

Business Climate Rankings and the California Economy

Jed Kolko

Supported with funding from the David A. Coulter Family
Foundation and the Donald Bren Foundation



The California Puzzle

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



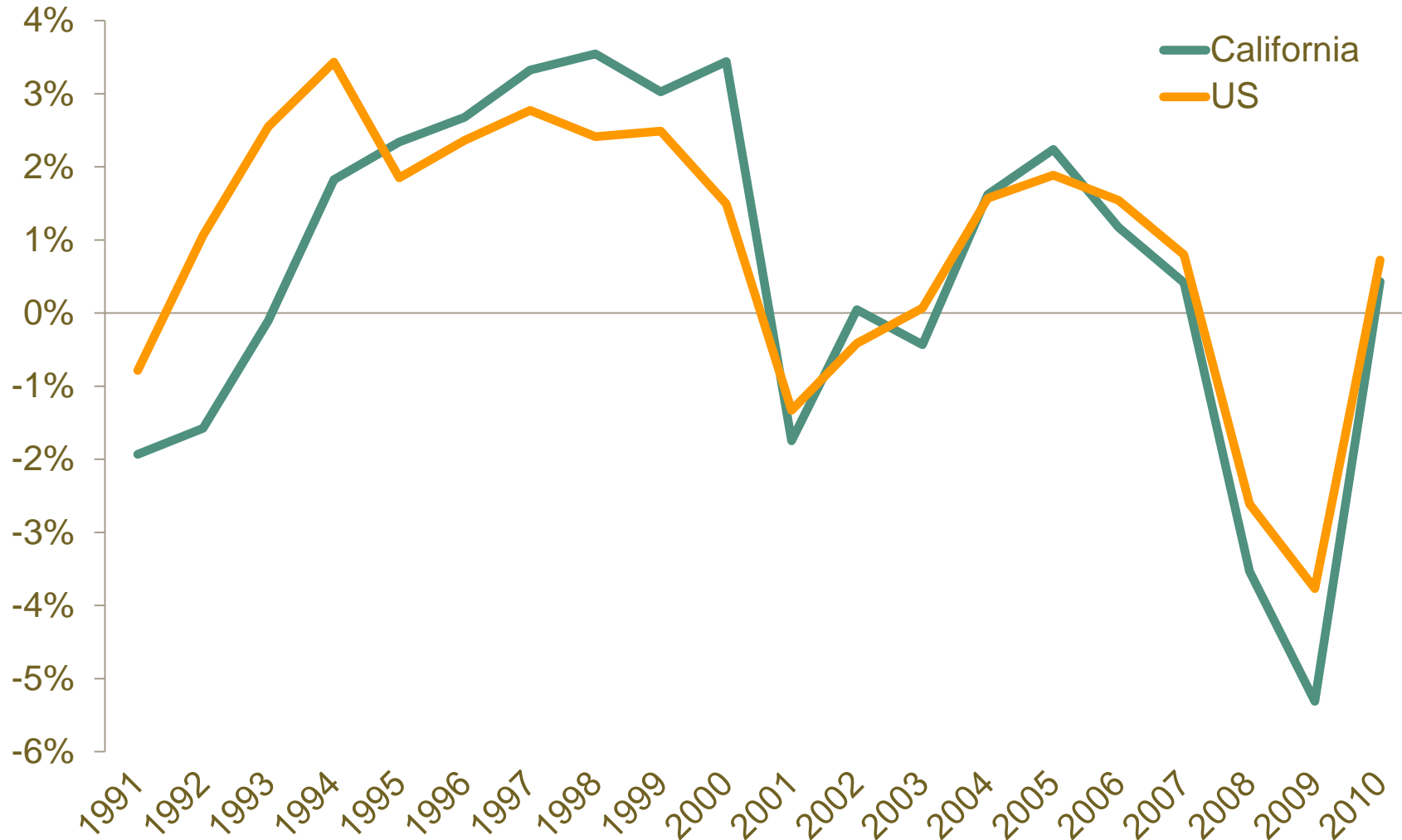
Outline

- **The California economy**
- The business climate rankings
- Better rankings = faster growth?
- Resolving the California puzzle



