PPIC

Economy

CALIFORNIA'S FUTURE

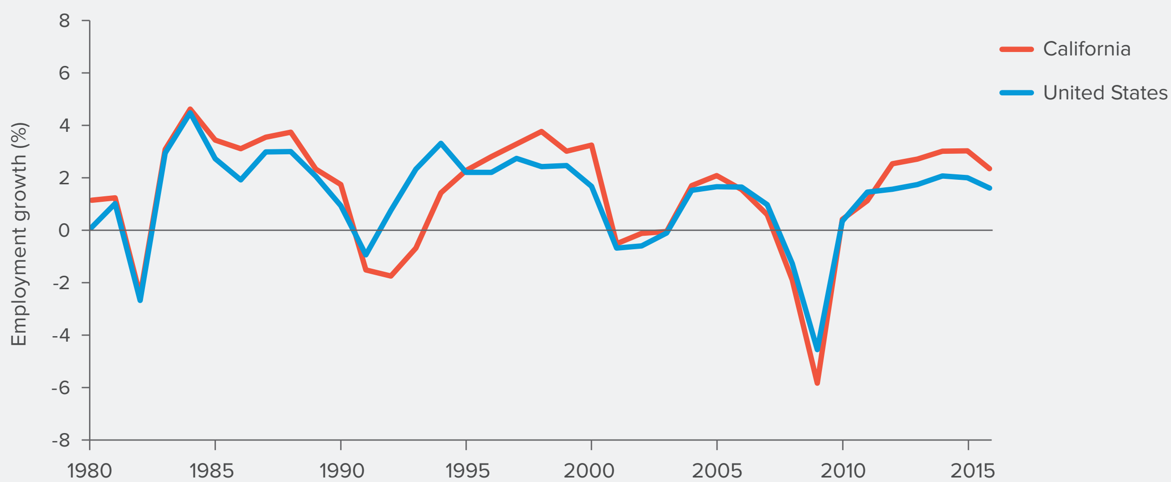
JANUARY 2017

California's economy is growing, but disparities persist

By many measures, California's economy is performing well. The state unemployment rate is nearing a 30-year low. Strong job growth continues, with California's job growth outpacing the nation's for five years straight. Construction and major service industries—at both the high- and less-skilled levels—drive job growth and are projected to continue to do so over the next decade. These job market improvements are reflected to some extent in family incomes, which are finally rebounding from their recession-era low. Although major labor market indicators are outperforming prerecession levels, incomes still lag behind for many California families. This mixed picture is reflected in Californians' views of the economy. According to the October 2016 PPIC Statewide Survey, 38 percent of Californians expect economic bad times over the next year, while 47 percent predict good times.

Recent trends are an important gauge, but 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. Major sectoral shifts—such as the transition from manufacturing to services—can occur over decades.

CALIFORNIA JOB GROWTH TRACKS GROWTH IN THE NATION OVERALL



SOURCE: US Bureau of Labor Statistics.

NOTE: Annual change in nonfarm employment, not seasonally adjusted, October to October.

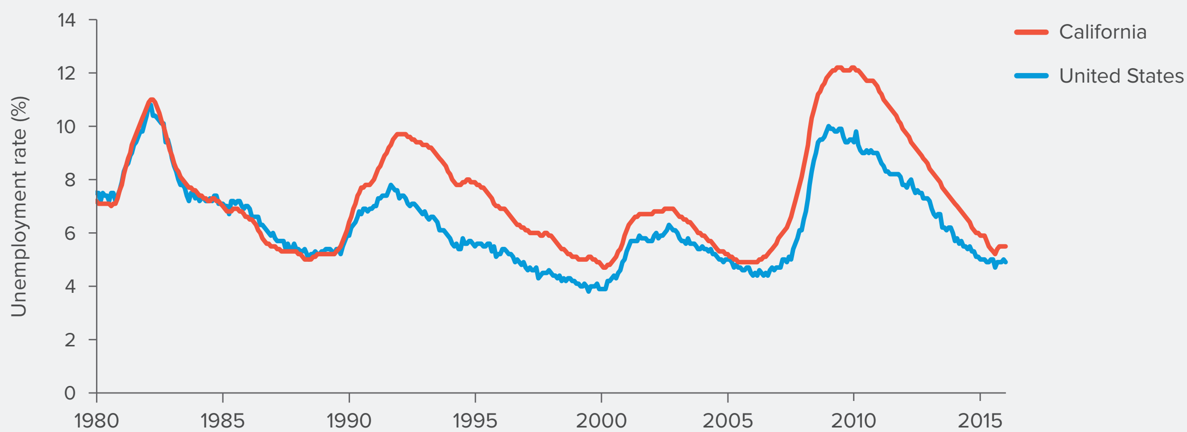
California's labor market continues to improve

