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THE CALIFORNIA ECONOMY: ON THE REBOUND

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This chapter outlines the geographic and economic distribution of growth in California following the recession which ended in 1993, drawing on research conducted for the UCLA Anderson Forecast and elsewhere. We examine regional growth patterns, the prospect of renewed positive immigration, the role of the national macroeconomic environment, as well as the distribution of earnings. Growth in California has returned to the relatively higher rates, vis a vis the U.S., which have historically characterized the California economy. The dramatic expansion of the electronics industry and related business services in Santa Clara County and San Francisco is leading the recovery of California's regions. The recovery has occurred within a national macroeconomic environment which has been remarkably stable.

Long term prospects for stable growth will eventually be challenged by increasing earnings inequality, wage stagnation, and the impending increase in the dependency ratio of elderly to working age population. That ratio will begin to rise around 2010 when older babyboomers start to retire. Young immigrants offer a solution to the dependency problem. But the integration of less educated immigrants into an economy already plagued by increasing earnings inequality will challenge the imagination of policymakers. The wider distribution of on the job training, upgrading of low wage jobs, and English language acquisition will be important components of an agenda to incorporate immigrants into the California economy.

A Return to Faster Growth

California and the U.S. are currently reversing the trend toward slowdown in the rate of real GDP growth that we have seen in the past three decades. Furthermore, growth rates in California have returned to their relatively faster growth rate with respect to the U.S (Figure 1). Growth rates in California have exceeded growth rates of the U.S. in nearly every year except for 1990-1995 (Lieser, September 1997), when the recession hit California particularly hard. California returned to this faster growth path in 1996 and is expected to maintain that position for the first two decades of the next century. Due to faster growth rates, wages in California have exceeded those in the U.S. for many years. California has weathered the loss of aerospace jobs and the influx of low wage immigrants without a noticeable decline in the California-U.S. wage ratio (Figure 2) (Richardson and Mitchell, 1997). However, the dispersion of wages for California's male workers has widened relative to the U.S.

California is making impressive employment gains. However, the new jobs tend to be concentrated in certain industries and regions, with net pay levels and skill levels

that are slightly below average (Jacoby and Goldschmidt, 1997). Between March 1996 and March 1997 California added more than 425,000 jobs, a gain of 3.4% (Lieser, June 1997). This is the highest number of jobs created in California since 1988. The majority of jobs added were in the service sector. Four industries comprising less than half of service sector employment accounted for 83% of the new service jobs during this period. These four industries included business services, motion pictures and television, engineering and management services and amusement and recreation services. The strongest gains in manufacturing employment were found in high technology industries and apparel .

The Technology Boom in Northern California

Growth in California is generated by distinctive regional competencies. The expansion of the electronics industry and related business services in Santa Clara County and San Francisco has produced a striking change in the geographic distribution of the state's growth. Although through much of the post World War II era, the state's economy was dominated by the greater Los Angeles five-county region, the balance of growth in recent years has shifted northward. Employment Development Department data from the first seven months of 1997 indicate that the San Jose metropolitan area is the fastest growing region in California, with an employment growth rate of 4.2% (Figure 3) (Lieser, September 1997). Unofficial surveys of large and small technology companies in the San Francisco metro area showed average employment growth rates exceeding 10% in 1996 (Lieser, June 1997).

However, the sustainability of northern California's fast-paced growth is questionable. With employment growth rates of 10% and vacancies of 5%, the Silicon Valley is becoming too crowded, too expensive, and too hemmed in by land use restrictions for the current expansion to endure. The congestion of northern California raises questions about where the technology boom overflow will locate. Southern California has a plentiful supply of office and industrial space, but it is perceived by northern California hi-tech entrepreneurs as being too far from the network of Silicon Valley suppliers and distributors. There will be a price at which high tech producers will opt to pursue lower cost locations. Given the slack growth in southern California and the benefit to the state of keeping the technology boom in California, policies should be considered to increase the attractiveness of locating in southern California .

Slow Growth in Southern California

Southern California is adding jobs, but the rate of growth is less than the rest of California. As of July 1997, employment growth rates in the greater Los Angeles region were the lowest of all metropolitan areas in California except for Fresno. While the average rate of employment growth for California as a whole was 3%, in the greater Los Angeles region it was only 2%. Job growth has been consistently stronger in the rest of

California than in the greater Los Angeles region in every year since 1990 (Schniepp, 1996). Because the difference between annual employment growth rates since the recovery began has been roughly constant, southern California is not about to catch up to the rest of the state.

