

COLLEGE of  
CHARLESTON

SCHOOL OF BUSINESS



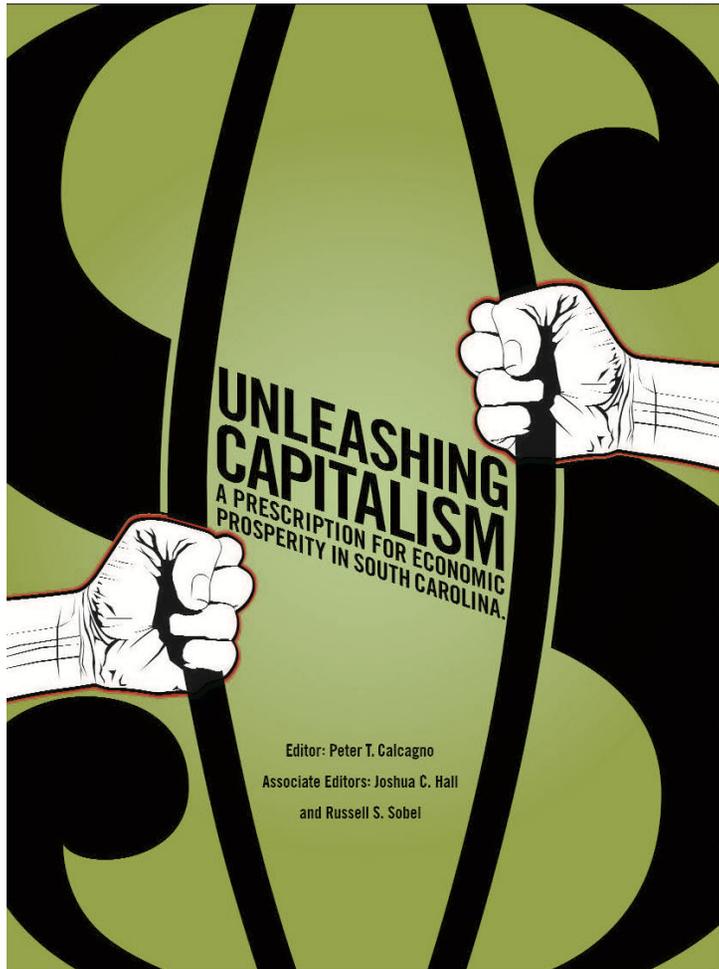
# South Carolina's Economic Policy and How it Can be Reformed to Better Create Economic Growth in the State



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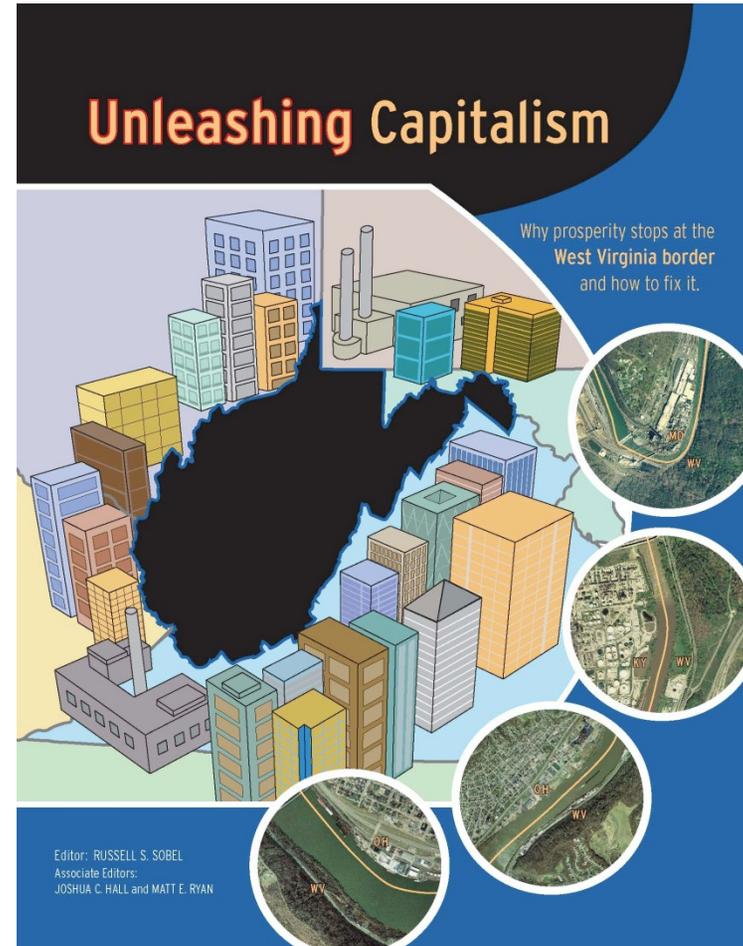
# Today's Talk is Based On:



