

COLLEGE of
CHARLESTON

SCHOOL OF BUSINESS



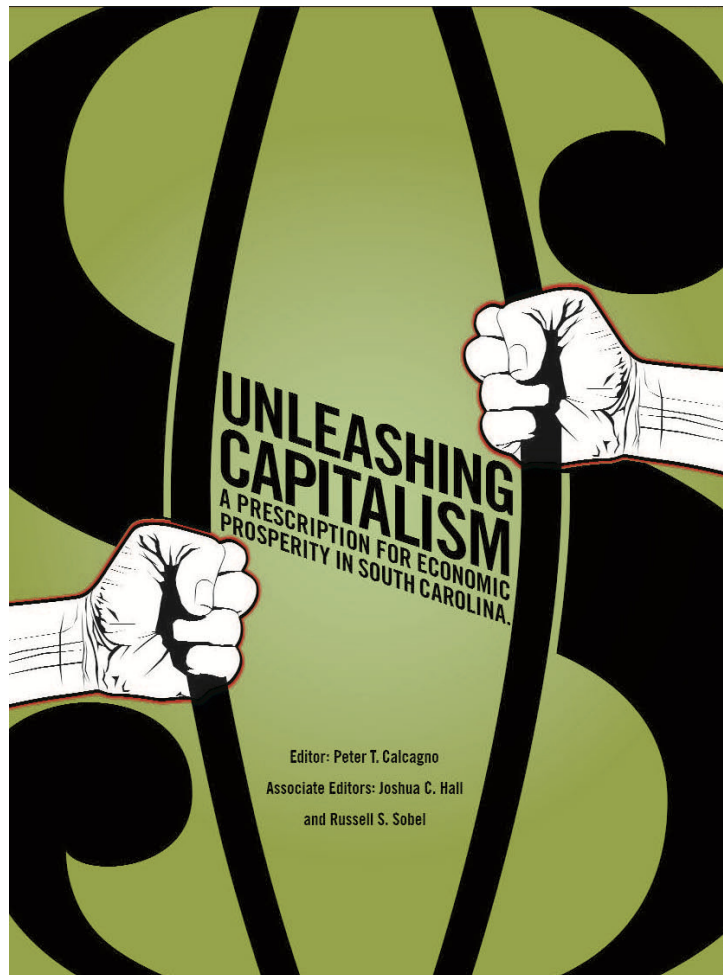
South Carolina's Economic Policy and How it Can be Reformed to Better Create Economic Growth in the State



Russell S. Sobel

School of Business, College of Charleston

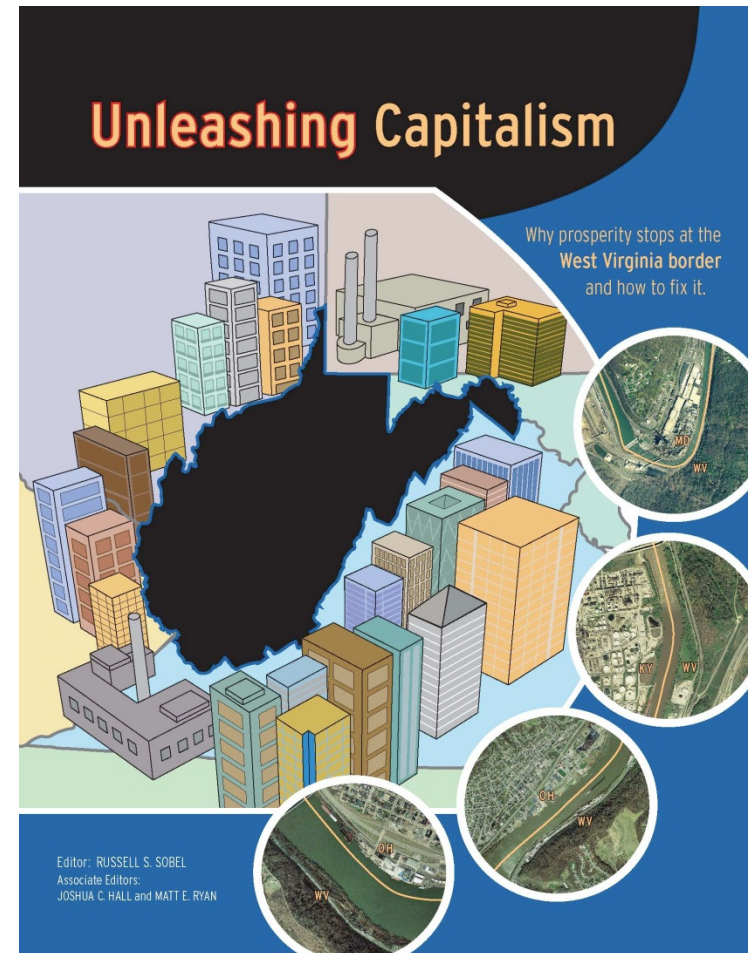
Today's Talk is Based On:



SC Version Released 2009

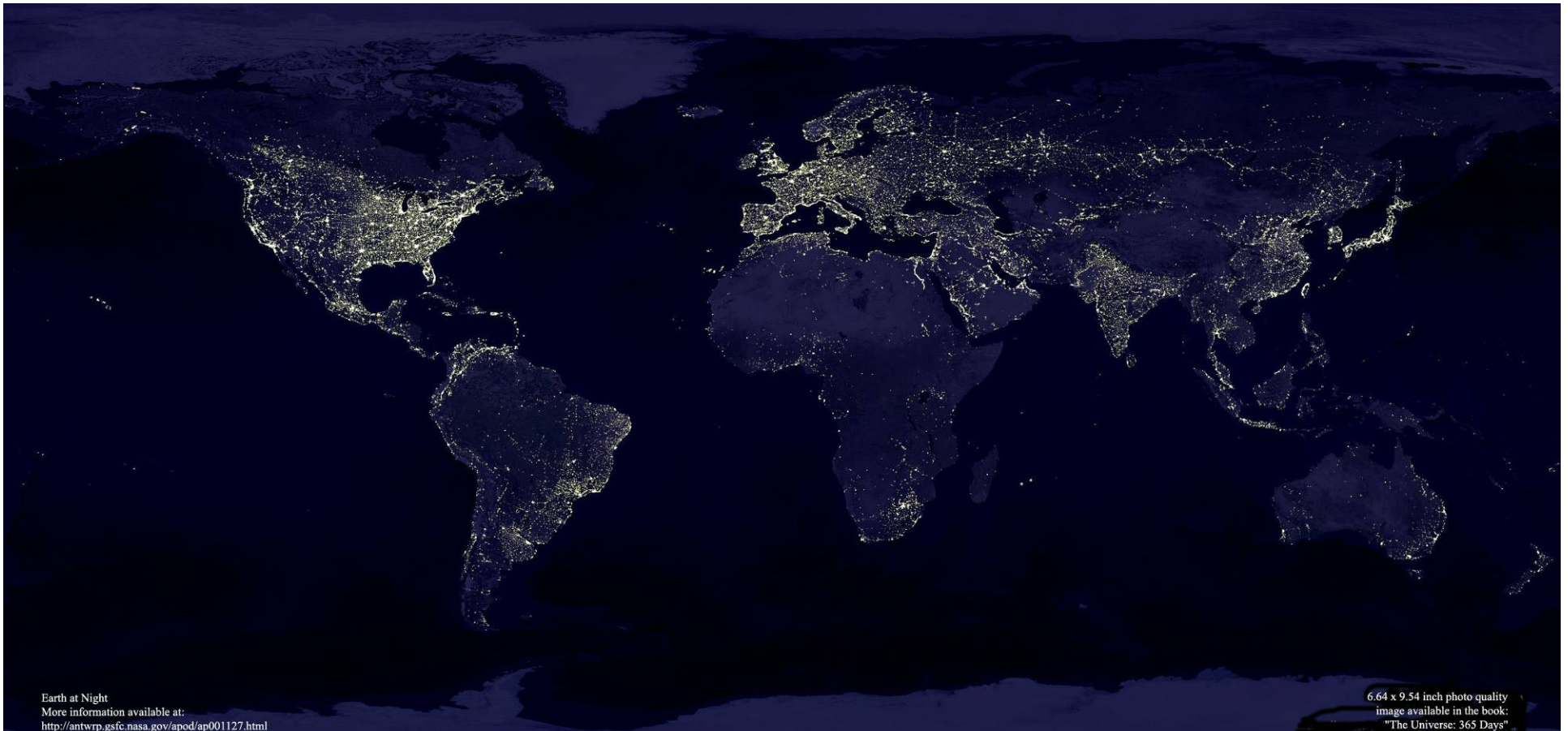
SC
PC

SOUTH CAROLINA
POLICY COUNCIL



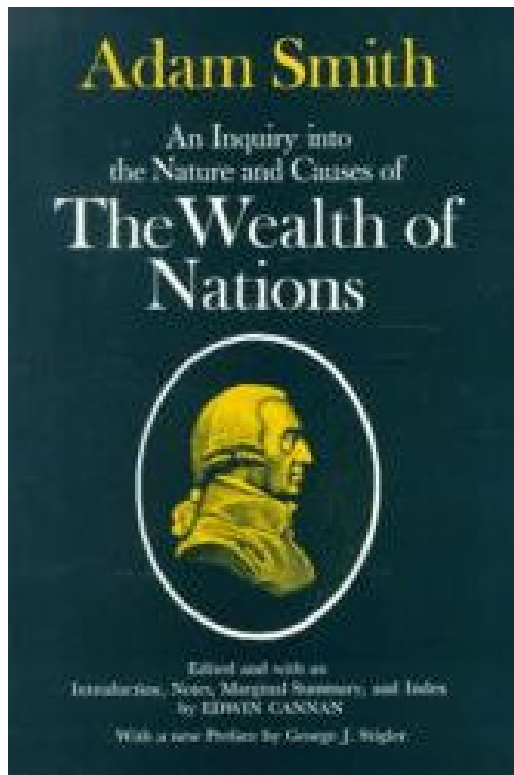
WV Version Released 2007 (winner of 2008
Sir Antony Fisher Award & 5,000 copies sold)

What Explains Prosperity?



