Economy

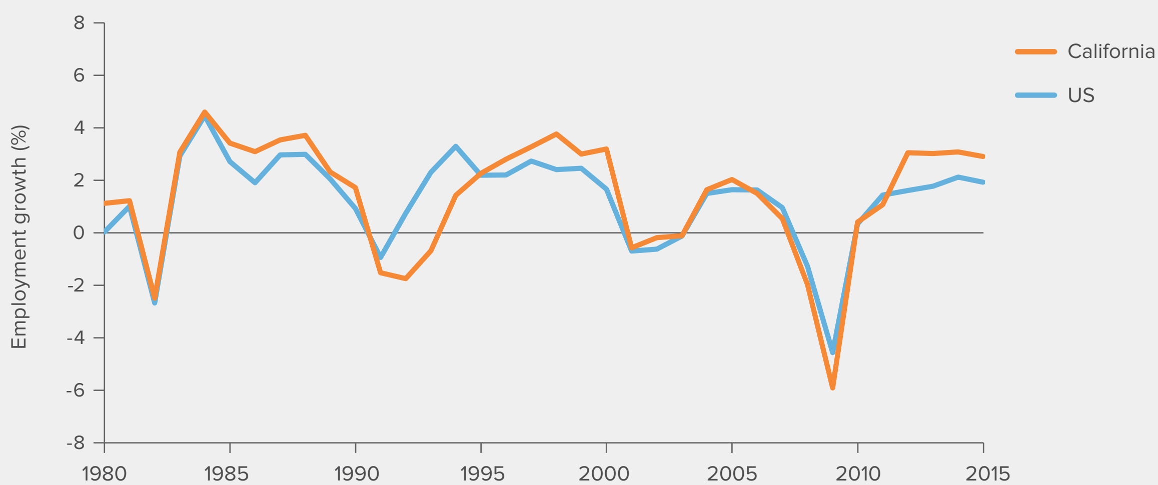
JANUARY 2016

California's economy is growing, but disparities persist

By many measures, California's economy has recovered solidly from the Great Recession. The state unemployment rate is lower than it has been in nearly eight years. Strong job growth continues, with California adding more jobs than were lost in the recession. As the housing market continues to improve, strong job growth has resumed in the hard-hit construction industry. Service industries—at both the high-skilled and less-skilled levels—led the recovery in the early years. Services continue to be job-growth leaders and are projected to remain so over the next decade. These job market improvements are reflected in family incomes, which are finally rebounding from their recession-era low point. However, for many California families, the rebound is slow. Median family income still lags behind historical averages. Moreover, many Californians are still unemployed or underemployed. This mixed picture is reflected in Californians' views of the economy. According to the May 2015 PPIC Statewide Survey, 42 percent of Californians expect economic bad times over the next year, while 48 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.

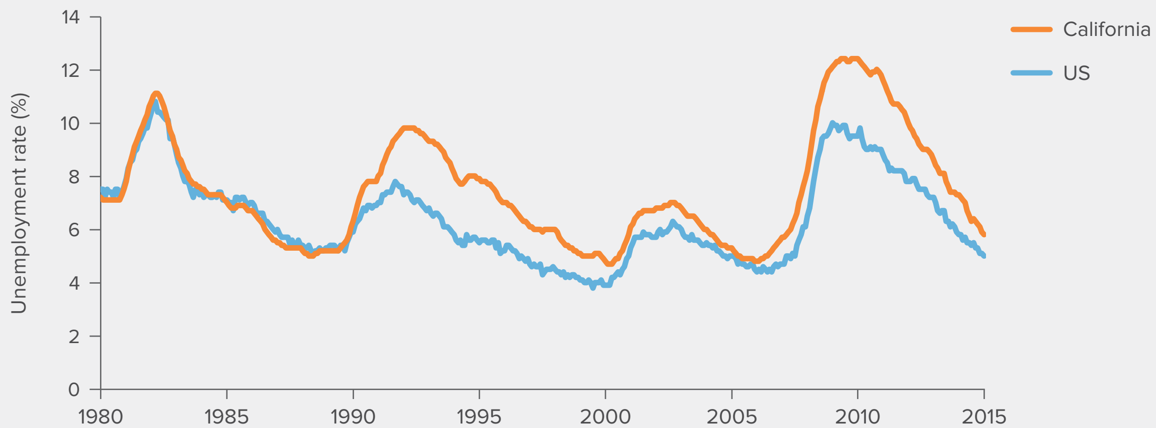
California is returning to its long-term, strong fundamentals

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 permanent features of the state's economy.

- **California has experienced three 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 four years, California's 3 percent job growth has been stronger than the 1.9 percent growth in the US. 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 2015, for the sixth year in a row.

