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The California Recession in Perspective

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### Publication Date

1992-02-15

# Quarterly Report

Center for Real Estate and Urban Economics • University of California, Berkeley • Feb. 1992

## The California Recession in Perspective

*This article is the first of a two-part series that seeks to put the California recession in perspective. It asks and answers five sets of questions:*

- *How bad is the recession in California, and how does it compare with the rest of the U.S.?*
- *What were the immediate causes of the California recession?*
- *How is this recession different from, or similar to, past recessions?*
- *Which areas of the state are suffering more (or less) from the effects of recession?*
- *What is the prognosis for recovery?*

*Readers should bear in mind that this article, which focuses primarily on employment, was written in a period when the basic employment data upon which most analyses depend is being challenged. While existing data may reflect current comparisons among places accurately, estimates of recent changes over time are more likely to be revised when data controversies are resolved.*

Like other Americans, Californians are wondering when the current recession will finally end. Psychologically, if not statistically, the recession has hit California fairly hard.

Some of the worry Californians feel is rooted in reality. Although the current unemployment rate in California is lower than during the recessions

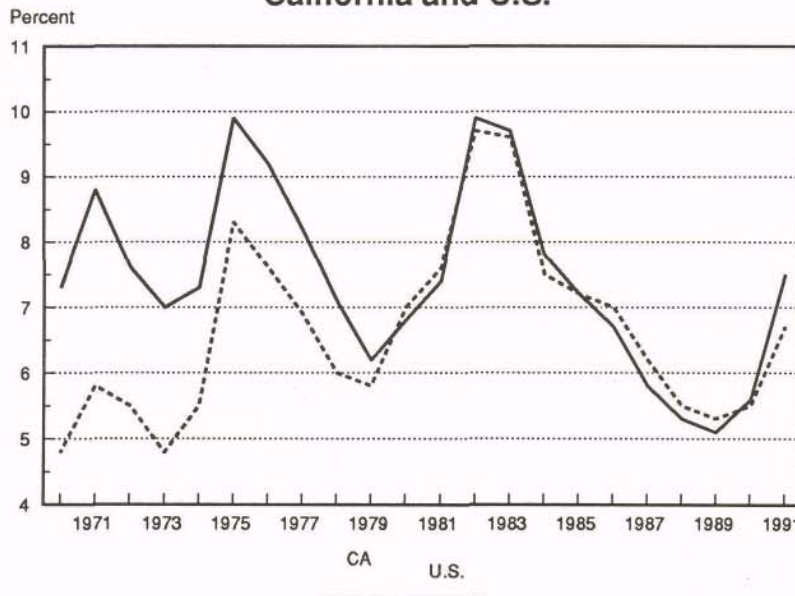
of 1981-82 and 1974-75, it is because the state's labor force has grown so much since the early 1980s; the actual number of unemployed workers is comparable to 1981 levels. Despite an unprecedented combination of tax increases and expenditure reductions in 1991, the state budget remains significantly out of balance. Many of the high technology, finance, and business service industries that led California's growth during the 1980s are in the midst of a serious, and perhaps permanent, downsizing. Finally, despite record low

interest rates—a traditional cure for recession—the national economy shows no immediate signs of reviving.

The perceived severity of the recession in California is also due to the fact that it has so confounded expectations. Many economists expected that the recession in California would be less deep and shorter than for the U.S. as a whole. In fact, the depth of the recession in California has fairly mirrored the recession for the country. Moreover, California will proba-

*(Continued on page 2)*

**FIGURE 1**  
Unemployment Rates  
California and U.S.



Source: California Economic Development Dept. and Bureau of Labor Statistics



## Recession...

(Continued from page 1)

bly lag, not lead, the rest of the country in coming out of the recession. Among noneconomists, a range of assumptions—from continued inflation of home values to stability of white collar jobs—are also being challenged. Media stories and some Wall Street analysts have raised fears that the current recession is not a business downturn, but actually represents a structural “sea-change” in the composition and adaptiveness of the California economy.

