





## ON CALIFORNIA

First in a series that will examine the Golden State's challenges and potential going forward

### Hard Truth: Shaky Miracle

On the surface, California's economy seems to be on a roll. While the Great Recession battered California even harder than the nation, the state's economy has come roaring back. Over the entire recession-recovery period from the fourth quarter of 2007 to the present, cumulative job growth in California was 4.9%, roughly 50% higher than U.S. job growth of 3.3%.

Personal income growth in California also has outpaced the nation. In 2007, California's per capita personal income of \$43,200 was 8.4% higher than the nation's \$39,800. By 2015, California had widened the gap to 10.3%, with per capita personal income of \$52,700 compared to \$47,700 for the U.S.

What has become known as the "California Miracle" also is reflected in the state's general fund revenues, which have increased from \$95.4 billion in fiscal year 2006-07 to \$118 billion in 2015-16, a cumulative increase over that nine-year period of 24%. Since the recessionary trough, the increase has been an even greater 40%, from \$84.5 billion in 2009-10.

#### Beneath the Surface

Looking beneath the surface, however, reveals a number of deep-seated structural problems that jeopardize California's future. Perhaps most alarming is that California's economic recovery is not broad-based but rather geographically focused in the five-county Silicon Valley area that includes San Francisco.

From the fourth quarter of 2007 to the same period of 2015, jobs in the Silicon Valley increased 11.2%. That compares to an increase of only 1.4% in Los Angeles County and 2.8% in previously high-flying Orange County, both increasing at a rate lower than the U.S. average of 3.3%. California's overall job growth of 4.9% was obviously skewed higher because of Silicon Valley's rapid growth. Indeed, Silicon Valley accounted for about 40% of all job growth in California between 2007 and

2015, even though it represented only 13.8% of the state's population by the end of the time frame.

Findings on total job growth, however, mask a great deal of change occurring within the state's job sectors. Since the fourth quarter of 2007, information services jobs increased 58.7% in Silicon Valley. This compares to a decrease in information services jobs of 0.8% in Los Angeles County and an even sharper decrease of 16.7% in Orange County.

The 58.7% increase in information services jobs in Silicon Valley includes jobs in categories such as software developers, computer programmers and statisticians that command an average salary of \$188,000—a salary more than three times the average for all California jobs.

Total annual wages for all jobs increased 49.5% in Silicon Valley between 2007 and 2015, with average wages per employee hitting \$95,700 in 2015. In sharp contrast, total annual wages in California increased 27.2%, with an average salary of \$61,685. As in the case of jobs, Silicon Valley accounted for a disproportionately large share of the total increase in wages paid. But in this case, its disproportionate share was an even greater 43% of the total.

While Silicon Valley was a veritable job machine in generating service-sector jobs, particularly those that were information-related, California was shedding manufacturing jobs. The state lost 11.3% of its manufacturing jobs since the fourth quarter of 2007. That wasn't too far off the 11.6% drop in U.S. manufacturing jobs. But in Los Angeles County, the loss in manufacturing jobs was a significantly higher 19.5%, or 86,000 jobs.

These job losses help explain why people are moving out of California in record numbers. During the 2012 to 2015 period, California lost, on net balance, 167,000 people

who migrated to other states, with Los Angeles County accounting for 152,000 of the decline. Not surprisingly, given its growth trajectory, Silicon Valley registered a positive net inflow of about 7,000.

Another factor forcing people to flee California is home prices. The median price of an existing single-family home in California was \$474,200 in 2015, more than double the U.S. median price of \$220,900. Yet 2015's average annual wages in California of

states, it is an even greater problem now.

As noted in Gov. **Jerry Brown's** "May Revision 2016-17" to the state budget, **Moody's Investors Service** released a report that evaluated 20 of the largest states' preparedness for the next recession. The report ranked California last in preparedness, except for Illinois.

Rapid economic growth in Silicon Valley has made it possible for California to put away \$6.7 billion as a "Rainy Day Fund" for future economic uncertainties. But compare that \$6.7 billion to the recent California's Department of Finance estimate of a loss of \$55 billion in the state's tax revenues from a recession of "average magnitude."

#### Pension Debt

Another problem hanging over the head of California and other states is unfunded pension debt. That problem, though, is even greater in the Golden State. When states are ranked by actuarial pension debt as a percentage of general fund expenditures, California ranks 11<sup>th</sup> highest when a 7.5% rate of return is assumed. It ranks in fifth place at a more realistic 2% percent rate of return. If the actual return is in the middle of that range at 4.75%, California's unfunded pension liability would be six times its general fund expenditures. That's equivalent to about \$600 billion in unfunded liability. That \$6 billion "Rainy Day Fund" is looking pretty paltry.

