Economic development policy in the 1990s—are state economic development agencies ready?

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"State and local economic development strategies typically evolve incrementally, without an underlying economic theory, except that more jobs are good and less jobs are bad."—Beaumont and Hovey[1]

The rules for economic development are changing in response to a new economic development landscape characterized by global markets, the rapid pace of innovation, and increasingly mobile capital. The new economy features firms that compete through technology and export growth. States are trying to find new ways to capture economic growth and to adapt to upheaval and restructuring. While state and local economic development agencies have been quick to establish new programs to meet the changes in economic activity, they are increasingly short on resources. Economic development agencies have been among the first to be slashed during budget crunches.[2] In part, agencies have been the target of budget cuts because of the perception that the vast number of existing development programs have failed to produce significant results. In response to recent budget cuts, development agencies have, partly out of necessity, invested time and effort to articulate new ideas for guiding current and future programs and policies.

Changing directions in economic development strategy is not new to the states. Historically, states have adopted diverse strategies in rapid succession from industrial recruitment to small business incubators and high tech industry development to the current emphasis on key industry clusters. The somewhat erratic record of past development strategies places the current strategic thinking under close and critical scrutiny.

This article will examine how state economic development programs—especially those in the Seventh District—are responding to fiscal pressures and to the current wisdom concerning economic development in the 1990s. The article concludes with a critical look at what may be missing from some of these new strategies and how formal evaluation of development programs may provide the key to understanding the value of current and future development efforts.

Economic development policy in the 1990s

A variety of forces have led states to reexamine their economic development strategies. Chief among these forces are the severe fiscal pressures which have plagued the states since the start of the 1990s. With Medicaid and prison expenditures accounting for a larger slice of the budgetary pie, discretionary programs such as economic development have offered ready targets for budget cuts. In fiscally strapped states like Illinois and Michigan, the state economic development agencies have seen the state funded portions of their budgets cut by more than 70 percent since FY90.

While budget cuts may have precipitated a hard look at economic development programs, the new strategies emerging from these reduc-

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tions also reflect new paradigms for successful economic development. These new paradigms tend to reject programs emphasizing industrial recruitment and related tax abatement and subsidy strategies and instead emphasize those government programs that enhance private industry productivity and innovation. In particular, they stress the state's role in creating a sound foundation for economic growth by supporting broad based factors such as infrastructure and education rather than targeting assistance to individual firms.

Many refashioned state development strategies start by rejecting previous development programs. Often this critique is borrowed from so called third wave theories of the evolution of development strategies which have been articulated by the Corporation for Enterprise Development (CfED).[3] According to CfED, economic development policy can be conceptualized in three waves. The first wave consisted of industrial recruitment strategies and was particularly prominent from the 1950s to the 1970s. The first wave ended because global trends toward more open markets and changing technology made it possible for branch manufacturing plants to locate in countries other than the U.S. When even low cost U.S. states could be undercut by cheaper and sometimes more productive foreign locales, the value of "smokestack chasing" as an economic development strategy was called into question.

This era was supplanted by second wave policies characterized by emphasis on home grown economic development activities. The idea here was to improve the productive inputs of the local economy. Economic advantage could be established through a skilled work force, available technology and capital, and modern telecommunications. Economic development success stories consisted of regions where local advantages had been identified and home grown industries had sprung up. In these cases, the basis for supporting high growth industry was to push development policy down to the most grass roots level. The idea was that economic development occurred only when local actors such as businesses and nonprofit groups were empowered through policies which placed resources and decisionmaking in their hands.[4] However, while the second wave's capacity building policies did a better job at understanding the new dynamics of economic growth, they too stumbled when it came to leveraging significant economic growth on a large scale.

This has led to a third wave in development policy which primarily examines the institutions through which development policy is carried out. As described by Scott Fosler of the Committee for Economic Development:

> "The transition from the second to the third wave ... involves important changes in organization: policy continues to focus on internal development, but new organizational approaches are used to pursue that objective."[5]

The third wave blames the uneven success of second wave policies on a "deficient public technology." In second wave policy, when a development problem was discovered, the natural response was to create a program to fill the gap. The problem was that the new programs were often provider driven and not customer driven. Fundamental to third wave principles is to make certain that customer demand drives program design and objectives. To ensure this, the customer must be willing to invest time and resources in the program. Government would then have feedback to measure the effectiveness of existing programs and would no longer create programs that fail to meet customer needs. If there is no real demand for the program it would be eliminated. This was often not the case in the second wave. Other improvements in the technology of government suggested by third wave analysts include devising programs which encourage competition among suppliers and ultimately leverage resources from sources other than government. As such, if the public technology for delivering these services could be enhanced, better performance could be achieved.

