THE COMPARATIVE COST OF DOING BUSINESS IN CALIFORNIA

November 2015

Central Valley Communities are Competitive with the Rest of the Nation

Prepared for California Dairies, Inc., Dairy Farmers of America, Inc., and Land O' Lakes, Inc.

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CENTRAL VALLEY COMMUNITIES ARE COMPETITIVE WITH THE REST OF THE NATION

My name is Lon Hatamiya. I am the President and CEO of The Hatamiya Group, an economics and strategic advisory consulting firm located in Davis, California. I was retained by California Dairies, Inc., Dairy Farmers of America, Inc., and Land O' Lakes, Inc. ("Cooperatives") to provide an independent and objective analysis of the cost of doing business in California. I have been asked to respond to the assertion that the current cost of doing business in California when combined with the creation of a federal milk marketing order will place California cheese makers at a competitive disadvantage with the rest of the nation.

I. Introduction – Cost of Doing Business

Through my extensive professional experience and expertise, I believe I bring a unique perspective to this analysis. From 1993 to 1997, I served as Administrator of the Agricultural Marketing Service of the United States Department of Agriculture ("USDA"), where I oversaw over 50 federal programs, including the Federal Milk Marketing Order ("FMMO") system. I also served as Administrator of the Foreign Agricultural Service at USDA from 1997-1999, and then returned to my native California to serve as Secretary of the Technology, Trade and Commerce Agency from 1999-2003, where I oversaw the promotion of statewide economic development, job creation, and business retention.

Prior to my service at USDA, I practiced law and worked with my three-generation family farm in Yuba and Butte counties. Since 2003, I have been a consulting economist, analyzing local, regional, state, national and international economic impacts, trends, and economic development opportunities on various industries including agriculture, energy, high technology, real estate, retail, professional sports, transportation, tourism, and higher education. I have testified over a hundred times before the World Trade Organization, U.S. Congress, California State Legislature, and federal, state and local courts, boards, and commissions on a wide variety of relevant issues.

Throughout my professional career, I have acquired and maintained an international, national, regional as well as a statewide and local perspective with regard to agriculture and its pertinent economic impact upon all communities. For this analysis, I have relied upon that combined experience, and most specifically, on my tenure as Secretary of Technology, Trade and Commerce for California to determine the best measure of the costs of doing business across the country.

There are various periodic surveys, reports, and studies that have regularly monitored the cost of doing business across the United States. *Forbes*, *CNBC*, and other assorted economic development organizations provide some form of comparative analysis on the costs of doing business from state to state. However, there is common thread among most of these analyses – they rely upon the primary data generated and analyzed by *Moody's Analytics* in their biennial *North American Business Cost Review*[1]. Through its team of economists, *Moody's Analytics* is a leading independent provider of data, analysis, modeling, and forecasts on national and regional economies, financial markets, and credit risk. The company offers unique tools and best practices for measuring and managing risk through expertise and experience in credit analysis, economic research, and financial risk management. By providing leading-edge software, advisory services, and research, including the proprietary analysis of Moody's Investors Service, *Moody's Analytics* integrates and customizes its offerings to address specific business challenges. For purposes of my analysis, I rely upon Moody's Analytics trusted and objective *North American Business Cost Review*.

II. Cost of Doing Business is not Uniform Statewide

As a whole, there is no question that California generally ranks among the states with the highest cost of doing business. However, focusing on the statewide average is an improper measure for the cost of doing business in California's primary milk manufacturing regions.

With repect to statewide averages that have been incorrectly relied upon by others testifying at this hearing, Table 1 highlights the various rankings of some of the largest cheese manufacturing states according to *Moody's Analytics 2014 North American Business Cost Review*:

[1] "North American Business Cost Review," Moody's Analytics, May 2014, and updated October 2014.

Table 1: Cost of Doing Business Index[2]		
	Index	**Rank**
California	**110**	**7**
New York	**107**	**9**
Michigan	**105**	**13**
Pennsylvania	**103**	**15**
Wisconsin	**102**	**16**
Colorado	**101**	**17**
Minnesota	**100**	**21**
New Mexico	**99**	**22**
Washington	**95**	**31**
Idaho	**92**	**38**
Texas	**92**	**39**
Oregon	**90**	**42**
South Dakota	**84**	**49**

Index (National Average = 100)

Rank (among 50 states, with highest cost at "1")

The Moody's Analytics cost of doing business index compares a state or metropolitan area's average business cost with that of the U.S. For metro areas, the index comprises four components: (1) Unit Labor Cost; (2) Energy Cost; (3) State and Local Taxes; and (4) Office Rent. Because of lack of office rent data at the state level, only the first three categories are utilized to calculate the Cost of Doing Business Index for states.

