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Regions as Loci of Conflict and Change: The Contributions of Ben Harrison to Regional Economic Development

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By 1970, the civil rights and anti–Vietnam War legacies had provoked new forms of scholarship and novel approaches to regional and industrial planning. Bennett Harrison was a key figure in the shift from regional science toward a politically committed scholarship that incorporated new radical and institutionalist theories with creative empirical analyses and links to real world practice in economic development. Harrison, I argue, saw regions as loci of capitalist conflict and change, not as the rarified analytical units of regional science or as the faceless regional actors of the “new regionalism.” The actions of corporations and labor unions and the conflict between firms and between capital and labor were central to his interpretation of regions, which he approached in an unabashedly inductive manner. In this article, I review Harrison’s regional writings and make the case for the durability of his insights and his path-making contributions to the field.

In the 1970s, a number of freshly minted economists, political scientists, sociologists, and geographers, influenced by the on-campus intellectual ferment of the Vietnam War period, began to question the narrow and politically disconnected analyses of urban economics and regional science. Graduate students in the late 1960s had begun to complement their class reading with study groups on Marx and the institutionalists, producing new affinity groups and journals—radical political economy (RRPE), radical geography (Antipode), and Kapitalistate, for example. With some variations, they introduced (or reintroduced) concepts of historical materialism, class conflict, and capitalist crisis tendencies back into urban and regional analysis.

Bennett Harrison was one of a number of economists who began to devote his work to dissident views and interpretations of spatial phenomena. He devoted his doctoral work to urban poverty and prospects for Black inner-city residents. After moving from economics to planning as his academic home, he added regional analyses to his portfolio. In several of his books and in 10 articles, Harrison sought to interpret the pace and character of regional growth, first in his own adopted New England, and later in other high visibility regions, Emilia-Romagna in Italy, Silicon Valley, and also in Pittsburgh, where he taught for a number of years in the early 1990s.

In what follows, I remark on several attributes of Harrison’s regional approach, which is profoundly inductive and synthetic—that is, built upon theories and evidence from a number of

AUTHOR’S NOTE: My thanks to Ned Hill and John Brennan for excellent comments and to Michael Leary and Gregory Schrock for research assistance.
disciplines. I argue that Harrison never reified the region, as regional scientists did before him and many new regionalists are doing today, but saw regions as loci of conflict and change. I demonstrate the centrality of class conflict in his work, a particularly important contribution in the American context where class is muted or absent in most analyses. Even his interpretations of the firm were strongly shaped by his normative concern for workers and his considerable skills at analyzing the occupational and income consequences of corporate decision making. Harrison (1984) gave center stage to competition between firms, which he interprets differently from the neoclassical model of pure competition, and he consistently acknowledges the powerful role of the state at all levels:

The future development of the newly emerging economic base depends on the interplay between the forces of competition among firms on the one hand and the antagonism between managers and workers (both inside the workplace and in the community) on the other, all mediated by the policies and regulations of governments at the local, state, and, especially, federal level. (p. 50)

The focus on the state permitted him to engage in a relatively sophisticated way in regional policy analysis and economic development prescription. He was a consistent advocate of the public sector and its ability to intervene on behalf of working people.

AN APPRECIATION FOR HISTORY AND EVIDENCE

Harrison’s work on regions was so successful, I believe, because his unapologetic advocacy of working people and communities was accompanied by a method that placed great stock in data, scientific methods of testing, and historical specificity. In his first full-length assessment of New England’s relatively unique regional economy, “Regional Restructuring and ‘Good Business Climates’: The Economic Transformation of New England Since World War II” (1984), Harrison adopted a historical framework. Here, Harrison offered a careful and unconventional interpretation of the origins of the 1970s wave of growth in New England. He devoted the first portion of the chapter to an extensive and synthetic discussion of the industries (textiles, machining, aircraft engines), key firms (General Electric, Pratt & Whitney), and occupations (the shift from a disproportionately large blue-collar to white-collar distribution). The richness of this discussion is the result of Harrison’s ability to synthesize historical literature with emerging radical as well as conventional social science concepts. In subsequent accounts of New England, he took care to insert historical argument when it was important to demonstrating context and causality (Harrison & Kluwer, 1989).

Similarly, in his critiques of the Italian and Silicon Valley literatures, which painted relatively static pictures of networked production among relatively small and cooperative producers, Harrison strove to place each region in historical context, showing how earlier periods of district formation gave way to the present and probing the new forces eroding and altering each district’s character (1994a, 1994b). In these efforts, his work was chiefly synthetic, relying on secondary literature and deftly confronting overly simplistic accounts with solid evidence of missing actors, contingency, and change.

Harrison’s ability to weave in original and secondary data in support of his arguments gave his work considerable weight. In another relatively unusual article, written with Maryellen Kelley and Jon Gant (1996), the authors take on the hypothesis, embedded in the new industrial districts and clustering literatures, that localization economies are stronger determinants of innovation and economic development than are urbanization economies. Using sophisticated statistical techniques on a large survey data set and controlling for a number of other explanatory factors, they found that urbanization economies continue to be strong and dominant in explaining innovation.
Harrison was interested in regions primarily as arenas in which conflict and change take place. He studied those regions in which he was working—New England, where he taught at the Massachusetts Institute of Technology; California, where he taught at the University of California-Berkeley one semester and frequently visited; Pittsburgh, where he taught at Carnegie Mellon University; and Europe, where he often collaborated with other regional scholars. He was relatively uninterested in the microeconomics of regional growth—the stuff of location theory, trade theory, and so on. Indeed, he rarely speculates in his work on why some regions grow faster than others although he sometimes demonstrates such differentials (Bluestone, Harrison, & Gorham, 1987; Harrison, 1982). Nor does he spend much intellectual capital on the role of national policies in causing differential growth rates.

Instead, Harrison used the regions as a stage on which to demonstrate firm (he preferred the term corporation) behavior and dynamics as well as labor’s role and response. Although he generally focused on a single region, he often began or closed by reflecting on whether the patterns he found might hold in other regions. He suggested (1982), for instance, that other U.S. regions might follow New England’s deindustrialization path in the future (p. 41), whereas he disparages the possibility that other regions could emulate Silicon Valley.

Harrison frequently began his regional studies by positing a normative concern. For instance, writing critically of the apparent revival of New England in the early 1980s, he downplayed the significance of efficiency, as evinced in aggregate growth rates, and focused on the other two goals of the traditional economist’s triad—equity and stability. At the time he wrote, the economics profession was already retreating from an even-handed concern with all three, in large part the result of the transcendence of the so-called micro foundations of macroeconomics school over Keynesians and institutionalists. But in Harrison’s work, distribution and stability matter. In his “Instability and Inequality” (1982) article, he documented the worsening income distribution accompanying the region’s revival and warned that the region may become less stable in the future.

Mirroring the seminal article of Doreen Massey and Richard Meegan, “Industrial Restructuring Versus the Cities” (1978), Harrison also rejected the notion that the causal forces in regional development can be found solely in the region itself. In an article on plant closings (1989), he demonstrated the futility of searching for causality in the characteristics of localities. His evolving thinking about regions was strengthened by his work on the Black ghetto and labor. In an early 1980s talk to the City and Regional Planning Department at Berkeley, he revealed that he had come to believe that he had been studying the wrong actors, that it was capital, not labor or minorities or localities that were the most powerful shapers of society, and that it had come time for him to study capital. This insight marked the beginning of his long interest in the behavior of large firms and consequences for workers and communities.

Nevertheless, Harrison remained committed to the regional scale in his work, not because it provided a satisfactory theoretical entry point but because it is there that the politics of change are rooted. In Harrison’s macro work with Barry Bluestone, it is Harrison, with his origins in a northern New Jersey working-class community and his work on ghetto economics, who continually grounds the research in particular regions, whereas Bluestone’s background as the son of a major labor leader pulls Harrison’s work toward the national level. In The Deindustrialization of America (Bluestone & Harrison, 1982), for instance, they illustrated the ravages of deindustrialization by choosing particular communities and regions—Youngstown, Ohio; Newark, New Jersey; Johnstown, Pennsylvania; and New England as a whole (chaps. 3, 4). These examples, and the use of Houston as a putative boomtown, are used to show the multiplier (or in their colorful words, the “ripple”) effects of deindustrialization and too rapid growth.

This moving back and forth from supraregional and powerful agents of change to the regional perspective can be seen even in Harrison’s unusual typological work with Michael Storper on industrial production systems (Storper & Harrison, 1991). Here, they placed firms and firm networks central to their ambitious analytical structure. But toward the end of the article, they shift the
viewpoint back to the region and show how this production system structure might appear if one looked outward.

THE CENTRALITY OF CLASS STRUGGLE

For Harrison, the structural antagonism between capital and labor is a central determinant of regional dynamics. This antagonism comes directly from Marxism and is arguably the single most profound distinction between a Marxist or critical approach and a neoclassical approach that posits the relative harmony of interests of owners of capital and labor power. Harrison’s emphasis on class politics is almost singular in the recent American regional literature.

In Harrison’s (1984) interpretation of New England’s regional dynamics, for instance, he continually stresses “the struggles of working people to improve their living conditions through direct action, unions, and participation in electoral politics” (p. 51). His account explained that capital flight was not simply a response to lower wages elsewhere, but to militant and successful labor organizing, not just in unions, but at the state and municipal levels. He reminds us that many industrial cities—Lynn and Haverhill, Massachusetts, and Norwalk and Bridgeport, Connecticut—had Socialist mayors and that these victories led to innovations in unemployment insurance and welfare programs at the regional level (p. 54). Among four factors explaining New England’s resurgence—recreation of a tractable labor supply, the availability of finance capital, new infrastructure, and active promotion of economic development by local governments—Harrison stressed the first:

I honestly believe that the “labor factor” is of paramount importance—precisely because it is so much more than a factor of production. (p. 64)

Harrison’s placement of class conflict at the center of his analysis enabled him to anticipate the future of the capital/labor relationship and its impact on regional growth. In 1984, he forecast, correctly, the decline of labor militancy and the displacement of class conflict from the workplace and into neighborhoods, suburban tract developments, and state capitals. In his work with Bluestone (Bluestone & Harrison, 1982), such conflict was framed as “Capital Versus Communities,” the title of one of the reports from a project commissioned in 1979 by a coalition of trade unions and community organizations concerned with the causes and consequences of plant closings all across the United States (p. 9).

ECONOMIC DEVELOPMENT IN A POLITICAL CONTEXT

Much of the recent new regionalism and new economic geography scholarship is surprisingly devoid of concrete planning and economic development counsel. Even when its proponents prescribe, they do so in a way that abstracts from the messy real world politics of place. Harrison’s regional work was extraordinarily skillful and nuanced, a product of his ongoing work with progressive politicians, labor, and community groups.

Harrison’s earliest work on New England, the 1974 study “Economic Development in Massachusetts” (1988), was commissioned by State Senator Alan McKinnon, “a friend of labor and one of the most powerful members of the legislature as co-chairman of the Joint Commerce and Labor Committee” (Lampe, 1988, p. 74). The study critiqued the conventional wisdom about Massachusetts’s slow growth and high unemployment problem (high cost of doing business, government as antibusINESS, the priority placed on industrial versus service development, and poorly motivated workers) and instead concluded that the causes are too many low-wage and unstable jobs, too little development capital, and virtually nonexistent economic planning in state government (p. 81). Harrison presented a six-point program for economic development: public investment in infrastructure, upgrading low-wage jobs, more carefully planned and visible manpower training,
enhanced equal opportunity programs, and yes, selective firm recruitment. But he did not stop there. He went on to propose an 11-point agenda for implementing the program (pp. 82-85). Many of these proposals did, in fact, become policy over the ensuing 15 years.

In his economic development policy work, Harrison departed from much of the public policy literature in rejecting the notion that there is a single common good. His policy prescriptions are thus not addressed only to the state but also to labor and community groups. Harrison is most interested in ways of enhancing the power and prospects of working people, and this prominence of class is reflected in his policy counsel. Unlike much of the new regionalist literature, which celebrates capital/labor collaboration or focuses on creating cooperative relationships between firms, Harrison’s evolving New England work called for interclass and interracial coalitions and new, place-based efforts to create jobs. The marriage of class and community is prominent in these prescriptions, which are preoccupied with what working and poor people’s organizations might do rather than with good government policy per se.

In Harrison’s national audience-oriented joint work with Bluestone (1982), the macro policy prescriptions of more public investment, a better social safety net, and radical industrial policy were complemented by those that are pioneered within, or targeted on, regions and localities: plant-closing legislation and early warning systems, worker ownership, and conversion of abandoned facilities (chap. 8). These latter formed common elements in the agendas of emerging labor/community organizing committees such as the Coalition to Save Jobs in Massachusetts, the Delaware Valley Coalition for Jobs in Pennsylvania, the Community-Labor Organizing Committees in Rhode Island, and the Coalition to Stop Plant Closings in Los Angeles, among others.

**METHODS OF RESEARCH AND ARGUMENTATION**

Harrison was sometimes disliked by regional economic developers, perhaps because his careful empirical work and powerful language provided effective ammunition for groups trying to prevent plant closings, start and maintain community-based development institutions, and pursue high-road paths to regional growth. Consider the following language, in Lampe’s (1988) introduction to Harrison’s 1974 study:

> Although Harrison’s views were colored somewhat by his particular views on labor issues, he presented an intriguing picture of Massachusetts’ economy from someone independent of the bias of both the state government and the business community. (p. 74)

Imagine how a parallel passage might sound if it suggested that a Federal Reserve Bank economist’s views might be similarly colored by particular views on business but independent of the bias of labor! As Ned Hill pointed out to me, Harrison’s work was viewed by reviewers and in the New York Times obituary as “intensely irritating but important” (Nasar, 1999).

Harrison, in his research, displayed an extraordinary ability to home in on the most significant questions and frame them in a way that would make a broad swath of readers, from practitioners to academics, want to read his work. Consider these chapter headings and subheading from Lean and Mean (1994b): Are small firms the technology leaders? Is Silicon Valley an industrial district? and Who is “us”?

His answers to such questions are always empirically grounded. His challenge to the myth of small businesses as significant job creators employed clear operational definitions and elegant data analysis (1994b). His work with Bluestone on “the missing middle” (Harrison & Bluestone, 1988) harnessed highly disaggregated data on incomes and economic regions to show regional patterns of growing inequality in income distributions, linked to differences in industrial restructuring.

By the 1980s, Harrison had developed a method for approaching regional economies that enabled him to identify key sectors and deficits and prescribe tailored economic development solutions. For example, on moving to Pittsburgh, he teamed up with Sabina Deitrick on a future-oriented study of the region. Their report (Deitrick & Harrison, 1994) advocated three initiatives: a
focus on industrial recycling, or remanufacturing; a selective growth-center strategy within the region, targeted on the Pittsburgh airport corridor; and better skills training for transformed manufacturing and emerging service jobs, especially for workers of color left behind.

Consider the dramatic difference between Harrison’s approach and that of new regionalist economists and geographers. Economic geographers Storper (1997) and Scott (1998) deduced the significance of metropolitan economic regions by positing a weakened nation state, but they offer no evidence for this contention. Along with economists Barnes and Ledebur (1998), they argued that metropolitan regions are the new building blocks of the economy. Their depictions abstract from significant (and often antagonistic) economic actors within these regions and omit the strong ties that many local firms, establishments, and industries have with units in other regions (Markusen, 1994, 1996). In contrast, Harrison (1994b) demonstrated the salience of large, global companies whose local commitments continue to wane and whose global machinations are greased by activist national governments.

Harrison's method of research and argumentation stands in contrast to a disturbing recent trend toward fuzzy conceptualizations unaccompanied by even the pretense of qualitative or quantitative evidence. Elsewhere, I demonstrate the inadequacies of concepts, such as flexible specialization, industrial districts, and world cities, all of which retreat to a lesser or greater extent from agency and causality in economic development and are difficult to operationalize (Markusen, 1999). In the same vein, the cluster notion as a new economic development approach has been critiqued theoretically by Feser (1998), who underscores the absence of theory, whereas Hill and Brennan (2000), in an energetic effort to identify clusters in northeastern Ohio, find that cluster features embedded in Porter’s (2000) narrative left some important regional sectors out of the running. With Glasmeier, Harrison (Glasmeier & Harrison, 1997) critiqued the notion, implicit in Porter’s (2000) cluster work, that competition between firms in regional clusters will drive successful development.

SCHOLARLY FLEXIBILITY AND LEARNING

An endearing aspect of Harrison’s regional policy work is his ability to learn from experience and change his mind over time. This demonstrates, I think, his strong social scientific orientation and willingness to confront real world evidence, a test to which few of the new regionalists appear willing to submit their work (Markusen, 1999). He was not a brute empiricist because his work was strongly informed by causal theories about actors, their behavior, and constraints in their environments. But neither was he an ideologue. By the late 1980s, for instance, in his “Reassessing the Massachusetts Miracle” article with Jean Kluwer, Harrison (Harrison & Kluwer, 1989) was willing to admit that his strongly advocated industrial policies did not seem to be working. They ascribed this to the Manhattanization of New England—the devolving of the state’s competitive advantage onto a small number of business services and the real estate and construction activities that refashion the built environment for these growth industries and their employees (pp. 790-792).

Harrison was also capable of appreciating genuinely new innovations in the regional planning field. In his “Old Wine in New Bottles” (1992), written in honor of Ben Chinitz, he asks whether the new industrial districts’ work simply resuscitates the work of earlier urban economists and regional scientists on agglomeration economies. He concludes in the negative, that the introduction of noneconomic variables, such as social connections and networks, and motivations, such as trust, constitutes something genuinely new in the literature.

In this case, Harrison not only welcomed the new, more expansive approach but began to employ it himself in a new round of work on his old topics: inner-city labor market organization and workforce training. Beginning in the early 1990s, he returned to a focus on the institutions that had grown up to serve inner-city poverty areas since the decline of the Great Society programs, especially community development corporations (CDCs) and related institutions such as community colleges. Applying the network notion and emphasizing social institutions, Harrison (1996) found that maturing CDCs and other community-based organizations engage in several variants of networks that enable them to bridge from their own communities with relatively meager resources to other organizations in the larger region. In joint work with others (Harrison & Weiss, 1998), he
proceeded to develop a typology of these networks, illustrate them with a series of careful case
studies, and fashion policy recommendations around their improvement and diffusion.

**CONCLUSION**

The qualities of Harrison’s work reviewed here constitute only a portion of his contribution to
economic development. I have restricted my review to his work in and around regional economic
development, where I think his influence has been remarkable, even though he would not have con-
sidered himself primarily a regional planner. He also made substantial contributions in labor eco-
nomics, minority economic development, and community development.

I have given short shrift to places where Harrison’s work showed lapses. He missed some phe-
nomena of import: in New England, the potential of new technology, and service and finance sector
growth, stimulated by a national regime of free trade and financial deregulation, for instance, or the
role of in-migration via educational institutions of young well-educated people who then stay in
the region. But overall, his work shows remarkable range and, much valued these days, flexibility.

Among Harrison’s enduring contributions to regional economic development, I would stress
the following: his continued commitment to class, his refusal to shrink from analyses of power and
conflict, and his honoring of historical evolution and particularity. Admirable, too, is his durable
commitment to reformism, that is, to planning and policy recommendations that push the envelope
as far as it is reasonable to go at the time and that encourage ongoing political and organizing efforts
of the relatively weaker and disenfranchised against the more powerful. It is my own hope that gen-
erations of students will continue to learn from his approach, fashioning their own economic devel-
opment innovations from similarly astute and value-driven research and action.

**NOTE**

1. By new regionalists, I refer to the work of Allen Scott (1998), Michael Storper (1997), and William Barnes and Larry
Ledebur (1998), whose analytical frameworks concentrate on economic characterizations of metropolitan regions while
suppressing actors, such as the state, capital, and labor, and avoiding politics and class conflict as shapers of regional econo-
 mies. Others, sometimes grouped under the rubric of the new regionalism, Myron Orfield (1997), for instance, offer excel-
 lent political analyses of changing metropolitan regions, connecting them to income and race differentials but not to capital,
labor, or class. See also John Lovering (1998) and Ron Martin (1999) for two powerful critiques of the new regionalism.

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This article explores various aspects of the conventional wisdom regarding local economic development policy and policy making. Much widely accepted knowledge about why and how local governments approach economic development is based on a fairly narrow array of methodological approaches. And the conclusions often suffer from the limitations inherent in their respective methodologies. This may mean that what we think we know about local economic development might be reasonably accurate, but it does not quite reflect actual local dynamics. Yes, the conventional wisdom is true, but... Using data from a large survey database of Canadian and U.S. cities along with findings from nine case studies in medium-size and smaller cities in both nations, the authors challenge a number of accepted truths and present an alternative civic culture framework for better understanding economic development policy making.
cities in both nations. Using the best of methodological options, this article challenges a number of accepted truths:

- Economic development policy making is largely about economics and politics,
- local government structure matters in determining policy processes and resultant policies,
- fiscal and economic stress force cities to approve costly incentives for private businesses,
- the composition of local governing regimes largely determines policies,
- cities with similar governing regimes will have similar approaches to economic development,
- businesses are a critical part of most local economic development regimes,
- businesses will always push for incentives to lower their costs of production,
- local economic development policies and processes will vary depending on the extent of business and/or citizen input into the decision-making process, and
- cities employing a broad array of economic development techniques or most incentives allowed by state law are “shooting at everything that flies” and lack rational focus in their economic development efforts.

HOW DO WE KNOW WHAT WE KNOW?

To evaluate the quality of what is known about local economic development, it is useful to consider epistemology: How did we come to know what we know? What methodologies are traditionally used to study local economic development? and Are there any limitations inherent in those methods that might raise questions about the findings? Obviously, these are rhetorical questions. How scholars have studied local economic development reflects a classic “good news, bad news” story. Much research has been based on case study analyses, examining individual large central cities or comparing a small number of cities. Such methodology has provided detailed but possibly idiosyncratic pictures of local development politics, processes, and policies. Other research has relied on large cross-sectional surveys providing uniform data across many cities that tend to be static and shallow in explanatory power.\(^1\)

The pros and cons of cross-sectional survey methodologies as opposed to case studies are well known. The great advantage of surveys is that they provide uniform and/or comparable data on a wide array of variables for a large number of cases. Because much of the research on local economic development to date has been based on single or limited case studies, findings regarding the development techniques employed and the forces behind policy choices have often been conflicting. This stems from variation in individual places and the inability to compare across a large number of cases. Surveys overcome these limits and allow for more sophisticated statistical analyses, including regression and path analysis. As a whole, such studies have provided a more inclusive picture of what cities across the United States and, in some cases, other nations are doing as far as economic development.

However, there are some significant limitations to the survey approach. These include variation in the measurement of both independent and dependent variables; lack of explanatory depth and the overgeneralizations required for large surveys; low response rates; sampling error and bias; inability to probe, question, or verify responses; misinterpretation of survey questions; incorrect data; and, perhaps most damning, the typically low explanatory power of analyses based on survey research. Obviously, the major trade-off between survey and case study research relates to the depth of information obtained. Although large-scale surveys produce a great deal of uniform information, they are inherently limited to measuring surface effects. Questions have to be simple and clear enough to be uniformly understood. Clarification and probing are impossible. Unless surveys are sent to a number of different types of respondents in a city (mayors, managers, council members, department heads), they reflect only the views of the particular respondent. Even then, it is often impossible to be sure exactly who is answering the questionnaire. Self-administered surveys do not elicit the kind of rich, detailed information that can be obtained in case studies; it is deceptively easy to construct a bad survey and extremely difficult to create a good one.
The body of research purporting to explain or identify the determinants of local economic development policy choice using analysis of survey data is also problematic. It tends to offer contradictory findings based on variation in the questionnaires used and hence data collected, operationalization of indicators, mix of variables examined, statistical technique employed, and the sample drawn. Furthermore, extant models have explained widely varying amounts of policy behavior. For example, Green and Fleischmann (1991) accounted for .159 to .285 of the variance in economic development activities, whereas Reese (1991, 1992, 1997) accounted for .05 to .89 of the variance in policy choices, depending on the particular type of policy examined. The extent of variation supports the notion that different research methodologies and samples have gotten in the way of explanation. As Wolman (1996) noted, “With so many different model specifications, it is extremely difficult to assess the impact of any of the variables across studies” (p. 126). The preponderantly low explanatory power of current models suggests another problem: There are clearly important variables or dynamics missing from the analysis.

Many interesting and indeed critical dynamics may be missed in such cross-sectional analyses. Perhaps, the mixed results and limited explanatory power of past research lie within the cities themselves. Historical trends or even more idiosyncratic causes of policies may be hiding under our noses, so to speak, buried in macro and static analytic methodologies. A potentially more fruitful avenue for understanding such local decisions may lie in analysis of the history, characteristics, personnel, and operating forces in cities that use particular policies. The need is to describe the unique character of each community that produces such a decision, stepping back from the macro analysis and seeking patterns among the idiosyncrasies. If, as it appears, current theories provide only partial explanations, then perhaps deconstructing the analysis to the case level will permit reconstructing more robust theories.

A COMBINED APPROACH TO METHODOLOGY

It seems clear that a combined methodology that takes advantage of the strengths of both surveys and case studies would be the optimal approach to many research questions. However, this has not been done in the economic development literature to date. Although obviously more expensive and labor intensive, the combination of methodologies offers a unique and potentially powerful research approach. This research rests on findings from both a large survey database and comparative case studies. The surveys were sent in the spring of 1994 to the chief executive officer (CEO) of all cities in Canada with a population of more than 10,000 and of all U.S. border-state cities (with Canada) meeting the same population criteria. The CEOs were asked to forward the survey to the individual responsible for economic development or answer it themselves, if appropriate.2 From that data set, nine cities were selected for intensive case studies. Selection was purposive, based on an extensive knowledge base about the cities and on statistical cluster analysis. The case cities were drawn from two states (Michigan and Ohio) and one province (Ontario). The most obvious reason for this choice was ease of analysis because the locations were all relatively proximate to the researchers. More important, it was determined better to have more cities within the same state or province than to increase the number of state/provincial jurisdictions. Previous research has pointed to the importance of state and provincial enabling legislation on local economic development policy choice (Reese, 1997; Reese & Malmer, 1994). In short, the enabling environment at the state or provincial level determines permissible local development policies. Selecting cities from the same state or province controls for enabling legislation as well as for other economic, structural, and cultural forces that may vary along state or provincial lines. Having multiple cities within the same state/province allows for some certainty that any internal variation results from differences in the cities themselves rather than in the larger environment.

Cluster analysis was then used to identify different types of cities based on a number of variables found to be related to economic development policy. These included the extent of community and business input into decision making, intercity competition for economic development, extent of local planning and evaluation, residential need for services, change in unemployment, and governmental structure.3 The case cities are described more fully in Appendix A; they include Allen Park,
Cadillac, and Romulus, Michigan; Coshocton, Fairborn, and Kettering, Ohio; and, Cornwall, Gloucester, and Oakville, Ontario.

A uniform script of questions was asked in each of the nine cities although the particular order and emphases varied by the exigencies of individual actors. A uniform set of groups or actors was targeted for face-to-face interviews although this too varied somewhat, depending on each city’s economic development arrangement and governmental structure. Interviews focused on economic health, history of politics, perceived competition, locus of power, business input, citizen input, planning and evaluation, nature and effectiveness of development policies, intergovernmental relations, racial diversity, policy orientations of decision makers, and local goals/vision/symbols. The actors interviewed included the chief executive (mayor and/or city manager/administrator), economic development director or individual responsible for economic development, representatives from city council, representatives from the planning and zoning board/commission, planning director, downtown development authority director, chamber of commerce representatives, and regional/county economic development director. From 7 to 10 individuals were interviewed in each of the nine cities, typically over a 2-day period.

QUESTIONING THE CONVENTIONAL WISDOM

Politics Matters

In the wake of Peterson’s City Limits (1981), much of the conventional wisdom has been devoted to making and supporting the argument that politics matters in local policy making generally. Politics has been defined a number of ways but typically includes the form and operation of local government as well as the governing regime. The latter, distinct from the formal structure, operates to form the coalitions and resources necessary to govern (Stone, 1989). Defined in either manner, the preponderance of the conventional wisdom says that local government structure matters in shaping policy processes and determining policies (Jones & Bachelor, 1993). Although a strong argument, it raises two primary concerns—one related to structure and the other to governance.

Local government structure matters. Yes, but... putative structures do not necessarily represent real dynamics. There are strong mayors, and there are strong mayors who are not really influential. Ward elections can be divisive in some cities but “public-regarding” in others. Nonpartisan elections often mean just the absence of a label on the ballot because most voters know each candidate’s partisan pedigree. These facts may seem obvious but are often disregarded in the many studies focusing on relationships between formal structure and policy outcome.

This point was well made in analysis of both survey and case study data. First, arguing that structure matters almost presupposes coherent structural forms—that is, local governments are either reformed or unreformed. Correlational and regression analyses clearly reveal wide variation in structure and little pattern of reform. Neither partisan nor nonpartisan elections are related to type of executive or to whether council seats are filled by a district or an at-large election. Only the nature of the city council elections appears significantly related to economic development policy choice; ward elections are associated with greater use of loan packages, whereas at-large elections are related to more Type II or redistributive policies. These two relationships, however, represent the extent of correlation between any structural variable and economic development policies.

The general lack of relationship between structure and policy could result from two causes: Either structure simply doesn’t matter, or structure is important, but cross-sectional survey research is not the best way to identify the effects. Case study analysis strongly suggests that the latter is more accurate. However, it highlights further complexities in examining the role structure plays in local policy making. Very simply, form of government seldom reflects actual operations. For example, Coshocton, one of the case cities, has a strong mayor form of government set by city charter. At the time of the interview, however, it was clear that the mayor was not a strong executive. Instead, the safety services director was serving as a city administrator, department heads had a great deal of discretion, and economic development was conducted by an external private body.
Hence, if a strong mayor system on paper, Coshocton really operated more like a weak mayor/manager system. Such situations are not static, however. Follow-up telephone interviews since the time of the case study visit indicated that the weak mayor was unseated in the last election, and all signs suggest that the new mayor may revert back to the traditional strong mayor form. The moral here, again, is that the formal structure may not represent the actual structure and that real structures may change over time. So, formal structure matters but . . . is highly fluid. Form does not necessarily match substance, and cities are idiosyncratic in their histories and hence their operation. Conclusions about the relationship between structure and policy should be made with caution.

**Governing regimes.** The composition of local governing regimes largely determines policies, and cities with similar governing regimes will have similar approaches to economic development. Yes, but . . . each community has a unique, historically shaped system for public action and processes for the distribution of goods. The particular mix of policies and programs pursued in a community is a product of the interaction between the environment of the community and its history. It is thus possible (and even likely) that two communities could have the same interests within the ruling coalition, yet because of different customs or processes, use very different economic development policies.

