ECONOMIC WHITE PAPER - MAY 2013

The Future of State and Local Economic **Development Policy**

Dick Heupel, MA, CEcD Director of Community and Economic Development, Building Better Communities Michael J. Hicks, PhD Director, Center for Business and Economic Research

BACKGROUND

When most Americans think of state and local efforts in economic development, they envision a fairly narrow set of efforts to lure jobs to a region. They will describe officials offering prospective businesses years of state tax incentives, new infrastructure construction, state subsidized job training, government financed buildings and local tax abatements to relocate a business. Whether they are comfortable with it or not, this is what most people think of when they speak of economic development.

The hope is that these efforts will bring 'footloose jobs' to a region, which in turn will increase incomes and improve the area. We have participated in these activities at different levels in four different states and feel they have an important role in improving the economic outcomes of a region. However, for reasons we will explain in this white paper, they cannot successfully be the primary focus of efforts to improve the lives and livelihoods of citizens.

It is increasingly clear that this model of economic development only really worked well in the American South in the decades after the invention of air-conditioning. Research findings as well as common sense suggest that these policies have limited effectiveness. Let us explain with two simple points.

First, a large and growing body of technical research on traditional economic

development policies suggests that heavy usage of tax abatements and incentives have little or no effect. Indeed an emerging body of research suggests these incentives are symptomatic of deeper problems within communities or underlying tax structures in places that use them. But we contend that this is reasonably obvious, and does not require a

vast review of economic research to understand. The worst places to do business, such as Illinois or California offer tremendous business incentives. In contrast, the fastest growing communities in America, such as Fairfax County, Va., engage in little or no business attraction efforts and offer few fiscal inducements. Indeed, Indiana is remarkable for the paucity of state incentives, and the most successful communities in Indiana (e.g. those in Hamilton County) offer few special inducements to new businesses. These are simply great places to live and do business.

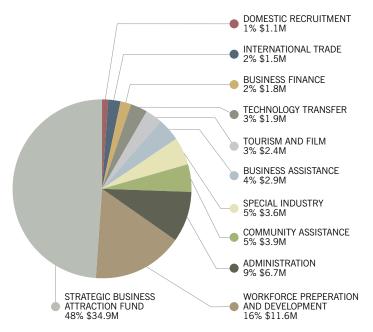
Second, even if these policies mattered at the margin for some businesses, they cannot ensure prosperity in a region. We offer Indiana as an example. In 2010, the Indiana Economic Development Corporation



reported its best year. It detailed 23,017 jobs created through its efforts. These are gross new jobs lured to the state that year. However, the Census and Bureau of Labor Statistics also collect data on gross job flows in each quarter. In 2010, it reported that 514,412 new jobs were created in the state. So, in its best year, Indiana's economic development arm has played a role in no more than 1 out of every 22 new jobs created in the state.(1)

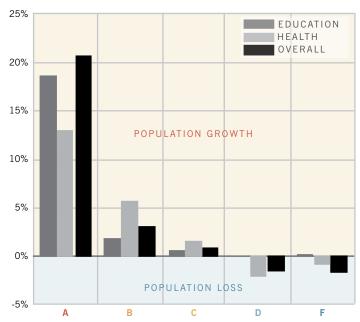
According to data collected by the Council for Community and Economic Research, the state of Indiana spent more than \$72 million on activities related to business attraction in fiscal year 2010, returning a very reasonable \$3,100 per job. Indiana spent only 5.3 percent of this money on community assistance, while the national

FIGURE 1: TOTAL STATE EXPENDITURES FOR INDIANA BY FUNCTIONAL ECONOMIC DEVELOPMENT PROGRAM AREA. FISCAL YEAR 2010



Source: The Council for Community and Economic Research, State Economic Development Expenditures Database 2010, http://www.c2er.org/products/ stateexpenditures.asp.

FIGURE 2: INDIANA COUNTY POPULATION CHANGE BY COMMUNITY ASSET GRADES FOR HUMAN CAPITAL (EDUCATION AND HEALTH), 2000-2009



Source: Ball State University Center for Business and Economic Research, Community Asset Inventory and Rankings 2012, http://asset.cberdata.org.

average is 35.1 percent of economic development funding allocated to community assistance. No doubt this is partly due to the lean nature of Indiana's economic development spending, but Indiana's position in quality of place rankings suggest deeper consideration on a focus toward improving communities. See Figure 1.

This white paper is not a critique of the IEDC or state economic development groups in general. We do not seek to alter state job attraction efforts in Indiana, only supplement them. Indeed, Indiana's last four secretaries of commerce have consistently spoken publicly in support of the message we here offer. Rather, the goal of this white paper is to address the policies and programs that help create 95.5 percent of new jobs that traditional economic developers have no hand in attracting.

COMMUNITIES: THE NEW BUSINESS **ATTRACTOR**

Increasingly the role of livable, attractive and well-run communities has come to the attention of researchers and policy makers. This is not really new, just better understood in more successful cities. In fact, at about the same time the American South started to lure business investment through the methods mentioned above, dozens of cities, in the South and elsewhere, adopted a more holistic approach to economic development. They simply worked to become great places to live.