In order to improve on the delivery and design of economic development programs the structure of government itself would need to change. All agencies of state and local government would need to recognize that their programs can contribute to economic growth strategies. Coordination between different levels of government and between agencies would be essential in structuring a better system for delivering development programs. Without better coordination and cooperation between agencies with as diverse missions as education, transportation, and economic development, to name just a few, the various pieces of economic development could not be put into place to really support private sector economic growth.

Third wave theory has been bolstered by the ideas of a series of popular policy critics including Michael Porter, Robert Reich, and Peter Eisinger.[6] These analysts have identified the fundamental changes occurring in the economy and accordingly set new directions for government to cope with these changes. In their work, themes such as the globalization of commerce, the rapid pace of innovation, the need for human capital and worker training, and the importance of an entrepreneurial climate are stressed. For most of these policy critics, economic growth is part of a turbulent process in which constant innovation and technological breakthroughs create new markets for the best firms. Firms that fail to innovate are doomed to fall by the wayside as competitors throughout the world overtake them. The overarching policy prescription for government is to complement private sector economic changes by broadly supporting the building blocks of growth. Fundamental to this view is the idea that government's role should establish a solid foundation for economic growth through a sound physical and social infrastructure. Less emphasis is placed on specific programs and more emphasis is placed on the broader understanding of a region's economy and how it creates wealth and raises productivity. Broad concerns include establishing a base for economic development through an appropriate and well funded education and training system, stable regulatory policies, and a solid infrastructure. The issue here is one of scope; the new development strategy expands far beyond the purview of a traditional economic development department and instead cuts across all services provided by all departments of state government.[7]

Another thread running through this process oriented approach is that economic development is driven by decisions made by the private sector. State programs should accordingly reflect the needs of private industry and should therefore get specific information from industry. Accurate information about industry needs will only be revealed when industry itself decides to commit its own resources to a government sponsored program. For example, government money can be used to encourage active participation in industry trade associations or to create associations where none exists, but the direction of the association must be charted by members of the industry and not the government.

These new policy prescriptions are designed to support an economy driven by technological change, innovation, and a constant process of identifying and exploiting new markets. The identification of these forces as the engines of the capitalist economy have their intellectual roots in the works of Joseph Schumpeter.[8] Schumpeter was among the first to stress that technological progress is the most important driver of the capitalist economy. Through innovation in products, production, transportation, and entry to new markets, firms drive economic growth. This innovation is not costless; Schumpeter also coined the phrase "creative destruction" to describe what happens to those firms left behind in an innovation driven economy. For Schumpeter, a critical question in trying to determine the best organizational structure for innovation was whether small or large firms were best suited to innovation. Through his research, Schumpeter found both large and small firms had certain advantages which might position them to innovate effectively, and this ambivalence over what organizational form is best able to innovate continues today. Such questions highlight government's key role in economic development. In addition to supporting basic inputs such as physical infrastructure and skilled workers, government must set the market conditions and rules which will best spur technological progress.

How are the states changing their development strategies?

In many states, elements of these new paradigms are finding their way into development strategies. States appear to be willing to embrace these models of economic growth based on technology, innovation, and global markets to define their economic development programs. This section begins with a discussion of the State of Oregon because it has achieved perhaps the most profound changes in direction in accord with the new development ideas. Then, using Oregon for comparison, the development strategies of the five states of the Seventh Federal Reserve District—Illinois, Indiana, Iowa, Michigan, and Wisconsin—are reviewed.

Oregon—relying on benchmarks

Oregon's approach is unique in that it developed a strategic plan for the state's economy in accord with comprehensive third wave thinking. The state has chosen to implement its strategic plan by establishing specific benchmarks for a wide range of social and economic goals. Quantifiable goals are to be achieved by specific dates and are intended to provide Oregon with the economic underpinnings to successfully compete in the future. This process also corresponds with much of the recent interest in adapting the total quality management (TQM) standards developed by the private sector to the public sector. Like the private sector, government agencies must have the proper incentives if they are expected to meet quantitative goals. In Oregon, budgetary incentives ensure that the operations of all state agencies respond to these benchmarks.

