POLICY report

Goldwater Institute

No. 251 | October 17, 2012

Lessons from Texas on Building an Economically Healthier Arizona

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EXECUTIVE SUMMARY

During the recent recession, the experience of Texas provides a marked contrast to that of Arizona. Arizona's gross domestic product (GDP) fell at more than double the rate in the nation while Texas's GDP barely fell at all. Texas's employment in 2011 was at an all-time high and even greater than in 2007; by contrast, Arizona's total employment in 2011 was 10 percent below its peak. Although most of the nation has seen hard times like Arizona has since 2007, Arizona's economic challenges did not begin with the Great Recession. In fact, Arizona's inflation-adjusted per capita income has lagged the nation's for decades and stands steady at around 87 percent of the national level. While Arizona's per capita personal income growth was fifth lowest among the states, Texas's was seventh highest despite a large influx of people without jobs.

Arizona performs poorly because it taxes and regulates as if it were a state with natural advantages that can absorb bad public policy. In a comparison of several economic policy indexes between Arizona and its six neighbor states, Arizona outranks only California and New Mexico. These policy indexes include measures of economic freedom, business friendliness, tax systems and burdens, and cost of living. Texas ranks first in one measure, ranks second in two measures, and receives eight top-10 rankings.

Although many think oil and gas are the secret of Texas's success, energy production is half the relative size of Texas's economy now compared to what it was in the 1980s. The real secret is Texas's policies. Those policies include no personal income tax, relatively low business taxes, a mostly simple tax structure that is fairly easy to enforce and comply with, gentle regulation that allows its natural advantages to be exploited, and private ownership of most of the state's land.

Arizona has its advantages, including mineral wealth, balmy winters, stable geology, an outsized allocation from the Colorado River, and an advantageous state constitution that protects individual property rights and liberties. Arizona's natural disadvantages are significant and very costly, though. They include lack of access to a water port, remoteness from the majority of Americans who live near and east of the Mississippi River, relatively limited labor and energy resources, and geological features that are visually stunning but topography that presents a surface transportation nightmare. Lawmakers need to take these issues into account when formulating policy and not add costs in a state that is already at some cost disadvantages.

The experience of Texas shows that Arizona can best exploit its comparative advantages with lean, unobtrusive government. The state should adopt Texas-style policies that (1) lower taxes and keep them low; (2) simplify the tax system, especially sales taxes and property taxes; (3) restructure the tax system to eliminate income taxes; (4) reduce business property taxes; (5) reduce regulations such as licensing, land use planning, and zoning; (6) sell state trusts, increasing the stock of private land; and (7) reduce the size of government and end state revenue sharing with local government.

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Arizona's Economic Challenges

The severity of Arizona's recession more than doubled that of the downturn in the nation as a whole. From 2007 to 2009, Arizona saw a decline in its real (inflation-adjusted) GDP of 7.4 percent. Leaving out government, the private portion of real GDP declined even more, by a whopping 8.6 percent. Only two states, Michigan and Nevada, fared worse. By contrast, the United States saw real GDP decline by 2.8 percent, with the private portion declining 3.7 percent. Over the same time, Arizona's drop in per capita personal income (sixth worst drop among the states) also more than doubled the drop experienced in the country as a whole (–4.2 percent versus –1.7 percent). Arizona's total annualized employment fell almost 11 percent between 2007 and 2010.

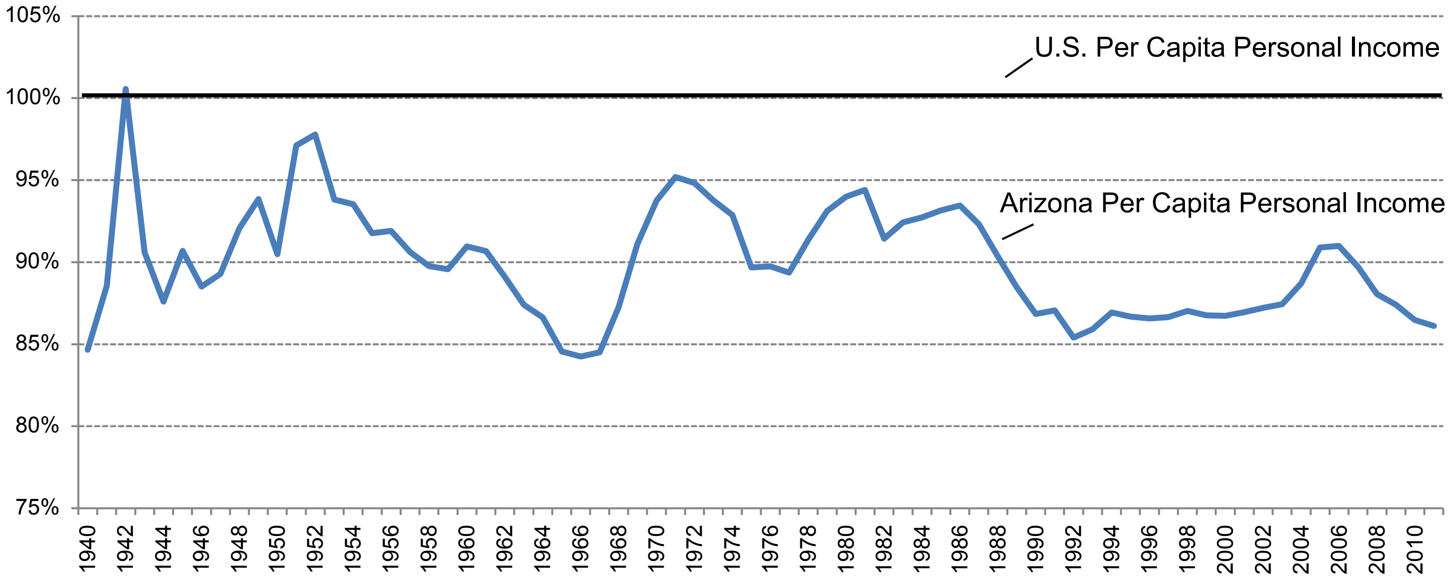
As of this writing, federal GDP numbers only extend through 2010, the first full year of the national recovery. During that year, Arizona saw its GDP grow by only 0.75 percent (the private portion grew by 1.1 percent). Only two states, Wyoming and Nevada, fared worse. They both saw real GDP fall in 2010. For Wyoming, the decline in GDP was a minor setback because the state had grown considerably, counter to the rest of the nation, from 2007 to 2009. For Nevada, it was a continuation of that state's uniquely long recession. Nationally, real GDP grew 2.6 percent in 2010, well over three times the rate of Arizona. From 2009 through 2011, Arizona's per capita personal income saw the fifth lowest rate of growth (5.7 percent) among the states. Between 2010 and 2011, Arizona recovered only 20,000 jobs, and employment was still almost 10 percent below its peak.[1]

Instead of trying to anticipate what the next big economic trend might be, we should be asking, "What policies can put Arizona on a sustainable path of economic growth?"

A threat that Arizona's economic identity is up for grabs looms, and there appear to be competing visions for what that identity should be. The data in figure 1 explain part of Arizona's identity crisis. With the exception of the recently expired housing bubble, Arizona's personal income per capita has flatlined since the early 1990s at about 87 percent of the national level. Before the 1990s, Arizona's relative personal income per capita peaked during times of hot and cold wars. The big blip in 1941 coincides with the buildup to World War II. The next peak, in 1952, coincides with the Korean War. The big rise in in the 1960s coincides with the Vietnam War. During wars, both hot and cold, Arizona's personal income per capita has performed relatively well. The last big drop in Arizona's personal income coincides with the end of the Reagan-era defense buildup, the end of the Cold War, and the end of an earlier nationwide construction boom. Arizona's personal income then stabilized, and we did not see another spike in personal income until the housing bubble.

With the closing of military bases and the scaling back of defense industries, Arizonans' personal income appears to have retreated to what might be considered a natural level. There appears to be a general sense that Arizona has some catching

Figure 1. Arizona Personal Income Per Capita as a Percentage of U.S. Personal Income Per Capita



Source: U.S. Bureau of Economic Statistics, author calculations.

up to do, and it arguably does. But we are casting about looking for a way to accomplish the feat. Some seem to want the state to become a higher education haven and research leader. Others appear satisfied that it should be a housing mecca and retirement destination. Still others seem to see the state mainly as a tourism destination. Instead of trying to anticipate what the next big economic trend might be, we should be asking, "What policies can put Arizona on a sustainable path of economic growth?"

Arizona's Economic Burden: Remoteness

Arizona's economic challenges are not merely statistical. Although Arizona's topography is beautiful to observe and fun to drive on a motorcycle, it represents significant costs for heavy transportation in time, fuel, and wear and tear. The Grand Canyon practically barricades the state to the north. Arizona neither has ports nor means of water transport. Businesses trying to succeed in Arizona thus face a heavy and unavoidable economic burden—the cost of remoteness. This characteristic is a significant disadvantage compared to the experience of Texas, a state that arguably does less than Arizona to impose costs on itself through government.

On a map of the United States, the first thing one notices about Arizona is its size. In land area (acreage), Arizona is the sixth largest of the states. Arizona also sits in the arid southwest and has no coastline.[2] The state borders on other geographically large, mostly arid states, including the state with the largest population, California. Texas, conversely, has a coastline that includes the Port of Houston, the Port of Corpus Christi, and a host of other ports in addition to 1,000 miles of ship channels maintained by the U.S. Army's Corps of Engineers.[3] Nevertheless, Texas has such breadth that, although not obvious from mere observation on a map, the city of El Paso is, by road, about a dozen miles closer to San Diego, California, than it is to Houston.[4]

As remote as El Paso might be, of the two states, Arizona is more remote than most of Texas. Table 1 shows the distances of Phoenix and Dallas from the 22 largest cities, by population, in the nation. Phoenix is closer to six of these cities, including itself, four in California, and one in Texas. Dallas is at

Although Arizona's topography is beautiful, businesses trying to succeed in the state face a heavy and unavoidable economic burden—the cost of remoteness.

