

Community Choices

Public Policy Education Program

Module Four

Understanding the Local Economy

David Mulkey
University of Florida

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Module Four Instructor's Guide

Understanding the Local Economy

Objectives

This module's objective is to develop the necessary understanding to identify and discuss economic development issues at the local level. This module does not directly address human capital issues as do the other modules in the series. Rather, this module focuses on the economic environment within which human capital investment takes place. A small group activity is suggested to allow participants to think about their local economy, identify types of industries in their community, and to consider development alternatives.

Specifically, this session focuses on understanding the local economy through the following topics:

- ◆ Presenting export base theory as a model of the way a local economy works;
- ◆ Relating the general export base framework to the participants' state and community; and
- ◆ Using the community's economic framework to address the concept of economic development and to introduce a variety of programs to encourage local economic development.

Procedures and Time Line

- ◆ Provide an overview of the export base model (15 minutes).
- ◆ Undertake a discussion (for about 25 minutes) in which the participants relate the export base model to the state and community in which they reside.
- ◆ Provide an overview of the development concept and present some development alternatives that are available to communities. Allow about 40 minutes for this presentation.
- ◆ Break up into groups of equal number and carry out the accompanying activity. Have a representative from each group share a summary of their discussion and decisions (for about 5 minutes each).

Materials Needed

- ◆ Microsoft PowerPoint and flip charts for use in the small group sessions.
- ◆ Copies of the overview document and the activity sheet on *Analyzing Your Local Economy*.



Understanding The Local Economy: Implications for Economic Development Programs

David Mulkey
University of Florida

Preface

Earlier in this program, we explained that an individual's ability to make human capital investments—education, job-training, and work experience—in him/herself can either be aided or impeded by factors which influence economic opportunities in the community. The last four modules in the program will examine in greater detail human capital/resource issues. Before fully addressing these issues, however, program participants must first understand the economic development “context” in which they occur. This module presents a clear discussion of economic development issues at the community level that affect and are related to individuals' human capital investment options. We feel that by understanding how economic development works and the manners in which it can be achieved, the program participants can have a better basis for determining the human resources that will be needed to bring these development opportunities to fruition.

“It strains credibility to assume that local development will travel far on ignorance of the locality and how it works.”

Introduction

With the advent of the 1980s, a series of national and international events combined to reverse the economic fortunes of many, if not most, rural areas. Employment declines in traditional rural industries—agriculture, manufacturing, and natural resource-based industries—were exacerbated by a national shift toward a service/information-based economy, by the internationalization of the U.S. economy, and by structural shifts within traditional agriculture and manufacturing [5]. While the 1990s have been much better for rural areas, some rural pockets continue to lag behind. Even among rural communities that are fairing well, many of them continue to depend on lower paying jobs. As a result of these factors, rural development is re-emerging as a priority issue at all levels of government.

The litany of reasons for the renewed interest in rural development is familiar: the lack of local job opportunities for young people, the obsolescence of job skills among older workers, over dependence on agriculture or other resource-based industries, the need for additional local tax revenue, concerns over the quality of rural life, and a general feeling of loss of local control. All point to a series of difficult challenges facing rural policy makers.

Given this setting, this module provides an overview of the economic development process for use by local program participants. The following section offers a framework for understanding in general how a local

As noted by Woods and Sanders [13], the economic challenges facing communities include the following:

- ♦ Maintaining and enhancing the competitiveness of farms and rural businesses;
- ♦ Bringing further diversification to the economic base of rural areas;
- ♦ Finding alternative uses for rural resources;
- ♦ Easing the transition for farm families;
- ♦ Providing technical and educational assistance for local units of government;
- ♦ Helping communities to identify and implement policy options designed

economy works. Subsequent sections focus on defining economic development and exploring economic development alternatives. The activity section provides an opportunity for relating these general economic development ideas to specific processes occurring in the community.

