II

Perspectives on the Economy and Demographics

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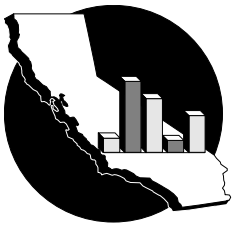


Economic and demographic developments are extremely important factors in California's budget outlook. For example, the strength of California's economy is the single most important determinant of the levels of collections from personal income taxes, sales and use taxes, and corporate income taxes. Similarly, California's population and economic trends affect spending in many of the state government's key program areas, including health and social services, education, and youth and adult corrections.

In the early 1990s, the downturn in California's economic performance contributed to major revenue reductions which led to substantial budgetary shortfalls. More recently, just the opposite has occurred—the state's economic recovery has resulted in healthy growth in General Fund revenues, which in turn has contributed to significant improvements in the state's fiscal condition. The Governor's proposed budget for 1998-99 assumes that continued, though moderating, economic growth will characterize California over the next 18 months.

In this part, we review recent economic and demographic developments, discuss the forecasts contained in the *1998-99 Governor's Budget*, and provide our own perspective on California's economic and demographic outlook.

BACKGROUND—A PERSPECTIVE ON CALIFORNIA'S ECONOMY

California's Economy Is Large and Diverse

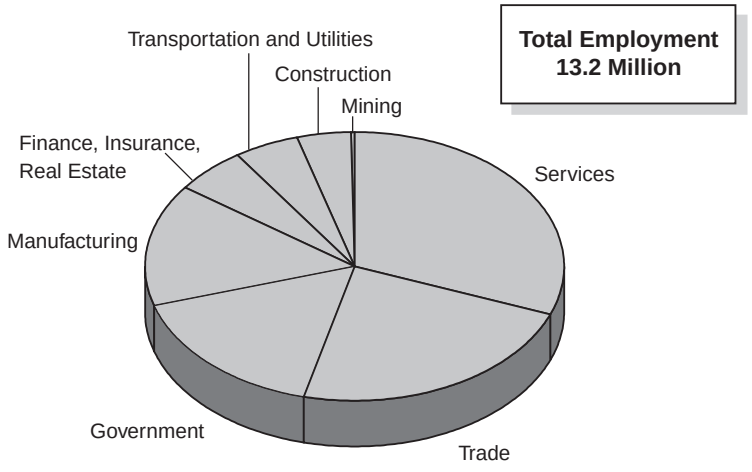
With total economic output exceeding $1 trillion last year, California's economy is the seventh largest in the world. The state's economy also is arguably the most diverse in the nation, with workers employed in a wide variety of different industries.

As shown in Figure 1, about one-third of the state's jobs are in the broadly defined services sector, which includes such diverse industries as computer and software design, motion picture production, hotel and travel services, engineering, business and professional services, landscape design, and auto repair. About one-fourth of the workforce is in the trade sector, which includes retailers, wholesalers, and import-export firms. An additional one-sixth each is in manufacturing and government. The remainder of California's jobs are spread among the construction, finance-related, transportation, utilities, and mining sectors.

Figure 1

Composition of California Jobs By Major Industry Sector

1997



Major Changes Have Occurred In California's Economy During the 1990s

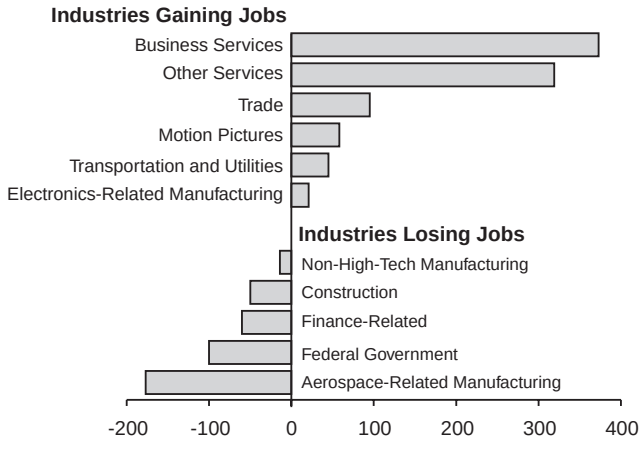
The state's economy has undergone major changes over the past eight years, including a major recession, the permanent downsizing of some industries, and the emergence and growth of others. Figure 2 shows the net impact of these changes on the state's major industries.

It shows that most of the net increase in California employment in the 1990s has been in the state's services-related industries. Within the broadly defined services sector, many of the new jobs created have been computer-related positions in the business services subsector. Significant employment gains also have been experienced involving motion picture production, as well as in the "other services" category. The latter includes amusement and recreation, health services, engineering, biotechnology, and management consulting activities.

Figure 2

Job Performance by Industry Has Been Mixed in the 1990s

Net Change in California Jobs Since 1990 for Selected Industries (In Thousands)



The *non*service industries showing significant employment increases include computer and electronics-related manufacturing, wholesale and retail trade, transportation, communications, and utilities.

