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After the oil rush

In the Williston Basin, less drilling activity has created uncertainty about the future

By PHIL DAVIES
Senior Writer

PHOTOGRAPHY BY PHIL DAVIES

Tod Maleckar is a "land man" working in western North Dakota's oil country. He and his staff at Diamond Resources Inc. in Williston pore over deeds and maps at county courthouses to figure out who owns land that may hold millions of barrels of crude oil. Then they track down those landowners and try to sign them to oil drilling leases—before a land man working for another oil company does.

Demand for Maleckar's services is a leading indicator of the health of the oil industry in the Williston Basin, a vast area in the western Dakotas and eastern Montana endowed with rich petroleum deposits. Oil companies active in the region must secure drilling rights before they sink new wells. When they stop calling, it's a sign of flagging interest in developing oil fields. In recent months the signs have been discouraging; Maleckar has been getting a lot fewer calls than he did last summer, at the height of the oil boom in North Dakota.

A sharp drop in drilling activity in the region caused by a collapse in oil prices forced him to cut 40 percent of his workforce last winter. And despite an increase in the price of oil since then, business had not picked up appreciably as of late June. "I haven't had to make any further cuts, but I think I'm going to be very cautious through the end of the year, to see how things go," Maleckar said.

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People in the Williston Basin are at once fearful and hopeful about the oil industry, cheered by an increase in the price of oil this year and some signs of renewed drilling activity, yet still unsure about what the future holds. "No question, that sense is there," said Lynn Helms, director of the North Dakota Industrial Commission's Oil and Gas Division, which regulates the industry in the state. "It affects Main Street in western North Dakota; it affects the state tax revenues [and] everything in general. We're kind of holding our breath, I guess."

For most of this decade oil had been a sure bet in the region. The Basin has produced oil since the 1950s, but in 2000 new horizontal drilling technology allowed oil companies to tap into the Bakken Formation, a deep layer of oil-bearing shale in the northern part of the Basin. Bakken crude is "light and sweet"—low in sulfur and easy to refine.

Driven by rising oil prices, the oil rush began in northeastern Montana in 2002, then spread to the western counties of North Dakota in 2006. Drilling rigs sprouted by the score on rolling cropland and pasture, giving way to bobbing pumping units as oil fields were developed. The wells produce natural gas as a byproduct.

Oil and gas development infused wealth into Basin communities such as Williston and Dickinson, N.D., and Sidney, Mont. Oil field service firms thrived and expanded their operations. Farmers and ranchers grew rich on leasing fees and oil royalties paid by the oil companies. A recent study by researchers at North Dakota State University estimated that in 2007 the oil and gas industry spent $3.1 billion in North Dakota, supporting 7,700 jobs and generating $520 million in state and local tax revenue.

Non-oil businesses such as construction firms, retailers, motels and restaurants also benefited from the gush of oil money. The city of Williston handed out over 20,000 "Rockin' the Bakken" bumper stickers, caps and lapel pins celebrating the boom.

Today prospects for the Basin's oil economy don't look as bright. As of early July, with crude oil selling for about half of last summer's prices, oil companies such as EOG Resources, Marathon Oil and Amerada Hess had drastically cut back drilling in the region. In much of the Bakken, it no longer paid to drill new wells and put them into production.

And when the big oil firms aren't exploring and drilling, locally based firms that provide them with raw materials, equipment and services suffer as well. Many were forced to curtail operations and lay off workers last fall.

The Ninth District's oil industry hasn't gone away. Drilling rigs still dot the countryside in highly productive parts of the Basin such as Mountrail County in North Dakota. Existing wells continue pumping and need to be maintained. Over the summer there was some evidence that oil field activity was increasing in response to higher oil prices.

However, many businesses in the region, oil and non-oil firms alike, want to see a sustained rally in oil prices before hiring new employees or investing in improvements. Oil firms, chastened by the tumble oil prices took last fall, are proceeding cautiously. Non-oil firms have also felt the impact of volatile oil; their anxiety is reflected in a slowdown in business and consumer spending, less demand for bank loans and falling rents for apartments.

Long-time residents of the region recall vividly the 1980s, when a drop in oil prices caused widespread business failures, home foreclosures and an exodus from Williston and Sidney. That probably won't happen again, even if oil drilling stays at lower levels for an extended period. A somewhat softer landing for the oil economy of the Williston Basin is more likely; businesses and local governments in the region learned hard lessons from their years in the wilderness.

Rigs on the run

A sharp drop since last fall in the number of rigs drilling new oil wells in the Williston Basin is the most dramatic indication of oil industry retrenchment in the region. "None of us would have ever believed in the summer of last year that it would have fallen this far this fast," said Maleckar. "It was a shock to all of us."

Last November, 96 rigs were operating in the Basin, according to Baker Hughes, an oil field technology firm that compiles drilling statistics. All but seven of those rigs were located in North Dakota, the highest number in the state since the early 1980s. By May the number of rigs working the Bakken had fallen to 36. There was one active rig in Montana (see Chart 1).

In mid July the North Dakota rig count bounced back up to 41, perhaps in response to crude prices rising above $70 per barrel on the New York Mercantile Exchange (NYMEX) in June, a 40 percent increase since March. That was welcome news for Ron Ness, president of the North Dakota Petroleum Council, an oil and gas trade association. "I think we've likely hit the bottom as far as our decline in activity," he said. But Ness added that the outlook for oil drilling was still iffy because of a lack of capital and fluctuating oil prices.

Diminished cash flow because of lower oil prices has forced oil companies to slash their exploration and drilling budgets. And even for companies with the money to drill, the precipitous fall in oil prices (in July 2008 crude peaked at nearly $150 a barrel) has made drilling for oil financially untenable in much of the Williston Basin.

The economics of tapping the Bakken Formation get shaky when oil dips below about $75 a barrel. Compared with other oil regions such as west Texas and the Gulf Coast, drilling in the Bakken is expensive. To reach oil, crews must bore 10,000 feet down, then horizontally through a shallow layer of shale. "Fracing"—injecting a mixture of water and sand that fractures the shale—helps coax the honey-hued crude to the surface. Last year drilling and completing a typical Bakken well cost about $6 million.

Development costs have fallen since last summer because of lower demand for materials and labor. But a well still must produce a lot of oil over its expected working life of 25 to 30 years to cover its expenses, which include taxes and royalties paid to landowners. It's even tougher for oil companies operating in the Williston Basin to turn a profit because of limited pipeline capacity. In both North Dakota and Montana, oil must be transported by rail or truck to refineries, increasing production costs. As a result, in the past 18 months, Bakken oil has been discounted anywhere from 7 percent to 60 percent below prices for West Texas crude, depending on production volume and transportation costs.

Unable to recoup their expenses, oil firms have opted to let their oil leases expire and forgo drilling in many parts of the Basin. Since last fall the majority

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One of the Minneapolis Fed's congressionally mandated responsibilities is to gather information on the Ninth District economy. The *fedgazette* is published bimonthly to share that information with the district, which includes Montana, North and South Dakota, Minnesota, northwestern Wisconsin and the Upper Peninsula of Michigan.

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of drilling activity has focused on Mountrail, eastern McKenzie and northern Dunn counties in North Dakota, areas where wells can produce three to five times as much oil as wells elsewhere in the region.

In the heart of the Bakken, new wells in choice areas can still be expected to pay their way even when west Texas (undiscounted) oil prices dip below $60 per barrel—which is why Stanley, the seat of Mountrail County, is still riding the oil boom. Since 2006, when Texas-based EOG scored a big oil strike in the county, the town of 1,400 has become a base for oil companies and oil field service firms that want to be close to the action.

"It's really taken off, and it's still going gangbusters here," said Mayor Mike Hynek. EOG is building its North Dakota office and a rail shipping facility in Stanley that together will employ 65 people. A local real estate agent said that residential property values have risen 10 percent to 15 percent over the past five years with no sign of letup because of demand for housing from oil industry workers and their families.

In the rest of the Bakken, many people in the industry say it will take NYMEX oil prices consistently north of $70 a barrel to cover production costs and significantly increase drilling. An early-summer hike in oil prices was insufficient to instill confidence in oil companies and their investors, said Steven Durrett, CEO of Augustus Energy Partners, an oil and gas developer based in Billings, Mont. "Continued volatility in the crude markets makes companies hesitant to loosen up their wallets," he said via e-mail. Realizing a return on a new well can take up to two years, Durrett said, so oil firms and private equity investors crave stability—oil prices above a critical threshold that appear to have staying power.

Lower, variable oil prices have also led oil firms in the Basin to throttle back output from existing wells, contributing to a marked drop in oil production since last fall (see Chart 2). North Dakota production peaked in November at about 6.5 million barrels; by April it had fallen about 10 percent.

Contraction pains

The decline in drilling has resulted in reduced sales not just for drilling contractors—many of whom are based in other states—but also for a multitude of local service firms that provide the oil companies everything from leasing services to fracing sand to well parts. The Petroleum Council estimates that every new drilling rig supports 40 jobs in the oil industry.

Oil activity always picks up in the spring when load restrictions are lifted on county roads, allowing crews to resume heavy drilling and maintenance work. Oil field job listings with Job Service North Dakota have increased since the end of March, when oil-related companies posted only 45 job orders statewide. At the end of June, there were 65 listings. But demand for oil field labor was still nowhere near the level of June 2008, when Job Service had over 100 listings in that category.

Many oil field service firms in the Basin were still feeling contraction pains; to survive they laid off employees and cut costs. Maleckar of Diamond Resources said his firm was getting very little new work from oil firms. He's meeting his reduced payroll by renegotiating old leases due to expire in the next few months.

Another Williston company, Red River Supply, was trucking less drilling salt and saltwater (injected underground to reduce pressure on drill bits) to well sites than last year. Owner Rich Vestal said that by April he had laid off almost a third of his workforce; he figures many of those workers left town to look for employment.

At Richland Pump & Supply in Sydney, owner David Williams has had to cut one of his 12 employees. After several years of strong growth, orders have fallen off for oil well components. He expects sales to decline 20 percent this year, despite the June spike in oil prices that raised spirits across the Basin.

"I'm hoping there's a change, but when the price comes up things don't automatically get busier," he said. "The price has to stay there for quite a while before the oil companies are going to start doing anything." Williams was hoping to cut costs and avoid further layoffs by reducing his inventory and waiting to rebuild stocks until business improves.

The struggles of these firms and hundreds of others in the Basin ripple out far beyond the oil patch. Stagnant oil field revenues mean fewer goods and services purchased from other businesses that have become accustomed to black gold in their cash registers. Local government also feels the impact when less direct and indirect oil spending reduces tax revenue.

Star not so bright

A drive down Second Avenue West, the main commercial strip in Williston, reveals no hints of faltering prosperity. At the end of the day, pickup trucks laden with oil field tools and equipment line up outside motels. Help wanted

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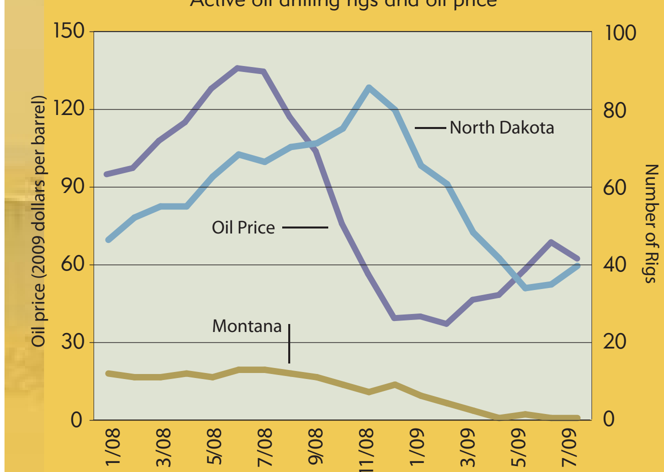
For most of this decade oil had been a sure bet in the region. The Basin has produced oil since the 1950s, but in 2000 new horizontal drilling technology allowed oil companies to tap into the Bakken Formation, a deep layer of oil-bearing shale in the northern part of the Basin.

CHART 1

Drilling rigs have declined

Active oil drilling rigs and oil price

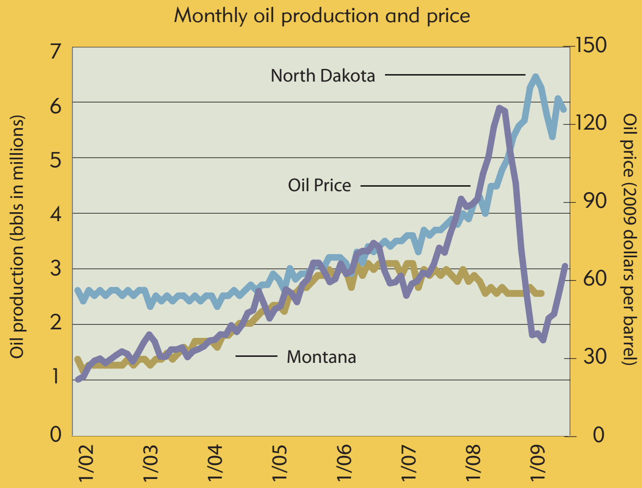


Sources: Dow Jones & Co. (spot price of West Texas intermediate); Baker Hughes Inc.

CHART 2

Oil production taking a breather

Monthly oil production and price



Sources: Dow Jones & Co. (spot price of West Texas intermediate); Montana Board of Oil & Gas Conservation; North Dakota Industrial Commission, Oil and Gas Division

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signs hang in the windows of restaurants, bars and gas stations. On the west side of town, clusters of upscale single-family homes and townhouses are under construction, some adjacent to trailer parks and modest one-story houses built during the 1970s boom.

Although "The Western Star" is the hub of the region's petroleum industry, with 200-odd oil field service firms, the city of 14,500 does not live by oil alone. Before oil was discovered in North Dakota in 1951, farming was the Basin's economic mainstay, and it remains so. As oil prices fell last fall, small-grain farmers reaped handsome profits because of high commodity prices. A plant that processes peas, lentils and chickpeas was acquired by a Canadian firm and expanded in 2007.

But the oil industry's recent travails have cooled a regional economy that last year burned red hot, untouched by the recession that was tightening its grip on the nation as a whole. "We're not feeling the pressure that we hear is going on around the rest of the country, but [the oil downturn] has had an impact," said Ward Koeser, president of the city commission and owner of a local communications firm.

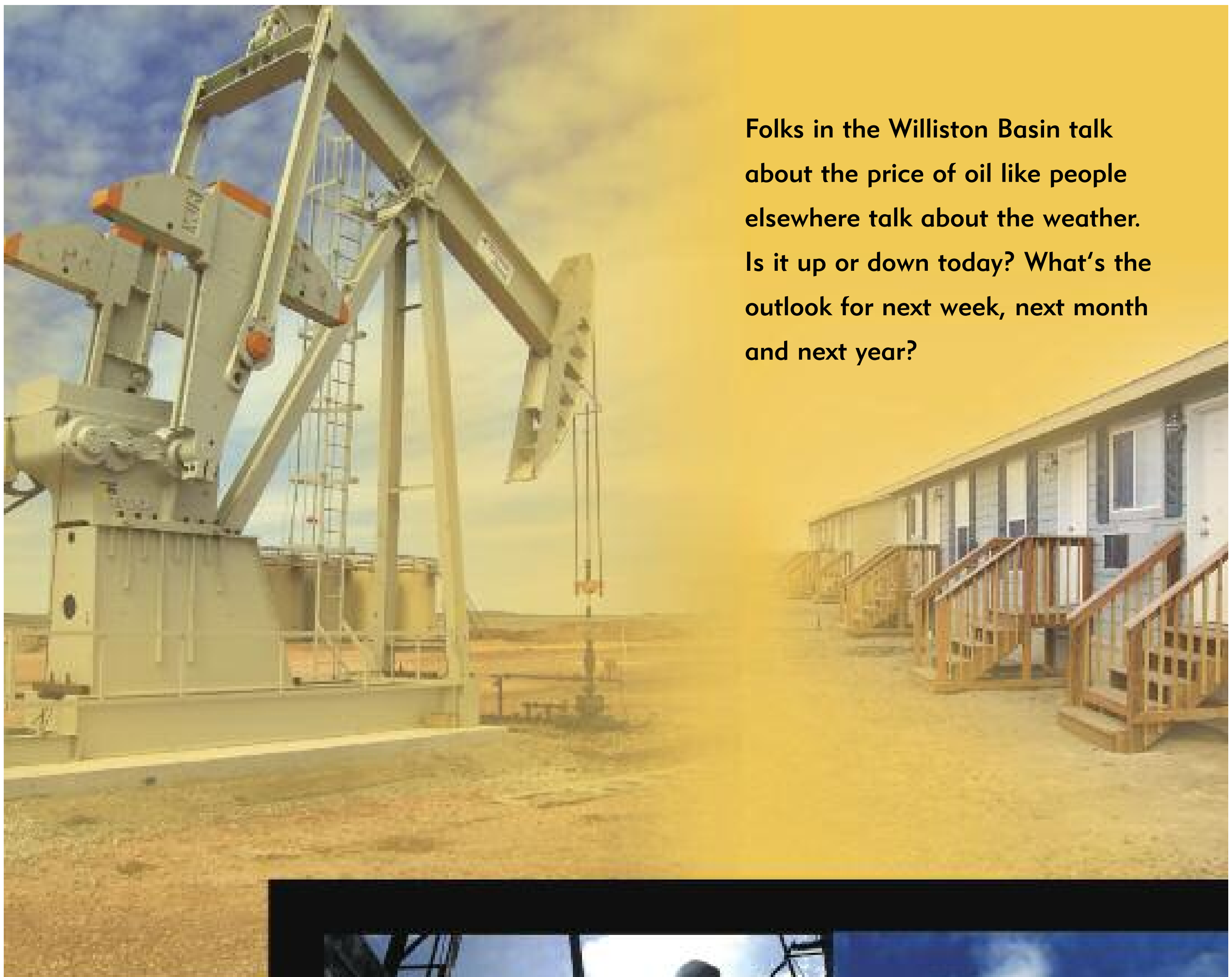
Williston is still doing very well compared with other communities in the state (see Chart 3). City sales tax collections increased 20 percent in the second quarter over the same quarter in 2008. However, Williston tax collections for April and June fell 2 percent below city estimates, suggesting that economic growth is slowing.

