



COMPETITIVE STATES

Texas v. California

Economic Growth Prospects for the 21st Century

ARDUIN, LAFFER & MOORE ECONOMETRICS



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The Economic Scorecard: Texas v. California

There is no finish line in the interstate economic competition. It is a never-ending struggle requiring states to consistently maintain an advantageous economic environment vis-à-vis other states. States that establish and maintain the most pro-growth economic environment will be the leaders in the interstate economic competition. This is especially true with respect to key economic rivals. One key economic rivalry is the rivalry between Texas and California: the two economic heavyweights of the United States.

Both Texas and California have the allure of geography, and the economy in both states has been outperforming the national trends. But, current policies matter for future economic performance. Texas' superior policies over the past several years are making Texas more resilient to the current economic downturn and will provide powerful tailwinds for the Texas economy going forward. The opposite is true for California.

The results of a head-to-head competition between the two economic heavyweights are not even close. Economically, Texas is just too much for California to handle. At the state level, there are six broad categories in which the states compete: taxes on labor income; taxes on capital income; taxes on consumption; overall tax environment; government spending policies; and government regulatory policies. On net, Texas' economic environment is more competitive in five of these categories, and is equal to California's in the 6th (taxes on consumption)—see the Table below.







Competitive Event	California	Texas	Winner
Taxes on Labor			
Top Marginal Personal Income Tax Rate	10.30%	0.00%	
Marginal Personal Income Tax (average income earner)	9.30%	0.00%	
Taxes on Capital			
Property Tax Burden	\$28.24	\$42.13	
Estate/Inheritance Tax Levied	NO	NO	
Top Marginal Rate: Income, Dividends, and Cap. Gains	10.3%	0.0%	
Top Marginal Corporate Tax Rate	8.84%	1% GRT	

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Competitive Event	California	Texas	Winner
Taxes on Consumption			
State Sales Tax Rate	7.25%	6.25%	
Sales Tax Burden per \$1,000 of Personal Income	\$28.06 (32 nd)	\$28.64 (34 th)	
Overall Tax Environment			
Overall Tax Burden	\$118.33	\$99.49	
Personal Income Tax Progressivity	\$33.58	\$0.00	
Recent Legislated Tax Changes per \$1,000 of Personal Income	+\$0.29	-\$4.35	
Number of Tax Expenditure Limits	2	1	
Regulatory Environment			
State Liability System (PRI U.S. Tort Liability Index Rank)	34 th	18 th	
State Minimum Wage	\$7.50	\$5.85	
Average Workers' Compensation Cost	\$4.13	\$2.84	
Right-to-Work State	NO	YES	
Education Freedom Index Score	2.11 (14 th)	2.32 (7 th)	
Government Spending Policies			
Total Expenditures per Capita	\$9,448.26	\$6,652.11	
Average Growth in State Government Expenditures	7.04%	5.96%	

Current state economic policies have important implications for future economic performance. Texas' win over California is an encouraging sign for Texas' future, and an ominous sign for California's. Texas' future prosperity looks bright: stronger income, wealth and employment growth will occur in the Lone Star state relative to California as well as the country as a whole. The opposite is true for California: weaker economic performance and less relative wealth growth will ensue both relative to Texas and the country as a whole.

Texas v. California: Economic Growth Prospects for the 21st Century

States fiercely compete with one another: they compete for jobs, they compete for businesses, and they compete for people. The results of this economic competition have real implications for future state economic performance. States with strong competitive environments have flourishing economies while states with weak competitive environments have struggling economies. A dismal competitive environment in Michigan, for instance, has led to the “Michigan Recession” even while the rest of the country prospered.¹

Many factors impact a state’s competitive environment. A number of these factors—such as climate, natural resources, or geographical location—do not change. State economic policies (i.e., tax, expenditure, and regulatory policies) vary across states and across time within a state and have significant implications for a state’s economic prospects. For this reason, state economic policies are crucial economic competitive metrics.

This paper evaluates the economic policies of two key economic competitors: Texas and California—“the heavyweight competition” amongst the states. To judge whose economic prospects are brighter, Texas or California, we compare each state’s current economic policies in a head-to-head competition.

The result of a head-to-head competition between Texas and California is an economic blowout. The economic environment in Texas has significant advantages over California. The implications of this competitive advantage are clear; Texas’ economic prospects are bright and the Texas economy will significantly outperform California’s. Put another way: In a heavyweight competition between Texas and California, Texas wins!

State Government Policies Matter for Economic Growth

Before we get to the main event, some background information on the importance of the “competitive events” is appropriate. Whether it is excessive taxation, excessive regulations, or excessive expenditures, the result is the same—poor economic policies lead to poor economic outcomes.

Excessive taxation, regulations, and expenditures are detrimental to labor and capital, poor and rich, men and women, and old and young. Poor economic policies are equal opportunity tormentors. In the short run, poor economic policies lead to higher taxes on labor or capital, and lower after-tax earnings. In the longer run, mobile factors “vote with their feet” and leave the state, leaving immobile factors (such as low wage workers and land and property) to suffer the tax and regulatory burdens. Businesses suffer lower after-tax earnings, and residents suffer decreased employment growth. The incentives to work, save and produce are all diminished.

Government expenditures also directly impact the overall economic growth environment. In order to spend money the government must first take it from the private

sector either through taxes or borrowing. Depending upon how these revenues are spent, the contribution of the government expenditures to the economy may be less than the value of the money to the economy prior to its removal from the private sector. When this is the case, government expenditures create additional negative impacts on economic growth and development beyond the tax impacts already considered.

The principals of Arduin, Laffer & Moore Econometrics (ALME) have produced decades of research demonstrating that states that impose high and/or increasing taxes, burdensome regulations, and poor expenditure policies experience relative income and population declines, rising relative unemployment, and declines in housing values. Alternatively, states that impose a pro-growth economic policy that consists of low taxes, appropriate regulations, and disciplined expenditure policies experience accelerated income and population growth, declining unemployment, and rising housing values.

Examining the economic growth performance in the states with the highest tax burdens compared to the economic growth performance in the states with the lowest tax burdens illustrates these trends. Not surprisingly, the economic performance of the low tax states beats the economic performance of the high tax states. Table 1 summarizes the latest results.

TABLE 1: STATE AND LOCAL TAX BURDEN VS. 10-YEAR ECONOMIC PERFORMANCE

(2006 state & local tax burden vs. economic performance between 1996 and 2006, unless otherwise noted)

	2006 S&L Tax Burden	Personal Income Growth	Population Growth	Net Domestic In-Migration as a % of Population	Non-Farm Payroll Employment Growth	Unemployment Rate
South Dakota	\$87.40	76.0%	5.2%	-1.8%	14.5%	3.2%
Tennessee	\$88.99	63.6%	11.9%	4.3%	9.6%	5.2%
Alabama	\$90.44	61.6%	6.1%	0.8%	8.0%	3.5%
New Hampshire	\$90.51	73.0%	13.2%	6.0%	15.9%	3.4%
Colorado	\$94.00	88.5%	21.9%	5.1%	19.5%	4.4%
Missouri	\$98.48	56.6%	7.8%	1.3%	7.3%	4.8%
Texas	\$99.49	87.2%	20.6%	2.1%	20.8%	5.0%
Oklahoma	\$100.21	70.1%	7.2%	0.1%	13.8%	3.9%
Oregon	\$101.10	65.0%	14.3%	4.7%	16.0%	5.4%
Georgia	\$102.50	78.1%	23.8%	6.4%	15.7%	4.7%