Is it Resources? Location? Democracy? Or

Adam Smith's Question: Why Are Some Countries Rich and Others Poor?



An Inquiry into the Nature and Causes of the Wealth of Nations (1776)

Policies and the system of economic organization (e.g., capitalism) matter more for prosperity than things such as resources, geography, education, etc.

Rankings of Reliance on Capitalism

The key ingredients of economic freedom are personal choice, voluntary exchange, freedom to compete, and the protection of persons and property. Economic freedom creates an environment in which personal ingenuity can flourish.

A special chapter by William Easterly of New York University compares the impact of economic freedom with that of foreign aid, the old nostrum for creating economic well-being in the developing world. He shows that foreign aid is ineffective, but he has extremely good news for poorer countries. They can lift themselves from poverty on their own, without depending on uncertain and often politically motivated outside "help."

Dr. Easterly shows that economic freedom is a powerful tonic for growth. Quite literally, poorer nations only need liberate their people from policies that limit economic freedom. The unleashed dynamism and ingenuity will build prosperity and reduce poverty in a way that foreign aid has repeatedly failed to achieve.

The *Economic Freedom of the World* provides the most comprehensive index of economic freedom available. It uses reproducible measures appropriate for peer-reviewed research. Approximately 200 scholarly articles have employed the index.

The full data-set, including all of the data published in this report, can be freely downloaded at www.freetheworld.com

Economic Freedom of the World:
2006 Annual Report
Printed and bound in Canada

Economic Freedom of the World 2006 Annual Report James Gwartney & Robert Lawson with William Easterly

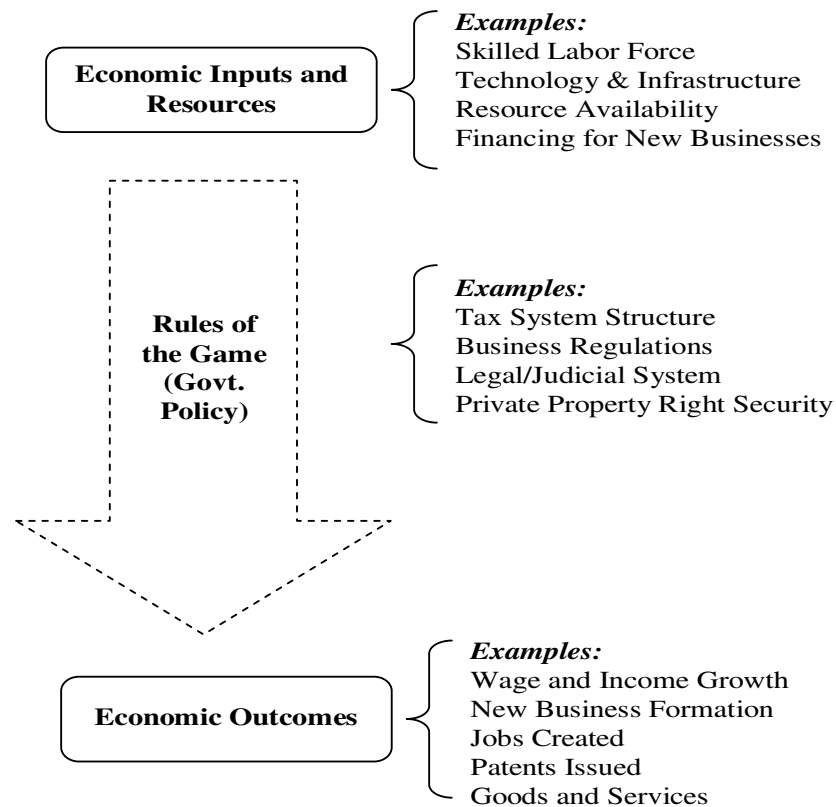
Economic Freedom of the World 2006 Annual Report

James Gwartney and Robert Lawson with William Easterly
with a Dedication to Sir John Cowperthwaite

Alaska: Alaska Center for Economic Research (ACER) • Argentina: Fundación Libertad • Australia: Institute of Public Affairs • Austria: IFO • Azerbaijan: Center for Economic and Political Research • Bahrain: The Heritage Institute • Bangladesh: Making Our Economy Right (MOER) • Belarus: Scientific Research House Center • Belgium: Centre for the New Europe • Bolivia: Fundación Libertad y Democracia (FLAD) • Brazil: Instituto Liberal do Rio de Janeiro • Bulgaria: Institute for Market Economics • Cambodia: Centre for the Study of Democracy and Policy • Canada: The Fraser Institute • Chile: Instituto Libertad y Desarrollo • Colombia: Instituto Libertad y Progreso (ILP) • Costa Rica: Instituto para la Libertad y el Análisis de Políticas • Croatia: The Institute of Economics • Czech Republic: Libertas Institut • Denmark: Center for Policy Studies • Dominican Republic: Fundación Económica y Desarrollo • Ecuador: Instituto Ecuatoriano de Economía Política • Estonia: International University Co-operative Academic • France: Association pour la Liberté Économique et le Progrès Social (ALPES) • Georgia: Society for Open Society Economic Knowledge New Economic School • Germany: Humboldt Institut • Ghana: The Institute of Economic Affairs • Guatemala: Centro de Investigaciones Económicas y Sociales • Haiti: Institut de Recherche pour la Liberté Économique et le Progrès Social (IRLPS) • Hong Kong: Hong Kong Center for Economic Research • Hungary: The Heritage Foundation • Iceland: Center for Social and Economic Research (CSER) • India: Center for Policy Studies • Indonesia: The Institute for Development of Economics and Statistics • Ireland: Open the public Institute • Israel: Institute for Advanced Studies and Political Studies • Italy: Centro Studi • Ivory Coast: Bureau d'Analyse d'Économie et de Politique (BAEP) • Kenya: Africa Research Center for Public Policy and Market Process • South Korea: Center for Free Enterprise • Kyrgyz Republic: Economic Policy Institute • Lithuania: Lithuanian Free Market Institute • Luxembourg: Luxembourg Center • Mexico: Centro de Investigación para el Desarrollo A.C. • Mongolia: Open Society Forum • Mozambique: The Center for Entrepreneurship and Economic Development • New Zealand: The New Zealand Business Roundtable • Nigeria: Institute of Public Policy Analysis • Norway: Center for Business and Society Incorporated (CBS) • Oman: International Research Foundation (IRF) • Pakistan: Alternative Solutions Institute • Panama: Fundación Libertad • Peru: Centro de Investigación y Estudios Sociales (CIES) • Philippines: The Center for Research and Communication • Poland: Centrum im. Adama Smitha • Portugal: Casa Liberal • Romania: Romanian Think Tank • Russia: Institute of Economic Analysis • Serbia: Free Market Center (FMC) • Slovak Republic: The EAF, EAF Foundation • South Africa: The Free Market Foundation of Southern Africa • Sri Lanka: The Pathfinder Foundation • Sweden: The Heritage Foundation • Switzerland: Swiss Institute • Switzerland: The Heritage Foundation • Taiwan: The Heritage Foundation • Thailand: The Heritage Foundation • Turkey: The Heritage Foundation • Ukraine: The Heritage Foundation • United Kingdom: The Heritage Foundation • United States: The Heritage Foundation • USA: The Heritage Foundation • Venezuela: The Center for the Study of Economic Freedom (CSEF) • Vietnam: Research Center for Entrepreneurship and Development Policy • Zambia: Zambia Institute for Public Policy Analysis (ZIPP)

Growth is a function of “inputs” AND “institutions”

Figure 2.1: Inputs, Institutions, and Outcomes



Source: Hall and Sobel (2006).



