

MILKEN INSTITUTE



CALIFORNIA  
SUMMIT

MARCH 2015

# CALIFORNIA SUMMIT

Final Takeaways From  
a Meeting of the Minds

*Review and Recommendations*



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# **CALIFORNIA SUMMIT**

## Final Takeaways From a Meeting of the Minds

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### *Review and Recommendations*



## **Acknowledgments**

The authors thank our Milken Institute colleagues for the efforts they devoted to making the California Summit possible, and we are grateful to all the supporters of the California Center.

## **About the Milken Institute**

The Milken Institute is a nonprofit, nonpartisan think tank determined to increase global prosperity by advancing collaborative solutions that widen access to capital, create jobs and improve health. We do this through independent, data-driven research, action-oriented meetings and meaningful policy initiatives.

## **About the California Center**

The Milken Institute California Center identifies ways to keep the state's economy vibrant and growing.

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## CALIFORNIA SUMMIT SESSIONS

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**Bettering California's Business Climate:** This session set the tone for the entire Summit. We discussed investing in infrastructure and female entrepreneurs, retaining talented foreign students, and revising regulations that inhibit innovation.



**The Water Challenge: Doing More With Less:** Given the impact of the drought, water conservation and efficiency were the dominant themes. In particular, the focus fell on recycling, retention, and the need to reduce usage.



**Training the 21st Century Workforce:** As states and countries compete to attract high-paying science and technology industries, the need to increase the number of students studying math and science in California is paramount. This session focused on engaging students at an early age and providing the means for tech companies to recruit locally.



**The Public/Philanthropic Partnership:** With state and local budgets strained, it's become increasingly important for philanthropies and nonprofits to fill the void. This session focused not only on the need to identify silos and break down barriers to develop a more effective relationship among philanthropic, business, and policy leaders, but to recognize the limits of philanthropic resources to temper government expectations.



**Bay to Basin: Cities Making a Comeback:** As cutbacks continue at the federal and state levels, municipalities need to collaborate on major issues and vital infrastructure projects. This session focused on how cities and regions can form effective partnerships and the elements needed to navigate the potentially complex process.



**Energy: Powering the Green Economy:** With California a leader in green energy legislation, it's time to examine our mechanisms for encouraging and developing further environmental investments. Participants discussed how government can promote innovation without artificially tilting the market toward specific options.



**The High Cost of the California Dream:** If the Great Recession had an upside, it was the opportunity for many people to buy homes at more affordable prices. As the market recovered and wages stagnated, affordability suffered a setback. And college tuition has continued to climb. This session addressed these cost barriers and explored potential solutions that can be implemented in the near term.



**Effective Government: Tax Reform:** The impact of California's unstable public revenue flows continues to be felt at the state and local levels, even as the so-called rainy day fund mitigates the worst effects. Furthermore, the system imposes a disproportionately high tax burden on small businesses without providing sufficient tax or structural incentives to invest in the state. Participants examined the limitations of the system and tradeoffs that could bring significant change.



**California the Pioneer: Blazing the Trail of Innovation:** This panel discussed the reasons California leads in innovation and examined ways to support the state's culture of risk-taking. We considered the challenges posed by the cost of living and loss of skilled talent as well as how to encourage entrepreneurs to stay committed to their efforts.







*During the “High Cost of the California Dream” panel, our expert speakers considered what it takes to afford living in the Golden State.*



*Milken Institute Chairman Mike Milken engages California Senate President Pro Tempore Kevin de Leon during the “Bettering California’s Business Climate” panel.*

## **The third annual Milken Institute California Summit**

provided an opportunity to focus on key issues facing the world’s eighth-largest economy and its diverse population. A discussion of California’s costly business climate opened the November 20 gathering at the Fairmont Miramar Hotel in Santa Monica, leading to explorations of aging infrastructure, workforce development, and other topics. Participants focused on harnessing the tremendous resources of this great state to overcome these challenges. This report is intended to not only inform stakeholders of the main conclusions of those discussions but also how the Institute will address several of the challenges raised.

