technology, and support for the providers of training. Indirectly, federal policy can also support skills investment by means of assuring that school graduates have an adquate grounding in verbal and mathematical skills, so that business can concentrate on imparting job-related skills.

Defense Conversion Update

Although California has seen the worst effects of defense budget reductions, federal policies can raise the prospects for the state's companies, workers, and communities to transition successfully.

At the industry level, the federal government should continue to fund pre-competitive R&D programs targeted for defense and other high technology firms, but should institute clearer outcome measures.

Federal planning and infrastructure support for communities affected by defense reductions remains important, particularly for communities affected by base closures. In this regard, funding for the Office of Economic Adjustment and the Economic Development Administration should be continued.

Despite some recent progress, some obstacles remain to the successful re-use of closing military bases. The most serious include:

- A slow and cumbersome property transfer process, including resource and social requirements
- Inadequate financial resources for toxic remediation, re-use planning, and infrastructure upgrades.

The primary obstacle to expediting the re-use process involves revising the Federal Property and Administrative Services Act of 1949, which governs most federal property disposals. The Act dictates a hierarchy for transfer, with public sale to private parties being the last resort. This should be reversed to place a greater emphasis on transfer to the private sector.

The transfer process is compounded by federal property laws that require the sale of utility assets at fair market value, which military departments have interpreted to mean the intrinsic value of the assets, rather than their realistic economic value. Federal law should be modified to permit the transfer of properties based on market values.

Finally, financial assistance for base reuse should be directed first to critical infrastructure needs that hasten further development on former bases. One example is the upgrading of utilities, such as major water and sewer lines. This is particularly important for communities that have few other sources of funding available.

inventors not to publish their findings until they have filed; today many researchers publish then file. More broadly, copyright, patent, and trademark protection under GATT will provide legal basis for protecting intellectual property, and it will be important for federal policy to insure that the provisions of GATT are implemented in a timely fashion and strongly enforced. These protections will benefit a number of California's industries including software, multimedia, entertainment, professional services, biotechnology, and semiconductors.

Increase Venture Capital Supply

Federal policy aspects of economic competitiveness in a global economy extend beyond trade pacts. Federal tax code on investment tax credits, investment depreciation schedules, and capital gains taxation can crucially affect the vitality of an industry. Favorable tax treatment can encourage investment in R&D, equipment, and skills, as well as the creation of new firms. For example, in the semiconductor equipment industry the economic life of a chip generation is about three years, whereas the depreciation schedule for the equipment used in fabricating it currently has a five year horizon—creating a drag on investment in equipment for the next generation. Tax policy can also be expected to affect the supply of venture capital. New ventures, typically risky and tight for cash, often employ stock options as an element of compensation, and so the tax treatment of stock options and capital gains affects the ability of new firms to compensate their managers and workers for their effort and willingness to bear risk.

"Congressional support of current education and training reforms is essential."

This is particularly relevant in California, which has large numbers of startup firms in information technology and biotechnology and the potential for substantial economic growth in these fields. By the same token, tax and patent policy can influence the supply of venture capital. Venture capital is crucial to launching new firms—to proving the concept and developing product, marketing, and distribution before raising additional capital by going public or being acquired by a large corporation. One study estimates a $45 billion shortfall in venture capital nationally, or about $7 billion in California alone (William Wetzel, University of New Hampshire).

Improve Our Education System

Another federal role is the support of education reform through research and analysis. Every state has its own elementary, secondary, and higher education system, all of which are largely dependent on state and local revenues. Yet at a time when hard research on the efficacy of education reforms is at a premium, the states have few funds for demonstration, evaluation, and analysis of reforms. California in particular faces serious challenges to improve its elementary and secondary education system and to shore up the quality of its world renowned high education system. A rigorous program of federally funded research can help California meet these challenges. First steps have already been taken toward vast improvements in the quality of our education data and through the formation of education research centers, and these efforts should be strengthened and continued.

Invest in Skills

Investment in human capital is of utmost importance for California. The state's growing technology base will require higher numbers of increasingly skilled workers in the next century. At the same time, business in the state views education increasingly as a quality of life issue and as an essential element to business success. Congressional support of current education and training reforms is essential if California is to prosper. Progess on these reforms can be buttressed by providing firms and workers with strong incentives to invest in human capital. The fast pace of technological change means that continual retraining has become a core ingredient of business success. Without proper training, workers and managers cannot take full advantage of the productivity potential of technological advances. At the same time, training has historically led to higher wages and greater job security.

Federal policy can encourage investment in skills through financing (e.g., student aid, training grants to firms or industry consortia), investment in training facilities and training

resulted in the large scale loss of U.S. jobs. In the long-term, we believe that NAFTA and other similarly-crafted free trade agreements will result in net positive effects for the U.S., but particularly for California. As a border state and as the home of many Mexican-Americans with family and business connections in Mexico, California is well positioned to benefit from NAFTA.

"California stands to lose the most from reductions in federal R&D support, based on its current share of federal R&D outlays."

Yet GATT, low shipping costs, and the telecommunications revolution in effect bring many other trading partners virtually as close as Mexico. Greater trading opportunities, extending to include overseas manufacturing, assembly, and service centers, can also be seen as greater competition for U.S. workers. The U.S., in comparison to all countries save West Europe and Japan, is now a high wage economy. To preserve its position in the face of low wage yet well educated labor in developing countries (e.g., Malaysia, Indonesia, India, Hungary, Poland), U.S. labor must continue to increase its productivity.

FOCUS ON LONG-TERM PRODUCTIVITY INCREASE

This can be done through technological progress, investments in human capital through formal education and on-the-job training, and improvements in the organization and management of work within firms. Many of these investment activities occur normally in a well functioning market, but there are important federal roles.

