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KERN ECONOMIC JOURNAL

Volume 7 Issue 2
2005 Second Quarter



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Cool Website: economagic.com

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KERN ECONOMIC JOURNAL is a quarterly publication of California State University, Bakersfield. Its purpose is to track local trends and analyze regional, national, and global issues that affect the economic well-being of Kern County. The journal provides useful information and data that can help the community make informed economic decisions.

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Editorial and analytical articles on important local, regional, national, and international issues and trends are invited for *consideration* of publication in the journal. Articles (not exceeding 800 words in length) must be submitted to the Managing Editor in hard or electronic copy. Individual authors are responsible for the views and research results.

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LETTER FROM THE PUBLISHER

We appreciate the support of Comerica Bank as a journal sponsor and Valley Public Radio as an advertiser. We would also like to recognize contributions of two departing members of the Board of Editors, Jeffrey Johnson and Randy Bye who have provided valuable advisement for the betterment of the journal. In the meantime, we welcome new Board members, Michael Stepanovich of the CSUB and Michael Olague of Rabobank.



Kern County's economic highlights of the second quarter 2005 are twofold: (1) the rate of unemployment remained in single digits and the median housing price reached a record high. Our assessment of local economic conditions is summarized as follows:

Kern's economy has improved in the second quarter of 2005. The survey data we have collected show moderate increases in the Business Outlook Index and Consumer Sentiment Index, indicating that both businesses and households (1) remained optimistic about local economic conditions and (2) their degree of optimism has improved since the previous quarter.

The economy added \$100 million of personal income and expanded at an annual rate of 2.8 percent. Labor productivity inclined \$895 and manufacturing workers earned an additional \$16 per week. The labor force and total employment expanded and the number of unemployed workers declined. As a result, the rate of unemployment declined to 8.4 percent. Bakersfield, California City, China Lake, Edwards, Frazier Park, Inyokern, Kernville, Lebec, North Edwards, Ridgecrest, Rosamond, and Taft recorded unemployment rates below the county average. While farm employment declined sharply, nonfarm and informal employment increased. The private sector added jobs, whereas the public sector reduced employment.

The county's median housing price appreciated 14.8 percent in one quarter to reach \$224,100. Housing prices appreciated in Bakersfield, California City, Delano, Ridgecrest, Rosamond, Taft, and Tehachapi. The construction and real estate boom continued with low mortgage interest rates and a greater number of new building permits issued.

Prices of consumer and producer goods and services continued to rise at faster rates. In particular, oil and gasoline prices soared substantially. Output prices received by farmers fell short of the input prices that they had to pay, which widened the price gap in agriculture.

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THE CEO PROFILE!



Introduction

Eugene J. (Gene) Voiland is President and CEO of Aera Energy LLC, one of California's largest producers of oil and gas. He has held that position since June 1997 when Aera was formed following the merger of the California exploration and production (E&P) operations of Shell and Mobil. Today, Aera is jointly owned by Shell and ExxonMobil.

Previously, Voiland worked for Shell Oil Company, most recently as President and CEO of CalResources LLC, a California Shell affiliate. During his 28-year Shell career, Voiland held a series of E&P engineering and management assignments in California, the Gulf Coast, and Texas, including several head office senior management positions in Houston.

Active in civic affairs, Voiland is the 2005 Chair of the California Chamber of Commerce and a director of the R. M. Pyles Boys Camp, the Cal State Bakersfield Foundation, and the United Way of Kern County. In addition, Voiland is Past Chairman of the Board of Directors of the Western States Petroleum Association.

Voiland received a Bachelor of Science degree in Chemical Engineering from Washington State University (WSU) in 1969. He was named a Distinguished Chemical Engineering Alumnus in 1991 and serves on the Advisory Board of the University's College of Engineering and Architecture. He is also a member of the Investment Committee of the WSU Foundation and is a past member of the WSU Board of Trustees.

Interview

How does the oil industry contribute to the economy of Kern County?

Kern County is fortunate and somewhat unique in having a large concentration of oil and natural gas reserves. If Kern County were a state, it would be the fourth largest oil-producing state in the U.S. Indeed, Kern County produces more oil than the state of Oklahoma. This bounty translates into approximately 10,000 people working in the industry in the San Joaquin Valley. Five of the top 21 Kern County employers are typically in oil-related businesses and the jobs they create pay among the highest wages. The county further benefits from property taxes collected from the industry. For the 2004-05 fiscal year, the top four taxpayers in Kern County were oil companies, which together contributed \$114 million or 21% of the property taxes paid.

How does Aera Energy contribute to the economy and community of Kern County?

Aera is one of the largest exploration and production companies in California. Here in Kern County the company employs approximately 900 people and hundreds of contractor companies. We spend around \$1 billion per year in new capital and expenses in our operations in Kern County. In the 2005-06 fiscal year, we will pay \$44 million in property taxes.

But as importantly, Aera people – as employees and as individuals -- actively participate and volunteer in many community organizations. The company also provides financial and in-kind support to over 100 community organizations. We have a deep interest and commitment to education. In a unique partnership, we have joined with the Greenfield and Rosedale school districts and other business partners to create and

(Continued on page 4)

implement a cost-effective academic-based preschool program, which successfully prepares children to be “Ready to Start” kindergarten. We are committed to using our resources and our people’s talents to make a real difference in our community.

What about oil prices and the outlook?

This is a simple but yet a very complex question. Crude oil prices are fundamentally driven by demand for oil-related products and the reality and/or perception of reality of the available supply. Demand, which is currently high due to the overall strength of the world economy, is made even higher by the increasing demand in India and China. Other factors also push oil prices up or down, but now seem to be all pushing prices upward. These include a shortage of excess capacity in both crude oil production and petroleum refining compared to historical norms; political instability in many of the world’s largest oil-producing regions; and finally, a weak dollar. (World oil is traded in U.S. dollars). All of these factors combined with volatile, reactive financial commodity markets are creating real upward price pressure at this time. No one knows what will occur in the future. Historically these factors have been self-correcting over time. High prices reduce demand while spurring more investment in production and refining capacity, which tends to bring supply/demand more in balance and moderate prices.

The fact is, though, no one really knows what will happen and when. In my view, the historical drivers have not changed and will ultimately prevail.

What should Kern County do to accommodate its economic and demographic growth?

I believe the county and city need to be realistic regarding the population growth that will occur and not underestimate its impact. The county and city need to plan how to accommodate this growth and then execute those plans. The two areas that I view most critical to do this from a public standpoint are education and transportation. High quality schools that produce well-educated, capable students are the foundation for improving the quality of life in our community. Even though the state sets many standards and regulations, in the end it is the responsibility of local school districts, educators and parents to deliver a quality education.

Transportation is an obvious need. The lack of an east/west freeway across town will just create more and more problems and lost productivity if not addressed now. The hard choices need to be made.

What should the state do to assist Kern County to continue to grow and develop?

Philosophically, I believe the state should largely stay out of the way of local government regarding the economy. The state has a legitimate role of developing and enforcing environmental standards that provide a healthful environment for all of us. The state should also be working to ensure a business climate that can support jobs for those of our 36-million-person population who need to work, want to work, and rely on a job. Unfortunately, many bills that continue to move through the legislature make it more expensive and more onerous to do business in the state. In the long run this drives high paying jobs out of the state and results in an economically stratified society of rich and poor. That is not sustainable for the long term.

KERN COUNTY BUSINESS OUTLOOK SURVEY

ABBAS P. GRAMMY

PROFESSOR OF ECONOMICS, CSUB



Kern County's business outlook has improved in the second quarter of 2005. To measure business outlook, we administered telephone surveys to a random sample of 250 local private-sector managers and public-sector administrators. We asked the survey participants two sets of questions, one regarding the assessment of local business conditions in the current quarter and another in the forthcoming quarter. Each set included four questions.

The survey participants represented a wide range of industries including automotive services, business and legal services, construction, education, finance, insurance, real estate, health services, hospitality and personal services, retail trade, and social and cultural services. The survey results are shown in the table below.

Employment Outlook – An overwhelming majority of survey respondents reported that the number of jobs in their companies stayed constant this quarter. They also expected the number of jobs to remain unchanged next quarter.

Financial Outlook – Fifty-eight percent of survey respondents said that financial conditions (sales and profits) of their companies improved this quarter and 44 percent expected improvements to continue next quarter.

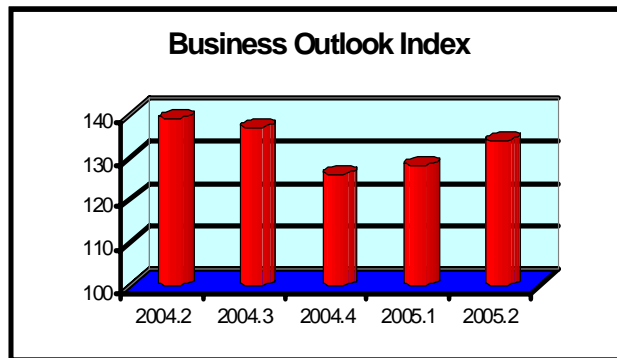
General Business Outlook – The majority of survey respondents perceived that employment and general business conditions of their industries remained the same this quarter and will be unchanged next quarter. More than 40 percent of survey respondents reported improvements in employment and general business conditions of their industries this and next quarter.

County-wide Economic Outlook – Many survey respondents perceived no improvement in local business conditions this and next quarter. However, one-half felt that conditions have improved this quarter and one-quarter said improvements will continue next quarter.

Business Outlook Index - Survey responses were enumerated to construct the Business Outlook Index (BOI).

