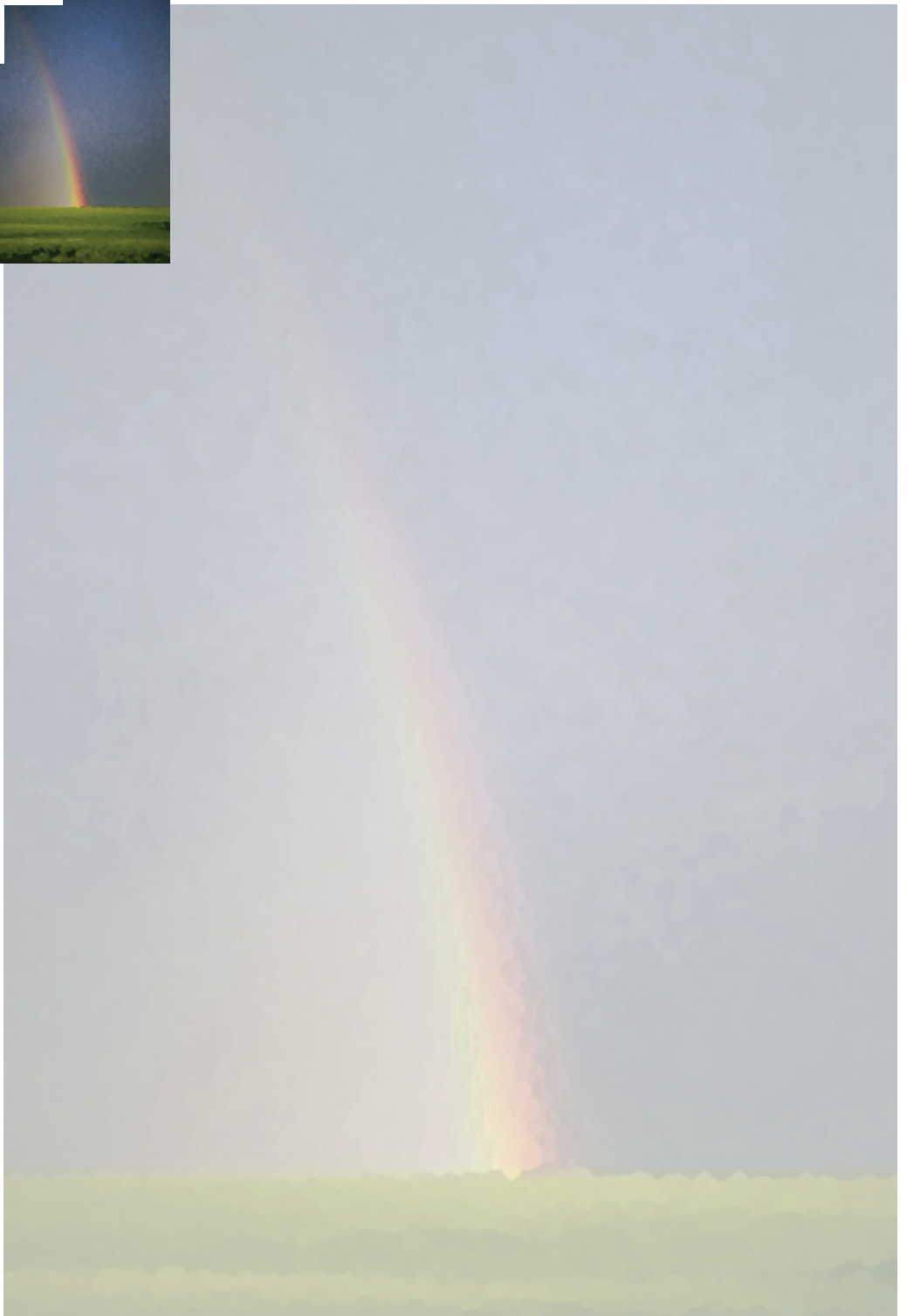


FRAMEWORK FOR CALIFORNIA PROSPERITY

*Comments of California Civic Leaders
from the Statewide Economic Vitality Conversations*



CONVENED BY
CABINET MEMBERS
OF THE
SCHWARZENEGGER
ADMINISTRATION

SEPTEMBER 2005

– Foreword –

September 2005

When Governor Schwarzenegger was sworn into office in November 2003, he immediately focused on economic recovery and prosperity – making it one of the highest priorities for his entire Administration. He even appointed himself the “Job Czar” in his first State of the State Address, calling for “Jobs, Jobs, Jobs” for all Californians.

