

TEXAS

BUSINESS REVIEW

Bureau of Business Research
College and Graduate School of Business, University of Texas at Austin

February 1989

The Texas Economy: School Finance and Economic Development

Of all the issues facing the Texas legislature, none is more critical to the economic future of the state than educational funding.

The Problem


As a nation, our ability to compete is threatened by a decline in the productivity of our work force—more than half of the workers entering the labor force lack the ability to perform even moderately complex tasks such as reading blueprints or understanding equipment operating instructions. While the capability of our work force is declining, Japan's economic success can be attributed at least in part to their investment in education. Japan's literacy rate is 95 percent, whereas ours has slipped to about 80 percent.

The international competition for economic growth is mirrored by the competition between Texas and other states. With oil and gas extraction decreasing as a source of income in Texas, the competition for new businesses in new industries is especially critical to the future of the state. The kinds of business we attract now will determine the shape of the Texas economy for a long time to come. If we maintain our current levels of educational funding, we will tend to attract low skill, low wage industry. If we improve our educational system, we will be able to effectively compete for the kind of economic development we would prefer.

Businesses rarely base a location decision on such vague concepts as quality of life or the special amenities a community claims to offer. In the real world, businesses locate where they can be assured of getting adequate supplies of the inputs they need to produce their product. In a recent survey of business economists, the input to production most often cited as being in short supply was *skilled labor*. Skilled labor doesn't simply happen on its own—it is the product of an efficiently run, adequately funded system of public education.

Primary and secondary educational expenditures in Texas amounted to \$3,117 per student in the 1987-88 school year, split about evenly between state and local funding. This funding level places Texas squarely at the median level compared to other states. We are the worst of the best, or the best of the worst, depending on your point of view. While I suppose we can take some comfort in spending nearly half again as much as Alabama and Mississippi, if Texas is serious about attracting high-tech industry with high-paying jobs, investment in educating our work force must be increased to compare favorably with the states against which we compete for economic development. New York, ranked second among the states in educational funding, spent two-thirds more per student than Texas. New Jersey ranks third in the nation in educational spending and beats Texas by 64 percent. Massachusetts, ranked tenth, exceeds Texas by 26 percent.

Our rank against these other states was even lower before the educational reforms of 1984.



The funding increases adopted as a result of the Perot commission recommendations raised us from 38th out of 50 states in 1981 to our current median position. These reforms are responsible in part for Texas' ability to attract investment in such highly visible projects as MCC, Sematech, and the Superconducting Supercollider. The investment has already begun to pay off—but there is still a compelling gap between Texas and the more fully industrialized states.

Being for education is sort of like being for mom and apple pie. But being for higher taxes is about as popular as being for terrorism. Unfortunately, for Texans, any meaningful increase in educational spending will almost surely require some kind of tax increase. In fact, because of falling property values, many school districts have had to increase their tax rate simply to stay even. In this environment, local efforts to channel more resources to education are unlikely to succeed—state and federal funding are the obvious alternative.

Even though George Bush campaigned as the “education president,” it is probably unwise to expect our school funding problem to be solved by federal aid. For one thing, federal funds are usually distributed as matching funds, or on some other index of state and local effort. If we are not even willing to put up some of our own money, the feds are not going to be interested in bailing us out. The solution to our problem ultimately lies at the state level.

The Texas educational funding situation is complicated by the *Edgewood vs. Kirby* school finance equity case. It now appears that the case will not be resolved until late 1989, after the legislature meets. This delay reduces the pressure on the legislature to solve the equity problem, but it should not become an excuse for inaction. The legislature should use the opportunity to undertake a systematic overhaul of the entire school funding system, with respect to equity, efficiency, and the overall level of funding.

There are many competing uses for state tax revenues—prisons and aid to families with dependent children being two of the most visible. In pay-as-you-go Texas, where total expenditures are limited by tax revenue, funds spent on one program necessarily come out of the hide

of other programs. It is estimated that every dollar spent in education will save about six dollars in future prison and welfare costs. With a payoff like that, education is one of our best investments. Unfortunately, it takes more than a biennium to achieve the payback. In the world of politics, where the planning horizon often ends at the next election, long-range considerations don't show up on the balance sheet as they ought to.

