CALIFORNIA ECONOMY

PPIC | PUBLIC POLICY INSTITUTE OF CALIFORNIA

CALIFORNIA'S ECONOMY IS ON THE MEND, SLOWLY

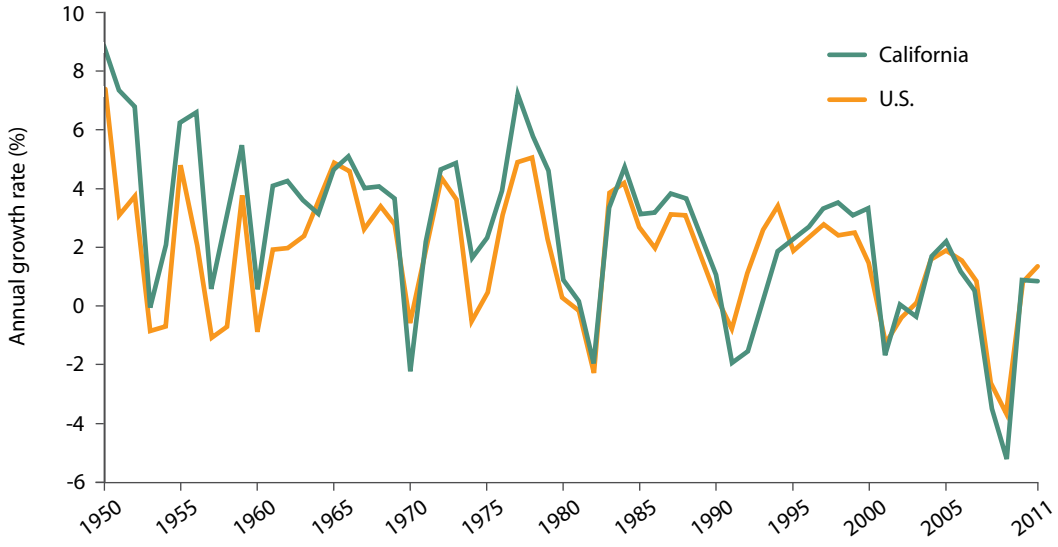
By many measures, California is seeing a consistent pattern of economic recovery following the Great Recession. California's unemployment rate has fallen more than 2 full percentage points from its recession-era peak. By the end of 2012 the state was adding jobs at a higher rate than the nation as a whole. However, a large share of Californians are still unemployed or underemployed. Because of this, family incomes in California continued to decline well into 2011, and perhaps beyond. These facts are reflected in Californians' views of the economy: according to PPIC's December 2012 statewide survey, 50 percent believe that the economy will face bad times over the next year.

Despite the lingering pessimism, long-term historical patterns are still the best guide to California's economic future. Economies tend to return to growth rates and unemployment levels established over the long term, and major industry shifts—such as the transition from manufacturing to services—can take place over decades.

CALIFORNIA'S LONG-TERM ECONOMIC PROSPECTS ARE FUNDAMENTALLY STRONG

The California economy generally keeps pace with the U.S. economy. California consistently experiences higher unemployment and higher costs of doing business than other states, but these trends are explained or offset by the state's strengths and are likely to remain permanent features of the California economy.