The Oregon plan clearly contains two elements of the new economic development theory: the state's program is designed to strengthen the foundation of the economy more than it is designed to benefit specific companies; and the plan recognizes that it is a function of all agencies of government to contribute to economic growth. In all, Oregon has set 155 quantifiable benchmarks. Thirty of the goals are considered critical and receive special attention. These goals are very specific and set intermediate and final benchmarks for the state's economy and overall quality of life (see Table 1).

To encourage agencies to support benchmarks, agency heads are required to develop concrete mission statements relating to the benchmarks and to budget resources to achieve specific benchmarks. This process is then further reinforced by specifically linking the budget planning structure to the benchmarks. This occurs by first requiring all state agencies to reduce 1992 spending by 20 percent. Second, the agencies are able to recover the missing 20 percent only through two means. The first 10 percent can be recovered by proving that the additional appropriation is related to an essential service performed by the agency. The second 10 percent can be recovered only if the agency is able to demonstrate that the spending will support one of the critical benchmarks. Restoring this second 10 percent requires the approval of a designated manager who is appointed by the Governor to oversee one of the critical benchmarks. Agencies can present joint proposals in order to receive funding.[9]

The hope is that, through the benchmarks, Oregon will establish an economic foundation

TABLE 1

Benchmarks for the Oregon economy

Intermediate	1990	1995
Percentage of lumber and wood products employees in value added manufacturing	28%	39%
National ranking in workers' compensation costs	8	20-25
Industrial land that is suitable for development	?	100%
Taxes as a percentage of U.S. average	90%	90-100%
Spending for public facilities as a percent of gross state product	2.1%	3%
High schoolers in technical education	9%	18%
Babies born to drug free mothers	89%	95%
Teen pregnancy rate per 1,000 females	19.5%	9.8%

Final	1990	2010
Per capita income as a percentage of U.S. average		
Portland	103%	115%
All other areas	85%	106%
Manufacturing employees in industries other than the state's largest	71%	80%
Manufactured goods sold overseas	22%	50%
Oregonians working outside of Portland	55%	55%
Adults proficient at written and quantitative skills	35%	65%
Adults with good health practices	46%	75%
International ranking of 12th graders' math ability	12th out Of 15	1st

that will lead to future and sustainable economic growth by focusing government activities on necessary and appropriate activities. As a related strategy, the state has reoriented its direct economic development strategy to serve whole sectors of the economy rather than specific firms. By adopting a sectoral strategy, Oregon hopes to overcome three weaknesses that it found in traditional economic development plans. First, sectoral strategies overcome the lack of sufficient scale common in many previous development efforts. Traditional development programs are designed to help a handful of specific firms, not entire industries. Second, traditional state run programs tend not to be responsive to the competitive needs of firms because few programs represent true collaborations with business. Finally, the sectoral approach attempts to provide services that improve the performance of firms in global markets. An example of this sectoral approach is the establishment of the quasi-public Wood Products Competitiveness Corporation. This corporation is intended to bring together all participants in the wood products industry, from suppliers of raw materials to producers of final products, to identify challenges and opportunities for the industry. The corporation is also expected to provide information to the state on policy improvements which might be needed. State funds have also been used to establish associations for software and biotechnology firms. State funds have been channeled into research and development consortia for computer related parallel processing research.[10]

Seventh District states

In contrast to Oregon, the five Seventh District states have been more conservative in embracing change. Massive budget cuts in the state economic development departments in Illinois and Michigan have left those states groping for a new paradigm to redefine the role and mission of their development efforts. In Indiana, Iowa, and Wisconsin, a two track approach is being used in which long range development strategies are planned in harmony with the internal capacity building suggested by the new development paradigms, but short term development efforts still utilize business recruitment strategies.

