

PER

TEXAS

THE UNIVERSITY OF TEXAS AT AUSTIN
NOV 12 1986
GENERAL SALES

BUSINESS REVIEW

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

December 1986

The Texas Economy: Return to Growth

Other than the federal deficit, which has been blamed for almost every evil in U.S. society over the past six years except for the heartbreak of psoriasis, it is hard to think of another subject for which so many trees have been sacrificed in vain than the parlous state of the Texas economy. The plain facts are that there is no evidence to support the notion that the Texas economy has experienced a recession in 1986 (although some sectors of the economy and some geographic locations certainly have). The overwhelming weight of the evidence is that in the first half of 1986 the overall Texas economy experienced a "growth pause" that was not much worse than that experienced by the entire country from mid-1984 to the present.


The limited evidence currently available suggests that the "growth pause" bottomed out in May or June of this year and that the Texas economy is now back to growing at least at the national average, if not somewhat faster. Perhaps the best indicators of this timing are the facts that the year-over-year declines in employment peaked then and have grown progressively smaller since and that the rate of increase in total personal income in the second quarter from the same quarter a year ago (4.01 percent) was the lowest since the first quarter of 1983, a point from which it rebounded significantly then and is likely to do again in 1986 and 1987.

The really good news for the Texas economy for the third quarter of 1986 came from

Detroit, where General Motors came up with a scheme (record low interest rates on automobile financing) to cause the month of September to break all previous records for the numbers of cars and trucks sold in the United States in a single month. This kind of activity creates jobs for lots of sales and service personnel as well as creating an unexpected and very welcome fiscal dividend for the state because of the increase in sales tax receipts.

The recently enacted tax reform bill ensures that the current U.S. economic expansion will last for at least another three years and provides Texas with more optimism for the end of 1986 as well. This near-term buoyancy is caused by the fact that sales taxes will not be deductible by consumers after the end of 1986, so anyone who is thinking about a major purchase in the next year and is among the 32 percent of all Texas residents who itemize their income taxes has an even greater incentive than usual to make this the best Christmas shopping season most retailers have ever seen.

The effects of tax reform will slow both the Texas and U.S. economies in 1987 considerably below what they otherwise would have been, primarily because of the effects on business fixed investment, on commercial real estate, and on apartment buildings. Real GNP growth for the United States is not likely to exceed 3.5 percent in 1987, and Texas will probably perform about in line with this. However, in 1988, when tax reform is fully implemented and the top marginal tax rate on individuals will be lower than in any year since 1932, we can expect a significant increase in growth for the United



States and for Texas. A side effect of this, of course, for those who follow the political theory of the business cycle, is that it virtually guarantees that the Republican candidate for president will be elected in 1988, no matter whom they decide to nominate.

Of course, the political theory of business cycles, a remarkably accurate political and economic forecasting tool, may need to be slightly recalibrated, since Ronald Reagan is the first Republican president since Calvin Coolidge to get through the second year of his term without having the U.S. economy experience a recession.


The other major effect of tax reform on economic growth will come through its impact on interest rates. The vast majority of consumers, at least 80 percent of them by nearly all estimates, will have more disposable personal income in 1987 than in 1986, even with the same gross income level. At the same time, demand for funds will be depressed, both because of the factors stated above and because consumers lose the deductibility of interest and finance charges on everything but their home mortgages. As a result, significant declines in interest rates should occur during 1987, helped greatly by the strong probability that inflation will stay down in the 3 percent range. This scenario, if it develops as we anticipate, includes several more cuts in the Federal Reserve's discount rate, which will get the prime rate down to 5 percent by next summer with long-term government bonds down to 6 percent and corporates only a little above that. This development is enough to offset most of the tax effects on the expected return on investment and will contribute significantly to good economic growth (a little above 4 percent for real GNP) in 1988 and only slightly less real growth in 1989. Such a rebound in growth rates for the total U.S. economy will create the best possible economic environment for the Texas economy.