That worries city officials. City sales taxes are earmarked for infrastructure improvements and don't fund operations. But receipts from a state tax on oil production dropped sharply in the first quarter, and the city auditor forecasts a $6.1 million budget deficit this year unless oil tax funds and revenue from other sources rebound in coming months. "That's going to be a challenge, something we'll have to wrestle with," Koeser said.

Other signs that the city's fortunes may be on the wane include reduced commercial lending and falling rental rates.

First International Bank & Trust, with offices in Williston, Watford City and Killdeer, is one of the biggest lenders in the Basin. The bank lends to farmers, manufacturers and retailers as well as oil field service firms. Not surprisingly, demand for credit from oil-related businesses has fallen over the past year, said President Larry Dewhirst. During the boom oil field firms borrowed to buy new equipment and upgrade facilities; now that oil drilling and production are down, they're delaying new capital investments. But lending to non-oil businesses has also dropped as businesses put expansion plans on hold. "There's not as much demand for commercial loans right now," Dewhirst said.

A year ago landlords were charging



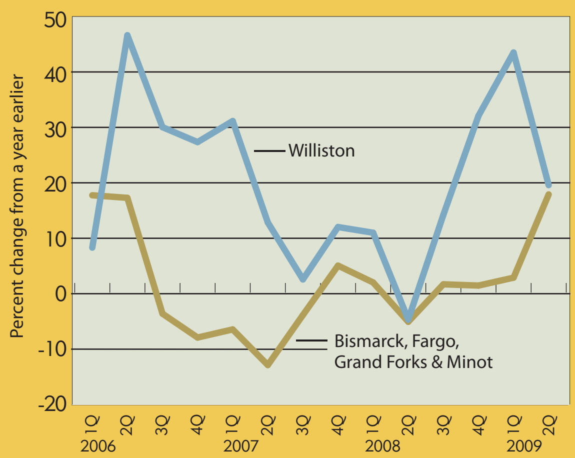
Folks in the Williston Basin talk about the price of oil like people elsewhere talk about the weather. Is it up or down today? What's the outlook for next week, next month and next year?

SHUTTERSTOCK

CHART 3

Williston feels the impact of oil slowdown

Sales tax revenue*

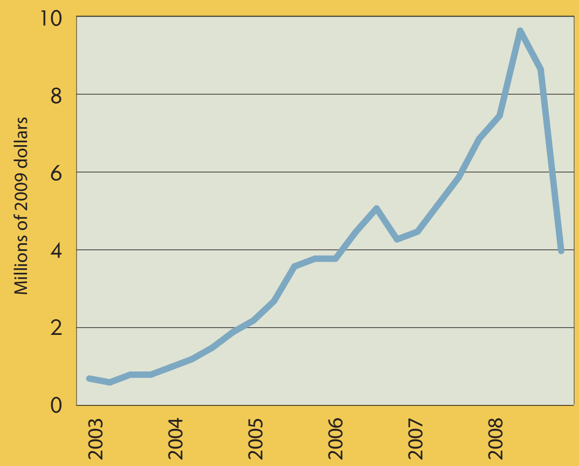


*Adjusted for inflation
Source: North Dakota State Treasurer

CHART 4

Less oil tax money for Richland County, Mont.

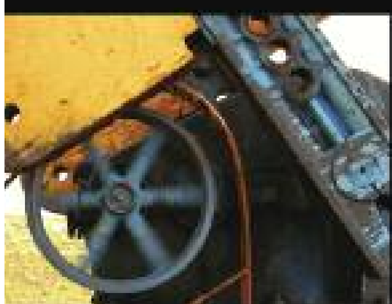
Oil and gas tax revenue



Source: Montana Department of Revenue

A year ago landlords were charging over $1,000 per month for a two-bedroom apartment. Today apartment rates have dropped because there are fewer oil workers in town who can afford high rents.

Williston sales taxes are earmarked for infrastructure improvements and don't fund operations. But receipts from a state tax on oil production dropped sharply in the first quarter.



over $1,000 per month for a two-bedroom apartment. Today apartment rates have dropped because there are fewer oil workers in town who can afford high rents. Mike Marcil, a Fargo-based real estate developer, said that his company lowered rates last spring at several properties it owns in the city. "There are still more people who need an apartment in Williston than there are apartments, but what they're able and willing to pay is declining," he said.

Marcil and a partner plan to expand an apartment complex in the city, but securing financing has become more difficult over the past year. Many local banks, including First International, were shying away from financing construction of multifamily housing. "If you're at the end of a boom cycle, you don't want to be investing in apartments," Dewhirst said.

Despite the vicissitudes of the oil industry, some Williston businesses are expanding their operations. Even as crude prices were dropping a year ago, Sheila and Bryan Goehring undertook an extensive remodeling project to house their video rental business and a new liquor store. The couple took out a $450,000 loan from the U.S. Small Business Administration to pay for the work. "We knew that even if they quit drilling and oil production in the area dropped off considerably, it would still be something we'd want to go ahead with," Sheila Goehring said.

Bryan Goehring figures liquor and video rentals are oil-bust resistant ("knock on wood"). He said business improved at a bowling alley the couple owns when drilling declined last fall; laid-off oil field workers had more time to bowl.

But other Main Street businesses have settled into wait-and-see mode. At Ryan Motors, a Chrysler and Honda dealership, sales in June were down about 30 percent from last summer, when truck purchases by oil field service companies helped the dealership post its third consecutive year of 10 percent to 15 percent growth. Last fall those firms stopped buying, and despite the spring uptick in oil field activity, oil-related sales had not fully recovered. This summer General Manager Barron Parizek's goals were modest: Sell enough vehicles to general consumers to avoid laying off employees. "We're maintaining and seeing what's going to happen in the future," he said.

Last of the gravy?

Uncertainty about oil pervades other communities in the Williston Basin. For all of the bustle in Stanley, there were subtle signs that the local economy had cooled somewhat since last summer. A new apartment building with rents geared to oil salaries had vacancies, and fewer oil field workers were stopping in for breakfast at Joyce's Café on Main Street. Owner Cory Rice said his oil field clientele had dropped 75 percent since last fall.

Over the Montana border in Richland County, which accounts for over half of oil production in the state, vanishing oil rigs represent another stage of an industry slowdown that began two years ago. Oil production in the county peaked in August 2006 and by the end of last year had fallen by more than a quarter. In this part of the Bakken, the output of new wells hasn't been enough to replace the naturally declining production of older wells. "The activity in Montana is declining," said Durrett of Augustus Energy Partners. "The good areas have largely been drilled."

In the county seat of Sidney, residential valuations started softening in late 2007 after several years of strong growth, said Leif Anderson, owner of Beagle Properties, a local real estate agency. As oil field exploration and drilling leveled off, so did the number of oil company managers buying $200,000-plus houses.

Today Anderson is worried about eroding demand for less expensive houses if city residents who have been laid off from oil field service firms in the area don't go back to work. "If the price of oil doesn't come up significantly, I feel that the boom time, the gravy, may be over," he said.

There's evidence that the recent virtual shutdown in drilling is further undermining the area's economy. Local banks report a drop in demand for credit from oil service companies since last summer; one banker observed that firms have all the equipment they need to perform maintenance work on existing wells.

The Sidney Job Service Workforce Center has seen a marked drop in listings for non-oil jobs. In June 2008 about 180 employers had job openings in Richland County; a year later there were fewer than 80 (although there were plenty of openings in retail and food service—Kentucky Fried Chicken in Sidney was closed some weekdays because of problems finding help).

And the drilling pullback has hurt the bottom line of Tri-County Implement, a farm equipment dealer in Sidney that services oil field equipment as a sideline. Since last winter fewer oil field trucks have come into the shop for repair, said co-owner Tami Christensen. She expected the decline in oil field repair work, combined with farmers' chagrin over smaller oil royalty checks, to translate into a 5 percent decline in sales this year. "Like everybody else, we're going to watch what we're doing a little closer, and we probably won't be doing any big expansions this year," she said.

As in Williston, local government officials were concerned about a drop in tax

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revenues tied to oil production. Since 2002 Richland County has spent tens of millions of dollars in oil tax revenues on public infrastructure such as a new criminal justice center and renovation of a county park. "We've done it all just on oil money; we haven't gone to the taxpayers for anything," said County Commissioner Mark Rehbein. That may have to change in the future; in the fourth quarter of last year, the county received $4 million in oil tax receipts—less than half the amount it got in the previous quarter, when oil prices peaked (see Chart 4).

Watching and waiting

Folks in the Williston Basin talk about the price of oil like people elsewhere talk about the weather. Is it up or down today? What's the outlook for next week, next month and next year? Many express hope that the downturn in drilling is a brief hiatus in a long period of prosperity in the region. If oil prices mount a sustained rally later this year in response to global economic recovery, drilling could come back strong, at least in the core areas of the Bakken that promise oil companies the greatest return on their investment.

To that end, in April the North Dakota Legislature enacted a tax incentive for newly drilled wells. When oil drops below $70 a barrel, oil producers pay a top tax rate of 7 percent on oil from those wells—3.5 cents less than the standard rate. The tax break expires after 18 months or when the well exceeds production thresholds.

Helms of the North Dakota Industrial Commission anticipates a spurt in drilling early next year, when Enbridge Inc. of Canada plans to complete a pipeline expansion that will allow an extra 50,000 barrels per day of crude to flow east to Minnesota. Easing constraints on oil shipments may eliminate or reduce the market discounts on Williston Basin oil.

But if oil activity stays depressed for years, the consequences might not prove as damaging to the economic well-being of the region as the oil crash of the mid-1980s. When oil prices plummeted then, 5,000 people without a livelihood pulled up stakes and left Williston. Home foreclosures rose as property values fell.

Certainly a long-term contraction in oil drilling—and over time, significant drops in production from existing, aging wells—would mean hardship for the multitude of oil field service firms in the Basin. Some companies would fold—the fate of a number of oil field firms in the 1980s; those that survived would have to get back up to speed quickly when oil activity picked up again.

Maleckar of Diamond Resources frets that the land men he has laid off will find work in oil fields elsewhere in the country and not return when oil activity recovers. "For all of us, we wish it was not such an up-and-down deal," he said. "When you lose people, it's not like you can go and grab them off the shelf."

But much has changed in the Basin over the past 25 years. For one thing, farming—for more than a century the backbone of the economy—is more stable than it was back in the late 1980s, when a drought compounded the misery of low crop prices. So far in this recession, prices for wheat, canola, peas and other commodities have held up fairly well.

For another, some Basin communities have diversified their economies since the 1980s oil bust. More than a dozen oil-related companies have a presence in Dickinson. But the city of 16,000 also hosts a state university and tourists headed for nearby Theodore Roosevelt National Park. And it's home base for a number of non-oil companies, including cabinetmaker TMI Systems and Steffes Corp., a manufacturer of refrigeration and air conditioning equipment.

Those firms have received low-interest loans and other forms of aid from local government—part of a concerted effort to broaden the local economy beyond oil and agriculture. Said Gaylon Baker, executive vice president of Stark Development Corp., a nonprofit economic development group: "A number of community leaders saw [the oil crash], and they said, 'We don't want that to happen to us again.'"

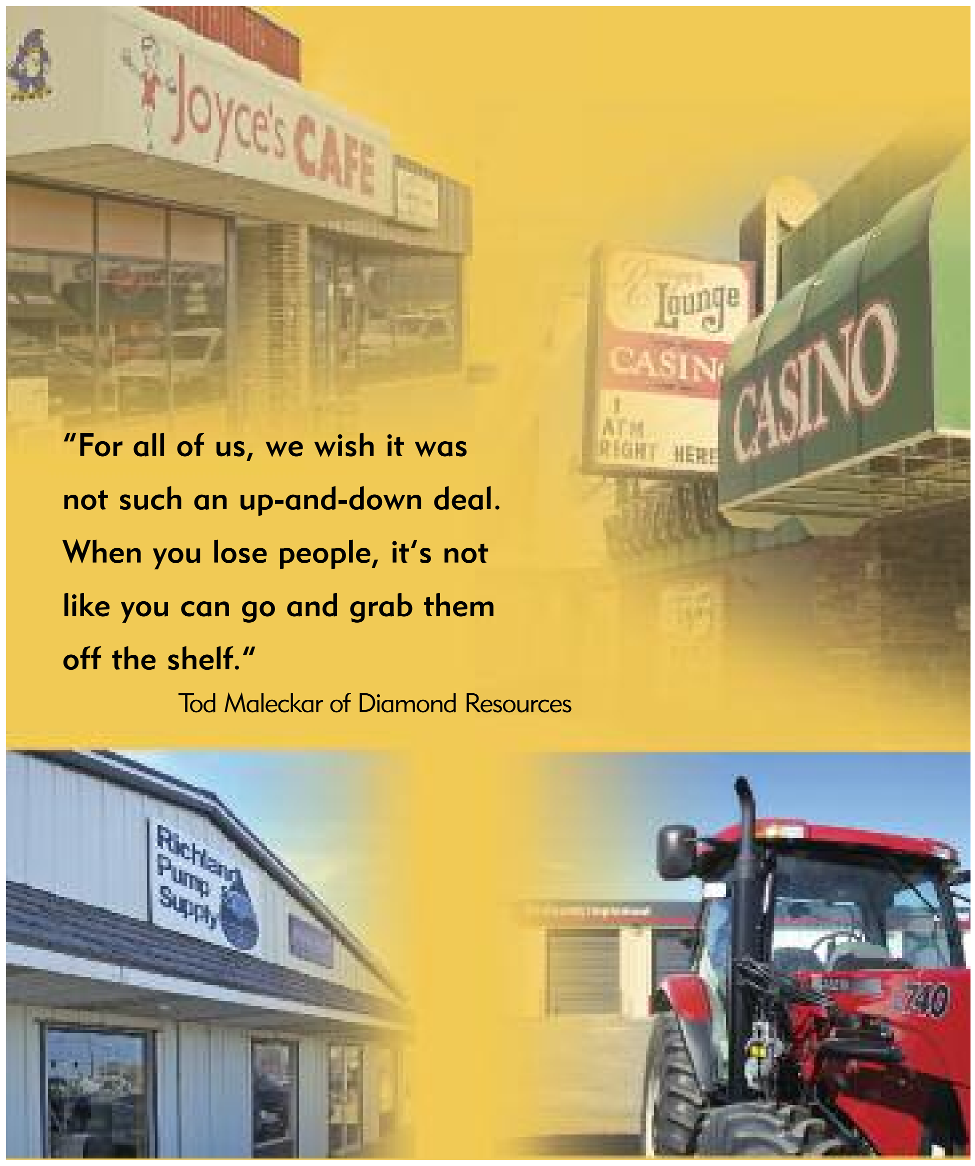
That sentiment is shared by cities such as Williston that remain more dependent on oil. Businesses, investors and local governments behaved differently in the recent boom than they did in the 1970s oil rush. They exposed themselves to less risk, remembering the trauma they—or someone they knew—experienced the last time oil prices tanked.

Lessons from the bust

For the most part non-oil businesses in the Williston Basin avoided taking on a lot of debt to expand, even as oil prices and drilling activity soared. Anderson's reaction to the boom at Beagle Properties in Sidney was typical: "I probably could have expanded this office and added more agents, but because I was around for the last boom, I didn't borrow a bunch of money and do that. I definitely had the mindset that this boom won't last forever."

A few businesses in the Sidney area borrowed heavily to capitalize on the boom, and "in most cases those guys have gotten in trouble," Anderson said.

Even oil field service firms that had the most to gain from the oil rush played it cagey. Borsheim Crane Service in Williston, a provider of heavy cranes and trucks used in well construction, borrowed over $1 million for new equipment in 2007 and 2008. But owner Tyler Goodman he says he was careful not to go overboard. The memories of the



"For all of us, we wish it was not such an up-and-down deal. When you lose people, it's not like you can go and grab them off the shelf."
Tod Maleckar of Diamond Resources

1990s, when he had to scrounge for every conceivable type of work to keep the firm afloat, were still fresh. "We were pretty conservative in our borrowing, compared with the opportunity," he said.

Banks also lent conservatively, particularly for housing projects. Local banks and other North Dakota financial institutions that were saddled with hundreds of home foreclosures in the late 1980s took pains to protect themselves when demand for housing rose again with an influx of oil workers. Less housing was needed in this boom because drilling workers often lived at the well site in temporary housing or "skid shacks," but banks also made housing projects more difficult to finance by requiring developers to put up more equity.

Typically, banks require developers in western North Dakota to bring more of their own capital to the table to qualify for a loan—25 percent to 40 percent of the project cost, compared with 20 percent in Fargo and other cities in the state. The reason is cyclical demand for housing in an oil economy, said Dewhirst of First International; volatility increases financial risk.