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Survey Response Rates (%)			
Question	Response		
	Better	Same	Worse
1. Employment in your company this quarter was	21	75	4
2. Employment in your company next quarter will be	19	79	2
3. Financial conditions of your company this quarter was	58	34	8
4. Financial conditions of your company next quarter will be	44	56	0
5. General business conditions in your industry this quarter were	46	48	6
6. General business conditions in your industry next quarter will be	40	60	0
7. General business conditions in Kern County this quarter were	50	48	2
8. General business conditions in Kern County next quarter will be	25	73	2



BAKERSFIELD CONSUMER SENTIMENT SURVEY

MARK EVANS

ASSOCIATE DEAN AND PROFESSOR OF ECONOMICS, SCHOOL OF BUSINESS AND PUBLIC ADMINISTRATION, CSUB



The Bakersfield Index of Consumer Sentiment reached a value of 148 in the second quarter of 2005, attaining an all-time high for the third consecutive quarter. This is a slight increase from the first quarter when the index reached 146 and a large jump from the second quarter of last year when the index attained 119.

We compile the Bakersfield Consumer Sentiment Survey from telephone surveys administered to a random sample of households listed in the phone book. The index is designed to help local business leaders determine whether changes in their sales reflect movements in the overall economy or shifts in their relative competitiveness. Measuring the consumer sentiment index is important because it provides the economic data that would be needed to make this sort of determination is not available on a timely basis at the local level.

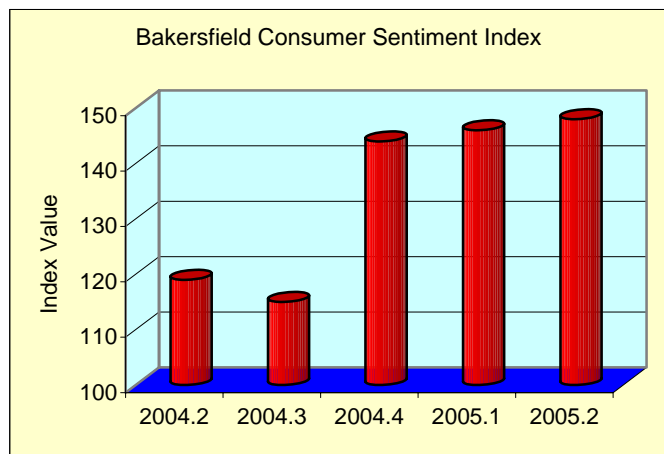
The index is disaggregated into sub-indexes relating to recent trends and future expectations. The sub-index measuring recent trends is constructed from responses to questions relating to expenditures on discretionary items, financial status of the household compared to one year ago, and perceived changes in the financial condition of acquaintances in Kern County. This sub-index attained a value of 147 in the second quarter, a strong increase over the value of 124 attained in the previous quarter. This is the highest value the sub-index measuring current economic well-being has achieved since measurements began in 1999. A greater percentage of households reported spending more than usual on discretionary items. More

households reported they were doing better financially compared to one year ago – a miniscule five percent reported they were worse off financially compared to 23 percent in the previous quarter.

To assess future expectations, households are asked how they think the financial situation of their families will change over the coming year, how their acquaintances in Kern County view the coming year, and whether this is a safe or risky time to draw down savings or incur debt. This sub-index measuring future expectations fell to 149 from an all-time high of 167 in the first quarter. However, a reading of 149 is very optimistic and is exceeded less than ten percent of the time. The decline in the future expectations index was attributable to two factors: (1) 60 percent thought their financial situation would improve over the coming year compared to 70 percent in the first quarter and (2) only 51 percent thought this was a safe time to draw down savings or incur debt compared to an astronomical 87 percent in the previous quarter.

Summarizing, the Bakersfield Index of Consumer Sentiment has recorded a record-setting high for the third consecutive quarter. The overall increase from the previous quarter was modest (from 146 to 148) and masked a significant difference in the pattern of responses between the two quarters. The sub-index measuring recent economic trends increased significantly from the previous quarter, while the sub-index measuring future optimism showed a near-comparable decrease.

(Continued on page 7)



	Most Recent Quarter	Previous Quarter	One Year Ago
Consumer Sentiment Index	148	146	119
Index of Recent Buying & Financial Trends	147	124	112
Index of Consumer Expectations	149	167	127

Table 2: Recent Buying and Financial Trends			
	More than usual	Same as usual	Less than usual
Your recent spending on discretionary items (dining out, weekend outings, entertainment)	55 %	38 %	7 %
	Better off	Same	Worse off
How your family is doing financially compared to one year ago.	57 %	38 %	5 %
How your acquaintances in Kern County are doing financially compared to one year ago.	48 %	44 %	8 %

Table 3: Future Expectations			
	Better or more stable	About the same	Worse or more risky
The most likely financial situation of your family one year from now	60 %	31 %	9 %
	Optimistic	Neutral	Fearful
How your acquaintances in Kern County view the coming year.	63 %	28 %	9 %
	Safe time to buy	Neutral response	Risky time to buy
Is now a safe or risky time for most people to use savings or incur debt to buy expensive goods?	51 %	40 %	9 %

Business Outlook (Continued from page 5)

In the second quarter of 2005, the BOI rose 6 percentage points from 128 to 134. This index value indicates that (1) business managers remained optimistic about local business conditions and (2) their degree of optimism has improved since the previous quarter. Our historical data show that after a decline in the fourth quarter of 2004, the BOI index has increased over the previous two quarters.

Survey responses were then disaggregated to construct two sub-indexes. The Index of Current Business Conditions increased 15 percentage points to reach 138. However, the Index of Future Business Conditions stayed constant at 132. These increments express that business managers feel more confident in current and future conditions.

Factors Affecting Business Outlook – Survey respondents were also asked to identify local, regional, national, or international factors that have affected employ-

ment and financial conditions of their companies. They felt several factors brightened the local business outlook:

- Increased retail sales due to population growth and improved economy
- The construction boom creating business for its supporting industries
- Greater community support for non-profit organizations

However, the survey respondents expressed the belief that several factors darkened the local business outlook:

- Rising price of gasoline
- Higher insurance premiums for workmen’s compensation
- Population growth pressuring the availability and quality of K-12 education

	This Quarter	Previous Quarter	Change
Index of Business Outlook	134	128	6
Index of Current Business Condition	138	123	15
Index of Future Business Condition	132	132	0

CHALLENGES AND OPPORTUNITIES FACING KERN COUNTY

*CHRIS FRANK*¹
COMMUNITY LEADER



For the last several years I have had the pleasure to work with some great people all working to provide Bakersfield with the “edge” it needs to attract and retain business in our great valley. As I look to the future, I see some challenges and opportunities that once addressed will allow community to realize its potential.

One of the challenges we face is that we don’t always get a chance to talk to businesses considering Kern County as a relocation site. We simply do not get the call and the reason for it is that the site consultants are smarter than ever. The information super-highway has not only worked to complement what goes on in our county, but has also worked against us. Businesses and their site consultants often use online databases to profile the area offering both general and business-specific information. These individuals are very knowledgeable. They know the cost of doing business in the area, from utilities and land cost to construction, regulation, work force, litigation, and specific site requirements. They know because they do their homework and in many cases we have found, over the years, that when company representatives call us often they have more knowledge on the specifics than we do. This is not to say that we do not make our best attempt to give them the information, but they are very knowledgeable about our community. This was not the case even ten years ago. We had an opportunity that if we could get them on the phone, given our enthusiasm for our community, we could persuade them to come here and that’s simply not the case anymore.

The next challenge we face is that decisions are made faster than ever. Companies today are looking for existing buildings and they want to set up fast. This is a challenge because we might not always have the infrastructure available to meet their needs. For example, a company that recently located in Bakersfield wanted the opportunity to open multiple sites all at once, so that they could leverage the cost of their advertising over several stores. In the past, we had time to “wine and dine” them and could look at a six-month or eight-month build out on projects. But, now they want a turn-around time in ninety days.

Another challenge we face is the California budgetary crisis and its effect on Kern County. This is a real concern for companies looking to come to California and Kern County. Our ability to build and maintain our infrastructure on the existing dollars is limited, so we must look into new sources of funds. Site consultants not only look at what is going on in a county, but they’ll dive into the county budgets and city budgets.

A critical challenge we face is work force preparation. Many local workers lack the necessary skills to perform production and services jobs. Only 23 percent of our 16 year olds do not graduate from high school and about 6 percent of our high school graduates attend college. This problem will certainly remain a challenge for us and something we must overcome.

We also need better coordination of our local governments. Site consultants and company representatives know what happens in a community that they are evaluating. They know how municipalities work together and they target for rejection those communities that do not. Having governments that work with the private sector and with each other is important in local economic development.

Our eroding infrastructure is also a very important concern. In my career at the Chamber of Commerce, transportation was often the number one issue that would come up with companies inquiring into our community. I think today that is probably the same case. It is very important that we are able to have strategies that demonstrate that we can fully accommodate the companies relocating to our community. We must look at all aspects of our infrastructure including water and electricity. Of course, air quality is a major challenge for our community. We are showing a lot of efforts in improving air quality, especially in the area of stationary sources. The county governments and residents must develop a comprehensive plan to improve air quality; otherwise we will continue to lose in economic development, as well as dollars we spend on pollution-related health care.

(Continued on page 9)

¹Former president of the Greater Bakersfield Chamber of Commerce. This is an abbreviated version of a speech given in the Kern County Economic Summit, March 30, 2005.

While we face serious challenges, I think there are also many opportunities. I believe great progress has been made in Kern County. Thanks to the efforts of various areas of Kern County, our image is better than it has ever been. Vision 2020 in Bakersfield, the Mojave airport and the space program, Ridgecrest and China Lake on technology, the cost of owning a home and having a good quality of life at an affordable price, are all examples. I think, again, we have made tremendous progress.

