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A Cautionary Tale for California

The nearby California highlights essay documents the unique geographic variability of GDP and jobs growth in California. The reality is that California is not one economy but several, and the performance of each economic unit varies considerably. The essay also details a pattern that we have been following closely since early 2016, whereby the growth premium enjoyed by California, relative to the Nation, is shrinking. All of this underscores a central tenant of CERF analysis. That is, *policy matters*. The difference in economic performance between California and the rest of the Country, in particular, the fact that California's growth premium is rapidly vanishing, is the result of policy. The differences in economic performance of various regions within California also reflects, in many ways, important differences in policy.

Historically, one of the primary drivers of California's growth premium has been the existence of legacy industries such as the Motion Picture industry in Los Angeles, Technology in Silicon Valley, and Financial Services in Orange County. These are California's *golden geese*. In many cases, the presence of these legacy industries reflects favorable policies which were employed decades ago which supported the emergence and growth of a particular industry cluster.

The health and continued vibrancy of these legacy industries should not be taken for granted. The reality is that many of the policies which fostered innovation and dynamic economic growth in years gone by have been replaced by policies of a very different sort – ones that erect barriers to new innovation and limit the growth of existing industries. High rates of taxation, CEQA, AB-32, super-minimum wage and overtime regulations, local growth restrictions—these are all among the new regime of policies which play an increasingly large role in the State's economy. Under this new regime, many of the innovators of old merely seek to hang on. What economic opportunity and innovation still exist often exist despite the new policies. And it tends to be concentrated in areas of California which are relatively less hostile to economic growth than neighboring ones.

Recent analysis that we conducted in Coastal Southern California truly bears this out. Consider

Ventura County and it's geographic next door neighbor, the San Fernando Valley. Each is an economic unit built on the strength of a legacy industry. In Ventura County, it's biotech—Amgen, the world's largest independent biotechnology company, began in a garage in Ventura County in 1980. The company grew to have more than 10,000 local employees (19,000 world wide) and fueled the birth of a large industry cluster that serves as a major economic engine in the County's economy. In the San Fernando Valley, the legacy industry is Information & Technology (IT), a sector that includes software engineering and internet development as well as the Motion Picture and video production for which the Valley is famous.

Currently, one of these legacy industries is enjoying robust growth. The other is in steep decline. Not surprisingly, the broader regional economy which houses the growing industry is thriving. The regional economy which is home to the declining industry is faltering.

The legacy industry that is enjoying robust growth is Information & Technology in the San Fernando Valley. IT has grown by an astonishing 74.1 percent in the San Fernando Valley over the past decade. Not surprisingly, over the year 2014-2016, San Fernando Valley GDP grew at annual rates of 4.2, 5.5, and 2.6 percent—growth which exceeds that of the State and almost any comparative geography that we can find. The industry in rapid decline is BioTechnology in Ventura County. In the year 2016 alone, economic output in that sector declined by nearly $1 billion, pushing the Ventura County economy into recession. Together, the years 2014-2016 represent the three slowest years of growth in Ventura County for which we have data—worse even than the Financial Crisis and the Great Recession.

Keep in mind that the decline of BioTech in Ventura County is not simply the result of broader national trend. This decline is local, and in many ways, the causes are local.

Amgen recently announced plans to pare its Ventura County based workforce by nearly 10 percent, at the same time that it is building a new, 136,000 square foot facility in Tampa, Florida. The reason Amgen cited for moving their workforce to Tampa: "affordable cost of living and the potential for growth." Ventura County boasts the most stringent urban containment policies in the nation. A series of land use measures, passed in the late 1990s, requires voter approval of any expansion of urban areas—and residents have a decidedly one-sided record of rejecting urban expansion. The promise made to the residents of the County was that growth restrictions would ensure a singular quality of life that would attract other leading employers to the area. That promise has proved hollow. People and businesses, including many in the BioTech industry upon which the County economy is so heavily reliant, are voting with their feet and leaving behind a faltering economy.