	2006 S&L Tax Burden	Personal Income Growth	Population Growth	Net Domestic In-Migration as a % of Population	Non-Farm Payroll Employment Growth	Unemployment Rate
10 States with Lowest Tax Burden	\$95.31	72.0%	13.2%	2.9%	14.1%	4.4%
10 States with Highest Tax Burden	\$132.31	59.5%	5.5%	-2.3%	12.9%	4.4%
Connecticut	\$119.41	61.6%	5.6%	-3.1%	5.6%	4.3%
Wisconsin	\$121.73	59.8%	6.8%	0.6%	10.3%	4.7%
West Virginia	\$123.38	46.3%	-0.4%	-0.5%	8.2%	4.8%
Rhode Island	\$125.32	60.5%	5.8%	-1.9%	11.8%	5.3%
Alaska	\$131.39	52.6%	9.8%	-3.9%	19.4%	6.8%
Hawaii	\$133.05	46.9%	6.5%	-6.5%	16.5%	2.6%
Maine	\$134.56	62.6%	6.3%	3.7%	13.1%	4.6%
Wyoming	\$140.43	86.0%	5.0%	-2.0%	23.9%	3.2%
Vermont	\$143.29	64.9%	5.8%	1.0%	11.9%	3.5%
New York	\$150.52	53.8%	3.9%	-10.1%	8.3%	4.5%

Economic growth in the 10 states with the lowest total state and local taxes per \$1,000 of personal income (i.e., the lowest tax burdens, which includes Texas), exceeds the economic growth in the 10 states with the highest total state and local taxes per \$1,000 of personal income (i.e., the highest tax burdens). Overall economic growth as measured by residents' total personal income growth has been significantly higher in the low-tax states. Stronger economic growth has led to more jobs and higher population growth in the low-tax states as more and more people choose to relocate to the lower-taxed states. These results are not unique to 2006 either. This relationship holds in years past just as strongly as it held in 2006.

Similar to the experience of the low-tax states, economic growth in the states with no personal income tax (including Texas) exceeds economic growth in the states with the highest personal income tax (including California). Table 2 illustrates this relationship.

TABLE 2: RELATIONSHIP BETWEEN STATE PERSONAL INCOME GROWTH AND TOP MARGINAL PERSONAL INCOME TAX RATE (STATE & LOCAL) 2006

	Top PIT Rate	Personal Income Growth	Population Growth	Net Domestic In-Migration as a % of Population	Non-Farm Payroll Employment Growth	Unemployment Rate
Alaska	0.00%	52.6%	9.8%	-3.9%	19.4%	6.8%
Florida	0.00%	83.9%	22.4%	8.9%	30.4%	3.2%
Nevada	0.00%	120.1%	52.7%	20.5%	52.9%	4.1%
New Hampshire	0.00%	73.0%	13.2%	6.0%	15.9%	3.4%
South Dakota	0.00%	76.0%	5.2%	-1.8%	14.5%	3.2%
Tennessee	0.00%	63.6%	11.9%	4.3%	9.6%	5.2%
Texas	0.00%	87.2%	20.6%	2.1%	20.8%	5.0%
Washington	0.00%	70.6%	14.7%	3.1%	18.6%	5.0%
Wyoming	0.00%	86.0%	5.0%	-2.0%	23.9%	3.2%
9 States With No PIT	0.00%	79.2%	17.3%	4.1%	22.9%	4.3%
9 States With Highest Marginal PIT Rate	9.12%	59.6%	7.6%	-1.8%	12.1%	4.6%
Kentucky	8.20%	61.0%	7.4%	1.7%	10.4%	5.8%
Hawaii	8.25%	46.9%	6.5%	-6.5%	16.5%	2.6%
Maine	8.50%	62.6%	6.3%	3.7%	13.1%	4.6%
Ohio	8.87%	45.0%	2.3%	-2.8%	3.0%	5.4%
New Jersey	8.97%	63.3%	7.9%	-4.2%	12.1%	4.8%
Oregon	9.00%	65.0%	14.3%	4.7%	16.0%	5.4%
Vermont	9.50%	64.9%	5.8%	1.0%	11.9%	3.5%
California	10.30%	74.1%	14.0%	-3.5%	17.7%	4.8%
New York	10.50%	53.8%	3.9%	-10.1%	8.3%	4.5%

Further substantiating the relationship between personal income taxes and economic growth, we compared the top marginal state and local personal income tax rate to state personal income growth. While other factors impact state personal income growth, there is a negative and significant relationship between a state's top marginal personal income tax rate and the economic growth rate in the state—the higher the top marginal personal income tax rate, the lower the expected economic growth rate. Once again, the relationship is not unique to 2006 either. Since 1999, the states with a higher marginal income tax rate tend to have slower state personal income growth, except for the recession year of 2001.

The consistency of low-tax states economically outperforming high-tax states is consistent with the theory of incentives. The theory of incentives provides the basis for establishing an optimal tax policy. Changes to marginal tax rates are critical for growth because they change incentives to demand and supply work effort and capital.

Firms base their decisions to employ workers, in part, on the workers' total cost to the firm. Holding all else equal, the greater the cost to the firm of employing each additional worker, the fewer workers the firm will employ. Conversely, the lower the marginal cost per worker, the more workers the firm will hire. For the firm, the decision to employ is based upon gross wages paid, a concept which encompasses all costs borne by the firm.

Workers, on the other hand, care little about the cost to the firm of employing them. Of concern from a worker's standpoint is how much the worker receives for providing work effort, net of all deductions and taxes. Workers concentrate on net wages received. The greater net wages received, the more willing a worker is to work. If wages received fall, workers find work effort less attractive and they will do less of it. The difference between what it costs a firm to employ a worker and what that worker receives net is the tax wedge.

Government economic policies matter because these policies impact the incentives to work, save, and invest for workers, employers and investors. States with greater incentives to work, save, and invest have higher economic growth rates.

With respect to the competition between Texas and California, the future economic prospects of Texas and California are crucially dependent on the respective impact that each state's policies have on the incentives to work, save, and produce. The competitive events analyzed below are designed to capture these impacts.

Introducing the Competitors

Texas and California have a similar history. The Mexican-American War began with Texas' entry into the United States—it ended with California's. The lure of climate, opportunity, and resources helped both Texas and California grow into the two largest states in the country. Thanks to this extraordinary growth, the economies of Texas and California now dwarf the size of most countries—as of 2006, the California and Texas economies were the 7th and 10th largest economies in the world.² And yet, the recent performance of both of these states has varied.

Overall Economic Growth

Texas' overall economy has grown more than California's since 1997—even including the impacts of the Internet revolution on California's economy during the late 1990s, see Figure 1. On average, Texas' real economy grew 4.3 percent a year since 1997. California's real economy grew a slower 3.7 percent and the nation as a whole grew a slower, but still impressive, 3.0 percent. Since the end of the tech boom, the economic environment has skewed even further into Texas' favor. Since 2002 (the end of the 2001 recession), real economic growth accelerated in Texas (5.0%) and the nation as a whole (3.1%). California's economic growth rate remained basically constant at a still strong 3.6 percent. Income growth tells a similar story, albeit slightly more favorable to Texas, see Figure 2.

Real personal income in Texas has grown 4.2 percent a year on average between 1997 and 2007. This exceeded average personal income growth in California over this time period (3.4% and for the nation as a whole (2.9%). Since 2002, Texas's real personal income growth premium has expanded further as personal income growth in Texas has continued expanding 4.2 percent a year while real personal income growth has slowed in California (2.8%) and for the nation as a whole (2.6%).

From a broad macroeconomic perspective, the Texas economy has been expanding at an accelerated rate compared to California and the nation overall.

