National Governors Association

Issue Brief

Redesigning State Economic Development Agencies

Policies to boost innovation, competitiveness and job creation are top priorities for the nation's governors. State economic development agencies play a large role in making and putting in place those policies and, accordingly, how states are rebounding from the recession that ended in 2009. State leaders seeking to lay the foundation for renewed economic prosperity should try to ensure that such agencies function as effectively and efficiently as possible, so that the economic recovery brings with it strong growth and high-paying jobs.

The fact that states are now facing daunting economic challenges makes it easier to muster broad support for transforming their economic development agencies. Governors have a unique opportunity to review the economic landscape and to propose critical changes that previously would not have been feasible. Within the past two years, at least 12 states have created new entities for economic development or have consolidated existing agencies to streamline their approach to economic development.

Introduction

State commerce departments were not designed for current economic realities where U.S. businesses and workers face rapid changes in technologies and markets as well as new competitors from around the world. Traditionally, state economic development agencies focused on attracting investments by larger firms and often competed with one another in offering incentive packages. In recent years and particularly before the recent recession, however, it has been newer firms that have accounted for the majority of economic growth and new jobs. According to the Kauffman Foundation, new firms added an average of 3 million new jobs per year between 2000 and 2007. Following the recent recession the number of jobs created by startups fell to fewer than 2.5 million annually by 2010.[1] Generating new jobs from the fast growing firms that created jobs in the 2000s will be key to restoring employment to the levels recorded before the recession.

A new understanding of how young and fast-growing businesses fuel economic growth has led state economic development agencies to focus on fostering a pro-business environment rather than ad hoc deal making. A state with a tax system favorable to investment, predictable regulation, a good education system, skilled workers, modern infrastructure, and adequate access to capital is more likely to attract investment and cultivate entrepreneurship than a state that offers a raft of specific programs and incentives.[2]

Challenges Facing States

The creation of effective and efficient state economic development agencies is no easy task. Governors and policymakers eyeing the opportunities for economic development reform should be cognizant of three considerable challenges:

- **Rise of global competition**. Businesses from China, India, Singapore, and Eastern Europe have established themselves as competitors in the global economy. Those rising global competitors will test the sophistication of state economic development strategies and agencies as never before. In a globalized economy, state efforts to support businesses that create high-wage jobs are essential. The links between innovation and growth suggest that strategic support for key innovation-based industries helps create the environment for quality job creation. The provision of strategic support for innovation-based industries—and the well-paying jobs they bring—requires going beyond the traditional state commerce department's practice of marketing a state and using tax credits to close business investment deals. Other key levers of strategic support for innovation-based industries include support for research and development (R&D), the ability to provide a skilled workforce, linkages to robust regional industry clusters, and a proven technology development and transfer system—all things that lie outside the purview of economic development agencies in traditional state commerce departments.

- **Structural inefficiencies in state economic development agencies**. According to business leaders and others, some of the most common difficulties associated with the traditional model of economic development in state commerce departments are cumbersome agency designs that constrain flexibility and responsiveness; agency leaders and staff who lack sufficient professional experience with economic development and an inability to connect businesses to key support systems such as sector-based workforce training, R&D infrastructure, and early-stage business development assistance.

- **The state fiscal crunch**. The slow economic recovery is likely to leave economic development leaders in the United States working with extremely constrained budgets for some years. Funding for economic development support will have to compete with other state priorities, such as growing Medicaid costs. New global players have emerged, often granting government a larger role in supporting industry through government investments and tax credits than the U.S. does. States will find matching those investments difficult, so they will have to do a better job of linking businesses to needed supports such as training, education, and early-stage financial support.

This issue brief focuses on what states are doing—and can do—to redesign their economic development agencies so that they are more effective.

Strategies for Creating Successful Economic Development Agencies

The NGA Center for Best Practices' review of current practices and conversations with business leaders and government officials reveals that there are three foundational strategies that can greatly increase the effectiveness of economic development agencies:

- **Engage and sustain private sector involvement.** Engaging local businesses through the use of public-private development boards and other cooperative endeavors can bring useful expertise and perspective to the development process. In **Oregon**, for example, the private sector has become a central actor in the economic development process through an independent organization called the Oregon Business Council (OBC) that is run entirely by a collective of supporting businesses.

- **Create mechanisms to encourage collaboration.** Collaboration among businesses, academic institutions, and government agencies is one of the most important characteristics of effective economic development infrastructures. **North Carolina** spurs collaboration through a 37-member economic development board made up of representatives from government agencies, nonprofit organizations, private businesses, and the state legislature. Collaboration between states and regions is becoming increasingly important, as well. **Colorado**, **New York**, and **Tennessee** have all recently completed regional plans that have been rolled up into a statewide economic development plan.

- **Institute a quantitative evaluation system.** Economic development agencies that use metrics for evaluation such as return on investment and job creation have the statistical information they need to target areas for focused policy and to ensure that state funds are being channeled to the most productive uses possible. **Maine**, **Massachusetts**, **Mississippi**, and **Oregon** benchmark specific indicators related to the innovation economy and the contribution of those indicators to state economic growth.

Note: For a more detailed discussion of actions that states can take to redesign economic development, please see the NGA white paper Redesigning State Economic Development Agencies.

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Endnotes

1. E.J. Reedy and Robert E. Litan. "Starting Smaller, Staying Smaller: America's Slow Leak in Job Creation." Ewing Marion Kauffman Foundation, Kansas City, MO, July 2011 [online] [cited 25 July 2012]. Available at: <http://www.kauffman.org/uploadedfiles/job_leaks_starting_smaller_study.pdf>.

2. Dane Stangler, "High-Growth Firms and the Future of the American Economy," Ewing Marion Kauffman Foundation, Kansas City, MO, March 2010 [online] [cited 24 March 2011]. Available at: <http://www.kauffman.org/uploadedfiles/high-growth-firms-study.pdf>.