# Shaping the Great Lakes economy: a conference summary

**Richard H. Mattoon**
**and William A. Testa**

The global marketplace today is a scene of intense struggle, with powerful contenders from around the world. In order to survive, U.S. firms must become fleet-footed competitors, able to adapt quickly to changes in market conditions. Nowhere is this more true than in the Great Lakes region. Building on the area's natural resources and its historic strength in manufacturing and agriculture, policymakers hope to consolidate the region's dominance in some industries while bolstering or revitalizing other areas of its economy. The question is which economic development strategies can accomplish these goals.

On October 15, 1992, a distinguished group of development experts met in Indianapolis for a conference called *Shaping the Great Lakes Economy,* sponsored by the Federal Reserve Bank of Chicago, the Great Lakes Commission, and the Institute for Development Strategies of Indiana University. The purpose of the conference was to take stock of the region, to survey and assess economic policies currently in place, and to explore other approaches that might benefit the region. The following is a summary report of that conference. (For a complete presentation of speakers' remarks, see *Shaping the Great Lakes Economy*, published by the Federal Reserve Bank of Chicago. See box for articles and authors.)

### State of the region and policy environment

David R. Allardice, Vice President and Assistant Director of Research at the Federal Reserve Bank of Chicago, began with an overview of economic conditions in the Great Lakes states. During the most recent recession, the region has fared about as well as the U.S. as a whole. That performance is noteworthy, since the region has historically been hammered during national downturns.

Viewed in this perspective, the Great Lakes economy has clearly experienced long-term structural change in the past thirty years. The region comprised of Illinois, Indiana, Iowa, Wisconsin, and Michigan has lost 13 percent of its manufacturing employment since 1963 and has seen its share of the nation's employment drop from 27 to 22 percent. During the 1980s, the economy flourished on the nation's east and west coasts, yet Great Lakes firms suffered slow export growth in basic industries such as steel, autos, and machinery, which were affected by the climb in the value of the dollar overseas. Agriculture also waned from 1980 to 1985, dampening the region's prospects. By the end of the 1980s, a falling dollar and an increased demand for Great Lakes capital goods brightened the region's outlook just as growth on the coasts cooled.

Today, the Great Lakes region shares many of the nation's problems, including a slowly-growing labor force, overbuilt commercial real estate, and structural adjustment. Yet these problems have been far less severe regionally than on the coasts. Mr. Allardice said he believes that in the short term, a shallow recession

Richard H. Mattoon is a regional economist and William A. Testa is senior regional economist and research officer at the Federal Reserve Bank of Chicago.

will translate into a shallow recovery for the region. Long-term prospects have also improved, as the region now seems well positioned to capture future growth.

The next two speakers outlined federal and state policies affecting the Great Lakes region. According to Richard Munson, Executive Director of the Northeast-Midwest Institute, the impact of federal policies on the region has been somewhat contradictory. Because its population has not increased, the region has lost a number of seats in the House of Representatives. This loss may be offset, however, by increased clout on key congressional committees. Thanks to the seniority of the region's congressional delegation, the Great Lakes holds several key chair-

## Shaping the Great Lakes Economy

Papers presented at the conference on October 15, 1992

**Welcoming remarks**
Charles F. Bonser, Institute for Development Strategies, Indiana University

**Session I. State of the region and policy environment**
*State of the regional economy*
David R. Allardice, Federal Reserve Bank of Chicago
*The federal policy environment*
Richard Munson, Northeast-Midwest Institute
*State development policy in Indiana*
James D. Laughlin, Indiana Economic Development Council, Inc.

**Session II. Midwest industry—new machines, new labor, and new management**
*The new manufacturing paradigm*
Daniel C. Knudsen, Institute for Development Strategies, Indiana University
*Advanced manufacturing application and education centers*
James A. Richter, National Center for Manufacturing Sciences
*Work force preparation for the new economic environment*
Robert G. Sheets, Center for Government Studies, Northern Illinois University

**Session III. What are the Great Lakes states and Canada doing with economic development?**
*Technology and entrepreneurship*
Andrew T. Greenberg, Department of Commerce, State of Pennsylvania
*The Canadian experience*
Anne Charles, Consul General of Canada, Detroit
*Development activities in Michigan*
Marge Byington, Michigan Department of Commerce
*Strategic planning in Minnesota*
Lee W. Munnich, Jr., Hubert H. Humphrey Institute of Public Affairs, University of Minnesota

