



Where Do We Go From Here?

Small Business and the Economics of California

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Introduction

- Small businesses are engines of growth
 - Entrepreneurship, innovation here
 - Local communities recognizing that
 - Not only high tech firms
 - Weren't all businesses small at one time?
- Recession makes small businesses least likely to survive without regional support
 - Large businesses can diversify and insulate against major shocks
 - Global, federal and state issues abound
 - Where are the opportunities?

The Light at Tunnel's End

- Federal Stimulus can do a lot
 - Much focused on supply-side stimulus (good)
- Monetary policy has done a lot
 - Economic potential must become kinetic
- Housing market to hit bottom soon
 - Mortgage rates so low, has to be good
 - Commercial real estate still a mystery
- What makes the future a bit opaque
 - California
 - Inflation to come
 - Consumer credit

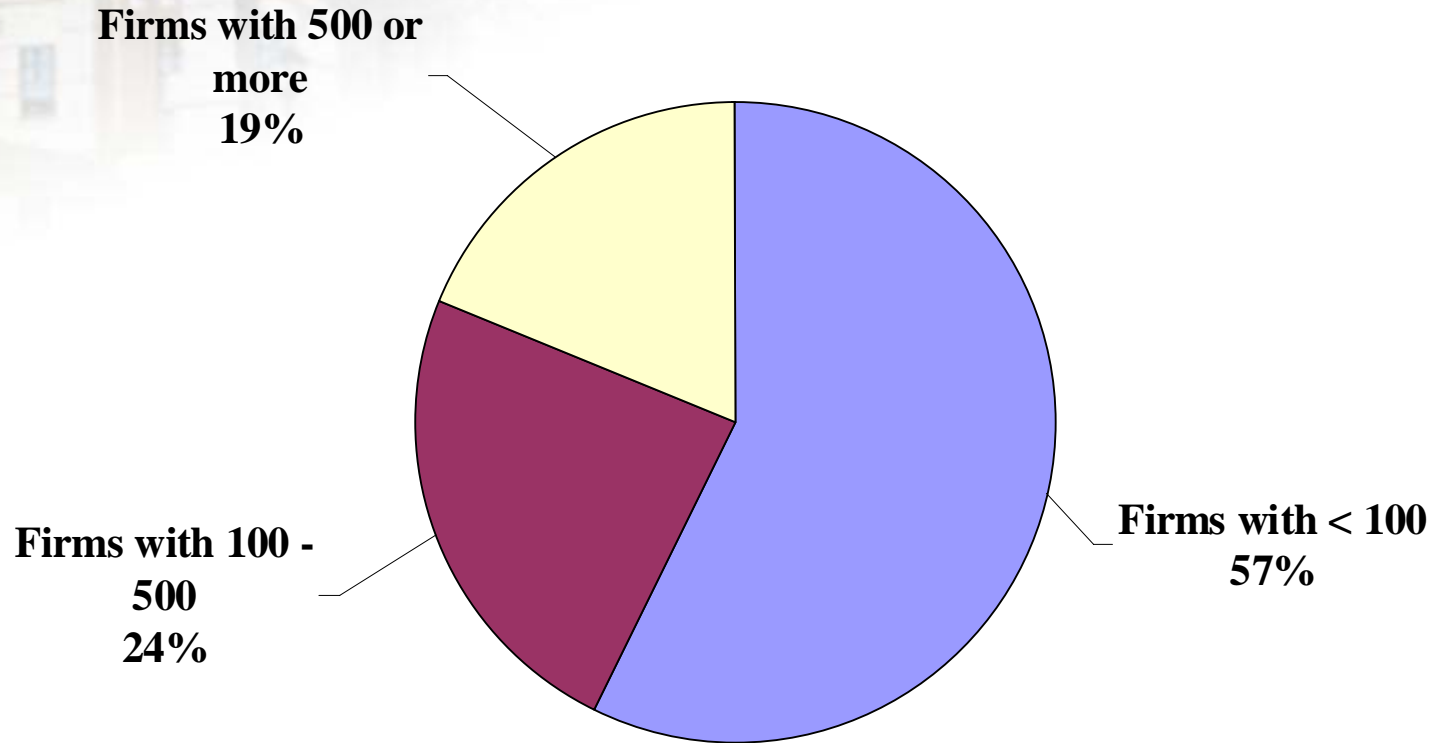
Small Business' Role

- Defining Small Business
 - Fewer than 500 employees technically
 - Less than 100 really
 - Construction is major goods-producing sector dominated by small business
 - 88% of GDP from construction due to small businesses
 - Services otherwise are mainly small businesses
 - Technology, Real Estate, Restaurants

Small Business' Role (cont.)

