Job Creation, Business Growth and State Policy: Glimpses of the Third Wave

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Introduction

Jobs and business growth have always been the immediate objects of state economic development, but our understanding of their dynamics and the policy initiatives appropriate to spur them, have changed markedly.

For all intents and purposes, the **First Wave** of modern state economic development policy began in 1936 when Mississippi launched its Balance Agriculture With Industry (BAWI) program. The strategy was straightforward, lure manufacturing branch plants (new and existing) from the high cost North by marketing the low costs of labor, land, government, and living in Mississippi. And if costs were not low enough, to reduce them further through government subsidy parading in any number of forms from tax abatements, to customized training, to outright grants.

It worked. For awhile. Employment rolls and wages rose dramatically relative to the rest of the country during the fifties, and more modestly in the sixties. The strategy spread, of course in the Southeast, but also increasingly, to all corners of the country, from New Hampshire to Washington, to Arizona. If the existing private costs of doing business weren't low enough, then there were always taxes to credit or abate, subsidized loans to offer.

By the late seventies, and clearly in the early eighties, the strategy was producing even more limited results in the South. Fewer plants were coming; more were closing or leaving the country for cheaper territory. The march of per capita incomes toward the national average, slowed, stopped, some places even reversed.

The **Second Wave** of state development policy began not in the South, but in New England in the early and mid-seventies. For it was here where the first impact of global economic restructuring was first felt, most directly in the acute contraction of the apparel and footwear industries.

After some initial flailing at stopping the closings (a chase pursued longer, if unsuccessfully, at the Federal level), states discovered the growing strength of new, young, and small businesses, often (not always) in information and service industries. Even before they were taught how to count the job and growth contribution of such firms by David Birch and others, Massachusetts and other states like Connecticut, California, Minnesota, began to craft policies aimed at stimulating and steering the growth of such firms. Massachusetts spewed out a stream of quasi-public financial institutions aimed at pluging perceived capital market gaps; build roads and targeted state aid to a base of community based development organizations in depressed communities; launched a series of training, retraining and employment linking programs; created new joint university-business research and technology transfer programs.

The **Second Wave** spread, first to other states in New England, then to states like California, Minnesota, Colorado, Washington, feeling the initial impact of global competition from East and West alike. In general the innovation would follow the

onslaught of global restructuring. To the industrial heartland, where leaner, more modern Japanese and German manufacturers would move in on the markets of Midwest automobile and steel firms in the mid-seventies. Many of these states, notably Michigan, Ohio, Pennsylvania, Illinois, Indiana would respond with an array of new financing, technology, training and infrastructure initiatives, labor-management cooperation initiatives, often adapting programs as they adopted them, to reflect both the lessons learned from the Northeast experience and the industrial nature of the midwestern economy.

In the late seventies and early eighties, it was the Southeast's turn, as the underdeveloped countries of the Third World open their doors to firms looking for cheaper homes for a more mobile capital and technology. The South awoke to find the bill come due from its earlier Faustian bargain of short term industrial gains at the expense of long term investments in the people, businesses and infrastructures. But, if the challenge of 100 years of poverty and 50 of under-investment were huge, Southern leaders didn't blink. Led by states like Florida, North Carolina, later Arkansas, South Carolina and now Mississippi, the South was the first region to fully realize the centrality of educational investment and reform to economic development, a reality which spread to other sections of the country.

The collapse of resource industries -- agriculture, mining, energy -- in the early eighties plunged the high flying economies of the Plains and Mountain states from Texas to Alaska into durress. Some states -- Oklahoma, Iowa, notably -- have used **Second Wave** policies to reverse their fortunes, evolving creative rural strategies. But most of these states have yet to respond.

The Northeast, of course is back -- at least if one considers unemployment rates, income, and trade measures. The Midwest is coming back, led by leaner, more technologically advanced and more flexible manufacturing firms. And the South, while still hobbled by the time it takes for investments in basic foundations of growth to mature, shows rising business prowess. And throughout the period we have been adding 600,000 firms and 2 million jobs annually.

Policy had something to do with it. How much is a matter of debate. Policy probably added only incrementally and on the margins over a long period of time. But the pattern of recovery is too consistent, the results too tangible, for the message not to be clear: investing in yourself pays.

