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### Author

Collier, Robert

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# **CALIFORNIA ON THE GLOBAL HIGH ROAD**

**State trade and investment strategy  
for the 21<sup>st</sup> century**

**Robert Collier**

**Institute of Governmental Studies  
University of California, Berkeley**

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**State trade and investment strategy  
for the 21<sup>st</sup> century**

Robert Collier  
Institute of Governmental Studies  
University of California at Berkeley  
May 20, 1999

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## ***EXECUTIVE SUMMARY***

California is a paradox. Its industries, services and farm products dominate markets worldwide, yet public support for international trade appears to be dwindling. Its economy is booming, while most people's income levels stagnate. Its environmental technology is the best in the world, but its firms must compete with companies in nations that gain competitive edge by routinely abusing the environment. Some of the state's industries rely heavily on foreign sales, while others don't even know how to export. Some sectors are flooded with investment capital; others can hardly get a bank loan.

As the effects of globalization become ever more complex, policymakers can no longer take for granted public support for free trade. Consensus has been lost. Political and economic trends make it imperative for California's leadership to redesign state policies, not just with new language but with bold new ideas.

*California on the Global High Road* examines the state's policies on international trade and investment, compares them with those of other states and nations, and makes a broad range of policy recommendations. Its analysis is based on a novel combination of issues that have long been viewed as unrelated. Politicians, business leaders and policy experts have ignored the links between, on one hand, programs promoting exports and recruiting foreign investment – virtually the beginning and end of current state trade policies – and, on the other, such seemingly disparate topics as pension-fund investments, environmental standards, border infrastructure, government procurement, corporate codes of conduct and international human-rights abuses.

The traditional, narrow focus is misguided, especially at the current economic crossroads. With the world's worst financial crisis of recent decades plunging many large foreign markets into recession, California has begun to feel the pinch. The state's exports have begun to shrink, eliminating jobs and cutting corporate profits; imports made even cheaper by foreign recessions and devaluations are edging out California products ranging from apparel to computer chips to electronics assembly; and the state's public pension funds have lost billions of dollars in the decline of foreign stock values.

Renewed economic insecurity is likely to revive a debate over the state's international competitiveness that was heated during the late 1980s and early 1990s, then quieted amid the mid-'90s boom. However, the political and economic conditions for such a debate have changed fundamentally. A growing number of voters now believe that free trade drives down wages, lowers crop prices and helps large corporations squeeze out small firms. Because of this public-opinion shift in California and across the nation, the Clinton administration and its free-trade allies in Congress lost a series of historic battles in 1998 on proposals such as “fast track” negotiating authority.

As public support for trade erodes, orthodox state policy tools have become increasingly weak. The past decade of rapid economic globalization has caused a dramatic transfer of power from the federal and state governments to financial markets. Yet by continuing to limit state trade policies to mere export promotion, California’s governor and Legislature have tied their hands. As a result, the state has been unable to use its enormous market clout as investor and purchaser to create jobs and establish a level playing field for international corporate conduct.

Little by little, however, local governments throughout the nation – including in California – are broadening the reach of their trade policies to address the local effects of globalization. Rather than taking the low road of slashing wages and regulations to the level of foreign competitors, they are choosing a high-road strategy: using pension and treasury funds to create local employment; wielding government procurement practices as both carrot and stick to create minimum environmental and human-rights standards on corporate conduct; and aiding industrial “clusters” of fast-growing, environmentally sensitive technologies.

## **HISTORIC MOMENT**

Rather than the old, sterile quarrel of free trade versus protectionism, a debate needs to be opened on the state level that echoes the emerging, federal-level debate over ways to reform international trade and investment relationships. This state-level debate will differ substantially from the federal one because of the U.S. Constitution’s mandate placing most trade regulatory authority under federal purview. But the emergence of new, proactive policy tools has made old definitions obsolete. In Sacramento as in Washington, the challenge is the same – Americans need reforms that allow international commerce to create wealth for all citizens, not just a few. California needs policies that place the well-being of Californians themselves at center stage.

In 1999 and following years, Governor Gray Davis' administration, other elected state officials and the Legislature will have a historic opportunity to carry out a comprehensive overhaul of trade and investment policies. By doing so, California can fill a big policy vacuum among state governments nationwide, providing leadership that is sorely needed. This leadership can help catalyze a movement at the state and local level to bring increased democratic control over the huge forces of globalization that are transforming California, the United States and the world.

*California on the Global High Road* is intended as an initial contribution toward the new debate. Much additional research and analysis is needed, in large part because state-level trade and investment policy remains a relatively obscure field. Surprisingly few studies of state-level trade and investment have been carried out by academic, governmental, business or nonprofit groups. Most existing research takes a narrow focus on one or another subsector of state policies, with little recognition of broader social or economic implications.

## **POLICY RECOMMENDATIONS**

The policy recommendations in this report fall under five broad categories:

### **1. State trade promotion**

- The state should play to its strengths, not its weaknesses. Rather than a beggar-thyself, low-road strategy of cutting taxes, regulations and wages, it should take a high-road focus that nurtures the high-skilled, high-paying, high-value-added, environmentally sensitive industries in which California is a world leader and in which its growth potential is greatest.
- The state's 1998 budget mandate to develop cost-benefit performance data for the Trade and Commerce Agency's foreign trade offices should be broadened to: A) include all state agencies with economic development programs; B) analyze the effects of these programs on a broad range of economic indicators, such as exports, foreign investment, jobs, wages, income distribution and the environment; and C) provide for the development of such data biennially.
- The state should revamp its trade-promotion programs, emphasizing support for "clusters" of small exporters and fast-growing firms, in partnership with local, regional and federal government agencies. However, such aid should be based on careful analysis. Related legislation in the 1999 legislative session, AB 180, which would give \$4.6 million annually to public-private partnerships, appears premature, given its failure to provide for cost-benefit analysis of recipient organizations or for private-sector fee payments. In



addition, as a means of broadening support for a partnership strategy, aid should be barred to firms that are consistent labor-law violators.

- To help the state keep and increase its worldwide dominance in environmental technologies, the state should continue full support for export-promotion and research-and-development programs of the California Energy Commission and the California Environmental Protection Agency.
- The state's network of foreign offices should be reoriented to provide targeted, in-depth research and networking expertise for California's small-business growth industries.

## **2. Public advisory panels**

- To eliminate administrative duplication and increase public input into new policy debates, the state's two overlapping economic advisory panels – the World Trade Commission (an ineffectual arm of the Trade & Commerce Agency) and the Economic Strategy Panel (influential yet unfunded and with no clear administrative powers) – should be replaced with a single advisory council for state economic policy. This Economic Advisory Council should: A) include subcommittees on major policy areas, such as international trade, domestic economic development, agriculture, investment and procurement, environmental technology standards (see #4 and #5 below); B) report directly to the governor, as well as to relevant Cabinet agencies and the Legislature; C) include representatives from a broad cross-section of stakeholders, including major business and farm sectors, major regional and city organizations, labor unions and environmental organizations; D) receive adequate state funding to carry out its work.

## **3. Relations with Mexico**

- The governor and Legislature should press forward with their new policy of improving relations with Mexico. They should use the revived Commission of the Californias to help increase the quality and scope of cross-border cooperation on a wide variety of issues, ranging from trade to infrastructure, environment, occupational safety and health, and law enforcement.
- The governor and Legislature should urge the Mexican federal government and the Baja California state government to respect normal democratic labor rights and allow independent unions in the maquiladora sector, as Mexico is required to do under Mexican federal law, the North American Free Trade Agreement and International Labor Organization conventions. California should suspend its participation with Baja California in joint foreign trade missions until there is compliance with these obligations.

- The state should move aggressively to obtain funding and finish work on cross-border highway and railroad infrastructure projects. Also needed is more effective state lobbying for Mexican enforcement of its own environmental laws.

#### **4. International lobbying and standards negotiations**

- The Governor and the Legislature should work aggressively yet pragmatically with the White House, Congress and multilateral trade organizations to defend the wide range of interests of California’s residents and expand international market opportunities for California firms.
- The governor and Legislature should increase their participation in multilateral negotiations over the creation of domestic and international environmental standards for industry, while ensuring that these new measures improve existing international norms – creating regulatory floors, not ceilings – and that they not weaken California’s environmental protections.
- A subcommittee within the Economic Advisory Panel (see #2 above) should be named from the public and private sectors, including nongovernmental environmental groups, to help design strategy for this environmental standards work.

#### **5. State government investment and procurement**

- The state should use its enormous clout as investor and purchaser to help California businesses and workers and to support the growing movement to establish international corporate standards for human rights, labor rights and the environment.
- A subcommittee should be named within the Economic Advisory Panel (see #2 above) to analyze “economically targeted investment” policies and propose ways to enable their increased use by California Public Employees’ Retirement System, California State Teachers’ Retirement System and the State Treasurer’s Pooled Money Investment Account. The panel should consider the advisability of adopting a “California first” investment strategy that creates investment intermediaries to allow increased capitalization of small firms, especially in disadvantaged areas.
- The Attorney General’s office should continue its support of Massachusetts’ appeal of a federal district court decision ordering that state to end its boycott of firms doing business with Burma. A defeat for Massachusetts in the case – which is expected to eventually reach the U.S. Supreme Court – could limit California’s ability to control its own procurement practices and could open many of its current laws to court challenge.

## *Chapter 1*

### ***INTRODUCTION: HOLLOW TRADE BONANZA***

#### *Chapter contents:*

- The formerly broad public consensus supporting free-trade policies is fading. Fears of job loss and lowered wages have prompted debate over new ways to establish social standards in the global marketplace.
- The world financial crisis is starting to affect California, threatening to end the state's export-led economic boom. Exports are shrinking and imports are likely to grow, leading to heightened pressure on California workers to take wage cuts to compete with ever-cheaper foreign competition.
- Amid the loud debate over federal trade policies, a nationwide renaissance in state and municipal international trade policies has taken place.
- Rather than waiting for solutions from Washington, California policymakers should look beyond the old liberal-versus-conservative dichotomy – more regulation of business or less, more government spending or less – by expanding their policy toolbox to include a proactive use of the state government's existing power as investor and purchaser.

Boom times are upon California – or so it seems. The state is the envy of its world competitors in industries ranging from electronics and software to entertainment, environmental technology and telecommunications. The state's foreign exports have tripled in the past decade to more than \$100 billion annually. An estimated 1 in 7 of the state's jobs are directly or indirectly supported by foreign trade, an increase from 1 in 12 a decade previously.<sup>1</sup> With well-deserved pride, state officials never tire of boasting that California has the world's seventh-largest economy, larger than those of nations such as Canada, Spain, China, Russia and Mexico.

But not all is well. In California and throughout the United States, public sentiment is turning against international trade. Since late 1997, the Clinton administration has lost a series of political battles on key trade issues such as “Fast Track” negotiating authority, free trade with Africa and Caribbean Basin Initiative-NAFTA parity. More than one-half

of California's lawmakers joined the congressional majority in opposing the trade bills, with their positions cutting across party and geographical lines.<sup>2</sup>

In reaction to these defeats, President Clinton has adopted some of his critics' rhetoric – if not the substance of their proposals – by appearing to increase his support for the incorporation of labor, environmental and consumer standards in international trade agreements. In his 1999 State of the Union address, for example, he said: “Trade has divided us, and divided Americans outside this chamber, for too long. Somehow we have to find a common ground on which business and workers and environmentalists and farmers and government can stand together. . . . We ought to tear down barriers, open markets, and expand trade. But at the same time, we must ensure that ordinary citizens in all countries actually benefit from trade – a trade that promotes the dignity of work, and the rights of workers, and protects the environment.”<sup>3</sup>

Despite the overriding importance of international trade to California's economy, the debate over social implications of federal trade policies has not been accompanied by a public discussion of the state's own policies. In other states, the lack of attention has been similar. State-level trade policies languish far off the political radar screen, and those few policymakers who try to raise state-level initiatives find themselves ignored by the public and the press.<sup>4</sup> In part, this disinterest exists because states' policy tools have traditionally been much weaker than those of the federal government. The U.S. Constitution stipulates that the federal government, not the states, is the dominant authority over international trade policy; as a result, state governments have generally limited their trade policies to export-promotion activities.<sup>5</sup>

In fact, however, states have a growing amount of legal and political space to take more proactive stances. More than two centuries of political wrangling and court battles between the states and Washington over federalist powers has resulted in an undeclared draw.<sup>6</sup> As a result, state trade and investment policy authority is a dynamic new field, and many states and cities have begun to flex their muscles on international affairs. From Massachusetts to Texas, New York City to the Bay Area, state and local governments have adopted new policy tools. Instead of the standard liberal recipe – increasing regulations on the private sector and boosting spending – they have adopted a new progressivism that uses the state's existing power as a participant in the marketplace to create local jobs and set international business standards.

The Wilson administration took a *laissez-faire* stance on trade policy, viewing its proper function as that of passive facilitator for the private sector. Forgoing a more active role, the administration saw environmental, labor, consumer, health and other social concerns as extraneous and even deleterious to trade policy. Wilson appeared to ignore important policy initiatives from within the state government, such as those advanced by the California Economic Strategy Panel, which advocated the creation of networks of state and local authorities with the private sector in regional “clusters” of key industries and the expansion of research, education and job training.<sup>7</sup>

According to many state trade experts, the Wilson administration allowed a haphazard overlap of state trade programs with similar or identical federal, local and private-sector programs, creating a welter of duplicated services, turf wars and unnecessary spending that largely ignored businesses in the state's less-advantaged areas. While the political cost of this policy vacuum has been negligible during boom times, the darkening skies on foreign horizons indicate that such complacency may cost the state dearly in the not-so-distant future.

Already, the economic crisis spreading from East Asia to Russia, South America and western Europe has affected California's exports, which fell 4.2 percent in 1998, the first decline since state export record-keeping began in 1987, and shrank an additional 6.7 percent in first-quarter 1999.<sup>8</sup>



No records are kept of California import figures because the complexity of commercial networks makes it impossible to track the final destination of shipments entering at customs ports. The lack of data is unfortunate because the recent surge in the federal trade deficit indicates that California's own deficit is rising fast, with what may become a deluge of low-priced imports from Asia. As the Asian economies wallow in recession, currency devaluations and deflation are slashing the region's wage costs to tiny fractions of those in California.

Can California workers compete against the ever more impoverished and desperate – yet increasingly high-tech and productive – Asian workers? In 1998, Asia's implosion was so severe that many of its corporations could not obtain the loan and equity capital they needed to increase production for exports. Although Asia's wages are expected to remain depressed for many years, its corporations are likely to soon regain access to investment capital, causing California's imports from the region to increase considerably.

## CALIFORNIA EXPORT DESTINATIONS (in millions of U.S. dollars)

<i>Country</i>	1996	1997	1998	% change 1997-98	1998 rank
Japan	18,881	17,460	14,602	-16.4	1
Mexico	9,087	12,082	13,344	+10.4	2
Canada	10,767	11,426	12,673	+10.9	3
China (incl. Hong Kong)	5,533	6,440	6,120	-5.0	4
Taiwan	5,613	6,991	5,926	-15.2	5
Great Britain	5,074	5,414	5,756	+6.3	6
Singapore	5,925	5,674	4,723	-16.8	7
Germany	4,133	4,108	4,700	+14.4	8
South Korea	8,585	7,046	4,413	-37.4	9
Netherlands	2,395	3,411	3,893	+14.1	10
Australia	2,076	2,457	2,647	+7.7	11
France	2,377	2,469	2,457	-0.5	12
Malaysia	3,184	2,996	2,399	-19.9	13
Saudi Arabia	233	734	1,659	+126.1	14
Philippines	1,998	2,000	1,485	-25.8	15
Brazil	1,263	1,217	1,316	+8.2	16
Belgium	1,082	1,142	1,316	+15.2	17
Thailand	2,225	2,251	1,274	-43.4	18
Italy	1,139	1,198	1,272	+6.1	19
Switzerland	1,281	1,358	1,153	-15.1	20
Ireland	699	789	1,059	+34.2	21
Sweden	1,046	798	767	-3.9	22
Spain	705	681	740	+8.7	23
Israel	624	688	726	+5.5	24
Argentina	367	527	619	+17.4	25
India	461	462	471	+1.8	26
Russia	276	306	422	+37.7	27
Chile	331	400	380	-5.0	28
Finland	275	275	370	+34.8	29
New Zealand	415	405	369	-9.0	30
Indonesia	813	955	361	-62.2	31
Turkey	209	529	360	-31.9	32
South Africa	288	289	353	+22.2	33
Denmark	319	315	281	-11.0	34
Venezuela	176	185	247	+33.6	35
etc.					
Total CA Exports	103,254	109,537	104,968	-4.2	

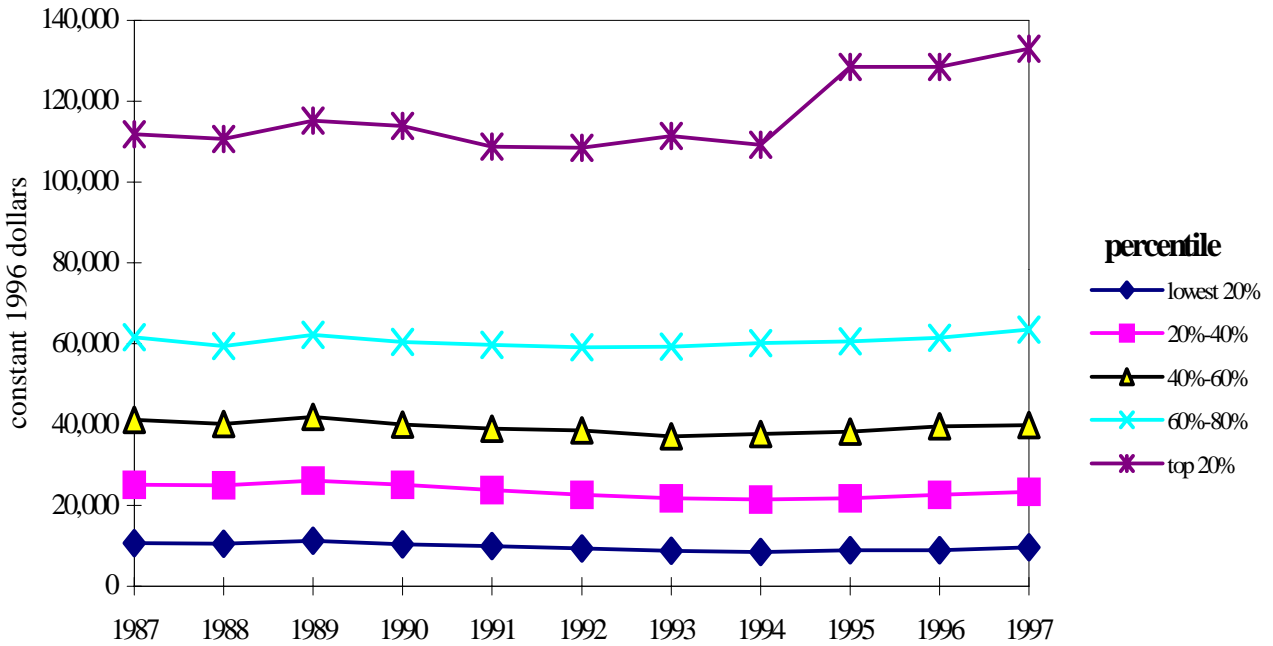
Source: Massachusetts Institute for Social and Economic Research

At the time of this writing (May 1999), the ultimate direction and impact of the international downturn is unclear. At best, it will dissipate gradually over the next few years, with slow, uneven growth in foreign consumer and capital-goods industries. At worst, recession will deepen in Japan, East Asia, Russia and Brazil, and will take hold in

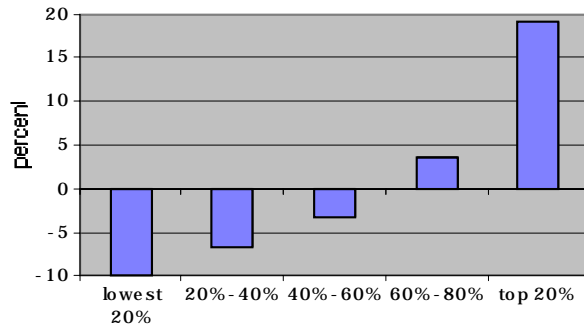
Europe – leading to renewed instability in world financial markets and an end to the U.S. boom. In both these cases, California’s exports are unlikely to resume the rapid growth of 1987-97 that helped fuel the state’s economic expansion. The upshot will be continued negative pressure on California’s trade balance, increased public resentment against trade, and a possible protectionist backlash.<sup>9</sup>

For millions of Californians, economic globalization appears to contribute to an increase in income inequality. Surprisingly, no comprehensive, authoritative studies have been carried out by the state’s universities or government to investigate the role of international trade in California inequality growth. But several recent nationwide studies indicate that low-wage competition from abroad has displaced domestic production and suppressed workers’ incomes, forcing many to accept wage and benefit cuts to preserve their jobs, and weakening labor unions’ bargaining power.<sup>10</sup>

### MEAN CALIFORNIA HOUSEHOLD INCOME



### Net change 1987-97



Source: California Department of Finance, Demographic Research Unit, data calculated from the U.S. Census Bureau's Current Population Survey.<sup>11</sup>

Across California, trade-related complaints are diverse, coming even from industries that strongly advocate free trade. For software and entertainment companies, the problem is copyright piracy abroad. For other sectors, such as chip and clothing manufacturers and growers of cut flowers, pitted fruits and table grapes, it is unfair competition, such as child labor, in developing nations. As for job loss, no reliable data are available. The 34,019 California workers certified by the U.S. Department of Labor as losing their jobs to trade since 1994 amount to a tiny fraction of the more than 300,000 jobs created annually in the state.<sup>12</sup> Yet most experts call these certification statistics deeply flawed, with many categories of affected workers uncounted. As a result, state policymakers are left with few facts at their disposal for analyzing trade's real economic impact on employment.

