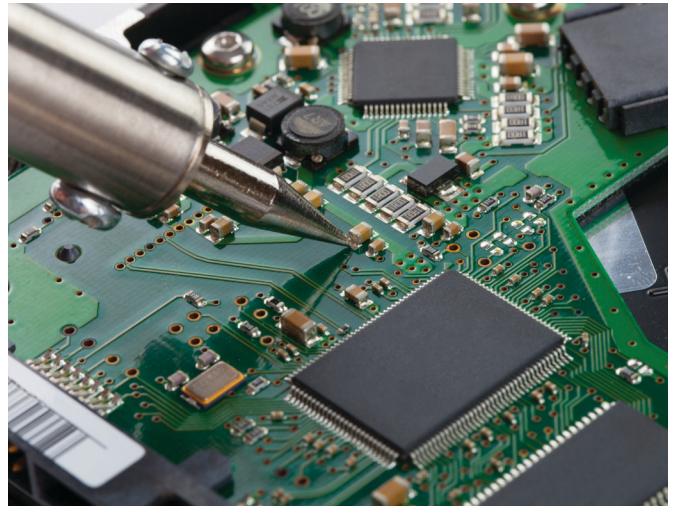


A Labor Market Comparison: *Why the Texas Model Supports Prosperity*



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A Labor Market Comparison: Why the Texas Model Supports Prosperity

by Vance Ginn, Ph.D., Economist

Executive Summary

The Texas model has been touted as an approach to governance that other states and Washington, D.C. would be wise to follow. This approach promotes individual freedom through lower taxes and spending, less regulation, fewer frivolous lawsuits, and reduced federal government interference. Does this Texas restatement of the unalienable rights of “Life, Liberty and the pursuit of Happiness” actually promote freedom, prosperity, and jobs when compared to the largest states and U.S. averages?

To answer this question, this paper (in most cases) compares various measures in California, Texas, New York, and Florida—the states with the largest populations and economic output—and U.S. averages during the last 15 years. Five fiscal measures of economic freedom and government intervention for these states show that Texas generally leads the pack as the most free with the least government intrusion. Eight measures of the labor market indicate that Texas provides the best opportunities to find a job. Five measures of income distribution and poverty show that Texas leads in most categories with a more equal income distribution and less poverty despite fewer redistributory policies than these large states, particularly California and New York.

MEASURE	U.S.	TEXAS	FLORIDA	CALIFORNIA	NEW YORK
Economic Freedom of North America (2014)	--	1st	21st	43rd	47th
State Business Tax Climate Index (2015)	--	10th	5th	48th	49th
Avg. Annual Nonfarm Job Creation (2000-14)	0.5%	1.6%	1.0%	0.7%	0.5%
Avg. U-3 Unemployment Rate (2000-14)	6.4%	5.7%	6.3%	7.6%	6.3%
Avg. Employment-Population Ratio (2000-14)	61.2%	62.6%	58.3%	60.1%	58.4%
Real Avg. Annual Private Pay (2001-14)	6.1%	10.2%	6.1%	6.9%	5.4%
Supplemental Poverty Measure (2011-13)	15.9%	15.9%	19.1%	23.4%	17.5%

Notes: Dates in parentheses are for the data identified per measure. Data in light blue indicate “best” while red indicates “worst” per measure.

The evidence is clear: the Texas model supports economic prosperity. Other states and D.C. would be wise to consider similar economic policies that champion individual liberty, free enterprise, and personal responsibility. This is a path to providing an economic environment that allows entrepreneurs the greatest opportunity to thrive and for prosperity to be generated for the greatest number of people.

However, there is room for improvement in Texas despite this success. Policy changes that could boost the Texas model include effectively limiting the growth in government spending, eliminating the state’s onerous business franchise tax, expanding international trade whenever possible, and reducing the mounting burden of property taxes. Even with the work that needs to be done, though, the data clearly show that the Texas model has contributed to relatively better labor market outcomes that have been nothing less than a miracle: the Texas miracle.

Ranking the States on Freedom

The last 15 years of job creation, wage growth, and income distribution provide evidence that the Texas model of low taxes, no individual income tax, less regulation, and a sensible lawsuit climate supports economic prosperity. How do the results of the Texas model compare with other states and U.S. averages? By examining labor market data, we attempt to answer this question and evaluate whether the Texas model, or similar economic policies, should be emulated in other states and D.C.

In adopting many of their economic models, economists claim *ceteris paribus*—all else equal—to simplify the real world. But all else is not equal in a dynamic world. Given that federalism in the U.S. provides the opportunity for each state to devise different policies within a framework determined by the federal government, this system provides a laboratory of competition among states where all else is close to equal, allowing an examination of their economic results to determine which policies may work better than others.

Though each state operates under a federal tax and regulatory regime, states retain a high degree of flexibility in both areas. Demographics also play a part in states' economic profiles; therefore, it is important to compare states that are similar to provide less biased comparisons. The four largest states in terms of population and economic output are California, Texas, New York, and Florida. After comparing fiscal indicators, California and New York tend to have liberal policies diametrically opposed to the more free-market-oriented policies in Texas and Florida.

- ★ Stansel et al. (7) rank states in their Economic Freedom of North America 2014 report based on the size of government, takings and discriminatory taxation, and labor market freedom. They find that Texas ranks as the most free, Florida 21st, California 43rd, and New York 47th.
- ★ Drenkard and Henschman (3) provide another state comparison in their 2015 State Business Tax Climate Index that is based on how well states structure their tax system. They show that Florida ranks 5th best, Texas 10th, California 48th, and New York 49th. The authors note that Texas' burdensome property taxes and onerous business franchise tax, otherwise known as the margins tax, hold them back from moving up. Eliminating the margins tax would bring this Index to 3rd best (Drenkard, 11) and generate billions in new personal income and hundreds of thousands of new private sector jobs (Ginn, 13).
- ★ DeVore (20) constructed the Soft Tyranny Index, which measures a state government's bureaucracy, state spending, income tax, and tax burden. His results show that Texas ranks first with the least government intrusion, Florida 17th, California 49th, and New York 50th.
- ★ Malm and Prante (3-4) calculate the state and local tax burdens as a percentage of state income for fiscal year 2011—the latest data available. According to their findings, New York ranks first with the highest tax burden, California fourth, Florida 31st, and Texas 49th.
- ★ Ginn and Roach (331-333) find that another contributing factor to the Texas model's success is increased international trade after the 1994 North American Free Trade Agreement (NAFTA). Lower trade costs led to industrial diversification to meet the desires of Mexico and Canada contributing to Texas now leading the U.S. in exports for the last 13 consecutive years supporting millions of jobs in small to large firms. They conclude that freer trade helped Texas' economy be more stable by coping better with oil price fluctuations and other U.S. economic disruptions. Comparatively, the Census Bureau (2015) provides 2014 data for international exports in terms of dollars and share of U.S. total exports showing that Texas ranks first, California second, New York fourth, and Florida seventh.

These rankings indicate that Texas and Florida have policies that promote economic growth compared with the high-tax, high-regulation, and high-spending policies in California and New York.

