

Preserving the Vital Center Renew the Economy of the Industrial Heartland

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Summary

The United States is undergoing a profound economic restructuring, due to pressures of globalization and the rising knowledge economy. America's Great Lakes region, once the core of the nation's industrial production and wealth creation, is losing ground rapidly. This 12-state region reaches from Buffalo and Pittsburgh in the east, to Minneapolis-St. Paul and St. Louis in the west. Some parts of the region, like Chicago and the Twin Cities, are thriving in the knowledge economy, while other communities, such as Buffalo, Detroit, Cleveland, and Milwaukee, are losing jobs, talent, and economic vitality. For many residents of this important region, the future is dimming.

At this critical moment, federal investment in U.S. competitiveness lacks a regional focus. Federal policy fails to recognize that national growth is driven by integrated regional economies with the strong underlying assets necessary for talent creation and innovation. The competitiveness agenda of the next President should include an investment strategy that focuses on regional assets and institutions that steer the transition to the knowledge economy.

The Great Lakes region offers an opportunity to develop and test a regional framework for federal action on competitiveness. The human, corporate, educational, civic, institutional, and natural resources within the region are tremendous. The scale of its contributions to U.S. output, trade, knowledge, and talent generation makes it an overarching source of national strength. To aid the region's transition to the knowledge economy, the next President should greatly expand federal investment in



the region's competitive assets, while engaging its leadership in fashioning a new federal-state partnership capable of addressing major challenges that impede regional and national competitiveness.

Specifically, the next President should focus investment to:

- tap the Great Lakes region's unrivaled educational infrastructure to produce the talent needed to compete in the 21st century, by fostering a "Great Lakes Compact on In-State Tuition" and a "Passport to Higher Education"
- expand the public-private research and development infrastructure in the region to cultivate the technologies of the future
- promote sustainable development within the "North Coast"
- strengthen economic integration with Canada, creating a new mechanism for bi-national coordination and cooperation on transportation and other issues
- enlist the region's labor, business, civic, and political leadership to remake the nation's social compact—and thus spur competitiveness—through a regional health care consortium and a portable defined-contribution pension plan

Context

Regional economies drive national prosperity. As global economic forces push the United States away from the manufacture of goods and toward the provision of services, successful regional economies are emerging as the engine of U.S. macroeconomic growth. And today, as in the past, investment by the federal government has the capacity to expand regional innovation and entrepreneurship and thereby accelerate national growth. Unfortunately, though, this key federal investment is not taking place. Current federal economic development policy fails to recognize that the success of individual regions will determine the nation's overall competitive strength.

Great Lakes States' Contributions to U.S. Greatness

Over the past half century, globalization and rapid technological change have created new economic realities, forcing regions to find fresh competitive functions. The search

for new economic drivers has been different in each geographic area, defined by distinct assets and legacies. The role of several regions has become uncertain at best, precarious at worst.

For much of the 19th and 20th centuries, the Great Lakes region¹ provided natural resources and industrial advances vital to the growing U.S. economy. There, social and economic innovations were forged that have come to define modern America. The promise of the western frontier was first realized in the Great Lakes, as land, timber, water, and other raw materials were converted into products and traded to the world. The industries that drove America's ascent as a global industrial power were born there, as creative genius unearthed ways to produce consumer goods, steel, automobiles, and chemicals. Detroit's assembly-line production methods reverberated across the nation and globe. Great symbols of American economic dominance, such as the personal automobile and the skyscraper, rose up in this region.

Perhaps most important, key American values were animated in the cities and states of the Great Lakes region: free (non-slave) labor, free education, and workers' rights. The region led the way in organizing the workplace and spreading to workers the vast wealth created by emerging industries. The region's land-grant universities broadened access to higher education, fueled commerce, and significantly advanced the global agricultural and industrial revolutions. The region's labor unions and employers led in developing a 20th century social compact that included better wages and working conditions, paid leave, and the expectation that employers would deliver health care and pension benefits.

