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DATE: June 16, 2004  
TO: California Budget and Economy Friends  
FROM: Stephen Levy  
SUBJECT: Expanding Economic Opportunity for California and Californians

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### Summary

1. National economic policy and national economic trends such as job and wage growth are the most important factors in expanding economic opportunity. Low, middle and higher income California families share an interest in a strong national economy that produces low unemployment rates and rising real income. As we have seen in all recent recessions, it is virtually impossible for state or local economic policies to overcome the negative impacts of slow national economic growth.
2. California is continuing to become a Hispanic state but there is a new and important dimension to our ethnic diversity. As time passes, a majority of California's Hispanic residents are "settled immigrants" (more than 10 years of residence) versus "new arrivals". The children and grandchildren of immigrants will speak English and have an excellent chance of graduating from high school if the state adopts such a goal. These children and grandchildren of immigrants will be California's schoolchildren and then California's workforce. **They are the state's opportunity and challenge.**
3. California's economic base is diverse and contains many of the nation's leading growth sectors. Recent data show that California's economy has mirrored the national trends in job and income growth. This performance is far better than a decade ago when California trailed the nation's recovery by two years.

4. Californians are currently debating what is the best focus for state economic policy. One group emphasizes “reducing the negatives” and is concerned about cost differentials between California and other states in workers’ compensation, energy and regulations. Other groups emphasize “increasing the positives” and are concerned about investment in K-12 and higher education, transportation and in creating great communities for living and working, including adequate and affordable housing.

An understanding of California’s economic base, i.e., what industries are critical for future prosperity, is essential to select the best policies for increasing California’s competitive edge and expanding economic opportunity.

5. **Guaranteeing effective access to public higher education for eligible students is one policy that addresses both broad economic competitiveness goals and expanding economic opportunity goals simultaneously.**

California will have an expanding workforce when the nation faces a major slowdown as baby boomers retire. Our workforce will be largely the children, grandchildren and great-grandchildren of immigrants and they will face an exciting array of career choices. Not every worker needs or is best suited to a four-year college education, but most will need some post-secondary training.

Effective access means:

--Enough space and class offerings to accommodate all eligible students

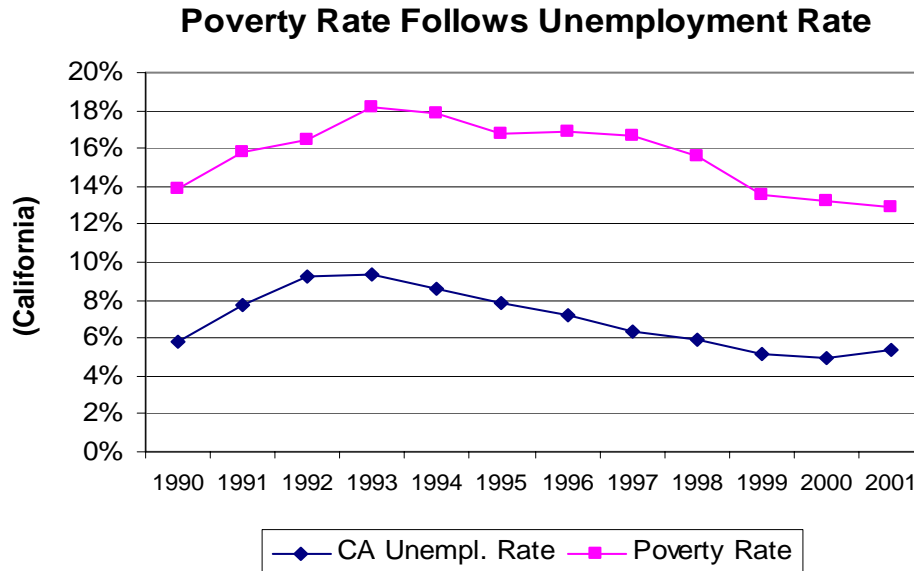
--Enough financial aid to make sure that financial need does not prevent students from getting a higher education opportunity

--And, in some cases, effective access will mean early education help so that all potentially eligible students get a chance to prove their academic eligibility for higher education.

