CCSCE
Center for Continuing Study of the California Economy
Numbers in the News
July 2009

Are Businesses and High-Income Residents Fleeing California?

The state and national media are filled with continuing claims that businesses and high-income residents are leaving (fleeing) California and that it is because the state has a horrible business climate.

Recently the Milken Institute, a respected California think tank, published a report on manufacturing job trends in California. The majority of the report is focused on discussion of a wide range of policy proposals designed to improve the state's competitive position. Milken's ideas join those of other institutions in an ongoing discussion of the best economic policies for California. Milken's proposals in support of increased attention to workforce training issues are particularly welcome based on CCSCE's analysis of what is needed to prepare California and Californians for future prosperity.

But, in addition, the Milken report makes claims about job data and trends that are contradicted by other evidence. And last week the Public Policy Institute of California (PPIC) released data that contradicts the claim that most residents who move to other states are California's high-income residents.

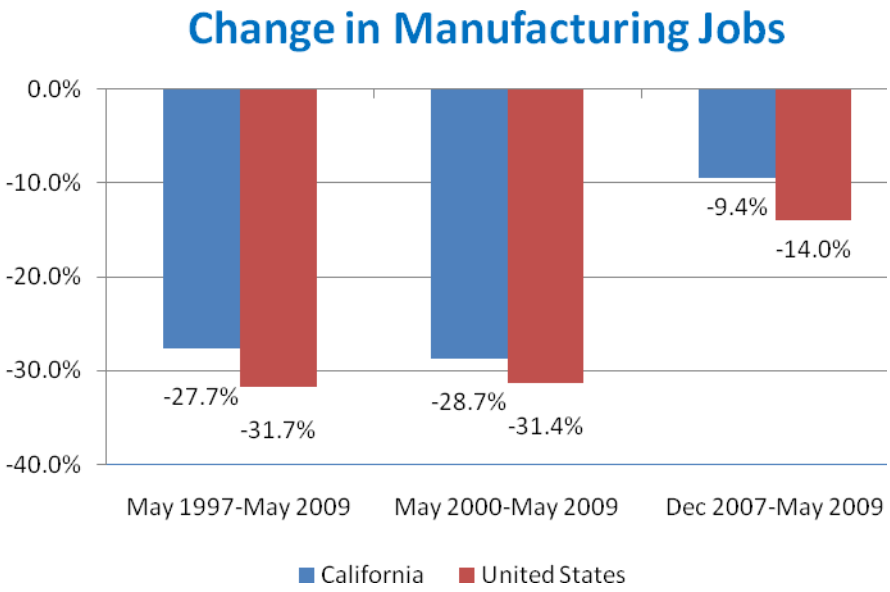
The state does face challenges in being a great place to live and work—a state that can attract businesses and workers and enjoy prosperity. The debate is not about whether the state faces economic challenges but about what are the best policy answers to respond to the state's emerging 21st century economy.

This *Numbers in the News* reviews recent data in the hope that ongoing policy discussions can move forward with some agreement about what the data say.

Recent Manufacturing Job Growth Trends

Manufacturing job levels have shrunk rapidly in California and across the nation. During the past nine years manufacturing job levels fell by 5.4 million in the nation and nearly 540,000 in California. CCSCE looked at three time periods—1) starting in 1997 to capture the possible impact of the state's high-tech boom, 2) the past nine years starting in 2000 to bring Milken's analysis, which ended in 2007, up to date, and 3) the recession period starting in December 2007.

In each period manufacturing job losses were substantial but in each period the percentage job losses in California were below the national average.

