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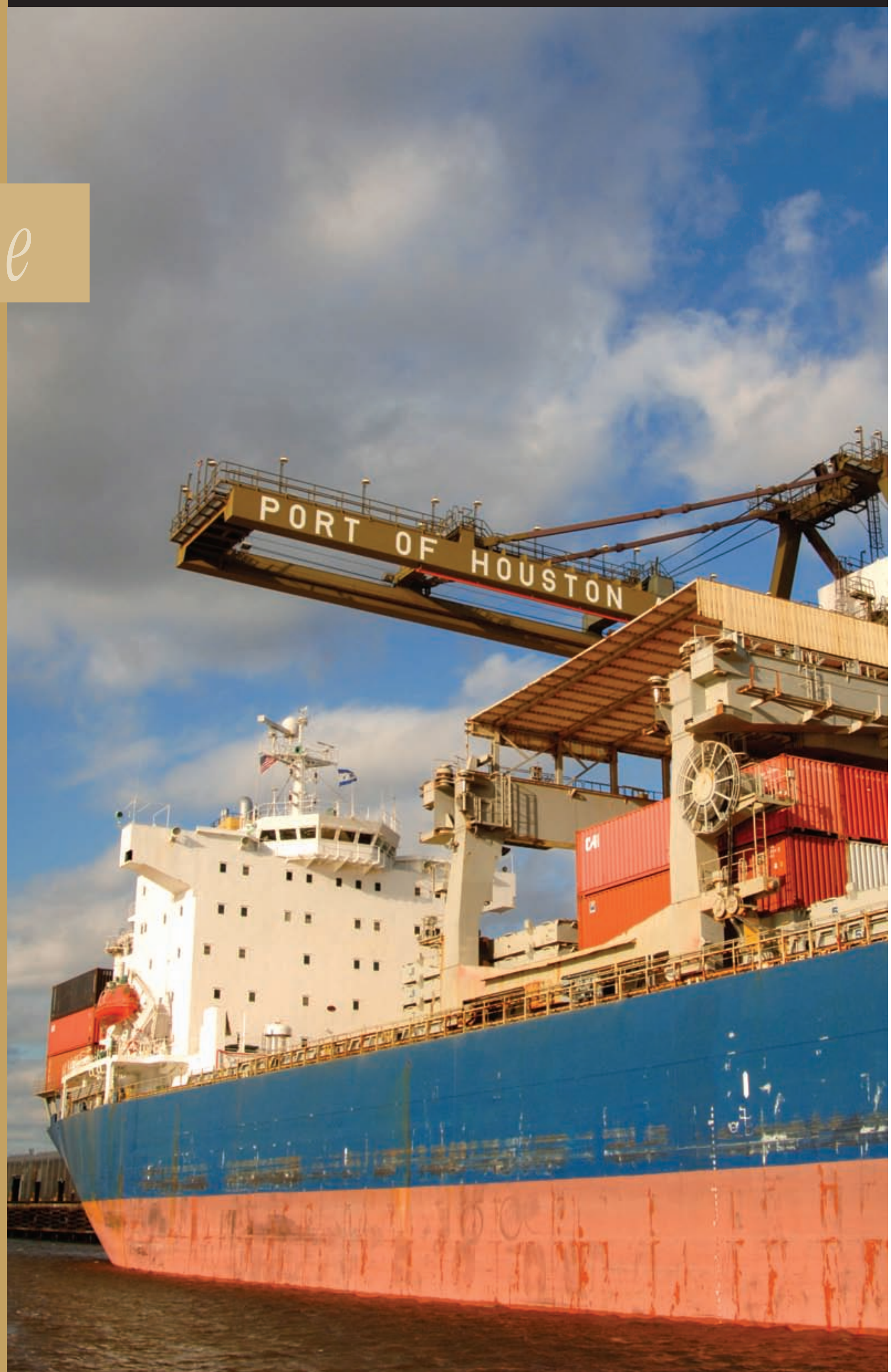
In This Issue



President's Perspective

> *Friedman's philosophy of individual responsibility and limited government has special resonance in the American Southwest.*

For more than 70 years as a teacher and writer, Milton Friedman was a fountainhead of powerful ideas, stretching countless minds—mine included—and profoundly impacting public policy. His ideas have enhanced our understanding of economics and, in many ways, of life.

Friedman, who died in November at 94, was the West's premier intellectual cold warrior, best articulating the case for capitalism, driven by the belief that the path to long-term prosperity lay in free enterprise and the least intrusive government. In classical Jeffersonian style, he believed in individual responsibility and defended economic, civil and political freedoms and the freedom of choice.

Time and again, Friedman showed us that cumbersome regulations and government inefficiencies impede economic activity, reminding us of the power of incentives to spur individuals and companies into action. He also tackled headline policy issues, expressing his positions clearly and defending his views with quick wit and precise logic. He prescribed remedies for reforming Social Security, advocated eliminating military conscription and passionately argued for school vouchers.

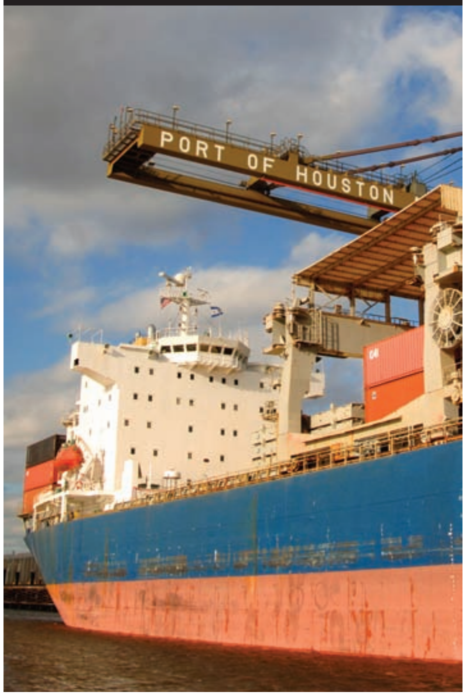
Friedman fundamentally influenced modern monetary policymaking as well. For much of the 1960s, theory suggested that central bankers had to choose between low unemployment and low inflation. Before we struggled with stagflation in the 1970s, Friedman had been arguing that there was no long-run trade-off between high unemployment and high inflation. By controlling growth in the money supply, he contended, a central bank could contain inflation without sacrificing jobs. Monetary policymakers around the world would soon realize that money matters most in influencing price stability, a prerequisite for long-term economic growth.

Friedman's philosophy of individual responsibility and limited government has special resonance in the American Southwest. The Dallas Fed has a history as a disciple of Friedman's free enterprise gospel. And his contributions to the practice of monetary policy have helped the Federal Reserve be a better central bank. For all these reasons, Milton Friedman truly is the patron saint of the Dallas Fed.

Shortly after becoming Bank president in 2005, I made a pilgrimage to California to meet with Friedman. We had an extraordinary conversation, highlights of which you'll find in this issue of *Southwest Economy*.

Richard Fisher

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



Full Steam Ahead for Texas Ports

By José Joaquín López and Keith R. Phillips

Trade is booming. In real terms, world exports have nearly doubled since 1980, topping 26 percent of total output. As the world's largest importer and second-largest exporter, the United States has been a key contributor to the expansion of global trade. The surge in international shipments has meant increased business for U.S. ports, including those in Texas.

Texas is home to two of the nation's top five port districts and four of the top 20. Over the past decade, growth has been consistently strong at ports across the state. In 2005, the value of imports and exports processed through Texas ports was more than two and a half times what it was in 1996, growing about twice as fast as the national average (*Chart 1*).

Texas is home to two of the nation's top five port districts, and growth has been consistently strong at ports across the state.