It's apparent after looking more closely at the data that the "California Miracle" is really a "Silicon Valley Miracle." That regional miracle has lifted the tide for the entire state, thereby leading many to believe that the California economy is stronger than it really is. Rather than wait for the next recession to hit or wait until state workers start retiring in droves, the state should act now to address its structural problems while the "miracle" is still working its magic. ■



**By James L. Doti**  
President and Donald Bren  
Distinguished Chair of Business  
and Economics  
Chapman University

\$61,685 is only 16% greater than the U.S. average of \$52,900. Median home prices in California are, therefore, 7.7 times the state's average annual wages as compared to 4.2 for the nation.

Even the 24% increase in California's general fund revenues noted earlier presents structural challenges. Given the strength of Silicon Valley's economy in generating high-paying jobs, a sharp jump in revenues from California's highly progressive state income tax explains the increase. In fact, it explains all of it. While personal income tax revenues increased a whopping 50% from \$51.9 billion in 2006-07 to \$77.7 billion in 2015-16, the sum of all other California state taxes from such sources as sales and use and corporate taxes actually decreased. That explains why the highly cyclical personal income revenue has increased as a share of total tax revenues from 54.4% in 2007-08 to 65.8% in 2015-16, with the top 1% of earners paying 48% of all personal income taxes in the state.

So if California's over-dependence on personal tax revenues was a major problem that explains why the California state budget was harder hit by the Great Recession than other

## Slyde

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"She's a lot better at talking to people than I am," said Steve Watts, 39. "And making sure their needs are met. It was a very fluid, organic way we jelled together in terms of who gets what done. And we've never really had an issue or dispute about something. I keep an eye on everything. The great thing about working with family—there's no doubt that they have your best interest in mind."

#### A Big Idea

Handboarding is a sport that's probably older than surfing itself, he said. Handboards are one-handed surfboards that strap to a surfer's hand for bodysurfing. They work by allowing bodysurfers to lift out of the water when they catch a wave, increasing speed and maneuverability.

In Watts' native South Africa, bodysurfers would use trays, flip flops, or whatever they could get their hands on, he said.

Watts started surfing, both with a handboard and with a surfboard, when he was about 13. He first got the idea to create a company to sell handboards when he was 16, he said.

"I enjoyed doing it, and I could see that

other people enjoyed doing it," he said. "Just to see a smile on someone's face."

Watts created Slyde Handboards in Venice in 2010 because of the city's "cool art, culture, surf and skate scene," he said.

He soon was making 10 trips a month to Orange County to get supplies, sparking an epiphany that San Clemente was the best place for his company, he said.

"We feel like we're in the heart of surf culture, and the **Surf Industry Manufacturers Association** is in Orange County," said Angela Watts, 33.

She came on board in 2013, and her aunt, **Joyce Ferendo**, moved here from Rhode Island to handle shipping and distribution.

The couple became engaged in December 2014 but had to put their wedding on hold because all their money was being invested in the company, Angela Watts said. They also borrowed from relatives to keep the business going.

Her mom surprised them by telling them she had \$10,000 saved that she wanted to give them for the wedding. They put a deposit down on a venue, but then they needed the money for the company, Angela Watts said.

With her mother's blessing they used it, and then they got a call from "Shark Tank."

The episode aired in April, revealing a funding deal of \$200,000 for 22% equity in the company from shark **Mark Cuban** and guest shark **Ashton Kutcher**.

Around the time the couple got the initial call from "Shark Tank," a serendipitous opportunity attracted another investor. Angela Watts' brother, **Frank Ferendo**, was working on a video for Slyde on an airplane. His seatmate, **Mitchell Cox**, turned out to be an investor and inquired about the company. Cox ended up investing \$75,000.

With the investments, the couple was able to pay back their family members, Angela Watts said. They got married last September in Rhode Island, her home state. Now she's six months pregnant with their first child, a girl.

#### Investment Boost

Sales have grown by almost 300% since the "Shark Tank" episode aired, and the company already has surpassed the \$180,000 in sales it made last year, Angela Watts said. The funding enabled the couple to move its operations

out of their one-bedroom apartment, into an office and warehouse in San Clemente.

Slyde got another jumpstart from the **San Diego Sport Innovators** program, which gave Slyde five advisers to help them prepare to pitch to investors, Angela Watts said. They also were just invited into a business development program put on by the Laguna Niguel-based Surf Industry Manufacturers Association, which helps with global distribution and operations, Angela Watts said.

The couple said the Business Journal award validated all the hard work they've both invested in the company.

"It makes me feel so good, and this year for us, especially, has been an incredible year," she said. "We want to keep it going, and it just makes us work harder, getting these types of awards."

Another bonus is that their customers are now using the name of the company as a verb. To "slyde" is becoming synonymous with Slyde's brand of handboards, although the company does have some competition, she said.

Future goals include new kid-friendly products that don't have release dates yet, she said. The current products are "very high-performance, high-quality," she said, adding that they range in price from \$120 to \$200. ■