Table 1. Driving Distances between Phoenix and Dallas and the Nation's Largest Cities, by Population

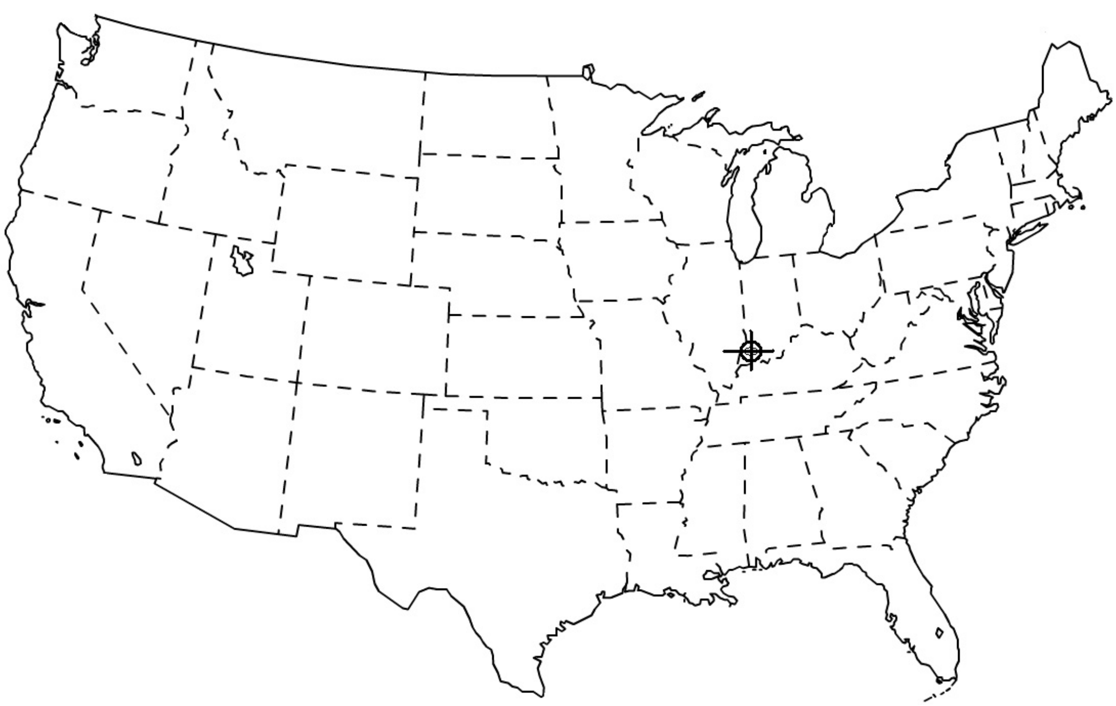
City	Miles from Phoenix	Miles from Dallas	Mileage difference
New York, NY	2,465	1,549	916
Los Angeles, CA	373	1,432	−1,059
Chicago, IL	1,808	969	839
Houston, TX	1,178	239	939
Philadelphia, PA	2,399	1,487	912
Phoenix, AZ	0	1,067	−1,067
San Antonio, TX	983	274	709
San Diego, CA	355	1,360	−1,005
Dallas, TX	1,067	0	1,067
San Jose, CA	711	1,691	−980
Jacksonville, FL	2,048	1,044	1,004
Indianapolis, IN	1,754	901	853
San Francisco, CA	752	1,733	−981
Austin, TX	1,008	195	813
Columbus, OH	1,930	1,040	890
Fort Worth, TX	1,035	32	1,003
Charlotte, NC	2,094	1,028	1,066
Detroit, MI	2,040	1,186	854
El Paso, TX	431	636	−205
Memphis, TN	1,472	452	1,020
Baltimore, MD	2,379	1,367	1,012
Totals	**28,282**	**19,682**	**8,600**

Source: Mapquest.com.

least 700 miles closer to each of the others. If we take the difference between the cumulative distances between Phoenix and Dallas and the other cities, Dallas wins the comparison by almost 9,000 miles. Other than itself, Phoenix is closest to San Diego, but that distance is still 355 miles. Even this comparison, however, fails to fully show how remote this state's population is from the rest of the United States.

Consider another way to look at Arizona's remoteness. For many years, the U.S. Census Bureau has calculated the population median center point of the United States. The bureau draws an east–west line, north and south of which one-half of the nation's population lives. Then the bureau draws a north–south line, east and west of which one-half of the nation's population lives.[5] The point where these two lines cross represents the median population center of the country. That point is currently in southwest Indiana (see figure 2), approximately 1,660 miles by road from Phoenix, 840 miles from New York City, 800 miles from Dallas, 450 miles from Atlanta, and 1,300 miles from Bangor, Maine. In 2010, the population of all the states that border the Mississippi River and of all the states to their east constituted two-thirds of the U.S. population. The states east of the Mississippi constituted 58 percent of the nation's population. Despite the southwestward movement of populations over several decades, the territory east of the Mississippi River constitutes the bulk of any national market and will do so for the foreseeable future.

Figure 2. Median Population Center Point of the United States



Source: Hist-Geo.com.

Limited Human Resources and Lack of Nearby Markets

Table 2 shows the 2010 U.S. populations within 50 miles, 100 miles, and 250 miles of six major U.S. cities, including Phoenix. The cities were chosen mainly because they are spread around the country and, except for Phoenix and Los Angeles, their 250-mile-radius circles do not overlap. Several points are worth noting in this table. First, with Arizona's population in 2010 at about 6.4 million, more than two-thirds of the state's population lives within a mere 50 miles of Phoenix. Nevertheless, within 50 miles of every listed city except Atlanta and Phoenix, there are more people than live in the whole of Arizona. At a 100-mile radius, Phoenix picks up fewer than half a million people, yet every other city picks up more than a million. More people live within 100 miles of New York City than in the state of Texas. At a 250-mile radius, each of the cities' populations is remarkably similar, save for Phoenix and New York. Within 250 miles of New York City, there are at least parts of 11 densely populated states, and 15 million more people live within that radius than live in California. And more than three times as many people live within 250 miles of every other city than the number that lives within 250 miles of Phoenix.

Despite record-setting relative population growth for over two decades, Phoenix and the State of Arizona have a distinct population disadvantage relative to many other major cities. Arizona's main hope for staying competitive is to keep costs associated with government as low as possible.

Despite record-setting relative population growth for over two decades, Phoenix and the State of Arizona have a distinct population disadvantage relative to many other major cities. Relatively sparsely populated countryside surrounds the Dallas–Fort Worth metro area; however, within 250 miles are Oklahoma City, Austin, Waco, the outskirts of San Antonio, and the suburbs of Houston, with the circle penetrating well into Louisiana and Arkansas. Los Angeles and its densely packed suburbs are outside Phoenix's 250-mile radius, but to some they might seem near enough to cast doubt on the idea that Phoenix is all that isolated. After all, Los Angeles and Las Vegas lie well within a day's drive. Phoenix's Sky Harbor Airport gives ready access to the rest of the country too. But consider that Los Angeles's 250-mile radius includes San Diego, and yet the population mustered is only a few million more than live within the same proximity of Dallas. Of course, half of the circle around Los Angeles is over water, but half the circle around New York City is as well, where the population more than doubles the population of the Los Angeles circle.

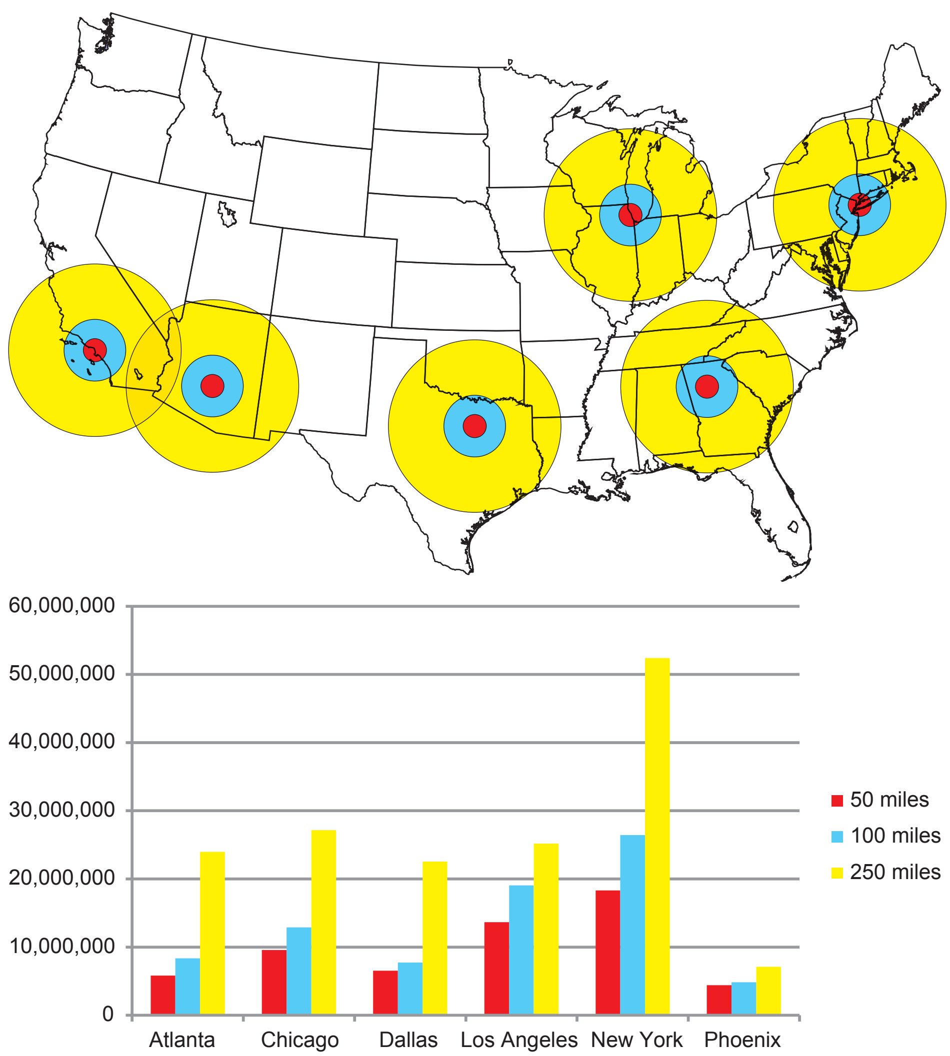
Lastly, each of the cities mentioned has readier access to water ports than does Arizona. Water transportation for heavy, bulk shipping is cheaper than land transportation. Right now, the Panama Canal is being widened to accommodate vessels with significantly wider girth than it can handle at present. Within four years, the comparative advantage of shipping into California ports from Asia will have been significantly reduced. A shift away from California ports to Texas and other ports began some years ago because of longshoreman strikes.[6] Barring major changes in California, completion of the Panama Canal expansion will likely accelerate the shift.[7] Arizona will find it more difficult to compete for businesses

Table 2. Populations Proximate to Select U.S. Cities

City	Population		
	50 miles	100 miles	250 miles
Atlanta, GA	5,807,833	8,348,443	23,980,723
Chicago, IL	9,560,033	12,894,936	27,155,797
Dallas, TX	6,536,407	7,735,247	22,550,153
Los Angeles, CA	13,660,110	19,046,776	25,201,651
New York, NY	18,324,590	26,448,019	52,396,546
Phoenix, AZ	4,421,065	4,845,116	7,113,458

Source: Population numbers derived by Erin Teague using geographic information systems data from Esri at http://www.esri.com.

Figure 3. Map of Cities and Proximity Circles from Table 2



Source: Population numbers derived by Erin Teague using geographic information systems data from Esri at http://www.esri.com.

and industries fleeing California. It would make little sense to ship inputs from Texas to Arizona, and then ship finished goods back to the east where most people in the United States live. Export to Pacific-rim countries in bulk would be better accomplished with production near eastern ports and shipment through the Panama Canal.

There are two strong implications for Arizona as a result of its remoteness and relationship to California. First, Arizona must look to Mexico's Port of Guaymas as an alternative transportation node to California's ports. Already, Arizona-based enterprises are making this adjustment.[8] Second, and more to the point of state policy, Arizona's main hope for staying competitive is to keep costs associated with government as low as possible. These costs include taxes, obviously, as well as costs that are attributable to regulations that provide little benefit in return. Keeping taxes high to subsidize government-driven enterprises such as solar energy and professional sports is just one example of what not to do.

Tourism has a relatively large share of the state's economy, and this comparative advantage for Arizona could be much greater if more land in the higher elevations were open for business and were not controlled by the federal government.

Arizona's Reasons for Hope: Climate, Water, Geology, Mineral Wealth

Arizona has relatively large shares of GDP in retail trade, construction, and real estate compared to the nation (see appendix), partly because Arizona's climate makes it a great place to retire. Weather is the number one reason retirees cite for their move to Arizona.[9] Indeed, Arizonans have always bragged about the climate. Climate is one of the state's "five Cs" depicted in the state seal and was considered one of the state's sources of prosperity decades ago. Although summers in the Sonoran Desert are brutal, with temperatures often rising above 115ºF, Flagstaff's temperatures are so mild that many city residents have no air conditioning. Moreover, Phoenix's average low temperatures in December and January fall to a relatively balmy 41ºF. It is difficult to find another well-populated place in the country as pleasant as the populated areas of Arizona during the winter. And yet, during a snowless, mild winter in Phoenix, a resident can drive two hours to ski some of the deepest snows in the nation. By contrast, Dallas sees average lows of 37ºF and 34ºF, depending on the month. New York City sees average lows that fall below freezing for three months of the year.[10] The lack of brutal winter weather—together with plenty of options for dealing with the summer heat—is a major advantage for Arizona. Tourism has a relatively large share of the state's economy, and this comparative advantage for Arizona could be much greater if more land in the higher elevations were open for business and were not controlled by the federal government.