That more than regime matters in local development policy making is brought home in analysis of both survey and case study data. For example, regression analysis using economic development policies as the dependent variables indicates that all policies are related to a complex mixture of environmental, regime, and local cultural forces. Environmental variables, such as country and fiscal health, are related to economic development policies. Regime issues, such as who has input into the decision-making process (citizens vs. business) and who has primary responsibility for development decisions, are also important. However, broader local characteristics, including goals for the community, how decisions are made, and how entrepreneurial or reactive is the approach to economic development, are also included in all the policy regression models.

Case study analysis clearly indicates that cities with governing regimes composed of the same actors can have very different approaches to economic development and ultimately pursue different development policies. For example, Kettering and Allen Park have similar governing regimes for economic development. In both cities, economic development is conducted in-house. The city manager/administrator and the bureaucrat responsible for economic development constitute the locus of power for development decisions. Local planning commissions and engineering departments also play a significant role. Although the city councils have a role in the selection of the city manager, they tend not to get involved in the details of development policy making. There is little community or business input in either city. Hence, both cities have a development regime led by public administrators, and broader input tends to occur only through formal planning commission or city council hearings. It is also useful to note that both cities have similar economic conditions: They are reasonably healthy, with low unemployment and poverty and relatively high average incomes.

Beyond this, however, other local conditions and hence approaches to economic development are very different. Local politics in Kettering is quite calm. Although term limits existed for the mayor in the past (no longer the case), within that framework there was little turnover in elected officials. Despite ward-based council elections, there is little geographic division on council; most votes are unanimous. Kettering takes an active, entrepreneurial stance toward development, and the resultant policies are quite innovative. The use of traditional financial incentives, such as tax abatements, is limited and tied to the number of jobs likely to result. The city has taken a major role in the development of a business park on the site of a now closed air force base, which has become a national model. The city also emphasizes the development of parks and the arts as magnets for economic development. In short, economic development is active, innovative, and somewhat risky.

The situation in Allen Park is quite different. Historically, politics has been quite confrontational. A one-term mayor was defeated after an administration that included a recall effort and a slander suit. City council is not necessarily supportive of recommendations by city administrators and the contracted planning firm. Various bond efforts have met with failure at the polls, and the local government is now wary of community opinion, even to the extent of trying to circumvent it. The overall approach to economic development is very passive in Allen Park. Traditional policies,
such as a downtown development authority and tax abatements, are the primary means of economic development. Local development officials are likely to wait for businesses to come to them rather than proactively seeking or developing new investment.

These cases suggest that a consensual political atmosphere can support an innovative and active program of economic development, whereas an uncertain environment and distrust may limit economic development efforts to the passive and known. Yes, regime matters, but local history and other unique forces and dynamics can shape and replace the basic regime composition.

The Growth Machine

Local economic development policies and processes will vary depending on the extent of community input, especially business input, into the decision-making process. Businesses are an important part of most local economic development regimes, particularly because the preponderance of conventional wisdom has suggested that development regimes (composed of local officials and business and land-based interests) are most common (Logan & Molotch, 1987). Yes, but . . . different dynamics and policies depend on the nature of businesses involved in a given regime. In short, all business or growth machine regimes are not the same. Businesses can vary along several critical lines: local versus nonlocal ownership, local versus nonlocal roots, branch plants versus headquarter sites, commercial versus industrial, large versus small, single-industry versus multi-industry bases. The kind of business involved in the governing regime may be just as important as the existence of a growth regime.

Some examples from the case studies show how differences in the composition of businesses in the community can lead to different policy processes and outcomes. For example, Cadillac and Coshocton have an economic base reflecting local industries or local industries that have recently changed to external ownership but with a strong local presence. On the other hand, the economic base in Fairborn is primarily state or federal governments; the major employers are Wright State University and Wright Patterson Air Force base. The largest employers in Romulus revolve around the transportation industry (Romulus is home to Detroit Metropolitan airport) or are automotive-related (e.g., Northwest Airlines, General Motors, Federal Express, and Borg Warner).

These different business systems play out in different roles for business in the decision-making process and produce different policy choices. Business has a strong formal role in economic development in Coshocton and Cadillac. Although the former is a strong mayor system and the latter a city manager system (see arguments above), businesses are an important component of the governing regime. In Coshocton, this is manifest in delegation of economic development functions to an external, private corporation, which, although receiving public funds, provides no formal role for local government officials. Although structurally, economic development is conducted in-house in Cadillac, there are many formal and informal avenues for business input, and private and public/private business organizations have central roles in both policy making and implementation. It is not surprising, then, that both communities evidence a strong ethic of business volunteerism and have a great deal of business participation in economic development; local business leaders and groups have primary responsibility for many aspects of economic development. Indeed, in Coshocton, almost no public money has been used to date for development initiatives. This culture of business volunteerism and a general lack of political conflict in both cities—“Conflict is not appropriate here,” indicated officials in Cadillac—appear to interact to create a system involving numerous public/private bodies. Policies in both communities tend to be very active, often focusing on downtown development.

In Romulus and Allen Park, where large, multinational corporations tend to dominate the employment base, there is much less formal and/or direct business involvement in either decision making or policy implementation. Although both cities are attuned to corporate needs and desires, policy responses tend to take the form of traditional tax abatements and provision of infrastructure. This is completely logical because these established firms tend not to need or demand the more creative financing and start-up support required by smaller, often local, concerns.
In both situations, city officials are reacting to the needs of their respective businesses. Because business composition differs among cities, it is understandable that the content of economic development policy, the role of businesses in making policy, and the extent of business involvement in policy implementation also vary. Yes, businesses matter, but they do not necessarily have the same roles in the regime, nor do the same policies result.

Another element of the conventional wisdom is that businesses will always push for incentives to lower the costs of production. Yes, but ... current and potential businesses have different needs and interests (see above). Businesses may value predictability and cooperation over the bottom line, and businesses have a stake in the overall health of the local community. Business pressures are more complex than the zero-sum competition the literature seems to suggest. For example, regression analysis of survey data indicates that business input is related to a number of different economic development policies. Greater levels of business input are associated with greater use of development loans and more active marketing campaigns by local governments. But they do not seem to influence the use of financial incentives such as tax abatements. In a broader sense, business input is also positively correlated with alternative goals emphasizing new investment and small business development, as opposed to more traditional industrial attraction strategies. Thus, although in some cases business input has the predictable effects of increasing small-business loans, it does not appear to lead to the more traditional financial incentives, site preparation, or infrastructure investment. Furthermore, it appears that there are as many cities in the data set where progrowth and no-growth groups are evenly represented in the input structure as there are cities where progrowth groups predominate. It may not be safe to conclude that the growth machine dominates decisions in all or even most cases.

Case study data suggest that where business input and involvement in both decision making and implementation is high, the result appears to be a greater emphasis on business volunteerism and support for all aspects of the community. This extends from arts to education, includes more emphasis on quality-of-life issues, and in some cases, reduces the use of public funds for economic development. It is also linked to the presence of Type II policies such as local purchasing goals, formulae for tax abatements that include the number and quality of jobs generated, and claw-back provisions.

A corollary of the above argument—that businesses will push only for self-interest incentives—is the contention that business and citizen needs and desires are incompatible. Businesses presumably are pushing for policies to lower their costs of production and shift public resources to private firms. Citizens, on the other hand, presumably want neighborhood or service improvements over business development. Or at the very least, they support economic development policies that promise to give something back to the community through local hiring requirements, worker training, or public benefits accruing from linkage programs. These assumptions are belied by several findings. For example, survey data suggest that business and citizen input are not trade-offs or mutually exclusive; rather, they are positively and significantly correlated. In other words, communities that are more open to business input are also more open to citizen input. Thus, even assuming a singular self-interest by businesses, neighborhood or citizen concerns should provide a countervailing force.

In politically inclusive cities such as Oakville and Fairborn, avenues for both citizens and businesses appear related to greater use of planning and evaluating strategies and a tendency to more closely examine the potential impacts of growth. Although these two cities vary greatly in their economic health, it appears that in both cases, the avenues for citizen and business input produce a balanced approach to economic development. In short, business input matters, but the presence of many avenues for citizen input and the differentiation among local businesses can lead to different goals among businesses and variation in the roles they assume in the community. From a public benefit standpoint, high levels of business input can be a good thing.

Finally, it is important to recognize the difficulty of accurately measuring citizen and business input. Input mechanisms can be confused with actual input or actual influence. Much of the conventional wisdom may be based on data measuring opportunities for input that are interpreted...
as reflecting influence. Typically, large surveys have measured input by asking questions about avenues or opportunities for input. This obviously does not address whether such avenues are used, how frequently, and with what intensity and, more important, how successfully they are used. From the case studies, it becomes clear that many local officials would like to enhance business and citizen input and interactions with the city. Kettering, Gloucester, and Fairborn employ active strategies to increase citizen and business input, but levels remain low, particularly in the first two cities. Avenues for input exist, but it cannot be assumed that they are used. The converse is also true: Simply because there are few formal mechanisms for business or citizen input in Allen Park and Romulus, for example, it should not be construed that input and influence are unimportant. Businesses in the former are becoming increasingly involved in local decision making, serving as watchdogs. In the latter, the mayor regularly travels the city making contact with many business owners and citizens who are more than happy to share their opinions. Furthermore, in many of the cities—Romulus, Fairborn, Cadillac, and Allen Park—citizens make good use of public hearings and planning commission meetings to air their concerns. Again, yes, avenues for citizen and business input matter, but it is almost necessary to study communities in depth to really measure influence in a qualitative sense.

**Shooting at Everything That Flies**

The conventional wisdom suggests that cities employing a broad array of economic development techniques or most policies allowed by state law are “shooting at everything that flies” and lack rational focus in their economic development efforts. Yes, but . . . there is shooting, and then there is creativity and flexibility, and the two can be distinguished. If policies are dominated by professional staff and have a base of external, possibly state-level support, shooting may represent a coherent or at least planned strategy. These points were driven home in analysis of survey and case study data. Through factor analysis of survey data, an index was created that explicitly attempts to measure shooting behaviors. It was constructed from responses to four questions: The city offers all economic development incentives legally allowed, any project increasing the number of jobs in the community is good, incentives offered by other cities strongly influence local activities, and the city tries to implement policies that are successfully used by other cities in the region. Interpreting this index points to an important lesson about the conventional wisdom. In previous research (Reese, 1997), a similar index was interpreted as demonstrating that a city was shooting at anything that flies. Using all available policies implied that a city was trying everything possible in a scattershot manner, in the hope that something—anything—would lead to revitalization. Adopting policies employed elsewhere was the silver bullet, with little consideration for local contingencies. This interpretation seemed to match the conventional wisdom presented initially by Rubin (1988). However, further analysis of survey data coupled with the case studies suggests that reconsideration, and indeed reconceptualization of the index and corresponding behaviors, are in order.

For example, regression analysis of the survey data indicates that some cities that initially appeared to be shooting—that is, high use of traditional financial incentives, such as tax abatements—were also more likely to embrace demand-side policies such as underwriting training programs, funding research and development, and operating business incubators. Furthermore, such cities were also likely to offer small business loans, start-up loans, community development loans, and employment tax credits. Such an economic development program certainly appears to be less a random and unfocused effort to try everything than an entrepreneurial and innovative approach to growing the local economy.

Cadillac represents a perfect case in point. Cadillac employs a broad array of economic development techniques, including comprehensive business visitation, attraction of workers, one-stop development shopping, brownfield redevelopment, parking linkage programs, public/private funds for downtown and industry development, a very strong downtown development authority, and innovative land and property management programs. To fund these efforts, they use a creative variety of federal, state, and private funds. In short, for some cities, it may well be the case that using a number of different policies is shooting. In Cadillac, the same behaviors actually represent
entrepreneurialism. For these cities, taking creative advantage of a number of program and funding options and scanning the environment to find new policies that can be adapted for local use represent a creative, proactive, and entrepreneurial strategy. Yes, pursuit of a wide number of possible economic development policies and copying policies used elsewhere may be shooting, but it may reflect a conscious, innovative, and creative approach to policy, particularly when linked to planning and evaluation.

Economic Determinism

Conventional wisdom also suggests that economic development policy making is largely about economics and, to a lesser extent, politics. Although it is widely agreed that politics matters and that economic determinism alone cannot explain local policy, it is accepted that fiscal and economic stress force cities to provide costly incentives to businesses (Jones & Bachelor, 1993). Such environmental factors may not determine but certainly define what is possible in local economic development. Yes, but . . . the determinants of local economic development policies include more than local fiscal health, intercity competition, or even governing regime. Economics, as well as other broader forces in a locality, including, but not restricted to, governing regime, frame the economic development policy process and shape each city’s approach to economic development.

Regression analyses using six policy types as dependent variables—loans, zoning, marketing, demand-side policies, financial incentives, and Type II policies—and a variety of economic, structural, and cultural variables clearly indicate that the determinants of local development policy represent a complex mix of forces. An index of residential need, including average income, poverty rates, and unemployment, affects only three policy areas (loans, zoning, and financial incentives). In no case is it the best predictor of the policy in question. Other forces, such as governmental structure, input systems, planning and evaluation, approach to economic development, and development goals, are equally influential in determining local development policies.

Case study analysis also highlights the variable effects of the economy. For example, the most economically stressed cities—Cornwall, Cadillac, and Romulus—manifest differing approaches to economic development. Indeed, even the governing regimes vary significantly across cities. In Romulus, the mayor dominates decision making, and the economic development policies reflect a mix of traditional location incentives as well as a number of Type II policies including performance guarantees, local hiring goals, and an abatement formula that gives consideration to the number and type of jobs likely to be generated. Clearly, this stressed city is not giving away the store. Policies in Cadillac, with a development regime dominated by local officials and business interests, have already been discussed; they represent a creative and innovative approach to economic development, not one driven by desperation. Finally, Cornwall, with a regime basically devoid of either citizen or business input, has an essentially passive approach to economic development, with efforts focused on marketing and the development of an industrial park. Again, this is not a city driven to offer incentives, despite a weak economy. Yes, the economy matters for some policies, but it does not determine policy across the board. Nor does it appear to determine the composition of the governing regime. Local history and patterns of process and interaction also matter when it comes to how economic development decisions are made and the policies that emerge.

LOCAL CIVIC CULTURE: A THEORY REVISITED

The fact that much of the conventional wisdom appears only partially correct is a result of methodological problems. In addition, the “yes, buts . . .” offered here say less about what the conventional wisdom says and much about what it does not. In short, the “sins” may be more of omission than commission. Why is it that much current thought and theory does not appear to fully portray the realities of local economic development? To fully understand the forces behind the choice and use of particular economic development policies in communities, research must include an examination of local civic culture. Even regime theory, allowing as it does for variations in local
governance and an array of possible actors, still does not consider the interplay between governing coalitions and the larger civic culture from which they emerge. In other words, it does not consider the forces behind the development of a particular governing regime.

Although different governing coalitions favor different combinations of interests and logically lead to different local policies, a more basic question begs to be answered. What leads to those particular governing regimes in the first place? Obviously, history plays a large role. Each community has a unique political and economic history that shapes the current governing structure. But there is much more to how a particular community operates than just the governing regime. In short, the regime system is just one part of a larger way of doing things in a community, a larger civic culture. The limits of the conventional wisdom stem from lack of sensitivity to local civic culture. Analyses and conclusions are limited and presented out of context. Civic culture is significant and can be identified. Civic culture is important apart from the specific governing regime and helps explain how local economic development decisions are made, who is involved, and what policies result.

The concept of political culture has been explored in the political science literature for decades (see, e.g., Almond & Verba, 1963; Elazar, 1994; Jackman & Miller, 1996). It has been used to explain international, national, and state-level institutions, policies, and processes. To a lesser extent, local political, or more accurately, civic cultures have also been explored although usually tied to regime approaches and arguments. Yet, the earlier debates about culture offer much about local policy making in general and economic development policy in particular. Local civic culture is as a penumbra—its attributes and components defining what issues are problems, what solutions are possible, how decisions are made, and who is involved in decision making. Local civic culture embodies shared visions—past, present, and future—and is the essence of the local community. Civic culture shapes everything from governmental institutions to governing regimes and to the policies employed.

Each community reflects a unique civic culture, historically defined local systems for political and/or public action and processes for distribution of goods. It is thus possible that two communities could have the same interests within the ruling coalition, yet because of different customs or processes, use very different economic development policies. In the same way, similar structures of local government—strong mayor or city manager, for example—may operate very differently in practice across communities because of differences in local culture. The potential differences in local civic culture are more important than many surface similarities in structure and even economics. Indeed, to paraphrase Wallace Sayre, local governments may be similar in all unimportant respects—form of government, composition of tax base, and even makeup of governing coalition, for example. The fine distinctions in local culture—the habitus of how interests are balanced, problems defined, symbols interpreted, goals envisioned, and decisions made—will have the greatest and perhaps most subtle effects on public policy. This broader approach to local economic development, including explicit attention to the nature and role of civic culture, will go a long way toward bringing greater wisdom to conventional knowledge.

**APPENDIX A**

*MICHIGAN CASES.* The Michigan cities selected for case analysis were Allen Park, Cadillac, and Romulus. Romulus and Allen Park are older suburbs of the city of Detroit, whereas Cadillac is on the western side of the state. Romulus is of particular interest because of its significant African American population as well as relatively high poverty and unemployment rates at the time of the survey. The governmental structure reflects a mix of reformed and unreformed elements, with a strong mayor and at-large nonpartisan elections. Because Michigan has a strong history of city managers as opposed to mayors, Romulus is important in that it continues with the strong mayor form of government. Cadillac serves as a good counterpoint to Romulus in that it also had relatively high poverty and unemployment levels but a predominantly White population. Like most cities in the state, it has a city manager. However, the city council is composed of at-large and ward seats. Allen Park had low poverty and moderate unemployment at the time of the survey. It has a weak mayor form of government and an administrator. It has at-large and nonpartisan council elections and is predominantly White.
Ohio cases. The Ohio case study cities were Coshocton, Fairborn, and Kettering. Fairborn and Kettering are suburbs of Dayton, whereas Coshocton is in the central part of the state at the beginning of the Appalachian region. Coshocton is a predominantly White city with high poverty and unemployment, according to the 1990 census, much like Cadillac, Michigan. It has an unreformed governmental system with a strong mayor, partisan elections, and a council with at-large and ward seats. Kettering has a city manager with nonpartisan elections and both at-large and ward council seats. It is a much healthier city, with lower poverty and unemployment rates at the time of the survey. Fairborn has a slightly higher non-White population as well as relatively high poverty and unemployment. It has a reformed governmental structure with at-large council seats, nonpartisan elections, and a city manager.

Ontario cases. The Ontario cities selected were Cornwall, Gloucester, and Oakville. Gloucester is a suburb of Ottawa, whereas Cornwall is an hour’s drive from both Ottawa and Montreal. Oakville is a suburb of Toronto. Cornwall exhibited very high unemployment and poverty, according to the 1991 census. It is an independent unit of government, which means that it is not part of a two-tier, federated, or otherwise consolidated system, increasingly more common in Ontario. It has a city administrator (equivalent to a city manager), at-large seats, and nonpartisan council elections. At the time of the research and writing, Gloucester was part of a regional system of government, the Ottawa/Carleton region. It had moderate levels of poverty and unemployment and combines a city manager system with nonpartisan and ward-based council elections. Oakville maintains a town governmental structure although it is the largest of the case cities. It has ward-based elections with a town manager. Its economy was very healthy at the time of the survey, with low levels of poverty and unemployment, and little change in unemployment over a 10-year period.

APPENDIX B
Factor Analysis: Independent Variables

<table>
<thead>
<tr>
<th>Factor</th>
<th>Loadings</th>
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</thead>
<tbody>
<tr>
<td>Community input</td>
<td></td>
</tr>
<tr>
<td>Elected neighborhood commissions</td>
<td>.64</td>
</tr>
<tr>
<td>Pro-growth and no-growth groups evenly represented</td>
<td>.75</td>
</tr>
<tr>
<td>Community groups primarily determine policies</td>
<td>.62</td>
</tr>
<tr>
<td>Business input</td>
<td></td>
</tr>
<tr>
<td>Mostly progrowth groups are represented</td>
<td>.56</td>
</tr>
<tr>
<td>Local business leaders primarily determine policies</td>
<td>.76</td>
</tr>
<tr>
<td>Business needs surveys are used to develop policies</td>
<td>.55</td>
</tr>
<tr>
<td>Representatives of nonlocal businesses primarily determine policies</td>
<td>.60</td>
</tr>
<tr>
<td>Extraregional competition</td>
<td></td>
</tr>
<tr>
<td>Community seeks to attract firms from outside the region</td>
<td>.79</td>
</tr>
<tr>
<td>Community seeks to attract firms from North America</td>
<td>.89</td>
</tr>
<tr>
<td>Community seeks to attract firms from foreign countries</td>
<td>.82</td>
</tr>
<tr>
<td>City is in competition with others in the nation</td>
<td>.54</td>
</tr>
<tr>
<td>Residential need for service</td>
<td></td>
</tr>
<tr>
<td>Percentage in poverty</td>
<td>.89</td>
</tr>
<tr>
<td>Percentage unemployed</td>
<td>.89</td>
</tr>
<tr>
<td>Resources</td>
<td></td>
</tr>
<tr>
<td>Staff</td>
<td>.82</td>
</tr>
<tr>
<td>Budget</td>
<td>.82</td>
</tr>
<tr>
<td>Evaluation and forecasting</td>
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</tr>
<tr>
<td>Post hoc evaluation</td>
<td>.61</td>
</tr>
<tr>
<td>Cost/benefit analysis</td>
<td>.74</td>
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<tr>
<td>Cost/effectiveness analysis</td>
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</tr>
<tr>
<td>Internal rate of return</td>
<td>.77</td>
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<tr>
<td>Strategic planning</td>
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<tr>
<td>Economic forecasting</td>
<td>.78</td>
</tr>
<tr>
<td>Input/output analysis</td>
<td>.78</td>
</tr>
<tr>
<td>Market analysis</td>
<td>.74</td>
</tr>
<tr>
<td>Turbulence</td>
<td></td>
</tr>
<tr>
<td>I have to spend too much of my time “firefighting” rather than on longer term problems.</td>
<td>.73</td>
</tr>
</tbody>
</table>

(continued)
### APPENDIX B continued

<table>
<thead>
<tr>
<th>Factor</th>
<th>Loadings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Turbulence (cont.)</td>
<td></td>
</tr>
<tr>
<td>People in this community too often judge my work on immediate results rather than on long-run progress.</td>
<td>.67</td>
</tr>
<tr>
<td>I undertake activities just to please constituents or other officials even if I think these activities accomplish little.</td>
<td>.72</td>
</tr>
<tr>
<td>Cities emphasize showcase projects to distract from a lack of progress in solving more pressing problems.</td>
<td>.69</td>
</tr>
<tr>
<td>Other city officials do not have a very good idea of what an economic development practitioner should do.</td>
<td>.57</td>
</tr>
<tr>
<td>Entrepreneurialism</td>
<td></td>
</tr>
<tr>
<td>City offers all economic development incentives legally allowed.</td>
<td>.70</td>
</tr>
<tr>
<td>Any program increasing the number of jobs is good.</td>
<td>.63</td>
</tr>
<tr>
<td>Incentives offered by other cities strongly influence the activities we pursue.</td>
<td>.62</td>
</tr>
<tr>
<td>City tries to implement policies used successfully in other cities in the region.</td>
<td>.59</td>
</tr>
<tr>
<td>Bureaucratic decision making</td>
<td></td>
</tr>
<tr>
<td>Economic development decisions are mostly left to professional administrators.</td>
<td>.76</td>
</tr>
<tr>
<td>Professional staff is more important in initiating economic development policies than are elected officials.</td>
<td>.78</td>
</tr>
<tr>
<td>Economic development projects should be guided by professionally trained decision makers.</td>
<td>.74</td>
</tr>
<tr>
<td>Traditional goals</td>
<td></td>
</tr>
<tr>
<td>Diversify the economic base</td>
<td>.62</td>
</tr>
<tr>
<td>Attract new business</td>
<td>.70</td>
</tr>
<tr>
<td>Expand/retain existing business</td>
<td>.56</td>
</tr>
<tr>
<td>Promote industrial growth</td>
<td>.79</td>
</tr>
<tr>
<td>Alternative goals</td>
<td></td>
</tr>
<tr>
<td>Promote small-business growth</td>
<td>.58</td>
</tr>
<tr>
<td>Promote service sector growth</td>
<td>.71</td>
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<tr>
<td>Promote tourism/conventions</td>
<td>.61</td>
</tr>
<tr>
<td>Type II goals</td>
<td></td>
</tr>
<tr>
<td>Promote social equity</td>
<td>.76</td>
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<td>Develop minority business</td>
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<td>Economic development activities are conducted by a commission/corporation outside of the city government.</td>
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### Factor Analysis: Economic Development Techniques

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NOTES

1. In the interests of brevity and to simplify the arguments, we have not cited the voluminous literature supporting each of the methodologies or conventional wisdmons. For a good summary of this literature, see Blair and Reese, 1999.
3. Measures and indexes developed from the survey are complex, and full explication here would again dilute the arguments presented. Full description of all measures can be obtained from the authors and is available in Reese and Rosenfeld (in press). Central independent and dependent (policy) indexes are presented in Appendix B.

REFERENCES

If Civic Culture Is the Answer, What Is the Question?

Clarence N. Stone
University of Maryland

Governing coalitions arise in response to recognized problems. They are mediating forces, not isolated universes operating only by an inner logic. The character of urban regimes concerns not only simply who makes up a governing coalition but also how the members are related to one another—the terms on which they cooperate and the resources they bring to bear. Regime analysis does not in itself explain the context from which members of a governing coalition come, but it provides a gateway to forms of explanation. With greater specificity about what civic culture is and what it explains, the concept of civic culture could help illuminate the local political context. However, at its current level of development, civic culture sheds little light on some key questions, such as those about political agency and how change occurs or about why economic development holds such a high place on the policy agenda of most localities.

Reese and Rosenfeld (2001 [pp. 299-312, this issue]) fruitfully combine survey research with comparative case analysis, spanning communities located both in the United States and Canada. Through their research they expand our knowledge of economic development by examining smaller localities, including suburbs within metropolitan regions. Overall, their analysis makes a strong case for looking beyond a community’s economic situation and its formal structure of government to understand how local economic development policy takes shape. Although there is much about Reese and Rosenfeld’s study that is commendable, it suffers on two counts, and these are points around which extended discussion might take place.

First, Reese and Rosenfeld (2001) employ a seemingly narrow conception of an urban regime. They divide governance into two apparently distinct categories: (a) the legally defined form of government and (b) the membership composition of the ruling group, equated with the regime. Reducing politics and governance to these two categories leaves a considerable vacuum, which can be filled by “local civic culture” (p. 307).

From this starting point, Reese and Rosenfeld (2001) challenge the “accepted truth” that politics matters in the form that the “composition of local governing regimes largely determines policies” (p. 300). By showing that the membership of a locality’s ruling group does not, in fact, determine policy, they pave the way for an alternative explanation. But who embraces the view they refute? Whose accepted truth is it? No one argues, for example, that a governing coalition operating in a consensual manner is the same as a ruling group embedded in confrontational relations.

Governing coalitions do not operate in a vacuum; they arise in response to recognized problems and thus are best seen not as isolated political universes operating only by some inner logic but rather as mediating forces (Stone, 1993, p. 2; Stone & Sanders, 1987, p. 269). Even as mediating 

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forces, they take shape in response to challenges from the larger world, and this shape includes how members of the coalition are related to one another.

Atlanta’s biracial coalition, for example, can best be understood against a background of a Black struggle to dismantle a Jim Crow system that had been in place for a half century or more. The Atlanta story is in part a story of how the civil rights movement played out in an important city in the deep South. Business involvement in the biracial coalition took a particular character because corporate executives concerned with the impact of a changing transportation technology on the central business district saw a need to create and maintain a cohesive inner group—a group able to formulate and act on an urban redevelopment agenda. Within the African American community, coalition building stemmed from recognition that a city-centered White business elite could provide leverage against the defenders of White domination, based largely in the state and region’s agricultural economy. For their part, Atlanta business leaders saw that an enfranchised Black population could be politically useful, particularly in overcoming resistance to changes in land use within the city (Stone, 1989).

I have briefly reviewed this history of the formation of Atlanta’s biracial coalition as a reminder that an urban regime is not simply a membership roster but involves a coalition held together by a set of arrangements and understandings. As stated in Regime Politics (Stone, 1989), a governing coalition is “the core group at the center of the workings of the regime” (p. 5). In identifying a regime, asking who needs to be complemented by asking how. The important question concerns not simply who makes up the inner group but how they are related to one another—the terms on which they cooperate and the resources they bring to bear on the task of governance (Stone, 1989, p. 6; 1993, p. 2).

As far back as the initial misinterpretations of Floyd Hunter’s Community Power Structure (1953), many observers have seen governance as who governs rather than as how governance is structured (structured not in a formal or legal sense but informally). But the very title of Hunter’s book points to his emphasis on “structural relations” (p. 75) and to his view that the “power of the individual must be structured into associational, clique, or institutional patterns to be effective” (p. 248). For Hunter and those who follow in his path, then, this process of structuring is a pivotal research concern (Abrams, 1982).

What, then, gives form to this structuring process? The division of labor between state and market is one factor, but important as it is, it is not a force sufficient unto itself. In my own work, I have argued that the “power of specific groups and the relationships between groups are likely to be shaped by the norms and traditions of the community” (Stone, 1987, p. 293). Consistent with the general thrust of Reese and Rosenfeld’s (2001) work, I (Stone, 1987) have also asserted that regime theory holds that a governing coalition reflects the particulars of time and place as well as a general structural condition. The particulars of time and place involve many elements, but especially the complex ways in which community political and civic life is organized. (p. 291)

Like Reese and Rosenfeld (2001), I (Stone, 1987) believe that local history is important and “the present is shaped by the past” (p. 294). Clearly, Reese and Rosenfeld and I hold many common positions, and a less narrow treatment of governing coalitions would bring that into the foreground.

Where we diverge most is over the centrality of the concept of civic culture to an understanding of local economic development policy. Civic culture, then, is the second count on which I would like to see extended discussion.