The exciting political issues in Texas in 1987 will obviously be how the legislature copes with our fiscal problems. This will not be easy and it probably won't be pretty to watch, either (as Bismarck warned a long time ago), but it can't be avoided. The problem is easy to outline: over the past twenty-

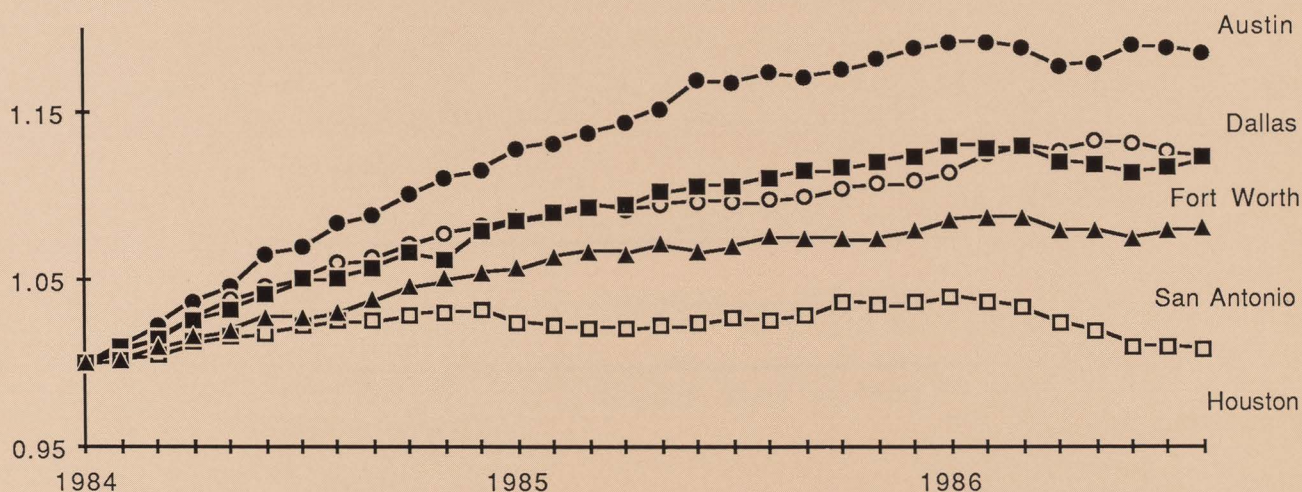
five years successive legislatures have voted for various types of expenditures and various ways of raising revenues that all passed for what seemed like good reasons at the time but that now leave Texas in a situation where its revenues and its expenditures cannot be brought into balance without major restructuring.

The situation calls for a complete reevaluation of every expenditure category and every revenue possibility. Some expenditure categories undoubtedly need to be increased significantly, others slightly, and some have surely outlived their usefulness. A full examination of revenue sources and of experiences in other states would also be useful. For example, a lottery as successful as California's would nearly eliminate the currently anticipated shortfall for 1987-88 under a current services budget. Also, the state that has had the lowest unemployment rate in the United States for the past seven years is New Hampshire, which has no income tax and no sales tax and has had population growth of over 2 percent a year during the period. With personal income in Texas running at \$228 billion in the latest figures, others will see that as a prime revenue source. It should be remembered, however, that individuals pay *all* the taxes already, no matter on whom the tax is levied.

If given the opportunity to swap economic performance of the past decade with Texas, including the slowdown of the first half of 1986, virtually every state except California and Florida would probably be delighted to trade places with us. We have a talented, dedicated, energetic labor force. We have lots of inexpensive land and room to expand for several more centuries. We have a range of climates to satisfy most people's tastes, and air conditioning was invented to satisfy the people who wanted to improve on nature's bounty. We have a wide diversity of natural resources and industries that other states would love to have. We are also among the leaders in most emerging new technologies, which, while they are not creating a large number of jobs today, will be responsible for millions of jobs in the decades to come.



Nonagricultural Employment in Five Largest
Texas Metropolitan Areas
(January 1984=1.00)



Nonagricultural Employment and Total Unemployment Rate by Metropolitan Area

Area	Nonagricultural employment (thousands)			Unemployment rate
	Sep. 1986	Sep. 1985	Percentage change	Sep. 1986
Abilene	52.6	53.9	-2.4	9.5
Amarillo	80.9	80.4	0.6	6.6
Austin	366.8	363.6	0.9	5.8
Beaumont-Port Arthur	128.6	135.9	-5.4	14.1
Brazoria	57.1	58.6	-2.6	11.3
Brownsville-Harlingen	65.6	65.2	0.6	16.2
Bryan-College Station	48.3	48.3	0.0	6.4
Corpus Christi	135.1	137.2	-1.5	12.1
Dallas	1,345.4	1,321.1	1.8	5.9
El Paso	178.3	180.4	-1.2	13.5
Fort Worth-Arlington	510.1	510.6	-0.1	6.6
Galveston-Texas City	72.3	72.6	-0.4	11.3
Houston	1,465.1	1,494.0	-1.9	10.5
Killeen-Temple	68.3	67.2	1.6	8.2
Laredo	35.7	35.2	1.4	15.9
Longview-Marshall	67.4	69.0	-2.3	12.3
Lubbock	92.0	92.6	-0.6	6.5
McAllen-Edinburg-Mission	85.1	82.5	3.2	19.9
Midland	46.0	49.3	-6.7	12.3
Odessa	46.1	52.4	-12.0	17.5
San Angelo	36.8	37.8	-2.6	7.4
San Antonio	484.1	483.5	0.1	7.6
Sherman-Denison	37.6	37.1	1.4	8.1
Texarkana	46.1	45.9	0.4	8.3
Tyler	63.6	63.4	0.3	9.4
Victoria	27.6	30.1	-8.3	10.8
Waco	78.3	79.2	-1.1	7.8
Wichita Falls	51.6	52.5	-1.7	8.4
Total Texas	6,666.3	6,711.0	-0.7	9.1

