

POLICY ISSUES AFFECTING COMMUNITY
ECONOMIC DEVELOPMENT

by

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The American economy has been undergoing significant structural change and competitive pressure in recent decades. Some industries and regions have been affected more negatively than others, including the agriculture and manufacturing backbone of the rural regions. States are responding to this predicament with an array of economic development strategies, programs and initiatives.

What are the issues and choices facing state and local decision makers in developing the capacity of communities in rural regions to retain and generate employment? The paper will identify the five foundations upon which economic development is based and primary issues of state and local policy in relation to each. The focus is on nonmetropolitan communities, that multitude of cities and towns below 50,000 population scattered throughout rural America, and on the way state and local policy can influence their development.

Though more thoroughly documented elsewhere (for example, Henry Drabenstott and Gibson 1986, 1987; Krider and Houston 1986), the first section establishes basic dimensions of the serious rural employment problem and the global and technological forces which are buffeting rural economies. Second, the scope for nonmetropolitan economic development is asserted and broad strategic issues facing states and communities are identified. Third, five key foundations for economic growth are discussed which must be present for development and job creation to occur at the community level. Success, finally, will depend in part on how well states and communities develop partnerships to address these significant issues.

THE NATURE OF THE PROBLEM

Significant changes have occurred in the structure of the U.S. economy in recent decades. This is illustrated in Table 1, which shows the share of each industry sector in the economy for the period 1960 to 1984 as measured by income and employment. Employment in the farm sector declined consistently from 8.3 percent of total employment in 1960 to 3.2 percent in 1984. Manufacturing employment dropped from 25.5 to 18.5 percent between 1960 and 1984, while mining employment fell from 1.1 to 0.9 percent of total employment. Over the same period, services grew from 11.2 to 19.8 percent.

TABLE 1
U.S. Personal Income and Employment by Industry Type
% of Total

	1960	1970	1980	1984
<u>Personal Income</u>				
Farm	3.56%	2.26%	1.45%	1.31%
Manufacturing	24.51%	21.75%	19.09%	17.02%
Service	10.83%	12.28%	13.04%	14.51%
Government	11.64%	13.88%	12.17%	11.72%
Trade	14.61%	13.38%	12.14%	11.65%
Construction	4.96%	4.99%	4.38%	3.88%
Mining	1.15%	0.83%	1.32%	1.15%
Other	28.75%	30.63%	36.41%	38.75%
Total	100.00%	100.00%	100.00%	100.00%
<u>Employment</u>				
Farm	8.30%	4.40%	3.39%	3.16%
Manufacturing	25.54%	24.62%	20.43%	18.49%
Service	11.22%	14.68%	19.13%	19.77%
Government	12.66%	15.95%	16.36%	15.22%
Trade	17.32%	19.13%	20.45%	21.08%
Construction	4.45%	4.56%	4.38%	4.14%
Mining	1.08%	0.79%	1.03%	0.94%
Other	19.43%	15.87%	14.83%	17.20%
Total	100.00%	100.00%	100.00%	100.00%

SOURCE: U.S. Statistical Abstract, U.S. Census; State Personal Income (1929-82), Local Area Personal Income (1979-84), U.S. Bureau of Economic Analysis.

The impact of this significant structural change on the rural sector has continued unabated (Drabenstott, Henry and Gibson 1986, 1987):

- 1) Nonmetropolitan population growth remains lower, and in the 1980s rural outmigration quickened with nearly half the rural U.S. counties losing population between 1983 and 1985;
- 2) The ratio of nonmetropolitan to metropolitan county per capita income has fallen from 78 percent in 1973 to 75 percent in 1984;
- 3) The education gap between metropolitan and nonmetropolitan counties has also widened, particularly in relation to post-secondary schooling, as reflected in Table 2.

Table 2
Education Levels
(persons 25 years and over)

Years of School Completed	METRO % Completing	NONMETRO	% Difference
1980:			
12 years or more	68.9%	58.6%	10.3%
16 years or more	17.9%	10.9%	7.0%
1970:			
12 years or more	55.0%	44.8%	10.2%
16 years or more	11.8%	7.3%	4.5%
1960:			
12 years or more	43.5%	34.4%	9.1%
16 years or more	8.6%	5.3%	3.3%

SOURCE: State & Metropolitan Area Data Book 1979, 1986. U.S. Department of Commerce, Bureau of Census.

