TEXAS PUBLIC POLICY FOUNDATION

How Big Government Hurts the Economy

Texas vs. California, a case study in jobs and prosperity




By Arthur B. Laffer, Ph.D., Nicholas C. Drinkwater,
Stephen Moore & The Honorable Chuck DeVore

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Contents

3 Introduction by Dr. Arthur Laffer

3 A Tale of Two States: A 59 Bullet Point Summary

6 Section I: November 2012 Elections in Texas and California

6 Section II: Economic Performance: California, Texas, and the U.S.

12 Section III: A Brief Note on Poverty Metrics

12 Section IV: The Texas Oil Boom and California's Oil Bust: A Clash of Economic Cultures

14 Section V: An Overview of Total State and Local Government Revenues: Texas and California

16 Section VI: Texas, California, and U.S.: Comparison of Tax Revenue and Debt Financing

20 Section VII: Policy Variables Affecting Growth

27 Section VIII: The Relationship between Taxation, Spending, and the Achievement of Policy Objectives—A Study of "Parasitic" Leakages

28 Section IX: Intergovernmental Revenues

31 Section X: The Provision of Public Services by State and Local Governments

33 Section XI: The Performance of State and Local Public Education

35 Section XII: Highways: California vs. Texas

36 Section XIII: Prisons: California and Texas

37 Conclusion

38 Endnotes

How Big Government Hurts the Economy[1]

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Introduction by Dr. Arthur Laffer

Observing the colorful interchange of words between three-term Texas Governor Rick Perry and three-term California Governor Jerry Brown is entertaining to say the least.

For my academic friends, the most hilarious comment was made inadvertently by Governor Brown when he, in reference to people coming to California, said "the British are coming here, so are the French, so are the Russians, so are the Chinese—everybody with half a brain is coming to California."[2]

But for my 12-year-old grandson and me, the best was yet to come. My grandson and I both have a keen sense of appreciation for public displays of scatological humor, and of this there was no shortage. We could scarcely contain ourselves when comments like "looking at our backside"[3] hit the mainstream media.

But beneath all of this slapstick humor is an enormous substrate of the most deadly serious issues of the human condition: poverty versus prosperity.

Millions of people unnecessarily underemployed or unemployed for years and years are hardly a joke. Economic policies that force people to flee their homes in search of a better way of life are not really funny either. And the vast agglomeration of other issues that almost always accompanies subpar economic performance such as loss of self esteem, alcoholism, abusive behavior, lack of respect for others, crime, and poor education, just to name a few, are far from laughable. State capitols are not appropriate TV venues for *Saturday Night Live*.

This paper takes a serious look at the economics of two states, Texas and California, over the past decade, in order to highlight the impact of the very different policies of these two states on their citizens.

A Tale of Two States: A 59 Bullet Point Summary

- A decade ago, Texas accounted for 7.4 percent of total U.S. output and today accounts for 8.7 percent. California started this same period and ended this same period at 13 percent of total U.S. output.
- Population growth in Texas over the past decade was 20.4 percent, 4th highest in the nation, while California's population growth was 9.3 percent, 22nd highest.
- Growth in output, both in aggregate and on a per capita basis, is far higher in Texas than it is in California.
- Texas surpassed California in per capita GDP in 2011 and expanded its lead in 2012.

TAXES

- California is one of the highest taxed states in the nation, while Texas is one of the lowest taxed states in the nation.
- State and local tax revenues are growing far faster in Texas than they are in California, both absolutely and on a per capita basis.

- Texas has no income or capital gains tax. California has the nation's highest income and capital gains tax rates.

- California has the 3rd highest workers' compensation costs in the nation ($2.92 per $100 of payroll). Texas is the 13th lowest in this category ($1.60 per $100 of payroll).

- Even in sales taxes as a percent of personal income, Texas (2.30 percent) is a good bit lower than California (2.61 percent).

- Both Texas and California have repealed their state estate taxes.

MIGRATION

- Over the past six years, the net adjusted gross income gain for Texas was $14.7 billion, and the net adjusted gross income loss for California was $19.2 billion.

- California has swung from being one of the biggest net in-migration destination states in the nation to being one of the biggest exodus states. Texas in-migration as of today is the highest in the nation and has, if anything, been increasing.

- Taxpayers especially are moving out of California and into Texas.

- Renting a U-Haul moving van is far cheaper from Texas to California than from California to Texas.

- Average adjusted gross incomes of people moving out of California and into Texas is consistently much higher than is the average adjusted gross income of taxpayers out of Texas and into California.

- From 2001 to 2012, California dropped from having 55 Fortune 500 companies to 53, a loss of two, while over that same period Texas went from having 45 Fortune 500 companies to 52, a gain of seven.

POVERTY

- Accounting for cost of living and government assistance, Texas has significantly less poverty as a share of its population (16.5 percent) than does California (23.5 percent).

- Texas has the fourth lowest percent of population on welfare (Temporary Assistance for Needy Families-TANF) in the nation (0.43 percent), while California has the highest percentage of its population on welfare (3.88 percent).

- California has 30 percent of its population enrolled in Medicaid while Texas has 18 percent. The U.S. average is 22 percent.

- Texas has 15.5 percent of its population on food stamps compared to California's 9.7 percent, but Texas' administrative costs are far less.

EMPLOYMENT

- Texas' unemployment rate (6.5 percent in June 2013) is much lower than is California's unemployment rate (8.5 percent in June 2013).

- The percentage of people in the labor force is higher in Texas (65.2 percent in March 2013) than it is in California (63 percent in March 2013).

- California has a higher minimum wage ($8.00) than does Texas ($7.25).

- California has the nation's most powerful public employee unions, while in Texas union membership and power is moderate.

- Texas is a right-to-work state. California is a forced-union state.

- Texas ranks 3rd fastest in employment growth in the nation while California ranks 42nd.

OIL

- Texas is doing a far better job in developing its oil and gas reserves than is California.

- California is estimated to have over 15 billion barrels of shale oil, but regulations and restrictions prevent access to these reserves. California oil production continues to fall each year, while Texas has ramped up production to levels not seen in 25 years.

- California is one of a few states that has banned fracking in some areas. Texas encourages fracking.

DEBT

- State debt in Texas is substantially lower than it is in California.

- Texas' S&P credit rating (AAA) is far higher than is California's S&P credit rating (A).

PUBLIC SERVICES—EMPLOYEE INPUTS

- California pays its educators 40 percent more per full-time equivalent employee than does Texas.
- Public welfare employees in California make over $56,000 per year to Texas' $37,000 per annum—a 52 percent premium.
- California pays its hospital employees 53 percent more than does Texas.
- California pays its police protection employees 70 percent more than does Texas.
- California pays highway employees 76 percent more than does Texas.
- California pays fire protection personnel 86 percent more than does Texas.
- California pays its corrections employees 93 percent more than does Texas.
- California pays its state legislators over $95,000 per year. Texas pays its state legislators $7,200 per year.

PUBLIC SERVICES—PRODUCT COSTS

- California's teachers union has been the single largest contributor to political campaigns in California over the past decade ($212 million), double that of the next largest contributor, also a state government employees union.
- California's corrections officers are some of the most highly unionized state employees in the nation.
- California has far and away the most organized and politically active prison guard union in the country. In 2010 alone, this union spent $32 million in political funds ranking it the 15th largest political contributor in the state.
- The annual cost of a prisoner held in Texas is $21,390, or $58.60 a day. In California, the equivalent prisoner costs taxpayers $47,421 per year, or $129.00 per day.
- California builds one mile of state highway at an average cost of $265,000 while for that same mile of highway in Texas the average cost is a little over $88,000.

PUBLIC SERVICES—OUTCOMES

- Texas employs 345 educators for every 10,000 of population, while California employs only 231 educators per 10,000 of population. The U.S. average is 286.
- As measured by the U.S. Department of Education, California student test scores are the fourth worst in the nation, while Texas students' scores are 29th highest out of 50.
- The California Teachers Association has called 170 strikes over the past decade, while Texas teachers are prohibited from striking. In Texas, any teacher who strikes loses his license to teach immediately.
- Of the five mega states—California, Texas, New York, Illinois, and Florida—California, according to the Department of Education, has the lowest educational test scores while Texas has the highest.
- Texas has more hospital employees per 10,000 of population than does California.
- Texas employs more police protection employees per 10,000 of population than does California (28.9 versus 26.4, respectively).
- Texas has far more prisoners per 100,000 of population (923 prisoners per 100,000 population) than does California (621 prisoners per 100,000 population).
- California prisons are currently running at 75 percent over design capacity, while Texas prisons are occupied at about 15 percent below design capacity. California has been ordered by the Supreme Court to reduce its prison population to 137.5 percent of design capacity.
- Texas has more corrections employees per 10,000 of population than does California (27.7 vs. 24.4).
- Texas has almost 30 percent more highway employees per 10,000 of population than does California.
- Texas ranked 23rd in the nation in state road conditions, while California ranked dead last.

PUBLIC SERVICES—BOTH INPUTS AND OUTCOMES

- Looking solely at classroom teachers in elementary and secondary education, California pays its teachers almost 50 percent more than does Texas, and California employs 40 percent less teachers than does Texas does per 10,000 of population.

- For police officers only, Texas employs 21 for every 10,000 people while California only 18. But California pays its police officers a 75 percent premium over Texas police officers.

- For firefighters by themselves, Texas employs 9.2 per 10,000 of population versus California at 7.7 per 10,000. California's firefighters are paid $120,000 per year to Texas' $63,000.

- California has 74 percent more public welfare employees per 10,000 of population than does Texas, and California pays its welfare workers 52 percent more per worker than does Texas.

I. November 2012 Elections in California and Texas

On November 6th, 2012, California voters, by a 55 to 45 margin, passed Governor Jerry Brown's Proposition 30, which is a constitutional amendment that raises the state sales tax rate by 25 basis points from 7.25 percent to 7.5 percent, which, when combined with local rates, averages 8.41 percent.[4] Proposition 30 also raises the highest marginal state income tax rates from 9.3 percent to 10.3 percent for incomes between $250,000 and $300,000, from 9.3 percent to 11.3 percent for incomes between $300,000 and $500,000, from 9.3 percent to 12.3 percent for incomes between $500,000 and $1 million, and finally from 10.3 percent to 13.3 percent for incomes over $1 million, the highest rate in America.

The new income tax schedule applies retroactively to all income earned or received since January 1, 2012.

In addition to passing Governor Brown's tax increase, California voters also gave the advocates for big government supermajorities in both houses of the Legislature.

Only a few weeks after the election, California's Franchise Tax Board notified taxpayers who had reported a qualified small business stock exclusion or deferral for taxable years beginning on or after January 1, 2008 that, because these provisions are invalid and unenforceable, Notice of Proposed Assessments will be issued denying the exclusion or deferral.[5] This represents a doubling of the state's capital gains tax for this group of filers, retroactive five years, no less.

The election victory championed by Governor Brown has also set into motion a major effort to eviscerate or repeal Proposition 13, also a constitutional amendment, passed in 1978. California's Prop 13 has limited property tax rates to 1 percent of the property's market value at the time of sale with annual assessments limited to no more than an increase of 2 percent per year. And now there is talk of California setting up an exit fee for anyone who wishes to leave California.

On February 28, 2013, California's Board of Equalization voted 3-2 to raise the state gasoline tax by 10 percent from 36¢ to 39.5¢ per gallon effective July 1, 2013. According to the *San Diego Union Tribune*, "The increase is partly due to a $157 million shortfall in gas-tax revenue in fiscal 2012, and also a projection of less consumption by California drivers… [The] American Petroleum Institute [had] listed California's gas taxes as second highest in the nation behind New York. After the July 1 tax increase, however, the 70.1 cents average tax per gallon will lead the nation."[6]

The people have spoken.

On the same day that California voters spoke so clearly, November 6, 2012, Texas voters sent a majority of moderates and conservatives to the Texas state House and Senate. Texas also elected one of the most economically pro-growth U.S. Senators, Ted Cruz, to replace Kay Bailey Hutchison.

Texas has never had an income tax on either earned income or "unearned income," such as dividends, interest, etc. Texas has no capital gains tax either. And, Texas' state sales tax rate is 6.25 percent, that, when combined with local rates, averages 8.15 percent.[7]

This paper attempts to provide an objective assessment of the data without hope or agenda, as if it were Christmas. At Christmas you always tell the truth.

II. Economic Performance: California, Texas, and the U.S.

Before we jump into the explicit measures of economic performance, there are a number of everyday observations that should give us a strong clue as to how well California is doing relative to Texas. Quite simply, people "vote with their feet," only nowadays it is with moving vans. Because so many people are trying to leave California for Texas and other destinations and so few people are trying to leave Texas for California, moving van companies have adjusted their prices. In **Table 1** we have listed the one-way U-Haul prices both ways between four California cities and four Texas cities. It is amazing.

Table 1
U-Haul Rental Prices between California and Texas
(prices obtained from uhaul.com on 2/15/2013 for 26' truck rental)

From Texas to California		To California			
		to Sacramento	to San Diego	to Los Angeles	to San Francisco
From Texas	from Austin	$1,260	$1,037	$1,075	$1,259
	from Dallas	$1,336	$1,087	$1,138	$1,335
	from Houston	$1,007	$1,098	$1,140	$1,006
	from San Antonio	$849	$714	$774	$1,069

From California to Texas		From California			
		from Sacramento	from San Diego	from Los Angeles	from San Francisco
To Texas	to Austin	$2,087	$2,634	$2,734	$2,159
	to Dallas	$2,035	$2,650	$2,770	$2,108
	to Houston	$2,178	$2,791	$2,898	$2,255
	to San Antonio	$2,037	$2,546	$2,646	$2,108

Source: U-Haul

When Dr. Laffer left California for Tennessee he discovered these data in a very personal way. As Steve Moore and Dr. Laffer wrote in their 2008 paper, "California, Who are You? Part II":

> [T]housands and thousands more California residents are choosing to leave the state than U.S. residents are choosing to move into California—and it's getting worse … The out-migration flows have become so systemic that the cost to rent a full-sized U-Haul truck to move from Los Angeles to Nashville, Tennessee is $4,285—more than six times the $557 cost of moving in the opposite direction. Similarly, it costs $4,254 to rent a full-size truck from Los Angeles to Austin, Texas, yet only $407 to complete the reverse trip.[8]

This section provides a high-level yet comprehensive overview of California and Texas over the past decade. After reviewing the U-Haul data you will not be surprised by the results.

Our presentation of each state's economic performance starts with population and from population moves on to the state's labor force, and then to employment and real output. In terms of each of these measures of economic performance we use the percentage change over the most recent 10-year period. State economic performances can be quite different. Many factors contribute to a state's economic performance, including state and local economic policies.[9]

States can attract or repel interstate migration, they can impact how many of their residents choose to join the labor force, and how many members of the labor force actually get jobs. State policies can also influence the types of jobs a state has and how productive those jobs are. This process starts with population and ends with total output. State and local policies affect each and every step of the process from beginning to end.

State policies are not the only factors influencing the process starting with population and ending with total state output. In fact, state policies may not even be the most important influences on the organization of labor, capital, and technology to create output. Over the past decade, for example, North Dakota has registered the fastest growth in total output of the 50 states, due in large measure to its recent development of oil fields. On the other side of the ledger, Hurricane Katrina in 2005 had a large negative impact on Louisiana's growth rate.

State policies are important, and differences in state policies can reasonably be expected to have measurably different impacts on state results. In **Table 2** we list the objective metrics of California, Texas, and the U.S. over the past 10 years. Row 1 ranks population growth over the past decade. Row 2, again ranks Texas, California, and the U.S. in terms of its participation rate's change.