The majority of job *losses* in the 1990s have been in aerospace manufacturing. This industry, which includes producers of aircraft, missiles and

other navigation systems, has lost 177,000 jobs, or more than two-thirds of the aerospace manufacturing jobs that existed in 1990. Military base closures are primarily responsible for the 100,000 decline in federal government employment between 1990 and 1998. Consolidations of major California banks were responsible for the 60,000 job decline in the finance, insurance, and real estate industry subsector. Despite recent gains, construction employment also has experienced a net loss in employment in the 1990s. The 50,000 jobs lost in construction are due to declines in residential building activity during the decade (relative to levels in the 1980s).

Are the New Jobs of the Same "Quality" as Jobs in the Past?

An often-asked question is whether the new jobs created in California in recent years are of the same quality and pay level as those lost in the recession. The answer is somewhat mixed. The downsizing of the aerospace and banking industries resulted in the loss of many middle-income and upper-middle-income jobs in the early 1990s. In contrast, the new jobs being created in California's current economic expansion include a diverse mix of jobs at both the high and low ends of the income scale. Among the high-paying jobs are those being created in areas of computer and software design, and motion picture production. Among the lower-paying jobs are part-time jobs being created in areas of temporary employment services, retail trade, and tourism-related services. The net impact of these changes is that, while the *average* pay (in inflation-adjusted terms) of the newly created jobs may not be all that different from those lost during the recession, the *distribution* of pay levels has widened. That is, there are relatively more jobs now at *both* the high end and low end of the pay scale, and relatively fewer in the middle, than before.

RECENT DEVELOPMENTS

1997 Was a Strong Year

The economic expansion accelerated at both the national and state levels in 1997. The U.S. real Gross Domestic Product (GDP) increased by nearly 4 percent, the strongest gain of the 1990s. Despite healthy growth and an historically low rate of unemployment, inflation remained low, and interest rates fell over the course of the year. The past year also was very positive for California's economy, where personal income increased nearly 7 percent and wage and salary employment was up 3.5 percent.

Figure 3 summarizes the major features shaping California's near-term economic outlook.

Figure 3

Major Features Shaping California's Economic Outlook

☑ **California currently is enjoying strong growth and low inflation:**
- Continued improvement in job growth.
- Broadening expansion.
- Long-awaited recovery in home building.

☑ **However, Asian financial problems will likely affect future growth:**
- Lower demand for California exports.
- Less tourism in U.S. from Asia.
- Losses on U.S. investments in the region.

Job Growth Currently Strong. The recent performance of California's economy has been stronger than was assumed in previous forecasts made last year. As indicated in Figure 4 (see next page), wage and salary employment in the last three quarters of 1997 was up strongly from the prior year. The updated increases shown in the figure are greater than assumed in both the *1997-98 Budget Act* forecast, and the Governor's January 1998 budget economic forecast. These upward employment-growth adjustments indicate that the California economy ended 1997, and is beginning 1998, with considerable momentum.

Expansion Has Spread to All Regions and Industries. California's recent job growth has been broad-based, with major gains in services, construction, retail trade, and computer and electronics manufacturing. Regionally, continued job growth has occurred at a strong pace in the San Francisco Bay Area, and gains have accelerated in southern California—where growth had lagged in the earlier stages of the expansion.

Residential Construction Finally Rebounding. Permits for new construction in California during 1997 were up by 18 percent from the prior year, reflecting gains in virtually all regions of the state. Key indicators point toward further gains in home sales and construction in 1998. For example, home prices in California rebounded 10 percent in 1997, which is a sign of renewed confidence and activity in the state's real estate markets. As shown in Figure 5 (see next page), home price appreciation has been strongest in Santa Clara County, the San Francisco Bay Area, and Orange County. However, the gains are now extending to all regions of the state.

Figure 4

California's Economy Currently Stronger Than Previously Thought

1997 California Wage and Salary Employment
Estimated Year-Over-Year Percent Changes

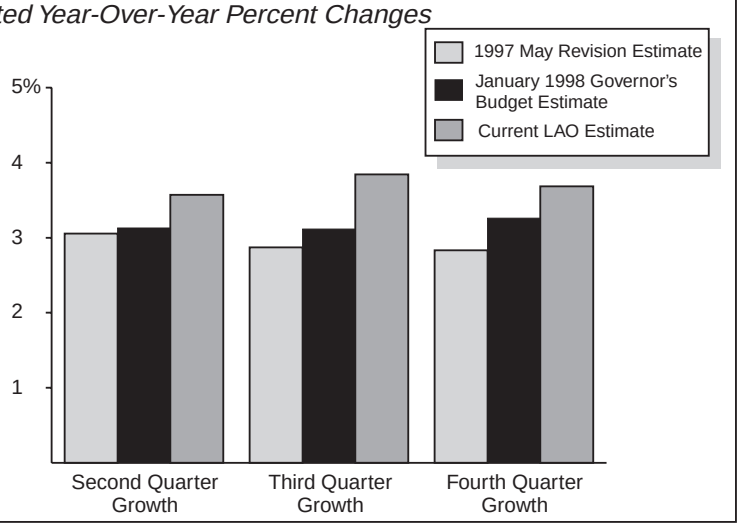
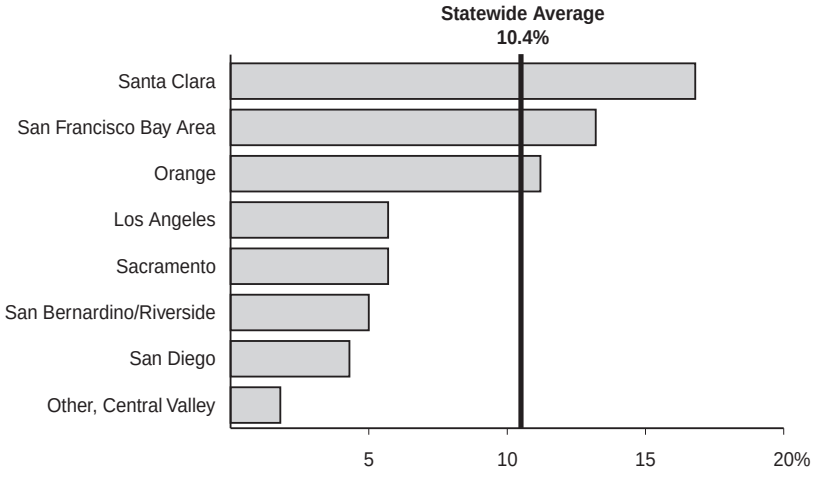