The type of jobs being created in southern California tend to be low wage. Higher paying industries, such as transportation equipment manufacturing, communications, public utilities, finance and insurance, petroleum refining and state and local government, with the exception of education, are downsizing. Although Los Angeles is the largest manufacturing center in the nation (Wolff, 1997), in 1996 only 36% of California's new job formation in manufacturing was located in the greater Los Angeles region. The average salary for the net job created in Los Angeles County during 1996 was \$24,730 (Schniepp, 1996).

The Return of Positive Net Migration

Declines in outmigration from California are prompting expectations of the return of positive net migration. Prior to the 1990s, more people migrated to California from abroad and from other U.S. states than departed the state for other destinations. During the 1980s average net inflows of 337,000 were recorded (Lieser, September 1997). U.S. Bureau of the Census estimates show a large exodus from California during the first half of the 1990s. Statistics from the U.S. Internal Revenue Service suggest that the net outflow from California peaked at about 425,000 persons in 1993-94. The slowing of net domestic outmigration in 1995-96 returned the overall domestic and international migration count to near zero (Gabriel, 1997).

Low unemployment rates in the destination state relative to the origin state, tend to prompt strong migration between those areas (Gabriel, 1997). This tendency is particularly true if the states are near each other. The sharp increase in net domestic outmigration from California during the early 1990s coincided with the sharper decline in employment opportunities in California relative to that of other states, attendant to the greater severity of the recession in California. Recent declines in California's unemployment rate are projected to reverse the direction of net migration flows (Figure 4)

Net immigration is expected to become a substantial factor in California's economy by the turn of the century, with major implications for housing and labor markets. This expectation is based on the projected convergence of California and U.S. jobless rates over the 20 years beyond the turn of the century. According to Lieser, the faster rate of growth in California during this period will eventually close the California-U.S. differential in unemployment rates. Historically, the convergence of California and U.S. unemployment rates is a rare occurrence and has typically been accompanied by large numbers of immigrants from other states (Lieser, September 1997).

The Impact of State-to-State Migration on Workforce Education Levels

In addition to boosting the demand for housing and consumer goods, increased domestic migration to California will expand the workforce while raising its educational level. Unlike flows of foreign immigrants, domestic migrants to California are dominated by persons with a college education (Figure 5). From 1985 to 1990 California had a net gain of college educated workers because domestic immigration was very high. It is unlikely that the return of positive domestic migration will be sufficient to overcome the trend toward declining education levels in California's workforce, but domestic immigration will partially offset the decline (Bolton, 1997).

As recently as 1980, California had the highest percent of college educated workers of the ten largest states. However, by 1995 California had fallen to fourth place in this ranking (Bolton 1997). During 1983-1993 managerial/professional employment increased by 1% in California, compared to 4% in the U.S (Figure 6) (Richardson and Mitchell, 1997). Whereas prior to 1983 the share of managerial/professional occupations in California clearly exceeded that of the U.S., by 1993 they were roughly equal. Jacoby and Goldschmidt's study of California's fastest growing occupations indicates that 45% of these jobs will require skills consistent with less than a high school education (Jacoby and Goldschmidt, 1997).

Maintaining a Stable Macroeconomic Environment for Growth

The national macroeconomic environment since the last recession has been remarkably stable. Real GDP growth, GDP deflator inflation, and the unemployment rate seemed fixed at desirable levels. Faster growth during the recovery would have risked too much inflation. High rates of resource utilization have drawn the attention of Federal Reserve Chairman Alan Greenspan (Kimbell and Dhawan, 1997). Fearing that wage growth pressures could be building given the current tightness of labor markets, Greenspan warns that the threat of rising inflation may require a slowdown in growth. Waiting too long to raise the interest rates could provoke a recession while slowing inflation. Greenspan may act to slow the national economy by mid 1998, and this slowdown will affect California as well.

The ability to maintain the strict monetary discipline which has been achieved in the past fifteen years will become more problematic in the future, especially after 2010 when the aging babyboomers begin to retire. This mass retirement will put upward pressure on government spending, while placing downward pressure on savings rates. Other policy dilemmas which will be aggravated by the retirement of the babyboomers include: 1) the projected deficit in Social Security, 2) the smaller size of the future workforce which will be supporting the retirees, and 3) current trends of slow growing productivity, wage stagnation and increasing earnings inequality. In last year's

California Policy Options, we suggested that California could welcome an influx of young immigrants as part of the solution to the projected 75% increase in the ratio of elderly to working age population. We offered this proposal cautiously, with recognition of the near term labor market tensions it would create.

