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Testimony

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Center for Economic Freedom

Economic Development—Texas Style

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A state that keeps its taxes low and overregulation at bay is one that fosters economic development. On the other hand, a state that plows its cash into economic development programs and government spending is one whose businesses and citizens will soon be leaving for greener pastures.

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Mr. Chairman, members. Thank you for having me here today. My name is Bill Peacock. I am the Vice President of Research and the director of the Center for Economic Freedom at the Texas Public Policy Foundation. I appreciate the opportunity to testify on Interim Charges #2 and #5:

> **Interim Charge #2:** Examine ways to keep Texas' workforce and economy competitive. Determine how Texas can enhance its competitiveness in a strategic manner, including bringing new jobs to Texas.
>
> **Interim Charge #5:** Analyze the awards that have been granted under the Texas Enterprise Fund and Emerging Technology Fund and determine how these awards have impacted job creation, capital investment, and economic development in the state.

There are two schools of thought when it comes to economic development. One—let's call it the traditional school—is focused on subsidizing businesses using taxpayer's money. This approach uses grants, loans, tax abatements, economic development sales tax funds, etc., to lure business into coming or staying in a particular location.

The other approach—let's call it the free-market school—seeks to bring and keep businesses in a state by providing the best economic climate for people to live, work, and do business. It keeps taxes low, keeps regulations at a minimum, and generally tries to keep government out of people's lives—unless it belongs there. One might also call this the Texas approach.

For years, the Texas approach has been much maligned. Texas' ranking of 49th in this measure and 50th in that measure of government spending has not been favorably received in the press and other quarters. Yet the approach is paying off as Texas had led the nation for a decade now in economic performance and job creation.

I understand that the hearing today is focused not on overall state tax and spending policy, but on a subset known as economic development policy. Yet I hope to show that the two are actually one in the same. A state that keeps its taxes low and overregulation at bay is one that fosters economic development. On the other hand, a state that plows its cash into economic development programs and government spending is one whose businesses and citizens will soon be leaving for greener pastures.

Those that call for Texas to offer grants, loans, and tax abatements to businesses are correct when they say we need to provide the proper incentives to get business to locate and stay in Texas. But they get the incentives all wrong. The incentive that keeps jobs coming to Texas—I might note here that we recently surpassed both New York and California as the home to the most Fortune 500 companies—is the low tax and regulatory climate in Texas that has become unique among the United States' most populous states.

The Texas Approach: Market-based Economic Development

According to the Commonwealth Foundation, Texas ranks 37th in the nation in per capita spending on economic development.[1] This isn't a surprise when we look at other spending categories—Texas tends to rank low on spending when compared to other states. Yet Texas also ranks high when it comes to economic performance. This highlights the difference in the two approaches to economic development.

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Table 1: The Texas Approach: Economic Development Incentive Indicators*

Incentive Indicator	50 State Rank	Source
Property Tax Burden	10	Rich States, Poor States
Federal R&D Spending	20	Development Report Card for the States
Sales Tax Burden	23	Rich States, Poor States
Businesses Created via University R&D	24	Development Report Card for the States
SBIC Financing	26	Development Report Card for the States
SBIR Grants	26	Development Report Card for the States
Grad Students in Science & Engineering	27	Development Report Card for the States
Affordable Urban Housing	30	Development Report Card for the States
Ph.D. Science & Engineers	30	Development Report Card for the States
Health Care Spending per capita	30	StateMaster.com
Four Year Degrees	35	CFED Assets and Opportunities Scorecard
EcoDevo spending per capita	37	Commonwealth Foundation
Corporate Tax Rate	40	Rich States, Poor States
Regulatory Climate	40	Forbes: The Best States For Business
Head Start Coverage	49	CFED Assets and Opportunities Scorecard
State Spending per capita	50	Kaiser State Health Facts
Health Insurance Uninsured Rate	50	CFED Assets and Opportunities Scorecard
Personal Income Tax Rate	50	Rich States, Poor States
Estate/Inheritance Tax	50	Rich States, Poor States
State Minimum Wage	50	Rich States, Poor States
Right-to-Work State	50	Rich States, Poor States
Total Tax Burden	50	StateMaster.com

Table 1 is a cross section of indicators that shows the general approach that Texas takes when providing incentives for economic development. For instance, Texas ranks in the middle of the pack (24) when it comes to businesses created via research and development efforts in the state's universities. Neither are we overly concerned when it comes to federal research and development funds (20). Texas doesn't rely heavily on Small Business Administration grants (26), and again ranks in the lower end of overall economic development spending (37).