Bitter experience has also guided the actions of local officials in the Basin. During the boom cities and counties invested in new infrastructure and services—Richland County built its justice center, the city of Williston spent $25 million to upgrade its water system and Stanley hired two police officers, tripling its police budget.

But despite high demand for housing, they resisted the temptation to subsidize new residential development. In the early 1980s the city of Williston footed the bill for street improvements in planned subdivisions, to encourage development. But many of the subdivisions were never built, saddling the city with vacant lots and $27 million in bond debt. Determined not to repeat its mistake, this time the city required developers to pay for their own lot improvements. Other communities such as Sidney and Stanley have followed Williston's example, letting developers and banks bear all the market risk.

Koeser sees the drop in oil prices and drilling activity since last fall as a vindication of the city's measured approach to the boom. "I don't feel that we've overreacted this time," he said. "We realize that oil is cyclical—it goes up and it goes down. When there are as many of us around who have lived through it, we're going to be a little cautious about what we do."

Much of the private sector in the Williston Basin adopted the same attitude toward the run-up in oil prices and drilling activity of the past few years. The good times rock in the Bakken, as the bumper stickers say. Just be ready for when the music stops. f

Research Assistant Wonho Chung contributed data collection and analysis to this article.

OMG! Like, where are all the teen workers?

Teens have been quietly, and increasingly, leaving the labor force

By RONALD A. WIRTZ
Editor

When you think of summer and teenagers, you think of car cruising, beach time, ice cream and *endless* cell phone chatter. Kids being kids.

What's that? A summer *job?* LOL, that's so phat-free (generational translation: not cool).

At least that's what it might seem like after a glance at trends in teen labor, both nationally and in the Ninth District. Yes, some teens manage to shun the lure of a carefree summer, choosing instead to guard beaches, wait tables, paint houses and perform other entry-level jobs to earn money for the necessities and pleasantries of teenhood.

But going back a decade and a half, teens have been slowly and steadily leaving the labor force, and the recession has had a Red Bull effect on the trend. The phenomenon is stark compared to the work habits of other age groups. But just like teens slipping out of the house after their parents are asleep, their absence from the workplace has gone largely unnoticed.

The faltering work hours of teens make easy fodder for the timeless "kids these days" debate over generational work ethics. But the job market is a complicated place for teens, and many factors—demographic, economic and even generational—contribute to the long-term decline in teen labor.

That's not to make excuses for teenagers. There's some evidence that teens today are (or at least were, until recently) increasingly removed from the necessity of work. Given the recession, teen labor participation could well drop below already historic lows. Teenagers today have probably not faced such a desperate job market since at least the early 1980s, when unemployment approached 10 percent. Indeed, the job market for teens today might be worse because youth are jockeying with a much older, more experienced crowd of job seekers.

But when the economy recovers, as it will eventually, teens will stand at the proverbial labor fork in the road. While teen labor participation rates will likely recover somewhat from recession levels, what's not clear is whether the long-term trend will continue its downward course or swing back upward. Some evidence suggests that although teen job seekers are suffering from the recession, the economic downturn has reintroduced the value of work, even for those who can't land a job.

Junior (under) achievement

It shouldn't come as a big shock that teen job seekers have fallen on hard times. According to a June report by the Minnesota Department of Employment and Economic Development (DEED), teen employment fell in each of the past four recessions. When the overall job market tightens, teens are forced to compete for available jobs with more workers who are both older and more experienced—two factors that employers tend to prefer, all else equal.

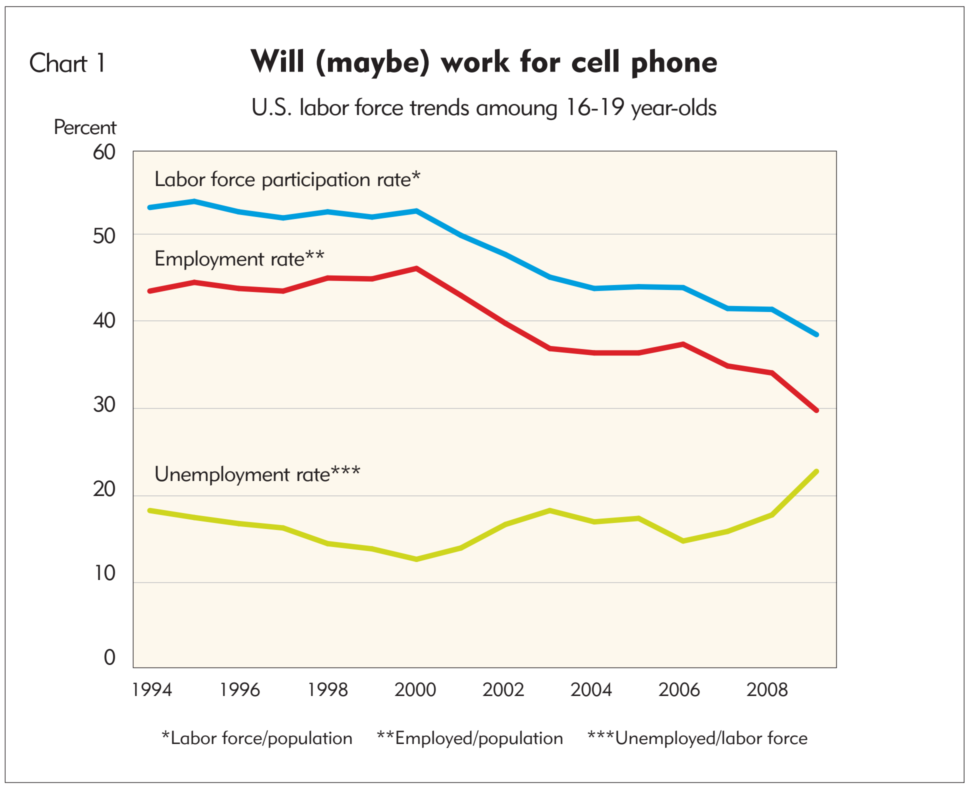
But it would be wrong to conclude that the downward trend in teen labor participation is a result of the recession. It's more accurate to say the recession has compounded a long-running trend.

Teen labor force participation, which counts both workers and those actively seeking a job, has fallen across the United States for about 15 years. But the rate has dropped much more steeply since 2000 (see Chart 1). In fact, during the strong economy of the late 1990s, the rate of employed teens actually rose and teen unemployment dropped significantly. But overall labor force participation—the percentage of those seeking or holding a job—still fell slightly during this time because many teens simply weren't interested in or searching for a job. With the onset of the 2001 recession, teen labor force participation rates plummeted, joined by a related drop in teen employment, while the teen jobless rate almost doubled.

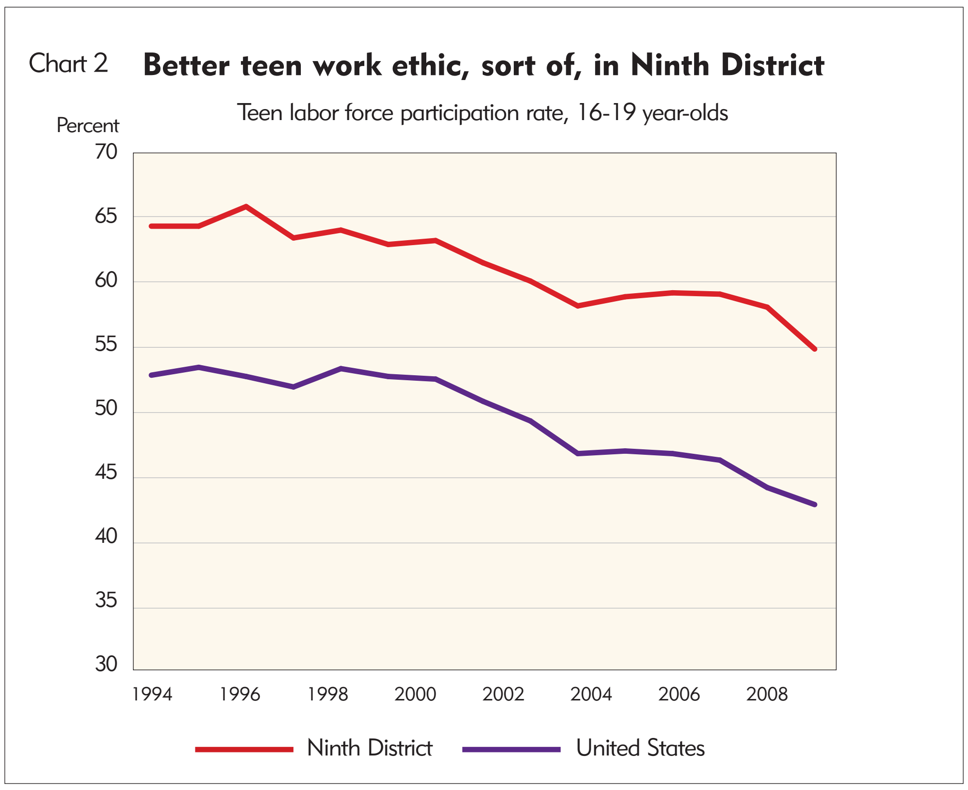
Though the district has mirrored the overall national decline in the teen labor force over the past 15 years, teens in district states have fared somewhat better than their national counterparts. Indeed, you could say that teens in district states work harder, because the district's labor force participation rate has consistently maintained a 10-14 percentage point advantage over the national rate (see Chart 2).

Among district states, teen participation trends aren't as uniform (see Chart 3). The teen labor rate differs considerably from state to state: Labor force participation in North Dakota is near 60 percent; in Montana, it's about 45 percent. But each state in the district (including all of Wisconsin) has experienced a general decline in its teen labor participation, though to varying degrees. Minnesota, Montana, South Dakota and Wisconsin all saw drops of at least 10 percentage points from 1994 to 2009, with Minnesota seeing the largest drop, from 71 percent to less than 55 percent.

In contrast, North Dakota's teen labor participation rate dropped just two percentage points over this period. It was on the same downward trajectory for much of this decade, then rebounded in 2006 as the state's economy surged, thanks to strong agriculture and energy sectors. Last year the state had the highest overall growth in the nation, according to the U.S. Bureau of Economic Analysis.



Source: Current Population Survey, U.S. Census



Source: Current Population Survey, U.S. Census

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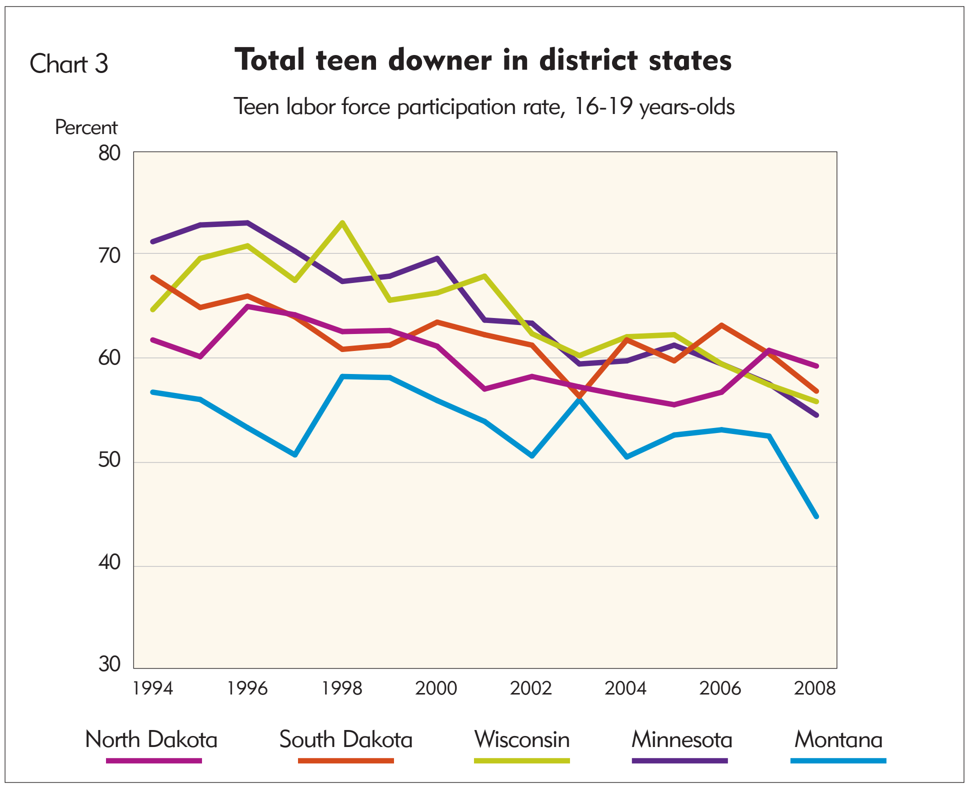
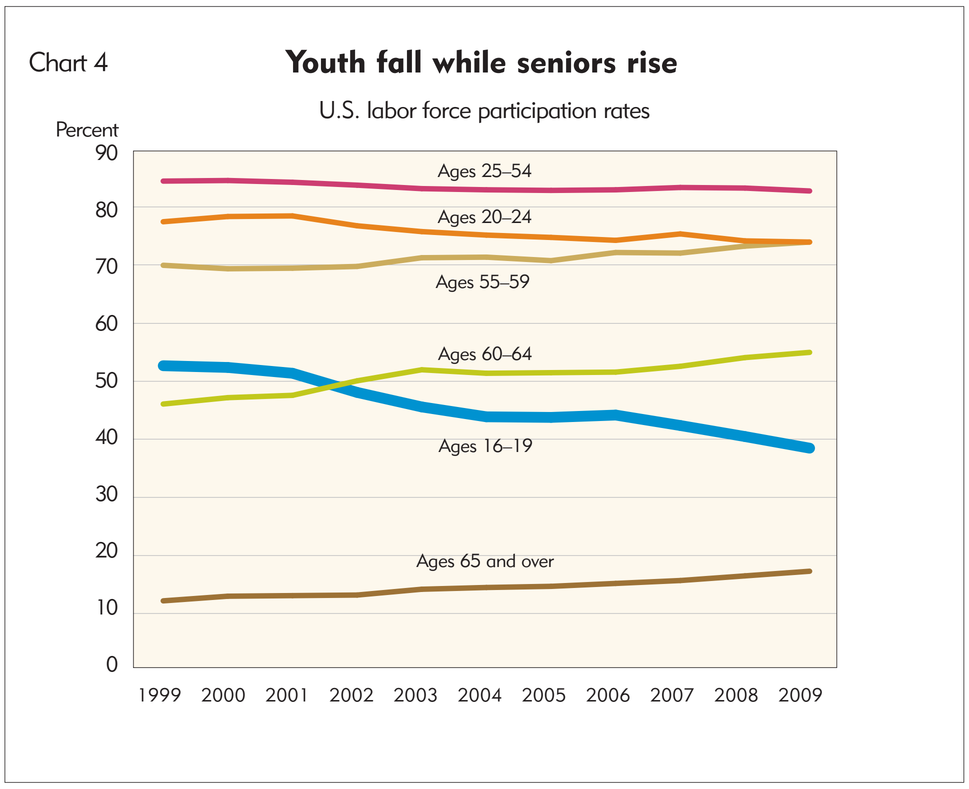
"The entry-level labor market is getting more crowded as experienced workers are hit by layoffs, older workers delay retirement and brand new college graduates seek employment outside their fields of study." —Minnesota DEED report



Source: Current Population Survey, U.S. Census



Source: Current Population Survey, U.S. Census

Teen labor from page 7

Economy: What's the deal?

Then came the recession, and teens found out firsthand what a little competition does to job prospects.

In South Dakota, an April report by the state Labor Market Information Center described the upcoming summer job prospects for teens and other young adults as "uncertain and possibly gloomy. … Not long ago employers were begging for students to fill traditional summer jobs, but with the current economic cycle it might be the young doing the begging." In the same report, an employment agency manager in Mitchell said that "scouring local businesses in search of summer employment opportunities proved to be a challenge this year."

In Grand Forks, N.D., some employers are "not hiring as many summer employees," opting to stretch their existing workforce rather than add another employee, according to Barry Wilfahrt, president and CEO of the Grand Forks/East Grand Forks Chamber of Commerce.

To the south in Fargo, N.D., unemployment still lingers in the 4 percent range and the labor market would appear to favor workers. But there has been a notable shift, according to Marty Aas, a manager with the state Job Service office in Fargo. Last year, the office had 3,800 openings for workers, winnowed down to 1,600 by this past June. Until fairly recently, "employers were desperate," said Aas. "Now it's flip-flopped. … It's an employer's market right now; they have a bigger choice" of workers because of the slowdown in job openings.

A tightening labor market hurts teen workers first and worst, because they tend to be on the bottom of the labor totem pole due to their lack of experience. Statewide unemployment has been slowly rising in South Dakota, and job listings in South Dakota were down this past spring. As a result, "employers do not have the work or the profit margin to justify hiring unskilled youth," according to Deb Halling, a state workforce specialist, via e-mail. "The available labor pool includes older and sometimes more skilled, dislocated workers. The spillover effect is [that] teens are having a harder time finding summer employment."

In Minnesota, the June DEED report said employers "will have the privilege of choosing from an unusually diverse pool of applicants. The entry-level labor market is getting more crowded as experienced workers are hit by layoffs, older workers delay retirement and brand new college graduates seek employment outside their fields of study."