The third row combines Row 1, growth in a state's population, and Row 2, the percentage change in a state's participation

Table 2
State-by-state Comparisons for the Most Critical Metrics

Row	Percentage Change, 2001-2011	U.S.*	TX	TX Rank	CA	CA Rank
1	Population	9.5%	20.4%	4	9.3%	22
2	Labor Force Participation Rate	2.3%	3.2%	16	0.2%	35
3	Labor Force	11.9%	24.3%	2	9.5%	32
4	Employment Rate	-3.8%	-3.1%	18	-6.7%	48
5	Employment	7.6%	20.5%	3	2.2%	42
6	Productivity	40.4%	42.4%	14	43.1%	11
7	Gross State Product	51.4%	71.5%	7	46.2%	27
8	Gross State Product per Capita	38.3%	42.4%	12	33.7%	30
	Percentage, Dec-2011					
9	Unemployment Rate	7.7%	7.4%	22	11.2%	49

* equal-weighted averages of the 50 states

rate, and is the percentage growth in the state's labor force over the past decade.[10]

Row 4 is the 10-year percentage change in each state's employment rate (1 minus the unemployment rate) which, when added to each state's growth in labor force (Row 3) results in the percentage change in each state's total employment over the past decade, Row 5.[11]

With Row 5 being decadal employment growth, Row 6 is the ranking of nominal output per worker growth of California, Texas, and the U.S. over the past decade. When Rows 5 and 6 are added together,[12] the result is total nominal income growth over the past decade, Row 7.

Row 8 is Row 7 minus Row 1[13] and is the decadal growth in nominal income per capita. Row 9 is closely related to Row 4 and is the 2011 end-of-year unemployment rate.

Table 2 is fascinating because it contains so much relevant information in a format that facilitates easy comparisons of states. The full table literally allows state-by-state comparisons for the most critical metrics. But our focus in this paper is not on just any generic bilateral comparison. This paper focuses on California and Texas. Our hope is to uncover the effects each of these two states' widely divergent policies have had: and, from these results, to infer a more general guide to achieving economic prosperity.

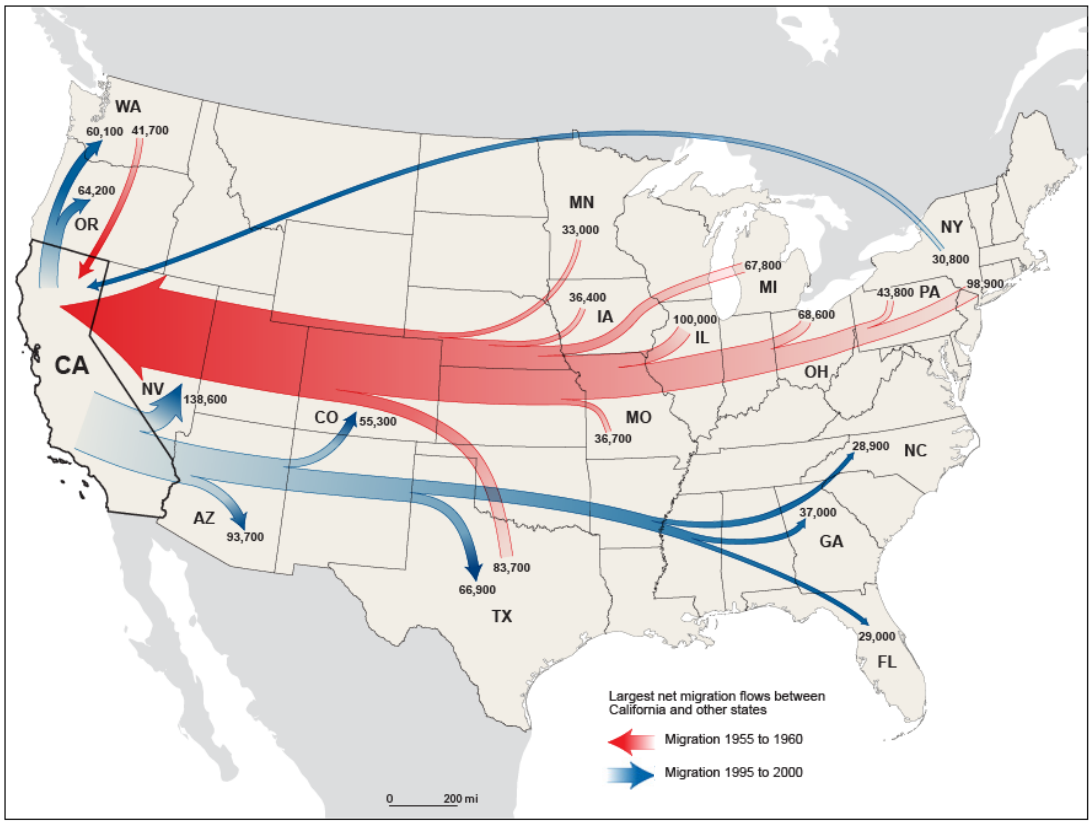
In Table 2, looking at Row 1 you can see Texas' population growth, which is the 4th fastest growing among all the states in the nation. And by way of comparison, California's population growth is only slightly below the national average and ranks as the 22nd fastest growing state in the nation. However, when a percentage point comparison is made solely between California and Texas, the difference in decadal population growth is really quite large, at 11.1 percent. Texas' population growth exceeds California's population growth by more than California's population growth exceeds the slowest growing state in the nation, Michigan at -1.2 percent. If people are voting with their feet, Texas is beating California by a very large amount.

One chart that especially caught our attention was produced by the U.S. Census Bureau in March 2013 (**Figure 1**). This chart illustrates the enormous change in population flows into and out of California over the past half century. The red arrows reflect the large population flows into California from wherever in the 1955 to 1960 period, while the blue arrows reflect the reverse population flows out of California to wherever from 1995 to 2000.

If President Reagan were still alive and could see what Governor Brown has done to California we wonder if he would still joke that "if the Pilgrims had landed in California instead of Plymouth Rock, the East would still be unsettled."

In a recent paper by Tom Gray and Robert Scardamalia,[14] the basic facts of California's radical change in net migration patterns are presented in a very thorough context using multiple sources for data. California has gone from the greatest destination state in the nation in the late 1980s, to a state that is currently below the national average in population growth.

Figure 1
Net Migration Between California and Other States: 1955-1960 and 1995-2000[15]



Among the many factors Gray and Scardamalia point to are unemployment differentials, significantly different business climates and relative tax rates. What interested us from their analysis were their observations that:

i.) foreign migration into California has fallen and is trending downward,

ii.) the natural increase in California's resident population—births minus deaths—is also falling and will most likely fall further or may even turn negative at some point in the foreseeable future, and

iii.) California's net domestic migration, with but a few exceptions, has been negative since about 1992 and could well be more negative as time goes on.

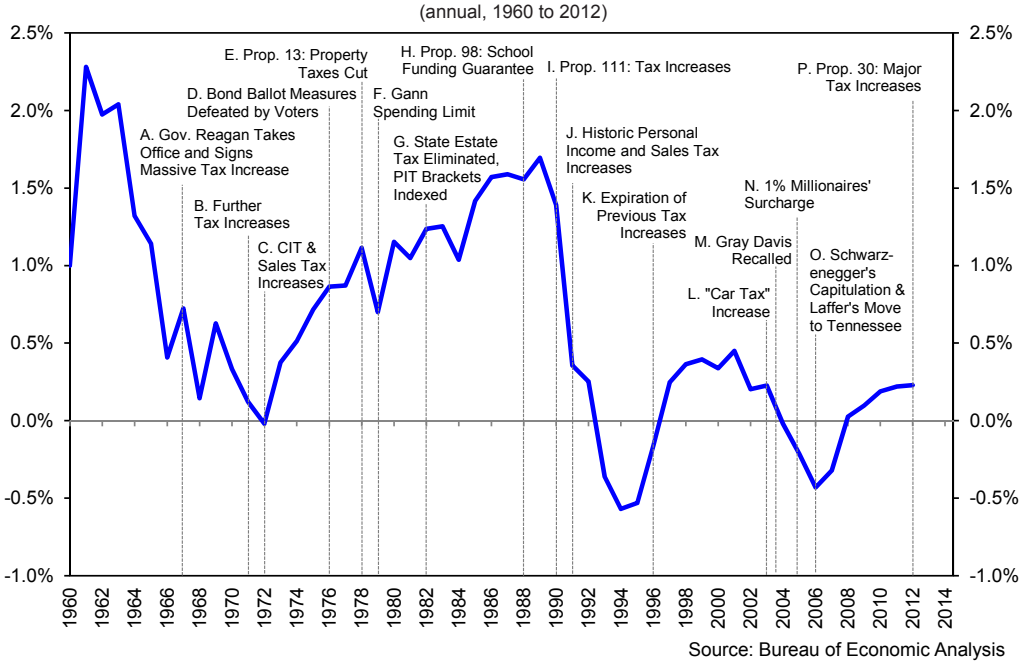
And, as a consequence of these trends, the authors conclude, "If all these trends continue, California may find itself in a situation similar to that of New York and the states of the midwestern Rust Belt in the last century, which have seen populations stagnate for decades, or even fall."[16]

In a rare display of humor, the authors add, "California is still contributing to the population boom of the southwestern U.S. but now seems to do so mainly by sending residents to neighboring states."[17]

Our view of the changing migration patterns for California focuses primarily on California's changing economic policies. In **Figure 2**, we have plotted California's population growth as compared to annual U.S. growth rates, versus some of California's major economic policy changes.

It is also worthwhile to note that California's migration patterns are not only obvious in migration of people—they are quite clear in the migration of companies as well. Each year, *Fortune* ranks the world's largest companies and publishes the list as the Fortune Global 500. In 2001, 55 Fortune Global 500 companies were headquartered in California, while 45 were headquartered in Texas. It should not surprise you that in the latest 2012 *Fortune* rankings, California is now home to 53 Global 500 companies, a decline of two, while Texas has added seven over that time period, for a total of 52 Global 500 companies now calling Texas home. Just as people migrate, companies do too—and much for the same reasons!

Figure 2
California's Annual Population Growth Compared to the U.S. vs. Major Policy Changes
(annual, 1960 to 2012)



Source: Bureau of Economic Analysis

Row 2 of **Table 2**, Texas' labor force participation rate, has risen by a greater percentage than has California's participation rate; 3.2 percent in Texas versus 0.2 percent in California. What this means in plain English is that in Texas the percentage of the state's population that chooses to look for work is increasing faster than it is in California. In the category of changes in the participation rate, Texas ranks 16th in the nation, above the national average, while California ranks 35th in the nation, well below the national average.

Combining above-average population growth (Row 1) with an above-average increase in the participation rate (Row 2) puts Texas in 2nd place in the nation when it comes to growth in its labor force (Row 3), at 24.3 percent. California's labor force growth, however, comes in at 9.5 percent, ranking the state at 32nd out of 50.

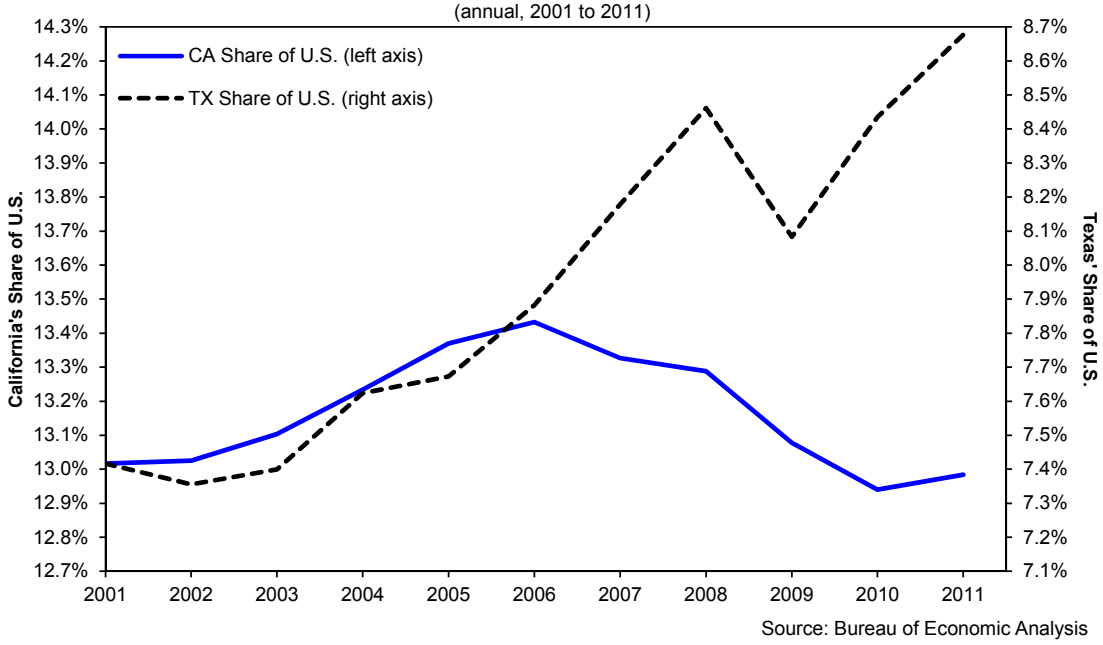
Row 4, the percentage change in the employment rate over the decade, reflects the percentage change in the number of employed workers per 100 members of the labor force. The unemployment rate, which is the percentage of the labor force not employed, is what economists normally focus on. In this case, because we are looking at total output rather than foregone output, we concentrate on the employment rate. The employment rate is nothing more or less than one minus the unemployment rate. In the category of the decadal change in the employment rate, Texas comes in 18th in the nation at -3.1 percent, still slightly above the 50-state average of -3.8 percent, while California is 48th at -6.7 percent.

The powerful influence the overall U.S. economy has on state economies is rarely so clearly demonstrated as it has been during the past decade. The decade began rather innocently in 2001 but ended with the aftermath of the Great Recession. Over this 10-year period, the U.S. unemployment rate rose from 4.7 percent in 2001 to 8.9 percent in 2011. Not one state—not one—in this nation of 50 states witnessed a fall in its unemployment rate.

Combining a state's 10-year percentage change in labor force with its 10-year change in employment rate produces its 10-year percentage change in total employment.[18] Here again Texas is very close to the top of the national rankings, coming in at number three with growth at 20.5 percent. California, on the other hand, ranks 42nd in the nation, with employment growth at 2.2 percent.

To put employment growth from 2001 to 2011 into perspective, Texas' population grew 20.5 percent over the past decade, and Texas' employment grew 20.5 percent as well. This means that Texas' participation rate growth of +3.2 percent and its employment rate growth of -3.1 percent almost precisely offset each other. California's population, on the other hand, grew 9.3 percent, which was far faster than Califor-

Figure 3
Shares of U.S. GDP: Texas vs. California
(annual, 2001 to 2011)



Source: Bureau of Economic Analysis

nia's employment growth of only 2.2 percent. In the case of California, this differential is explained by the fact that the participation rate in California grew by a mere 0.2 percent, while the employment rate shrank by 6.7 percent. But this is not the end of the story.

When it comes to growth in dollar income per worker—nominal productivity growth—California ranks number 11 in the nation at 43.1 percent, outperforming Texas, which ranks number 14 in the nation at 42.4 percent.

Not only is the overall U.S. economy a major factor on each individual state's growth, but also during this past decade the production and prices of hydrocarbons such as oil have had a major influence on the growth rates of specific states.

Combining productivity growth with employment growth yields the single most comprehensive measure of a state's success—growth in Gross State Product (GSP).[19] This is generally considered to be the end game for evaluating the performance of state and local government. Over the past 10 years, Texas' GSP has grown 71.5 percent, putting Texas as the 7th fastest growing state in the nation.

