

Texas Public Policy Foundation

# Competitive States

## Texas vs. California 2010

*Economic Growth Prospects for the 21st Century*

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Arduin, Laffer & Moore Econometrics*



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October 2010



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# Competitive States 2010

## TEXAS vs. CALIFORNIA

### Economic Growth Prospects for the 21st Century

#### EXECUTIVE SUMMARY

Even amid the country's worst economic setback in decades, our updated analysis shows that Texas' competitive edge over California remains sharp. This paper updates the economic scoreboard we calculated in our study of Texas and California in 2008. Although the policy environment has changed over the last two years, Texas' edge over California has not.

Like the rest of the nation, Texas' economic growth hit a serious speed bump during the great recession. But, its economic decline in the state has been milder than in California and the rest of the country. The Texas economy has been growing stronger, with less negative volatility, than California or the nation overall.

#### State and Local Tax Burden vs. 10-Year Economic Performance

	Tax Burden % PI	Gross State Product Growth	Personal Income Growth	Population Growth	Net Domestic In-Migration as a % of Population	Non-Farm Payroll Employment Growth
Texas	8.40%	94.5%	67.6%	20.5%	3.4%	13.7%
U.S. Average	9.70%	66.34%	65.54%	10.08%	0.80%	10.42%
California	10.50%	70.1%	56.6%	10.3%	-3.9%	2.5%

Texas economic strength can particularly be seen in job creation. According to employment data released last month by the Bureau of Labor Statistics, Texas created 129,000 new jobs in the last year—over one-half of all the new jobs in the U.S. In contrast, California lost 112,000 jobs during the same period.

Texas' most significant competitive advantage over California is that Texas has no income tax where California has a steeply progressive income tax. Texas' appropriate level of government spending relative to the income of Texans is another competitive advantage that keeps its economy strong. Finally, the lighter regulatory burden in Texas also helps its economy flourish in comparison to California.

Our study shows that it is these Texas policies of relatively low taxes, low spending, and less regulation that have helped the Lone Star State weather the Great Recession better than California and the nation as a whole.

Unlike the complicated policy prescriptions coming out of Sacramento and Washington, D.C., Texas has proven that keeping the tax, spending, and regulatory burdens low—and staying away from the personal income tax—is a simple remedy

to the economic malaise afflicting our nation. As we show later in the paper, the states that do this the best far outperform the rest of the country in almost every economic measure.

However, Texas could be passed by others if it simply relies on its past record; its competitive advantages could disappear absent decisive and principled responses to its challenges and competitors.

Texas' pending budget shortfall provides such a challenge. For the third time in 20 years, Texas faces the increased spending burden (state spending relative to the state economy) that generally occurs in the wake of recessions. To meet this challenge and avoid California's path toward overspending and economic decline, the Texas Legislature in 2011 must ensure that Texas maintains its long run trend of controlled government spending.

To meet this challenge, Texas should:







- Balance the 2012-13 budget without raising taxes;
- Reduce its reliance on federal funds;
- Establish stricter tax and expenditure limitations, including limits on property tax growth, that restrict growth in government spending to inflation plus population growth;
- Reduce taxes on capital; and
- Continue to rely on its vibrant private sector to grow its economy by maintaining its relatively sound tax, land use, and environmental policies.

## INTRODUCTION

This paper updates the economic scoreboard we calculated in our study of Texas and California in 2008. Although the policy environment has changed over the last two years, Texas' edge over California has not. Texas' policy report card is superior to California's. Our study shows that the state with the superior pro-growth policy report card achieves superior economic results. This was true in 2008 and it remains true today. Texas' economic performance leads the nation due to the competitive advantages created by its pro-growth policy environment.

Texas has also fared better when it comes to economic volatility. Although Texas has not been spared hardships, the economic recession in the state has been milder than in California and the nation overall.

## THE ECONOMIC SCORECARD: TEXAS VS. CALIFORNIA\*

Competitive Event	California	Texas	Winner
<i>Taxes on Labor</i>			
Top Marginal Personal Income Tax Rate	10.55%	0.00%	
Marginal Personal Income Tax (average income earner)	9.55%	0.00%	
<i>Taxes on Capital</i>			
State and Local Property Tax Burden	\$32.89	\$36.50	
Estate/Inheritance Tax Levied	NO	NO	
Top Marginal Rate: Income, Dividends, and Cap. Gains	10.55%	0.0%	
Top Marginal Corporate Income Tax Rate	8.84%	1% GRT	
<i>Taxes on Consumption</i>			
State Sales Tax Rate	8.25%	6.25%	
Sales and Local General Sales Tax Burden per \$1,000 of Personal Income	\$25.62	\$29.47	
<i>Overall Tax Environment</i>			
Overall Tax Burden	\$115.96	\$94.00	
Personal Income Tax Progressivity	\$36.19	\$0.00	
Recent Legislated Tax Changes per \$1,000 of Personal Income (2008 & 2009)	\$6.19	-\$2.59	
Number of Tax Expenditure Limits	2	1	
<i>Regulatory Environment</i>			
State Liability System (PRI U.S. Tort Liability Index Rank) <sup>1</sup>	27th	2nd	
State Minimum Wage	\$8.00	\$7.25	
Right-to-Work State	NO	YES	
<i>Government Spending Policies</i>			
Total State and Local Expenditures per Capita (2008)	\$11,356.83	\$7,763.49	
Average Growth in State and Local Government Expenditures (2008)	7.29%	7.02%	

Depending upon how tax policies are structured, a state's tax system can exacerbate economic volatility. The evidence shows that Texas' tax environment leads to less overall economic volatility, while California's leads to more overall economic volatility. Texas' most significant competitive advantage over California is that Texas has no income tax where California has a steeply progressive income tax. Progressive income taxes shower riches on states during good times, which

\* For a complete review of the updated scorecard, see Appendix.

are inevitably spent. When hard economic times arrive, progressive income taxes intensify the loss of revenues that naturally occur. The higher spending obligations created during the good times pressure states to raise taxes higher than economically optimal in an attempt to “close the revenue hole.” Because Texas does not suffer from the progressive revenue rollercoaster, its budget and economy have exhibited more stability compared to California, which has one of the most progressive tax systems in the country. Still, Texas business and property tax structures can be improved.

Texas’ appropriate level of government spending relative to the income of Texans is another competitive advantage that helps to keep its economy strong. When a state government consistently spends money in excess of the citizen’s ability to finance that spending (including state spending from federal funds), the state’s economy suffers. Historically, Texas has done a better job of keeping revenues in line with the income of its residents than California. But the Texas economy faces a challenge due to the increased spending burdens that usually follow recessions. Unless the Texas Legislature responds to these challenges by reducing the spending burden, Texas could shift away from its long run trend of controlled government spending and head down California’s path toward overspending and economic weakness.

The lighter regulatory burden in Texas also helps its economy flourish in comparison to California, which overloads businesses in the state with excessive costs and burdens. For instance, some commentators claim that Texas’ economy is currently performing so well due to the abundance of oil in Texas coupled with the high price of oil. But California, which is underperforming the national economy, also possesses an abundance of natural resources—including oil—whose prices are high. Examining the resource riches of both states, this paper debunks the theory that Texas’ current growth is due solely to its energy resources. Instead, we find the lower level of restrictions imposed by Texas on the use of its resources allows Texas to take superior advantage of its resources compared to California and many other states. Once again, Texas is capable of exploiting opportunities—in this case rising oil prices—due to its economic policies.

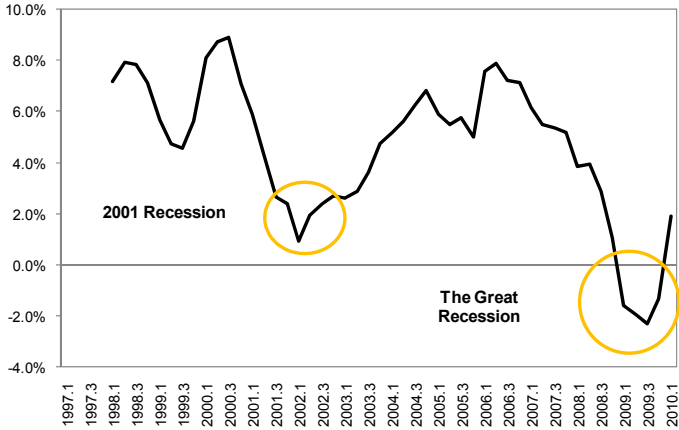
## **EVALUATING TEXAS VS. CALIFORNIA: RECENT ECONOMIC PERFORMANCE**

The “Great Recession” has created economic hardships not seen in a generation. **Figure 1** illustrates the relative decline in U.S. personal income compared to what occurred during the relatively mild downturn in 2001. A similar story also holds true for employment, see **Figure 2**.