Spending to increase
“inputs” won’t work unless
the “oven” is turned on

Route 50 in West Virginia



North Korea vs. South Korea



**Per Capita
Income
= \$1,800**

**Per Capita
Income
= \$24,200**

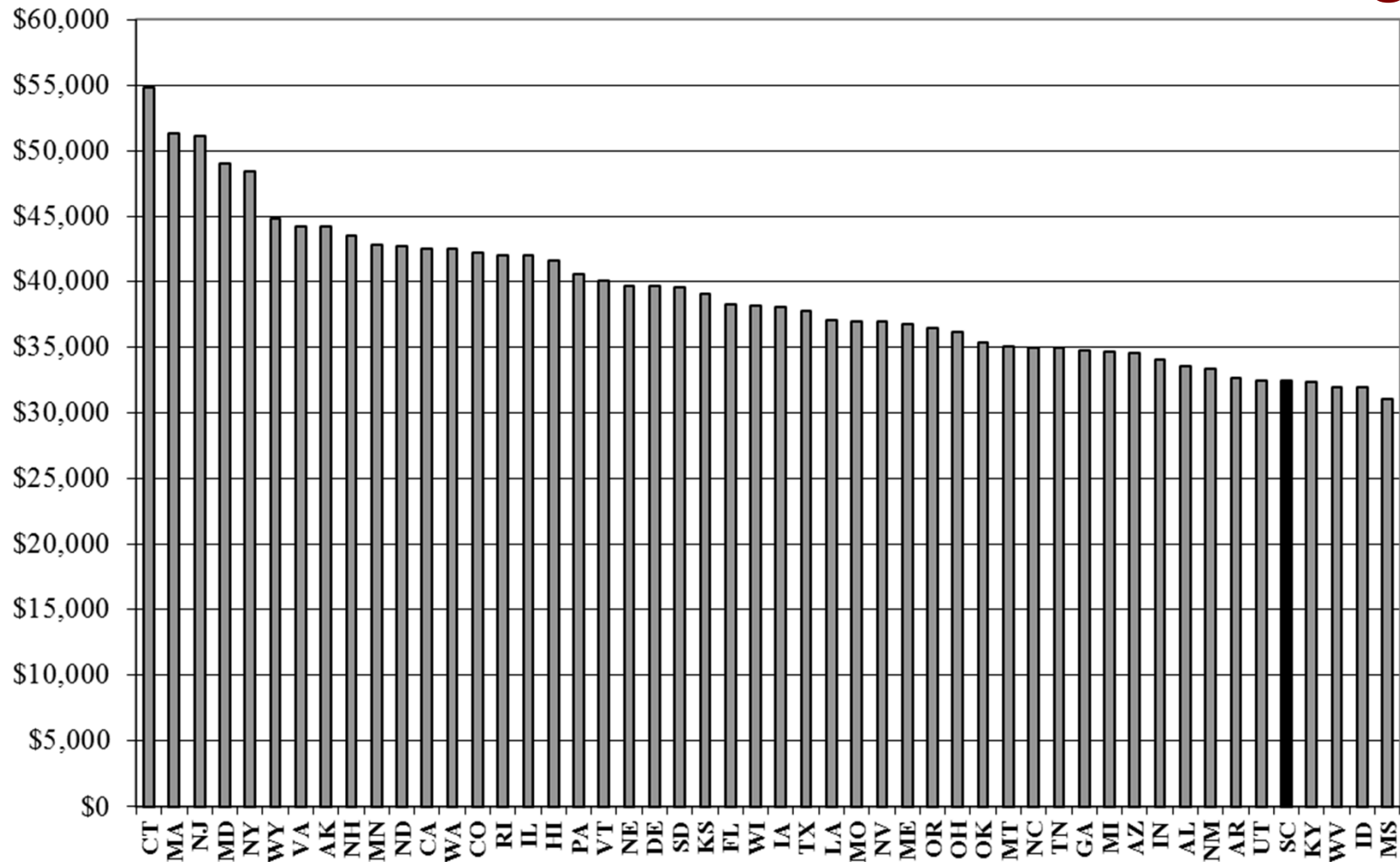
States also Differ in Reliance on Capitalism