Meanwhile, many small businesses across the state are starved for the capital they need to join the trade bonanza. Merger-mania and consolidation in the banking industry has caused the disappearance of small banks and bank branches in many communities; most remaining banks refuse to make export loans to small businesses, calling them too risky. A recent analysis of business capital needs by the California Research Bureau, the state government's policy research arm, found a shortfall of \$6.1 billion, mainly among small firms in Southern California, the Central Valley, and rural and disadvantaged areas. In contrast, the study found much of the Bay Area to be over-capitalized, with Sand Hill Road venture capital firms deluging local startups with money.<sup>13</sup>

The capital gap has a strong negative impact on job growth because of its disproportionate impact on small business. From 1993 to 1997, firms with fewer than 100 employees created more than 1.3 million net new jobs in California, and firms with less than 20 workers accounted for 65 percent of this growth. Meanwhile, large businesses lost 277,443 net jobs.<sup>14</sup>

This growing gap between bounty and scarcity offers state policymakers a challenge to rethink and remake California's trade strategies. With the economic future increasingly uncertain, authorities in Sacramento should not wait for the next recession to discover that current policies don't work. Nor should they expect fast solutions from Washington. The past decade of economic globalization has caused a dramatic shift of power from the federal and state governments to financial markets, leaving traditional government fiscal measures increasingly weak. Only if California recognizes this change by expanding its concept of trade to include a broad range of investment policies – including a proactive use of state government's huge clout as investor and purchaser – will Sacramento authorities begin to regain control.

One of the major premises of this report is that inclusion of investment and procurement practices is legitimate and absolutely necessary in any comprehensive review of state international economic policies. Such inclusion does not by itself indicate a certain preordained policy conclusion. To exclude investment and procurement, however, is to ignore reality.



Because the public debate over state-level international trade policies is barely beginning, clear answers are few. The policy solutions discussed in this report may be controversial. They should be. They are intended as tools for further discussion, through which policymakers and the public can begin creating a competitive economy in which all Californians – not just a few – benefit from trade's immense possibilities.

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## ENDNOTES

<sup>1</sup> California Economic Strategy Panel, *Collaborating to Compete in the New Economy: An Economic Strategy for California* (Sacramento: 1996).

<sup>2</sup> For example, in the September 25, 1998, vote in the House of Representatives on Fast Track, the California delegation voted 28-22 to oppose the bill, with 22 Democrats and 6 Republicans in opposition, and 5 Democrats and 17 Republicans in favor. Overall, the bill was defeated 243-180, with 71 Republicans, 171 Democrats and one independent in opposition.

<sup>3</sup> State of the Union address, January 19, 1999. In his speech, Clinton called for conclusion of an International Labor Organization convention banning abusive child labor and announced that his FY 2000 budget proposal would include funds for the ILO to help developing nations implement core labor standards. These proposals echoed Clinton's first major attempt to stake out a progressive free-trade position, in his May 18, 1998, address to the World Trade Organization in Geneva, Switzerland. In that speech, he said: "We must do more to ensure that spirited economic competition among nations never becomes a race to the bottom in environmental protections, consumer protections or labor standards. We should be leveling up, not leveling down. Without such a strategy, we cannot build the necessary public support for continued expansion of trade. Working people will only assume the risks of a free international market system if they have the confidence that the system will work for them." Clinton's proposals included some olive branches to the WTO's left-of-center critics: the creation of a WTO consultative forum of labor, environmental and consumer groups; provision for these groups to file amicus briefs in WTO trade disputes; protection for nations' health and safety, environment and biodiversity laws that are stronger than WTO-sanctioned norms; close collaboration between the WTO and the International Labor Organization to defend core labor standards; a "sunshine" policy of public WTO meetings and documents; and a re-energizing of the WTO Committee on Trade and Environment, which was virtually mothballed after the December 1996 WTO ministerial meeting in Singapore. However, critics said Clinton's WTO speech was mere rhetoric. "The speech was a joke," said Lori Wallach, director of Public Citizen's Global Trade Watch. "Not one item was not already required of the administration in the 1994 GATT (General Agreement on Tariffs and Trade) implementing bill. The administration has failed to do any of it. This was just pandering, a charm strategy to get Congress to approve fast track." Interview, November 20, 1998.

<sup>4</sup> A recent nationwide analysis of state trade programs by the Southern Growth Policies Board (SGPB) – a public, nonprofit, interstate, economic-development organization based in Research Triangle Park, N.C. – concluded that these policies are little known and little appreciated. "SGPB's Clearinghouse on State International Policies keeps an ear

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to the ground to track major program developments, and the National Association of State Development Agencies does a biannual survey of state offices, but neither has more than the most general picture of the types of trade entities that are out there, the funding, or their impact. This is because the [state] trade system has developed ad hoc, with no dominant policy or funding structure, and no national forum for professional academic debate and research. ... Where these organizations are aware of each other, the defining relationship is one of competition. The export organizations, both public and private, are particularly weak. They lead a Cinderella-like existence with brief moments in the limelight in the company of high-level business and elected officials, but most of the time they sit in the ashes of political unpopularity, uncertain funding and high staff turnover." Unpublished essay by Carol Conway for the Commission on the Future of the South, a panel of state officials convened by SGPB, 1997.

<sup>5</sup> Article 1, Section 8 of the U.S. Constitution declares, "The Congress shall have power ... to regulate commerce with foreign nations," and Article 1, Section 10 adds, "No state shall enter into any treaty, alliance or confederation; ... no state shall, without the consent of the Congress, lay any imposts or duties on imports or exports, except what may be absolutely necessary for executing its inspection laws: and the net produce of all duties and imposts, laid by any state on imports or exports, shall be for the use of the Treasury of the United States; and all such laws shall be subject to the revision and control of the Congress."

<sup>6</sup> See Earl H. Fry, *The Expanding Role of State and Local Governments in U.S. Foreign Affairs* (New York: Council on Foreign Relations, 1998), pp. 56-58, 91-92; and Harry N. Scheiber, "International Economic Policies and the State Role in U.S. Federalism: A Process Revolution?", in Douglas M. Brown and Earl H. Fry, eds., *States and Provinces in the International Economy* (Berkeley: Institute of Governmental Studies Press, University of California, 1993).

<sup>7</sup> California Economic Strategy Panel.

<sup>8</sup> All export figures cited in this report are from the Massachusetts Institute for Social and Economic Research (MISER) at the University of Massachusetts at Amherst, which adapts U.S. Customs data to account for point of origin. Although MISER data are generally accepted for year-to-year comparisons for individual states, many experts believe that they are inaccurate for comparisons between states. For example, see Jock O'Connell, "California's New Latin American Trade Strategy Based on Flawed Data," *Sacramento Bee* (March 7, 1999), p. FO1.

<sup>9</sup> No public-opinion polls have been taken recently about trade issues in California. The most recent nationwide poll, conducted in December 1998 for the Wall Street Journal and NBC News, showed that 58 percent of those polled agreed that foreign trade has been bad for the U.S. economy because cheap imports have cost wages and jobs, while only 32 percent said trade has been beneficial. See Jackie Calmes, "Despite Buoyant Economic Times, Americans Don't Buy Free Trade," *Wall Street Journal* (December 10, 1998), p. 10, and Jonathan Peterson, "Trade's Image Takes Beating Among Public," *Los Angeles Times* (May 31, 1999), p. A1.

<sup>10</sup> A study by one prominent pro-free-trade economist estimated that international trade accounts for 39 percent of the increase in inequality. William R. Cline, *Trade and Income Distribution* (Washington, D.C.: Institute for International Economics, 1997). See also

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Deborah Reed, *California's Rising Income Inequality: Causes and Concerns* (San Francisco: Public Policy Institute of California, 1999); Kate Bronfenbrenner, *The Effects of Plant Closing or Threat of Plant Closing on the Right of Workers to Organize* (Dallas, Texas: North American Commission for Labor Cooperation, 1997); Cynthia A. Kroll, Dwight M. Jaffee, Ashok Deo Bardhan, Josh Kirschenbaum, and David K. Howe, *Foreign Trade and California's Economic Growth* (Berkeley: California Policy Seminar, University of California, 1998); California Budget Project, *Unequal Gains: The State of Working California* (Sacramento: 1998); and Chris Benner and Susan Mulloy, *All That Glitters: Jobs, Wages and Opportunity in California's New Economy* (San Jose: Working Partnerships USA, 1998).

<sup>11</sup> Experts warn that income-inequality data comparisons are merely approximate because the Census Bureau changed its methodology in 1994 to adjust for the 1990 census undercount. "Without making any adjustment for the fact that CPS income prior to 1993 is not directly comparable to 1993 and later, the data would seem to overstate the loss in income at the bottom and understate the gain in income at the top between 1987 and 1996," said Richard Lovelady, an analyst at the California Finance Department's Demographic Research Unit. Professional statisticians have not reached consensus on how to adjust the data to resolve this problem. But Lovelady noted that even if the data are adjusted to take into account statistical trends before and after the 1994 change, the general importance of the data is the same: evidence of dramatically increasing inequality in California. Telephone interviews August 31, 1998, and subsequently.

<sup>12</sup> U.S. Department of Labor data for Trade Adjustment Assistance and NAFTA Trade Adjustment Assistance certifications for workers in California from January 1, 1994, to April 15, 1999. However, these statistics are widely viewed as incomplete. As one critical analysis stated, "Workers are only eligible if they produce a 'product' that is 'directly affected' by NAFTA. Thus, all service workers and all retail and agricultural workers are automatically excluded, as are all manufacturing workers who lose their jobs because their industry is indirectly affected by the agreement - for example, makers of inputs for manufacturers who have relocated to Mexico." Public Citizen's Global Trade Watch, *NAFTA at 5: California Report* (Washington, D.C.: 1998).

<sup>13</sup> Koehler, Gus, and Rosa Maria Moller, *Business Capital Needs in California: Designing a Program* (Sacramento: California Research Bureau, 1998), pp. 43-44. See also Gus Koehler, *Meeting the Needs of Small and Medium-Sized Manufacturers in California* (Sacramento: California Research Bureau, 1997).

<sup>14</sup> Koehler and Moller, *Business Capital Needs in California*, p. 5.

## *Chapter 2*

# ***MARKETING CALIFORNIA***

### ***Chapter contents:***

- Since the early 1990s, when tax cuts and downsizing government were the rage, California policymakers have moved gradually toward a “high-road” economic strategy that uses government to stimulate clusters of cutting-edge technologies and high-wage industries. Further development of this strategy holds high promise. However, careful cost-benefit analysis of existing and proposed public-private partnerships is needed before state aid is authorized.
- The state’s network of foreign offices is expanding, but the growth appears poorly planned and ill-timed.
- The lack of loan and equity financing for small businesses places the global marketplace out of reach for large sectors of the state’s economy. New state financing mechanisms are required.
- To eliminate administrative duplication and increase public input into new policy debates, the state’s two overlapping economic advisory panels – the World Trade Commission and the Economic Strategy Panel – should be replaced with a single advisory council for state economic policy.

Despite California political and business leaders’ frequent inattention to trade policy, nearly all agree that state government should actively promote international commerce and investment. For better or worse, the state’s prosperity is clearly tied to foreign business: Nearly 1 in 7 jobs is directly or indirectly supported by trade; more than 30 percent of agricultural production is exported; and billions of dollars of foreign capital has been pumped into firms and real estate in California. The state has become a world leader in high-value-added industries ranging from electronics to computing, entertainment and environmental and health-care technologies, and its location on the Pacific Rim gives it unparalleled opportunity to cash in on business opportunities in East Asia – although that region's sudden economic crisis has temporarily soured its promise.

In recent years, state policymakers have moved toward a bipartisan consensus that California should carry out a “high-road” economic strategy rather than a “low-road” one. In other words, rather than trying to attract investment by cutting taxes, regulations and wages, the state should focus on nurturing the high-skilled, high-paying, high-value-added industries in which California is a world leader and in which its growth potential is greatest.

This still-evolving consensus marks a dramatic turnaround. In the early 1990s, a loud chorus formed behind Peter Ueberroth, the leader of Governor Wilson’s Council on California Competitiveness, who said the state’s business climate was “the most highly tuned, finely honed job-killing machine that this country has ever seen.”<sup>1</sup> Ueberroth and his allies repeatedly advocated expensive corporate tax breaks, deregulation and cuts in programs such as worker’s compensation insurance. Since then, such arguments have been disproved by the economic boom and California industries’ increasing dominance of world markets. But if the state slips into economic doldrums again, it is likely that the low-road advocates will reappear, urging the state to engage in a race to the bottom with its neighbors and competitors by lowering its living standards and weakening its regulatory capacity.<sup>2</sup>

## **TRADE PROMOTION PROGRAMS**

California has the largest trade and investment program of the 50 states. Five state agencies – Trade and Commerce Agency, Department of Food and Agriculture, Environmental Protection Agency (Cal-EPA), Energy Commission, and the Community College System – spend a total of about \$13.5 million annually to promote exports (but not imports), attract foreign investment and operate the state’s nine foreign offices.

These five agencies offer a broad range of consulting services to businesses that are small and medium size, with fewer than about 150 employees.<sup>3</sup> The programs help firms prepare their products for the international export marketplace, find buyers abroad, negotiate shipping and customs paperwork, and weave through foreign legal, business and cultural systems. Other activities include organizing trade shows and delegations, recruiting foreign corporations to invest in California, providing guarantees for loans with private banks, and operating the state’s nine foreign offices. (For more details, see Appendix A.)

During 16 years of free-market, anti-government-intervention philosophy under the Deukmejian and Wilson administrations, state trade policy belied the official rhetoric. Political pressures from the business community and elected Democrats, as well as the Republicans’ hidden pragmatism, resulted in a wide-ranging series of trade programs, many of which are widely viewed as effective despite their limitations.<sup>4</sup>

Below is a comparison of trade programs of some of California’s U.S. and Canadian trade rivals:

## California's Peers: State and Provincial Trade Programs in 1998

	Spending (\$U.S. millions)	Foreign offices	Exports (\$U.S. millions)	Percent change exports 1997-98
Arizona	1.7	6	12,240	-18.0
California	13.5	9	104,967	-4.2
Florida	6.9	12	28,677	+3.9
Illinois	3.3	6	31,544	+8.1
Massachusetts	2.1	4	17,191	-4.6
Michigan	4.7	6	31,438	-9.6
Nevada	.3	0	761	-34.6
New York	5.5	6	41,561	-0.4
Oregon	3.8	3	9,842	-2.3
Texas	3.5	1	86,853	+3.0
Washington	2.4	5	41,759	+15.9
British Columbia	9.7	4	16,778	-2.5
Quebec	20.7	25	38,036	+8.9

*Sources: State and provincial governments; Massachusetts Institute for Social and Economic Research.*

In its first months in office, the Davis administration has taken a deliberate, go-slow approach toward trade policy. “We’re reviewing our policies and analyzing where they need to be improved,” said Trade and Commerce Agency Secretary Lon Hatamiya. He added that for at least several months, all new initiatives – including the 1998 budget allocations for four new foreign offices – are on hold.<sup>5</sup> This prudent strategy is characteristic of the Davis administration’s general political caution, in which all policy changes are planned meticulously.

But as Hatamiya and other officials carry out their policy review, they are likely to find that underneath the sheen of bipartisan support for California’s trade programs there is plenty of criticism of the status quo.

### **TURF BATTLES**

California’s five state-run programs are overlapped by 17 federal ones and several dozen regional, city and private-sector operations, which offer small business owners a broad – and confusing – mix of aid, research, promotion activities and financing for export promotion. The result, not infrequently, is bureaucratic turf warfare and uneven coordination between programs.

For example, the Commerce Department's Export Assistance Centers provide a full range of export services: export readiness evaluation, consulting, market research, short-term and long-term financing. In addition, they trump California's foreign offices with a much wider range of contacts abroad: there are Commerce Department export officers in nearly every U.S. Embassy worldwide. However, a drawback is that these centers are not

exclusively focused on small firms, as California's programs are. Under the Clinton administration, the Commerce Department has reduced its longtime focus on big business, but its programs are still criticized by some as “corporate welfare.”

In theory and in rhetoric, the state and the federal government cooperate warmly, referring clients to each other, combining resources and intertwining programs. In practice, however, their record is spotty. According to business owners and officials on both sides of the government divide, cooperation varies widely between individual agencies and officials.

“The state and federal programs have similar programs, but they have a hell of a time just communicating with each other,” said Paul Oliva, executive director of BayTrade, a trade-promotion organization in the Bay Area, alluding to the Wilson years. “The two sides still don't do well in creating service delivery mechanisms and figuring how to retail them to small businesses.”<sup>6</sup> However, Oliva praised Hatamiya’s initial steps to improve state-federal communication.<sup>7</sup>

Hatamiya came to Sacramento after five and a half years with the U.S. Department of Agriculture in Washington. “One of my main goals is to re-establish and better develop the agency’s interface with the federal government, as well as with (the California Department of) Food and Agriculture,” he said.<sup>8</sup>

## **CAUSE AND EFFECT**

Total annual export sales claimed by the Trade and Commerce Agency is \$1.5 billion, an impressive return on the agency’s less than \$12 million in expenditures. However, this sales total is only 1.4 percent of California's annual exports of \$104.9 billion. For some legislators and trade experts eager to justify trade programs, the state's data on exports and jobs produced offer justification for continuing and expanding spending levels. In fact, last year's data – the first time such detailed figures had been produced – were generated as a result of lawmakers' demands for easily measured yardsticks.

Other experts, however, say even the new data are unreliable and prove little. And beyond the problem of raw data, state agencies – and other organizations such as BayTrade and LATrade, described below – appear to exaggerate the importance of their work on trade deals. “The critical question is how significant a role did an agency's minions play in arranging a given export transaction,” said Jock O’Connell, a Davis-based international business consultant who was an adviser during the 1980s to the Assembly and two state economic policy commissions. “If all they did was provide a list of telephone numbers of possible buyers, it would be a real stretch to claim credit for whatever transactions ensued. The plain truth is that there is no easy or straightforward way of measuring how valuable export promotion programs are unless our standard is that a given export transaction would not have occurred without the agency's intervention.”<sup>9</sup>

Many critics in the Legislature and private business say the Trade and Commerce Agency accepts almost anyone who knocks on their door, whether or not they are likely to benefit from the agency's services. Although all programs conduct initial analysis of clients to determine their export-readiness and reject those who don't make the grade, the fact that there is little public outreach or strategic attention to specific, strategic industries means that the agency's role is essentially passive.

## **PERFORMANCE BENCHMARKS**

A major barrier toward building political support for a comprehensive state government economic strategy has been the lack of reliable performance benchmarks. Lawmakers often cite a 1996 report by the independent State Auditor, who indicated that the Trade and Commerce Agency did not adequately measure the effectiveness of its programs.<sup>10</sup> Without serious cost-benefit data, many state programs are left wide open to criticism that they are mere corporate welfare.

Major questions have long gone ignored: How many potential clients remain unreached? Are potential clients fully aware of the state's programs? What are the unreached clients' overall loan needs? What type of market information do they need? How are they geographically distributed? Are they concentrated in minority urban districts, rural districts or other disadvantaged areas?

“The problem with the state's economic-development programs is that they don't gather data to provide cost-benefit program efficiency analysis,” said Jean Ross, executive director of the California Budget Project. “It's not at all clear whether many of the programs really achieve their outcomes when compared with the huge size of the state's economy. ... For example, are the state's foreign offices a productive way to boost exports, or just a way for Pete Wilson or Gray Davis to give plum jobs to campaign contributors?”<sup>11</sup>

Several attempts have been made recently to address the problem. The 1998 budget required Trade and Commerce to produce cost-benefit data for its foreign offices. And in 1999, AB 1617, authored by Assemblywoman Sally Havice, D-Cerritos, would require the agency to produce such data for all its international programs. However, it is unclear why such data should be limited to foreign trade programs, which account for a small proportion of the state's overall economic-development spending.

**Policy recommendation: The state should develop cost-benefit performance data – including effects on exports, foreign investment, jobs, wages, income distribution and the environment – for all economic-development programs, as a means of ensuring that funds are efficiently spent and achieve the stated goals.**



## A NEW COOPERATIVE MODEL

An important alternative for state trade programs is to turn businesses into stake-holders in the process. For conservatives and liberals alike, increased business involvement in government trade programs is appealing. It gives firms a bigger say in running programs of which they are the intended beneficiaries, and reduces unnecessary government subsidy of the private sector. It can remedy a major problem of state and federal programs – distrust by their clients. “Many businesses view government programs as part of the problem, not the solution,” said Greg Migniano, a trade program consultant who founded BayTrade, LATrade and a similar program in Florida in 1994. “When they have a problem, they don't look to the government for help – or even think of doing so – even though government programs have a lot to offer.”<sup>12</sup>

Public-private partnering has had good results in trade promotion programs in Europe and British Columbia (for details, see Chapter 3). In California, home-grown variants have been practiced successfully by the Energy Commission, Cal-EPA and regional and private-sector groups such as Bay Area Economic Forum and San Francisco Partnership.

Another step in this direction is the California Trade Coalition (CalTrade), which comprises BayTrade, LATrade, BorderTrade and the Fresno City Export Forum. Bridging the deep bureaucratic and cultural divisions between business and government, the coalition is a unique public/private hybrid – a nonprofit network of seven offices in the Bay Area and Sacramento, four in the Los Angeles area and one each in San Diego and Fresno – that is funded by the U.S. Commerce Department, city governments, port authorities and private corporations. As a network of “one-stop” service centers, it offers a wide variety of consulting and training to small would-be exporters and act as brokers for state and federal programs. Local private-sector leaders are involved directly in managing the organizations, and local corporations provide some of the financing. For example, BayTrade's office in San Francisco is a joint operation with the Bay Area World Trade Center;<sup>13</sup> its office in Sacramento is run jointly with the Sacramento Chamber of Commerce; and LATrade is run cooperatively with the Los Angeles Chamber of Commerce.

Because CalTrade has 12 offices – far more than the four Trade and Commerce Agency offices statewide that have international trade staff – and has extensive contacts in the private sector, it is able to do more outreach than the state agency, reaching businesses that may have not thought about exporting. “Many businesses that could export just don't think about it unless it's presented to them,” said Oliva. “The owners already have a lot on their minds, and selling to a foreign country is such a daunting process – the language barrier, customs, bureaucracy, standards, patent problems – they shy away from it unless trade services are made accessible to them.”<sup>14</sup>

In addition, the coalition's organizations have a more populist, Main Street focus than the state and federal agencies. They serve only small firms under 50 employees, unlike the state and federal inclusion of firms of as many as 150 workers – a size that includes multimillion-dollar corporations with the resources to make it on their own without

government aid. The organizations' outreach is aimed at diversity. For example, LATrade works with Urban League, South Central Los Angeles Economic Alliance, the First African Methodist Episcopal church business alliance, among others.