This line of reasoning follows from the historical account of economic and political institutions by Acemoglu and Robinson (2012) who discuss the differing results between extractive and inclusive institutions. Extractive institutions are those associated with such institutions or autocracies and socialism that take resources through force from people and either enrich the leaders or redistribute those resources in society; creating winners and losers, as is prevalent in California and

New York. Historically, these types of institutions typically lead to less economic activity, more poverty, and an overall lower standard of living. Inclusive institutions are those associated with such institutions as democracies and capitalism that allow resources to be voluntarily distributed in society based on market factors, giving much more power to the people instead of the ruling class, as is prevalent in Texas and Florida. These types of institutions usually generate more economic activity, less poverty, and a higher standard of living.

Ranking the States in Labor market Categories

The most inclusive institutions tend to best reward people and create an environment conducive to prosperity for all. While multiple economic indicators may be considered in determining which policy outcomes most benefit people, the best path to prosperity is through work. This section examines multiple labor market measures, including the distribution of income, during the 2000 to 2014 period and compares them among the largest states and U.S. averages.* These data show that the Texas model has supported substantial job creation during the last 15 years, contributing to prosperity reaching most Texans, including the neediest among us. But more reforms are needed to take Texas to the next level of economic opportunity and success.

Texas Led in Multiple Labor Market Categories from 2000 to 2014

Texas employers created 2,470,300 nonfarm jobs, or 73 percent of the U.S. total nonfarm jobs, during the last 15 years. Chart 1 shows that these additional jobs contributed to a higher average annual job-growth rate in Texas than in other large states and the U.S. as a whole. More recently, Texas has fared better and created jobs at a faster pace than many states recovering from the Great Recession.

Chart 1: Texas leads in average annual job creation since 2000 and has led in most months since 2006

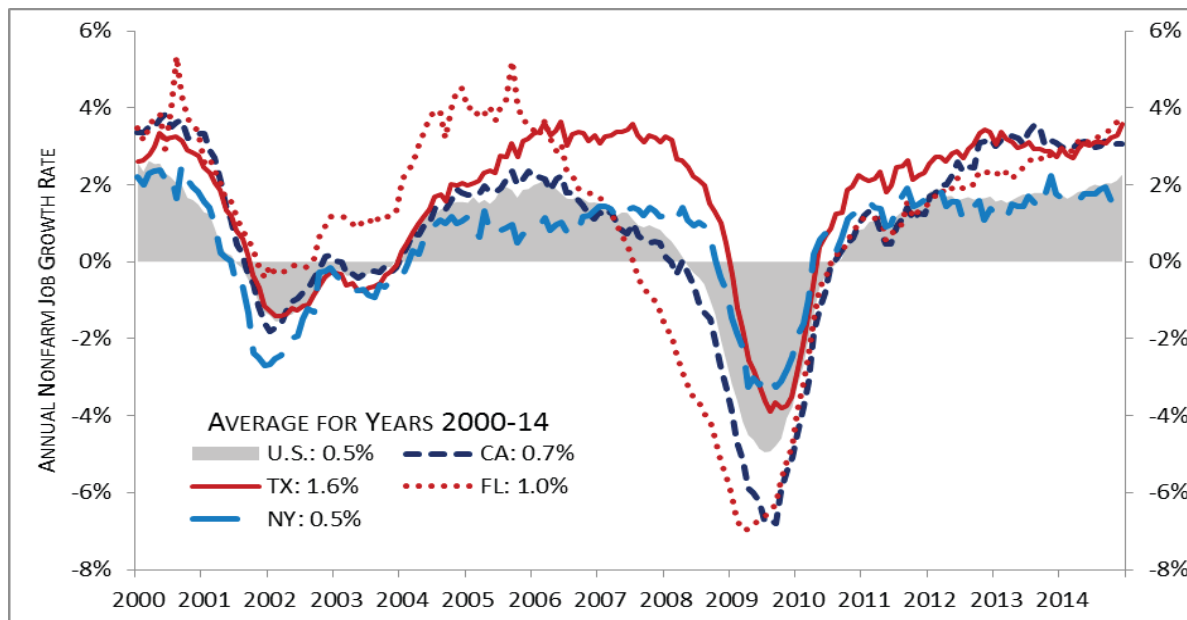
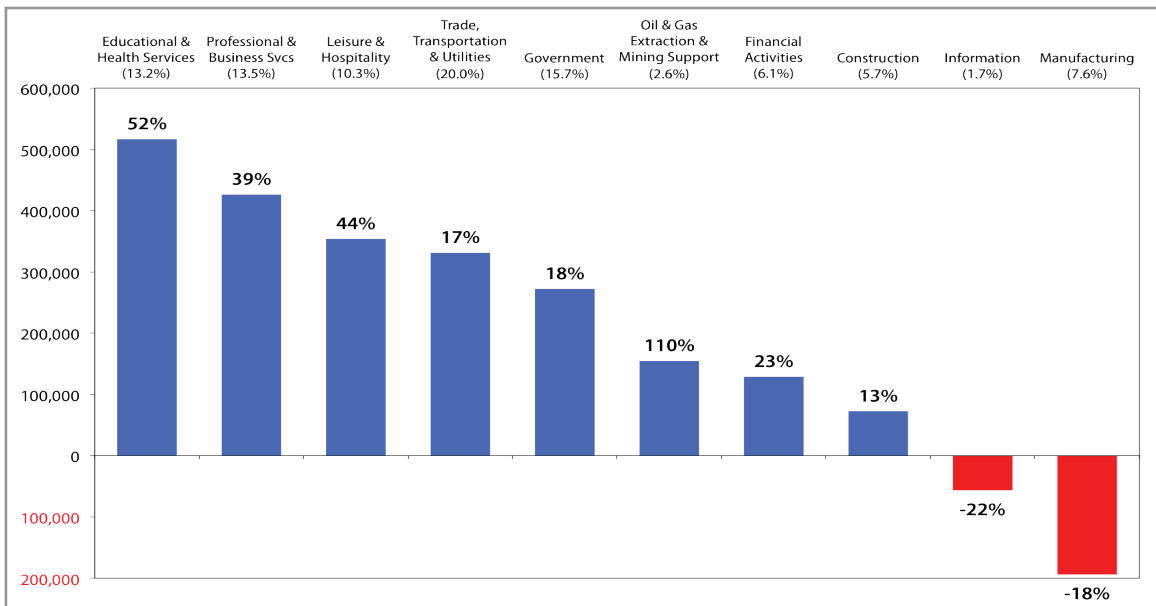


Chart 2 shows that most Texas industries have seen double-digit percentage increases in job creation since 2000, with the mining and logging industry (which mostly comprises the oil and gas sector) more than doubling, and declines in only two industries. Though there was a large percentage increase in the mining and logging industry, the diversification of the Texas economy is shown by this industry being less than three percent of the total labor force and other industries, such as professional and business services that created more than twice as many mining and logging jobs.

* Seasonally adjusted monthly nonfarm employment data from the U.S. Bureau of Labor Statistics are used throughout the paper unless otherwise noted.