Of course, these incentives all cost money. Taxpayer money. So a major reason for these lower levels of spending and emphasis on government incentives is that Texas doesn't tax it citizens a high enough levels to find itself in the top tiers of those states that look to government-based incentives to spur economic development.

Economic Development Spending

Table 2 shows that a state's approach to economic development spending has an economic impact quite similar to a state's macroeconomic tax policy. On the macro side, states that have lower state and local tax burdens and lower taxes have higher job growth, income growth, and population growth than their high tax and spend counterparts. And vice versa. The same is true for states when it comes to economic development spending. Those states that spend a lot on economic develop programs tend to have lower job growth, lower income growth, and lower population growth. Government spending always has this effect, no matter how targeted it might be.

The link between high economic development spending and macroeconomic policy could also be because states that spend a lot of money on economic develop also tend to be the ones that spend a lot of money overall. **Table 3** lays out the relationship between states that have high economic development spending and high overall spending. Four of the top five in overall spending are also in the top five when it comes to development spending. The top five economic development states averaged $10,416 in total state per capita spending. While the bottom five states in economic development spending averaged only $3,970.

* Texas' personal income tax rate (0%), inheritance tax rate (0%), state minimum wage ($0.00), and its right-to-work status place it in a tie for last place with various other states who share some or all of those characteristics.

Table 2: Impact of State's Fiscal Policy on Economic Growth				
		Economic Growth 2003-2007		
State Economic Policy		**Job Growth**	**Income Growth**	**Population Growth**
State Economic Development Spending	Lowest States per capita	10.7%	36.6%	7.9%
	Highest States per capita	7.0%	30.0%	3.2%
State & Local Tax Burdens	Lowest States per capita	11.0%	38.0%	7.4%
	Highest States per capita	4.3%	28.3%	1.9%
Change in Tax Policy	Tax Cutting States	12.6%	39.1%	9.4%
	Tax Raising States	5.0%	29.4%	4.0%

Source: Commonwealth Foundation; Tax Foundation; The Council for Community and Economic Research

Table 3: Correlation of Economic Development Spending and Total State Spending – 2008

State	Economic Development Spending per capita (50 state rank)	Total Spending per capita (50 state rank)	Total State Spending per capita ($)	
Alaska	1	1	17,907	
Hawaii	2	5	8,668	
Wyoming	3	4	9,302	
Arkansas	4	16	5,893	
West Virginia	5	2	10,309	**Top 5 Avg.: $10,416**
Florida	46	49	3,494	
Nebraska	47	29	4,889	
Idaho	48	41	3,882	
Indiana	49	43	3,794	
Georgia	50	44	3,791	**Bottom 5 Avg.: $3,970**

Sources: Commonwealth Foundation; Kaiser State Health Facts

Measuring the Texas Approach

Of course, Texas' approach to economic development must work not only in theory, but in practice as well. And by most measures, it works well. Very well.

For instance, the reason Texas doesn't have to worry about its lack of effort to spur new businesses through government-funded R&D is because it ranks fourth among the states when it comes to job creation from startup businesses. Texas' employment growth is 4th in the country, thanks in large part to its high ranking in fast-growing private companies and the 64 Fortune 500 companies headquartered here.

However, there is more to the Texas economic miracle than just the number of jobs here. One aspect in particular that stands out is how affordable it is to live in Texas. For instance, the average annual pay in Texas ranks second in the country when adjusted for the cost-of-living here—which is much cheaper than any other major state. Additionally, Texas homes are the 5th most affordable in the country.

One reason Texas is more affordable than, say, New York, is demand—we don't have 1.6 million trying to squeeze into the 23 square miles of Manhattan; but there are two sides to that equation. Manhattan's population density

Table 4: Market-based Measures of the Texas Approach

Measurement	50 State Rank	Source
Fortune 500 Companies	1	Fortune
2009 State Economic Performance	1	Rich States, Poor States
Best States to Do Business	1	Chief Executive.net
Average Annual Pay, Adjusted for COL	2	CFED Assets and Opportunities Scorecard
Fastest-growing Private Companies	2	Inc.
Employment Growth %	4	CNN
Job Creation by Start up Businesses	4	Development Report Card for the States
Affordability of Homes	5	CFED Assets and Opportunities Scorecard
Homeownership Equity by Race	7	CFED Assets and Opportunities Scorecard
Foreclosure Rate	10	CFED Assets and Opportunities Scorecard
Microenterprise Ownership Rate	11	CFED Assets and Opportunities Scorecard
Minority Ownership Business Rate	11	CFED Assets and Opportunities Scorecard
Bankruptcy Rate	12	CFED Assets and Opportunities Scorecard
Out-of-Pocket Medical Expenses	13	CFED Assets and Opportunities Scorecard
Unemployment Rate	19	Bureau of Labor Statistics
Foreclosure Rate	22	RealtyTrac

reached its peak in 1910. Part of the problem with the high cost of living in Manhattan today—and elsewhere—is the supply of housing. And that is where regulations play a role.

