PETER WEBER
TESTIMONY TO LITTLE HOOVER COMMISSION
ON CALIFORNIA ECONOMIC DEVELOPMENT POLICY

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You have asked me to examine the state's role in economic development and to identify hallmarks of successful economic development strategies. My perspective is that of a former CEO of two publicly traded California companies and senior executive of a Fortune 500 multi-national corporation that reduced its California employment from more than 7,000 people to less than 300 over a period of about twelve years. For the last eight years, I have dedicated myself exclusively to pro-bono economic, community and workforce development activities in California's San Joaquin Valley.

I begin with a definition:

> ***Economic Development is the process that influences growth and restructuring of an economy to enhance the economic, social and environmental well-being of communities.***

The days when economic development, community development and workforce development were approached as parallel, largely disconnected processes are, or at least should be, over. Increasing the economic strength of a community generates resources to improve social and environmental conditions. Workforce skills are the single most important community attribute sought by employers. Community development activities that increase the attractiveness of communities to the workforce needed by employers are highly beneficial to economic development. Communities that are not fully integrating these development processes are almost certain to underperform in today's economy.

Recent polls show that California voters are highly dissatisfied with California's governance. Many governance reform initiatives are under consideration, most of them focused on budget, fiscal and political reform. These are all vitally needed reforms, but they are insufficient. To reclaim its role as the Golden State, California must also pursue economic development reform. Economic growth will generate tax revenue growth that the state can invest to create a virtuous economic cycle. As per capita income increases, the funding needs for income supports and social services will be reduced.

Much has been written about the adverse impact of California' fiscal and regulatory system on the economic development of the state. While it is hard to understate the importance of these issues, I will touch on them just briefly in my remarks, preferring to address my testimony to a topic that is at least equally important and that has received far less attention. This testimony will attempt to make the following points:

- **Slippage in California's global competitiveness is adversely affecting the State's ability to address its economic, social and environmental challenges.**
- **The drivers of economic growth are very different today than they were in the last century.**
- **Regions, defined by economic rather than political boundaries, are the new building blocks of prosperity.**

- **California is not one economy but a tapestry of very different economic regions.**
- **California's current governance structure and policies are not well suited to address the drivers of economic growth in the 21st century.**
- **If properly governed, California's economy has great potential to resume its once unparalleled global economic leadership.**

CALIFORNIA'S COMPETITIVENESS IS SLIPPING

As the 8th largest economy in the world, California remains an economic powerhouse, but the fact that the size of the State's economy has dropped from 5th to 8th in the world since 2003 should not go unnoticed. Whereas California's economy in 2003 was smaller only than the economies of the U.S., Japan, Germany and China, today the State's economy is also smaller than those of France, the United Kingdom and Italy. Most economic observers see this as a trend, with California continuing to lose ground.

State-by state rankings of economic competitiveness from think tanks that span the political gamut place California at or below the median off all 50 states. Beacon Hill's Eight Annual State Competitiveness Report Index (2008) ranks California 25th, while the American Legislative Exchange Council (2008) ranks California as 27th and projects the state's economic outlook for 2009 as 43rd. This is a far cry from the economic leadership that once characterized our state.

It is instructive to compare the economies of the two largest states in the union, California and Texas. Between 2002 and 2008, annual economic growth in Texas averaged 4.9 percent compared to California's 3.3 percent. Personal income growth in Texas averaged 4.2% while California grew at 2.9%. Texas ranks 15th in incoming foreign direct investment, while California ranks 33rd. Texas saw a positive *internal migration rate* of more than 400,000 people, while California lost about one million residents within the same period. These differences are significant. Had California's GSP grown at the same rate as Texas, California's economy would have generated over half a trillion in additional top-line revenues and about $100 billion in additional state and local tax revenues over this 6-year period. These are revenues that the state could have invested to renew its infrastructure (ranked 48th by Beacon Hill), reform its education system (ranked 45th) and clean up its air (ranked 47th). And had the personal income growth in California been similar to that of Texas, the state's cost of income supports and social net services would have been significantly reduced.