A big problem with the public-private cooperative model, however, is that although the private sector often is eager to help managing and publicizing the programs, it rarely contributes enough money. BayTrade, for example, receives only about \$100,000, less than 10 percent, of its annual budget in contributions from its corporate members. "Corporations here are not as far-sighted as one would hope," said Martina Johnson-Kent, former executive director of the California Council on International Trade, a private-sector lobbying group that relies on corporate members for its sustenance. "This is not like Europe, where corporations think nothing of paying real money to further their enlightened self-interest. Here, it's much more difficult to get them to chip in."<sup>15</sup>

By far the largest share of CalTrade members' funding comes from the U.S. Commerce Department – more than \$7 million over the past four years, mostly in defense conversion funds that are expected to dry up by late 1999. At the end of this funding cycle, these groups are expected to become self-sustaining – a prospect that appears highly unlikely. As discussed below, the state government is now being asked to step in with further funding to rescue CalTrade, leading to questions over whether the public-private model should be labeled cooperation or outright subsidy.

## **PROPOSALS FOR REFORM**

In 1996, a new plan emerged with a comprehensive vision of public-private partnering. The California Economic Strategy Panel, a study group of politicians, business leaders and experts created at the request of Senator John Vasconcellos, D-San Jose, proposed that the state help finance and develop a system of public-private hybrids, much like BayTrade and LATrade, throughout the state that would serve as lead organizations for the state's clusters of emerging, fast-growth industries. The new organizations would act as one-stop service providers for education and training, technology development and business-assistance services.<sup>16</sup>

The report also focused attention on the state's education system, which is both a boost and a hindrance to California's international competitiveness. The state's university research and graduate programs have played crucial roles in developing the computer industry, as well as health care, environmental and energy technologies, engineering, biotechnology, multimedia, telecommunications, and other information- and knowledge-based industry clusters. Maintenance and further strengthening of the university system is a must for the state's future economic development.

On the other hand, the report pointed out, several other aspects of the educational system weaken the state's economic competitiveness. The state's record on primary and secondary education, for example, is poor. California ranks 42<sup>nd</sup> in spending per student among the 50 states, 49<sup>th</sup> in computers per student and 50<sup>th</sup> in class size.<sup>17</sup>

Since the California Economic Strategy Panel report was published in February 1996, the response in Sacramento has been mixed. The Trade and Commerce Agency's main response was to create TeamCalifornia, a network of existing government initiatives and private-sector organizations throughout the state. TeamCalifornia has facilitated communication between these groups and helped coordinate development programs.

In 1999, new legislation became the most ambitious attempt yet at putting into effect a cluster strategy. AB 180, authored by Assemblywoman Havice, the chair of the Assembly Committee on International Trade and Development, calls for a \$4.6 million annual subsidy of CalTrade. (For discussion of AB 180 and other trade legislation, see Appendix B.)

Although the motives of AB 180 are laudable, its methodology has provoked complaints from some critics that the new policy verges on corporate welfare.

"AB 180 represents a galling misuse of taxpayers' money," said O'Connell. "The clients targeted by these export development groups are not indigent widows and orphans. Instead, they are all profitable business enterprises that could presumably afford to pay a token (i.e., subsidized) fee for any services they truly regard as valuable. Why, then, is soliciting a state bailout deemed preferable to charging modest fees? Perhaps the answer is that the private business people do not hold these services in anywhere near the high esteem the service providers apparently do. So is the Legislature, in effect, being asked to subsidize a network of quasi-public organizations providing business services for which there is no viable market?"<sup>18</sup>

Such criticism may be overly harsh, but it does point to the economic and political necessity of carefully carrying out careful cost-benefit analyses before spending large sums on economic-development programs.

The criticism also is an indication of the larger political dilemma for international trade programs: They are viewed by many Californians as having no larger social impact or benefit to workers and surrounding communities. In AB 180 and virtually all other trade legislation, the funds go directly to private firms by grants and consultancies, with only passing mention of worker training and education, and no mention of giving preference to firms that pay the prevailing wage or banning firms that are consistent labor-law violators.

**Policy recommendation: The state should revamp its export-promotion strategy to emphasize public-private partnerships and eliminate duplication of services with federal, regional and local trade agencies. AB 180 should be rewritten to authorize a cost-benefit comparison of existing public-private partnerships and other policy options before any large grants are authorized. In addition, AB 180 and similar economic development spending bills should prioritize worker training programs and ban assistance to firms with consistent records of labor-law violations.**

## **PUBLIC INPUT AND POLICY COORDINATION**

Designing new policies and gaining public consensus for them would be easier if the state had a unified advisory council that brought business leaders and other stakeholders to the table in a coordinated way. Unfortunately, California has two economic-policy advisory bodies, whose responsibilities overlap considerably. The World Trade Commission, a 15-member panel within the Trade and Commerce Agency, advises the agency's leaders on international policy. Nine of the members are gubernatorial appointees, and the rest are named by the Assembly and Senate. The commission is little known outside the Sacramento bureaucracy and appears to have done little. The Economic Strategy Panel, however, is broadly based, with its 14 members ranging from state officials to business owners, academics and labor leaders. Its recommendations generally have focused on domestic economic policy and have not examined trade and investment in depth. But its conclusions and recommendations have been highly influential.

The Economic Strategy Panel's biggest problem is lack of funding. It receives no state government money, and in 1998, Wilson blocked a proposal by Vasconcellos for \$200,000 in funds. As a result, the panel is completely dependent on corporate and foundation grants for its operating budget – a highly unusual situation for a state panel that is meant to be independent and beholden to no special interest.

**Policy recommendation: To eliminate duplication and increase public input, the state's two overlapping economic advisory panels – the World Trade Commission and the Economic Strategy Panel – should be replaced with a single advisory council for state economic policy. This Economic Advisory Council should: A) have subcommittees on major policy areas, such as international trade, domestic economic development, agriculture, investment and procurement, and environmental technology standards; B) report directly to the governor, as well as to relevant Cabinet agencies and the Legislature; C) include among its appointed members a broad cross-section of stakeholders, including representatives of major business and farm sectors, regional and city organizations, labor unions and environmental organizations; and D) receive adequate state funding to carry out its work. (For a discussion of the environmental standards subcommittee and the investment and procurement subcommittee, see Chapters 5 and 6, respectively.)**

## CALIFORNIA'S FOREIGN EMPIRE

Since the state's first foreign office was opened in Tokyo in 1987, these mini-embassies have been a source of pride to Sacramento officials, demonstrating California's nation-size ambitions and worldwide economic clout. Business leaders and trade experts say most of the foreign offices' staff are competent and efficient. But many also say the network is spread too thin. The state's nine mini-embassies have a total budget of only \$5.9 million, a small sum that leaves many offices so understaffed and underfunded that they are able to do little more than answer phones and faxes.

The location of offices has long been subject of political log-rolling in Sacramento, with little economic reasoning for some.<sup>19</sup> For example, the offices in Israel and South Africa (nations that purchased only \$726 million and \$353 million, respectively, in California exports in 1998) are viewed by insiders as the result of political pressure rather than economic necessity. Although the trade deals generated by these two offices appear to have given the state a positive return on its expenditures, their importance pales when compared with the lack of full-time offices in other nations such as Canada (\$12.7 billion in California exports), Singapore (\$4.7 billion), Malaysia (\$2.4 billion) and China excluding Hong Kong (\$2.5 billion).

### Location of Foreign Trade Offices of U.S. States

<b>Japan</b>	32
<b>Mexico</b>	25
<b>Taiwan</b>	18
<b>Germany</b>	15
<b>South Korea</b>	13
<b>Canada</b>	10
<b>Belgium</b>	10
<b>Hong Kong</b>	8
<b>Great Britain</b>	6
<b>China</b>	5
<b>Others</b>	20

*Source: National Association of State Development Agencies, 1994.*

In late 1998, the Wilson administration and the Legislature agreed to extend the Seoul representative office, close the Jakarta representative office and add four new representative offices: Shanghai, Manila, Sao Paolo and Calgary. (For more details, see Appendix C.) As mentioned earlier, Hatamiya has delayed opening the new offices pending further analysis.

**Policy recommendation: The state should postpone action on all proposals for new foreign offices until a comprehensive cost-benefit analysis has been done; at the same time, all foreign offices should be reoriented to provide greater in-depth research and networking expertise for California’s growth industries rather than the existing all-comers approach.**

## **SMALL EXPORTERS' ACHILLES HEEL**

For many small businesses, a key difficulty in entering foreign markets is the lack of capital. Trade experts from all perspectives recognize that for some of California’s industry sectors and geographical areas, both private equity markets and commercial bank lending are woefully hard to find. “Without government guarantees, the private (banks) don’t want to get it because they see it as too risky,” said California Export Finance Office Director Caroline Brown. “They see trade finance deals as too exotic, too complicated.”<sup>20</sup>

Even with the state guarantees, many banks still view such deals unfavorably. “The bank will see that it’s only going to profit \$250 for one deal, and won’t think about creating a long-term relationship with a growing company,” said Oliva. “It’s a very short-term focus. In Europe, the banks have a different outlook and are willing to do that – start when a company is small and grow with it.”<sup>21</sup>

The California Research Bureau report on the state’s \$6.1 billion business capital gap, discussed on page 6 of *California on the Global High Road*, advocates the creation of nonprofit investment intermediaries that would act as convener and match-maker for existing venture-capital networks and “gazelles,” or fast-growing, early-stage small companies.<sup>22</sup> The report also suggests that the state take equity positions in these firms. A similar model is the Texas Growth Fund (see Chapters 4 and 6), a \$75 million fund capitalized largely by state pension funds and the private sector. The report cautioned, however, that other states’ direct business-loan programs have had mixed records, with failures as well as successes, and an inherent conflict between rate-of-return and economic-development priorities.

Recent research by the Washington-based Center for Policy Alternatives has demonstrated the power of “economically targeted investment” practices to help spur economic growth.<sup>23</sup> (For more details, see Chapter 6.) In the 1998 legislative session, an important initiative in this regard was the California Seed Capital and Early Stage Corporation Act, AB 1752, authored by Assemblywoman Susan Davis, which died in committee.

**Policy recommendation: The state should consider creating a professionally managed, nonprofit venture-capital firm or public-private intermediary directed toward undercapitalized business sectors with strong growth potential, especially those in disadvantaged and rural areas; at the same time, the state should analyze the possibility of requiring the state’s pension funds, CalPERS and STRS, to invest in this nonprofit firm if it meets the funds’ fiduciary standards for return, risk and liquidity. The California Seed Capital and Early Stage Corporation Act is a good starting point, and deserves careful consideration.**

Another alternative is for the state to use the federal Community Reinvestment Act (CRA) of 1977, a powerful anti-redlining measure that requires banks to meet the needs of low-income sectors as a condition of receiving renewal of their Federal Reserve charters. In addition, the state could design its own legislative equivalent, perhaps including the insurance industry.

“The CRA is an incredible tool for getting loan capital for small businesses, whether for export or for other business activity,” said Robert Gnaizda, policy director of the San Francisco-based Greenlining Institute, which in the past two years has used CRA to force Wells Fargo, Union Bank, Bank of America and Washington Mutual to promise a net increase of \$100 billion in new loans to California low-income sectors over 10 years. “But the Wilson administration always opposed the CRA for the same reason that it ignored the low-income and minority population in most economic programs, and the (state) Democratic leadership has shown little interest either.”<sup>24</sup>

**Policy recommendation: The state attorney general and the state treasurer should use the federal CRA to urge the San Francisco Federal Reserve to compel California commercial banks to increase their proportion of loans destined to export-oriented and other activities of small businesses – especially those in disadvantaged areas. In addition, the governor and Legislature should consider enacting a state-level CRA that covers both the banking and insurance industries.**

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## ENDNOTES

<sup>1</sup> Council on California Competitiveness, *California's Jobs and Future* (Sacramento: 1992). For alternative views of state competitiveness, see: Earl H. Fry, *The Expanding Role of State and Local Governments in U.S. Foreign Affairs*; Jock O’Connell, “How Much of the Business Climate Is Hot Air?”, *Sacramento Bee* (May 9, 1993), p. FO1; and Jock O’Connell, “What's a Governor to Do? Think Long Term When It Comes to Bolstering Economy,” *Sacramento Bee* (November 1, 1998), p. FO1.

<sup>2</sup> In a 1993 essay, O’Connell foresaw the end of the Ueberroth doomsday chorus: “The role of a recession – apart from weeding out badly managed firms – seems to be to invite complaints about taxes and regulations for the simple reason that declining profits make

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company executives more acutely aware of the costs of doing business. ... Business people now proclaim themselves to be oppressed victims in need of their own version of affirmative action – namely tax breaks and regulatory relief. But boardroom fashions change with economic cycles. During the expansionary years of the mid-1980s, it was not uncommon to hear the CEOs of California corporations deploring the quality of public education, the lack of serious worker retraining programs, and a crumbling infrastructure of roads, bridges, ports, and waste treatment facilities. With any luck, business organizations will soon be back griping about how California can hardly expect to sustain high-technology aspirations by ranking 41<sup>st</sup> (just above Louisiana) in education spending per pupil.” O’Connell, “How Much of the Business Climate Is Hot Air?”

<sup>3</sup> California state agencies use the federal Small Business Administration formula for determining what is a small business. The formula is complicated, varying by industry, but most firms with less than 150 employees are able to qualify.

<sup>4</sup> Some critics of the Wilson administration take a more nuanced view. Jock O’Connell, for example, dissents from the above analysis, saying, "I think you perhaps overdo the apparent irony that "laissez-faire" administrations presided over the expansion of the state's trade programs. For one thing – at least under Deukmejian – the initiatives came from Democrats in the Legislature. For another, I doubt either administration was sufficiently thoughtful to embrace a theoretical construct, even by default. The real irony, I think, is that the political leaders of the party that is supposed to best understand the needs of business showed themselves wholly unable to administer these programs in a business-like manner." Email to the author, July 2, 1998.

<sup>5</sup> Telephone interview, March 3, 1999.

<sup>6</sup> Interview, March 17, 1998.

<sup>7</sup> Telephone interview, March 18, 1999.

<sup>8</sup> Telephone interview, March 3, 1999.

<sup>9</sup> *ibid.*

<sup>10</sup> California Bureau of State Audits, *Trade and Commerce Agency: More Can Be Done to Measure the Return on the State's Investment and to Oversee Its Activities* (Sacramento: 1996).

<sup>11</sup> Telephone interview, November 20, 1998.

<sup>12</sup> Interview, March 30, 1998.

<sup>13</sup> The more than 300 World Trade Centers in over 80 nations are membership organizations that help private firms with export and import deals. Most of the centers are nonprofit, although a few are for-profit companies.

<sup>14</sup> Interview, March 17, 1998.

<sup>15</sup> Interview, February 6, 1998.

<sup>16</sup> California Economic Strategy Panel, *Collaborating to Compete in the New Economy: An Economic Strategy for California* (Sacramento: 1996). The report is vague on many key proposals, and should be read as a general introduction to new ideas rather than as a detailed policy blueprint.

<sup>17</sup> *Ibid.*

<sup>18</sup> O’Connell, letter to Assemblywoman Sally Havice, April 19, 1999.

<sup>19</sup> See Dan Walters, “Trade Offices Politicized?” *Sacramento Bee* (April 21, 1999), p. A3. In the 1998 legislative debate over new foreign offices, many lawmakers from both



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parties criticized the Trade and Commerce Agency. For example, Senator Rob Hurtt, R-Garden Grove, said that Trade and Commerce officials “are not able to provide us quantitative information about how much new business those existing offices brought” to California. “Our position has been ‘prove it’ and maybe we’ll open more locations. ... Until they can give us direct cause and effect, it does not make sense to open new offices.” See Eric Young, “Trade Office Growth Hits Snag: Lawmakers Debate Expansion Plans,” *Sacramento Bee* (May 6, 1998), p. C1.

<sup>20</sup> Testimony before the Assembly International Trade Committee, Sacramento, February 26, 1998.

<sup>21</sup> Interview, March 17, 1998.

<sup>22</sup> Koehler and Moller, *Business Capital Needs in California: Designing a Program*, pp. 43-45.

<sup>23</sup> See Koehler, *Meeting the Needs of Small and Medium-Sized Manufacturers in California*; Koehler and Moller, *Business Capital Needs in California: Designing a Program*; and the following reports by the Center for Policy Alternatives: *Capitalizing on Collaboratives: New Partners for Community Development Finance* (1996); *Investment Intermediaries: Model State Programs* (1995); *Economically Targeted Investments by Statewide Pension Funds* (1993); and *State Policy Support for Targeted Pension Fund Investment* (1992).

<sup>24</sup> Interview, July 1, 1998.

## *Chapter 3*

# LESSONS FROM AFAR

### *Chapter contents:*

- California has much to learn from export success stories – and failures – in other states and nations.
- British Columbia’s provincial government and Italy’s Emilia-Romagna region have boosted exports by “clustering” small firms in strategic sectors.
- Oregon imported foreign ideas and tried to make them work. It failed.
- Texas avoided the pitfalls of California-style confrontation with Mexico, trying to turn good-neighbor relations into profitable trade and investment deals. It succeeded.

*“You can no longer rely on your home market because your home market is now an export market for everybody else.” – Niels Christian Nielsen, co-director, Danish Technology Institute.<sup>1</sup>*

In recent years, western Europe and Canada have developed a wide variety of export promotion services designed to help even the smallest businesses become global competitors. Despite the individual nations' relatively small economies, they have prospered by becoming export powerhouses. They have developed programs ranging from helping with initial market research to forming networks of companies – and in some cases actually brokering individual transactions. Those nations' government export finance agencies give sustained, strategic support to their firms, a far cry from the U.S. model. While the U.S. government backs only 2 percent of national exports with financing, France gives 15 percent and Japan provides 35 percent.<sup>2</sup>

Aspects of the overall policies vary from country to country, such as the deliverer of the aid (whether they are private organizations, government agencies or public/private partnerships) as well as the location (be it locally, regionally or nationally). But the common element is that they unite business and government in collaborative relationships that treat exporting not as an end in itself but as part of a medium- to long-term process of regional and sectoral economic development.

## **BRITISH COLUMBIA**

Despite a stagnant economy, dragged down by low prices in forestry and mining, the British Columbia government has created a bright spot in its export sector, which has grown rapidly in recent years. It has done so by creating 13 marketing alliances of firms with similar or complementary capabilities that share a common objective – whether selling to a particular market, winning a specific contract or simply improving their export performance – and occupy a strategic, internationally competitive niche of the economy, such as finished wood products, biotechnology, industrial design, environmental engineering, or “green” architecture and construction materials. Four provincial ministries – Employment and Investment, Advanced Education and Technology, Forestry, and Energy and Mines – help the alliances with staff research, funding for company R&D and foreign diplomatic contacts. In the five years since the program was started, eight of the alliance organizations have become profitable and self-sustaining.

British Columbia's investment in foreign trade is large. Total export program spending is \$9.7 million (U.S.) in a province of only 4 million residents, compared with California's \$14 million spending for its 33 million residents. These policies have helped British Columbia break away from its former dependence on exporting raw materials to the United States. In 1998, trade with the United States was 63 percent of the province's total, much less than the Canada-wide average of 84 percent.

This success has come despite nearly 50 percent budget cutbacks in the early 1990s because of the province's sharp recession during those years. For example, the trade office's former 12 foreign offices has been cut to four: Tokyo, Hong Kong, Taipei and London.

The heavy attention to trade promotion might surprise some U.S. business analysts. Since 1991, the province has been governed by the New Democratic Party, Canada's third largest, whose social-democratic stance is roughly equivalent to the U.S. Democratic Party's liberal wing. But the NDP has found a recipe for success by aggressively using the power of government to focus subsidies, research and development funds and job training, as well as large tax concessions and electricity rebates, on the strategic sectors.

Local business leaders grudgingly say they don't mind the change at all. "Medium and large-size companies have come to recognize the role of the government," said Werner Knittel, president of the British Columbia chapter of the Alliance of Manufacturers and Exporters, Canada's main business group. "Five to eight years ago, it was very unusual to find companies that would even consider partnering with the government. Now no one bats an eye."<sup>3</sup>

The one area where the provincial trade agency shows its political colors is on international policy. Its policy division carries out research and lobbying against NAFTA, the proposed Free Trade Area of the Americas and the Multilateral Agreement

on Investment. British Columbia exercised its right under the Canadian constitution to opt out of NAFTA's side accords on labor and the environment,<sup>4</sup> and it has taken a lead role in the international campaign to stop the MAI, saying the treaty might act as a veto over the province's economic policies.

## **ITALY'S EMILIA-ROMAGNA REGION**

Two decades ago, northern Italy's Emilia-Romagna area was an economic failure. Its economy, dominated by small, family-owned industrial companies, had a per-capita income of 90 percent of the national average. Now, its income is 120 percent of the average, propelled by burgeoning foreign trade. The reason for this dramatic turnaround is the region's intensive organizing of flexible manufacturing networks, hybrid organizations that deliver sophisticated business services to firms too small to afford them on their own.

SVEX, a public-private service center for export development, was created in 1989 by the government, the chamber of commerce and other private-sector groups. Assuming that the region's firms need no help exporting to Europe, SVEX focuses on developing long-term trade relationships in untapped overseas markets that are difficult to penetrate but potentially important, such as the former Soviet Union and India. It conducts market analysis, organizes trade fairs and delegations (from Emilia-Romagna to the foreign country and vice versa), and establishes representative offices in that nation – usually an overseas national under contract to SVEX.

As it develops trade leads and coaxes the region's small firms to begin exporting, SVEX provides in-depth, tailored assistance. But the aid is not free. Firms must pay for it, on a sliding scale that typically starts out as a token amount and progresses to near-market rates. SVEX, whose initial funding was provided by the regional government, has become self-sustaining through fees charged to its customers.<sup>5</sup>

Similar regional hybrids have been established in Denmark and in France's Brittany and Essonne, as well as Germany's North Rhine-Westphalia. But the principle is the same – forming networks of small firms that work collectively to achieve the scale benefits of large companies while keeping the flexibility inherent in smallness.

However, a problem with the model is that the networks also engage in political lobbying on a wide variety of issues. From a California perspective, this would seem like unacceptable government aid to business at the expense of labor. In Europe, however, the aid is offset by the governments' simultaneous support for labor unions, and by Europe's long tradition of cooperation between government, business and labor. What's more, in Italy, Germany, France and other nations, national chambers of commerce have public law status – chartered by the government, with membership mandatory for all firms. In California, where a fire wall exists between the three sides and where relations between business and labor are often acrimonious, it would be necessary to prohibit any such

networks from lobbying. Otherwise, they would be justifiably criticized for being politically unfair.

