

Silicon Valley Roundtable

National Association for Business Economics

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WILL 2004 BE THE YEAR FOR JOB CREATION IN THE SAN FRANCISCO BAY AREA?

by Anne Ramstetter Wenzel, M.A.

The San Francisco Bay Area has been hit hard by the 2001 recession and jobless recovery. Bay Area employers had 389,000 fewer jobs on their payrolls in January 2004 than in January 2001. Almost 90% of the payroll job losses (344,000) occurred in San Francisco, San Mateo and Santa Clara counties. The North Bay Napa and Solano counties actually experienced modest growth of 8,000 payroll jobs from January 2001 through January 2004.

Bay Area Vacancy Rates

Office vacancy rates have stabilized in some areas of the San Francisco Bay Area, but remain at historically high, double-digit rates (see table below). Continued job losses in Silicon Valley (which includes southern San Mateo County and Santa Clara County,) are hampering demand for office space. Office vacancy rates in the area increased slightly for 2003 (see table). BT Commercial, a Northern California real estate brokerage firm, estimates that the Bay Area needs to generate approximately 139,000 jobs for the office vacancy rate to drop to 10%: the Association of Bay Area Governments is forecasting growth of 17,000 jobs for 2004 and 33,000 for 2005.

Office rents fell throughout the Bay Area, to a monthly average of \$2.09 per square foot in 2003, down from \$2.31 per square foot in 2002 and the peak of \$5.64 per square foot in 2000. Rents have stabilized however as the average

Bay Area asking rate remained at \$2.09 per square foot in both the third and fourth quarters. Direct lease space available continues to increase, but there was a substantial drop in sublease space available on the San Francisco Peninsula (including Santa Clara County) and in the East Bay, which helped reverse the trend of rising vacancy rates.

San Francisco Bay Area Office Vacancy Rates by Area:

County/Area:	2000	2001	2002	2003
East Bay*	5.5%	13.3%	17.0%	16.7%
Marin County	—	19.0%	18.1%	17.2%
Napa County	na	na	na	na
San Francisco (Central Business District)	4.6%	15.3%	20.3%	20.1%
San Mateo County	4.1%	22.2%	25.5%	27.3%
Santa Clara County	3.5%	13.9%	17.1%	18.7%
Solano County	na	na	na	10.0%
Sonoma County	na	na	na	15.0%

*Includes the cities of Richmond, Emeryville, Berkeley (central business district and West Berkeley), Oakland (central business districts and Oakland Coliseum Airport), and Alameda.

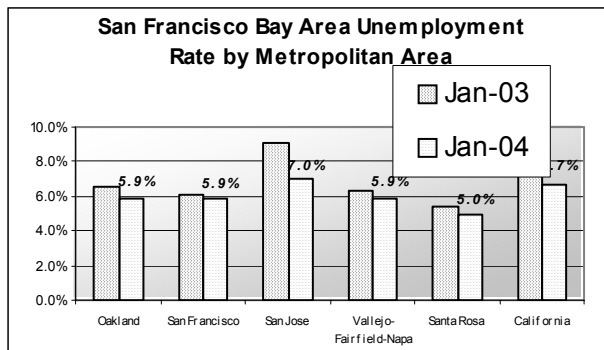
Source: BT Commercial, www.btcommercial.com

Job Losses

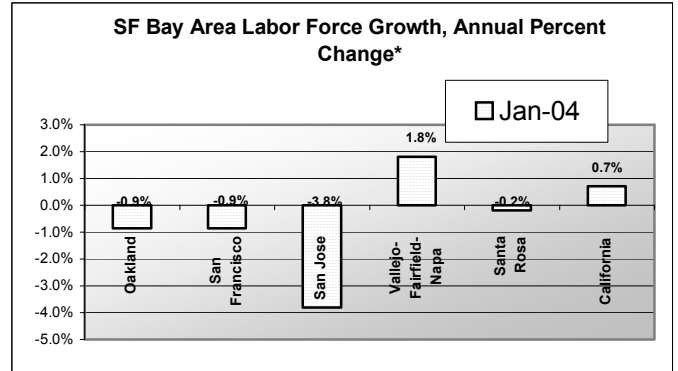
The sluggish economy, outsourcing (whether overseas or to other regions of the United States), and productivity increases have led to a decline in the number of jobs on the San Francisco Peninsula. Employees in the area are

very productive: Value added per employee rose to \$188,300 in Santa Clara County in 2003, up from \$180,300. San Mateo County value added per employee increased to \$197,600 in 2003, up from \$180,000 in 2002 (nationally, value added per employee was \$87,500 in 2003). Despite the increasing productivity of the region's work force, Silicon Valley Joint Venture estimates that average pay in Silicon Valley dropped in 2003 for the third year in a row, to \$62,400, down from a peak of \$81,700 in 2000.

