Business Climate Rankings and the California Economy

Jed Kolko

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The California Puzzle

- Ranks poorly on many business climate indexes
- Economic growth at or above national average
Outline

- The California economy
- The business climate rankings
- Better rankings = faster growth?
- Resolving the California puzzle
California Moves with the National Economy

Annual employment change

-6% -5% -4% -3% -2% -1% 0% 1% 2% 3% 4%


California
US
California Ties or Surpasses the U.S. on Many Measures

**Annualized changes**

  - US: 0.9%
  - California: 0.8%

  - US: 1.2%
  - California: 1.4%

  - US: 5.1%
  - California: 5.1%

  - US: 5.1%
  - California: 5.6%
California’s Economic Heyday Ended Long Ago

Annualized employment change

1950–1980
- US: 2.2%
- California: 3.6%

1980–2010
- US: 1.2%
- California: 1.1%
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Business Climate Rankings Are Broad and Varied

- Published by many organizations, including
  - Tax Foundation
  - Corporation for Enterprise Development
- Figure prominently—but selectively—in public debate
- Tend to emphasize either
  - Productivity factors
  - Taxes and other costs of doing business
- Often include narrower sub-indexes
Indexes Cover Diverse Policies

- Productivity indexes include
  - Quality of life
  - Human capital
  - Infrastructure

- Taxes and costs indexes include
  - Tax rates and tax burden
  - Size of government
  - Regulation and litigation
## California’s Rank Ranges from Top to Bottom

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Few States Rank High or Low on All Indexes
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- The California economy
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- **Better rankings = faster growth?**
- Resolving the California puzzle
Assessing the Relationship Between Rankings and Growth

- Examined growth measures and business climate index scores
  - Employment, aggregate wages, and GSP
- Used growth measures in years after rankings published
- Controlled for other factors
  - Population density
  - Industry mix
  - Climate
  - Proximity to coasts and waterways
Only Taxes and Costs Indexes Associated with Growth

- Productivity indexes: no relationship with any growth measure
- Some taxes-and-costs indexes: a significant, positive relationship with growth
  - Stronger for employment and wages than output
  - Stronger for manufacturing growth
  - Strength of relationship varies across indexes
Industry Mix and Mild Weather Contribute More to Growth

Contribution of each factor to employment growth

- Business climate index
- Industry composition effect
- Population density
- Mildness

Growth rate (%)
Sub-Indexes Offer Tighter Policy Focus

- Sub-indexes reflect narrow sets of policies
  - Tax rates and structure
  - Size of state and local government
  - Human capital
  - Infrastructure
  - Regulation and litigation

- Help explain index performance
Two Sub-Indexes Link Rankings and Growth

- Most are unrelated to growth
- Two show clear association with growth
  - Welfare and transfer payments
    - NOT overall size of government or tax burden
    - Similar results across multiple indexes
  - Corporate tax structure
    - NOT the corporate tax rate
    - No association between economic growth and other taxes
Some Caveats to Our Results

- Studied relatively short time period
- Cannot isolate effect of changes in rankings or policies
- Growth rates may affect rankings and policies
- Some policies omitted from or crudely measured in indexes
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California: Poor on Sub-Indexes, Good on Most Non-Policy Factors

- Poor rankings on key sub-indexes
  - Welfare and transfer payments
    - #42 on EFINA, #43 on EFI
  - Corporate tax
    - #43 on SBTC

- Key non-policy factors
  - Very favorable climate
  - Favorable industry mix
  - Unfavorable population density
California’s Advantages Offset Unfavorable Rankings

Economic growth

Annual economic growth (%)

Contribution to economic growth:

- Natural advantages
- Tax and cost policies

Economic growth indicators:

- Employment (NETS)
- Employment (QCEW)
- Wages
- GSP
Conclusions

- Business climate rankings differ and sometimes contradict
- Only two sub-indexes associated with faster growth
- Factors beyond policy matter more for growth
- California’s advantages preserve average growth
  - But a better business climate would promote faster growth
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Notes on the use of these slides

These slides were created to accompany a presentation. They do not include full documentation of sources, data samples, methods, and interpretations. To avoid misinterpretations, please contact:

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Thank you for your interest in this work.