Good afternoon. I’m delighted to be able to speak to such a distinguished audience about a matter that should be in the forefront of our thinking, not only in California, but also across this nation.

And that matter can be put in the form of a question: How can we ensure our future economic success in the context of ever-widening disparities of economic opportunity?

I am especially delighted to be here at the Center on Urban and Metropolitan Policy, given the groundbreaking work the Center has done. And, I am particularly pleased to be here at the invitation of Bruce Katz, whose work has inspired my thinking.

After 16 months as Treasurer of the State of California, I’d like to share with you some ideas that we are pursuing to build an investment policy which sustains our economic and social strength well into the 21st Century. And even though I am going to talk about the California experience, I believe these ideas will have applicability not only in my State, but also in other parts of the country.

We’re fortunate to live in an extraordinary moment in California and American history. We are in the midst of a remarkable economic boom. It is not an understatement to say that California is the most economically vibrant State in the richest nation on earth. Our financial strength is reflected in a wide array of indicators including record low unemployment, record rises in personal income, and dramatic increases in state revenues.

Yet, California is a state that faces enormous challenges which, if unmet, threaten to undermine our sustained economic progress. Among the most serious of those challenges is the disparity of economic opportunity up and down the length of the State.

Despite all of our successes, California has the greatest gap between rich and poor of all but four states and the gap widened during the last decade. The level of poverty, particularly among children, remains stubbornly high. In January of this year, the Center on Budget and Policy Priorities completed a study which showed that, in the 1990s, the poorest 20 percent in California saw their real incomes drop by 10 percent – to just over $12,000 per year – while the incomes of the wealthiest 5 percent rose by 18 percent.

And, as we look to the future, there are warning signs that economic disparities may widen further. A December 1999 survey conducted by the Public Policy Institute of California found a deep digital divide. Households with incomes of greater than $80,000 per year are more than twice as likely to frequently use computers than those with incomes below $40,000 per year.
The economic chasm is also reflected in the stark differences in California’s communities. An economic mosaic of the State would display the vibrant colors of prosperous neighborhoods and thriving commercial and industrial areas. But the mosaic – in every region – would be dotted with the duller hues of struggling businesses, brownfields and families in poverty.

Clearly, many Californians and many communities are not sharing in the bounty of the current economy. The story of the Silicon Valley is not the story of the San Joaquin Valley.

This disparity presages a future of “two Californias” – one which reaps the benefits of an economic boom and another which is left to languish in economic struggle.

Failure to address the growing inequality of opportunity poses great dangers. Aristotle saw poverty – the absence of a shared stake in society – as a great threat to democracy. Federal Reserve Chairman Alan Greenspan has cited economic inequality as a potential threat to the nation’s security. And, as Lester Thurow, the noted MIT professor, has rightly asked, “How does one preach political equality in an economy of ever-growing inequality?”

In the February 21st edition of U.S. News & World Report, James Lardner wrote: “Ask most economists about the forces that might ultimately undo the longest expansion in U.S. history, and they’ll talk about inflation, interest rate moves by the Federal Reserve, or a plunging stock market. The gap in wealth and income is rarely mentioned. That, an increasing number of observers contend, could be a big mistake.”

As the State’s chief investment officer, it is my obligation not only to be a prudent steward of our fiscal resources today, but also to look ahead and take actions which will strengthen California’s economy into the future. A large and growing underclass outside of the mainstream of hope will not only tear at our social fabric, it will also dim the economic prospects for all Californians.

For more than 30 years, the question of growing economic inequality has been absent from the center of debate in California’s civic, political and financial circles. Indeed, we could make the same statement for the rest of the country. Now is the time to engage in a new discussion of how to expand opportunity for the communities struggling in our midst. That discussion must occur across a broad public policy front, and must result in a full-fledged commitment to lift up the hopes and prospects of the communities left behind in the wake of the surging economy.

That’s why, last year, we released a report called Smart Investments which outlined policies to direct the State’s infrastructure investment in ways that address California’s future challenges. A key tenet of that report is that State infrastructure expenditures should be focused on at-risk communities.

Since its release, the Treasurer’s Office has moved forward to implement the policies of the report in a variety of State public financing programs – re-directing more than $7 billion in public funds over the next three years in pursuit of the “smart investment” goals of community reinvestment and sustainable growth.

Smart Investments recognized that public infrastructure investment was only one tool in an array of State public policy initiatives that must be seriously pursued if we are to close the gap between the “two Californias.”

Our report noted that it would take a powerful and determined attack that mobilizes the resources of the public sector generally, and State government in particular, if we are to overcome the challenges facing California’s struggling communities. The State must truly commit itself to a set of public investments – in education, job skills training, and social services – which create the environment of economic hope. As Bruce Katz and Katherine Allen noted in the Brookings Review, “People in these neighborhoods often face a triple whammy: poor schools, weak job information networks, and scarce jobs.”

