



# THE ECONOMICS OF PROSPERITY: A TEXAS TALE

**L**IKE MUCH OF the rest of the nation, Texas is enjoying a low-inflation, low-unemployment economy. The Texas misery index—the sum of the inflation and unemployment rates—is bouncing near its 30-year low (*Chart 1*), and both its components are lower than they were during the early-1980s boom. Unemployment is below 4 percent in more than half the state and, for the first time in recent memory, in single digits along much of the border.

In a low-unemployment environment, labor force growth limits employment growth, and barring a major change in the percentage of the population seeking work, population growth limits labor force growth. Therefore, the patterns of unemployment, labor force participation and population growth will heavily influence the economic future of Texas. This article explores these patterns and discusses their implications.



## INSIDE

*Where Have All the Savings Gone?*

*The World's Newest Currency*

*Focus on the Energy Industry*

## Unemployment

Unemployment rates in Texas vary widely (*Chart 2*). For example, the unemployment rate is more than seven times as high in McAllen as it is in Bryan/College Station. Unemployment tends to be higher along the coast and on the border with Mexico and lower in North and Central Texas. Interestingly, three of the four cities with the lowest

**Chart 1**  
Texas Misery Index Bounces  
Near Its 30-Year Low



SOURCE: Bureau of Labor Statistics.

rates—Austin, Bryan/College Station and Lubbock—are also home to major state universities.

While levels vary substantially, there is definitely a common trend in Texas unemployment rates. As Chart 2 shows, unemployment has been falling throughout the state. Over the past year, rates have fallen everywhere except oil-sensitive cities like Houston and Midland/Odessa (and Bryan/College Station, where there was essentially no room for further declines). The decreases have been particularly sharp in Brownsville, McAllen and Texarkana, where unemployment fell more than 2.5 percentage points between July 1998 and July 1999. Unemployment rates in Dallas, Fort Worth, Killeen, San Antonio, Sherman and Waco are now less than half what they were when rates began falling seven years ago. Unemployment in Dallas and Fort Worth hasn't been lower in 20 years.

## Labor Force Participation

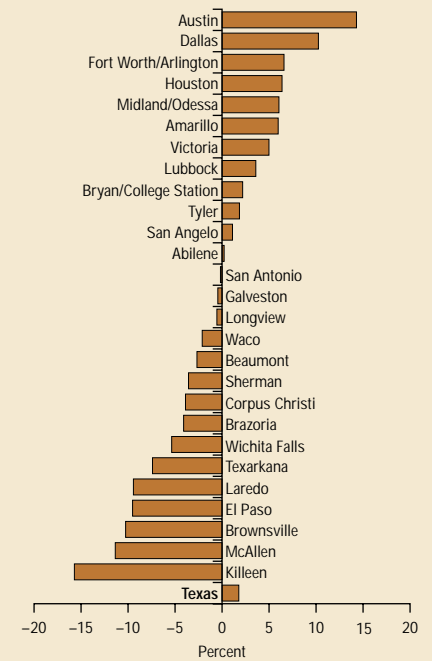
Labor force participation also varies dramatically across Texas. The civilian participation rate is the share of the working-age population (that is, everyone over 16) that is working or actively seeking work. It excludes people who are in the military, retired, attending school full time, keeping house or staying at home with the kids. Labor force participation rates tend to be highest in communities with relatively few people of retirement age or children in need

of parental supervision and lowest in areas with low real wages and high unemployment.

Chart 3 illustrates deviations from the national average participation rate of 67 percent. As the chart shows, rates are already quite high in much of the state, particularly in areas with low unemployment. (The major exception is Killeen, where Fort Hood skews the data.) The participation rates for Austin and Dallas are more than 10 percentage points above the national average. Among major U.S. cities, only Minneapolis/St. Paul has a higher rate than Dallas/Fort Worth.

Overall, Texas participation rates have been drifting upward in metropolitan areas with low unemployment and drifting downward in areas with high unemployment; beyond that, there has been little meaningful change among the metros. The Texas areas with the highest rates in 1998—Austin, Dallas, Fort Worth and Houston—also had the highest when unemployment rates began falling in 1992. Among major Texas metropolitan areas, only Austin has seen a substantial increase in its participation

**Chart 3**  
Deviations from the  
National Labor Force  
Participation Rate, 1998



SOURCES: Bureau of Labor Statistics; Bureau of the Census.