### How Bad Is the California Recession?

Thus far, the California recession has been distinguished more by its duration than by its depth. California’s economy officially fell into recession during the third quarter of 1990, when, for the first time since early 1982, the state lost jobs. As of

December 1991, California employment stood at 13,950,000 (including proprietors, self employed, and wage and salary workers)—down from an all-time high of 14,024,000 in June 1990. Compared to 1990, California employment fell by 0.9% in 1991. By contrast, California’s employment base grew by 3% between 1988 and 1989, and by 0.5% between 1989 and 1990.

California’s unemployment rate has recently been more volatile than the national unemployment rate—lower during periods of expansion in the 1980s, and higher during recessionary periods (Figure 1). In 1991, California’s unemployment rate averaged 7.6%, almost 1% above the U.S. rate of 6.7%.

California’s employment picture varies by sector (Table 1). Between 1990 and 1991, employment in California’s key high technology industries declined by 5.4%, a greater rate of decline than for the nation as a whole.\* Employment also declined between 1990 and 1991 in non-high

technology manufacturing, but the rate of decline was lower than for the U.S. The number of jobs in California’s construction industries declined by 6.6% between 1990 and 1991, a significant decline, but one which was much less severe than for the nation as a whole.

\* The California economy differs somewhat in composition from the U.S. economy. Accordingly, we have redefined the traditional SIC-based “1-digit” sectors into a set more relevant to the California economy. The California sectors include: High-Technology Manufacturing, Other Manufacturing, Wholesale Trade and Transportation/Public Utilities, Retail Trade, Tourism, Finance-Insurance-Real Estate, Business Services, and Resident Services. The composition of the Agricultural Services, Natural Resources, Mining and Extraction, and Construction sectors continues to follow national definitions. For a correspondence of industries and sectors, see “California Real Estate Investment Opportunities in the 1990s” (Center for Real Estate and Urban Economics, RP93).

**TABLE 1**  
**Wage and Salary Employment Change in California and the United States,**  
**Current and Previous Recessions**

SECTOR	Average Annual Wage and Salary Employment in Cal 1991 Estimate*	Percent Change 1990-1991		Percent Change 1981-1982		Percent Change 1974-1975	
		CA	US	CA	US	CA	US
Total Nonagricultural	12,832,100	-0.3	-0.9	-1.8	-1.7	0.2	-1.7
Construction	623,400	-6.6	-10.4	-14.4	-6.8	-10.0	-12.3
Manufacturing	2,041,500	-3.8	-3.9	-3.7	-6.9	-6.3	-8.7
High-Technology Manufacturing	1,013,300	-5.4	-5.0	-1.4	-6.6	-7.1	-8.6
Other Manufacturing	1,028,200	-2.2	-3.2	-6.0	-7.1	-5.6	-8.8
Tourism	20,500	2.0	-0.1	0.9	1.3	2.8	2.4
Wholesale Trade and TPU	1,404,300	-0.2	-0.8	-1.8	-1.9	-0.8	-1.8
Retail Trade	2,225,100	-1.0	-2.2	-1.0	-0.1	2.2	0.7
FIRE	842,500	-0.3	-2.3	-0.1	0.8	0.4	0.4
Business Services	762,100	2.1	0.8	-0.8	0.9	3.1	0.7
Services Ex. Tourism and Bus Svc	2,594,300	2.8	4.9	1.3	2.6	2.8	3.9



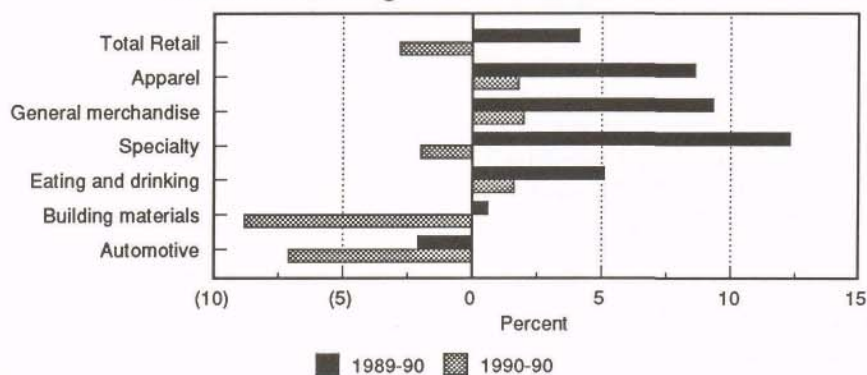
Two major California sectors actually *gained* employment in 1991. Employment in tourism grew by 2% compared to 1990, while service sector employment grew by nearly 3%.