As used by Reese and Rosenfeld (2001), civic culture is a broad residual category. It is not operationally defined, but we are told that it “embodies shared visions” and it includes “customs or processes.” At another point, it is equated with “a larger way of doing things” (p. 308) and is described as “the habitus of how interests are balanced, problems defined, symbols interpreted goals envisioned, and decisions made” (p. 308). In other words, it includes or shapes just about everything that is interesting and thus is indeed a promising bearer of greater “wisdom.” But how exactly does it impinge on the making of policy and the managing of conflict around that policy? To say that the
effects of local civic culture are extensive, yet subtle, still leaves us with a need to know how this 
works and with what consequences.

To what intellectual question does the notion of civic culture respond? Like the concept of 
habitus employed by Goodwin and Painter (1997), it appears to be a catalog of factors ordered by 
no specific theory. What, for instance, are the significant variations in civic culture and why are 
they significant? How does the culture of a political community take shape? How does change 
occur? What are the consequences of one type of civic culture versus another? How does civic cul-
ture relate to the ethos theory of Banfield and Wilson (1963)? Or the “ecology of issues” of 
Matthew Crenson (1971)? Without a guiding question or questions, the notion of civic culture seems to 
be a catchall that substitutes description for analysis.

Another problem attached to the concept of civic culture is that it may take us back into the kind 
of explanation by social determinism so effectively refuted by Martin Shefter (1976). Moreover, 
civic culture seems to shed little light on the issue of change, that is, on how or why the actors in a 
given locality might alter the arrangements through which they make economic development policy. 
How does local civic culture explain shifts from one mode of promoting economic develop-
ment to another?

When not narrowly conceived, regime analysis covers much the same open-ended consider-
atons as Reese and Rosenfeld’s (2001) view of civic culture. So how do the two approaches differ? 
Although I admit that regime analysis has a better record of raising questions than of providing set 
answers, it might nevertheless be worth reviewing briefly the questions it raises.

As I see it, urban regime analysis begins with the assumption that local political, economic, and 
civic leaders face the challenge of governing while juggling multiple considerations. How human 
agents govern is the central question. We therefore need to ask what purposes they are after and 
what they have to take into account. A governing coalition never has the luxury of pursuing only a 
favored policy aim. Multiple considerations come into play. A given coalition cannot single-
mindededly seek to pursue economic growth without regard to a voice for popular sentiment, the 
maintenance of social peace, and financial solvency for local government, but neither can they, 
without dire consequences, fail to induce a degree of private investment in the local economy 
(Shefter, 1992). Furthermore, there are no technically derivable answers as to how best to meet any 
of the several imperatives for governance, much less a technically certain solution to the question 
of how exactly to balance these imperatives.

To some degree, governing arrangements are thus politically constructed rather than socially or 
economically determined. Norms, traditions, and institutions are potential building blocks for gov-
erning arrangements, but for some policy aims, they may be obstacles and therefore in need of 
being modified, overridden, or replaced. Structures (which can consist partly of community cus-
toms and folkways) are not immutable. The formation of Atlanta’s biracial coalition overrode sig-
nificant norms and traditions. In Pittsburgh after World War II, a recognized need for urban 
redevelopment led to the altering of old institutions and the creation of new ones (Ferman, 1996). 
In governing, human agents are shaped, but not determined, by their structured situation, and they 
can act to alter that situation.

What, then, are the creative forces that human agents bring to the task of constructing and mak-
ing use of governing arrangements? And what are the constraining factors they confront? These are 
the questions regime analysis puts on the table. Civic culture or habitus, standing alone, seems to 
offer little intellectual leverage. By contrast, Sewell’s (1992) concept of schema and its dynamic 
relationship to resources hold significant promise. Schemas and the resources they can direct and 
sometimes even create enable us to understand change as well as continuity. They also point to sig-
nificant constraints. The uneven distribution of resources (accentuated by private control of invest-
ment activity) works against some policy pursuits and the governing arrangements they require, 
but they favor others. There are ways of countering, to a degree, business advantages and resources.
Autonomous expertise housed in the public sector is one possibility to which Reese and 
Rosenfeld’s (2001) research points. From my observation, a strong and independent nonprofit sec-
tor is also a countervailing force.

Another important dimension, central in regime analysis, concerns modes of cooperation. 
Patronage and related forms of selective incentives are powerful facilitators, but they appear to
have built-in limitations and may, if unchecked, contain the seeds of their own destruction (Stone, 1998, pp. 10-12). What are the alternative foundations on which civic cooperation can be built? At this stage, we know too little about the answer to that question. A refined and carefully bounded concept of civic culture might contribute to that answer. But if wisdom is to advance very far, we need more than a catchall notion of habitus and civic culture. And we need a conception of civic culture that is hospitable to human agency as a force for change, not a conception that can explain only continuity or that assumes culture causes policy without considering how change occurs.

A final caution is worth considering. Though there are advantages to looking at a single policy area, as Reese and Rosenfeld (2001) have done, it would also be helpful to know how economic development fits into a locality’s overall set of priorities and relates to other areas of policy and politics (see, e.g., Ramsay, 1996). For political economy reasons, business development has a foundation for claiming a central position in a community’s agenda but moves to promote business development occupy only a narrow band of policy space. If researchers look only at variations in approach to economic development policy, then the economic imperative from which pursuit of business investment emanates doesn’t show up very clearly—and neither does how economic development is balanced against other considerations. In a sense, we would be looking only at variation within a policy category, not at mixes of policy that extend across categories. It is important to think about our frame of reference in looking at variation. If attention focuses only on factors influencing variations in development policy—not on the fact that there is such a policy—then we should be cautious about downplaying the economy. The structural force of the political economy has not been fully examined.

In undertaking our studies, there are trade-offs we must always make, but without a wider research lens than economic development policy conventionally understood, scholars are not well positioned to weigh the force of capitalism as an economic structure, see its full impact, and appreciate the challenge in modifying its workings. The particulars of the locality loom large, and especially if policy is viewed only at one slice in time, these situational and cultural particulars may seem to be prime causes. A wider slice of time and a broader consideration of the community agenda might bring a different set of questions to the forefront and perhaps even suggest a greater, even if constrained, role for human agency.

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RESPONSE

Two Steps Forward, One Step Back: Uncertainty in Local Economic Development

Ann O’M. Bowman
University of South Carolina

The Reese and Rosenfeld analysis of the conventional wisdom about economic development is important and timely. They correctly argue that research has not yielded a set of unequivocal laws, general truths, or first principles regarding local economic development. However, in their enthusiasm to arrive at their conclusion, they overstate the problem, and they overlook methodological advances in the field. Over the past 15 years, researchers have produced findings that clarify and fine-tune a dynamic and complex process. Furthermore, the Reese and Rosenfeld prescription—to focus on the unique civic culture of a community as the explanatory variable—takes inquiry in the wrong direction.

Economic development is a tough field in which to toil. That’s true whether one actually does economic development or simply studies it. City economic development officials may spend weeks and months trying to lure a big prospect, only to see the firm locate elsewhere. They lament the lost opportunity—the relocating corporation that would have meant 500 new jobs, the start-up company that would have led to additional investment, the signature sports team that would have transformed the city’s image. They complain about recalcitrant elected officials, about administrators unwilling to think outside the box. Or they single out the unfair practices of competing jurisdictions or the whimsical decision-making processes of corporate leaders.

Students of local economic development policy have similar experiences when they try to understand the phenomenon. They design an elaborate survey of the economic development practices of hundreds of jurisdictions and discover, when tallying the responses, that items on the questionnaire have been interpreted differently from one respondent to another. They identify seemingly important causal variables only to construct a model that explains less than 20% of the variance. They devote large amounts of research time to unearth the tiniest details of a specific city’s economic development behavior only to find that in the town across the river, a different set of details seems to matter. Is it any wonder, then, that even the most experienced practitioners and scholars alike might be tempted to throw up their hands in exasperation and ask, What really matters in local economic development?

In their article, “Yes, But . . . : Questioning the Conventional Wisdom About Economic Development,” Laura Reese and Raymond Rosenfeld (2001 [pp. 299-312, this issue]) tackle the “what really matters” question straight on. Reexaming some of the extant research findings and adding...
their own work on U.S. and Canadian cities to the mix, they conclude that the conventional wisdom does not yield satisfactory answers. The so-called true facts are little more than a collection of half-truths and inaccuracies. Reese and Rosenfeld offer an alternative view. In their view, what matters in local economic development is the local civic culture. The unique political and economic history of a place determines local economic development policy making.

The Reese and Rosenfeld (2001) analysis is important and timely. They are correct about the difficulty in identifying unequivocal laws, general truths, or first principles regarding local economic development. It has never been as simple as Variable 1 + Variable 2 = Economic Development Policy A. Instead, it has been more along the lines of Variable 1 + Variable 2 (if Variable 3 is present and Variable 4 is partially absent) = Economic Development Policy A sometimes. The same is true when economic development policy is the independent variable. Even within a single jurisdiction, combining Policy A and Policy B may produce the desired outcome in some instances; other times, it does not. The absence of certainty has confounded analysis and prescription. A favorite phrase of social scientists, “ceteris paribus,” is particularly apt in discussions of local economic development.

In their assessment of the conventional wisdom, Reese and Rosenfeld (2001) are critical not only of the so-called truths but also of the methodologies used to pursue them. However, in their enthusiasm to arrive at their conclusion, they cut a few corners. First, Reese and Rosenfeld overstate the problem. The various items composing the body of “conventional wisdom” have seldom been taken as gospel by practitioners and scholars. Yes, the findings tend to be equivocal and, therefore, not as useful to local economic development officials as a set of hard and fast rules would be. Still, to researchers, the “it depends” findings have utility as guides for developing better indicators and measures. Admittedly, the work has not achieved the status of best practice or incontrovertible fact, but that does not negate its impact. The research process has been neither precise nor linear, but we have learned at least a few ceteris paribus truths about local economic development along the way (see, e.g., Buss, 2001, for a review of the literature on state tax incentives and economic growth, from which is derived a series of policy prescriptions). Furthermore, the clash of findings is what may, if the stars line up right, produce real theoretical breakthroughs. Building a literature is typically an iterative, incremental (and frustrating) process, punctuated only rarely by a paradigmatic shift.

Second, the idea of methodological pluralism that characterizes the Reese and Rosenfeld (2001) research on U.S. and Canadian cities is not new to the study of economic development. Others have recognized the value of blending quantitative inquiry and case studies in economic development research. For example, in Cityscapes and Capital, Pagano and Bowman (1995) analyzed the economic development practices of 10 medium-size U.S. cities. The case study cities were selected from respondents to two national surveys: Pagano’s survey of city fiscal conditions and Bowman’s survey of city economic development activity. Fiscal conditions and economic development policy activism were used to produce a four-cell typology from which representative cities were selected for field work. In The Work of Cities, Clarke and Gaile (1998) wrapped their argument around data from surveys of 113 cities as well as case study data emerging from extensive field work in 15 cities. In the book, they developed a four-cell typology using a city’s institutional linkages and its decision logics. The blended methods used in these studies go a long way in providing a more comprehensive look at local economic development, both as an independent and dependent variable. As King, Keohane, and Verba (1994) have argued, a research design that combines features of quantitative and qualitative methods often yields the most robust findings.

And that brings us to the most fundamental concern: the Reese and Rosenfeld (2001) prescription. As problematic as extant research might be, the notion that local civic culture holds the key to understanding economic development policy is unsettling. There are several reasons for the discomfort.

Local civic culture is difficult to isolate and measure. It is, at once, everything and nothing. Problems with validity abound for a concept as expansive and amorphous as local civic culture. Furthermore, local civic culture is not static. It evolves in response to external and internal stimuli and, ultimately, confounds measurement. Yet, despite its slippery nature, students of economic development would undoubtedly admit its existence and even its importance. However, few would
find it useful as a direct causal factor. Undoubtedly, a city’s history and traditions influence the design of institutions and the behavior of political leaders. The difference between civic culture on one hand and institutions or behaviors on the other is that institutions and behaviors can be observed and measured. The role for civic culture is as antecedent, as background and context, not as quantifiable concept.

Even more troublesome in the Reese and Rosenfeld (2001) formulation of local civic culture is the word unique. In several places in the article, they refer to the “unique character” of a community, the “unique civic culture,” the “unique political and economic history.” If used in its true meaning—being the only one of its kind—then the Reese and Rosenfeld prescription has effectively quashed large N studies of local economic development. If civic culture is the explanatory variable and if each city’s civic culture is unique, then case study methodology is the only viable approach. Building a literature in local economic development would become an insurmountable task. Understanding economic development policy in Kansas cities, for example, becomes a 627-part story because each of the cities in Kansas has its own unique civic culture. A methodological morass awaits.

The fact that local economic development policy research to date has not eliminated uncertainty is no cause for alarm (see, e.g, King, Keohane, & Verba, 1994, on the positive role of uncertainty in social science research). After all, the local economic development milieu is dynamic and complex. What is cause for alarm is the notion that certainty rests in the unique civic culture of a community.

REFERENCES

RESPONSE

Well, Maybe . . . : Taking Context Seriously in Analyzing Local Economic Development

Susan E. Clarke
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Reese and Rosenfeld’s challenge to the myths about local economic development raises important questions about theory development and notions of causality implicit in current empirical work. In addition to the authors’ advocacy of more utilization of combined research approaches, case studies, and cultural analyses, the author argues for embracing concepts of contingent causality, employing counterfactuals and pattern-matching methods, and developing more systematic and rigorous contextual methodologies.

Reese and Rosenfeld (2001 [pp. 299-312, this issue]) offer an intriguing challenge to conventional understandings about local economic development. They claim there is a narrow evidentiary base for myths about local economic development because of the constraints of the methods and measures generally employed. As a result, the validity and stability of the findings are suspect; as they see it, when critical variables and dynamics are left out of models, the consequent mis-specification contributes to the low explanatory power of most models in the literature. In particular, they stress the importance of historical and cultural features in shaping local economic development strategies and the difficulties of systematically analyzing such features in current approaches. Not surprisingly, they argue for multimethod research strategies that bridge the divide of large N research and more intensive case studies. They model such a strategy by presenting aggregate analyses of survey data from U.S. and Canadian cities and case studies of matched pairs of selected cities to demonstrate how the more intensive analyses inform the quantitative findings and question the conventional wisdom available in other (uncited) studies.

Such a broad-brushed critique invites a closer examination of the authors’ claims, of course. There would be little argument with their characterization of the literature as tending to split into quantitative and qualitative approaches, but they do slight the growing body of scholarly work using multiple methods to examine local economic development policy.1 Indeed, most of the reports and studies available through groups, such as the National League of Cities, the Urban Institute, and the U.S. Housing and Urban Development department, customarily use such multiple method approaches. So their claim that such combined methods have “not been done in the economic development literature to date” misrepresents that literature (Reese & Rosenfeld, 2001, p. 301).

Similarly, the myths themselves tend to be overstated. Although these are thematic perspectives in the literature, they are rarely posited or used in the baldly determinative manner the authors imply. Even straightforward relationships between, for example, government structure and policy choices are usually considered in a relatively nuanced fashion by scholars arguing for their

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importance, whether using inductive or deductive methods. Nor are case studies necessarily the 
best means of unpacking these relationships: In illustrating the operational realities of seemingly 
formal electoral structures, the authors appear to resort to personality factors and some implicit 
(and unstated) criteria to identify “strong” and “weak” mayors in their cities rather than the institutional 
capacities usually referenced by those categories (Reese & Rosenfeld, 2001).

Some of these difficulties may be traced to the lack of documentation and the continued refer-
ences to the authors’ previously published or forthcoming work. But it is a disservice to the authors 
and the readers to present research aimed at challenging conventional wisdom without providing 
any of the means for evaluating that challenge. There are references throughout to results from 
regression analyses, cluster analyses, and an appendix with factor analysis loadings, but the argu-
ment is not directly grounded in these empirical findings. As a result, more questions are raised 
than answered: Did they actually utilize cluster analysis—a case-wise method for analysis—and 
are their community cases representing distinctive clusters? Or did they use factor analysis—a 
variable-wise method of analysis that undermines analysis that underlines their concern with contextual features?

Nevertheless, Reese and Rosenfeld (2001) raise some interesting issues meriting further discus-
sion. Although their critique of extant models is rather familiar, it points to larger issues of theory 
development and causality that are not often addressed by scholars of local economic develop-
ment. If we are aiming for some ever grander causal theory of local economic development policy 
making, then the weak and widely varying coefficients produced by mostly incommensurable 
quantitative studies are important. They signify how far we are from that goal—mis-specification 
is indeed worth worrying about to the extent that it obscures causality. But if we seek to explain, at 
best, clusters or classes of events, problems, or dynamics, we need analytic frameworks to help us 
understand those patterns. Rather than assuming a world without multicollinearity and featuring 
“arrow through the heart” notions of causality, we would seek out anomalous cases, employ 
counterfactuals and pattern-matching methods, and delve into patterns of contingent causality. As I 
tell my students, “The world is multicollinear; get over it”—the appropriate goal is developing ana-
lytic skills capable of uncovering complex patterns of contingent causality and communicating 
their meaning effectively to other scholars and practitioners.

Reese and Rosenfeld (2001) seem more comfortable with this contextual goal as well, but com-
bined approaches alone are not necessarily the answer. Adding more methods does not always 
bring in more context. Although their narratives on U.S. and Canadian towns are interesting, it is 
hard to characterize them as case studies. They illustrate the points being made, but we don’t really 
know the criteria used in characterizing the different settings and outcomes, nor do we understand 
the evidentiary logic that makes the arguments credible. There are limits to doing so in an article 
format, and the larger work from which this work is drawn may provide a better sense of these judg-
ments, but we need to consider case studies more seriously if we are to take them seriously. To be 
persuasive, there needs to be transparency in the case selection and logic of comparisons, as well as 
 systematic, rigorous comparisons across cases or between cases and theoretical expectations. In a 
recent debate on the characteristics of a good case study (Symposium, 2000), the extent to which 
there should be compatible orienting concepts employed and the need for explicit frames of refer-
ence in comparing cases were key issues. Furthermore, systematic approaches to integrating and 
synthesizing case studies open up opportunities for refining analytic frameworks or developing 
theoretical arguments that can extend beyond the cases in question. Regin’s (1994) qualitative 
comparative analysis (QCA) strategies, for example, are one of several means of methodically inte-
grating and synthesizing multiple cases. Regin proposed an emphasis on approaching causality in 
terms of the necessary and sufficient conditions to account for an outcome rather than the probabil-
istic and additive notion of causality underlying conventional statistical approaches.

Reese and Rosenfeld’s (2001) turn to a civic culture argument as the solution to the limits of conven-
tional wisdom is promising but problematic. Most notions of political and civic culture 
remain captive to the tendency to rely on cultural features as residual concepts that shape every-
thing and, in that sense, explain nothing. Here, the admonitions to incorporate civic culture into the 
study of local economic development are reasonable but come with few empirical designs for doing so. As is often the case, it is not clear how to avoid treating cultural features as residual con-
cepts without making them into causally prior factors. Fortunately, a number of recent studies offer
alternative ways to think about incorporating omitted political culture and history in empirical analyses of local economic development (DiGaetano & Klemanski, 1999; Hero, 1998; McGovern, 1998; Reichl, 1999). Similarly, framing local development agendas in terms of livelihood issues and the politics of livability (Evans, 2001) promises to open up innovative approaches to the concerns that Reese and Rosenfeld identify.

Although there are questions raised by the arguments and analyses presented, Reese and Rosenfeld (2001) set out an important agenda: They invite us to contemplate whether and how to accommodate the “historical turn” and the “cultural turn” (Symposium, 2000) in analyses of local economic development politics. Ironically, this could contextualize conventional wisdoms in ways that might make them more powerful and robust but less amenable to theorizing.

NOTE

1. Work on local economic development issues incorporating macro analyses and case studies include, for example, Clarke and Gaile, 1998; Goetz, 1993; Markusen, Lee, and DiGiovanna, 1999, and the many Fiscal Austerity and Urban Innovation projects spearheaded by Terry N. Clark.

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REJOINDER

What Is the Question to Which the Answer Is: Local Civic Culture?

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The commentaries to our article (Reese & Rosenfeld, 2001b [299-312, this issue]) remind us of the wonderful “shaggy porpoise” tale in the “Knock, Knock Cantata” by Peter Schickele (1992) better known as P.D.Q. Bach. This long and involved choral work, ultimately ending with a story about a mishap with a zookeeper and some frisky dolphins, begins with several rather convoluted knock-knock jokes that all start, “What is the question to which the answer is . . .” The best one goes, “What is the question to which the answer is—‘9 W’?” The question is, “Do you spell your name with a V, Mister Wagner?”

So, what is the question to which the answer is local civic culture? To directly answer Clarence Stone (2001 [pp. 313-316, this issue]), there are several. How do we understand local governing and policy making when there is no regime? How do we understand regimes when the actors do not pursue the types of policies predicted by regime theories? and What would provide a sufficiently broad theoretical framework for considering context seriously?

At the outset, we would like to make several points about our original article in this issue. First, our intent was for it to be read and evaluated as commentary: The central purpose was to raise questions and pose an argument. That discussion, dialogue, and indeed, disagreement have ensued indicates we succeeded. We acknowledge that we overstated the literature or created straw men in posing and critiquing the conventional wisdom. Hence, our colleagues are completely correct that there are extant studies that mitigate, moderate, or modify most of the conventional wisdom we presented. Yet, there is intuitive appeal to the wisdom, easily recognizable by scholars and practitioners of economic development, and our intent was not to “cut corners” so much as to highlight assumptions that we have all encountered in research and practice as well as the generalizations we teach.

Second, we also acknowledge that our commentary provides, in very condensed form, a larger argument that we develop fully in our book, The Civic Culture of Local Economic Development (Reese & Rosenfeld, 2001a). In the transition from the book to commentary, detail has obviously been omitted. And it puts us in the somewhat awkward position of suggesting that readers buy and read the book (although not a bad outcome). Clearly, however, important elements of the methodology and the civic culture argument were left out, and as the responses make clear, this makes it more difficult to assess the basic arguments presented. Thus, we would like to devote a bit of space in our response to provide, first, some of the methodological detail and then move on to the more basic questions about the utility of approaching local policy making in general and economic development policy making in particular through the paradigm of local civic culture.
Susan Clarke (2001 [pp. 320-322, this issue]) asks several broad questions about the methodology underpinning our arguments. First, the selection of the nine case studies was based on cluster analysis as indicated; the cities were chosen to represent particular mixes of local conditions (e.g., fiscal stress, competitive environment, local government structure, decision-making style, business and citizen input). Full case studies were conducted in each city involving a number of interviews, analyses of documents, and so on. The excerpts from the case studies were used here only as illustrations of central points, as Clarke suggests. They do not include the depth of descriptive information that lies behind the vignettes. Regression and path analysis are included in the book (and some findings briefly described here) to explore the relationship between specific elements of local civic culture as well as to explain particular policy choices. Finally, factor analyses were run to reduce the data and construct indexes, not to select the cases.

A point raised by Clarke (2001) and Bowman (2001 [pp. 317-319, this issue]) is the extent to which our “mixed” methodology, using survey and case study analysis, is really all that unique. It is always dangerous to say that something has not been done in the literature to date because it so quickly becomes one of those things you wish you had never said. Of course, there are studies that mix quantitative and qualitative methods—as noted—but they tend not to do so in quite the same way, or, we would argue, necessarily take full advantage of both methods. For example, Pagano and Bowman (1995) use survey data sets to select case study cities, but their book presents the case study analyses. They do not link the two levels of analysis. Although Clarke and Gaile (1998) used linked survey and case study analyses, the former focused on larger cities and the latter on only four cases.

Clearly, the concept of local civic culture needs more discussion both on a theoretical and an operational level. We will take on this task briefly here but end with some suggestions about what needs to be done in future research. First, what is the local civic culture? The civic culture of local economic development policy includes the arrangements for the decision-making enterprise, the process through which decisions are made, the interests involved in decision making, and the decision-making styles evident in the local public arena. The arrangements for economic development decision making include the nature and extent of community resources devoted to economic development and the structure of the economic development enterprise itself. Is the economic development function placed within the office of the chief executive? Is there an independent department for economic development? And is economic development part of a larger planning or community development department? These placement or structural decisions do not necessarily relate to the larger form of local government and reflect diverse aspects of the local milieu: the emphasis placed on economic development, whether decisions tend to be made politically (by elected officials) or professionally (by bureaucrats), and the extent to which decisions are likely to be open to outside pressure and scrutiny. Decision-making processes include the locus of primary power in economic development decisions, encompassing the balance between government and other actors; the role of local bureaucrats in the decision process; and most important, the balancing of business and citizen groups in development decisions. Decision-making styles are represented by the world views of participants, the extent of rationality in the process, how goals are set and the nature of those goals, and how the community envisions itself now and in the future, and the extent to which development participants feel they can affect and control the destiny of their community. In this sense, local economic development decisions and policies are more than economics and indeed are more contextually defined than a particular regime; they are socially embedded within the cultural fabric of a local community. In short (Granovetter, 1985),

actors do not behave or decide as atoms outside a social context, nor do they adhere slavishly to a script written for them by the particular intersection of social categories that they happen to occupy. Their attempts at purposive actions are instead imbedded in concrete, ongoing systems of social relations. (p. 487)

These components of local civic culture reflect the central attributes of political culture identified in early work by Kluckhohn (1954). The decision-making styles include the language used to describe the community and the visions that local stakeholders identify when they talk about the community and its future. The way decisions are made is also shaped by and reflect local symbols.
and myths. The standardized orientation to life is encompassed within the decision-making process and includes how individuals are recruited for office, whose support is needed to run for office, and more broadly, the perceived proper role of government in the community. The structures of development decision making affect how group interests are maintained. A consideration of the interests involved in development decision making includes how institutions deal with individual demands and how competing demands are mediated. Finally, the balance between citizen and business needs in the decision-making process has much to say about who is a citizen and hence has the greatest right to governmental services.

As all of the responses note, it is also critical to consider what the local civic culture is not. First, civic culture is not the environment that surrounds or is exogenous to policy making. This would include the general economy, the location decisions of businesses and individuals, the fiscal health of the city, the level of residential need, the location or geography, enabling legislation, the competitive position or stance of the city, actions of neighboring cities, federal and state policies, and the formal government structure or charter, for example. These factors shape the rules of the game or set the parameters that both define and confine local choice. In other words, they represent the very many ways in which local politics does not matter. Local civic culture is also not synonymous with governing regime. It encompasses the regime in cities that have one but does not require the presence of a regime to understand local policy processes. Third, local civic culture is not as broad as the local culture per se. Local civic culture is the governing or decision-making culture; thus, it does not include racial, ethnic, religious, or language-based cultures particularly pertinent for the Canadian cities in our study with large French-speaking populations. Finally, local civic culture is certainly not a “residual category” as suggested by Stone (2001) and Clarke (2001). To the contrary, it is a central independent variable, or more specifically, an organizing principle for a complex of independent variables.

At this juncture, several specific comments of our colleagues are critical. First, Ann Bowman (2001) notes that we indicate that each community will have a “unique” civic culture. If this is the case, she reasons, then it will be impossible to build theory based on a civic culture because such theory requires generalization across cases. We agree completely and would like to disown the statement about unique cultures at this point. In part, it reflects another unfortunate choice of words. But, more important, it illustrates the evolution of a concept and research process. Our article was written as we were still in the process of analyzing and understanding our case study data. It soon became clear both from the case study data and from further cluster analysis on the data set that indeed, there are discernable patterns of local civic culture. In our book, we identify four: politically inclusive, mayor-dominated, elite-dominated active, and elite-dominated passive cities. In short form, the inclusive cities have very open decision-making systems and are comfortable with relatively high levels of conflict over development policy. The mayor-dominated systems are, obviously, heavily controlled by the elected chief executive. The remaining types favor elites (either bureaucratic or business) in the decision-making process and differ in the extent to which they approach economic development in an active, innovative, or creative manner. In sum, we argue that there are identifiable cultural patterns although we make no claim at this point that we have either explored all the salient aspects of civic culture or identified all cultural types.

This latter issue gets to the point of several other concerns raised by our colleagues. First, we agree completely with Clarke (2001) and Bowman (2001) that operationalizing civic culture is a methodological challenge, and we do not pretend that the current state of operationalization in our work is the optimal system. Yet, we strongly disagree that just because civic culture is “difficult to isolate and measure” scholars should not consider it as a very real force affecting local policy making. It is only everything and nothing until scholars take seriously the task of defining and measuring it. Although behavioralists would argue that if we can’t see and empirically measure something, it is not an appropriate topic for study, we cannot just dismiss the very real effects of local civic culture just because they present problems for us as scholars. Thus, we see this issue as a call for future research that provides different means of operationalizing and measuring local civic culture. We continue to work on new quantitative studies and case analyses designed specifically to further refine these indicators. The measurability of local civic culture is open to debate and future research. What happens if we try?
Compounding this challenge is the point made by Clarke (2001) and Stone (2001) that local civic cultures are not static; they evolve and change over time. We completely agree. Indeed, we were able to see these changes in two of the case cities (Cornwall and Allen Park), where business leaders are beginning to organize and press for a more active role in development decision making. Whether development regimes will form in these currently “regimeless” cities is open to question, but it is clear that cultures change, although perhaps very slowly, over time. This is another challenge to future research: to identify how cultures change, what forces prompt cultural change, and what effects change has on local policy. Accordingly, we are in the midst of quantitative and case study analyses that will provide some initial time series insights, and we hope that this exchange will stimulate others to do the same.

In a similar vein, Clarence Stone (2001) raises important questions ripe for future research. First, how does civic culture operate in other policy arenas? Are there separate civic cultures for economic development as opposed to educational policy, for example? We’re not sure. Another important research task is to expand the use of civic culture to other policy areas. We would note, however, that contrary to Stone’s concerns that in looking at economic development we may have “downplayed” the effects of economy, this is the policy area where the economy should have the greatest role. By looking at a policy arena where business should have the greatest interest if not influence (research on cozy or iron triangles would suggest that businesses should focus their efforts to affect policy in those areas that are most important to them) and where global economic forces would have significant impacts, we have conservatively biased the findings. If economic forces have only a limited role vis-à-vis the local culture in economic development, they should have even less for recreation or public safety services.

As a corollary, the role of civic culture also needs to be explored in larger cities. For example, would it be reasonable to assume that a large and racially diverse city such as Detroit would have a single civic culture? and Would there be different cultures around different policy areas, as suggested by Painter’s (1997) discussion of the concept of habitus, or would different ethnic and racial cultures be evident that would support the development of separate governing or civic cultures? These are all legitimate and important questions for future research. But just because civic culture has not yet answered these questions is not a reason to assume that it is not or can’t be the answer. And that brings us full circle; we believe that local civic culture offers a paradigm for understanding many of these critical questions about economic development policy making and local policy making more generally. It takes Stone’s (2001) statement that “how human agents govern is the central question” to task and begins to build a new and appropriate framework for answering this question. The real test is in articulating the questions to which the answer is...local civic culture.