But even a broad public sector effort cannot succeed without engaging the powerful potential of
the capital markets. After all, in our free enterprise system, financial capital plays a fundamentally important role in shaping our society. While public goods – from high quality infrastructure to community amenities to quality schools – are critical to economic expansion, it is the engine of investment capital, coupled with entrepreneurship, that ultimately creates jobs and wealth.

Therefore, any policy thrust to broaden economic opportunity must also examine how the assets and investment capital of the public and private sectors can be deployed in pursuit of that cause.

Accordingly, as Treasurer, I have been looking at what I can do to mobilize the powerful instrument of financial capital in new and innovative ways, consistent with my fiduciary duties, to respond to the challenges of widening economic disparity.

The State of California – principally through its $300 billion plus pension and investment portfolios – is integrally woven into the fabric of the global capital markets. And, California’s private sector investors lead the world in financial and economic innovation. This investment power comes with the responsibility to manage capital wisely. It also provides the opportunity to set a leadership example in a new movement of capital to economically struggling communities.

There is clearly a need for new investment to pry open the doors of economic opportunity for the communities left out of the boom of the last decade.

As Glenn Yago of the Milken Institute observed, domestic emerging markets continue “to be overlooked and untapped due to misperceptions and lack of information. Demand for capital remains unsatisfied.”

It is estimated that only 1 percent of domestic private equity capital is currently targeted toward real estate development and businesses in core urban areas. Only 1 to 2 percent of equity capital invested in the United States is flowing to the minority business community, much of which is located in at-risk communities, despite rapid growth in that sector. As a recent financial study pointed out, such businesses “are thirsting for capital resources.”

One of the phenomena that has struck me throughout my first year and half in office is the unquestioning ease with which billions of dollars of American capital have flowed during the past decade to risky and highly volatile developing countries across the globe and the difficulties faced by our own underdeveloped communities as they struggle to attract desperately needed capital investment to fuel their resurgence.

California’s pension funds – CalPERS and CalSTRS – have over $5 billion invested in the so-called overseas emerging markets. While the commitment of that capital is playing a role in lifting up some of the poorest nations on this earth, returns from those markets have been uneven at best. An examination of CalPERS returns for the three years ending December 1999 showed annualized losses in Indonesia of minus 29 percent; in Malaysia of minus 24 percent; and in the Philippines of minus 25 percent.

I know that we can do better investing here at home. And, for all their challenges, you don’t need a CIA report to underwrite the San Joaquin Valley or South Los Angeles.

It is time to examine anew the confluence between the need for capital in this nation’s undercapitalized communities and the opportunities that exist for financially prudent investment in our own emerging markets.

It is, in this context, that the Treasurer’s Office this week released a report – The Double Bottom Line: Investing in California’s Emerging Markets – which outlines a new set of State investment policies and initiatives to link the jet stream of the capital markets with public purpose.

The report calls on the public sector – from public pension plans to state and local governments – to invest in ways that meet “the double bottom line” – achieving good returns and broadening economic opportunity in California’s struggling communities. It also calls on the private sector –
the engine of our remarkable economy – to join the public realm in making investments that bring new life and vitality to the State’s less prosperous neighborhoods.

*The Double Bottom Line* goes beyond the advocacy of policies. It sets forth specific initiatives that direct more than $8 billion in investment capital – through State programs and the State’s pension and investment funds – to create economic growth and development in California’s communities. These initiatives will spur substantial additional private investment in the sectors and communities most in need of capital for economic expansion. The proposed programs are just a beginning – beachheads in what must be a wider war on economic inequality.

*The Double Bottom Line* builds on a growing knowledge base about the opportunities for successful investment in the communities historically overlooked by institutional capital sources. It comes at a time when old myths are being swept away by the facts and experience of successful reinvestment – from retailers profitably re-entering inner-city markets to lenders finding new opportunities in traditionally underserved communities.

There is growing evidence that opportunities abound for prudent investment in domestic emerging markets. Here are just a few examples.

- A 1999 HUD study showed that the retail purchasing power of America’s inner-city markets exceeds by nearly $9 billion annually the retail sales in those markets. In Watts alone, the gap is nearly half a billion dollars a year – showing that retail investment is needed and can be successful.

- Ethnic and minority markets – often centered in traditionally underserved communities – are growing dramatically. The Hispanic consumer market has gone from $208 billion in 1990 to an estimated $383 billion in 1999, and the revenues of companies listed on the Black Enterprise 100 have increased from $470 million in 1972 to over $13 billion in 1997.

