Chapter 2.
Regional Economic Development: A Look at the Supply-Side Approach

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Historically cities have focused on export based economic development strategies. Since it is impractical for cities to create demand for the services from their region, in general people do not care where something is produced; they must focus on attracting industries that already have a strong demand base. Cities seek to increase the demand for their products by enticing strong industries that bring with them a strong demand base. A city that is able to bring in a business that sells a product or service in high demand, which results producing more than needed for the local market and therefore exporting to other markets, is able to increase demand for the products and services created in their region. The emphasis of these strategies is on attracting businesses that will bring in outside money, from export sales of their goods or products, into the local regional economy. Classic economic base analysis seeks to identify those industries in the economic base and understand their strengths and weaknesses. By using economic base analysis cities are able to identify those industries that are producing more of their product that can be supported by the local government and as a result must be exporting elsewhere. The central idea to this type of analysis is that these economic basic industries are the ones driving the economy. As a result, cities often seek to attract these industries to grow the economy. To this end, cities have used a variety of incentives such as tax freezes, and building infrastructure.

There is another side of economic development theory that is often overlooked. This is the use of supply-side economic development strategies to spur economic growth. Supply-side economic development in concerned with supply related factors such as land, labor, increasing productivity and many more. This chapter is broken into three sections. The first section will discuss many of the conventional export centric economic development strategies. The second section will explore supply-side economic development strategies available to cities and regions. The final section of the chapter will discuss the work of Richard Florida and the use of his strategies for supply-side economic development.

Export Based Model of Economic Development

After World War II and up to the 1980’s economic development focused on attracting new business and industries to the region. To do this, cities employed a variety of tools mostly in the form of incentives. These incentives included: industrial bonds, building office parks, tax cuts, free land, and reducing utility rates (Blakely and Bradshaw, 2002). Incentives were first used in the South where agriculture revenue was declining. The South positioned themselves as locations of cheap labor where businesses could relocate and used incentives to entice manufacturing businesses (Blakely and Bradshaw, 2002). After some time the use of incentives was adopted in areas outside the South, thereby increasing competition (Blakely and Bradshaw, 2002). This increased competition made it increasingly difficult to recruit businesses as more and more cities offered incentives. Not surprisingly this form of economic development is commonly referred to as “smokestack chasing.”

One classic example of smokestack chasings is the creation of industrial parks. It seems that over the past 50 years every city with a decent size population has jumped on the industrial park bandwagon. In many instances cities bought land and improved it with the needed infrastructure without any buyers lined up. This “if you build it they will come” mentality demonstrates the faith, or perhaps hope, placed in the export model of economic development. The problem is that with so many cities developing industrial parks there was not enough businesses to meet the supply. This problem was compounded by the fact that many of the factory jobs that industrial
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parks were designed to create were being moved to other nations where labor was cheaper. As a result there are many industrial parks throughout the country still waiting for tenants. With the high cost of land and infrastructure improvements cities have invested large amounts of money in these projects without any guarantee that the investment would pay off in the end.

Another favorite method of the export based model is the use of tax breaks as incentives to attract businesses. Common tax incentive programs include: tax credits, tax abatements and reductions, tax exemptions, tax refunds or a mix of tax benefits (Eberts, 2005). A national survey of state business incentive programs found that 40 percent of those programs were tax based (Eberts, 2005). Tax credits were the most pervasive tax incentive program with tax exemption coming in a distant second (Eberts, 2005). These incetive programs can reduce the tax burden on the business by 9-36 percent (Fisher and Peters, 1998).

Export based economic development is successful for as long as the supply of businesses and industries is large. As time progressed and growth slowed there were fewer firms looking to relocate. The reduction in supply greatly increased the demand, which resulting in something akin to a bidding war for new or relocating businesses. This shifted the power to the businesses as they were able to play cities against each other in order to get the best “deal”. In the frenzy to secure businesses many cities’ made large sacrifices, some of which ended up hurting the city economically.

Later research would show that incentives have little effect on the location decision of businesses. These ineffective incentives were wasting tax payer’s dollars by rewarding businesses when they would have chosen to relocate to the city without the incentives. This has led many to question the use of these strategies. Despite the many problems associated with using incentives for economic development many cities and regions still employ these strategies. One of the most recent incarnations of this strategy is the large incentives used to secure major league sports teams, often in form of tax breaks or funding for new stadiums. The increase of the expenditures spent to secure professional sports teams in the last decade demonstrate that the export based model is still alive and well (Rosenthal, 1999).

