
MEMORANDUM

DATE: May 4, 2009

TO: Chairman and Members of the Assembly Committee on Jobs, Economic Development, and the Economy

FROM: Staff of the Assembly Committee on Jobs, Economic Development, and the Economy

RE: May 5, 2009 Oversight Hearing on California's Economic Recovery and Small Business Issues

The Assembly Committee on Jobs, Economic Development, and the Economy (JEDE) is the policy committee within the California State Assembly responsible for providing oversight of the state's economic development programs and services, as well as providing policy direction in areas related to business advocacy within California and the United States.

On May 5, 2009, Chairman V. Manuel Pérez will convene the second in a series of hearings designed to examine the state's current economic development recovery efforts. The first hearing held on March 17, 2009, focused on workforce issues and how federal stimulus funds are assisting the state to support the emergence of green and clean technologies.

This second hearing will provide a special focus on the specific challenges facing small businesses during these difficult economic times and how these challenges may impact businesses ability to successfully embrace the opportunities potentially available in emerging industry sectors, such as those associated with the green and clean technologies.

Organization of the Hearing

The May 5, 2009, hearing is organized around two primary panels with opening remarks being provided by the California Small Business Advocate. During the course of the hearing, Members will hear testimony from researchers, economic development practioners, and state officials on the current conditions being faced by small businesses and the programs, services, and initiatives being used to address their challenges.

In addition to this briefing memorandum, background materials being provided to the Members include a fact sheet on California's Small Business Economy, a summary of small business legislation from the current and most recent legislative sessions, a copy of the JEDE report "California Economic Development Recovery Strategy (Recovery Strategy)," copies of the publicly available regional economic recovery strategies, and summary of the small business provisions in the American Recovery and Reinvestment Act (ARRA.)

California Economic Development Recovery Strategy

In anticipation of the enactment of the \$787 billion federal stimulus package, JEDE Chairman Pérez called for the preparation of a 24 month blueprint on how to most effectively use federal stimulus funds to address the state's most immediate economic and workforce needs while still serving as a

catalyst for advancing the state's long-term economic growth. In March 2009, the Recovery Strategy was published and is currently out for public comment.

The Recovery Strategy proposes to use the broadest set of community, economic, and workforce development tools to link these new federal resources with the people and organizations they are designed to serve. In order to accomplish this important task, the Recovery Strategy recommends that the state serve as a facilitator to support and enhance each community's individual initiative to design and implement policies and programs which best fit their needs. The recommended actions in the Recovery Strategy are organized around five community development goals. The five goals are to:

- Goal 1 – Improve business access to business capital
- Goal 2 – Target infrastructure projects that link to economic development
- Goal 3 - Expedite workforce services and training opportunities
- Goal 4 – Enhance local and regional community development capacity
- Goal 5 – Ensure that the state's recovery strategy is a plan for all Californians.

Each of these goals includes a list of specific action items, including actions that should start immediately, to actions proposed in the next six-to-12 months and, finally, those actions which will help to fortify the economy as the state begins to move out of the recession in the next 12-to-18 months.

As noted above, a copy of the Recovery Strategy has been included in the Member's briefing binder under Tab 5 – The California Economic Development Recovery Strategy. Several sections of the Recovery Strategy may be useful to review in preparation for this hearing including Section 1, which includes the small business recommendations and Section 2, which includes the regional economies information.

Background on Small Business in the California Economy

Small businesses form the core of California's \$1.8 trillion economy. Businesses with less than 50 employees comprise 96.1% of all businesses in the state. There were an estimated 3.6 million small businesses¹ in California in 2006. Self-employment accounted for 2.3 million firms, an increase from 2.2 million firms in 2005. The state's economy is not dominated by a single industry; rather it is comprised of a variety of industry clusters throughout the state.

California's largest industry sectors are trade, transportation, and utilities, which encompass major retail outlets, import-export businesses, transportation, and warehousing. Other major nongovernmental industries include professional and business services, educational and health services, and manufacturing.

