

Southwest Economy



Another Great Texas Boom

The mighty Texas economy is starting to take a breather after a decade of extraordinary growth. Rapid development of high-technology industries contributed directly and helped stimulate a construction boom and expansion of the region's distribution network. By some measures, the economic growth of the 1990s came close to matching that of the oil boom in the early 1980s. Texas employment is likely to expand at a more moderate pace in 2001 than in previous years during the boom.

The New Texas Economy

During the latter half of the 20th century, the Texas economy evolved from resource-based industries toward more knowledge-based industries. This transformation was put on hold during the energy boom, when rising oil prices encouraged the Texas economy to take advantage of the increased value of one of its abundant natural resources. During the past decade, however, the Texas economy accelerated the shift to knowledge-based industries, such as computers, semiconductors and telecommunications as well as equipment and service suppliers of the high-tech industry.

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INSIDE:
*California Is Giving
 Electricity Deregulation
 a Bad Name*

Raising Taxes in Mexico

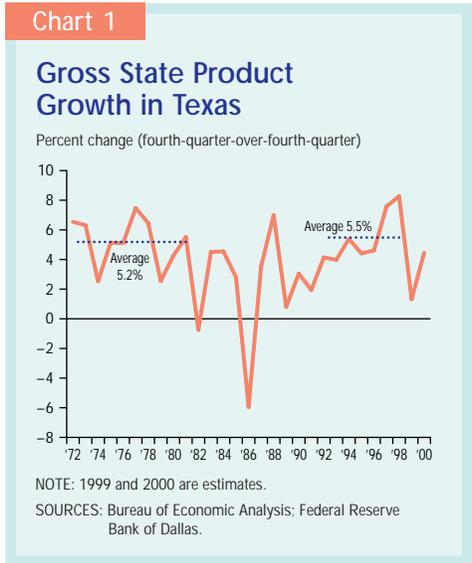
The Rise of Stock Mutual Funds

Since the early 1990s, U.S. households have increasingly used mutual funds as a way of owning equity, with rising IRA assets responsible for much, but not all, of this growth (*Chart 1*). The percentage of all stock assets held in mutual funds almost tripled, from about 8 percent in 1990 to almost 24 percent in 1998, and the percentage of all non-IRA stock holdings in mutual funds more than doubled, from around 6 percent to roughly 14 percent.

This article reviews several explanations for this trend, including the possible effects of the increasing use of IRA and thrift plans, the aging of the baby boom generation, falling mutual fund costs and rising investor confidence. In addition, the implications of the increased reliance on mutual funds are explored, including effects on labor mobility, consumption and public policy. Finally, the advent of new financial products that may draw some households away from mutual funds is briefly discussed with an eye toward

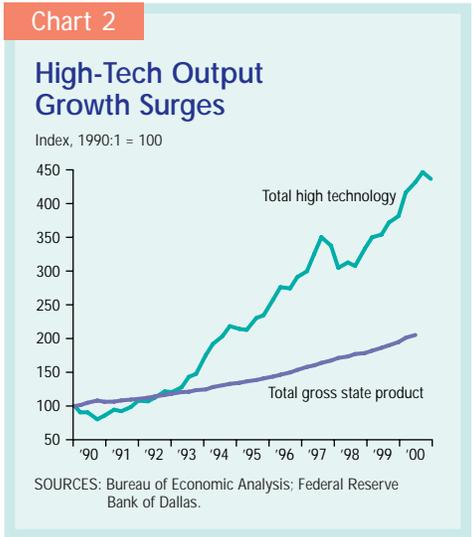
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During the most recent expansion, output growth rivaled that of the go-go days of the 1970s and early 1980s. Total Texas output grew at an average of 5.5 percent per year between 1992 and 1998, while output growth between 1972 and 1981, the oil boom years, averaged 5.2 percent per year (*Chart 1*).

High-tech industries contributed significantly to output growth in the 1990s (*Chart 2*). Between 1990 and 1999, total state output increased 41 percent, but high-tech output in Texas grew 281 percent. Telecommunications output rose 68 percent; semiconductor industry output increased 180 percent; and computer industry output jumped a whopping 1,526 percent. High-tech industries now make up roughly one-eighth of Texas manufacturing employment. As in the nation, investment in high-tech equipment by all



types of Texas firms has brought considerable productivity increases. As shown in *Chart 3*, Texas productivity growth accelerated in the 1990s.

Labor Force Growth Limits Current Expansion

While recent output growth was comparable to the levels during the oil boom, job growth was slower. Employment in Texas increased at an average annual rate of 6.7 percent between 1972 and 1981 but grew at a rate of only 3.7 percent between 1992 and 1998. Texas labor markets were tight during both periods, with the unemployment rate dipping close to 4 percent (*Chart 4*).