Arizona also does not see as many storms as other states. It has no coastline and is located well away from oceans, so hurricanes are not an issue. Widespread flooding does not happen. Tornadoes are practically nonexistent because the weather patterns that spawn them in the nation's Midwest are almost impossible to generate in Arizona. With predictable weather that is unlikely to bring about widespread property damage and with prevailing dry air, Arizona is attractive as an aviation graveyard for the U.S. Department of Defense and private industry. Industries heavily affected by corrosion should find Arizona an advantageous place to locate.

Surprisingly, as compared to regional states other than Texas, Arizona is relatively well endowed with water, so much so that in past five years, there have been no official announcements from water authorities to curtail water usage. In Texas, by contrast, water use curtailment is almost a way of life. Even though local water authorities may still discourage heavy water use in Arizona, they do so with official encouragement to xeriscape lawns and use water pricing rather than with heavy-handed direct rationing methods. Arizona's most heavily populated areas benefit from the Central Arizona Project, a water canal made possible by federal loans that brings water from the Colorado River to the center of the state.[11] Arizona's allocation is relatively outsized as a result of regional state compact negotiations decades ago, making the state an advantageous place for water-intensive industry to locate. [12]

Arizona is a very safe place to make long-term capital investments meant to last more than a lifetime.

Furthermore, unlike California and some other western states, Arizona is also geologically stable. The dramatic geologic processes that created the state's spectacular geological sights, such as the Grand Canyon and the Mogollon Rim, occurred eons ago. Extinct volcanoes, though numerous in Arizona, actually testify to the remote likelihood that any new eruptions might occur within a living person's lifetime. In short, with stable weather and stable geology, Arizona is a very safe place to make long-term capital investments meant to last more than a lifetime.

Finally, Arizona has mineral wealth, especially copper. Arizona produced 8.8 percent of total U.S. nonfuel minerals in 2009. Only Nevada produced more. Texas ranked sixth in nonfuel mineral production in 2009.[13] As evidenced by hardrock mining activity and proposed mining in the state, Arizona has a great deal of mineral wealth to exploit. Arizona was the biggest producer of copper in 2006 and the second biggest producer of molybdenum and sand and gravel. The state boasts uranium deposits as well as gold and silver production. In addition, there are deposits of iron and other base metal sulfides.[14] Most of these minerals are currently shipped elsewhere to be turned into industrial products. But unprocessed metals are heavy, and Arizona could conceivably be the place where more of these metals could be processed and turned into final goods for shipment elsewhere.

Arizonans must govern and work to exploit the state's strengths. We cannot afford to forgo hardrock mining, an area where we have a comparative advantage because of the mineral deposits in this state. We cannot hope to thrive economically without an export industry. Although our weather is effectively exported through tourism, with so much land off limits to anything other than rough-country camping, tourism cannot be relied on to be much more significant than it already is, which is not as significant as many Arizonans seem to believe (see appendix). Here again, too often we forgo opportunities to play to our strengths.

General Comparisons of Economic Institutions in Arizona and its Neighbors

In light of the tenuous, yet hopeful, situation in which Arizona finds itself, should Arizonans commit their government to building industries that are currently not here or perhaps are only beginning to be developed? Should we constantly chase what we think might just be the next big trend in the economy? Or should we respect the freedom of business leaders and laborers—those who have an immediate stake in economic outcomes—to decide what risks they will take and for what rewards? Arizona often seems to make the former choice.

Is there a specific path that we should take to ensure the state's prosperity? Is there a particular vision that is most desirable for economic growth? The short answer is yes.

The choice to chase the golden goose was made when the Arizona Biomedical Research Commission was funded by initiative.[15] The same choice was made when the legislature created the solar industry tax credits.[16] The legislature effectively made the same choice yet again with its creation of the Arizona Commerce Authority, thereby allowing government officials and not market forces and free enterprise to determine success or failure.[17] What has been the result of such economic tinkering? A comparison of the policies and outcomes of regional states suggests that Arizona may be ignoring or even undercutting its competitiveness and performance.

Consider the series of rankings in table 3 that reflect on Arizona's business climate. Although the rankings are based on more than government policy alone, policy considerations figure heavily in the rankings. Tax policy rankings are purely government policy rankings. Perhaps the only ranking in the table that does not explicitly reflect government policy is cost of living. Even here, though, government policy does have its effects through taxation and regulation because higher levels of both increase the cost of living. Hence, the cost of living ranking is included. The rankings show that Arizona is a long way from being at the top of the states in areas that the state's policymakers at all levels of government can control.

Despite nearly scoring as well as Nevada, Arizona could only muster three top-10 rankings. On average, Arizona ranks better than only California and New Mexico. This mediocre standing has been confirmed by the Ewing Marion Kauffman Foundation, which recently surveyed businesses in the states and graded

Table 3. Various Tax and Government Policy Rankings for Select States

Ranking type and organization	State						
	Arizona	Texas	California	Colorado	Nevada	New Mexico	Utah
Economic freedom—Mercatus Center	22	14	48	7	6	37	20
Economic freedom—Fraser Institute	15	2	46	13	9	41	9
Economic freedom with feds—Fraser Institute	23	2	26	4	8	47	4
Best for business —*Forbes* magazine	20	6	39	5	36	32	1
Best for business—CNBC	22	1	40	8	45	36	2
Best for business—ChiefExecutive.net	10	1	50	11	12	33	9
Tax climate—Tax Foundation	27	9	48	16	3	38	10
Tax on new investment—Council on State Taxation	39	20	29	18	33	50	17
Tax per capita—*Milwaukee Journal Sentinel*	22	16	42	14	32	23	13
Cost of living—Missouri Economic Research and Information Council	35	7	46	30	19	25	10
Income tax—*Milwaukee Journal Sentinel*	29	7	36	5	17	44	32
Sales tax—Sales Tax Clearinghouse	43	40	44	24	39	26	28
Property tax, residential—Minnesota Taxpayers Association	8	37	23	6	23	8	10
Property tax, business—Minnesota Taxpayers Association	20	44	12	47	14	15	19
Economic performance—American Legislative Exchange Council	11	2	47	24	18	6	12
Economic outlook—American Legislative Exchange Council	9	16	38	8	18	35	1
Average	**22**	**14**	**38**	**15**	**21**	**31**	**12**
Average excluding specific tax ranks	**21**	**8**	**42**	**13**	**20**	**34**	**9**

each state on the basis of how friendly the state was to business. Arizona's grade was a C; Mississippi's was a C+. Among the states listed in table 3, Arizona outscored only California and New Mexico on Kauffman's index.[18] Arizona, it seems, is firmly committed to a mediocre status among the states in economic freedom, business taxation, cost of living, and other indicators of economic dynamism and potential.

So is there a specific path that we should take to ensure the state's prosperity? Is there a particular vision that is most desirable for economic growth? The short answer is yes. All the rankings in table 3 effectively ask how low taxes are, how little regulation there is, and how free individuals are to pursue enterprise. Those states with lower taxes and less regulation rank higher. The foregoing table reveals that Texas scored three times as many top-10 rankings—*nine in total*. Moreover, if duplicative tax policy scores were excluded, Texas would rank highest among our regional states, at eighth in the nation, with Utah at ninth. These high rankings correspond to Texas's economic success. The policy path taken by Texas provides us with a vision for Arizona's future because Texas has done relatively well economically in recent years. That policy path includes low and simple taxes, reliance on private property, efficient and low-cost government, and low regulation.

Texas's Recent Success

While much of the country has been mired in a tepid recovery from the deepest national recession in recent history, Texas has performed relatively well. Texas's GDP actually rose from 2007 through 2009 by a slight 0.35 percent, although the private portion of GDP fell, but only by 0.4 percent. Several states fared better, but they were mostly small states with uniquely local economic booms. Texas's per capita personal income fell about the same as the nation's as a whole (–1.61 percent versus –1.66 percent for the United States). Between 2007 and 2009, annualized employment in Texas fell by 90,000, a less than 1 percent decline.

While much of the country has been mired in a tepid recovery from the deepest national recession in recent history, Texas has performed relatively well.

Texas's recovery has been robust compared to Arizona's, but 13 states saw even higher GDP growth rates in 2010. Several of these states had worse problems to contend with during the recession, however, so much of their growth is recovering what they lost. At 2.8 percent, Texas's GDP growth was only slightly higher than the nation's, yet considerably higher than Arizona's. Texas's per capita personal income rose 8.5 percent from 2009 to 2011, a faster growth rate than for the nation and seventh highest among the states.

With respect to total employment, Texas cannot be beat. Only three states had higher total employment in 2011 than in 2009: Alaska, North Dakota, and Texas. Texas had 160,000 more people employed in 2011 than in 2007. The nation as a whole had 6.2 million *fewer* people employed in 2011 than in 2007. Arizona had 271,000 fewer people employed in 2011 than in 2007. Texas has lately been the nation's job-creation machine, by any absolute measure.[19]

As a result, in 2010, Texas saw more new housing construction permits than any other state, at 88,500. This number was higher than that of all of the Pacific states combined—including California—at 75,600. Somewhat surprisingly, Arizona saw 12,370 new housing permits in 2010, 2 percent of the U.S. total housing permits.[20] Texas far overperformed, at 14 percent of U.S. total housing permits, considering that its population is roughly 8 percent of the U.S. total.

The Secret to Texas's Success

A *Wall Street Journal* article[21] from November 2011 describes Texas this way:

> David Booth, who moved Dimensional Fund Advisors' headquarters to Austin from Santa Monica in 2008, puts Rick Perry's role in perspective: "He understands his job isn't to get in the middle of everything." (Fluor's Alan Boeckmann seconded that.) But Mr. Booth and others said this is also true of the Texas lieutenant governor, its attorney general and the comptroller.
>
> "They are very supportive of business," says Lee Raymond, "in the sense of moving things along. If there is a rock in the road, they want to know what they can do to move it out of the way."
>
> This isn't merely the "pro-business" bias of a Rick Perry or any other governor. Texas's pro-business bias goes back about 175 years—and never died. "It's just that they believe in the whole Horatio Alger myth down here," said Mr. Booth. "It's hard to understand if you haven't lived here."

The article also describes how the large construction firm, Fluor, relocated from California to Texas, in part because of California's regulatory hassles. Another company that relocated from California had to hire a separate company just for California regulatory compliance purposes.

This isn't merely the "pro-business" bias of a Rick Perry or any other governor. Texas's pro-business bias goes back about 175 years—and never died.

Texas's history at least partly explains its emphasis on free enterprise and the cultural bias that views regulation skeptically. The early Anglo influence in Texas consisted of mostly dispossessed, highly individualistic southerners eager to stake a claim in property. They effectively staked their claims with no assistance other than the willingness of the Mexican government to allow them to do so. This history helped to create a strong bias in the state in favor of private property rights, on which regulation tends to intrude. After Texas won its independence, the Texas nation and then the state owned large tracts of land. Although lands and mineral rights were designated to benefit schools and universities, there was effectively no effort to hold surface rights indefinitely. Three million acres were readily offered in trade for construction of the Texas capitol building.[22] Land grants to settlers and railroads were made, amounting to at least 77 million acres.[23] Today, less than 5 percent of Texas's surface is government owned.[24]

Texas's history with Mexico and the Reconstruction Era brought about a culture suspicious of governmental power. Thus, the legislature meets for regular sessions only five months every two years, and only the governor can call 30-day special sessions. Counties have no power to make ordinances, and cities are presumed to have only the powers they have been granted by the legislature. Houston, which governs almost 10 percent of the state's population, has no zoning laws. Unlike most other states, regulation in Texas is applied lightly and almost apologetically. Government is viewed as furnishing the law and order needed to facilitate economic success.