- 4) Unemployment is becoming a persistent problem for many rural regions. In the 1980s, rural unemployment has climbed well above the levels of the 1970s to surpass urban unemployment levels.

The declining manufacturing and agriculture sectors constitute the backbone of the nonmetropolitan economy, with manufacturing being the dominant component of the economic base.

Table 3

U.S. Nonmetropolitan Counties, 1984
Personal Income and Employment Data

	% of Total	
	Personal Income	Employment
Manufacturing	36.37%	39.47%
Trade	16.73%	16.54%
Government	12.73%	13.00%
Farm	11.72%	9.13%
Retirement	11.63%	10.84%
Mixed	5.74%	2.72%
Mining	2.68%	5.71%
Other	<u>2.40%</u>	<u>2.52%</u>
	100.00	100.00

SOURCE: "A Changing Rural America," Economic Review July/August 1986.
Federal Reserve Bank of Kansas City.

At the same time, service jobs were about 15 percent of total rural employment in 1984, compared with 22 percent of total urban employment, and from 1979 to 1984 had increased 24.1 percent in metropolitan and 18.0 percent in nonmetropolitan counties.

In summary, the nonmetropolitan economic structure is over-dependent on declining sectors, and significantly underrepresented in the growing service sector. Future job creation will depend on doing better within the existing configuration and at the same time achieving a greater share of the newly emerging economic structure of the future. This will only occur if state and local decision makers clearly understand and adapt to powerful forces underlying this structural change.

The United State economy is now buffeted by powerful competitive global forces that are beyond domestic control. Both agriculture and manufacturing are subject to international supply and demand conditions, with long-run survival and profitability becoming strongly dependent on efficiency and productivity growth.

This is also the era of the most rapid scientific and technological change in history, driving an economic transition from the industrial age to the information age. Competitiveness will depend on innovation and entrepreneurship. The most important point however, is that these global and technological forces are not temporary in nature, from which relief might ultimately be expected. Rather, they will if anything become more pervasive and dominant than they are now. The implications for the rural economic base are clear. Agriculture will continue to decline in significance unless it becomes more efficient through improved production methods based on new science and technology applications, and unless new products and new uses for agricultural goods suitable to the changing markets of the future can be developed. Inputs to agriculture have changed dramatically since 1957, as illustrated in Table 4, and these changes must be accelerated in the future.

Table 4
Indexes of Farm Input Subgroups, Northern Plains Region, 1950-85
(1977=100)

Year	Farm Labor	Mechanical Power and Machine	Agricultural Chemicals
1957	191	88	9
1967	127	84	51
1977	100	100	100
1985	81	81	127

SOURCE: U.S. Department of Agriculture. Economic Indicators of the Farms Sector Productivity & Efficiency Statistics. 1985.

The manufacturing mix today is changing dramatically from "old style", traditional mass production to a "new style" innovative, human-capital intensive production.

We have, in essence, gone to our strength: innovation. We are making more and more of the kinds of things that require high levels of innovation - such as instrumentation and fabricated metal products - and have relinquished to others the production of

items that have not changed a great deal in the past 20 years: automobiles, television sets, shoes, clothing, and paper...The whole point of the process is to substitute brains for brawn...We will produce different products in different ways with an increasingly skilled labor force (Birch 1987).

Rural manufacturing is over-represented in the "old style" form of production. It tends to be low wage, low skill, and repetitive in process, creating a standardized product. Plant closings and displaced workers have resulted directly from loss of competitiveness and inability to make the transition to new products and processes. Job creation in nonmetropolitan communities will depend on the suitability of those localities to education intensive, smaller scale, product manufacturing based on entrepreneurship and innovation and requiring an adaptive work force and flexible work processes.

Key emerging elements of the service sector that are part of the wealth creating economic base include export services and business services, and these have tended to prosper in the metropolitan areas where opportunities are greater (Howe 1986). Yet some rural regions may be able to compete for these subsectors.

THE SCOPE FOR JOB CREATION

What then is the scope for nonmetropolitan economic development to occur? Basically, it is only realistic to recognize that the potential is limited. Certainly it varies across communities. Development efforts will only be successful if they are based upon the economic principle of comparative advantage, that is building upon existing and potential strengths and advantages. For nonmetropolitan communities heavily dependent on the traditional sectors of agriculture and "old style" manufacturing,

survival and growth will depend on the development of new processes and the evolution of new products in 'old' industries and on the emergence of new industries, some related to the traditional sectors and serving it, and some that will benefit competitively from a rural location. The service sector will create the most jobs nationally, and it will be a major challenge for rural America to get its share. In agriculture and manufacturing the challenge will be to generate enough new jobs to replace those lost.