California, on the other hand, had GSP growth of 46.2 percent over the past decade, putting California at 27th place among the 50 states. While California's GSP growth is only a little below the U.S. average, this is a far cry from previous decades when California was at the very top rungs of the U.S. ladder. More on this later.

The consequences of differences in economic growth accumulate. In **Figure 3**, we have plotted Texas' GSP as a share of U.S. GDP and California's GSP as a share of U.S. GDP over the past 10 years (2001 to 2011). Texas has gone from 7.4 percent of U.S. GDP to 8.7 percent while California started the decade at 13.0 percent of U.S. GDP and ended at 13.0 percent as well.

Taking the performances of various states a few steps further, we find that Texas even outperformed California in the 10-year growth of average income per capita. At the end of this past decade, Texas also had a lower unemployment rate than did California. As opposed to international comparisons where populations are considerably less mobile, when considering state-by-state comparisons, measures such as growth in average income per capita and unemployment rates are notoriously unreliable as indicators of good economic policies. But, if achieved in the correct way—via economic growth rather than contraction—income per capita growth and low unemployment rates go a long way to improve a state's quality of life.[20]

And there you have it. To summarize:

Table 3
The Economic Performance Record: Rank Among the 50 States

	Texas	California
Population Growth	4th	22nd
Labor Force Participation Rate Growth	16th	35th
Labor Force Growth	2nd	32nd
Employment Rate Growth	18th	48th
Employment Growth	3rd	42nd
Productivity Growth (nominal)	14th	11th
Income per Capita Growth	12th	30th
Unemployment Rate, Dec-2011	22nd	49th
GSP Growth	7th	27th

When it comes to economic performance, Texas far outperforms California in all categories save productivity growth. Is it any wonder why people are moving into Texas and out of California?

III. A Brief Note on Poverty Metrics

Performance is not only about economic growth, although economic growth is the single most important measure of performance. The plight and circumstances of our nation's least fortunate is also a matter of great concern.

In the November 2012 edition of the *Current Population Reports* of the Department of Commerce entitled "Supplemental Poverty Measure: 2011,"[21] improved measures of state poverty are presented for each state as an average of the period 2009 to 2011. These improved measures of the incidence of poverty by state include many items which the old measures did not include such as i.) payroll taxes, ii.) in-kind public benefits such as food stamps, iii.) expenses needed to hold a job such as transportation or child care, iv.) medical costs, v.) family situations in addition to family size such as child support, cohabitation, etc. and, most important for our purposes vi.) geographic differences in the cost of living.

In **Table 4**, the numbers of people in poverty and their percentage of the respective population is reported for the three-year average (2009-2011) of those in poverty for both Texas and California and the U.S. as a whole, using this "Supplemental Poverty Measure."

Both Texas and California have larger shares of their populations in poverty than does the U.S. as a whole. California, however, not only has a larger share of its population in poverty than does the U.S., but California's share of the population in poverty is virtually 50 percent greater than the U.S. average and is the highest in America. Texas' share, on the other hand, is only a smidgeon above the U.S. average.

Table 4
Poverty: U.S., California and Texas
(three-year average 2009-2011)

	U.S.	California	Texas
Number of People (000s)	48,423	8,773	4,145
Percent of Population	15.8%	23.5%	16.5%

Source: U.S. Census Bureau

When it comes to alleviating poverty, despair, and unemployment, Texas also outperforms California hands-down. Texas not only does a lot better job than California does when it comes to the care and the nurturing of the most prosperous; Texas also treats its least fortunate better than does California. Nevertheless, both states could stand some improvement: California a lot more than Texas.

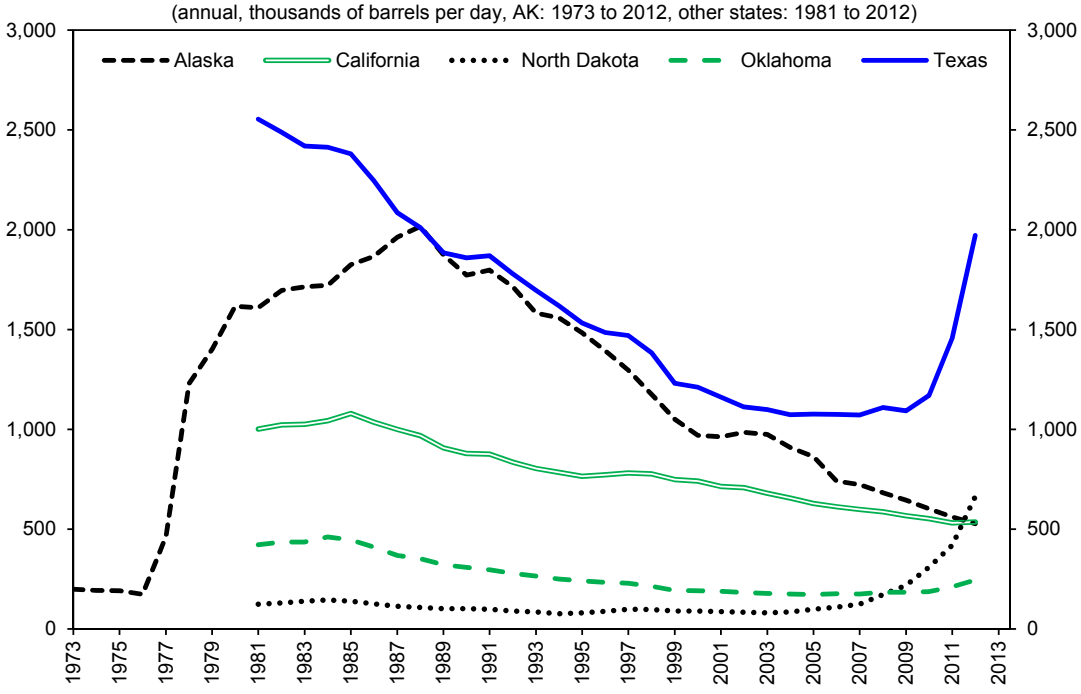
IV. The Texas Oil Boom and California's Oil Bust: A Clash of Economic Cultures

The greatest irony of the Obama presidency is that the man who pledged in 2008 to "end the tyranny of oil in our generation" has presided over the greatest oil and gas boom in U.S. history. Doubly ironic is that this drilling boom, with oil production up more than 40 percent since 2008, is almost single-handedly keeping the Obama economy afloat. While much attention has been devoted to the astounding oil and gas blitz from the Bakken Shale in North Dakota, the even more impressive surge in production has gone almost unnoticed. It is happening in south and west Texas—the birthplace of the American oil boom 100 years ago—and where the spigots are today operating on full throttle.

Meanwhile, California's oil output continues to fall (**Figure 4**). This did not happen by accident. It is the culmination of intentional policy choices by these two states, and the hows and whys are worth investigating.

In the wake of historically high oil prices of $80 to $100 a barrel, Texas has capitalized on oil prices by nearly doubling its oil output since 2005. The two richest fields are the Eagle Ford shale formation in south Texas, where production of this black gold is up an astonishing 50 percent in the last

Figure 4
Crude Oil Production
(annual, thousands of barrels per day, AK: 1973 to 2012, other states: 1981 to 2012)



Source: U.S. Energy Information Administration

year, and the 250 square mile Permian Basin, one of the richest oil fields on the planet, and which never seems to run dry. The epicenter of the oil revival is Midland-Odessa, one of the fastest growing metro areas in the country.

Even with the celebrated surge in output in North Dakota, which has moved that state into the number two position in the output of oil ahead of Alaska and California, Texas produces more oil than the four next biggest producing states combined. The Lone Star State now produces more than two million barrels a day, which generates about $80 billion a year in economic activity. Just the value of this oil production alone surpasses the annual output of all goods and services in 13 individual states. The Texas oil boom is the real and under-appreciated economic stimulus in America, and its impact on jobs, revenues, and economic production is spectacular.

Now look to the state west of Texas, California, which has been nearly immune to all of these economic forces. Since 1986, California's oil production has fallen by about half, down about 21 percent since 2001 even as the price of oil has skyrocketed. This is NOT because California is running short of oil. To the contrary, California has access to huge reservoirs of oil offshore (about 10 billion barrels, 1 billion of which is in state waters) and even more in the Monterey Shale, which stretches 200 miles south along the coast and inland from San Francisco. The Department of Energy estimates that California has reserves of about 15 billion barrels of oil—which is about double the Bakken Shale in North Dakota. Occidental Petroleum, the big oil player in California, has recently purchased leases from the U.S. Department of the Interior. But the regulatory climate is still hostile to undertake the hundreds of millions of dollars of speculative investments needed to extract oil from this region.

Part of the explanation between the oil boom in Texas and the bust in California is deeply rooted in each state's culture. California voters have thumbed their noses at fossil fuels as "dirty energy." The state has passed cap and trade climate change legislation which threatens to add substantially to the costs of conventional energy production and refining in the Golden State. The politicians in Sacramento and the Silicon Valley financiers have made huge and mostly wrong multi-billion dollar bets on "green energy"—especially wind and solar power. Texas has also invested in wind power, generating the most wind energy in America, but that did not deter the oil bonanza.

While California has frowned upon new drilling innovations, Texas has fully embraced the new technological marvels of horizontal drilling and fracking. These breakthroughs have made old oil fields profitable again. The culture of drilling is so ingrained in the business ways of south and west Texas that almost no one in places like Midland ever questioned the wisdom of moving aggressively forward. Meanwhile in California, fracking is viewed as a sinister policy and is even banned in some places—even though fracking is far superior today technologically in cracking through shale rock formations to get at the hydrocarbon gases and liquids stored there for millions of years.

But perhaps California's citizens are starting to see all the jobs and income that they are missing due to their anti-fracking stance. On May 31, 2013, a bill placing a statewide moratorium on fracking in the Golden State failed in the state assembly by 37 to 24. The interesting part of the vote is that 12 Democrats were among the 37 votes against the bill, and 18 Democrats abstained. A University of Southern California study estimates that the fracking industry could provide roughly 500,000 jobs to California over the next few years and tens of billions of dollars in state and local tax revenue each year.[22] Now that's an outcome that even the liberals can love.

Another contrast between Texas and California is that almost all the oil in the Lone Star State is on private lands—this is a state where private land ownership is sacrosanct. So farmers and other landholders hope and pray that they are modern-day Jed Clampetts sitting on oil so they can get rich off leasing their land to oil and gas producers.

One of the craziest decisions by the California lawmakers and voters was to impose on the Golden State energy companies a cap and trade tax on what they produce. This means, for example, that the cost of refining oil and gas extracted from California is made more expensive and inhibits development. In short, Texas loves being an oil-producing state; California hates it.

To Texans, oil is about industrial expansion and jobs, jobs, jobs. Texas has been leading the nation in job creation since the recession ended, and the jobs are in subsidiary industries related to energy production—transportation, high-technology, pipebuilding, light manufacturing, and so on.

ELECTRICITY

How much impact do California's high electrical prices have on manufacturing? Well, the 2012 price for industrial customers in California was 10.8 cents per kilowatt hour, the seventh-highest in the nation. This cost is 88 percent higher than Texas' industrial rate of 5.73 cents.

About $27 billion of electricity was sold in California last year. If California's residential, commercial, and industrial rates were the same as in Texas, California's consumers, businesses, and manufacturing would have saved $10 billion, or about $265 for every Californian.

In the years ahead, this cost gap will get wider as AB 32, California's Global Warming Solutions Act, bites harder in addition to the mandated steep increases in the use of expensive renewable energy.

A couple more observations about energy, the master resource: California imports the most electricity of any state, in effect turning much of the West into an energy colony of California. Other states, even Canadian provinces, are keen to get in on the action—especially if they can sell California electrons and charge more for them if they are "green."

Texans have come to realize another windfall benefit from oil production: it is a cash cow to pay for government services. In 2012, oil and gas royalties, fees, and taxes raised $12 billion in revenue to state governments. This aids Texas in financing its public services with no state income tax. California charges a 13.3 percent income tax on the richest in the state.

V. An Overview of Total State and Local Government Revenues: Texas and California

We should point out here that state- and local-centric taxes are only one of several sources of revenues for state and local governments. Federal intergovernmental transfers are also an important source of revenues for state and local governments, as are insurance trust revenues, current charges, miscellaneous general revenue, and utility and liquor store revenue.

In **Table 5**, we listed each of these major sources of state and local government revenues and their totals for all 50 states combined, i.e., the U.S. total, California, and Texas for the fiscal years 2010 and 2000. The explanation of each item in Table 5's footnotes is exceptionally important.

With respect to intergovernmental revenue—a far from inconsequential item to say the least—these funds were intended to pay a significant portion of some specific federally-mandated programs for all the states. Because both the

Table 5
State & Local Government Finances: Revenue, FY2010 & FY2000
(dollar amounts in $ billions and as a percent of GSP)

FY2010	United States		California		Texas	
Revenue Category	($bln)	(% of GDP)	($bln)	(% of GSP)	($bln)	(% of GSP)
Total Revenue	$3,171.4	22.0%	$451.6	24.1%	$209.2	17.1%
Total Taxes[1]	$1,269.6	8.8%	$172.6	9.2%	$86.5	7.1%
Intergovernmental Revenue[2]	623.7	4.3%	74.3	4.0%	45.3	3.7%
Current Charges[3]	409.6	2.8%	57.6	3.1%	28.2	2.3%
Miscellaneous General Revenue[4]	199.1	1.4%	21.9	1.2%	14.5	1.2%
Utility and Liquor Store Revenue[5]	153.5	1.1%	26.7	1.4%	11.6	0.9%
Insurance Trust Revenue[6]	515.8	3.6%	98.5	5.2%	23.1	1.9%

FY2000	United States		California		Texas	
Revenue Category	($bln)	(% of GDP)	($bln)	(% of GSP)	($bln)	(% of GSP)
Total Revenue	$1,942.3	19.7%	$270.4	20.5%	$120.7	16.5%
Total Taxes[1]	$872.4	8.8%	$120.1	9.1%	$52.2	7.1%
Intergovernmental Revenue[2]	291.9	3.0%	38.5	2.9%	18.6	2.5%
Current Charges[3]	223.5	2.3%	30.9	2.3%	14.5	2.0%
Miscellaneous General Revenue[4]	153.5	1.6%	18.9	1.4%	10.3	1.4%
Utility and Liquor Store Revenue[5]	89.5	0.9%	13.8	1.0%	6.2	0.8%
Insurance Trust Revenue[6]	311.5	3.2%	48.2	3.7%	18.9	2.6%

This report presents data on state and local government finances based on information collected from the 2000 and 2010 Annual Survey of State Government Finances. Duplicative intergovernmental transactions are excluded.

[1] The total tax revenue including property taxes, sales taxes, income taxes, license taxes, taxes on corporate income, severance taxes, and death and gift taxes.

[2] Federal grants and financial support for mandated spending such as public welfare, housing, veterans' services, nutrition services, education, housing, unemployment, Medicare, and Medicaid.

[3] Fees for education, hospitals, highways, airports, parks and recreation, sewerage, and solid waste management. Costs of collection are not deducted from these revenues.

[4] Revenues from lottery, parking facilities, rents, royalties, and revenues from related current charges. Again, costs of collection are not deducted from revenues.

[5] The fees to government for water, electric power, gas supply, and public mass transit. Costs of collection are also not deducted from revenues in this category. Liquor sales by state and/or local liquor store operations. Expenses for operating said stores are not deducted from revenues.

[6] Employer and employee contributions to social insurance programs such as unemployment compensation, government employee retirement, workers' compensation, and sickness and disability.

