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KERN ECONOMIC JOURNAL

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Median Household Income in Kern County

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Economic Developer's Forecast
Utilization, Little's Law and the Curse of Success

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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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Photo: Fall Foliage, Campus Park North, Bakersfield, CA —Photographed by Mick O'Brien, O'Brien Images

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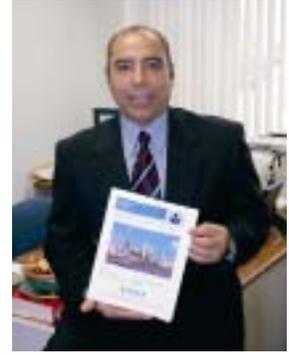
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LETTER FROM THE PUBLISHER



One of the most pleasant challenges I have ever undertaken is to publish the *Kern Economic Journal*. As a locally focused quarterly publication, the Journal offers valuable economic and business information about Kern County. Recently, the Journal's Board of Editors recommended that I send complimentary copies of the Journal to local businesses in order to disseminate the information that they may find helpful in making more informed business decisions.

In each issue, the Journal reports on two quarterly surveys concerning the local business climate and consumer confidence and tracks local economic trends. Featured in this issue are two studies regarding the economic contributions of the Tejon Ranch and CSUB.

Generous support from the university and business community has enabled us to deliver this unique publication. A renewed subsidy from the university has helped with the payment of additional printing and postage costs. I enthusiastically invite you to join them in the support of this valuable Journal, a Journal that provides interesting and timely information about subjects of relevance to local private enterprises and government agencies and those who serve them. If you would like to join this distinguished group of Journal sponsors, please fill out the enclosed sponsorship form and mail it to me with your contribution.



Kern Economic Journal Board of Editors—Front 1-r: Mark Evans, Abbas Grammy;
Back: Jeff Johnson, Brent Dezember, Randy Bye, Guy Greenlee

My assessment of Kern's economic conditions is summarized as follows.

Kern County's economy improved in the third quarter of 2004. Businesses and households have remained optimistic about local economic conditions. The economy expanded to \$14.2 billion or at an annual rate of 2.3 percent. In the meantime, labor productivity inclined \$400 to reach \$47,000.

Labor markets improved with lower rates of unemployment and job growth. The rate of unemployment plunged nearly one percentage point to 10.7 percent. In the meantime, nonfarm employment increased at an annual rate of 2 percent. Weekly wages paid to local manufacturing workers inclined \$5 to reach \$600.

The median housing price appreciated 10.7 percent last quarter, lowering the affordability index to 39 percent. Nonetheless, the construction and real estate boom continued with lower mortgage interest rates and higher numbers of new building permits issued.

Higher oil and gasoline prices fueled inflation in the market for consumer and producer goods and services. Output prices received by farmers fell short of the input prices that they had to pay. However, the gap between prices received and prices paid continued to shrink.

KERN COUNTY BUSINESS OUTLOOK SURVEY

ABBAS P. GRAMMY
PROFESSOR OF ECONOMICS, CSUB



The expectation of an improved economic outlook is a major factor in undertaking business investment. Optimistic managers plan for expansion of their operations by hiring additional labor, buying more equipment, or adding extra space. Additional dollars spent on business expansion places more dollars in the hands of consumers, accelerating economic growth.

In the third quarter of 2004, we measured a high degree of optimism about local economic conditions. We administered telephone surveys to a random sample of private-sector managers and public-sector administrators across the county, asking each two sets of questions. Each set included four questions, one set regarding the assessment of local economic conditions in the current quarter and the other set in the forthcoming quarter.

Employment Outlook - The majority of survey respondents (44%) reported that the number of jobs in their companies stayed constant this quarter. Fifty-one percent expected the number of jobs to remain unchanged next quarter.

Financial Outlook – More than one-half of the survey respondents reported improvements in financial conditions (sales or profits) of their companies this quarter and expected such improvements to continue next quarter.

Industry-wide Business Outlook – More than 50% of survey respondents perceived that employment and gen-

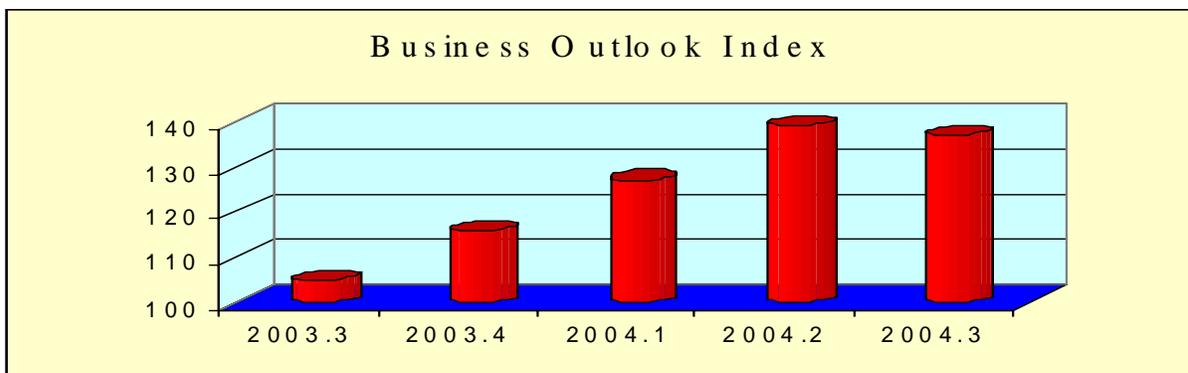
eral business conditions of their industries improved this quarter. However, they anticipated that these conditions would remain constant next quarter.

County-wide Business Outlook – More than 50% of survey respondents perceived no improvement in local business conditions this quarter. However, 50% felt that conditions are likely to improve next quarter.