**Session IV. New directions: regional strategy in a global environment**
*Third wave approach to economic development*
Brian Dabson, Corporation for Enterprise Development
*Emerging development strategies*
William Testa, Federal Reserve Bank of Chicago
*Fashioning intiatives for Great Lakes policymakers*
Timothy P. McNulty, Council of Great Lakes Governors, and
William Brah, Center for the Great Lakes

For a complimentary copy of these proceedings, write or phone:

**Public Affairs Department**
**Federal Reserve Bank of Chicago**
**P.O. Box 834**
**Chicago, Illinois 60690-0834**
**Telephone: 312-322-5111**

manships on the major policymaking committees.

A second contradictory trend has to do with federal spending. Because of concern over the deficit, less federal money will be available for all regions. Yet defense cuts will affect the Great Lakes less than other regions. Moreover, a shift in the composition of federal spending toward infrastructure investment could provide some real benefit, given the region's infrastructure needs.

In conclusion, Mr. Munson raised the issue of undercounting in the 1990 census. Because census figures are critical to federal funding and representation, it is essential that future counts and adjustments be reliable and accurate.

Next, James D. Laughlin, Senior Research Fellow at the Indiana Economic Development Council, Inc., discussed development policies of Great Lakes state governments. Here again, contradictory trends are at work. Like the federal budget, state budgets have come under the ax. Yet states need to allocate more for productive resources, particularly infrastructure, work force development, and business investment. Given fiscal austerity, states will increasingly seek to leverage private sector investments.

This approach should significantly help the Great Lakes area. Many sewers, roads, and bridges are in disrepair, and this may have hurt the region's competitiveness. Since the Great Lakes states have low levels of bonded debt, they could use this means to raise funds to restore infrastructure.

Work force development will also be critical, since workers need upgraded skills to produce the high-value-added products that will dominate future production. To reach this goal, states must increase vocational education and provide incentives for individuals to invest in their own education.

Finally, well-targeted investment incentives and abatement programs can stimulate some types of economic development. Any such measures should contain safeguards so that they do not become giveaways.

### Midwest industry—new machines, new labor, and new management

The conference turned next to changes in industry and their impact on the region. Daniel C. Knudsen, Associate Director of the Institute for Development Strategies of Indiana University, described flexibilism, the new manufacturing paradigm that is replacing Fordism as the "best practice" production process. Fordism is a process-based organization of production with a highly technical division of labor in which most workers perform single, repetitive functions. Profits accumulate through the exploitation of economies of scale. Flexibilism, by contrast, is a product-based organization of production, with economies of scope producing profit. Rather than having one single function, each worker performs a variety of tasks and shares responsibility for production planning, organization, and quality. Similarly, under flexibilism a machine may serve a range of functions rather than one fixed function. These flexible production methods cost less, require less space, and yield higher quality products than traditional production methods.

Historically, Fordism has been the production method of choice throughout the Great Lakes region, and both management and labor have resisted adopting flexibilism here. Nevertheless, flexibilism is gradually gaining ground here as elsewhere in the nation. Research and education can help speed this trend. James A. Richter, Vice President of Strategic Development for the National Center for Manufacturing Sciences, described how networks of "teaching factories" can encourage collaboration and dissemination of innovative manufacturing practices. Such programs can be especially helpful to small manufacturers, who often fear the added expense and risk of failure associated with new technologies and methods. At the same time, collaboration lets large manufacturers try out new techniques without disrupting production. In general, collaboration enables firms to share the costs and risks of innovation and to hasten commercialization. Our competitors are ahead in this regard: Japan now has 170 teaching factories, while Germany has 50. The U.S. would do well to follow their lead.

Fundamental to flexibilist manufacturing is a work force educated in new ways. Robert G. Sheets, of the Center for Governmental Studies at Northern Illinois University, discussed the example of front-line workers. Under flexibilist production, they do not simply operate one machine, but also share in production planning, monitoring, and adjustment. Traditionally, front-line workers have not needed a college degree, yet in flexible manufacturing systems, they must be multiskilled and capable of cross-training and job rotation. In addition, the shift from functional to customer- or product-centered organization means that all employees will be involved in improving products and services. This requires some knowledge of industry trends and pressures, product design, and production.