The Solution: A Bitter Pill

Even if every legislator could be convinced that an increase in school expenditures is vital to the economic well-being of the state, there is little that could be done within the current funding situation. The state's money problems have their roots in Texas' dependence on the oil and gas severance tax. In 1982, this tax made up 27 percent of the state's budget. Now, the severance tax is only 8.5 percent of the budget. Part of the decline in severance tax revenue was made up by raising other taxes and user fees. These other taxes and fees are now approaching their practical limits, and further rate increases could actually reduce total revenue.

Now that our familiar taxes are “maxed out,” the time has come to consider a state income tax. Unfortunately, the state income tax has become a knee-jerk issue for a lot of people. Enemies of the tax don't want to be confused with facts even where their own economic well-being is at stake. One fact that ought to change a few people's minds about the state income tax is the change in federal tax law ending the deductibility of state sales tax. Now that sales taxes are not deductible and state income taxes are, Texas taxpayers pay a higher federal tax than their counterparts in states with an income tax.

A reasoned assessment of the current state revenue and expenditure trends suggests that a state income tax is inevitable. The only question is, will we wait for some crisis to force our hand, or will we take a proactive attitude and reform our entire tax system now? The sooner we start, the sooner we can enjoy the benefits.

The Texas Poll released November 12 said 56.1 percent of the Texans interviewed favor in-



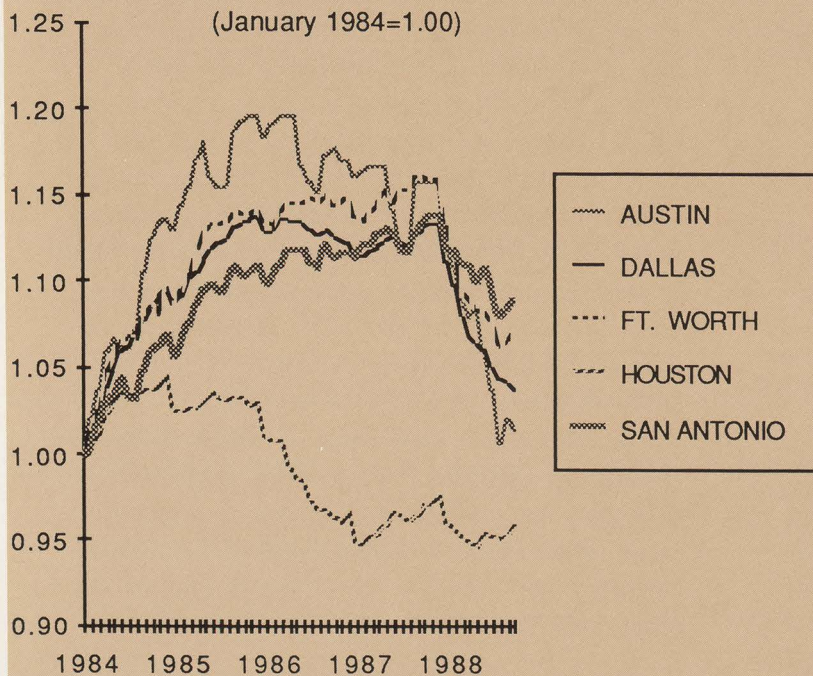
Employment and Unemployment Rate by Metropolitan Area