As a result, we are finding it is easier to recruit employees here because they are finding that we have an affordable community with a high quality of life. People are coming here who never took a look at us before. Today, employers and employees coming here do not have to start at Kern County 101. But, this certainly was the case ten years ago when I was at the Chamber of Commerce. We were more involved in economic development than we are today. Back then, company representatives would call us as they did not have a clue about Kern County, but they thought they had better check into it.

There is also less uneasiness about the California market and some appreciation that California is attempting to address some of its issues. I think we owe a lot to the Governor who has sent the message that Kern County and the State of California are working very hard to improve their fiscal conditions. He is been a great cheerleader for our state and quite frankly, under the last two years of the former Governor, it was a really hard state to sell. We only looked at the companies within California

which had to be part of the California market because it was hard to look outside California. Today, we're finding that they are much more comfortable, that California is addressing their issues.

In conclusion, my opinion is that we need to work very hard to adopt a regional mindset. And I will be the first one to tell you that a regional mindset was not something that I came to very easily. I do not like the word regional, so it was a hard thing for me to accept. But, quite frankly, it is very important that we develop a regional mindset. We are off the list of companies if we do not do this and if we do not act on it. It is not enough to just say it. We have to actually act the part. We have to keep in mind that they are watching and that we are being judged, either favorably or unfavorably, on how we adapt to a regional approach to identifying and resolving issues.

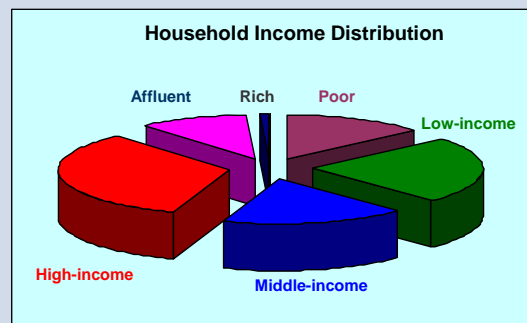
We must send the message that, as Kern County, we are one. So goes Mojave, so goes Ridgecrest, Inyokern, Lake Isabella, Frazier Park, Kern Valley, Delano, Shafter, Bakersfield, Lamont, and Arvin, so goes us all. We should celebrate when any business comes to Kern County. I think the future is very bright. I absolutely believe that we must reinforce a county-wide thinking. We must focus on clusters and their impacts. We must reward collaboration and innovation, which will enable us to stand here ten years from now and affirm that we have indeed achieved a sustainable and prosperous future. Thank you!

Econ Brief!

Income Distribution in Kern County

In terms of inflation-adjusted 2003 dollars, more than 13 percent of the households living in the county earn less than \$15,000 annually. In contrast, nearly 11 percent of local households make more than \$100,000 per year of whom less than 1 percent earns in excess of \$200,000. The "middle-income" class, earning between \$35,000 and \$50,000, includes 17.4 percent of the households. "Low-income" households earning \$15,000 to \$35,000 per year make up 24.5 percent of the households. In contrast, "high-income" households with annual income between \$50,000 and \$100,000 compose 33.6 percent of all households.

Level of Income	Classification	Households
Less than \$15,000	Poor	13.3%
\$15,000-\$35,000	Low-income	24.5%
\$35,000-\$50,000	Middle-income	17.4%
\$50,000-\$100,000	High-income	33.6%
\$100,000-\$200,000	Affluent	10.3%
\$200,000 or more	Rich	0.9%



FACTORS AFFECTING U.S. ECONOMIC PERFORMANCE

HENRY LOWENSTEIN

DEAN, SCHOOL OF BUSINESS AND PUBLIC ADMINISTRATION, CSUB



A key element in strategic planning is environmental scanning. Understanding critical factors in the business environment helps to set the context for internal and external formulation of plans, strategies, and tactics in achieving your corporate goals. This economic summary, while not exhaustive, is meant to provide you a general feel for and quick overview of key factors driving the overall economy in which your businesses operate. Economic analysis is often complex and technical. In today's world, it rarely has a shelf life beyond a few years. However, our goal here is to distill the often confusing landscape of economic factors into general summary trends operational to your thinking.

In this discussion keep in mind some key themes often impacting the economy.

(1) **Global Markets:** there is no longer any such thing as a purely “domestic market.” The proliferation of global trade stimulated by phenomenal growth and advances in information technology put most industries or suppliers into, and dependent upon, international competition. The U.S. continues to run a major trade deficit paid for with “cheaper” dollars that raise costs of imports and lower prices of exports in the world market.

(2) **Information Technology:** the growth of Internet and E-Business has transformed opportunities for business. They have also put at the fingertips of consumers and businesses immense amounts of information that allow them to shop aggressively, hold down prices, and, for businesses, to increase prices and margins. At the same time, productivity gains have been the primary source of profitability rather than price. The “flattening” of world markets in information access is also democratizing world transactions into a more transparent, if not level, playing field of trade.

(3) **China and India:** the explosive growth on the world stage of the China and India markets is having a substantial impact on the global economy. This is particularly the case in markets for industrial commodities such as oil, steel, cement, and other key resources simultaneously in demand in the growing U.S. market. China and India represent major markets for consumer products and

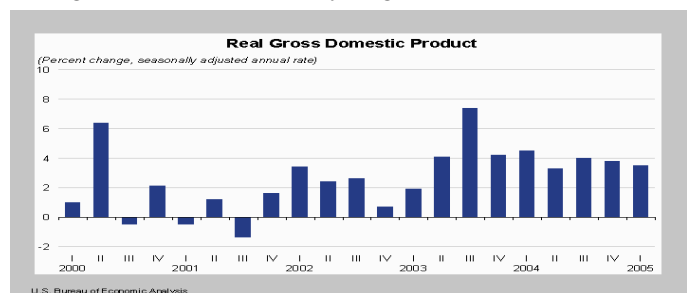
services. In addition, they create an export effect due to their extremely high populations and race to catch up in the world economy.

(4) **Uncertainty:** any view of the economy is based on factors as they currently exist. The unexpected, be it 9/11, a war in the Mideast, a major pipeline/refinery outage, or other exogenous factor, can quickly change the short term landscape of the economy. Information technology has made possible quicker responses by consumers and producers to changes in conditions. Hence, all markets are much more volatile than in the past, impacted by emotion, quick to react to “negative” information, and slow to adjust to “positive” information.

Economic Growth

The U.S. economy suffered a major blow on September 11, 2001. This extraordinary event and the negative impact it had on both business and consumer confidence caused radical short run policy changes to maintain and restart the economy. An easy money policy, record low interest rates, tax cuts, aggressive marketing by businesses, and improved consumer confidence all led to a rapid increase in the economy led by consumer spending. By approximately mid-2004, a long awaited “hand off” occurred from consumer spending to industrial spending and investment by businesses. Most notable was the increased activity in new manufacturing and commercial building. Consumer spending, while moderating somewhat, shows continued strength.

Large federal budget deficit, a weak dollar policy, growing trade deficit, and adverse fiscal policies of states have not to date exerted material downward pressure on GDP growth or the economy in general.



(Continued on page 11)

Since 2004, the GDP has grown at a healthy rate of 3%+. Current GDP is growing at a rate of 3% to 4.5%. This rate is sufficient to create jobs, although at a slow rate, and grow the economy without creating major inflation. While energy prices have caused some softness, growth rates continue at a positive moderate pace. Economists have continued to be embarrassed by unsuccessfully predicting a business slowdown for two years. Every indication is that, absent an unexpected shock to the system, the next 2-4 years will see continued growth in the 3% to 4% range.

Productivity

A hallmark of the U.S. economy is the continued growth in productivity. This is primarily due to continued intense investment in new equipment (stimulated by the need to conserve energy) and information technology. In 1974, U.S. productivity growth fell annually at a -1.5% rate. Today, productivity has been the secret weapon of price stability. Current economic productivity in 2005 is increasing at a +2.6% rate. For the past few years, productivity has averaged in the +2% to 4% range. Interestingly, this is nearly the same rate as inflation, meaning that real inflation (inflation adjusted for productivity) remains near zero.

Inflation

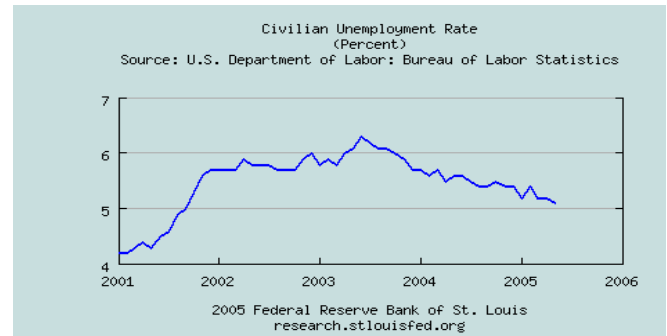
Memories are short of the late 1970s/1980s when poor monetary policy led to a near hyper-inflation rate. For example, in 1974, inflation was running at 12.3% a year. In 2005, inflation is currently running at a rate of 3.1% a year. Given that productivity is at 2.6%, the real general inflation is less than 1% a year. This is not to say spot price increases are not present. Major increases in energy, commodities, some food items, and housing are major concerns. However, these are offset by declines in the cost of computing, automobiles, home furnishings, retail, and a number of other industries due to intense price competition. The expectation is that inflation will remain in the 3% range for the foreseeable future. The Federal Reserve sees no major inflationary pressure or bubble on the horizon, as reflected in its interest rate policy. The Fed remains watchful of inflation and will act quickly at any sign of inflationary acceleration.

Unemployment

Unemployment in the U.S. continues to be at levels near what economists define as full employment (4-5%). Current national unemployment rate runs approximately 5.3%, but the Central Valley's unemployment rate is double that figure. From the GDP growth, most economists expect national job creation of approximately 150,000 jobs a month. We have witnessed that the

month-to-month results can be erratic. For example, one recent month saw a near record 300,000-job growth and was followed by a month of 79,000-job growth. The overall direction is positive and the unemployment rate remains low.