The state leads the nation in export-related jobs shipping to over 220 foreign destinations annually. California's largest export markets in 2008 were its NAFTA trading partners Mexico (\$20.5 billion) and Canada (\$17.7 billion), followed by Japan (\$13.1 billion). Small and medium-sized firms generated more than two-fifths (43%) of California's total exports of merchandise. This represents the

¹ Based on the federal definition of businesses with less than 500 employees

seventh highest percentage among states and is well above the 29% national average export share for these firms.

Among the 50 states and Washington, D.C., California ranked first in 2004 in the number of women-owned firms, first in employment, and first in sales. As of 2004, there are an estimated 1.2 million privately held, women-owned firms in California, accounting for 48.6% of all privately held firms in the state.

The growth in minority owned firms is another important component in California's small business economy. In 2000, the Milken Institute's Center on Emerging Domestic Markets, reported that minority-owned firms are surpassing the growth of all U.S. businesses, growing at a rate of 17% per year, six times the growth rate of all other firms. Minority firms' sales were growing 34% per year—more than twice the rate of all other firms. California has also seen an increase in minority-owned firms, including a 27% increase in Latino-owned firms; a 43% increase in Black-owned firms; a 19% increase in Asian-owned firms; and a 52% increase in American Indian and Alaska Native-owned firms between 1997 and 2002. However, even with this growth, minority-owned firms are reported to receive less than 2% of venture capital.

Additional information on California's small business economy can be found under Tab 3 – Fast Facts on California's Small Business Economy and Tab 5 – The California Economic Development Recovery Strategy.

Presentation I – Overview from the Small Business Advocate

The state's top policy advisor on small business issues is the Small Business Advocate, who is located within the Governor's Office. The Small Business Advocate is charged with facilitating and advocating for issues and programs serving small business including: participating in the consideration of legislation and regulations affecting small businesses, representing the interests of small businesses before state agencies, and implementing strategies that encourage state agencies to meet or exceed the state's 25% small business participation goal in state procurement and construction contracts.

Legislation passed in the prior two sessions have directed the Small Business Advocate to facilitate the implementation of several new projects, including initiatives to improve the small business certification process for public contracts, assess the impact of state regulations on small businesses, develop emergency preparedness materials for small businesses, and designate department-level small business liaisons.

Last fall, the Office of the Small Business Advocate lead in the development of a State Conference on Small Business, mirrored after the federal White House Conference on Small Business held during the Regan Administration.

Currently, Mr. Keller participates on three stimulus working groups comprised of Administration staff. During his presentation, Mr. Keller will be sharing his insights on how small businesses are addressing the current economic crisis and what actions the state is taking to support them in those efforts.

Speaker and Additional Background Materials

During the May 5, 2009, hearing, Members will have an opportunity to hear from **Marty Keller**, Small Business Advocate, Office of Planning and Research

Additional information on the state's small business programs is available under Tab 4 – Small Business Legislative Actions and Tab 5 – California Economic Recovery Strategy, Section 4. Public Economic and Workforce Development Resources.

Presentation II – Small Business Access to Capital

In December 2008, the National Bureau of Economic Research officially declared that the U.S. was indeed in a recession, which had begun in December of the previous year and dramatically moved into a full blown economic crisis by the close of September 2008.

Due to small businesses important role in the national and state economy, small business trends are carefully watched by economists. In April 2009, ADP, the nation's largest provider of business payroll services, reported that total employment in the U.S. decreased by 742,000. Small businesses, defined as businesses with less than 50 employees, reduced employment by 284,000, of which 111,000 were in goods-producing small businesses and 173,000 were in service-related businesses.

According to ADP, the magnitude of the job loss indicates that the recession has clearly spread to small businesses and the "resiliency displayed by these businesses earlier in the recession, as compared to medium- and large-size businesses, is no longer apparent." For community developers and policy makers, this finding is particularly troubling as small businesses have historically functioned as economic engines in prior recessions. As an example, during the nation's economic downturn from 1999 to 2003, microenterprises (businesses with less than five employees) created 318,183 new jobs or 77% of all employment growth, while larger businesses with more than 50 employees lost over 444,000 jobs.