Area	Total nonagricultural employment (thousands)			Total employment (thousands)			Unemployment rate
	Nov. 1988	Nov. 1987	Percentage change	Nov. 1988	Nov. 1987	Percentage change	Nov. 1988
Abilene	50.5	49.2	2.6	53.0	51.0	3.9	5.5
Amarillo	77.3	78.4	-1.4	96.0	96.4	-0.4	5.8
Austin	351.9	353.8	-0.5	408.0	409.2	-0.3	5.3
Beaumont-Port Arthur	130.1	129.5	0.5	147.6	145.3	1.6	9.1
Brazoria	59.1	57.6	2.6	78.1	75.4	3.6	7.0
Brownsville-Harlingen	67.5	65.8	2.6	87.1	83.7	4.1	11.1
Bryan-College Station	50.5	48.9	3.3	58.3	56.0	4.1	4.1
Corpus Christi	126.2	124.4	1.5	148.4	144.6	2.6	8.1
Dallas	1,340.8	1,340.8	0.0	1,400.2	1,390.4	0.7	5.3
El Paso	190.8	186.7	2.2	218.5	213.1	2.5	10.2
Fort Worth-Arlington	517.5	519.1	-0.3	646.7	644.5	0.3	5.6
Galveston-Texas City	69.3	69.6	-0.4	97.6	97.8	-0.2	7.6
Houston	1,439.2	1,397.5	3.0	1,558.6	1,501.9	3.8	5.9
Killeen-Temple	71.4	70.0	2.0	90.6	87.8	3.2	7.4
Laredo	38.1	35.9	6.1	42.6	39.8	7.0	11.6
Longview-Marshall	65.6	64.8	1.2	73.9	72.5	1.9	8.1
Lubbock	94.5	92.7	1.9	111.3	108.6	2.5	4.5
McAllen-Edinburg-Mission	97.7	90.7	7.7	131.6	124.9	5.4	15.9
Midland	45.3	43.7	3.7	48.1	47.0	2.3	5.3
Odessa	43.2	43.2	0.0	50.2	49.9	0.6	7.4
San Angelo	36.6	36.8	-0.5	44.1	43.5	1.4	5.4
San Antonio	514.9	506.9	1.6	588.1	575.2	2.2	7.0
Sherman-Denison	37.5	38.2	-1.8	46.6	46.9	-0.6	6.0
Texarkana	45.1	46.2	-2.4	54.3	54.6	-0.6	7.5
Tyler	61.9	61.2	1.1	72.4	71.6	1.1	6.8
Victoria	27.6	27.4	0.7	34.7	34.4	0.9	5.7
Waco	79.6	78.9	0.9	90.0	88.1	2.2	5.7
Wichita Falls	51.2	50.1	2.2	55.5	53.9	3.0	5.6
Total Texas	6,676.7	6,575.2	1.5	7,868.0	7,730.9	1.8	6.6
Total United States	108,332.0	104,548.0	3.6	116,314.0	113,809.0	2.2	5.1

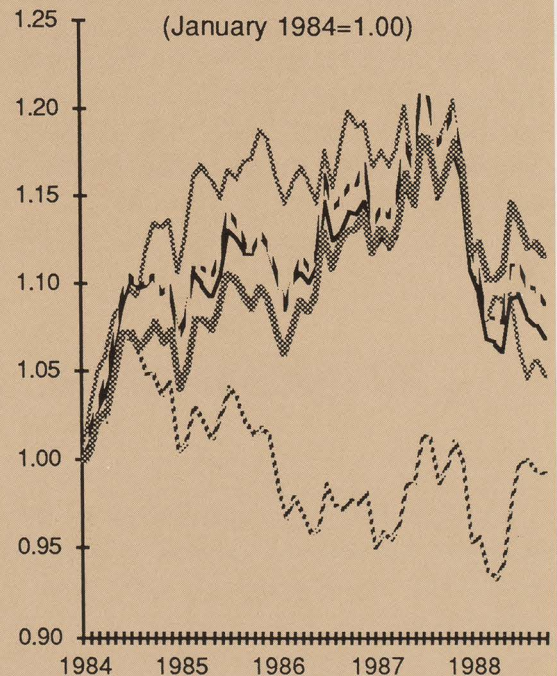
Note: These data reflect the Bureau of Labor Statistics' redefined metropolitan areas in Texas. Data are not seasonally adjusted. Figures for 1987 have undergone a major revision; previously published 1987 figures should no longer be used. Revised figures are available upon request. All 1988 figures are subject to revision, with the exception of Texas and U.S. total employment.

