

EDA Reauthorization:
Rating Past Performance and
Setting Goals During an Economic Crisis

Testimony Before the
U.S. House of Representatives

House Committee on Transportation and Infrastructure

Subcommittee on Economic Development,
Public Buildings and Emergency Management

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March 10, 2009
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Testimony of Jonathan Sallet,ⁱ
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Summary

I believe that the Economic Development Administration, (EDA) should support regional innovation clusters in order to bring together the key ingredients of competitiveness policy – encouraging innovation, lowering the effective costs of operation for growing businesses, matching workers’ talents with Twenty-First Century requirements, and creating private-public partnerships in which governments can play a constructive role by fostering the best conditions for economic growth and job creation through bottom-up, industry-led processes.

My recommendation is that regional innovation clusters should become the centerpiece of a reauthorized EDA, empowering the agency to work with businesses, universities, community colleges, state and local governments and community leaders to foster regional competitiveness strategies. That will help boost job creation and business growth by spurring the creation and growth of successful regional ecosystems, striking exactly the right balance between federal leadership and local responsibility and between the private and public sectors. It can also serve as a model for federal micro-economic initiatives more generally, which should support regional competitiveness strategies.

Testimony

Madam Chair, Congressman Mica and members of the Subcommittee on Economic Development, Public Buildings and Emergency Management, thank you for the opportunity to testify today on the reauthorization of the Economic Development Administration.

With the current economic crisis and increasing unemployment throughout the nation, this is the best time to consider how the federal government can work with state and local governments, business, universities, community colleges and communities to restore long-term economic health to our nation. That is the charge of the EDA specifically and of the Department of Commerce generally.

I would like to focus my testimony on one topic: Why the Congress should adopt a novel mission for the EDA – to facilitate the creation and growth of regional “clusters” of innovation, which are the building blocks of national competitiveness. The President’s budget for FY2010 wisely recommends that, for the very first time, the EDA adopt a specific policy to “support the creation of regional innovation clusters that leverage regions’ existing competitive strengths to boost job creation and economic growth.”ⁱⁱ That proposal builds on longstanding academic research and practical experience at the regional level. It could be, I believe, the cornerstone in turning the traditional Economic Development Administration into a new *Economic Renewal Administration* – more focused, more efficient, and more effective.

Promotion of regional innovation clusters would provide a distinctive focus for the EDA, enhance federal innovation policy and serve as an important example of how the federal

government can support regional competitiveness initiatives, while recognizing the importance of local leadership and bottom-up strategies.

I served as the Director of the Office of Policy & Strategic Planning for the Department of Commerce for Secretary Ron Brown in the early 1990's. I am currently working with Silicon Flatirons of the University of Colorado on entrepreneurship and innovation policy. Last year, I authored the chapter on the Department of Commerce for the transition volume produced by the Center for American Progress. In that essay, I proposed that the new administration forge a concentrated approach to globalization to benefit both U.S. businesses and workers by building on local and regional "clusters" of competitiveness. Specifically, I recommended that the Department of Commerce should institute a "regional competitiveness initiative" that would

empower local communities and businesses to work together to achieve a national objective: finding the best formulae for sustainable economic growth and innovation. Geographic regions have a proven track record for facilitating innovation, productivity, and high-paying jobs in growing companies. Yet current economic policy does not effectively utilize the potential of these regional clusters or their ability to work with local businesses. This initiative should place special emphasis on how the department can facilitate collaboration between local governments, educational institutions, and businesses, through competitive cost sharing and a longer-term grant program.

A culture of learning and experimentation will be critical to the department's future success. As part of this, the secretary should convene key governmental and business leaders in 2010 to benchmark and share ideas for how the Regional Competitiveness Initiative can best be implemented at the local level and supported by the federal government. The summit should include successful "case studies" from regional competitiveness initiatives such as those implemented in South Carolina, Oregon, Maine, and California, and include a specific focus on energy-efficient and low-carbon technologies. A portion of this summit should be devoted to discussing the feasibility of the Economic Development Administration supporting an initiative for privately-run microfinance programs built on the model of Grameen Bank's first location in New York City.ⁱⁱⁱ

The importance of public policy to further the success of regional innovation clusters is based on a long history of academic research and regional success. More than any other single person, Professor Michael Porter of the Harvard Business School has pioneered the insight that "clusters" – geographically concentrated areas of specialization – form the foundation of regional, and the basis for national, competitiveness.^{iv}