In moving forward, small businesses are facing a triple challenge in accessing capital. First, small businesses' historical sources of start-up and working capital, such as home equity and credit cards, have disappeared. Second, consumer spending has severely constricted new revenues. Third, the flow of private equity, venture, and other sources of growth capital to small businesses has also slowed.

The President and Congress have placed a high priority on using federal stimulus moneys to help transition the nation's economy to a lower carbon and more sustainable green economy. Successfully making this transition is dependent on a number of factors, including the ability to bring products that are in laboratories today into the market place in the near future. Small businesses are expected to play a pivotal role in advancing this flow of ideas to product placement. However, without access to capital, a skilled workforce, and increased market demand for existing products, it is unclear how this transition will take place.

Presentations during this panel will discuss this triple threat through new research on the impact of the constriction in the capital markets on small business viability and how the current capital crisis jeopardizes the state's green economy transformation.

Speakers and Additional Background Materials

During the May 5, 2009, hearing, Members will have an opportunity to hear from:

- ***Samuel D. Bornstein, Kean University, School of Business***
- ***David Gallo, California State University***
- ***Gus Koehler, Time Structures, Inc.***

Additional information on the Tab 5 – The California Economic Recovery Strategy, Section 1. The 24 Month Blueprint, Section 3. California's Emerging Green Economy, and Section 4. Public Economic and Workforce Development Resources. Information on small business provisions in the federal stimulus package can be found in Tab 7 – Small Business Overview of the American Recovery and Reinvestment Act.

Presentation III – California Recovery Tools

While funding for many state programs have been cut back in recent years due to poor economic times, numerous federal programs will be receiving additional funding through the federal stimulus package and the new federal budget. The Recovery Strategy includes an extensive discussion of federal, state, and local resources that are available to assist communities in California to take actions that mitigate the impact of the current economic crisis and to help communities move forward in establishing more diverse and sustainable local economies.

It is not likely that any specific program or service will, in and of itself, trigger a national economic recovery. However, taken collectively, these programs can provide important gap financing to small businesses while debt markets are frozen; offer training so unemployed workers can fill job openings that still exist; and help communities obtain critical infrastructure to support the health and safety, and economic development needs of struggling neighborhoods.

Clearly the largest economic recovery tool is provided through the ARRA, which authorize \$787 billion in federal assistance through \$288 billion in tax relief and \$499 billion in supplemental program spending. Key expenditures include:

- \$144 billion in state and local fiscal relief;
- \$111 billion for infrastructure and science related investments;
- \$81 billion for protecting the vulnerable including extending unemployment benefits;
- \$59 billion for health care including;
- \$53 billion for education and training; and
- \$43 billion for energy related investments.

Overall, the programs and funding included within the ARRA are designed to serve many purposes, including preserving and creating jobs, assisting those impacted by the recession, and providing investments to spur technological advances in science, health, and environmental protection. Appendix L of the Recovery Strategy (Tab 5) includes an expanded summary of the programs and tax benefits in the ARRA.

Early forecasts indicate that nearly 400,000 California jobs would be retained or created as result of this package and an estimated 12.4 million California workers would benefit from a tax cut of up to \$1,000 per household. At least 1,208 schools would be modernized with new labs, classrooms, and libraries. The chart below, Anticipated Impact of the Federal Stimulus Package on California, provides additional information on potential monies flowing to California pursuant to the federal stimulus package.

