THE BEACON OUTLOOK
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CALIFORNIA'S NOVEMBER PROPOSITIONS: GOOD INTENTIONS, BAD ECONOMICS

Since the pandemic, there have been countless proclamations and headlines claiming that California is on the decline—tech is supposedly leaving, Hollywood is fading, and businesses are fleeing the state. This is affecting how Californians view the state's economy. A recent poll from the Public Policy Institute of California (PPIC) reported that 55% of respondents believe the state is going in the wrong direction and expect bad economic times in the coming year.

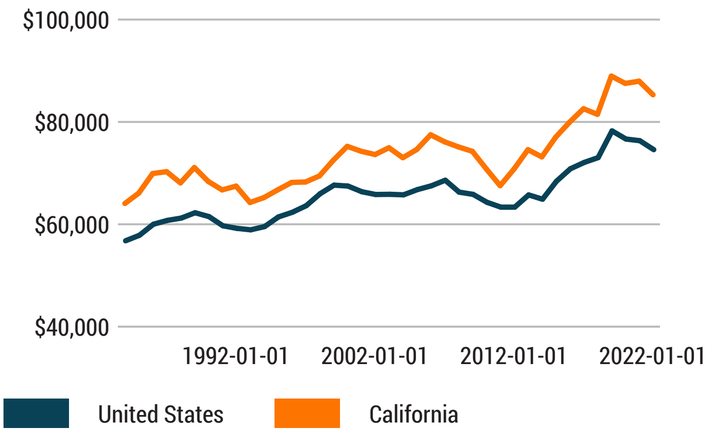
But let's set the record straight. Yes, Silicon Valley is still a global tech powerhouse, home to giants like Apple, Google, and NVIDIA, and yes, the entertainment industry remains firmly rooted in the state. What's really happening is more positive. California continues to see income growth, a rebounding tourism industry, and steady GDP growth, largely driven by the tech industry.

Real median household income in California remains substantially higher than the national average, with the latest data showing over $85,000 annually—approximately 15% above the national median of less than $75,000. Interestingly, Californians' perceptions are closer to reality when it comes to incomes; the same PPIC poll found that over three-fourths of respondents believe their own financial situation will remain the same or improve in the next year.

Even with this income edge, California's economy is following the same trend as the rest of the country. Nominal GDP grew at an annualized rate of 4.42% in Q1 2024, down from 8.51% in Q1 2023. When adjusted for inflation, real GDP growth has decelerated even further, from 3.99% in Q1 2023 to just 1.25% in Q1 2024.

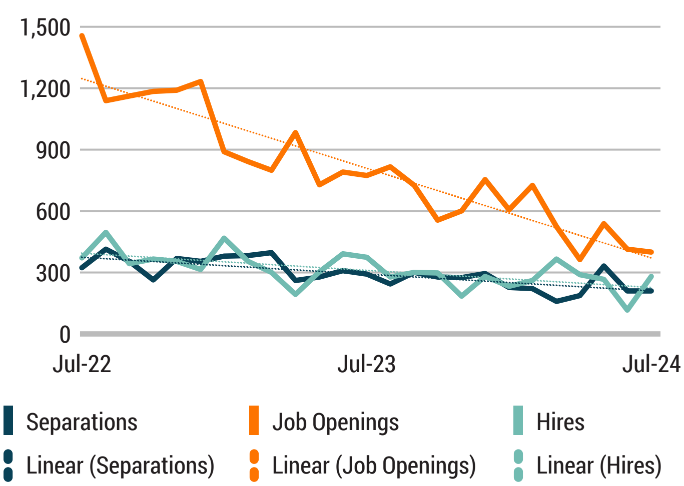
Job growth is solid and while unemployment has climbed, that's more about younger, entry-level workers entering the job market than a wave of layoffs. Hires continue to outpace separations, telling us that California is still adding jobs, with an average of 23,925 jobs gained per month since August 2023.

