

Chicago Fed Letter

Industry targeting: a new approach to local economic development

Industry targeting is one of several new subnational economic development strategies that have emerged since the late 1970s. It reflects a shift away from a conventional concern with firm recruitment to a desire to support indigenous industry. Rather than measuring economic success by the number of jobs, this approach to economic development focuses instead on overall productivity and efficiency gains among related industries. Within this perspective, the role of government is to establish the necessary social and physical infrastructure to encourage firm growth and retention. Industry targeting has been particularly attractive to state and local governments in the last few years, when their resources for economic development have been especially limited. By the late 1980s, over fifty industry targeting initiatives had been undertaken in the United States, from Pittsburgh's steel industry to Alaska's timber industry.¹

The State of Illinois and the Chicago region have both recently undertaken new development projects targeting specific industrial sectors. This *Fed Letter* analyzes industry targeting in the broad context of economic development theory and practice. It also examines the Illinois and Chicago initiatives as examples of this approach.

What is industry targeting?

Industry targeting rests on a theory of the ways in which firms create and sustain competitive advantage within their respective industries. Successful firms usually share certain characteristics, including an ability to innovate, exploit new markets, and develop and maintain strong linkages with other firms that

support the production or distribution of their goods or services. Firms with these characteristics tend to be leaders in global markets.

Yet even successful firms operate in changing markets, so development strategies need to help them continue to succeed. Part of this strategy includes strengthening the linkages between successful firms and their suppliers and other service providers.² With strong interfirm linkages, an industry is likely to remain rooted in the local area. Moreover, successful supplier and service firms will provide higher quality inputs to producers, making them more successful. This in turn helps keep the targeted industry dynamic and increases its prospects for sustaining its competitive advantage. Industry targeting theory argues, therefore, that state or regional economic development efforts must first identify industries containing successful firms with linkages to the local economy, and then must insure that the social and physical infrastructure exists that will help these industries remain successful.

Why is targeting better than previous development strategies?

In the past, most economic development efforts were of two types. The first was offering incentives to firms in hopes of persuading them to relocate to or remain in the state or region. The second was providing a variety of general business services to firms that requested assistance. Targeting avoids problems inherent in both of these approaches. It recognizes that firms, not regions, succeed in economic competition. Additionally, it moves away from providing subsidies to inefficient firms in an effort to prop them up. Instead, targeting allows the state to use its limited financial resources in a way that will have greater impact.

Because targeted industries have linkages in the local economy, any programs that support them will have larger multipliers or spillover effects within the local economy than would programs supporting firms or industries with few local relationships. In fact, targeting theory uses a multiplier yardstick to judge whether incentives should be offered to attract or retain individual firms or whether state resources should be devoted to firms with few links to the local economy. States can use this yardstick even if they choose to continue offering locational incentives to out-of-state firms. The State of Alabama, for instance, recently offered Mercedes-Benz more than \$300 million in incentives to persuade the company to locate a plant there. Many analysts criticized this offer on the grounds that few other Alabama firms will benefit from the plant's location there. They argue that if the state had used a multiplier yardstick, it would have determined whether the supplier and distributor linkages exist that would increase the economic value of this package, such that the same level of resources could not be invested more effectively elsewhere.

Targeting also helps states focus their economic development services more narrowly and effectively, rather than dissipating state resources by trying to offer programs for every type of business. For example, a state that targets a chemical industry may devote resources to training more chemists and lab assistants and supporting research at local universities.

What are the potential problems with targeting?

Traditionally, economic development strategies have tended to be "people strategies" designed to increase immediate employment opportunities—for example, by luring a new employer to

the state. Industry targeting focuses on the success of firms rather than directly on employment, and seeks to improve efficiency and productivity to promote industry success. If firms are successful global competitors, the overall state economy will benefit. But in the short run, increasing firm productivity may lead to less job creation and in some cases may require employment cuts. Since part of government's concern is the distribution of social welfare, industry targeting may involve political conflict. It may be politically difficult for a government to encourage a firm to modernize plant and equipment and reduce labor even if these steps are necessary for the long-term success of the firm.

Compounding this problem is the fact that the payoffs promised by industry targeting are often less immediate and tangible. Building a sound educational and physical infrastructure may set a foundation for success in future economic competition, but the benefits will begin to appear only after years of sustained effort. By contrast, providing an incentive package that induces a plant to open, bringing hundreds of new jobs, creates instant benefits. It may be difficult to stay with a long-term approach when economic development policy in the past promised such clear, immediate gains for the area's economy.