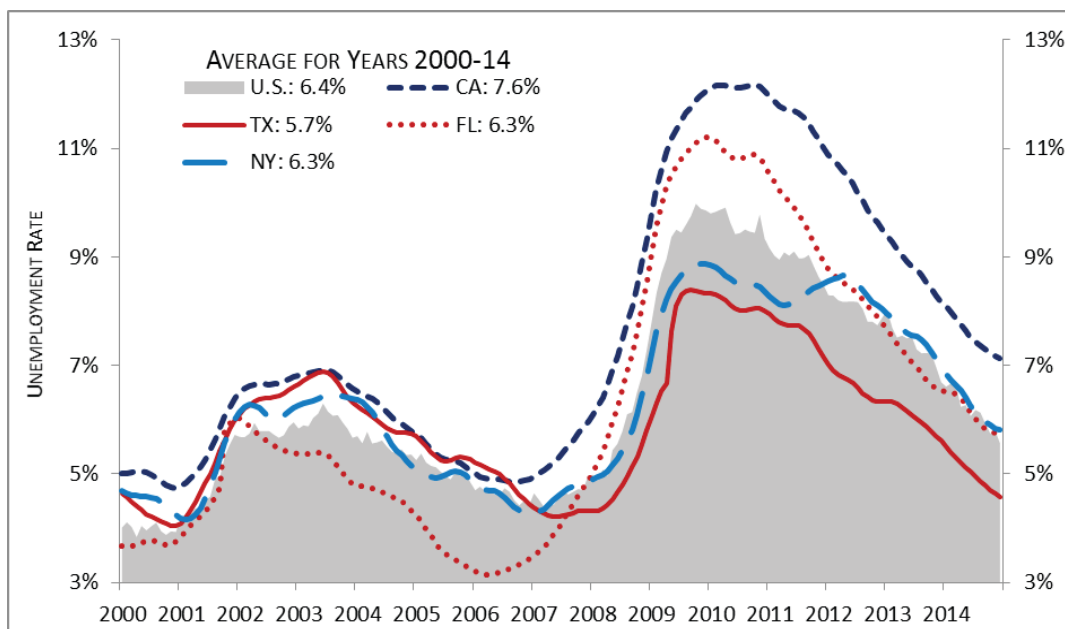
Chart 2: Texas job creation was positive in all but two industries from 2000 to 2014



Note: Numbers in parentheses are total share of Texas nonfarm employment accounted for by each sector.

This quick pace of job creation statewide among most industries, especially in the last five years, has led to Texas having one of the lowest unemployment rates in the country. Chart 3 presents evidence that Texas’ U-3 unemployment rate, the official rate reported most often that includes the share of the labor force of those who are unemployed and have searched for a job during the last four weeks, has been at or below the overall U.S. unemployment rate since September 2006 and the rates of other large states around the same time. Texas ended 2014 with an unemployment rate of 4.6 percent, lower than that of these other states as well as the U.S. average.

Chart 3: Texas’ average official unemployment rate is lower than other large states’ since 2000



However, with many people dropping out of the labor force nationwide after an unsuccessful job search or choosing an alternative lifestyle (e.g., retirement, college, work from home, or the military), the U-3 rate may be misleading. In addition, part-time workers are counted as employed in the U-3 rate even though they would prefer a full-time position.

The broader U-6 underutilization unemployment rate includes those counted as unemployed in the U-3 rate along with discouraged and underemployed workers. Chart 4 presents the available data for the U-6 rates, noting that Texas' 2014 rate was 2.1 percentage points lower than the U.S. average, compared with a U-3 rate that was only 1 percentage point lower. California and Florida's labor markets indicate weaknesses throughout much of the period, as their U-6 rates were higher than the rates for the U.S. average and Texas.

Chart 4: Broader U-6 underutilization rate lower in Texas

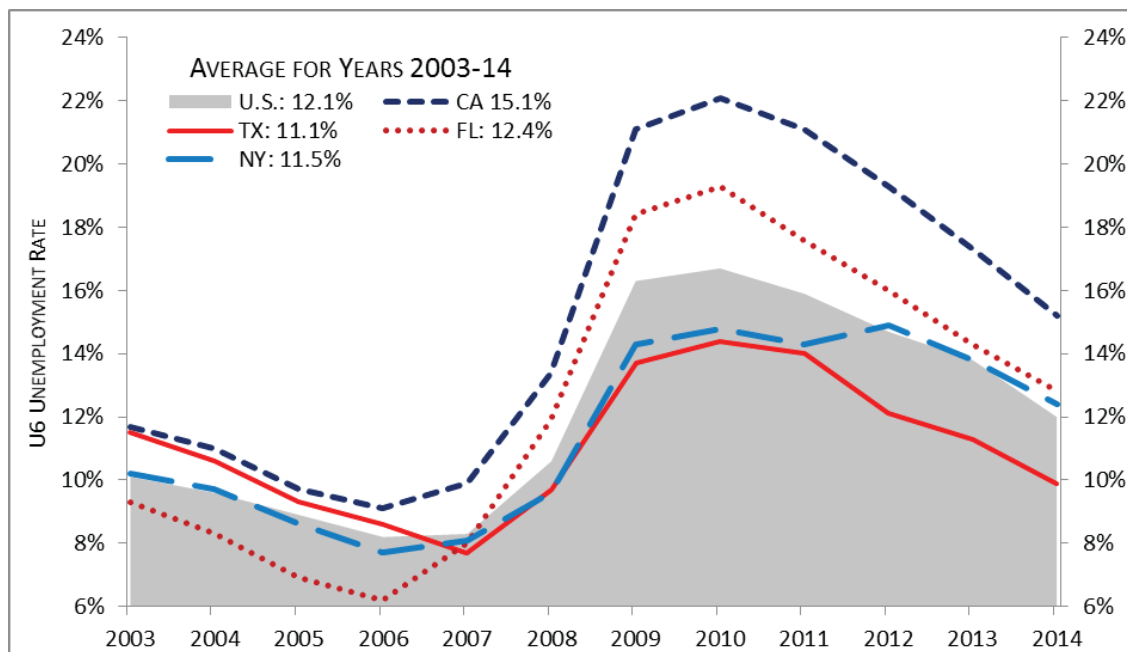
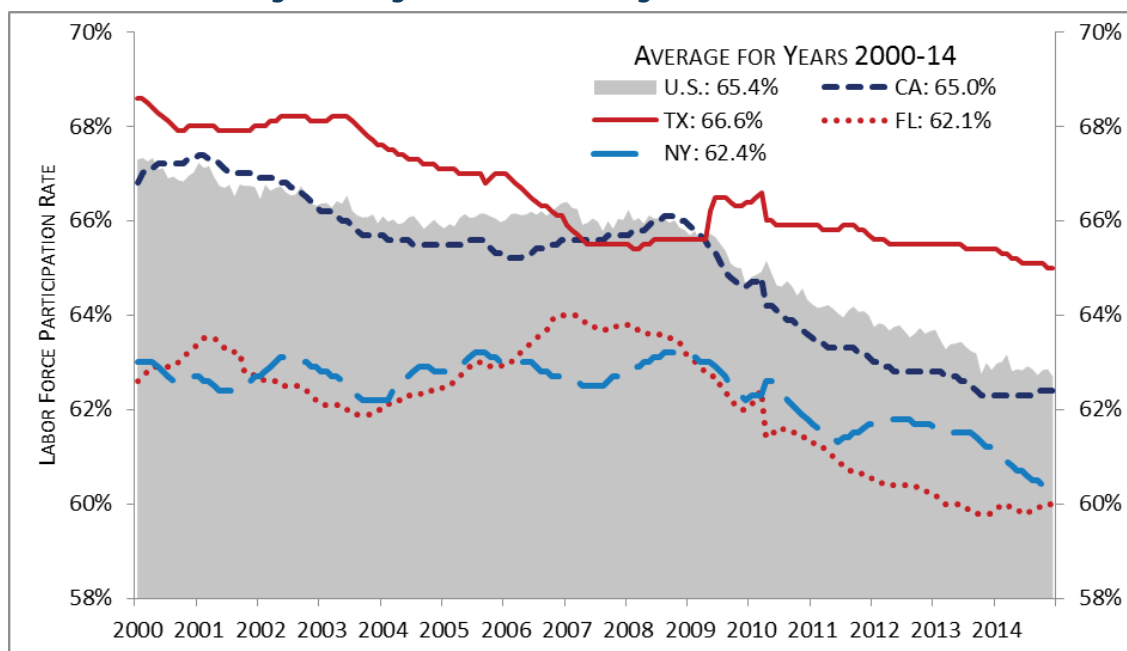


