The State New Economy Index uses 21 indicators to measure the extent to which state economies are knowledge-based, globalized, entrepreneurial, IT-driven, and innovation-oriented.

The two states that are farthest along the path to the New Economy are Massachusetts and Washington. Also topping the list in 1999, Massachusetts boasts a concentration of software, hardware, and biotech firms supported by world-class universities such as MIT and Harvard in the Route 128 region around Boston. Washington is up from fourth, in part on its strength in software (in no small part due to Microsoft), but also because of the entrepreneurial hotbed of activity that has developed in the Puget Sound region and very strong use of digital technologies by all sectors. California is third, with Silicon Valley remaining the world’s most dominant technology region. Colorado comes in at number four, with the highest score in the composite knowledge jobs indicator, and the third highest in innovation indicators. These and the other top 10 New Economy states (Maryland, New Jersey, Connecticut, Virginia, Delaware, and New York) have more in common than just high-tech firms. They tend to have a high concentration of managers, professionals, and college-educated residents working in “knowledge jobs” (jobs that require at least a two year degree). With one or two exceptions, their manufacturers tend to be more geared toward global markets, both in terms of export orientation and the amount of foreign direct investment.

Most are at the forefront of the IT and Internet revolutions, with a large share of their institutions and residents embracing the digital economy. Most have a solid “innovation infrastructure” that fosters and supports technological innovation. Many have high levels of domestic immigration of highly mobile, highly skilled knowledge workers seeking good employment opportunities coupled with a good quality of life. Moreover, while they tend to be richer states (there is a positive correlation of 0.75 between their rankings and their per capita income), wealth is not a simple proxy for advancement toward the New Economy.

Some states with higher incomes lag behind in their scores (for example, Illinois and Michigan), while other states with lower incomes do relatively well (such as Arizona and Utah). Finally, the top-ranked economies don’t score well simply because they have found ways to get the right mix of companies,
individuals, and institutions. They also score well because they tend to adapt quickly. A high rate of “creative destruction” — the shedding of old practices while embracing the new — is the key to economic transformation in the private, public, and non-profit sectors. In fact, the degree to which businesses close in a state is positively correlated with total New Economy scores and income growth from 1990 to 1999 (0.44 and 0.63, respectively). The two states that remain most firmly rooted in the old economy are West Virginia and Mississippi. Other states with low scores include Arkansas, Alabama, Wyoming, Louisiana, North Dakota, South Dakota, Kentucky, South Carolina, and Wisconsin.

Historically, the economies of many of these and other Southern and Plains states depended on natural resources or on mass production manufacturing, and relied on low costs rather than innovative capacity, to gain advantage. But innovative capacity (derived through universities, R&D investments, scientists and engineers, and entrepreneurial drive) is increasingly what drives competitive success in the New Economy. While lower-ranking states face challenges, they can also take advantage of new opportunities. The IT revolution gives companies and individuals more geographical freedom, making it easier for businesses to relocate, or start up and grow in less densely populated states farther away from existing agglomerations of industry and commerce. But as discussed below, a key policy challenge will be to extend advanced telecommunications infrastructure to these places, particularly for business to access.

Regionally, the New Economy has taken hold most strongly in the Northeast, the mid-Atlantic, the Mountain West, and the Pacific regions; 15 of the top 20 states are in these four regions. (The five exceptions are Florida, Illinois, Minnesota, Texas, and Virginia.) In contrast, 16 of the 20 lowest ranking states are in the Midwest, Great Plains, and the South. Given some states’ reputations as technology-based, New Economy states, their scores seem surprising at first. For example, Georgia and North Carolina rank 22nd and 26th respectively, in spite of the fact that the regions around Research Triangle Park and Atlanta boast top universities, a highly educated workforce, cutting-edge technology companies, and global connections. In both cases, however, many parts of the state outside these metropolitan regions are more rooted in the old economy — with more jobs in traditional manufacturing, agriculture, and lower-skilled services; a less educated workforce; and a less-developed innovation infrastructure.

As these examples reveal, most state economies are in fact a composite of many regional economies that differ in the degree to which they have adapted to the New Economy. 5 How closely do high scores correlate with economic growth? States that score higher appear to create jobs no faster than states that score lower. Between 1990 and 1999, there was in fact a slightly negative correlation (-0.08) between the rate of employment growth and the New Economy score. However, it’s not clear that job growth is the true measure of a state’s economic well being. Rapidly growing states are likely to experience rising home prices, traffic congestion, declining open space, and environmental pollution. As a result, growth in per-capita income is a more accurate measure of the economic well-being of the residents of a state. New Economy scores were in fact positively correlated with absolute growth in state per capita incomes between 1990 and 2000 (0.70). As the New Economy continues to take hold over the next decade, higher scoring states can be expected to experience greater per-capita income growth than lower scoring states.