Material presented is summarized from sources listed in the reference section. This listing also is recommended as additional reading for persons who want a more detailed treatment than that provided here.

Export Base Theory: A Community Economic Framework

Export base theory is often used by community economists as a general framework for understanding how a local economy works and as a basis for a variety of community studies and economic development activities. The total spending associated with this recirculation of new dollars is the multiplier effect often seen in references to development programs. This approach considers that a region's economy consists of two distinct types of economic activity:

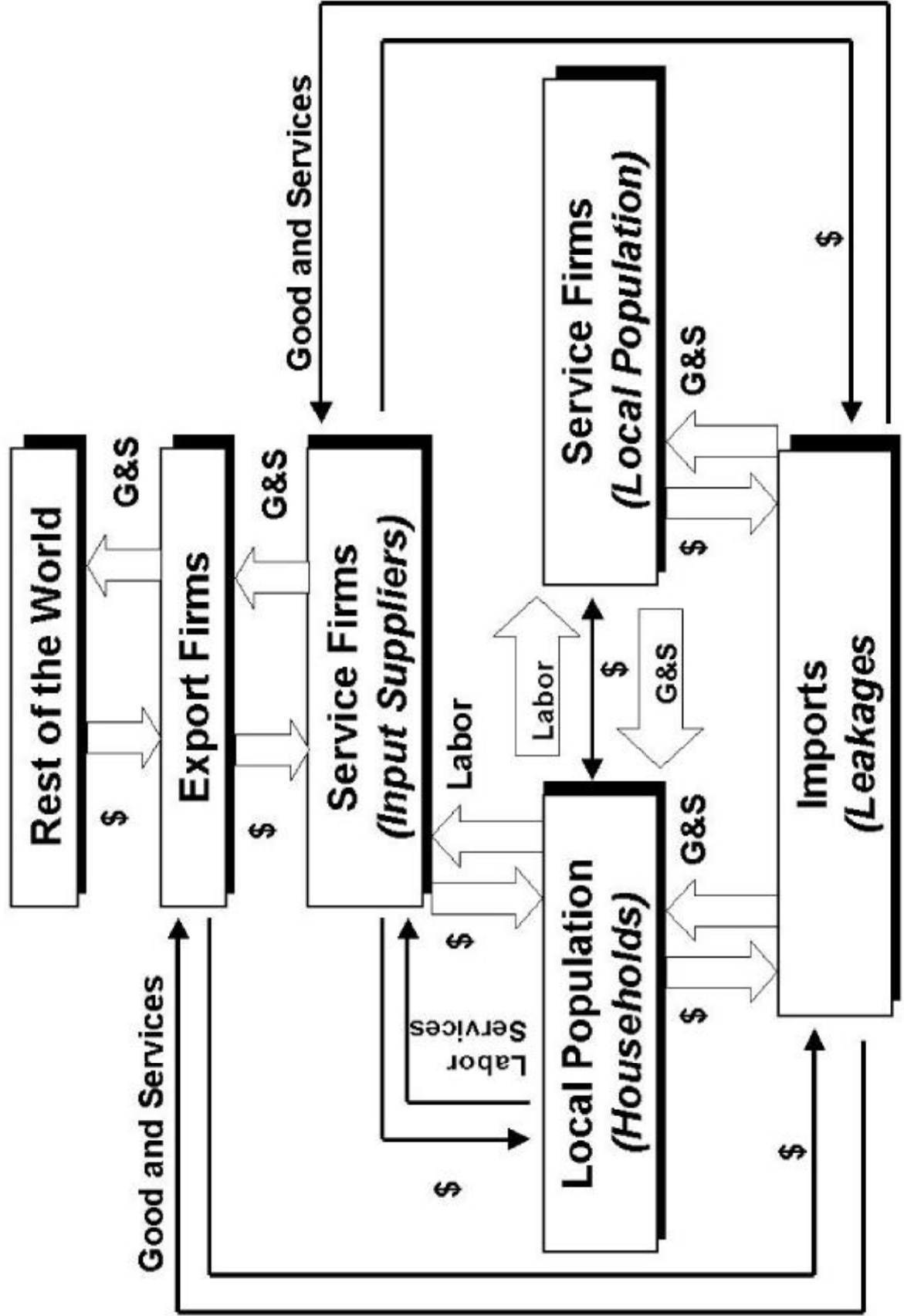
- ♦ **basic industries** that sell goods and services to markets located outside the local area; and
- ♦ **service industries** that mainly serve local markets. Basic industries attract outside dollars into the local economy, dollars that are then recirculated through local service industries (see Figure 1).

