

Redefining the “Crowding Out” Effect Economic Development Capacity and Long-Term Resilience in the Face of an Energy Boom

North Dakota recently established itself as the United States’ second largest crude oil producer – only Texas produces more. This development represents a remarkable opportunity for North Dakota but it is not without significant challenges. The state and the communities of western North Dakota (where most of the current boom development is occurring) are appropriately focused on trying to manage this boom. Dealing with issues of employment, roads, infrastructure, housing and environmental

protection are the topics of the day. But there is a long-term issue foundational to the future of western North Dakota that warrants current attention and action – how do communities across the region maintain and build long-term community economic development capacity, leadership and investment that ultimately will determine the resilience of the region over time. This issue is, in many ways, a redefining of a term used to describe the economic impact of a boom economy referred to as the Crowding Out Effect. This thought piece begins by describing the more traditional Crowding Out Effects associated with an energy boom and then explores the implications for a crowding out of economic development capacity for the long-term prospects of the region.

The Crowding Out Effect

In the field of economic development, the Crowding Out Effect has been used to refer to the disruptions in labor markets, and the associated impacts, in response to energy booms. In this thought piece, we apply the Crowding Out Effect concept to the potential loss of long-term economic development capacity that can occur when there is a long and sustained economic boom that dominates a community or regional landscape. Prolonged booms that overwhelm the development leadership and investment capacity of an area in the short run can undermine long-term diversified economic and community development that is needed to ensure regional resilience and prosperity once the boom has abated.

Crowding Out – Labor Markets

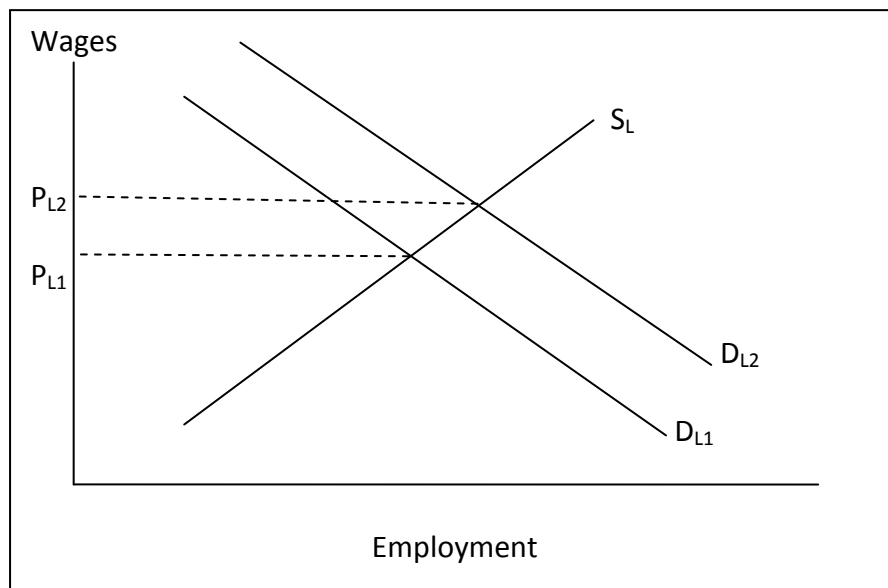
The Crowding Out Effect of an energy boom begins as a labor market challenge. The ramp up of exploration, discovery, and drilling puts upward pressure on the demand for labor in rural markets. Figure 1 on the next page illustrates the primary labor market dynamics.

The increased demand for labor (D_{L2}) puts upward pressure on wages (P_{L2}). These higher wages, in the short run, attract labor away from sectors that pay relatively low wages (e.g., retail/food service, public service, agriculture and food processing) as workers

rationally seek higher paying jobs consistent with their skills. For example, a county sanitation worker may choose to drive a truck for a drilling company.

