THE FOLLOWING ARTICLE is based on Dallas Fed President Bob McTeer’s speech to the Japan–U.S.–Southern Conference in Houston, September 5, 1996.

Texas, New Mexico, Louisiana, Oklahoma, Arkansas and Mississippi have experienced dramatic changes in the structure of their populations and economies over the past few decades. (Throughout this article, these states are referred to as the South.) Although these states have maintained distinctive cultural and ethnic identities, their economies have become more similar to one another's, as well as to the U.S. economy as a whole. Although the South’s economy more closely resembles that of the nation, the regional economy has outpaced the nation’s throughout the 1990s. This article explores the recent economic performance of these southern states and the unique characteristics of the region that account for much of its current strength.

These six southern states have diversified away from resource-based industries and traditional manufacturing to become more service-oriented economies. Charts 1 and 2 demonstrate this shift. In 1970, agriculture and mining combined (which includes oil and gas exploration and production) accounted for 15 percent of the South’s
Texas

The slowdown in the national economy will reduce the present strength of Texas’ economic growth over the next two to three years....GSP growth is expected to slow to 3.2 percent in 1996 from 4 percent in 1995 and to more sustainable rates of 2.8 percent in 1997 and 2.5 percent in 1998. Employment growth will follow a similar trend, falling to just over 2 percent annually in 1997 and 1998. During this time, personal income growth will slow from 6.7 percent in 1995 to under 5 percent in 1998. Services will continue to be the state’s most important source of new jobs....Because of the slowdown in high-tech and construction-related industries, total manufacturing employment will grow somewhat slower over the next two to three years than in the recent past.

—Texas Comptroller of Public Accounts (July 1996)

New Mexico

The outlook for the New Mexico economy is moderate at best, with employment and income growth significantly below the rates we have recently enjoyed. Employment growth, which averaged about 4.5 percent annually from 1993 through 1995, is expected to fall to 3.2 percent in 1996 and 1.9 percent in 1997. Personal income growth is also expected to be subdued, with gains of 5.4 percent this year and 4.5 percent next year....The services sector will likely remain fairly robust....While trade and manufacturing will enjoy moderate employment growth. Growth in construction and government employment, however, will be weak.

—University of New Mexico, Bureau of Business and Economic Research (1996)

gross state product (GSP). By 1992 — the most current year for which GSP figures are available — agriculture and mining’s share of regional output had fallen to 8 percent. Yet over the same period, narrowly defined services, such as health care, temporary placement services and computer-related services, grew from 10 percent to 17 percent of GSP. In Texas alone, oil and gas extraction’s share of state output was 9 percent in 1970, then peaked at 18.5 percent in 1981, only to fall to just below 7 percent by 1992. The story is similar in agriculture. For instance, in 1970, agriculture accounted for 6.6 percent of Mississippi’s GSP but had fallen to 3 percent of GSP by 1992.

While the South has become less dependent on its natural resource-based sectors, they still exert a strong influence on the region’s economy. For example, agriculture accounts for a much larger share of total GSP in New Mexico, Oklahoma, Arkansas and Mississippi than in the nation as a whole. While Texas’ agricultural sector makes up less than 2 percent of its total GSP, Texas still has more farmland and produces more cattle and cotton than any other state in the nation.

The South accounts for 50 percent of the nation’s mining sector. In fact, Texas alone accounts for 27 percent of national mining output, most of which is oil and gas extraction. While the national energy industry has been downsizing and consolidating, the increased concentration has favored Texas and Louisiana. For example, near the height of the oil boom in 1981, 47 percent of all energy industry wages, salaries and benefits went to workers in Texas and Louisiana. By 1993, industry consolidation had boosted this figure to 62 percent. In short, the size of the national energy industry pie has been shrinking, but the South’s piece is getting larger.

Continued diversification of the southern economies means the region will be less vulnerable to the cycles associated with the energy and agricultural sectors. On the other hand, when these industries do well, consolidation will bring the South a greater share of the benefits relative to the nation.2

Any comparison of the southern region with the United States should be qualified by noting that Texas, because of its size, is overrepresented in regional GSP, employment and population figures. Texas accounts for 60 percent of the South’s combined GSP (Chart 3) and about 57 percent of its population (Chart 4). Texas employment as of June 1996 was 8,256,200—larger than the combined total of........
6,013,600 jobs in the region’s five other states.

Southern Economies
Outpace the Nation in the 1990s

The United States began the 1990s with negative employment growth as a result of the 1990–91 recession. Chart 5 shows that the southern states weathered this downturn much better than the rest of the nation, with positive annual employment growth over the period. The chart also shows that as the 1990s have progressed, each state in the region has continued to outpace the nation. What is the source of this growth? In general, the South continues to benefit from resource-based sectors like energy and agriculture, but the region has developed several new strengths as well.