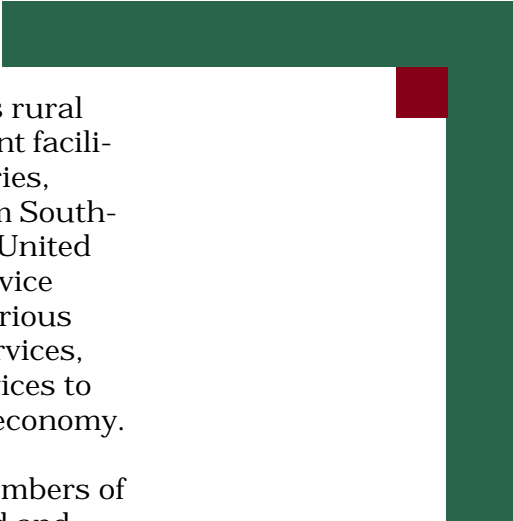
BASIC INDUSTRY

The key to identifying basic industries is, as noted above, the non-local nature of markets served, a distinction that is more important than the exact nature of the good or service produced. Typically, basic industries are associated with activities such as agriculture or manufacturing, but, in fact, almost any type of business can play a basic role at the local level if its products are sold elsewhere or if it attracts customers from other areas. In either case, the basic industry attracts outside (new) dollars into the local economy. Sales by basic industries initially provide jobs and income for employees of basic industries, but when re-spent locally, dollars attracted by basic industry sales support a variety of local service activities (the multiplier effect noted above).

“Export base theory is often used by community economists as a general framework for understanding how a local economy works and as a basis for a variety of community studies and economic development activities.”

Figure 1. Economic Activities of a Community





What are the basic industries in Southern states and various rural communities? Clearly, any listing would include federal government facilities and the traditional basic sectors—agriculture, forestry, fisheries, mining, and manufacturing—which ship a variety of products from Southern communities to markets located elsewhere, either within the United States or abroad. Many other businesses (often thought of as service industries) also serve a basic role in attracting outside dollars. Various service businesses (banking and financial services, real estate services, and consulting firms) are basic industries when they provide services to non-local clients; new dollars are attracted into the local or state economy.

Further, in many rural areas, businesses that serve large numbers of tourists are relatively important. Visitor expenditures include food and lodging, entertainment, travel services, and other goods and services associated with vacation or business travel. Tourist and travel-related firms differ from traditional basic industries only in the nature of the product provided and in the fact that customers travel to the region rather than purchasing a regional product and shipping it to their home state or country. The purchase represents new dollars attracted, dollars that provide jobs and income for residents and support a variety of service activities in the areas in question.

Finally, with regard to basic activities, one must also consider the large numbers of retirees who spend all or some part of each year in Southern states, particularly states like Florida. When retirement benefits are derived from sources that are located elsewhere, expenditures by retirees represent new dollars to the economy of the state where they reside in retirement. Thus, retiree spending represents basic activity in the same way as does spending by tourists. New dollars provide jobs and income for local residents, and multiplier effects provide support for local service activities.

SERVICE INDUSTRY

Service industries, unlike basic industries, are those firms that serve local markets. Examples include the full range of retail and service establishments that serve local residents as well as firms that sell goods and services (inputs) to firms engaged in basic activities. Service firms, in essence, prevent “leakages” of dollars from the local economy (see Figure 2).