The impacts of these labor market disruptions are twofold. One, to compete for labor, retailers, public service providers, and other local businesses must raise their wages. The higher wages may end up destabilizing some of the smaller, marginal enterprises and their doors may close. There is the potential, in this process, to lose some of the entrepreneurial energy that defined the region prior to the boom. Two, higher wages across many sectors begin to drive up the cost of living in the region. Increased demand for housing, food, entertainment and other services leads to price increases, creating hardship for those most vulnerable in the area – seniors living on fixed incomes, low income residents, those with limited capacity to relocate and/or earn higher incomes.

Figure 1. Labor Market Dynamics associated with Energy Boom



In the medium term, higher wages will attract often temporary workers from outside the region. It has been common to find oil field workers moving from Texas, Louisiana and other areas into western North Dakota. While some may make the region their permanent home, often these workers will remain in the region only during specific phases of the energy boom, e.g., drilling. This influx of new residents brings its own challenges – increased demand for housing, cultural conflicts, demands for public services, etc.

In addition to these labor-market induced disruptions in the local/regional economy, there are other potential crowding out effects. In the case of oil field development, there may be pressure for agricultural lands to be turned over to oil development and/or there may be environmental impacts that make farming more difficult. The loss of agricultural production capacity in the short term may have implications for

agricultural input suppliers, processors and others involved in adding value to these products. If broad-based agricultural capacity is lost, it may be difficult to restore to the same level after the boom period has passed.

There may be specific policy interventions that can address some of these challenges effectively. For example, rent subsidies for seniors might be one way to address the negative impacts of rising housing costs on those with fixed incomes. However, other disruptions are not so easily addressed by policy, including the crowding out of long-term economic development capacity in communities across the region.

Crowding Out – Economic Development Capacity

In the U.S., the primary responsibility for community economic development lies with the local community. The motivation for investing in meaningful community economic development is driven by what some call “pain points.” Communities that have experienced a severe disaster or economic loss – downtown destruction from a severe

flood, loss of a major employer – or tremendous opportunity – influx of retirees to a Sunbelt region – are often highly motivated to address change, invest and act on initiatives that can steer the community toward greater prosperity. When things are going well, leaders are less likely to consider a new direction or advocate for real and meaningful change. Right now, North Dakota and the communities in the western part of the state are largely focused on dealing with the immediate impacts, positive and negative, of the oil boom. Nearly all the civic capacity within these communities is focused on addressing issues of roads, housing, crime and other impacts. As a result, there is less capacity, motivation and energy to think long term and ensure broad-based, diversified growth in the local and regional economies. ***In essence, economic development capacity, leadership and investment related to the oil boom are crowding out any consideration of non-boom and long-term economic development and diversification.***

Potential Magnifiers

The extent to which long-term economic development capacity is “crowded out” may be influenced by three potential magnifiers:

Scale – the impacts of the boom dwarf any other component of the local economy in western ND and civic infrastructure is thin, often characterized as STP (the Same Ten People).

Duration – a generational boom (25 years) could contribute to loss of capacity that cannot be easily restored, e.g., agricultural production and processing.

Pacing – more rapid scale up of energy development affords less time for planning, adjustment and mitigation on the part of local and regional public and private sector leaders.

Similar to the impacts on local and regional labor markets, the crowding out of development capacity can manifest itself in a number of ways.

Quality of Life Impacts. One component of a region's long-term development capacity is quality of life. With access to technology, people can afford to choose where they live, work and play based on the amenities and quality of life that a given region has to offer. One example illustrates the potential challenge that the energy boom has created for the western North Dakota region in competing for new talent based on quality of life:

Dickinson State University (DSU) is trying to recruit a new faculty member. The compensation is competitive with other smaller regional universities. DSU has historically been challenged in recruiting new talent given its somewhat isolated location; now there is the additional challenge of finding quality and affordable housing for this faculty member and young family. Potential fears of truck traffic, congestion and even competition for a table at local cafes undermine the quality of life image the region has worked to build and, as a result, reduce DSU's competitiveness in attracting talent.

