California’s economy is strong, but underlying economic realities present challenges

By many measures, California’s economy is performing well. The statewide unemployment rate is at a long-term low. Jobs have been growing for an unusually long period, improving in almost all major industries and across California’s diverse regions. These improvements are reflected in family incomes, which have picked up substantially over the past few years. California’s job growth has outpaced national growth for several years, and the state now has the world’s fifth-largest economy.

Although major labor market indicators are outperforming long-term trends, many Californians see jobs and the economy as a top challenge for the state (according to the September 2019 PPIC Statewide Survey). If historical patterns are any guide, California may face an economic downturn in the near future. But even if growth continues, underlying economic realities such as stubbornly high poverty rates, income inequality, high housing costs, and polarized job opportunities may limit the state’s potential. State policymakers face a fundamental challenge: making sure that all Californians—regardless of geographic location, race, or socioeconomic background—can benefit from the state’s prosperity.

TEN YEARS OF JOB GROWTH ADD UP TO ONE OF THE LONGEST EXPANSIONS IN RECENT HISTORY

California’s labor market is strong

The California economy generally moves with the US economy. The state’s labor market tends to be hit harder than the nation as a whole during recessions, but it also benefits from faster recovery rates. According to economy-wide metrics, the labor market is stronger today than it has been in decades.

- **California has experienced ten years of job growth—the longest expansion on record.**
  Over the past 30 years, job growth has averaged about 1.2 percent annually in California and 1.1 percent for the nation as a whole. California’s 2.4 percent job growth over the past eight years has outpaced national growth (1.7%), adding on average 385,000 new jobs every year. In 2019, for the tenth year in a row, both the state and the nation experienced job growth; California’s growth rate held steady, while the US rate declined slightly. Sustained employment growth over such a long period is unprecedented.

- **Unemployment is at historic lows...**
  In October 2019, California’s unemployment rate was 3.9 percent, slightly above the national rate (3.6%) but lower than at any point since 1976. California’s unemployment rate has been higher than the national rate for nearly three decades, in part because of more drastic swings during recent economic downturns, such as the mid-1990s recession and the Great Recession. The number of unemployed Californians was higher three decades ago than it is today (765,300 as of October 2019); this is striking, given that California’s population has grown by nearly 10 million
since then. The shares of discouraged or underemployed workers (those who have stopped looking for jobs but would like to be working or part-time workers who would like to be full time) are also near long-term lows.

- **...but so is labor force participation.**
  To get the full story, we need to go beyond unemployment and look at labor force participation: the share of the population working or actively looking for work. California’s labor force participation rate continues to be historically low, at 62 percent. Labor force participation has trended down since around 2000; much of this decline is due to demographics—California’s population is aging and many baby boomers are retiring—but it is also the result of falling youth employment rates and long-term exits from the labor force during and after the most recent recession.

- **Job growth will continue in service industries and construction, while manufacturing will stagnate.**
  Nearly half of job growth (49%) between October 2018 and October 2019 occurred in three industries: health care, professional and technical services, and accommodation and food services. These industries are expected to lead growth through 2026. The construction, administrative services, educational services, information, and transportation and warehousing industries also grew at a fast rate—faster than the state overall. State and local governments added about as many new jobs as did the construction sector. By contrast, the finance and insurance, retail, and wholesale trade industries shrunk, and the manufacturing sector grew less than 1 percent. These trends are likely to continue, with manufacturing expected to add virtually no new jobs by 2026.

**Underlying economic conditions remain uneven**

- **Regional economic differences persist—but they are smaller than in previous years.**
  Sustained economic growth has benefited almost all parts of the state. However, unemployment continues to be higher in inland and far northern California than in urban coastal areas. Rates are lowest (below 3.3% as of October 2019) in the San Francisco Bay Area as well as the San Diego and Anaheim-Irvine metro regions. Rates elsewhere are typically a few points higher, but they exceed 6 percent in only a few metro areas (Bakersfield, Hanford, Visalia)—in marked contrast to dramatic recession-era differences. El Centro’s high rate (21.2%) remains an exception. Higher inland rates are driven in part by population growth: the working-age populations of the Central Valley, Inland Empire, and Sacramento area are expected to grow more than 10 percent between 2018 and 2030, while the projected growth rate in the rest of the state is only 2 percent.

