THE PRESIDENT HAS SEEN
11-22-93

THE WHITE HOUSE

WASHINGTON

November 18, 1993

MR. PRESIDENT:

The attached is a memo from Ron Brown on possible initiatives to address California's economic problems.

You do not need to focus on this right now, but you should know that Ron may very well bring it up on the ride out to Seattle.

TDS
Todd Stern

Mack

we need to discuss this — (1) plans
(2) [illegible] B

12-8
(3)
Call
Emo

THE WHITE HOUSE

WASHINGTON

THE PRESIDENT HAS SEEN

11-22-93

November 18, 1993

MEMORANDUM FOR THE PRESIDENT

FROM: TODD STERN DS

SUBJECT: Ron Brown Memo on California

Attached is a memo from Ron Brown that seeks your guidance in developing options to alleviate California's economic distress.

After reviewing the dire straits in which California, and particularly the southern part of the state, finds itself, the memo presents three basic issues:

- **Should the NEC work up an initiative specific to California or one that is addressed more generally to needs that particularly affect California, but affect other areas as well?** The downside of a California-specific strategy is that other states and regions where times are tough (though concededly not as tough as in California) would be unhappy. The shortcoming (as far as California is concerned) of a plan that generally targeted in-need areas is that fewer resources would be directed to California.

- **If the initiative is to be need-based, what "need" should the NEC focus on in preparing options: defense-impacted communities or areas suffering from structural unemployment?** A defense-oriented approach is appealing since it would address a problem resulting from federal action (spending cuts), but could be criticized for leaving out other distressed areas.

- **Should efforts be made to target more existing federal dollars to California or, beyond targeting, should significant new funding -- $3-6 billion beyond current levels -- be devoted to aiding California?**

Ron recommends that you direct the NEC to develop options (1) that are both California-specific and needs-based; (2) that define "need" in terms of both defense-related pain and structural unemployment; and (3) that new federal money should be devoted to California, as well as targeting existing funds.

There is by no means unanimous NEC agreement on these points. In particular, most members of the NEC disagree with the idea of a California-specific initiative and disagree with spending significant new funds on California.

THE SECRETARY OF COMMERCE
Washington, D.C. 20230

THE PRESIDENT HAS SEEN

11-22-93

November 17, 1993

'93 NOV 17 P7:19

MEMORANDUM FOR THE PRESIDENT

THROUGH: Robert Rubin

FROM: Ronald H. Brown RB

SUBJECT: Addressing California's Economic Crisis

I. ACTION-FORCING EVENT

This memorandum is part of the ongoing initiative, established at your request, to address the economic conditions of California. Your guidance is now needed on the scope and focus of options from which we must develop a federal strategy to support economic recovery in California.

II. BACKGROUND: THE STATE OF THE CALIFORNIA ECONOMY

The California economy, and especially the economy of Southern California, is in danger of becoming detached from that of the nation. This fact has enormous economic and political consequences. This memorandum will discuss only the former, since the consequences of the latter are painfully obvious and since the manner and effectiveness with which we deal with the California economy will profoundly affect the politics of the state.

The situation in California is grave. For a long time, the unemployment rate in California closely tracked the national average. But during the recession that situation changed -- the unemployment rate in California has remained stubbornly above the national average for the past two years. Last week's unemployment figures tell the tale. California's rate (9.8%) is a full three percentage points above the nation's (6.8%) and almost two percent above the next highest major industrial state (New York at 7.9%). Since October, 1991 the California unemployment rate has climbed by 2.3% (from 7.5% to 9.8%).

Economic projections strongly suggest that this disparity will continue for the foreseeable future: the California unemployment rate is predicted to be 8.5% or higher in 1996, compared to a national average that is projected by my Department to be under 6%.

Declining employment is heavily concentrated in Southern California. By one estimate, over 25% of national job loss between June 1990 and December 1992 was located in and around Los Angeles. For instance in two industries heavily concentrated in Southern California, aerospace and electronics manufacturing, job loss was significant. In aerospace

112,000 were lost over the last four years. During the same period, California employment in construction and electronics manufacturing dropped by 120,000 and 25,000 respectively.

