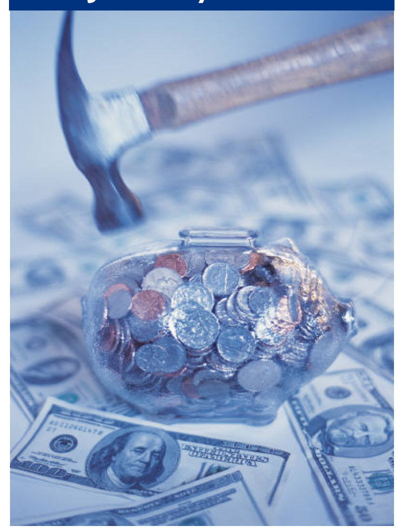
TEXAS PUBLIC POLICY FOUNDATION

Government Growth or Poverty Reduction?
Lessons from the States

January 2007



By Matthew Ladner, Ph.D. &
Byron Schlomach, Ph.D.

Table of Contents

About the Texas Public Policy Foundation

The Texas Public Policy Foundation is a 501(c)3 non-profit, non-partisan research institute guided by the core principles of individual liberty, personal responsibility, private property rights, free markets, and limited government.

The Foundation's mission is to lead the nation in public policy issues by using Texas as a model for reform. We seek to improve Texas by generating academically sound research and data on state issues, and recommending the findings to policymakers, opinion leaders, the media, and general public.

The work of the Foundation is primarily conducted by staff analysts under the auspices of issue-based policy centers. Their work is supplemented by academics from across Texas and the nation.

Funded by hundreds of individuals, foundations, and corporations, the Foundation does not accept government funds or contributions to influence the outcomes of its research.

The public is demanding a different direction for their government, and the Texas Public Policy Foundation is providing the ideas that enable policymakers to chart that new course.

Government Growth or Poverty Reduction?

Lessons from the States

Matthew Ladner, Ph.D.
Vice President for Policy Research
Goldwater Institute

Byron Schlomach, Ph.D.
Chief Economist
Texas Public Policy Foundation

RR 01-2007

Government Growth or Poverty Reduction?
Lessons from the States[i]

by Matthew Ladner, Ph.D. & Byron Schlomach, Ph.D.

Executive Summary

In fairytales, Robin Hood and his band of merry men heroically take from the rich and give to the poor. In modern politics, many believe the government plays the role of Robin Hood. Through progressive taxation and spending, proponents believe that government reduces poverty while making everyone pay their fair share. The pages that follow will empirically evaluate the effectiveness of state government as Robin Hood.

In the mid 1990s, the federal government eliminated the largest welfare program, replacing it with a system of block grants to the states. In essence, the federal government admitted its failure in administering welfare, and looked to the states to serve as "laboratories of reform" in the effort to reduce welfare and poverty. The results have exceeded the hopes of proponents.[1]

States also serve as laboratories of democracy in fiscal policy. Some states maintain relatively low levels of taxation and spending, and others have much larger and ambitious state governments. Nationwide, both general and childhood poverty rates dropped during the 1990s. Some states, however, reduced poverty much more than others. Some states, in fact, suffered increases in poverty rates during the 1990s despite the booming national economy and the general success of welfare reform.

A myriad of individual, state, and federal policy decisions influence how many people live below the poverty line in a given state. Nevertheless, this paper addresses the broad question: are big or small government states better at reducing poverty?

Using data from the United States Census Bureau, the pages that follow demonstrate that low tax and spending states enjoyed sizeable decreases in poverty rates during the 1990s. High tax and spending states, meanwhile, suffered *increases* in poverty rates.

Private sector job growth is the most effective anti-poverty program. Citizens and policymakers who seek to reduce poverty and improve the lot of the poor should embrace policies promoting as much private sector growth as possible.

[i]Based on *How to Win the War on Poverty: An Analysis of State Poverty Trends*, a paper from the Goldwater Institute.

Introduction: The Role of Government in Reducing Poverty

What role should the government play in reducing poverty? For centuries, that question had a rather straightforward answer: not much. In medieval Europe, for example, conventional thinking understood poverty as the product of character flaws—indolence or drunkenness, for example. Government left the function of reducing poverty to religious and private charitable organizations.

The first anti-poverty legislation, Britain's Poor Laws of 1601, very much reflected this traditional thinking. The law distinguished between the "worthy" and "non-worthy" poor. The law defined the "worthy poor" as those unable to work through no fault of their own—those having suffered a debilitating injury or widowed mother with children, for example. The non-worthy poor included everyone else, most certainly everyone who was able-bodied. The law kept the amount of aid strictly minimal, well below what a person could earn by working.[2]

"Some years ago the United States declared war on poverty, and poverty won."

-Ronald Reagan

This philosophy lasted in the United States until the advent of the Great Depression beginning in 1929. The United States experienced a prolonged economic crisis, with mass unemployment. Politicians of the time blamed the downturn on "big business" and the "plutocrats" of the roaring 1920s.

President Franklin Roosevelt responded to the crisis by vastly increasing the size and scope of government in the area of poverty reduction. Economic historians now understand that the Federal Reserve, Hoover and Roosevelt administrations worsened and prolonged the downturn with a series of policy blunders. In monetary trade and labor market policies, those in charge of the economic policy levers made a number of glaring errors to worsen the Great Depression.[3]

Politically, however, Roosevelt's administration received credit for fighting the Depression. Roosevelt created the political and intellectual foundation for future governmental anti-poverty efforts at both the federal and state levels for years to come.

These efforts reached their crescendo with Lyndon Johnson's War on Poverty programs, the apex of the American government's anti-poverty efforts. Johnson transformed government ambitions from simply alleviating poverty to actually eliminating poverty. Within a decade, a powerful backlash against such programs began.

President Reagan famously quipped that, "Some years ago the United States declared war on poverty, and poverty won." Reagan's jest reflected a concern that government anti-poverty programs had not only failed to reduce poverty, but actually had contributed to an increase in poverty. Charles Murray's critique of the welfare system's perverse incentives discouraging work and marriage, for example, eventually led to major welfare reform in 1996.[4] Even amidst dire warnings of catastrophe from some, substantial reductions in poverty rates were achieved after passage.[5]

Despite the public backlash and subsequent change in policy, many of the War on Poverty programs continue to this day. Some, such as the Medicaid program, are major drivers of state budgets.

Competing Models for the Reduction of Poverty

In broad terms, there are two strategies for reduction of poverty: state government growth and private sector growth.

Government programs and subsidies do not lack for boosters in Texas. These groups not only lobby for increased spending on their favored programs, they also advocate against reduction in state tax rates.

Alternatively, some argue that tax cuts promote economic growth, and that economic growth constitutes by far the best anti-poverty measure.