SC Version Released 2009

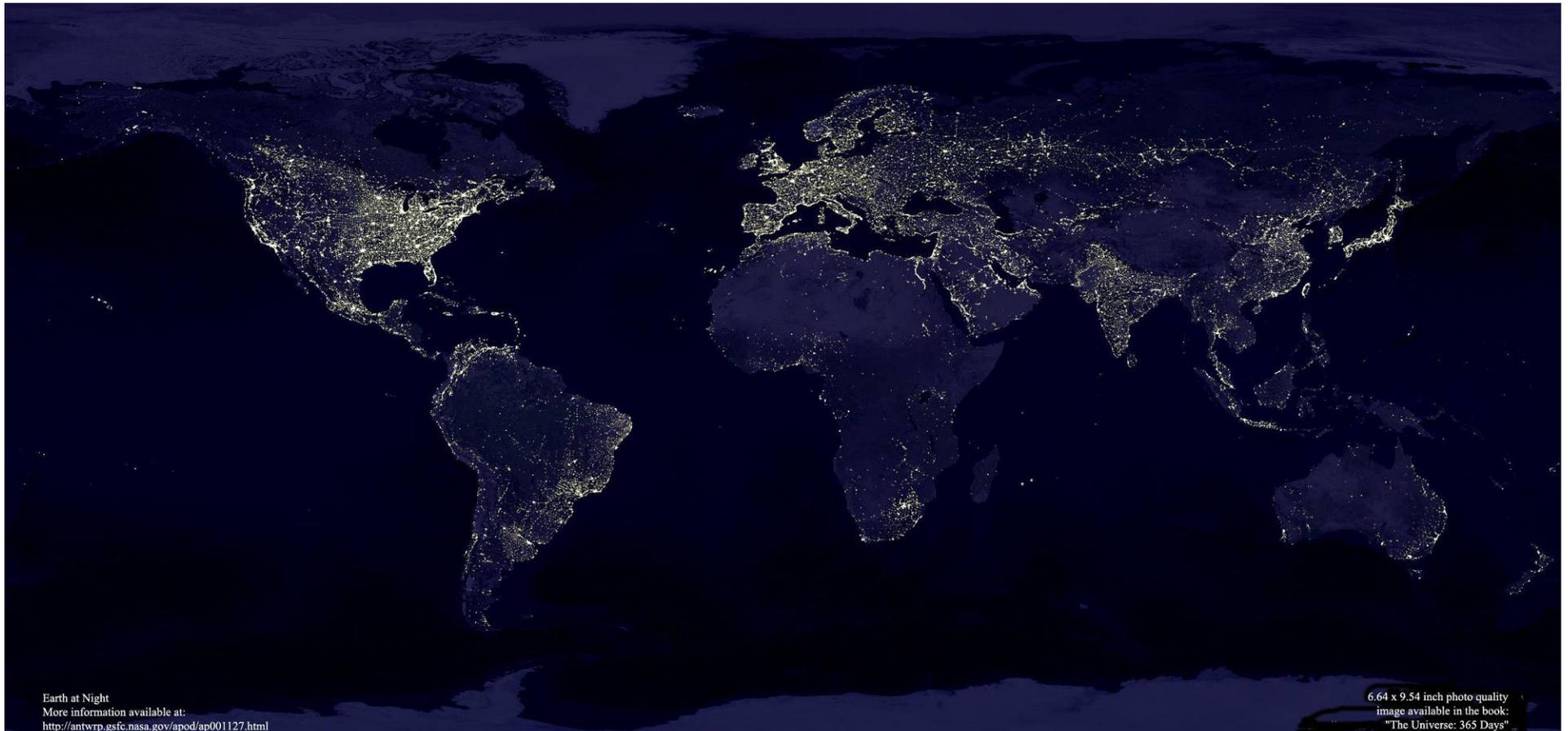


SOUTH CAROLINA  
POLICY COUNCIL



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

# What Explains Prosperity?

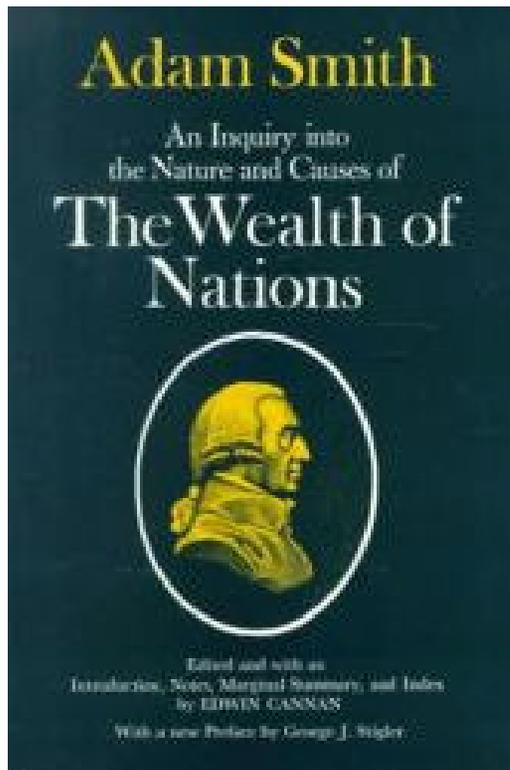


Earth at Night  
More information available at:  
<http://antwrp.gsfc.nasa.gov/apod/ap001127.html>

6.64 x 9.54 inch photo quality  
image available in the book:  
"The Universe: 365 Days"

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

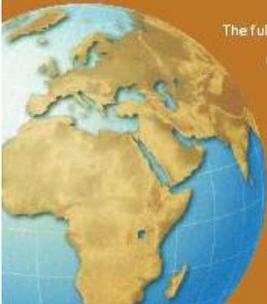


The key ingredients of economic freedom are personal choice, voluntary exchange, freedom to compete, and the protection of persons and property. Economic freedom creates an environment in which personal ingenuity can flourish.

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](http://www.freetheworld.com)

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

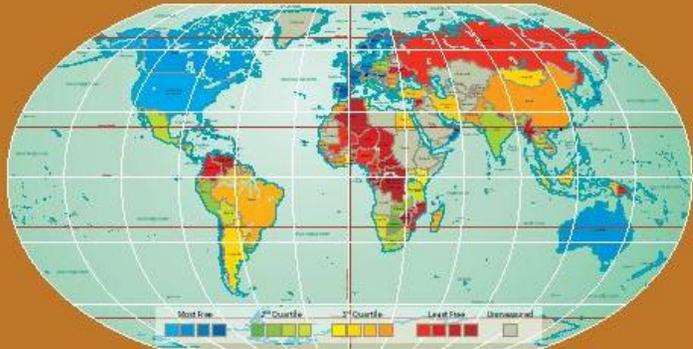


## Economic Freedom of the World 2006 Annual Report

James Gwartney and Robert Lawson with William Easterly

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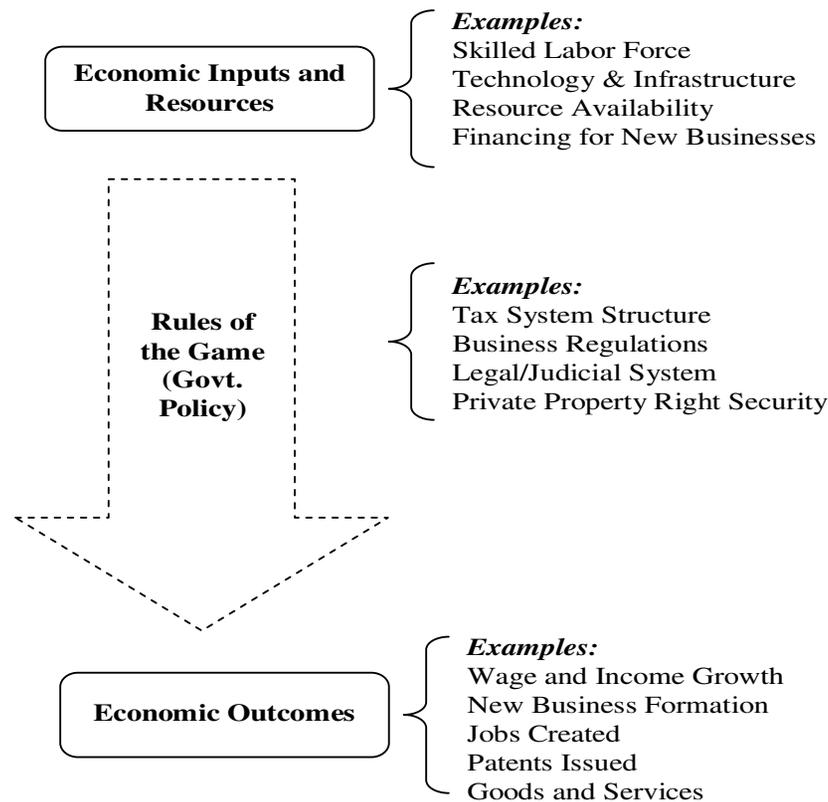


Most Free   2<sup>nd</sup> Quartile   3<sup>rd</sup> Quartile   Least Free   Unranked

Alaska: Alaskan Center for Economic Research (ACER) • Argentina: Fundación Libertad • Australia: Institute of Public Affairs • Austria: ICFE • Azerbaijan: Center for Economic and Political Research • Bahrain: The Heritage Institute • Bangladesh: Making Our Economy Right (MOER) • Belgium: Scientific Research Mine 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 de l'Institut de Développement et de l'Étude • 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 Política • Croatia: The Institute of Economics • Czech Republic: Libertad (Institute) • Denmark: Center for Political Studies • Dominican Republic: Instituto de Economía y Desarrollo • Ecuador: Instituto Ecuatoriano de Economía Política • Estonia: International University Coöperatie Academie • France: Association pour la Liberté Économique et le Progrès Social (ALPS) • Georgia: Society for Open-minded Economic Knowledge (New Economic School) • Germany: Liberal Institute • 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 (IRLEP) • Hong Kong: Hong Kong Economic and Social Research Council • Hungary: Institute for Economic Reform • Iceland: Centre for Social and Economic Research (CRES) • India: Centre for Social Policy • Indonesia: The Institute for Development of Economic and Social Studies • Ireland: Open the Public Institute • Israel: Institute for Advanced Strategic and Political Studies • Italy: Centro Studi • Ivory Coast: Bureau of Analysis and Research of the Logistics (BANO) • Kenya: Africa Research Centre for Public Policy and Market Process • South Korea: Center for Free Enterprise Strategy • Kyrgyz Republic: Economic Policy Institute • Lithuania: Lithuanian Free Market Institute • Luxembourg: Orléans University • 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 Investigaciones Económicas y Sociales (CIE) • Philippines: The Center for Research and Communication • Poland: Centrum im. Adama Smitha • Portugal: Caixa Liberal • Romania: Romanian Think Tank • Russian: Institute of Economic Analysis • Serbia: Free Market Center (FMC) • Slovak Republic: The Free Market Foundation • South Africa: The Free Market Foundation of Southern Africa • Sri Lanka: The Pathfinder Foundation • Sweden: The Heritage Institute • Switzerland: Open Society Institute • Switzerland: Solvay Institute of Business • Turkey: Heritage Foundation for Liberty • Ukraine: The Ukrainian Center for Independent Policy Research • United Kingdom: The Heritage Foundation • United States: LEA, Cato Institute • Uruguay: The Center for the Organization of Economic Knowledge (CEOE) • Uzbekistan: Research Center for Entrepreneurship and Development Policy • Zambia: Zambia Institute for Public Policy Analysis (ZIPP) • Zimbabwe: Zimbabwe Institute for Economic Research (ZIMRE)

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

Figure 2.1: Inputs, Institutions, and Outcomes



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

Source: Hall and Sobel (2006).