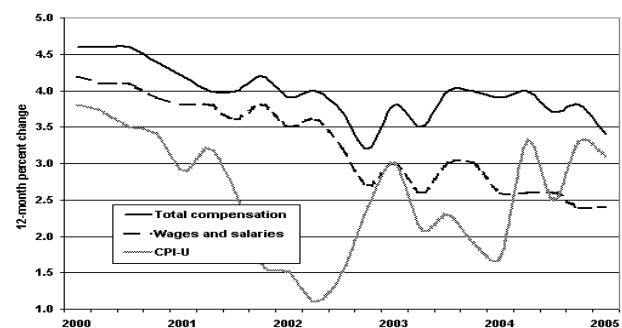
The overall picture hides the fact that many industries are experiencing significant labor shortages due to high demand relative to supply. Skilled construction labor and its sub-specialties are clear examples.



Anecdotal evidence already exists of wage inflation in some markets where these shortages exist. Accountants and financial analysts are in heavy demand due to the impact of the Federal Sarbanes-Oxley Act.

Wages and Benefits

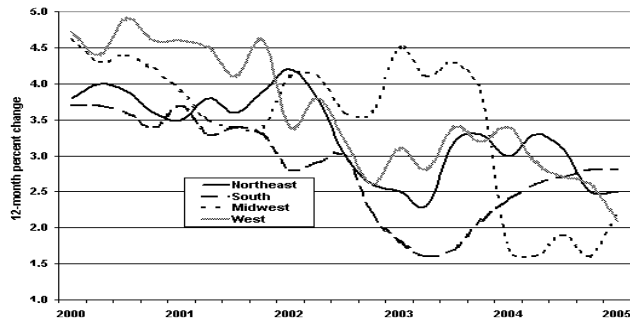
Years of low to no wage increases, together with increased labor demand, will see pressure on business for wage increases averaging 3% to 4% for the next few years. These will track inflation and are considered moderate in the face of high demand. Other than the public sector, union pressure will remain weak as businesses find substitutes in technology, contracting out and outsourcing in key areas for labor costs. Major industries still adapting to industrial change (such as auto industry and airlines) will see large layoffs offset by productivity gains elsewhere.



Source: U.S. Department of Labor-BLS, May 2005

(Continued on page 12)

The medical inflation line is showing slowness for the first time in a decade. Annual medical costs for the past year were under double digits for the first time. Nevertheless, mandates from government will continue to keep upward pressure on medical costs, and these will remain significant. Pension costs will also rise as government overreacts to recent high profile pension defaults.



Source: U.S. Department of Labor-BLS, May 2005

A key uncertainty will be the impact of the ultimate Social Security legislation on business. One disturbing proposal is to lift the cap on wages subject to the tax. This would have a negative impact on employers because employers match the SSI employee contribution. The current wage cap is \$90,000. Eliminating the cap would subject all earnings to the tax and thus the match by business, the largest tax increase in US history.

Workers Compensation rates, a major problem in California, are finally decreasing from the reforms of past two years. The Insurance Commissioner of California has recommended rate reductions for 2005 of -13.8%. State Fund, the largest WC carrier, has announced -14% rate reductions effective with policy renewals July 1. The cumulative recommended rate reduction since reform in 2004 has been -33% to -36% and actual reductions so far have been -22%. While this is welcome, these reductions are from rate levels higher than national averages. Continued reduction will be necessary to bring California into line, competitive with national averages. However, it is clear that a downward trend on rates is present, and this will be of major benefit to labor intensive construction and related firms.

Stock Market

Stocks continue to reflect returns but not to the spectacular level of the 90's. Corporations have reported record earnings, but the market is not reflecting these in stock values (although some have boosted dividends). Stock pricing remains generally flat. The average stock market return over time has been 10% a year. In 2005, the Dow is currently trading -2.2% vs. last year, and the broad-

based S&P 500 is down -0.8%. We see the stock market ultimately finishing the year somewhere near 11,000 (S&P 1,200), a return of from 8%-9%, slightly below the historic averages. With more day trading investors, access from internet, and real time information, the stock market has become more volatile and subject to emotion than ever in its history. Investors are looking into alternatives such as the strong housing and bond market. Nevertheless, equities continue to be strong in the U.S. and will benefit from continued merger and buy-out (M&A) activity in a growing economy.



Interest Rates

Despite multiple Fed increases that have raised the Fed Fund rate from .05% to 3% in two years, the market continues to keep interest rates low. Short-term rates, despite increases, remain at historic lows. The short-term benchmark 90-Day T-Bill yields 2.96%, with like commercial CD's at 2.56%. This is a major stimulus to consumer spending. Teaser rates to consumers continue to be from 0% to 1%. Banks have kept the prime rate tight and not responded directly to Fed increases. Negative real interest (interest rates adjusted for inflation) continues to be present in the short term.

Long-term rates have proven to be most significant. Despite the Fed increases, long-term rates have actually fallen! This is an unusual situation but not unexpected. With a low yield stock market, demand by consumers for high investment returns has turned to housing. Housing, of course (and commercial building), is a function of available mortgage funds, typically from mortgage-backed securities/bonds. The demand for these bonds has been strong, and as demand for bonds goes up, bond prices increase, and yields drop. Demand for "risk free" government bonds is strong and adding to a bidding up of bond prices and yield decreases.

Hence, the benchmark 10-year Treasury bond in two weeks has gone from a yield of 4.2% to 3.89%. This is immediately reflected in a competitive mortgage market where mortgage rates have fallen from an average 6.1%

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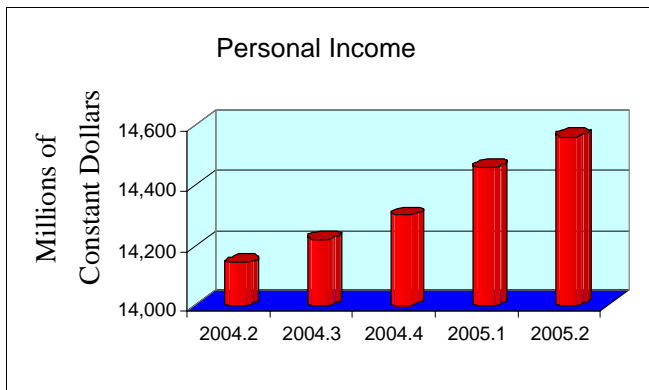
TRACKING KERN'S ECONOMY

ABBAS P. GRAMMY

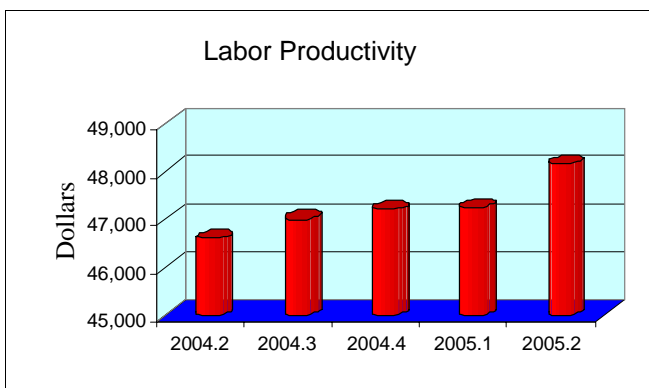
PROFESSOR OF ECONOMICS, CSUB

Economy

Personal Income - Kern County's personal income (in constant 1996 dollars) increased from \$14.46 billion in the first quarter of 2005 to \$14.56 billion in the second quarter of 2005. The county's economy expanded \$100 million or at an annual rate of 2.8 percent. Kern County's economy has added \$420 million of personal income since the second quarter of last year.

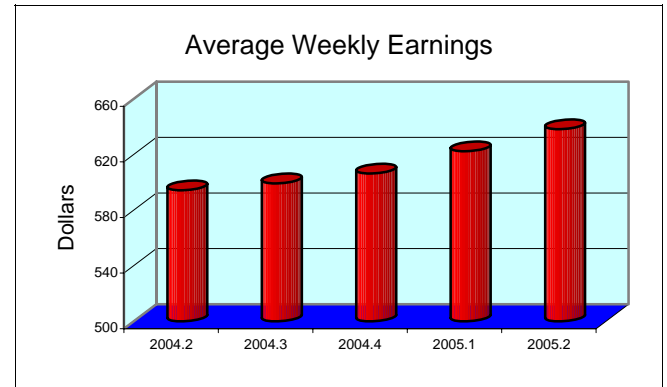


Productivity - Labor productivity is personal income per worker. In constant dollars, labor productivity inclined \$895 (or 1.9 percent) from \$47,255 in the first quarter of 2005 to \$48,150 in the second quarter of 2005. Modest economic growth and slow labor force growth fueled this increase in labor productivity. Since the second quarter of last year, labor productivity has increased \$1,550.



Manufacturing Wages - Weekly wages paid to local manufacturing workers inclined \$15.92 from \$622.30 in the first quarter of 2005 to \$638.22 in the second quarter of 2005. This wage increase was attributed to both the rise in the hours of work and average hourly earnings. Compared

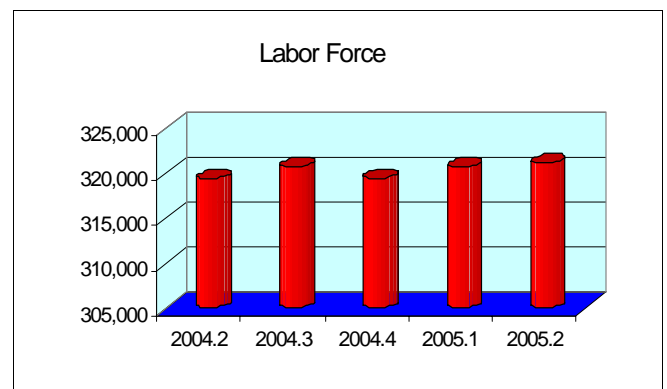
with four quarters ago, local manufacturing workers earned \$43.92 more per week.