REAL MEDIAN HOUSEHOLD INCOME FOR CALIFORNIA AND THE UNITED STATES: 1990-2022



Source: U.S. Census Bureau, Real Median Household Income in California [MEHOINUSCAA672N], retrieved from FRED, Federal Reserve Bank of St. Louis. Analysis by Beacon Economics.

CALIFORNIA LABOR FORCE METRICS: HIRES, OPENINGS AND SEPARATIONS (THOUSANDS): JULY 2022 TO JULY 2024



Source: JOLTS, Bureau of Labor Statistics. Analysis by Beacon Economics.

However, this growth is happening against a backdrop of a cooler labor market compared to two years ago. Seasonally adjusted job openings have seen a significant drop, from 1,375,000 in July 2022 to 622,000 in July 2024, reflecting a slowdown in demand for new employees. New hires have also declined, from 602,000 to 539,000, during the same period. On a positive note, separations have decreased as well, from 569,000 in 2022 to 488,000 in 2024, signaling a more stable workforce.

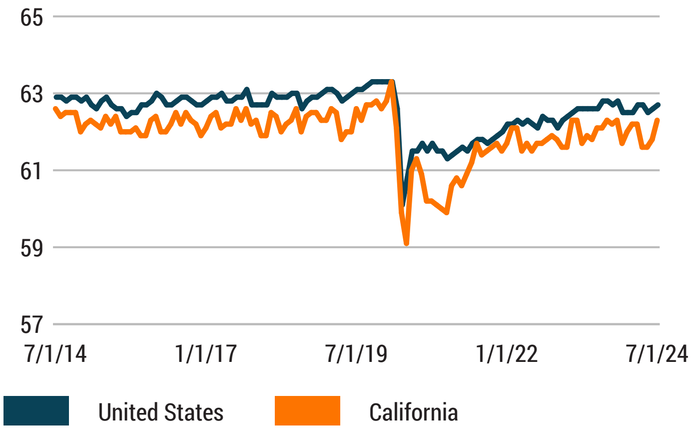
The labor force participation rate in the state has been on an upward trend, rising from 59.9% in January 2021 to 62.3% in July 2024. Despite this increase, compared to the pre-pandemic average, the average participation rate over the past three years remains relatively low at 61.7%.

All in all, the foundation of California's economy is robust, and we can see that in rising home prices and low vacancy rates—people still want to live and work here, despite the headlines. But it's not all sunshine and roses. The state faces real challenges: misguided housing and minimum wage policies, the high cost of doing business, and skyrocketing energy expenses are creating headwinds.

California has tremendous upsides, but there's a risk of squandering that potential if we keep buying into false narratives and implementing flawed policies. Beacon Economics' outlook is that the state will continue to grow, but in a more constrained way. Wages and consumer spending will rise, but growth will be on the intensive margin—concentrated in existing industries. And some businesses will surely be pushed out due to rising costs and regulations.

All that said, let's dive into this November's propositions. Are they going to make things better, or worse, for the Golden State?

LABOR FORCE PARTICIPATION RATE IN CALIFORNIA AND THE UNITED STATES: 2014 TO 2024



Source: U.S. Bureau of Labor Statistics, Labor Force Participation Rate for California [LBSNSA06], retrieved from FRED, Federal Reserve Bank of St. Louis

PROPOSITION 32

With the state minimum wage now set at $16 per hour, with a special carve out for fast-food workers to receive $20 per hour, and with an initiative on the November ballot (Proposition 32) to raise California's minimum wage to $18, the question is how will employment be affected?

Beacon Economics' recent white paper, California's Minimum Wage and the Long-Run Consequences for the State's Youth (2024), highlights that California's rising minimum wage may be worsening unemployment, particularly for younger workers. Our report suggests that when a state's minimum wage is below a certain threshold—$10 or $12—raising it can positively impact youth employment. However, when the minimum wage exceeds this range, further increases tend to create higher youth unemployment rates.