Along with identifying the most crucial items on California’s to-do list, our speakers and attendees debated and ultimately defined a series of actionable recommendations. As part of the California Center’s engagement with stakeholders and public officials, we have focused on developing a more thorough understanding of the issues discussed at the Summit and creating a plan for implementing many of the recommendations over the coming year. We aim to facilitate change in areas we have the capacity to address and in other cases, raise awareness of proposed solutions on a broader scope.



## BACKGROUND AND RECOMMENDATIONS

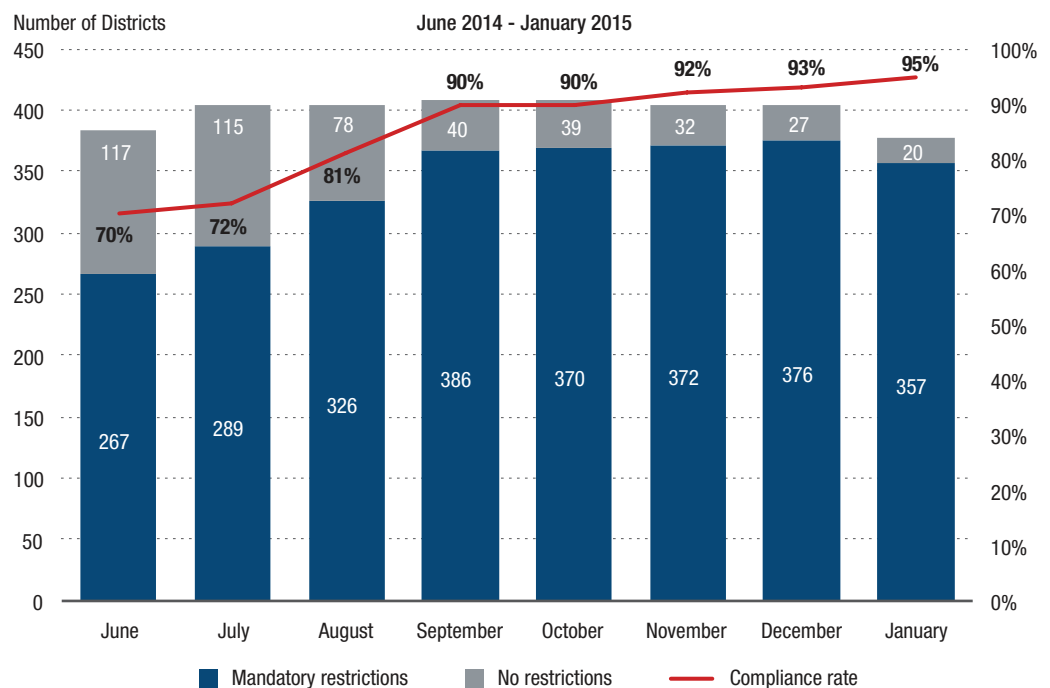
Panelists and participants made numerous important recommendations, many of which we have integrated into our agenda for 2015. Below, we discuss issues central to California's future and actions to be taken both by the Milken Institute and by leaders of the state.

### ➔ INVESTING IN INFRASTRUCTURE

Infrastructure issues in California are significant and wide-ranging. After decades of underfunding the state's transportation network, energy grid, and water distribution systems, the need is acute. At the same time, state and local jurisdictions are facing fiscal pressures. Shortfalls are not only hitting their general funds but also specialized transportation spending as more efficient vehicles generate less gasoline tax revenue and the federal government pares its role in infrastructure funding. The result of the disengagement of federal resources at the local level has been to spur the rise of regional collaboration models focused on producing local solutions addressing infrastructure challenges as well as efforts to build alternate regional structures that cross state boundaries. Further, regulatory uncertainty—both in terms of the rules themselves and who administers them—prolongs the time it takes to complete projects and discourages private-sector providers from directly engaging state and local partners on infrastructure projects.