The employment picture in California's other major sectors is more mixed. Compared with 1990, retail employment fell by 1% in 1991, and the number of jobs in the wholesale trade, transportation, and public utilities sector declined by less than half a percent. Employment in California's FIRE sector (Finance-Insurance-Real Estate) also declined by less than half a percentage point. In none of these three sectors was California's recession as severe as the nation's. A more onerous picture of the California recession emerges from statistics on retail sales and on building activity. Comparing second quarter sales activity, taxable retail sales in California declined nearly 3% from 1990 to 1991 (Figure 2), as compared to growth of almost 4% from 1989 to 1990. The drop was particularly severe in automobile sales (down 7%) and building materials (down more than 8%).

Declining sales of building materials reflect the slowdown in new home construction. Permits for new single-family homes in California declined 31% in 1991, while permits for multi-family units declined 49%. The slowdown in multi-family construction follows a long-term trend, although it has been made much worse by the recession (Figure 3). The slowdown in single-family construction is both a cause and effect of the California recession.

The combination of declining retail sales and significant job losses in the higher-wage sectors of the economy (particularly the high-technology sector) have contributed to California's acute state budget woes. Taxes on personal income and retail sales taxes account for 44% and 35%, respectively, of state general funds. When these sources decline, as they have during the current recession, state revenue collections decline sharply.

**FIGURE 2**  
**Retail Sales in California**  
**Percent Change in Taxable Sales**



Note: Second quarter comparisons  
Source: California State Board of Equalization

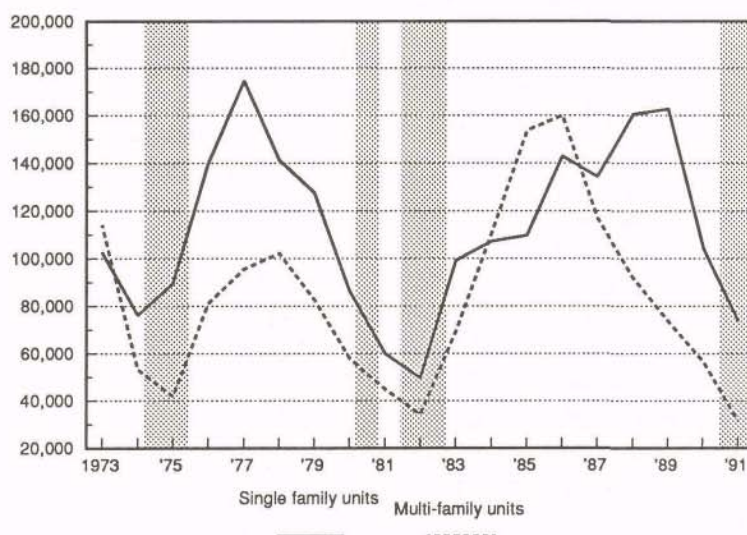
## The Causes of the California Recession

According to the available numbers, California is in the midst of a recession more moderate, but longer lasting, than the 1981-82 recession. California's recession is not regional but is directly associated with factors at the national level—adjustments to overbuilding and speculation of the 1980s and recent changes in the Federal budget, especially in defense spending.