The basic question is not whether to retain existing industry in its present form or to abandon the existing economic structure for an artificial new one. Rather, the thrust is to foster the evolution of the new from the fundamental strengths of the old. While the outcome of economic development is the growth of jobs, output and income, the dynamics of development is constant adaptation in the face of a changing economic environment. The harsh reality of the world economic order is that those industries which develop and apply new knowledge and techniques the most rapidly and the most efficiently will be the ones with the competitive edge. It is these industries that will create jobs.

The role of the state and local government is limited, but nevertheless it is vital. The state does not have the capacity or power to conduct a comprehensive industrial policy that makes broad, strategic allocation decisions affecting all aspects of economic development throughout its jurisdiction. Nor does the state have control over commodity markets, tariffs, capital markets, or the money supply. State and local government also have limited scope to be an active partner in business activity in light of the prevailing philosophy of free enterprise and the traditional perception of the function of government in our society. However, state and

local government together have the capacity to establish the preconditions and environment for economic development to occur. This involves:

- establishing an optimum foundation for development (e.g., physical infrastructure, public education);
- fostering productive linkages and interrelationships (e.g., private sector-governmental cooperation, university-business joint research);
- cultivating a favorable business climate and environment (e.g., tax structure);
- removing barriers and obstacles to entrepreneurship and innovation (e.g., regulatory impact on small business); and
- leveraging resource development through strategic investment (e.g., seed capital, customized training).

This focus on enhancing the multiple underpinnings of development stems from the basic premise that rural economies are undergoing structural change and are being altered by powerful international forces and technological change. These forces are beyond state and community control, and are not amenable to a quick fix strategy, as exemplified by the tax breaks approach that some states and communities have pursued. Rather, the task is to adapt to and build upon these changes and imperatives to forge new economic opportunity out of the old. The approach is pragmatic and long term.

THE FOUNDATIONS FOR ECONOMIC GROWTH

Developing this capacity to underpin economic growth is akin to an investment in capital stock in the sense that both are designed to achieve long-term pay-offs. The state and local role therefore can be couched in terms of an investment in the following foundations of economic growth:

- Infrastructure capital
- Innovation capital
- Commitment capital
- Financial capital
- Human capital

All five foundations must be present for development to occur, and the degree of success will depend largely on how well they are combined.

One of the keys to successful economic development is the fostering of synergy among factors: for example, entrepreneurs, venture capital, good universities, high tech businesses, skilled workers, effective training programs, and physical infrastructure. These factors do not operate in isolation of one another; they need to work together in combination with each other, "on the ground" in some specific location. One of the tasks of state strategy is to assure not only that such factors are present in the state, but that they are present in the same location and are working together (Fosler 1987).

Infrastructure Capital

Infrastructure capital refers to the physical infrastructure that supports economic activity including local roads and linkage highways, airports, waste disposal, water resources, and sewers. Fundamental issues facing the state in this regard include

- (1) the relative importance to be accorded physical infrastructure needs vis-a-vis other economic development initiatives, given the trend of diminishing capital expenditures nationwide;
- (2) the adequacy of capital expenditures based on the pay-as-we-go principle rather than debt financing to meet existing as well as future needs; and
- (3) the scope to re-orient capital expenditures from serving the past to leveraging the future (Flentje, 1986).

Major issues affecting nonmetropolitan areas of a state include the urban-rural distribution of highway maintenance and construction funding, the extent to which the state highway network relates to economic potential, the availability of highway pool funds to create or respond to economic opportunity at the community level, and special state support for industrial parks, business incubators, and other community development initiatives. Local government faces similar issues, including the extent to which resources should be diverted to support new development rather than to meet

existing needs, and the extent to which local tax funds need to be committed to leverage private development.

Infrastructure capital has other important dimensions. For example, the quality of life depends on social and cultural infrastructure in a community and region, and an important question could be the extent of state support for the arts and recreation to complement community initiatives. Similarly the public education and post-secondary systems are key elements of state and local infrastructure in that they develop human capital. Finally, for further illustration, the governmental structure in a state at all levels can have a profound influence on the availability and effectiveness of public services and the business environment.