That theme was echoed by job service professionals. In Anoka County, Minn., the economic downturn "has definitely affected teens in our local communities," said Sandy Froiland, assistant director at the Anoka County Job Training Center, via e-mail. A suburban Twin Cities county, Anoka's unemployment rate hit 9.4 percent last March, and "as viable job opportunities diminish for adults, they are pressed to take jobs that in the past would have been options for teens."

This year, her agency has seen a rise in recent college graduates applying for services because they cannot find employment in their occupational field. "All of this combines for a very tight job market," said Froiland. So tight and so competitive, it turns out, that an annual spring job fair at a shopping mall was canceled this year. "We were concerned that the high number of job seekers—adult and youth—would overwhelm the limited number of employers that are actually hiring," she said.

Kathy Zavala, executive director of the Stearns-Benton Employment & Training Council in St. Cloud, Minn., said the region is home to several higher education institutions, so teens "have always had to compete" with older students for available jobs. With the recession, she added, "it's even tougher to get a job" because the quality of available labor is increasing as workers get laid off and unemployment rises. She said she has seen a "substantial difference" in the age of restaurant servers and other customer service positions. Now it's not uncommon to see people in their 30s and 40s "considering a position they never would have considered in the past," Zavala said.

The dearth of opportunities for teens can also be seen in the rising interest in public jobs programs. The city of Minneapolis saw over 3,200 applications for 1,300 openings in its youth jobs programs. Applicants to one of those programs, called Step-Up, offer some insight into the teen job-hunting experience. The program targets disadvantaged youth who qualify based on several at-risk characteristics. An informal survey of Step-Up applicants (both accepted and rejected, conducted by program officials at the request of the *fedgazette*) found that many were having a difficult time getting a job. Said one 18-year-old applicant, "I never got so much as an interview before I did Step-Up."

A 17-year-old revealed that her mother had just died, and she was working "to make money to support myself so I don't have to depend on others." She added that "it's harder to find a job that is satisfying. I've already applied for a lot of them, and they either need experience or some sort of requirement that I don't reach, so they just never get back to me."

And finally, asked about the difficulty of finding a job, one 15-year-old girl, in seemingly her best teen "duh" voice, said, "It's been pretty hard, seeing as how I still don't have a job."

Whassup, gramps?

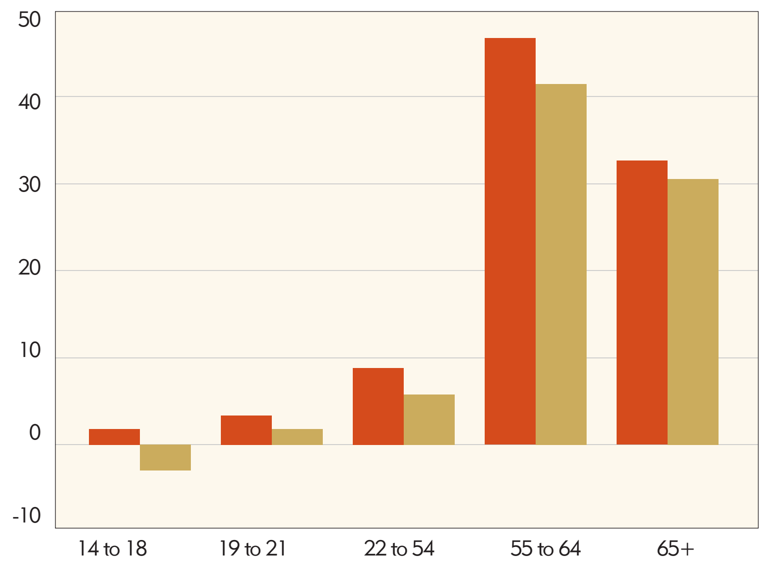
What's behind this teen labor trend is both simple and puzzling. In Minnesota, teen unemployment rose from about 15 percent to almost 19 percent this past May, according to DEED. No real surprise there, given the recession and rising unemployment across the board. But now it gets perplexing: The state's teen unemployment rate went from 7.5 percent in 2001 to almost 15 percent in 2006—a much bigger overall jump, in a period when the economy saw generally decent growth.

What's ultimately driving this trend is a multitude of forces that are pushing from different angles and with varying vigor. For example, states have passed laws that restrict the types of jobs and hours that teens can work. The federal minimum wage has also increased, and research has shown that a higher mini-

Interest in youth jobs programs has been intense. The Stearns-Benton agency received more than three applications for every spot in its program. ... In Missoula, Mont., "before we could even advertise, we got a hundred applications in a week."

Chart 5 **Tortoise vs. hare, on the job**

Percent change in North Dakota covered employment,* by age group, 2002–2007

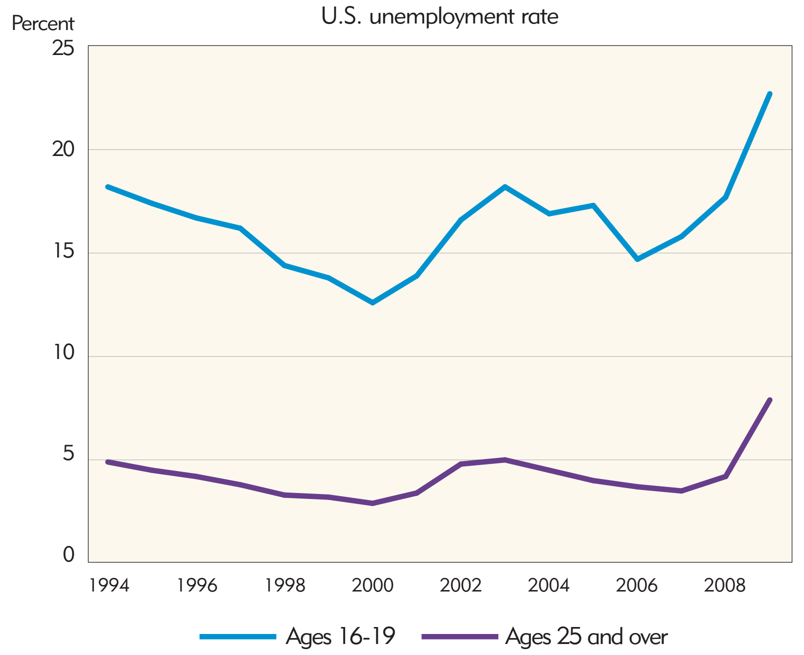


*Employment at firms that pay unemployment insurance taxes

Source: Job Service North Dakota

Chart 6 **U.S. unemployment rate: Like father, kind of like son**

U.S. unemployment rate



Source: Current Population Survey, U.S. Census

mum wage reduces the number of low-paying jobs typically held by teenagers because some employers can't afford to hire at that rate.

Labor supply trends are also likely having an effect. For example, a look at trends by age groups shows that the drop in teen labor sticks out like yesterday's dated fashions (see Chart 4). Teens are not the only age group to see some decline in their propensity for work: Labor rates among workers aged 20 to 24, and even 25 to 54—the bedrock of the U.S. labor force—have also declined, but to a much lesser degree.

But not everybody is working less. As multiple sources noted, more older workers are joining or staying in the workforce today than just a decade ago. The only age group to see growth in labor participation rates is workers at least 55 years old, and growth has been particularly hearty among those 60 and up. It's hard to know for sure how often gramps is stealing a teenager's job, but sources say it does happen: In Anoka County, Froiland said she has seen more retired individuals reentering the workforce and competing for entry-level jobs.

In North Dakota, employment has skyrocketed among older age groups while declining slightly among teens, according to data from Job Service North Dakota. Part of this is due to demographic trends: The population of 16-19 year-olds in North Dakota, a low-growth state, has shrunk this decade. But job growth among workers aged 55 and older has far outstripped population growth (13 percent statewide) for this age group, a trend that is even more pronounced in growing areas like Fargo (see Chart 5).

And when the job competition gets tough, teens … apparently get discouraged. With little job-hunting experience, many teens struggle to effectively search for jobs. Tammy Dickinson, head of Step-Up in Minneapolis, has seen and heard of instances where kids have "knocked on a bunch of doors and not gotten anything, so they just give up."

Remember the (job) Alamo

Andrew Sum is an economics professor and director of the Center for Labor Market Studies at Northeastern University (NU) in Boston, which has paid special attention to teen labor issues. Via e-mail, Sum ticked off a not-so-short list of factors "that empirically matter" regarding teen labor tendencies. Immigration—particularly illegal immigration—can negatively affect teens, especially males, he pointed out, because they are often competing for the same low-wage jobs. Teens today also compete with more low-income mothers who have to find a job because of time limits on government assistance that were established with the welfare reform of the mid-1990s.

Overall job growth is also critical, according to Sum. "Teens benefit most from strong labor markets." That's because employers prefer older, more experienced workers, so teens tend to be last in and first out; this means they feel a smaller net effect in good times and an exaggerated effect in bad times (see Chart 6).

Another important consideration is higher education. It's well known that young people are less likely to work if they attend college. But Sum pointed out that the inverse is also true: Teens are more likely to pursue additional schooling if immediate job prospects are poor. "The school attendance factor heavily reflects the absence of jobs for teens and young adults," according to Sum. "Research has repeatedly found school attendance linked to the state of job availability."

And college enrollments have been rising. For example, spring enrollment at the 32 Minnesota State Colleges and Universities rose by 3.7 percent over a year ago. But whether teens are going to college to invest in their occupational future or simply avoid a poor job market is something of a moot point, because college attendance offers only a partial (or yet another) answer to the teen labor puzzle.

For one, college attendance doesn't involve a significant portion of teens who are still in high school. Second, college attendance among recent high school graduates doesn't always square with teen labor trends. To be sure, it does in some states. For example, according to the National Center for Higher Education Management Systems, the rate at which Minnesota high school seniors immediately enrolled in college went from 53 percent in 1994 to 68 percent in 2006—roughly in line with the state's drop in teen labor (from 71 percent to 61 percent) over that period (see Chart 7).

But the relationship doesn't hold everywhere. For example, South Dakota's college-going rate soared from 50 percent to 72 percent over this period, but the teen labor rate dropped less than five percentage points. Wisconsin's teen labor rate during this period dropped from 65 percent to 59 percent, but the college-going rate only inched up, from 60 percent to 61 percent.

Job ADHD

Still other matters influence teens' decisions to work. Numerous sources, for example, said that teens were playing more sports, attending more camps of all variety and even volunteering more in hopes of burnishing their admissions applications to colleges. Such activities are difficult to substantiate because comprehensive data are elusive. Even where some data are available, they do not support the conventional thinking. For example, figures from the Bureau of Labor Statistics show a slight decline in volunteering among 16-24 year-olds in recent years.

At the same time, while specific activities might not be a major blow to teen labor habits, taken as a whole, teen labor might be dying from a thousand small diversions. Wilfahrt, from the Grand Forks Chamber, said that in his 25 years there, "I have seen the teen labor participation rate pressured by more and more diverse extracurricular options for teenagers."

A 2008 report by Minnesota's DEED noted that some teens and young adults "have definitely expanded their options by looking for alternatives to working for pay in the summer," including summer school, activities camps and volunteering. The report noted that such experience "looks great on a resume" as an indicator to employers "of a candidate's soft skills, self-motivation, service ethic and other leadership traits."

Some of this trend is surely good

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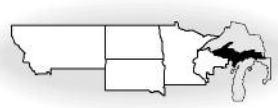
UPPER PENINSULA



Crying wolf—no joke this time, really

The rebound of the gray wolf is one of the big environmental success stories in the Upper Midwest. Just don't tell that to ranchers, hunters and others who have suffered from their growing numbers.

Gray wolves, also referred to as timber wolves, are the largest wild members of the dog family. Because of bounties, it's believed there were only a handful of wolves left in the U.P. by the 1960s. But thanks to federal protection starting in 1974, that population has since rebounded to an estimated 580 across the U.P.'s 15 counties. Wisconsin is believed to have more than 600, based on estimates by the state Department of Natural Resources.

Now environmental groups are fighting the U.S. government over delisting wolves from federal protection. In fact, this might simply be called round three of an environmental cage match for control over wolf populations. Back in 2007, the U.S. Fish and Wildlife Service took the timber wolf off the endangered species list in the western Great Lakes region, which includes the Upper Peninsula, Wisconsin and Minnesota. That put wolf management under state control, and states allowed farmers and others to shoot or trap wolves if they threatened livestock.

But that ruling was overturned a year ago by a federal judge, returning wolves to their federally protected status, which reinstated a no-kill policy except in the case of an attack on humans. Then in May, U.S. Fish and Wildlife again delisted the wolf, but a court-ordered settlement followed in June after a coalition of wolf advocate groups sued in federal court, arguing that the delisting took place without proper notice or public comment.

A 2007 research paper by a Michigan environmental consultant pointed out that despite the protective push from environmentalists, popular support in the U.P. for the wolf population has decreased as wolf numbers have increased—at least as measured by attendance and crowd sentiment at public hearings over time. Maybe ironically, support for wolf recovery has increased among residents of lower Michigan, where wolves have not repopulated.

If current population trajectories continue, it's estimated that wolf numbers may rise to approximately 1,700 animals in the U.P and Wisconsin by 2012.

—Ronald A. Wirtz

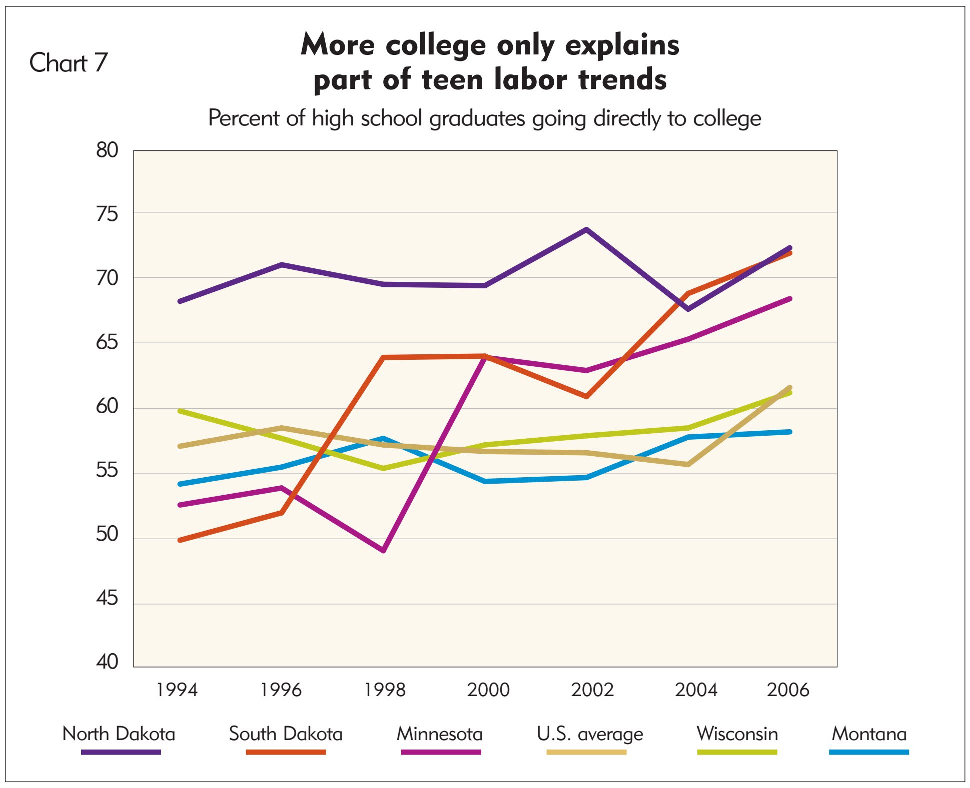
Teen labor from page 9

news, because it suggests that teens are working less, in part, because they can; people are wealthier in general, which removes the financial necessity for teens to work for some households. Research by Shirley Porterfield and Anne Winkler, both of the University of St. Louis, looked at teen employment by household education and found that employment rates for all teens declined from 1995-96 to 2003-04, but rates "declined most precipitously" for teens whose parents were college graduates, which tend to be high-earning households.

But as teens become more involved in nonwork activities, and working less as a consequence, a subtle message is also transmitted to peers about the value of work. Many sources described a situation—before the recession, at least—where teen attitudes toward work had become more and more proscriptive, almost optional if the conditions were not right.

"I think some youth don't want to start on the bottom. They seem more demanding and not satisfied to work hard. There's more of an entitlement," said Aas, from the Fargo Job Service office.

Zavala, from St. Cloud, agreed. "We hear from employers all the time that young workers expect to show up to work today and be supervisors tomorrow, with flexible hours and the pay of supervisors."



Source: National Center for Higher Education Management System

Will work for job

One final factor worth discussing is the demise of federal youth employment programs.

Reforms in the 1998 Workforce Investment Act did away with a focused summer youth employment program by 2000 in favor of year-round programs geared more toward skill and career development. It's estimated that the summer program created 700,000 jobs annually nationwide for youth.

This fits broadly with the accelerated decline in teen labor participation witnessed since 2000, but neither can any dramatic drop be seen that would be expected given the termination of the program. A June report by the Center for Labor Market Studies estimated that ending the summer youth jobs program "can at best only account for 10 percent of the job deficit" that occurred among 16-19 year-olds by 2008, mainly because many federally funded summer jobs covered only part of the summer, and some went to 14-15 and 20-21 year-olds.