Figure 5

California Real Estate Prices Rebounding

Percent Change in Median Home Price, by Area/County
November 1996 to November 1997



Interest Rates and Inflation Low. Despite the fact that the U.S. economy has been operating at near full capacity (reflected in part by a very low unemployment rate and reportedly tight labor markets), inflation has remained remarkably low. The U.S. Consumer Price Index (CPI) was up just 1.7 percent between December 1996 and December 1997, and other measures of inflation show similarly low increases. Although wages have started to rise in response to tightening labor markets, these increases have not yet been translated into higher product prices. In response to the positive news regarding inflation, U.S. long-term interest rates declined over the past year, with the yield on 30-year Treasury bonds falling to below 6 percent at year-end. These low interest rates will give an added boost to home construction in the state. Lower monthly mortgage payments resulting from the refinancings of existing mortgages also will add to consumer discretionary incomes in 1998, further bolstering consumption spending in the state.

In summary, California is entering 1998 with considerable momentum, with jobs and income expanding at a healthy pace. The greatest known threat at this time to this otherwise bright outlook relates to Asia's financial and related economic problems. Given the potential threat to California associated with Asia, we discuss below in more detail the topic of Asia's financial crisis, including its implications for California in 1998 and 1999.

Asia's Financial Problems

Over the past several months, Korea, Malaysia, Indonesia, and other emerging economies in Asia have been beset by major financial and economic crises, characterized by significant business losses, loan defaults, bank failures, and declining stock market values. Most analysts attribute Asia's problems to the over-direction of investment funds by governments and central banks in the region toward favored businesses and industries. This eventually led to economic imbalances, mounting investment failures, and loan losses. These factors have caused international investors to "pull back" from the region, which has, in turn, led to major currency depreciations and further financial and economic problems in Asia. Major loan losses have also led to insolvencies in Japanese and Hong Kong investment houses, and have raised the risk that these problems will spread geographically beyond just the emerging Asian economies.

Impacts on California—Negative on Balance. Figure 6 (see next page) summarizes the principal ways in which Asia's problems could affect California.

Figure 6

How Asia's Problems Could Affect California

Negative Factors

- ☑ Investment losses and negative wealth effects
- ☑ Reduced exports
- ☑ Greater import competition
- ☑ Loss of tourism

Possible Mitigating Factors

- ☑ Reduced wage costs of foreign California-owned subsidiaries
- ☑ Lower product prices, generating consumer savings
- ☑ "Excess demand" in some affected industries, insulating them from near-term job losses

As indicated in the figure, there are four main negative effects involved:

- *First*, U.S. banks and investors in mutual funds with large Asian holdings face financial losses related to loan defaults, stock price declines, and currency depreciations. Direct investment by the U.S. in this region is not as large as it is in Japan or Europe; thus the impact of Asian financial defaults on the U.S. has been fairly minor to date. However, the U.S. could be vulnerable to future losses, especially if Asia's problems spread into other regions and precipitate a larger-scale global financial crisis.
- *Second*, Asia is a major destination for California *exports* of computers, electronics, other capital goods, engineering services, and agricultural products. As indicated in Figure 7, nearly one-half of California's $100-plus billion in annual exports are destined for Asia. This is about 5 percent of our total economic output—nearly double the share for the U.S. economy as a whole. Given this, an

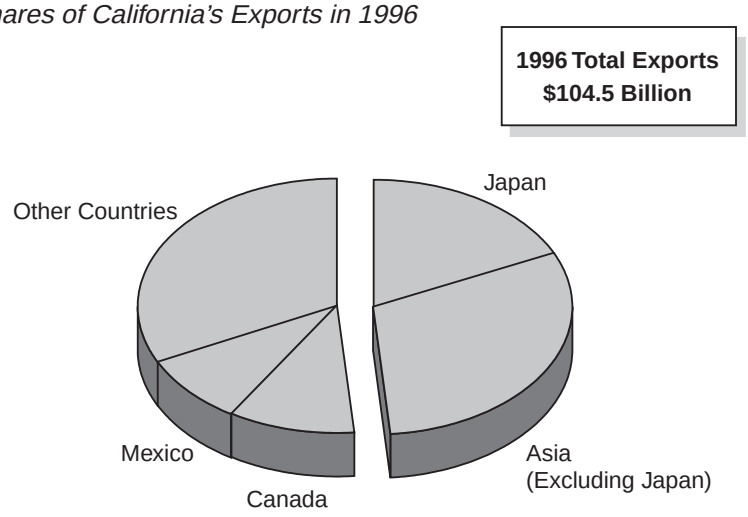
economic slowdown or recession in that region could disproportionately affect California.