By the end of 1989—after nearly eight years of expansion—the U.S. economy had simply run out of steam. Consumer spending, two-thirds of the economy, had leveled off, as did productivity growth. The investment and speculative tax incentives of the early 1980s had been removed, and federal defense spending had begun to decline. Payment on the worst excesses of the 1980s—leveraged

(Continued on page 4)

**FIGURE 3**  
**California Residential Building Permits**  
**Single Family and Multi-Family**



Source: Construction Industry Research Board



## Recession ...

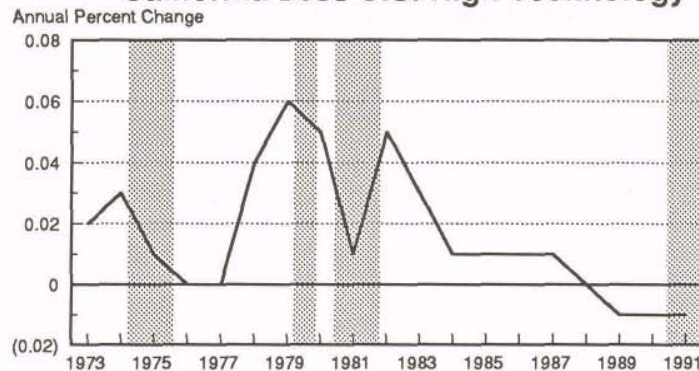
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buyouts financed by junk bonds and unneeded commercial real estate financed by weak savings and loans and banks—was coming due. The federal budget deficit continued to rise, thereby limiting the extent to which fiscal policy might be used to forestall the recession. Rolling regional recessions during the 1970s and 1980s had taken their toll on state and local finances.

California weathered the early stages of the recession with apparent ease. California aerospace and high technology companies were able to stretch out their defense contracts beyond the first period of cuts. California's other major export industries, agriculture and tourism, continued to grow, as did trade with the Pacific Rim. The sharp job cutbacks in the financial services industry that followed Wall Street's October 1987 crash were much less severe in California. California residential real estate prices continued to rise—the result of pent-up demand, not enough supply, and pure speculation. State spending and the number of state workers also continued increasing.

In hindsight, the same factors that first insulated the California economy from the national recession are now exacerbating it. Defense contracts to California companies finally began to decline, as did business spending on personal computers and other high-technology goods. Both of these reductions had spatial implications: cutbacks in defense spending disproportionately affected the Southern California economy, while reductions in personal computer sales impacted Northern California's Silicon Valley. Furthermore, after three years of record home price increases, California's speculative real estate boom flattened, with home sales dropping sharply and appreciation ending.

**FIGURE 4**  
**Differential in Employment Growth Rate**  
**California Less U.S. High Technology**



Source: Bureau of Labor Statistics

The slowdown in home sales had repercussions throughout the economy. With apartment and commercial construction already reduced, con-

struction jobs began to decline. Commercial banks and thrifts, which had used ever-larger portfolios of residential loans to offset other poorly per-

**TABLE 2**  
**Unemployment Rates, California MSA**  
**December 1990 and 1991**

MSA	December Unemployment Rate (Percent)		Difference in Rate 1990-1991
	1990	1991 (P)	
Anaheim-Orange County	4.1	4.4	0.3
Bakersfield	12.1	12.7	0.6
Fresno	12.0	12.3	0.3
Los Angeles-Long Beach	6.2	8.3	2.1
Modesto	13.8	13.9	0.1
Oakland	4.7	4.8	0.1
Oxnard-Ventura	6.9	7.2	0.3
Riverside-San Bernardino	7.9	8.2	0.3
Sacramento	6.1	6.4	0.3
Salinas-Seaside-Monterey	12.4	12.1	-0.3
San Diego	5.4	5.6	0.2
San Francisco	3.6	4.0	0.4
San Jose	4.8	5.2	0.4
Santa Barbara	5.6	6.2	0.6
Santa Rosa-Petaluma	5.2	5.2	0.0
Stockton	12.6	12.9	0.3
Vallejo-Napa-Fairfield	6.5	6.3	-0.2
California	6.6	7.4	0.8
United States	5.9	6.8	0.9

(P) Preliminary

Note: Not seasonally adjusted

Source: Bureau of Labor Statistics, Jan. 1992, California Employment Development Dept.



forming loans, found themselves vulnerable to further layoffs and consolidations. With fewer new homes being built, sales of durable goods and home furnishings declined. Thus, as in the past, California has proved vulnerable to a nationwide recession and will depend upon improvements at the national level to emerge out of the recession.

