



Spoils of War

California's economy could grab back old defense jobs in a new surge of military spending

By Joel Kotkin

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The prime cause of California's steep economic downturn a decade ago — defense spending — could emerge as a major contributor to a new boom. With both presidential candidates committed to expanding intelligence, homeland security and military spending, the state stands to gain a large portion of the new federal outlays.

Already, the tide of military dollars flowing into California — up about 44% since 2000, to nearly \$30 billion last year — has washed over a broad range of companies, from Northrop Grumman and TRW to scores of small suppliers. The surge in defense spending has been most felt in Southern California, with Los Angeles County as the second-leading recipient of the Pentagon's largess in the nation; San Diego and Orange counties rank among the top 15.

California's main advantage in attracting new defense dollars is the high-tech orientation of its existing defense industry. The state has a powerful presence in guided-missile technology, navigation equipment, electronic surveillance, radar-evading technology and unmanned aircraft — critical components in a defense strategy that relies on a qualitative edge in the war on terrorism.

The end of the Cold War cost California a huge portion of its defense-related employment; as many as 150,000 jobs disappeared in the early 1990s. The losses were concentrated in traditional military manufacturing, most heavily in aircraft and related construction. The defense industry not only created high-paying science and engineering jobs, it also spawned many blue- and pink-collar positions in manufacturing and administration. In short, the defense industry significantly contributed to the expansion of the state's growing middle class.

There were other factors contributing to California's diminishing share of the defense budget, in particular the lack of a coordinated lobbying strategy by the state's divided political leaders. But the result is clear: The state's portion of military-related spending shrank from roughly 23% under President Reagan to barely 15% today.

Much of the heavily unionized defense-related employment of yesteryear will never return. Even when job growth picked up in the mid-1990s, much of it was in retail, light manufacturing and tourism, sectors that tend to pay low wages. As a result, the gap between the state's cadre of richly rewarded information-industry workers and everyone else widened. The prospects for well-paying blue-collar jobs have so diminished that as many as 20,000 people are expected to apply for about 3,000 such part-time positions this month at the Port of Los Angeles.

This is why the state's current opportunity to gain defense and homeland security contracts, and their higher-wage jobs, is so critical, especially when the stars of the late-1990s expansion — computer software, entertainment, etc. — have

been hit by industry restructuring and foreign competition. Some entrepreneurs already have a newfound appreciation for the slower but steadier business offered by the Pentagon or the Department of Homeland Security.

Take E Team. Founded in 1998, the Woodland Hills company didn't have many customers for its Internet-based security systems until the last year or two. It is now a 40-person shop, up from 25 two years ago, and counts among its clients 10 states and several cities — including Los Angeles and New York — as well as the Athens Olympics.

"Sept. 11 was the defining moment for companies like ours," said Matt S. Walton III, founder of E Team. "When you get involved in this kind of business, it takes time to get going, but there are a lot of opportunities to make money over the longer term."

The defense and homeland security boom also could stimulate the state's long-suffering industrial sector, which has lost 250,000 jobs since 2000, largely because of increased outsourcing to China and a severe decline in civilian aircraft orders. In contrast to the computer and apparel sectors, defense work is largely insulated from foreign competition.

The state's technological base may be the main beneficiary of the new defense spending. Overall, California is responsible for about 20% of the nation's high-tech output; more defense contracts would increase the state's share.

In the wild days of the late-1990s dot-com boom, many pundits and venture capitalists believed that a combination of capital, entrepreneurial moxie and research at elite universities would sustain the state's technological supremacy. Largely overlooked was the less glamorous truth that much of California's high-tech reputation flowed from defense investments made during the Cold War. The origins of such industries as wireless communications, semiconductors, lightweight and bullet-resistant materials and, most critical, the Internet can be traced to the Defense Department or NASA.

"People forget the roots of California's high technology," said Rohit Shukla, chief executive of the Los Angeles Regional Technology Alliance, a group that promotes the technology business. "The defense industry was critical to Silicon Valley.... Pointing to the role of Lockheed missiles and space or Boeing doesn't confirm the myth of Silicon Valley, but it was critical to its emergence" as a center of technological progress.

No one expects the new defense and homeland security buildup to fuel the kind of expansion that accompanied World War II, Korea, Vietnam or even the Reagan years. The defense industry accounted for as much as half the state's economic growth between 1947 and 1957, a level not attainable — nor desirable — today. The \$30 billion being spent now restores the state to 1984 levels.

Yet capitalizing on the defense boomlet is strategically important for California's economy. The expanding market for new, increasingly tech-oriented military weaponry could accelerate the development of such California industries as nanotechnology, software sensors and communications in a more reliable and sustainable way than venture capital.

This opportunity will present itself, most observers believe, whether President Bush or Sen. John F. Kerry takes office in January. Although Bush may seek more defense dollars overall, Kerry may be predisposed toward high-tech weaponry because of his strong ties to technology executives in his native Massachusetts and in Silicon Valley.

Furthermore, Kerry, unlike Bush, probably won't favor defense-related firms in Texas and other rock-solid Republican states, a pattern that began during the administration of George H.W. Bush and continues today. In fact, because California is a reliable and bountiful source of Democratic dollars and votes, Kerry will owe California.

Regardless of who wins the White House, California must become more competitive to participate in the new military buildup. High housing costs, regulatory burdens and workers' compensation fees make the state intrinsically less attractive than states like Florida, Georgia or Texas. Fast-growing defense and homeland security companies in these states report that lower housing costs make it relatively easy to lure younger engineers and recently retired military

personnel.

California could do more to lower construction costs by reducing regulatory requirements. It can further cut workers' compensation and discourage frivolous lawsuits against employers. Still, the state may never be as cheap as Texas or Florida, but that doesn't mean it can't be more business-friendly.

More critical is California's shortage of technical and engineering manpower, where it has traditionally enjoyed a big advantage. Efforts to replenish this aging workforce have been hampered by the state's lack of a comprehensive worker-training system.

"Companies that are strong and growing are struggling with a lack of skills," said David Goodreau, president of the Small Manufacturers Assn. of Southern California. "I am getting lots of companies calling to get people. But there's not a lot of new talent available. There's hardly a single machinist-training program in all of L.A. County."

California's manpower problem is further intensified by the state's dependence on foreign engineering and technical talent. Although many naturalized U.S. citizens work in the defense industry, those applying for citizenship or green cards are often barred from defense work.

Finally, California's congressional delegation, for the most part, is less focused on bringing defense work to the state than many of their colleagues on the Hill.

"Let's put it this way," said E Team's Walton. "California is not showing a great sense of urgency, while a lot of other places are."

As in the past, California's economy is, in many ways, still tied to defense spending. The terrorist threat that propels higher defense and security budgets is not going to go away. If Gov. Arnold Schwarzenegger and other state leaders are serious about attracting new business and high-wage jobs, they need to focus their energies on the Pentagon and other security-related contracts. In that way, he could provide a new generation of Californians a reasonable shot at joining the middle class.

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