MAINTAIN R&D

One role is the support of R&D, which otherwise would be undersupplied for the reason that its benefits cannot be captured by private investors acting individually. Members of the EAC are concerned about proposed reductions in federal technology programs and their effects on the state.

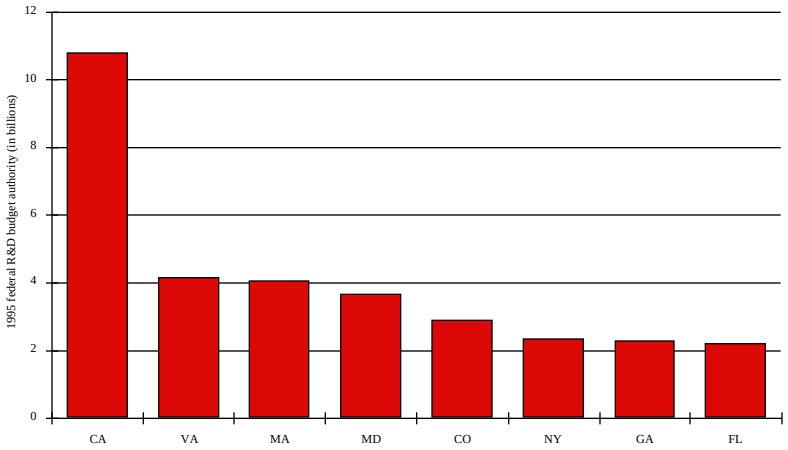
Some of the reductions in federal technology support come at a particularly difficult time for many state businesses as they try to transition from defense to commercial products. We support strict evaluation guidelines and measures of the success for these programs, but we believe that large funding reductions and program eliminations are not cost effective in the long run. California stands to lose the most from reductions in federal R&D support, based on its current share of federal R&D outlays (Figure 14).

Moreover, university-industry partnerships are not likely to fill the gap created by federal research funding reductions, at least in the near term. Industry focuses on applied, proprietary research and shies away from basic research and the research infrastructure investments that must accompany it.

PROTECT INTELLECTUAL PROPERTY

GATT contains provisions that can facilitate the expansion of U.S. trade involving intellectual property. GATT provides 50 year copyright protection, as well as detailed dispute resolution procedures for copyright disputes.

GATT also provides 20 year patent protection unlike the U.S.'s 17 years. However, the GATT system is based on first-to-file, whereas the U.S. system provides a one year grace period for filing, with the point of discovery being documented in lab notebooks. The GATT system creates an incentive for



Source: Critical Technologies Institute (RAND)

Figure 14—Largest recipients of federal R&D outlays

IV. FEDERAL POLICIES TO STRENGTHEN CALIFORNIA'S ECONOMIC GROWTH

Several themes draw together our views on California's economic future and the nature of federal policies that will support the attainment of that future. These include:

- Globalization
- Dependence on technology for competitiveness
- Creation and application of new technology
- High quality labor force
- Appropriate regulatory, tax structure.

In addition, we will provide an update on defense conversion in California, which also bears on the state's economic prospects.

Globalization

California, like the United States itself, is one of many players in an ongoing process of economic globalization. The rapid growth in U.S. foreign trade that has occurred over the past decade vividly illustrates the trend toward globalization, and California's high level of exports and rapid growth in exports underscore the importance of trade for its future.

California benefits from trade directly in two ways: through the operations of its ports and through the trade sector, i.e., export-related production and import-related jobs. Federal policies that enable California to improve the efficiency of its ports, including local warehousing, distribution, and transshipment to other states, will help California maintain its edge in handling trade as the volume of trade continues to expand. For instance, the Alameda Corridor project in Los Angeles will facilitate transshipment and complement other investments that have already been made to modernize and expand port facilities there. Similarly, federal trade policy that stimulates exports should be beneficial for California's export sector. The EAC notes that California's export strengths are based on its strong technology base. In the last several years, technology-based exports have accounted for up to two-thirds of California's merchandise exports.

Two major trade agreements have recently been enacted, NAFTA and GATT. NAFTA liberalizes the terms of trade among the U.S., Canada and Mexico, and GATT provides for widespread rollbacks in trade restrictions and tariffs and strengthened intellectual property protection. NAFTA and GATT will further stimulate the process of globalization already underway.

Risks from Globalization

But while trade liberalization means greater market access and economic opportunity for all countries, it also brings risk. Firms that are slow to respond to new opportunities may lose market share in the world market. Firms in industries now protected by high tariffs or other restrictions will need to adjust as the level of these protections diminishes. Further, reduced trade barriers will facilitate the internationalization of production. Countries with expensive labor or capital may lose new investment and jobs to countries that have lower costs of doing business, especially if the underlying technology is not difficult to transfer or duplicate abroad. Therefore, federal policies that help, or at least do not hinder, firms' adjustment to globalization are likely to be beneficial in the long run.

"In the long-term, we believe that NAFTA and other similarly-crafted free trade agreements will result in net positive effects for the U.S., but particularly for California."