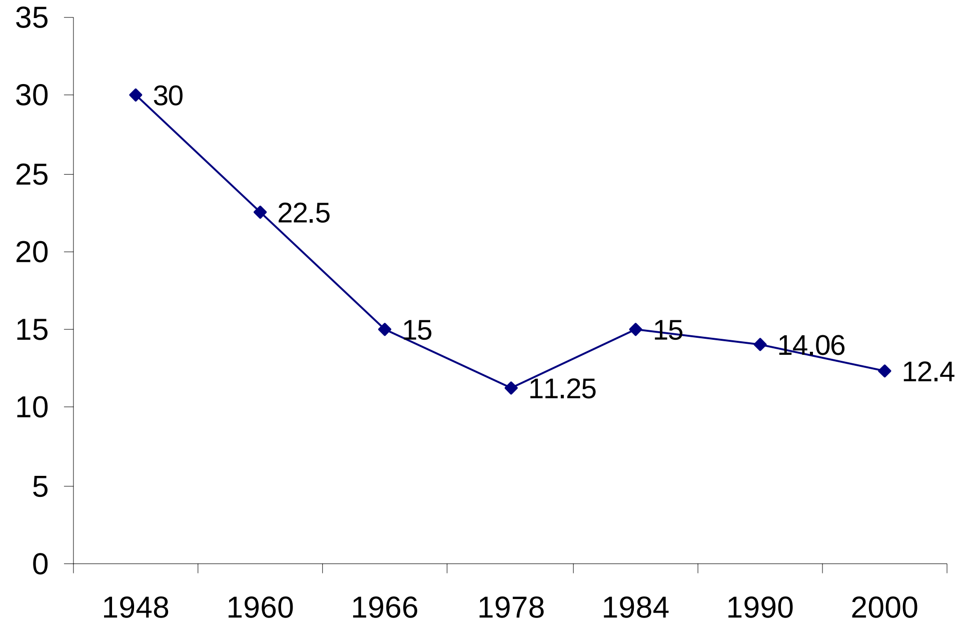
Many of the War on Poverty programs continue to this day. Some, such as the Medicaid program, are major drivers of state budgets.

According to classical liberal thought, government should keep taxes and spending at the lowest possible levels. Governments should also avoid burdensome and counterproductive regulation of the private economy. Classical liberals argue that this model produces superior rates of economic growth, which in turn would lead to a sustained reduction in poverty.

George Mason University economist Tyler Cowen, for example, notes that had the United States grown one percentage point less per year between 1870 and 1990, the America of 1990 would be no richer than the Mexico of 1990. Cowen also noted the compound power of economic growth by calculating that at an annual growth rate of five percent, it takes just over eighty years for a country to move from a per capita income of $500 to a per capita income of $25,000 in constant dollars. At a growth rate of one percent, such an improvement takes 393 years.[6]

The influence of economic growth on poverty rates can be seen in examining data from the post-World War II period. **Figure 1** (next page) presents poverty rate data from the United States between 1948 and 2000.[7]

Figure 1: United States Poverty Rate, 1948-2000



Source: *Theodore R. Marmor, Jerry L. Mashaw, and Philip L. Harvey, America's Misunderstood Welfare State, New York, Basic Books, 1990. Data for the year 2000 come from the U.S. Census Bureau.*

As evidenced in **Figure 1** above, the majority of the decline in poverty occurred before the advent of War on Poverty programs of the mid-1960s. The post-war economic boom, which roared through the 1950s and into the early 1970s ultimately served as the catalyst for a dramatic decline in the poverty rate. Likewise, the economic difficulties of the late 1970s and early 1980s increased the poverty rate. The national poverty rate has been stuck in the teens since the mid-1960s.

The progress of the post-war boom eventually faded at the national level. The national statistics, however, represent an aggregate figure that may conceal much about the relationship between economic growth and poverty. Considerable variation exists between American states, for example, regarding economic growth.

Per capita income varies widely by state in the United States. In 2005, Connecticut had the highest per capita income at $51,390 while Mississippi had the lowest at $27,404.[8] Five of the bottom 10 states in per-capita income are southern states. This largely represents a legacy of the century of economic stagnation following the Civil War. Southern states clung stubbornly to a status-quo in economics and politics which slowly but surely transformed it from being one of the wealthiest regions in the world before the Civil War, to having a per-capita income around half the national average by the early 1940s.

For slavery, the South substituted sharecropping and Jim Crow laws. Rather than embracing the industrial revolution, southerners maintained an agrarian economy. By the early 1940s, the southern states were growing more cotton than ever. Other regions, however, had embraced dynamic economic change, such as industrialization and immigration, and raced past the antiquated economies of the South.

More recently, strong rates of economic growth have led to an economic resurgence of southern states. It is also interesting to note that the per-capita figure for the United States' poorest state is equivalent to the nations of the European Monetary Union. This is reflective of the higher rates of economic growth in the United States in recent decades.[9]

The per-capita figure for the United States' poorest state is equivalent to the nations of the European Monetary Union. This is reflective of the higher rates of economic growth in the United States in recent decades.

State Performance in Poverty Reduction

Table 1 on the following page presents a ranking of the states in terms of both general and childhood poverty rates from 1990-2000. Nationwide, the general poverty rate fell by 5.3 percent. The median state saw a decline in general poverty of 10 percent. Because the median mitigates the impact of the extreme results, it will serve as a baseline to judge the scale of success in judging anti-poverty rates of the states.

States scoring 50 percent or more above the median in poverty reduction earn an "A." States scoring below this level but still above the national median score a "B." States scoring below the median, but within 50 percent of the median fall into the "C" category. States with reductions in poverty less than 50 percent of the national median score a "D." States experiencing increases in poverty against a strong national decline receive a well-deserved "F." The top two states in each category receive a "plus," the bottom two receive a "minus."

Table 1: Grading the States in Reduction (Increase) of General Poverty, 1990-2000

States	Change in Overall Poverty	Overall Poverty Reduction Grade
Minnesota	-22.5%	A+
Mississippi	-21.0%	A+
Iowa	-20.9%	A
Colorado	-20.5%	A
Michigan	-19.8%	A
Wisconsin	-18.7%	A
Utah	-17.5%	A
North Dakota	-17.4%	A
Arkansas	-17.3%	A
South Dakota	-17.0%	A
Louisiana	-16.9%	A
Kentucky	-16.8%	A-
Ohio	-15.2%	A-
Texas	-14.9%	B+
Tennessee	-14.0%	B+
Kansas	-13.9%	B
Nebraska	-12.6%	B
Missouri	-12.0%	B
Alabama	-12.0%	B
Oklahoma	-12.0%	B
Georgia	-11.6%	B
Arizona	-11.5%	B
Idaho	-11.3%	B
Indiana	-11.2%	B
New Mexico	-10.7%	B-
Illinois	-10.1%	B-

States	Change in Overall Poverty	Overall Poverty Reduction Grade
Montana	-9.3%	C+
West Virginia	-9.1%	C+
South Carolina	-8.4%	C
Oregon	-6.5%	C
Virginia	-5.9%	C
North Carolina	-5.4%	C-
Vermont	-5.1%	C-
Wyoming	-4.2%	D+
Washington	-2.8%	D
Florida	-1.6%	D-
Pennsylvania	-0.9%	D-
Maine	0.9%	F+
New Hampshire	1.6%	F+
Maryland	2.4%	F
Nevada	2.9%	F
Alaska	4.4%	F
Massachusetts	4.5%	F
Delaware	5.7%	F
New Jersey	11.8%	F
New York	12.3%	F
California	13.6%	F
Connecticut	16.2%	F
District of Columbia	19.5%	F
Rhode Island	24.0%	F-
Hawaii	28.9%	F-

Source: *Author calculations from Digest of Education Statistics, 2002. Data available online at http://165.224.221.98/programs/digest/d02/dt020.asp.*

States vary widely in poverty reduction success, from Minnesota and Mississippi at the top—each with more than four times the national average in poverty reduction—to Rhode Island and Hawaii in the F- category with very large increases in the poverty rate. The difference between the best and worst experience is over a 50 percent difference in a single decade (Minnesota's 22.5 percent decline compared with Hawaii's 28.9 percent increase.)

Table 2 below grades states with regard to childhood poverty reduction results in an identical fashion. Again, there is more than a 50 percent difference between the experience of the top ranked state (Colorado) and the lowest (Rhode Island). The median state experienced a 10 percent decline in childhood poverty. The rankings below again assign those states 50 percent higher than this median score an A. Those states with decreases between 50 percent higher than the median and the median score a B. Those states below the median to 50 percent below the median score a C. Those below this standard but still having some decline score a D, and those experiencing an increase in childhood poverty against a strong national decline receive an F.

