State of Business

Lawmakers need a strategy to create a robust economic environment during hard times.

BY KENNETH E. POOLE

The economy is showing its first signs of sputtering forward, but unemployment remains high. Even though there may be an economic spring thaw already afoot, many job seekers appear to be losing hope that the recession will ever end. Policymakers faced a similar sentiment in the early 1980s, and there are lessons from that experience in healing the economy.

Most past recessions were much milder because the American consumer began spending again soon after the recession started, helping to regenerate economic activity relatively rapidly. Unfortunately, we often consumed our way out of past recessions by buying houses or cars. Now we cannot afford them, and the easy credit that helped us overcome this little detail in the past simply is not available. Essentially, the piled-up bills from easy credit are now coming due for many citizens, investors and lenders.

So Americans have cut back. As home prices have returned to normalcy, banks are reluctant to lend, and consumers are hesitant to borrow. This new behavior is most affecting the banking, housing and automotive sectors. As these industries struggle, they have a ripple effect in the form of job losses across the rest of the economy.

If one can be found, the silver lining from this recession is that consumers and lenders appear ready to change their ways. Profligate spending is out of vogue. Americans are now saving more for a rainy day, and consumers are trying harder to live within their means. While this will slow the economic recovery in the short term, it may make a long-term recovery more sustainable.

For state legislators, one lesson at least is clear: No single entity can control the entire U.S. economy. Certainly, no single state policy—no tax break or big spending program—will magically return the economy to what it once was. In fact, we probably don't want to restore the old economy anyway. As time and technology march forward, we need to prepare for the next generation economy.

But how?

CREATIVITY AND PATIENCE

Like being stuck in a traffic jam, there is seldom an easy solution to economic problems. We all recognize the 2010 elections are coming up. Voters are angry, and they want to blame someone. The truth, however, is politically unpalatable—we are all to blame for living beyond our means. Yet, by laying the groundwork today, there are opportunities for success.

Many of today's most successful companies grew out of seeds planted during past recessions. They succeeded with creativity, preparation and time. We have to help workers and companies focus on the future, identify opportunities for potential success, and prepare for a transforming economy as it emerges from the recession. Frequently, this preparation involves public sector engage-

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ment, and state policymakers play an essential role in making public investments.

For years, experts have been saying—and relative wages confirm—that the most successful workers have some post-secondary education. Not everyone needs a four-year college degree or even an associate's degree, but unemployment rates among people with these credentials are lower than for the rest of the economy. Career and technical skills combined with a creative mind and an entrepreneurial spirit make employees invaluable to their employer, and companies protect these workers because they will be needed as the economy surges.

For companies, information and knowledge are also fundamental public goods that provide an economic advantage to the states where those firms are located. Just as for people, businesses depend on the lessons their managers learn and how well their enterprise can adapt to a new economic order.

While we frequently talk of education and training, rarely do we consider the importance to our business decision makers—especially in small- and medium-sized enterprises—whose everyday choices have the greatest influence on our states' economic conditions.

ECONOMIC DEVELOPMENT POLICY

State legislators today are faced with tough choices and less discretion in investing limited public funds, although most remain committed to investing in economic development. Across the country, states invested more than $2 billion in economic development programs, excluding tax incentives, in FY 2009. Critics maintain that economic development investments, however, do not always have a significant effect and often are not transparent.

Here are seven key principles policymakers can keep in mind when making these investments.

Conduct better evaluations. It is difficult to ascertain how effective some economic development investments have been. Few states have invested the resources to ensure programs are evaluated consistently and with a high level of professional expertise. Managers report the results their programs have had, but these are often viewed with skepticism. Evaluation systems have been underfunded, so managers with little or no expertise in program evaluation are left to estimate the effect of their own efforts. Maine's comprehensive evaluation system examines the entire portfolio of economic development programs, but sustaining this sort of effort beyond a one-time assessment is challenging. The U.S. Manufacturing Extension Partnership, which receives matching funds from most states, provides a model for multi-year, third-party evaluations used for program management, resource allocation and program development.