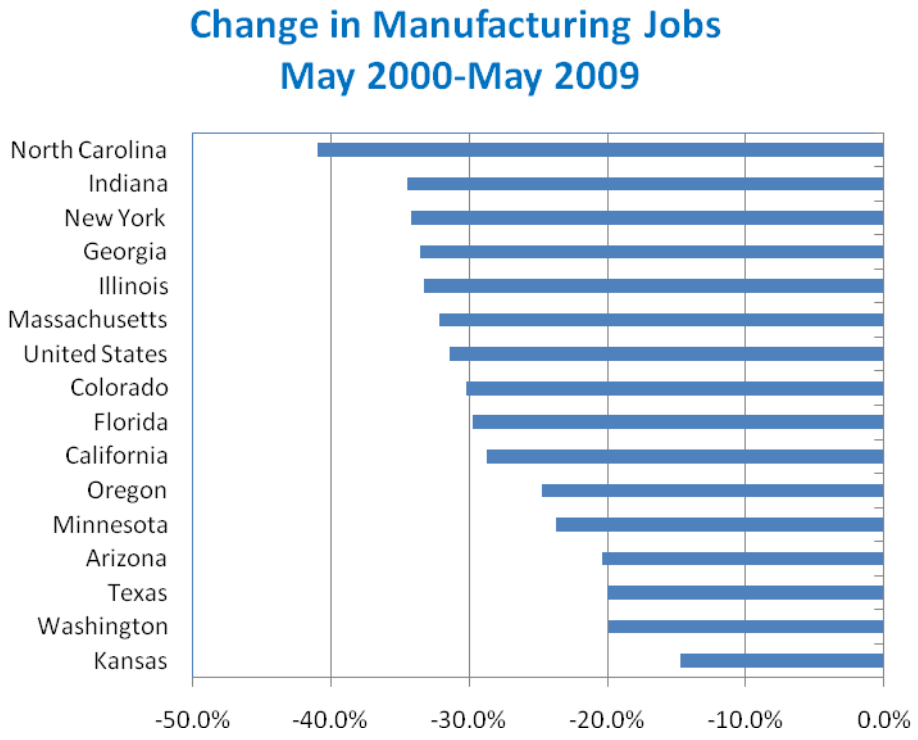


The Milken report identified seven states called "peer" states where the state's share of U.S. manufacturing jobs increased between 2000 and 2007. Since California's manufacturing job performance was only slightly above the national average, it is logical that some states performed better and some worse.

To broaden the data collection CCSCE went to Milken's recently released report *North America's High-Tech Economy* to include other states identified by Milken as high-tech centers. Milken's group of "peer" states include Arizona, Indiana, Kansas, Minnesota, Oregon, Texas, and Washington. Of Milken's 50 high-tech centers Texas has 4, Kansas has 2 and the other five states have 1 each compared to 6 for California.

To this list CCSCE added well-known high-tech centers identified by Milken that could also be seen as "peer" states including Colorado (3 centers), Florida (3), Georgia (1), Illinois (1) Massachusetts (1), New York (2), and North Carolina (2). The manufacturing job performance for all of these states for the period from May 2000 through May 2009 is shown below,

Six of the seven "peer" states identified by Milken continued to have smaller percentage manufacturing job losses as compared to California through May 2009—Indiana falls off that list. **But every one of the other states on CCSCE's list had higher percentage job losses compared to California.** So California is in the middle, below the national average measured by percentage job losses, and definitely not trailing the pack when a broad group of states is included.



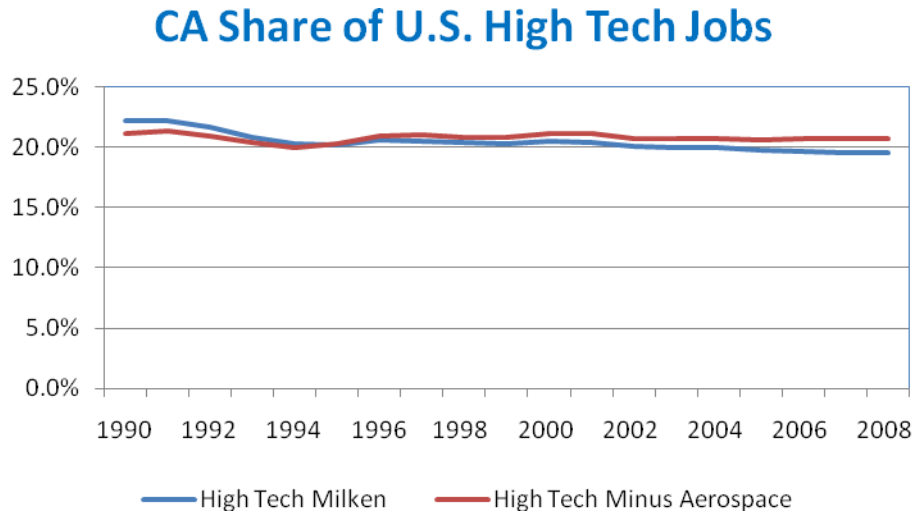
What are the data to support Milken's claim that, within the manufacturing sector, California is falling behind in the important high tech industries? Aerospace is included in the Milken definition of high tech and accounts for a slight drop in California's share of high-tech jobs since 1990, with most of the decline coming before 1995 when aerospace job losses were large here and elsewhere.