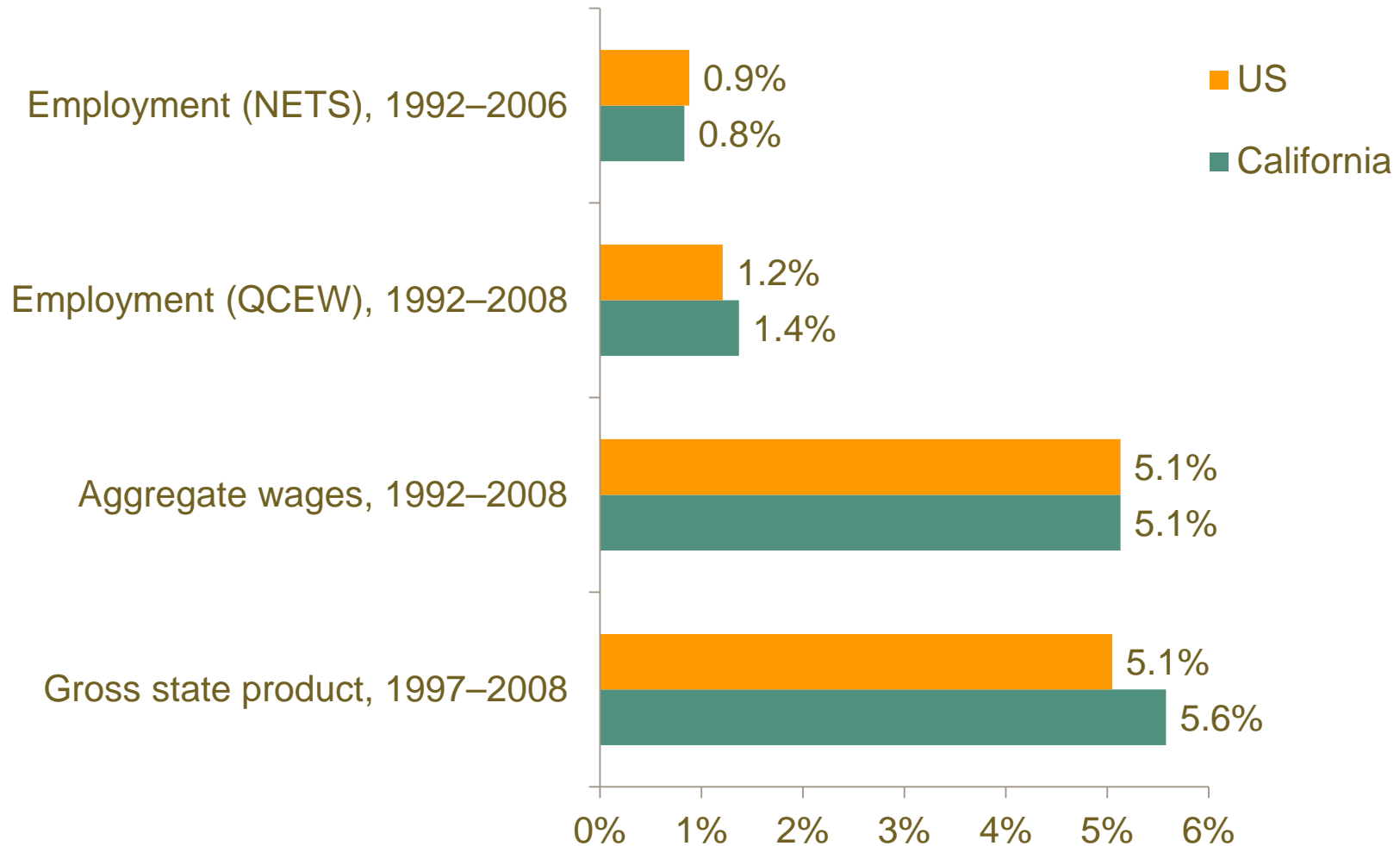
California Moves with the National Economy