## **OREGON**

In the 1980s, amid a nationwide debate about U.S. competitiveness in trade, Oregon officials went looking around for foreign models. In Europe, they found one – or so they thought. Oregon lawmakers fixed upon the notion that the secret to the Europeans' trade success was that they “picked winners” and dedicated their efforts almost exclusively to them. That is, rather than the usual U.S. practice of accepting nearly any small business that knocked on a trade agency's door, Oregon chose specific, mid-size firms in strategic areas, then gave them specialized aid. The state trade officials thus become virtual employees of the client firms, directly negotiating deals on a paid basis.

But the drawbacks to the strategy quickly became clear. The Oregon Economic Development Department found that it only had enough trained staff to help several dozen firms per year. Criticism came fast, both from private export consultants who claimed that the state was competing with them unfairly on a subsidized basis and from politicians who said the \$1.8 million annual expense simply represented a fleecing of the taxpayer to fatten a few corporations' profits. In 1997, the program was gutted, leaving the department with only its traditional export training seminars and reduced staffing at its offices in Tokyo, Taipei and Seoul.

Experts agreed that the program had been ill-conceived. “The state's primary role should be as a convener, data gateway, subsidizer and flag-carrier, not as a deliverer of technical advice,” said Carol Conway, an expert on state trade policies at the Southern Growth Policies Board in North Carolina. “A state can't reach enough companies through one-on-one technical assistance to make an impact on its statewide export performance.”<sup>6</sup>

In 1998, the pendulum swung the other way. The Economic Development Department began a new plan under which the state would create a system of regional partnerships of state and local government agencies (but not private-sector organizations) to coordinate all government economic activities. The program was explicitly focused on the state's poorer areas and included authorization of small-firm export financing, which had been eliminated the year before. However, critics say the program appears to be merely a public-relations makeover of previous practices, ignoring firms and local governments in depressed areas outside the Willamette Valley.

Many experts say the lesson to be learned from Oregon's experience is that simply copying European success stories is bad strategy. Neither “picking winners” nor creating regional partnerships will work if the programs are poorly planned and managed.

## TEXAS

Much has been said about the Wilson-era difference in trade strategies between Texas and California. Texas Governor George Bush has made a high priority of maintaining good relations with his state's biggest trading partner, Mexico, while the Wilson administration became reviled throughout Mexican politics – by parties of the right as well as of the center and left – for perceived anti-immigrant, Mexico-bashing policies.<sup>7</sup> In Mexico's clubby world of tight links between government and corporations, good diplomacy means good business. As a result, many business leaders and experts say that California has lost out to more Mexico-friendly states – especially Texas, where Bush has wooed Mexico on many fronts – in cross-border business deals.

The headquarters of three key institutions linked to NAFTA – the North American Development Bank (NADBank), the Border Environmental Cooperation Commission (BECC), and the North American Commission for Labor Cooperation – were placed in San Antonio, Ciudad Juarez and Dallas, respectively, in a sign of Mexico's preference for Texas.

However, despite Texas' good relations with Mexico, the rest of its trade programs are lackluster and poorly funded. The state Department of Economic Development – roughly equivalent to the California Trade & Commerce Agency – has an annual budget of only \$2.6 million, and the state's energy and environmental programs do not have the same economic focus as their California counterparts. The state's only foreign office is in Mexico City, a drastic reduction from the five offices that flew the state's banners abroad until the Texas legislature eliminated them during the early 1990s recession.

“The Bush administration takes a very dim view of anything that could be called ‘industrial policy,’ unlike the [Governor Ann] Richards administration before it,” said Chandler Stolp, director of U.S.-Mexico Policy Studies at the University of Texas at Austin. “One of the things plaguing the Economic Development Department is that it views any effective state economic policy to be top-down *dirigisme*.”<sup>8</sup>

In one area, however, Texas has been a highly successful innovator. The Texas Growth Fund, created in 1991 by the Richards administration, harnesses the power of the state's pension funds to help capitalize fast-growing, under-funded “gazelle” firms. The \$75 million fund provides private equity and subordinated debt to established well-managed, small and mid-sized companies with operations in Texas. The state constitution was amended to allow the state's pension funds to invest in the fund – a crucial element that has given the fund all but \$10 million of its capital. The fund has been a success, stimulating more than \$1 billion in exports and creating thousands of jobs. Perhaps more important, it has produced a 25.9 percent annual return since 1992, thus outperforming state pension funds in Texas and California, as well as all major U.S. stock index funds.<sup>9</sup>

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## ENDNOTES

<sup>1</sup> As quoted in William Nothdurft, *Going Global: How Europe Helps Small Firms Export* (Washington, D.C.: Brookings Institution, 1992), p. 2.

<sup>2</sup> James Harmon, chairman of the Export-Import Bank, interviewed in Lewis Dolinsky, "Notes From Here and There," *San Francisco Chronicle* (August 28, 1998), p. A15.

<sup>3</sup> Telephone interview, March 21, 1998.

<sup>4</sup> The Canadian federal system is more decentralized than the U.S. system, giving provinces full authority over labor, natural resources and other issues.

<sup>5</sup> Nothdurft, pages 35-37.

<sup>6</sup> Carol Conway, electronic posting to California Trade Programs Forum, October 7, 1997.

<sup>7</sup> For a broad discussion of the Texas-California contrast, see Robert Collier, "Mexico Likes Texas' Governor Better," *San Francisco Chronicle* (April 27, 1998), p. A1.

<sup>8</sup> Telephone interview, April 20, 1998.

<sup>9</sup> Texas Growth Fund (TGF) internal investment statistics were provided to the author by the Texas Senate Finance Committee. TGF itself does not publicly reveal its rates of return – a surprising policy for a government-created fund whose officers are named by the governor and the majority of whose funds come from state employee pension funds. It is worth noting that TGF's 25.9 annual return from 1992 to 1997 outperforms the CalPERS U.S. Equities index (21.4 percent), CalPERS Total Equities index (18.8 percent) and CalPERS Custom 2500 index (21.5 percent).

## *Chapter 4*

# **TRADE DIPLOMACY WITH MEXICO**

### *Chapter contents:*

- Governor Davis' high-level focus on improving the state's relations with Mexico constitutes a sharp break from Governor Wilson's hard line on Mexico-related issues. Wilson's stance cost the state hundreds of millions of dollars in investment and thousands of jobs.
- Despite the sizable benefits of improved relations with Mexico, some pitfalls await. An example of misplaced goodwill is the Trade and Commerce Agency's policy of urging foreign manufacturers to install factories in Baja California – not north of the border. This policy should be re-evaluated because of Mexico's antidemocratic suppression of labor rights in the maquiladoras.
- As much as three-quarters of California's exports to Mexico are merely destined for assembly in the maquiladoras and immediate re-import to California. This "revolving door" process artificially inflates the real impact of Mexico trade on the California economy.
- Border infrastructure, especially transportation facilities and pollution cleanup, needs more attention and funding.

In many ways, Mexico is more important to California than any other nation. More than 8 million Mexicans or Mexican Americans live in California, and their presence has enriched the culture, politics and economics of the state at the same time as it ignites hot political debates over illegal immigration and related matters. Other issues such as drug trafficking, cross-border environmental issues and broad cultural ties – as well as the estimated \$28 billion in annual two-way trade and the billions more in cross-border investment – form a complex web of connections between the two neighbors.

However, eight years of Wilson administration policies undermined good relations with Mexico. Wilson gained domestic political advantage by taking a hard line against illegal immigration, bilingual education and other issues related to Mexico. These stands made him unpopular in Mexico and fostered a hostile image for California with that country's politicians, press, academia and general public.



It is hard to quantify how much California lost in exports of goods and services because of Mexican resentment. Comparable export statistics for individual states are unavailable.<sup>1</sup> But the Mexican government made little attempt to disguise its disapproval of Wilson.

The chill had a dramatic effect in Mexican direct investment in California, costing the state hundreds of millions of dollars and thousands of jobs. Mexican investors have shunned the state, sending their money to Mexico-friendly Texas instead. From 1992 to 1996 (the most recent year for which records are available), the value of Mexican-owned property, plant and equipment in California registered a net loss of 15 percent – from \$695 million to \$594 million – while the state’s total employment in Mexican-owned firms grew from 5,356 to 6,653 – a 24 percent increase. Meanwhile, Mexican-owned property, plant and equipment in Texas soared from \$614 million to \$997 million – a 62 percent increase – and employment jumped from 4,704 to 7,243 – a 54 percent increase.<sup>2</sup>

In his first few months in office, Davis has made a dramatic turnabout from the Wilson years, wooing Mexico and establishing good relationships with the Mexican federal and state governments. In addition to Davis himself, the new Mexico strategy has several high-placed supporters, such as Lieutenant Governor Cruz Bustamante, Assembly Speaker Antonio Villaraigosa and Senator Richard Polanco. Their logic is well-founded. In 1998, Mexico imported \$13.3 billion from California, rising from No. 3 among the state's export destinations to No. 2, outpacing Canada.

Quickly solidifying the new detente, the Davis administration exchanged high-profile trade missions with Mexican President Ernesto Zedillo, saying the diplomacy would bring lucrative new business for California. But some of the boosterism was overdone, in part by the Mexican government, which clearly wanted the new California-Mexico diplomacy to succeed. For example, Davis announced a deal with Teléfonos de México (Telmex), the Mexican telecommunications giant, to move from Houston to San Diego the headquarters of its U.S. joint venture with Sprint. Telmex Chairman Carlos Slim said the move would create a total of 600 new jobs for California, Telmex officials said. The Mexican presidency, which has long had a hand-in-glove relationship with Slim, helped hype the deal, bringing Slim and Davis together for maximum media exposure.

Away from the hoopla, company officials quietly admitted that all but 20 of the new California jobs would have been created without the headquarters move, that the company’s decision was based on economic factors alone and that the deal was under way before Davis took office.<sup>3</sup>

But despite the hyperbole, it is likely that the new diplomacy has not been in vain. The exchange of high-profile visits was undeniable evidence that the Mexican government is taking seriously its new alliance with California and expects it to produce important, concrete results.

Michael Flores, Davis' top aide for Mexican affairs, urges critics to be patient and take a long-term perspective. "We're in a process of establishing a good bilateral relationship, and out of that will come good business and good policy on lots of issues ranging from trade to education to culture," he said.<sup>4</sup>

"California can lead the nation by deepening its relationship with Mexico beyond just trade," said Raul Hinojosa, a newly named member of the state World Trade Commission and director of the North American Integration and Development Center at the University of California at Los Angeles. "Cooperation should take place on many levels, ranging from education to economic development planning to health and safety standards. ... No other state has such a deep social interrelationship with Mexico as California, village by village across the border, and we need to recognize this and take advantage of it."<sup>5</sup>

### **CROSS-BORDER LINKS**

On the border itself, however, bilateral cooperation is haphazard and disjointed. The Davis administration, Bustamante and Polanco have said that a top priority will be to improve regional cooperation. But they will find plenty of work to do. The capacity of cross-border organizations, both public and private, to deal with bilateral issues is surprisingly limited, given these issues' great importance. Existing organizations include the following:

- Cal/BECC, the Border Environmental Cooperation Committee. Formed in 1994, it brings together the governments of California, Baja California and Baja California Sur to help coordinate applications to the federal-level Border Environment Cooperation Commission and NADBank. Cal/BECC has been hindered by NADBank's slow rate of loan approvals. As of May 1999, NADBank had loaned or granted only \$2.1 million and channeled \$23.7 million in U.S. Environmental Protection Agency grants to California projects. Nevertheless, Cal/BECC remains California's most active example of cross-border economic cooperation and is a much-needed antidote to the severe environmental damage caused by unregulated industrialization on the border.
- Office on California-Mexico Affairs. A small office in San Diego with only two staff members, woefully understaffed to represent Sacramento on a wide range of economic, governmental, cultural and educational links. The Davis administration has proposed adding two more staff members to the office.
- The Commission of the Californias. Established in 1964 to promote economic, educational and cultural relations with the states of Baja California and Baja California Sur, and the rest of Mexico. It was mothballed in 1995.<sup>6</sup>
- Bi-State Transportation Technical Advisory Committee. A grouping of six southern and Baja California government agencies.
- San Diego Dialogue. A private coalition of government officials, leaders of major corporations, and the University of California at San Diego.
- At least 100 private organizations in the San Diego-Tijuana-Tecate area, ranging from medical associations to cultural, charity and religious groups.

Together, these groups are inadequate for coordinating and advancing cooperation between the 33 million people of California and the 92 million people of Mexico – the seventh and thirteenth largest economies in the world, respectively. The Wilson administration signaled that such cross-border links were a low priority, blocking funding for the Commission of the Californias. The Davis administration has taken initial steps with its Mexican counterparts to revive the commission.

**Policy recommendation: The state should use the reactivated Commission of the Californias to spur cross-border cooperation on a wide variety of levels, such as public health, the environment, education, law enforcement and industrial health and safety. The state should also encourage cross-border links between nongovernmental organizations.**

### **THE MAQUILADORA TRAP**

Since 1994, the Trade and Commerce Agency has pursued a strategy of participating in joint international trade missions with the Baja California state government, advertising to foreign investors the synergy of low maquiladora wages in Baja California with high technology in Alta California. Put your factory in Mexico – not in California – while putting your laboratories and corporate offices north of the border, the sales pitch says. As a result of this unusual promotion strategy, some maquiladora headquarters offices have opened on the U.S. side, providing white-collar jobs to Californians, while hundreds of thousands of blue-collar jobs have taken root in low-wage Mexico.

The fascination with maquiladoras has a superficial logic. Many state businesses undoubtedly benefit from trade with the booming maquiladora sector, and California officials are hoping for more: Under NAFTA, the so-called duty drawback programs, which allow manufacturers from non-NAFTA nations to recoup import duties on components imported to Mexico for assembly into products to be re-exported to the United States or Canada, will be eliminated on Jan. 1, 2001. The end of duty drawback will oblige Baja California's maquiladoras to sharply cut their imports of components from Asia, which now are estimated at \$4 billion annually. California politicians and manufacturers hope the state's manufacturers will substitute much of that amount.

Yet this logic may be faulty. Many Asian corporations are now busy building their own component factories in Mexico, leaving California with little likely benefit from the 2001 change. In addition, it is likely that California's exports to maquiladoras merely represent a "revolving door," in which the goods are sent across the Mexican border only to be immediately re-imported after assembly by low-wage labor, thus counting both as exports and imports when they really are neither.<sup>7</sup> Exactly how much falls under this category is unknown because the Trade and Commerce Agency fails to collect data on maquiladora-destined exports. However, it is likely that the state equals or exceeds the U.S. national norm, in which 73.2 percent of exports to Mexico go to its maquiladoras.<sup>8</sup> If this is true, California's real, job-producing exports to Mexico are only about \$3.6

billion annually, giving that country the very unimpressive ranking of 11<sup>th</sup> place among the state's trading partners, behind the Netherlands and just ahead of Australia.

In this context, it is debatable whether California's official infatuation with cooperation with Mexico's maquiladoras truly creates in-state jobs and business opportunities or simply transfers them south of the border.

Joint trade missions should also be re-evaluated in the context of Mexico's policy of keeping wages artificially low by violating labor rights that are enshrined in both Mexican law and international labor standards. A key example of this has been the dispute at Han Young, a maquiladora in Tijuana that makes truck trailer chassis for Hyundai. In two elections, the Han Young workers voted overwhelmingly to choose an independent union and negotiate a contract. But these elections have been repeatedly overruled by a hard-line alliance of company management, the Tijuana and Baja California governments (controlled by the conservative National Action Party, or PAN), the federal government (controlled by the long-ruling Institutional Revolutionary Party, or PRI), and corrupt, PRI-controlled "official" unions. If fully recognized, the union would be the first independent one among northern Mexico's 4,000 maquiladoras, which employ more than 1 million workers.<sup>9</sup>

In an in-depth study of the Han Young case released in April 1998, the U.S. Department of Labor concluded that repression of the company's union by the Mexican federal government and the Baja California state government "has raised questions about Mexico's enforcement of its labor law." The report added that in the Han Young case, the Mexican and Baja California governments appear to have violated NAFTA's labor side accord and International Labor Organization conventions signed by Mexico. The Department of Labor repeatedly criticized the Baja California state labor relations boards, which it said "have not been consistent and have not applied uniform criteria in adjudicating disputes between established unions aligned with the ruling party (PRI) and independent unions."<sup>10</sup>

The Han Young workers have been on strike since May 28, 1998, to demand recognition of their union. The Department of Labor has asked the Mexican government to stop the illegal offensive against the Han Young union; although Mexico is obliged to do so under the trade agreement, it has stonewalled. As of the writing of this report (May 1999), the Mexican federal and Baja California state governments were still filing spurious criminal charges against Han Young union leaders and refusing to compromise. President Clinton and Labor Secretary Alexis Herman have urged Mexican President Ernesto Zedillo to enforce his country's laws and resolve the standoff. The California governor and Legislature might also exert a positive influence.

"Governor Davis should not fall into the trap of embracing the maquiladoras, because he would become complicit in the violation of human rights," said Enrique Hernández, secretary-general of the Han Young union and co-president of the Baja California chapter of the Unión Nacional de Trabajadores, Mexico's nationwide federation of independent

unions. “We hope he uses his government's prestige to help encourage democratic conduct by his Mexican business partners.”<sup>11</sup>

The lack of full democracy in Mexico acts indirectly to lower wages among Mexican workers and also, more indirectly, to lower them among California workers. With maquiladora wages in Baja California averaging only \$5 per day, U.S. factory managers can easily use the threat of moving facilities to Mexico to coerce their workers to forgo wage raises or unionization. While Mexico's repression of workers may be of little worry to California corporations, it is one of the most important trade-related issues for California workers. Little surprise, then, that state labor unions' overall support for international trade – especially regarding other nations that are even more repressive than Mexico – is merely lukewarm. In order for California unions and their supporters to support a trade agenda, Mexico's maquiladora sector must move in the direction of more democratic practices.

**Policy recommendation: The governor and Legislature should seek appropriate channels to urge the Mexican federal government and the Baja California state government to respect democratic labor rights in the maquiladora sector, in accordance with Mexican law, the NAFTA labor side accord and International Labor Organization conventions. Until there is reasonable compliance with these standards, California should suspend participation with Baja California in joint foreign trade missions.**

Despite objections about the seamy side of Mexico's maquiladora system, national and international economic trends will inevitably increase competitive pressures on California's low-wage manufacturing sectors. “We cannot hope to keep low-value-added production in the United States,” Hinojosa said. “As a result, there's a major crisis looming on the horizon. What are we going to do with this huge Latino labor force that has been brought to the state over the past 25 years or so to work in low-wage manufacturing in Southern California, but which now finds that because of the incredible competition from Mexico and Asia, that kind of manufacturing is unviable here? ... We must adopt a conscious strategy to upgrade, to recognize the inevitability of job loss and to make sure jobs are created for those people.”

Hinojosa suggests a policy combining thorough job training tied to new industries, support for emerging business clusters, and stimulus for ethnic-based, informal international financing networks.<sup>12</sup>

**Policy recommendation: State authorities must develop a comprehensive, high-road policy to help revamp Southern California's manufacturing sectors and ensure well-paying jobs for workers displaced by competition from Mexican maquiladoras and other low-cost international producers.**

## COOPERATION AND INFRASTRUCTURE

Another necessary factor in gaining public support for trade is to ensure that California's cross-border cooperation organizations are broadly based, with representation from all stakeholders in international trade. They must not be dominated by U.S. corporate interests to the exclusion of small, minority- and women-owned businesses, labor unions, environmental groups and community interests. Nor should they reflexively defend the interests of Mexico's most powerful interest groups, such as maquiladora owners.

**Policy recommendation: All cross-border cooperation organizations should be as broadly based as possible, reflecting a wide range of stakeholders in trade issues.**

Infrastructure is another problem that most analysts and business leaders say requires a greater level of bipartisan attention from Sacramento than existed during the Wilson years.<sup>13</sup>

The long delays in arranging financing for highway and railroad construction of three main border cargo crossings – State Routes 905 and 7, at Otay Mesa and Calexico, respectively, and the San Diego and Arizona Eastern Railway – have seriously hindered growth in trade with Mexico. Yet when infrastructure projects are fully funded, care must be given to ensure that they benefit all sectors of the population. For example, the \$1.9 billion Alameda Corridor project in Los Angeles has been slowed by opposition from local minority and small-business groups, who charge that the new rail and truck system will merely benefit large corporations. (For details, see Appendix D.) But Wilson vetoed a bill to address the problem – SB 1742, the Alameda Corridor Cities Economic and Community Development Act, authored by Senator Betty Karnette, D-Long Beach. The bill would have required the Trade and Commerce Agency to lead a broad-based planning process to develop a strategic plan for the Alameda Corridor region.

**Policy recommendation: The state should provide funding to CalTrans to help fill the funding gaps for construction and repair of State Route 905 and the San Diego and Arizona Eastern Railway. Also needed is more effective state lobbying for Mexican enforcement of its environmental laws and for further NADBank funding of Mexican waste treatment facilities. On infrastructure projects such as the Alameda Corridor, the state should seek ways of ensuring that small businesses share the economic benefits. For this reason, SB 1742 should be reconsidered.**

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## ENDNOTES

<sup>1</sup> The most widely used state export statistics are those of the Massachusetts Institute of Social and Economic Research at the University of Massachusetts at Amherst, known as MISER. But many trade experts say the MISER statistics of California and Texas are not

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comparable because the Mexico border ports of Texas serve key shipping corridors for other states (including California), while California's ports mainly serve California shipments. See Jock O'Connell, "California's New Latin American Trade Strategy Based on Flawed Data," *Sacramento Bee* (March 7, 1999), p. FO1.

<sup>2</sup> Data provided to the author by the Bureau of Economic Analysis at the U.S. Department of Commerce.

<sup>3</sup> Robert Collier, "Slumping Asian Trade Takes Sparkle Off State Economy," *San Francisco Chronicle* (March 18, 1999), p. A1.

<sup>4</sup> Telephone interview, March 17, 1999.

<sup>5</sup> Interview, May 19, 1999.

