RESEARCH BRIEF

Public Policy Institute of California

JUNE 2003 ISSUE #72

How Globalized Is California's Economy?

Over the last two decades, international economic activity has increased markedly. Eager to capitalize on increased global integration, California policymakers have sought to boost the exports of California firms and to attract foreign companies to operate businesses here. Although other states also seek to increase exports and foreign investment, and economic globalization is usually measured at the national level, the sheer size and complexity of California's economy make an analysis of its international trade and other forms of economic exchange especially useful.

In *Business Without Borders? The Globalization of the California Economy*, Howard J. Shatz describes California's global exposure with special emphasis on goods and services trade, foreign direct investment, and port activity. He finds that California differs from the rest of the United States in many standard measures of economic globalization. Compared to the rest of the United States, for example, California's goods exports are proportionately high, but its foreign direct investment is relatively low. Shatz also finds that California is at the leading edge of several emergent trends in international economic activity. Compared to the rest of the United States, California exports more services, and its ports ship more exports by air than by land or sea. Also, California manufacturers are more likely to use production-sharing than other U.S. firms.

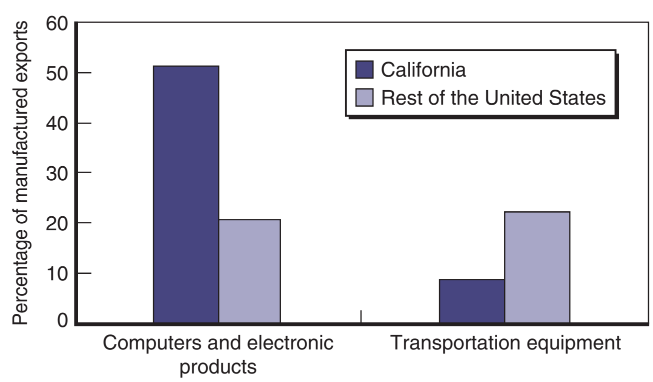
California's Global Economic Profile

Compared to firms in the rest of the United States, California businesses engage in proportionately less outward foreign direct investment. Their foreign investment is particularly strong, however, in two dynamic areas: nonmanufacturing industries and manufacturing industries that use production-sharing—that is, the process by which multinational enterprise networks produce and assemble components in different locations. This form of production is prominent in technology industries, such as industrial machinery and electric and electronic equipment. California outward foreign direct investment is especially strong in Asia, the site of much production-sharing.

The state's inward foreign direct investment—the level at which foreign firms invest in California—is also low relative to the size of the state's economy, and the industrial mix of that investment differs from that of the rest of the United States. For example, California has a much lower share of foreign-affiliate manufacturing employment than does the rest of the United States but a higher share of employment in wholesale trade, information industries, and professional, scientific, and technical services.

Although California's manufacturing sector is relatively small, its manufacturers export a higher proportion of their output (28 percent) than do producers in the rest of the United States (20 percent). In addition, California merchandise exports are heavily tilted towards high-technology industries (Figure 1). Computer and electronics products, for example, accounted for 51 percent of the state's manufacturing exports. California agriculture exports a high proportion of its output, between 16 and 19 percent, but this proportion is about the same for the rest of the United States.

Figure 1—Industrial Mix of Manufactured Exports, 2001



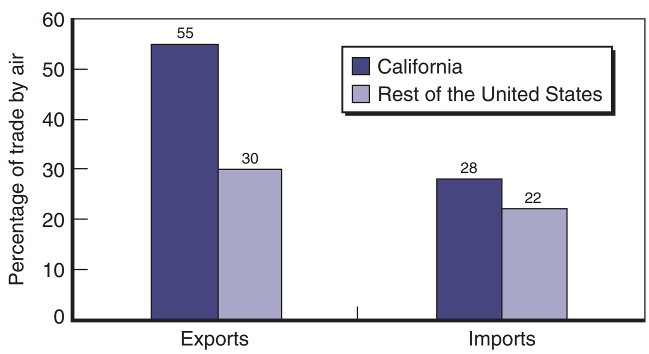
SOURCE: Massachusetts Institute for Social and Economic Research.

Compared to the rest of the nation, California's manufacturing exports lean heavily toward computers and electronic products and away from transportation equipment.

The rapid growth of services trade is a new phenomenon in the world economy. No direct measures of services trade by California exist, but estimates indicate that California's economy generates a slightly higher proportion of private services exports than does that of the rest of the United States. Specifically, private services exports as a percentage of the private California economy measured 3.5 percent in 1998 and 3.3 percent in 1999, compared to 3.1 percent in both years for the rest of the United States. By this estimate, California services exports were higher than the total exports from California's second- through seventh-leading goods-exporting industries.

The report's final measure of economic globalization is port activity. Although California's two busiest ports are the seaports of Los Angeles and Long Beach, its two biggest export gateways in terms of value are the San Francisco and Los Angeles International Airports. A very high proportion of trade flows by air through California gateways (Figure 2). In addition, a much higher proportion of Asia trade flows through California ports than through ports in the rest of the United States.

Figure 2—Air Trade Through California Ports and Other U.S. Ports, 2001



SOURCE: Massachusetts Institute for Social and Economic Research.

A very high percentage of trade flows by air through California gateways.

Shatz concludes that, in many respects, California's economy is not dramatically more global than the rest of the nation's. He notes, however, that California firms tend to be more active in those aspects of economic globalization that are growing fastest.

Economic Globalization and State Policy

California's current trade policy focuses on increasing merchandise exports and inward direct investment to strengthen the state's economy and to create jobs. Yet the California economy also depends on other aspects of international exchange, including outward foreign direct investment, merchandise imports, and services trade. Shatz notes that these other aspects of the global economy can also be used to help the state economy. With the growth of production networks, for example, one policy option is to help California firms identify appropriate partners and suppliers abroad in addition to the current practice of helping foreign firms find appropriate partners in California.

State policymakers might also consider whether they have a role in port planning and infrastructure provision. Ports bring both benefits and costs to California's economy, and even smaller ports affect areas beyond their immediate location. Although the ports in general are self-financing and much port planning takes place at the local level, policymakers could assess whether state assistance makes economic sense.

The state can also refine its role in export promotion. The merchandise export figures currently used for policy planning are not meant to represent production in California for export. Accordingly, the state might consider other means, such as periodic surveys, to better understand both the level and the destination of California goods trade.

Finally, Shatz notes that increased international economic exchange has contributed to widening income inequality, although the extent to which it has done so is a source of continuing debate. The effects of international trade and global integration cannot easily be separated from the effects of other economic trends, in particular technical change that favors employment of highly-skilled workers. However, the policy prescriptions for mitigating widening income gaps are the same for trade-induced and technology-induced change. These prescriptions are to improve the educational opportunities and the education of the population and to maintain a social safety net for workers displaced by economic change.

This research brief summarizes a report by Howard Shatz, Business Without Borders? The Globalization of the California Economy *(2003, 144 pp., $12.00, ISBN 1-58213-067-1). The report may be ordered by phone at (800) 232-5343 [U.S. mainland] or (415) 291-4400 [Canada, Hawaii, overseas]. A copy of the full text is also available on the Internet (www.ppic.org). The Public Policy Institute of California is a private, nonprofit organization dedicated to independent, objective, nonpartisan research on economic, social, and political issues affecting California.*

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