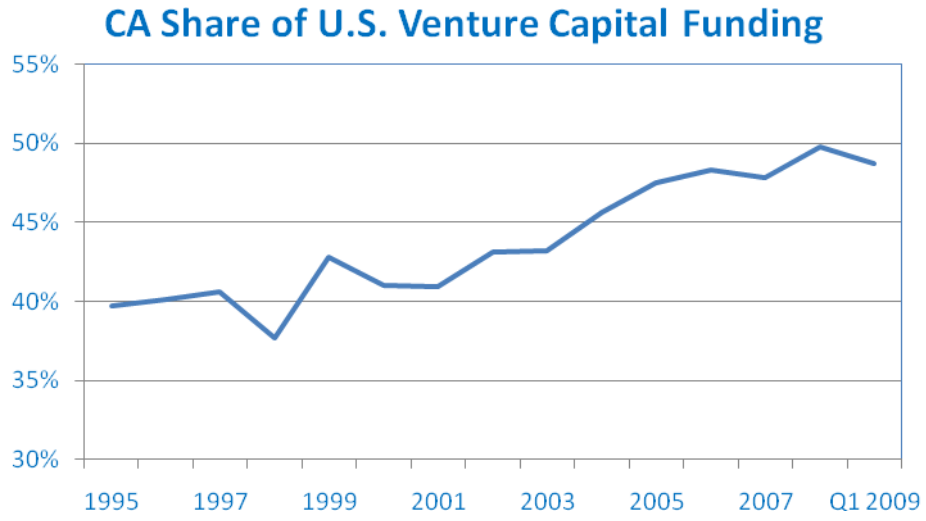
If aerospace jobs are removed from the high tech category, California's share has remained remarkably steady at just over 20% of the nation's high tech jobs. Both job share trends, with and without including aerospace, are relatively unchanged from 1995 through 2008.

On the other hand California's share of U.S. venture capital formation, another measure of location decisions and competitiveness, has been in a steady upturn. California's share recently hit an all-time record level of near 50% of total U.S. venture capital funding.

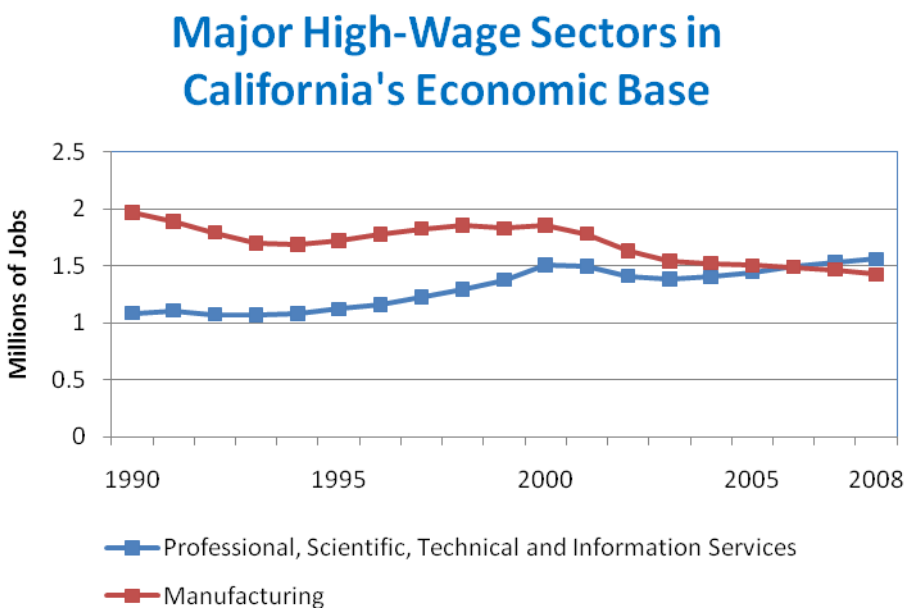
The job and venture capital trends portray an important message for thinking about California's future prosperity. While manufacturing is an important sector in many regards, more and more high tech activity is taking place outside of manufacturing. California firms will design innovative approaches to conserve energy whether or not production takes place here. Many venture capital investments are in non-manufacturing areas related to the Internet, software, telecommunications and the many areas where California is the leader in design

and engineering. The iPhone story comes to mind—designed in Silicon Valley, manufactured in China.





One of the questions before policy makers in California is “where is high-wage job growth likely to come from”. Recent high-wage job growth has followed the venture capital funding trends. In 1990 California had 2 manufacturing jobs for every job in professional, technical, scientific and information services. By 2008 the lead had reversed. All projections of U.S. and California job growth over the next ten years show manufacturing jobs continuing to shrink while jobs in professional, technical, scientific and information services are set to rise sharply.



