

California Business Climate

Are California's tax rates too high? Is California a poor place to start and grow a business? Let's look at the facts.

This paper presents a number of surveys and indexes that evaluate California's business climate. While outcomes are swayed based on the different weighting of each component of the different models, overall, it is clear California businesses experience higher costs than in many other areas of the nation.

It is also clear that even with those costs, certain regions of the state remain highly competitive within the national and global marketplace. However, the surveys and indexes below demonstrate areas of weakness that threaten California's long-term economic strength. In particular, the state needs to improve its government fiscal policies so that we can make long-term investments in infrastructure, K-12 education, and workforce development. If the state does not regain competitiveness in these areas, California's advantages in entrepreneurship, finance, and technology will erode.

Businesses' Outlook

A recent survey of California small business owners found that 66% of respondents believe the business climate in California is poor or very poor. The top issues for these small businesses are:

1. The Rising Cost of Health Care (86%)
2. Quality of Education (75%)
3. Infrastructure (71%)
4. Regulations (63%)
5. Energy (62%)
6. Taxes (57%)
7. Procurement (54%)
8. Immigration (53%)
9. Workers Compensation (52%)
10. Access to Capital (50%).ⁱ

Relatively High Cost of Doing Business

Below is a survey of a number of indexes which score various costs for doing business in California. In general, California is a high-cost state under all indexes. However, these indexes measure cost inputs and not production and service outcomes. These measurements are found in the following section.

- **State Competitiveness**: California ranks 22nd among 50 states relative to a 2004 index that scores 8 specific areas of competitiveness. The following are the areas and California's rank within the individual category: Business Incubation (6th), Environmental Policy (22th), Government and Fiscal Policy (48th), Human Resources (33rd), Infrastructure (47th), Openness (3rd), Security (24th), and Technology (7th).ⁱⁱ

- **Overall Cost of Doing Business**: California ranks 6th highest among 50 states relative to the cost of doing business, i.e. 45th in the nation. This 2007 index measures wage costs, taxes, electricity costs, and real estate costs. States with overall higher costs include Hawaii, New York, Alaska, Massachusetts, and Connecticut.ⁱⁱⁱ
- **Total Tax Climate**: California ranks 13th among 50 states for total state and local tax burden. In 2005, California state and local governments collected \$4,055 per capita in taxes, compared to \$3,698 in the nation as a whole. Comparable rates from other states were \$5,752 in New York, \$3,849 in Illinois, \$3,369 in Florida, and \$3,015 in Texas. Adding in fees, charges, special assessments, and other miscellaneous sources, California's combined "tax" burden is \$5,961 per capita, compared to \$5,338 nationwide. Based on total "tax" burden, California ranks 9th in the nation.^{iv}
- **Business Tax Climate**: California ranks 4th highest among 50 states as having the worst business tax climate, i.e. 47th in the nation. The 2008 State Business Tax Climate Index, prepared by the Tax Foundation, is based on a composite score of the state taxes related to income, sales, unemployment, and property. California ranked worst in the nation for its individual income tax system and 9th worst in its sales tax system.^v
- **Wage Costs**: California ranks 4th highest among 50 states relative to wage costs, i.e. 47th in the nation. This 2007 wage index measures the average annual wage per employee in all industries. States with higher wage costs include Connecticut, New York, and New Jersey.^{vi}
- **Tax Burden**: California ranks 10th highest among 50 states relative to state and local taxes, i.e. 41st in the nation. This 2007 index measures annual state revenues as a share of personal income. States with higher tax burdens include Vermont, Hawaii, Wyoming, Alaska, West Virginia, New Mexico, Arkansas, Minnesota, and Delaware.^{vii}
- **Electricity Costs**: California ranks 9th highest among 50 states relative to electricity rates, i.e. 42nd in the nation. This 2007 index measures commercial and industrial electricity cost in cents per kilowatt-hour. States with higher electricity costs include Hawaii, Massachusetts, New Hampshire, Rhode Island, Connecticut, Alaska, Maine, and New York.^{viii}
- **Industrial Rent Costs**: California ranks 5th highest among 50 states relative to the cost of industrial rents, i.e. 46th in the nation. This 2007 index measures the cost of renting industrial space on a per square foot basis. States with higher industrial rents include Hawaii, Alaska, New Jersey, and New York.^{ix}
- **Office Rent Costs**: California ranks 3rd highest among 50 states relative to the cost of office rents, i.e. 48th in the nation. This 2007 index measures the cost of renting office space on a per square foot basis. States with higher office rents include New York and Massachusetts.^x
- **Highway Construction**: California ranks 48th in investment in highways and 40th in overall infrastructure investment based on personal income. Despite a 50% increase in population, California has increased the lane capacity of highways by only 7% in the past 20 years.^{xi}