The Policy Framework

Five years ago, after about five years of toiling in the policy vineyards of state and local government, we at the Corporation for Enterprise Development decided to take a step back, and attempt to understand better the dynamics of today's economy, and the strategies likely to yield success. We reviewed virtually every major study we could find on the foundations of long term, widely shared economic health, the nature of the global economy, the dynamics of job and business growth, and the programs, policies and practices with the most evidence of success. We

examined our own experience working with states and communities, here and abroad. After broad consultation, we constructed the index and sub-index structure of the **Development Report Card for the States.** We looked for the best measures we could find to illuminate how states were doing relative to one another on those diverse dimensions of economic health. In 1989, we issued our third edition, now with 125 measures as well as international benchmarks.[1]

The Report Card is, needless to say, not a precise, econometric model. A good deal of (subjective) judgment went into it. It is a best a first order and impressionistic diagnostic tool.

That said, the framework has withstood the very public scrutiny of economists, business and labor leaders, state officials, press, community leaders. And its acceptance grows -- in high-performing states and low. We continue to believe that the Report Card framework coheres better with what we know about economic development than any other index available.

But the real test, and the one I am most comfortable with is yours. Does it make sense to you, given the sum of your experience and knowledge?

The Report Card is premised on the understanding that we will no longer compete in this world economy with any real chance of offering our people chances of a better standard of living on a pure cost basis. We will not be, whether we are in Michigan or Mississippi, the lowest cost place to do business in the globe. If all you really need as a business is simply a low cost environment -- unskilled labor, cheap machinery, no taxes, no education system -- there will be cheaper places to do business in the Third World countries. I don't think we want to be a Third World country.

The Report Card asks four basic questions to assess the long term health of a state economy. (The same questions apply at the community level, the national level, the international level.) They are: One, Economic Performance. How well is the economy performing in terms of its primary purpose of providing the citizens of the state and their children with chances for a better life? Two, Business Vitality. How competitive are existing businesses in the state; at what rate are new businesses being formed? Three, Capacity. Are the resources in place to fuel future growth and start ups? And four, Public Policy. Is the public sector an active and intelligent partner with the private sector in making sure that the basic investments and the basic services are in place.

Performance

The Report Card asks four kinds of questions under performance: One: Employment. How available are jobs? Can everyone who wants one get one? What's the rate of new job formation? What's the duration of unemployment? Two: Job Quality. After all, not all jobs are created equal. How much do they pay, and what benefits like health coverage, do they carry. Here we clearly

depart from the traditional thinking. They would say the higher your wages are the worse a place you are to do business. But to us, high wages, and using per capita income, are primary goals of economic development. The trick and the challenge is to make sure that productivity increases faster than income, to find ways of adding value so that you can justify a continually improving quality of life. Three: Equity. How widely shared is the prosperity shared around in the state. Fourth and finally, we try to look at quality of life. We recognize that people don't live by bread alone.

Business Vitality

We think business development is a means to an end, not an end in itself; but it is the primary means to the end.

In this index, we look primarily at the health, growth and formation of in-state businesses. This is not to say that you don't look outside, that you don't recruit. However, it is based on several finds from the best research in the area. First, in most states during the last 15 years, at least 80% of new jobs have come from businesses that start-up or expand within the state. And that's a conservative figure. The lion's share of new jobs are coming from inside. It means to me that that's the dog and that recruitment is the tail, and should primarily assist that and complement it. Second, what does it take to be competitive in today's global to find the answer, we think is best to look at the businesses that are doing very well in this economy. There is an association of such businesses in Washington called the American Business Conference (ABC). It claims to be the only meritocracy in Washington and it may well be. They have as their membership about 100 firms representing all sectors of the economy -- high tech, low tech, manufacturing service, financial and real estate. These companies, by any standard, are winners in the global competition. They have on average, increased their earnings form international sales 20% a year in the 1980's -- five times the national average. They have increased employment on an average each year of 14%.

ABC surveyed its members and asked "How are you competing?" The answers were very clear. They were all competing in terms of quality, service, innovation, flexibility, timeliness - not cost. In fact, they said they couldn't afford to pay their people low wages, because they needed not just their brawn; they needed their brains.