Part of the economic renaissance of several American towns was accidental. Savannah, Ga., worked on urban renewal with little expressed interest in long-term economic growth. It has grown remarkably, not because of its commerce or seaport, but because people want to live there. Maryville, Tenn., attracted a large corporate headquarters because it made its small downtown a pleasant place to be, with a walking trail adjacent to a clean, but tiny creek. It is prospering well. Other places, such as Columbus, Ga., or Fayetteville, N.C., prospered because people whose jobs took them to the region enjoyed the community improvements enough to draw them there in retirement. Other places become a regional draw for large cities. Virginia's Loudon County, Ohio's Montgomery County and Indiana's

Hamilton County simply became the best places to live for new residents in large metropolitan areas. Other places worked hard to be places people simply wish to live, examples include Asheville, N.C., and Columbus, Ind.

We recently published a ranking of counties in Indiana that begins to outline quality of place measures. While no single measure is perfect, we offer a simple graph of the county-level overall rankings, and population growth within Indiana's counties. This figure speaks loudly to the connection between broad measures of community attributes and the economic outcomes associated with them. This study convincingly showed that 'nice' places grow while unattractive places do not. See Figure 2.

In Indiana, there is a growing number of well-led communities that fully and effectively understand this message. Kokomo, Westfield, Charlestown, Batesville, Portland, and Fort Wayne are well on their way to being the next set of success stories in economic development.



SIDEBAR A: OPINIONS ON LOCATION DECISIONS

- "Keep your tax incentives and highway interchanges, we will go where the highly-skilled people are. They will go where they want to live."
 - Carley Fiorina, CEO, Hewlett-Packard
- "In the knowledge-driven, computer-networked economy of the future, what matters most is being a place where people want to live—a place with great public schools, clean air and water, wonderful recreational opportunities. Low crime rates, and a common bond of community pride and unity. These places, the places where people want to live, will also be the places where companies want
- Gary Locke, former governor, State of Washington, U.S. Secretary of Commerce
- "While surely both phenomena occur, we think that the evidence supports the view that industries are responding to the area's skill distribution more than the view that the skill distribution is responding to the area's industries mix."
 - Edward Glaeser, economist, Harvard University
- "Factors that tend to drive emerging-industry human-resource evaluations include the number of engineers and technicians within the labor shed, the presence of colleges and universities with matching technical programs, the overall educational level of the local work force, and the presence of other higher technology companies and similar industries in the area."
 - Phil Schneider and Raj Vahra, Deloitte Consulting

The Bottom Line

We believe that the greatest effort in economic development, characterized as those that engage workers, wisdom, and wealth in the crafting and execution of development efforts, should be dedicated toward making communities better places to live. We believe the most important people to consider when crafting economic development efforts are not the site selectors—brokers who will not invest their own wealth in the purchase of a home or send their children to the public schools in the districts where they facilitate investments. No, the most important people to consider are the men, women and children who choose to live in a particular community of their own free will. These non-traditional VIPs, like footloose industries, are free to select a location from among many communities within a region. And the highest-value prospective residents do so based on the best overall return on investment: stated broadly to include public school performance, prospective housing price appreciation, safety, and amenities—livability. The most valued residents, like the most valued businesses, are not those who base their location decisions on the lowestpriced option.

MAKING COMMUNITIES ATTRACTIVE

Too many communities ignore factors that contribute to their quality of place because the community does not have mountains, rivers, or large sporting venues. This approach misses the central issue of economic development efforts: the goal is not to reach an end state, but to foster a rate of change. Four hundred years from now, residents of Indiana will still be concerned with issues of economic development. What matters today is not how "good" we are or are not, but rather how fast are we improving.

Americans live in many places, with many different climactic and geographic conditions, differing levels of urbanism, and a wide variety of entertainment options. However, only a few factors matter deeply to new residents.

Schools

The quality of local K-12 education is the number one attractor or deterrent for new residents. Communities with below average schools must expect to see reduced populations, lower personal incomes and declining fortunes in the decades to come. Communities with schools that are not in the top quartile should expect economic stasis over the coming decades. Indeed, local K-12 (and increasingly pre-K instruction) is so critical to economic growth that

radical efforts are warranted. In the absence of high-performing schools, we recommend city and county chambers of commerce and private groups pursue charter school and private school options.

Quality of Place

The livability of communities is a close second only to schools in driving residential investment, growing wealth and boosting the economic prospects of a region. Americans live and work in a variety of climates, with a variety of local amenities. Public policy can little affect the natural distribution of climates, but it can improve upon them. More importantly, communities can make themselves safe, habitable, easily navigated, possessed of attractive signage and local transportation infrastructure. There is an abundant and easily accessible set of research and planning literature on quality of place attributes. While some simple aspects are common, each community must craft for itself an improved community if it intends to draw more residents and their incomes in this century.