Chart 5 notes that Texas' labor force participation rate has proven to be relatively more stable since the Great Recession. California's average rate falls the closest, yet substantially, behind but is consistently below the U.S. average, with New York and Florida's falling even lower. This is yet another indication of Texas' substantial job creation, which contributed to a lower unemployment rate compared with a large number of people dropping out of the labor force elsewhere.

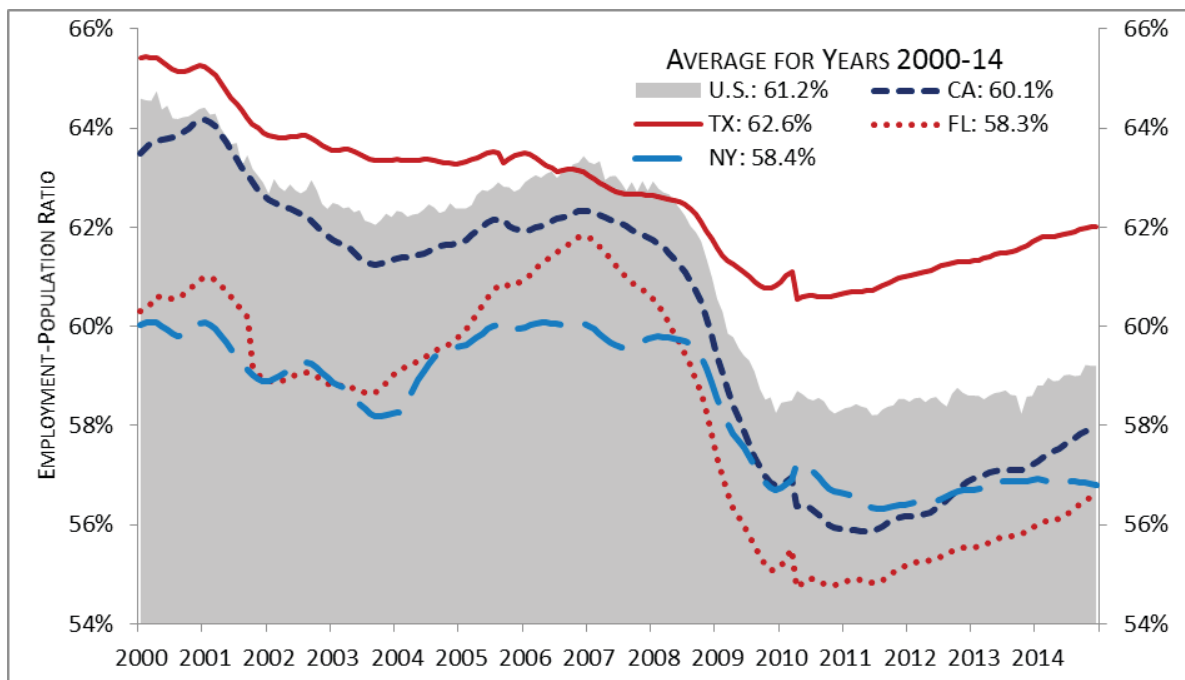
Chart 5: More Texans, on average, looking for work or working from 2000 to 2014



As noted by Mulligan (72-73), the expansion of social safety net programs (e.g., Patient Protection and Affordable Care Act, unemployment insurance, and food stamps) implemented during and subsequent to the Great Recession contributed to the severity of the downturn and weak job creation and economic expansion. Specifically, many recipients of these programs chose to not work because of the increase in the marginal labor income tax rate. He defines this “implicit” income tax rate as “the extra taxes paid, and subsidies foregone, as the result of working, expressed as a ratio to the income from working” (Mulligan, 4). The higher the implicit tax rate, the less incentive there is for recipients to work, contributing to a smaller labor force.

The unemployment rate may not be the best measure to assess these labor markets because of labor force volatility. Chart 6 provides a potentially better indicator by presenting a comparison of the share of the population employed.

Chart 6: Texas’ share of the population employed nears its pre–Great Recession level

