

## APPENDIX B-25: CALIFORNIA

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<b><u>Business Poll Ranking</u></b>	
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### **Overview**

California is the nation's most populous states and has the nation's leading economy. Moreover, its economy is as diverse as its citizenry. California's economy ranks among the largest in the world and is made up of various economic sectors.<sup>1</sup> Some of the leading industries include agriculture, entertainment, technology, tourism, and oil production. However, given the diverse economy, most reports view California as somewhat hostile to business in its tax structure, public policy, and restrictive business regulations.<sup>2</sup> The aforementioned factors have prompted a significant number of businesses to flee the state during the past decade. However, a recent 2007 report by the Public Policy Institute of California (PPIC) indicated effects of this year's exodus had been negligible amounting to a tenth of a percent of the workforce leaving the Golden State.<sup>3</sup>

According to the state rankings by *Forbes*<sup>4</sup>, which rates state business climates on a scale of 1-50 (with a ranking of one being the best); California's overall ranking was a 34. This was an increase of two points from the previous year. California's worst category was the cost of doing business. This was largely due to high utility rates and an aggressive litigation rating. Specifics will be discussed in further detail later in the profile.

<sup>1</sup> "California World's Sixth Largest Economy? Not Anymore." Associated Press. The International Herald Tribune. 17 Jan. 2007 <http://www.iht.com/articles/ap/2007/01/12/business/NA-GEN-US-California-No.-8-Economy.php>

<sup>2</sup> "State Lost Few Jobs From Business Moves, Study Says." Reuters News Service. Los Angeles Times. Lexis-Nexis Universe. Online. 7 Nov. 2007.

<sup>3</sup> "State Lost Few Jobs From Business Moves, Study Says."

<sup>4</sup> Kurt Badenhausen. "Special Report: The Best States for Business." Forbes Magazine. July 2007. [http://www.forbes.com/business/2007/07/10/washington-virginia-utah-bizez\\_kb\\_0711bizstates.html](http://www.forbes.com/business/2007/07/10/washington-virginia-utah-bizez_kb_0711bizstates.html)

California's <i>Forbes</i> Rankings	
Overall Rank	34
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## **Public Policy**

The “State Competitiveness Report (SCR) 2007,”<sup>5</sup> a study by the Beacon Hill Institute ranks a state’s ability to produce high income, and generally a better quality of life for its citizens. The rankings compare all the states and rank them 1-50 (a ranking of one being the best). In this study, California ranked 24<sup>th</sup> overall. The state ranked very well in the categories of business openness to international markets, 3<sup>rd</sup> and for technological innovation, 9<sup>th</sup>. However the state fiscal policy, which will be discussed in this section, receives a dismal ranking of 49<sup>th</sup> in the country.

California has long been seen as the nation’s laboratory for several public policy issues as many initiatives begun in the Golden State are eventually adopted in other states and regions in the country. Recently, Governor Arnold Schwarzenegger has taken a leading role with two of the major policy issues being debated across the country: climate change and health care.

### *Global Warming/Climate Change*

In 2006, Governor Schwarzenegger made history by signing the first mandatory legislation to reduce greenhouse gases by 25% by the year 2020.<sup>6</sup> Governor Schwarzenegger followed with a recent executive order calling for producers of transportation fuel to reduce their carbon emissions by 10% by the same year. These new requirements have paved the way for a new “Cap and Trade” market whereby manufacturers of energy can gain credits for tons of carbon that have been reduced to acceptable levels. These credits can be sold to other companies struggling to regulate and who need to escape penalty, thereby creating a new business market. Governor Schwarzenegger has been active in recruiting other governors in the western half of the country to commit to guidelines similar to California’s.<sup>7</sup> These states include Arizona, New Mexico, Oregon, Utah, and Washington.<sup>8</sup>

<sup>5</sup> David Tureck, Jonathan Haughton, Frank Conte, and Christopher Doyon. State Competitiveness Report 2007. Boston: Beacon Hill Institute for Public Policy Research at Suffolk University, 2007. 20. <http://www.beaconhill.org/Compete07/Compete2007State.pdf>.

<sup>6</sup> Kenneth Schwarz. “California’s Fight Against Global Warming Changes The Business Climate.” February, 2007. Fedcontracts.com. <http://www.fedcontracts.com/california2019s-fight-against-global-warming-changes-business>

<sup>7</sup> Judy Fahys. “Climate Change: Guvs to Team Up.” The Salt Lake City Tribune. Lexis-Nexis Universe. Online. 20 May 2007.

<sup>8</sup> Fahys.