The good news for teens—and the organizations that provide them with job services—is that this year's federal stimulus bill resurrected the summer jobs program with an injection of about $1.2 billion, which goes to subsidize jobs mostly in local government and nonprofit organizations, but also some private firms. Public and nonprofit employment agencies in Minnesota received about $15 million expressly targeting summer employment for youth, according to DEED.

These stimulus-funded programs target youth who are both economically disadvantaged and meet at least one at-risk criterion (involving such things as household income, school status and living arrangements). Interest in youth jobs programs has been intense. The Stearns-Benton agency received more than three applications for every spot in its program. In Moorhead, Minn., the local WorkForce Center managed to increase the number of youth placed into subsidized work by 40 percent, yet there was still a waiting list for job-seeking young people, according to team leader Theresa Hazemann.

In Missoula, Mont., "before we could even advertise, we got a hundred applications in a week," said Maggie Driscoll, employment and training director for the Missoula Human Resource Development Council. The organization received a little over $300,000 to put to work between 100 and 120 kids in its three-county region.

Driscoll believes the summer jobs program "has a tremendous impact. I don't know if you can measure the impact, especially in small communities" where jobs are less available. "There's a misconception that any kid can get a job." But summer jobs programs "are about more than just putting kids to work." That's a useful objective, but many kids have to learn what it means to work because "there's not always a good role model at home for a lot of kids," Driscoll said.

Some programs have had difficulty finding appropriate work for teens. In the face of budget cuts, local governments and nonprofits are offering fewer jobs for teens. Private-sector jobs are harder still for programs to come by, despite the wage supplements. Dickinson, of Step-Up in Minneapolis, said the program "has had to work a lot harder and be more creative. … Staff is taking a lot more time to get those jobs." But she added that it's not hard to see why private employers are reluctant. Many companies "are laying off workers at one level" and then being asked to take on young workers. "That's a challenge."

Most agency sources were skeptical that federal funding for the summer jobs program would continue. One source said she was approaching the stimulus funding as "a one-time shot." Driscoll said future funding was "wait and see. I would like it to continue. It's one federal program that gives taxpayers good bang for their buck."

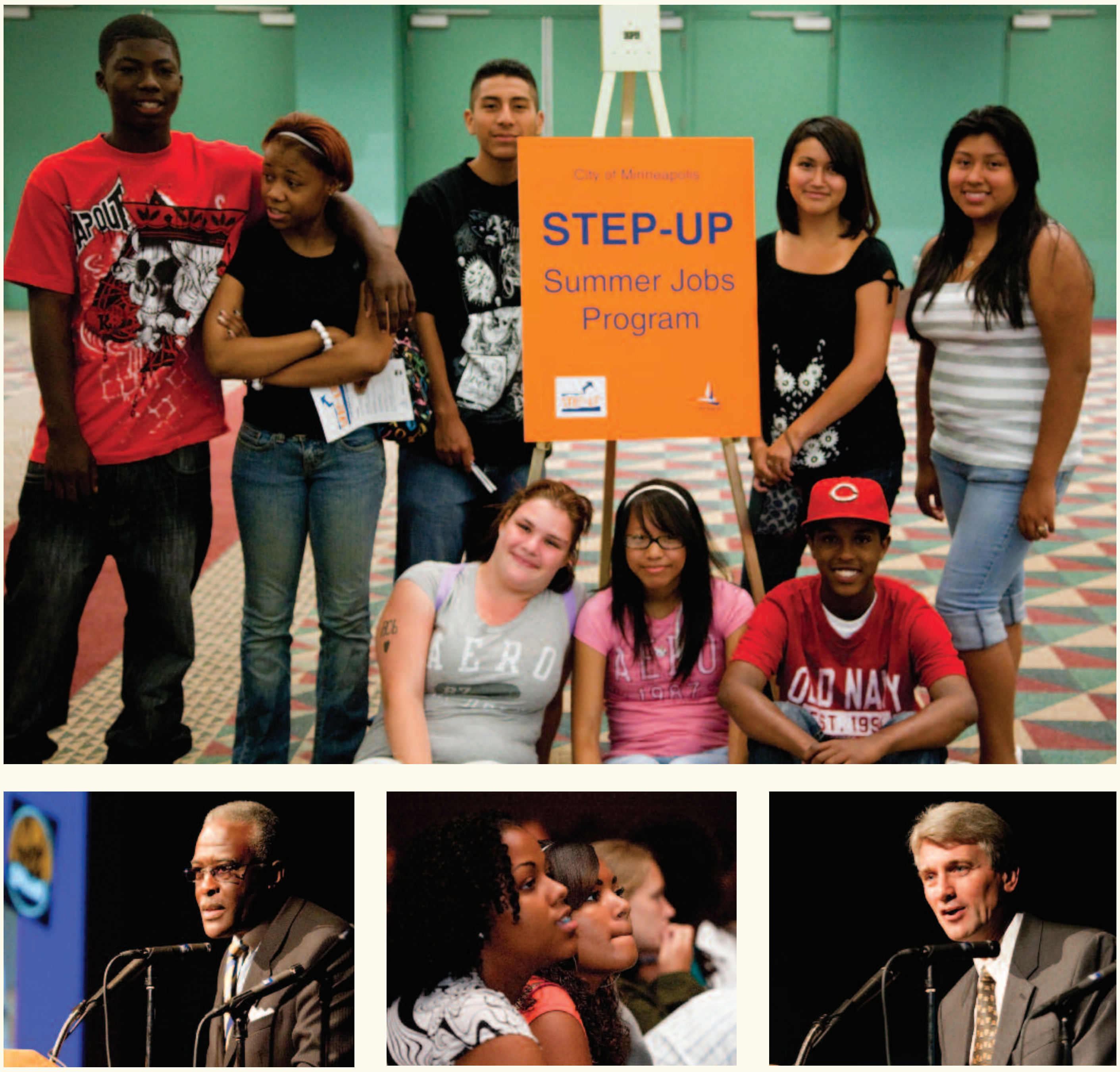
The new cool?

Some might not fret at the lack of teenagers in the workforce. After all, they have their whole lives to work, right?

But there are a lot of reasons to care, or at least pay the matter some attention, according to NU studies and other research. For starters, work at an early age brings insight to interests and potential career paths. Equally important, it familiarizes a person with the nuances of work, establishes work ethic and promotes attachment to work—what researchers call "path dependency." For teen employment, and employment later in life, work this year begets work next year.

The outlook for teen employment is a bit divided. Though unemployment is expected to keep rising in the near term, the general forecast is for economic growth around the corner, and many believe job growth will return in 2010. But job growth coming out of the past two recessions has been slow, and teens will be the last to sip from the job hose.

From a labor supply standpoint, the good news is that teens will have to bat-



PHOTOGRAPHY BY TODD HAFERMANN

Minneapolis teens Step-Up to a jobs program

The 2009 Step-Up summer jobs program held a celebration ceremony in August. Top: program participants; bottom left: Robert Jones, University of Minnesota; bottom middle: audience members; bottom right: Minneapolis Mayor R. T. Rybak.

tle fewer of their peers for available jobs; the number of teens is slowly declining as the millennium generation passes to adulthood. According to the Minnesota State Demographer's Office, the number of high-school-aged youth is projected to fall from 294,000 in 2008 to below 280,000 by 2012.

Then again, the huge baby boom generation is moving toward retirement, and the trend of higher work participation among workers over age 55 appears likely to continue given the carnage many suffered in the stock market over the past 18 months. Only a small fraction of the 76 million boomers would have to stay in the lower half of the wage pool for them to repay teens for all the loud music.

And, of course, there's the wild card: the work ethic of teens. That reputation has taken a beating, something acknowledged even among those who work regularly with teens. But Dickinson and others believe the recession could reverse some of the entitlement attitude, even if temporarily. Dickinson noted that she sees more eagerness toward work among teens now. "The attitude is different when there is competition. … I hear from parents and youth that they'll take whatever you've got," even if it's volunteer work.

"I would like to think that [teens' attitude toward work] has changed," said Gleason, in Mankato. "In this economy, youth are seeing their parents laid off and see the struggles that result. I would think this would change a youth's attitude about work and how important it really is."

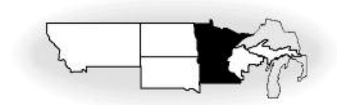
In the survey of applicants to the Step-Up program, one 17-year-old high school graduate said, "My opinion about work has changed due to the recession. It has caused me to value my job more because of work scarcity." When applicants were polled as to what kind of job they were looking for, a half-dozen teens responded with some form of "anything."

Of course, it might be naïve to think any change in teens' attitude toward work would be long lasting—*as if!*—once the economy is back on its feet. Indeed, that likely won't happen unless some of the factors underlying teen labor rates—like returns to education, labor rates of older workers—also change. Unfortunately for teens, the current recession has probably reinforced, not diminished, those trends.

Still, Zavala and others also see some signs of a bootstrap mentality among teen workers. While driving around St. Cloud this summer, she saw a sign to support a local youth car wash. But it wasn't a fundraiser, she said, "It was kids (washing cars) in their driveway. It was the teen version of a lemonade stand." f

Research Assistant Wonho Chung contributed data collection and analysis to this article.

MINNESOTA



This one's for all those with hammers

When it comes to housing, news reports from around the state trumpet something typically heard in a country music ballad: Down so long this feels like up.

For example, six cities in the St. Cloud region issued all of 11 housing permits in May, yet local industry officials said the $8,000 federal tax credit for first-time home buyers was winnowing down the number of houses for sale, a precursor to more building permits.

In the Twin Cities, things got so bad that the industry is celebrating a modest drop in the percentage of distressed (or "lender-mediated") homes, which went from about 60 percent of all home sales to about 40 percent earlier this summer; the total number of such homes on the market in July dropped by 18 percent from a year earlier.

But a dark side might still be lurking. Closed sales of such houses more than doubled over this period, which industry officials also attributed to the tax credit for first-time home buyers. The program likely offers limited demand, but the supply of such homes continues to climb, rising by 9 percent over this period.

Some places do, however, appear to be on the mend. In June, Rochester housing permits returned to levels from a year earlier, and permits for all types of construction rose to their highest level in 13 months.

The hollow sound of vacancy

Housing isn't the only construction or real estate sector suffering through the recession. In the Twin Cities, for example, commercial real estate is on the ropes, grasping for traction as vacancy rates rise.

According to a report this summer by NorthMarq, a real estate brokerage, vacancy rates for retail property owners in the Twin Cities hit a 14-year high, at 9 percent overall and 10.3 percent including subleased space looking for renters. High vacancy rates are hitting normally strong suburban locations as well, including shopping meccas in Minnetonka and Bloomington, according to NorthMarq. At the same time, discount stores and thrift outlets like Goodwill and pawn shops are about the only retail segments seeing growth.

—*Ronald A. Wirtz*

What grows in the Ninth, stays in the Ninth

Community supported agriculture flourishes in the district

By KATHY COBB
Contributing Writer

JOE MAHON
Staff Writer

The past few decades have seen an explosion of imported, perishable food—apples from China, kiwi from New Zealand, grapes from Chile and many other foods from faraway lands. But recently, the pendulum has been swinging the other way. You might say that food is trying to become more like politics—with all the important stuff being local.

Avocados don't grow in Aberdeen, nor mangoes in Minneapolis, but what does grow in the Ninth District is increasingly sought by consumers, and growers are responding with new, expanded methods for delivering locally grown produce and other foods to customers.

One fast-growing piece of the local-food movement is community supported agriculture (CSA), where local farmers grow, harvest and often deliver fresh produce and other foods to members who buy annual "shares" in the operation's output. Not so long ago, growing your own food and sharing it with neighbors seemed to be the province of rural communes and backyard gardens. But available data and sundry anecdotes suggest that CSAs in some areas are drawing more members than farmers can handle.

Redesigned model

The local-food trend has a lot of green shoots. Probably the most visible is the rising number of farmers markets throughout the district (see the September 2008 *fedgazette* at minneapolisfed.org). But other outlets have developed to expand the frequency of local food reaching your dinner plate because consumers are demanding it. Packaged Facts, a market research firm, reported that consumer demand for locally grown products hit nearly $5 billion in 2007 "and could rise to as much as $7 billion a year by 2012."

That's why supermarkets and even Wal-Mart tout seasonal, locally grown produce. Trendy restaurants often list the sources of the food on their menus, and distribution networks are sprouting up to channel locally grown and raised products to retail and institutional markets. According to the National Restaurant Association's 2009 industry forecast, chefs reported that use of local produce is the biggest trend. The association's research showed that nine of every 10 fine-dining establishments already serve locally sourced items, and they expect continued growth. The association also found that about three of 10 fast-food businesses serve locally sourced items now, and nearly half of the respondents believe these items will continue to grow more popular.

Government has also been trying to encourage the trend in locally grown foods. The state of Wisconsin provided $225,000 in grants last year to seven projects, including a 200-member farm produce co-op to expand sales through a partnership with the Institutional Food Market Coalition of Dane County and a program to connect restaurants and food service operations with local farmers. The goal of the program is to increase local-food sales, with the

PHOTOGRAPHY BY MARC NORBERG

Phil Hannay, with his wife, Kathy Kubal, have operated Trumpeter Swan Farm in Buffalo, Minn., for eight years. In their second year as a CSA, they filled their subscription quota and turned down other requests. Hannay is seen here in a high tunnel, which extends the growing season by a couple of months.

implied purpose of expanding the state's economy. And if the state had $3 million more to share, there were 87 other applicants standing in line.

But the local-food trend doesn't get any more grass-roots—literally and figuratively—than in the hundreds of CSAs popping up across the Ninth District. A fairly young movement, CSAs were introduced in the United States in the mid-1980s, brought to Massachusetts originally by a Swiss farmer inspired by similar operations in other countries. The basic idea of a CSA is to create a consistent market for farmers and a consistent supply of fresh produce for consumers.

Here's the way it works. The farmer sells "shares" in farm products, guaranteeing weekly delivery of a variety of items over the growing season; in the Ninth District that usually means from April through October. Generally, farmers offer a mix of products, though if one crop fails and another is overly abundant, shareholder members could end up with lots of squash and meager offerings of other produce for the week's delivery. But that's the idea; the community bears the natural risks associated with farming.

A share will typically run from $300 to $700, with some farms selling half shares. A share gives the member about a bushel basket of produce each week. The cost of shares depends on the farmer's operational costs and other variables like the length of growing season, selection of crops grown and what the soil can bear.

Erin Barnett, director of Local Harvest, a national CSA support network, said that CSAs provide a measure of economic security for farmers, who, by marketing their crops to subscribers during the off-season, develop a known customer base for those crops before they're planted. Barnett said CSAs are a big part of making small-scale farming viable in the 21st century.

Data farming

Data and other research on CSAs are not particularly robust, which means that gauging the size and spread of the CSA movement can be tricky. CSA operators and suppliers to farmers markets and other food outlets typically operate smaller farms; many of them adhere to organic growing guidelines and supplement their income with other employment.

In a 2002 survey of Upper Midwest CSA operators, the Leopold Center for Sustainable Agriculture at Iowa State University found that the typical CSA farmer in the region (including Michigan, Minnesota, North Dakota and Wisconsin) was 45 years old, had 14 years of farming experience and was likely to be a college graduate. Half the respondents had an off-farm job, but also farmed at least 20 percent of the time. The 2007 Census of Agriculture also shows growth in small farm operations—a reversal of a decades-long trend—many of them run by part-time farmers with other jobs. (See the May 2009 *fedgazette* for more on the 2007 Census.)

Nancy Welty, owner of Culinary Delights Farm in Big Lake, Minn., fits the Leopold Center's profile. She is in her third year of full-time CSA farming after 25 years of working in corporate finance. Welty sells 100 shares each year at $550 a full share or $375 a half share and offers 15 pickup sites to her members, many of whom are her husband's co-workers at a suburban Twin Cities company. She, like most CSA farmers, also has an agreement with subscribers that they share in any crop failure. She grows her produce using sustainable methods and said she needs to educate members that as a result they may not get the big, picture-perfect produce found in grocery stores, but the flavors will be fuller.

Jonda Crosby, executive director of the Alternative Energy Resources Organization (AERO) in Helena, Mont., said there's been "a huge influx of under-35 farmers flooding to the land." Anecdotal evidence suggests that many younger farmers are often choosing a local-food approach, including CSAs.

But the number and growth trajectory of CSAs are difficult to pin down. For starters, CSA numbers are fluid, with farmers going to the CSA model if they have enough subscribers or choosing to market their products another way if the subscription process doesn't work for them. According to a report by the Leopold Center, 30 percent to 40 percent member attrition each year is not unusual, as many members decide that the volume and variety of produce is more than they need. That means farmers might be in and out of a CSA from year to year.

Figures from a variety of sources vary quite significantly. For example, the 2007 Census of Agriculture reports about 12,500 CSA farms, but that includes all farms producing for a CSA program, since some CSAs might involve multiple farms.

The numbers offered by national directories and state groups are somewhat smaller. For example, the U.S. Department of Agriculture (USDA) Marketing Service estimates that CSAs grew from just 60 operations in 1990 to approximately 1,150 operations by early 2007. Numbers tracked by national groups connected to the CSA movement are closer to those of the Marketing Service and also confirm that upward trend.

Local Harvest's CSA directory grew from 374 listings at the end of 2000 to 1,046 by 2005, according to Barnett. By the end of last year, the directory had 2,128 listings.

Chris Mayer, program manager at the Robyn Van En Center, a national resource center for CSAs, said that its CSA directory has grown by 13 percent since 2006.