The excitement about "green" job growth reminds us that opportunity for the growth of "good jobs" is not exclusively or primarily in manufacturing. California stands in good position to compete for design, engineering, construction and a wide array of support jobs as the green economy expands with the development of new products and new ways of being more energy efficient.

Explanation of Key Issues and Trends

Business Relocations—Stories, Inference and Quantitative Research

Both the Milken and the CCSCE analysis make inferences from reported data about job trends. The only comprehensive analysis of actual business relocations in California was conducted by the Public Policy Institute of California (http://www.ppic.org/main/publication.asp?i=710).

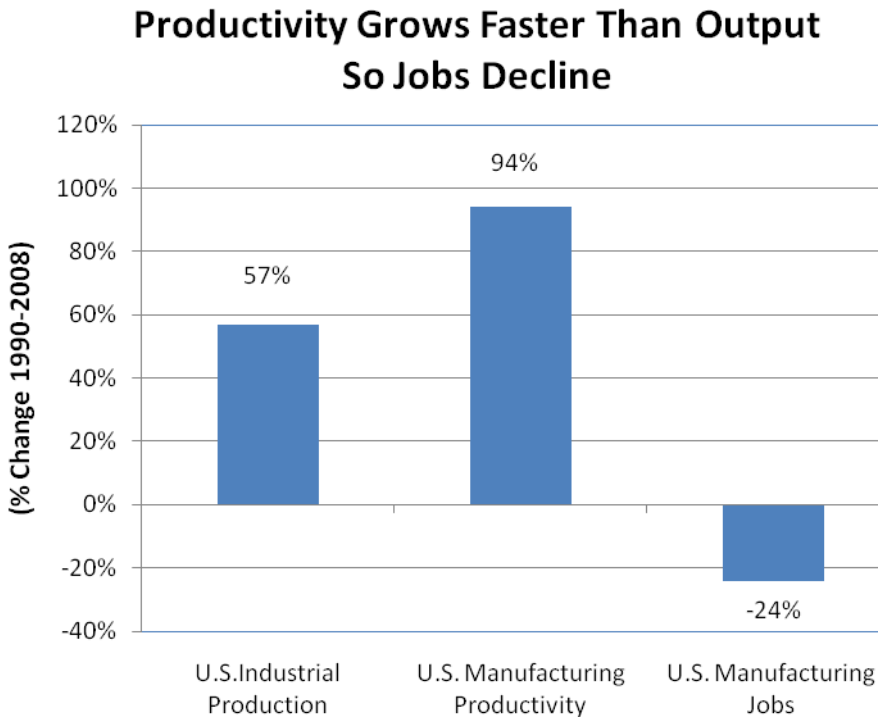
One of their main conclusions is "The authors find that the small number of California jobs moving to other states due to business relocation is relatively inconsequential—about 11,000 jobs per year out of more than 18 million (.06 percent). Business births, deaths, contractions, and expansions have a much greater effect on employment".

In a new PPIC study (http://www.ppic.org/main/publication.asp?i=895) titled *Planning for a Better Future*, PPIC comments "Rhetoric aside, California loses very few jobs to other states…Business relocations, thought highly visible, are a misleading guide to the overall performance of the California economy".

The stories about businesses relocating to other states are anecdotes, correct in their individual stories, but not a contradiction to the Public Policy Institute quantitative research that out of state relocations are negligible compared to overall job changes in California.

Why Are Manufacturing Job Levels Falling

CCSCE published an analysis in March 2009 (http://www.ccsce.com/pdf/Numbers-Mar09-Mfg_Job_Losses.pdf). There are two basic conclusions: 1) that manufacturing job losses are primarily the result of productivity gains outpacing sales growth and 2) that, therefore, a "lost" job is most likely not a job that moved to another locale (here or abroad) but a job for which there was no longer any demand. With manufacturing productivity growing at 5-6% per year, substantial production gains are possible while job levels fall.



Is Everyone Leaving California

Another version of the "bad business climate" discussion is the claim that people are fleeing California.

During the past 20 years, migration to California has been positive except for four consecutive years in the early 1990s when California's recession was deeper and longer than the national downturn. More people are coming to California than are leaving the state.