How Do We Integrate Immigrants without Exacerbating Inequality?

The integration of young, less educated immigrants is and will be a daunting task, but the other policy options are no less so. Due to a faster drop at the bottom of the earnings distribution, earnings inequality among men in California is already increasing faster than in the U.S. (Figure 7) (Richardson and Mitchell, 1997). If a smaller workforce, composed of predominantly low wage workers, is going to support the baby boomers, the question of how to raise their productivity is inescapable. Rising productivity would lighten the tax burden as well as raise wages. The continued growth of low-skill, low-pay jobs may be due to the unwillingness of employers to upgrade the skill content of jobs. To the extent that the low wage economy is due to employers' reluctance to upgrade jobs, policies could be designed to assist employer-provided training (Jacoby and Goldschmidt, 1997, Wolff, 1997).

Instead of trying to create high-skill, high-wage industries, that we upgrade low-skill, low-wage ones instead. The most effective means of raising the earnings of low wage workers is to develop comprehensive industrial upgrading strategies in light manufacturing which facilitate changes in marketing, production and human resource practices. While heavy industry and high tech manufacturing have been declining in the Los Angeles region, light manufacturing industries have been growing (Wolff, 1997).

By implementing a high-skill/high wage competitive strategy. Light manufacturing industries can reposition themselves in product markets that require better technology, reorganized workplaces and better trained workers. This strategy allows industries to compete on the basis of quality, customized products and fast response, rather than just low prices. Furthermore, the high-skill/high wage path has the triple advantage of raising the wages of low wage natives as well as immigrants, while raising profits for employers by increasing the competitiveness of their firms.

Conclusions

California has rebounded to its customary faster growth path. Southern California has not recovered as much as northern California and it does not appear that it will regain its former dominant position in terms of faster growth. The California economy is generating jobs that pay lower wages than average, however, the California-U.S. wage ratio has remained stable, implying that the trend toward lower paying employment is national rather than local. Declining unemployment rates have prompted expectations of a return to positive net domestic migration, which should partially offset the declining

educational level of the workforce and stimulate consumer demand. Although the recovery has taken place in a remarkably stable macroeconomic environment, prospects for future stability will be challenged by faster growth rates, increasing earnings inequality, wage stagnation and the impending increase in the dependency ratio of elderly to working age persons. Policies to facilitate the integration of young immigrants will pose controversial solutions to the future crisis of dependency.

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Figure 1. Real GDP Growth in California and The U.S.: Rates of Change 1985-1995

