

THE TEXAS ECONOMY

O'NEIL CENTER FOR GLOBAL MARKETS AND FREEDOM ★ SMU COX SCHOOL OF BUSINESS ★ JANUARY 2016

Taking an In-Depth Look at the 'Texas Model'

By W. Michael Cox and Richard Alm

The Texas economy is interesting in a number of ways. First of all, there's its sheer size—nearly 13 million workers producing \$1.7 trillion of goods and services annually, large enough to rank 14th among nations in GDP, between Canada and South Korea.

Second, Texas' economy exhibits a remarkable diversity, with automobile manufacturing, agriculture and ranching, high technology, oil and gas, petrochemicals, financial services, trade and so much more.

Third, the Texas economy offers an energetic and somewhat eccentric cast of characters, ranging from wildcatters like H.L. Hunt in the early years to tech billionaire Mark Cuban today.

Fourth, the Texas economy has been a notable success as the United States stumbled through crises and recession in the 21st Century, leading all states in GDP growth job creation and globalization.

Fifth, the emergence of the "Texas model" as a blueprint for prosperity shows the worth of a political economy of low taxes and smaller government that gives the private sector more room to thrive.

Growth and job creation

The Texas Economy will showcase the O'Neil Center's research on this interesting state economy. The goal will be an in-depth look at the Texas model, identifying the reasons for its successes and examining the criticisms that its pro-business slant shortchanges the state's poor. The publication will take regular trips backward in time, searching for the historical, political and cultural forces that made the Texas economy what it is today.

We can't study Texas in isolation. To provide context, our research will require collecting data and making comparisons with other parts of the country. Along with many others, we've

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been finding that Texas and its major cities outperform other states and cities on many key economic measures, often by large margins.

Start with GDP growth, the broadest gauge of economic performance. From 2005 to 2015, Texas increased its output of goods and services by \$497 billion in inflation-adjusted dollars (*see chart below*). That beats California, a state with a bigger population, by \$150 billion; Texas outstripped New York by \$300 billion. In fact, Texas accounted for 23

percent of the nation's real GDP gain over this period.

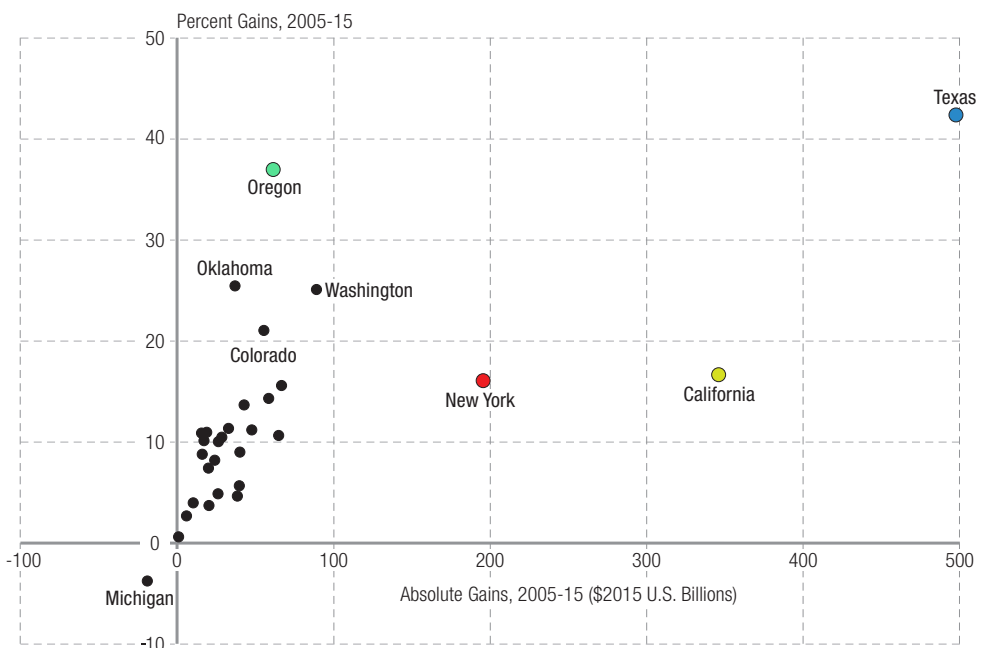
Texas is a big state. To take away the advantage of size, GDP growth can be converted to percentage terms. From 2005 to 2015, Texas posted a total gain of 42.4 percent, an annual average of 3.5 percent. Only oil-boom North Dakota did better, with an off-the-charts 86 percent. Among the 30 largest states, just three managed to achieve 25 percent GDP growth—Oregon, Washington and Oklahoma.

Texas exhibits a similar prowess in employment growth. From 2005 to 2015, the state added 2.3 million jobs—850,000 more than California and 1.5 million more than New York. Texas' share of the nation's total job gains nearly matched its share of GDP gains at 22 percent.