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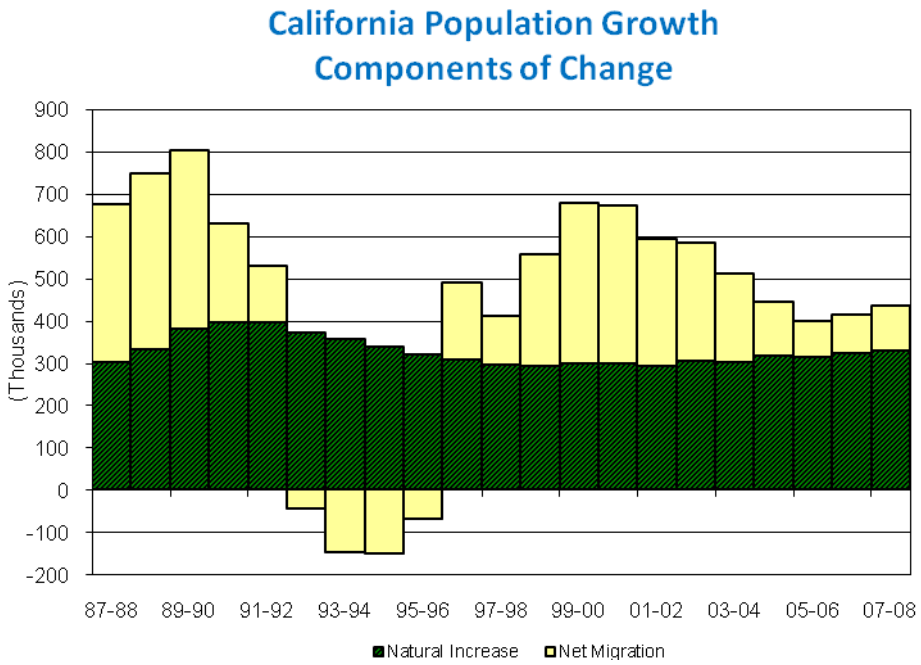


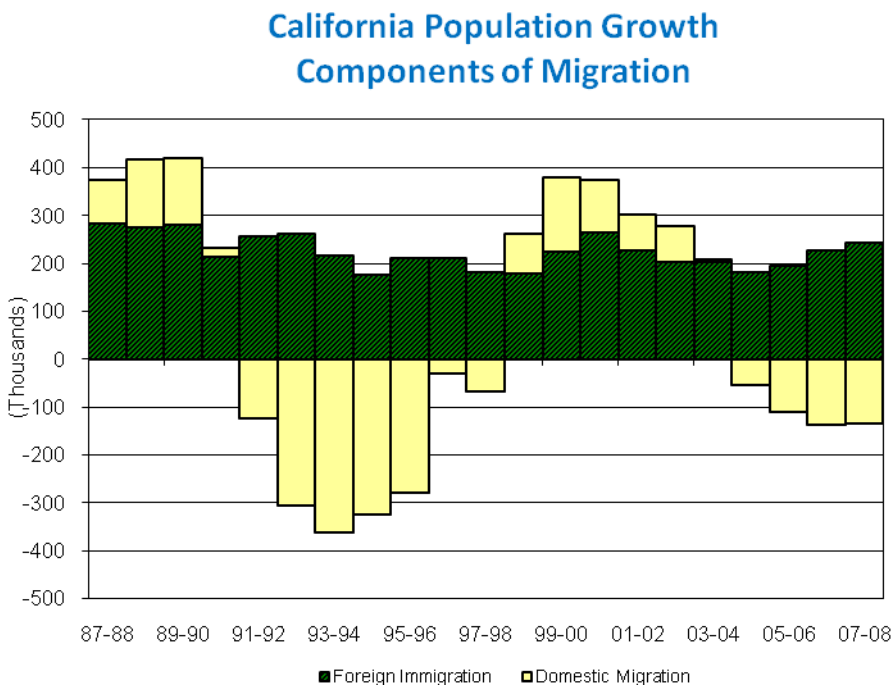
The net migration data shown above includes movements between California and foreign countries (net foreign immigration) and movements between Caliornia and other states (net domestic migration). Foreign immigration, including residents who move back to foreign countries, has been positive in each of the past 20 years. Domestic migration was positive in 9 of the past 20 years and was negative in 11 years. Total migration has been postive in every year since 1995-96.

When people claim that residents are fleeing Califorina, they are focusing on the recent period of domestic out-migration (2004-2008) and overlooking that total migration remained positive even during the past four years. There is probably no intention to dismiss the choices of foreign citizens to choose California as a place to live and work.

What Explains Domestic Migration?

The relative weakness of the California economy after 1990 explains the surge in domestic out-migration between 1991 and 1998. The California economy recorded substantial job losses in 1991, 1992 and 1993 even as the national economy was recovering. People left in search of better job opportunities.