Clusters are geographic concentrations of firms, suppliers, support services, specialized infrastructure, producers of related products, and specialized institutions (such as training programs) whose expertise reinforces one another's. So, for example, a successful cluster can connect firms with academic institutions, research labs, and other nonprofit organizations in order to create the kind of virtuous cycle of competitiveness that creates jobs, stimulates business formation, and improves productivity. Examples of U.S. clusters include metal manufacturing in

the upper Midwest, entertainment in Los Angeles, information technology in Silicon Valley, and furniture in Mississippi. Clusters are common to every advanced economy.

What are the kinds of advantages that are shared by the participants in clusters? They could be a set of workers who have honed particular skills, like building boats in Maine. Or community colleges that offer training to advanced manufacturing workers in places where advanced manufacturers have located. Or research centers that conduct basic research into biotechnology close to biotechnology firms. Anything, really, that creates what an economist would call a “positive externality” – a benefit that is captured not just by a single firm, but that enriches the community as a whole. Positive externalities are nothing new – the externalities produced by K-12 education is the basis for our public school system – but what is new is this: The notion that regions can consciously focus on the creation of shared advantages within clusters to create jobs, help businesses be created and, of course, stimulate long-term economic growth.

The Massachusetts Life Sciences Center is a good example. Massachusetts, of course, has many of the ingredients of a successful life-sciences ecosystem, including teaching hospitals, research facilities, successful biotechnology companies and risk capital firms. Even so, because a cluster has the characteristics of what economists call a “public good”, public-private partnerships can spur additional economic growth. The Massachusetts Life Sciences Center commits state matching funds to support the biotechnology by identifying unmet needs and challenges and then focusing its efforts on areas in which its stakeholders, including the business community of course, believe that the cluster initiative can most make a difference. That includes support for early stage companies and technology transfer, workforce development, the competitive position of academic and medical research institutions, and acting as a convener and coordinator of cluster participants. Within the first year of its existence, the Massachusetts Life Sciences Center has committed \$33 million in public funding, leveraging more than \$327 million in private investment, which is projected to create more than 850 new jobs.^v

As this example illustrates, clusters enhance collaboration and value-creation, drive productivity, and play a fundamental role in knowledge creation, innovation, the accumulation of skills, and the development of pools of employees with specialized skills. They effectively lower the cost of capital, increase accessibility to specialized labor, create positive learning effects and decrease the cost of finding talented workers. They create an ecosystem that is helpful to the creation of new firms in which specialized advantages reinforce each other to the benefit of firms, workers and communities. Their operating principles could be phrased as “Innovation, Collaboration, Value Creation.”

Scholarship from Professor Porter and other scholars^{vi} have established the real advantages of “clusters” for a growing economy, including strong correlations between:

- Per-capita GDP and cluster concentration,
- Cluster strength and wage levels, and
- Cluster strength and higher wages.^{vii}

In other words, clusters are good homes for the high-growth, high-wage companies that move quickly to take advantage of competitive opportunity and create jobs as a result. And that means, of course, that successful clusters are important to the creation and application of successful

innovation policy. Innovation – the use of emerging and old information to create new forms of value – is absolutely critical to the future economic success of the United States. Indeed, in a globalized economy, our ability to be a smart economy is basically our ability to be growing economy. Innovation not only boosts the creation of value, but it also helps ensure that economic growth is sustainable – from the perspectives of both economic and environmental concerns. For example, increased advanced manufacturing correlates highly with increases in energy-efficient manufacturing – the more process technologies evolve, the more that they can do more with less. From this perspective, cluster policy *is* innovation policy.

I believe that the cluster approach brings together the key ingredients of competitiveness policy – encouraging innovation, lowering the effective costs of operation for growing businesses, matching workers’ talents with Twenty-First Century requirements, and creating private-public partnerships in which governments can play a constructive role in fostering the best conditions for economic growth and job creation.

So it is no surprise that the concept of “clusters” has been embraced across the United States. Manufacturing in Cleveland, nanotechnology in upstate New York and metals in Oregon are just some of the examples of strategic initiatives to create regional competitive strength alongside traditional clusters such as the finance industry in New York City, technology in Silicon Valley, music in Nashville and innovation in North Carolina.

