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> *I'm hoping that what happens in California will not stay in California, but spread all across the country.*
>
> *- California Governor, Jerry Brown*

The rash of federalist sentiment in California, which we noted in the previous forecast publication, continues apace. An embrace of the idea of *states as laboratories* for policy experimentation has already manifest itself in the form of sweeping over-hauls of large segments of California's economy. The Global Warming Solutions Act (AB-32) of 2006, which sought to reorganize the state's economy around specific, climate related goals and which was heralded as a "watershed moment" in the State's history, has now been joined by truly remarkable labor market regulations including a super minimum wage and sweeping over-time rules.

Make no mistake, California legislators seek to disprove long-held economic orthodoxies and to prove to the rest of the country that they can have their cake and eat it too.

In the case of their latest attempt, the California legislature would like us to believe that everyone can have government provided health insurance and it will cost us less too.

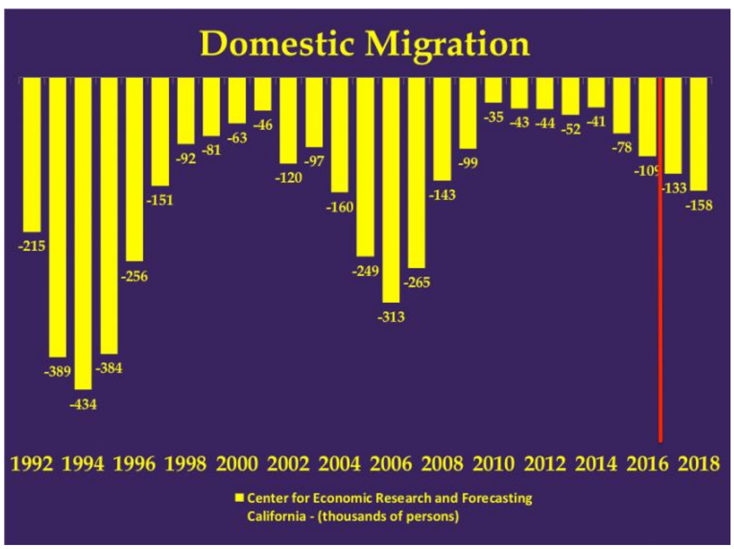
In the hope of initiating the latest experiment, on June 1, the State Senate passed the Healthy California Act (SB 562) by a vote of 23 to 14. The bill now heads to the State Assembly for consideration. SB-562 would end private insurance coverage in California and move every resident, legal or otherwise, to a single, government-provided healthcare plan. According to optimistic estimates from California's Legislative Analyst's Office, the cost of implementation would be approximately 400 billion dollars per year, of which only half would be covered by federal and other existing forms of revenue.

Even if we assume that the rosy assumptions underpinning the estimates are accurate, in order to cover the costs of universal healthcare, California would need to raise over 200 billion dollars per year in additional revenue. According to the latest version of the Governor's state budget, total state tax revenue in the 2016/17 fiscal year is estimated to be less than 122 billion dollars. We are being asked to believe that the State can increase tax revenue by more than 250 percent without serious distortions or displacements in the state's economy.

Global warming solutions, a super minimum wage, government-provided health coverage for all. Indeed, this state is a laboratory of experimentation. The only problem is that Texas is eating our cake.

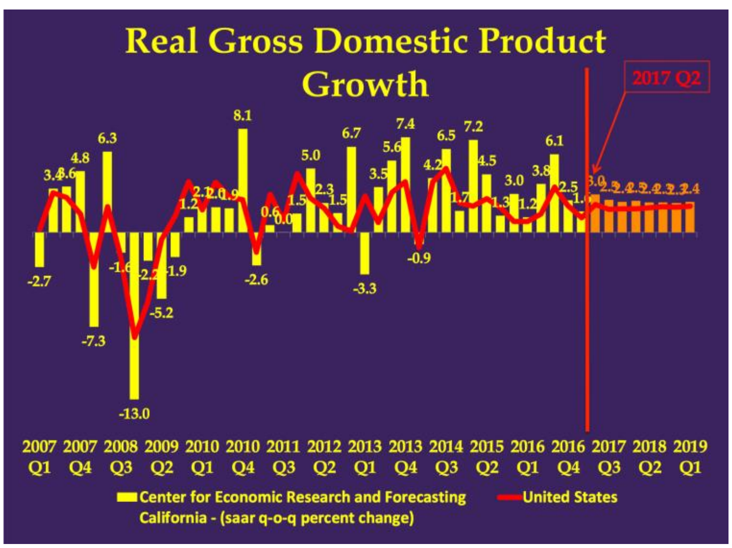
While Governor Brown hopes that what happens in California will spread across the country, what is actually spreading is Californians themselves, especially younger and middle class ones. As elaborated in the nearby California Forecast Highlights essay and as noted in previous forecast publications, net domestic migration has been negative in California for more than 25 years. Every year, more people leave California in search of economic opportunity in one of the other states than come to California to find economic opportunity here. More are heading to Texas than to any other state in the Union.

California's out-migration is a reflection of what many Californians think about the great policy laboratory that they are leaving behind. The mix of policies being implemented in other states provide greater economic opportunity than those in California.



In February, fewer than 4 months before the California State Senate's vote on universal healthcare, the Missouri legislature had its own watershed moment. On that day, Missouri voted to become the 28th right-to-work state. Right to work laws prohibit unions from compelling employees to join the union and to pay dues. [Empirical studies] reveal that, since the 1990s, right-to-work states have enjoyed higher population growth, higher labor productivity, increased growth of per capita income, and larger increases in manufacturing employment. More than almost any other set of policies, right-to-work has been spreading across the country. We wonder if California's Governor and legislature have even noticed.

It is against this background that we publish the latest economic forecast for California. As with the previous quarter's forecast, we note that the growth premium which California enjoys over the Nation is shrinking and we predict that it will continue to shrink over the entire forecast horizon. Considering California's tremendous abundance of natural resources, advantageous location relative to Asian markets, and awesome legacy of technological and creative innovation, a shrinking growth premium in California is almost inexplicable. In our estimation, only extraordinary policy experimentation, the kind that challenges basic economic principles, can explain such a trend. For the first time, the CERF team has begun to speculate as to when California's economic growth may actually begin to lag the Nation's.



Forecast charts are included on the next page.

Forecast Charts