CALIFORNIA ECONOMY

PPIC | PUBLIC POLICY INSTITUTE OF CALIFORNIA

THE ECONOMY REMAINS A BIG CONCERN FOR CALIFORNIANS

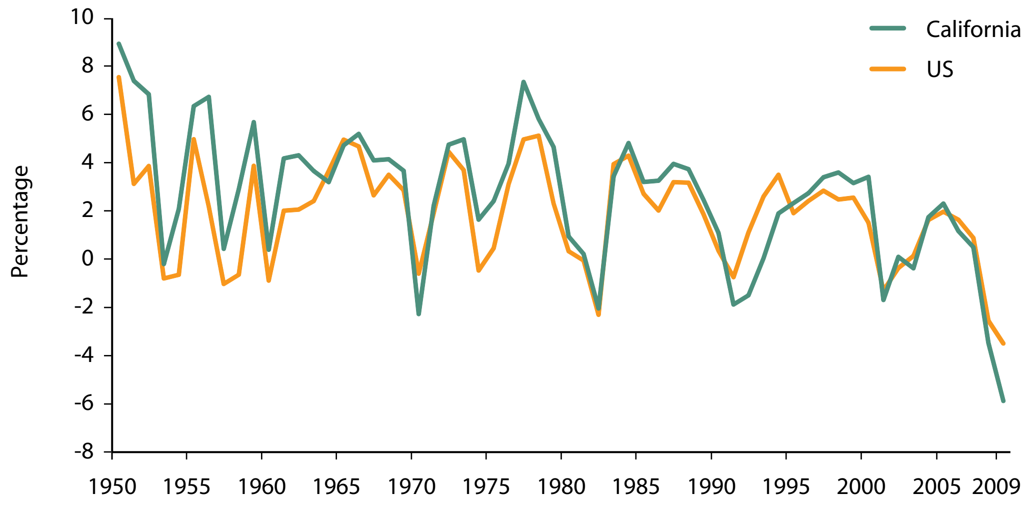
The current recession reveals important fundamentals about California's economy and shows where some longer-term challenges and growth opportunities lie. Californians remain worried about the economy: in PPIC's March 2010 Statewide Survey, 65 percent of respondents thought that the economy will face bad times over the next year, only a slight improvement over 71 percent in March 2009. But the current downturn is neither an indicator of trouble unique to California's economy nor a harbinger of long-term economic weakness in the state. Despite the state's frequent booms and busts, historical patterns are 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 are explained or offset by the state's strengths and are likely to remain permanent features of the California 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. Job growth over the past 30 years has averaged 1.2 percent annually for the nation and 1.1 percent annually for California. In 2009, California's job loss of 5.7 percent was worse than the U.S. job loss of 3.5 percent. Although California might emerge from the recession on a slightly different timetable, its long-term growth rate is likely to remain similar to that of the nation.

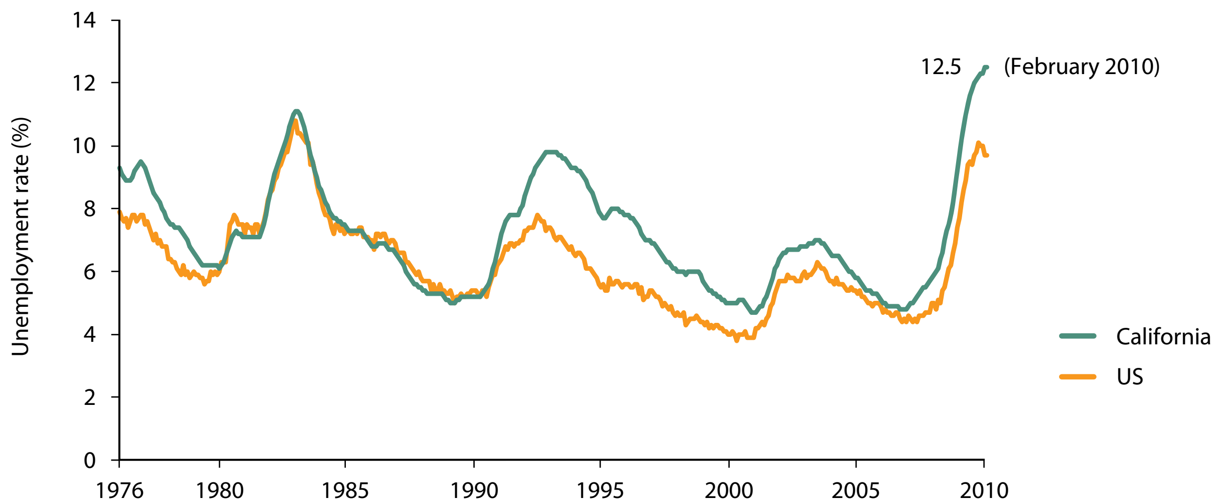
CALIFORNIA JOB GROWTH TRACKS GROWTH IN THE NATION OVERALL



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

- **Unemployment is persistently higher in California than in the nation.**
  In the current recession, California's unemployment is higher and rising faster than the U.S. rate, even though employment growth is similar for the state and the nation. In February 2010, California's unemployment was 12.5 percent; it was 9.7 percent for the nation. But California's unemployment rate consistently exceeds the U.S. rate, even when California's employment growth surpasses U.S. growth, as it did during the technology boom in the late 1990s.

UNEMPLOYMENT IS THE HIGHEST IN DECADES



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

This seeming paradox arises because California's labor force grows faster than the U.S. labor force. The state's economy, therefore, generates jobs at a rate similar to the national rate, but this is not enough to keep up with California's faster-growing population. California unemployment is likely to remain above the U.S. level even after the effects of the current recession have been forgotten.

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

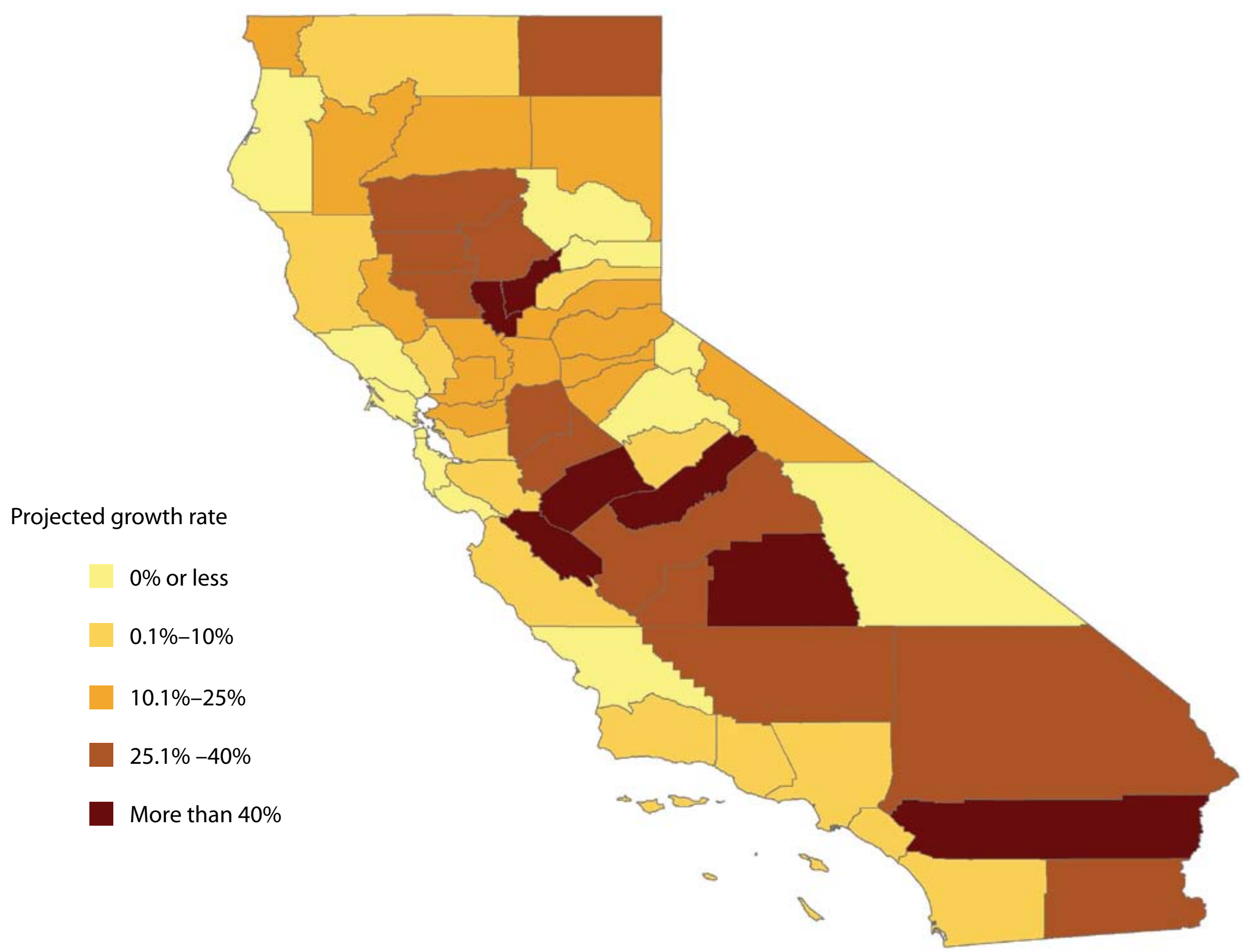
- **Businesses are not fleeing the state.**
  Rhetoric aside, California loses very few jobs to other states. Businesses rarely move either out of or into California and, on balance, the state loses only 11,000 jobs annually as a result of relocation—that's just 0.06 percent of California's 18 million jobs. Far more jobs are created and destoyed as a result of business expansion, contraction, formation, and closure than because of relocation. Business relocations, although highly visible, are a misleading guide to the overall performance of the California economy. The employment growth rate, which takes into account job creation and destruction for all reasons—not just relocation—is a much better measure of the state's economy.

- **The "business climate" debate understates California's strengths.**
  California consistently scores poorly in business climate rankings. These rankings, however, focus primarily on tax and regulatory costs, which are only one part of the business climate. The business climate should instead be defined to include all costs and benefits that businesses face from locating in California. The business climate also should take into account 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. These unemployment differences are due 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: aside from the current recession, in most years some regions of the state grow quickly while others grow slowly or contract. Although the recession has hit inland California hardest, the region's low housing costs will still contribute to high growth of the workforce there. The working-age population is projected to grow more than 25 percent between 2010 and 2025 in much of inland California; in California overall, that growth will be 13 percent.

INLAND CALIFORNIA'S LABOR FORCE WILL GROW FASTEST

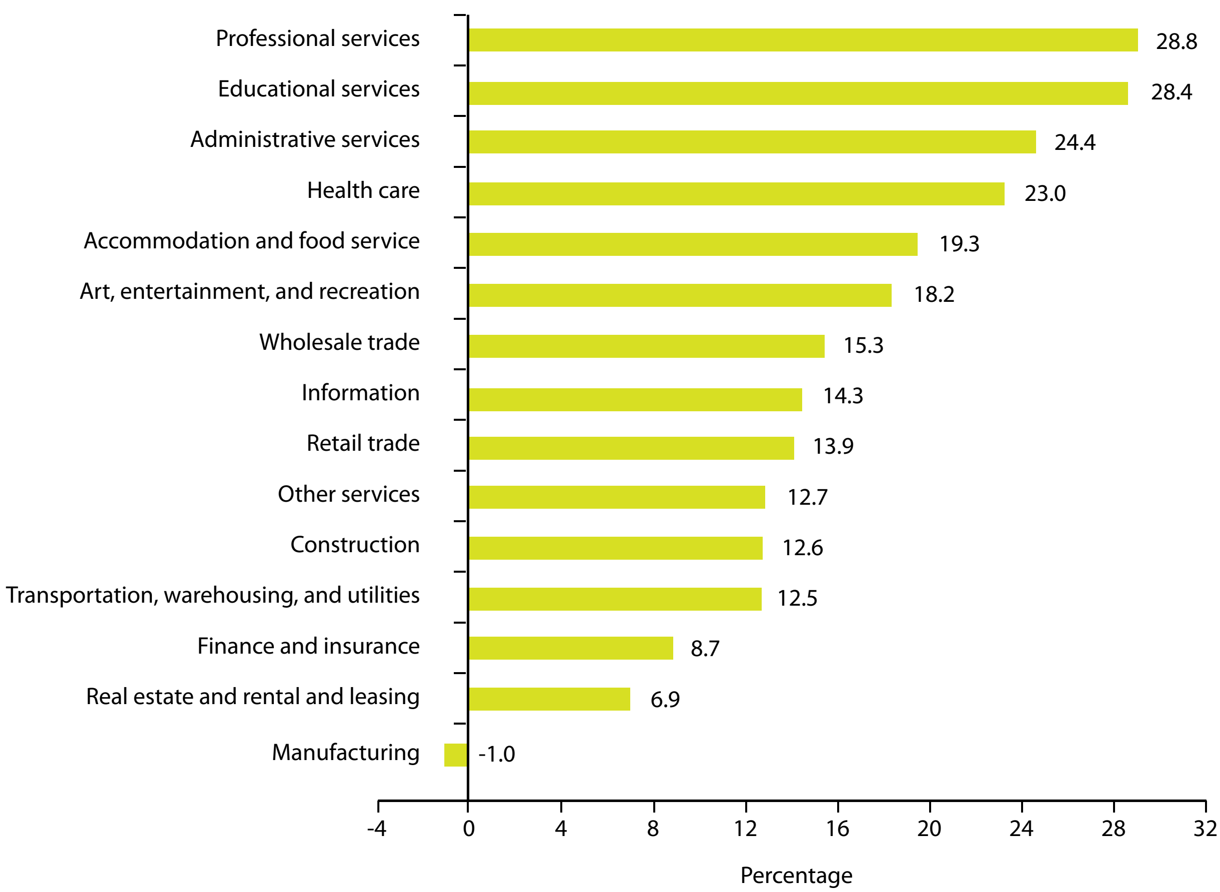


SOURCE: California Department of Finance.
NOTE: California's projected growth rate, by county, of working-age population, 2010–2025.

- **Housing is expensive still and probably always will be.**
  Even before this decade's real estate bubble, housing in California was much more expensive than in the nation as a whole. And although housing prices have fallen more in California than in the nation during this recession, housing remains far more expensive in California, especially in its coastal cities. At the end of 2009, the average U.S. home was worth $185,000; in metropolitan Los Angeles, the average home was worth over $400,000, and in the Bay Area, over $500,000, according to Zillow. Expensive real estate makes it harder for some businesses to locate in California and attract workers, pushing growth out of state. The growing gap between high house prices on the coast and rapidly falling prices inland could accelerate the movement of businesses and households inland.

- **Services will continue to grow; manufacturing will continue to stagnate.**
  Manufacturing accounted for only 9 percent of California's employment at the end of 2009; its share has been declining for decades, and it will continue to be California's slowest-growing sector. In the current recession, the construction industry has contracted most sharply, but once the existing housing stock has been absorbed by California's growing population, construction employment will rise again, although it will not reach its boom-time levels. The fastest-growing industries over the longer term are projected to be professional services, administrative services, education, and health care; these are also the sectors least hurt by the current recession.

PROJECTED PRIVATE-SECTOR INDUSTRY GROWTH



SOURCE: California Employment Development Department.
NOTE: EDD Employment Growth Projections, 2006–2016 (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 business climate, and a realistic sense of the state's strengths and weaknesses.

- **Focus on the right economic measures.**
  To know how well California's economy is doing, the best measure to examine is employment growth or gross state product growth. The unemployment rate is also an important indicator, showing how households are faring in the labor market and the demand on government services. Other indicators—such as whether businesses leave the state—can be misleading.

- **Take a broad view of the business climate.**
  Assessments of the state's business climate should take into account all of the costs and benefits of doing business in California. Because California is a high-cost, high-benefit state, looking only at the cost side—as many business climate indices focused on taxes and regulation tend to do—fails to explain why California's growth tends to keep up with or surpass national economic growth.

- **Review housing policies that do harm.**
  California's expensive real estate is a major cost for businesses and their workers. Housing is expensive partly because California's climate, natural features, and topography both raise the demand for land and constrain supply. Regardless of policy, California's housing prices will remain well above the national average, especially along the coast. But regulations that discourage new housing construction push prices up further, especially in expensive coastal cities, and raise the cost of doing business in California. Local efforts to review restrictions on housing development could boost California's economic growth in the long term.

- **Don't pin all hopes on one industry.**
  Although many industries—such as motion picture, 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 national industry mix. 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.

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

Business Location Decisions and Employment Dynamics in California
Do California's Enterprise Zones Create Jobs?
The California Economy: Housing Market Update
Are the Rich Leaving California?
Does Broadband Boost Local Economic Development?

Contact a PPIC expert:
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