Iowa Competitiveness: Creating a State Economic Strategy

Professor Michael E. Porter
Harvard Business School

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For further material on regional competitiveness and clusters: www.isc.hbs.edu/econ-clusters.htm
For state economic profiles: www.isc.hbs.edu/econ-statesregions.htm
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
## Iowa Performance Scorecard

### Prosperity
GDP per Capita, 2000-2010

- **Start Position:** 31
- **Trend:** 6
- **Current Position:** 22 (+9)

### Wages
Average Private Wage, 1998-2009

- **Start Position:** 39
- **Trend:** 35
- **Current Position:** 42 (-3)

### Job Creation

- **Start Position:** 42
- **Trend:** 5
- **Current Position:** 10 (+32)

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

- **Start Position:** 9
- **Trend:** 10
- **Current Position:** 3 (+6)

### Labor Productivity
GDP per Workforce Participant, 2000-2010

- **Start Position:** 40
- **Trend:** 13
- **Current Position:** 27 (+13)

### New Business Formation

- **Start Position:** 36
- **Trend:** 7
- **Current Position:** 14 (+22)

### Innovation
Patents per Employee, 2000-2010

- **Start Position:** 27
- **Trend:** 15
- **Current Position:** 27 (+0)

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

- **Start Position:** 40
- **Trend:** 4
- **Current Position:** 21 (+19)

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

- Processed Food (7)
- Financial Services (23)
- Heavy Machinery (2)
- Forest Products (10)
- Analytical Instruments (18)
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 Mobilization Performance
1999-2010

High but declining versus U.S.
High Labor Force Participation and Participation rising versus U.S.
U.S. Labor Force Participation Rate: 64.7%

Low and declining versus U.S.
Change in Labor Force Participation Rate: -2.4%

Low but rising versus U.S.

Notes: Source BLS.
2012 State Competitiveness – Rich Bryden
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Comparative State Labor Force Productivity Performance
2000-2010

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

-0.5% 0.0% 0.5% 1.0% 1.5% 2.0% 2.5% 3.0% 3.5%

Gross Domestic Product per Labor Force Participant, 2010

$60,000 $70,000 $80,000 $90,000 $100,000 $110,000 $120,000 $130,000 $140,000

Highly productive and productivity rising versus U.S.

High but declining versus U.S.

Low and declining versus U.S.

Low but rising versus U.S.

Sources: BEA, BLS. Notes: GDP in real 2005 dollars. Growth rate is calculated as compound annual growth rate.
Comparative State Employee Productivity Performance
2000-2010

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

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

U.S. average Patents per 10,000 Employees: 7.77

Low and declining innovation

Growth Rate of Patents per 10,000 Workers, 2000 to 2010


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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

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)

Downstream

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)

Oil Trans- portation
Oil Trading
Oil Refining
Oil Distribution
Oil Wholesale Marketing
Oil Retail Marketing

Gas Gathering
Gas Processing
Gas Trading
Gas Transmission
Gas Distribution
Gas Marketing

Oil & Natural Gas Transportation
Oil & Natural Gas Trading
Oil & Natural Gas Refining
Oil & Natural Gas Distribution
Oil & Natural Gas Wholesale Marketing
Oil & Natural Gas Retail Marketing

Gas Gathering
Gas Processing
Gas Trading
Gas Transmission
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Gas Marketing

Example: Houston Oil and Gas Cluster

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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

Hospitality and Tourism

Transportation and Logistics

Power Generation

Communications Equipment

Information Technology

Aerospace Vehicles and Defense

Analytical Instruments

Education and Knowledge Creation

Medical Devices

Bioscience Research Centers

Biotech / Pharmaceuticals

Traded Cluster Composition of the Iowa Economy

Overall change in the Iowa Share of US Traded Employment: -0.01%

Iowa Overall Share of US Traded Employment: 1.29%

Change in Iowa share of National Employment, 1998 to 2009

Prefabricated Enclosures

Analytical Instruments

Lighting and Electrical Equipment

Processed Food

Forest Products

Heavy Machinery

Chemical Products

Footwear

Processed Food

Leather and Related Products

 Employees 9,900 =
Traded Cluster Composition of the Iowa Economy

Overall change in the Iowa Share of US Traded Employment: -0.01%

Iowa Overall Share of US Traded Employment: 1.29%

Change in Iowa share of National Employment, 1998 to 2009

-0.3% -0.2% -0.1% 0.0% 0.1% 0.2% 0.3% 0.4%
Iowa Job Creation in Traded Clusters
1998 to 2009

Net traded job creation, 1998 to 2009: -16,692

* Percent change in national benchmark times starting regional employment. Overall traded job creation in the state, if it matched national benchmarks, would be -36,849.