But Texas's biggest advantage compared to most states is its lack of a personal income tax. In a blog post on *The Economist* website, an individual from New York described how he learned from a driving instructor in Texas that the demand for driving instruction for adults had dramatically increased there in recent years. People from all over the world, and from large U.S. cities where driving is less necessary, were relocating to Texas.[25] One reason was very likely that earners got to keep more of their income. A Californian blogger explained how the income tax, among other reasons, drove her to leave California, with Austin at the top of her list of places to move.[26]

Texas's taxes are relatively simple. The sales tax is administered across the state by the Comptroller of Public Accounts, a statewide-elected office that combines the powers of Arizona's Office of the State Treasurer and Department of Revenue. The sales tax base is solely determined by the state; local governments only set a local rate. All sales taxes are paid to the comptroller, who then pays local governments their portions. This system makes things simpler for businesses that must collect and remunerate sales taxes. The same items are taxed statewide without exception, and the only auditor for the sales tax is the comptroller.

The secret to Texas's success is simplicity. Its tax system is low-cost administratively, both for taxpayers and tax collectors.

The property tax in Texas is high, but it is relatively simple. It is purely a local rate, and entities that can tax property include school districts, cities, counties, and a few special districts. Two rates can be determined: one for maintenance and operations, the other for bond payments. All property is taxed at the same rate, with primary residences getting a modest exemption up to a certain level of assessed value. Homeowners over the age of 65 enjoy a property tax freeze on school taxes.

In short, the secret to Texas's success is simplicity. Its tax system is, for the most part, low-cost administratively, both for taxpayers and tax collectors. Tax policies do relatively little damage to market price signals, thereby allowing resources to be put to their highest and best use.

Texas has maintained sustained economic growth in the face of changing demographics, historical baggage that comes with being a Southern state, and arid and semiarid land. Indeed, like Arizona, Texas's climate can be quite brutal—so much so that, unlike Arizona, the state runs an almost constant tourism deficit.[27] And yet some might say the biggest "secret" to Texas's recent relative economic success is oil and gas. Indeed, states with robust energy and farming sectors have enjoyed quicker economic recoveries.[28] Undoubtedly, the energy industry does play an important part in the Texas economy. Given the dramatic differences in natural endowments between Texas and Arizona, we may question whether Texas furnishes Arizona with a workable vision for prosperity. A deeper understanding, however, reveals why the good policy choices made in Texas will also work in Arizona.

Texas is not doing well purely because of its natural endowment; it was growing even before oil was discovered at Spindletop in 1901. In fact, Texas's intercensal (10-year) population growth rate has never exceeded the rates achieved in the 1870s, 1880s, and 1890s.[29] Another little known fact is that Texas has transitioned out of an economy dominated by fossil fuel energy production to an economy more diverse and resilient than it had in the 1980s. In 1981, the mining industry (which includes oil and gas) directly constituted more than 19 percent of Texas's GDP. Today, it is 9 percent.

Why and How Arizona Can Succeed

Natural resources are not all that matters for wealth creation and income potential. Institutional structures matter too. Early Americans surpassed their British cousins partly because of Americans' hard work and the incentives they faced that encouraged them to apply themselves. The availability of land was not the only factor; Americans could take possession of and improve the land largely without interference from the government but, at the same time, with rights enforced by government.[30] The most obvious example of how resources are not directly related to wealth and income is Hong Kong, which has no significant natural resources of its own. As a tiny British colonial enclave surrounded by Maoist China, Hong Kong was relatively rich. The natural endowment of a port helped, but Hong Kong had no natural resources of its own except people. Mainland China had people and ports, as well as readier direct access to natural resources, yet its cities were very poor for many decades.

Natural resources are not all that matters for wealth creation and income potential. Institutional structures matter too.

Harvard economists Daron Acemoglu and James Robinson, in their recent book *How Nations Fail*, divide economic institutions into two groups, extractive and inclusive. Extractive institutions are those that accrue economic benefits to small elites—benefits that are extracted from the rest of a population that is denied any opportunity to do much of anything other than to serve the elites. Thus, economic growth is arrested because relatively few have an incentive to innovate, take risks, and develop new technologies. The elites are mainly interested in preserving the status quo whereby they continue to benefit materially and almost exclusively exercise political power relative to the rest of society. Inclusive institutions that "foster economic activity, productivity growth, and economic prosperity" "are those that allow and encourage participation by the great mass of people in economic activities that make best use of their talents and skills and that enable individuals to make the choices they wish." Inclusive economic institutions "feature secure private property, an unbiased system of law, and a provision of public services that provides a level playing field in which people can exchange and contract; [they] must also permit the entry of new businesses and allow people to choose their careers."[31]

The inclusive institutions Acemoglu and Robinson describe are basically the same ones measured across the states by the Mercatus Center and the Fraser Institute, whose rankings for select states appear in table 3. They are also basically the same ones measured in the Cato Institute's *Economic Freedom of the World* report, wherein Hong Kong ranks first and mainland China ranks 96th.[32] Although each index places different weights on each policy, they have a great deal in common. They look at the size of government, the level of taxation, how complex the tax system is and the degree to which it discriminates among industries and businesses, the degree of regulation, the legal structures, and property rights protection. Mercatus also measures "paternalism," or the regulation of individual choices. Of the states listed in table 3, Texas has the advantage over the other states in the Fraser index. Mercatus places Texas behind Colorado and Nevada. However, the general business climate and tax climate indexes tend to favor Texas. In every index, Texas has a distinct advantage over Arizona.

Laws, regulations, and tax policies that encourage economic activity, productivity growth, and economic prosperity, do as little as possible to distort prices and economic decisions.

The change in China's economic fortunes illustrates the interaction of the four factors that affect economic well-being and growth: natural resource endowments, institutions that determine incentives, human resource endowments and training, and previous investment. A region with many natural resources, a dense population, and a lot of inherited investment can overcome high taxes and heavy regulation to some extent. Institutional effects, however, can trump all else. South America is covered in natural resources with hardly any desert, but it has lagged far behind the United States, which has a huge arid and semiarid region in its lower 48 states. Regardless of how they might arise, institutions matter to the extent that the resource rich can be rendered destitute and the resource poor rendered rich entirely as a result of whether institutions encourage hard work, investment, and risk taking by the widest possible swath of a population. Only by incentivizing private economic behavior can widespread prosperity be ensured. The history of centrally planned economies throughout the 20th century testifies to this fact, and this truth is not affected by size or by resource endowment. Except for their location and language, Hong Kong and Maoist China could not have been more different in size and resource endowment. Yet Hong Kong, the smaller and resource poorer of the two economies, was actually much richer. Adopting many of the institutions and policies of Hong Kong has made mainland China richer.

Individuals discover their comparative advantages and choose their careers by identifying their own interests and talents, pursuing skills, and specializing. Comparative advantages are also discovered collectively through business enterprises that seek the optimal use of resources given the readiness of their availability through a freely functioning price system. Laws, regulations, tax policies, and subsidies that obstruct individual economic pursuits and that affect prices so that actual costs and willingness of consumers to pay are not accurately signaled interfere with inclusive institutions and prevent the discovery of true comparative advantages. Laws, regulations, and tax policies that encourage economic activity, productivity growth, and economic prosperity, do as little as possible to distort prices and economic decisions. Nations and their provinces and states that pursue such policies grow in no small part because they discover true comparative advantages and are quick to adapt to changing circumstances. They grow not at the behest of government officials but through the ability of free individuals to act according to the profit motive. In this last regard, Texas has an institutional edge on Arizona and many other states. Fortunately, this institutional edge can be replicated.

Embrace Private Enterprise in Government

Several years ago, Arizona's road-related public–private partnership law was extensively rewritten to modern standards. The old law had never been implemented. The new law hasn't, either. During the past legislative session, it was amended to allow strict enforcement of tolls, which are key to paying back private financiers of publicly owned highways.[33] Policymakers, especially bureaucrats, must stop finding reasons for failing to exercise these new laws and must move forward with projects that the state needs. Legislators and others should put away plans that are now a quarter-century old and complete Loop 202 (the freeway on the east side of Phoenix which is planned to be extended from Ahwatukee to I-10 at 55th Avenue) through a public–private partnership, if necessary, that, imaginatively assembled, might garner greater cooperation from the Gila River Indian Community.[34] Instead of building a highly speculative road to Las Vegas so that Arizonans could more readily gamble away their money, the state should consider a road that bypasses Phoenix and/or Tucson altogether, perhaps one purely dedicated to trucks and funded with tolls that are paid to a public–private partnership. Although there have been problems, Texas has embraced these types of partnerships. Private companies are entirely financing and building a publicly owned highway between Austin and Seguin, Texas, in exchange for collecting tolls. This road would not be built for years but Texans will benefit from it soon as a result of the public–private partnership and tolls.

Arizona must have both an east and a west orientation. This will provide access to the highly concentrated population of California and the bulk of the national population near and east of the Mississippi River.

If Arizona is to fully benefit from its integration with the rest of the nation, it must have both an east and a west orientation. To the south is Mexico, an improving trading partner but still one facing institutional and developmental challenges. To the north lies nearly 700 miles of largely empty space. The directions to access the highly concentrated population of California and the bulk of the national population near and east of the Mississippi River are west and east, respectively.

At the local level, Phoenix recently passed ordinances that allow faster development of properties and construction of business properties by effectively privatizing the permitting process. Architects who wish to do so receive training and certification for

Phoenix building code requirements and self-certify projects. Random audits keep them in line. Privatizing permitting can cut weeks, if not months, of valuable, costly time from project development and can make the city much friendlier to business development. Other cities in Arizona should follow suit.[35]

Restructure the Tax System

Arizona's tax system has dictated the character of Arizona's economy as much as anything else. Although Arizona is not a high-tax state, it is not a low-tax state either. Texas regularly ranks sixth lowest among the states in overall taxation. Arizona ranks sixteenth.[36] Arizona cannot afford such a high tax burden.

Arizona's tax system is decidedly antibusiness, pro-residential housing, anti-production, and pro-retirement. Like the majority of states, Arizona imposes a personal income tax along with a corporate income tax. These taxes largely piggyback on the federal tax code. Because income is the reward for work, investment, and risk taking, income taxes negatively affect work, investment, and risk taking. Income taxes, in a very real sense, directly tax the qualities and efforts that make our standard of living possible. And because we accomplish our work, investment, and risk taking through business organizations, the income tax has a decidedly antibusiness bent. Retirees, because of their relatively low incomes, are taxed relatively lightly by the income tax.

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The state also imposes a transactions privilege tax (TPT), which is similar to a sales tax. Arizona's TPT, combined with local rates, is the eighth highest tax of its kind among the states (see table 3). Legally, businesses rather than consumers pay the TPT. Conversely, consumers are legally liable for a sales tax. In both cases, businesses remit collected funds to the state, and for all intents and purposes, the two taxes are the same. It is telling, though, that Arizona imposes a TPT, which despite its sales-tax-like operation, is technically an assessment on business and is legally a business tax. The TPT is also complex because Arizona allows local governments the discretion to determine which goods and services are taxed, independent of the state's established tax base. Retirees cannot easily avoid the TPT except that they spend a higher proportion of their resources on necessities such as food, and food is not taxed under the TPT in most locations.