Although trade liberalization can bring long-term benefits, it can also bring short-term disruption to certain markets. There are concerns about whether NAFTA has resulted in the loss of a high number of U.S. jobs, for instance. In fact, the U.S. Department of Labor certified two months ago that 38,000 U.S. workers have lost their jobs due to the agreement. At the same time, many U.S. firms have been very successful in increasing exports to Mexico. While a precise assessment of the net job losses or job gains from NAFTA is difficult because of the short-term effects of the peso crisis, it is unlikely that the agreement has

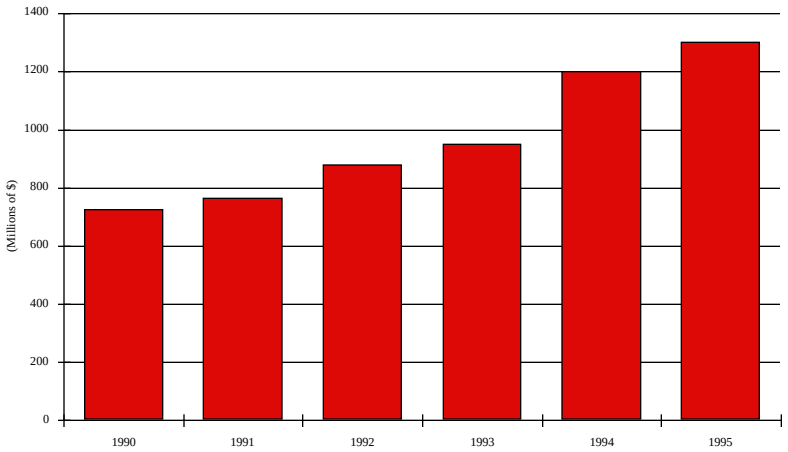
California's ports and airports are expanding to meet future demand. The Los Angeles-Long Beach port complex is the nation's largest. By embarking on a $2 billion expansion program these ports are responding to trends favoring large freight vessels and have become the world's third largest container port behind Hong Kong and Singapore. Similar expansions are underway in San Diego and the Bay Area.

As foreign nations prosper, their consumers are creating strong demand for foreign travel and for the products of California's entertainment industry. Tourism and entertainment, already a key pillar in the economy, could expand at double the rate of overall job growth. California has been a world leader in these markets.

"Tourism and entertainment, already a key pillar in the economy, could expand at double the rate of overall job growth."

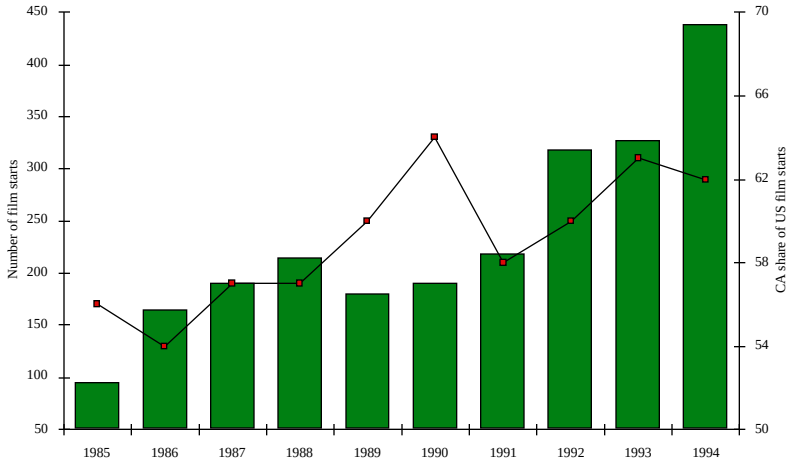
The strength of a key component of the entertainment industry, film production, is apparent from its performance over the last five years. Despite the recession, California has had a near doubling of film starts and maintained more than a 50 percent share of U.S. film production since 1990 (Figure 13).

In the past year, California has added 30,000 jobs in motion picture production. These jobs, plus strong gains in computer and engineering services are providing substantial high wage job growth opportunities which are likely to continue in the decade ahead.



Source: San Jose Mercury News

Figure 12—Venture capital funding in Silicon Valley



Source: California Film Commission

Figure 13—California film industry starts

California has a strong position in some older industries as well. The state's apparel industry, led by design talent and the know-how and drive of immigrant entrepreneurs, has posted steady job gains while the nation has lost 400,000 jobs in the industry. Likewise, the state's agricultural sector has just posted records in revenue and exports.

Finally, California is a leader in a number of professional services, from legal to engineering to management. Many of these services pay high wages. Growth in these high-wage service industries will provide an offset to the decline in some manufacturing sectors.

In short, we expect California's economy to perform well in 1996, despite some continued challenges. In the long-term, the state's economy is likely to outperform the nation.

transition, the decline in the state's aerospace and defense industry employment has been offset by an increase in employment in entertainment and tourism (Figure 10). A second example is the similar juxtaposition of employment in metal products and computer services (Figure 11).

"The BLS expects the nation's high tech sector to grow at three times the rate of other manufacturing in the decade ahead."

The strength of these industries of the future is apparent from their performance over the last several years during the state's long and deep recession.

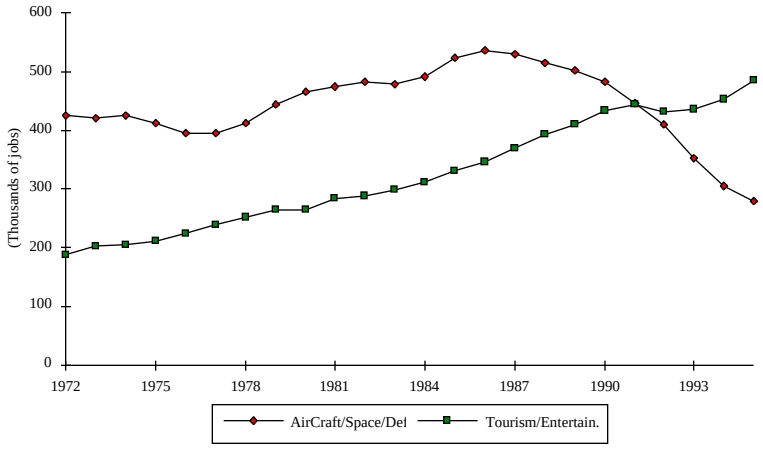
California's high tech sector has performed well during the last few years. The BLS expects the national high tech sector to grow at three times the rate of other manufacturing in the decade ahead. One key signal of the health of California's high tech sector is the continued willingness of venture capitalists to invest ever greater amounts in California. Venture capital funding in Silicon Valley, for example, has increased for six consecutive years, nearly doubling between 1990 and 1995 and set records for funding levels in each of the last three years (Figure 12).