Supply-side Model of Economic Development

The supply-side model of economic development focuses on the environment in which businesses operate. This includes such things as: land, capital, entrepreneurship, agglomeration, productivity, import substitution, quality of life and labor. A major strength of the supply-side model is that it seeks to affect those things that cities have the most control over, the nature and attractiveness of the local business climate (Helburn, 1974). Export based economic development are highly vulnerable to shifts and changes in demand as well as changes in the business environment. As cities are unable to affect demand or national trends, focusing on the supply-side model for economic development ensures that their investment will be wasted.

Land

Land is one of the most basic components of the supply-side model for economic development. Land is the only truly immobile factor of production (Blair, 1995). In the past, natural resources such as mineral deposits, farm land and forests where very important factors in contributing to economic development. Cities would locate near industrial inputs to reduce the transportation costs which would thereby reduce the overall cost of the inputs. During the early stages of the Industrial Revolution location and proximity to natural resources was very important. As technology progressed, the cost of transportation was drastically reduced. Proximity to natural resources became less of an economic necessity. This is particularly true in today’s globalized world where businesses float between countries and continents to find locations with the cheapest
labor and land. There are still some industries where proximity is important, often in the agricultural industry where the freshness of their product is paramount. Once valued solely for the economic value of its mineral and timber resources, land is now valued as an end in itself. The natural environment has become an invaluable resource for many cities. Many residents enjoy the aesthetic and recreational value of having a pristine natural environment within and nearby the city. As will be seen later, quality of life improvements that result from natural environments can also be characterized as a form of economic development.

**Capital**

Capital provides a nice contrast to land as it is the most mobile factor of production. It also tends to be fairly evenly distributed. Capital can be secured for most any location. This is especially true of large corporations that have access to large banks for capital (Blair, 1995). Smaller and new businesses often have a harder time finding capital. During these early stages private equity and venture capital provides much needed capital for small and new businesses. Many government and quasi-governmental agencies such as community development corporations have recognized the need for capital for small and new businesses (Blair, 1995). These entities have started many new programs designed to provide capital to firms unable to obtain capital. The availability of capital for small and new businesses has a direct effect on another component of the supply-side model, entrepreneurialism.

**Entrepreneurialism**

Entrepreneurship is a major driver of economic growth. In American, small businesses with less than 20 people account for almost half of the new job created (Blair, 1995). An increased rate of new business formation is often attributed to entrepreneurship (Blair, 1995). Conversely some authors have been able to relate waves of economic decline with the lack of entrepreneurship in a city or region (Blair, 1995). As can be seen entrepreneurship can have a major effect on the economic growth of a city or region. Cities do a variety of things to encourage entrepreneurial activity. One popular method is the use of incubators to get new businesses up and running. These programs are designed to provide support during the most tenuous time for new businesses, when they are first starting out. Entrepreneurship is considered a supply-side strategy for economic development due to the fact that entrepreneurs are almost always local residence. The ability of a region to create and sustain new businesses has a lot to do with many of the supply-side factors discussed in this chapter. New businesses need capital to get started and expand. Without this critical input new businesses will wither and die. New businesses also need a good supply of talented labor. The business environment is also very important. New businesses will have an easier time getting started if the supporting businesses providing services and inputs are found locally. The higher quality these supporting businesses the better off new businesses will be. A diverse economy with competition also provides a variety of externalities that benefit small businesses as will be shown in the next section.

**Agglomeration Economy**

In regional economic development theory it has been noticed that similar industries that agglomerate or cluster together gain competitive advantages. Most often these clusters are around large export industries. Clusters include similar industries as well as their support industries. In Memphis, for example, there is a shipping and packing cluster. FedEx is the large export industry but there are many other shipping and packing industries that have also started in Memphis. Clusters do not have to be around a single export industry. Often there are multiple export businesses which compete against each other. There are many different theories of why industries cluster together. One theory is that clusters create increased efficiencies by forming tight linkages between firms (Florida, 2005). These linkages ensure that inputs are efficiently
supplied and the economy of scale that is possible with firms linked together allows them to drive down the cost of production. Another theory is that clustering creates positive externalities or spillovers that can be enjoyed by all in the cluster (Florida, 2005). These spillovers can be in the form or shared information and increased efficiencies resulting from competition. Still others speculate that clustering allows face to face contact which is necessary for business (Florida, 2005). One author believes that industries cluster to take advantage of concentrations of talented individuals in one geographic location (Florida). This theory will be explored in greater depth later in the chapter.

**Efficiency and Productivity**

One supply-side approach to increase income without increasing exports is by becoming more productive. The idea is that by doing more with less one is able to reduce costs while keeping revenue constant, which has the net result of increasing revenue. There are many different ways to increase productivity. Some strategies include the use of new technology to do the same job more efficiently, and improving the productivity of the workers. Labor and technological solutions that increase productivity can be encouraged in a region through the use of local research and advanced education institutions. Cities can encourage increased through workforce development programs as well as programs that spur and encourage the adoption of new technology. As was noted before, increased competition has the effect of spurring innovation and ensures that the businesses are operating at peak productivity. Cities should take this lesson to heart and encourage a diverse and competitive economy and not “protect” industries from inter-regional competition.

