Little Hoover Commission

Public Hearing on State's Coordination of Economic Development Activities
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Remarks by Max Neiman
Senior Fellow, Public Policy Institute of California
500 Washington Street, Suite 600
San Francisco, CA 94115
e-mail: neiman@ppic.org
phone: 415-291-4441

Thank you for the privilege of appearing before you to discuss the complex and important topic of state economic development policies. My remarks today are based on my research experience, rather than as someone who has worked in the trenches delivering economic development programs. I do have some practical experience, having served for several years as a member of the City of Riverside Planning Commission, when economic development issues were often on the agenda. I do take the perspective of local government, which is the angle that guided most of my work. Even so, that still requires me to consider the role of state government, particularly in terms of the state-local link.

Please note that I am representing myself and my remarks and this material are mine alone, for which I am exclusively responsible. My current employer, the Public Policy Institute of California does not necessarily endorse anything I say today.

Some General Considerations First: You've asked participants to address a number of specific issues, and I'd like to preface those with some more general comments which I believe are critical and must be addressed and incorporated into policy discussions and policy action. These general concerns are related to some of the specific issues and questions raised.

- ***Economic progress results from the behavior of individuals; economic improvement is not the product of some "concept" like "prices."*** We need to "get real" about what happens when "economies" turn up or down or do things we find "good" or "bad." We can discuss it at greater length, but the point is that what we call economic development stems from human beings that exert labor, take risks, or consider the benefits or costs of alternatives.

  The physical result of these choices is what produces the array of outcomes by which we decide whether we are doing well or not concerning economic development. We often seem to talk about economic development as if somehow disembodied "economic forces" cause the economic development. My point is that the focus needs to be on how the structure of incentives affects different kinds of individuals in different sectors of the state's economy.

  I tend to avoid fixating on ideas like prices, rates of return, regulation, or taxes without concentrating on the need to figure out the link between desired behavioral outcomes and these "business climate" factors. Prices and costs are issues to the extent that they affect behavior. The hard part of the research is to estimate how much certain cost increases or declines affect economic development behaviors.

- ***Quality pays off in economic development. Quality has costs. Can there be too much quality? Yes. Can there be not enough quality? Yes.*** California will always be an above-average-cost-state. So the appropriate issue is how to judge when public policy is unnecessarily adding to costs. But the fact is that certain California attractions will always draw people and provide the state an edge. These include its natural attributes – oceans, climate, mountains, and other amenities. This attractiveness will be reflected in higher land and housing prices. Moreover, some of these amenities and other desirable state features are vulnerable to depletion or degradation and so the state's attractiveness necessarily requires some amount of regulation.

Other states with amenities of this sort find themselves compelled to do more regulating in the face of high levels of development. Moreover, complex, socially and economically diverse states will pose social and training challenges that will also be reflected in part in a larger public sector. California will not be able to compete as a "low cost" state, and the key question is not to have some panicked effort to lower costs, but rather to ensure that important, necessary regulation is implemented to minimize deleterious effects. Further, high value-added economic activity is accompanied invariably by high investments in human resources, namely education and workforce training and development.

In short, the high road to economic development is never cut-rate. Nevertheless, and very importantly, we must not use the fact that California will always be a place with above-average costs as an excuse to inflict unnecessary, awkward, and costly regulations or burdens on economic activity. We must always strive to expose and eliminate unnecessary costs and regulations.

- ***Which leads to the next general point – do we have a policy-useful definition of economic development that permits us to gauge how we are doing; in short, what, in measurable, operational terms, is economic development?*** Is doing better in California when it comes to economic development measured in terms of greater personal income, minimizing income inequality, attaining a greater share of patents in key sectors, higher rates of state domestic product, minimizing unemployment, maximizing home ownership, or maximizing the share of the nation's business openings?

  How do we assess the immigration and emigration of business? Is every business that expands outside of California or moves from the state an indication of there being something wrong? If not, then at what point would we see a business departure or failure to attract a business as a reflection of something being amiss? How do we know when businesses choose not to come to California? If we don't expect or want every business location decision to result in a move to California, then which ones do we get miffed about?

  Without a workable, guiding, operational concept of economic development objectives, it will be difficult to develop coherent policies that can be evaluated rigorously.

- ***Public actions are but one component in the cycle, pace, and substance of economic development.*** Of course public policies matter, although it is sometimes hard to measure how much. But let's not forget that the U.S. and California still operate largely in market systems, where the movement of private capital and the decisions of private sector actors here, throughout the nation, and in the rest of the world matter at least as much as and often more so than public actions. Yes, when times are tough, public sector actors are often blamed, and so it's understandable that government officials will claim credit when things go well. That's expected.

