

## WHY IS TARGETED REGIONAL ECONOMIC DEVELOPMENT IMPORTANT IN TODAY'S POLICY SETTING?

Mark Drabenstott  
Director and Research Professor  
RUPRI Center for Regional Competitiveness  
University of Missouri-Columbia

Federal economic development policy in the United States is just awakening to the importance of focusing on *regional* development and the twin need to *target* public investments to those public goods that most advantage the region. For most of the past century, U.S. federal policy has been focused on industrial development at the community or county level. This resulted in economic development policy that was generally “one-size-fits-all” in character. It also meant that federal policy largely aided and abetted an industrial recruitment, or smokestack-chasing, approach at the local level.

The tide is beginning to shift, but slowly. The Economic Development Administration has been actively promoting a regional competitiveness approach to its programs. It also sponsored the Strengthening America's Communities Initiative, which convened the first federal panel on economic development policy in more than 40 years (Department of Commerce 2005). The U.S. Department of Labor has undertaken the Workforce Innovation Regional Economic Development (WIRED) Program over the past two years. This innovative program has launched more than a score of multi-year, multi-county economic development efforts around the nation. Shifts such as these illuminate the leading edge of policy innovation, but fail to show how much progress remains.

A comprehensive review conducted in 2005 shows that federal economic development policy remains a sprawling enterprise in Washington with little coordination or common purpose (Drabenstott 2005). By one estimate, there are 180 programs scattered across nine federal

departments and five independent federal agencies—all with the goal of regional economic development. This daunting array of programs has sprung up over more than five decades with little attempt to create a coherent development policy.

The good news is that in the United States, and elsewhere, the need for policy reform is gaining real traction—in regions and in federal capitals. For example, the Organization for Economic Cooperation and Development's Territorial Development Policy Committee has become a valued forum for the 30 member OECD countries because regional policy has risen sharply in priority in many federal capitals (OECD, 2003). In the United States, development stakeholders such as the National Association of Counties and the National Association of Development Organizations have voiced growing interest in a better approach to development policy.

This chapter concludes that U.S. economic development policy is likely to move further in the direction of a targeted, regional framework. It begins with a brief review of regional economic trends that serve as backdrop to the policy dialogue. It then reviews how the shift to regional, targeted development is supported by recent shifts in the economics literature. It concludes with a discussion of where regional development policy is likely to go in the period ahead.

## **RECENT TRENDS IN REGIONAL ECONOMIC GROWTH**

Globalization has dramatically redrawn the economic landscape. The biggest impact has been to delineate sharp differences in economic performance along regional lines. In many cases, these lines fall not along traditionally political boundaries, but rather along the more

practical lines drawn by functional economic regions. These arise due to commuter-sheds, shopping patterns, or unique cultural or topographical features.

One sign of the regional character of globalization is the growing recognition that the variation in regional economic performance is now much wider than the variation across nations. Recent analysis shows, for instance, that job growth in 27 OECD countries ranged from a low of -2.2 percent a year (Poland) to a high of 4.0 percent a year (Spain) (Figure 1). The range across regions was much wider, however, in nearly all countries. In the United States, for example, the range was 10 percentage points (-4.0 percent to 6.0 percent) (Figure 2).

What is more, regions are increasingly becoming the drivers of national economic performance, not the other way around. The same OECD report also shows that more than half of all new jobs in OECD countries were created in just 10 percent of regions (Figure 3). In the United States, the percentage is fully 67 percent. This means that policies that shape growth at the regional level have big implications for the national economy.

Rural regions appear to be particularly disadvantaged in the globalizing economy, underscoring the need to create fresh new approaches to rural development. Rural regions lack critical mass and often have limited access to the innovation that is transforming many cities throughout the nation. As but one indicator of these twin challenges, rural areas have captured a relatively small portion of overall growth in the U.S. economy over the past decade. A significant number of rural areas rank among the top ten percent tier of counties when the ranking reflects simple rates of growth (Figure 4). But in many ways, this is simply a reflection of the small employment base in many rural areas. When the top ten percent are defined in terms of total number of jobs created, only 5 rural counties stay in the top tier. This suggests that

current development strategies, frequently focused on business recruiting, simply do not work, especially when a region lacks critical mass, as most rural counties demonstrably fail to muster.

### **THE SHIFT TO TARGETED REGIONAL DEVELOPMENT POLICY<sup>1</sup>**

The shift to targeted regional development has been a long journey, shaped by a steady evolution in economic thinking. That said, the movement to thinking about development in a *regional* framework (as opposed to community focus) and with a goal of building a region's *competitive advantage* has gathered significant momentum over the past decade. In many respects, the shifts in policy have been larger and swifter in other parts of the world than the United States, but that appears to be changing more recently, especially with new policy directions at the Economic Development Administration and with the Department of Labor's WIRED program.