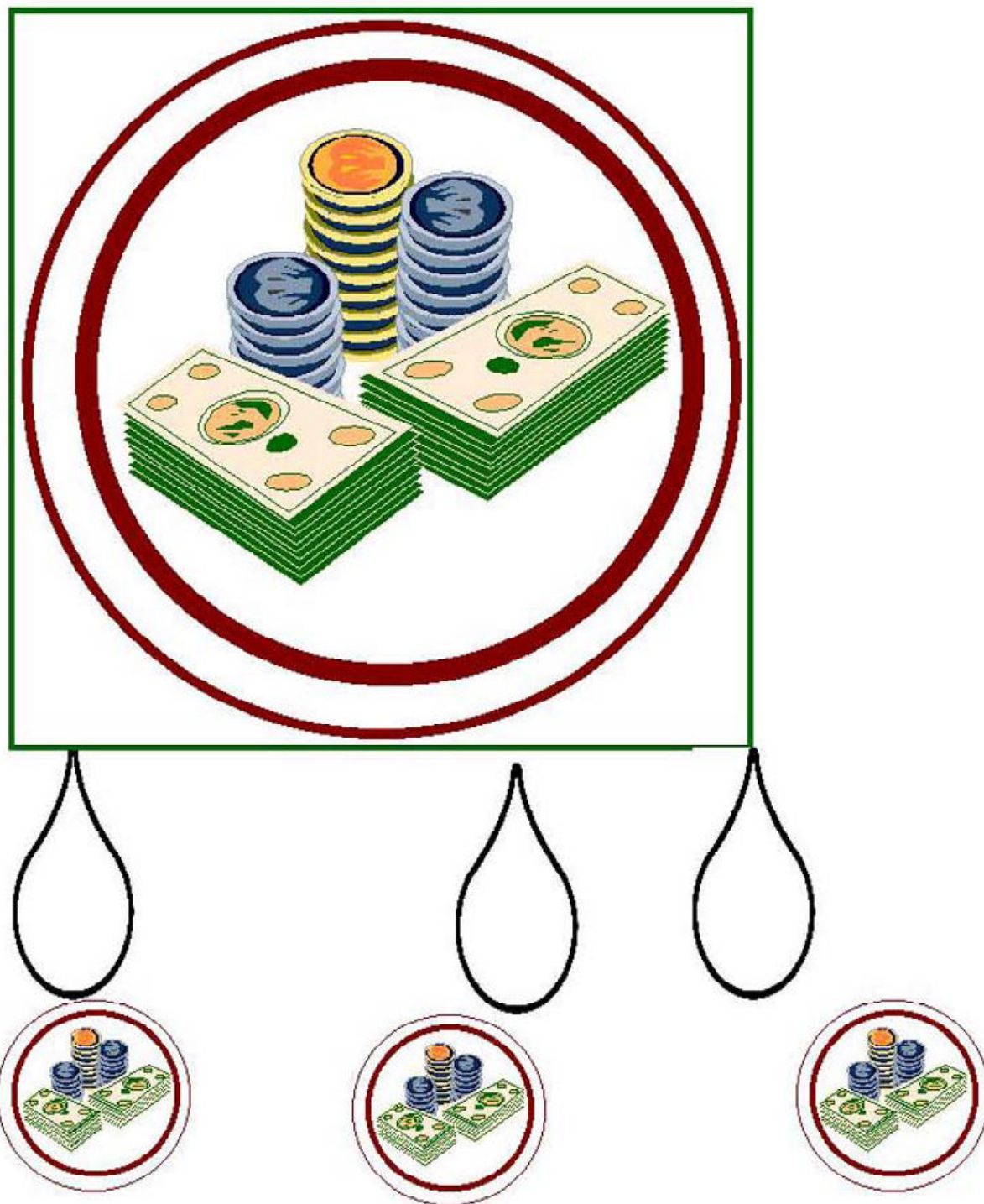
Again, the key distinction in determining basic versus service activity is the location of the market and not the type of good provided. Any of the activities noted above as basic may be classified as service (non-basic) if products or services are sold in local markets.