Consider the table below that shows a breakdown of U.S. states by their minimum wage range: $7.25, $8.75 to $13.67, and $14 to $17. States with lower minimum wages have lower unemployment rates and states with higher minimum wages have higher unemployment rates (in terms of the median, average, and maximum). It's not surprising that California has the third highest minimum wage in the country, after Washington D.C. and Washington state, and the third highest unemployment rate in the country, after Washington D.C. and Nevada.

MINIMUM WAGES AND UNEMPLOYMENT RATES ACROSS U.S. STATES

Number of States	Minimum Wage Range	Unemployment Rate			
		Min	Median	Average	Max
20	$7.25	2.2	3.3	3.3	4.7
16	$8.75-$13.67	2	3.55	3.58	5.4
15	$14-$17	2.8	4.1	4.09	5.5

Source: U.S. Census Bureau, Analysis by Beacon Economics.

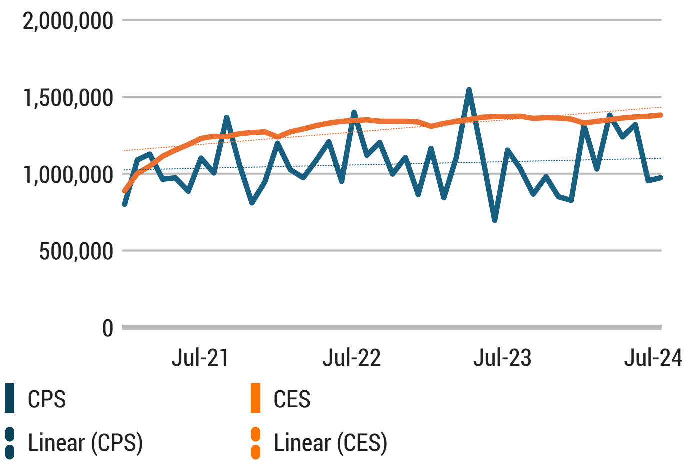
As of July 2024, California was one of only six states where the number of unemployed individuals exceeded the number of available job openings, with 1.6 unemployed persons per job opening—higher than the national average of 0.9. Even when compared to the state's 10-year monthly average, this figure is high. From January 2014 to June 2024, California averaged 1.3 unemployed persons per job opening when excluding the pandemic year.

Of course, in discussing the unemployment rate it's important to also consider the U-6 rate, which takes into account all those workers who are underemployed (i.e. part-time workers who would like full-time work but cannot find it), marginally attached to the workforce (those "on the edge" of the labor force), and discouraged (i.e. have given up looking for work). While the official, or U-3, unemployment rate in California has risen by over 20% between Q4 2022 to Q2 2024, the U-6 unemployment rate has risen by about 12% over the same period. This means that California's labor force is not as troubled as it initially appears to be based on the standard measure of unemployment, Nonetheless, even when considering this broader measure of unemployment, it's evident that California's unemployment rate continues to rise.

As far as the U-3 unemployment rate, the state is no longer in the feared number one spot, as it was a few months ago; having come down from 5.4% to 5.3%, California's unemployment rate now sits in third place. This is mostly because over the last two years, the state's unemployment rate has risen at a much faster clip compared to the rest of the nation. The national unemployment rate went from 3.6% to 4.2% between August 2022 and August 2024—a roughly 17% increase—whereas California's rate climbed from 3.8% to 5.3%, reflecting a nearly 40% rise.

And what about the impact of the $20 minimum wage on California's fast-food workers? When we consider payroll employment numbers (from the CES) in the restaurant industry, all seems fine. It appears that employment hasn't been affected by the special minimum wage hike. However, when we take the CPS data into account, things don't look so rosy. According to the CES data (which is based on survey data collected monthly from a sample of employers), employment in Restaurants and Other Food Services went up by nearly 20,000 workers or 1%, since April 2024 when the special fast-food minimum wage went into effect. According to the CPS data (surveys collected from a sample of households), however, employment in Restaurants and Other Food Services has declined by over 20% in the same period. Why such a big discrepancy?

