7 Overview of State and Local Economic Development Policies and Practice in the United States

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1. Introduction

The United States is a diverse economy of more than 290 million people residing within 3.8 million square miles. Its $11 trillion GDP is distributed among 50 states, 362 metropolitan areas, 3,034 counties, and nearly 20,000 municipal governments. Employment growth across these jurisdictions varies widely. For instance, during the past decade the Mountain region of the country grew 3.7 times faster than the Middle Atlantic region. Employment in the Mountain region has expanded nearly 38 percent over the 10-year period while the Middle Atlantic region has grown only 10 percent. A 12 percent decline in the goods-producing sector contributed to the laggard growth in the Middle Atlantic region, compared with a 25 percent increase for the Mountain state. Metropolitan areas exhibit even sharper contrasts between the faster growing and slower growing and even declining areas. During the past four years, the US economy overall has lost 451,000 jobs, with 2 million jobs (-12.5%) disappearing from the manufacturing sector. During that time, the national unemployment rate peaked at about 6.3 percent and currently stands at 5.4 percent.

Unlike some countries, the United States does not pursue a concerted national industrial policy. Rather, the country engages in more than 5,000 separate economic development policies, as each state and local jurisdiction pursue efforts to attract and retain existing businesses or nurture new ones. State and local governments use their resources and powers to reduce the risks and costs that could impede private investment within their jurisdiction. In addition, a significant number of local (substate) economic development efforts are carried out under the leadership of non-governmental agencies, such as chambers of commerce or partnerships among businesses, government, local employment agencies, and non-government organizations.

Estimates of the amount of funds (direct and indirect) spent on economic development efforts are elusive. Yet, some studies place that amount as high as $30 billion a year, which translates to around $103 per person or $213 per worker in the United States (Bartik, 2003). This figure includes all state and local tax and other financial incentives, plus job training and infrastructure incentives. Still, this amount is not much more than 0.2 percent of US GDP. However, when one considers that most of these incentives and other economic development activities are targeted at manufacturing firms, the ratio of funds to targeted jobs increases significantly to over $2,000.

Why are economic development initiatives necessary to achieve these outcomes? The primary justification for government to intervene in a market economy, in addition to protecting property rights and providing a workable regulatory environment, is to counter market failures. Bartik (2003) notes several possibilities of market failures that prevent regional economies from realizing their full potential: 1) information on how to improve business productivity may not be adequately supplied; 2) research and development in business may be under-produced, 3) business capital may be insufficiently supplied, 4) businesses may not train employees sufficiently for fear of losing workers to other employers, 5) public infrastructure may be insufficiently provided to businesses, and 6) business regulation and taxes may need to be more flexible. Therefore, economic development programs should be designed to address these issues.

This paper provides an overview of state and local economic development policy in the United States. The federal government provides some support for these state and local efforts, but the support is limited and is targeted primarily at economically distressed areas, small businesses and workforce training. The federal government has been reluctant to support one region over another because of possible "zero-sum" or even negative outcomes for the country as a whole if government incentives were to promote poor site selection in less than optimal locations. State and local governments, on the other hand, view the goals of economic development primarily in the context of their own jurisdictions and pursue what they deem best for their region, with little regard for its broader effects.[1] Therefore, this paper focuses on the efforts of the many state and local governments in pursuing policies to create jobs within their respective jurisdictions.

2. Economic Development Process

Promoting economic development can lead to job creation, better incomes, improved tax base, wealth creation, and a more stable employment base. Of the various outcomes that can result from economic development, however, job creation appears to be the most sought after by policy makers. For example, in a recent survey of municipal chief administrators, 81.3 percent responded that job creation by new businesses was their economic development goal (ICMA, 2000). From a regional growth perspective, employment is a derived demand. The primary goal of business is not to employ workers, but to make a profit through producing as efficiently as possible and marketing as widely as possible. Therefore, to promote employment is to enhance the competitiveness of businesses. Various key factors affect business competitiveness. The direct factors are land and three types of capital: human (labor), physical (plant and equipment), intellectual (patents on processes and products). Indirect factors include access to physical infrastructure (roads, rail, ports, telecommunications, water supply and treatment) and social capital. The cost of doing business in a particular location is related to the costs that businesses must incur for those factors, and the taxes and regulatory costs imposed by the various layers of government in that location.

The economic growth process is more involved than simply the aggregation of the activities of individual firms, however. Firms operate within local markets, for labor, land and intermediate products, and thus they depend upon the activities of other businesses, the services provided by government entities such as schools, universities, and workforce development agencies, for example, and quality of life that makes an area attractive to workers, entrepreneurs, and business owners. As businesses seek highly trained workers and economic developers appreciate the need to nurture entrepreneurial activity, the ability to attract what Richard Florida (2002) has called the "creative class" is an important dimension of economic development, and quality of life is an important factor in that effort.

It should be noted that many economists make a distinction between economic growth and economic development. Economic development is a qualitative change, which entails changes in the structure of the economy, including innovations in institutions, behavior and technology. Economic growth, on the other hand, is quantitative and denotes a change in the scale of the economy as measured by investment, output, consumption, income, and employment. The two processes are intertwined. Economic growth is a result of economic development, in that institutional change is a prerequisite for growth. Innovations, changes in attitudes toward risk, the willingness to reallocate resources from traditional industries to emerging ones, the formation of networks among businesses and partnerships between private and public entities all reflect structural change and can contribute to a region's growth. On the other hand, growth itself can lead to new changes in the economy by introducing new products and processes into the local economy and fostering new business leadership. It is important to recognize that a region may undergo economic development without experiencing economic growth in the form of employment gains or output expansion, particularly in the short run. Yet, without structural change,

[1] The widespread use of incentives to attract businesses to states and local jurisdictions has raised con-cerned that this competition among jurisdictions leads to unnecessary subsidies to business that in turn leads to an inefficient distribution of investment across the country. Efforts have been made to introduce legislation in Congress and for states to form multi-state agreements that curb this type of practice, but little progress has been made.

the local economy risks stagnating as its traditional economic base matures and its comparative advantage diminishes.