**Future job growth is likely to perpetuate today’s polarized labor market.**

Health care and professional service sector jobs are expected to grow substantially over the next six years; these industries offer many high-wage jobs like health care practitioners and computer occupations ($86,619 and $102,034 median salary in 2018, respectively). Significant growth is also projected in the leisure and hospitality industry, but many of these jobs are low wage. Indeed, most of this industry’s growth is expected to come from food preparation and serving occupations, which had median annual salaries of only $25,232 in 2018. The food services industry alone accounts for nearly 15 percent of the state’s low-wage workers.
• **The lack of affordable housing can curtail economic growth.**

The state’s housing crisis has broad economic effects. High housing costs put a strain on household budgets, leaving many with less money to save or spend. In California, 38 percent of mortgaged homeowners and 55 percent of renters spend more than 30 percent of their total household income on housing, compared with 28 percent and 50 percent nationwide. The lack of affordable housing may make it harder for employers to attract and retain workers. Rising housing costs also mean that many workers, particularly those who are low income, have to live farther from where the jobs are.

• **Employment—even full time—does not eliminate poverty.**

Nearly 2 million Californians ages 25–64 were working but living in poverty in 2017 (12.2% of working adults in that age group). About two-thirds were employed year round—45 percent full time and 21 percent part time—while another third worked less than the full year. California’s minimum wage increased to $12/hour in 2020 (for small employers; large firms must pay $13/hour), but many working-poor adults earn above minimum wage. For these workers, sufficient work hours, affordable child care, and building skills for career advancement are persistent challenges.

• **Incomes have improved, but economic polarization is increasing.**

The median or “middle-income” family of four in California today is doing about 24 percent better than the median family in 1980 ($87,829 in 2018 and $70,950 in 1980, in today’s dollars). However, top-income families (the 80th and 90th percentiles) earn 50 to 60 percent more today than in 1980. These historically high levels of income polarization are driven by labor market shifts that favor college graduates and also by boom-and-bust cycles. The top 10 percent of families make more than 10 times as much as the bottom 10 percent; this gap has nearly doubled since 1980. The lowest-income families recovered slowly from the recession—their incomes did not catch up to 2007 levels until 2017.

• **Income trends also reflect underlying demographic disparities.**

In 2018, median annual earnings in California for a family of four headed by Asian Americans or whites were about $115,000. Families headed by African Americans or Latinos earned substantially less: $66,000 and $60,000, respectively. Not surprisingly, there are striking differences linked to educational attainment. The median income for a family of four headed by an adult with a college education was $144,000 in 2018, compared with only $63,000 for a family of four headed by an adult with no more than a high school education.

**Looking ahead**

California’s economy is strong, but long-standing disparities create challenges that state leaders must confront while also preparing for the next economic downturn. Effective policies require accurate assessments of California’s economic performance and a balanced view of the state’s competitiveness.
Pursue policies that build a skilled workforce. Ensuring access to education that prepares the state’s increasingly diverse workers for in-demand jobs is critical to economic growth and the well-being of California’s families. Promoting education is also an important strategy for addressing inequality and improving economic mobility. State leaders can take actions to ensure that more Californians earn college degrees—and/or career education credentials that can help them access high-paying jobs in fast-growing industries such as health care and professional services.

Address modern labor market challenges. While “gig” work is still a small share of overall employment, it has been the subject of high-profile policy debates. Rideshare and other app-based platforms receive a lot of attention, but the work performed by independent contractors is diverse, encompasses all sectors of the state’s economy, and has been growing for some time. It has been difficult for researchers to determine the prevalence of this kind of work or its long-term effects on Californians’ economic well-being. Better data are needed to fully understand the implications of these labor market developments.

Prepare for the next downturn. Historical patterns suggest that California’s long-running economic expansion will not continue indefinitely. The state has built up budget reserves capable of weathering a mild recession—but further set-asides are needed to avoid deep reductions in support for education and other state programs. Ensuring the fiscal health of both the state’s safety net and skill-building programs that assist dislocated workers will help mitigate the impacts of a future economic downturn on workers and their families.