California is a state with a strong economic base and a talented and vibrant workforce. In general, the challenge of increasing economic prosperity for Californians is the same challenge as making California a great place to live and work. But, just as the nation is struggling with how to make “no child left behind” a real vision, so, too, must California also focus on a “no Californian left behind” attitude relative to educational and employment opportunity.

## Expanding Economic Opportunity

**A strong national economy is the best single policy to reduce poverty and expand incomes.** Reducing the unemployment rate is the single most effective policy to reduce poverty. Safety-net policies, such as the minimum wage, are easier to expand in periods of strong national economic growth. Rising **real wages** for low and middle income workers usually rise **only in periods of strong national economic growth.**



**Policies that support expanded economic opportunity for low-income individuals and families have significant overlap with policies that support higher rates of job and income growth for all Californians.** It is hard to conceive of a situation where the economic well being of low-income residents advances while the standard of living for middle and upper-income residents lags. As a result, the conditions for increasing the competitive edge of the California economy are of interest to **all residents.**

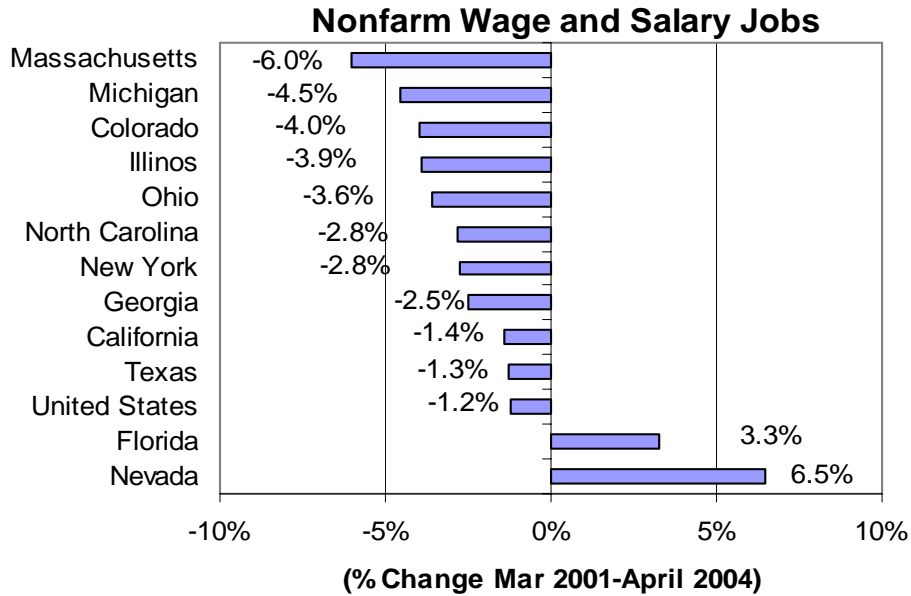
### Strategies for Increasing California's Competitive Edge and Expanding Economic Opportunity

Recent economic data show that the California economy is suffering along with the nation from the current jobs slowdown. Compared to other states, however, California is holding its own, unlike during the early 90s recession. California's economic base is diverse and concentrated in industries that have solid long-term growth prospects.

