Influential Issues

The Economy

TEXAS PUBLIC POLICY FOUNDATION

By Bill Peacock & Talmadge Heflin

Talking Points

What Makes An Economy Grow?

- Government policies influence people's decisions on whether, where, and how much to work, save, and invest, impacting the ability of states to retain and attract residents and businesses.
- Pro-growth policies result in higher after-tax returns, increased economic activity, and an eventual improvement in overall state fiscal health.
- There are a lot of factors involved in shaping state and local economies, but they can be boiled down one underlying principle: the level of economic freedom enjoyed by the citizens within a government's borders.

How Texas Ranks

- Texas ranks in the top 10 in three different studies that examined the economic vitality of the 50 states.
- The generally pro-growth policies in Texas allowed our economy to create 1,615,000 jobs from 1997-2007; during the same period, Ohio lost 10,400 jobs.
- The lack of a personal income tax and state inheritance tax puts Texas at the top of the economic pack.
- Texas ranks first in *Site Selection* magazine's survey of real estate professionals.
- Employment growth in Texas remains strong, and well above the national average.
- Texas' heavy property tax burden ranks 8th among the states.
- Texas ranks 27th with 559 public employees per 100,000 population.

Taxes

- The state's new margins tax taxes businesses on the lowest amount of 1) 70 percent of total revenue; 2) total revenue minus total cost of goods, or 3) total revenue minus total compensation and benefits.
- The margins tax taxes Texas' businesses by approximately $3 billion more per year than the old franchise tax.
- Sales taxes offer a system that is simple, transparent, fair, and causes the least amount of economic damage.
- Property tax collections generate more revenue in Texas than any other tax, including state and local sales taxes combined.
- Texas' 3,758 taxing units levied over $35.5 billion in property taxes in fiscal year 2006—a 6.2 percent increase from the previous year.
- The Legislature should provide additional property tax relief by dedicating all revenue from the margins tax above that of the old franchise tax and all state surpluses to reduce school property tax rates.
- The Legislature should consider lessening the school property tax burden further by using

revenue from widening the base of goods and services subject to the sales tax.

Spending

- Last session, the Texas Legislature had a record $14 billion budget surplus.
- Because there is no automatic process in statute for returning budget surpluses to the taxpayers, about $7 billion of the surplus was left in the state coffers for 2009 and could be used to increase spending rather than to decrease taxes.
- Texas is projected to have a $10 to $15 billion surplus next biennium.
- In 1978, 84 percent of voters cast their ballots in favor of the *Texas Tax Relief Act*, demanding government control its spending.
- Texas' Tax and Expenditure Limit applies to only half of the state budget and has no effect on local government expenditures.
- Texas' Tax and Expenditure Limit should be reformed by 1) applying it to expenditures made from all state revenue, 2) using the sum of population and inflation increases instead of growth in total personal income to control state spending, and 3) providing for a mechanism that provides automatic refunds of surpluses to state taxpayers.
- Enact an expenditure limit for local governments, limiting expenditure growth to inflation plus the growth of the population.

Energy and the Environment

- Texas has prospered in recent years as its population and economy has grown. One reason for Texas' economic progress is the reliable and affordable supply of electricity available to meet the state's growing energy needs.
- The largest potential increase in energy costs comes from global warming regulations. The U.S. EPA predicts that passage of Lieberman-Warner or similar legislation would result in a reduction of GDP up to 3.8 percent by 2030 and 6.9 percent by 2050.
- Lieberman-Warner would cause Texans to experience a decrease in disposable household income per year of $1,044-$3,384 by 2020 and $4,395-$8,015 by 2030.
- Some people blame deregulation for high electricity prices, but it is important to remember that Texas' electricity prices are high because energy prices are high everywhere and Texas is highly dependent on natural gas.
- Texans face a future of both higher energy prices and less reliable energy supplies unless we build more generation plants fired by coal and nuclear energy, maintain a deregulated electricity market, and eliminate subsidies for renewable energy.

Regulation and Government Intervention

- Milton Friedman once said, "Many people want the government to protect the consumer. A much more urgent problem is to protect the consumer from the government."
- Government regulation often harms economic growth by increasing costs on consumers and businesses.
- The overregulation of forms by the Texas Department of Insurance—in an attempt to protect consumers—actually cost consumers around $900 million dollars in increased homeowners' premiums from 2001 to 2005.
- Price controls on oil in the 1970s led to higher gasoline prices.
- Subsidies, such as those for ethanol and renewable energy, cost taxpayers billions of dollars and increase the price of food, energy, and related products to consumers.