Fueling the expansion of port activity have been such factors as increased U.S. international trade, a strong Southwest economy and Texas companies' rapidly rising exports.[1]

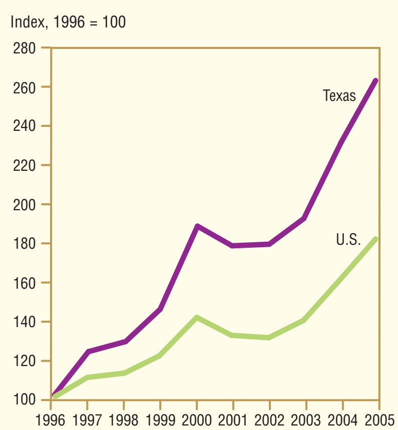
In Texas, international trade passes primarily through large seaports on the Gulf Coast, large land ports on the Texas–Mexico border and, to a lesser degree, inland facilities such as Dallas/Fort Worth International Airport. While the border ports primarily serve Mexico, sea and air facilities provide Texas with direct or indirect routes to nearly all U.S. trading partners. Highway, railroad and pipeline connections link Texas' ports with energy, manufacturing, distribution and retailing centers throughout the country.

The increasing globalization of the U.S. economy seems likely to further tax Texas' trade networks, and some analysts foresee an increasing need for inland ports, which are located away from primary land, air and seaports but have the ability to process international trade. Although projects are under way in several parts of the state, the tremendous growth in international trade flowing through Texas hasn't yet created a significant demand for inland port services.

Chart 1

Texas Outpaces U.S. in Port Growth

(Value of international trade processed)



SOURCE: U.S. Customs and Border Protection.

Texas' Traditional Ports

Port activity is commonly measured either by weight or value of imports and exports processed through U.S. Customs. We focus on value rather than weight because the data are estimated in the same way for all port types, and they're more consistent with other economic measures, such as gross domestic product. Since we're interested in overall port activity, we don't distinguish between imports and exports.

For administrative and statistical purposes, U.S. Customs and Border Protection combines individual facilities into port districts that usually encompass large geographic areas.[2] The Dallas/Fort Worth district port, for example, covers a region roughly enclosed by a box with corners at San Antonio, Midland, Amarillo and Tulsa, Okla. (*Table 1*).

Texas' port districts are busier than ever and growing quickly (*Chart 2*). The

Table 1

Texas' Port Districts, 2005

Port district	Port	Share of total value (percent)
Dallas/Fort Worth	D/FW	97.65
$38.24 billion	Austin	0.85
	San Antonio	0.85
	Oklahoma City	0.28
	Tulsa	0.16
	Amarillo	0.15
	Alliance	0.03
	Addison	*
	Lubbock	0
	Midland	0
El Paso	El Paso	96.43
$46.68 billion	Santa Teresa, N.M.	2.59
	Presidio	0.84
	Columbus, N.M.	0.11
	Albuquerque, N.M.	0.02
	Fabens	0.01
Houston/Galveston	Houston	62.89
$136.41 billion	Corpus Christi	11.30
	Houston Intercont.	7.01
	Freeport	6.86
	Texas City	5.73
	Galveston	5.57
	Lavaca	0.65
Laredo	Laredo	69.26
$137.89 billion	Hidalgo	13.93
	Brownsville	8.65
	Eagle Pass	5.60
	Del Rio	2.24
	Rio Grande City	0.17
	Progresso	0.10
	Roma	0.06
	Edinburg Airport	0
Port Arthur	Port Arthur	63.30
$23.94 billion	Beaumont	36.48
	Orange	NA
	Sabine	NA

*Less than .01 percent

SOURCE: U.S. Customs and Border Protection.

North American Free Trade Agreement reduced barriers and greatly increased commerce between the U.S. and Mexico, helping make the Laredo port district the nation's fourth largest. The Houston/Galveston port district follows right behind Laredo in terms of the total value of exports and imports. El Paso, West Texas' major U.S.–Mexico border crossing, ranks 15th. Somewhat surprisingly, the inland trade hub under D/FW's jurisdiction is 20th.

U.S. Customs data by district, which are available since 1996, show that Houston and Laredo have been the fastest growing among the nation's 10 biggest ports over the past nine years (*Chart 3*). The Houston port district's spurt has been especially rapid in the past three years, with trade value almost doubling.

Laredo is the leading route for cargo flowing to and from Mexico, accounting for roughly half the value of land-borne U.S.–Mexico trade. Nearly 97 percent of the Laredo port district's activity involves Mexico. For El Paso, the figure is 93 percent. Inputs and finished products from maquiladoras and other manufacturing-related products make up the bulk of the trade passing through El Paso and Laredo.

While El Paso and Laredo largely serve Mexico, Houston's port district is more diversified. Mexico ranks as its largest trading partner but accounted for just 11 percent of activity in 2005. Venezuela, Nigeria, China, United Kingdom, Germany and Saudi Arabia play significant roles in Houston's imports and exports (*Table 2*). It takes 47 countries to make up 90 percent of the port's activity. The surge in Houston's traffic in the past three years has been broadly spread across countries, although trade with China, Iraq and Angola has been particularly strong, each more than tripling.

Much of the economic activity along Texas' Gulf Coast is related to the oil and gas, petrochemicals and refining industries. This is reflected in trade activity, where 57.1 percent of the imports and exports in the Houston port district is oil and related products and chemicals.

Although D/FW has a relatively small share of total U.S. trade, it ranked second among the nation's 42 port districts in growth over the past nine years. In terms of diversity, D/FW lies between the border ports and Houston. Six Asian countries account for more than three-fifths of the district's trade, led by China. The share of trade value with China going through the D/FW port district has more than tripled in the past 10 years, going from 8.4 percent to 27.5 percent. During the same period, the share of trade value between the U.S. and China increased from 4.3 percent to 11 percent.

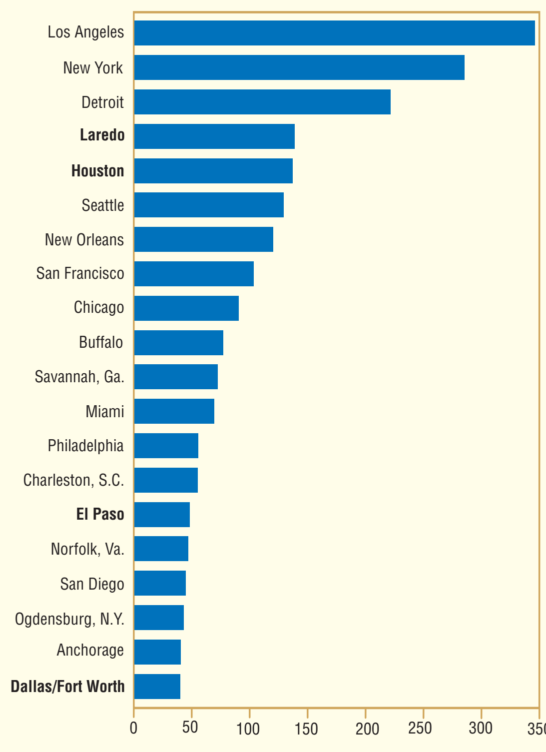
When looking at Texas trade from the perspective of individual ports rather than districts, almost all significant state facilities have experienced strong growth over the past nine years (*Chart 4*). D/FW's international trade expanded at an average annual rate of 21.5 percent, followed by Port Arthur at 15.1 percent, Hidalgo at 14.2 percent, Corpus Christi at 13.7 percent, Houston at 11.6 percent, Laredo at 10.6 percent, El Paso at 8.9 percent and Brownsville at 7.1 percent.[3] In the past three years, Houston and Corpus Christi have been the fastest growing Texas ports.

Texas ports—in particular, those on the Rio Grande—may well see a further increase in traffic because of the potential for Asian shipments to be processed through Mexican facilities and sent to the U.S. market.

Lázaro Cárdenas, on Mexico's lower west coast, is the country's deepest Pacific

Chart 2

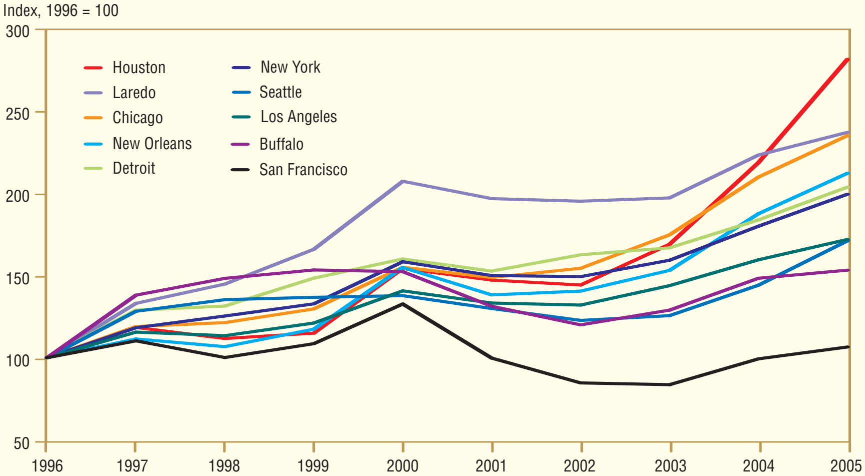
Four Texas Port Districts Among Top 20 in the United States, 2005



SOURCE: U.S. Customs and Border Protection.