California firms are playing a lead role in the world's exicting new technologies. The multimedia industry is centered in California. The growing collaboration between the creative genius of Hollywood and the technological leadership of Silicon Valley give the state an enormous competitive advantage. The partnership between Silicon Graphics and Dreamworks exemplifies the strength of California's major regions working together.

The race to harness the power of the Internet as a powerful business tool is on. California firms like Netscape are leading in the market to make information accessible and inexpensive to use. The market potential around the Internet is just beginning to explode.

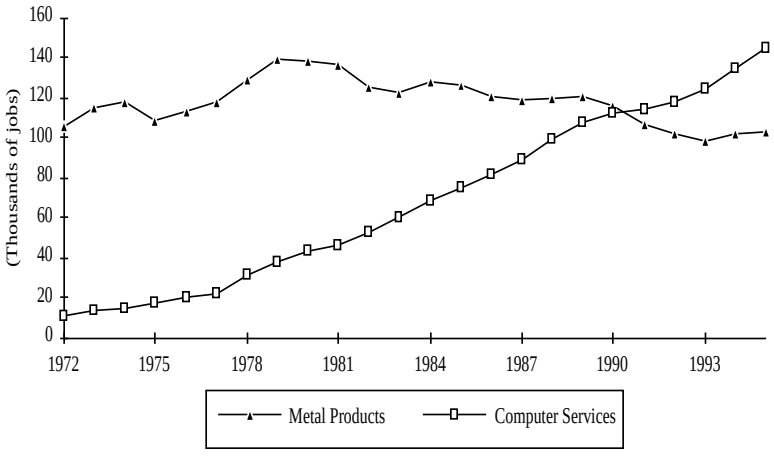
Advanced telecommunications is another area where California has great opportunities. Pacific Bell is organizing to play a leadership role in wiring the state. Qualcomm in San Diego has developed the industry standard for wireless communication and has joined with Sony to develop a manufacturing base in California.

Foreign trade will continue to play a vital role in the state's economic future. As in the past few years, California's trade sector likely will continue to be its fastest growing sector, mirroring the growth of trade at the national level. California has strong positions in several areas: agriculture, technology, entertainment, and legal, financial, construction, and management services.



Source: Employment Development Department

Figure 10—Aerospace/defense versus tourism/entertainment employment



Source: Employment Development Department

Figure 11—Metal products versus computer services employment

finally taken out of operation.

California's construction sector has not yet recovered. Residential building is down in 1995 despite job and income growth, lower housing prices, particularly in the south, and lower mortgage rates (Figure 9.) The improved economic conditions have yet not translated into the increase in confidence necessary to ignite the residential market.

There has been a slight rebound in non-residential building. Anecdotal evidence points to strengthening in the market for industrial land. Office construction, while still low, shows the first signs of a turn around.

III. Outlook for 1996 and Beyond

Our outlook for 1996 suggests continued growth in the state's economy. Indeed, recent employment statistics suggest that California likely will grow faster than the nation.

Among the highlights over the next year, we expect:

- Job growth of 300,000
- Personal income and spending up 6 percent
- A construction upturn in both residential and non-residential sectors
- Continued growth in California's "industries of the future"
- A broad recovery, with strong participation by Southern California
- Consumer prices up by a maximum of 3 percent.

California will continue to face a number of challenges over the next several years, but it is clear that the state also faces a number of opportunities. California's economic base is well positioned for emerging opportunities in the world economy. The state has four areas of strength and opportunity:

- High technology
- Foreign trade
- Entertainment and tourism
- Professional services.

These opportunities are centered around two favorable factors:

- Substantial growth is expected in world markets
- California has a large or growing share of U.S. production and jobs.

In addition, California has numerous opportunities in traditional industries, such as agriculture and apparel.

Industries of the Future

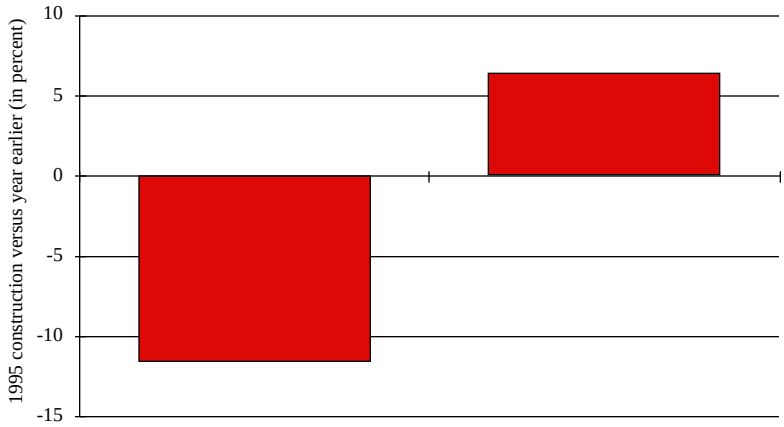
California's economic base is transitioning from aerospace and defense to a more diversified, internationally-focused, technology- and service-oriented economy.

As one example of this

Table 2—Job Losses Due to Defense Downsizing
(in thousands)

	1986	1990	August 1995
Aircraft	157.0	162.3	80.7
Missiles, space	79.8	75.7	30.6
Search and navigation	142.5	99.3	55.9
Other def. manuf.	18.1	14.2	12.5
Defense manuf. subtotal	397.4	351.5	179.7
Federal DOD	138.8	130.6	96.4
Total	526.2	482.1	276.1

Source: Employment Development Department



Source: Construction Industry Research Board

Figure 9—Construction growth 1994-1995

rose 63 percent. Exports to Taiwan totaled $5.3 billion in 1994; these had risen 17 percent by the middle of 1995.