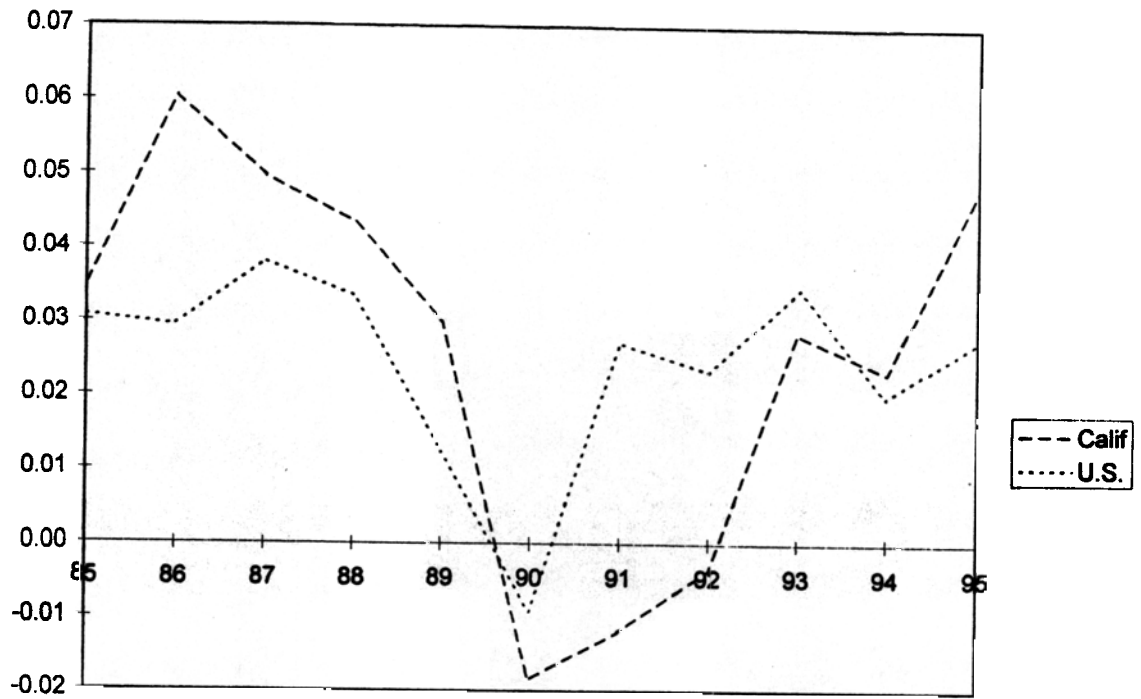


Figure 2. California/U.S. Wage Ratios: Hourly, Weekly and Annual Pay 1983-1993

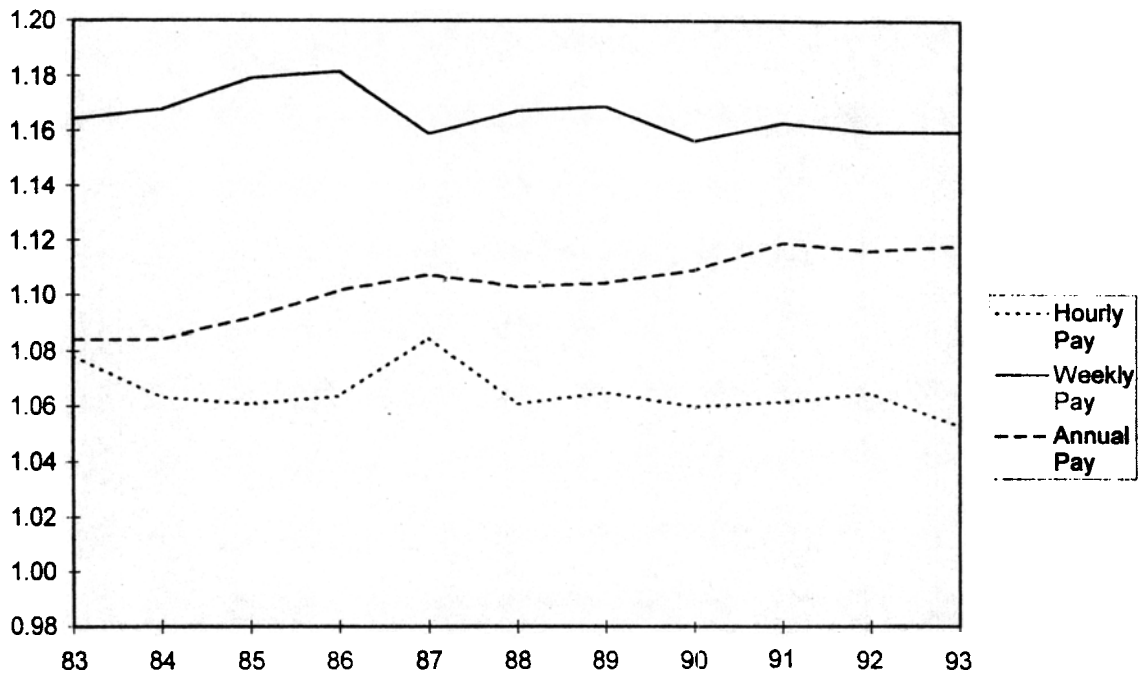


Figure 3. Rates of Nonfarm Employment Growth: Santa Clara and Los Angeles Counties