What Makes An Economy Grow?

Economist Arthur Laffer points out that government policies influence people's decisions on whether, where, and how much to work, save, and invest. These policies impact the ability of a nation, state, or community to retain and attract residents and businesses. The evidence suggests that pro-growth policies result in higher after-tax returns, increased economic activity and an eventual improvement in overall state fiscal health; anti-growth policies result in the opposite effects (Moore, Arduin, Laffer 2005, 17).

When examining a state's economic well being, Laffer asks several questions, including the following:

- ★ How frequently does the state legislature turn to higher taxes, or do they resist the spend-and-tax cycle?
- ★ What after-tax incentive is there to earn or invest that next dollar?
- ★ Is income taxed in a relatively efficient manner?
- ★ How does the state tax burden compare to that of other states?
- ★ And what about workers' compensation costs and other indirect taxes?

Other studies attempting to measure the economic well being of states ask different questions. For instance, the Economic Freedom of North America Index looks at the size of government, takings and discriminatory taxation, and labor market freedom (Karabegović & McMahon 2007).

In its annual rankings of the top state business ranking, *Site Selection* magazine factors in the opinions of real estate executives on the most important factors in companies' decisions about where to locate their business. The following were the top 10 reasons from its 2007 survey (Arend and Bruns 2007):

- ★ Availability of desired workforce skills
- ★ Ease of permitting and regulatory procedures
- ★ State and local tax scheme
- ★ Land/building prices and supply

There are many factors involved in shaping state and local economies, but they can be boiled down one underlying principle: the level of economic freedom enjoyed by citizens within a government's borders.

- ★ Availability of incentives
- ★ Transportation infrastructure
- ★ State and local economic development strategy
- ★ Flexibility of incentive programs
- ★ Higher education resources
- ★ Union activity

There are many factors involved in shaping state and local economies, but they can be boiled down one underlying principle: the level of economic freedom enjoyed by citizens within a government's borders.

Gwartney, et al explain that "individuals have economic freedom when (a) property they acquire without the use of force, fraud, or theft is protected from physical invasions by others and (b) they are free to use, exchange, or give their property as long as their actions do not violate the identical rights of others" (Gwartney, Lawson, and Block 1996, 12).

The close connection between economic freedom and economic prosperity is well documented.

De Haan and Sturm (2000, 19) show that positive and negative changes in economic freedom lead to positive and negative changes in rates of economic growth. Karabegović & McMahon (2007, 10) say that "research has found that economic freedom is positively correlated with per-capita income, economic growth, greater life expectancy, lower child mortality, the development of democratic institutions, civil and political freedoms, and other desirable social and economic outcomes."

How Texas Ranks

Texas is often criticized by "big government" advocates for ranking below average in government taxes and spending. However, when it comes to evaluating Texas' economy, those lower levels of taxes and spending are listed as reasons for Texas' economic vitality.

For instance, the nine states with no personal income tax significantly outperform the nine states with the highest marginal personal income tax rates in economic indicators such as personal income, population, and non-farm payroll growth (Laffer 2008, 7). Lower government spending as a percentage of GDP is also recognized as a driver of economic growth (Karabegović & McMahon 2007, 7).

A quick survey shows that Texas ranks near the top of the 50 states when it comes to economic growth, economic freedom, and business climate:

Index	ALEC/Laffer	Fraser	Site Selection
Texas' Rank	10	5	3

Comparing Texas with Ohio helps highlight why Texas is doing so well. As *The Wall Street Journal* points out,

Ohio's economy has been struggling for years, and most of its wounds are self-inflicted. Ohio now ranks 47th out of 50 in economic competitiveness, according to the American Legislative Exchange Council. Ohio politicians deplore plant closings even as they impose the third highest corporate income tax in the country (10.5%) and the sixth highest personal income tax (8.87%). A common joke is that Ohio lays out the red carpet for companies—when they leave the state. By contrast, Texas has no income tax, a huge competitive advantage.