California Productivity

Below is a survey of indexes that measure California's productivity and overall economic environment. Following this survey are separate sections detailing how California competes relative to access to venture capital, knowledge-based economy, and its relative domination in a range of industry sectors.

- **Best Places to Work**: California metro areas hold 8 of the top 15 slots for areas to do business and advance a career. California also holds 10 of the top 25 spots. Top California locations include San Diego (1st), Santa Rosa (2nd), Ventura (4th), San Louis Obispo (7th), Oakland (8th), Orange County (10th), Riverside-San Bernardino (11th), and Vallejo (15th). This 2002 index evaluates wages and salary growth, jobs growth, high-tech GDP, and job momentum.^{xii}
- **Best Performing Cities**: California metro areas hold 4 of the top 25 slots for areas that are best to create and sustain jobs. Top California locations include Riverside-San Bernardino (3rd), Bakersfield (17th), Vallejo-Fairfield (22nd), and Sacramento–Arden-Arcade–Roseville (25th). This 2007 index evaluates job and wage growth as well as several technology indicators.^{xiii}
- **Growth in Gross State Product (GSP)**: California's percentage increase in Gross State Product exceeds that of the U.S. in 8 of the last 15 years for which data is available.^{xiv}
- **Exports**: Exports from California accounted for 12% of total U.S. exports in 2006.^{xv} California's export shipments of merchandise in 2006 totaled \$128 billion, ranking California 2nd only to Texas (\$151 billion) among the states in terms of total exports. California leads the nation in export-supported jobs – 1 in 7 jobs is related to trade.^{xvi}
- **Manufacturing Strengthening**: California has 4 of the top 5 strongest manufacturing regions in the West, which is comprised of Alaska, California, Hawaii, Oregon, Nevada, and Washington. California's top regions include: Yuba City-Maryville, San Diego-Carlsbad-San Marcos, Fresno-Madera, and Stockton.^{xvii}

Access to Venture Capital

Below is a summary of indexes on businesses' access to venture capital. California has consistently been a leader in attracting venture capital; although other states are beginning to close the gap.

- **Impact of Venture Capital**: California is the leader in revenues tied to venture-backed companies with \$507 billion, followed by Texas (\$274 billion), Washington (\$127 billion), Pennsylvania (\$113 billion), and Massachusetts (\$112 billion). Venture-backed companies contributed to 10 million jobs and \$2.1 trillion in revenues nationally in 2005.

The 5 states with the highest employment attributable to venture-backed companies were California (2.2 million jobs), Texas (1.1 million jobs), Pennsylvania (697,000 jobs), Massachusetts (640,000 jobs), and Georgia (604,000 jobs).^{xviii}

- **Growth Rate of Venture-Backed Companies**: California had the 2nd highest growth in revenues attributed to venture-backed companies among 50 states during 2003-2005, growing 12.9%. Other states with high growth rates for revenues include Connecticut (14.5%), Washington (12.6%), Illinois (12.3%), Texas (11.7%), Georgia (11.6%), and Minnesota (11.2%).^{xix}
- **Highest Venture Capital Investments by Region**: California had 4 of the top 18 regions in the nation for venture capital investments, including Silicon Valley (34.22%), San Diego (6.04%), Los Angeles/Orange County (3.62%), and Sacramento (0.7%). Other top performing regions include New England (12.28%) and the Southeast (6.84%).^{xx}
- **Fastest Growing Venture Capital Investments by Region**: Los Angeles ranks 4th among the top 5 fastest growing regions for venture capital investments, representing a 155% increase in investments and a 72% increase in the number of companies over the past 10 years. Other top performing regions include New Mexico with a 375% increase in investments and a 650% increase in the number of companies, Pittsburgh/Tristate with a 513% growth in investments and a 267% increase in the number of companies, Seattle with a 211% growth in investments and a 103% increase in the number of companies, and the Washington DC Metroplex with a 130% growth rate in investments and a 71% increase in the number of companies.^{xxi}