Responding to this imperative, Governor Schwarzenegger’s Cabinet Secretaries launched a series of 17 Economic Vitality Conversations with civic leaders throughout California to listen to the people and to gather their recommendations for achieving and sustaining economic prosperity. The first Conversation was convened in December 2003, and the series concluded in April 2005. We benefited greatly by listening to a wide range of representatives from business, labor, economic development, agricultural, community, environmental and governmental organizations.

We were generously assisted in organizing this effort by the California Center for Regional Leadership (CCRL) with sponsorships from the Pacific Gas and Electric Company and Bank of America for the 12 regional Conversations, and with sponsorships from The California Endowment and Humboldt Area Foundation for the statewide gathering with rural leaders. Two separate summary reports titled “Innovation, Entrepreneurship, Collaboration” have been published by CCRL and are excellent companion documents.

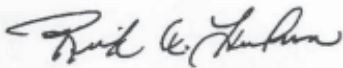
This report summarizes the input from the statewide meetings and sets forth the consensus conclusions and recommendations that emerged from all the Economic Vitality Conversations. It articulates a framework for an Action Agenda for Economic Prosperity. We invite all civic leaders in California to join us in implementing this Action Agenda and look forward to working with you.



Terry Tamminen, Cabinet Secretary



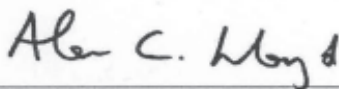
Sunne Wright McPeak, Secretary
Business Transportation and Housing Agency



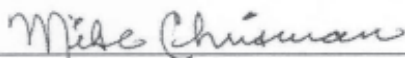
Roderick Q. Hickman, Secretary
California Department of Corrections



A.G. Kawamura, Secretary
California Department of Food and Agriculture



Alan C. Lloyd, Secretary
California Environmental Protection Agency



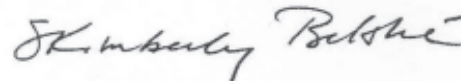
Mike Chrisman, Secretary
California Resources Agency



Fred Aguiar, Secretary
California State and Consumer Services Agency



Thomas Johnson, Secretary
Department of Veterans Affairs



Kimberly Belshé, Secretary
Health and Human Services Agency



Victoria Bradshaw, Secretary
Labor and Workforce Development Agency



Alan D. Bersin, Secretary
Office of Education

The Business, Transportation and Housing Agency, for the economic vitality conversations, used a conceptual framework that is a vision for California's future, premised on the requisite foundations for the State's comparative advantage. This vision builds on the State's history of great creativity, entrepreneurial spirit and unique natural assets.



The Building Blocks of Comparative Advantage

Research Excellence and Knowledge Base

Competitive Advantage Industry Clusters

Infrastructure and Smart Growth

Efficient Government and Regulations

Effective Governance and Civic Leadership

Magnet for Innovation + Drivers of Economic Growth + Quality of Life + Culture of Accountability = Stability for Economic Development

The foundations depicted here and outlined on the following page are the building blocks of California's economic comparative advantage in global competition.

The Building Blocks of Comparative Advantage

Research Excellence and Knowledge

Base: California is a knowledge-based economy; research universities and institutions are the idea factories and the wellspring of innovation for new businesses and job – they are magnets for innovation.

- Secure increase of GDP for research (>3%) with “optimal investment share” for California.
- Promote collaboration with and among research institutions.
- Facilitate technology transfer to private sector.

Competitive-Advantage Industry Clusters:

Industry clusters are the drivers of economic growth and prosperity. They are regional and cross-regional and include aerospace, agriculture, biotechnology and biomedical manufacturing, design, entertainment, international trade, logistics, travel and tourism, and many more.

Convene and interface continuously with leaders in comparative-advantage industry clusters:

- Information Technology:
 - Accelerate broadband deployment – connect to compete.
 - Support and partner with semiconductor industry.
 - Promote technology application to homeland security.
- Biotechnology – Life Sciences: Cooperatively implement strategic action plan.
- Film Production: Revitalize film commission as industry partnership.
- Travel and Tourism: Support commission and link trade to other industries.
- Agriculture: Embrace “California Renaissance” and partner with industry organizations.