Annual employment change



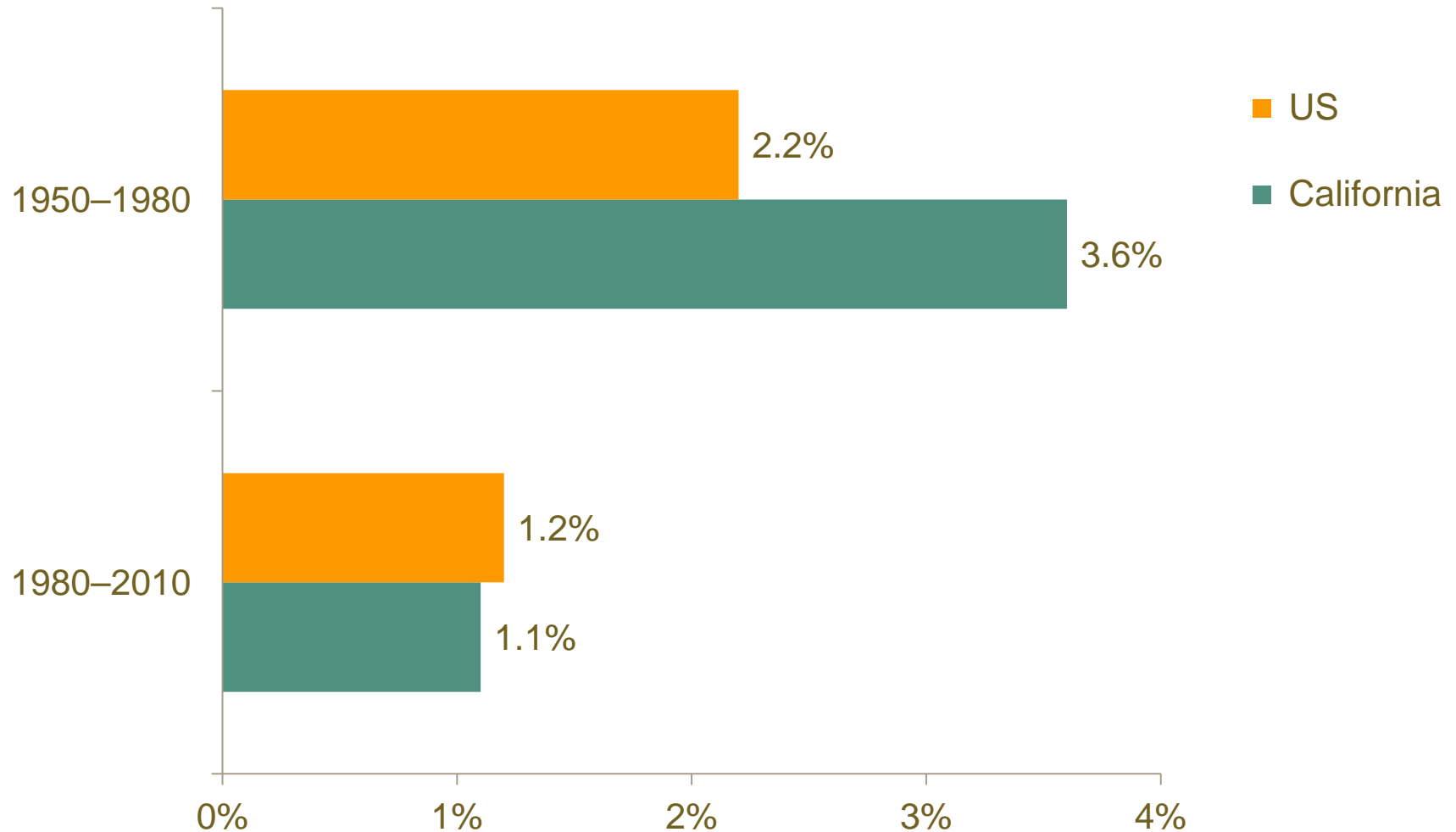
California Ties or Surpasses the U.S. on Many Measures

Annualized changes



California's Economic Heyday Ended Long Ago

Annualized employment change



Outline

- The California economy
- **The business climate rankings**
- Better rankings = faster growth?
- Resolving the California puzzle