The current economic downturn has prompted increased recent interest in how regions can create their own competitiveness strategies in places as different as the Redwood Coast of California, North Louisiana and even my own home on the Eastern Shore of Maryland where agriculture is an important sector.

In fact, national governments around the world, including South Korea, Canada and Sweden have been eager to boost their competitive standing in the global economy by latching onto the concept of clusters. The European Community, in fact, has formed a trans-national European Cluster Alliance.^{viii}

What is surprising is that, for all of its efforts to grow the American economy, the U.S. federal government has never adopted the concept of clusters as a basis for incentivizing regional competitiveness strategies. Rather, the work of the federal government has tended to be project-specific – often valuable but not necessarily tied to the particular strengths of regional economies

Given that the government’s direct ability to help in this realm, now is the time to turn the Economic Development Administration into the Economic Renewal Administration. And that is why President Obama’s recent budget proposal is so important. His FY2010 budget provides “\$50 million for regional planning and matching grants within the EDA to support the creation of regional innovation clusters... and \$50 million to create a nationwide network of public-private business incubators to encourage entrepreneurial activity in economically distressed areas.”^{ix}

My recommendation is that this proposal – the conscious federal adoption for the very first time of a plan to work with state and local governments to foster regional competitiveness strategies –

becomes the centerpiece of a re-authorized EDA. In my view, it strikes exactly the right balance between federal leadership and local responsibility and between the private and public sectors.

Analysis of successful clusters has shown that they succeed with local leadership from industry, non-governmental organizations, including universities and community colleges, and the public sector. Regional leaders have the best grasp of their own competitive advantages and prospects and they are in the best position to execute the kind of collaborative, bottom-up strategies that enhance cluster success.

There is, however, a problem – and one only exacerbated by our current economic crisis. Cluster initiatives are “too few” and they are “thin and uneven in levels of geographic and industry coverage, level and consistency of effort, and organizational capacity.”^x Moreover, traditional clusters are under terrible stress – the automobile cluster in Michigan is suffering not just from the perspective of the automobile manufacturers and their direct workers, but only with regard to the impacts on their supply-chain, including specialized suppliers, and their communities. Consider, for example, automobile parts manufacturers, who have told the Treasury Department that 130,000 jobs were lost in eighteen months.^{xi} Similar attention should be paid to the negative spill-over effects coming from the downsizing of the financial sectors in New York and Boston.

Now is the time for the federal government to play a critical role in supporting regional efforts by framing, facilitating and funding cluster strategies. By that I mean that the federal government can identify the critical national goals, like energy independence, that serve the national interests – an approach endorsed by Congress in the America Competes Act of 2007. The federal government can improve the efficiency of cluster strategies by improving the delivery of various forms of federal expertise to the clusters that need them and by increasing the ability of clusters to learn from each other. And, of course, in difficult fiscal times for states, the federal government can provide additional resources that can smartly leverage existing local and private funds.

For example, the EDA could ask regions, to compete for federal matching funds by offering proposals created in collaboration with their companies, universities, research facilities and non-profits. Funding would be provided for implementation of the best strategies. The EDA should establish a set of criteria that allow the plans with the biggest impact and best prospects for success to be funded quickly. Such criteria could include identifying the proposals that:

- Move fast, with significant impact,
- Use public-private partnerships and other forms of regional collaboration,
- Have a proven track record,
- Integrate distressed areas into larger regional economies, and
- Further the goals of national “challenges” in areas such as energy, healthcare, manufacturing and life sciences.

The federal program should be flexible, of course, in order to respond to the best ideas that come from the regions. The cluster initiative could provide federal matching funds for targeted, high-leveraged activities, such as university research consortia, business incubators, for community-college training programs and technology-transfer efforts focused on small and medium-sized firms.

At the same time, small planning grants would be made available for those regions that have yet to formulate a cluster strategy. An advantage of the cluster approach, especially as we move into an era of budget-deficit reduction, is that the federal funding need not be enormous – indeed, the President’s proposal of \$50 million for regional innovation cluster and another \$50 million for associated business incubators will get these efforts off to a strong start.

The implications are larger, of course, than the EDA alone. One of the advantages of the regional cluster initiative is that it provides the Executive Branch as a whole with a good way of ensuring that micro-economic initiatives are effective and efficient. I would like to see the EDA become an evangelist for high-performance government, tailoring federal efforts to best meet regional needs, fostering collaboration among federal programs that are too often operated in “stovepipe” isolation, and ensuring that federal funds are well-spent.