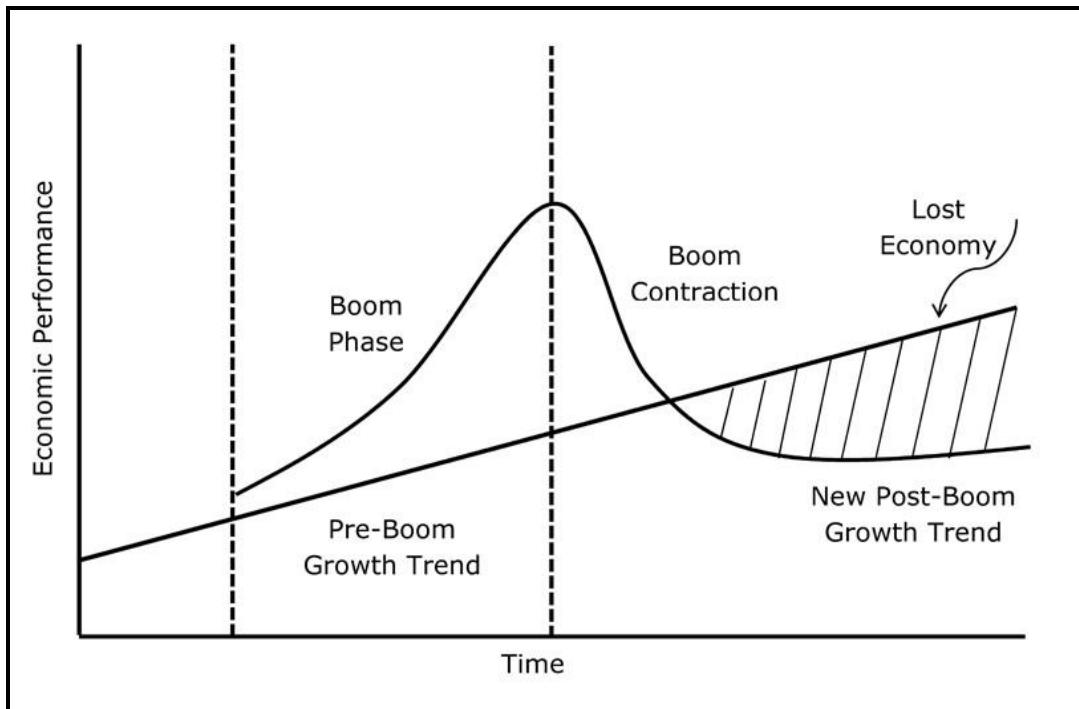
Diversified Economic Development Capacity. Viewed from the outside, western North Dakota appears as a shining star, experiencing an economic boom driven by oil development while much of the rest of the world is struggling to recover from the Great Recession. Viewed from the perspective of local and regional non-oil related businesses, however, the cost of doing business and the underlying cost of living for workers in the region are rising and rising rapidly. Successful regional businesses with growth opportunities unrelated to the oil boom may find it more difficult to expand within the region and be forced to pursue expansion outside of the boom area. This out-placement of growth can undermine the rootedness of locally- owned businesses.

At the same time, growth opportunities created as a result of the boom may benefit non-local rather than local firms. The pace and scale of oil-related development in the region is so quick and large that small, local businesses (e.g., construction, machine shops) are challenged to respond. The result is often that outside firms move into the region to temporarily meet this demand. If these firms are lost to the region as the boom abates – and if local business capacity is negatively impacted in the process – the foundation for a diversified local economy may be damaged. The result may be increased spending leakages with dollars exported to outside business interests, potentially dramatic contraction in economic activity when these firms exit the region with implications for other sectors in the local economy, and the appearance of a boom-bust cycle often associated with non-renewable energy development.

Figure 2 conceptually illustrates what a significant crowding out of economic development capacity can mean for a community or regional economy. In this illustration, we compare the slower but positive pre-boom general economic growth rate with a boom development event – a steep expansion during the exploration and particularly development phases followed by a dramatic drop off in boom activity. If

traditional or non-boom economic development capacity is crowded out during the boom period, the result may be lower post-boom economic activity and a weaker growth rate. If the boom and bust cycles are significant enough, the recovery to the pre-boom economic growth rate may take years or even decades.