At the same time, strained water supplies as well as aging delivery systems are pressuring the state. Not only is the flow continuing to decline after the fourth year of drought, but the our ability to invest in water efficiency and retention systems is limited. The passage of the recent water bond offers an opportunity to fix several infrastructure issues at the state level but does not address efficient use and developing new sources.

#### California Water Suppliers Implementing Mandatory Restrictions



Source: Natural Resources Defense Council.



- Taking advantage of low financing costs, the state should invest up to \$100 billion in infrastructure. This would invigorate the economy and the tax revenue generated by growth would outstrip debt payments.
- Retool public funding mechanisms for infrastructure to ensure consistent availability of capital, with better screening tools for projects suited for direct government investment or public-private partnerships.
- Establish standards and predictability in the regulatory process to encourage private investment and make business planning easier, including intelligent reforms to the California Environmental Quality Act to compress the time involved in the permitting process while maintaining environmental protections.
- Reform local government structures and spur regional collaboration to build needed facilities. This will also reduce uncertainty among investors and private funders.
- Reward quality and expand capacity in energy delivery. Encourage utilities to invest in infrastructure that improves efficiency and facilitates new services.
- Reauthorize local infrastructure financing authority before it expires in 2016 and enhance planning and procurement to invite participation by state investment funds.
- Examine Australia's successful water-use practices, including recycling and on-site storage. Incentivize investment and develop effective regulations for the use of new sources. Educate the public on the need for conservation, including personalized bills that provide real-time monitoring and compare consumption among neighbors.

## Actions for 2015

The Milken Institute plans to address several aspects of the state's infrastructure needs from a research standpoint over the next two years, with a particular emphasis on trade and transportation. On a broader scale, the California Center intends to engage key state leaders on infrastructure financing but also convene public officials, unions, contractors, and investors to establish an actionable framework for a sustained solution. These events will include discussion of bond financing, requirements for private capital, improved governance, and mechanisms for expediting project approvals while satisfying key constituencies. In addition, the Institute will continue to pursue discussions on incentives for improving water infrastructure at the state and local levels.

