The Flow of Money

How local economies grow and expand.

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POLICOM CORPORATION

William H. Fruth

Economic Analysis Everyone Understands

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For the past fifteen years, I have visited communities across this country, determining the condition of their local economy and offering ideas on how to improve or maintain the situation.

Some of the areas were growing and dynamic. Others were in significant decline.

Most of the time, one of the principal reasons an area was doing well was the result of community leadership. Local governments, civic and business groups teamed together to implement an aggressive "economic development program."

Unfortunately, I also discovered one of the reasons an area was in economic decline was the absence of the desire to do what was necessary to reverse what was happening. Oftentimes this was the result of not understanding what had caused the problem and what was needed to correct it.

The Flow of Money has been written to assist community leaders in understanding the nature of their local economy. It presents the "basics" on what every community needs to do to cause a growing economy or to stop decline.

It is hoped that after reviewing *The Flow of Money*, communities will embrace and put into action what is necessary to improve the economic quality of life for all of the residents in their community.

Sincerely,

William H. Fruth

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Let's Get Started.

You might have a brother, cousin or friend in another town or state who always seems to brag about how good things are going in the community while in your town it seems to be dead, economically. Or you might be the one doing the bragging as your area is growing, dynamic, and expanding.

The difference, of course, is the condition of each "local" economy.

Each day we hear on the news what is going on with the national economy. Unemployment might be up or retail sales down, nationally. But national data can have little resemblance to what is happening in the thousands of local economies in this nation.

As an example, for the five years from 2004 to 2008, the nation had a 1.8% average annual increase in jobs. However, among the more than 3,000 counties in the nation, more than 1,100 of them had job growth which was faster. During the same time, almost 500 counties lost jobs.

In 2010 national unemployment was 9.8%. In Las Vegas, Nevada unemployment was 14.7% while in Fargo, North Dakota it was 3.7%.

The condition of the local economy affects people's lives more than national data or trends reflect.

Why do some communities do better than others? That's the billion dollar question.

The Flow of Money will help us understand how your local economy works, the flow of money into the area, the flow of money out, and what causes this to happen.

We will learn the difference between growing in size and growing in quality, and review some of the characteristics of strong and weak economies.

Finally, we will discuss what communities like yours need to do in order to create a robust, dynamic area, improving the standard of living for all the residents.

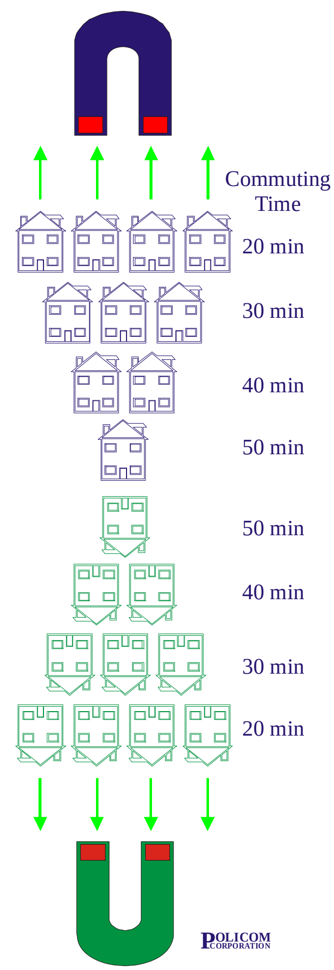
So let's get started.

What is a local economy?

Before we can discuss how your local economy influences the businesses and lives of the people who live in your area, it is important to first understand what a local economy actually is.

A local economy is simply a geographic area where a vast majority of the people lives and works. Within this area, which can be as small as a single county or include multiple counties, people earn their money and spend their money. In essence, the area is a “contained” economy.

Job Centers Pull Economies Together



The geographic boundary of a local economy is mainly determined by the commuting patterns of the people in the area. The location and number of “jobs” within an area determines how big geographically the economy will be.

Job centers are like magnets. They draw people toward them. Just like a magnet, the closer you are to it, the greater the pull of the force. The further away from the magnet, the less the draw until there is no force at all.

The pull or draw of an employment center begins to diminish the further away someone lives from its location. Basically, it boils down to how long it will take for someone to travel to work each day.

Areas can have multiple magnets in different cities and counties, causing a maze of commuting throughout, consequently linking them “economically” even more.

The extreme “reach” is approximately an hour. This is about the limit a person is willing to commute for a job. In the United States, the average commuting time is about 26 minutes. However, a vast majority of all economic activity occurs within 30 minutes of the “place of work” for an individual.

A local economy is not limited in size by county or state lines. Oftentimes people commute across county and city boundaries to work, thus joining each economically. For the most part, if 75% of the people live and work in an area, it is a contained economy.

How a local economy works – the Flow of Money.

Now that we know what a local economy is, we can discuss how it will grow or decline.

Imagine all of the wealth of a local economy is contained in a bucket. It swirls around and around, like being churned with a mixer. It goes from person to person, business to business, person to business, and is constantly moving.

One person buys a house and a bank makes a loan. The Realtor buys a car. The auto sales person buys a stereo. The storeowner makes a life insurance payment. The insurance agent pays school property taxes. The teacher pays the water bill. The money moves on and on and on.

Money is like a hive of bees following the path of a three-dimensional spider web, moving around and around as it circulates throughout the economy.

But there is a hole in the bucket and all the wealth of the community is leaking out.

Every time you purchase an automobile, a good share of the purchase price is returned to Detroit, Nashville, or Tokyo, or wherever the car was made. Every time you purchase a shirt, buy a pair of shoes, make your utility payment, go on vacation, pay your income taxes, money leaves the community and goes to the area in which the product was made or the service performed.

Money is continuously leaving the community through the hole in the bucket. The outward flow is constant, pervasive, and ongoing. Nothing can be done to stop it, no matter how small the hole.

So what can be done? A community needs to add money to its economic bucket, replenishing its supply. A faucet at the top of the bucket needs to be turned on, filling it with fresh, rejuvenating wealth, which enables the churning process to continue.