However, and more specifically, the cost of doing business in California should not be considered in its entirety as the state is made-up of at least nine distinct economic regions with differing labor, energy, state and local taxes, and office rental costs, which collectively result in the 8th largest economy in the world. The more appropriate measure is to examine the available regional cost of doing business within the state.

[2] "North American Business Cost Review," Moody's Analytics, May 2014, and updated October 2014, pg. 8.

For purposes of my analysis, I have focused upon the San Joaquin Valley Region (green) in the California state map above, since most of the largest cheese manufacturing plants are located within this area. This region includes from north to south the counties of San Joaquin, Stanislaus, Merced, Madera, Fresno, Kings, Tulare, and Kern. The remainder of my testimony will be focused upon this most relevant region of California.

III. Examination and Comparison of the Cost of Doing Business Index of the San Joaquin Valley Metro Areas Versus Other U.S. Cheese Manufacturing Locales

Moody's Analytics provide not only a state-by-state comparison, but also provides more specific comparative *U.S. Metropolitan Area Relative Business Costs.*[3]

[3] "North American Business Cost Review," Moody's Analytics, May 2014, and updated October 2014, pgs. 9-16.

For cheese plant manufacturing cost comparions, these *U.S. Metropolitan Area Relative Business Costs* are the most relevant to be considered. The following San Joaquin Valley metropolitan areas (highlighted in Table 2 in alphabetical order), which are also home to many of the largest cheese manufacturing plants in California, provide more reasonable and competitive costs for doing business.

Table 2: Cost of Doing Business Index by San Joaquin Valley Metropolitan Areas[4]

City	County	Cost of Doing Business		Unit Labor Cost		Energy Cost		State & Local Tax		Office Rent	
		Index	Rank	Index	Rank	Index	Rank	Index	Rank	Index	Rank
Bakersfield	Kern	94	96	94	226	143	35	95	119	73	119
Fresno	Fresno	92	122	92	257	143	35	97	98	69	169
Hanford	Kings	97	69	108	27	143	35	96	105	58	289
Merced	Merced	81	307	81	366	143	35	98	86	51	354
Modesto	Stanislaus	90	148	91	267	143	35	98	86	64	214
Stockton	San Joaquin	98	60	106	47	143	35	98	83	65	206
Visalia	Tulare	92	112	104	67	130	64	97	98	55	308

As the figures from Table 2 clearly indicate, the cost of doing business in the San Joaquin Valley falls well below the national average (Index = 100), and well below the Cost of Doing Business Index collectively of the state of California.

Most importantly, Moody's Analytics also provides *U.S. Metropolitan Area Relative Business Costs* for 384 metropolitan areas across the country. The availability of this data has enabled me to develop the following Table 3, which compares more specifically the *Cost of Doing Business* for top 25 manufacturing plant locations across the key cheese producing states of California, Colorado, Idaho, Michigan, Minnesota, New Mexico, New York, Oregon, Pennsylvania, South Dakota, Texas, and of course, Wisconsin. The **Index** is based upon a National Average of 100; the **Rank** is based upon the relative position among the 384 metropolitan areas measured.

[4] "North American Business Cost Review," Moody's Analytics, May 2014, and updated October 2014, pgs. 15-16.

