

# BUILDING A NEW AMERICA

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A couple of days before releasing his economic plan, President Clinton urged the American people to be "vigilant" and "to stay informed" about what he would be proposing to accomplish. Then, at his State of the Union message in February, he announced that his initiatives would seek, above all, to "make our economy thrive again."

It is by now fairly obvious that big government is solution that the Clinton administration and some members of Congress have in mind. Yet, the more one looks at the evidence, the more one doubts the need for even modest federal efforts to get the economy moving again. Bigger government will only impede the private investment and restructuring that are required to make our economy "thrive again." Private investment, not government spending, holds the key to economic revitalization.

Economic rejuvenation requires a far different role for the federal government than the President appears ready to give it. This country must reduce government's role, shrink the massive deficit, and give states and localities more flexibility to respond to changing economic conditions. Most of all, the nation must commit itself to free and open trade and work to attract -- not shut out -- foreign investment and technology. Only by doing so can we create an economic climate that will spur American firms to increase their exports, modernize their factories, retrain their workforces, and thus become strong global competitors.

A country simply cannot succeed in creating long-term, high-value-added jobs if its leaders insist on boosting spending for programs that only benefit well-placed constituencies -- like struggling firms and industrial sectors that demand government protection under the euphemism of managed trade; or real estate interests and organized labor, which continue to

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promote the notion that our infrastructure is falling apart, even though statistics suggest otherwise.

It is becoming more and more apparent that economic recovery is already here. As The New York Times reported last February, the nation as a whole shows "tantalizing signs that America's economic engine packs more horse-power than it used to: last year's productivity was the fastest in 20 years, profits are rebounding despite weak sales growth, and business has gone on a high-tech spending spree. Job growth may finally be picking up too."

The recovery is uneven, however. Regions and states like New England, the Sunbelt, New York and even California which led the nation in growth through the mid-1980s remain mired in recession, while once-written off areas such as the industrial Midwest are going strong. The reason is plain. Economic success goes to those regions which can strengthen their manufacturing bases, move toward quality production, increase productivity and limit growth of government spending make the transition to new form of industrial organization. Economic problems beset regions which are artificially propped up by traditionally high levels of government spending, particularly defense spending, and whose companies have fallen behind in the move to quality and productivity improvement.

### THE ECONOMIC TRANSFORMATION OF AMERICA

Behind these trends lie a deeper restructuring of the American economy -- one which requires not more government, but less.

The Industrial Heartland -- meaning the Great Lakes states, long assumed to be in permanent decline -- exhibits the strongest signs of this economic transformation. Just a decade ago, the Industrial Heartland appeared headed for total deindustrialization. Its unemployment rate exceeded the national average, reaching 25 percent in some industrial cities. The eight Great Lakes states had the highest rate of business failures and the steepest decline in real income. The region was rocked by plant closings. The consensus among business leaders, policy-makers and academics was that the region would never again be a center for competitive manufacturing -- its costs were too high, and labor climate too conflictual. The manufacturing heartland, it was argued, would be left behind in a broad and fundamental shift to a post-industrial economy of high-technology, finance and services.

Yet, by the late 1980s and early 1990s, manufacturers in this region succeeded in reversing their severe deindustrialization and initiated a re-industrialization that not only has caused a surge in manufacturing performance, but has also provided a model for economic renewal that the rest of the nation should take note of.

A few statistics will help to convey the magnitude of the turnaround in what has come to be known as the Rustbelt. After a severe contraction from 1977 to 1987, manufacturing output from this part of the country grew at 7.8 percent from 1987 to 1988, surpassing not only the



7.4 percent rate of the U.S. as a whole, but also the 6.3 percent rate for Japan and the 5.2 percent rate for Germany. From 1980 to 1988, manufacturing productivity in the Great Lakes rose by 36 percent, compared to 15 percent for Germany, 32 percent for the U.S., and 52 percent for Japan. Roughly 15 percent of this gain for the region came from 1986 to 1988, a surge that not even the Japanese economy could match. A Federal Reserve Board study found Midwest manufacturers to be 20 percent more efficient than their national counterparts. Meanwhile, manufacturing employment has virtually stabilized in the Great Lakes, after shrinking 15 percent from 1977 to 1982 and continuing to fall until recent years.

