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❖ U.S. Economic Developments

Slowing Real GDP Growth

Real Gross Domestic Product increased 3.7 percent in the third quarter, higher than the second quarter gain of 3.3 percent. Both quarters are down from late 2003 and early 2004, when GDP was increasing at annual rates averaging well over 4 percent. Many economic forecasters expect moderately strong growth to continue. An August 2004 Federal Reserve Bank of Philadelphia survey of 30 professional forecasters calls for real GDP to increase 4.3 percent for the calendar year, largely based on the strength of early 2004 growth. The same forecasters predict real GDP growth of 3.7 percent in 2005.

Rising Energy Costs Having Modest Inflation Impacts

Despite rapidly rising energy prices earlier in the year, overall price increases have been modest so far in 2004. U.S. consumer prices have increased 2.5 percent from September 2003 to September 2004, slightly more than the 2.3 percent annual average increase for 2003.

Unemployment Rate Declining Slowly

The U.S. unemployment rate averaged 5.4 percent for the third quarter. The rate has declined since June after staying a stable 5.6 percent for most of the first half of the year. The U.S. unemployment rate for the third quarter of 2004 is well below the 6.1 percent rate recorded for the third quarter of 2003.

❖ California Economic Developments

Payroll Jobs Growth Flat in Third Quarter

California nonagricultural payroll employment was essentially unchanged from the second to third quarter of 2004. This followed monthly increases averaging about 0.1 percent during the first half of the year. Despite the recent slowdown in job creation, many forecasters expect employment growth in California to continue this year and next. The October *Western Blue Chip Consensus* forecast—an average of eight economic forecasts—calls for California nonagricultural employment to increase 1.0 percent in 2004 and 1.9 percent in 2005.

Unemployment Rate Falling

The California unemployment rate averaged 6.0 percent in the third quarter, the lowest quarterly average since 2001. The third quarter 2004 rate is down from the second quarter rate of 6.3 percent. It is well below the third quarter 2003 average of 6.8 percent.

Strong Taxable Sales Increase in First Half of 2004

Based on preliminary data, the Board of Equalization estimates an increase of 6.0 percent in California taxable sales for the second quarter of 2004 compared to the same quarter of 2003. This is very close to the 6.1 percent growth rate for the first quarter. Taken together, the first two quarters of the year indicate the strongest

(California continued on page 4)

In-Depth Perspective: Taxable Sales

A Long-Term Historical Perspective on U.S. Consumption

California's sales and use tax system came into existence during the 1930s, more than 70 years ago. Consumer spending patterns have changed substantially in those intervening years. Understanding those changes can help us better analyze their long-term revenue implications.

Changes in Consumer Spending

The U.S. Bureau of Economic Analysis data on personal spending ("personal consumption expenditures") goes back to 1930. Personal spending is made up of amounts individuals spend on items for their own use.

The table below compares the composition of 1930 personal spending for major consumption categories with 2003 spending

in the same categories. The bar chart on the next page shows changes in those spending categories by percentage of change, ranked from the largest decreases to the greatest increases.

More Spending on Durable Goods

Percentages of total personal spending in some categories have changed little over the past 70 years, while others have changed radically. Durable goods (items designed to last at least three years) accounted for 10.3 percent of U.S. consumer spending in 1930. In 2003, the proportion spent on durable goods had increased slightly, to 12.2 percent.

At the same time, spending on nondurable goods decreased sharply. About 48.5 percent of total personal spending went

Composition of Personal Spending in 1930 and 2003

Percent of Total Personal Consumption Spending, by Category

<i>Category</i>	<i>1930</i>	<i>2003</i>	<i>Percent Change</i>
<i>Durable goods</i>	<i>10.3</i>	<i>12.2</i>	<i>1.9</i>
Motor vehicles and parts	3.1	5.7	2.6
Furniture and household equipment	5.4	4.2	-1.2
Other durable goods	1.6	2.4	0.8
<i>Nondurable goods</i>	<i>48.5</i>	<i>28.3</i>	<i>-20.2</i>
Food ^{1/}	25.7	13.7	-12.0
Clothing and shoes	11.4	4.0	-7.4
Gasoline and other energy goods	4.7	2.7	-2.0
Other nondurable goods	6.7	8.0	1.3
<i>Services</i>	<i>41.4</i>	<i>59.4</i>	<i>18.0</i>
Housing	16.0	15.3	-0.7
Household operation	5.6	5.6	0.0
Transportation	3.1	3.8	0.7
Medical care	3.4	16.8	13.4
Recreation	2.4	4.1	1.7
Other services	10.8	13.9	3.1

^{1/} Includes alcoholic beverages.

In-Depth Perspective: Taxable Sales

toward purchasing nondurable goods in 1930. In 2003, U.S. consumers' personal spending for nondurable goods was only 28.3 percent, a drop of 20.2 percent.

Less Spending on Food

The most precipitous drop in nondurable goods spending was for food and alcoholic beverages. In 1930, 25.7 percent of total personal spending went for food. By 2003, expenses in that category had dropped by nearly half as a percentage of personal spending, to only 13.7 percent.

This is significant for sales tax purposes because sales of groceries and food to go generally are not taxable. While restaurant meals are taxable, data indicate that the proportion of personal spending for restaurant meals has changed little since 1930. According to the Bureau of Economic Analysis, the percentage of personal

spending on restaurant meals decreased by only 1 percent from 1959 to 2003, from about 6 percent to 5 percent.

Declines in Clothing and Gasoline Sales

Relative spending has decreased dramatically in some taxable spending categories since 1930. The percentage of total personal spending on clothing and shoes fell from 11.4 percent of spending in 1930 to 4.0 percent in 2003. The percentage of personal spending on gasoline and other energy products declined from 4.7 percent in 1930 to 2.7 percent in 2003.

