

## CHARACTERISTICS OF A HEALTHY BUSINESS CLIMATE

### BRIEFLY

There is no “best business climate,” but common features in nine recent business climate rankings could help guide policymakers in the coming legislative session.

Lawmakers can act to assure that Washington offers entrepreneurs a secure and supportive business climate.

The great recession began in December, 2007, according to the National Bureau of Economic Research (NBER). Nearly five years on—and three years after NBER says the recession ended—unemployment remains high, consumer and investor confidence remains shaken, and the national economy remains roiled by global and domestic uncertainty. In our state, the May unemployment rate reached 8.3 percent. Nearly 300,000 people are out of work and seeking jobs.

Washington state policymakers cannot stabilize the Eurozone, increase demand from China, or quicken the pace of pro-growth legislation and regulatory reform in the other Washington. But lawmakers here can act to assure that, within a maddeningly difficult global environment, Washington offers entrepreneurs a secure and supportive business climate.

Various national reports attempt to identify the factors that characterize positive business climates. Typically, they produce state rankings, with varying degrees of transparency. Popular business magazines like *Forbes* and *Chief Executive* produce such rankings. So, too, do site selection periodicals like, well, *Site Selection*. Policy research groups like the Tax Foundation and business advocates like the U.S. Chamber of Commerce also assess and report on business climate issues in the states.

In this brief, we examine nine recent business climate rankings and identify common features to guide policymakers in the coming legislative session.

Although 20 states appear at least once on the “top 5” lists in the nine reports, Texas dominates, showing up among the five best in seven reports and claiming first place in three of them. North Carolina follows, with five appearances among the top five. Virginia and Utah get four mentions, with North Dakota, South Carolina and Colorado each

appearing among the top five in three reports.

Washington, while not among the five best places in any of the reports, comes in No. 6 on one list and No. 7 on another.

### The Business View

In *Enterprising States 2011*, the U.S. Chamber of Commerce and National Chamber Foundation examined economic performance and public policy conducive to growth and development among the states (Chamber 2011). The report, written by the Praxis Group and Joel Kotkin, an internationally recognized expert on economic and political policy, avoids a definitive ranking of “best states,” choosing instead to evaluate the states on key metrics and issue areas.

Our state gets high marks for economic performance and several key policy markers. In addition, Washington is cited as one of the states positioned for growth.

Washington ranks No. 8 in overall economic performance, a combination of factors measuring “growth, productivity and livability.” The report, citing this state’s software industry, says Washington is “one of the few states with a growing information sector.” As well, “led by aircraft and other transportation equipment building” our manufacturing sector “significantly outperformed the national manufacturing industry since 2001.”

The five policy areas selected for additional evaluation are exports and international trade, entrepreneurship and innovation, taxes and regulation, talent pipeline and infrastructure. The areas were chosen because they represent “policy domains wherein states can proactively and meaningfully impact and stimulate” economic opportunity and job creation. While Washington did not rank among the top ten in any of the five areas, the state scored well on key measures within the policy areas, including: science, technology, engineering and math (STEM) job con-

Table 1: Next Boom States  
(U.S. Chamber of  
Commerce)

- 1 North Dakota
- 2 Utah
- 3 Texas
- 4 Virginia
- 5 Wyoming
- 6 Washington

 Table 2: Small Business  
Survival Index (SBEC)

- 1 South Dakota
- 2 Nevada
- 3 Texas
- 4 Wyoming
- 5 South Carolina
- 11 Washington

 Table 3: Beacon Hill Institute's  
Most Competitive

- 1 Massachusetts
- 2 North Dakota
- 3 Colorado
- 4 Minnesota
- 5 Utah
- 9 Washington

centration, STEM job growth, broadband provider availability, business birth rate, high school advanced placement intensity and college affordability.