Through its local governments, Arizona also imposes property taxes, but local governments only set a property tax rate. The state determines the property tax base statewide and the relative tax levels for nine classes of property.[37] Each class of property is taxed at a different level depending on its "assessment ratio."[38] Arizona taxes business property at twice the residential rate by applying a relatively high assessment ratio. This treatment provides one more example of Arizona's antibusiness tax system. Arizona's residential property taxes are among the lowest in the nation. Though they have moderated recently, just a few years ago Arizona's business property taxes were among the nation's highest. Once again, the advantage goes to retirees. Those who are not retired, even if they own houses, are more heavily burdened with high business taxes because they suffer lower incomes than if businesses could afford to pay better.

In table 4, Arizona's and Texas's state taxes are compared.[39]

As can be seen in table 4, Texas depends heavily on its sales tax, much more so than Arizona. Texas has no personal income tax. (Texas, however, depends more on its business income tax than Arizona depends on its corporate income tax.) Texas also depends more on its "sin" taxes (alcohol and tobacco, called luxury taxes in Arizona) than does Arizona. Arizona taxes tobacco at a higher rate than Texas[40] and much of that funding is dedicated. But Arizona taxes alcohol relatively

Arizona's tax system is decidedly antibusiness, pro-residential housing, anti-production, and pro-retirement.

Table 4. Arizona and Texas State Tax Comparison

Tax	Arizona		Texas	
Transaction	Amount ($)	Percent	Amount ($)	Percent
Privilege and sales[a]	4,850,390,444	56.4	25,263,165,662	70.7
Personal income[b]	2,473,970,521	28.7	N/A	N/A
Corporate income	482,896,483	5.6	N/A	N/A
Franchise	N/A	N/A	3,932,114,437	11.0
Alcohol and tobacco	391,172,807	4.5	2,421,537,756	6.8
Insurance[c]	407,403,000	4.7	1,349,641,599	3.8
Energy production	N/A	N/A	2,582,564,757	7.2
Inheritance and estate	808,158	0.0	1,806,641	0.0
Other	21,428,838	0.2	201,144,550	0.6
Total	8,606,641,413	100	35,751,975,402	100

Source: For Arizona, Joint Legislative Budget Committee and *Fiscal Year 2011 Annual Report* (Phoenix: Arizona Department of Revenue, November 15, 2011), table 8, http://www.azdor.gov/Portals/0/AnnualReports/FY11_Annual_Report_Web.pdf. For Texas, "Revenue by Source for Fiscal Year 2011," on the website of the Texas comptroller, Window on State Government, http://www.window.state.tx.us/taxbud/revenue.html.

Note: N/A= not applicable.

a. Texas's sales tax number includes hotel taxes and utility taxes that are separately listed in the Texas source, but both taxes are included in Arizona's transaction privilege tax numbers. The numbers are included together here to make the two states' totals comparable. The total reflected here is net of distributions to local governments. See *Fiscal Year 2011 Annual Report* (Phoenix: Arizona Department of Revenue, November 15, 2011), table 8, http://www.azdor.gov/Portals/0/AnnualReports/FY11_Annual_Report_Web.pdf.

b. These figures are shown net of urban revenue sharing.

c. The figure for Arizona comes from the Joint Legislative Budget Committee website, http://www.azleg.gov/jlbc.htm.

lightly compared to Texas.[41] Texas taxes energy production modestly; this has the benefit of exporting some of the cost of taxation without undermining the state's natural energy competitiveness, although local property taxes significantly impact energy. Finally, although property taxes are relatively high in Texas, such taxes are transparent, and there is constant agitation for them to be lowered. Texas's property tax system also keeps business and residential property owners relatively unified as taxpayers, because all classes of property pay the same rate.[42] All things considered, Texas's tax system is somewhat more efficient than Arizona's because (a) Texas taxes transparently, (b) it taxes more to its comparative advantages than Arizona does,[43] (c) it taxes goods with unresponsive demand more than Arizona does, [44] and (d) it does not tax personal income. As compared to Arizona's tax policy, Texas's policy encourages savings, investment, and growth while minimizing distortion of its economy and maximizing political accountability. These factors help prevent excessive taxation (although Texas does tax a good deal of business income and even expanded its franchise tax in 2007—an unwise move). Arizona would do well to follow Texas's example.

End the Income Tax

Arizona should restructure its tax system away from income taxes and into sales taxes.

Arizona should restructure its tax system away from income taxes and into sales taxes. Income taxes have several deleterious effects. First, they are complicated. To the extent that any state deviates from federal formulas, uncertainty is created in the tax system, and the federal system is complicated enough. Second, the personal income tax requires every income earner to file a tax return. Hence, the government violates the privacy of every income-earning individual, literally delving into some of our most personal activities. Third, income taxes directly tax work effort, risk taking, and investment. Work is much easier to discourage than consumption. Thus, consumption taxes are more robust. In order of volatility, from the most volatile tax to the least, are (a) corporate income taxes, (b) personal income taxes, (c) sales taxes, and (d) property taxes.[45] Arizona could radically restructure toward consumption taxes by including services in the sales tax base, perhaps even taxing some services at a lower rate than other goods are taxed, while abolishing its income tax system. This strategy would give Arizona a comparative advantage relative to other states, most of which impose income taxes.[46]

A comparison of the nine states with no personal income tax and their economic performance over the past decade to the nine states with the highest income tax rates shows the deleterious economic effects of the income tax. From 2001 to 2010, the GDPs of the states with no personal income tax grew by almost 59 percent, while those of the states with the highest income tax rates grew by 42 percent. The population in states with no income tax states grew at double the rate of the other states. Employment in the states with a high income tax actually declined while, on the heels of a deep recession, employment grew more than 5 percent in the states with no income tax.

Although Texas has what amounts to a corporate income tax, the rate is relatively low. Texas is among those states with the lowest corporate income tax rates and, once again, those states with relatively low tax rates economically outperform those with relatively high tax rates. At the same time, states with the highest rates of sales tax, Arizona among them, actually prospered in comparison to those with the lowest sales tax rates, seeing greater growth in GDP and employment. The evidence shows that dependence on a sales tax, with less or no dependence on a personal income tax, yields far better economic results than dependence on an income tax. As noted above, Texas is one of those states with no personal income tax and is relatively dependent on the sales tax.[47]

Broaden and Harmonize the Sales Tax Base

Arizona's sales tax base is balkanized among the state, counties, and cities. Large cities collect their own sales taxes with the state separately collecting its own. Cities are allowed to deviate from the state's sales tax base, taxing items that the state does not tax and potentially not taxing items that the state does tax. For example, the City of Phoenix taxed groceries in recent years.[48] Thus, business owners must be aware of multiple rules and regulations under which sales are taxable. They must remit these taxes to multiple addresses, thus creating the need for multiple audit authorities, each of which will have different policies, different schedules, and different employees to deal with. This system creates unpredictability and a more hostile business environment than a more unified system would.

Arizona could leap ahead of all other states by broadening its tax base and reducing its sales tax rate to make the change revenue neutral.

Texas makes the system simpler for taxpayers. First, the legislature determines the tax base statewide for all levels of government, so businesses do not have to learn about multiple taxation rules. Cities, counties, and special districts have discretion only over the rates they impose, and their combined rate is limited. Second, the state collects all sales taxes, keeping track of the jurisdictions in which each business is located, so businesses write only a single sales tax check. Accordingly, the state is the only audit authority with respect to the sales tax. Local governments report their rates to the state's Comptroller of Public Accounts (a statewide elected office), and these rates are used to compute the share of sales tax collections from their jurisdictions that must be remitted to those governments. Arizona could simplify its system and make the state more business friendly by following Texas's sales tax model, thereby standardizing the tax base and having the state do all collections.

Arizona could leap ahead of all other states by broadening its tax base and reducing its sales tax rate to make the change revenue neutral. In exchange for eliminating income taxes, Arizona's sales tax base could be broadened to include legal and medical services, groceries, prescription drugs, and a number of other consumed goods and services. Some of these items could be taxed at a lower rate than the general rate, if necessary. Already, medical and legal services, groceries, and prescription drugs are taxed in this state through the income tax, so such a change would not be as radical as it might initially seem. Besides, one likely reason our national economy has so rapidly shifted into services is that services are relatively lightly taxed, are not subject to sales tax, and do not have their value in tangible property, thereby avoiding real property taxes. The suggested shift to broaden the services tax would reverse many years of economic distortion.

Goldwater Institute economist Steven Slivinski has elaborated further on how Arizona might eliminate dependence on the income tax and replace it with a broadened, low-rate sales tax in a forthcoming paper. He estimates that the sales tax rate could fall to between 4.6 percent and 5.5 percent, depending on the degree of broadening. It could be even lower at the state level if revenue sharing were eliminated, although local governments might raise their portion of the sales tax rate to make up the difference.[49]

Equalize and Simplify Property Taxes

Arizona deviates from the rest of the country with its various property tax classes and assessment ratios, which make its system more complex and unfriendly to business.

As noted earlier, different classes of real property are taxed at very different rates in Arizona depending on state-determined assessment ratios. As in other states, the values of taxed properties are determined using various methods. Residential property values are determined by looking at the market prices of comparable properties. Agricultural property values are derived from income earned from the property and are thus valued at relatively low levels for tax purposes. Business property values are determined in a variety of ways, including construction costs minus depreciation, market value comparisons, and income methods. Business personal property (transportable equipment) is taxed, yet residential personal property is not. Arizona follows fairly standard valuation methodologies. It deviates from the rest of the country with its various property classes and assessment ratios, which make its system more complex and unfriendly to business because the assessment ratio for business property is twice that for residential property.

An additional level of complexity and uncertainty for taxpayers is added with Arizona's primary and secondary property tax rates. The primary rate funds operations of various local governments, and the secondary rate funds bond payments. This much is familiar to most residents of states with property taxes. However, Arizona has made the secondary rate a vehicle to override property tax limits and to fund some special districts, thereby creating more taxpayer vulnerability. The state limits the primary rate on residential property to 1 percent of tax value, but no such limitation applies to Arizona's business properties, illustrating once again the antibusiness bent of Arizona's tax system.

Texas's system is only marginally simpler, but in ways that matter. Texas property taxes have two basic components: a rate to fund operations and a rate to fund bond issues. The rate that funds bond issues only funds bond issues. Because there are limits on how much property taxes can increase in Texas, similar to limits in Arizona, elections must be held to override those limits. But taxes above the limit are applied to the operations tax rate. Although various methods are used to value business property, which can sometimes work to favor a business owner, all properties are taxed at the same rate. Some consideration is given to residential property owners, who receive an exemption on part of the value of their properties, and residents age 65 and older see their property taxes frozen. Otherwise, commercial and residential real property is treated similarly. The final exception is personal property. Texas taxes business personal property but does not tax residential personal property, just like Arizona.

Even if residential property taxes were to increase relative to where they are now, Arizona should tax all property at the same rate. Arizona has moved in this direction in recent years by reducing the business assessment ratio from 25 percent to, eventually, 18 percent.[50] By comparison, residential property's assessment ratio is 10 percent. Business personal property tax relief may also be granted.[51] However, until rates are equalized, voters, the majority of whom do not own businesses, will see property tax increases as having lower costs for a given benefit than is truly the case, and tax increases that cost businesses $1.80 compared to $1.00 for residents are more likely to occur, bringing with them all the negative economic effects taxes entail. In addition, changes in the law should be made to simplify tax rates by reserving the secondary rate only for bond service and by keeping all rates for operations on the primary rate, even if doing so means adjusting the current legal limits. These changes would make the system more transparent, thereby allowing taxpayers to better hold officials accountable.