The fundamentals of economic development, particularly the emphasis on interrelationships between the various factors (both direct and indirect), are captured to a large extent in the currently popular concept of clusters. Clusters include the geographic concentration of similar, related, or complementary businesses. These businesses share specialized infrastructure, workers with special skills, services supplied by other businesses and from government entities such as universities and research centers. The cost advantages from agglomeration economies result from better access to more specialized skilled labor, more specialized suppliers, and more specialized information about industry innovations. A distinguishing feature of clusters is that there are extensive flows of workers between firms and active channels for business transactions, communications, and dialogue.

From a policy perspective, the advantage of using clusters as a theoretical concept is that it directs policy makers to consider the growth/development process as a systemic process. Thus policy makers must recognize the interdependencies of businesses and appreciate that interventions that are systemic rather than targeted at an individual business will have the greatest impact. It also highlights features of clusters that may be improved by local economic efforts. For instance, the concept of clusters helps policy makers focus on the availability of median-skilled workers rather than the high-skilled workers. High skill workers are generally highly mobile and are connected to a national labor market. Medium skilled workers are less mobile and may require interventions, such as government-sponsored training, to ensure their availability. Clusters also highlight the importance of public investments in universities and research institutions to bolster the competitiveness of local businesses.

It should be recognized that not all jobs contribute equally to the economic goals of increasing employment and reducing unemployment. Every jurisdiction would like to advance a policy that creates high-paying jobs with employee benefits such as health insurance and a pension, in high value-added businesses that do not pollute the environment and are good corporate citizens by supporting local charitable and cultural functions in their community. While this is not always possible, Bartik (2003) suggests guidelines that can maximize the employment benefits of local economic development efforts. A fundamental aspect of local labor markets is that employment gains within a local area do not necessarily go to local residents. Bartik reports that the available research suggests that for every ten jobs created in a local labor market, such as a metropolitan area, about eight jobs end up going to persons who recently migrated to the area, presumably to take advantage of the increase in job opportunities. This in-migration effect of new jobs going to initially non-residents reduces the potential benefits from economic development efforts, particularly if the effort's goal is to reduce an area's unemployment rate. Thus, policies need to 1) encourage businesses to fill a higher proportion of vacancies with unemployed or underemployed residents by working closely with the local public employment service, 2) focus on high wage-premium jobs, 3) pursue economic development aggressively if and when unemployment rates are high.

3. Site Selection Factors

What do businesses look for in selecting a site? As mentioned earlier, this question is too narrow to capture the determinants of economic development, but it is a starting point. It is narrow in the context of the cluster concept since clusters address the interrelationships and the complementarities of locating near firms in similar industries or pursuing similar functions. Nevertheless, understanding the factors that affect business location decisions provides a useful framework for understanding the set of financial and tax incentives that make up a large portion of the arsenal of tools used by economic developers. These factors should be viewed not only as important to location decisions but also to retention decisions. Businesses are reluctant to stay in an area that becomes deficient in key factors that affect their operation costs.

To begin to sort out the important factors in site selection, the first approach is simply to ask companies how they rank the various factors that may affect their cost of doing business in a specific location. The *Area Development Site and Facility Planning*, a journal for site selection professionals, conducts an annual survey of manufacturing companies, as well as warehousing,

Table 1. Survey of Site Selection Factors

Site Selection Factors	Survey of Corporate officials					
	1995		1999		2003	
	Response (%)	Rank	Response (%)	Rank	Response (%)	Rank
Availability of skilled labor	87.9	5	95.8	1	89	3
Highway accessibility	93.6	2	94.6	2	88.9	4
Labor costs	94.2	1	93.8	3	89.7	2
State and local incentives	87.8	6	90.3	4	92.7	1
Occupancy or construction costs	90.2	3	87.5	5	86.3	5
Tax exemptions	86.4	8	85.9	6	86.2	6
Energy availability and costs	89.6	4	85.2	7	80.8	8
Availability of telecommunications services	80.2	12	85.1	8	77.9	11
Availability of land	83.7	9	85	9	78.1	10
Cost of land	83.2	10	80.9	10	77.3	12
Low union profile	82.8	11	79.5	11	71.6	14
Environmental regulations	86.5	7	79	12	72.9	13
Availability of unskilled labor	64.9	18	77.3	13	55.8	19
Nearness to major markets	74.5	14	75.6	14	80	9

Source: Area Development Site and Facility Planning, *Annual Corporate Survey,* selected years.

wholesalers, distributors, and business service firms. Three quarters of the respondents in 2003 were from manufacturing firms. The first thing to note about the survey, as shown in Table 1, is that no one factor dominates the list. The factors were ranked by the percentage of respondents who rated the factors as very important or important. In 2003, the spread between the top ten factors was 12 percentage points and still 78 percent of the respondents considered the 10th ranked factor very important or important. Having said this, there are factors, such as waterway accessibility (not shown in table), that received few positive responses.

