

Economics behind Economic Diversity

George A. Erickcek

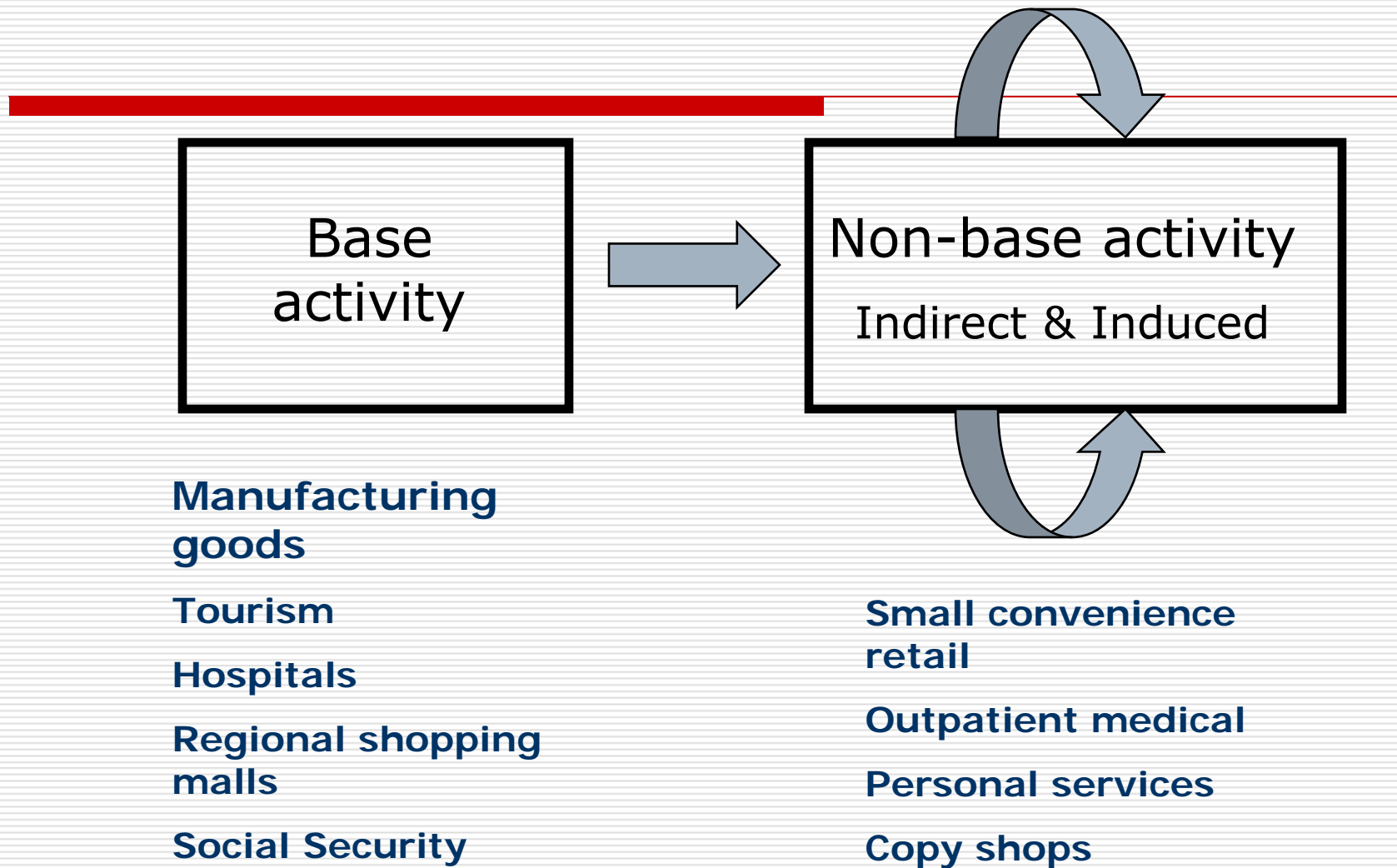
W.E. Upjohn Institute for Employment Research

February 17, 2010

Agenda

- How to define economic diversity
 - Industry or Stages of the Product Cycle
- Industry Diversity
 - Base vs. non-base industries
 - The cluster debate
 - The inability to pick winners
- Product life cycle and emerging industries— *It is **Not** the industry but the success of the products/services that counts.*
 - Evidence
- What do we think the future holds?