In the Ninth District, numbers vary. Wisconsin and Minnesota show the most CSAs in the Local Harvest directory at 137 and 84, respectively. In the Twin Cities area alone, the number of CSAs grew from 32 to 43 in the past year, according to Brian De Vore, spokesperson for the Land Stewardship Project in Minnesota.

But listing in any directory is voluntary, and many CSAs find subscribers via word-of-mouth and through community advertising. That's probably why there are 14 Montana CSAs listed in Local Harvest, while Crosby put the number at somewhere between 40 and 50. And according to Crosby, that's still not enough to satisfy the demand. She said that CSAs in Montana generally have waiting lists for subscribers. North and South Dakota both list fewer than 10 CSAs, but the real numbers are likely higher, particularly given agriculture's presence in both states.

While CSAs have grown mostly around metro areas, Terry Vanderpol, who directs community-based food systems in Montevideo, Minn., for the Land Stewardship Project, said they are moving increasingly to rural areas. She noted two near Montevideo that sell local shares. One couple built a solar greenhouse and offers winter crops of greens and broccoli.

And it's not just individuals operating CSA farms. Mayer from the Van En Center said the center often receives calls from municipalities interested in leasing vacant city properties to CSA operators; others want to use land trusts and other similar land sitting idle.

A fork in the road

The growing CSA movement is likely both a driver and a benefactor of a broader push for locally grown foods. In addition to homes, supermarkets and restaurants clamoring for local-food products, hospitals, schools and company cafeterias throughout the district are expressing greater interest in using locally grown items. And to do so, new business and distribution models—even legislation—are often needed to allow institutions to change their purchasing methods so that contract food vendors and local-food producers can operate side by side.

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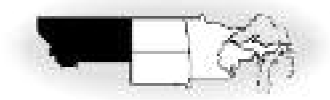
MONTANA



Logs, with strings attached

The state's timber industry has complained for years about diminishing wood supplies from national forests, the result of objections to logging by environmental groups, tight U.S. Forest Service budgets and other factors. U.S. Sen. Jon Tester has a controversial plan to provide Montana timber companies with more logs while improving the overall quality of forestland.

Tester's proposal, dubbed the forest jobs and stewardship bill, would create a new kind of working relationship between the Forest Service and timber companies. To ensure that timber firms get the logs they say they need to stay in business, loggers would be allowed to harvest at least 10,000 acres annually for 10 years in two national forests within the state. Cutting would target stands of trees killed or weakened by a severe outbreak of pine-bark beetles. But in return for the right to log, timber companies would be required to carry out restoration work, such as fixing culverts and cleaning up after wildfires.

In addition, the bill would set aside 677,000 acres of Montana wilderness and create a new national recreation area in southwestern Montana.

Environmental and outdoors organizations as well as timber firms helped draft the bill. But other groups such as the Alliance for the Wild Rockies have blasted it, saying that it would lead to excessive logging, endangering habitat for elk, grizzly bears and fish.

Base Living Inc.

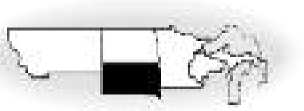
Under a U.S. Air Force plan to privatize its housing, military families would no longer live rent-free at Malmstrom Air Force Base near Great Falls. The Air Force has proposed turning over the construction, renovation and demolition of base housing to a private developer by October 2010.

Recognizing that private developers could furnish base accommodations more efficiently than the government, the Defense Department began entering into housing contracts in 1996. Currently more than two-thirds of family housing units at air bases in the continental United States are run by private landlords. Military families receive a basic housing allowance that they use to pay rent.

At Malmstrom the Air Force would award a 50-year contract to a single developer, who would also build, operate and maintain housing at bases in Wyoming and Missouri.

—*Phil Davies*

SOUTH DAKOTA



State sales tax: Running on empty?

The performance of taxable sales in South Dakota during the last fiscal year is a classic case of half-full or half-empty analysis.

The state's economy has been performing well for several years running and has treaded water better than most during the recession. Taxable sales in Sioux Falls and Rapid City grew in the 3 percent to 5 percent range annually in fiscal years 2007 and 2008. Some of the state's other larger cities saw even higher growth, particularly in 2008, like Aberdeen's 10 percent growth.

Fiscal year 2009 closed at the end of June, and the state managed to eke out a 1.8 percent gain in taxable sales for the year. Surprisingly, it managed to do so despite the fact that Sioux Falls saw a 1.8 percent drop in taxable sales, and Rapid City clocked growth of just 0.3 percent. Growth came from counties like Beadle, Brown, Brookings, Davison and Hughes—all counties with at least $250 million in taxable sales and growth of 4 percent or more in the last fiscal year.

Scratching out another gain this year might be tough. May and June totals showed a decline of more than 5 percent statewide compared with a year earlier, with Rapid City and Sioux Falls—which make up about 38 percent of all taxable sales—seeing accelerated declines as well.

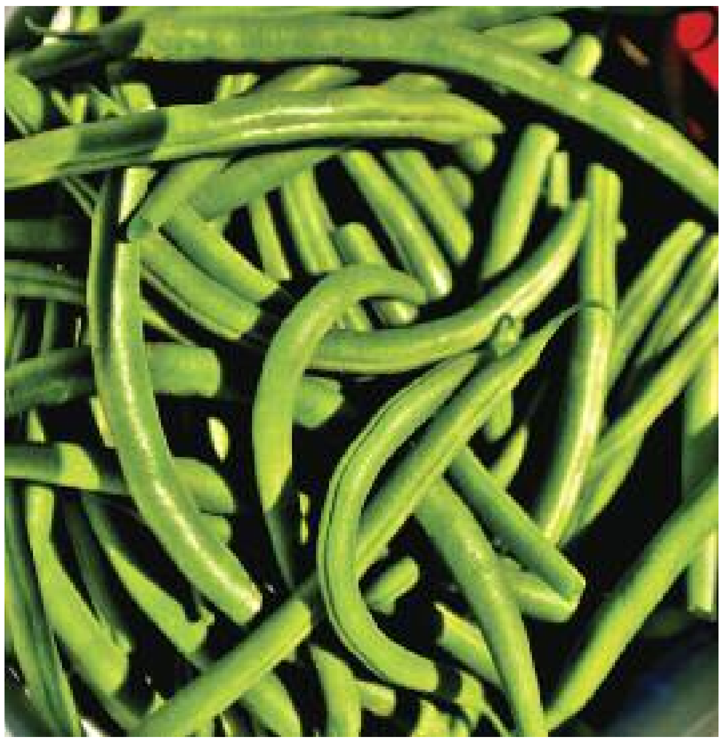
A bumpy road for transportation

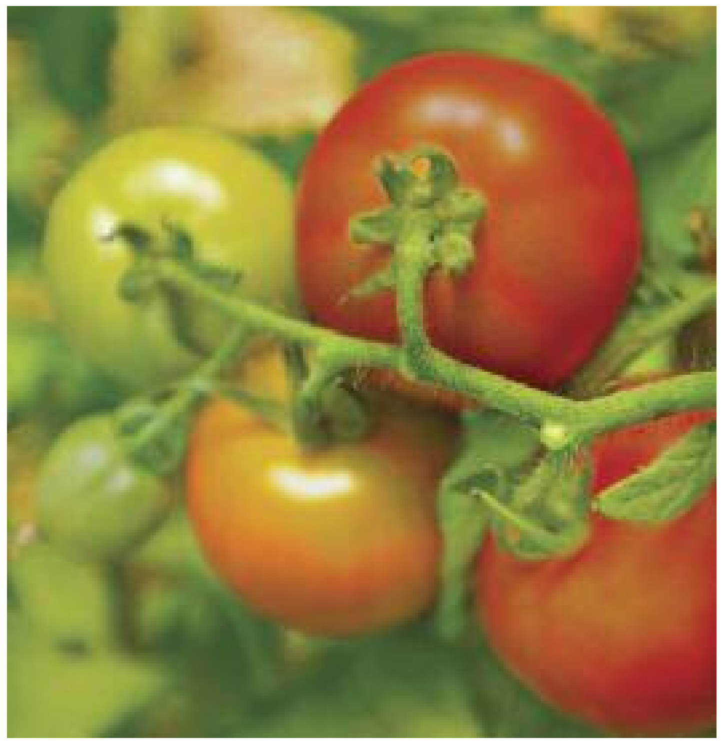
How do you like your roads: bumpy and cheap, or smooth and not so cheap?

A report this year from the South Dakota Department of Transportation showed that the state managed to improve the overall condition of its highways from 1998 to 2008, though it fell short of its improvement goals. The bad news is that the state is on a slippery funding slope, with an annual shortfall of $81 million for meeting local road and bridge needs going forward. Other news sources put the statewide figure at about $90 million.

The problem: Gas tax revenue has been flat because people are driving less with higher gas prices and a slumping economy, yet highway construction costs have increased significantly. A legislative committee has been charged with developing a strategy for addressing the funding gap and is due to report in October.

—Ronald A. Wirtz





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For example, it's typically very difficult for small growers to sell to institutions because food purchase contracts with large vendors often limit outside purchases, said James Barnham, an economist with the USDA's Marketing Services Division. But he added that more state policies are making it easier for school districts and other institutions to buy local produce.

Montana's Crosby was part of a group supporting local-food markets that developed legislation to change food procurement laws to allow state institutions to purchase Montana-grown and raised products, even if the seller doesn't have the lowest bid. The law, now in effect, allows the institutions to pay more for local products as long as they stay within budget.

Public institutions in Montana purchase about $33 million worth of food annually, Crosby said, and prior to the new law only 6 percent (about $2 million) of the products came from Montana farms and ranches. The University of Montana was one of the first vendors to take advantage of the new law and has bought $3 million worth of Montana products for its cafeteria system, up from $100,000 in 2004. Montana State University started its program three years ago and now purchases 15 percent of its food from Montana. According to Crosby, buyers have also discovered that while they may pay more for products initially, they are getting better quality, such as leaner meat, and products have a longer shelf life because they arrive fresh.

A number of Minnesota colleges buy local when they can. St. Olaf College and Carleton College in Northfield and the University of Minnesota campus in Morris, in the southwestern part of the state, all look for local products, said JoAnne Berkenkamp, program director for local foods at the Institute for Agriculture and Trade Policy (IATP), a research and advocacy group in Minneapolis. Since 2003, the Morris campus, for example, has replaced national wholesale purchases to the extent possible with locally grown foods. By 2009, those local purchases could reach $500,000.

The National Farm to School program, a nonprofit organization dedicated to connecting local farm producers with school districts, is active in 41 states and about 8,850 schools. All district states are enrolled, except North and South Dakota. Minnesota has the highest participation rate in the district with 130 schools, including the Minneapolis and St. Paul school districts. Although the Dakotas aren't involved with the national program, some schools do work local products into their food services. For example, in Fargo and Grand Forks, N.D., school gardens supply produce to some schools, with the help of 4H and Future Farmers activities.

Edward Christensen is the assistant supervisor of food and nutrition services for the Missoula, Mont., public school system, which includes 12 elementary and four high schools and is a member of the Farm to School program. Schools began touting local products in 2005 with meal events, using Montana-grown beef, cheeses, carrots and honey, for example. Christensen said the biggest challenge is that with 3,200 children to feed daily, guaranteeing volumes of local products is hard. "I want to purchase as much as I can here," he said. Christensen has been putting money where his locally grown mouth is: The volume purchased by food service rose from about 18,000 pounds in the 2006-07 school year to about 45,000 pounds in the 2008-09 school year. Christensen also said he'd like to see the USDA loosen its rules around entitlement program dollars to allow schools to purchase local commodities.

Food deserts; oases needed

But for all the hoopla around growing local products and creating healthier communities, the movement continues to face obstacles, particularly in the Catch-22 of consumers recognizing the benefits of fresh produce and needing wider market access to such goods. AERO's Crosby, for example, described parts of Montana as a "food desert"—rural areas that don't have easy access to much more than convenience stores loaded with processed foods. These areas offer opportunities for small farmers and CSAs.

Minnesota's Vanderpol echoed Crosby's concern. She lives in a town with one stoplight and needs to go 30 miles to find fresh produce and meats. "It's a food desert with a direct impact on public health for those who don't have access to fresh produce and healthy foods," Vanderpol said.

So while there are some bumps in the locally grown road, the movement continues to expand, and farmers in the district can benefit. "We're still trying to see the bad news in this. We've got fresher [food] and a higher flavor profile," Missoula's Christensen said.

Forest products taken to the woodshed

The housing slump has had a big impact on the industry that provides building materials

By WONHO CHUNG
Research Assistant

Earlier this year, Ainsworth Lumber Co. Ltd., a leading Canadian forest products company, announced the permanent closing of mills in Cook and Bemidji in northern Minnesota. The mills produced oriented strand board (OSB), a structural wood panel used as sheathing in walls, floors and roofs for residential and commercial construction. The company had already closed its mill in Grand Rapids the previous August.

Company president and CEO Rick Huff, in a press release, said that market conditions since the third quarter of last year and the housing outlook going forward, especially in the United States, "do not warrant making the additional investments that would be required to make the two mills economically viable."

The news for other wood products businesses was equally bad elsewhere in the Ninth District. In a Montana survey of the sector this year by the Bureau of Business and Economic Research (BBER) at the University of Montana, two-thirds of executives indicated that production, sales and profits in 2008 had decreased from a year earlier. Another 20 percent said business was about the same, leaving only a sliver of respondents whose businesses grew last year.

The forest products industry is not a big one compared with other major industries at the national level, representing just 1 percent of gross domestic product. But the industry is relatively more important in the Ninth District, cumulatively representing 2 percent of gross state product across district states (not including Michigan). The industry provided $9 billion in total output in the district in 2007 and 120,500 jobs as of April 2009, the latest government figures for both measures.

But throughout the district and country, companies in the forest products industry are struggling to keep chainsaws buzzing and sawmills open, mostly because of the downturn in housing. The forest products industry is categorically composed of two sectors—wood products and paper—and is regionally concentrated in the district in northern Wisconsin, the Upper Peninsula of Michigan, northeastern Minnesota and western Montana.

Both sectors are strained, but for different reasons. The wood products industry—the focus of this article—includes logging, sawmills, millwork, wood containers and wood buildings and is highly dependent on the housing market, which is suffering a severe contraction.

The smaller paper industry, which accounts for about 30 percent of all wood harvested in the United States, has been consolidating for years as it tries to come to grips with production overcapacity. The district also has a big presence in this sector; Wisconsin has been the top pulp and paper producer in the United States for more than 50 years, but the industry continues to struggle. Ohio-based NewPage Corp., which has four paper plants in central Wisconsin, reported a 39 percent drop in sales in the first quarter of this year and said it would reduce production by 150,000 tons by taking downtime at its mills during the second quarter.

Crumbling castles

It's no secret that a key factor for the wood products industry is the housing market. Home construction traditionally accounts for more than 50 percent of all lumber and manufactured wood products in the United States each year. Housing units authorized, a key market indicator, peaked in 2005 and began decreasing for both the United States and the Ninth District. From April 2005 to April 2009, housing units authorized in both the United States and the district decreased by about three-quarters (see Charts 1-2).

That trend, in turn, unleashed a cascade through the wood products industry: Demand for wood products in the construction of new homes dropped, which led to decreases in prices for wood products. North American demand for both lumber and OSB was down over 60 percent from respective peaks in 2005. The nationwide composite lumber price, which is designed as a broad measure of price movement in the lumber market, decreased almost 50 percent—from $386 to $198—from May 2005 to May 2009. Price declines appeared to be fairly uniform; for example, both the nationwide composite and the north central prices for OSB dropped by 50 percent over this period (see Chart 3). Prices received by many producers in the north-central region (which includes Michigan, Minnesota and Wisconsin) also are often lower to boot. For example, the OSB price in the north-central region maintained a 15 percent to 20 percent discount of the national price during both the boom and the subsequent decline.

The dual drop in demand and prices has translated into a large drop in sales for many wood products companies. For example, U.S. and Canadian structured wood panel production totaled 5.4 billion square feet in the first quarter, 14 percent below the fourth quarter of 2008 and 33 percent below the first quarter of 2008, according to the latest Engineered Wood Association quarterly production report.

Though recent statewide data for wood products sales are not available, sales among a few major firms in the district show a sharp drop. Norcraft Cos., based in Eagan, Minn., manufactures cabinetry and other wood products and is the largest wood products manufacturing company headquartered in the district. The company saw a 30 percent drop in revenue (to about $61 million) during the first quarter of this year from one year ago and a 44 percent drop from the first quarter 2006, when the district housing boom was in full swing. The company also reported a $4.3 million loss in the first quarter.

Many other multinational forest products corporations with operations in the district are also struggling. Louisiana Pacific, a leading manufacturer of basic building products, has siding plants in Hayward and Tomahawk, both in northern Wisconsin. Those plants reported a 41 percent drop in sales in the first quarter of 2009 compared with the previous year.

With lower sales, wood products companies have cut production, leading to layoffs across the industry. From April 2005 to April 2009, the number of employees in the wood products industry in both the United States and the Ninth District has dropped about 30 percent (see Charts 1-2).

Plum Creek Timber Co., the largest private timber owner in the United States, has its largest acreage in Montana, and additional timberland and operations in Wisconsin. The company, based in Seattle, Wash., provides a diverse line of lumber, plywood, medium-density fiberboard and raw materials. Due largely to the housing slump, the company reported losses from the wood manufacturing business of $30 million in 2008 and $18 million in the first quarter of this year.

