

California's New Economy

California is leading the world in a revolution of productivity and economic growth. This revolution is centered on information, technology, innovation, and human capital. The state is by far the nation's leading producer of electronic equipment and components, and the machinery used to manufacture high technology goods. The State's leadership is even greater in the areas of design, research, and development.

In addition to high-technology manufacturing, California is also the nation's leading provider of computer services, including software and the Internet. From mid-1998 to mid-1999 (the latest period for which figures are available), the computer services industries added 39,000 new jobs, a growth rate of 16 percent. Information retrieval-the Internet-accounted for more than one-third of these new jobs, surging by 76 percent over the year. Computer services comprise not only the fastest-growing high technology industry in the state, but also the largest—281,000 jobs as of June 1999, and almost certainly in excess of 300,000 as the new year begins.

The Administration proposes the following initiatives to keep California the world's leader of the New Economy:

Information Technology and the Internet

- **Continuing California's Leadership in Science and Innovation**—State investments in science and technology are critical for California to maintain its leadership in an increasingly competitive technology-based economy. To ensure that California remains in the vanguard of technological and scientific innovation in the next century, the Administration commits \$75.0 million annually for the next four years to the University of California (UC) to launch three California Institutes for Science and Innovation to be established at separate campuses of the University of California. This new initiative will give rise to world-class centers for strategic innovation that combine excellence in cutting-edge research with collaboration and training for our next generation of scientists and technological leaders.

The Institutes will concentrate intellect, experience, and entrepreneurial talent in focused areas of scientific inquiry to discover and apply the breakthroughs necessary for the next generation of technologies. The California Institutes for Science and Innovation—whether they concentrate on medicine and bioengineering, telecommunications and information systems, energy resources, space, or agricultural technology—will seek matching funding from private industry, foundations, the federal government, and local communities to ensure that California maintains and expands its role at the leading edge of technological innovation in the 21st Century. These institutes will be created through a competition for excellence conducted by a gubernatorial panel, administered by the University of California in 2000.

- **Next Generation Internet Application Centers**—The federal government partnered with the private sector to develop technology that increases Internet transmission speeds one hundred fold. To apply this technology commercially, the Trade and Commerce Agency will partner with the federal government, universities, other public entities, and the private sector to establish two Next Generation Internet Centers. These incubators/centers will provide resources to small companies and individual researchers to develop new software and applications for the next generation of the Internet. The Budget proposes \$5.0 million for this effort for each of the next three years. Benefits include helping California's high-tech industries maintain their worldwide leadership, economic growth for the state, job creation, and potentially higher tax revenues.
- **Internet2**—The University of California has been a major participant in the federal/university/private effort to increase backbone transmission speeds of the Internet. The UC budget includes \$8.0 million to expand and maintain the campus network connections needed to provide direct access to Internet2. Funding will foster research initiatives among campuses and industry that are vital to California's high technology economy. This program is also discussed in the Higher Education section.
- **Connecting Rural Communities**—Increasingly, the Internet is pivotal to job creation and economic development. In the emerging new economy, access to high-speed digital communications is a requirement, not an option. The Budget provides \$2.1 million to the Trade and Commerce Agency for a project coordinated through California State University in Fresno to encourage the development of electronic commerce in rural communities. Through matching grants, this program will allow communities to establish Internet centers, provide e-commerce training to businesses, and develop local telecommunications plans.
- **Education Technology Funding**—To prepare our students to use the developing technology of the new economy and to take advantage of the power of that technology in an instructional setting, the Budget includes \$364.0 million in one-time funds for schools. K-12 schools will receive \$175.0 million for computer acquisition, focused first on high schools not currently offering advanced placement courses and second on increasing the number of computers available to students in schools. The Budget also includes \$25.0 million for intensive training of K-12 teachers in instructional strategies incorporating technology. Additionally, the Budget proposes \$164.0 million for the fourth and final year of the Digital High School Program.
- **Commercial Space**— The Budget proposes \$4.1 million overall to support the commercial space and aerospace industries, including \$2.3 million for competitive grants, \$1.0 million to continue the effort to locate launch and production facilities for the VentureStar reusable launch vehicle in California, \$250,000 to secure the Joint Strike Fighter project, and \$210,000 to construct an aerospace supplier data base.

E-Government

California companies lead the world in developing and using information technology to do business better. The Administration is committed to enabling California government to provide an equivalent quality of service by seizing the opportunity to use the Internet and other new technologies.

- **One-Stop E-Business Center**—Over three-dozen state departments and a larger number of local and federal agencies regulate business in California. Companies and individuals can spend an inordinate amount of time and money navigating disjointed reference sources and websites in order to comply with regulatory requirements.