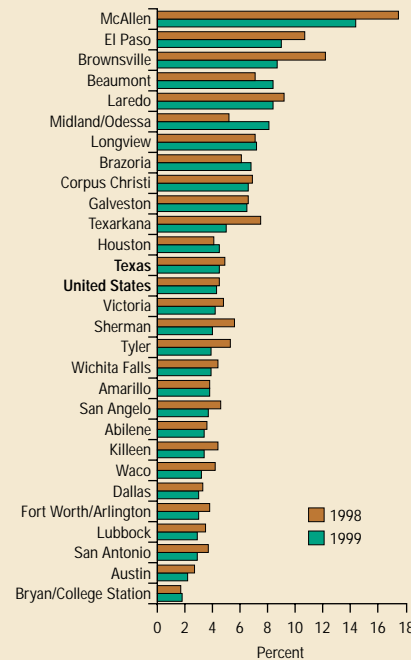
rate over this period of tightening labor markets. Austin's rate rose from 75 percent in 1992 to 81 percent in 1998.

## Population Growth

The Texas population tends to grow at twice the national rate. Two important factors explain this pace—a faster rate of natural increase (meaning that the young Texas population produces substantially more births than deaths each year) and strong net domestic migration (meaning that more people from elsewhere in the country move in than Texans move out). However, as Chart 4 shows, there is at least as much variation in Texas' population growth rates as there is in its unemployment and labor force participation rates.

The working-age population is growing most rapidly in Laredo, McAllen, Austin and Dallas. Laredo and McAllen benefit from especially strong rates of natural increase and international migration; on net, domestic migration has a negligible effect on these cities. In con-

**Chart 2**  
Texas Metro Area  
Unemployment Rates



SOURCE: Bureau of Labor Statistics.

trast, Dallas and Austin grow more rapidly than much of the rest of the state because net domestic migration is so strong. In 1998, 51,000 people moved into these two metro areas from elsewhere in Texas and the United States.

At the other end of the spectrum, domestic migration was the primary source of drag on the weakest Texas metros. The areas shown in brown in Chart 4 lost population to other parts of the state and the nation in 1998. Interestingly, no Texas metro area lost population to international migration in 1998.

## Implications

All tight labor markets experience the same economic forces, albeit to varying degrees. Therefore, focusing on one or two can illustrate the broader economic implications for the state as a whole.

Austin and Dallas have by far the tightest labor markets in Texas. Unemployment rates are low, and labor force participation is unusually high. As a consequence, there are nearly nine jobs for every 10 residents between the ages of 16 and 65 in Austin and Dallas. Meanwhile, population growth has not kept up with recent job growth (non-farm employment in both areas has increased by at least 4 percent a year for the past three years). Something's got to give. Because there will always be some "frictional unemployment," as workers search between jobs or gather information upon entering the labor force, there is little room for unemployment rates to fall further. Therefore, the current rate of job growth in Austin and Dallas is unsustainable without a significant increase in either labor force participation or net migration.

The market forces needed to lure workers into the Austin and Dallas labor forces will induce a number of changes. First, there will be significant upward pressure on labor compensation. As many employers find themselves chasing the same set of workers, bidding wars will erupt for workers with specific skills. A recent Manpower survey indicated that one-fifth of Dallas employers were planning to hire in the fourth quarter. Some of them had best

prepare for sticker shock. It's becoming a seller's market for labor in Austin and Dallas.

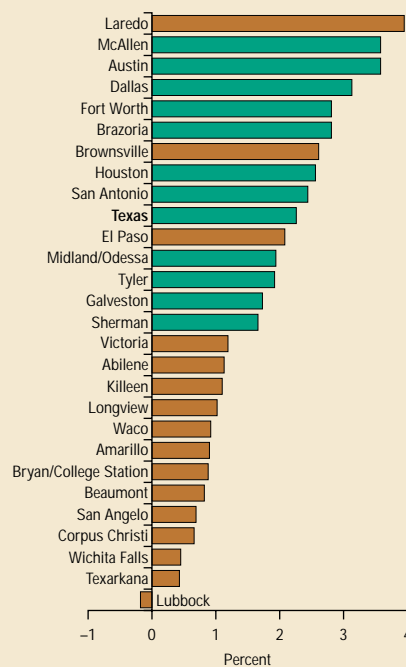
Increasing labor compensation may not take the form of rising wages, however. Industry contacts suggest that working environment, fringe benefits and stock options are becoming an increasingly important part of the total compensation package.