OTHER CONSIDERATIONS

At both the state and local levels, two additional items are worth noting when considering the basic/non-basic distinction for any particular business firm or industry. First, many businesses actually perform both

“New dollars provide jobs and income for local residents, and multiplier effects provide support for local service activities.”

Figure 2. The Local Economy—Leaking Resources?



basic and service activities at the same time. At the state level, agriculture provides a useful example. A variety of commodities are sold outside the state, a basic (export) activity. At the same time, agriculture in each Southern state performs an important service function by selling the same variety of products to local consumers.

The same point holds for numerous other firms across the country that sell goods and services in both local and non-local markets. Examples would include banks, restaurants, amusement parks, retail stores, and repair shops that serve local residents as well as tourists and retirees. This mix of activities is certainly a complicating factor for community analysts, but from the economic development standpoint, it is important to remember that the activities are distinctly different in terms of the impact on the local economy.

An additional consideration grows out of the basic/non-basic distinction at the local or regional level as opposed to the state level. The geographic definition of the economy may determine whether a particular industry is engaged in a basic or non-basic activity.

Recall that the basic/non-basic distinction depends on whether a firm serves local or non-local markets. If the local community is defined as a city or county, markets located elsewhere within the same state are treated as non-local when assessing the economic role of a particular firm. Numerous examples can be cited. Consider the tourist from Pensacola, Fla., who vacations in Miami Beach; a business traveler from Mobile, Ala., who spends time in Birmingham; a Biloxi, Miss., consulting firm working for state government in Jackson; and state facilities located in rural communities.

At the state level, each activity clearly fits into the service category—each market served is local (within the state), and no new dollars are generated at the state level. If the development of a particular local area is the matter of concern, then each activity noted attracts new dollars (a basic activity) to a particular community. The fact that the new dollars come from Pensacola, Mobile, or Jackson rather than New York, Chicago, or Detroit makes no difference when considering the growth of a local economy. New dollars provide jobs and income for local residents and support local service firms.

Basic and Service Firms and Local Economic Development

The basic/service dichotomy of export base theory shows the importance of both basic and service firms to local economic development. Basic industries influence local economic activity through sales outside the community (**direct impacts**) and generate additional local sales as funds are spent locally to purchase inputs and employ workers (**indirect impacts**). Finally, additional sales are generated locally (**induced impacts**) as employees and owners of direct and indirect business firms spend income that translates into additional local economic activity. The existence of “multiplier” effects associated with basic industry often

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explains the emphasis of many economic development programs on attracting new, basic industry to the local community. Local service firms are equally important to local economic development. Multiplier effects are not infinitely large and are dependent on local service firms to recirculate money within the local economy. Initially, not all dollars from basic industry sales are re-spent locally, and at each successive round of spending, impacts are reduced as funds are lost from the local economy. Leakages are in the form of savings in non-local institutions, taxes and fees paid to state and federal governments, corporate profits that accrue to non-local shareholders, and perhaps most importantly, as payment for goods and services that are imported from outside the local area. In short, multiplier effects vary with the industry and the size of the local economy in question. A larger and more diverse local service economy tends to magnify the effects of changes in the basic sector. More importantly, economic development activities must also devote attention to the service sector of the local economy.


Defining Economic Development

Economic development is often defined only from the perspective of a particular interest within a local community or, more often, equated to community growth as measured in economic or demographic terms—population change, income, jobs, retail sales, and bank deposits. By the same token, “a development” often refers to a particular event in a community—a new shopping center, a subdivision, or an industrial plant. However, this presents an overly narrow perspective on economic development.