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

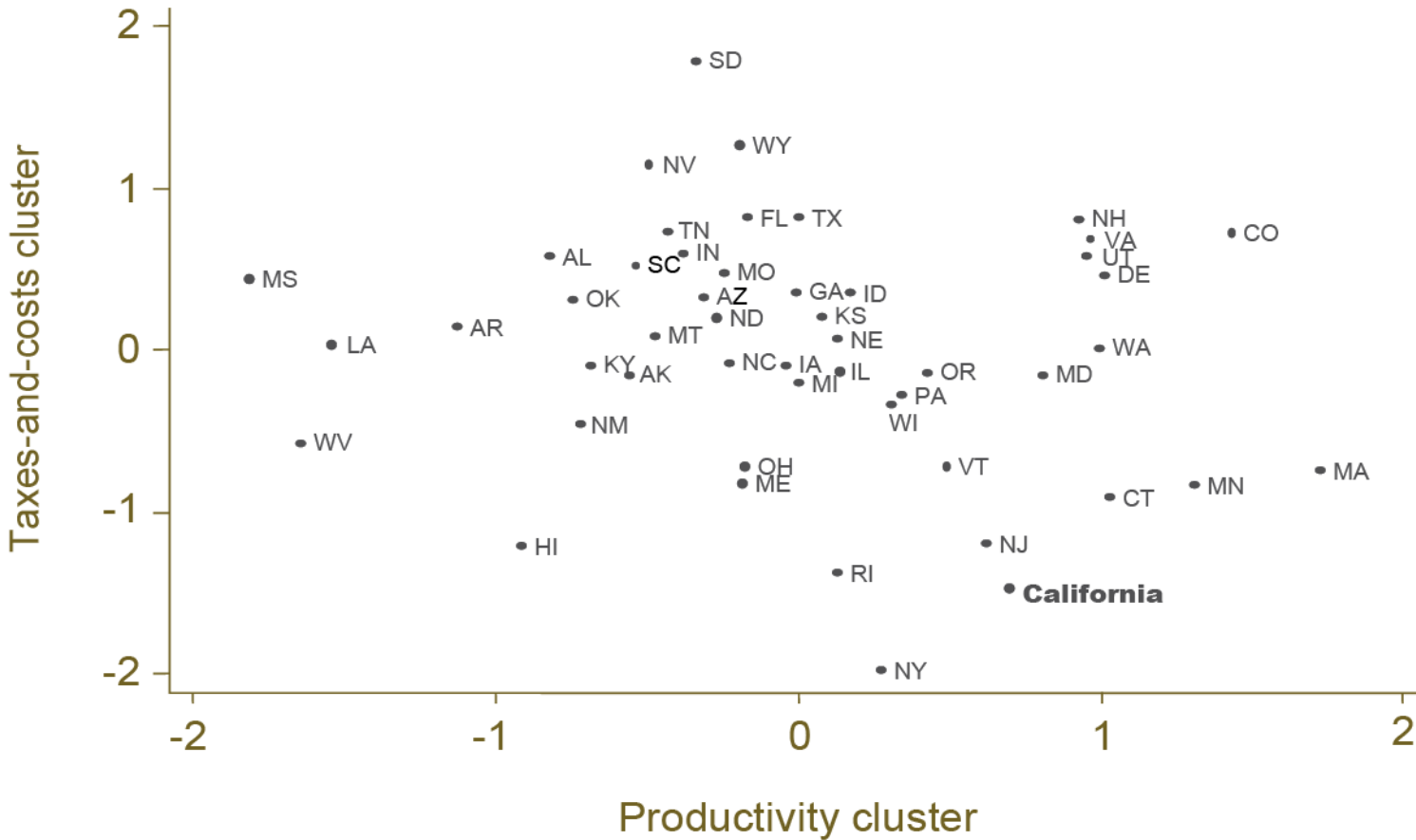


California's Rank Ranges from Top to Bottom

Index	California's rank (1=best)
Productivity Indexes	
State New Economy Index	4
Development Report Card of the States – Business Vitality	4
Development Report Card of the States – Development Capacity	17
State Competitiveness Index	20
Development Report Card of the States – Performance	31
Taxes and Costs Indexes	
Economic Freedom Index of North America	43
State Business Tax Climate Index	45
Small Business Survival Index	46
Cost of Doing Business Index	47
Economic Freedom Index	47



Few States Rank High or Low on All Indexes



Outline

- The California economy
- The business climate rankings
- **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