Michigan—a program wholesaler

The Michigan Department of Commerce is going through a process of redefining its mission.[11] Following a two year reduction of more than 70 percent of its $82 million state budget, the department has adopted a strategy that emphasizes working with broadly defined groups of economic actors rather than specific firms. The groups are seen as customers of economic development and include community development officials, industry and trade associations, governmental units, and local economic developers. This strategy has three stated missions. First is to safeguard the state's quality of life. Second is to work with local communities and developers to retain or expand business growth and investment by removing regulatory and other barriers to private investment. Third is to promote an economic development environment where all participants have access to resources, information, and systems which encourage profitable businesses. A final strategy is to take advantage of existing, but underutilized, public infrastructure by trying to channel new investments into communities around the state with underutilized capacity.

Michigan, similar to other states, is making the transition from what David Osborne[12] has termed being a program retailer to a program wholesaler. The distinction is that "retail" programs tend to be suited to the individual firm while the "wholesale" approach tends to address problems in a whole industry with a particular eye toward leveraging the resources of the industry to both stretch and channel the impact of government dollars. In trying such an approach there is a basic recognition that state economic development dollars alone are simply insufficient to create sweeping changes in industries and the economy. However, if state money can trigger private investment by promoting efficient markets, significant economic development can occur.

This new policy direction is also evident in specific programs with a clear emphasis on building up the roots of the economy. For example, the state has launched "Build Michigan," a large infrastructure program focusing on roads, bridges, ports, airports, and rail lines. The program is designed to leverage nearly $3.5 billion in federal transportation money over a five year period.[13] Similarly, the state is launching a $25 million, employer driven adult training program. This innovative program matches potential employers who have guaranteed that they will hire program graduates with individuals who successfully complete the training. The providers of the training are paid only half of each student's total training cost until the trainee has a new or upgraded job and has worked twelve weeks.[14] This assures that both employer and employee are satisfied with the training by building a feedback loop directly into the process. This type of enhancement of human capital, driven by industry needs, is characteristic of the new direction in economic development policy.

Finally, Michigan is trying to leverage resources and provide more information to industry through joint departmental programs, such as the Environmental Services Division. The division is a joint service of the Department of Commerce and the Department of Natural Resources and is designed to provide technical assistance to Michigan businesses in the area of waste reduction, recyclable product opportunities, site reclamation, and permit processing. These programs are all designed to help establish a strong foundation for economic development by working with industry to promote a sound economic base rather than by targeting the particular needs of an individual firm.

Illinois—a focus on clusters

The Illinois Department of Commerce and Community Affairs has undergone an 80 percent reduction in its general fund based budget authority. The department has responded by beginning a process which will redefine its role and which will focus on new directions in economic development for Illinois. As a first step in this approach, a study was commissioned to analyze both the state's economy and economic development policies and to assess Illinois' capacity to compete. The report, conducted by SRI International and DRI/McGraw-Hill, identifies government's most effective role in development as having shifted from targeting specific industries and using tax and trade policies for creating advantage toward supporting economic foundations and creating a level playing field for tax and trade policy. Success in the new economy will be measured by a higher standard of living rather than job creation alone.

Part of this new approach evaluates government's role in the state's economy and, as a related function, streamlines those existing programs which slow the ability of companies to respond to change. In the SRI report, these broad programs are designed to support industry clusters.[15] Clusters are defined as concentrations of competing, complementary, and interdependent firms across several industries, including suppliers, service providers, and final product manufacturers. These are both large and small firms which are strengthened by being able to share a common economic foundation. This can include specialized labor, supply and support services, access to capital and technology resources, economies of scale, and ease of communications. Clusters are seen as the source of global competitive advantage. As such, economic development policies have to support the vitality of all aspects of the cluster rather than targeting support to just one industry in the cluster. For Illinois, 12 key industry clusters were identified (see Table 2).

Iowa—the state as a product

While Iowa is borrowing from the new economic paradigms in looking to the future, it is unwilling to completely abandon the use of recruitment strategies from the past. In Iowa's recent planning document, *Positioning Iowa for the 21st Century: A 20 Year Economic Development Vision* (1991), the change in the method and scope of economic development is evident. By 1989, Iowa's planning documents began to take on a distinctly third wave flavor when the emphasis for measuring success was shifted from direct job creation to improving the standard of living and building the fundamental capacity of the state to grow. The need to increase productivity received particular attention. State strategies called for investing in human and physical capital, creating an environment which would encourage business investment, and keeping pace with technology.