DRIVERS OF ECONOMIC GROWTH IN THE 21ST CENTURY

Globalization has fundamentally transformed the American Economy. The period from the end of World War II into the early 1980's was characterized by communities' efforts to attract manufacturers and other large scale businesses. As a result of deregulation and the onset of globalization, the decade that followed was characterized by re-engineering, down-sizing and right-sizing -- all aimed at cost cutting to increase competitiveness. For most businesses, however, no amount of cost-cutting was to going to enable them to compete on a cost basis with countries with far lower labor rates and less stringent regulatory environments. That ushered in the current era of **regional competitiveness,** where regional specialization is the path to success and *innovation, entrepreneurship, workforce productivity and effective networks are the drivers of competition.* To be sure, communities still need a healthy business climate and quality infrastructure, but they are unlikely to succeed if they are not faster to the market with better, well-implemented ideas.

In the U.S. today, it is innovate or perish. Entrepreneurs, not big established companies, are the principal job creators. And a skilled workforce is the factor that economists today most closely correlate with growth in per capita income, productivity and output. In a world of constantly growing complexity, success is dependent on superb networking and connectedness. This is true of both the private and public sectors. Indeed, it is particularly true of the public-private partnerships that are so vital to success in today's economy. In their 2004 book, *Government by Network,* William Eggers of Deloitte Research and Stephen Goldsmith of the Ash Institute for Democratic Governance and Innovation argue that *"The era of hierarchical government bureaucracy, the predominant organizational model used to deliver public services and fulfill public policy goals for a century now, is coming to an end… and being replaced by 'governing by network', in which government executives redefine their core responsibilities from managing people and programs to coordinating resources for producing public value".* This new model, the authors say, is characterized by the web of multi-organizational, multi-governmental, and multi-sectoral relationships that increasingly constitute modern governance.

REGIONS ARE THE NEW BUILDING BLOCKS OF PROSPERITY

Competitiveness today comes from a "clustering" of industries, in which groups of firms or industries, capitalizing on innovation and workforce productivity and drawing on the unique assets, history and character of a region, emerge to gain leading market positions. These "clusters" can be national in scale – e.g. Japan in consumer electronics; Switzerland in pharmaceuticals; Germany in printing presses; the U.S. in software – but most often they are regional: L.A. in entertainment; The New Jersey Turnpike in flavors and fragrances; the San Joaquin Valley in water technology; the Greater Akron region in synthetic polymers (see box below).

In short, successful communities are making objective assessments of where their regional assets will enable them to compete globally and then specializing in those niche markets.

The Akron Story

From the mid-seventies through most of the eighties, Akron was in deep economic trouble. While they had once been the world's leading producers of rubber tires, the manufacture of tires had largely moved overseas. So they re-invented themselves. Rubber is a naturally occurring polymer. Was it not possible to capitalize on the region's understanding of this one polymer to pursue a broader agenda of modern polymer-based synthetic materials? Private sector leaders, with support from local and State government and the University of Akron, committed themselves to a polymer future. The University built a Department of Polymer Engineering, dedicated to providing global technology leadership for a broad base of commercially viable polymer-related materials, processes and products. In 1985, the Polymer Processing Society was established at the University to attract polymer research to the region. By the end of the eighties, more than 300 polymer companies were operating in Akron. Today, there are more than 2,600 polymer-related companies operating in Ohio, and the Greater Akron region employs more than 31,000 people in the polymer industry. The Akron metro area, which had experienced compound annual GDP growth of 2.2% from 1980 to 1990, saw its GDP growth triple to 6.7% from 1990 to 2007.