Texas v. Ohio

	Texas	Ohio
New Job Creation 1997-2007	1,615,000	-10,400
Net Domestic Migration*	667,000	-362,000
Unemployment Rate December 2007	4.5%	6%
Per Capita Income Growth 1996-2006	55%	43%
Exports 2006 (in bill.)	$150.9	$37.8

* Net increase in state population excluding foreign immigrants
Source: *The Wall Street Journal*

Despite the good news about Texas' economy, there is still plenty of room for improvement. Here are a few of the positives and negatives from the studies cited:

- ★ The lack of a personal income tax and state inheritance tax puts Texas at the top of the economic pack.
- ★ Texas ranks first in *Site Selection's* survey of real estate professionals.
- ★ Employment growth in Texas remains strong, well above the national average.
- ★ The Fraser study says Texas is doing a good job keeping transfers of wealth and subsidies low.
- ★ The state's relatively low minimum wage and right to work status rank Texas high in labor freedom.
- ★ Texas' heavy property tax burden ranks 8th among the states.
- ★ Texas ranks 27th with 559 public employees per 100,000 population.
- ★ A high level of debt service puts Texas at 41st in this category.

Example of the Ranking Process: Texas

(as of January 2008)

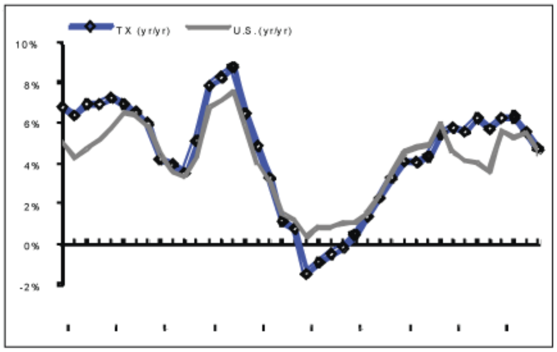
Texas

Economic Performance Rank: **1st** Best

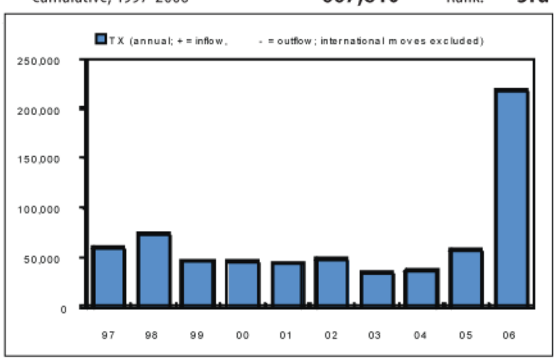
Economic Outlook Rank: **10th** Best

Economic Performance Rank (1=Best, 50=Worst): A backward looking measure based on the state's performance (equal-weighted average) in the three important performance variables shown below.
These variables are highly influenced by state policy.

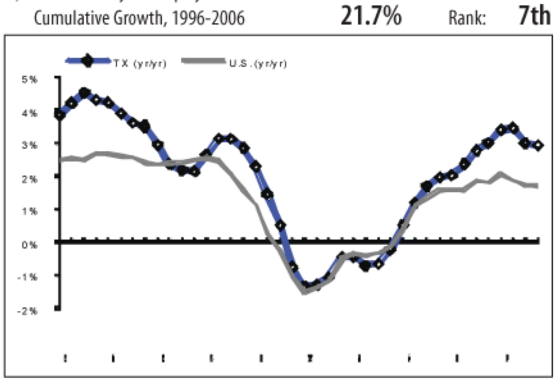
1) Personal Income Per Capita Cumulative Growth, 1996-2006: **55%** Rank: **12th**



2) Absolute Domestic Migration, Cumulative, 1997-2006: **667,810** Rank: **3rd**



3) Non-farm Payroll Employment Cumulative Growth, 1996-2006: **21.7%** Rank: **7th**



Economic Outlook Rank (1=Best, 50=Worst): A forward looking forcast based on the state's standing (equal-weighted average) in the 16 important state policy variables shown below. Data reflect state + local rates and revenues and any effect of federal deductability.

