COMMENTARY

On the Continuing Popularity of Industrial Recruitment

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Classic arguments against industrial recruitment as a local economic development strategy are reviewed. These include zero-sum effect, long odds, overbidding, low multipliers, increased costs to businesses and residents, and industrial obsolescence. Potential reasons for industrial recruitment's continuing popularity are explored, including tradition, expected value, political payoff, high discount rate, weak communities, diversification, broad applicability, appropriateness, perverse outcomes, potential success, and underestimated benefits. Methods for quantifying major reasons for the popularity of recruiting are outlined.

Regional economists have always been preoccupied with the question of why firms choose particular locations. The forefathers of the discipline (Von Thunen, Weber, Lösch, and Christaller) all touched on this question. Initially, the interest in industrial location was to describe and predict; lately, the tone and focus of such research has become increasingly prescriptive, if not strident. This shift in focus reflects, to a large extent, the changing nature of state and local policies. When the United States had significant frontier regions, migrant and investor interest centered on identifying regions with the most valuable natural resources. By the 1930s, the frontier nature of the economy had passed; regions with little industrial development (particularly the South) began to adopt strategies of recruiting manufacturing from the more fully developed, high-wage areas of the North. Innovation in transportation, telecommunications, and international trade made it possible for more and more areas to compete in this arena in succeeding years.

Finally, the northern states, pressured due to the erosion of their manufacturing base, also began to recruit industries from elsewhere. In the 1980s and early 1990s, we witnessed what has been artfully described as the second and third waves of economic development strategies. The first wave was the industrial recruitment; the second focused on retention and expansion of existing industry. The third wave is characterized by reinventing government to focus on market-based incentives, leveraging resources for development, and building networks for development. Both the second and third wave are enthusiastically supported by economists, other academics, and pundits interested in economic development.

Regional economists' main contribution to this debate has been to determine whether it makes sense to engage in industrial recruiting. Typically, this has been done by examining the importance of location incentives within local policymakers' control (e.g., tax breaks, low-interest loans) vis-à-vis other determinants of location or by examining public costs and benefits of incentives to

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specific firms. Most of these research projects conclude that second- and third-wave policies make more sense than do first-wave policies.\(^3\)

Despite the attention and homage paid to second- and third-wave policies by regional economists, local practitioners appear to see these new strategies as supplements, rather than replacements, for the tradition of industrial recruitment. A Minnesota directory of small-business resources shows nearly all local economic development organizations devoting some of their energy to industrial recruitment;\(^4\) Minnesota is not exceptional in this respect.\(^5\)

The object of this article is to explore why economic development practitioners have not been converted by the second- and third-wave gospel. What drives the industrial recruitment phenomenon? This article first reviews the arguments against industrial recruitment; several alternative explanations are then offered for its continuing popularity among practitioners. Such explanations are not necessarily mutually exclusive; future research may want to examine the relative strengths of the theories that follow.

**REVIEW OF ARGUMENTS AGAINST INDUSTRIAL RECRUITMENT**

This section summarizes the arguments against the industrial recruitment strategy. When appropriate, opposing or minority arguments are briefly summarized.

**A Zero-Sum Game**

Moving industries from one locale to another, claims this argument, does not result in greater national income or employment; individual communities win or lose, but the national picture remains constant. Some argue this is a basis for limiting industrial recruiting activities.\(^6\) Other critics point out that shifting economic activity can result in greater overall efficiency, as firms correct past mistakes or adjust to new circumstances or if the community getting the jobs values them more than the community losing them.\(^7\)

**Long Odds**

The number of communities pursuing industrial recruitment has increased over the years, whereas the number of firms likely to relocate within the United States has remained constant or dropped. Improved communications and transportation infrastructure, combined with a shift in Latin American, Asian, and Caribbean nations’ policies toward foreign ownership, has increased competition for manufacturing facilities and even for certain types of services.\(^8\) There are some 200 to 300 significant new locations per year, courted by 15,000 local economic development agencies.\(^9\) With more communities chasing fewer firms, the expected return on investment for identifying prospects has probably dropped below the opportunity cost. Many communities, because of isolation or high labor costs, have no hope of recruiting industries and should get out of the business.