- *Third*, the declines in Asian currency values make exports from these regions less expensive on international markets. Cheaper goods from Asia may adversely affect demand for California products in other regions of the world, to the extent they compete with one another. Less expensive imports also negatively affect sales and profits of California industries that directly compete with products from Asia.
- *Fourth*, currency depreciations in Asia also reduce the purchasing power of Asian tourists visiting California, thereby affecting tourism-related spending in this state.

Figure 7

Asia Accounts for About One-Half Of California Exports

Shares of California's Exports in 1996



Mitigating Factors. In evaluating the net adverse impact of Asia's problems, it is also important to take into account mitigating factors which tend to reduce the net effect on California:

- *First*, a significant portion of California's exports to Asia involves electronic components and other unfinished goods, which are subsequently assembled in U.S. subsidiaries located in Asia, and then are either returned to the U.S. or sold to other countries. In

these cases, California firms could benefit from the depreciation of Asian currencies to the extent that such depreciations reduce the U.S. dollar value of wage costs and other expenses that subsidiaries located there incur.

- *Second*, although less expensive imports from Asia would compete with domestic *producers*, they would benefit California *consumers*, who would face lower import prices and consequently less inflation generally.
- *Third*, industries facing the greatest potential impact of an Asia slowdown—namely, high-technology manufacturing and services industries—are currently running at or near full capacity and some are actually facing labor shortages. In these cases, at least some of the potential loss in business associated with Asia may not affect jobs in these sectors, due to existing excess demand for their output. Indeed, employment growth in California's high technology industries has accelerated over the past year, even as exports to Asia have fallen.

Asian-Related Problems Expected to Slow But Not Stall California's Expansion. Overall, we estimate that financial and economic problems in Asia will depress employment and income growth in California by between 0.5 percent and 1 percent per year in 1998 and 1999. However, as indicated above, the state is entering 1998 with considerable momentum, so even after accounting for the negative effects of Asia, the state should register moderate economic growth over the next two years. The "bottom line" is that, while Asia's problems do pose a risk to California, they are but one of several factors shaping the outlook for the next two years.

THE GOVERNOR'S BUDGET ECONOMIC OUTLOOK IN BRIEF

The budget assumes that both the U.S. and California economies will experience ongoing, though tapering, economic expansion during the next three years, accompanied by continued modest inflation. As shown in Figure 8, the budget forecast projects that U.S. real GDP will increase by 2.7 percent in 1998 and 2 percent in 1999, following a 3.8 percent gain last year. In California, wage and salary employment is projected to increase 2.8 percent this year and 2.3 percent in 1999, while personal income is forecast to grow by 6.3 percent and 6 percent over the two years. The budget assumes that state employment and income growth will continue to exceed the nation in both 1998 and 1999.

Figure 8

Summary of Department of Finance's Economic Outlook

Percent Changes[a]

	Preliminary 1997	Projected 1998	Projected 1999
United States Forecast			
Percent change in:			
Real GDP	3.8%	2.7%	2.0%
Pretax corporate profits	7.3	4.6	-0.4
Unemployment rate (%)	4.9	4.7	4.9
Federal funds interest rate (%)	5.5	5.9	6.5
California Forecast			
Percent change in:			
Personal income	7.2%	6.3%	6.0%
Wage and salary jobs	3.1	2.8	2.3
Taxable sales	5.9	4.8	4.3
Consumer Price Index	2.2	2.6	3.4
Unemployment rate (%)	6.3	5.6	5.4
New housing permits (000)	110	130	126

[a] Unless otherwise indicated.

Effect of Asia. The administration indicates that its forecast includes a slightly greater than 0.5 percent downward adjustment to the rate of growth in personal income in both 1998 and 1999 to reflect the net impact of the problems in Asia.

LAO'S ECONOMIC FORECAST

Based on recent developments in Asia and California's economy, the LAO's revised economic forecast assumes slightly greater near-term employment growth, but a slightly sharper economic slowing in 1999 and 2000, than does the administration.

National Forecast

Our economic forecast is summarized in Figure 9 (see next page). With regard to the U.S. economy, our forecast assumes that real GDP growth will slow from 3.7 percent last year to 2.3 percent in 1998 and 1.8 percent

in 1999, before rebounding modestly to 2.4 percent in 2000. We project that U.S. corporate profit growth will slow sharply, reflecting the combined effects of tapering output growth and rising wage pressures over the next two years. Interest rates and inflation are projected to remain in the modest-to-moderate range, with the CPI increasing 2 percent this year, 2.4 percent next year, and 2.9 percent in 2000. The main reasons for the projected near-term slowdown are weakening exports and some slowing in U.S. capital spending.