Woods and Sanders [13], for example, note that development refers to the “well-being of people in a particular geographic area, wherever they eventually reside.” Economic development would include programs to improve local services and increase the equality of opportunity, as well as expanding the economic base of the community. They further note that “actual development activities will depend on the goals and needs identified by residents in the region of concern.”

In a similar vein, Shaffer and Pulver [11] speak of economic development in terms of the goals of vitality and wealth. **Vitality** refers to the “...capacity to respond to changes inside and outside the community, creating a need for some kind of adjustment” to include “...shifting resources and responding to changing markets in order to provide the jobs and incomes and lifestyles the community desires.” **Wealth**, in their words, includes “quality of life and personal well-being, relates to a community’s ability to produce those things that people cherish.” Their examples refer to community attributes such as clean air and water, jobs and income, scenic beauty, health, and housing, which have both monetary and non-monetary dimensions. Shaffer and Pulver [11], like Woods and Sanders [13], stress the importance of the values of people affected by development activities.

Other authors discuss similar attributes when discussing the concept



of development. Flora et al. talk in terms of community “self-development” to distinguish events that involve a local organization, that rely on the investment of substantial local resources, and that result in an enterprise that remains under local control. Coffey and Polese [2] use the term “endogenous development” to refer to development from within, while others stress the importance of structural, institutional, and technological change [3, 9, 10, 12].

In short, economic development is a much more complex issue than is implied by simple concerns over community growth, and economic development programs involve a wide range of activities. This can be visualized by thinking of the local economy as a system for meeting the needs and wants of people in a particular geographic area over time [13]. The capacity of this system to meet local needs then becomes the focus of the economic development process over time.

Economic Development Alternatives

A variety of theories exist to explain the process of community development at the local level; however, there is no one theory that is sufficient to guide local development activities. Rather, success may depend on a mix of

Several options are available for local community development programs:

- ◆ Provide local educational programs to improve the management capacity of existing firms. Such programs may be offered in partnership with the Cooperative Extension Service, Small Business Development Centers, or other community education organizations.
- ◆ Organize a business and industry visitation program where local volunteers visit local firms on a regular basis in an attempt to identify limitations to expansion.
- ◆ Encourage business growth by identifying capital sources. Include efforts to involve local financial institutions, to identify non-local sources of capital, and to organize local capital pools.
- ◆ Sponsor educational programs to keep local businesses aware of the latest developments in science and technology. Cooperative Extension Service programs for agricultural producers may provide a model for use with other types of firms.
- ◆ Improve the quality of the local workforce. Efforts could include such activities as vocational-technical training and literacy programs, as well as programs designed to improve supportive social services such as job counseling and day care.
- ◆ Provide local and regional services that compete in price with those of other communities. This includes the full range of public services such as water and sewer, waste disposal, and communications.

“Residents of every community control substantial sums of money that will be spent on the purchase of goods and services.”

“ Attempts to attract new industry in the basic employment category is perhaps the best-known type of economic development program and it offers a viable option for many localities.”

Several types of efforts are possible:

- ◆ Survey consumer needs and buying habits to identify the market potential of retail and service outlets.
- ◆ Analyze and renew downtown shopping districts or other retail areas.
- ◆ Help develop training programs for local retail and service employees.
- ◆ Encourage local residents and businesses to buy locally through information programs and seek opportunities to combine sales and service activities with recreational events.

activities drawn from a number of approaches to the problem. Shaffer and Pulver [11] draw on existing theory to characterize development approaches as:

- ◆ supply-oriented,
- ◆ demand-oriented, or
- ◆ institutional.

The approaches differ in that they focus, respectively, on the community's resource base, on markets to be served by firms located in the community, or on the functioning of the local community. Alternatives discussed in the following sections incorporate a mixture of the three general approaches.

IMPROVE EFFICIENCY OF EXISTING FIRMS

As firms become more efficient, they are more competitive in local and non-local markets, they are able to return a greater net income to the community, and their ability to stay in business or expand is enhanced.