Note: These data reflect the Bureau of Labor Statistics' redefined metropolitan areas in Texas.

Source: Texas Employment Commission.

U.S. and Texas Total Personal Income
(Billions of current dollars, seasonally adjusted at annual rates)

Year/quarter	U.S.	Texas	Texas as percentage of U.S.
1980/1	2,181.00	133.52	6.12
2	2,202.30	136.62	6.20
3	2,278.50	142.82	6.26
4	2,372.30	149.20	6.28
1981/1	2,440.80	156.50	6.41
2	2,484.50	160.78	6.47
3	2,567.50	167.94	6.54
4	2,590.90	172.12	6.64
1982/1	2,614.30	177.40	6.78
2	2,655.90	179.27	6.74
3	2,683.60	180.06	6.70
4	2,729.20	182.70	6.69
1983/1	2,753.10	184.50	6.70
2	2,812.60	187.08	6.65
3	2,846.80	188.85	6.63
4	2,941.80	195.84	6.65
1984/1	3,034.20	200.00	6.59
2	3,077.40	203.63	6.61
3	3,139.70	208.64	6.64
4	3,189.60	211.06	6.61
1985/1	3,253.10	217.14	6.67
2	3,298.70	219.81	6.66
3	3,323.20	222.03	6.68
4	3,382.90	223.87	6.61
1986/1	3,432.60	227.63	6.63
2	3,483.30	228.62	6.56

Source: U.S. Department of Commerce, Bureau of Economic Analysis.

Components of the Texas Index of Leading Economic Indicators
(June 1986 - August 1986)

Measure	Jun.	Jul.	Aug.
Manufacturing weekly hours	41.09	41.50	41.70
Retail sales (billions of 1967 dollars)	2.44	2.51	2.47
New housing permits (thousands)	6.84	5.51	6.60
U.S. wellhead price of oil (1967 dollars per barrel)	3.31	3.35	3.35
Initial claims for unemployment insurance (claims per thousand employees)	13.28	13.86	12.71
Leading indicators index (January 1984 = 1)	0.76	0.77	0.77

Note: All figures are seasonally adjusted.

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

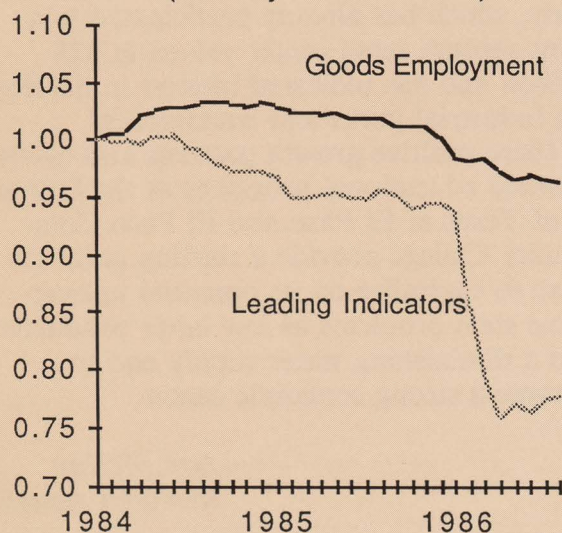
We are now the third largest state in population, about 1.3 million people behind New York. We'll pass New York, if not by 1990, then soon after. By the turn of the century, Florida will have passed New York as well, so that the three most populous states will all be in the Sunbelt. Of course, we're not likely to catch up with California (they're 10 million people ahead now) unless most of that state falls into the Pacific Ocean or we merge with Chihuahua.

The major source of growth is small business, and Texas is blessed with a large number of these and thousands of as yet unknown entrepreneurs. It only takes a few of these people to be successful, and then the public will start reading about the next generation of great Texas companies.

The conclusion is that the Texas economy is in much better shape than the conventional wisdom would suggest. That's why people call it "conventional"; it's nearly always wrong.