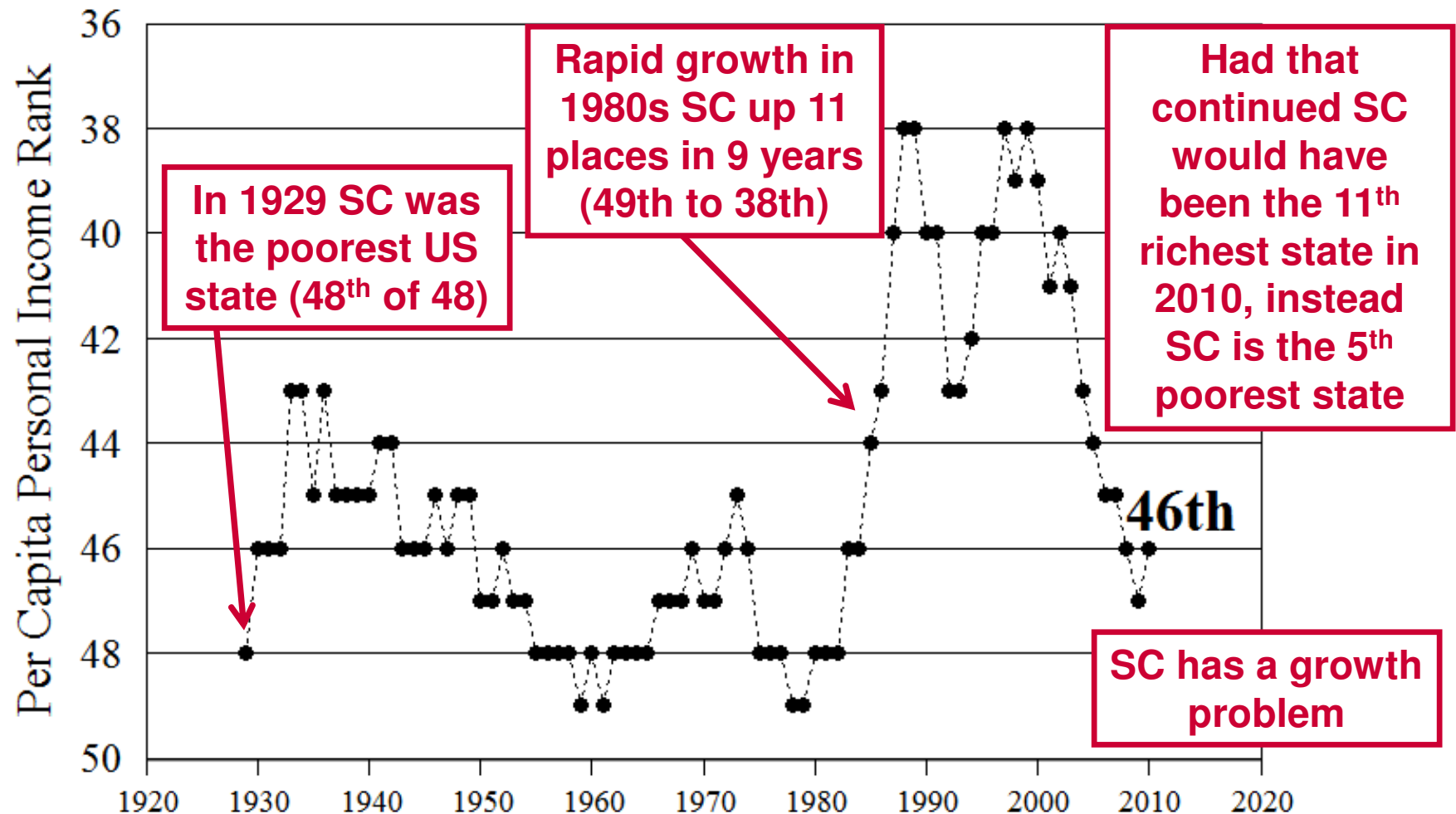
South Carolina
Ranks 43rd in
Capitalism

West Virginia
Ranks 50th in
Capitalism

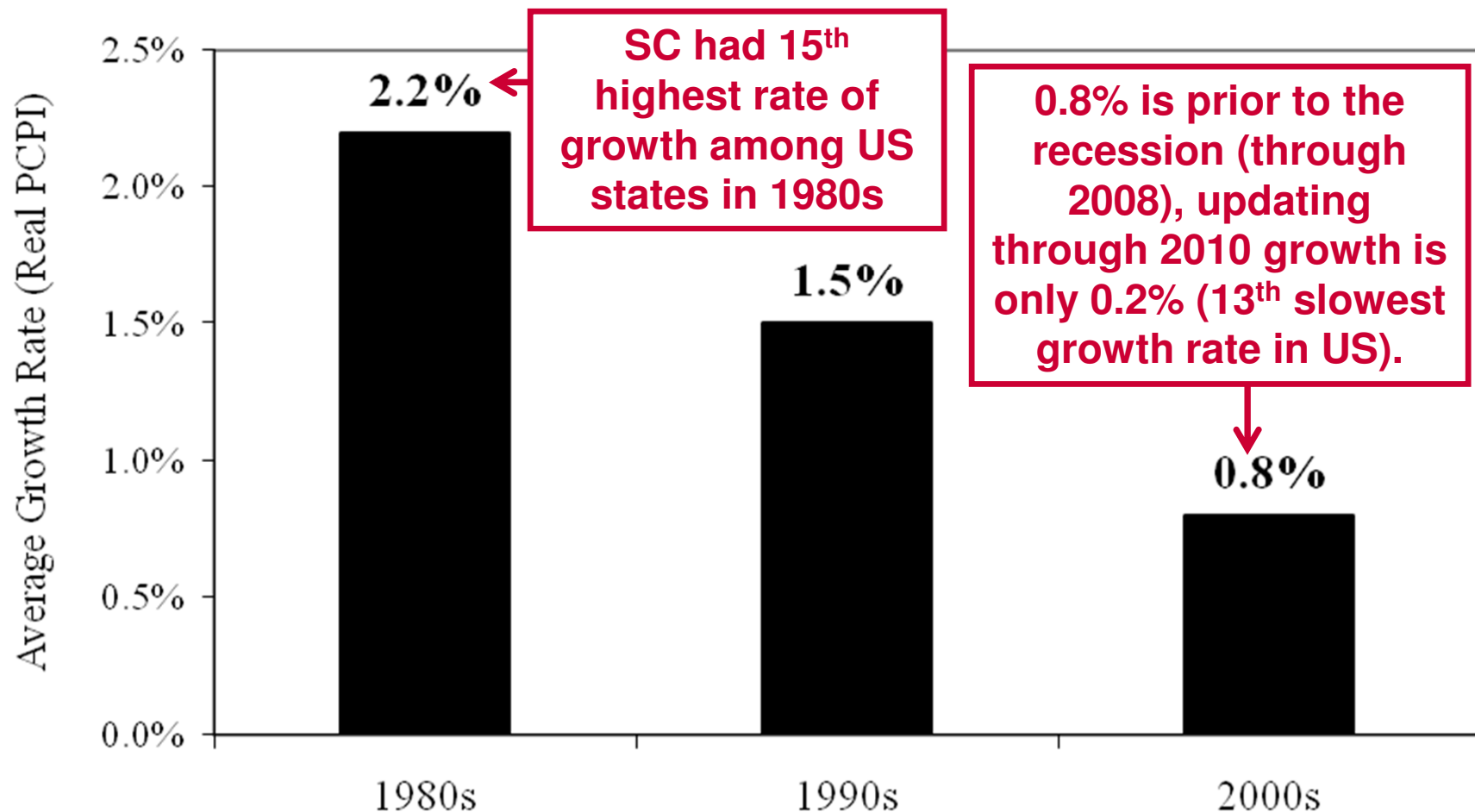
SC's PCPI: Rank 46th – 81% of U.S. Average



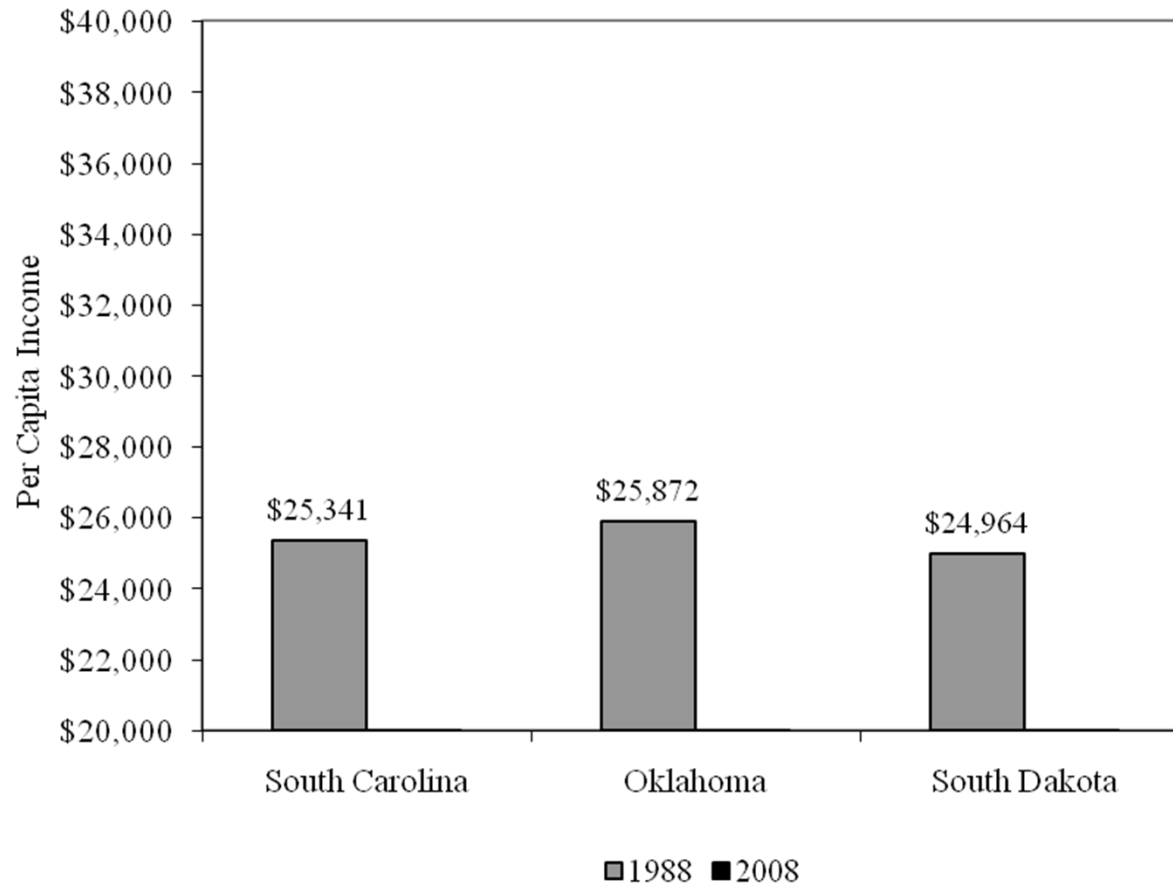
South Carolina's Rank Among States



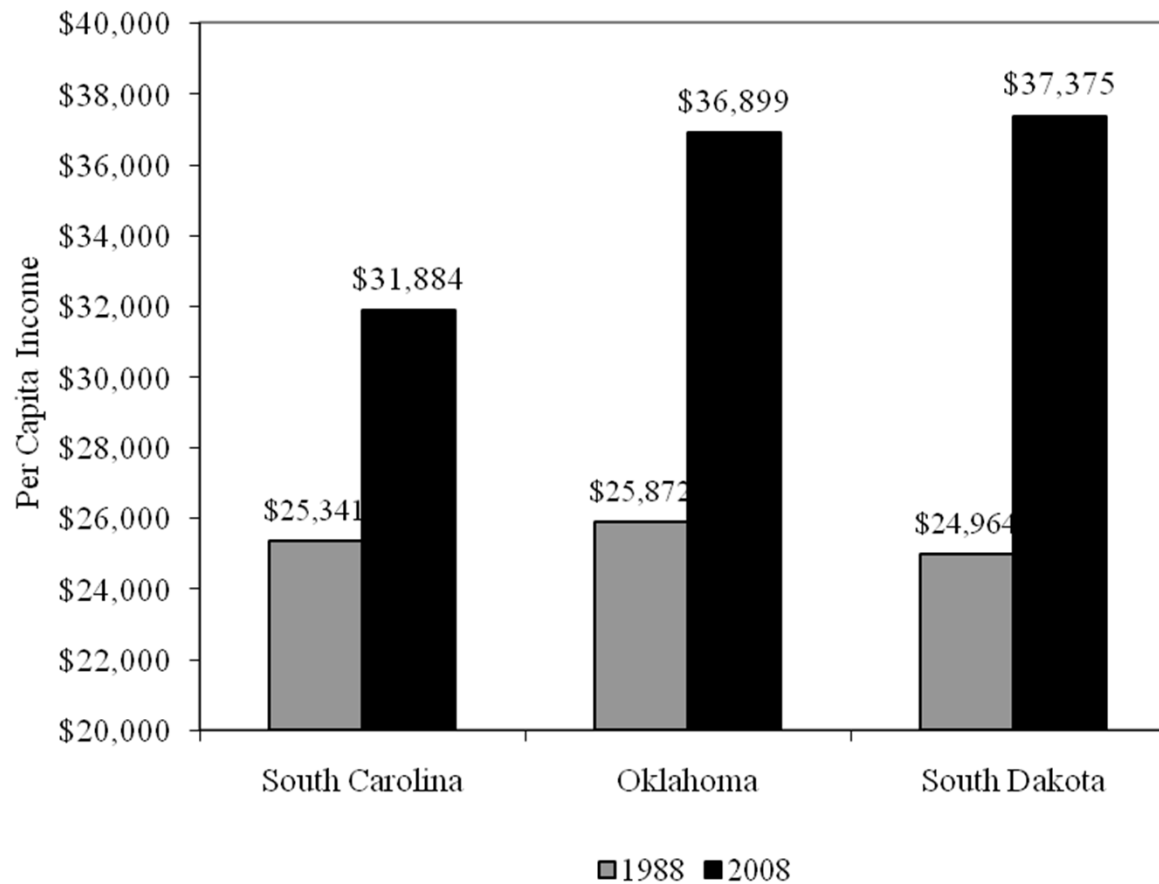
South Carolina's Declining Rate of Growth