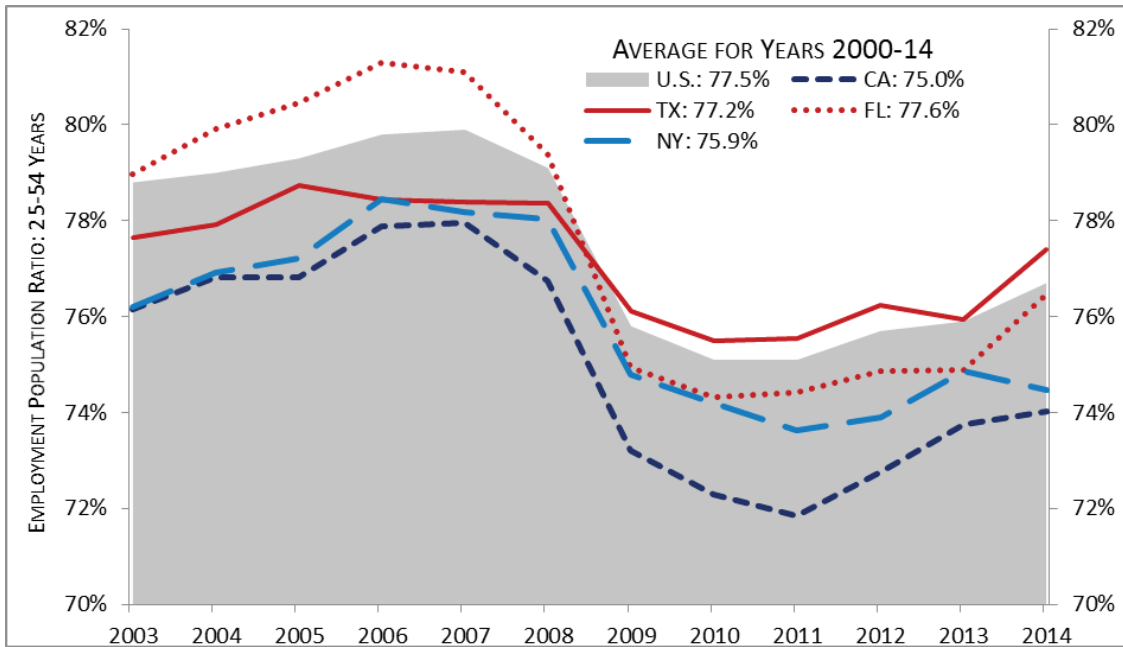


Compared with the other large states and the U.S. average, which have an employment population ratio far below their pre-Great Recession levels, Texas’ ratio barely budged lower and had a higher average during the last 15 years. Combined with the labor force participation rate, this ratio suggests that the lower unemployment rate in Texas is driven primarily by robust job creation and not by people dropping out of the labor force. Though the common argument is that the decline in the labor force and employment participation rates derives from baby boomers retiring, which is partially true, potentially the greatest threat to the prosperity of the U.S. and these states in particular is the declining share of employment of the 25-to-54 prime working age group.



Chart 7 shows that since 2003—the earliest data available—the U.S. employment ratio for this prime-working-age group fell 2.1 percentage points, Florida’s declined 2.5 percentage points, California’s fell 2.1 percentage points, and New York’s dropped by 1.7 percentage points. The smallest decline of 0.25 percentage points was in Texas. The average ratio for this age group among these states during the last 15 years and the ratio at the end of the period were highest in Florida and Texas, with their relatively more inclusive economic institutions.

Chart 7: Prime-working-age group doing best in Texas since 2009



The steep decline in this key age group’s employment ratio for the U.S. average and many large states is troubling because these people are especially likely to raise children, take care of elders, and make productive investments. Fewer job opportunities force many of them on government assistance, making it difficult for them to improve their well being. While some rationally choose to stay home or go to college after unsuccessful job searches, loss of lifetime earnings and increasing student loans could have adverse long-term consequences for many. Less of a decline in their share of employment in Texas from more job opportunities contributes to more sustainable family budgets and an overall more stable economy compared with other large states.

Job Creation Comparison Since the Great Recession Started

To expand on the recovery since the Great Recession started, Chart 8 shows that Texas created 1.6 million more total civilian jobs in December 2014, determined by the Bureau of Labor Statistics’ (BLS) household survey, than in December 2007; however, the rest of the U.S. employed 404,694 fewer than the pre-recession level.

Chart 8: America’s job engine, Texas

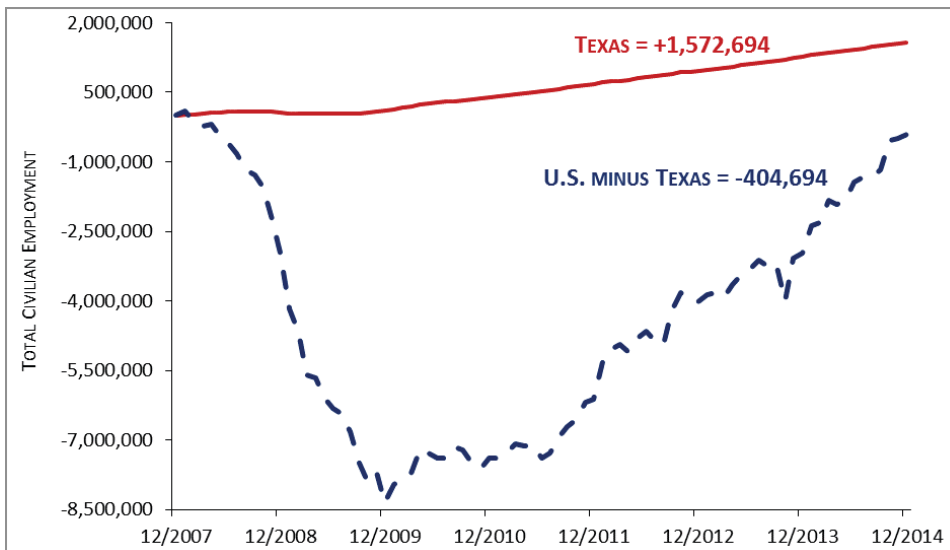
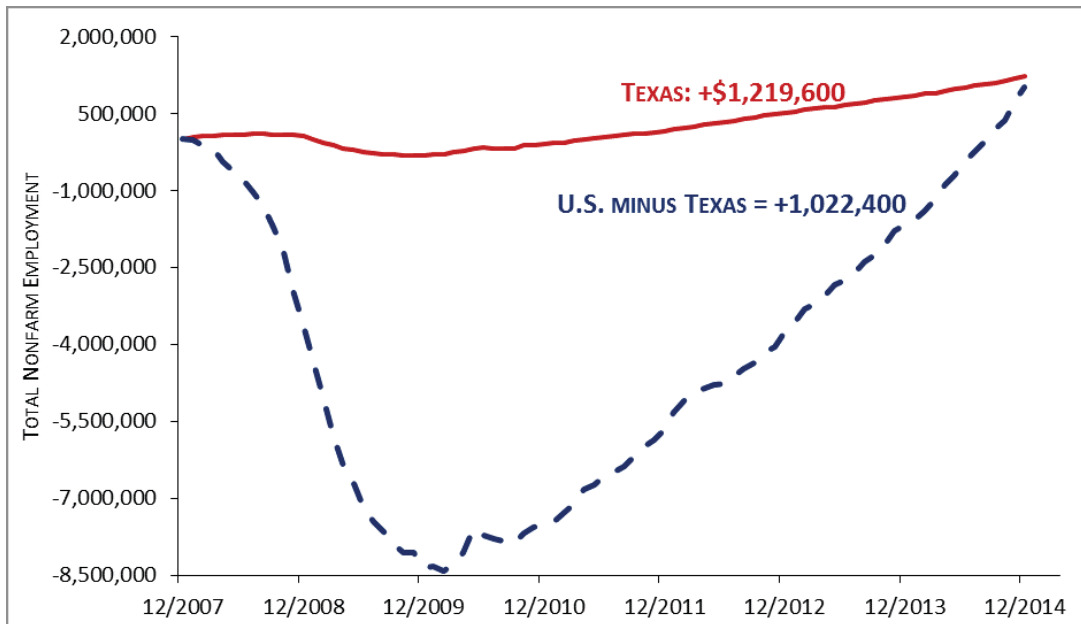


Chart 9 presents evidence that Texas also led the rest of the U.S. in total nonfarm job creation, determined by the BLS establishment survey of businesses, since the Great Recession started. While job creation is improving nationwide, more people in many places are struggling to find jobs than in Texas.