1) Top Marginal Personal Income Tax Rate:	0.00%	Rank:	1st
2) Top Marginal Corporate Income Tax Rate:	4.50%	Rank:	6th
3) Personal Income Tax Progressivity: (change in tax liability per $1,000 income)	$0.00	Rank:	2nd
4) Property Tax Burden: (per $1,000 of personal income)	$42.13	Rank:	42nd
5) Sales Tax Burden: (per $1,000 of personal income)	$28.64	Rank:	34th
6) Remaining Tax Burden: (per $1,000 of personal income)	$20.36	Rank:	31st
7) Estate/Inheritance Tax Levied?:	No	Rank:	1st
8) Recent Legislated Tax Changes: (2005 and 2006, per $1,000 of personal income)	-$4.13	Rank:	3rd
9) Debt Service as a % of Total Tax Revenue:	10.7%	Rank:	41st
10) Public Employees Per 10,000 of Population (full-time equivalent)	559.4	Rank:	27th
11) State Liability System Survey: (tortlitigation treatment, judicial impartiality, etc.)	54.3	Rank:	44th
12) State Minimum Wage: (Federal Floor is $5.85)	$5.85	Rank:	1st
13) Ave. Workers' Compensation Costs: (per $100 of payroll)	$2.84	Rank:	35th
14) Right-To-Work State: (optional joining or supporting of a union)	Yes	Rank:	1st
15) Number of Tax Expenditure Limits: (0=least/worst, 3= most/best)	1	Rank:	13th
16) Education Freedom Index Score: (vouchers, ease of private/home schooling)	2.32	Rank:	7th

Source: Arduin, Laffer & Moore Econometrics

The rest of this paper examines Texas' performance in several areas that impact economic growth to see how the state is doing and how it can improve.

Taxes

The Tax Foundation (2007) found that Texas has the 43rd lowest state and local tax burden in the U.S. In other words, only seven states in 2007 had lower state and local tax burdens than Texas. However, these findings do not include the increased revenue that is being generated from the newly created margins tax on businesses.

The Margins Tax

The new margins tax is actually a revision to the state's franchise tax that was part of an effort to reduce property taxes. It will affect 200,000 more businesses than the old franchise tax, and has a 0.5 percent tax rate for retailers and wholesalers and 1.0 percent for all other businesses. Businesses are taxed on the lowest amount of: 1) 70 percent of total revenue, 2) total revenue minus total cost of goods, or 3) total revenue minus total compensation and benefits. Over the next two years, the new business tax is estimated to raise almost $12 billion in revenue—more than twice the amount raised by the old franchise tax. Texas is the only state in the nation with this type of tax.

One of the challenges of the margins tax is its impact on small business. Many small businesses that never had to pay the franchise tax will have to pay the new margins tax. Others who did have to pay under the old tax area now seeing their tax liabilities increase significantly. Wilma Peters and her husband own Peters Truckline, which boasts 14 trucks and 15 employees. She says the new margins tax will increase their tax liability from $2,000 to $10,000 (NFIB Texas 2008, 2).

Since the tax applies to all business transactions, including intermediate purchases of goods necessary in the production process, goods are taxed multiple times. This tax cascading creates distortions in the marketplace by raising the end price of a product beyond what would be paid if the good was only taxed once when it was consumed. Although no taxes are desirable, the best tax is one that creates the least harm to the economy and does not significantly influence consumer decisions.

Tax cascading also violates one of the virtues of any well-designed tax, transparency. When a business is taxed, those costs are always passed on to shareholders, employees, or consumers. Because the margins tax is assessed at multiple levels in the production process, its tax incidence is difficult to discern. This is good for tax collectors who wish to remain anonymous, but bad for consumers who can't understand why the prices of products are increasing, or for employees who don't know why their wages are not increasing like it once did.

The Sales Tax

For over two decades, Texas has relied heavily on the sales tax to fund state and local government. The sales tax is an important revenue source that offers a number of unique advantages to both taxpayers and government, including simplicity, transparency, equality, and minimal market distortions.

A conventional sales tax only charges the end-user, making the system relatively simple to administer. Businesses are only required to add state and local taxes to the goods or services being purchased and then turn the proceeds over to government. This minimizes the need for state involvement and frees business owners from otherwise time consuming paperwork. Since only the end user bears the cost, tax cascading is also avoided by the sales tax.

Consumers also benefit from the tax system's transparency. After each purchase, every consumer is provided with a receipt that clearly shows the amount of tax paid in addition to the price of the actual good. Tax manipulation without public knowledge is virtually impossible, meaning that "stealth" government growth cannot occur.

The Property Tax

In fiscal year 2006, 60 percent of the total local tax levy consisted of the school property tax, for a total of nearly $21 billion—almost 4 percent higher compared to the previous fiscal year.