**Import Substitution**

The import substitution model seeks to replace products and services that are imported into the local economy with indigenous products and services. This is an attempt to keep money from “leaking” to businesses outside of the local economy. Classic export based theory uses a multiplier to determine the effect of one job created in an export industry. The multiplier of 1.5 says that for every 1 job created in the export industry will result in 1.5 jobs created in the local economy. This multiplier effect has to do with the fact that the more money is recycled in a region the greater the benefit to the local economy. This is due to the fact every new employee will require products and services from the local economy such as housing, entertainment and transportation. Something similar happens with import substitution. There are two methods of import substitution. The first one seeks to replace products and services sold to the citizens of the region from businesses outside the local economy. The second method seeks to replace products and services from outside businesses sold to local businesses. In both scenarios products and services already bought by local consumers is replaced with products and services produced locally. This results in increased job creation which also leads to more jobs created in other businesses. Import substitution can have the effect of increasing the multiplier discussed above by keeping money cycling through the local economy (Blair, 1995).

**Quality of Life**

Unlike the other supply-side economic development strategies mentioned so far quality of life does not seem to be directly connected to the economy at first glance. In recent years there have been many who have suggested that improving the quality of life has an indirect effect of improving the local economy. Many businesses are now looking at quality of life issues when relocating. Improving the quality of life within the region makes the area more desirable for future and current residents. This has the effect of attracting talented individuals to the region and keeping talented individuals from moving out of the region. Businesses believe that areas with a high quality of life will have a good labor pool. The main idea is that quality of life attracts and
retains talented labor, which attracts businesses which produces economic development. This is similar to the “if you build it they will come” argument used for industrial parks mentioned earlier. There is an important difference between improving the quality of life in a city vs. building industrial parks. For one, the improvements used to increase the regions quality of life are not dependent on any businesses. Put another way, the amenities created to increase the quality of life in the region will not go away if the businesses that were attracted into the region move to another area. Quality of life improvements are something that cities can have control over, the character of their city.

**Labor**

Labor is the most important component of supply-side economic development. A talented and experienced labor market is one of the most important inputs for businesses. Labor is often referred to as “human capital” because it is just as important as monetary capital required to keep the businesses running. There are two major ways to increase the human capital, increase human capital within the region through education and training or increase the human capital in the region by attracting talented individuals from outside the region.

**Endogenous Labor Methods**
The first method uses the indigenous population. The main goal is to take the current population of the region and through education and training increase their worth as workers. There are a variety of programs that are used to increase human capital within a region. In the past, when the export centric programs of economic development dominated the sense, population would be trained in a particular trade. Many cities would provide training to prepare the workforce for new industries moving into the region. This method was rather short-sited and was often focused on a particular industry. A more comprehensive program of education prepares the workforce for a variety of jobs. The problem of public education within the inner city is one of those sticky problems that can solved by a single silver bullet. This makes it difficult to increase the human capital of a region, as no one has been able to figure out how to fix the ailing education system in America.

**Exogenous Labor Methods**
The difficulty of properly educating a region’s workforce often attracts policy-makers towards solutions that involve attracting talented workforce from outside the region. Towards this end there has been a lot work. The main population that cities and regions are seeking to attract are college educated individuals between 25-34. Carol Coletta and Joseph Cortright call this group the “Young and the Restless.” This group is both highly educated and highly mobile. Cities are attempting to attract this group to their cities in hopes of increasing the cities human capital. While a lot of work has documented the importance of human capital there has been very little research on why certain people move while others do not. One author, Richard Florida, believes he has the answer to this question.

**The Creative Class and Supply-Side Economic Development**

**Creative Class**

Richard Florida, author of, *Rise of the Creative Class* and *Cities and the Creative Class*, believes that the creative economy is and will continue to be the leading source of economic growth. He points to the large growth of creative jobs in the last 50 years. Globally one third of the jobs are in the creative sector (Florida, 2005). In the United State half of the income generated from wages comes from individuals in creative jobs (Florida, 2005). The creative class is the creators of the creative capital needed to drive the creative economy. Florida defines the creative class as individuals who engage in work whose function is to “create meaningful new forms.” (Florida,
2005) This class includes: scientists and engineers, university professors, poets and novelists, artists, entertainers, actors, designers, and architects to name a few. In his research Richard Florida has been able to correlate high concentrations of the creative class with regional economic growth. As he admits, his ideas about the creative class are not new. There are many scholars and researchers that have identified creativity and innovation as one of the major driving forces behind economic development in cities. Jane Jacobs believed that the innovation that occurred in the cities was a result of a diverse set of industries and individuals intermingling (Glaeser, Kallal, Scheinkam and Shleifer, 1992). To Jacobs the city was a “cauldron of diversity and difference, creativity and innovation” (Florida, 2005). Where Florida’s research branches off from others is where he begins to try to explain why creative individuals are concentrated in particular regions.