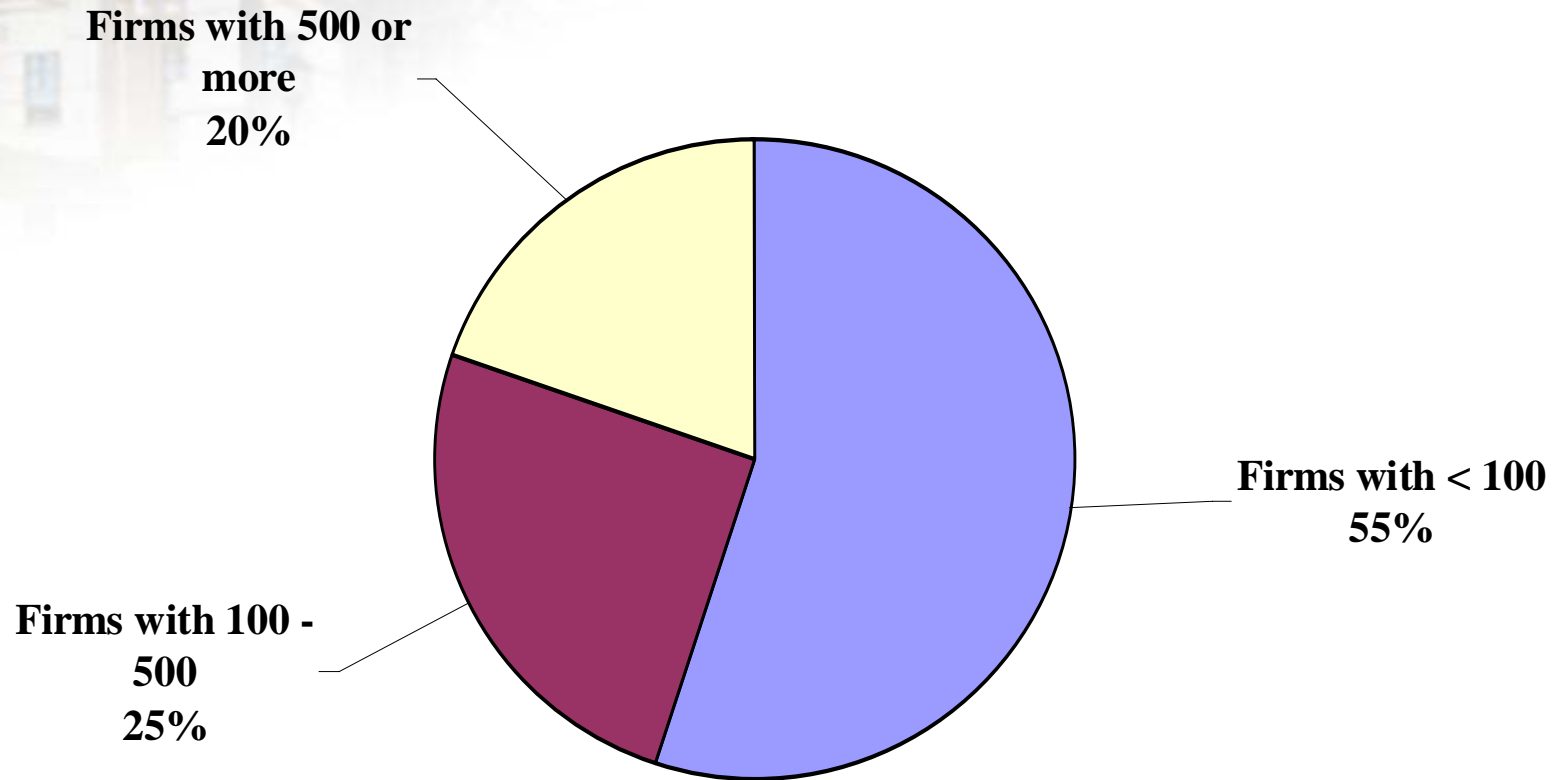
- Why are small businesses important for recovery and eventual growth?
 - Innovation now begins here
 - Not in R&D lab of large firm anymore
 - Large firms would rather acquire small business once proven
 - Banking, as an industry, full of small companies
- All businesses start here
 - Will the Federal stimulus leave small business behind?
- Must be supported regionally
 - Beyond county borders

