

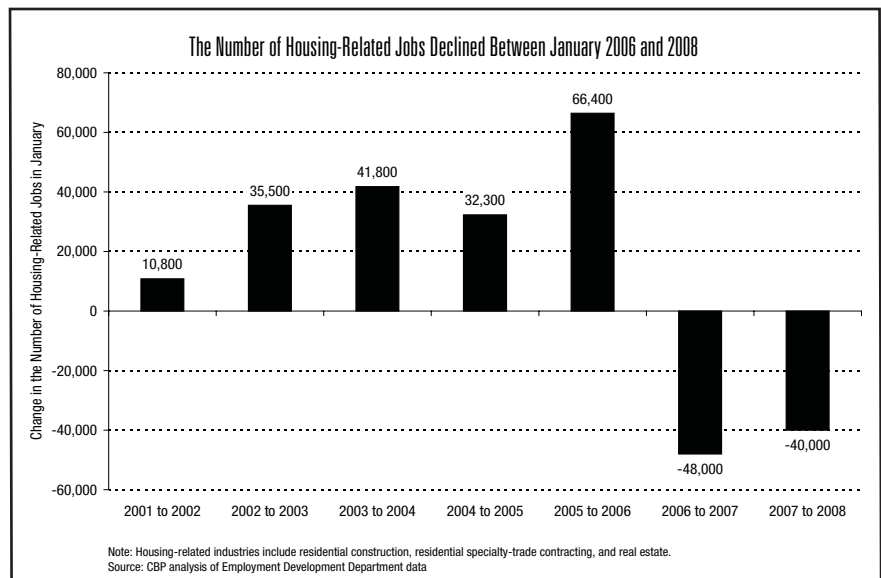
## THE ECONOMIC SLOWDOWN IS BAD NEWS FOR CALIFORNIA'S WORKERS AND THEIR FAMILIES

In recent months, economists and other analysts have debated whether the US economy is headed for a recession. Although the data have yet to confirm whether the nation has "officially" entered a recession, key economic indicators show that the California economy has weakened considerably. This is bad news for California's workers and their families. A slowing economy typically brings higher unemployment, declining incomes, and rising poverty, and these problems tend to endure for many years. This *Policy Points* reviews the latest economic indicators and examines what an economic slowdown could mean for the state.

### K E Y F A C T S

- The state's economic troubles began in the housing sector.

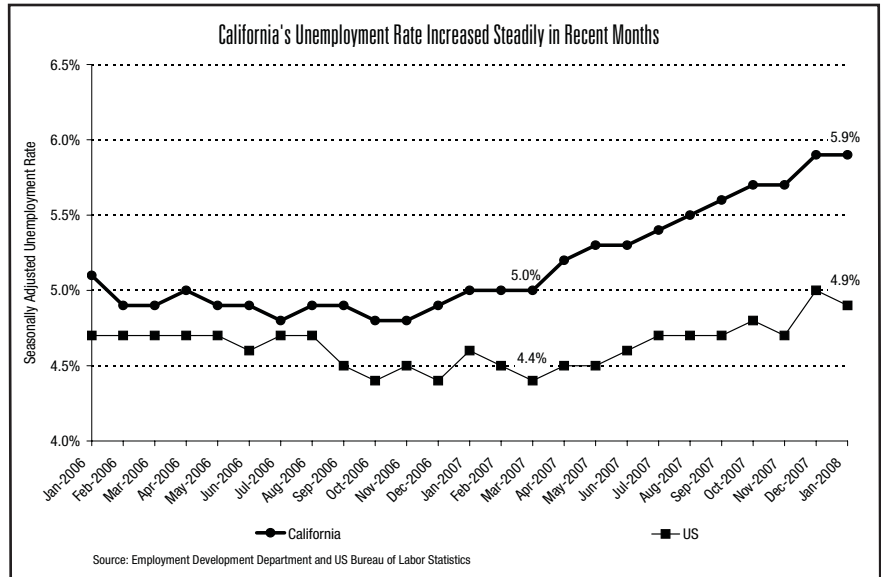
Beginning in late 2005, home prices fell and the number of jobs in housing-related industries plummeted. In January 2008, the median price for a California home was down by 17.1 percent from the same month of the prior year, and home sales were the weakest on record.<sup>1</sup> Notices of default, which are sent to homeowners who are delinquent on their mortgage payments, more than quadrupled – an increase of 363.7 percent – between



2005 and 2007, while the number of foreclosures rose nearly 30-fold (2,787.9 percent).<sup>2</sup> Meanwhile, the state lost 88,000 jobs in housing-related industries between January 2006 and January 2008, a 12.0 percent decline in those industries.<sup>3</sup>

■ **The slowdown in housing has spread to other sectors of the economy.**

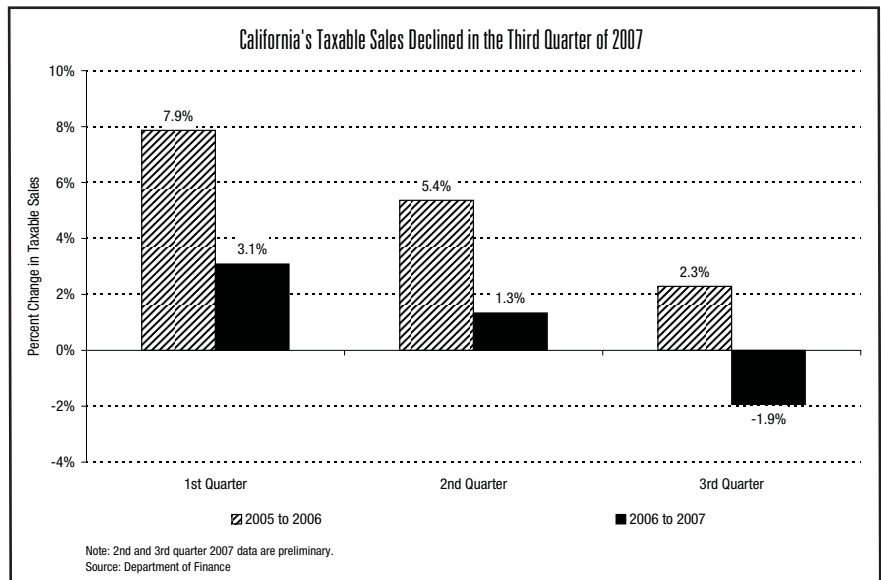
The number of nonfarm jobs in the state increased by a modest 0.3 percent between January 2007 and January 2008 – one-quarter of the increase during the prior year (1.2 percent).<sup>4</sup> As job growth has slowed, California’s unemployment rate has increased steadily. The state’s seasonally adjusted unemployment rate reached 5.9 percent in January 2008 – up by 0.9 percentage points from the first three months of 2007.<sup>5</sup> The number of unemployed Californians increased by more than 180,000 between January 2007 and January 2008.



■ **Consumer spending – a key driver of the economy – has weakened.**

Consumers are spending less in response to the slowdown in the housing market, diminishing job growth, and rising inflation.<sup>6</sup> California’s third quarter 2007 taxable sales were down by 1.9 percent from the third quarter of the prior year.<sup>7</sup> Nationally, retail sales in January 2008 were the weakest in nearly four decades.<sup>8</sup> Some economists consider the slowdown in consumer spending to be the most significant risk to the economy in coming months because weakening demand for goods and services could lead to further layoffs and increased unemployment.<sup>9</sup>

■ **A slowing economy hurts workers and their families.**



The previous two recessions resulted in increased unemployment, declining incomes, and rising poverty in California. During the downturn of the early 1990s, nearly 770,000 Californians lost their jobs and the unemployment rate increased by 4.8 percentage points.<sup>10</sup> In addition, the income of the typical California household – the household exactly at the middle of the distribution – lost purchasing power, declining by more than \$5,000 (9.7 percent), and the number of Californians with incomes below the poverty line increased by more than 2 million.<sup>11</sup> During the milder recession of the early 2000s, nearly 400,000 Californians lost their jobs; the typical household income declined by more than \$2,000, after adjusting for inflation; and 430,000 people fell into poverty.

Change in Key Economic Indicators in California During Recent Recessions		
	Early 1990s	Early 2000s
<b>Monthly Indicators</b>		
Number of Nonfarm Jobs	-511,000	-372,200
Number of Unemployed	+769,000	+396,900
Unemployment Rate (Percentage Points)	+4.8	+2.2
<b>Annual Indicators</b>		
Median Household Income (2006 Dollars)	-\$5,007	-\$2,273
Median Household Income (Percent)	-9.7	-4.1
Number of People in Poverty	+2,031,000	+430,000
Poverty Rate (Percentage Points)	+5.3	+0.6

Note: Figures represent the change from peak to trough of each indicator during the previous two recessions. The date on which each indicator peaked may precede the official beginning of the recession by up to one year. The recession of the early 1990s began in July 1990, and that of the early 2000s began in March 2001.

Source: CBP analysis of US Census Bureau data, Employment Development Department, and US Census Bureau

The negative impact of the previous two recessions on California's workers and their families endured well beyond the official end of the downturns, which are determined based on national economic indicators.<sup>12</sup> State employment took more than six years to rebound following the downturn of the early 1990s and took nearly three years to rebound after the recession of the early 2000s, even though both recessions officially

lasted just eight months. In addition, California's typical household income did not regain lost purchasing power for 10 years following the recession of the early 1990s and for six years after the downturn of the early 2000s. California recovered relatively slowly from the last two recessions because they originated in sectors of the economy that were disproportionately concentrated in the state.<sup>13</sup>

- **The weakening economy will have a significant impact on the state budget.**

Revenue forecasts for 2006-07, 2007-08, and 2008-09 used to develop Governor Schwarzenegger's Proposed 2008-09 Budget were \$9.3 billion below those assumed when the 2007-08 Budget was enacted.<sup>14</sup> More recently, the Legislative Analyst's Office (LAO) estimated that revenues for these three years will be \$1.5 billion lower than the Governor's projections.<sup>15</sup> The drop in anticipated revenues is largely due to the weakening economy. For example, sales tax receipts are lower than originally anticipated because of the housing slowdown, which has reduced demand for household goods, such as furniture and appliances.<sup>16</sup> In addition, local property tax revenues are lower than previously anticipated.<sup>17</sup> This shortfall in revenues will increase the state's school funding obligations under the Proposition 98 school funding guarantee.<sup>18</sup>

- **Proposed spending cuts could exacerbate the economic slowdown.**

Governor Schwarzenegger's Proposed 2008-09 Budget would cut General Fund spending by \$9.3 billion, reducing support for public services, such as public education, health care for low-income families and children, and cash assistance for low-income families, seniors, and persons with disabilities. In addition, the President's federal fiscal year (FFY) 2009 budget cuts domestic discretionary programs other than homeland security by \$20.5 billion relative to FFY 2008, after adjusting for inflation. This means fewer federal dollars for a broad array of public services provided by the state and by local governments, including education, child care, and energy assistance for low-income families and seniors.<sup>19</sup>

Spending cuts are particularly problematic given the slowing economy because they will reduce the amount of money flowing into local communities. Approximately three out of four dollars spent out of the state's General Fund go to local communities, individuals, and local businesses, such as health service providers.<sup>20</sup> Fewer dollars flowing into local communities reduces demand for goods and services, which can impede economic growth.

*Alissa Anderson prepared this Policy Points. The California Budget Project (CBP) was founded in 1994 to provide Californians with a source of timely, objective, and accessible expertise on state fiscal and economic policy issues. The CBP engages in independent fiscal and policy analysis and public education with the goal of improving public policies affecting the economic and social well-being of low- and middle-income Californians. General operating support for the CBP is provided by foundation grants, individual donations, and subscriptions. Please visit the CBP's website at [www.cbp.org](http://www.cbp.org).*

## ENDNOTES

- <sup>1</sup> DataQuick Information Systems, *California January 2008 Home Sales* (February 18, 2008), downloaded from <http://www.dqnews.com/RRCA0208.shtml> on February 19, 2008. California's median-priced home was \$383,000 in January 2008. A total of 19,145 new and resale houses and condos were sold in California in January 2008, the lowest number of sales in DataQuick's records, which go back to 1988. Home sales have declined on a year-over-year basis for 28 consecutive months.
- <sup>2</sup> DataQuick Information Systems. Foreclosures reflect the number of homes that lenders have taken possession of or have been sold at auction. DataQuick reports 254,824 notices of default and 84,326 foreclosures in California in 2007.
- <sup>3</sup> CBP analysis of Employment Development Department data. This decline followed a gain of 98,700 jobs between January 2004 and January 2006. The number of housing-related jobs in the rest of the US decreased by 7.1 percent between January 2006 and January 2008.
- <sup>4</sup> Employment Development Department. Diminished nonfarm job growth reflects the decline in housing-related jobs as well as weak gains in nonhousing-related sectors of the economy.
- <sup>5</sup> Employment Development Department.
- <sup>6</sup> In recent years, homeowners used equity from rapidly appreciating home values to finance a variety of purchases. However, as home values have declined, many homeowners have lost the ability to supplement their incomes by refinancing their homes and withdrawing equity. In addition, the decline in home sales has reduced demand for household goods, such as furniture and appliances. US Bureau of Labor Statistics data show that inflation reached a 10-year high in December 2007, reflecting increases in energy costs as well as increases in the cost of food, medical care, and nondurable commodities.
- <sup>7</sup> Department of Finance. In contrast, third quarter taxable sales increased by 2.3 percent between 2005 and 2006.
- <sup>8</sup> The Associated Press, "Retailers Report Weak January Sales," *The New York Times* (February 7, 2008). In addition, several measures show that US consumer confidence has weakened. See Reuters, "Feb Consumer Confidence Slumps to 5-Year Low," *The New York Times* (February 26, 2008); Reuters/University of Michigan Surveys of Consumers, "Consumer Growth Engine: Barely Above Stall Speed," downloaded from <https://customers.reuters.com/community/university/default.aspx?> on February 19, 2008; Michael Barbaro and Louis Uchitelle, "Americans Cut Back Sharply on Spending," *The New York Times* (January 14, 2008); and Jeannine Aversa, "Confidence Sinks to Record Low," *The Associated Press* (January 11, 2008).
- <sup>9</sup> See L. Josh Bivens, *Rapid deceleration in fourth quarter GDP* (Economic Policy Institute: January 30, 2008) and Dean Baker, *Flat Screen TVs Keep GDP Growing in Fourth Quarter* (Center for Economic and Policy Research: January 30, 2008). US Bureau of Economic Analysis data show that consumer spending makes up approximately 70 percent of economic activity. Personal consumption grew by 1.9 percent in the fourth quarter of 2007, down from a 2.8 percent increase in the third quarter of 2007.
- <sup>10</sup> The change in unemployment is measured from the economic "peak" – the month in which the number of unemployed bottomed out, which may precede the official beginning of the recession by up to one year – to the economic "trough" – the month in which the number of unemployed reached its highest point following the onset of the recession.
- <sup>11</sup> The change in annual median household income is measured from the economic "peak" – the year in which median household income reached its highest point, which may precede the official beginning of the recession by one year – to the economic "trough" – the year in which median household income reached its lowest point following the onset of the recession. The change in the number of Californians with incomes below the poverty line is measured from the economic "peak" – the year in which the number of poor reached its lowest point, which may precede the official beginning of the recession by one year – to the economic "trough" – the year in which the number of poor reached its highest point following the onset of the recession.
- <sup>12</sup> According to the National Bureau of Economic Research, a recession is "a significant decline in economic activity spread across the economy, lasting more than a few months," typically apparent in inflation-adjusted gross domestic product, inflation-adjusted income, employment, industrial production, and wholesale-retail sales. The previous two recessions began and ended on the following dates: July 1990 to March 1991 and March 2001 to November 2001. See <http://www.nber.org/cycles/recessions.html>.
- <sup>13</sup> The recession of the early 1990s was concentrated in defense-related industries, such as aerospace manufacturing, and the early 2000s downturn originated in high-tech industries.
- <sup>14</sup> Legislative Analyst's Office, *The 2008-09 Budget: Perspectives and Issues* (February 2008), p. 47.
- <sup>15</sup> Legislative Analyst's Office, *The 2008-09 Budget: Perspectives and Issues* (February 2008), p. 47.
- <sup>16</sup> The LAO reports that taxable sales increased by just 0.8 percent in 2007. Legislative Analyst's Office, *The 2008-09 Budget: Perspectives and Issues* (February 2008), p. 60.
- <sup>17</sup> The Governor's Proposed 2008-09 Budget estimated that property tax revenues for 2005-06, 2006-07, and 2007-08 were nearly \$1.4 billion below what was assumed when the 2007-08 Budget was enacted. More recent estimates by the LAO project that property tax revenues for these three years will be nearly \$1.1 billion below what was assumed when the 2007-08 Budget was enacted. Legislative Analyst's Office, *Analysis of the 2008-09 Budget Bill* (February 2008), pp. E-28 and E-29.
- <sup>18</sup> Legislative Analyst's Office, *Analysis of the 2008-09 Budget Bill* (February 2008), p. E-28. In most years, the Proposition 98 school funding guarantee is met by the sum of local property tax revenues and state General Fund revenues. In these years, lower local property tax collections require increases in General Fund support.
- <sup>19</sup> Sharon Parrott, et al., *Bush Budget Would Cut Domestic Discretionary Programs by \$20 Billion in 2009 Many Cuts Come on Top of Sizable Reductions in Recent Years* (Center for Budget and Policy Priorities: February 20, 2008). This report projects that the President's proposal would reduce federal funding for both discretionary and mandatory programs – exclusive of Medicaid – in California by \$2.6 billion in FFY 2009. Projected spending cuts for discretionary programs alone are not available for individual states.
- <sup>20</sup> Department of Finance, *Governor's Budget Summary 2008-09*, p. A-35.