- **Unemployment is persistently higher in California.**
  In October 2015, California's unemployment rate was 5.8 percent, slightly above the 5 percent national rate. The state's jobless rate is still about 1 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 12 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 13 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 locating 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.

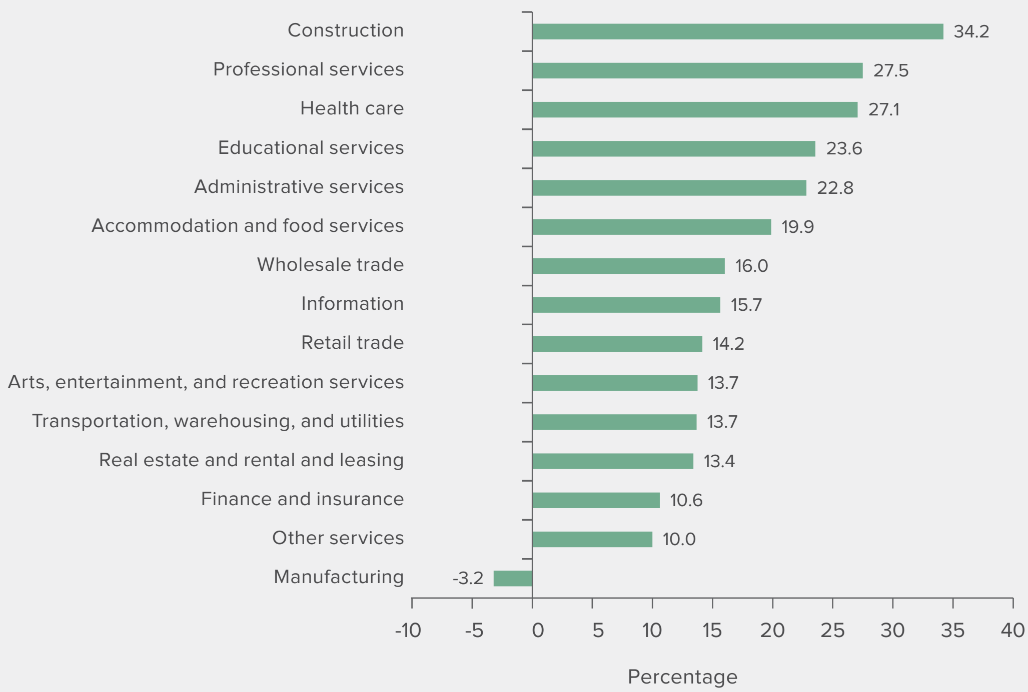
Economic conditions continue to be uneven

- **Improved labor market conditions have yet to benefit all Californians.**
  Despite improvements, California still has 1.1 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, roughly half of unemployed Californians have been looking for work for 15 weeks or longer. The length of the average spell of unemployment shortened slightly over the previous year but was still long by historical standards. Furthermore, 6 percent of workers are underemployed; that is, they are working part-time when they would rather be working full-time. Altogether, 13.3 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 have been slow to improve across the board, median household income has only begun to increase in the past two years. In 2014, the median household earned about $62,000, an improvement from the low of $60,000 in 2012 but still 9 percent lower than in 2007. California median income is higher than the $54,000 in the nation as a whole.

- **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 2015, unemployment rates were lowest in the Bay Area (ranging from 3 to 5%) and highest in Imperial County (21.8%) and the Central Valley (8 to 10%). 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, three disparate service industries—accommodation and food services, health care, and professional services—led employment growth, contributing 43 percent of new jobs. The construction industry also continued to rebound in 2015, adding jobs at a rate of 8.1 percent, more than twice the state's overall job-growth rate. These industries are projected to continue leading growth through 2022. By contrast, manufacturing grew at a comparatively slow 1.7 percent rate. Manufacturing job growth has been slowing for decades and will continue to be sluggish in California.

PROJECTED PRIVATE SECTOR INDUSTRY GROWTH, 2012–22



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 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 has added more than the number of jobs lost during the recession and must continue to do so. About two million Californians are either unemployed or might reenter the labor force if more jobs were available.

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.

- **Don't pin all hopes on one industry.**
  Although some industries—such as film, high-tech, and wine—are highly concentrated in California, the state's economy is actually very diversified, and the 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 might be to try 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 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.

CONTACT A PPIC EXPERT

Sarah Bohn
bohn@ppic.org

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Public Policy Institute of California
500 Washington Street, Suite 600
San Francisco, CA 94111
T 415.291.4400   F 415.291.4401
PPIC.ORG

PPIC Sacramento Center
Senator Office Building
1121 L Street, Suite 801
Sacramento, CA 95814
T 916.440.1120   F 916.440.1121

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