Comparison of Large and Small Business, % of Total CA Employment 1990



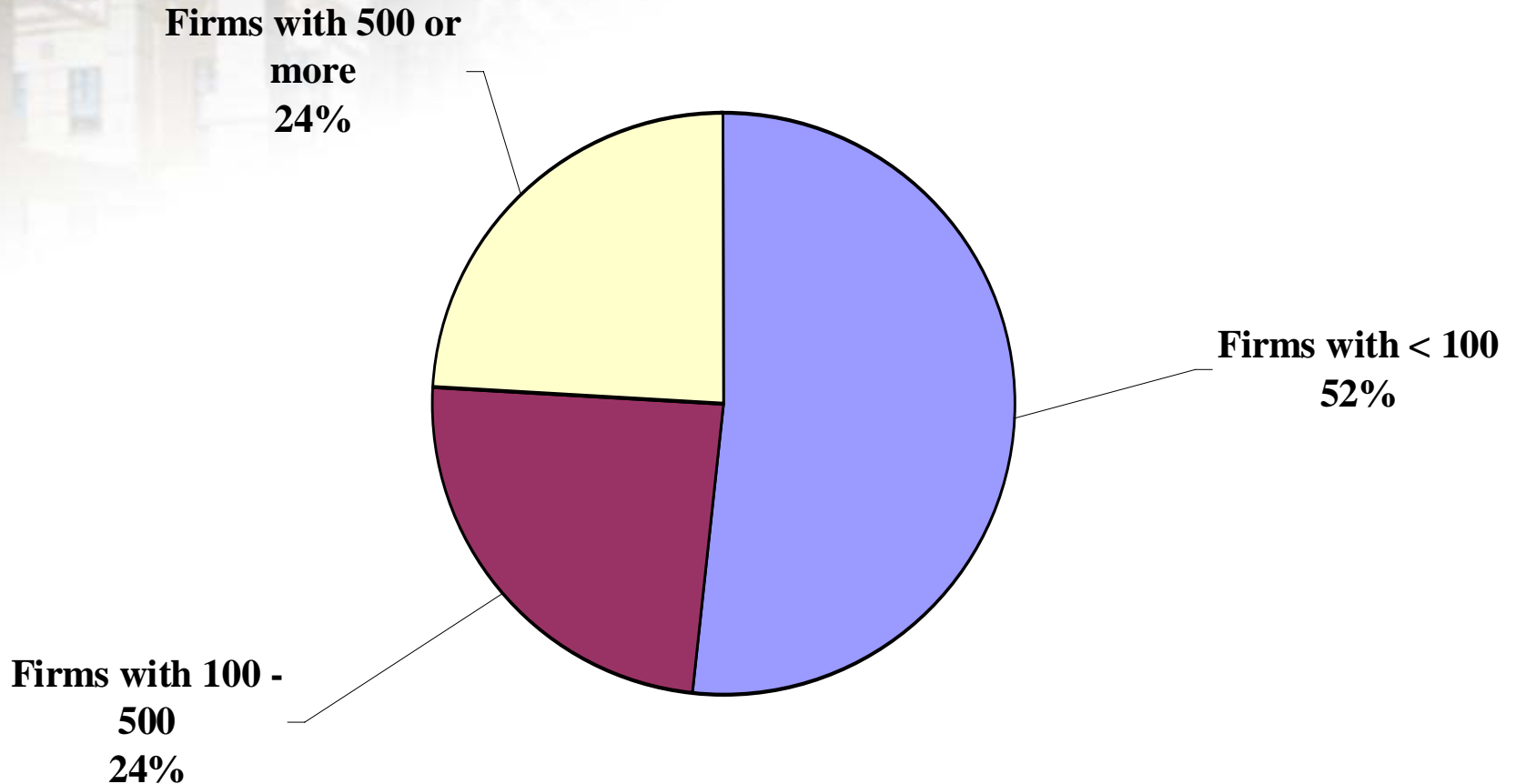
Source: SBA.gov

Comparison of Large and Small Business, % of Total CA Employment 2007



Source: SBA.gov

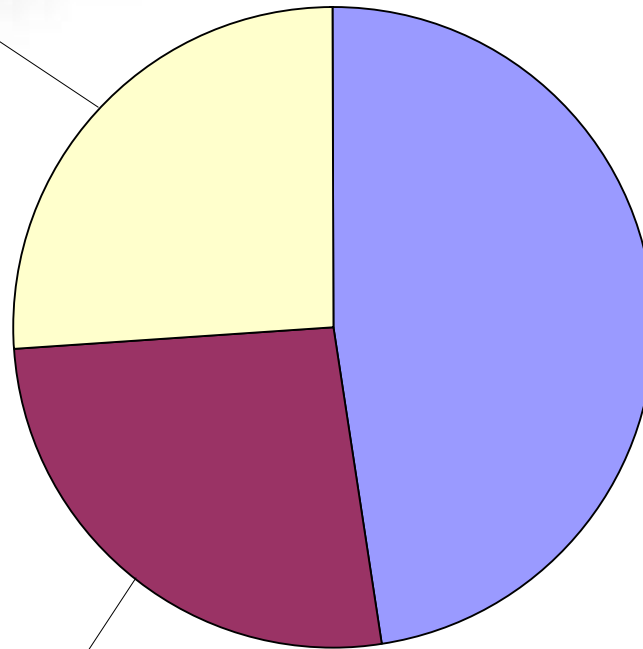
Comparison of Large and Small Business, % of Total CA Wages Paid 1990



Source: SBA.gov

Comparison of Large and Small Business, % of Total CA Wages Paid 2007

**Firms with 500 or
more
26%**



**Firms with < 100
48%**

**Firms with 100 -
500
26%**

Source: SBA.gov

International Review

- Small business issues are international phenomena
 - Microfinance based on small business
 - Lack of infrastructure in many countries necessitates small businesses provide goods and services
- Recession is global
 - China showing small signs of recovery
 - Housing starts mainly
 - Europe moving with the U.S.
 - World likely to follow an American recovery
 - Inflation to come to emerging markets more than emerged

Macro Review

- National and state economic situations continue to worsen, but...
 - Light starting to show: not in job markets yet
 - Is it real light or just a reflection of the past?
- State budget issues cloud both state and local forecasts
 - Taxation and local services likely to change adversely for businesses
 - What choices remain?
- Banking and housing remain major concerns

Comparison of Equity and Labor Market Rebounds, 1947-Present

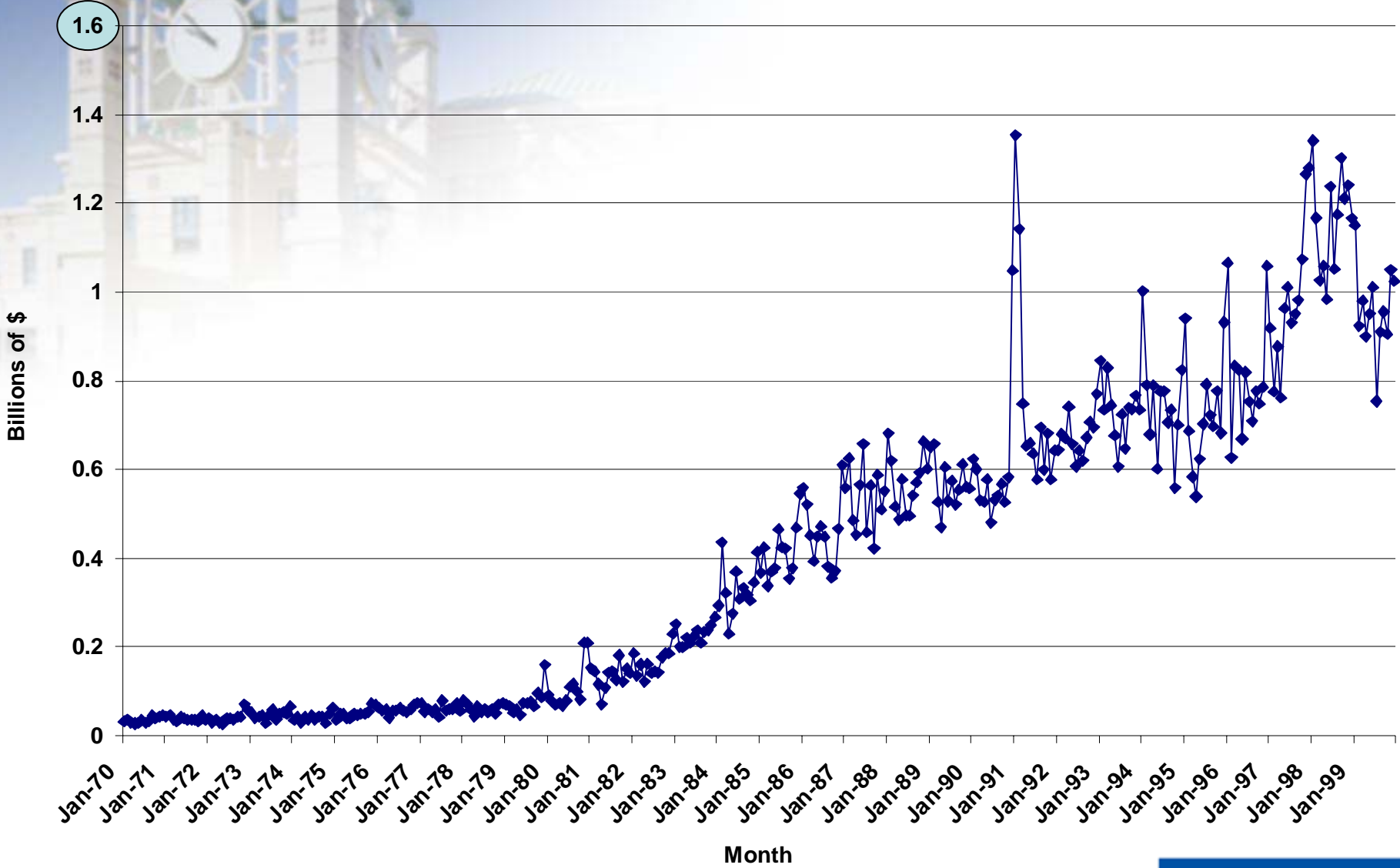
Econ Cycle	Date of:		Number of Months Stock Market Bottoms Before Job Market	Percent Gain in Stock Market* From its Low Until Job Market Low
	Stock Market Bottom	Job Market Bottom		
1	Jun-49	Oct-49	4	13.3%
2	Aug-53	Aug-54	12	27.9%
3	Dec-57	Jun-58	6	13.1%
4	Oct-60	Feb-61	4	18.8%
5	Jun-70	Nov-70	5	19.9%
6	Sep-74	Apr-75	7	37.4%
7	Mar-80	Jul-80	4	19.2%
8	Jul-82	Dec-82	5	31.3%
9	Oct-90	May-91	7	28.2%
10	Sep-02	Aug-03	11	23.6%
Average			6.5	23.3%

