

# **Texas: What Makes Us Exceptional? Where Are We Vulnerable?**

---

*Remarks before the Texas Economic Development Council Annual Conference*



**Richard W. Fisher**  
President and CEO  
Federal Reserve Bank of Dallas

Dallas, Texas  
October 6, 2011

---

*The views expressed are my own and do not necessarily reflect official positions of the Federal Reserve System.*

# Texas: What Makes Us Exceptional? Where Are We Vulnerable?

Richard W. Fisher

Thank you, Mike [Rosa] for that kind introduction. It is an honor to speak at the Texas Economic Development Council's 2011 annual conference.

Let me first congratulate you on your historic 50th anniversary. From advocating pro-business policies that attract investment and jobs to Texas, to educating our state's public officials on tax and regulatory matters, this organization has done much to promote and support the economic growth of Texas. So thank you for making my job much easier.

There are few subjects I enjoy speaking about more than the Texas economy. For reasons well known to all of you, Texas' record of economic growth and job creation provides an oasis in a national economic desert devoid of life-giving job creation. This record has become a subject of intense interest to the national media. Indeed, my staff and I at the Dallas Fed have been deluged with requests for data on all aspects of the Texas economy.

Today I will attempt to separate fact from fiction, with a heavy focus on the data. In particular, I will take both a short- and long-term view of the Texas economy and wrap-up with some of the challenges facing our state as we go forward.

## Federal Reserve Functions



Before I dive into these weighty matters, I think it best to provide some background on the Fed so you'll understand where I am coming from. If you look closely at the face of any \$1 note, you will see a letter in the middle of the left side. Every \$1 bill bears the imprint of one of the Federal Reserve Banks, starting with the "A" of the Boston Fed and ending with the "L" of the San Francisco Fed. On the screen behind me you will see that this bill has the letter "K" printed on its face and four "11s" printed near each corner. The Dallas Fed is the 11th Federal Reserve District out of 12 operating across the country. K is the 11th letter in the alphabet. There are two

concentric circles around this letter K. The outermost says “Federal Reserve” and “Texas.” The innermost circle says “Bank of” and “Dallas.” I like to chide my colleagues that not all dollar bills are equal. I tell them those with the letter K on them—what I call “Texas dollars”—are worth more than all the rest because they represent the nation’s most dynamic economic machine.

The 12 Federal Reserve Banks were set up by federal law in 1913. I am president and CEO of the Federal Reserve Bank of Dallas, which, together with our branches in Houston, San Antonio and El Paso, handles the business of the Fed in this part of the country. We are responsible for ordering and distributing paper money according to the needs of our district, supervising and regulating banks, lending money against good collateral to all banks in our district for their operating needs—whether we supervise them or not, handling payments (for a fee) for the U.S. Treasury, doing economic studies, educating the public on basic financial matters and helping determine the nation’s monetary policy at meetings of the Federal Open Market Committee (FOMC).

At the FOMC table, I represent the perspectives of some 27 million people who reside in the approximately 360,000 square miles of land that stretches from northern Louisiana to southern New Mexico and produces an economic output that is greater than that of Mexico or Australia and, until recently, exceeded that of India.

The Dallas Fed makes a profit through its lending and other fee-generating activities: We receive no tax appropriations. After paying a small preferred dividend to the member banks of our district, we turn over our annual profit to the U.S. Treasury. Indeed, the 12 Federal Reserve Banks, collectively, transferred over \$125 billion to the Treasury in 2009 and 2010. You are looking at an odd duck: A member of a team within a government agency that doesn’t swallow taxpayer money but, instead, operates with private-sector efficiency and uses its profits to directly pay down the nation’s debt.

Another thing that makes me an odd duck: I am not accountable to any political authority. Unlike the five members of the Federal Reserve Board (two shy of normal, thanks to a hold-up in the nomination and confirmation process), neither I nor my counterparts who operate the Fed’s business through the 12 Reserve Banks are appointed by the president of the United States or confirmed by the U.S. Senate. I was selected for this job by—and serve at the pleasure of—the nine directors who compose the Dallas Federal Reserve Bank board, all of whom are citizens of the Fed’s Eleventh District. That board, which was chaired by Ray Hunt when I was hired, has been chaired by Jim Hackett, CEO of Anadarko Petroleum, and currently is led by Herb Kelleher, founder of Southwest Airlines. The board consists of eight others who hail from Dallas, Houston, Plano, Brady, Huntsville, Fort Worth and Alamogordo, N.M. The Dallas Fed is a Main Street operation.