# Route 50 in West Virginia



# North Korea vs. South Korea



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

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

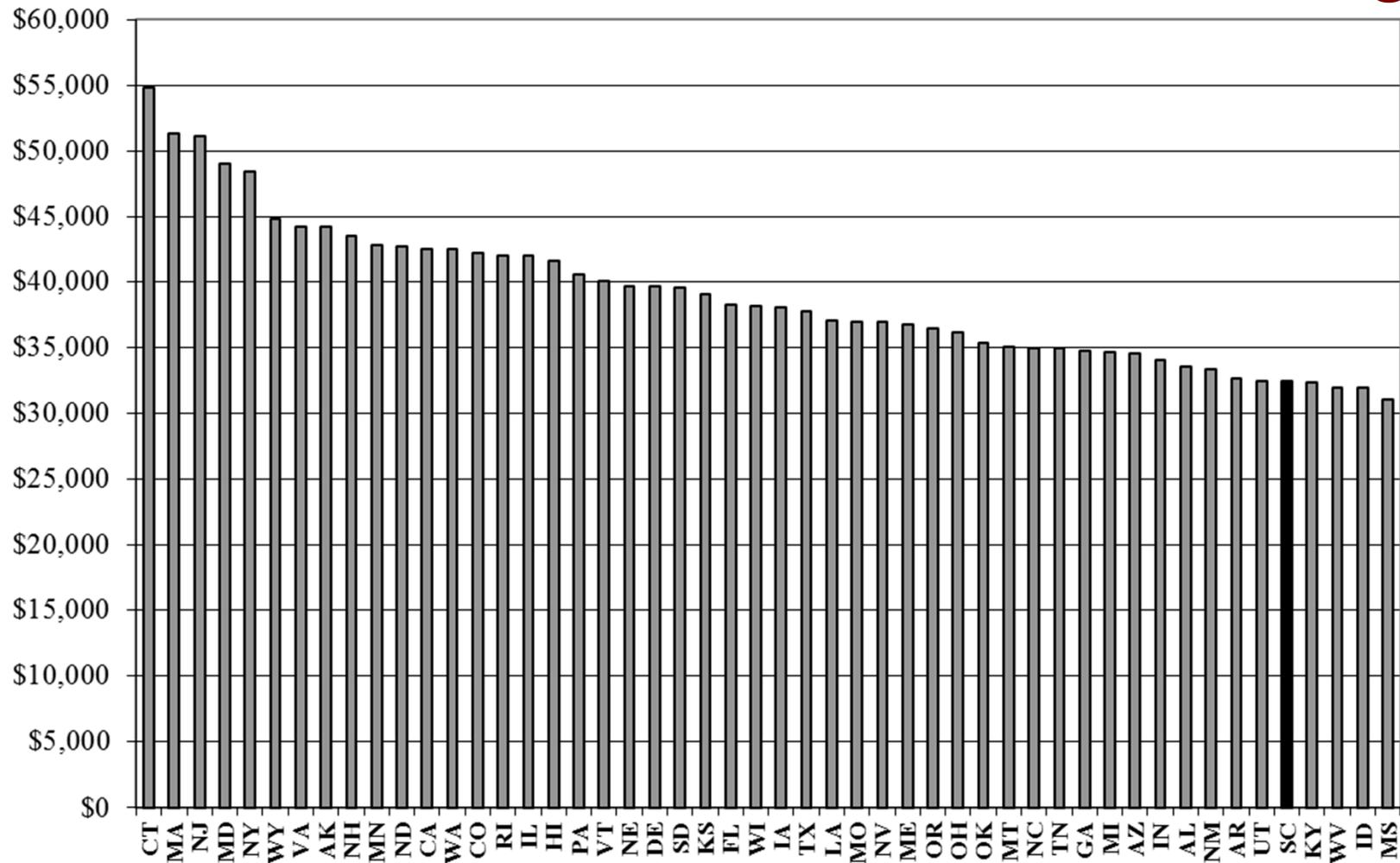
## States also Differ in Reliance on Capitalism



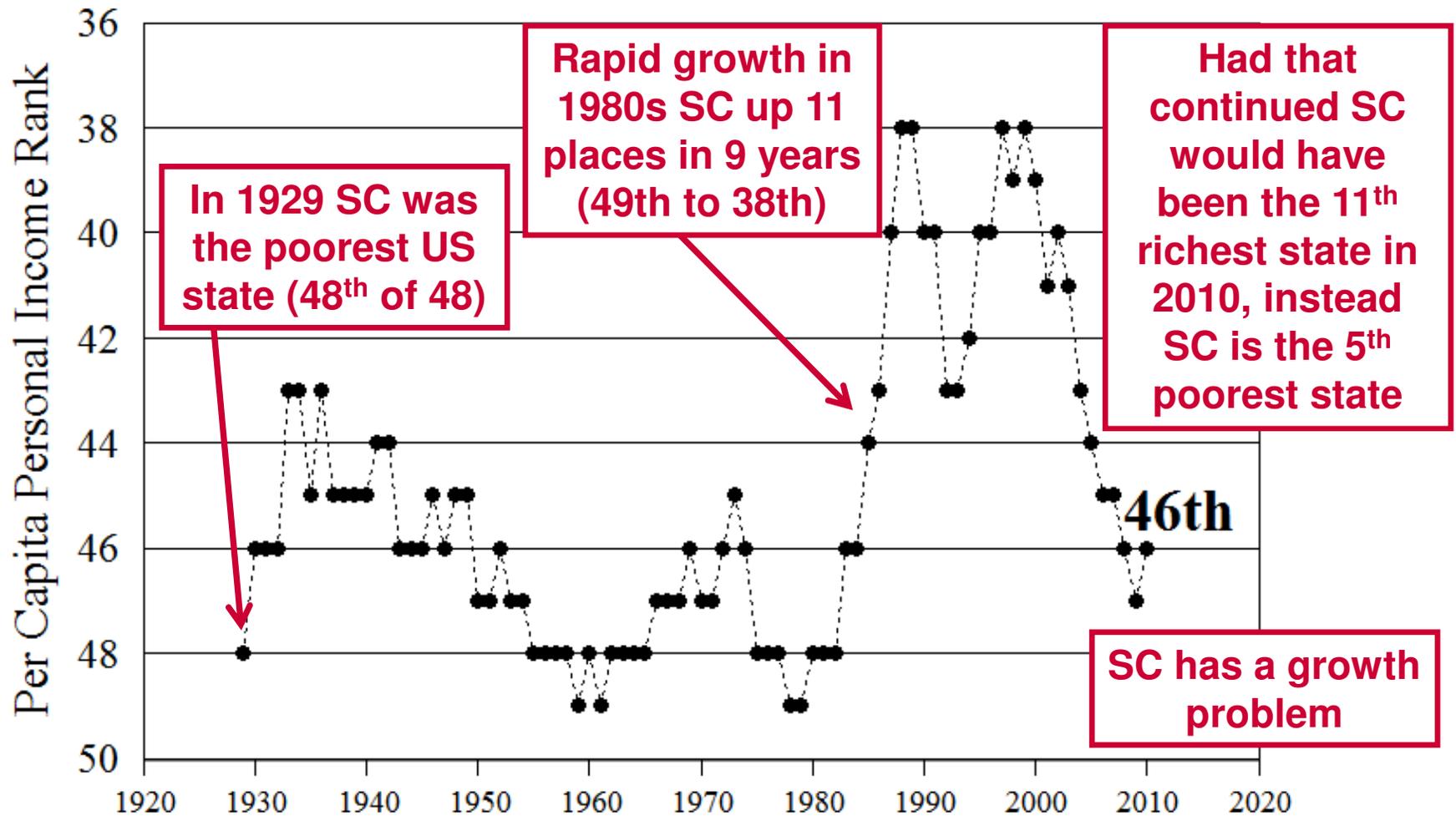
South Carolina  
Ranks 43<sup>rd</sup> in  
Capitalism