There are lessons here for other regional economies. The San Fernando Valley is one Information & Technology downturn from economic decline. Even when a critical industry sector such as IT is thriving in other parts of the Country, local policies can be the proverbial straw that breaks the camel's back. Piled atop state-wide policies which increase the cost of doing business and constrain productive economic activity, local policies can mean the difference between growth and decline for individual industry sectors and for the regional economies in which those industry sectors reside.

There are also lessons here for the State. California is killing the golden geese. As long as California continues to advance policies which stifle innovation and growth, California's economic prospects will continue to dim. Individuals, households and businesses will continue to vote with their feet and move to states that they believe host greater opportunity. Expect to see more Ventura Counties and fewer San Fernando Valleys in California's future.

The current forecast calls for declining jobs and GDP growth in California. In the 4th quarter of 2017, we are forecasting GDP and Jobs growth premiums equal to 0.4 percentage points. That is, California's GDP growth rate is forecast to be 0.4 percentage points higher that the Nation's. The same is true for Jobs growth. In the quarters that follow, the forecast calls for GDP and Jobs growth which shrinks more rapidly in California than in the Nation. Both growth premiums are forecast to decline to just 0.1 percentage points within the forecast horizon.

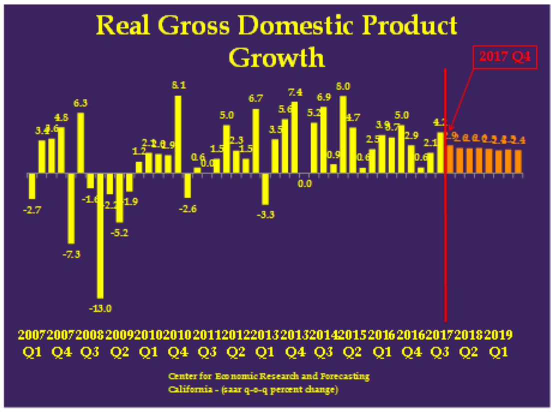
Quarter	CA Jobs	US Jobs	Premium
2017 Q4	2.1	1.7	0.4
2018 Q1	1.8	1.5	0.3
2018 Q2	1.6	1.4	0.2
2018 Q3	1.6	1.4	0.2
2018 Q4	1.5	1.3	0.2
2019 Q1	1.4	1.3	0.1
2019 Q2	1.4	1.3	0.1
2019 Q3	1.5	1.4	0.1
Average	**1.6**	**1.4**	**0.2**

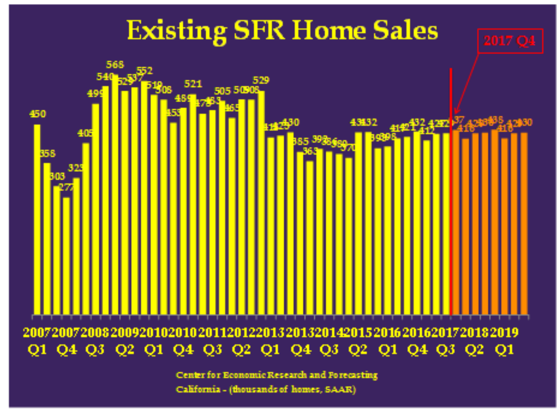
Sources: US Bureau of Economic Analysis and CERF