*Enterprising States* assesses the state's growth prospects positively. The researchers rank Washington No. 6 in their evaluation of the "next boom states" (table 1). Critical factors in their assessment: employment growth over the last decade, projected job growth, education, median income, cost of living, personal income growth and export density. Washington's ranking is based on "solid all-around performance." Aerospace and software sectors are credited with giving the state a particularly high ranking in export intensity.

*Small Business Survival*. Although it uses a much different ranking system, the Small Business and Entrepreneurship Council (SBEC) also gives Washington high marks (Keating 2011). The 16<sup>th</sup> annual edition of the Small Business Survival Index ranks Washington as having the 11<sup>th</sup> friendliest policy environment for entrepreneurship among the 50 states and District of Columbia. South Dakota ranks No. 1, followed by Nevada, Texas, Wyoming, and South Carolina (table 2).

SBEC focuses on taxes and business costs. "Substantive, permanent tax relief, deregulation, and limiting the growth of government spending are critical policy steps" writes SBEC chief economist Ray Keating. The index is constructed by summing the scores on "44 major government-imposed or government-related costs impacting small businesses and entrepreneurs."

Of the 44 metrics, 19 concern taxes, including one on tax limitation. Because Washington does not have personal income or corporate income taxes, the state ties for top rankings on 11 of the 19 tax measures. Not having an income tax gives a state a substantial advantage in the SBEC rankings.

Other factors, reflecting SBEC's small government and free market approach, include the number of health care mandates, right to work laws, state minimum wage laws, regulatory flexibility, trends in government spending and share of state and local government revenues coming from the federal government (a higher share counts against a state because SBEC believes federal revenues contribute to waste and, when reduced, can increase pressure for tax hikes). Only one of the 44 metrics relates to education, a composite measure looking at charter schools, online learning, school regulations,

standards and private school choice.

SBEC cites key elements of Washington's business climate: "No personal income, individual capital gains, corporate income, and corporate capital gains taxes, very low electric utility costs, very high consumption-based taxes, high unemployment taxes, high workers' compensation costs, high gas and diesel taxes, a large number of health insurance mandates and a high state minimum wage."

### A Think Tank View

The Beacon Hill Institute (BHI), a market-oriented research group associated with the economics department of Suffolk University in Boston, publishes an annual review of state competitiveness. Massachusetts tops the BHI list, followed by North Dakota, Colorado, Minnesota and Utah.

BHI usefully defines competitiveness:

We consider a state to be competitive if it has in place the policies and conditions that ensure and sustain a high level of per capita income and its continued growth. To achieve this, a state should be able both to attract and incubate new businesses and provide an environment that is conducive to the growth of existing firms.

To evaluate a state's competitiveness, the Eleventh Annual BHI State Competitiveness Report uses 44 indicators, grouped into eight categories: government and fiscal policy, security, infrastructure, human resources, technology, business incubation, openness and environmental policy (BHI 2011). For example, the government and fiscal policy subindex considers bond ratings, full-time-equivalent government employees, the state budget deficit as a share of gross state product, and the average weekly payment to insured unemployed.

Washington fares well, coming in No. 9 (table 3). The state shows particular strength in openness (No. 3), environmental policy (No. 6), infrastructure (No. 8) and technology (No. 9). The six infrastructure measures include mobile phones, high-speed lines, air passengers and electricity prices (all competitive advantages for Washington) as well as average travel time to work and the average rent for a 2-bedroom apartment (disadvantages).

### The Media View

Washington's ranking on the most popular media measures varies considerably.

*Chief Executive* magazine's most recent

Table 4: Best States for Business (Chief Executive)

1 Texas
2 Florida
3 North Carolina
4 Tennessee
5 Indiana
37 Washington

report ranks Washington the 37<sup>th</sup> best state for business in 2012 (Donlon 2012). That’s down three slots from 2011. The top five states in the 2012 rankings are, in order, Texas, Florida, North Carolina, Tennessee and Indiana (table 4).

