Michigan Competitiveness: Creating a State Economic Strategy

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

Professor Michael E. Porter
Harvard Business School

March 20, 2012
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>
<tr>
<th>Category</th>
<th>Start Position</th>
<th>Trend</th>
<th>Current Position</th>
<th>State Rank</th>
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<tbody>
<tr>
<td><strong>Prosperity</strong></td>
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<tr>
<td>GDP per Capita, 2000-2010</td>
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<td><strong>Wages</strong></td>
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<td>Average Private Wage, 1998-2009</td>
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<td>50</td>
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<tr>
<td><strong>Job Creation</strong></td>
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<td><strong>Labor Mobilization</strong></td>
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<tr>
<td>Proportion of Working Age Population in the Workforce, 2000-2010</td>
<td>22</td>
<td>49</td>
<td>43</td>
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<td><strong>Labor Productivity</strong></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><strong>Innovation</strong></td>
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<td>Patents per Employee, 2000-2010</td>
<td>11</td>
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<tr>
<td><strong>Cluster Strength</strong></td>
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<td><strong>Leading Clusters</strong></td>
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<tr>
<td>by employment size, 2009 (national rank)</td>
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<tr>
<td>• Automotive (1)</td>
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<td>• Metal Manufacturing (4)</td>
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<tr>
<td>• Plastics (4)</td>
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<td>• Production Technology (5)</td>
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<tr>
<td>• Biopharmaceuticals (7)</td>
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</tbody>
</table>

2012 State Competitiveness – Rich Bryden
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%
Change in Labor Force Participation Rate: -2.4%
Low and declining versus U.S.
Low but rising versus U.S.

Notes: Source BLS.

Change in Proportion of Working Age Population in the Workforce, 1999-2010

Proportion of Working Age Population in the Workforce, 2010

50% 55% 60% 65% 70% 75%
-7% -6% -5% -4% -3% -2% -1% 0% 1% 2%
Comparative State Labor Force Productivity Performance
2000-2010

U.S. GDP per Labor Force Participant Real Growth: 0.803%

Highly productive and productivity rising versus U.S.

-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

High but declining versus U.S.

Low and declining versus U.S.

Low but rising versus U.S.

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

High but declining versus U.S.

Highly productive and productivity rising versus U.S.

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

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

Low and declining innovation

High and improving innovation rate versus U.S.

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

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

Patents per 10,000 Workers, 2010

0 5 10 15 20
-6% -4% -2% 0% 2% 4% 6%
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
- Analytical Instruments Cluster
- Teaching and Specialized Hospitals
- Biological Products
- Biopharmaceutical Products
- Research Organizations
- 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
- Cluster Organizations
  - MassMedic, MassBio, others
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)

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

Specialized Institutions
(e.g., Academic Institutions, Training Centers, Industry Associations)

Downstream

Oil Transportation

Oil Trading

Oil Refining

Oil Distribution

Gas Gathering

Gas Processing

Gas Trading

Gas Transmission

Gas Distribution

Gas Marketing

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

Oilfield Services/Engineering & Contracting Firms

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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.*

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 Michigan Economy

Overall change in the Michigan Share of US Traded Employment: -0.73%

Michigan Overall Share of US Traded Employment: 2.99%

Change in Michigan share of National Employment, 1998 to 2009

Traded Cluster Composition of the Michigan Economy

Overall change in the Michigan Share of US Traded Employment: -0.73%

Michigan Overall Share of US Traded Employment: 2.99%

Employees 23,000 = 2.0%


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Michigan Job Creation in Traded Clusters
1998 to 2009

Net traded job creation, 1998 to 2009: -262,659

Indicates expected job creation given national cluster growth.*

* Percent change in national benchmark times starting regional employment. Overall traded job creation in the state, if it matched national benchmarks, would be -169,965.

Michigan Wages in Traded Clusters vs. National Benchmarks

- Fishing and Fishing Products
- Information Technology
- Financial Services
- Biopharmaceuticals
- Aerospace Engines
- Oil and Gas Products and Services
- Business Services
- Distribution Services
- Analytical Instruments
- Automotive
- Chemical Products
- Heavy Construction Services
- Forest Products
- Medical Devices
- Production Technology
- Publishing and Printing
- Aerospace Vehicles and Defense
- Metal Manufacturing
- Entertainment
- Heavy Machinery
- Processed Food
- Motor Driven Products
- Prefabricated Enclosures
- Power Generation and Transmission
- Jewelry and Precious Metals
- Plastics
- Communications Equipment
- Building Fixtures, Equipment and Services
- Lighting and Electrical Equipment
- Transportation and Logistics
- Agricultural Products
- Leather and Related Products
- Sporting, Recreational and Children’s Goods
- Furniture
- Construction Materials
- Education and Knowledge Creation
- Textiles
- Hospitality and Tourism
- Apparel
- Tobacco
- Footwear


2012 – State Competitiveness – Rich Bryden
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.

