay back TARP funds. This includes judging whether the weak economy could pose further troubles.

For Bank of America, the decision likely also factored in possible financial challenges issuing from its acquisitions of Countrywide in 2008 and Merrill Lynch in 2009. "It may still have to stomach losses from its portfolios associated with [those] acquisitions," notes Daniel Indiviglio of *The Atlantic*.

TARP was initiated by the U.S. Treasury in October 2008 following the onset of the financial crisis. The program gave eligible banks capital in exchange for preferred shares of common stock granted to the government. The only way for banks to recoup those shares is to buy them back which, in effect, is a repayment of the TARP money. But they can only do that with government approval. Treasury allows TARP repayment based on an institution's soundness, capital, and ability to lend, all of which are determined in concert with the bank's regulator.

Regulators also have a say in how banks finance TARP repayment. Banks are required to hold a certain amount of capital against assets to protect against possible future losses. Using existing cash to repay TARP funds will lower the bank's capital ratio, all else being equal. A bank's capital cushion will help weather strains stemming from the financial crisis. That means repaying TARP funds could impair its ability to withstand future turmoil. Alternatively, banks can repay TARP funds by issuing new shares, but that displeases current shareholders who want shares to stay scarce and, hence, more valuable.

The Federal Reserve's Fifth District was home to two of the nation's largest banks prior to TARP's inception: Bank of America and Wachovia, both based in Charlotte. However, San Francisco-based Wells Fargo announced in the same month TARP was created that it would merge with Wachovia. Wells Fargo received $25 billion in TARP funds, and repaid the money late in December.

Citigroup, the New York-based bank, was the largest recipient of TARP funds at $50 billion. Citigroup paid $20 billion back in December. Repaying TARP funds and reassuming control over executive pay likely also made it easier for Bank of America to secure a replacement for CEO Kenneth Lewis who retired at the end of 2009. Brian Moynihan, an internal pick, was chosen as the new head of the banking giant. — RENEE COURTOIS

Apples, Soybeans, Poultry

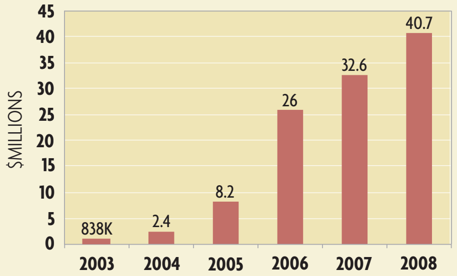
Virginia's Exports to Cuba Grow

Cuba is an expanding market for Virginia agricultural products, with $45 million sold as of the third quarter of 2009. Virginia ranks among the top five states in the value of exports to the Caribbean nation. Cuba was opened to medical and agricultural exports in 2000 for the first time since 1962.

The Virginia Department of Agriculture and Consumer Services reports that the state's agricultural exports totaled $2.2 billion in 2008 to all corners of the globe to the mutual benefit of farmers and consumers. Virginia cattle, for instance, are shipped to Turkey and this export of genetic stock improves Turkish stock, says VDACS marketing director Charles Green. Virginia also sells $100 million in agricultural goods annually to China.

Farmers and VDACS representatives went to Cuba last November to promote and negotiate shipments of soybeans, pork, poultry, and apples. The state has exported agricultural products to Cuba since 2003, when it sold $838,000 in

Virginia Agricultural Exports to Cuba



SOURCE: Virginia Department of Agriculture and Consumer Services

products. In 2008, that number had grown to $40 million.

The process takes patience, though. Transactions must go through a third-country bank. But the relationship is paying off. The Cuban government buys through its agent, Alimport. VDACS sets up meetings between exporters and government representatives. "They may relay a desire to quote on a particular product; we bring it back and put it out here to the industry to see if anyone is interested in providing a quote on that particular product," Green says.

Foreign consumers can help diversify markets for farmers. Apple growers Philip Glaize of Winchester, Va., and Henry Chiles from Crown Orchards, for instance, work together to supply necessary volume for their overseas buyers.

The Cuban government agency coordinates purchase requests of multiple agencies, and consolidates them into contracts with exporters, Green says. The market could be expanded, he says, but current trade and travel restrictions limit growth. There are other transaction costs as well. Because of everything from travel licensing to the necessary export licenses from the U.S. Treasury and U.S. Department of Commerce, it's not as easy as going to Mexico City to visit a customer. But it has been worth the investment.

This is one of those markets where it's truly unique when you see someone who is American," Green adds. And when he does, it's often someone from the South. "Geographically it makes sense — we have a competitive advantage. It's a three-day transit time to get a vessel down there with soybeans."

— BETTY JOYCE NASH

Cash Economy

Underground Commerce Grows in Recession

Some transactions in the economy aren't conducted on the books. Some are simple cash transactions between people in what analysts call the "underground economy." Contrary to the connotation, much of this activity is not illicit. Most of the underground economy does not involve drugs, prostitution, or other illegal activities but is more likely to involve paying a neighbor to mow your lawn or shovel snow — tasks that, were it not for the nonreporting of the earned income, would be otherwise perfectly legal.

Recessions tend to be fertile periods for these deals. One way to measure the underground economy is to evaluate the ratio of unreported income to reported income. Edgar Feige, professor emeritus of economics at the University of Wisconsin-Madison, estimates that in 2008, unreported income reached about $2 trillion, the highest since World War II. This estimate puts the percentage of unreported income at between 22 percent and 24 percent of reported income.

As a first step to estimating the underground economy, Feige took a look at currency in circulation, which at the start of 2009 hit $824 billion. His research shows that about a third of U.S. currency is held overseas, less than earlier estimates. The remainder, Feige notes, includes underground transactions.

During World War II, the calculated percentage of unreported income rose dramatically, but fell off during the post-war period and remained fairly stable until 1973. This figure rose to a temporary peak in 1982, also a recession year. Feige estimates that the 1980s and 1990s showed considerable fluctuations in levels of reported and unreported income. Yet during the past decade, levels of unreported income rose substantially.

Lack of employment opportunities probably plays a role in the rise of unreported income. "People do try to substitute work in the unofficial sector for work in the official sector where they're losing their jobs," Feige says.

When so much income is unreported, legislators have fewer tax revenues at their disposal. His findings suggest that governments could be out more than $600 billion a year, which includes money from overseas tax havens. That figure, called the "tax gap," was last published by the Internal Revenue Service in 2002, when it was about $345 billion. Collecting that money could allow lawmakers to reduce deficits.

Feige also posits a close relationship between distrust of the government and the growth in unreported income. Events like the Vietnam War and Watergate scandal caused an increase in government mistrust. That led to an increase in noncompliance with tax laws, Feige says. He expects dissatisfaction with the Iraq War and other policies to drive increased rates of government distrust. "I suspect that could be an important factor in the increase in noncompliance we've witnessed."

— DAVID VAN DEN BERG