The company has responded with a series of layoffs at Montana plants this

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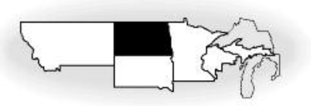
NORTH DAKOTA



Bismarck Island

In today's economic gloom, Bismarck is a beacon of light. So says an index by Moody's economy.com.

The site classifies the economic status of 381 metro areas based on six-month growth figures. Every metro in the country—save one—is classified as in recession. The loner is Bismarck, which has been helped by rebounding energy prices in the nearby Williston Basin, not only helping private activity in that part of the state, but also propping up tax revenue at the state capital.

Bismarck is close to losing its special status; the online site lists the city as "at risk" for falling into recession and notes that slowing growth of personal income might pull the city into an official contraction, but one that would not likely be very deep, or prolonged.

A sunny day for farm insurance

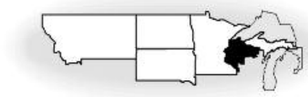
The federal government has long been involved in providing insurance to farmers to help them when Mother Nature doesn't cooperate.

For example, in June the insurance program for sunflower farmers was expanded by the federal Risk Management Agency to include guarantees for both seed yields and prices, the latter being particularly relevant because prices have fallen considerably in the past year. The other half of the story is that prices spiked in 2007 and 2008, rising to about $22 per hundred pounds, and remained above average over the past decade, according to data from the U.S. Department of Agriculture. All of this bodes well for growers in North Dakota, the nation's leader in sunflower production.

State farmers are also hoping for better government-subsidized insurance policies for hay and rangeland. The current program for forage insurance began in 2007 to help livestock farmers deal with drought. It uses either a rainfall or vegetation index—but not both—to determine when losses occur. North Dakota uses a rainfall index, and the state's ag secretary petitioned the RMA to give farmers there access to the vegetation index as well because the state has a limited number of rainfall reporting stations, which can skew local rainfall results—hypothetically, at least. According to an Associated Press report, the program paid out on 85 percent of policies in its first two years without the vegetation index.

—Ronald A. Wirtz

WISCONSIN



Dropping all the way to #1

Wisconsin recently became the nation's number one state for manufacturing, but it might be forgiven for not feeling very celebratory because it assumed the throne somewhat by default.

According to federal data, 15.6 percent of the state's workers are employed in manufacturing—just a shade over the 15.4 percent rate for Indiana, the former champion. Wisconsin grabbed the top spot despite shedding more than 61,000 manufacturing jobs—almost 13 percent of all jobs in the sector—from the most recent May-to-May period.

That job loss cut manufacturing's share of jobs down from 17 percent, but demonstrates the job devastation in the Hoosier state, where manufacturing once enjoyed a rate of 17.8 percent.

Go ahead, hit me

Drivers in Wisconsin might feel both better protected and poorer next summer, when a new state law goes into effect mandating car insurance for all residents.

Starting in June of next year, it will be a crime for state drivers to go without car insurance, complete with a $500 fine. However, some might be willing to roll the dice, as the only enforcement mechanism is a check by police during a traffic violation. Drivers will be expected to carry proof of insurance; a small fine of $10 will be doled out for those who have insurance but no proof. The law doesn't yet specify how exactly police will be able to determine who has insurance but isn't carrying it and who is simply lying. Drivers will also be required to carry underinsured motorist coverage.

The new law might feel like a drastic step, but Wisconsin is simply catching up: 48 other states currently mandate car insurance. New Hampshire is now the lone holdout.

Critics argue the new law hurts low-income drivers, who can't afford the hundreds of dollars in new insurance and are likely to continue doing without. Ironically, the law might do little to provide universal insurance protection. In 2007, 15 percent of drivers in Wisconsin were uninsured, according to the Insurance Research Council. That was only a shade less than the 13.8 percent for those states with mandatory insurance laws.

—Ronald A. Wirtz

Wood products from page 15

year. In March, for example, the company permanently shuttered a plant in Fortine, affecting 74 workers; in June, a total of 150 people were laid off when mills closed at Pablo and Kalispell, and another 23 were laid off in Columbia Falls when operations there were scaled back.

Wood products companies have tried to diversify into new markets to dilute their risk in any one sector. Some large companies produce paper and allied products in addition to housing-related wood products. Some, like Plum Creek, have started to leverage their forest and other land holdings for revenue through real estate development, tourism or other activities. Still other companies are doing research into biomass applications for wood products and byproducts. Logging companies are also looking at different types of end users for their forest products.

But none of these markets is large or lucrative enough currently to overcome the impact of the housing slump. For example, most of Montana's industry executives are pessimistic about 2009, based on the BBER survey. More than 90 percent anticipate that production, prices and sales will be about the same or worse in 2009 compared with 2008.

In Minnesota, total industrial wood consumption (defined as in-state harvest plus imports minus wood exports) is expected to hit bottom at approximately 2.8 million cords this year, according to a report by Don Deckard, state forest economist at the Minnesota Department of Natural Resources. This compares with 3 million cords in 2008 and a peak of 4.3 million cords in 2005.

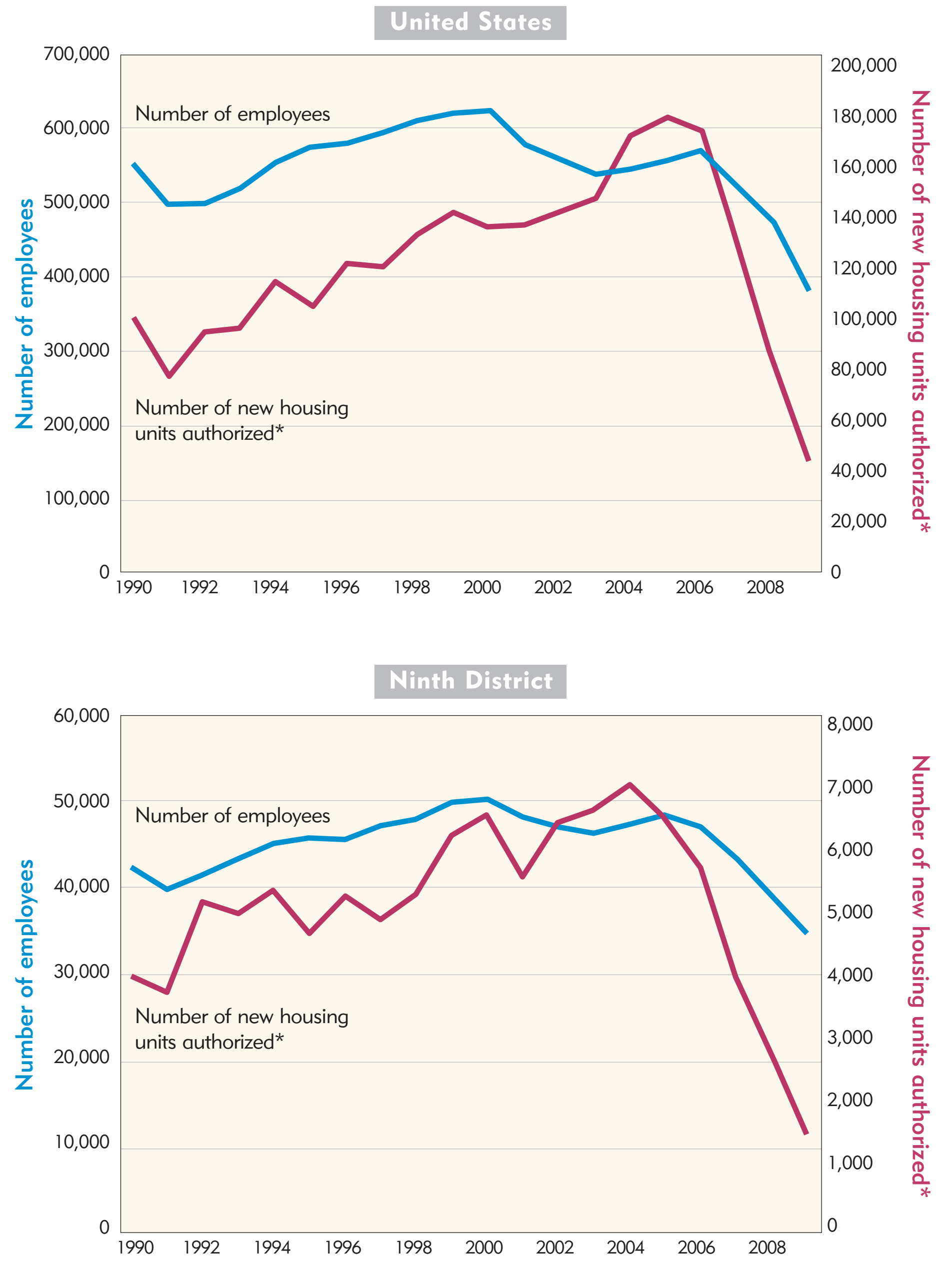
This industry will be largely tethered to the pace of recovery in the housing market. In general, though the rate of decline has slowed, housing market indexes do not yet show clear evidence that housing markets have bottomed out. The decline in monthly and quarterly housing units authorized from a year earlier in the Ninth District and United States has held relatively steady since January; worse, the trend line on housing authorizations (see Charts 1-2), combined with expected economic conditions in the near term, does not suggest a quick reversal.

The latest projections for housing unit authorizations by the Minneapolis Fed predict continued decreases from most district states through the fourth quarter of this year. (For more forecast details, go to minneapolisfed.org.)

The good news is that the forecast calls for a strong recovery of at least 15 percent among all district states in 2010. The bad news: Authorizations in district states next year will still be 30 percent to 65 percent below peak levels of the housing boom. So despite the expected upturn next year, many firms in the wood products industry will have to work hard to avoid the woodshed. f

Charts 1-2 **Wood products employment follows housing slump**

Industry employment and housing units authorized (Month of April)

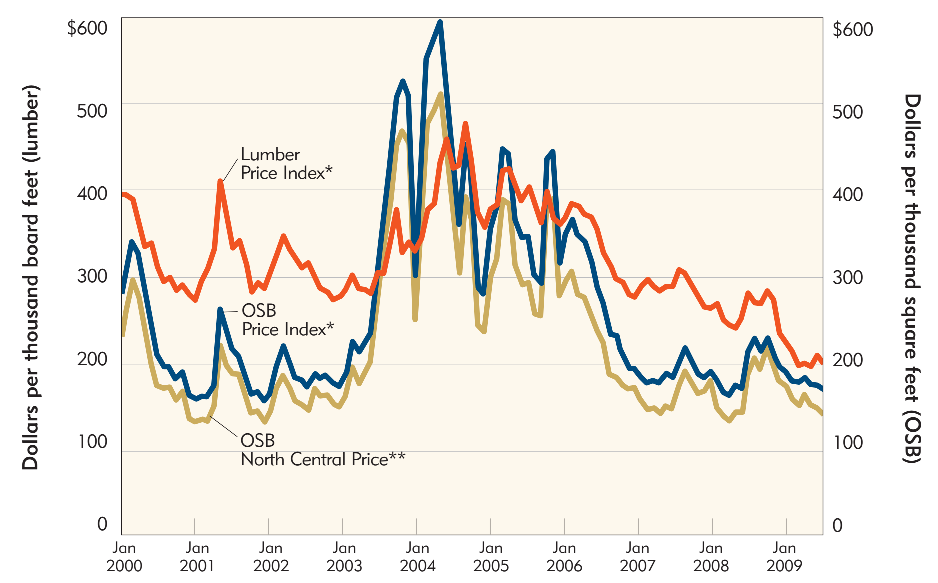


* Three-month average ended in April, not seasonally adjusted

Sources: Bureau of Labor Statistics; U.S. Census Bureau

Chart 3 **Wood products prices are falling**

Lumber and oriented strand board



*National composite price indexes **North central region 7/16" prices net f.o.b. mills

Source: Randon Lengths Publications

Remote sellers: The tax man cometh?

State-led initiative to tax remote sales slowly gaining momentum

By MADELINE CHRISTENSEN
fedgazette Intern

In the not-so-distant past, consumers had no choice but to travel to the grocery store when they wanted food, trek to the mall when they needed clothes and, if necessary, journey across three suburbs to find that perfect holiday gift. Thanks to myriad Internet sellers hawking more goods than a shopper could possibly find under any single roof, these things now can be bought from the safety and comfort of a swivel chair.

But what's good for shoppers is a complicated tax mess and revenue loss for states. Remote sellers—like Internet sites and catalogs—do not have to pay taxes to states where they are not physically located. In two cases, *Bellas Hess v. Illinois* in 1967 and *Quill Corp. v. North Dakota* in 1992, the Supreme Court ruled that the complications of the tax system created too great a burden for sellers to pay taxes to states where they do not have a physical presence, be they catalog companies or Amazon.com. The rulings have translated into sizable revenue losses for states. A study by the University of Tennessee estimates that Minnesota, North Dakota, South Dakota and Wisconsin will collectively lose $258 million in revenue from untaxed e-commerce sales in 2009 alone.

To address the loss of revenue from e-commerce and other remote sellers, states have created the Streamlined Sales and Use Tax Agreement. The idea behind the agreement is to simplify the sales tax system enough so that out-of-state sellers pay the appropriate state sales tax.

The SSTA effectively harmonizes states' sales tax systems in order to "simplify and modernize sales and use tax administration in order to substantially reduce the burden of tax compliance," according to the initiative's governing board. That doesn't mean that e-businesses or other remote sellers are stuffing state coffers with new tax revenue—indeed, new collections have been exceedingly modest, mostly because such tax charges are still considered voluntary. But the initiative has higher hopes of convincing Congress to pass legislation allowing states to mandate sales tax payments from remote sellers and buyers if one of the parties resides inside state borders.

Along with Internet and catalog sales, the SSTA also works to secure collections from other sellers that do not collect taxes despite a physical presence. For example, some traveling salespeople and installation companies doing business across state lines are notorious shirkers of sales taxes, according to Scott Peterson, executive director of the Streamlined Sales Tax Governing Board. Unlike remote sellers, these businesses are already legally required to collect sales tax, but enforcement is difficult. "There's all kinds of people out there who aren't collecting tax," Peterson said.

Member states of the SSTA hope to eventually see federal legislation that mandates tax collection by Internet and other remote sellers. But the SSTA did not originally form with the intention of coercing such businesses into paying taxes. Rather, the agreement germinated from the hypothesis that states could catch more tax revenue with honey than with vinegar.

"It was kind of an, 'If you build it, they will come' mentality. This was a 'field of dreams' concept when we started," Peterson said. "The Supreme Court said that the system was too complicated to let states require other state retailers to collect, and for years businesspeople have said, 'You've got all these different things that make it complicated.' So our thought in the beginning was, 'Let's take them at their word and address their issues and see whether or not there's anybody who starts collecting.'" In time, the SSTA took up the cause of getting the legislation adopted, a cause that other groups had already begun.

So far, 22 states have adopted the agreement. Michigan, Minnesota, North Dakota and South Dakota are full members of the SSTA. These states were part of the original few that have been on board since Oct. 1, 2005. Wisconsin is an associate member until Oct. 1, 2009, when it will become a full member, which means that it is in compliance with all components of the agreement.

When companies sign up through the SSTA's central registration, they are then required to collect taxes for transactions with buyers in member states, according to Myles Vosberg, division director for sales income and special taxes at the North Dakota Department of Revenue. In order to become full members, states must adopt a number of simplification measures, including administering taxes at the state level only and adopting standardized definitions.

Minnesota was one of the first four states to adopt the full agreement, signing on in 2002, before the agreement was formalized. Larry Wilkie, assistant commissioner for business taxes at the Minnesota Department of Revenue, said that joining early brought both challenges and benefits. Joining early meant that Minnesota had to adjust some of its own statutes to suit the needs of states joining later that wanted changes in the stipulations of the agreement. But becoming a member early also brought its perks. Wilkie believes that it gave Minnesota leverage over the points of the agreement itself. Being an early adopter, "we had more of a say in how the agreement was crafted and some influence in deciding how it should be administered," he said.

Besides the bump in tax revenue, states had a variety of motivations when they signed on. Member states wanted to remove unnecessary complications for retailers. "We just thought it was a good idea to try to be more uniform with the other states, and it was a good service to the retailers to try to reduce the burden as much as we could to make it easier to collect," said Vosberg. "In the long run it's going to be advantageous to the state as well because … as we make it simpler … it should increase revenues for us as well." States also wanted to be fair to local businesses. "It's really a fairness issue. … It puts the local businesses at a competitive disadvantage because they need to collect that tax," Vosberg said.

States get some revenue now from the 1,163 companies that have essentially volunteered to pay taxes to SSTA member states. "That's tiny," Peterson said. "We're just barely scratching the surface." Though the identities of the companies are confidential, Peterson said that the businesses span a wide variety of sizes and industries. "Most of the companies on the list are small to medium-sized companies. … A couple are quite large and names you would recognize," he said. "There's a pretty wide variety—hardware companies, telecommunications companies, medical supply companies, sporting goods companies—a pretty good cross section of commerce other than … heavy equipment or cars or things like that."

Peterson added that businesses generally did not agree to pay more taxes out of purely altruistic motives, often joining instead to secure an amnesty from past unpaid taxes. "The majority of people we consider to be volunteers; they don't consider themselves to be volunteers," explained Peterson. "They came in because of an amnesty, and the deal we made with them was, 'If you want to come in and take advantage of Minnesota's (tax) amnesty, you have to collect for South Dakota.'"