### How Different is This Recession?

The current recession is clearly longer than past recessions, but is it different in other ways as well?

■ As noted above, California's current unemployment rate is slightly higher than the national unemployment rate. This was also true during the much more severe "double-dip" recessions of 1980-81 and 1981-82. However, the difference is much less than existed in the 1970s.

■ Income loss may be at least as severe as in earlier recessions. Based on California Department of Finance estimates, state real per capita income dropped a modest 0.6% in 1990 but may have dropped by over 4% in 1991. In contrast, per capita income

dropped by 0.7% in 1974, by 2.9% in 1980 and by an additional 2.7% over the 2 year period of 1980 to 1982.

■ The current rate of job loss in California is considerably more severe than during the recessions of 1974-75, and 1980-81, but less severe than during the 1981-82 recession (Table 1).

■ In the past, California's high-technology employment growth outperformed that of the nation as a whole, even during recessionary periods. As Figure 4 shows, this is not true for the current recession.

■ Although California's other manufacturing and construction sectors have suffered significant job declines during the current recession, the rate of loss in these sectors has been less than for the nation as a whole.

■ FIRE and business services in California are outperforming the nation, in contrast to the 1981-82 recession.

■ During past recessions, California's other services underperformed the nation, while the state's tourism sector out-performed its national counterpart. These differences are also evident during the current recession.

■ Retail trade employment growth has been weaker in California than in the nation in 1991.

■ The number of residential building permits taken out in 1991 declined to 106,000—a level lower than in 1974 or 1981, but higher than in 1982.

In summary, the current California recession is serious—job and income loss is more severe than for 1974-75 and 1980-81. While as yet (based on available data), the recession has been milder than the recession of 1981-82, it has lasted longer. Larger income losses and an unusually weak performance of high-tech industry are particularly worrisome in this recession. Nevertheless, there's little evidence to suggest that structural shifts will lead to long-term decline in the state.

At the national level, the current recession differs from past recessions in two significant ways. First, as noted above, the current recession is already longer than any other Post-War recession. Furthermore, the recession continues to linger in spite of strong moves by the Federal Reserve to stimulate consumption by slashing interest rates.

*(Continued on page 6)*

**TABLE 3**  
**Annual Wage and Salary Employment Growth (Decline) in Selected California Metropolitan Areas, 1990-1991E (Percent Change)**

SECTOR	California	Anaheim-Orange Cnty	Los Angeles-Long Beach	Oakland	Riverside-San Bernard.	Sacramento	San Diego	San Francisco	San Jose
Total Nonagricultural	-0.3	-0.9	-0.9	0.7	2.3	0.5	-0.7	0.4	-1.3
Construction	-6.6	-10.9	-5.3	-5.1	-10.3	-9.7	-6.7	-0.3	-3.8
Manufacturing	-3.8	-2.8	-5.4	-0.7	-1.1	0.0	-3.5	-1.1	-3.1
High-Technology Manufacturing	-5.4	-3.4 (1)	-8.0	0.0	-2.6	NA	-4.3	-3.4	-3.2
Other Manufacturing	-2.2	-2.2	-3.1	-1.2	-0.3	-0.7	-1.8	-0.2	-2.8
Wholesale Trade and TPU	-0.2	0.5	-0.3	0.5	2.5	1.0	-1.3	-1.3	-0.2
Retail Trade	-1.0	-1.5	-1.7	1.5	2.6	0.4	-1.4	-1.0	-1.6
FIRE	-0.3	1.0	-0.5	-1.2	3.5	4.4	-2.7	-0.1	-1.3
Business Services	2.1	0.7	0.8	5.7	11.2	1.4	1.7	0.4	0.3
Hotels And Lodging	2.2	-1.3	2.0	1.3	7.4	-1.3	0.1	3.0	1.2
Services Ex. Hotels and Bus Svc	2.8	1.8	3.1	2.3	6.4	2.2	2.5	3.0	0.6