**Tolerance**

One of the major factors influencing the concentration of the creative class is the level of tolerance within in the city or region where the concentration is located. He attributes this to the low entry barriers to open participation that breeds interaction and encourages creativity. Through his research he was able to predict concentrations of the creative class base on measures of tolerance. Florida created different indexes to measure the tolerance of cities. His indexes are the melting pot index, the bohemian index, and the gay index. All three indexes had strong predictive ability. His research shows that the creative class prefers to live in areas that are open and diverse.

Due to tolerance’s strong predictive behavior Florida believes that cities should seek to create an open and diverse society within the city. The problem not addressed by Florida is just how this is done. Once again there are two possible solutions, one derived from outside the city and derived from within the city. The solution that is derived from within involves changing people’s beliefs and perceptions. This can be done through a variety of measures, such as education and programming. The problem with this method is that it is very difficult to change people’s prejudices through broad public programs. Change occurs individually from person to person interaction. The other option is to bring in tolerant individuals from outside the region. Most often this is going to be the young and the restless we discussed earlier. The problem is that, as Florida’s research has show, this group is attracted to areas that already have a tolerant society. So the method of bring in outsiders to increase tolerance is not feasible because you need a tolerant society to attract them in the first place.

One possible solution would be to shift the focus away supporting a tolerant society to supporting an artistic society. This pill seems much easier to swallow and can have the effect of increasing the tolerance and diversity of the city. Artists are often an open-minded and tolerant group. Most everybody can get behind supporting the arts and the people have an easier time accepting people different from themselves if they are artists. Artists are seen as eccentric or weird but not morally depraved individuals. In fact, artists have been the pioneers in leading many inner-city revitalizations. Artists move into depressed areas for the cheap land and large spaces. The creative class is soon to follow and with them innovation, creativity and economic growth. The central problem with this model is that it is not sustainable. When the creative class moves into the area, the price of land goes up. These increases in land value cause the artists to move out of the neighborhood. Without the artists the creative class will move elsewhere for more “authentic” neighborhoods. The major challenge will be to keep the artistic community intact despite rising land values.

**Amenities**

Many argue that place no longer matters. The reduced cost of transportation, the advent of globalization and the growth of the internet all make business possible in most any location. Kevin
Kelly in his book, *New Rules for the New Economy*, believes that the new economy occur in space rather than place (Florida, 2005). Florida completely disagrees with this characterization of the “new economy.” He believes that places matter more than every. He points to the fact that people and businesses remain highly concentrated and that the high tech, knowledge-based industries are highly concentrated as proof that place still matters (Florida, 2005). In fact, the environment and amenities of the place have a large impact on the local economy.

A major factor that effects the location decision of the creative class is quality of life amenities. This shares many similarities with the quality of life measures discussed earlier. Richard Florida’s analysis provides a more detailed look at the type of amenities that the creative class enjoy. Authenticity is very important to the creative class. They want real world experiences and are attracted to outdoor activities and recreation. Many of the usual amenities associated with larger cities such as professional sports teams, and cultural institutions such as the opera, symphony the ballet are not important to the creative class. Individuals in the creative class look for activities that provide validation for their sense of self.

**Supply-side Solutions to Economic Development**

Export based theories of economic development have long dominated the field. There are many weaknesses to this approach. For one it attempts to control something that is outside the realm of control cities and regions, that is the location decisions of businesses. There is no guarantee that businesses will remain or even locate to the region in the first place. Perhaps the biggest failing of export based theories is that they fail to take into the supply-side into consideration. Supply-side solutions have focus on those things that cities can have control over, that is the supplies needed for economic development. There is no single solution to increase economic development in a region. Planners should use all the tools and theories available as some will be more suitable in different situations. What is needed how ever is a greater awareness of and use of supply-side economic development strategies. Towards this end planners should focus on the major components of supply-side economic development: land, capital, entrepreneur ship, agglomeration, productivity, import substitution, quality of life and labor. There are many who have beaten the path ahead. One such individual is Richard Florida. Many of the tactics used to attract the creative class fall into the supply-side paradigm. According to Florida cities must ensure a tolerant culture filled with authentic life high amenities. Fostering a culture of creativity will lead to economic growth as the creative economy continues to grow.

**References**