To take advantage of the new theory on economic development, the report suggests that Iowa view itself as a product. This approach focuses on discovering strategies which will make Iowa a more appealing product than is available in either national or international markets. The emphasis is on the whole economy rather than tax incentives for individual firms. As the report puts it, "The job of state

TABLE 2

Illinois' key industry clusters

	Employment 1990	Employment concentration	Output	Projected annual growth in output 1990-2000
	(thousands)	*(U.S.=100)*	*(millions of 1977$)*	*(percent)*
Agriculture and food processing	191.5	113	20,711.8	2.0
Business and personal travel	454.5	94	9,252.0	3.8
Coal mining	13.1	167	2,018.5	1.4
Consumer appliances and electronics	16.8	188	1,533.2	2.1
Electrical equipment	84.0	139	4,923.1	5.8
Export services	1,105.5	110	40,738.8	3.3
Health services and biomedical products	446.2	106	13,239.5	3.5
Industrial machinery	142.7	187	8,695.3	4.4
Manufactured inputs	251.3	144	27,627.0	2.6
Telecommunications equipment	35.9	116	3,228.7	4.4
Transportation and distribution	205.7	121	9,046.8	2.8
Transportation equipment	50.9	64	5,156.0	4.3

government, in this instance, is one of making policy that enhances our strengths, helps overcome critical weaknesses, and finds and exploits our own special areas of competitive advantage. In essence, the state must make every effort to insure that Iowa will continue to be—and be seen as—a good buy."[16]

In implementing this competitive advantage strategy, two parallel avenues are suggested. These avenues are termed supply side and demand side approaches to economic development and have meaning similar to that described in the work of Eisinger (1988). The supply side approaches are characterized as traditional incentive based policies aimed at lowering business operating costs to attract business. By the 1980s, these supply side incentives had become quite intricate and usually were finely targeted. However, their effectiveness was increasingly questioned. Because incentives were being offered in virtually all states, their effect on business location decisions was being diluted. Given this, supply side policies are most effective for the first state to offer them, according to the Iowa report; however, they cannot be abandoned as they are expected by private firms as part of an expansion or relocation deal.

A longer term but possibly more effective approach is found in demand side policies. Demand side policies focus on the local economy and are designed to help generate economic opportunities within the state. These policies are designed to help existing companies grow, often by easing access to capital and streamlining regulatory burdens. The measure of success of these efforts is not job creation but rather wealth creation. These policies assume that by assisting wealth creating industries, jobs will follow. Most of the recent thinking in economic development strategy has focused on the demand side. Government can accomplish this by making key, critical investments which can improve productivity and unlock the economy's potential to meet new and expanding markets.

In devising a development plan for the future, Iowa intends to use both strategies. Supply side activities will continue because other states (and, increasingly, other nations) will continue to offer incentives as a method for attracting investment. However, it is the demand side strategies which will ultimately differentiate Iowa's economy and lead to the more sustainable competitive advantage which Porter and other economic development theorists favor.

Wisconsin—building internal capacity

Wisconsin moved to restructure its approach to development earlier than many of its counterparts. In 1984, the state conducted a survey of state businesses to gauge their satisfaction with the state's business climate. Not only were the results worse than had been expected, but 65 percent of the respondents actually indicated that they had "suffered" at the hands of Wisconsin's government.[17] In response to the perception that the state was creating such a negative business climate, the Wisconsin Strategic Development Commission was launched in 1985. From the beginning, the commission was not structured to propose specific programs for economic development, but rather to establish a strategic guide for development policy in the state.

A critical aspect of the development commission's work was to establish three "strategic objectives" for the state by which to measure economic development progress. The three benchmarks were:

- to create 150,000 new jobs between 1985-1990;
- to achieve an unemployment rate of 5 percent or two percentage points below the national average, whichever is less; and
- to stimulate growth in per capita disposable income of 3.5 percent annually.[18]

These measures have been recalibrated for 1990-1995. The job growth benchmark has been fine tuned to focus on nonfarm wage and salary growth (success over this period will require a 5.1 percent growth in this broad job category). The unemployment benchmark remains at 5 percent or less and the goal for real per capita income growth has been set at 6.8 percent over the five year period. While the job growth benchmark for the 1985-1990 period was exceeded and the unemployment benchmark was essentially met, the income growth figure fell below target.