Basic Economic Model

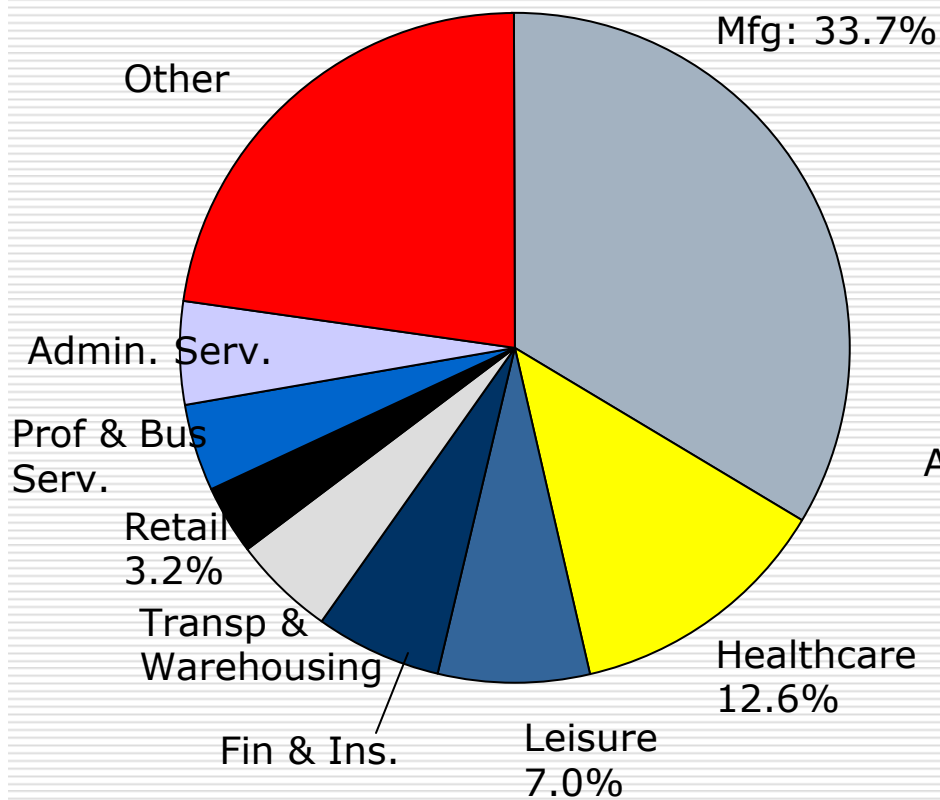


Challenge to the Traditional Base Model

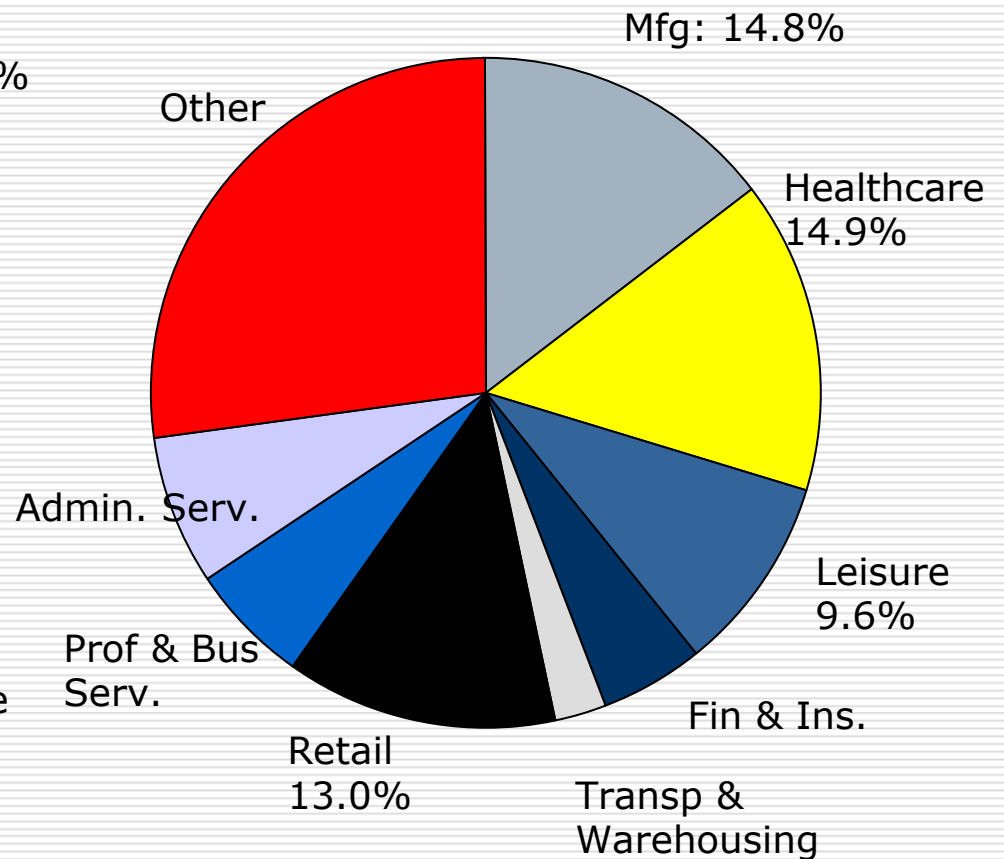
- Increasingly, it is NOT the industry but the activity that matters:
 - New medical procedures
 - Specialized law services
 - Specialized software design
 - Green architecture

Diversity in the base is different than the diversity of total private employment.

Economic Base



Total employment



What does the Kalamazoo region

export? *Pharmaceuticals, motor vehicle parts, and medical instruments.*

□ Top five industries account for 54% of the region's value of exports

- Chemical (drugs)
- Auto and truck parts
- Misc. mfg (medical instruments)
- Food products
- Machinery