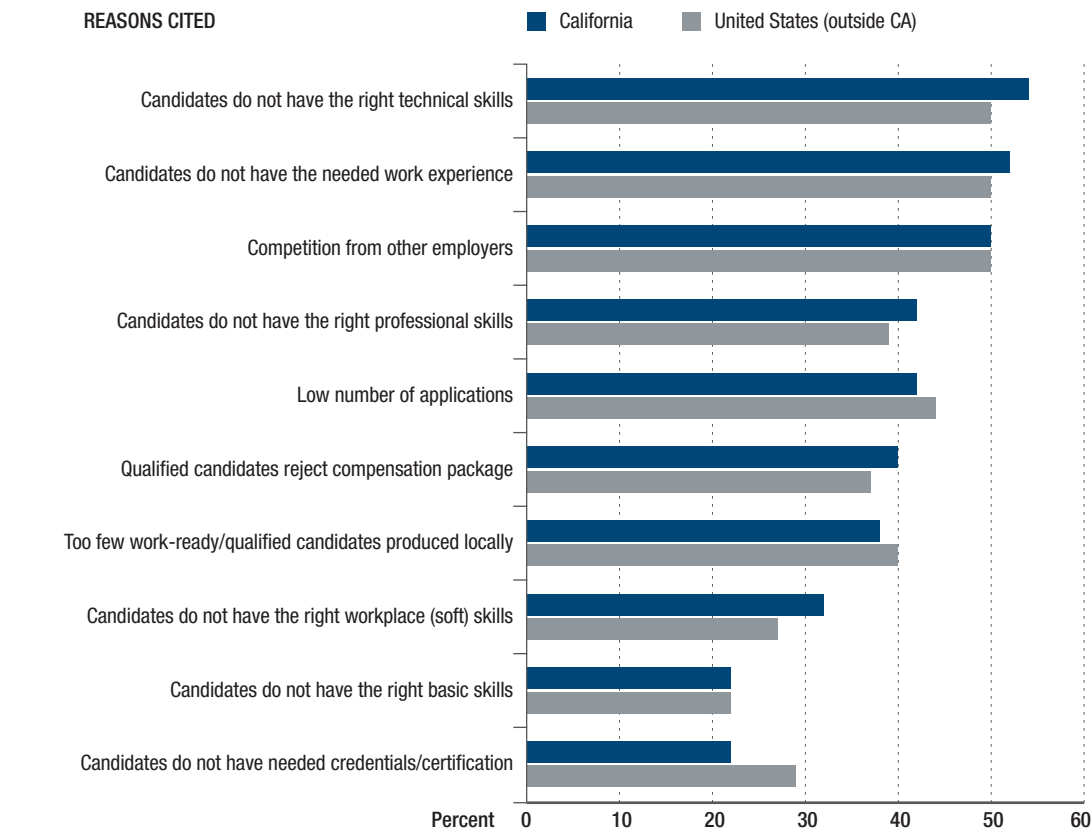
## ➡ IMPROVEMENTS IN HUMAN CAPITAL AND AFFORDABILITY

Human capital represents a fundamental challenge for the state of California. As demonstrated in the Milken Institute report "What Brain Drain?" California does an excellent job retaining locally produced graduates in STEM fields, or science, technology, engineering, and mathematics. However, the number of STEM graduates at two- and four-year colleges is inadequate to meet employer demand. Further, as shown in the Institute's "A Matter of Degrees" study, California is home to several metros with the lowest levels of educational attainment in the nation.

Attracting students to STEM fields in school, community college, universities, and via online courses will be crucial to the state’s future economic success. Likewise, better linking students to employers, so they can find work upon graduation, should be a priority. The “Training the 21st Century Workforce” panel focused on engineering and computer science along with technical competence at every skill level. Not only is demand still strong for computer science graduates, but their skills are applicable across a wide range of high-tech professions. California has too few computer scientists to meet demand, and companies often must recruit from out of state.

Seen broadly, California’s economy is doing well. San Francisco topped the Milken Institute’s Best-Performing Cities index in 2014 and was joined by three other California metros in the top 25. But California’s performance on some metrics in our recent “State Technology and Science” report raises concerns that the state is underinvesting in its people. While we can import skilled workers from other states, this risks leaving portions of California society out of the 21st century workforce and increases the challenges faced by companies operating here. At Boeing, for instance, 50 percent of the workforce will enter the retirement window within five years, so recruitment is a core business concern. The engineering program at California State University, Fresno, was being considered for elimination a few years ago because of budget constraints. At the same time, our industries were having trouble finding engineers to hire.

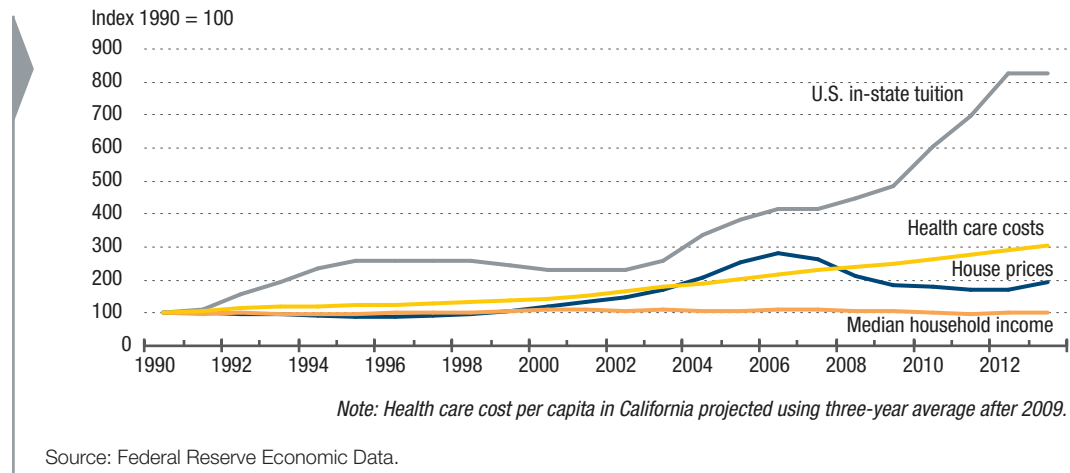
**More Than Half of California Employers Surveyed Reported Difficulty Recruiting for Full-Time Positions**



Source: Society for Human Resource Management.