Labor Market

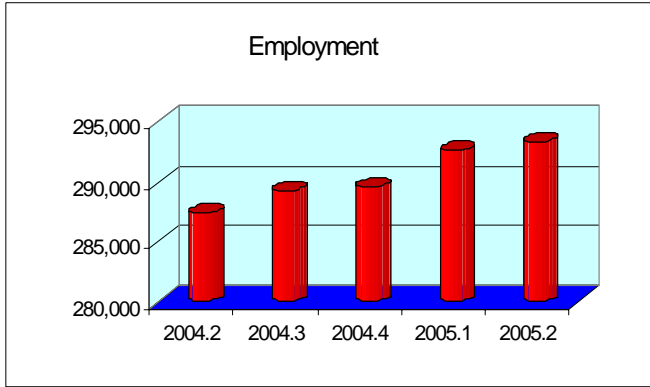
To analyze labor market conditions in Kern County, a time-series dataset was established (January 2000 – most recent month). The monthly employment data were adjusted in three ways: (1) to account for “informal” employment, which is the difference between total employment and industry employment, which accounts for such members of the labor force who are self-employed or work outside their county of residence; (2) to adjust the dataset for the effects of seasonal variations; and (3) to take three-month averages for the analysis of quarterly changes.

Labor Force - The civilian labor force inclined from 320,700 in the first quarter of 2005 to 321,200 in the second quarter of 2005. Over the previous four quarters, the labor force has expanded by 1,800 workers.

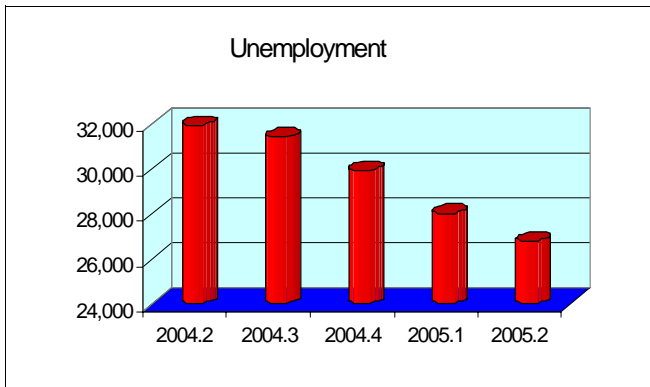


Employment - Total employment increased from 292,620 in the first quarter of 2005 to 293,375 in the second quarter of 2005. The number of employed workers inclined 5,980 since the second quarter of last year.

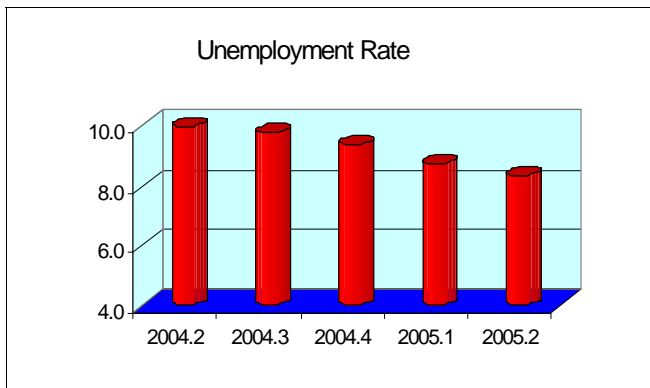
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Unemployment - In the meantime, the number of unemployed workers declined sharply from 28,080 in the first quarter of 2005 to 26,820 in the second quarter 2005. The number of unemployed workers has fallen by 5,180 since the second quarter of 2004.



The rate of unemployment dropped 0.4 percent from a revised figure of 8.8 percent in the first quarter of 2005 to 8.4 percent in the first quarter of 2005. The county's unemployment rate has declined from 10 percent in the second quarter of last year to 8.4 percent in the second quarter of this year.



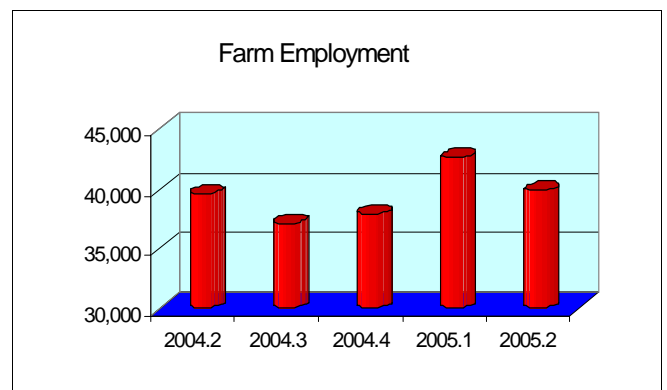
The rate of unemployment varied considerably across the county. It ranged from 3.2 percent in Kernville to 22.2 percent in Arvin. The rate of unemployment was below the county average in Kernville, Lebec, Ridgecrest, Tehachapi, Inyokern, Bakersfield, California City, Rosa-

mond, Edwards, North Edwards, Frazier Park, Taft, and China Lake. In contrast, the rate of unemployment was above the county average in Oildale, Lake Isabella. Buttonwillow, Mojave, Shafter, Lamont, Weedpatch, Wasco, Lost Hills, McFarland, Delano, and Arvin.

Location	Unemployment Rate (%)	Location	Unemployment Rate (%)
Kernville	3.2	Oildale	8.6
Lebec	3.5	Lake Isabella	9.9
Ridgecrest	4.5	Buttonwillow	10.0
Tehachapi	5.4	Mojave	10.2
Inyokern	5.4	Shafter	14.8
Bakersfield	5.7	Lamont	14.9
California City	6.3	Weedpatch	15.3
Rosamond	6.6	Wasco	15.5
Edwards	6.6	Lost Hills	16.1
North Edwards	6.8	McFarland	17.6
Frazier Park	6.9	Delano	22.0
Taft	7.9	Arvin	22.2
China Lake	8.2		

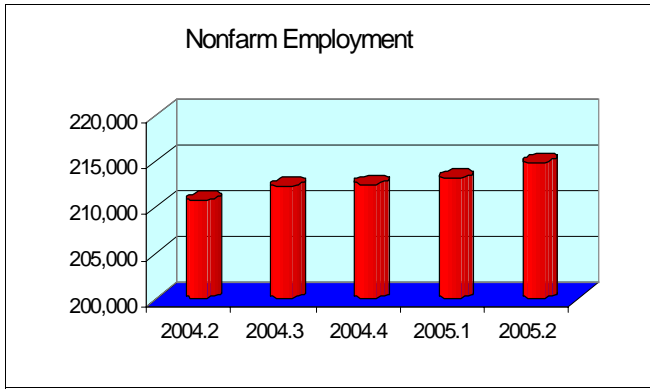
Note: City-level data are not adjusted for seasonality.

Farm Employment - In the second quarter of 2005, farm employment declined sharply from 42,610 to 39,820. However, farm employment this quarter was 225 more than that of four quarters ago.

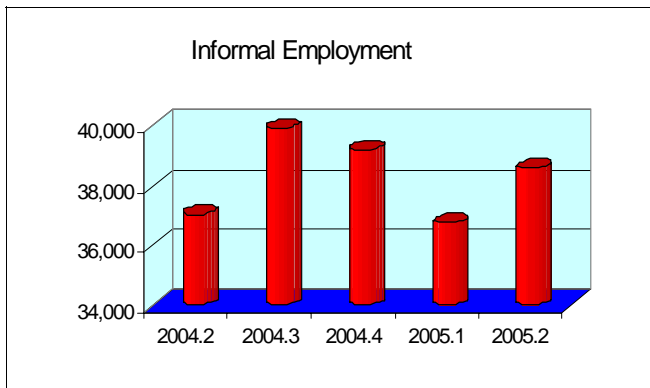


Nonfarm Employment - In the second quarter of 2005, the number of nonfarm workers climbed from 213,260 to 214,960 for a gain of 1,700 jobs. The nonfarm sector has added 4,195 new jobs since the second quarter of last year.

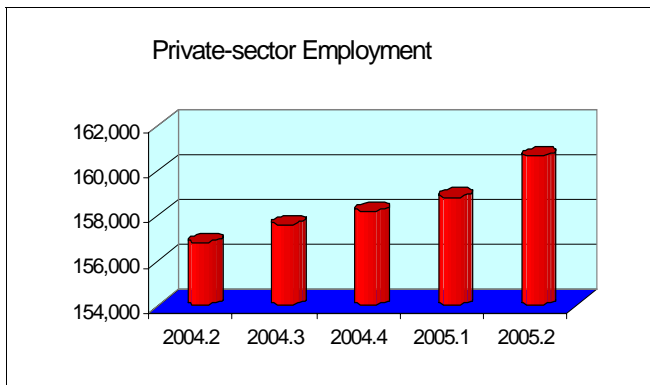
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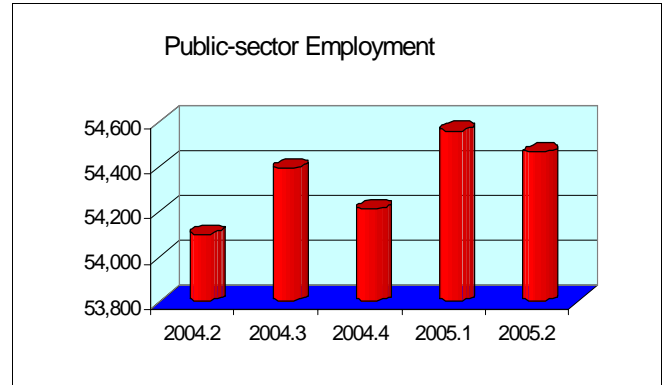
Informal Employment - Informal employment is the difference between total employment and farm and non-farm employment. It accounts for self-employed workers and those who work outside their county of residence. The number of workers engaged in this market jumped from 36,760 in the first quarter of 2005 to 38,605 in the second quarter of 2005. The informal labor market has added 1,750 jobs since the second quarter of 2004.