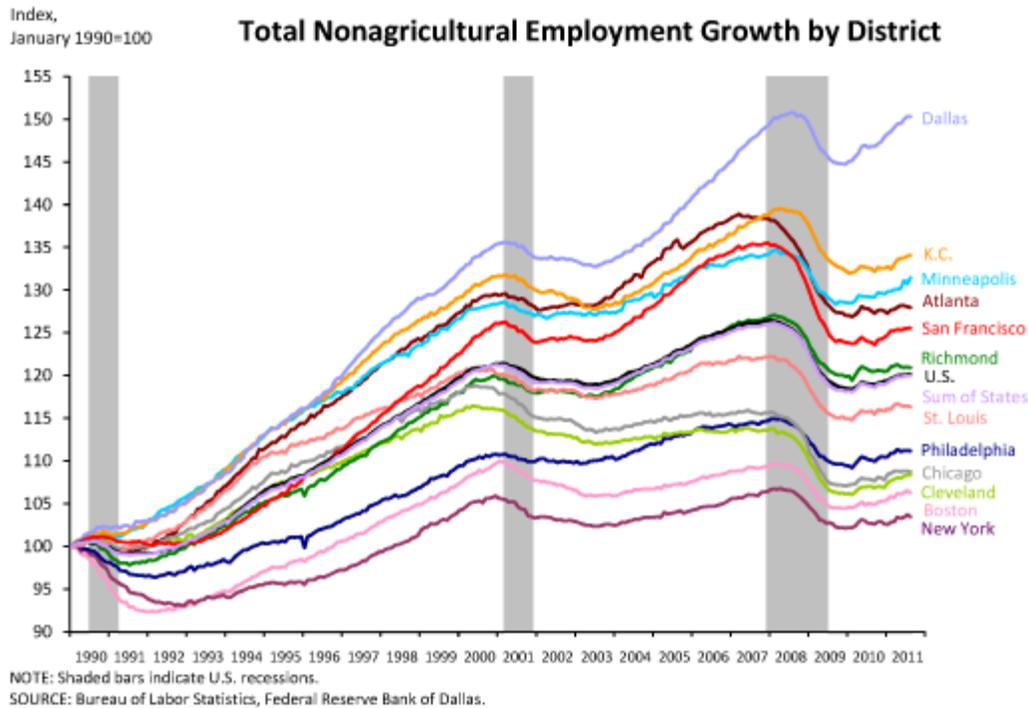
When I was sworn into office, I checked all politics and partisanship at the door. I am neither an “R” nor a “D”; I am politically indifferent. When I took this job, Alan Greenspan told me I had only one obligation, which in his words was “to speak to the truth.” I do my best to speak the straight skinny, informed by the work of the staff of the Dallas Fed, the input I receive from the bankers and businesses and citizens of my district, and my own career as a banker, an investor, a trade negotiator and a man smart enough to come to Texas 37 years ago.

## The Texas Economy

So what is the straight skinny about the Texas economy?

The Texas economy has a long tradition of outperforming the nation—a tradition matched only by our long-standing reputation for modesty. From December 1967 through December 2007—the most recent employment peak according to the National Bureau of Economic Research—long-run nonfarm job growth in Texas exceeded that of the nation by 1.1 percentage points.

Over the past 20 years, employment has grown at a compound annual growth rate of about 1.9 percent and our economic output has expanded at a 3.6 percent annual rate. On the screen is what we call a “spaghetti chart”—it charts employment growth in the Eleventh District economy (the bulk of which is Texas) relative to other Fed districts for the past 20 years. This graph says it all: We have consistently outperformed the rest of the nation in growing economic prosperity.