The idea of industry clusters is not new. After all, there is probably no industry cluster more famous in the world than California's Silicon Valley, created by the confluence of state and private sector investment in an extraordinary university infrastructure, the visionary leadership of business/civic entrepreneurs like Bill Hewlett and David Packard, and the largest assemblage of venture capitalists in the world. Almost as famous is the San Joaquin Valley -- recognized as having the most productive agriculture in the world -- created by the confluence of beneficial soils and climate, innovative farmers, and public sector investment in water projects and farm-related university infrastructure.

But the origin of these stories dates back decades. The fact is that neither California nor the nation as a whole are devoting adequate attention to systematic, purposeful development of regional competitiveness as a core strategy for global economic competitiveness. While many states have engaged in the creation of specific state-supported industry clusters (e.g. at least 40 states have created biotechnology initiatives), few states have developed comprehensive regional leadership structures. North Carolina is one notable exception. They have implemented a comprehensive economic development plan based on the organization of every county into one of seven regional partnerships, each of them closely networked with state and local leaders. Florida has organized its economic development around eight geographic regions and eight state-wide industry clusters. The successful diversification of the Florida and North Carolina economies stands in marked contrast to the inability of Michigan to reduce its reliance on the automobile industry.

Nowhere does regional economic competitiveness make better sense than in California, which is not --never has been since the gold rush days of 1849 -- a single economy.

CALIFORNIA IS A TAPESTRY OF REGIONAL ECONOMIES

California is a tapestry of regional economies, each with its own assets, history and character. The high-tech economy of the Silicon Valley, the agribusiness economy of the San Joaquin Valley, the multi-media economy of Los Angeles and the biotech industry of San Diego are very different from each other. And each of these regional economies is larger than those of most countries (the smallest of the four examples listed, the San Joaquin Valley, would rank 54th in a list of 183 country economies). Each region faces a unique set of economic and community development challenges. One-size governance does not fit all.

But California has no regional governance. There is little correlation between the borders of political jurisdictions we have inherited from history and the borders that define regional economies. Local governments operate within political rather than economic boundaries; and state government operates through functional organizational units. While efforts have been made to create inter-agency units, funding streams create a powerful gravitational pull towards silo-based government. There are few mechanisms for aligning efforts to common goals, setting priorities or finding efficiencies.

I hasten to say that I am not proposing we add another tier of government in between cities and counties and the state (although I certainly wouldn't preclude consolidation of services where that makes sense), nor am I suggesting encroachment on the jurisdiction of local governments. But it is possible for the State of California to play a strong role in ***catalyzing and supporting the development of voluntary, self-defined, multi-sectoral, multi-government regional partnerships aimed at fostering strong regional economies***. I'll say more about this in the next section, where I address policy prescriptions. But first, I'd like to expose the Commission to an experiment in networked regional governance started as a result of an executive order issued by Governor Schwarzenegger.

A PETRI DISH: THE CALIFORNIA *PARTNERSHIP FOR THE SAN JOAQUIN VALLEY*

The California Partnership for the San Joaquin Valley (the "Partnership") is the most comprehensive example of sate-regional collaboration in California. Created in June 2005, Executive Order S-5-05 assigned eight cabinet officers to work with local government and private sector representatives from each of the eight Valley counties to develop a *Strategic Action Proposal* to improve the economic well being of the region and the quality of life for its resident. No funding was provided to develop the plan. The Strategic Action proposal, submitted to the Governor and the Legislature in October 2006, was approved in December 2006 and is now in its third year of implementation.

No funding was provided by the State for the planning process. The implementation has been supported with $1 million in annual state funding. The State also provided $2.5 M for seed grants to launch 14 initiatives identified in the strategic Action Proposal.

The 10-year plan focuses on six measurable initiatives with measurable outcomes. Implementation is divided between ten work groups defined by topic area, listed here to illustrate the breadth and ambition of the Partnership:

- Economic Development
- Higher Education and Workforce Development
- PreK-12 Education
- Transportation
- Land Use, Agriculture and Housing
- Air Quality
- Water Quality, Supply and Reliability
- Energy
- Health and Human services
- Advanced Communication Services and Information Technology

These ten working groups are facilitated by business leaders, government officials and universities, with the vitally important interconnections between the work groups managed by a secretariat function. Each work group has a set of goals, strategies and measurable indicators of progress.