Table 2: Childhood Poverty Rates of Reduction (Increase), 1990-2000

States	Change in Overall Poverty	Overall Poverty Reduction Grade
Colorado	-26.9%	A+
Iowa	-25.0%	A+
Wisconsin	-24.9%	A
Minnesota	-24.1%	A
Michigan	-24.1%	A
North Dakota	-22.9%	A
Ohio	-20.6%	A
Mississippi	-20.2%	A
Kansas	-19.0%	A
Utah	-18.1%	A
South Dakota	-17.5%	A
Texas	-17.3%	A
Indiana	-17.0%	A
Louisiana	-16.7%	A
Kentucky	-16.6%	A
Illinois	-16.0%	A

Table continued on next page

States	Change in Overall Poverty	Overall Poverty Reduction Grade
Arkansas	-15.4%	A-
Tennessee	-15.1%	A-
Georgia	-14.5%	B+
Alabama	-12.5%	B+
Idaho	-12.5%	B
Arizona	-12.1%	B
Missouri	-11.4%	B
Oklahoma	-11.0%	B
South Carolina	-10.5%	B-
New Mexico	-10.4%	B-
Virginia	-8.1%	C+
Nebraska	-7.4%	C+
Vermont	-7.3%	C
North Carolina	-6.9%	C
Maryland	-6.8%	C
Montana	-6.8%	C
Massachusetts	-6.7%	C
Pennsylvania	-6.0%	C-
Florida	-5.2%	C-
West Virginia	-4.7%	D+
Washington	-4.5%	D+
Oregon	-4.2%	D
Connecticut	-2.3%	D
Maine	-2.2%	D
New Jersey	-2.0%	D
Wyoming	-0.6%	D-
Delaware	-0.5%	D-
New Hampshire	5.2%	F+
Nevada	5.4%	F+
New York	5.5%	F
Alaska	7.1%	F
California	7.4%	F
Hawaii	22.5%	F
District of Columbia	26.0%	F-
Rhode Island	26.6%	F-

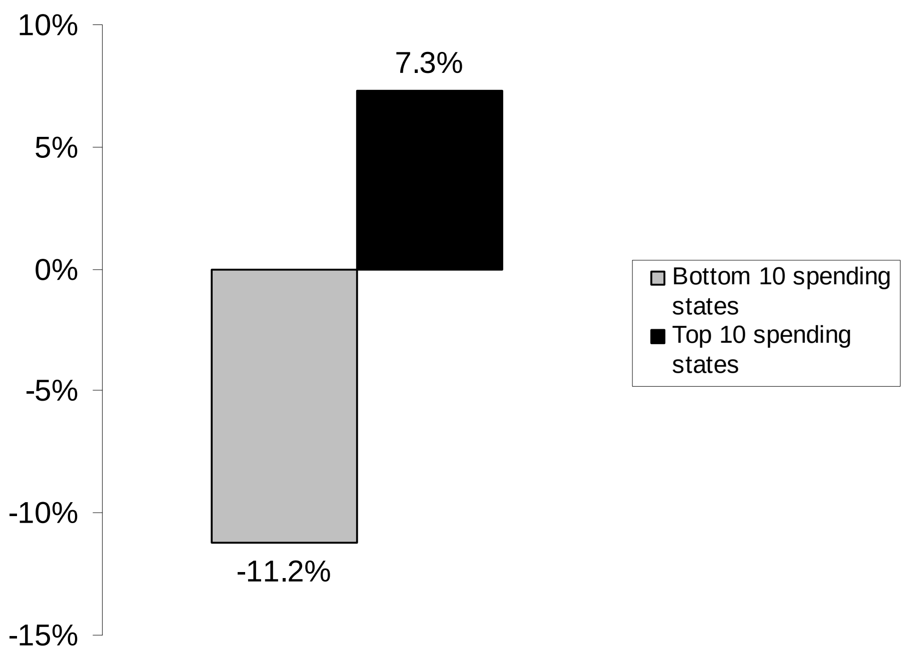
There is more than a 50 percent difference in poverty reduction between the experience of the top ranked state (Colorado) and the lowest (Rhode Island).

Source: *Author calculations from Digest of Education Statistics, 2002. Data available online at http://165.224.221.98/programs/digest/d02/dt020.asp.*

Testing the Theories: Government v. Markets in Poverty Reduction

Fighting poverty is a major justification for state spending. However, does state government spending actually reduce poverty? **Figure 2** below indicates that big spending governments did a terrible job of reducing poverty during the 1990-2000 period. The figure compares average poverty rates in the 10 states spending the most money per capita (Alaska, California, Delaware, Hawaii, Massachusetts, New Mexico, New York, Rhode Island, Vermont, and Wyoming) to the 10 states spending the least per capita (Arizona, Colorado, Florida, Georgia, Missouri, Nebraska, Nevada, South Dakota, Tennessee and Texas).

Figure 2: Average Poverty Rate Changes in Low and High Spending States, 1990-2000



Source: *Author calculations from Digest of Education Statistics, 2002. Data available online at http://165.224.221.98/programs/digest/d02/dt020.asp.*

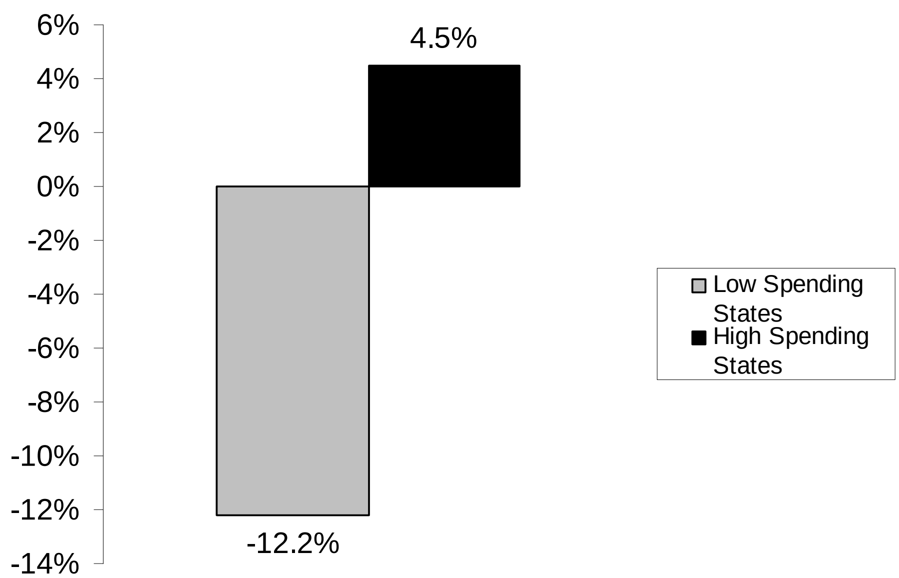
Fighting poverty is a major justification for state spending. However, does state government spending actually reduce poverty?

Doubtlessly there are some who benefit from high state government spending, but the poor do not seem to be among them. The 10 states with the lowest per capita spending enjoyed a sizeable reduction in overall poverty rates, approaching twice the national average. On the other hand, the top 10 big spenders not only failed to reduce poverty rates, they actually suffered an *increase* in poverty rates of 7.3 percent, on average.

Often, advocates justify high government spending on behalf of children. In Arizona, for example, the Children's Action Alliance imbeds this theory directly into the name of their organization. The Children's Action Alliance opposes cuts in Arizona taxes and favors increased state spending as a part of its stated mission to promote "the well being of all of Arizona's families and children."

It is hard to imagine anyone disagreeing with the goal of promoting the well-being of children and families. The advocated means to achieving the goal, however, seem quite suspect. **Figure 3** below will examine *childhood poverty rates* between states for the 1990-2000 period, again comparing the top 10 spending states to the bottom 10 spending states.