Perhaps the least encouraging trade statistic for the last year comes from Mexico. As noted in our report last year, exports to Mexico doubled between 1987 and 1990 and then increased at an annual average of about 15 percent between 1990 and 1994. But the value of California's exports to Mexico fell in the first half of 1995, albeit only by 4 percent.

Continued economic uncertainty in Mexico will likely preclude any large increases in exports this year. However, as Mexico stablizes both politically and economically, California can expect to gain from trade with its southern neighbor.

California's exports are produced throughout the state. Los Angeles County firms sold $22 billion in exports in 1994 (Figure 8). Santa Clara County, led by exports of semiconductors and computers, sold $20 billion to overseas markets. Orange County ($6.7 billion), San Diego ($4.9 billion), and the Oakland ($5.1 billion) and San Francisco ($9.3 billion) metro areas also contributed to the state's $80 billion in exports last year.

Defense and Construction Have Not Recovered

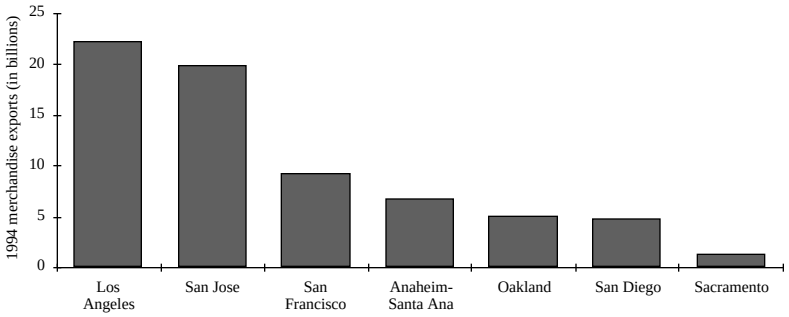
Reduced defense spending will continue to affect the state's economy adversely, as noted in our report last year.

California has lost more than 200,000 direct jobs due to reduced defense spending since 1990, including 171,000 in the aerospace and electronics industries and 38,000 from closing military bases (Table 2).

Table 1—High Tech Exports and Countries Importing California's Products

Exported Products	1994 ($billions)	Change First Half 1995 (in percent)
—Electronics	$21.1	32.0%
—Industrial Machinery including computers	19.0	20.0
—Transportation equipment	9.4	15.0
—Instruments	5.9	13.0
Countries Importing CA Products		
—Japan	13.2	14.0
—Canada	8.5	13.0
—Mexico	7.7	-4.0
—Korea	5.5	63.0
—Taiwan	5.3	17.0

Source: U.S. Department of Commerce



Source: International Trade Administration (U.S. Department of Commerce)

Figure 8—Exports by Metro Area

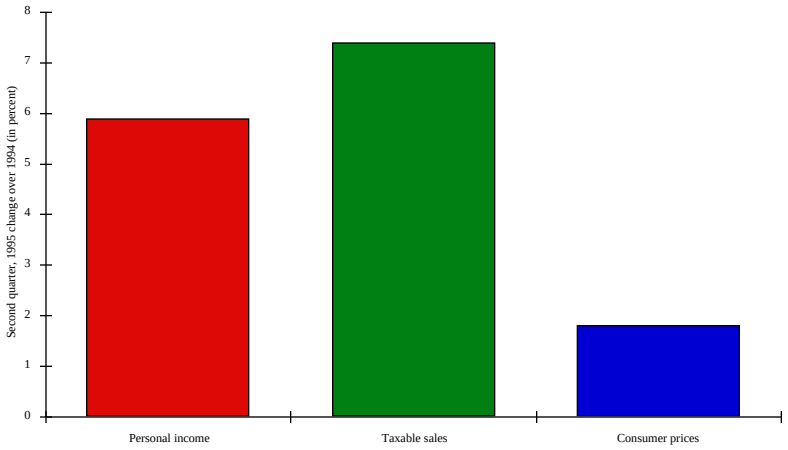
"California aircraft, space, electronics, and defense jobs have been cut in half since 1990."

Moreover, this year California had a fourth round of base closures. The net job loss from this is 19,400, less than the two previous rounds. California's loss accounted for nearly 45 percent of the national net job losses due to base closures. In the four closure rounds, the figure is even more onerous. Despite being home to less than 15 percent of Department of Defense (DOD) personnel, net job losses in California account for 60 percent of national job losses due to base closures.

With this final closure round now completed and DOD procurement steadying, California is finally nearing the end of job losses due to defense budget reductions. California will likely lose an additional 60,000 direct jobs in aerospace and electronics, although this figure could fall substantially if DOD procurement increases. An additional 61,000 direct and indirect jobs are likely to disappear from military bases as 17 major installations slated for closure, but still in opeation today, are

High Tech Products Lead the Way

High technology products continue to account for much of the growth in trade volume and exports. In 1994, electronics exports reached $21.1 billion, while computers and machinery added $19.0 billion (Table 1). Transportation equipment exports, including aircraft and parts, has risen for two consecutive years and reached $9.4 billion in 1994. High tech exports in 1995 are up more than 20 percent.



