Unlike the 1980s, Texas Keeps Growing with Oil Prices Low

By W. Michael Cox and Richard Alm

While much of the rest of the United States struggled, the Texas economy bounced back smartly from the financial crisis and recession of 2008-09. The state added more than 1.5 million jobs from 2009 to 2014—about half of the nation’s total employment gains in the period.

The Texas economy was humming along nicely in 2014—then falling oil prices put the good times in jeopardy. The benchmark West Texas Intermediate (WTI) price dropped below $100 a barrel in late July, then continued to spiral through $90 in October, $80 and then $70 in November, $60 in December, $50 in January 2015, and $40 by year’s end. WTI hit a low point just below $30 a barrel in February 2016. It rebounded to $40 by mid-March, but the overall slide exceeded 60 percent.

Remembering Texas’ history, many feared the worst—for good reason. In the mid-1980s, a sharp plunge in oil prices sent the Texas economy into a tailspin, with many a fortune lost. As the oil money ran dry, real estate values plummeted, and just about all the big Texas banks went belly up. Texas fell into a steep recession at a time when the overall U.S. economy was shifting toward higher growth. State GDP fell 3 percent in 1985-86, accompanied by a decline of 252,000 jobs, or 3.8 percent, between November 1985 and January 1987.

In percentage terms, the current oil-price collapse has been larger than the one in the mid-1980s—but outcomes for the Texas economy have been starkly different. As expected, oil-industry activity and employment have declined as crude prices fell over the past 20 months. The overall economy, reportedly soaring in 1979-80 and 2007-08 and plunging in 1985-86, 2008-09 and 2014-15 (see chart below, black line), Texas’ inflation-adjusted state GDP growth, the broadest measure of the state economy’s performance, clearly shows the oil bust’s heavy toll in the mid-1980s (see chart below, red bars).

It wasn’t an oil price rebound that pulled Texas out of recession in the mid-1980s. In fact, oil remained cheap for the next two decades. No matter, the Texas economy shrugged it off and bounced back, growing at an average annual rate of more than 4 percent from 1986 to 2005. An economy that had been devastated by an oil-price collapse quickly and efficiently remade itself, gaining strength from the expansion of non-oil industries.

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Inflation-adjusted oil prices have been volatile over the past four decades, notably soaring in 1979-80 and 2007-08 and plunging in 1985-86, 2008-09 and 2014-15 (see chart below, black line). Texas’ inflation-adjusted state GDP growth, the broadest measure of the state economy’s performance, clearly shows the oil bust’s heavy toll in the mid-1980s (see chart below, red bars).

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OIL PRICES FALL—BUT NO REPEAT OF TEXAS’ 1980s SLUMP

Monthly Oil Prices in Constant $2015

Texas Real GDP Growth Rate


2014-15: Oil prices crash, but Texas’ economy continues to grow.
Back then, oilfield revenues’ share of state personal income hit an all-time high of 26 percent (see chart at right). In 1981, oil’s share of the economy once again spiked at 25 percent, largely because Texas benefited from OPEC’s success in driving prices to unheard-of heights. With crude prices in a long-term lull, oil’s share of state personal income hit its low point in 1998—just 1.4 percent.

Over the past six years, the development of hydraulic fracturing, or “fracking,” technologies has helped restore Texas oil’s mojo. Even with record production and prices above $100 a barrel, oil’s share of state personal income rebounded to only 9 percent in 2014. A year of falling prices has sent oil back to less than 5 percent of personal income.

Even the state government now depends less on oil money. When crude prices and production were high from 1981 to 1983, the oil sector’s contribution to state revenues averaged 12 percent. In recent years, real oil prices have been as high as they were in the early 1980s, but oil has provided less than 5 percent of state revenues since 2012.

Texas still faces vulnerability to low oil prices—but it shows up mostly in industry and regional data. By early 2016, just about all drilling activity had stopped. Midland, the hub of the oil-rich Permian Basin, has seen employment fall more than 5 percent since February 2015 (see chart below).