Figure 3: Average Childhood Poverty Rate Changes in Low and High Spending States, 1990-2000



Source*: Author calculations from Digest of Education Statistics, 2002.*
Data available online at http://165.224.221.98/programs/digest/d02/dt020.asp.

As **Figure 3** demonstrates, it hurt to be a child in a high spending state. While low spending states experienced substantial declines in childhood poverty rates, high spending states suffered an actual increase in childhood poverty. During this period, the average state saw childhood poverty decline by 8.4 percent, but it increased by 4.5 percent in the 10 states with the highest per capita spending. Meanwhile, the average reduction in childhood poverty in the states with the lowest state and local spending per capita was 45 percent greater than the average state.

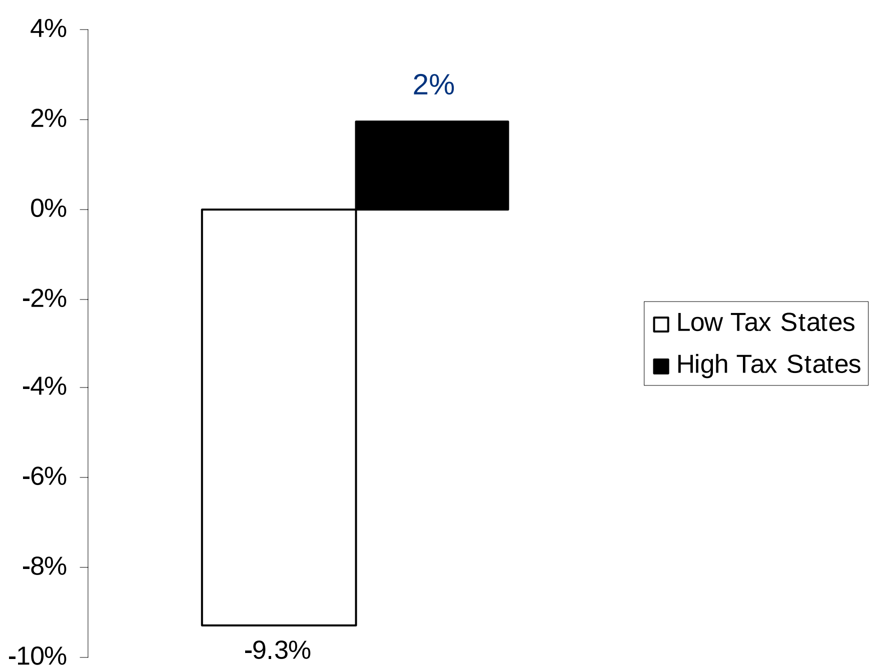
Does it follow then that state government spending directly causes poverty? Not necessarily. Government spending ultimately derives from taxes. The American federal system presents a variety of choices for individuals and businesses in terms of where they wish to live and do business. States with relatively high tax rates suffer greatly from the process of internal emigration. People and businesses flee from high tax states to low tax states. Such movements respectively damage and reward state economies according to their fiscal and regulatory choices.[10] Apparently, high taxes and the policies that come with them inflict more harm than the resulting spending does good for the poor.

Tax and Poverty Rates

The state spending method for reducing poverty seems to have been terribly ineffective, possibly even counterproductive. If classical liberals are correct that lower taxes will result in higher economic growth and thus in lower rates of poverty, we should be able to find evidence of this in state economic statistics. **Figure 4** below presents data from the United States Census Bureau on state poverty rate reductions between 1990 and 2000. Figure 4 compares the relative performance in poverty reduction between the 10 states with the lowest and highest overall tax burdens in 2000. Alabama, Colorado, Florida, Mississippi, Nevada, New Hampshire, South Dakota, Tennessee, Texas, and Virginia spent the least per capita (taxes per 1000 of income). Alaska, California, Connecticut, Hawaii, Minnesota, New Mexico, New Jersey, New York, Vermont, and Wisconsin spent the most.[11]

High taxes and the policies that come with them inflict more harm than the resulting spending does good for the poor.

Figure 4: Poverty Rate Changes in Low and High Tax States,1990-2000



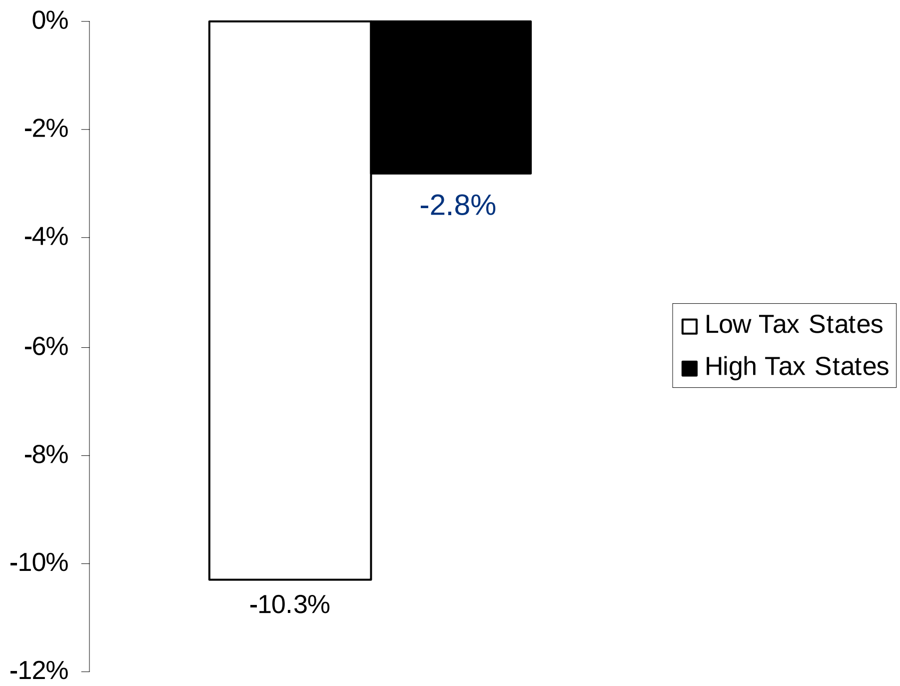
***Source**: Author calculations from Digest of Education Statistics, 2002.*
Data available online at http://165.224.221.98/programs/digest/d02/dt020.asp.

The low-tax states saw an average decline in poverty rates of 9.3 percent (-9.3 percent). Overall poverty rates increased in the high tax states by 2 percent.

Figure 5 demonstrates the childhood poverty rate trends for the same states Again, the same pattern holds: the high tax states badly under-perform in comparison to the low-tax states.

Low tax states substantially outperformed both the national average and the high tax states in reducing poverty. In fact, the low tax states experienced a reduction in childhood poverty more than four times larger than the high tax states.

