



STATE BOARD OF EQUALIZATION

# ECONOMIC PERSPECTIVE

*Summary of Recent Economic Developments*

*August 2002*

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## ❖ *U.S. Economic Developments*

### Revised Estimates Show Weaker 2001 Real GDP Growth

In late July the U.S. Department of Commerce released its annual revisions of real gross domestic product (GDP) and related income and spending components. The revisions include more complete data and go back three years. The revised estimates show that the economy was much weaker in 2001 than previously thought. Real GDP increased only 0.3 percent in 2001, and it declined in the first three quarters of the calendar year. The previous estimates showed real annual GDP increasing 1.2 percent in 2001, with a decline in only one quarter. Real GDP increased 5.0 percent in the first quarter of 2002 (largely caused by an inventory buildup), but the growth rate dropped to a preliminary estimate of only 1.1 percent for the second quarter. The data revisions did not affect overall economic growth for 1999, but real GDP growth in 2000 was revised slightly downward (from an original estimate of 4.1 percent to a revised estimate of 3.8 percent).

### Has the Recession Come to an End?

Following the declines in the first three quarters of 2001, real GDP has been increasing for the past three consecutive quarters (the fourth quarter of 2001 and

the first two quarters of 2002). Despite the small magnitude of the second quarter 2002 increase, it appears likely that the recession has ended and a recovery has begun. The most recent press release from the National Bureau of Economic Research (NBER) Business-Cycle Dating Committee notes that small increases in nonagricultural employment and strength in other economic statistics "... indicate that the decline in activity that began last year may have come to an end." The NBER press release explains that they are likely to wait several months after an apparent trough to make its decision because of data revisions and the possibility that the contraction would resume. (This press release was issued prior to the July Department of Commerce GDP data revisions.)

### Jobless Recovery?

So far, this appears to be a "jobless" recovery, similar to the 1991-1992 recovery period. While the early 1990s recession ended in March 1991, nonagricultural employment stagnated for about a year afterward. It was not until May 1992 that U.S. nonagricultural employment surpassed the level recorded for March 1991. During the current recovery, the Bureau of Labor Statistics's employment surveys indicate little jobs growth since February 2002. From March through July 2002, nonagricultural employment increased an average of just 18,000 jobs per month. With 130.8 million people employed in July, these data show that nonagricultural employment was essentially unchanged on a percentage basis, growth of 0.01 percent per month.

While this is miniscule growth, it is a much better performance than the previous 12 months. From March 2001 through February 2002, nonagricultural employment declined an average of approximately 0.1 percent (160,000 jobs) per month.

With people continuing to come into the labor force, the U.S. unemployment rate increased from an average of 5.6 percent for the first quarter of 2002 to 5.9 percent in the second quarter. These rates are much higher than the 4.0 percent average unemployment rate for 2000, before the recession started.

### **Continued Economic Growth Forecast**

Many coincident and leading monthly economic indicators, (such as the purchasing managers' index, industrial production, productivity, housing starts, and consumer spending) suggest continued economic growth for the rest of 2002 and into 2003. The June 2002 UCLA forecast predicts that real GDP will increase 2.6 percent in 2002 and 2.9 percent in 2003. Many other economists are forecasting similar or faster growth rates. The average forecasts of a panel of 30 economists from the National Association for Business Economists (NABE), released in May, predict real GDP to increase 2.8 percent in 2002 and 3.7 percent in 2003. Another survey of 37 economists by the Philadelphia Federal Reserve Bank, also taken in May, calls for real GDP to increase 2.7 percent in 2002 and 3.4 percent in 2003.

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(Information derived from: U.S. Department of Commerce, STAT-USA website: <http://www.stat-usa.gov>; National Bureau of Economic Research (NBER), website: [www.nber.org](http://www.nber.org); *NABE Outlook*, May 13, 2002, National Association for Business Economists, website: [www.nabe.com](http://www.nabe.com); "Survey of Professional Forecasters," Federal Reserve Bank of Philadelphia, May 21, 2002, website: <http://www.phil.frb.org/redirect.html>; *The UCLA Anderson Forecast*, June 2002, website: <http://www.anderson.ucla.edu/research/forecast>.)

## **❖ California Economic Developments**

### **Little Growth in Jobs so Far in 2002**

Similar to the U.S., there has been no growth in jobs in California during the first half of 2002. From January through June 2002, there has been no net increase in California nonagricultural employment. The California unemployment rate has likewise remained reasonably flat so far in 2002. From January through June, the unemployment rate averaged 6.4 percent. Over the same time period, the U.S. unemployment rate averaged 5.8 percent, so the California unemployment rate was about 0.6 percent above the U.S. unemployment rate. This is slightly higher than the average gap between the state and national unemployment rates for 2001, which was 0.5 percent.