Chart 9: Texas outpaces the rest of the U.S. in nonfarm job creation since December 2007

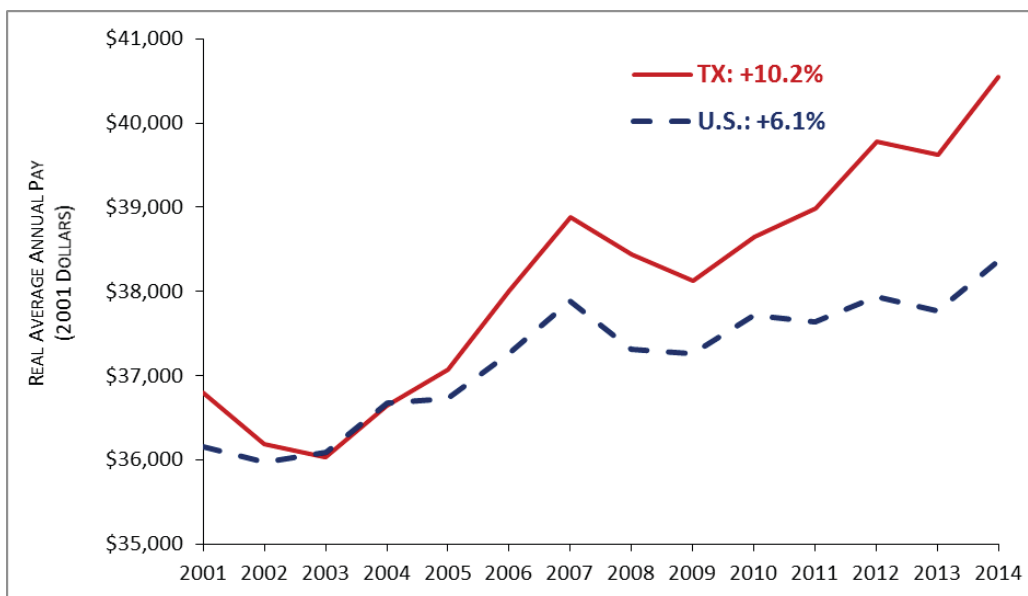


More Wage Growth and More Equal Income Distribution in Texas

Though the Texas Model has supported more job opportunities than the policies of its counterparts and the U.S. average, critics attempt to discredit these gains by arguing they are primarily low-paying jobs. The data tell a different story.

Chart 10 shows that consumer price inflation-adjusted (real) average annual private pay for Texans is higher than in 2001 (the earliest year of available BLS data). During the last 14 years, the Consumer Price Index (CPI) increased by 33.7 percent. Adjusted for CPI, the 10.2 percent increase in Texans’ real private pay is 67.3 percent greater than the U.S. average 6.1 percent increase.

Chart 10: Real average annual private pay up more than the U.S. average since 2001

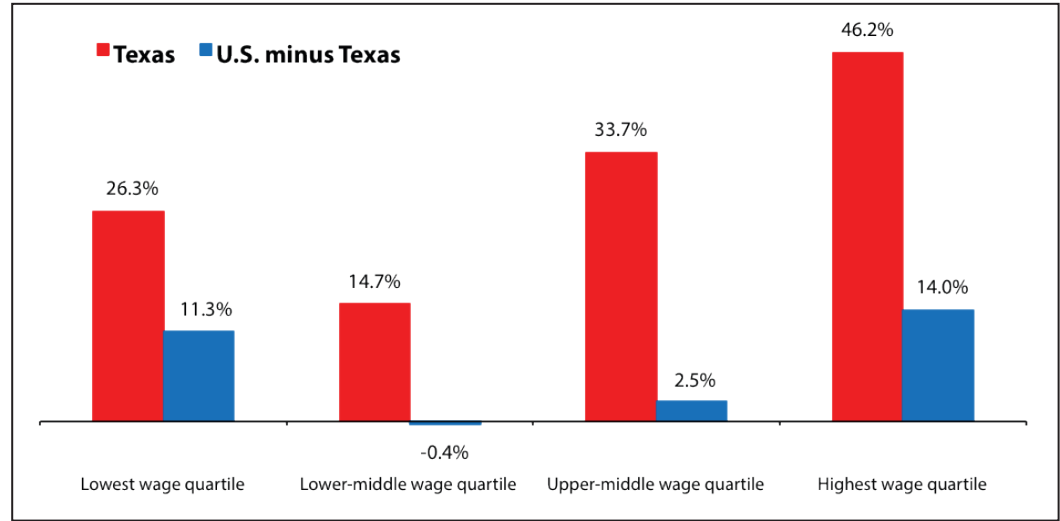


Source: *Bureau of Labor Statistics*

These real-wage data suggest Texas has created well-paying jobs. Chart 11, by former Federal Reserve Bank of Dallas President Richard Fisher (Z), confirms this is the case, with substantially larger percentage increases in high-paying jobs since 2000 in Texas than the rest of the nation.

The increases in job growth in the highest and lowest wage quartiles may contribute to rising income inequality—a widening gap between the top and bottom income earners. Though it is beyond the scope of this paper to discuss the economic significance of this gap, as this is an empirical question that could be addressed, widening income inequality may be positively related to economic growth (Frank, 2009) but possibly not (Piketty). To examine how Texas’ distribution of income ranks against others, consider the U.S. and state-level data from 2000 to 2012 (latest data available) provided by Frank (2015) for the Gini coefficient and total income shares of the top 10 percent and top 1 percent of income earners.

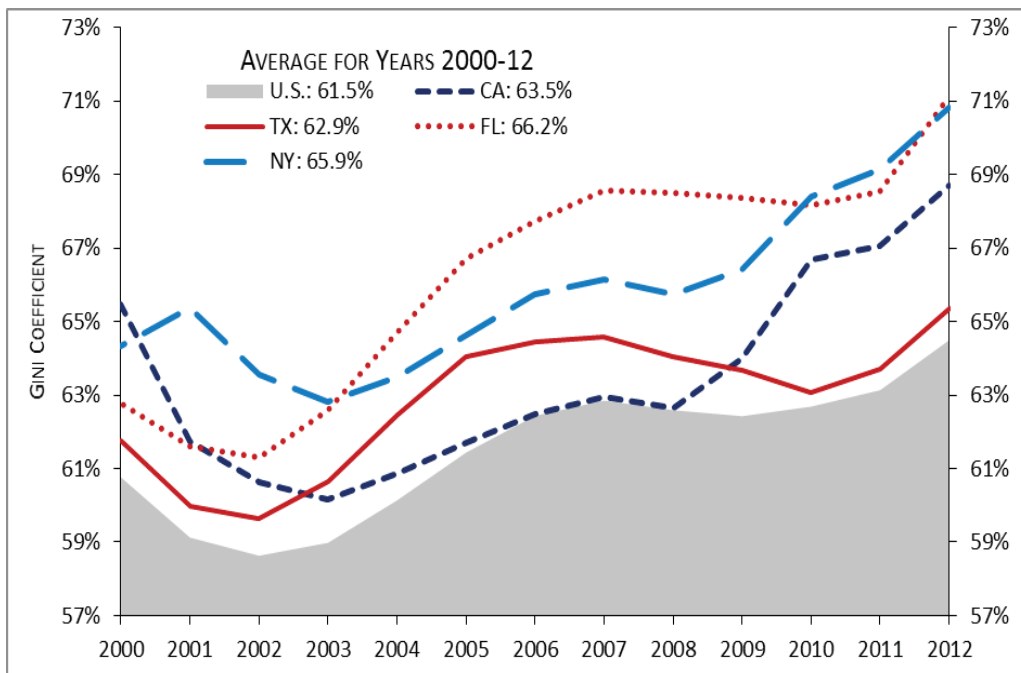
Chart 11: Job growth across all wage quartiles, 2000–2014



