How state entrepreneurial development strategies may make income inequality worse

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In recent decades many US states have explored new methods of attracting new business and by extension, enhancing employment opportunities. But do these strategies benefit all workers equally? In new research which examines state policies to create an 'innovation economy' attractive to business, **Sarah Young** *finds that such policies actually increase inequality between low and high wage earners; a result which is at odds with the desire of many state officials to create a labor market made up of 'quality' jobs.*

Business is important to the US; recent decades have seen many US states implement policies which attempt to encourage firms to invest and even relocate to their area. But what affects do such policies have on workers? Studies classifying and comparing the varying economic development strategies used by the American states gained attention after the publication of Peter Eisinger's *The Entrepreneurial State* in 1989 and have proliferated ever since. Much focus has centered on the differences between locational and entrepreneurial development strategies: the former attempt to lure business investment through cutting costs, especially labor costs, while the latter endeavor to create an 'innovation economy' with higher-paid jobs and greater overall economic demand.

Previous evaluations of the outcomes of these differing strategies have addressed their impacts on median wages, availability of resources for public services, and the number of jobs created. Economic inequality has been less examined as an outcome of either strategy, with one study contending that entrepreneurial policy was more equalizing than locational strategy, which appeared to increase distributional disparities.

My new research which uses panel longitudinal data from states from 1983 to 2004 finds that increases in use of these entrepreneurial approaches had the long-term effect of raising inequality, while locational strategies had no significant effect.

The demand-side strategies of the entrepreneurial approach attempt to build a wealth-generating economy by promoting high-tech, finance, green energy, or communications industries. The government has a more interventionist role in demand-oriented strategies than it does in locational strategies. Demand-side development goes beyond the provision of tax relief and other passive administrative incentives; it makes government and business active partners in growing capital. Public–private venture capital funds, business incubators in state higher education institutes, and research and development partnerships are features used in this entrepreneurial approach.

Entrepreneurialism has become a preferred economic growth strategy among many politicians and practitioners of economic development, especially as an alternative to competitive bidding wars between states through tax breaks, subsidies and other incentives. ''Growth from within'' state administrators reasoned, could replace an outdated and inefficient model that pushed states to ''beat out'' neighboring states in a mad dash for investment dollars. Moreover, the increased wages offered by entrepreneurial professions offered the promise of richer revenues for public programs, further enhancing the quality of life of citizens.

My findings appear somewhat at odds with the often stated intent of entrepreneurism – to create a labor market composed of “quality” jobs which fuel demand broadly in the economy. Entrepreneurial approaches apparently fail to make low income workers better off, while disproportionately benefiting high-end professionals. One possible reason for this is that entrepreneurial development strategies may exacerbate skills-biased technical change in the labor market. The research of Daron Acemoglu and others, for instance, suggests that higher education levels and skills training of professional-class workers has intensified “between-worker” inequality in recent decades. Furthermore, Acemoglu specifically linked skills-bias change to deunionization, arguing that highly-skilled workers find little benefit in joining unions due to their associated wage compression effects. Highly skilled workers are likely to command premium wages due to market demand for their skills, and union income equalization between classes of workers may run counter to their own individual interests.

Entrepreneurial policy pushes job expansion specifically within the high-skills labor sectors. Such development programs are government mechanisms that appear to reinforce inequities already present in the labor market due to skills-bias. My research found the positive association between entrepreneurial policy and inequality to be significant even when controlling for other important economic and political factors that could affect inequality, such as partisan control of government, unemployment, internationalization of the state economy, and unionization.

My findings suggest that a re-appraisal of the promise of entrepreneurial approaches to development may now be needed. While such policies may push growth in the economy overall and deliver wealth gains for some classes of workers, they do little to advance the interests of workers who are paid the least. These are arguably the citizens that need economic development opportunities the most. The distributional consequences of economic development strategies may warrant more attention from concerned state and municipal economic planners. A future research direction is a more detailed analysis of case studies of particular entrepreneurial programs using process tracing to discover current limitation in the programs’ design which hinder more equitable job creation, as well as identification of possible mechanisms that could improve these programs’ capacities to offer employment opportunities to lower-skilled workers.

This article is based on the paper “The Impact of Economic Development Strategy on Market Conditioned Income Inequality in the American States” in State and Local Government Review.

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About the author

Sarah Young – *Pellissippi State Community College*
Sarah L. Young currently teaches as an instructor of political science at Pellissippi State Community College, Knoxville, Tennessee.