- The federal Community Reinvestment Act of 1977 – the CRA – is proving that historically underserved communities have great untapped potential. That law requires lenders to maintain a continuing and affirmative obligation to help meet the credit needs of all the communities they serve. In 1998, the Federal Reserve’s Greenspan stated that the CRA “has helped financial institutions discover new markets that may have been underserved before…” Greenspan further noted that there is “no evidence that banks’ safety and soundness have been compromised by [low and moderate income] lending, and bankers often report sound business opportunities.”

- Investment funds, targeted to distressed communities, are writing new chapters in the story of possibility. The Massachusetts Capital Resource Company has invested $260 million in economically targeted communities, while achieving returns in excess of 20 percent. The California Community Mortgage Fund is investing in affordable housing and commercial properties in underserved neighborhoods, with annualized returns of 9.8 percent. And more funds – from Genesis LA to the Bay Area Family of Funds – are set to enter the market.

The foundation has been set for increased capital market engagement in America’s emerging markets. *The Double Bottom Line* builds on that foundation by articulating five key policies to guide a new era of investment.

I’m going to quickly list those policies, along with some of the actions the Treasurer’s Office is already taking to provide leadership in their implementation.

Number one: Public pension funds and investment pools can lead the way in a new era of “double bottom line” investment – achieving successful investment results and broadening economic opportunity.

Publicly managed investment funds represent an important source of capital in the American economy. The top 200 public pension funds across the nation have close to $2 trillion in assets. California public pension plans and investment pools hold over $400 billion.

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The Double Bottom Line calls on public pension funds and investment pools to dramatically increase their investments in underserved communities – with the goals of achieving market returns and economic growth where it is needed most.

Specifically, the report urges CalPERS and CalSTRS to set an initial goal – to be reached by December 2002 – to invest at least $5 billion in California’s emerging markets. This is the same amount that those two funds currently invest in foreign emerging markets.

We know that this goal can be accomplished, because we are already hard at work putting in place State investments that meet “the double bottom line.”

- The Treasurer’s Office last year purchased $400 million in mortgages made by California lenders under the Community Reinvestment Act to low and moderate income households or in low and moderate income neighborhoods. By doing so, we provided new capital to lenders to make additional loans, at the same time that the State is receiving competitive returns for its investment portfolio.
- We have increased State deposits in California lending institutions by over $1 billion. These deposits provide well priced capital to California lenders for home and business lending, while assuring a yield to the State that is above the Treasury bill rate.
- CalPERS and CalSTRS, in the last year, have committed over $1 billion in new capital investment for urban, in-fill development – from mixed use to office to commercial to housing – targeted to California communities. These investments are designed to achieve market returns and build the State’s future.

These investments are not only the right thing to do, they are the smart thing to do.

The second policy that’s part of The Double Bottom Line is that public pension funds need managers who can capitalize on California emerging opportunities.

At the same time that public investment funds take a new leadership role in investing in California’s emerging markets, they must also take the organizational steps to avail themselves of the best opportunities in these markets. Such efforts are particularly important given the institutional and cultural biases that have stood in the way of full exploration of investment opportunities in capital starved communities.

The Double Bottom Line proposes that California public pension funds – and specifically CalPERS and CalSTRS – establish New Generation investment manager programs in the area of community reinvestment. This proposal recognizes that the most successful private and public investment funds not only build relationships with proven and experienced partners, but also are on a constant search for the next generation of competitive, emerging talent best positioned to help the funds realize success in rapidly evolving markets.

We must reach out to the talent of diversity to expand our investment horizons. There is a large and growing pool of talented ethnic and minority managers who have roots in and knowledge of underserved markets. We need to call on their networks and their skills to find the new vistas of emerging market opportunity.

The third policy in the report is that public financial resources and assets should leverage capital investment in economically struggling communities.

The Double Bottom Line urges that the State take a more active role in creating new private capital investment in California’s emerging markets through targeted State economic and community development financing programs.

In the context of the capital shortages that plague many California communities, it is critical that State and local programs providing financial assistance for business, community and economic development be focused sharply on the communities most in need. In addition, public financing programs must leverage multiples of private investment beyond public dollars.
The Treasurer’s Office is pursuing a set of model programs which not only focus public resources on struggling communities, but also use those dollars to create private investment.

For example, the California Pollution Control Financing Authority, which I chair, is developing a new program to attract $400 million in private investment to clean up and redevelop brownfield sites in distressed urban areas.

As another example, we are expanding our CalCAP small business lending program with the goal of increasing loan volumes to $300 million over the next three years.

And, we are proposing to create the California 21st Century Fund, initially capitalized with $100 million in State funds, to spur private real estate investment in California’s underserved markets.

The fourth broad policy in The Double Bottom Line initiative is that state government – in partnership with local governments, educational institutions, foundations and the private sector – should spur capital investment in historically overlooked communities by funding critically needed market research.