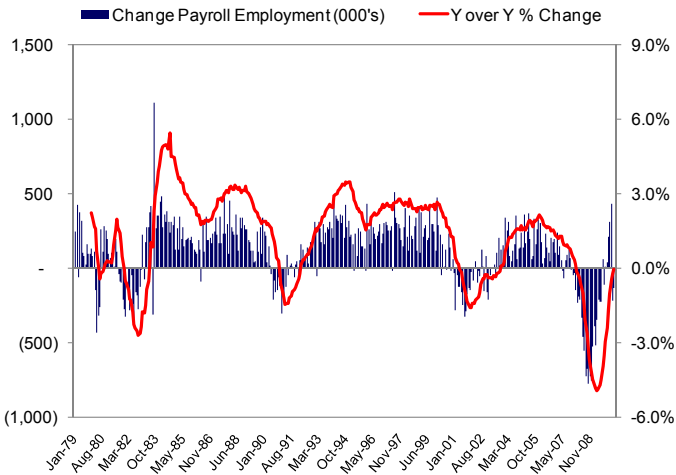
Like the rest of the nation, Texas’ economic growth hit a serious speed bump during the great recession. But, its economic decline in the state has been milder than in California and the nation overall. **Figure 3** presents data on the state of the employment market in the United States, Texas, and California compared to peak



**Figure 1**  
**Year over Year Growth in U.S. Nominal Personal Income**  
**(1997Q1-2010Q1)<sup>2</sup>**

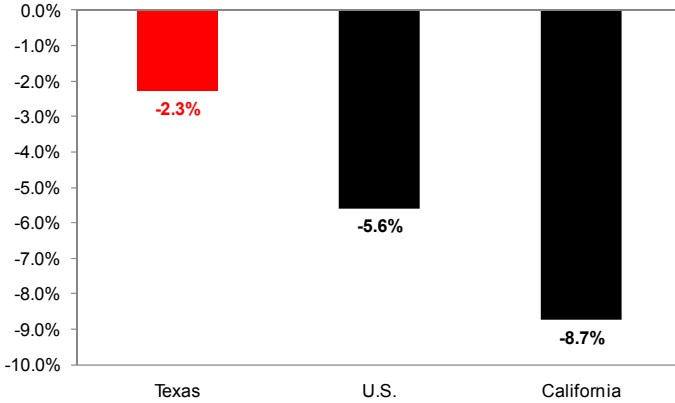


**Figure 2**  
**Change and Year over Year Percentage Change in U.S. Payroll Employment**  
**(January 1979-July 2010)<sup>3</sup>**



employment levels. As of July 2010, total jobs in the United States were down 5.7 percent from December 2007. The job loss in Texas was not nearly as severe—a 2.3 percent decline compared to its peak performance reached in August 2008, eight months after the U.S. economy peaked. Compared to these benchmarks, California’s job performance has been abysmal: 8.7 percent lower than the peak rate reached in July 2007. Undoubtedly, while Texas’ recent employment performance has been regrettable, it is much better than those of the nation and California.

**Figure 3**  
**Decline in Payroll Employment July 2010 Compared to Peak Employment Level**  
**Texas and California<sup>4</sup>**

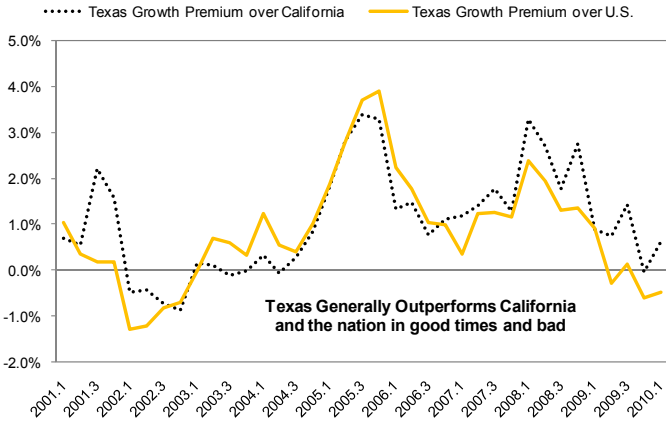


The same holds true for personal income growth. **Figure 4** traces the year-over-year personal income growth advantage of Texas compared to California and the United States. Personal income growth in Texas since the 2001 recession has been generally outperforming both the nation and California. Another significant point: While Texas' economy outperforms significantly in the good times, it does not underperform during the bad times, or when it does underperform, only by a small amount. Compared to the peak of personal income growth in the second quarter of 2008, current personal income in the U.S. is still down 0.9 percent. Texas is down a similar 1.0 percent. Meanwhile, personal income in California is still down 2.2 percent compared to its peak in personal income, which occurred in the third quarter of 2008.

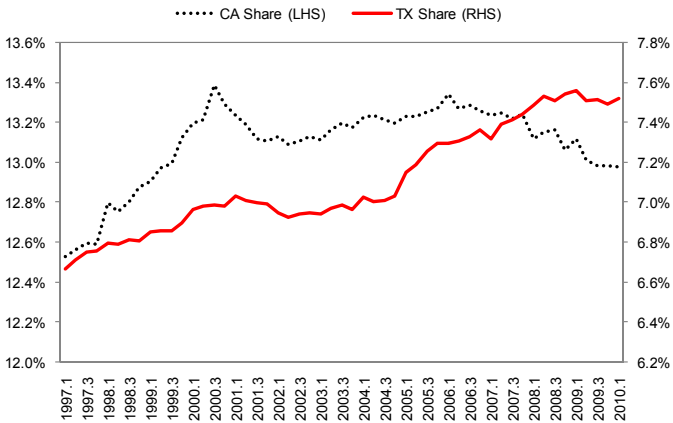
Because income growth in Texas grew significantly faster than the U.S. average during the good times, declining by approximately the same amount during the bad times, Texas' share of total U.S. income has been on an upward trajectory since 1997. The opposite is true for California, see **Figure 5**.

These results are not surprising. In our earlier paper we evaluated the economic policies of the two states, finding that the Texas economic environment enjoyed significant advantages over both California's and the nation's.<sup>5</sup> Texas' out-performance and California's underperformance throughout the Great Recession are the expected results based on each state's relative policy environment.

**Figure 4**  
**Texas Growth Premium Compared to California and the U.S. in Year over Year Personal Income Growth (2001Q1 – 2010Q1)<sup>6</sup>**



**Figure 5**  
**Texas' and California's Share of U.S. Personal Income (2001Q1 – 2010Q1)<sup>7</sup>**



Economic policies matter. Those states that implement pro-growth policies experience the best economic performance. For evidence of this relationship, Tables 1 and 2 (page 12 & 13) update two comparisons from our earlier study. **Table 1** compares the economic performance for the 10 states with the highest tax burden (including California) to the 10 states with the lowest tax burden (including Texas). **Table 2** compares the nine states without a personal income tax (including

**Table 1**  
**State and Local Tax Burden vs. 10-Year Economic Performance**

(2009 state & local tax burden vs. economic performance between 1999 and 2009, unless otherwise noted)

	Tax Burden % PI*	Gross State Product Growth**	Personal Income Growth***	Population Growth	Net Domestic In-Migration as a % of Population	Non-Farm Payroll Employment Growth****
Alaska	6.40%	106.8%	69.0%	11.8%	-2.0%	15.8%
Nevada	6.60%	106.2%	81.3%	36.6%	14.1%	21.4%
Wyoming	7.00%	137.6%	91.6%	10.7%	4.3%	24.8%
Florida	7.40%	78.4%	65.5%	17.6%	6.5%	8.7%
New Hampshire	7.60%	53.5%	52.6%	8.4%	2.5%	4.4%
South Dakota	7.90%	77.9%	63.9%	8.3%	0.8%	9.7%
Tennessee	8.30%	56.7%	55.1%	11.7%	4.2%	-0.7%
Louisiana	8.40%	88.2%	62.1%	0.7%	-6.1%	1.6%
<b>Texas</b>	<b>8.40%</b>	<b>94.5%</b>	<b>67.6%</b>	<b>20.5%</b>	<b>3.4%</b>	<b>13.7%</b>
Arizona	8.50%	80.9%	80.1%	31.3%	10.7%	13.0%
10 States with Lowest Tax Burden	7.65%	88.07%	68.87%	15.76%	3.83%	11.23%
U.S. Average*****	9.70%	66.34%	65.54%	10.08%	0.80%	10.42%
10 States with Highest Tax Burden	10.76%	58.02%	51.58%	4.93%	-3.06%	1.41%
Rhode Island	10.20%	60.4%	50.9%	1.2%	-3.8%	-0.6%
Wisconsin	10.20%	49.6%	44.6%	6.0%	-0.1%	-0.9%
Vermont	10.30%	59.7%	52.5%	2.8%	-0.1%	1.2%
Ohio	10.40%	35.2%	34.4%	1.8%	-3.1%	-7.7%
<b>California</b>	<b>10.50%</b>	<b>70.1%</b>	<b>56.6%</b>	<b>10.3%</b>	<b>-3.9%</b>	<b>2.5%</b>
Hawaii	10.60%	70.0%	66.6%	7.0%	-2.2%	12.0%
Maryland	10.80%	68.8%	66.0%	8.5%	-1.5%	6.4%
Connecticut	11.10%	48.7%	47.7%	3.9%	-2.6%	-1.8%
New York	11.70%	66.6%	48.0%	3.5%	-8.3%	1.9%
New Jersey	11.80%	51.2%	48.7%	4.2%	-4.8%	1.0%

Note: \*Tax Foundation calculations based on data from the U.S. BEA, the Census Bureau, the Council on State Taxation, the Travel Industry Association, Department of Energy, and others. The deductibility of federal taxes from state tax liability are included where applicable. New Hampshire and Tennessee tax dividend and interest income only; \*\*through 2008; \*\*\*through 3Q 2009; \*\*\*\*through November 2009; \*\*\*\*\*equal-weighted averages.

