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## ❖ *U.S. Economic Developments*

### **Recession Widely Anticipated Following September Terrorist Attacks**

The tragic events of September 11, 2001 are causing major repercussions for current and expected economic conditions. The economy was already very weak before the terrorist attacks. Real gross domestic product (GDP) increased just 0.3 percent in the second quarter of 2001. Were it not for strong government spending, economic growth would have been negative in the second quarter. Even before the terrorist attacks, many economists were forecasting weak or negative growth for the two remaining quarters of 2001. The "Advance" report of third quarter 2001 GDP, released by the U.S. Department of Commerce on October 31, shows that real GDP declined by 0.4 percent in the third quarter.

A survey of 21 members of the National Association for Business Economists (NABE) was taken on September 20, more than a week after the terrorist attacks. Eighteen of the 21 NABE panelists surveyed believe that we are currently in a recession. The impacts of the attacks reduced the panelists' median real GDP growth forecasts by 1.2 percent in the third quarter, 2.8 percent in the fourth quarter, and 1.9 percent in the first

quarter of 2002.<sup>1</sup> (That is, before the attacks the median forecast was for 1.4 percent growth in real GDP in the third quarter, but now the median forecast is for growth of just 0.2 percent.) After the first quarter of 2002, there are no further reductions in the forecasts resulting from the terrorists' attacks.

The NABE panel predicts a 0.5 percent decline in real GDP in the fourth quarter of 2001 before a recovery begins with 1.0 percent growth in the first quarter of 2002. For the rest of 2002 the survey panel expects real economic growth to return to rates at or above its long-term average of approximately 3 percent. (For the ten-year period from 1991 through 2000, real GDP increased an average of 3.2 percent per year, according to revised historical estimates released in July.)

### **Jump in Unemployment Rate**

Monthly employment statistics clearly show the current weakness of the economy. After hovering at approximately 4.5 percent from April through July, the U.S. unemployment rate rose to 4.9 percent in both August and September and 5.4 percent in October. The number of employees on nonagricultural payrolls reached a peak in March 2001, and has generally been falling since then. Nearly 900,000 net payroll jobs have been lost since March.

<sup>1</sup> This and subsequent panel figures cited are the medians of the 21 responses.

(Information derived from: U.S. Department of Commerce, STAT-USA website: [www.stat-usa.gov](http://www.stat-usa.gov); *NABE Outlook*, September 21, 2001, National Association for Business Economists, website: [www.nabe.com](http://www.nabe.com).)

## ❖ *California Economic Developments*

### **UCLA Predicts Mild Recession in California**

In September, the UCLA Anderson Forecasting Project released its forecast for the California economy. UCLA is predicting a mild recession for the state, as they cited data indicating slowing nonagricultural employment growth for the first half of 2001. (Nonagricultural payroll employment is one of the most comprehensive measures of economic well being available for states on a timely basis.) According to UCLA, nonagricultural employment increased at a seasonally adjusted annualized rate of just 0.4 percent growth in the second quarter, down from 2.9 percent growth in the first quarter of 2001 (seasonally adjusted annualized nonagricultural employment compared to the corresponding employment figure for the prior quarter). UCLA expects no further growth in nonagricultural employment for the rest of 2001 before a recovery begins in early 2002.

### **High Technology Industries Expected to Fare the Worst**

Regionally, UCLA expects the San Francisco Bay Area, particularly the technology-oriented Silicon Valley, to fare worse than Southern California in this recession. The San Jose metropolitan area (Santa Clara County) had a 4.5 percent decline in nonagricultural employment in the second quarter of 2001, reflecting the continuing impacts of failures of many dot.com

companies. This was the largest decline in nonagricultural employment of any major region of the state in the second quarter. With the decline in payroll jobs, the unemployment rate for the San Jose metropolitan area has increased from 2.2 percent in July of 2000 to 4.7 percent in July of 2001 (not adjusted for seasonality). These statistics are reflecting weakness in information technology, which is a particularly important industry in the San Jose area. The national recession and weak international markets have reduced the demand for technology products.