CALIFORNIA JOB GROWTH TRACKS GROWTH IN THE NATION OVERALL

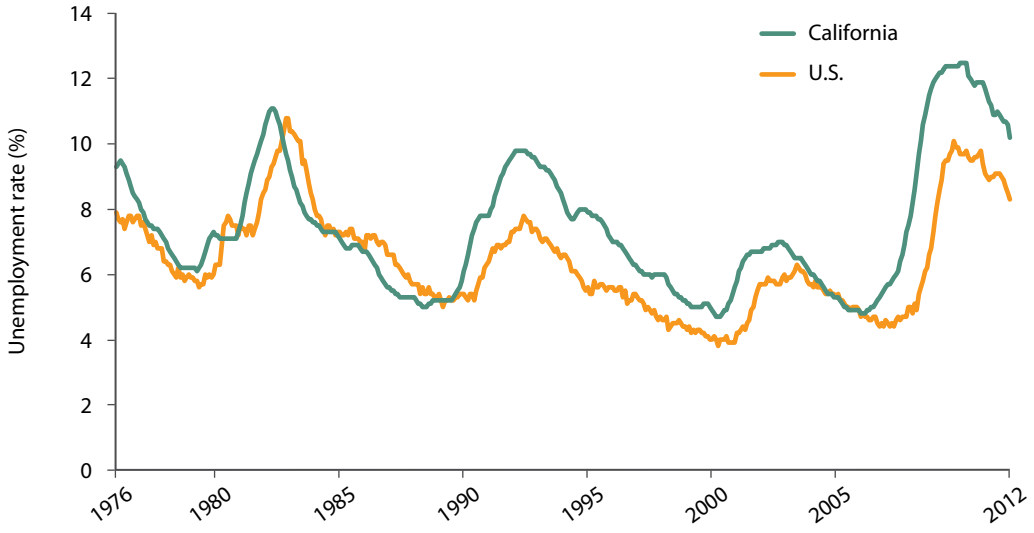


SOURCES: U.S. Bureau of Labor Statistics and California Employment Development Department.
NOTE: Annual change in nonfarm employment, December to December.

- **California's economic performance closely tracks that of the nation as a whole.**
  The broadest measure of California's economic performance—employment growth—follows the nation's growth rate very closely. Over the past 30 years job growth has averaged 1.2 percent annually for both California and the nation—and both saw positive job growth in 2012. Toward the end of 2012, job growth in California outpaced that of the nation, growing at an annual rate of 2.1 percent.

- **Unemployment is persistently higher in California.**
  In October 2012, California's unemployment rate was 10.1 percent; the national rate was 7.9 percent. While high, these rates reflect two years of declines from the peak during the Great Recession. California's unemployment rate remains higher than that of the nation and has done so for 20 years—even when the state's employment growth has surpassed national growth, as it did during the technology boom in the late 1990s. This seeming paradox occurs because California's labor force grows faster than the U.S. labor force: the state's economy generates jobs at a rate similar to the national rate, but this is not enough to keep up with California's faster-growing population. So California unemployment is likely to remain above the U.S. level even after it fully recovers from the recession.

UNEMPLOYMENT IS ON THE DECLINE



SOURCES: U.S. Bureau of Labor Statistics and California Employment Development Department.
NOTES Monthly unemployment rate, seasonally adjusted.

- **Labor market conditions have contributed to sizeable declines in family income.**
  California unemployment remains historically high. Moreover, in 2011 the average period of unemployment reached 37 weeks—the longest average since 1948, when this data was first collected. Workers are employed for fewer hours, on average, and are less likely to work full-time than before the recession. Unemployment and underemployment caused median household income to fall 14 percent between 2006 and 2011. Declines were greater for the median household in California than for the median household nationwide, which experienced a 7 percent decline over the same period. However, median income levels are higher in California than in the nation as a whole, particularly for households headed by those with a college degree: income is 78 percent higher for the median household headed by someone with a bachelor's degree than for the median household headed by someone with a high school education only.