Economists have discovered a whole new set of strategies that offer the greatest potential in helping regions compete in the global marketplace. These new strategies focus more on the region at hand. In particular, they aim to help entrepreneurs and skilled workers build on their strengths, innovate, and seize new market opportunities. Such an approach is strikingly at odds with past strategies that were aimed mostly at recruiting industrial facilities to a region. Under the old strategy, regional development was often a zero-sum game—one region's gain was another's loss. As a result, some analysts have styled the traditional economic development strategy as an ongoing "economic war among the states" (Burstein and Rolnick 1995).

Economists have been wrestling with economic development for a long time. It remains an ongoing field of discovery, constantly shaped by innovations in markets, technology, and human behavior. While many important questions are still being investigated, consensus is

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<sup>1</sup> This section draws on author's work originally presented in Drabenstott (2005) and Drabenstott (2006).

emerging that regional economic development is now driven by principles quite different from the ones that guided practitioners in the 20<sup>th</sup> century.

### **Three eras of economic development & policy**

Over the past half century, economic development thinking has passed through three eras (Table 1). These three eras have corresponded with very different approaches to economic development policy and practice. While the eras often overlap, the third era of economic thinking has not yet been matched by a commensurate shift in economic development policy.

*Industrial recruiting*, often called smokestack chasing, prevailed from the 1950's through the early 1980's. The goal was to do whatever it took to lure a factory to town. This strategy grew out of the economic theory of export base, first put forward by North in the 1950's (North 1955). This theory essentially looked at economic development from a demand point of view and posited that money must flow into a region for it to grow. The only way to get more money was to export more. Industrial recruitment and industrial parks were standard strategies to build a region's export base in much of the postwar period. State and local governments created a whole plethora of subsidies, tax breaks, and other financial incentives to lure companies, often industrial firms, to a particular city or place. These incentives took full advantage of large, well-funded federal programs that helped keep local recruiting war chests full.

The raft of recruiting practices has lingered into the 21<sup>st</sup> century, but the theory has moved on. Indeed, much of the recent economic development literature is devoted to critiquing industrial targeting (Bartik 2005). One researcher concludes that industrial recruiting "is based on poor data, unsound social science methods, faulty economic reasoning, and is largely a political activity" (Buss 1994).

*Cost competition* was ushered in by the onset of deregulation in the early 1980's. Deregulation was a driving force, as policy officials explored ways to drive down the cost of doing business. In many respects, active government involvement in development devolved to states and localities. This "New Federalism" was a critical turning point in economic development and led development practitioners to engage more private sector players in development strategies (Kossy 1996).

Widespread embracing of the cost competition framework pushed industry consolidation and cost-cutting to the forefront as strategies for regional growth. The health of a region's industries was a critical determinant of economic gains. For instance, the Rust Belt, with a concentration of aging industrial plants, struggled in the 1980's as consolidation swept through autos, steel, and other industries. The Sun Belt, on the other hand, prospered with the emergence of high technology and service industries.

Cutting costs was a worthy goal, but increasingly integrated global markets for goods and services raised fresh doubts about its efficacy as a development strategy. Regions quickly discovered that cost advantages can be fleeting in a global market. Huge threats to Detroit's hegemony in autos and Pittsburgh's in steel served as stark reminders that economic development cannot simply be a race to the low-cost bottom. Driving down costs is no guarantee of economic gains when elsewhere in the world costs are dropping even faster.

*Regional competitiveness* emerged as a new development framework in the early 1990's. Economists then began to realize that regional economies must constantly create new value in global markets by exploiting their indigenous strengths. Many experts now refer to this complex process as *regional competitiveness*. The process is fueled by innovation—an ability to invent ideas and bases of knowledge that can open up new economic vistas. In the same way that

automobiles displaced buggy whips, so regions now explore whether fields of pharmaceutical crops can displace commodity corn.

If innovation is the fuel in the process, then entrepreneurs are the engines—turning ideas and knowledge into jobs, income, and wealth. Whereas past development strategies often aimed at big firms, small entrepreneurial companies are the pack mules for economic development in the 21<sup>st</sup> century.

The importance of innovation in economic growth is not a new idea. Joseph Schumpeter talked about “creative destruction” nearly a century ago. Over the past decade or so, though, globalization has brought new attention to his concept that vibrant economies are constantly churning, with some firms dying and others being born. Under this view, the key to growth is turning a steady stream of new ideas into successful products in the marketplace.

