

Reagan adviser unveils Texas vs. California economic study

by Mark Lavergne

And guess which state won out?

Arthur Laffer, the semi-legendary progenitor of supply side economics, has only praise for Texas' "pro-growth" and limited-regulation economy, which he contrasts with a high-tax, high-spending, increasingly hard-pressed California economy.

Laffer's study of the California-Texas divide, presented at a Texas Public Policy Foundation luncheon Sept. 9 in Austin, attributes Texas' superior economic growth to several factors, including taxes on income and capital, sales taxes, regulatory policies like workers' compensation and minimum wages, and government spending.

In almost every category, Laffer said, Texas' policies were clearly more conducive to economic growth than were the policies of the onetime "Golden State."

Gov. **Rick Perry** beamed appreciatively.

Perry, who spoke at the luncheon, hailed the report as a vindication of policies implemented in 2003 in response to a \$10 billion budget shortfall. The solution of Perry and other fiscal conservatives at the time was to cut the budget rather than raise taxes to try to fill the gaps — to the chagrin of many. "We took a lot of grief in 2003," he said. He called the report a testament to the fact that "competition is what makes us stronger," saying he hopes it can serve as an example for other states including California.

"It's a sad day to report that California has done so poorly," said Laffer, who lived there for a time. (He wrote and presented a paper to Gov. **Arnold Schwarzenegger** in January 2006 explaining why he was leaving the state.) He pointed to pro-growth policies adopted in the 1970s, notably Proposition 13, which limited property tax increases, and also abolition of the inheritance tax. But in the late 1980s and '90s, he said, "things started reversing." Today, he said, California is in "desperate, desperate shape."

**Taxes.* When it comes to basic fiscal policy, Laffer pointed to principles that he called "common sense."

"If you tax people who work, and you pay people who don't work, don't be surprised if you find a lot of people not working," he said.

Texas wins hands down, Laffer said, in taxes on labor. California's progressive income tax is among the highest in the nation, maxing out at 10.3 percent. The median household in California pays 9.3 percent of its income in income taxes.

Texas, of course, has no personal income tax.

The study says if there are two workers, one Texan and one Californian, each of them making \$55,319 a year, the Texan's after-tax income would be \$1,952 more than the Californian's.

Additionally, California's top marginal corporate rate is almost 9 percent. Texas' gross margins tax is considerably lower at 1 percent.

If there is one area in tax policy where California does better than Texas, it is property taxes. Proposition 13 in California placed a constitutional cap on property taxes, with the effect of limiting such taxes to \$28.24 per \$1000 there. In Texas, the burden per \$1000 is \$42.13.

At the luncheon Perry called for "downward pressure" on appraisals in the next session, saying that people are tired of the property tax system being taken advantage of.

Even so, the report says, "California's property tax burden advantage is overwhelmed by its excessive tax burden on income, capital gains, and corporate income." Texas has no capital gains tax.

The study finds that simply by locating in Texas, companies can earn an extra \$50.41 per \$1,000 of net income, 8.6 percent higher. Factoring in state personal income taxes and capital gains taxes grows the number to \$85.99, giving Texas a "significant competitive advantage in attracting businesses," the report said.

Even California's sales tax rate is higher (7.25 percent) than Texas' (6.25 percent), where it is the largest source of government revenue. California's sales tax burden is 58 cents lower (\$28.06 per \$1000 personal income) than in Texas (\$28.64), the report said. But that may indicate that people in Texas are buying more stuff, and thus contributing more to the free market, than in California.

The economy, Laffer says, tends to move in cycles, expanding and then slowing down, and so forth. Government budget revenue levels tend to rise and fall along with the markets and incomes whose taxes they rely upon. Taxation, then, serves to make revenues more volatile — higher peaks, but lower valleys. Texas is an example of a more stable budget environment, and California of a more volatile one, the report says.

Perry called for a constitutional amendment that would allow refunding the budget surplus to the taxpayers. He also called for funding the Texas Department of Public Safety through general revenue rather than the gas tax, saying those dollars should go towards build-

ing roads. He called for continuing to increase government transparency and spending, urging that schools post their checkbooks online.

**Regulatory policy.* Texas also holds a clear edge over California on tort reform and workers' compensation, the report concludes. Thus Texas' liability system costs less than the national average and considerably less than California's tort system.

Also, per \$100 of payroll, California businesses face a burden of \$4.13 compared to \$2.84 for Texas businesses for workers' compensation. California's costs are the second highest in the nation, but Texas', at 16th highest, aren't a lot better. The Lone Star State would "benefit from addressing this issue," the report said.

Laffer, no big fan of minimum wages, understandably finds Texas more competitive due to the lack of a mandate other than the \$5.85 minimum imposed by the federal government. California, the report said, exacerbates the problem by setting a state minimum wage of \$7.50, thus "unnecessarily increasing employer costs."

The report also applauded Texas' status as a "right-to-work" state, meaning workers in unionized industries here are not required to pay dues to unions. In California, they are, if their workplaces are unionized.

**Education policy.* The report plugged fiscal restraint and school choice in education policy, extolling the virtues of vouchers in low-income areas, tuition credits, and corporate tax deductible scholarship programs. Laffer's study finds that both California and Texas rank well among other states in providing choice to their citizens, but applauds Texas for "experimenting" with "more effective education strategies."

At the luncheon, Laffer also criticized California's teacher pay system. He observed that teachers in California are the highest paid in the country. Yet they have the 47th lowest scores at the 4th and 8th grade levels in the nation on Department of Education standardized tests (which he says are more reliable than SAT scores, which are not weighted the same from state to state). Only Louisiana, Mississippi and New Mexico perform worse, he said. "High pay does attract good employees, that's true," Laffer said. "But high pay also attracts bad employees. In fact high pay attracts all employees. What you have to do is figure out a way of filtering the wheat from the chaff." ☞