- Aerospace: Retain military assets and joint venture with California Space Authority.
- International Trade: Establish new California International Trade Partnership.

Infrastructure and Smart Growth:

The basis for quality of life is achieved through investments in both human and physical infrastructure. The underpinning is more efficient use of land linked to housing, transportation and jobs. This in turn will lead to: more housing production, choice and affordability; better mobility; conservation of natural resources and valuable habitat; and protection and enhancement of productive farmland. Quality of life includes: a healthy environment; reliable, efficient and environmentally sustainable supply of energy and water; high achieving schools and students; a workforce system linked to economic development; healthier people and cost-effective health care.

Efficient Government and Regulations:

Effective government supports a healthy enterprise and serves the public well. Effective government is not punitive but encourages regulatory compliance through incentives and innovation-driven ideas. Pathways include streamlining, improving performance and cutting red tape. In short, creating a culture of accountability to the public, focused on outcomes and productivity.

Effective Governance and Civic Leadership:

Effective governance engages people, encourages individual responsibility and community cooperation, and provides for stability for economic development through state, regional and local collaboration.

Many participants emphasized that these dialogues constituted an important step toward changing California's business climate. Participants commented that a willingness to listen, hear all sides, and take action on tough issues encourages business and consumer confidence.

Purpose and Process of the Statewide Economic Vitality Conversations

In December 2003, a series of economic vitality conversations were convened on behalf of the Schwarzenegger administration. These conversations were held with business and civic leaders throughout the State and were intended to provide a forum to determine how best to stimulate California's economic recovery in the immediate future and improve the State's long-term economic competitiveness and comparative advantage to sustain economic prosperity.

The State of California convened three statewide sessions between December 2003 and April 2004. The California Department of Food and Agriculture convened a fourth conversation in July 2004 to focus on economic issues and policies relative to California's agricultural industry. More than 450 specific suggestions and recommendations were generated covering a wide range of topics. These recommendations are the subject of this report. The full text of the recommendations can be accessed on the Internet at www.bth.ca.gov.¹

These statewide sessions were supplemented with a series of 12 regional conversations between March and November 2004, convened by the California Center for Regional Leadership. The regional sessions were organized for State policymakers to better understand how the State's regional economies function and provide area perspectives on economic strategies. The regional conversa-

tions are summarized in the California Center for Regional Leadership report available on the Internet at www.calregions.org.²

Collectively, these reports will help facilitate an open dialogue to receive and act upon wide-ranging issues important to the people of California. Future conversations and strategic planning can help to calibrate the effectiveness of policy actions taken on these issues.

The Schwarzenegger administration is focused on taking the necessary actions needed to restore and enhance competitiveness of the California economy. Providing employment opportunities for a growing population requires that private sector businesses, especially those businesses that have flexibility to operate facilities in other states or countries, believe that California-based operations can be profitable in the long-term. Excessive regulation and bureaucratic red tape, high fees and taxes, and high operating costs undermine that potential.

Finding solutions that protect the environment, protect workers from abuses, and enhance the quality of life for all while providing an attractive business climate is the core of State economic policy. However, while such policies are necessary, they are insufficient to secure a prosperous economic future for the State.

As competitive forces intensify, businesses must consider comparative advantages among alternative business locations. Not only do they expect a favorable business climate, they also expect a region to offer access to a skilled workforce, access to specialized research institutions, and access to key vendors, suppliers and customers.

¹ The full report aligns participant recommendations with Governor Schwarzenegger's Five-Point Economic Recovery Plan and the Economic Vitality Framework developed by the Business, Transportation and Housing Agency. The Economic Vitality Framework is an adjunct to the Economic Recovery Plan. Aligning comments in this fashion allows policymakers to benefit from the full range of these discussions.

² "Innovation, Investment, Collaboration: A Statewide Action Agenda for Economic Vitality from California's Regional Leaders," March 2005.



It is important that the State perceive its economy as an amalgam of regional economies that have unique comparative advantages for existing and emerging industries.