Chart 3

Houston and Laredo Lead Growth in Trade Value of Top 10 Port Districts



SOURCE: U.S. Customs and Border Protection.

Coast port, able to receive the largest containers currently built. It's already considered a cheaper alternative to Los Angeles. Kansas City Southern, a U.S. railroad company, has acquired the railways connecting Lázaro Cárdenas' port to Mexico City and Monterrey to Laredo.

Inland Ports: An Alternative?

Inland ports are being developed to augment traditional trade channels. These facilities are still not well understood, even though they've existed in the U.S. for at least 80 years.[4]

Inland ports not only move export or import processing away from potentially congested borders, seaports and airports, they also serve as a location where goods receive further processing before shipment to their final destination.

A logistics or business park located away from usual ports of entry but staffed with a U.S. or foreign customs broker is one example of an inland port. Inland ports are typically foreign trade zones, where duties aren't paid on imports until they're shipped out of the designated area to a U.S. location. If goods are sent to a foreign country, no duty is imposed.

Inland ports' potential benefits aren't wholly dependent on processing of international trade, and the status is often sought to enhance the activities commonly associated with industrial parks, such as warehousing and manufacturing.

For producers, shippers and carriers, inland ports offer lower supply-chain costs, foreign trade zone benefits and logistics improvements. Some goods may be processed at traditional ports but then travel to inland ports for extra processing and assembly. If the value-added operations occur at an inland port, one or more supply-chain links can be eliminated or significantly reduced.

Goods assembled or manufactured at an inland port can also be warehoused on-site, eliminating transport from manufacturing to warehousing. These gains are more likely at inland ports strategically located near sources of value-added inputs to imported components, including labor, or close to retailers and other final destinations.

Texas' inland ports are in their infancy. Alliance Texas Logistics Park in Fort Worth is the state's only significant inland port currently processing international trade through customs. At least two other large projects are being developed, however. The Port Authority of San Antonio has begun work on an inland port on the city's south side, but it doesn't yet have customs operations. The Dallas Agile Port System/Port of Dallas is in the planning stages.

Alliance Texas Logistics Park—formerly Fort Worth Alliance Airport—opened in December 1989 as the first entirely industrial airport in the Western Hemisphere.[5] The 11,600-acre facility houses more than 140 companies. It includes a runway able to handle virtually any type of aircraft, access to the interstate highway system via I-35 and one of the nation's largest intermodal rail yards, operated by BNSF Railway.

The Alliance development has spurred the creation of housing, parks and retail stores in surrounding areas. While the development has grown to a significant size, U.S. Customs data for Alliance show that the inland port processed only $10.85 million of international trade in 2005, or less than 1 percent of customs trade value in the D/FW port district.

After Kelly Air Force Base closed in July 2001, its facilities were leased to the Port Authority of San Antonio, a business entity that, with support from the city of San Antonio and Bexar County, created KellyUSA, recently renamed Port San Antonio.[6] The development's 1,928 acres include an 11,500-foot, heavy-duty runway and access to the Union Pacific and BNSF railroads. The project has more than 63 tenants, almost fully leasing its 8.2 million

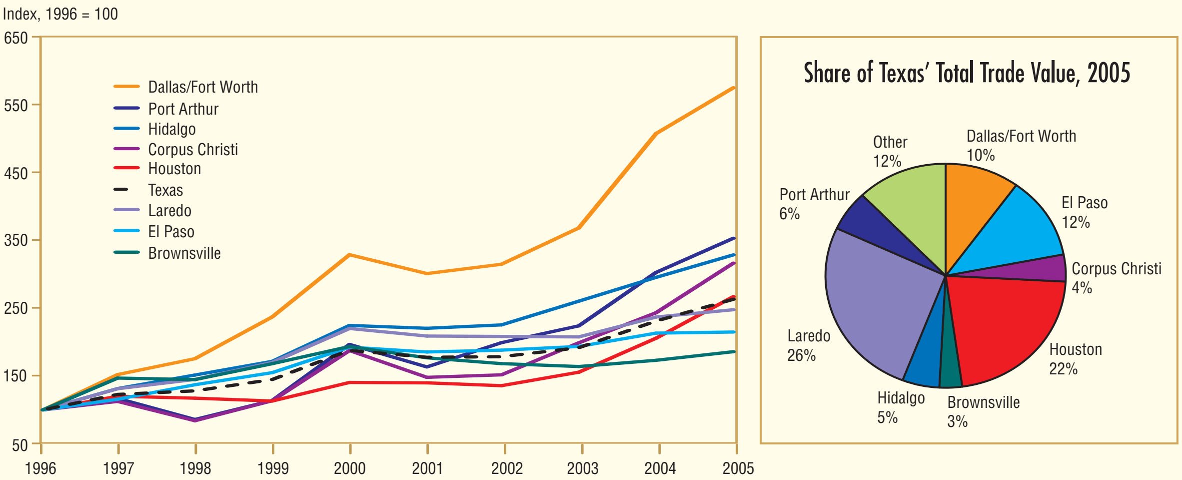
Table 2

Houston and Dallas/Fort Worth Trade Links

Trade partner	Share of total value, 2005 (percent)	Growth in share, 1995–2005 (percent)
Houston/Galveston		
Mexico	11.38	4.43
Venezuela	9.23	1.52
Nigeria	4.65	1.99
China	4.37	2.23
United Kingdom	4.21	–2.95
Germany	4.15	0.30
Saudi Arabia	4.06	–0.40
Brazil	3.60	–0.05
Netherlands	3.05	–0.43
Algeria	2.81	–0.03
Dallas/Fort Worth		
China	27.49	19.08
South Korea	10.02	3.98
Japan	6.99	–14.39
Singapore	6.27	2.54
Malaysia	6.19	2.75
Taiwan	6.05	–1.75
Germany	3.30	–1.77
Philippines	3.26	1.07
United Kingdom	2.89	–1.73
Thailand	2.81	–1.03

SOURCE: Foreign Trade Statistics, U.S. Census Bureau.

Chart 4
Value of Goods Processed at Texas Ports



SOURCE: U.S. Customs and Border Protection.

The Texas and U.S. economies have benefited from the growing amounts of trade that have flowed through Texas' ports.

square feet of building space. Currently, Customs data show no processing of international shipments at Port San Antonio.

Planning for the Dallas NAFTA Trade Corridor project, located south of Dallas, began in the fall of 2004.[7] It includes a component called the Dallas Agile Port System/Port of Dallas, which will be a shipping, receiving and distribution hub for inbound and outbound containers through Gulf Coast and Pacific seaports. In April 2005, Dallas authorities signed an agreement with the U.S. Maritime Administration and Port of Houston Authority to further develop the facility. In addition, the Dallas development seeks to serve as an inland distribution center for the ports of Los Angeles and Long Beach, as well as for the Mexican Pacific ports of Lázaro Cárdenas, Manzanillo, Topolobampo and Guaymas.

Keep on Truckin'

The total value of trade flowing through Texas ports has been increasing rapidly in recent years, and it's likely to continue to grow at strong rates.

Ports throughout the state have seen gains, and two of the largest port districts in the country, Laredo and Houston, are the fastest growing of the top 10 U.S. ports. Much of the growth over the past 10 years has been spurred by increased trade with Mexico and, more recently, by gains in trade with China.

The Texas and U.S. economies have benefited from the growing amounts of trade that have flowed through Texas' ports. Increased globalization will likely result in continued growth for the state's traditional ports. As they develop, inland ports could play a larger role in making Texas an efficient place to process imports and exports.