FIGURE 1 — CUMULATIVE GDP GROWTH: TEXAS AND CALIFORNIA, 1997-2006

(Scaled to 1.0 as of 1997)

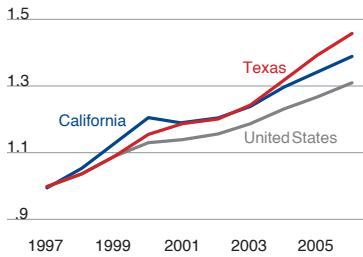
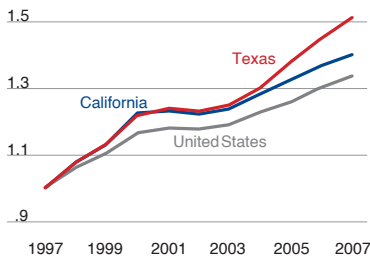


FIGURE 2 — CUMULATIVE PERSONAL INCOME GROWTH: TEXAS AND CALIFORNIA, 1997-2007

(Scaled to 1.0 as of 1997)



Employment

The employment trends of the competitors have been more erratic, see Table 3 and Figure 3. Employment growth in both Texas and California has been outpacing employment growth in the nation as a whole. Employment growth in Texas is currently outpacing employment growth in California; however, this was not the case from 1997 through 2003.

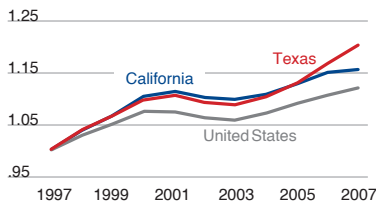
Table 3 and Figure 3 illustrate that California’s employment growth of 3.3 percent during the tech boom years was especially strong. Texas’ employment growth rate (3.1%) was also exceptional, but did not keep pace with California’s. Employment growth turned to declines from 2001-03 in both Texas and California; as it did for the country as a whole. Since the “jobless recovery” has ended, Texas’ employment record has been stellar—growing more than twice as fast as California and nearly twice as fast as employment growth for the country as a whole.

TABLE 3 — CUMULATIVE EMPLOYMENT GROWTH: TEXAS AND CALIFORNIA

	U.S.	California	Texas
1997-00	2.4%	3.3%	3.1%
2001-03	-0.7%	-0.7%	-0.8%
2004-07	1.5%	1.4%	2.9%

FIGURE 3 — CUMULATIVE EMPLOYMENT GROWTH: TEXAS AND CALIFORNIA, 1997-2007

(Scaled to 1.0 as of 1997)



Population Trends

Every day people vote with their feet by moving; and over the past eight years, more people have voted for Texas than California. The total U.S. population is estimated to have grown 1.0 percent a year between 2000 and 2007. California’s population grew at approximately the national average, for a total population increase of 2.7 million people. Texas’ average annual growth was nearly twice the national average (1.9 percent or a total population increase of 3.1 million people).

Total population increases include what the U.S. Census calls “Natural Increases” or total births and deaths. Such measures do not reflect people *choosing* to enter or leave a state. The U.S. Census tracks a more accurate measure of Americans voting for states with their feet called “Net Internal Migration.” Net Internal Migration tracks the choices residents of the U.S. make with respect to which state they want to live. Net Internal Migration is measured as the number of residents moving to a state minus the number of residents leaving the state. By this measure, California looks sickly while Texas looks stellar. On net, over a half million U.S. residents chose to move into Texas from some other state between 2000 and 2007—the third highest total behind Florida and Arizona. California, on the other hand, lost over 1.2 million residents over the same time period.

Texas’ total package is attractive enough to retain, on net, all of its current U.S. residents and attract a half million more. California’s total package is not attractive enough to retain, on net, all of its current U.S. residents.

Relocating one’s life is a personal decision, but economics matters too. The data presented above shows that Texas’ economy has been stellar. Perhaps more important, the economic policy environment is very pro-growth—indicating that Texas will experience future jobs and income growth. The same cannot be said of California. The economic environment in California has taken a turn for the worse. Out of control spending, rising regulatory burdens, and rising taxes all point toward diminished economic opportunities in California now and into the future. Such outcomes are the consequences from losing the state economic competition; and the rewards from winning.

...And Now, the Heavyweight Competition

The competition between Texas and California is measured in three broad categories:

- Tax Policy
- Regulatory Policy
- Expenditure Policy

Government policies, especially tax policies, have large and varied impacts on the competitive economic environment of a state. To fully account for these broad impacts, it is useful to track the impact from government tax policies on the economy’s production process.

For instance, someone has to exert effort to create all of the goods and services in our economy. Economists generally classify this effort as the “labor input” into production. The other *inputs into production* are classified as *capital* or the tools and machines people use (which comes from savings and investments), and *technology* or the know-how/skills needed to create the things we need and want. Government policies matter because the taxes levied by governments, or the expenditures made by governments, or the regulations imposed by

government impacts the inputs into production. These impacts either discourage the use of labor, capital, and technology, or in some cases, encourage their use.

Due to the importance of labor and capital in the economic process, it is useful to further divide the tax policy competition into its impact on labor and capital in addition to the tax burden on consumption and the overall tax burden in the state.

Competition I: The Tax Burden on Labor

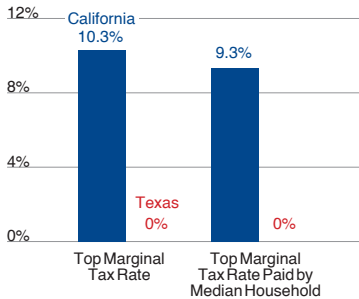
People do not work to pay taxes. People work to earn the highest wages, after taxes. High (or rising) taxes on labor reduce workers' after-tax wage, reducing the incentive to work. Because workers can receive a higher (or rising) after-tax wage for the same gross wage if they moved to a state with a lower (falling) tax burden, the economic climate of other states are (become) critical. People have an incentive to leave a state with high (or rising) taxes on labor income and relocate to a state where the taxes on labor income is lower (falling). As people respond to these incentives, income growth, employment growth, and overall economic growth suffer in the state with high or rising taxes.

California levies a progressive income tax system—as people's income increases, the tax rate on the higher income increases. It is this marginal tax rate that is relevant from an economic perspective. Because the marginal tax rate varies depending upon the income of the worker in California, we track two marginal income tax rates: the marginal tax rate faced by the highest income earners; and, the marginal tax rate faced by the average (or median) worker.

California imposes the highest top marginal state income tax rate in the country: 10.3 percent. The median household income in California in 2006 was \$55,319.³ This family (the average or median family) faces a 9.3 percent marginal state income tax rate in California.

Texas does not impose a state income tax. By definition, the marginal income tax rate for both the highest income earners and the average worker are 0 percent. Figure 4 summarizes the comparisons between Texas and California.

FIGURE 4 — MARGINAL INCOME TAX RATES: TEXAS AND CALIFORNIA



These comparative tax rates clearly illustrate Texas' economic attractiveness and California's economic unattractiveness. If there are two workers earning \$55,319 a year, one in California and one in Texas, then the Texas worker's after-tax income would be \$1,952 higher than the California worker's after-tax income.^{*} Texas' tax savings provides workers with a 3.5 percent raise compared to his California counterparts. Put another way, with respect to the income taxes imposed on labor competition, Texas is the winner.