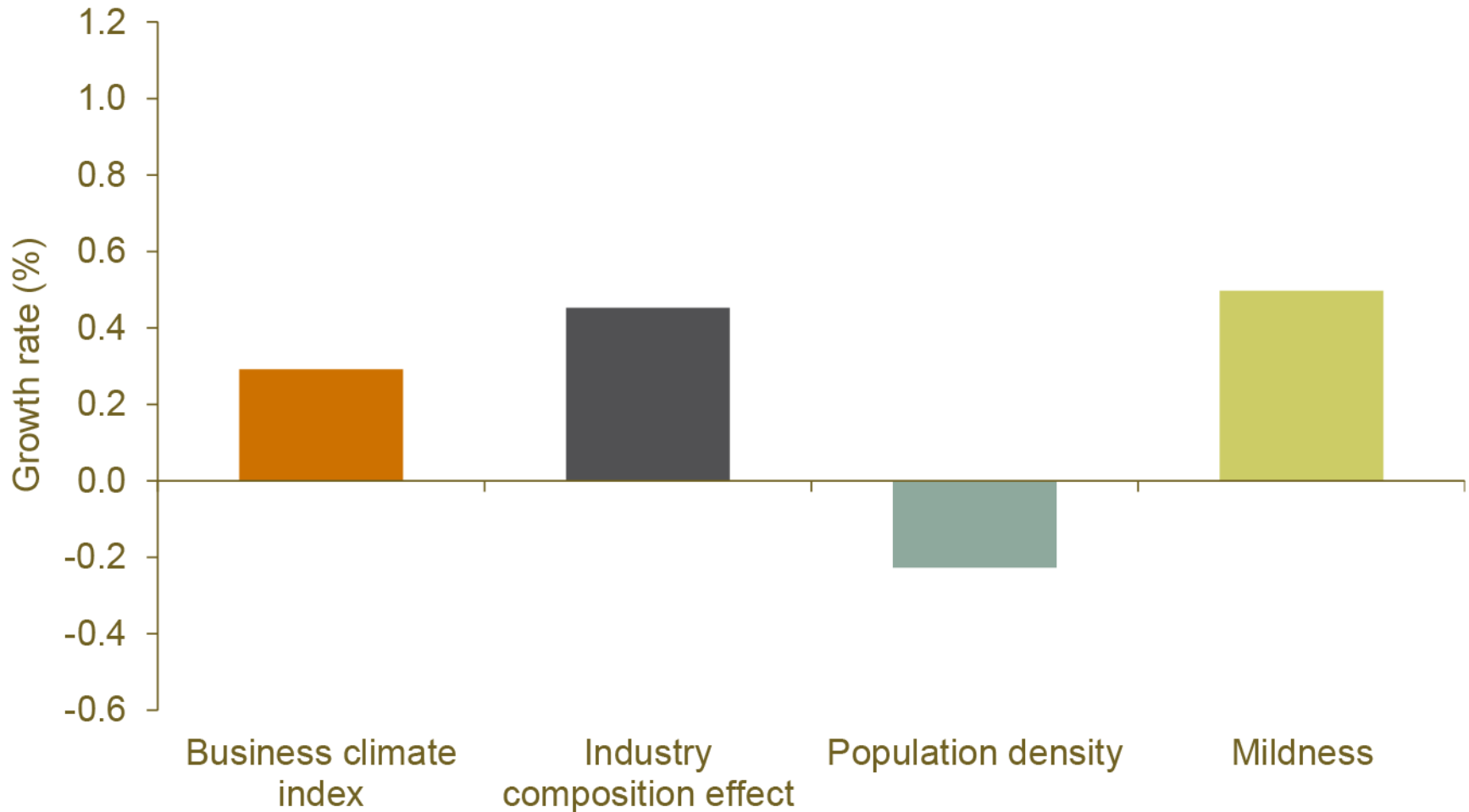
Only Taxes and Costs Indexes Associated with Growth

- 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



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



Outline

- The California economy
- The business climate rankings
- Better rankings = faster growth?
- **Resolving the California puzzle**