Money is imported to an area principally by the business activity of the "primary" or contributory industries located within the economy.

A business which is a primary industry sells its goods or services outside the area, importing money to the local area.

When an automobile is purchased in one area, the community where the car was assembled imports money from the purchasing community.

In turn, the communities which manufactured the tires, fenders, headlights, seat cushions, and all of the other components import a portion of the purchase price to their respective areas, replenishing their supply of money, filling their bucket.

When a farmer sells grain, money flows into the home community. When an engineer designs a bridge in another state, money flows into the home community. When a research firm secures a federal grant, money flows into the local area.

When the primary business is paid for its goods or services, its workers are paid and the wealth enters the local economy. It is then mixed and churned; it ripples and multiplies, until it is eventually consumed, drained through the hole in the bucket. The churning process of the wealth in the bucket generates most of the jobs for the residents within a community as goods and services are consumed.

For the most part, a business either contributes or consumes. If the business is not dependent upon the local marketplace, it likely is "primary" in nature.

A vast majority of all businesses in an area are consumptive in nature. This means they are dependent upon and use the money flowing into the area. They include most retail stores, service companies, restaurants, banks, doctors and lawyers. Local government is a "consumptive" enterprise as it depends upon local money. If you check which companies advertise in the Yellow Pages, a local marketing tool, you will quickly get a list of consumptive, dependent businesses.

Typically, about 25% of an area's workforce is employed by "primary" businesses with the balance working for "consumptive" enterprises. For the most part, only about 5% of the businesses in an area are primary, the rest consumptive.

"An expanding retail sector is the result of a growing economy, not the cause of it."

A local economy, along with the consumptive businesses, will grow or decline in direct proportion to the amount of money being imported to the area by the primary businesses.

Economic Impact – The Multiplier Affect.

When a primary employer sells it products, it pays its workers. Through its payroll, local taxes paid, and local purchases, it has a positive - contributory impact upon the local economy.

The ***Flow of Money*** to the right shows the annual economic impact of a manufacturer which employees 1,000 people and pays an average wage of $45,000.[1]

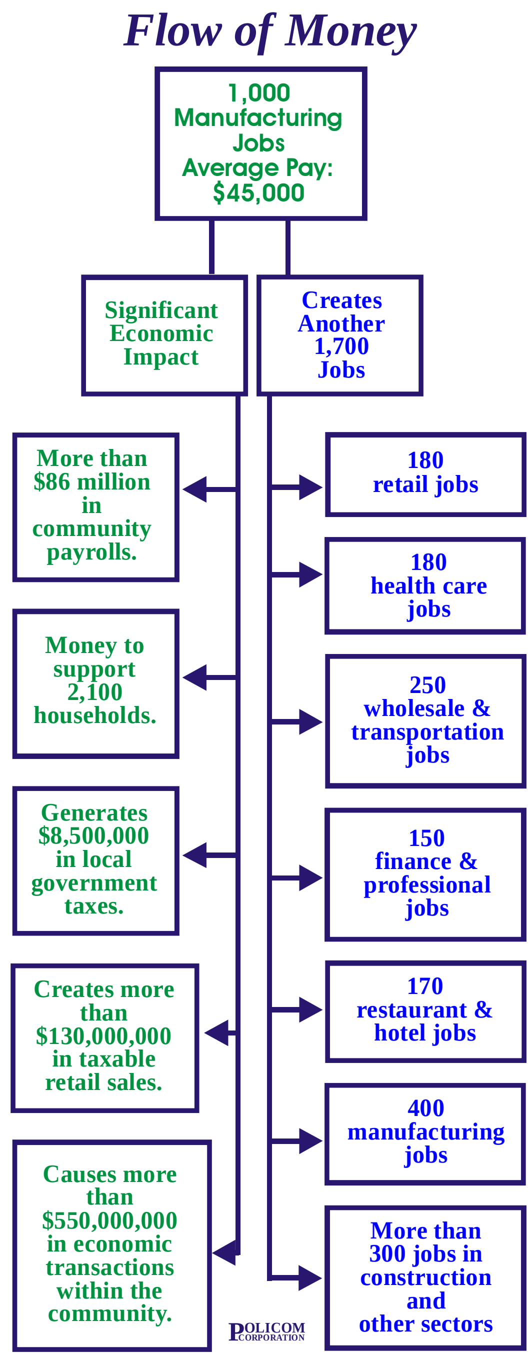
As a result of this company being located in the community, about 1,700 additional spin-off jobs (mostly consumptive) are created, $8,500,000 in local taxes collected, $130,000,000 in taxable retail sales generated, and 2,100 households are supported.

However, imagine the impact if another company like this one moved to town. Well, over a couple years, you would see another $130,000,000 in taxable retail sales, another $8,500,000 in local taxes collected, and another 1,700 jobs created.

What if the company reduced its workforce to only 500 jobs? Yes, there would be a significant reduction in the positive impact the company would have on the economy.

While not completely cut in half, the amount of money flowing into the economy would be significantly reduced. At least 500 other jobs would be lost in the community and the volume of economic activity will be much less.

The economic impact by primary employers is not the same for all. Some do not have as great of impact as our example company. Others have more. We will discuss which types of business have the greatest impact later.



[1] The Flow of Money impact flow chart was created from an actual *Economic Impact Study* created by POLICOM for a comparable employer in a Florida community. Impacts will vary among communities as a result of local tax systems, wage rates, and supplier support systems.

In What Ways Do Local Economies Grow?

Local economies are dependent upon importing money to the area. This is principally caused by the business activity of the primary industries. The consistency of the economy is dependent upon how regular or dependable the flow occurs. The increase or reduction in the size of the economy is in direct proportion to the amount of money flowing into the local economy. The quality of the economy, or the standard of living for the people, seeks the level of the wages paid by the employers of the contributory businesses.

Consistency of Growth

"Consistency" is the dependability, stability, or regularity of the money flowing into the economy.