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Cities and Economic Development: Does the City Limits Story Still Apply?

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The dominant explanation for city policy choices over the past two decades has been the city limits story. This scenario represents the application of public choice theory to local policy making. Theorists argue that rational self-interest by cities compels local elected officials to favor developmental policies and compete with other jurisdictions. Inefficient economic development outcomes and evolving trends in the practice of economic development prompt a reevaluation of the city limits story as the primary explanation for economic development policies. This research investigates the influence of intercity competition and other factors on the support for economic development by cities. Results from regression analyses using data from a sample survey of U.S. local economic development professionals reveal virtually no support for the city limits story. However, the population needs within cities, the support of elected officials, and the existence of formal economic development planning did influence support for economic development.

The city limits explanation for local economic development has dominated the literature for almost two decades (Wolman, 1996). This explanation offered by Paul Peterson (1981) asserted that local policy makers are single-minded in their policy objectives. They pursue developmental policies above all other interests, with economic strength as the sole objective. Peterson’s argument is based on an extension of public choice theory as presented by Tiebout (1956). From this perspective, residents and businesses seek the best tax-to-services ratio and will move from one locality to another to attain it. In other words, individuals are self-interested and possess mobility as a strategy to fulfill their preferences. City officials can discourage mobility of the population, specifically middle- to upper-income residents, by adopting policies that strengthen the local economy. Therefore, rational self-interest by cities compels local policy makers to favor economic development policies and leads to intercity competition for residents and businesses (Peterson, 1981; Schneider, 1989; Swanstrom, 1985; Tiebout, 1956).

The structural determinism of the city limits scenario has been criticized by many scholars for at least two reasons. First, it is argued that urban politics are complex and other factors besides economic self-interest help explain local policy decisions. For example, interest group influence, regime structures, and intergovernmental policies are thought to influence city policy making (Clark & Ferguson, 1983; Stone, 1989; Waste, 1989; Wong, 1990). Second, federal devolution and globalization have resulted in changes to local economic development practice. These two factors have expanded the field of economic development to include a wide variety of public, private, and nonprofit actors (Agranoff & McGuire, 1998; Clarke & Gaile, 1997). Therefore, economic development is no longer the exclusive jurisdiction of single-minded city officials. Furthermore, according to Peter Eisinger (1988), entrepreneurship and a focus on the development of local firms

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“promises to dampen . . . competition for investment” (p. 25). At the same time, federal devolution shifts responsibilities to the local level, potentially stoking the fire of competition. Globalization has resulted in cities competing for foreign direct investment (Eisinger, 1988; Rondinelli, Johnson, & Kasarda, 1998). Although some scholars of urban policy may revile the economic determinism of the city limits explanation, others find empirical support for the theory or implicitly accept its premise by considering the effects of intercity competition (Blair & Kumar, 1997; Fisher & Peters, 1998). Moreover, even the toughest critics acknowledge the persistence of city self-interested behavior in the local-policy-making process. For example, Clarke and Gaile (1997) noted “many cities balk at discarding the city limits story of a unitary interest in economic development” (p. 36).

The city limits story is troublesome to many policy scholars in theory and practice. In practice, research has shown that competition often results in inefficient and inequitable outcomes for cities and their populations. In fact, research has suggested that many economic development approaches simply cannot be justified on economic terms (Wolman, 1996). Furthermore, researchers have raised concerns about the beneficiaries of the gains from economic development programs (Reese & Fasenfast, 1997).

Criticisms of the city limits story, the changing context of local economic development, and questions regarding policy outcomes prompt a reassessment of the city limits story as an explanation for support of economic development by cities. This research investigates local economic development in a representative cross section of U.S. cities. Specifically, the purpose of our analysis is to determine the factors that influence the support of economic development by cities. We use regression models with intercity competition, needs, and political factors as explanations for local economic development support. The data are from a 1996 mail survey of city economic development staff in a probability sample of U.S. cities with a population of 25,000 or more, supplemented with 1990 and 1992 data from the U.S. Census Bureau.

This introductory section is followed by a literature review of theoretical and empirical studies concerning city policy making. The third section discusses the research methodology, the data, and the study variables. In the fourth section, we describe the analysis and present and discuss the results. Finally, we summarize our findings and conclude with the implications of our results.

CITY POLICY MAKING: COMPETING EXPLANATIONS

Public choice theorists argue that local officials act in the city’s economic interest and compete with other localities for economic benefits. As a result, local officials pursue developmental policies with a dogged single-mindedness. This policy approach further promotes interjurisdictional competition between cities and embeds competition into the workings of the local policy process. Many policy scholars reject the structural determinism of the public choice perspective and identify political factors as shaping the local policy-making process. These competing explanations have been applied to a wide variety of city policy-making studies, including investigations of the support for local economic development.

Public Choice Theory

The city limits story began with a seminal piece written by Charles Tiebout (1956). Using a set of highly restrictive assumptions to bound his argument, Tiebout developed a public choice theory concerning individuals’ locational decisions and public goods. He argued, “The consumer-voter may be viewed as picking that community which best satisfies his preference pattern for public goods” (p. 418). If the community fails to satisfy the preferences of the individual, he would move to another locality. Tiebout concluded his theoretical analysis by stating, “Local government represents a sector where the allocation of public goods (as a reflection of the preferences of the population) need not take a back seat to the private sector” (p. 424). In other words, local population patterns reflect individual preferences for public goods similar in operation and result to the market for private goods.
Tiebout’s (1956) work generated a considerable response from scholars. In fact, his public choice argument influenced decades of research about public policy making (Bish & Ostrom, 1973; Ostrom, Bish, & Ostrom, 1988). The most influential extension of Tiebout’s argument was proffered by Paul Peterson (1981). Peterson developed the theoretical structure for the city limits story. His argument relaxed Tiebout’s assumptions, while making similar claims about the behavior of individuals. Although acknowledging imperfect information, Peterson argued that individuals weigh the costs and benefits of local government services in their residential location decisions. He asserted that city officials recognize the import of these individual decisions. Furthermore, officials are primarily interested in the strength of their city’s economy and, therefore, compete with other cities to retain and attract middle- and upper-income households and businesses. These two conditions, the mobility of residents, individuals and businesses, and the concomitant intercity competition, result in limited policy making. Specifically, Peterson argued that cities will prefer developmental policies, which seek to build the local economy, to redistributive policies.

Peterson’s (1981) city limits story spurred a number of empirical investigations into local policy making. Mark Schneider (1989), for example, examined the role of intercity competition on different types of policy making in suburban cities. Beginning with Peterson’s premise, Schneider asserted, “It is the relationship between the above-average income community member and the local benefit-cost ratio which informs the interests of local governments” (p. 201). He recognized a competitive local market for public goods and placed businesses and residents on the demand side of the market and elected officials and professional bureaucrats on the supply side. Schneider underscored the effects of different types of policies on a city’s benefit-cost ratio. Economic self-interest ensures developmental policies will be preferred to redistributive policies. Furthermore, Schneider emphasized that “the degree of competition in the local market” (p. 42) influences the level of support for different types of local policies. Using Peterson’s argument, Schneider posited, “Competition to lure attractive, fiscally productive individuals, families, and firms increases the incentives of local governments to invest in the developmental services which will appeal to them” (pp. 71-72).

Schneider (1989) conducted numerous multiple regression analyses on pooled, cross-sectional data from suburban cities. For the developmental policy model, he specified developmental expenditures as a function of demographic, economic composition, intergovernmental, fiscal, and competition factors. The model produced an adjusted $R^2$ of 48% and had a statistically significant and negative coefficient for the borders competition measure (defined as the number of cities contiguous to each city in the sample). Schneider concluded that the results “provide some evidence to support . . . Peterson’s argument” (p. 78). The negative finding for competition seems puzzling given an expectation that cities will favor developmental services in more competitive local markets. Two reasons may account for this finding. First, Schneider defined developmental services expenditures as outlays for infrastructure such as streets, sewers, and transportation. This operationalization of developmental policy captures only a single dimension of the concept. Expenditures specifically on economic development most likely would capture more aggressive developmental strategies. Second, as Schneider noted, his findings suggest that competition limits public expenditures across policy areas as elected officials seek to maintain lower costs.

Schneider (1989) examined policy areas in separate models, which limits direct comparison, and used a broad definition of developmental policy. Basolo (2000), however, tested the public choice thesis by comparing economic development to affordable housing expenditures in a cross section of U.S. cities. She specified a logistic regression model with the ratio of economic development to affordable housing expenditures as the dependent variable coded as a ratio above 1 or a ratio equal to or below 1. Her independent variables included intercity competition (measured as the number of cities in a sample city’s metropolitan statistical area), political influence, and institutional and demographic factors. The coefficient for the competition variable was positive and statistically significant, indicating that as intercity competition increased, cities were more likely to spend more on economic development than on affordable housing. Several researchers have applied public choice theory to studies of local economic development. A number of these studies are empirical without an explicit theoretical base (Wolman, 1996). However, some studies implicitly tie their investigation to public choice theory by considering competition as an explanatory
variable in the analysis. For example, using the average number of economic development tools in an area as a measure of competition, Fleischmann, Green, and Kwong (1992) and Green and Fleischmann (1991) found a positive association between competition and economic development effort. In her study of tax abatements, Reese (1999) found that competition failed to explain tax abatement levels.

Political Influence

Many scholars argue that local policy making involves more than the unitary self-interest in economic benefits assumed by the city limits story. The political perspective identifies power relationships and institutional factors as important influences on city policy making. These factors have been applied to many city policy areas including studies of local economic development support.

The literature on the effect of power on the local policy-making process is represented by distinct, but highly related, theories. Community power is one of the oldest explanations for city policy decisions. This perspective focuses on the influence of elites on the policy-making process. Elites, often identified as local business interests, were thought to control the city policy agenda (Hunter, 1953; Jennings, 1964; Polsby, 1963). Pluralists rejected this view of the local policy process and argued that the participation of diverse interests can impact the policy agenda (Dahl, 1961; Wildavsky, 1964). Bachrach and Baratz (1962) criticized both the elite and pluralist models for ignoring a hidden source of power in their analyses. Specifically, these authors equate this power with the ability to keep issues from ever reaching the policy agenda. The interest in traditional community power studies ebbed over two decades ago, but related arguments have emerged over time.

Land-based elites are the powerful force in the growth machine explanation of local policy making. These elites work to stimulate growth and marshal resources to increase land values for personal profit (Logan & Molotch, 1987; Molotch, 1976; Molotch & Logan, 1984). This powerful group influences the policy agenda by working with local government to develop progrowth policies. The growth machine argument has faded as more localities are experiencing an antigrowth, antispawl movement initiated from the grassroots level.

Regime analysis shares characteristics with community power studies and the growth machine thesis. These relationships are reflected in the following definition (Keating, 1991) of regimes: “A set of arrangements through which policy decisions are made, encompassing formal structures and informal relationships, among political and economic elites comprising the governing coalition” (pp. 93-94). In other words, elites wield the power in local policy making, but the development of policy requires economic and political elites to work together. These arrangements between politicians and local business leaders were identified by Elkin (1987) in his study of Dallas, Texas. He described Dallas as an entrepreneurial political economy comprised of a progrowth coalition.

The distinctive characteristic of regime analysis is the nature of the public-private relationships. Instead of economic elites dominating the policy agenda or manipulating local public officials, regime analysis characterizes economic and political elites as collaborators seeking to achieve mutually desired outcomes. Policy outcomes depend on cooperation, interdependence, and long-lasting relationships between the elites. The primary role of the public sector is to coordinate and maintain the relationships (Stoker, 1995; Stone, 1986, 1993).

Interest group theory also is tied to community power and regime analyses. In each of these approaches, a coalition of individuals possesses power that can impact local policy making. For example, business is considered an interest group by some scholars (Clark & Ferguson, 1983). Racial minorities also are identified as an interest group in studies of urban policy (Greenstone & Peterson, 1976; Waste, 1989; Wong, 1990).

Local officials are thought to influence the direction of city policies. Some scholars have found that professional bureaucrats possess power to shape the local policy agenda (Appleton & Clark, 1989; Elkin, 1987). Other studies focus on the preferences of elected officials. For example, the spending preferences of mayors have been considered in several studies (Longoria, 1994; Saiz, 1999). In one study by Appleton and Clark (1989), the preferences of elected officials explained policy decisions better than did contextual variables such as the tax base.
Formal planning also may influence local economic development support. Early economic development work exhibited a lack of planning, but today, many cities have adopted plans to improve program targeting (Eisinger, 1988). Based on existing studies of economic development, the effects of these plans are not well known. Although Reese (1997) included economic development planning as one element of her rational planning and evaluation index, she did not specify a direct relationship with expenditures. Formal planning, however, may represent more effort toward economic development and may be associated with higher levels of city expenditures on economic development.

A number of other factors have been identified empirically as affecting local policy making. The economic conditions within the city may influence local decision making. Two dimensions of economic conditions have been considered in past studies. First, the fiscal circumstances of the local government are thought to affect policy decisions (Cable, Feiock, & Kim, 1993; Clark & Ferguson, 1983; Goetz, 1990). Second, population needs may direct policy. For example, unemployment and the poverty rate have been used in empirical studies to capture needs (Reese, 1991; Rubin & Rubin, 1987). In addition, some researchers have identified population growth (Clark & Ferguson, 1983; Goetz, 1990) and form of government as important factors in explaining policy decisions (Feiock & Clingermeyer, 1986; Green & Fleischmann, 1991).

Finally, the type of city—central or suburban—might result in differences in expenditures. Decades of population migration show an increase in suburban city populations and a general decline in central city populations, even in metropolitan areas that experienced overall growth (Gale, 1987; Kasarda, Appold, Sweeney, & Sieff, 1997; Moss, 1997). Furthermore, globalization of the economy and economic restructuring from a manufacturing to a service economy has resulted in a shift of employment opportunities from central cities to suburbia (Downs, 1994; Imbroscio, Orr, Ross, & Stone, 1995; Mollenkopf, 1983). In other words, central cities have tended to experience economic decline, whereas suburban cities have enjoyed growth and prosperity. Therefore, success in suburban cities may preclude the need to spend extensively on economic development, whereas decline in central cities may lead to higher levels for these types of expenditures.

The next section discusses the methodology used in the research. In addition, we describe the data and present the variables used in analysis.

**RESEARCH METHODOLOGY AND DATA**

This research is designed to investigate the different explanations of local economic development policy making. The cross-sectional design uses cities as the units of analysis. The sampling design was developed to allow for generalizability to the population of cities. To strengthen the validity and reliability of the data and results, we followed systematic survey procedures, developed concepts and variables based on theory and previous studies, and performed regression analyses to control for extraneous variables. This section describes the sampling design, survey procedures and response, and the data used in the analyses.

**Sampling, Survey Methods, and Response Rates**

The research population included all cities with a 1990 population of 25,000 or greater in the United States (N = 1,070). We selected a disproportionate, stratified random sample of 709 cities from the population. The sample was stratified by city population and geographic region to improve sampling efficiency. We disproportionately sampled from the strata with the largest cities to increase the likelihood that this group of cities would be represented in the final sample (Foreman, 1991; Kish, 1967). This sampling design is accounted for in the analysis by weighting each case by the inverse of the sampling proportion times the response rate in its stratum.

A mail survey was used for the collection of data from economic development professionals in the sample of cities. A survey questionnaire was developed to capture the perceptions of professionals about the economic development politics in their city and to collect specific information.
about the cities’ economic development policies and programs. The initial draft of the questionnaire was reviewed by a local economic development practitioner. The purpose of this review was to ensure proper professional language and the reasonableness of the questions. After revisions, the questionnaire was mailed to 20 cities outside the study’s sample. The results of this pretest indicated a solid survey instrument with a potentially high response rate (65%). The questionnaire needed only minor revisions for clarity reasons prior to implementation of the survey.

Optimization of the response rate was a major objective of the survey design. Therefore, we followed Dillman’s (1978) method for a mail survey as it is known to produce good response rates. This systematic approach involves identification of a reliable respondent mailing list, a persuasive cover letter, and multiple mailings.

The survey achieved a 58.3% response rate, with 413 cities responding to the questionnaire. Although this response rate is very good for a mail survey, two issues need consideration. First, the purpose of the sampling design is to produce results that represent the population of cities. If, however, respondents differ from nonrespondents in a systematic manner, then the results will not be generalizable to the population. To test for nonresponse bias, a logistic regression model using response as the dependent variable (1 = responded, 0 = no response) was run in SAS using citywide characteristics as independent variables. These variables included the unemployment rate, revenue-to-expenditures ratio, per capita income, percentage below poverty, population growth rate from 1980 to 1990, region dummies, and population category dummies. Only the coefficient for the unemployment rate was statistically significant \((p = .01)\) in the response bias model. Therefore, cities with higher unemployment rates were less likely to respond to the survey. In addition, the largest category of northeastern cities contained only one city. It was necessary to collapse this information into an adjacent category. For this reason, generalization to the population must include a warning that analytical results may not apply to the largest cities in the northeast region or to cities with high unemployment rates.

Second, the variable total economic development expenditures was missing for many of the cities. In fact, only 332 cities provided adequate expenditure data. The response bias test relies on citywide characteristics that were available from U.S. Census sources. It may be that the cases used in the analysis are biased toward cities more heavily involved in economic development. In other words, cities omitting the expenditure data simply may not be expending funds on economic development, and therefore, the respondent left the expenditure section of the questionnaire blank instead of entering a zero. Given the information available, we cannot confirm this supposition.

### Data and Variables

The survey provides the key variables for this research including the dependent variables. These survey data were merged with selected variables downloaded from the 1990 U.S. Census of Population and Housing summary tape files (U.S. Department of Commerce, 1992, 1993) and the 1994 County and City Data Book (1995). Specifically, policy variables, for example expenditures, and opinion variables, such as the perception of business influence on economic development decisions, were collected in the sample survey, and city contextual factors came from the U.S. Bureau of Census sources.

This research investigates the factors thought to influence the support for economic development by cities. Support for economic development has been operationalized in several different ways. The existence of a particular tool, such as tax abatements, as a dichotomous dependent variable, is used in some studies; that is, the locality either employs the tool or not (Cable et al., 1993; Sharp & Elkins, 1991). Wolman (1996) criticized this approach as failing to capture the extent of economic development. The count of tools also has been used to measure local economic development effort. Wolman emphasized that the measure fails to account for the amount of resources put into economic development. Furthermore, he noted that there is no evidence that there is a correlation between the number of tools and amount of resources devoted to economic development.

The survey of economic development professionals conducted for this research asked for expenditures data as well as use of inducements. Table 1 displays a list of economic development inducements used by cities. Regulatory relief was used by more than 75% of the cities in the
sample. Interest rate subsidies, industrial development bonds, and tax incentives/abatements also were popular economic development tools. Cities used 4.3 of these inducements (see Table 2), on average, and only one city in the sample reported using none of them.

The survey data revealed that 295 (91.4%) of the cities expended at least some funds on economic development. The mean of these expenditures is $1,858,038, as shown in Table 2.\(^2\) The distribution of the expenditures, however, was substantially and positively skewed. Expenditures seem to be a good approach to measuring the extent of resources devoted to economic development. Prior to specifying our models, however, we ran a correlation between the count of inducements and expenditures to assess the validity of using a tools approach as a measurement of economic development support. The analysis produced a zero-order correlation coefficient of \(-.38\) \((p = .000)\). In other words, there is a moderate and negative relationship between the number of inducements and the expenditures in our sample of cities. This result suggests that the count of tools is indeed a questionable measure of economic development support as suggested by Wolman (1996). We used total economic development expenditures as the dependent variable in our models (see Table 3). In doing so, we recognize our support measure fails to capture off-budget tax abatements and other forms of economic development support, such as technical assistance and regulatory relief. However, we believe that expenditures do reflect a major dimension of support for economic development by cities.

Public choice theory predicts that intercity competition will be a major factor in the support of local economic development. In some studies, competition is measured as the average number of economic tools used by localities within a specified area, such as the region or state (Fleischmann et al., 1992; Green & Fleischmann, 1991). This measure can be criticized for at least two reasons. First, the average number of tools ties the competition measure to a summary statistic that may reflect a highly skewed distribution. Second, the measure is not generalizable to other local policy areas. In other words, if the city limits story is appropriate, competition must be operationalized to apply to all policy types.

This research directly links the operationalization of intercity competition to public choice theory as developed by Tiebout (1956). We count the number of competitors, or jurisdictions, within each sample city’s metropolitan statistical area (see Table 4 for a description of all independent variables). A similar approach was used by Schneider (1989) and Basolo (2000).\(^3\)

Support for economic development should be tied to the objectives of the policies. The objectives of economic development in practice tend to be twofold. First, cities often compete for direct fiscal benefits such as the taxes generated by certain businesses. Cities with relatively worse fiscal conditions may be more likely to spend economic development funds to attract or retain these types of businesses (Pagano & Bowman, 1995). This research uses the revenues-to-expenditures ratio in cities as a measure of fiscal conditions (Basolo, 2000; Goetz, 1990). Second, economic development seeks to serve population needs such as jobs and livable wages. Population needs have been measured a variety of ways, including the unemployment rate (Reese, 1991), poverty rate, and median household income (Rubin & Rubin, 1987). We compute the \(z\) scores for these three variables and create an additive, composite index to measure population needs. The intercorrelations

---

**TABLE 1**

Types of Economic Development Inducements Used by Cities, Fiscal Years 1992-1995

<table>
<thead>
<tr>
<th>Inducement</th>
<th>n</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax incentives/tax abatements</td>
<td>167</td>
<td>51.9</td>
</tr>
<tr>
<td>Loans or grants</td>
<td>135</td>
<td>41.9</td>
</tr>
<tr>
<td>Interest rate subsidies on loans</td>
<td>238</td>
<td>73.9</td>
</tr>
<tr>
<td>Land write-downs for industrial/commercial development</td>
<td>232</td>
<td>72.0</td>
</tr>
<tr>
<td>Industrial development bonds</td>
<td>225</td>
<td>69.9</td>
</tr>
<tr>
<td>Regulatory relief</td>
<td>249</td>
<td>77.3</td>
</tr>
<tr>
<td>Technical assistance</td>
<td>139</td>
<td>43.2</td>
</tr>
</tbody>
</table>

NOTE: The number of responding cities was 322.
TABLE 2
Economic Development Effort

<table>
<thead>
<tr>
<th>Type</th>
<th>M</th>
<th>SE</th>
<th>Mdn</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total number of inducements</td>
<td>4.30</td>
<td>0.09</td>
<td>4.90</td>
</tr>
<tr>
<td>Total expenditures</td>
<td>$1,858,038</td>
<td>$269,944</td>
<td>$268,000</td>
</tr>
</tbody>
</table>

TABLE 3
Dependent Variables

<table>
<thead>
<tr>
<th>Variable</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Logistic regression model</td>
<td>Economic development expenditures 1, if dollars expended on economic development in fiscal year 1994-1995; 0, if no dollars spent.</td>
</tr>
<tr>
<td>Linear regression model</td>
<td>Economic development expenditures&lt;sup&gt;a&lt;/sup&gt; Total dollars expended on economic development in fiscal year 1994-1995 (includes only cities spending at least some dollars)</td>
</tr>
</tbody>
</table>

<sup>a</sup> Variable was logged prior to analysis due to substantial positive skewness.

TABLE 4
Independent Variables

<table>
<thead>
<tr>
<th>Variable</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intercity competition&lt;sup&gt;a&lt;/sup&gt;</td>
<td>For each of the sample cities, the sum of all incorporated cities plus counties (1990) in its metropolitan statistical area (MSA) (or primary metropolitan statistical area if the city is in a consolidated metropolitan statistical area); for cities outside an MSA, the sum of all incorporated cities plus the county in the sample city’s county.</td>
</tr>
<tr>
<td>Population need</td>
<td>An additive index of the z scores for three items: unemployment rate, percentage below the poverty level, and median household income, 1989.</td>
</tr>
<tr>
<td>Business influence</td>
<td>Ranges from 1 (no influence) to 7 (very strong influence); subjective estimation based on the perceptions of economic development professionals.</td>
</tr>
<tr>
<td>Elected officials’ support for economic development</td>
<td>Ranges from 1 (not supportive at all) to 7 (very supportive); subjective measure based on the perceptions of economic development professionals.</td>
</tr>
<tr>
<td>Economic development plan</td>
<td>1, if city had an official economic development plan/strategy in fiscal year 1994-1995; 0, if city had no official plan.</td>
</tr>
<tr>
<td>Form of government</td>
<td>1, if strong mayor/council form; 0, if council/manager or other form.</td>
</tr>
<tr>
<td>Central city</td>
<td>1, if central city; 0, if other than central city.</td>
</tr>
<tr>
<td>Population&lt;sup&gt;b&lt;/sup&gt;</td>
<td>Total city population, 1990.</td>
</tr>
<tr>
<td>Growth rate&lt;sup&gt;b&lt;/sup&gt;</td>
<td>Percentage change in population, 1980-1990.</td>
</tr>
<tr>
<td>Region&lt;sup&gt;c&lt;/sup&gt;</td>
<td>1, if city in the region; 0, if not.</td>
</tr>
</tbody>
</table>

<sup>a</sup> Variable was logged prior to analysis due to substantial positive skewness.

<sup>b</sup> An inverse transformation of the variable occurred prior to analysis due to severe positive skewness.

<sup>c</sup> Midwest (reference), Northeast, South, West.
between the items in the index are strong for our data with the index producing a Cronbach’s alpha of .89.

The regression models also include political factors that reflect the power structure in the city as well as institutional variables. The power factors are the influence of business and the level of support for economic development from elected officials. These variables are the perceptions of respondents to the survey. The institutional variables are the form of government in the city and the existence of formal economic development planning.

Finally, we include several control variables in the models: type of city, central or not, 1990 population, 1980 to 1990 population growth rate, and geographic region.

REGRESSION ANALYSES

The analyses consider factors influencing total expenditures on economic development by cities. Approximately 8% of the cities had zero expenditures on economic development, and the distribution of the variable was positively skewed. We chose to model the dependent variable in two ways. First, we created a dichotomous expenditures variable: Either the city spent dollars on economic development or not. For this model, we use logistic regression. Second, we removed the zeros and took the natural log of expenditures to produce a near normally distributed variable. We use linear regression for this analysis. This model is conditional because it considers only cities that spent on economic development.

Prior to multivariate analysis, we inspected the data for potential problems. A few missing values on several independent variables were filled using the relevant mean or mode. The distributions of categorical independent variables were good; however, several of the continuous variables had skewed distributions. We used a natural log or inverse transformation for these variables.

The results of the logistic regression are presented in Table 5. The intercity competition coefficient is negative and statistically significant ($p = .05$). In other words, as competition increases in a region, cities are less likely to spend any funds on economic development. Elected officials’ support for economic development had a positive relationship with the propensity to spend, and the coefficient is statistically significant ($p = .01$). The coefficient for economic development plan also was positive with a significance level of .10. A strong mayor-council form of the government is negatively associated with spending on economic development. The coefficient for total population is positive and highly significant ($p = .01$). Finally, the South ($p = .10$) and West ($p = .05$) regions were less likely to spend any funds on economic development compared to the Midwest.

The linear regression considers only cities that spent funds on economic development. The results from this model are shown in Table 6. The population-needs variable is positive and highly significant ($p = .01$). Therefore, as the needs in cities increase, cities tend to spend more on economic development. Similar to the results from the logistic regression model, the coefficients for elected officials’ support and formal economic development planning are positive and statistically significant ($p = .05$). The population and growth rate are positively associated with economic development expenditures, and the coefficients are statistically significant ($p = .01$). Of the region variables, only the South has a significant coefficient ($p = .10$), and the estimate has a negative sign, indicating the South spends less on economic development than does the Midwest. Contrary to public choice predictions, the competition variable was not significant. Overall, the model explains 36% of the variation in local economic development expenditures.

DISCUSSION

The analyses offer little support for the public choice thesis. In fact, neither model found intercity competition positively associated with economic development spending. . . . In our analysis, higher levels of competition are related to the absence of spending on local economic development.
economic development. Schneider’s interpretation would suggest that competition suppresses spending in all policy areas. 

The support of elected officials for economic development activities and the existence of formal economic development planning had positive impacts in both models. These findings are reasonable, and the former is consistent with existing studies. Cities with a strong mayor-council form of government (compared to council-manager or other forms) were less likely to spend more on economic development. This finding is contrary to some previous studies but may reflect the rise of the economic development profession and entrepreneurial spirit of city administrators (Eisinger, 1988). In other words, economic development is no longer controlled by elected officials, such as mayors, but instead may be led, even if tacitly, by professional bureaucrats such as the city manager (Basolo, 2000). Formal planning is positively associated with the dependent variable in both models. It may be that planning reflects a desire to support economic development and acts as the blueprint for making expenditure decisions. Cities without planning may consider economic development as a lower policy priority and refrain from spending in this area.

The results indicate that business does not influence decisions about economic development expenditures, or at least the influence is not perceived as an important factor in these decisions. This finding may reflect a goals compatibility between entrepreneurial city administrators and

### Table 5

<table>
<thead>
<tr>
<th>Variable</th>
<th>Parameter Estimate</th>
<th>SE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intercity competition (log)</td>
<td>–0.736**</td>
<td>0.305</td>
</tr>
<tr>
<td>Population need</td>
<td>0.058</td>
<td>0.095</td>
</tr>
<tr>
<td>Fiscal conditions</td>
<td>–1.000</td>
<td>2.027</td>
</tr>
<tr>
<td>Business influence</td>
<td>–0.156</td>
<td>0.302</td>
</tr>
<tr>
<td>Elected officials’ support</td>
<td>0.603***</td>
<td>0.183</td>
</tr>
<tr>
<td>Economic development plan</td>
<td>1.101*</td>
<td>0.580</td>
</tr>
<tr>
<td>Form of government</td>
<td>–1.068**</td>
<td>0.503</td>
</tr>
<tr>
<td>Central city</td>
<td>–0.598</td>
<td>0.606</td>
</tr>
<tr>
<td>Population (log)</td>
<td>2.638***</td>
<td>0.743</td>
</tr>
<tr>
<td>Northeast region</td>
<td>0.948</td>
<td>1.008</td>
</tr>
<tr>
<td>South region</td>
<td>–1.329*</td>
<td>0.787</td>
</tr>
<tr>
<td>West region</td>
<td>–1.711**</td>
<td>0.738</td>
</tr>
</tbody>
</table>

**Note:** n = 322, $F = 2.74^{***}$ ($df = 13,295$).

*p = .10, **p = .05, ***p = .01.