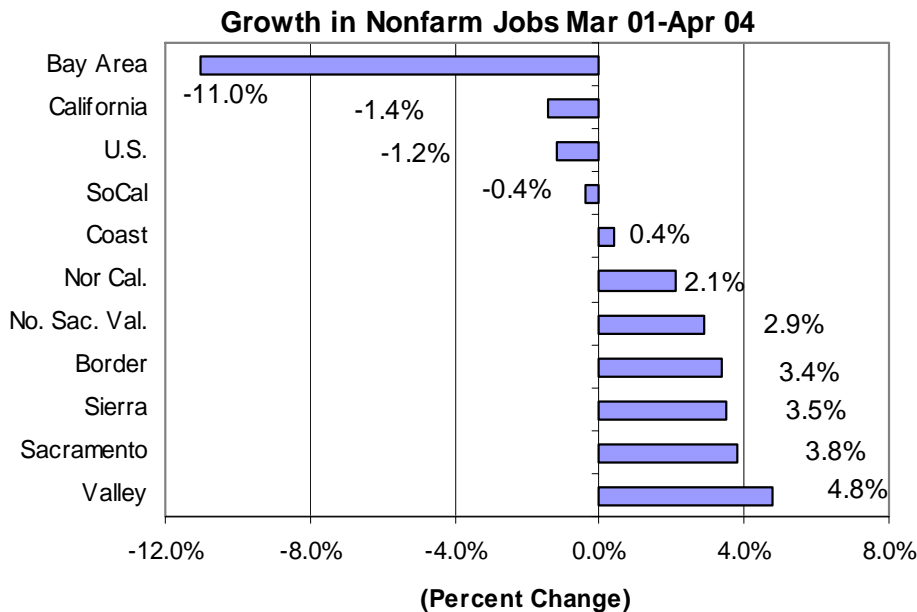
## The California Economy—Where We Are Now?

The national recovery is the weakest since the Great Depression in terms of job growth. In an “average” recession since 1960, the U.S. economy would now have 6.2 million additional jobs and California’s job level would be nearly 700,000 higher and at an all-time record high.

Between March 2001 and April 2004, California lost 1.4% of the state’s job base, compared to a 1.2% loss nationally. Many large industrial states, including high tech centers such as Massachusetts, Colorado and North Carolina have experienced far larger job losses.



California’s job losses were concentrated in just one region—the Bay Area. The state’s other eight economic regions all outperformed the nation and seven regions added jobs during the recession.



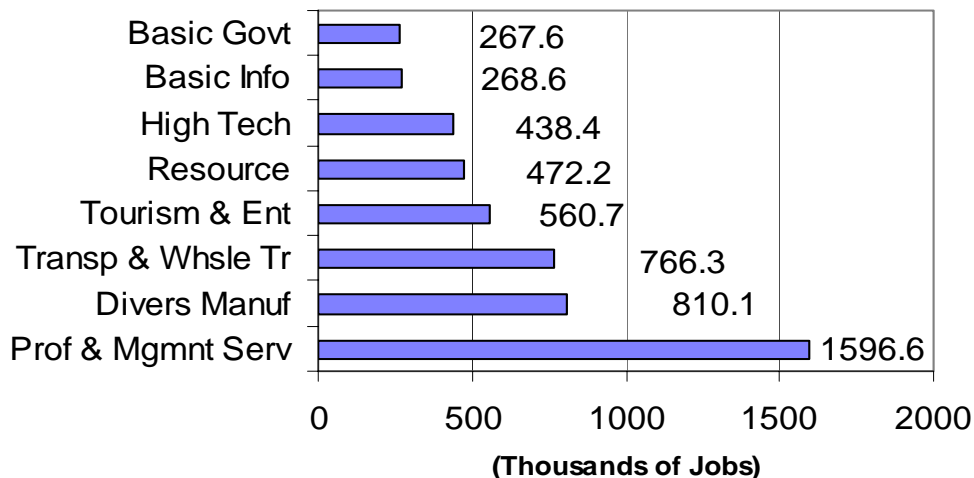
## California's Economic Base—Some Basic Data and Trends

The following data was prepared as part of the Regional Economies Project co-sponsored by the California Workforce Investment Board and the California Economic Strategy Panel. California's economic base can be disaggregated into eight major categories for purposes of providing a summary of key trends in each region:

- High Tech Manufacturing
- Diversified Manufacturing
- Wholesale Trade and Transportation
- Professional, Technical, Scientific and Management Services
- Basic Information Services
- Entertainment and Tourism
- Basic Government Services (Federal and State Government)
- Resource Based

In 2003, approximately 5.2 million of the state's 16.1 million jobs (32%) were in California's economic base. Professional, Technical, Scientific and Management Services is the state's largest basic industry category with 1.6 million jobs in 2003.