Lopez is an economic analyst and Phillips is a senior economist and policy advisor at the San Antonio Branch of the Federal Reserve Bank of Dallas.

Notes

The authors thank John McCray and Jason Saving for comments and Christopher Reynolds, currently a research assistant at the Federal Reserve Board of Governors and formerly an intern at the San Antonio Branch, for valuable research assistance.

[1] For an analysis of the strength of exports from Texas producers, see "Spotlight: Texas Exports Taking Top Spot in Selling Overseas," by Fiona Sigalla, *Southwest Economy*, Federal Reserve Bank of Dallas, January/February 2006.

[2] For a complete listing of U.S. ports of entry, see www.cbp.gov/linkhandler/cgov/toolbox/contacts/ports/cbp_ports_entry.ctt/cbp_ports_entry.pdf.

[3] Even though the Texas border towns are not considered inland ports, their geographic proximity to the Mexican maquiladora industry creates the merging of inbound logistics and manufacturing that is distinctive of inland ports.

[4] For a complete description of inland ports, see "The Identification and Classification of Inland Ports," by Sara Jean Leitner and Robert Harrison, Center for Transportation Research, University of Texas at Austin, Research Report no. 4083-1, August 2001, and "Inland Ports: Planning Successful Developments," by Jolanda Prozzi, Russell Henk, John McCray and Robert Harrison, Research Report no. 4083-2, October 2002, at www.utexas.edu/research/ctr/pdf_reports.

[5] See www.alliancetexas.com/Alliance/About+Alliance.

[6] See www.portsanantonio.us/ongoing_development.asp.

[7] See www.dallasnafta.com/default.asp.

SpotLight

Shreveport–Bossier City

Louisiana Metro Prospers with Diversified Economy

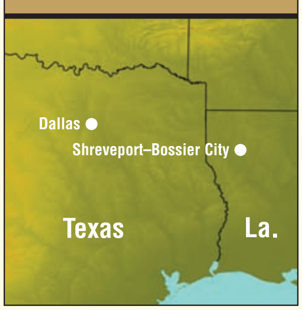
Nestled on the banks of the Red River, Shreveport was founded in 1836 as a regional trading center. For its first 80 years, the town stayed true to its original purpose, focusing on goods trading along a navigable waterway that ran from Texas to the Mississippi River.

In the early 20th century, however, the Standard Oil Co. chose Shreveport for its headquarters, and the town's focus shifted toward capitalizing on the East Texas oil boom. When the gushers played out, some towns lost their luster. But Shreveport remained resilient, adapting to shifting economic winds by developing a diverse portfolio of new industries.

Today, Shreveport is Louisiana's third largest city, with a population of 390,000. The metropolitan area, which includes neighboring Bossier City, is home to an Air Force base, six major casinos, an automotive manufacturing facility, a bustling port and six accredited colleges and universities.

New industries are planting roots. Biomedical research incubators are sprouting up in the area, adding to a health care industry that employs more than 13,000. Multinational firms are actively looking at Shreveport's port for expansion projects. Lately, the area has even become a popular location for shooting TV and film projects.

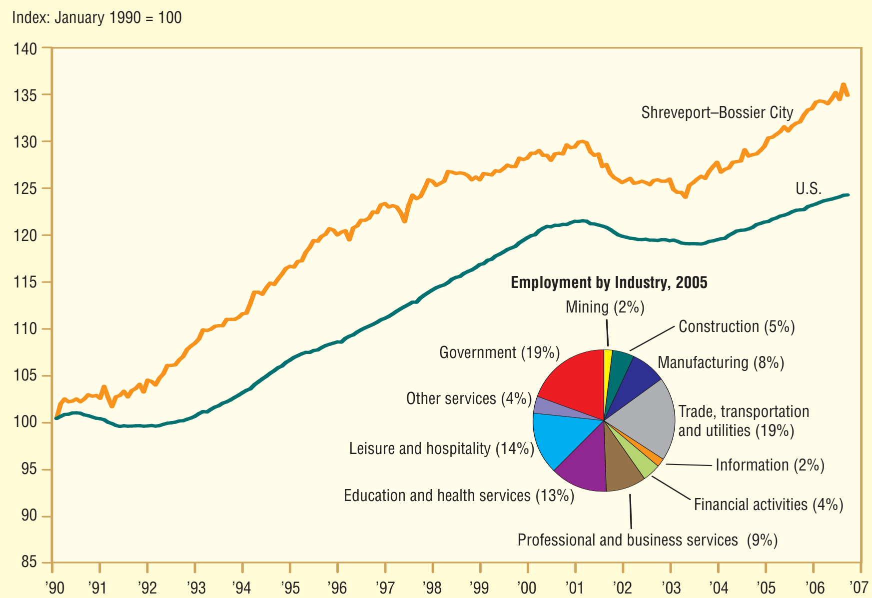
11th District Places



Shreveport–Bossier City residents enjoy a relatively low cost of living and faster job growth than the nation (*see chart*). While per capita income remains below the national average, its growth has kept up with the rest of the United States since 1990.

Barksdale Air Force Base is the area's single largest employer, with about 9,000 workers. The 22,000-acre base is home to hundreds of aircraft, including B-52 bombers and command aircraft and A-10 Thunderbolt II attack jets. Base personnel tend to live in the surrounding community, providing a lift to the area's housing and retail markets. All told, the base provides an estimated annual economic benefit of $450 million.

Shreveport–Bossier City Employment Growth Outstrips U.S. Rate



SOURCE: Bureau of Labor Statistics.

The Port of Shreveport–Bossier offers seagoing freight service via the Mississippi. The 2,000-acre, multimodal facility connects to three major rail lines, two existing interstate highways and the proposed I-69 corridor. Because the port is a foreign trade zone, goods leaving the country are duty-free. The port plans to build a 2-gigawatt power plant on-site to service the facility and accommodate future tenants, making it one of the first U.S. ports to have its own generation capacity.

Since its 1990 revitalization, the port has attracted tenants from an array of industries, including chemicals and petroleum, fertilizers, steel and pharmaceuticals. The port also houses barge and yacht builders.

Gambling kicked off in 1994 with the opening of three casinos, bolstering tourism's role in the area's expanding economic base. Gaming operations have seen steady growth, reaching 14.7 million admissions and $814.2 million in revenues in 2005. Average spending by casino guests increased from $41.60 in 1995 to $55.40 in 2005.

The casinos have helped Shreveport build its convention business. In 2005 alone, the area hosted 411 conventions, attracting more than 316,000 visitors.

Shreveport–Bossier City provides an excellent example of the beneficial effects of a diversified and evolving economic base. If the metro can continue to attract new industries and opportunities for its residents, it should continue to do at least as well as the nation as a whole.

—Laila Assanie and Bryan Macktinger

Note

The data cited in this article are from the Greater Shreveport Chamber of Commerce, Barksdale Air Force Base, Center for Business and Economic Research at Louisiana State University–Shreveport, Louisiana State Police Department, Port of Shreveport–Bossier and the U.S. Census Bureau.

OnTheRecord

An Appreciation of **Milton Friedman**

Champion of Economic Freedom

A year before his death in November, Nobel laureate economist Milton Friedman sat down for a wide-ranging conversation with Dallas Fed President Richard Fisher. The following excerpts capture Friedman's belief in free enterprise and limited government.

Fisher: You wrote *Free to Choose* in the 1980s, when we had this titanic struggle between capitalists and communists, with the Soviet Union still in place, the Berlin Wall still standing and a very different kind of regime in China. Today, where is the battleground for ideas?

Friedman: The battleground for ideas is where it has always been—in the minds of the people in the U.S., Britain and the rest of the world. But the place where you have had the major changes has been, not in the U.S., not in what's known as the West, but in the former Soviet Union, China and East Asia. That's where practice has been changing and along with it, we hope, beliefs.

Fisher: Why did that happen? Was it good luck? Was it good ideas?

Friedman: What really brought about that change and recognition was the collapse of the Soviet Union and the fall of the Berlin Wall. That was as strong a demonstration as you could have of the fact that a totalitarian state, controlled from the center, was not an efficient way to run a country. And certainly was not a way that was consistent with human freedom.

Fisher: So now today we have some new competitors in the system?

