Research Department
Federal Reserve
Bank of
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FRBSF Weekly Letter

The Not-so-Wild West

The current economic conditions of the nine states in the Twelfth Federal Reserve District seem inconsistent with the popular view of the western economy as healthy and—indeed, recession-proof. Indeed, the West traditionally has been a leader in the development of new industry and it enjoys a supply of skilled laborers and entrepreneurs. If the West has so much apparent capability, why has the region's economy reacted relatively adversely to the national recessionary conditions?

The economies of Alaska, Arizona, California, Hawaii, Idaho, Nevada, Oregon, Utah, and Washington remain depressed as the end of 1982 draws near. For the District as a whole, unemployment is higher than the 10.8 percent national rate for November, and the slowing of job growth in the early part of this year has turned into actual net job losses in many areas. This depressed level of economic activity reflects in large part the current nationwide recession, but special conditions in some of the Western states have exaggerated the effect of the national downturn.

Two Western problems

Two main problems appear to underlie the exaggerated Western response to the national recession. First, some of the states' economies are unusually dependent on a few resource extraction or industrial sectors. This limited diversification lessens the West's protection from (and indeed exaggerates) cyclical downturns.

The second problem is a paradox. The relative attractiveness of future prospects in the West has induced continued in-migration which can raise unemployment rates by swelling the labor force. Employment creation is hard-pressed to match the population growth rate during prosperous times; under recessionary conditions, the task is that much more difficult. With the present exception of Oregon, all of the Western states are net recipients of new migrants.Nevada's population grew the fastest in the West, increasing 63.5 percent in the decade ending 1980.

Diversified state

California is the only state in the District that can be characterized as fully "diversified" industrially. Its economy is composed of a broad mix of agricultural, manufacturing, service, and resource-based industries (such as lumber production and petroleum extraction).

In this sense, the industrial pattern of California's economy is very much like that of the nation as a whole. Indeed, California's automobile manufacturing and other heavy industries have been as hard-hit as those elsewhere. The jobs in this sector have declined by almost one-third since 1979. High interest rates have also weakened formerly strong housing demand, led to weak construction activity, and depressed the allied lumber industry in the state. The aerospace and electronics industry—although potentially more recession-proof in California because of its defense orientation—suffers from the same sluggish demand and weak foreign markets that plague this industry nationwide. California agriculture, while producing record harvests in many crops, is also struggling because of continued high operating costs, low prices, and weakened foreign demand as a result of a strong dollar.

Although all of these developments are true of analogous activities nationwide, California had an unemployment rate of 11.2 percent in November, significantly higher than the national rate. The major explanation for the state's relatively poor employment performance would appear to be the continued strong influx of workers—including illegal immigrants—who remain attracted by California's long-term prospects. The legal civilian labor force alone grew nearly 3 percent this year in California, while the national increase averaged only 1.3 percent.

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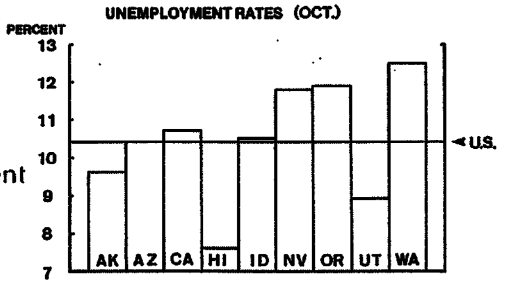


Less diversified economies
In contrast to California, many states in the District depend on a few major industries or resources, and their economic problems are more clearly linked to this feature. For example, the economies of the Pacific Northwest states—although more diversified now than in the past—remain heavily dependent on the lumber and wood products industry.

As high interest rates and a weak export market plague this credit-sensitive industry, softwood lumber production in the Northwest has dropped nearly 40 percent from its peak level in 1978, and 22 percent in 1981 alone. In Oregon, this sector represents nearly one-third of the state's manufacturing employment. Thus it was inevitable that Oregon would suffer an exaggerated downturn. Its overall unemployment rate was 11.9 percent in October, far above the national average, and some local unemployment rates now exceed 30 percent.

Similarly, the state of Washington, with 15 percent of its workers employed by the lumber and wood products industry, has felt the effect of the lumber products slump both locally and statewide. The unemployment rates in some counties have soared above 20 percent and the unemployment rate for the state as a whole was 12.5 percent in October. Washington has suffered additionally from the effects of a weak airline industry hurt in its important airframe manufacturing business.

The intermountain states and Alaska, traditionally known for their orientation toward the mineral industry, have suffered serious declines in mining activity. Arizona, for example, is the nation's largest copper producer, providing two-thirds of the nation's copper output. But weak worldwide demand for copper has depressed its price and forced the shutdown of several large mines. Employment in copper mining in Arizona has fallen forty-five percent in the last year, leaving 10,000 of the state's copper mining employees out of work. Low prices for gold, silver, and molybdenum have curtailed mining activity in Nevada as well, causing a loss of 11 percent of mining jobs between August 1981 and August 1982.

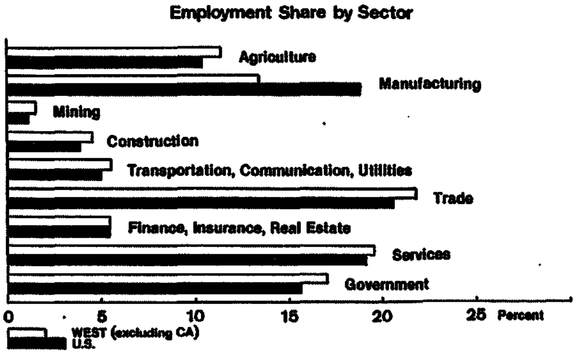
A similar story can be told about Idaho's silver mining industry. Idaho's Silver Valley produced 40 percent of the nation's silver in 1981, but depressed silver prices have forced three primary mines to close this year, leaving 2,800 workers jobless—a 50 percent drop in mining employment that has devastated several counties' economies. Local unemployment rates run as high as 33 percent.