Figure 5: Childhood Poverty Rate Changes in Low and High Tax States, 1990-2000

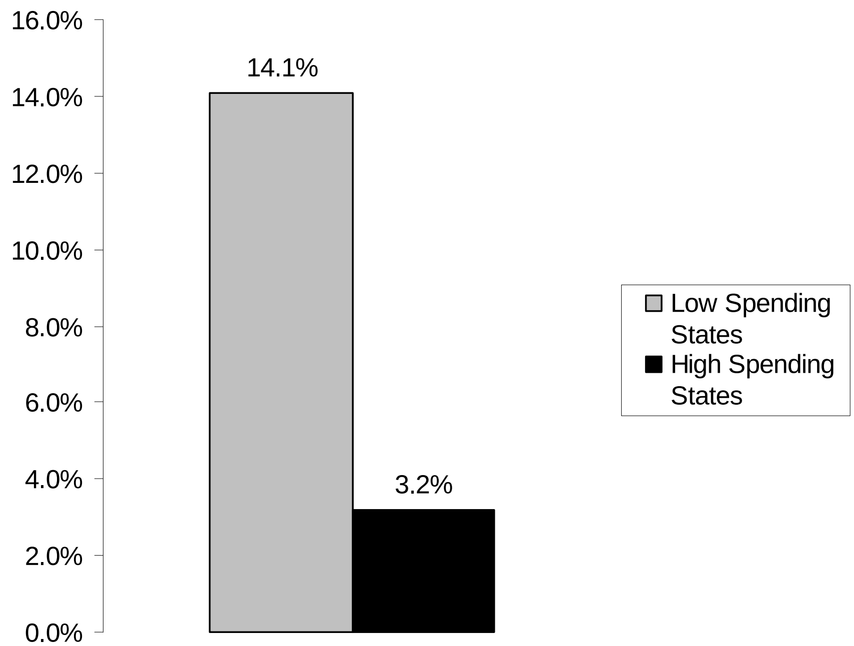


***Source**: Author calculations from Digest of Education Statistics, 2002. Data available online at http://165.224.221.98/programs/digest/d02/dt020.asp.*

Again, low tax states substantially outperformed high tax states in reducing childhood poverty. In fact, the low tax states experienced a reduction in childhood poverty more than three times larger than the high tax states.

The dramatic declines in poverty in the "small government" states strongly confirm the classical liberal hypothesis: low spending and low taxes promote economic growth which in turn reduces poverty. These states seem to have succeeded in reducing poverty by allowing the private economy to flourish. We can further test this hypothesis using the growth in real per-capita income. **Figure 6** compares the records of the top 10 high spending states to the record of the lowest 10 spending states in generating real per person income growth during the 1990-2000 period.

Figure 6: Average Real Per Capita Income Growth in Low and High Tax States, 1990-2000



***Source**: Author calculations from Digest of Education Statistics, 2002. Data available online at http://165.224.221.98/programs/digest/d02/dt020.asp.*

The dramatic declines in poverty in the "small government" states strongly confirm the classical liberal hypothesis: low spending and low taxes promote economic growth which in turn reduces poverty.

Alternative Explanations: Immigration and Economic Catastrophe

Taxes and business climate alone, of course, do not completely explain trends in poverty or per capita income. A number of factors could influence such trends, and difficult problems vex attempts to statistically model per capita income growth.[12] Heavy rates of illegal immigration into states such as Arizona, California, and Texas, for example, could negatively influence per capita income figures. Relatively affluent retirees moving out of the Northeast and into states like Florida make an impact. Some states experience the good fortune of having a world-beating firm develop within their state to become a major generator of wealth and employment. Northwest Arkansas, headquarters of Wal-Mart, certainly comes to mind.

With regard to immigration, some states with very large increases in the percentage of the population born in a foreign country also experienced large *decreases* in poverty rates during the 1990s. For example, Arizona and Texas both more than doubled the number of foreign-born residents during the 1990s, but experienced poverty declines well above the national average. Texas gained more than 1.3 million foreign born residents during the 1990s, and scored a B+ and an A on the above rankings of general and childhood poverty reduction. New York scored an F in both categories after gaining fewer than a million foreign born residents.[13]

Despite the fact that immigrants often come to the United States poor, there is no reason to assume that most of them will stay poor in a vibrant economy. Immigrants, both legal and illegal, often come to the United States in search of economic opportunity. In a healthy state economy producing large numbers of jobs, there is nothing inevitable about even the most penniless immigrant remaining in poverty for long. A state with the combination of being a traditional immigration destination and experiencing stagnant economic growth, however, will almost certainly see their poverty rates rise. Both California and New York fall into this unfortunate category. These states have been gateways for decades, with immigrant social and family networks in each of them. What changed for the worse in these states during the 1990s was not immigration, but rather the ability of these state economies to economically assimilate immigrants through job creation.

Texas gained more than 1.3 million foreign born residents during the 1990s, and scored a B+ and an A on the rankings of general and childhood poverty reduction.

Another possible explanation to explain poverty trends: regression to the mean. States with high levels of poverty in 1990 might have found it much simpler to reduce poverty rates than states with low rates. Of all Mississippians, for example, 25 percent lived below the poverty line in 1990, while only 6.4 percent of those living in New Hampshire lived in poverty. One could argue that New Hampshire had nowhere to go but up, while Mississippi had nowhere to go but down. Several of the states that were star performers in poverty reduction, however, began the 1990s with poverty rates well below the national average. Colorado, Iowa, Minnesota, and Wisconsin, for example, began the decade with poverty rates well below the national average and still experienced dramatic declines. The District of Columbia meanwhile had a poverty rate 29 percent higher than the national average in 1990 but 60 percent higher than the national average in 2000.

Localized economic downturns can also influence state poverty rates. States sometimes experience external shocks, leaving them out of sync with the national economy. Take Hawaii, for example—which scores at the very bottom of the state rankings with a 28.9 percent *increase* in poverty rates during the 1990s. Hawaii faced severe economic difficulties associated with the collapse in the Japanese stock market beginning in 1989. Asian interests had invested heavily in Hawaiian real estate, and the prolonged Japanese recession, coupled with subsequent troubles in other Asian stock markets, put a severe strain on the economy of Hawaii.

We cannot, however, absolve Hawaii of its terrible economic performance. As a high tax, high regulation state, it has failed to adapt quickly to a changed economic environment.[14] Other states have had more success facing similar economic calamities. For example, Texas faced an economic catastrophe in 1986 when the price of oil dropped from $40 to $9 a barrel. That same year, Congress removed "passive loss" provisions for real estate investments from the federal tax code in the Tax Reform Act of 1986. Coupled with the collapse in oil, these changes led to a collapse in the Texas commercial real estate market and, subsequently, a Savings and Loan banking crisis.[15]

During the 1970s, the Texas economy swam against the national trend, experiencing strong economic growth fueled by the oil industry and speculative real estate investments. In 1986, the wax on the wings melted. In short, while the national economy grew stronger during the late 1980s, Texas found itself mired in a regional recession, facing the need to reinvent its once high-flying economy for a changed set of circumstances.

The Texas turnaround stands in stark contrast to Hawaii's experience. Market forces in Texas went to work as the collapse of the commercial real estate market helped attract major corporate headquarters looking to leave high cost states. Firms formerly associated with the petroleum industry reinvented themselves. High-tech entrepreneurs found a low-cost and business friendly state. Good luck also plays a role. During this period, for instance, a small company in Houston invented the first personal computer clone. Around the same time, a student named Michael Dell mapped out the beginnings of a company that would revolutionize the computer industry from his dorm room in Austin.

Economic growth represents a mysterious phenomenon, with a wide myriad of possible explanations. Solid fiscal policy, however, can only help, while poor policy can make a bad situation much worse.

While the Texas calamity occurred three years prior to that of Hawaii, it seems instructive that Texas experienced a 14.9 percent decline in poverty during the 1990s while Hawaii experienced a 28 percent increase. Economic growth represents a mysterious phenomenon, with a wide myriad of possible explanations. Solid fiscal policy, however, can only help, while poor policy can make a bad situation much worse.