### California Economic Base in 2003

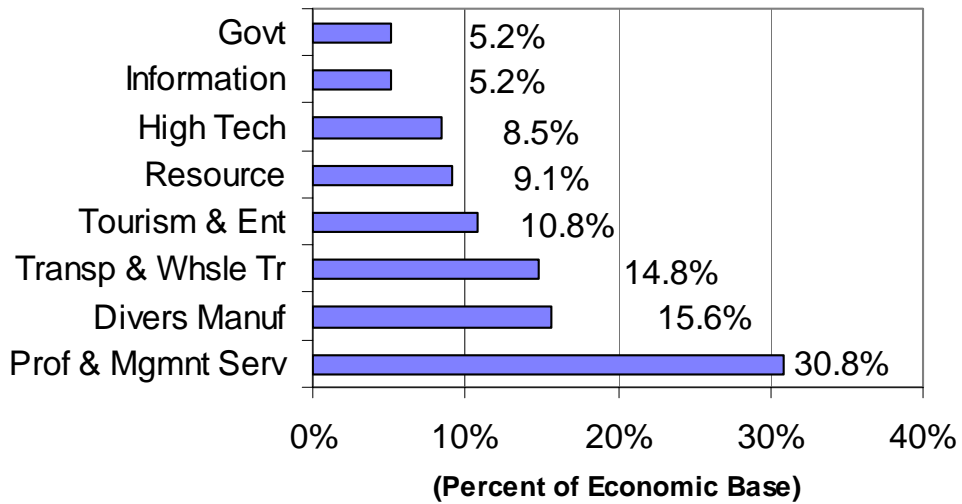


Diversified Manufacturing is the second largest basic industry category with 810,100 jobs followed by Transportation and Wholesale Trade (766,300 jobs) and Tourism and Entertainment with 560,700 jobs.

Professional, Technical, Scientific and Management Services accounted for 30.8% of all basic industry jobs in California in 2003. Diversified Manufacturing accounted for 15.6% followed by Transportation and Wholesale Trade with 14.8%. High Tech, Resource Based industries and Tourism and Entertainment

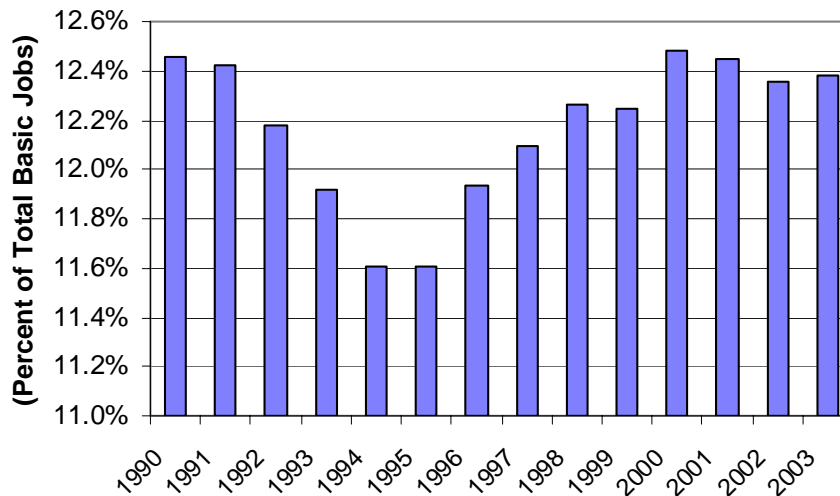
each had approximately 10% of basic jobs while basic information and basic government each accounted for approximately 5% of California's economic base.

### California Economic Base in 2003



California's share of the nation's basic industry jobs is shown below. This is the single best indicator of how the state is doing in terms of competitive edge.

### California Share of U.S. Economic Base



California's share of basic industry jobs fell from 12.5% in 1990 to 11.6% in 1994 reflecting both the loss of defense-related jobs and the decline in the state's

share of aerospace jobs. The state's share of total basic jobs rose back to 12.5% by 2000, reflecting share gains in Diversified Manufacturing, Information and Professional, Technical, Scientific and Management Services.

California's economy is in a good position to participate in future worldwide economic growth. As described below, the state has a strong position in the application of creativity to a whole range of goods and services and strong location advantages for the growing Pacific Rim markets.