Therefore, in general it is important to recognize that businesses look for a wide range of factors in selecting a site. During the past decade, the relative rankings of the various factors have changed some, but those that have consistently remained within the top 10 are 1) availability of skilled labor, 2) highway accessibility, 3) labor costs, 4) state and local incentives, 5) occupancy or construction costs, 6) tax exemptions, 7) energy availability and costs, and 8) availability of land. The relative importance of these factors has changed slightly over time. Most noticeable is the top rating of the availability of skilled labor during the boom years of the late 1990s, but then the greater emphasis on costs and incentives in the slower periods of the early 2000s. Yet, while interesting, one should not read too much in the slight changes in percentage responses to these factors. Quality of life factors are also important. These, too, have not changed much over the past decade and are not shown in a table. The top factors throughout this period are low crime rate, quality public schools, health facilities, housing costs, and housing availability.

The importance of these factors in the actual site selection depends on the extent to which the cost of these factors varies across possible sites. Obviously, if factor prices were nearly the same across all sites, then these factors, however important to a company, would not matter much in determining which site was selected. However, there are substantial differences in various key costs to firms. For example, Eberts and Stone (1992) show that there is a 36 percentage point difference in labor costs from the highest to lowest cost metropolitan area among the 44 most populous areas. This range narrows slightly to 30 percentage points after adjusting for the quality of the workforce in these metropolitan areas, but the fact remains that large differences do exist across possible location sites. And these differences strongly persist over time.

Econometric studies provide insight into the relative importance of each of these factors on the actual location of facilities. Bartik (1991) concludes from a literature review and his own empirical research that in addition to the direct production costs from labor and capital, local taxes have a negative effect on regional business growth. Furthermore, other studies such as Mofidi and Stone (1990) and Gabe and Bell (2004) find that the government services funded through taxes exhibit positive effects on business growth. Therefore, it appears that economic development efforts that provide incentives to businesses have the potential to affect business location. Yet costs are not the only factors. Businesses today require communities to provide a skilled workforce willing to work collaboratively with management and fellow employees, local training and technical programs responsive to the needs of industry, and a modern telecommunications infrastructure. Economic development tools must meet these needs as well in order to provide a competitive environment for business.

4. Types of Economic Development Policies

As seen in the research cited in the previous section, one can argue that nearly everything that state and local government do with respect to taxes, services, and regulations has at least an indirect if not a direct effect on business activity. The purpose of this section is to identify state and local policies that have an explicit economic development objective, primarily directed at creating and retaining jobs. State and local economic development incentives fall into several categories. The first distinction is between supply and demand side programs. Supply side programs are aimed at businesses and are in the form of tax incentives and non-tax incentives and within these categories are discretionary or non-discretionary policies. Discretionary policies can be targeted at specific businesses whereas non-discretionary programs must include any business that meets certain pre-specified categories. Demand side programs are directed toward improving the business environment within the region. These programs may be designed to stimulate entrepreneurship, provide assistance to small business startups, subsidize research and development, train workers, promote technology transfer from university research to marketable products, raise venture capital, and foster networks between businesses and among other community stakeholders.

Herbers (1990) and Ross and Friedman (1990) have used a different classification which traces the evolution of state and local economic development in the United States. Described as three waves, they view the first two waves as focusing on the supply side by offering incentives directly to firms. The goal of the first-wave policies is to attract firms, primarily manufacturing plants, from outside the area by reducing the cost of production. These policies began in the 1940s with Mississippi's "Balance Agriculture with Industry" program. All economic development programs in place today offer a sophisticated set of incentives to reduce the cost of firms doing business in their area. The difference between the first wave and the second wave, as shown in Table 2, is that the incentives are extended to local firms for retention and expansion purposes as well as to outside firms that are looking to locate locally. The

Table 2. Classification of Economic Development Strategies

Component	First Wave	Second Wave	Third Wave
Goal	Attract outside firms	Retention & expansion of existing firms	Enhance regional resources to promote industrial clusters
Location Assets	Discount them to attract outside businesses	Reduce taxes and provide incentives to all businesses	Build regional collaboration
Business focus	Outside firms	Assist all local firms	Create context for better relations among firms
Human resources	Create jobs for local unemployed people	Develop training programs	Utilize workforce training to build businesses
Community base	Physical resources	Social and physical resources	Leadership and development of quality environment

Source: Adapted from Blakely and Bradshaw (2002).

third wave of economic development policies, which is still unfolding, corresponds to the demand side policies listed above and aims at enhancing regional resources to promote industry clusters. While the waves denote an evolution of economic development strategies, all three types of policies are pursued concurrently. States and to a lesser extent local governments have an arsenal of incentives and tax-reduction measures aimed at reducing the cost of doing business in their jurisdictions while at the same time pursuing programs that provide the infrastructure to support business growth.

4.1. Tax Incentives

The use of tax incentives as an economic development tool must be viewed with respect to a state's basic tax system. As states have been more aggressive in competing for jobs they have become more concerned about their overall business tax climate and have taken steps to avoid any tax that may be viewed negatively by potential investors. They also are careful that their overall tax structure does not look too different from their competitor states. Shannon (1991) points to six characteristics that may raise concern among investors: 1) a high overall tax burden, 2) business taxes that are out of line with other states, 3) heavy property taxes on business realty, 4) any property tax on business personal property, and 5) a sales tax on a substantial share of business purchases. Therefore, many states that levy taxes on such aspects of doing business in their jurisdiction may turn to tax incentives to try to reduce their effect on business costs. Fisher and Peters (1998), using a hypothetical firm analysis computed for the 24 largest industrial states, found that the state and local tax rate of the state with the highest tax burden is generally three times the tax rate of the state with the lowest tax burden. However, they found tax incentives did not help close this gap in tax burdens across states. States with a favorable basic tax system appear to be just as aggressive in offering tax incentives as those that have a less favorable tax system.