The SSTA taxes paid to states are growing, but very modestly. Minnesota currently receives the most SSTA revenue in the district, collecting $11 million in 2008—a nice jump from the $1.5 million in 2006, but a minuscule rounding error amid the state's overall sales and use tax, which was $4.6 billion in 2008.

But now the ultimate goal for SSTA states is the passage of federal legislation that would mandate this model for all states and remote sellers. That does not necessarily mean that sales tax compliance from e-commerce and other remote sellers will be easy or universal. Peterson acknowledged that the SSTA does nothing to ease the difficult task of sales tax enforcement at the state level. Still, federal legislation would turn these voluntary payments into required tax liabilities, which carries significantly more payment leverage, and states would stand to gain a hefty boost in tax revenue. The University of Tennessee study concluded that Minnesota lost $160 million in 2008 from uncollected sales taxes on e-commerce alone.

Though a bill in Congress has not yet been introduced this year, Peterson is optimistic that it will be. "I think it's been introduced for seven or eight years in a row," he said, adding that this year looked especially good for the legislation. "The last administration didn't like this concept," said Peterson. "I have no idea what the current president thinks. … He hasn't come out and said no." One factor in SSTA's favor is that state budgets are "crap, for lack of a more delicate way of saying that," Peterson said."I think there's a greater likelihood this year, but Congress is an extremely difficult thing to predict."

But struggles could still lie ahead for the bill's passage. "There's lots of people out there who don't want this to pass," including businesses and some members of Congress, said Jane Page, assistant director of the business tax division at the South Dakota Department of Revenue and Regulation. She added that other federal bills are being introduced that could get attached to the streamlined bill, "and then it won't look quite as attractive." Page said that the main point of contention currently is a vendor compensation part of the bill, which would require states to compensate vendors from whom they collect tax.

But the SSTA initiative has surmounted many other challenges. "For the last eight years now, we've worked through lots and lots of things that people didn't think would be able to be resolved," said Page. "But they have been." f

The not-as-big three

Chrysler, GM dealerships slashed across the district

By MADELINE CHRISTENSEN
fedgazette Intern

Once powerful pillars of the American auto industry, the Big Three car companies—Chrysler, General Motors and Ford—have been buckling under the dual weight of a poor economy and a bad business model.

With both Chrysler and GM filing for bankruptcy—and the former being taken over by Fiat and the latter currently enduring a government-run reorganization—automakers have been making unprecedented cuts to their businesses. Every state, including those in the Ninth District, bore some brunt of the fallout when these two automakers announced the termination of car contracts with almost 2,000 dealerships nationwide. But the fallout likely won't be as bad as these numbers suggest because many dealerships will remain open selling other cars, at least in the near term.

In late April, Chrysler publicly released a list of 789 dealers—almost a quarter of its retail stores—that would close by June 9 (see map). Many of them were closed because of low sales of Chrysler vehicles. Others were terminated as part of Chrysler's efforts to thin out the dealers who weren't selling all three Chrysler brands—Jeep, Chrysler and Dodge—as Chrysler strives to bring the three brands under each dealership roof. Given the short deadline, the sale of inventory was reportedly fast as dealers slashed prices. Chrysler offered to help closing dealers sell their remaining Chrysler cars and parts to surviving franchises, but gave no guarantee on prices.

Eighteen Chrysler locations closed in Wisconsin: five in Milwaukee, three in Madison and the rest spread throughout the state. Chris Snyder, attorney for the Wisconsin Automobile & Truck Dealers Association, estimated that these dealerships employed approximately 600 workers, around 35 per dealer. Not all of the dealerships are closing outright. Six (all in the state's larger markets, which lie outside the Ninth District) have the option to continue in business.

Chrysler terminated contracts with 19 dealerships in Minnesota. Two dealers, one in Pine City and the other in Bloomington, were already closed, according to Scott Lambert, a representative of the Minnesota Automobile Dealers Association. Lambert said that 810 jobs would be lost as a result of closing Chrysler locations, though not all of them immediately, as most of the dealers are staying open selling used cars for the time being.

Bob Lamp, a representative from the Automobile Dealers Association of North Dakota, said that seven Chrysler dealerships in the state were affected, although all of them are staying open selling other brands.

Four Montana Chrysler locations felt the impact of the Chrysler announcement, but all four are staying open with other car lines, according to Marilyn Olsen, a representative from the Montana Automobile Dealers Association. In South Dakota, only one of the seven dealerships with termination notices from Chrysler will close outright, said Terry Averson, a representative for the South Dakota Automobile Dealers Association. That dealer had six employees.

In mid-May General Motors notified 1,100 of its 6,000 dealerships that it was terminating their contracts. The dealers have until 2010 to sell their remaining GM inventory, at which point the company will not renew their contracts. General Motors has not publicly released this list of dealerships, and many of them have asked not to be revealed by their state auto associations.

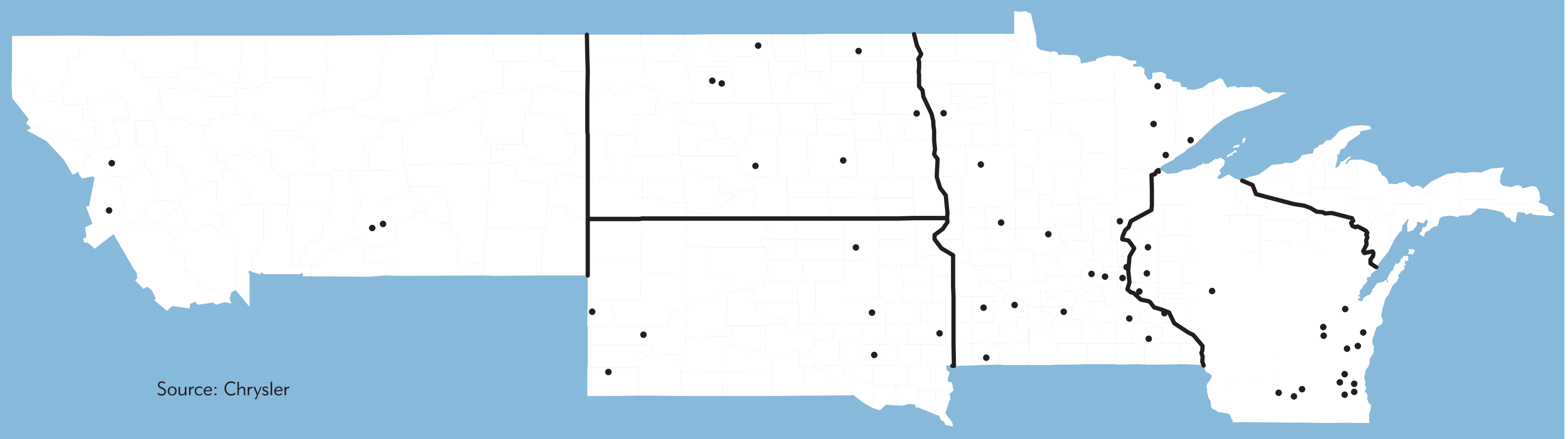
Snyder said that so far, about 30 Wisconsin GM dealers have told the Wisconsin Automobile Dealers Association that they received wind-down letters from GM, though he added that there were probably more. In Montana, Olsen said that terminated GM dealers in Livingston, Three Forks, Kalispell and Wolf Point had gone public, and dealerships in Shanook and Roundup had already closed before the GM letters.

In Minnesota, more than two-thirds of the state's 149 GM dealerships are facing some kind of change. The most notable are the 37 GM dealers that received wind-down letters, which Lambert estimated could lead to 1,600 or more job losses. In addition, according to the state Automobile Dealers Association, more than 70 GM dealers in the state are facing some direct disruption of their business other than outright closure, including the loss of one or more of their GM brands, or demands that dealers get rid of competing car lines.

Ford has said that it would not follow GM and Chrysler's big dealer cuts. It has thinned out its network by 700 dealers since 2005. So far, Ford appears to be weathering the financial storm better than Chrysler and GM. Ford has not accepted government bailout money or filed for bankruptcy.

The future may hold more gloom for the auto industry and dealers in the region. GM has said it is likely to cut another 900 dealerships within the next year. "It's all speculation, but … I think it's just going to get harder, especially on rural dealers," said Averson, from South Dakota. "There's a lot of unknown, actually, [regarding] how GM is going to deal with these dealers after … all the dust has settled." f

Chrysler dealerships with terminated contracts



Source: Chrysler

District Voices

How is the recession affecting enrollment and student finances at post-secondary institutions?

[O]ur admissions department ... is seeing many more people coming in who either don't have a job, or who are looking to upgrade their skills to look for another job perhaps. ... Our enrollment overall is a little bit up right now. You never know how that's going to shake out until September when we see who shows up. But we have seen increased traffic among people who are nontraditional students.

Tom Pink, Director of Public Relations
Lake Superior State University—Sault Ste. Marie, Mich.

In general what we're seeing and hearing is that two-year colleges in particular are growing in enrollment more than we've seen in the last five years. ... [But] the two-year colleges have an ability to expand more so than a St. Olaf or a Carleton or a St. John's, because those folks try to keep their enrollment pretty constant. ... There were definitely some stories about applications being down at St. Olaf and maybe St. Mary's in the last couple of months ... [but it is] really hard to gauge whether it's recession-related or what that might be.

Barb Schlaefer, Director of Communications
Minnesota Office of Higher Education—St. Paul, Minn.

[W]e have seen expected enrollment for this coming year up 35 percent over last year. We like to think it's because of our marketing, but it probably has a lot to do with the recession; community colleges typically do better during recessions. We're seeing financial aid applications up too. ... Financing is still widely available in Montana, but we're seeing a lot of the banks that we've worked with for years aren't making student loans anymore.

Darren Pitcher, Vice President of Student Success and Institutional Research
Miles Community College—Miles City, Mont.

What we've seen is actually a pretty significant increase in requests from students. I think it relates directly to the cost of attendance, and in addition a number of lenders have exited the student loan programs, so for those of us that are remaining in business, we've definitely seen an increase in our loan volume requests. ... More [lenders] are exiting every day; I've seen some announcements from large student loan lenders that are exiting the program over the next few months. But we're definitely not the only lender left out there.

Shirley Glass, Associate Director of Student Loan Services
Bank of North Dakota—Bismarck, N.D.

We've seen a big increase in the number of people planning to return to school who want to know what else they can apply for as far as private loans, et cetera. We spend a lot of time counseling them on their options and also emphasizing the fact that they need to realize that we cannot replace their full-time income for them.

Denise Grayson, President
South Dakota Association of Student Financial Aid Administrators—Madison, S.D.

We're probably going to be looking at a record in full-time enrollment. We're going to see a freshman increase that's going to probably be in the double-digit range. We've got a wait list for students who want to live on campus. ... Of course, the budget problems that they're having at the state affect the way in which [public universities] are able to finance their education. ... Because we're private, we haven't had to deal with some of those same issues.

Patrick Kerrigan, Vice President for Communications and Marketing
Viterbo University—La Crosse, Wis.

ECONOMIC Myth Busters

"Immigration is bad for native-born workers."

By TOBIAS MADDEN
Regional Economist

RACHEL WEST
Intern

Over 30 percent of people polled by Fox News feel that immigrants reduce jobs for U.S. citizens. Many native-born Americans are feeling the pressure of a changing labor market and see immigrants as an economic threat. In the United States, where the foreign-born make up about 12 percent of the population, should policymakers curb immigration to "protect American jobs"?

In a nutshell, no. This myth stems from the idea that the number of jobs in America is fixed, and every job taken by an immigrant reduces the total number of available jobs, always to the detriment of native-born workers. This overlooks some valuable economic contributions from immigration on both the supply of and demand for labor.

That's not to say immigration has no downside. Setting aside the controversy of legal versus illegal immigration, both economic theory and practical evidence suggest that immigration does affect native-born workers. When an individual immigrates to the United States, native-born workers face additional competition for available jobs and may find it harder to get a job. The increase in regional labor may also drive wages down by a marginal amount.

Most immigrants take low-skill jobs; thus, the burden of displacement and lower wages falls disproportionately on low-skilled, minimally educated workers. However, most economists find very modest impacts on wage levels: A 2008 National Bureau of Economic Research study estimated that the positive immigration effect on wages of U.S.-born workers with at least a high school degree offsets the small negative effect on wages of U.S.-born workers with no high school degree.

Economists also see supply-side benefits from immigration. For starters, increased labor competition, and any dampening effects on compensation, helps employers spend less time and money filling labor needs. Increased labor competition also provides incentives for native-born workers to improve their skills through additional education or other training. Such an outcome is good for native workers, who should see their wages increase, as well as employers, who benefit from a higher-skilled workforce.

Equally important, and often overlooked by opponents in this debate, are the positive, demand-side effects of immigration. Immigrants spend money on food, shelter, and other goods and services. This spending raises the overall level of economic activity in the community, leading employers to create more jobs in response to increased demand. There is some empirical evidence that immigrants create more jobs than they fill—thereby increasing overall employment.

Meanwhile, changes stemming from increased demand accrue to a wide swath of participants in the economy. In 1997 the National Research Council estimated that immigrant labor conferred net benefits of anywhere from $1 billion to $10 billion per year on the native-born population. Immigrant workers contribute taxes to governments at all levels. Studies suggest that the majority of foreign-born laborers will generate more in tax revenue than they generate in public costs through the use of social programs.

Part of the net public benefit stems from more taxpayers shouldering the cost of government, whether it be for interest payments on national debt or for public goods and services; without immigrants, who generate most of the population growth in the United States today, costs per taxpayer would be higher. However, costs may be concentrated in the short run and borne by specific local governments. For example, education expenses are shouldered by local school districts with high numbers of immigrants, while benefits (including returns from that education) are often more dispersed over time and geography.

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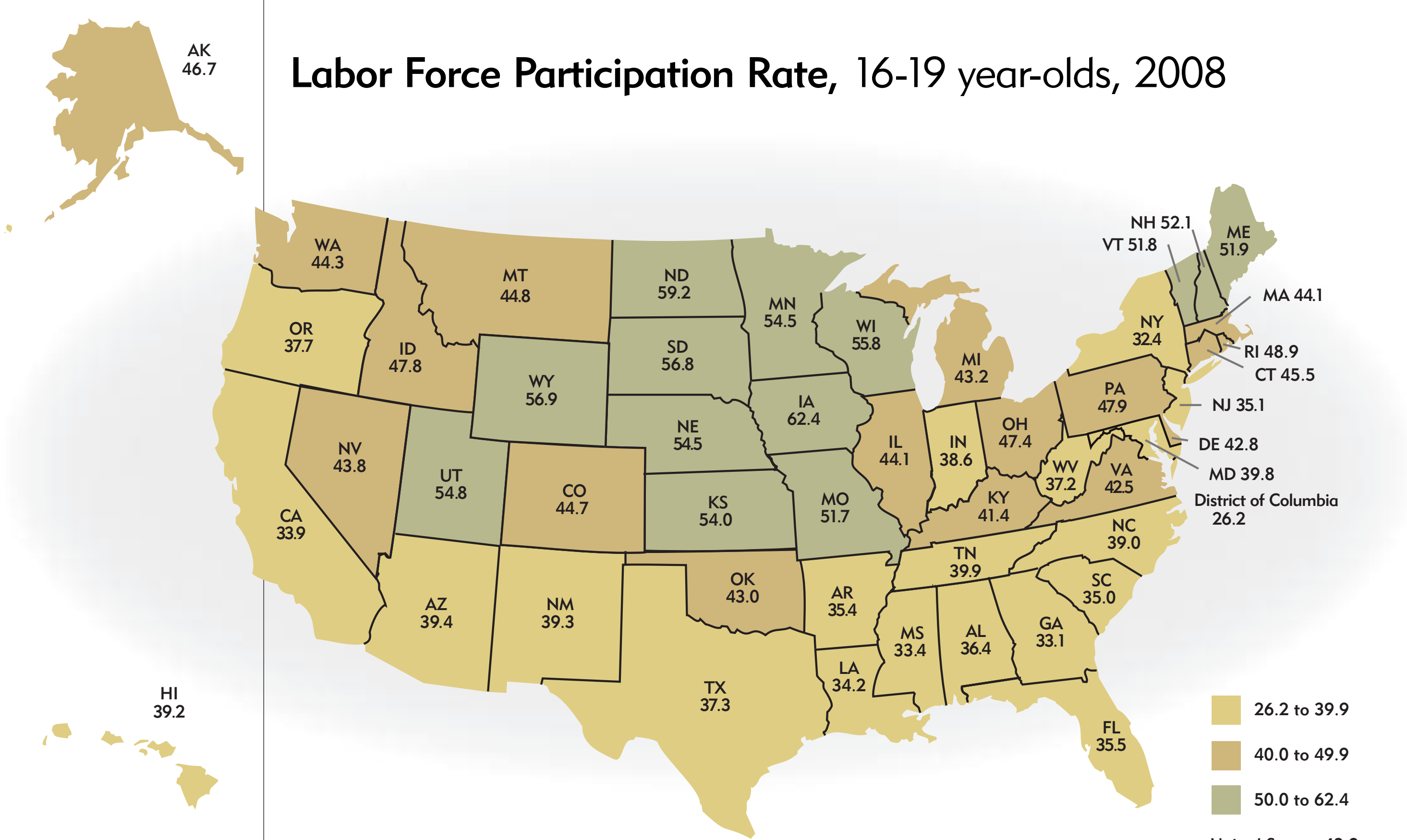
September 2009

Labor Force Participation Rate, 16-19 year-olds, 2008



Source: Current Population Survey, U.S. Census