TEXAS PUBLIC POLICY FOUNDATION
PolicyBrief

June 2011
Center for Economic Freedom

Texas' Economic Leadership Due to Our Leadership in Limited Government Policies

by Bill Peacock, Vice President of Research and Planning and Director, Center for Economic Freedom*

Texas has been the hands-down winner in the national jobs-growth contest for quite some time. Since June 2009, when the recession ended, Texas has added 265,300 net jobs, accounting for 45 percent of net U.S. job creation. Over the last ten years, the numbers are even better: Texas created more than 1 million jobs during this period, more than all other states combined; while California, New York, Florida, and Illinois have combined to lose 930,000 jobs.

Why is Texas lapping the rest of the field when it comes to jobs creation?

There are two schools of thought when it comes to economic development. One—let's call it the old-school approach—is focused on subsidizing businesses using taxpayers' money. This approach relies fundamentally on grants, loans, tax abatements, economic development sales tax funds, and the like to lure business into coming to or staying in a particular location.

The other approach—let's call it the free-market school—seeks to bring and keep businesses in a state by providing the best economic climate for people to live, work, and do business. It keeps taxes low, keeps regulations at a minimum, and generally tries to keep government out of people's lives unless it belongs there. You might also call this the Texas model.

Texas has largely built its success on the free-market model. Consider this: Texas ranks 50th among the states in state tax burden, compared with California at 9, New York at 11, Florida at 36, and Illinois at 25.

Low-tax states have remarkable advantages over high-tax states in employment growth, income growth, and gross domestic product growth. Low-tax states also have a strong advantage in net domestic in-migration as a percent of population—people come to Texas because there are jobs here that they can't find in their home states. This helps explain why Texas and New York have almost identical unemployment rates: Folks who couldn't find jobs in New York have moved to Texas to work. Texas is keeping the entire nation employed.

Attempts have been made, however, to seek other reasons for Texas' success. Perhaps these are made to discredit the Texas-model approach. One of the arguments along this line is that Texas is doing better than other states because it is rich in natural resources, especially oil.

The flaw with the claims that Texas is outperforming the national economy because of oil is that many other states, for instance California, also have abundant natural resources that are facing favorable price trends. And, some of those natural resources also include oil.

The California Chamber of Commerce has documented that "California is a national leader in the energy industry. The state ranks third in oil production, third in refining capacity, and leads the nation in the production of non-hydroelectric renewable energy, according to the U.S. Energy Information Administration." Future oil production can also be robust in California. The Minerals Management Service (MMS) for the Pacific OCS Region found that "nearly 11 billion barrels of undiscovered oil and 19 trillion cubic feet of undiscovered gas in the region may be recoverable using existing technology."

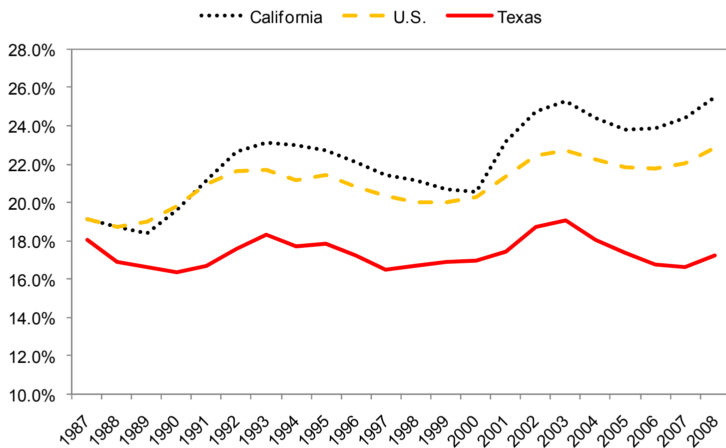
California's natural resources also extend beyond oil. In California, there were 25.4 million acres of farmland as of 2007 due to the nutrient-rich soil and a variety of elevations and climates. California's economy also benefits from many highly profitable fisheries. One of the state's most valuable fisheries, the California market squid, Loligo opalescens, has become the largest and most valuable California commercial fishery by volume, with 54,200 tons (49,200 metric tons) landed in 2006.

Cultivating California's biodiversity, coastal resources, deserts, energy, forests, geology, plant life, water, wetlands and wildlife offers a tremendous economic opportunity for the state. The problem is that while certainly beneficial, abundant natural resources are not a sufficient condition for economic growth. If this were the case, then resource-rich Saudi Arabia's GDP per capita would not be 49 percent of barren Japan's. The same is true for Texas, California, and the United States overall.

continued on back

Ultimately it is the business environment that encourages entrepreneurial firms to innovate and capitalize on emerging opportunities. Texas' low tax burden and prudent state government expenditure level play an important part in establishing the state's pro-growth business environment. Regulations matter too. Texas benefits from its abundant oil reserves because Texas also fosters an environment that allows businesses, individuals and entrepreneurs to work, save, and invest without facing overly burdensome regulatory costs and delays—including businesses in the oil industry. The same is not true for California. California's regulations make it more difficult for its people to harness the abundant natural resources available to its residents.

Yet we don't have to just compare Texas to other states to see how the Texas model fares. We can look at Texas history to see how the state has fared when it has strayed here and there from the Texas model.



The chart above from our recent paper, *Texas vs. California: Economic Growth Prospects for the 21st Century*, shows that Texas has much lower government spending as a percentage of the private economy than the U.S. or our largest competitor, California. In other words, Texas generally imposes a lower spending burden on it citizens, which translates into lower taxes. But a low spending burden isn't a constant in Texas. The chart also shows that Texas spending burden has increased at certain times.

The spending burden can increase for two reasons: because of a decrease in the size of the economy relative to spending or because of an increase in spending relative to the economy. Quite often the increased spending burden can be attributed to both. That has been the case recently in Texas.

The chart quite obviously shows the increased spending burden leading up to 2003, when Texas lawmakers showed up in Austin facing a $10 billion budget shortfall. Yet they met the challenge by balancing the state's budget without raising taxes. Because of this policy decision, Texas' spending burden declined significantly, and even after a recent increase remained slightly below its 1987 levels—a major accomplishment since our paper also shows a close negative correlation between government spending and economic growth: the less spending, the more growth.

However, the recent increase fueled by increased spending in 2007 and 2009 and by the Great Recession, translated into a $15 billion shortfall only eight years later. So for the third time in 20 years, the spending burden has significantly increased. The next two years will show us how well the 82nd Legislature dealt with the spending burden.

A state that keeps its taxes low and overregulation at bay is one that fosters economic development. On the other hand, a state that plows its cash into government spending is one whose businesses and citizens will soon be leaving for greener pastures. ✭

* Portions of this paper were excerpted from *Competitive States 2010: Texas vs. California* by Arduin, Laffer & Moore Econometrics.

900 Congress Ave., Suite 400 | Austin, Texas 78701 | (512) 472-2700 phone | (512) 472-2728 fax | www.TexasPolicy.com