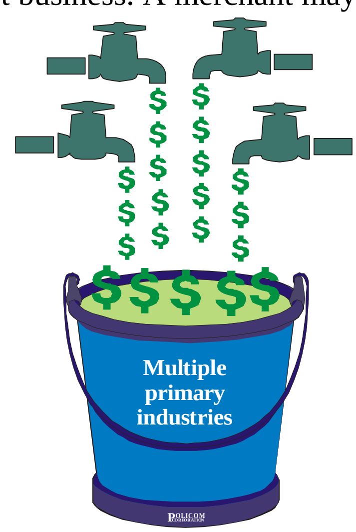
If you ever irrigated your garden using a gasoline powered pump drawing water from a pond, you understand consistency of flow. Sometimes air will enter the pump causing it to lose its "prime" momentarily. The water will gush, stop, and gush again until the pump is properly adjusted.

It might take some time before the pump produces a smooth flow of water, and sometimes it just will never adjust properly, causing a repeated, ongoing gushing and stopping of water. Eventually the volume of water reaches the needed level, but the means by which it was achieved is not desirable.

The rate of money entering a community is similar. If the money is flowing smoothly, the churning activity within the economy is regular and consistent. Businesses and residents can count on certain things happening and be able to better plan their financial future.

When the flow is disrupted, slowed, or stopped, there is an immediate change in the churning process. With less money available for circulation, some businesses have to lay off workers and some families postpone purchases, until the next gush of money enters the economy, if it ever comes at all.

Areas with unstable, boom and bust economies are difficult places to conduct business. A merchant may lease extra floor space and increase inventory following three or four great years of activity only to bankrupt after a sudden collapse in the local economy. Residents are subject to economic uncertainty. A person might make significant long term financial commitments based upon rapid increases in earnings or employment in the area, only to loose everything as a result of a downturn which causes massive layoffs.



How does a local economy become consistent? The volume of the money entering the area generated by the primary industries is regular and dependable. For the most part, areas with the most consistent economies are those which have multiple primary industries. They are diversified economies, not dependent upon one or two major primary industries. If "one of the many" primary industries fails, the negative impact upon the local area is not nearly as significant as when "one of a couple" of primary industries declines.

Growth in Size or Volume

There are several ways to measure the growth of the size of a local economy. Let's take a look at some of them.

Remember the discussion on how money, once it enters the bucket of wealth, is mixed and churned. The flow back and forth is the result of "transactions" occurring. When you buy a pair of shoes, there is a transaction. When you go to the doctor, there is a transaction.

One of the components of "economic impact" is the value of all the transactions which occur as a result of the presence of a particular business enterprise in an economy.

You have likely heard the term "Gross National Product." This is the measure of all the transactions in the United States. Counties and cities also have a "gross product."

The dollar amount of transactions can become a very large number. Our 1,000 job manufacturer causes about $550,000,000 in transactions each year.

Gross and taxable retail sales are also a way to measure the growth in the size of an economy. Retail sales are essentially the purchases made by consumers at the end user level while transactions are the movement of all the money in the economy.

Typically, taxable retail sales are about 20% of all transactions, but this varies from county to county and state to state. Our 1,000 job manufacturer causes about $130,000,000 in taxable retail sales each year. As the volume of money increases in the economy, there are more transactions, then more taxable retail sales, which are of interest to local government.

However, the dollar volume of sales (transactions) by the businesses in an area is not necessarily a direct reflection of the impact upon the people. A yacht broker who sells expensive boats scattered around the country could have $100,000,000 in sales in one year. But the only impact upon the local economy is the amount of commissions earned by the broker and the broker's local purchases.

A corporate headquarters based in an area might have worldwide sales of $20 billion, but the impact of the headquarters upon the local economy is limited to the amount of the $20 billion, typically the wages paid to the administrative workers, local taxes, and local purchases, which actually enters the local area. This amount is likely a small percentage of the company's gross sales.

Therefore, economic growth, as it affects the people who live and work in an area, is most appropriately measured by the increase in the number of jobs and total worker earnings.

Total worker earnings are all the wages and salaries paid and the profits of sole proprietor businesses. Worker earnings account for most of the money circulating in the bucket, causing the vast majority of all of the transactions to occur.

As worker earnings increase, so does the amount of transactions and gross retail sales.

By increasing the number of jobs, those which are unemployed have the opportunity to earn and spend. Also, employers now compete for the best workers, providing opportunities for all to improve themselves.

The strongest economies in the nation have had a significant increase in the number of jobs and total worker earnings as a result of the growth of their primary industries.

The weakest economies have had little growth in employment and some have fewer people working in the area than ten years ago. For some weak areas, after adjusting for inflation, they actually have fewer dollars in the economy than they did twenty-five years ago.

However, just creating jobs of any kind can, in the long run, actually hurt a local economy. It is basically a "myth" that any new job will help an area. It's time to talk about "quality."

Quality of Growth

The quality of the economy is a reflection of the standard of living of the people residing and working in an area. It is the amount of money earned by the individuals annually.

Earl Nightingale, the famous writer and philosopher, was fond of saying, "There is nothing more important than money - for the things money is intended." Money has purchased better housing, better food, more clothing, more leisure time, better health care, better education, and a more secure retirement than poverty ever has.

The amount of money an individual earns each year, for a vast majority of the people, determines their lifestyle. The annual wages in a local economy, therefore, reflect the quality of the economy.

The type of primary industry jobs located in the economy determines the quality of the economy. The average area wage will seek the level of, but cannot exceed, the wages paid in the primary industries.

The Great Myth
"Any type of job will help an economy."

If a local economy has a large number of primary employers which employ high-wage workers, the overall level or quality of the economy, including the consumptive industries, will rise toward those wages.

If the area is dominated by primary businesses which pay low-wages, the overall quality will be pulled down to that level.

In fact, the addition of low-wage primary jobs into a high-wage economy can actually hurt an area.

Typically, a low-wage employer would not locate in a high-wage economy, as its workforce would not be available. But what if the employer "imported" the low-wage, low skilled workforce. Since this employer does not pay a wage sufficiently high enough to support a household in a high-wage economy, the community will actually have to subsidize this employer through increased property taxes (schools and county services), housing subsidies, and host of other low-income programs.