While the governor's efforts have been routinely praised throughout the country, some businesses have been much less enthusiastic.<sup>9</sup> Some business leaders have complained that they have already invested a sizable chunk of money in making their businesses energy efficient. Now business will be required to spend more on expensive technology to reduce their emissions. Still, several other business leaders have backed the governor's policy noting that the new policy will help create new jobs within the field of alternative energy.<sup>10</sup>

### *Health Care*

Following the governor's reelection, he announced in his 2007 State of the State Address that he intended to make universal health care the focus of his agenda.<sup>11</sup> One of the integral planks in the governor's plan is that the burden of shouldering the health care cost would fall largely on the shoulders of business owners.<sup>12</sup> Under the governor's plan, all but the smallest companies (10 employees or less) would be required to make health insurance available to their employees.<sup>13</sup> Companies that do not comply would be subject to a 4% payroll tax for not offering insurance. Furthermore, the governor's proposal would subsidize healthcare for a further 1.2 million indigent citizens who do not qualify for Medi-Cal.<sup>14</sup>

According to the November 2007 issue of the *Sacramento Bee*, the health plan is currently detained in the legislative process.<sup>15</sup> The issue is the method to pay for the uninsured. Governor Schwarzenegger's "shared responsibility" plan calls for the uninsured to pay for a portion of their health insurance. Meanwhile, Californian Democrats would prefer employers pay the estimated \$10 billion dollar cost and take the burden off the poor.<sup>16</sup> Due to the impasse, the governor's chief priority appears to be unlikely to pass.

### *Business Environment*

Governor Schwarzenegger entered office in 2003 in a recall election and earned a large public following by promising to restore the business climate. However, the 2007 Small Business Survival (SBS) Index ranked California among the very worst states in terms of

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<sup>9</sup> "The vote heard round the world: California enacts the toughest global warming law in all the land; California. Global Warming Solutions Act." *On Earth Magazine*. 1 Jan. 2007. <http://www.mywire.com/pubs/OnEarth/2007/01/01/2433699>

<sup>10</sup> Rod Blagojevich. "Statement from Governor Rod R. Blagovich Regarding Global Warming." State News Service. *Lexis Nexis Universe*. Online. 2 Feb. 2007.

<sup>11</sup> Arnold Schwarzenegger. "State of the State Address." Office of the Governor. 9 Jan. 2007. <http://gov.ca.gov/index.php/?/press-release/5089/>

<sup>12</sup> Kevin Yamamura. "California Republican Convention, Governor Speaks To The GOP: He Tells Meeting Of The Party Faithful He Wants To Build More Dams, Prisons." *Sacramento Bee*. *Lexis Nexis Universe*. Online. 21 Feb. 2007.

<sup>13</sup> Yamamura.

<sup>14</sup> Laura Kurtzman. "Governor Makes Tough Promise." Associated Press. *Palo Alto Daily News*. 9 Jan. 2007. <http://www.paloaltdailynews.com/article/2007-1-9-health-care>

<sup>15</sup> Dan Walters. "Health Plan Not Dead, But Gasping." *Sacramento Bee*. *Lexis Nexis Universe*. Online. 5 Nov. 2007.

<sup>16</sup> Walters.

business friendliness, ranking 49<sup>th</sup>.<sup>17</sup> California's exorbitant number of regulatory restrictions and high tax rates have kept its business climate ranking low.

## **Regulatory Affairs**

California received a ranking in *Forbes* as one of the worst regulatory environments. The state is ranked 39<sup>th</sup> out of 50 states.<sup>18</sup> Meanwhile, the surrounding states, Arizona, Nevada, Oregon and Washington, rank 37<sup>th</sup>, 34<sup>th</sup>, 31<sup>st</sup> and 5<sup>th</sup> respectively.<sup>19</sup> The main influences behind California's dismal rating are astronomical utility rates, restrictive labor laws, and a high litigation environment.

### *Utilities*

California suffers some of the worst utility rates in the country when comparing gas and electric rates to those in other states. For example, SBS Index places California last (including the District of Columbia) for gas taxes.<sup>20</sup> The closest state in the region, Washington, also places poorly at 46<sup>th</sup>, yet neighboring Arizona at 10<sup>th</sup> and Oregon at 23<sup>rd</sup> place better in this category.<sup>21</sup>

Finally, when it comes to electric costs, California, who struggled mightily with electricity shortages in the earlier part of this decade, continues to pay among the highest rates in the nation. California is ranked 45<sup>th</sup> in this category while surrounding states such as Arizona place among the highest.<sup>22</sup>

### *Labor Laws*

Most California businessmen find the states labor laws particularly stringent.<sup>23</sup> Some of those regulations include:

- *Overtime laws*: Require an employee to be paid time and a half the usual rate if he or she works more than eight hours. Double the employee's regular rate or pay for all hours worked in excess of 12 hours in any workday and for all hours worked in excess of eight on the seventh consecutive day of work in a workweek.<sup>24</sup>

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<sup>17</sup> Raymond J. Keating. *Small Business Survival Index 2007: Ranking the Policy Environment for Entrepreneurship Across the Nation 12<sup>th</sup> Annual Edition*. Small Business & Entrepreneurial Council, Washington, DC, November, 2007. 2.  
[http://sbecouncil.org/Media/pdf/SBSI\\_2007.pdf?CFID=514256&CFTOKEN=91743709](http://sbecouncil.org/Media/pdf/SBSI_2007.pdf?CFID=514256&CFTOKEN=91743709)

<sup>18</sup> Badenhausen.

<sup>19</sup> Badenhausen.

<sup>20</sup> Keating, 40.

<sup>21</sup> Keating.

<sup>22</sup> Keating, 36.

<sup>23</sup> "Labor and Employment." California Chamber of Commerce. *Business Issues*.

<http://www.calchamber.com/cc/governmentrelations/businessissues/laborandemployment.htm>

<sup>24</sup> "Overtime." California Department of Industrial Relations.

[http://www.dir.ca.gov/dlse/FAQ\\_Overtime.htm](http://www.dir.ca.gov/dlse/FAQ_Overtime.htm).

- *Meal Periods:* In California, an employer may not employ an employee for a work period of more than five hours per day without providing the employee with a meal period of not less than thirty minutes, except that if the total work period per day of the employee is no more than six hours, the meal period may be waived by mutual consent of both the employer and employee. A second meal period of not less than thirty minutes is required if an employee works more than ten hours per day, except that if the total hours worked is no more than 12 hours, the second meal period may be waived by mutual consent of the employer and employee only if the first meal period was not waived.<sup>25</sup>
- *Family Leave:* California was the first state in the nation to adopt a state family leave plan, which took effect in 2004.<sup>26</sup> Under the current law, California requires firms with 50 or more people to have up to 12 weeks of unpaid leave for employees who needed to take time for a personal illness or to bond with a baby.<sup>27</sup> Additionally, workers can have up to six weeks of paid leave in order for a worker to take care of a sick parent, child, spouse, or domestic partner.<sup>28</sup> Since the initial passage of the Family Leave Act, there have been attempts to expand the reach of the program to apply to grandparents, siblings, or in-laws.<sup>29</sup> However, Governor Schwarzenegger vetoed the latest provision citing it to be “too expansive.”<sup>30</sup>

According to the California Chamber of Commerce, rigid enforcement of these laws has led to several business litigation cases in the courts.<sup>31</sup>

### *Litigation*

According to the Institute for Legal Reform, which ranks states according to various areas of the litigation process (#1 being best); California is in dire need of reform. The state is ranked 44<sup>th</sup> out of the 50 states in terms of the quality of the state liability system.<sup>32</sup> In most categories, the state is ranked near the bottom in almost every category. For example, California is ranked 45<sup>th</sup> in “overall tort and contract litigation” and 47<sup>th</sup> in “dismissals by summary judgment” (where a case would be dismissed early in the process).<sup>33</sup> These two rankings suggest California is an extremely litigious society, particularly disturbing was the area of “punitive” (monetary punishment beyond compensation) awards. Out of the 44 states that allow these types of awards, California

<sup>25</sup> “Meal Periods.” California Department of Industrial Relations.

[http://www.dir.ca.gov/dlse/faq\\_mealperiods.htm](http://www.dir.ca.gov/dlse/faq_mealperiods.htm)

<sup>26</sup> Mark Sappenfield. “California’s Paid Family Leave Act.” *NPR*, 24 Sep. 2002.

<http://www.npr.org/templates/story/story.php?storyId=1150569>.

<sup>27</sup> Ilana Debare. “Governor Vetoes Leave Expansion.” *The San Francisco Chronicle*. Lexis Nexis Universe. Online. 16 Oct. 2007.

<sup>28</sup> Debare.

<sup>29</sup> Debare.

<sup>30</sup> Debare

<sup>31</sup> “Labor and Employment.”

<sup>32</sup> *Lawsuit Climate 2007: Rating the States*. The Institute for Legal Reform. 2007. 6.