Friedman: Not new competitors. We have new resources, new cooperators. In the last 20 years, there's been an enormous increase in the number of laborers available for cooperation with capital through private enterprise means. That's what's happening in Asia, in India and in much of the former Soviet Union.

The really remarkable thing about the world is how people cooperate together. How somebody in China makes a little bit of your television set. Or somebody in Malaysia produces some rubber. And that rubber is used by somebody in the United States to put on the tip of a pencil, or in some other way. What has happened, has been an enormous expansion in the opportunities for cooperation.

Fisher: You've often talked about political freedom as well as economic freedom—a government that is the least intrusive. How will this resolve itself in China?

Friedman: I do not believe that China can continue to move as it has been moving in expanding the range of the market and at the same time continue with its wholly, fully centralized government. Let me emphasize that there has been considerable increase in not political freedom, but civil freedom. I have decided that it was important to separate and distinguish three categories of freedom. Economic freedom, the freedom to buy and sell, to make transactions. Civil freedom, the freedom to speak freely, the freedom to write and have freedom of speech. And then political freedom, which was the freedom to elect your leaders.

Fisher: Do you worry about the fiscal deficits that we now have in this country that have been accumulating over time?

Friedman: The problem is not the deficit, the problem is the spending. Which would you rather have: government spending of $10 billion, completely paid for by taxes, or government spending of $5 billion, completely paid for by borrowing?

Fisher: What's your answer to that question?

Friedman: Oh, I'd rather have $5 billion paid for by borrowing. What matters is not whether the money that pays it is borrowed or taxed, but whether the spending takes place. What really uses up resources is the spending. In fact, borrowing and taxing are really two different forms of taxation. The borrowing is an indirect form of taxation. One of the reasons I have always been in favor of tax cuts is because it seemed to be the only way that you can keep down government spending.

Fisher: Has it worked?

Friedman: Not completely, not 100 percent. But I think it has worked. I think that if we had not had those tax cuts, government spending today would be higher than it is. We spend close to 40 percent of our national income through government. That's a very high number. But it's lower than all of the European countries. It's lower than most countries in the world.

We would be much better off if we could cut down on that spending. Most entitlements, in my opinion, are not justified. They do not serve a useful function. Take Social Security for a moment. What Social Security is, is a Ponzi game. People put money into a pot, people take money out of the pot, and the whole thing is dependent on new entrants coming in and feeding that pot. The money is not invested. The money that comes in, the government spends routinely. It does not accumulate any assets. Everybody talks about how the aging popu-

"I do not believe that China can continue to move as it has been moving in expanding the range of the market."

lation is raising difficulties for Social Security. I haven't heard anybody ask, why doesn't it raise difficulties for life insurance companies? It doesn't because the aging population means that life insurance companies have larger reserves because people bought insurance in their youth.

Fisher: You have been a staunch advocate of free trade.

Friedman: Somebody asked me to write a letter or statement in support of the recent trade bill with the CAFTA. I decided I would look up this CAFTA bill. No one who read that bill could be in favor of it. It's a very long piece, a thousand pages. You get free trade on a thousand pages of rules and regulations? It's the opposite of free trade. The best thing that we in the United States could do, there's no question in my mind, would be unilateral free trade. We have nothing to lose by trading freely with every other place in the world.

Fisher: Even if other countries do not embrace free trade and subsidize farm products?

Friedman: If they want to waste their money, why should it bother us? And in particular, if they waste their money in a way which benefits us, if they make their agricultural products cheaper to us, why should we refuse the gift? We think it's OK for us to give foreign aid. Isn't it OK for us to receive foreign aid? You must regard foreign subsidization as a form of foreign aid.

Fisher: We've had many shocks to our system in recent years—a huge stock market reversal, the Sept. 11 terrorist strikes, natural disasters, energy price developments. And yet we continue to increase our productivity. Why is that?

Friedman: The economy has behaved remarkably well over the past 10 years, particularly over the period since 9/11. It's been fluid, it's been adjustable, and I think a very important part of credit for that does go, in this case, to the Federal Reserve and to the stable monetary policy.

Fisher: It is remarkable to hear you say that because you've been a frequent critic of the Fed.

Friedman: I have not been afraid to criticize it when I thought it deserved criticism. But having once adopted the view that its fundamental objective was to maintain stable prices, the Fed has been able to do so. And over the period of about 1990 to now, you've had close to stable prices. It's been about 2 or 3 percent inflation, on and off, up and down. And that has provided a stable background, which has facilitated adjustment to these other changes that have come along.

Not only has there been greater price stability, but there has been greater stability of the economy. The accepted doctrine among monetary economists was that there was a trade-off between price stability and economic stability—to get greater stability of the economy, you had to have more instability in prices. You had to use ups in prices and downs in prices to keep the economy straight. And that has turned out to be wholly false. It's just the opposite. The stability of prices facilitates the stability in economic output.

Fisher: What do you worry about in terms of the future of America?

Friedman: Well, I am basically, innately an optimist. So I see a great future for America. I think we have the right kind of a basic government if we can keep it. And what I worry about most for America is that we will not control the propensity for government spending to increase.

If freedom is going to be lost in America, it will be lost by excessive government involvement. It's hard to say, but it's true. We are much wealthier today than we were in 1950, but we are less free today than we were in 1950. If you think of all the regulations that have been imposed in the period since then, all of the organizations—Medicare, Medicaid, aid for disabled people, you can go down the line—there are hundreds of them. There's less regulation on business, but there's more regulation on people. From the long-run point of view, the one and only thing I'm really worried about is that government will grow too large.

Video clips of this conversation and other information about Friedman can be found on the Dallas Fed's web site at http://dallasfed.org/research/friedman.cfm.

TN Visas: A Stepping Stone Toward a NAFTA Labor Market

By Pia Orrenius and Daniel Streitfeld

TN visas are especially attractive to workers and employers because they can be extended repeatedly and have simple entry requirements, low fees and, most strikingly, no annual quotas limiting the number of workers who can be admitted.

The North American Free Trade Agreement established the NAFTA Professional—or TN—visa in 1994. Buried in the 1,708-page document, the provision received little attention at the time; indeed, some experts complained that the agreement had ignored the issue of migration, particularly between Mexico and the United States.

TN status is granted in one-year, renewable increments to high-skilled workers from Canada and Mexico who are in eligible occupations and have U.S. job offers. The visas are especially attractive to workers and employers because they can be extended repeatedly and have simple entry requirements, low fees and, most strikingly, no annual quotas limiting the number of workers who can be admitted. Moreover, they don't require filing applications by mail with U.S. Citizenship and Immigration Services (USCIS).

In contrast, most other major job-based visa programs for high-skilled foreigners, such as H-1Bs and employment-based green cards, have costly requirements, fixed limits on the number of workers allowed into the U.S., and processing delays that add months or even years to the wait.

The TN visas' flexibility allows them to serve a vital economic function by permitting free and timely movement of skilled workers into areas with growing demand. In light of the limitations and failures of other visa programs, the TN's combination of market-based efficiency and minimal red tape makes it a potential model for a type of guest-worker plan and a stepping stone toward a common NAFTA labor market.

Job-Based Migration to the U.S.

Because the TN visa program applies only to skilled employees, it can't be used by the largest group of NAFTA workers seeking entry to the U.S.—low-skilled migrants from Mexico. Even so, three developments have given the TN visa program increasing importance: growth in U.S. demand for high-skilled workers, shortages of H-1Bs and other employment-based visas, and the TN program's user-friendly procedures.

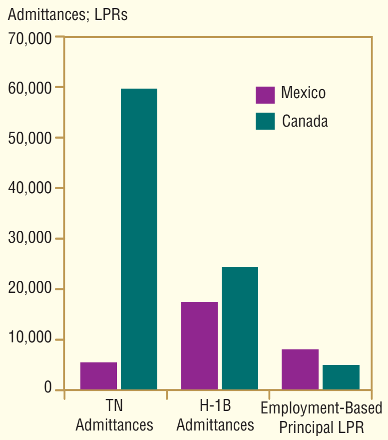
Once applicants have a job offer, confirmed by a letter presented to an immigration or consular officer, TN visas involve little paperwork or delay, which makes them well-suited for meeting companies' needs in a timely manner. Canadians need only supply job documents, proof of citizenship and a basic application to the immigration officer at any U.S. port of entry to petition for entry under TN status.