Texas) to the nine with the highest marginal income tax rates (including California). The results clearly show that, consistent with the historic pattern, states that impose low tax burdens and avoid personal income taxes—or both at the same time—enhance economic performance.

**Table 2**  
**The Nine States with the Lowest and the Highest Marginal Personal Income Tax (PIT)**  
**Rates 10-Year Economic Performance**

(performance between 1999 and 2009, unless otherwise noted)

	Top PIT Rate*	Gross State Product Growth**	Personal Income Growth***	Population Growth	Net Domestic In-Migration as a % of Population	Non-Farm Payroll Employment Growth****
Alaska	0.00%	106.8%	69.0%	11.8%	-2.0%	15.8%
Florida	0.00%	78.4%	65.5%	17.6%	6.5%	8.7%
Nevada	0.00%	106.2%	81.3%	36.6%	14.1%	21.4%
New Hampshire	0.00%	53.5%	52.6%	8.4%	2.5%	4.4%
South Dakota	0.00%	77.9%	63.9%	8.3%	0.8%	9.7%
Tennessee	0.00%	56.7%	55.1%	11.7%	4.2%	-0.7%
<b>Texas</b>	<b>0.00%</b>	<b>94.5%</b>	<b>67.6%</b>	<b>20.5%</b>	<b>3.4%</b>	<b>13.7%</b>
Washington	0.00%	64.9%	58.8%	14.1%	3.4%	8.2%
Wyoming	0.00%	137.6%	91.6%	10.7%	4.3%	24.8%
9 States with No PIT*****	0.00%	86.28%	67.26%	15.52%	4.12%	11.76%
U.S. Average*****		66.34%	65.54%	10.08%	0.80%	10.42%
9 States with Highest Marginal PIT Rate*****	9.92%	59.81%	53.36%	6.10%	-1.91%	2.48%
Ohio	8.24%	35.2%	34.4%	1.8%	-3.1%	-7.7%
Maine	8.50%	56.7%	55.3%	4.1%	2.3%	1.9%
Maryland	9.30%	68.8%	66.0%	8.5%	-1.5%	6.4%
Vermont	9.40%	59.7%	52.5%	2.8%	-0.1%	1.2%
New York	10.50%	66.6%	48.0%	3.5%	-8.3%	1.9%
<b>California</b>	<b>10.55%</b>	<b>70.1%</b>	<b>56.6%</b>	<b>10.3%</b>	<b>-3.9%</b>	<b>2.5%</b>
New Jersey	10.75%	51.2%	48.7%	4.2%	-4.8%	1.0%
Hawaii	11.00%	70.0%	66.6%	7.0%	-2.2%	12.0%
Oregon	11.00%	60.1%	52.3%	12.7%	4.5%	3.0%

Note: \*Highest marginal state and local personal income tax rate imposed as of 7/1/09 using the tax rate of each state's largest city as a proxy for the local tax. The effect of the deductibility of federal taxes from state tax liability are included where applicable. New Hampshire and Tennessee tax dividend and interest income only; \*\*through 2008; \*\*\*through 3Q 2009; \*\*\*\*through November 2009; \*\*\*\*\*equal-weighted averages.

Tables 1 and 2 clearly show that Texas' economy benefits from the state's low tax environment. On the other hand, California's economy is suffering due to the high tax burden. Figures 1 through 5 illustrate the economic benefit that Texas already receives due to its pro-growth policy environment. The remainder of this analysis delves into this relationship deeper.

## EVALUATING TEXAS VS. CALIFORNIA: ECONOMIC VOLATILITY

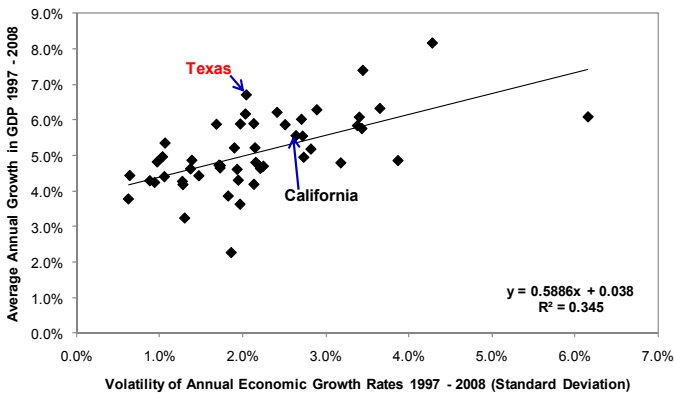
Economic volatility is an unavoidable fact of life; however, state economic policies will often aggravate volatility. One such policy is the implementation of a progressive income tax system. The consequences from using progressive tax policies are:

1. Reduced economic growth; and
2. Excessive economic and budget volatility that will often, ironically, reduce the income and economic opportunities of those precise groups the policy is designed to help.

States that have steeply progressive income tax systems, as does California, should experience more volatility than states such as Texas that do not. In fact, with regard to state GDP growth, personal income growth, and employment growth, Texas' economy has been growing stronger, with less negative volatility, than California or the nation overall.

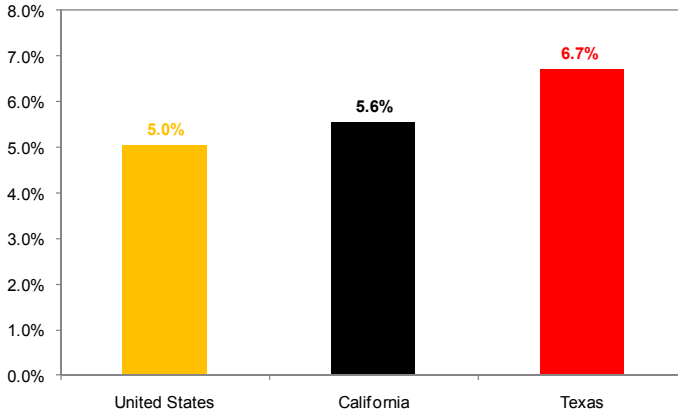
State GDP is a measure of overall economic activity. Higher economic growth and higher economic volatility tend to be positively related. States that experience higher economic growth also experience larger economic fluctuations. **Figure 6** shows that there is a clear positive relationship between a state's economic growth rate and the volatility in its economic growth rate.

**Figure 6**  
Average State GDP Growth Compared to Volatility of GDP Growth  
All 50 States (1997 through 2008)

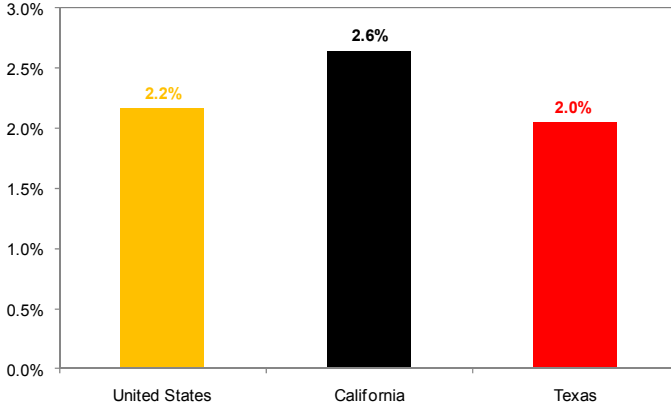


There are deviations from this general pattern, however, caused by government policies such as progressive tax systems. Texas experiences higher than average economic growth (6.7% per year between 1997 and 2008) but significantly less volatility than would be expected for this economic growth rate. California, on the