The regional competitiveness framework has developed in three distinct strands of economic research. Some economists are focusing on the importance of clusters, suggesting that a concentration of similar firms creates synergies that can fuel growth (Porter 1990; 1996; 1998). Others describe a new economic geography, in which local amenities are critical determinants in creating a pool of skills and capital that can spawn new ideas and businesses to grow a region’s economy (Krugman 1991). Still others focus more on entrepreneurs and innovation, arguing that fresh technologies and the right climate can lead to a rich seedbed of businesses, spurring economic gains (Acs and Armington 2004). While each strand has merit in its own right, together they form a strong consensus that regional competitiveness is becoming the accepted model for regional economic growth.

Economic development strategy shifts dramatically when regional competitiveness is the goal. The very root of competitiveness is a region understanding its inherent economic

strengths—and the markets available to exploit them. Accordingly, development strategy is moving away from industrial recruitment and being a low-cost competitor to strategies that help regions identify and exploit their distinct assets—things like human capital and scenic amenities.

The most recent era has been remarkable in that regional strategies are increasingly being shaped by scholarly research. This shift is occurring in part because development practitioners, confronted daily by tectonic shifts in the global economy, are seeking new answers to pressing challenges. But it is also true that economic research is developing frameworks that can more naturally address the often conflicting development choices regions must make. While this emerging synergy between theory and practice is encouraging, it is still more evident in local strategy than in national policy.

### **Taking stock of where we are**

In every era, the goal for economic development is the same—a prosperity that lifts the economic and social well-being of the residents in the place in question. While that goal has not changed, the three eras of development thinking highlight vastly different assets and strategies. In the first two stages, the focus was largely *external*—rooted in the belief that forces beyond the region were the drivers of development. By contrast, the current era puts the focus on the *region itself*, recognizing that regions can develop only by exploiting their distinct economic assets, seizing unique opportunities in rapidly shifting markets, and fostering the entrepreneurs that make both happen at once.

Another critical distinction between today and the earlier eras is that economic development is no longer a matter of one economic development strategy applied to all regions—what some might call a “one-size-fits-all” approach. Industrial recruitment was universal. Indeed, the remnants of this strategy still run far and wide. Competing on cost was a

similarly far-flung approach. Regional competitiveness, by contrast, is highly idiosyncratic. Every region has a different set of economic assets, a unique capacity to innovate, its own crop of entrepreneurs, and its own opportunities in global markets. While some might argue it has ever been thus, the fact remains that the unrelenting pace of globalization now forces every region to reinvent its economic engine. In short, this demands a regional scope and a targeted approach.

## **THE FUTURE FOR REGIONAL POLICY**

In light of how economic thinking and development policy has shifted, where is U.S. regional policy headed? The answer, of course, depends on the *political* economy. This will be shaped by coming elections, a constellation of forces at the state and local level, and the number of champions that emerge to encourage additional shifts. In every country that thus far has charted bold new directions for targeted regional development, social “entrepreneurs” have been critical to its design and implementation. Italy’s Mezzogiorno policy, for example, was implemented only with the urging of the prime minister (Barca 2003).

While the *who* and *when* of future shifts in regional policy in the United States are not entirely clear, the *what* is much more evident. There is a growing consensus among experts, practitioners, and public officials on what regions need to prosper. These needs provide a useful road map for thinking about where regional policy is likely to go in the period ahead.

Regions need four essential ingredients to be gain competitive advantage in the global economy: strategy, governance, innovation, and entrepreneurship. These four form a self-reinforcing system aimed at producing a region’s prosperity (Figure 6). The strategy serves to identify the region’s distinct competitive advantage and align public and private actions

necessary to seize it. The governance supplies a framework to unite public, private, and nonprofit leaders as a collective guide and owner of the strategy. The innovation element links the region with new ideas and technologies that can transform the region's economic assets. And the entrepreneurship element provides a fertile climate in which new ideas can be taken successful to the marketplace.

### **Regional Strategy**

With regional competitiveness as the overall frame for economic development today, a regional strategy is the cornerstone for sound public policy and effective local action. Unfortunately, asset-based competitive advantage strategies remain relatively scarce throughout the nation, although that appears to be changing. The WIRED program clearly sets a threshold for the crafting of such strategies. The EDA has added grant incentives that reward regions for developing a comprehensive economic development strategy (CEDS). Still, robust strategies are more exception than norm. The prevailing strategy of business recruitment remains the status quo in too many areas of the nation.