Responsive Government

A common mistake among traditional economic development advocates is that low tax rates enjoy a primacy of placebased economic development. While businesses and residents prefer low taxes, all else being equal, all else is never equal.



Communities with both low and high local tax rates grow rapidly throughout the United States for the simple reason that individual households and businesses like and seek different mixes of local public goods and services. The technical term for this is Tiebout Sorting, but most Americans know it as 'voting with your feet.' Some of the best communities we have mentioned in this white paper have very high local tax rates, while many failing communities have low rates. What matters is not a rate alone, but whether the quality of public services matches the tax rate. Where public services are equal to or better than the cost of providing them (as judged by citizens), growth will occur. In places where the tax rate exceeds the value of local services, they will decline. This requires responsive local government, unfettered by national agendas, and focused on economic prosperity within a county or municipality. Some places can survive with poor local government, but it requires an astonishingly effective set of amenities to do so.

Health Care and Healthy Options

Among the key features of a livable community are access to health care options and locations that promote a healthy lifestyle. These go beyond little league fields and gymnasiums, to the presence of bikeways, trails and park lands, and access to these amenities.

Healthy communities also share a variety of good outcomes. They are correlated with higher incomes, lower employment costs, and higher levels of educational attainment. While the directional effect is uncertain, a clear indicator of prosperity in a region is the measures of the health of its residents.

Regionalism of Economic Development Efforts

Business attraction and retention efforts are difficult. They require a great deal of data collection and dissemination tools, and a professional staff that is able to negotiate with site selection consultants who are compensated at many times the rate of local economic development officials. Traditional economic development efforts also require significant local knowledge coupled with the capacity to interface quickly and smoothly with a variety of state and regional players, from large real estate holding firms to transportation departments and local elected officials. Success in these endeavors also requires specialized knowledge in industries likely to relocate to a region, in workforce development, in bond financing, and in tax incentive structure of the state and local area. Few communities with less than a half a million residents will possess the resources to do these things well. More importantly, businesses are typically unconcerned with the particulars of county borders or municipalities. More bluntly, few new business

care where they go within a region, unless a specific city or town suffers a very poor or very good reputation. These factors argue for increased regionalism of economic development efforts. While obtaining funding for regional efforts may be more difficult than obtaining funding for local economic development activities, we argue that it is more important, especially for communities that are successful at preparing themselves for new residents.

A CALL TO ACTION

The wake of the great recession will continue to place great burdens on state and local elected officials to whom many residents will look for leadership on matters that effect economic prosperity in their communities. While many in the Midwest are already following the advice we offer in this white paper, most are not. The next two to three decades will largely determine which areas of the American Midwest will recover and which areas will devolve into sparsely populated farming communities, devoid of manufacturing and other commerce, and inhabited by citizens receiving an ever-increasing share of their income through public assistance.

For communities dissatisfied with their economic prospects, it is necessary to deploy resources and governmental focus toward improving the quality of public services in schools and communities. This will necessarily lessen the dependence upon traditional local economic development efforts. Communities that do not make themselves attractive to the families of prospective employees will not find themselves benefitting from the re-deployment of private investment that continues to occur across the nation. Communities with poor schools, and unattractive, poorly designed and unwelcoming neighborhoods will, with increasing speed, see their economic fortunes decline.

The next two to three decades will largely determine which areas of the American Midwest will recover and which areas will devolve into sparsely populated farming communities, devoid of manufacturing and other commerce, and inhabited by citizens receiving an ever-increasing share of their income through public assistance.

ABOUT THE AUTHORS

Dick Heupel is director of community and economic development at Ball State University. He has three decades of experience in community and economic development at local, regional and state-level organizations in Indiana and Ohio. He directed rural and urban, regional and local non-profit, foundation, and private sector economic development initiatives. He served as president of the Indiana Economic Development Association and the Mid-America Economic Development Council and numerous boards and advisory commissions of the state, development agencies, and universities.

Mike Hicks is director of the Center for Business and Economic Research at Ball State University. He has worked with site selectors, private developers and state and local economic developers, and has written books on tax incentives and local government consolidation and testified on tax incentives in several state legislatures. Under his leadership, the Center for Business and Economic Research has developed a suite of data tools to assist policymakers in understanding their communities' economies and to aid in their decision-making thereabout.

BALL STATE UNIVERSITY CENTER FOR BUSINESS AND ECONOMIC RESEARCH



About the Center for Business and Economic Research

Ball State University's Center for Business and Economic Research conducts timely economic policy research, analysis, and forecasting for a public audience. CBER research includes public finance, regional economics, manufacturing, transportation, and energy sector studies. We produce the CBER Data Center, a site featuring a suite of data tools, and the Indiana Business Bulletin, a weekly newsletter with commentary and dozens of regularly updated economic indicators.

Center for Business and Economic Research Ball State University (WB 149) 2000 W. University Ave. Muncie, IN 47306-0360

www.bsu.edu/cber