**Figure 7**  
**Average State GDP Growth: Texas, California, and the US**  
**(1997 through 2008)**

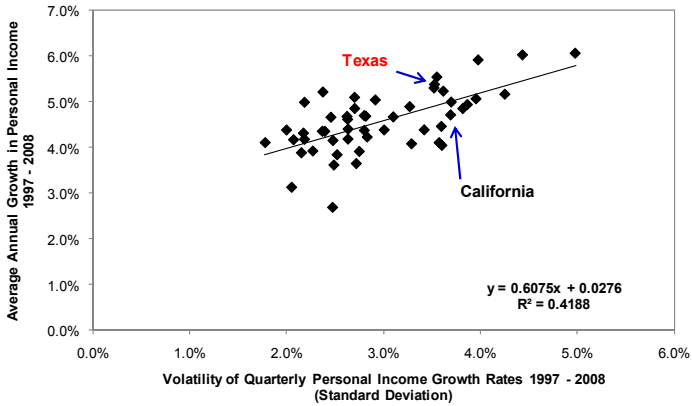


**Figure 8**  
**Volatility of State GDP Growth: Texas, California, and the US**  
**(1997 through 2008)**

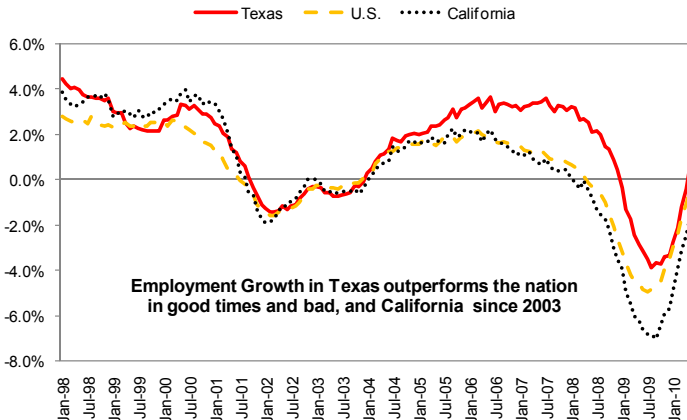


other hand, experiences less economic growth than Texas (5.6% per year between 1997 and 2008), but more volatility. **Figure 7** presents the average annual growth rate in Texas, California, and the United States between 1997 and 2008. **Figure 8** illustrates the volatility of the growth rates. The three figures clearly illustrate that Texas has been able to generate higher than average economic growth with less volatility.

**Figure 9**  
**Average State Personal Income Growth Compared to Volatility of Personal Income Growth**  
**All 50 States (1997 through 2008)**



**Figure 10**  
**Percentage Change in Year-over Year Non-farm Employment Growth**  
**Texas, California, and the United States (January 1998 through July 2010)**

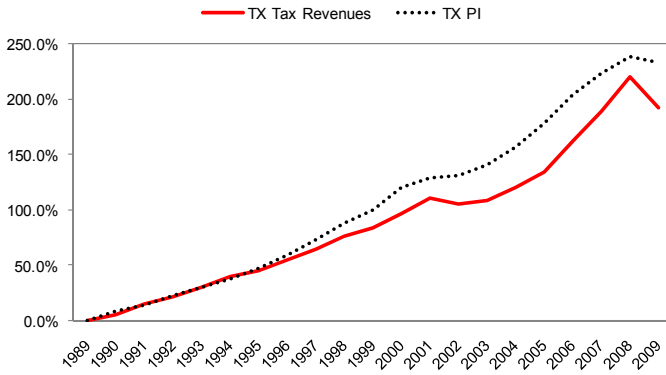


Personal income growth also exhibits this beneficial pattern for Texas, see **Figure 9**. Texas experiences higher than average personal income growth (5.4% per year between 1997 and 2008) but significantly less volatility than would be expected for this personal income growth rate. California, on the other hand, experiences less personal income growth than Texas (4.7% per year between 1997 and 2008), but more volatility.

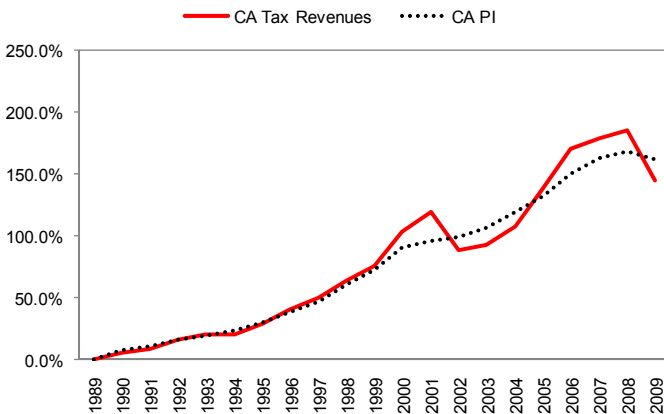
The same patterns also hold for the employment markets in Texas and California as well. As illustrated above, non-farm employment is still below where it was prior



**Figure 11**  
**Cumulative Growth in Personal Income and Tax Revenues: Texas**  
**(1989 through 2009)**



**Figure 12**  
**Cumulative Growth in Personal Income and Tax Revenues: California**  
**(1989 through 2009)**



to the Great Recession but the impact in Texas has been less. Texas’ ability to experience greater employment growth but not larger employment declines during slowing economic times has generally held over the past 12 years, see **Figure 10**.

Figures 11 and 12 directly link the additional volatility of California’s economy compared to Texas’ into more volatile state government revenues. **Figure 11** compares the cumulative growth in Texas’ personal income compared to tax revenues. The cumulative growth in personal income in Texas was 233 percent larger in 2009 than 1989. Total tax revenues were up a similar 192 percent. Additionally, the growth in tax revenues never exceeded the growth in personal income, indicating that the state government in Texas was not increasing its burden on the citizens. The growth in

income and tax revenues was also relatively smooth when compared to the volatile pattern of tax revenue growth and personal income growth in California.

**Figure 12** compares the cumulative growth in California's personal income compared to tax revenues. Comparing Figures 11 and 12 it is clear that the cumulative growth in personal income in California has been less than Texas—personal income was only up 162 percent between 1989 and 2009. Over the entire period, total tax revenue growth in California was up 145 percent—less than the cumulative tax revenue growth Texas has been able to achieve. Additionally, the extreme volatility in California's tax revenue growth relative to its personal income growth is easily seen in Figure 12.

Tax revenue growth in California is significantly more erratic than in Texas: full of starts and stops, and marked by increasing overall economic volatility. A pattern of sharp increases in revenues, followed by several years of stagnant revenue growth, is due to California's steeply progressive tax code. California's tax system showers riches on the state during periods of prosperity. These revenues are immediately spent. When downturns come, state revenues fall disproportionately compared to personal income because there are fewer high income earners and high income earners have less money. Yet since budgets are much easier to expand than contract, the revenue shortfalls lead to massive deficits. To close the gap, the "solution" all too often is to hike taxes even more, thus further discouraging employment and output—and correspondingly shrinking the tax base even further. Because of the dynamic effects (as illustrated by the Laffer Curve\*), the tax hikes don't raise as much revenue as predicted. Thus, the budget deficits persist. At the same time, welfare rolls and other support programs expand because of rising unemployment. State revenues plummet.

This process explains the link between California's more volatile economy and the state's policy environment. Texas' economy is far less volatile due to its having neither a progressive income tax system nor a large tax burden. The result is a faster-growing, less-volatile economy.

## STATE SPENDING

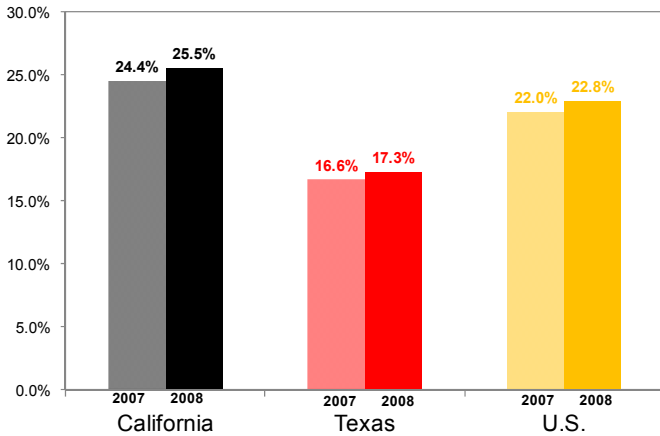
In response to the Great Recession, policymakers in Washington, D.C. and many states have chosen massive increases of government spending, tax rebates, and temporary tax cuts as the means to spur economic growth. However, these Keynesian-inspired spending policies have not produced the desired results, with economic weakness returning in the second quarter of 2010 and likely continuing well into the future. The reason: increases in federal, state, or local government spending change the underlying incentives in the economy and reduce its growth potential, resulting in a strong negative relationship between economic growth and government spending.

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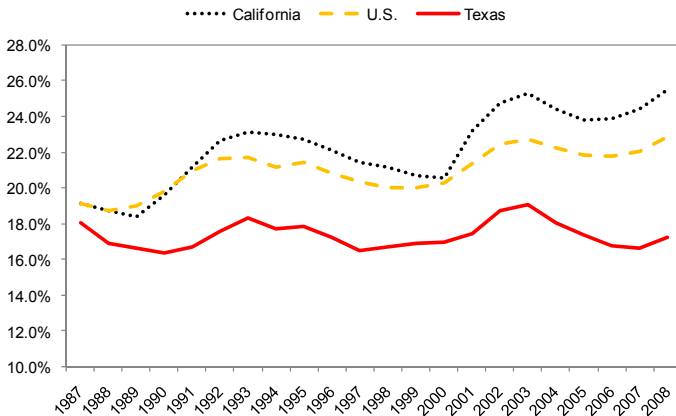
\* See *When You're Right, Well, You're Right: The Laffer Curve*.