Regions face two main challenges in crafting a strategy. The first is the general lack of skills and tools to identify their competitive advantage. In many cases, regional leaders have only mounted business recruitment campaigns. Mapping assets and identifying competitive advantage is a much more complex task. Thus, an important starting point is boosting the capacity of regional leaders to undertake the task in the first place. While this has been a component of regional policy initiatives in other countries (Italy and England), it is rarely part of regional initiatives in the United States. As one sign of change, though, early discussion of the next farm bill indicates that some groups are pushing to include this as a core piece of the next rural development title.

The second is a paucity of tools that provide analytical insights into a region's competitive advantage. Cluster analysis is the principal tool today. While it provides helpful insights, it also has blind spots. For instance, the WIRED region in Western Alabama/Eastern Mississippi conducted extensive cluster analysis as part of crafting its regional development plan. That analysis showed a large paper and pulp industry cluster. That cluster is founded on the region's extensive pine forest. But paper and pulp is only one potential use of that forest resource. Its value for outdoor recreation might exceed that of paper. Cluster analysis, though, only sees the existing use, not other promising uses.

To develop a better composite analysis of competitive advantage, the RUPRI Center for Regional Competitiveness is combining cluster analysis with spatial benchmarking, sector and demographic trend analysis, and economic linkage analysis. Such a composite approach attempts to combine the "best of all worlds" and also use one technique to make the other tools more robust.

Once a region has a strategy, the analysis is not done. The region must still prioritize its public investments in light of that strategy. That is, which public goods will most advantage the region's strategy? Today, few tools are available to conduct such investment analysis. User friendly tools that compare returns in light of the region's strategy are badly needed.

Notwithstanding recent efforts by policy officials and local practitioners, regions still need better tools to see the most promising economic directions. Future innovations in regional policy, therefore, will likely have a common starting point—improving both the skills sets and the tools that regional leaders must have to craft sound regional development strategies.

### **Regional governance**

Designing a regional strategy can only happen when there is an engaged group of stakeholders to own and drive the strategy. Experts increasingly refer to this leadership group as “regional governance” (OECD 2005; 2006). Much remains to be learned about forming effective regional governance. Experience to date, however, suggests that it is the result of a catalyst “convening” organization and broad engagement of leaders from public, private, and nonprofit sectors (Sertich 2007).

A critical outcome of regional governance is aligning initiative across these various sectors. Crafting and implementing a regional strategy places many demands on a region. Not only must the region simultaneously map its distinct assets and understand the markets it can exploit, but it must also align public investments with those by the private and nonprofit (often philanthropic) sectors. This alignment of investments across widely divergent stakeholders necessarily requires some roundtable where those interests combine with the long-term success of the region as a common benchmark.

While more and more regions understand the importance of regional governance, they often do not know how to build it. The problem is often twofold. The first problem is the lack of a trusted organization to play “King Arthur” and provide the roundtable, or safe space, for region-wide discussions to occur. This appears to be a particularly difficult problem in many rural regions.

One solution is to consider how public policy might provide incentives for organizations to become “King Arthur”. Other countries, including Mexico and Italy, have provided federal incentives for communities to come together as a region. This approach appears to have had positive results overall (OECD 2007; Barca 2003).

The second problem is that many regions have weak social networks. Analysts are just now beginning to adapt network theory to the issue of regional governance. This theory is a valuable framework for thinking about how work gets done in organizations (Cross and Parker 2004). The same concepts may be extremely helpful in developing practical hands on ways to spur the formation of regional governance that can be sustained. With that in mind, new public programs may be conceived with an eye toward developing user friendly practices and guidelines to forge regional governance where it does not naturally emerge. In a sense, the WIRED program is a clear step in that direction.

### **Regional innovation**

Experts and policy officials both agree that most regions need to shift further and faster to knowledge-based economic engines. This is especially true for rural regions, still heavily reliant on the production of commodities. The problem for many regions is that they often lack connections to the sources of innovation, often universities, and they also lack the capacity to implement them once found. Public policy, therefore, will likely be exploring new mechanisms to create better links with universities and new practices to boost innovation capacity.

Ever since the creation of the land grant university in the 1860's, taxpayers have made significant investments in public research, with the view that such investments pay economic dividends, particularly in the state where the university is located. Over time, as funding streams have become more national in scope and as state share of funding has declined, the links between university research and economic impact have become correspondingly more diffuse. As but one big example, the web browser was discovered at the University of Illinois-Champaign Urbana, but the commercial impact (Netscape) happened in the Bay area of California.