We continued that performance over the past three especially difficult years. Texas was last into the recent frightful recession and one of the strongest coming out. In 2008, the nadir of the downturn, we were still creating jobs here. In fact, while the U.S. lost 3.1 million jobs, Texas added 45,000 private-sector jobs in 2008. But stout as we are, we caught the recessionary flu at the onset of the fall of 2008, with the result that we lost 362,000 jobs in 2009. We recovered quickly and at a faster pace than the rest of the nation. We added jobs in 2010, and we have continued to add jobs in 2011. So far this year, we have added 171,200 jobs (including 13,700 jobs in August) and grown at an annual pace of 2.5 percent—more than twice the national average of 1 percent.<sup>1</sup>

In fact, the only other states that are back to or have punched through their previous peak employment levels are Alaska and North Dakota, which, combined, have a population of 1.4 million good citizens. As of August, the Texas unemployment rate stood at 8.5 percent. To be sure, this is lower than the national average of 9.1 percent. But while our recovery has outpaced that of the nation thus far, unemployment remains stubbornly high and too many Texans are out of work. A big part of your job as economic development professionals is to help craft the incentives for business to invest and create jobs here and drive down that rate of unemployment.<sup>2</sup>

A quick plug: As fellow Texans who are interested in the economic development of our great state, I encourage you to visit our website ([www.dallasfed.org](http://www.dallasfed.org)) for factual, nonpoliticized briefs on the Texas economy. There you will find a plethora of economic briefings and economic data, including the job-creation figures that get bandied about in debates among presidential aspirants. At a minimum, I am hopeful our web postings will help you separate spin from reality and fact from fiction, as well as dispel some of the stereotypes of Texas.

### **Economic Prognostications**

I expect that during the Q&A, you might ask me for a forecast for Texas' economic growth going forward. Let me head that off at the pass. I am wary of precise economic forecasts. Economics is more an art form than a science, despite claims to the contrary. As such, economic prognostications need to be taken with a grain of salt, even when delivered by Federal Reserve officials, for they are seldom accurate and are subject to constant revisions. One of my professors in college used to say that "the only function of economic forecasting is to make astrology look respectable."

So let me just say—as a Piscean—that our Texas economy continues to face significant headwinds, including uncertainty that derives from the indecision or sometimes counterproductive decisions of the national government. And we will continue to be handicapped by low levels of construction activity, reduced state and local government spending and still moderate gains in consumer spending and demand. Despite these conditions, I expect Texas job growth to continue increasing at a moderate pace, but only if we can preserve the image and reality of Texas' uniqueness as a place to do business and grow profits. Profit-making enterprises create jobs. We have too many unemployed workers. We need to attract businesses to come here and grow here. To do so, we have to press our comparative advantage relative to other states.

### **Comparative Advantage**

So what is our comparative advantage?

As I see it, the key to Texas' success lies in our ability to change to a rapidly globalized and competitive economic landscape. Texas' transition from a resource-based economy built on cattle, cotton and oil to a knowledge-based economy built on human capital and innovation is our greatest success. We have made a fine transition "from cow chips to computer chips" and "from boots to suits." Texas has mastered the art of what the iconic economist, Joseph Schumpeter, called "creative destruction." We don't linger long on the old, and we are quick to usher in the new.

In the 1930 census, for example, agriculture represented 39 percent of all jobs in the state; today, it is less than 2 percent. Despite this decrease, we continue to be one of the top agriculture-producing states in the nation. We are currently No. 1 in ranching and No. 2 in terms of crop production.

In 1981, oil and gas extraction made up 18 percent of the state's output. After the oil bust, we diversified our economy and that share dropped significantly. That said, we are certainly blessed with abundant natural resources here, and we most definitely benefit on net from high commodity prices. Currently, oil and gas extraction contributes about 9.5 percent to state output and employs about 2 percent of our workforce.

In 1970, 15 percent of Texas jobs were in manufacturing. Presently, manufacturing accounts for only 7 percent of our employment, though output in manufacturing has fallen much less, from 18 percent to 15 percent. These sectors saw a decline in job share not due to the demise of industry, but rather because productivity growth has allowed technology to do more of the work. This has allowed labor to shift to other areas of the economy that are in high demand as our population has become wealthier. These include health care, education, finance, professional business services and leisure services.