As Table 1 shows, growth in services and construction in all six southern states’ economies has exceeded the national average. The growth in these sectors has been fueled by rapid population growth in the South—much of it

**Louisiana**

The Louisiana economy will pick up an additional 66,000 jobs between now and 1998. Our growth rate will average about 1.8% a year....[D]espite setbacks in textiles and apparel and the health care industry, the state’s economy will continue its record setting pace....[T]echnological advances and unusually productive fields in the Gulf [will help] the extraction industry to add another 2,300 jobs over the next two years....Louisiana will gain manufacturing jobs over 1997–98, a trend that is counter to trends at the national level.

—Scott et al. (1996)
Louisiana State University

**Oklahoma**

Real Gross State Product...is predicted to grow by...2.6 percent during 1996 on the basis of strong national stimulus and continuing trends and structural adjustments....This expansion of economic activity is expected to generate at least an additional 30,000 nonagricultural wage and salary jobs and combine with higher nonearnings forms of income (i.e., profits, dividends, rents, and interest) to see an increase of total personal incomes of 4.6 percent....As usual, job growth will be almost totally in the broadly defined service industries. Retail trade, health services, and business services account for the majority of growth.

—Oklahoma State University, College of Business Administration (1996)
from relocations, as well as high birth rates due to its relatively young population and immigration. Population growth tends to benefit homebuilders, home furnishings suppliers, retailers and service providers, which in turn tends to encourage further increases in population as these sectors draw firms and workers from other states and countries. Another factor boosting the expansion of the service and construction industries in the South has been the fast-growing tourism and gaming industries, especially in Louisiana and Mississippi. While the casino boom remains alive in Mississippi, it has tapered off in Louisiana and may provide less stimulus to the region in coming years.

From 1990 through 1995, growth in the South’s service and construction sectors was accompanied by job gains in the manufacturing sector. During the early 1990s, manufacturing lost 605,330 jobs nationally, while each of the southern states recorded job gains in that sector. In Arkansas and Mississippi, manufacturing accounts for more than 20 percent of total employment, a larger share than in Texas, New Mexico, Louisiana and Oklahoma, where manufacturing’s share is less than the 15-percent national average. Arkansas’ and Mississippi’s manufacturing sectors have expanded in the 1990s, partly due to strong growth in industrial machinery manufacturing in Mississippi and transportation equipment manufacturing in Arkansas.3 Texas and New Mexico have benefited from the expansion of high-tech manufacturing, such as semicon-
A favorable climate... makes the South an attractive place to live and conduct commerce.

Table 3
State Rankings for Per Capita Tax Revenue As a Percentage of Personal Income in 1992

<table>
<thead>
<tr>
<th>States</th>
<th>Total state and local tax revenue</th>
<th>Property tax</th>
<th>Income tax</th>
<th>Sales tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Texas</td>
<td>34</td>
<td>14</td>
<td>None</td>
<td>9</td>
</tr>
<tr>
<td>New Mexico</td>
<td>10</td>
<td>49</td>
<td>36</td>
<td>3</td>
</tr>
<tr>
<td>Louisiana</td>
<td>28</td>
<td>45</td>
<td>39</td>
<td>4</td>
</tr>
<tr>
<td>Oklahoma</td>
<td>36</td>
<td>48</td>
<td>25</td>
<td>14</td>
</tr>
<tr>
<td>Arkansas</td>
<td>42</td>
<td>46</td>
<td>26</td>
<td>8</td>
</tr>
<tr>
<td>Mississippi</td>
<td>45</td>
<td>37</td>
<td>40</td>
<td>10</td>
</tr>
</tbody>
</table>

Source: Advisory Commission on Intergovernmental Relations (1994).

The South: A Good Place for Business

A favorable climate, in terms of business as well as the weather, makes the South an attractive place to live and conduct commerce. Several characteristics of the region provide its economic environment with a comparative advantage over much of the rest of the nation. Texas, New Mexico, Louisiana, Arkansas, Oklahoma and Mississippi enjoy cheaper labor, less expensive real estate and a lighter tax burden than their counterparts in the Northeast and on the West Coast.

Labor. Perhaps the biggest business advantage the South offers is cheaper labor. Average hourly manufacturing wages are below the national average in all states except Louisiana (Table 3).4 Louisiana’s average wage numbers are higher because a large share of Louisiana’s manufacturing jobs are in the high-paying chemical industry. On a less positive note, while relatively cheaper labor is good for business, it translates into lower per capita income. Nevertheless, the region’s recent economic prosperity has meant that, in most cases, incomes have been increasing faster than the national average in the 1990s.