West Virginia  
Ranks 50<sup>th</sup> in  
Capitalism

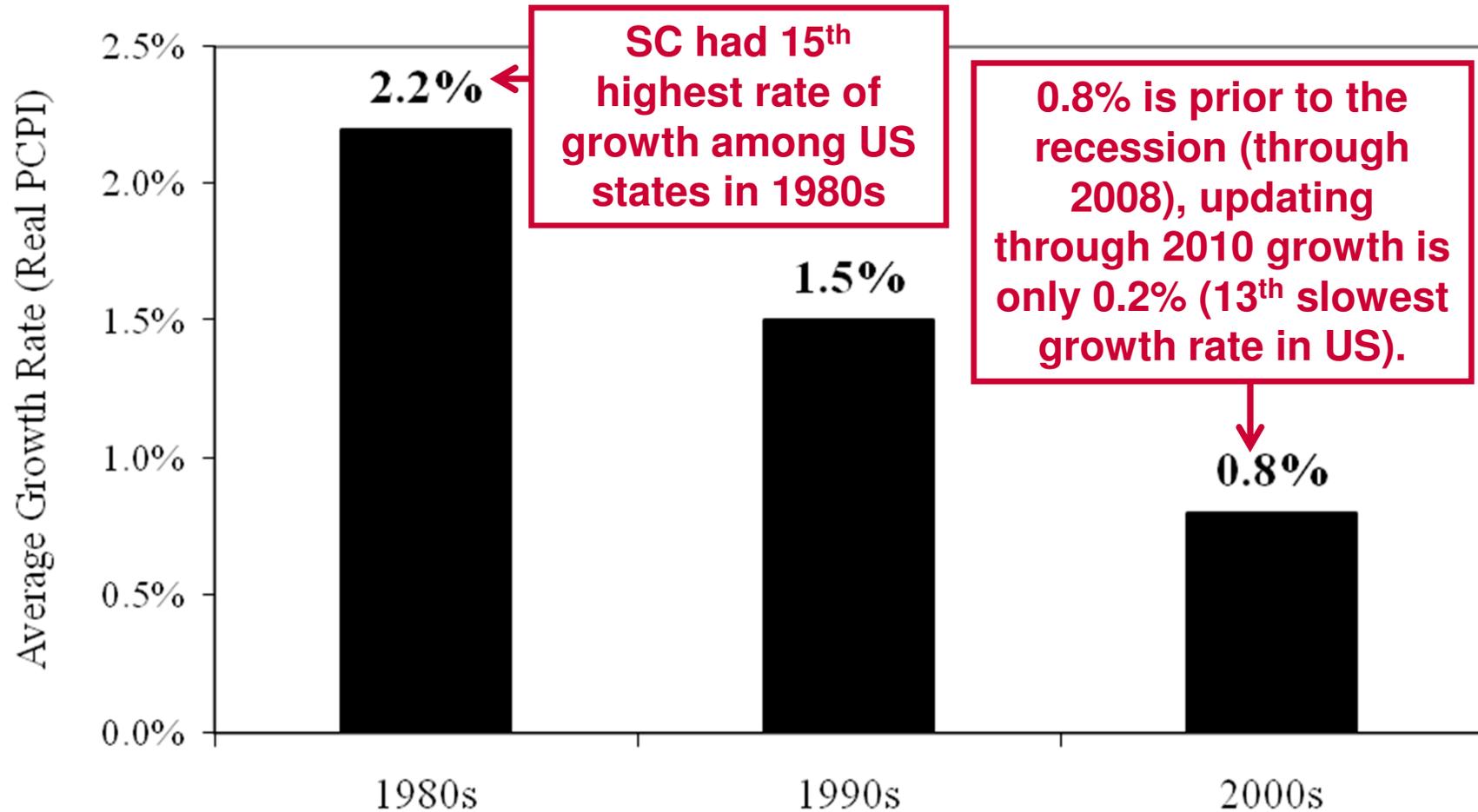
# SC's PCPI: Rank 46th – 81% of U.S. Average