Sources: Texas Employment Commission and U.S. Bureau of Labor Statistics.

Nonagricultural Employment in Five Largest Texas Metropolitan Areas



Total Employment in Five Largest Texas Metropolitan Areas



creasing state taxes to improve education. Four-fifths of those interviewed felt that the increased educational expenditures of 1984 constituted money well spent. It may be that the citizens of the state are more capable of making rational inferences regarding state spending issues than is customarily thought.

If we were to implement a state income tax, how large a tax rate would be necessary? Existing rates vary widely among the states, with New York at the top with a high bracket of over 13 percent and Illinois near the bottom with a flat 2.5 percent rate. Stuart Greenfield, whose economics career includes estimating tax revenues for the State Comptroller, estimates that a 2 percent flat-rate state income tax coupled with a similar tax on business would bring

in approximately \$7.5 billion per year—more than enough to cut the sales tax to a reasonable level and improve educational funding as well.

Spending on education is actually an investment in economic development. If we short-change education, we can revert to being 38th out of 50, and our economy will grow at a 38th out of 50 rate, and the quality of jobs we will attract will be 38th out of 50. If we continue the trend started with the 1984 reforms, the cost will be substantial, but the reward will be that we can realistically compete with more advanced states for economic growth and quality jobs.

— Jerry Olson
Economist
Johnston, Olson, & Associates

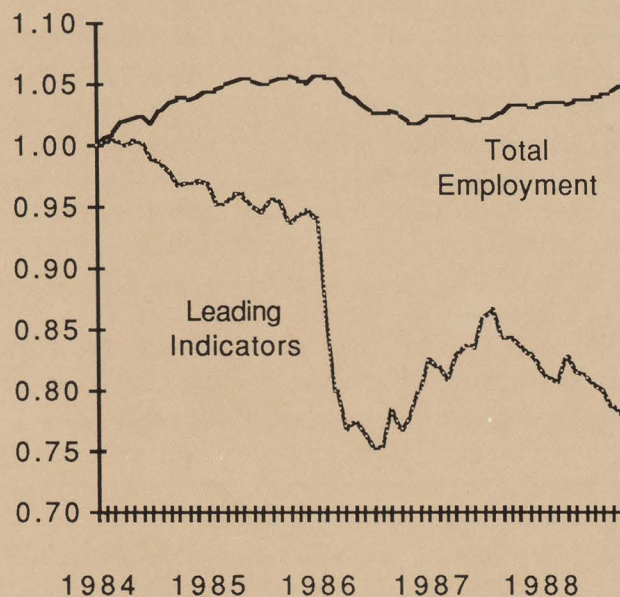
Components of the Texas Index of Leading Economic Indicators (August 1988–October 1988)

Measure	Aug.	Sep.	Oct.
Manufacturing weekly hours	41.64	41.49	41.79
Retail sales (based on 1982-84 = 100)	7.71	7.60	7.40
New housing permits (thousands)	3.36	3.18	3.10
U.S. wellhead price of oil (based on 1982-84 = 100)	10.26	9.69	8.83
Initial claims for unemployment insurance (claims per thousand employees)	9.91	10.11	9.14
Leading indicators index (January 1984=1)	0.80	0.79	0.78

Note: All figures are seasonally adjusted.

Sources: Texas Employment Commission, U.S. Bureau of the Census, and U.S. Department of Energy.

Texas Index of Leading Economic Indicators (January 1984 = 1.00)



Beaumont: An Economy in Transition

For the most part, the economic story for Beaumont in the 1980s has been a tale of transition from an externally fueled, fast-growth economy to a downsized, industrialized, slow-growth economy. After the transition has been fully accomplished, conditions can be expected to be strikingly similar to those that existed prior to the growth activities of the 1970s.

During the 1970s, the Beaumont economy experienced a robust rate of growth. Driven by conditions in the international petroleum market, total employment in the Beaumont-Port Arthur metropolitan statistical area (MSA) increased 15.8 percent while weekly wages in manufacturing jumped 76.3 percent between January 1974 and January 1980. For the decade, disposable personal income and the dollar value of retail sales increased 187.8 percent and 164.7 percent, respectively. Based on these trends, shopping centers and malls were built, large regional and national retail firms entered the local market for the first time, and housing construction prospered.