Public policies remain important for California to translate economic opportunity into real gains in jobs and income.

### **The Diversity of California's Economic Base**

The advice that "one size does not fit all" applies to determining how to increase California's competitive edge. An analysis of California's economic base confirms the diversity of California's leading industries. Given the diversity of the state's economic base, it is clear that policies to increase the state's competitive edge must themselves be diverse.

California's manufacturing base ranges from semiconductors to cut and sew apparel, from aerospace to furniture, from medical equipment to plastics and chemicals and from pharmaceuticals to paper.

Outside of manufacturing the state's economic base has strength in professional services and information. Specific industries range from scientific R&D services to telecommunications, from computer services to architectural and engineering services and from management, scientific and technical consulting to software publishing and Internet services.

California also has major job concentrations related to foreign trade, tourism and entertainment and agriculture. Specific industries range from wholesale trade to motion pictures and from accommodations to agriculture and amusements.

New national job growth projections confirm that California's economic base is concentrated in areas with above-average growth prospects. Foreign trade is a leading growth sector. Professional services and information services have above-average job growth prospects. Entertainment and tourism have above-average job growth prospects.

California's basic industry growth is helped significantly by the formation of new firms. The state regularly captures more than 40% of new venture capital funding and a recent PPIC study showed that most of Silicon Valley's job growth in the 1990s came from new firms, not from firms in existence in 1990.

## **Increasing the Positives, Reducing the Negatives**

State policies play a role in creating a solid foundation to attract and retain private capital investment in California. Two sets of policies have received attention in the media and in the many regional meetings of the Regional Economies Project. One set of policies is focused on “reducing the negatives” and includes policies that deal with direct business costs such as workers’ compensation reform, energy costs and taxation.

A second set of policies is focused on “increasing the positives” and includes policies to increase investment in education, infrastructure and quality of life.

Concern about the adequacy and affordability of housing in California is a crosscutting issue. California’s high housing costs are frequently mentioned as a disincentive for new investment because firms must pay higher wages to offset the high housing costs for new residents. But housing is also a quality of life issue in the sense that if “nurses, teachers and public safety officials” can’t afford to live near where they work, the level of services provided to local residents is diminished.

**A longer version of this discussion will be provided after it is presented as part of the Regional Economies Project.**

## **Great Places to Live and Work**

For decades, California communities were recognized as great places to live and work. A great climate, excellent recreational facilities, access to both mountains and oceans, good local parks and public facilities and steady improvements in air and water quality helped California rank at or near the top in polls asking “where would you like to live”.

These attributes, together with sufficient housing, good schools and adequate infrastructure, constitute the main elements of “a high quality of life”. And a high quality of life is one of California’s major “competitive” forces in attracting new entrepreneurs and innovations. When you can locate a business anywhere, why would you locate in a place that was not attractive for living as well as working?

The Governor and Legislature have a significant role in developing public policies that affect the quality of life in California communities. Both the state budget and state-local fiscal relationships, including Proposition 13, heavily influence local government funding and land use choices.

State-local fiscal relationships and the incentives produced by the current system have proven difficult to improve, but there is no question that these choices affect California’s competitive edge.

## **Two Barriers to Reaching Consensus on Expanding Economic Opportunity**

There are two “big picture” conflicts in coming to consensus on policies to increase California’s competitive edge.

The first dilemma is that not all businesses are attracted by the same factors. For example, high-tech startups may care more about the educational system, infrastructure and quality of life, while paint manufacturers may care more about energy costs and taxes.

**So, in part, what makes a good business climate and what the state should do depends on what kind of industry the state wants to attract.**

The second dilemma is that policies for the state in supporting and attracting private investment **sometimes point in different directions**. Investing more in education and infrastructure and creating great places to live and work may require more public funding than is currently being spent, while lowering tax rates or granting tax incentives for business will reduce the funds available for public services and public investment.

**The search for public policies that support the creation of new private investment and associated jobs is caught in the same set of choices that have paralyzed the state’s budget process.** Do Californians think the way to attract business is to support spending for education, infrastructure and local governments, which will probably require an increase in public revenues? Or, is the best approach for attracting private investment to reduce the level of public services in an effort to balance the budget without raising taxes? Or is there a third way, which will allow the state to invest more without raising taxes or fees?