The skills required for these varied tasks go far beyond basic reading and math, to problem solving, communication, and team building. Unfortunately, the U.S. lags behind other countries in offering this type of training. In Germany, for instance, an advanced apprenticeship program teaches broad higher-level skills in combination with rigorous practical ones. Upon successful completion of a three-year apprenticeship, students may continue on to advanced training and degrees. Germany's system is considered a model in easing the school-to-work transition.

The U.S. should establish programs like this to help ensure that future managers and engineers have a strong practical orientation and that front-line workers are lifelong learners who can adapt to shifting work roles. Sheets advocated a demand-driven, market-based approach, coordinating public and private institutions. To begin, government should offer firms incentives to train front-line workers as well as managers and technicians. Next, more training opportunities for school-aged youth, such as Tech Prep and youth apprenticeship programs, should be available as alternatives to four-year colleges. Finally, national minimum skills standards should be established for all vocational and technical training.

### What are the Great Lakes states and Canada doing about economic development?

Four development professionals described how governments have responded to the changing economic landscape. Andrew T. Greenberg, Secretary of the Pennsylvania Department of Commerce, noted that Pennsylvania's development efforts have focused on improving quality and competitiveness. State assistance currently has three goals: to help traditional industries streamline and retool in order to be competitive; to identify new ventures that can generate jobs to replace the jobs disappearing in large, traditional industries; and to develop the skilled, flexible work force needed now and in the future. In pursuit of these goals, the state offers business financing, has set up Industrial Resource Centers to introduce smaller manufacturers to new technologies, and has established the Ben Franklin Partnership, an incubator program for new products and processes. To be eligible for any of these programs, a company must be designated a quality firm.

Canada faces a different set of challenges, said Anne Charles, Consul General of Canada in Detroit. While the U.S. economy is highly integrated, Canada's is still largely a collection of regions with differing primary products and activities. The federal government has sought to equalize fiscal disparities among provinces, develop regional economic programs, share costs for health and social services, and establish federal fiscal transfers to the provinces while harmonizing income tax collections.

Exporting is a particular concern of the Canadian government. The 1989 Canada-U.S. Free Trade Agreement has worked very positively to make Canada's economy more competitive and less resource-based. Canada hopes the North American Free Trade Agreement (NAFTA) will similarly improve its access to the Mexican market.

Marge Byington, Chief Deputy Director for the Michigan Department of Commerce, described how a state facing severe fiscal constraints can craft development programs. Michigan is now focusing on the building blocks of the economy—transportation, education, environmental protection, and export development. The state is launching a huge capital outlay program to repair roads, bridges, ports, airports, and rail lines. A major new adult education program will be driven by employers rather than educators. To improve environmental protection, the state offers businesses technical assistance in waste reduction, recycling, site reclamation, and permit processing. In addition, the state is working with the Big Three automakers and the Motor Vehicle Manufacturers Association to reduce toxic emissions.

Michigan is also seeking to spur growth through aggressive exporting. Since 1987, annual sales by Michigan firms to Mexico have jumped 60 percent, and the state is now Mexico's third largest trading partner. NAFTA should bolster this trend.

Lee W. Munnich, Jr., Director of the State and Local Policy Program at the Hubert H. Humphrey Institute of Public Affairs at the University of Minnesota, provided a final perspective on state activities. Munnich highlighted two economic development tools Minnesota has used—state assistance in funding megaprojects, and strategic planning. The first megaproject was the state's offer of $800 million to Northwest Airlines to keep its principal operations within the state. Although the economic justification for this act was shaky, its political purpose was clear. Northwest Airlines is a major Minnesota employer, so its location is of great interest to state politicians; in their eyes, the risk of losing the airline outweighed the sizable cost of the state's investment.

Minnesota's second megaproject was the 4.2 million square foot Mall of America. Here the state's investment was limited to highway improvements and local tax increment incentives; it was justified by a projection that the Mall will attract 47 million visitors per year and employ 10,000 people. It remains to be seen whether these megaprojects will boost the state's development.

Strategic planning is also part of Minnesota's development policy. The state has instituted "Minnesota Milestones," a benchmarking program patterned after a pioneer effort in Oregon. Benchmark programs establish specific goals for a state's development efforts. In conjunction with this effort, the state Department of Trade and Economic Development has developed an "economic blueprint" with seven broad goals: 1) sustained, above-average growth consistent with environmental protection; 2) internationally competitive levels of productivity growth; 3) adequate levels of family income; 4) adequate capital investment; 5) a business environment conducive to business creation, innovation, and retention; 6) improvement in employment and economic opportunity for all citizens and regions of the state; and 7) a diversified industrial base to insulate the state from economic shocks.