The issue of affordability is becoming increasingly important in the more urbanized parts of California. During the Great Recession, plummeting prices gave many families the opportunity to buy a home. As the real estate market recovers and prices rise, homeownership is again out of reach for broad swaths of the population. In addition, those prices as well as apartment rental rates have climbed much faster than wages, particularly in urban areas, creating difficulties for the middle class in the state. The number of Californians who rent their residences is approaching 50 percent of the population and may soon surpass homeowners. This is a blow to Californians' optimism and their aspirations to create better lives for themselves and their families.

### Stagnant Incomes and Increased Cost of Living



- Train workers for environmental, or “green,” jobs, including specialized degrees, and expose children to STEM fields early in their lives.
- Foster educator-employer partnerships in the form of internships, curriculum development, shared projects, and employer speaking engagements to provide STEM learning opportunities.
- Increase enrollment capacity at state schools for STEM students, particularly those in computer science and engineering.
- Examine potential impacts of minimum-wage hikes at the city and state levels to increase workers' buying power, but consider effects on small business and job creation.
- Invest in effective local transportation and smarter, denser development to widen access to jobs. Local zoning rules should incentivize industry, not just high-cost housing.
- Restore the affordability of education to working people, particularly by expanding capacity at community colleges.

### Actions for 2015

These recommendations are divided into two categories: improving access to STEM education and increasing the affordability of city living for workers, particularly in regard to housing and transit-oriented multi-family dwellings and accessible work locations, in addition to overall efforts to boost job creation.

The Milken Institute will be directly involved in several aspects of STEM and developing human capital. STEM-related issues raised at the California Summit will be highlighted at our upcoming Global Conference, particularly in regard to women. We will produce research at the Institute's Center for Jobs and Human Capital, including a large report in the second half of this year. The California Center plans to address STEM issues and the need for effective links between students and employers through local engagements in multiple regions of California as well as direct conversations with state leaders in Sacramento.

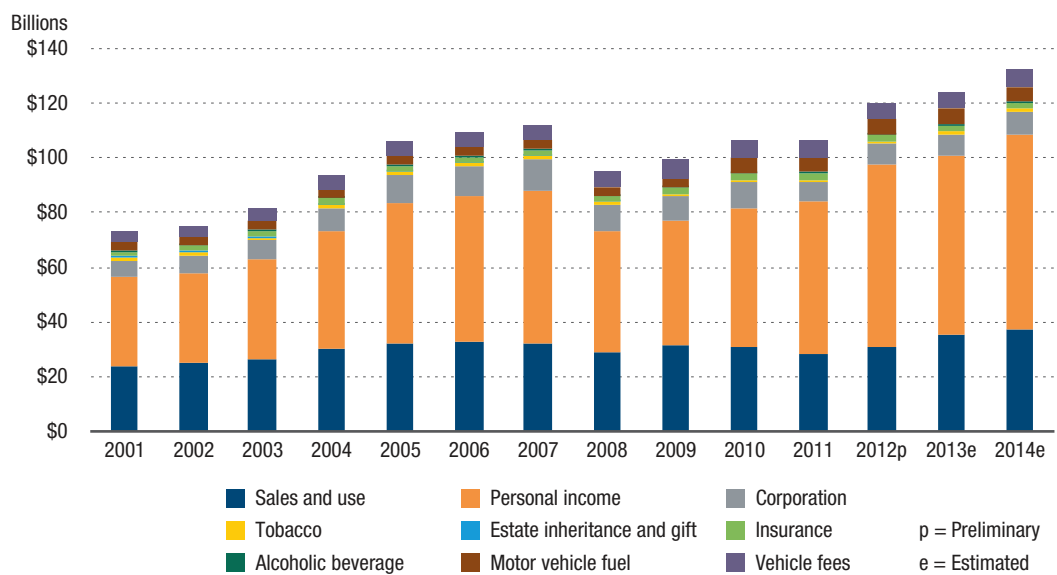
Affordability will also be directly addressed over the course of this year. Working with partners, the Milken Institute will address the issue extensively at the Global Conference and as part of a series of ongoing stakeholder roundtables and forums intended to push for specific policy changes, particularly at the regional level.