Private parties own less than one-fifth of Arizona's land. The state's largest landowner, by far, is the federal government, with 42.1 percent.

Sell State Trust Lands

According to the Arizona State Land Department, private parties own less than one-fifth (17.6 percent) of Arizona's 73 million acres, and even this low percentage is slightly overstated because of unquantified local government ownership of rights-of-way, parks, and other parcels. The state's largest landowner, by far, is the federal government, with 42.1 percent of the state's surface area under the control of various federal agencies. Tribal lands cover 27.6 percent of the state. The last 12.7 percent of the state's land area consists of state trust land, granted to the state by the federal government under the state's enabling act. Of the original grant of 10.9 million acres, about 15 percent has been sold during the 100 years after Arizona became a state in 1912. At this rate, it would take at least another 550 years to sell all of the state trust lands. The situation is even worse for trust land dedicated to public schools. Of the 8.5 million acres originally allocated to schools, only about 500,000 acres, or 6 percent, have been sold.[52]

Precise statistics for true private ownership of land for national comparisons are not easily obtained. Two sources with similar numbers apparently count tribal lands as private property when, in fact, reservations are collectively owned and regulated to some degree by the federal government. Nevertheless, by these comparative statistics, Arizona ranks sixth in the percentage of land area owned by federal and state governments, with 57 percent so owned. Texas ranks 44th, with less than 5 percent so owned.[53]

Land ownership determines the use of valuable resources, including forests, fertile soil, minerals, water, and surface area. Private ownership allows resources to be used in the way that they are most highly valued by permitting others to bid for those resources. Land is no exception. With collective ownership of any resource, the resource's use is determined in a political setting. That setting requires coalitions to develop to determine the resource's use. Political trade-offs occur in dealings with individuals and groups who are ignorant of a resource's potential and who often have interests that run counter to those of the collective. Landowners whose homes border open lands enjoy a property value premium and tend to favor measures to keep those lands from being developed, although such measures may be deleterious to the economic interests of the state as a whole.

Land ownership determines the use of valuable resources, including forests, fertile soil, minerals, water, and surface area. With collective ownership of any resource, the resource's use is determined in a political setting.

An example involves the Union Pacific (UP) railroad, which wants to build a switching yard near Picacho Peak and attempted to buy nearly 1,500 acres of state trust land to do so. Partly as a result of efforts by those who currently lease the land, protests were organized regarding possible environmental impacts, and UP scaled back the size of its project. Arizona can ill afford to become a bottleneck to rail transportation given its potential for becoming an inland port and for adding value to imports from the Pacific, whether the imports land in California or a port in Mexico.[54]

Limited land availability affects housing prices. The Lincoln Institute of Land Policy in Cambridge, Massachusetts, has constructed quarterly housing price statistics for the 50 states dating back to 1975. Housing prices are divided between the value of a home, based on construction costs, and the land it occupies. Land value as a percentage of total housing prices is then calculated. Most of the difference in housing prices from state to state results from differences in land values, according to this methodology. A ranking of the states by an average of the land value percentages for every quarter since 1975 shows Arizona with the sixth most expensive land for housing among the states. Those with more costly land include California, Connecticut, Colorado, Hawaii, and Florida. At one point in 2006, land costs made up almost 61 percent of the price of a house in Arizona. Texas has the third *least* expensive land, with only Tennessee and Nebraska being less costly. During the housing bubble, land costs as a percentage of the price of a house in Texas never exceeded 8 percent.[55]

Connecticut and Hawaii are small states with limited supplies of land. Florida has high demand, as does California. All four of these states have expensive beachfront property skewing their statistics. Colorado, like Arizona, is limited by federal land ownership, but it also has highly desirable and limited mountain properties pushing up its land costs. After the federal government, Arizona's biggest limit on land availability currently is the reticence of state policymakers to propose changes needed to more expeditiously sell state trust lands. This effort includes pushing the U.S. Congress to change the state's enabling act, which contains confusing language about minimum acceptable pricing and maximum allowable acreage that a single person may purchase.[56] The state's constitution, partially based on the enabling act, also contains confusing language and needs to be changed.

One objection often heard when the sale of state trust lands is suggested concerns the potential impact on tourism. This objection seems to hinge on two ideas: first, that state trust lands are a major input in the state's tourism industry and, second, that tourism is a very large part of the economy so that any significant loss of tourism is economically disastrous. As will be explained, the evidence does not support either of these contentions.

If we consider the benefits of private ownership in addition to the small likelihood that tourism would be significantly affected, we find that the sale of state trust lands would be a net positive to the economy and, therefore, to all the areas that trust lands are supposed to benefit.

Although state trust lands are roughly 13 percent of the state's land area, federal lands, not including tribal reservations, make up 42 percent of the state's land area. Federal lands include areas controlled by the Bureau of Land Management, which allows camping; the Forest Service, which allows camping and sightseeing; the National Park Service, which controls some of Arizona's biggest tourist draws; the Fish and Wildlife Service; and the Department of Defense. Even if the sale of trust lands negatively affected tourism, the effect would be negligible because of the substantial amount of federal land open to tourists. Moreover, given the success of Meteor Crater, which is privately owned, as a major tourist attraction, tourism might even be enhanced.

Tourism likely directly contributes a low single-digit percentage to the state's economy. The appendix shows that the two industry sectors of the economy that tourism most affects, "arts, entertainment, and recreation" and "accommodation and food services," together make up less than 5 percent of the state's economy. Neither of these two sectors is supported entirely by tourism. Even if 10 percent of retail trade is attributable to tourism, that portion would contribute less than 1 percent to the state's economy. None of this is to say that tourism is unimportant or that we can afford to lose anything in our economy. However, if we consider the benefits of private ownership in addition to the small likelihood that tourism would be significantly affected, we find that the sale of state trust lands would be a net positive to the economy and, therefore, to all the areas that trust lands are supposed to benefit.

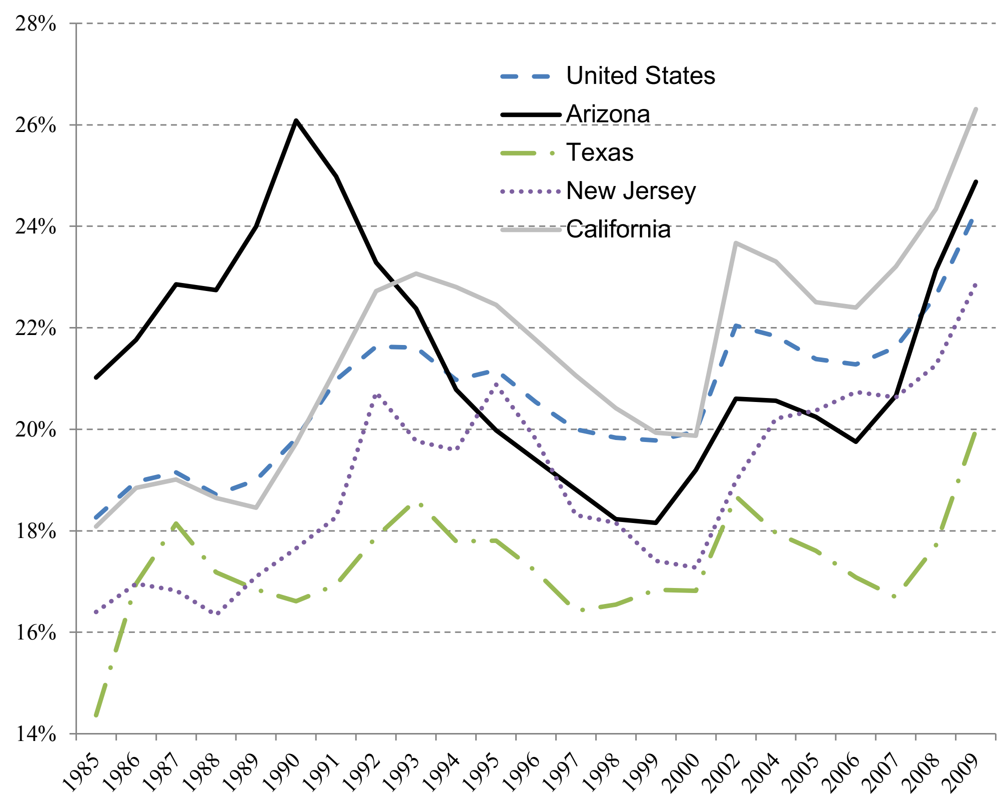
Reduce Government's Share of the Economy

Figure 4 tracks Arizona's state and local direct expenditures as a percentage of the state's private GDP from 1985 through 2009. It includes the same statistic for California and New Jersey, both considered big-government states, and for Texas, and it includes the average for the nation. When state and local expenditures rise relative to GDP, the ratio rises. Conversely, when GDP falls relative to expenditures, as occurs during recessions, the ratio also rises. Therefore, the ratio is best interpreted as reflecting the affordability of the various levels of government in a state.

Despite a general belief that Arizona's levels of governments are relatively affordable, figure 4 shows that Arizona's government expenditures as a percentage of private GDP often exceed the same ratio for New Jersey.[57] In fact, by this measure, Arizona's burden of government was much higher than that of California before the 1990s and was third highest of all states in 1990. All states saw this measure substantially increase in recent years because of drops in GDP during the recession. However, between Arizona's relatively large economic decline and unwillingness on

Despite a general belief that Arizona's levels of governments are relatively affordable, Arizona's government expenditures as a percentage of private GDP often exceed the same ratio for New Jersey.

Figure 4. State and Local Direct Expenditures as a Percentage of State Private Sector GDP



Sources: Author's calculations based on data from U.S. Census Bureau and U.S. Bureau of Economic Analysis.

the part of state leadership to address declines in government revenues by reducing spending, Arizona's government burden rose even more quickly than most such that by 2008 it exceeded the national average for the first time in 15 years.

Although Arizona substantially reduced the size of its government expenditure compared to its private economy during the 1990s, public expenditure never fell to the level in Texas or even New Jersey during that period. In fact, Arizona's burden of government by this measure fell below New Jersey's for only two brief periods since 1985 and was substantially above New Jersey's burden of government in 2009, much closer to California's level than Texas's. And there is the rub. Gallons of ink have been spilled describing the relative economic success of Texas compared to the failures of California. California's fiscal house stays in chaos despite substantial tax increases, while Texas's fiscal house has been made relatively sound without tax increases.[58] Texas experiences net in-migration while California sees out-migration. Businesses flock to Texas while California sheds them. *The Economist* portrays California as a fat, old, flaccid has-been and portrays Texas as a virile, trim, buff up-and-comer.[59] Meanwhile, Arizona lies somewhere in between, not just geographically but institutionally.

Of late, the Arizona legislature has taken steps to substantially reduce the government's share of the Arizona economy by putting the state on a path to reduce tax burdens and by substantially reducing state spending. More can be done.

Of late, the Arizona legislature has taken steps to substantially reduce the government's share of the Arizona economy by putting the state on a path to reduce tax burdens and by substantially reducing state spending.[60] More can be done. State government should get a tighter rein on local government. In Texas, cities and counties can act only in areas where they are granted authority. In Arizona, local governments seem to assume they have powers unless they are told otherwise. Income tax revenue sharing is an example: sharing occurs because of threats by cities decades ago to establish their own income tax. Counties in Texas have no ordinance-making power; in Arizona, they do. Officials at every level of government should identify core missions, focus resources in those areas, and emphasize efficiency over size or convenience. Other functions must be shed.

