



The Late Great State Of California

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My family moved to California in 1950, part of the post-WWII westward migration. My widowed mother, tired of Boston's dreary winters, felt the westward pull. My eldest brother, a WWII Navy veteran, had heard good things about San Diego from sailors who had been stationed there during the war. So, California, here we come.

I would like to think those were the golden years, at least for us. California was new, bright, warm, and full of promise. The East was old and cold. And San Diego was thriving. Defense and aerospace jobs were plentiful. Land was cheap, homes were cheap. A building boom met the housing needs for optimistic migrants. You could get things done in California.

It's not that California anymore. We are overregulated and overtaxed and people aren't so optimistic. People want to leave.

What Happened to the Golden Years?

A recent poll of the state's registered voters by Cal's Institute of Governmental Studies revealed that half have considered leaving the state. The top reason was the high cost of housing (especially by young people); high taxation was second.

The poll also asked if California was one of the best places to live or a just an OK-to-lousy place to live. About half said yes and half went the other way. Interestingly 67% of Democrats said it was one of the best while 77% of Republicans disagreed. Apparently, Democrats like expensive housing, high taxes, and being over-regulated.

Are people leaving California? It depends on whom you are talking about. More people are out-migrating to other states than those coming in (-156,000), but much of that was offset by international migrants(+118,000) resulting in a net population loss of only 38,000 (2018).

Perhaps it has something to do with the fact that California is the most regulated state in the nation — by far. The Cato Institute analyzed the laws of each state by measuring the amount of individual legal restrictions in their legal codes. California was at the top, way at the top with 395,503 individual restrictions (laws, prohibitions). We surpassed No. 2, ultraleft New York, by almost 90,000 restrictions. Our politicians in Sacramento keep passing hundreds of new laws every year yet half of Californians are thinking of leaving.

And then there are taxes. California has the highest income tax rate of all states (13.3%). The highest combined federal and California income tax rate is now about 50% of taxable income. If

you and your spouse have \$200,000 of taxable income, your combined federal and California tax rate is 41.3%. That's not something you should be applauding since California ranks 42 out of 50 states in fiscal solvency.

Two new pieces of legislation will make things worse, much worse. One is statewide rent control. The other is the reclassification of independent contractors as employees.

The War Against Low-income Renters

A rent-control law, Assembly Bill 1482, was signed by Governor Newsom on October 8, 2019. It limits apartment rent increases to 5% plus inflation per year (not to exceed 10%). It affects units built at least 15 years ago (on a rolling timeline). Rents can be adjusted to market rates only when a tenant leaves, but tenants can only be evicted for "cause." Newsom said "These anti-gouging and eviction protections will help families afford to keep a roof over their heads ..." But what if it doesn't? What if it will harm tenants, especially poor ones?

The advocates of rent control seem to have no grasp on the economics of price controls. Perhaps they should consult an economist. In a survey of prominent economists, 81% agreed that rent controls have not had a positive impact where they have been tried.

Why would these cold-hearted economists oppose rent control? Because rent controls don't work and they do the opposite of what was intended: they hurt poor renters.

Here is what will happen with rent control in our high-demand coastal communities:

- Owners will raise rents to the maximum every year to protect asset values.
- Owners will be far more selective in choosing tenants, thus limiting housing for poor, less creditworthy applicants.
- Tenants will be reluctant to move from rent controlled properties which tends to freeze the rent-controlled rental market leaving fewer apartments available for rent.
- Rent controlled units will be gentrified as historical evidence shows that higher income tenants will be the most benefited class of renters.
- Affordable apartment inventory will be further reduced as owners evict tenants, tear down older buildings, and build new, more expensive units which will be exempt from rent control.
- More apartments will be converted to condos, further reducing affordable inventory.
- Owners will cut back on expenses to preserve cash flow, thus reducing the quality of rentable units.

Overall, rent control will disincentivize investors from investing in affordable apartments.

These conclusions aren't guesses or just fuzzy theories — they are based on actual experience from rent controlled areas.

Adios Gig Economy

The new law on classifying independent contractors as employees (AB 5) is a stab in the heart of the gig economy — the economy that provides convenient low-cost services when you want them. Think Uber and Lyft for ride sharing. You will now pay more and get less. That assumes they will stay in California. Uber, as everyone knows loses money (EBITDA earnings for 2018: -\$2.41 billion). If they can't make money on their present business model, how can they possibly make money if their driver costs go way up? So, I repeat myself: will they be around in a couple years? Will those drivers who feel they are being treated unfairly be out of work?

This is a classic example of the *Canute Effect*.¹ If you recall, Canute was the Danish king, who, legend has it, ordered the tide to stop coming in. Canute was obviously either detached from reality or just an arrogant megalomaniac who thought he could command nature.

In our case, our legislators believe they can just pass a law and make things better. It doesn't work that way. There are controlling economic realities that they ignore or, most likely, aren't even aware of.

Everybody knows that Uber changed the world for the better. Consumers loved the new service. Drivers signed up to make extra money, setting their own hours. So why do our politicians want to kill Uber and Lyft? We should ask ourselves: who would be better off without Uber and Lyft? Here's a clue: in the governor's statement supporting AB 5 he went out of his way to say, "A next step is creating pathways for more workers to form a union, collectively bargain to earn more, and have a stronger voice at work." It's an obvious power grab by unions who wish to unionize (i.e., kill) the gig economy. Unions are famous for protecting the status quo and fighting for more power. Taxi companies no doubt had their hand in it too.

Understand that Uber and Lyft are just the tip of the gig economy. We all lose.

The Tipping Point

I just reread Malcolm Gladwell's wonderful book, *The Tipping Point*, in which he details the things that push societal change over the edge. My fear is that California is getting to a point where the dynamism that has driven our mighty state's prosperity will be snuffed out. Are we at the tipping point yet? I don't really know, but with 395,503 restrictions on the books, I don't see how it can get better.

Our politicians are quick to say this will never happen. They say we have the most vibrant tech economy in the world. Our farms feed the country. People love California. They believe they are making things better. Yet they continue to pass laws that tamp us down. At some point it will tip over and the impact of their regulations and taxes will overcome the forces that made California great. These new laws are getting us closer.