### **California Unemployment Rising**

The California unemployment rate stood at 5.4 percent in September, up from a low of 4.5 percent in February. UCLA is predicting that the California unemployment rate will continue to rise over the next couple of quarters, before stabilizing at a rate of approximately 6.0 percent in mid-2002.

### **Dramatic Slowdown in First Half 2001 Taxable Sales Growth**

As a consequence of a weaker economy, taxable sales growth slowed dramatically in the first half of 2001. The Board of Equalization's preliminary estimate shows that taxable sales increased just 0.6 percent in the second quarter of 2001 compared to the second quarter of 2000. This growth figure is down from a 2.5 percent increase in the first quarter of 2001 compared to the first quarter of 2000. The weakness in taxable sales was largely anticipated by the Department of Finance's May Revision of the Governor's Budget Summary 2001-02, which forecasted taxable sales to rise 1.4 percent in 2001. To put the weakness of these figures in perspective, taxable sales increased 11.9 percent in 2000. For the five-year period 1996

through 2000, taxable sales rose an average of 8.0 percent per year. In 1991, the first year of the last recession experienced in California, taxable sales declined 3.9 percent. However, the recession of the early 1990s was much more severe than the current recession is expected to be.

(Information derived from: *The UCLA Anderson Forecast*, September 2001; California Employment Development Department (EDD), *Labor Market Conditions in California*, October 12, 2001, EDD Labor Market Information website: [www.calmis.ca.gov](http://www.calmis.ca.gov); Board of Equalization, News Release #52, October 12, 2001, *Taxable Sales in California*, website: [www.boe.ca.gov](http://www.boe.ca.gov); California Department of Finance, *May Revision of the Governor's Budget Summary 2001-02*, website: [www.dof.ca.gov](http://www.dof.ca.gov).)

## ❖ A Review of County Taxable Sales to Personal Income Ratios

### California Taxable Sales Closely Related to Incomes

A well established principle of economics is that consumption and income are strongly correlated to each other. This relationship has important ramifications for estimating taxable sales, which are a component of total consumption.<sup>2</sup> In 1999, California taxable sales were approximately 40 percent of personal income. This ratio has been fairly constant in recent years; from 1994 through 1998 the taxable sales to personal income ratio was 0.39 each year before rising slightly to 0.40 in 1999. Therefore, if one had an estimate of personal income, a reasonable estimate of taxable sales could be made by multiplying it by 0.40.

<sup>2</sup> In California's sales and use tax system, most services are exempt, while most goods are taxable (major goods exemptions include food consumed at home and prescription drugs).

### Great Variability in Ratio Among Counties

While the ratio appears to be fairly stable for the state as a whole, there is a great deal of variation in it by county. In 1999, the ratio of taxable sales to income ranged from a low of 0.24 for Sierra County to a high of 0.79 for Alpine County. It could be argued that the low populations in these two counties make such ratios more variable than statewide averages because the county data are more subject to the impacts of unusual fluctuations in either sales or incomes. (The July 1, 2000 population of Sierra County was 3,610 people; Alpine County was 1,220 people.) However, even counties with relatively high populations varied quite a bit from the statewide average of 0.40. For example, Marin County (population of 250,100) had a taxable sales to income ratio of 0.27 in 1999.<sup>3</sup> Contra Costa (population of 963,000) had a ratio of 0.31. At the other extreme, Yolo County (population of 170,900) had a taxable sales to income ratio of 0.51, and San Bernardino (population of 1,742,300) had a ratio of 0.48. Sacramento and El Dorado, which are adjacent counties in the same Primary Metropolitan Statistical Area,<sup>4</sup> had wildly different ratios; Sacramento's was 0.46 in 1999, while El Dorado's was 0.26. Overall, 30 counties had taxable sales ratios above the state average of 0.40 in 1999, while 26 counties had ratios below the state average, and two counties had ratios equaling the state average. Data throughout the 1980s and 1990s show similar patterns of county variation around the statewide averages.