The economy was performing so strongly during this period that Chase Econometrics ranked the MSA as the top area for job growth potential. When this information was published in the May 1978 issue of *Money*, expectations for effortless economic expansion were widespread.

But the very conditions that created prosperity in the 1970s began to cause serious problems in the 1980s. High crude petroleum prices attracted more and more resources into oil exploration, increasing the supply of oil to such an extent that a glut existed in the market. Market forces then began to erode OPEC's ability to maintain crude petroleum prices at artificially high levels, and prices began to fall. At about the same time, falling demand and increased foreign competition forced domestic refineries and petrochemical manufacturers to recapitalize, substituting capital for labor. The region's oil-based, recession-proof economy then went into a tailspin—not so much because of recessionary forces but because of fundamental structural changes.

Although an increasing body of evidence indicates that the area economy has worked its way through the problems of structural decline and

has begun rebounding, two important changes from the past are likely to be noticed. First, because firms in the region's base industries recapitalized plants and substituted capital for labor, fewer high-paying manufacturing jobs will be available and real per capita personal income will, therefore, be smaller. In essence, the smaller economic pie of the MSA will support a smaller population at the same standard of living or the same population at a lower standard of living. Many of the frustrations of the past several years have been caused by gravitations toward a combination of these alternatives.

Second, the trauma of lost jobs, business closings, and reduced governmental revenues created a cooperative attitude among leaders in the public and private sectors of the MSA. There is an increasing awareness that the region's economy is highly interdependent and that when something good happens in one location, the region as a whole benefits. Developmental efforts of individual agencies, therefore, have been coordinated and combined to promote expansion for the MSA rather than for particular cities or counties. These combined activities have brought new businesses into the area throughout the period of overall decline.

Contract construction is expected to strengthen in the next few years, demand for petrochemical products has caused producers along the Gulf Coast to consider expansion, and substantial projects outside of the petrochemical industry have already been announced. These projects will provide construction work, and the resulting income will be spent with merchants in the region.

Perhaps the single most important piece of economic news in the past year was an announcement by Ramcor, an airplane maintenance firm, that the Jefferson County Airport had been selected as the site for its operations. After several years of employment layoffs by area firms and little success in recruiting new businesses, this signaled a major breakthrough. It is anticipated that this event could launch the local economy on a growth path stronger than the moderate trend that is now expected.

— Charles F. Hawkins, Professor, and
J. M. Pearson, Associate Professor
Department of Economics and Finance
Lamar University, Beaumont



Bureau of Business Research
P.O. Box 7459
Austin, TX 78713-7459

NONPROFIT ORG.

U.S. Postage

PAID

Austin, Texas


Permit No. 1630

Editor: Lois Glenn Shrout

Texas Business Review is published six times a year (February, April, June, August, October, and December) by the Bureau of Business Research, Graduate School of Business, University of Texas at Austin. *Texas Business Review* is distributed free upon request.

Announcements

The first meeting of the Bureau of Business Research Advisory Committee will be held at the Bureau on February 17, 1989, from 9 a.m. until 1 p.m.



The **1989 Directory of Texas Manufacturers** should be available to the public by the time this issue of the **Texas Business Review** is mailed. The 1989 edition includes changes on 48 percent of the firms reported in the 1988 edition and adds over 1,900 plants not previously listed in the **Directory**. Information is updated monthly by **Texas Industrial Expansion**, which is automatically sent to each purchaser of the **Directory**. Price for the 1989 edition is \$110 plus \$8.80 tax for Texas residents. For additional information, call (512) 471-1616.

The December 1988 issue of **Texas Economic Indicators** included July 1, 1987, population estimates for metropolitan statistical areas in Texas from the U.S. Department of Commerce, Bureau of the Census. To obtain a copy of the issue, call Dan Hardy at (512) 471-5179.