Fortunately, despite the severity of these declines in mining activity the effect on these states' general economies has not been as severe as that of the decline of the lumber industry on the Northwest. The relatively smaller proportion of total employment engaged in these resource industries has meant smaller economic repercussions. Thus, the October unemployment rates of Idaho and Arizona were 10.5 and 10.4 percent, respectively—at a time when the national average was 10.4 percent.

The luckier ones
Some Western states are even relatively prosperous, despite their seemingly less-diversified economies. Weakened energy demand for example, has stifled growth in Utah's vast energy-related industries—including coal, oil and gas. But the growth of defense manufacturing and information processing industries in the state is helping to offset the losses experienced in the previously more important raw materials industries.

The state of Utah also has benefitted from special demographic circumstances. Unlike California, the previously rapid rate of labor force in-migration has slowed and the state's homogenous, high quality labor force and cohesive social community have buffered the impact of the national recession. Utah thus enjoyed the second lowest unemployment rate in the West in October at 8.9 percent.

Employment Share by Sector



Alaska, dependent on petroleum extraction, continues to enjoy the benefits of this massive source of revenue despite the weakness in world demand for crude oil that has lowered oil prices. It has maintained better than average economic conditions, with an October unemployment rate of 9.6 percent. And new jobs continue to be generated.

Hawaii, although dependent on only three major activities—tourism, agriculture, and the military—has not suffered as much as might be expected from its lack of diversification. Indeed, employment this year has been buoyed by an unusually strong tourist season. The number of visitors to Hawaii is expected to pass the record mark of four million—an increase of nearly 8 percent over the level a year ago. This growth, combined with the growth in military activity, has counterbalanced the effects of a world oversupply of sugar and pineapples that has lowered their prices and caused cutbacks and job losses in the agricultural sector.

Special problems

In addition to the general problems created by the national recession and problems posed by lack of diversification in certain regional economies, some Western states have suffered from unusual structural or policy problems. Certain industries in Washington, for example, also have to cope with a 58 percent increase in the price of electric power in October due to a realignment of Bonneville Power Administration rates. The rate increase affects most the heavy users of direct service electrical power, such as aluminum processors who already face a glutted product market.

Fiscal austerity has jeopardized government jobs throughout the District, but most particularly in California where a legacy of budget control referenda has created strong pressure for reductions in the size of the state's bureaucracy. This year, nearly 24,000 state and local government employees lost their jobs and California's recently passed budget was actually below that of a year ago.

The national recession has reduced the growth in Nevada's gambling revenues as consumers tighten their belts, but the problem has been compounded by the loss of the state's monopoly on gambling. The industry is now legal in areas such as Atlantic City, New Jersey. As a result, Nevada's unemployment rate grew to 11.9 percent this October, from 7.0 percent one year ago, and gaming revenue growth in 1981 fell sharply.

California's diversified argicultural sector was battered by natural as well as economic storms. Early rains destroyed 20 percent of the tomato crop in September and damaged valuable grape crops. In addition, an unusually strong dollar and competition from subsidized imports threaten the viability of the state's raisin crop.

Future prospects

Are conditions in the Twelfth District states really as bad as they appear to be? Despite the comparatively poor unemployment statistics of the West, it is clear from in-migration trends that workers continue to have confidence in the future vitality of the region. Indeed, the West's civilian labor force grew nearly 3 percent in 1982—twice as fast as the national rate of 1.5 percent.

Indeed, there is considerable basis for this enthusiasm. The West harbors a disproportionate share of the nation's agricultural capacity, much of its high-technology industry and substantial natural and human resource bases. In addition, the industries in many of these states are oriented toward defense products and are, therefore, expected to benefit from the projected annual increases of 5 to 7 percent in the Reagan Administration's defense budget.

These characteristics, combined with a modern transportation and communications infrastructure and fiscally conservative state governments, should permit the West to rebound soundly. Most likely, the West will rebound more rapidly than the nation as a whole as the recovery ensues.

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 12/8/82	Change from 12/1/82	Change from year ago Dollar	Change from year ago Percent
Loans (gross, adjusted) and investments*	161,801	– 334	6,334	4.1
Loans (gross, adjusted) — total#	141,941	– 500	7,603	5.7
Commercial and industrial	44,924	– 610	3,932	9.6
Real estate	57,448	– 49	1,882	3.4
Loans to individuals	23,627	– 9	171	0.7
Securities loans	2,504	160	230	10.1
U.S. Treasury securities*	6,947	157	1,133	19.5
Other securities*	12,913	9	– 2,402	– 15.7
Demand deposits — total#	41,842	–1,715	698	1.7
Demand deposits — adjusted	29,242	– 44	– 329	– 1.1
Savings deposits — total	32,903	224	2,714	9.0
Time deposits — total#	96,710	– 525	8,513	9.6
Individuals, part. & corp.	87,038	– 273	7,431	9.3
(Large negotiable CD's)	33,516	– 732	– 1,251	– 3.6

Weekly Averages of Daily Figures	Week ended 12/8/82	Week ended 12/1/82	Comparable year-ago period
Member Bank Reserve Position			
Excess Reserves (+)/Deficiency (–)	93	134	93
Borrowings	2	43	100
Net free reserves (+)/Net borrowed(–)	91	91	– 7

* Excludes trading account securities.
# Includes items not shown separately.

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