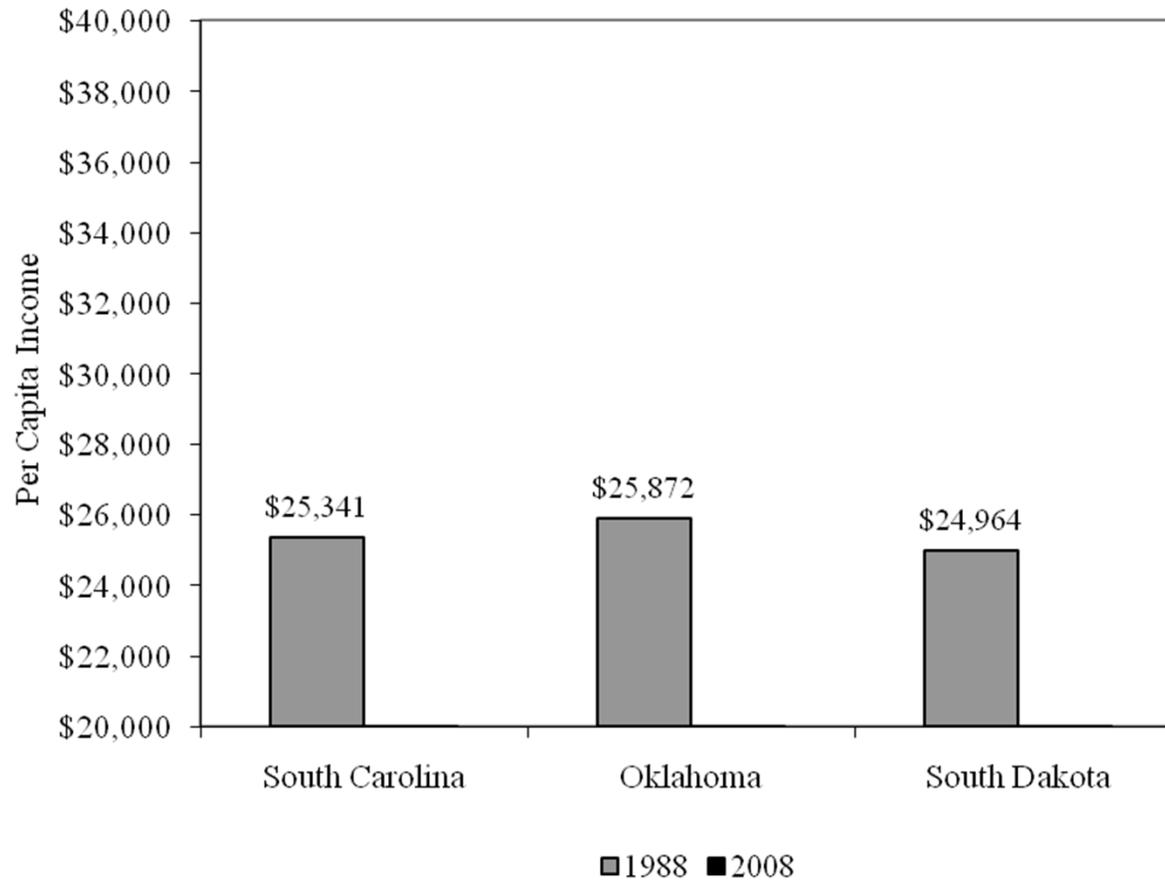
# South Carolina's Rank Among States



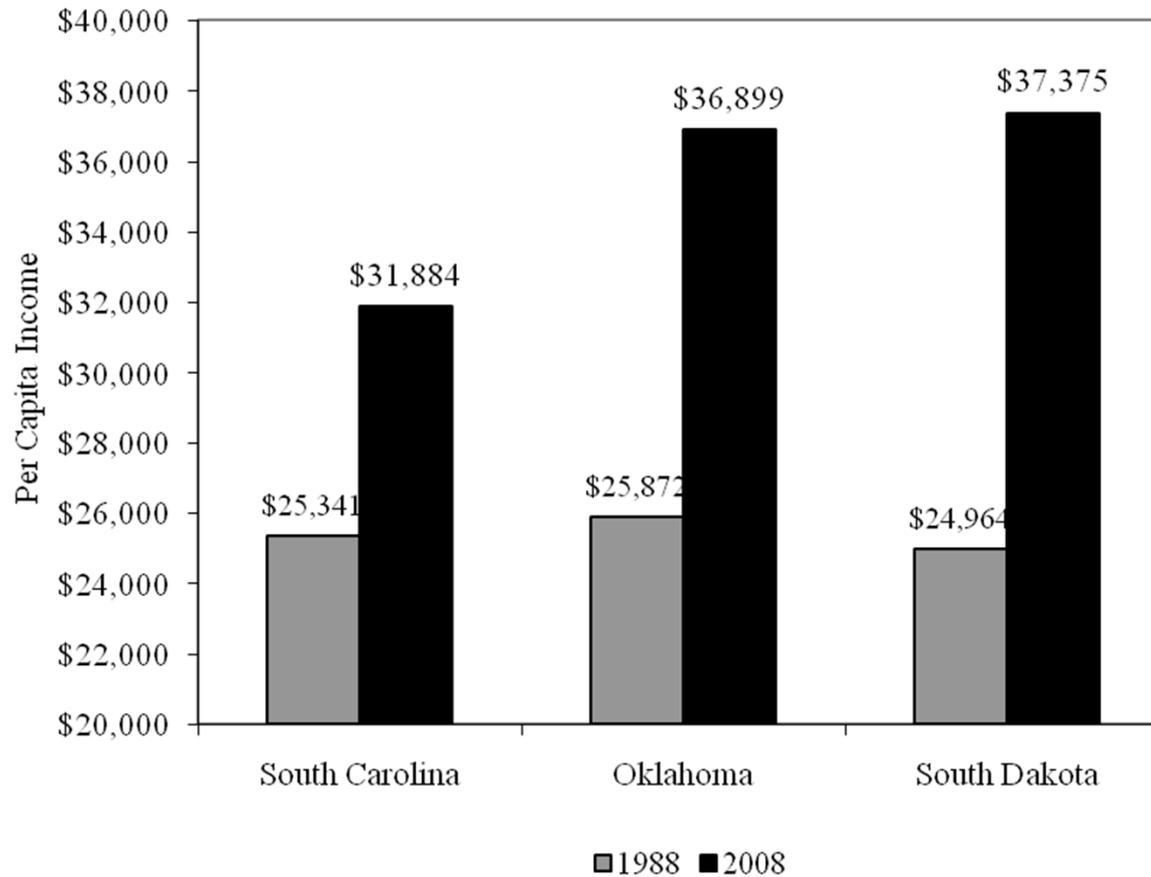
## South Carolina's Declining Rate of Growth



# South Carolina is Falling Behind



# South Carolina is Falling Behind



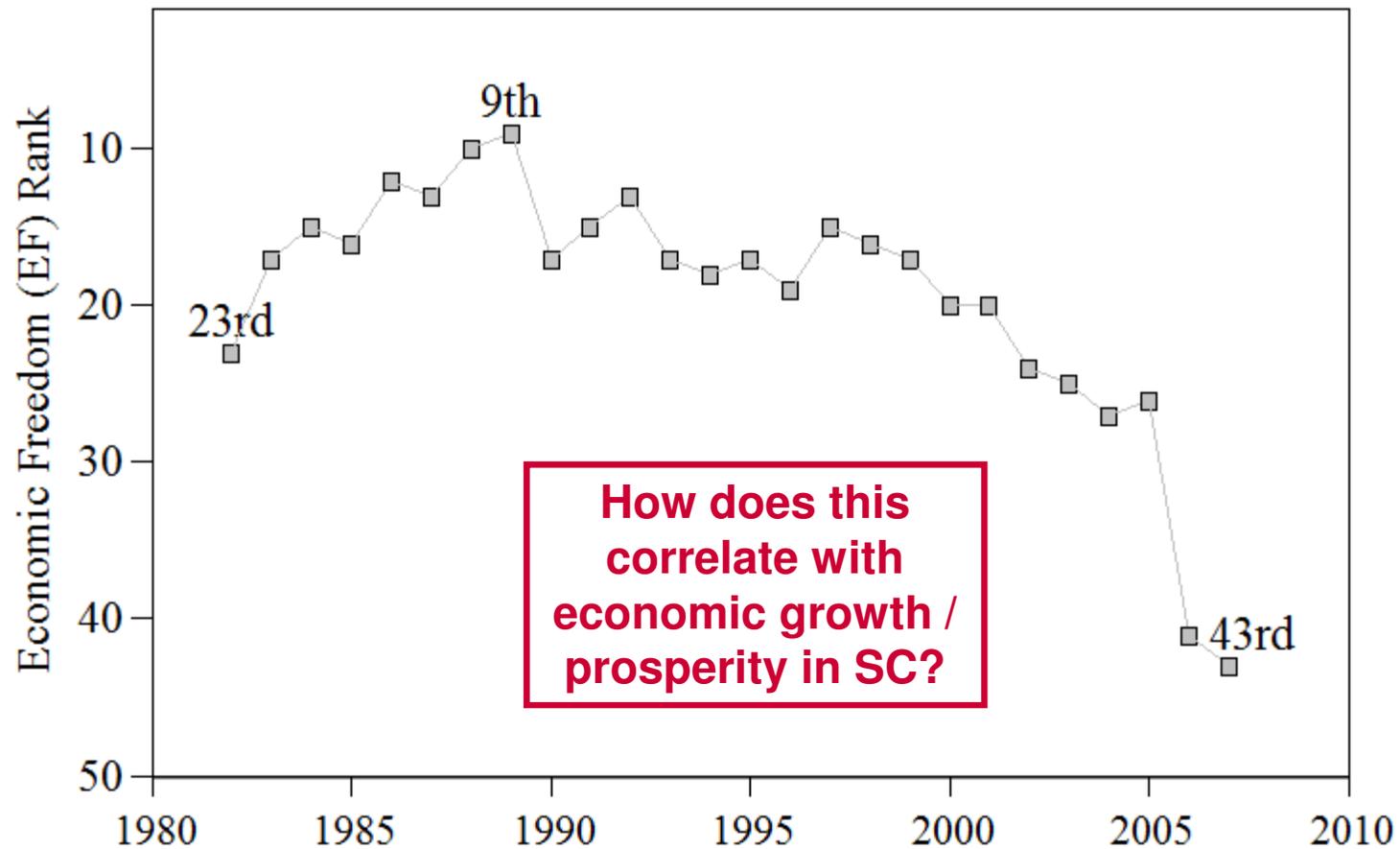
Growth Rates: SC = 1.2%    OK = 1.8%    SD = 2.1%

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

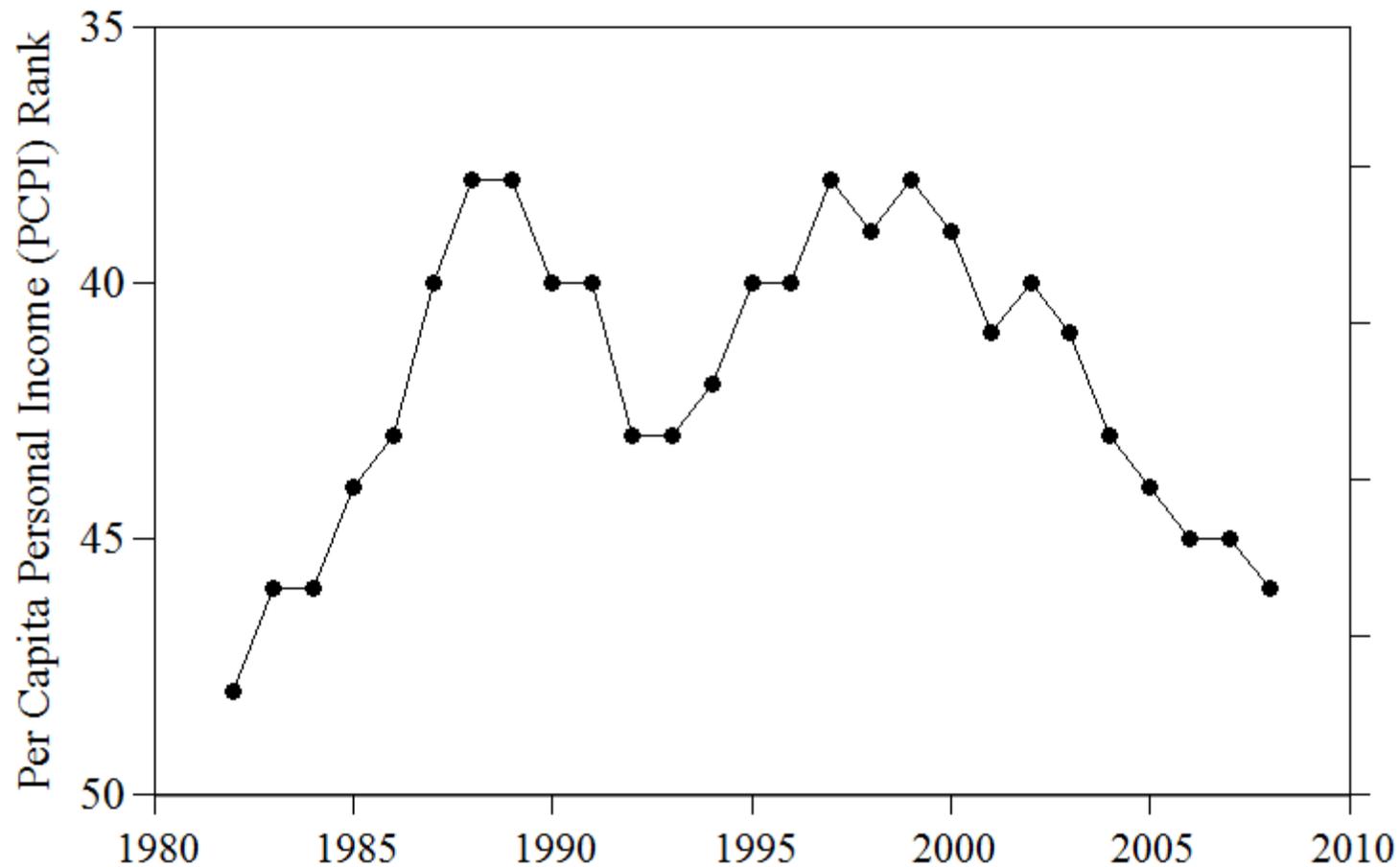
24 <sup>th</sup>	Tax Foundation’s State Business Tax Climate Index (2011)
43 <sup>rd</sup>	Fraser Institute’s Economic Freedom of North America (2010)
27 <sup>th</sup>	Directorship Magazine’s Boardroom Guide to the Best States for Business (2009)
37 <sup>th</sup>	CNBC’s America’s Top States for Business (2011)
40 <sup>th</sup>	Corporation for Enterprise Development (CFED) Development Capacity Index (2007)
39 <sup>th</sup>	Progressive Policy Institute’s (PPI) New Economy Index (2010)
42 <sup>nd</sup>	Beacon Hill Institute’s State Competitiveness Report (2010)
43 <sup>rd</sup>	Milken Institute’s National State Technology & Science Index (2010)
39 <sup>th</sup>	Institute for Legal Reform (ILR)/Harris State Liability Systems Ranking Study (2010)
14 <sup>th</sup>	Pacific Research Institute's U.S. Tort Liability Index (2010)
28 <sup>th</sup>	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 3<sup>rd</sup>)