Texas property owners anxiously await the arrival of the 81st Texas Legislature to see how lawmakers can provide further property tax relief. Even though property taxes have always been a "hot-button" issue in Texas, steady increases in property values and tax rates have made this subject particularly pressing this biennium. School property taxes generally represent the bulk of property tax bills with county, city, and special taxing units collecting the rest.

Property taxes collected by the city, county, and special taxing units have a rational basis in that property ownership can be directly related to a demand for services from these entities. However, property taxes for education have less of a rational basis because the value of real property owned bears little relationship to the demand for education services.

For these reasons—the rising school property tax burden, the lack of a rational link between school property taxes and educational services, and the constitutional complexities surrounding the school property tax—many believe it is time to dramatically reduce, if not eliminate, school property taxes.

Previous estimates have determined that if growth in state-funded expenditures were limited to the sum of population growth and inflation, and if school expenditures were similarly limited, the school M&O property tax could be reduced to zero within two decades. This could be accomplished even more quickly using future surplus windfalls for property tax reduction.

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Spending

Even though Texas has been running a budget surplus for several years, some critics argue that Texas' tax system has not kept pace with the growing needs of its citizens—and they are partly right. Unbridled state expenditures will always grow faster than revenues from even the best-designed tax systems. From the critics' perspective, Texas doesn't have a revenue problem, so much as it has a spending problem—we aren't spending enough to satisfy them. However, the path of profligate spending is a dangerous one—controlling government spending is critical to maintaining both a healthy economy and a reasonable tax system. And Texas is doing pretty well at restraining spending. It is 41st among the 50 states in per capita spending (Karabegović & McMahon 2007, 36).

The Budget Surplus

Last session, the Texas Legislature had a record $14 billion budget surplus on its hands—a tempting pot of money for appropriators. Sure enough, some of that money went to increase Medicaid spending caused by the repeal of sensible reforms put in place in 2003. Some did also for property tax relief, but about $7 billion was left in state coffers for 2009 to "ensure available funds to balance the budget, continue local school property tax cuts, and provide Texans with the services they deserve."

Next biennium's surplus is looking to again be in the neighborhood of $10 to $15 billion. The cost of property tax reduction to the state should run around

$6.75 billion next year, leaving $3 to $7 billion on the table. The problem is that instead of being returned to taxpayers, that money might be used to "provide Texans with the services they deserve." This is because there is no automatic process in statute for returning budget surpluses to the taxpayers.

Tax and Expenditure Limitations

Texas' constitutional spending limit works by limiting the growth of non-dedicated tax revenue to the growth of total personal income, except in emergencies. Revenue from other sources—federal funds and non-tax proceeds (i.e., fees, fines, etc.)—does not count towards the TEL, and spending from these funds can increase freely. Since non-dedicated tax revenue represents only about half of all state expenditures, the TEL's original intent to limit total state spending has never been fully realized.

Basing the state-spending limit on projected total personal income growth is another area of weakness in the current TEL. By "dividing the estimated Texas total personal income for the next biennium by the estimated Texas total personal income for the current biennium," the LBB projects the state's rate of growth to determine the maximum amount the Legislature can spend. Allowing state appropriations to increase based on these figures has meant that spending has doubled every decade since 1978. A more responsible alternative would be to limit state spending to the sum of population and inflation growth.

In addition to its design flaws, the constitutional spending limit has failed to control government spending because it is often ignored or "emergencies" are declared to avoid it. Since there are no provisions allowing lawmakers to look back at the accuracy of the adopted growth rate and make adjustments when the rate adopted was higher than actual growth, many simply disregard the statute altogether.

Thirty states currently have some form of tax and spending limit used to control government spending. Of these, Colorado's Taxpayer Bill of Rights (TABOR) has been the most successful in limiting the growth of government and encouraging private investment. The sustained growth of Colorado's economy under TABOR has demonstrated what a state can accomplish when it prioritizes its spending habits. Texas should adopt stricter expenditure limits on both state and local governments.

Energy and the Environment

As the nation deals with high energy prices, how to achieve a reliable supply of affordable energy is a highly debated topic. Proposed and enacted solutions run from higher taxes and subsidies to mandated production from renewable sources such as wind, ethanol, and biomass. However, these all miss the mark. A long-term solution for securing affordable, reliable energy supplies must rely on market-based innovations and a proper understanding of our current situation.