To remedy this, the State is investing \$2.1 million in 2000-01 and up to \$90.0 million over five years to organize, in a single Internet portal, the many governmental services and information sources already available on-line in a simple "one-stop shop." This program will be administered by the Department of General Services.

While work is in progress on developing the One-Stop E-Business Center, the Administration proposes the following projects which will provide better service to the public through the Internet:

- **Motor Vehicle Registration**—By early spring 2000, owners will be able to renew their vehicle registrations over the Internet, using a credit card for payment. Vehicles insured through participating insurance companies, as well as those for which proof of insurance is not required, will be able to use this option. Persons using this service will receive their tags in the mail within a few days of completing the transaction on-line. As more insurance companies transmit proof of insurance to the Department of Motor Vehicles electronically, more car owners will be able to renew their registrations on-line.
- **Electronic filing of income tax returns**—The Governor's Budget provides \$260,000 to inform taxpayers of the option to file income tax returns over the Internet (e-filing). For the 1998 tax season, over 1.3 million taxpayers used the e-filing option. For the filing season that starts January 2000, the Administration expects over 2.0 million taxpayers to file electronically. By 2001, e-filing should increase to 2.5 million returns.

Currently, individual taxpayers can e-file by using an on-line filing service. A list of these providers is available through the Franchise Tax Board's website (<http://www.ftb.ca.gov>). Payment options vary depending on the method of filing. Beginning January 2000, those who e-file and file by telephone (telefile) can pay by credit card through their filing service or by check.

In addition, taxpayers using the website can arrange for payment of taxes owed and refunds of over-payments. Although the system does not yet accommodate all filing (e.g., prior year returns, taxpayers with foreign addresses, amended returns), the vast majority of individuals can file electronically.

For the 2001 tax season, many taxpayers will be able to e-file directly (i.e., not go through a service provider), making payment if they wish by authorizing the electronic transfer of funds from their bank account. Similar to the Internal Revenue Service's program, electronic funds transfer allows the taxpayer to file at their leisure, and specify a future date that any payment due is transferred from the taxpayer's bank account—such as April 15.

- **One-Stop Website for Public School Construction**—The Budget includes \$3.3 million in 1999-00 and \$2.4 million in 2000-01 for the Department of General Services, the Department of Education, and the Department of Toxic Substances Control to develop jointly a one-stop website for public school construction. The site will provide school districts, parents, and other interested parties with information on the state approval process and the status of public school construction projects.

In addition to Internet-related projects, the Administration proposes steps toward developing better information technology support for delivery of education and state programs as follows:

- **Public School Technology Inventory**—The Budget provides \$300,000 for a survey of existing technology in public schools, including hardware, wiring, Internet access, staff expertise, and compatibility. This survey is in preparation for a statewide education technology master plan. Additional support of technology in schools is discussed in the Education section.
- **Information Technology Innovation Fund**—The Budget includes \$10.0 million to create a fund to take quick advantage of creative new technology applications in state government. This will supplement the State's normal information technology development efforts by funding projects that will serve as demonstrations of the most effective use of new technology within the government setting. An Information Technology Innovation Council will administer this program. (See organization code 9905 in the Governor's Budget.)

New Economy Tax Incentives

In addition to tax relief proposals targeted to individuals, the Governor's Budget proposes tax changes targeted to assist cutting edge industries with an annual estimated cost of \$101 million by 2004-05. A summary of all of the Governor's tax initiatives is included in the Revenue section.

