Aspects of Economic Development in Substate Regions

David Darling
There are very few industries which don’t bring in some new dollars. An example of one which doesn’t is the local newspaper. As long as it sells advertising space to local firms and sells newspapers to residents of the community, it does not capture any outside income. However, if the newspaper accepts a contract to print materials for a firm located outside the area, then it begins to be a primary income earner.

The Multiplier Effect
A developed economy does more than earn new primary income. It also must generate, internally, secondary income from each new dollar of primary income. This phenomenon has been defined by economists as the “income multiplier effect.” The multiplier ranges in value from one to some value greater than one. Each multiplier has two components. The initial new dollar of income is the first component, and the remaining amount generated by the expenditure of the first component is the secondary effect.

Thus, a multiplier of 1.75 can be divided into:

- **Primary effect** = 1.00
- **Secondary effect** = 0.75

Total effect = 1.75

In this example, a local resident earns one new dollar. After he spends that new income, other local residents receive an additional 75 cents in income. The total income produced by that new dollar is $1.75.

The remainder of this publication will be devoted to explaining the major factors that affect the amount of secondary income generated locally.

New income must be spent locally for the secondary income effect to occur. Otherwise, money leaks out of the region to become income to some other region. Once it is spent locally, other residents have an opportunity to receive a portion of that income.

More value should be added to locally produced goods before they are exported. This can be done when the raw products originate locally and are sold to local processors, then to wholesalers, and finally are shipped out as finished consumer goods to distant markets. Thus, the increases in value of the material as it passes along a production path add to the wealth of the community.

Allied with the concept of value added is the concept of backward and forward linkages. A linkage, in economic terms, is a purchase or sale by one firm to another. Thus, a backward linkage is the purchase of a firm retailing lumber to another firm which builds houses. As more linkages develop in an economy, more money passes through the hands of residents and less leaks out in the form of purchases of items from firms located in other regions.

In summary, the income multiplier measures the total income effect on any new source of money to local businesses and residents. Every type of industry has the potential for earning primary income, but some have the potential for earning a much larger amount than others. Therefore, concerned citizens considering the impact of expanding various industries such as amusement parks, manufacturing, mining, and shopping centers must consider what size income stream will be earned by such an investment. Then they must consider how much secondary income will be created by the multiplier effect.

Finally, the essential consideration in making decisions to speed up and direct the economic development process is to invest in ways which overcome the most limiting constraints to development. If, for example, the skill level of a county’s labor force is well known to be below average, a decision to set up vocational training programs may advance that county’s development faster than any other single action. This is why the previously discussed five factors which lead to economic development are so important to keep in mind. Community leaders analyzing what is retarding the development of their community will discover it within one of the following five areas:

1. A shortage of various resources
2. An out-of-date level of technology
3. A stagnant or dwindling market for goods and services produced locally
4. The high cost of overcoming geographic distances
5. Institutions needed to use local resources efficiently are ineffective or do not exist.

**Recommended Readings**

For the interested reader who desires more information on economic development, the following publications are recommended:

- "As Your Community Grows: Some Economic Considerations," by John Gordon and Glenn Nelson. EC-446, Cooperative Extension Service, Purdue University, West Lafayette, Ind.
- "Some Characteristics of an Ideal Industry to Promote Your Community’s Economic Growth," by David Darling, EC-446, Cooperative Extension Service, Purdue University, West Lafayette, Ind.
- "Choosing Economic Goals for Your Community," by David Darling, EC-471, Cooperative Extension Service, Purdue University, West Lafayette, Ind.

This publication is one of a series available through the Cooperative Extension Service at Purdue which accompanies an Extension program aimed at helping citizens plan the economic development of their community. See your County Extension Agent for more information.

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**EC-474**

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3. An economy can develop faster when new or expanded markets are discovered for goods and services produced locally. In a timber producing area, for example, the location of a new pulp and paper mill will stimulate local economic activity. Producers realize a higher return which provides capital to reinvest in machinery, buildings, and tools. These purchases provide more business for others in the area. And the results add up to an expanded economy.

