Montana Competitiveness: Creating a State Economic Strategy

Professor Michael E. Porter
Harvard Business School

March 28, 2012

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 2011

Achieving Fiscal Stability

Enhancing State Competitiveness
What is Competitiveness?

• Competitiveness is the \textit{productivity} with which a state utilizes its human, capital, and natural endowments to create value.

• Productivity determines \textit{wages, jobs,} and the \textit{standard of living}.

• It is not \textit{what} fields a state competes in that determines its prosperity, but \textit{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
# Montana Performance Scorecard

<table>
<thead>
<tr>
<th>Category</th>
<th>Start Position</th>
<th>Trend</th>
<th>Current Position</th>
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<tbody>
<tr>
<td><strong>Prosperity</strong> (GDP per Capita, 2000-2010)</td>
<td>48</td>
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<td><strong>Wages</strong> (Average Private Wage, 1998-2009)</td>
<td>50</td>
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<td><strong>Labor Mobilization</strong> (Proportion of Working Age Population in the Workforce, 2000-2010)</td>
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**Leading Clusters**
- Entertainment (34)
- Oil and Gas Products and Services (21)
- Heavy Machinery (38)
- Sports, Recreational and Children’s Goods (36)
- Fishing and Fishing Products (26)
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

Proportion of Working Age Population in the Workforce, 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

Montana

50%
55%
60%
65%
70%
75%

50%
55%
60%
65%
70%
75%

-7%
-6%
-5%
-4%
-3%
-2%
-1%
0%
1%
2%
Comparative State Labor Force Productivity Performance 2000-2010

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

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

Highly productive and productivity rising versus U.S.
- Delaware
- Alaska
- New York
- Massachusetts
- California
- Louisiana
- Hawaii
- Maryland
- U.S. GDP per Labor Force Participant: $85,229

High but declining versus U.S.
- Wisconsin
- Oklahoma
- Alabama
- New Mexico
- Michigan
- Arizona
- Idaho
- Mississippi
- Iowa
- Alabama
- West Virginia
- Montana

Low and declining versus U.S.
- North Carolina
- Minnesota
- Nebraska
- South Dakota
- Wyoming
- Delaware
- Alaska
- New York
- Massachusetts
- California
- Louisiana
- Hawaii
- Maryland
- U.S. GDP per Labor Force Participant: $85,229

Low but rising versus U.S.
- Washington
- Illinois
- Texas
- Colorado
- New Jersey
- Connecticut
- Virginia
- North Carolina
- Minnesota
- Nebraska
- South Dakota
- Wyoming
- Delaware
- Alaska
- New York
- Massachusetts
- California
- Louisiana
- Hawaii
- Maryland
- U.S. GDP per Labor Force Participant: $85,229

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

Gross Domestic Product per Employed Worker, 2010

Highly productive and productivity rising versus U.S.

High but declining versus U.S.

Low but rising versus U.S.

Low and declining versus U.S.

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

Montana

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

U.S. average Growth Rate of Patenting:
+2.25%

Patents per 10,000 Workers, 2010

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

High and declining innovation

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
Example: Houston Oil and Gas Cluster

Upstream

Oil & Natural Gas Exploration & Development

Oil & Natural Gas Completion & Production

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

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

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

Downstream

Oil Transportation

Gas Gathering

Gas Processing

Gas Trading

Gas Transmission

Oil Refining

Oil Trading

Oil Distribution

Oil Wholesale Marketing

Oil Retail Marketing

Gas Distribution

Gas Marketing

Oilfield Services/Engineering & Contracting Firms

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

Business Services
(e.g., MIS Services, Technology Licenses, Risk Management)
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
- Aerospace Vehicles and Defense
- Analytical Instruments
- Education and Knowledge Creation
- Medical Devices
- Biotech / Pharmaceuticals
- Sporting Equipment
- Information Technology

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Traded Cluster Composition of the Montana Economy

Overall change in the Montana Share of US Traded Employment: 0.04%

Montana Overall Share of US Traded Employment: 0.22%


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Traded Cluster Composition of the Montana Economy (continued)

Overall change in the Montana Share of US Traded Employment: 0.04%

Montana Overall Share of US Traded Employment: 0.22%

Change in Montana share of National Employment, 1998 to 2009

Processed Food
Agricultural Products
Transportation and Logistics
Publishing and Printing
Distribution Services
Metal Manufacturing
Automotive
Motor Driven Products
Plastics
Apparel
Biopharmaceuticals
Lighting and Electrical Equipment
Aerospace Vehicles and Defense


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Montana Job Creation in Traded Clusters
1998 to 2009

Net traded job creation, 1998 to 2009:
+11,429

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 2,304.