Figure 9

Summary of LAO's Economic Outlook

Percent Changes[a]

	Preliminary	Projected		
	1997	1998	1999	2000
United States Forecast				
Percent change in:				
Real GDP	3.7%	2.3%	1.8%	2.4%
Personal income	5.8	5.1	4.2	4.5
Wage and salary jobs	2.3	2.0	1.1	1.5
Consumer Price Index	2.4	2.0	2.4	2.9
Unemployment rate (%)	4.9	4.8	5.2	5.5
Housing Starts (000)	1,476	1,446	1,435	1,414
California Forecast				
Percent change in:				
Personal income	6.8%	6.4%	5.7%	5.3%
Wage and salary jobs	3.5	3.4	2.5	1.9
Taxable sales	5.9	5.8	5.6	5.1
Consumer Price Index	2.2	2.7	3.1	3.2
Unemployment rate (%)	6.3	5.5	5.4	5.5
New housing permits (000)	107	138	150	155

[a] Unless otherwise indicated

California Forecast

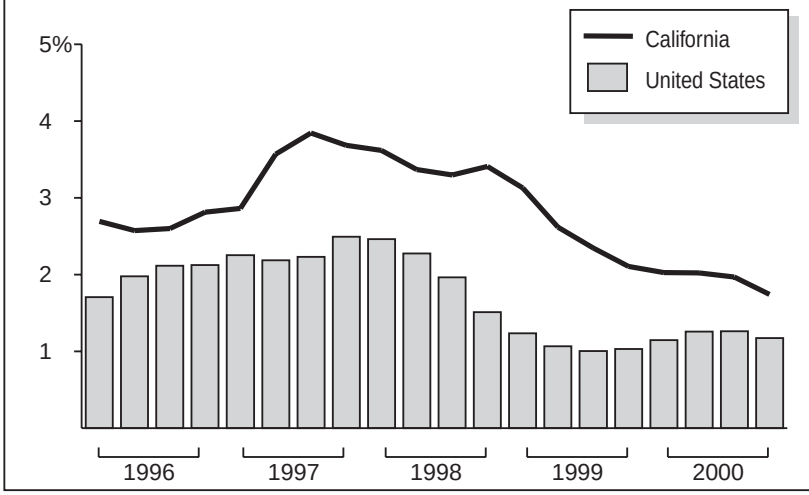
With regard to California, our forecast assumes that wage and salary employment will increase 3.4 percent in 1998 (to 13.6 million jobs), before moderating to 2.5 percent growth in 1999 and 1.9 percent growth in 2000. Personal income is projected to grow by 6.4 percent this year, before moderating to gains of 5.7 percent during 1999 and 5.3 percent in 2000. While both the U.S. and California economies are projected to slow in

1999 and 2000, we project that California will maintain a significant growth margin over the nation during this period (see Figure 10). The state's higher projected growth partly reflects the positive near-term outlook for both California residential and nonresidential construction activity.

Figure 10

California's Economic Growth to Moderate But Remain Above Nation's

Year-Over-Year Percent Growth in Jobs
1996 Through 2000, By Quarter



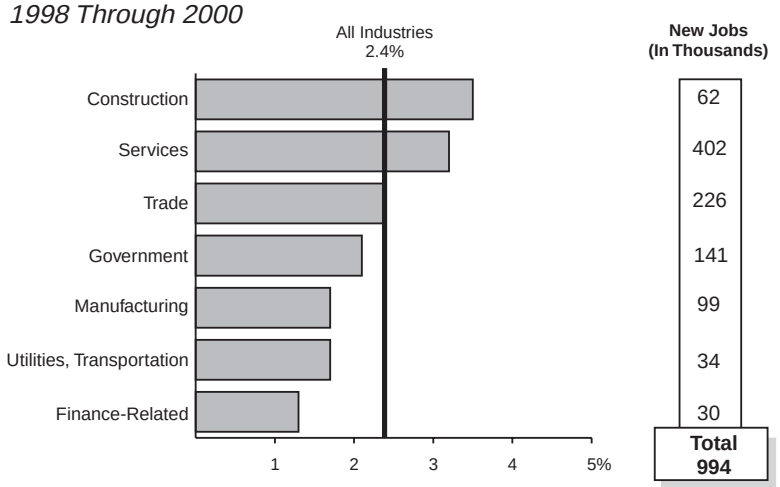
Services and Construction to Lead California's Economy. Figure 11 (see next page) shows our outlook for job growth in individual industry sectors in California. It indicates that in numeric terms, services employment is projected to be the fastest growing sector. As in past years, many of the new jobs will be in high-technology computer services, systems design, and software development occupations. The projected increases in residential and nonresidential building activity are expected to lead to major gains in construction employment.

Manufacturing employment is projected to increase by nearly 100,000 between 1997 and 2000. Most of these jobs are expected to be in the high-technology computer and electronic equipment subsectors. The slow increase in aerospace employment that began in 1997 (following several years of major declines) is expected to continue, with this subsector adding about 12,000 jobs between 1997 and 2000. Modest gains are forecast for utilities, trade, government, and finance-related industries during the next three years.

Figure 11

Construction and Services Sectors To Lead Job Growth

Average Annual Percent Change in California Jobs 1998 Through 2000



Home Construction to Continue Climbing in 1998. As indicated earlier, the long-awaited improvement in California home construction finally materialized in 1997. As shown in Figure 12, we assume that construction of both single-family and multi-family residential structures will continue to climb over the next three years.