### Table 6

<table>
<thead>
<tr>
<th>Variable</th>
<th>Parameter Estimate</th>
<th>SE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intercity competition (log)</td>
<td>–0.009</td>
<td>0.101</td>
</tr>
<tr>
<td>Population need</td>
<td>0.144***</td>
<td>0.043</td>
</tr>
<tr>
<td>Fiscal conditions</td>
<td>0.054</td>
<td>0.710</td>
</tr>
<tr>
<td>Business influence</td>
<td>0.112</td>
<td>0.101</td>
</tr>
<tr>
<td>Elected officials’ support</td>
<td>0.187**</td>
<td>0.082</td>
</tr>
<tr>
<td>Economic development plan</td>
<td>0.443**</td>
<td>0.173</td>
</tr>
<tr>
<td>Form of government</td>
<td>0.322</td>
<td>0.225</td>
</tr>
<tr>
<td>Central city</td>
<td>–0.153</td>
<td>0.221</td>
</tr>
<tr>
<td>Population (log)</td>
<td>2.345***</td>
<td>0.358</td>
</tr>
<tr>
<td>Population growth rate 1980-1990 (inverse)</td>
<td>2.320***</td>
<td>0.551</td>
</tr>
<tr>
<td>Northeast region</td>
<td>–0.289</td>
<td>0.283</td>
</tr>
<tr>
<td>South region</td>
<td>–0.305*</td>
<td>0.258</td>
</tr>
<tr>
<td>West region</td>
<td>0.246</td>
<td>0.282</td>
</tr>
</tbody>
</table>

**Note:** n = 295, $R^2 = .36$, $F = 10.69^{***}$ ($df = 13,268$).

*p = .10, **p = .05, ***p = .01.
business persons (Basolo, 2000). Or, as suggested by H. J. Rubin (1988), the decisions of city economic development professionals may be systematically biased toward business interests even if these decisions are not explicitly intended to favor business. As a result, professionals may not perceive any direct influence from business.

CONCLUSION

The city limits story of unitary, economic self-interest by cities has persisted in research and the practice of local economic development. However, criticisms of public choice theory, the theoretical basis of the city limits scenario, and the changing context of local economic development practice provide an ongoing challenge to the public choice explanation of economic development policy in cities.

Our investigation was designed to determine the importance of the city limits story as well as the strength of political and needs factors as explanations for support of economic development. Using regression analyses on data collected from a national sample of U.S. cities, combined with U.S. Census sources, we investigated competing hypotheses thought to explain local economic development expenditures.

Our analyses provide little support for a public choice explanation of city economic development expenditures. However, a political variable—the preferences of elected officials—and an institutional variable—formal economic development planning—proved to be important factors influencing economic development expenditures. Both variables were associated with higher levels of spending. Population needs also were found to be an important factor explaining the level of economic development expenditures in cities. The results show that as needs increase, so does the level of economic development expenditures.

The results of this research have several implications for research and practice. First, it appears that the doubts about the continued, blanket application of the city limits story to local economic development policy making are reasonable. More attention needs to be focused on less deterministic influences such as political factors. Specifically, researchers need to consider the ways in which elected officials form their policy preferences and the influences on those preferences. Second, researchers and practitioners should closely examine the level of planning across cities and the impacts of planning on effort as well as outcomes. Many cities have population needs that should be the central concern of economic development policy. Ultimately, the importance of planning rests with effectively serving those needs.

NOTES

1. All cities with missing expenditures data were dropped from the analysis, and an additional city was deleted due to an exceptionally high expenditure figure and its influence on the multivariate analyses.
2. Frequencies were computed in SAS using weighted data. Means and regression coefficients were computed using STATA to account for the sampling design.
4. Three types of cities were identified: central, suburban, and nonmetropolitan. We recoded into dummy variables and attempted to run the analysis with the nonmetropolitan and central dummies included in the model. The relatively few cases of nonmetropolitan cities in the sample resulted in problems with the models’ results. We chose to retain the 29 nonmetropolitan cities instead of reducing our sample even further. Therefore, we recoded the type of cities into central and other types.
5. The dichotomous variable for expenditures has limited variability. However, the model converged without difficulty and produced reasonable results.

REFERENCES


The Impact of the North American Free Trade Agreement on the Economy of Western New York

Renee Will
Alan MacPherson
State University of New York at Buffalo

This article examines the economic impact of the North American Free Trade Agreement (NAFTA) on western New York (WNY). A variety of theoretical perspectives are reviewed, notably impact assessment. Evidence from a survey of local industrial firms suggests that NAFTA has not played an especially important role in the various upswings and downswings that have affected the WNY area in the 1990s. In contrast to a number of inquiries that have appeared in the recent literature, the authors find little evidence to support the view that WNY has been negatively affected by NAFTA. Instead, the authors' evidence suggests that NAFTA has had a positive impact in terms of new export development, job creation, input sourcing, and sales growth. The article concludes with a brief discussion of the empirical and theoretical difficulties that confront researchers who wish to explore the effects of trade agreements upon regional economies.

As the North American Free Trade Agreement (NAFTA) enters its 7th year, academic and policy debate continues regarding the long-term economic and social implications of the accord (Gould, 1998; Hanson, 1998; McKinney, 1999). In the United States, for example, some critics have argued that NAFTA has established ideal conditions for large-scale capital out-migration to Mexico, in large part because of that nation’s low unit costs and lax environmental standards (for a recent overview, see Husted & Logsdon, 1997). Similar concerns have been raised by Canadian critics (Drache, 1993; Merritt, 1996), such that by now, opposition to NAFTA is noticeably stronger in the United States and Canada than in Mexico.

Part of this dissent flows from a lack of faith in the geographic and economic logic that underpins traditional trade theory (Pasquero, 1999). For example, few markets operate on the basis of perfect competition; factors of production have become increasingly mobile at the international level; and from a neoclassical perspective, free trade with factor mobility ultimately implies international cost convergence (leaving some countries richer or poorer than before). Recent opposition to NAFTA has also been feeding from empirical work on subnational events, including local plant closures, company relocations, and other types of negative effects (e.g., environmental degradation, trade diversion, etc.). This article seeks to contribute to the NAFTA debate by offering a regional case-example that considers the import, export, and investment impacts of the 1994 accord. Our case-example is western New York (WNY), a stagnant but trade-sensitive region that lies on the eastern edge of the U.S. Rustbelt. Although we do not pretend that WNY is representative of other U.S. regions (stagnant, declining, or otherwise), some of our results may be of interest to policy practitioners who reside in similar types of places.

Set against this backdrop, our article is organized as follows: First, we provide a research context that summarizes the main theoretical positions that have been taken by trade economists. Here,
particular attention is given to the benefits predicted by classical and new trade theories. This section also reviews the results of several econometric studies that have attempted to quantify the impact of NAFTA on the United States. We then offer a regional context for the inquiry: Why is WNY worth looking at? Next, we discuss the results of a recent survey of WNY companies that participated in a pilot project on the regional economic impact of NAFTA. The implications of our findings are then discussed. The article concludes with a synopsis of our main results, along with an agenda for future empirical work on the regional impact of NAFTA.

**RESEARCH CONTEXT**

Conventional wisdom holds that aggregate production and consumption can be maximized by allowing tradable outputs to move freely across international borders. The long-established Heckscher-Ohlin (H-O) theorem frames this proposition in terms of relative costs and factor proportions, yielding a textbook model of trade in which nations compete on the basis of comparative advantage (Ohlin, 1933). Although this model is far from perfect (see Atkinson, 1998), variants of the H-O theorem have sometimes been used to recruit political support for regional integration initiatives (Gould, 1998). Borrowing from Viner’s (1950) work on customs unions, trade bloc enthusiasts have also pointed to the dynamic benefits of market integration, including economies of scale, intensified competition (which can further reduce prices), and technological innovation (driven primarily by heightened competition). Nevertheless, the fact that trade blocs confer preferential status to members contradicts the spirit of free trade initially envisioned by Ohlin (1933), the General Agreement on Tariffs and Trade (1945-1995), and the World Trade Organization. Yet, as Krugman (1993) and several others have observed, trade blocs represent local attempts at liberalized commerce at a time when global efforts in the same direction have not been faring too well.

With regard to NAFTA, which was ratified on January 1, 1994, the H-O school of trade policy emerged as a victor in the push for a three-way agreement. Specifically, Mexico was cast as a labor-abundant economy with low wages, Canada was characterized as a resource-oriented economy, and the United States was seen as the capital-abundant nation (well endowed with advanced technology and skilled workers). On the face of it, a better geographic juxtaposition of factor-based complementarities would be hard to find anywhere else in the world. Notwithstanding, the fact that Canada had gained a reputation for world-class exports outside the resource sector well before 1994 (e.g., aerospace) or that Mexico itself was a bigger supplier of capital-intensive exports in 1994 (e.g., oil) than labor-intensive exports (e.g., textiles), the factor-proportions argument was widely broadcast within the United States during the immediate pre-NAFTA period (McConnell & MacPherson, 1994).

Prior to the approval of NAFTA, however, several scholars predicted that the accord would amount to little more than a legally codified framework to guide patterns of commerce that had already gained substantial momentum long before 1994. For instance, Krugman (1993) argued that NAFTA was a U.S. foreign policy imperative rather than an economic necessity, in that helping a friendly neighbor to the south would make more sense than risking a return to the “bad days of U.S.-Mexican relations” (p. 19). In a similar vein, McConnell and MacPherson (1994) argued that NAFTA was designed to remove “irritants” within a system of trade and investment that had already been shaped in the 1980s. Given that the average U.S. tariff on imports from Mexico was only around 4% in 1993, Krugman argued that a phased elimination of tariffs over a 15-year period would not have a significant long-term impact on U.S. industrial employment. Now that NAFTA is almost 8 years old, however, it is perhaps time to reassess the employment debate in terms of outcomes.

As far as the U.S. literature is concerned, employment outcomes have typically been estimated on the basis of two interlinked approaches. The first approach involves a multiplier methodology that relates U.S. export levels to job creation (e.g., Century Foundation, 1997; Gould, 1998; Hufbauer & Schott, 1993; North American Integration and Development Center [NAID], 1996). For example, the U.S. Department of Commerce has long used a multiplier that estimates 20,000 jobs gained for every $1 billion rise in U.S. exports. Over the period 1993 to 1998, WNY’s
combined exports to Canada and Mexico increased from $680 million to $1.59 billion (an increase of 133%), suggesting a trade-related employment increase of 18,000 new jobs (using the Commerce Department’s multiplier). Over the same period, the Commerce Department noted that approximately 2,500 jobs in WNY were lost as a direct result of import competition from Mexico and Canada, giving a net gain of approximately 15,500 jobs. Estimates regarding job losses come from trade adjustment assistance (TAA) claims that are filed by employers or individual workers with the U.S. Department of Labor. Although this illustration considers jobs created or lost as a result of trade with Mexico and Canada, it does not say very much about the role of NAFTA itself. Even if one were to fully accept the accuracy of the Commerce Department’s multiplier, estimates of trade-related job creation would need to be deflated with regard to trade that would have taken place anyway.

Not surprisingly, impact estimates that come from the Commerce Department’s approach (or variants of that approach) have been criticized by trade economists on a number of grounds. The most obvious problem is that a substantial proportion of WNY’s increased trade with Mexico or Canada would have taken place regardless of NAFTA (in which case, the basic task would be to assess NAFTA’s contribution to the increase). Even if this could be done, there are a number of other problems with the multiplier approach. For example, the multiplier that links employment with exports is rather old (last calibrated in 1993); the multiplier represents an aggregate (national) parameter that may not apply to specific regions as a result of structural differences in the composition of exports at the metropolitan or county levels; and more fundamentally, the multiplier does not account for the possibility that export growth can take place in the absence of any employment growth at all. (We illustrate this point later.)

On the import side, the TAA approach is also problematic. For instance, TAA certifications are issued on the basis of self-reported employment effects by firms and workers. Verification standards are far from rigorous in that the Department of Labor does not have a methodology for assessing the legitimacy of trade-induced losses (NAID, 1996). A related problem is that jobs lost to import competition might well have disappeared anyway (regardless of whether NAFTA was in place). Will (2000) reported that TAA certifications have not increased dramatically in the post-NAFTA period and that there is no correlation between import growth rates from Mexico or Canada and TAA certifications with regard to either of these two nations.

A more sophisticated approach toward impact assessment comes from the NAID-Armington methodology (NAID, 1996), which differentiates the employment effects of export and import change by industry sectors that were liberalized under NAFTA compared to sectors that were not. This approach attempts to measure the degree of substitutability (and complementarity) between imports and domestic production (Armington elasticities). The most recent results from this technique reveal that the sectors with the largest employment gains (electronic equipment, industrial machinery, apparel, and transportation equipment) are also the sectors that are most vulnerable to import competition. On the basis of Armington elasticities, NAID ranked Erie County (the single largest part of WNY) 65th in the nation in terms of NAFTA sensitivity (i.e., the potential for job loss). An important disclaimer in the NAID study is that reliable impact assessments at the county level are unlikely to emerge until a multiperiod, multiregional, dynamic general equilibrium model of trade, capital, and labor flows linking all three nations is constructed (see Kouparitsas, 1997). An operational model of this type has yet to be developed.

From the sketch outlined above, it would seem that any assessment of the impact of NAFTA ought to address the contingency issues inherent to the current debate. Specifically, what would have happened if NAFTA had not been approved in the first place? In an effort to answer this question, Gould (1998) employed a multiperiod gravity model of trade that included incomes, prices, and exchange rates. Once the fundamental determinants of trade flows were accounted for in the pre- and post-NAFTA periods, extraordinary U.S.-Mexico flows were attributed to the free trade agreement. Although Gould’s results suggested a net gain for the United States as a whole, his model was not framed to capture regional effects, nor did it consider specific sectors. To the best of our knowledge, regional applications of Gould’s approach have yet to appear in the literature. This is unfortunate, if only because Gould’s methodology could be combined with a multiplier approach to estimate jobs created (or lost) as a direct result of trade legislation.
Although several other approaches toward impact estimation have been proposed in recent years, this article offers a microeconomic perspective based on the experiences of individual firms. Although the contingency issue remains the same, the task of assessing the impact of NAFTA is transferred to the owners and managers who make production and employment decisions at the plant level. In short, rather than attempt to find an econometric estimate, we decided to ask decision makers themselves about the economic effects of NAFTA. Given that Erie County was ranked within the nation’s top 100 counties in terms of potentially negative impact (NAID, 1996), we expected to find some evidence of this at the establishment level. After all, it is reasonable to assume that owners or managers ought to know something about the extent to which NAFTA has had an impact on the businesses that they preside over. (We shall say more about this assumption presently.) Before looking at our results, however, it is appropriate to provide a contextual backdrop regarding the nature of the study region. Why might WNY be considered trade sensitive? and What can we learn from an examination of this region’s responses to NAFTA?

**REGIONAL CONTEXT**

WNY is a declining industrial region located on the eastern perimeter of the U.S. Rustbelt. Although several definitions of WNY exist for planning purposes, we define the region in terms of the two contiguous counties (Erie and Niagara) that share an international border with Canada along the Niagara River. These two counties contain the bulk of upstate New York’s older industries. Nationally recognized for Buffalo wings and lake-effect snow, this region has a long history of capital out-migration, population decline, and slow income growth (Institute for Local Governance and Regional Growth, 1999). With the passage of the Canada-United States Free Trade Agreement (FTA) in 1989, however, public agencies throughout the WNY area seemed optimistic that economic revival would soon take place as a result of expanded bilateral trade (including new inward investment from Canada). Although two-way trade across the Niagara River has certainly increased over the post-FTA period, growth rates for imports and exports remain similar to those that prevailed prior to 1989. In fact, 10 years after the FTA, the economy of WNY can be described as slow growing at best—despite substantially increased trade (Bagchi-Sen, 1999). Although increased trade has contributed significantly to gross regional product (GRP), the same cannot be said for employment (Institute for Local Governance, 1999). More specifically, job growth trails export growth by a considerable margin.

None of this should be taken to imply that the FTA (or NAFTA) has done nothing to help the region. In a series of surveys sponsored by the Canada-U.S. Trade Center (CUSTAC) at the State University of New York at Buffalo, it was found that significant numbers of small WNY firms had become export active in the early 1990s as a direct result of the trade opportunities implied by the FTA (Chandra, 1992; MacPherson, 1997; McConnell & MacPherson, 1990). Although none of this had much to do with tariff cuts or other regulatory factors, it would appear that the accord provided a symbolic wake-up call to many local firms. On balance, however, these types of micro-level effects have not amounted to very much in aggregate terms, and the same can be said for post-FTA Canadian investment in the WNY area (MacPherson, 1997). Nevertheless, it should be emphasized that the various CUSTAC surveys were conducted in the early to mid-1990s, leaving room for the possibility that FTA/NAFTA impact might not have had enough time to manifest itself (recall that tariff reductions for many commodities were given as much as a 15-year phase-in period under NAFTA).

For regions like WNY, however, the importance of exports is hard to overstate. Over the period 1978 to 1998, CUSTAC’s cross-sectional export-base model yielded an $r^2$ of .67 (the export parameter was 0.562 at $p < .05$). According to this model, a 1% increase in local exports delivers a 0.56% increase in GRP. Parameters of this magnitude and significance have rarely been found at the national level for any time period, and the same can be said for most states. Clearly, then, exports are strategically important to the WNY economy. Given that more than 70% of the region’s exports are sold to Canada, the liberalized trade provisions of the FTA and NAFTA would seem to serve WNY’s economic interests quite well.
Keeping this context in mind, our survey was structured to capture basic information across a number of impact categories, including trade, investment, total sales, and employment. With regard to trade, potential NAFTA effects include cheaper imports of raw materials or intermediate inputs, increased import competition, new export development, or a mix of all three. We initially expected that the relative importance of any specific trade effect would show up in terms of broader aspects of company performance (e.g., sales or employment). Finally, we included an investment variable to assess the extent of NAFTA-related capital out-migration (i.e., outflows of foreign direct investment [FDI] to either Canada or Mexico). This variable was included in light of NAFTA’s liberalized rules regarding FDI within the trade bloc. The question thus remains, Does NAFTA deserve the attention it regularly attracts in local academic, media, and policy circles?

SURVEY METHOD AND EMPIRICAL RESULTS

As a first step toward answering this question, a postal survey of 200 WNY industrial establishments was conducted by CUSTAC in August of 1999. The survey was stratified in two ways. First, the region’s 100 largest manufacturing establishments were surveyed (complete coverage). Second, a random sample of 100 small-to-medium-size enterprises (SMEs) was surveyed. We defined these SMEs as single-plant firms with fewer than 100 employees.

The survey instrument was designed to yield categorical data across the various impact dimensions noted earlier. A categorical approach was adopted for several reasons. First, preliminary attempts to obtain ratio or ordinal data proved fruitless, in that pretests revealed that few firms could separate the impact of NAFTA from other factors (e.g., national economic conditions). For instance, telephone interviews with the chief executive officers (CEOs) of five of WNY’s largest manufacturing companies revealed that exports to Mexico had increased appreciably since 1994 but that pre-NAFTA growth rates had also been strong. All five of these CEOs suggested that we rephrase our questions to capture general impressions rather than exact impact figures. Second, our pretests revealed that questions based on ordinal scales were also hard to answer in that many respondents stated that they simply could not rank the impact of NAFTA. For example, several of the SMEs that we talked to noted that they export to and import from Canada on a sporadic basis and that the task of assigning an impact rating was difficult in light of factors such as the relatively weak value of the Canadian dollar in the post-NAFTA period (among other things). On the basis of these pretests, then, our final survey instrument was reduced to a crude device that listed only four response classes across each impact category: positive, negative, no impact, and impossible to tell.

Of the 200 questionnaires that were mailed, a total of 70 valid returns were received (giving a response rate of 35%). The response rate for the random sample of SMEs was 28%, compared to 42% for the larger establishments. One possible reason for the relatively low response rate for the survey as a whole is that most industrial firms in the WNY area have not been directly affected by NAFTA. Follow-up telephone calls to nonrespondents revealed a consistent set of reasons for nonparticipation in the survey (e.g., “we neither import nor export,” “we have no import competition,” “NAFTA is not relevant to our business,” etc.). Put another way, it would appear that the survey had little saliency to a substantial number of firms. This said, roughly half of the nonrespondents refused to comment on their reasons for nonparticipation. From the outset, then, it should be recognized that our survey results are suggestive rather than conclusive. After all, there are no published data that can be mustered to compare respondents versus nonrespondents in terms of trade or NAFTA-related variables. All that we can say with confidence is that respondents and nonrespondents differed little in terms of size (employment), industry focus (durable vs. nondurable goods), and age (number of years in business).

The final sample contained firms distributed across the following industries: fabricated structural metal (11), electronics (9), auto parts (7), food processing (4), chemicals (6), textiles and apparel (8), scientific instruments (7), plastics and ceramics (6), machine tools (5), furniture (4), and paper products (3). This distribution closely matches WNY’s industrial profile in terms of manufacturing employment. Despite our low response rate, the sample at least resembles the bigger picture in terms of the structure of the manufacturing sector.
On this note, Table 1 presents a descriptive summary of the overall impact results. At first blush, the numbers suggest that NAFTA has not been particularly important to local firms in that few have been positively affected (fewer still have been negatively affected). Because no significant differences between the two size groups of respondents were found across any of the variables shown in our tables (chi-square tests), all subsequent discussion is focused on the total sample. In terms of employment, Table 1 shows that only 8 respondents (11% of the sample) felt that NAFTA had contributed positively to job creation compared to 5 firms on the negative side (7% of the sample). Fully 68% (n = 48) of the survey firms belong to the zero impact category, whereas 9 firms (13%) indicated that NAFTA's employment impact was impossible to tell.

A more encouraging picture emerged in terms of sales and export effects, in that 16 firms indicated a positive impact on sales (22% of the sample), whereas 17 firms indicated a positive impact on exports (24% of the sample). Across all of the impact classes, however, it should be noted that negative effects were confined to less than 10% of the sample. For instance, 5 firms indicated a negative impact on jobs (7% of the sample), 6 indicated a negative impact on sales (9% of the sample), and 3 reported a negative impact on exports (4% of the sample). In terms of frequency counts, then, respondents indicating a positive impact outnumbered their negative counterparts by a considerable margin.

On the employment front, Table 2 shows that all of the firms that reported new job creation under NAFTA also indicated a positive export effect (n = 8). Yet, of the 17 firms that reported a positive export impact overall, 1 stated that jobs had actually been lost (an import competition effect in this case), whereas 8 noted that jobs had either remained constant or that the impact of NAFTA on employment was impossible to tell. In short, it would appear that expanded export activity created new jobs among only half of the firms that indicated positive export effects. Although we cannot estimate the export elasticity of employment with these data, we suspect that it must be low.

With regard to import competition, only 18 firms (26% of the sample) implicated NAFTA with a negative impact (see Table 3). Canada was cited as the source of increased competition in 12 cases, compared to 10 cases for Mexico. Curiously, however, only 2 of these import-competing firms also implicated NAFTA with a negative employment or sales effect. Various cross-tabulations (not shown here) suggest that import competition under NAFTA has created negative consequences other than those considered in this article. (We shall return to this point later.)

Of the 70 firms in the database, only 11 (16% of the sample) noted that NAFTA had created opportunities for cheaper input sourcing (see Table 4). These opportunities were closely divided between Canada (7 cases) and Mexico (8 cases). Of the firms that indicated a positive effect on this variable, 2 also indicated a negative effect on total employment. This particular relationship was ultimately traced to international outsourcing in that certain types of routine tasks (formerly conducted in-house) had been transferred to producers in Mexico. Thus, a positive effect at one level (i.e., cheaper input sourcing via imports) can in some cases translate into a negative effect at another level (i.e., local job losses as a result of international subcontracting).

The impact of NAFTA on export expansion is presented in Table 5. These data show that 17 firms identified a positive export effect. Again, the export effect was closely divided between Canada (15 cases) and Mexico (12 cases). Significantly, the 8 firms that cited NAFTA as being a positive factor in recent employment expansion (see Table 1) are located within the first cell of Table 5.
An implication here is that firms on a growth trajectory in terms of employment have also been on a growth path as far as exports are concerned. (i.e., exports have increased both to Canada and Mexico). An implication here is that firms on a growth trajectory in terms of employment have also been on a growth path as far as exports are concerned. Data tabulated elsewhere indicate that the 8 firms that cited NAFTA in a positive light on the employment front are part of a distinct group of export-oriented firms (Will, 2000) in that most of these companies typically earn at least 30% of their annual sales from foreign markets.

This said, an obvious problem with Tables 1 to 5 is that we are dealing with categorical data rather than absolute numbers. Thus, the 5 firms indicating a negative employment impact (see Table 1) may have lost more jobs than the 8 firms indicating a positive impact (or vice versa). Precisely the same criticism can be applied with regard to all of the other variables. In an effort to attach a sense of scale to the data, then, we conducted telephone interviews with two groups of firms. We defined the first group as positively affected (Group 1). This group consists of the 8 firms that indicated a positive employment impact. We defined the second group as negatively affected (Group 2). This group consists of the 5 firms that indicated a negative employment impact. Group 1 consists of 2 metal fabricators, 1 food processor, 3 producers of electronic goods, and

TABLE 2
Export and Employment Change Under NAFTA

<table>
<thead>
<tr>
<th>Employment Effects</th>
<th>Export Effects</th>
<th></th>
<th></th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Positive</td>
<td>Positive</td>
<td>8</td>
<td>0</td>
<td>8</td>
</tr>
<tr>
<td></td>
<td>Negative</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>Other</td>
<td>Othera</td>
<td>8</td>
<td>1</td>
<td>48</td>
</tr>
<tr>
<td></td>
<td></td>
<td>17</td>
<td>3</td>
<td>50</td>
</tr>
</tbody>
</table>

NOTE: NAFTA = North American Free Trade Agreement. Six of the nine cells have expected frequencies of less than 5, thus the chi-square value (45.06 at $p < .05$) is questionable. The $2 \times 2$ portion of the matrix (positive and negative export and job effects) is statistically significant ($p = .054$, Fisher’s exact test).

a. Irrelevant, neutral, or impossible to tell.

TABLE 3
Incidence of NAFTA-Related Import Competition

<table>
<thead>
<tr>
<th>Import Competition From Mexico</th>
<th>Yes</th>
<th>No</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Import competition from Canada</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yes</td>
<td>4</td>
<td>8</td>
<td>12</td>
</tr>
<tr>
<td>No</td>
<td>6</td>
<td>32</td>
<td>38</td>
</tr>
<tr>
<td>Total</td>
<td>10</td>
<td>40</td>
<td>50</td>
</tr>
</tbody>
</table>

NOTE: NAFTA = North American Free Trade Agreement. Twenty survey participants did not respond to questions about import competition.

TABLE 4
Incidence of Cheaper Input-Sourcing (imports)

<table>
<thead>
<tr>
<th>Cheaper Imports From Mexico</th>
<th>Yes</th>
<th>No</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cheaper imports from Canada</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yes</td>
<td>4</td>
<td>3</td>
<td>7</td>
</tr>
<tr>
<td>No</td>
<td>4</td>
<td>20</td>
<td>24</td>
</tr>
<tr>
<td>Total</td>
<td>8</td>
<td>23</td>
<td>31</td>
</tr>
</tbody>
</table>

NOTE: Thirty-nine survey respondents did not reply to questions about cheaper imports.
2 manufacturers of scientific instruments. Group 2 consists of 2 metal fabricators, 1 producer of electronic goods, 1 furniture company, and 1 manufacturer of paper products.

The 8 companies contacted in Group 1 revealed that a total of 145 jobs had been created as a direct consequence of NAFTA. (This figure is a rough estimate that came from a series of rough estimates supplied by the firms themselves.) All of these firms reported that their exports had increased as a direct result of NAFTA’s tariff reductions. On average, export sales for this group increased by 13% over the 1994 to 1998 period. (The range was from 1% to 50%.) One of these companies reported an increase of 40 jobs, along with a 20% increase for both exports and total sales. This firm also declared that a “substantial” direct investment in Mexico had taken place since 1994 but that production levels in WNY had also grown since that time. The 5 companies contacted in Group 2 reported losing a total of 43 jobs as a result of NAFTA (import competition). From this sample, then, the net employment effect is positive (142 additional jobs).

In themselves, of course, these figures are not terribly illuminating, in that the sample may not be representative of the broader population of WNY establishments. It is interesting to note, however, that the TAA/export multiplier methodology (when applied to WNY) suggests that the employment gains from increased trade with NAFTA members ought to be about 7 times higher than the employment losses (keep in mind that we have not deflated these gains to account specifically for NAFTA). Our estimates suggest that the gains are 3 times higher than the losses. Still, our estimates may be on the low side, in that not 1 of the 5 companies in Group 2 actually applied for TAA relief over the 1994 to 1999 period. According to the nearest TAA center (Binghamton, New York), TAA claims from the WNY area more typically come from firms experiencing import competition from Asian or European nations—not Canada or Mexico. The question thus arises, How important is NAFTA to regions like WNY?

**DISCUSSION**

Evidence from our survey suggests that NAFTA has had a positive impact on WNY, in that post-1994 employment gains have exceeded losses by at least 300%. There is also evidence that NAFTA has promoted increased export activity and/or cheaper import sourcing. On a more cautious note, it should be repeated that many firms simply do not know whether NAFTA has had an impact or not. In terms of employment effects, for instance, fully 68% of the survey firms belong to this “unknown” category. Among those firms that did indicate an impact, moreover, rather few were able to describe the positive or negative effects with any real precision. As a result, we are left with a series of general impressions rather than robust estimates. In short, there is insufficient evidence to warrant unqualified enthusiasm or disdain for NAFTA as far as local economic impact is concerned.

Nevertheless, the fact that exports continue to play an important role in WNY’s economic performance (growth of GRP) suggests that any regulatory initiative that safeguards the region’s access to foreign markets ought to be applauded. In this sense, NAFTA provides a legal framework that serves the interests of WNY quite well. Moreover, the relatively sparse number of adjustment assistance claims over the past few years implies that the negative effects of NAFTA have not been

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**TABLE 5**

Incidence of NAFTA-Related Export Growth

<table>
<thead>
<tr>
<th></th>
<th>Increased Exports to Mexico</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Increased exports to Canada</td>
<td>10</td>
<td>5</td>
</tr>
<tr>
<td></td>
<td>2</td>
<td>19</td>
</tr>
<tr>
<td>Total</td>
<td>12</td>
<td>24</td>
</tr>
</tbody>
</table>

NOTE: NAFTA = North American Free Trade Agreement. Thirty-nine respondents did not reply to questions about export growth.