Like any policy initiative, industry targeting efforts must include evaluation components that will make it possible to assess their effectiveness. Program success can be measured by the extent to which targeted industries are succeeding in exploiting new markets, gaining market share, and increasing productivity. Unless efforts are made to measure targeting programs by these outcomes, it will be impossible to know whether targeting is a superior strategy to previous ones. For this reason, project planners should establish both intermediate and final benchmarks to judge the progress being made toward an economic development goal. This is being tried extensively in Oregon, which is using measures including literacy, math skill levels of state residents, and penetration of foreign markets by key industries to assess the degree to which state

policies are improving the competitive climate of Oregon's economy.

The Illinois experience

To launch its key industries initiative, the Illinois Department of Commerce and Community Affairs hired an outside agency to analyze the state economy and recommend directions for economic revitalization. This effort resulted in a report entitled *Economic Leadership in Illinois: New Approaches for the 1990s*.³ Using the concept of industry linkages, the report identified twelve key industrial clusters: agriculture and food processing, business and personal travel, coal mining, consumer appliances and electronics, electrical equipment, export services, health services and biomedical products, industrial machinery, manufactured inputs, telecommunications equipment, transportation and distribution, and transportation equipment.

As noted above, using linkages to identify industry clusters requires an understanding of the potential for supplier-buyer multiplier effects in the local economy. The criteria for choosing target industries must be made explicit, and planners must clarify how government policy could strengthen linkages among the firms in each cluster. How are firms in the industries related? Do they share particular raw materials or other inputs, or do they supply inputs used by another? Substantial linkages increase the importance of any one firm in the chain and enable government dollars to go farther. When the linkages are unclear, it is difficult to design programs so that the industry as a whole benefits.

Although the choice of Illinois key industries unquestionably reflects sectors important to the state's economy, the relationships among sectors within each cluster are unclear. For example, the export services cluster includes such diverse activities as insurance, printing, education, and data processing. Perhaps the state used a political perspective to select certain indigenous industries as critical; that is, perhaps they were considered important because they employ large numbers of workers.

Presumably, one reason to help these targeted clusters is to help them continue to employ large numbers of state residents. This illustrates the tension between recognizing that the economic health of the region depends on competitive firms, and the political difficulty of relinquishing job creation or retention as an unstated goal of state development policy.

Yet the report does recognize that some clusters use a supplier base located outside Illinois, and directs some attention to strengthening cluster relationships. In this regard, the report suggests that several sectors be the target of industrial recruiting efforts in order to supply the "missing links": semiconductors, inorganic and organic chemicals, plastics and synthetics, mining machinery, glass products (except containers), and equipment rental and leasing.

Overall, however, the report stresses human resource development as the top priority for all clusters, reflecting the industry targeting view that the state should provide "fertile ground" to foster market-based development, in contrast to earlier policies that more often aimed at cost minimization. Specifically, it calls for more coordination among vocational training agencies, and vocational training both for displaced workers and for non-college-bound high school students. It advocates expanding vocational training for occupations needed by target industry clusters—for instance, community college programs for the tourism industry and the insurance industry, and trade school programs for the food processing industry.

The report also suggests five other broad areas of possible government action, including access to capital financing, funds for technology research and development, tax and regulatory issues, physical infrastructure needs, and quality of life concerns. Within each area, specific recommendations are given for each of the target industries. All of the recommendations have the potential to provide "fertile ground," although if not implemented carefully, some could become cost-minimization programs. For example, under tax and regulatory issues, workers' compensation problems are men-

tioned for the export and business services and high-technology clusters. This initiative, coupled perhaps with a broader focus on worker safety in the affected industries, could provide an incentive for innovation and could free up funds for other improvements. But in isolation, it could become merely another tax incentive. Other suggestions more clearly reflect the "fertile ground" approach: improving telecommunication speed and quality for the transportation industry, increasing the accessibility of Midway Airport for export services, and increasing coordination among businesses and the Environmental Protection Agency for the food processing sector.

The Chicago experience

The Chicago project used outside consultants specifically to solicit private and public sector support for a new strategic approach to regional economic development. The consultants were directed to focus on industries that would help create a "high-performance" economy. This was defined as an economy "that builds on local business, labor, and infrastructure assets, while simultaneously advancing their quality in order to assure the region's long-term competitiveness."⁴ The city instructed the consultants mainly to identify possible industries, but also included some preliminary suggestions as to policies or initiatives for fostering sectoral growth. The final report named six promising industrial sectors: biotechnology, advanced telecommunications, environmental technologies, software development, high-definition television, and high-speed rail.