Taking size into account, Texas retains its dominance in creating jobs. The state increased employment by over 24 percent from 2005 to 2015. Among the 30 largest states, the next best were

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TEXAS LEADS IN GDP GAINS AMONG THE LARGEST 30 STATES



Washington and Colorado at around 15 percent (see chart at right).

Measured in either dollars or percent, Texas ranks at or near the top in GDP growth and job creation. If nothing else, that suggests Texas should have something to teach the rest of the country about what makes an economy succeed.

Dumb luck or design

Simply showing that the Texas economy has been doing better than other states and the nation as a whole goes only so far. It doesn't validate the Texas model.

In fact, many Americans no doubt attribute Texas' prosperity to a form of dumb luck—i.e., the state sits atop large oil reserves and pumps prosperity out of the ground. So it might be doing well with high or low taxes and with big or small government.

An important question for our research, then, will be how much credit for the state's economic success should go to the Texas model. Finding out will require an data-driven way to compare Texas' political economy to other states—those that have policy mixes like Texas' as well as those that are quite different.

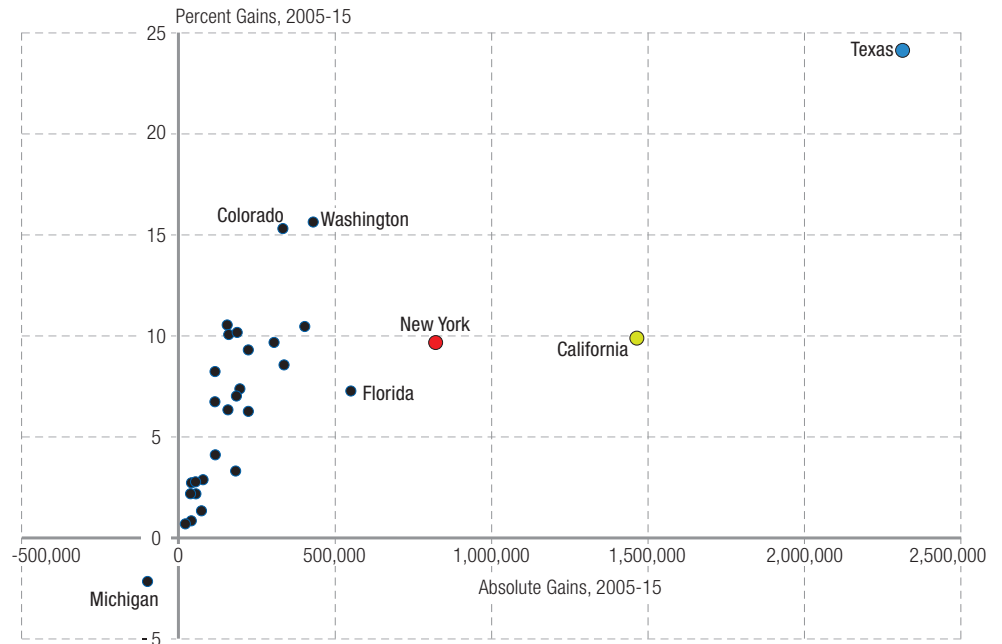
Fortunately, economists have devised

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such measures. The *Economic Freedom of North America* report uses data on government size, tax burdens and labor market regulations to rate all 50 states on their degree of economic freedom, giving higher marks to states with lower taxes, smaller government and market-friendly policies.

As might be expected, the economic freedom index ranks Texas highly. Since 1981, the first year of the data, the state has consistently been in the Top Five, often at No. 1. Texas led in economic freedom as recently as the 2014 report. Its raw score actually increased in the to 2015 report, but Texas slipped to third because of larger gains by South Dakota

SAME STORY ON JOB GAINS—TEXAS LEADS AMONG BIGGEST 30 STATES



and New Hampshire.

In empirical studies, high economic freedom can serve as a quantitative measure of the Texas model, although the appellation may seem parochial to the half dozen or so other states with similar policies.

Another relevant economic freedom measure, first published in 2013, focuses on America's 380-plus metropolitan areas. It provides a tool for research on the booming growth and job creation in the Dallas-Fort Worth and Houston metropolitan statistical areas (MSAs). Both rank in the Top 5 on MSA economic freedom.

The Wealth of Cities, an essay we wrote for the O'Neil Center's 2014-15 annual report, shows how the scores can help answer the question of whether economic freedom matters in economic performance (for full report, click here).

Our study looked at the nation's 100 largest MSAs, finding economic freedom associated with faster GDP and employment growth, lower unemployment and living costs, higher real wages and less income inequality.

Americans seem to recognize that MSA economic freedom makes them better off—and they vote with their feet. Among the 100 largest MSAs, the most-free 20 percent attracted a net in-migration of 9 million residents from 1992 to 2011, while the net loss for the least-free 20 percent totaled more than 7.1

million. The freest group has a net gain of 24 percent, compared to a net loss of 14 percent for the least-free MSAs.