In addition to benchmarking, the council adopted a set of principles to guide the state's economic development efforts. These principles recognize the nature of global markets and the inability of states to completely control their economic futures. With this in mind the three principles established are:

- to recognize that, while the role of the state government is limited, state actions can be decisive in shaping the way a state economy adjusts to the world economy;
- for state government officials to recognize the fundamental importance of a market driven private sector and for the private sector to recognize the role of state government in assisting and supporting development; and
- for the state to conceive a strategy which identifies priority actions, gives cohesion to government actions, and avoids policies that may be harmful to the economy.[19]

While the bulk of Wisconsin's policies appear to be focused on building internal capacity, the state has still not abandoned recruitment strategies. The state's "Forward Wisconsin" program plays an active role in recruiting out of state businesses to Wisconsin and leaves the impression that, much like Iowa, the state has chosen to use both supply and demand economic development policies in pursuing economic development in the 1990s. However, it is worth noting that "Forward Wisconsin" frames the state's business advantages in terms of the quality of the Wisconsin work force and business environment. This strategy is based on offering a sound foundation for business location, not simply providing tax breaks and cheap labor.

Indiana—bridging the old and new

Indiana's approach to formulating development strategy is similar to that of Wisconsin. The state has not abandoned traditional recruitment and retention strategies as illustrated by the state's recent bidding efforts which won the state the United Airlines repair and maintenance facility.[20] However, Indiana's recruitment advertising also stresses the state's home grown, quality oriented advantages over offering the lowest cost operating environment.

Similar to Wisconsin, the state has established an organization which is charged with having a long range vision for state economic development. In 1985, the Indiana Economic Development Council was established as a private, not-for-profit corporation charged with helping to define economic development strategy. The legislation establishing the council defined three broad missions:

- to update, revise, and manage the state's strategic planning process to adapt to changes in society and in the economy;
- to establish and coordinate the operation of programs commonly available to all citizens of Indiana; and

- to evaluate and analyze the state's economy and economic development efforts to determine the direction of future public and private actions, and report and make recommendations to the governor with respect to the state's economy.

The council functions with a board comprised of 72 members, an executive committee of 15 members, and a full-time staff of five. The organization is driven by a broad based consensus approach with both the executive committee and the board being drawn from diverse interests. Its structure is nonpartisan, allowing long range development planning to be accomplished in a less political atmosphere.[21]

The contribution of this approach is to split the state's economic development activities into short term supply side measures, such as business attraction through abatements and tax breaks, and longer term demand side programs which will allow the state to adopt those strategies in the areas of infrastructure and education which are essential to future prosperity.

Events this year bear this out. By midyear, the Indiana Economic Development Council will be releasing a major update to the state's long range development plan. This is coupled with Governor Bayh's renewed emphasis on economic development efforts which has already produced a statewide development summit held in December 1992 and created a development cabinet comprised of senior policymakers. Other longer term programs include increasing capital availability for small business, export promotion, and increased work force training. In the meantime, while these more long term measures are pursued, short term strategies still focus on incentives. The "Indiana edge" program would allow Indiana to match incentives offered by other states in order to attract or keep firms creating new jobs in Indiana.[22]

Evaluating the new directions in economic development policy

As these examples show, these six states have moved at various speeds to revise their economic development efforts to reflect the new paradigms for economic development. While these new paradigms appear to accurately describe the new economic geography of the world, are their policy prescriptions well suited to state governments? How can state policymakers be certain that these new development strategies are better than their predecessors?

Many believe that an evaluation mechanism is needed to judge the success of these new programs.[23] What made it so easy to discard previous development programs was the perception that they did not work. Too often there was simply too little follow up to know whether a program had in fact had the intended impact. As a report from the Urban Institute points out, "... effective performance monitoring systems have not been developed and used by most economic development agencies."[24] The report notes that even when states have tried to evaluate the effectiveness of economic development efforts, it has been on a sporadic basis with such ad hoc measures as future employment projections and occasional client surveys.

In order to know if the adoption of programs under this new paradigm are justified, intermediate and final benchmarks need to be formally established to judge programmatic success or failure. As such, Oregon's approach is a step in this direction. By defining specific goals, the state can determine whether a program is contributing to these objectives. Otherwise states can end up accepting the logic behind the new paradigms without knowing whether associated programs are reaching desired outcomes.