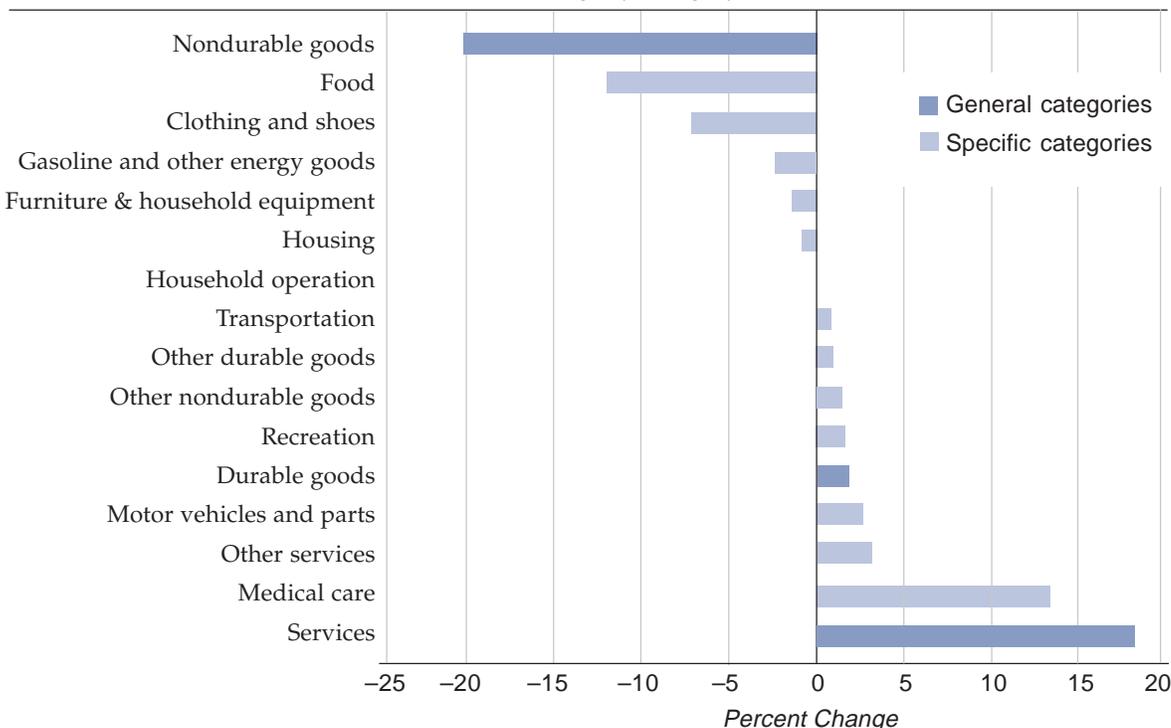
More Spending on Services

Perhaps the most striking change since 1930 reflects the much-discussed transformation of the U.S. economy into a more service-oriented economy. The services share of total personal spending rose from

(*Long-Term* continued on page 4)

Change in Composition of Personal Spending, 1930 to 2003

Percent Change by Category



(*California* continued from page 1)

taxable sales growth since 2000. In comparison, preliminary data indicate that taxable sales increased by only 3.0 percent for all of 2003. The first and second quarter 2004 growth rates are also above the 5.3 percent long-term taxable sales annual growth average from 1994 through 2003.

Record Home Sales Rate Moderating

August 2004 resales of existing homes declined 8.5 percent compared to August 2003, dropping to an annual average rate of 591,150 units. Despite a decrease from July, August resales were only about 2 percent below the record annual level of 601,770 homes resold in 2003. In addition, home sales in 2004 remain on pace to set a new record. For the first eight months of the year, home sales ran 5.2 percent above 2003 sales. The August 2004 median single-family California home price of \$474,370 was 17 percent higher than the median price in August 2003.

(*Long-Term* continued from page 3)

41.4 percent in 1930 to 59.4 percent in 2003. Much of the increase has come in medical services spending, which has surged from 3.4 percent of personal spending in 1930 to 16.8 percent of personal spending in 2003.

Erosion of Sales Tax Base

From a California sales and use tax perspective, the changes in personal spending patterns initially indicate erosion of the tax base from 1930 to 2003. Consumers are spending relatively more on non-taxable services now than in the past. However, reduced spending on nontaxable food has offset much of the tax effect of this shift in spending patterns. If the shift had been accompanied by reduced spending on taxable goods instead of nontaxable food, the effect on sales tax revenue would have been much more significant.

Online Resources

For more information about topics covered in this issue, please visit any of the websites listed below.

Some sites charge a fee to use their services.

National Association for Business Economics

www.nabe.com

The UCLA Anderson Forecast

September 2004 Forecast

www.anderson.ucla.edu/research/forecast/

Federal Reserve Bank of Philadelphia

Survey of Professional Forecasters,
August 20, 2004

www.phil.frb.org/econ/spff/index.html

U.S. Department of Commerce, STAT-USA

www.stat-usa.gov

U.S. Bureau of Economic Analysis

Survey of Current Business

www.bea.doc.gov/bea/pubs.htm

California Department of Finance

www.dof.ca.gov

California Employment Development Department (EDD)

Labor Market Conditions in California,
October 18, 2004

www.calmis.cahwnet.gov

California State Board of Equalization

October 18, 2004, News Release

Taxable Sales in California—

Second Quarter, 2004

www.boe.ca.gov/news/newscont04.htm

California Association of Realtors

www.car.org

Contact Us

Please contact us if you would like to be added to our mailing list, need additional copies, or have any questions or comments.

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www.boe.ca.gov/news/epcont.htm.

Taxpayers' Rights Advocate: 888-324-2798