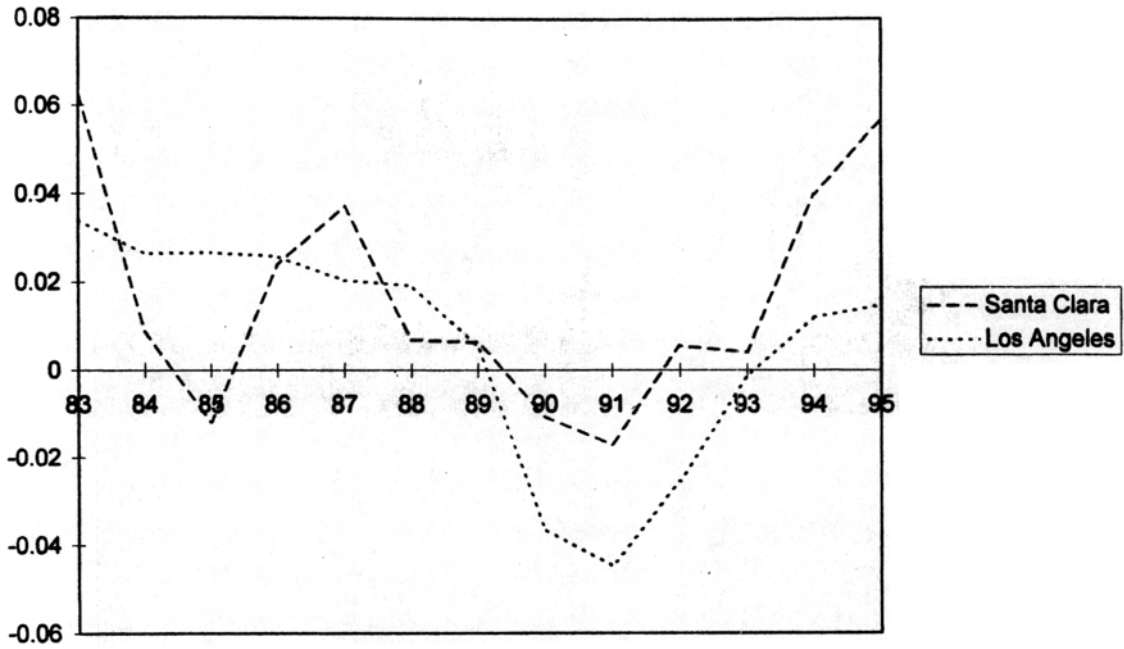


Figure 4. Unemployment Differential and California Domestic Migration

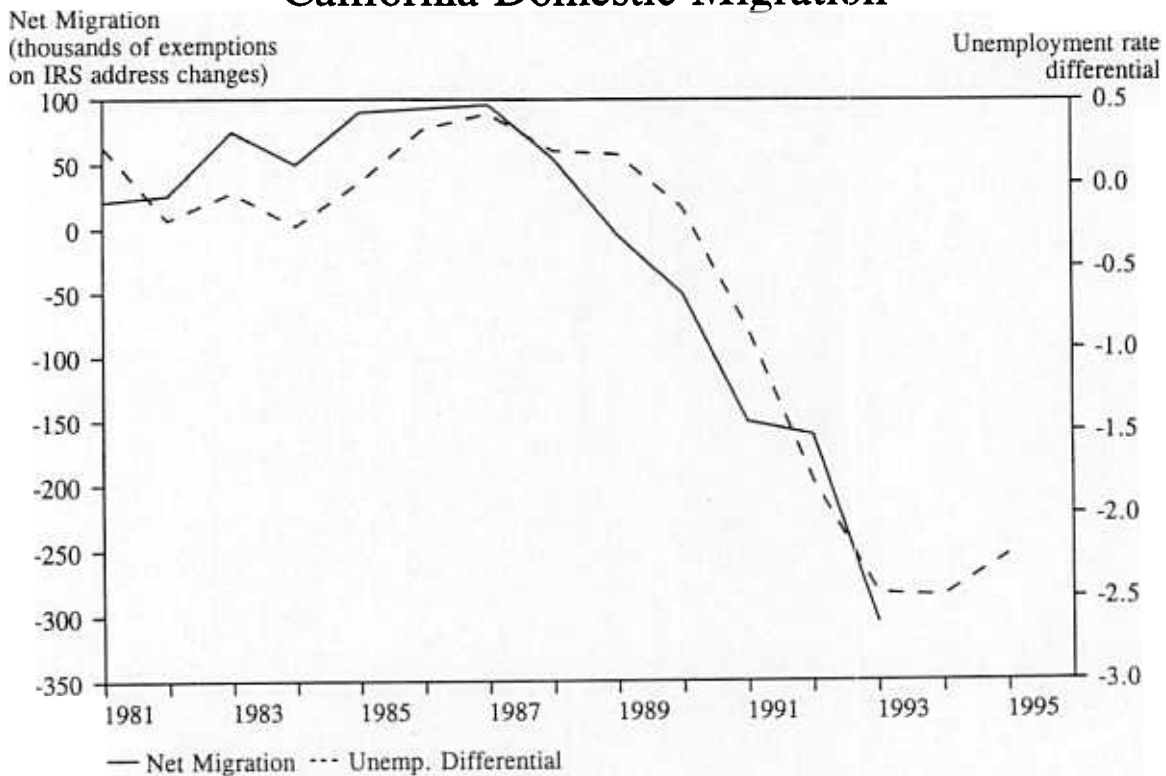


Figure 5. Educational Profile of Domestic Migrants into California Aged 25-64: 1990-1995

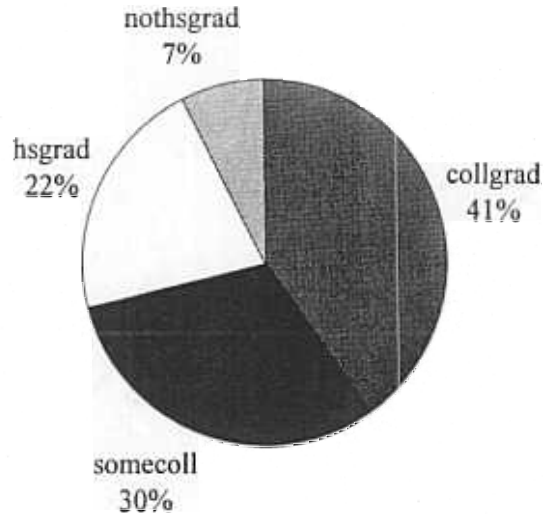