Table 3: Costs of Doing Business Index[5] (lowest to highest with national average at 100 index)										
City	Cost of Doing Business		Unit Labor Cost		Energy Cost		State & Local Tax		Office Rent	
	Index	Rank	Index	Rank	Index	Rank	Index	Rank	Index	Rank
Mankato, MN	77	352	83	358	89	261	101	42	79	69
Amarillo, TX	78	335	89	296	65	374	68	334	73	115
Merced, CA	81	307	81	366	143	35	98	86	51	354
Greeley, CO	83	274	97	182	92	212	70	329	60	262
Yakima, WA	84	260	99	152	79	330	83	232	54	322
Eau Claire, WI	85	252	96	207	92	236	98	80	59	271
La Crosse, WI	85	241	100	145	92	236	99	79	54	328
Appleton, WI	87	207	101	127	90	245	100	64	59	269
Wausau, WI	87	203	99	154	90	245	101	39	62	230
Kennewick, WA	87	200	103	90	62	383	82	239	67	185
Grand Rapids, MI	89	174	97	193	115	102	100	59	55	310
Janesville, WI	89	165	103	91	107	129	101	51	54	331
Fond Du Lac, WI	90	158	102	99	107	129	101	46	56	305
Modesto, CA	90	148	91	267	143	35	98	86	64	214
Fresno, CA	92	122	92	257	143	35	97	98	69	169
Racine, WI	92	119	104	77	112	118	102	30	58	281
Visalia, CA	92	112	104	67	130	64	97	98	55	308
Sheboygan, WI	94	104	107	37	107	129	100	63	62	237
Madison, WI	94	98	105	61	106	141	100	66	67	183
Bakersfield, CA	94	96	94	226	143	35	97	119	73	119
Oshkosh, WI	94	95	106	39	107	129	100	62	64	217
Rochester MN	95	76	106	43	89	261	101	57	81	63
Hanford, CA	97	69	108	27	143	35	96	105	58	289
Stockton, CA	98	60	106	47	143	35	98	83	65	206
Milwaukee, WI	99	57	111	16	112	118	101	55	70	148

[5] "North American Business Cost Review," Moody's Analytics, May 2014, and updated October 2014, pgs. 9-16.

Once again, as the data from Table 3 indicates, the *Cost of Doing Business* in San Joaquin Valley Metro Areas (as noted in gold) compare favorably with other cheese producing metro areas around the country.

IV. Further Examination and Comparison of the Specific Components that make up the Cost of Doing Business Index

A further examination and comparison of the specific components of *Unit Labor Cost*, *State and Local Tax*, and *Office Rent* reveal even more competitive positioning of San Joaquin Valley Metro areas. It is also clear that San Joaquin Valley Metro areas' overall *Cost of Doing Business Indices* would be much lower if it were not for the high cost of energy in these communities, which rank among the highest *Energy Cost*[6] areas in Table 3. Nevertheless, according to the most recent California Department of Food and Agriculture Dairy Manufacturing Cost Exhibit for the period of January through December 2013, the weighted average Electricity Cost in cheddar cheese manufacturing makes up only 2.9% of the overall cost of manufacturing cheese.[7] Therefore, it seems clear that *Energy Cost* has a small impact on the overall *Cost of Doing Business*, at least in California cheese manufacturing Metro areas.

A much more siginifcant component upon cheese manufacturing costs is *Unit Labor Cost*. Again, according to CDFA's Cheese Manufacturing Costs exhibit, Processing Labor Costs make up nearly 25.5% of overall manufacturing costs.[8] The following Table 4 highlights the compelling cost competitiveness of San Joaquin Valley Metro Areas:

[6] Moody's Analytics calculates the Energy Cost Index by comparing the average commercial and industrial electricity costs, in cents per kilowatt-hour, with the national average. The data comes from the Energy Information Adminsitration, a division of the Department of Energy. The EIA reports commercial and industrial prices of all major independent and publicly owned utilities, as well as cooperatives.

[7] "Cheese Manufacturing Costs," California Department of Food and Agriculture Dairy Manufacturing Cost Exhibit for the period of January thorugh December 2013, dated November 12, 2014.

[8] "Cheese Manufacturing Costs," California Department of Food and Agriculture Dairy Manufacturing Cost Exhibit for the period of January thorugh December 2013, dated November 12, 2014.

Top Ten Cheese Manufacturing U.S. Metro Areas with Lowest Labor Costs	Table 4: Unit Labor Costs[9]	
	Index	Rank
1. Merced, CA	81	366
2. Mankato, MN	83	358
3. Amarillo, TX	89	296
4. Modesto, CA	91	267
5. Fresno, CA	92	257
6. Bakersfield, CA	94	226
7. Eau Claire, WI	96	207
8. Grand Rapids, MI	97	193
9. Greeley, CO	97	182
10. Wausau, WI	99	154

For purposes of simplicity, I have ranked only the ten Cheese Manufacturing U.S. Metro Areas with lowest *Unit Labor Costs*. Four of the top six are San Joaquin Valley metro areas (as noted in gold), with Merced the lowest, followed by Modesto in 4th, Fresno in 5th, and Bakersfield in 6th. In short, the vast majority of cheese manufacturing metro areas in other states exceed these California areas in *Unit Labor Cost*.