Tax incentives are commonly offered in the form of tax credits, tax abatements and reductions, tax exemptions, tax refunds or a mix of tax benefits. A national survey of state economic developers compiled a total of 1,105 business incentive programs across the 50 states. Of those, 40 percent are tax-based and about 2 percent are categorized as mixed. Tax credits are the most prevalent of the tax incentives (258 out of a total of 445 tax incentives) with tax exemptions a distant second (101). All but four states — Alaska, Nevada, South Dakota, and Wyoming — have at least one tax credit program. Three of the four states without tax credits do not have a corporate income tax. Alaska is the only state in the country with a corporate income tax that does not provide any tax incentives. The use of tax incentives seems to be distributed fairly evenly across regions of the country, at least with respect to their population share. For instance, states in the South, which in the 1950s and 60s aggressively lured manufacturing plants from the north, offer 40 percent of the tax incentives, while claiming 36 percent of the population. The states in the West offer the fewest incentives — 17 percent, but this is still in line with their share of the population, 17 percent. The value of the incentive is not necessarily associated with the number of programs, since some states can be more generous than others in the extent to which tax incentives reduce a business's tax burden, as discussed above. The most recent estimate of the value of tax incentives approaches $4.6 billion in foregone state tax revenues.

Each tax incentive is associated with a particular state or local tax. Tax credits are used to reduce the tax rate of corporate income taxes and include credits on different aspects of business. States offer tax credits against investment, new jobs, inventory property tax, sales tax on fuel and electricity, and other state income taxes. Tax exemptions are typically related to a state's sales tax on business purchases. States exempt manufacturing machinery and equipment and electricity and natural gas. Instead of complete exemption, some states reduce the tax rate on specific expenditures if used directly in the manufacturing process. Tax abatement is associated with property taxes, which are levied primarily by local governments. Therefore, tax abatements are one of the key economic development tools used by local governments. Local governments may offer them to businesses that are locating or expanding their facility or may designate only certain locations, such as within enterprise zones, within which businesses are eligible for the tax breaks.

The advantage of these tax incentives in reducing the tax burden of businesses depends to a large extent on the type of business, their use of the various inputs that are targeted by the tax incentives, and the respective tax rates. Fisher and Peters (1998) show that a typical tax abatement results in the largest percentage reduction in tax burden for the various types of businesses included in their analysis, followed by the sales tax exemption for manufacturing machinery and equipment and then the new jobs tax credit. These incentive programs reduce the tax burden for a group of representative firms in the range of 9 percent to 36 percent.

4.2. Non-tax Incentives

Non-tax incentives are even more prevalent than tax incentives. The survey of state economic developers reveals 643 programs. Non-tax incentives are offered through direct or indirect financial assistance to businesses. The survey defines direct financial incentives as financial assistance through grants, loans, equity investments, and loan insurance/guarantees to businesses through the state government or a state-funded organization.

In addition to addressing business financial needs, these programs also invest in workforce training, market development, manufacturing modernization, and technology commercialization (NASDA, 2002). States also provide grants and loans to local governments and community organizations, such as universities, community colleges, and training providers, to support business investment and community economic development. The latest tally of expenditures on non-tax incentives amounts to $5.3 billion, with 35% of the funds devoted to community assistance (indirect non-tax incentives) and 23% to workforce preparation and development. Upwards of 21% was spent on direct financial assistance to businesses. Not included in the $5.3 billion estimate for non-tax incentive spending are infrastructure subsidies.[2] States provide funds for road improvements and water and electricity hookups to new, relocating, or expanding facilities.

The analysis by Fisher and Peters (1998) shows that non-tax incentives are generally of greater value to firms than tax incentives, especially when only state incentives are considered. The most that tax incentives contributed to the overall effect of the entire state incentive package was a 16 percent reduction in the tax burden. Including city incentives raises the contribution of tax incentives to as much as 75 percent because of the property tax abatement component. The contribution varies by firm size, however. Non-tax incentives are more beneficial to small plants than large plants. The reason is that most non-tax incentives have strict threshold limits, such as a maximize loan size, and small plants are less likely to hit that ceiling. Nonetheless, infrastructure and training grants are the most significant class of non-tax incentives, with job training assistance having the largest impact, even for large plants.

Fisher and Peters (1998) offer a useful metric for understanding the extent to which incentives may affect the location decisions of firms. They measure the range of incentive effects in terms of equivalent savings in wages. They find that the difference between the most attractive and least attractive location sites, after taking into account the combined effects of taxes and incentives, is equivalent to paying all employees 72 cents an hour less, for each hour worked over the 20-year life of the plant. With the median manufacturing wage at $18.35 per hour, this wage differential of 72 cents is only 4 percent. Studies have shown that a 2 percent difference in wage costs can offset as much as a 40 percent difference in taxes (Cornia, Testa, and Stocker 1975). Given the much wider variation in wage rates across metropolitan areas, Fisher and Peters conclude that it seems unlikely that taxes and incentives are large enough to overcome spatial differences in the costs of labor and other factors of production. For places where incentives have made a difference, they appear to serve as tie-breakers between similar locations. Obviously, states and local governments continue to offer incentives for fear that if they do not, they may lose out to a similar region that does.