Today the Great Lakes region is in transition. Over the past generation, intense global competition has diminished its economic primacy, shattering its traditional employment base. More than a third of the nation's manufacturing job losses from 2000 to 2005 occurred in seven Great Lakes states; in 2005, one-third of the country's mass layoffs occurred in the region.

¹ The Great Lakes region stretches across 12 states: all of Illinois, Indiana, Michigan, Ohio, and Wisconsin; eastern Iowa, Minnesota, and Missouri; northern Kentucky; and western New York, Pennsylvania, and West Virginia.

Regional Upheaval

Change has not come easily to many communities and citizens in these states. Legacy costs of the industrial past are high, damaging prospects for successful transition to the knowledge economy. In almost all the Great Lakes states, BA attainment levels lag the national average. Factory work did not require, and much of the workforce today lacks, the post-secondary education and skills needed to fill knowledge economy jobs. This education deficit is hampering the region's ability to grow new jobs. Similarly, the pattern of rich health care and pension fringe benefits has become unsustainable, putting Great Lakes firms and workers at a severe competitive disadvantage. As traditional employers are driven out of business, labor market flexibility and worker mobility are receding.

And yet, with help, the Great Lakes region could reconstitute itself as an economic powerhouse and social innovator. It comprises just under 100 million people, is one of the world's largest industrial production centers, and includes several major consumer marketplaces. It has powerful assets critical to U.S. competitiveness: a well-developed innovation infrastructure that positions it at the center of new knowledge creation and talent production; a strong network of private and public research and higher education; the world's leading concentration of advanced manufacturing; and leadership in the emerging energy, transport, information technology, and biomedical sectors.

Great Lakes states are making valiant efforts to speed their adaptation to the realities of the knowledge economy by reforming their education systems, garnering resources for post-secondary education and job training, creating new state financing pools to incubate new industries, and collaborating on innovative health care and prescription drug programs to reduce costs and increase access.

The Federal Role

If the Great Lakes region is to transition successfully to leadership in the knowledge economy, its citizens and leaders will need coordination and support from the federal government. While current state and local efforts are commendable, the opportunities and the challenges are too great for any single state or city to address effectively. ***The next President should recognize the Great Lakes region's national economic importance and adopt policies that speed its economic transition and growth.***

Moreover, the region offers an excellent opportunity to test a new federal-state division of responsibility in the search for national solutions. As the 2008 Presidential election unfolds, a conversation on the federal role in regional economic development should take place. Many national priorities—including development of high-tech manufacturing and innovation industries, expanded access to high-quality health care, education that prepares graduates to compete in the global economy, and workforce development for the knowledge economy—can best be achieved through new strategic federal-state partnerships.

Adopt a Blueprint for Renewing the Great Lakes Region

A national competitiveness strategy, centering on core strengths and unique assets of the Great Lakes region, would include four components: a regional compact on innovation, sustainable development of the nation's "North Coast," economic integration with Canada, and a new federal-state partnership to safeguard social benefits.

Develop a Regional Compact on Innovation

According to the Council on Competitiveness, the chief economic challenges of 21st century America include innovation and the twin forces that power it: cultivation of talent and investment in research and development.

Educate the Talent Needed to Compete

America is losing its dominance in science and engineering—and its potential to drive innovation worldwide—as India, China, and other emerging economic powers begin to produce more scientists and engineers and assume positions of leadership in the knowledge economy. Much of the infrastructure needed to educate more American scientists, teachers, engineers, and mathematicians already exists in the learning institutions of the Great Lakes region.