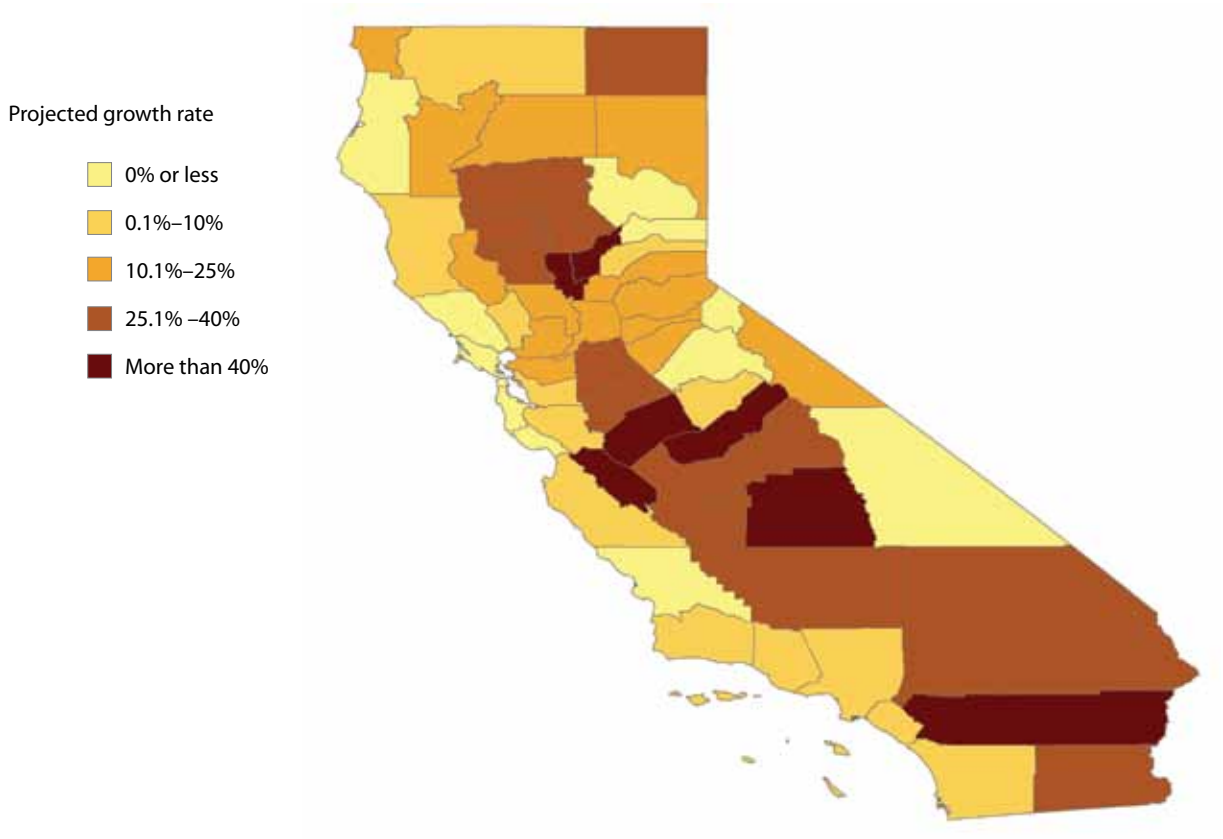
- **California is a high-cost, high-benefit state.**
  California workers, on average, earn 12 percent more than the national average—even after adjusting for differences in workers, occupations, and industries. But output per worker in California is 13 percent above the national average, so California's higher productivity fully offsets the higher average wages. All of California's immediate neighbors—Nevada, Oregon, and Arizona—pay their workers less and have lower output per worker.

- **The "business climate" debate understates California's strengths.**
  California consistently scores poorly on many business climate rankings that focus primarily on taxes and other costs of doing business. California's economic performance is stronger than these business climate rankings alone would indicate. Businesses locating in California face higher costs but they also enjoy many benefits, such as the skill level of the workforce, the availability of capital and support for new business, and the amenities that make California an attractive place to live.

GROWTH WILL BE UNEVEN

- **Regional economic differences are dramatic—and persistent.**
  Economic differences within California are likely to continue. Unemployment tends to be higher in the Central Valley—sometimes considerably higher—than in the urban, coastal parts of the state. This variation is attributable to a different industry mix and to the faster-growing workforce in the inland parts of the state. Even among urban coastal areas, California's regional economies don't move in concert: in most years some regions of the state grow quickly while others grow slowly or contract. Although inland California currently has higher unemployment rates, that region's low housing costs will contribute to high growth of its workforce. The working-age population is projected to grow more than 25 percent between 2010 and 2025 in much of inland California; in California overall, the growth rate will be 13 percent.