Business Outlook Index – We enumerated the survey responses to construct the Business Outlook Index (BOI). The index value greater than 100 expresses *optimism*, and less than 100 *pessimism*. The BOI fell 2.1% points from 138.9 in the second quarter to 136.8 in the third quarter. These numbers indicate that business managers remain *optimistic* about local business conditions, but their degree of *optimism* has slightly declined. However, the BOI has risen 32% points over the last four quarters.

Furthermore, we calculated the index for each of the two sets of questions. The Index of Current Business Conditions had a value of 142.3 and the Index of Future Business Conditions measured at 131.3. These index values confirm the survey results that although the survey respondents are *optimistic* about the local economic climate, their degree of optimism is lower regarding business conditions in the next quarter.

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BAKERSFIELD CONSUMER SENTIMENT SURVEY

MARK EVANS
INTERIM DEAN, EXTENDED UNIVERSITY
DIVISION, CSUB



As sales levels change, a business leader must ask, “To what extent are my company’s trends the result of changes in the overall economy and to what extent do they result from changes in my competitive position?” Unfortunately, companies serving the local market do not have access to sufficient economic data when pondering this question. For example, data on taxable retail sales have not yet been released at the county level for the four previous quarters.

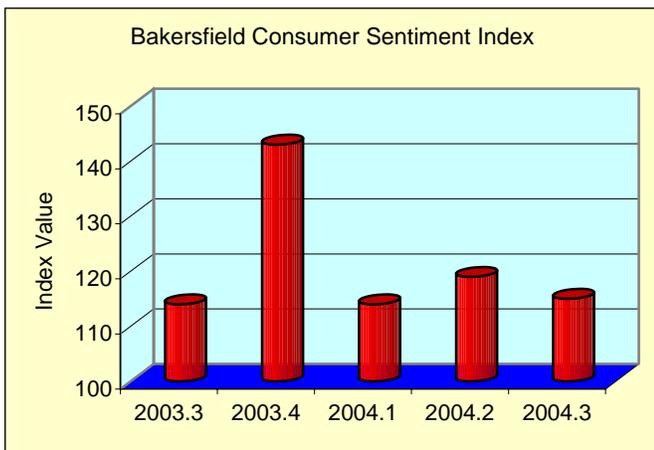
To help decision makers assess local economic conditions, we began compiling the Bakersfield Consumer Sentiment Survey in 1999 from telephone surveys administered to a random sample of households listed in the phone book. Consumer sentiment indexes have been shown to embody information about current economic conditions as well as future short-term changes in the economy.

The Bakersfield Index of Consumer Sentiment attained a value of 115 in the third quarter. This exactly equals the average value of the quarterly index since its inception in 1999. In the previous quarter, the index attained a value of 119, which exceeds the value attained in roughly two-thirds of the quarters.

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 107. This is not exceptional, as the recent trends sub-index exceeds 107 about two-thirds of the time and stood at 112 in the previous quarter. About one-fourth of the respondents reported spending more than usual on discretionary items compared to one-third in the previous quarter. Twenty-eight percent reported spending less than usual in the third quarter compared to only 13 percent in the second quarter.

To assess future expectations, households are asked how they thought the financial situation of their families would 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. The sub-index measuring future expectations attained a value of 123. This shows greater optimism about the future than in 62 percent of the previous

(Continued on page 5)



INDEX VALUES			
	Most Recent Quarter	Previous Quarter	One Year Ago
Consumer Sentiment Index	115	119	114
Index of Recent Buying & Financial Trends	107	112	109
Index of Consumer Expectations	123	127	119

Consumer Sentiment (Continued from page 4)

quarters, although the reading was higher in the previous quarter (127). Paradoxically, while only three percent thought the financial situation of their family would worsen over the coming year compared to 16 percent in the previous quarter, the percent who thought this was a safe time to incur debt or draw down savings declined from 49 to 28 percent. Forty percent thought it was a risky time to make a major purchase compared to just 17 percent in the previous quarter.

In summary, the Bakersfield Consumer Sentiment Index is constructed from responses to questions relating to both recent trends and future expectations. Overall, the third quarter index attained a value that was the same as the average for all quarters since 1999. Although the aggregate value is equal to the average for all quarters, self-reported recent trends were less robust than the quarterly average, while future expectations were more optimistic than usual.

Survey Results	More than usual	Same as usual	Less than usual
Your recent spending on discretionary items (dining out, weekend outings, entertainment)	26%	46%	28%
	Better off	Same	Worse off
How your family is doing financially compared to one year ago.	32%	49%	19%
How your acquaintances in Kern County are doing financially compared to one year ago.	21%	67%	12%
	Better	Same	Worse
The most likely financial situation of your family one year from now	36%	61%	3%
	Optimistic	Neutral	Fearful
How your acquaintances in Kern County view the coming year.	60%	29%	11%
	Safe	Same	Risky
Is now a safe or risky time for most people to use savings or incur debt to buy expensive goods?	28%	32%	40%

Business Outlook (Continued from page 3)

Index of Business Outlook	136.8
Index of Current Business Condition	142.3
Index of Future Business Condition	131.3

Factors Affecting Business Outlook – We also asked the survey participants to comment on local, regional, national, or international factors that have affected employment and financial conditions of their companies. They felt several factors brightened the local business outlook:

- The continued real estate and construction boom
- Growing county and city economies and recovering state and national economies
- The expansion of business activity in Bakersfield

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

- Rising fuel costs
- The higher cost of health insurance
- The re-routing of Highway 58 to bypass Mojave

Our survey results show that local decision-makers have remained highly optimistic about the economic climate. Kern County’s bright outlook, coupled with an affordable cost of producing, provides incentives for the expansion of business activities as well as the initiation of financial ventures and consideration of business relocation.