The Urban Institute suggests a set of monitoring procedures to insure the proper evaluation of programs. First, monitoring should rely heavily on client based assessment of performance. Second, the procedures should be incorporated into the normal operations of the development agency so that regular reports can be generated and problems can be identified and corrected early. Third, intermediate and final benchmarks are needed to insure that the program is on the right course. The intermediate benchmarks are particularly critical since they can identify intermediate steps which are required along the way to reach final objectives. For example, if a final benchmark identifies the need to raise productivity, intermediate benchmarks might include expanded worker training and equipment investment. Since it may take months or even years to achieve the final goal of increased productivity, it is critical to know whether firms are taking the necessary intermediate steps which will lead to the final benchmark.

In including evaluation as a critical component of economic development strategy, the focus will be on quality of public service. This is a departure from previous evaluation efforts which have emphasized activity levels (such as the number of programs conducted or newsletters sent) or budget targets (such as actual expenses compared to budgeted expenses or the amount of activity per employee). While this knowledge can be informative, it is not related to the success of a particular program in meeting a specific benchmark. It also does not provide managers with direction to correct programs which may not be reaching desired goals.

Other potential problems emerge when trying to adapt the policy prescriptions of the new development paradigms to existing state government structure. To begin, the new paradigms favor long range investment in the productive factors of the state's economy. Building up a state's physical and human capital will take years and even decades. Third wave critics have noted that long term economic development strategies have been difficult to pursue given the traditional structure of state and local government. The election cycle of governors and state legislators calls into question whether the states can carry out long range investment, particularly if the investment's political payoff occurs years after the elected official is out of office. Continuity has not been one of the hallmarks of economic development policy as many governors have used economic development offices to pursue specific short term advantages rather than to coordinate a long range investment strategy for the state. The political gain which can be accrued by luring a major facility with thousands of jobs to a state still outweighs a job training program which will improve the state's human capital availability five or ten years down the road. To partially overcome this, Indiana and Wisconsin have established strategic planning bodies which are able to identify where future development programs will be needed. While this will increase planning continuity it does not invest these planning bodies with the authority to develop actual programs.

More fundamental is whether the structure of state government can be adapted to support broad based efforts which cut across agency boundaries. While the new paradigms call for economic development efforts which cut across all government agency boundaries, developing such a shared vision may take time to breach existing interdepartmental barriers. Traditionally, economic development departments were set up to address the economic development needs and/or business interests within the state. Other departments were established to address other state needs. With the growing recognition that successful economic development requires the participation of all agencies of government, a growing challenge is whether other agencies of government will be willing to take on explicitly economic development goals as part of their mission. For example, will state education agencies be willing to support vocational education programs needed to strengthen the economy? Will environmental and tax departments recognize their role in promoting the economy as well as protecting the environment and maximizing the revenue intake for the state? Part of the third wave critique is that previous development efforts have failed to achieve sufficient scale in part because they have not coordinated the resources of government with those of the private sector. Whether government structure can change to improve cooperation will be a critical test.

While Oregon's benchmarking program specifically establishes a system of incentives for departments to adjust their mission and behaviors, other states are leaving it up to the state development agency to cajole other departments to join the economic development parade. With smaller budgets and fewer programs, state development agencies will be at a relative disadvantage with larger agencies. Therefore, they will need to act more as a facilitator of development than as a direct participant. More time will need to be spent convincing other departments to launch economic development efforts than launching such efforts themselves. Other alternatives which might overcome this obstacle include establishing a development supraagency with the power to compel other agencies to adopt policies which encourage development goals or simply allowing the governor to establish development as a clear goal of the state. For example, in Indiana, an economic development cabinet has been created to improve policy planning and coordination.

Similarly, it is unclear whether states will be able to abandon those past development strategies which are widely considered to be ineffective and costly. While tax incentive and abatement strategies have been condemned as inefficient, it is still likely that states will continue to pour resources into questionable attraction and retention strategies as a defensive response (unless all other states agree to simultaneously end these programs.) Iowa's acceptance of both supply and demand economic development strategies grudgingly recognizes the need to continue these questionable policies. The problem is that as long as everyone else continues to provide such incentives, the political cost of ending these incentives is very heavy. Furthermore some development professionals argue that incentives may still be the best policy for poorer regions lacking the physical and human capital levels of other regions. These analysts argue that the building block strategies can be adopted once these region have secured a certain threshold of economic activity.

