CALIFORNIA’S ECONOMY IS REBOUNDING, BUT CHALLENGES PERSIST

By many measures, California’s economy is making a strong recovery from the Great Recession. The state unemployment rate is lower than it has been in about six years, and jobs have been growing for five years straight. As the housing market continues to improve, the construction industry has regained some of the jobs lost during the recession. Many high-skill industries are experiencing strong growth, which is projected to continue over the next decade. These job market improvements are reflected in family incomes, which are finally rebounding from their recession-era low point. However, many Californians are still unemployed or underemployed. This mixed picture is reflected in Californians’ views of the economy: according to the September 2014 PPIC Statewide Survey, 45 percent believe economic bad times are likely over the next year, while 44 percent predict good times.

While recent trends are an important gauge, historical patterns are still the best guide to California’s economic future. Booms, busts, and recoveries take place in the context of long-term trends, and major industry shifts—such as the transition from manufacturing to services—can occur over decades.

CALIFORNIA JOB GROWTH TRACKS GROWTH IN THE NATION OVERALL

The California economy generally keeps pace with the U.S. economy. Higher unemployment and the higher costs of doing business in California are explained or offset by strengths. And they are likely to remain permanent features of the state’s economy.

- 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 about 1.3 percent annually for both California and the nation—and both saw job growth in 2014, for the fifth year in a row. For the past three years, job growth in California (2.7%) has been stronger than growth in the U.S. (1.8%).

CALIFORNIA’S LONG-TERM ECONOMIC PROSPECTS ARE FUNDAMENTALLY STRONG
• Unemployment is persistently higher in California.

In November 2014, California’s unemployment rate was 7.2 percent; the national rate was 5.8 percent. While high, California’s rate has dropped 1.2 percentage points from December 2013 and has declined steadily from its peak of 12.4 percent during the Great Recession. California’s unemployment rate has been higher than the national rate for more than 20 years—even when the state’s employment growth surpassed national growth, as it did during the technology boom in the late 1990s. This may seem paradoxical, but it makes sense in the context of California’s fast-growing 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 for some time to come.

UNEMPLOYMENT IS ON THE DECLINE

![Unemployment Rate Chart]

NOTE: Monthly unemployment rate, seasonally adjusted.

• 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, and this higher productivity fully offsets the higher average wages. All of California’s immediate neighbors—Nevada, Oregon, and Arizona—have lower wages and lower output per worker.

• The “business climate” debate understates California’s strengths.

California consistently scores poorly in many business climate rankings that focus primarily on taxes and other costs of doing business. But the state’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, the support for new business, and the amenities that make California an attractive place to live.

ECONOMIC CONDITIONS CONTINUE TO BE UNEVEN

• Improved labor market conditions have yet to contribute to sizable improvements in family income.

Despite improvements, California unemployment remains high by historical standards. Moreover, as of March 2013 the average period of unemployment was 31 weeks—only slightly lower than during the Great Recession. Largely because of labor market conditions, median household income has increased slowly and is well below its pre-recession peak. In 2013, the median family earned about $57,500, reflecting an improvement from the low in 2011 but still 8 percent lower than in 2006. Median income is higher in California than in the nation as a whole ($52,000). But incomes are skewed in California; in 2013, half of the state’s families were earning $57,500 or less and nearly one-quarter earned more than $100,000.
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 different industry mixes and job growth patterns—and 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 the growth of its workforce. The working-age population in much of inland California is projected to grow more than 25 percent between 2010 and 2030; in California overall, the growth rate will be 8.8 percent.

Inland California’s labor force will grow fastest

Housing is still expensive and probably always will be.
Housing prices have increased year over year for 31 consecutive months in California. In November 2014, the median U.S. home was worth $177,600; in California, the median home was worth $434,200, according to Zillow. Even during the Great Recession, housing in California was much more expensive than in the nation as a whole. Expensive housing creates pressures on both households and employers and reflects the mix of jobs, industries, and amenities across the state. In the past year, median housing prices have increased across California—in both inland and coastal regions—with the largest percentage gains in the El Centro, Merced, and Vallejo metro areas (16–18% increases since November 2013) and the largest dollar increases in the San Jose, San Francisco, and Santa Rosa metro areas ($48,000 or more).
Strong job growth in services will continue; manufacturing will continue to stagnate.

Over the past year, service industry jobs—both higher-skilled professional services, education, and health care jobs and lower-skilled jobs in accommodation, food, and administrative services—have added 66 percent of all new jobs in California and are projected to continue to lead growth. Manufacturing accounted for only 8 percent of California’s employment in November 2014; year over year, manufacturing employment was virtually unchanged, whereas almost every other industry in the state has grown. Manufacturing has been declining for decades and will continue to be a sluggish sector in California. During the recession, the construction industry contracted most sharply (dropping 37% from peak to trough). As the housing market rebounds and existing housing is being absorbed by California’s growing population, construction employment is rebounding as well. Over the past year, construction employment grew by 6.3 percent, faster than any other industry (except administrative services). Construction is projected to grow 26 percent by 2020—making construction one of the fastest growing industries in the state.

**PROJECTED PRIVATE SECTOR INDUSTRY GROWTH, 2010–2020**

<table>
<thead>
<tr>
<th>Industry</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Educational services</td>
<td>28.8</td>
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<tr>
<td>Accommodation and food services</td>
<td>27.5</td>
</tr>
<tr>
<td>Construction</td>
<td>26.2</td>
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<tr>
<td>Wholesale trade</td>
<td>25.8</td>
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<tr>
<td>Professional services</td>
<td>25.6</td>
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<tr>
<td>Health care</td>
<td>24.9</td>
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<tr>
<td>Administrative services</td>
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<tr>
<td>Retail trade</td>
<td>22.0</td>
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<tr>
<td>Transportation, warehousing, and utilities</td>
<td>16.7</td>
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<tr>
<td>Finance and insurance</td>
<td>16.0</td>
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<tr>
<td>Arts, entertainment, and recreation services</td>
<td>15.3</td>
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<tr>
<td>Other services</td>
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<tr>
<td>Real estate and rental and leasing</td>
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<td>Information</td>
<td>8.3</td>
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<tr>
<td>Manufacturing</td>
<td>0.4</td>
</tr>
</tbody>
</table>

SOURCE: California Employment Development Department.
NOTE: Employment growth projections for 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 economy is recovering, but slowly: about 1.4 million Californians remain unemployed, nearly double the number who were unemployed before the recession. 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 both the short and long run. Economic policy that stimulates business and fosters a strong, skilled workforce is crucial to job creation in California.

• Don’t pin all hopes on one industry.
  Although some industries—such as film, high-tech, and winemaking—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 and focus economic development efforts there, booms usually don’t deliver stable growth, as the Internet and housing industries have demonstrated. And some hyped industries fail to take off at all. Economic development policy needs to nurture new, innovative industries that might constitute California’s next boom along with 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 addressing inequality and ensuring economic opportunity across the income spectrum. And because the new economy demands a highly skilled workforce, education plays a crucial role in helping California remain economically competitive.
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