Our estimates suggest that the gains are three times higher than the losses.

... it should be repeated that many firms simply do not know whether NAFTA has had an impact or not.
terribly dramatic. Of the 5 firms in our survey that implicated NAFTA with job losses, recall that not 1 applied for adjustment assistance over the study period (despite the relative ease associated with obtaining TAA compensation).

Having said this, only half of the 16 firms that indicated positive effects on total sales also indicated positive employment effects. In short, 50% of these firms experienced output growth in the absence of any employment growth. Personal interviews revealed that this pattern typically occurs among firms with relatively low capacity-utilization rates, which are not unusual in the WNY area. Specifically, output can increase substantially without any need for additional hiring. In many cases, in fact, increased export demand can usually be handled by adding an extra hour or two of overtime within the plant (thus, total wage earnings grow but employment does not). This type of scenario casts doubt on the generalizability of the Commerce Department’s export-employment multiplier, in that regions with low capacity-utilization rates can sometimes increase their export sales without creating new jobs.

On the import side, it is curious that none of the firms that implicated NAFTA with increased competition applied for TAA relief over the 1994 to 1999 period. (Of these firms, 19 actually employed more workers in 1999 than in 1994.) These data suggest some peculiar elasticity conditions at the level of individual firms. In one case, for example, total employment expanded considerably over the post-NAFTA period—despite rising import competition and reduced exports. Here, the puzzle can be resolved by looking at other factors (in this case, rapid expansion of the domestic market provided enough room for continued growth). Clearly, it would be difficult to make sense of these types of cases in the absence of follow-up interviews.

A further example of ambiguity emerged on the import side, in that we initially thought that cheaper input-sourcing should be classified as a positive impact. In 2 cases, however, NAFTA was directly responsible for a switch from in-house production to imports (resulting in local job losses); in another case, FDI in Mexico was viewed as an overall corporate benefit from the perspective of management (presumably, labor had a different view). Recall also that only 2 of the 18 import-competing firms (see Table 3) cited NAFTA as a negative factor in recent employment trends. How can this be? The short answer is that we did not have a comprehensive list of impact categories (our project was a pilot study). Follow-up inquiries confirmed that import competition can occur without job losses or falling sales: Firms in this situation can respond by cutting prices (profits shrink), reducing employee benefits or hours (job levels remain constant, but compensation declines), or by spending more money on marketing (among other things). In short, many of the seemingly contradictory findings that emerged from our initial analysis were finally traced to a lack of attention to other variables (e.g., capacity-utilization rates, profit levels, outsourcing, worker benefits, etc.). We hope to fix these flaws in a larger multiregional survey that is planned for the near future.

CONCLUSION

Despite the categorical and qualitative nature of our data, several general impressions can be sketched from the findings discussed earlier. First, the task of assessing the impact of trade legislation is problematic from an econometric perspective. Equally intractable difficulties face those that opt for alternative approaches based on survey research or case studies. Specifically, it is hard (if not impossible) to estimate accurately what would have happened in the absence of NAFTA. A second conclusion is that the overall impact of NAFTA on WNY would appear to be positive. Although our survey results point to smaller effects than those implied by the Commerce Department’s export-employment multiplier, a positive impact is surely better news than a negative one. Third, it would appear that the competitive problems facing firms in places such as WNY are shaped more by national or regional economic conditions than by international agreements on trade. This conclusion comes from our follow-up interviews, as well as from other studies that have been conducted in the WNY area, including southern Ontario.

These conclusions ought to serve as cautionary notes to decision makers who see expanded trade as a central priority in regional economic planning. The importance of trade is not in dispute. However, the fact that regions like WNY can experience strong export growth in the absence of
strong employment growth raises serious questions regarding the generalizability of nationally calibrated export-employment multipliers. If local capacity-utilization rates are low, then export expansion can take place without any significant job creation. On the flip side of the coin, rising import competition may not necessarily kill very many jobs either. Over the long term, in fact, it is possible that import competition might spur the types of innovations that are required to sustain or expand jobs in import-threatened sectors. The task remains to develop an impact assessment methodology (survey-based or econometric) that can link a region’s specific industry and trade structure to locally estimated elasticity conditions across several variables. Although this is a tall order in terms of data assembly and model calibration, the prescription is not impossible to fill.

REFERENCES


Certified Capital Companies (CAPCOs): Strengths and Shortcomings of the Latest Wave in State-Assisted Venture Capital Programs

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Julia Sass Rubin
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Certified Capital Companies (CAPCOs) are state-certified venture capital companies funded by insurance companies. As an incentive to invest in CAPCOs, insurance companies receive a $1 credit on premium taxes for each $1 invested (tax credits are spread over a 10-year period). The CAPCOs must invest in specific types of businesses according to an established time schedule to ensure the availability of tax credits to the insurance companies. Legislation authorizing CAPCO programs has passed in five states (Louisiana, Missouri, Florida, New York, and Wisconsin) and has been considered in eight other states (Iowa, Illinois, Arizona, Texas, Kansas, Vermont, Colorado, and North Carolina). This article summarizes the characteristics and experiences of CAPCO programs in the states that have passed enabling legislation. Lessons learned from the experiences of the state programs are provided, and the advantages and disadvantages of CAPCOs as compared to alternative state-sponsored venture capital programs are reviewed.

Access to venture capital is recognized as critical for business start-ups and expansions and, consequently, important for state and local economic development prospects (Bingham, Hill, & White, 1990; Federal Reserve Bank of Kansas City, 1999; Florida & Kenney, 1988; Florida & Smith, 1990; Leicht & Jenkins, 1994; Parker & Parker, 1998; Timmons & Bygrave, 1986). Yet, the supply of venture capital is concentrated geographically, and venture capital investments are focused on a relatively small number of regions and industries (PricewaterhouseCoopers, 1999). The geographic concentration and industrial focus of venture capital investments have contributed to the perception that specific regions of the country (the more geographically isolated and/or sparsely populated) and certain industries (traditional, non–high tech) are underserved by private venture capital firms. A common response to this perception of a venture capital shortage is the initiation of public programs to enhance the availability of equity capital for local entrepreneurs and businesses.

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State programs to promote the availability of venture capital first appeared in the late 1970s, with early programs including the Massachusetts Capital Resource Company, the Connecticut Product Development Corporation, and Kansas Venture Capital, Inc. (Daniels & Lynch, 1998; Eisinger, 1991; Fisher, 1988, 1990; Thompson & Bayer, 1992; U.S. Small Business Administration [SBA], 1985). Adoption of state-assisted venture capital programs spread rapidly across the states, and a recent survey of state departments of commerce and economic development identified 144 programs in 46 states (Barkley et al., 2000). These 144 state-assisted venture capital programs fall into five principal program types: publicly funded and publicly managed funds (17), public funding provided for privately managed funds (30), tax credits or incentives for individuals or businesses making venture capital investments (22), state-sponsored or assisted angel networks (53), and state-sponsored or assisted venture capital fairs (22). The development of state-supported venture capital programs was attributed by Eisinger (1991) to the reduction in federal revenue sharing in the late 1970s, which encouraged states to seek innovative methods for stimulating economic development using local resources. Leicht and Jenkins (1996) also suggested that “grow your own” entrepreneurial policies, such as publicly assisted venture capital, are more likely to be adopted in states “pressured by deindustrialization,” and these policies spread among states as a result of the movement of development professionals and the tendency for states to mimic successful programs in other states.

The type or organizational structure of the state-assisted venture capital program selected depends to a large extent on the availability and sources of funding and the goals articulated for the program. Public involvement can be viewed as a continuum along which the state makes trade-offs between control over investment decisions and a share in both the upside and downside of investment returns. At one extreme, publicly funded and managed programs provide the greatest public control over investment decisions, thus permitting the targeting of investments to achieve explicit economic development objectives. However, the state also bears total responsibility for funding the program as well as any financial losses or gains that occur under state management. At the other extreme, the state may create enabling legislation that provides tax credits to encourage private venture capital investments. Public control is limited in this model to the restrictions placed in the enabling legislation. The state does not, however, share in the financial gains or losses these investments may incur. The state also may take on a purely facilitative role by supporting networks of individual investors (angels) and venture capital fairs. Again, the state exercises no control over investment decisions and has limited financial responsibility and risk.

The success of state-sponsored venture capital programs (measured in terms of financial returns, economic development impacts, and sustained political support) has been quite mixed. In some states, public venture capital programs were criticized for one or more of the following reasons: inadequate public funding for capitalization and management, lack of needed expertise in fund management, perception of political interference in investment decisions, government regulations that impeded fund operations, and poor financial return on fund investments (Barkley, Markley, & Rubin, 1999). Concerns with previous state-sponsored venture capital programs and/or changes in the fiscal and/or political environments encouraged at least 13 states to investigate Certified Capital Company programs (CAPCOs) as an alternative for increasing the supply of venture capital and enhancing venture capital infrastructure and management capacity in the state. As of October 2000, legislation authorizing CAPCOs was passed in 5 states (Louisiana, Missouri, Florida, New York, and Wisconsin) and was considered in 8 other states (Iowa, Illinois, Arizona, Texas, Kansas, Vermont, Colorado, and North Carolina).

CAPCOs offer state tax credits to insurance companies to encourage private investments in private venture capital firms certified under the state enabling legislation. The certified private venture capital funds (CAPCOs), in turn, must invest in specific types of businesses according to a specified time schedule to ensure the availability of the tax credits. The purpose of this article is to review the characteristics and experiences of CAPCO programs in the five states that have passed enabling legislation. Information on CAPCO programs was obtained from state legislation (passed and proposed) and on-site and telephone interviews with state officials and CAPCO managers. The lessons learned from the experiences of the five operating state programs are summarized in terms of the advantages and disadvantages of CAPCOs versus state-sponsored venture capital programs.
programs that are publicly funded and managed or those that are publicly funded and privately managed. An appreciation of early CAPCO programs will enable other states to better assess the attractiveness of CAPCOs as an alternative to enhance the availability of venture capital and to stimulate state economic development. An understanding of existing CAPCO legislation also will assist interested states in fashioning legislation that best achieves their specific venture capital and economic development objectives.

**STRUCTURE OF CAPCOS**

The first CAPCO legislation was passed in Louisiana (1983), with more recent adoptions in Missouri (1997), New York (1997), Wisconsin (1997), and Florida (1998). In addition, CAPCO legislation was proposed, but not passed by July 2000, in eight other states (Arizona, Illinois, Iowa, Kansas, Michigan, Texas, Vermont, and Colorado). Enabling legislation for CAPCOs varies by state; key features of CAPCO legislation (passed and proposed) are summarized in Tables 1 and 2. The typical CAPCO model has the following characteristics with respect to sources of capital, certification process, qualified businesses, returns to state treasury, and reporting requirements:

**Source of Capital**

Tax credits (100% at a rate of 10% per year for 10 years) are allocated to insurance companies in return for investments (certified capital) in CAPCOs. The credits are available for taxes insurance companies pay on premiums collected on policies sold in the state (referred to as premium taxes). An insurance company’s premium tax payment is relatively stable over time; thus, insurance companies are willing to make current investments in exchange for tax credits over the next 10 years. Credits are usually transferable or saleable by the insurance companies. Most states place a cap on the total and annual amount of tax credits available and then determine a process for allocating credits among CAPCOs.

**Certification Process**

Specific certification requirements established by the state include minimum capitalization (typically $500,000), principals with a minimum of venture capital investing experience (e.g., 2 to 5 years), and establishment of an in-state office. To maintain certification (and retain the tax credits for the insurance company investors), CAPCOs must meet specific investment milestones and invest the equivalent of 100% of certified capital before any liquidating distributions can be made, that is, before any gains from the investments can be distributed to the partners. The CAPCOs are permitted, however, to make qualifying distributions that include management fees (usually a maximum of 2.5% of capital available for investment) and other expenses necessary to the operation of the fund.

**Qualified Businesses**

States define qualified businesses to meet their specific economic development objectives. Generally, the business must be small (at least by the SBA definition) and located and operated within the state, and most of the employees must be residents of the state. Qualified businesses are usually manufacturers or others engaged in commerce and the export of services. Certain sectors generally are specifically excluded from the list of qualified businesses (e.g., banking, real estate, professional services, insurance, and retail). CAPCO investments must be in qualified businesses to ensure the availability of tax credits for insurance company investors.
<table>
<thead>
<tr>
<th>State</th>
<th>Total Credit Allocated</th>
<th>Structure of Tax Credit</th>
<th>Who Is Eligible for Tax Credit</th>
<th>Qualified Businesses</th>
<th>State Share in Distribution</th>
<th>Timing of Investments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Florida-CS/HB1575</td>
<td>$150 million</td>
<td>100% premium tax credit; maximum 10% per year</td>
<td>Insurance companies</td>
<td>Fewer than 200 employees; 75% employment in state</td>
<td>10% of amount in excess of original certified capital</td>
<td>20% within 1 year; 30% within 2 years; 50% within 4 years; 50% early stage</td>
</tr>
<tr>
<td>(passed 1998-1999)</td>
<td></td>
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</tr>
<tr>
<td>Louisiana (Act 642,</td>
<td>Unlimited 1983-1997;</td>
<td>110% premium tax credit; maximum 11% per year; 35% income tax credit</td>
<td>Insurance companies; individuals; corporations;</td>
<td>Fewer than 500 employees; net worth less than $18 million; net income less than $6 million</td>
<td>None, 1983-1997; after 1998, 25% of excess over amount required to yield 15% IRR (including value of tax credits)</td>
<td>50% within 3 years with 40% in qualified businesses; 80% within 5 years with 50% in qualified businesses</td>
</tr>
<tr>
<td>passed 1983)</td>
<td>1998, $8 million annual cap on premium tax credits; 1999, $4 million annual cap on income tax credits</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Missouri (Certified</td>
<td>$50 million, 1997;</td>
<td>100% premium tax credit; maximum 10% per year</td>
<td>Insurance companies</td>
<td>Fewer than 200 employees; 80% employment in state; revenues less than $4 million</td>
<td>25% of excess over amount required to yield 15% IRR (including value of tax credits)</td>
<td>25% within 2 years; 40% within 3 years; 50% within 4 years</td>
</tr>
<tr>
<td>Capital Company</td>
<td>$50 million, 1998;</td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>law, passed 1997)</td>
<td>$40 million, 1999</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>New York (Chapter 397</td>
<td>$100 million (maximum</td>
<td>100% premium tax credit; maximum 10% per year</td>
<td>Insurance companies</td>
<td>Fewer than 200 employees; 80% employment in state; revenues less than $5 million</td>
<td>None</td>
<td>25% within 2 years; 40% within 3 years; 50% within 4 years; 50% early stage</td>
</tr>
<tr>
<td>of 1997 laws)</td>
<td>of $50 million in 1999)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wisconsin (SB333,</td>
<td>$50 million</td>
<td>100% premium tax credit; maximum 10% per year</td>
<td>Insurance companies</td>
<td>Fewer than 100 employees; 75% employment in state</td>
<td>None</td>
<td>30% within 3 years; 50% within 5 years</td>
</tr>
<tr>
<td>passed 1997)</td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

NOTE: CAPCO = Certified Capital Company; IRR = internal rate of return.
<table>
<thead>
<tr>
<th>State</th>
<th>Total Credit Allocated</th>
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<th>Who Is Eligible for Tax Credit</th>
<th>Qualified Businesses</th>
<th>State Share in Distribution</th>
<th>Timing of Investments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Arizona (SB1415, proposed 1998)</td>
<td>Not specified in the draft legislation</td>
<td>100% premium tax credit; maximum 10% per year</td>
<td>Insurance companies</td>
<td>SBA definition; headquarter in state&lt;sup&gt;a&lt;/sup&gt;</td>
<td>None</td>
<td>30% within 3 years; 50% within 5 years</td>
</tr>
<tr>
<td>Colorado (HB001296, proposed 2000)</td>
<td>$20 million per year</td>
<td>100% premium tax credit; maximum 10% per year</td>
<td>Insurance companies</td>
<td>SBA definition; headquarter in state&lt;sup&gt;a&lt;/sup&gt;</td>
<td>None</td>
<td>30% within 3 years; 50% within 5 years</td>
</tr>
<tr>
<td>Illinois (HB0144, proposed 1999)</td>
<td>$30 million per year</td>
<td>100% premium tax credit; maximum 10% per year</td>
<td>Insurance companies</td>
<td>SBA definition&lt;sup&gt;a&lt;/sup&gt;</td>
<td>None</td>
<td>30% within 3 years; 50% within 5 years</td>
</tr>
<tr>
<td>Iowa (HB513, proposed 1999)</td>
<td>$60 million per year</td>
<td>100% premium tax credit; maximum 10% per year</td>
<td>Insurance companies</td>
<td>Fewer than 100 employees; net income less than $2 million; 75% employment in state</td>
<td>None</td>
<td>25% within 2 years; 40% within 3 years; 50% within 4 years</td>
</tr>
<tr>
<td>Kansas (SB315, proposed 1999)</td>
<td>$50 million; maximum $10 million credit per CAPCO</td>
<td>100% premium, income, or privilege tax credit; maximum 10% per year</td>
<td>Persons or entity</td>
<td>50% employees in state; sales less than $1 million/year; age younger than 5 years</td>
<td>10% of amount in excess of original certified capital</td>
<td>25% within 3 years; 40% within 4 years; 50% within 5 years; 70% within 7 years</td>
</tr>
<tr>
<td>Michigan (HB4137, proposed 1999)</td>
<td>$100 million per year</td>
<td>125% tax credit; maximum 12.5% per year</td>
<td>Any “taxpayer”</td>
<td>SBA definition&lt;sup&gt;a&lt;/sup&gt;</td>
<td>None</td>
<td>25% within 3 years; 40% within 4 years; 50% within 5 years</td>
</tr>
<tr>
<td>Texas (SB899, proposed 1999)</td>
<td>$100 million per year</td>
<td>100% premium tax credit; maximum 10% per year</td>
<td>Insurance companies</td>
<td>Fewer than 100 employees; 80% in state</td>
<td>None</td>
<td>30% within 3 years; 50% within 5 years; 50% early stage</td>
</tr>
<tr>
<td>Vermont (HBH113, proposed 1999)</td>
<td>$25 million per year</td>
<td>100% premium tax credit; maximum 10% per year</td>
<td>Insurance companies</td>
<td>Gross revenues less than $3 million</td>
<td>None</td>
<td>25% within 2 years; 40% within 3 years; 50% within 4 years; 50% early stage</td>
</tr>
</tbody>
</table>

NOTE: CAPCO = Certified Capital Company; SBA = U.S. Small Business Administration.

<sup>a</sup> Refer to Note 5 for SBA definition of small business.
State Returns

In return for future tax revenues sacrificed (due to tax credits) the state may receive new tax revenues from the businesses that start, expand, and remain within the state as a result of the CAPCO program. Some states also crafted or amended their legislation to permit state participation in the returns to CAPCO investments. Through these legislative changes, states can share in the returns from investments in businesses along with the additional tax revenues that may be generated through the investments.

Reporting Requirements

CAPCOs are required to report to some regulatory authority on an annual basis. Information reported includes identity and amount of capital received from each investor; the amount of tax credits allocated to each investor; the identity, type, size, and location of qualified businesses in the portfolio; the amount of investment made in each business; jobs created by these companies (reported by the CAPCO but not independently verified by the regulatory authority); and audited financial statements.

SUMMARY OF STATE EXPERIENCES

CAPCO legislation has evolved over time as states attempt to better regulate the timing of the CAPCOs’ investments and target these investments toward specific types of businesses. The sections that follow summarize the experiences of Louisiana, Missouri, New York, Florida, and Wisconsin. Greatest attention is given to Louisiana and Missouri because these states have the most mature and active CAPCO programs.

Louisiana

The Louisiana CAPCO program was authorized by the 1983 legislature. The goals of the program included diversifying and stimulating the state economy, attracting and preserving jobs, developing a venture capital infrastructure, and attracting experienced venture capital management to the state. The program initially was structured with a 200% tax credit for insurance companies on the state insurance premium tax (taken over 10 years) and a 35% income tax credit for other investors (taken in the year of the investment). However, there was little activity under the CAPCO program until 1988 as a result of (a) a weak state economy and, consequently, a weak pool of potential investments and (b) regulatory restrictions within the insurance industry that made equity investments relatively unattractive. The program became attractive to insurance companies when the CAPCOs developed a bond-type instrument (fully insured, fully guaranteed, and rated a number 1 by the National Association of Insurance Commissioners) that provided a guaranteed rate of return. Attempts by the CAPCOs to attract insurance company investment using a more traditional venture capital limited partnership structure with an 80/20 split of returns were not successful.

The structure of this guaranteed bond-type instrument is included in the private placement memorandum that is negotiated between the CAPCO and each insurance company. However, the general structure involves the set-aside of 40% of the certified capital in zero-coupon bonds to guarantee that the principal invested by the insurance company is returned at the end of 10 to 12 years. The CAPCO also guarantees the stream of tax benefits over a 10-year period, either through a parent organization (e.g., a bank) or through a third-party guarantor. In most cases, the insurance company takes no equity position in the CAPCO and, as a result, does not share in any final liquidating distributions of the fund.

According to a Louisiana Department of Economic Development (1999) report, the use of a guaranteed bond-type instrument by CAPCOs to attract insurance company funding is an expensive and inefficient means of capitalizing the CAPCOs. For example, the Louisiana study estimated that each $27.5 million of tax credits raises $25 million in certified capital (where tax credits ... a guaranteed bond-type instrument by CAPCOs to attract insurance company funding is an expensive and inefficient means of capitalizing the CAPCOs.
equal 110% of certified capital raised) but results in only $14 million of capital available for investments in qualified Louisiana businesses. The remaining $11 million of the original $25 million raised is reserved for $10 million of collateral on the insurance companies’ loans to the CAPCOs and $1 million for financing and related costs.

The Louisiana program has been amended over time. The 200% tax credit for insurance company investors was reduced to 120% in 1989 and to 110% in 1998. The original legislation placed no limit on the total amount of credits on premium taxes or income taxes the state would provide. In 1998, the legislature placed an annual limit ($72,727,272) on investments in CAPCOs that would result in premium tax credits. No limit on the availability of income tax credits was enacted at this time. However, in 1999 the Office of Financial Institutions, the state regulatory authority, proposed an annual limit on income tax credits of $11,428,571. This proposal was in response to investments in CAPCOs at the end of 1998 that resulted in unexpectedly large income tax credit liabilities for the state.

As of March 2000, there were 32 CAPCOs certified in Louisiana. Of these 32, 11 were organized by Advantage Capital, 3 by BancOne, and the remaining 18 by other companies within the state. From 1988 to 1991, the CAPCO program raised an annual average of $4.5 million in certified capital. This annual average increased to $27.5 million over the 1992 to 1996 period. In 1997 to 1998, the capital raised jumped to $361.4 million as a result of almost $180 million raised via income tax credits. For the entire period of 1988 to 1998, CAPCOs raised more than $517 million in certified capital (committing the state to more than $570 million in tax credits) and invested more than $149 million in 122 qualified businesses. As of December 1999, the CAPCOs reported investments in 149 qualified businesses and claimed 4,841 jobs created or retained. This employment figure is reported by the CAPCOs to the regulatory authority but is not independently verified.

As the CAPCOs increased in size, they sought larger and later-stage investments. The average investment in portfolio companies over the 1988 to 1998 period was $1.2 million. In an effort to retarget investments toward smaller companies, the state may require that beginning in 2000, 10% of certified capital be invested in either (a) approved capital management funds focused on preseed, seed, or early-stage investments of less than $1 million or (b) CAPCOs whose primary focus is investments of less than $1 million in certified economically disadvantaged businesses or in businesses located in economically distressed areas.

To retain their certification, Louisiana CAPCOs must follow a schedule for investing certified capital. Within 3 years, at least 50% of the investment pool must be invested, with 30% in qualified businesses. Within 5 years, at least 80% must be invested, with 50% in qualified businesses. For funds certified before December 31, 1998, the CAPCO may voluntarily decertify once 60% of the investment pool has been invested in qualified businesses. For funds certified after this date, voluntary decertification can occur only when 100% of certified capital has been invested in qualified businesses. No distribution to equity owners—that is, CAPCO partners—can be made before these decertification thresholds are reached, with the exception of qualified distributions (e.g., management fees, debt payments to the insurance companies).

The 1983 legislation provided no return to the state from investments made by CAPCOs; however, in 1998, the legislature added a state profit sharing component to the CAPCO program. The state will receive 25% of the returns above the amount necessary to achieve a 15% internal rate of return (IRR) on a specific pool of certified capital (including value of tax credits). This change was implemented to help the state recoup part of the cost of the program and encourage the CAPCOs to expedite their investments in certified businesses.7

In summary, the Louisiana legislation was the result of efforts on the part of state economic development officials to stimulate the economy during a period of decline and to create venture capital resources within the state. According to state officials, Louisiana businesses have a source of venture capital they did not have prior to the CAPCO programs, and there has been a demonstration effect for other venture funds in the state. However, the lack of a cap on tax credits issued, particularly in terms of the income tax credit, created large, unexpected tax credit obligations on the part of the state. These obligations forced negotiations between the state and CAPCOs to postpone realization of tax credits over time.
Missouri

The Missouri CAPCO program was authorized in 1997 with the purpose of inducing private investment in new or expanding small businesses. The original legislation was sponsored by a member of the state legislature and championed by a coalition including a St. Louis regional economic development group and Advantage Capital, a partnership that operated CAPCOs in Louisiana. The Missouri Department of Economic Development supported both the CAPCO concept and modifications to the bill as it moved through the legislative process. Several factors made a tax credit program attractive to policy makers in Missouri. First, Missouri is constitutionally prohibited from making any direct investments in businesses, so economic development strategies in the state generally rely on tax credits. Second, Missouri has a limit on state tax revenues, and revenues collected in excess of this cap are returned to taxpayers. As a result, tax credit programs have been attractive, particularly during the recent economic expansion. Third, the Missouri State Retirement Fund’s past experience with venture investing was not positive, suffering from poor management and political pressures.

The Missouri program provides a 100% tax credit, taken over 10 years, to insurance companies who invest in CAPCOs. The legislation allocated $50 million in tax credits in 1997 and $50 million in 1998. The state viewed this initial $100 million as a demonstration program to see how well the CAPCO program performed. An additional $40 million allocation of tax credits was made in 1999, with the money targeted to distressed communities in the state. Businesses in these distressed communities could have up to $5 million in revenue as compared to the $4 million limit for businesses in other parts of the state. In 2000, legislation providing additional tax credits for CAPCOs was passed in the Missouri House and Senate but vetoed by the governor.

When CAPCO legislation was passed, the state placed an initial cap of $25 million on total capital that any CAPCO could raise. This limit was designed to encourage the creation of CAPCOs in the state other than established CAPCOs such as Advantage Capital and BancOne. These two existing CAPCOs had a competitive advantage in raising funds from insurance companies relative to newer CAPCOs because of their established relationships with insurance companies and existing investment instruments.

Similar to the revised Louisiana legislation, Missouri legislation allows the state to capture some of the return on investments made in portfolio companies by the CAPCOs. The Missouri Development Finance Board will receive 25% of any distribution in excess of the investment return that, in combination with the value of the tax credits, yields a 15% IRR. Given the short operating history of the program, it is unclear what the magnitude of the return to the state will be.

The Missouri legislation provides a more restrictive definition of qualified businesses than does Louisiana. CAPCO investments must be made in Missouri businesses with fewer than 200 employees, 80% of whom must be employed in Missouri. Annual revenues for qualified businesses cannot exceed $4 million, or $3 million if the firm is less than 3 years old. The business also must demonstrate a need for venture capital and show an inability to obtain conventional financing (i.e., unable to qualify or turned down for a bank loan).

Since 1997, four CAPCOs have been active in Missouri, one established by Advantage Capital, one by BancOne (Gateway Ventures), and two established by other Missouri firms (Stifel CAPCO and CFB Emerging Fund). In 1997, CAPCOs certified $50 million in capital (committing the state to $50 million in future tax credits) and made investments of more than $27 million in 12 firms. Average investment per firm was $2.2 million. In 1998, another $50 million in capital was certified and $5 million invested, all but $504,000 as follow-on investments in existing portfolio companies. The CAPCOs reported total jobs created by these investments as 726.

In summary, state officials believe the program has improved the infrastructure and environment for venture capital in the state. The program provides a demonstration effect for other venture funds and has functioned to attract additional venture capital to the state through coinvestment on CAPCO deals. One state official described the program as “priming the pump.” On the other hand, although Missouri’s CAPCO legislation is relatively restrictive in defining qualified investments, the legislation has resulted in relatively little seed capital investment within the state. According to
CAPCO representatives, more restrictive legislation may encourage the CAPCOs to do fewer seed deals. That is, fewer restrictions on investments would encourage more seed investment because the CAPCOs can offset the higher risk seed deals with investments in larger, less risky ventures. The experience in Louisiana, however, suggests that when CAPCOs have no size restrictions, they will focus on relatively large companies and large deals.\textsuperscript{8}

**New York**

The New York CAPCO legislation was signed into law in 1997 with the stated objective of encouraging the investment of private financial resources in state venture capital markets as a means to fostering the creation and expansion of new small business enterprises. The legislation created a 100\% tax credit for insurance companies, taken at a rate of 10\% over 10 years. A total of $100 million was allocated to the program by the 1997 legislation, with $50 million in tax credits available in 1999 and the remaining $50 million in 2000. An additional $30 million in funding for the program was authorized in 1999, with all $30 million available for tax credits in 2001.

The $30 million appropriation that New York authorized for CAPCOs in 1999 was significantly less than the $150 million proposed initially. In addition to the $30 million, however, the New York legislature also authorized the state controller to invest up to $250 million of state pension funds in New York venture capital firms. The venture capital funds must match the state's investment and place the capital in New York firms that meet the CAPCO definition of qualified businesses. Legislation also was proposed but not passed, enabling banks to receive a 100\% tax credit for investing in certified capital companies.

Initially, six CAPCOs qualified for certification in the state. However, one of these CAPCOs opted to manage BancOne’s New York CAPCO, reducing the number of CAPCOs to five. The remaining four CAPCOs are Advantage Capital New York Partners, New York Small Business Venture Fund, Wilshire Advisers, and Exponential Business Development Company. The initial $100 million allocation was distributed as follows: approximately $31 million each to Advantage Capital and the New York Small Business Venture Fund, approximately $28 million to BancOne Capital Corporation, and approximately $3 million each to Wilshire Advisers and Exponential Business Development Company.