South Carolina is Falling Behind



South Carolina is Falling Behind



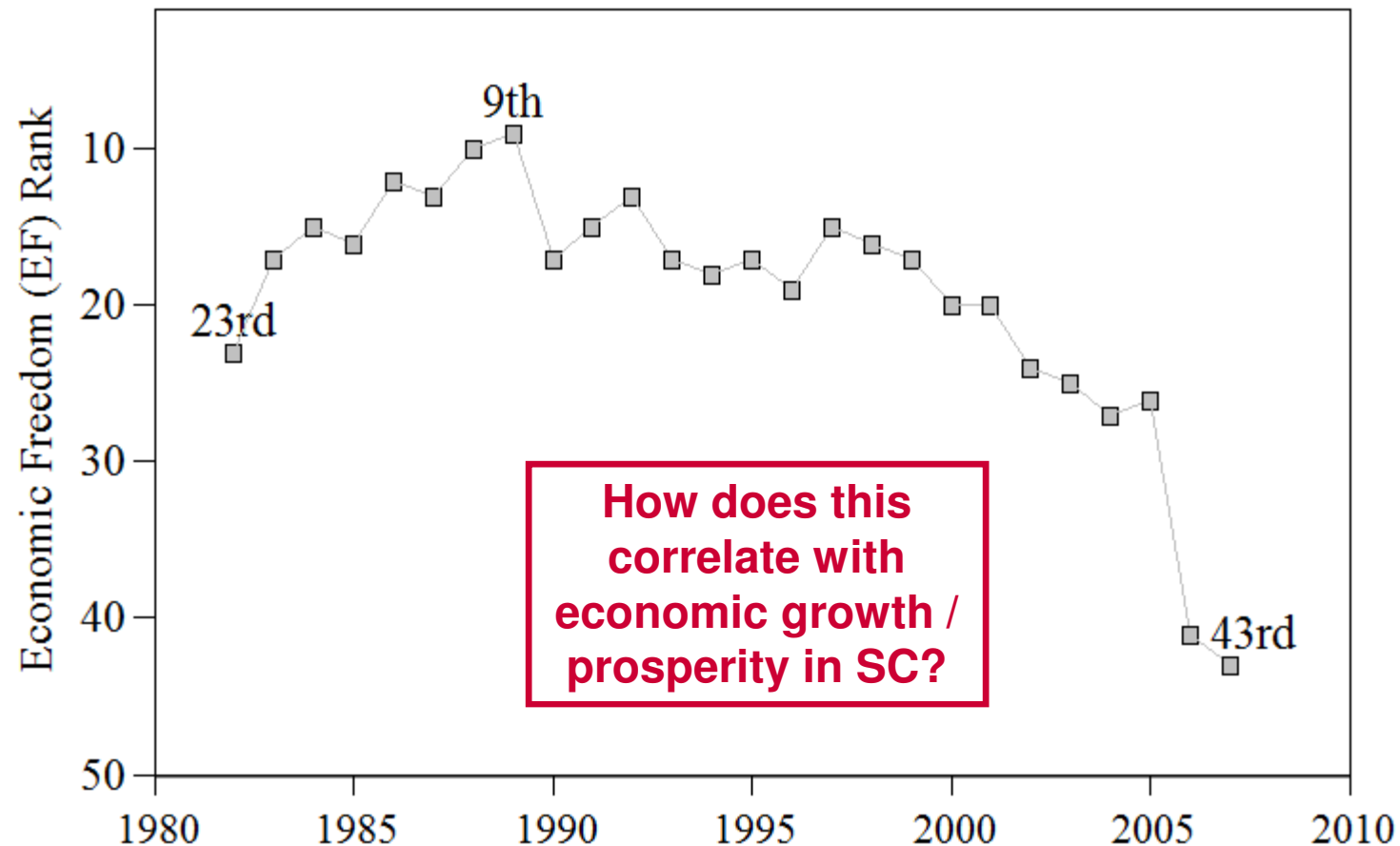
Growth Rates: SC = 1.2% OK = 1.8% SD = 2.1%

Does “Bad” Policy Explain This? South Carolina’s Business Climate Rankings:

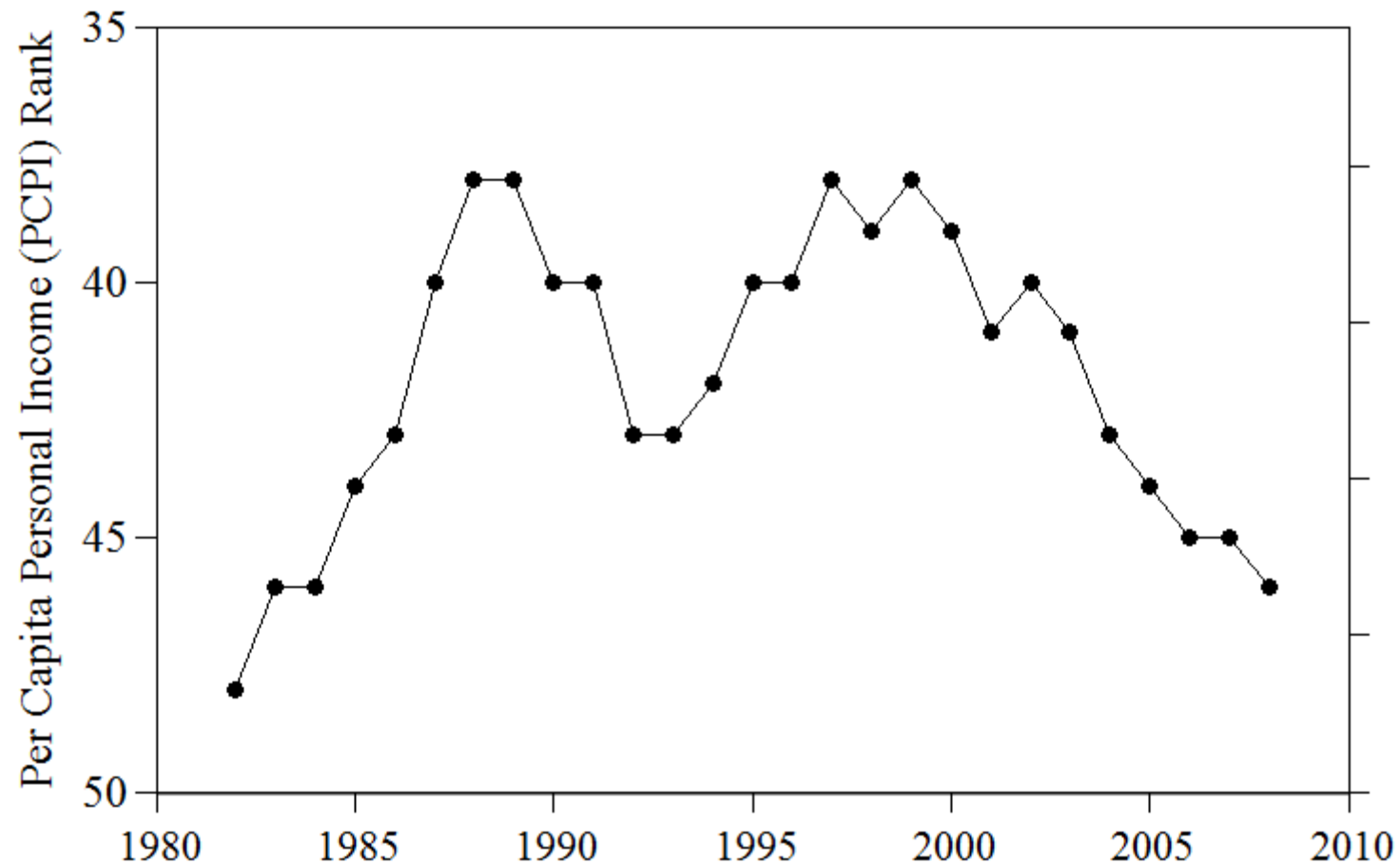
24 th	Tax Foundation’s State Business Tax Climate Index (2011)
43 rd	Fraser Institute’s Economic Freedom of North America (2010)
27 th	Directorship Magazine’s Boardroom Guide to the Best States for Business (2009)
37 th	CNBC’s America’s Top States for Business (2011)
40 th	Corporation for Enterprise Development (CFED) Development Capacity Index (2007)
39 th	Progressive Policy Institute’s (PPI) New Economy Index (2010)
42 nd	Beacon Hill Institute’s State Competitiveness Report (2010)
43 rd	Milken Institute’s National State Technology & Science Index (2010)
39 th	Institute for Legal Reform (ILR)/Harris State Liability Systems Ranking Study (2010)
14 th	Pacific Research Institute's U.S. Tort Liability Index (2010)
28 th	Forbes Best States for Business (2011)