Source: U.S. Census Bureau, Bureau of Economic Analysis, Laffer Associates

revenue and the spending are, to a large extent, federally-funded and mandated, their evaluation as state and local economic policies will be generally moderated. Section IX evaluates these programs based on the spending consequences by state.

The percentage of GDP of total state and local government revenues from all sources to state and local governments is 21.9 percent for the entire U.S., 24.1 percent for California, and 17.1 percent for Texas. If ever a word like taxaholic were invented, California would fit the concept to a tee. California has almost 50 percent more state and local revenue relative to the size of its economy than does Texas. California's governments at all levels are huge consumers of revenues. Texas governments are far more sparing with other people's money.

In each and every one of the total revenue components as a share of Gross State Product (GSP), California's governmental complex absorbs as much or more than does Texas. This is true pretty much across-the-board. When it comes to contributions to workers' compensation, social insurance programs such as unemployment compensation, government employee retirement and sickness and disability, California's revenues as a share of California's GSP are more than 2.5 times Texas' share of its GSP. Yikes!

For overall total revenue for state and local governments as a share of GSP, Texas is the 3rd lowest in the nation, while California ranks 36th in the nation. For total taxes, in 2010 California's ranking is not much different at 32nd in the nation (lowest=1) and Texas ranking 5th. Both California and Texas do poorly in the category of utility and liquor store revenue ranking 43rd and 32nd respectively.

California is exceptionally high when viewing insurance trust revenue, which includes workers' compensation costs, health care contributions, and pension fund contributions. California is the 47th lowest in the nation, i.e., almost the highest, and Texas is 5th lowest.

Viewing changes over the past decade (2000 to 2010), California increased total revenue by 67 percent, while Texas increased total revenues slightly more by 73 percent. Of course, this difference is more than made up for by the more rapid growth in Texas Gross State Product than in California's Gross State Product. As a percent of GSP, California's total revenues have increased by 17.6 percent and Texas' total revenues by only 3.6 percent.

But the Devil is in the details.

For Texas, taxes as a share of Gross State Product have remained the same over the decade. For California, taxes went up by one tenth of one percent of state GSP. For both states, intergovernmental revenue went up a lot—1.2 percentage points of GSP for Texas and 1.1 percentage points of GSP for California.

Current charges as a percent of GSP also rose by 0.3 percentage points in Texas and by a huge 0.8 percentage points in California. Miscellaneous general revenue went down by 0.2 percentage points of GSP for both states, and for utility and liquor store revenue Texas was up 0.1 percentage points of GSP and California up 0.4 percentage points of GSP.

The big swing item is the insurance trust revenue. In Texas, insurance trust revenue as a percent of GSP fell 0.7 percentage points of GSP while in California it rose 1.5 percentage points from 3.7 percent of GSP in 2000 to 5.2 percent of GSP in 2010.

Overall, without the increase in intergovernmental revenue, Texas would have reduced all taxes and fees by six-tenths of one percent of GSP. California, on the other hand, would still have increased total revenues 2.5 percent of GSP even without intergovernmental revenues.

The reader should be aware that the concepts here are simple and straightforward and should not let a confusing volume of details deter him or her from drawing obvious conclusions. We will help to be an objective and accurate guide. But for the time being and at the level of abstraction we have, the items of greatest concern are first total taxes, second intergovernmental transfers in conjunction with their mandated spending, and, to a far lesser extent, insurance trust revenue.

In a later section of this paper we show just how much good these extra revenues do for the provision of public services in California and Texas.

VI. Texas, California, and U.S.: Comparison of Tax Revenue and Debt Financing

Moving now from population, labor force, and output measures, we cross over into state and local government finances. Just as a state cannot tax its way into prosperity, so too a state cannot balance its budget on the backs of people who are out-of-work. To run a state the size of Texas or California, state and local governments need tax revenues—lots of tax revenues. To get those tax revenues into the state's coffers, the state needs both a viable tax base which the government can tax and a tax rate to do the heavy lifting. The interesting twist here is that the size of the tax base and the tax rate itself are integrally related to each other.

But here again there is a great deal of readily available information that bears directly on our current topic at hand: state and local taxes. We cannot begin to list all the articles on who is moving from California to Texas (as did paper co-author Chuck DeVore, a former California State Assemblyman), which businesses have decided to expand in California, and so on and so forth. There are also a series of studies which have been highly touted by those who support higher taxes on millionaire tax returns in California,[23] Maryland,[24] and New Jersey,[25] but these studies are of dubious value. Such anecdotes are one unreliable way to draw serious conclusions, but there are some widely publicized comprehensive indicators that do make sense and universally point to the conclusions we will reach in this section.

The U.S. Internal Revenue Service (IRS) has been keeping track of tax returns by filer and where those tax returns are filed since 1992 and reporting these data in collective groups so as not to reveal any single tax return's data. We can trace groups of filers by filing location since 1992. We not only know where they filed this year and last year, but

Figure 5
Total Net Adjusted Gross Income Migration: Texas and California
($ billions, 3-year sums of data, '92-'93 to '09-'10)

Source: IRS, Laffer Associates

we also know the number of dependents, types of income and, most of all, Adjusted Gross Income (AGI).

For example, for the 18 years of tax returns, 1992-1993 to 2009-2010, the total number of returns moving from Texas to California is 300,310 while the number of returns moving from California to Texas over this same time period was 427,607. Quite a difference in favor of Texas. Not only did more filers move from California to Texas than from Texas to California, but the average adjusted gross incomes of the filers moving from California to Texas was considerably larger than the average adjusted gross incomes of filers moving from Texas to California.

In each and every year the surplus of filers moving to Texas from California was positive.

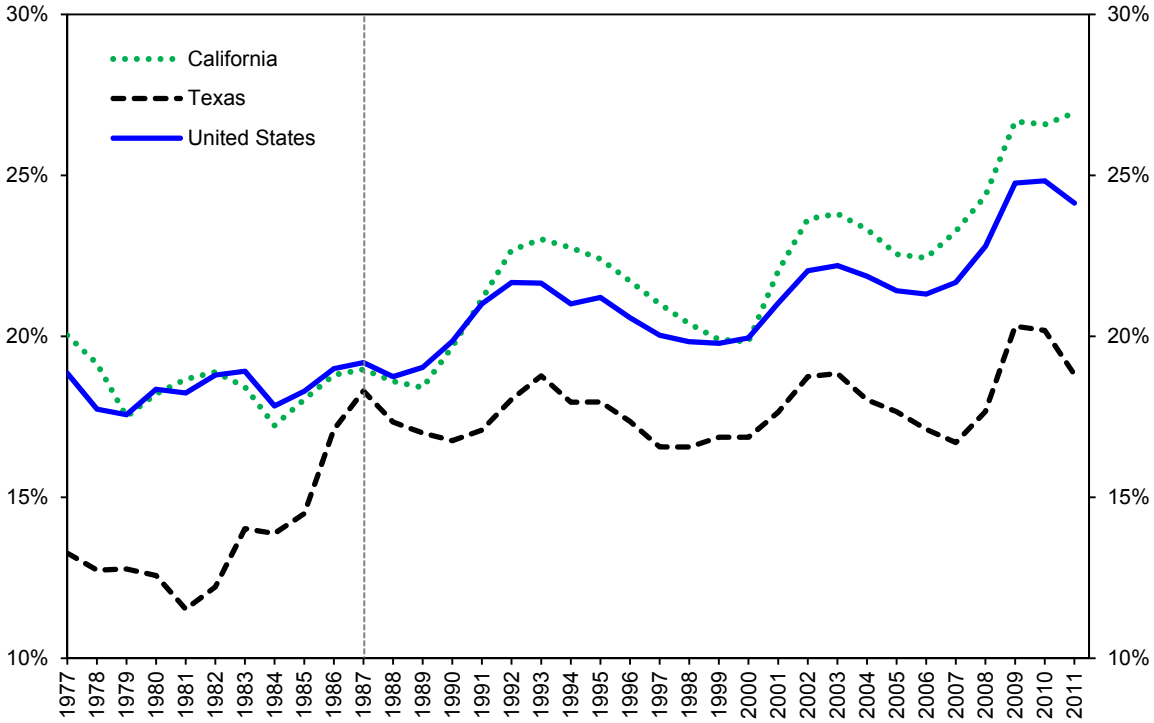
But obviously people can move from California to Oklahoma and then on to Texas and from Texas to West Virginia and then on to California. A better measure of the relative attractiveness of these two states would be total net inflows and net outflows of adjusted gross incomes for both California and Texas over this time period. And this is exactly what we have plotted in three-year intervals for the entire period that the IRS has reported these data. The answer of who is moving and where they are moving to and where they are moving from is crystal clear.

And as a quick explanation of exactly why all of this income and population migration is taking place, take a look at total state and local taxes as a share of private output for Texas, California, and the U.S. (**Figure 6,** next page). Do we need to write more?

Restrictions on land use are another bane of California. High fees to build on private property. Artificially restricted access to water. Global greenhouse gas rules. Zoning laws. These conspire to make housing, office space, and factories more costly.

How much more costly? The cost of housing in California stood at 176.3 percent of the national average in the last quarter of 2012. Only some of this cost differential is due to the desirability of living in California. Various estimates

Figure 6
Total State & Local Direct Expenditure as a Percent of Private GDP: U.S., California, and Texas
(annual, 1977 to 2011)



Source: U.S. Census Bureau, Bureau of Economic Analysis

have pegged the added cost to housing due to restrictive land use regulations of up to 61 percent.

Higher costs for housing drive about two-thirds of the cost of living differences across America, with California coming in at an overall cost of living of 127 percent of the national average in the fourth quarter of 2012 compared to Texas' 92 percent of the national average.*

Cost of living impacts everything, and, in California, higher costs are largely due to public policy choices: high taxes, burdensome regulations, and a bad lawsuit climate.

In **Table 6**, Row 1 is the 10-year growth in nominal Gross State Product over the period 2000 to 2010. Row 7 in Table 2 was also the 10-year growth in nominal income but reported for the more recent period 2001 to 2011. The reason we use the period 2000 to 2010 in Table 6 is because of delays in reporting fiscal data. We thought it more important that all data covered the same fiscal period rather than being the most recent. The nominal growth in a state's Gross State Product is the tax base for both state and local governments.

Row 2 of Table 6 is a highly aggregated measure of the decadal change in a state's average tax rate—total state and local tax revenues divided by Gross State Product. Row 3 is what we all are looking for after all is said and done—it is the percentage change in total state and local tax revenues over the decade 2000 to 2010 (Row 3 is the sum of Rows 1 and 2). This number reported in Row 3 represents the wherewithal for state and local governments to carry out their appointed obligations or more for the citizens of that state.

Row 4 of Table 6 is a combination of Row 1 of Table 2 (10-year percent increase in a state's population) and Row 3 of Table 6 and is the percentage increase in total tax revenues per person in the state.[26] Row 4 of Table 6 really provides a metric of how one state can provide for the average citizen versus any other state. We also include two additional rows in Table 6. Row 5 provides the total dollar value as of the end of fiscal year 2011 of state and local government debt plus total unfunded liabilities of pensions, trust loans, and budget gaps as a percent of state GSP, and Row 6 shows the latest bond ratings by Standard & Poor's for each state.

*ACCRA Cost of Living Index, 2nd Quarter 2013 as derived from U.S. Census Bureau data.

Table 6
State Fiscal Health: From Economic Growth to Debt Ratings

Row	Percent Change, 2000-2010	U.S.*	TX	TX Rank	CA	CA Rank
1	Gross State Product	51.1%	67.3%	7	42.3%	34
2	Total State & Local Tax Revenue as a % of GSP	-0.9%	-1.0%	26	1.0%	32
3	Total State & Local Tax Revenue	49.8%	65.6%	5	43.8%	27
4	Total State & Local Tax Revenue per Capita	36.7%	37.4%	20	30.9%	30
	2011					
5	State & Local Debt Outstanding + Unfunded Pension Liabilities + Unemployment Trust Loans + FY2011 Budget Gaps as a % of GSP	28.5%	21.6%	12	31.2%	33
	Current Rating**					
6	General Obligation Credit Rating – S&P	N/A	AA+	14	A	49

* U.S. is equal-weighted averages of the 50 states. ** "Current Rating" is as of 2/27/2013, or, if a state is not currently rated, it is the state's rating as of May 2012.

Source: Bureau of Economic Analysis, U.S. Census Bureau, California State Treasurer Public Finance Division, Texas Bond Review Board

For Row 1 of Table 6, as was the case for Row 7 of Table 2, Texas is significantly outperforming California when it comes to economic growth. But Row 2 of Table 6 presents a more ambiguous metric of state fiscal measures. In the eyes of many people, a state has to raise tax rates to provide government with the requisite revenues to serve its citizenry appropriately. For other people, lower tax rates, because they encourage private sector growth, are *prima facie* better than higher tax rates. Interestingly, Row 2 of this Table 6 shows California and Texas diametrically opposed—but not by a very large magnitude. California raised tax rates by 1 percent over the decade, while Texas lowered tax rates by 1 percent over the decade.

Equally interesting, two of the five best performing states in the U.S., Alaska and Wyoming, were two of the five largest tax rate increasers, while two of the five fastest growing states in the nation, Louisiana and Utah, were the two biggest tax rate cutters. Go figure! The relationship between tax rates and tax *revenues* is not quite as simple as it may look at first glance. And this is especially true when there are major swings in the production—and the prices—of fossil fuels such as oil, as shown earlier in Section IV.

When it comes to state and local tax revenue, however, Texas, even after reducing tax rates, increased tax revenues over the decade by 65.6 percent, ranking Texas number five in the nation. California, on the other hand, even with its tax rate increase, grew tax revenues by only 43.8 percent over the decade, putting California in 27th place.

Going from total tax revenues to tax revenues per capita, Texas, even with much higher population growth than California, still outperforms California at a 37.4 percent decadal increase for Texas compared to a 30.9 percent decadal increase for California. This phenomenon, lowering tax rates and yet increasing tax revenues, is an interesting possibility implied by incentive economics and is part of the subject of this paper.

As an alternative to the first four rows of Table 6, we could have used total state and local revenue instead of total taxes. This measure would correspond to Table 5's Total Taxes plus Current Charges, Miscellaneous General Revenues, Utility and Liquor Store Revenues and, finally, Insurance Trust Revenues (see **Table 7,** next page).

What **Table 7**, in conjunction with Table 6 itself shows is the huge expansion in non-tax, non-intergovernmental revenues to California vis-à-vis Texas. Insurance trust revenues, for example, as a share of state GSP have risen from 3.7 percent in 2000 to 5.2 percent in California, while in Texas they fell from 2.6 percent of GSP in 2000 to 1.9 percent in 2010.

To round out Table 6 on aggregate state finances, Row 5 shows that Texas at the end of fiscal year 2011 had a total debt inclusive of unfunded liabilities as a share of GSP of 21.6 percent and ranked 12th lowest in the U.S., while California was 33rd lowest with a ratio of 31.2 percent of GSP. Texas once again officially outperformed California.

Table 7

Row	Percent Change, 2000-2010	U.S.*	TX	TX Rank	CA	CA Rank
1	Gross State Product	51.1%	67.3%	7	42.3%	34
2	Total State & Local Own Revenue as a % of GSP	2.1%	-4.0%	14	14.4%	45
3	Total State & Local Own Revenue	52.8%	60.5%	15	62.7%	12
4	Total State & Local Own Revenue per Capita	39.5%	33.1%	37	48.1%	10

* U.S. is equal-weighted averages of the 50 states.

Source: Bureau of Economic Analysis, U.S. Census Bureau

The last row of Table 6 lists the Standard & Poor's ratings of the debt for each state from best to worst. Texas tied for 14th place along with 14 other states, while California was by itself second from the bottom at 49th place.