EMPLOYMENT IN RESTAURANTS & OTHER FOOD SERVICES SECTOR IN CALIFORNIA: 2021 TO 2024



U.S. Bureau of Labor Statistics, Current Population Survey and Current Establishment Statistics.

Part of the difference can be attributed to how the surveys are conducted. Since the CES data comes from a sample of businesses, the overall numbers are estimated using a net birth-death model of businesses, which is based on historic trends in births and deaths of businesses. However, when there are more than the expected number of firms entering the market, the CES net birth-death model underestimates employment numbers, and eventually, the CES numbers are updated to reflect figures closer to reality. When there are more than the expected number of firms exiting the market, the net birth-death model overestimates employment numbers – which is probably what is happening with fast-food establishments in California. Come March, we can expect some significant downward revisions to the payroll employment numbers for this sector. At the very least, we should wait until we see the revised numbers in March before passing new minimum wage legislation.

Standard economic theory predicts that minimum wages, when set above the market equilibrium rate, will increase unemployment rates and create inefficiencies. And there is plenty of empirical evidence supporting this theory[1]. Yet, there are groups that perpetually try to discredit this evidence and claim that only gains result from raising minimum wages.

The expected effect of Proposition 32 is an increase in unemployment, especially among the state's youngest workers.

PROPOSITION 33

One of the few topics that nearly all economists agree on is rent control. Economic theory and years of empirical research concur here: rent control creates more problems than it solves. And yet, the topic of rent control continues to be debated across the nation, with some of the most fervent debate taking place in California.

The concept of rent control began to take shape in California in the 1970s, spurred by rising housing costs and the inflationary environment of the decade. Several California cities implemented local rent control ordinances in the 1970s and 1980s, initially with the intention that they would be temporary measures: Beverly Hills (1978), Los Angeles (1978), Hayward (1979), San Jose (1979), San Francisco (1979), Santa Monica (1979), Berkeley (1980), East Palo Alto (1986), and West Hollywood (1985) all enacted city-wide rent control policies.

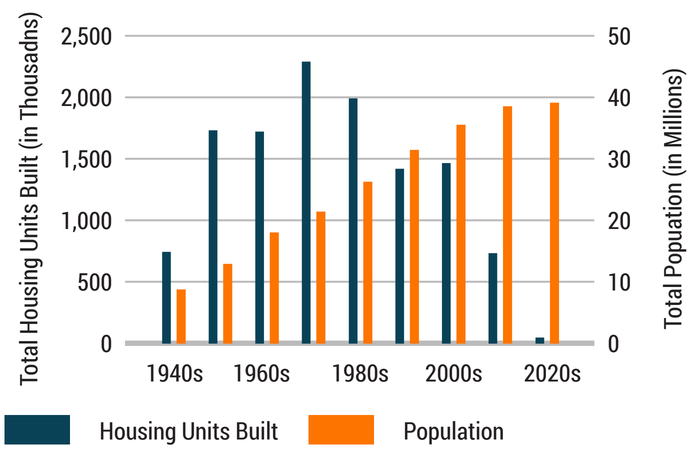
1 For example: Neumark, D., & Wascher, W. L. (2007). Minimum wages and employment. *Foundations and Trends® in Microeconomics*, *3*(1–2), 1-182.

The passing of the Costa-Hawkins Rental Housing Act in 1995 was a saving grace for California. This act provided much-needed clarity and consistency for landlords and tenants across the state. Beyond standardizing rent control regulations statewide, Costa-Hawkins offered a balance between the interests of landlords and tenants through (a) an exemption of properties constructed after February 1, 1995, (b) an exemption of single-family homes and condominiums, and (c) an allowance for vacancy decontrol.

