

THE

*Real Spelce*

# AUSTIN LETTER

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Dear Client:

**One of the Austin area's biggest economic engines, UTAustin, will go before the legislature next month to try to remove the cap on its student tuition rates.**

As we have been telling you for months, the next session of the Texas Legislature will be facing a budget shortfall (not a deficit) of at least \$5 billion if it is to maintain its current level of funding to meet the needs of a fast-growing state. **UTAustin, along with other state agencies, will be scrambling for every dollar it can get to finance its operations for the next two years.** A tuition hike would generate funds without tapping stretched state revenues.

TexasA&M is joining UTAustin in this effort to remove the cap on what universities can charge their students for an education. "I hope our legislators will allow our flagship public universities to set their own tuition levels within reasonable limits," said **Robert Sloan**, the president of Baylor University.

Why is the president of a *private* institution supporting such a move? Obviously, if UTAustin and TexasA&M raise their tuition, then **Baylor's higher fees will be more competitive.** But Sloan says his support goes beyond that. "Excellence at the state institutions is good for all of Texas," he believes.

Sloan maintains, "Texas needs the sort of research provided by its tier-one institutions." He says, "**Texas can't afford to cede medical breakthroughs, technological advances or industrial developments to other states or regions.**" He points out Rice University, Texas A&M and UTAustin are the only three tier-one national universities in Texas. "Massachusetts, with a much smaller population and budget than Texas, claims five," he noted.

"The vitality of Texas' future depends not only on the education of its people, but also on the strength of its research and development efforts," Sloan says. "**That can't happen simply with revenue from the state budget.**" And, he says allowing UTAustin and TexasA&M to adjust their tuition to market prices would more accurately reflect the cost of public higher education.

There will be legislative opposition to this effort. But, from an Austin economic perspective, more monies that flow through UTAustin result in more economic benefits for our area.

**While the budget will bedevil Texas legislators next month, the Texas financial problems are nothing compared to those in other states.**

How bad is it for state budgets? “This is the worst fiscal situation for the states since World War II,” says **Ray Scheppach**, executive director of National Governors Association. That’s a pretty staggering comment, especially when you think about the economic ups-and-downs this nation has faced in the 57 years since WWII ended.

Other states are facing *deficits*. Texas is facing a *shortfall*. This is not just semantics. As we told you 9/13/02, **a shortfall represents how much more money may be needed to keep government operating at the same level**. This isn’t to minimize Texas problems because the shortfall can be anywhere from \$5 billion to \$12 billion for the biennial budget, depending upon who is doing the estimating. But, Texas does not have a spending *deficit*. We’re not in the hole.

Take a look at California. The 12/9/02 edition of *FORTUNE* magazine surveyed state budgets and while California is not in the worst position percentage-wise, it is a state with which Texas competes in many ways. California is facing a deficit of 7.8% of its fiscal 2003 budget. **In pure dollars, the Golden State is facing a cumulative deficit of \$21.1 billion for just one year — fiscal 2004**. This is big-time serious. You don’t want to be a taxpayer in California, since your already-high taxes are probably getting ready to go higher.

Because state budgets vary widely, let’s look at a few other states by percentage. Here are the **states with the highest deficits**, as a percentage of their fiscal 2003 budgets: Nebraska, 5.9% ... New York, 6.3% ... Michigan, 6.5% ... Washington, 7.8% ... California, 7.8% ... Arizona, 8.0% ... Idaho, 8.1% ... Colorado, 9.2% ... Nevada, 10.5% and Alaska, a whopping 20.6%. Last year many of these states balanced the books by doing the easy things – delaying capital expenditures, cashing in their tobacco settlements, raiding their rainy day funds and the like. The going will be tougher this year, and *FORTUNE* predicts a combination of service cuts and higher taxes is inevitable in those deficit-damaged states.

Some Texas legislators are already signaling they want to tap the Texas rainy day fund and cash out the tobacco settlement that is being paid out over time. Raising selective taxes, such as a buck-a-pack increase in cigarette taxes (see our 10/18/02 issue), are being discussed as we speak. Leaders of the Republican majorities in both the House and Senate say **they will not raise taxes, but will cut appropriations to various state agencies** to match the anticipated revenue. Scaled-back spending by the state will be felt more in Austin than any other city due to the concentration of state government here.