[http://www.instituteforlegalreform.com/lawsuitclimate2007/pdf/Individual\\_State\\_Rankings.pdf](http://www.instituteforlegalreform.com/lawsuitclimate2007/pdf/Individual_State_Rankings.pdf)

<sup>33</sup> Institute for Legal Reform.

is ranked 42<sup>nd</sup>.<sup>34</sup> The state's abysmal ranking suggests that corporations found liable for specific claims may be required to pay large monetary awards.

## **Tax Policy**

California remains rather infamous for exorbitant taxes imposed upon both individuals and their businesses. With the exception of real estate/property taxes, which are regulated by Proposition 13, Californians pay some of the highest tax rates in the country. The State Business Tax Climate (SBTC) is a tool for lawmakers and the media to compare the state's tax policies (with a ranking of one being the best). In this index California placed 47<sup>th</sup> out of 50.<sup>35</sup> Meanwhile, the 2007 Small Business Survival (SBS) index rates a state's public policies according to how friendly a state is toward entrepreneurial activity. In that study the state placed 49<sup>th</sup> out of all states and the District of Columbia.<sup>36</sup>

According to the California's Chamber of Commerce, the "big three" taxes (income, corporate income, and sales and use taxes) account for 95% of the general fund budget.<sup>37</sup>

### *Individual Income Tax*

California's individual income tax is a graduated income tax. There are six levels of income brackets that cover Californian workers. On the lower end of the income scale, those earning \$1-\$6,146 pay 1% on every dollar of income. On the other end of the scale, Californians who earn \$40,346 or more pay up to 9.3% of their income. Finally California's wealthiest citizens who make over \$1 million dollars or more are saddled with an additional 1% surcharge, which pushes the state's highest earners to a 10.3% tax on their earnings.<sup>38</sup>

These rates rank poorly when compared to income tax rates across the nation. The 2008 State Business Tax Climate (SBTC) index ranks California's income tax structure 47<sup>th</sup> out of the 50 states.<sup>39</sup> Meanwhile the 2007 Small Business Survival (SBS) index rates California last out of all states (including the District of Columbia) for its tax rates.<sup>40</sup> At the same time, the index rates of surrounding states are Arizona 16<sup>th</sup> and Oregon 48<sup>th</sup> respectively, while Washington State earns the best income tax rating in the nation.<sup>41</sup>

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<sup>34</sup> Institute for Legal Reform.

<sup>35</sup> Chris Atkins and Curtis S. Dubay. Background Paper: 2008 State Business Tax Climate Index. October, 2007, Number 52. The Tax Foundation. 10. <http://www.taxfoundation.org/files/bp57.pdf>

<sup>36</sup> Keating, 2.

<sup>37</sup> "Taxation." California Chamber of Commerce. Business Issues.  
<http://www.calchamber.com/CC/GovernmentRelations/BusinessIssues/Taxation.htm>

<sup>38</sup> "2007 California Tax Rates and Exemptions." State of California: Franchise Tax Board.  
[http://www.ftb.ca.gov/forms/catxrate\\_exmpt07.shtml](http://www.ftb.ca.gov/forms/catxrate_exmpt07.shtml)

<sup>39</sup> Atkins and Dubay.

<sup>40</sup> Keating, 28.

<sup>41</sup> Keating.



## Sales Tax

The state fares somewhat better when it comes to the ranking of its sales tax. Statewide, citizens are subjected to a 7.25% sales tax and it's collected by the state board of equalization.<sup>42</sup> Additionally, regional and municipal governments are permitted to tack on an additional tax. Therefore, state sales tax varies by region from 7.25% to 8.75%. Nationally, the 2007 SBTC ranks these taxes as 42<sup>nd</sup><sup>43</sup> while the SBS index ranks these taxes 29<sup>th</sup>.<sup>44</sup> According to the latter index, Oregon leads the region and nation with the best sales tax,<sup>45</sup> while Arizona and Washington's rates are ranked behind California at 44<sup>th</sup> and 48<sup>th</sup> respectively.<sup>46</sup>

## Corporate Income Tax

Corporations doing business in the state of California are subject to the State Income or Minimum Franchise Taxes. The rate for different corporations doing business in the state is:<sup>47</sup>

C corporations, other than banks and financial corporations .....	8.84% <sup>48</sup>
C corporations that are banks or financial corporations.....	10.84%
S corporations, other than banks and financial corporations .....	1.5%
S corporations that are banks or financial corporations.....	3.5%

Additionally, some large companies may have earnings both in and outside California. The portion that is liable to California can be determined by a unitary form.<sup>49</sup> Under this method, all of the elements comprising trade or business are viewed as one unitary business, whether or not the activities of a business are conducted in separate corporate forms. The business income of unitary business is then divided and assigned to California by means of an apportionment formula in a combined report. The combined business income is apportioned to California by a mathematical formula. The formula is based on the three primary contributions to income earned by your unitary business: property, payroll and sales (which are generally counted twice).