COMPETITION I

WINNER 

Competition II: The Tax Burden on Capital

Capital taxes are more complicated than taxes on labor income. State governments do not treat all forms of capital equally. Oftentimes, states (and the federal government) double- or even triple-tax capital income. All factories, equipment, land, etc. used to produce goods and services are considered capital from an economic perspective.[†] Purchases of capital require an investment on the part of businesses or individuals. Businesses do not invest as a matter of social conscience. They invest to earn the highest possible rate of return on their investments. Businesses and other investors will only purchase capital if the expected return to the capital exceeds all costs—including all tax costs.

Taxing the return on capital is synonymous with taxing saving and investment. High taxes on savings and investment lowers the after-tax rate of return from saving and investing, diminishing the incentives to invest. Lower investment translates into a smaller and less productive capital stock. Income, employment, and economic growth are all subsequently reduced.

^{*} This calculation assumes a joint household in the 9.3 percent marginal tax bracket for California state income taxes and the 15 percent marginal tax bracket for federal taxes and incorporates the deductibility of state income taxes from federal income taxes.

[†] Human capital, oftentimes the most important input into production, is impacted by the tax burden on labor, not the tax burden on capital as it is defined here.

Returns to saving and investment are taxed in many ways. First, corporations earn profits, which are the returns to the investors or the owners of the “capital.” These profits are subject to corporate income taxes or in the case of some firms, personal income taxes. If the profits are then distributed to investors as a taxable dividend, the income is taxed again through dividend taxes. Should the owner of the company, or any income generating asset, decide to sell his ownership rights to the capital, any increase in the value of the stream of payments from the capital (capital gains) are taxed. Similarly, the interest income from savings or bond investments faces income taxes. Finally, states will tax the value of some assets in addition to the income stream generated from these assets (another instance of states taxing the same income multiple times) by taxing property and imposing estate and gift taxes. Table 4 summarizes the tax burden on capital imposed on California v. Texas.

TABLE 4 — TAXATION OF CAPITAL IN TEXAS AND CALIFORNIA

Taxes on Capital	California	Texas
Property Tax Burden (per \$1,000 of personal income)	\$28.24	\$42.13
Estate/Inheritance Tax Levied	NO	NO
Top Marginal Rate: Income, Dividends, and Cap. Gains	10.3%	0.0%
Top Marginal Corporate Tax Rate	8.84%	1% GRT

Neither California nor Texas imposes an estate tax—a very encouraging sign for both states. With respect to property taxation—thanks to Proposition 13—California is more competitive than Texas. The tax burden on property in Texas is \$42.13 per \$1,000 of personal income, while it is only \$28.24 per \$1,000 of personal income in California. With respect to all other forms of capital taxation, Texas is more competitive than California.

However, California’s property tax burden advantage is overwhelmed by its excessive tax burden on income, dividends, capital gains, and corporate income. The numbers below overwhelmingly illustrate California’s significant competitive disadvantages.

As discussed above, the marginal tax rate a business or individual faces determines the incentives to engage in productive economic activity. In order to see the impacts from these taxes on incentives to acquire capital (i.e., save and invest) we incorporate the impact of federal taxes and simply follow the money.

Imagine two representative companies facing the highest marginal income tax brackets earning an additional \$1,000 in profits. One firm is located in California; the other is located in Texas. Each representative company faces a federal income tax liability. Depending upon the company’s structure, the tax liability could be either the top marginal corporate income tax rate or top marginal personal income tax rate. In this example, the representative companies pay a weighted share of the corporate and personal income tax rates. The weights representing the share of total net income subject to the corporate income tax and the share

of total net income subject to the personal income tax are calculated based on the share of total net corporate income subject to corporate taxes as reported by the Internal Revenue Service (IRS) SOI data.⁴

With respect to federal income tax rates, the division is irrelevant as the top corporate and personal income tax rates are both 35 percent. The distinction for California's and Texas' income tax is relevant. In California the top corporate income tax rate is 8.84 percent while the top personal income tax rate is 10.3 percent. In Texas there is no personal income tax rate, but there is a 1 percent gross receipts tax. To put the gross receipts tax on a comparable basis to California's net income tax, we transform the gross receipts tax rate into an equivalent net income tax rate.^{*} Based on this transformation, Texas' 1 percent GRT is the "equivalent" of a 5 percent net income tax. We use the 5 percent figure as the appropriate corporate income tax rate for our calculations. Table 5 summarizes this information.

TABLE 5 — TAXATION OF CORPORATE INCOME

	California	Texas
Additional Net Income	\$1,000.00	\$1,000.00
Federal Income Tax Liability		
Corporate Income Tax (weighted)	13.7%	13.7%
Personal Income Tax (weighted)	21.3%	21.3%
State Income Tax Liability		
Corporate Income Tax (weighted)	3.5%	5.0% (1% GRT)
Personal Income Tax (weighted)	6.3%	0.0%
Additional Net Income after Taxes	\$586.76	\$637.17

The final line of Table 5 calculates the additional after-tax net income to each one of these companies if they were located in Texas versus California, and taking into account the deductibility of state income taxes. As Table 5 clearly shows, just by locating in Texas, companies can earn an extra \$50.41 per \$1,000 of net income, or an *8.6 percent higher* after-tax return.

Texas' competitive advantage grows even more, because the income tax burden imposed on this income is not finished. The owners of a corporation (individuals) that pay dividends face another round of taxation on this income. Using national payout-ratios based on the Bureau of Economic Analysis National Income and Product Account (NIPA) tables, and the ratio of companies that are dividend payable, we can estimate the percentage of net income that is subject to dividends taxes. These figures are summarized in Table 6.

^{*} Specifically, the GRT rate is multiplied by the ratio of GDP to total capital income and profits.

TABLE 6 — CORPORATE INCOME SUBJECT TO DIVIDEND TAXES

	California	Texas
Additional Net Income after Taxes	\$586.76	\$637.17
Earnings Paid Out	\$496.80	\$539.48
Earnings Paid Out Subject to Dividends Tax	\$156.83	\$170.30
<u>Individual Dividend Tax</u>		
Federal	15.0%	15.0%
State	10.3%	0.0%
Total After-tax Income (incl. retained earnings)	\$547.09	\$611.62

Table 6 illustrates that in total, if both a company and the individual owning the company is located in Texas rather than California, then both the companies and its stockholders can earn an extra \$64.53 per \$1,000 of net income or an *11.8 percent higher* after-tax return.

There are still more taxes on capital. California and the federal government also taxes interest income and capital gains income—Texas does not. This provides another after-tax rate return advantage to the owners of capital from locating in Texas compared to California. Using a similar methodology, we track \$1,000 of interest and capital gains income if it were earned by an individual living in Texas compared to that same income if it were earned by an individual living in California. The results are summarized in Table 7.

TABLE 7 — TAXATION OF INTEREST AND CAPITAL GAINS INCOME

	California	Texas
Individual Interest Income	\$1,000.00	\$1,000.00
Federal Interest Income Taxes	35.0%	35.0%
State Interest Income Taxes	10.3%	0.0%
Individual Interest Income (after tax)	\$583.05	\$650.00
Capital Gains Income	\$1,000.00	\$1,000.00
Federal Income Tax Liability		
Capital Gains Taxes (long-term)	15.0%	15.0%
Capital Gains Taxes (short-term)	35.0%	35.0%
State Income Tax Liability		
Capital Gains Taxes	10.3%	0.0%
Capital Gains Income (after tax)	\$748.88	\$834.87

Table 7 illustrates that the after-tax return to both interest income and capital gains income is significantly higher in Texas compared to California. The after-tax interest and capital gains income for a \$1,000 investment is *11.5 percent higher* in Texas than California for the exact same investment.