Colleges and universities in the Great Lakes states annually produce 38 percent of all U.S. bachelor degrees, 36 percent of all science and engineering degrees, and 37 percent of all advanced science and engineering degrees, outstripping all other regions.² Nineteen of the world's 100 top-ranked universities are located there—compared with only 15 in the Northeast/Mid-Atlantic and 13 on the West Coast. These 19 universities contain top-tier business schools and many of the world's leading social science, health sciences, and engineering programs, providing the region with tremendous capacity for knowledge production. Great Lakes land-grant and other public universities are truly global, attracting the best and brightest students from around the world and facilitating the international exchange of people, ideas, and commerce—while firmly anchored in America's heartland.

To build on this infrastructure, the next President should work with state and regional leaders to develop a dynamic and flexible marketplace for enhanced educational opportunity. State leaders, for their part, should capitalize on educational resources by establishing a *Great Lakes Compact on In-State Tuition*, so no college within the region could charge out-of-state tuition to a resident of any Great Lakes state. To accelerate the region's consolidation as a center of high-quality, low-cost education, state leaders also should increase the portability of post-secondary education credits and develop common standards across educational institutions.

² Authors' analysis of the *Science and Engineering Indicators*, National Science Foundation, 2006.

At the federal level, the next President should forge a new, highly visible *Passport to Higher Education* partnership program. Like GI benefits, the passport program would provide a federal match, through Pell grants and other forms of scholarship assistance, for state contributions and co-payments. Aid recipients' co-payment levels would be determined on a sliding scale based on income. For example, the federal government might provide up to \$4,000 per student per year toward tuition and related education expenses, while the state provided \$2,000, and the student or family a \$2,000 co-payment. Besides expanding youth access to higher education, the passport program would help adults achieve new credentials, flexibly upgrade their skills, and thus improve their position in the workforce.

Invest in R&D

Competitiveness proposals recently released by the Bush Administration and the National Academy of Sciences, among others, call for reviving the federal commitment to basic and applied R&D, which, over the past 30 years, has dropped from 2 percent of GDP to less than 0.8 percent. Rather than pick specific industry "winners and losers," this commitment should cover the broad areas of health, energy, basic sciences, and communications technologies, which often have launched new technologies and industries.

The Great Lakes region claims a formidable concentration of R&D resources. Its network of universities is complemented by more than 300 Fortune 1000 firms and their corporate headquarters and R&D centers. Together, these institutions produce 32 percent of the nation's new intellectual property each year. The array includes the corporate R&D divisions of Bell Labs, Battelle, GM, Ford, and Toyota, and the federally funded research laboratories of Argonne, Fermilab, and TACOM. In the Great Lakes manufacturing sector, highly skilled professionals are using transformative new technologies involving robotics, electronics, cutting-edge biomedical devices and techniques (including nanotechnology), energy-producing and -conserving materials and products, new sensing devices, and graphic and computer design. Detroit/Ann

Arbor, Chicago, and St. Louis are among the nation's leading biomedical research centers, and the region is peppered with top hospitals and related research programs.

Not only does the region remain a world leader in advanced manufacturing, but it also is emerging as a leader in "green" technologies. In this sector, regional researchers are engaged in a broad range of promising activities:

- development of cleaner energy production and transportation systems
- a host of agri-science technologies, including genetic engineering, FARMaceuticals (genetically-engineered drugs and antibodies from livestock), biomass, and biofuels
- new industrial processes that create less pollution and waste
- emerging "green chemicals," such as biodegradable plastics

To enhance U.S. competitiveness, the next President should propose a long overdue increase in federal non-defense research funding, through the National Science Foundation, National Institutes of Health, and other entities. And, the Great Lakes region should receive more than a proportionate share of this increase, based on the quality of its research infrastructure and its profound historical contributions to national economic growth. For example, federal investment in new energy technology could exploit the region's strengths in energy research by developing a new Regional Energy Lab as an outgrowth of the Argonne National Laboratory at the University of Chicago.

In order for Great Lakes states to warrant receiving more resources, they should agree to deliver "bang for the buck" by matching federal research dollars, perhaps on a 5:1 federal-state basis. This could be accomplished by tapping bonding authority and pension funds, partnering with university endowments, and (as some already are doing) securitizing tobacco master settlement agreement monies. One advantage of this partnership approach would be to assure that state research dollars go toward high-quality, federally vetted and backed projects, as opposed to appropriations politically steered from state capitals.

