K-STATE Kansas State University

Understanding Your Community's Economy

COMMUNITY DEVELOPMENT SERIES

CREATING ECONOMIC OPPORTUNITIES

Local government leaders across Kansas and in rural America have rediscovered the need to work with private firms and pursue community-based economic development. In fact, in the Great Plains states, economic development is the hottest issue on the public agenda because of the drop in oil, field crop prices, and foreign competition with U.S. manufacturers.

Many people will gladly share their simple recipe. They often mention the possibility of manufacturing products using local agricultural commodities or manufacturing hi-tech products. But the recipes are only partial answers and simplistic solutions to complex problems.

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Static Model

First let's start by building a model of a community's economy. For simplicity, let us compare it to a rain barrel. In this static model, money flows into and out of the rain barrel, but nothing is happening in the barrel itself. The water level in the barrel will rise and fall, depending upon the volume flowing into and leaking out of the container. This water line represents the prosperity of the community.

From Figure 1 we can learn the following:

A. Money flows into the barrel two ways:

1. When products are sold to an outside customer (exported) then local firms *earn* new dollars. In addition, when local people commute to out-of-town jobs their wages are new dollars.
2. When dollars flow in from outside sources to local governments and to community citizens; these new dollars also fill the barrel. These are *captured* dollars. These unearned dollars can come from social security and other retirement payments, interest, rent and dividend from outside investments, grants from higher governmental agencies and foundations, and from investors by outside interests.

B. Money flows out of the barrel seven ways:

1. Local firms buy (import) their needs from outside sources.
2. Local households shop out of the area to buy goods and services.
3. Local firms and employees pay taxes and social security to higher governmental units.
4. Community citizens, local firms, and local government hold assets such as land, buildings and human skills that are underutilized and are not gen-

Static Rain Barrel Model

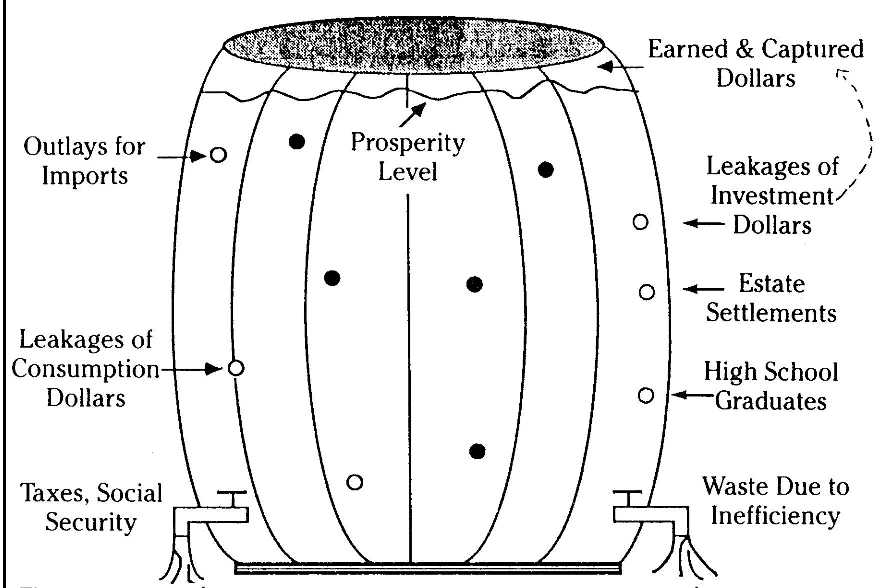

Figure 1

Kansas State University Agricultural Experiment Station and Cooperative Extension Service

erating a flow of income. Or, local investors spend time and dollars on local ventures that don't pay off.

5. Community citizens invest their dollars in stocks, bonds and federal government securities instead of local business opportunities or real estate developments.

6. Estate settlements usually go to the spouses and children of the deceased. Often the children of older Kansans have left the area and moved to urban centers in and outside the state. Thus, the wealth of that estate can be lost to the community.

7. Property taxes are collected and spent on educating K–12 age students in rural schools. The money is invested in the human capital embodied in the youth. When the youth leave the investment is lost to the rural community.

The idea that the local economy is stimulated by the dollars earned from exports is often called **Economic Base Theory.** This theory suggests that the way to expand the local economy is to sell more goods and services to outside customers. Many types of economic activity can be part of the economic base that earns these export dollars. The types of industries most often considered are the goods-producing ones such as agricultural production, mining, forestry, fishing, and manufacturing. However, any industry and any firm can become an exporter. When a motel serves the traveling public, that motel earns outside dollars. If a newspaper sells printing services to an out-of-town customer, it also earns outside dollars. It is important to look at the potential export markets of all local firms.