□ Top 10 account for 70% of its value of exports

- Paper
- Wholesale
- Utilities
- Health care
- Fabricated metals

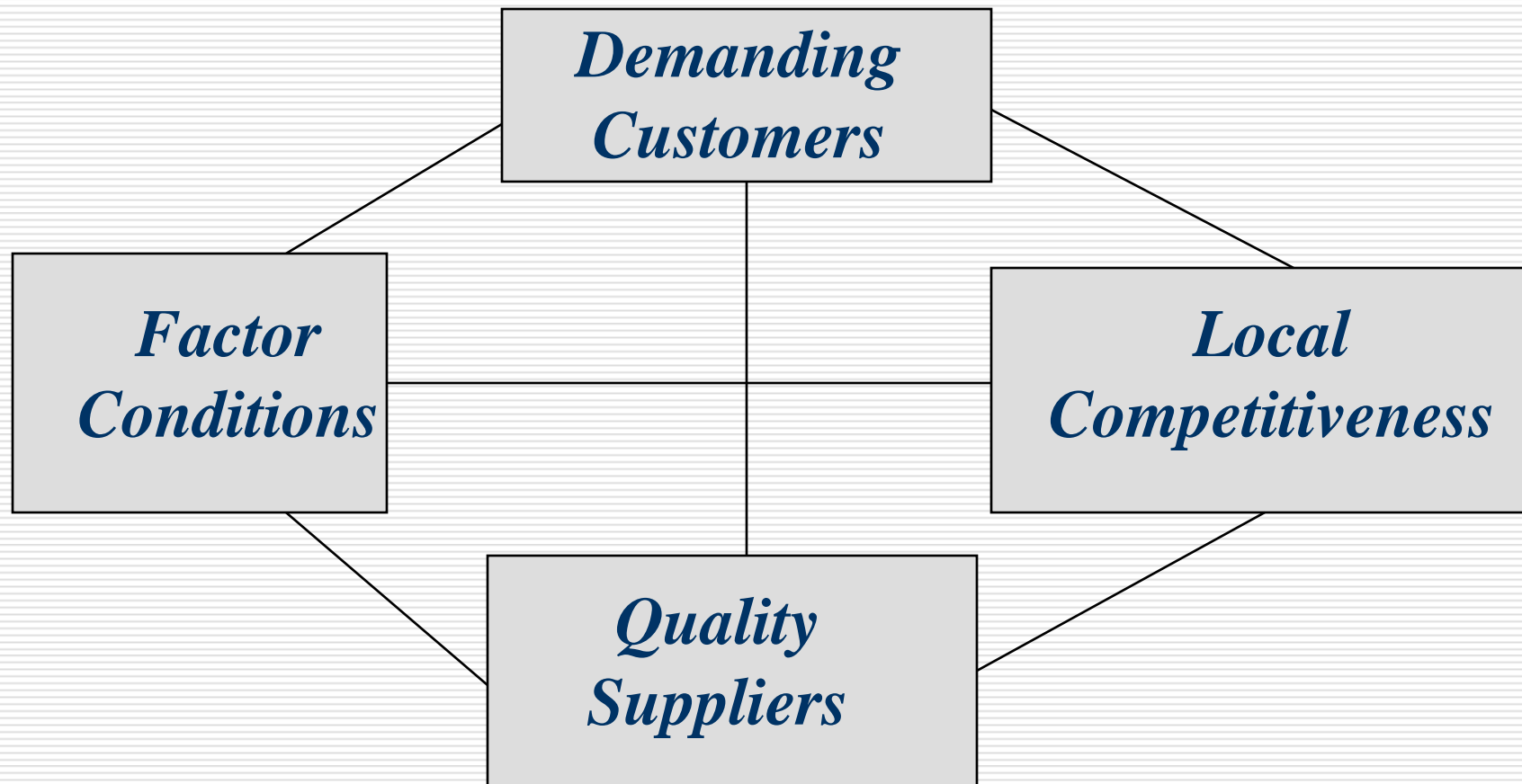
Manufacturing matters.

- ❑ Without production, we also can lose invention, innovation, design, and our seat at the global table for many industries.
- ❑ Controlling for educational achievement, manufacturing pays better wages than any other industry.

The importance and danger of clusters

- Competitive advantage due to
 - Having close, buy-sell relationships
 - Utilizing common technologies or resources, and/or
 - Sharing a common and specialized labor pool

Porter's Cluster Diamond



The Problem with the Clusters

- Too many eggs in one basket.
 - Autos and Michigan
 - Office furniture and Grand Rapids
 - Textiles and the Carolinas
 - Paper in Kalamazoo
- There can be strong clusters and dangerously weak clusters.

The Inability of Picking Winners

- Rapid shifts in competing technologies:
 - Promising technologies can be eclipsed quickly by better technologies .
 - The more powerful technologies cross traditional industrial lines.
 - Many technologies are not feasible or marketable.
 - Technology change in industry is likely to occur in cluster locations.

The inability of picking winners

- Competition is fierce—Everyone and I mean everyone is going after:
 - Life sciences
 - Alternative energy
 - Sustainable industries—*What are these anyway?*

Thoughts on Economic Development

The very essence of long-run growth is, in fact, *the transition* ...from one export base to another as the area matures in what it can do, and as rising per capita income and technological progress change *what the world economy wants done.*

W.R.Thompson (1965)

Success depends on identifying interaction of three key elements of regional economies:

Global Factors

Demographic change

Environmental

Political/Social

Technological Change

Applications

Feasibility

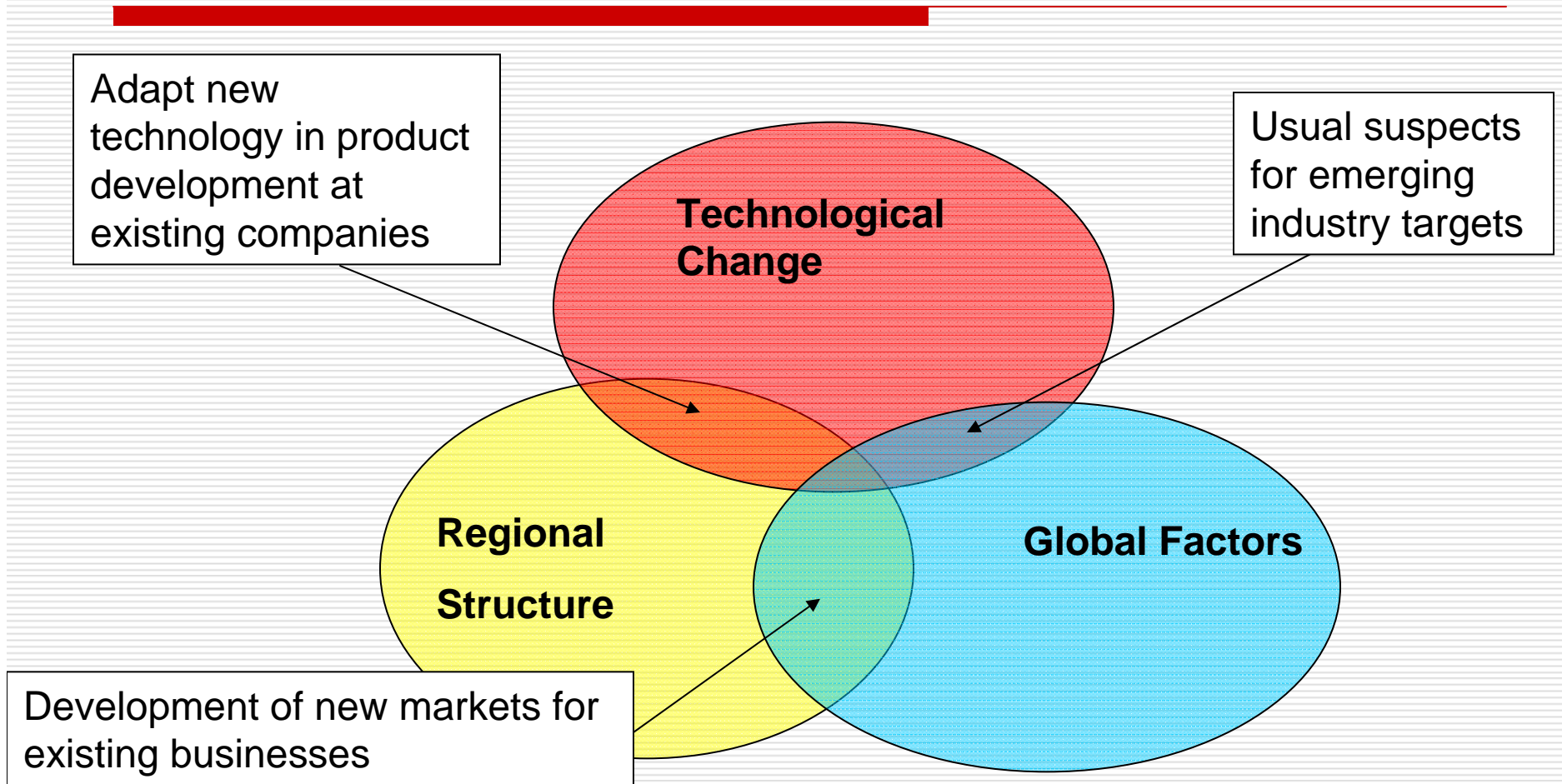
Survivability

Regional Structure

Export Base activities across all industries

Non-Export Base activities

Emerging Industry Opportunities



Stages in a Firm's Product's Life Cycle

Stage 1: Birth—*An environment of entrepreneurship*

Stage 2: Product development and wealth creation—*An environment for success*

Stage 3: Product standardization—*Low cost, competitive environment*

Stage 4: Death—*An environment of abandonment*

Innovative ideas can happen and do happen in almost any industry

- According to the Europeans, Innovation happens when:
 - Strong inter-industry networks and “third places” are created.
 - Marshall (1890) innovation happens when there are “ideas in the air.”
 - Design matters.

Evidence from the UK and Italy

- ❑ Rapidly growing businesses are nearly six times as likely as static ones to see design as integral.
- ❑ Shares in design-led businesses outperform key stock market indices by 200%.
- ❑ Design firms are less likely to compete on price, and more on quality.
- ❑ Businesses that add value through design see a greater impact on business performance than the rest.

Source: Design Council, *The Value of Design*, 2007.

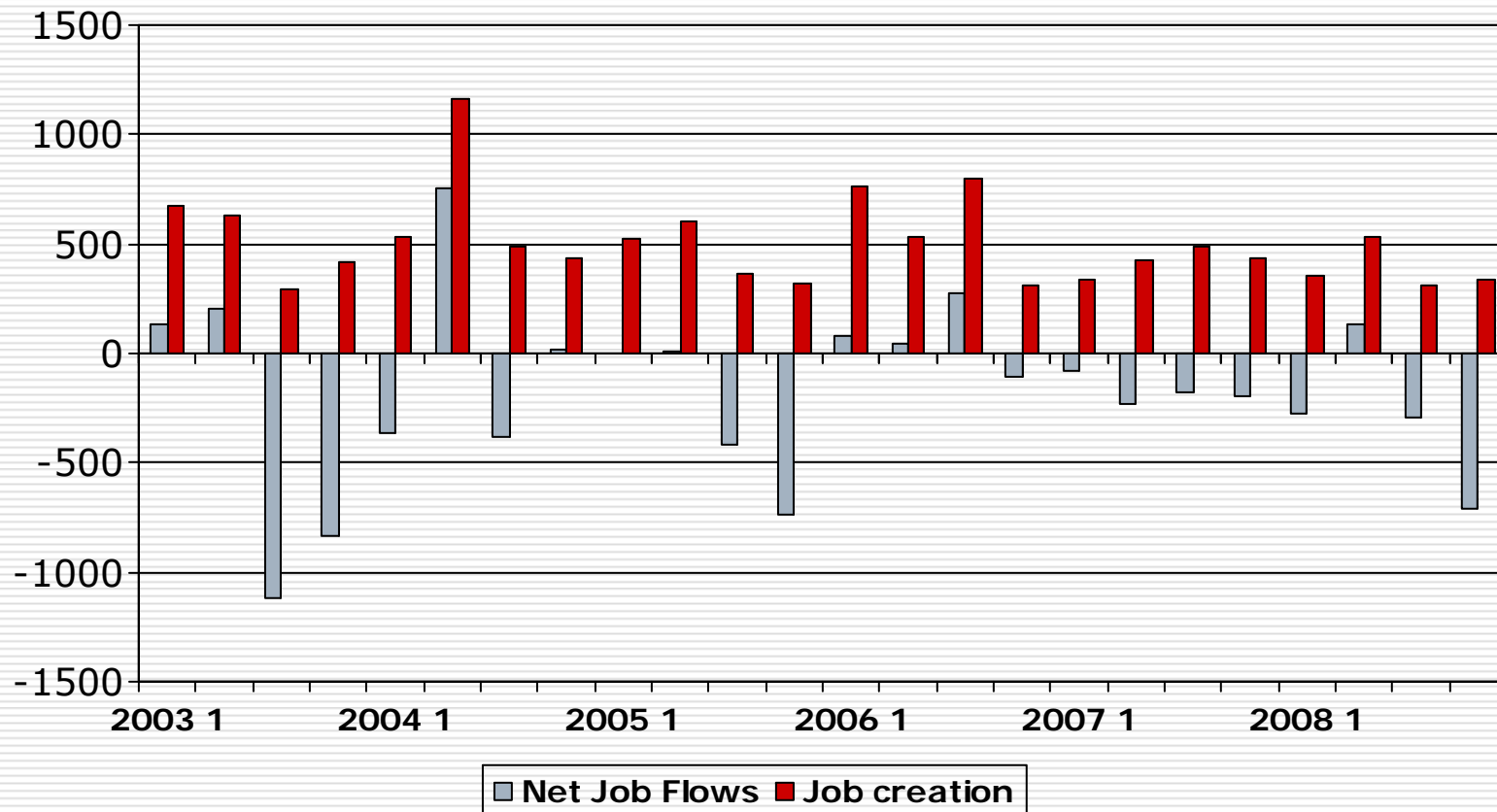
Ongoing Research Effort on the Importance of Design