Because of the presence of individuals "willing to work for less," the wages for existing low-skilled jobs, such as retailing, will actually drop. In this case, the entry of a low-wage employer actually hurts, or brings down, a high-wage economy. The quality of this economy will begin to seek the level of the low-wage employer.

However, if an area is chronically distressed economically, with high unemployment, the entry of the low-wage employer in this case is welcomed.

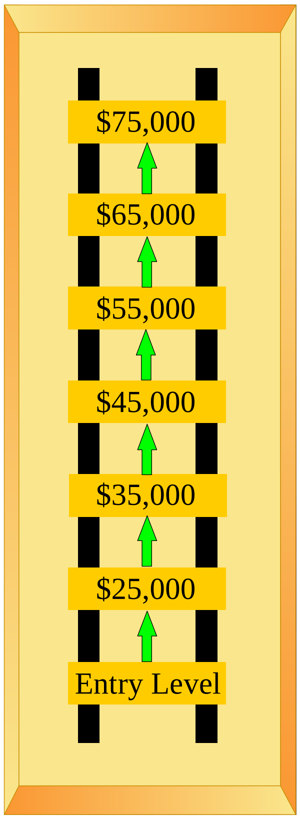
The opposite is also true. If a moderate-wage employer enters a low-wage economy, its presence will lift all other jobs in the area.

How can we improve a local economy?

What can communities do to improve the local economy, to increase the amount of money flowing within the area and improve the standard of living for the people who live and work in the community?

It is really very simple.

Create more primary industry jobs which pay a wage higher than the area average wage.



By doing this, more money will flow into the economy and the quality of the economy will improve over time. Not only will the wages for the workers enter the bucket of wealth, so will all the spending and taxes paid by the companies themselves.

As a result, all businesses will grow, more taxes will flow to local government enabling more and better services, schools will improve, and socio-economic problems will begin to fade.

When a community increases the number of high-wage primary industry jobs, a "force" pulls up the bottom rung of the economic ladder, lifting all through a series of wage and skill steps, improving the standard of living for most people.

This "force" causes part-time low paying retail and service jobs to fold into full-time jobs at higher wage levels and with fringe benefits.

The quality of the economy will continue to rise if the new primary jobs created in the area pay a wage higher than the local average.

However, the quality will regress, decline, or dilute if new primary jobs created pay less than the area average.

What is "Economic Strength?"

"Economic strength" is the long term tendency for an area to consistently grow in both size and quality.

Each year POLICOM Corporation ranks the 363 Metropolitan Statistical Areas and the 576 Micropolitan Statistical Areas for economic strength. Twenty-three economic factors which reflect how consistently areas grew in size and quality over a twenty-year period are measured.[2]

The economic strength rankings are created so POLICOM can study the characteristics of strong and weak economies.

The highest ranked areas have had rapid, consistent growth in both size and quality for an extended period of time.

The lowest ranked areas have been in volatile decline.

It is a characteristic of strong economies to create or maintain primary industry jobs, which pay a wage higher than their local average wage, which improves the quality of the economy.

It is a characteristic of weak economies to either lose high-wage jobs, or create a plethora of low-wage jobs, which dilutes the quality of the economy.

One of the most important features of the strongest areas is they have diversified economies. This means they have multiple primary industries filling their bucket of wealth. This provides a consistent flow of money into the economy even if one of the industries has a downturn.

2010	**Ten Strongest - 366 Metropolitan Areas**
1	Seattle-Tacoma-Bellevue, WA
2	Washington-Arlington-Alexandria, DC
3	Denver-Aurora-Broomfield, CO
4	Houston-Sugar Land-Baytown, TX
5	Sacramento-Arden-Arcade-Roseville, CA
6	Salt Lake City, UT
7	Des Moines-West Des Moines, IA
8	San Diego-Carlsbad-San Marcos, CA
9	Madison, WI
10	Dallas-Fort Worth-Arlington, TX

2010	**Ten Weakest - 366 Metropolitan Areas**
366	Danville, IL
365	Muncie, IN
364	Anderson, IN
363	Danville, VA
362	Springfield, OH
361	Bay City, MI
360	Rome, GA
359	Mansfield, OH
358	Flint, MI
357	Steubenville-Weirton, OH-WV

2010	**Ten Strongest - 576 Micropolitan Areas**
1	Edwards, CO
2	Gillette, WY
3	Durango, CO
4	Hilton Head Island-Beaufort, SC
5	Rock Springs, WY
6	Helena, MT
7	Bozeman, MT
8	Concord, NH
9	Kahului-Wailuku, HI
10	Jackson, WY-ID

2010	**Ten Weakest - 576 Micropolitan Areas**
576	Tallulah, LA
575	Helena-West Helena, AR
574	Lamesa, TX
573	Indianola, MS
572	Fitzgerald, GA
571	Pittsburg, KS
570	Kennett, MO
569	Clarksdale, MS
568	Tuskegee, AL
567	Hope, AR

[2] For a complete list of the rankings for all Metropolitan and Micropolitan areas and "Economic Strength" methodology, please go to www.policom.com.

What is Economic Development?

All of the discussion regarding how local economies work now brings us to "economic development."

Economic development is the activity, which is directed toward improving the overall economic strength of a community and the economic quality of life for all of the residents in the area.

Economic development differs from community development.

Community development, while an important activity for an area, is designed to relieve or cure socio-economic problems within the community. It is targeted to assist a specific geographic section or economically distressed class of residents.

Programs which eliminate urban blight, revitalize crime-ridden neighborhoods, or provide housing assistance to the poor are community development activities. However, they are not economic development activities.

A successful economic development program will improve the standard of living for all the residents. Oftentimes, when successful, the need for community development programs begins to fade.

> **"Economic development raises the entire ship, bringing with it all the passengers and crew."**

There are three basic economic development programs, which focus directly on creating primary industry jobs: 1) existing industry program, 2) attraction-recruitment program, and 3) start-up program.

The ***Existing Industry Program*** is designed to foster the retention and cause the expansion of the existing primary-contributory businesses in the community. It is the most important yet least expensive of the three programs.