*Stock Market data based on monthly closing values

The Role of Banking

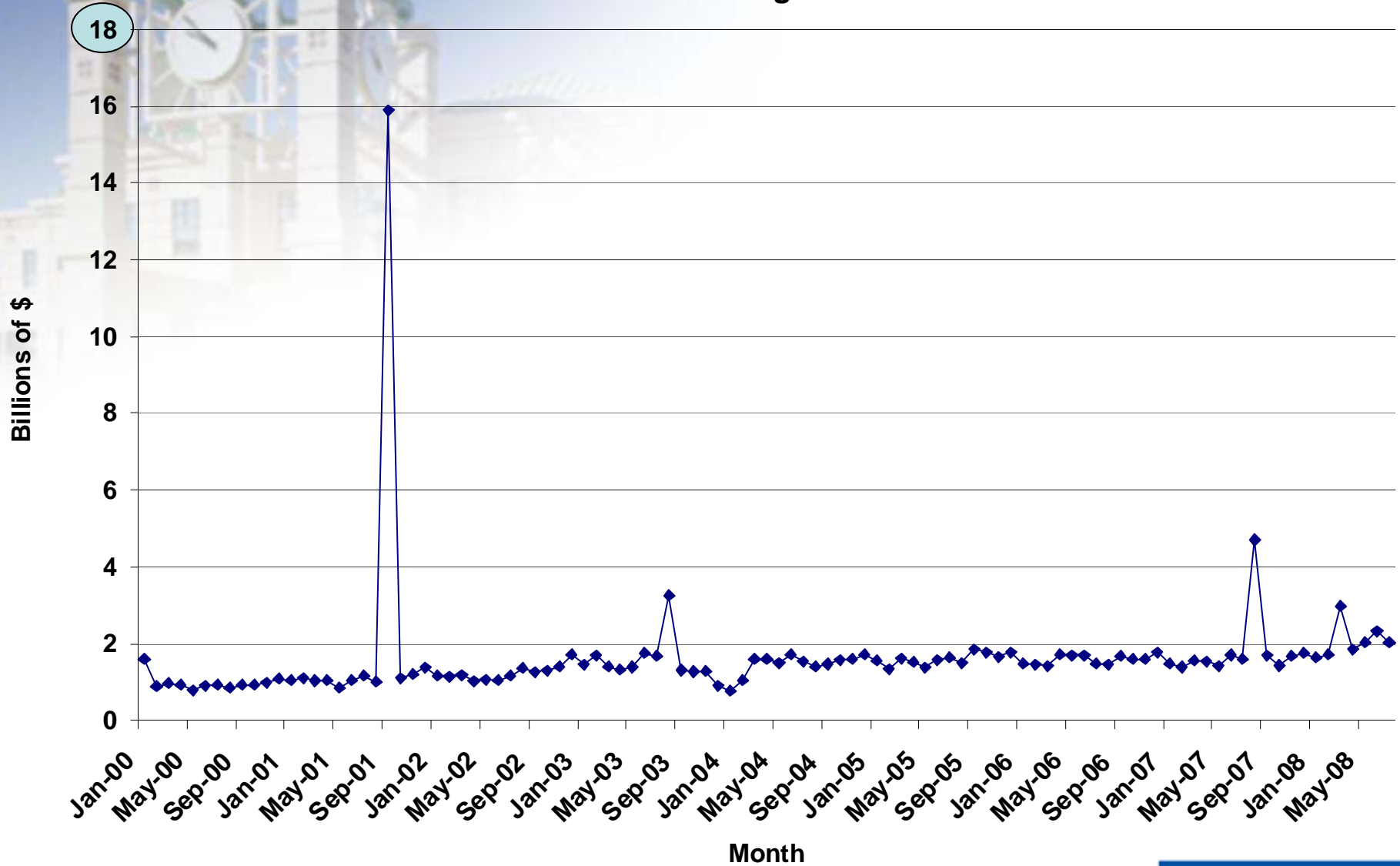
- Banking is both culprit and savior here
 - Riskiness drove current issues
 - Securitizing loans allowed this
 - History tells us credit availability the key to small business success
- Classic model of growth
 - Investment from savings begets economic growth
 - Lending should be for investment primarily, not consumption
 - Housing market became a mix of both
 - Expected profits attracted funding

Excess Reserves at U.S. Banks (Loanable Funds Not Lent), 2008\$ Jan 1970 - Dec 1999



