**What is economic dynamism?**

The term “economic dynamism” refers to the rate and pervasiveness of change across industries, geographies, and the labor market. Economic dynamism is not simply disruption; it equates more closely to a state of productive churn and adaptation that enables the economy and its workers to *respond* to disruption.

Dynamism is an important marker of vitality that lies at the heart of a well-functioning market economy. The U.S. economy has historically been one of the most dynamic in the world, and its dynamism has been tied to high rates of economic growth and unparalleled innovation. A robust ferment of churn and change underneath the surface endows the economy with an inherent flexibility that allows it to adapt, evolve, and grow. Dynamism is safeguarded by multiple forces: the intensity of healthy market competition, demographic vitality, a high-quality human capital base, strong institutions, and even social and cultural factors like the population’s entrepreneurial proclivity.

**Index of State Dynamism components**

The Index of State Dynamism (ISD) combines eight economic indicators into a single measure of a state’s dynamism each year from 1992 to 2020.

Change in Firms

* What it measures: Annual percent change in the total number of employer firms
* Why we use it: Economic dynamism entails “churn,” or a consistent disruption of leading firms and industries by new upstarts, models, and methods. But churn alone does not specify which of the dual forces of creation and destruction comes out on top, so this measure captures the rate of increase (or decrease) in the total number of firms in an economy. Places where new firms outnumber closing ones, meaning that the absolute base of companies is growing, rise to the top on this measure, while places with dwindling numbers of firms fall to the bottom. An economy in which more businesses are opening than closing is an indicator of dynamism and confidence of enduring growth, while places that experience more closures become less competitive internally and provide fewer opportunities for workers. The overall change in firms also represents entrepreneurs’ capacity to start businesses and survive in the market. Economies lacking dynamism will be dominated by incumbents that prevent the entry of new rivals and quickly push smaller competitors out of business.
* Source: U.S. Census Bureau Business Dynamic Statistics

Core Startup Rate

* What it measures: The median startup rate across a range of industry sectors, excluding agriculture, mining, and utilities
* Why we use it: This metric captures the median share of businesses that were formed in the past year across major industry sectors, an important gauge of the entrepreneurial and risk-embracing tendencies of the local population. In contrast to the overall startup rate, which can be dominated by a single industry in smaller economies, the modified startup rate measures the median rate among industries (excluding the utilities sector, which is government-dominated, and the mining and agriculture sectors, which tend to be extremely volatile) to reward broad-based dynamism across sectors rather than booms in one industry, which may reflect temporary conditions or idiosyncratic factors. A healthy level of startup activity leads to greater innovation and productivity growth than in an economy which lacks this disruptive element. The presence of new firms — and the associated economic competition they bring — incentivizes existing firms to make investments and become more productive, while also providing more competition and options for workers who can move among firms seeking out greater compensation and better skills matching.
* Source: U.S. Census Bureau Business Dynamic Statistics

Jobs in Young Companies

* What it measures: Share of total state employment in firms that started within the previous five years
* Why we use it: The share of the workforce employed by relatively young companies, meaning those five years or younger, is a marker of economic dynamism in that young firms tend to be more innovative and faster growing than their older competitors. Economies dominated by longtime incumbent firms are likely to be less innovative, grow slower, and use their market position to entrench themselves, extract special protections or subsidies from the public sector, and lower wages. Younger firms, by contrast, drive productivity growth forward and stoke healthier competition between firms, in both product and labor markets. Dynamic economies not only foster the creation of new firms, but allow them to grow and challenge incumbents for market share. While the startup rate is a key component of economic dynamism, many new firms often fail, so this measure complements it by capturing a place’s ability to encourage and sustain businesses that survive beyond the initial phase of business formation.
* Source: U.S. Census Bureau Business Dynamic Statistics

Worker Reallocation Rate

* What it measures: The magnitude of shifts in labor among employers as firms open, close, expand, and contract, measured annually as the job creation rate plus the job destruction rate minus the absolute value of the net change in jobs
* Why we use it: The churn of workers across firms and jobs is a key ingredient of economic dynamism indicating that the economy is continuously reallocating labor and resources to more productive uses, leading to output- and wage-enhancing benefits from better optimized matches. More efficient allocation of human capital drives firm-level and economy-wide productivity growth higher, making businesses more innovative and efficient. At the same time, reallocation is good for workers, who typically get pay bumps when switching jobs. Barriers to mobility across employers likely both slow down productivity growth and lower workers’ wages. While low turnover may provide stability, it also signals an economy in which the pace of economic change is slow.
* Source: U.S. Census Bureau Business Dynamic Statistics

Labor Force Participation Rate

* What it measures: The share of the civilian noninstitutional population ages 16 and over that is either currently employed or actively seeking work
* Why we use it: This measure is primarily a reflection of a place’s ability to deliver economic opportunity combined with the population’s propensity to seek it. A dynamic, growing economy is one that not only attracts workers but also employs them at a high rate. States that score highly on this component will be those with both low unemployment rates and a younger working-age population. An economy that is either not able to provide jobs for its potential workers or lacks a workforce with the necessary skills to perform the jobs available is a major drag on potential economic dynamism.
* Source: U.S. Bureau of Labor Statistics

Net Migration

* What it measures: Net movement of domestic and international migrants to and from a state as a percentage of the prior year’s population
* Why we use it: Whether a state is a net exporter or importer of people provides a good gauge as to whether the economy is dynamic, growing, and opportunity-rich. Population growth itself fosters dynamism, just as population loss saps it, and a dynamic economy tends to create market signals that attract workers and entrepreneurs seeking out benefits like higher pay and good investment opportunities. In turn, these new residents often contribute valuable new ideas and talent to local firms and may produce spillover effects that increase local economic productivity.
* Source: U.S. Census Bureau

New Housing Construction

* What it measures: New housing permits issued, expressed as the number of permits per 1,000 residents
* Why we use it: New housing construction is a physical and visible manifestation of economic dynamism in that it measures a place’s capacity to successfully and efficiently absorb new people. The metric is a proxy for churn and renewal in the built environment. Dynamic economies are able not only to attract new talent but accommodate it through the construction of new housing — ensuring that economic growth is not hindered by an inability to absorb additional residents. Even in places with stable populations, new housing permits symbolize reinvention and reinvestment, as opposed to stagnation or decay. This issue is particularly influenced by state and local government policies, and over time, local economies’ proclivity to build new housing has diverged dramatically, with nationwide consequences for housing affordability and geographic mobility.
* Source: EIG analysis of

Utility Patents Rate

* What it measures: New utility patents issued, expressed as the number of patents per 1,000 residents
* Why we use it: Patents are arguably the most tangible measure of innovation in an economy, representing new, unique, and valuable ideas — many of which will contribute to the commercialization of new products and new production methods that ultimately make firms more efficient or improve economic output. Utility patents are a specific category covering the vast majority of patents filed in the U.S. and are issued for the invention of a new or improved useful product, process, machine, manufacture, or composition of matter. Dynamic economies are more likely to host firms and innovators conducting research and producing new products and ideas. Even as the growth in patents issued over the last 20 years partly reflects the increased issuance of low-quality patents that don’t stand up to litigation, the measure still offers a good — if imperfect — proxy for innovation occurring within a state.
* Source: EIG analysis of

**How components are calculated and combined**

For each index component, we find the maximum and minimum value in the 1992-2020 period. Then, for each state-year in the dataset, we calculate the index component:

*Index component = (Value - Minimum)/(Maximum - Minimum)\*100*

Each of the eight component indices is then averaged together to get the overall Index of State Dynamism.