### **Tolerance as a Competitive Advantage**

Tolerance has been one of California’s strongest competitive advantages. Tolerance of diverse lifestyles has added to the competitive attraction of Hollywood and San Francisco. Tolerance of diverse dress preferences and work hours was a major attraction for people to live and work in Silicon Valley. Tolerance of ethnic diversity has made California a major destination for immigrant entrepreneurs and workers.

Much of the tolerance comes from the spirit of California residents. But part comes from the legal rights established and enforced in the state.

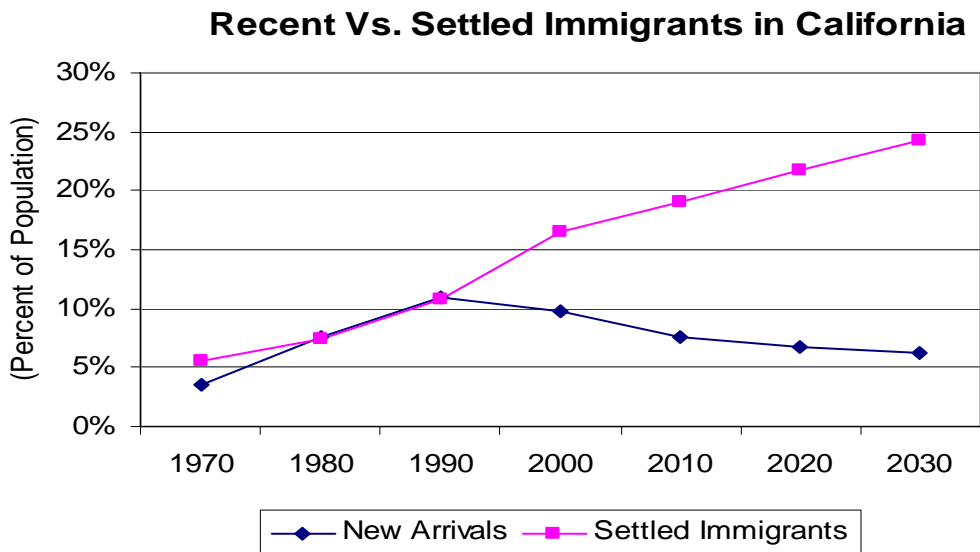
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## Demographic Trends—The “New” Hispanic Majority

The new population projections released by the California Department of Finance show a continuation of rapid growth in California’s Hispanic population. By 2020, the state’s Hispanic population is projected to reach 18.9 million and Hispanics will be California’s largest ethnic group. Between 2000 and 2020, Hispanic population growth will account for 80% of the state’s overall population gains.

**However, the characteristics of California’s Hispanic population will change during the next 10 to 20 years and these changes should be reflected both in the attitudes and public policies of Californians.**

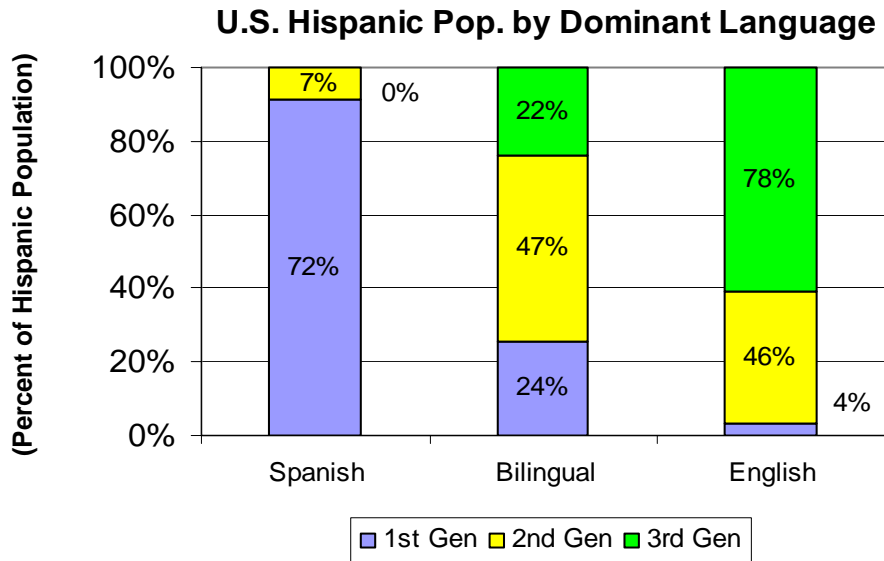
During the next two decades, an increasingly larger share of California’s foreign-born population (primarily Hispanic) will be **settled** versus **recent** immigrants. **There are substantial differences between settled immigrants (here more than ten years) and more recent immigrants in terms of education, language and poverty.**