### **UCLA Predicts Sluggish California Employment Turnaround**

The June UCLA forecast shows moderate increases in California nonagricultural employment in the second half of 2002 and into 2003. On an annualized basis, UCLA expects employment increases of nearly 2 percent per quarter for the last half of 2002 and the first half of 2003. On an annual basis, UCLA predicts nonagricultural employment to rise 0.2 percent in 2002 and 2.0 percent in 2003. These growth rates are both much lower than the average annual growth in nonagricultural employment of 3.1 percent from 1996 through 2000. UCLA predicts the California unemployment rate to average 6.4 percent in 2002 and 6.3 percent in 2003, little changed from those of recent months.

## Continuing Declines in Taxable Sales

As a consequence of the state's recession, taxable sales have declined sharply in recent quarters. Board of Equalization staff estimate that first quarter 2002 taxable sales decreased 4.5 percent compared to those of the first quarter of 2001. This fall in sales follows reductions in both the third and fourth quarters of 2001 (2.9 percent decline in the third quarter and 5.1 percent decline in the fourth quarter). For 2001 as a whole, preliminary data show that taxable sales were 0.8 percent below those of 2000, the largest decline since 1991. To put the weakness of these figures in perspective, for the five-year period 1996 through 2000, taxable sales rose an average of 8.0 percent per year.

(Information derived from: California Department of Finance, website: <http://www.dof.ca.gov>; California Employment Development Department (EDD), *Labor Market Conditions in California*, August 9, 2002, EDD Labor Market Information website: <http://www.calmis.cahwnet.gov>; *The UCLA Anderson Forecast*, June 2002, website: <http://www.anderson.ucla.edu/research/forecast/>; Board of Equalization, News Release #16, March 27, 2002, *Taxable Sales in California*, website: <http://www.boe.ca.gov>.)

## ❖ Prison Impacts on Small Host Cities

Government analysts are frequently called upon to estimate the future expected economic impacts of proposals to construct large public works projects such as schools, water projects, roads, and prisons. However, it is rare for analysts to look back in history to retrospectively determine what the economic impacts of existing facilities were after their construction. Last year the Board of Equalization was directed to examine such impacts on taxable sales. Sixteen new prisons were constructed in "small host cities" (population less than 50,000) in California since 1987. Legislation signed last year required the Board to "...prepare a report on the local sales tax revenues allocated to small host California prison cities in comparison to that of larger urban cities within a 100-mile

radius." The study was to include taxable sales and related economic and demographic data preceding, during and after prison construction. The prison impacts study was completed in April 2002, and it can be found on the Board's web site. Highlights of the report are summarized here.

To fulfill this study directive, real annual per capita (excluding inmate populations) taxable sales for host cities were tabulated from 1970 to 2000. The California Department of Corrections (CDC) provided data (by zip code) on where staff lived in 2001. This demographic information is extremely relevant, since people tend to shop near where they live.

Some of the findings from this data were rather surprising. One, somewhat unexpected finding, is that overwhelming majorities of CDC staff commute, many with distances of over an hour each way. Only 6 to 32 percent of CDC staff of facilities in small host cities located less than 100 miles from larger urban cities live in the small host cities. The rest commute from other places, many from the closest large metropolitan area. For example, the CDC data show that 44 percent of the staff members of the North Kern State Prison located in Delano live in Bakersfield, while 16 percent of staff live in Delano. The prison is approximately 30 miles from Bakersfield.

Another somewhat unexpected finding is that real taxable sales trends before and after facility construction and startup generally show no obvious consistent increases in these small host cities. The prisons employ large numbers of staff (generally around 1,000 employees) and pay them wages and salaries (including overtime) that are typically twice as great as county averages per employee. One would think that such an employer appearing in cities with populations ranging from 7,000 to 36,000 people would have a large and obvious impact on per capita taxable sales. While this is the case in some cities, it is not so for others. The results of a quantitative analysis of average annual changes in real taxable

sales (five years before and after facility construction and startup) are inconclusive. Four of the eight host cities less than 100 miles from larger urban cities showed increases in average annual taxable sales after construction and startup, while four showed decreases. The fact that many staff members do not live in these cities no doubt contributed to lower than expected taxable sales. Of course there are likely many unknown external factors causing changes in taxable sales in these cities that we were unable to determine. Examples of such factors include the opening or closing of major retailers or other large employers in these cities or in nearby localities.

The study also included analyses of taxable sales impacts for prisons more than 100 miles from urban areas. Here the findings are more consistent with expectations. Quantitative analyses of real per capita taxable sales (five years before and after facility construction and startup) indicate that four out of five of these host cities had increases in average annual

taxable sales in the five years after facility construction and startup. Compared to prisons located within 100 miles of urban areas, greater percentages of staff also generally lived in these cities.

There were a couple other findings of note. Lists of the top 25 taxpayers for the small host cities show that CDC facilities are often among them. These taxable sales are typically from prison commissaries that sell meals and other taxable items to staff, visitors, and inmates. The last finding observed is that an analysis of CDC expenditure categories by facility suggests that less than five percent of the operating budgets of the facilities are used to purchase taxable items.

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(Information derived from: Board of Equalization, *Prison Impact Study: Supplemental Report of the 2001 Budget Act for Fiscal Year 2001-02*, website: <http://www.boe.ca.gov>.)

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