Despite this compromise between renters and tenants, there have been several attempts to reverse Costa-Hawkins – none of which have been successful. Yet again, Proposition 33 on the November 2024 ballot will allow Californians to repeal the act, clearly showing that the debate on rent control is not over.

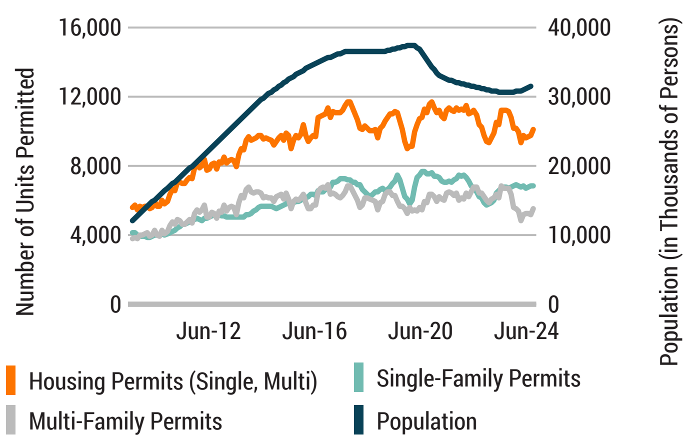
California's housing affordability crisis is fundamentally a supply issue. While rent control aims to protect tenants, it leads to unintended consequences – discouraging property investment and the construction of new housing – which hurt tenants in the long run. Essentially, rent control takes the very problem it's trying to solve and makes it worse, as it leads to higher rents and fewer available rental units.

TOTAL POPULATION AND TOTAL HOUSING UNITS IN CALIFORNIA



Source: Decennial U.S. Census, 1930-2020 and U.S. Census American Community Survey, 2022. Analysis by Beacon Economics.

RESIDENTIAL PERMITS AND POPULATION IN CALIFORNIA: 2011 TO 2024



Source: U.S. Census Bureau, Resident Population in California [CAPOP], retrieved from FRED. Analysis by Beacon Economics.

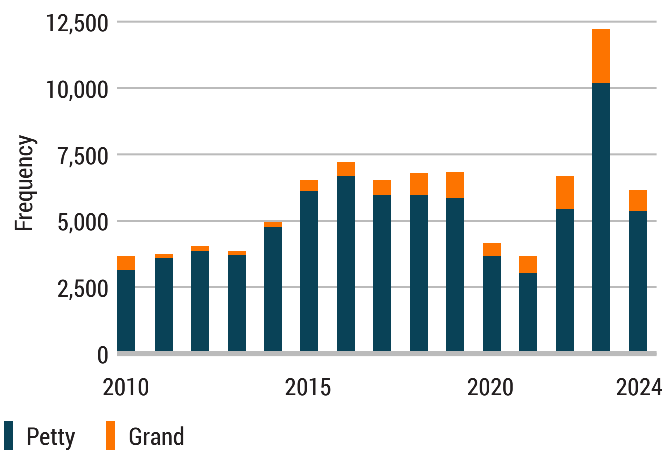
The lack of new housing supply is evident in the state's housing permit data. Between 2011 and 2018, monthly permits and population were both increasing in California, though population growth was outpacing new residential construction. After peaking in mid-2018, the number of permits issued has been hovering between 8,000 and 10,000 per month. Meanwhile, the state's population, after years of growth, has flattened and even started to decline in early 2022.

The lack of new construction is not just a housing issue; it's an economic constraint. Without new homes, California can't attract new workers, and without new workers, we're stuck in low gear when it comes to economic growth. Unless we see a dramatic uptick in housing construction, the affordability issue will continue to hold the state's economy back, more Federal Reserve rate cuts or not. Proposition 33, if passed, could make these issues worse by further restricting new housing development and driving up prices.