Slower job growth in Texas during the 1990s boom appears to be the result of slower population growth. Texas' population has grown faster than the

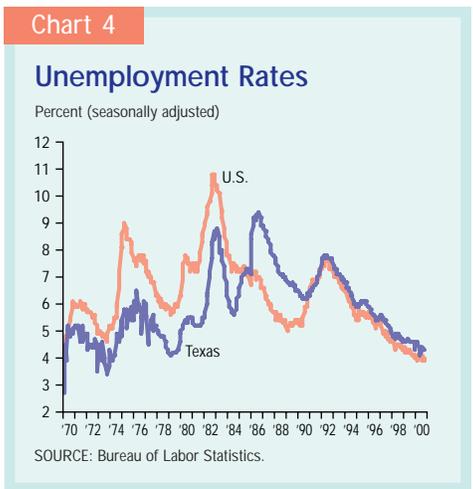


Chart 5

Texas and U.S. Population Growth



national average, rising at a long-run average of roughly 2 percent while the nation's population has increased at about 1 percent. During the current expansion, Texas' population growth has continued to increase faster than the nation's, but the rate has been below the state's long-run average. Between 1992 and 1998 Texas' population increased at an average of 1.8 percent per year, significantly below the 2.5 percent population growth of the 1970s (Chart 5). Not surprisingly, labor force growth also failed to keep pace with the growth rate during the oil boom days.

Texas' population growth surged during the oil boom because of a large influx of people moving to the state. This rapid migration was due, in part, to the strength of the Texas economy compared with the rest of the nation. Texas' output and employment grew significantly faster than that of the United States during the 1970s (Chart 6). However, U.S. economic growth was strong during most of the 1990s, so Texas was competing with the rest of the nation for workers throughout the recent expansion. Slower population growth during the 1990s appears to have restrained employment and output growth.

Another Texas Construction Boom

The real estate collapse that accompanied the oil bust of the mid-1980s left many investors believing the construction crane would become extinct in Texas. In fact, construction activity took many years to revive, but in early 1990

building permits began to increase. While total permits per capita failed to reach the levels of the early 1980s, job growth and the lowest mortgage interest rates in 20 years¹ pushed residential permits close to the levels seen in the early 1980s (Chart 7).

Texas construction activity began to cool in mid-1999, when rising interest rates and concerns about overbuilding discouraged investment. Long-term mortgage rates dipped in early 2000, leading to a brief pickup in residential activity, but by fall residential permits plateaued at high levels. Nonresidential activity waned throughout 2000, and heavy construction along the Gulf Coast came to a halt. Concerns about overbuilding continue to percolate in some markets, particularly retail, apartment and office, but most real estate markets remained buoyant, with only slight softening in rental rates in some areas.

While the construction boom of the 1990s rivaled that of the 1970s, there is one important difference. In the 1970s, a lot of building stemmed from tax breaks and hefty expectations for future growth, such as "\$85 per barrel oil in 1985." During the 1990s boom, building occurred primarily when properties were mostly preleased. There was little speculative building in the 1990s.

Energy Remains an Asset

Although the recent boom was not driven primarily by expansion of the energy industry, oil price changes continue to affect Texas economic growth.

Chart 6

Texas Competes for Workers in the 1990s

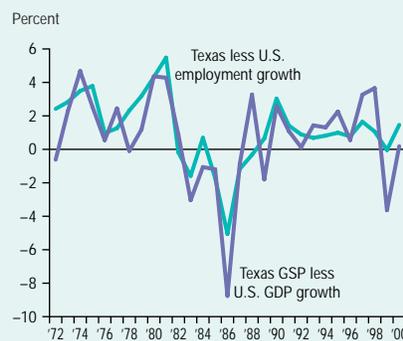
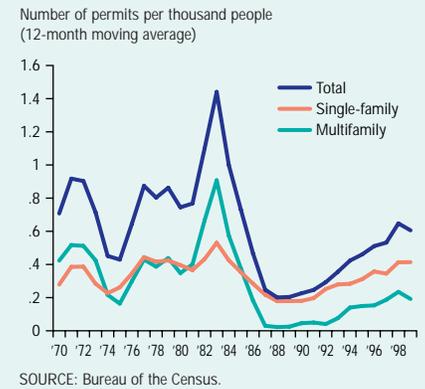