The formula works as follows:

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<sup>42</sup> "Detailed Description Of The Sales and Use Tax Rate." California State Board of Equalization. 28 Nov. 2007. <http://www.boe.ca.gov/news/sp111500att.htm>

<sup>43</sup> Atkins and Dubay, 4.

<sup>44</sup> Keating, 33.

<sup>45</sup> Keating.

<sup>46</sup> Keating.

<sup>47</sup> "What Are The Tax Rates For Corporations?" State of California Franchise Tax Board. <http://www.ftb.ca.gov/businesses/faq/717.shtml>

<sup>48</sup> State of California Franchise Tax Board "What Are The Tax Rates For Corporations?" Businesses:. <http://www.ftb.ca.gov/businesses/faq/717.shtml>

<sup>49</sup> "Frequently Asked Questions." California Franchise Tax Board. California's Corporation Taxes. 2003. <http://www.ftb.ca.gov/forms/misc/1083.pdf>

Property Factor or percentage = California Property / Property Everywhere  
Payroll Factor or percentage = California Payroll / Payroll Everywhere  
Sales Factor or percentage = California Sales / Sales Everywhere \* 2

The Percentage of Business Income to be apportioned to California is the sum of Property Percentage, Payroll Percentage, Sales Percentage, and Sales Percentage divided by four.

### *Corporate Minimum Franchise Tax*

Business owners must pay a minimum franchise tax if their corporation or limited liability company treated as a corporation is doing business in California.<sup>50</sup> Doing business in California is defined as actively engaging in any transaction within the state for the purpose of financial gain or profit.

Corporations and Limited Liability Corporations that were qualified to do business in the state on or after January 20, 2000, are not subject to the minimum franchise tax during the first taxable year. However, after that taxable year, the corporations are subject to an annual \$800 minimum franchise tax.<sup>51</sup> Federal S corporations doing business in the state are subject to this tax in addition to shareholder taxes.

### *Corporate Tax Credits//Tax Incentives*

California provides tax incentives in the form of tax credits, deductions, and allocation formula adjustments. These incentives are intended to encourage business investment and economic development within the state:

- *Research Credit.* This credit can be claimed for costs attributable to research activities conducted in California. The credit is 15% of the excess of qualified research expenses for the taxable year over the base period research expenses. Corporations are allowed the 15% credit amount plus credit for 24% of the basic research payments.<sup>52</sup>
- *Enterprise Zones, Local Agency Military Base Recovery Areas, Manufacturing Enhancement Areas or Targeted Tax Areas:* Corporations operating in an enterprise zone, Local Agency Military Base Recovery Area, Manufacturing Enhancement Area, or Targeted Tax Area, may be eligible for a hiring credit that they can claim for a portion of wages paid to qualified employees.<sup>53</sup> Employers may also be eligible for:
  - A sales or use tax credit that you can claim for the sales or use tax you paid to purchase qualified property

<sup>50</sup> California's Corporation Taxes.

<sup>51</sup> "Range Of State Corporate Income Tax Rates." Federation of Tax Administrators.  
[http://www.taxadmin.org/fta/rate/corp\\_inc.html](http://www.taxadmin.org/fta/rate/corp_inc.html)

<sup>52</sup> California Franchise Tax Board. 2006 Research Credit. California Form 3523.  
<http://ftb.ca.gov/forms/misc/1082.pdf>

<sup>53</sup> "Frequently Asked Questions."



- A special net operating loss carryover provision
- A deduction for a portion of the cost of qualified property
- *Employer Child Care Credit Program*: Employers can claim a credit, not to exceed \$50,000, equal to 30% of the costs for establishing a child care program or constructing a childcare facility for use primarily for your employees' children or tenants' employees' children.<sup>54</sup>
- *Manufacturers' Investment Credit*: (This tax credit was allowed to expire in 2003) Prior to its elimination, business owners could claim this credit if they were a manufacturer (Standard Industrial Classification codes 2011 to 3999) or a tax payer with activities related to computer programming or computer software design (Standard Industrial Classification code 7371 to 7373) that purchases qualified property placed in service in California after January 1, 1994.<sup>55</sup> Qualified property for codes 7371 to 7373 must be placed in service on or after January 1, 1998. The amount of the credit is 6% of the cost of the qualified property.