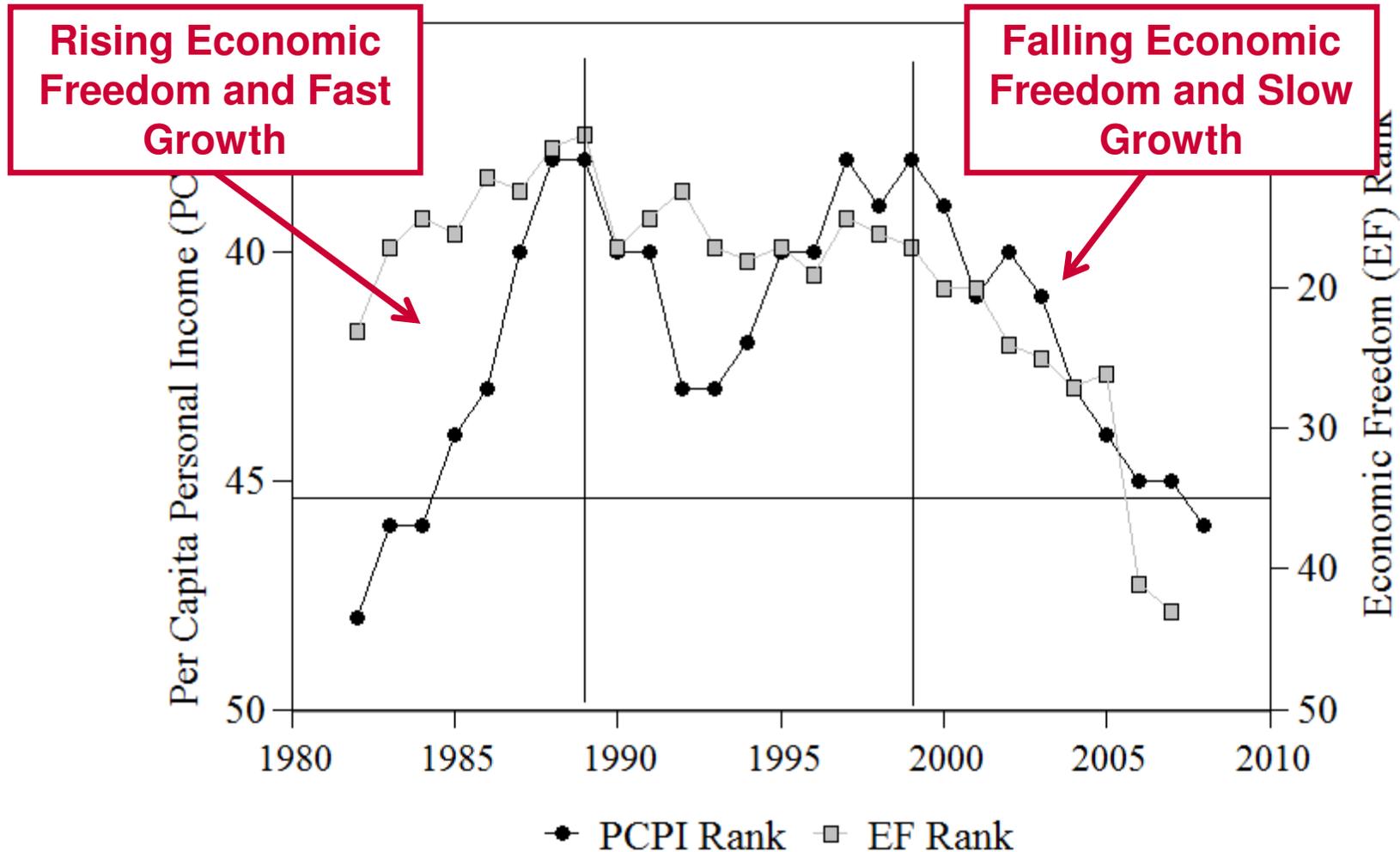
# SC's Economic Freedom History



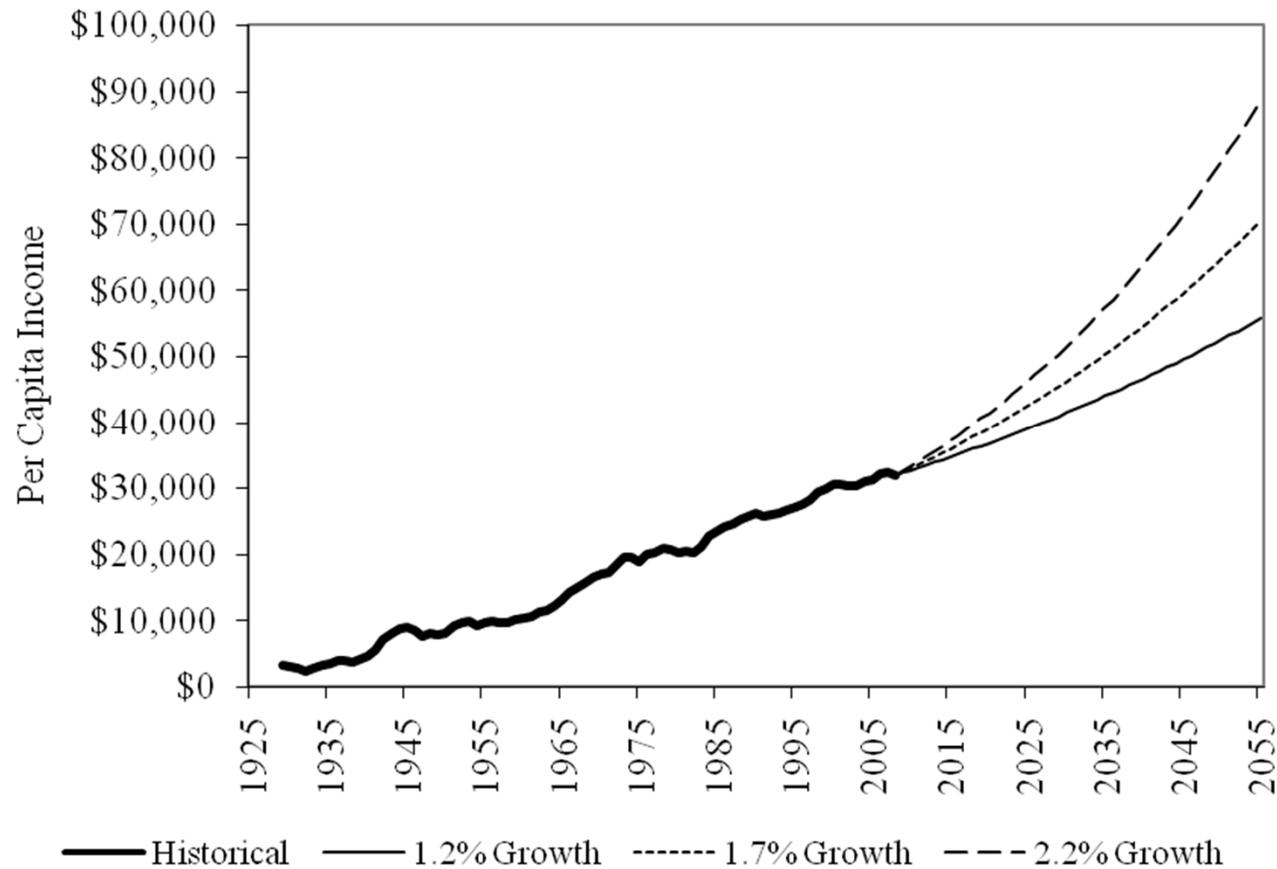
# SC's Recent Prosperity (PCPI) Rank



# Economic Freedom vs. Growth



# Which Future for South Carolina?



1980s growth rate

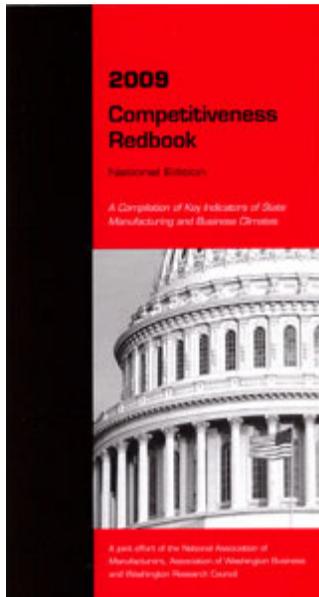
**To grow, South Carolina needs to enact policy reforms to improve economic freedom**

**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

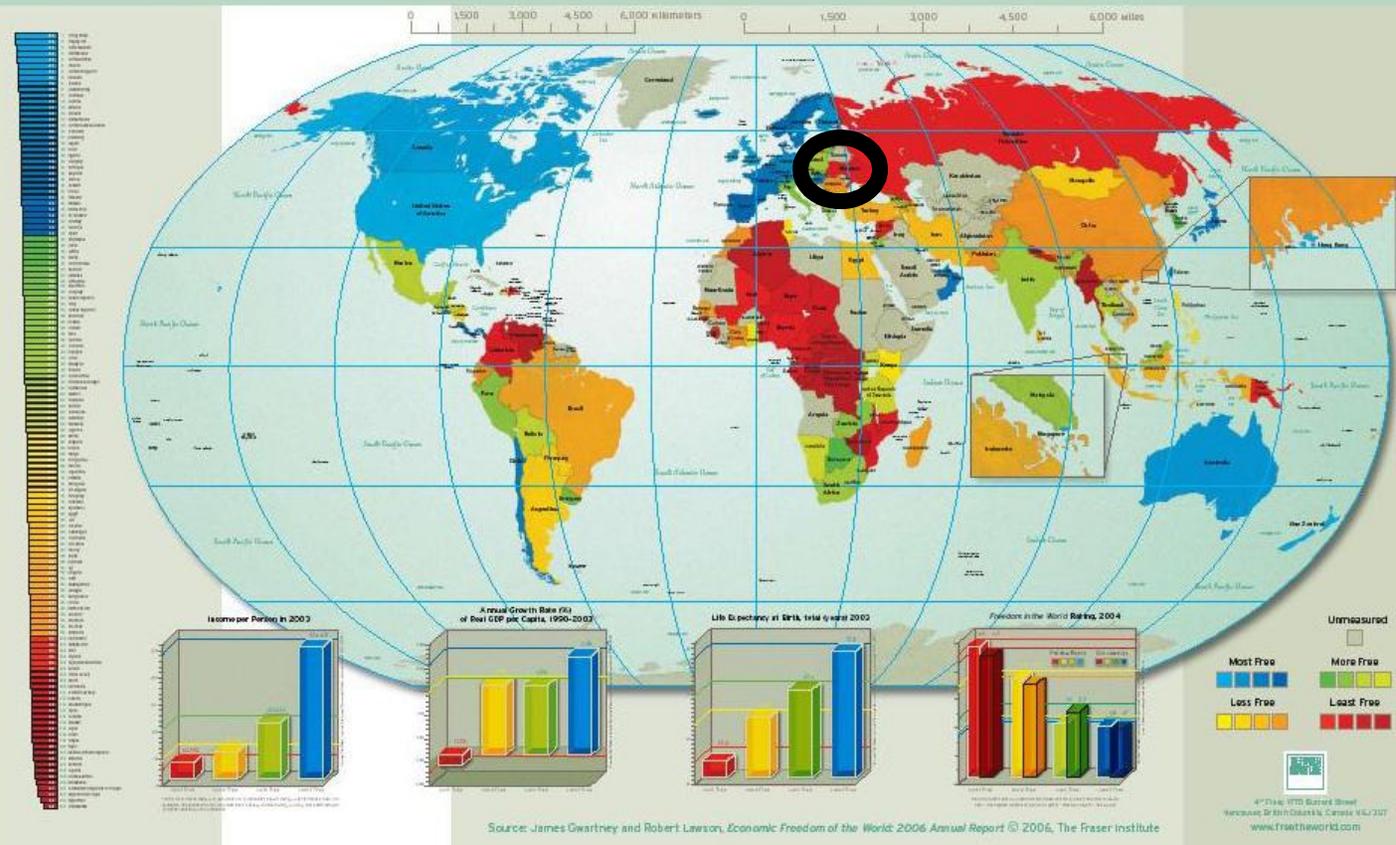
- “Crony Capitalism” is when business winners and losers are determined by political connections rather than private market forces
  - The Case of Serious Materials
- Baumol’s Theory of Productive and Unproductive Entrepreneurship
  - “Too Many Lobbyists & Lawyers and Too Few Scientists and Engineers”
  - SC Ranks: 19<sup>th</sup> in Unproductive Entrepreneurship and only 29<sup>th</sup> 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



## Economic Freedom of the World

Economic freedom means that people are free to trade with others, compete in markets, buy what they want, earn a living in a job they choose, keep what they earn, and own things privately. This index indicates the degree to which economic freedom can be found in various countries.



# 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."

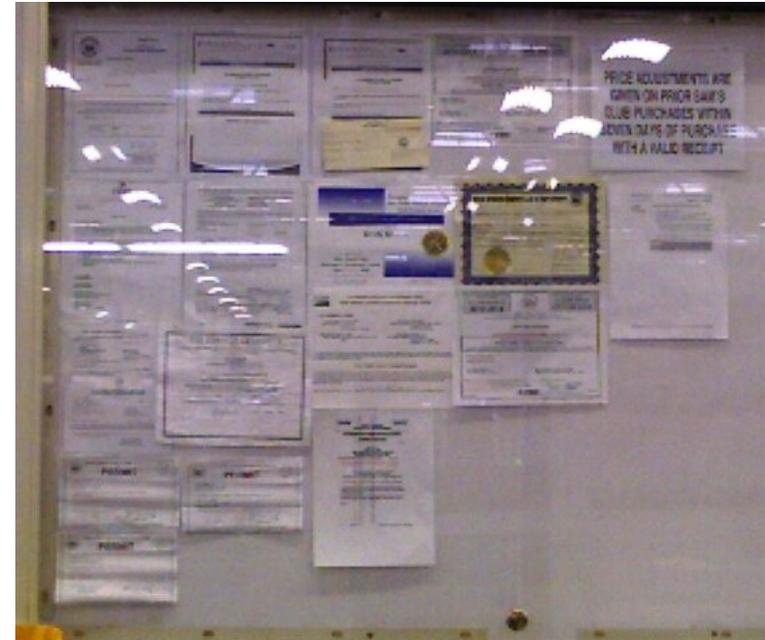
### Would You Have Invested?