The evidence suggests that economic freedom is key to prosperity at the local level—a finding with important implications for policy-makers and citizens.

The Wealth of Cities report is just a beginning. Texas and its major cities offer an opportunity to fulfill the O'Neil Center's mission of studying why some economies succeed while others struggle. *The Texas Economy* will provide regular insights on what's probably America's most interesting state economy.

References

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Next issue: *The Texas Economy* will begin its historical series by looking at how geology and geography shaped the state's economic development.

About the Authors



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CHARTING THE TEXAS ECONOMY

Among Big U.S. Metros, Neither DFW nor Houston Show Unusual Income Inequality

Economists often measure income inequality with Gini coefficients. A completely equal society, where everyone had the same income, would produce a Gini of zero; complete inequality, with one person earning all income, would yield a value of one. The real world, of course, is somewhere in between.

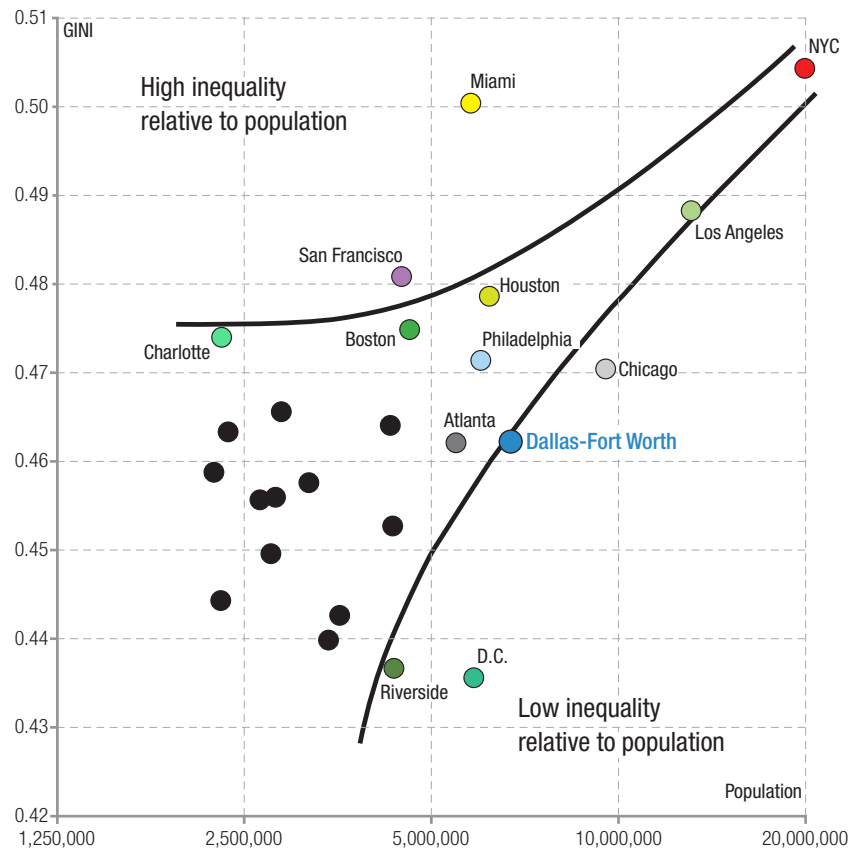
According to the Census Bureau's American Community Survey, the U.S. five-year average Gini coefficient was 0.4712 in 2012—high for a developed country.

Turning to the nation's 366 metropolitan areas, the ACS data show that Gini coefficients range from a high of 0.5376 for Bridgeport-Stamford-Norwalk in Connecticut to a low of 0.3944 for Ogden-Clearfield in Utah.

The Dallas-Fort Worth area ranks as the 99th most unequal urban economy at 0.4622. The Houston area has slightly greater inequality at 0.4787.

Among the 25 largest metropolitan areas, Gini coefficients tend to rise with population (*chart*). The greatest inequality occurs in the most populated area: New York City, including its Long Island and New Jersey suburbs. Miami and San Francisco exhibit a high degree of inequality relative to population. Riverside, California, and Washington, D.C., have surprisingly low inequality.

The Dallas-Fort Worth area has relatively low inequality for a city with its population. Houston is a bit high for its size.



ABOUT THE TEXAS ECONOMY AND THE O'NEIL CENTER

The Texas Economy is an electronic publication of the William J. O'Neil Center for Global Markets and Freedom, a research institute in the SMU Cox School of Business.

The center was founded in 2008 with an initial grant from William J. O'Neil, a 1955 SMU business school graduate, and his wife Fay C. O'Neil. Its broad mission is the study of why some economies prosper and others do poorly, focusing on two critical issues for the 21st Century economic environment—globalization and economic freedom.

The center's programs promote understanding of how capitalism works among the general public, policy makers, business managers and the next generation of business leaders. To these ends, the O'Neil Center teaches SMU Cox students, conducts economic research, publishes economic reports, sponsors conferences and educates the public through the media and speeches.

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