### *State Ranking for Corporate Taxes*

Despite these corporate tax credits, California still ranks toward the bottom for corporate income taxes. In this category, the SBTC and SBS indexes are especially consistent, ranking California among the ten worst corporate tax environments. The SBTC index ranks California 40<sup>th</sup><sup>56</sup> in the country while the SBS Index ranks California 42<sup>nd</sup>.<sup>57</sup> Oregon and Arizona place 23<sup>rd</sup> and 26<sup>th</sup> respectively and Washington is ranked as having one of the best corporate income tax rates in the country.<sup>58</sup>

### *Property (Real Estate Tax)*

In both indexes, California's best and most competitive tax rating is in the area of property tax. Both indexes rank California 13<sup>th</sup> in the nation.<sup>59,60</sup> Appropriately, the source of California's high ranking was the popularly supported Proposition 13, which was passed on the ballot in a popular election in 1978 labeled the "taxpayers revolt".<sup>61</sup> The most significant operative language of the proposition stated that:

"SECTION 1. (a) The maximum amount of any *ad valorem* tax on real property shall not exceed one percent (1%) of the full cash value of such property. The one

<sup>54</sup> California Franchise Tax Board. 2006 Employer Childcare Program Credit. California Form 3501. [http://www.ftb.ca.gov/forms/06\\_forms/06\\_3501.pdf](http://www.ftb.ca.gov/forms/06_forms/06_3501.pdf)

<sup>55</sup> "Manufacturers Investment Credit References." State of California Franchise Tax Board. <http://www.ftb.ca.gov/businesses/credits/mic/references/index.shtml>

<sup>56</sup> Atkins and Dubay, 4.

<sup>57</sup> Keating, 30.

<sup>58</sup> Keating.

<sup>59</sup> Atkins, 4.

<sup>60</sup> Keating.

<sup>61</sup> Michael New. "The Tax Revolt Turns 25." 29 May 2003. The CATO Institute. [http://www.cato.org/pub\\_display.php?pub\\_id=3118](http://www.cato.org/pub_display.php?pub_id=3118)

percent (1%) tax to be collected by the counties and apportioned according to law to the districts within the counties".<sup>62</sup>

The act was effective in lowering property taxes by an average of 57% across the state. Additionally, the language of the proposition required that any subsequent increase in tax rates receive a two-thirds approval in both houses of the legislature.

The effect of Proposition 13 has been disproportionate as some areas, such as the Los Angeles basin and the Bay Area, have higher housing costs than inland communities. Cities and counties have become more dependent on the state for funds in the form of "block grants" than they otherwise would have been prior to the passage of the proposition. Ongoing studies are being conducted to determine whether this redistribution of tax base and the cost of lost revenue outweigh the benefits of Proposition 13.

### **Innovation**

National studies that rank the states for their progress in innovation and technology have been extremely complimentary toward California. The New Economy Index<sup>63</sup> (NE) rates the states according to advancements in innovation (with a ranking of one being the best). In this index California placed 5<sup>th</sup> overall. In particular respect towards patents, which are crucial in determining a new competitive advantage in specific markets, California leads its regional geographic area. California placed 4<sup>th</sup><sup>64</sup> (in the NE) and also placed 3<sup>rd</sup><sup>65</sup> in SCR nationally in the number of patents produced over the past year. The NE Index further stated that California is first in the nation for being home to "independent innovators", or trained scientists that work to develop their own projects and inventions.<sup>66</sup>

California remains one of the leading states when it comes to science and innovation. It is famous for developing high-technology products and further innovation is encouraged in the universities. Currently, the University of California leads the world in high-speed computer technology and is poised to debut the next generation of supercomputers.<sup>67</sup> In addition to university developments in computer technology, the California Institute for Telecommunications and Information Technology lists the state as having 20% of all technology jobs in the country. Moreover, the Institute also claims that Californians are responsible for 25% of the nation's patents.<sup>68</sup>

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<sup>62</sup> The Constitution of California. Article 13A Section 1(a).

[http://www.leginfo.ca.gov/const/article\\_13A](http://www.leginfo.ca.gov/const/article_13A)

<sup>63</sup> Robert Atkinson and Daniel K. Correa. The 2007 State New Economy Index.: Benchmarking Economic Transformation in the States. Innovation Technology and Innovation Foundation. February, 2007. 13. [http://www.kauffman.org/pdf/2007\\_State\\_Index.pdf](http://www.kauffman.org/pdf/2007_State_Index.pdf)

<sup>64</sup> Atkinson and Correa, 37.

<sup>65</sup> Tureck et al, 20.

<sup>66</sup> Atkinson and Correa.

<sup>67</sup> "Schwarzenegger Proposes \$95 Million For Tech Initiative." 5 Jan. 2007. HBCWire. <http://www.hpcwire.com/hpc/1181200.html>

<sup>68</sup> "Schwarzenegger Proposes \$95 Million For Tech Initiative."

