

THE TEXAS ECONOMY

O'NEIL CENTER FOR GLOBAL MARKETS AND FREEDOM ★ SMU COX SCHOOL OF BUSINESS ★ SECOND QUARTER 2018

Trump and the Texas Economy

By Richard Alm

Texas casts an outsized shadow over the nation's politics, with its multitude of voters, big Congressional delegations and deep roster of Washington insiders, including three presidents since 1963. All that clout doesn't guarantee the country will follow the policies that are best for the Texas economy.

Just 15 months into Donald Trump's presidency, potentially disruptive White House initiatives on trade, taxes, immigration and many facets of regulation lend greater urgency to questions about the impact of national policies on the state's economy. "As we judge economic policy, it's not a question of whether or not we like Donald Trump," said Doug McCullough, an analyst with the Dallas-based Lone Star Policy Institute. "It's a question of whether the economic policy promotes prosperity, competition and innovation."

Most of Trump's policies are still a work in progress, but there's little doubt that Texans want to know what they mean for the state. About 200 people came to the SMU campus in early May for the O'Neil Center's fourth Texas Economic Forum, where McCullough and three other experts gave an early assessment of how some of the president's key initiatives might impact the Texas economy, for good or ill.

Troubles with Trade

Trump's predecessors in the Oval Office all took aim at imports—for example, President Reagan with

Japanese cars and President Bush with imported steel. During the first half of 2018, Trump began his effort to restructure America's trade policies by threatening to impose tariffs of 25 percent on steel products and 10 percent on aluminum.

"There's a lot of uncertainty about what's going to happen to trade," said Vance Ginn, an economist for the Austin-based Texas Public Policy Foundation.

Economists consistently preach that freer trade leads to greater overall prosperity, and Ginn reminded the audience that America's commitment to free trade has been shaky. On the most recent *Economic Freedom of the World* rankings, the United States was a middling 63rd among 157 nations in freedom to trade internationally.

Among states, Texas has the biggest stake in trade, Ginn said. It has been

the top exporting state for 16 years and growth in its overseas sales has exceeded the U.S. average since 1994. "We've also imported a lot," Ginn said, "and importing allows us to keep prices low [and] allows entrepreneurs to invest."

Texas has been the biggest beneficiary of the North American Free Trade Agreement (NAFTA). Over the past two decades, Texas' exports to Mexico and Canada, the other nations in the pact, have jumped by nearly \$48 billion, or 65 percent, far above the rates for the rest of the world, Ginn said.

Trump injected a big note of uncertainty by calling the Texas-friendly NAFTA "the single worst trade deal ever approved in this country" and threatening to pull the United States out of it. The three countries are trying to avoid that outcome by renegotiating and updating the deal.

"NAFTA is by no means perfect," Ginn

"We've also imported a lot, and importing allows us to keep prices low [and] allows entrepreneurs to invest. Parts of it that can be improved would focus on adding private property rights, which would allow for economic freedom to flourish."



Vance Ginn

said. “Parts of it that can be improved would focus on adding private property rights, which would allow for economic freedom to flourish.”

Trump’s proposed tariffs may help steel and aluminum producers, but Ginn worried that companies using the metals as inputs will face higher prices—and there are far more users than producers. The worst fears may never be realized, but the protectionist rhetoric, proposed tariffs and NAFTA attacks give businesses the jitters, creating a potential drag on investment and economic growth.

“At the end of the day, American consumers are going to be hurt [by tariffs and trade wars],” Ginn added later in response to a question from the audience. “Instead, we should look at ways to reduce the cost of doing business here at home.”

Less Taxing Situation

In his campaign, Trump vowed to lower taxes. In December, Congress delivered with the Tax Cuts and Jobs Act, which promises to reduce tax rates for most individuals and cut the top federal rate on corporate profits from 35 percent to 21 percent.

On the individual side, Texans will benefit from paying lower rates but will be largely spared from tax changes that hit hardest in high tax and high cost of living states, McCullough said. He cited two examples—less generous limits on the deductibility of mortgage interest and state and local taxes.

“Texas did fairly well by comparison [to high tax, high cost of living coastal states],” McCullough said, “because our real estate tends to be a little lower, so having the lower cap on the mortgage interest deduction may not affect us quite as much, and the state and local tax cap doesn’t affect us as much because we don’t have a state income tax.”

McCullough said the new tax



Doug McCullough

“Frankly just making the United States a more competitive place to do business. This is something that is pro-growth”

law’s real action will be the lower rates on the corporate side. “This creates opportunities for more capital expenditures, building more plants, building more facilities, improving research and development and frankly just making the United States a more competitive place to do business. This is something that is pro-growth”

The new law removes provisions that allowed U.S. companies to avoid taxes through elaborate structures that stashed profits and intellectual property offshore. Getting rid of these provisions will tilt the balance in favor of keeping business in the United States rather than

moving it overseas, McCullough said.