- **Net Operating Loss Carryover**—The Administration proposes to phase in an increase in the percentage of losses that businesses can carry forward to subsequent years. In 2000, the carry-forward rate would increase from 50 percent to 55 percent, and in 2002 the rate would increase again from 55 percent to 60 percent. In addition, the carryover period would be extended to ten years. Expansion of the loss carryover provisions is particularly important to firms in cyclical industries, such as high-tech and agriculture, as well as start-up businesses. Although the tax system is based on a 12-month reporting period, the economic cycle of a business can be much longer. This proposal will improve the match between the economic and tax cycles. This is expected to result in revenue losses of \$1 million in 2000-01, \$7 million in 2001-02, and increase to \$198 million by 2009-10.
- **Graduate Student Expenses**—The Administration proposes a personal income tax exclusion for graduate school expenses paid by an employer. The proposal aligns the tax treatment of graduate student expenses with that allowed for undergraduate expenses at a cost of \$10.0 million per year beginning in 2000-01.
- **Alternative Incremental Research and Development Credit**—The Administration also proposes an increase from 80 percent to 90 percent of the June 30, 1999, federal credit for this variation on the basic research and development credit. The alternative incremental research credit was designed to assist firms that had significant research expenses, but could not utilize the traditional research credit because it requires an increase in expenditures over a specific base period. This proposal increases California's competitiveness in attracting aerospace and other high-tech firms that utilize this credit. It is estimated to result in revenue losses of approximately \$4 million in 2000-01.
- **Aerospace Employment Credit**—The Budget recommends a credit of \$1,000 for each new employee hired by small and start-up employers to perform work in the aerospace industry. Other states and nations vigorously compete for aerospace firms. Retention and growth in these emerging companies are key to maintaining California as a leader in this major growth industry. Revenue losses resulting from the proposal are expected to be minor.
- **Biomass Credit**—The Administration proposes up to \$10 million per year of allocated tax credits to encourage biomass conversion activities for the 2001 and 2002 tax years. (As noted under the discussion on the Central Valley, this tax credit program will be preceded by a grant program in the budget year.)
- **Rural Investment Tax Exemption**—In order to spur economic development, the Administration proposes a state sales tax exemption aimed primarily at Central Valley counties with chronically high unemployment. The exemption would be capped at \$5.0 million annually, for manufacturing equipment purchased by businesses that locate facilities in counties that have an unemployment rate at least 3 percentage points above the statewide average. The businesses must make an investment in facilities in the county of at least \$150 million and create at least 500 new jobs. The Trade and Commerce Agency will administer the program, allocating the exemption authorizations through the California Infrastructure and Economic Development Bank Board.

- **Housing Tax Credit**—The Budget also recommends increasing tax credits allocated for low-income housing development from \$35.0 million annually to \$50.0 million. Chapter 9, Statutes of 1998, authorized this increase for two tax years only, 1998 and 1999. The Administration's proposal would make this increase permanent, beginning with the 2000 tax year. The proposal recognizes that lack of affordable housing limits economic development in California's fastest growing areas.

Central Valley Economic Development

Although California has an exceptional economy, the economic blessings have not fallen equally. Unemployment in the eight San Joaquin Valley counties—San Joaquin, Stanislaus, Merced, Madera, Fresno, Kings, Tulare and Kern, averages 12.3 percent, a full 7 percentage points higher than the statewide level of 5.3 percent.

Figure A

In large measure, the Central Valley's high unemployment and low per capita income reflect the region's dependence on agriculture, which results in lower wages with pronounced seasonal demand. However, even at peak harvest season, unemployment rarely falls below 10 percent, suggesting a large residual structural jobless population.

The Administration is committed to ensuring that all of California benefits from the global new economy. To help the valley develop and diversify its economy, the Administration supports several steps:

- **UC Merced**—The Administration continues its commitment to rapidly develop the new campus as a focal point for a high-skill job force and the spin-off of new businesses, as seen around other University of California campuses. In addition to \$9.9 million for continuing operational support, the Budget contains \$14.3 million from higher education bond funds for initial site development and infrastructure at Merced, as well as planning funds for the first complement of academic buildings, including library, classroom, laboratory, and academic support facilities. The Administration has requested that state agencies and local governments work with University of California officials to accelerate the opening of the Merced Campus by one year to the 2004-05 year. To further this effort, the Governor has created a "UC Merced Red Team" co-chaired by the Secretary of the State and Consumer Services Agency and the Chancellor of UC Merced, and composed of seven cabinet secretaries, the Lieutenant Governor, and a UC Regent.
- **Internet Access**—As noted in the Information Technology and the Internet section above, the Administration proposes \$2.1 million for a project coordinated by California State University Fresno to encourage electronic commerce development in rural communities by improving access to the Internet.
- **Transportation Infrastructure**—The Budget includes \$20.0 million for track improvements in the Fresno area to reduce trip times by 45 minutes and improve service reliability on the San Joaquin corridor of the Intercity Rail Program. Additionally, \$36 million is proposed to extend service on the Altamont Commuter Express trains to Modesto and increase frequency of service. The Governor has also announced support for two highway projects in the Fresno area—the Shaw Avenue-State Route 99 interchange and the Seventh Standard Route-Route 99 interchange. These two projects connect potential business development areas. Caltrans will be working with regional transportation authorities to speed up the funding for these projects in conjunction with the Budget's Transportation 2000 initiative. Some of these projects are also discussed in the section on that initiative.
- **Biomass Conversion to Energy**—As noted above, the Budget includes \$10.0 million for grants administered by the Trade and Commerce Agency to facilitate the ability of the emerging biomass industry to convert agricultural waste into clean energy. This program will be converted to a tax credit for 2001-02 and 2002-03.

- **Rural Investment Tax Exemption**—As noted above in the discussion on the New Economy Tax Incentives section, the State will offer a partial sales tax exemption to businesses making a major investment in specified areas with unemployment significantly higher than the statewide average.