While Texas isn't the only state with lots of land, it is one of the few that doesn't make most of its land unavailable to new development through heavy zoning, smart growth, and other regulatory restrictions. The same is true for regulations on business. For instance, the Mercatus Center at George Mason University ranks Texas 5th in overall freedom. Forbes says that Texas has the 10th best regulatory climate in the nation.

Standing Alone Among the Most Populous States

While Texas measures up well no matter how one looks at the numbers, there are other states that compare favorable in some areas. For instance, Texas' unemployment rate is only 19th best. Yet every state with a better unemployment rate is a much smaller state. Texas—and the Texas approach—stand out among all the top 10 most populous states. **Table 5** shows why.

Texas' job creation over the last decade dwarfs every other major state. At 11.02 percent, it is more than three times as high as second place Florida's 3.02 percent. New York and Pennsylvania come in at 1.41 percent and .05 percent, respectively. And that is it. The other six most populous states have all had negative job growth since 2000.

Table 5: Ten Most Populous States: Economic Performance and Incentive Indicators

State	10 Year Job Growth %: 2000 - 2009	Laffer Economic Performance 1997-2007	Mercatus Freedom Rank	Total State Tax Burden per capita	State EcoDevo Spending per capita	Total State Spending per capita (2008)
Texas	11.02%	1	5	50	37	50
Florida	3.02%	2	22	36	46	49
New York	1.41%	43	50	11	31	15
Pennsylvania	0.05%	46	20	20	13	31
North Carolina	-1.58%	23	23	29	45	37
California	-2.61%	27	47	9	44	24
Georgia	-3.49%	20	17	42	50	44
Illinois	-6.33%	48	42	25	38	45
Ohio	-10.22%	49	38	27	9	28
Michigan	-17.31%	50	14	10	24	38

Similarly, Texas overall economic performance stands out in this group. Texas is ranked the number one performing state—regardless of size—from 1997-2007 in the Laffer Economic Performance Index. And while Florida ranks second, every other large state ranks in the middle or at the bottom of the list—with Michigan coming in dead last.

At least for the time being, Texas stands alone among its top economic competitors. And it is easy to see why. The others all have higher—generally much higher—levels of taxes and spending—and regulation. While Florida and Georgia are significantly better than the rest of the ten, they still fall far behind Texas.

Renewable Energy and Green Jobs: How to Harm Economic Development in Texas

Texas is not without its traditional economic development programs. Tops among them are the Emerging Technology Fund and the Enterprise Fund. There are also local economic development corporations and tax increment financing districts. All of these suffer from the problems already laid out in this testimony.

A new type of economic development, however, has taken hold in Texas, that may ultimately cost Texans more jobs and more money than all of the traditional programs combined. This new economic development focus is on renewable energy and green jobs.

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For instance, through a combination of good wind and heavy subsidies, Texas has become the number one wind-producing state of electricity. And studies have shown that many areas of West Texas have benefitted from this effort. But the Foundation's own research has also shown that these benefits are generally a transfer of wealth from Texas electricity consumers to the school districts, local governments, and property owners in West Texas of over $20 billion dollars through 2025.[2]

Now non-wind producers are trying to get their share of the economic development pie. Proposals from the 2009 legislative session and others currently under discussion at the Texas Public Utility Commission would mandate purchase of renewable energy generation from non-wind sources, such as biomass, solar, and geothermal. Some of these proposals would create a distributed solar generation program, which requires retail electric providers to purchase electricity generated by small- and utility-scale solar generation.

While wind energy is expensive, biomass and solar costs are astronomical. Most electricity can be profitably brought to market today for $0.12/kWh or less. Distributed solar generation will run closer to $0.28/kWh. Utility-scale solar is only slightly less. The difference between these costs will be made up through subsidies by electricity customers and taxpayers.

Solar is already the most subsidized energy source at around $24/MWh. The most expensive proposals from the last legislative session would have required subsidies of up to $220 million a year from residential consumers alone to make these solar and biomass programs work.