Innovation Capital

Innovation, based on science and technology, underpins competitiveness and new business development. Innovation capital relates to state and local investment in basic and applied research and development; in technology transfer; in post-secondary and higher education business linkages, research parks and incubators; in fostering a technological climate, and an entrepreneurial and risk taking environment; and in mechanisms to foster state-of-the-art business practices. Major issues here include state aspirations for quality in higher education, level of state support for pockets of research excellence and for university-business research cooperation, and the establishment of mechanisms for industry liaison and technology transfer within the state.

Special problems that innovation capital must address include the dispersion of economic activity throughout a state and its relationship to

the location of the limited number of post-secondary institutions capable of supporting innovation and business competitiveness. Innovation capital may resolve some of the difficulties inherent in small business entrepreneurship, the backbone of rural development. How can local communities cultivate an entrepreneurial climate in an environment of decline and concern for economic survival? How do small businesses gain access to needed resources, develop the technical capacity required, and be motivated to take risk, so that they can build upon new technological developments and new ideas? To what extent (financial and technical assistance), and in what ways (incubator development, loan guarantee, seed capital, abatements, export assistance), can the state and community support small business development cost-effectively?

Commitment Capital

Commitment capital refers to the resources, leadership, time and effort that must be devoted to establishing productive linkages, to interrelations and partnerships at the state and community levels, and to the development of a climate for growth. Ultimately, economic development in a state will depend largely, though by no means exclusively, on local community efforts, and the key question for the state is how to nourish, but not direct, these activities. Important questions for state officials include whether to force community planning and regional cooperation, whether to encourage it through rewards or support it only if and when it evolves. What mechanisms are needed to foster productive interaction between the private sector and the universities and community colleges, business and government, and state and local governments? How can broader input into economic development policy

formation from those sectors be encouraged? How and to what extent can the state effectively involve itself in local development efforts? And finally, how can economic development be structured as an ongoing dynamic process rather than as an end in and of itself?

What is the role of local government in fostering and participating in community efforts to promote development? Is it a leadership role or a response and support role? In what areas and to what extent can the involvement be enhancing, and under what conditions does it become stultifying? What is the optimum approach to community strategic planning for economic development, and what is the appropriate mix of resource commitment by the various groups in the community? How do communities determine the cost-effectiveness of alternative strategies, like business attraction or retention, tax incentives or foundation development?

Financial Capital

A fundamental barrier to nonmetropolitan economic development is the lack of financial capital at an appropriate risk-return relationship. There is the problem of availability and accessibility, and the intensity varies with type of capital and geography. The forms of capital needed at different stages of the life cycle of a business enterprise include research, seed, venture, development, working and expansion capital. Only working capital is pervasive in nonmetropolitan areas, although some venture capital may also be accessible through informal local networks. Economic development and job creation will not flourish in rural regions unless different forms of finance are available to support innovation, entrepreneurship, startup and maturity.

A myriad of questions arise with respect to potential state involvement in financial markets for development purposes. Basically, should state and local government be involved, and if so where can the impact be greatest? What form should it take: direct, such as providing seed capital to support the development of new products through incubator facilities, or indirect, through tax credits for research and development expenditure or for seed and venture capital fund development? Should existing financial structures be modified (e.g., state banking systems) to better serve development needs? And given the general sparsity of financial capital in rural relative to urban areas, are additional measures needed to mitigate this imbalance?

Human Capital

Human capital is important to economic development in its own right. It is also integral to a comprehensive strategy based on a synergism of the above foundations, and is central to success. It is the foundation for growth that state and local government can influence the most; it is also the dimension that is most resistant to change.

Roger Vaughn (1985) makes two key observations concerning human capital:

The major source of growth in all states is the rate of improvement in the education and skills of the work force...What states do about education and training must be a central part of their economic development strategy...At a time when the importance of human capital is growing, for many, opportunities to acquire it are diminishing.....(Further) by the end of the century, the one occupation career may be history. The rapid pace of technological advance...threatens almost every skill and occupation with obsolescence.