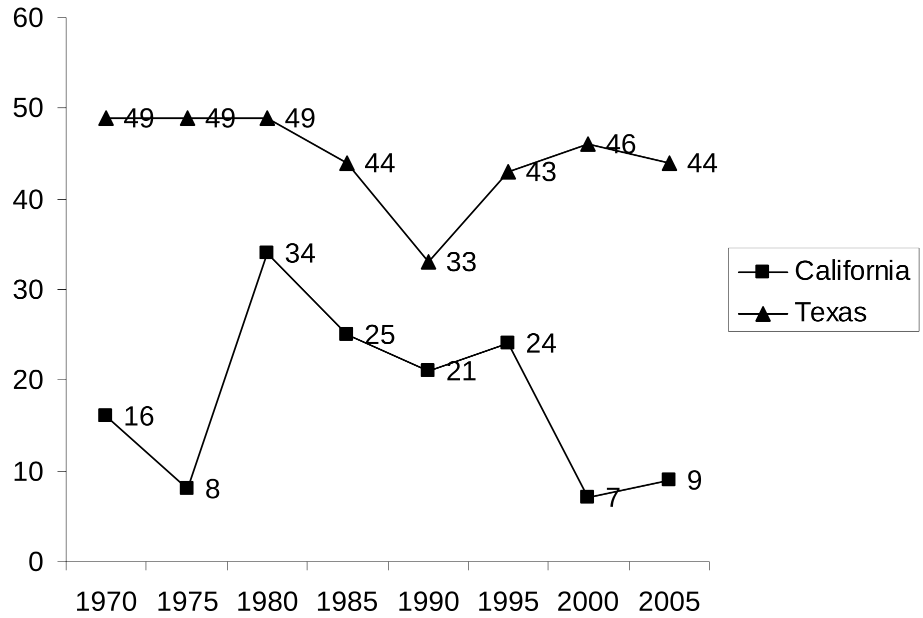
Texas and California: Two States Moving in the Opposite Direction

During the 1990s, Texas and California embraced different fiscal policies, and experienced different economic results. Judged on the poverty statistics alone, Texas made wise fiscal decisions, while California did not.

In 1990, as Texas continued to suffer economically from the oil and property value collapses of the 1980s, more than 18 percent of Texans lived below the poverty level, and more than 23 percent of Texas children lived below the poverty line. Both of these figures were well above the national averages of 13.1 percent for the general poverty rate and 17 percent for childhood poverty. In 1990, Texas suffered from a *general* poverty rate that was 45 percent higher than California and a *childhood* poverty rate 36 percent higher than that of California.

California had a higher tax burden than Texas in 1990, ranking 21st, where Texas' ranking was 33rd. Nevertheless, California also had lower rates of poverty, showing that a variety of factors affect the economic performance of a state. With general poverty at 12.5 percent and childhood poverty at 17.2 percent, California had better numbers than both the national average and Texas in 1990. Trends since 1990, however, illustrate how profligate fiscal policy can negatively affect economic outcomes.

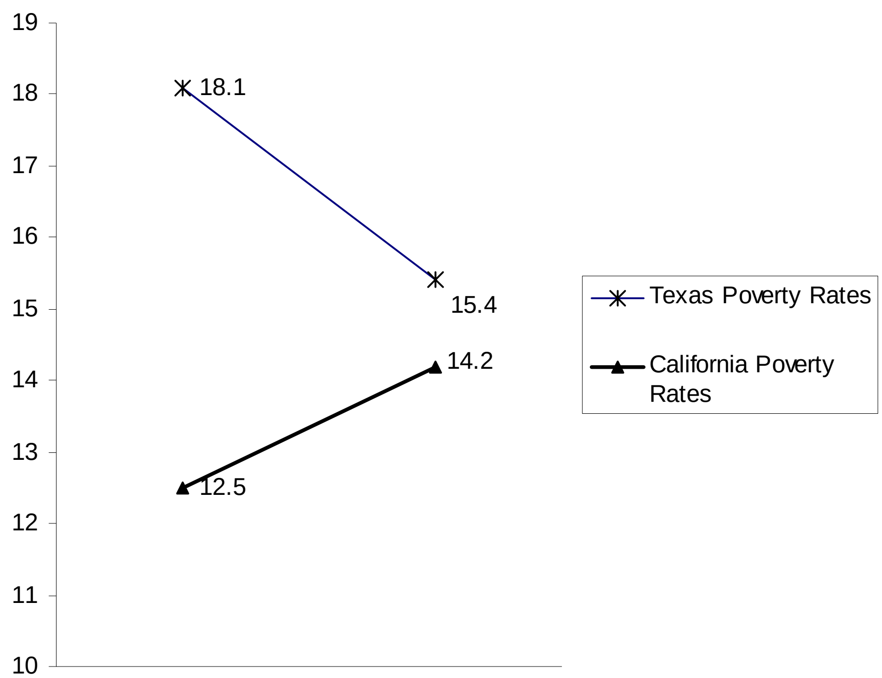
Figure 7: National Rankings of Texas and California Tax Burdens
(1 = Nation's Highest Tax Burden)



***Source**: Tax Foundation*

During the 1990s, tax burdens in Texas and California went their separate ways. Under Governors Bill Clements and Ann Richards, Texas saw modest tax increases early in the decade but then began to see some modest tax relief during the term of Governor Bush. Texas' tax burden fell from 33rd highest in the nation to 44th in 2000. California moved up from the 25th spot to the 9th highest tax burden in 2005.

Figure 8: Trends in Poverty Rates: Texas v. California, 1990-2000



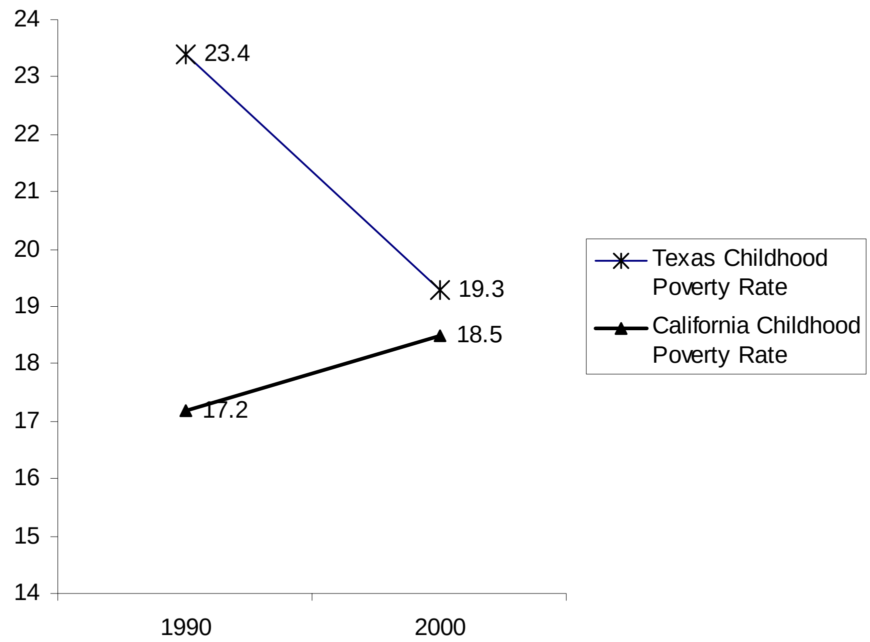
***Source**: Author calculations from Digest of Education Statistics, 2002.*
Data available online at http://165.224.221.98/programs/digest/d02/dt020.asp.

Should current trends continue, Texas will soon have poverty rates lower than those of California. Indeed, it is likely that this has already occurred.

The effect on poverty was exactly the opposite of what big-government advocates would have us believe. As **Figure 8** shows, in California the poverty rate rose with the higher taxes and spending. In Texas, the poverty rate fell, even as the tax burden fell and spending growth was more limited. The trend proves very similar with childhood poverty rates, as seen in **Figure 9**.

Should current trends continue, Texas will soon have poverty rates lower than those of California. Indeed, it is likely that this has already occurred. This despite the fact that Texas suffered as a result of low petroleum prices in the 1990s. With the higher petroleum prices today, it is all the more likely that Texas' poverty rates have fallen markedly. Meanwhile, California continues to have difficulty getting its fiscal house in order. In fact, should the trend of the 1990s continue, even Mississippi's poverty rates will be lower than California's rates by 2010.