Many communities have fallen into economic distress simply because their existing primary industries have reduced employment or left the area entirely. Many times the reason the company has curtailed its operation is the result of a reduction in its marketplace or foreign competition.

> **"It is easier to keep what you have than to recruit new companies to an area."**

An existing industry program focuses on ways to reduce the costs to primary businesses as much as possible, thus causing them to be as profitable as possible. Additionally, a community can help a company, especially smaller companies, expand the market for its products or service. As profitability increases, the companies not only do not leave the area, but they expand and employ more people, creating economic growth.

The secret to a successful existing industry program is to build trust between the primary employers and the community at large. As a result of this trust, the company will willingly communicate problems caused locally with community leaders, who, in turn, work to solve these issues.

Few people realize that aside from market conditions, the most frequent reason a company will leave one area and move to another is "local community attitude."

Essentially, if a company has been treated poorly by the community over a period of years, and this treatment has added costs to the operation, when it comes time to expand or "retool," the company will seek a community in which it is better appreciated.

Sometimes overlooked by an existing industry program are enterprises which are geographically restricted to the area. Some of these include agriculture, mining, petroleum extraction, or the manufacture of energy (major power plants). The unfortunate assumption by some communities is that "these enterprises will never leave, because they can't." As a result, the needs of these industries are sometimes ignored. What's worse, the businesses are taken for granted and repeatedly taxed by local and state governments. In reality, all are competing in the world marketplace. If they become unprofitable, they will close or discontinue operation until the time profitability returns.

The ***Attraction or Recruitment Program*** encourages new contributory companies to locate in the area. The program is designed to increase the amount and quality of money flowing into the area and to make the economy more consistent through diversifying the types of contributory businesses.

A recruitment program is time consuming, expensive and results may take years. Yet, even for growing economies the program is desirable if for no other reason than to offset the eventual curtailment of its existing companies. For areas which are in decline, recruitment is absolutely necessary.

An Attraction – Recruitment Program is designed in a similar fashion to the marketing program of most businesses. The following steps are taken:

1. Determine what you have to sell.
2. Identify who will want to buy what you have to sell.
3. Then, repeatedly, overall a long period of time, ask them to buy your product.

Now, your product is not your community. A lot of people think it is. For many, where they live is the best place in the world. They believe, since it is a great place to live, companies will move there. Sorry. This is not the case.

What you have to sell is a geographic location which has certain economic assets which will cause a company to be profitable if they are located there. So, when you "determine what you have to sell," you are actually making an inventory of these assets.

In order to "identify who will want to buy what you have to sell," you need to examine the various industrial sectors to determine what types of companies need what you have. These are the companies to which you market.

The ***Start-Up Program*** is designed to cause the creation of new contributory companies, which have a chance to grow and develop as the years pass.

Several communities in the United States have created dynamic economies by "growing their own" primary businesses. By assisting and coaching imaginative entrepreneurs, an idea can grow into a thriving business. Dell Computer was once a "Start-Up" company.

The visible and financial rewards to the community of such a program are in the future. Patience is required.

Essentially, a Start-Up Program assists a local person who has an idea for a new product or service which can be marketed outside the area (primary.) Most of the time the individual does not have the financial resources or the knowledge to take this "great new idea" from a great thought to a great product. This is where the community comes in.

The community has a team of professionals ready to guide the individual through the process of determining if the idea has merit, the development of the product, and the eventual marketing of the product. Usually a building (incubator) is needed along with venture, investment capital to convert the idea into an active business.

"It is like planting a seed. If you nurture it, someday it will grow into something beautiful."

Typically, a Start-Up program requires a relationship with an institution of higher learning (university or large community college), but it is not absolutely necessary. Many times areas with a major research university have active start-up programs as university related research oftentimes can be commercialized.

Overall, an economic development program should limit its activities to servicing existing, attracting new, and causing the creation of primary, wealth generating employers. All of the other jobs in the area, which consume the money flowing into the area, will "take care of themselves" as a result of the expanding marketplace.

Who does the work?

Implementing an economic development program is usually done by …. an economic development organization.

There are at least 6,000 economic development organizations in the United States trying to keep their existing primary employers in their community, attract new companies to their town, and to grow new primary businesses.

These organizations come in different sizes and shapes. Some are branches of the county or city government. Others are a division of the Chamber of Commerce. However, the most frequent is a free standing, not-for-profit economic development corporation.

The economic development corporation is usually funded by investments from the private sector along with money from city and county governments. In some places in the United States, citizens have voted to increase their taxes to pay for an economic development program.

Nationally, some economic development organizations are very successful in improving the area's economy, while others are not. The organization must be adequately funded and have the support of the community along with the city and county governments.

Most residents in an area are not aware of the activities of their economic development organization. This is because its activities are usually "confidential" in nature. When a business is looking for a community to expand or relocate to, it needs to keep the process a "secret."

If it is known publicly, the business will receive thousands of calls and visits from economic development organizations from all around the world, the cost of property many times escalates, and the workers "back-home" become anxious about their jobs, fearing a closure. As a result, most companies use private consultants and usually the economic development organization does not even know the name of the company until the end of the process.

"Communities which support an active, well financed economic development program have the best chance to create a dynamic economy."

It is a characteristic of the strongest local economies in the United States to have had an active, well funded, economic development organization for quite some time.

Which types of businesses should a community focus upon?

When a community conducts its economic development program, it should focus upon enterprises which will enhance the economy.

For areas which are growing and dynamic, the "bar" should be set high, targeting the best and highest paying companies, so all can be drawn upward.

However, areas which are chronically distressed, with high unemployment, need to first increase the size of the economy, to absorb the existing workforce and to get more money into the bucket of wealth. The focus for such a community should be upon primary industries, with less attention to the wages paid.

Earlier we talked about the economic impact upon a community of a 1,000 job manufacturing company. The amount of impact, spin-off jobs created, taxes paid, and local purchases is different for each business.

"Focus, focus, focus on the businesses which will help you the most."