A key source of Texas' growth in manufacturing and services has been technology. A recent Milken Institute study on high-tech centers across the U.S. concludes that Texas has three of the top 25 high-tech centers in the country—Dallas, Houston and Austin.<sup>3</sup> Another study by the Milken Institute ranked Texas ninth in its Technology Concentration and Dynamism Composite Index, which measures “the stock of capable entrepreneurs and risk capital available to support the conversion of research into commercially viable technology products and services.”<sup>4</sup>

The key factors that have contributed to our ability to grow and adapt to the changing landscape are low tax and regulatory burdens, flexible labor markets, open land availability, the success of tort reform, great seaports, airports and transportation and communication infrastructure, and, simply put, the fact that people come here to work and better themselves. All these factors have contributed to a low cost of living and have made doing business in Texas much easier.

Businesses sell to national and international markets and must compete with producers throughout the world. As a result, they seek areas of production where nominal wages are low for a given level of worker productivity. What matters to workers, however, is their real wages—what they can buy for an honest day's work. A worker can move from the Silicon Valley or Boston to Dallas or Austin (or Fort Worth or Houston or San Antonio or El Paso), and both the company and the worker are better off. The company can pay him, say, 15 percent less, and yet the worker, who spends a significantly smaller amount for the same home he had in Silicon Valley or Boston, is taxed at lower rates, finds the cost of living cheaper and sees his real income increase by a significant amount. This is what I call the “pull factor,” and it has been a key component of the net immigration of workers and job-creating businesses to the state of Texas.

Data from the 2010 census show that net domestic immigration to Texas has been positive every year for the past 19 years. In just the past five years, net migration from other U.S. states (not including international migration) has totaled about 690,000 individuals—equivalent to about 40 percent of the population of the Austin–Round Rock metropolitan statistical area. Positive net

migration from other states is a key indicator that we are, in fact, exceptional. People do vote with their feet. They are moving to Texas from other states and from abroad because we offer them something better than they had before.<sup>5</sup>

This has not gone unnoticed. A recent report published by the Brookings Institution in Washington ranked Austin as the No. 1 city in the U.S. and No. 26 in the world in terms of jobs and income growth during the current economic recovery.<sup>6</sup> The Brookings explanation for Austin's (and Texas') success: "continued attraction and retention of high-skilled human capital, its diverse set of export-based industries, and its avoidance of the worst U.S. housing market excesses." This same study ranked Dallas fourth in the U.S. and 39th in the world in terms of the strength of the recovery. San Antonio ranked 11th and 51st, respectively, while Houston ranked 15th and 61st. As to how others held up during the recession itself, Brookings cited San Antonio as the most "recession-proof" city in the United States.

In case you are looking for further evidence, the Lone Star State also dominated the Milken Institute's 2010 Best-Performing Cities index.<sup>7</sup> According to this report, Texas "metros occupied 11 of the top 25 positions among the 200 largest metros in the country and five of the top 10." It goes on to note that, "Another way to highlight Texas' dominance is that just two of the state's 13 metros didn't make the top 25." The institute's reason for Texas' outperformance—"Texas metros have benefited from a low reliance on durable goods manufacturing, a low cost of doing business, a favorable business climate, the benefits of BRAC [Defense Base Realignment and Consolidation] activities, greater reliance on trade with Mexico and South America ... and ongoing energy exploration activities and alternative fuels research."

## **Vulnerabilities**

There is a lot of room for Texas brag when we talk about our economy and our potential. But we also have vulnerabilities that keep Texas from reaching its full potential. In the latest rankings on the competitiveness of states, the Beacon Hill Institute gave mixed results to Texas. The "good news," according to the institute, is that Texas scores high on overall tax burden, employment in high-tech industries, venture capital, initial public offerings, low unionization, unrestrictive minimum wages, exports, foreign direct investment and percent of population born abroad who come to work. The bad news: Texas ranks near the bottom in most human capital measures. Texas is dead last in the percent of the adult population that graduated from high school, 37th in percent of population enrolled in degree-granting institutions, 35th in academic R&D and 41st in science and engineering degrees awarded.<sup>8</sup>

When you get a chance, take a look at the membership list for the Association of American Universities (AAU), which is regarded by most scholars as the definition of the cream of the crop of research universities. The AAU consists of 59 U.S. (and two Canadian) universities. These 59 U.S. schools garner over 50 percent of all federal R&D dollars to colleges and universities; they are home to 87 percent of all elected members of the National Academy of Sciences, the National Academy of Engineering and the Institute of Medicine—the highest recognition in each of those fields. Since 1901, 35 percent of all Nobel Prizes have gone to individuals affiliated with AAU universities.<sup>9</sup>

California has nine AAU members. The New York area also has nine. And Texas? We have three: Rice, UT–Austin and Texas A&M.