For Mexicans, the process is slightly more complicated and can't take place at a port of entry. Since 2004, Mexicans have faced the same documentation requirements as Canadians. Because they must be issued an actual visa, however, they must submit their materials to a U.S. consulate. If approved, they receive a TN visa and can then be admitted at a port of entry.

In addition to TN visas, highly educated Canadians and Mexicans have other options for legally residing and working in the U.S. They can enter permanently as an employment-based lawful permanent resident (LPR), obtaining a green card and eligibility to apply for citizenship after five years. Job-based green cards, however, typically require workers and employers to undergo an elaborate labor certification process. The green cards are also subject to quotas. As a result, they often take several years to be processed and approved.

Another alternative is a temporary, or

Chart 1
How They Got Here: High-Skilled Labor Migration to the U.S.



NOTE: 2005 data.

SOURCE: Office of Immigration Statistics, Homeland Security Department.

nonimmigrant, visa, more similar to a TN than a green card. Nonimmigrant job-based visas allow skilled foreign workers to reside and work in the U.S. for specified periods.

The most important is the H-1B program, which allows employers to petition for three-year, once-renewable visas for high-skilled professionals in specialty occupations.[1] H-1Bs are expensive to obtain and involve a time-consuming application process, although it's not nearly as burdensome as the procedure for job-based green cards. The major obstacle to H-1Bs is an annual quota that limits private-sector firms to 65,000 visas.[2] The cap is binding in most years. In fact, the H-1B quota was reached well in advance of the end of fiscal 2004, 2005 and 2006. With the backlog of applications growing, the 2007 allocation was exhausted in July 2006, before the start of the 2007 fiscal year in October 2006.

A closer look at high-skilled in-migration from the NAFTA countries shows that Canadians' use of TN status is particularly large, accounting for about 60,000 admittances in 2005 *(Chart 1)*.[3] By contrast, relatively few high-skilled Mexican workers enter the U.S., and they often don't use the TN visa. In 2005, the country had only 4,900 TN admittances. Mexicans make greater use of H-1Bs, with 17,100 admittances in 2005, close to Canada's 24,000. Among permanent migrants, Mexican job-based green cards, excluding dependents, numbered 7,680, eclipsing Canada's 4,612.[4]

Not all those Mexican green cards go to high-skilled workers. A small subcategory of the green-card program (called EB-3 visas) allocates 10,000 visas to low-skilled workers and their families, and some of these go to Mexicans.

Although admittances are the only data available, they don't perfectly capture the volume of work-related migration from NAFTA nations. The admittances record entries into the U.S. and aren't the same as visa issuances (for Mexicans) or the number of authorizations (for Canadians, who do not need visas to enter the U.S.).

Admittances typically exceed issuances or authorizations because individuals are normally counted each time they travel back and forth to their country. Mexicans in particular tend to visit their homeland frequently. On the other hand, those who renew their TN status within the U.S. and don't return home during the year aren't counted in admittances. Adjusting the admittance data based on historical patterns suggests that new and renewing TN authorizations were around 50,000 for Canadians and 2,500 for Mexicans in 2005.[5] Corresponding numbers for new H-1Bs are estimated at 16,000 for Canadians and 4,000 for Mexicans.

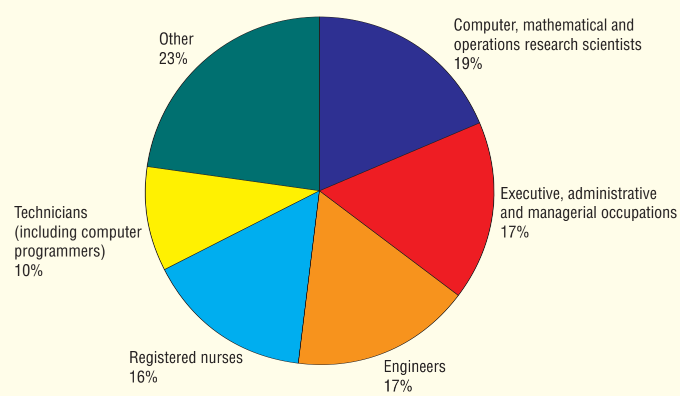
TN status is available only to workers in occupations on the official NAFTA professionals list, and almost all require at least a bachelor's degree *(Chart 2)*. They include 12 medical professions, 23 science categories, three teacher categories and 25 other professions. The majority of TN authorizations go to job categories in which labor demand is growing faster than the domestic supply, including computer scientists, programmers and registered nurses.

Because the program is temporary and work-based, inflows of TN workers are sensitive to economic conditions and fluctuate with the business cycle. Both Canadian and Mexican TN admittances grew sharply during the boom years of the late 1990s, peaking in 2000 *(Chart 3)*. In addition to strong cyclical demand, growing awareness of the visa and its ease of use surely contributed to the steady rise through the second half of the 1990s.

Admittances for both countries dropped substantially from 2001 to 2003, a decline that can be attributed to the 2001 recession and its aftermath. The labor market recovery, beginning in mid-2003, appears to have spurred a rise in TN admittances, more so for Mexicans than Canadians.

U.S. regulations require TN visas to have a "reasonable and finite end that is not permanent residence." As a result, TN status must be renewed annually, which can be done from the migrant's home country, at a

Chart 2
Composition of TN Occupations

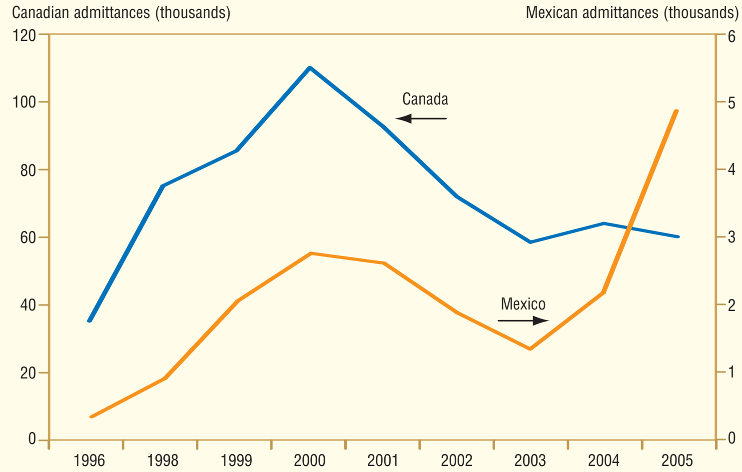


NOTES: Based on 1997–99 data, the most recent available. Percentages do not total to 100 due to rounding.

SOURCE: "Canadians Authorized to Work in the United States Under NAFTA Provisions," by Michael Hoefer, Doug Norris and Elizabeth Ruddick. Presented at the Metropolis Conference in Vancouver, 2000.

Most employment-based visa programs fall short because they limit immigration during economic expansions, they are cumbersome and costly to use and administer, and they exclude low-skilled workers.

Chart 3
TN Admittances Reflect U.S. Economic Conditions



NOTE: No data available for 1997.

SOURCE: *Yearbook of Immigration Statistics*, 1996–2005, Office of Immigration Statistics, Homeland Security Department.

port of entry or within the U.S. Renewals can occur repeatedly until a U.S. official determines that the "temporary" nature of the worker's intent has been exhausted. However, less than half of TN visa holders renew, according to the Homeland Security Department's Office of Immigration Statistics. A 2000 study showed 40.8 percent of TN visa holders who were first authorized in 1995 renewed at least once in subsequent years.[6] And 25.3 percent renewed for at least a fourth time in subsequent years. While the numbers indicate a significant share of TN workers are finding the visa useful and are renewing, a majority of those on TN status are either moving back to their home countries or switching to another type of U.S. visa or immigration status.

The first 10 years of the TN program, NAFTA imposed an annual quota of 5,500 on Mexican TN visas and required Mexican workers to file a "labor condition application" and apply by mail to USCIS. Policymakers imposed these restrictions, which didn't apply to Canadians, because they feared a rush of high-skilled workers across the southern U.S. border. Yet, the reality has been quite different. Canada has consistently averaged about 40 times as many TN admittances as Mexico for the past 10 years *(Chart 3)*. Canadian TN workers continued to greatly outnumber Mexicans even after the restrictions on Mexican workers expired at the end of 2003. The gap may seem surprising, since Mexico had a labor force of 43.4 million in 2005, much larger than Canada's 16.3 million.