- What we found so far:
 - Design is risky, but inaction can be fatal.
 - Design can beat out engineering.
 - Design is expensive; being an industry leader invaluable.
 - Design is customer-focused, while it is too easy to become provider-focused.
 - It is easier to lose Design than to regain it.

What is the evidence in west Michigan for births?

- ❑ The “net” numbers do not hold much promise.
- ❑ Nevertheless, job creation in the Kalamazoo region is robust.

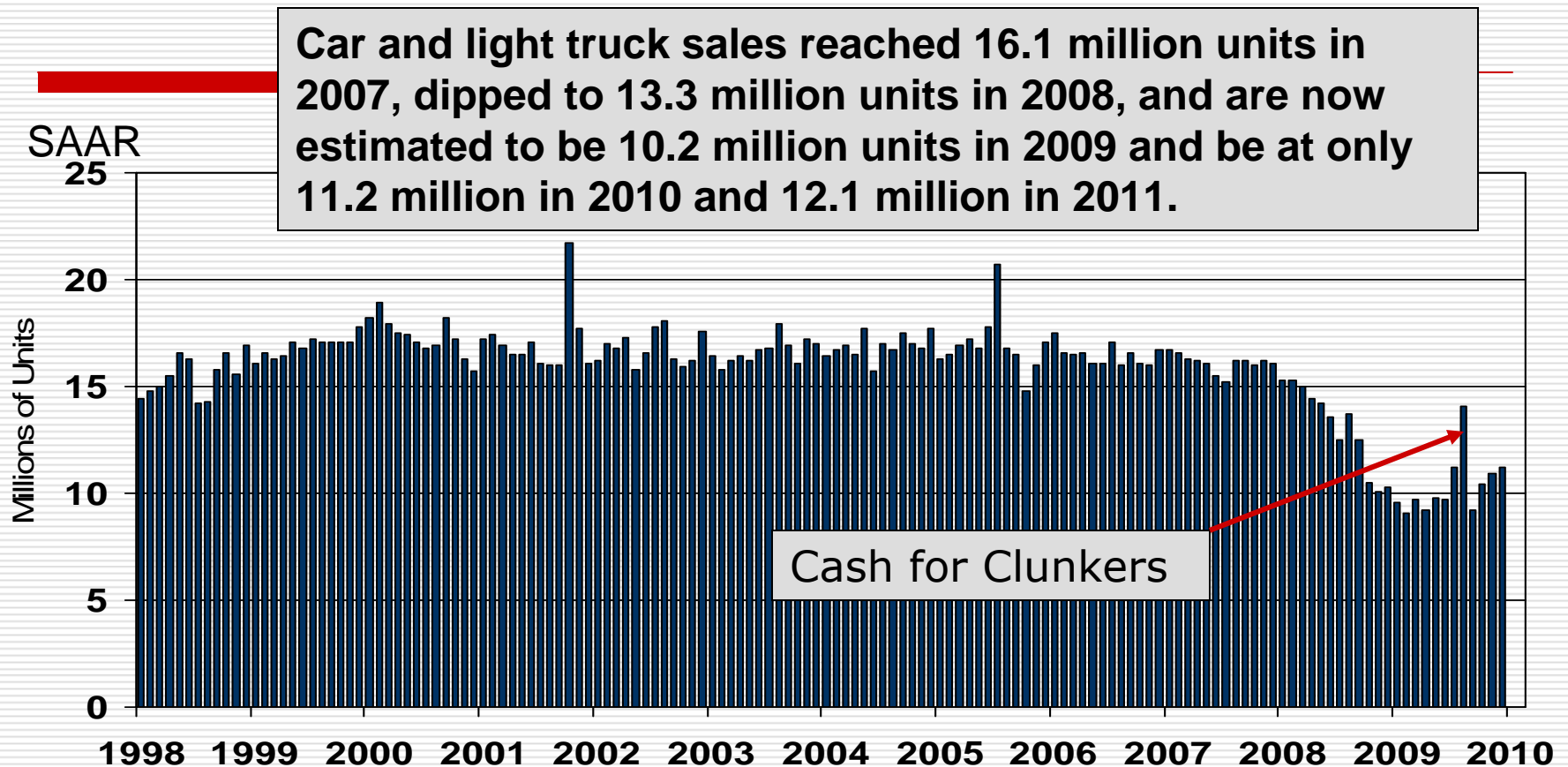
In manufacturing the number of new jobs created every quarter has been pretty impressive.