Several specific options are available.

- ◆ Develop local industrial, office, or commercial sites, as well as public services, and provide information on the local labor supply.
- ◆ Develop community and regional facilities to provide transportation, recreation, business services, and communications. Conditions that make a community a nice place in which to live are becoming increasingly important.
- ◆ Provide local incentives that reduce the location or operating costs of new or expanding firms. These incentives include assistance with capital resources, such as revenue bond financing and a variety of tax incentives.
- ◆ Identify state and federal programs and facilities that might be located in the community and lobby to get them. Both the state and federal government are significant employers.
- ◆ Do not overlook nontraditional sources of basic income and employment. Rural communities have had success in attracting retirees, in developing area trade centers, in exploiting recreational resources, and in serving as bedroom communities for nearby urban centers.

Local communities can encourage business formation in a number of ways.

- ◆ Form capital groups to invest private funds locally. These pools can be informal arrangements or more formal such as a community development corporation.
- ◆ Provide counseling and educational assistance for those interested in starting businesses.
- ◆ Study the market potential for new retail, wholesale, service and industrial input providing businesses. This study can point out opportunities for new local establishments.
- ◆ Be aware that adversity often stimulates entrepreneurship. Events such as plant closures or lay-offs may stimulate interest in new businesses or self-employment.
- ◆ Adopt an encouraging community attitude towards new business

Local communities can take actions to capture a larger share of these dollars:

- ◆ Organize efforts to ensure the correct use of assistance programs by the elderly, the handicapped, and others who qualify for state and federal assistance programs, and work to improve services (that is, transportation, meals, or medical assistance) to the elderly and other qualified citizens.
- ◆ Obtain aid from state and federal governments in the form of grants for local projects (that is, water-sewer, streets, or parks). It is important to monitor government programs in a systematic, organized way so opportunities are not missed.

“State and federal governments return large sums of money to local communities through grants and individual assistance programs.”

IMPROVE ABILITY TO CAPTURE DOLLARS

Residents of every community control substantial sums of money that will be spent on the purchase of goods and services. Efforts to influence the amount of spending that takes place within the local community contribute to local jobs and income.

ATTRACT NEW BASIC EMPLOYERS

Attempts to attract new industry in the basic employment category is perhaps the best-known type of economic development program and it offers a viable option for many localities. However, communities must realistically assess their chances for success. Factors such as labor supply, transportation, location of related businesses, water or other resource constraints, and community attitudes and preparedness, come into play.

ENCOURAGE BUSINESS FORMATION

There is a continuous need for new businesses to meet changing demands from population growth or evolving goods and services. New businesses in a community may mean both new dollars and increased sales for existing businesses.

INCREASE AID RECEIVED FROM BROADER GOVERNMENT

A community may be able to recapture some of the funds taxed away by other units of government. State and federal governments return large sums of money to local communities through grants and individual assistance programs.

Concluding Comments

This overview has offered a framework for understanding the way a local community works and has suggested several types of alternatives for encouraging local economic development. Not every alternative is suitable for every community and no one alternative guarantees success. It is, therefore, essential that program participants examine how their local economy is structured, how it changes, and what role its human resources play, in order to decide on future development strategies. Community economic development is an ongoing process that is largely dependent on community efforts in defining opportunities consistent with local values and capabilities. Success is likely to come in small increments and only through hard work.

Endnotes

a. This section is taken from Coates et al. [1], Pulver [8], Shaffer and Pulver [11], and Woods and Sanders [13].

References

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Module Four Instructor's Guide

Understanding the Local Economy

Small Group Activities



Activity # 1

Analyzing Your Local Economy

How can you analyze your own community's economy? This activity lets you relate the concepts of economic development discussed in this module to your community and state. It is suggested that program participants divide up into three or four groups of equal size and discuss the questions below. The groups should then come together and compare their findings in an attempt to more fully understand the many issues involved in the community's economic development. Remember that this activity is designed to promote and understanding of the economic context in which human capital resource issues arise. The next four modules will explore those issues addressed here. Worksheets are provided to allow more space to be used to unite and discuss answers to the various questions.