Source: Board of Equalization, California Department of Finance, Bureau of Labor Statistics

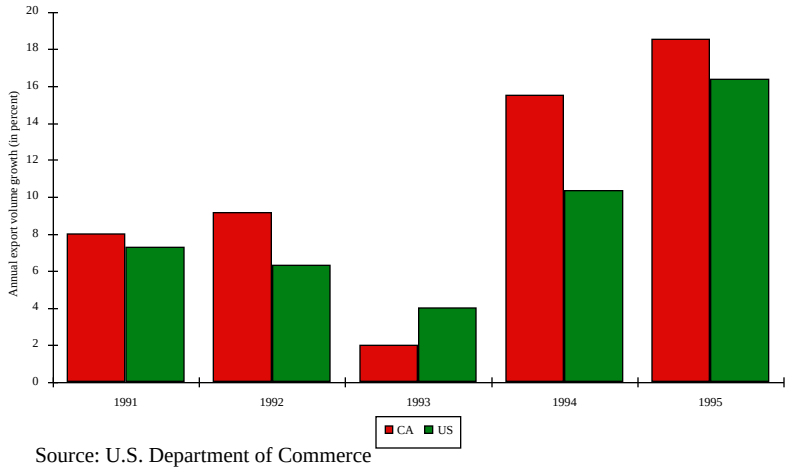
Figure 5—Personal income, taxable sales, and consumer prices

Growth With Key Trading Partners

Growth in exports to most of its trading partners in the America's, Europe, and the Pacific Rim have increased (Table 1).

Japan continues to lead the list of partners importing California's products. In 1994, Japan imported more than $13 billion from California. In the first half of 1995, California's exports to Japan are up by 14 percent.

"Exports to Japan in 1995 are up by 14 percent."

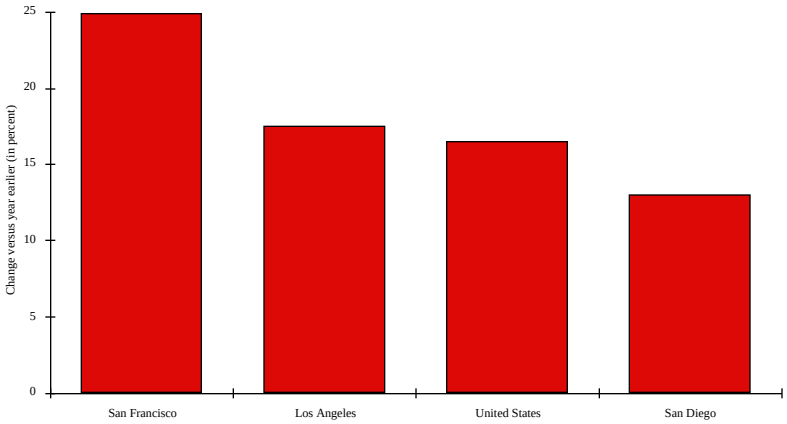


Source: U.S. Department of Commerce
Note: 1995 data are January-June.

Figure 6—U.S., California export growth

Several other countries make up the list of top importers of California products. Canada imported $7.7 billion of California products in 1994. Like Japan, California's exports to Canada are up 13 percent in the first half of 1995.

Exports to Korea totaled $5.5 billion in 1994, making it the fourth largest importer of California products. Korea is well on the way to replace Mexico as California's second largest export market. Export growth in the first half of 1995



Source: U.S. Department of Commerce

Figure 7—Export growth by California Customs District

allowing residents a real increase in living standards for the first time since 1990 (Figure 5).

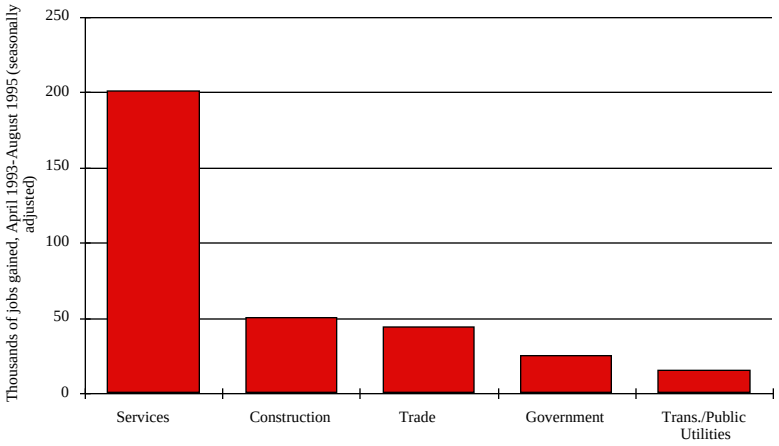
Trade Gains Continue

Foreign trade continues to be a tower of strength for the U.S. and California economies. As we noted in our report last year, not only is U.S. trade expanding at a rapid rate, but California is winning a disproportionate share of this larger trade volume. Exports account for more than 10 percent of California's Gross State Product, about double the level in 1987.

Trade, particularly exports, continues to grow rapidly. In 1991 and 1992, California exports expanded at between 8 and 10 percent before falling to a 2 percent gain in 1993. In 1994, exports surged up by 15.5 percent,with each region of the state exceeding the national average. Exports climbed another 18.7 percent in the first half of 1995 (Figure 6) versus a year earlier.

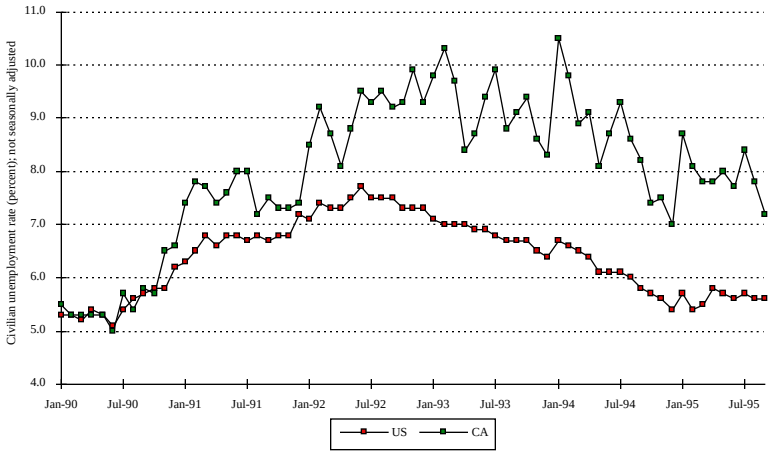
"High tech exports in 1995 are up more than 20 percent."