INLAND CALIFORNIA'S LABOR FORCE WILL GROW FASTEST

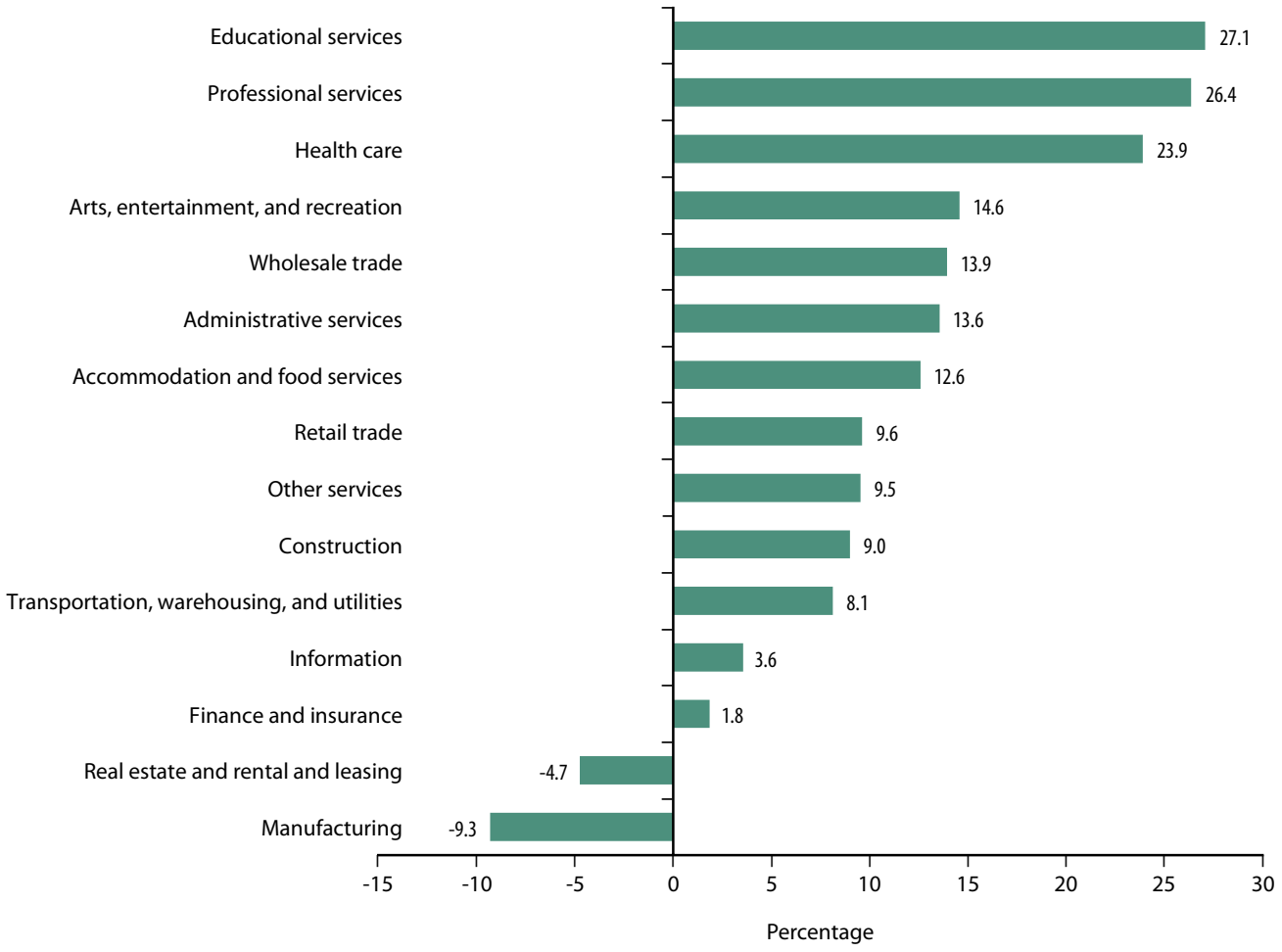


SOURCE: California Department of Finance.
NOTE: California's projected growth rate, by county, of working-age population, 2010–2025.