Montana Wages in Traded Clusters vs. National Benchmarks


Indicates average national wage in the traded cluster

Montana average traded wage: $34,111

U.S. average traded wage: $56,906

Wages, 2009

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

Montana average
traded wage:
$34,111

U.S. average
traded wage:
$56,906

Indicates average national wage in the traded cluster

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

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<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>
</tr>
<tr>
<td>Massachusetts</td>
<td>+16,169</td>
<td>4,391</td>
<td>11,778</td>
</tr>
<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>
</tr>
<tr>
<td>Maryland</td>
<td>+6,651</td>
<td>2,496</td>
<td>4,155</td>
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<tr>
<td>Washington</td>
<td>+5,652</td>
<td>2,692</td>
<td>2,960</td>
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<td>Virginia</td>
<td>+5,319</td>
<td>1,617</td>
<td>3,702</td>
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<td>Illinois</td>
<td>+2,658</td>
<td>16</td>
<td>2,642</td>
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<td>Colorado</td>
<td>+1,662</td>
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<td>Texas</td>
<td>+352</td>
<td>2,494</td>
<td>-2,142</td>
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<td>Delaware</td>
<td>+164</td>
<td>11,060</td>
<td>-10,896</td>
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<tr>
<td>Alaska</td>
<td>-930</td>
<td>-2,417</td>
<td>1,487</td>
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<td>Pennsylvania</td>
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<td>Louisiana</td>
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<td>Georgia</td>
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<td>Minnesota</td>
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<td>New Hampshire</td>
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<td>-6,761</td>
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<td>Arizona</td>
<td>-7,021</td>
<td>1,149</td>
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<td>Kansas</td>
<td>-7,705</td>
<td>2,241</td>
<td>-9,946</td>
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<td>Wyoming</td>
<td>-8,057</td>
<td>1,040</td>
<td>-9,097</td>
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<td>Michigan</td>
<td>-8,176</td>
<td>-2,544</td>
<td>-5,633</td>
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<td>North Carolina</td>
<td>-9,245</td>
<td>-4,330</td>
<td>-4,915</td>
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<tr>
<td>Ohio</td>
<td>-9,284</td>
<td>-2,495</td>
<td>-6,788</td>
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<tr>
<td>Rhode Island</td>
<td>-9,791</td>
<td>-2,290</td>
<td>-7,501</td>
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<td>Oregon</td>
<td>-10,359</td>
<td>-1,304</td>
<td>-9,056</td>
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<tr>
<td>Missouri</td>
<td>-10,427</td>
<td>-1,425</td>
<td>-9,002</td>
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<tr>
<td>Alabama</td>
<td>-10,934</td>
<td>-3,563</td>
<td>-7,371</td>
</tr>
<tr>
<td>Florida</td>
<td>-11,007</td>
<td>-1,559</td>
<td>-9,448</td>
</tr>
<tr>
<td>Wisconsin</td>
<td>-11,722</td>
<td>-3,516</td>
<td>-8,206</td>
</tr>
<tr>
<td>Nebraska</td>
<td>-11,777</td>
<td>241</td>
<td>-12,018</td>
</tr>
<tr>
<td>Utah</td>
<td>-11,992</td>
<td>2,072</td>
<td>-14,064</td>
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<tr>
<td>Tennessee</td>
<td>-12,172</td>
<td>-3,156</td>
<td>-9,016</td>
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<tr>
<td>Indiana</td>
<td>-12,554</td>
<td>-4,840</td>
<td>-7,714</td>
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<tr>
<td>Vermont</td>
<td>-13,368</td>
<td>-1,572</td>
<td>-11,796</td>
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<td>497</td>
<td>-14,069</td>
</tr>
<tr>
<td>Nevada</td>
<td>-14,277</td>
<td>2,365</td>
<td>-11,911</td>
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<tr>
<td>North Dakota</td>
<td>-14,394</td>
<td>1,004</td>
<td>-15,397</td>
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<tr>
<td>South Carolina</td>
<td>-15,276</td>
<td>-5,067</td>
<td>-10,209</td>
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<tr>
<td>Arkansas</td>
<td>-15,378</td>
<td>-4,560</td>
<td>-10,818</td>
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<tr>
<td>Hawaii</td>
<td>-16,043</td>
<td>-12,555</td>
<td>-3,487</td>
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<tr>
<td>New Mexico</td>
<td>-16,123</td>
<td>-288</td>
<td>-15,835</td>
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<tr>
<td>Kentucky</td>
<td>-16,215</td>
<td>-5,024</td>
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<tr>
<td>Maine</td>
<td>-16,379</td>
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<td>-15,412</td>
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<td>Iowa</td>
<td>-16,606</td>
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<td>West Virginia</td>
<td>-16,645</td>
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<td>Idaho</td>
<td>-18,671</td>
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<td>-17,884</td>
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<tr>
<td>Mississippi</td>
<td>-19,942</td>
<td>-5,291</td>
<td>-14,651</td>
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<tr>
<td>Montana</td>
<td>-20,073</td>
<td>-2,259</td>
<td>-17,815</td>
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<td>South Dakota</td>
<td>-20,968</td>
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<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.
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*State Rank*  
- 1-10 (Green)  
- 11-20 (Yellow)  
- 31-40 (Orange)  
- 41-50 (Red)
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
  - Neighboring State
The economies of states are often an aggregation of distinct economic areas with differing circumstances.
Wage Performance in Montana Metropolitan Areas

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

U.S. Growth Rate of Employment: 0.52%
Montana Growth Rate of Employment: 1.91%

U.S. Average Private Wage: $42,403
Montana Average Private Wage: $31,211

Billings MSA
Missoula MSA
Great Falls MSA
Rest of State

Growth Rate of Private Employment, 1998-2009

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

- **Integrate** policies and infrastructure planning with neighbors

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

3. **Connect** rural regions with proximate urban areas
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.