<sup>6</sup> The last meeting of the Commission of the Californias was held in 1994 in San Diego. Costs of the meeting were entirely paid by corporate sponsors because the California government provided no funds. The commission's next scheduled meeting in 1995 in Baja California Sur was postponed because of hurricane damage; because of official disinterest, the commission has virtually ceased to exist since then.

<sup>7</sup> Harley Shaiken, memo to U.S. Representatives Richard Gephardt and David Bonior, June 23, 1997. A similar analysis was made by San Diego Dialogue, a cross-border alliance of business, government and university representatives: "There is no economic data available at this time on the 'Gross Regional Product' of San Diego/Tijuana. Much of the region's trade is internal to the region; Sony and Samsung import television componentry through LAX, truck it across the border at Otay Mesa to Tijuana factories and install it in television sets that are then returned to the United States for sale. Componentry comes in through LAX as an import, goes out through Otay as an export and returns through Otay as part of an import." *San Diego Dialogue Report*, "Debate on Brown Field Will Shape San Diego's Air Cargo Future" (January 1999), p. 5.

<sup>8</sup> The Mexico-U.S. figure is calculated from data compiled by the Mexican government's Instituto Nacional de Estadística, Geografía e Informática (INEGI). For an overall analysis, see Jock O'Connell, "The Mexican Economy That California Really Trades With," *Los Angeles Times* (May 16, 1999), p. M6.

<sup>9</sup> In 1996, after much pressure from the U.S. government, the Mexican federal government and the Sonora state government gave legal status to an independent union at the Maxi-Switch maquiladora in the northern town of Cananea, which made Nintendo video games. But the agreement soon proved to be worthless, as the Mexican officials reneged on their agreement to oblige the factory owners to abide by Mexican law and rescind their firing of the union's entire leadership. As a result, the union leaders cannot enter the factory, the union remains crushed despite a certified union election vote, and enforcement of Mexican labor law remains deeply influenced by partisan interests of the PRI.

<sup>10</sup> U.S. Department of Labor/National Administrative Office, *Public Report of Review of NAO Submission No. 9702* (Washington, D.C.: April 28, 1998).

<sup>11</sup> Interview, March 13, 1999.

<sup>12</sup> Interview, May 19, 1999.

<sup>13</sup> On lobbying for border infrastructure projects, Wilson did "absolutely nothing to help get the funding we need," said Representative Bob Filner, D-San Diego, who was a major player in the state Congressional delegation's successful 1998 negotiations with

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other legislators and the Clinton administration to get \$700 million for a border transportation project fund. “I ... found the governor and his people professionally inept and politically naive,” Filner said. “On the transportation bill, we were fighting for a fair share of the money in a bipartisan way, and the governor was ... vilifying the whole process. It almost cost us a lot of money.” Telephone interview, September 11, 1998.



## *Chapter 5*

# ***CALIFORNIA'S EDGE – ENVIRONMENTAL TECH***

### ***Chapter contents:***

- Wind power is an example of the many renewable energy technologies that rely on the California Energy Commission's highly successful export programs.
- How to do it: The Energy Commission helped Zond Corp. win a contract to put windmills on the Greek island of Crete.
- Green business is big business, and California leads the world.
- The state government's work to help create international environmental standards for industry holds great promise for creating markets for California technologies and for protecting the environment. But plenty of pitfalls await, and policymakers must carefully analyze all available multilateral mechanisms to ensure that standards are raised, not lowered, and are based on performance rather than mere procedure.

Since the late 1970s, California has been the world leader in renewable (non-fossil-fuel) energy technologies – especially wind, solar, hydro, geothermal and natural gas cogeneration. Much credit is due to the state government, which together with the U.S. Energy Department and private firms has cooperatively spearheaded development of these new, environmentally advanced industries. The California Energy Commission and similar programs of Cal-EPA for environmental technologies are viewed by many experts as models for what could be an overall state policy to promote other high-value-added "appropriate technologies."

In recent years, the Energy Commission has spent tens of millions of dollars annually on research and development; now, in a special grant authorized under the state's move to deregulate electricity markets, it is receiving an additional \$540 million over four years.<sup>1</sup>

The commission has also played a crucial role in helping state renewable-energy firms get into exporting. Although it is unclear how much of the new funding will go to export programs, the commission's current level of about \$850,000 annually will increase markedly.

One example of this cooperative role started in July 1993, when the Energy Commission hosted a trade mission from Greece. Commission officials showed the Greek government and corporate leaders around California and tried to drum up export deals for local energy companies. It was the sort of "reverse trade mission" that the Energy Commission and the Trade and Commerce Agency host nearly 40 times per year. The commission's work has become well known in international energy-industry circles, so when the Greeks arrived in California, they were consciously looking to state officials for some answers to their problems.

Jim Mitchell, president of Princeton Development Corp., a small Sacramento-based energy consulting firm, met with the Greeks and got a bright idea. Among the visitors was a top official of the provincial government of Crete, Greece's largest island, who told him of the island's situation – total dependence on imported oil, with a sharp increase in energy demand during the summer tourist season, and incessant wind blowing off the Mediterranean.

"It was clear that there was an opportunity to do a miniature of California there," said Mitchell, referring to the state's then-No. 1 position worldwide as wind energy generator (it has since slipped to No. 2, behind Germany).

So Mitchell went to the Energy Commission, which had helped him on earlier energy efficiency projects within the state. The commission gave Princeton a \$25,000 repayable grant for "market development" – one of 10 it gives annually – which covered the costs of an extended trip to Crete, where Mitchell met with top Crete officials and researched potential sites. He joined with Zond Corp., a Kern County-based wind power firm (which was subsequently bought out by Enron Corp., the Houston-based energy giant), to draw up a proposal for a series of wind power plants. Despite tough competition from European firms, Princeton and Zond won a 10-year, \$30 million contract with the state-owned Greek Public Power Co. to build and operate two plants producing 15 megawatts. Princeton repaid the Energy Commission for the grant, but much more important was the deal's generation of \$12 million in exports for Zond, supporting dozens of well-paying jobs at the firm's headquarters and factory in Tehachapi.

"This (grant from the Energy Commission) was a very good example how seed money is so important to help generate export deals," said Mitchell. "While the money wasn't a substitute for our own sweat equity, it helped focus our attention on the export market, and really helped facilitate things and give us credibility. The Greeks saw that we weren't just an individual entrepreneur but had the backing of the California government. ... So it really opened doors for us with the (Crete) governor and other parts of the government there."

The plants now are under construction and are scheduled to be online by May 1999. Princeton expects to win further contracts to build 150 megawatts of wind-power plants on Crete. And after receiving two more Energy Commission grants, it won a similar contract on nearby Andros Island and is competing for another on the Turkish mainland.

“In Homer’s *Odyssey* it says that those sites were windy, and they’re still windy now, so you know these are good investments long-term,” joked Mitchell.

In all these dealings, Princeton faced competition from Danish and German firms, whose governments gave them extensive aid for R&D and market development. “Americans who think that our companies should do everything on their own dime need to realize that internationally, U.S. firms are competing in very different systems from our own,” Mitchell said. “European and Japanese companies have a lot more export support from their governments. We need to have the support of ours.”

## **INTERNATIONAL STANDARDS = CALIFORNIA PROFITS**

Much like the Energy Commission's work spearheading the growth of renewable energy technologies, Cal-EPA has had an important role in helping develop other environmental technologies such as waste management and remediation, water and air purification, recycling, engineering services, pesticide management, and instruments for measuring and control. In these industries, California firms are No. 1 worldwide, leading the pack in innovation, production and marketing. They are expected to grow rapidly in coming years, but they will have to work hard to fend off the growing foreign competition. For now, they are winners. Whether they will continue to be is an open question. The outcome will depend in large part on the state's policies.

Reliable statistics on environmental technologies in California are hard to come by. Dividing lines between what is "environmental" technology and what is not have become blurred in recent years because many large industrial firms use (and create) environmental standards in their everyday business activities. According to one recent study, environmental technologies employ more than 160,000 Californians and generate \$22 billion in annual sales and \$1.5 billion in exports.<sup>2</sup> What's more, the jobs created in these industries are well paying. A recent survey of state environmental firms showed average wages of \$42,600 per year for their employees.<sup>3</sup>

However, California exporters face growing competition in these fields from European and Japanese firms, which receive much more support from their governments than California firms get from their own. In biomass power generation, for example, European companies have taken the lead.

California firms must also navigate skillfully through the changes in domestic and international markets, which are moving away from pollution cleanup and toward

pollution prevention. From the developed nations of Europe to the developing nations of East Asia and Latin America, corporations and governments are demanding new materials, equipment and production processes that both reduce pollution and improve profits.

**Policy recommendation: Continue existing funding for Energy Commission and Cal-EPA export promotion and R&D programs. Included in these programs must be close monitoring of electricity deregulation's possible negative impact on California firms' ability to stay at the forefront of world competitiveness and environmental leadership.**

Another difficulty for California firms is that the state environmental regulatory system is extremely decentralized, with hundreds of separate regulatory districts, such as air quality and water boards. The result is a fragmented local marketplace in which state firms must obtain approval from authorities of each district in which the product will be sold. Environmental technology business owners have complained loudly that this lack of common standards puts them at a disadvantage against firms from countries with more uniform regulatory systems – that is, nearly all foreign firms. In recent years, the Wilson administration tried to persuade state districts to harmonize their standards. But Wilson failed to make much headway because of opposition from environmentalists and local government officials, many of whom accused Wilson of using the move as a backhanded way to weaken standards to the lowest common denominator rather than trying to raise them to a higher uniform level.

**Policy recommendation: Where possible, encourage regulatory districts to harmonize their standards upward to a higher common denominator rather than downward to a lower one. Simultaneously, however, the state must respect local governments' sovereign right and duty to enact nonconforming regulations and laws that address local needs and conditions.**

In perhaps its most innovative work for boosting exports, the state is carrying out a three-pronged effort to help create multilateral environmental standards for industry. Some of this pathbreaking work has partly failed because of the inevitable problems of world environmental diplomacy, but experts say it offers excellent possibilities – and big potential pitfalls – for the medium and long terms if it is decisively renewed by the state's new governor. The initiatives include the following:

**ISO 14000.** In early 1998, Cal-EPA and government agencies and universities from more than a dozen other U.S. states started several pilot projects to study the possibility of adopting the ISO 14000 environmental management systems – or some variant thereof – as a partial substitute or supplement for state standards. ISO 14000 is a series of benchmarks developed by the International Organization for Standardization, the Geneva-based, 100-nation, private-sector group that sets common sizing and quality standards for international commerce.<sup>4</sup>

The ISO has many critics, however. On the right, some conservatives distrust it as yet another example of “world government,” while some on the left note that the ISO 14000 series concentrates on management practices rather than results, and relies on management self-enforcement rather than external monitoring. These latter critics also note that ISO offers no participation by environmental or consumer groups in its own internal policymaking.

In addition, some experts say ISO 14000 is displacing a superior system common in European industrial regulatory systems – the Environmental Management and Auditing System. “ISO is a procedure-based standard rather than performance-based,” said Gil Friend, president of Gil Friend & Associates, a Berkeley-based environmental technology consulting firm. “It’s the wrong direction. It creates more bureaucracy without helping the environment. What’s needed is to set and enforce environmental standards for industry, and then give companies the leeway to figure out how they’re going to comply with them. Instead, ISO tells industry how they should do it without telling them what the final results should be.”<sup>5</sup>

Other experts say the jury is still out. “ISO 14000 is very tricky,” said Naomi Roht-Arriaza, a professor at the University of California’s Hastings School of Law. “It could put the foxes in charge of the henhouse, leaving industry to regulate itself. Or it could help companies save a lot of money while keeping the same results (of environmental protection). But whether or not this particular standard goes anywhere, there’s a general movement from command-and-control standards to ones that involve a cooperative relationship with industry.”<sup>6</sup>

**Cooperation between U.S. states.** Founded in 1995, the Interstate Technology and Regulatory Cooperation Work Group is a coalition of environmental regulatory agencies from seven states that works cooperatively with federal agencies and stakeholders to standardize environmental technology licensing among the states and thus to aid the development and commercialization of these technologies.<sup>7</sup> The project explicitly seeks to maintain high standards, viewing them not as a market hindrance but as a comparative advantage.

**International standards.** Separately from the ISO project, Cal-EPA and the Trade and Commerce Agency are consulting with several foreign governments to promote the creation and adoption of international environmental standards for industry. However, this work has been slowed by a questionable choice of foreign participants. Five of the eight governments chosen for the project – Mexico, Indonesia, Brazil, China and Thailand – also have fought hard to prevent the introduction of environmental or labor issues in international trade negotiations,<sup>8</sup> so it is no surprise that they have dragged their feet on the California initiative.

“Those countries actually are very interested in environmental technology, but they’ve got a hide-the-ball attitude – they don’t want to admit to anyone on the outside that they have any problem with pollution,” said one Cal-EPA official who asked not to be

identified. "They recognize that we're leaders in a lot of the technology, but they shy away from any external standards."<sup>9</sup>

Some insiders also say that the mid-level state officials who have spearheaded the program were not given the high-level diplomatic backing from the Wilson administration that was needed to strengthen California's position at the negotiating table. As always in international diplomacy, protocol and the appearance of having the full support of the chief executive are key elements to achieving success. Without them, little can be achieved.

Despite the diplomatic difficulties – or in part because of them – it would be in the state's interest to unite these three efforts into one high-profile, coordinated campaign. Economically, such a strategy could be very profitable. If international environmental standards were adopted, developing nations would probably need to spend huge amounts of money importing the new technology from California in order to comply. The state's firms could reap a bonanza, and so could the world's environment.

The state's own environment could also benefit indirectly. The creation of minimum international benchmarks would help brake the international “race to the bottom” between governments eager to weaken their own enforcement of environmental laws in order to attract and retain investment by corporate polluters. By slowing this mutually destructive race, the new standards could reduce the downward pressure on California and other states and give them more leeway to strengthen their own environmental protections.

**Policy recommendation: A panel of experts from the public and private sectors, including nongovernmental environmental groups, should be appointed as a subcommittee of the new Economic Advisory Council to coordinate and oversee domestic and international environmental standards work. Emphasis must be placed on maintaining or improving environmental results, without undermining California's high levels of protection, while streamlining the regulatory process whenever possible.**

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## ENDNOTES

<sup>1</sup> Many industry experts warn that deregulation may create a “monoculture” of highly efficient gas powered plants and may doom solar and biomass power, which trail wind power technology in efficiency and are not yet fully competitive. Although the wind power industry is likely to survive on its own after the one-time \$540 million R&D program expires, solar and biomass will need continued – although reduced – levels of government development aid.

<sup>2</sup> Trade and Commerce Agency Web site, "NAFTA Case Study: Environmental Technology," at <http://commerce.ca.gov/international/nafta/environm.html>

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<sup>3</sup> *ibid.*

<sup>4</sup> The ISO 14000 series, which was unveiled in 1996, is used by many corporations in Japan and other East Asian countries, and by some large firms in Europe and the United States. However, its acceptance in Asia may be diminished by corporate cost-cutting amid the region's current economic crisis. For more information on Cal-EPA's pilot programs, see: California Environmental Protection Agency, *White Paper: ISO 14001 Environmental Management System Pilot Study* (Sacramento, 1998).

<sup>5</sup> Telephone interview, July 6, 1998.

<sup>6</sup> Telephone interview, August 18, 1998.

<sup>7</sup> Participating states are California, Illinois, Massachusetts, New Jersey, Pennsylvania, Ohio and Texas.

<sup>8</sup> These governments have led the successful resistance against attempts by the United States, Canada and several European nations to include environmental and labor protections in the World Trade Organization, the Asia Pacific Economic Cooperation pact, as well as the proposed Free Trade Agreement of the Americas and the Multilateral Agreement on Investment. The opponents of such standards argue that social concerns are extraneous to international trade and are merely disguised forms of First World protectionism; proponents say the standards are necessary to prevent continued abuse of labor rights and worsening environmental conditions.

<sup>9</sup> Telephone interview, May 8, 1998.

## *Chapter 6*

# ***CALIFORNIA AS FOREIGN INVESTOR***

### ***Chapter contents:***

- California's role as a multibillion-dollar participant in the global marketplace – as investor and purchaser – occasionally conflicts with the interests of the state's workers and consumers.
- States and cities across the nation are addressing this problem by using their pension funds, treasury investments and procurement practices to promote in-state jobs and businesses and to induce foreign competitors to agree to base standards for corporate conduct.
- “Economically targeted investment” strategies often outperform orthodox portfolio investments, and help create private-sector jobs.
- Recent initiatives to create international corporate codes of conduct offer practical lessons for enforcement of state investment standards.

As international free-trade agreements proliferate and California's economy increasingly merges with world markets, the state's businesses, workers and consumers find themselves competing directly with nations that have notoriously lax labor and environmental standards. Some of those nations' governments are outright dictatorships, such as China, Burma and Vietnam, while many others are far less than fully democratic. So when Americans look at free trade, they often see foul play – child labor and forced labor used widely, independent unions smashed, forests put to the blade without even the pretense of sustainable yield practices, factory pollution spewed on local communities, and protesters jailed and even killed.<sup>1</sup> In these conditions, trade appears as an uneven playing field on which Americans must obey rigorous rules of conduct that are flouted by many of their opponents. No wonder free trade gets a bad name in the United States.

However, the California government is no passive bystander. In fact, it has a contradictory role in the international marketplace – both as part owner of many foreign firms that take advantage of these unequal conditions and as defender of the state's 33 million workers and consumers. The state is one of the world's largest institutional investors, with \$280 billion in stocks, bonds and real estate, about one-fifth of which are foreign holdings.<sup>2</sup> The two state employee pension funds, California Public Employees'



Retirement System (CalPERS) and California State Teachers' Retirement System (STRS), own large chunks of foreign corporations that have been roundly criticized for their environmental and human-rights abuses and compete directly with California firms – for example, MacMillan Bloedel Ltd., Itochu Oil Exploration Co., Hyundai Motor Co., Royal Dutch Petroleum, Broken Hill Proprietary Co. and Mitsubishi Heavy Industries.<sup>3</sup>

“It makes no sense for the state to be investing in firms that harm the interests of the state’s people,” said James Nixon, vice-president of Progressive Asset Management, Inc., an Oakland-based investment firm with \$500 million in accounts that are screened to eliminate firms violating environmental and human-rights standards. “That’s not only having the left hand and the right hand fighting each other, but it’s a direct violation of the government’s obligation to its citizens.”<sup>4</sup>

Although the state is the biggest such institution with a dual role, it is by no means alone. Across North America, a broad movement has begun to coalesce behind the search for ways to address the problem. State, provincial and municipal governments, as well as institutional and individual investors, are finding new ways to use the power of the marketplace to impose new, progressive standards on trade and investment. To be sure, this movement – known as socially responsible investment – is in its early stages. It lacks common benchmarks, strategy, tactics and coordination. But important legal, financial and political precedents have been set by local governments in the United States and Canada. California now has a unique opportunity to use its economic and political influence to take a leadership position on the cutting edge of this movement.

## **PROGRESSIVE PROFITS**

Over the past decade, “economically targeted investment” (ETI) and “socially responsible investment” (SRI) criteria have been gradually adopted by pension funds and institutional investors nationwide. Once derided by Wall Street analysts as fuzzy-minded philanthropy, such criteria are gaining respect as solid money-makers. More than \$1.2 trillion is now invested with some sort of socially targeted goals – 20 percent of total internal U.S. institutional tax-exempt assets.<sup>5</sup> The number of mutual funds managed under social criteria has nearly tripled over the past two years to 144, even managed by such old-guard Wall Street giants as Solomon Smith Barney.

The two acronyms, ETI and SRI, are often confused in public debate. Economists usually refer to ETI as investments that address economic-development goals and offer competitive rates of return, while SRI is often interpreted as quasi-charitable investments that offer below-average returns. However, the division between the two terms has blurred in recent years because of SRI successes in offering market-rate returns. This financial success opens broad policy opportunities for state and local governments.

Many SRI funds have dramatically disproved critics’ predictions that they would be less profitable than non-screened firms and thus would fail to obey fund managers’ fiduciary responsibility to maximize returns. In fact, they have proved that social concerns can be

extremely profitable. For example, the Domini 400 Social Index – which excludes companies that derive revenues from areas such as tobacco, gambling or nuclear power plants or that have been widely accused of environmental or labor abuses – returned an annualized 26.45 percent in the five years ending March 31, 1999, outpacing the S&P 500 return of 26.22 percent. About one-half of the largest 1,000 publicly traded U.S. companies meet most socially responsible mutual funds' criteria. The funds' *modus operandi* also varies, with some divesting totally from the screened companies, and others taking a more cautious posture of retaining their shares in the firms in order to submit shareholder resolutions that urge management to reform their business practices.