- **Housing is still expensive and probably always will be.**
  Even during the Great Recession, housing in California was much more expensive than in the nation as a whole. In October 2012, the average U.S. home was worth $155,400; in California, the average home was worth $314,500, according to Zillow. Expensive real estate makes it harder for some businesses to locate in California and attract workers, potentially pushing growth out of state. In the last year, median housing prices have increased across most of California—in both inland and coastal regions—with the largest gain in San Jose metro area (an 11 percent increase over October 2011–2012) and the largest decline (15 percent) in the Susanville metro area.

- **Services will continue to grow; manufacturing will continue to stagnate.**
  Manufacturing accounted for only 9 percent of California's employment in October 2012; year over year, manufacturing employment fell about 1 percent in October 2012. Its share has been declining for decades, and it will continue to be California's fastest-declining sector. During the recession, the construction industry contracted most sharply. As the housing market rebounds and the existing housing stock is being absorbed by California's growing population, construction employment has rebounded as well. Over the past year, construction employment grew about 5 percent and is predicted to continue to grow, but not to boom-time levels. The fastest-growing industries over the longer term are projected to be professional services, education, and health care—these are also the sectors least hurt by the recession.

PROJECTED PRIVATE-SECTOR INDUSTRY GROWTH, 2008–2018



SOURCE: California Employment Development Department.
NOTE: EDD Employment Growth Projections, 2008–2018 (private sector only).

LOOKING AHEAD

California's long-term economic trends reflect strengths but also create pressures that policy must respond to. The most effective economic policies require accurate assessments of California's economic performance, a balanced view of the state's competitiveness, and a realistic sense of the state's strengths and weaknesses.

- **Pursue policies to help create jobs and foster full-time employment.**
  California's economic recovery is proceeding, but slowly. Nearly 2 million Californians remain unemployed, and more workers are underemployed or have left the labor force. Creating jobs and increasing full-time employment is key to enhancing California's recovery. A thriving California economy is the best route to future employment growth in the short and long run. Economic policy that stimulates business and fosters a strong, skilled workforce are crucial to job creation in California.

- **Don't pin all hopes on one industry.**
  Although many industries—such as film, high-technology, and wine-making—are highly concentrated in California, the state's economy is in fact very diversified, and its industry mix is quite similar to the nation's. Economic policy should reflect the breadth and diversity of the state's economy. Tempting as it is to identify the next boom industry—such as clean technology—and focus economic development efforts there, booms usually don't deliver stable, steady growth, as the Internet and housing industries demonstrate. And some hyped industries fail to take off at all. Economic development policy needs to nurture both new, innovative industries that might constitute California's next boom and established, steadily growing industries such as health care services.

- **Promote economic opportunity through education.**
  Education is essential to Californians' economic well-being. Highly educated workers were somewhat protected from the impact of the Great Recession and are likely to do better during future boom and bust cycles. Promoting education is thus an important strategy for ensuring economic opportunity across the income spectrum and addressing income inequality. And because the new economy demands a highly skilled workforce, education has a crucial role in helping California remain economically competitive.

We invite you to dig deeper at ppic.org. Related PPIC resources include:

The California Economy: Employment in 2012
The California Economy: Unemployment in 2012
The Great Recession and Distribution of Income in California
Consumption Tax Options for California
Business Climate Rankings and the California Economy
Are the Rich Leaving California?

Contact a PPIC expert:

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This publication is part of PPIC's Planning for a Better Future project.

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