The New York legislation differs from the standard CAPCO model in that early-stage businesses are targeted. CAPCOs must invest 25\% of certified capital within 2 years, 40\% within 3 years, and 50\% within 4 years, of which at least 50\% must be in early-stage businesses as defined by the legislation. The remaining capital can be invested in any qualified business, defined as firms with fewer than 200 employees and less than $5 million in gross revenues.

**Florida**

The Florida CAPCO program was authorized in 1998 with the goal of stimulating investments in new and expanding businesses in Florida. The legislation allocated $150 million in tax credits at 10\% a year over a 10-year period. The program provides a 100\% premium tax credit for insurance companies doing business in Florida. Unlike CAPCO programs in other states, the Florida program is administered by three agencies. The Department of Banking and Finance (DBF) certifies and decertifies the CAPCOs; the Governor’s Office of Tourism, Trade, and Economic Development (OTTED) allocates the premium tax credits and reports on the program; and the Department of Revenue oversees tax filings, audits, and credit forfeiture.

The implementation of the Florida CAPCO program is illustrative of a potential shortcoming of CAPCO legislation in general. On December 31, 1998, the DBF certified 15 CAPCOs. On January 26, 1999, OTTED notified the 15 CAPCOs that they had until March 15, 1999, to obtain binding investment commitments from insurance companies. Unlike the other state programs, each CAPCO had to receive commitments of at least $15 million. Similar to New York, each CAPCO could not submit commitments of more than the $150 million appropriation. Only 3 of the 15 certified CAPCOs were able to raise $15 million in commitments, and these 3 CAPCOs requested...
$274 million in tax credits. The credits were allocated among the 3 CAPCOs on a pro rata basis with Advantage Capital receiving almost $82 million, BancOne receiving approximately $31 million, and Wilshire Partners receiving about $37 million. It is important to note that all of these CAPCOs were operating in other states at the time of their certification in Florida. This experience supports the idea that existing CAPCOs have a competitive advantage in fund-raising over newer CAPCOs because of (a) their expertise in designing an investment instrument that is acceptable to insurance companies and (b) the contacts that existing CAPCOs have developed within the insurance industry through their activities in other states.

In Florida, the certification requirements for CAPCO managers are more stringent than in most other states. Managers must have at least 5 years of venture investing experience in a private venture fund, including investing in early-stage businesses. This experience is important because Florida requires, as does New York, that 50% of certified capital be invested within 5 years with at least 50% of these investments in early-stage technology businesses.

Florida also places more restrictions on its definition of a qualified business than do most other states. Qualified businesses must have fewer than 200 employees, and businesses must agree to keep their headquarters and any manufacturing facility financed with CAPCO investments in Florida for 10 years. In addition, there should be a reasonable expectation that the business will grow to have $25 million in revenues within 5 years of the investment.

The Florida legislation provides for state participation in returns to CAPCO investments. No liquidating distributions can be made until 100% of certified capital is invested in qualified businesses, and if distributions to the investors exceed the original amount of certified capital, the CAPCOs must pay 10% of the excess to the state.

As is the case in other states, the legislation passed in Florida was significantly different from that first proposed. Promoters of the initial CAPCO legislation sought tax credits of $500 million with no annual tax credit limit. The amount authorized was $150 million, with an annual limit imposed. The original legislation also contained no provision for the state to share in the gains from CAPCO investments, and CAPCO principals were required to have only 2 years of experience, with no reference to early-stage investing experience. Finally, small businesses were defined more broadly, according to the SBA definition, and there were no additional requirements in terms of workforce size, remaining in Florida, or types of industries that qualified for investment.

Wisconsin

Wisconsin passed CAPCO legislation with an allocation of $50 million in tax credits in 1997; however, the rules implementing the legislation were not established until 1999. Seven CAPCOs were certified by the state (Advantage Capital Wisconsin Partners, BancOne Stonehenge Capital Fund Wisconsin, CFB Wisconsin CAPCO Division, Stifel Wisconsin CAPCO I, Venture Investors CAPCO I, Wilshire Investors, and Wisconsin Development Capital), but only one of these CAPCOs (Venture Investors) was headquartered in Wisconsin prior to passage of the CAPCO legislation. Of the seven CAPCOs, only three submitted applications for tax credits based on certified capital raised from the insurance industry (Advantage Capital, BancOne Stonehenge, and Wilshire Investors). Each of these CAPCOs received an allocation of $16,666,666.65 on October 21, 1999.

The provisions of the Wisconsin CAPCO legislation are similar to the standard CAPCO model with two exceptions. First, qualified businesses are restricted to those with fewer than 100 employees and less than $2 million net income. Second, voluntary decertification of a CAPCO is permitted when the CAPCO has invested an amount equal to 100% of certified capital or when at least 10 years have passed since the last certified capital investment was made in the CAPCO. The state’s regulatory authority over the CAPCO ends with voluntary decertification. Because the state requires that only 50% of certified capital be invested within 5 years, it would be possible for a CAPCO to voluntarily decertify after 10 years, having invested only the equivalent of 50% of certified capital. At this point, distributions of profit could be made to the partners, without meeting the 100% investment requirement. This language provides a loophole in the legislation that may be abused by the CAPCOs.
Program Evolution

CAPCO legislation has evolved over time and across states as state legislatures attempted to address concerns in earlier legislation and better direct the program to the needs of individual states. Changes in CAPCO legislation include a reduction in tax credits for certified capital from 200% to 120% to 100%, limitations on the amount of tax credits available to insurance companies, limitations on the size of individual CAPCOs, greater targeting of the CAPCO investments through more restrictive definitions of qualified businesses, procedures for the state to recoup a portion of CAPCO program costs through state profit sharing with the CAPCOs, the availability of tax credits for investors in CAPCOs other than insurance companies, and attempts to use CAPCO legislation to facilitate the funding of specialized venture capital programs such as Kansas’s innovation and commercialization corporations. It should be noted, however, that most changes in CAPCO programs over time are little more than fine-tuning a generic model. The CAPCO industry (i.e., established CAPCOs) is aggressively involved in state legislation to ensure that the basic program design is preserved.

LESSONS LEARNED

The experiences of CAPCOs in the five states with enabling legislation provide insights into the strengths and limitations of CAPCO programs as compared to two alternative state-assisted venture capital programs (publicly funded–publicly managed funds and publicly funded–privately managed funds). These strengths and limitations are summarized below, along with suggestions for ways that public policy might mitigate program shortcomings. Policy makers can use this information to assess the attractiveness of a CAPCO program versus other available alternatives and, if the CAPCO model is considered appropriate, develop CAPCO legislation that best meets the needs of their state.

CAPCO Strengths

1. State-assisted venture capital programs capitalized via tax credits, such as CAPCOs, do not require current state budget expenditures or bond sales (as do public venture capital funds and publicly funded private venture capital funds). Moreover, the actual cost (present value) of tax credit programs to the state, including the CAPCO program, is reduced by the allocation of tax credits over time. For example, tax credits generally are taken in Years 2 to 11 of the CAPCO program; thus, the present value of $100 million in tax credits (assuming a 7% discount rate) is $65,640,960. Funding CAPCOs with tax credits and spreading tax credits over 10 years make CAPCOs an attractive alternative when compared to programs that commit the state to additional current expenditures or debt.

2. According to interviews with managers of public venture funds, state funding for these programs is often insufficient to achieve an optimum program size relative to the desired number of investments in portfolio companies and availability of capital for follow-on investments (Barkley et al., 1999). The 100% tax credits provided in a CAPCO program are a way of raising significant funds ($50 million plus) from insurance companies to capitalize venture capital funds. Through the use of 100% tax credits, in conjunction with an investment instrument providing a guaranteed rate of return, CAPCOs were able to attract funding from insurance companies in a relatively short period of time. These resources, in turn, have contributed to an expansion of venture capital infrastructure, management capacity, and investments in those states with CAPCO legislation.

3. One weakness of publicly funded and managed venture capital programs is the potential for political interference in investment decisions. Similarly, for publicly funded and privately managed venture capital programs, there is the potential for political interference in the selection of the private funds in which the public monies will be placed. With CAPCO programs, political pressure to place state monies in specific private venture capital firms is
eliminated because the state’s role is limited to certifying the capital companies. The participating insurance companies individually select in which of the CAPCOs to place their funds. In addition, political pressure for CAPCOs to make investments in specific businesses also is diminished because the CAPCOs receive no direct state funding.

4. Private venture capital funds are reluctant to coinvest with state-supported funds (both public funds and publicly funded, privately managed funds) because of the perception of potential political interference in fund selection and management. However, private venture funds may be willing to coinvest with the privately managed CAPCOs, thus increasing the funds’ ability to participate in syndicated deals and leverage their certified capital.

5. Publicly managed funds in some states are limited by state pay regulations in the amount they can compensate the managers of the public fund. Experienced venture capitalists command significant compensation in the private sector, and such individuals may not be easily attracted to a public fund. CAPCOs do not have restrictions on compensation packages for fund managers; thus, CAPCOs may be able to more easily attract experienced fund managers because of higher salary, profit sharing, and benefit offerings.

6. Some states (e.g., Maine and Iowa) are constitutionally restricted from making direct equity investments in private businesses. In these situations, tax credit programs like CAPCOs may provide the only opportunity for state support for venture capital programs.

**Shortcomings/Limitations**

1. CAPCOs may be a costly way of increasing equity capital in a state. All state-sponsored venture capital programs result in new costs (state appropriations, debt payments, or tax revenues forgone) and new revenues (returns from investments, new tax revenues) for the state’s treasury. The net cost of CAPCOs to the state treasury (costs minus revenues) relative to that of similar-sized alternative programs (publicly funded and managed or publicly funded and privately managed) depends on the performance of the fund. For CAPCOs, the cost to the state is the present value of future tax revenues lost due to tax credits over the 10-year period. For public investments in public or private venture capital funds, the cost to the state is typically the current lump sum value of state funds invested. If returns from program investments were poor, the state treasury would lose less with a program financed with 10 years of tax credits than with a program funded with one lump sum payment.

   However, in situations where CAPCOs and alternative publicly assisted programs recoup much of their original investment or realize a profit, CAPCOs will have a higher net cost to the state than a comparable state investment in a publicly or privately managed fund. Publicly or privately managed funds will be less costly than CAPCOs because the cost to the state of its investment in these funds will be offset to the extent that proceeds from the funds are distributed to the state as the principal or limited partner in the funds. Alternatively, proceeds from CAPCO investments generally are distributed to the insurance companies providing capital to the CAPCOs and to CAPCO management. Thus, the state does not receive a share of returns from CAPCO investments to help defray program costs.

   The potential cost disadvantages of a CAPCO program may be reduced with requirements in the enabling legislation that stipulate a return of a share of CAPCO’s liquidating distributions to the state treasury (e.g., the Louisiana and Missouri model). However, even the Missouri and Louisiana legislation does not eliminate the cost disadvantage of the CAPCO alternative. For venture capital programs that provide fair or good returns on their investments, the net cost to the state is less with state investments in publicly or privately managed funds than with tax credits and profit sharing with CAPCOs.

2. With CAPCOs, as opposed to public funds or publicly supported private funds, the state has less control over the quality of the fund managers. Moreover, the CAPCO structure does not include a strong incentive for the CAPCOs to hire the best fund managers. Most insurance companies invest in CAPCOs in exchange for a guaranteed fixed debt instrument; thus, the
incentive to select CAPCOs that have the most qualified venture capital investors is diminished. Insurance companies do not benefit from any upside in the CAPCO’s performance or risk losing money should the CAPCO investments fail to perform. As a result, insurance companies make investments in CAPCOs based on familiarity and the CAPCO’s ability to design a debt instrument that the insurance companies find attractive.

States concerned with the quality and experience of CAPCO management should institute a system that ensures adequate due diligence in certifying CAPCO managers. One alternative would be to use a review team of professional venture capitalists to assess the qualifications of CAPCO applicants. States also may include more specific and restrictive language in the enabling legislation regarding required managerial experience. For example, Florida legislation requires that managers have at least 5 years of venture investing experience, including investing in early-stage businesses. And proposed Kansas legislation requires that CAPCO managers meet the standards established by SBA for small business investment company programs.

3. CAPCOs make limited seed and start-up investments. CAPCOs try to maximize profitability within the parameters allotted by individual state requirements. As such, they tend to invest at the upper end of the size limit permitted by state law because such investments generally have lower risk and cost than seed and start-up investments. States have attempted to address the limited seed and start-up investment problem with more restrictive legislation regarding qualified businesses, limitations on the size of individual CAPCOs, or with separate (non-CAPCO) venture programs focusing on technology commercialization and seed investments.

Additional Observations

In addition to the strengths and limitations of CAPCO programs, three attributes of CAPCO programs were observed that may influence the attractiveness of the program to a state. First, CAPCOs and insurance companies devote considerable resources to lobbying for additional appropriations in states with existing CAPCO programs and for new CAPCO legislation in states where CAPCOs do not already exist. In all the states that currently have CAPCO legislation, except Louisiana, the legislation was introduced through the efforts and financial investment of the existing CAPCO industry. In general, CAPCOs identified champions in the state legislature to promote the concept and hired lobbyists to push for the legislation’s passage. The advantage existing CAPCOs have in obtaining new capital commitments and the program’s profitability also encourage CAPCOs to devote resources to lobbying for additional rounds of appropriations. The lobbying efforts by CAPCOs and their supporters may result in an information base that is somewhat biased. States may ensure that more balanced information is available by making time and resources available for an independent review of the state venture capital market and the proposed CAPCO legislation.

Second, the CAPCO industry will resist (lobby against) efforts by states to be too innovative in developing CAPCO legislation in terms of sources of certified capital other than insurance companies or tax credits less than 100%. The reliance on insurance companies as the sole source of certified capital gives existing CAPCOs (i.e., CAPCOs established in other states) a significant advantage over new CAPCOs in obtaining commitments of capital. There are several reasons why this may occur. Existing CAPCOs have an established relationship with insurance companies and a ready-made debt investment instrument that is attractive to the insurance industry and difficult and costly to imitate. Moreover, state legislation does not always provide sufficient time for new CAPCOs to develop a competitive debt investment instrument and market it to insurance companies. Finally, even those in-state funds that are able to obtain some capital commitments may not be able to meet the minimum capitalization stipulated in the state legislation.

Evidence of the dominance of established CAPCOs in raising funds from insurance companies is provided in Table 3. Advantage Capital and BancOne (both established Louisiana CAPCOs)
have acquired a large share of the certified capital in the four states adopting legislation after Louisi-
iana, and Wilshire (a New York CAPCO) has acquired significant certified capital in the two states
(Florida and Wisconsin) that implemented the program after New York. And among the 15
CAPCOs receiving certification in Florida, only 3 CAPCOs (Advantage Capital, BancOne, and
Wilshire) were able to meet the $15 million minimum stipulated in the Florida legislation.

States may benefit from a larger number of CAPCOs and CAPCOs with greater in-state investing
experience. Venture capital firms tend to specialize according to industry type and stage of
investment (e.g., seed, start-up, and expansion). Thus, an increase in CAPCO numbers may pro-
vide venture capital access to a greater variety of state businesses. The smaller CAPCOs also may
be more willing to consider seed and start-up investments, an area of concern in many states.

States may encourage new, in-state CAPCOs by expanding qualified CAPCO investors to
include corporations and individuals, that is, reduce the importance attached to connections to
the insurance industry. State legislation may increase CAPCO numbers by providing a longer time for
fund-raising, placing a low minimum on certified capital raised, creating a cap on total certified
capital raised per CAPCO, and allocating the tax credits equally among CAPCOs (e.g., Louisiana)
rather than on a pro rata basis based on insurance company commitments per CAPCO (e.g.,
Florida). In addition, states could provide prospective CAPCOs with examples of investment
instruments needed to attract insurance funds. This tutoring of in-state CAPCOs would reduce the
time and expense associated with fund-raising and increase the probability of successfully compet-
ing with out-of-state CAPCOs for funding.

Third, CAPCOs can offer more favorable terms to portfolio companies than do other private
venture capital firms in the state because of their cost advantage in raising capital. This advantage
may lead to the crowding out of other in-state venture capital providers and may ultimately dis-
courage new venture capital formation in the state. A competitive advantage over indigenous ven-
ture capital providers may not be a concern in states with little or no formal venture capital
infrastructure; however, the potential impact of CAPCOs on the state venture capital industry
should be considered in states with numerous private venture capital funds.10

### TABLE 3

**State Allocations of Tax Credits, by CAPCO**

<table>
<thead>
<tr>
<th>State</th>
<th>CAPCO</th>
<th>Total Certified Capital ($)</th>
<th>Percentage of State Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Missouri (total 1997-1999 allocations)</td>
<td>Advantage Partners</td>
<td>50,685,000</td>
<td>36.2</td>
</tr>
<tr>
<td></td>
<td>BancOne/Gateway Ventures</td>
<td>47,395,000</td>
<td>33.8</td>
</tr>
<tr>
<td></td>
<td>Stifel CAPCO</td>
<td>26,941,000</td>
<td>19.2</td>
</tr>
<tr>
<td></td>
<td>CFB Emerging Fund</td>
<td>12,525,000</td>
<td>8.9</td>
</tr>
<tr>
<td></td>
<td>CAPCO Holdings</td>
<td>2,454,000</td>
<td>1.8</td>
</tr>
<tr>
<td>New York (1999-2000 allocations)</td>
<td>Advantage Capital</td>
<td>30,913,844</td>
<td>32.4</td>
</tr>
<tr>
<td></td>
<td>NY Small Business Venture Fund</td>
<td>30,913,844</td>
<td>32.4</td>
</tr>
<tr>
<td></td>
<td>BancOne Capital Corporation</td>
<td>28,282,264</td>
<td>29.6</td>
</tr>
<tr>
<td></td>
<td>Wilshire Advisers</td>
<td>2,673,797</td>
<td>2.8</td>
</tr>
<tr>
<td></td>
<td>Exponential Business Develop</td>
<td>2,673,797</td>
<td>2.8</td>
</tr>
<tr>
<td>Florida (1999 allocations)</td>
<td>Advantage Capital Florida Partners, LP</td>
<td>81,862,834</td>
<td>54.6</td>
</tr>
<tr>
<td></td>
<td>BancOne Capital Finance, LLC</td>
<td>30,753,138</td>
<td>20.5</td>
</tr>
<tr>
<td></td>
<td>Wilshire Partners, LLC</td>
<td>37,384,028</td>
<td>24.9</td>
</tr>
<tr>
<td>Wisconsin</td>
<td>Advantage Capital Wisconsin Partners I, LP</td>
<td>16,666,666</td>
<td>33.3</td>
</tr>
<tr>
<td></td>
<td>Wilshire Investors, LLC</td>
<td>16,666,666</td>
<td>33.3</td>
</tr>
<tr>
<td></td>
<td>BancOne Stonehenge Capital Fund WI, LLC</td>
<td>16,666,666</td>
<td>33.3</td>
</tr>
<tr>
<td>Louisiana (1999 allocations)</td>
<td>Stonehenge Capital (BancOne)</td>
<td>21,300,000</td>
<td>35.1</td>
</tr>
<tr>
<td></td>
<td>Advantage Capital</td>
<td>21,000,000</td>
<td>34.6</td>
</tr>
<tr>
<td></td>
<td>Wilshire Advisers</td>
<td>16,400,000</td>
<td>27.0</td>
</tr>
<tr>
<td></td>
<td>Source Capital</td>
<td>2,000,000</td>
<td>3.3</td>
</tr>
</tbody>
</table>

**NOTE:** CAPCO = Certified Capital Company.
SUMMARY

Interest in establishing state-assisted venture capital programs is unlikely to diminish. As state policy makers consider how best to organize these programs, they must consider the relative strengths and limitations of alternative models. Publicly funded and managed programs and publicly funded, privately managed programs offer states more control over investment decisions; however, these programs also suffer from potential political interference that can jeopardize the effectiveness of the program. The creation of CAPCOs provides a means for the state to attract private sector resources into privately managed venture funds, in this case by using state tax credits to encourage insurance company investments in CAPCOs.

Although CAPCO programs may insulate the capitalization and investment decisions from political pressure, the programs have important disadvantages for policy makers to consider. The principal disadvantage of CAPCOs relative to alternative state-assisted programs is the cost to the state treasury resulting from (a) losses of future tax revenues and (b) little or no return to the state from CAPCO profits. A study prepared by the Louisiana Department of Economic Development (1999) concluded that “the CAPCO program, in its current form, is expensive and inefficient to the state” (p. 64). The study’s principal concern is that CAPCOs typically have a significant amount of overhead, in terms of capital used to provide collateral on insurance company loans, rather than having that capital available for investments in qualified businesses.

The potential high cost of CAPCOs compared to alternative state-assisted venture capital programs should encourage in-depth analysis of the state’s venture capital market and great care in drafting legislation before a CAPCO program is introduced to the state legislature. Recommended analysis includes a cost-benefit study of CAPCOs versus publicly funded–publicly managed funds and publicly funded–privately managed funds. This cost-benefit study should include estimates of jobs generated and costs per job associated with the program alternatives.  

If the above cost-benefit analysis indicates that CAPCOs are cost effective, then further research should be undertaken to assess the availability of investment opportunities (deal flow) to determine the appropriate amount of tax credits to be provided in the legislation. Excess tax credits (relative to good venture capital deals) will encourage questionable investments, whereas too few credits will preclude worthy companies from obtaining financing. Next, CAPCO legislation should be carefully written to focus investments on desired recipients or goals. CAPCOs are profit-maximizing entities, and they will seek investments that provide the highest expected rate of return. Thus, if the state wishes to target venture capital at a specific group of businesses, this group must be identified explicitly in the enabling legislation. Third, the state should investigate means of significantly sharing in the upside gains of CAPCOs to reduce the costs to the state treasury. Finally, CAPCOs do not appear to be a panacea for all venture capital needs of state businesses. Entrepreneurs and businesses needing seed or start-up capital are not well served by CAPCOs; thus, legislation and programs addressing the needs of early stage businesses should be considered in conjunction with CAPCO legislation.

NOTES

1. On-site or telephone interviews were conducted with the following individuals: Dennis Manshack and Mike Williams, Louisiana Economic Development Corporation; Darin Domingue, Louisiana Office of Financial Institutions; Thomas J. Adamek and Michael Kirby, BancOne Stonehenge Capital, Baton Rouge, Louisiana; Bill Bergmeyer and Stacey Hurst, Missouri Department of Economic Development; Chip Cooper, Missouri Innovation Center; Scott A. Zajac, Advantage Capital Partners, St. Louis, Missouri; Monique Cheek, Florida Governor’s Office; Mike Ramsden, Florida Department of Banking and Finance; Colleen Holton, Wisconsin Department of Commerce; Anna Lemecha, State of New York Insurance Department; Tim Roche, New York State Senate Information Office; George Lipper, Iowa Department of Economic Development; Charles Ranson and Mikel Miller, Kansas, Inc.; and Kevin Carr and Michael J. Wojcicki, Kansas Technology Enterprise Corporation, Topeka, Kansas. This research effort was part of a larger project funded by the U.S. Department of Agriculture’s Fund for Rural America and the Rural Policy Research Institute.

2. The regulated nature of the insurance industry usually precludes insurance companies from investing in Certified Capital Companies (CAPCOs) as limited partners, a model common to more traditional venture capital funds. As a result, the CAPCOs have created an investment instrument that is attractive to insurance companies because it is classified as a
number 1 rated investment by the National Association of Insurance Commissioners. The insurance company receives a guaranteed rate of return on its investment in the CAPCO rather than a share of future profits. In this way, the insurance company is basically investing in a guaranteed security rather than in a relatively risky equity investment. More detail regarding the structure of the investment instrument is provided in the discussion of the Louisiana program.

3. In most states, the amount of certified capital raised from insurance companies (and the resulting tax credits requested) exceeds the amount of tax credits approved by the state. In these situations, states have allocated tax credits among eligible CAPCOs in one of three ways: first come, first served; a pro rata distribution based on share of total tax credits requested; and an equal split of tax credits among all eligible CAPCOs. The first come, first served and pro rata methods are advantageous to existing CAPCOs (CAPCOs currently operating in other states) because these CAPCOs have well-developed investment instruments and contacts within the insurance industry.

4. State legislation also provides a means for CAPCOs to decertify, either voluntarily or as a result of noncompliance with the rules governing CAPCOs. In most cases, voluntary decertification occurs either when a CAPCO fails to meet requirements for raising certified capital or when a CAPCO has met the investment requirements under the legislation. Based on the experience in Louisiana, decertification for noncompliance and decertification because of fund-raising constraints occur rarely. With the exception of Louisiana, however, CAPCOs can voluntarily decertify once an amount equivalent to 100% of certified capital is invested. After decertification, the CAPCO is no longer required to invest capital in qualified businesses as defined by the state.

5. The Small Business Administration (SBA) definition of small businesses varies by major industry group (e.g., manufacturing, services, retail), and exceptions exist for industries within these major groups. However, in general, the SBA definition for small business is fewer than 500 employees for manufacturing and less than $5.0 million in annual sales for retail trade and services. SBA regulations are available at http://www.sba.gov/regulations/121/210.htm.

6. The Massachusetts Capital Resource Company (MCRC), started in 1978, has similarities with CAPCOs, and its existence may have influenced the design of the Louisiana CAPCO program in 1983. According to Markley and McKee (1992), MCRC was created as a result of a deal struck between the governor of Massachusetts and the state’s life insurance industry. The insurance companies agreed to create and manage a $100 million venture capital fund in exchange for repeal of a 1% tax on gross income.

7. The state profit sharing program selected by Louisiana (25% of returns above the amount necessary to achieve a 15% internal rate of return [IRR]) will not likely result in sufficient returns to the state to cover the cost of future tax credits. In a hypothetical analysis of a CAPCO program (Barkley, Markley, & Rubin, 1999, pp. 53-56), it was estimated that the Louisiana profit sharing program will provide returns (present value) to the state treasury exceeding costs of tax credits (present value) only if CAPCOs realized an IRR on their investments exceeding 22%. An IRR above 20% may not be easily attained by CAPCOs if a significant portion (e.g., 40%) of the CAPCOs’ certified capital is held in zero-coupon bonds as collateral on insurance company loans to CAPCOs.

8. The lack of seed capital investment in Missouri led to the creation of the Missouri Seed Capital Coalition and the passage of legislation (SB518) in 1999 designed to encourage private venture capital management to give greater attention to the issue of commercializing university research and other early-stage ventures.

9. The state of Kansas developed CAPCO legislation (HB2688) that differed significantly from CAPCO legislation in other states. The Kansas legislation included (a) tax credits for certified capital provided by individuals, (b) 365 days to raise certified capital, (c) a requirement that 70% of certified capital be invested within 7 years, and (d) a restriction on CAPCO investments to businesses with annual sales less than $1 million. Pressure was brought on Kansas legislators (through the Growth Capital Alliance, a CAPCO lobbying organization) to change their legislation to permit only insurance company investors, increase the size of qualified businesses, reduce CAPCO fund-raising time to 30 to 60 days, and require a less restrictive investment schedule. The Growth Capital Alliance agreed to cease lobbying against the Kansas legislation only if drafters of the legislation agreed not to use the name CAPCO. In the Kansas legislation, Capital Formation Companies was selected as the compromise name for the new venture capital firms.

10. Public venture capital firms and publicly assisted private venture capital firms also may have a cost advantage relative to private venture capital firms. However, the potential for crowding out private venture capital firms is generally greater with CAPCO programs than with other publicly assisted programs because of the relatively large size of CAPCO programs ($50 million or larger).

11. The most thorough study of a CAPCO program to date is the CAPCO Study prepared in 1999 for the Louisiana Department of Economic Development by Postlethwaite and Netterville (1999), a professional accounting corporation located in Baton Rouge, Louisiana. A copy of the study is available on the department Web site (http://www.lded.state.la.usa). The Postlethwaite and Netterville study compared the present value of tax credits to the present value of new state tax revenues resulting from the Louisiana CAPCO program (under alternative scenarios regarding the future growth rate of the funded businesses and the percentage of the businesses’ financing attributable to CAPCO investments). The Louisiana study found that program costs exceeded new tax revenues for most of the growth rate business financing scenarios estimated.

REFERENCES


Changing Work Organization in Small Manufacturers: Challenges for Economic Development

Nik Theodore
Rachel Weber
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This review article examines the growing literature on the changing employment practices of small and medium-sized manufacturers. Specifically, the authors examine the literature in three areas: (a) hiring practices, (b) employment security and retention, and (c) career ladders. Observers disagree about the extent to which restructuring has taken place in smaller firms, the nature of workplace change, and the impact of this change on employees and firms. The policy arena is just as contentious; a host of different strategies have been proposed to provide employment opportunities in manufacturing, particularly for low-income populations. By synthesizing the research to date and evaluating the key debates in this area, this literature review will assist economic development researchers and practitioners in making the leap to workforce issues.

The economic expansion of the 1990s created conditions in labor markets that would have seemed inconceivable even a few years earlier. Job growth and accompanying declines in unemployment finally reached some of the most disadvantaged job seekers who entered employment in record numbers. At the same time, the booming economy sent mixed signals. Processes of workplace restructuring transformed labor markets and eliminated pathways for worker advancement, particularly in manufacturing.

Increased competition placed pressure on small and medium-sized manufacturers to lower costs and rein in new investments. Traditional methods of hiring, managing, and promoting workers inside many enterprises broke down and were replaced by workforce systems that relied heavily on low-wage, temporary, and subcontracted labor. At the same time, the shortage of skilled production workers reinforced the “low-road” hiring practices of many companies, encouraging employers to poach employees from their competitors rather than train their own. To keep their labor needs flexible and costs low, many small companies now offer only low-wage, low-skilled employment.

Because these labor practices reduce the potential gains from job creation, they pose a growing challenge to economic development practitioners. Economic development practitioners are also beginning to recognize that labor market conditions play an integral role in their ability to attract, retain, and nurture businesses. If the workforce needs of businesses cannot be met by the supply of local job seekers and if the needs of job seekers cannot be met by the provision of decent jobs, then even the most well crafted economic development policies will founder.

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Understanding and meeting the workforce needs of local businesses and residents require different information, skills, and policy tools from those used in decision making about conventional “bricks-and-mortar” economic development. Moreover, much of the workforce-related information economic development practitioners receive comes from representatives of large companies (that participate in Private Industry Councils, for example) or from the popular business literature, which speaks primarily to Fortune 500 companies rather than the typical small manufacturer. The lack of knowledge about small and medium-sized manufacturers with older production systems is unfortunate because these companies continue to be the backbone of many local economies.

This article reviews the growing literature on the changing employment practices of small and medium-sized manufacturers. Specifically, we examine the literature in three areas: (a) hiring practices, (b) employment security and retention, and (c) career ladders. Observers disagree about the extent to which restructuring has taken place, the nature of workplace change, and the impact of this change. The policy arena is just as contentious; a variety of strategies—from investment tax credits to training programs—have been proposed to provide employment opportunities in manufacturing, particularly for low-income populations. By synthesizing the research to date and evaluating the key debates in this area, this literature review will assist economic development researchers and practitioners in making the leap into workforce issues.

