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
<table>
<thead>
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<th>Start Position</th>
<th>Trend</th>
<th>Current Position</th>
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<td>GDP per Capita, 2000-2010</td>
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<td><strong>Job Creation</strong></td>
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<td>Proportion of Working Age Population in the Workforce, 2000-2010</td>
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<td>GDP per Workforce Participant, 2000-2010</td>
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<td><strong>New Business Formation</strong></td>
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<td>21</td>
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<td>- Business Services (10)</td>
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<td>- Analytical Instruments (6)</td>
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<td>- #NA</td>
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</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

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

High but declining versus U.S.

U.S. GDP per Employed Worker Real Growth: 1.42%

Highly productive and productivity rising 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 Innovation Performance
2000 - 2010

High and declining innovation

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

High and improving innovation rate versus U.S.

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

**Downstream**
- Oil Transportation
- Oil Trading
- Oil Refining
- Oil Distribution
- Oil Wholesale Marketing
- Oil Retail Marketing
- 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.


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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

Maryland Overall Share of US Traded Employment: 1.81%

Overall change in the Maryland Share of US Traded Employment: 0.29%

Traded Cluster Composition of the Maryland Economy (continued)

Maryland Overall Share of US Traded Employment: 1.81%

-1.2% -0.8% -0.4% -0.0% 0.0% 0.2% 0.4% 0.6% 0.8% 1.0% 1.2% 1.4% 1.6% 1.8% 2.0%

-0.4% -0.3% -0.2% -0.1% 0.0% 0.1% 0.2% 0.3% 0.4% 0.5% 0.6% 0.7% 0.8% 0.9% 1.0%

Change in Maryland share of National Employment, 1998 to 2009

Employment 1998-2009

- Added Jobs
- Lost Jobs

Overall change in the Maryland Share of US Traded Employment: 0.29%


Employees 30,000 =
Maryland Job Creation in Traded Clusters

1998 to 2009

Net traded job creation, 1998 to 2009: +75,053

* Percent change in national benchmark times starting regional employment. Overall traded job creation in the state, if it matched national benchmarks, would be 44,291.

Maryland Wages in Traded Clusters vs. National Benchmarks

Indicates average national wage in the traded cluster

Maryland average traded wage: $64,669
U.S. average traded wage: $56,906

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

<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>
</tr>
</thead>
<tbody>
<tr>
<td>Connecticut</td>
<td>+27,171</td>
<td>7,028</td>
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<tr>
<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>New Jersey</td>
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<td>California</td>
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<td>Maryland</td>
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<td>Rhode Island</td>
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<td>Oregon</td>
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<tr>
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<td>-21,257</td>
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</tbody>
</table>

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.
## Maryland Performance Scorecard

### Prosperity
**GDP per Capita, 2000-2010**
- Start Position: 18
- Trend: 8
- Current Position: 13 (+5)

### Wages
**Average Private Wage, 1998-2009**
- Start Position: 12
- Trend: 5
- Current Position: 9 (+3)

### Job Creation
- Start Position: 10
- Trend: 32
- Current Position: 22 (-12)

### Labor Mobilization
**Proportion of Working Age Population in the Workforce, 2000-2010**
- Start Position: 13
- Trend: 35
- Current Position: 18 (-5)

### Labor Productivity
**GDP per Workforce Participant, 2000-2010**
- Start Position: 20
- Trend: 5
- Current Position: 13 (+7)

### New Business Formation
- Start Position: 9
- Trend: 43
- Current Position: 32 (-23)

### Innovation
**Patents per Employee, 2000-2010**
- Start Position: 23
- Trend: 25
- Current Position: 23 (+0)

### Cluster Strength
**Employment in Strong Clusters, 1998-2009**
- Start Position: 21
- Trend: 8
- Current Position: 8 (+13)

### Leading Clusters
**by employment size, 2009**
- (national rank)
  - Business Services (10)
  - Education and Knowledge Creation (12)
  - Analytical Instruments (6)
  - #NA
  - #NA

**State Rank**
- 21-30
- 31-40
- 11-20
- 41-50
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
- State
- Metropolitan Areas
- Rural Regions
- Neighboring State

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Defining the Appropriate Economic Regions

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

Wage Performance in Maryland Metropolitan Areas

Maryland Average Private Wage: $45,525

U.S. Average Private Wage: $42,403

Average Private Wage, 2009

Growth Rate of Private Wages, 1998-2009

Maryland Growth Rate of Wages: 3.60%

U.S. Growth Rate of Wages: 3.01%

*Maryland portion only

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

- **U.S. Growth Rate of Employment**: 0.52%
- **Maryland Growth Rate of Employment**: 0.83%

**Average Private Wage, 2009**
- **U.S. Average Private Wage**: $42,403
- **Maryland Average Private Wage**: $45,525

**Growth Rate of Private Employment, 1998-2009**
- **Washington MSA**: 2.7%
- **Baltimore MSA**: 1.8%
- **Salisbury MSA**: 0.6%
- **Cumberland MSA**: -0.3%
- **Philadelphia MSA**: 1.5%
- **Hagerstown MSA**: 0.9%
- **Rest of State**

*Maryland 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
Agenda

1. How is your state doing?  
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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

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?

<table>
<thead>
<tr>
<th>Tactical (Zero Sum Competition)</th>
<th>Strategic (Positive Sum Competition)</th>
</tr>
</thead>
<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>
</tr>
<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>
</tr>
<tr>
<td>Every city and sub-region <strong>for itself</strong></td>
<td>Harness efficiencies and coordination <strong>across jurisdictions</strong>, especially with neighbors</td>
</tr>
<tr>
<td><strong>Government</strong> drives investment attraction</td>
<td>Government and the private sector <strong>collaborate</strong> to build cluster strength</td>
</tr>
</tbody>
</table>

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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

<table>
<thead>
<tr>
<th>Cluster Committees</th>
<th>Task Forces</th>
</tr>
</thead>
<tbody>
<tr>
<td>Automotive</td>
<td>Cluster Activation</td>
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<tr>
<td>Hydrogen / Fuel Cells</td>
<td>Research / Investment</td>
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<tr>
<td>Textiles</td>
<td>Distressed / Disadvan. Areas</td>
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<td>Apparel</td>
<td>Education / Workforce</td>
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<tr>
<td>Agriculture</td>
<td>Start-ups / Local Firms</td>
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<tr>
<td>Travel and Tourism</td>
<td>Measuring Progress</td>
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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.