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How to keep the Bakken oil boom from becoming a bursting bubble

Louis D. Johnston
College of Saint Benedict/Saint John's University, ljohnston@csbsju.edu

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How to keep the Bakken oil boom from becoming a bursting bubble

By Louis D. Johnston | 08/26/13

REUTERS/Jim Urquhart

Roughneck Brian Waldner is covered in mud and oil while wrestling pipe on a True Company oil drilling rig outside Watford, N.D.

The most recent issue of fedgazette, the Federal Reserve Bank of Minneapolis' regional business and economics newspaper, devotes most of its space to the economic effects of the Bakken oil boom. The lead article summarizes North Dakota's situation: "Congratulations on your oil boom...now the real work begins." (If you don't already subscribe to fedgazette, you should do so right away. Go ahead, I'll wait...)

In particular, North Dakota's 13.4 percent growth rate of GDP in 2012 led the nation. What might surprise you is that Minnesota was in fifth place at 3.5 percent, with part of that growth driven by the Bakken boom. (In the rest of the neighborhood, it was Iowa in 16th at 2.4 percent, Wisconsin 32nd at 1.5 percent and South Dakota 46th at 0.2 percent.)

These numbers raise a couple of questions: Can North Dakota and Minnesota profit in the long term?

And do plentiful natural resources promote economic development?

As with most economics questions, the answer is "on the one hand… but on the other hand…" Adam Smith, one of the founders of our discipline, was adamant that mining and other types of natural resource extraction were dead-ends, that "they are the projects, therefore, to which of all others a prudent law-giver, who desired to increase the capital of his nation, would least choose to give any extraordinary encouragement."

Resource curse

Smith's skepticism has been generalized as the concept of the resource curse. The general idea goes like this: An oil boom draws workers and capital out of long-run productive sectors (for example, high-tech manufacturing) for short-term gain. Once the boom is over, incomes grow more slowly and there is nothing much to build on for future productivity.

But the American experience is a counter to this view. In a series of papers, Gavin Wright of Stanford University, along with his co-authors have written that "not only was the United States the world's leading mineral economy in the very historical period during which the country became the world leader in manufacturing (roughly from 1890 to 1910), but linkages and complementarities to the resource sector were vital in the broader story of American economic success."

So where does that leave North Dakota? As Ronald A. Wirtz writes in the fedgazette, "local communities and the state Legislature are realizing that oil production and its concomitant economic activity and wealth come with a laundry list of things to fix and otherwise spend money on."

In other words, North Dakota can avoid the resource curse if it uses its bounty wisely and invests its short-term gains in projects that have long-run payoffs. North Dakota took a step in this direction by creating the North Dakota Legacy fund, into which 30 percent of the state's oil and gas taxes are deposited annually.

Kevin Allenspach of the St. Cloud Times wrote an award-winning series on the economic effects of the Bakken oil boom on central Minnesota. (Go read it here; I'll wait.) He identified a number of routes through which the boom traveled to the St. Cloud area, including central Minnesota businesses opening offices in the area (Coborn's grocery stores, among others) and participating in construction projects (for example, Lumber One of Avon and Cold Spring building apartments).

Minnesota can continue to earn returns from this relationship by being ready to take advantage of these types of indirect benefits. Minnesota health-care networks are looking at opportunities to expand in North Dakota, Minnesota law and accounting firms can work on Bakken projects, Minnesota engineering companies can gain expertise in oil field work and leverage that knowledge into projects outside the upper Midwest.

Lessons from the Gold Rush

One of my favorite stories I tell students is about the California Gold Rush. When the dust settled and people took stock of who benefited most, it was clear that miners and mine owners profited the least. In the end, it was the shopkeepers who sold miners and mine owners the provisions and equipment they needed who benefitted. Collis P. Huntington and Mark Hopkins, two of the “big four” who founded the Central Pacific Railroad, made their fortune by doing exactly this in Sacramento, Calif.

Minnesota entrepreneurs should keep their eyes open for these opportunities, especially those that have the potential to create spin-offs and long-term growth after the oil boom settles down to more regular production. And policy makers in Minnesota should make it possible for Minnesota companies to take advantage of these opportunities and not get bogged down in border conflicts on taxes and the like.

ABOUT THE AUTHOR:

Louis D. Johnston

Louis Johnston writes Macro, Micro, Minnesota for MinnPost, reporting on economic developments in the news and what those developments mean to Minnesota. He is Joseph P. Farry professor in the Eugene J. McCarthy Center for Public Policy and Civic Engagement at Saint John’s University. He is also a professor of economics at the university.

MinnPost | 900 6th Avenue SE | Minneapolis, MN 55414 | 612.455.6950

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