4. An economy can develop faster when the costs of conquering space diminish at a relatively faster pace than costs are decreasing in other regions. An example of the cost of conquering space is transport costs of goods to the market. The Erie Canal made a dramatic difference in the cost of shipping wheat from the Midwest to the East Coast. The telephone system in the United States has provided a valuable communication service which has lowered the cost of communication business. A new highway through a region may lower the transportation cost for local industry enough to either increase their market share of traditional markets or allow penetration of new markets in other regions of the country. Thus, decreasing the transportation cost is an example of an institution which has made it possible for every child to have access to an education. This has resulted in a more productive labor force because people have the basic understanding and skills necessary to be technologically trained for specific jobs. Another important institution is the formal exchange. The stock exchange makes it possible for firms to raise capital by selling interests in their corporation to anyone with investable cash who wishes to take the risk. Through this institution, capital in the hands of a Texas investor can flow to a corporation that is developing lignite mines in North Dakota. Thus, capital can be much more productive because of the existence of a stock exchange, and people can be much more productive because of the education received in public schools.

All five factors need to be present to facilitate the economic development process. However, just one factor alone can be the catalyst which hastens the process. When you think about what needs to happen in your local economy, the critical question to answer is what action would give the biggest "bang for the buck" and result in the best type of stimulation of the local economy. It may be the construction of a sewage system, or it may be the attraction of a new industry to town.

**Industrial Development**

If the decision is to stimulate the economy through industrial development, there are three alternatives. The first one is for existing industry to expand operations. The second way is for new firms to be started. The third alternative is the opening of a new plant in town.

The first alternative is often the most promising and should be investigated before considering the other two. The second alternative is often overlooked, but every major company in the country was started somewhere by an ambitious entrepreneur. The third alternative is the establishment of Chamber of Commerce considers at one time or another. The competition is tough, particularly for manufacturing plants, because the number of manufacturing jobs in the United States reached a peak four years ago.

**A Classification of Industry**

All economic activity can be classified as either bringing new dollars into the economy or circulating money within it. The following five industries are usually thought of as prime income earners for an economy because they usually sell to markets that are located in other regions of the country:

- Agriculture
- Forestry
- Fisheries
- Mining
- Manufacturing

However, other industries in certain situations also can bring in outside dollars. The following is a list of these, with examples of when the industry can be a primary income earner.

<table>
<thead>
<tr>
<th>Industry</th>
<th>Examples</th>
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</thead>
<tbody>
<tr>
<td>Construction</td>
<td>Building a power plant with borrowed capital</td>
</tr>
<tr>
<td></td>
<td>from distant money markets</td>
</tr>
<tr>
<td>Transportation</td>
<td>A port facility</td>
</tr>
<tr>
<td>Utilities</td>
<td>A power plant</td>
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<tr>
<td>Wholesale</td>
<td>A regional center with warehousing facilities</td>
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<tr>
<td>Retail</td>
<td>A regional shopping center</td>
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<tr>
<td>Finance</td>
<td>A concentration of banks serving a larger</td>
</tr>
<tr>
<td></td>
<td>region</td>
</tr>
<tr>
<td>Insurance</td>
<td>A regional office</td>
</tr>
<tr>
<td></td>
<td>processing claims for a wide area</td>
</tr>
<tr>
<td>Government</td>
<td>All state, federal or regional offices*</td>
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<td></td>
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<tr>
<td>Business and</td>
<td>A resort hotel or a convention center</td>
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<tr>
<td>personal services</td>
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<td></td>
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<tr>
<td>Professional</td>
<td>Medical center such as Mayo Clinic</td>
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<tr>
<td>services</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Amusement parks, theaters</td>
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</tbody>
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* All transfers from federal and state governments are primary income sources to local residents. These include Social Security payments, aid to dependent mothers, food stamps, Medicare, and so on.

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* Dr. Clark Edwards sets out these five factors and explores them in his article, "The Political Economy of Rural Development: Theoretical Perspectives," *American Journal of Agricultural Economics,* December 1976.