This initiative goes one step further than does the Illinois one in that it identifies specific firms that anchor, or have the potential to anchor, the target industry. In this, the Chicago plan more closely reflects the belief of industry targeting theorists such as Michael Porter that development initiatives must be directed toward specific firms, because economic success depends upon the fortunes of these firms. For Chicago, particular firms were identified in each sector that were leaders in their fields or in the area. Some of these

firms actually took part in the planning process. The selection of final targets depended to a large extent on the presence of a firm that was an industry leader or the presence of an existing consortium of private and public entities. In this way, the report reflects a concern with linkages to the existing economy. In the case of software, for instance, the report asserts that the key to real growth requires focusing on a chain of related activities, from product development to customer services.

The Chicago report in general stresses the importance of using public resources effectively by consulting directly with private sector actors, and tailoring development initiatives with private sector recommendations in mind. For example, according to the report, the telecommunications industry is primarily interested in regulatory relief. While it is unlikely that firms in the industry would turn down an offer of financial assistance, the state might be able to support the industry more cost-effectively simply by providing regulatory relief.

Finally, the report discusses how to determine appropriate levels of public development support for any given industry. The fact that this question is addressed directly reveals Chicago's commitment to provide public support only where needed. For example, the report approves a high level of public sector involvement for industries in which government aid would provide well-defined benefits that would be shared by many firms. The advanced telecommunications industry qualifies under this criterion, partly because it is highly regulated.

Conclusion

Industry targeting is still an evolving strategy, yet it seems to offer the promise of correcting some of the flaws of previous development strategies. By recognizing the limited resources that government has to influence development, and by building closer ties with firms in specific industries, targeting aims to leverage resources and provide the assistance needed by the industries that anchor an area's economy.

The ultimate question will be whether industry targeting policies actually strengthen the competitive position of targeted industries. For this reason, it is essential to establish benchmarks and evaluation mechanisms for judging the health of targeted sectors. Such a component will help assess whether industry targeting represents a new deal in economic development or simply a reshuffling of the deck.

—Virginia L. Carlson and
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¹Wim Wiewel and Wendy Siegel, "Industry task forces as pragmatic planning: the effect of ideology, planning process, and economic context on strategy selection," *Journal of Planning Education and Research*, Winter 1990, pp. 107-115.

²This firm-driven understanding of competitive economic success dates back to the work of Joseph Schumpeter and has been significantly developed in the work of Michael Porter. See, for instance, Joseph Schumpeter, *Capitalism, Socialism, and Democracy*, New York: Harper, 1942; and Michael E. Porter, *The Comparative Advantage of Nations*, New York: Free Press, 1990.

³Illinois Department of Commerce and Community Affairs, *Economic Leadership in Illinois: New Approaches for the 1990s*, Springfield: Center for Economic Competitiveness, SRI International, and DRI/McGraw Hill, 1992.

⁴"Creating a high performance economy in Chicago: an exploration of potential," Center for Urban Economic Development, University of Illinois at Chicago, draft report, October 1993, p. 1.

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Tracking Midwest manufacturing activity

Manufacturing output index (1987=100)

	Sept.	Month ago	Year ago
MMI	120.0	119.5	110.5
IP	112.0	111.6	106.7

Motor vehicle production (millions, saar)

	Oct.	Month ago	Year ago
Cars	5.9	5.3	5.5
Light trucks	4.7	4.6	4.2

Purchasing managers' surveys: production index

	Nov.	Month ago	Year ago
MW	65.3	64.7	63.9
U.S.	59.3	56.0	60.1



Midwest manufacturing activity expanded at a relatively rapid rate in recent months, after losing some momentum in the third quarter. The production component of purchasing managers' surveys in Chicago, Milwaukee, and Detroit indicated faster expansion than the national average, with activity at one of the highest levels in the past four years.

Light vehicle production surged in October and November, after production interruptions held back output in the third quarter. A number of other indicators of Midwest economic activity also showed renewed upward momentum in recent months, notably housing starts, surveys of small businesses, surveys of hiring plans, and machine tool orders. While some concerns persist about the pace of expansion in the new year, 1993 is ending on a solid note.

Sources: The Midwest Manufacturing Index (MMI) is a composite index of 15 industries, based on monthly hours worked and kilowatt hours. IP represents the FRBB industrial production index for the U.S. manufacturing sector. Autos and light trucks are measured in annualized physical units, using seasonal adjustments developed by the Federal Reserve Board. The PMA index for the U.S. is the production components from the NPMA survey and for the Midwest is a weighted average of the production components from the Chicago, Detroit, and Milwaukee PMA survey, with assistance from Bishop Associates and Comerica.

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