TEJON RANCH: PRESERVING CALIFORNIA'S LEGACY AND PROVIDING FOR CALIFORNIA'S FUTURE

BARRY ZOELLER

VICE PRESIDENT, DIRECTOR OF COMMUNICATIONS,
TEJON RANCH



To say that Tejon Ranch Company plays a significant role in Kern County is an understatement. By virtue of land area alone, Tejon Ranch is a major player. The Ranch's 270,000 acres make it the largest landholding under single ownership, not only in the county, but in the entire State of California as well.

But Tejon Ranch's impact on Kern County can be measured in more ways than just sheer size. From the very beginning, the history of Kern County and the history of Tejon Ranch have been intertwined. The Ranch was established by Edward Fitzgerald Beale, whose name adorns the Beale Memorial Library in downtown Bakersfield. The library sits on the street named for Beale's son, Truxtun Beale. In 1904, Truxtun Beale presented the City of Bakersfield with a 64-foot clock tower as a memorial to his mother. The Beale Memorial Clock Tower, which stood at the corner of Chester and 17th Streets until it was toppled in the 1952 earthquake, now graces the entrance to the Kern County Museum. This year the community is commemorating the 100th anniversary of the clock tower.

But just as the history of Kern County and Tejon Ranch are tied together, they are also connected economically – a bond which will likely get stronger in the coming years. Last year, Tejon Ranch Company unveiled its vision for the next 25 years, a vision which can be summarized as a commitment to preserve California's legacy and provide for California's future. The twin pillars of this vision promise to produce positive economic results for Kern County.

For example, the commitment to preserve California's legacy includes the Ranch's dedication to continuing its historic ranching and farming operations. Having sold its cattle in 2002, the Ranch currently

leases grazing land to two large cattle operations. Depending on season, as many as 14,000 head of cattle roam the vast reaches of the ranch, still tended by cowboys on horseback. The ranch is also currently farming about 6,000 acres. The primary crops include almonds, pistachios, wine grapes and a variety of row crops such as potatoes, onions, broccoli and carrots.

While any commodity-based operation, viewed on a year-by-year basis, is subject to varying results, the overall value of such operations should not be underestimated. In addition, the Ranch plans to set aside significant portions of the ranch as permanent conservation areas. Working with its conservation partner, the Trust for Public Land (TPL), Tejon anticipates dedicating about 100,000 acres as a conservation preserve. The exact boundaries of that preserve area are still being determined, as are the terms of such a transaction – whether it's a fee sale or a conservation easement – but the positive impact of such a preserve both environmentally and economically will be significant.

For Tejon Ranch, *providing for California's future* means responsibly using its resources to meet the housing, economic and lifestyle needs of Californians, while being guided by its core values of conservation and good stewardship. Three distinct environmentally-sensitive master-planned communities – Tejon Industrial Complex at the Interstate 5 – Highway 99 split, Centennial, near Interstate 5 and Highway 138, and Tejon Mountain Village, which is in the final planning stage - frame the majority of this pillar of the Ranch's vision.

Though it is difficult to put an exact number on the potential economic impact of these developments, two of which are either in the final planning stages

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THE ECONOMIC IMPACT AND ALUMNI CONTRIBUTION OF CALIFORNIA STATE UNIVERSITY, BAKERSFIELD

MICHAEL STEPANOVICH
PUBLIC AFFAIRS DIRECTOR, CSUB



California State University, Bakersfield had a nearly three-quarters-of-a-billion-dollar impact on Kern County in 2002-03, a study of the university's economic impact shows.

The study conducted by Abbas Grammy, Professor of Economics, reveals that:

- CSUB has \$706 million impact on Kern County's economy.
- CSUB contributes \$268 million in direct and indirect spending to Kern County.
- CSUB helps increase the earning power of its graduates by \$140 million.
- CSUB helps improve total factor productivity by \$294 million a year.
- CSUB's direct spending of \$152 million creates 4,198 jobs in the local economy.

Viewed simply in institutional terms, the university contributes \$60.4 million in wages and salaries to the local economy, and another \$9.5 million in the local purchase of goods and services. But CSUB's impact is much more than that. Thousands of alumni who live in Kern County enjoy increased earnings due to their CSUB degree. Retired faculty and staff add another \$8.6 million to the area's economy. Plus students spend some \$51.4 million in the community.

Indirect economic impact occurs when each dollar of direct spending creates additional dollars of expenditure in the community. In addition to these local expenditures, CSUB contributes to the local economy in a less obvious manner. As a regional university, CSUB supplies an educated and trained workforce to fill higher-paying jobs, thus increasing the earning power of its graduates.

But CSUB's contribution is far more than just dollars and cents. It provides local residents a means to

pursue professional careers and achieve greater economic security through an affordable education. It enhances the area's quality of life through cultural and athletic events. And as both California and Kern County evolve to a knowledge-based economy, CSUB is helping lay the foundation for economic growth through its graduates. Kern County would simply not enjoy the level of prosperity that it does were it not for the existence of CSUB.

Furthermore, the presence of the university increases the levels of educational attainment and labor productivity in the county. The reason for this intangible effect is that knowledge and expertise are more easily and quickly interchanged when educated workers interact with each other, hence increasing production of goods and services in the economy.

Among highlights of the economic impact report:

- CSUB spent \$15.5 million in capital expenditures in 2002-03, including remodeling of existing campus structures and construction of new buildings. Passage of propositions 47 and 55 mean another \$25 million in capital expenditures over the coming few years.
- CSUB students, faculty, staff and alumni contributed 14,000 hours of community service to such organizations as the Bakersfield Homeless Center, Kern Adult Literacy Council, Boys and Girls Club, Ebony Counseling Center, Greater Bakersfield Chamber of Commerce, Hispanic Chamber of Commerce, and the American Cancer Society during 2002-03. Time value of that service is \$6.7 million.
- Kern County enjoyed an \$82.1 million income boost from alumni who continue to live and

(Continued on page 8)

work in Kern County and who say they would not have earned a degree if not for CSUB.

