

ERODING TALENT BASE RAISES CONCERN FOR THE BAY AREA'S FUTURE, REPORT FINDS

*Vigorous Economy Spurts Past Dot-Com Peak by \$17 Billion,
But the Bay Area Loses "Most Productive Region" Crown to Boston*

SAN FRANCISCO, March 24, 2006 – The Bay Area economy ultimately rests on the skills of its workers and their employers, yet this talent base is slipping away, according to a biennial economic profile issued jointly by the Bay Area Economic Forum, the Bay Area Council, and the Association of Bay Area Governments. To stay competitive the region urgently needs path breaking solutions and investment in education, housing, and infrastructure.

The new report, "The Innovation Economy: Protecting the Talent Advantage," lays out optimistic but cautionary findings:

1. The Bay Area must take action to preserve its edge in talent.
2. Its thriving, resilient economy is now larger than at the height of the dot-com bubble.
3. The Bay Area has lost its "Most Productive Region" title to Boston.

"Continuing historical trends, the Bay Area has clearly emerged from the most recent recession in a strong position," said Jim Wunderman, President and CEO of the Bay Area Council. "Bay Area employers are in the center of one the world's most dominant and rapidly growing economic hubs. That said, economic conditions change extremely rapidly. Forces that many would argue are in our control are at this very moment rapidly eroding our economic advantage."

The Bay Area must take action in key areas to preserve its edge in talent, either by attracting able immigrants or cultivating skills within. The Bay Area is an innovation hotbed and knowledge-based occupations lie at its core. Many companies locate here to tap the outstanding talent pool, the report shows, and the region's future depends on these highly-skilled individuals. Yet vacancies loom in the talent base. As the economy expands, Baby Boomers are retiring, individuals are relocating to less costly areas in the nation, and foreign professionals are moving back home, especially to India and China.

The Bay Area faces a dual challenge in meeting this need. First, its schools must prepare all segments of the population to succeed in the sophisticated local economy. Second, the region has to better attract and retain talent, by addressing its high cost of living – especially housing – and the strained infrastructure.

- **Education.** In contrast to students admitted to the Bay Area's world-class universities, too many local K-12 public school students lack the skills to contribute to the knowledge-based economy.

- **Cost of living.** The most striking development over the past 10 years is the escalation of the Bay Area's cost of living. It has grown much faster than productivity and, as a result, the Bay Area is falling behind in cost-adjusted productivity. Paychecks may be higher than elsewhere, but expenses are much higher.
- **Housing.** Housing is by far the most important ingredient in the lofty cost of living. Local residents spend 48 percent of their income on housing, compared to 29 percent for the country as a whole. By federal standards, Bay Area housing is unaffordable for individuals of median income.
- **Infrastructure.** On many fronts Bay Area public services have not kept pace with the demands of the economy and the growing population. Freeways are jammed, commutes are longer, the power supply is vulnerable to a hot summer, water systems could snap in a major earthquake, and the patchwork of governmental authorities could slow a coordinated response in the case of disaster.

“The Bay Area has always attracted creative, educated people from around the world,” said Henry Gardner, Executive Director of the Association of Bay Area Governments.

“However, as opportunities increase in the international arena, particularly in China and India, fewer immigrants may choose to face the Bay Area's high cost of living, the obstacles raised by U.S immigration policies, and factors that reduce our regional quality of life, such as the high cost of housing, severe traffic, and risk prone infrastructure. These issues, coupled with our K-12 education system challenges, put the creative workforce that is the foundation of Bay Area's prosperity at serious risk.”

The report states that there is no shortage of efforts or vision to solve these challenges, and Bay Area leaders and citizens have the intrinsic capacity to meet them. The innovations will come from the private sphere – its companies, engineers, entrepreneurs, and inventors – and the solutions from the public sector. The report posits that by acting today, policymakers can stop these problems from widening, make the Bay Area more competitive, lessen the impact of a potential Katrina-scale disaster, and give today's residents and future generations a better quality of life.

The Bay Area's thriving, resilient economy is now larger than at the height of the dot-com bubble. The high-tech boom caused a surge in the economy and the subsequent downturn vaporized much of it. Today, the region has managed to transform itself and emerge prosperous, according to the report, and in 2004 it outpaced its 2000 GDP by \$17 billion.

In fact, in terms of gross domestic product (GDP) distribution, the local economy has largely reverted to its pre-bubble structure. Overall GDP, which measures the total output of the economy, grew steadily from 1994 to 2000, crested at \$335 billion, and then dropped off over the next three years. In 2004, though, the Bay Area came back, reaching a new high at \$352 billion.

The Bay Area's boom-and-bust cycle mirrored nationwide trends, but the local concentration in high-tech magnified it. The report shows that economic diversity played a central role in the Bay Area's recovery, as growth in sectors such as financial services offset declines in electronics and computer manufacturing.

"The Bay Area is exceptionally innovative and continually reinvents itself," said Sean Randolph, President and CEO of the Bay Area Economic Forum. "While we have our challenges, it is important to stress that the Bay Area's economy is one of the strongest and most adaptive on the planet. The region has very high productivity, strong large businesses, dynamic small companies, and top-notch talent, not to mention one of the most attractive physical settings and climates in the United States."

Indeed, over the last 10 years the share of major U.S. companies based in the Bay Area has increased. In 1994, 20 of the largest 500 companies in the country were headquartered here. Today, 26 are, and only New York City has more. Moreover, on average these Bay Area companies have grown faster than the stock market as a whole, in both sales and market value.

The Bay Area has lost the "Most Productive Region" title to Boston. While Bay Area employee productivity (the goods and services each employee produced), has steadily grown and outpaced the U.S. average from 1994 to 2004, the Bay Area is no longer leads the nation in productivity. Though the Bay Area was the top performer in productivity for most of the past 10 years, the report reveals that Boston has surpassed it since 2001. The average Boston worker now produces \$54,000 worth of goods and services each year, compared to the average Bay Area worker's \$51,000. Both easily exceed the U.S. average of \$40,000.

The report also finds that the Bay Area has the highest cost of doing business in the nation. While local companies spend approximately the U.S. average on taxes and direct labor costs (in terms of wages and salaries per dollar of output), they pay more in benefits and other costs, twice the average energy costs, and a 32 percent premium for rent. In addition, though recent reforms have lowered workers compensation premiums, they are still more than twice the national average.

"Bay Area elected officials are weather-makers and must work to improve the business climate," said Lenny Mendonca, a director at McKinsey & Company, the international management-consulting firm that has researched the *Bay Area Economic Profile* series for the past ten years. "It's a win-all-around opportunity. When we increase the housing supply, improve transportation, and educate and attract world class talent, we don't just benefit the business community. We benefit everyone in the region. The future success of the Bay Area rests on resolving these challenges."

#