Shortly after California passed Proposition 30, a landmark retroactive tax rate increase, Standard & Poor's actually upgraded California's credit rating to A from the lowest rating ever, tied with Illinois at A-. In the same spirit of static analysis, Standard & Poor's also lowered California's credit ratings after the passage of Proposition 13 (1978) and subsequent supply-side tax cuts (1982) only to be forced to raise those ratings back up again once California growth soared as a result of the tax rate cuts (**Figure 7**). What is surprising is that, in general, higher taxes are more often than not associated with lower credit ratings, not higher credit ratings.

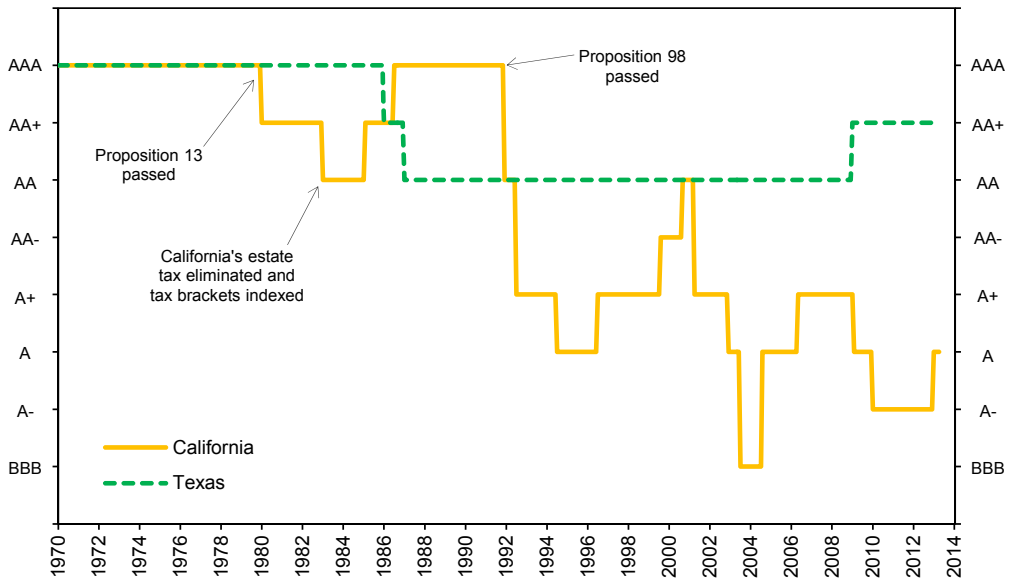
Standard & Poor's upgrade of California's debt after a massive tax rate increase represents the triumph of hope over experience.

To summarize: When it comes to the soundness of a state's fiscal circumstances and the generation of tax revenues, Texas outperforms California in each and every category.

VII. Policy Variables Affecting Growth

In the previous sections of this paper, we have shown beyond a shadow of a doubt that 1.) Texas' economy has outperformed California's economy over the past decade and 2.) Texas' government finances have also outperformed California's government finances over the same decade. Now let us see why.

Figure 7
Standard & Poor's Credit Rating, General Obligation Bonds: Texas vs. California
(monthly, Jan-70 to Apr-13)



Source: California State Treasurer Public Finance Division, Texas Bond Review Board

Table 8
Rank Among the 50 States

	Texas	California
GSP Growth	7th	34th
Total State & Local Tax Revenue as a % of GSP Growth	26th	32th
Total State & Local Tax Revenue Growth	5th	27th
Total State & Local Tax Revenue per Capita Growth	20th	30th
State & Local Debt Outstanding as a % of GSP	12th	33rd
S&P General Obligation Credit Rating	14th	49th

Source: Bureau of Economic Analysis, U.S. Census Bureau, California State Treasurer Public Finance Division, Texas Bond Review Board

A state's economic performance, and yes even a state's government finances, are subject to powerful external forces outside the control of the state's political apparatus. Oil price increases, for example, have benefitted zero income tax states such as Wyoming and Alaska beyond their wildest dreams. But oil price increases have also benefitted North Dakota and Louisiana, two states which do tax income.

This section attempts to evaluate the policies of state and local governments independent of their actual economic results or the change in their fiscal circumstances to account for good actions. Sometimes contingencies matter to outcomes, but all one can ask is that state governments do the right things to increase the odds that good outcomes will prevail.

Rich States, Poor States,[27] a book Steve Moore, Jonathan Williams, and Dr. Laffer have co-authored every year for the last six years, lists 15 government policy variables that contribute to or detract from each state's relative and absolute economic prosperity. These 15 factors are policy variables controlled by state and local governments themselves and are not meant to be, nor are they, the only factors that influence a state's prosperity. But these 15 variables are highly influential in determining a state's prosperity, and most of all they are policy tools that can be changed through politics. Here we rely on Reinhold Niebuhr's *The Irish Serenity Prayer*, parts of which are:

God grant me the serenity to accept the things I cannot change;
Courage to change the things I can;
And wisdom to know the difference. …
Taking, as He did, this sinful world as it is, not as I would have it …

Most of these policy variables are straightforward, and their inclusion should be self-evident. The other policy variables are a little trickier—but not much—and, therefore, deserve a few words of explanation. Listed below are the 15 policy variables in order of importance, with a brief explanation where warranted.

The Five Primary Policy Variables:

1) The state's highest personal income tax rate.

2) The progressivity of the personal income tax, i.e., how rapidly tax rates rise in relation to income.

3) The state's highest corporate income tax rate.

4) Is the state a right-to-work state?

5) The static revenue legislated tax changes over the past two years as a percentage of personal income.

The Second Five Policy Variables:

6) Is there a death or estate tax?

7) Workers' compensation cost as a percentage of total payrolls.

8) The state's minimum wage.

9) Business friendliness of the state's tort liability system, as measured by the U.S. Chamber of Commerce's State Liability Systems Survey Index.

10) The state's sales tax burden as a percent of personal income.

The Final Five Policy Variables:

11) The state's property tax burden as a percent of personal income.

12) The burden of total other taxes, which include taxes such as motor fuel, alcoholic beverages, tobacco taxes, public utilities taxes, motor vehicle license taxes, etc., as a percentage of personal income.

13) Number of state and local public employees per 10,000 population.

14) State and local debt plus unfunded liabilities of state and local governments as a percentage of state GSP.

15) The number of tax or expenditure limits placed on state and local government.

In **Table 9**, we list the most recent state rankings for California, Texas, and the U.S. for each of the 15 policy variables and each state's overall score and overall ranking. The overall scores of each state's rankings give the appearance of being more precise than they actually are, but they do paint a picture that is quite representative of what is actually going on in state and local governments for all the states, California, and Texas.

i.) The Five Primary Policy Variables

When it comes to the five primary policy variables, Texas has it all over California. Texas has no income tax—either earned or unearned—economic policy variable #1—and no capital gains tax either. In this category, Texas is tied for number 1 in the nation along with six other states. California, on the other hand, has the highest personal income tax rate in the nation, and that rate applies to capital gains as well as dividends, interest, and other forms of unearned income.

California's personal income tax structure is the single most progressive tax structure in the nation as well—economic policy variable #2—and Texas, as strange as this may seem without an income tax, is tied for only second place, not first place in this category. It just so happens that Alabama allows federal income taxes to be deducted at the state level, and with their state's statutory tax rate schedule this means that the effective marginal state income tax rate actually goes down the more a taxpayer earns. Go figure! Higher income people in Alabama progressively pay a smaller portion of their incomes in state income taxes because they pay a larger portion of their incomes in federal income taxes which are deductible at the state level.

In fact, even as high as California's income taxes are, if they were completely eliminated, California would still tax

Table 9
Components of ALEC-Laffer *Rich States, Poor States* Ranking[28]

	State	Texas	California
	Overall Economic Outlook Rank	7	43
	Overall Score	19.60	31.90
1	PIT Rate	1	50
2	PIT Progressivity	2	50
3	CIT Rate	4	38
4	Right-to-Work?	11.5*	36.5*
5	Legislated Tax Changes	30	33
6	Death Tax?	14.5*	14.5*
7	Workers' Compensation Costs	13	48
8	Min. Wage	16.5*	43
9	Tort Liability	35	47
10	Sales Tax Burden	24	33
11	Property Tax Burden	38	27
12	Other Tax Burden	37	12
13	Public Employees per 10,000 Population	32	5
14	State & Local Government Debt + Unfunded Liabilities as a share of GSP	12	33
15	# of Tax / Expenditure Limits	23.5*	8.5*

* For variables that are "yes" or "no" or tests such as "# of tax/expenditure limits," we use rankings that have been modified so as not to overweight such metrics. These modifications of the rankings are the reason that, for example, Texas ranks #14.5 in the nation on the death tax metric, rather than #1

Source: Laffer Associates, American Legislative Exchange Council

more of its residents' income than does Texas! To see just how consequential an income tax and its progressivity—economic policy variables #1 and #2—can be, we list in **Table 10** for purposes of illustration the primary metrics of state economic performance over the past 10 years for the nine states with no earned income tax, the U.S., and the nine highest income tax rate states:

It is also worth pointing out that each and every one of the 11 states that has introduced a progressive income tax over the past half century has declined as a share of the U.S. economy in population and output.

The California and Texas comparison when it comes to corporate taxes—economic policy variable #3—is not much different than it was for personal income taxes. Texas has a very low corporate tax rate with its business franchise tax—from 0.5 percent to 1 percent of taxable margin—that falls on a very broad tax base, making the tax close to the ideal tax for raising revenue while doing the least harm, ranking Texas number four in the nation though the tax has been complex to administer. California, on the other hand, has a very high marginal corporate income tax rate on a narrow tax base.

Table 10
9 Zero Personal Income Tax States vs. 9 Highest Personal Income Tax Rate States: 10-Year Growth
(tax rates as of 1/1/2013, growth rates 2001 to 2011 unless otherwise noted)

State	Top Marginal Personal Income Tax Rate	Gross State Product	Nonfarm Payroll Employment	Population	State and Local Tax Revenue***
Alaska	0.00%	85.2%	13.2%	14.0%	166.8%
Florida	0.00%	48.9%	12.5%	16.5%	57.0%
Nevada	0.00%	64.9%	18.1%	29.8%	74.0%
New Hampshire	0.00%	42.2%	4.2%	5.0%	53.1%
South Dakota	0.00%	59.1%	12.4%	8.7%	48.9%
Tennessee	0.00%	45.1%	5.5%	11.3%	46.8%
Texas	0.00%	71.5%	20.5%	20.4%	65.6%
Washington	0.00%	54.2%	8.9%	14.1%	42.9%
Wyoming	0.00%	100.7%	18.9%	14.9%	131.3%
9 Zero Personal Income Tax Rate States*	**0.00%**	**63.54%**	**12.68%**	**14.98%**	**76.26%**
50-State Average**	**5.69%**	**51.41%**	**7.62%**	**9.54%**	**49.79%**
9 Highest Personal Income Tax Rate States**	**10.23%**	**45.90%**	**5.30%**	**6.50%**	**47.74%**
Kentucky	8.20%	41.6%	5.0%	7.4%	35.4%
Ohio	8.43%	26.5%	-2.5%	1.4%	26.8%
Maryland	8.95%	53.9%	9.5%	8.4%	53.5%
Vermont	8.95%	37.7%	4.5%	2.3%	57.5%
New Jersey	9.97%	33.4%	5.2%	3.9%	55.6%
Oregon	10.61%	73.1%	6.5%	11.6%	39.5%
Hawaii	11.00%	57.5%	10.2%	12.1%	60.9%
New York	12.70%	43.1%	7.2%	2.0%	56.8%
California	13.30%	46.2%	2.2%	9.3%	43.8%

* equal-weighted average, NH and TN tax only "unearned" (dividend and interest) income only
** equal-weighted average, does not include D.C.
*** 2000-2010 due to data release lag

Source: Laffer Associates, Bureau of Economic Analysis, U.S. Census Bureau

California taxes the bejabbers out of successful companies that cost-effectively make desirable products and does not tax loser companies at all. In fact, even at the state level, California subsidizes a number of loser companies. If you ever get a chance to drive from Palm Springs, California to Los Angeles, California, you will pass miles and miles of windmills. Without state and federal subsidies, these windmills would be bankrupt in minutes.

Texas is a right-to-work state, and California is a forced-union state. Whether a state is a right-to-work state or a forced-union state makes a huge difference to a state's prosperity. In fact, even comparing performance metrics of zero income tax non-right-to-work states to right-to-work states *with* income taxes shows that right-to-work legislation makes a material impact on state economic performance.[29] Again, Texas dominates California on economic policy variable #4.

In **Table 11** we list summary economic performance statistics for right-to-work and non-right-to-work states—economic policy variable #4—over the past decade:

When it comes to primary policy variable #5 of the top five, legislated tax changes, both Texas and California are in the bottom half of all states. But even here, Texas, which ranks number 30 in the nation, ever-so-slightly outperforms California, which ranks 33rd. **Table 12** below summarizes the top five policy variables for California and Texas.

ii.) The Second Five Policy Variables

The next five policy variables are not as important as are the primary five policy variables, but in and of themselves they can still be quite influential. And, as was the case for the five most important primary policy variables, Texas dominates California. Only when it comes to the death or estate tax—policy variable #5—do the two states have a tie. In 1982, California, on the heels of Proposition 13, repealed its estate tax, leaving the state one of 30 states without an estate tax. Texas does not have an estate tax either.

The existence of a state estate tax can have a shockingly large impact on an admittedly small but highly important segment of a state's population. In **Table 13** we list the number of federal estate tax returns per 1,000,000

Table 11
22 Right-to-Work States vs. 28 Non-Right-to-Work States: 10-Year Growth
(RTW status as of 1/1/2012*, grow th rates 2001 to 2011 unless otherw ise noted)

State	RTW? Yes=1*	Gross State Product	Nonfarm Payroll Employment	Population	State and Local Tax Revenue***
22 Right-to-Work States*	**1**	**59.2%**	**11.2%**	**13.1%**	**53.8%**
50-State Average**	**0.44**	**51.4%**	**7.6%**	**9.5%**	**49.8%**
28 Non-Right-to-Work States*	**0**	**45.2%**	**4.8%**	**6.8%**	**46.6%**

* equal-weighted average, Indiana and Michigan not included as RTW states because the laws had not passed or were not in effect during this time period. Indiana passed RTW Feb 1st, 2012 with an immediate effective date, and Michigan passed RTW in Dec. 2012 with the law going into effect in late Mar 2013.
** equal-weighted average, does not include D.C.
*** 2000-2010 due to data release lag

Source: Laffer Associates, Bureau of Economic Analysis, U.S. Census Bureau

Table 12
The Five Primary Policy Variables

	Texas	California
Personal Income Tax Rate	1st	50th
Personal Income Tax Progressivity	2nd	50th
Corporate Income Tax Rate	4th	38th
Right-to-work?	1st	50th
Legislated Tax Changes	30th	33rd

Table 13
Federal Estate Tax Filings in Tennessee, Florida and the U.S.:
Number of Estate Filings per 1,000,000 Population and Size of Average Estate Filing, 2011

	Estates Filed per 1,000,000 Population	Size of Average Estate*
Tennessee (Separate Estate Tax)**	12.5	$ 10,626,625
U.S. Average	14.8	$ 10,464,213
Florida (No Separate Estate Tax)	24.0	$ 15,771,867

* gross estate ** Tennessee passed legislation in 2012 to phase out its estate tax. The exemption amount increases each year through 2015, and the estate tax is fully repealed from 2016 onward.

