The Economic Challenge for Governors in 2012

Achieving Fiscal Stability

Enhancing State Competitiveness
What is Competitiveness?

• Competitiveness is the *productivity* with which a state utilizes its human, capital, and natural endowments to create value

• Productivity determines *wages*, *jobs*, and the *standard of living*

• It is not *what* fields a state competes in that determines its prosperity, but *how productively* it competes
Where Does Productivity Come From?

Businesses and government play different but interrelated roles in creating a productive economy

• Only businesses can create jobs and wealth
• States compete to offer the most productive environment for business
Agenda

1. How is your state doing?  
   State Performance Scorecard

2. Why?  
   Explaining your state’s performance, strengths, and weaknesses

3. Where to go from here?  
   Action Steps
### California Performance Scorecard

**Prosperity**
*GDP per Capita, 2000-2010*
- Start Position: 11
- Trend: 26
- Current Position: 10 (+1)

**Wages**
*Average Private Wage, 1998-2009*
- Start Position: 7
- Trend: 10
- Current Position: 6 (+1)

**Job Creation**
- Start Position: 6
- Trend: 44
- Current Position: 38 (-32)

**Labor Mobilization**
*Proportion of Working Age Population in the Workforce, 2000-2010*
- Start Position: 33
- Trend: 27
- Current Position: 30 (+3)

**Labor Productivity**
*GDP per Workforce Participant, 2000-2010*
- Start Position: 7
- Trend: 25
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**New Business Formation**
- Start Position: 7
- Trend: 45
- Current Position: 30 (-23)

**Innovation**
*Patents per Employee, 2000-2010*
- Start Position: 3
- Trend: 5
- Current Position: 2 (+1)

**Cluster Strength**
*Employment in Strong Clusters, 1998-2009*
- Start Position: 13
- Trend: 47
- Current Position: 30 (-17)

**Leading Clusters**
*by employment size, 2009 (national rank)*
- Distribution Services (1)
- Entertainment (1)
- Information Technology (1)
- Publishing and Printing (1)
- Analytical Instruments (1)

<table>
<thead>
<tr>
<th>State Rank</th>
<th>1-10</th>
<th>11-20</th>
<th>31-40</th>
<th>41-50</th>
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<tbody>
<tr>
<td>Count</td>
<td>21-30</td>
<td>31-40</td>
<td>41-50</td>
<td>1-10</td>
</tr>
</tbody>
</table>
Comparative State Prosperity Performance
2000 - 2010

Source: BEA. Notes: GDP in real 2005 dollars. Growth rate is calculated as compound annual growth rate.
Comparative State Labor Force Productivity Performance
2000-2010

Real Growth in Gross Domestic Product per Labor Force Participant, 2000-2010

Sources: BEA, BLS. Notes: GDP in real 2005 dollars. Growth rate is calculated as compound annual growth rate.

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Comparative State **Employee Productivity Performance**

2000-2010

**Real Growth in Gross Domestic Product per Employed Worker, 2000-2010**

**Highly productive and productivity rising versus U.S.**

- Delaware
- California

**High but declining versus U.S.**

- Alaska
- New York

**Low and declining versus U.S.**

- Wisconsin
- Minnesota

**Low but rising versus U.S.**

- Oregon
- North Dakota

Sources: BEA, BLS. Notes: GDP in real 2005 dollars. Growth rate is calculated as compound annual growth rate.
Comparative State **Innovation** Performance

**2000 - 2010**

**High and declining innovation**

- Idaho

**U.S. average Growth Rate of Patenting:**

- **+2.25%**

**High and improving innovation rate versus U.S.**

- California
- Massachusetts
- Washington (16.5, +10.6%)

**Low and declining innovation**

- Alaska
- Arkansas
- South Dakota
- West Virginia
- Mississippi

**Low and improving innovation**

- Montana
- Nebraska
- South Carolina
- North Carolina
- Wyoming

Why?
What Drives State Productivity?

1. Quality of the Overall Business Environment
2. Cluster Development
3. Policy Coordination among Multiple Levels of Geography/Government
Why?

What Drives State Productivity?