Studies of the actual responses of businesses to location incentives have not produced overwhelming results showing that incentives do work. One problem is that it is difficult to measure with any precision the value of the package of incentives to businesses, except for the approach used by Fisher and Peters. Evaluations of specific programs have been conducted, but these are lim-

[2] The federal government provides states and local governments with more than $20 billion annually to expand and improve their highway systems. States and local governments have a good deal of discretion in how these funds are to be used and thus these funds should be considered as part of the economic de-velopment efforts of these jurisdictions.

ited and the results are mixed. State and local governments perform return on investment calculations of some of the offers extended to businesses, but both the costs and the benefits are difficult to quantify. Benefits are particularly difficult to estimate since there is no appropriate counterfactual of what would happen if the company did not move to the area, or even whether or not the company would chose to locate locally even without receiving the incentives. Bartik (forthcoming) concludes that incentives have little effect in low unemployment areas but can have a positive benefit/cost ratio in high unemployment areas. In addition, Bartik suggests that the effectiveness of incentives can be improved by opening the process up to broader public participation, subjecting incentive packages to more rigorous benefit-cost analysis, encouraging stronger coordination of incentives at the local level, and tying incentive offers to performance goals and legally-binding "clawback" provisions. These improvements can be accomplished through stronger public/private partnerships, as discussed below.

4.3. Place-based Development Programs

Since the 1980s, federal, state, and local governments have established economic development policies that focus on stimulating private investment in specific chronically depressed areas. These policies have taken the form of enterprise zones, empowerment zones, industry processing zones, and community development zones. These programs target resources to companies that are willing to locate within a designated area, which by several measures has a high unemployment rate and concentration of poverty. These programs make low-interest loans in older and existing neighborhoods of metropolitan areas, grant tax breaks on hiring, developing, or sustaining economic activity, and market poor neighborhoods to potential investors. Michigan, for example, has established 20 regions of the state as Renaissance Zones, which are located in areas of high unemployment, poverty, and on abandoned industrial sites. Companies willing to locate in these areas are exempt from paying nearly all state and local taxes. The size of the zones ranges from 5 to 3,000 acres.

Studies of the benefits of such place-based economic development initiatives show that they have little effect on business decisions. For example, Peters and Fisher (2002) studied 75 enterprise zones in 13 states and concluded that few location decisions are made in response to place-based incentives, that any wage premiums associated with the zones are minimal, and that the programs are expensive to state budgets. Greenbaum and Engberg (2000), using detailed establishment-level data, found that many of the establishments that chose to locate in enterprise zones moved to the zones from areas close by, so the net effect was basically a shuffling of locations and did not result in a net creation of new jobs for the larger area.

4.4. Example of Economic Development Activities

The previous section offered generic categories of incentives and programs offered by most of the states. The specific programs and activities pursued within each one of these categories vary across jurisdictions and over time. New administrations will bring their particular brand of programs, replacing the old ones in name and at times focus. The desire to nurture high-technology firms, such as biotech firms, in many states has replaced the heavy emphasis on business recruitment, for example. States are quick to copy economic initiatives pioneered in other states, so it does not take long for many of these programs to be widely adopted.

To get a better sense of the package of incentives offered by states and local governments, I reproduce the table of Michigan programs compiled by Bartik, Eisinger, and Erickcek (2003). For perspective, Michigan has a population of 10 million, total private-sector employment of 4.4 million, manufacturing employment of 730,000, and an unemployment rate of around 7 percent. Even though Michigan has the one of the highest unemployment rates in the nation and is experiencing significant restructuring within its manufacturing sector, its economic activities are similar to those of other states. It places a large emphasis on tax incentives for firms to locate or expand in the state. As shown in Table 3, nearly three-quarters, $531 million, of the total economic development expenditures in the state are devoted to tax incentives. The lion's share of these incentives comes from local governments through property tax abatements for new and expanding firms. Due to the nature of tax abatements and other tax incentives, the $330 million attributed to tax abatements, are not direct

Table 3. Annual Resources Devoted to Economic Development Activities in Michigan, 2003

A. Tax Incentives	Description	Level of Government Funding	Amount (million USD)
Industrial Facilities & Property Abatement	50% tax break on new projects; 100% on expansion	Local; state indirectly via formulas	$330
Tax Increment Financing	Property taxes devoted to infrastructure and other area-specific services	Local; state indirectly via formulas	90
MEGA Tax Credit	Selected projects; mix of hi-tech and other industries	State	46
Brownfield Tax Credit	Tax credit for redevelopment of abandoned industrial sites	State	28
Renaissance Zones	Complete tax exemption from local & state taxes in designated areas	Local and state	26
Empowerment Zone & Enterprise Community	Tax credit for targeted expenditures in selected pre-determined areas	Federal	11
B. Non-Tax Incentives			
SBA Loans	Guaranteed loans to small businesses	Federal	
Economic Development Job Training	Grants from state to support training for specific firms, including new location, expansion, and retention	State	13
Life Sciences Corridor	Funds for biotech research at universities that lead to job creation	State	42
Michigan Manufacturing Technology Center	Technical assistance to improve productivity in small and medium size manufacturing firms	30% federal, 20% state; 50% fees	7
Infrastructure Investment	Federal Community Development Block grants for non-urban areas	Federal	60
State Activities	State efforts to retain and recruit business	State	33
Local Activities	Similar to state efforts but by local organizations	Local	15
Federal Activities	Federal support for local small business development centers	55% federal, 45% local	5
		Total	$706

Source: Bartik, Eisinger, and Erickcek (2003).

expenditures of local governments, but rather the amount of revenue from property taxes that they do not collect. The presumption is that additional tax revenue will be forthcoming because of the new and expanded economic activity in the area. The State and Federal governments also provide tax incentives through credits on state and federal corporate income taxes, but the estimated amounts of these incentives are relatively small compared to the local governments' efforts. Renaissance zones are a state program that offers tax breaks for investment in distressed city neighborhoods and rural areas. They are like enterprise zones, but waive all business and resident state and local taxes, including property taxes, city and state income taxes, and the state business tax, for up to fifteen years.