Source: IRS Statistics of Income Division

population for Tennessee, which did have an estate tax up to and including 2011, the whole U.S., and Florida, which did not have an estate tax, and the average size of each state's taxable estates.[30]

With regard to workers' compensation costs, the 7th most important economic policy variable, Texas ranks 13th lowest in the nation, while California comes in as the 3rd highest workers' compensation costs in the nation. If you will remember Table 5 on page 15, workers' compensation costs are included in that table as part of "Insurance Trust Revenue" which, as of 2010 at least in California, represented 5.2 percent of California GSP while in Texas represented only 1.9 percent of Texas GSP. Adding further insult to actual injury, professional athletes who were never actually based in California but who played a game or two there have been using California's workers' compensation system as a retirement supplement at the end of their careers. For instance, Denver Broncos running back Terrell Davis, a former Super Bowl MVP, played only nine games in California out of an 88 game career. He applied for workers' compensation and received a $199,000 injury settlement on top of his $6.8 million contract and endorsement deals.[31] Or Ernie Conwell, who, according to the *Los Angeles Times*, "won $160,000 plus future medical benefits in California after collecting $181,000 in Louisiana and $195,000 from the NFL. Conwell never played a down for a California team."[32] These policies do not make you want to move your production facilities to California. Once again, Texas wins a clean sweep.

California, when it comes to policy variable #8, has always had a higher minimum wage than the federal minimum wage, while Texas has always stuck with the federal minimum wage. Whatever else you may think of the minimum wage, it surely does increase production costs and reduces a state's competitive position. Just imagine what would happen to a state if it adopted, say, a $100 an hour minimum wage when every other state's minimum wage is below $10 an hour. Texas, which is governed by the federal minimum wage, is tied with 30 other states as the lowest minimum wage in the nation, while California has the 8th highest minimum wage in the nation and thus ranks 43rd. Texas has it hands down over California.

Table 14
The Second Five Policy Variables

	Texas	California
Death or Estate Tax?	NO	NO
Workers' Compensation Costs	13th	48th
Minimum Wage	1st	43rd
Tort Liability	35th	47th
Sales Tax Burden	24th	33rd

Measuring the degree to which a state's legal system is business friendly—policy variable number nine—is a tricky business. But using our measure, neither Texas nor California ranks very well amongst all the states. State judicial systems tend to have a life of their own independent of the political climate elsewhere in a state. But using these rankings, California's courts are significantly less business friendly than are Texas courts. Texas ranks poorly at number 35 out of 50 states, while California once again comes in near the bottom at 47th out of 50 states. Importantly, before Texas reformed its medical malpractice system in 2003, the U.S. Chamber of Commerce ranked Texas' legal system 46th worst in the nation, just behind California at 45th, so Texas has improved, and California has worsened in this category—and that is before the ranking took into account Texas' major loser pays reform in 2011. This ends up as a nail-biting win for Texas, but a win nonetheless.

Rounding out the second group of five policy variables, we have the sales tax burden as policy variable #10. In general all taxes are bad, but some are worse than others. On a dollar-for-dollar basis, sin taxes—included in policy variable #12—are about the best group of taxes because discouraging "sins" is usually considered a positive outcome. What is difficult is determining just exactly what constitutes a sin.

Sin taxes tend to be generally small revenue sources and, therefore, of little consequence save for the state and local governments of Nevada. Of the bigger taxes, we view that on a dollar-for-dollar revenue basis, a broad-based sales tax does less damage than most other taxes. Property taxes—policy variable #11—as currently used by state and local governments, are better than income taxes but not as good as sales taxes.

Yet even when viewing sales taxes, Texas once again outperforms California. Even though Texas has no income tax at all, California has the highest income tax, and Texas has far lower corporate taxes than does California, Texas' sales tax burden still ranks number 24 in the nation, while California's sales tax burden ranks number 33. Putting the second set of five policy variables together, Texas beats California in four categories and ties California in the fifth.

iii.) The Final Five Policy Variables

When we consider the final five policy variables, which, are considerably less important than are the first or second groups of five policy variables, we have a total "U" turn, and California beats Texas in four out of five policy variables.

Property tax revenues—policy variable #11—which we have already mentioned above, in Texas as a share of Gross State Product, are quite a bit higher than they are in California. California's unexpected success with property taxes, most likely, is a direct consequence of California's landmark constitutional amendment of June 1978, referred to either as Proposition 13 or the Jarvis/Gann initiative (see Figure 2 on page 10). This constitutional amendment restricted property taxes on a specific piece of property in California to never exceed 1 percent of that property's true market value and to never increase by more than 2 percent per year unless the property is sold. When sold, the new basis of a property for tax purposes is the market price at which it sold. In spite of Proposition 13, California's property taxes as a share of personal income are still fairly high in large part because of the enormous historical rise in property values in California relative to the rest of the nation (the numerator) and the recent collapse of California's economy and California's personal income (the denominator). But more on this later. California is the winner.

Policy variable #12 is the remaining tax burden of other taxes not included in any of the prior categories as a percentage of a state's GSP. We also mentioned a few paragraphs earlier that some of these taxes are referred to as "sin" taxes. This tax category includes taxes on motor fuel, alcoholic beverages, tobacco, public utilities, and motor vehicle licenses. These are not individually all that important, but they can add up and definitely should be included in our overall measure of the pro-growth nature of a state's economic policies. Here again, California beats Texas. Not only does California beat Texas, but California's victory over Texas is by a wide margin.

California also has a lot fewer public employees per 10,000 people than does Texas. In fact, Texas has more public employees as a share of its population than does the U.S. average of all the states, while California is down near the bottom of the pack. Policy variable #13 belongs to California. We will have a lot more to write about this variable later on but, in Texas' case, this statistic is driven mostly by the large number of public school teachers there. It is far more important and the conclusions to be reached far more ambiguous than the few words written here.

Policy variable #14 once again is state and local debt service plus state and local government unfunded liabilities as a share of the state's GSP, and in this category Texas ranked 12th in the nation while California ranked 33rd in the nation (see our discussions of this in Section VI).

Table 15
The Final Five Policy Variables

	Texas	California
Property Tax Burden	38th	27th
Other Tax Burden	37th	12th
Public Employees per 10,000 Population	32nd	5th
State & Local Government Debt plus Unfunded Liabilities as a Share of State GSP	12th	33rd
Number of Tax/Expenditure Limits	23.5th	8.5th

* For variables that are "yes" or "no" or tests such as "# of tax/expenditure limits," we use rankings that have been modified so as not to overweight such metrics. These modifications of the rankings are the reason that, for example, Texas ranks #14.5 in the nation on the death tax metric, rather than #1.

The final policy variable, policy variable #15, looks at the number of legislated or constitutional tax and spending limits put in place limiting expansive state legislatures. There are at present two in California—Proposition 13, which we discussed briefly in regard to Figure 2 on page 10 and also with respect to policy variable #11, and the inoperative Gann spending limit, which was called Proposition 4. There is only one legislated spending limit in Texas, and it is fairly effective. But California wins with two.

Putting all five of the final five policy variables together, California beats Texas in four of the five policy variables. For California's sake, it is a shame its victories were exclusively where policies are of relatively small weight, and its losses were on the big ticket items.

Summarizing all 15 policy variables that affect growth, Texas easily bests California and by a considerable amount, especially when it comes to the more important policy variables. However, Texas, whether it is the winner or not, still has considerable room for improvement. California though has even more room for improvement.

VIII. The Relationship between Taxation, Spending, and the Achievement of Policy Objectives—A Story of "Parasitic" Leakages

Quite understandably, people, even experts, supposedly knowledgeable experts, in state and local finances, use a type of shorthand when they link tax policy to spending objectives. To them, higher tax rates mean more schools, more highways, more policemen, more firemen, more nurses, and more prison guards. If you extend their logic, higher tax rates lead to equal percentage increases in tax revenues and, therefore, equal percentage increases in dollar expenditures which in turn leads to equal percentage increases in real resources for state and local governments to provide to the people, i.e., an equal percentage increase in the provision of public services.

Unfortunately, this shorthand is simply wrong. The relationship, as espoused, between tax rates and state and local provision of public services gets carried too far when tax rate changes, tax revenue changes, dollar government spending changes, and increases in the provision of public services (i.e., real spending changes) are treated as synonyms. They are not.

a.) Higher tax rates are not synonymous with higher dollar tax revenues.

b.) Higher dollar tax revenues are not synonymous with higher dollar government spending.

c.) Higher dollar government spending is most definitely not synonymous with the greater provision of public services.

The leakages here are the equivalent of "parasitic loss," a term used to describe the diminution of measured horsepower of an automobile when measured at the engine itself and then measured again at the back tires. Not surprisingly, the loss in measured horsepower is quite large when moving from the engine to the back tires. So too are the losses in the provision of public services from an increase in tax rates—"parasitic leakages."

Table 16
All Policy Variables and Overall State Ranking

	Texas	California
Personal Income Tax Rate	1st	50th
Personal Income Tax Progressivity	2nd	50th
Corporate Income Tax Rate	4th	38th
Right-to-work?	1st	50th
Legislated Tax Changes	30th	33rd
Death or Estate Tax?	NO	NO
Workers' Compensation Costs	13th	48th
Minimum Wage	1st	43rd
Tort Liability	35th	47th
Sales Tax Burden	24th	33rd
Property Tax Burden	38th	27th
Other Tax Burden	37th	12th
Public Employees per 10,000 Population	32nd	5th
State & Local Government Debt plus Unfunded Liabilities as a Share of State GSP	12th	33rd
Number of Tax/Expenditure Limits	23.5th	8.5th
Overall State Ranking	12th	47th

* For variables that are "yes" or "no" or tests such as "# of tax/expenditure limits," we use rankings that have been modified so as not to overweight such metrics. These modifications of the rankings are the reason that, for example, Texas ranks #14.5 in the nation on the death tax metric, rather than #1.

Now it is very true that to have any state and local government spending, real or nominal, there have to be tax revenues, which means there have to be tax rates and tax bases. But going from that statement to a statement that higher tax rates mean an equivalent increase in state and local government services for state residents is simply false.

Proposing higher tax rates is invariably justified on the grounds that there is an increased need for public services—more schools, more school teachers, more policemen, more firemen, more nurses, more prison guards, more libraries, more public welfare, more roads, a cleaner environment, better health standards, and the like. But advocates of higher tax rates ignore the large conceptual leap of faith from higher tax rates to increased public services. And one truth is universal when it comes to tax increases—you never get as much as you thought you would. In other words, beware of "parasitic leakages."

We now come to the final two stages of the state and local government political process which start with a.) tax rates and tax bases and then moves on to b.) tax revenues and from there to c.) government spending and the process ends with d.) provision of public services. The distinction we wish to make is between the total dollars spent by a state's state and local governments (category c) and the actual provision of public services to state residents (category d). This distinction is not just at a technical point. There can be a large difference between the dollar amount state and local governments spend on a specific program (such as K-12 public education) and the actual services those programs provide (such as educational test scores)—yet another example of "parasitic leakages."

IX. Intergovernmental Revenues

As noted in Table 5, Intergovernmental Revenues represent a large (almost 20 percent nationwide) federal source of total state and local government revenues. These revenues are remitted to state and local governments to fund a significant portion of some specifically-mandated programs for all states. In 2010, these federal funds accounted for 4 percent of California's GSP, or 16 percent of California's state and local government revenues and 3.7 percent of Texas' GSP and

22 percent of Texas' state and local government revenues. In spite of the large federal funding of these programs, state and local governments are still required to pay for a consequential portion of the total funding necessary. We will review three such programs:

While welfare, Medicaid, a large portion of unemployment benefits, and food stamps are all partially federally-funded and federally-mandated state programs, we have generally avoided referring to them when comparing and contrasting all 50 states of America. These programs are, after all, applicable to all states. But these programs do have specific state effects, require substantially different state funding across all states, and these effects can vary significantly from state to state. Not only do these federally-funded and federally-mandated programs have different effects by state, they also reflect widely divergent characteristics of the states where they are applied. But because the dollars involved are not directly comparable to state and local tax dollars, we have separated the discussions of each.

i.) Temporary Assistance for Needy Families (TANF)

We will start with the program that is officially designated as "welfare," which has the formal handle of Temporary Assistance for Needy Families (TANF). In **Table 17** below we list the percentage of California's, Texas' and the U.S. average state's population on welfare as of 2011 along with each state's percentage of U.S. population and each state's percentage of U.S. welfare recipients.

Just look at and compare and contrast California and Texas. California has 3.88 percent of its population on welfare, far and away the highest percentage in the nation, while Texas has less than one half of one percent on welfare, rating Texas an enviable rank of 4th lowest in the nation. California has over 34 percent of the nation's welfare recipients.

Not only does California have 34 percent of the nation's welfare recipients, but California state and local governments also employ 18 full-time equivalent (FTE) state and local government welfare workers per 10,000 of population, almost 75 percent more than does Texas at 10.4 full-time equivalent state and local government welfare workers per 10,000 of population (see Table 20 on page 32).

But now the rub really gets bad. California, on an average salary basis, pays its state and local welfare government employees over 50 percent more per worker than does Texas (again see Table 20 on page 32). Just how does this behavior lead to economic growth and prosperity? Quite simply, it does not.

ii.) Medicaid

Medicaid is another federally subsidized state and local government administered program. And it too is very large. In 2010 there were 67 million people enrolled in Medicaid nationwide, and the total bill for Medicaid was $383.5 billion. The federal government paid for 67.8 percent of the total Medicaid bill, and state and local governments paid for 32.2 percent, or $123.5 billion (see table below). Between 2006 and 2010, total Medicaid payments nationwide went up by almost $85 billion, and enrollment rose by almost seven million people.

While we do have the total U.S. Medicaid numbers for 2010, we do not have the 2010 numbers separately for California and Texas, or any of the other states for that matter. On a state-by-state basis we have 2009 numbers. Medicaid enrollment in Texas in 2009 was 4.488 million, or 18 percent of the state's population. California, on the other hand, had a total Medicaid enrollment in 2009 of 11.168 million, or 30 percent of its population. California's state and local governments unluckily were held liable for

Table 17
Welfare Participation, 2011: Texas vs. California

	U.S.	Texas	California
% of Population on Welfare	1.38%	0.43%	3.88%
Rank	N/A	4	50
Welfare Recipients as a % of 50-state Welfare Recipients	100.00%	2.58%	34.07%
State Population as a % of Total 50-State Population	100.00%	8.26%	12.12%

Being a "Welfare Recipient" is defined here as receiving Temporary Assistance for Needy Families (TANF)

Source: BEA (population), U.S. Department of Health and Human Services: Administration for Children & Families

Table 18
Medicaid: U.S., California, and Texas

	U.S.	California	Texas
	2010	2009	2009
Enrollment (000s)	66,695	11,168	4,488
% of Population	21.6%	30.2%	18.1%
Total Medicaid ($bn)	$383.5	$40.8	$23.0
Medicaid per Recipient ($000s)	$5.75	$3.66	$5.12
State Share of Medicaid (%)	32.2%	40.1%	31.7%
State Share of Medicaid ($000s)	$123.5	$16.4	$7.3

Source: Medicaid.gov

40 percent of California's total Medicaid bill (the federal government paid the rest) while Texas' state and local governments had only to pay 31.7 percent of its state's total Medicaid bill.

Once again California comes out the biggest loser (see **Table 18**).

To summarize, in 2009 Texas had a much smaller percentage of its population in Medicaid than did California (18 percent vs. 30 percent), and Texas had a larger share of its Medicaid expenses paid by the federal government than did California (68.3 percent versus 60 percent).

iii.) Supplemental Nutrition Assistance Program (SNAP) alias Food Stamps

Another federally-funded state-administered program is what we used to call food stamps, but it now has the official moniker SNAP. In **Table 19** below we list the U.S. numbers and the California and Texas numbers for this program.