With such demanding needs, not every location can meet these requirements for all industries. This is why regions must build on their strengths and unique regional qualities to attract the industries for which they offer the best match. In such a meritorious process, regions have an opportunity to attract and grow businesses within industries where they already have concentrations of businesses greater than other locations. In most instances, economic growth stems from existing and emerging “clusters of opportunity” already present in the region.

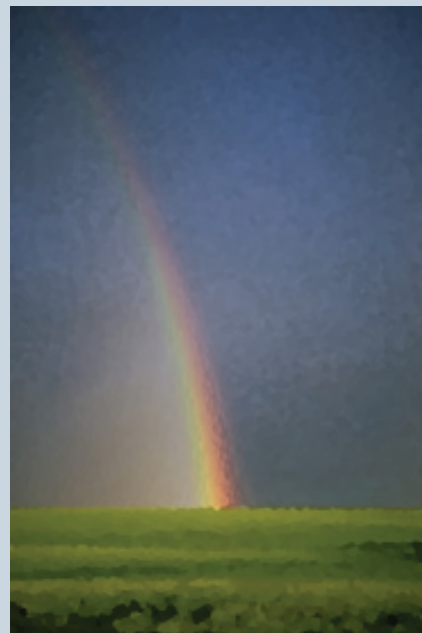
For this reason, it is important that the State perceive its economy as an amalgam of regional economies that have unique comparative advantages for existing and emerging industries. “One size fits all” policies can dim economic prospects for individual regions if flexibility is not incorporated to adjust for these regional differences.

Studies performed regarding California’s economy over the last decade have discerned that the State has at least nine distinct regional economies, all of which offer comparative advantages to a varying array of industries. Understanding the characteristics of regional economies is an important element in formation of good public policy to facilitate economic prosperity among all of California’s regions.

THREE KEY QUESTIONS

The four statewide sessions were attended by 225 individuals. In addition to members of the Governor’s cabinet, participants included distinguished economists, economic development practitioners, business leaders, elected officials and others. After a series of presentations on elements of the California economy and its regional components, participants were asked to respond to three major questions:

1. What actions will have the most immediate positive impact on California’s economic recovery?
2. What actions will result in the most significant long-term improvement to California’s economic competitiveness and comparative advantage?
3. Given the inherited current-year State budget deficit and funding constraints for next year’s budget, and the inevitable impacts on all State agencies, departments and operations, what additional ideas can we offer to address the budget deficit problems?



Economic Vitality Framework

As with the Governor's five-point economic recovery plan, there is widespread interest and willingness among civic leadership organizations to join with the State in promoting and improving California's economic vitality.

GOVERNOR SCHWARZENEGGER'S FIVE-POINT ECONOMIC RECOVERY PLAN

- Develop a fair and competitive tax structure that encourages job growth and business creation.
- Solve energy cost crisis.
- Reform Business & Professions Code Section 17200.
- Fix runaway workers' compensation costs.
- Cut bureaucratic red tape and regulation.

Governor Schwarzenegger's administration can use input from the economic vitality conversations to formulate a strategic plan and engage civic leaders throughout California to ensure successful short-term actions and long-term investments.

1. A viable economic vitality strategic plan for California should identify both short-term actions and long-term strategies. It is important to take immediate action to improve the business climate while focusing on improving the underlying fundamentals of California's economic competitiveness.
2. There is widespread concurrence with Governor Schwarzenegger's 5-Point Economic Recovery Plan. It provides a good agenda for immediate action to improve California's business climate.

3. A comprehensive campaign to market California's assets and products should be developed building upon Governor Schwarzenegger's special ability to communicate worldwide. Opportunities should also be provided for interested civic leader organizations to participate and augment the State's efforts.
4. The theory of economic comparative advantage provides a sound foundation for developing and prioritizing strategies for promoting long-term economic vitality. The building blocks of comparative advantage in the strategic framework reflect the relative value of each component in attracting capital investment, which in turn generates jobs.
5. Recognizing that California's economy is actually composed of several regional economies can optimize economic vitality statewide. Thus, State policies, strategies and actions should be implemented to complement regional economic vitality and encourage regional civic leadership and collaboration.
6. A strategic plan needs to recognize the interrelationship of comparative advantage components and economic vitality forces. State leadership needs to coordinate and integrate actions and resources. Continued collaborative leadership from Governor Schwarzenegger's cabinet can make a major difference in promoting California's economic vitality.
7. There should be an established mechanism for accountability and an ongoing process to track progress in implementing a strategic plan.