The absence of high quality information about domestic emerging market opportunities has been a key deterrent to the flow of capital. A 1999 report prepared for the Brookings Institution commented that “America’s inner cities have vast undervalued assets that are largely unseen by conventional business. The resulting underinvestment reflects a serious information gap affecting neighborhood markets. In today’s information age, where market intelligence is the single most valuable commodity in business, little reliable, accessible data or knowledge is available about emerging markets.”

So, The Double Bottom Line proposes that the State provide $5 million for a pilot program of matching grants to localities and non-profit organizations to fund market research which can lead to capital investment in at-risk communities. The commitment of such resources represents a highly cost-effective way to leverage a significant infusion of needed capital resources.

This approach would be consistent with a long history of public research efforts that have made possible subsequent private investment. The National Institutes of Health has advanced the understanding and treatment of diseases, leading to many commercial applications – particularly for pharmaceuticals. And technology developed for NASA has found more than 30,000 secondary commercial uses in products, ranging from tennis shoes to sunglasses to medical equipment.

The same principles of publicly-driven research and development can be applied to the important arena of community reinvestment.

The fifth and last policy of The Double Bottom Line is that private sector and foundation capital must join in partnership with the public sector in a new commitment to investing in California’s struggling communities.

California’s private sector investment leaders have demonstrated, time and time again, their extraordinary ability to create wealth and economic success for the State. The talents which have produced the strongest economy in the world must be enlisted in helping to assure continued economic success in the 21st Century.

Foundations across this nation and in California have proven to be progressive forces in grappling with the societal challenges facing the State, including the consequences arising out of the growing inequality of economic opportunity. The impact and contributions of the non-profit sector can be amplified by new investment partnerships with public and private capital sources.

The public, civic and private sectors all bear a responsibility to be prudent stewards of our economic future. And all share the opportunity to create economic growth and productivity in a way which secures that future.
The broader engagement of the capital markets and foundations is more critical today than ever before, not only because of the depth of the challenge of economic disparity, but also because of the rapidly evolving contour of our financial markets.

As an example, although the CRA has had a significant, positive effect on capital availability in California’s at-risk communities, changes in the financial marketplace are beginning to limit its impact. The last several years have seen a wave of mergers and acquisitions in California’s financial sector that has dramatically reduced the number of large, home state lending institutions. Banks and thrifts, to which CRA obligations apply, represented only 23 percent of the financial services market as of 1997, down from 51 percent in 1950.

This dispersion of lending and investment capital across a broad band – insurance companies, investment banks, venture capitalists, high wealth individuals, to name a few – represents both a challenge and an opportunity to create a new investment dynamic which moves capital to communities in economic need. The challenge is to mobilize diverse interests around a common goal critical to the future of all. The opportunity lies in the very fact that the diversity of capital sources is a reflection of the unprecedented creation of wealth that has occurred across the country during the past decade.

Private capital investment in our own emerging markets will not only help build the future, it also makes good, long-term business sense. As the recent report, New Markets: The Untapped Retail Buying Power in America’s Inner Cities, observed, “If America is to sustain its strong economy, we must tap new markets, drawing on unmet consumer demand, harnessing underutilized labor, and investing in developable urban land. There is a simple reality: the economy needs new room to grow – new markets where business capital can be invested to generate significant return and produce jobs and lasting community benefits.”

The principles that underlie the CRA should be embraced by private capital sources and foundations. By seeking out new markets, new investment frontiers will be discovered and new doors to economic opportunity will be opened.

There should be no doubt that the capital markets can find ways to successfully invest in domestic emerging markets if the commitment to do so is present. After all, in an economy in which American capital invests in vehicles as diverse as foreign emerging market stocks to securitized credit card portfolios, the capability certainly exists to find smart ways to channel capital to enrich our society’s future.

The full engagement of the public and private sectors in pursuing the policies of The Double Bottom Line holds out great possibilities. The risks of not pursuing new paths of investment policy will be an uncertain economic future, accompanied by economic and social divisions unlikely to produce good results. The returns of investing prudently to close the gap between the “two Californias” will be an economy of sustained strength and a social fabric bound together in common purpose.

In The Double Bottom Line, we talk about the challenges and opportunities for California. The report is a reflection of the actions we are taking – with our available investment resources – to meet the challenges before us. But, to fully realize our vision of a brighter future, it will require hundreds and thousands and tens of thousands across the land to join together in common cause and collective action.

I believe we are on the verge of a great era in California and across this nation. It will be an era of immense challenge, and the intelligence with which we handle it will define our future.

In pursuing the policies of The Double Bottom Line, and in throwing open the door of economic opportunity, we are hopeful that California can serve as a model of economic and social success for the nation.

Thank you for inviting me to be with you.