The prime cause is not hard to find. Defense spending in California has fallen from about $60 billion in 1988 to about $51 billion (in constant dollars) in 1992. Economists at the Berkeley Roundtable on the International Economy believe that "cuts in defense procurement and R&D contracts have been responsible for better than one third of California's total job losses in the period 1990-93." For example, over 200,000 manufacturing jobs have been lost in the state since 1991.

Of course, the economic conditions in California are now more complex than any single cause would suggest. The California economy suffers from a vicious cycle: slow income growth (in part due to the contraction of the defense sector) that weakens the real estate market, which is turn tightens bank lending, which then further slows employment and income growth.

In sum, whether the current state of the California economy is characterized as a fundamental structural problem or a cyclical problem evidenced by a painfully slow recovery from the recession, the central economic truth remains the same: The California economy is being battered. The effect on the rest of the nation is indisputable: California accounts for one-eighth of all U.S. output and population.

III. THE CREATION OF ECONOMIC OPTIONS

At your instruction, I have been leading an inter-agency effort to confront the difficulties faced by California. To date, I believe that we have made important progress in addressing the needs throughout the State. Critical aspects of that effort, such as the formulation of a political strategy, are beyond the scope of this memorandum.

It should be noted, however, that there has been much positive activity by the Administration. I have made 10 trips to the state since April and have met personally one-on-one and in small groups with several hundred political, business, community and academic leaders. You, the Vice President, and members of the Cabinet have made numerous visits to the state. We have staff on the ground, in both northern and southern California, who have been coordinating our initiatives and expanding our outreach. (See attached). Notwithstanding these efforts, it is increasingly clear that they are not enough.

Economic policy must, of course, be a critical part of any Administration effort directed towards California. Accordingly, I have consulted with my NEC colleagues about the construction of economic options that would permit you to determine the scope and focus of a response to the economic difficulties that California faces.

I can report general agreement that we must continue our efforts to improve the coordination of federal action in California. It is very difficult to come up with precise estimates for total Federal support that goes to California. In FY 1994, California is expected to receive its proportionate share (about one-eighth) of federal grants to state and local governments. But this level of fiscal assistance is not expected to cause any material improvement in California's economy.

The NEC also agrees that we should develop for your consideration measures that have little or no fiscal impact but that would nonetheless be helpful to the California economy. A prime example of non-fiscal, but very important, action is export controls. As you know, about 35% of export control license applications come from California. That's why our recent announcement of significant reform of computer export licensing requirements has had such a dramatic effect -- and has received such a warm welcome from the business community.

These measures are a useful beginning, but no one on the NEC is prepared to say that they should constitute the entire federal solution. It has become increasingly apparent to me that more will be needed.

While I do not share this view, some on the NEC have raised concerns about the appropriateness of special attention being given to California. Whatever the approach -- you will need to determine whether additional fiscal resources, either out of existing funds or through new fiscal measures, should be applied to the economic problems of California.

Thus, this memorandum is intended to seek your guidance on the creation of policy options that go well beyond our current efforts and that can be developed through the NEC process and presented to you for decision.

This memorandum will present options on the following three issues:

(i) Should the NEC prepare for your consideration a "place-specific" plan for the California economy, or confine its further work to the construction of place-neutral, "needs-based" alternatives?

(ii) What definition(s) of "need" should be the basis for the preparation of needs-based alternatives for your consideration?

(iii) What fiscal options should be prepared to implement either a California-specific or a needs-based approach?

<u>Issue 1: The Choice Between California-Specific or Needs-Based Approaches</u>

As explained above, the economic problems facing California are dramatic -- we face the possibility that the economy of our largest state is becoming unhinged from the national economy, and that, left to its own devices, the California economy will not soon enjoy an unemployment rate comparable to the nation's. The problems in Southern California are especially acute. Commercial vacancy rates in Los Angeles have risen from 17 to 23 percent. Latest HUD data indicates that there is a shortfall of nearly 500,000 affordable housing units in Los Angeles County. In addition, crime rates in the Los Angeles area are very high. The FBI reports that violent crime rates in Los Angeles are 44 percent higher than in New York City.