PROPOSITION 36

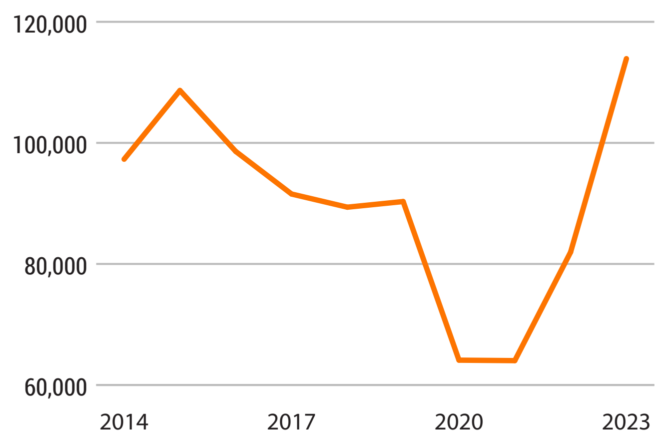
With the 2014 passage of Proposition 47, also known as the Safe Neighborhoods and Schools Act, the threshold for misdemeanor shoplifting was lifted from $500 to $950 in California. While the rationale for the change was to reduce the state's prison population and allocate savings from reduced incarceration costs to other statewide costs, the policy may have very likely generated unintended consequences. More specifically, the proposition could have led to increased crime and challenges for businesses dealing with frequent thefts in certain areas, such as in the City of Los Angeles – even if overall, shoplifting crime rates are below pre-pandemic levels in California.

SHOPLIFTING CRIMES IN THE CITY OF LOS ANGELES FROM 2010 TO 2024



Source: Los Angeles Police Department. Analysis by Beacon Economics.

SHOPLIFTING CRIMES IN CALIFORNIA FROM 2014 TO 2024



Source: California Department of Justice, Crimes and Clearance. Analysis by Beacon Economics.

Proposition 36 gives California voters a chance to make changes to Proposition 47 this November. Under Proposition 47, repeat theft offenders were no longer eligible for felony charges, but Proposition 36 aims to restore that penalty, allowing individuals with two prior theft convictions to face felony charges, regardless of the value of the stolen property. Proposition 36 also proposes longer felony sentences, such as for theft or property damage committed by three or more people and requires that some felonies be served in prison. The expected effect of Proposition 36 is a likely reduction in shoplifting crimes in the state.

California's economy is healthy but complex, and many of the November ballot propositions don't provide the answers we need. They indeed mean well, but ideas such as raising the minimum wage and expanding rent control are likely to backfire. History and basic economics tell us that policies like these create unintended consequences, including more housing shortages and higher unemployment. Voters need to really think about how these propositions could impact the state's economy. It's time for smarter, not reactive, solutions.

CALIFORNIA FORECAST

CALIFORNIA FORECAST - KEY INDICATORS

	Current	Forecast			
	Q2-24	Q3-24F	Q4-24F	Q1-25F	Q2-25F
Nonfarm Payrolls (000s, SA)	**18,026.0**	18,065.1	18,104.1	18,148.1	18,196.8
Unemployment Rate (%, SA)	**5.2**	5.3	5.3	5.2	5.2
Real GDP (Millions 2012$, SAAR)	**3,354,963.0**	3,363,456.0	3,390,139.0	3,418,248.0	3,440,628.0
Home Prices ($, SA)	**726,138.6**	736,677.8	736,068.5	740,947.2	746,616.3

	Forecast				
	Q3-25F	Q4-25F	Q1-26F	Q2-26F	Q3-26F
Nonfarm Payrolls (000s, SA)	18,243.6	18,285.0	18,318.7	18,350.5	18,384.5
Unemployment Rate (%, SA)	5.2	5.2	5.2	5.2	5.3
Real GDP (Millions 2012$, SAAR)	3,463,795.0	3,487,423.0	3,511,084.0	3,534,496.0	3,557,951.0
Home Prices ($, SA)	750,841.9	753,428.2	757,508.7	762,264.0	766,685.8

Source: U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, CoreLogic; Forecast by Beacon Economics