Texas has prospered in recent years as its population and economy have grown. One reason for Texas' economic progress is the reliable and affordable supply of electricity available to meet the state's growing energy needs. Thus continued economic growth, and the prosperity it brings and spreads, relies upon continued growth in available power.

Texas' deregulated electricity market—the most competitive in the United States—provides Texas with the infrastructure to meet this needed increase in energy supplies. However, environmental and market regulations, as well as mandates and subsidies for alternate energy sources, threaten to push energy prices in Texas even higher. This could have a disastrous effect on the Texas economy.

The largest potential increase in energy costs comes from global warming regulations. The U.S. EPA predicts that passage of Lieberman-Warner or similar legislation would result in a reduction of GDP up to 3.8 percent by 2030 and 6.9 percent by 2050. Texas would undergo more economic loss than any other state. In production and use, Texas is

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the most energy intensive state. Texans would experience a decrease in disposable household income per year of $1,044-$3,384 by 2020 and $4,395-$8,015 by 2030 (Kathleen Hartnett White 2008, 1).

There are also challenges here at home. Some people blame deregulation for high electricity prices, but it is important to remember that high electricity prices are not unique to Texas, or even the United States. In addition, Texas is highly dependent for electricity generated by expensive natural gas. If calls for re-regulation prevail, Texans would face a future of both higher energy prices and less reliable energy supplies.

This is also the likely scenario if Texas doesn't build more generation plants fired by coal and nuclear energy. Only coal and nuclear can deliver the amount of reliable, inexpensive power Texas residents and businesses desire. While coal-fired power plants have environmental impacts—as do all forms of electricity production—these impacts are not a threat to human health or the environment. This can be seen from the fact that from 1980 to 2005, even as coal consumption increased more than 60 percent and driving nearly doubled, air pollution of all kinds sharply declined. Polls show most Americans are unaware of this astounding progress.

Other forms of generation that might be used in the place of coal and nuclear power are more expensive, and—except for natural gas—also more unreliable. For example, wind blows intermittently and is not generally available during times of peak loads, so it cannot be used for base load or peaking capacity. Yet, Texas consumers are being asked to subsidize wind generation at a cost that could exceed $7 billion dollars.

To maintain a strong economy, Texas needs to move forward with its newly deregulated electricity markets, eliminate mandates and subsidies for generation technologies that can't compete in the marketplace, and reduce ever-increasing environmental standards that do little to improve the quality of the environment but do much to decrease our standard of living.

Regulation and Government Intervention

Milton Friedman once said, "Many people want the government to protect the consumer. A much more urgent problem is to protect the consumer from the government."

When trying to understand Friedman's sentiments, an obvious place to start is the differing incentives faced by those in the private sector and those in the public sector. An entrepreneur in the marketplace has to satisfy his customers, because they voluntarily give him their money in exchange for his goods or services. If his product is shoddy, or if his employees are surly, he will lose business. In contrast, a government agency gets its money from the legislature, and ultimately from the taxpayers. It's true that citizens direct government policy by periodically casting votes, but the connection between customer and provider is much more tenuous in the public sector.

We see that the private market and the government sector have very different institutional frameworks and incentives. This explains why government intervention in the market so often fails to achieve its ostensible goals. The voluntary private arrangement, where all parties benefit, is replaced with a coercive arrangement where a third party imposes its own rules on the interactions. It's no wonder that government intervention leads to higher costs, lower quality, and unintended consequences.

Homeowners' Insurance

A perfect example of this is policy form regulation in the Texas homeowners' insurance market. In 1997, the Texas Legislature passed SB 1449, which allowed the commissioner to "adopt policy forms and endorsements of national insurers or policy forms and endorsements adopted by a national organization of insurance companies or similar organization on policy forms and endorsements" in place of state-promulgated forms and endorsements. However, TDI did not adopt any national policy forms under this provision until 2002.

In the meantime, the Texas mold crisis began to unfold following a 1999 lawsuit that resulted in a court finding that TDI's standard form required insurers to cover mold claims. With companies unable to use national forms, mold claims under the state-mandated form grew from 1,050 in the first quarter of 2000 to 14,706 in the fourth quarter of 2001. The average cost of mold claims per policyholder per year increased from $24.32 in 1999 to $300.50 at the end of 2001, having peaked in the third quarter at $444.35. Consequently, premiums rapidly increased, though not nearly as fast as claims. In 2001-02, premiums increased over 40 percent.