*Chief Executive* bases its ranking exclusively on a survey of business leaders. Editor-in-Chief JP Donlan writes, “CEOs were asked to grade states in which they do business among a variety of areas, including tax and regulation, quality of workforce and living environment.” The scores are tallied and a ranking produced. On a five-star scale, Washington received two stars for taxes and regulations, four for workforce quality and four for living environment.

The general results roughly correspond with economic reality. As Donlon notes, “It is perhaps no coincidence that Texas and Florida have the highest net migration of people to their states from 2001 to 2009.” Bottom-ranking California and New York, on the other hand, have had large negative net migration out of state.

Table 5: Top State Business Climates (Site Selection)

1 Texas
2 Georgia
3 North Carolina
4 Virginia
5 South Carolina
Washington not ranked.

*Polling Site Selectors.* Texas also topped the rankings produced by *Site Selection* magazine, a publication aimed at an economic development and corporate real estate audience (Arend 2011). *Site Selection* blends opinion research with objective data to come up with its “top state business climate rankings.” Annually, the magazine surveys site selectors, asking them to identify the most business-friendly states. The objective side of the ranking is based on five factors: total new and expanded facilities, total projects per million population, the state’s ranking on the magazine’s competitiveness ranking, qualified new plant projects year to date, and the business tax climate as measured by the Tax Foundation. The objective and survey results are weighted equally in the final analysis.

*Site Selection’s* top five are Texas, Georgia, North Carolina, Virginia and South Carolina (table 5). The magazine only publishes the top 25; Washington does not make the cut.

*The Forbes List.* Washington reliably makes the top 10 in *Forbes* magazine’s annual Best States for Business. Utah, Virginia, North Carolina, North Dakota and Colorado head the list in 2011, with Washington ranking No. 7 (table 6) (Badenhausen 2011). *Forbes* evaluates business costs, labor supply, regulatory environment, economic climate, growth prospects and quality of life.

Washington gets its highest marks for growth prospects (No. 5), labor supply (No. 6) and economic climate (No. 7). On two policy-driven measures—business costs and regulatory environment—the state ranks near the middle of the pack: No. 21 and No. 20, respectively. Surprisingly, the state claims the No. 26 spot for quality of life. That disappointing finish becomes more understandable when the criteria are explained: quality of life includes poverty rates, mean temperature, cost of living, school test performance and the number of top-ranked four-year colleges in the state.

While *Forbes* does not publish the weighting factors, the magazine acknowledges that business costs are most heavily weighed. Business costs “incorporate Moody’s Analytics cost of doing business index which include labor, energy and taxes .... Moody’s weighs labor the most heavily in its index. [*Forbes*] also included a new state tax index from the Tax Foundation that looks at the tax burden on business in each state across different industries.”

*CNBC.* Washington fell from No. 15 in 2010 to No. 20 in 2011 on CNBC’s “top states for business” rankings (Cohn 2011). CNBC uses 43 different competitiveness measures, grouping them into 10 categories. The three most heavily weighted categories are cost of doing business, workforce and quality of life—all of which receive equal weighting in the 2011 report (methods changed from 2010 to 2011, reflecting some adjustment for the fiscal crisis). Other factors, weighted more lightly, include the economy, education, technology and innovation, business friendliness, access to capital and the cost of living.

Virginia ranked No. 1, followed by Texas, North Carolina, Georgia and Colorado (table 7). Washington’s top marks on the CNBC rankings came in technology and innovation (No. 5) and access to capital (No. 8). The lowest marks, as in other reports, came in cost of doing business (No. 43) and economy (No. 38). Among the economy metrics were projected state budget gaps and number of major corporations located in the state.