The significant after-tax return premium in Texas compared to California with respect to corporate income, interest income, and capital gains income gives Texas a significant competitive advantage vis-à-vis California in attracting businesses and investors. California's advantages with respect to property tax burdens, which equates to an advantage of 1.4 percent of personal income, does not compensate for the significant disadvantages with respect to the remaining capital taxes in these two states.

The winner of Competition II is clear: Texas has the more competitive capital tax environment.

COMPETITION I

WINNER 

COMPETITION II

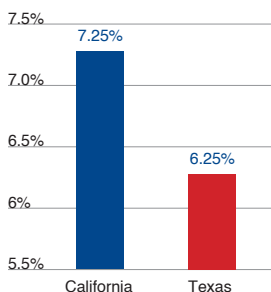
WINNER 

Competition III: The Tax Burden on Consumption

Texas has to fund state operations. Certainly California must impose a smaller tax on consumption than Texas given California's loss in the tax on labor and tax on capital competitions. Such an assertion is incorrect. Texas' and California's tax burdens on consumption are actually very similar. Additionally, Texas does not impose a state income tax; consequently, residents of Texas can deduct the state sales taxes from their federal income tax thereby reducing their effective sales tax liability further.

California's general state and universally applied local sales tax rate of 7.25 percent is higher than Texas' sales tax rate of 6.25 percent, see Figure 5. California's sales tax rate is also higher than Texas' when comparing the highest sales tax rates applied in the state (the state sales tax rate plus the highest local tax rate). Under this comparison, California's combined state and highest local sales tax rate is 8.75 percent compared to 8.25 percent in Texas.

FIGURE 5 — STATE SALES TAX RATES



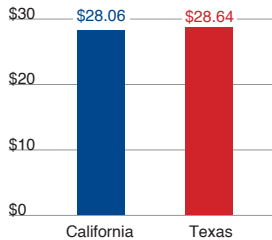
With respect to the actual rate applied, Texas has a distinct advantage compared to California. But, sales tax bases vary tremendously from state to state. Are groceries taxable? What about medicines? Taxing services is an even more complex issue. The

result is that a 1 percent sales tax in one state is not necessarily comparable to a 1 percent sales tax in another state. The tax base matters.

A comprehensive review of each state’s sales tax base, if conducted with the right amount of diligence, would address these questions but is a tremendous undertaking. There is a way to shortcut these issues—examine both California’s and Texas’ sales tax revenues in comparison to the state’s total personal income. By definition, total sales tax revenues are a function of the sales tax rate and the sales tax base. Personal income measures the amount of money available to consumers in the state to pay the sales tax. Consequently, we can obtain a sense of the sales tax burden by examining the sales tax revenues as a percentage of personal income.

On this measure, California’s sales tax burden (\$28.06 per \$1,000 of personal income) is slightly less than Texas’ sales tax burden (\$28.64 per \$1,000 of personal income), see Figure 6. The difference between the two are minimal, however; less than ½ of 1 percent per \$1,000 of personal income. The ranking of California and Texas compared to the other states—California has the 32nd highest sales tax burden and Texas has the 34th highest sales tax burden—further supports the similarity of the sales tax burdens in California and Texas.

FIGURE 6 — STATE SALES TAX BURDEN



Because Texas has a lower sales tax rate, but California has a marginally lower sales tax burden, the tax on consumption competition can be most accurately considered a draw.

COMPETITION I



COMPETITION II



COMPETITION III



Competition IV: The Overall Tax Burden

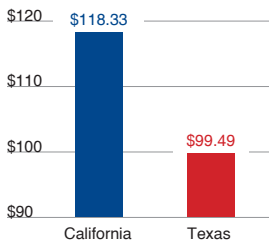
Our final tax competition examines the overall tax environments between California and Texas. The overall tax environment competition measures the “other” aspects of tax policy that affect overall incentives in each state but are not covered in the previous three

competitions. These include:

- The total tax burden in the state measured by total tax revenues divided by personal income;
- Personal income progressivity of the state measured by the change in the tax liability between the top and average tax rates per \$1,000 of personal income;
- The net impact of recent legislated tax changes per \$1,000 of personal income; and
- The number of tax expenditure limits effective in the state.

The overall tax burden provides a measure for the size of the government in California compared to the size of government in Texas. Over-taxed states *per se* restrain economic growth. State tax systems are so complex, however, that it can be difficult to discern which states are more heavily taxed than others. This is not the case with California and Texas—California is clearly over-taxed compared to Texas. California’s relative over-taxation is clearly visible by looking at total tax revenues in each state as a share of total state personal income. California’s current tax burden of \$118.33 per \$1,000 of personal income is nearly 20 percent higher than Texas’ current tax burden of \$99.49 per \$1,000 of personal income. Such a large discrepancy gives Texas a distinct competitive advantage over California that boils down to one simple reason: more of every dollar earned by a Texan ends up in his pocket compared to every dollar earned by a Californian.

FIGURE 7 — OVERALL TAX BURDEN



Progressive state tax systems are one of the most problematic, but least appreciated, aspects of state tax policies. Despite our best efforts to end recessions, the U.S. still experiences a business cycle—the economy expands quickly, stagnates, and then contracts. By definition of the business cycle, when the economy is expanding, people’s incomes are expanding at a faster than normal rate.

As the economy slows, so does the growth in income. When the stagnant income finally turns to outright decline, personal income will oftentimes decline right along with the economy. These effects are magnified at the upper-income levels where swings in capital gains and corporate profits can have a pronounced impact on personal incomes.

A progressive state tax system amplifies the business cycles impacts on state budget revenues. During the expansion phase of the business cycle, state tax revenues increase because the economy is growing and because more people are moving into higher marginal income tax brackets. An even greater revenue surge flows into the state's coffers compared to the surge in economic growth. Human nature being what it is, all too often, state governments spend too much (if not all) of this excess revenue surge.

Due to the dynamics of the business cycle, the revenue surge is only temporary. As the inevitable slowdown takes hold and personal income growth stagnates, state tax revenues decrease at an even faster pace as more people move into lower marginal income tax brackets. Because much of the revenue surge has been spent—perhaps even committing the state to higher than efficient spending paths—state budget crises emerge. Oftentimes, these budget crises beget calls for state tax increases at precisely the wrong time economically—during a recession. California is an excellent example of the budgetary problems that arise due to progressive state tax systems.

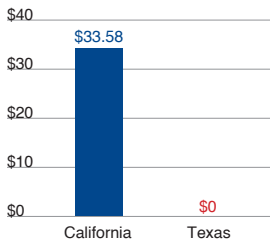
California inevitably paints itself into a corner. The tax code is steeply progressive, with the richest 10 percent of earners paying almost 75 percent of the income tax. This setup showers riches on the state during periods of prosperity, which are of course immediately spent. Then when the downturn comes, state revenues are hit disproportionately because of the loss of high income earners. Yet since budgets are much easier to expand than contract, the revenue shortfalls lead to massive deficits. To close the gap, the “solution” all too often is to hike taxes even more, which serves to further discourage employment and output—and hence the tax base. Because of the dynamic effects (as illustrated by the Laffer Curve), the tax hikes don't raise as much revenue as predicted, and thus the budget deficits persist.

At the same time, welfare rolls and other support programs expand because of rising unemployment. The downward spiral is arrested when the public is finally fed up and demands drastic tax relief. Yet old habits die hard; the vicious cycle resumes once again in a few years when the public has forgotten the lesson. But at each new cycle the tax and spending problems ratchet up further and further. California may just be testing how far this vicious cycle can go.