Knowledge-Based Economy

Below is a summary of indexes on the components of a high technology economy. While California scores well in most categories, these indexes also provide evidence that other states are becoming increasingly competitive in knowledge-based industries.

- **Knowledge-Based Economy**: California ranks 2nd among 50 states related to 12 key criteria Milken Institute has selected as being critical to future high tech growth. Other top performing states in the index include Massachusetts (1st), Colorado (3rd), Connecticut (4th), and Maryland (5th). This 2001 index ranks states based on research and development dollars, number of patents issued, venture capital investment, business starts, and IPO proceeds.^{xxii}
- **Biotechnology Transfer to Commercialization**: The University of California ranks 2nd with Caltech 3rd and Stanford 4th among all universities for biotechnology transfer. MIT scores 1st and University of Florida ranks 5th.^{xxiii}
- **Educational Attainment**: California ranks 8th among 50 states relative to people over 25 years of age with a bachelor's degree or greater. Other top performing states in the index include Massachusetts (1st), Connecticut (2nd), Maryland (3rd), Colorado, (4th), New Jersey (5th), Vermont (6th), and New Hampshire (7th). California ranks 10th among states relative to the percentage of persons over 25 years who have advanced degrees and 14th for the percentage of persons over 25 who are doctoral scientists.^{xxiv}
- **Federal R&D**: California ranks 8th among 50 states relative to the percentage of federal R&D dollars per capita. Other top performing states in the index include Maryland (1st), New Mexico (2nd), Vermont (3rd), Maryland (4th), Georgia (5th), Alabama (6th), and Rhode Island

(7th). California ranks 7th among states for industry dollars expended and 15th for academic dollars expended per capita for R&D.^{xxv}

- **Patents Issued:** California ranks 1st among 50 states for patents issued in 2006 when 25,043 total patents were granted. Other top performing states include Texas (6,717 patents), New York (6,407 patents), Massachusetts (4,369 patents), and Michigan (4,179 patents).^{xxvi}

Depth of the California Economy by Industry Indexes

California's \$1.7 billion economy ranks 8th in the world. The state has the largest population, comprised of over 11% of the total United States population. Below is a selection of industry sectors and where the state ranks nationally relative to business start-up and expansions.

- **Aerospace:** California ranks 1st in start-ups and 1st in new branches in aerospace. Other top ranking states include Florida, Texas, Washington, and New York for start-ups and Florida, Texas, Washington, and Virginia in new branches.^{xxvii}
- **Agribusiness/Food Processing:** California ranks 2nd in start-ups and 1st in new branches in agribusiness and food processing. Other top ranking states include Florida, Texas, Michigan, and New York for start-ups and Texas, Florida, Illinois, and Georgia in new branches.^{xxviii}
- **Automotive Original Equipment Manufactures (OEMs):** California ranks 1st in start-ups and 5th in new branches in automotive OEMs. Other top ranking states include Texas, Florida, Michigan, and Indiana for start-ups and Michigan, Texas, Ohio, and Indiana in new branches.^{xxix}
- **Auto Suppliers:** California ranks 2nd in start-ups and 3rd in new branches in auto supplies. Other top ranking states include Michigan, Texas, Indiana, and Ohio for start-ups and Michigan, Texas, Ohio, and Kentucky in new branches.^{xxx}
- **Bioscience:** California ranks 1st in start-ups and 1st in new branches in bioscience. Other top ranking states include Florida, Texas, Massachusetts, and New York for start-ups and Texas, Florida, Pennsylvania, and New York in new branches.^{xxxi}
- **Health Services:** California ranks 1st in start-ups and 1st in new branches in health sciences. Other top ranking states include Florida, Texas, New York, and Michigan for start-ups and Texas, Florida, Pennsylvania, and New York in new branches.^{xxxii}
- **Manufacturing:** California ranks 1st in start-ups and 1st in new branches in manufacturing. Other top ranking states include Texas, Florida, New York, and Michigan for start-ups and Texas, Illinois, Florida, and Michigan in new branches.^{xxxiii}
- **High-Tech Manufacturing:** California ranks 1st in start-ups and 1st in new branches in high-tech manufacturing. Other top ranking states include Texas, Florida, New York, and Michigan for start-ups and Texas, Florida, Missouri, and New York in new branches.^{xxxiv}