In light of these trends, public policy may explore new mechanisms that would more deliberately connect the pipeline of discovery at public universities with the regions that can best implement them. Purdue University's Center for Regional Development is one such innovation that is along these lines. In principle, these mechanisms will catalog university discovery in a way that is searchable and accessible to regions on a quest for innovation that perfectly aligns with their new competitive advantage. Regions, for their part, will understand their innovation need so well that they know the broad contours of the "right" innovation. This, of course, presumes that regions have the kind of strategies outlined above.

Policy may also give new attention to understanding and boosting the innovation capacity of regions. For some time, economists have assumed that innovation capacity is not evenly distributed across the landscape. Recent work by Barkley, Henry, and Lee (2006) has shown that such capacity is strikingly uneven. Better indicators of the innovation landscape are certainly needed as an essential starting point. But policy will also need to emphasize the "therapeutic" aspect—what can be done to boost capacity in regions that start out with limited capacity. Little practical work has been done on the best fix for this problem.

### **Regional entrepreneurship**

Regional innovation, and competitiveness for that matter, will mean little if regions cannot create a world-class entrepreneurial climate. This notion has received widespread attention over the past few years, and there are signs of innovation in policy and practice across the landscape. These include private-led initiatives, such as by the Nebraska Community Foundation's efforts to spur grass roots engagement of business formation and the recycling of a region's wealth (Nebraska Community Foundation 2006). They also include public/private

partnerships, such as the Entrepreneurial League System, now under trials in three regions across the country (Lyons 2004).

Looking forward, two issues are likely to receive significant attention in regional policy. The first is rationalizing a far-flung federal effort to support small businesses with the need to focus on the broader concept of entrepreneurship. The Small Business Administration was created in the Eisenhower administration, and reflects a historical commitment to growing small business. Most entrepreneurship experts, however, view the entrepreneurial process as requiring a much broader range of skills and supports than is traditionally envisioned by SBA and small business development centers. A national commission argued for a broad based approach that would include financial markets, intellectual property, entrepreneurial skills, and dependable infrastructure valued by entrepreneurs (NCOE 2002). Obviously, federal policy engages many different parts of this agenda through a multiplicity of programs. The key is paying attention to the sum of the parts—and to unintended gaps or conflicts in the disparate programs. This overview has been missing to date.

The other area for public attention will be equity capital. Public policy in the past has focused almost entirely on debt financing—and commercial banks, in particular—when it comes to entrepreneurship. In an entrepreneurial economy, however, equity capital takes on much bigger significance, since it is the fuel for new entrepreneurs. Mechanisms that help regions recycle their wealth in new businesses become especially important. While the number of such funds has grown, with community development venture funds a noted example, they remain relatively scattered across the nation. Thus, federal and state incentives to encourage the formation of regional equity funds will likely remain a major issue going forward.

## CONCLUSIONS

Globalization is a powerful force making regions critical actors in economic development. As economists have begun to understand the full reach of globalization's impacts, they have built a new framework for regional development. This framework is now styled "regional competitiveness." This framework focuses on exploiting a region's distinct assets through innovation and entrepreneurship.

Development policy has begun to align with this new framework, but significant shifts remain. In many respects, development policy and practice at the local level are still dominated by business recruitment, a carryover from the export base model that emerged in the postwar period.

Looking ahead, regional policy is likely to be shaped by the overarching need for regions to combine strategy, governance, innovation, and entrepreneurship. To help regions craft effective strategy, policy will likely focus on lifting the skill sets of regional leaders and providing better tools to diagnose a region's competitive advantage. Keys to regional governance will be new policy incentives for catalyst organizations to step forward as conveners and programs that thicken regional networks. Regional policy will also focus on new mechanisms to connect public research with regions best able to use it, while also developing better ways to boost innovative capacity, especially in regions that lack it. Finally, entrepreneurship will continue to be a priority for regional development, with attention shifting to regional support networks and incentives for the formation of new equity funds.