—James F. Smith
Chief Economist & Acting Director

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



Growth Trends in El Paso

Diversification in five major economic sectors has sustained the economy of El Paso through recent downturns in energy and the devaluation of the Mexican peso beginning in 1982.

El Paso, located halfway between the east and west coasts, has been a trade and transportation center since the midnineteenth century. With a population of over 500,000, it is the sixth largest city in Texas. Both the population and the economy continue to grow although the economy still lags state growth.

The fastest growing economic sectors include trade, services, finance, insurance, and real estate, and manufacturing. Government, including the military post at Ft. Bliss, has been a major source of income for the city.

Trade employed more people in the year ending May 1986 than any other sector. Total employment in the trade sector increased 8.83 percent from 1982 to 1986 in spite of a 5.79 percent dip between 1982 and 1983. This decline reflected the devaluation of the peso and the general recession in the nation and resulted in the closing of numerous small businesses, especially those near the border.

Service employment, following a national trend, has experienced the largest growth of the sectors between 1982 and 1986 with an increase of 22.14 percent, slightly below the state rate of 24.12 percent. This sector has increased to 19.14 percent of total nonagricultural employment against 16.58 percent in 1982. In 1984 the largest service employers were health with 32.93 percent and business with 22.37 percent of total employment in the sector. The business component increased significantly more than others in this sector, and business service is expected to continue to grow to support an anticipated expansion in manufacturing and business.

The emergence of finance, insurance, and real estate as a major economic sector in El Paso is encouraging. This sector grew 18.95 percent between 1982 and 1986, a growth that is indicative of stronger business development.

Finally, the manufacturing sector employed 19.19 percent of the total work force in the

year ending May 1986, well above the state rate of 14.15 percent even though employment in this sector is down 10.44 percent since 1982. The manufacturing sector became important mainly because of the apparel industry, the largest component, but this concentration has become vulnerable to cyclical downturns and the decline of the industry nationwide. Manufacturing is nevertheless considered a major growth area in El Paso, and long-range economic planning and development for the city includes an intensive search for diversified light manufacturing that will benefit all facets of the economy. There are now approximately 700 plants in El Paso; some 180 of these are in-bond (maquila or twin plant) assembly plants located in Cd. Juárez with managerial and service support in El Paso. New types of industry that have located in El Paso include publishing, telecommunications, Westinghouse's new research and development facility, LTV's missile assembly plant, Honeywell's microswitch assembly plant, and other plants in the electronic components assembly industry.

In addition to these major sectors, construction has maintained stable employment, a result of diversity in building patterns that has led to new construction in all segments of the industry. Not overbuilt to the extent other large cities in Texas are, El Paso has approximately one year's absorption rate for all types of construction. The new patterns of growth have drawn the attention of developers such as the Trammell Crow Company, which has already participated in a joint venture retail center valued at \$25 million and has indicated interest in developing industrial parks and warehouses.

These positive growth patterns and newly planned educational programs at the University of Texas at El Paso and El Paso Community College provide a starting point for El Paso to capitalize on its potential to overcome such problems as low labor productivity and a diminishing water supply and to become a strong economic center.

—Jym McKay
Research Associate



Bureau of Business Research

P.O. Box 7459

Austin, TX 78713-7459

NONPROFIT ORG.

U.S. Postage

PAID

Austin, Texas

Permit No. 1630

GENERAL LIBRARIES
TX UNIV OF
PCL 1 114 SERIALS RECORDS
CAMPUS MAIL CAMPU

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.

The Bureau of Business Research serves as a primary source for data and information on Texas and on the dynamics of change. The Bureau's research program concentrates on the determinants of regional growth and development and investigates specific issues for clients. The information services division answers inquiries by telephone and mail, responds to walk-in visitors, and offers computerized data from the 1980 census of the population and on manufacturing firms in Texas. The publications division produces periodicals, directories, books, and monographs on a variety of topics that shape the development of the Texas economy.



Announcements

The Bureau will hold its annual economic outlook conference series for 1987 in Houston, Austin, and Dallas Feb. 18, 19, and 20 and in Lubbock, San Antonio, and El Paso Mar. 3, 5, and 6. Dr. James F. Smith, chief economist for the Bureau and former director of regional services for Wharton Econometric Forecasting Associates of Philadelphia, will be the key speaker. Together with other noted experts from the University and business sector, Dr. Smith will discuss current trends and expected developments in the national, state, and area economies. For more information, call Lisa Sparkman or Patti Hudgens-Higginbotham at (512) 471-1616.