- In terms of employment, the economic impact translates into nearly 4,200 jobs in Kern County, or 1.6 percent of all jobs in the county. This is a significant rise from the last economic impact survey completed in 1997 that showed CSUB's impact created 2,450 jobs, a 71 percent increase.

A companion survey of CSUB alumni showed that 41 percent of alumni responding reported that without their CSUB education they would not have qualified for their current job; 32 percent reported that they most likely would not have earned their bachelor's degree if CSUB did not exist; 36 percent said their CSUB education significantly improved their competitiveness in obtaining their current job; and 50 percent reported that their CSUB education led to a promotion and enhanced career paths with their current employer.

Significantly, 94 percent of CSUB alumni said their CSUB education was a good investment. They cited jobs and incomes their education made possible, workplace-relevant skills it developed, the economic opportunity the university creates for local residents, the wide range of cultural amenities it offers, and the civic values and community leadership a university education nurtures.

The university's greatest contribution to the quality of life in the community is its alumni. CSUB graduates stay in the community, work in the community, spend their wages in the community, and participate in a range of community activities. The report demonstrates that Kern County's future prosperity depends on a broad base of educated men and women to meet the challenges of this rapidly changing region. CSUB is a key to the region's economic well-being as we move deeper into the 21st century.



CSUB President Mitchell and Professor Grammy, CSUB Economic Impact Study Press Conference, October 26, 2004

ECONOMIC DEVELOPER'S FORECAST: INCREASINGLY SUNNY WITH SOME CLOUDS REMAINING

KATIE BURNS

INTERNATIONAL ECONOMIC DEVELOPMENT COUNCIL
REPRINTED FROM *ECONOMIC DEVELOPMENT NOW*

If you want to know how the economy is doing, one of the most logical groups to ask would be economic developers. After all, it is their job to create and keep jobs in their communities. If Company Y is expanding locally, the area's economic development gets to put out a press release and trumpet the new jobs that are on the way. If Company Y merges with another firm halfway across the country, the economic developers have to worry about local residents who could get restructured out of their positions and, as a result, stop shopping in local stores.

So, for the second year in a row, International Economic Development Council (IEDC) collaborated with the Greater Phoenix Economic Council (GPEC) to survey members about their view on the nation's economy about the challenges and opportunities in their own regional economies. More than 700 IEDC members responded, representing all 50 states, Puerto Rico and four Canadian provinces.

The Findings - In a nutshell, economic developers are more optimistic than they were a year ago. Seventy-three percent of the respondents rated economic conditions in their regions or communities as very good or somewhat good, compared with 62 percent a year ago. Nationally, the outlook improvement was even greater, with 72 percent rating national economic conditions as very good or somewhat good, compared with 46 percent in October 2003.

"That's certainly good news," Paul Ringer, interim president and CEO of GPEC said, expressing surprise at the dramatic improvement. At the same time, the respondents' views of federal efforts to keep the economy headed in the right direction sounded so-so. With potential answers ranging from "very satisfied" to "not at all satisfied" with current federal efforts, 65 percent of the respondents said they were either "somewhat satisfied" or "not very satisfied."

The biggest factors impacting their regions: Increased global competition and outsourcing, state and local budget conditions, off-shoring of manufacturing and service jobs, and corporate restructuring. Ringer noted that increased defense spending and the Iraq war drew more concern than last year, with 31 percent saying it was having significantly or somewhat negative impacts on their areas' job growth. He explained that wars create uncertainty and businesses don't like to make investments during uncertain times. Ringer also said he was surprised by the extent to which outsourcing was affecting economic development work, even as some academics and other experts have said outsourcing isn't the calamity it's been made out to be. "It's still a concern among economic development professionals," he said.

What do you think would have the most impact on economic development in their communities? The response was investment in education, improving workforce quality and infrastructure improvements. What should the incoming presidential administration do overall to help the economy? Most took a middle approach, calling for some financial assistance and some policy development to promote economic competitiveness. Public policy makers ought to take note of the survey findings and of the views of economic developers in their own backyard, Ringer suggested: "This group of professionals is a valuable resource."

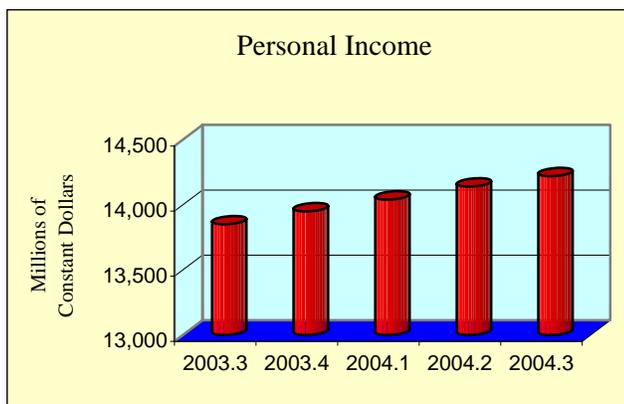
This article was submitted by the Kern Economic Development Corporation, the lead agency for economic development in Kern County. The International Economic Development Council is the nation's largest economic development professional association, serving economic developers and the economic development profession. The full report is available via the GPEC website at www.gpec.org.