## THE ECONOMY AND PHILANTHROPY

What starts in California influences culture and business around the world. The state's immense diversity, its collision of ideas, passions and risk-taking, stimulates innovation. However, with all our experimentation, we may need to pay greater attention to the fundamentals of building a strong economy. The high cost of living can make it difficult to recruit talent, and the high cost of doing business can make it difficult for small-to-mid-sized firms to expand. The volatility of state tax revenue, its impact on the quality of public services, and its effects on business costs and planning have undermined the business climate.

Despite the implementation of the rainy day fund, California officials are grappling with substantial uncertainty in the state's revenue streams as it recovers from the recession. Small businesses are feeling the brunt of a disproportionately high tax rate. In addition, there has been a failure to properly incentivize state investment. The rainy day fund has been a significant advantage in terms of tax revenue in California. It has addressed some of the worst extremes of year-to-year revenue volatility, but 2012's Proposition 30, which provided additional revenue by raising the marginal tax rate on top income earners, has only increased the state's dependence on income taxes.

### Sources of California Tax Revenue



Source: California Department of Finance.

The volatility of tax revenue has contributed to funding shortfalls for human services. Philanthropies are often engaged to provide services to the public as well as interact with businesses that are concerned about these gaps. With Sacramento dependent on philanthropies and other nonprofits, those organizations struggle with their own funding limitations while tempering legislative expectations.

To address these gaps, strong working relationships between philanthropies and local governments are essential. The key to forming effective partnerships is facilitating a mutual understanding of public agency and philanthropic limitations. For instance, procedural requirements and regulatory restrictions can slow government action. However, government is best situated to provide the necessary intersection between business and philanthropies while defining specific challenges and in many instances organizing the private sector's efforts to address them. Despite the absence of expansive infrastructure and robust funding, participants recommended that philanthropies look to backfill social services through targeted advocacy while accelerating innovative solutions. Adding to this funding dilemma, California tends to suffer from a lack of local investment compared to other regions in the U.S.

- Address the instabilities created by the high marginal tax rate, which inhibits business expansion, drives entrepreneurs out of the state, and injects volatility into public revenue streams. Alternatives should not unduly burden small businesses, the main source of jobs in California. In addition, examine the long-term effects of Proposition 2's revision of the rainy day fund on state revenue and the ability to pay for state and local services.
- Implement software-driven improvements in tax collection and raise the state's low rate of collecting taxes owed.
- Encourage investment in funds run by female money managers and support the elevation of women to governance positions in corporations and investment funds. Ensure wider access to capital for women-led or -owned firms.
- Establish local and regional collaborations between government and philanthropies to address specific social needs and cultivate best practices. Find and empower change agents in government who can lead initiatives for partnering with philanthropies as well as directly engage the community.
- Focus on intelligent reforms to the California Environmental Quality Act (CEQA) to aid business investment, job creation, and affordable housing construction.

## Actions for 2015

Addressing pivotal budget issues and supporting changes in the state's tax code are long-term projects that will require analysis not only of current tax laws but where proposed reforms would shift their burden. Substantial stakeholder engagement will be essential to this process. The California Center will work with partners such as Think Long California as well as leaders in the state Legislature to facilitate the analysis and development of effective proposals. It will involve private roundtables and public briefings starting later this year.

In philanthropy, the Milken Institute has established several practices, including the Philanthropy Advisory Service, run by our *FasterCures* center in Washington, D.C. The California Center intends to help local governments and philanthropies improve their relationships by providing detailed analysis of gaps in public services that could be addressed through partnerships as well as by holding a series of engagements to establish best practices for both sets of stakeholders.



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