An important factor behind California's success in patents and inventions has been industrial and state funding. With a particular focus on industry's contribution, funds from the private sector are beneficial in two respects.<sup>69</sup> First, they yield new product innovators that may not have otherwise had the funding to fully develop their ideas. Additionally, the financial support of these innovators aides the development of their ideas. Through the efforts of the industry to fund these projects, a greater knowledge for advancement of a particular industry can be made.

In addition to funding from the private sector, funding from the state is especially important. In late 2006 Governor Schwarzenegger decided to infuse state funds with his pro-environment and alternative fuel public policies with a commitment of \$95 million dollars.<sup>70</sup> Sectors that benefited from the governor's disbursement included cleantech, nanotech and biotech industries. Some of those projects included:

#### *Helios Project*

The governor's budget provides \$30 million in lease revenue bonds for the Helios Project, a groundbreaking initiative by the University of California's Lawrence Berkeley National Laboratory to create sustainable, carbon-neutral sources of energy.<sup>71</sup>

#### *Energy Biosciences Institute*

The governor's budget provided \$40 million in lease revenue bonds to the University of California for UC, Berkeley or UC, San Diego in the event that either won a global competition for the British Petroleum (BP) Energy Biosciences Institute grant. These campuses were among only five universities in the world that were invited to compete for this \$500 million grant to build and operate an Energy Biosciences Institute, which will be dedicated to long-term research into the production of alternative fuels.<sup>72</sup>

#### *California Centers for Science and Innovation*

The governor's budget provided \$19.8 million (General Fund) for the California Institutes for Science and Innovation (CISI). CISI is a multidisciplinary research effort by the University of California - working in partnership with private companies - in the areas of information technology, biomedical research and nanotechnology.<sup>73</sup>

#### *High Technology support/Petascale supercomputer*

In addition to the environment, the governor contributed state funds for high technology projects such as the Petascale Supercomputer. The governor's budget provides the first \$5 million increment in state-matching funds to enhance the University of California's bid to build a \$200 million Petascale computer. The Petascale computer, named for the speed at which it can process information, will be the most powerful computer in the

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<sup>69</sup> Atkinson and Correa.

<sup>70</sup> "Schwarzenegger Proposes \$95 Million For Tech Initiative."

<sup>71</sup> "Schwarzenegger Proposes \$95 Million For Tech Initiative."

<sup>72</sup> "Schwarzenegger Proposes \$95 Million For Tech Initiative."

<sup>73</sup> "Schwarzenegger Proposes \$95 Million For Tech Initiative."

world. It will provide an enormous competitive advantage for California businesses and universities, helping to attract the best students and faculty from around the world.<sup>74</sup>

## **Workforce**

California's workforce is recognized by national employers as a key asset, in terms of education and preparation for the workforce. According to the US Census Bureau, more than 26% of the state's resident population over the age of twenty-five has received at least a bachelor's degree.<sup>75</sup> This is 2.2% higher than the national average.<sup>76</sup> However, the State Competitiveness Report (SCR) gave California a below average ranking in the category of "Human Resources" placing the state 36<sup>th</sup> out of 50.<sup>77</sup>

California's labor force receives a low ranking with respect to a business friendly environment when looking at its unionization level and state labor regulations. According to the Department of Labor Bureau of Labor Statistics, the state unionization rate was approximately 15.7% in early 2007,<sup>78</sup> which would put it nearly three percentage points higher than the national average and would rank California among the very highest unionization rates in the country.<sup>79</sup> Furthermore, Californian employers must comply with many of the strict labor requirements. The Beacon Hill State Competitiveness Report (SCR) ranked California's current minimum wage of \$7.50 as among ten highest wages in the country, a frequent complaint of California's business owners.<sup>80</sup> Additionally, the increase to \$8 will likely have an adverse effect on the state's business competitiveness ranking. Finally, the labor regulations previously mentioned in the "regulatory environment" portion of this state profile are also widely criticized by employers. They view them as rigid and inflexible.

Despite employer complaints of a hostile job environment, the state's employment statistics receive mixed results. Currently, the state's unemployment record stands at 5.3%, nearly a full percentage point above the national average. However, that number has increased significantly in recent months from its March 2007 rating at 4.8%.

On the positive side, California appears to have stalled the number of jobs fleeing the state. A Public Policy Institute of California (PPIC) study revealed that the state only lost 11,000 jobs over the past year which is relatively inconsequential considering these losses came from a base of 18 million jobs.<sup>81</sup> Furthermore, the SCR rates California 9<sup>th</sup>

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<sup>74</sup> "Schwarzenegger Proposes \$95 Million For Tech Initiative."