1. Quality of the Overall Business Environment

2. Cluster Development

3. Policy Coordination among Multiple Levels of Geography/Government
Quality of the Overall Business Environment

Context for Firm Strategy and Rivalry

Rules and incentives that encourage local competition, investment and productivity
- e.g., tax policy that encourages investment and R&D
- Flexible labor policies
- Intellectual property protection
- Antitrust enforcement

Factor (Input) Conditions

Access to high quality business inputs
- Human resources
- Capital access
- Physical infrastructure
- Administrative processes (e.g., permitting, regulatory efficiency)
- Scientific and technological infrastructure

Demand Conditions

Sophisticated and demanding local needs and customers
- e.g., Strict quality, safety, and environmental standards
- Consumer protection laws
- Government procurement of advanced technology
- Early demand for products and services

Related and Supporting Industries

Local availability of suppliers and supporting industries

- Many things matter for competitiveness
- Economic development is the process of improving the business environment to enable companies to compete in increasingly sophisticated ways
Improving the Business Environment
Common Action Items

1. Simplify and speed up regulation and permitting

2. Reduce unnecessary costs of doing business

3. Establish training programs that are aligned with the needs of the state’s businesses

4. Focus infrastructure investments on the most leveraged areas for productivity and economic growth

5. Design all policies to support emerging growth companies

6. Protect and enhance the state’s higher education and research institutions

7. Relentlessly improve the public education system, the essential foundation for productivity in the long run
Why?
What Drives State Productivity?

1. Quality of the Overall Business Environment
2. Cluster Development
3. Policy Coordination among Multiple Levels of Geography/Government
What is a Cluster?

A geographically concentrated group of interconnected companies and associated institutions in a particular field

Traded Clusters

• Compete to serve national and international markets
• Can locate anywhere
• 30% of employment

Local Clusters

• Serve almost exclusively the local market
• Not directly exposed to cross-regional competition
• 70% of employment
Example: Massachusetts Life Sciences Cluster

- Health and Beauty Products
- Surgical Instruments and Suppliers
- Medical Equipment
- Dental Instruments and Suppliers
- Ophthalmic Goods
- Diagnostic Substances
- Containers

Teaching and Specialized Hospitals

Biological Products

Biopharmaceutical Products

Research Organizations

Cluster Organizations
- MassMedic, MassBio, others

Specialized Business Services
- Banking, Accounting, Legal

Specialized Risk Capital
- VC Firms, Angel Networks

Specialized Research Service Providers
- Laboratory, Clinical Testing

Educational Institutions
- Harvard, MIT, Tufts, Boston University, UMass

Analytical Instruments Cluster
Example: Houston Oil and Gas Cluster

Upstream

Oil & Natural Gas Exploration & Development

Oil & Natural Gas Completion & Production

Downstream

Oil Transportation

Oil Trading

Oil Refining

Oil Distribution

Gas Gathering

Gas Processing

Gas Trading

Gas Transmission

Gas Distribution

Gas Marketing

Oilfield Services/Engineering & Contracting Firms

Equipment Suppliers
(e.g., Oil Field Chemicals, Drilling Rigs, Drill Tools)

Specialized Technology Services
(e.g., Drilling Consultants, Reservoir Services, Laboratory Analysis)

Subcontractors
(e.g., Surveying, Mud Logging, Maintenance Services)

Business Services
(e.g., MIS Services, Technology Licenses, Risk Management)

Specialized Institutions
(e.g., Academic Institutions, Training Centers, Industry Associations)
Strong Clusters Drive Regional Performance

- Specialization in **strong clusters**
- **Breadth** of industries within each cluster
- Strength in **related clusters**
- Presence of a region’s clusters in **neighboring regions**

- **Job** growth
- Higher **wages**
- Higher **patenting** rates
- Greater **new business** formation, growth and survival

*On average, cluster strength is much more important (78.1%) than cluster mix (21.9%) in driving regional performance in the U.S.*

Clusters and Economic Diversification

Note: Clusters with overlapping borders or identical shading have at least 20% overlap (by number of industries) in both directions.
The Evolution of Regional Economies
San Diego

- Climate and Geography
- U.S. Military
- Bioscience Research Centers


- Hospitality and Tourism
- Transportation and Logistics
- Power Generation
- Communications Equipment
- Information Technology
- Medical Devices
- Biotech / Pharmaceuticals
- Education and Knowledge Creation
- Aerospace Vehicles and Defense
- Analytical Instruments
- Sporting Equipment
- Information Technology
- Bioscience Research Centers
- U.S. Military
- Climate and Geography
Traded Cluster Composition of the California Economy

Overall change in the California Share of US Traded Employment: 0.40%

California Overall Share of US Traded Employment: 12.74%

Traded Cluster Composition of the California Economy (continued)

California Overall Share of US Traded Employment: 12.74%

Overall change in the California Share of US Traded Employment: 0.40%

Change in California share of National Employment, 1998 to 2009

Employees 136,000 = 0.8%

California Job Creation in Traded Clusters

1998 to 2009

Net traded job creation, 1998 to 2009: -3,323

* Percent change in national benchmark times starting regional employment. Overall traded job creation in the state, if it matched national benchmarks, would be -46,795.