Texas had grown faster than most other states under the old tax regime. It should continue to do better under a tax system more favorable to investment and doing business in the United States.

Immigrants at Work

Since 1997, the Texas economy grew by 86 percent, the fastest among the 10 largest states. On a parallel growth path, the state’s labor force added 2.6 million workers in those two decades—a good many of them coming from other countries.

How important are foreign-born workers to the Texas economy? The question comes to the fore because the Trump administration proposes to protect Americans’ jobs and security by restricting immigration and building a wall along the border with Mexico.

W. Michael Cox, founding director of the O’Neil Center, said immigrants made up 22 percent of Texas employment in 2016, above the national average of 17.2 percent and sixth among states behind California, New Jersey, New York, Nevada and Florida. Texas ranks second only to California in workers from Mexico, Cox said. “Workers born in Latin America are very important to the Texas economy—specifically, those from Mexico.”

Looking at employment by sector in Texas, Cox found that “the construction industry is heavily dependent on foreign-born workers, particularly workers from Mexico.” Immigrants held nearly 42 percent of the jobs in the state’s construction industry—and 80 percent of those workers came from Mexico.

Whether working in commercial or residential construction, immigrant laborers contribute to the low cost of living that attracts Californians and others to Texas. “You’re going to be able to afford a house if the workers are here to make it affordable,” he said.

In addition to construction workers, Texas growth and living standards also



W. Michael Cox

depend on immigrants who work in all parts of the economy—cooks, groundskeepers, maids and many others. According to Cox, data on net immigration shows that fewer workers have been coming directly from Mexico, but there's a trend toward foreign-born Hispanics relocating from other states to Texas.

In a state with tightening labor markets, Cox worries, policies that restrict access to foreign-born labor result in labor shortages that would harm the nation's fastest growing state economy. "There is no Texas Miracle ... apart from getting the workers we need," he said.

In response to a question, Cox said illegal immigration erodes the rule of law, so it's not the best way to ensure that Texas had enough workers. "We need to relax the restrictions on immigrants coming into this country, not just the ones coming from Mexico," he said. "The best approach is to have much more legal immigration."

“The construction industry is heavily dependent on foreign-born workers, particularly workers from Mexico.”

Mostly Good News on Energy

Even after decades of diversifying its economy, Texas still has a big stake in the nation's energy policy. Texas oilfields pump 3.5 million barrels a day, with another 1.6 million barrels offshore. It produces a quarter of the nation's natural gas and leads in lignite coal and wind power. The state's refineries account for 30 percent of U.S. capacity.

Merrill Matthews, resident scholar at the Institute for Policy Analysis in Irving, saw signals of shifting energy policy early in the Trump administration. Two months into office, the president signed an executive order supporting energy independence and calling for a review of federal actions that burden domestic energy production. Trump has since followed up by clearing the way for pipelines, expanding offshore oil and gas leasing and suggesting an easing of renewable fuel standards.

While Trump promises policies more friendly to traditional energy, Matthews said, producers are facing new uncertainties. He returned to the steel tariffs, pointing to wind energy, which uses a lot of steel, and companies that need steel for pipelines and well casings. If domestic suppliers

“If a trade war ensues, the Texas economy could be hit harder than other states.”

can't supply what Texas businesses need, Matthews said, "we have to pay those higher tariffs."

In the event of a trade war, Texas oil exports would be at risk, too. In the past two years, Texas overseas shipments of crude oil rose more than 900 percent, twice as fast as the nation as a whole. U.S. natural gas exports have been rising, too, with much of it going by pipeline to Mexico and Canada—but China was America's third largest customer for liquefied natural gas in 2017.

For the U.S. energy industry, China represents a \$9 billion market. According to Matthews, Chinese retaliatory tariffs would most likely target exports from parts of the country that support Trump. "If a trade war ensues, the Texas economy could be hit harder than other states," Matthews said.

To sum up, Matthews said: "Trump's support for the energy industry and regulatory restraint could significantly benefit the Texas economy. But his trade war saber-rattling could undermine most if not all of this two steps forward."

In the recap following the presentations, Ginn and McCullough saw a potential downside to Trump's approach to policy, warning that it increased uncertainty



Merrill Matthews

that could disrupt business planning and investment. With the drags from trade and immigration foremost in his mind, Cox told the audience that Texas had more to lose from Trump's policies than any other state. To which Matthews interjected "and more to gain," pointing to the stimulus of lower tax rates and other policies.

References

Ginn, Vance, Raia, Elliott and Rajagopalan, Dayal. "People Prosper

from Trade: NAFTA & Texas. Texas Public Policy Foundation, May 2018.