The bright side: Texas budgets for two years at a time. And, State Comptroller **Carole Keeton Rylander** as well as the Legislative Budget Board are predicting the **state’s economy will grow by almost 12%** during that 2004-2005 budget cycle. This could help the state’s revenue picture. Any way you cut it though, Texas will struggle — but is not as desperate as other states.

**Air travel is tailing off in the Austin area and this is not a hopeful sign for the local economy.**

For much of 2002, air travel was plodding back to where it had been. After 9/11/01, the total number of passengers at Austin-Bergstrom International Airport (ABIA) dropped below the levels of 1999 and 2000. Then the numbers slowly started ratcheting upward. In fact, **for most of 2002, the totals moved higher than the 1999 numbers.** All that remained was to get back to the record years of 2000. But that trend was reversed in September 2002.

The September 2002 numbers turned back south and nose-dived dramatically below the 1999 totals. It wasn't just a blip. The newly-released October tally of ABIA passenger traffic showed the **2002 totals were still below those recorded in 1999** (and nowhere near the 2000 record) and were only 2.25% higher than those measured the month after 9/11/01 when travelers were very skittish about flying.

**We keep a close eye on this economic barometer for you because it measures both business and leisure activities.** It's a good economic sign when businesses increase their travel. The same for leisure travel. But it looks as if we need to wait awhile for those positive signs.

**During the past year, 2,300 more jobs were filled in the 5-county Austin metro area. With so many jobs lost during the slowdown, where was the increase?**

As an example, in the year from October 2001 to October 2002 (the latest data available from the Texas Workforce Commission), **6,200 jobs were lost in manufacturing and 800 jobs were lost in construction.** That's 7,000 jobs lost just in two categories. Since retail jobs remained steady, where was that deficit offset enough to actually end up with a 2,300 job gain?

Look no further than government. **Six hundred jobs were added at the federal government level** – many of those coming at ABIA where security screeners were increased and added to the federal payroll. **Another 3,200 jobs were added at the state government level and 4,000 were added in local government.** Remember the state and local government totals include educational institutions and school systems as well as the standard governmental classifications.

The services sector also added about 900 jobs during this one-year period. There were ups and downs in other categories, but you can easily see new government jobs offset the loss of manufacturing and construction jobs. This raises two important elements. First of all, it underscores the **importance of the economic underpinning of government jobs** in our area. And secondly, it reinforces the **concern about what the next session of the legislature might do about cutting government services and/or jobs** to balance a tight budget. As we've noted, cuts in state government spending in 2004 and 2005 will have a greater impact on Austin than any other area in the state. And that could, possibly, slow our economy's rebound.

**Last week, President Bush ordered the US to begin processing applications of 130 Mexican truck companies seeking authority to send their big rigs from Mexico up IH35 through Austin. Then, this week, a federal court suit was filed to stop the action. Here's what's really behind the delaying tactics that are causing tension between the US and Mexican governments.**

The lawsuit was filed in San Francisco by environmentalists, labor groups and US trucking industry reps. They say they want to **keep Mexican trucks off our roads until their impact on air quality is studied in more detail**, even though the Bush administration ruled earlier there would be no significant impact. The US agreed on the trucking arrangement when the North American Free Trade Agreement was passed years ago. But it's still dragging on.

Behind the scenes, here's what some are saying is the **real reason the US has yet to make this NAFTA provision a reality**. A driver for a major US trucking firm can make as much as \$30 an hour. A driver for a Mexican trucking company makes only a fraction of that amount.

Think about it. Such low wage competition could really cause problems for US trucking companies and drivers. Environmental concerns, **even safety issues**, are what's being talked about publicly. But you can bet the **economic concerns are driving this delay**.

Not only are US-Mexico relations being strained by this impasse, but also the US could be facing some serious penalties if the Mexican trucks are not eventually allowed to travel IH35 and other US routes. **Penalties, maybe as much as \$2 billion, could be levied against the US** if the Mexican trucks continue to be kept off US roadways.

**Dr. Louis Overholster** has been watching the wild stock market fluctuations throughout 2002 and said a cartoon he saw in *The Wall Street Journal* pretty much sums up the situation. The caption on the cartoon: "Stock prices fell sharply today on the fear that stock prices would fall sharply!"

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