California Wages in Traded Clusters vs. National Benchmarks

Wages, 2009

<table>
<thead>
<tr>
<th>Cluster</th>
<th>Average Traded Wage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial Services</td>
<td>$66,249</td>
</tr>
<tr>
<td>Information Technology</td>
<td>$64,949</td>
</tr>
<tr>
<td>Oil and Gas Products and Services</td>
<td>$62,900</td>
</tr>
<tr>
<td>Communications Equipment</td>
<td>$65,443</td>
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<tr>
<td>Medical Devices</td>
<td>$64,991</td>
</tr>
<tr>
<td>Distribution Services</td>
<td>$64,379</td>
</tr>
<tr>
<td>Power Generation and Transmission</td>
<td>$61,837</td>
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<tr>
<td>Aerospace Vehicles and Defense</td>
<td>$63,341</td>
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<tr>
<td>Publishing and Printing</td>
<td>$63,000</td>
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<tr>
<td>Analytical Instruments</td>
<td>$62,656</td>
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<tr>
<td>Entertainment</td>
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<td>Business Services</td>
<td>$60,000</td>
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<tr>
<td>Education and Knowledge Creation</td>
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<td>Heavy Construction Services</td>
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<td>Heavy Machinery</td>
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<td>Chemical Products</td>
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<td>Aerospace Engines</td>
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<td>Sporting, Recreational and Children's Goods</td>
<td>$58,000</td>
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<td>Production Technology</td>
<td>$56,906</td>
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<tr>
<td>Lighting and Electrical Equipment</td>
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<tr>
<td>Motor Driven Products</td>
<td>$53,315</td>
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<td>Transportation and Logistics</td>
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<td>Agricultural Products</td>
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<td>Metal Manufacturing</td>
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<td>Processed Food</td>
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<td>Automotive</td>
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<td>Plastics</td>
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<tr>
<td>Building Fixtures, Equipment and Services</td>
<td>$49,900</td>
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<td>Forest Products</td>
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<td>Jewelry and Precious Metals</td>
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<td>Leather and Related Products</td>
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<td>Construction Materials</td>
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<td>Fishing and Fishing Products</td>
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<td>Hospitality and Tourism</td>
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<td>Footwear</td>
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<td>Apparel</td>
<td>$39,300</td>
</tr>
<tr>
<td>Tobacco</td>
<td>$38,900</td>
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</tbody>
</table>

Productivity Depends on How a State Competes, Not What Industries It Competes In

On average, cluster strength is much more important (78.1%) than cluster mix (21.9%) in driving regional performance in the U.S.

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<thead>
<tr>
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<th>Cluster Mix Effect</th>
<th>Relative Cluster Wage Effect</th>
</tr>
</thead>
<tbody>
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<tr>
<td>Oregon</td>
<td>-10,359</td>
<td>-1,304</td>
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<td>Missouri</td>
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<tr>
<td>South Dakota</td>
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<td>289</td>
<td>-21,257</td>
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</tbody>
</table>

LQ, or Location Quotient, measures the state’s share in cluster employment relative to its overall share of U.S. employment. An LQ > 1 indicates an above average employment share in a cluster.
# California Performance Scorecard

## Prosperity
GDP per Capita, 2000-2010

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- **Trend**: 26
- **Current Position**: 10 (+1)

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Average Private Wage, 1998-2009

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## Job Creation

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Proportion of Working Age Population in the Workforce, 2000-2010

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## Innovation
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## Cluster Strength
Employment in Strong Clusters, 1998-2009

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## Leading Clusters
by employment size, 2009 (national rank)

- Distribution Services (1)
- Entertainment (1)
- Information Technology (1)
- Publishing and Printing (1)
- Analytical Instruments (1)
Cluster Development
Common Action Items

1. Build on the state’s existing and emerging clusters rather than chase “hot” fields

2. Pursue economic diversification within clusters and across related clusters

3. Create a private sector-led cluster upgrading program with matching support for participating private sector cluster organizations
   • Government should listen and remove obstacles to cluster improvement

4. Align other state economic policies and programs with clusters
Clusters provide a framework for organizing the implementation of many public policies and public investments to achieve greater effectiveness.
Why?
What Drives State Productivity?

1. Quality of the Overall Business Environment
2. Cluster Development
3. Policy Coordination among Multiple Levels of Geography/Government
Geographic and Governmental Influences on Productivity

Nation

Neighboring State  State  Neighboring State

Metropolitan Areas

Rural Regions
Defining the Appropriate Economic Regions

The economies of states are often an aggregation of distinct economic areas with differing circumstances.