True, again, across sectors. We're not just talking service here; we're not just talking manufacturing. When they were asked "What do you need?" they didn't refer to the absence of things. The two items that did top their agenda: A good education system (and a skilled and adaptable labor force) and second, access to capital at the right times and of the right kinds.

Thirdly, what you find when you examine scientific studies of the determinates of business location decisions, is that the location decision is idiosyncratic. But if

you look at the preponderance of answers. they're always the same thing. It is the quality of the labor force, quality of the education system, quality of life, proximity to growing markets. Way down the list come the cost factors.

And, by the way, I should add I'm not saying you should ignore costs; obviously you would want to keep costs to a minimum. But often you get what you pay for, whether it's labor, skills, and adaptability, commitment or the quality of the raw materials. Interestingly enough, 30% of the cost of a manufactured good now, in general, in the United States, is a function of poor quality, the cost of rejects, repair inspection. Most companies who have focused on quality end up not only achieving increased quality but drastically reduced costs.

The point is this is a case where you can have your cake and eat it too. Do the things that are necessary to grow in-state business -- develop the education system, the quality of life, a flexible and adaptable labor force, good infrastructure -- and you also have a very attractive environment for out-of-state plants.

The only danger in recruitment seems to me to be if it becomes the sole focus or is pursued in a way, as I think it too often was in some southern states, where it undermines the in-state investments. I think it was very significant that two years ago a candidate for Governor won an election by running against a Toyota plant incentive package which was thought to be too large and unfair to in-state businesses and in-state citizens.

So, we look at the competitiveness of existing business. To assess competitiveness we look at manufacturing investment rates, business failure rates, traded sector strength.

Secondly, we look at entrepreneurial energy. The rate at which businesses are forming and the breadth of new business formation. Our best data suggests that over the last 15 years half of new jobs created in any community and in any state of the union came from independent firms under five years of age. That means that if the next five years are at all like the past 15, half the new jobs created in North Carolina in the year 1994 will be created by businesses that don't now exist, by people not now in business but who are overwhelmingly already resident in the state.

It means if you focus only on existing businesses, you almost by definition miss at least half of the target. It means to me that you've got to look beyond them to invest in people and the infrastructure and those unidentifiable entrepreneurs who will create the business and identify the markets of tomorrow.

We look at business formation rates, the percentage of companies that are growing very rapidly. Nationally, the rate of women's business formation is now increasing at 3 to 5 times that of men's. It is an incredible resource, it seems to me, to be drawn upon. It is also, I might add, our secret weapon against the Japanese, who have not realized that their own women have any economic role to play.

We also look at the diversity of the economy. The extent to which not only the economy looks diverse but acts diverse.

Capacity

Are the resources in place to fuel continued growth? What are those resources?

Far and away all the evidence we have suggests that the key resource is the human resource. Edward Dennison at the Brookings Institution figures he can account for 75% of GNP growth in this country over the last 50 years through increases in human capital -- the health, utilization and skills of the labor force. And everything we know suggests that human skills only become more important from here on out. The Workforce 2000 Report for the Department of Labor suggests that by the year 2000, half of new jobs will require college-level skills. On average in this country, a little more than 20% of the labor force has college-level skills.

We then look at technology resources -- fundamentally another form of human resources. We look at things like numbers of scientists and engineers, federal R&D, University R&D, and patent rates.

We look at financial capacity. Not just how much a state has, but whether its accessible to growing business. We look at the availability of seed capital for start-ups, venture capital or other sorts of risk capital, and debt money for business expansions.

Finally, we also look at infrastructure and amenities. The traditional infrastructure -- roads, sewers -- the new infrastructure of telecommunications (we don't have a good measure for that but we at least ask the question) plus availability and cost of housing, (controlled for per capita income) environmental amenities, environmental qualities, arts, and doctors.

Developmental Policy

Finally we look at public policy. Now the traditional myth is that the best government is the one that governs least. That all you have to do for the economy to prosper is to get government out. But when we looked around at the states that continually seemed to perform well in terms of employment, income, patents and so on, they were states like Massachusetts, Connecticut, Minnesota, and California. They were states where you had a strong public sector working together with a strong private sector, making sure that the basic investments in education and infrastructure and the basic services - police, fire, whatever - were in place. Private investment depends upon those services and those investments. There are things that the private sector won't do, can't do on its own - basic education, basic literacy. It is no accident, it seems to me, that it is business that has leased the push for increased investment in education in Texas, in Washington, in Colorado, even at the expense of higher taxes, because they are the

ones who must pay the bill for an underеducated and underskilled labor force.