California pays more per person and per family on food stamps than does either Texas or the U.S. as a whole. Likewise, state and local governments in California pay a larger share of the administrative costs than does Texas or the average of all states. But where Texas moves way ahead of California is that Texas' administrative costs in aggregate are far lower than are California's administrative costs, in

Table 19
SNAP, FY 2011: U.S., California, and Texas

	U.S.	California	Texas
Number of People (000s)	44,709	3,673	3,977
% of Population	14.4%	9.7%	15.5%
Number of Families (000s)	21,072	1,613	1,608
$ Amount of SNAP Benefits (billion)	$71.81	$6.48	$5.99
Monthly Benefit per Person	$133.85	$147.12	$125.57
Monthly Benefit per Family	$284.00	$335.04	$310.50
Total Administrative Costs (billion)	$6.83	$1.29	$0.54
State Share of Administrative Costs (%)	50.2%	52.3%	47.2%

Source: U.S. Department of Agriculture Food and Nutrition Service

part reflecting the higher costs per employee in California and the expanded administrative efforts in California.

X. The Provision of Public Services by State and Local Governments

Just how to measure the provision of public services by state and local governments is notoriously difficult and exceptionally important. In most cases, we decided to sidestep output measures of public services and have instead relied upon measures of real inputs such as police personnel per 10,000 population. Where available, we have focused on output measures as well as measures of inputs, i.e., education test scores plus number of educational employees per 10,000 population.

State and local governments all across the U.S. are employers of a large number of people, many of whom have specific skills and/or specific duties for which they were hired. State and local governments also subcontract a large number of projects out to private companies. The degree to which states outsource the services they provide can vary quite dramatically from state to state. In California, for example, private prisons are almost nonexistent, while in Texas 11 percent of all prisoners are held in privately-run facilities.

This section looks solely at specific employees of state and local governments from elected officials on down. The total costs associated with these services as described in this table are the product of the average (mean) salary and the number of full-time equivalent employees hired. These data do not include unfunded retirement benefits or unfunded health benefits.

Table 20 (next page) lists the current average annual salaries for the governor, state legislators, education employees, hospital employees, police protection employees, correctional facilities employees, highway employees, fire protection employees, public welfare employees, and other employees. Table 20 also lists the annual average pay per full-time equivalent employee, the number of these full-time equivalent employees per 10,000 population for state and local government employees combined by function for the U.S. and both California and Texas, and the ratio of California to Texas for both the numbers of employees per 10,000 population and their average pay. As a final row, we have total pay for each function for each state as a share of Gross State Product (i.e., average pay times the number of full-time equivalent employees divided by state GSP).

The pattern defined in Table 20 is rather interesting. The first three rows reaffirm what we already know.

Even a cursory overview of this table illustrates the problem to which we have been alluding throughout this paper. Annual average salaries for equivalent categories of state and local government employees vary considerably across the states. The average annual salary for police protection employees, for example, ranges from $35,442 in Mississippi to $91,663 in California. On average for all state and local government employees, annual salaries range from $37,022 in Arkansas to $67,524 in California. These types of salary variations make a huge difference to state and local government budgets and to the provision of public services.

What is striking, however, is that for all state and local government employees as well as for almost every subcategory, California has the highest average annual salaries in the nation—and that is without consideration of the notorious problem with California's unfunded government employee pension and health benefits.

Average annual pay in Texas, on the other hand, is below the U.S. average in every single category of state and local government employees. Salaries have consequences. If the dollar amount of funding is fixed, doubling the price of everything halves the amount. And California sure has the highest prices when it comes to salaries of government employees.

Take hospitals for example. The average annual salary for a hospital employee in Texas is $52,699 while that same hospital employee in California earns $80,617. For police protection employees the average annual salary is $91,663 in California and $53,944 in Texas. For correction facilities, i.e. prisons, the average annual salary in Texas is $37,660, and in California it is $72,723. You would think this were a two-for-one special, and it is. We will cover corrections a little more thoroughly in a few more pages.

We will also cover education much more thoroughly a little later on, but the message is clear even in these summary tables. California educational employees have an average annual salary of $61,575 while the same group of employees in Texas earns $43,955. Average annual salaries for highway employees in Texas are $42,885 while in California they are $75,549. And what does California get for its highly paid highway employees? It gets an average cost of

Table 20

Annual Pay per FTE Employee, Based on March 2011 Pay

	Governor	State Legislator
CA	$173,987	$95,291
TX	$150,000	$7,200
CA to TX Ratio	1.16	13.23

Note: CA state legislator salary down from $113,098 in 2007

State	Total	Education Total*	Hospitals	Police Protection Total**	Corrections	Highways	Fire Protection Total***	Public Welfare	Other
U.S.	$51,627	$49,335	$56,246	$63,342	$50,253	$49,834	$69,169	$46,336	$52,687
CA	$67,524	$61,575	$80,617	$91,663	$72,723	$75,549	$114,722	$56,238	$67,146
TX	$45,022	$43,955	$52,699	$53,944	$37,660	$42,885	$61,813	$36,960	$45,278
CA to TX Ratio	1.50	1.40	1.53	1.70	1.93	1.76	1.86	1.52	1.48

FTE Employees per 10,000 Population, as of March 2011

State	Total	Education Total*	Hospitals	Police Protection Total**	Corrections	Highways	Fire Protection Total***	Public Welfare	Other
U.S.	526.0	286.0	31.0	29.7	23.1	16.5	10.9	16.1	112.7
CA	464.8	231.1	28.0	26.4	24.4	10.8	8.6	18.0	117.4
TX	564.8	344.6	30.3	28.9	27.7	13.6	10.0	10.4	99.3
CA to TX Ratio	0.82	0.67	0.92	0.91	0.88	0.79	0.86	1.74	1.18

Total Annual Pay (mean salaries times FTE employment) as a % of GSP, Based on March 2011 Pay

State	Total	Education Total*	Hospitals	Police Protection Total**	Corrections	Highways	Fire Protection Total***	Public Welfare	Other
U.S.	5.38%	2.80%	0.35%	0.37%	0.23%	0.16%	0.15%	0.15%	1.18%
CA	6.04%	2.74%	0.44%	0.47%	0.34%	0.16%	0.19%	0.20%	1.52%
TX	4.99%	2.97%	0.31%	0.31%	0.20%	0.11%	0.12%	0.08%	0.88%
CA to TX Ratio	1.21	0.92	1.39	1.52	1.67	1.37	1.56	2.59	1.72

* Elementary & Secondary Instructional Employees Only:	Annual Pay per FTE Employee	FTE Employees per 10,000 Population	Total Annual Pay as a % of GSP
U.S.	$52,859	151.4	1.67%
CA	$67,970	110.1	1.44%
TX	$45,700	188.5	1.69%
CA to TX Ratio	1.49	0.58	0.85

** Police Officers Only:	Annual Pay per FTE Employee	FTE Employees per 10,000 Population	Total Annual Pay as a % of GSP
U.S.	$68,928	22.2	0.32%
CA	$104,729	18.1	0.37%
TX	$59,551	20.9	0.24%
CA to TX Ratio	1.76	0.87	1.50

*** Firefighters Only:	Annual Pay per FTE Employee	FTE Employees per 10,000 Population	Total Annual Pay as a % of GSP
U.S.	$70,093	10.0	0.15%
CA	$119,698	7.7	0.18%
TX	$62,962	9.2	0.11%
CA to TX Ratio	1.90	0.83	1.55

Source: U.S. Census Bureau, National Conference of State Legislatures, The Council of State Governments

$265,061 to build a mile of highway in California versus $88,539 for that same mile of highway in Texas. Is it any wonder why Texas' highways are so much better? The same could be written for bridges as well.

And when it comes to hospital and fire protection full-time equivalent employees, the answer is still the same. Hospital employees in California earn on average $80,617 per year while in Texas they earn $52,699. For fire protection, California full-time equivalent employees pull in $114,722 on average. The same group in Texas earns $61,813. Does it still surprise you why all these cities in California are going broke and Texas is booming?

The last category of full-time equivalent workers we have looked at separately is almost anti-climactic—public welfare employees. Given what you know about welfare from Section IX and what you know about salaries from this section, you can guess that California pays its welfare employees a lot more and employs a lot more of them. The average public welfare employee in Texas earns $36,960 per year. In California, that same employee earns $56,238. And there you have it—California pays way more than Texas pays. But there is more. Now we get to the actual provision of public services—the number of public employees per 100,000 population.

Whereas in education, hospitals, police protection, corrections, highways, and fire protection, Texas employs far more professionals per 10,000 of population than does California, in public welfare, the roles are reversed. California employs almost 75 percent more welfare workers per 10,000 population than does Texas. And, of course, as mentioned in the paragraph above, California pays each of its welfare employees on average over 50 percent more than Texas does. Here is the problem.

In the category of other state and local government employees, California's newfound leadership continues. California pays almost 50 percent more per worker than does Texas, while Texas employs almost 20 percent more workers per 10,000 population than does California.

Whether we like it or not, education, hospitals, police protection, corrections, highways, and fire protection are all government functions that increase output, employment, and at certain levels, general prosperity. These are the areas where Texas far outperforms California.

Welfare and other public services, on the other hand, detract from output, employment, and general prosperity but are purported to increase equity and social justice and reduce income disparities. These are the areas where California outspends and outemploys Texas. And to what avail? California has more poverty, unemployment, people in need, and general despair than does Texas. California's highest tax rates create the very destitution that is used as a rationale for more welfare and higher tax rates.

XI. The Performance of State and Local Public Education

From the previous tables you should be able to surmise that it would take a miracle for California to do a better job educating California's K-12 population than Texas does educating its K-12 population. California has 231.1 people in education per 10,000 population while Texas has 344.6 people in education per 10,000 population. Texas has 50 percent more people as a share of population working in education than does California.

California's education elite are paid on average $61,575 annually while Texas' average salary is $43,955. California's average for a full-time equivalent employee in education is a full 40 percent higher than is the average pay for the same person in Texas. And to round things out, education is the one major category where Texas actually spends more as a share of state GDP than does California. Unfortunately, as opposed to the hockey competition at the 1980 Winter Olympics at Lake Placid, there is no miracle. California's kids are the big losers.

The National Assessment of Educational Progress (NAEP) is a congressionally-authorized project of the National Center for Education Statistics (NCES) within the Institute of Education Services of the U.S. Department of Education. They have, over the years, comprehensively and systematically evaluated what American students "know and can do" across all states in math and reading. They have also evaluated subjects such as science, writing, the arts, civics, economics, geography, and U.S. history, but in a much less systematic way. NAEP carries out these comprehensive tests for fourth graders (9-year-olds) and eighth graders (13-year-olds) for comparing states at any one moment in time and for assessing long-term trends. These test scores are about as good a measure of "the provision of public services" as exists.

Table 21
50-State Ranking of NAEP Test Scores: Texas vs. California

	2011	2009	2007	2005	2003
Texas	29	31	26	27	33
California	47	47	48	46	46

Source: U.S. Department of Education: Institute of Education Sciences, Laffer Associates

In **Table 21** above we have listed summary statistics compiled by NAEP for each state. We have added the test scores in both math and reading for eighth graders and fourth graders in order to arrive at one summary statistic for a state's educational achievement in any one year. We rank each state for several years from 2003 to 2011 in the table below from best (1) to worst (50). Take a look at how California fared compared to Texas.

In the summary statistics of the preceding table, California ranks consistently in the bottom five states in the nation while Texas is around the average of all states and way ahead of California year in and year out.

For fourth graders in reading (not shown separately in the above table) for the years 1992, 1994, 1998, 2002, 2003, 2005, 2007, 2009, and 2011, Texas outperformed California by a wide margin each and every year. In fact, California was below the national average every single year. Texas' results were mixed when compared to the U.S. average.

When it comes to eighth grade math over a similar sample of 10 specific years from 1990 to 2011, Texas' students outperformed California's students each and every year by wide and increasing margins over the entire time period. No exceptions.

For the eighth grade reading tests for selected years for which data were available between 1998 and 2011, Texas students again outperformed California students each and every year. In eighth grade science and writing, where tests were performed by NAEP, Texas students were always far superior to California students.

Many forces influence children here in the United States. It is not just state and local government policies that tip the balance. But state and local governments do fund the schools, hire the teachers, set the standards for educational excellence, and set the framework for how teachers as a group are permitted to operate in the broader context of political and social life. The state and local governments' educational system has to be the single most dominant influence on our children's educational achievements.

If it were not so tragic, we would find it extremely funny that California's classroom teachers are the highest paid classroom teachers in America, and yet California students rank 5th from the bottom in America. In 2011, California students were only able to test better than their counterparts in D.C., Mississippi, Louisiana, and New Mexico. Who can argue with a straight face after seeing the example of California that all we need to do is spend more to improve the quality of education?

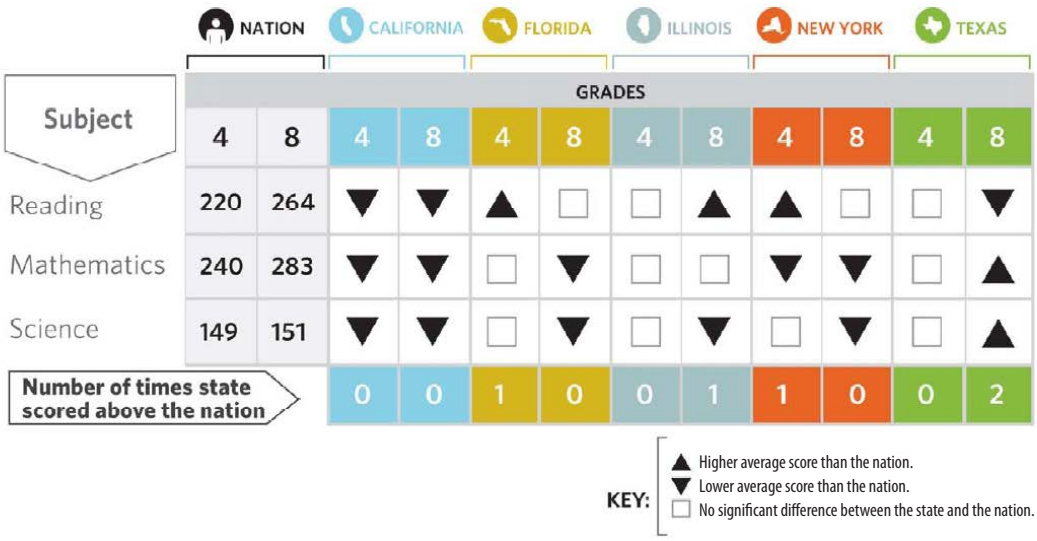
Teachers in K-12 schools are not just any old randomly-selected group of people. They are "special" in many ways. Because, in part, of their single employer status and because of their significance to society at large, teachers are members of a well-organized workers guild in every state in the nation. This is especially true in California.

The California Teachers Association (CTA) was founded in 1863, has about 325,000 members, and represents all teachers in public schools K-12. The California Faculty Association and the California Community College Association are also affiliated with the CTA.

In politics, the CTA spent about $212 million on political campaigns in the 10-year period from January 1, 2000 to December 31, 2009. This is more than any other union, business, organization, or individual—nearly double that of the California State Council of Service Employees, which came in 2nd.