Despite having only 30 percent of the nation's population, the region accounts for 36 percent of all manufacturing output in the U.S., 60 percent of the steel, 55 percent of its automobiles, and 50 percent of its machine tools. Remarkably, the Great Lakes states produced more automobiles and steel in 1992 than a decade ago, even when counting the General Motors plant closings. Exports from the region have risen at twice the national rate, reaching more than \$100 billion per year in the early 1990s, leading the Wall Street Journal to proclaim that the region "singlehandedly" returned the United States to the position of the world's largest exporter.

Three factors account for these developments. One, manufacturers in the Rustbelt never became as defense-dependent as those in other parts of the country, winning the region only one-third as much defense business as California and Massachusetts on a per capita basis. In 1991, Michigan, Indiana and Wisconsin ranked 48th, 49th and 50th respectively in federal spending per person. The Heartland region is less defense-dependent than any other, with defense outlays per person of only 60 percent of the national average. The region's \$444 per person in defense spending compares to more than \$1,200 per capita for California and more than \$1,400 for Massachusetts. As a result, Great Lakes manufacturers retained their commercial focus during the 1980s and are better positioned to weather proposed defense cuts.

Two, Heartland region companies such as Xerox, Motorola and Steelcase responded to mounting global competition by restructuring themselves into better organizations than they were before. These companies invested heavily in new factories and production technology, instituted total quality management programs, and developed powerful partnerships with their suppliers, moving toward world-class, high-performance production. In doing so, they have greatly increased their ability to compete globally and capture new overseas markets for their products.

I/N Tek, a joint venture between Inland Steel and Nippon Steel, just outside South Bend, Indiana, provides a powerful example of this new system of high-performance manufacturing in the most basic of industries -- steel. The factory itself is a paean to modern industrial architecture, spanking white, with gleaming concrete floors and colored rails. The machines and production equipment sparkle. Workers, positioned in high-tech, climate-controlled booths, monitor the production process on advanced computerized equipment. I/N Tek has transformed the process of cold rolling steel into a continuous process that takes less than an



hour from start to finish -- a tremendous advance over the old way of producing it in separate steps or "batches" that could take as long as twelve days to complete. The key to this transformation was unleashing the collective intelligence of the work force. The company mobilized factory workers, engineers, and R&D scientists to combine the various batch processes. They recently worked together to connect the entire cold rolling process to another high-tech steel finishing process, called electro-galvanizing, which coats steel, for corrosion-resistant automobile body parts. And for those who still believe that such advances can only be made in the absence of a union, most of the workers were transplanted from Inland Steel's sprawling Indiana Harbor steel mill.

High-performance manufacturing is moving beyond just large companies and is rapidly diffusing into the broader manufacturing supplier base as well. Preliminary results from a survey of roughly 2,000 small and medium-sized manufacturers in the Great Lakes states indicate that a considerable share of these companies -- more than half of all survey respondents -- are implementing elements of high-performance production, such as total quality management programs, self-direct work teams, and just-in-time inventory control. The region's economy as a whole is beginning to adopt key high-performance principles.

Three, politicians in the Industrial Heartland ended up embracing foreign trade and welcoming foreign investment, even as they denounced the painful aspects of adjusting to a global economy. The Rustbelt is almost singlehandedly responsible for returning the United States to its status as the world's leading exporter. In 1991, the region shipped over \$100 billion dollars in manufactured goods to more than 80 countries, including \$9.4 billion to Japan and \$5.6 billion to Germany. The region's rate of increase in manufactured exports is double the national average.

Foreign investment, especially that from Japan, has played a key role in rebuilding the region's traditional industries. More than half of all Japanese foreign direct investment in automobiles, steel and tires and rubber is concentrated in four Great Lakes states -- Ohio, Indiana, Michigan and Illinois. Most important, the Japanese transplants have facilitated the transfer of world-class manufacturing technology and state-of-the-art management practices to American soil. A key competitive advantage lies in the region's ability to attract a growing constellation of the world's best companies.

Bolstered by exports and foreign direct investment, the Heartland region is recreating its industrial base in traditional sectors like steel and automobiles and developing new high-technology sectors as well. The region is home to the world's newest and most advanced steel finishing and automotive assembly technology. It is a center of world-class office furniture production, as companies like Steelcase pave the way to the electronic office of the future. It houses a state-of-the-art image-processing complex of Xerox, Eastman Kodak, and Bausch & Lomb. And, it is a budding center of advanced television production anchored by Sony, Matsushita, major European television producers, and American suppliers of the flat glass used in picture tubes.



