

Midland and Odessa Permian Basin Cities Ride Oil Boom Again

Midland and Odessa lie only 20 miles apart on West Texas' arid plains, but a combination of historical accident and geography give each a different role in the industry that determines their destiny.

The Permian Basin's first commercial oil well started pumping in 1921, and Midland and Odessa were boomtowns by the late 1920s. Midland offered the best hotel and drew oil company executives, investors and speculators. The city became

home to white-collar corporate oil, with a per capita income of \$40,885 in 2005, topping the state's \$32,460.

Odessa's location to the west positioned it closer to the oil fields, giving the city an advantage in the blue-collar oilfield service and machinery industries. Its per capita income was \$25,590 in 2005.

Despite their differences, the two cities have been yoked together in the booms and busts of the oil business. Job growth has been an on-again, off-again proposition for both (*Chart 1*). For example, a sharp decline followed the collapse of oil prices in 1997-98. Now in full boom, the cities have separated themselves from the rest of the U.S. since oil prices per barrel moved above \$40 in 2004 on their way to triple digits.

The seasonally adjusted unemployment rate in February 2008 pushed down to 2.7 percent in Midland, the lowest in the state, and to 2.9 percent in Odessa, well below the state's 4.1 percent, a historic low.

Midland and Odessa form the economic hub of the Permian Basin region that stretches across West Texas and southern New Mexico. Drilling activity fluctuates with energy prices and drives such economic indicators as the unemployment rate (*Chart 2*).

The Permian Basin rig count fell to a

cyclical low of 43 in early 1999, when oil hit \$10 per barrel, and then found another bottom of 85 in early 2002 on the heels of the U.S. recession. Rig counts climbed rapidly over the next few years, flattening out over the winter of 2006-07 and crawling past 200 in early 2008—a level not seen since the mid-1980s.

Historically a black-oil region, the Permian Basin has turned increasingly to natural gas over the past decade. Recent data show about a third of drilling activity directed to natural gas. Some gas is associated with oil, but drilling directed to exclusively deep gas or gas in tight sands has been active for some time, and unconventional gas in the Barnett and Woodford shale formations is now attracting significant interest.

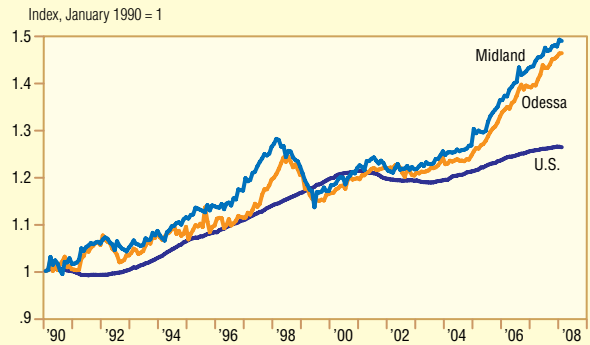
Today, the Permian Basin produces 16.4 percent of the nation's oil and 7.1 percent of its natural gas.

Every Permian Basin economic report in recent years has emphasized not only the high level of economic activity but also the severe labor shortages that accompany it. High wages paid by the local oil industry allow it to hire labor away from other local businesses at will, creating big problems in these relatively isolated communities.

Non-oil businesses are being hurt. Some have closed. Restaurants are trying to save labor, with some full-service establishments closing rear sections and fast-food places operating only drive-through lanes at night. New-home construction has slowed to a standstill.

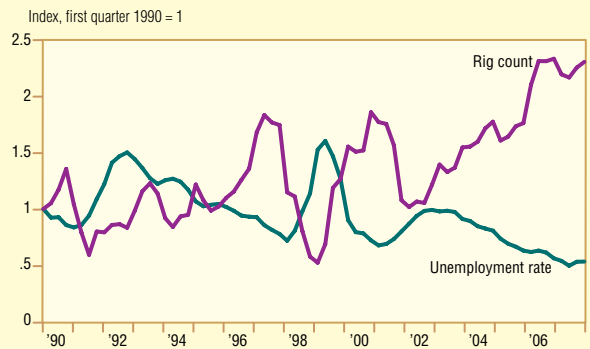
Boom times are back for now, but resource-driven regions like the Permian Basin

**Chart 1
Midland and Odessa Job Growth
Compared with U.S.**



SOURCE: Bureau of Labor Statistics.

**Chart 2
Permian Basin Rig Count Plotted Against
Midland-Odessa Unemployment Rate**



NOTE: Data for all years are first quarter only.
SOURCES: Smith International; Bureau of Labor Statistics.

face a recurring dilemma. At the bottom of every cycle, when the oil industry is shrinking and times are tough, nothing is pursued with more fervor than industrial diversification. Yet, on the way up, the oil industry can be so profitable it pushes other businesses to the side. At the peak, diversification dwindles. Any cushion for the downside is gone—and the downside has always come in commodity industries.

—Robert W. Gilmer and Charles James