More specifically, governments must reevaluate their public employee policies. The state recently passed a law that will eventually transition all state employees into at-will status.[61] All levels of government should do the same. Local contracts with unions should exclude provisions for "release time" whereby union representatives are paid public salaries and benefits for performing union duties. Such provisions are likely a violation of the state's constitutional gift clause anyway.[62] All levels of government should convert health benefits from the low deductible, low co-pay plan to high deductible plans that include health savings accounts. Finally, public employee pension plans represent a looming threat over the state, with acknowledged unfunded obligations of $16 billion that are estimated by some to be as high as $60 billion.[63] We should do our best to meet obligations already incurred, but we must stop digging the hole. We can do so by putting new employees on defined-contribution plans such as 401(k) accounts.

End Revenue Sharing

In 2011, the State of Arizona collected and remitted almost $1.5 billion in income tax and TPT to county, city, and town governments. The state also shares fuel tax and vehicle license tax revenues with local governments. Those taxes are not collected for local governments on the basis of tax rates such governments have chosen to impose. They are collected as a result of the state's established tax rates on income and sales. In an example of how Arizona's local governments prevail in bullying the sovereign state, the legislature has seen fit to share these funds with local governments.

Revenue sharing allows city and county policymakers to make spending decisions without taking full responsibility for collecting the revenues that support those decisions. In 2011, the City of Phoenix collected $947 million in actual revenues, of which $255 million were "intergovernmental." That is, the city had to collect only 74 percent of its own revenues.[64] To be sure, some of the revenues from the state were for dedicated purposes, such as transportation, but a significant amount went to the city's discretionary general fund. It is not difficult to see how, when a city has to collect only 75 cents to spend a dollar, spending decisions can be inefficiently skewed. This behavior can be compared to the housing boom, when people could spend beyond their earnings by taking out another mortgage and extracting their home equity for the sake of current consumption. In the case of shared revenue, though, the distortion never ends. Perhaps because of shared revenue Phoenix city leaders feel the city can afford to sign union contracts that allow employees to receive full city pay and benefits while doing union work.

Revenue sharing allows city and county policymakers to make spending decisions without taking full responsibility for collecting the revenues that support those decisions.

By contrast, there is no revenue sharing in Texas except where public education funding flows to local school districts, just as it does in Arizona. Both states have a constitutional obligation to fund public education. Arizona, however, has no constitutional requirement for revenue sharing. Both states at least flow education funding in a relatively transparent manner, showing education spending in their respective budgets. Although income tax revenue sharing is readily reported in Arizona's Joint Legislative Budget Committee documents, it is not reported as an expenditure in budget or spending documents but as a reduction in revenue. That portion of the sales tax remitted to cities and counties, amounting to nearly a billion dollars in 2011, can be discovered only in obscure Arizona Department of Revenue reports. Revenue sharing results in less accountability, less transparency, and a less efficient government that is more burdensome to the private sector than necessary.

Reduce Regulation

Texas has substantially deregulated its electricity market. It has developed a system that measures electricity usage and generation by each seller, settles accounts accordingly, and maintains the state's grid. The result has been positive, with electricity prices falling, service options expanding, and improving service.[65]

Arizona should do the same, but it should go even further by allowing small, independent grids to develop. If necessary, the state should rethink the purpose of the Arizona Corporation Commission and amend the constitution to radically restructure or, possibly, abolish this anachronistic holdover of the Progressive Era.

Furthermore, in a recent publication, the Goldwater Institute argues that professional licensing has limited value for the public at large but is of enormous value to those in the licensed professions, driving up the prices practitioners can charge and limiting their numbers in a cartel-like fashion.[66] Although Arizona licenses relatively few professions compared to other states, local governments in conjunction with the state have created an environment especially hostile to low-income workers by excessively licensing low-income professions. In fact, a recent Institute for Justice publication shows that Arizona is the very worst offender among the states by this measure.[67] If necessary, the legislature should step in and exercise its sovereignty by limiting this type of economic abuse. Instead, the Arizona legislature recently made a bad situation for alarm companies better for them but worse for consumers. Local governments have licensed alarm companies for years but have failed to harmonize their policies. Instead of taking this failure as an opportunity to deregulate an industry, the state consolidated alarm company licensing into a single state agency subject to capture by the industry and likely to be used to limit competition and push up prices for consumers.[68] Although Texas does not serve as much of a shining example, it is, at least, less of a sinner with regard to professional licensing than is Arizona.

The state should rethink the purpose of the Arizona Corporation Commission and amend the constitution to radically restructure or, possibly, abolish this anachronistic holdover of the Progressive Era.

Land use planning, which was implemented statewide in 1998, slows development and effectively produces an artificial shortage of available land. The Cato Institute's Randal O'Toole has shown that, "Regional growth-management planning makes housing unaffordable and contributes to a business-unfriendly environment that slows economic growth."[69] O'Toole calculated that Arizona's regional planning law effectively imposed an average "tax" of $77,400 on each house sold in the state in 2006 and a total "tax" on all homes sold in Arizona that year of $6.9 billion. The "tax" came due with the collapse of the housing bubble, which was partly caused by the planning law in the first place.[70] The legislature should propose the repeal of the Growing Smarter initiative, which was passed in 1998. Although voters rejected the legislature's proposal to empty and repurpose the balance of the Growing Smarter fund, that proposal received little active support from state leaders, and the only reason given for raiding the fund was to balance the state's general fund budget. The costs to the state of the Growing Smarter law are much broader and arguably include much of the economic disruption caused by Arizona's housing bubble.

The legislature, if necessary, should take the bull by the horns and set the state on a path to reform zoning, too. Economists Edward L. Glaeser and Joseph Gyourko, in a 2002 National Bureau of Economic Research paper, state, "we do believe that the evidence suggests that zoning is responsible for high housing costs and, to us, this means that if we are thinking about lowering housing prices, we should begin with reforming the barriers to new construction in the private sector."[71] Zoning and the state's planning law combine to push up the cost of housing, a major source of Arizona's relatively high cost of living which, in turn, makes Arizona less attractive for business than it could be otherwise. Houston is the best example of a city that thrives and grows without a zoning ordinance. Private covenants and deed restrictions serve to protect homeowners and their expectations without the involvement of government bureaucracy.[72]

Harvard economists Peter Ganong and Daniel Shoag demonstrated in a recent paper that the housing regulation and the resulting relatively high prices for housing have aided in halting the convergence of states' incomes toward nationwide parity. From 1880 to 1980, states' incomes converged at an average rate of 1.8 percent per year. Over the past 30 years, the rate of convergence has halved.[73] As O'Toole has pointed out, "The rising cost of higher education and the high cost of moving into regions with land-use regulation prevent less-educated people from bettering themselves. Increased regulation of commercial operations limits people's ability to start small businesses. Increased traffic congestion (favored by "progressive" anti-auto cities) also hits working-class people harder than middle-class workers as the former are less likely to be able to take advantage of flex-time, telecommuting, and other ways of avoiding congestion."[74]

If we want to be "hit" by the latest economic boom, the worst thing we can do is chase after a boom that is already occurring. Such a boom has already played out.

Stop Chasing Economic Splashes

In the days of battleships and giant naval rifle duels, one of the methods that ships' captains used in naval combat to avoid getting hit by the enemy's projectiles was to "chase splashes." That is, they would watch for the splash of an enemy's projectile and head for that splash. They reasoned that with the movement of ships, ocean swells, and the influence of wind, two enemy rounds were unlikely to hit the same spot twice.[75] Missing the spot where the next enemy shell might hit was a good thing, and splash chasing was a sound strategy for accomplishing that objective in naval warfare. Unfortunately, our policymakers seem to have followed the same sort of strategy for economic development. We have pursued strategies that resulted in economic misses rather than economic hits.

Economic development professionals and those representing other interests chase splashes when they push policymakers to subsidize facilities in booming industries such as microchip and software development to locate here. When they see biotechnology booming in other states and push for an initiative to create the Arizona Biomedical Research Commission, they are chasing an economic splash.[76] When they see solar panel manufacturing in Portland, Oregon, and, for no more substantive reason than that Arizona is sunny, push for special tax privileges for solar panel companies, they are chasing an economic splash.[77]

Whereas we want to be "hit" by the latest economic boom, regardless of the industry in which that boom is occurring, the worst thing we can do is chase after a boom that is already occurring. Such a boom has already played out, and chasing that splash is the surest way to make economic missiles miss, partly because focusing on booms in progress prevents us from focusing on what really matters. The best way for us to get hit with an economic boom is to present a giant target. Texas has done this relatively well, as table 3 illustrates. With low taxes, no personal income tax, an overall climate friendly to business, relatively gentle regulation, and a natural endowment that Texas allows to be exploited, that state encourages entrepreneurship, business development, and perhaps even a big economic boom. Arizona, however, presents a big target for a real estate boom, especially in residential real estate, because of its relatively low residential property taxes and relatively limited supply of private property. But Arizona does not present a big target for an economic boom, in general.

Policymakers waste time and resources of Arizonans and those in the targeted industries—especially industries with very specific and specialized labor needs—when they target specific industries for subsidy. As noted in table 2, Arizona's largest city has far less population within a 250-mile radius than most other major cities in the nation, thereby diminishing the odds of having a critical mass of individuals with select skills to fit an industry. Much as Arizonans love the state's relatively unique climate, not everyone does. A company cannot automatically count on relocating its labor force if it moves facilities here. This circumstance does not mean Arizona will never develop a unique industrial cluster. It already has; it's called mining. But it is highly unlikely government-driven economic development efforts will ever accurately predict what a new Arizona-based industrial cluster might be.

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Economic booms and industrial clustering happen for a variety of reasons, not the least of which is simple serendipity. Seattle, Washington, benefits from Microsoft's headquarters mainly because co-founder Bill Gates was born and raised there. Apple is located in California mainly because co-founder Steve Jobs grew up in San Francisco. Dell Computer got its start in Austin because founder Michael Dell was raised in Texas, attended the University of Texas, and started his company building personal computers for other college students. It does help, though, when an innovative seed lands on fertile soil. Gates's good fortune is that he could locate anywhere without worrying much about shipping costs; programming code has little physical substance. California's university system provided a steady stream of able engineers for Apple, although no one could have anticipated the development of Silicon Valley when California's now unaffordable university system was created.[78] Texas's business climate, the University of Texas, and Texas's proximity to the rest of the country aided Dell.

Dell and Texas provide an instructive example. Before the 1990s, Dell Computer located all its operations in Texas. In 1999, Dell located new production facilities in Tennessee. One of the reasons cited for locating facilities outside Texas was traffic congestion.[79] Other reasons included closer proximity to customers and the availability of labor (see the earlier discussion about Arizona's isolation).[80] Texas's reaction could have been to offer tax breaks, subsidies, and outright grants to computer companies to have them locate or stay in the state. Texas's policymakers have used such strategies to some degree.[81] More important, though, Texas restructured its decisionmaking processes for road construction, and it implemented a policy of seeking public–private partnerships in major road projects. In other words, Texas policymakers sought to make the state more attractive in general rather than chasing specific company or industry deals. Even Texas's economic grant programs show a diversity of targets.[82]

There are right ways to promote economic development, including having government-paid professionals who are intimately familiar with a state and community's regulatory structure guide businesses investing in an area through its regulatory maze, thus making the process as seamless and painless as possible.

So does all this mean that employing professionals to work on promoting economic development in the state and communities is a waste? Not really. There are right ways to promote economic development, and there are wrong ways. Right ways can include having government-paid professionals who are intimately familiar with a state and community's regulatory structure guide businesses investing in an area through its regulatory maze, thus making the process as seamless and painless as possible. Nothing is wrong with promoting an area's positive, business-friendly characteristics or with informing policymakers of potential generally applicable improvements in the institutions that affect the area's business environment. However, this work can be done through private efforts and probably should be, because individuals working in economic development tend to see themselves as deal makers and deal brokers who fashion (a) favorable tax treatment, (b) land leases and purchases from government, and (c) subsidies for select industries. These three items are the worst kind of "economic development" efforts, because they actually exclude some citizens in favor of a privileged few and likely have negative economic development effects in the long run.