Chart 7

Texas Building Permits



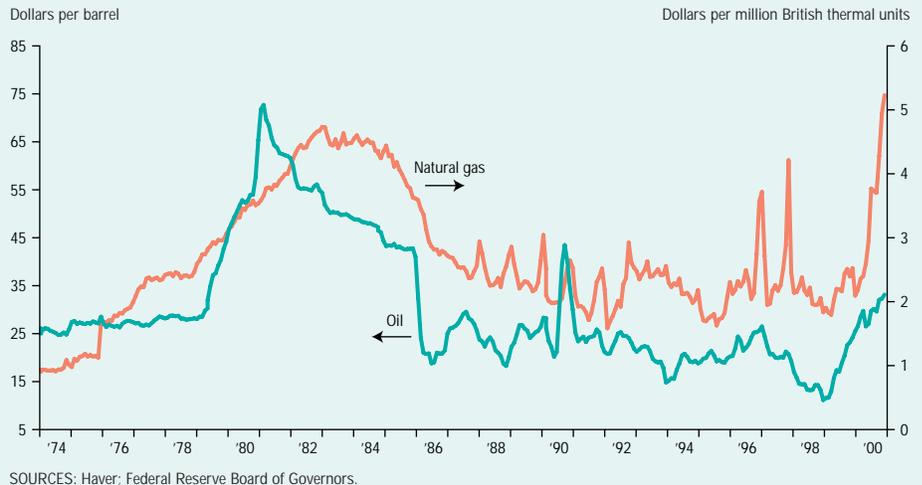
The state has become more diversified, however, and energy price swings have a much smaller effect on economic growth than years ago.² Still, Texas benefits on net from high oil and natural gas prices and suffers when energy prices are low. This continued bond to the energy industry became apparent in mid-1998. Following the Asian crisis, falling demand for energy products led to rising supply, and oil prices plummeted to nearly \$10 per barrel. While the U.S. economy and some Texas industries benefit from low energy prices, the oil price drop muted the growth of the Texas economy overall.

When rebounding global economies and a booming U.S. economy led to a sharp increase in oil prices in 1999, the oil and gas extraction industry was slow to respond. Low prices had left the industry in debt. Companies wanted to clean up their balance sheets and wait to see if the high prices were sustainable before making investments to take advantage of higher prices. By late 1999, oil and gas activity began to increase, stimulating Texas' expansion.

The Texas economy surged in the first half of 2000, propelled by rebounding world economies, strong domestic growth and high oil and gas prices. Low inventories pushed oil prices to above \$35 per barrel in 2000. Natural gas prices more than tripled, breaking new record highs; spot prices reached \$9 per million British thermal units. Adjusted for inflation, natural gas prices are higher than during the oil boom or any other time in history (Chart 8).³

Chart 8

Inflation-Adjusted Natural Gas and Oil Prices



Texas tends to grow more slowly than the nation only when oil prices are low for a prolonged period.

Texas Grows More Strongly Than the Nation

On average, Texas employment growth outpaces that of the nation by slightly more than 1 percentage point annually (*Chart 9*). Many factors encourage faster job growth in Texas than in the rest of the country. Rapid population growth, a central location, a relatively low cost of living and an attractive business climate all contribute to strong growth in the state. The countercyclical nature of the energy industry is also an important contributor to the region's ongoing prosperity.

Texas tends to grow more slowly than the nation only when oil prices are low for a prolonged period. Since 1989 Texas employment has grown faster than in the nation, with the exception of 1999, when low oil prices muted the expansion. During the first 10 months of 2000, employment increased 3.1 percent (annualized) in Texas while rising 1.7 percent in the nation.

Although Texas benefits on net from high energy prices, the state also receives a positive stimulus when low energy prices spur global economic activity by lowering costs for firms and