Figure 9: Childhood Poverty Rates: Texas v. California, 1990-2000



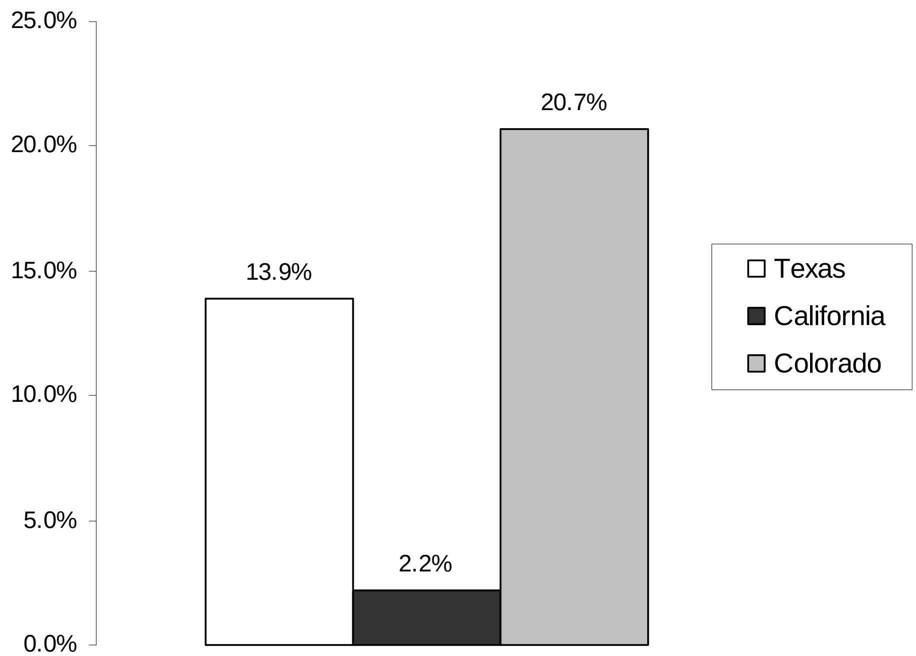
***Source**: Author calculations from Digest of Education Statistics, 2002.*
Data available online at http://165.224.221.98/programs/digest/d02/dt020.asp.

Colorado experienced the largest combined decline in general and childhood poverty in the nation, despite starting from already relatively low levels of poverty in 1990.

Texas should not feel complacent since the star performer left *both* Texas and California behind during this period. Colorado experienced the largest combined decline in general and childhood poverty in the nation, despite starting from already relatively low levels of poverty in 1990. Colorado also experienced the second highest level of per capita income growth during the 1990-2000 period, narrowly edged out of first place by fellow small government state South Dakota. **Figure 10** (next page) compares the per-capita income growth figures for Texas, California and Colorado.

Figure 9 demonstrates that Colorado made more than *nine times* the per-capita income growth of California. Colorado began the decade with a per-capita income figure 16 percent lower than California, but closed the gap in a single decade. During the early part of the current decade, Colorado surpassed California in per-capita income.

Figure 10: Real per Capita Income Growth, 1990-2000



Source: *Author calculations from Digest of Education Statistics, 2002. Data available online at http://165.224.221.98/programs/digest/d02/dt020.asp.*

In 1992, Colorado enacted a Taxpayer's Bill of Rights (TABOR) limiting increases in state and local government spending to the combined rate of inflation and population growth. Under TABOR, the state rebated excess revenue to Colorado taxpayers.

Colorado: Fiscal Restraint and Poverty Declines

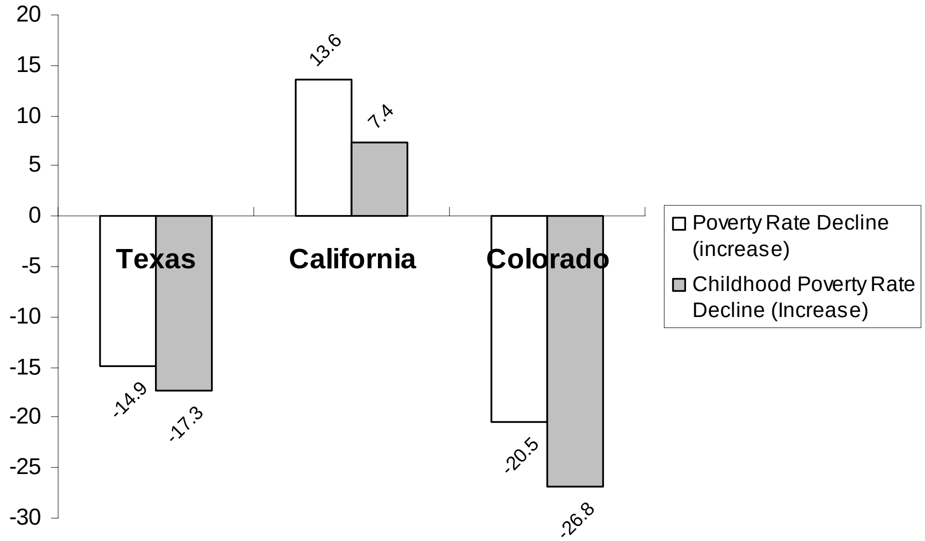
Fiscal policy adopted by Colorado helped make its remarkable income progress possible. In 1992, Colorado enacted a Taxpayer's Bill of Rights (TABOR) limiting increases in state and local government spending to the combined rate of inflation and population growth. Under TABOR, the state rebated excess revenue to Colorado taxpayers.

The result is that Colorado taxpayers have received $32 billion in tax rebates since 1997, an average of $900 per taxpayer. Despite predictions of doom by opponents, Colorado's economy has been exceptionally strong. Between 1995 and 2000, Colorado ranked first among all states in gross state product growth and second in personal income growth.[16]

Ironically, during the 1992 campaign, then Colorado Governor Roy Romer bitterly denounced the TABOR proposal, saying that defeating TABOR at the ballot box was the "moral equivalent of defeating the Nazis at the Battle of the Bulge." Governor Romer warned that the Colorado border would have to be posted with signs reading, "Colorado is closed for business."[17]

The trends in poverty rates tell quite a different story, as seen in **Figure 11** below. Colorado made enormous gains, Texas made solid gains, and California suffered greater rates of poverty. Despite the predictions of doom offered by TABOR opponents in 1992, Colorado's economy enjoyed a golden era of income growth and poverty reduction.

Figure 11: General and Childhood Poverty Trends: Texas, California, Colorado, 1990-2000



Source: *Author calculations from Digest of Education Statistics, 2002. Data available online at http://165.224.221.98/programs/digest/d02/dt020.asp.*

Conclusion: The Moral Case for Small Government in Texas

In the fight against poverty, it is clear that less government equals more prosperity. We cannot know all the reasons that high tax/spending states proved so inept at reducing poverty during the 1990s. Some broad explanations, however, should be considered.

First, the failure of many government programs to reduce poverty should instill policymakers with a definite sense of humility. The causes of poverty have proven to be complex, and the ability of government programs to affect them limited.

Second, in contrast to the apparent impossibility for government agencies to make progress against poverty, economic growth has proven to be an effective tonic in reducing poverty. Private sector growth possesses much greater power in the fight against poverty than government programs. Government spending greater than necessary to ensure law, order, and property rights provides limited economic returns. Although advocates justify high taxes for the sake of the poor and children, the truth of the matter is that taking money out of the private sector slows job creation and income growth; the economy creates fewer private sector employment opportunities, meaning less opportunity for skilled and unskilled labor. Ultimately, the most vulnerable—those looking for the first rung on the economic ladder—are the most hurt by this process. The best anti-poverty program is a four-letter word: jobs. Taxes and regulation destroy them.