TRACKING KERN'S ECONOMY

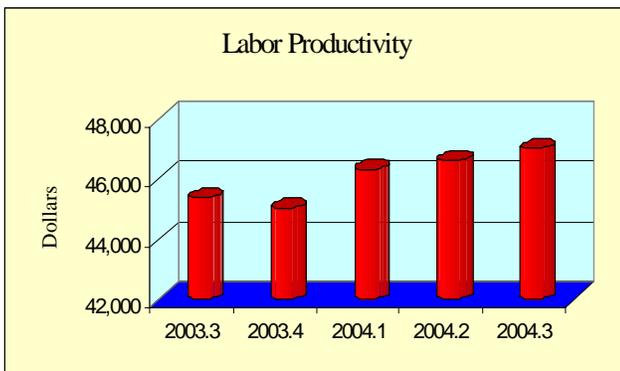
ABBAS P. GRAMMY
PROFESSOR OF ECONOMICS, CSUB

Economy

Personal Income - Kern County's personal income (in constant 1996 dollars) increased from \$14.14 billion in the second quarter to \$14.22 billion in the third quarter. The county's economy expanded \$80 million or at an annual rate of 2.3%. Over the last four quarters, Kern's economy has created \$370 million of income.

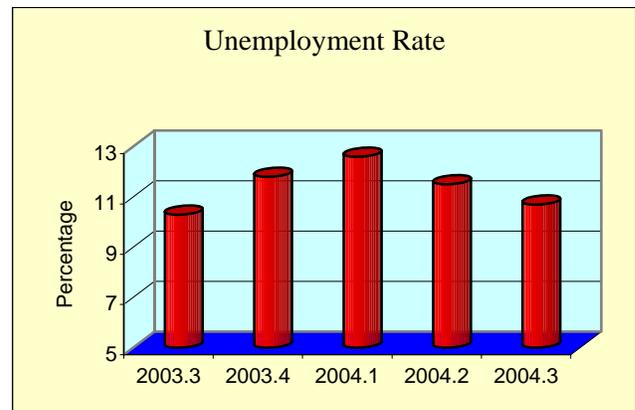


Productivity - Labor productivity is measured as Personal Income divided by Labor Force. In constant dollars, labor productivity inclined \$400 from \$46,600 in the second quarter to \$47,000 in the third quarter. This increase translated into an annual productivity growth rate of 3.4%. Compared to four quarters ago, labor productivity in Kern County has increased \$1,620.

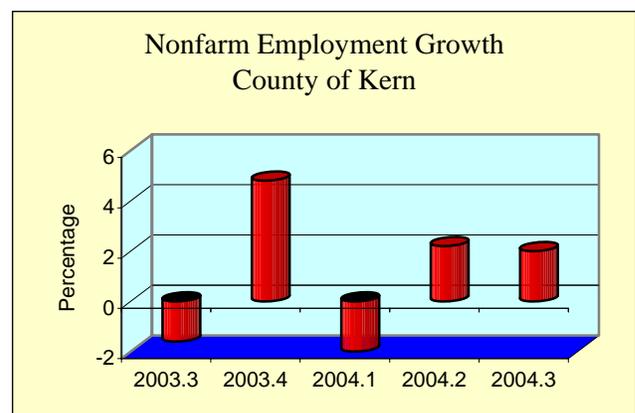


Labor Market

Unemployment Rate - In the third quarter of 2004, greater farm employment coupled with lower unemployment helped reduce the rate of unemployment. When adjusted for seasonality, the rate of unemployment in Kern County plunged 0.8% from 11.5% to 10.7%. In spite of this drop, the county's unemployment rate was still 0.4% higher than that of four quarters ago. Kern's unemployment rate was 4.7% higher than the state average and 5.3% greater than the national average.



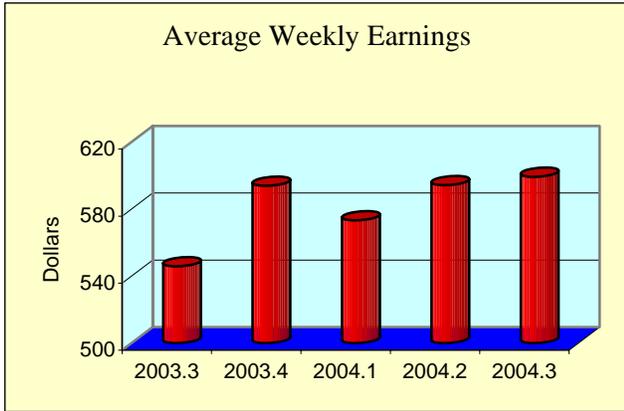
Employment Growth - Nonfarm employment, when adjusted for seasonality, increased at an annual rate of 2%. Among the nonfarm industries, construction, manufacturing, retail trade, transportation, warehousing and utilities, and leisure and hospitality added jobs. However, wholesale trade, financial activities, professional and business services, and state and local governments reduced employment.



Wages - Weekly wages paid to local manufacturing workers inclined \$5 from \$594.30 in the second quarter to \$599.30 in the third quarter. This wage increase was attributed partly to the rise in the hours of work. The average weekly hours increased from 38.4 to 38.7. Com-

(Continued on page 11)

pared with four quarters ago, local manufacturing workers earned \$53.40 more per week.



Housing Market

Housing Prices - The median sales price of all homes (i.e., new and existing condominiums and single-family detached homes in current dollars) soared \$17,500 or 10.7% from \$162,830 in the second quarter to \$180,330 in the third quarter. Since the third quarter of last year, the county’s median price has appreciated \$51,330 or 39.7%.



In the third quarter of 2004, housing prices appreciated in all of the major cities of Kern County. In dollar value, housing prices appreciated more than the county average in Wasco, Tehachapi, Rosamond, and Bakersfield. Meanwhile, Wasco, Taft, Tehachapi, and Rosamond recorded larger than average percentage gains.