What do we think the future holds?

- Moderate growth for the nation in 2010, improving in 2011
- Potential Barriers
 - Credit markets
 - Employment conditions
 - Consumer confidence
- Cars sales are expected to remain weak.

The showrooms are still pretty quiet.

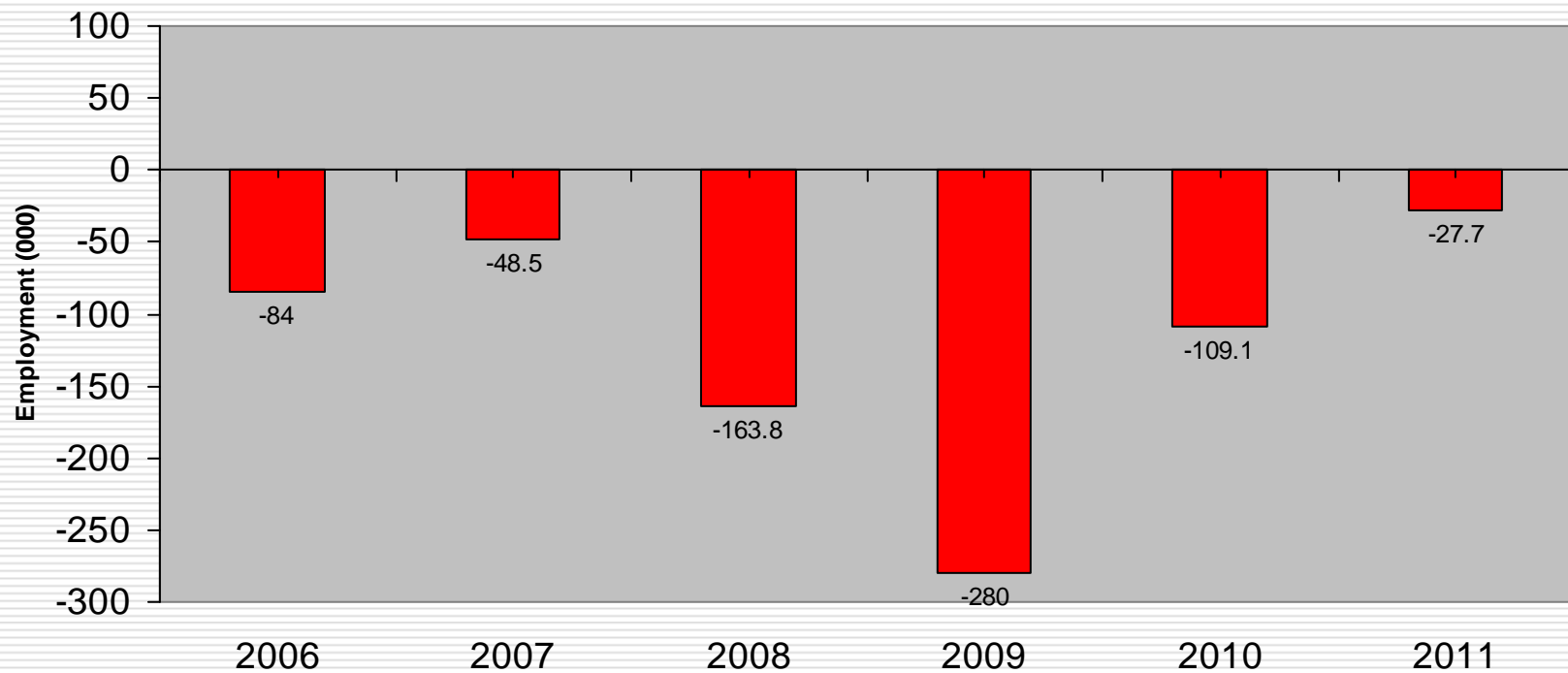


Source: BEA.

Fueled by cash-for-clunkers, sales hit a 14.1 million unit rate in August but have fallen back since. Sales were up to a 11.2 million unit pace in December.

Total employment has declined for 10 straight years and is expected to decline in 2010 and 2011.