The place that best exemplifies the turnaround that can be accomplished by embracing the global economy is Battle Creek, Michigan. During the 1970s, Battle Creek was synonymous with deindustrialization. The city experienced one of the worst bouts of disinvestment and plant closings of any in the Industrial Heartland. Its historic manufacturing base of food and cereal producers, agricultural equipment factories and automotive parts producers underwent significant decline and the city was hit by plant closings. Battle Creek then developed a coordinated strategy to attract high-performance companies from around the world. The city turned a defunct army base, the old Fort Custer, into a new industrial park and sent trade missions to Europe and Japan. Battle Creek is now home to more than a dozen Japanese automotive component parts manufacturers, including the giant Nippondenso. Nippondenso is currently working with the local community college to restructure both its curriculum and administration along the lines of total quality management. Battle Creek is now developing new approaches to worker training and vocational education to train workers to meet the needs of the new economy.

This combination of trade, foreign investment, corporate restructurings and less government has fueled overall economic performance exceeding national averages. The Industrial Heartland has largely been spared in the "bicoastal" recession of the early 1990s. During the current downturn, 12 of the region's 17 major industries outperformed their national counterparts. The unemployment rate for the Great Lakes states was below that of the nation in 1991. In the first quarter of 1992, over half the nation's housing starts occurred in the Great Lakes region.

President Clinton and his advisors can learn a lot from the economic transformation of the Industrial Heartland. Companies and communities are better able to respond to economic change than is government. In fact, government often impedes their ability to do so, by offering hand-outs, protection and other false solutions that provide short-run relief, but only allow them to avoid doing what is required for long-run survival. Private action and private investment, not government spending, holds the key to economic revitalization.

#### **WHY CONVENTIONAL ECONOMIC POLICY WON'T WORK**

Washington's most recent failures are symptomatic of a much deeper crisis of economic policy. Put at its simplest: Current approaches to economic policy are out of sync with the underlying forces at work in the American economy. This is just as true for Republican approaches as it is for Clinton and the Democrats. Neither the hands-on interventionism favored by the Democrats nor the "let-the-market-solve-it," supply-side, tax cutting of the Republicans will work in this new economic environment. The reason is simple. Both approaches were developed to meet the needs of an economic system that is no longer here. As such, both are ill-equipped to meet the needs of the new economy.

The United States, like all other technologically-advanced nations, is caught up in a shift to a new age of industrial capitalism -- a shift to a high-performance economy -- where the keys



to success are harnessing the ideas and innovative capabilities of all workers from the R&D lab to the factory floor to turn out the high-quality, state-of-the-art products the world's consumers want to buy.

In this new high-performance economy, knowledge and intelligence replace physical labor as the fundamental source of value and profit. The factory is becoming more like a laboratory - the place where new ideas and concepts are generated, tested and implemented. It is no longer merely a place of dirty floors and smoking machines, grease, muscle and sweat, but is increasingly an environment of brain-power and technological innovation. Success in the new age of manufacturing requires linking the R&D lab and the factory in a seamless web of activity to unleash the intelligence of all workers. This is not the "passive" involvement of the labor-management committees and American quality circle movement of the 1970s and 1980s. This is a new kind of direct involvement in which workers' intelligence and ideas are mobilized on a day to day basis as a source of new innovations and improvements in the manufacturing process. At factories like Honda's huge automotive assembly complex and Ford's transmission plant in Ohio, engineers and managers are told that they must listen to shop-floor workers who have the hands-on knowledge and the ideas required to improve the production process. In some cases, factory workers actually supervise engineers.

The rise of this new economy requires a sweeping redefinition of government's role in the economy. Indeed, America's political and economic leaders confront the same challenges that faced the leaders of the early twentieth century, when education, transportation and regulatory policies were all reshaped to support the economic dynamics unleashed by Andrew Carnegie, Henry Ford and the small cluster of mass production firms they and their peers created. The nation pioneered those efforts, and emerged as the world's strongest economy. Nothing less than a task of the same magnitude is required today.