Private-sector Employment - Nonfarm employment is comprised of private-sector employment and public-sector employment. The private sector consists of two main groups: the goods-producing industries and the services-providing industries. The number of workers employed in the private-sector increased from 158,900 in the first quarter of 2005 to 160,700 in the second quarter of 2005. The private sector has added 3,920 jobs since the second quarter last year.

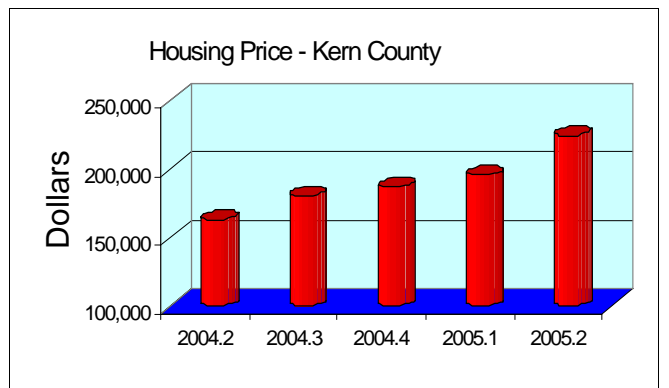


Public-sector Employment - The public sector consists of federal, state, and local government agencies. The local government labor market includes county and city agencies and public education. Employment in the public sector declined from 54,570 in the first quarter of 2005 to 54,470 in the second quarter of 2005. However, public-sector employment has inclined by 370 jobs since the second quarter of 2004.

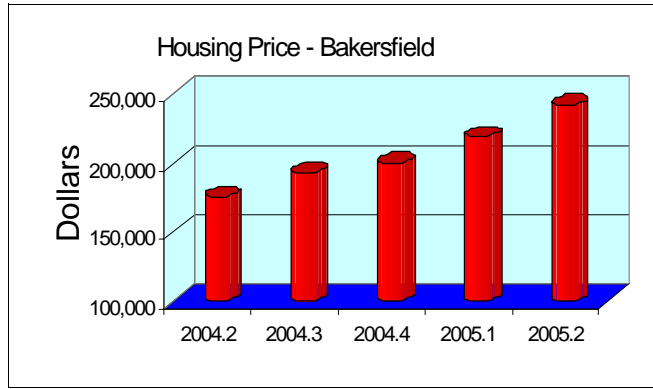


Housing Market

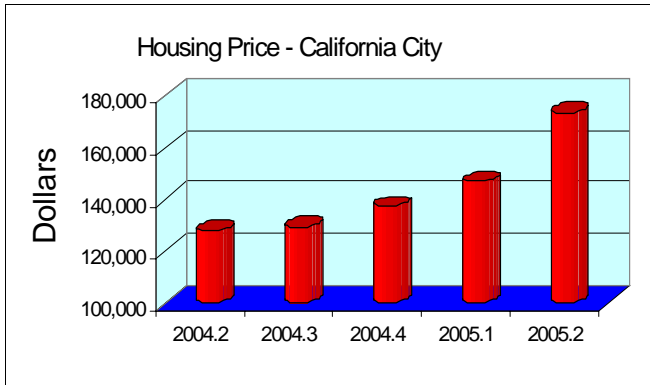
Housing Price - In Kern County, the median sales price of all homes (i.e., new and existing condominiums and single-family detached homes in current dollars) inclined from \$195,200 in the first quarter of 2005 to \$224,100 in the second quarter of 2005. This was a quarterly increase of \$28,900 or 14.8 percent. The county's median housing price appreciated \$61,100 (or 37.5 percent) since the second quarter of 2004.



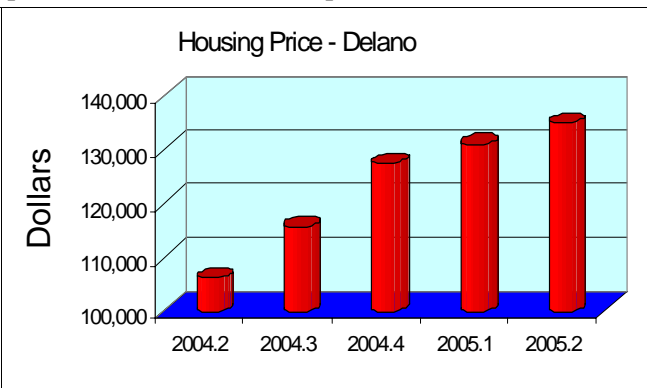
In Bakersfield, the median sales price of all homes rose \$22,700 (or 10.3 percent) from \$219,600 in the first quarter of 2005 to \$242,300 in the second quarter of 2005. Since the second quarter of the previous year, the city's median price has appreciated \$66,300 (or 37.7 percent).



Meanwhile, in California City, the median housing price climbed to \$173,800 in the second quarter of 2005 from \$147,000 in the first quarter of 2005. This jump was a \$26,800 (or 18.2 percent) price increase. The city's median housing price has gained \$45,800 (or 35.8 percent) relative to the second quarter of last year.

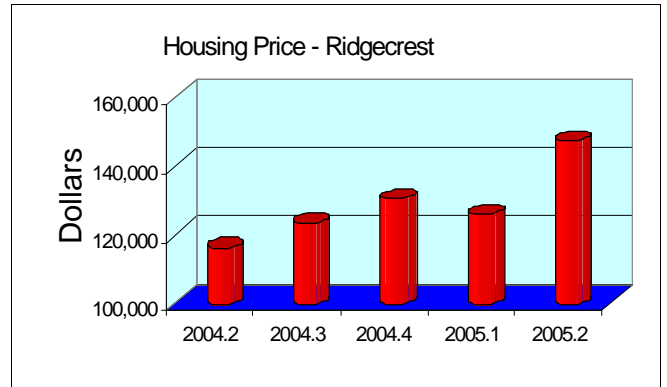


In Delano, the median housing price appreciated \$3,950 (or 3.0 percent) from \$130,800 in the first quarter of 2005 to \$134,750 in the second quarter of 2005. Compared with one year ago, the city's housing price has appreciated \$28,750 (or 27.1 percent).

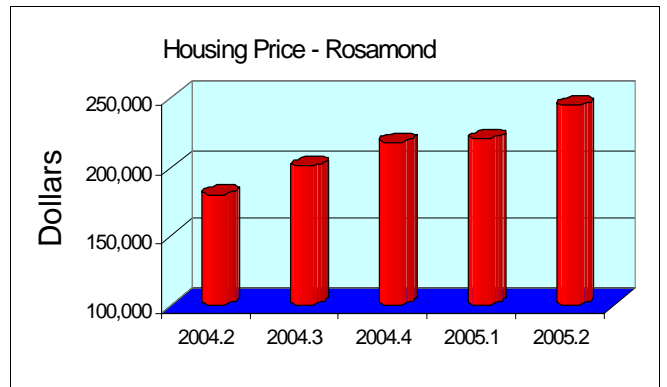


Likewise in Ridgecrest, the median housing price gained \$21,100 (or 16.7 percent) from \$126,000 in the first quarter of 2005 to \$147,000 in the second quarter of 2005. Ridgecrest's housing price has appreciated

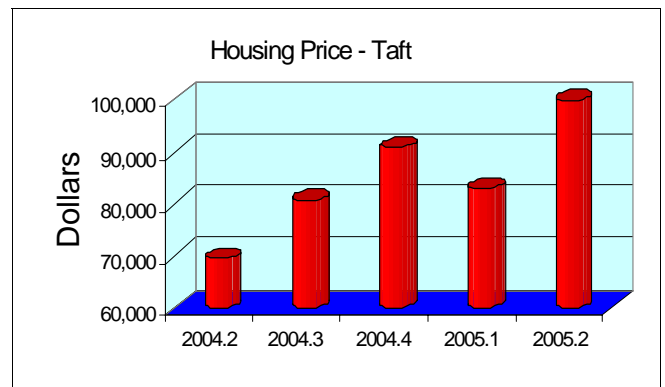
\$31,000 (or 26.7 percent) since the second quarter of last year.



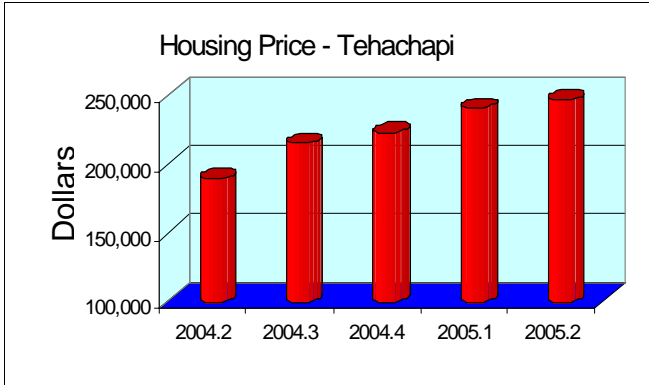
In Rosamond, the median housing price climbed to \$245,000 in the second quarter of 2005 from \$220,700 in the first quarter of 2005. This was a price increase of \$24,300 (or 11.0 percent) in one quarter. Over the previous four quarters, the city's housing price has inclined \$65,000 (or 36.1 percent).