Source: Federal Reserve

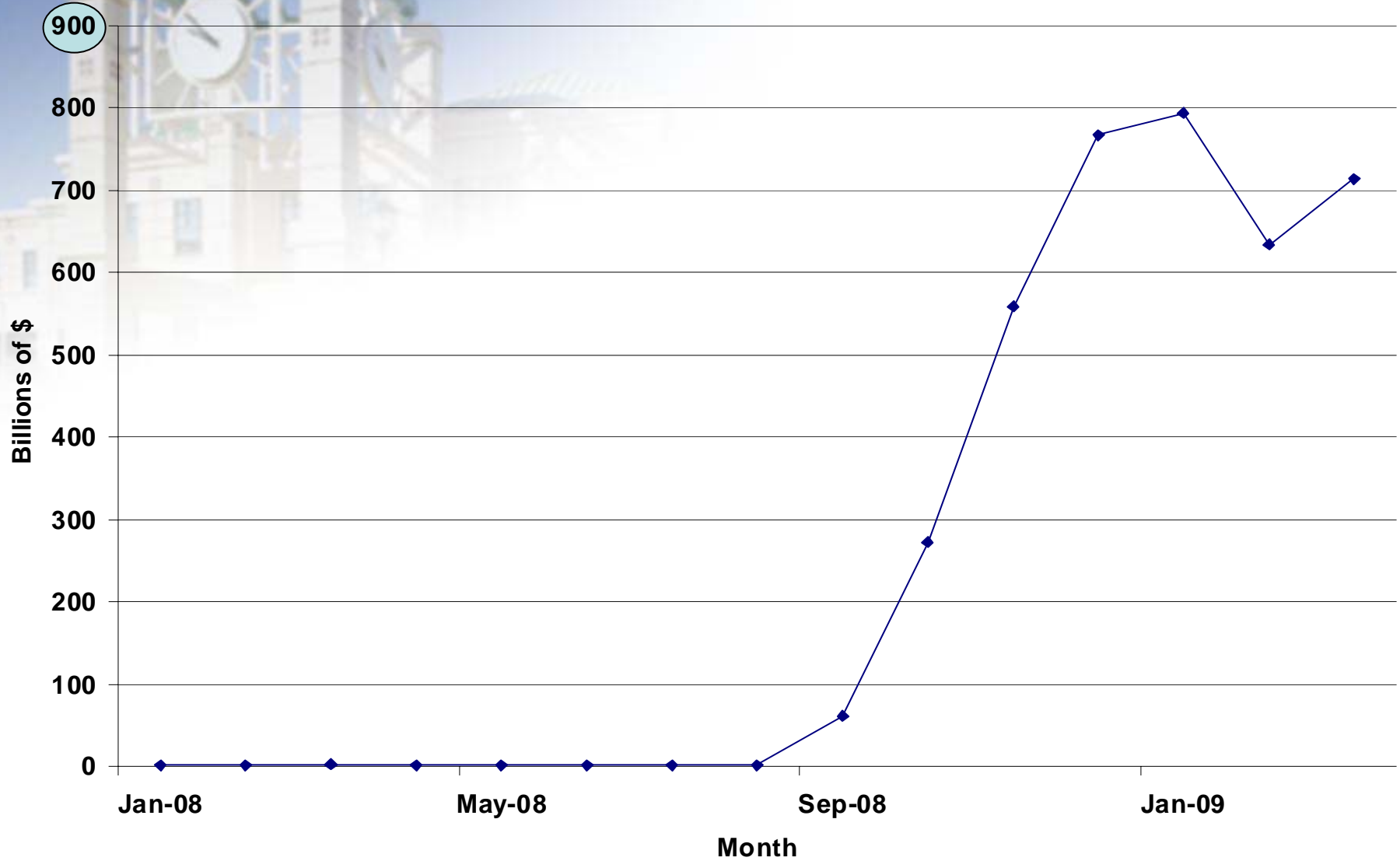
Excess Reserves at U.S. Banks (Loanable Funds Not Lent), 2008\$ Jan 2000 - Aug 2008



Source: Federal Reserve



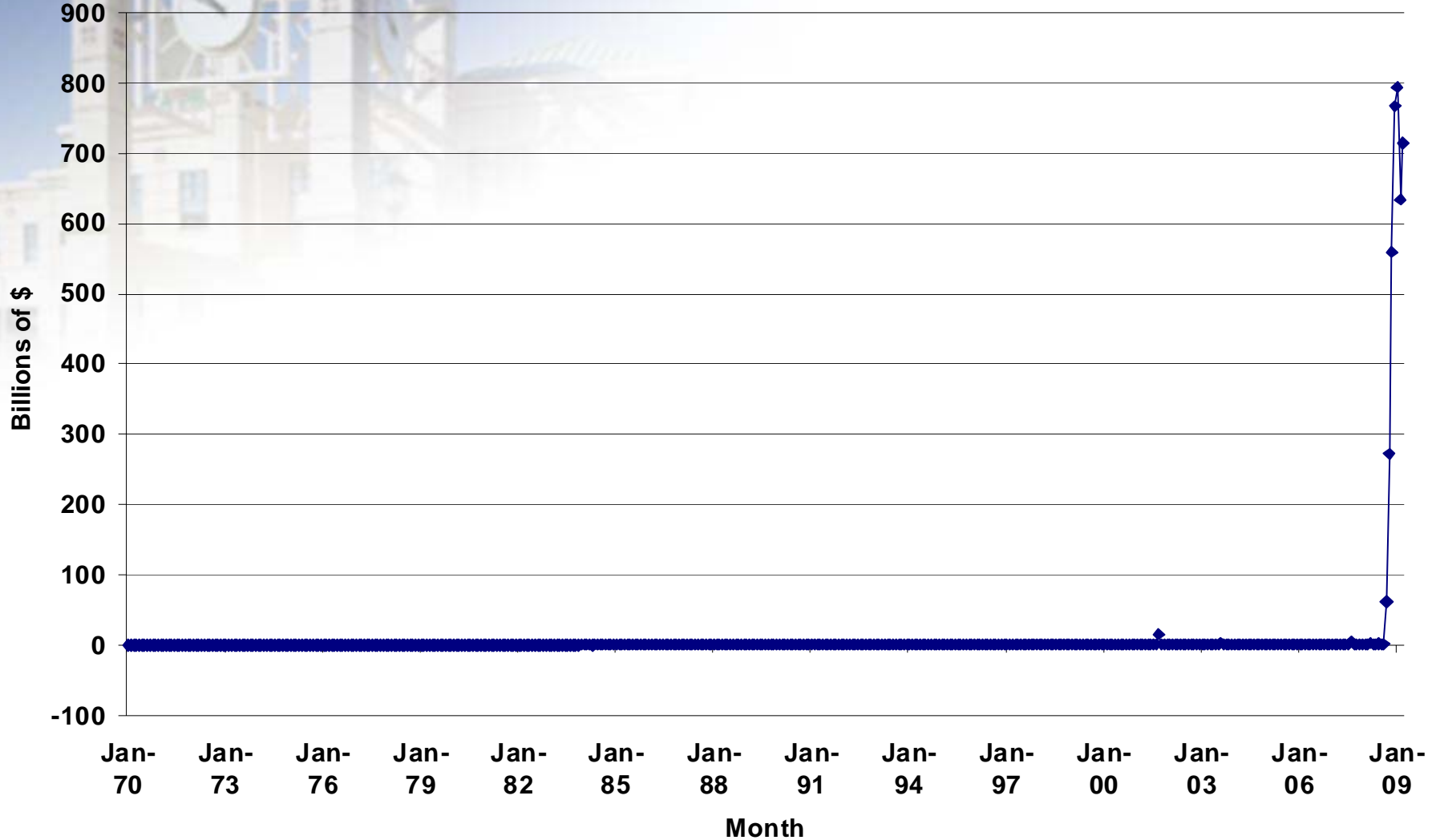
Excess Reserves at U.S. Banks (Loanable Funds Not Lent), 2008\$ Jan 2008 - Mar 2009