Government policy must "fit" underlying economic realities if it is to be effective. In fact, the incredible strength of the U.S. economy in the first half of the twentieth century was based upon just such a fit between the underlying economic system of mass-production manufacturing and government policy. For most of this American century, the economy grew by extracting natural resources such as coal and iron ore, making materials such as steel and chemicals, and manufacturing durable goods such as autos, appliances and industrial machinery. The nation prospered because it had natural comparative advantages that allowed it to be a mass producer of commodities competing largely on the basis of relatively low production costs. The vitality of the nation's mass production system was bolstered by a broader political economy that supported mass production --- everything from roads, rails and ports to the land grant post-secondary education system that grew up alongside and in support of mass production industry.

But, government policy -- which once worked so well -- is out of sync with the demands of the emerging high-performance economy. The entire edifice of modern economic policy which emerged during Franklin Roosevelt's New Deal and became accepted "economic law" in the period immediately following World War II is based upon an economic system which



no longer exists. This policy framework which grew up in a piecemeal fashion to meet the needs and demands of the mass production economy thus no longer works. In fact, this entire policy system has become an unwieldy layer-cake of policies and programs, which are out of touch with the new economy. The latest round of economic policy proposals to bolster American competitiveness from government support of critical technologies and publicly subsidized venture capital funds and the establishment of government-funded industrial extension services would simply add another layer of frosting to this massive and unmanageable layer-cake of government intervention. This entire structure is not only costly and inefficient; it comprises a considerable obstacle to the emergence of the new economy.

Government intervention of the sort favored by Clinton can do little to address this underlying transformation of the American economy. In fact, the states have already experimented with the same mix of "critical technologies," public venture capital, and manufacturing extension programs currently touted as the "key to success" by the Clinton team. During the 1980s, Pennsylvania set up its Ben Franklin program to fund new critical technologies; Ohio established the Thomas Edison program to finance new technology and pump venture capital into startup enterprise; and Michigan set up its Modernization program to provide technology, marketing and management assistance to small and medium-sized enterprises. By the early 1990s, these and other states had learned a great deal about what works and what does not, and began to scale back many of these programs. In part, this retreat is a byproduct of tough budget times. Cutbacks and curtailment have also been prompted by doubts in the ability of government to transform business operations and a lack of confidence in retail programs that serve one company at a time. More to the point, the states have come to realize that such programs simply cannot meet the needs of the new economy.

World-class firms do not want direct government intervention in technology development or manufacturing modernization of the sort proposed by the Clinton Administration and some members of Congress. During the race for the Presidency, candidate Clinton promised to create hundreds of "manufacturing extension" centers, modelled after the old agricultural extension program, to provide hands-on assistance to companies that wish to upgrade their manufacturing technology and management. But, the evidence we have been able to collect through extensive interviews with high-performance firms and surveys of hundreds of small and medium-sized manufacturers make one thing abundantly clear: companies absolutely do not want government advice on how to run their business or organize their factories.

The Clinton administration can learn from the recent state efforts to rethink their economic policies. A number of states are moving toward developing the integrated set of regulatory, educational, and investment policies required to support a high-performance economy. Oregon, for example, has established a pioneering "benchmarking" program to develop performance indicators for government programs. The states in the Industrial Heartland, under the leadership of the eight state consortium of the Council of Great Lakes Governors, are focussing is on building an integrated government policy infrastructure which can leverage and reinforce high-performance production. New directions are already evident in a



spate of regional partnerships between business and government in states and regions across the country. Xerox has mounted pioneering efforts in Rochester, New York, to invest in restructuring community colleges and school systems. Xerox is also working closely with Carnegie Mellon University to develop new generations of engineers and business students that can function in a team environment and understand the basic principles of total quality management. Nipponenso has worked closely with community colleges in Michigan to reorient their curriculum to favor team-based approaches to learning.

The Great Lakes states are pioneering new approaches to environment and economic development policy under the rubric "sustainable advantage." States in the region are leaders in the development of market-based approaches to environmental protection and pollution prevention. Under one regional initiative, automakers and their suppliers will work together on the development and deployment of new process and prevention technology to reduce levels of 65 key toxic substances and at the same time reduce reliance on costly end-of-the-pipe controls and improve the efficiency of the production process.

The Great Lakes states are also working on systemic change in education and training through competency based approaches, and have forged a partnership with major trade associations and the federal government to develop occupational standards which directly link classroom curriculum to the workplace. States in the region are working to expand access to telecommunications for training, technology transfer and total quality management. Pennsylvania's Industrial Development Authority recently made quality a requirement for firms seeking low-interest financing to expand production and preserve jobs.