Change in Total Employment



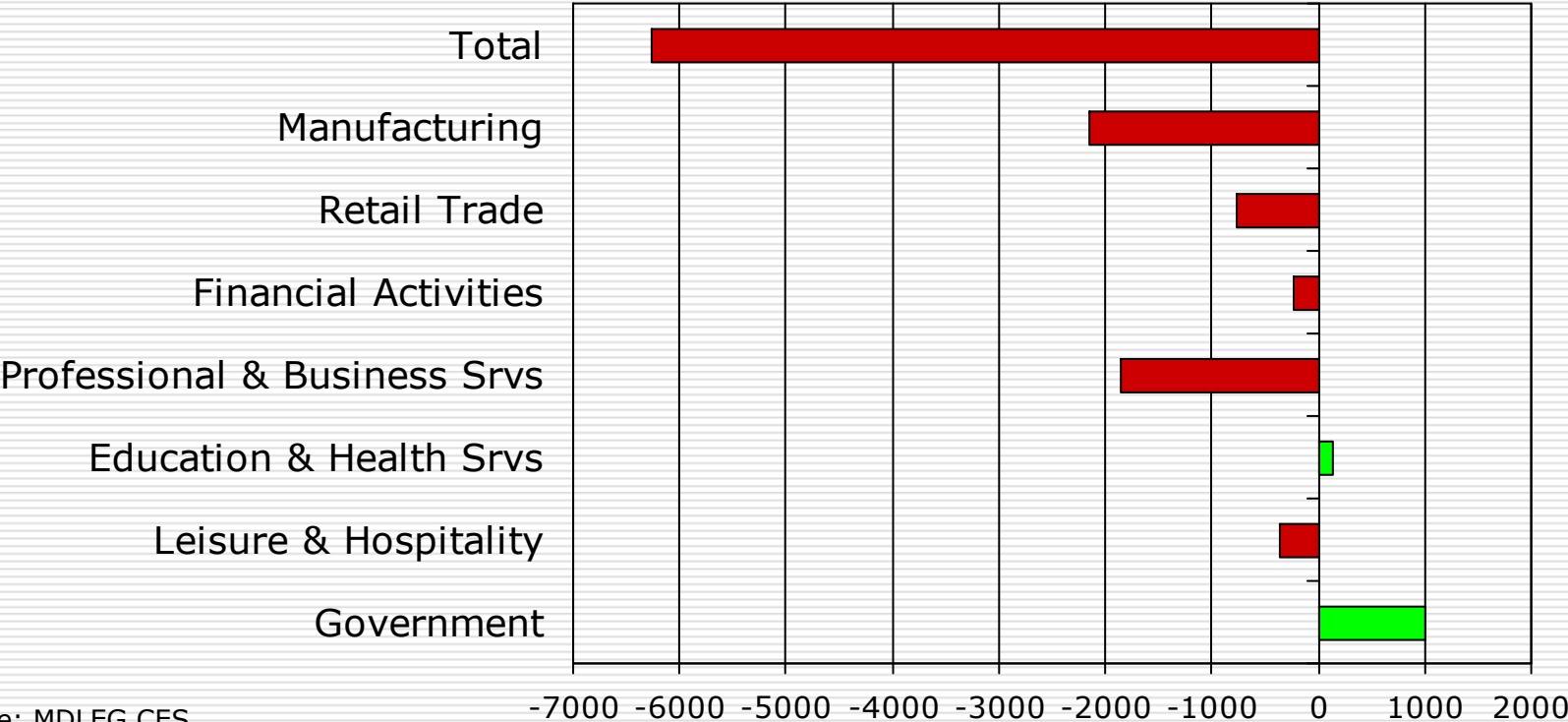
Source: University of Michigan, Nov 2009.

Kalamazoo County—*2009 was not a good year.*

- ❑ Serious employment declines. In December unemployment stood at 12.3%
- ❑ Too many people are moving out.
- ❑ Housing prices are still retreating.
- ❑ Residential construction is at a standstill.

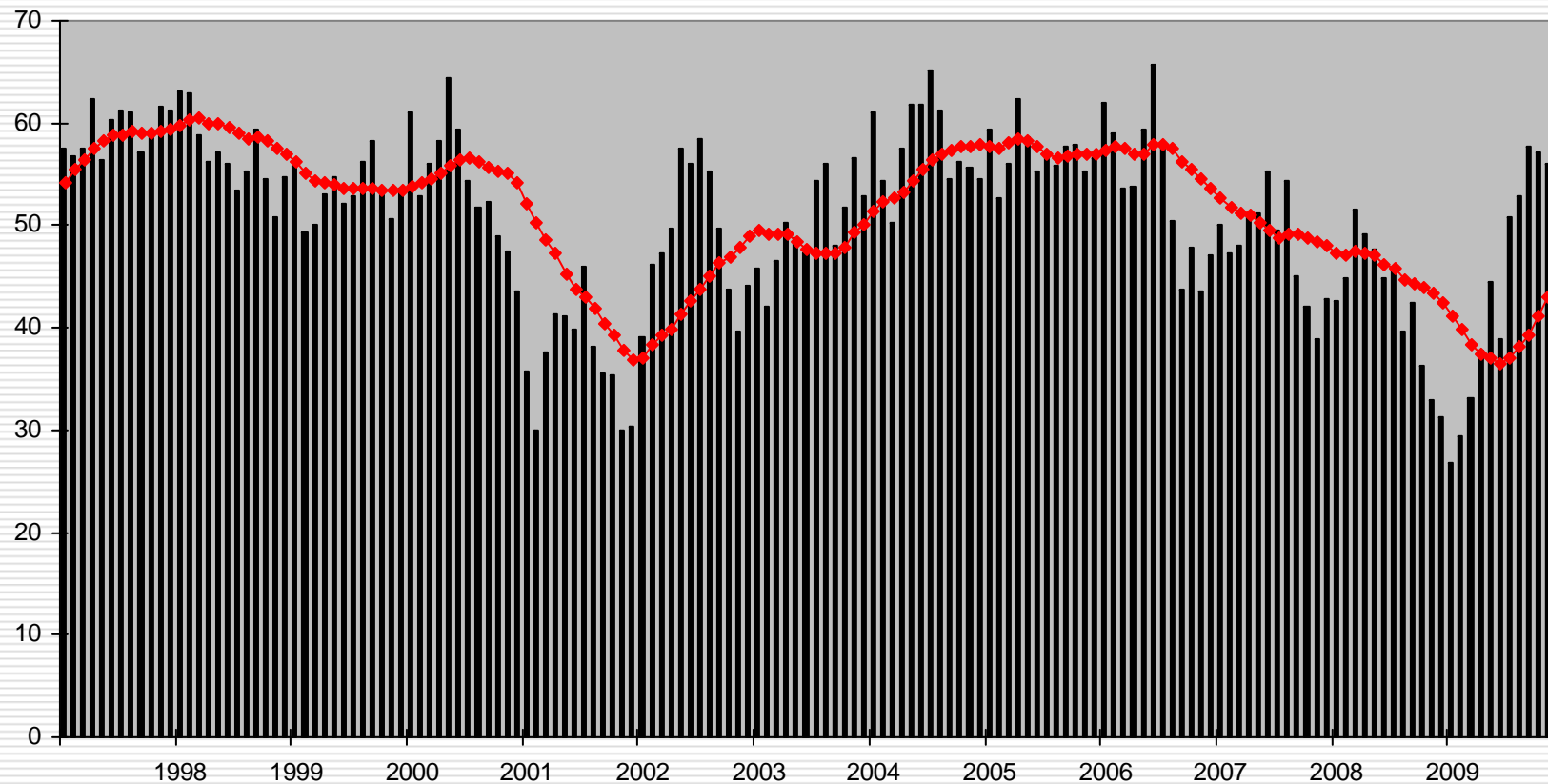
Employers cut more than 6,200 jobs from their payrolls in 2009.