The main factors behind the projected improvement in single-family construction are a rebound in population growth, as well as ongoing gains in jobs and income. The recent uptrend in housing prices, particularly in the inland regions of the state where there is room for new development, has also led to an improvement in confidence on the part of both prospective buyers and developers. And, this confidence is contributing to increased building activity.

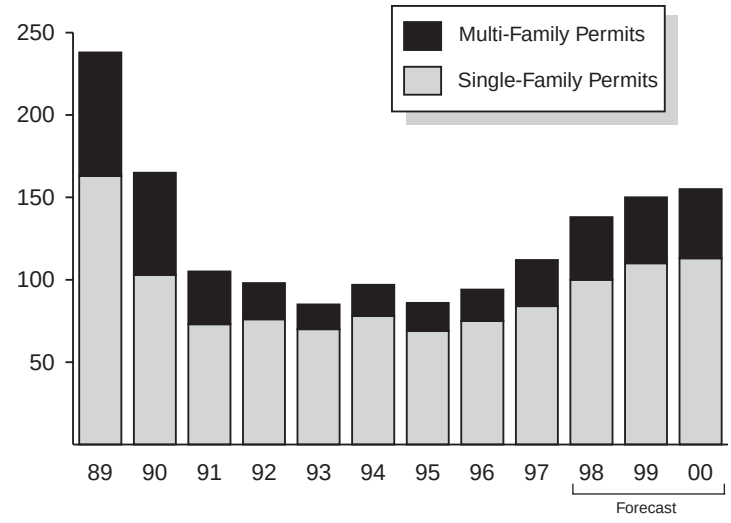
Signs of improving conditions for new multi-family construction include a recent jump in average rents and declining vacancy rates in major metropolitan regions. Over the past twelve months, for example, the CPI for residential rents in the San Francisco Bay Area is up nearly 8 percent, which is the largest gain this decade.

Overall, we forecast that total permits for new residential construction will increase steadily from 112,000 in 1997 to 155,000 by the year 2000. While the projected levels are still well below those achieved in the 1980s,

Figure 12

Housing Sector Finally Recovering

California Residential Building Permits (In Thousands)
1989 Through 2000



the level of building activity forecast for the end of the decade is nearly double that of the lowest levels experienced in the early 1990s.

Nonresidential Construction Also Strong. The high-technology economic boom in California has already led to major increases in the construction of office and industrial space in the San Francisco Bay Area during the past two years. More recently, however, gains in nonresidential building have spread to other regions of the state. Permits for nonresidential construction in late 1997 were up over 20 percent from the prior year. While the largest increases have been experienced in the Bay Area, where permit valuations are up by more than 35 percent, all regions of the state are experiencing increases in excess of 15 percent. We project that this sector will continue to grow over the forecast period, with the value of permits (in constant 1997 dollars) increasing from $11.9 billion in 1997 to $12.8 billion in 1998, $13.3 billion in 1999, and $13.5 billion in 2000.

COMPARISONS OF RECENT ECONOMIC FORECASTS

Figure 13 (see next page) compares our current forecasts for the nation and California to our November 1997 forecasts (see *California's Fiscal Outlook: The LAO's Economic and Budget Projections for 1997-98 Through*

1999-2000), as well as the University of California, Los Angeles' (UCLA's) December 1997 economic forecast and the Governor's January 1998 budget forecast.

Figure 13

Comparison of Recent Economic Forecasts[a]

Percent Changes

	Preliminary 1997	Projected 1998	1999	2000
United States Real GDP:				
LAO November	3.7%	2.3%	2.2%	2.5%
UCLA December	3.8	2.6	1.9	2.3
DOF January	3.8	2.7	2.0	0.8
LAO February	3.7	2.3	1.8	2.4
California Wage and Salary Jobs:				
LAO November	3.4%	3.1%	2.6%	2.3%
UCLA December	3.3	2.9	2.3	2.7
DOF January	3.1	2.8	2.3	1.9
LAO February	3.5	3.4	2.5	1.9
California Personal Income:				
LAO November	6.7%	6.4%	5.8%	5.6%
UCLA December	6.5	6.0	5.6	6.0
DOF January	7.2	6.3	6.0	5.2
LAO February	6.8	6.4	5.7	5.3
Taxable Sales:				
LAO November	5.6%	5.6%	5.5%	5.2%
UCLA December	5.9	5.6	5.5	5.8
DOF January	5.9	4.8	4.3	—
LAO February	5.9	5.8	5.6	5.1

[a] Acronyms used apply to Department of Finance (DOF); Legislative Analyst's Office (LAO); and University of California, Los Angeles (UCLA).

Taking into account the impacts of both a stronger economy in early 1998 as well as the negative consequences of Asia's problems on future California economic growth, our updated forecast has a sharper cyclical profile than our November 1997 projections. Specifically, we now project comparatively *more* growth in 1998 but *less* growth in 1999 and 2000. Our current forecast also contrasts with the budget forecast and UCLA in the same way (that is, more growth in 1998 but less growth in the out years).