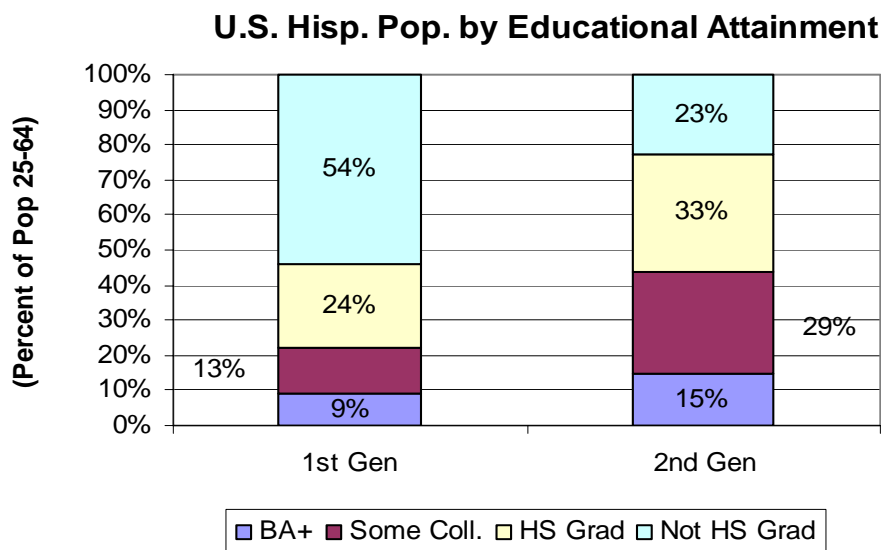
Recent analyses from the Pew Hispanic Center and the Urban Initiative at USC (Dowell Myers) document these important trends in generational differences between Hispanic immigrants. As the years pass, California’s Hispanic population will become heavily weighted toward the children and grandchildren of immigrants. And these children and grandchildren will have characteristics different from their parents and grandparents.

By 2010, there will be 2 settled immigrants for every 1 recent immigrant and by 2020 there will be 3 settled immigrants for every recent immigrant in California.

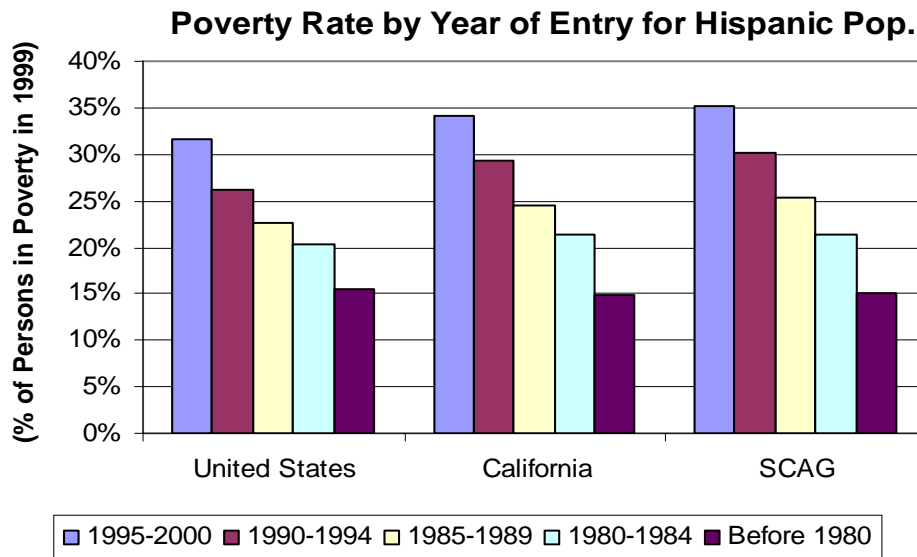
The second and third generation will speak English or be bilingual. Only 4% of first generation immigrants speak English as their primary language but that share rises to 46% for the 2<sup>nd</sup> generation and 78% for the 3<sup>rd</sup> generation. Only 7% of 2<sup>nd</sup> generation immigrants speak Spanish as their primary language.