Executive order S-22-06 restructured and expanded the board to include:

- Eight state government officials
- Eight elected local government officials, one from each county
- Eight civic leaders, one from each county
- One representative each from the Federal Interagency Task Force for the San Joaquin Valley, the Economic Strategy Panel, the California Transportation Commission, the California Air Resources Board and the California Workforce Investment Board.
- Up to twelve representatives of regional consortia of existing organizations recognized by the partnership; and
- Up to three individuals with specialized expertise and knowledge.

All San Joaquin Valley members of the legislature are ex-officio, non-voting members of the Partnership board and are frequent participants at board meetings.

The Partnership produces an annual report that is available on its website (www.sjvpartnership.org). A few highlights from the second annual report follow:

- The entire 8-county region is now focused on 5 target industry clusters: (1) Agribusiness, including Farming, Food Processing, Agricultural Technology and Biotechnology; (2) Manufacturing, including Water Technology; (3) Supply Chain Management and Logistics; (4) Health and Medical Care; and (5) Renewable Energy. Workforce development across the spectrum of education and training institutions is focused on career paths in these target industries.

- Launched Careersinthevalley.com, a one-stop web site designed to link employers, job-seekers and vocational training programs throughout the Valley.

- Launched the *San Joaquin Valley Clean Energy Organization* (the "SJVCEO") as a 501c3 to bring together the Valley's efforts to conserve energy and advance the development of fuels and energy from renewable sources. The SJVCEO has signed an MOU with the 25x'25 Initiative (25% of the nation's energy from renewable resources by 2025) to become the first national demonstration project for the accomplishment of this goal.

- Launched the *San Joaquin Valley Housing Trust* to help jurisdictions achieve their housing goals.

- Implementation of fourteen initiatives to jumpstart action for immediate impact or lay the groundwork for long-term progress. To date, the $2.5 M investment by the State has been leveraged with more than $15 M in funding from non-state sources.

- Designation of five new enterprise zones in the Valley

- A regional blueprint for the 8-county region that coordinates land-use and transportation plans is nearing completion. And the blueprint is fully coordinated with the air quality, carbon footprint and water use goals of the region.

- County organizations which did not do much joint planning or implementation, in particular the region's eight Council's of Government, Workforce Investment Boards, Economic Development Corporations and K-12 County superintendents, are now all rowing in the same direction.

- Business, agricultural and environmental groups, which three years ago did not agree on much as related to air quality now are in total agreement on the sources of the problem, and mostly in agreement on the strategy and tactics to solve the problem.

- The Valley, always been a microcosm for the water wars that have pervaded California for decades, has now largely reconciled varying views and there is optimism that a comprehensive plan can be put forward that will be acceptable to all in the Valley and beneficial to all Californians.

- Consensus was developed in the region on high speed rail routes. The Partnership played a major role in revision of the High-Speed Rail bond provisions to provide for greater accountability as well as a much larger community of riders in Phase One, helping ensure voter approval of the bond measure.

- Working closely with the California Emerging Technology Fund ("CETF"), the Partnership is implementing ways to aggregate uses of bandwidth for the greatest number of users, especially in remote and rural communities. Pilot programs have been implemented in rural communities like Pixley and Firebaugh . CETF has matched seed capital from AT&T and the Partnership to support UC Merced in the development of a telemedicine network throughout the region.

- Supported planning efforts to build a UC Merced medical school to help train physicians, badly needed to address the most underserved region in California.