Housing Affordability - The index of housing affordability plunged 7% points from 46 in the second quarter to 39 in the third quarter. Over the past four quarters, the county’s index has fallen 13% points. The current index value indicates that a family earning the median household income has 39% of the income necessary to qualify

for a conventional loan covering 80% of a median-priced existing single-family home.

Area	Third Quarter (\$)	Second Quarter (\$)	Quarterly Change (\$)	Quarterly Change (%)
Kern County	180,330	162,830	17,500	10.7
Bakersfield	193,200	175,500	17,700	10.1
California City	129,500	128,000	1,500	1.2
Delano	115,500	106,000	9,500	9.0
Ridgecrest	123,300	115,000	8,300	7.2
Rosamond	200,900	180,000	20,900	11.6
Taft	80,700	69,500	11,200	16.1
Tehachapi	214,400	189,000	25,400	13.4
Wasco	114,500	87,750	26,750	30.5

Source: California Association of Realtors

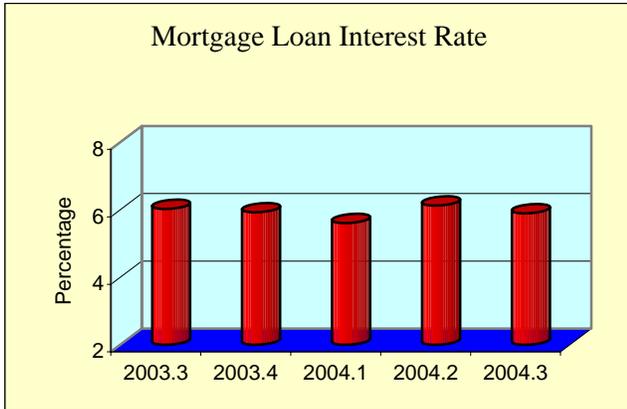


Building Permits – The construction and real estate boom continued in the county as the number of new building permits for single-family homes remained at the same high level of 585 in the third quarter. Relative to four quarters ago, 61 additional building permits were issued.



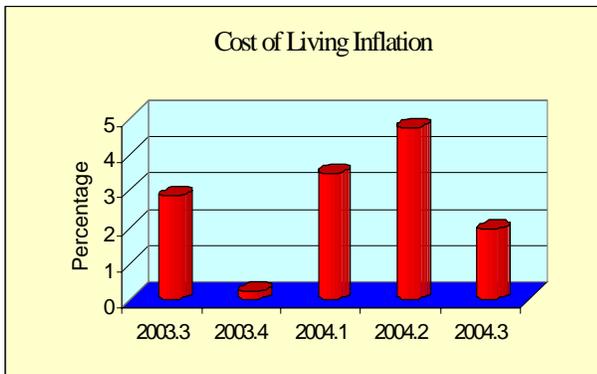
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Interest Rate - The interest rate of thirty-year conventional mortgage loans dropped from 6.13% in the second quarter to 5.90% in the third quarter. Compared to four quarters ago, the mortgage loan interest rate has fallen 0.13%.



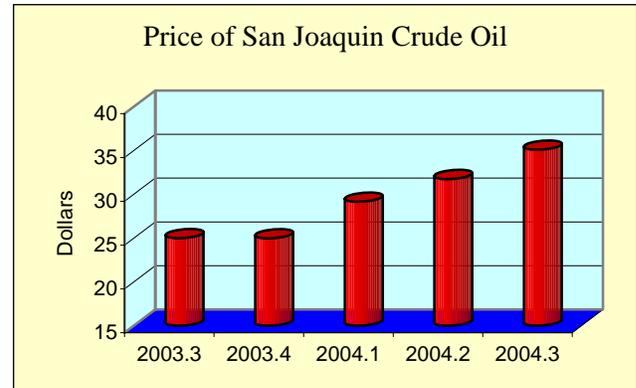
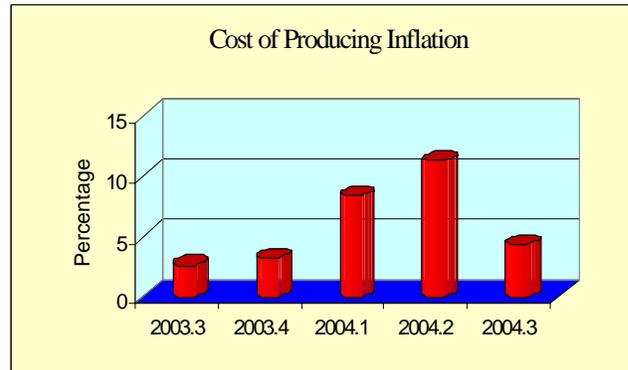
Commodity Prices

Cost of Living - The Consumer Price Index for all urban areas (1982-84 =100) rose from 188.6 in the second quarter to 189.5 in the third quarter. The annual cost of living inflation rate was 1.9% in the third quarter of 2004.

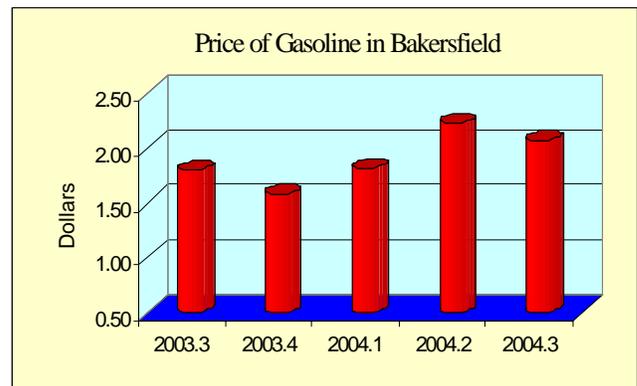


Cost of Producing - The Producer Price Index for all commodities (1996 =100) jumped from 146.2 in the second quarter to 147.7 in the third quarter. The annual cost of producing inflation rate was 4.2% in the third quarter of 2004.