The California economy generally keeps pace with the US economy. Higher unemployment is explained by the state's younger and faster-growing labor force, and the higher costs of doing business in California are offset by the state's economic strengths. And both are likely to remain prominent features of the state's economy.

- **California has experienced five years of stronger-than-average job growth.**
  Employment growth—the broadest measure of California's economic performance—historically follows the nation's job-growth rate very closely. But for the past five years, California's 2.7 percent job growth has been stronger than the 1.8 percent growth in the United States. Over the past 30 years, job growth has averaged about 1.3 percent annually in both California and the nation. Both the state and the nation experienced job growth in 2016, for the sixth year in a row. Historically, such patterns have not lasted much longer than the current expansion.

- **Unemployment is nearing historic lows.**
  In October 2016, California's unemployment rate was 5.5 percent, slightly above the 4.9 percent national rate. The state's jobless rate is still about half a percentage point higher than before the recession, but it has dropped steadily, and the gap between the US and California rates has narrowed considerably. California's unemployment rate has been higher than the national rate for more than 20 years—even when the state's employment growth surpassed the nation's, as it did during the technology boom of the late 1990s. This may seem paradoxical, but it makes sense. The state generates jobs at about the same pace as the nation as a whole. But California has faster population growth, fueling faster-than-average expansion of the labor force. The result is a persistently higher unemployment rate, which is likely to remain above the US level for some time to come.

UNEMPLOYMENT IS NEARING PRERECESSION LEVELS



SOURCE: US Bureau of Labor Statistics.
NOTE: Monthly unemployment rate, seasonally adjusted.

- **California is a high-cost, high-benefit state.**
  California workers, on average, earn 11 percent more than the national average—even after adjusting for differences in the mix of workers, occupations, and industries. But California's output per worker is 14 percent above the national average. This higher productivity fully offsets the higher average wages. All of California's neighbors—Nevada, Oregon, and Arizona—have lower wages and lower output per worker. Businesses in California face higher costs but also enjoy many benefits, such as the higher productivity just noted, as well as the skill level of the workforce, the availability of capital, and the amenities that make California an attractive place to live.

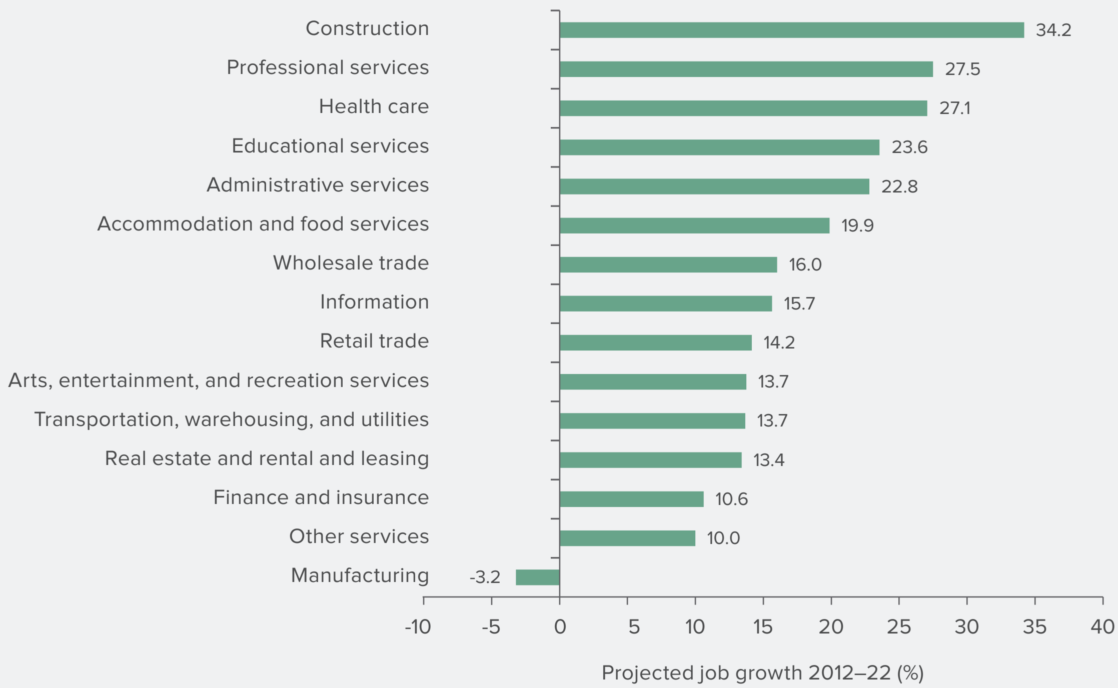
Underlying economic conditions remain uneven