In recent years, governments in California and elsewhere have adapted ETI and SRI tactics to their own goals, taking precedent-setting steps to use investment power to advance their constituents' interests:

- **Nazi gold.** A dramatic victory for California investment activism. In 1998, Switzerland's two largest banks ceded to pressure from California, New York and other U.S. states and municipalities by agreeing to pay Holocaust survivors and the relatives of Holocaust victims \$1.25 billion in damages. With bipartisan support, State Treasurer Matt Fong had barred the banks from bidding on bond offerings from the state treasury's \$32 billion Pooled Money Investment Account because of the banks' role in profiting on gold stolen from Holocaust victims by the Nazis. The treasurer's move – California's most aggressive foreign-policy stance since it placed sanctions on South Africa's apartheid regime in 1986 – was opposed by the U.S. State Department and by the Swiss government, which suggested that the sanctions violated the World Trade Organization's Government Procurement Agreement.<sup>6</sup>
- **Holocaust insurance claims.** In 1998, Governor Wilson signed legislation that orders the state Department of Insurance to research unpaid claims against insurance companies by relatives of Holocaust victims and to revoke the California business license of any insurance firm that refuses to pay a valid claim. The bills, SB 1530, was authored by Senator Tom Hayden, D-Los Angeles. In 1999, legislation introduced by Assemblyman Wally Knox, D-Los Angeles, would crack down further by requiring all insurance companies to disclose a list of their European, Holocaust-era policies. The bill, AB 600, is similar to a bill that was vetoed by Wilson in 1998.<sup>7</sup>
- **San Francisco.** Since mid-1998, City Treasurer Susan Leal has been working with Public Investing Consulting Service (PICS), a San Francisco-based firm formed by Trillium Asset Management Corp., on a broad review of the city treasury's \$9 billion in investments. PICS is designing an investment strategy to eliminate any conflict with the city's progressive values regarding foreign sweatshops, environmental practices, low-income community lending and tobacco.
- **California city funds.** A coalition of local officials from 11 California cities and counties, Elected Officials for Responsible Public Investment, is urging the State Treasurer's Office to adopt social investment criteria for its \$13.4 billion Local Agency Investment Fund, which contains treasury accounts from cities, counties and special districts across the state.<sup>8</sup>

- **Tobacco.** Massachusetts, Florida, New York, Minnesota, Maryland, Pennsylvania and Vermont have sharply restricted their state treasury and/or pension fund investment in tobacco companies and are gradually divesting from tobacco securities. In each case, the state legislatures acted because of growing public outrage over the health-care costs and death toll from smoking, as well as tobacco companies' marketing policies and their long record of duplicitous behavior. State officials supported this grass-roots pressure with two financial arguments: that tobacco securities have become unacceptably risky because of the barrage of lawsuits and legislation; and that the states were damaging their own economic interests by investing in tobacco securities at the same time that the state governments were participating in legal action against the companies.<sup>9</sup> A growing number of local governments also have moved to divest from tobacco – San Francisco, Oakland, Richmond, El Cerrito, Santa Cruz, Santa Monica, Arcata and Alameda County, as well as Boston, Denver, Philadelphia and Pittsburgh, among others.
- **Canada.** In April 1998, major Canadian corporations reached agreement with the country's labor unions and non-governmental organizations to work together in creating a code of conduct on human-rights issues and in lobbying the government to create a task force. The agreement was the result of a comprehensive, three-year campaign by Canadian unions, using their \$225 billion (U.S.) in pension funds to support shareholders' resolutions on social concerns.
- **AFL-CIO.** In 1998, the labor federation formed the Center for Working Capital, a think tank to educate and coordinate U.S. union pension funds in voting on progressive shareholder resolutions. AFL-CIO officials say they hope all unions will follow the example of the center – and of the few unions that have begun shareholder social activism, such as the United Steelworkers of America, the United Auto Workers, the Service Employees International Union and UNITE – in adopting ETI criteria.

Two barriers have blocked progress toward a new California investment strategy. One was official resistance from the Wilson administration. State Treasurer Matt Fong opposed requests by Elected Officials for Responsible Public Investment to have the Local Agency Investment Fund adopt broader social criteria, saying such a change would violate state laws on fiduciary responsibility. However, Fong's decisive stance on the Nazi gold issue set a clear precedent for adopting such a strategy. The difference, it seems, is the level of political pressure, which in the Nazi gold case was considerable. As of the time of writing of this report, the Davis administration and the State Treasurer's Office had not publicly defined their positions on the above investment issues.

## STATE PENSION FUNDS

Another barrier to developing a broader strategy is opposition by the managers of the state's two pension funds, CalPERS and STRS, which have assets of \$150 billion and \$95 billion, respectively. These funds – especially CalPERS, which is the more innovative and high-profile of the two – have a complex position that is often poorly understood by the public. They are influential advocates of a narrowly defined ETI

strategy but energetically fight attempts to introduce broader ETI issues – what fund officials disparage as a “social agenda” – in their portfolio management decisions.

The funds are politically powerful yet have come under fire in recent years, with mild criticism from the left and heavy attack from the right. Liberal critics say CalPERS has not done enough to establish ethical standards on its investments or to protect California jobs; conservatives say even CalPERS' limited investor activism is too much. Republican lawmakers in Sacramento and Washington have frontally attacked the funds, withholding hundreds of millions of dollars in payments and attempting to pass legislation to eviscerate the funds.

Conservatives bristle at CalPERS' advocacy of “corporate governance reform,” under which shareholders closely oversee corporate managers' performance and ensure that corporate boards of directors are strong and independent of management. The pension fund also is a nationwide leader in limited forms of ETI, such as buying home mortgages packaged by banks as FNMA or GNMA securities. In addition, CalPERS' Responsible Contractor Policy, adopted in 1994, tacitly encourages unionization for workers employed by the fund's contractors and subcontractors.

At the same time, however, CalPERS and STRS have drawn a deep line in the sand, campaigning vocally against strategies that seek to impose more explicit social or economic-development goals. In 1998, for example, they were instrumental in stopping three bills – AB 1679, sponsored by Assemblyman Don Perata, D-Oakland; AB 1744, sponsored by Knox; and SB 1433, sponsored by Hayden – that would have obliged the funds to gradually divest their \$1.8 billion in tobacco holdings.

Although CalPERS and STRS officials say divestment of tobacco stocks would reduce the funds' returns, their main objection is political. They argue that any use of social criteria would set a clear precedent, reducing the fund managers' control over investment strategy. “This is not about tobacco,” said Charles Valdes, vice-president of the CalPERS Board of Administration and chair of the Investment Committee. Tobacco divestment, he said, would put the funds on a “slippery slope” leading to the introduction of other issues. “We can't pick and choose investments based on social or political bases. If tobacco now, what next?”<sup>10</sup>

CalPERS managers' opposition to social issues even extends to shareholder resolutions on issues that, by any measure, would have no adverse fiduciary implications. For example, at the May 20, 1998, shareholders meeting of Maxxam Corp., CalPERS voted against a nonbinding shareholder resolution that would have simply asked the company to study the feasibility of ending old-growth logging of the Headwaters Forest and adopting ecologically sustainable forestry practices.<sup>11</sup> In 1986, CalPERS and STRS unsuccessfully opposed the South Africa Disinvestment Act, which was approved by the Legislature to restrict the funds' investments in companies doing business in South Africa. The bill was one of 185 such laws enacted by local governments across the United States against South Africa's white-ruled, apartheid regime.<sup>12</sup> The laws are widely viewed as having been a major cause of the overthrow of apartheid and the democratic

election of President Nelson Mandela in 1994 – providing eloquent proof of just how powerful local governments can be when they join progressive principles to their clout in the marketplace.

CalPERS and STRS managers' adherence to orthodox, Wall Street-style stock-index investment strategies also gives short shrift to California's own economy. Despite attempts by Controller Kathleen Connell and Treasurer Phil Angelides and other CalPERS and STRS board members to increase the funds' share of investments in California businesses, the funds hold about 21 percent of their portfolios – more than \$50 billion – in foreign markets. In contrast, only 11 percent is invested in California firms.

By comparison, California represents 12 percent of the U.S. Gross Domestic Product, so both funds are underweighted in the state – a strange strategy for public funds. Connell and Angelides have argued that the overweighting of foreign firms relative to California firms in the CalPERS and STRS portfolios prevents needed capital from going to profitable California firms that create in-state jobs. These critics say that the funds could increase their California investments while maintaining proper fiduciary attention to return, risk and liquidity.<sup>13</sup>

“Investment is needed in emerging markets in California, ... not just in Indonesia or other foreign emerging markets,” said Deputy Treasurer Michael Picker.

“If you look at the state across the board, portions are still in deep recession,” Picker said. “Mariposa County has 16 percent unemployment, and some urban neighborhoods are also in bad shape. ... Lots of these areas that aren't Silicon Valley or West Los Angeles could develop thriving industries if they had the same access to investment capital as foreign emerging markets.”<sup>14</sup>

Such ideas are looked upon with skepticism by William Crist, president of the CalPERS Board of Administration, who has become a highly influential advocate for the fund's philosophy on the state and national level. “I will fight any and all attempts to force us to carry out investments for social reasons,” he said. “I've got a million members out there, and my only responsibility is to keep the fund on firm ground.”<sup>15</sup>

Crist notes that CalPERS has excellent relations with the state's labor unions, despite unions' recent insistence that pension funds take a more activist stance on issues such as Headwaters. In fact, Crist and Valdes are union leaders themselves. Crist is a member of the Board of Directors of the California Faculty Association and is president of its Political Action Committee, and Valdes is a member of the International Executive Board of the Service Employees International Union.

But Crist accurately points out that the fund's caution has protected it from attacks by conservatives in Sacramento and Washington. For example, Crist played a key role in helping defeat a 1995 Republican campaign in Congress against economically targeted investments. In that battle, conservatives backed by major banks and investment firms passed a resolution in the House of Representatives to restrict the U.S. Labor

Department’s advocacy of ETI strategies. However, the resolution died in the Senate. The following year, Republicans in the California Legislature nearly succeeded in passing a bill that would have created a “portable retirement plan” that would have allowed the creation of private, 401(k)-type funds – essentially the partial privatization of CalPERS and STRS.<sup>16</sup>

For its part, the Wilson administration saw the funds as cash cows. During the 1992-94 budget crisis, Wilson failed to pay CalPERS \$910 million in government worker pension contributions, instead using the money illegally to reduce the state’s budget deficit. In 1997, CalPERS finally won a hard-fought legal fight over the issue when a state appeals court ordered Wilson to repay the money with interest.

Amid the growing debate over pension fund investments, the catch is whether ETI investment policies reduce the funds’ returns. If divestment or other socially motivated actions reduces a pension fund's returns in the medium and long term, such actions are prohibited under the California Constitution's provisions regarding state pension funds and under federal ERISA rules.<sup>17</sup> If there is no negative impact, such policies are permitted. Experts have failed to reach a clear consensus on what the impact is, leading to confusion and plenty of heated rhetoric. (For details, see Appendix E.)

The U.S. Department of Labor, however, has lent its support to the pension-fund activists. It issued a policy declaration refuting criticism of ETI strategies, stating that they are consistent with ERISA if they produce returns equal to or greater than other available investments.<sup>18</sup> In a comprehensive analysis of the department's stand and recent court decisions, University of California at Berkeley labor policy specialists Kirsten Snow Spalding and Matthew Kramer concluded that the opportunity for pension-fund ETI activism “cannot be overstated. With nearly \$5 trillion worth of pension fund assets in the United States, trustees have an incredible – and as yet mostly untapped – source of power at their fingertips.”<sup>19</sup>

**Policy recommendation: The governor and Legislature should empower the Economic Advisory Council to name a panel of experts to analyze ETI policies and their potential use by the Pooled Money Investment Account, CalPERS, STRS, and local public pension funds and treasury accounts. Among the ETI policies analyzed should be those that establish standards for international investments. The study should consider the impact on return, risk and liquidity of ETI policies; rather than being narrowly defined, however, this analysis should consider all collateral economic impact on the funds and on the state. After such studies are carried out, the council could analyze possible legislative initiatives to enable pension-fund ETIs by creating financial intermediaries that use credit enhancements and guarantees to manage risk. The panel should be broadly based, including ETI and SRI professionals and public employee unions, as well as CalPERS and STRS staff. The panel also would be authorized to study related issues (see recommendations below).**

## SELECTIVE PURCHASING

In addition to its clout as an investor, the California state government has market-shaking economic power as a purchaser – it spends \$1.3 billion per year on procurement of goods (not including services or highway construction). But in contrast to its investment policies, the state has set several clear precedents for using social criteria to help guide its procurement policies. Although these precedents have no common theme, they open the door for a strategic review leading to a consciously designed “selective purchasing” policy.

- **Convict labor.** In 1996, Governor Wilson signed into law AB 2457, which requires all firms that sell goods to the state to certify that they do not use any foreign-made materials produced by convict or forced labor. The bill, authored by Assemblywoman (now Senator) Liz Figueroa, D-Fremont, provides for no mechanism to verify these pledges, and many experts on foreign labor practices say further legislation to enable verification and on-site inspection is needed as part of a comprehensive review of the state's purchasing policy.
- **Preference for impoverished and enterprise areas.** The Department of General Services provides a 5 percent bid preference on service and commodity contracts valued at more than \$100,000 if the business work site is located in a "distressed area" or a "enterprise area," as defined by the Governor's Office of Planning and Research. Companies qualifying for the preference may request an additional 1 percent to 4 percent preference by pledging to hire a specified percent of their contract workforce employees from the area.
- **Preference for disabled veterans.** The Department of General Services sets on all state contracts a non-mandatory quota of 3 percent for businesses owned by disabled veterans.
- **Universities/sweatshops.** A resolution approved by the Legislature in August 1998 urges all public and private California universities to bar the licensing of merchandise made with foreign sweatshop labor or child labor. The resolution, sponsored by State Senate President John Burton, D-San Francisco, was based on similar regulations enacted earlier in the year by Duke and Brown universities. Important federal precedent was set in May 1998, when the U.S. House of Representatives voted 393-29 to approve a resolution sponsored by Representative George Miller, D-Martinez, to urge all U.S. colleges and universities to adopt anti-sweatshop codes of conduct. In September 1998, the University of California adopted a similar policy, and as of May 1999, a growing student movement was pressuring the university's authorities to strengthen its code, while UC was considering joining the Fair Labor Association as a means of enforcing it (see below).<sup>20</sup>
- **San Francisco/sweatshops.** A resolution passed by the Board of Supervisors in 1997 calls for the city to stop buying products made by foreign sweatshop labor. The resolution, authored by Supervisor Mabel Teng, resulted in an increased emphasis by city purchasers on buying locally made uniforms rather than imported ones. However, Teng and the San Francisco City Attorney's office apparently gave only cursory research to the question of how to enforce the resolution through the city's

procurement code, ignoring best practices such as those described in International Corporate Standards (below) and abandoned the issue as unworkable.<sup>21</sup>

Across the United States and Canada, local governments are jumping quickly on the bandwagon. Selective purchasing policies have been adopted on a wide variety of social issues. Among international issues, the most popular have been boycotts of the world's most well-known pariah governments or U.S. exile causes. These governments have enacted more than 40 boycott laws against Burma, Nigeria, China, Northern Ireland and other nations and foreign issues. In California, eight localities and the state government have adopted similar laws, which either prohibit government purchases from firms with proscribed business practices or provide substantial bid preferences for firms that comply:

### California governments with international selective purchasing laws

	Burma	Nigeria	N. Ireland	Tibet (China)	Forced labor	Sweatshops	Environment
Alameda Co.	1996	1997					
Berkeley	1995	1997		1997			
Los Angeles	1998						1997 <sup>22</sup>
Oakland	1996	1996					
Palo Alto	1997						
San Francisco	1996		1989			1997	1990
Santa Cruz	1997						
Santa Monica	1995						1998
W. Hollywood	1997						
State of Calif.					1996		

Sources: "Country-Specific Selective Purchasing Laws," Investor Responsibility Research Center; author's research.

The San Francisco law against Burma and a similar one by Massachusetts, enacted in 1996, have been markedly successful in bringing Motorola, Hewlett-Packard, Apple Computer, Phillips Electronics, PepsiCo and Texaco to end their operations in that country – a major blow against the Burmese military junta and a boost to Aung San Suu Kyi, the 1991 Nobel Peace Prize winner and the winner of Burma's 1990 national elections, which the junta quashed in a bloody crackdown.

But a two-pronged legal counterattack has begun, turning Massachusetts into a prominent test case that could endanger California's selective purchasing laws on issues ranging from Burma to Nazi gold. In November 1998, a federal district court judge issued an injunction against Massachusetts' Burma law, which provides a 10 percent violates the constitutional power of the federal government to conduct foreign policy. The ruling



came in a lawsuit brought by the National Foreign Trade Council, a coalition of more than 600 corporations linked to USA\*Engage – a Washington-based lobbying group that has spearheaded the corporate fight against unilateral foreign trade sanctions. bid preference on procurement contracts to U.S. or foreign firms not doing business with or in Burma,

Massachusetts has appealed the ruling, and many legal experts say the case is likely to eventually reach the U.S. Supreme Court. In January 1999, only weeks after taking office, California Attorney General Bill Lockyer filed an amicus curiae brief in support of Massachusetts. As of the writing of this report (May 1999), the attorneys general of 10 other states, including New York and Texas, had done likewise. The Clinton administration, internally divided over the issue between political pragmatists and free-trade purists, took the unusual stand of remaining neutral.

The Massachusetts law on Burma is also under attack in the World Trade Organization. In September 1998, the WTO set up a dispute panel to rule on a complaint filed by the European Union and Japan. Their complaint alleges that the law violates the WTO's Government Procurement Agreement, which has been signed by the Clinton administration and was informally ratified by then-Governor William Weld. The EU acted despite pressure from the European Parliament, which passed a resolution urging the EU not to proceed in the case.<sup>23</sup> Although the EU and Japan suspended their WTO complaint in February 1999, they said they will revive it if Massachusetts wins its court appeal.

The EU-Japan complaint is the first time that a U.S. state law has been challenged in the WTO. In a sign of the high stakes in both cases, the EU also filed an amicus brief in U.S. court in support of the National Foreign Trade Council lawsuit.<sup>24</sup>

Thomas Barnico, the Massachusetts assistant attorney general who is handling both cases, said the state's Burma law is mere purchasing policy, not foreign policy, and thus does not violate the Constitution: "Our law merely is a matter of our state government deciding with whom it will do business. We're not impinging on the federal government's foreign policy." He noted that the state's boycott is broadly consistent with U.S. policy because a 1997 executive order signed by President Clinton bars new American investment in Burma.<sup>25</sup>

"If USA\*Engage and the EU had had their way in the 1980s with South Africa divestment, Nelson Mandela would still be in prison on Robben Island doing hard labor," said Simon Billenness, a policy analyst in Boston with Trillium Asset Management Corp., which has campaigned on behalf of the sanctions. Billenness warns that if the Massachusetts ruling is upheld on appeal, it would sharply limit states' ability to enact legislation on a broad variety of issues. "This case could be a really dangerous legal precedent, not just on foreign divestment issues but on states' ability to choose how and with whom they choose to do business," he said.<sup>26</sup>

**Policy recommendation: The California Attorney General's office should continue its support of the Commonwealth of Massachusetts in the National Foreign Trade Council case, and the governor should ask the U.S. State Department and the U.S. Trade Representative to support Massachusetts.**

The Wilson administration strongly opposed attempts to introduce selective purchasing, such as AB 888, a Burma-related bill sponsored by Assemblywoman Dion Aroner, D-Berkeley, which died in committee in February 1998. The bill also was opposed by the California Chamber of Commerce, the National Association of Manufacturers and major corporations such as Unocal, Arco and Eastman Kodak, which argued that U.S. trade and "engagement" with foreign governments, not boycotts, is the best way to bring about reform and democracy.

Another problem of country-specific sanctions, rarely mentioned even by detractors, is the lack of consistent standards. Although Burma is a clear example of oppressive foreign dictatorship, there are more oppressive regimes elsewhere that are not being targeted by sanctions advocates. For example, Saudi Arabia, Afghanistan and Sierra Leone are arguably worse cases, yet there is little public pressure for sanctions against them. Country-specific sanctions advocates appear to have no firm, constant yardstick of acceptable behavior; instead, the sanctions rely on ad-hoc concerns, dependent on public mood and the vagaries of what is feasible under current U.S. foreign policy. For this reason, a Burma-related boycott may be morally appropriate and necessary, but it offers little guidance for coherent government policymaking on similar issues.

In the past year, the sweatshop issue has catapulted into the selective-procurement debate, propelled by front-page scandals about Kathy Lee Gifford, Nike and other high-profile brand names.

In May 1997, North Olmstead, Ohio, a blue-collar suburb of Cleveland, became the first U.S. city to ban municipal purchases of products made in sweatshops. A month later, San Francisco followed, and Portland, Maine, came soon afterward. At time of this writing, more than 10 other cities have similar legislation or resolutions pending.

In considering selective purchasing policies, a more difficult complication must be considered: the WTO's General Procurement Agreement, which was endorsed by Governor Wilson in 1994. It bars procurement sanctions on all contracts executed by state executive agencies (those agencies directly under the control of the governor) that are over \$507,000 for goods and services or \$7.1 million for construction. However, the agreement exempts procurement by non-executive agencies such as state universities, community colleges and pension funds.

The WTO has been heavily criticized from left and right, called an undemocratic institution whose regulations trample on local sovereignty. But it remains undeniable that any serious noncompliance with the WTO procurement agreement would create big legal trouble for California. Whether the U.S. Constitution also is a barrier to state selective-

purchasing policies is a matter that will be decided in the Massachusetts case now being tried in federal court.

**Policy recommendation: The governor and Legislature should empower the Economic Advisory Council to analyze the economic, human rights and legal aspects of potential selective-procurement legislation, and to recommend legislative action if needed. Whenever appropriate, such legislation should be designed to comply with WTO terms.**

## INTERNATIONAL CORPORATE STANDARDS

In any selective procurement policy, verification of companies' compliance is one of the most difficult challenges. To date, governments have no widely accepted verification mechanisms to help them enforce existing and potential procurement laws. But important work has been done to research and develop standards for international corporate trade and investment. Some of these initiatives act like a progressive Good Housekeeping seal of approval – a label conferred by an independent organization that allows consumers to know that a product is made without sweatshop labor and without violating internationally recognized human rights. Others confer no label yet act as important benchmarks for corporations, governments and the public at large. California, with a consumer juggernaut that dominates world markets, determining what becomes fad, fashion and cutting-edge in the four corners of the globe, could do the same for progressive consumerism.

The corporate standards movement is still in its early stages, with no easy answer yet for governments and consumers. Complicated issues remain to be worked out, such as how to ensure compliance in countries – such as China – that routinely violate international labor conventions and other human-rights standards, how to define an acceptable wage, whether monitoring should be company-run or independent, how the process should be regulated and publicized. But several initiatives in North America and Europe deserve serious analysis:<sup>27</sup>

- **Fair Labor Association.** Founded in November 1998 as the successor to the Apparel Industry Partnership, a two-year-old initiative of the U.S. Labor Department. The FLA membership includes major clothing and footwear firms such as Nike, Reebok, Kathie Lee Gifford and Liz Claiborne; four highly regarded nongovernmental organizations: International Labor Rights Fund, National Consumers League, Robert F. Kennedy Center for Human Rights, and Lawyers' Committee for Human Rights; and, as of May 1999, more than 50 universities, including the seven Ivy League schools, University of Southern California, California State University at Sacramento and Santa Clara University. The FLA is creating a monitoring and verification mechanism that will inspect its member companies' foreign factories and then, upon certification of compliance, will allow the firms to use the FLA logo on their products – an attraction for ethically-minded consumers. Although the FLA's standards and methods have received criticism from activists who call them overly weak, the FLA

remains the largest such initiative to date. As such, it serves as an invaluable reference point for government procurement initiatives.