Using Texas and California as examples, **Figure 13** illustrates that the tax and expenditure burden in Texas is significantly less than in both California and the United States. This is a strong competitive advantage for Texas.

**Figure 13**  
**Total State and Local Expenditures as a Percentage of Private GDP: California, Texas, US (2007 & 2008)<sup>8</sup>**



**Figure 14**  
**Total State and Local Expenditures as a Percentage of Private GDP: California, Texas, US (1987 through 2008)<sup>9</sup>**



**Figure 14** shows that Texas’ policy since 1987 has led to the gap in spending burdens between Texas compared to California and the United States. Following the economic recessions of 1991 and 2001, the expenditure burden relative to the size of the private economy rose in Texas, California, and the nation overall due to the sluggish/negative growth in the private economy compared to continued growth

in overall state and local government expenditures. Such a result is not unexpected. However, only Texas reduced its expenditure burden back to historical levels after the recessions—California and the rest of the country (on average) allowed spending levels to permanently remain higher. The difference is quite obvious after the 2001 recession when in 2003 Texas met the challenge by balancing the state’s budget without raising taxes. Because of this policy decision, Texas’ 2008 spending burden remained slightly below its 1987 levels—a major accomplishment.

However, in Texas, as well as in California and the United States overall, the total state and local expenditure burden on the private sector grew in 2008 (again, the most recent year for which data are available), though the growth in the state and local expenditure burden in Texas (+0.6%) was smaller than the growth in either California (+1.0%) or the U.S. (+0.8%).\*

Though Texas’ current budget reflects sound fiscal policy by keeping spending growth below the increase in population growth plus inflation, the most recent recession—along with a sharp increase in federal funds for the states—likely explains the current growth in Texas’ expenditure burden and the large budget shortfall the Texas Legislature will be facing in 2011. So for the third time in 20 years, a significant danger arises for Texas. If the current growth in the expenditure burden that naturally occurs during recessions is not reduced by the Texas Legislature, it will create a change in Texas’ long run trend of controlled government spending and put Texas on California’s path toward overspending and economic weakness. Fortunately, Texas has a strong historical precedent to follow in meeting this challenge and keeping the spending burden on Texans low.

## ENVIRONMENTAL AND LAND USE REGULATION

As of mid-September 2010, oil prices continue to hover around \$70 per barrel. With oil prices at such high levels, many analysts link Texas’ relative prosperity compared to California and the nation overall to the favorable oil market. Certainly, Texas is benefitting from its abundant oil reserves. The flaw with the claims that Texas is outperforming the national economy because of oil is that many other states, including California, also have abundant natural resources that are facing favorable price trends. And, some of those natural resources also include oil.

The California Chamber of Commerce has documented that “California is a national leader in the energy industry. The state ranks third in oil production, third in refining capacity, and leads the nation in the production of non-hydroelectric renewable energy, according to the U.S. Energy Information Administration.”<sup>10</sup> Future oil production can also be robust in California. The Minerals Management Service (MMS) for the Pacific OCS Region found that “nearly 11 billion barrels of undiscovered oil and 19 trillion cubic feet of undiscovered gas in the region may be recoverable using existing technology.”<sup>11</sup>

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\* Due to the growth in expenditures between 2008 and 2010, coupled with the declines in GDP, the burdens have only become worse since 2008.

California's natural resources also extend beyond oil. In California, there were 25.4 million acres of farmland as of 2007 due to the nutrient-rich soil and a variety of elevations and climates.<sup>12</sup> California's economy also benefits from many highly profitable fisheries. One of the state's most valuable fisheries, the California market squid, *Loligo opalescens*, has become the largest and most valuable California commercial fishery by volume, with 54,200 tons (49,200 metric tons) landed in 2006.<sup>13</sup>

Cultivating California's biodiversity, coastal resources, deserts, energy, forests, geology, plant life, water, wetlands, and wildlife offers a tremendous economic opportunity for the state. The problem is that while certainly beneficial, abundant natural resources are not a sufficient condition for economic growth. If this were the case, then resource-rich Saudi Arabia's GDP per capita would not be 49 percent of barren Japan's.<sup>14</sup> The same is true for Texas, California, and the United States overall.

As we have been discussing throughout this paper, ultimately it is the business environment that encourages entrepreneurial firms to innovate and capitalize on emerging opportunities. Texas' low tax burden and prudent state government expenditure level play an important part in establishing the state's pro-growth business environment. Regulations matter too. Texas benefits from its abundant oil reserves because, in addition to the other advantages reviewed, Texas also fosters an environment that allows businesses, individuals, and entrepreneurs to work, save, and invest without facing overly burdensome regulatory costs and delays—including businesses in the oil industry. The same is not true for California. California's regulations make it more difficult for its people to harness the abundant natural resources available to its residents.

In the economic scorecard, we focus on regulatory issues such as excessive minimum wage costs, pro-union regulations that artificially raise the cost of doing business, and the tort liability environment due to the pervasive impacts these regulations have across all industries. The regulatory environment in each one of these areas favors Texas over California. There are many other state (and local) regulations that also matter.

States that levy reasonable workers' compensation costs gain a significant competitive advantage compared to the states that burden businesses with high workers' compensation costs. Here again, California's workers' compensation costs are higher than Texas' leading to higher costs and burdens on businesses and job creators in California compared to Texas.

As another example, according to Riley (2007) Texas has "historically recognized the priority of mineral estate owners to access and consume natural resources, like natural gas, under the time-honored 'rule of capture.'"<sup>15</sup> The rule of capture is optimally understood as a common law rule relieving individuals of liability for draining oil and gas beneath neighbors' land. The rule of capture reduces a potential anti-growth liability to firms and entrepreneurs who engage in

oil exploration and extraction in Texas. As a result, the Texas economy experiences robust oil exploration and extraction and benefits when oil prices rise.

Whereas the Texas government regulates in the interest of promoting productive and efficient enterprise, California's regulations undermine enterprise. For instance, unless delayed by a last minute proposition, California is about to implement AB 32, which would impose cap and trade regulations on California businesses—a major regulatory cost that will impose significant cost increases on businesses and consumers if they use energy in California. Other environmental regulations are also problematic. As the California Chamber of Commerce noted, “the cost of California's draconian environmental regulations have been escalating for years, [for instance] it can cost \$75,000 to get state approval of a timber harvest plan even before a tree is cut.”<sup>16</sup> Overall “business planners have noted that the complexity of state and local regulatory requirements in California often mean lengthy delays in permitting and approvals—a powerful disincentive to business expansion and job creation.”<sup>17</sup>

In fact, the regulatory costs for zoning and permitting both residential and commercial properties are significantly more complex in California than Texas. For instance, according to the federal government's web site, [www.business.gov](http://www.business.gov), “All businesses or individuals who construct or alter any building, highway, road, parking facility, railroad, excavation, or other structure in California must be licensed by the California Contractors State License Board (CSLB) if the total cost (labor and materials) of one or more contracts on the project is \$500 or more.”<sup>18</sup> By contrast, while home builders must be registered in Texas, they need not be licensed.<sup>19</sup> Legal construction costs are subsequently more expensive in California than Texas.

California's more complex (and time consuming) permitting processes and more restrictive zoning ordinances create high regulatory costs that deter businesses from starting in California. The California Chamber of Commerce may have summed-up California's regulatory environment the best when it said: “Taken together, the rules, regulations, and red tape coming out of the state capitol are sending a message to business: Keep away!”<sup>20</sup> Texas' costs are considerably lower and thus afford a more attractive business environment. Texas' lower-cost, less-burdensome regulations, in combination with its low-tax burden and historical spending discipline, create an environment conducive to business growth. It also allows Texas to benefit from opportunities when they arise—such as the benefits gained from a healthy oil industry.

## A BEST PRACTICES REVIEW

In this paper, we have focused on the economic competition between Texas and California. Texas does not simply compete with California, however. The economic competition also includes other states such as Florida, Virginia, and Iowa; as well as foreign nations such as China, Indonesia, Germany, Brazil, etc. Texas' stronger economic policies provide an economic advantage vis-à-vis California. But this is not enough.

A review of the economic competition between Texas and California provides broader lessons that Texas could apply to create an economic advantage compared to any and all of these competitors. The following summarizes the key policies that make Texas a more formidable economic competitor than California:

- Texas imposes a lower, flatter tax burden;
- The government spending burden in Texas is more reasonable; and
- The regulatory environment in Texas is more reasonable and less burdensome.

Texas also has weaknesses. The most troubling of these weaknesses is the property tax burden, which is above the national average and a recent pick-up in state spending that, if it is not reversed, could lead to a weakening of Texas' historic spending control. Toward this end, the most important policy change that Texas could implement is reducing Texas' two main taxes on capital—the Gross Receipts Tax (GRT) and the above-average property tax.