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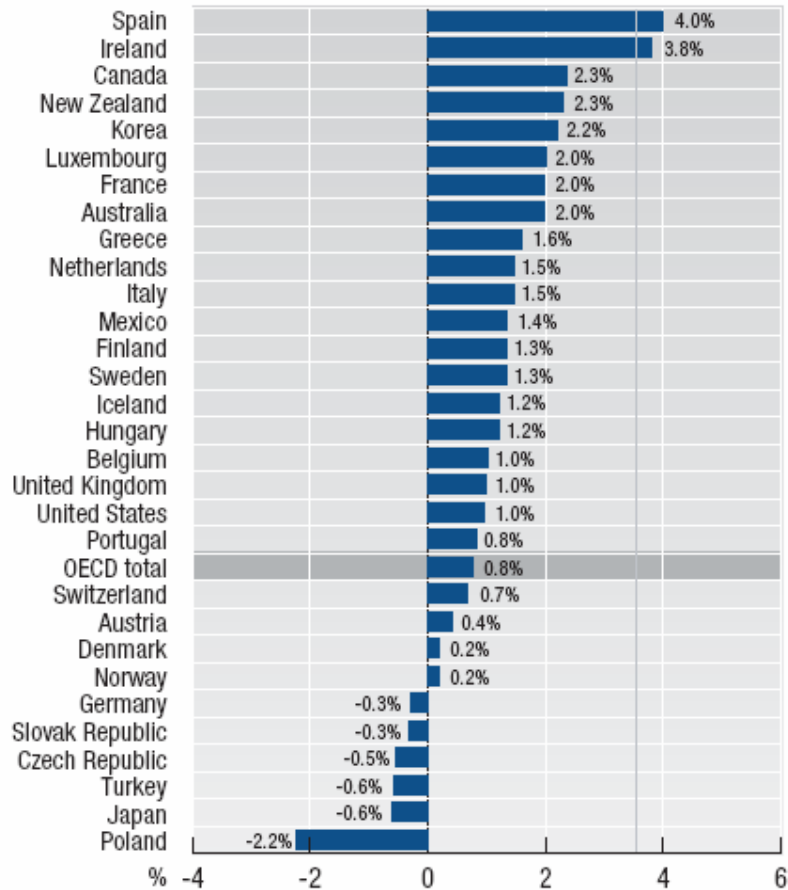
**Table 1. Three Eras in Regional Economic Development Practice & Policy**

|                            | <b>Industrial Recruiting:<br/>1950's to early 1980's</b>                      | <b>Cost Competition:<br/>Early 1980's to<br/>Early 1990's</b> | <b>Regional Competitiveness<br/>Early 1990's to Present</b>                          |
|----------------------------|---|---|--|
| <b>Driver</b>              | Export base   | Scale economies   | Innovation & entrepreneurship  |
| <b>Strategies</b>          | Financial incentives to firms<br>Industrial parks                             | Industry consolidation<br>& cost-Cutting<br>Deregulation      | Entrepreneurship<br>Clusters<br>Commercializing Research                             |
| <b>Keys to<br/>Success</b> | Government funds for subsidies<br>and tax breaks<br>Industrial infrastructure | Health of existing<br>industries                              | Distinct regional assets, such as:<br>Human capital<br>Higher Education<br>Amenities |

Source: Drabenstott 2005.

**Figure 1.**

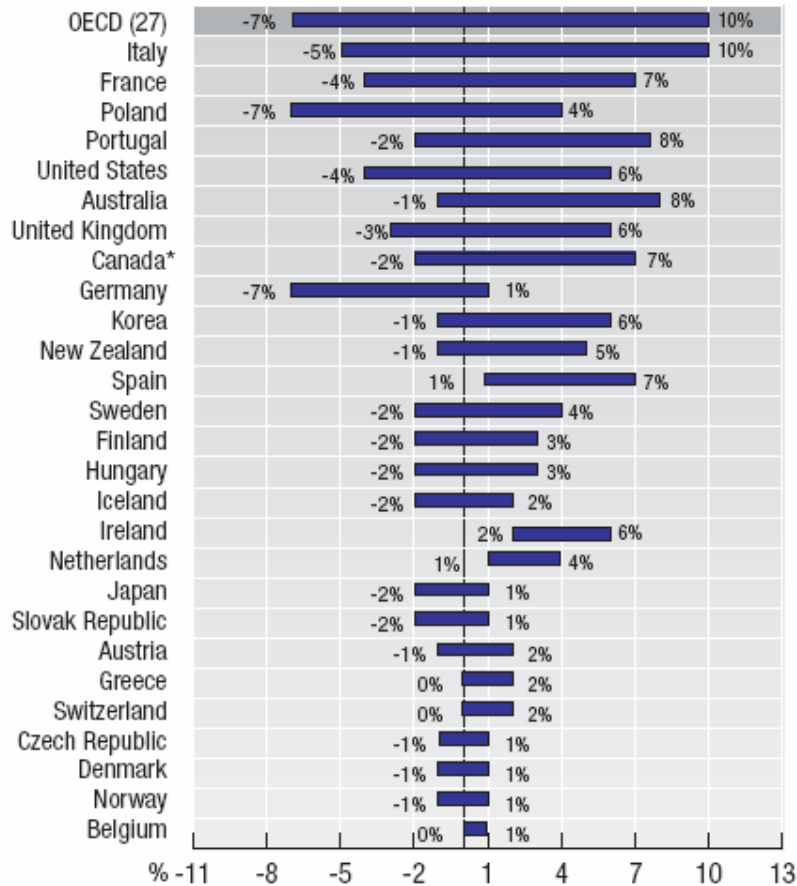
**From 1998 to 2003 employment growth varied significantly among OECD countries**  
Average annual growth rate in national employment, 1998-2003



Source: OECD 2007

Figure 2.