Another source that underscores the Achilles' heel of Texas' economy is *U.S. News & World Report*. According to its assessment, Massachusetts has 10 schools ranked in the top 100 universities. The New York area has 11 and California has 13. We have only six: Rice, ranked 17th, UT–Austin (45th), Texas A&M (58th), SMU (62nd), Baylor (75th) and TCU (97th).<sup>10</sup> I admire the Rice Owls, but I am embarrassed by having them as the sole university in the nation's top 20. You should be, too. We ought to have several.

You can't be happy with the fact that we are falling behind in all aspects of education, from kindergarten right up to the university level. Think about it. We know that incomes and net worth are directly correlated to educational attainment. We know that in the Knowledge Age in which we live, the mind is the capital plant of the modern economy. We all admire those who work with their muscles and by the sweat of their brow in pulling prosperity from the soil on our farms and ranches, or from deep beneath the earth in our mighty oil and gas sector. We rightly applaud those who help Texas produce almost 10 percent of the nation's manufactured goods. But the world of today and tomorrow is driven by digits, not widgets. We will continue to move up the value-added ladder and stay ahead of the competition—not just from other states, but from China and the new emerging powers—only if we are able to nurture and harness Texas brains.

We must not lose track of this simple, unalterable, indisputable, critical fact: We have done well so far; our economy is mighty. But to stay ahead of the curve and compete in tomorrow's global marketplace, Texas must better educate its population.

My plea is that each of you makes it one of your principal goals to make Texas an educational powerhouse. High-value-added, job-creating businesses that are world beaters will not move their top executives to Texas unless they can send their children and grandchildren to top schools and universities.

Whatever our ethnicity or origin, Texans are a race of risk takers. We have from the very start defied conventional wisdom. We must now take risks, defy conventional wisdom and turn around our education system. Our economic future depends upon it.

### *Lone Star*

If you're looking for motivation to do what most others consider unthinkable, dust off T.R. Fehrenbach's history of Texas, titled *Lone Star*.<sup>11</sup> It's a long book—some 719 pages. But it is most readable and is, to my mind, perhaps the finest history of Texas ever written, though it has now been over 40 years since it was first printed.

For example, Fehrenbach walks his readers through how Mirabeau B. Lamar moved the capital to Austin in 1840. Then, only 900 people lived there on the border of Comanche country, facing a wild, frightful, untamed western frontier. Yet, here we are today, as I mentioned, with one of the most elite think tanks in the country concluding that Austin is the highest ranked of all American cities in this recovery and ranked internationally, incidentally, just below São Paulo and above Montreal. Little old Austin, ranked right up there with two of the best-known cities in the world. Who would have thought that possible?

Who would have dared think that in the blink of history's eye, Texas would be outproducing Mexico or Australia and giving the more than 1 billion people of India a run for their money? Fehrenbach recites how great men and establishment figures of the time like John Quincy Adams scoffed at Houston and Lamar and at Texas. Too bad they aren't around now to see what those early Texans and their successors set in train.

What has been accomplished here could only have been made possible by a people who understand that it pays to respect the "animal spirits" that drive the entrepreneurialism and risk taking that push the economic frontier both literally and figuratively. As Fehrenbach puts it: "The Texan ethic and Texas society rewarded enterprise ... work was the real virtue." "We chose this land; we took it; we made it bear fruit." We are a people for whom "the cult of courage was obvious."

Fehrenbach distills the Texas spirit into one simple sentence: "Men who exist get overrun by men who act."