All of this was due to three things: 1) incorrect judicial interpretation of the standard homeowners' form, 2) a feeding frenzy of lawsuit abuse following the first lawsuit, and, ultimately, 3) TDI's belated implementation of SB 1449.

A comparison of premium increases during this time to national premiums reveals that the overregulation of forms from 2001 to 2005—in an attempt to protect consumers—actually cost consumers around $900 million dollars in increased premiums (Thornley and Peacock 2008, 22).

Price Controls

In 1981, the U.S. still had in place remnants of the Nixon/Ford wage and price controls in the form of wellhead price controls (in which Americans were forbidden from paying U.S. oil producers the same price that they were allowed to pay foreign oil producers), an excess profits tax on oil companies, and gasoline rationing.

As so often happens, government intervention in the oil market achieved the exact opposite of its intentions. The price controls on crude oil paradoxically kept oil more expensive than it otherwise would have been. First, we must understand that the controls only directly affected American oil producers—after all, if the U.S. government decreed that foreign producers received less than the prevailing world price when selling oil to Americans, the foreign producers would've simply shipped their oil exports elsewhere. What the price controls did achieve was a reduction in the profit earned by U.S. producers per barrel of oil. As with any industry, an artificial cap on prices stifled supply. Consequently, total world oil production was lower than it otherwise would have been, and the world price of oil was higher than it otherwise would have been.

The removal of price controls in 1981 on oil led to lower oil prices. Critics considered it a huge giveaway to the oil companies, and predicted skyrocketing prices. But in December 1980 (one month before the full decontrol), average acquisition costs for imported crude were $35.63 per barrel. By December 1983 they had fallen to $29.30, and by December 1986 they had collapsed to $14.17 per barrel. Apparently, deregulated markets (along with big tax rate cuts) achieved what price controls could not.

Subsidies

The mass subsidy of corn-based ethanol is a perfect example of the problems with subsidies. For years, Congress has been ignoring what market prices have been telling them about ethanol—it is too costly to be a substitute or additive for gasoline. Yet Congress has continued to increase subsidies and has mandated use of ethanol in an attempt to lessen air pollution and our dependence on foreign oil.

Only now are the results of this push becoming readily apparent. Corn prices have skyrocketed as the demand for corn increased. At first this was felt mostly by those who depend on corn tortillas as a food staple, and large protest marches were set off in Mexico City when the price of tortillas doubled. But now the higher prices are being noticed here at home. The increased price of animal feed is leading to higher prices for poultry, pork and eggs. Soft drinks, which rely on corn syrup, shouldn't bear behind.

Another result of the ethanol policies is that the increased production of corn is putting heavy pressure on water supplies throughout the Midwest and West. The National Academy of Sciences reported that "in some areas of the country, water resources are already significantly stressed. . . . Increased biofuels production will likely add pressure to the water management challenges the nation already faces." Environmentalists, many of whom were early proponents of subsidies, are now second-guessing themselves and the policies.

We haven't quite learned the lesson about subsidies here in Texas. Expensive renewable energy, particularly wind, is being supported through both mandated production and subsidies. The subsidies come in the form of a federal tax credit, Texas' renewable energy credits, and the building of transmission lines for wind-generated electricity out to West Texas through the CREZ process. The state subsidies alone could cost Texas consumers more than $7 billion—all for an unreliable source of energy that usually isn't available when it is needed most.

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About the Authors

Bill Peacock is the vice president of administration and director of the Texas Public Policy Foundation's Center for Economic Freedom. He has been with the Foundation since February 2005.

Bill has extensive experience in Texas government and policy on a variety of issues, including economic and regulatory policy, natural resources, public finance and public education. His work has focused on identifying and reducing the harmful effects of regulations on the economy, businesses and consumers.

The Honorable Talmadge Heflin is the Director of the Texas Public Policy Foundation's Center for Fiscal Policy.

For 11 terms, Talmadge served the people of Harris County as a state representative. Well regarded as a legislative leader on budget and tax issues by Democratic and Republican speakers alike, he for several terms was the only House member to serve on both the Ways and Means and Appropriations committees. In the 78th Session, Talmadge served as chairman of the House Committee on Appropriations. He navigated a $10 billion state budget shortfall through targeted spending cuts that allowed Texans to avoid a tax increase.

About *Influential Issues*

Influential Issues is a series of papers by the Texas Public Policy Foundation designed to address topics that are driving today's public debate on Texas policy concerns.

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