  But it is also true that much of what happens – good and bad – regarding personal income, gross domestic product, corporate profits, new businesses, business expansion, innovation, or downturns in all of the above are in the hands of private actors. This is important, because when things get bumpy, it is convenient for some of us to turn to the government to blame it for what's going on, no matter how much that blame is deserved.

Commission's Specific Questions:

1. ***"Where and what is the demand in California for economic development assistance?"*** Institutionally and in terms of where the demand derives, the short answer is from everywhere, involving everyone. For example, if one considers the important issues of workforce development and technical training, lots of cities and counties and virtually every community college district in the state might be involved.

   Addressing the workforce needs of California and how best to satisfy them with the best return to the state is an enormously critical, ubiquitous issue. When considering the immediate needs of businesses for labor, capital, and facilities, the range of business types and individuals involved is equally daunting, but should be a task best managed in the first instance by localities and regional bodies.

   This is already being done to an extent, with the regional economies and regional clusters work, although we need to be careful so as not to "typecast" regions and lock them into preconceived notions about what is possible (e.g., Riverside/San Bernardino is a logistics and warehousing and housing center or the Bay Area is where all high value-added activity occurs).

   Clearly the actors here are mainly private sector entrepreneurs, sometimes working in collaboration with local and regional bodies. Local governments – cities and counties or regional transportation bodies – are likely to be involved with regard to physical infrastructure. Answering this question would be a lot more efficient in the context of having a working, policy model of economic development. That would also permit the state to focus on agreed upon priorities, based on having a limited amount of resources to commit to economic development.

2. ***What is the difference between creating a healthy business climate and providing economic development assistance? How are these two issues related, and are agencies aligned to address these issues?*** I'll address the second question first. I don't believe that agencies are aligned with the mission of linking these two items. There are efforts to do this from time to time in the legislature and the executive branches. Moreover, AB 1721 in October, 2007 sought to accomplish some of this and I believe that the Business, Transportation and Housing Agency has attempted to coordinate much of the linkages between business climate and facilitating information regarding economic development assistance.

   In surveying the literature and examining places to determine whether there are such models that are appropriate for California, doesn't provide examples of such alignments at the state level suitable for a state the size of California. At the regional levels for particular economic sectors (e.g., bio-tech, film, transportation, and tourism) there do exist such entities, but not at the state level in places that have application for California.

   Texas has concentrated its efforts within the Governor's Office, where leadership has emanated for several administrations. The executive-centered approach has some attractive qualities, but depends on the individuals involved. New York State and Florida rely on a much more decentralized approach, focused on regional councils and local governments.

   As to the first part of the question, there is a conceptual difference between creating a healthy business climate and providing development assistance, but they are related, of course. The former relates to the host of quality of life and more concrete factors that shape the advantages of being in a particular place. Policies regarding the substance and implementation of policies on matters like taxing and spending, regulating, educating and training the workforce are important.

The issue of trade-offs between the burden and cost of regulation and taxes and economic development is very complex. Clearly the guiding principle is to regulate and tax in the most efficient way given the policy choices that are made. It is also important to know that while there might be some optimum balance among these things in theory, in the course of making actual policy it is more difficult to strike that sweet spot.

While California often scores high on the amenities side of the business climate side, increasingly there are concerns about whether the state can produce the needed workforce, whether its regulatory apparatus is too rigid or too costly, whether taxes are too high, or whether there are counter-productive labor-market policies (e.g., public sector prevailing wage questions).

These are issues fraught with considerable political baggage, however, and we require nonpartisan, objective evaluation in order to get a sense of what gains might result in return for reducing the costs of regulatory compliance or lowering tax burdens generally or with respect to specific economic gains (e.g., lower unemployment; more affordable housing).

On the other hand, infrastructure issues are critical as well, and insofar as shipping and transportation are critical to California's economic well-being, financing is critical. How infrastructure financing is accomplished in a fiscally constrained environment is a major challenge for the business climate

3. ***"Is California best served by a single voice for promoting economic development?"*** If this refers to a focal point for the general policy area, absolutely. On the other hand, locating the voice and restricting the number of voices in a state like California is problematic. As a result, there needs to be a fair amount of interplay between state and local-regional bodies. Local governments, for example, do a lot in the economic development arena, and having an on-going sense of how active these local and regional bodies are and what they are doing is critical, particularly since it makes sense for California to build on what it is that the local governments are doing, which extends substantially beyond the traditional redevelopment core.