- A region that previously spoke to Sacramento and Washington with multiple voices (more than those of the eight counties because every City and municipality had its own agenda) now speaks with one voice. Valley legislators welcome and have been very supportive of this shared agenda. The same is true of the Governor. The Partnership estimates that in the past two years, the benefit of this "one-voice" approach has been to realize at least one billion dollars more in state funding than would have been the case under its prior more fragmented approach.

Can California compete in the 21st century?

The answer should be an emphatic "yes". California has huge natural resources. It's still an entrepreneurial hotbed and it remains the global innovation leader (in 2003, the University of California alone generated more patents than either China or India). By temperament and history, our private sector culture is better suited to networking than most other regions, states and nations. Companies still want to locate here because of the size of our market and our port access to the Far East. But the positive answer is less emphatic when we look at our drawbacks.

First, there is the issue of our **business climate**. To put it simply, business finds other states much more attractive than California. Take it from someone who has seen a single company reduce its California workforce from more than 7,000 employees to less than 300, and from seven California worksites to just two. We badly need fiscal reform that will reduce economic volatility and give businesses more predictability. We need to reduce the tax burden on business and reduce the tax progressivity that is driving investors away from California. We need to extend fiscal incentives for innovation, such as R&D tax credits and NOL's. We need regulatory streamlining. And we need tort reform.

Second, we simply must improve our **hard and soft infrastructure**. The competitive handicap placed on our businesses is huge when our hard infrastructure is ranked 48th in the nation, our education system is ranked 45th, our air quality is ranked 47th, and we still have many pockets that do not have broadband access.

Third, and in my judgment most important, we must fully commit ourselves to an economic development strategy that will significantly accelerate **regional economic growth**. I think of this as most important because growing our regional economies is the way to generate the added resources we need to invest in our infrastructure without imposing even more onerous tax burdens on businesses and residents.

With the exception of the California Partnership for the San Joaquin Valley, the State of California does not have a history of purposeful, systematic engagement in the development of strong economic regions. While some would argue that the development of economic regions is best left to mechanisms of the market place and that government should not be involved, that's really a false choice. The public sector always plays a role, directly or indirectly, in setting the stage for employment-generating investment by the private sector, and it is most certainly deeply involved in all aspects of environmental quality and social equity that affect economic development. The critical question is not whether government should be involved, but how. Should that involvement be random and sporadic, or purposeful and systematic?

The State could conceivably take a top-down approach and organize itself into several regions defined by the Governor and the legislature, but Californians and their local elected leaders don't respond well to state mandates. Instead, I propose an evolutionary and incremental approach, with the State of California playing a strong role in ***catalyzing and supporting the development of voluntary, self-defined, multi-sectoral, multi-government regional partnerships aimed at fostering strong regional economies***. In short, I am proposing that the state help catalyze the formation of regional networks that will develop and implement regional economic development strategies. The California Economic Development Partnership, created by Governor Schwarzenegger and led by the Secretaries for Labor and Workforce development, Agriculture and Business , Transportation and housing, is a natural leader for the implementation of such a strategy, but it has little authority and no resources today. The proposed state policies follow:

(a) Regional competitiveness should be formally identified by the Governor and the legislature as the overarching strategic economic development goal for the State of California;
(b) All cabinet officers and their respective agencies and departments should be charged by the Governor with responsibility for helping advance regional competitiveness, with the *California Economic Development Partnership* serving as the principal state body responsible for implementation of this strategy;
(c) An incentive-based scheme should be put in place to catalyze the creation and support the ongoing development of a state-wide network of regional partnerships ("California Regional Partnerships"); and
(d) The state-local relationship should be restructured to place resources and authorities closer to the people who can best drive regional economies.

These policy prescriptions are more fully described in a policy paper I produced for California Forward and can be accessed on their website, www.caforward.org. If California is to restore its economic leadership, it must be able to compete in the global economy. The sooner we are able to get our regional economies to contribute to this goal, the faster we will ascend from the economic malaise that now affects us.

Thank you for allowing me the opportunity to present this testimony.