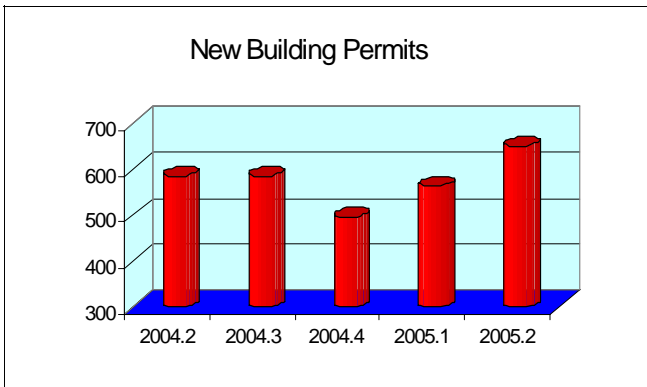
In the meantime, Taft's median housing price jumped \$16,900 (or 20.4 percent) from \$83,000 in the first quarter of 2005 to \$99,000 in the second quarter of 2005. The city's median housing price has appreciated \$30,400 (or 43.7 percent) since the second quarter of last year.



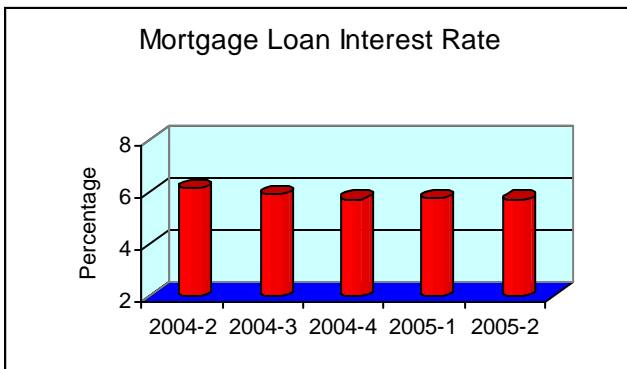
In Tehachapi, the median housing price appreciated \$6,200 (or 2.6 percent) from \$240,000 in the first quarter of 2005 to \$246,200 in the second quarter of 2005. Over the previous four quarters, the city's median housing price soared \$57,200 (or 30.3 percent).



Building Permits – The monthly average number of building permits issued for the construction of new privately-owned dwelling units in Kern County increased by 67 from 563 in the first quarter of 2005 to 652 in the second quarter of 2005. Relative to the second quarter of last year, 89 more building permits were issued.



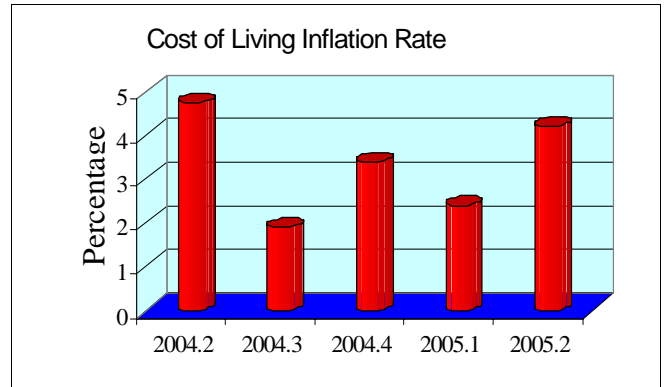
Mortgage Interest Rate – Mortgage interest rates remained low. The interest rate of thirty-year conventional mortgage loans decreased slightly from 5.76 percent in the first quarter of 2005 to 5.72 percent in the second



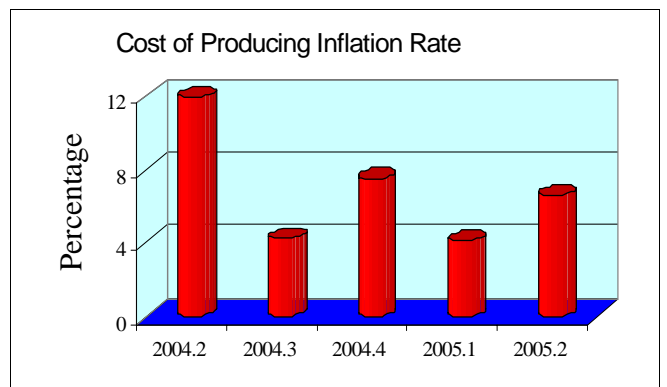
quarter of 2005. Relative to the second quarter of 2004, the mortgage loan interest rate has fallen 0.41 percent.

Price Trends

Cost of Living - The Consumer Price Index (CPI) for all urban areas (1982-84 =100) rose from 192.2 in the first quarter of 2005 to 194.1 in the second quarter of 2005. The annualized CPI inflation rate accelerated from 2.4 percent in the first quarter of this year to 4.2 percent in the second quarter. Relative to the second quarter of 2004, the CPI inflation rate was 0.2 percent lower.

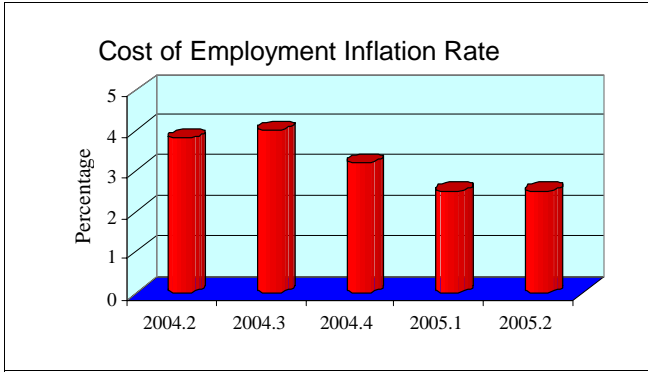


Cost of Production - The Producer Price Index (PPI) for all commodities (1996 =100) jumped from 152.0 in the first quarter of 2005 to 154.5 in the second quarter of 2005. The annualized PPI inflation rate accelerated from 4.1 percent in the first quarter of this year to 6.6 percent in the second quarter. Relative to the second quarter of last year, the PPI inflation rate was 5.3 percent lower.

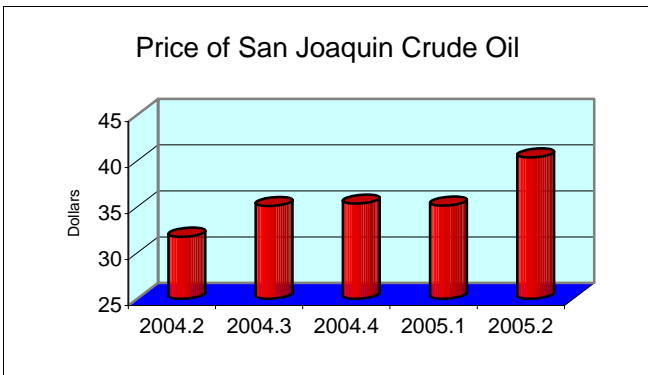


Cost of Employment - The Cost of Employment Index (CEI) for all workers in the private industry (1989 =100) jumped from 177.3 in the first quarter of 2005 to 178.4 in the second quarter of 2005. The annualized CEI inflation rate remained constant at 2.5 percent in the second quarter of 2005. Relative to the second quarter of last year, the CEI inflation rate was 2.1 percent lower.

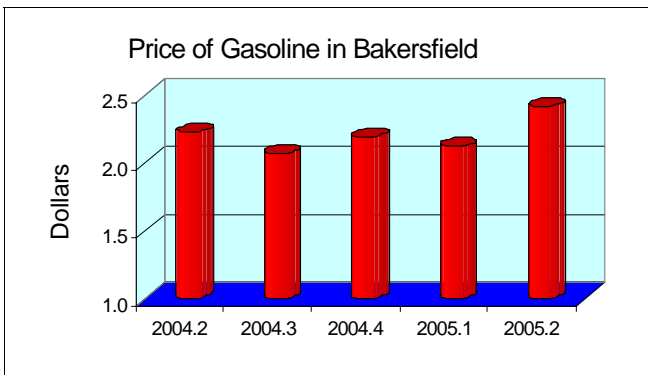
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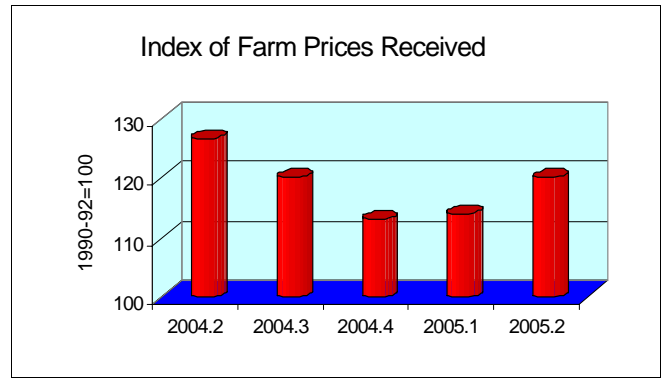
Price of Oil - The average price of San Joaquin Valley heavy crude jumped \$5.23 per barrel from \$35.13 in the first quarter of 2005 to \$40.36 in the second quarter of 2005. Relative to the second quarter of 2004, the average price of crude oil inclined \$8.62 per barrel or 27 percent.