<sup>75</sup> "California Quick Facts." US Census Bureau. 31 Aug. 2007.  
<http://quickfacts.census.gov/qfd/states/06000.html>

<sup>76</sup> US Census Bureau.

<sup>77</sup> Tureck et al, 20.

<sup>78</sup> "United States Department of Labor: Bureau of Labor Statistics Union Affiliation Of Employment Wage And Salary Workers By State." January 26, 2007. Union Membership (Annual). Table 5.  
<http://www.bls.gov/news.release/union2.t05.htm>.

<sup>79</sup> United States Department of Labor: Bureau of Labor Statistics.

<sup>80</sup> Tureck, et al.

<sup>81</sup> "State Lost Few Jobs From Business Moves, Study Says." Reuters News Service. Los Angeles Times.  
Lexis-Nexis Universe. Online Nov., 2007.

in the country for having the most scientists and engineers as part of the labor force and is a slight regional second in this category, falling just below Washington State.<sup>82</sup>

### **Education**

In the 1960's, California served as the example for the rest of the nation in how to provide higher education to its citizens. The state offered a three-tiered system of affordable national public universities, state universities, and also community colleges geared to make higher education available to those who wanted to pursue an advanced degree. Today, California is home to a number of leading universities and research institutions that produce a significant number of patents and publications.<sup>83</sup> According to the *US News and World Report* rankings, 11 of the state's public and private universities are ranked among the top 100 national universities in the country.<sup>84</sup> Moreover, a record nine California graduate engineering programs are ranked among the nation's top 50. However, the SCR report indicates that California has only a mediocre ranking when it comes to the number of science and engineering graduate degrees awarded in the state.<sup>85</sup>

Although California's higher education programs remain among the best in the nation, it received mixed results for secondary education. According to the US Chamber of Commerce's "*Leaders and Laggards: A State by State Report Card on Educational Effectiveness*" study, young Californian students perform especially poorly on academic proficiency tests which have led to the state's overall ranking of a "D" for a return on its spending on educational programs.<sup>86</sup> However, the study does give the state high marks for rigorous academic criteria for high school students, which has prepared them well for college and success on advanced placement examinations.<sup>87</sup>

### **Cost of Market Entry**

The overall cost of doing business in California is the sixth-highest in the nation, preceded only by Hawaii, New York, Alaska, Connecticut and Massachusetts according to a national study by the nonprofit organization Milken Institute.<sup>88</sup> This study includes costs for wages, taxes, electricity, and industrial and office rents.

New regulations imposed by the governor's environmental policies will likely pose some difficult challenges for small business owners already struggling to contain their carbon emissions. Employers are warily looking to the governor's efforts to revive his health care plan which would require business owners to provide health insurance for their

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<sup>82</sup> Tureck, et al, 20.

<sup>83</sup> "Schwarzenegger Proposes \$95 Million For Tech Initiative."

<sup>84</sup> "America's Best Colleges 2008." *US News and World Report*, 2007.

[http://colleges.usnews.rankingsandreviews.com/usnews/edu/college/rankings/rankindex\\_brief.php](http://colleges.usnews.rankingsandreviews.com/usnews/edu/college/rankings/rankindex_brief.php)

<sup>85</sup> Tureck, et al.

<sup>86</sup> The Institute for a Competitive Workforce. *Leaders and Laggards: A State by State Report Card on Educational Effectiveness*. US Chamber of Commerce, 2007.

<http://www.uschamber.com/icw/reportcard/default>

<sup>87</sup> US Chamber of Commerce.

<sup>88</sup> Milken Institute. 2007 Cost of Doing Business Index." December, 2006.

<http://www.milkeninstitute.org/pdf/2007CostofDoingBusiness.pdf>

employees<sup>89</sup>. While this plan is temporarily stalled in the legislative process, the governor has declared health care to be his new top priority and is likely to revive the issue in subsequent legislative sessions. Employers will likely look upon this plan as yet another restrictive regulation that ties their hands in the marketplace.

Unionization is also a concern for many companies looking to relocate to California. The proportion of workers represented by unions is especially high in California 15.7%<sup>90</sup>, making it one of the most highly unionized states in the country.

Finally, Californians are saddled with some of the highest utility rates in the country. The state, which struggled mightily with energy problems in the past, is ranked among the worst for gas and electric tax rates which will likely intimidate any business owner looking to establish a business in California.

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<sup>89</sup> Walters.

<sup>90</sup> “Department of Labor: Bureau of Labor Statistics.”