There is also the question of the capacity of government to absorb some of the functions being thrust upon it. Many analysts are asking government to absorb investment risk, particularly in high technology industries which have potentially large, but highly uncertain future returns.[25] Whether state government will have the patience and the capacity to provide these ventures with resources which are unavailable in the private market remains an open question. Furthermore, policymakers should be careful that in establishing programs to address a failure in private markets, they do not end up inadvertently discouraging private sector solutions. It is equally important that the root of the "market failure" is understood and that a government response is appropriate. In some cases, the hesitance of the private market to invest may be well founded and can be a signal for government to avoid a similar mistake.

Government may need to be more farsighted in adapting to economic change. As the development gurus of the 1990s point out, the new innovation driven economy will be less stable. To succeed, government policies will need to abandon efforts to protect significant but declining industries and instead develop an effective transition for redeploying these available resources. The ability of government to anticipate industry changes and have an effective transition policy for declining industries will be another test of government's ability to adapt to economic change. Programs which stress retraining displaced workers will need more attention. As a related issue, an increasing body of research stresses the link between economic development and wise use of environmental resources. The concept of sustainable development is likely to become a more common feature of long range development strategies. As the link between environmental policies and economic growth continues to strengthen, development policies will be pressured to include measures to promote the responsible stewardship of natural resources.

Finally, there is one wild card which the states need to consider. With the Clinton Administration's arrival in Washington, it is possible that more funding and support for the types of programs suggested by these new paradigms will be forthcoming. Promoters of these new paradigms such as Robert Reich have been tapped as cabinet members in the new Administration. Furthermore, during his tenure as Governor of Arkansas, Clinton created an economic development strategy for the state which relied heavily on the ideas contained in these paradigms. It is likely that national policy will be supportive and complementary to those states that are trying to recast their economic development efforts along these lines.

State development agencies are entering a new era. With smaller budgets and a new conception of the engines of future economic growth, these agencies are developing new ways of doing business. As always, the success or failure of these strategies remains to be seen, but if the theory of growth presented in these new paradigms is right, the states may be on the right track.

FOOTNOTES

[1]Eisinger (1988), p. 31.

[2]National Council for Urban Economic Development (1992), pp. 4-5.

[3]For more on the third wave, see Ross and Friedman (1990), pp. 3-10.

[4]Toft (1992), pp. 1-3.

[5]Ross and Friedman (1990), p. 7.

[6]The major works by these three authors on economic

development policy are: Michael E. Porter, *The Comparative Advantage of Nations*, The Free Press, New York, (1990); Robert B. Reich, *The Work of Nations*, Knopf, New York, (1991); and Peter K. Eisinger, *The Rise of the Entrepreneurial State*, The University of Wisconsin Press, Madison, (1988).

[7]Zehner (1992), pp. 1-2.

[8]For a review of Schumpeter's writings in this area, see Scherer (1992), pp. 1416-1433, and Schumpeter (1942).

[9]Proffer (1992), pp. 33-35.

[10]Cortright (1991).

[11]Michigan Department of Commerce (1991).

[12]Osborne (1988), pp. 259-260.

[13]Byington (1993), p. 36.

[14]Ibid.

[15]Illinois Department of Commerce and Community Affairs, *Economic Leadership in Illinois: New Approaches for the 1990s*, prepared by SRI International and DRI/McGraw-Hill, (1992), pp. ES1-ES3.

[16]Iowa Department of Economic Development (1991), p. 25.

[17]Eisinger (1988), pp. 136-137.

[18]Wisconsin Strategic Planning Council (1990), p. 2.

[19]WSPC, p. 3.

[20]Crain Communications Inc. (1991), p. 8. In all, the city offered $111.5 million in incentives to win a four city competition for the UAL maintenance facility. Combined with state incentives, the total package is expected to top $200 million.

[21]Indiana Economic Development Council, Inc. (1992), pp. 1-3.

[22]State Policy Research, Inc. (1993), p. 5.

[23]A session at the "State and local economic development strategy summit" sponsored by the University of Minnesota's Humphrey Institute and the National Conference of State Legislatures specifically addressed this topic. The conference was held December 3-5, 1992 in Minneapolis.

[24]Hatry, Fall, Singer, and Liner (1992), p. 1.

[25]Greenberg (1993), pp. 28-30.

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