Price of Oil - The average price of San Joaquin Valley heavy crude climbed \$3.35 per barrel from \$31.74 in the second quarter to \$35.09 in the third quarter. Compared with four quarters ago, the average price of crude oil ascended \$10.09 per barrel.

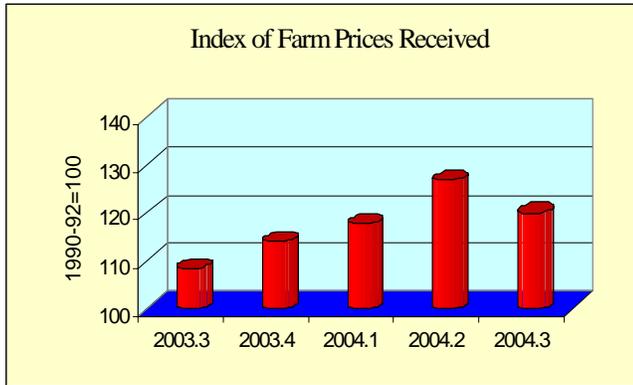


Price of Gasoline - In the Bakersfield metropolitan area, the average retail price of regular gasoline per gallon declined 16 cents from \$2.23 in the second quarter to \$2.07 in the third quarter. However, compared with four quarters ago, the price of gasoline was 27 cents higher.



Farm Prices - The national Index of Prices Received by Farmers for all farm products (1990-92 = 100) plunged 8% points from 127 in the second quarter to 120 in the third quarter. However, the Index has inclined 12% points since the third quarter of last year.

(Continued on page 13)



In the meantime, the national Index of Prices Paid by Farmers for commodities, services, interest, taxes, wages, and rents remained unchanged at 134. Over the last four quarters, this Index has soared 8% points.

Here, we measure the Index of Price Parity as the ratio of the Index of Prices Received to the Index of Prices Paid. In the third quarter of 2004, the Index of Price Parity plummeted 6% points from 95 in the second quarter to 89 in the third quarter.

Econ Brief!

Home Price Appreciation in California

California has been the hottest real estate market in the nation. Of the top 20 metropolitan areas seeing the biggest gains over the past year, 13 are located in California. The list includes the metropolitan areas of southern California (e.g., Orange County, Los Angeles-Long Beach, and San Diego) as well as rapidly growing communities of central California (e.g., Fresno, Bakersfield, and Visalia-Tulare-Porterville). The top ranking metropolitan area in the state is Riverside-San Bernardino where home prices appreciated 25% between June 30, 2003 and June 30, 2004. Four of the San Joaquin Valley communities show in the list: Fresno, Bakersfield, Visalia-Tulare-Porterville, and Modesto. Bakersfield places 8th in the top 20 list and 6th in the California list, where home prices appreciated 20% in one year and 59% in five years.

In spite of such unprecedented price increases, there are some signs across the nation that the red-hot housing market is losing some of its steam:

- The inventory of homes for sale has climbed
- Multiple offers are becoming the exception rather than the rule
- Properties are staying on the market longer
- More buyers are making offers below the list price
- Some builders are now providing incentives to buyers

Metropolitan Area in California	1-Year (%)	5-Year (%)
Riverside-San Bernardino	24.7	85.7
Fresno	23.2	77.8
Orange County	21.6	88.2
Los Angeles-Long Beach	21.5	80.8
Ventura	21.2	87.8
Bakersfield	20.3	58.7
San Diego	20.2	102.5
Visalia-Tulare-Porterville	19.8	42.8
Sacramento	18.2	90.4
Redding	17.7	74.7
Salinas	17.7	99.7
Modesto	17.6	89.4
Chico-Paradise	17.4	82.8

Source: The Wall Street Journal, Wed., Sept. 8, 2004

BUSINESS EDUCATION:

UTILIZATION, LITTLE'S LAW, AND THE CURSE OF SUCCESS

MICHAEL WAY

ASSISTANT PROFESSOR OF MANAGEMENT, CSUB



After some rough patches at the beginning, John's new business is experiencing an increase in sales. He has won customers with product quality and short lead times. Early on, John was afraid he would have to lay someone off because there wasn't enough work to keep everyone busy. Now there is ample work.

Lately, however, there have been some problems. John's lead times have gotten longer, to the point where he is starting to miss due dates on orders. Also, the amount of inventory is ballooning, straining his cash flow.

I have seen the above scenario played out several times in a wide variety of businesses: increasing sales leading to a decline in performance that threatens the business. Higher sales and the accompanying higher revenues are certainly good things, but this success can be a curse if you are not careful.

John's problems arise from a capacity crunch. The increase in sales has resulted in increased utilization. Utilization is simply the percentage of production capacity used. For any business, as utilization increases, the lead-time for producing a good or providing a service increases. This is because excess capacity is a buffer for the unevenness of demand. As utilization approaches 100%, the excess capacity shrinks and your margin to handle unevenness of demand is reduced. This lead-time increase comes in the form of increased waiting, as work begins to compete for increasingly scarce production resources. The effect can be exponential: at high utilizations, a 5% increase in demand can double your lead-time.

Coupled with this is a relationship known as Little's Law. It states that the average total inventory (I) in a system is equal to the average rate of production

(R) multiplied by the average lead time (T) of product through the system. In other words: $I = RT$.

Now, suppose that an increase in business has brought an increase in demand, resulting in a higher production rate (R). Also, as we've seen, the increased demand will result in a higher lead time (T). Since both R and T increase, the result is greatly increased inventories (I).

This, then, is what happened to John. The increase in demand has resulted in higher utilization. As orders/product entered and moved through the system, they were more likely to wait at each stage, and to wait for longer periods; lead-times increased. The increased demand coupled with the increased lead-time drove inventories through the roof. John has been cursed by success.