These state efforts to develop a new role for government share a common theme. They are all informed by the new requirements and realities of the new high-performance economy.

### **GETTING AMERICA READY FOR THE NEXT CENTURY**

The new, high-performance economy demands a sweeping redefinition of government's role. In so doing, it creates an unprecedented opportunity to cut across traditional partisan and ideological cleavages and dramatically recast the debate over the proper role of government in the American economy.

It is becoming increasingly apparent that the current policy environment of regulatory, tax and fiscal policies which grew up to meet the requirements of the old, mass production economy is ill-equipped to meet the requirements of this emerging, high-performance economy; worse yet, it may even be an obstacle to the emergence of that new system. American firms and managers operate within a maze of economic and policy-incentives which were well suited to a mass production environment, but which frequently create disincentives for needed restructuring along high-performance lines. Bank lending policies, for example, typically require that small- and medium-sized manufacturers put up their inventory as collateral for bank loans -- a practice which impedes their ability to adopt the



just-in-time inventory and delivery practices which are required of world-class, high-performance manufacturers.

Our nation is, in effect, caught between two economies and two business climates -- an old one structured to accommodate the dynamics of mass production, and an emerging one taking form around high-performance economic principles. Our economic future will not be secured until this economic transformation is successfully accomplished, and the transition between business climates is complete. Everything from credit requirements and inflexible environmental permits, to the way teachers receive their credentials must be transformed to meet the demands of the new economy.

The critical need for government is not to bolster sagging firms and industry with industrial policy and trade protection, or help finance or invent new "critical technologies," or institute a massive plan of "supply-side" tax stimulus. Rather, government must help put in place the incentive structure, business climate and economic infrastructure required for this new, high-performance economy to flourish.

#### A NEW ECONOMIC POLICY AGENDA

While the transition to high-performance is likely to take years even decades to complete, government can begin to support this process by organizing its efforts around seven basic pillars.

**Cut Federal Spending:** The federal government must drastically reduce its spending and administrative control over the economy. It is commonly understood that federal spending has gotten way out of hand. What is less well understood is why. The reason is that nearly all of what government does was established to meet the needs of the old mass production economy. As a result, a great deal of government's effort is counter-productive to the needs of the new, high-performance economy. The federal government must begin to dismantle its layer-cake of spending programs, retaining only what is necessary and beneficial to the new economy, and discarding the rest.

Such an effort could begin in two big-ticket areas, which have come to define the postwar American State -- defense and welfare. The federal government should begin by drastically reducing mission-oriented military spending. The Cold War is over and our national security no longer faces the kinds of threat it once did. Military spending, which was less of a drain in the past, now simply functions to allow companies to avoid the restructuring and commercial discipline required to compete in world markets. The time has come to cut this huge industrial welfare state and let companies meet the test of the market. Government defense spending must be drastically reduced, so that firms are forced to redirect their efforts to international commercial markets.



The huge federal welfare bureaucracy must also be drastically scaled back. While welfare may have had a function in the past by providing temporary assistance for laid-off, disabled or dysfunctional members of society, its costs both to society and to individuals now far exceed any benefit. The federal government must move quickly to workfare and other development approaches to economic and social problems which enable people and groups to contribute to society and the economy.

**More Flexible Regulatory Policy:** The federal government must develop a more flexible and responsive system of financial and industrial regulation. Deregulation and regulatory reform are needed in many areas. Existing environmental policies currently regulate toxins at the end of the pipe, giving companies little incentive to implement workplace restructuring along high-performance lines. Such policies must be reformed to encourage continuous improvement in both the efficiency and environmental quality of production processes. The Great Lakes states have taken the lead in developing policies which enable firms to improve environmental quality by implementing new production processes which are both cleaner and more efficient.

The old, New Deal financial system must be allowed to fade from existence, and banks and other financial institutions allowed to compete for new markets. The current system of financial regulation makes it difficult for companies to reorganize themselves to compete in the new economy. As we have seen, small and medium-sized manufacturers are frequently required to use their inventory as loan collateral, making it impossible to adopt modern just-in-time inventory practices. New financial incentives are badly needed so that the broad infrastructure of small and medium-sized manufacturers can meet the demands of the new economy.

**Use Government Investment to Leverage the New Economy:** Government investment must leverage the new economy -- not the old. The federal, state and local governments makes massive investments in an educational system which was designed to turn out people who can function effectively in the bygone mass production age. This educational system includes primary and secondary schools which teach people how to compete as individuals, vocational schools which teach specific and individualized skills, and colleges and universities which turn out specialists in business, engineering etc. Educational programs must be redesigned to produce people who have general skills, are able to use their intelligence in a group context, and function in a team environment.

The federal government also makes massive investments in transportation and infrastructure which reinforce the old mass production economy, by contributing to the suburban sprawl and decentralization that sells cars, houses and appliances. But, the new economy requires physical proximity and the development of high-performance production complexes of hub firms and their suppliers. One of Japan's greatest competitive advantages, that is seldom mentioned, is the concentration of its people, firms and government agencies in the Tokyo,



Osaka, and Nagoya areas. Such concentration makes it easier for knowledge and ideas to be transferred among people, firms and organizations. Government transportation and infrastructure policies must be redesigned to encourage greater concentration of key economic activities. The need to reduce cycle times from R&D to manufacturing requires better telecommunications and electronic networks that support data and image interaction from plant to plant. This can be done through the existing information superhighway that is being created by telecommunications, cable television, and computer corporations. There is no need for massive government investments here.

**Commit to the Global Economy through Free Trade:** The federal government must retain this nation's commitment to free trade and integration into the global economy. Trade policy is particularly important because it sets the framework in which firms compete. Pressure is mounting within the Clinton Administration and a number of key constituencies to abandon free and open trade in favor of "managed trade" -- basically higher tariffs and greater protection from industries ranging from steel to autos and semiconductors. But, protectionism damages the prospects for future economic renewal, by giving American firms an excuse to avoid needed restructuring. It also threatens a crucial source of foreign capital, technology and management expertise. Over the past decade, Japanese transplant factories alone have invested more than \$25 billion dollars in new automobile assembly plants, automotive parts factories, and refurbished steel mills, creating or preserving more than 100,000 jobs for American workers. Increasing competitive pressure from foreign imports and transplant companies has forced a growing number of American corporations to adopt cutting-edge manufacturing techniques as well.

**Organize Government Along High-Performance Lines:** Government itself must be organized and managed according to high-performance principles. The management and organization of government will also have to change to meet the demands of the new economy. Government policy, which developed over the past century to meet the needs of various constituencies of the old mass production system, must change dramatically to reflect the underlying functional requirements of the new high-performance economy. Motivated by the underlying dynamic of mass production capitalism, government policy evolved as a system of specific interventions in functionally-specialized policy areas -- banking policy, trade policy, economic policy, labor policy, transportation policy, housing policy, development policy, welfare policy etc. But, in the new economy, policy will be increasingly called upon to cut across boundaries and integrate these various functions. Government will have to move increasingly away from specific interventions to a new approach which focuses on building the broad infrastructure of technological, manufacturing, physical and human capabilities required for the new economy to function effectively and evolve further.

The existing management of government itself reflects the hierarchical and functionally-specialized structure of the mass production system. This structure will have to change to



reflect the underlying functional requirements of the new high-performance economy. This is much more than simply "reinventing government." High-performance means harnessing the knowledge and intellectual capabilities of a much broader spectrum of employees. The harnessing of knowledge must also be the central organizing principle of government and public policy reorganization as well. This will require increasing functional integration of government through the use of teams, decentralization of functional responsibilities to operators and front-line workers, greater empowerment of government workers and work teams, and perhaps even a scaling back of government activities and/or restructuring of government activities to lower levels of the hierarchy such as regional government. Though it may appear exceptionally remote or even impossible from the current vantage point, government itself will in time come to reflect the core principles of high-performance organization.

**Decentralize Government Responsibility to the State, Local and Regional Levels:**

The federal government must begin shifting responsibility for economic, technology- and productivity-oriented programs and activities to the regional, state and local levels, giving them the flexibility to develop the economic climates required for success in the new economy. In a recently published essay, Kenichi Ohmae, the Chairman of McKinsey & Company in Japan, points out that a new form of economic and social organization -- the "region-state" -- is coming to replace the nation state as the centerpiece of economic and social life:

The nation state has become an unnatural, even dysfunctional unit for organizing human activity and managing economic endeavor in a "borderless" world. It represents no genuine, shared community of economic interests; it defines no meaningful flows of economic activity. On the global economic map the lines that now matter are those defining what may be called "region states." Region states are natural economic zones. They may or may not fall within the geographic limits of a particular nation -- whether they do is an accident of history.