Promote Sustainable Development of the North Coast

While other regions face long-term sustainability challenges from lack of water, congestion, costs of infrastructure, sprawl, and risk of natural disaster, the country's "North Coast," with proper policy actions now, offers the prospect of environmentally and financially sustainable commercial and population growth.

To support sustainable development and attract new residents and economic activity to the Great Lakes region, the federal and state governments should capitalize on the area's natural assets. The Great Lakes watershed includes one-fifth of the world's fresh water and almost 11,000 miles of coastline. The region is not threatened by hurricanes or earthquakes, and its many rivers, forests, lakes, resorts, and outdoor recreation areas foster economic activity based on recreation and the environment—such as tourism, boating, fishing, and outdoor sports—as well as opportunities for related commercial and residential development.

The states should do their part by collaborating through existing organizations (including the Great Lakes Governors, Great Lakes Commission, and International Joint Commission) to build out a North Coast strategy that includes:

- cross-state branding of the North Coast to promote the Great Lakes, regional waterways, forests, parks, historical sites, cultural institutions, and natural scenic assets as major attractions
- in-state and cross-state policies to expand public access to the shoreline and to enhance preservation of natural and recreational areas as key components of economic development
- public-private and philanthropic economic development, natural and scenic environmental amenity development, and tourism

On the federal level, the next President should direct the Departments of the Interior and Commerce, among other agencies, to collaborate with the Great Lakes states on North Coast economic development. The President should give priority to the Great Lakes restoration effort, which, under a Bush Administration agreement with the

states, pledges \$13 billion of federal spending and \$7 billion of state spending to rehabilitate and maintain infrastructures, like aging sewer systems, that are integral to clean water in the Great Lakes. Environmental remediation is essential to North Coast economic development.

Encourage Economic Integration with Canada

The most economically successful areas today are city-regions—homes to global firms, universities, and diverse populations that shape the global exchange of ideas, people, cultures, products, and services. These burgeoning areas also are springboards for international economic cooperation. Canadian Senator Jeremiah Grafstein (Liberal-Metro Toronto, Ontario) has noted that cross-border regions represent a new economic unit that can enhance the global competitiveness of international partner nations. Certainly, the European Union demonstrates the mutual economic benefits of knocking down barriers and creating efficient common markets out of national economies.

The combined U.S.-Canadian Great Lakes economy is a huge, mutually reliant, and highly integrated “mega-region” market. With Ontario included, the Great Lakes region has a gross “domestic” product larger than that of the United Kingdom, Germany, or China and behind only those of Japan and the United States as a whole. This bi-national region is especially strong in the manufacture and distribution of autos, plastics, chemicals, and metals. Its metropolitan areas are trading hubs, as about one-third of U.S. global exports and a far higher share of Canadian exports originate by the shores of the Great Lakes. These goods travel by rail, road, water, and polar air routes to destinations as distant and important as China.

Because the U.S. government plays a critical role in the economic integration of the international Great Lakes region, the next President should promote U.S.-Canadian economic dialog and collaboration. The next Administration should explore ways to strengthen bi-national economic development planning and policy development, and it should help create a formal collaboration and coordination mechanism addressing trade and travel. Such a bi-national mechanism could spur development of multi-

modal transportation links, including high-speed rail, among the densely populated metro belts of the region. It also could address issues of infrastructure, water and environmental management, standards in commerce and industry, credentials and standards in professions and academe, tourism, marketing, and border management and logistics.

Build a New Federal-State Partnership on Employee Benefits

The pattern of employer-provided health and income security benefits that most Americans depend on was designed in the Great Lakes region. The wealth generated by its industries allowed the American dream to be codified in a social compact that placed increasingly generous health care, pension, retirement, and unemployment benefits first in negotiated agreements, then in public policy.