**Kalamazoo MSA Change
2008 to 2009**

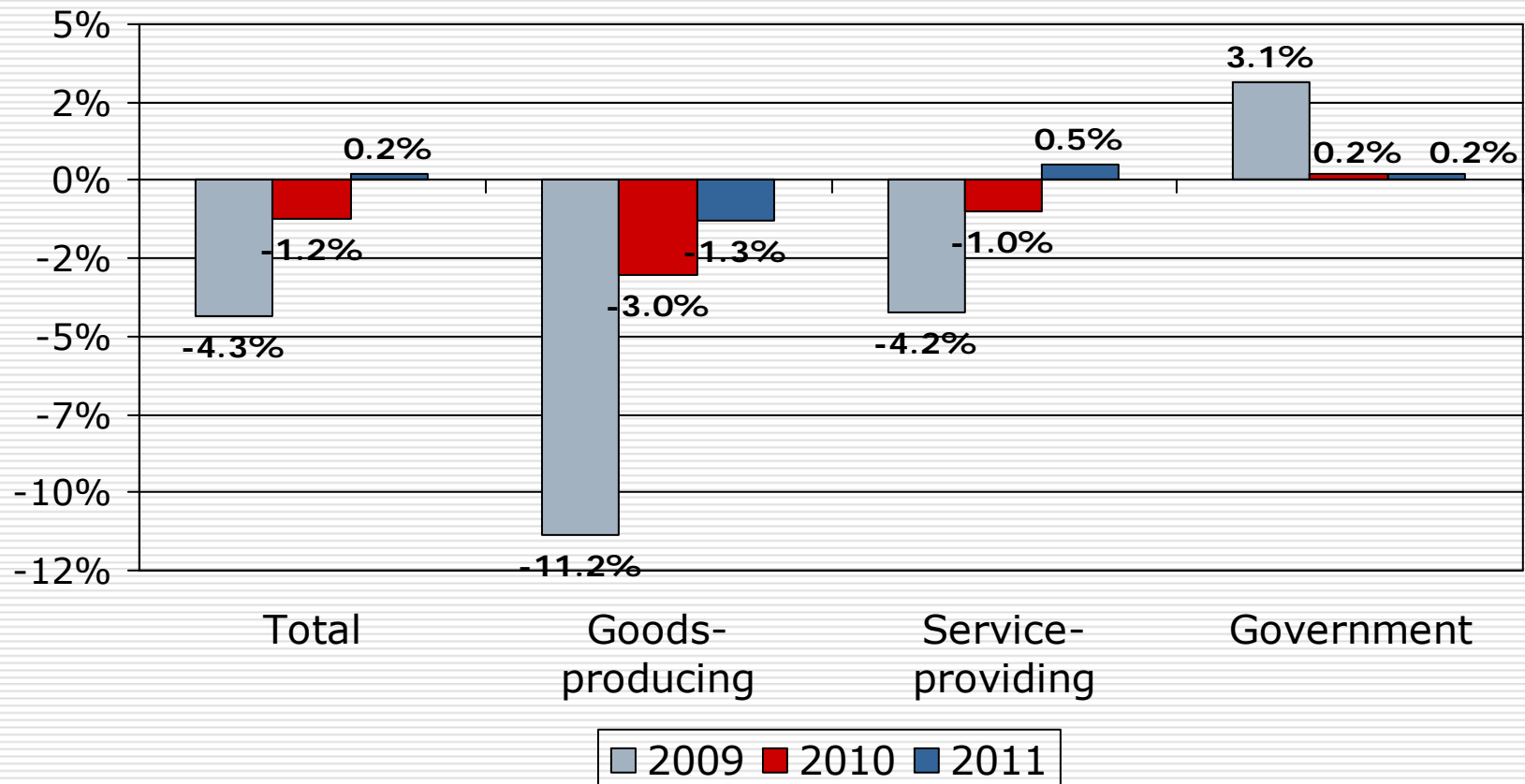


Source: MDLEG CES

Polling of Purchasing Managers is positive.



2010 and 2011 Forecast for Kalamazoo County—*Not out of the woods yet.*



Economics behind Economic Diversity

George A. Erickcek

W.E. Upjohn Institute for Employment Research

February 17, 2010

This presentation is available in the West Michigan section at www.upjohninstitute.org

Or e-mail me: erickcek@upjohn.org