**Differences in employment growth among regions within countries were substantial**  
 Range in annualised employment growth across regions,  
 1998-2003 (TL3)

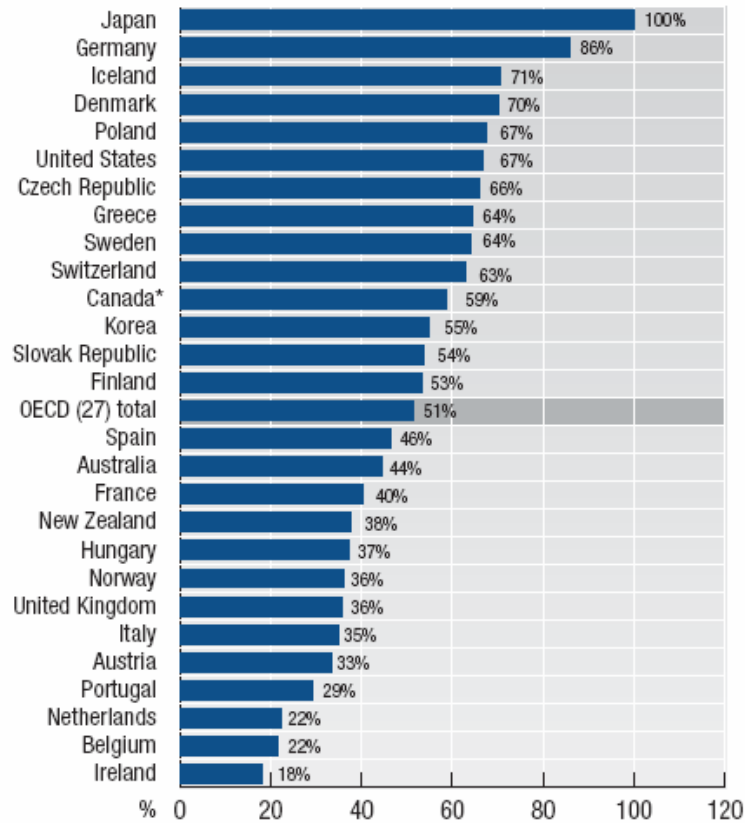


Source: OECD 2007

**Figure 3.**

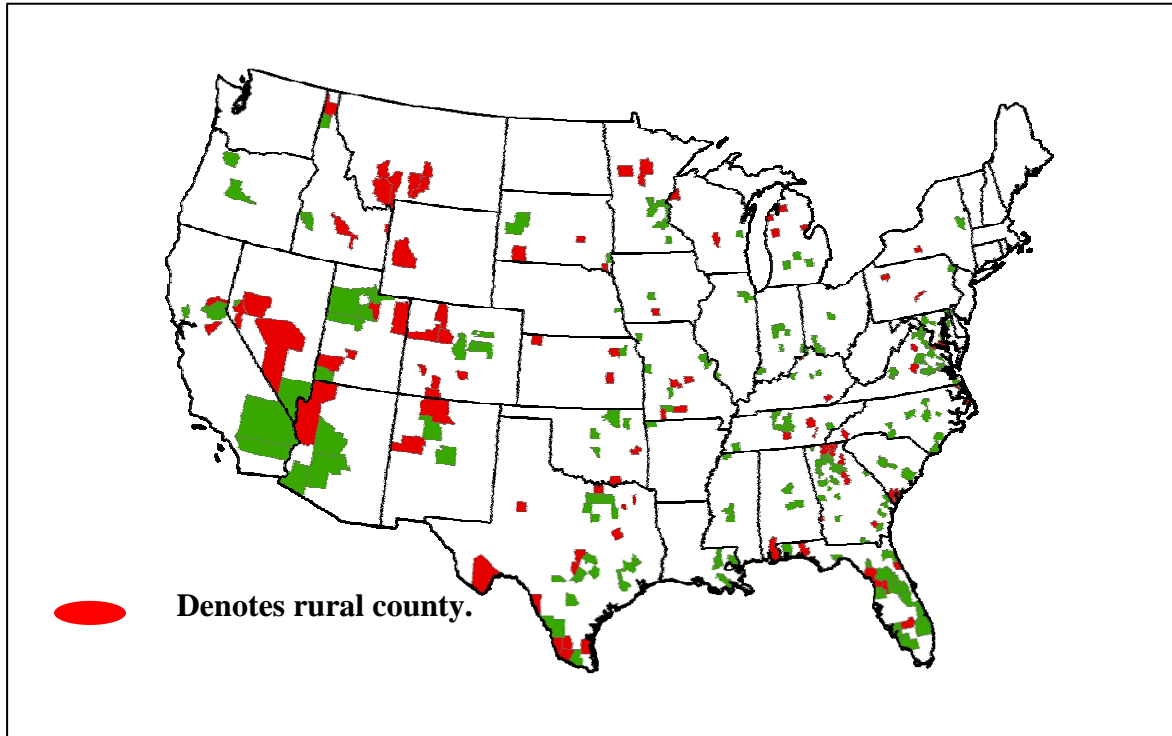
**More than half of OECD-area employment growth during 1998-2003 occurred in 10% of regions**