Mexicans' Use of TN Visas

Why haven't Mexicans taken as well to the TN program as Canadians? Cost of living may be one reason. Although U.S. high-skilled wages are higher than Mexico's, Mexican professionals may be less inclined to migrate because their paychecks go further in a country with a significantly lower cost of living.

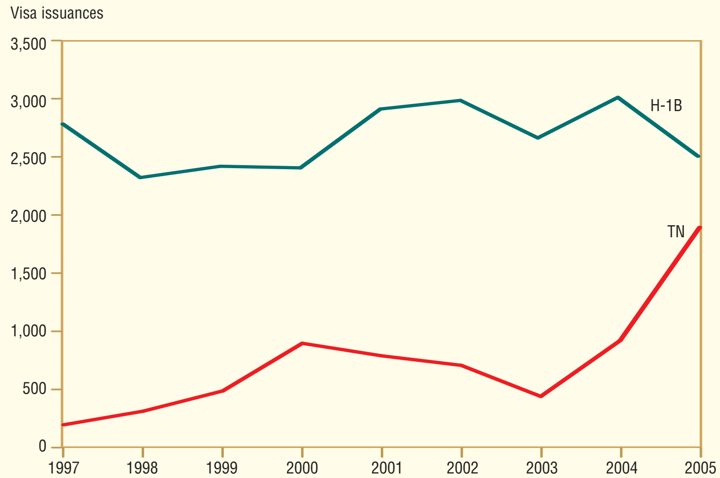
There also may be fewer Mexicans with the educational background required for high-skilled U.S. jobs. In 2003, only 18.7 percent of Mexicans aged 25 to 34 had at least some college, compared with 52.8 percent for Canadians. Another important, though less quantifiable, aspect is the similarity of Canadian and American educational institutions. U.S. employers are likely to be more familiar with and confident in the transferability of skills taught at Canadian schools than Mexican schools.

The education differential, however, doesn't fully account for the TN visa gap. Several other factors limit the ability of even highly educated Mexicans to obtain jobs in the U.S. The most important barrier is language. Most Americans and Canadians speak English as their first language, but the majority of Mexicans grow up speaking primarily Spanish. Americans and Canadians also share similar ethnic and cultural backgrounds, which makes the transition to the U.S. less jarring for Canadians than for Mexicans. These affinities may also make it easier for Canadians to adapt to the U.S. labor force and assimilate.

Despite a slow start, TN visa use among Mexicans is increasing. While usage continues to be low, its growth has turned up sharply, quadrupling between 2003 and 2005 *(Chart 4)*. The surge has been helped by the lifting of the restrictions on Mexican workers at the end of 2003. At the same time, a lack of H-1B visas may have pushed Mexicans to seek TN status instead.

The TN visa growth rate among Mexican workers is likely to remain high. Mexico's education levels are on the rise, and English language skills are more widespread today than in previous generations of Mexican college students. In addition, U.S. security concerns and visa caps are taking a bite out of the inflows of students and skilled workers from the Middle East and Asia, another factor expected to spur demand for NAFTA talent. Finally, deepening economic and cultural ties between Mexico and the U.S. should increase demand for workers who are fluent in both English and Spanish and possess an in-depth knowledge of Mexico.

Chart 4
TN Visas Gaining Acceptance Among Mexicans



NOTE: Visa issuances do not include visas issued within the U.S. or any visa renewals.

SOURCE: Office of Visa Statistics, U.S. State Department.

Visa restrictions are mainly intended as protections for native-born workers, but it's questionable whether such provisions have the desired effect, particularly if they keep high-skilled workers out or—in the case of low-skilled workers—encourage them to enter illegally instead.

Reaping Economic Gains

Immigration provides economic benefits beyond the direct gains by employers and foreign workers. The in-migration of foreign workers boosts economic growth, efficiency and innovation. This lowers prices for consumers and raises incomes for U.S. natives.

Most employment-based visa programs fall short because they limit immigration during economic expansions, they are cumbersome and costly to use and administer, and they exclude low-skilled workers. Visa restrictions are mainly intended as protections for native-born workers, but it's questionable whether such provisions have the desired effect, particularly if they keep high-skilled workers out or—in the case of low-skilled workers—encourage them to enter illegally instead.

A version of the TN visa program, under modified rules, could be designed for less-educated workers. In that case, most illegal entrants from Mexico, as citizens of a NAFTA country with job offers from U.S. employers, would fulfill the visa's requirements. Such a program would allow for the legal inflow of workers on a timely and low-cost basis.

Growth-based, flexible quotas could be used for low-skilled workers to ensure that migration responds more to changes in U.S. than Mexican labor market conditions. The demand for low-skilled foreign workers could be curbed by licensing employers wishing to hire them; licensing fees would not only deter hiring foreigners over comparable native-born workers but would also defray the costs of running the program.

As is currently the case with the TN visa, the duration of stay and the employer–employee match would be flexible so that the worker could return home or move on to a better job, depending on the demand for labor and the desire to supply it. The temporary and work-based nature of the visa would ensure procyclical labor flows and more return migration, minimizing use of welfare programs.

Prioritizing NAFTA countries in such an arrangement—like the TN visa does—would promote growth and stability in the region and allow for legal migration by workers who might otherwise come illegally. The benefits of a more fluid NAFTA labor market—with mobility for both high- and low-skilled workers—may prove deep and lasting.

Orrenius is a senior economist and policy advisor in the Research Department of the Federal Reserve Bank of Dallas. Streitfeld was an intern in the department in the summer of 2006.

Notes

The authors thank Anna Berman, Mike Hoefer, Steve Ladik and Alan Viard for helpful comments.

1 According to U.S. Citizenship and Immigration Services, a specialty occupation requires "theoretical and practical application of a body of specialized knowledge along with at least a bachelor's degree or its equivalent." Examples of specialty occupations include scientists, engineers and computer programmers.

2 Since 2005, an additional 20,000 H-1B visas have been available per year for firms hiring foreign students graduating from U.S. universities with master's degrees or higher. As has always been the case, H-1B workers hired by nonprofit employers, such as universities and the public sector, are exempt from the cap.

3 This decomposition excludes other, smaller, business-related visa categories, such as B-1 (temporary visitors for business), E-1 (treaty trader, spouse and children) and L-1 (intracompany transfers), and foreign students who remain for one year of optional practical training.

4 Unlike the TN and H-1B numbers, the green card totals include dependents (spouses and minor children) because they count against the green card caps. To present comparable data, we exclude dependents from the LPR inflows.

5 TN visa issuances to Mexicans abroad were 1,888 in 2005, according to the State Department's Office of Visa Statistics.

6 "Canadians Authorized to Work in the United States Under NAFTA Provisions," by Michael Hoefer, Doug Norris and Elizabeth Ruddick. Presented at the Metropolis Conference in Vancouver, 2000.

NoteWorthy

QUOTABLE *"Texas' economy will moderate but will grow faster than the U.S. in 2007."*

–Keith Phillips, Senior Economist

JOBS: Shortages Continue in Some Industries

With the Texas economy humming, businesses are draining the pool of available workers as they expand to meet strong local and global demand. Labor scarcities have amplified wage pressures in several industries.

Recent data confirm an exceedingly tight labor market. Despite an expanding labor force, Texas' unemployment rate stands at 4.8 percent, its lowest point since May 2001. New claims for unemployment insurance are at a 24-year ebb.

The energy sector first exhibited signs of labor market tightening, and business contacts continue to report shortages in almost all energy-related skills. Geologists, geophysicists and petroleum engineers are hard to find, and recent engineering graduates are receiving large signing bonuses.

Construction firms report difficulty finding skilled craftsmen and supervisors in most trades.

The service sector isn't immune to the labor squeeze. Demand for workers is outstripping supply in the transportation, computer science and financial services industries. Moreover, temporary staffing firms have raised pay rates due to strong demand for skilled workers.