Future jobs in rural America will stem from new style manufacturing and small business entrepreneurship in both manufacturing and services. This has

important implications for rural labor demand. First, a better educated work force will be necessary to handle the level of technology and to adapt to its rate of change. Second, global and domestic competitive pressures will require an innovative and entrepreneurial business development and work environment to ensure survival. Third, the change in work processes from repetitive, single product, assembly line to job batch, custom order type production will demand an adaptive, flexible and multi-skilled labor force. And finally, smaller scale production modes arising from and in conjunction with these forces will necessitate more flexible and team-oriented work place arrangements and new forms of employer-employee relationships.

This changing nature of labor demand has profound implications for labor supply. The rural work force is less educated than its urban counterpart and significantly so in many states. Existing manufacturing in rural America has tended to be predominantly low wage, low skill in nature and hence subject to less employer provided training than more sophisticated urban plants. Further it is often less technological and more labor intensive in its production method. Lastly it uses an older work force, likely to be inherently less adaptable, innovative and flexible.

Thus, in an era of rapid technological and competitive change, the rural labor force is less educated, less trained, less technological, and less adaptable. Some offset to these negatives is provided by its strong work ethic and resulting productivity. However in the long run this qualitative gap between the needs of industry and the human capital foundation of the rural work force will widen significantly, further exacerbating current rural job creation trends, unless it is remedied.

However, there are significant problems in modifying labor supply patterns. First, focus that affect human capital are spread across the fields of education, employment, welfare and training, with multiple and independent institutions, mechanisms and philosophies. They are fragmented across federal, state and local jurisdictions, and the public and private sectors.

Second, the quality of formal education in many rural areas has been influenced by diminishing resources as county tax bases erode and state budgets in many instances are unable to offset the decline because of struggling state economies.

Third, vocational education remains a stepchild in the world of learning in terms of resources and tends to educate each student for a specific lifetime vocation rather than for the multi-skilled nature of today's and tomorrow's jobs.

Fourth, the scale of federal programs like JTPA has been too limited to have any significant impact on facilitating the transition of the overall work force through this period of structural change, and their focus has been on short duration, single skill training rather than more enduring, meaningful skill enhancement.

Finally, particular work force groups have been overlooked. Considerable underemployment and hidden unemployment exists among rural women. And the federal/state effort with respect to dislocated workers is modest in scale and reactive in nature, lacking any concept of the inevitability of dislocation and the notion of anticipation in dealing with it.

The fundamental question facing all states is how to convert a piecemeal, fragmented and reactive system into a comprehensive, purposeful and effective strategy embracing elements of re-education, re-training, re-employment, and re-institutionalized delivery. Within this broad framework, serious policy dilemmas face state and local policy-makers in establishing an optimum human capital basis for nonmetropolitan job creation. Some of the more pertinent questions include the following:

- (1) How do we refocus the mission of education institutions in general and professional/technical/vocational units in particular to the changing nature of occupational demand?
- (2) How do we instill a "lifelong learning" orientation in workers and firms and provide the education opportunities to underpin that concept?
- (3) What fundamental changes does a refocussed mission and concept of lifelong learning mandate for current programs of study and curricula? What special measures are necessary to generate adaptation and response to change in rural community-oriented institutions?
- (4) Should rural institution programs be determined predominantly by local needs and potential or by a broader geographic concept of work opportunity? Can our multifaceted educational institutions be linked to serve a broader regional and state market without detriment to the local base?
- (5) How can the local linkage between business and vocation/technical institutions be developed? What roles and mechanisms can be developed for joint effort not only to enhance traditional programs for youth, but also to support continual upgrading and retraining of the aging rural work force?
- (6) What is the role of nonmetropolitan educational institutions in the supporting innovation and entrepreneurship in their communities and regions? If appropriate, does the capacity exist to support business development directly through, for example, incubators and technology transfer? Can this function be reconciled with the primary educational mission of such institutions?

CONCLUSION

The small to medium-sized communities in nonmetropolitan America face long-term economic decline because of the powerful global and technological forces that are affecting their traditional economies. Survival and growth will depend on the ability of these rural centers to establish the favorable conditions and capacity for development to occur. The dynamics of development will be constant adaptation of the old into the new in the face of never ending change in the economic environment. This capacity for change will depend partly on community action and partly on state policy decisions. The synergism of it all must be at the local level.

The scope for nonmetropolitan economic development does exist. It will depend on how well the communities and the state invest in the appropriate foundations for growth, namely infrastructure, commitment, innovation, finance, and human capital. All are important, all are necessary, all present major policy dilemmas, with human resource development possibly constituting the greatest challenge.

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