Other ideas suggested by this simple rain barrel model focus on plugging leaks. One way to plug leaks is to provide locally those goods or services currently being purchased outside the area. This may be a product bought by a local firm to use in its production process or purchased by many local households to consume. This idea is called **import substitution.**

Another way to plug leaks is to encourage people to invest their savings locally. This keeps the money circulating in the economy and adds to the productive capacity of the local economy. Using the barrel illustration, the dimensions of the barrel can be expanded by investments in new buildings, equipment, and public infrastructure.

Another idea for plugging a leak might be to start or expand a local foundation that improves the community's quality of life. Gifts from estates are an obvious source of money for a community foundation.

Also, it is common for young people to leave rural communities after high school graduation. It is less common to see rural communities try to attract other communities' youth. But, to offset a lost investment in local youth it is possible to benefit from attracting young families who grew up in other places.

Finally, if we put the inefficiently utilized local resource to work more productively, this plugs a leak. For example, if a building on Main Street is empty or partially unused, it can be put back into service by the private sector as a marketing cooperative for local crafts people. Another example would be to use an empty building as a recreation and exercise center.

In summary, from this simple model we learn that new dollars must be either **earned** or **captured** from outside sources. We also learn that if we can plug the leaks going to outside businesses and if we can avoid the inefficient uses of local resources, the rain barrel may be able to fill up faster than it empties out.

Here are some other examples of ways to bring in outside dollars:

Industry	**Examples**
Construction	Building a new highway when the investment capital comes from outside sources.
Transportation	A truck terminal which services cross-country traffic.
Utilities	An electric power plant which sells to a regional market.
Wholesale	A firm which buys locally produced crops, warehouses it and sells it to retailers all over the country.
Retail	A regional shopping center.
Finance	A concentration of banks serving a large region.
Insurance	A regional or national headquarters of a large insurance company.
Government	All federal, state, and regional offices.
Business and Personal Services	A convention center.
Professional Services such as Medical and Education.	A medical center which attracts people from a multi-county area or a university.
Entertainment Services	An amusement park which attracts people from other states.

Income Multiplier in the Dynamic Model

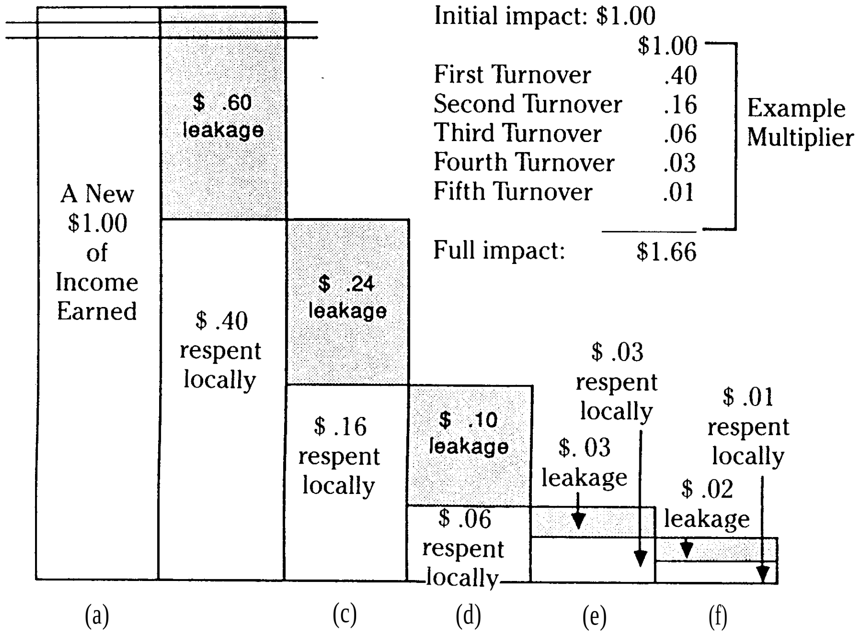

Figure 2. *Source: Community Economic Analysis, page 19.*

Dynamic Model

Now let us put this economy in motion. Instead of a rain barrel which has inflows and outflows only, imagine the barrel's contents in motion. If a motor stirs up the water, the water level will rise with the speed of the motor.

One can compare the speed of the motor with the speed of the local economy. When all firms, households, governmental units, and other producing and consuming entities are functioning at full capacity, the level of prosperity is high. When the productive forces slow down, the level of prosperity drops. The "motor" is driven by the economic activities of **production, consumption,** and **reinvestment.**

Most people are familiar with measures of this dynamic model. One is the **turnover** of the dollar as it passes from one firm to another and from local firms to local households. Another related concept is the **multiplier** which can be expressed as an income multiplier, an employment multiplier, or an output multiplier.

In Figure 2 we see a new dollar enter the local economy and turn over five times. Each time it turns over, some of that dollar leaks out. The leakage is dependent on the proportion of all local household budgets which is spent or invested locally in the community. Also, the leakage and the resulting income multiplier are dependent upon the portion of a dollar earned by local firms that becomes income to local households. This will depend on the profitability of local firms as well as their purchasing patterns. Do they buy labor locally or do they hire people who commute into town to work? Do they buy their supplies locally or do they import them? Local households receive income as a result of this multiplier effect. We call this **making** new income.