Another important cost component measured by Moody's Analytics is *State & Local Tax*. The effective tax rate index is measured as the total state and local tax revenue as a percent of total personal income in the area, indexed to the national effective tax rate. This is a top-down measure that uses government revenues to represent the tax burden. This measure includes all taxes, including personal, property and corporate, less severance taxes, corporate license taxes, education, hospital, and intergovernmental transfers. Business contributions to unemployment and workers' compensation programs also are included because they represent costs for hired labor. However, only the contributions from employers are included in calculating an area's tax burden.[10]

[9] Moody's Analytics calculates Unit Labor Cost Total by creating a weighted average of unit labor costs in each three-digit NAICS industry. The weights are equal to the national share of employment in each industry. This adjustment is necessary since unit labor costs vary across industries as a result of the occupational mix of the industry's employment and the capital structure of its operations. However, such a compositional bias can be avoided by using the national share of employment for each industry to weight the unit labor cost components. A state-specific component weight system is used in lieu of a uniform fixed component weighting system. State-specific weights were generated by analyzing interindustry capital flows via IMPLAN modeling software.

[10] "North American Business Cost Review," Moody's Analytics, May 2014, and updated October 2014, pg. 4.

Table 5 highlights the top ten Cheese Manufacturing U.S. Metro Areas with the lowest *State & Local Tax Index*:

Top Ten Cheese Manufacturing U.S. Metro Areas with Lowest State & Local Taxes	Table 5: State & Local Tax[11]	
	Index	Rank
1. Amarillo, TX	68	334
2. Greeley, CO	70	329
3. Kennewick, WA	82	239
4. Yakima, WA	83	232
5. Bakersfield, CA	95	119
6. Hanford, CA	96	105
7. Fresno, CA	97	98
8. Visalia, CA	97	98
9. Merced, CA	98	86
10. Modesto, CA	98	86

Once again, San Joaquin Valley metro areas are among the lowest in *State and Local Tax*, with six areas out of the top ten (as noted in gold). For comparison purposes, it was impossible to determine the *State and Local Tax* component for California cheese plants since CDFA's Cheese Manufacturing Costs Exhibit does not break it out for those expenditures. Nonetheless, Table 5 illustrates the competitive position of San Joaquin Valley metro areas and that *State and Local Tax* burdens are higher in most other cheese manufacturing metros areas across the U.S.

Lastly, I examined the *Office Rent* component of the *Cost of Doing Business Index*. According to CDFA's Cheese Manufacturing Costs exhibit, *Office Rent* makes up nearly 6.3% of overall manufacturing costs. The following Table 6 highlights the compelling cost competitiveness of San Joaquin Valley Metro Areas:

[11] "North American Business Cost Review," Moody's Analytics, May 2014, and updated October 2014, pg. 4.

Top Ten Cheese Manufacturing U.S. Metro Areas with Lowest Office Rent	Table 6: Office Rent[12]	
	Index	Rank
1. Merced, CA	51	354
2. Janesville, WI	54	331
3. La Crosse, WI	54	328
4. Yakima, WA	54	322
5. Grand Rapids, MI	55	310
6. Visalia, CA	55	308
7. Fond Du Lac, WI	56	305
8. Hanford, CA	58	289
9. Racine, WI	58	281
10. Eau Claire, WI	59	271

San Joaquin Valley metro areas are among the lowest in *Office Rent*, with three areas included within the top ten (as noted in gold). Merced is far and away the lowest cost metro area among all considered.

V. Conclusion

The dairy industry is an important and vital contributor to the agricultural and overall economy of the great state of California, and reflected in the industry's overall productiveness. As my analysis of the *Cost of Doing Business* has shown, the major cheese manufacturing metro areas located in California's San Joaquin Valley are among the most cost competitive as compared to other metro areas across the country. Contrary to incorrect popular belief, there are important regions within California that remain among the lowest metro areas with regard to *Unit Labor Cost, State and Local Tax*, and *Office Rent*. Moreover, the *Cost of Doing Business* when combined with the creation of a federal milk marketing order will not place California cheese makers at a competitive disadvantage with the rest of the nation.

[12] Moody's Analytics Office Rent index compares the cost of renting office space in a metropolitan area with the national average. The Torto Wheaton office rent index from CBRE forms the basis of the office rent index. Further, the index standardizes the rental measure to a 10,000-square-foot building of average age and class for five years in an average area of the market. Again, this standardization avoids compositional bias caused by differing mixes of buildings and terms of individual contracts in a given period.