To ensure that Texas' state and local expenditure burden is reduced, Texas should establish stricter tax and expenditure limitations—including limits on property tax growth—that set government spending at an appropriate level relative to a state's personal income (the citizen's ability to pay). Such reforms will provide greater protections against the current pressures that are pushing state and local expenditures above their current pro-growth levels and even help reduce the burden over time. Toward this end, Texas should also reduce federal funds flowing into the state that will ultimately force Texas into spending more funds than it can afford in the future.

Finally, our review has shown that while Texas' current land use and environmental regulations do less harm than California's, changes can still be made to improve Texas' economic performance. Regulations in Texas should undergo constant review to ensure that the regulations achieve their intended purposes, while imposing the lowest cost possible on businesses and entrepreneurs.

Effectively competing with all of Texas' economic competitors requires reforms that leverage the state's historic strengths, address its current weaknesses, and establish policy rules that will help prevent future events from derailing Texas' strong competitive environment.

## **LIVING WITH THE RESULTS: CONTINUAL IMPROVEMENT IS KEY**

Texas and California are case studies illustrating the cause-and-effect relationship between state economic policies and state economic performance. Texas grew robustly throughout the economic expansion between 2001 and 2008 surpassing the average national economic performance across many key economic metrics. California, despite the temporary (and unsustainable) push from the

housing bubble, experienced at best only average economic performance. On the downside, Texas has withstood the current economic storm much better than both the average state and California.

The significant differences between California's and Texas' economic policies have led to this widely divergent economic performance. Texas maintains a pro-growth economic environment by not levying an income tax, imposing a low overall tax burden, keeping regulations from becoming overly burdensome on businesses, and maintaining a lower, more stable spending level. California's economic environment has been worsening over time as the state continues to raise income taxes, increase the progressivity of the income tax, raise sales taxes, impose a high overall tax burden, maintain a confusing and burdensome regulatory environment, and allow state and local government spending to become a larger and larger burden on the private sector.

States that implement pro-growth tax, spending, and regulatory policies experience robust economic growth during strong economic times and are more resilient to adverse economic trends during weak economic times. The experiences of California and Texas are simply another case study that illustrates the importance of state tax, spending, and regulatory policies. To this end, we recommend that Texas:

- Balance the 2012-13 budget without raising taxes;
- Reduce its reliance on federal funds that ultimately result in Texas spending more than it can afford;
- Establish stricter tax and expenditure limitations, including limits on property tax growth, that restrict growth in government spending to inflation plus population growth;
- Reduce taxes on capital; and
- Continue to rely on its vibrant private sector to grow its economy by maintaining its relatively sound tax, land use, and environmental policies.

While Texas' economic environment is strong, it is by no means ideal. As we have shown, improvements are both possible and desirable. Such reforms will help improve Texas' economic competitiveness and desirability as a place to live and to work—not just as compared to California but compared to the rest of the world. ★



## APPENDIX: STATE POLICIES MATTER FOR ECONOMIC GROWTH— THE UPDATED SCORECARD

The competition between Texas and California is measured in three broad categories:

- Tax Policy
- Regulatory Policy
- Expenditure Policy

Government policies, especially tax policies, have large and varied impacts on a state's competitive economic environment. To fully account for these broad impacts, it is useful to track the impact from government tax policies on the economy's production process.

We start with a basic truth: To create all the goods and services in our economy, someone must exert effort. Economists generally classify this effort as the “labor input” into production. The other *inputs into production* are classified as *capital* or the tools and machines people use (which come from savings and investments), and *technology* or the know-how/skills needed to create the things we need and want. Government policies also matter. The taxes that governments levy, the expenditures they make, and the regulations they impose affect materially the varied factors that go into production. These governmental actions either encourage or discourage the use of labor, capital and technology.

Due to the importance of labor and capital in the economic process, it is useful to divide further the tax policy competition into 1) impact on labor; 2) impact on capital; 3) the tax burden on consumption; and 4) the overall tax burden.

Neither Texas nor California has a natural advantage over the other. Both are large, strategically located states, with strong demographics and bountiful natural resources. California has a comparative advantage with respect to its high quality high-tech workforce. A 2009 survey of American top-level executives published in *Chief Executive Magazine* hails California for offering the best quality of life in the nation.<sup>21</sup> But, in the eyes of these same executives, California polls as the worst state for business. Meanwhile, Texas ranks as the best.<sup>22</sup>








Texas' rank as the “best state for business” and California's rank as the “worst” are due to the policy decisions made in each state. California's regulatory and tax costs, coupled with budgetary and policy instability, render it an impotent competitor when standing next to low-tax, business-friendly Texas, which levies no capital gains or income taxes to support its affordable government. Other things being equal, policy propels Texas's boom just as it ushers California's decline.

In August 2008, Arduin, Laffer & Moore Econometrics explored the disparity in economic performance between Texas and California. While both Texas and California have comparable foundations of resources, Texas has done a markedly better job of allocating and nurturing those resources. The paper predicted that, in

the absence of major policy changes, the gap in performance between these states would only increase. That prediction has come to pass.

Overall, the economic landscape is now more favorable for Texas than for California. The policies governing Texas' economy have brought about less heartburn than those in other states, with Texas outperforming both California and the nation overall throughout the Great Recession. In turn, the state is able to provide services more efficiently.

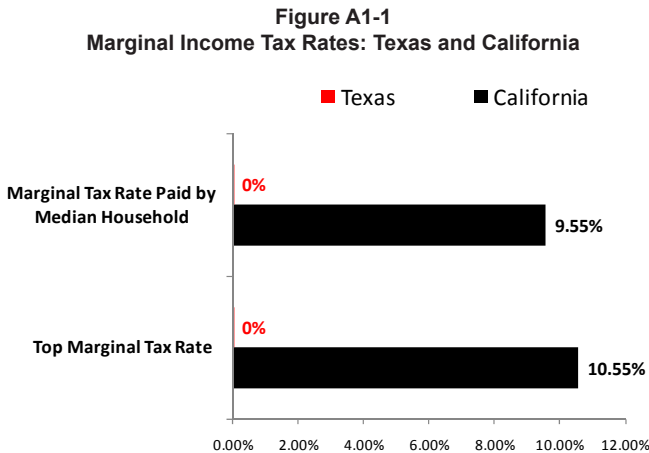
**Table A1-1**  
**The Economic Scorecard: Texas vs. California**

Competitive Event	California	Texas	Winner
<i>Taxes on Labor</i>			
Top Marginal Personal Income Tax Rate	10.55%	0.00%	
Marginal Personal Income Tax (average income earner)	9.55%	0.00%	
<i>Taxes on Capital</i>			
State and Local Property Tax Burden	\$32.89	\$36.50	
Estate/Inheritance Tax Levied	NO	NO	
Top Marginal Rate: Income, Dividends, and Cap. Gains	10.55%	0.0%	
Top Marginal Corporate Tax Rate	8.84%	1% GRT	
<i>Taxes on Consumption</i>			
State Sales Tax Rate	8.25%	6.25%	
State and Local General Sales Tax Burden per \$1,000 of Personal Income	\$25.62	\$29.47	
<i>Overall Tax Environment</i>			
Overall Tax Burden	\$115.96	\$94.00	
Personal Income Tax Progressivity	\$36.19	\$0.00	
Recent Legislated Tax Changes per \$1,000 of Personal Income (2008 & 2009)	\$6.19	-\$2.59	
Number of Tax Expenditure Limits	2	1	
<i>Regulatory Environment</i>			
State Liability System (PRI U.S. Tort Liability Index Rank)	27th	2nd	
State Minimum Wage	\$8.00	\$7.25	
Right-to-Work State	NO	YES	
<i>Government Spending Policies</i>			
Total State and Local Expenditures per Capita (2008)	\$11,356.83	\$7,763.49	
Average Growth in State and Local Government Expenditures (2008)	7.29%	7.02%	

To recap the competitive events from the last study: Texas is still winning. But it's more than just "winning." In no single category has California gained a new advantage over Texas. In several key areas, California's economy has become even less competitive than before. However, certain facts ought to be emphasized in order to illustrate just how Texas has increased its dominance.

### Competition I: The Tax Burden on Labor

A progressive income tax system—one which imposes a higher tax upon higher earners—reduces the incentive to work, save, and invest. Given the perceived opportunity cost associated with a high tax burden, states like Texas will continue to thrive just by virtue of not taxing income, so long as states like California continue to tax income at such high rates. The highest earners in California are set to pay 10.55 percent of their income to the state. The average earner pays 9.55 percent. This is a 0.22 percent increase from 2008. In Texas, income remains untaxed, see **Figure A1-1**. The reduced economic incentive (e.g., after-tax income) from working more in California compared to Texas deters potential high-income earners from working in California, and encourages these same workers to locate in Texas.



The fact that California's rates have jumped higher while the Lone Star State's have remained low gives Texas the clear victory in this competition.