Source: Fisher (2015)

The Gini coefficient represents the income distribution and thus is often used as a measure of inequality. A value of one indicates perfect income inequality (i.e., all income is held by a single person) and zero, perfect income equality (i.e., income is dispersed equally). Chart 12 illustrates that Texas’ average Gini coefficient of 62.9 percent was below the levels in other large states and only slightly above the U.S. average.

Chart 12: Texas’ distribution of income is more equal compared with other large states



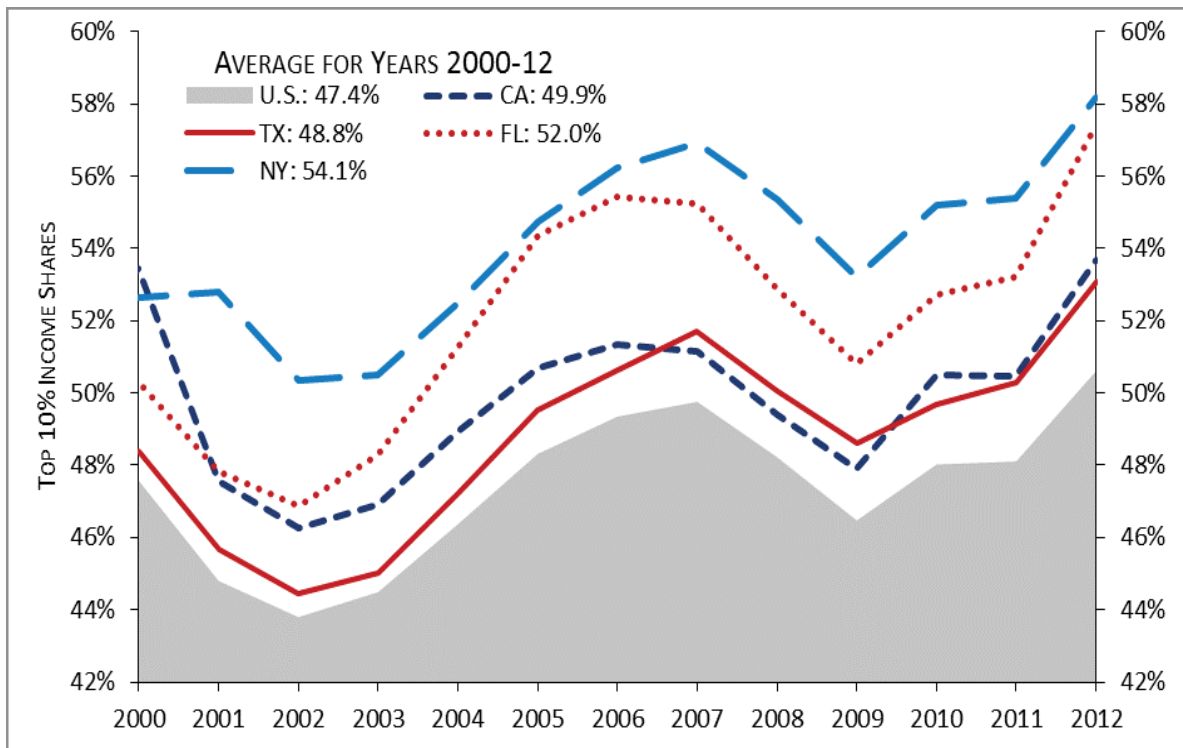
Source: Frank (2015)

For example, in 2001, California’s Gini coefficient was at 61.8 percent compared with Texas’ 60 percent. But during the next 11 years, California’s coefficient increased 11 percent to 68.7 percent and Texas’ increased only 9 percent to 65.3 percent, indicating a lesser increase in concentration of income. Considering that job growth in California has also underperformed compared with Texas, the big-government policies in California have not been effective in creating a more equal distribution of income and more jobs.

However, the Gini coefficient may not be a reliable indicator of income inequality because of demographic changes and the limitation of income thresholds (Frank 2009, 64). To provide another measure of income distribution at the state level, Frank (2009) constructs the income shares of the top 10 percent and 1 percent of income earners with data published in the Internal Revenue Service’s (IRS) Statistics of Income for the number of returns and pretax adjusted gross income by state and by size of the adjusted gross income. This income includes wages and salaries, capital income (e.g., dividends, interest, rents, and royalties), and entrepreneurial income (e.g., self-employment, small businesses, and partnerships). It does not include transfer payments from federal and state governments or interest on state and local bonds. Since the IRS data doesn’t appropriately separate these income sources at the state level, Frank (2015) makes an adjustment similar to Piketty and Saez (2003) that constructs the U.S. top income shares by estimating these shares relative to the overall population of potential tax units.

Charts 13 and 14 present income distribution data for the shares of total income going to the top 10 percent and top 1 percent of income earners respectively. Though both show these four large states’ top income earners had a larger share of their states’ total income than U.S. averages, Texas had the lowest or second-lowest average share from 2000 to 2012.

Chart 13:
Texas’ top 10% of income earners held less average total income than other large states during the period