Non-tax incentives are relatively small in estimate dollar amounts compared with the tax incentives. These are direct expenditures by government entities, and thus are subject to budgetary limitations. For State of Michigan, the largest state program is Life Science Corridor Grants, which funds biotech research at universities that has the potential to lead to job-creating business ventures. The largest Federal contribution is through Community Development Block Grants, which is a federal program to fund local infrastructure projects that are determined by local government entities. Not listed in the table, but also a significant Federal contribution, are highway funds for road construction.

4.5. Economic Development Incentives and Local Economic Conditions

Do policy makers and economic development practitioners use incentives to respond to local economic conditions? More specifically, has the slow employment growth during the past four years prompted states and local governments to offer more and richer incentive packages? There is no clear consensus from the various empirical studies on this topic that incentives are more prevalent during recessions that during expansions (Fisher and Peters, 1999). One reason is that incentives cost money and during recessions or periods of slow growth distressed states are not in a financial position to devote significantly more funds to economic development efforts. Furthermore, the push to expand state incentives may have trouble gaining sufficient political support since it is not certain how effective such incentives may be in increasing jobs within the immediate future. The effects of economic development efforts may be more long-term and by the time they work, if they do, the recession may be over and the state may have moved into an expansionary period.

There is also little agreement as to whether states that have long-term structural problems that place them at an economic disadvantage pursue incentives more aggressively. Fisher and Peter (1999) find no correlation between the amount of standing incentive offers by states and local governments and the unemployment rates within these jurisdictions. Even if states do initiate new and more generous incentive packages during times of economic distress, they are reluctant to reduce or eliminate these incentives during good times for fear of being labeled as "anti-business." Furthermore, states tend to imitate one another so that they do not appear to be less responsive to the "needs" of business than their neighbors. Hanson (1993) found considerable long-term inertia in state-level economic development policy making.

5. Small Business Development

Small businesses have been hailed as the source of most new jobs, and for this reason much attention has been given to ways to promote small business startups. Such claims are exaggerated, however. According to Davis, Haltiwanger and Schuh (1994), there is little correlation between firm size and their contribution to net employment. Nonetheless, small business can have a positive effect on the growth of the local economy in several ways. First, although they typically sell locally, they can still expand the local economy if their sales replace goods and services that were previously imported into the region. Second, new small businesses may expand the local economy by hiring persons who are hard to employ and giving them the opportunity to gain skills and expand and improve the quality of the labor pool. Third, some small businesses, typically those focusing on high-technology applications, introduce new products and innovations into the local area that can be a catalyst for other similar enterprises possibly leading to a new cluster of economic activity in the region (Bartik 2003).

Programs to help startups and small businesses typically include entrepreneurial training, small business advice, business incubators and capital market programs. Entrepreneurial training offers instruction in the basics of starting and operating a business: developing a business plan, devising a marketing strategy, and learning where and how to apply for financing. Such training is prominently offered by the federal Small Business Administration (SBA, an agency of the Department of Commerce) through the more than 1,000 Small Business Development Centers (SBDCs). Half of the funding for these centers comes from the Small Business Administration and the other half from state and local sources. These Centers serve around 250,000 people annually. Many who receive assistance already own a business while others wish to do so.[3]

Business incubators provide inexpensive space and shared administrative support to help entrepreneurs start and grow their businesses. Today, according to the National Business Incubator Association, there are about 950 business incubators in the United States, up from only 12 in 1980. Incubators are established to meet a variety of needs, from fostering commercialization of university technologies to increasing employment in economically distressed communities to serving as an investment vehicle. Most incubators are non-profit organizations, sponsored by universities, government entities, and economic development organizations. Over a third of the incubators focus exclusively on technology businesses, less than 10 percent serve manufacturing firms, and nearly a half are for mixed uses assisting a range of early-stage companies. Business incubators differ from SBDCs in that they specifically target early-stage companies, whereas the centers often serve small businesses at any stage of development. However, some business incubators partner and share management with SBDCs to avoid duplicating business assistance services in a region.

Evaluations suggest that incubator assistance helps their clients, although many of these evaluations are not rigorous and based on customer satisfaction surveys or do not use appropriate comparison groups of firms. Nonetheless, surveys reveal that about two-thirds of incubator clients said that incubator assistance was important to their success, and the National Business Incubator Association reports that 84 percent of firms leaving incubators stay within the local community.

Small businesses also receive financial assistance through local revolving loans funds and through subsidies to private lenders to assume more risk. The revolving loan funds are created with public subsidies, many of which were originally capitalized with grants from federal agencies, such as the Economic Development Administration. These funds are supplemented with state and local investments. The Small Business Administration also administers a guarantee loan program, which is operated in partnership with private banks. Bartik (2003) summarizes several studies that examine the effectiveness of these programs and concludes that they are providing loans to businesses that private banks would not be willing to make.

High-technology startups have access to the same services and incentives that small businesses enjoy, as long as the size threshold for some government programs is not exceeded. In addition, some states have established designated funds to promote the creation of high-tech firms. Pennsylvania and Ohio, for example, have established technology centers (Ben Franklin Technology Partners and the Edison Technology Centers, respectively) which have strong ties with world class universities and federal research facilities, providing state of the art basic and applied research technologies; a range of technical services including testing, technology analysis and assessment, training, hotlines, business and economic studies, information database retrieval, pilot plant and micro-factory assistance and computer modeling; networking and services which cover informational needs through frequent seminars, forums and conferences.