**Giving Away the Store**

In the long run, labor and transportation costs as well as market access are more important in determining cost differences between locations than are policy-controlled variables, such as taxes\(^10\) and site costs. Businesses may cite taxes and inducements as important, but such firms’ decisions are really based on the more important labor and transportation costs.\(^11\) However, since communities are willing to pay to attract businesses, they tend to play communities against one another as a means of extracting rents. Information about business costs is asymmetric. Communities do not really know what it will take to attract a firm, so they overbid. Thus costs are rising.\(^12\)
Pyrrhic Victory

A successful bidding effort can raise costs for businesses already located in the community.\textsuperscript{13} The need for services increases because of the new firm, but incentives used to woo it may mean that the newly created tax base does not cover the full cost of these service needs. Such costs may be passed on to other businesses and residents as increased property taxes, user fees, or even reduced service levels. Any increased costs decrease the competitiveness of existing firms and reduce amenities for residents, creating incentives for out-migration.

The Hollow Economy

Importing a firm from somewhere else does not affect an economy the same as having a firm develop locally; the imported firm has a propensity to rely on imported inputs and to sell its semifinished products elsewhere for final processing.\textsuperscript{14} Multiplier effects of the imported firm, therefore, tend to be low relative to its outputs because of this reliance on an exterior economy. Household wage effects are typically the largest element of a local multiplier,\textsuperscript{15} and these would remain—at least for those directly employed—but a homegrown job is worth more than an imported job,\textit{ ceteris paribus}. Of course, all jobs are not created equal, and quite possibly, some recruited firms might have better local linkages than do homegrown firms.

The Profit Cycle

Firms that relocate are often in declining industries; these businesses are seeking to lower their wages to compete in producing a standardized product that requires little skill.\textsuperscript{16} Attracting low-skill, low-wage jobs to a local economy does little to foster a competitive workforce through on-the-job training and very little to produce a tax base with which to finance physical infrastructure and next-generation human capital. Once these firms exhaust their subsidies, they may move to foreign countries with even lower wages (or simply go out of business, as the product becomes obsolete).

WHY IS INDUSTRIAL RECRUITMENT POPULAR?

The above arguments lead many to the conclusion that industrial recruitment is a waste of resources for most communities.\textsuperscript{17} The academic community has been touting alternative development strategies for over a decade,\textsuperscript{18} yet practitioners continue to focus on recruitment.\textsuperscript{19} Creating more studies to test the (in)effectiveness of industrial recruitment policies in helping communities achieve their economic development goals is not likely to change the behavior of practitioners unless these studies consider the motives for industrial recruitment. With a better understanding of such incentives, the development profession can better evaluate alternatives to recruitment.

An obvious and oft-cited explanation for the popularity of industrial recruiting is that its hypothesized zero-sum outcome is only zero sum at the national level; therefore, individual communities have incentives to continue recruiting. Yet, if the arguments in the previous section are to be believed, there are strong reasons why most communities should abandon this strategy, even from pure self-interest. We now look beyond the zero-sum argument to develop other hypotheses that may help explain the continued popularity of industrial recruitment.

Hypothesis 1: Tradition

Local economic development started with industrial recruitment; most of the training and educational materials, philosophy, and success stories revolve around this theme. Many people who are in economic development positions got their training before the onset of the second and third waves. Those who got started more recently are influenced by the behavior of more seasoned
peers. Communities doing nontraditional economic development may be seen as innovators. Early adopters are beginning to try the innovators' techniques, but the payoff period is so lengthy that late adopters (the majority) have not yet seen concrete payoffs "in their neighborhood." Thus industrial recruitment remains a primary development strategy. If the hypothesis is correct, we can expect this strategy to gradually taper off in the next few years—and, perhaps, we can hasten its demise by spreading the word.

Hypothesis 2: Expected Value

Recruitment has long odds but high perceived payoffs, so the expected value may be about the same as other strategies with better odds of success but lower payoffs. Once commitment to recruitment is made, it may be politically difficult to back down.20

Hypothesis 3: Political Payoff

The "big fish that got away" may be preferable, in collecting political support for economic development programs, to small entrepreneurship programs, whereby the agency can claim 10 jobs after investments are made in training or incubators. Consider an analogy with lottery tickets: As long as the price of the ticket is low relative to their budget, people will buy into the lottery, even though they know they will probably lose money. This is consistent with the behavior modification theory that says intermittent but positive reinforcement is a more powerful motivator than consistent reward.21 This hypothesis is slightly different from the expected-value hypothesis, because here, people will buy into industrial recruitment even if the expected value is negative.