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Common Themes from the Conversations

California is “open for business.” Many emphasized the special ability that Governor Schwarzenegger has to communicate the message that California is “open for business.” Active attention to factors that affect the business climate and ability to market California can increase opportunities for industries ranging from tourism and entertainment, high-tech and manufacturing.

Retaining those industries in which the State has a comparative economic advantage is a vital strategy for economic prosperity. International trade, trade with other states, and goods movement logistics are key industries in several regions of California. The ports of Los Angeles, Long Beach and Oakland are the first, second and fourth largest ports in the nation, respectively. San Diego, Oxnard, Stockton and Sacramento also have major ports that facilitate regional, national and international trade and the movement of goods between cities and states. The highway and rail transportation networks connecting the ports are major economic drivers for the State’s economy. These components of infrastructure enable the movement of goods to California’s large market and to national and international markets.

Participants recommended that the State should assess legislation and regulations that may have led industries to move to other states and ensure that economic consequences are factored into regulatory decision-making before final decisions are made.

Participants also emphasized preserving existing jobs in California. For instance, saving California’s military bases and the associated aerospace expertise.

Workers’ compensation. Participants commented that California’s workers’ compensation costs have grown tremendously in the past few years, while injured workers receive

benefits that are among the lowest in the nation.³ While the governor and the Legislature worked together to enact SB 899 (Chapter 34, Statutes of 2004), which proscribed a wide range of workers’ compensation reforms, participants commented that businesses will watch closely to determine if premiums truly decline and fraud is reduced enough to positively impact business in California.

Unemployment insurance. This is an issue impacting California businesses, particularly in light of the \$2 billion deficit in the Unemployment Insurance (UI) fund. Several participants stressed the need for revamping the UI system to lower costs and provide more certainty for businesses, while ensuring that funds are adequate to support laid-off workers.

Energy. This is an ongoing concern and as a major cost to conducting business in the State. Several participants suggested strategies to increase supply and competition, along with the need for streamlining State energy regulation and permitting requirements. California’s obligation to repay municipal utilities for energy purchased by the State in past years was also raised as an unresolved issue.

Renewable energy. Agriculture can be an important part of the solution to meeting our energy needs, mitigating global climate change, and revitalizing our rural communities. By utilizing the renewable resources on our farmland, we can generate electricity, fuel our vehicles and create a variety of products. Partnerships should be formed between the State, local governments and universities to conduct regional renewable resource assessments. Farmers must be provided education and technical assistance, given access to local electrical grids, and provided with initial support to get these ventures off the ground.

³ 2004-2005 Governor’s Budget Summary, Workout Plan, p. 5, *supra* n. 1. Costs for the workers’ compensation system ballooned from \$11 billion to \$28 billion in five years, while premiums rose 200 percent to 300 percent for many California employers. *Id.*

Investing in education, workforce training, basic research and a quality environment will pay economic and social dividends. How to make these investments in light of California's budget was the subject of much discussion.



Research and development must continue to bring down costs and discover innovative and economical ways to produce energy and products from agricultural commodities and waste streams. At the same time, there must be ongoing market development for these products. At present energy prices, this market represents a \$1-billion per year business that is poised to happen. The State can make it happen with a comprehensive policy on renewable energy that supports these markets.

Health care. Health care is a major cost driver for businesses and families. Likewise, the lack of affordable health care influences public participation in education and the workforce. Health care costs have also been a major cost factor in California's workers' compensation system. Some participants expressed their opposition to health care mandates on businesses, as this approach would only discourage growth of business. Obesity and consequent diseases were also identified as an area of concern in economic productivity and health that must be systematically addressed.

Transportation and logistics. These investments would create a large number of well-paying jobs accompanied by good benefits through the construction phase and through the industries they facilitate. Promoting investments in broadband technologies and telecommunications were issues raised that will also spur growing industries and facilitate education. If done well, such investments can simultaneously enhance the quality of life, improve the environment and stimulate the economy.