The Rising Crisis in Employee Benefits

Today, this system of employer-provided benefits—especially health care and pensions—is an economic yoke tying older employers to outmoded and at-risk jobs, making U.S. manufacturers and other industries noncompetitive on labor costs, and curbing labor flexibility and adaptability in the fast-changing economy. As a result, Ontario now assembles more autos than Michigan (with roughly comparable wages), and Canadian manufacturing employment has remained far more stable than that just across the Detroit and Niagara Rivers.

Employers across the United States are curtailing employee benefits, with only one in five private-sector employees now participating in a defined-benefit pension plan. Existing pensions are under-funded by an estimated \$450 billion, and eight of the top 10 severely under-funded pension funds are held by Great Lakes-based firms. As for employer-based health insurance, the percentage of U.S. workers covered by such plans has dropped from 64 to 59 percent in the past four years—and this decline is even greater in the Great Lakes region. To escape pension and health care obligations, many employers are resorting to strategic bankruptcy, setting in motion large layoffs and a heightened sense of job and benefit insecurity. The benefit crisis

also affects state governments directly. Most Great Lakes states retain the defined-benefit (as opposed to defined-contribution) model for state employee pensions and thus face potential fiscal crises.

The outdated social compact is one of the greatest current challenges to the overall competitive position of the United States. ***Finding creative ways to remake our vital employee-benefit and social security systems in an era of global competition, while maintaining our high quality of life, will be one of the most pressing concerns of the next President.*** A federal-state partnership to transform these pillars of our society can enhance employer competitiveness, as well as worker mobility and adaptability, and state and local governments' fiscal position. The next President will have the opportunity, working in concert with Great Lakes political, labor, and business leaders, to develop a regional strategy to remake the social compact.

Create a Regional Health Care Consortium

The Great Lakes region has a great deal to gain from a successful transition to a health care system that makes firms more competitive and allows workers to move from job to job without having to worry that their health coverage will be reduced or eliminated. The federal government should encourage the region's states to join together to create lower-cost, portable health insurance plans, with contributions from employers and workers, and give them the regulatory flexibility to do so. This includes having broad latitude to use dollars from Medicaid, the State Children's Health Insurance Program, and other federal-state programs to finance these plans.

Create a Portable Defined-Contribution Pension System

Similarly, the next President should work with state governments to promote labor market flexibility through cross-state and nationally portable pension systems. Great Lakes states stand to benefit by together creating portable defined-contribution, 401(k)-style savings plans with diversified investment options for all employers and

employees, similar to those now offered federal employees. The President can help by assuring appropriate, even-handed tax treatment of these retirement plans.

Another way for the next President to help is through proactive engagement in labor negotiations to ensure that workers do not lose their entire pension stake. In return, employees and unions must assist in the transition to defined-contribution plans with much lower employer contributions. Such a transition will save many defined-benefit plans now at risk, while reducing employers' legacy costs and allowing them to compete more effectively.

Concluding Observations

National policies set the stage for robust innovation and productivity. The next President will lead a nation struggling to retain an innovative edge in the global economy—a nation searching for a new competitiveness strategy. A wise approach to new federal investments would recognize that the primary locus of innovative activity is within geographic regions. That is the level where companies, workers, universities, and governments form networks that drive production and the sharing of ideas. Regions serve as “laboratories of democracy,” inventing new models for industry, education, social security and workplace organization.

The Great Lakes region is ideally suited as a test case in creating a federal-state regional partnership. The region is experiencing the pain of economic transition, yet is well-positioned to take advantage of new economic and technological opportunities. The next President should partner with the Great Lakes states on smart policies to fuel growth, so that they can continue to be a significant source of innovation, progress, and prosperity for their region and the nation. This agenda will help the 12 Great Lakes states surmount their common challenges, leverage their common assets, and renew and advance their economic leadership.

About the Authors and the Project

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