

The Shaffer Star: Markets, Export Base Theory

When using a systems approach to reflect on community economic development it is useful to have a paradigm to organize one's thinking. Ron Shaffer offered a six point paradigm which we call the "Shaffer Star": decision-making, resources, **markets**, society, rules, and space. Shaffer maintained that nearly every issue a community may face falls into one of these components or elements of the community.

The **markets** node refers to the economic forces that are at play in a capitalist economy. In the simplest sense, we are talking about the forces and logic behind supply and demand. But when we think about markets in a spatial context we are thinking about the spatial boundaries of goods and services upon which a community relies for production (supply) and consumption (demand). The local market is comprised of businesses buying and selling locally to other businesses and households. It is important to remember that the local market is composed of two distinct parts -- households and businesses.

The non-local market refers to those goods and services that the community produces locally and sells to non-local households and businesses. It is important to remember that the critical element of the non-local market is that the non-local market is essentially an external source of sales and income. Thus, it can be the local production of manufactured goods or agricultural products that are sold outside the community or health care that is paid by a third party, such as Medicare. It can also be the local production of goods and services that are sold to non-local residents including tourists and in-commuters.

Community economic development policy has historically focused on only the external market for goods and services. This focus has followed from a simple model of economic growth known as export base or economic base theory. Export base theory argues that the community's economy can be divided into two. The first sector is the export or basic sector. The export sector consists of that portion of the community's goods and services market that trades with other areas. The export sector brings dollars into the community because someone outside the community purchases goods and services produced in the community. The second sector, termed the non-export, non-basic, or residentiary sector sells its product within the boundaries of the community (internal markets) and exists to support the export sector.

It is a fairly simple theory claiming that the local economy can be divided into two parts: basic and non-basic.

$$\text{Total} = \text{Basic} + \text{Non-basic} \quad \text{or} \quad E_T = E_B + E_{NB}$$

The non-export base (E_{NB}) component of the local economy (E_T) is generally larger than the export sector (E_N) but is dependent on the export sector. Thus, the export base model argues that any change in the export base leads to some multiple change in the total local economy. Specifically, the change in the export sector has a feedback or multiplier impact on the non-basic sector. For example, if dairy is an export or basic sector for the community, and dairy sales (exports) increase, then the dairy farmer must increase local purchases to increase production. That feedback from an increase in export or basic activity onto local or non-basic activity is a multiplier effect and drives economic growth.

This simplistic view of the markets and how to “grow an economy” has its draw backs. The simplicity has inadvertently resulted in overly simplistic approaches to economic growth policy: the engine of economic growth is the promotion of exports. This has historically been viewed as manufacturing, agriculture or resource extraction (e.g., mining). Only recently have communities come to appreciate that “basic industries” include more than good producing industries and can include some services such as tourism and health care. In addition, because of the focus on basic industries, non-basic industries are ignored. Today communities are starting to realize that the ability to retain dollars injected through basic industries is equally important. In addition, the export market is completely dependent on the demand for the community’s goods and services beyond the borders of the community. While the community’s economy is never isolated from broader economic forces, blind pursue of export based growth policies maximizes the community’s dependency on the larger economy.

There are other problems with this view of the world from a purely theoretical perspective. First, for the theory to work all communities export, but none are allowed to import. This simple internal inconsistency has led many economists to dismiss export base as a viable theory of community economic growth. Second, the theory falls apart as the size of the community or region becomes larger. At the extreme, export based theory does not allow the world economy to grow because there are no export markets.

In the end, this element of the markets component of the Shaffer Star is simply reminding the practitioner that there are markets that are both internal (non-basic) and external (basic) to the community.

$$(1) E_t = E_b + E_{nb}$$

$$(2) E_{nb} = rE_t$$

$$(3) E_t = E_b + rE_t$$

$$(4) E_t - rE_t = E_b$$

$$(5) E_t(1-r) = E_b$$

$$(6) E_t = \underbrace{1/(1-r)}_{\text{Export-base multiplier}} E_b$$

Export-base multiplier

We want to identify the relationship between basic activity (E_b) total activity (E_t). To accomplish suppose that there is some fixed ration relationship between total economic activity (E_t) and local or non-basic economic activity (E_{nb}) and call that ratio “ r ”. By definition r will range between zero and one and as r goes to zero a larger share of the total economic activity is devoted to basic or export focused.

Simply substituting and solving for total activity allows to identify the “export-based multiplier”. Specifically, take equation (2) and substitute it into equation (1). This gives us equa-