Third, the Robin Hood mythology of state as anti-poverty crusader requires serious reexamination. Economists term the pursuit of government subsidy, whether through direct government appropriation or through the tax code, as "rent seeking." Rent seeking represents an alternative way to seek riches. Justifying a subsidy to a handful of well-connected special interests, rather than producing something for which people will voluntarily hand over their money, can grant some enormous fortunes.

Accordingly, we should not be surprised that the poor suffered in high spending states. Wealthy interests possess enormous advantages over the poor in the process of rent seeking. The poor vote, participate in civic organizations, make campaign contributions, and hire lobbyists at very low rates. The wealthy pursue all of these activities at much higher rates. Progressives implicitly assume that government spending will help the poor as if a non-political board of altruists set fiscal policy.

The best anti-poverty program is a four-letter word: jobs. Taxes and regulation destroy them.

The reality is quite different. Politicians set fiscal policy in an entirely political context. Rather than a Federal Reserve peopled by figurative Mother Theresa's, politicians in competitive democratic races make decisions about state taxing and spending. High tax and spending states dole out a great deal of "rent" so we should not be shocked to find that it is the powerful, rather than the powerless, who benefit. Outside of fairytales, a government acting like Robin Hood often takes from the poor and gives to the rich.

If the poor seldom lobby for their own interests, the same cannot be said for public employees. Government programs have reached sufficient scale that those employed by the system have become major political forces in lobbying for the expansion of government programs. This has occurred at all levels of government, primarily representing the efforts of government service providers, rather than consumers of services. Teacher unions, for example, constantly lobby and engage in electioneering for the purpose of increasing public school spending, while parents and taxpayers do so only on a much smaller scale, if at all.

Texans interested in reducing poverty should seek to emulate Colorado rather than California. We should reduce taxes and limit the growth of spending in the future. The last special Texas legislative session saw a decline in taxes overall, though the new business tax is not a positive signal in a state that already has one of the highest business tax burdens in the nation. (See Schlomach, "The Case for Surplus-Financed Business Tax Relief," Texas Public Policy Foundation, November 2006, http://www.texaspolicy.com/pdf/2006-11-PB14-bs.pdf.)

A Taxpayer Bill of Rights, limiting the increase in state spending to the sum of the inflation and population growth rates, and returning surplus amounts to the taxpayers would be an excellent way to increase future income growth. Beyond limiting future mistakes, however, Texas policymakers should reexamine past decisions. High tax burdens on any one sector and wasteful spending destroy wealth and hurt the poor along with everyone else.

Endnotes

[1]*See* Robert Samuelson "One Reform that Worked: The welfare overhaul of 1996 has helped reduce poverty. Why can't we duplicate this sort of pragmatic progress in other areas?" (7 Aug. 2006) http://www.msnbc.msn.com/id/14096483/.
[2]Theodore R. Marmor, Jerry L. Mashaw & Philip L. Harvey, *America's Misunderstood Welfare State* (Basic Books, 1990) 22-52.
[3]Jim Powell, *FDR's Folly: How Roosevelt and his New Deal Prolonged the Great Depression* (Crown Publishing, 2004).
[4]Charles Murray, *Losing Ground: American Social Policy 1950-1980* (New York: Basic Books, 1984).
[5]Robert Rector & Patrick F. Fagan, *The Continuing Good News About Welfare Reform,* Heritage Foundation Backgrounder #1620 (6Feb. 2003) http://www.heritage.org/Research/Welfare/bg1620.cfm.
[6]Tyler Cowen, "Why the Growth Rate is Important," entry on the weblog "Marginal Revolution" (20 Aug. 2004) http://www.marginalrevolution.com/marginalrevolution/2004/08/why_the_growth_.html.
[7]Source of data for Figure 1: 1948-1990, Theodore R. Marmor, Jerry L. Mashaw & Philip L. Harvey, *America's Misunderstood Welfare State* (Basic Books, 1990) The figure for the year 2000 came from the United State Census Bureau.
[8]http://www.taxfoundation.org/news/show/290.html.
[9]http://www.finfacts.com/biz10/globalworldincomepercapita.htm.
10Matthew Ladner, *The Tax Man and the Moving Van,* Goldwater Institute Policy Report no. 194 (24 May 2004).
[11]Washington State Department of Revenue, *Revenue News,* http://dor.wa.gov/Docs/Pubs/News/2003/nr_03_01_ComparativeTaxes2000Final.pdf.
[12]*See* Dani Rodrick, "Why We Learn Nothing from Regressing Economic Growth on Policies," Harvard University Working Paper, http://ksghome.harvard.edu/~drodrik/policy%20regressions.pdf.
[13]Data from the Center for Immigration Studies, http://www.cis.org/articles/2003/back1203.html#table1.
[14]*See* Lowell L. Kalapa, "Let's Talk About This Economic Slump," Tax Foundation of Hawaii Weekly Commentary (20 Sep. 1998) http://www.tfhawaii.org/cols/1998/092098.html.
[15]For a summary of the petroleum downturn in Texas, see David Brown, "The Crash of '86 Left Permanent Scars," http://www.aapg.org/explorer/2006/01jan/crash.cfm.
[16]In 2005, Colorado voters narrowly voted to temporarily suspend Tabor after the early decade recession "ratcheted down" state government spending. The combination of a general economic downturn and a reduction in air travel following the 9/11 attack forced cuts in state government spending, which then under Tabor became the new baseline for the following year. This is a design feature of Tabor that need not be replicated in other states.
[17]Stephen Moore & Dean Stansel, "The Great Tax Revolt of 1994," *Reason* (Oct. 1994).

About this Report

Many believe that government programs and expenditures are key to alleviating poverty. However, the experience of the states tells a different story. During the decade of the 1990s some states chose a path of growing, ever-more-expensive state government. Others chose low spending and small state governments. These two types of states' experiences with their poverty rates are as different as their choices regarding the size of government.

High-spending states suffered rising poverty rates while low-spending states saw their poverty rates decline. In fact, Colorado, which reversed a tendency toward growing government by passing a strict limit on spending growth saw its already relatively poverty rate decline more than any other state. California did the opposite and has seen its poverty rate increase drastically. Texas has seen a marked decline in its poverty rate.

About the Authors

Dr. Matthew Ladner is vice president of research for the Goldwater Institute. Prior to joining Goldwater, Ladner was director of state projects at the Alliance for School Choice, where he provided support and resources for state-based school choice efforts. Ladner has written numerous studies on school choice, charter schools and special education reform. Ladner is a graduate of the University of Texas at Austin and received both a Masters and a Ph.D. in Political Science from the University of Houston. Ladner previously served as director of the Center for Economic Prosperity at the Goldwater Institute and as vice president of policy and communications at Children First America.

Dr. Byron Schlomach is the chief economist for the Texas Public Policy Foundation, and the director of the Center for Fiscal Policy Studies. Raised in Texas, Schlomach received both his bachelor and doctorate degrees in economics from Texas A&M University. Schlomach came to the Foundation from the Texas Education Agency. He has also served as a staff member in the Texas Legislature, most recently as the chief of staff to State Rep. Kent Grusendorf, former chairman of the House Committee on Public Education. Previously, Schlomach was a researcher in the Office of the Texas Comptroller. There he conducted research into education and transportation, and was the principal author of a study examining the public school start dates. He has also served as an assistant lecturer in the Texas A&M Department of Economics, and has taught at Austin Community College. Schlomach was named a "Senior Fellow" with the Foundation in 2002.

Texas Public Policy
FOUNDATION