California's cautionary tale warns of the budget instabilities that can arise due to steeply progressive tax systems. The composition of a state's tax burden is as important as its overall burden. Broad, flat rate, and consumption taxes compare favorably to taxes on capital creation and high marginal personal and corporate income tax rates. With respect to tax progressivity, Texas is significantly more competitive than California. Where California's tax system is the most progressive in the country, Texas' is the best, see Figure 8.*

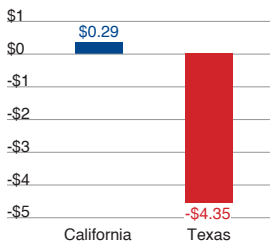
* Having the most progressive tax system, California is subject to numerous ill-effects; these include budget revenues that are subject to wild revenue swings, and a tax system that creates the largest disincentive to work, save, and invest. Economic efficiency and growth suffer in California due to its steeply progressive income tax system. Texas, on the other hand, does not have a progressive tax system. Consequently, the ill-effects that plague California do not impact Texas.

FIGURE 8 — PERSONAL INCOME TAX PROGRESSIVITY



Another key measure of the overall tax environment is the direction of the tax burden. Disregarding the level of taxes, whether the tax burden is rising or falling is also important. States with rising (falling) tax burdens are lowering (increasing) the returns to workers, savers and investors. Consequently, previous decisions regarding working, saving, and investing will be re-adjusted in light of the current tax implications of these decisions. Employment, income growth, and population flows will all be positively or negatively impacted depending upon whether the tax burden is falling or rising, respectively.

FIGURE 9 — RECENT LEGISLATED TAX CHANGES
(per \$1,000 of Personal Income)



Once again, the tax environment in Texas beats the tax environment in California. Whereas the overall tax burden in California has been rising, tax burdens have been falling in Texas.

The final key measure is the number of tax expenditure limits effective in the state. One successful strategy employed by some states to prevent squandering budget surpluses during times of economic expansion is a state Tax or Expenditure Limitation (TEL). A popular form of a TEL is to cap taxes at some predetermined rate of growth. In general, tax expenditure limits limit the government’s ability to raise taxes or spend the tax revenues. Creating hard tax limits reduces the ability of state legislators to implement anti-growth policies. Conversely, the ability to create sounder tax environments and a more competitive economic environment are enhanced when a state has larger numbers and more stringent tax and expenditure limits.

California truly is a state of exaggerated policy swings moving from Karl Marx to Adam Smith and back again in what in fiscal time is but a blink of an eye. The legacy of swinging to Adam Smith has left California with two expenditure limits—a very promising sign. Texas, on the other hand, has one tax and expenditure limit. While the existence of a tax and expenditure limit in Texas is a promising sign, it is not as promising as California's.

Judging by the purpose of TELs, Texas has clear advantages compared to California. TELs are designed to limit excessive growth in government while increasing overall budget stability. Historically, the growth in overall state spending has been significantly more volatile in California than Texas. For instance, between 1996 and 2005, the standard deviation in state spending in California was 4.5 percent compared to 2.4 percent in Texas. Sound budget practices have also led to an estimated \$10.7 billion surplus for Texas in the current fiscal year.⁵ In the spirit of a sound TEL, Texas should use the surplus to reduce the corporate tax rate that was just increased as part of the property tax reduction package in order to ensure static revenue neutrality.

Texas' overall tax environment has economic advantages over California's. Texas imposes a smaller burden that is declining and is not progressive. California imposes a large, rising, progressive tax burden. The implications are clear. Texas should experience relatively stronger economic growth with more stable budget revenues; California should experience relatively weaker economic growth with more volatile budget revenues. Texas is the clear winner of Competition IV.

COMPETITION I

WINNER 

COMPETITION II

WINNER 

COMPETITION III

WINNER  

COMPETITION IV

WINNER 

Competition V: The Regulatory Policy Competition

Regulatory burdens can also create positive or negative economic incentives. Burdensome regulations that increase business costs excessively reduce overall economic incentives. In this competition, we examine five regulatory issues that have important impacts on a state's overall economic competitiveness:

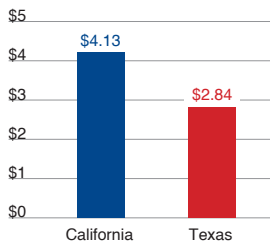
- State Liability System
- Average Workers' Compensation Cost
- State Minimum Wage
- Right-to-Work State
- Education Freedom Index Score

According to the Pacific Research Institute's *2008 U.S. Tort Liability Index*, California has the 34th least competitive state liability tort system out of all 50 states.⁶ Texas ranks a significantly more competitive 18th (where the state ranked number 1 has the most efficient state liability system). California's below average rank indicates that the tort liability system adds more than average costs to businesses that operate in the state compared to businesses that operate in other states, including Texas. This places California at a distinct competitive disadvantage compared to Texas when it comes to attracting businesses and jobs into the state.

From here the news only gets better for Texas, and worse for California. Workers' compensation costs impose additional costs on employers. When employers consider hiring additional workers it is the total costs from increasing employment that is relevant, which includes all salaries, benefits, taxes and regulatory costs. Workers' compensation increases the costs from employing additional workers; consequently, these regulations increase overall unemployment and decrease a state's potential economic growth.

FIGURE 10 — STATE WORKERS' COMPENSATION COSTS

(per \$100 of Payroll)



Workers' compensation costs add \$4.13 per \$100 of payrolls in California. These additional costs in California are the second highest workers' compensation costs in the country and are a major discouragement to employment growth in the Golden State.

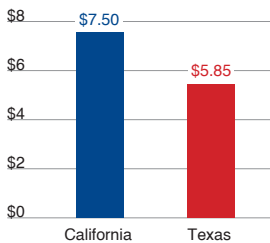
In comparison, workers' compensation costs in Texas look stellar. Texas' workers' compensations costs are \$2.84 per \$100 of payrolls, or 45 percent lower than California's, see Figure 10. This differential between workers' compensation costs in Texas compared to California is a significant competitive advantage for the Lone Star state. Before looking at any salary or any other tax costs, a firm must pay an extra \$1.29 per every \$100 of payroll to locate workers in California rather than Texas.

While Texas' workers' compensation costs are a competitive advantage compared to California, nationally Texas' workers' compensation costs are the 35th lowest (or 16th highest). For our purposes in this competition, this ranking is not relevant and the cost of workers' compensation regulations provides an important victory for Texas

in the Regulatory Competition. Nationally, Texas' workers' compensation costs are higher than average and overall employment growth in the state would benefit from addressing this issue.

California mandates that businesses in the state pay a minimum wage of \$7.50 per hour, which exceeds the federal minimum wage standard. Texas, on the other hand, mandates that businesses in the state only need to meet the federal minimum wage standard of \$5.85 per hour; see Figure 11.

FIGURE 11 — STATE MINIMUM WAGES



Minimum wage laws can have only one of two effects. Either the minimum wage is below the wage that would be paid to any employee, so it is irrelevant; or, the minimum wage law raises the wage costs for employers leading to greater unemployment. By imposing a minimum wage in excess of the federal minimum wage, California is unnecessarily increasing employer costs. In so doing, business flexibility is reduced and overall employment in the state is reduced. These effects do not exist in Texas, providing Texas' regulatory environment with another comparative advantage vis-à-vis California's.

The Labor Department reported in early 2007 that union membership in America keeps shrinking. Unions lost 326,000 members in 2006 and the percentage of working Americans who belong to unions dipped to 12 percent, which is way down from the all-time high of 34 percent in the 1950s. Today, only one in 13 private-sector workers is a member of a labor union—the tiniest percentage in at least 60 years. Four times as many Americans are stockholders as union members.⁷

States are divided into two distinct categories with respect to their union organizing laws. They are either right-to-work, which means workers have the right to not join a union, or non-right to-work, which means that workers are forced to join a union and pay dues if they work in a unionized industry.⁸ The evidence points overwhelmingly to the fact that right-to-work states have much greater growth of employment than non-right-to-work states. Texas is a “right-to-work” state; California is not.