Many workers in Santa Clara County, discouraged by poor employment opportunities, have left the labor force. People have moved from the area in search of better opportunities, returned to school for more training, or are pursuing other family and personal interests until job prospects improve. As a result, the Santa Clara county unemployment rate has declined, even as the number of jobs in the county continues to decline (see graphs, below).



Job losses have taken their toll on family finances in the Bay Area, according to the California Consumer Confidence Survey conducted by the Survey and Policy Research Institute at San Jose State University. In January 2004, a third of Bay Area Consumers (33.6%) said they are financially worse off than a year ago, while 29% percent said they are better off. Expectations have recently improved only slightly: In January 2004, 39% of Silicon Valley residents surveyed expected



they'd be better off financially in a year, versus 37% of those surveyed a year earlier (prior to January 2004, only Silicon Valley residents were surveyed). Expectations are not always met, however: In January 2003, only 12% of Silicon Valley residents surveyed expected to be worse off financially in a year, but, according to the January 2004 survey results, 35% of Silicon Valley residents surveyed now say they are worse off financially.

According to the household survey of employment, which includes self-employed persons, employment has stabilized even in Santa Clara County, the area hardest hit by job losses due to the drop in information technology investment in 2001-2002. In February 2004, Santa Clara County employment was 1% lower than in February 2003, after dropping an average of 9% per year from February 2001 to February 2003.

Prospects for Growth

A recovery does appear to be taking hold in the San Francisco Bay Area. The national recovery is underway, led by higher profits and increased investment in information processing equipment. In the San Francisco Bay Area, 40% of companies surveyed reported higher revenues versus 6 months ago, while only 14% reported lower revenue. Twenty-seven percent of companies surveyed reported higher profits, while 18% reported lower profits. Responses

varied by county, with only 30% of Marin, Napa and Sonoma counties reporting higher revenue and only 19% reporting higher profits.

The outlook for private sector jobs in the region is improving. The Bay Area Council's Business Confidence survey shows that one third of the companies surveyed in January plan to add to their Bay Area workforce in the next 6 months. Again, the responses varied by county, with only 16% of respondents from Marin, Napa and Sonoma counties expecting to hire within the next 6 months, while 47% of San Mateo county respondents are planning to add Bay Area staff.

The smaller North Bay counties won't see much employment growth, as state, county and city employers grapple with cutbacks in state funding (e.g., Sonoma County relies on state funds for 44% of its operating budget). Napa, Solano, Sonoma and Alameda counties rely on government agencies for 15% of their employment base, versus 10% for Santa Clara and 11% for San Francisco, San Mateo and Marin counties. On the San Francisco Peninsula, however, the improved hiring outlook for larger companies, combined with the numerous engineering and sales manager jobs opening up at venture capital funded companies, mean that employment growth should resume soon. The Association of Bay Area Governments (ABAG) is forecasting an increase of 17,000 jobs for the 9-county San Francisco Bay Area: 2004 may be the first time in three years that forecasted job growth is too conservative.

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THE GOVERNOR'S NEXT CHALLENGE: CALIFORNIA'S WORKERS' COMPENSATION

by Kenneth H. Jacobson

Arnold Schwarzenegger's first months in office have been a rousing political success, but he now faces a new challenge—reform of California's troubled and controversial workers' compensation program.

Successful Ballot Initiatives

On March 2, the new governor won the fight for a group of ballot initiatives, with surprising support from the state's majority Democratic voters. Of key importance were propositions 57 and 58. The first will allow California to escape impending insolvency by issuing a \$15 billion bond, while the second will require lawmakers to balance the budget each year and set up a rainy day reserve. Schwarzenegger declared that the state is "back on the track" at a victory rally in Santa Monica. Actually, Proposition 57 will only buy the state a breathing space to pay some \$14 billion in past borrowing that falls due in June. The state must still close a "structural" gap between spending and revenues which could amount to \$4 billion in the 2004-2005 fiscal years.