**Other Survey-based Rankings**

Recently, Thumbtack.com partnered with the Kauffmann Foundation on a small business survey that received considerable media attention (Allen 2012). Thumbtack, a young web-based business that links customers with service professionals, posted a link to a survey on its website. The firm says some

Table 6: Best States for Business (Forbes)

1 Utah
2 Virginia
3 North Carolina
4 North Dakota
5 Colorado
7 Washington

Table 7: Top States for Business (CNBC)

1 Virginia
2 Texas
3 North Carolina
4 Georgia
5 Colorado
15 Washington

Table 8: Small Business Picks (Thumbtack.com)

1 Idaho
2 Texas
3 Oklahoma
4 Utah
5 Louisiana
32 Washington

250,000 small business owners and managers list services on the site. Of them, 6,022 completed the survey.

Small businesses here gave Washington an overall grade of C-minus on overall small business friendliness, ranking us 32nd of 44. (Six states were excluded because not enough respondents filled out the survey.) Idaho, Texas, Oklahoma, Utah and Louisiana were the top five for overall small business friendliness (table 8). Vermont, Hawaii, California, New York and Michigan landed on the bottom.

Washington-based respondents gave Washington below average marks on hiring costs, regulation and taxes. Thumbtack reports that small businesses here were the third least healthy nationwide and fourth slowest growing, based on survey responses.

Table 9: Winning States (DCI)

1 Texas
2 North Carolina
3 South Carolina
4 Tennessee
5 Florida
38 (t) Washington

*Another Look at What Site Selectors Think.* Since 1996, Development Counselors, Inc. (DCI), a firm specializing in economic development and travel marketing, has conducted a triennial survey of corporate executives with site selection responsibilities. The wide-ranging survey considers such things as a state’s economic development website, best marketing techniques for developers, use of social media and the like. To test general perceptions, DCI also asked about the favorability of a state’s business climate. The 2011 Winning Strategies report drew 322 responses (DCI). Nearly half identified Texas as having the nation’s most favorable business climate, with North Carolina coming in second, followed by South Carolina, Tennessee and Florida. After the top states, the percentages fall dramatically. Washington ranked well behind, identified as “most favorable” by just 1.3 percent of respondents, in a tie for No. 38 (table 9).

**Discussion**

As we’ve written before, there is no “best business climate.” The number of claimants to the title makes the point. As criteria change, new contenders arise. Different industries will place higher or lower emphases on factors like land and energy costs, presence of research universities, access to markets and capital, business taxes, regulatory requirements and so on. A good business climate for a tech firm may not be the ideal match for a manufacturing industry.

Then again, it may. In the metropolitan Puget Sound region, Washington boasts of global leaders in airplane manufacturing and software development.

Several patterns emerge from a review of

the rankings.

Costs continue to matter. The rankings, whether based on weighted assessments of a state’s policies or the perceptions of business owners, tilt south, toward states that have aggressively courted business with incentive programs and business-friendly tax, labor and regulatory policy.

Quality public services, particularly education, also matter. Technology and innovation, as well as more traditional industry, rely on a skilled workforce, research and development, and high-performing transportation and communications systems.

As *Enterprising States*, the most comprehensive of the reports we reviewed, observes:

Businesses need a highly skilled workforce – which includes many workers with certificates or two-year degrees – that is able to perform the jobs of a 21st century economy. States that are able to get students involved in the STEM fields – science, technology, engineering, and math – will be the most competitive.

Innovation, now the essential driving force for creating and sustaining economic opportunities, is much more multidisciplinary and global in scope than ever before. Innovation and market cycle times are much shorter and continue to accelerate. This makes it more important than ever that states provide the tools, support, and tax and regulatory environments for companies to continuously innovate without onerous delays and burdensome costs that put their entrepreneurs and businesses at a competitive disadvantage.

Washington’s major corporate leaders have made a similar observation. In 2011, the Washington Roundtable launched *Benchmarks for a Better Washington*. The group uses 12 metrics to define quality of life and cost. The Roundtable says, Washington “must position itself to compete on value and on cost. In our view, that means being among the top 10 states in the nation on key quality-of-life and innovation metrics. It also means doing a better job competing on key business cost measures.”

While the measurements vary, the substance of most business climate studies remains consistent. High quality public services and competitive costs are critical to a state’s long-term growth prospects.

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