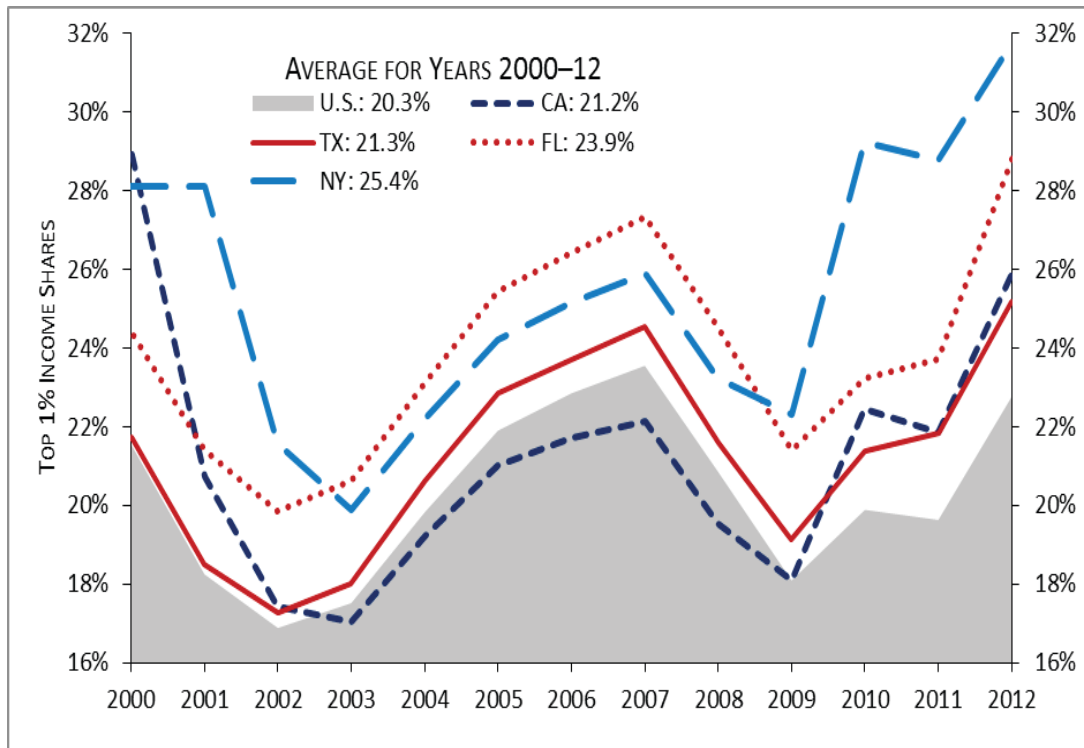


Source: Frank (2015)

California, New York, and Florida have larger income gaps throughout much of the period despite having a slightly higher share of the top 1 percent of income earners. During the post–Great Recession period since 2009, both shares grew at a slower rate in Texas than the other large states at the same time as the Lone Star State created the most jobs.

Chart 14:

Texas began and ended the period with the lowest top 1% income share compared with other large states



Source: Frank (2015)

Texas’ top income shares are higher than U.S. averages and were more concentrated since 2000; but compared with Texas’ closest counterparts, these income-inequality statistics show that the pro-growth, conservative policies in Texas, along with a more international trade, have contributed to a relatively more equal income distribution.

These data tell us little about the level of poverty in the Lone Star State compared with others. The U.S. Census Bureau’s (2015a) Official Poverty Measure for the average during the 2009 to 2013 period shows the shares of the population under the federal poverty level are 15.4 percent for the U.S. average, 17.6 percent for Texas, 16.3 percent for Florida, 15.9 percent for California, and 15.3 percent for New York. However, these data do not include key metrics such as the variable cost of housing among states, or noncash government assistance, like food stamps and Section 8 housing subsidies.

To account for these key metrics, Short (9-10) constructed a new measure of poverty for state-level data for the 2011 to 2013 period—the Supplemental Poverty Measure. These data paint a much different picture, as the U.S. rate is 15.9 percent, Texas’ is 15.9 percent, New York’s is 17.5 percent, Florida’s is 19.1 percent, and California’s is the highest at 23.4 percent. Texas’ supplemental poverty measure is the same as the U.S. average, with the cost of housing, and many other living expenses, being much lower in Texas compared with other large states because of less regulation and higher levels of freedom.



Conclusion

Chart 15 summarizes the findings throughout the paper that the Texas model of low taxes, no individual income tax, less regulation, and a reasonable lawsuit climate provide a solid foundation for more job growth, higher wages, lower income inequality, and less poverty than comparable states and U.S. averages, in most cases.

Chart 15: The Texas model leads comparable states and U.S. averages in most measures

Measure	U.S.	Texas	Florida	California	New York
Economic Freedom of North America (2014)	--	1 st	21 st	43 rd	47 th
State Business Tax Climate Index (2015)	--	10 th	5 th	48 th	49 th
Soft Tyranny Index (2014)	--	1 st	17 th	49 th	50 th
State-Local Tax Burden (2011)	--	47 th	31 st	4 th	1 st
Census Bureau State Exports (2014)	--	1 st	7 th	2 nd	4 th
Avg. Annual Nonfarm Job Creation (2000-14)	0.5%	1.6%	1.0%	0.7%	0.5%
Avg. U-3 Unemployment Rate (2000-14)	6.4%	5.7%	6.3%	7.6%	6.3%
Avg. U-6 Underutilization Rate (2003-14)	12.1%	11.1%	12.4%	15.1%	11.5%
Avg. Labor Force Participation (2000-14)	65.4%	66.6%	62.1%	65.0%	62.4%
Avg. Employment-Population Ratio (2000-14)	61.2%	62.6%	58.3%	60.1%	58.4%
Avg. Employment-Pop. Ratio 25-54 (2003-14)	77.52%	77.19%	77.59%	75.02%	75.90%
Total Civilian Emp. (12/07-12/14), ex. TX	-404,694	+1,572,694	+367,222	+617,937	-124,249
Total Nonfarm Emp. (12/07-12/14), ex. TX	+1,022,400	+1,219,600	+33,900	+438,500	+382,300
Real Avg. Annual Private Pay (2001-14)	6.1%	10.2%	6.1%	6.9%	5.4%
Avg. Gini Coefficient (2000-12)	61.5%	62.9%	66.2%	63.5%	65.9%
Avg. Top 10% Income Shares (2000-12)	47.4%	48.8%	52.0%	49.9%	54.1%
Avg. Top 1% Income Shares (2000-12)	20.3%	21.3%	23.9%	21.2%	25.4%
Supplemental Poverty Measure (2011-13)	15.9%	15.9%	19.1%	23.4%	17.5%

Notes: Dates in parentheses are for the data identified per measure. Data in light blue indicate "best" while red indicates "worst" per measure.

Texas is doing something right. Other states and D.C. would be wise to consider adopting Texas' inclusive economic and political institutions that champion individual liberty, free enterprise, and personal responsibility. This is a path to providing an economic environment that allows entrepreneurs the greatest opportunity to thrive and for prosperity to be generated for the greatest number of people.

Despite this success in Texas, there is more work to do to take the Texas model to the next level of creating opportunities for all to succeed. This includes such policy changes that reduce the size and scope of government. Specifically, effectively limiting the growth of government spending to population growth plus inflation, eliminating the state's onerous business franchise tax, expanding international trade whenever possible, and reducing the mounting burden of property taxes on Texans would do much to generate greater prosperity.

Even with the work that needs to be done, the data clearly show that the Texas model has contributed to labor market success statewide that has been nothing less than a miracle: the Texas miracle. ★

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About the Author



Vance Ginn, Ph.D., is an economist in the Center for Fiscal Policy at the Texas Public Policy Foundation. He is an expert on Texas' state budget, franchise tax, tax and expenditure limit, and other fiscal and labor market issues. In 2006, he graduated with honors from Texas Tech University with a B.B.A in economics and accounting and minors in political science and mathematics. After interning for a U.S. Texas Congressman in Washington, D.C., he started his doctoral degree in economics at Texas Tech University and graduated in 2013. Before joining the Foundation in September 2013, Ginn was a Koch fellow at the Foundation and taught at three universities and one community college across Texas. He has published peer-reviewed articles in academic journals, as well as commentaries in major media outlets across Texas and the nation.

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