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AUSTIN LETTER

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Dear Client:

The number of state governments slashing spending and cutting jobs is more than triple the size of previous years. While Texas is feeling some of the effects of the national slowdown, the Lone Star State — its economy and its government — is impressively strong.

As state legislators nationwide prepare budgets for next year, *The Wall Street Journal (WSJ)* is reporting that as many as 32 states may face shortfalls. The economies of those states have been so battered that **their state governments are in a position of cutting state jobs, reducing spending and in many cases, raising taxes for 2009.** Not so in Texas.

Those concerned with the economy in Austin keep a close watch on state government. Really, it's the whole magilla – state payroll jobs, state purchases and contracts with local companies, travel to Austin generated because of state government's presence, state appropriations to various entities such as UTAustin, etc. You get the picture. As the old saying goes, **if state government sneezes Austin catches a cold.**

What is happening in a majority of the states is sobering. The *WSJ* report cited a study by the National Conference of State Legislatures (NCSL) that showed 22 states are reporting sales taxes that are below forecast, and in nine of those states, the collections were **below forecasts that had already been reduced downward.**

The NCSL went on to say **17 states had a shortfall in corporate income taxes, 11 states were behind on personal income taxes** and 11 were also behind on miscellaneous taxes, such as insurance premium taxes. And at the same time, costs are rising for these state governments. Not a pretty picture. And the fiscal-program director for NCSL said "We expect it to get worse before it gets better."

The picture is much brighter as far as Texas state government is concerned. For instance, State Comptroller **Susan Combs** has forecast that **Texas will end its current budget cycle with a General Revenue Fund Balance of \$10.7 billion** (more about that in the next item). She also reports that sales tax receipts are up about 6% so far this fiscal year compared to fiscal year '07. These are just two comparisons that show the relative economic strength of Texas to the majority of other US states. This seems like a good time to give you a more complete picture of Texas vis-à-vis the nation. We'll do that in the next few items.

If it weren't true, the strength of the Texas economy might seem like another "Texas Brag" story. But, as the ole cowboys say, "it ain't braggin', if it's true." Check out the facts.

Let's start with what may be the most impressive comparison — jobs. As you know, jobs are the most important indicator of the health of an area's economy. So, hold on. You may find this hard to believe, but from June 2007 – June 2008, **Texas job growth accounted for 73% of all the job gains in every single state in the US.**

Let this sink in for a minute. The 73% figure reflects that about 247,000 jobs were gained in Texas in the June to June time frame, which is **more than the next nine top job growth states combined.** Add 'em up: Washington, 36,000 ... Louisiana, 33,000 ... Colorado, 32,000 ... Maryland, 30,000 ... New York, 29,000 ... North Carolina, 26,000 ... Oklahoma, 23,000 ... Virginia, 14,000 and Utah, 13,000.

You'll notice this list of Top Ten states for adding jobs does not include some of the biggies. Far from *gaining* jobs for their citizens, **Florida lost 78,000 jobs, Michigan lost 49,000 and California lost 40,000.** Texas gained almost a quarter million jobs, while these three states were losing jobs. Amazing.

This isn't to say Texas is hitting on all economic cylinders. **Sales tax revenue, while up 6% so far during fiscal year 2008, is slowing from a recent double-digit pace. Existing home sales and building permits are off the pace of the recent past.** But the important point is the comparison to other states. When companies and business leaders decide to invest in a new location or to expand existing operations, Texas looks pretty good to them, compared to others.

Oil and gas provide the ultimate mixed bag assessment. High gasoline prices run up the cost of all types of transportation and this trickles down to the cost of items that need to be transported. But Texas derives tax revenue on oil and gas production as well as the energy companies operating in Texas. **Oil Production tax revenue was up about 65% compared to last year and Natural Gas Production tax revenue was up about 33%.** There may be pain at the pump, but there is gain in state revenue.

We promised in the previous item to provide more detail about the estimated **\$10.7 billion surplus** legislators will be looking at when they convene in Austin in January 2009. Well, even the folks at the State Comptroller's office will tell you **that figure is a bit squishy and likely to change.** There will still be a positive fund balance, but the totals may change a bit.