The overall impact upon a local economy is based upon the wages paid, the amount of local support needed by the company (local purchases of products or services), capital investment (taxes paid), and the potential for ancillary companies to be formed as a result of the presence of the business in the community.

For example, an automobile assembly plant will likely employ about 1,000 workers, piecing together lots of parts to make the car. The cost of constructing the factory including equipment could very well have been $1 billion and wages are very high. It is quite likely another 5,000 people are employed by more than 50 other companies which are located within a 24 hour "delivery area." These companies are manufacturing the parts for assemblage. As a result, the assembly plant has a significant overall economic impact upon the local economy.

Suppose there is a headquarters for a major insurance company which employs 1,000 workers. The wages are very high for this company as insurance actuaries and corporate executive are paid well, due to their "value" to the company. However, this type of enterprise does not need very many support companies, like the car manufacturer. Typically it will occupy a general office building which costs much less than an auto factory. While is it a very desirable business to have in a community, the overall economic impact is much, much less than the car manufacturer.

Continuing, a manufacturer of simple plastic products such as milk jugs or tubing requires few if any support companies and a relatively low-skilled, low-wage workforce. While it contributes to the economy, the "ripple effect" or impact as a result of its presence is much less than the first two examples.

The following[3] is a list of contributory businesses which serves as a guide relative to the amount of impact upon a local economy:

Manufacturing of high value, high bulk products: High wages, large capital investment, and a large number of supporting businesses are needed. Examples include automobile assembly, commercial aircraft, ship building, energy production facilities, chemical manufacturing, and petroleum refineries.

Manufacturing of high value, mid to low bulk products: High wages, large capital investment, but fewer supporting businesses than high bulk. Examples include satellites, sophisticated electronic devices, medical equipment, and pharmaceuticals.

Sophisticated Information or Technical Services: High wages, average capital investment, few support companies. These businesses perform tasks which require highly educated and experienced individuals in the discipline of the company. Examples include insurance actuaries, financial management, major engineering and architectural firms, software development, computer systems design, and marketing research.

Transportation of products: High wages, large capital investment. Examples include major trucking, rail, air, and port facilities dedicated to the handling and movement of products.

Research and Development: High wages and oftentimes high capital investment. Support companies are usually few in number but high in quality. Examples include the development of pharmaceuticals, electronic components, nuclear energy, industrial metals, and photonics. An ancillary "testing facility" adds more impact. One of the greatest benefits is the opportunity for "Start-Up" companies as result of the research.

Federal Government: One of the highest average wages of any major industrial sector. Typically a consistent employer with annual wage increases greater than the rate of inflation. Difficult to recruit, however, as oftentimes locations are determined via the "political" process. Examples include a regional headquarters for the IRS, major postal distribution facility, military installations, and research facilities.

Corporate Headquarters: High to medium wages, depending on the activity at the headquarters. Few support companies needed. Some headquarters house all the top, highly paid executives, with a minimal number of low paid support positions. Others, however, have few high paid positions (these are scattered through the region or country at the facilities they manage) and a large number of low-wage support workers. The number of high-wage jobs determines the impact. Included in headquarters are the administrative centers for banking, healthcare, manufacturers, insurance, and a host of other businesses.

[3] The industries are listed from greatest impact to the least impact.

Manufacturing of mid-value products: Middle-wage jobs, sometimes a large capital investment and sometimes support industries are needed. Examples include computer assembly, metal fabrication, food processing, boat building, household appliances, and building materials.

State Government: Middle-wage jobs but typically higher than the local average. Most state government employment operations are usually located in the state capital, bolstering its economy. However, some states have distributed the employment centers throughout the state to provide benefit to more than one area.

Information processing and telecommunication centers: Middle to low wage jobs, low capital investment, and usually few support industries are needed. Many of the businesses perform repetitious work and require a moderate to low-skilled workforce. Examples include subscription fulfillment, telemarketing centers, and the processing and collating of information for a host of industries such as banking and insurance.

Manufacturing of low value products: Low-wages and relatively low or average capital investment. Few support companies are needed. Examples include apparel, household appliances, food processing, low value plastics, and animal slaughtering.

Retirement industry: Low wages, little capital investment except by the healthcare industry. This industry typically promulgates the formation of low-wage, low-skill service and retail jobs. It is very consistent, but growth of the economy is dependent upon the in-migration of more retirees.

Tourism industry: Low wages and little capital investment except by hotels. This industry typically promulgates the formation of low-skill service and retail jobs and is very inconsistent as a result of seasonal employment. Economies solely dependent upon tourism lack dependability and are generally low in quality.

Within each of the above categories are exceptions as to their impact upon a local economy based upon the wage level paid and the consistency of the employment of each business enterprise. Some will pay more, or less, hire more, or fewer, invest more, or less. Each project must be evaluated based upon its economic impact upon the area.

So how do we do it?

The first step in trying to get primary employers to expand in or locate to your community is to understand the most important concern of these companies which is "**profitability**."

Companies do not exist to provide jobs for a community, to pay taxes to local government, or to add money to the bucket of wealth. Primary businesses exist for only one purpose … to make money. If they don't, they close. Period.

While the sales for a primary employer are generated from outside the area, <u>many or most of its costs (expenditures) are driven locally</u>.

When a business conducts its community – site selection evaluation, it will consider a host of issues including wage rates, the cost of utilities, highway, airport, and seaport systems, local and state taxes, higher educational resources, and on and on and on.

However, usually a business will have one or two major geographic economic issues which must be satisfied to locate in an area.

As an example, if a company needs an abundant supply of inexpensive electricity, then communities with low electric rates will be given priority consideration. A major distribution center will locate only in areas with direct access to the interstate highway system. A corporate headquarters typically will not locate further than sixty minutes from a major airport.

For businesses which will invest hundreds of millions of dollars in its facility, such as a drug manufacturing facility or data center, the local property tax rate is of great concern. A software development company usually needs to locate close to a university which offers advanced degrees in computer science.

While there are specific needs which must be considered, for most site selection projects, more than 100 economic issues relative to the state or the community will be measured to determine their effect upon the cost of producing the product or service.