One view is that the problems of California are so intense as to justify the creation of a California-specific remedy. The notion that a regional economy requires specific federal intervention is not new. When hurricanes hit Florida, we responded. When floods hit the Midwest this year, we responded.

Our difficult fiscal straits offer another rationale for the creation of a California-specific approach. Finding fiscal resources for any new initiative will be difficult, which means that fiscal resources must be carefully targeted. A needs-based approach inevitably means that less than the full amount of assistance actually reaches California. (So, for example, a new national defense conversion initiative might favor California, but, by definition, it would not focus exclusively on California). A California-specific initiative obviously places all of its resources in that state.

Most members of the NEC have to date said that they believe that a specific, state-oriented approach would cause political and policy difficulties. For example, members of Congress from other parts of the United States might argue that their home states face equivalent economic difficulties -- and that California should not be singled out for special assistance. Such congressional reaction, should it occur, would make the actual appropriation of additional funds very difficult.

Thus, it is argued, measures to address the California economy, such as the targeting of existing funds or the expenditure of new funds, should be needs-based. In other words, they must address problems of particular importance to California, but they would not be structured as California solutions per se. For example, it is said that a national initiative might be structured around defense conversion and defense reinvestment, but one should not be created with the sole objective of targeting funds exclusively for California.

The question is whether the NEC should construct a California-specific, or a needs-based approach, or both.

[] Please construct only California-specific initiative for my further consideration.

[] Please construct only needs-based initiatives for my further consideration.

[] Please construct both California-specific and needs-based approaches for my further consideration.

Issue 2: Selecting The "Need" On Which Action Would be Based

If you have instructed the NEC to construct a needs-based initiative (either alone or accompanying a California-specific initiative), it remains necessary to define the "need" that addresses the difficulty faced by the California economy.

NEC members have identified two leading approaches. First, additional federal efforts could be directed towards defense-impacted communities. That includes Southern California, where the decline in defense spending has had a truly dramatic impact on defense contractors, and Northern California, where a number (express number to come) of military bases will be closed.

Second, federal efforts could be directed towards those communities that appear to be suffering from structural unemployment, which might be defined as unemployment that is 125% or more above the national average. According to the NEC, such a measure would include roughly 50 SMSAs, including 11 in California, 6 total in New York, New Jersey and Connecticut; 5 total in Michigan and Illinois; 5 each in West Virginia and Texas; and 3 each in Pennsylvania and Massachusetts.

The advantage of the defense-oriented approach is that it addresses a problem that is clearly of the federal government's making -- and, therefore, clearly the federal government's responsibility. The disadvantage is that it aims funds by focusing on the "cause" of economic dislocation instead of focusing directly on the most obvious effect -- high unemployment. The focus on "cause" permits the argument that non-defense-impacted communities, although suffering equivalent levels of unemployment, are being unfairly denied assistance.

The advantage of the structural-unemployment approach is that it selects communities -- wherever located -- that are being left behind in the recovery -- for whatever reason. The disadvantage is that it defines need only by looking at the present; a community where, for example, a military base would be closing in the future would not meet the eligibility criterion even if significant dislocation could be predicted.

The NEC believes that it should develop for your decision both of these, and possibly other, approaches, each of which should address the problems of the California economy by means of defining a particular need.

[] Yes, the NEC should develop need-based options for my subsequent review.

[] No, the NEC should not develop need-based options for my further review.

[] The NEC should develop the defense-impact option only.

[] The NEC should develop the structural-unemployment option only.

[] The NEC should develop both a defense and an unemployment option.

Issue 3: A Level of Funding

As noted above, simply by taking no action, a "baseline" level of fiscal assistance is delivered to California each year. Continuation of that baseline is unlikely to yield change in California's economic conditions. The question is whether we should do more.

