Tennessee 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
### Tennessee Performance Scorecard

<table>
<thead>
<tr>
<th>Component</th>
<th>Start Position</th>
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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

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

$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

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

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

High and declining innovation

Low and improving innovation

High and improving innovation rate versus U.S.

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

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

Oil Wholesale Marketing

Oil Retail Marketing

Gas Gathering

Gas Processing

Gas Trading

Gas Transmission

Gas Distribution

Gas Marketing

Oilfield Services/Engineering & Contracting Firms

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

Hospitality and Tourism

Transportation and Logistics

Power Generation

Communication Equipment

Information Technology

Education and Knowledge Creation

Bioscience Research Centers


Aerospace Vehicles and Defense

Analytical Instruments

Medical Devices

Biotech / Pharmaceuticals

Sporting Equipment

Climate and Geography

U.S. Military

Hospitality and Tourism

Transportation and Logistics

Power Generation

Communication Equipment

Information Technology

Education and Knowledge Creation

Bioscience Research Centers

Traded Cluster Composition of the Tennessee Economy

Overall change in the Tennessee Share of US Traded Employment: -0.28%

Tennessee Overall Share of US Traded Employment: 2.01%

Motor Driven Products

Prefabricated Enclosures

Chemical Products

Tennessee national employment share, 2009

Motor Driven Products

Prefabricated Enclosures

Chemical Products

Tennessee national employment share, 2009

Overall change in the Tennessee Share of US Traded Employment: -0.28%

Tennessee Overall Share of US Traded Employment: 2.01%

Traded Cluster Composition of the Tennessee Economy (continued)

Overall change in the Tennessee Share of US Traded Employment: -0.28%

Tennessee Overall Share of US Traded Employment: 2.01%


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Tennessee Job Creation in Traded Clusters
1998 to 2009

Job Creation, 1998 to 2009

Net traded job creation, 1998 to 2009:
-109,250

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 -101,659


2012 State Competitiveness – Rich Bryden
Tennessee Wages in Traded Clusters vs. National Benchmarks

Productivity Depends on How a State Competes, Not What Industries ItCompetes 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>
<td>20,142</td>
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<tr>
<td>New York</td>
<td>+24,102</td>
<td>3,628</td>
<td>20,474</td>
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<td>Massachusetts</td>
<td>+16,169</td>
<td>4,391</td>
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<td>New Jersey</td>
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<td>California</td>
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<td>Florida</td>
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<td>Wisconsin</td>
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<td>Nebraska</td>
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<td>Tennessee</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.
# Tennessee Performance Scorecard

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

Wage Performance in Tennessee Metropolitan Areas

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

Tennessee Average
Private Wage: $37,196

Growth Rate of Private Wages, 1998-2009

Average Private Wage, 2009

$25,000
$30,000
$35,000
$40,000
$45,000

1.5%
2.0%
2.5%
3.0%
3.5%

Nashville MSA
Memphis MSA*
Knoxville MSA
Kingsport MSA*
Chattanooga MSA*
Jackson MSA
Cleveland MSA
Morristown MSA
Rest of State
Clarksville MSA*
Johnson City MSA

Tennessee Growth Rate of Wages: 2.90%
U.S. Growth Rate of Wages: 3.01%

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

- **Tennessee Growth Rate of Employment:** 0.07%
- **U.S. Growth Rate of Employment:** 0.52%

**U.S. Average Private Wage:** $42,403
**Tennessee Average Private Wage:** $37,196

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

*Tennesssee portion only*
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

• What **elements of the business environment** can be unique strengths relative to peers/neighbors?

• What **existing and emerging clusters** represent local strengths?

Develop Unique Strengths

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

Achieve and Maintain Parity with Peers

• 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.