What the victory of the propositions does demonstrate is the governor's Hollywood charisma and political savvy. His \$8.5 million advertising blitz and phone campaign won over Democrats at the polls and support from Democratic leaders, such as State Controller Steve Westly and Senator Dianne Feinstein. Schwarzenegger also won a yes vote on Proposition 55, an initiative to issue \$12.3 billion in bonds for state schools and colleges, and opposed successfully Proposition 56, which would have reduced to 55% from two-thirds the majority in the legislature needed to pass a budget.

The Need for Workers' Comp Reform

Reform of California's workers' compensation program is a Schwarzenegger priority dating from his State of the State speech in January, when he warned that if lawmakers failed to pass substantial workers' comp reforms, he would put a business-backed initiative on the November ballot to do it. The governor and his GOP allies in the Assembly and Senate and the legislature's top Democrats have been negotiating for weeks to try to reach a compromise on how to check the skyrocketing cost of treating work related injuries. The governor has set an April 16 deadline for a legislative solution. Without a settlement he will then submit more than 598,000 voter signatures needed to qualify this proposal.

Workers injured in California are entitled to more treatments than those injured in other states. And a higher percentage of workers here are found to have some disability after their injuries—entitling them to an average payment of about \$35,000 apiece. Such differences boost costs for large employers who pay for most injuries themselves. They also burden small employers, which buy insurance to cover injuries and must pay the highest premiums in the country.

Employers began pressing for legislation to curb workers' compensation costs after their expenses covering workplace injuries began climbing in 2001. Average workers' comp expenditures jumped from \$2.68 per \$100 of payroll in 2000 to \$6.30 per \$100 in 2003.

The high costs might be tolerable if the system rehabilitated workers and got them back on the job. Instead the process is permeated with confusion, delays, and complexity. California workers hire more lawyers than workers in other states, and those who live on disability checks—among the lowest weekly payments in

the nation—believe the system not only shortchanges but demonizes them.

Labor leaders and workers' attorneys trace the cost explosion to the elimination of a minimum-rate law and an ensuing price war in the mid-1990s among insurance companies that provide employers with workers' coverage. The competition drove 25 workers' comp insurers into insolvency and a number of others into mergers or out of the California market. According the same leaders and attorneys, the price spikes sprung from a loss of competition and an effort by remaining insurers to recover investment losses.

The Governor's Growing Confidence

On Sunday, March 28, the governor and leading Democrats met to reach agreement on cost-cutting legislation and thereby head off a bitter and potentially explosive November ballot fight. On Tuesday, March 30, Schwarzenegger told reporters in Sacramento that a compromise agreement was "in the home stretch." He also claimed to have made progress in persuading Indian tribes to return \$500 million in casino money to offset the state deficit.

To date the governor has managed to maintain good relations with the Democratic leaders in the legislature, notably the partisan John Burton, President Pro Tem of the Senate. Burton is far from enamored of Schwarzenegger's pro-business policies but appears to get along with him personally. Term limits will claim other veteran liberal Democrats after many years. In addition to Burton, Senator Byron Sher, an environmental advocate from Palo Alto, and Senator John Vasconcellos, a Santa Clara eccentric, will end their long careers in Sacramento at the end of the year.

The governor is not without critics in his old party. Republican Senator Tom McClintock, who ran against him for the governorship, is critical of Proposition 57 as an ill-advised attempt to “borrow our way out of debt.” Socially conservative GOP voters oppose his liberal tack on gay marriage. Nonetheless, Schwarzenegger has begun to take on national celebrity status, a fact that California Republicans and even the Bush White House must take into account.

As former British Prime Minister Harold Macmillan wisely said, “In politics, two weeks is a long time.” Still the passing of the liberal Democratic leadership in Sacramento, the limited appeal of conservatism to the California electorate, and the apparent popularity of the celebrity governor’s “Republican-lite” politics to centrist voters augurs well for his policies.