The surge in domestic out-migration came **after** the job losses had peaked and continued even as job growth resumed in early 1994.



There has been a presumption that the current cycle of domestic out-migration also reflects weakness in the California economy but that claim does not fit the timing of recent job trends and overlooks a more compelling explanation—that the out-migration trends are the result of relative home prices.

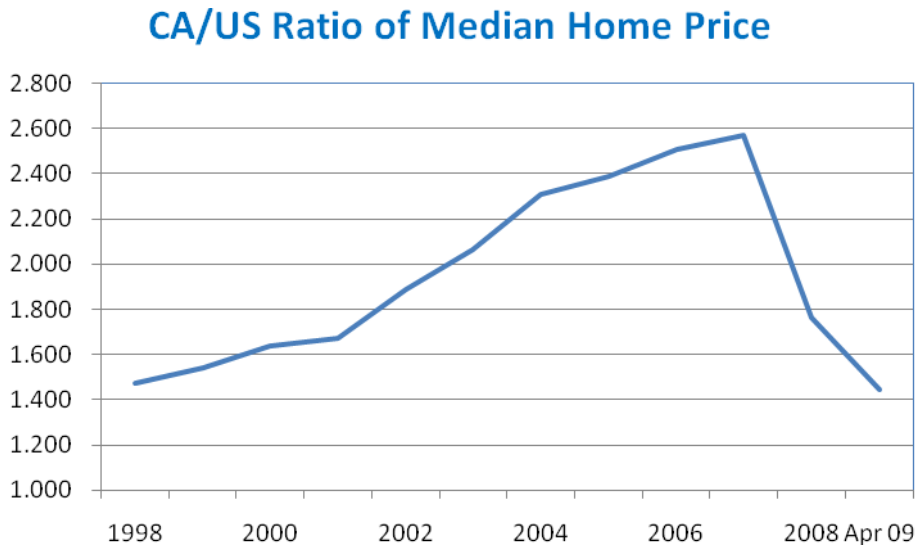
Between 2004 and 2008 the U.S. had a slightly higher job growth rate (3.8%) compared to 2.9% for California. But jobs were growing and growing at similar rates in 2005, 2006 and early 2007 when most migration decisions were made. California's economy in the past 12 months has been slightly weaker than in the nation but the timing is wrong for recent job losses to have had any influence on migration decsions up to July of 2008.

Relative housing price trends provide a more compelling explanation of domestic migration trends after 2004. In 2004 California's median housing price reached the highest recorded "gap" relative to the nation. And the housing price gap continued to grow until early 2007.

There are two reasons that a relative price gap will trigger some out-migration. The gap increases the incentive for California homeowners to take their profits and move to lower cost areas where they can buy a larger home and still have money left over. The press is filled with stories of people cashing out on their California home and moving to nearby states.

On the other hand the price gap reduces the incentive for people from other states to move to California. In fact during these years California's housing "unaffordability" was probably the principal competitive disadvantage facing the

state. The timing of housing price and domestic migration trends makes sense. The decline in net domestic migration coincided with the period during which the state's median homes price gap reached record levels relative to the nation.



Are High-Income Residents Fleeing California?

This claim is often heard in policy discussions about changing California's tax structure to reduce income tax rates on higher-income households. Once again, it is important to distinguish the data from the policy debate.

In July 2009 PPIC released one of their *Just the Facts series* and the brief (http://www.ppic.org/content/pubs/jtf/JTF_LeavingCAJTF.pdf) provides some data on this assertion. PPIC concludes:

RICHER HOUSEHOLDS ARE LEAVING CALIFORNIA—BUT SO ARE POORER HOUSEHOLDS, AND MORE OF THEM.

POOR HOUSEHOLDS ARE MORE LIKELY TO MOVE—INTO AND OUT OF CALIFORNIA

CALIFORNIANS OF ALL INCOMES DEPART FOR—AND ARRIVE FROM—STATES WITHOUT INCOME TAXES

THE POOR, MORE THAN OTHERS, ARE MOVING TO STATES WITHOUT INCOME TAXES.

INCOME TAXES AREN'T DRIVING AWAY THE HIGHEST-INCOME HOUSEHOLDS

Californians will continue to discuss the best approaches to economic competitiveness and prosperity. Hopefully these discussions will focus on important trends and changes in the state's economy as we move further into the 21st century and move beyond anecdotes and assertions not reflective of overall data and economic trends in California.