BACKGROUND

Manufacturing accounts for just under 20% of the nation’s employment and remains a strategically important component of many regional economies (Census of Manufacturers, 1996). The majority of manufacturers are small and medium-sized businesses (fewer than 500 employees) and privately held. The National Tooling and Machining Association, for example, estimates that its typical member establishment has about 29 employees and $3 million in sales (Ackerman, 1997). The greatest concentration of manufacturers can be found in the printing, industrial machinery, fabricated metals, and food products industries.

Manufacturing production systems have been in the throes of great change. From the 1950s through the 1970s, oligopolistic market structures sheltered large corporations from product competition while wage increases tied to rising productivity allowed unions to gain a share of the profits for their members (Appelbaum & Berg, 1996). Workers engaged in mass production expected some measure of job security, advancement opportunities, and steady raises from their employers (Harrison, 1994). In exchange, employers could expect loyalty and the development of firm-specific skills as employees advanced along established career ladders. In mass production systems, workers developed skills by repeating the narrowly defined and often routine tasks set forth in union job classifications.

Starting in the 1970s, financial deregulation, overvalued dollars, technological advances in information exchange, and foreign competition drastically altered the environment in which large American manufacturers operated. Foreign corporations challenged American dominance in steel, automobiles, consumer durables, and other product markets that had been the foundation of the U.S. economy. In this increasingly unstable environment, domestic manufacturers faced declining profitability and were forced to restructure. To lower fixed costs, large companies shifted job tasks previously performed in-house to external contractors (Harrison & Bluestone, 1988). Firms shed excess capacity and outsourced tasks that did not qualify as core competencies, creating new opportunities and challenges for the small suppliers from which they obtained parts and intermediate products.

Because of the increasing frequency of outsourcing, most small and medium-sized manufacturers are now suppliers to larger firms as opposed to original equipment manufacturers (Harrison, 1994). Large customers demand that their suppliers reduce prices, speed up delivery times, and hold additional inventory—all while insisting that quality standards remain high (Luria, 1996; McCormick, 1996). In effect, these large customers exert market pressure on their predominantly small suppliers to bear the brunt of upturns and downturns in product demand, and as a result, production schedules for small firms are highly unstable. In his study of 1,000 establishments with
fewer than 500 employees, Luria (1996) found that even though, on average, the total volume of company sales had risen in the early 1990s, most had also experienced significant, occasional downturns in demand during the same period. As large customers streamlined production, they sought to decrease the number of vendors. At the same time, they solicited from a larger pool of potential suppliers in pursuit of the lowest quotes and the highest quality. Indeed, Luria (1996) discovered that competition for each contract appeared to be increasing—smaller suppliers were quoting each job against a larger number of competitors than in previous years.

Small firms have pursued various strategies to adjust to this increased competition and uncertainty. A subset of small manufacturers has made efforts to redefine critical production tasks (e.g., through the use of numerically controlled machine tools) and restructure relations with their own suppliers (e.g., just-in-time production). These firms, which many authors have dubbed “high road” or “high performance” (Appelbaum, Bailey, Berg, & Kalleberg, 2000; Appelbaum & Batt, 1994; Brown & Reich, 1997; Gittleman, Horrigan, & Joyce, 1998; Osterman, 1999), have managed to supplement price/cost-based competitive strategies with quality-based ones. High performance strategies allow firms to compete on the basis of continual innovation, customer service, and product quality. Rather than skimp on capital investment, high performance companies invest in new equipment and the training necessary to achieve productivity gains from it.

Because high performance plants have the capacity to improve productivity and quality while lowering costs, their flexible work practices can lead to mutual gains for employers and employees (Harrison, 1994; Kochan & Osterman, 1994). Many have adopted new systems of work organization to operate self-contained stations or cells where workers are responsible for a variety of tasks, including quality control and machine setup. Such multiskilling practices, including work teams, quality control circles, and job rotation within a few broad classifications, require investments in training and workforce development. Studies have found that these innovations offer workers greater wages, autonomy, input into decision making, and employment security (Appelbaum et al., 2000; Osterman, 1999).

Evidence suggests that larger firms have greater scope to manage changing customer demands in a quality-oriented way and are increasingly turning to high performance work systems to improve competitiveness (Brown & Reich, 1997). But how widespread are these high-road practices among smaller manufacturers? These practices appear to be penetrating the small-firm sector as well although at a much slower pace (Kelley, 1996). Luria (1996) found that compared to previous years, some smaller shops were spending more time and money on technical training and investing in new computer-controlled technologies that automated scheduling, manufacturing, and quality assurance. These firms typically had higher capital-to-worker ratios and paid higher wages across their workforces (see also Jenkins & Florida, 1999). Among the 1,000 small shops he studied, Luria (1996) found that 15% to 20% of these establishments were becoming more productive, and in these shops, wages were also rising.

Although some small and medium-sized manufacturers have been able to adopt high-performance practices, the transition is neither complete nor painless. Most small manufacturers remain entrenched in low-road practices, competing for market share and pursuing flexibility primarily by lowering costs, often by withholding investment in new equipment or workforce upgrading. In these firms, uncertainty about future sales disables their budgeting and planning processes and discourages investment. They are reluctant to upgrade technology and use advanced telecommunications and production technologies. Luria (1996) noted that these companies

keep as much as possible of their cost structure variable (i.e., composed of unskilled labor and materials and other factors of production that can be added or shed as needed rather than becoming permanent features of the business). That means minimizing capital investment; otherwise, expensive machinery would sit idle whenever orders fell, driving costs per unit through the roof. (p. 12)

Falling average wages in small manufacturers “make clear that high-roaders are a declining proportion of the small manufacturer population” (p. 16).
Most small manufacturers have also sought flexibility through lowering labor costs—by reducing the number of full-time employees (e.g., substituting part-time, contract, and temporary workers), suppressing wages, flattening career ladders, or further outsourcing production. Because these strategies can undermine the value of local economic development efforts, we explore the changing workforce practices of smaller manufacturers in more depth in the following sections.

HIRING PRACTICES

Hiring practices—the point of entry for workers into the firm—depend on a range of factors. On the supply side, these factors include the local unemployment rate, adequacy of vocational preparation systems, and composition of the regional industrial base from which potential employees may be hired. On the demand side, hiring decisions depend on product demand, capital intensity, and the skill requirements of production.

Most entry-level occupations in manufacturing require workers with strong basic skills. In manufacturing, as in other sectors, the requirements for entry-level jobs are considerably higher than in the past (Cappelli & O'Shaugnessey, 1993; Murnane & Levy, 1996). Many positions require workers to possess an understanding of new manufacturing practices and technologies such as process flow, quality assurance, and just-in-time production (Jenkins, 1999). A recent survey found that employers most frequently report they are looking for workers who are reliable and who have a positive attitude (Regenstein, Meyer, & Hicks, 1998). Although few employers claim that prior work experience or previous training are required, many request references from previous employers as well as a reason for leaving the last job when considering an applicant for employment.

Manufacturers may recruit to fill open positions using conventional methods such as employment agencies and newspaper advertisements. Less costly and more common methods include relying on informal networks, primarily walk-ins and word-of-mouth referrals from current employees. In his 1996 study of the employment prospects for less-educated workers in four U.S. cities, Holzer found that referrals made by current employees and walk-ins accounted for 35% to 40% of the new applicants hired. Newspaper advertisements accounted for 25% to 30% of the hires, and state employment services accounted for less than 5%. Holzer’s findings are supported by a survey of hiring practices in Chicago manufacturing plants (Jenkins & Theodore, 1998), which found that employers viewed referrals from current employees as the most effective method for hiring new production workers. Employers reported that current employees were best able to identify high-quality workers who could fit into the work environment. Manufacturers were least satisfied with the quality of referrals from public employment agencies.

Employers often rely on screening methods to test applicants’ qualifications and to identify potential new hires who may have poor skill levels and aptitudes. The survey of Chicago manufacturers found that almost two thirds of the employers used reference checks, half of them administered drug tests, and more than one third tested applicants’ basic English and math skills (Jenkins & Theodore, 1998). For many employers, the best proxy for aptitude was previous experience in manufacturing. Respondents reported that 70% of new hires for higher skilled positions had more than 5 years of experience in manufacturing.

Low unemployment rates present challenges for small and medium-sized manufacturers seeking to fill both skilled and unskilled positions, particularly because they often do not employ the full-time human resource managers who are needed to recruit workers in tight labor markets. In 1998, 65 of the nation’s 100 largest metropolitan regions reported unemployment rates of under 4% (Headen, 1998). Many rural areas also experienced tight labor market conditions in manufacturing, aggravated by problems of poor transportation access (McGranahan, 1998). After a decade of corporate restructuring and downsizing (from roughly 1985 to 1995), demand for skilled manufacturing workers increased dramatically in the late 1990s, due, in part, to the retirement of large portions of the manufacturing workforce.

Manufacturers may face a major human resource crisis if they cannot replace these retirees. Employers already complain frequently about the shortage of workers for skilled manufacturing jobs. The National Tooling and Machining Association estimates that the metalworking industry is...
short at least 20,000 people nationwide (Ackerman, 1997). Similarly, a National Association of Manufacturers’ survey of firms (Miller, 1998) with 500 or fewer employees reported that nearly 35% of 1,400 respondents cited “finding and keeping qualified employees” as their most serious problem (p. 13). In another recent survey (McGranahan, 1998), rural manufacturers reported that the “quality of available labor” was a major problem, especially among firms that paid below-average wages (p. 6).

Shortages of qualified workers present challenges to large as well as small firms. Large firms, however, are better able to poach workers from their smaller competitors, suppliers, and customers. This practice is not new; larger companies have historically relied on their supplier bases as pools for new employees (Cappelli, 1999). The Big Three automakers, for example, commonly use their supplier bases to obtain trained and tested workers who can quickly be used in production or engineering operations (Smith, 1996). Employees often gain improved pay, benefits, and career ladders by re-employing with the Big Three.

The primary problem with this trickle-up arrangement is that smaller suppliers are stripped of their best workers. If they have invested time and resources in training, small companies may forfeit the benefits of this training to other firms (Lynch, 1993). As large customers move to replace their aging workers in the coming years, the raiding is likely to intensify and take place in faraway locales. Seattle-based Boeing, for example, recently sent recruiters to New England seeking machinists to help fill a $1.4 billion backlog in work orders. Allied Signal in Phoenix began recruiting in the Midwest after receiving complaints about poaching from several of its local parts suppliers (Siekman, 1998). Intensified poaching of workers has caused some smaller firms to move away from areas with concentrations of similar industries to regions with less labor market competition, such as rural areas and southern states (Kenney & Florida, 1993; Rubenstein, 1996; Smith, 1996).

Another way that hiring practices of manufacturers have changed in response to volatile product markets and labor shortages is the increased use of temporary staffing agencies (Cappelli et al., 1997; Peck & Theodore, 1998). Staffing agencies take on many of the responsibilities traditionally handled by human resource departments. These include recruitment, screening, hiring, payment of wages and benefits, and payment of employment taxes, such as unemployment insurance and workers’ compensation. Manufacturers may use temporary staffing agencies as a low-cost way to recruit for permanent employees, or more commonly, bring on workers who remain in temporary status for the duration of their employment. More than one third of temporary-help workers nationwide are in the light-industrial sector of the economy, performing work as assemblers, hand packers, and material movers in factories and warehouses (National Association of Temporary and Staffing Services [NATSS], 1999).

For most of the past 20 years, the use of part-time and temporary (what economists refer to as contingent) staffing arrangements in the United States has been viewed as an anomaly. Only recently has a consensus formed that contingent work is more than a short-run deviation from regular business practices. Recent survey evidence indicates that contingent work has become institutionalized in the majority of U.S. businesses. According to the National Association of Temporary and Staffing Services, 90% of companies now use temporary help services (NATSS, 1999). A survey by Olsten Corporation found that about 50% of manufacturers use blended workforces, employment systems designed to make use of temporary, outsourced, and part-time workers as well as independent contractors alongside full-time employees (“Forty-nine percent of manufacturers,” 1998).

The findings from several national employer surveys have shed light on many of the reasons behind the growing use of nonstandard employment arrangements (Blank, 1998; Houseman, 1999; Osterman, 1994, 1999). The most common reason why employers use temporary agencies is to staff peak periods or to handle short-term increases in demand for products or services. In addition to managing workload fluctuations, employers hire temporary workers to fill in before a regular employee is hired and to fill in for a regular employee who is ill, on vacation, or on family medical leave. The third most common reason why employers use contingent workers is to screen workers for regular jobs. But Houseman (1999) also found that a significant percentage of employers use contingent workers on a more permanent basis to reduce wages and benefit costs across the board (see also Mangum, Mayall, & Nelson, 1985). Her survey revealed that the use of contingent

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workers by employers was positively related to the provision of good benefits packages (pension and health insurance benefits) to their regular, full-time employees.4

EMPLOYMENT SECURITY AND RETENTION

The shift to more flexible forms of production and the intensified poaching of skilled workers appears to be creating problems for many smaller manufacturers in the form of increased turnover, workforce instability, and breakdowns in internal skill-development systems (Appelbaum & Batt, 1994; Luria, 1996). Workforce instability does not just hurt workers; it also hinders the ability of employers to plan work orders and production timetables and can cause productivity losses.

Employers experienced higher rates of turnover in the 1990s than they had in the two previous decades (Bureau of National Affairs, 2000). In particular, turnover increased sharply among those businesses with fewer than 250 workers. Small manufacturers reported losing about 40% of their workforces annually (Siekman, 1998). The entry-level job market in particular is characterized by considerable churning. A survey of 500 small employers revealed that in half the firms surveyed, the majority of entry-level workers stayed with the employer for 1 year or less (Regenstein et al., 1998). Another study found that young employees now work for more employers and have shorter tenures at each job site (Bernhardt, Morris, Handcock, & Scott, 1998). Rapid job churning is most pronounced among workers with less than a high school education (Monks & Pizer, 1998). Even in manufacturing, where workers tend to be older and presumably less mobile, job tenure is much shorter than it once was—the odds of a job separation in manufacturing are 30% higher for workers in the 1990s than for workers two decades ago (Bernhardt et al., 1998).

Of course, turnover may be either employer-initiated (firings and layoffs) or worker-initiated (resignations and retirements). These separations are often referred to as involuntary or voluntary, respectively. Although there is an obvious difference between choosing to leave and being forced to leave a job, especially in terms of one’s eligibility for unemployment insurance, dissolving an employment relationship is most often a joint decision. The greater the threat of being laid off involuntarily, for example, the greater the likelihood of voluntary separation (Stoikov & Raimon, 1968).

Employees are working for individual employers over shorter tenures—whether by choice or because their jobs are being created and destroyed at a rapid rate. Despite evidence of record job creation in the United States in the 1990s, urban and rural economies still have experienced large-scale layoffs arising from plant closings, downsizing, and mergers and acquisitions. Following a surge in downsizing in the recession of the early 1990s, permanent job loss remained quite high throughout the decade (Hipple, 1997; Valletta, 1998). In particular, layoff incidence increased sharply between 1994 and 1995, due in part to a delayed response by defense-dependent contractors to declines in the military procurement budget. Even in the late 1990s, voluntary job leaving constituted a relatively small share of the unemployment incidence (14% on average) (Economic Policy Institute, 1999). Although small manufacturers often find ways to retain their most valued employees during downturns, pressures to lower costs force companies to do more with less.

What explains the increasing frequency of employment turnover in the economy? A certain amount of turnover is to be expected from a dynamic economy; individuals choose employers and positions, and employers decide which applicants are suited to filling available jobs. Specific environmental factors, however, contribute to higher rates of turnover. Voluntary turnover tends to follow the business cycle. During periods of economic prosperity, workers have greater confidence in their ability to migrate to other, often better paying, jobs (Economic Policy Institute, 1999). At the same time, when a strong economy leads to labor shortages, workers filling entry-level positions are more likely to be young, have little work experience, and few proven skills. These workers have a higher propensity to quit or be fired (Cappelli, 1999). The opposite is true during recessions.

A number of studies have explored the causes of employee turnover. In their summary of this literature, Cotton and Tuttle (1986) noted several factors that appear to be positively correlated with decreases in turnover. These include age, job tenure, number of dependents, wage levels, job satisfaction, union presence, and aggregate unemployment rates. This supports earlier findings that
younger, less experienced, and nonunionized workers are more likely to voluntarily leave jobs or be fired. More educated workers are also more likely to be job leavers although for a different set of reasons.

In addition to employee characteristics, job quality encourages or discourages turnover. A study (Holzer & LaLonde, 1998) of both manufacturing and service employment found that “the characteristics of the jobs to which less educated workers have access, including starting wages, occupations, and industries, seem to affect their turnover rates independently of personal characteristics” (pp. 24-25). Another study found that businesses that pay higher wages experience less turnover (Regenstein et al., 1998). Employers whose entry-level employees stay for an average of 2 years are also more likely to report that their establishment provides health insurance, paid sick leave, and paid vacation. Another study of manufacturing employees found that total compensation (including monetary awards such as merit raises and benefits) substantially reduced voluntary turnover (Lust & Fay, 1989).

Thus, not all manufacturers experience high turnover. Those establishments that approximate the high performance model described earlier are less likely to have problems with employee retention (Jenkins & Florida, 1999). In such companies, employees are likely to be given opportunities for advancement and on-the-job training, two other factors that are highly correlated with retention (Lynch, 1993). A study of 30 steel minimills found that firms with commitment-oriented human resource systems, which allowed workers more discretion in carrying out their job tasks and involvement in managerial decisions, experienced less turnover than did firms with control-oriented systems in which emphasis was placed on compliance with specified rules and procedures (Arthur, 1994). The commitment-oriented firms did not pigeonhole employees into narrowly defined jobs and allowed them significant voice in defining job tasks. For job retention to be beneficial to the worker in the long run, employees must have career advancement opportunities within the organization, and employers must be willing to train and advance their low-skilled workers to more highly skilled positions rather than hire from outside (Brown, Ganzglass, Golonka, Hyland, & Simon, 1998).

What are the implications of high rates of turnover? Some believe that turnover is a sign of a healthy economy in which workers have many opportunities and employers have the flexibility to hire the best workers (Ryscavage, 1995). However, there are costs to high turnover as well. When employers experience difficulties finding qualified replacement workers, turnover can raise the cost of both recruitment and operations because employers must pay costly overtime or hire less productive temporary workers. A study of turnover among entry-level staff estimated costs ranging from 25% to 50% of a worker’s annual pay (Coopers & Lybrand, 1997). The study found that most of the turnover cost, about 85%, is related to productivity losses. Costs are highest in work teams or manufacturing line situations in which an employee’s work performance is likely to influence other employees. Also, it is more difficult to replace employees with firm-specific skills.

Job insecurity is a serious problem for workers as well. Income growth, benefits, and promotion are typically attained through stable employment. A lack of tenure can limit future employability because employers may be wary of an employee with an unstable work history. There is some evidence that short and erratic spells of work could disadvantage individuals seeking work. Whereas earlier studies found that young workers’ income increased with each job change, more recent work demonstrates that in the longer term, job instability has a negative effect on wage growth (Bernhardt et al., 1998 and 2001) and benefits (Gladden & Taber, 1999; Regenstein et al., 1998). These findings may be due to the fact that during earlier periods, job changes were less frequent and were related to skill development.

A lack of turnover, however, may imply that employees are bypassing better job opportunities or that the market presents them with few opportunities for advancement. When other, better jobs are available, staying at a lower-level job imposes opportunity costs of forgone alternative employment. It often is in the interest of employees, after entering the workforce and establishing a stable work record, to search for jobs with better opportunities and rewards. Too often, however, high turnover actually prevents career progression as workers cycle in and out of poorly paid, dead-end jobs (Rogers, 1995; see also Holzer, 1999). For many job seekers, career progression is halted shortly after it begins.
Employees are working for individual employers over shorter tenures—whether by choice or because jobs are being created and destroyed at a rapid rate. Overall, current research has not concluded that managers have little commitment to their workers. However, this research does demonstrate how the market pressures being exerted on small manufacturers to keep costs low and variable may create working conditions that discourage retention and loyalty.

**CAREER LADDERS**

Job stability will lead to increased wages and benefits only if career ladders exist and if workers obtain the skills needed to advance them. The “ladder” theory of career advancement suggests that workers, gaining skills, experience, and seniority advance from entry-level work into better paying, higher skilled occupations. This model suggests that employers also benefit because labor productivity increases as workers accumulate knowledge about production processes. Although such a ladder may not exist in a single manufacturer, the concept of a career ladder is still appropriate for understanding occupational mobility in a local economy as well as within an industry.

For most production jobs, the traditional model has been for employers to seek entry-level applicants with strong basic skills. In the case of the metalworking industry, for example, employers prefer to hire workers who have completed high school, are able to read and write English, and can demonstrate proficiency in mathematics (Theodore, 2000). Strong communication skills and the ability to work well with others are also required for work sites organized around team concepts. Entry-level metalworking employees often begin as helpers or assistants to experienced operators. The responsibilities of an assistant include material feeding, removal of finished products, and cleanup. As their responsibilities increase, trainees adjust feed speeds, change cutting tools, and inspect the quality of finished products.

As workers gain familiarity with technology and work practices, they may become machine operators responsible for an entire set of machinery. In most cases, metalworking machine operators learn their trade on the job. During this time, workers develop a basic proficiency in operating machines, hone these skills over the course of several years as they improve their technique, and eventually become highly skilled operators. Workers who advance to the position of setup operator are required to exercise discretion over the entire work process and must be multiskilled because they work with several machines (many of them computer-controlled) and often in teams. Increasingly, these workers communicate with other functional areas within the workplace and even with customers.

Moving between semiskilled assistant and the skilled machine operator positions is critical to advancing from low-wage to livable wage employment (Jenkins, 1999). Whereas the median hourly earnings of a material handler (semiskilled) in the Chicago metropolitan area was $9.90 in 1998, the median wage of skilled machinists was $14.08 an hour. The most advanced production positions, such as numerical controlled machine programmers, pay median hourly wages of around $21.

Union seniority rules traditionally guarded the rungs on the ladder, calibrated wages, and made promotion decisions more predictable (Dresser & Rogers, 1997). Does this model still hold? It appears that new pressures for flexibility have disrupted job ladders and muddled job responsibilities, especially in smaller establishments. Recent studies suggest that career ladders are becoming flatter and that certain entry-level occupations are becoming disconnected from high-quality jobs to which workers had traditionally advanced (Cappelli, 1999; Cappelli et al., 1997; Fitzgerald & Carlson, 2000; Herzenberg, Alic, & Wial, 1998). Even those workers who progress beyond the most poorly paid entry-level jobs may find that the career paths offered by their employers have been dramatically shortened or eliminated.

Career ladders are already truncated or nonexistent in many small companies because of their less developed divisions of labor. The smallest firms offer the fewest opportunities for promotion, their highest paid positions having the least turnover. Like their larger customers, small manufacturers are frequently turning to temporary staffing agencies to provide entry-level workers.
The emphasis on reducing payroll costs may have led some managers to define jobs more narrowly and make them even more routine to employ less-skilled, lower cost workers or to substitute capital equipment for labor (i.e., low-road behavior) (Appelbaum et al., 2000). Throughout the economy, the number of unskilled, entry-level jobs, such as shipping and receiving, proliferated during the economic expansion of the late 1990s (Wright & Dwyer, 1999). Surprisingly, at the same time that there has been downgrading in the skill requirements of many entry-level jobs, other studies have found that manufacturing employment has shifted toward higher skilled jobs. Higher skilled manufacturing jobs are becoming increasing complex—due in large part to the introduction of new workplace practices that emphasize decision making, problem solving, and teamwork as well as to the growing use of computer technologies—and workers are now expected to take on increased responsibilities (Cappelli & O’Shaughnessey, 1993; Teixeira, 1998). These two findings—an increase in entry-level and higher skilled jobs—do not necessarily contradict each other. Instead, they support the hypothesis that the distribution in job growth during the 1990s recovery was bipolar—weighted heavily on the bottom and top ends of the spectrum (Wright & Dwyer, 1998). It may be that the jobs that link the two ends—the “bridge” jobs—are missing (Jenkins, 1999).

The breakdown of career ladders within a given company is reinforced by the fact that manufacturers continue to lose some of their best employees to customers and competitors. Poaching of quality workers reduces incentives to make investments in individual workers through training. American firms have long held the reputation for investing less in skills training than many of their foreign competitors (Appelbaum & Batt, 1994; Dertouzos, Solow, & Lester, 1989; Lynch & Black, 1998; MacDuffie & Kochan, 1995). Small manufacturers in particular appear to invest little in training their workforce. Luria (1996) noted that where the typical large company “spends about 2 percent of payroll on training shop workers in its large plants, the training investment in a typical small–plant employee is less than 0.5% of payroll” (p. 12). Employers may claim that the tasks performed are either not dangerous or not unique enough to warrant training, but the underlying reasons relate to their inability to capture a return on their investment (Weber, 1999a). As responsibility for product and process control is shifted downward to lower tiers of the supply chain, it will become more difficult to maintain quality and other performance goals vital to the success of business without high performance work systems backed by investments in the training of current employees.

**IMPLICATIONS FOR ECONOMIC DEVELOPMENT POLICY**

How do corporate restructuring and workforce change affect economic development activities? Most economic development programs were crafted during the era of deindustrialization when retention and attraction of any job was necessarily the objective. In periods of long-run employment growth, however, alternative goals are necessary. Flexible staffing arrangements, flatter career ladders, reduced training, and skilled worker shortages mean that job creation no longer can be regarded as the primary measure of successful business development. Instead, economic development programs must help firms in moving toward high performance work systems that provide more stable, higher quality jobs.

Local economies will be unable to sustain high growth rates unless firms invest in new technologies, implement innovative workforce systems, and undertake skill development of their employees. These activities require a coordinated economic and workforce development system that is responsive to the needs of both firms and workers (Giloath, 1998; Harrison & Weiss, 1998a, 1998b).

Conventional urban economic development strategies—for example, low-interest loans, property tax abatements, and brownfield redevelopment—are geared almost exclusively toward meeting the “bricks and mortar” needs of businesses despite evidence that a key factor in business location decisions is the availability of qualified labor. Rural development policy has also tended to focus on infrastructure, credit, and business assistance (McGranahan, 1998). Human capital
investments too often are viewed as ancillary to the primary goal of real estate and business growth, or worse, as a cost to be minimized (Ranney & Betancur, 1992). However, firms frequently leave localities because they cannot find residents with the qualifications for vacant positions—not simply, as many contend, because of the lack of developable space or the heavy tax burden (Giloth, 1998). Economic development staff must think of labor as an asset that along with its arsenal of financial incentives, can be used to attract and retain businesses. Especially during periods of low unemployment and shortages of skilled production workers, they have little choice but to adopt workforce-focused policies.

Businesses seek workers with basic skills who are prepared for work; tax abatements and credits that encourage firms to hire unqualified workers are counterproductive. Most localities lack the means of addressing these skill shortages and connecting workforce development to ongoing industrial retention and attraction efforts. Existing job training programs are often loosely connected to actual employment needs and operate without any guarantee that their graduates will find positions in the occupations for which they have been trained (Harrison & Weiss, 1998b; Jenkins, 1999; Weber, 1999b). This means that job seekers may not achieve the hoped-for wage gains or the career-track jobs that prompted their participation in training programs. Moreover, programs to boost the supply of skills through mandated training or new workforce development programs—in the absence of actions by firms to adopt new approaches to organizing work—might not significantly improve demand or the utilization of skills. The resulting lack of coordination between economic and workforce development systems compromises the effectiveness of economic development efforts.

CONCLUSION

American manufacturers simply cannot compete with low-wage countries on the basis of labor costs alone. When they decide to cut labor costs, rather than pursue performance-enhancing strategies, firms may dampen productivity in the long run and make it harder to retain their best employees. Moreover, cost-cutting strategies, such as the widespread use of low-wage temporary workers, jeopardize many of the goals of local economic development.

Small producers must pursue economic advantage based on performance—improved product quality, flexibility, innovation, and product differentiation, all of which require a high-quality workforce. To implement the new technologies that are necessary for these firms to meet higher quality standards and compete for larger contracts, they must build long-term capacity by investing in new forms of workforce organization. Initial access to an adequate supply of workers who possess problem-solving skills and can read and perform basic math is only the first step. Businesses must provide on-the-job training and an atmosphere conducive to firm-based learning to capture the productivity gains from valued employees. Increased productivity is the primary means through which employers can raise wages.

Firms that do not make productivity-enhancing investments run the risk of providing dead-end, low-paying jobs that contribute little to the local economy in terms of earning power. Conversely, firms that elect to make these investments can develop a skilled and stable local workforce able to make home purchases and contribute more to the revenue base of the locality. This, in turn, can lead to a decreased reliance on transfer payments from the federal and state governments.

Because firms are able to pursue alternative strategic paths, economic development policy making needs to assist those firms trying to make the transition to high performance workplaces. It can do so by improving the supply and the access of job seekers to good jobs, which increasingly involves sectoral, firm-to-firm initiatives as opposed to tax breaks oriented toward individual companies. They can also create an environment that encourages firms to modernize in ways that do not displace workers or downgrade the quality of available jobs. Public support for related investments in workforce development and firm modernization can yield significant returns for regions and workers, benefits that do not have to come at the expense of the private sector.
NOTES

1. The performance measures to which the moniker refers often include increases in productivity growth, quality (e.g., ISO 9000 status), rates of customer retention, and employee retention.

2. A 1993 survey of a random sample of 800 larger U.S. manufacturing establishments found that roughly 35% report the use of teams, 55% rotate workers between teams, and 45% use quality circles (Osterman, 1994). More recent evidence suggests that the use of teams and quality circles among manufacturers is on the rise in larger establishments.

3. The benchmarking survey conducted by the Michigan Manufacturing Technology Center detected an upward trend in wages in small manufacturers beginning in 1998 (D. Luria, personal communication, March 2000).

4. Houseman (1999) offered two possible explanations for this finding. First, employers may wish to provide different benefits packages to different groups of workers, a practice that would be in violation of federal labor laws. Staffing certain occupations through temporary help agencies would allow employers to offer premium benefit packages to regular workers while excluding contingent workers from such benefits. An overall savings from wages and benefits could then be achieved. A second possible explanation is that before employers are willing to provide costly benefits packages to workers, they prefer to screen prospective employees, initially hiring them as temporaries prior to offering them regular employment.

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