- SC scores lower than NC on 10 of the 11 indices & lower than GA on 8 of the 11 indices
- Both GA and NC rank in the top 5 of the Economic Freedom Index (they are tied for 3rd)

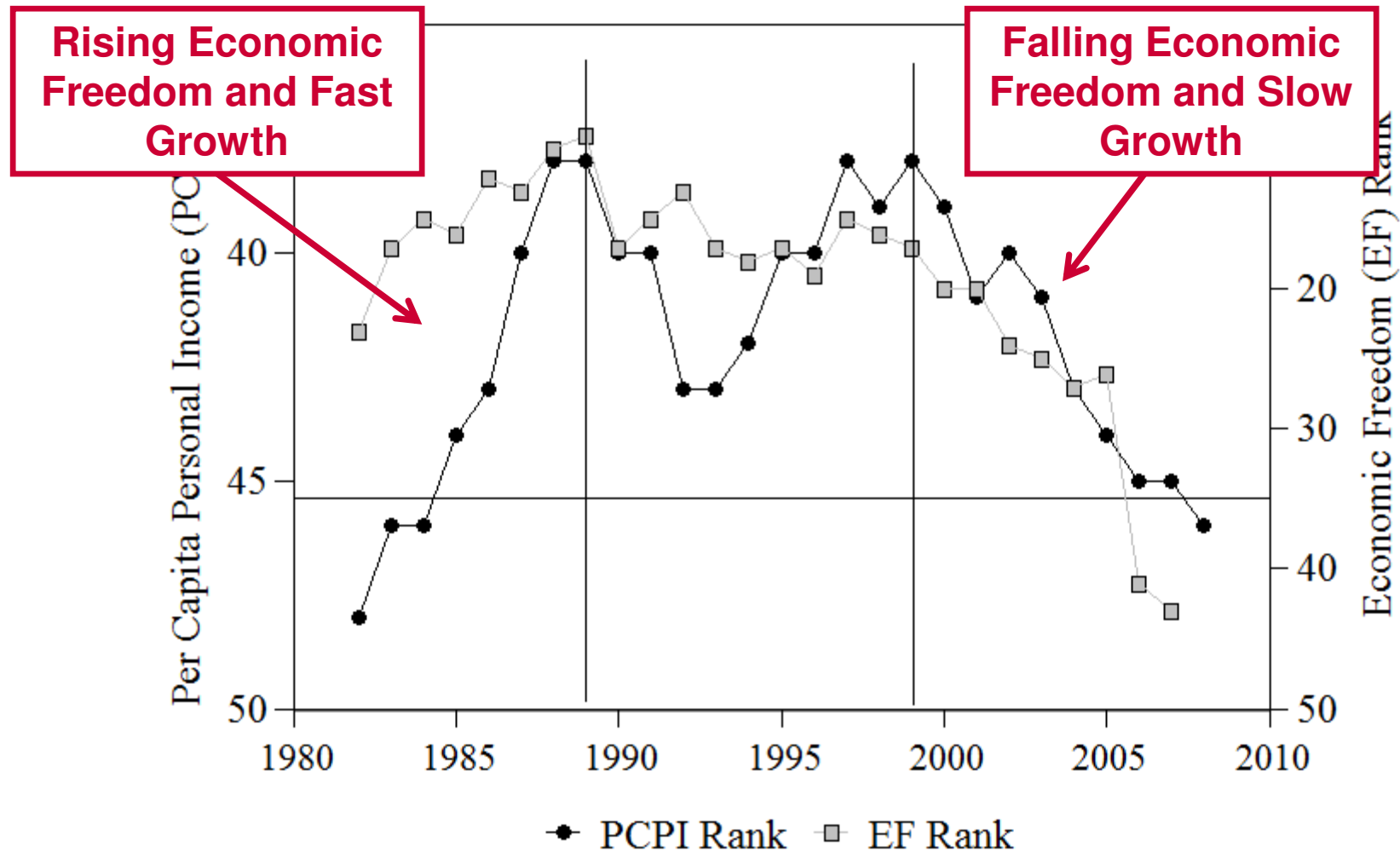
SC's Economic Freedom History



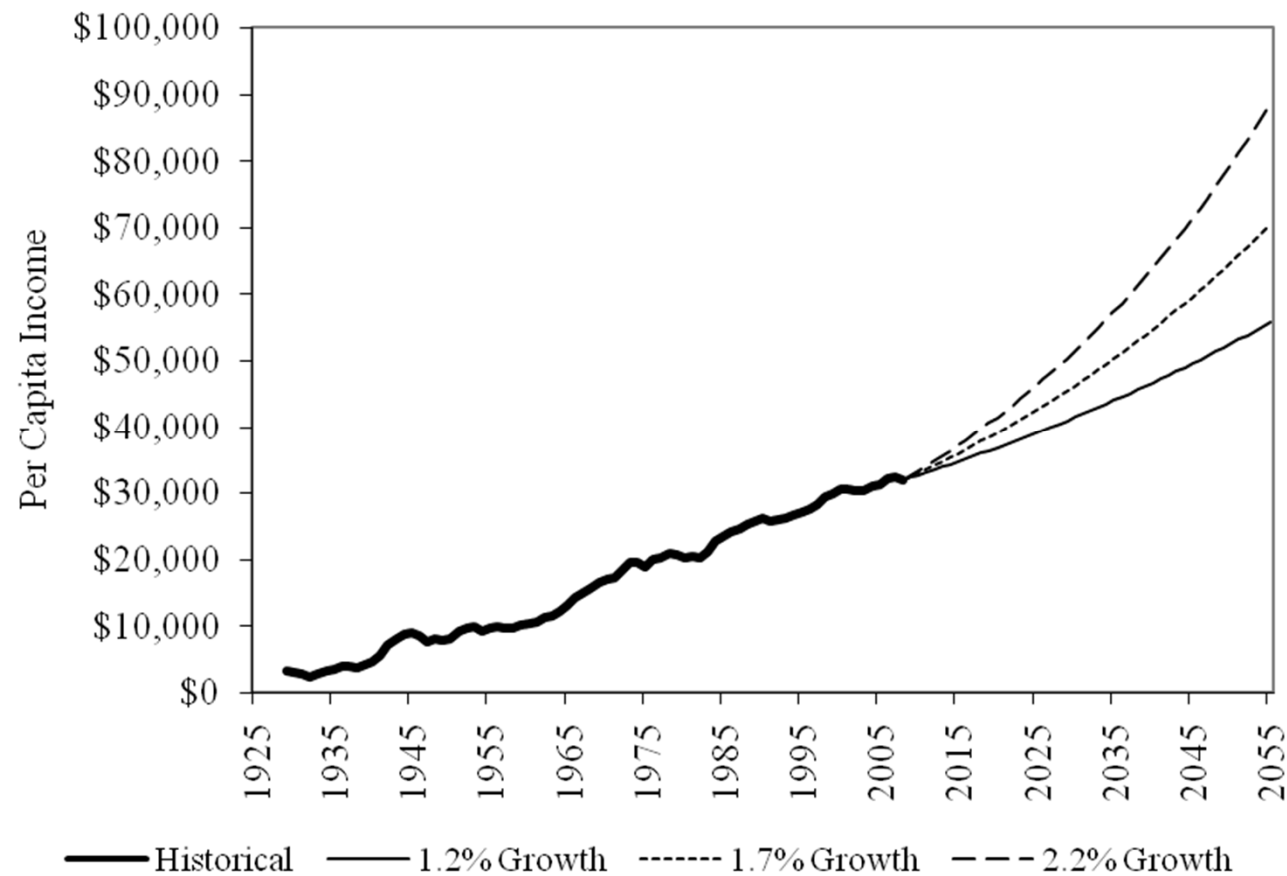
SC's Recent Prosperity (PCPI) Rank



Economic Freedom vs. Growth



Which Future for South Carolina?