4. ***"Is California's current governance structure for economic development sufficient to evaluate ongoing programs for effectiveness or elimination?"*** Promoting economic development occurs on a very broad front, focused on a variety of points in the process. Workforce development and education and training programs are sometimes difficult to evaluate strictly as economic development programs.

   On the other hand, identifiable programs with high costs should be assessed according to certain performance indicators, and it would be useful to have legislation authorizing such programs to include evaluation requirements. This is not so much a question of governance structure, as it is simply requiring evaluation to occur. Evaluations should be done in an objective and non-partisan manner.

5. ***"What are the hallmarks or best practices of successful economic development activities (i.e., programs, money, leadership, local tie-ins, marketing)?"*** I have not made an extensive study of comparative economic development programs with a view to assessing which are deemed successes and what the traits of successful programs are. Programs that are touted by the

clients of economic development programs, including business and labor, often include such process qualities as customer friendliness and high quality, accessible information.

Customer friendliness refers to timeliness and a capacity to minimize the cost of processing requests and projects, whether it involves one-stop permitting or having well-trained and knowledgeable personnel. Accessible information refers to being able to identify appropriate locations that might serve as sites for a particular project, including site certification programs, where government provides information about "shovel-ready" sites for particular kinds of development.

Certainty and consistency of outcomes also seem to be important features, which mean that clients of economic development projects will not have to fear that a deal that went according to the rules will unravel because of unexpected or unanticipated opposition in a community. In short, uncertainty and political capriciousness have very bad consequences and should be actively discouraged.

6. ***"What barriers to local economic development have you identified in your research? What recommendations have you developed to address these issues?"*** My recent work on local economic development has developed a detailed discussion of barriers that are reported by local economic development officials. These are listed and elaborated upon on pp. 22-30 of the report that I've attached to this written testimony (Report available for free download at: http://www.ppic.org/main/publication.asp?i=787).

   I focused on what the localities consider to be important in their communities. Of course, there are some general criticisms that localities have about state, such as certain features of prevailing wage policies, lack of consistent and clear sources of information on state programs, lack of funding for state programs, and the inconsistency between state programs in such areas as environmental protection and economic development.

   Perhaps the most frequently voiced criticism of the state vis-à-vis local economic development was the creation of a state-local finance system that encourages inter-jurisdictional competition for tax base, the so-called "fiscalization" of land use.

   As for problems of a more localized nature, the top five that I have reported on include (a) lack of affordable housing, (b) inadequate transportation infrastructure, (c) shortage of land for industrial development , (d) shortage of land for retail, commercial development, (e) shortage of land for retail, commercial development, and (f) opposition from residents.

   In a sense a number of these "local" issues reflect the state's fiscal system. The fact is that localities simply don't gain much from doing more broad-based economic development. When asked about priorities, my research indicates that job development, for example, is generally a much lower priority than is enhancing the local tax base.

   Unless the state provides greater benefits to localities that provide a broader mix of economic development programs that includes housing and job development, for example, localities will do things that are biased towards retail development.

   It is worth pointing out that among other important local barriers cited were energy costs, lack of required workforce with needed skills, traffic congestion, restrictive local land use and environmental regulations, inadequate K-12 schools, and high local fees. A number of these, by the way, also reflect local fiscal constraints.

Clearly local governments strapped for cash and finding it difficult to raise taxes are more dependent on fees and user charges, which increase the cost of doing economic development projects.

State policies to mitigate some of these barriers are obvious, but are sometimes expensive and occasionally politically risky. Mitigating the fiscal competition among cities and balancing the current bias to retail have well known remedies, but the barriers to adopting such reforms are political. Some localities believe they benefit from the current system, and these tend to resist changes.

My own recommendation is that while the state has tried to "discipline" localities for the most egregious examples "poaching" economic development, it is more productive to focus on incentives and grants to encourage desired local conduct than trying to regulate away undesired conduct.

7. ***"Does the existing structure accommodate changes in the composition of the state's economic activities that may demand new approaches or new programs?"*** I believe that the decentralized structure within which the economic development activities of the state occur is a "good" thing. Cities, counties, regional bodies, and public-private economic development corporations have developed a very sophisticated and effective communications network. These local and regional bodies are also a source of considerable innovation and sharing of ideas and best practices.

   Moreover, the state's own fairly fluid economic development structure, even while perhaps focused in the Business, Transportation, and Housing Agency is also nimble. The key problem really doesn't appear to be structure, as much as it is a question of political will or overcoming fundamental philosophical barriers, say over such issues as the link between economic development, regulation, taxes and quality of life.