Higher compensation should increase labor force participation, but the near-term effect is likely to be modest. Participation rates tend to change at a glacial pace, Austin's recent experience notwithstanding. For example, the Texas rate has changed less than 1 percentage point over the course of the decade. Simple diminishing returns will keep Austin from continuing to increase its participation rate at the pace of the past eight years.

Higher compensation is more likely to attract economic migrants than to draw existing residents out of the woodwork. Therefore, tightening labor markets in Austin and Dallas could increase the rate of net domestic migration into the two areas. Such a change would only

*The current rate of job growth in Austin and Dallas is unsustainable without a significant increase in either labor force participation or net migration.*

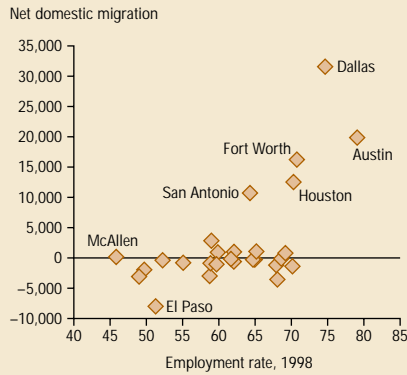
Chart 4  
Growth in the Working-Age Population, 1998



SOURCE: Bureau of the Census.

***While rising wages will pull some people out of school or retirement and others out of an adjacent county... firms are as likely to move as workers.***

**Chart 5**  
**The Tightest Labor Markets Attract the Most Workers**



NOTE: The employment rate is household employment divided by the working-age population.  
 SOURCES: Bureau of Labor Statistics; Bureau of the Census.

reinforce an existing trend; as Chart 5 shows, the Texas metros with the tightest labor markets experienced the greatest net domestic migration in 1998.

On the other hand, as economic conditions have improved nationwide, the factors that were pushing workers out of other states have dissipated, and any influx of workers would bid up housing costs and push up the cost of living in Austin and Dallas. These factors could counterbalance the attraction of wage increases. So unless labor compensation rises dramatically, net migration into the two areas is unlikely to accelerate markedly.

It is more likely that tight labor markets in the two areas will attract commuters from the surrounding counties. Such a pattern is particularly likely in Dallas. There are two yardsticks by which metro area employment is measured: by the location of the worker and by the location of the firm that employs the workers. Usually, the worker-based measure of household employment produces a higher job count because it includes self-employed and agricultural workers who are not captured by the establishment survey. Since 1997, however, the Dallas establishment survey has reported more jobs than the household survey. This shift could arise from a number of factors, but it most likely reflects Dallas firms' hiring of an increasing number of non-Dallas residents (who are not included in the household

survey estimates for the area). If the commuting becomes common enough, the boundaries of the metropolitan areas will be expanded after the 2000 census to sweep up the outlying counties and reflect the new economic reality.<sup>1</sup>

While rising wages will pull some people out of school or retirement and others out of an adjacent county, the supply side is only part of the market response to tight labor markets. Firms are the other side of the equation, and they are as likely to move as workers. Firms often cite the availability of workers with the appropriate skills as a major factor in their location decisions. If firms cannot expand easily or must pay a wage premium to expand in Austin or Dallas, they will expand elsewhere instead. Some of those alternative locations will be in Texas, but not all. For example, tight labor markets were cited as one of the important factors behind Dell Computer Corp.'s recent decision to build its first major non-Austin facility—in Tennessee. Thus, even as good economic times continue, job growth is likely to slow significantly in Austin and Dallas.

—Lori L. Taylor

*Taylor is a senior economist and policy advisor in the Research Department at the Federal Reserve Bank of Dallas.*

### Note

<sup>1</sup> An outlying county is included in a metropolitan statistical area (MSA) on the basis of commuting patterns and the urbanicity and population density of the outlying county. Generally, counties are not added to MSAs between censuses unless the central city expands into the county (through annexation, for example).