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



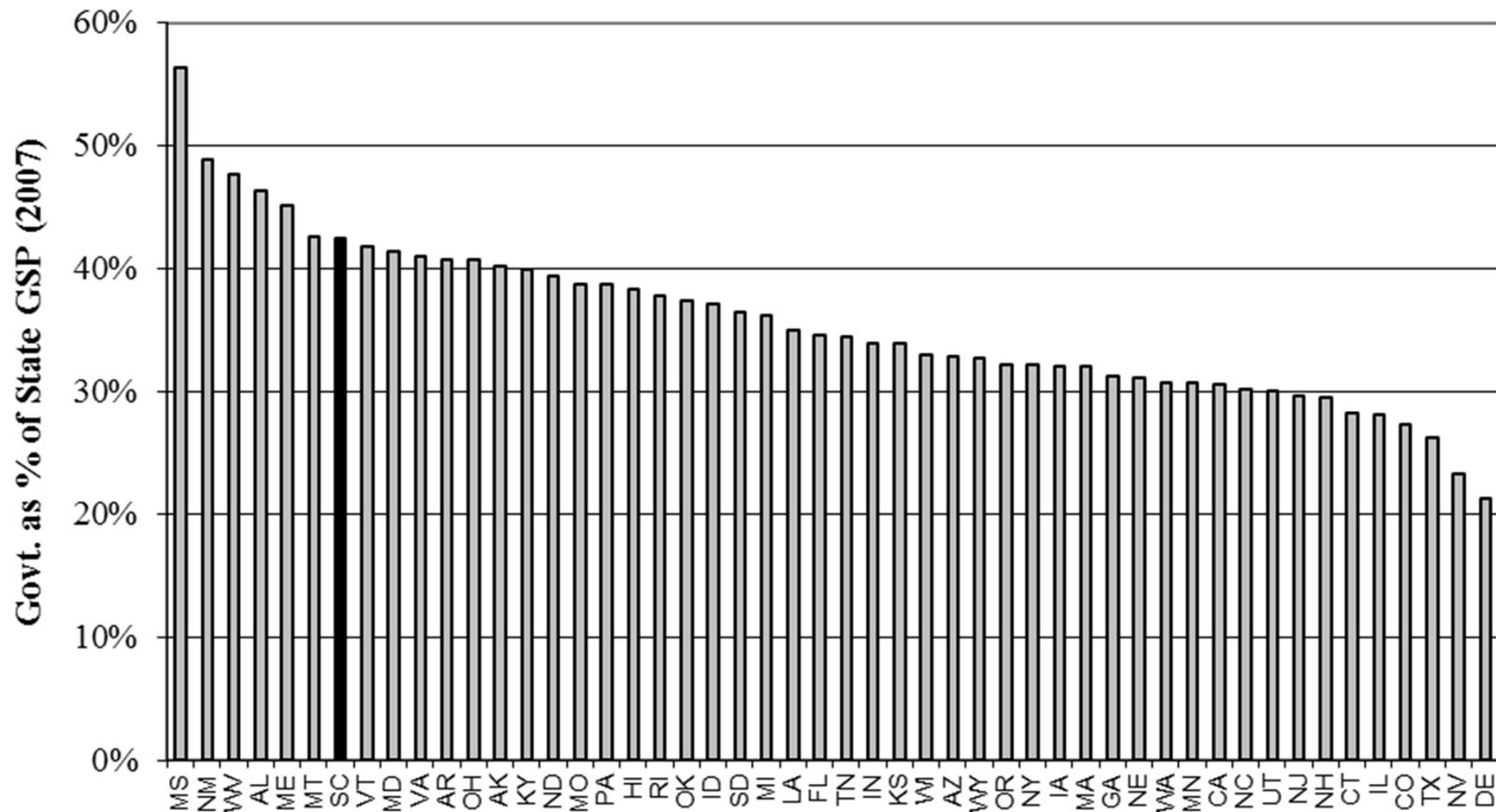
- Secondary effects / Unintended consequences of regulation
- Gives advantage to big national firms over small businesses
- No natural profit/loss mechanism to get bad regulations repealed
- Regulations should be subject to **cost-benefit analysis** and include **sunset provisions** based on proof of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

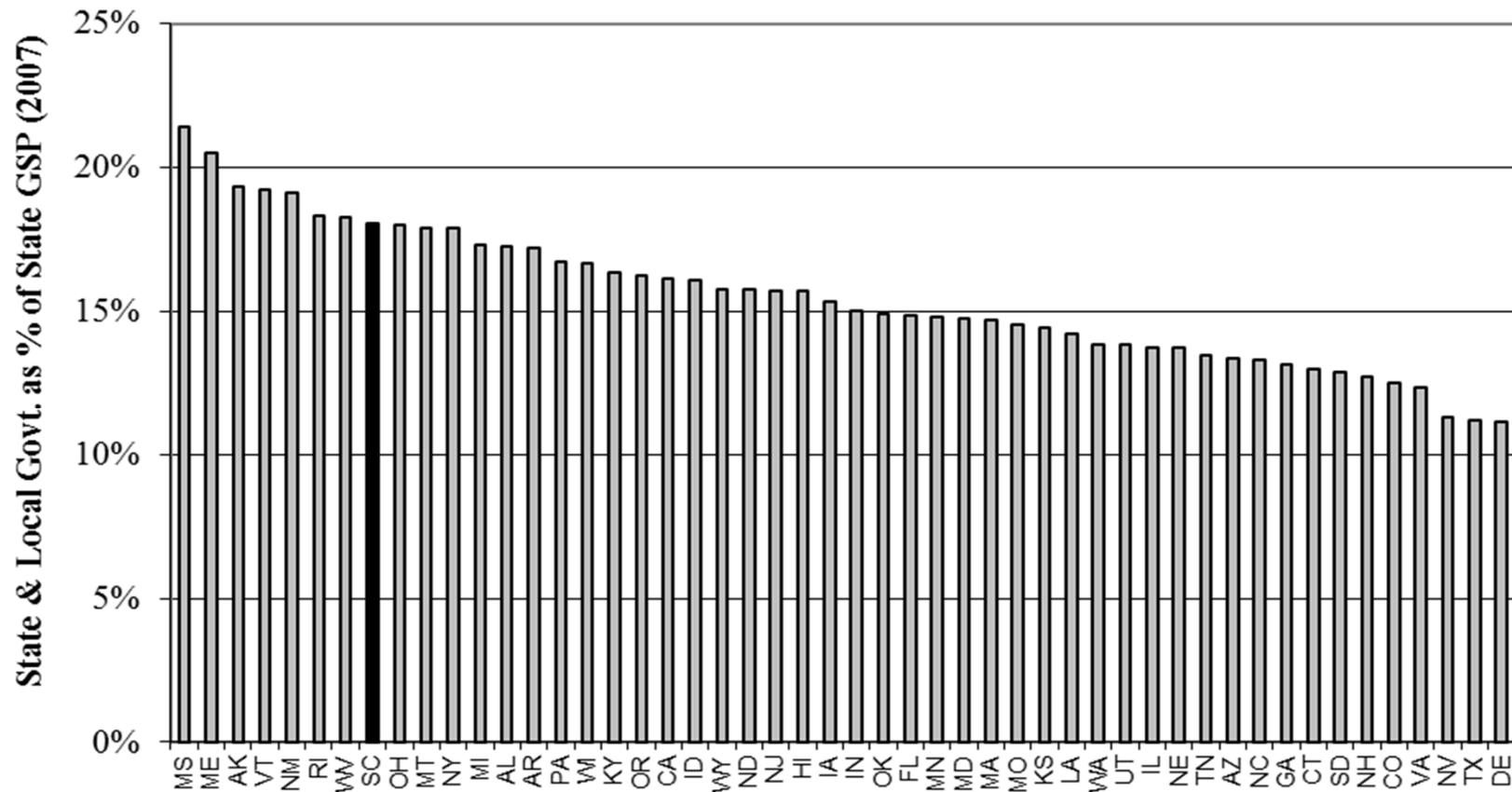
# Size of (All) Government in SC

42.5% = 7<sup>th</sup> highest in the U.S.



# Size of (S&L) Government in SC

18.0% = 8<sup>th</sup> 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 14<sup>th</sup> 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

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& 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/>