Finally, Minnesota is also investing considerably in infrastructure development, including telecommunications, human capital, and transportation.

### New directions: regional strategy in a global environment

The next two speakers examined regional strategies from an overall perspective. Brian Dabson, President of the Corporation for Enterprise Development, placed current economic development practices in the context of "third wave" development thinking. According to this theory, state governments have progressed through three eras of development policy. In the first wave, the goal was to attract industry; thus states offered tax abatements and incentives. These strategies lost their appeal once firms found they could locate more cheaply overseas, and once they realized that a skilled work force was more critical than low operating costs in making products that could compete in export markets. In the second wave, states tried to help firms compete in the global economy and to encourage entrepreneurship. This approach led to a wide range of development programs, from financing and export initiatives to technology transfers. While these programs seemed promising, they were often fragmented and uncoordinated and therefore often did not produce the intended results. Lacking both accountability and scale, these efforts failed to leverage private sector resources.

A third wave of development thinking has now emerged. In this view, states can promote growth by investing in all forms of infrastructure, defined broadly as human, financial, physical, and technological. Hoping to learn from the mistakes of the past, third wave planners focus on the implementation of development policy, paying special attention to program quality, accountability, and impact. Third wave programs are customer-driven, and governments seek the input of business when designing them. Further, programs are planned to be continuously evaluated and improved.

Finally, third wave programs share four characteristics: 1) the resources allocated are commensurate to the scale of the problem; 2) additional resources may be harnessed from other sources outside government; 3) investment and capacity-building are emphasized; and 4) targeted problems are ones faced by an entire industry or a group of industries rather than by single firms.

More and more economic development programs reflect third wave principles. Examples in the Great Lakes region include Michigan's Strategic Fund for development financing, Ohio's Edison Technology Centers, and Pennsylvania's Ben Franklin Partnership and Industrial Resource Centers. While these are promising efforts, it is still not clear whether programs of this scale can improve the competitive position of the nation. Perhaps a next wave will involve regional cooperation to leverage greater amounts of resources.

William Testa, Senior Regional Economist and Research Officer at the Federal Reserve Bank of Chicago, pursued this issue of regional cooperation. The single most compelling economic change in recent years has been the enormous growth in global competition, which vigorously pits regions such as the Great Lakes against other regions of the world. Some regions, such as the European Community, have lowered internal trade barriers and other impediments in an attempt to improve the regional export base in world markets while enhancing the region's quality of life.

Perhaps the U.S. too should reexamine certain nontariff barriers erected by states. For instance, many states have health and welfare standards that were designed more to protect in-state industries than to ensure the well-being of residents. So-called health regulations against importing produce into a state were often meant to protect that state's produce industry. State-specific occupational licensing limits the mobility of workers across states, causing a loss to workers and society. States have also created inefficiencies in their regulation of in-state commerce. In some states, for example, *intrastate* trucking rates may exceed *interstate* trucking rates.

A final class of impediments stems from the lack of uniformity and reciprocity in public programs. While these are not attempts to inhibit regional trade, they represent missed opportunities for cooperation between states. Minnesota and Wisconsin provide an example of what can be done in this regard. The two have agreed that students from either state may attend a public university in either state at the lower, in-state tuition rate. This arrangement gives students more academic choice and gives universities a larger student pool from which to draw.

Unfortunately, cooperative ventures such as this are rare, yet they could be especially effective in planning infrastructure and attracting new business opportunities. Moreover, a cooperative approach could produce the leverage and scale that are critical to third wave strategies. While the region has tried some cooperative programs such as the Circle Tour and the "fresh-coast" campaign, more needs to be done. By eliminating unnatural barriers, rationalizing and standardizing key government services, and acting cooperatively, the Great Lakes region could significantly boost its competitiveness in world markets.

One major effort at regional cooperation is now underway. Timothy P. McNulty of the Council of Great Lakes Governors, and William Brah of the Center for the Great Lakes described their organizations' joint study of the region's policy environment. The study seeks to determine which types of policies can strengthen the region in the face of global competition. It will survey key policymakers and industry leaders to learn their views on the health and future of the region. Ultimately, the goal is to develop an action plan with three to five focuses that can be implemented on both sides of the U.S.-Canada border. The study is scheduled for completion by the end of 1993.