CCSCE
Center for Continuing Study of the California Economy
Issues in the News
December 2010

California Economy Update

The Bottom Line

- The state and national economy are growing
- The economic recovery will be long and slow—not what we hope for
- There are dangers to the economic recovery.

But the biggest threat in my opinion is not the events beyond our control but the rancor and persistent disagreement in our public discourse. At a time when we need to feel and act on the connections that link us together, the public rhetoric is pushing us apart and making areas of agreement so hard to find.

The Economy is Growing

Last month California added 39,000 jobs. The nation has added nearly 1 million private sector jobs in 2010. Today's GDP report was a little better than expected. Last week General Motors found a strong welcome for its return to the stock market as the government began to eliminate its ownership position.

The state economy is picking up based on the 3 T's—technology, trade and tourism. A growing world economy is filling our ports again and leading to an increase in exports—almost back to pre-recession levels. The state is adding jobs in professional, technical and information services and there are the beginnings of job growth related to energy efficiency. Tech firms are, once again, competing for skilled workers.

Expect a Long and Slow Recovery

The slowness of recovery is primarily because this is a "triple threat" recession with 1) severe shocks to the housing and financial sectors leading to 2) losses in home and portfolio wealth for many residents and 3) a resulting decline in spending and the associated job losses as the fallout from the housing and financial market meltdown reduced business and consumer spending.

For most businesses there is always an incentive to invest to increase productivity or to launch a new product or service and that is happening. But at the same time businesses are facing a shortage of customers. There is no rush to expand capacity when the purchasing power of customers is weak.

Some residents can continue spending at previous levels. But for many residents there is the need to pay down debt and, of course, some residents remain unemployed for more than two years.

In the absence of aggressive federal policies (that seem unlikely in today's environment), the prudence of business and consumers will slow the recovery.

Why is Unemployment Higher in California?

Construction spending fell from $100 billion to $40 billion as new home construction fell from 2000,000 per year to under 40,000. These declines in construction contributed to the loss of more than 600,000 construction and related jobs in California and are the major reason for such high unemployment,

In addition, state and local government job levels have declined as a result of budget pressures, which will continue into the future. These two factors account for the state's unemployment rate at 12.4% compared to the U.S. 9.6% rate.

In terms of manufacturing jobs, which get a lot of press attention, California had losses that were average (33%) compared to the nation—Texas did better (lost only 21% of their manufacturing jobs since 2000) but many large states including Florida, Georgia and North Carolina had greater manufacturing job losses than California both since the recession started and for the entire decade.

Time Heals

My personal opinion is that the economic recovery could and should be accelerated by additonal federal spending as long as it is combined with real long-term deficit reduction policies. But here is the more likely and longer path ot recover—the "time heals" path.

Housing starts are far below long-term demand and population contiues to grow. Many owners are able over time to rebuild equity. Some properties are foreclosed. Home prices decline. Eventually the market reaches equilbirium. It took seven years in the 1990s to see a sustainde upturn in building and prices.

Contimued job growth will slowly reduce the number of unemployed workers and rebuild spending power. Eventually cars and appliances wear out and need to be replaced. Most people will gradually reduce their debt levels—through income growth or some through bankruptcy.

The world economic growth will be a positive creating demand for our goods and services and supporting trade and tourism. A new wave of innovation is possible whether that is in clean tech or biotech or a field beyond our current imagination.

With or without public policy, time heals a recession.

There are always Risks

No one knows for sure how much risk there is of another housing market downturn. The banking system looks more secure than it did two years ago but no one knows the risks posed by increasing evidence of sloppy or fraudulent mortgage and foreclosure activity. The risks of a “double dip” recession and the risk of inflation seem less than they did a few months ago.

Our fate is also connected to the world economy. Today Ireland and Europe are in the news. At other times we worry about China. While world economic trends are a positive force long term for the state and nation, today presents risks.

But beyond the risks provided by markets and human behavior, there are risks from the deep divisions we have over how to proceed to accelerate the economic recovery and at the same time avoid lasting federal and state budget deficits.

Positions seem to be hardening as we face decisions in the months ahead. Several national groups have proposed long-term deficit reduction packages that combine spending and tax measures. The one area of agreement that stands out is that people on both sides of politics have already said “hell no” to part of the package—but they disagree about which part is absolutely off the table.

In California our fates as residents are connected—across age and ethnic groups, and across geographic boundaries north and south, inland and coastal. But our public discourse speaks more to our divisions, not our connections.

Some groups are working to develop better governance rules. My take is that we need to squarely face the tough content choices about the economy and budget that are dividing and paralyzing us. But my friend Susan Clark gave me a new word and idea. She said “it’s the relationship, stupid”. And I agree with Susan and my friend Dowell Myers that we need to engage people in developing and choosing a different, more accurate story for California than the path we are on.

Connections, relationships and a more accurate story—we just might get there.