Focus on helping groups of companies, not individual firms. One-on-one assistance to companies probably has the most effect, but it is also relatively expensive. Cluster or sector initiatives are now being explored as methods for targeting investments. They also offer a

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way to address challenges in a more collaborative model. In some cases, key barriers to success may be tied to industry-wide challenges, and the public sector can play a role that may cost little in the way of new direct funding. This approach is becoming increasingly common in addressing industry-wide workforce challenges. The resulting discussions among firms has led them to tackle other problems, such as common quality standards, advocacy for key sectors, or fairness in tax policy across companies and industries.

Provide companies with data and analyses to succeed. As large companies consolidate, many states have fewer corporate headquarters. Fewer companies are locating branch plant operations, but instead are seeking suppliers to produce outsourced products. Furthermore, the most successful existing or entrepreneurial firms are those capable of competing to access new supply chains. Local branch plants must operate more entrepreneurially, identifying ways they can develop competitive market niches within a multinational's corporate structure. Ultimately, the critical advantage for these firms will be the ability to get market information about their respective industries. As a result, economic development is becoming more an intelligence gathering and analysis function aimed at helping local companies succeed. Even the recruitment process is becoming less focused on the amount of incentives that must be offered and more on how well the state's staff can help targeted companies gain competitive insights about unique global niches.

Develop job training programs to keep a competitive edge. When unemployment is high, companies tend to retain their "mission critical" workers as long as possible. The key is to ensure the workforce can adapt to changing economic conditions. A few years ago, when labor markets were tight, companies complained about the quality of new workers, expressing concern about both life skills and technical skills. Since these are the very people who are most likely unemployed, now is the time to address such issues with education and training programs designed to correct these deficiencies. When the economy picks up again, these workers will be better prepared to help the state's economy prosper. In the long run, this may be more important than trying to get workers quickly back to jobs for which they will be ill-prepared.

Help companies compete in an entrepreneurial economy. Economic development programs must be prepared to adapt to rapid change. Today's needs will not be the same as tomorrow's. States can offer incentives to economic developers to collaborate and leverage one another's expertise, not only across agencies but among federal, state and local business assistance providers. This role is critical in helping companies succeed, and it will require new skills among economic developers—including business research, management and cross-cultural communication skills. States can invest in educating and training these professionals to better understand how to work closely with the state's workforce development and educational systems. This will ensure the best use is made of state economic development investments.

Diversify the economic base. Different industries have their own business cycles.

The cycle for the real estate industry differs from that for the food manufacturing sector. Likewise, health care and education respond to markets differently than do finance or agriculture. States with a diverse set of economic drivers are much more likely to weather economic storms than others. Certainly, they are less likely to have major business cycle swings—declining less rapidly in the downturns and growing more moderately during the upswings. It is easier to plan in states that grow steadily. States must balance their efforts to target help to key sectors with consideration of new ways to diversify growth.

Invest for the long haul. Products, companies and even industries have life cycles. Today's entrepreneurial success stories are tomorrow's legacy industries. Investment in research and development—especially applied research that engages companies of all sizes—is critical for seeding tomorrow's future opportunities. The mere presence of key research activities has served to attract companies interested in taking full advantage of the results of the research or the talent this activity attracts. The payoff is often long term, but states that do not make the investments do not reap the benefits. Public-private research collaborations have been at the core of success for many regions, as illustrated by the relative economic success of most communities with research institutions.

MOVING FORWARD

States must continue to invest in key long-term priorities. Education, training, economic development and research are core to creating growth. The payoff on all these efforts is certainly longer-term than individual election cycles. Recognizing the short-term political nature of many economic development decisions, states are turning to public-private leadership models designed to sustain long-term investment strategies. These models are emerging in different forms, as exemplified by Enterprise Florida, Science Foundation Arizona or the Wyoming Business Council.

Although these emerging models can offer a much needed buffer between the reality of relatively short-term political time frames and the need for a long-term economic investments, many also argue they may shift too much of the decision making from elected officials. The key in balancing these concerns is to ensure that gubernatorial and legislative priorities are addressed in these public-private initiatives. That is often best done through the annual or biennial policymaking and budgeting process, leaving long-term investment decisions to professional managers and a public-private board leadership.

Improving the effect of state investments in education, workforce development, economic development and research are essential. Better information on the success of investments and a more stable decision making process could help states make the right strategic choices for their respective economies.