Real Estate. Real estate prices are also lower in these six states, making this region attractive to relocating firms and their employees. In the South, home prices and office rents plummeted after the 1986 bust and have only begun to recover in recent years. Some of the cost differential between the South and other areas has ended as firm relocations and expansions have helped the region’s real estate markets recover, but the South remains a bargain. For example, office rents average about $18 per square foot in Albuquerque and Las Colinas, near Dallas. This figure compares with rates of $32 per square foot in New York and $25 per square foot in San Francisco. In addition, Chart 6 shows that while home prices are rising in some southern cities, for the most part they remain lower than the national average, with one exception being fast-growing Albuquerque.

Tax Burden. In addition to lower labor and real estate costs, most southern states have relatively low total tax burdens. As Table 3 shows, with the exception of New Mexico, the southern states rank in the bottom half of the 50 states in estimated tax burden.5 The distribution of the tax burden, however, is not shared equally among all goods, services and factors of production. The weight of taxes in the South tends to fall more heavily on consumption of goods and services through relatively high sales tax burdens. Because Texas has no state income tax, it must generate revenue through other forms of taxation, particularly property taxes. On the other hand, New Mexico imposes a very low property tax liability, but the state ranks high in terms of total tax burden because it has one of the nation’s largest sales tax burdens.

Demographics. Another distinguishing feature of the South is its younger and faster growing population. Overall population growth averaged 1.5 percent in the South during the first half of the 1990s, compared with 1 percent for the nation. In particular, Texas’ and New Mexico’s populations grew at least twice as fast as the national average in the 1990s. Growth rates were less marked in the other southern states, but as the overall U.S. population ages, growth rates may pick up in states that attract retirees, such as Arkansas. Strong population growth in the region is a result of both high rates of domestic and international migration and generally higher than average birth rates.
The southern region's population is also younger than the national average. For example, Texas' population is the third youngest in the nation, behind Utah and Alaska. In 1994, the median age was 31.9 years in Texas and 32.4 in New Mexico, Louisiana and Mississippi. In comparison, the national median age was 34.

A faster growing and younger population should benefit the South in several ways. First, a faster growing population is likely to boost the construction sector as more homes and apartments are needed in the South relative to other areas. Second, the South's fast-growing population should attract retailers and other consumer-oriented businesses. Finally, labor force growth is likely to be faster in the South than at the national level, which may be important as the aging of the baby boomers causes U.S. labor force growth to cool. This could be a positive factor for businesses in southern areas with tight labor markets, as entry-level positions will be less difficult to fill.

A Challenge: Education. Youth and diversity have brought a special challenge to the South. In most of the region, the percentage of the population that is high school and college graduates remains below the national average. Rapid improvement in these figures seems unlikely, given that high school dropout rates in Texas, Louisiana and Mississippi are above the national average.

As the South's population increases, it is also expected to become more ethnically diverse. In fact, minorities are likely to represent the largest segment of new entrants into the labor force in the coming years. Because the high school dropout rate is higher for minorities, they may be less likely to obtain the education necessary for high-skill, high-wage positions. A challenge for the southern states is to train, educate and successfully assimilate these young Southerners into an increasingly diverse labor force.

The South has staged quite a comeback from the difficult economic times of the late 1980s. In addition to a mild climate and central location, several unique factors have attracted people and businesses to the southern states. These factors—which include low labor and real estate costs, relatively favorable tax treatment and a relatively young population—should help keep the South's expansion alive in coming years.

Because the South has diversified away from resource-based industries toward service-based industries, the southern states' economies are more like the nation's and are therefore governed in large part by national trends. The national economy is expected to slow in the next few years as the recent expansion matures, and the economies of the southern states are expected to slow as well. Based on the forecast of a softening in national growth, the coming years in the South are expected to be somewhat less robust than the first half of the decade. Still, barring any purely regional shocks, the South's economy should continue to perform somewhat better than the national economy as a whole.

— D'Ann Petersen
Marci Rossell

Notes

We would like to thank Tim Smith of the Federal Reserve Bank of Kansas City for information on the Oklahoma and New Mexico economies. Also, we are grateful to Zsolt Becsi of the Federal Reserve Bank of Atlanta for guiding us to information about Mississippi and Louisiana. We also thank Michelle Burchfiel and Sheila Dolmas of the Dallas Fed for their excellent research assistance.

1 For a more thorough discussion of the oil industry's recent consolidation, see Gilmer (1996).
2 For an explanation of how different states respond to an increase in oil prices, see Brown and Yücel (1995).
3 In 1996, the manufacturing sectors in these two states have weakened, but growth was quite healthy over the 1990–95 period.
4 These wages are nominal—that is, not adjusted for the price level. The lower nominal wages that make the South attractive to business would make the South unpopular among workers were it not for the fact that the cost of living in the South tends to be lower than the national average as well.
5 Tax burden here is defined as the amount of total state–local revenues as a percentage of state personal income. For other measures of state tax burden, see Tannenwald (1996).

References