6. Who Provides Economic Development Services?

The provision of government services in the United States is characterized by a bottom-up, decentralized structure. With few exceptions, state and local govern-

[3] One of the only random assignment evaluations of the effectiveness of small business assistance was conducted for the self-employment experiments associated with the Unemployment Insurance System. This program offered the unemployed entrepreneurial training in lieu of unemployment compensation. The evaluation showed that 60 percent of those who received the training ended up with some self-employment experience compared with 44 percent of those in the control group.

ments have been given the responsibility of providing services to their residents, such as public safety, education, the building and maintenance of roads and other infrastructure. As a result, the implementation and evolution of various social programs, including economic development and workforce development initiatives, have benefited greatly from the innovative and experimental approaches that states and local governments have pursued. Several programs adopted at the federal level were first initiated and developed by state and local governments. The federal government may partner with state and local governments in order to ensure that minimum standards are maintained across the country in providing services or that adequate funding is available for programs that have externalities that extend beyond the borders of the state jurisdictions. Economic development efforts are clear examples of a bottom-up, decentralized approach to developing policy and delivering services. In fact, as evident with the partnerships described below, the grass-roots efforts even extend beyond governments. Non-government organizations and businesses have initiated many innovative economic development programs.

For states, economic development activities are typically operated through state agencies and carried out by state employees. A few states have tried to move some of these activities into the private sector in order to be less encumbered by salary caps on agency executives and to have more discretion in working with private employers in putting together incentive packages. For instance, the State of Michigan established a quasi-government entity in the late 1990s in which the economic development unit was able to employ staff that was not under the state's employment and salary policies while still using state government funds to leverage economic development efforts. Described as a corporation, the Michigan Economic Development Corporation, was created through inter-local agreements between the Michigan Strategic Fund (the vehicle by which state appropriations are made for economic development) and local economic development agencies. The Michigan Economic Development Corporation is governed by an executive committee comprised of members from the private sector who are appointed by the governor.

Most of the variation in the types of organizations pursuing economic development activities occurs at the local level. While local governments take responsibility for several aspects of economic development, such as zoning regulations and infrastructure development, many communities have established private non-profit organizations to promote their area. A survey of chief municipal administrators revealed that public/private partnerships and private business have a significant role in developing local economic development strategy.

7. Partnerships

The hallmark of many economic development organizations is the emphasis on forming strong partnerships with local governments, private entities, and non-profit organizations in the community. Historically, there has been a distinct separation between activities related to workforce development and those related to economic development. These activities are typically performed by different levels of government and by different non-government entities. However, in recent years, as employers have become increasingly frustrated with the lack of qualified workers, organizations responsible for economic development have recognized that workforce development is one of the top priorities of economic development. They have consequently turned their attention to forging closer working relationships with the workforce and educational systems. At the same time, workforce development agencies have come to recognize that their customers include not only job seekers and trainees but also businesses. The current federal workforce program, the Workforce Investment Act of 1998, calls for greater involvement with businesses by reserving the majority of seats on the state and local workforce investment boards for business representatives. These boards set workforce strategies for their respective areas, within the guidelines and requirements of the federal programs that they administer.

The emergence of partnerships has made dramatic changes in *how* and *by whom* economic development initiatives are pursued, but less so in *what* is provided. Many of these partnerships are based upon the cluster concept and constitute the third wave of economic development initiatives described in section 4. They emphasize networking, integration of services, attention to the needs of business, active involvement of the business community, and workforce preparation. Incentives, as described in the previous sections, are still essential instruments in state and local economic development strategy, but they are used differently. States and local governments recognize that they should use their incentives and investment more wisely and strategically, such as nurturing existing clusters rather than trying to "buy" new ones. Economic development partnerships are paying closer attention to the needs of existing businesses, identifying their region's strengths and building on them. They are also addressing the barriers facing their region's key and emerging industries, and they are working collectively, not individually, with customers to solve the problems they face (NGA 2002).

At the same time, these economic development partnerships rely to a large extent on existing economic development programs and tax and incentive tools. While many have been able to obtain the support of charitable foundations, typically for the purpose of helping to generate jobs for low-income persons, and some have been able to garner support from key businesses in their area, the largest source of funds is from government sources. Therefore, partnerships turn to the same tools that government economic and workforce development agencies have at their disposal, but they often combine these in ways that government entities are not able to because of regulations and other constraints as government entities. Therefore, partnerships provide the flexibility to delivery services in innovative and effective ways that in many instances can better meet the needs of businesses and job seekers.

Partnerships reflect the needs of the industries and communities that they seek to serve. Therefore, it is impossible to provide a profile of a typical partnership, yet they do share common elements. The OECD/LEED has been instrumental in exploring the contribution of area-based partnerships to improve policy effectiveness and governance, by sponsoring at least three studies on various aspects of this topic. This section includes descriptions of several partnerships, most of which were included in these studies (Eberts, 2001).

WIRE-Net, the Westside Industrial Retention and Expansion Network, was established in 1988 by residents, businesses, and workers in a west-side neighborhood of Cleveland, Ohio. It was formed to create a community development strategy that would promote further growth and retain existing small-and medium-sized businesses. The neighborhood has been home to small tool-and-die manufacturers that were coming under increased competitive pressure from other areas. WIRE-Net's 12 full-time staff focus on workforce development, industrial real estate development and specific business issues to the 150 companies that are part of the network. They operate a precision machining training program to help local residents meet the skill needs of local manufacturers. They also lobby the City of Cleveland for improved infrastructure and services. It is funded by the City of Cleveland, the State of Ohio, federal agencies, foundations and membership fees.