Figure 6. Managerial/Professional Employment As Share of Total Employment: California and U.S. 1983-1993

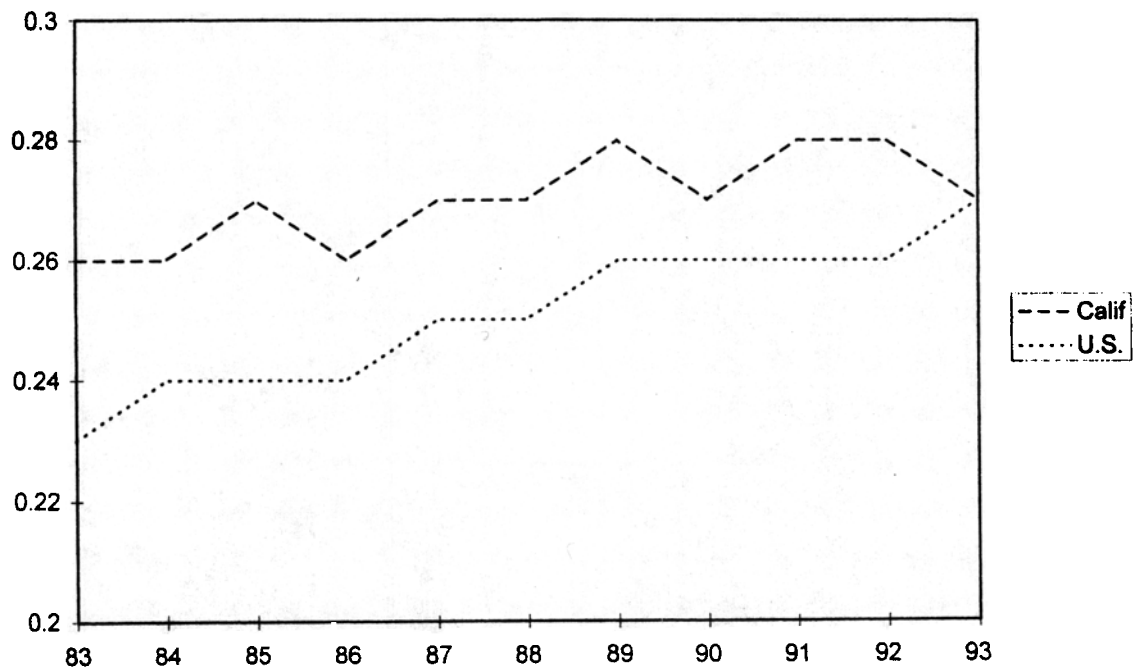


Figure 7. California/U.S. Ratio of Wage Dispersion As Measured by Male Earnings at 75th/25th Percentiles