The final category in the regulatory competition is the state's education freedom index score. Measuring education freedom is crucial for a state's economic competitiveness because of the importance of education in creating the skills for tomorrow's workers,

fostering the new innovations and technologies for today’s economy, and for the simple reason that such a large fraction of state budgets are devoted to education.






Despite the fact that education is one of the largest expenditure items in state and local budgets, study after study documents that spending is only tangentially related to school performance. For instance, Washington D.C. now spends \$12,000 per public school student, but it has many of the worst schools in the nation, with abysmally low high school graduation rates.

To address the lack of relationship between money and performance in education, many states are experimenting with market-based school reforms—or in a slightly different vernacular, deregulation. School reforms have included:

- Vouchers in low-income areas so parents can send their kids to alternative private schools or public charter schools,
- Tuition credits, and
- Corporate tax deductible scholarship programs.

Texas’ Education Freedom Index score ranks as one of the best in the nation, 7th, while California is ranked a lower, but still respectable, 14th.⁹ There is an important caveat to these seemingly positive results. While Texas (and even California) scores high relative to other states, education performance in Texas and California still lag relative to other countries or to an absolute education quality standard. The U.S. rankings are clustered so closely together that a high score, on a curve, still means the state is a long way from potential levels of education freedom. If other states implement choice systems, Texas’ relative rank would fall precipitously. Texas should not see its high rank as a reason to celebrate; rather as evidence that Texas is making important first steps in a crucial and lengthy reform process.

Combining these divergent regulations, it is once again clear that Texas’ economic environment is more competitive than California’s. Texas has a more efficient tort litigation environment, lower worker’s compensation costs, a lower minimum wage, freedom from union coercion, and a more free education environment in which to experiment with more effective education strategies. With respect to Competition V, once again Texas is the clear winner.

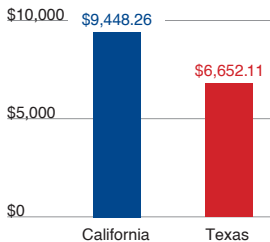
COMPETITION I	COMPETITION II	COMPETITION III	COMPETITION IV
WINNER 	WINNER 	WINNER  	WINNER 
COMPETITION V			
WINNER 			

Competition VI: The Spending Competition

The final competition measures the amount of fiscal discipline that both California and Texas have been exhibiting. We measure fiscal discipline in two broad categories. The first category measures the current size of the state governments, measured by the total expenditures per capita. The second category measures the growth in government spending, measured by the average growth in total expenditures per capita.

Government spending can negatively impact the state economy through two channels. First, in order for the government to have revenues to spend, it must take this money away from the private sector. As governments get larger and larger, the value of the dollar taken away from the private sector is greater if it were spent in the private sector than the value of the money if it were spent by the government. As a consequence, the government spending lowers the total potential output in the state. Second, larger government spending today oftentimes begets even greater government spending and activity tomorrow. In other words, the threat of higher tax and regulatory burdens grows as the size of the government grows.

FIGURE 12 — TOTAL EXPENDITURES PER CAPITA



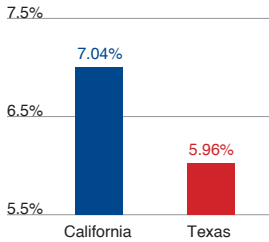
With respect to our competition, California's total expenditures, adjusted for the size of its population, is significantly more than total expenditures in Texas. Currently, expenditures per capita in Texas are 30 percent smaller than the expenditures per capita in California. This large discrepancy in the size and scope of government in Texas compared to California provides Texas with a significant economic comparative advantage, see Figure 12.

And, it is not simply the size of California's expenditures that are a comparative disadvantage for the Golden State. Based on data from the U.S. Census, state expenditures between 2000 and 2006 grew more than 7 percent a year on average in California, while they grew at slightly less than 6 percent a year in Texas.* The California state government's higher expenditures per capita than the Texas state government can be expected to continue to widen

* The most recent expenditure data available from the U.S. Census State Government Finances database is 2006, see: <http://www.census.gov/govs/www/state.html>. For interstate comparisons, the U.S. Census data provides a more accurate assessment as the differing state accounting methods are put on a comparative basis.

in the future—especially given the large expenditure increases that have been associated with the latest California budgets. Higher future taxes, increased fiscal crises, and slower economic growth will all follow as a result of the rising government expenditures in California. The reverse is true for Texas, especially as overall expenditure growth in Texas has been slightly below the national average expenditure growth—6.16 percent between 2000 and 2006.

FIGURE 13 — AVERAGE ANNUAL PERCENT CHANGE IN TOTAL STATE SPENDING, 2000-2006*



With respect to Competition VI, once again Texas is the clear winner. As Figure 13 illustrates, California’s government expenditures are not only bigger, they have grown faster than spending in Texas. This is particularly notable as Texas has a relatively larger number of public employees than California, with almost 560 public employees per 10,000 people in Texas compared to approximately 499 per 10,000 people in California. The implications from these trends are clear: Texas’ economic competitiveness will be improving while California’s will be weakening.

However, Texas should be careful not to mistake this head-to-head matchup as a permanent victory. Significant growth at all levels of government in Texas has frustrated Texas taxpayers and Texas must set out to be more competitive, both compared to California and other states, as well as to the rest of the world. As noted above, Texas could restrain the growth of the budget immediately by reducing the number of public employees with hopes of moving from 27th nationally to California’s 9th (with the state ranking 1st having the fewest public employees per 10,000 of population).

COMPETITION I	COMPETITION II	COMPETITION III	COMPETITION IV
WINNER 	WINNER 	WINNER  	WINNER 
COMPETITION V	COMPETITION VI		
WINNER 	WINNER 		

* Average annual growth in state spending is the compound annual growth rate based on the U.S. Census Data.

Living with the Results

Matched up in a head-to-head competition, Texas' economic environment beats California's—in fact, it is a knockout. Texas and California are case studies illustrating the cause-and-effect relationship between state tax policies and economic performance. And, these differences are manifesting themselves into California's and Texas' current economic prospects.

California faces tough economic times ahead:

SACRAMENTO, Calif.—Gov. Arnold Schwarzenegger will declare a fiscal emergency this week and release his blueprint for closing an estimated \$14 billion budget deficit, a gap so large that cuts to schools, health care and welfare programs appear inevitable. It's an uncomfortable déjà vu for the governor, who rode into office in 2003 facing a similarly sized shortfall and promising to fix the state's budget roller coaster once and for all...

Instead, Schwarzenegger has allowed spending to increase 40 percent under his watch and has backed tens of billions more in borrowing, mostly for construction projects, that will leave the state paying down debt for decades to come.

*- "California Budget Mess Brings Schwarzenegger Full Circle,"
The Mercury News, 1/5/08*

Also on Monday, Fitch Ratings placed \$43 billion worth of outstanding state bonds on a negative watch, which could lead to a downgrade in California's A-plus bond rating, one of the lowest among state governments...

Negative watch ratings affect the cost of future borrowing, which would include the governor's proposal for additional infrastructure bonds for water, classrooms and universities.

*- "Legislative Analyst Criticizes Across-The-Board Reductions,"
The Sacramento Bee, 1/15/08*

Compare these experiences to Texas' economic prospects:

With fears of a national recession growing by the day, Texas is still expected to avoid the worst of it, thanks to momentum from the state's booming energy business, healthy technology industry and strong foreign trade.