Source: Federal Reserve



Excess Reserves at U.S. Banks (Loanable Funds Not Lent), 2008\$ Jan 1970 - Mar 2009

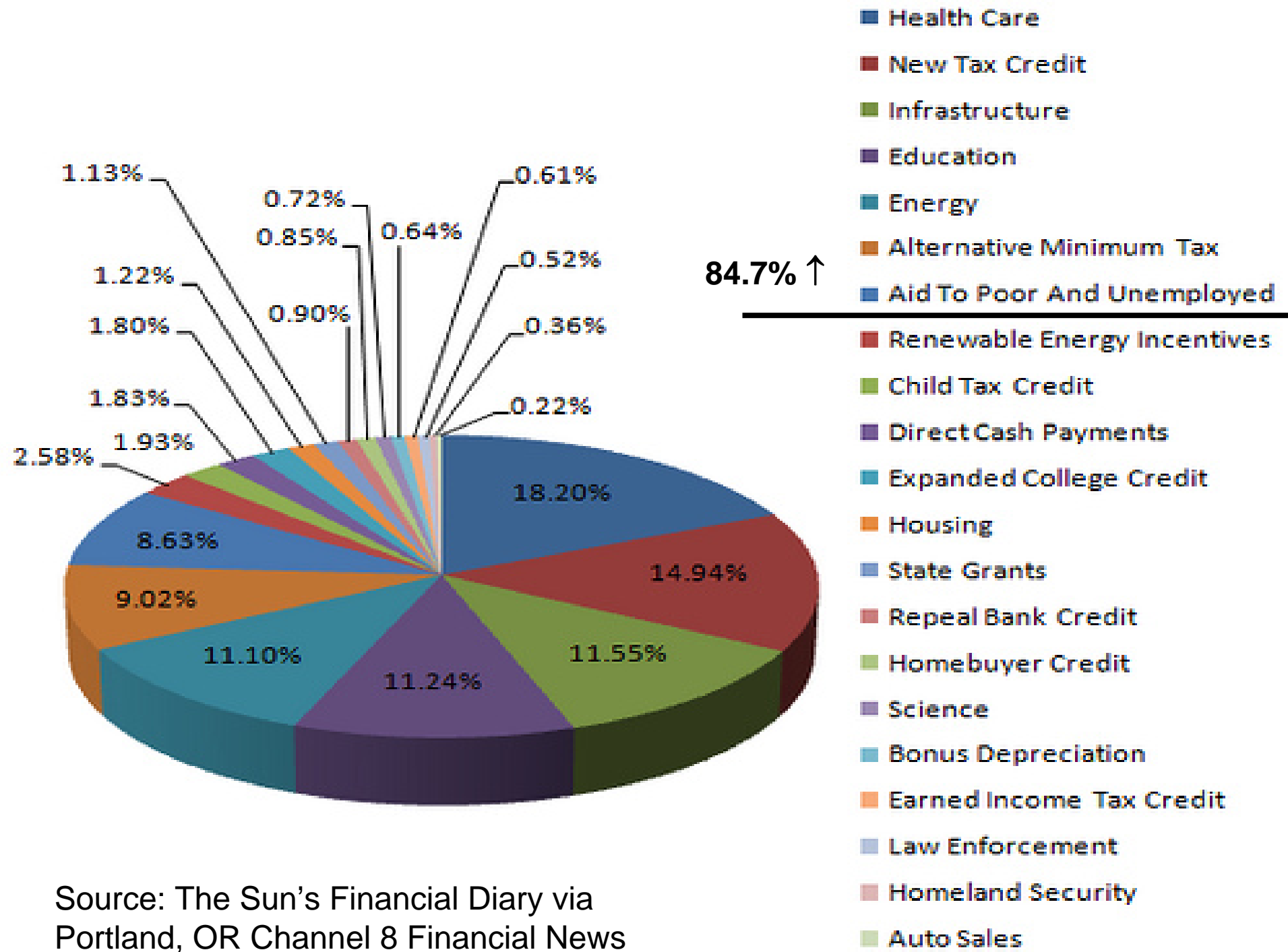


Source: Federal Reserve



The Stimulus Plan

- Five major sectoral targets as of Feb 19
 - Health Care: \$141.3 billion
 - New Tax Credit: \$116 billion
 - Infrastructure: \$90 billion
 - Education: \$87 billion
 - Energy: \$86 billion
 - Rough total of \$787 billion
- Small Business has a role here
 - Niche energy businesses
 - Non-profits
 - Alternative and residential health care



Long-Term Effects (no matter what)

- Eight years of fiscal stimulus already has made national debt soar
 - Is a \$2 trillion deficit feasible?
- Inflation is coming
- Permanent cuts have larger short-term effects than temporary, but...
 - Temporary cuts or spending provide better long-term signal of discipline
- Social security suffers during downturns due to reduced tax revenue and larger draw
- Recovery.org tracking federal stimulus