The good news is that this can be avoided through the careful management of capacity. John was thrilled that his workers were busier due to increased sales. Some excess capacity is needed, however; too little can be as harmful as too much. How much excess capacity is needed? This differs from business to business, though a general rule is that the more uneven the demand pattern, the greater the required excess.

Either increasing capacity or smoothing demand can help keep your utilization low enough. Most commonly, people think of adding resources (manpower and equipment) to increase capacity. You can also accomplish this by streamlining the process. Reductions in time required to complete work are effectively increases in capacity. Demand smoothing reduces the variability of workload so that the excess capacity is more able to handle the bumps in workload.

ECONOMIC EDUCATION:

COMPETITION

Competition is an economic fact of life. If you sell a product like mine, chances are that someone else will also sell a similar product. Since customers are free to choose in the marketplace, we must compete for the money they spend on that product. Assume I sell blue jeans for \$28 a pair and you are my chief rival in the marketplace. Also assume it costs the two of us the same amount to produce each pair of blue jeans. Of course, as a chief rival, I will keep an eye on what you do and try to follow your business lead.

We may compete in one or more of the following ways.

Price – You try to attract more customers by selling the same kind of blue jeans for \$25 a pair. The catch is that you make \$3 less for each pair you sell, but you must cover the same production cost as mine. Will you make more money? You certainly hope so! You need to sell a whole lot more blue jeans to make up the dollars lost from your price cut and end with a larger profit.

Quality – You decide to make *designer* blue jeans. You spend \$4 more to make each pair, but raise the price to \$38 a pair. Your strategy is to attract customers who are willing to pay higher prices for a better fit and more contemporary styling. Although you attract fewer customers, you may make a larger profit.

Service – You keep your price at \$28 a pair, but have your store at a more convenient location with helpful clerks, a well-decorated store, fast check out service, and an easy return and exchange policy. Customers may prefer to buy blue jeans from you because of the better service they receive.

Advertisement – You sell your blue jeans at \$30 each and spend the extra \$2 on promotion and advertising to attract more customers to your store. Increased sales volume would boost your profit.

Efficiency – You become innovative in managing your operations. For example, you install energy-saving air conditioning and lighting systems that cut your electricity bill. You still sell blue jeans at \$28 a pair, but increase your profit.

Technology – You take advantage of the communication technology to expand your market size and increase your profit. For example, you establish an interactive website to reach potential customers around the globe. Anyone interested in buying blue jeans could place an order over the Internet. With timely delivery and an accommodating return policy, your sales volume would rise. Increased market size will enable you to offer occasional promotions by reducing the price below \$28 a pair or by waving the shipping and handling charge.

Econ Brief!

Median Household Income in Kern County

The Bureau of Census reports data on the median household income for various geographical units in the nation. A *household* includes all the people who occupy a housing unit. The occupants may be a single family, one person living alone, two or more families living together, or any other group of related or unrelated people who share living arrangements. The *median household income* is the average income of persons 15 years old and over in the household.

The latest published data for the year 2003 report considerable disparity in the level of household income. The inflation-adjusted median household income is \$40,440 in Kern County. Kern's median household income is \$3,130 (7.7%) less than that of the United States and \$9,780 (24.2%) less than California's.

In the City of Bakersfield, the median household income is \$45,790, which is \$5,350 (13.2%) more than that of Kern County. Bakersfield's household income is \$2,230 (4.4%) more than that of the United States, but \$4,430 (8.8%) less than California's.

or just being processed, it's not a stretch to say the economic benefit of these communities will be substantial. For example, at build-out, the Tejon Industrial Complex (TIC) is expected to generate 6,000 new local jobs and produce nearly \$6 million in local tax revenue. As detailed in the following chart, the total investment in TIC through October 26, 2004 exceeds \$110 million. The economic investment in, and job and revenue generation potential from, Centennial and Tejon Mountain Village is anticipated to greatly surpass that of Tejon Industrial Complex.

While the economic impact of these communities will be huge, the impact on the land will be minimal. Each of the developments, including Tejon Industrial Complex, features a minimum of 50 percent open space. The end result is that upon completion 25 years hence, the land actually built upon will total no more than five percent of the Ranch's land.

As California continues to grow, Tejon Ranch recognizes its obligation to plan and provide for that growth in a manner that minimizes the impacts on its land and resources. That's why Tejon Ranch Company is intentionally limiting the portion of its land that will be used for these communities and why each of the developments will use the latest in environmentally friendly planning and construction techniques. Such an approach increases the Ranch's costs of development, but "doing things right" is worth the investment.

Tejon Ranch and Kern County are inexorably tied together. Both share a common history. And as it carries out its vision to preserve California's legacy and provide for California's future, the Tejon Ranch will certainly play a major role in what promises to be the positive future of its home – Kern County.

Tejon Industrial Complex: Total Real Estate Development		
Infrastructural Development		\$23,500,000
Structural Development:		\$87,820,000
IKEA	\$50,000,000	
Petro Travel Plaza	\$15,310,000	
Tejon Dermody	\$16,300,000	
Best Western	\$3,150,000	
Petro C-Store	\$1,190,000	
McDonalds	\$720,000	
Panda Express	\$600,000	
Starbucks	\$550,000	
Grand Total		\$111,320,000

Sponsorship Form

Category	Amount of Contribution	Sponsorship Benefits
Gold	\$1,500	Listing of organization name and logo 20 print issues each quarter Online journal including the archives 2 tickets to Kern County Economic Summit
Silver	\$1,000	Listing of organization name and logo 10 print issues each quarter Online journal including the archives
Bronze	\$500	Listing of organization name and logo 5 print issues each quarter Online journal including the archives

Yes, my payment in the amount of \$_____ is enclosed.

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