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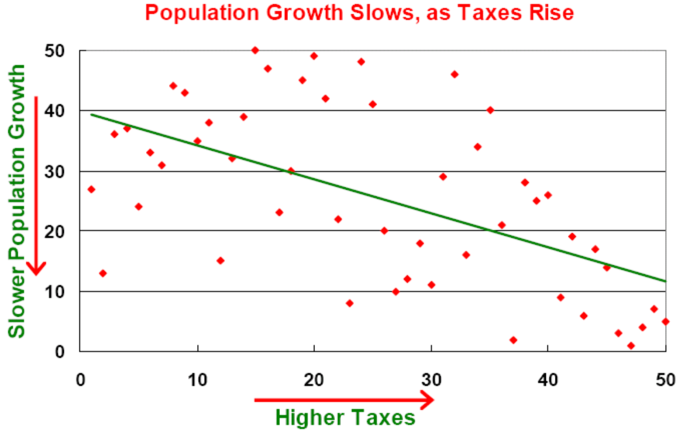
Voting With Our Feet

Yesterday's *Wall Street Journal* published the results of the Census Bureau's new 2007 population estimates, and highlighted an interesting relationship. The reporter found that the new data show states such as Nevada, Florida, and Arizona, which are experiencing extensive housing problems, had a slowdown in population growth. Michigan, another state with big housing problems, was one of two that saw population fall.

While we have no doubt housing problems are influencing demographic decisions in the short term, we think people are overly fixated on housing, and, as a result, are ignoring much more important factors.

We are not talking about weather, which is a no-brainer when discussing state population trends. We are talking about taxes. So, when we saw the WSJ story we immediately compared the population growth data with the Tax Foundation's measure of state tax burdens – a measure of *all* state and local taxes paid by individuals and businesses as a percent of total income. What we found did not surprise us. High taxes chase people away, while lower taxes are associated with faster population growth.



On the horizontal axis we ranked states from #1 – the lowest tax state in 2007 (Alaska, 6.6% tax burden) – to #50 (Vermont, 14% tax burden), the highest tax state.

On the vertical axis we ranked states based on population growth in the past year (based on data from the Census Bureau). Nevada, the fastest growing state, with population up 2.9%, ranks #50; while Rhode Island, which lost 0.4% of its population, ranks #1.

Although there are plenty of outliers, the trend-line shows a statistically significant relationship – higher tax burdens are associated with slower population growth.

The outliers are interesting. For example, New Hampshire and North Dakota are both low tax states experiencing slow population growth (relative to the U.S. as a whole). North Carolina and Washington (state, not D.C.) both have taxes near the national average while experiencing rapid population growth.

But these outliers do not change the relationship. When people are retiring, or when businesses are choosing a new location (or planning an expansion), tax rates matter. Companies in lower tax states have a competitive edge over competitors in higher tax states. They get an edge because they can keep prices down, while the after-tax pay for their employees is higher.

The willingness of taxpayers to vote with their feet can create a vicious cycle in some states and a virtuous one in others. For example, Michigan, which is experiencing pain from a hurting auto industry, has raised taxes in an effort to stem pressure on the state budget. But raising taxes causes the departure of even more of the state's productive workers, leaving a smaller tax base and bigger problems. Meanwhile, some states with low taxes attract so many people that the state can lower taxes further, resulting in even more population growth.

The gap in population growth between high and low tax states would likely be wider were it not for the federal government providing an income tax deduction for state and local taxes to taxpayers who itemize. When a state increases its tax burden, particularly on those with the highest incomes, some of this cost is shifted to the federal tax system as taxpayers in high tax states increase their deductions and pay less in federal taxes.

The bottom line: While housing woes may have caused some of the population changes shown in the most recent Census Bureau estimates, the tax factor is much more important and too often overlooked.

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