In terms of their impacts on state revenues, the differences in the economic forecasts shown in Figure 13 for employment and personal income are minor. For example, as discussed later in Part III of this volume, the majority of our revenue difference with the administration with regard to projected personal income taxes is related to the *translation* of economic projections into revenues, and not to the economic projections themselves. From a revenue-forecasting perspective, our most significant difference with the administration in the economic area relates to our respective estimates of taxable sales. As shown in Figure 13, our projection of taxable sales growth is similar to UCLA's but significantly higher than the Governor's. We discuss in detail the state revenue implications of our differing economic assumptions in Part III.

CALIFORNIA'S DEMOGRAPHIC OUTLOOK

California's population is very dynamic—rapidly growing, highly mobile, and undergoing significant changes in terms of its ethnic and age mix. Population changes can have substantial impacts on the state's revenue receipts and expenditure demands. Thus, it is important that the Legislature be aware of the state's demographic trends and understand their budget-related implications, from both a near-term and longer-term perspective.

Population Growth Rate Increases

Figure 14 (see next page) shows California's total population and population growth rates for the 1980s and 1990s. We project that California's population growth will average 1.8 percent during the period 1997 through 2000, reaching nearly 35 million by the millennium. Numerically, we project that California will add 1.8 million residents during these three years—an amount greater than the current population of San Diego, the state's second largest city.

While the state's expected population growth rate over the next few years is not as robust as California's 2.3 percent average annual growth experienced during the 1980s, it nevertheless is a considerable increase over the 1.2 percent average annual rate experienced during the three-year period prior to 1997.

The Migration Turnaround Has Arrived

Population growth is due to two factors: *natural increase* (the excess of births over deaths) and *net in-migration* (the difference between the number of people who migrate to California and the number that leave).

Figure 14

California's Population to Reach 35 Million by Millennium

Level and Growth of Population 1980 Through 2000 (July 1 Basis)

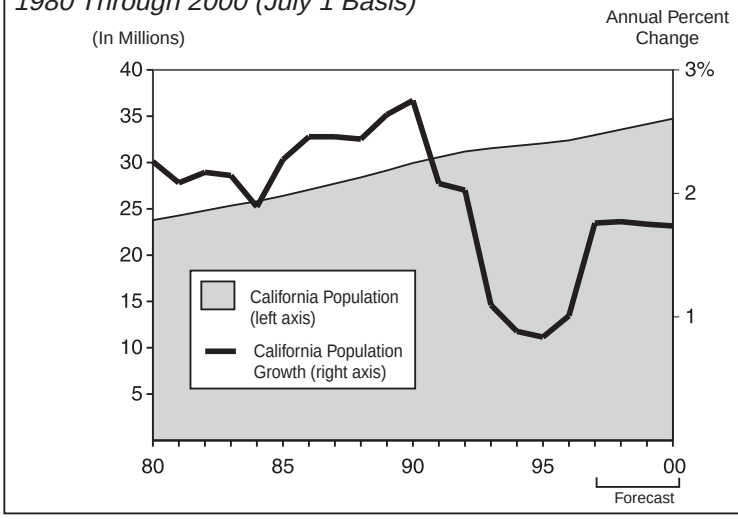


Figure 15 shows the state's annual population changes since 1980, and depicts the contributions of both natural increase and net in-migration to the overall changes. It shows that a sharp decline in net in-migration (and an actual net outflow in three of the years) is primarily responsible for the reduced annual population change experienced during the early 1990s. Indeed, while natural increase only declined gradually (reflecting declining fertility rates) between 1990 and 1995, net migration to California fell sharply, as the state's severe recession discouraged those who otherwise would have migrated to California in search of economic opportunities. Now that economic conditions have improved in the state, net in-migration has resumed; and we expect net in-migration to add an average of 275,000 persons annually between 1997 and 2000.

Dramatic Reversal Involving Domestic Migration. Net-migration itself reflects two factors—*domestic* migration (flows between California and the rest of the U.S.) and *foreign* migration (flows between California and other nations).

Figure 16 shows that the recent recovery in net in-migration has largely been a "domestic" phenomenon. California was the destination of significant numbers of both domestic and foreign migrants in the 1980s. While steady foreign net in-migration continued into the 1990s, domestic net in-migration evaporated. In fact, the substantial number (averaging about