- **Improved labor market conditions have yet to benefit all Californians.**
  Despite low unemployment rates overall, California still has 1 million unemployed workers and more than 800,000 people who have dropped out of the labor force but would like to work. Over the past year, two-fifths of unemployed Californians have been looking for work for 15 weeks or longer. The average length of the job search has steadily shortened, but some ready workers still struggle to find employment. Furthermore, 5.1 percent of workers are underemployed; that is, they are working part-time when they would rather be working full-time. Altogether, 11.4 percent of workers—more than double the official unemployment rate—are either unemployed, underemployed, or discouraged (meaning they would like to work but have dropped out of the labor force). Largely because labor market conditions vary across segments of the workforce, median household income has grown more slowly than one might expect based on labor market indicators. In 2015, the median household earned about $65,000, an improvement from the low of $60,000 in 2011 but still 6 percent lower than in 2007. California median income is higher than the nationwide median of $56,000.

- **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. As of October 2016, unemployment rates were lowest in the Bay Area as well as San Diego and Orange Counties (ranging from 3 to 5%), and highest in Imperial County (22%) and the Central Valley (8 to 11%). This variation reflects different industry mixes and job growth patterns—as well as the faster-growing inland workforce. Although inland California currently has higher unemployment rates, that region's low housing costs continue to fuel the growth of its workforce. The working-age population in much of inland California is projected to grow more than 20 percent between 2010 and 2030, compared with an expected 10.7 percent growth rate for California overall.

- **Strong job growth in construction and services will continue, while manufacturing will stagnate.**
Over the past year, construction and three disparate service industries—accommodation and food services, health care, and professional services—led employment growth, contributing 50 percent of new jobs in California. Other service industries—education as well as arts, entertainment, and recreation—though smaller, grew jobs at even faster rates, more than double the state average. All of these industries are projected to continue leading growth through 2022. By contrast, manufacturing employment actually declined at a rate of 1.2 percent in the past year. Manufacturing job growth has been slowing for decades and will continue to be sluggish in California.

CONSTRUCTION AND SERVICE INDUSTRIES ARE PROJECTED TO LEAD JOB GROWTH THROUGH 2022



SOURCE: California Employment Development Department.

NOTE: Employment growth projections for private sector industries only.

Looking ahead

California's long-term economic trends reflect strengths but also raise policy challenges. 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 growing jobs at a fast rate—continuing to do so is the first step in creating broad-based economic opportunities. Almost 2 million Californians are unemployed or might reenter the labor force if they could find appropriately matched jobs. A thriving California economy is the best route to employment growth, in both the short and long runs. Economic policies that stimulate business and foster a strong, skilled workforce are crucial to job creation in California.

Recognize that typical labor market indicators often mask challenges. The state's economy is very diversified across industries and encompasses a wide mix of occupations and workers. Though statewide economic indicators are a useful gauge of overall performance, economic policy should reflect the breadth and diversity of the state's economy. High job growth and low unemployment are positive signals, but long-term economic vitality depends on the quality of jobs created and strong competitiveness for all regions of the state.

Promote economic opportunity through education. Education is essential to economic well-being in California. Highly educated workers were better protected from the impact of the Great Recession and are likely to fare better in future boom-and-bust cycles. Promoting education is 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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