Participants stressed that investments should be analyzed across traditional lines of responsibility (funding) and coordinated among jurisdictions. Housing, transportation and economic development are usually planned and funded separately. However, by emphasizing the interrelationships between these investments and insisting that transportation projects, for instance, demonstrate how they will increase opportunities for affordable housing close to job centers creates a more comprehensive economic strategy.

Housing supply. Regulatory changes, such as reforms to the California Environmental Quality Act, brownfield regulations, construction dispute resolution, and prevailing wage would promote infill housing to existing population centers, especially along transit corridors. There is a great need for affordable home ownership opportunities, multifamily housing, and mixed-use developments that integrate commercial corridors and provide access to mass transportation. These housing strategies can be complemented by school modernization and construction projects that poise schools as community centers, offering joint use of these types of facilities, such as playgrounds, libraries and meeting rooms.

California Business and Professions Code Section 17200. Changes to the code will help prevent unwarranted and frivolous litigation against businesses. Several participants stressed the need for more flexible regulations that recognize the difference between regions. An example given was regarding earthquake risks that warrant retrofit requirements.

Growth and land use should be managed through regional strategic plans for growth management, protecting farmland using agricultural/conservation easements and higher density construction, and protecting wildlife habitats through selective agricultural cropping.

Education, workforce training, research and development. These are also vital to the economy's ability to create wealth and attract business. In addition to improving K-12 education, participants stated that investments are needed in workforce training to better prepare employees for business needs and contributing to the workforce. Several observed that investments in higher education and research in basic science and technology would spur innovation and economic competitiveness.

Quality environment and vibrant economy. Several contributors to the dialogue emphasized that there is no trade-off between these. Less smog, for example, draws more tourist dollars. Aside from meeting federal air quality mandates, a healthy environment fosters a healthy community.

Agricultural industry. Resource management policies that support the wide range of agricultural activities should be guided by several key principles. First, a watershed approach should be used to meet the needs of multiple land managers, leverage stakeholder resources, and solve problems ranging from water quality to loss of prime farmland. Next, create incentives for water conservation through a variety of means, including improved technologies and regional water plans that coordinate surface and ground water use. Growth and land use should be managed through regional strategic plans for growth management, protecting farmland using agricultural/conservation easements and higher density construction, and protecting wildlife habitats through

selective agricultural cropping. Support resource conservation districts by matching federal dollars with State funds and connecting research to the farm through strong technical assistance programs. Invest in alternative energy sources by allowing farmers to transfer or resell excess power and by promoting methane gas, ethanol and other biofuel development.

Domestic food security. Preserve domestic food production and forestry through sound planning. Aggressively market California products by expanding on success of the California Grown campaign. Invest in agricultural and resource education at K-12 and higher education. Work with the State's congressional delegation towards a coordinated agricultural policy for California.

Governments should be guided by key principles. Governments should promote cooperation between public and private sectors to develop an integrated natural resource policy, disseminate best practices to industry, ensure a balance between regulatory and voluntary programs, and encourage voluntary compliance with goals and regulations. Regulations should be simplified, based on the best science, and reviewed for cost implications. Governments should invest in infrastructure that would benefit a variety of critical efforts such as pest and disease eradication programs.

Budget structure. Many participants emphasized that the State's budget structure affects the State's ability to achieve these objectives. The budget creates incentives and disincentives. By shifting property taxes to education



to augment State funding, the current budget structure encourages localities to site as much retail activity as possible to generate sales taxes for local governments to retain. At the same time, it increases the perceived cost of housing, because local governments keep a reduced portion of property taxes. Many participants emphasized the need to establish a more cooperative relationship between the State and local governments so they are not fighting over the same tax dollar, but are partners in economic development and service to Californians. Although the share of property tax revenues dedicated to counties and cities was changed with voter approval of Proposition 1A in the November 2004 election, the effect of the changes as incentives for housing remain to be determined.

Government structure. Concomitant with an analysis of budget priorities and structure, participants emphasized the need to analyze and reform how California government is organized and how it provides services. They stressed that California's government structure needs to be more efficient, more inclusive through partnership with communities, organizations and the private sector to solve problems. Several participants emphasized the need to engage the State in support of California's nine regional economies, including rural areas.

Fair share of federal funds. Participants also stressed the importance of obtaining California's fair share of federal funds, the need for California to establish a budget reserve and reduce State spending with a goal of balancing long-term investments and equity considerations.