Educational attainment will increase. High school completion rates and college-going rates are currently much higher for 2<sup>nd</sup> generation Hispanics compared to recent immigrants and effective public policies can increase these rates further.



Poverty rates for immigrants are directly related to the length of time in the United States. This is true in the nation, state and Southern California (SCAG) region. These trends give hope that poverty rates in California will fall if the children and grandchildren of immigrants can become full participants in the state's economic progress.



### Implications of Hispanic Generational Differences

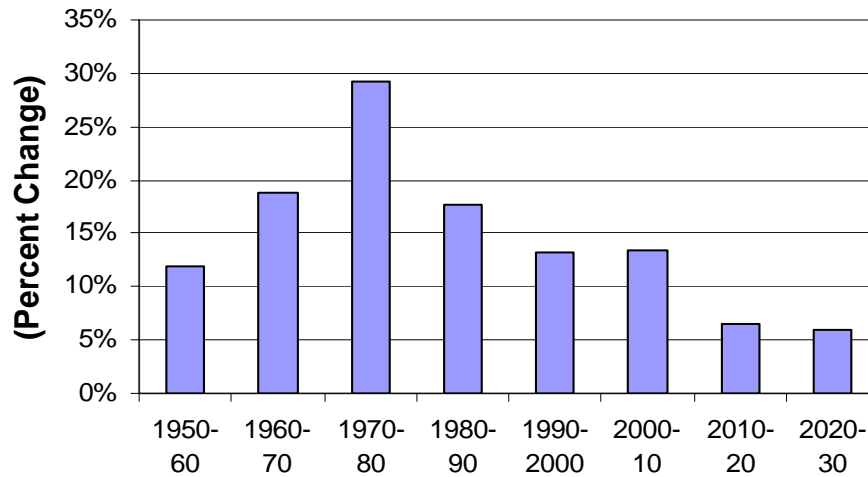
In 2020, California's Hispanic population will be increasingly fluent in English and the children of immigrants will have higher rates of high school graduation. These high school graduates will be entering a labor market desperate for trained workers.

The major national and state labor market trend between 2010 and 2020 will be the large wave of baby boomer retirements. This is true even with projections that workers over 65 will be staying in the labor force at higher and higher rates.

The national labor force slowdown will be milder in California as a result of the state's younger population and comparatively large number of people of school age. Both of these trends are the result of California's comparatively large foreign-born population and their children and grandchildren.

Both the next generation of young residents **and** the California economy face a tremendous opportunity and an equally large challenge. If the children and grandchildren of immigrants have the educational achievement to graduate from high school attend college **and adequate** space and financial support is available, the California economy will gain a significant competitive advantage. And the children and grandchildren of recent immigrants will have the chance to earn and provide a rising standard of living for themselves and their families.

### U.S. Labor Force Growth



**Public policy has a major role in converting challenge into opportunity. More than 90% of California school-age children attend public K-12 schools and approximately 90% of Californians attending college attend a public university or college in California.**

There is currently a legal case in California asserting that many children from low-income and minority families attend public schools that have inadequate facilities and a disproportionate share of teachers without credentials. Moreover, the current state budget debate highlights the danger that not all eligible students will gain admission into one of California's public colleges or universities. In addition, even if space is available and a full spectrum of classes is offered, there is concern that students may be denied a college education for lack of financial assistance.