- **Global Reporting Initiative.** Created by the Boston-based Coalition for Environmentally Responsible Economies (CERES). The initiative, started in 1997, is designing a standardized system of corporate environmental reporting worldwide. CERES members and supporters have included corporations such as BankAmerica, Coca Cola and General Motors; environmental groups such as the Sierra Club and Earth Island Institute; the AFL-CIO; and government officials such as California Governor Gray Davis.
- **SA8000.** Coordinated by the Council on Economic Priorities, a New York-based think tank, it includes major corporations such as Toys R Us, Avon Products, The Body Shop and Eileen Fisher, and nongovernmental organizations such as Amnesty International. It has a sophisticated auditing system, based on ISO 9000 and ISO 14000 and designed by international auditing firms SGS-ICS and KPMG-Peat Marwick. Its requires employers to pay their foreign workers a “living wage” – a higher standard than the Apparel Industry Partnership, which merely prescribes the minimum or locally prevailing wage.<sup>28</sup>
- **TransFair USA.** A recent American transplant of the highly successful TransFair consumer label from Europe and Canada for coffee, tea, cocoa, honey, bananas and sugar from developing countries. It does not currently include manufactured products. It is headquartered in Oakland.
- **Ethical Trading Initiative.** The British Labor government is giving significant funding to the Ethical Trading Initiative, a project by the London-based New Economics Foundation, Oxfam, and major European corporations and trade unions. The participating firms are currently field-testing the initiative's methods in a two-year pilot program. Results – and final disclosure of the standards used – are expected to be announced in 2000.

With the current trend toward adopting selective-purchasing legislation, California needs to carry out rigorous research into ways in which such high-minded principles can be turned into action. The British and Canadian governments have set an important precedent by granting financial support for research and public education for the fair-trade labeling initiatives. Practical, legislatively-oriented research by California on the subject could help the state and its cities define with greater precision the effects and feasibility of existing and proposed selective-purchasing proposals.

**Policy recommendation: The Economic Advisory Council should commission a study of international corporate standards initiatives and their possible implications for state and local selective-procurement legislation.**

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## ENDNOTES

<sup>1</sup> For a report on labor abuses in the export sector of China – a country that is likely to be California's most important competitor in the coming century – see Charles Kernaghan, *Made in China: Behind the Label* (New York: National Labor Committee, 1998). The report found abuses such as 60-to-96 hour work weeks for wages of 13 cents to 28 cents an hour without benefits, and a total government ban on independent labor organizing. Representatives Nancy Pelosi, D-San Francisco, Bernie Sanders, I-Vt., and Marcy Kaptur, D-Ohio, have endorsed the committee's National Corporate Disclosure Campaign, which pressures apparel corporations to stop rights abuses by their subcontractors.

<sup>2</sup> CalPERS had \$153 billion in assets as of January 31, 1999; STRS had \$92 billion in assets as of February 28, 1999; and the State Treasurer's Pooled Money Investment Account, a joint fund of state and individual cities' accounts, had \$34 billion as of February 29, 1999, with no foreign holdings but with extensive bond holdings in U.S.-based banks and multinational corporations. The nation's largest single fund is Teachers Insurance and Annuity Association-College Retirement Equities Fund (TIAA-CREF), the pension fund for college, university and private school employees, with \$249 billion as of February 28, 1999.

<sup>3</sup> Toronto-based MacMillan Bloedel has been widely criticized for logging virgin rain forests on Vancouver Island and elsewhere, using unsustainable forestry practices to undercut U.S. competitors; the San Francisco Board of Supervisors called on Pacific Bell in 1995 to stop buying the firm's paper. Japan-based Itochu Oil Exploration Co. is a major investor in a pipeline in Afghanistan, helping to support the pariah Taleban government. Hyundai Motor Co. has been criticized by U.S. labor unions and the U.S. Labor Department for its role in violating labor rights at the Han Young maquiladora in Tijuana, as described in Chapter 4. Royal Dutch Petroleum is accused of collaborating with the Nigerian military dictatorship in crushing democratic rights in the Ogoniland region, and has been criticized for environmental abuses in Chad, Cameroon, Colombia and Peru. The Australian mining firm Broken Hill Proprietary has reportedly trampled on the rights of aboriginal Papua New Guineans. Mitsubishi Heavy Industries is the subject of a long-running boycott by environmental groups for its clear-cut logging of tropical forests in the Pacific. Research provided by Progressive Asset Management, Inc., and Trillium Asset Management Corp.

<sup>4</sup> Telephone interview, May 21, 1998.

<sup>5</sup> Social Investment Forum, *1997 Report on Responsible Investing Trends in the United States* (Washington, D.C.: 1997), p. 1.

<sup>6</sup> The WTO Government Procurement Agreement, which Governor Wilson voluntarily adhered to in 1994, mandates that California's executive agencies (but not cities, counties or state entities such as state universities) give "national treatment" to all foreign firms – that is, give them the same benefits and access – for contracts over \$507,000 for supplies and services or \$7.1 million for construction. For a general analysis of Fong's position, see Robert Collier, "Controversy Over Boycott of Swiss Banks," *San Francisco Chronicle* (July 16, 1998), p. A1.

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<sup>7</sup> For analysis, see Henry Weinstein, "Hope Raised for Holocaust Claim Payouts," *Los Angeles Times* (April 14, 1999), p. A1.

<sup>8</sup> The coalition members are from the following cities: Albany, Arcata, Berkeley, Davis, El Cerrito, Emeryville, Kensington, Oakland, Richmond, San Francisco, Santa Cruz and Santa Monica, plus Boulder, Colo. Its co-chairs are Oakland Councilwoman Jane Brunner and El Cerrito Councilman Mark Friedman.

<sup>9</sup> In some of these cases, such as the New York State Common Retirement Fund – the world's third-largest pension fund after TIAA-CREF and CalPERS – divestment has only been partial. New York anti-tobacco activists now are pressing the fund to divest fully in tobacco stocks, prompting state Comptroller Carl McCall, the fund's sole trustee, to say the move is "a first step in a process that might lead to [divestment] should this [price] volatility get to the point where it is a considerable risk." At the same time, the fund has sponsored several shareholder resolutions – one with the Minnesota State Board of Investment – asking tobacco companies to reform their business practices. In other states, such as Pennsylvania and Florida, divestment will be completed over a three-year period.

<sup>10</sup> CalPERS press release, February 18, 1998. The CalPERS Investment Committee voted 11-0 to oppose tobacco divestment, with state Controller Kathleen Connell abstaining. In the past few years, Connell has tried to persuade the committee to increase the fund's proportion of investments in California-based firms, but has had little luck.

<sup>11</sup> In doing so, the fund spurned an open letter published in the *New York Times* on May 18, 1998, calling for support of the resolution, signed by San Francisco Supervisor Leslie Katz, Working Assets CEO Laura Scher, retired Judge William Newsom, the Rev. Sally Bingham (chair of the Environment Committee of the Episcopal Diocese of California), Elliott Hoffman (owner of Just Desserts) and other corporate officials and foundation directors.

<sup>12</sup> During the 1980s, 32 states, 112 cities and 40 counties, regional authorities and the Virgin Islands instituted restrictions on their banking, investment or procurement practices relating to South Africa. Of this total, 73 related not to investment but to selective purchasing. Investor Responsibility Research Center, *Country-Specific Selective Purchasing Laws* (Washington D.C.: 1997), p. 11.

<sup>13</sup> In his January 4, 1999, inaugural address, Angelides reaffirmed his campaign promises to adopt a "California First" investment strategy: "I will seek to invest more of our portfolio in California in ways that meet the highest fiduciary tests and that enrich us as a state into the 21st Century. I will advocate, with all my heart and with the platform of my office, for a renewed commitment to invest in the public fabric of schools, transportation and environmental quality that will sustain us in the years ahead. ... I will lead an effort in the public and private sectors to reinvest in the vibrant and promising communities of our state that capital has too often ignored. This is both the right and smart thing to do."

<sup>14</sup> Telephone interview, March 12, 1999. See Robert Collier, "Slumping Asian Trade Takes Sparkle Off State Economy," *San Francisco Chronicle* (March 18, 1999), p. A1.

<sup>15</sup> Interview, July 1, 1998.

<sup>16</sup> AB 3252, sponsored by Assemblyman Howard Kaloogian, R-Carlsbad, passed the Assembly in May 1996 but died in the Senate.

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<sup>17</sup> Article XVI of the California Constitution, Section 17 (b) appears to rule out the use of any social criteria, saying, "The members of the retirement board of a public pension or retirement system shall discharge their duties with respect to the system solely in the interest of, and for the exclusive purposes of providing benefits to participants and their beneficiaries, minimizing employer contributions thereto, and defraying reasonable expenses of administering the system. A retirement board's duty to its participants and their beneficiaries shall take precedence over any other duty." However, a later clause provides some wiggle room for using social criteria. Article XVI, Section 17 (g) says, "The Legislature may by statute continue to prohibit certain investments by a retirement board where it is in the public interest to do so, and provided that the prohibition satisfies the standards of fiduciary care and loyalty required of a retirement board pursuant to this section."

<sup>18</sup> U.S. Department of Labor, *Interpretive Bulletin 94-1* (Washington, D.C.: 1994).

<sup>19</sup> Spalding, Kirsten Snow, and Matthew Kramer, *What Trustees Can Do Under ERISA* (Berkeley: Unpublished monograph, University of California, 1997), p. 1. See also Lynn A. Bowers, *The Fiduciary Duty Aspects of Economically Targeted Investments* (Washington, D.C.: Center for Policy Alternatives, 1993). The Center for Policy Alternatives has conducted extensive research on pension-fund involvement in economically targeted investments and community banks.

<sup>20</sup> See Robert Collier, "A Movement at the Nation's Schools to Fight Sweatshops," *San Francisco Chronicle* (April 17, 1999), p. A7.

<sup>21</sup> Telephone interview with Teng aide Matt Lonner on April 9, 1999. Lonner said that city officials who analyzed the enforcement issue were unaware of the Fair Labor Association, the SA8000 or other current best practices.

<sup>22</sup> In its construction contracts, Los Angeles prohibits the use of old-growth hardwoods unless they are certified by an organization approved by the Forestry Stewardship Council, which verifies sustainable-yield, ecologically sensitive forestry practices worldwide. When this report went to press (December 1998) the Los Angeles City Council was debating measures to strengthen the ban. San Francisco and Santa Monica ban the use of old-growth redwood and tropical hardwoods. For an extensive analysis of "eco-labeling," see Jim Salzman, *Product and Raw Material Eco-Labeling: The Limits for a Transatlantic Approach*, (Berkeley: Berkeley Roundtable on the International Economy, 1998).

<sup>23</sup> The law's author was State Representative Byron Rushing, D-Boston, who also had authored the state's South Africa divestment legislation a decade previously. Early in 1998, he held several rounds of negotiations with the EU over the Burma law, with the U.S. Trade Representative as mediator. Under a deal offered by Rushing to the European officials, the law would be amended to comply with the WTO Government Procurement Agreement, exempting all contracts executed by state executive agencies that are over \$507,000 for goods and services or \$7.1 million for construction. However, the law would continue to fully cover all spending by non-executive state authorities such as Massport, Massachusetts Water Resources Authority and the University of Massachusetts system. The Europeans rejected Rushing's offer, and the talks broke down.

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<sup>24</sup> *Journal of Commerce*, “Unprecedented Intervention by EU in Bay State” (September 25, 1998).

<sup>25</sup> Telephone interview, July 13, 1998.

<sup>26</sup> Telephone interview, June 18, 1998.

<sup>27</sup> For a general analysis of the anti-sweatshop movement, the Fair Labor Association and recent reform moves by firms such as Nike and Reebok, see Robert Collier, “U.S. Firms Reducing Sweatshop Abuses,” *San Francisco Chronicle* (April 17, 1999), p. A1.

<sup>28</sup> A “living wage” is generally defined internationally as the total amount needed for an average-size family's basic living expenses, including a small amount for recreation and savings, divided by the average number of wage earners per family in the given nation.



## *Chapter 7*

### *A GLOBAL POLICY VOICE*

#### *Chapter contents:*

- During the Wilson years, California's national and international lobbying on trade issues was ineffective, hampering the effective defense of its constituents' economic and social interests.
- The state should develop a more proactive, pragmatic lobbying policy.

One of the great paradoxes of California's trade policy is that despite the state's huge economic and political clout, it has no similar influence on federal policymaking. The Wilson administration adopted a low-profile, passive stance on international trade policy, limiting itself to supporting NAFTA and free-market, free-trade economic policies. Rather than leading an aggressive, pragmatic lobbying charge in Washington and abroad to advance all of California's interests – businesses small and large, farmers, workers, consumers and the environment – it appeared to minimize cooperation with the state's Democratic members of Congress and the Clinton administration.

Responsibility for federal and international policy analysis and lobbying rests with the Trade and Commerce Agency's Trade Policy and Research Division, the World Trade Commission, the Governor's Office in Washington, and the state's Congressional delegation. But many farm, business, labor and consumer groups say California needs a more effective, unified voice on the following federal trade issues:

- **NAFTA and WTO consultation.** Under federal legislation implementing NAFTA and the Uruguay Round of the General Agreement on Tariffs and Trade, the U.S. Trade Representative is required to consult regularly with state governors about trade policy issues. On issues relating directly to the states, the USTR must involve states in its internal policy development mechanisms. However, the Wilson administration largely abdicated this role, reducing its participation to passive support for free-trade policies.<sup>1</sup> The Davis administration should exercise its right to consult regularly with the USTR to advance California's own trade interests. The state should pay particular attention to the December 1999 World Trade Organization ministerial conference in Seattle and the Millennium Round of WTO negotiations that is expected to follow.

- **Fast track and the FTAA.** During the last two years of the Clinton administration and under its successor, hot debates are likely over renewal of “fast track” presidential negotiating authority and the proposed Free Trade Agreement of the Americas. It is beyond the intent of *California on the Global High Road* to fully analyze these complex issues. However, as with all other trade initiatives, the Davis administration and the state's elected officials would be well advised to take an activist, pragmatic lobbying stance with the USTR and Congress. They should avoid purist free-trade rhetoric and should ensure that the state's interests are duly considered at every stage of trade negotiations.
- **Trucking.** Governor Wilson campaigned against the Clinton administration's decision to suspend implementation of the portion of NAFTA that would allow trucks from Mexico to travel anywhere in the four border states of California, Arizona, New Mexico and Texas, and eventually anywhere in the United States and Canada. The Teamsters union and environmental and highway-safety groups say the suspension is needed to keep thousands of unsafe, polluting Mexican trucks off California roadways and to protect state truck drivers' jobs against wage undercutting by Mexican companies, which pay their drivers as little as \$7 per day. The Mexican government has filed a formal complaint through the NAFTA dispute process about the suspension. As of the writing of this report (May 1999), the Clinton administration was negotiating with the Mexican government to lift the ban. Mexico is expected to lobby Governor Davis to adopt Wilson's stance. Davis should refuse to do so.
- **MFN for China.** Davis has expressed his support for China's request for renewal of Most Favored Nation trade status, as did Wilson. Although nearly all California business leaders support MFN for China, many say the United States must more aggressively use the MFN process to press Beijing's rulers to end the rampant pirating of patents and copyrights – especially in software, music and movies. The California government should use all available means to use China-California trade ties to advance these business interests and to address the concerns of California's human-rights groups and labor unions, point to China's totalitarian policies as an example of the sort of unfair competition that U.S. businesses and workers should not be expected to compete against.
- **Agriculture.** The expansion of international trade has benefited many sectors of California agriculture, yet a wide variety of farm products such as cut flowers, wine, brandy, stone fruits, vegetables and table grapes have been adversely impacted by Mexican imports under NAFTA. On wine and brandy, for example, the Wilson administration and state lawmakers of both parties appear to have botched their lobbying work while NAFTA was being negotiated. The trade pact slashed U.S. tariffs for Mexican wine and brandy, but Mexico refused to open its own markets because of an unrelated dispute over straw brooms. As a result, California winemakers initially opposed President Clinton's request for “fast track” trade negotiating authority in late 1997. They lifted their opposition only in exchange for an administration promise that U.S. diplomats would refuse any further tariff cuts on wine in talks for the Free Trade Area of the Americas. “I'm not sure what the governor's office in Washington was doing during the NAFTA negotiations,” said

Joseph Rollo, international affairs director for the San Francisco-based Wine Institute, which represents the state's wine industry. "At least it didn't do much for wine makers."<sup>2</sup>

- **Food safety.** Farmers' and consumer groups say that lax inspections by the state Department of Food and Agriculture and the Health Services Department, which work jointly with federal officers at state border stations, have allowed unsafe imported food onto California supermarket shelves, creating unfair competition for California-grown products. These groups say more funding is needed to improve border inspections and to help inspect and enforce growing and processing standards in foreign producing nations.<sup>3</sup>
- **Multilateral Agreement on Investment.** This international agreement, negotiated at the Organization for Economic Cooperation and Development until it was temporarily blocked by critics in late 1998, would have given foreign corporations legal standing to challenge California state or local governments in foreign tribunals. These tribunals would have been empowered to levy multimillion-dollar potential fines against governments that enact policies that directly or indirectly impact foreign investors' planned profits.<sup>4</sup> In a 1997 report, the Western Governors' Association, of which California is a member, warned that the MAI "may impact law-making powers of state and local government" in a wide variety of economic and social areas and "may protect investors by curtailing both sovereign powers and sovereign immunity."<sup>5</sup> The WGA advised all states to lobby the Clinton administration to ensure that any final agreement does not impinge on the states' current or future legislative powers. The Wilson administration took no stand on the MAI, while San Francisco, Oakland, Berkeley, Santa Cruz and Arcata enacted resolutions opposing the MAI, saying the measure could restrict local governments' economic and environmental policies.<sup>6</sup> The MAI talks may soon be transferred from the OECD and placed under the aegis of the WTO's coming Millennium Round of negotiations.
- **Encryption export controls.** The Davis administration, as Wilson before it, has opposed attempts by the Clinton administration to force encryption software manufacturers to hide a "back-door key" that would allow government regulators to break the code. Software manufacturers and electronic-privacy activists have noted that unadulterated, unbreakable encryption software is widely available internationally, making such a U.S. measure ineffective in its stated intent of fighting organized crime. For this reason, they say the Clinton administration's regulations would drive all U.S. encryption software from the international marketplace.
- **E-commerce.** The WTO has agreed to an interim global pact keeping electronic commerce, now estimated at \$300 billion annually, temporarily duty-free. The Clinton administration, backed by the Davis administration and the state's computer industry, is pressing for a long-term duty-free pact. The National Governors' Association opposes duty-free status, arguing that it would undermine sales tax revenues. Most poor developing nations agree. This is a difficult issue, with strong economic incentives for California on both sides.<sup>7</sup>

To be fair, it must be admitted that California is not alone in relinquishing its proper lobbying role in Washington and abroad. Virtually every other state does just as poorly, as does the National Governors' Association. "States are missing major opportunities to

participate in international meetings and forums that are, in effect, setting global standards for industry and the practice of economic development itself,” said Carol Conway, director of the Southern International Trade Council, a coalition Southern state governments based in Research Triangle, N.C. “Moreover, many are missing the chance to learn from other countries’ best practices in virtually every issue area, from health to crime. Foreign policy is a growing area of state responsibility, but few have any kind of a policy structure in place to deal with these issues in a consistent and competent manner.”<sup>8</sup>

Even within California, there is a glaring lack of public and private leaders who participate fully in international trade policy forums. Despite the state's wealth of business, academic and nonprofit institutions, few have been brought into policy-making.

**Policy recommendation: The governor, Legislature and Economic Advisory Panel should conduct a strategic overview of federal and international trade policies. The resulting analysis should guide the Governor's Office in Washington in carrying out an energetic, proactive lobbying policy with the White House, Congress and multilateral trade organizations to advance the multiple interests of California’s residents.**

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## ENDNOTES

<sup>1</sup> Orbuch, Paul M., and Thomas O. Singer, *International Trade, the Environment and the States: An Evolving State-Federal Relationship* (Denver: Western Governors’ Association, 1996).

<sup>2</sup> Interview, March 27, 1998.

<sup>3</sup> See U.S. General Accounting Office, *Food Safety: Federal Efforts to Ensure the Safety of Imported Foods Are Inconsistent and Unreliable* (Washington D.C.: 1998).

<sup>4</sup> Such a broad definition of “expropriation” could force the federal government to challenge many California laws, such as: the moratorium on fishing licenses; tax breaks to firms that use recycled materials, pollution controls or energy-efficient technologies; the Safe Drinking Water and Toxic Enforcement Act of 1986, commonly known as Proposition 65; and selective-purchasing preferences for firms in impoverished and enterprise areas and those owned by disabled veterans. The MAI's impact on states would be even stronger than the effect of the investment provisions of the WTO, which was founded in 1995 as the successor of the Uruguay Round of the General Agreement on Tariffs and Trade and whose full powers many experts say have not been fully tested in international tribunals. See Robert Stumberg, *GATT Impact on State Law: California* (Washington, D.C.: Center for Policy Alternatives, 1994). Under Article 8 of the WTO Agreement on Subsidies and Countervailing Measures, member nations' subsidies established for R&D or aid to disadvantaged regions may be called "non-actionable," and thus protected from dispute settlement or countervailing-duty actions. However, Article 8.5 of the same agreement prohibits government subsidies contingent on export performance or subsidies that cause injury to a domestic industry in another member

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country. See *Bridges Weekly Trade News Digest* (Minneapolis: Institute for Agriculture and Trade Policy, June 15, 1998).

<sup>5</sup> Singer, Thomas O., Paul M. Orbuch and Robert Stumberg, *Multilateral Agreement on Investment: Potential Effects on State and Local Government* (Denver: Western Governors' Association, 1997), pp. 2, 27.

<sup>6</sup> “We looked into the MAI, and we talked to the Clinton administration about it, but we don't feel there's any real problem,” said Lloyd Day, the Trade and Commerce Agency's then-deputy secretary for international programs, in March 1998. “It's been overblown by the critics.” Interview, March 30, 1998.

<sup>7</sup> *Bridges Weekly Trade News Digest* (Minneapolis: Institute for Agriculture and Trade Policy, June 8, 1998).

<sup>8</sup> Conway, Carol, Unpublished issue paper for Commission on the Future of the South (Research Triangle, N.C.: Southern Growth Policies Board, 1997).

## *Chapter 8*

### ***CONCLUSION: AN OPPORTUNITY FOR LEADERSHIP***

#### *Chapter contents:*

- With the world financial downturn creeping closer to California, the state must overhaul its trade and investment policies.
- An aggressive, imaginative new strategy will require unusual leadership – which, in turn, will fill a vacuum among state governments nationwide.