Wage Performance in California Metropolitan Areas

Source: Census CBP, authors' analysis. Note: “Bubble” size in chart is proportional to employment in 2009.
Employment Performance in California Metropolitan Areas

Source: Census CBP, authors’ analysis. Note: “Bubble” size in chart is proportional to employment in 2009.

San Francisco MSA
San Jose MSA (-0.94%, $75,784)
Los Angeles MSA
Santa Rosa MSA
Santa Cruz MSA
Salinas MSA
Santa Barbara MSA
Redding MSA
Merced MSA
Madera MSA
Fresno MSA
Modesto MSA
Sacramento MSA
Vallejo MSA
Oxnard MSA
Napa MSA
San Diego MSA
Bakersfield MSA
Riverside MSA
Hanford MSA
El Centro MSA

California Average Private Wage: $48,445
U.S. Average Private Wage: $42,403

California Growth Rate of Employment: 0.59%
U.S. Growth Rate of Employment: 0.52%
Rest of State (6.31%, $43,668)

Average Private Wage, 2009
Growth Rate of Private Employment, 1998-2009
Geographic and Governmental Influences on Productivity

1. Influence and access federal policies and programs

2. Work with each metro area to develop a prioritized strategic agenda

3. Connect rural regions with proximate urban areas

4. Integrate policies and infrastructure planning with neighbors
Agenda

1. How is your state doing?  
   State Performance Scorecard

2. Why?  
   Explaining your state’s performance, strengths, and weaknesses

3. Where to go from here?  
   Action Steps
Agenda

1. How is your state doing?  
   State Performance Scorecard

2. Why?  
   Explaining your state’s performance, strengths, and weaknesses

3. Where to go from here?  
   Action Steps

Biggest Action Item of All
Create an Economic Strategy

- What is the distinctive competitive position of the state or region given its location, legacy, existing strengths, and potential strengths?
  - What unique value as a business location?
  - For what types of activities and clusters?

Define the Value Proposition

Develop Unique Strengths

- What elements of the business environment can be unique strengths relative to peers/neighbors?
- What existing and emerging clusters represent local strengths?

Achieve and Maintain Parity with Peers

- What weaknesses must be addressed to remove key constraints and achieve parity with peer locations?

- Economic strategy requires setting priorities and moving beyond long lists of separate recommendations.
How Should States Compete for Investment?

**Tactical (Zero Sum Competition)**

- Focus on attracting new investments
- Compete for every plant
- Offer generalized tax breaks
- Provide subsidies to lower / offset business costs
- Every city and sub-region for itself
- Government drives investment attraction

**Strategic (Positive Sum Competition)**

- Also support greater local investment by existing companies
- Reinforce areas of specialization and emerging cluster strength
- Provide state support for training, infrastructure, and institutions with enduring benefits
- Improve the efficiency of doing business
- Harness efficiencies and coordination across jurisdictions, especially with neighbors
- Government and the private sector collaborate to build cluster strength
Harnessing the New Process of Economic Development

Competitiveness is the result of both **top-down and bottom-up processes** in which many companies and institutions take responsibility.

**Old Model**
- **Government** drives economic development through policy decisions and incentives

**New Model**
- Economic development is a **collaborative process** involving government at multiple levels, companies, teaching and research institutions, and private sector organizations
Example: Organizing for Economic Development

South Carolina Council on Competitiveness

- Chaired by a business leader and reporting to the governor
- Convenes working groups, provides direction and strength, holds working groups accountable

Executive Committee

Coordinating Staff

Cluster Committees

- Automotive
- Hydrogen / Fuel Cells
- Textiles
- Apparel
- Agriculture
- Travel and Tourism

Task Forces

- Cluster Activation
- Research / Investment
- Distressed / Disadvan. Areas
- Education / Workforce
- Start-ups / Local Firms
- Measuring Progress

Effective economic policy also requires coordination within government
Summary

• The goal of economic strategy is to enhance **productivity**. This is the only way to create jobs, high income, and wealth in the long run.

• Improving **productivity** and **innovation** must be the guiding principles for every state policy choice.

• Improving productivity does not require new public resources, but **using existing resources better**.

• Improving productivity demands that governors **mobilize the private sector**, not rely on government alone.

• Economic strategy is non-partisan and about getting **results**.
Next Steps

1. Reach out to your team

2. Reach out to the business community


The prosperity of the **U.S. economy** will depend more on the success of states in improving competitiveness than what happens in Washington.