- **Medical Device Manufacturing:** California ranks 1st in start-ups and 1st in new branches in medical device manufacturing. Other top ranking states include Texas, Florida, New York, and Ohio for start-ups and Texas, Florida, Ohio, and Massachusetts in new branches.^{xxxv}
- **Pharmaceuticals:** California ranks 1st in start-ups and 5th in new branches in pharmaceuticals. Other top ranking states include New Jersey, Florida, Texas, and New York for start-ups and New Jersey, New York, Pennsylvania, and Illinois in new branches.^{xxxvi}
- **Telecom:** California ranks 1st in start-ups and 1st in new branches in telecom. Other top ranking states include Texas, Florida, New York, and Michigan for start-ups and Texas, Missouri, Florida, and Georgia in new branches.^{xxxvii}
- **Transportation:** California ranks 1st in start-ups and 2nd in new branches in transportation. Other top ranking states include Florida, Texas, Michigan, and New York for start-ups and Texas, Illinois, Florida, and New York in new branches.^{xxxviii}

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ⁱ Small Business California, Survey of Businesses, 629 responses from every county in the state, 2008.

ⁱⁱ Metro Area and State Competitiveness Report 2004; Beacon Hill Institute;

<http://www.beaconhill.org/Compete04/Compete2004WebONLY.pdf>

ⁱⁱⁱ Milken Institute, Ranking in Cost of Doing Business Index, 2007;

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^{iv} California's Tax Burden, Just the Facts, Public Policy Institute, based on 2005 numbers, paper issued February 2008; www.ppic.org

^v 2008 State Business Tax Climate Index, The Tax Foundation; www.kiplinger.com/printstory.php?pid=12794

^{vi} Milken Institute, Ranking in Cost of Doing Business Index, 2007;

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^{vii} Milken Institute, Ranking Cost of Doing Business Index, 2007;

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^{viii} Milken Institute, Ranking in Cost of Doing Business Index, 2007;

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^{ix} Milken Institute, Ranking in Cost of Doing Business Index, 2007;

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^x Milken Institute, Ranking in Cost of Doing Business Index, 2007;

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^{xi} California Business Roundtable, Infrastructure; viewed 3/11/08; www.cbtr.org/infrastructure.html

^{xii} Forbes/Milken Institute Best Places Ranking, 2002;

<http://www.milkeninstitute.org/research/research.taf?cat=indexes&function=detail&ID=16&type=FMI>

^{xiii} Milken/Greenstreet Partners, Best Performing Cities 2007;

<http://www.milkeninstitute.org/research/research.taf?cat=indexes&function=detail&ID=30&type=BPC>

^{xiv} California Budget Project, The California Business Roundtable "Competitive Project": Myth and Fact, 2004

^{xv}

<http://www.calchamber.com/CC/BusinessResources/InternationalResources/AllAboutInternationalTrade/TradeStatistics.htm>; accessed 2/25/08

^{xvi}

<http://www.calchamber.com/CC/BusinessResources/InternationalResources/AllAboutInternationalTrade/TradeStatistics.htm>; accessed 2/25/07

^{xvii} 2006 Business Facilities Rankings Report, Manufacturing by Region;

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- ^{xxi} Fastest Growing Regions for Venture, National Venture Capital Association; March 11, 2008;
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