California has Problems

- 2002 saw use of fiscal surplus from capital gains taxes spent on **permanent** spending
 - We are now paying for that in current deficit of > \$40 billion through 2009-10
 - Federal spending will stimulate state economies
 - Will CA state deficit nullify gains (396,000 jobs est.)
 - Lag structure here between federal and state budgets affects speed of growth
 - Cannot rely on this model
 - Pension system to be stretched soon
 - School spending in CA now 50th in nation (\approx \$18K per pupil)
 - **Opportunity: public-private partnerships in education**

The California Budget: to 2010

- Tax Hikes
 - No change in property taxes
- Spending cuts: Total about
 - Education hammered: almost \$9 billion
 - Disabled and blind also hurt: \$750 million
 - State employees salaries (job cuts, O/T): \$1.4 billion
- Tax breaks: a lot here for small business
 - \$100 million for credits for those that buy new homes
 - \$200 million for credits for small business hiring new workers
 - \$790 million for larger firms to subsidize innovation

What is California Likely to Do

- Approx \$10 billion
 - Depends on ability to sell debt
 - Depends on amount of fiscal stimulus to state government
- Reform is needed
 - A consumer-led expansion may provide an ephemeral, illusory boost to state coffers
 - Tax reform: What about Prop 13?
 - Budget reform: need a change to 2/3 vote and term limits?
 - How can one vote hold up this process?

Housing Market

- Two questions to ask:
 - Was original pricing correct?
 - Is current pricing correct?
- Must consider a house a long term investment
 - Housing industry made homes a commodity
 - Lots of jobs, especially for small businesses
- Some data to consider

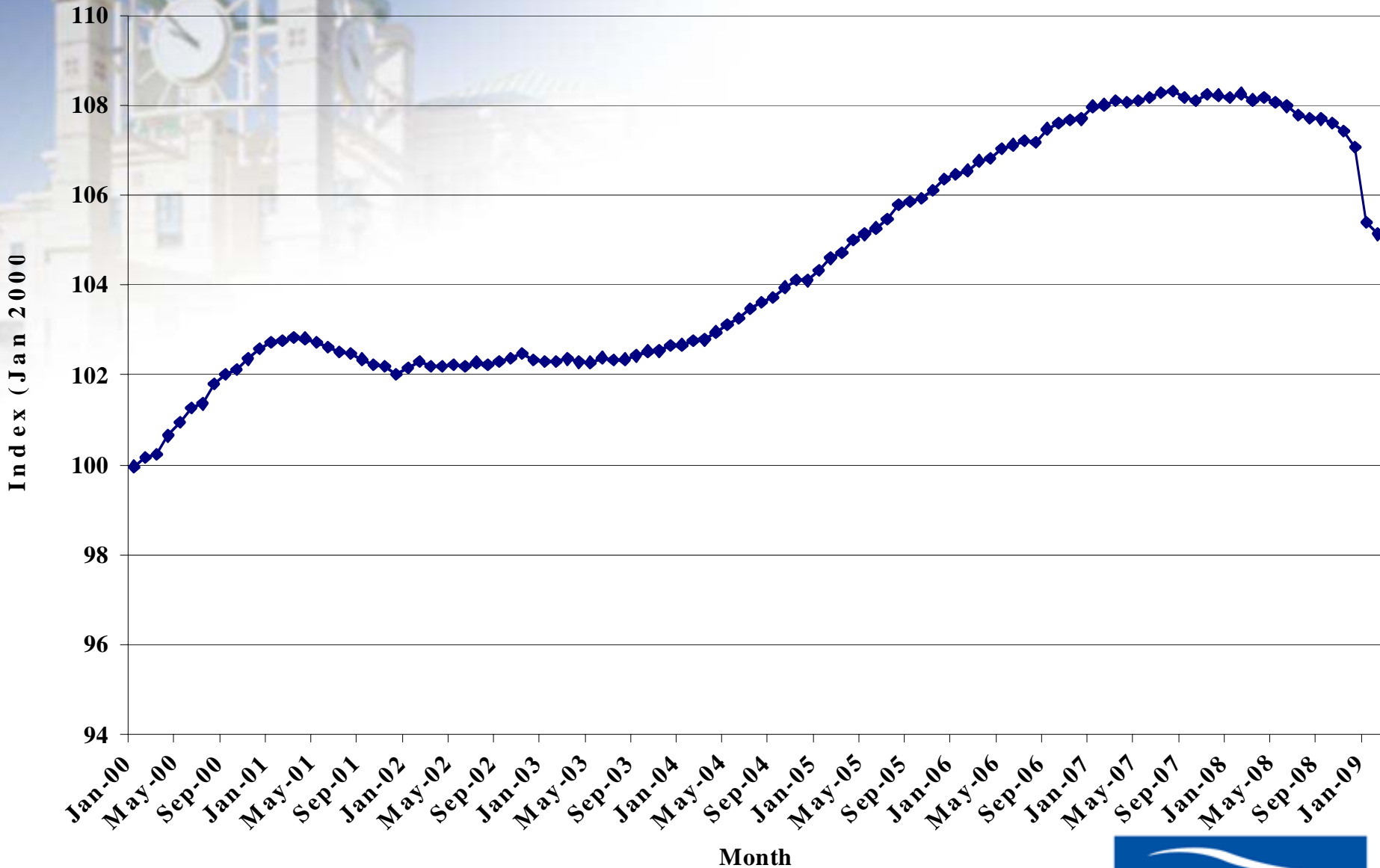
Data Considerations (CAR)

- Since Feb 2002
 - For 32 of California's 58 counties, data exists on median home price
 - Maximum for all 32 counties: median = \$535K
 - \$960K in Marin County (June 2007)
 - Minimum for all 32 counties: median = \$242K
 - 42% of peak
 - Tulare County = \$102K minimum (April 2002)
 - \$136K in Feb 2009, 54% of peak (peak = \$269K)

Job Market

- Recessions generally gauged by job losses
 - Unemployment in California has surged
 - In 2008, lost about 49,000 jobs (0.2% of employment)
 - Remember how unemployment measured
 - Payroll employment reductions and unemployment spikes may not be the same
 - Labor force can grow from employed or unemployed rising
 - YTY Comparison: Feb 2008 to Feb 2009
 - 495,000 more unemployed!!
 - Unemployment increased for 2008 by 69,000 workers total!
 - No county immune to the changes
- The unfortunate part:
 - Rising U rate likely dominated by former small business owners