Texas Policies to Avoid

Economic Development Funds

It is not uncommon to hear people who are discussing Texas's relative economic success mention that state's economic development funds as something to emulate. Texas has two such funds, both instituted and funded as a result of suggestions from Governor Rick Perry. One is the Texas Enterprise Fund. The other is the Texas Emerging Technology Fund. The first subsidizes companies to locate facilities in Texas. The second does the same but aims at firms developing new technologies, the idea being that Texas's government is helping to put Texas at the forefront of technological development. A report from the Texas Comptroller of Public Account's office in 2010 was mildly critical of the programs and suggested a number of reforms to better measure their economic effects. The Enterprise Fund, for example, subsidized a number of retail stores that would have located in Texas anyway. Claimed returns on investment are not rigorously measured and, in some cases, can be accurately described as ludicrous. The real return on any such subsidy programs is impossible to measure because we do not know what would have happened in their absence.[83]

Franchise Tax

Texas has had many of the same school funding challenges that Arizona has had in the past with ongoing equity problems that keep inviting lawsuits. In an effort to reduce local funding based on property taxes and increase the state's share of funding, the Texas franchise tax, which was an easily avoided corporate income tax, was reformed. Still formally the franchise tax, it was broadened to tax all businesses except sole proprietors and simple partnerships. But to avoid the state's constitutional prohibition against a personal income tax, it now has an odd twist. The franchise tax does not allow taxed companies to deduct all costs. Companies must choose to deduct either their payroll or the cost of goods sold, not both. The result of the reform has been to make the franchise tax more complex and to impose that complexity on even more enterprises. New rules had to be written, and greater uncertainty has been created in the Texas business community. Even so, the tax has never resulted in the level of revenue originally expected.[84]

Wind Power

Texas has spent and is spending billions of dollars to subsidize wind energy generated by wind turbines on its West Texas plains. There has been one problem, though. The turbines have not been integrated into the Texas electrical grid, requiring a huge additional investment in transmission lines. So the state is spending money to build transmission lines to connect a highly subsidized source of electricity—apparently in a bid to subsidize even more wind energy—all in a state with a competitive electricity system. That policy doesn't make much sense if some producers are subsidized and others are taxed. In short, the subsidy only reduces the efficiency of the Texas economy and adds to its costs. The $7 billion being spent to connect the turbines to the grid could pay seven months of electricity bills for every Texas household, build about 7,000 megawatts of natural gas–fired power plant generation, or replace 175 million fluorescent light bulbs with LED lights, thereby saving enough electricity to shut down 10 coal plants.[85] Wind power, at least with the technology currently available, is a boondoggle. Solar is too.[86]

Conclusion

Arizonans have suffered an economic setback of depression-like proportions. Since the end of the Cold War and despite remarkable population growth, the state's personal income per capita has languished at around 87 percent of the national level, save for the blip of the housing bubble. Some seem determined to discover a magic elixir, such as an up-and-coming industry no one else has noticed, an industry that has shown potential elsewhere, a tourism gimmick, a public sports venue, or open lands, to push the state to greater economic heights. None have worked. Even the housing bubble and all the faux prosperity it produced were only temporary.

A state with natural disadvantages cannot tax, spend, and regulate like a state with natural advantages. If a state with water ports, plentiful rain, a dense and plentiful population, and long-established fixed investments wants to hamstring itself with more taxes, government programs, and regulation than are truly necessary, such a state could probably get away with some excesses and continue to thrive. A state such as Arizona will be much more negatively affected by those excessive policies, and unfortunately, Arizonans, or at least their leaders, have been unwilling to face up to this fact. The actual situation is even worse, though. Texas has almost all these advantages, but most of its fiscal policies are relatively lean and efficient compared to Arizona.

Arizona's economic future does not lie in legislative committees or commissions, shiny new stadiums, or even the latest industrial boom. It lies in the creativity, hard work, and willingness to risk that Arizonans have always displayed, if only we are willing to free up these qualities.

Arizona's future lies in its natural comparative advantages. The state will continue to be an attractive retirement destination. It could and should more readily exploit its mineral resources and its geographic position between the two most populated states in the nation, California and Texas. Arizona has no choice but to view itself as a source of labor standing ready to add value to inputs from the east or west and to ship outputs to the west or east. What industries will or should our labor service? Who knows? It's not our job or the job of our leaders to see and make the future. Our job is to make Arizona as attractive to potential investment as possible, and that will be accomplished with lean, unobtrusive government.

Arizona's economic future does not lie in legislative committees or commissions like the state's Commerce Authority or Biomedical Research Commission, whether created by the legislature or by initiative. It doesn't lie in shiny new stadiums. It might not lie in the latest industrial boom. It lies in the creativity, hard work, and willingness to risk that Arizonans have always displayed, if only we are willing to free up these qualities by (a) lowering taxes; (b) simplifying our tax system; (c) eliminating income taxes even if it means greater reliance on the sales tax; (d) reducing business property taxes, even if it means residential property owners have to pay more; (e) reducing regulations such as licensing, land use planning, and zoning; (f) selling state trust lands to free up the state's resources; (g) reducing the size of government and ending state revenue sharing with local government; and (h) ending infatuations with past economic successes that occurred in other places. In short, we must free Arizonans to make Arizona the very best Arizona can be.

Appendix: Arizona's GDP by Industry Shares

The first three columns of table 5 show the percentage of gross domestic product (GDP) represented by each of the economy's major industries in the United States, Arizona, and Texas, respectively, in 2011. The last two columns show the differences between the Arizona percentages and the U.S. and Texas percentages, respectively. Negative differences indicate a lower percentage of Arizona's economy is made up of the sector in question as compared to that of the other economy. Arizona's economy is remarkably similar to the nation's. Arizona industry sectors with a significantly smaller state share than the United States include agriculture, nondurable goods manufacturing, information, and management and administration. The tourism-related areas, including

Table 5. Industry Shares of the United States, Arizona, and Texas Economies, 2011

Industry	United States (%)	Arizona (%)	Texas (%)	Arizona vs. United States (%)	Arizona vs. Texas (%)
Private industries	87.4	87.4	88.8	0.0	−1.4
Agriculture, forestry, fishing, and hunting	1.2	0.9	0.8	−0.3	0.1
Mining	1.9	2.1	9.1	0.1	−7.0
Utilities	1.7	2.0	1.9	0.3	0.1
Construction	3.5	4.7	4.4	1.2	0.2
Manufacturing	12.3	8.4	14.7	−3.8	−6.2
Durable goods	6.6	6.6	6.4	0.0	0.3
Nondurable goods	5.7	1.8	8.3	−3.8	−6.5
Wholesale trade	5.6	5.4	6.6	−0.2	−1.1
Retail trade	6.1	7.5	5.9	1.4	1.6
Transportation and warehousing	2.8	2.9	3.3	0.1	−0.4
Information	4.4	2.6	3.4	−1.9	−0.9
Finance and insurance	8.4	8.8	6.9	0.4	2.0
Real estate and rental and leasing	11.7	14.4	8.4	2.7	6.0
Professional, scientific, and technical services	7.8	6.2	7.0	−1.6	−0.8
Management of companies and enterprises	1.9	1.1	0.9	−0.8	0.1
Administrative and waste management services	3.0	4.1	3.1	1.1	1.0
Educational services	1.1	1.2	0.6	0.0	0.5
Health care and social assistance	7.7	8.5	6.3	0.8	2.3
Arts, entertainment, and recreation	1.0	0.9	0.6	0.0	0.3
Accommodation and food services	2.9	3.5	2.7	0.5	0.8
Other services, except government	2.5	2.3	2.4	-0.2%	-0.1%
Government	12.6%	12.6%	11.2%	0.0%	1.4%

Source: U.S. Bureau of Economic Statistics, author's calculations accommodations and recreation, are surprisingly not much different in absolute share size compared to the nation as a whole, although the difference in the relative percentages is significant.

Texas diverges most significantly from the national economy in the mining sector, which includes energy production. Even with mining eliminated, though, Texas diverges from the national economy more than Arizona does.[87] Given that Texas mimics the rest of the country in size, geography, and climatic diversity, this fact is surprising. We might expect Arizona's economy to diverge more from the national economy than Texas's because Arizona is so heavily dominated by desert.

Despite a recession led by the construction industry, Arizona's construction industry is still relatively large, not only compared to that of the United States, but also compared to that of Texas, where the economy never suffered as much as Arizona's. Arizona's tourism-related industries are not as large as we might expect, given the seemingly general belief in Arizona that tourism makes up a very large part of the state's economy. Real estate, despite its relatively depressed condition, still takes a greater share of the Arizona economy than it does for the United States. And real estate in Arizona is more than one-third larger, in GDP share, than it is in Texas. Arizona suffers a relative dearth of manufacturing, with two-thirds the share of the nation as a whole. Retail trade in Arizona is relatively high, but wholesale trade is low. Health care and social assistance in Arizona is relatively high as a share of the state's economy as well.

Here are a few conclusions that can be drawn from the GDP data:

1. Arizona's tourism-related industry categories are not nearly as large as we might expect given the heavy emphasis local governments have put on tourism, spending vast sums to build stadiums and other venues. This finding also raises questions about the heavy emphasis some put on preserving Arizona's vast undeveloped lands for the sake of tourism. Even if tourism were boosted by 20 percent, a tall order, it would directly constitute maybe one-twentieth of Arizona's economy. Even this estimate is generous, because the arts, entertainment, and recreation industry and the accommodation and food services industry are not entirely tourism related.[88]

2. Although educational services constitute about half of Texas's share of GDP, when compared to the economies of the United States and Arizona, Texas's economy is thriving. This finding casts doubt on the idea that *increased* spending on education is a key "investment" for an economy to thrive. In fact, there is evidence that the United States spends too much on education.[89] Texas also scores higher on three of the four fourth- and eighth-grade National Assessment of Educational Progress testing instruments. Arizona is one of the lowest-scoring states.[90]

3. The relatively high shares of construction, retail trade, finance and insurance, real estate, and health care and social assistance in Arizona indicate the state's continued status as a retirement mecca.[91] The state is relatively dependent on people moving here with money already in hand. For the next 30 years, demographics favor such economic dependency, although the current state of the housing market does not. Regardless, after 30 years, Arizona is in trouble.

4. Despite relatively abundant rainfall and a fairly large rural population, Texas is slightly *less* dependent on agriculture than Arizona. This finding indicates that there might be some significant economic distortion in Arizona favoring agriculture, keeping in mind that Texas has a generous property tax policy for agricultural land that is similar to that of Arizona.

ENDNOTES

1 Employment figures are derived from data available from the federal Bureau of Labor Statistics (http://www.bls.gov). GDP and income figures are derived from data available from the federal Bureau of Economic Analysis (http://www.bea.gov). Population figures are derived from data available from the federal Census Bureau (http://www.census.gov).

2 Nearly half the states have indirect or direct access to ocean shipping. Several states border the Great Lakes and have fairly ready transportation access to oceans. Philadelphia, Pennsylvania, has ready access to oceans although it has no ocean coastline. With a visit to Philadelphia, you can visit the Battleship New Jersey, moored on the New Jersey side of the Delaware River.

3 See the "Texas Ports," website, Texas Ports Association, http://www.texasports.org/.

4 Distance is determined using Mapquest.com with the routing set for the shortest drive time.

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