1980s growth rate

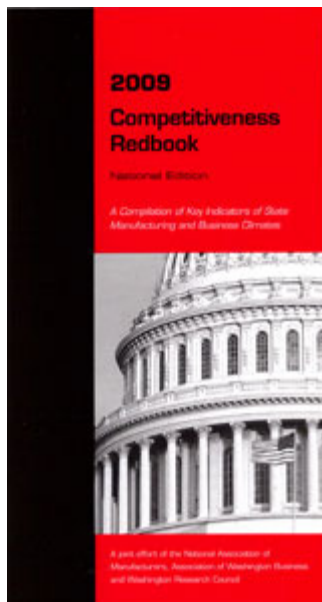
To grow, South Carolina needs to enact policy reforms to improve economic freedom

How can policy be reformed to better embrace economic freedom and promote long-run economic growth?

1. Lower Taxes on Productive Activities

Examples:

Taxes on Capital Investment



National Association of Manufacturers
2009 Competitiveness Redbook

SC has the highest effective property
tax rate on manufacturers in the US

SC = \$1,864,900 (highest in the US)

GA = \$760,381 (about 1/2 of SC)

NC = \$491,071 (about 1/4 of SC)

Firm with \$25m assets (\$12.5m machinery & equip., \$10m inventory, \$2.5m fixtures)

South Carolina's Personal Income Tax

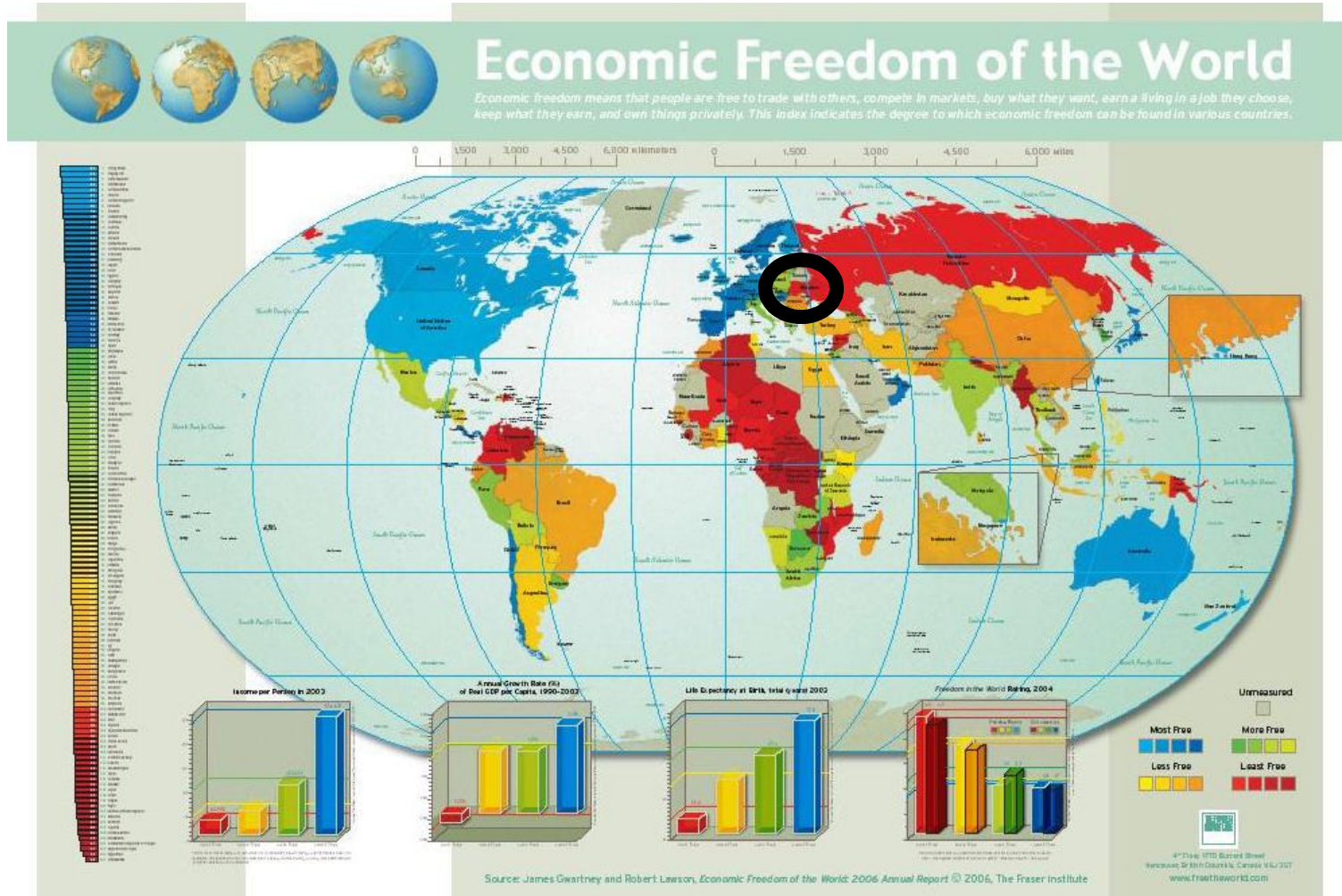
1959 Tax Brackets (start at)		2011 Tax Brackets (start at)		1959 Brackets Adjusted for Inflation
\$0	2.5%	\$0	0%	\$0
\$2,000	3%	\$2,760	3%	\$15,464
\$4,000	4%	\$5,520	4%	\$30,928
\$6,000	5%	\$8,280	5%	\$46,392
\$8,000	6%	\$11,040	6%	\$61,856
\$10,000	7%	\$13,800	7%	\$77,320

- In 1959 SC median family income = \$3,821 so in 3% bracket.
- Almost all SC taxpayers are now in the top tax bracket due to inflation.
 - Median family income now \$53,850 so in the top 7% bracket.
 - Virtually only state where a family in poverty would be in top tax bracket.
- If adjusted for inflation, average family would be in 5% bracket.
- Essentially SC has highest flat-rate income tax in US (others 3% - 5%).
- Most other state's top brackets begin around \$80,000.

2. Discourage “Unproductive” Uses of Resources

- “Crony Capitalism” is when business winners and losers are determined by political connections rather than private market forces
 - The Case of Serious Materials
- Baumol’s Theory of Productive and Unproductive Entrepreneurship
 - “Too Many Lobbyists & Lawyers and Too Few Scientists and Engineers”
 - SC Ranks: 19th in Unproductive Entrepreneurship and only 29th in Productive Entrepreneurship
- Examples:
 - Quit Playing Favorites: Avoid targeted taxes, credits, & subsidies - they encourage lobbying
 - Eliminate Targeted Tax Credits & Subsidies in Favor of Broad Based Tax Cuts
 - Enact legal reforms that reduce the reward to lawsuit abuse
- Bad policies lead creative people to invest their talents unproductively & limit their ability to create wealth

The Case of Romania



The Case of Romania



The Case of Romania



The Case of Romania



The Case of Romania



3. Rely on Entrepreneurial Discovery, Not “Central Planning,” to Guide the State Economy

- An economy undergoes continuous change – some industries fail, others are born (“Creative Destruction”)
- Entrepreneurs search for new combinations of resources
- Capitalism critically relies on entrepreneurship and the profit and loss system to direct this process
- Policy makers often say things like “it’s a shame half of all new businesses fail in their first year, we need to do something about this”
- A state’s economic future cannot be centrally planned or directed effectively - it must be discovered by a state’s citizens within the marketplace

The Reason ...Because Nobody Knows

Ken Olson, chairman/founder of Digital Equipment Corp., 1977:

"There is no reason anyone would want a computer in their home."

Fred Smith's (FedEx) Yale University Senior Project Grade Remark:

"The concept is interesting and well-formed, but in order to earn better than a 'C,' the idea must be feasible."

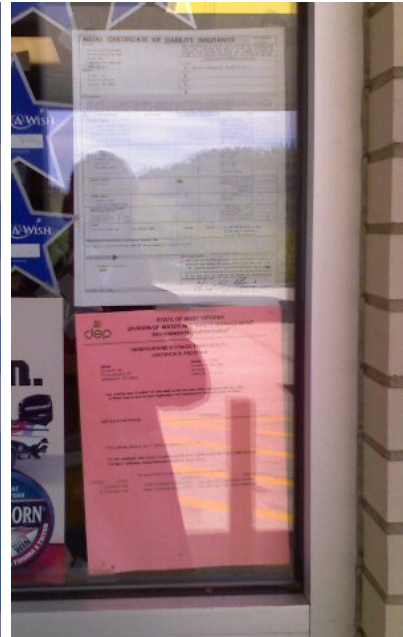
Would You Have Invested?