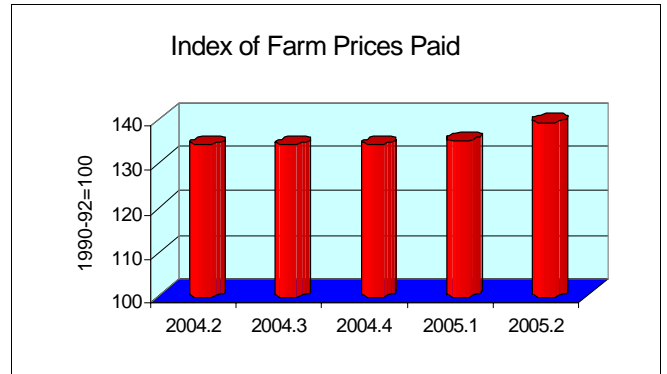
Price of Gasoline - In the Bakersfield metropolitan area, the average retail price of regular gasoline per gallon soared 29 cents from \$2.13 in the first quarter of 2005 to \$2.42 in the second quarter of 2005. Compared with the second quarter of 2004, the price of gasoline soared was 19 cents higher.



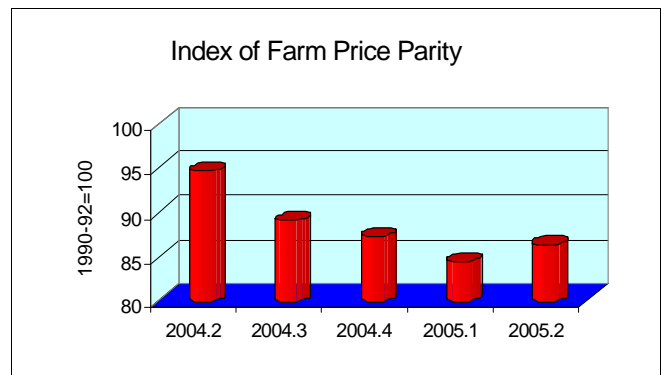
Farm Prices - The national Index of Prices Received by Farmers for all farm products (1990-92 = 100) soared 6 percentage points from 114 in the first quarter of 2005 to 120 in the second quarter of 2005. The Index was four percentage points lower relative to the first quarter of last year.



Likewise, the national Index of Prices Paid by Farmers for commodities, services, interest, taxes, wages, and rents rose 4 percentage points from 135 in the first quarter of 2005 to 139 in the second quarter of 2005. Relative to four quarters ago, this Index has gained 5 percentage points.



Here, we measure the Index of Price Parity as the ratio of the Index of Prices Received to the Index of Prices Paid. Values of this index less than 100 illustrate the imbalance between prices farmers pay for their inputs and prices farmers receive for their outputs. In the second quarter of 2005, the Index of Price Parity inclined 2 percentage points from 84 to 86. We detect a growing disparity between output prices farmers received and input prices farmers paid as the Index of Price Parity declined from 95 in the second quarter of 2004 to 86 percent in the second quarter of 2005.



ECONOMIC EDUCATION:

ISN'T GREEN YOUR FAVORITE COLOR TOO?

Money, what a precious commodity! Money is *not* income. Your monthly income is paid in money. Money is *not* wealth either. The price of your house is measured in money. A credit card is *not* money. When you use your card, you borrow money from a third party and agree to pay it back with interest. So, what is money?

Money is anything that is generally accepted as a medium of exchange. Without money, barter is very difficult, as it requires the *double coincidence of wants*: what I want to sell must be exactly what you want to buy and vice versa. The use of money makes trade much easier: I would sell what I have for money and use it to pay for what I want to buy.

There are two kinds of money:

- *Commodity money* is the money that has some intrinsic value of its own, like gold or silver that medieval merchants required as a medium of payment or cigarettes that POWs used in exchange.
- *Token money* is the money that is intrinsically worthless on its own such as coins, bills, and checks. The value of *token money* is the buying power embodied in it. For example, the cost of printing a \$1 or a \$100 bill is a few cents; the value of each bill is the amount of goods and services we can buy with it. Of course, we prefer a \$100 bill to a \$1 bill because we can buy a lot more goods and services with it.

Token money performs three important functions:

- Medium of exchange: we use money to pay exchange for goods and services we buy
- Store of value: we can store the buying power of money for future use

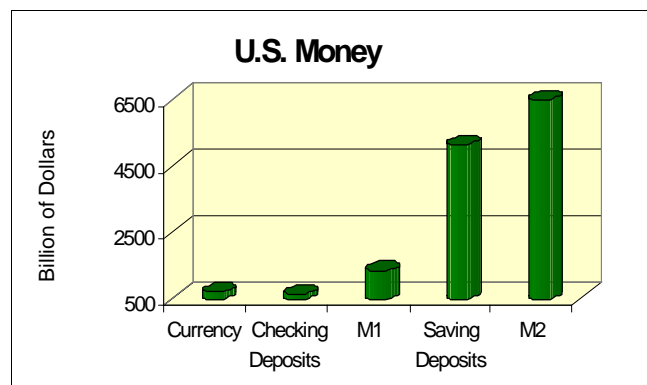
- Unit of account: we quote prices and keep books in money

In addition to performing these functions, token money must be

- Limited in supply
- Widely accepted
- Uniform
- Durable
- Portable
- Divisible

The dollar, or the *green back*, is the United States *token money* as established by a government decree. It performs all the functions of money and satisfies all the requirements of money. How many *green backs* do we have in circulation? Well, this is a hard question to answer as there are various measurements of the money supply. The *narrow* money supply is called M1 which consists of currency (coins and bills) and checking deposits. In April 2005, M1, the money we use to pay for our transactions, amounted to \$1.35 trillion (52 percent in currency and 48 percent in checking deposits). The *broad* money supply is named M2, which is M1 plus saving deposits of less than \$100,000. M2 amounted to nearly \$6.47 trillion (21 percent in M1 and 79 percent in saving deposits). If you have more than \$100,000 in your saving account, then your money is counted in M3!

Money is in high demand because it gives us the power to buy goods and services now and in the future. Having more money may not make us happier, but it surely gives us a wider range of goods and services to be able to buy. This is why *green* is my favorite color!



A COOL WEBSITE

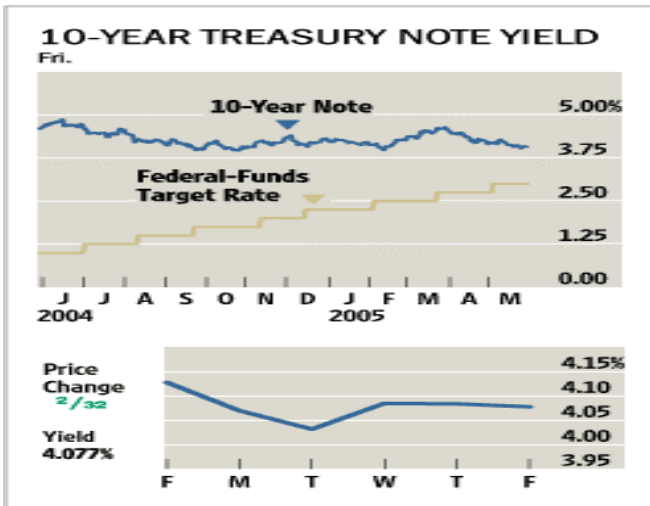
At economagic.com you go on a magical journey discovering a rich source of economic data. This cool website offers detailed data on nearly all macroeconomic indicators over a long time interval. The user-friendly features of the website will enable you to retrieve and process the data you need. Suppose as a business owner, you need data on the rate of inflation to calculate a cost of living adjustment for your employees. Visiting the site, you find data on the Consumer Price Index from January 1947 to the most recent month. You then transform the monthly data into *annual averages* by using the program's built-in calculator, the [transform this series](#) link. Once again, you trans-

form these *annual averages* into *annual percentage changes* to calculate annual inflation rates. Finally, you use the inflation rate you find for the most recent year to determine the percentage of salary increase to be given to your employees.

The website is subscription based with two levels. Level I is *Excel, Copy and Paste*, which allows you to retrieve, transform, and download data. Level II is *Forecast*, which allows you to use an on-site statistical program to forecast any dataset. The Level I subscription fee is US\$50 for one year and the Level II subscription fee is \$US 200 a year.

Economic Performance (Continued from page 12)

to 5.5%. All this fuels excess demand for housing, experiencing one of its biggest booms in history, and hence price inflation.



Developing a quality labor force is a challenge. Education remains a major key to available labor for employers. Areas with low educational attainment rates will remain high unemployment areas. In addition, employers are looking at creative ways to retain workers. Thus a critical success factor for businesses will be finding ways to attract and retain quality workers in a market in which replacements are not easy or cheap.

The good news is that the potential and continuing growth of family businesses, small businesses, and entrepreneurial enterprises will continue to be a source of job growth, offsetting large layoffs in high profile industries such as airlines and automotive. And, they will continue to be a source of economic stability in the economy.

Econ Brief!

Population Growth in the San Joaquin Valley

The San Joaquin Valley is one of the fastest growing regions of California. The Valley's population increased 8.5 percent from 3.3 million in 2000 to 3.6 million 2003. In this time period, the Valley gained nearly 281,000 residents. Of the nine Valley counties, San Joaquin, Stanislaus, and Merced recorded the fastest rates of population growth, while San Joaquin, Fresno, and Kern gained the largest number of residents. Kern County was the 13th fastest growing county in the state with a three-year growth rate of 7.8 percent. Between 2000 and 2003, the county added more than 51,000 residents to its population.

County	Population 2000	Population 2003	Increase (Percent)	Increase (Number)	State Ranking
San Joaquin	563,598	632,760	12.3	69,162	3
Stanislaus	446,997	492,233	10.1	45,236	4
Merced	210,554	231,574	10.0	21,020	5
Madera	123,109	133,463	8.4	10,354	11
Kern	661,645	713,087	7.8	51,442	13
Kings	129,461	138,564	7.0	9,103	16
Fresno	799,407	850,325	6.4	50,918	17
Tulare	368,021	390,791	6.2	22,770	19
Mariposa	17,130	17,803	3.9	673	32
Total	3,319,922	3,600,600		280,678	
Average			8.5%		

Sources: U.S. Census Bureau

Kern Economic Journal

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