TAXES ON LABOR

WINNER 

## ***Competition II: The Tax Burden on Capital***

Investments are made in order to optimize the after-tax return on the money invested. Businesses and other investors will purchase capital only if the expected return to the capital exceeds the costs—including all taxes on that capital investment. Lower returns on investment due to higher taxes reduce the incentive to invest, and smaller investments yield a less productive capital stock. A lower productive capital stock has a detrimental effect on income, employment, and economic growth in states with higher taxes on capital.

The top marginal tax rate in California for income, dividends, and capital gains increased from 10.3 percent to 10.55 percent in the past two years. Texas continues to levy no such tax. Texas does levy a 1 percent Gross Receipts Tax (GRT), which is problematic, but not as burdensome as California's tax of 8.84 percent on business income, which is among the highest rates in the country. Texas' higher property tax burden (\$36.50) compared to California (\$32.89) offsets this benefit somewhat. However, on net Texas continues to levy a lighter tax burden on capital than California. The numbers below overwhelmingly illustrate California's significant competitive disadvantages.

The marginal tax rate a business or individual faces determines the incentives to engage in productive economic activity. In order to see the impacts from these taxes on incentives to acquire capital (i.e., save and invest) we incorporate the impact of federal taxes and simply follow the money.

Imagine two representative companies facing the highest marginal income tax brackets earning an additional \$1,000 in profits. One firm is located in California, the other in Texas. Each faces a federal income tax liability. Depending upon the company's structure, the tax liability could be either the top marginal corporate income tax rate or top marginal personal income tax rate. In this example, the representative companies pay a weighted share of the corporate and personal income tax rates. The weights are calculated based on the share of total net corporate income subject to corporate taxes as reported by the Internal Revenue Service (IRS) Statistics of Income (SOI) data.<sup>23</sup>

With respect to federal income tax rates, the division is irrelevant as the top corporate and personal income tax rates are both 35 percent currently. Nevertheless, should Congress allow the Bush tax cuts to expire as of January 1, 2011, these rates will increase. Because the matter remains unresolved, we use the current federal tax rates for our analysis.

In California the top corporate income tax rate is 8.84 percent, whereas the top personal income tax rate is 10.55 percent. In Texas there is no personal income tax rate; there is, however, a 1 percent GRT. To put the GRT on a basis permitting comparison to California's net income tax, we transform the GRT rate into an equivalent net income tax rate.<sup>24</sup> Based on this transformation, Texas' 1 percent GRT is currently the "equivalent" of a 5.7 percent net income tax. We use the 5.7 percent figure as the appropriate corporate income tax rate for our calculations, weighted

by the share of companies that are subject to corporate income taxes as a proxy for those companies that must pay the GRT. **Table A1- 2** summarizes this information.

**Table A1-2: Taxation of Corporate Income**

	California	Texas
<b>Additional Net Income</b>	<b>\$1,000.00</b>	<b>\$1,000.00</b>
Subject to Corporate Tax Liability	\$375.91	\$375.91
Subject to Personal Tax Liability	\$624.09	\$624.09
Federal Income Tax Liability		
Corporate Income Tax	35.00%	35.00%
Personal Income Tax	35.00%	35.00%
State Income Tax Liability		
Corporate Income Tax	8.84%	5.70% (1% GRT)
Personal Income Tax	10.55%	0.00%
<b>Additional Net Income after Taxes</b>	<b>\$585.60</b>	<b>\$636.08</b>

The final line of Table A1-2 presents the after-tax net income to a representative company depending on its location—Texas or California—taking into account the deductibility of state income taxes. As table A1-2 clearly shows, just by locating in Texas, companies can earn an extra \$50.48 per \$1,000 of net income, or an **8.6 percent higher** after tax return.

Texas' competitive advantage grows even more because the tax burden imposed on this income is not finished. Dividend-paying owners of a corporation face another round of taxation. Using national payout-ratios based on the Bureau of Economic Analysis National Income and Product Account (NIPA) tables, and the ratio of companies that are dividend payable, we can estimate the percentage of net income that is subject to dividend taxes. These figures are summarized in **Table A1-3**.

**Table A1-3: Corporate Income Subject to Dividend Taxes**

	California	Texas
<b>Additional Net Income after Taxes</b>	<b>\$585.60</b>	<b>\$636.08</b>
Earnings Paid Out	\$460.03	\$499.68
Earnings Paid Out Subject to Dividends Tax	\$128.58	\$139.67
Individual Dividend Tax		
Federal	15.00%	15.00%
State	10.30%	0.00%
<b>Total After-tax Income (incl. retained earnings)</b>	<b>\$555.06</b>	<b>\$615.13</b>

Table A1-3 illustrates that, if both a company and the individual(s) owning the company are located in Texas rather than California, both the company and its stockholder(s) can earn an extra \$60.07 per \$1,000 of net income or a **10.8 percent higher** after tax return.

There are still more taxes on capital. California and the federal government also tax interest income and capital gains income. Texas does not. This provides another after-tax rate return advantage to the owners of capital from locating in Texas, compared to California. Using a similar methodology, we track \$1,000 of interest and capital gains income if it were earned by an individual living in Texas compared to that same income if it were earned by an individual living in California. The results are summarized in **Table A1-4**.

**Table A1-4**  
**Taxation of Interest and Capital Gains Income**

	California	Texas
<b>Individual Interest Income</b>	<b>\$1,000.00</b>	<b>\$1,000.00</b>
Federal Interest Income Taxes	35.00%	35.00%
State Interest Income Taxes	10.55%	0.00%
<b>Individual Interest Income (after tax)</b>	<b>\$581.43</b>	<b>\$650.00</b>
<b>Capital Gains Income</b>	<b>\$1,000.00</b>	<b>\$1,000.00</b>
<u>Federal Income Tax Liability</u>		
Capital Gains Taxes (Long-term)	15.00%	15.00%
Capital Gains Taxes (Short-term)	35.00%	35.00%
<u>State Income Tax Liability</u>		
Capital Gains Taxes	10.55%	0.00%
<b>Capital Gains Income (after tax)</b>	<b>\$746.79</b>	<b>\$834.87</b>

Table A1-4 illustrates that the after-tax return to both interest income and capital gains income is significantly higher in Texas, compared to California. The after-tax interest and capital gains income for a \$1,000 investment is **11.8 percent higher** in Texas than in California for the exact same investment.

The significant after-tax return premium in Texas compared to California with respect to corporate income, interest income, and capital gains income gives Texas a significant competitive advantage over California in attracting businesses and investors. California's advantage with respect to property tax burdens equates to an advantage of 1.4 percent in terms of personal income. Still, this does not compensate for the significant disadvantages with respect to the remaining capital taxes in these two states.

California holds no pronounced competitive advantage over Texas in the realm of taxes on capital. In fact, upon review, it becomes overwhelmingly clear that Texas wins Competition II, with a far more competitive environment.

TAXES ON LABOR

WINNER 

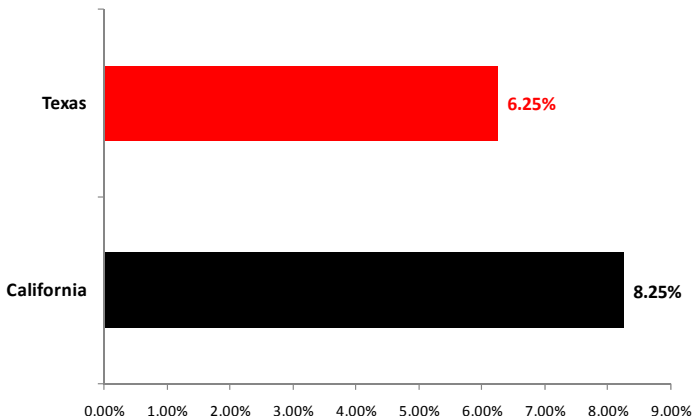
TAXES ON CAPITAL

WINNER 

### Competition III: The Tax Burden on Consumption

Despite the substantial tax burdens already imposed on Californian labor and capital, the Golden State’s government has not seen fit to offset the burden on its residents with a low sales tax. In the past two years, while Texas’ rate has remained a steady 6.25 percent, California actually boosted its nation-highest state sales tax from 7.25 percent to 8.25 percent! Moreover, because Texas does not impose a state income tax, its residents are currently able to deduct the state sales taxes from their federal income taxes, enabling them to reduce further their effective sales tax liability.

Figure A1-2  
State Sales Tax Rates



The difference in actual sales tax rates paid by consumers is even more dramatic. Combining the state sales tax rate with its average local sales tax rate, California is second in the nation with a 9.06 percent rate, while Texas is 12th at 7.39 percent.<sup>25</sup>








It is not only the sales tax rate that matters, but also the sales tax base, or the extent which the sales tax is applied. Because sales tax bases vary from state to state, the burden of the tax, estimated as total sales tax revenues as a percentage of personal

income provides a proxy for the extent that the sales tax rate is applied to the goods and services people actually purchase. These calculations produce figures with nominal statistical difference. The sales tax burden of \$29.47 per \$1,000 of personal income in Texas is \$3.85 higher than the \$25.62 per \$1,000 of personal income in California. The split between sales tax burden and the sales tax rates yields a draw for this competition.