Like the state as a whole, Texas’ big metropolitan areas have continued to add jobs in the past year. Employment rose 4.5 percent in Austin, 3.6 percent in Dallas-Fort Worth and 2.7 percent in San Antonio. Energy-dependent Houston managed to eke out a small gain in jobs, a testament to the metropolitan area’s increasing diversification.

Oil and related industries remain an important part of the state economy. However, the business that had symbolized Texas for so long has become far less dominant as the state’s entrepreneurs and businesses expanded other industries, giving the state economy a wider, sturdier foundation.

Let economic freedom ring

Commentators outside Texas like to portray the state as being just plain lucky, living off the bounty of the ancient seas that left behind the dead plants and animals to morph into oil and gas deposits that have enriched Texas for more than a century (see The Texas Economy, February 2016).

That oil-soaked view may have been true in the past, but not today. Texas’ rapid diversification points us to the real reason for the state’s success: a high level of economic freedom. The latest Economic Freedom of North America index finds Texas tied with Florida as this country’s third most economically free state, just slightly behind New Hampshire and South Dakota.

Texas’ high ranking in the latest economic freedom report isn’t a fluke. Since the first index in 1980, the state has never been below seventh—and in many years, it has ranked No. 1.

Keeping taxes, regulation and public spending low, while allowing labor markets to function with few restraints,
In an environment of economic freedom, two decades of low prices gave Texans and in-migrants incentives to develop the non-energy parts of the economy.

Even more dependent on its cash cow and vulnerable to wild swings in prices, Texas might have been headed that way in the 1980s: continued high oil prices probably would have left the state more skewed toward energy production. The recent decline in oil prices would have had dire consequences for the overall Texas economy.

Fortunately, the oil bust shunted the state’s economy onto a different track. In an environment of economic freedom, two decades of low prices gave Texans and in-migrants incentives to develop the non-energy parts of the economy. With the benefit of hindsight, the hard times Texas endured three decades ago come clearly into view as a blessing in disguise.

Now, Texas’ economy stands out as one of the nation’s most diverse—a topic we intend to explore in a future issue of The Texas Economy. Many parts of this highly diversified economy benefit from low oil prices—the airlines, the farm sector, and the petrochemical complexes along the Gulf Coast.

It would be too much to say that the oil bust transformed Texas. But the oil industry will no longer be the dominant feature of the state’s economy, no matter how oil prices fall.

In the past two decades, oil and gas have become far less important; non-energy businesses carry greater weight, and Texas’ economy doesn’t need high oil prices to continue growing. As long as they last, low oil prices will take some of the sizzle out of Texas’ economy, no doubt. But the oil industry will no longer determine the fate of the state.

References


Next issue: The Texas Economy’s historical series resumes with the story of how the state took on the first big challenge in building an economy—attracting settlers to a remote and dangerous part of the world.

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Housing Prices Lower, More Stable in Texas’ Biggest Metropolitan Areas

Housing prices are a key component of differences in the cost of living in major metropolitan areas, including Dallas-Fort Worth (DFW) and Houston.

According to National Association of Realtors’ data for the nation’s 12 largest urban areas, the two Texas cities’ housing markets have been relatively calm through the past quarter century’s booms and busts.

The housing bubble of 2002 to 2007 more or less bypassed the DFW area (thick blue line). In those years, prices for existing single-family homes rose slightly faster in Houston (thick green line) than in DFW, but most other metros had much larger run-ups, which set them up for chilling plunges when the housing bubble burst.

Since 2011, housing prices have been rising in all 12 metropolitan areas—more in some, less in others. Atlanta has had the largest price increase—84 percent. DFW’s gain of 45 percent ranks as the fifth largest; Houston is next at 42 percent.

In this housing cycle, DFW and Houston are looking more like other big cities, eroding the Texas cities’ edge in affordability. Texas’ bustling economy and growing population are fueling demand for housing, while new building hasn’t been able to increase supply fast enough to keep pace.