The primary linkages of region states tend to be with the global economy, and not with host nations. Region states make such effective points of entry into the global economy because the very characteristics that define them are shaped by the demands of that economy. Region states tend to have between five million and 20 million people. A region state must be small enough for its citizens to share certain economic and consumer interests but of adequate size to justify the infrastructure -- communications and transportation links and quality professional services -- necessary to participate economically on a global scale. It must for example, have at least one international airport and, more than likely, one good harbor with international-class freight-handling facilities. A region state must also be large enough to provide an attractive market for the broad development of leading consumer products. In other words, region states are not defined by their economies of scale in production (which, after all, can be leveraged from a base of any size through exports to the rest of the



world) but rather by having reached efficient economies of scale in their consumption, infrastructure and professional services.

Decentralization of governmental functions and authority is particularly important. Global corporations are drastically scaling back their central administrative functions, outsourcing many activities, and decentralizing responsibility to the business units and suppliers where work actually gets done. Alcoa plans to reduce its central headquarters staff to 45 people who specialize in strategic analysis and planning, but do little or no actual administration. The federal government needs to do the same. State, localities and regions have the knowledge, expertise and "feel" for developing better business climates and broader economic infrastructures which can support high-performance firms and organizations.

**Create High-Performance Zones:** Washington's penchant is for gridlock -- not change. Chances are it will be impossible to accomplish enough of this agenda to begin the change process before it's too late -- before our major competitors leave us far behind. Change, in the American system, is much easier to set in motion at the state, local and regional levels. But, current federal programs and regulations inhibit -- and frequently prohibit -- states and localities from doing what is required to establish high-performance business climates.

The concept of a "high-performance zone" offers a potential way out of this dilemma. High-performance zones aim to give regions the flexibility they need to create high-performance business climates. High-performance zones are similar to "enterprise zones" or "free trade zones" because they would create special areas outside the existing maze of federal rules and regulations. But, they differ from enterprise zones in an important respect. Enterprise zones want to make U.S. urban areas competitive with the Third World by lowering wages or eliminating environmental restrictions. But, the U.S. will never be competitive with countries like Mexico or China which pay anywhere from a dollar to a penny an hour for unskilled labor., High-performance zones, in contrast, focus on building American strength in high value-added, high-wage, high performance sectors of the economy.

High-performance zones would enable regions to experiment with regulatory and service delivery strategies to facilitate the transition to a high-performance economy, particularly by removing federal, state or local policies, programs and regulations which impede high-performance. High-performance zones would create incentives for team-based efforts, partnerships and collective action on the part of various levels and agencies of government.

### **BUILDING THE FUTURE**

The future of our nation is clear. For most of the past two decades, experts predicted a shift from manufacturing to a post-industrial service economy, or from basic industries to high technology. In the wake of the predictions, efforts were undertaken to invest in new critical



technologies and industries. But, the change underway in the United States and the world is not one of old sectors giving way to new, but a more fundamental change in the way goods are produced and the economy itself is organized -- from a mass production to a high-performance economy. This change holds sweeping implications for government. The critical need for government is not to help invest in new technologies, but to help put in place the economic infrastructure required for a high-performance economy. The challenge is one of reinventing education to focus on group processes, continuous improvement, and lifelong learning, recrafting regulatory policy to suit the dynamics of high-performance production, and literally redesigning the entire infrastructure of government economic policy and the incentive system it helps to set in place.

The basic lesson is clear. The actions of private firms -- not government -- have been responsible for America's most recent economic transformation. In fact, greater government intervention runs the risk of impeding the economic turnaround that is already underway. Short-term stimulus, managed trade and critical technologies merely aim to jump start, or worse yet, protect the old economy. Government must begin to create the underlying economic infrastructure and incentive structure for firms to make the transition to the new high-performance economy. Only private firms can create the kinds of jobs that America needs. And only by remaining steadfast in our commitment to free trade, continuing to attract capital from around the world, and orienting government programs to meet the needs of the new economy can an economic plan help to stimulate needed private investment. Until such measures become policy, a better future for either ourselves and our children will remain unsecured.

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