



Arrowhead Center

What is an economic base study and how can it be useful to small business?

Economic base studies are often conducted to help guide local economic development activities and to help economic development officials to make decisions such as what type of firms they should attempt to attract to local areas. Economic base studies can also help local and regional businesses to better understand local and export product markets.

The purposes of economic base studies include:

- (1) understanding regional economic growth
- (2) short term and long term forecasts
- (3) identification of potential growth sectors
- (4) identification of potential problem areas.

The procedures used in any particular economic base study vary, but generally involve the following steps.

1. Identifying the region to be examined (county, city, state, etc.) This is not as easy as it might seem. Is the meaningful area the City of Las Cruces, NM or Dona Ana County, NM? Should this region include El Paso, TX? What about Ciudad Juarez?

2. Assigning all economic activity in an area into two broad categories: basic and non-basic activities. Basic activities are those activities that serve an export market. Non-basic activities are those activities directed mainly toward serving the local market. The main idea behind this classification is that basic activities are said to generate (cause) additional non-basic activities. For example, a factory producing primarily for export from the local region may stimulate local retail sales or create demand for additional housing and public schools. Basic activities are viewed as essential to further economic growth. The location quotient (described in a different FAQ on this site) is often used to do this classification.

3. Once this assignment of economic activity into basic and non-basic sectors has taken place, multipliers may be developed. For example, suppose that a local economy has 9,000 employed workers and one-third (3,000) of those are employed in basic industries. The export base multiplier can be calculated as:

$$\text{Multiplier} = \text{Total Employment} / \text{basic employment}$$

In this case, the simple employment multiplier is 3. So, if a new factory in the basic sector were attracted to the area and employed 100 new workers, the total employment effect on the local economy would be 300 workers. Obviously, the multipliers can be developed in terms of income, value added or other economic variables.

4. Given alternative assumptions about future basic economic activity in the region, it is a simple matter to make either short term or long term projections.

Some common criticisms of the economic base study include:

1. The identification of industries as basic or non-basic is often arbitrary. Among the problems in assigning an industry to basic or non-basic activity is that some local industries may serve both local and export markets. If, for example, the area is heavily dependent on tourism, then even industries such as retail trade –generally considered a non-basic or local industry—may be partly an export industry.
2. The detailed data for local areas is sometimes difficult to obtain.
3. The basic/non-basic ratio may change over time. In other words, the multiplier may change over time.
4. The ratio is generally inversely related to the size of the area. In other words, large areas are likely to have more non-basic activity.
5. Economic base studies do not explain why new investment in an area occurs or how much it might be.
6. The economic base study considers only demand factors. That is, if a large new basic industry moves to the community and there may be local supply constraints prohibiting the expansion of the economy as implied by the multiplier.
7. The economic base approach focuses on a single region rather than how regions interact with each other.

Examples of economic base studies can easily be found on the internet. The Commerce Department of the State of Arizona decided that economic base studies were important enough that it contracted with Arizona State University in 2004 to conduct economic base studies for each community in the state. These economic base studies can be found at:
<http://www.azcommerce.com/Research/BaseStudies/Economic+Base+Studies.htm>

The classic introduction to economic base studies is: Charles M. Tiebout, *The Community Economic Base Study*, Supplementary Paper No. 16, Committee for Economic Development, December 1962.