	TAXES ON LABOR	TAXES ON CAPITAL	TAXES ON CONSUMPTION
WINNER			 

### ***The Remaining Competitions***

Overall tax burden, regulatory environment, and overall level of government spending are also crucial aspects of each state's economic landscape. In each of these crucial competitive areas, Texas outperforms California. Take the overall tax burden, or total tax collections divided by personal income. In California, the state imposes \$115.96 per \$1,000 of personal income; in Texas, the comparable amount is 19 percent less, or \$94.00 per \$1,000 per \$1,000 of personal income. Additionally, California has been raising taxes—a 2008/2009 static revenue increase of \$6.19—whereas taxes, on net, have been falling in Texas—a 2008/2009 static reduction of \$2.59.

	TAXES ON LABOR	TAXES ON CAPITAL	TAXES ON CONSUMPTION.
WINNER			 
	OVERALL TAX	REGULATIONS	SPENDING
WINNER			

On the regulatory front, although significant improvements are still necessary for Texas, the Pacific Research Institute has ranked the state's tort liability system as second best in the country—an important pro-growth incentive.<sup>26</sup> California's system ranked a distant 27th. California, which is not a right to work state, mandates an \$8.00 per hour minimum wage that is higher than the national rate of \$7.25 that is effective in Texas, which implemented one of the nation's first right to work laws. As a consequence, California's regulatory system creates significant additional business costs. Thus California's regulatory system, compared to Texas, creates a large disincentive for economic activity.



The final basis for economic competition is the spending policies of both states at the state and local levels. As of 2008, California's state and local expenditures per capita of \$11,356.83 were significantly more burdensome than Texas' \$7,763.49. The growth in state and local expenditures between 2000 and 2008 in California (7.29%) was also higher than the growth in state and local expenditures in Texas (7.02%). A point requiring clarification concerns Texas' growth rate in state and local expenditures over this entire period. There was, in fact, a marked increase in state and local expenditure growth between 2006 and 2008—an average 8.2 percent, compared with California's 7.0 percent. Consequently, Texas does currently have a more competitive spending environment than California, but this advantage could be lost without consistent spending control at the state and local level.

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## ENDNOTES

<sup>1</sup> McQuillan, Lawrence and Hovannes Abramyan, *U.S. Tort Liability Index: 2010 Report*, Pacific Research Institute.

<sup>2</sup> U.S. Bureau of Economic Analysis.

<sup>3</sup> U.S. Bureau of Labor Statistics.

<sup>4</sup> *Ibid.*

<sup>5</sup> Arduin, Laffer & Moore Econometrics "Competitive States: Texas v. California Economic Growth Prospects for the 21st Century" Texas Public Policy Foundation (Aug. 2008).

<sup>6</sup> U.S. Bureau of Economic Analysis.

<sup>7</sup> *Ibid.*

<sup>8</sup> Laffer Associates calculations based on U.S. Census and Bureau of Economic Analysis data.

<sup>9</sup> *Ibid.*

<sup>10</sup> California Chamber of Commerce, "A Growth & Jobs Agenda".

<sup>11</sup> Russell, Sean, *List of Valuable Natural Resources in the Western United States*.

<sup>12</sup> *Ibid.*

<sup>13</sup> California Market Squid.

<sup>14</sup> World Bank Data Indicators, GDP per Capita (Current US\$) 2008 data.

<sup>15</sup> Riley, "Wrangling With Urban Wildcatters: Defending Texas Municipal Oil and Gas Development Ordinances Against Regulatory Takings Challenges" *Vermont Law Review* (2007) 32:351.

<sup>16</sup> Jasper, William F., "California's collapse: California's woes high taxes, costly energy, burdensome regulations, and more are all symptoms of government run amok" *The New American* (6 Oct. 2003).

<sup>17</sup> California Chamber of Commerce, "A Growth & Jobs Agenda".

<sup>18</sup> Business.gov, Business Licenses and Permits-California.

<sup>19</sup> Business.gov, Business Licenses and Permits-Texas.

<sup>20</sup> California Chamber of Commerce, "A Growth & Jobs Agenda".

<sup>21</sup> "CEOs Select Best, Worst States for Job Growth and Business: Texas, North Carolina, Florida Top List as Best States; California, New York, Michigan Are the Worst" *Chief Executive.net*.

<sup>22</sup> *Ibid.*

<sup>23</sup> IRS Statistics of Income: Table 1.-- Number of Businesses, Business Receipts, Net Income, and Deficit by Form of Business, Tax Years 1980-2007.

<sup>24</sup> Specifically, the GRT rate is multiplied by the ratio of GDP to total capital income and profits. The ratio used in this analysis is the average yearly ratio between 1997 and 2009.

<sup>25</sup> Padgitt, Kail, "Updated State and Local Option Sales Tax".

<sup>26</sup> McQuillan, Lawrence and Hovannes Abramyan, *U.S. Tort Liability Index: 2010 Report*, Pacific Research Institute.

## ABOUT THE AUTHORS

### ***Donna Arduin***

Donna Arduin, Partner, ALME, served as California Governor Arnold Schwarzenegger's Director of Finance from November 2003 until October 2004, where she was the Governor's chief fiscal advisor and was a member of over 70 boards and authorities. Prior to her appointment as Director, Schwarzenegger asked Arduin to undertake an outside, independent audit of California government and state finances.

Prior to working for Governor Schwarzenegger, Arduin served governors from three additional states, including Florida, New York, and Michigan. She was Governor Jeb Bush's Director of the Florida Office of Policy and Budget for five years, where she managed the formulation of the governor's policy and fiscal recommendations, created the nation's first interactive "e-budget," and implemented performance-based budgeting and long-range planning. Additionally, Arduin served Governor George Pataki throughout his first term as First Deputy Budget Director and led his successful efforts to reduce and simplify property taxes in New York and reduce the size of state government. She also served Governor John Engler for three years during his first term, as Chief Deputy Director of the Michigan Department of Management and Budget, as well as the executive director of his reinventing government commission and his appointee to the Michigan Municipal Bond Board of Trustees. A graduate of Duke University, Arduin graduated *magna cum laude* with honors in economics and public policy.

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Dr. Arthur B. Laffer, Partner, ALME, is the founder and chairman of Laffer Associates. Dr. Laffer's economic acumen and influence in triggering a worldwide tax-cutting movement in the 1980s have earned him the distinction in many publications as "The Father of Supply-Side Economics." One of his earliest successes in shaping public policy was his involvement in Proposition 13, the groundbreaking California initiative drastically cutting property taxes in the state.

Dr. Laffer was a member of President Reagan's Economic Policy Advisory Board for both of his two terms (1981-1989). He was formerly the Distinguished University Professor at Pepperdine University and a member of the Pepperdine Board of Directors. He also held the status as the Charles B. Thornton Professor of Business Economics at the University of Southern California from 1976 to 1984. He was an Associate Professor of Business Economics at the University of Chicago from 1970 to 1976 and a member of the Chicago faculty from 1967 through 1976. During the years 1972 to 1977, Dr. Laffer was a consultant to Secretary of the Treasury William Simon, Secretary of Defense Don Rumsfeld and Secretary of the Treasury George Shultz. He was the first to hold the title of Chief Economist at the

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### **Steve Moore**

Stephen Moore joined *The Wall Street Journal* as a member of the editorial board and senior economics writer on May 31, 2005. He splits his time between Washington and New York, focusing on economic issues, including budget, tax, and monetary policy. Moore has been a frequent contributor to the *Journal* over the years, and is previously known as the founder and former president of the Club for Growth, which raises money for political candidates who favor free-market economic policies. He left that position in 2004. Just prior to coming to the *Journal*, Stephen was president of a new organization, the Free Enterprise Fund.

Over the years Moore has served as a senior economist on the Congressional Joint Economic Committee, as a budget expert for the Heritage Foundation and as a senior economics fellow at the Cato Institute, where he published dozens of studies on federal and state tax and budget policy. He was a consultant to the National Economic Commission in 1987, and research director for President Reagan's Commission on Privatization. He graduated from the University of Illinois and holds a masters degree in economics from George Mason University.

### **Wayne H. Winegarden, Ph.D.**

Dr. Wayne Winegarden manages Arduin, Laffer & Moore's policy studies and analyses. Prior thereto, he worked as an economist for Altria Companies Inc. in Hong Kong and New York City. In these roles he analyzed the impact of the economic environment in East- and Southeast-Asia on the company's operations, and integrated these insights into the company's strategic planning process. Additionally, Dr. Winegarden examined the impact of tax and regulatory polices on the company's operations and supported its government affairs objectives.

Dr. Winegarden also has experience analyzing federal and state budget, regulatory and financial sectors for policy and trade associations in Washington D.C. Dr. Winegarden is economics faculty at Marymount University, is a columnist for *Townhall.com*, and has been interviewed and quoted in such media as Bloomberg Radio and CNN. Dr. Winegarden received his B.A., M.A., and Ph.D. in economics from George Mason University.



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