Figure 15

Net In-Migration Rebound Boosts Population Growth

Population Change Components
1980 Through 2000

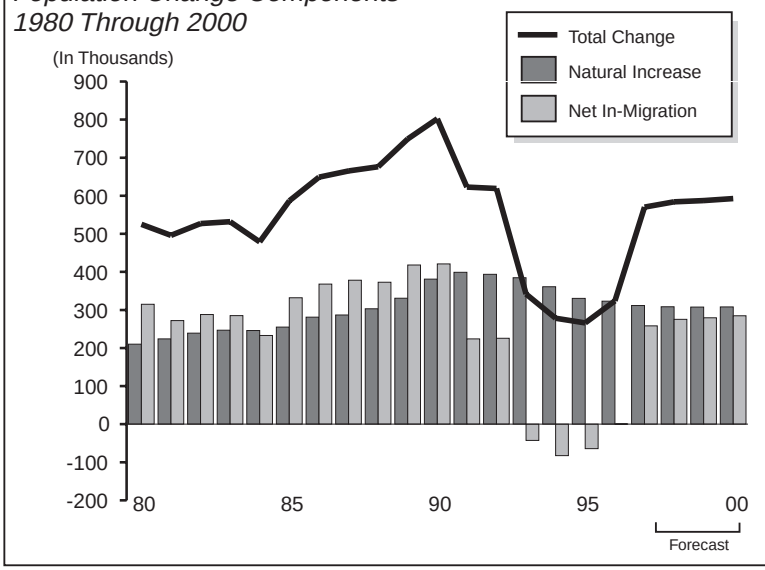
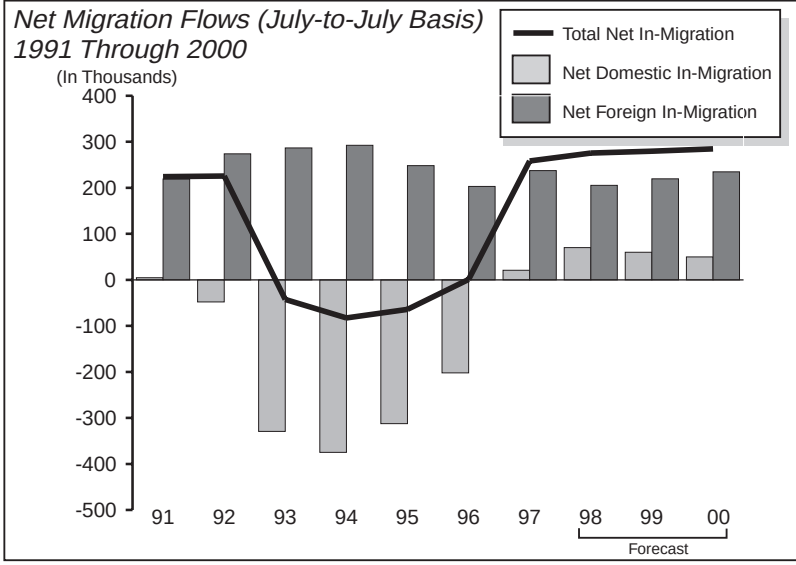


Figure 16

Domestic Inflows Drive Net In-Migration Turnaround

Net Migration Flows (July-to-July Basis)
1991 Through 2000



300,000 annually) of state residents leaving California for the other 49 states offset the net in-migration from other nations, resulting in the negative overall net in-migration identified in the figure (solid line).

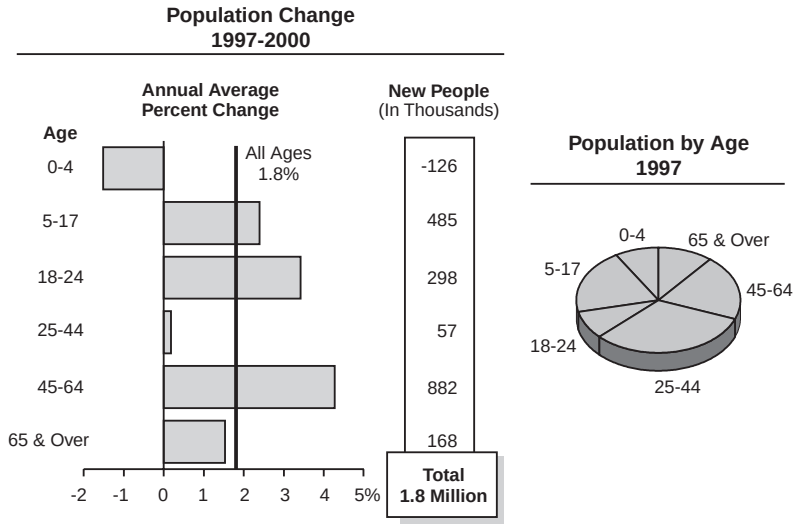
The recent reversal in domestic net in-migration—from a negative to a positive—reflects primarily an upsurge of people coming into California from other states, as opposed to a lessening of people leaving California for other states. Even during the worst years of the early-1990s'recession, the number of domestic out-migrants remained relatively stable. In contrast, the number of people coming into California from other states dropped off. Now that better economic times have returned, domestic migrants are flowing into California once more, resulting in positive overall net in-migration.

California's Age Composition Continues to Change

Persistent, ongoing changes are taking place in the age distribution of California's population. Figure 17 shows our estimated age distribution of the state's population in 1997, and summarizes our projections of how various age groups will be changing over the next three years.

Figure 17

The Growth and Mix of California's Population By Age



California's median age will be increasing, as the baby boomers enter their late 40s and 50s. The 25 to 44 year old group will stay relatively flat in numbers (and thus decline as a share of total population), as the baby boom cohort ages into the next-older age grouping. The K-12 school-age population will grow faster than the general population, while the college-age population's growth rate will be twice as fast. Conversely, the number of preschoolers is projected to decline, presaging a future slow-down in the K-12 population.

What Effect Will These Trends Have? Demographic trends occurring in the state are key determinants of both state revenues and expenditures. In the case of expenditures, for example, program demands are influenced by caseloads, which in turn are a function of such demographic factors as overall population growth and the age characteristics of the population. Likewise, revenues depend on such economic factors as income and job growth, which in turn are influenced by demographic variables such as the size of the labor force and the number of people using the various goods and services which businesses produce. The rapid changes in the size and composition of California's population will have many implications for California's economy, and for the volume and mix of public services in the budget year and beyond.