These gains in trade are uneven across California ports. In the first half of this year, trade volume increased 24.9 percent in San Francisco, 17.7 percent in Los Angeles, and 13.3 percent in San Diego (Figure 7). Much of this disparity appears to be related to the products California is exporting and to its trading partners. San Francisco's export surge is being led by high tech products. San Diego's slower pace is due to slower trade growth with Mexico this year.



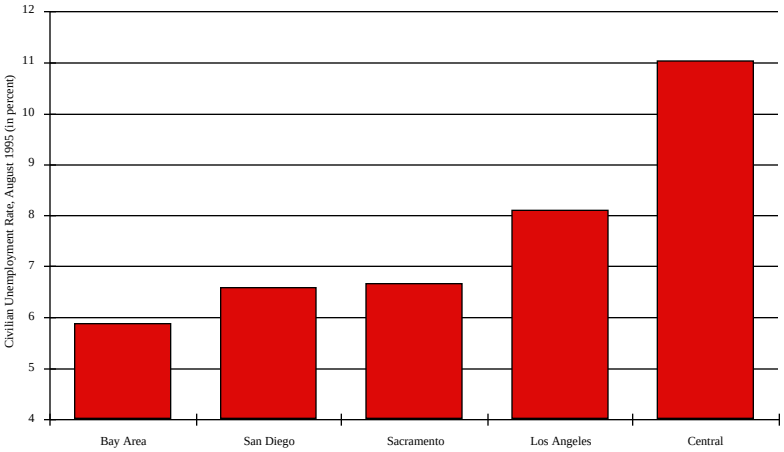
Source: Employment Development Department

Figure 2—Number of new jobs by sector



Source: Employment Development Department

Figure 3—California, U.S. civilian unemployment rates



Source: Employment Development Department

Figure 4—Unemployment rates by region

high. On balance, however, California appears to have turned the corner from the worst recession since the 1930s.

Job Growth Resumes

The 1990-1993 recession resulted in the loss of more than 500,000 California jobs. According to the Employment Development Department, the number of non-agricultural wage and salary jobs in California peaked at more than 12.5 million in 1990 before beginning a long drop to a low point of just above 12 million in April, 1993.

Revised job estimates show that the first signs of job growth occured in late 1993 but job growth did not become significant until early 1994. Recent data suggest that the number of non-agricultural wage and salary jobs exceeds 12.4 million (Figure 1). California has now regained 400,000 jobs since 1990.

More than 250,000 of these new jobs have been added to state payrolls in the past year. Of perhaps even greater significance, for the first time in five years, California job growth exceeds the national average. Between August 1994 and August 1995, the number of jobs grew 2.2 percent in California and 2.0 percent nationally.

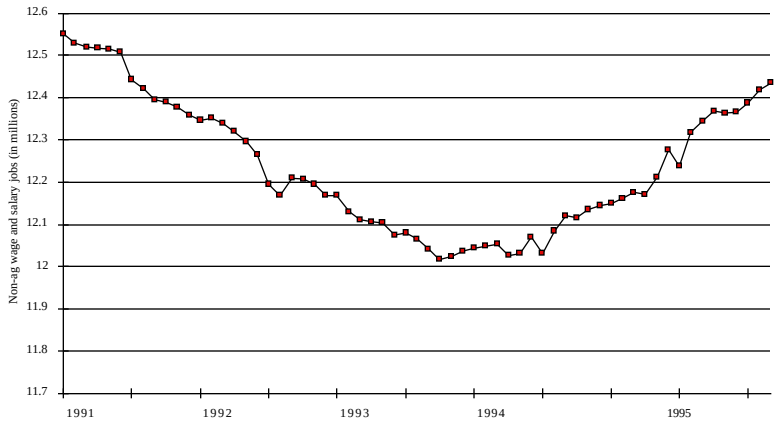
Moreover, in recent months job growth has accelerated in California while slowing in the rest of the country. This trend is comfirmed in recently-released September job statistics. According to the U.S. Bureau of Labor Statistics, 15 percent of the nation's 121,000 new jobs in September occured in Califonria.

Most New Jobs In Services

Job growth is occurring in California's "industries of the future." The motion picture industry added nearly 30,000 production jobs in the last 12 months. Wholesale trade gained more than 30,000 jobs linked to rapid growth in foreign trade. Engineering, management and computer services—tied to the state's surge in the high tech sector—added 30,000 jobs.

Construction showed solid job growth though building levels remained flat.

Nearly two-thirds of the new jobs in California since 1993 are in the service sector. Other sectors showing gains include government, retail trade, and transportation and public utilities (Figure 2).



Source: Department of Finance, Employment Development Department

Figure 1—California non-agricultural wage and salary employment

Unemployment Remains High

Despite this impressive level of job growth, unemployment rates in the state remain far higher than the national average.

"For the first time in five years, California job growth is greater than the national average."

According to recent figures, the nation's unemployment rate remain unchanged at 5.6 percent in September, down slightly from 5.8 percent a year earlier. California's September unemployment rate plunged to 7.2 percent from 7.8 percent in August (Figure 3). The September rate for the state is a full percentage point below the unemployment figure for August 1994. Over the last year, unemployment in the state has averaged 7.8 percent, more than two points worse than the national average of 5.6 percent.