Microsoft Corporation, 1978

**Governments can't PLAN this ...
but the way they can PROMOTE
it is by staying out of the way of
these crazy individuals**



Barriers to Entrepreneurship



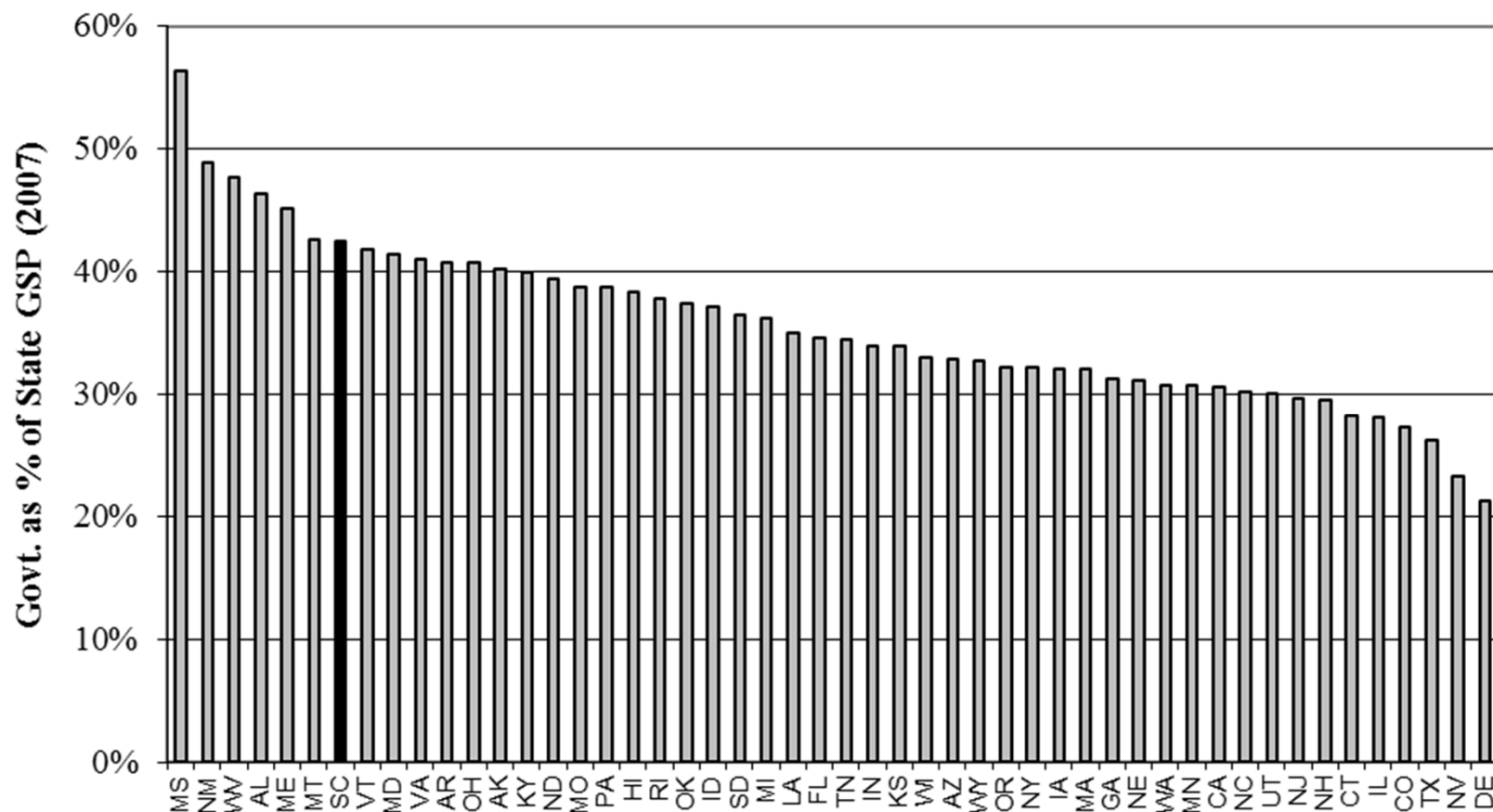
- Secondary effects / Unintended consequences of regulation
- Gives advantage to big national firms over small businesses
- No natural profit/loss mechanism to get bad regulations repealed
- Regulations should be subject to **cost-benefit analysis** and include **sunset provisions** based on proof of effectiveness

4. Reduce Government Size, Growth, and Centralization

- Increase the share of the economy's resources available to private entrepreneurs by reducing the size of government

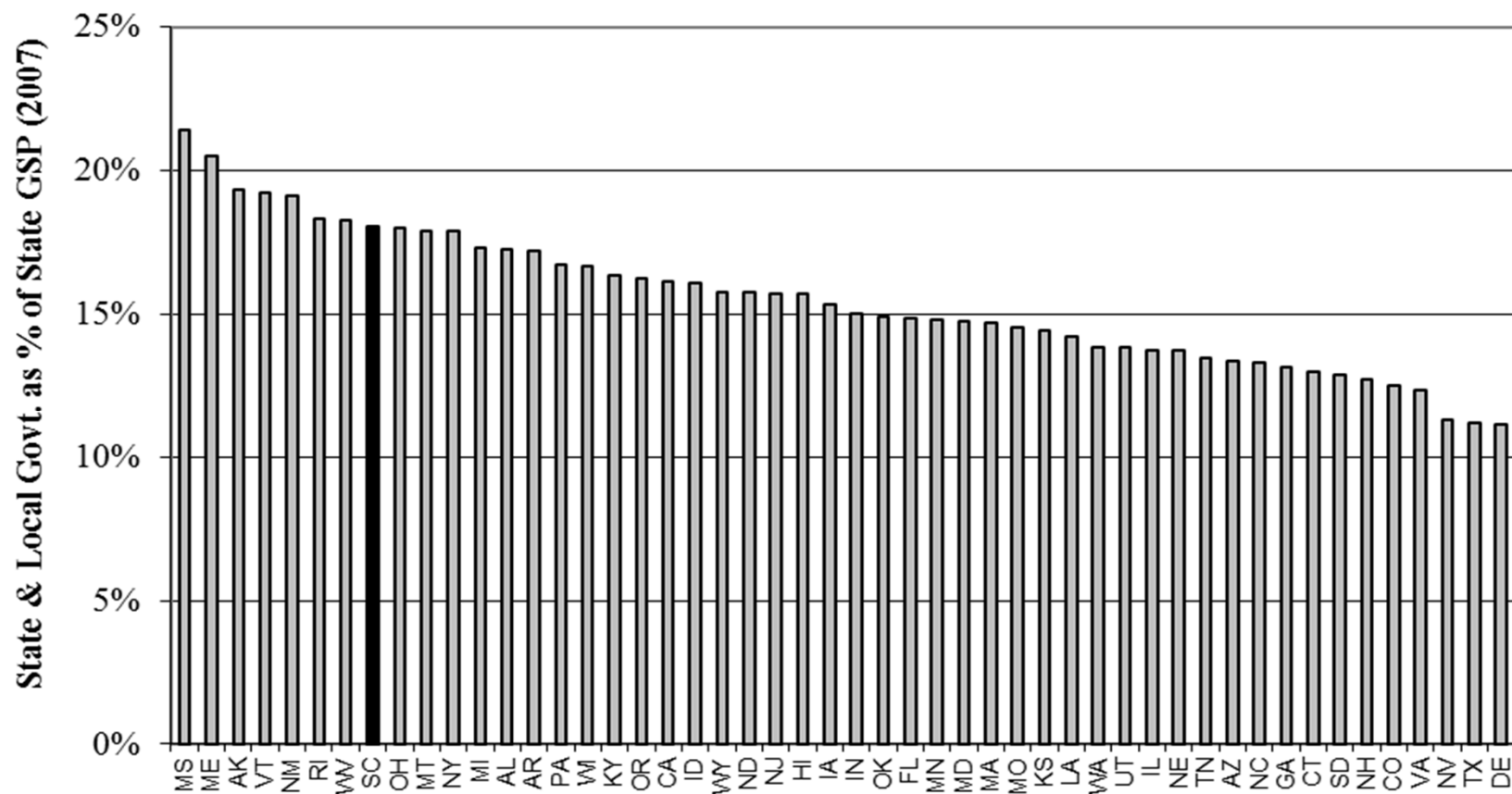
Size of (All) Government in SC

42.5% = 7th highest in the U.S.



Size of (S&L) Government in SC

18.0% = 8th highest in the U.S.



4. Reduce Government Size, Growth, and Centralization

- Increase the share of the economy's resources available to private entrepreneurs by reducing the size of government
- Big government as % of economy hurts economic growth
 - In 1980s when growth was 2.2% SC government shrank by 5% of the economy, it has grown by 12% of economy since
 - Economics literature estimates for every 10% increase in government as share of economy, economic growth falls by 1% - almost exactly what happened in SC
- Government can also be made more effective by decentralizing spending and power to local governments (SC is the 14th most centralized state)

5. Increase the Security of Property Rights

- Secure property rights are a cornerstone of investment & economic growth
- Restrict the use of eminent domain for private redevelopment (post-*Kelo*) and avoid government land takings that make property rights insecure

Thank You / Q&A

Russell S. Sobel

*School of Business, College of Charleston
& South Carolina Policy Council*

A free PDF copy of the book “Unleashing Capitalism: A Prescription for Economic Prosperity in South Carolina” is available at:

<http://www.unleashingcapitalismsc.org/>