Another way to look at this is through the following formula:

$$IM = \frac{1}{1 - (PCL \times PSY)}$$

Where:

IM = Income multiplier

PCL = The proportion of new, after-tax household income that is spend locally. This can range from .30 to .95 in Kansas communities.

PSY = The proportion of household income spent locally which remains in the area's economy to support other households. This usually ranges from .25 to .65 for non-metropolitan communities.

For example, when the proportion spent locally by households (PCL) is 80 percent or .80 and when the proportion of an earned dollar that becomes income to local households (PSY) is 50 percent or .50, then the income multiplier is the following:

$$IM = \frac{1}{1 - (.80 \times .50)}$$

$$IM = \frac{1}{1 - .40}$$

$$IM = \frac{1}{.60} = 1.66$$

In summary, when we put the static rain barrel model into motion by adding in the production activities of such groups as the local businesses, local governments, and schools, we add a dynamic element to the model. These decision-making units combine local resources such as land and buildings with non-local resources such as borrowed money and new inventions to make products and services sold both at home and away. The results of the community's dynamic element is the creation of new income within the community to support local households, i.e., making it. The key questions are: (a) how efficient and competitive are these units of production, (b) where do they buy their resources used to make goods and services, and (c) how much money leaks out of the community from household budgets, and (d) how much local money is being reinvested locally.

More Concepts

But even these concepts are not complete enough for local community leaders. They need one more set of ideas.

All the local firms together produce a gross community product (GCP). Just as the United States has a GNP, a city can have a GCP. This GCP is the sum of a year's economic activity which in turn is the total of all producers' output, using local resources and outside resources.

Local firms will respond to changes in internal and external markets. However, their ability to react to changes in markets will depend upon the availability of resources such as investment capital, skilled workers, and the know-how to produce at costs that are competitive.

These constraints can be overcome by discovering new local resources, bringing in new outside resources, or creating new ways to combine resources. Some new ways to combine resources will be created when new inventions are developed, new innovations are adopted and new institutions are formed. An example of a new institution is a county-wide economic development committee.

Finally, the people who combine resources must be put into this model of community economic development. Gross community output will be diminished if these producers are receiving outdated or incorrect information and if they are not able to keep up with change because they lack education and training. This can result in local firms losing their share of markets to competing firms in other communities.

In conclusion, there is no simple recipe for economic prosperity. However, following are some helpful concepts that identify important variables which need to be considered by community leaders. Three of the most usable concepts are:

EARN IT
CAPTURE IT } Dollars to support a community
MAKE IT

These three avenues of economic development can be pursued using the following five strategies:

1. Retaining and expanding existing firms
2. Improving local linkages between local buyer and sellers
3. Creating new businesses
4. Capturing outside dollars that are unearned
5. Bringing in outside firms

The first strategy is both an *"earning it"* one and a *"making it"* one. When a local firm is oriented just to markets outside the community, this strategy is an *"earning it"* one. But when a local firm is oriented towards a local market, this strategy is a *"making it"* one.

The second strategy is a *"making it"* strategy. The idea is to increase the flow of dollars between local buyers and sellers which will lead to a higher income multiplier.

The third strategy can be either an *"earning it"* strategy or a *"making it"* strategy. If the new firm wants to sell to outside markets then the strategy is an *"earning it"* one. If the new firm wants to sell to local customers then the strategy is a *"making it"* one.

The fourth strategy is obvious; it's a *"capturing it"* strategy for bringing in unearned dollars.

The fifth strategy is usually an *"earning it"* strategy. Most often outside companies enticed to open a branch in the community will be oriented to markets that are beyond the local community.

Does your community have a balanced portfolio of strategies?

For more information on how community development can be stimulated, send for the following literature.

- **"Strategies For Economic Development,"** L-732, K.S.U. Cooperative Extension Service
- **"Foundation Equals Self-Help,"** L-832, K.S.U. Cooperative Extension Service
- **"IS Your Community Ready For Tourists?"** L-444, K.S.U. Cooperative Extension Service
- **"Analyzing Your Market,"** L-745, K.S.U. Cooperative Extension Service
- **Community Economic Analysis: A How To Manual,** Ron Hustedde, Ron Shaffer, and Glen Pulver, North Central Regional Center for Rural Development, Iowa State University, 108 Curtiss Hall, Ames, Iowa 50011 *(Send for this publication at the above address).*
- **"Estimating the Role of Production Agriculture in a County's Economy,"** L-813, K.S.U. Cooperative Extension Service
- **"Strategic Planning for Community Development,"** L-830, K.S.U. Cooperative Extension Service

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