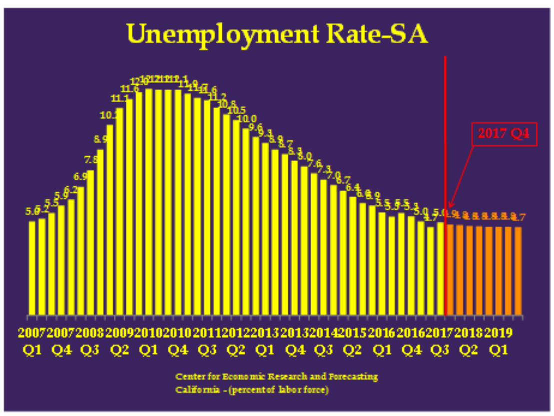
Quarter	CA GDP	US GDP	Premium
2017 Q4	2.9	2.5	0.4
2018 Q1	2.6	2.1	0.5
2018 Q2	2.6	2.2	0.4
2018 Q3	2.6	2.2	0.4
2018 Q4	2.5	2.0	0.5
2019 Q1	2.4	2.2	0.2
2019 Q2	2.5	2.2	0.3
2019 Q3	2.4	2.3	0.1
Average	**2.6**	**2.2**	**0.4**

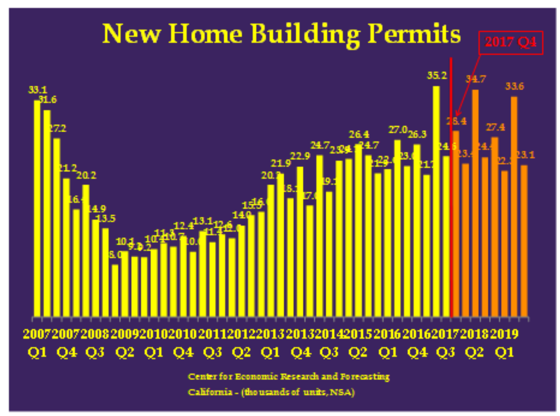
Sources: US Bureau of Economic Analysis and CERF

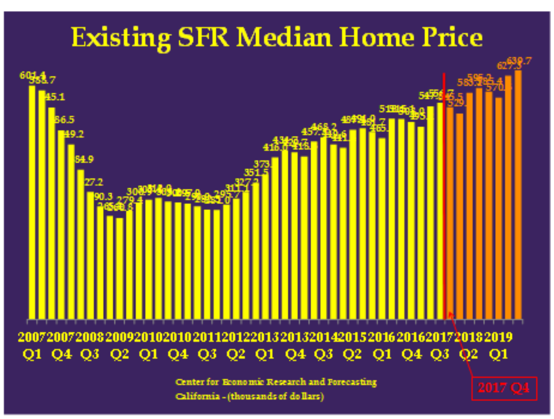
Additional forecast charts are included on the next page.

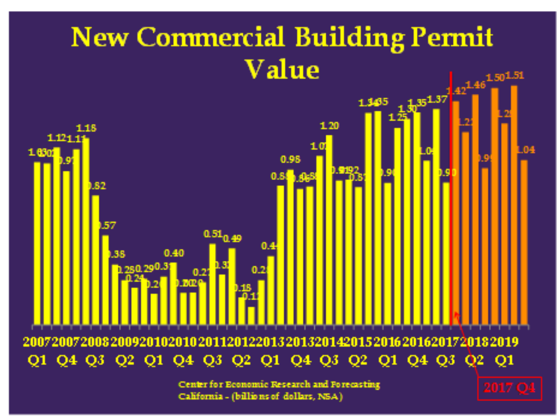

Real Gross Domestic Product Growth
2017 Q4
Center for Economic Research and Forecasting
California - (saar q-o-q percent change)


Existing SFR Home Sales
2017 Q4
Center for Economic Research and Forecasting
California - (thousands of homes, SAAR)


Unemployment Rate-SA
2017 Q4
Center for Economic Research and Forecasting
California - (percent of labor force)


New Home Building Permits
2017 Q4
Center for Economic Research and Forecasting
California - (thousands of units, NSA)


Existing SFR Median Home Price
Center for Economic Research and Forecasting
California - (thousands of dollars)
2017 Q4


New Commercial Building Permit Value
Center for Economic Research and Forecasting
California - (billions of dollars, NSA)
2017 Q4