For example, the Department of Commerce is the agency that, more than any other, focuses on economic competitiveness. Its programs range from assisting exporters to working with minority businesses and the telecommunications sector, to protecting our seas and coastlines, to gathering data on our nation, to working with small and medium-sized manufacturers, to creating industry standards, which are a critical infrastructure innovation. The National Institute of Standards and Technology, for example, has a highly successful manufacturing extension program and has worked with regional economic clusters through its Partnerships for Regional Innovation. As the EDA implements its “clusters” initiative, the Department more generally can align its efforts with the specific needs of regional economies. In this way, for example, the creation of business incubators, as proposed in the President’s FY2010 budget, should be constructed to dovetail immediately with regional clusters.

The federal government also offers many forms of economic assistance to boost business creation and help communities grow economies that could be better aligned with regional competitiveness strategies. Federal efforts in the Department of Labor, the National Science Foundation, the Department of Energy and the Small Business Administration could all focus on clusters.

In this way, the clusters approach can act as the “mortar” to bind together the “bricks” of economic recovery, providing, in essence, a multiplier effect that makes thriving initiatives even more successful. This Committee rightly focuses on physical infrastructure and other parts of the President’s agenda that are working to create a smart electrical grid, greater broadband availability, and the development of several high-speed rail corridors linking regional population centers. The impact of that infrastructure can be increased when strong regional competitiveness strategies exist to take full advantage of clusters’ creation and improvement.

In sum, a huge opportunity beckons when the nation needs economic renewal the most. We know that clusters represent an increasingly important economic unit, but unfortunately it is one that has been virtually ignored in policymaking at the federal level in the United States. By including regional competitiveness as a key mandate in the re-authorized EDA, which I think could be re-named the Economic Renewal Administration, a cluster approach can allow Federal policies to be implemented more effectively by better connecting them to regional leadership. In

addition, Federal policy based on cluster principles will reinforce economic specialization across states and regions, increasing productivity in the economy as a whole. Ultimately, we can create the launching pads for what America needs the most right now – jobs and long-term, sustainable economic growth.

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ⁱⁱ Office of Management and Budget, "A New Era of Responsibility; Renewing America's Promise," (2009).

ⁱⁱⁱ Mark Green and Michele Jolin, *Change for America; A Progressive Blueprint for the 44th President*, (Washington, Center for American Progress, 2008). A successful summit would, of course, include other key federal agencies, including the Treasury Department, the Small Business Administration, the Department of Energy and the Department of Labor.

^{iv} Among Professor Porter's extensive writings on the importance and nature of "clusters" is a recent paper summarizing both his academic work and his public-policy recommendations. "Clusters and Economic Policy: Aligning Public Policy with the New Economics of Competition" (Revised December 17, 2008). His analysis is based on extensive research into the sources of competitive advantage, which he first discussed in *The Competitive Advantage of Nations*, (New York: Free Press, 1990) and explained in, for example, "Clusters and the New Economics of Competition" (Harvard Business Review, 1998).

^v The Massachusetts Life Sciences Initiative: An Update (February 19, 2009).

<http://www.masslifesciences.com/docs/Masterpresentation020209.pdf>

^{vi} Important additional research on this topic includes Karen G. Mills, Elisabeth B. Reynolds and Andrew Reamer, "Clusters and Competitiveness: A New Federal Role for Stimulating Regional Economies," (Washington, Brookings, 2008) and Robert Atkinson and Howard Wial, "Boosting Productivity, Innovation, and Growth through a National Innovation Foundation," (Washington, Brookings, 2008).

^{vii} Mills, Reynolds and Reamer, "Clusters and Competitiveness."

^{viii} European Cluster Alliance, <http://www.proinno-europe.eu/index.cfm?fuseaction=page.display&topicID=395&parentID=0&CFID=886469&CFTOKEN=55624209>

^{ix} Office of Management and Budget, "A New Era of Responsibility."

^x Mills, Reynolds and Reamer, "Clusters and Competitiveness at 6.

^{xi} "The American Car Industry," *The Economist*,

http://www.economist.com/business/displaystory.cfm?story_id=13145718