THE OUTSOURCING OF SILICON VALLEY

by Claire Starry, TDS Economics

A National Perspective

The controversy over off shoring continues to grow as more and more U.S. workers face the loss of their jobs to foreign replacements. No longer limited to blue collar workers, the exodus of jobs has reached professionals in many service sector industries, including engineering, programming, data processing, and medicine. As of the end of 2003, estimates place the loss of jobs to off shoring at 500,000, about a fifth of the payroll jobs lost since 2001. With wages in foreign countries from a fifth to a half of what equivalent U.S. workers are being paid, it is unlikely this trend will stop anytime soon.

The enormous supply of skilled workers in Asia and Russia can easily meet the growing demand by U.S. companies. The number of skilled workers in this region is estimated to be

International Salary Comparisons

Country	Average Programmer Salary
U.S.	\$60,000 - \$80,000
Canada	\$28,000
China	\$9,000
India	\$6,000 – \$11,000

Source: Reported in San Francisco Chronicle, January 8, 2004

over 300 million and growing rapidly, compared to a total U.S. labor force (both skilled and unskilled) of less than 150 million.

Maintaining large wage differentials is difficult in a global labor market. Although some experts argue that U.S. colleges turn out more creative graduates, ones who can innovate and are flexible, others argue that this attitude is naïve and arrogant. Moreover, Asian countries are investing in productivity-enhancing infrastructure as well as higher education, while in the United States, many state and local governments, in reaction to budget woes, have cut funding in these area.

According to the principle of comparative advantage, when resources move to where they can most efficiently be used, global output increases. In practice, however, benefits from off shoring may not materialize quickly, and not all participants will benefit equally. It takes time, maybe years, for resources to shift to new jobs, and some workers may be at a point in their careers where retraining is difficult. Over the last year, many of those who have found work after losing their job to off shoring report taking major cuts in pay. A continued fall in the value of the U.S. dollar, especially if China and other Asian countries no longer keep their currencies artificially high relative to the U.S. dollar, can reduce the cost differential between Asian and U.S. workers, making it less profitable for U.S. companies to relocate jobs offshore. But a falling U.S. dollar will increase the prices consumers pay for imports, effectively reducing real incomes.

With the prospects for the wage gap between the United States and developing countries narrowing, there is a strong possibility that the U.S. standard of living for many workers will fall. The loss in real incomes has adverse implications for all levels of government. A lower personal income base reduces income taxes collections. With fewer workers covered by company-supported health insurance, more Americans will be relying on government provided health services. More people will be collecting unemployment and public support, such as food stamps.

A Silicon Valley Perspective

Outsourcing is not new to Silicon Valley. Over the past several decades, companies have relocated their production to other parts of the United States where land, labor, utilities, and other costs are lower. However, Silicon Valley’s entrepreneurship enabled the Valley to reinvent itself more than once, creating more jobs than it lost in the process. Is this time any different? The answer depends on whether or not the enormous competitive advantage that this area (and the United States) enjoys can be maintained.

Many of Silicon Valley’s jobs are among those most vulnerable to off shoring. Most business leaders in the Valley have publicly stated they are moving many facilities to Asia, and recent data from the Bureau of Labor Statistics (BLS) confirm this trend. Between March 2003 and March 2004, the Bay Area lost 48,800 jobs (www.bls.gov). Business leaders report that not only the lower labor costs, but also Asia’s efforts to build infrastructure to support high technology development and its accelerating demand for tech products propel the shift in investment to overseas locations. Carly Fiorina of Hewlett Packard and Craig Barrett of Intel Corporation warn that Silicon Valley is losing its competitive edge. According to Fiorina,

“over the long term, the greater threat is the source of well-educated labor” (*SF Chronicle*, January 8, 2004). Both leaders also express concern over lagging support for infrastructure development in the Valley. With declines in funding for California’s public universities and colleges and the state’s basic infrastructure, the competitive position of Silicon Valley may well erode. In the long run, efforts to augment Silicon Valley’s competitive advantage are likely to be more productive than protectionism, which could slow the impetus for productivity improvements.

Much as Americans complain about the loss of jobs to foreign workers, most readily shop at retailers selling products produced in Asia and low cost labor regions. Few consumers are willing to pay the premium for U.S.-produced goods, especially as they feel their real incomes shrink. The only long-term viable choice available to American workers is to meet the challenge and enhance their productivity.