In 1988, the California Teachers Association was able to get a constitutional amendment passed in California, Proposition 98, which forced the state to spend enormous amounts of the general fund budget on education, and these spending re-

Figure 8
Comparison of States to the Nation for the Most Recent NAEP Assessments*
(public school students in reading, math, and science, 2009 and 2011)



NOTE: The reading and mathematics assessments were administered at the state level at both grades 4 and 8 in 2011. Science was most recently administered at grade 4 in 2009 and at grade 8 in 2011.
SOURCE: U.S. Department of Education, Institute of Education Sciences, National Center for Education Statistics, National Assessment of Educational Progress (NAEP), 2009 and 2011 Science Assessments, and 2011 Reading and Mathematics Assessments.

*NAEP results for other subject areas and grade levels were either not available for all states or only available for one or two years, which would prohibit us from creating a composite state score for more than those available years.

quirements could only be suspended by a two-thirds majority of the legislature, the majority of which has also been bought and paid for by the California Teachers Association. The CTA also has sponsored 170 strikes between 1975 and 2012.

In Texas, it's illegal for teachers to strike.

In the NAEP publication on scholastic performance of students in five mega states—California, Texas, Florida, Illinois, and New York—fourth grade and eighth grade students are evaluated in reading, mathematics, and science during the years 2009 and 2011.[33] The way NAEP reports the results is to conclude ☐ no significant difference between the state and the nation, ▲ significantly higher average score than the nation and last, ▼ significantly lower average score than the nation. **Figure 8** lists the results:

California is significantly below the nation in every single one of the six categories for both fourth graders and eighth graders. Florida is significantly below the national average in two categories, significantly above the national average in one category and tied with the national average in three categories. Illinois is significantly below the national average in one category, significantly above in one category and tied in four, while New York is above in two, below in two and tied in two.

Texas is the winner in the mega states with only one category significantly below the national average, two categories significantly above the national average, and three categories tied. These results say it all.

XII. Highways: California vs. Texas

When it comes to highway spending as a share of state gross product, California has it all over Texas. California spends 37 percent more in total wages and salaries on full-time equivalent employees in highways as a percent of state GSP than does Texas. But, unfortunately, this dollar advantage does not carry over to improved public highway services. In fact, when it comes to highways, Texas not only offsets its spending shortfall vis-à-vis California, it flips the spending shortfall and actually provides substantially more highway public services than does California.

In the first place, even though California spends more, as of March 2011, California had 21 percent fewer state and local full-time equivalent governmental highway employees per 10,000 population than did Texas. Texas' citizens got more personnel attention than California's citizens.

Second, California paid 76 percent more in average salary than did Texas per full-time equivalent highway employee—$75,549 in California versus $42,885 in Texas. But you have not read anything yet.

In a very thorough, well-documented and careful analysis published by the Reason Foundation entitled, "19th Annual Report on the Performance of State Highway Systems (1984-2008)," the authors conclude the following:

i) The average cost to build one mile of highway in California in 2008 is $265,061, making California the 13th highest cost of highways per mile in the nation; while in Texas an equivalent average mile of highway costs $88,539, ranking Texas 48th highest in the nation. But even more important, it means Texas can build three times as many highway miles than can California for any given amount of dollars.

ii) A state's road condition is usually measured by special machines that determine the roughness of road surfaces with the smoother roads considered to be in better condition. In ranking the states' rural interstate condition, Texas ranked 23rd with 0.03 percent poor condition miles of rural road while California ranked 49th, or dead last, with 16.32 percent of their rural interstate in poor conditions. (Delaware is not included in this ranking because they do not have any rural interstates). Only California and three other states reported more than 5 percent poor rural interstate mileage: New York, New Jersey, and Alaska, while two-thirds of the poor-condition rural interstate mileage in the U.S. is just in California, Alaska, New York, and Minnesota.

iii) One performance variable where California ranked better than Texas was in the percent of deficient bridges, where California ranked 18.88 percent deficient bridges and Texas 19.01 percent. This inverse ranking is likely due to the strict bridge and highway maintenance laws implemented after earthquake damage; particularly after the 1994 Northridge earthquake where seven major freeway bridges in the area collapsed, and 170 were damaged, disrupting traffic in the Ventura-Los Angeles region for weeks following the earthquake.[34] With that being said, Texas was not all that far behind California.

Maintaining a state's highway system has to be about as important a duty as there is for state and local governments. Texas does a far better job than does California. Along these lines, The Reason Foundation released an additional report in February 2013 entitled "Are Highways Crumbling? State Performance Summaries," which evaluates state highway conditions over the past 20 years. Between 1989 and 2008 California's general performance ranked 50th while Texas' 20 year general performance ranked 17th.

XIII. Prisons: California and Texas

One of the final areas we wish to investigate is also one of the most fascinating areas of state and local governance. Firemen and policemen are wonderful heroes possessing both courage and self-sacrifice. Road builders and educators create the future while politicians and judges occupy positions of enormous personal responsibility and influence. But then we have the prison guards, whose life is far from glamorous and whose work is often ignored.

Corrections officers in California are paid, on average, 93 percent more per year than are Texas' corrections officers (see **Table 20**). At the same time there are 12 percent fewer corrections officers per 10,000 population in California than there are in Texas. The people of Texas pay less and get more, while the people of California once again pay more and get less. There is still more to this story.

Where the numbers get shocking are the differences in average annual cost per inmate. California's average annual cost per inmate is $47,421, or $129 per day, in 2012, while in Texas each inmate's annual cost is $21,390, or $58.60 per day. California spends more than twice as much per prisoner than does Texas.[35] Texas engages in law enforcement less expensively than California. Texas also encourages the use of private incarceration facilities, while California rejects them.

The reason why California does less and spends more harkens back to the 1978 Dills Act which granted the prison guard union—California Correctional Peace Officers Association (CCPOA)—incredible powers to negotiate pay standards and work codes. In 2010, the CCPOA spent a total of $32,452,083 influencing California voters and elected officials.[36] This union was the 15th largest political contributor in California.[37]

Not only does Texas incarcerate more scofflaws per 100,000 population than does California, but Texas does its job far less expensively than does California. And on top of all of

that, Texas houses its prisoners far more humanely than does California. Just read on.

On May 23, 2011 the U.S. Supreme Court upheld the ruling by a lower three-judge court that the state of California must reduce its prison population to 137.5 percent of design capacity. As of December 31st, 2011 California's prison population was at 175 percent of design capacity. Just what will California do with all of these excess prisoners—just let them go? In Texas, at the same time the prison population was at approximately 85 percent of design capacity—and this after closing a prison as part of a comprehensive criminal justice reform effort that shifted money from incarceration to rehabilitation and follow-up, saving taxpayer money while seeing crime rates drop to 1968 levels.[38] Over the past two years, Texas lawmakers approved the closing of three prisons.[39]

Conclusion

The differences between California's and Texas' economic policies and performances couldn't be more stark. Texas has a low-tax, business friendly environment. California has punitively high tax rates and seems to put up every possible barrier to entry for business. How did these two states with so much in common arrive at such different places today? The way we like to put it is that the translation from taxes to the eventual provision of public services suffers from three major "parasitic leakages."

The economic journey starts with tax rates. There is an enormous disconnect between tax rates and tax revenues. Despite California's tax rates being around 65 percent higher than those in Texas, Texas takes in approximately 25 percent less tax revenues than does California—"parasitic leakage" #1. Not only do higher tax rates cause less economic output, they also cause people to move to lower tax rate jurisdictions and cause the people who live in the higher-tax location to earn less taxable income. Lawyers, accountants, lobbyists, tax exemptions, exclusions, deductions and more all create a gap between tax rates and tax revenues. California's higher tax rates also create much of the poverty and deprivations that siphon off government spending. In fact, a significant portion of government spending is required just to offset the damage done by the higher tax rates themselves!

Texas taking in 25 percent less revenue per dollar of GDP than California, however, doesn't translate into 25 percent less spending for Texas. In fact, due to all sorts of waste and inefficiency at the administrative level, California's actual amount spent per dollar of GDP is approximately equal to Texas' amount of government spending—"parasitic leakage" #2. The reason for this second leakage is the size of the bureaucratic behemoth that is California's state and local government. As of June 2013, there were 380 separate state agencies listed on the State of California's website, including entities such as the Bureau of Home Furnishings & Thermal Insulation (BEARHFTI) and the Landscape Architects Technical Committee (LATC). Texas takes a much leaner approach to bureaucracy, and it shows when it comes to the translation from tax revenues to government spending.

Finally we get to the provision of actual services to citizens, which is the ultimate purpose of government after all. Once again we find California doing a disservice to its citizens—as a result of inflated government employee salaries, unions, regulatory and compliance costs and more, California's provision of services to its citizens on a per capita basis is around 25 percent less than Texas' provision of services—"parasitic loss" #3. Take firefighters for example—Texas employs 9.2 firefighters per 10,000 of population versus California at 7.7 per 10,000, but California's firefighters are paid $120,000 per year to Texas' $63,000. In just about every category of employment, California overpays public employees yet underprovides services to its citizens relative to Texas. About the only important category where California overpays public employees and overprovides services compared to Texas is in the category of public welfare employees. Need we say more?

At the end of the day, California exacts a larger share of its citizens' work output than Texas does and, due to perverse incentives, inefficiency, waste, greed and corruption, provides far less in terms of public services to its citizens. Texas is welcoming more and more companies, jobs and people each year, while California is desperately trying to build a wall to keep its companies, jobs and people from fleeing to greener pastures.

The people have spoken.

Endnotes

[1] Special thanks to Sally Pipes for her edits and comments during the writing of this paper.
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[4] Scott Drenkard, "State and Local Sales Tax Rates Midyear 2013," Tax Foundation, http://taxfoundation.org/article/state-and-local-sales-tax-rates-midyear-2013.
[5] "FTB Notice 2012-03," State of California Franchise Tax Board (21 Dec. 2012).
[6] Jonathan Horn, "It's Official: Gas Tax Going Up," *San Diego Union Tribune* (1 Mar. 2013).
[7] Scott Drenkard, Tax Foundation.
[8] Arthur B. Laffer and Stephen Moore, "California, Who are You? Part II," Laffer Associates (18 Jan. 2008).
[9] For a more extensive analysis of major policy variables and their associated performance outcomes, *see* Arthur B. Laffer and Wayne Winegarden, *EUREKA!*, Pacific Research Institute (2012).
[10] These combinations in fact are the products of one plus the percentage change in each row minus one. Think of them as the sums of each row, and you will not be too far off.
[11] Ibid.
[12] Ibid.
[13] Ibid.
[14] Tom Gray and Robert Scardamalia, "The Great California Exodus: A Closer Look," The Manhattan Institute, Civic Report, No. 71 (Sept. 2012).
[15] This net migration map has been reproduced as presented by the U.S. Census Bureau. The Census Bureau chose these specific time periods. U.S. Census Bureau (7 Mar. 2013).
[16] Ibid., 4.
[17] Ibid., 5.
[18] Ibid.
[19] Ibid.
[20] Average income per capita is what it says it is—a state's total income divided by the state's population. Income per capita can therefore rise because exceptional economic growth even exceeds exceptional population growth, as is the case with Texas. But there is also a second way average income per capita can increase rapidly, and that occurs when the economy collapses at a slower rate than the population flees, which is the case of West Virginia. Even though both Texas and West Virginia have rapid growth in average incomes per capita, they mean very different things. On the flip side, some economies have rapid population growth as a result of good economy conditions, but even though their economies also grow rapidly, they do not grow rapidly enough to make average income per capita rise exceptionally rapidly, which is the case of Nevada. Even though Nevada's average income per capita growth is low, Nevada is still a big winner. People are moving into Nevada in droves. With the unemployment rate, the same ambiguous principle is at work. The labor force can grow faster than jobs or vice versa.
[21] Kathleen Short, "The Research Supplemental Poverty Measure: 2011," *Current Population Reports* (Nov. 2012).
[22] "Fracturing in California," *The Wall Street Journal* (8 June 2013).
[23] Charles Varner and Cristobal Young, "Millionaire Migration in California: The Impact of Top Tax Rates," Working Paper (2012).
[24] "Where Have All of Maryland's Millionaires Gone? Nowhere – They're Probably Just Not Millionaires Anymore," Institute on Taxation and Economic Policy (29 May 2009).
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[26] These combinations in fact are the products of one plus the percentage change in each row minus one. Think of them as the sums of each row, and you will not be too far off.
[27] Arthur B. Laffer, Stephen Moore and Jonathan Williams, *Rich States, Poor States*, American Legislative Exchange Council.
[28] The state rankings in Table 6 differ from the published ALEC-Laffer *Rich States, Poor States* rankings because variable #14 in this paper, "State & Local Government Debt + Unfunded Liabilities as a share of GSP," is different than the debt variable used in the ALEC-Laffer rankings, "Debt Service as a share of Tax Revenue."
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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 ground-breaking California initiative that drastically cut property taxes in the state in 1978.

Dr. Laffer was a member of President Reagan's Economic Policy Advisory Board for both of his two terms (1981-1989). He was a member of the Executive Committee of the Reagan/Bush Finance Committee in 1984 and was a founding member of the Reagan Executive Advisory Committee for the presidential race of 1980.

Dr. Laffer has been widely acknowledged for his economic achievements. He was noted in *TIME* Magazine's March 29, 1999, cover story "The Century's Greatest Minds" for inventing the Laffer Curve, which it deemed one of a few of the advances that powered this extraordinary century. He was listed in "A Dozen Who Shaped the 80s," in the *Los Angeles Times* on Jan. 1, 1990, and in "A Gallery of the Greatest People Who Influenced Our Daily Business," in the *Wall Street Journal* on June 23, 1989. His creation of the Laffer Curve was deemed a memorable event in financial history by the *Institutional Investor* in its July 1992 Silver Anniversary issue, "The Heroes, Villains, Triumphs, Failures and Other Memorable Events."

Stephen Moore

Stephen Moore is a successful speaker and writer who shares his views and insights with his audiences. Moore joined *The Wall Street Journal* as a member of the editorial board and senior economics writer on May 31, 2005. He currently divides time between Washington and New York focusing on economic issues, including budget, tax and monetary policy.

Moore has been a frequent contributor to the *Journal* over the years, and is previously known as the founder and former president of the Club for Growth, which raises money for political candidates who favor free-market economic policies. He left that position in 2004. Prior to joining *The Wall Street Journal,* he was president of a new organization, the Free Enterprise Fund.

Moore is the author of five books, including *The End of Prosperity: How Higher Taxes Will Doom the Economy—If We Let it Happen.* His books also include *Its Getting Better All the Time: The 100 Greatest Trends of the Last Century,* and *Bullish on Bush: How the Ownership Society Will Make America Stronger*.

Nicholas C. Drinkwater

Nicholas Drinkwater began working at Laffer Associates in 2010 as a research intern. After graduating from Vanderbilt University in 2011 with a B.A. in Economics, Drinkwater joined Laffer Associates as an Operations Analyst before transitioning into the role of Research Analyst.

Chuck DeVore

Chuck DeVore is Vice President of Policy at the Texas Public Policy Foundation, one of America's premier conservative state-level public policy think tanks.

From 2004 to 2010, DeVore represented almost 500,000 people in the California State Assembly in the coastal Orange County region that includes the cities of Irvine, Newport Beach, Laguna Beach, and others. He was the Vice Chairman of the Assembly Committee on Revenue and Taxation and served on the Budget Committee as well.

DeVore was honored as the Legislator of the Year by seven groups while the Americanism Educational League named him with their American Spirit Award in 2010, a recognition once given to Ronald Reagan.

DeVore served as a Reagan White House appointee in the Pentagon from 1986 to 1988. As Special Assistant for Foreign Affairs his duties included working with Congress to advance the President's foreign and military policy.

DeVore is a lieutenant colonel in the U.S. Army (Retired) Reserve.

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