What we can hope to do depends, more than anything else, on how much money we are prepared to spend. A logical goal would be to address the discontinuities that are constricting the California economy, as demonstrated by its unemployment rate, which remains higher than the national average. Such a program would require the infusion of considerable new fiscal spending, perhaps $3-6 billion/year above present resources. Steps short of that, including the targeting of funds available from existing programs, will be useful, but are unlikely to remedy the underlying difficulty.

In other words, two fiscal choices (in addition to the maintenance of existing levels of assistance) should be considered:

> (i) Shift the spending of dollars that have already been appropriated (or will be appropriated as part of the FY 1995 budget) by "tweaking" or targeting existing fiscal programs, or
>
> (ii) Seek additional funding with the goal of addressing the discontinuities now present in the California economy.

These options are not in the alternative, because neither precludes the other.

Option One. The Administration has substantial discretion as to the manner in which programmatic funds are disbursed -- without the need for seeking additional fiscal authority.

Thus, for example, the Administration has proposed funding to implement the conclusions of the Forest Summit and has announced its Clean Car Initiative, without seeking new programmatic authority from Congress. Similar discretion could be exercised in order to increase the level of federal funding that flows to California by, for example, instructing departments to target assistance to defense-impacted communities or by simply targeting California directly.

The NEC generally favors the creation of an option that would present you with a plan for directing discretionary spending to particular goals. The NEC understands that such an option would be designed in accordance with the decision you have made above, which directs the manner in which an initiative is to be designed.

[] Yes, the NEC should create such option that directs the spending of discretionary funds without the need for additional congressional action.

[] No, the NEC should not create such an option.

Option Two. I believe that neither more effective management nor the targeting of existing funds will totally alleviate the distortions that threaten to separate California from the national economy.

Thus, this option would instruct the NEC to construct a package of new fiscal spending that could be expected to redress current discontinuities in the California economy, such as the current unemployment rate. Subsequent implementation might require the delivery of an additional $3-6 billion/year to California and, assuming that such spending is distributed through a needs-based program, would require even more overall (because a needs-based program would, by definition, deliver only some of its funding to California).

The economic argument in favor of the creation of such an option, in which I enthusiastically join, emphasizes two considerations:

(i) The California economy is undergoing stress, and perhaps structural failure, of enormous magnitude; the nation simply cannot stand by and allow a state that accounts for 1/8th of its economy to endure prolonged job loss and high unemployment; and

(ii) The nation has a special responsibility to ease the impact of a change in federal policies. As noted above, it is estimated that about one-third of recent job loss in California stems from the multi-billion dollar cutback in defense contracts for California contractors.

During NEC discussions to date, the predominant, though not definitive view, has been against support for the implementation of a broad, new spending plan. This view also notes difficulties that arose from the efforts to secure a FY 1993 stimulus package and the political pressures in favor of less, rather than more, governmental spending. But, to my knowledge, no member of the NEC opposes the mere creation of a new spending option for your consideration.

[] Yes, the NEC should create such an option.

[] No, the NEC should not create such an option.

IV. Conclusion

The future of the California economy is critical to the nation, both economically and politically. I hope that you will authorize the NEC to create a full menu of options that will permit you to consider both the content, and implications, of your California economic recovery strategy.

Attachment

U.S. DEPARTMENT OF COMMERCE
Office of the Secretary

93 NOV 17 P7:19

To : John Podesta

From : Jonathan Sallet

Enclosed is the "California" memo, which has been cleared through the NEC process, and which RHB would very much like the POTUS to get tonight. I've sent a copy to Bob Rubin's office

CS

0445055S

ST005

THE WHITE HOUSE
WASHINGTON

DATE: 11/22

NOTE FOR: Mack

The President has reviewed the attached, and it is forwarded to you for your:

Information ☐

Action ☑

Thank you.

JOHN D. PODESTA
Assistant to the President
and Staff Secretary
(x2702)

cc: