Economy

JANUARY 2018

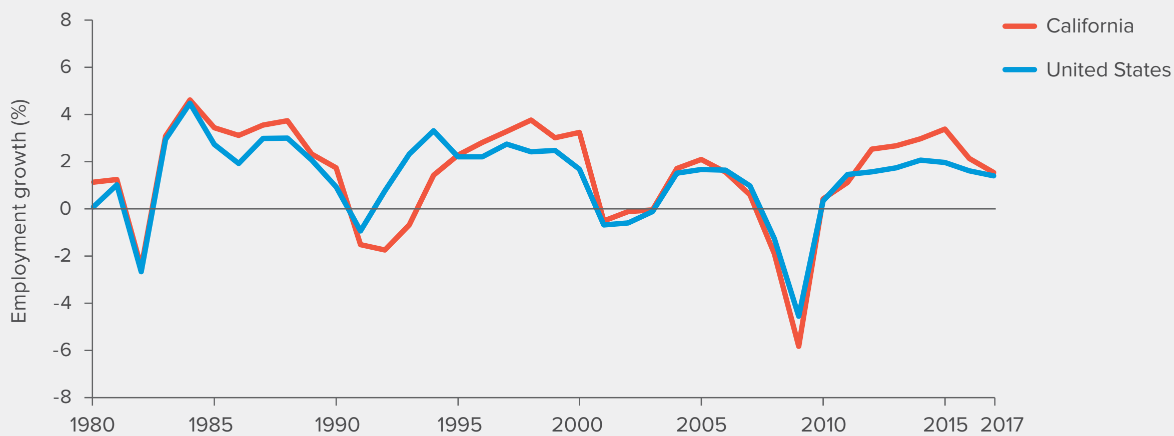
California's economy is strong, but persistent disparities could affect long-term growth

By many measures, California's economy is performing well. The statewide unemployment rate is at a long-term low. Jobs have been growing for more consecutive years than is typical. Construction and major service industries—at both the high- and less-skilled levels—are projected to continue to drive job growth over the next decade. These job market improvements are reflected in family incomes, which have picked up substantially over the past few years.

Although major labor market indicators are outperforming pre-recession levels, many Californians still struggle with unemployment and stagnant wages. This mixed picture is reflected in Californians' views of the economy. According to the September 2017 PPIC Statewide Survey, 40 percent of Californians expect economic bad times over the next year, while 51 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.

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



SOURCE: US Bureau of Labor Statistics.

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

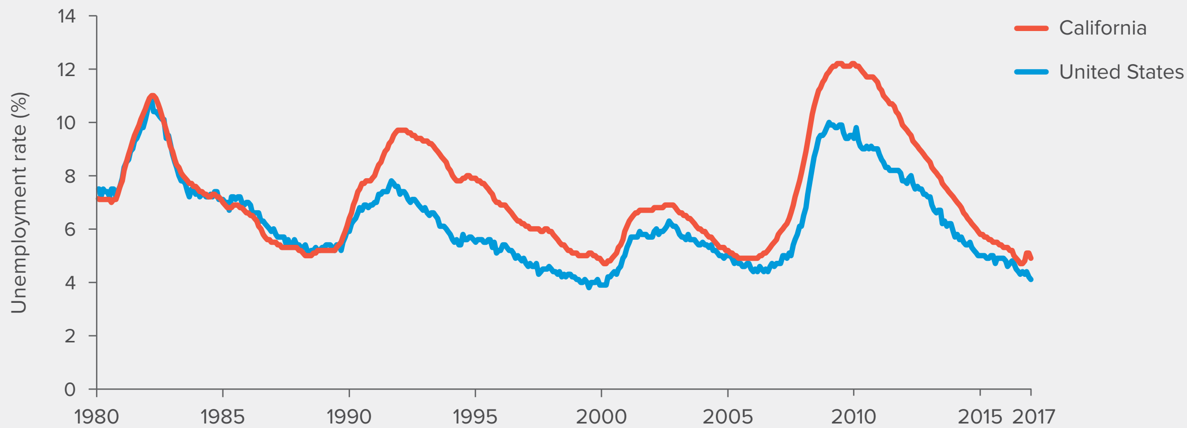
California's labor market continues to improve

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 typically 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.**
  California's employment growth—the broadest measure of economic performance—tends to follow the nation's job-growth rate very closely: over the past 30 years, job growth has averaged about 1.3 percent annually in both California and the nation. But for the past five years, California's 2.5 percent job growth has been stronger than the 1.8 percent growth in the United States. Both the state and the nation experienced job growth in 2017, for the eighth year in a row. Historically, this kind of sustained growth has not lasted much longer than that. Job growth in California slowed in 2017, bringing our rate into closer alignment with the US rate.

- **Unemployment is nearing historic lows.**
  In October 2017, California's unemployment rate was 4.9 percent, slightly above the 4.1 percent national rate. The state's jobless rate is essentially as low as it has been at any point since 1980 (it vacillates slightly from month to month). 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 national rate during the recent recovery and the technology boom of the late 1990s. Although this may seem paradoxical, it makes sense in the context of population growth. California's population grows at a faster rate, which fuels faster-than-average expansion of the state's labor force. The result is a persistently higher unemployment rate, which narrows—as it has over the past few years—only when California job growth exceeds that of the United States for several years in a row.

UNEMPLOYMENT IS AT A LONG-TERM LOW IN CALIFORNIA



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 differences in the mix of workers, occupations, and industries are accounted for. But the state's output per worker is 14 percent above the national average. This higher productivity fully offsets 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 advantages: in addition to higher productivity, they benefit from the skill level of the workforce, the availability of capital, and the amenities that make California an attractive place to live. The state's long-term competitiveness is tied to maintaining some of these advantages. Key challenges include ensuring that the workforce has adequate or exceptional skills and addressing the high cost of living (which has worsened in recent years).

Underlying economic conditions remain uneven

- **Many Californians remain underemployed—or out of the labor force.**
  California's low unemployment rate does not tell the whole story. The state has more than 800,000 unemployed workers and more than 700,000 people who have dropped out of the labor force but would like to work. California's labor force participation rate (the share of the population working or looking for work) is at a 40-year low. This is partly due to baby boomer retirements, but it also reflects a persistent disconnection from the labor market. Job growth has brought back some who left the workforce during the recession. But 4.4 percent of workers are under-employed: that is, they are working part-time when they would rather be working full-time. Altogether, 10.1 percent of workers are either unemployed, underemployed, or discouraged (meaning they would like to work but have dropped out of the labor force). This rate is more than twice as high as the official unemployment rate. And, while it is lower than it was during the recession, it remains above pre-recession levels.

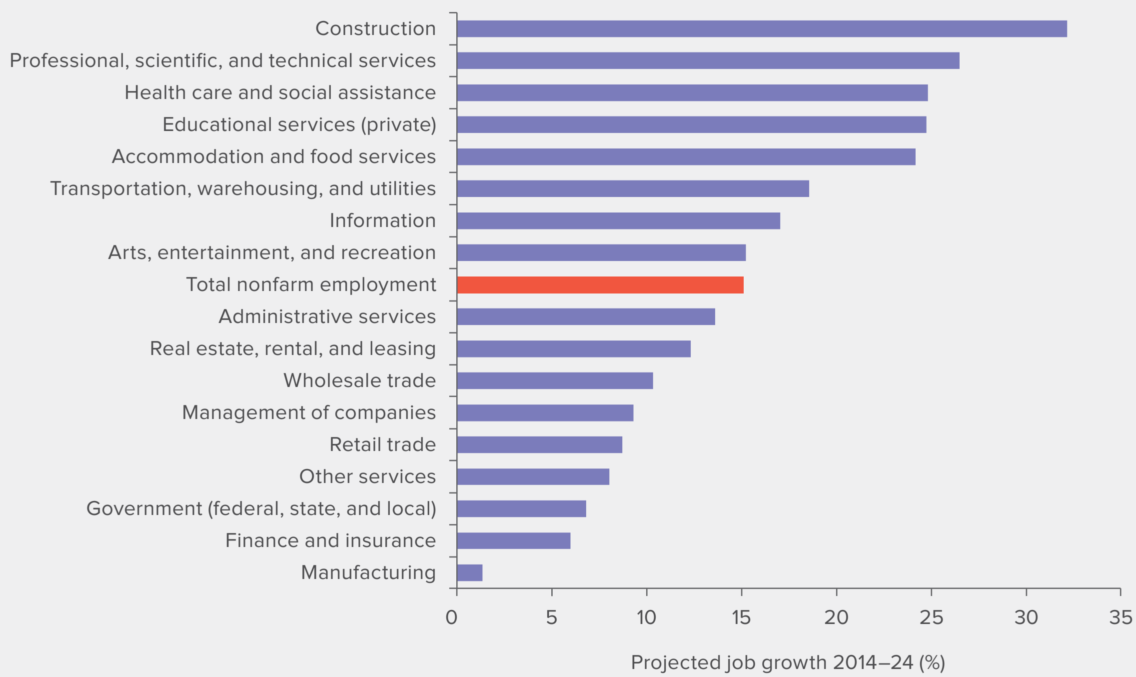
- **Income inequality is high by historical standards—even though family incomes have risen.**
  Uneven recovery across segments of the labor market—both before and after the Great Recession—has increasingly polarized the income distribution. The top 10 percent of families in California earn about 12 times as much as the

bottom 10 percent, doubling the gap between high- and low-income families since 1980. After growing sluggishly over the past decade, family incomes rose almost 4 percent from 2015 to 2016: the median family in California earned about $77,000. California's median family income is higher than the nationwide median of $71,000.

- **Regional economic differences are persistent.**
  Unemployment tends to be higher in inland and far northern California than in the urban coastal parts of the state. As of October 2017, unemployment rates were lowest in the Bay Area as well as San Diego and Orange Counties (ranging from 2.5% to 3.7%). Rates elsewhere are typically a few points higher, and only three counties (Colusa, Tulare, and Imperial) had rates above 8 percent, a marked improvement since the recession, when unemployment differences were more dramatic. Higher inland rates are attributable to both a faster-growing workforce and the mix of jobs and industries in those areas. Low housing costs continue to fuel the growth of the inland workforce: the working-age populations of the Central Valley and Inland Empire are expected to grow more than 20 percent between 2015 and 2030, while the projected rate in the rest of the state is only 6 percent.

- **Strong job growth in construction and services will continue, while manufacturing will stagnate.**
  Recent employment growth has been led by construction, accommodation and food services, health care, and "other" services; these industries created 60 percent of the new jobs in California between October 2016 and October 2017. Local governments also contributed substantially to job growth, adding about as many new jobs as did the accommodation and food services sector. These industries are likely to continue leading growth through 2024. By contrast, manufacturing employment is projected to continue its sluggish growth pattern: its job-creation rate is expected to be only 1.3 percent by 2024. The professional services industry, which tends to employ college graduates and offers high wages, is likely to grow as fast as the accommodation and food services industry, where lower-wage work predominates. If this long-term trend of increasing disparity in employment opportunities continues, California's income distribution will remain skewed.

CONSTRUCTION AND SERVICE INDUSTRIES ARE PROJECTED TO LEAD JOB GROWTH THROUGH 2024



SOURCE: California Employment Development Department.
NOTE: Employment growth projections for nonfarm industries only.

Looking ahead

California's long-term economic trends are positive, but they are also creating policy challenges. Effective 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 build a skilled workforce and spur economic growth. Continuing California's strong job growth is the first step in creating broad-based economic opportunities. Because the state economy demands a highly skilled workforce, education plays a crucial role in helping California remain economically competitive. Since highly educated workers fare better in boom-and-bust cycles, promoting education is also an important strategy for addressing inequality and ensuring economic opportunity across the income spectrum. State leaders can take actions to ensure more Californians earn college degrees as well as career technical credentials that lead to in-demand middle-skill jobs.

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

Address barriers to work. A smaller share of California's population is participating in the labor force than at any time in the past four decades. The aging population is a factor—and it raises concerns of its own. But the state must also focus on the substantial share of the population that is disconnected from work or underemployed. Boosting skills and addressing barriers such as transportation and child care are key to improving economic well-being and maximizing the potential of California's workforce.

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