From the cozy vantage point of an unprecedented economic boom, the state now awaits an uncertain future. Californians gaze with fascination across the Pacific at the Asian meltdown, wondering whether it will reach our shores. For many of the state's residents, globalization's risks are as dramatic as its benefits.

The challenge is clear. State policymakers can retain the status quo with a little tinkering here, a little there, ignoring the long-term economic, political and social risks of such a path. Or they can carry out a comprehensive review of California's trade strategies, with investment policy recognized as a central pillar of the new economic reality.

California's elected officials have a unique opportunity to help shape a 21<sup>st</sup>-century economy in which globalization is a tool to help improve the lives of the majority – not just a minority – of the 33 million Californians. International trade and investment policies can benefit all sectors, including workers, consumers, small businesses and the environment only if they are backed by the full potential strength of state government. As this report has discussed, such a strategy would combine a comprehensive clustering policy, a proactive use of investment and procurement tools and an aggressive lobbying voice. This strategy would be unorthodox. It would be controversial. Opposition from entrenched interests would be strong. But it would fill the huge policy vacuum among state governments nationwide, and it would truly benefit California. No other state has our economic and political clout or our inspiring potential. As the state moves into a new, hyper-globalized era, California must find its natural voice on the U.S. and international economic policy-making stage.

Determined leadership – unusual leadership – is required.

## *Appendix A*

### ***EXISTING STATE TRADE PROGRAMS***

**California Trade and Commerce Agency.** The largest player in the state's export programs. Agency officials say that in fiscal year 1996-97, the agency's international programs supported approximately \$1.22 billion in exports and international investment for the state, resulting in 10,324 jobs in California. Although many experts say these statistics are unreliable, most agree that the agency has many valuable programs that help produce exports and jobs:

- The Office of Foreign Investment works to attract foreign direct investment in California, recruiting and advising corporations that are considering opening business operations in California.
- The Export Finance Office helps fill an important need for small and mid-sized California firms – bank loans. The Export Finance Office does not make the loans directly, but issues guarantees to commercial banks for them. The guarantees cover 90 percent of a loan as large as \$833,000. The program works with more than 100 banks in California. Eligibility requirements include one year in business to demonstrate company performance and 51 percent California content on the total shipment. The \$10 million fund has leveraged about \$40 million in outstanding loans, with a 1.7 percent default rate – an acceptably low rate by commercial banking standards.
- The Office of Export Development organizes trade shows for California products in foreign countries. In a new function mandated by 1997 legislation, the office also helps firms access foreign government procurement contracts.
- Foreign offices. These quasi-embassies for the state government play an important protocol role in maintaining contacts with foreign governments and in hosting delegations of California politicians and business leaders, as well as coordinating trade shows and helping state companies with market research and a wide variety of connection-making. There currently are nine offices: Tokyo, London, Frankfurt, Mexico City, Hong Kong, Taipei, Jerusalem, Johannesburg, and a contract (in effect, free-lance) representatives in Seoul.
- Office of California-Mexico Affairs. Located in San Diego, it acts as the state's liaison to Baja California businesses and government, educational and cultural institutions.
- Trade Policy and Research Division. Advocates policies and provides trade statistics. Its policy work is devoted mainly to advocating free-market, free-trade economic policies and trumpeting the virtues of NAFTA. The division is supervised by the World Trade Commission, an advisory panel of 15 members, nine of whom are appointed by the governor.

**California Department of Food and Agriculture.** With a \$435,000 annual budget and six staff members, the department's Agricultural Export Program runs foreign food trade

shows and trade missions. It receives assistance from three Trade and Commerce Agency agricultural specialists – in the agency's offices in Hong Kong, Tokyo and Mexico City. The program also helps to bring buyers and sellers together by providing trade leads and market access information to California firms and by giving supplier lists to potential foreign customers. The Department claims that in 1996, its activities generated more than \$33 million in export sales by 53 state agricultural firms – a minuscule fraction of the state's \$12 billion per year agricultural exports. In the early 1990s, the Agricultural Export Program was virtually gutted, with its budget cut by over 80 percent from its previous level of \$4.5 million. The earlier funding levels had allowed small food-products firms to enter the export game. Now, many farm experts say new resources are needed to develop markets for specialty crops in which California is a world leader, such as organic foods, but which receive little attention from federal agricultural trade programs. In 1999, Senator Tim Leslie, R-Tahoe City, has sponsored legislation, SB 386, to provide an extra \$200,000 to the Food and Agriculture for two additional staff members to carry out foreign market research.

**California Environmental Protection Agency.** Cal-EPA's Environmental Technology Export Program, run in cooperation with the Trade and Commerce Agency, generated approximately \$73 million in environmental technology exports supporting 1,068 jobs. In addition, much related environmental research is done at state universities such as the UC campuses at Berkeley, Davis, San Francisco and Santa Cruz and the CSU campuses at Hayward and San Francisco.

**California Energy Commission.** The commission's Energy Technology Export Program helps firms export alternative energy technologies.<sup>1</sup> It conducts market research and trade missions, hosts trade missions from other nations to California, advises foreign governments on specific projects,<sup>2</sup> and gives "seed funding" grants of as much as \$25,000 to individual firms to help produce business export plans and do market research.

**Community Colleges.** A network of 15 Centers for International Trade Development are located at community colleges throughout the state.<sup>3</sup> The centers offer one-on-one counseling and technical assistance, as well as basic training workshops, seminars and short courses. They function as a basic, entry-level resource for small businesses and individual entrepreneurs, referring clients to state and federal programs for more complicated services and financing. Established by the California Community College System in 1989, the network has been growing rapidly and reported \$225 million in export sales in 1996.

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## ENDNOTES

<sup>1</sup> These include: biomass, clean coal technologies, co-generation, energy conservation, geothermal, hydroelectric, natural gas, petroleum, photovoltaics, solar electric, solar thermal and wind power.



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<sup>2</sup> Recent or current projects include consultancies to the Malaysian national utility and to the Australian and Armenian governments. In exchange for this aid, the foreign governments give California firms preference in bidding for contracts.

<sup>3</sup> The centers are at Butte College, Citrus College, Coastline Community College, El Camino College, Fresno City College, Gavilan College, Long Beach City College, Merced College, Oxnard College, Riverside Community College, Sacramento City College, Skyline College, Southwestern College, Vista College and West Valley Mission College.

## *Appendix B*

### ***LEGISLATIVE STEPS TOWARD A NEW MODEL***

A wide variety of trade-related bills were introduced in 1999. Several of them attempt to carry out goals set out by the California Economic Strategy Panel in its 1996 report: developing regional “collaboratives” of high-growth small firms and local government agencies and creating a strategic vision for trade policy.

- **AB 180.** Authored by Assemblywoman Sally Havice, D-Cerritos. The bill calls for \$4.6 million to be appropriated for the Trade and Commerce Agency to fund the 12 offices of the California Trade Coalition (CalTrade), whose annual funding of several million dollars in federal defense conversion funds is set to expire in late 1999. A parallel effort is being made by several legislators to insert the expenditure in the annual budget bill. The expenditure includes \$300,000 for performance measurement and other bureaucratic duties; however, no prior analysis is required. While the proposal offers a promising new direction for state trade policy, it sets a dangerous precedent for spending large amounts of state funds on aid to the private sector without prior performance measurement or benchmarks.
- **AB 1615.** Authored by Havice. Would require the Trade and Commerce Agency to convene a biennial strategy panel to create a strategic plan for international trade policy. Two aspects of the bill are highly unusual, demonstrating willingness to broaden the political base for international trade: 1) The panel’s membership would be broad-based, including: “businesses, labor unions, organizations representing the interests of diverse ethnic and gender groups, local government leaders, academic economists and business professors, chambers of commerce and other business organizations, government agencies, and key industries”; and 2) The panel would conduct public meetings throughout the state, in an apparent attempt to educate the public and gain grass-roots support. These innovative aspects mark a potentially dramatic change in political strategy. However, the new panel would add yet more redundancy to the state’s other two panels: the World Trade Commission and the Economic Strategy Panel. This duplication – or triplication – of efforts should be avoided. The bill should be reconsidered to provide for the consolidation of all three panels in one, such as the Economic Advisory Council discussed in Chapter 2 of this report, following AB 1615’s general guidelines yet extending the panel’s purview to all aspects of state economic development strategy.

- **AB 1617.** Authored by Havice. Would require the Trade and Commerce Agency to conduct cost-benefit analysis of its international trade programs. A laudable proposal, which should be expanded to include all state economic-development programs.
- **SB 897.** Authored by Senators Richard Polanco, D-Los Angeles, and Jim Costa, D-Fresno. It has several very distinct provisions: 1) It calls for the expansion of the state World Trade Commission from 15 voting members to 19; 2) It calls for the commission's membership to include "labor, business, environmental groups, and local economic development entities." 3) It mandates that an independent analyst be hired to review the performance of the overseas trade offices; 4) It sets minimum requirements for people hired for the foreign offices, such as at least one year of international business experience and foreign-language proficiency; and 5) It mandates the opening of an office in Buenos Aires. The first provision is, in essence, an attempt to return the World Trade Commission to the prominent role it had until a legislative shakeup in 1992, when the Wilson administration reduced its influence.<sup>1</sup> Despite its historical justification, such a move would dramatically increase bureaucratic overlap by keeping the World Trade Commission as a separate advisory panel, rather than merging it with the Economic Strategy Panel. As for the Buenos Aires office, there is no indication whether it would replace or supplement the existing plans for a Sao Paolo office. In any case, the recommendation follows a long tradition of the state's foreign offices, in which their location is chosen not because of careful cost-benefit analysis by Trade and Commerce Agency experts but is handed down by political fiat from the Legislature. As with AB 1615, the bill's call for the commission's membership to include labor, environmental, and local economic-development representatives indicates the emergence of a forward-thinking consensus in Sacramento and elsewhere that trade policy decision-making must be broadened beyond traditional business and bureaucratic elites and must address a wide variety of social concerns.

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<sup>1</sup> The 1992 legislation, SB 1909, merged the World Trade Commission and the Department of Commerce, thus creating the Trade & Commerce Agency. But the bill's backers say the Wilson administration distorted their intent by weakening the commission's policy-setting power, turning it into a rubber stamp for the governor's top aides. See Nick Vucinich, *Tapping New Markets: California's Role in Promoting International Trade* (Sacramento: Senate Office of Research, 1993).

## *Appendix C*

### **CALIFORNIA'S FOREIGN OFFICES**

In 1998, the state budget authorized the opening of four new Trade and Commerce Agency foreign offices, while one was closed, thus bringing the state's total to 13. The Seoul representative office was continued, the Jakarta representative office was closed and new part-time, "representative" offices were opened in Shanghai, Sao Paolo, Manila and Calgary.

The decision to close the Jakarta office is clearly correct, given Indonesia's plunge into economic chaos. But with the entire region's economy – except, as of early 1999, for China – falling into a deflationary spiral of bankruptcies and corporate retrenching, the state's existing offices in Tokyo, Taipei and Hong Kong are suddenly quiet, brokering far fewer trade deals than before and virtually empty of visiting California business executives. California businesses will be doing few, if any, new deals in the area in the near future.

For its part, Calgary should fail the test for other reasons. Although Canada is California's third-largest trading partner, Calgary is an illogical location – Canada's seventh-largest city, isolated from major markets to its west and east.

Sao Paolo has some logic as site for a fourth new office. It could serve as gateway to Mercosur, the Southern Cone's prosperous trade bloc. Some lawmakers, however, prefer Argentina. In 1999, Senators Richard Polanco and Jim Costa introduced SB 897, which would mandate the opening of a Buenos Aires office. Brazil and Argentina rank only 16th and 25th among California's export markets, but they have been rising rapidly in importance, with big appetites for California electronics, and electrical and transportation equipment.

Unfortunately, the timing of a South American offensive could hardly be worse. Brazil has plunged into economic crisis, pulling Argentina into recession. And negotiations to extend NAFTA to South America by creating the Free Trade Area of the Americas have slowed dramatically, and are expected to take at least until 2005 to finish – perhaps longer if the White House and Congress are unable to make a deal to renew the president's fast-track trade negotiating authority.

Perhaps as a result of all these problems, the new offices are on shoestring budgets of \$300,000 for Shanghai and about \$150,000 each for Manila, Sao Paolo and Calgary. These amounts are nowhere near enough to pay for staff with any specialized expertise in

California's growth industries, and barely enough to pay for office rent and to keep a coffee pot warm.

In addition to debating the foreign offices' location, some experts dispute their function. Rather than attending to virtually all firms that ask for help, the offices could be redesigned to focus exclusively on trade intelligence. Jock O'Connell, for example, suggests the following strategy:

“The overseas offices should become our eyes and ears on foreign markets. The London office, for example, might be restricted to acting as the state's liaison with the huge international financial center in the City of London. Quite apart from serving the information needs of California industry in an era of global finance, such an office could provide vital informational and liaison services to the State Treasurer, the State Controller, the Franchise Tax Board as well as the two major state pension funds, CalPERS and State Teachers' Retirement System. The role of other overseas offices should be similarly restricted to gathering the sort of market intelligence required to compete successfully in world trade. Thus, the office in Sub-Saharan Africa could be re-tasked to look not for new export markets for California companies but for opportunities for California firms to invest in and perhaps share management expertise with African-owned companies. Likewise, the Frankfurt office could be restricted to promoting joint ventures between small and medium-sized European and California firms in the environmental technology or biosciences sectors. The ... Manila (office) ... primary function would be liaison with the Asia Development Bank in pinpointing emerging market opportunities for California companies.”<sup>1</sup>

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## ENDNOTES

<sup>1</sup> O'Connell, Jock, *The Golden State and the Global Economy*.

# *Appendix D*

## **BORDER INFRASTRUCTURE**

A key factor in trade with Mexico is infrastructure on the border – highways, railroads, ports, and wastewater treatment and disposal facilities. The following projects are among those that many analysts and business leaders say require increased attention from the state government:

- Construction of State Route 905 from the Otay Mesa border to Interstate 805 and construction of State Route 7 from the Calexico East border to Interstate 8. The fact that these major trucking corridors do not have wide, modern freeways is one of the great mysteries of the NAFTA era.<sup>1</sup> As a result, billions of dollars of trade are bottlenecked by traffic, potholes and red lights every day. Partial federal funding for the two projects was finally ensured when Senator Barbara Boxer and Representative Bob Filner succeeded in including them in the May 1998 federal transportation bill. However, a funding gap of at least \$111 million remains to complete SR 905.
- Repair of the San Diego & Arizona Eastern Railway. This railroad, closed since 1984, runs from San Diego into Mexico near Tecate, where it connects with the Mexican rail system (including a trunk line to Tijuana and a planned line to the port at Ensenada), before re-entering the United States and heading to Arizona and points east. Reconstruction of the line, which would cost between \$75 million and \$123 million, is crucial to the future of the San Diego port and of the entire Tijuana-Ensenada area. But in a bizarre twist of political illogic, this project has been blocked by Representative Duncan Hunter, R-El Cajon, who claims that rebuilding the route will increase drug trafficking and illegal immigration from Mexico.
- San Diego-Tijuana airport. San Diego's tiny Lindbergh Field is too small to serve the region's booming cargo needs and has nowhere to grow. Tijuana's Rodriguez International Airport is underused and poorly equipped. Many business leaders and government officials in both countries say the solution is to expand the Tijuana airport, which is located right on the border near Otay Mesa and could be expanded to serve as a large, cargo-ready binational airport, with terminals on each side. Although the proposal raises some tough concerns over security, financing and logistics, it deserves careful study.
- Alameda Corridor. A test case of how a crucial trade infrastructure project can provoke opposition if the benefits are not spread to less-advantaged business sectors. This \$1.9 billion project will build a 20-mile-long, high-speed, high-volume, cargo-only rail and truck route linking the Los Angeles/Long Beach ports to the transcontinental railroad connection at Union Station. It is key to the area's dream of turning the customs district – already the nation's busiest, accounting for 12 percent of U.S. imports and exports – into the industrialized world's gateway to Latin

America and Asia. But the project has been slowed by grass-roots opponents who charge that it will help major corporations but ignore local poor areas. A recent study of the issue by the Pacific Council on International Policy at the University of Southern California concluded: "Plans to expand ports and airports meet with strong local opposition because of financial concerns but also because the link between the infrastructure for international trade and the economic welfare of distinct groups in the region is not sharply drawn."<sup>2</sup> Although state funding is not involved in the construction, the state should assume a supervisory role in spreading infrastructure improvements, jobs and business contracts to the area's less-advantaged and minority residents. In 1998, Governor Wilson blocked one such effort. He vetoed SB 1742, the Alameda Corridor Cities Economic and Community Development Act, authored by Senator Betty Karnette, D-Long Beach. The bill would have required the Trade & Commerce Agency to lead a broad-based planning process to develop a strategic plan for the Alameda Corridor region.

- New River cleanup. The fetid industrial and residential wastes from Mexico's border city of Mexicali endanger Calexico and other California communities and severely contaminate the Salton Sea. Cal/BECC has provided technical aid to the New River Sanitation Project in Mexicali, a \$50 million plan to rehabilitate the city's existing wastewater treatment facility and build a new wastewater treatment plant. The project has been certified by the federal BECC and is a candidate for NADBank funding.

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## ENDNOTES

<sup>1</sup> The Otay Mesa port of entry is connected to the Interstate highway system by only a four-lane city street that is currently operating at three times its designed capacity. At Calexico, the only connection between the new border crossing and the Interstate is State Route 98, a two-lane road. More than 90 percent of the state's \$11 billion in annual exports to Mexico travel by truck; the number of trucks crossing at California land ports has more than doubled from 668,000 in 1993 to more than 1.5 million today.

<sup>2</sup> Cited in Jim Newton, "Three Major Economic Projects Could Define the L.A. of 21st Century," *Los Angeles Times* (December 14, 1997), p. A1.

## *Appendix E*

### ***FIDUCIARY AND SOCIAL RESPONSIBILITY***

Conservatives in Washington, D.C., and some investment firms have strongly opposed the use of socially responsible investment (SRI) strategies by pension funds. They have cited critical analyses of South Africa and tobacco divestment to buttress their argument that SRI practices inevitably reduce funds' profitability and thus violate fund managers' fiduciary obligations.

For example, a 1991 report prepared for CalPERS by Wilshire Associates, a Los Angeles investment consulting firm that is one of the fund's principal investment consultants, said South Africa divestment had cost the fund \$590.2 million over five years. And on tobacco, a 1998 study for STRS by the Berkeley-based investment consulting firm BARRA RogersCasey concluded that divestment from the fund's \$1.2 billion in tobacco stocks would incur \$8.1 million in one-time costs and reduce the fund's overall returns by six basis points, or 0.06 percent.<sup>1</sup>

But other analysts draw opposite conclusions. They say the Wilshire study was marred by faulty methodology and by a conflict of interest because Wilshire, as CalPERS' longtime investment consultant, could be expected to fight any attempt to decrease its own power. "The Wilshire study has been thoroughly debunked," said Peter DeSimone, a South Africa funds analyst with the Investor Responsibility Research Center, a Washington, D.C.-based think tank. "There are so many variables in terms of market impact and opportunity costs ... that it is impossible to calculate exactly how much South Africa divestment cost the funds, whether it cost anything at all, or whether it actually helped improve their returns." DeSimone also noted that studies opposing SRI criteria, such as the BARRA study, fail to calculate socially undesirable investments' indirect costs for plan members and the state, such as the billion-dollar health price tag of tobacco smoking.<sup>2</sup>

In fact, tobacco-free indexes have outperformed CalPERS in recent years, and tobacco stocks ranked among the 10 worst-performing industry groups globally in the first half of 1998, with a negative return of 7.6 percent. In the case of the Massachusetts Pension Reserves Investment Management Board, which began immediate liquidation of all tobacco-related holdings on January 1, 1998, the fund's returns on its S&P 500 Ex-Tobacco Index for the 12 months to June 30, 1998 were 30.87 percent, versus the 30.21 percent return of the S&P 500.

Other SRI fund indexes have had equal success in beating Wall Street. As mentioned on page 47, the Domini 400 Social Index averaged annual returns of 26.45 percent in the



five years ending March 31, 1999, outpacing the S&P 500 return of 26.22 percent. The Domini 400 has also outperformed CalPERS' U.S. Equities index, CalPERS Total Equities index and CalPERS Custom 2500 index.<sup>3</sup>

These successes have persuaded many state officials. In Massachusetts, Florida and Pennsylvania – states which, like California, are participating in lawsuits against the tobacco companies – officials have decided that decreased tobacco consumption and the industry's growing legal problems create a clear fiduciary obligation to divest.

In Florida, which opted for full divestment, Attorney General Robert Butterworth wrote in a legal opinion to the State Board of Administration that fiduciary responsibilities should mandate – not prevent – full divestment from tobacco securities. “The tobacco industry is in an extremely volatile position, subject to the outcome of litigation, changing public opinion, and public policy decisions over which it has limited control. This volatile market environment places tobacco stock in a uniquely vulnerable position among investments.” He added that Florida’s simultaneous ownership of tobacco firms and its lawsuits against them create a potential legal conflict of interest. “The state’s investment of retirement funds in the tobacco industry is irreconcilable with its current attack on that industry for corrupt business practices, including the target marketing of cigarettes to children when every state prohibits the sale of tobacco to minors.”<sup>4</sup>

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## ENDNOTES

<sup>1</sup> BARRA RogersCasey, *California State Teachers’ Retirement System: Tobacco Divestment Analysis* (Berkeley, 1998).

<sup>2</sup> Telephone interview, June 3, 1998.

<sup>3</sup> Mark Friedman (El Cerrito councilman and co-chair, Elected Officials for Responsible Public Investment), Peter Camejo (CEO, Progressive Asset Management, and chair, Council for Responsible Public Investment) and Leah Sturtz (project director, Council for Responsible Public Investment), letter to State Assembly Appropriations Committee Chair Carole Migden, August 13, 1998.

<sup>4</sup> Letter by Butterworth to Tom Herndon, Executive Director of the Florida State Board of Administration, May 27, 1997, p. 9.

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## ***ABOUT THE AUTHOR***

Robert Collier is a staff reporter and editor at the San Francisco Chronicle, covering international trade policy and Latin America. He can be reached by telephone at (415) 777-6090 or by email at [rcollier@sfgate.com](mailto:rcollier@sfgate.com).