We look at six areas of public policy because we think the time is long since past when economic development was something that only the department of economic development or the development board or the department of commerce did.

We look at tax structure, not tax level. Now it may well be that taxes are too high or too low; but the issue really is "are you getting what you pay for?" And we found no way of measuring that directly. One of my favorite editorials after we came out with the first "Making the Grade" in 1987 was in the Atlanta Constitution. It said essentially, "For the last 20 years we could summarize this state's approach to economic development in three words: "No new taxes." Now comes a report on the heels of several other reports that suggests that sometimes you get what you pay for."

We do look directly at tax structure. Business investments are long-term investments. To the extent that they depend on a predictable level of public investment and public services business want to know year-in, year-out whether those services and investments are going to be around. We looked at the balance and stability of the tax system. Could the tax system, in good years and in bad, in recession and expansion, produce the revenues necessary to underwrite the essential services and investments. A big problem you see in Louisiana, Texas, and Alaska right now is they built their entire tax on petroleum revenues, and they are in trouble.

We look at the fairness of the tax system -- across industry lines, across income groups, across communities. Taxes should not determine the investment decision. What we want is lots of people making decisions about what they think are the best investments based on underlying value, on expectations of future return.

We look at mobilizing capital. Most investments for business development will come from the private sector. The question here is not direct public investments, although, sometimes that's needed. The question is to what extent is the public sector working with private financial institutions to adjust to the new economy where risk is inevitable and opportunity is abundant but where you have to be not risk-avoiders but risk-managers. There are lots of cheap ways to do that.

We look at business and technical assistance. Is technology getting out of the labs into commerce: are there incubator programs, small business assistance centers, a lot of the stuff that North Carolina is already doing.

We look at infrastructure. We look at the extent to which a state knows its infrastructure needs and assesses them regularly; investments in affordable housing, environmental quality, and health care.

Finally, we look at investment in distressed communities. We look, for instance, at the transfer payments system, particularly welfare and unemployment compensation.

It is having that safety net there that makes people willing to take risks - enables them, conserves human resources. But it seems to us that those payments can do more than merely maintain, that they can become investments in economic independence and employment and job creation. We measure the extent to which states invest transfer payments in this way.

We also look at community development corporation programs. State government is often a centipede without legs; the legs - are community institutions like community development corporations. neighborhood development organizations represent are absolutely crucial. We need to develop those legs.

The Second Wave: Achievement and Limits

The achievements of the **Second Wave** are, I believe, significant. Much has been tried, much has been learned, and a pattern of recovery has emerged which is hard to separate totally from the new policies.

But the limits of the **Second Wave** are becoming equally clear. First are the unabated challenges apparent in the pattern of results of the 1989 Development Report Card for the States: growing income inequality in virtually every state (only Hawaii, Alaska, and North Dakota broke the pattern) and the nation as a whole; acute distress in rural states (twelve of the thirteen states receiving no grade higher than a C on any index, are best described as rural) and rural areas of states. Growth and development are simply not reaching all areas of the country.

The second limit, also noted in the The Report Card's international measures, is the sense that whatever the success of **Second Wave** policy, we are yet meeting the test of international competitiveness. While we have responded to the impacts of international competition, we continue to lag our major trading partners on such measures as income growth, productivity improvement, exports and trade, manufacturing equipment investment. Our businesses are doubly buffered from meeting international standards -- by the size of our domestic market, and by the lower standards of most visible, domestic competitors. Having observed whole regions of Europe where virtually every business operates at global standards -- tracking global market trends, using the new technologies, employing broadly trained workers as partners in defining production, always seeking to improve quality -- I fear that most American businesses simply do not yet understand the nature of the competition they face (any more than do most students and schools). When the National Federation of Independent Business surveyed its 500,000 small firm members last year, they ranked exporting as 75th out of 75 problems they faced; it wasn't a problem because they didn't do it. That leaves a great problem for the nation. It is a challenge not only of magnitude, but time: How long do we have before the gap between general business practice, or general education practice, becomes so wide that catching up becomes unreasonable. I would guess the period is measured in years, not decades.

- Piecemeal Approach to Development. The current state of Second Wave strategies reflect a piecemeal approach to development. Existing practice generally compartmentalizes development initiatives so that the services are not delivered in a manner sensitive to the total needs of a business or community, but instead provides separate often uncoordinated assistance for technology needs, financing needs, training needs, etc. They view the needs of the business or community through the narrow perspective of what their program can offer rather than what the client needs. It is not unusual for a training program, for instance, to see all the problems as training problems.

  Also, the actors involved in economic development are often kept apart. Economic development is increasingly everybody's business -- chambers of commerce, universities, nonprofits, government agencies, school boards, and so on. And tackling the complex obstacles that constrain our development potential, from inadequate labor force skills to insufficient investment in new R&D, entails the creation of more and better public/private/nonprofit partnerships, where each actor is positioned to what it does best.

- Lack of Integration of Social and Economic Policy. Social problems need economic solutions and the key to a revitalized economy is to bring new people and products to the marketplace. Keeping our efforts bifurcated perpetuates a vicious circle of a faltering economy blocking further social programs, while increasing rates of poverty, crime, ill health, and poor education undermine our economic dynamism.

- Lack of Accountability. The most fitting characteristic that describes the shift to a "home grown" economic development strategy is broad experimentation. States across the nation have been trying to uncover ways of promoting and sustaining economic growth among its existing and newly formed businesses. But it was experimentation that too often placed an emphasis on innovation to the neglect of evaluation. At the end of nearly a decade of this Second Wave, there is a paucity of indicators to measure the successes and failures of the approaches undertaken. This lack of performance data makes it difficult to refine or adapt these newly crafted initiatives -- that is, to learn from the experiences of these initiatives.

  A related concern is that many of the initiatives created during this period of experimentation failed to clearly articulate who their intended clientele was and why. And even those initiatives that set cler and reasonable eligibility standards often neglected ways to promote ownership of these initiatives by their intended clientele and to require a client investment in the services being offered. By not emphasizing a client matching investment of some sort, these initiatives missed an

opportunity to create an automatic and self-enforcing feedback loop into the desirability and value of their services.

Finally, and most fundamentally, **Second Wave** policies beg the question of scale. Even if you accept the general proposition that the theoretical and empirical evidence suggest that policy has had something to do with the pattern of state recovery from international shocks, especially when measured against the magnitude of the domestic and international challenges we face, the question becomes, is it enough?

Thus far, I think the answer has to be no. All the educational reform and investment efforts of the past five years have yielded improvements of about five percent in test scores; still the educational system fails on the order of 30% of the kids going through it -- kids who don't finish, let alone the ones that do with little to show. Most of the 100 or so development finance programs launched by states in the last decade are lucky if they supply (needed) capital to a handful of businesses; in no way do they generally change the overall availability of capital in state economies. Rural areas, urban areas, remain mired in new and historic disadvantage. Business assistance programs reach out to few businesses with advice of uneven quality.

In reality the three challenges are one and overlapping. We cannot maintain a globally competitive economy if we are doomed to carry one-third of the nation in dependency. And however laudatory the results of program and policy initiatives, if they are too small or too slow to induce the needed change, then there is little cause for satisfaction.

The question becomes, are the policies of the magnitude of the challenges and opportunities we face? If not, we need to take what we have learned from **Second Wave** policies, to craft a more adequate new generation of policy--the **Third Wave**. We can begin to discern some of the dimensions of the **Third Wave** by looking at some emerging policies and policy proposals.

Glimpses at the Third Wave

Education[2]

That American education is not producing students educated to the skill levels required to meet current requirements, let alone the demands of global competitiveness, is no news. The statistics are now fairly familiar: one third of ninth graders drop out before completing high school. Most high school graduates fail to meet levels of math, science, geography even reading competency achieved by students in Singapore and other trading partners; we instead pride ourselves in the fact that 95% exceed 6th grade competency standards. Skill bottlenecks show up with increasing frequency, stifling our most booming state economies, condemning lagging economies to further mediocrity.

And so most states mounted education improvements efforts, at once increasing funding and introducing various reforms. But this wave of reforms has consisted chiefly in getting more out of the current system by increasing accountability, setting minimum standards for graduation rates etc., raising teacher certification and testing requirements, improving school management, and introducing special programs for particular groups of students. The results have been predictably modest: the best data we have suggest improvements of no more than 5% over several years in increased student competency.

The realization is dawning that we cannot get dramatically different results by pushing the existing machine a little harder, greasing it a little more. Instead, we will have to change fundamentally how we educate. The Third Wave reforms necessary to do this are beginning to emerge: Move from a "batch process" means of educating, where students are grouped in classes and taught the same things en masse, to individualized, computer-based instruction. Treat schools as the unit of reform, allowing parents, teachers, students under the leadership of the principal wide discretion for producing better results, rewarding improvements with large financial incentives which in turn can power further innovation. Extend the school year (Japanese students train year-round), and the school day; implement early childhood education and after-school programs everywhere. Adopt a "zero defects" goal, just like modern industry.

South Carolina has produced marked improvements from a school-based incentive program. And school districts as diverse as those in Miami, Harlem and Rochester have been able to show results from more entrepreneurial systems.

Development Finance[3]

Most states' development finance programs provide subsidized loans directly to a few worthy businesses. Even if we assume for a minute that all those deals are good and necessary -- surely an heroic assumption given the loss rates, allegations of political interference, etc. experienced -- they are not even conceivably of a magnitude to change the overall performance of a state economy. After all, in most states we are dealing with hundreds of thousands of businesses, and financial investment in the tens of billions. A state is unlikely to appropriate much more than $10-20 million to establish a development bank.

But if the resources committed are modest, the gaps they seek to fill are huge; lack of seed and risk capital, expansion debt. The best evidence we have is that capital is most difficult to obtain precisely when it is most needed for growth. For example, when NFIB polled its members to see how well banks were meeting their credit needs, the overall response -- 94-95% -- was just fine; but the 4-5% who said their credit needs weren't being met were different from credit needs last. The challenge is really to change private sector investment behavior -- individual and institutional.

The Michigan Strategic Fund is the one development finance institution in the country that at least attempts to take on the task of changing financial behavior/culture. The principles underlying its four innovative windows are instructive.

- **Extend financing at market rates.** The primary issue is access to capital not cost. Market rate financing helps reduce substitution of public for private capital, and allows the MSF to achieve long term sustainability, even growth.

- **Target financing to identfied market gaps.** The MSF's windows are aimed at providing seed capital, mezanine risk capital, expansion debt, and capital to minority ventures.

- **Wholesale capital to privately managed institutions.** By investing state funds in privately managed institutions meeting the purposes of the program, Michigan avoids both political influence on investments and the difficulty of attracting, maintaining, and managing highly specialized, skilled and expensive personnel. It can also move more money and leverage more.

- **Leverage private capital.** By requiring a private sector matching investment, Michigan both introduces a market test of the desirability of the financing vehicle, and multiplies the impact of the state investment. Direct leverage ratios -- the ratio of total funds in the pool to public contributions -- runs from a minimum of 2:1, to a high of 17:1 in the Capital Access Program.

  The MSF has only been operating for a little more than a year, so it is too early to call it a success. But already it has induced the participationg of 60 banks and 160 businesses in the Capital Access (expansion debt) Program; set up six BIDCO's expected to provide $500 million in mezanine financing over a decade; created a pool of $10 million in seed capital, and established several new seed funds.

Human Investment[4]

If, indeed, investment in yourself pays, then perhaps the problem in the chronically depressed communities not sharing in general recovery is that we haven't included them in the investment strategy. Oversimplified, the argument becomes: for fifty years we have spent on the poor, but we haven't invested in them. Indeed, our transfer payment programs (welfare, unemployment compensation, social security) have been premised on the social contract, as one colleague put it, "We will support you as long as you don't seek training, you don't work, and you don't, of all things, try to create a job for yourself." Pursue any of these routes to economic independence, and we will reduce benefits, often precipitously. The predictable result of such a contract is that effort is penalized, and the poor are

separated and stigmatized. Money is spent, but the returns -- economic and political -- are limited to sustained consumption.

There is another way. We call it Transfer Payment Investment (TPI), and asks how existing transfer programs can be changed to encourage and support individual (and group) movement toward economic independence through social support, skill development, employment and self-employment. The opening moves of this change are already in evidence -- in the extention of medical coverage and childcare to recipients moving into the workforce contained in last year's welfare reform bill, and in the broadened range of choices and state investments contained in programs like Massachusetts ET Choices program. But it is perhaps best signalled by the experiments underway in a dozen states (including North Carolina) to open a realistic self-employment option to the poor and unemployed.

During the last eight years, ll other nations that have changed their unemployment compensation and welfare systems to allow unemployed people receiving benefits to continue receiving benefits sometimes in a lump sum if they want to try to create a job for themselves. The most reliable data come from the British Enterprise Allowance Scheme which has allowed more than 300,000 unemployed -- 2-3 percent of those eligible -- to start a business. Even though there is little business assistance provided, 54% of the businesses are still trading and profitable 3 years after start up. The businesses are creating an average of 1.5 to 2 jobs each, and the British Exchequer figures that after the third year of the program it actually makes money on the scheme.

The state experiments now under way, including North Carolina's, test whether we can achieve such results in the United States with its far more varied unemployed and disadvantaged population. It is too early to know how well these experiments will work, but we are already finding some interesting things: One: the response among welfare recipients and unemployed people to the option is extraordinary. Three hundred people showed up to an introductory meeting in Detroit; one hundred forty people called in within 36 hours of hearing about the program in Meridian, Mississippi. Two: many long term welfare recipients will opt for the program; Three: already successful businesses have been started up by welfare recipients and dislocated workers.

But perhaps the real benefit of the programs is not so much the 1 or 2% of dependant people they will help escape poverty, but rather the changes in thinking that they induce. First, in this age of the entrepreneur, if the public comes to understand that welfare recipients are not only potential clients, beneficiary, trainees, employees, but also potential entrepreneurs and creators of wealth, it has to take another look at who is poor and why they are poor and what the ways out might be. In short they begin to recognize the capacity to produce, exists and justifies efforts to expand that capacity. In so doing a social and political trust can increase. Second, it can help us see the benefits of chaninging a maintenance system into an investment system. If, like the British, we find out that in fact our willingness to invest some money today will produce greater returns in the

future, then we have a powerful, political as well as economical program. This begins to suggest the outlines of a much broader human investment stratergy.

For almost fifty years we have had one set of policies to guard the main stream health of the economy -- largly a domain of white males, and another social service -- those who cannot support themselves in the main stream economy -- largly women and minorities. The limits of that bifurcated system are now obvious; while the rising tide helps, it does not lift all boats. Meanwhile the maintenance of social service systems may have provided a net but no ladder. A human investment system would bridge and intergrate this bifurcated structure. It would say to people, "We will invest in you and in your efforts at economic improvement, if you will invest yourself -- your talent, your efforts, your resources." Note: That money would be invested only where individuals are willing themselves to invest; and in that sense the entitlement is earned. Money would be dispersed according to return on investments. This is a strategy to increase supply not simply to distribute it, by engaging, building harnessing the productive capacity of people's energy and vision. It is designed to produce returns greater than the initial investment. We have good evidence, have many social programs -- Head Start is the clearest example -- where returns exceed investment, though we have never attempted in a coherent way to invest discretionary public funds on the basis of return, or to develop accounting and monitoring that would track real returns on investment. Of course, this is something we can never do perfectly and we can only do it inadequately at present, but we can certainly do better than we do now, and in building a system to collect the numbers and quantify returns, we build a powerful political and economic rationale for increased investment and increased returns over time.

People get poor for different reasons and they will escape through different routes. A human investment system can accommodate the wide range of choices of routes to self-sufficiency -- training, education, employment, and self-employment. And it can do so in a way that builds political and economic strengths over time. The outlines of the approach are clear enough; the precedent surmounting. But no state has yet to launch a truly integrated human investment system. It would not be outrageously difficult to do this; in its initial stages it could be done simply by reprogramming existing funds.

Business Assistance

Most states and localities provide assistance to business the old-fashioned way: one-to-one, one-by-one -- that is one (public or nonprofit) technical assistance provider to one business person. It is an expensive system. It is a slow system. It is one where no adequate evidence exists of the general effectiveness of the approach as a whole and where clearly the effectiveness of individual assistance providers varies dramatically. Most importantly it is clearly not of the scale of the challenge in terms of extent of business effect, or speed.