1. Refer to the overhead transparency #3 and list the **factors** you see that influence local economic activity. Afterwards discuss what changes in the local economy have taken place in your lifetime and why they have occurred.
 - a. _____
 - b. _____
 - c. _____
 - d. _____
 - e. _____
 - f. _____
2. Focusing on the present, list all the types of industries that bring money into your community. Remember these can be "major" economic activities in your community and state or "minor" economic activities in your community.
3. Once group members have come up with a full list of money generating economic activities, your group should identify which are the **basic** industries that sell goods and services primarily to markets located outside of the local community. Be sure to discuss what changes have occurred and why.
4. Now, group members should identify which are the **service** industries in your community and/or state that mainly serve local markets. Be sure to discuss what changes have occurred and why.
5. Next, decide if there are industries in your community and/or state that serve **both** local and non-local markets. Be sure to list them, discuss their importance and any changes that have occurred.
6. With your local economy clearly outlined, the next critical step is to agree on your community's economic development **goal(s)**. What is it that your group is hoping to achieve over time?

7. Identify possible **challenges** facing your community's economic development goals in the space provided below. You can refer to overhead transparency #4 but remember, the challenges should be ones that will affect the goal(s) you outlined in No. 6 above.

a. _____

e. _____

b. _____

f. _____

c. _____

g. _____

d. _____

h. _____

Have group members identify which challenges may be related to human capital/resource issues, discuss them briefly and be sure to use notes from this discussion in the upcoming modules dealing specifically with these issues.

8. For each economic development alternative listed in this module, discuss and assess what its potential consequences might be for your community's economic development goals. What is likely to happen if this alternative is carried out? How will the community, in general, benefit? What specific industries will benefit? Will some industries be affected negatively as a result of this alternative? As a group, list these possible consequences on the worksheet.



Worksheet

(numbers refer to activities on previous pages)

2. All Economic Activities

- | | |
|----------|----------|
| a. _____ | g. _____ |
| b. _____ | h. _____ |
| c. _____ | i. _____ |
| d. _____ | j. _____ |
| e. _____ | k. _____ |
| f. _____ | l. _____ |

3. Industries That Serve Markets Outside the Community

- | | |
|----------|----------|
| a. _____ | e. _____ |
| b. _____ | f. _____ |
| c. _____ | g. _____ |
| d. _____ | h. _____ |

4. Industries That Mainly Serve Local Markets

- | | |
|----------|----------|
| a. _____ | e. _____ |
| b. _____ | f. _____ |
| c. _____ | g. _____ |
| d. _____ | h. _____ |

5. Industries That Serve Both Local and Non-Local Markets

- | | |
|----------|----------|
| a. _____ | e. _____ |
| b. _____ | f. _____ |
| c. _____ | g. _____ |
| d. _____ | h. _____ |

6. Your Group's Goals

7. Positive and Negative Consequences of Each Alternative

ALTERNATIVE 1: IMPROVE EFFICIENCY OF EXISTING FIRMS

- a. _____
- b. _____
- c. _____
- d. _____

ALTERNATIVE 2: IMPROVE ABILITY TO CAPTURE DOLLARS

- a. _____
- b. _____
- c. _____
- d. _____



ALTERNATIVE 3: ATTRACT NEW BASIC EMPLOYERS

- a. _____
- b. _____
- c. _____
- d. _____

ALTERNATIVE 4: ENCOURAGE BUSINESS FORMATION

- a. _____
- b. _____
- c. _____
- d. _____

ALTERNATIVE 5: INCREASE AID FROM BROADER GOVERNMENT

- a. _____
- b. _____
- c. _____
- d. _____