Anticipated Impact of the Federal Stimulus Package on California	
Number of Jobs Created or Saved by the Plan	396,000
Number of UI Beneficiaries Receiving and extra \$100 per Month in Benefits in 2009	2,395,068
Number of Families Receiving the Making Work Pay Tax Credit	12,420,000
Number of Pell Grant Recipients	744,236
Additional Number of Households Receiving a \$2,500 Partially Refundable College Tax Credit	522,000
Number of Tax Payers Protected by the Alternative Minimum Tax Patch	4,683,000
Number of Food Stamp Recipients Receiving Benefits with ARRA monies	2,432,000
Number of Children Eligible under the Child Tax Credit	2,254,000
Total State Fiscal Stabilization Fund	\$4,850,845,144
Total Funding for Transportation Infrastructure	\$3,917,656,769
Total Medicaid Funding 1/09 to 1/11	\$11,230,000,000
Total Law Enforcement Funding	\$229,263,500
Total Job Training Funding	\$494,426,343
Source: Office of Speaker Nancy Pelosi	

In getting ARRA money out, the federal government has acted quickly. As of March 17, 2009, over \$30 billion has been made available to California in the form of funding for medical care, farm support, transportation, housing and education. In trying to maximize all available resources, California communities are coming together to define their local priorities and determine how to best use federal stimulus funds to meet their objectives.

As noted earlier, JEDE has prepared an initial draft of the state Recovery Strategy, which integrates well with the Administration's work on regional recovery strategies. In February 2009, the Business, Transportation and Housing Agency announced the development of a recovery planning model that regions could use in preparing themselves for better accessing federal dollars. The model assists regions in selecting priority projects and collaboratively moving forward on priority issues related to infrastructure, housing, and economic and workforce development.

JEDE Members were initially briefed in March on the BTH's activities. At this hearing, Members will be provided with a progress report on the draft regional strategies which were submitted to BTH on April 1, 2009.

Presentations during this panel will also include new research from the California Public Policy Institute on the tools communities have to support local economic development activities, as well as assessments from two small business development practitioners on the state of the California small business economy.

Speakers and Additional Background Materials

During the May 5, 2009, hearing, Members will have an opportunity to hear from:

- **Traci Stevens**, Business, Transportation and Housing Agency
- **Max Neiman**, Public Policy Institute of California
- **Clarence Williams**, California Capital Financial Development Corporation
- **Dan Ripke**, University of California at Chico, Small Business Development Center

Additional information on California economic and workforce development recovery tools can be found in Tab 5 – The California Economic Recovery Strategy, Section 1. The 24 Month Blueprint, Section 4. Public Economic and Workforce Development Resources, and Section 5. Private Economic and Workforce Development Resources.

Big-Picture Issues for Consideration

Chairman Pérez has convened this hearing to provide the Members with an opportunity to more closely examine the impact of the recession on small businesses. During your discussions, Members may wish to examine larger and more over arching economic development issues including, but not limited to:

- Does the state have the optimal mix of policies, programs, and services to meet the current and near-future economic challenges facing California's small businesses?
- Given the current market challenges, does the state have the optimal mix of policies, programs, and services to attract the private sector investment?
- Is the current administrative structure for providing programs and services conducive to the state's economic recovery?
- Does the current administrative, fiscal, and programmatic structure proactively support emerging technologies and innovative processes?
- Do the current policies, programs, and services strengthen historically weak regional or local economies, and thereby reduce future public costs for public assistance, law enforcement, and public health?

Supplemental Background Materials

As noted above, Members' briefing binders have been provided containing an agenda, briefing memorandum, and supplemental background materials. The tabs have been arranged as follows:

- Tab One - Agenda;
- Tab Two – Briefing memorandum;
- Tab Three – Fast Facts on California's Small Business Economy;
- Tab Four – Small Business Legislative Actions;
- Tab Five – California Economic Development Recovery Strategy;
- Tab Six – Selected Regional Recovery Strategies including Riverside and San Bernardino Counties, San Joaquin Valley, and the Bay Area; and,
- Tab Seven – Small Business Overview of the American Recovery and Reinvestment Act.

All of these materials are also available on the Committee website, located at:

<http://www.assembly.ca.gov/acs/newcomframeset.asp?committee=131>