A related argument is that high-stakes deals may secure the attention of community power brokers more easily than do quiet programs. The real payoff for local development groups may be attention from local power brokers (in funding economic development, for instance). Along the same lines, developers may prefer industrial recruitment, because it allows them to develop contacts with executives of established firms; this, in turn, may lead to jobs or contracts with the firm for the economic developer, whether or not the firm moves to the community.

Hypothesis 4: High Discount Rate

Other local economic development strategies have longer payoff periods than do successful industrial recruitment programs. Community leaders may prefer high-risk, quick-turnaround activity because of rapid turnover in local institutions supporting economic development. As anecdotal evidence, I offer the story of a community chamber of commerce dinner I once attended. The dinner marked two events: the completion of a major local business-needs survey and the handing of the gavel to the new chamber president. The outgoing president reviewed the community's nine-month effort to survey local businesses, the final report that came out, and the recommendations for action based on community discussion of survey results. Then the incoming president took up the gavel and outlined his plans for improving local business climate during his tenure. None of the business-needs survey recommendations made it into the new president's plans! This illustrates the high turnover and low institutional memory of volunteer-driven local development efforts.

The phenomenon is not limited to local efforts. Many state governments limit governors' terms. New governors frequently appoint new directors to their development offices, with attendant changes in policy direction. The point is that if changes do not happen quickly, support may evaporate before there is time for alternative strategies to benefit the community.

Hypothesis 5: Communities Are Weak

This hypothesis says that communities look upon industrial recruitment as a default, because certain aspects of small communities block efforts to use other techniques. There are several potential manifestations of the hypothesis. First, it may be easier to give subsidies to a newcomer
than to someone already in the community; financing a newcomer substantially decreases the possibility of being accused of favoritism or nepotism. Second, alternative local development strategies may require more community collaboration and coordination than does industrial recruitment, leading highly factionalized communities to avoid such alternatives. Third, alternative strategies may require more sustained effort than does industrial recruitment.

Returning to the fishing analogy: It is easier to cast your bait and wait for a strike than to build a pond, stock it with fingerlings, and then feed the fish until they mature. The economic developer who mails a brochure to a thousand companies can claim to have done something (but the fish just have not bitten yet); the economic developer who starts a training program or a business retention program creates higher expectations of concrete results (trainees produced and employed, businesses saved). These programs may require more funding and follow-up activities than would a mailing or attendance at a trade show. Thus reluctance to take on more intensive economic development tasks could be a function of laziness.

Before we go too far with that idea, consider that similar charges were leveled at farmers in developing countries as a way of explaining why output per person was (and is) so low. Schultz's book Transforming Traditional Agriculture argues that these farmers are rational and efficient, and pins the blame for poor productivity on limited technical and economic opportunities. Schultz's book reflects mainstream views of agricultural economists nowadays, but in its time, it was quite iconoclastic. Similarly, there may be ingredients missing from the mix of local resources for economic development: a lack of human resources or financial means to get the job done.

**Hypothesis 6: Diversification**

Many communities are pursuing nontraditional economic development strategies; however, they may want to keep a foot in the industrial recruitment door as a way of diversifying their economic development dollar. Industrial recruitment may also be a vehicle to accomplish or complement nontraditional economic development goals. For example, a development professional may tell the community, "No one will ever locate a business here if your downtown looks this bad." In this case, industrial recruitment may be one way to motivate the community to work on badly needed retail or housing development. Similarly, recruiting efforts can collect information on the community's competitiveness. Feedback from prospects can help identify the most pressing infrastructure development and labor-training issues. Promotional materials ostensibly assembled for recruitment can help the community's residents feel better about their environment.

**Hypothesis 7: Everyone Can Aspire to Recruit**

Recruitment, as a broad strategy, is amorphous enough that all communities can hold out a hope (however dim) of successfully attracting large firms. Few other strategies can make that claim. For example, substantial development, based on tourism or retirement strategies, is generally limited to areas with significant amenities; retail development implies a market to be tapped. Two other strategies as broad in geographic applicability as recruitment are retention-expansion and entrepreneurship. Not surprisingly, these strategies are quite popular.