Note: (1) Does not include chemicals and allied products for Anaheim-Orange County  
Source: Bureau of Labor Statistics



# Recession ...

(Continued from page 5)

## Regional Variations

The California recession arrived first in Southern California, and thus far, that is where its impact has been most pronounced. As Table 2 indicates, successive cutbacks in aerospace and defense-related industries have made the unemployment rate for the Los Angeles area jump to a level well above the state average. Many other California MSAs continue to have low unemployment rates despite job losses.

At the sectoral level, job losses continue to be concentrated in a few of the largest MSAs (Table 3). High-technology jobs have declined in most MSAs, with the loss most severe in the Los Angeles metropolitan area. The decline in non-high-tech manufacturing jobs was greatest in Los Angeles, the other Southern California coastal metropolitan areas, and the San Jose metropolitan areas. Smaller declines occurred in the San Francisco and Oakland metropolitan areas.

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The Quarterly Report is prepared as part of support from the Department of Real Estate, State of California, under contract ER91-0001 entered into with the Regents of the University of California. There were no other contractors or sub-contractors used in the preparation of this publication.

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The decline in construction jobs was concentrated in those regions that had previously seen the highest levels of construction—Sacramento and Los Angeles. Employment in hotels, a major component of tourism, increased in many California regions but declined slightly in Sacramento and in Orange County.

Despite the recession, all of the state's major metropolitan areas experienced growth in business services and in all other services. The inland metropolitan areas of Sacramento and Riverside/San Bernardino grew in retail trade, wholesale trade and FIRE employment, while most of the coastal metropolitan areas lost employment in these sectors.

## Prognosis for Recovery

Just as California entered the recession a little later than the rest of the country, so too will it recover a little later. By pushing interest rates to their lowest levels in 15 years, the Federal Reserve has already set the stage for a moderately strong recovery. Whether such potential can be realized will depend on how quickly consumers recover their confidence and begin spending. Any improvement in consumer confidence, in turn, will depend on there not being large additional job layoffs.

In the short-term, congressional approval of President Bush's homeownership incentive proposals (a \$5,000 tax credit for first-time homeownership, and the ability to withdraw IRA funds without penalty) would provide a strong stimulus for California's construction and retail trade sector. Such stimulus would be felt immediately in California's more affordable metropolitan areas—in particular, the Central Valley and the Inland Empire. Moreover, the economies of California's urban areas will get a boost as highway and transit construction monies from the Surface Transportation Act of 1990 start becoming available.

As of this writing, the prospects for a strong medium-term (1-2 years) recovery remain somewhat murkier. The strength of California's economic recovery will depend on what happens to the national economy, and, because it is such a large portion of the state, also what happens to the Los Angeles area economy. A strong and balanced national recovery will trigger a strong recovery in California, while a weak national recovery will leave the California economy treading water. At the local level, a gradually improving employment picture in Southern California, particularly in the aerospace, residential construction, and banking industries, would have beneficial effects statewide.

Unlike the last two recessions (1974-75 and 1981-82), real estate, by itself, will not lead the California economy out of the current downturn. Many of the state's office markets are over-built, and credit for new commercial construction is likely to remain tight. Although there is significant demand for new rental units, average rents are too low in many markets to justify new construction.

For the long term, California continues to have major strengths—a skilled and varied labor force, access to large markets, and a Pacific Rim location. Whether California will realize the potential of these strengths depends more on state initiatives than on federal action. The state faces the challenge of an aging and congested infrastructure, excessive housing costs, and an overly litigious regulatory environment. These issues must be addressed if the California economy is to enjoy another seven or eight years of economic growth and opportunity.

*In the next issue of the Quarterly Report, we will review the impact of the recession on California real estate.*

**John Landis and Cynthia Kroll**  
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