Chart 9

Texas Employment Growth Outperforming United States

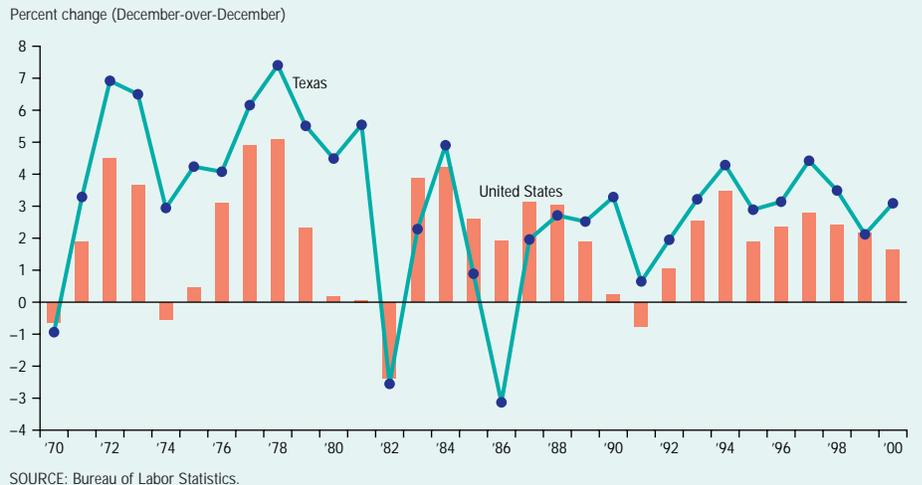
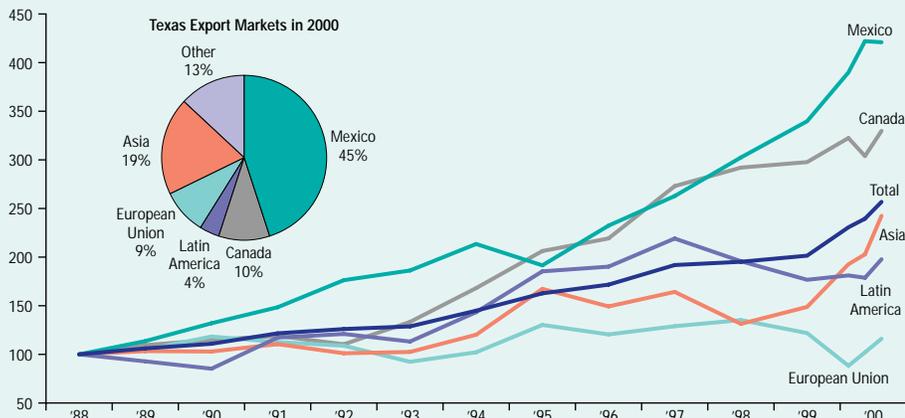


Chart 10

Texas Exports to the World

Real index, 1988 = 100



NOTES: EU comprises Denmark, Switzerland, Greece, Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, Netherlands, Portugal and Spain. Latin America comprises Argentina, Brazil, Colombia and Venezuela. Asia comprises China, Hong Kong, Indonesia, Japan, Korea, Malaysia, Philippines, Singapore, Taiwan and Thailand.

SOURCE: Massachusetts Institute for Social and Economic Research.

individuals. This boosts demand for Texas firms because Texas is a global exporter. The Texas economy is increasingly integrated with the global economy, exporting goods to countries in all parts of the world (Chart 10).

Slowing Global Economies Provide Headwinds for Texas Expansion

The recent increase in energy prices boosted the Texas energy industry but also led to slower U.S. and global economic growth. By midsummer of 2000 the Texas economy, which had been rebounding from low oil prices, ran into headwinds. Rising interest rates and slowing U.S. and global economies began restraining Texas economic growth.

The high-tech boom began to wind down. Many analysts began to think that there may have been overinvestment in the industry. Weakening sales for computers, semiconductors and telecommunications equipment caused many high-technology companies to lower earnings projections.

Manufacturing employment softened throughout 2000. High oil prices and rising overcapacity led to weakness in the chemical and refining industries. Many construction-related manufacturers also faced growing overcapacity as construction activity slowed.

Important Differences in the Two Great Texas Booms

While output growth during the two great Texas booms was similar, there were important differences. In the 1970s and early 1980s, the Texas economy responded to rising oil prices by undergoing one of the greatest economic booms in the state's history. The subsequent oil price collapse generated an equally great economic bust. While other factors helped stimulate the boom and bust, fundamentally the benefits of cyclical forces, such as high energy prices, are temporary. When oil prices fell, there was little change in the trend rate of economic growth.

The more recent Texas boom has been the result of rapid expansion of new industries—computers, semiconductors, communications and other high-technology firms. The growth of new firms attracts economic activity that increases the state's trend rate of growth. However, cyclical forces such as swings in semiconductor or computer prices will also affect these industries, bringing fluctuations around a higher trend rate of growth.

Growth in 2001 Will Be Softer Than in 2000

When 2000 is finally tabulated, Texas job growth should be about 3 percent. Growth is expected to be more moder-

ate in 2001, as slowing U.S. economic growth will dampen Texas growth. If world economies slow and demand tapers off, oil prices may drift down. Still, strong oil and natural gas prices will continue to be a positive force for the state. Employment growth will likely slip to 1.5 percent to 2 percent, but Texas' growth should remain stronger than the nation's.

— Fiona Sigalla
Mine K. Yücel

Sigalla is an economist and Yücel is an assistant vice president in the Research Department of the Federal Reserve Bank of Dallas.

Notes

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¹ In October 1993, mortgage rates fell to the lowest level in 20 years.

² Brown, Stephen P. A., and Mine K. Yücel (2000), "Oil Prices and the Economy," Federal Reserve Bank of Dallas. *Southwest Economy*, Issue 4, July/August, 1–6.

³ Brown, Stephen P. A., and Daniel Wolk (2000), "Natural Resource Scarcity and Technological Change," Federal Reserve Bank of Dallas *Economic and Financial Review*, First Quarter, 2–13.