A company is not necessarily looking for the "cheapest" area, but the one which offers the best "value." Communities, which are the most profitable location for companies, will be the ones considered.

Do We Need Business Incentives?

Nationally, there are thousands of economic development organizations all attempting to improve the condition of their local economies. Competition for a limited number of expanding or relocating "contributory" businesses is extremely fierce.

So, market forces, a limited supply of companies and a large demand by communities, have fostered the creation of business incentives.

Incentives or financial inducements offered by communities and states are designed to reduce the initial set-up and long term operating costs for primary employers, to help them be profitable.

> **"Local government profits as much as anyone when the local economy grows."**

If a local area is in chronic economic distress, community leaders many times will do anything they possibly can to lure a contributory employer to the area, including giving a company a free building.

However, offering incentives is not limited to distressed areas. Almost all of the most dynamic, growing economies in the United States offer an array of incentives. Why? Because community leaders know they must continuously attempt to grow economically, or they will surely decline.

The most frequent questions raised by citizens in a community are whether incentives are necessary and are they worth the expense. Sometimes offering incentives, government money, to a private concern can be controversial.

Determining whether or not the financial investment made by the community is worthwhile can be mathematically calculated. Let's revisit the economic impact of the 1,000 job manufacturer.

Suppose the local government offers an inducement package to this company worth $250,000 a year for ten years, or $2,500,000 total. Sounds like a lot of money. However, remember the company will generate $8,500,000 in local taxes and $85,000,000 in payrolls each year. You do the math.

The following are some of the basic incentives being offered by communities:

Training Funds: One of the most important issues relative to the site selection process for a primary employer is the availability of a trained or trainable workforce. Funds should be available from the community to finance the training of local residents for qualified companies.

Property Tax Abatement or Refunds: This is one of the most popular and sought after financial inducements for primary employers, especially those which have a large capital investment. Abatements are typically only given on the "new money" which the company is bringing to the tax roll.

As an example, suppose a vacant industrial site is presently taxed $50,000 per year. After the company builds a new facility, the value of the property increases to the point it should be taxed at $250,000 per year.

Abatement could be given for 50% of the new money for ten years. Over the term, the company would save $1,000,000 in taxes but would still pay $1,000,000 over what the local government had been receiving on the vacant land.

There is no cash outlay by the community for this incentive.

Flexible Incentives Fund: There is a wide array of financial issues relative to locating or expanding in a community. The specific need varies among companies. For one, the issue might be the cost of purchasing or moving equipment, for another it might be the cost of preparing a site for construction, and yet for another the cost of locating necessary utilities might be a major issue. A fund should be established for multiple uses which can be used to defray some of the costs of locating to an area.

Discount on Land or Building: Some communities have created industrial parks which are used for the sole purpose of recruiting new primary companies to the area. Oftentimes the community will discount the cost of the land or present it for free to a company as an inducement. Additionally, some areas are so economically distressed they will actually give a building to a company for a period of time just to get the jobs for the residents.

The value of all incentives is typically based upon the economic impact of the project. Incentives should only be offered to “qualified” companies.

Almost all incentive programs today have “claw back” provisions. This basically means if the company does not produce the economic impact as planned, the incentive is not awarded. The days of “taking the money and running away” are pretty much over.

To be competitive in the economic development marketplace, most communities need to have some type of incentive program available.

The Second Most Important Issue…

There are two issues which are more important than the others.

The second most important issue regarding the site selection process is the "**availability of trained or trainable labor**."

Without people to do the work, a business cannot succeed. However, having a "bunch of bodies" available to be hired is not sufficient for most high-wage primary employers.

The previous list of businesses which had the greatest impact upon a local economy also was a list of skills levels. The top several businesses pay high wages. This is also a reflection of the skills needed to produce the product or service.

As a result, the top tier businesses will seek a community in which the workforce is either trained or has the aptitude to be trained for the tasks they demand. They will evaluate the availability of workers and the current skills which they possess.

The "Wage Ladder" on Page 9 is also a "Skill Ladder." A worker is paid in direct proportion to the "value of service." Higher wages are paid to workers with the most experience, education, and overall knowledge as these are the traits necessary to perform the work required by the high-wage employer.

In the modern day high-wage manufacturing facility, there are few general laborers employed. Most of the workers perform highly technical tasks and need to be proficient in mathematics, computers, or science with an "associate's" or college degree. The same educational requirements apply to almost all of the top tier wage sectors.

The opposite also occurs. Low-wage employers typically need workers with modest skills who can be quickly trained to perform minimal tasks. Little education is required for these jobs.

"Young people who quit school to 'get a job' should realize the job they are taking could very well be the best job they will ever have… as they will not know enough to do any better."

As a result, the best educated individuals with the widest array of experiences will have the best chance to earn high wages. This has been the case for the last 1,000 years.

Throughout history the best educated people have always earned more money as they were able to provide a more valuable service than those who do not have the knowledge to perform complicated tasks.

The least educated people have always performed menial tasks. This is one of the reasons education is as important today as ever for an individual in order to succeed and enjoy a good standard of living.

So, when a primary employer is examining a community, it will review the current industries to determine if a potential workforce is available. If it requires an array of high-skilled people who can be trained to perform its specific tasks and such a workforce is not present, it will not locate in the area.

During this process, the company will also use a strategy which is directly related to the wage ladder. Suppose the company intends to pay $45,000. The business will review the type of industries which pay around $35,000. If, from this group, it is determined the skills, education and aptitude of the $35,000 workforce are sufficient for its operation, then they will seriously consider this community.

There are several reasons they target “one step down” on the wage ladder. First, there will be a large number of people applying for a job at their company, as they will be offering about 30% more pay than the workers presently receive.

The company also realizes if they drop down too many steps, the skills and work experience will not be suitable. (By the way, if this employer does come to town, the force pulling everyone up the ladder will begin, as the $35,000 employers will replace their people from the $25,000 pool and so forth.)

