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National Economic Trends

Will California Short-Circuit the Expansion?

Regional disruptions in economic activity are sometimes large enough to produce economy-wide effects. Examples include the downsizing that occurred in the industrial "Rust Belt" in the early 1980s; the 1989-92 credit slowdown that adversely affected banking activity in the Northeast and elsewhere; and the protracted weak growth in California during the early 1990s that reflected, in part, the sharp declines in defense spending at the end of the Cold War. In this vein, some analysts believe that the electricity shortages that have recently hit California might be significant enough to further weaken the pace of U.S. economic activity—a pace that slowed appreciably during the second half of 2000.

California's power problems, in short, stem from a worsening imbalance between the supply of electricity and the demand for electricity that has produced a series of temporary blackouts. The problem is exacerbated by controls on the retail price of electricity and a spike in natural gas prices that helped to push up wholesale electricity prices (which are not capped) dramatically in December. The latter effect caused a substantial financial squeeze at two important California utilities, roiling some financial markets.

The sheer size of the Golden State's economy, if for no other reason is a cause for concern among policymakers. After all, California's economic woes in the early 1990s—when the state's economy represented fully 14 percent of U.S. output—accounted for much of the national economy's slow recovery from the 1990-91 recession.[1] But, as California's economy weakened considerably from 1991 to 1993, there was an appreciable outflow of labor and capital, so that by 1995, California's share of the U.S. economy had dropped to 12.6 percent.

Beginning in the latter half of the 1990s, with the advent of the so-called "New Economy" industries in Silicon Valley, California began to grow appreciably faster then the rest of the country. By 1998 (the latest available data), its output of goods and services was up to 12.8 percent of U.S. output. Still, California does not loom as large on the American economic landscape as it did a decade ago.

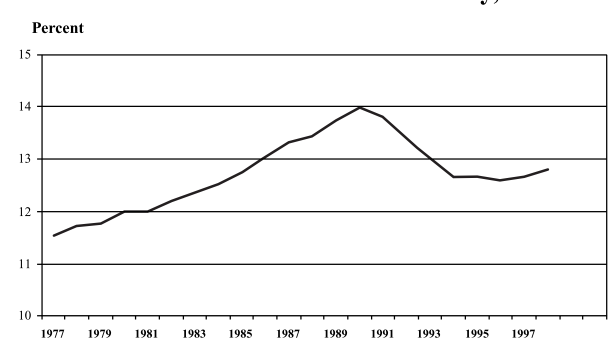
We can also look at California's share of the recent growth in the U.S. economy. During 1997 and 1998, U.S. real growth averaged nearly 5.25 percent; California's portion of this growth was about 0.75 percentage points a year, which is undoubtedly a significant contribution, but not overwhelming.

Though the situation is still evolving, it does not yet appear that the electricity blackouts are producing the types of dislocations seen during the early 1990s, when California's share of the U.S. economy was larger. Thus, in the short term, it is unlikely that California's power problems will short-circuit the U.S. economy. Unless the slim margin between the state's supply and demand for electricity widens within a year or two, however, California may experience outflows of labor and capital similar to those that occurred a decade earlier.

—Kevin L. Kliesen

[1]The data on California's output are gross state product (GSP) by industry, which are compiled by the U.S. Bureau of Economic Analysis.

California's Share of the U.S. Economy, 1977-98



SOURCE: U.S. Department of Commerce, Bureau of Economic Analysis.