Gwartney, James, Lawson, Robert and Hall, Joshua. *Economic Freedom of the World*. Fraser Institute, 2017.

Cox, W. Michael and Alm, Richard. "Foreign-Born Workers in the Texas Economy." *The Texas Economy*. O'Neil Center, First Quarter 2018.

Next issue: A look at the Texas

Triangle, an economically diverse area roughly bounded by DFW, Houston and San Antonio. It produces most of the state's gains in population, output growth, income and employment.

About the Author



Richard Alm

Richard Alm is writer in residence at the William J. O'Neil Center for Global Markets and Freedom at Southern Methodist University's Cox School of Business.

CHARTING THE TEXAS ECONOMY

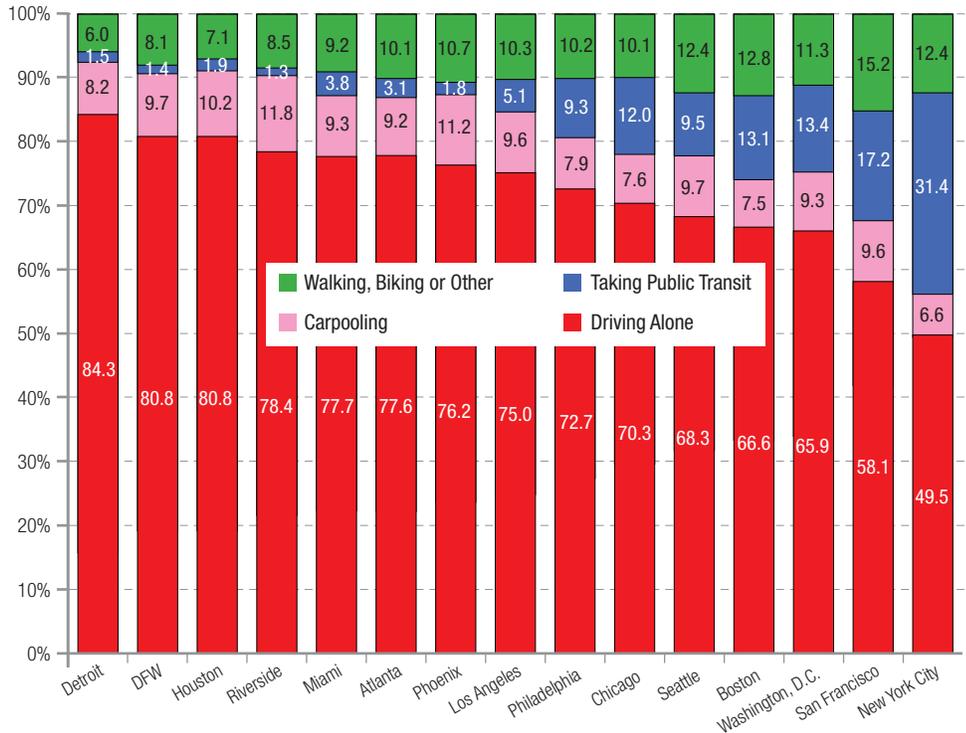
DFW, Houston Workers Rank Highly in Driving Alone to Work

In the movies and western lore, Texans loved their horses. In the real world of the 20th Century, four wheels have replaced four legs as symbol of the state.

According to Census data, residents of the Dallas-Fort Worth (DFW) area owned 4.5 million cars in 2016, an average of 1.85 per household. Among the nation's 15 largest metropolitan areas, that's second only to Riverside, California. Seattle comes next, followed by Houston with 1.82 vehicles per household.

Detroit, the legendary Motor City, leads the large metro areas with 84.3 percent of commuters driving alone to work (see chart). Right on Detroit's bumper are DFW and Houston, both at 80.8 percent. When car-pooling is included, the state's two biggest cities exceed 90 percent in driving to work.

DFW and Houston have both spent billions on bus and rail systems—but efforts to move commuting to mass transit have had little success.



ABOUT THE TEXAS ECONOMY AND THE O'NEIL CENTER

The Texas Economy is an electronic publication of the William J. O'Neil Center for Global Markets and Freedom, a research institute in the SMU Cox School of Business.

The center was founded in 2008 with an initial grant from William J. O'Neil, a 1955 SMU business school graduate, and his wife Fay C. O'Neil. Its broad mission is the study of why some economies prosper and others do poorly, focusing on two critical issues for the 21st Century economic environment—globalization and economic freedom.

The center's programs promote understanding of how capitalism works among the general public, policy makers, business managers and the next generation of business leaders. To these ends, the O'Neil Center teaches SMU Cox students, conducts economic research, publishes economic reports, sponsors conferences and educates the public through the media and speeches.

For more information, see our web site at www.oneilcenter.org, e-mail us at oneilcenter@cox.smu.edu, or call 214-768-4210.