The chart on page 4 shows the taxable sales to personal income ratios for California and the top ten counties in California as determined by 1999 taxable sales. These ten counties accounted for 72 percent of 2000

<sup>3</sup> All population data cited are from the Department of Finance website, [www.dof.ca.gov](http://www.dof.ca.gov), and are for year 2000.

<sup>4</sup> Primary Metropolitan Statistical Areas are defined by the U.S. Office of Management and Budget.

population in California. As shown in the chart, the ratios range from 0.33 for San Francisco to 0.48 for San Bernardino. Five counties are above the state average and five counties are below it.

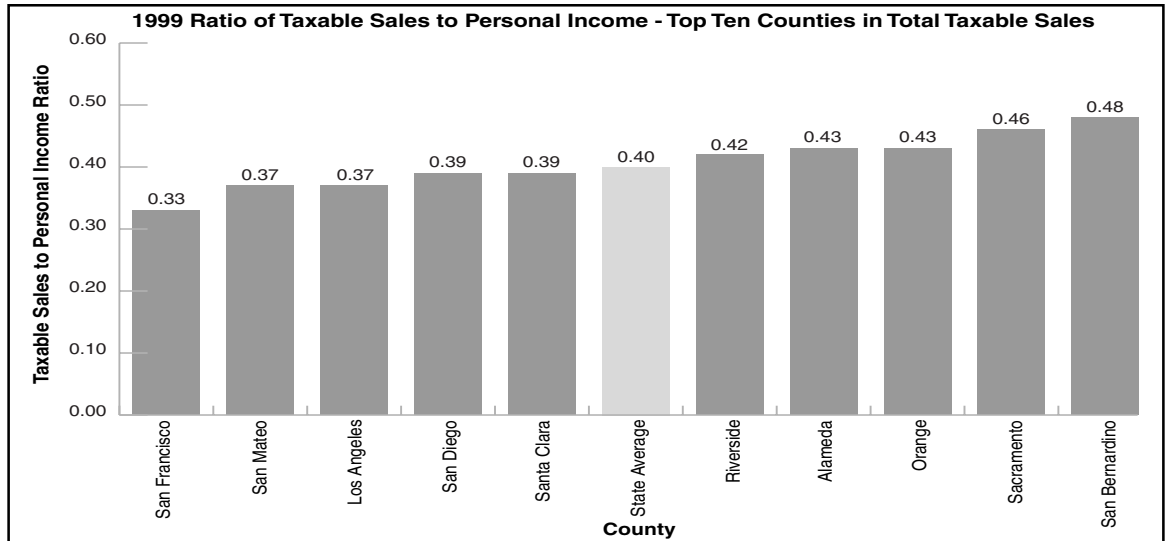
### Reasons for County Variation Unclear

One would generally expect counties with relatively higher per capita incomes to have lower taxable sales to income ratios since people with higher incomes tend to spend larger portions of their incomes on services (which are generally not taxable) than do people with lower incomes. While the data in the chart show this is generally true, there are exceptions. Two of the five counties with higher than average ratios had per capita incomes above the state average in 1999 (Orange and Alameda counties), while two of the five counties with lower than average ratios had incomes below the state average (San Diego and Los Angeles counties). The

data for all 58 counties similarly do not show conclusive expected relationships between their taxable income to sales ratios and per capita incomes.

While no one knows the exact factors responsible, the unexplained variation in county taxable sales to income ratios could result from varying combinations of the following factors: housing costs, employment commuting patterns, availability of shopping opportunities, advertising exposure, and demographic differences such as age or ethnicity. Whatever the reasons for the variation, one must be careful in applying specific and appropriate taxable sales to income ratios to make accurate taxable sales estimates resulting from changes in personal income.

(Information derived from: California Department of Finance, website: [www.dof.ca.gov](http://www.dof.ca.gov); Board of Equalization, *Taxable Sales in California*, website: [www.boe.ca.gov](http://www.boe.ca.gov).)



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