**Hypothesis 8: Recruitment May Be Appropriate**

For selected communities, recruitment is clearly an appropriate strategy. For example, some communities have a major facility (e.g., a plant, college, or military base) that is empty. Having such a facility on-site may represent a huge cost reduction for a new plant. If local business is unable to make use of the facility, recruitment may prove the best option.

**Hypothesis 9: Perverse Outcomes**

Alternatives to recruitment may have perverse results. This hypothesis is best illustrated with three examples.
Example 1. Investment in education is supposed to lead to greater capacity of the local workforce and, therefore, higher-paying jobs and more innovations. In fact, investment in education may lead to greater out-migration. Well-educated individuals find it easier to leave the community (at experience higher pay increases) than do the less well educated. The community may be left with a high education bill and no workers to pay for its educational services.

Example 2. Successful tourism development programs may save the town, but for whom? The original residents may not be able to afford increased property taxes associated with the influx of resort people. Tourism may result in congestion of the downtown or high-amenity areas, as well as proliferation of low-wage service-sector jobs. Tourists and newcomers who come to work in tourism-related jobs may have different values from the original residents; examples are the logging-versus-owls and ranching-versus-wolves debates going on in the northwestern states.

Example 3. Attracting the newly retired to a community may have job-creating effects in the short run; in the longer run, it may lead to severe fiscal distress for local governments. Retirees are living longer now than in the past, and medical expenses associated with extending lives have increased significantly. Current retirees may not have budgeted adequately for these higher medical bills. Communities recruiting retirees may end up having to extend financial support to them.

Hypothesis 10: Some Communities Are Doomed to Succeed

Rural communities on the urban fringes have historically experienced development. The advances in transportation and telecommunications over the last several decades have accelerated this phenomenon. More and more of us now live in what Lewis characterizes as "galactic cities": loose conglomerations of development orbiting around, but not interacting with, a central city. In this environment, it is easy to predict which places will develop next; economic development practitioners working here have only to set up shop, wait for the inevitable, and then claim success.

Hypothesis 11: Economists Underestimate the Benefits of Development

Most cost-benefit analyses related to industrial recruitment concentrate on wage generation, multiplier effects, and fiscal impacts. Ignored are the amenity effects of having additional people in the community. Recent research indicates that these amenity effects may be nontrivial and positive. Inclusion of amenity effects might influence the outcome of cost-benefit analyses of recruitment.

CONCLUSION

The above list of reasons for the popularity of industrial recruitment is no doubt incomplete. The point is that there may be valid reasons for practitioners' reluctance to let go of the tradition of luring manufacturing firms to their area. We need to put more resources into addressing the question of why practitioners put so much emphasis on recruitment. Some of the hypotheses listed could be tested relatively easily: The tradition hypothesis could be tested with a survey of practitioner habits and how they have changed over the past decade; the expected-value hypothesis could be tested by tracking communities' economic development strategies and the related payoffs for a sample of communities. Contingent valuation might be a starting point for testing the underestimated benefits. Opinion surveys might be used to test the perverse-outcomes hypothesis. Case studies would be appropriate for studying the political-payoff, weak-communities, and diversification hypotheses. Researchers need to accept the premise that practitioners are rational and to work to develop strategies taking better account of available resources and existing political structures. If taking these considerations into account shows attraction strategies to be misguided (and it may not), how can state and local economic development structures be changed to achieve a better outcome?
NOTES

10. Many empirical studies find a relationship between growth rates and taxes, but these studies do not usually distinguish between endogenous and exogenous growth. See Bartik, *Who Benefits?,* for a summary.
17. See note 3.
19. See notes 4 and 5.
20. This hypothesis is analogous to a classic model of human rural-to-urban migration patterns. Todaro studies the question of why rural people in developing countries migrate to cities despite very high (over 50%) unemployment in the urban areas. He notes two mutually reinforcing phenomena. First was that wages were much higher in urban settings than in rural settings; hence, even with very high unemployment, the average wage of a person who migrated was higher than that of a person who stayed in the rural area. Second was that people who migrated to the cities often used all their resources for the one-way trip. Failing to find a job, they could not afford the travel cost of going back to their place of birth. For more detail, see Michael P. Todaro, *Internal Migration in Developing Countries: A Review of Theory, Evidence, Methodology and Research Priorities* (Geneva: International Labor Organisation, 1976).

26. See Barkley, "Industry Location Incentives," for a summary of several of these studies.