Energy efficiency mandates are another source of current and future increased costs to Texas consumers. Several proposals were floated last session that would have cost electricity customers as much as $426 million per year. Now, the Texas Public Utility Commission is in the midst of a rulemaking that would expand Texas' energy efficiency program.

Actual expenses for the current program in 2008 were at least $57.9 million, and projected expenses for 2010—not including the cost of expansion—are $105 million. These costs are paid for by residential and commercial electricity consumers.

Direct subsidies for green jobs have similar detrimental impacts on the economy, taxpayers, and consumers. **Table 6** shows information about four companies that have probably chosen

The renewable energy and green jobs push highlight the ultimate problem with the traditional economic development approach. They are all based on taking small amounts of money from a large group of people—in this case electricity customers—and transferring them to another, smaller group. It might be a school district in West Texas that receives more tax revenue because of a new wind farm. Or it might be the homeowner who benefits from a zero-interest loan to purchase a new air conditioner.

Table 6: Green Companies Choosing Other States Over Texas

	Xtreme Power Inc. & Clairvoyant Energy Inc.	GlobalWatt	Suntech Co.	Yingli Americas Inc.
Proposed Project	renewable energy park -manufacturing energy-storage systems (Xtreme Power Inc.) - 90MW production line (Clairvoyant Energy Inc.)	production line for crystalline silicon solar panels	assembly factory for solar panels	photovoltaic panel plant
Proposed Facility	idle 320-acre Ford Motor Co. automotive assembly plant	vacant 74,000 sq. ft. Enterprise Automotive Systems	existing building	unknown
Company Investment	$475.4 million	$177 million	$10-$15 million	$19.8 million
New Jobs	2,770	500	75	300
Federal Subsidies	unknown	unknown	$2.1 million	$4.5 million
State Subsidies	$106 million (Xtreme Power Inc.) $31.2 million (Clairvoyant Energy Inc.)	$14 million	$1-$1.5 million	unknown
Local Subsidies	unknown	$13 million	$500,000	unknown
Location	Wixon, Michigan	Saginaw, Michigan	Goodyear, Arizona	Phoenix, Arizona or Texas

The same mechanism is at work with green jobs. Table 6 provides information on four green companies that have or seem likely to choose Arizona or Michigan over Texas for the location of new facilities related to the solar energy industry. Much has been made of this, that Texas has been the loser in the competition for these businesses. Yet it is hard to classify Texas as a loser when comparing its economy to that of either Arizona or Michigan.

Even if Texas would have "won" these competitions, it would have meant more subsidies for these companies at the expense of consumers and taxpayers. And likely not just direct subsidies as listed in the table. If the renewable energy subsidies for solar discussed above become law, then these companies would be the beneficiary of even greater subsidies. And all of these would have the negative impact on the Texas economy already demonstrated.

Renewable energy/energy efficiency mandates and green jobs initiatives don't create new jobs—they just transfer them—inefficiently—from one market sector to another.

Corporate subsidies—no matter how they are packaged—don't develop the economy. Instead, they deny the wishes of consumers by redirecting money from a more productive sector of the economy to a less productive sector.

This is why the only way to truly grow an economy is the Texas way of low taxes and less regulation where entrepreneurs, investors, workers, and consumers can work together through the market place to create new jobs and grow the Texas economy. ☆

[1] Nathan Benefield, "Six Years of Rendell's Stimulus is Enough," Commonwealth Foundation (Jan. 2009).

[2] Bill Peacock, "The True Cost of Wind Energy, Texas Public Policy Foundation (Nov. 2008) http://www.texaspolicy.com/pdf/ 2008-10-PP18-true-costofwind-bp.pdf.

About the Author

Bill Peacock is the Vice President of Research 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.

Prior to joining the Foundation, Bill served as the Deputy Commissioner for Coastal Resources for Commissioner Jerry Patterson at the Texas General Land Office. Before he worked at the GLO, Bill was a legislative and media consultant. He has also served as the Deputy Assistant Commissioner for Intergovernmental Affairs for then-Commissioner Rick Perry at the Texas Department of Agriculture and as a legislative aide to then-State Rep. John Culberson.

Bill has a B.A. in History from the University of Northern Colorado and a M.B.A. with an emphasis in public finance from the University of Houston.

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The Foundation's mission is to promote and defend liberty, personal responsibility, and free enterprise in Texas by educating and affecting policymakers and the Texas public policy debate with academically sound research and outreach. Our goal is to lead the nation in public policy issues by using Texas as a model for reform.

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.

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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.

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