“... from an economic perspective, the best place to be in the United States in 2008 is Texas,” Mr. Weinstein said. “The national economy may contract, but we’ll just have a slowdown here.”

- “Texas may dodge economic slump: State’s economy to fare better than most, but tough times still ahead,” *The Dallas Morning News*, 1/21/08

Our competition between California and Texas demonstrates how economic theory actually works in the real world. Low-tax states experience rising employment, income, home values, population, and tax revenues. High-tax states experience the opposite effects.

The U.S. Census Bureau has recently released their latest information on estimated population changes of metropolitan areas.¹⁰ Viewing the Census’ results in tandem with the results from our competition between Texas and California illustrates George Gilder’s famous maxim: “High tax rates don’t redistribute income; they redistribute people.”

According to the U.S. Census’ analysis, Texas was the big winner in 2007 again. Out of a total of over 360 metropolitan areas, 4 of the top 10 metropolitan areas with the largest population increases were in Texas. According to news accounts of the study:

Dallas-Fort Worth added more than 162,000 residents between July 2006 and July 2007, more than any other metro area. Three other Texas areas — Houston, Austin and San Antonio — also cracked the top 10...

“People are running away from unaffordable housing, from the economic slowdown,” said Karl Eschbach, a state demographer in Texas. “I would expect Texas to stay at the top of a slowing game.”

According to figures compiled by Eschbach, 16 percent of Americans who moved to other states between July 2006 and July 2007 came to Texas, which led the nation for the second straight year in that category.

Home prices continue to be a big factor. A report earlier this month by Global Insight found that housing prices in the Dallas area were undervalued by as much as 30 percent.

Ann Sekesan, a pharmacy technician, moved her family from Pennsylvania to suburban Fort Worth last June after seeing spacious homes in Texas for under \$200,000 on a television show.

“After we saw that on TV, my husband and I looked at each other and said, ‘Have you ever been to Texas?’” Sekesan said. “It’s amazing the size of a home you can get down here. It’s just incredible.”¹¹

The stark differences in the fiscal, economic, and regulatory policies in Texas compared to California explain the differing outlooks. California continues to increase regulations, raise taxes, and spend profligately. These anti-growth policies will continue to sap the economic vitality of California.

Texas on the other hand, has a pro-growth economic environment with a competitive tax system, sound regulations, and spending discipline that will help Texas maintain its superior economic performance well into the future. ★

Biographies of Key Personnel

Donna Arduin

Donna Arduin, Partner, ALME, served as California Governor Arnold Schwarzenegger's Director of Finance from November 2003 until October 2004, where she was the Governor's chief fiscal advisor and was a member of over 70 boards and authorities. Prior to her appointment as Director, Schwarzenegger asked Arduin to undertake an outside, independent audit of California government and state finances.

Prior to working for Governor Schwarzenegger, Arduin served governors from three additional states, including Florida, New York, and Michigan. She was Governor Jeb Bush's Director of the Florida Office of Policy and Budget for five years, where she managed the formulation of the governor's policy and fiscal recommendations, created the nation's first interactive "e-budget," and implemented performance-based budgeting and long-range planning. Additionally, Arduin served Governor George Pataki throughout his first term as First Deputy Budget Director and led his successful efforts to reduce and simplify property taxes in New York and reduce the size of state government. She also served Governor John Engler for three years during his first term, as Chief Deputy Director of the Michigan Department of Management and Budget, as well as the executive director of his reinventing government commission and his appointee to the Michigan Municipal Bond Board of Trustees.

Arduin offers extensive experience in bringing government spending under control through long-term policy planning and fiscally conservative budgeting. Her Governors have consistently received high marks on the Cato Institute's fiscal report cards during her tenure with their administrations. Arduin also sat on Governor Bush's Council of Economic Advisors and his Property Tax Reform Committee.

A graduate of Duke University, Arduin graduated magna cum laude with honors in economics and public policy. She worked as an analyst in New York and Tokyo in the private financial markets for Morgan Stanley and Long-Term Credit Bank of Japan.

Arthur B. Laffer, Ph.D.

Dr. Arthur B. Laffer, Partner, ALME, is the founder and chairman of Laffer Associates. Dr. Laffer's economic acumen and influence in triggering a world-wide tax-cutting movement in the 1980s have earned him the distinction in many publications as "The Father of Supply-Side Economics." One of his earliest successes in shaping public policy was his involvement in Proposition 13, the groundbreaking California initiative drastically cutting property taxes in the state.

Dr. Laffer was a member of President Reagan's Economic Policy Advisory Board for both of his two terms (1981-1989). He was formerly the Distinguished University

Professor at Pepperdine University and a member of the Pepperdine Board of Directors. He also held the status as the Charles B. Thornton Professor of Business Economics at the University of Southern California from 1976 to 1984. He was an Associate Professor of Business Economics at the University of Chicago from 1970 to 1976 and a member of the Chicago faculty from 1967 through 1976. During the years 1972 to 1977, Dr. Laffer was a consultant to Secretary of the Treasury William Simon, Secretary of Defense Don Rumsfeld and Secretary of the Treasury George Shultz. He was the first to hold the title of Chief Economist at the Office of Management and Budget (OMB) under Mr. Shultz from October 1970 to July 1972.

Dr. Laffer received a B.A. in economics from Yale University in 1963. He received a MBA and a Ph.D. in economics from Stanford University in 1965 and 1971 respectively.

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Dr. Wayne Winegarden manages Arduin Laffer & Moore's policy studies and analyses. Prior thereto, he worked as an economist for Altria Companies Inc. in Hong Kong and New York City. In these roles he analyzed the impact of the economic environment in East- and Southeast-Asia on the company's operations, and integrated these insights into the company's strategic planning process. Additionally, Dr. Winegarden examined the impact of tax and regulatory polices on the company's operations and supported its government affairs objectives.

Dr. Winegarden also has experience analyzing federal and state budget, regulatory and financial sectors for policy and trade associations in Washington D.C. Dr. Winegarden is economics faculty at Marymount University, is a columnist for Townhall.com, has been interviewed and quoted in such media as Bloomberg Radio and CNN/fn, and is asked to present his research findings at policy conferences and meetings. Dr. Winegarden received his B.A., M.A., and Ph.D. in Economics from George Mason University.

Nancy Epling, Ph.D.

Dr. Nancy Epling brings a deep understanding of cutting edge econometric technique to ALME. Dr. Epling merges her background in economics and empirical modeling to provide strong support for policy analysis. Dr. Epling has authored or co-authored several papers applying economic theory and statistical analysis to both firm strategy and government policy decisions. Prior to working at ALME, she was an Assistant Professor in the Department of Business Economics and Public Policy in the Kelley School of Business at Indiana University where she taught doctoral courses in econometrics and industrial organization. Dr. Epling has a B.A. in Economics with Honors from Stanford University, and an M.A., MPhil, and Ph.D. in Economics from Yale University.

Jeffery S. Thomson

Jeffrey S. Thomson joined Laffer Associates as a research analyst in 1996. Thomson is responsible for providing research support for a broad spectrum of the firm's economic research, investment and consulting activities, including weekly research papers, construction and maintenance of financial models, in-depth economic studies and newspaper and journal articles. He has co-authored a number of research papers with Dr. Laffer and his other colleagues on a variety of topics, from monetary and fiscal policy to politics and international trade. In addition, Thomson has helped develop and/or implement a number of investment strategies based used successfully in the institutional money management business of Laffer Investments. Thomson earned a B.A. in economics from the University of California at Berkeley in 1995.

Endnotes

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