Unemployment rates remain significantly higher in Los Angeles and in Central California than in the Bay Area, San Diego, or Sacramento (Figure 4).

Gains in Personal Income

This strong job growth has led to gains in personal income and spending. Over the last year, personal income grew by 5.9 percent while taxable sales expanded by 7.4 percent in the second quarter of 1995. At the same time, consumer prices remained under control, increasing by only 1.8 percent. As a result, income and spending gains far outpaced inflation,

INTRODUCTION

This economic update of the California Institute's Economic Advisory Council contains four sections:

- Section I reviews our 1994 outlook on the California economy
- Section II provides an overview of California's economy today
- Section III provides our outlook for 1996 and beyond
- Section IV discusses key aspect of federal policies that will strengthen California's economic prospects.

I. 1994 OUTLOOK REVIEW

Our 1994 outlook for the current year was cautiously optimistic, despite the length of the most recent recession. In late 1994, non-agricultural wage and salary employment appeared to have steadied at about 12 million, nearly 500,000 below employment levels in 1990. As a result of growth in the state's labor force, however, the unemployment rate had increased from 5.6 percent in 1990 to 9.0 percent in 1994.

A number of EAC members believed, correctly, as it turned out, that these employment figures overstated California's predicament because job estimates in 1993 and 1994 did not record a pick-up in new firm start-ups. Other economic indicators suggested that a recovery was underway. Among the positive indicators were rising consumer confidence, rising home sales and new construction permits, and increasing retail sales receipts.

First Stages of Recovery

Most EAC members believed that California's economy and the number of jobs in California would expand at 1-2 percent in 1995, or between 100,000 and 200,000 jobs. Further, we projected that California would regain its 1990 employment levels by 1996 or 1997, but that the unemployment rate would not return to its pre-recession level until near the end of the decade.

Continued Structural Changes

Our 1994 outlook anticipated that a number of structural changes would adversely affect the state's economy. The EAC anticipated that many of the state's lost jobs were unlikely to come back since these jobs were in industries, such as aerospace and banking, that continue to undero major long-term structural changes.

"The EAC anticipated that many of the state's lost jobs were unlikely to come back."

We also anticipated that defense reductions would continue over the next several years.

California's real estate slump signaled another obstacle to recovery. While we anticipated that construction would rebound, we expected housing starts to remain below pre-recession levels for quite some time.

Some of the anticipated structural changes were expected to be positive. The movement to a service economy favors California sectors like entertainment and foreign trade. Moreover, we anticipated growth in several industries like medical, electronics, and computer equipment; and legal, business, environmental, and engineering services.

II. THE STATE'S ECONOMY TODAY

California's economy has continued to strengthen over the past year and recently has begun to show very rapid growth. This section addresses several questions concerning the state's economy:

- How far has the state come in its recovery?
- What have been the major sources of growth?
- What is the outlook for 1996?

Current Economic Trends

Although California has not yet restored itself to pre-recession levels, current trends indicate continued—indeed accelerated—recovery. These favorable trends include:

- Rapid job growth
- Income and spending growth
- Growth in trade and other important sectors.

Not all of the news is good. Construction continues to move at a slow pace and unemployment levels remain unacceptably

EAC Members

Chairperson
Dr. James R. Hosek
Corporate Research Manager
RAND Corporation

Mr. Fred Cannon
Sr. Vice President
Bank of America

Dr. Walter E. Hoadley
Senior Fellow
Hoover Institution

Mr. Jack Kyser
Chief Economist
Los Angeles Economic Development Corporation

Dr. Tapan Munroe
Chief Economist
Pacific Gas and Electric Company

Charlene Wear Simmons, Ph.D.
Assistant Director, General Law & Government
California Research Bureau

Ms. Frances Banerjee
Asst. General Manager, Dept. of Transportation
City of Los Angeles

Ms. Leslie Appleton-Young
Vice President of Research and Economics
California Association of Realtors

Mr. Max Schetter
General Manager and Executive Vice President
Greater San Diego Chamber of Com merce

Dr. Philip J. Romero
Senior Economic Advisor
Office of Governor Pete Wilson

Vice Chairperson
Mr. Stephen Levy
Co-Director
Center for the Continuing Study of the California Economy

Barry Sedlik
Manager, Business Retention
Southern California Edison

Dr. Fred Furlong
Assistant Vice President
Federal Reserve Bank of San Francisco

Dr. Jon Goodman
Director, Entrepreneur Program
USC School of Business Administration

Mr. Doug Henton
Consultant
Joint Venture: Silicon Valley Network

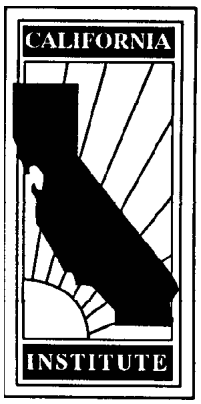
Larry J. Kimbell, Ph.D.
Director
UCLA Business Forecasting Project

Dr. John Taylor
Professor of Economics
Department of Economics
Stanford University

Mr. Kevin Scott
Principal
QueEs

Mr. Ted Gibson
Chief Economist
Department of Finance

Dr. Bruce DeVine
Chief Economist
Southern Califonria Assocation of Governments



THE CALIFORNIA INSTITUTE
FOR FEDERAL POLICY RESEARCH

REPORT OF THE ECONOMIC ADVISORY COUNCIL OF THE CALIFORNIA INSTITUTE

Presented by James Hosek,
Chairman, Economic Advisory Council
and
Stephen Levy,
Vice-Chairman, Economic Advisory Council

Washington, D.C.
October 11, 1995