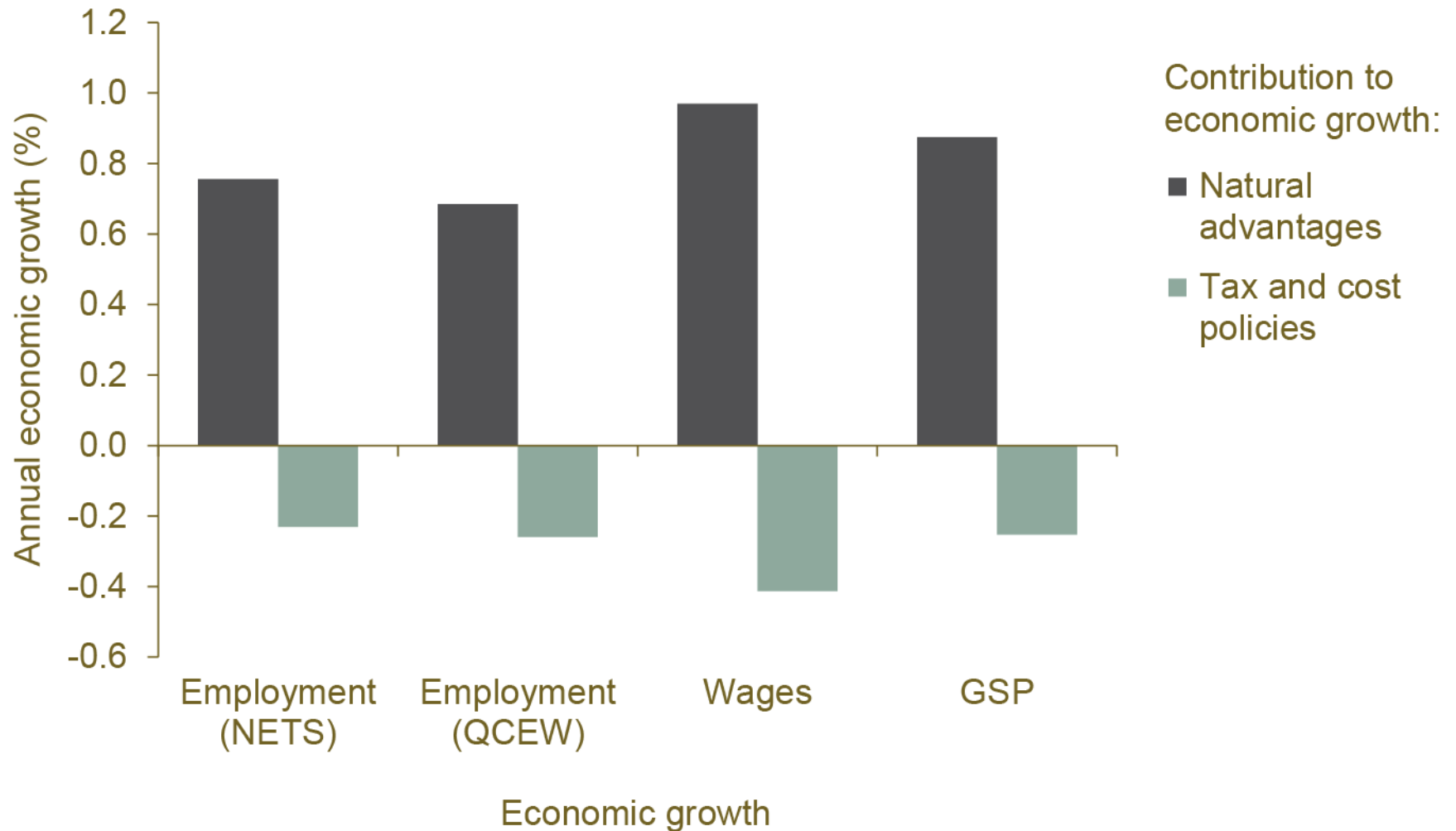


California: Poor on Sub-Indexes, Good on Most Non-Policy Factors

- 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



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



Business Climate Rankings and the California Economy

Jed Kolko



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:

Jed Kolko: 415-291-4483, kolko@ppic.org

David Neumark: 949-824-8496, 415-291-4476,
dneumark@uci.edu

Thank you for your interest in this work.