Some business contacts are concerned that stricter immigration enforcement could further tighten Texas' labor market and add to wage pressures.

—D'Ann Petersen

AGRICULTURE: Rain Provides Marginal Relief to Texas Farms

After a prolonged dry spell, agricultural conditions are finally improving in Texas.

Heavy rains fell in several parts of the state in early fall, improving prospects for irrigated crop yields, winter wheat and cattle grazing. According to the U.S. Drought Monitor, about 45 percent of the state is experiencing normal precipitation, compared with 7.3 percent in August.

Despite the rainfall, large parts of the state still suffer from the drought's lingering effects.

A substantial portion of Texas' dryland cotton and corn has been wiped out, and farmers in several regions are collecting insurance on these crops. Ranchers are taking out larger loans to keep up with high feed costs.

The Texas Cooperative Extension estimates the dry spell that began in mid-2005 has cost Texas more than $4 billion in economic losses, surpassing the $2.1 billion mark recorded in the drought of 1998. Ranchers' losses total $1.6 billion.

Texas lenders are feeling the pinch as well. According to the Dallas Fed's *Quarterly Survey of Agricultural Credit Conditions*, loan repayments are down from a year ago and requests for loan renewals and extensions are up.

In 2005, Texas agriculture generated $6.8 billion in output, contributing about 1 percent to gross state product.

—Laila Assanie

HOUSING: Inventories, Permits Point to Slowdown in Texas

After five years of vigorous growth, Texas' housing sector appears to be cooling. Buyers are taking longer to make decisions, and builders have pulled back on the number of homes slated for construction.

Relocations and a strong economy still make the state a bright spot among U.S. housing markets, but reports of weakness in other areas of the country appear to be dampening consumers' zeal for buying in Texas.

Real estate agents and builders alike detect greater hesitancy on the part of homebuyers as sales and prices decline elsewhere in the U.S.

Despite strong sales this year, business contacts report that the supply of vacant new homes has edged up in some Texas metros because of aggressive building earlier in the year.

With inventories building, Texas single-family permits fell 10 percent from the second to the third quarter, retreating to the levels of early 2005. The drop was a stark change from last year, when permits were on their way to a 23 percent increase, well above the nation's 2 percent.

Although builders and buyers are more cautious, Texas leads the nation in the number of permits issued year-to-date, thanks to strong employment growth and favorable demographics. The recent performance of inventories and permits suggests, however, that Texas' housing sector is moderating from the explosive growth seen over the past five years to a more temperate path.

—D'Ann Petersen

Regional Update

Texas Job Growth Still Strong Despite Slowdown in Housing

Despite a few signs of cooling, the Texas economy continues to expand strongly. Most sectors of the economy are adding workers. So far this year, Texas' employment has increased at an annualized rate of 3.2 percent. Job growth has been twice as fast as the nation's for over a year (*Chart 1*).

Texas' unemployment rate dipped to 4.8 percent in September and October, the lowest since May 2001 (*Chart 2*). Seasonally adjusted initial claims for unemployment insurance declined to 53,493 in October, a level not seen since January 1982.

Helping create new jobs has been the strength in Texas exports, which reached an inflation-adjusted record $11.9 billion in August. Overseas sales are posting the strongest growth since 1999, driven primarily by the energy industry, with increases in shipments of chemicals and oil and gas extraction equipment.

Home prices haven't risen as fast in Texas as in other parts of the country, but the state's building boom has been just as impressive as the nation's. Residential contract values reached record levels in Texas as well as the U.S. over the past year (five-month moving average).

Texas' construction sector is now outperforming the country overall. Over the past two years, the state's residential contract values increased from 8 percent to 10 percent of the U.S. total. Nonresidential building also strengthened over the past year and should boost the economy well into 2007.

The healthy building activity has meant new jobs. In the first 10 months of this year, construction employment increased 9.3 percent in Texas, compared with 1.2 percent for the nation (*Chart 3*).

Downshifting in Spots

Amid overall solid growth, there are signs of cooling.

While still strong, Texas homebuilding has slowed as inventories inched up during the summer. Still low by historical standards, the inventories suggest the supply of homes for sale is exceeding demand. Texas' inventory growth hasn't been as rapid as in the country as a whole (*Chart 4*).

The slowing homebuilding has reduced business for some Texas manufacturers.

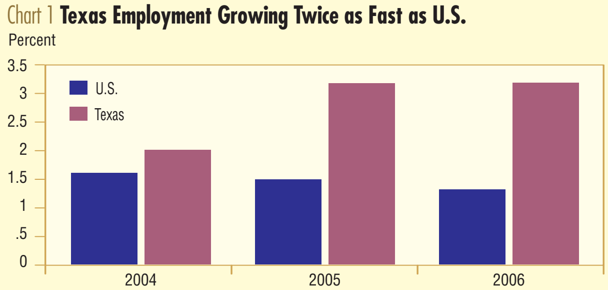
Texas' economy will continue to get a boost from a robust energy industry, which reports a backlog of orders for services and equipment from drilling activity around the world. Still, heavy inventories of natural gas and the recent dip in prices caused the state's drilling activity to pause in November.

The industry's growth will likely slow in coming months. Lower energy costs are a boon for business and consumers, but for Texas the news is mixed because the drop in energy prices results in lower royalty payments.

Aside from a few weak spots, the outlook for the overall economy continues to be bright. After declining between April and July, the Texas Leading Index bounced back in August, September and October. The index, however, still suggests slower job growth through the remainder of 2006.

—Fiona Sigalla

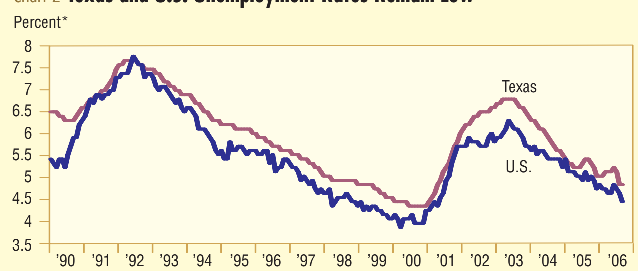
Chart 1 Texas Employment Growing Twice as Fast as U.S.



NOTE: 2006 data are first 10 months, annualized.

SOURCES: Texas Workforce Commission; seasonal and other adjustments by Federal Reserve Bank of Dallas.

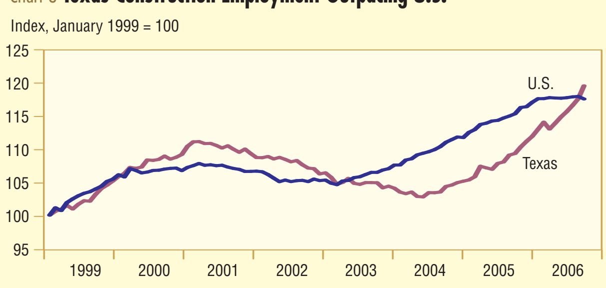
Chart 2 Texas and U.S. Unemployment Rates Remain Low



*Seasonally adjusted.

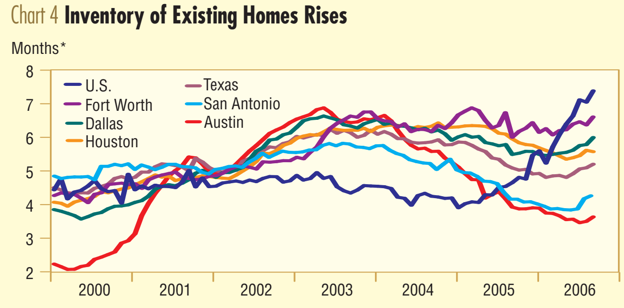
SOURCES: Texas Workforce Commission; seasonal and other adjustments by Federal Reserve Bank of Dallas.

Chart 3 Texas Construction Employment Outpacing U.S.



SOURCES: Texas Workforce Commission; seasonal and other adjustments by Federal Reserve Bank of Dallas.

Chart 4 Inventory of Existing Homes Rises



*Seasonally adjusted.

SOURCES: National Association of Realtors; Texas A&M Real Estate Center.

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2007 Border Economic Forecast Luncheon

Wednesday, February 7, 2007
Texas A&M International University
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Details at www.dallasfed.org/news.

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