The challenges indeed are huge. A problem, it seems to me, is not so much a problem of our best businesses. The top five percent or ten percent of American businesses, large and small, young and old, manufacturing and service -- are probably as competitive as any in the world. They meet global standards of awareness of global market trends, application of the new technologies, broad training of the employees in diverse skills, new management techniques that treat workers as partners and potential entrepreneurs. The best evidence we have is at the next 90 percent are not so operating. And yet, it is very clear that in other countries and certainly other regions of other countries like Italy, Germany, Denmark, Sweden; there are virtually every business, however small, including microbusinesses operate at global standards.

The way these other countries and regions have accomplished this change in business culture is instructive. In these "network regions" large numbers of small businesses collaborate to accomplish together what they cannot accomplish alone: tracking market trends, investigating new technology, purchasing new technology, negotiating working capital loans, developing design talent.[5] Sometimes seeded by government, these collaborative activities grow out of institutionalized communication among the firms which means that almost the moment any firm identifies a new market trend, or technological adaptation, all the firms in the region know about it. In essence, instead of trainers or assistance providers training firms, firms teach and learn from one another. It is a more proven and respected source of advice.

The most noted network region, though by no means the only one in Italy, let alone in the rest of Europe, is state size region of Emilia-Romagna, just north of Florence, south of Venice and east of the heavy industrial area of Milan and Turin. This region of four million people, rose from 17th amongst Italy's 30 regions in per capita income to 2nd in a ten-year period as wages rose from 90 percent the Italian norm to 125 percent. They accomplished this remarkable increase through the sort of networking described above. They did it in lots of small steps, not through any one breakthrough. They did it by building on the base they had, by building on the people they had. In this region in Italy, there are now 325,000 businesses, one for every five members of the active labor force of 1.7 million. In this region of Italy 3 out of 10 workers start businesses each year. When you go to the technical schools kids describe their career path as "mastery of the trade, working in a small firm, starting my own."

There are examples of networks in the United States. It is no accident perhaps that the industry which best demonstrates this form of organization is the film industry with its high quality standards, rapidly evolving technology and high needs for creativity. But conscious experimentation is only beginning. Western North Carolina happens to be the site of one of the more interesting experiments in this country at applying network concepts.

At their best, network models suggest a very different and promising way of upgrading, modernizing business culture. In many ways it is the business

We need to recognize entrepreneurship as an attribute not just of the private sector in terms of small firm formation, and also as a characteristic that can apply to larger firms, non-profit sector and indeed the public sector. The best definition of entrepreneurship seems to me to be the process of combining resources and new ways to add value. There is a premium on constantly figuring out how to do things better and differently. It means that all our systems must become more entrepreneurial. That all our institutions must become more entrepreneurial. Thus, how the system is structured then the spread of entrepreneurial systems to all aspects of policy becomes more than a question of means, it becomes the key, we think, to unlocking the scale.

Obviously, we can only glimpse the emergence of the **Third Wave**. But, the rising tide is observable and necessary.

1. See Making the Grade: The Development Report Card for the States. Washington, D.C.: Corporation for Enterprise Development, 1987; Making the Grade: The 1988 Development Report Card for the States. Washington, D.C.: Corporation for Enterprise Development, 1988; The 1989 Development Report Card for the States. Washington, D.C.: Corporation for Enterprise Development, 1989.

2. This discussion is based on the articles in "Education Reform." The Entrepreneurial Economy Review. Washington, D.C.: Corporation for Enterprise Development. December/January 1989. Volume 7, Number 5, particularly the lead article and thinking of Jack Brizius.

3. See "The Culture of Development Finance." The Entrepreneurial Economy Review. Washington, D.C.: The Corporation for Enterprise Development. Volume 7, Number 3, October 1988.

4. See Robert Friedman, The Safety Net As Ladder: Transfer Payments and Economic Development, Washington, D.C., 1988.

5. See "Flexible Manufacturing Networks" The Entrepreneurial Economy Review, Washington, D.C.: The Corporation for Enterprise Development. July/August 1987.