Figure 2 – Illustration of the Economic Impact of the Crowding Out Effect



Leadership and Investment. Depending on the scale and pace of energy development, local leadership capacity may be challenged to do anything beyond responding to the immediate short-term challenges created by intense development pressure. It is difficult to think about the potential post-boom contraction in the overall economy when you are faced with excess demands on your local water system; increased road maintenance due to heavy truck traffic; replacing skilled sanitation workers who are now working in the oil fields; heightened resident complaints about noise, crime and overcrowding; reduced participation in a local festival because of lack of available hotel rooms. And the list goes on. But, future prosperity may be challenged by a failure to maintain development capacity – leadership, investment, diversified development, quality of life – in the face of the pressures of an energy development boom.

Offsetting the Crowding Out of Economic Development Capacity

Recognizing the potential for crowding out of economic development capacity is the first step toward offsetting the impacts. Just as crowding out effects in the labor markets can be addressed with policy interventions, the same can be said for

maintaining development capacity. A number of key elements must be present however:

- Local and regional leaders must recognize that proactive, intentional and strategic economic development is critical even during boom times. Articulating and defending a long-term view of economic development is an appropriate role for public sector leaders.
- A deep commitment to economic diversification is paramount even if such development creates competition for resources and workforce with the booming sector in the economy. Communities need look no farther than the last energy boom to see the implications of a failure to maintain diversity in the economy in the face of a boom.
- While the appetite for planning during a time of constrained and overtaxed leadership may be minimal, smart and aggressive planning will provide a sound road map for diversification and economic development. Without such a plan, forward and strategically important momentum is harder to build and maintain.
- Local, regional and state leaders seeking invest to support a diversified economic development strategy should begin with the boom sector itself. Some of the tax dollars and wealth generated through the boom should be captured to create a pool of development resources that can capitalize strategic investment in maintaining and building non-boom related economic development capacity in the region. While this suggests an aggressive intervention in the overall economy, it is not without precedent in regions and states across the country. Community foundations and other regional foundations provide constructive examples of the institutional capacity needed to turn these development resources into strategic investments that ensure long-term resilience and prosperity for energy boom impacted regions.

Center for Rural Entrepreneurship

energizing entrepreneurial communities

The Center for Rural Entrepreneurship is the focal point for energizing entrepreneurial communities where entrepreneurs can flourish. Created in 2001 with founding support from the Kauffman Foundation and the Rural Policy Research Institute (RUPRI), the Center is located jointly in Nebraska, North

Carolina, and Missouri. The Center's work to date has been to develop the knowledge base of effective practices and to share that knowledge through training and strategic engagement across rural America. Working with economic development practitioners and researchers, the Center conducts practice-driven research and evaluation that serves as the basis for developing insights into model practices and other learning. The Center is committed to connecting economic development practitioners and policy makers to the resources needed to energize entrepreneurs and implement entrepreneurship as a core economic development strategy. To learn more about the Center, visit www.energizingentrepreneurs.org.



The Rural Policy Research Institute (RUPRI) functions as a national scientific research center, identifying and mobilizing teams of researchers and practitioners across the nation and internationally to investigate complex and emerging issues in rural and regional development. Since its founding in 1990,

*RUPRI's mission has been to provide independent analysis and information on the challenges, needs, and opportunities facing rural places and people. Its activities include research, policy analysis, outreach, and the development of decision support tools. These are conducted through a small core team in Missouri and Washington DC, and through three centers, **including the Center for Rural Entrepreneurship**, and a number of joint initiatives and panels located across the United States. To learn more about RUPRI, visit www.rupri.org.*



About The Center's Entrepreneurial Communities Work

Since its founding, the Center has assisted communities and regions in designing and implementing entrepreneur-focused economic development strategies. Our Entrepreneurial Community activities include consultation, opportunity and resource analysis, sharing of effective practices, and the development of appropriate and targeted strategies to support entrepreneurs. Our work is always undertaken in partnership with rooted organizations, public and private, and our goal is to assist local and regional leaders in developing the capacity to design and implement sustainable development strategies where the focus is on supporting local entrepreneurial talent. We have a prospectus about our Entrepreneurial Communities resources that can be shared free of charge upon request.

Questions and Additional Information

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