Iowa Wages in Traded Clusters
vs. National Benchmarks

Iowa average traded wage: $40,198
U.S. average traded wage: $56,906

### State Traded Wage versus National Average

<table>
<thead>
<tr>
<th>State</th>
<th>State Traded Wage versus National Average</th>
<th>Cluster Mix Effect</th>
<th>Relative Cluster Wage Effect</th>
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<tr>
<td>Connecticut</td>
<td>+27,171</td>
<td>7,028</td>
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<td>New York</td>
<td>+24,102</td>
<td>3,628</td>
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<td>Massachusetts</td>
<td>+16,169</td>
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<td>California</td>
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<td>+6,651</td>
<td>2,496</td>
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<td>Rhode Island</td>
<td>-9,791</td>
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<td>Oregon</td>
<td>-10,359</td>
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<td>Missouri</td>
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<td>Alabama</td>
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<td>Florida</td>
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<td>South Carolina</td>
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<td>Arkansas</td>
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<td>New Mexico</td>
<td>-16,123</td>
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<td>Kentucky</td>
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<tr>
<td>Montana</td>
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<tr>
<td>South Dakota</td>
<td>-20,968</td>
<td>289</td>
<td>-21,257</td>
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**On average, cluster strength is much more important (78.1%) than cluster mix (21.9%) in driving regional performance in the U.S.**

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.

Iowa Cluster Portfolio, 2009

LQ > 4
LQ > 2
LQ > 1.
# Iowa Performance Scorecard

**Prosperity**
- GDP per Capita, 2000-2010: Start Position 31, Trend 6, Current Position 22 (+9)

**Wages**

**Job Creation**

**Labor Mobilization**
- Proportion of Working Age Population in the Workforce, 2000-2010: Start Position 9, Trend 10, Current Position 3 (+6)

**Labor Productivity**
- GDP per Workforce Participant, 2000-2010: Start Position 40, Trend 13, Current Position 27 (+13)

**New Business Formation**

**Innovation**
- Patents per Employee, 2000-2010: Start Position 27, Trend 15, Current Position 27 (0)

**Cluster Strength**

**Leading Clusters**
- by employment size, 2009 (national rank):
  - Processed Food (7)
  - Financial Services (23)
  - Heavy Machinery (2)
  - Forest Products (10)
  - Analytical Instruments (18)
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
Defining the Appropriate Economic Regions

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

**Wage Performance in Iowa Metropolitan Areas**

Average Private Wage, 2009

- **U.S. Average Private Wage:** $42,403
- **Iowa Average Private Wage:** $34,144

**Growth Rate of Private Wages, 1998-2009**

- **Iowa Growth Rate of Wages:** 2.85%
- **U.S. Growth Rate of Wages:** 3.01%

Source: Census CBP, authors' analysis. Note: "Bubble" size in chart is proportional to employment in 2009.

* Iowa portion only
Employment Performance in Iowa Metropolitan Areas

Iowa Growth Rate of Employment: 0.51%
U.S. Growth Rate of Employment: 0.52%

U.S. Average Private Wage: $42,403
Iowa Average Private Wage: $34,144

Growth Rate of Private Employment, 1998-2009

Average Private Wage, 2009

*Iowa portion only
Source: Census CBP, authors' analysis. Note: “Bubble” size in chart is proportional to employment in 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
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1. How is your state doing? State Performance Scorecard
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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
```

- Economic strategy requires **setting priorities** and **moving beyond** long lists of separate recommendations.

```
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?
### How Should States Compete for Investment?

<table>
<thead>
<tr>
<th>Tactical (Zero Sum Competition)</th>
<th>Strategic (Positive Sum Competition)</th>
</tr>
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<tbody>
<tr>
<td>Focus on attracting <strong>new</strong> investments</td>
<td>Also support greater local investment by <strong>existing</strong> companies</td>
</tr>
<tr>
<td>Compete for <strong>every</strong> plant</td>
<td>Reinforce areas of <strong>specialization</strong> and emerging cluster strength</td>
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<tr>
<td>Offer <strong>generalized</strong> tax breaks</td>
<td>Provide state support for training, infrastructure, and institutions with <strong>enduring benefits</strong></td>
</tr>
<tr>
<td>Provide <strong>subsidies</strong> to lower / offset business costs</td>
<td>Improve the <strong>efficiency of doing business</strong></td>
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<td>Every city and sub-region <strong>for itself</strong></td>
<td>Harness efficiencies and coordination <strong>across jurisdictions</strong>, especially with neighbors</td>
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<td><strong>Government</strong> drives investment attraction</td>
<td>Government and the private sector <strong>collaborate</strong> to build cluster strength</td>
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- **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.