Proportion of increase in national employment due to 10% of regions with the largest increase, 1998-2003 (TL3)



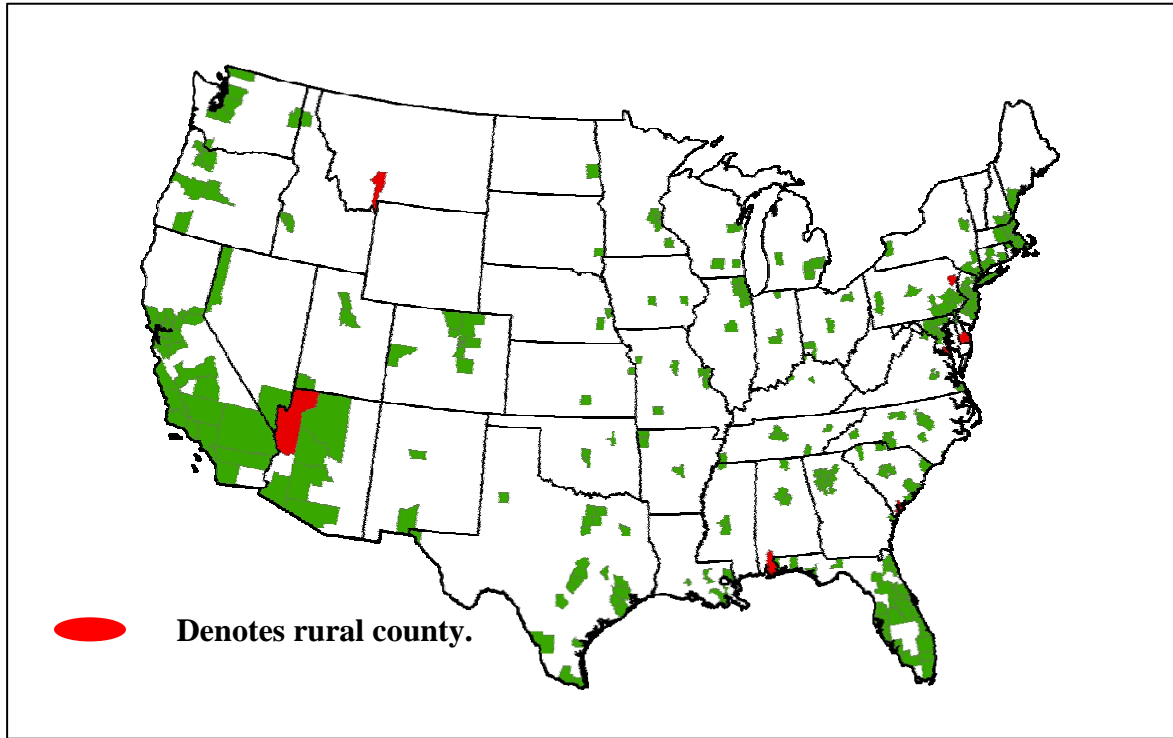
Source: OECD 2007

**Figure 4.** Top 10 percent counties for *employment growth rates, 1995 to 2005.*



Source: Author calculations of REIS data, Bureau of Economic Analysis.

**Figure 5.** Top 10 percent counties for *job creation*, 1995 to 2005.



Source: Author calculations of REIS data, Bureau of Economic Analysis.

**Figure 6. A New System for Regional Development**