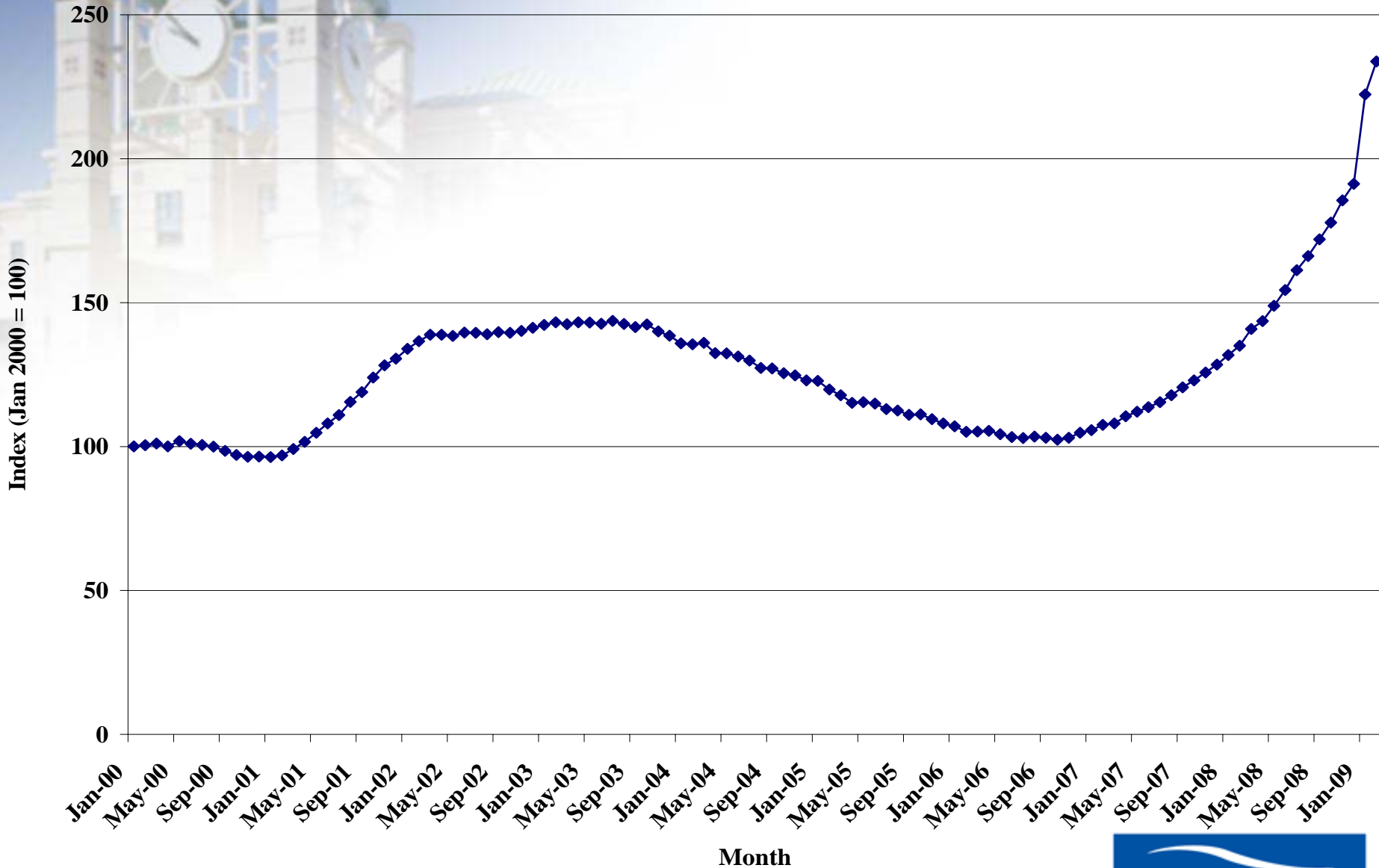
CA Employed Index, Jan 2000 – Feb 2009, Jan 2000 = 100



Source: EDD



CA Unemployed Index, Jan 2000 – Feb 2009, Jan 2000 = 100



Source: EDD



Job versus Econ Development

- Important to recognize a balance between three “E’s”
 - Economic Growth
 - Social Equity
 - Environmental Balance
- Regional Interdependence
 - The pursuit of new businesses will happen with competition or cooperation
 - Compete or cooperate over jobs versus residents?
 - Can counties work where synergies exist?
- Small business orgs can help

Economic Growth

- Need to foresee supply side growth areas
 - Environmental tech: will Silicon Valley become Hydrogen Valley?
 - Agriculture and links to biotech
 - Retail and professional services: more needed here?
 - Population aging
 - Growth means rising costs (think health care)
- Regional Interdependence
 - Need regional development plans, not county-specific plans
 - Need to share sales tax and property taxes

Social Equity

- Cost of living issues
 - Housing prices provide some relief to cost of living while reducing wealth accumulation
- Affordable housing and living wages
 - Need to be very careful here
 - Growth means affordability will fall again
- Working poor females an issue
- Ethnic diversity also a factor
- How is this state aging?
 - Affects labor supply at some point
- CalPers: a ticking time bomb?

Environmental Concerns

- The new engine, ironically
- AB 32 and AB 811
 - Will hopefully go two ways with this
 - Hire CA consultancies to figure out how to become more green
 - New technology firms will incubate in CA here to help with transition
 - Both mean small business growth
- Can opportunities be seized here?
 - Think high tech focusing efforts

Conclusions

- Recession to continue through 2009, with some mild pick after May or June
 - Signs of recovery beginning
 - So much potential had to become kinetic
 - State budget likely to affect businesses and residents of CA
- Small Businesses cannot rest
 - Opportunities exist for regional strategies
 - **Public/Private partnerships**
 - Environmental tech has boundless potential
 - Can also have similar post-1990s effects

Recommendations

- New fiscal stimulus must target jobs and small businesses
 - Energy/green tech
 - Infrastructure
 - Education
- State must look at tax reform
 - Sales taxes not a panacea for poor fiscal processes and management
 - Consider slow repeal of Prop 13: phases
- Small businesses and job development
 - Economic development is regional not county-wide
 - Jobs attracted and retained: use education to facilitate this



www.sonoma.edu/org/crea/sbdc091.ppt