A low-wage employer will shun areas which have an abundance of high-wage employers. The company will likely conclude it will not be able to attract a sufficient number of low-skilled workers for its operation. It will therefore target communities which have a large number of low-wage businesses or which are in economic distress.

Therefore, if a community wants to improve the quality of its economy by attracting higher paying companies, the skill and education level of its workforce needs to be addressed.

The Most Important Issue…

The most important issue relative to the "site selection" process is having an actual "site."

In fact, absent available improved, approved real estate for primary employers, a local economy <u>will decline</u>.

Economic development is ultimately a real estate transaction. In order for an existing company to expand, a new employer to move to the area, or a start-up business to grow, each needs a place to do it. They need a building.

"Without improved, approved industrial real estate, your economy will decline."

If a vacant, modern facility is not standing ready to be occupied (usually there are no suitable buildings available), a structure needs to be constructed. This means land must be ready.

All of the other geographic issues, such as transportation access, utilities, labor availability, or taxes are not considered if a place to operate the business cannot be provided.

A local economy will indeed decline if land is not available. Existing primary employers, when they need to expand, will have to leave the area causing a loss of money flowing into the economy.

Additionally, new, high-wage companies cannot come to the community as there is not a place to build a modern facility. Spin-off businesses coming out of the incubator will have to grow in another town.

There are examples of economic decline caused by the absence of improved, approved real estate throughout the United States.

The term "improved, approved" has been used continuously. What does it mean?

"Improved" real estate has the entire horizontal infrastructure in place. The roadways leading to the property, electric service, sewer and water lines are "to the site." Essentially, the property is "building-ready" and there will not be any delays starting construction.

Just as important, the land needs to be "approved" by the local government. All planning and zoning issues need to have been resolved in advance.

When a company is looking to locate in a community, it typically does not have the time to wait for a community to construct the infrastructure to the real estate or pass local legislation regarding land use and zoning. This process could consume one to two years (even longer in some states and counties).

As a result, site seekers will <u>summarily dismiss communities</u> which do not have a building-ready site upon which it can construct a facility, regardless of all the other geographic economic assets in the area. This is a major problem for many communities.

Private industrial developers will invest in private industrial or office parks. They will oftentimes construct speculative buildings, both office and industrial. However, the principal clients or users for this property are "consumptive" businesses.

Every community needs space for doctors and lawyers, engineers and accountants. Industrial areas are used by auto body shops, plumbing and electrical wholesalers, or dry cleaning plants. The growth of these businesses can be predicted.

However, no one knows when a new primary employer will come to town. As a result, the private developer will not wait. Land and buildings are sold or leased to the first business who wants to pay. The land for future primary employers is absorbed.

In a vast majority of the communities in the United States there is a shortage of real estate available for new primary employers.

Many communities in the United States fully understand this issue. This is why hundreds of counties and cities have invested in community owned industrial parks or employment centers.

The property is reserved for primary employers and is not available for consumptive businesses. The land is looked upon by the community as a long term investment in their economic future. It might take ten to twenty years for the land to be fully absorbed. Of course, once it is absorbed, the community is right back in the position of not having any land available.

This is why community leaders should look far out on the time horizon. For their long-term planning, they should identify today a 40-year supply of potential real estate to provide for long-term economic growth.

Let's Squeeze the Water Out of the Fat…

Let's review what we have learned so far:

- A local economy is a place where people live and work, earn and spend. Its growth is dependent upon money flowing into the area, principally imported by the primary industries. This money circulates and drives the profits and earnings of all other businesses, including local government.

- To improve a local economy, an area needs to increase the number of primary businesses which hopefully will pay a wage higher than the area average. To do this, the economic development organization should focus on companies which can utilize the area's geographic economic assets and have the greatest impact.

Given the two most important site selection criteria, does this mean if your community has hundreds of acres of improved, approved real estate and a trained or trainable workforce, you are guaranteed to have economic growth?

No. What it means is you have a chance. Without both, however, you have none. But there is one more issue, believe it or not, which will determine if your area grows or declines.

It is "local community attitude."

In order to do all the things necessary to build an economy, the support of the "people" and all local governments is necessary. Local laws need to encourage economic growth, not stifle it.

"Many times it is not the ability of a community to become prosperous, but the willingness to…"

Funding, from the private and public sector, needs to be available to pay for an aggressive economic development program, land, training, transportation systems, incentives, and all the other issues which influence profitability.

Existing companies need to be encouraged, not berated. New companies need to be welcomed, not protested.

It is a characteristic of the strongest economies to have the full support of the people and local government to cause and drive it to happen.

Usually a sour attitude by the community toward economic development is the result of the people not understanding what it is. Perhaps **The Flow of Money** will help change this.

About the Author

For the past fifteen years, William H. Fruth has served as an economic development consultant as President of POLICOM Corporation. POLICOM is an independent economics research firm located in Palm City, Florida, which specializes in studying the dynamics of local economies.

POLICOM determines if a local economy is growing or declining, identifies what is causing this to happen, then offers ideas and solutions to improve the situation.

During this time, Fruth personally evaluated the data for more than 600 local economies in the United States, created more than 150 community economic studies, and provided economic presentations and workshops in 36 states.

Annually Fruth creates “economic strength” rankings for the 366 Metropolitan and 576 Micropolitan areas in the United States. Fruth considers twenty-three economic factors, which measure how each area has grown in size and quality.

From 1988 to 1995, Fruth served as Vice President of a major industrial land development company directing the development and marketing of a 500-acre corporate park in the West Palm Beach, Florida area.

Prior to that, he was President of the Business Development Board of Palm Beach County, the economic development organization for the area. During that tenure he was named Florida's Economic Development Professional of the Year in 1987.

From 1980 to 1984, Bill served in a full time capacity as Mayor of Tiffin, Ohio. During this time, he was named one of the "Five Outstanding Young Men in Ohio" and was heavily involved in economic and community development both locally and statewide.

Fruth has been recognized by the Florida Administrative Court as an expert witness regarding local economies.

He received the Bachelor of Science and Master of Arts degrees from Bowling Green State University in Ohio, studying communications, journalism, and political theory.

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