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Foggy Business Climate Studies

Texas ranks relatively high on several "business climate" indices that compare state policies and outcomes related to economic growth and vitality. Texas' low business taxes are often claimed to be a magnet for relocating businesses and a catalyst for interstate competitiveness and survival of existing firms.

But in a new book, Grading Places: What do the Business Climate Rankings Really Tell Us? (http://www.epi.org/content.cfm/books_grading_places), author Peter Fisher finds that these indices are neither useful for companies in selecting sites nor for state policymakers in gauging economic competitiveness.

Fisher analyzes five major indices claiming to measure economic growth and vitality and finds that they focus largely on tax policies and regulation—and are not an accurate predictor of economic success.

In the rankings, the states with the lowest taxes, lowest wages, and most deregulated systems consistently rank higher while more comprehensive measures of economic growth, such as asset development, community development, and workforce development programs are ignored.

Flawed Methodology

Fisher faults both the methodology used in these studies and the individual indicators they choose to measure. Fisher also argues that their ideological fixation on low taxes obstructs any true measure of business climate.

The business climate indices are based on the shared premise that states with the lowest taxes and the fewest regulations will automatically perform better. In this framework, South Dakota, Kansas, and Colorado possess the superior business climates in the nation. However, the competitive nature of the marketplace is decidedly more complex than what these business climate lists report. The inherent danger of these studies, Fisher argues, is that they lead to a set of recommendations based upon largely irrelevant indicators, calling for reduced taxes, smaller government, and fewer regulations to stimulate economic growth. These recommendations are flawed precisely because these indices are not valid measurements of a state's economic attractiveness.

In addition, the scattershot pattern of states along the business climate continuum—depending upon the particular index or report card—demonstrates the flawed methodology employed by these reports. For example, 34 states can claim to be in the top 20% in at least one of the five national studies.

These measurements also rely on several arbitrary indicators, including:

- Licensing requirements for 42 health professions (Economic Freedom Index)
- Attorney General's salary (Economic Freedom Index);
- State and local government workers, as measured by FTE per 100 residents (Small Business Survival Index);
- Air passengers per capita (Beacon Hill Competitiveness Report); and
- Percent of population born abroad (Beacon Hill Competitiveness Report).

According to Fisher, rather than predicting the potential for real economic growth, these indicators betray the ideological bent of the studies' authors and call into question the validity of the indices. The "measures used must pass an ideological screen so the validity and relevance criteria go by the wayside," he says.

Fisher promotes a statistical model that incorporates multiple regression analyses to establish a level of causality. "To a significant degree," Fisher argues, "the legitimacy of an index depends on how well it mimics a more sophisticated statistical approach."

An Alternative Report Card

Short of doing a multiple regression analysis, a more accurate way to rank a state's business climate is to combine an analysis of tax and regulatory policy with an assessment of policies and programs related to asset development, community development, and workforce development. A state's investment in these areas equips its residents to succeed in regional labor and financial markets and increase the rate of return on business investment.

Since 2002, the Corporation for Enterprise Development (CFED) has released an annual state ranking and scorecard that measures states' asset-building and asset-protection capacity among its residents. The *Assets and Opportunity Scorecard* analyzes and compares the key parts of this socioeconomic equation by state, and examines state policies that can help or hinder residents' abilities to move up the economic ladder. In short, the *Assets and Opportunity Scorecard* measures how easy or hard it is for families to achieve the American Dream.

CFED's Assets Scorecard includes 31 outcome-based measures and 38 policy-based measures within a six-index framework, including financial security, business development, homeownership, health care, education, and tax policy and accountability.

When these factors are considered, Texas' competitiveness takes a dive, with low homeownership rates, rock-bottom household net worth, and lagging educational attainment—a clear contrast from the picture of Texas painted by the flawed business climate indices criticized by Fisher.

Overall, Texas earned a grade of "F" on the 2005 *Assets and Opportunity Scorecard*. The primary factors influencing Texas' overall grade were the low asset accumulation among many Texas families, low health care outcomes, and relatively low educational attainment.

How Texas Ranks: Asset Development v. Business Climate

CFED Indicator	**Texas Rank**		**Business Climate Study**	**Texas Rank**
Household Net Worth	48th		Small Business Survival Index	11th
Private Loans to Small Business	45th		State Business Tax Climate Index	4th
Homeownership Rate	45th		Competitiveness Index	20th
Uninsured low-income children	51st		CATO Fiscal Policy Report Card	N/A
Two Years of College	42nd		Economic Freedom Index	17th
CFED Overall Grade	**F**		**Average Rank (Climate Studies)**	**13th**

Sources: Center for Enterprise Development, 2005; *Grading Places*, Peter Fisher, 2005.

The Asset Scorecard results should alarm Texas' business community and potential investors, because CFED's indices more adequately measure human, social, and economic capital for the entire state population. College attainment levels, homeownership rates, and access to workforce training are more relevant to the long-term sustainability of business and industry than the amount of federally-owned land or the strictness of gun control laws—the type of indicators included in conventional "business climate" measures.

Moreover, the CFED Scorecard analyzes and measures statewide policies associated with these outcomes to guide policymakers concerning the causal relationship between outcomes and policies. In contrast to the "business climate" and "competitiveness" indices, the CFED scorecard establishes a more rational connection between outcome and policy indicators.

In many instances, Texas received substandard scores on several indicators directly determined by legislative policy decisions, including:

- Minimum wage
- Asset limits for public assistance
- Short-term loan protections
- Workers' compensation coverage and benefits
- Unemployment benefit level
- Microenterprise support
- Reliance on property taxes
- Average income for health coverage
- Workforce training

How Texas Measures Up

A brief analysis using the Asset Development Scorecard to compare Texas with four states—two states that finished in the top half in most or all of the "business climate" indices (Colorado and New York), and two states that finished in the bottom half in most or all of these indices (California and Missouri)—both illustrates the challenges that Texas faces in creating a climate of prosperity for its residents and the insignificance of the business climate rankings.

A Snapshot: How Texas Compares on Selected Asset Development Indicators

	State	California	Colorado	Missouri	New York	Texas
Households with Zero Net Worth	%	15.7	19.6	14.3	25.1	19.7
	Rank	29	44	22	49	45
Small Business Ownership	Ratio	15.1	13.9	11.4	11.5	11.8
	Rank	8	12	31	30	25
Homeownership Rate	%	58.9	71.3	74.0	54.3	64.5
	Rank	48	26	12	50	45
Two Years of College	%	8.9	7.5	7.3	8.6	6.7
	Rank	18	36	37	21	42

Source: Corporation for Enterprise Development, 2005.

As the table illustrates, Texas ranks near the bottom in three of four significant measures related to economic growth and vitality, along with other states ranked near the top of the "business climate" measurements. Although Texas' small business ownership rate is average, its homeownership, two-year college attainment, and zero-net worth household rate rank near the bottom of the 50 states.

Given their selective set of performance indicators, the "business climate" measurements obscure the whole economic picture, and fail to serve as a reliable guide for shaping policies to improve the economic or business climate of any state, especially Texas.

The Asset Development Report Card demonstrates the need for a more holistic approach to economic development—a framework that includes asset development, community development, and workforce development. Business climate studies that fail to take into account these factors advocate the wrong formula for economic growth.