The Right Place Program is a private, non-profit organization focused on promoting economic growth in the urban core of Grand Rapids, Michigan. It provides the standard set of economic development services (e.g., information on industrial sites, tax abatements, statewide business incentives) and works closely with businesses to help them connect with the proper government agencies to receive the appropriate incentives and assistance. In addition, it has partnered with other organizations to offer several unique programs. One such initiative partners with the City of Grand Rapids to redevelop abandoned industrial land in the inner city. Such a venture is risky, since companies looking to locate in an area are more attracted to undeveloped "greenspace" than to urban locations with uncertain payoffs.

Another partnership runs the largest industrial park in the state of Michigan. Battle Creek Unlimited (BCU) is a private, non-profit organization sponsored by the City of Battle Creek, Michigan established in the 1970s to help stem the loss of more than 10,000 export-based jobs during the previous two decades. BCU acquired 3,000 acres of a closed U.S. military base on the outskirts of the city and used this developable land along with its partnerships with the city government and the local community college to attract over 70 companies and 7,000 jobs. A considerable share of this investment is by Japanese auto suppliers.

Another type of partnership is centered on labor unions and businesses to retain and expand job opportunities for union members as well as non-unionized workers. The Wisconsin Regional Training Partnership (WRTP), a not-for-profit organization, was established in 1992 in response to the dramatic shift away from manufacturing in the Milwaukee, Wisconsin economy during the 1980s. During that time, the Milwaukee economy lost a third of its traditional industrial base. The Wisconsin AFL-CIO labor realized that its displaced worker program offered only a limited response to the broader issues facing their members and the Milwaukee workforce. Seeking broader solutions, the union partnered with employers and with the Center on Wisconsin Strategy at the University of Wisconsin. Since then the WRTP has partnered with an array of agencies and institutions to create programs that help develop family-supporting jobs, improve the skills of current employees, and recruit unemployed and low-income workers and youth into the sector. The partnership now has 63 member firms, 42 local unions and 14 international unions accounting for 60,000 industrial jobs in the area — more than one-fourth of the total. WRTP is funded through private foundations, public workforce programs, and federal grants.

Local workforce agencies comprise a wide and deep network of partners that are directed toward meeting the workforce needs of local businesses. Increasingly, they are becoming more closely integrated with the economic development efforts within their jurisdictions. The Workforce Investment Act of 1998 established more than 600 Workforce Investment Boards (WIBs) across the country. They are responsible for providing labor exchange and workforce training services to workers and businesses within their local areas. To do so, they subcontract with local providers, which include government entities, non-profit organizations, and for-profit businesses. Each WIB is governed by a local board of which the majority of members are representatives of local businesses. In many areas, the WIBs act as facilitators to bring together the various entities — businesses, social agencies, educational institutions, labor groups — to help address workforce issues in their areas. The extent to which the local WIBs are proactive in assuming this role varies. Nevertheless, WIBs have emerged as significant catalysts for integrating workforce and economic development activities in various areas.

Partnerships are constantly evolving as they try to position themselves to meet the needs of businesses in order to generate or retain jobs for their constituents. It is difficult to measure their success (Eberts, 2005). Even though some evaluations have been conducted showing positive results, none as yet has used an appropriate comparison group to see if they actually add value to their participants and stakeholders. Nonetheless, bringing together key stakeholders and leveraging resources can be a powerful catalyst. Several lessons for successful partnerships were gleaned from the OECD/LEED studies. The more pertinent ones for promoting economic development are: 1) business, as customer, should be the common focus; 2) outcomes must be agreed upon, quantified, and tracked, 3) local organizations must become entrepreneurial and problem solvers and form strong networks among the stakeholders; and 4) strong leadership is required to help define and advocate for the common purpose and to mobilize community resources (Eberts, 2003).

8. Capacity Building

With so many state and local governments, as well as non-government entities, engaged in economic development activities, there is a need for qualified leaders and staff to lead and carry out these efforts. In many instances, economic development leaders come from the business sector, and not from government. Leaders also emerge from the non-profit sector, and there is a growing group of individuals, sometimes referred to as civic entrepreneurs, who have led innovative economic development initiatives. Training of these individuals takes place on the job and through universities and professional associations. With the large number of entities engaged in economic development activities, professional networks, both formal and informal, have been formed. Some of the professional organizations, such as the Michigan Economic Development Association, offer courses for their members. Members who successfully complete the courses receive various levels of certification. Increasingly, universities are offering Master's degrees in public administration, with an emphasis on economic development. These programs help to advance an understanding of fundamentals of economic development, to evaluate what works and what does not work, and to pass along examples of best practices to practitioners.

9. Conclusion

Best practice in the field of economic development points to policies that promote a business climate that enhances productivity, nurtures entrepreneurship, and encourages collaboration. A key element of such an environment is the development of a workforce with the skills and motivations required by businesses. To improve such an environment, state and local economic developers use an array of financial incentives and resources. Financial incentives are also used to reduce the tax burden within their local areas. Yet, there is a growing realization and political pressure that not enough funds are available to provide sufficient incentive packages to overcome sizable differences in the business environment across regions. Also, the breadth of competition is much greater than in the past. Each state or city is not only competing with their neighbors but also with economies around the world, many of which have cost advantages that incentives can not come close to closing. Economic developers, therefore, are seeking to use their limited resources more wisely and strategically and are leveraging them with the existing resources and infrastructure (physical and social) within their communities. To do this, partnerships of various kinds have sprung up across the country. Many are relatively small and targeted to specific neighborhoods and industrial sectors. Others are broader-based but less focused. Yet, in being responsive to business and constituents, they have the potential to be flexible and better positioned to bring together a community's assets to nurture future growth.

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