Now, if you were from a part of the United States where the past is more glorious than the future and you were listening to what I have said today, you would at this point of the speech likely be thinking this all sounds like something that rhymes with "bull wit." But we who live here know this place and its spirit.

Consider yourselves the trustees of the future of our children's generation and all that come after it. You hold the future of this unique franchise we call Texas in your hands. Your job is to keep Texas exceptional—to create the conditions that safeguard and nourish our prosperity and that of our children and our children's children. If you do, I have no doubt we will continue to outshine the rest of the nation for another 50 years.

Thank you.

## Notes

<sup>1</sup> Dallas Fed data are slightly different from Bureau of Labor Statistics data. The BLS updates its data once a year to take into account better information. Instead we roll in this better information every quarter as it becomes available. This leads our data to be less subject to major annual revisions.

<sup>2</sup> Why have we outperformed the nation since 2007? Much of the answer lies in the importance of the energy and high-tech sectors to the Texas economy. These industries play a greater role in the Texas economy than in most states and, subsequently, play a large role in our relative fortunes. Importantly, however, the Texas economy was not hit as hard by the housing crisis. Some of this is due to the fact that, in response to our housing crisis of the late 1980s and early '90s, Texas policymakers instituted more stringent rules on home equity lending. Another buoying factor has been Texas' exports, which play an important role in the Texas economy. According to the Origin of Movement series produced by the Census Bureau, Texas is the No. 1 state in terms of the value of exports shipped: We surpassed California nine years ago. The rebound in exports over the past year has been a key factor driving the rebound in Texas manufacturing. For more on Texas' out performance, please see "Texas Economy to Ride Higher in the Saddle in 2011," by Keith Phillips and Emily Kerr, Federal Reserve Bank of Dallas *Southwest Economy*, First Quarter 2011 and "Breaking Out of Recession: Gauging Texas' Response to Fed Stimulus," by David Luttrell and Harvey Rosenblum, Federal Reserve Bank of Dallas *Southwest Economy*, Third Quarter 2011.

<sup>3</sup> See "North America's High-Tech Economy: The Geography of Knowledge-Based Industries," Milken Institute, June 2009, [www.milkeninstitute.org/publications/publications.taf?cat=resrep&function=detail&ID=38801199](http://www.milkeninstitute.org/publications/publications.taf?cat=resrep&function=detail&ID=38801199).

<sup>4</sup> See "2010 State Technology and Science Index: Enduring Lessons for the Intangible Economy," Milken Institute, Jan. 2011, <http://www.milkeninstitute.org/publications/publications.taf?function=detail&ID=38801259&cat=resrep>.

<sup>5</sup> See “Keys to Economic Growth: What Drives Texas” by Jason Saving, Federal Reserve Bank of Dallas *Southwest Economy*, First Quarter 2009, [www.dallasfed.org/research/swe/2009/swe0901c.cfm](http://www.dallasfed.org/research/swe/2009/swe0901c.cfm).

<sup>6</sup> See “Global Metro Monitor: The Path to Economic Recovery,” Metropolitan Policy Program, Brookings Institution, December 2010, [www.brookings.edu/reports/2010/1130\\_global\\_metro\\_monitor.aspx](http://www.brookings.edu/reports/2010/1130_global_metro_monitor.aspx).

<sup>7</sup> See, “Best-Performing Cities 2010: Where America’s Jobs Are Created and Sustained,” Milken Institute, Oct. 2010, <http://bestcities.milkeninstitute.org>.

<sup>8</sup> See “State Competitiveness Report,” Beacon Hill Institute for Public Policy Research, Suffolk University, 2010, [www.beaconhill.org/Compete10/Compete2010State.pdf](http://www.beaconhill.org/Compete10/Compete2010State.pdf).

<sup>9</sup> See Association of American Universities website at [www.aau.edu/about/default.aspx?id=4020](http://www.aau.edu/about/default.aspx?id=4020).

<sup>10</sup> See National Universities Rankings, *U.S. News and World Report*,

<http://colleges.usnews.rankingsandreviews.com/best-colleges/national-universities-rankings/>.

<sup>11</sup> *Lone Star: A History of Texas and the Texans*, by T.R. Fehrenbach, New York: Macmillan Publishing Co., 1985.