<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>
<td>20,142</td>
</tr>
<tr>
<td>New York</td>
<td>+24,102</td>
<td>3,628</td>
<td>20,474</td>
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<tr>
<td>Massachusetts</td>
<td>+16,169</td>
<td>4,391</td>
<td>11,778</td>
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<tr>
<td>New Jersey</td>
<td>+13,535</td>
<td>3,761</td>
<td>9,774</td>
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<tr>
<td>California</td>
<td>+9,573</td>
<td>349</td>
<td>9,224</td>
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<tr>
<td>Maryland</td>
<td>+6,651</td>
<td>2,496</td>
<td>4,155</td>
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<td>Washington</td>
<td>+5,652</td>
<td>2,692</td>
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<td>+5,319</td>
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<tr>
<td>Rhode Island</td>
<td>-9,791</td>
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<tr>
<td>Oregon</td>
<td>-10,359</td>
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<tr>
<td>South Dakota</td>
<td>-20,968</td>
<td>289</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.
### Michigan Performance Scorecard

**Prosperity**  
GDP per Capita, 2000-2010  
- Start Position: 24  
- Trend: 49  
- Current Position: 41 (-17)

**Wages**  
Average Private Wage, 1998-2009  
- Start Position: 10  
- Trend: 50  
- Current Position: 18 (-8)

**Job Creation**  
- Start Position: 27  
- Trend: 46  
- Current Position: 48 (-21)

**Labor Mobilization**  
Proportion of Working Age Population in the Workforce, 2000-2010  
- Start Position: 22  
- Trend: 49  
- Current Position: 43 (-21)

**Labor Productivity**  
GDP per Workforce Participant, 2000-2010  
- Start Position: 23  
- Trend: 47  
- Current Position: 40 (-17)

**New Business Formation**  
- Start Position: 25  
- Trend: 42  
- Current Position: 44 (-19)

**Innovation**  
Patents per Employee, 2000-2010  
- Start Position: 11  
- Trend: 20  
- Current Position: 12 (-1)

**Cluster Strength**  
Employment in Strong Clusters, 1998-2009  
- Start Position: 19  
- Trend: 48  
- Current Position: 32 (-14)

**Leading Clusters**  
by employment size, 2009  
(national rank)  
- Automotive (1)  
- Metal Manufacturing (4)  
- Plastics (4)  
- Production Technology (5)  
- Biopharmaceuticals (7)
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

- Geographic and Governmental Influences
- Productivity

- State Competitiveness – Rich Bryden

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

Michigan Metropolitan Areas

Muskegon MSA
Holland MSA
Kalamazoo MSA
Niles MSA
South Bend MSA
Battle Creek MSA

Grand Rapids MSA
Lansing MSA
Bay City MSA
Saginaw MSA
Flint MSA
Detroit MSA
Ann Arbor MSA
Monroe MSA
Jackson MSA
Wage Performance in Michigan Metropolitan Areas

Michigan Growth Rate of Wages: 1.85%
U.S. Growth Rate of Wages: 3.01%

U.S. Average Private Wage: $42,403
Michigan Average Private Wage: $40,137

Ann Arbor MSA
Detroit MSA
Battle Creek MSA
Jackson MSA

Monroe MSA
Kalamazoo MSA
Flint MSA
Muskegon MSA
Saginaw MSA

Grand Rapids MSA
Lansing MSA
Holland MSA
Niles MSA
Bay City MSA
Rest of State

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

*Michigan portion only
**Employment Performance in Michigan Metropolitan Areas**

- **Growth Rate of Private Employment, 1998-2009**
- **Average Private Wage, 2009**
- **U.S. Average Private Wage: $42,403**
- **Michigan Average Private Wage: $40,137**

- **Michigan Growth Rate of Employment: -1.33%**
- **U.S. Growth Rate of Employment: 0.52%**

*Michigan portion only*

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

Geographic and Governmental Influences on Productivity
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?

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

---

**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?
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.

<table>
<thead>
<tr>
<th>Old Model</th>
<th>New Model</th>
</tr>
</thead>
<tbody>
<tr>
<td>• <strong>Government</strong> drives economic development through policy decisions and incentives</td>
<td>• Economic development is a <strong>collaborative process</strong> involving government at multiple levels, companies, teaching and research institutions, and private sector organizations</td>
</tr>
</tbody>
</table>
Example: Organizing for Economic Development

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

Coordinating Staff

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

Task Forces
- Cluster Activation
- Research / Investment
- Distressed / Disadvant. 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.