But let's assume the \$10.7 billion figure for now. About \$3 billion of that would be dedicated to **replacing school property tax revenue** that was lost when the rates were cut in 2006. Another \$5.7 billion goes into the **Rainy Day Fund** that can only be used for emergencies (unless two-thirds of the entire legislature decides otherwise). **So this leaves a balance of \$2 billion** – nothing to sneeze at, but way short of the \$10.7 billion taxpayers might mistakenly believe is available to the Legislature to divvy up among various state agencies and programs.

It's also not bragging when third parties start dispensing the same sort of observations about the Texas economy. Others have taken note of what is happening in the Lone Star State.

Mostly, the kudos for Texas' economic position are coming from the business sector. After all, business is the engine that determines to a large extent the economic vitality of an area. And while public sector jobs are an important part of the mix, many public sector jobs dip when business slows down. (The first story in particular illustrates this quite vividly.) **Business observations from third party "outsiders" are lending validity to Texas' brag.**

The widely-watched business TV cable channel, CNBC, named **Texas as America's Top State for Business** after scoring each of the 50 states on 40 different measures of competitiveness. Some of the broad categories analyzed by CNBC: cost of doing business, workforce, economy, education, quality of life, technology and innovation, transportation, cost of living, business friendliness and access to capital. **Texas' strongest showings were in economy, transportation, technology and innovation, and cost of living.**

Then, just this week, a marketing company, Development Counsellors International (DCI), released the results of a poll of **281 corporate executives across the country. And 40.8% of those polled said Texas had the most favorable business climate.** While this current ranking was just released this week, Texas has held the top spot in this every-three-year survey since 1999.

There are other third party "endorsements" of Texas' top standing among the states. For instance, Ernst & Young ranks Texas **first in the US in overall attractiveness for renewable energy investments.** *CEO Magazine* named Texas as the **Best State to Do Business** for the third year in a row.

So what does the state's biggest booster say about all of this? Gov. **Rick Perry:** "There is simply **no better place to live, work, grow a business and raise a family** than the great State of Texas. We have the best business climate in the country and remain globally competitive thanks to our reasonable regulations, low taxes, fair legal environment, educated workforce and an unparalleled quality of life." (Okay, you can forgive the governor if he seems to brag a bit.)

Speaking of gasoline prices, an interesting development is happening to gasoline purchases in Texas. It appears Texans have cut back on gasoline consumption.

While gasoline tax revenue is up about 1.34% compared to the same period in 2007, there were drops in May and June 2008, compared to the same months in 2007. This was about the time the **\$4/gallon price point was hit.** The July numbers should be released any day now and if they also show a drop, you can assume that \$4/gallon is the "tipping point" for Texans.

Higher gasoline prices are not only leading to lower gasoline consumption, but there is a ripple effect that could be blamed for such events as lower Texas Lottery ticket sales and subsequently less money for public education.

By far the most ticket sales for the Texas Lottery occur in convenience stores where most people stop to pump gas. **If drivers are making fewer stops for gas, they have less opportunity to run into a convenience store for a lottery ticket.** And when they do “fill-’er-up” to the tune of \$75-\$100, motorists may not be inclined to take a flyer on a lottery ticket. So high gasoline prices may be one of the reasons for the recent declines in lottery sales.

In the most recent reports from the Texas Lottery Commission, **lottery ticket sales are down about 3% from the previous year.** Three percent is a small percentage but it translates to big bucks. How big? Don’t know precisely, but since 2004 the lottery has sent about \$1 billion a year to the state treasury to use on behalf of Texas public schools.

It’s also important to note, the money that goes to the school fund **represents only a portion of the money raised by the lottery.** Much of the lottery sales revenue goes to pay the winners of the various games and the significant overhead costs that come with running a lottery operation in a state the size of Texas. The Texas Lottery is a big enterprise.

See the ripple effect. High gasoline prices have triggered less purchases of gasoline. That, in turn, may have been a reason for lower lottery ticket sales. And that in turn means **less money may be sent from the lottery to public education.** Lottery ticket sales could be off as much as tens of millions of dollars when the state’s fiscal year ends.

Speaking of the economy, **Dr. Louis Overholster** tells us there is now a theory that when the snake in the Garden of Eden first approached Eve with the apple, she asked “What’s that?” And the snake said “Think of it as a sub-prime mortgage!”

Sincerely



Editor/Publisher