The Southwest Economy: A Prologue for the Future

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"Life must be lived forwards but can only be understood backwards."

—Kierkegaard

To understand what is happening in the Southwest economy today and what will happen in the future, it is imperative that we understand what happened here in the past. A good place to begin is to examine the past decade and the events that shaped economic developments in the Southwest. If we considered the 10 most important economic events of the 1980s in the United States, we would find that about seven of them were also of major importance for the Southwest and, in fact, continue to play an important role in shaping the 1990s.

In my discussion this morning, I am going to cover many topics, but before I do, let me state my conclusion at the outset: the economy of this region is finally headed in the right direction. Two years ago at this conference I presented a similar long-term economic outlook, and I could not say with confidence that we were headed in the right direction. Now I can say so with confidence.

I will first examine the region's near-term outlook based on what is happening nationally and its effects on the Southwest. Then I will turn to the long-term influences shaping the region's economy. I will explain several reasons to be optimistic about the future but will note several critical public-policy decisions that lie ahead and could have a great bearing on the Southwest's future.

Based on current economic indicators, the Southwest economy will outperform the United States' economy over the next few years. Yet, the decisions we make today could mean that, instead of outperforming the nation, the region will backtrack and underperform the nation. To understand the choices we confront now, let's look back to the 1980s and the factors that shaped that decade.
Top Economic Events of the 1980s

Since about 1989, I have been describing the Southwest’s experience during the 1980s as the Great Recession. It was not a depression, at least not on the scale of the 1930s. I use the term *Great Recession* because the Southwest’s experience in the 1980s was by no means an ordinary recession. What the region experienced was somewhere between a recession and a depression. If I had to pick which end of the spectrum it was closer to, the history of the 1980s for this region was closer to depression than to recession. Had it not been for people like Bob Boykin [former Dallas Fed president], the economy might have slipped further toward depression than it did.

In looking at the 1980s, it is helpful to remember a concept from business-cycle theory: every boom, every great expansion in the economy also carries with it the seeds of the next recession. Booms—and the 1970s for this region of the country were a boom—usually contain the seeds of a big bust. Economist Joseph Schumpeter many years ago said that one aspect of capitalism is that it carries with it the seeds of creative destruction. What he meant, I think, was that recessions renew things. In the Southwest, we are beginning to see the seeds of the next expansion take root; we are beginning to see the flowers come up above the ground. Nowhere is this more true than in the energy industry.

**Oil prices.** With the gyration of oil prices, this region experienced a boom-and-bust cycle in the energy business over the past decade. As a proportion of the District’s economic output, energy went from about 21 percent of the value of output—a little bit more than one-fifth—to a little bit less than one-tenth of the region’s economic output. In short, energy became half as important to this area of the country as it once was. The decline, of course, had spillover effects. The lower prices boosted petrochemicals and provided a premium to the high-tech and human-capital-intensive part of the oil business—the seeds of expansion, the use of brain power.

**Regional deflation.** The nation went from a period of inflation in the 1970s to a period of disinflation in the 1980s. Nationally, the consumer price index went from 13 percent at the start of the 1980s to 4 percent to 5 percent in the period from 1984 to 1989. But trends in the Southwest were not that way at all. We went through regional and sectoral deflation—not disinflation, but deflation.

As a result of the region’s deflation, a lot of goods and services here are cheap relative to other parts of the country, which makes us a relatively attractive place to do business—another example of the seeds of expansion.

**Tax reform.** The Economic Recovery Tax Act of 1981 provided all kinds of special incentives to real estate investment, encouraging diversification out of energy lending and into real estate lending by our banking industry. Then the Tax Reform