Taxing Texans:

A Six-Part Series Examining Taxes In The Lone Star State

by Richard Vedder

Part 3

Executive Summary

Does population growth require higher levels of taxation because of the increased cost of providing essential government services? At first glance, the experience of Texas seems to bear out that proposition. State tax collections in fiscal year 2001 were more *than 11 times as large* as they were in fiscal year 1972. Tax revenues grew at a compounded annual rate of 8.87 percent over the 29-year period. Adjusted for inflation and population growth, the growth in per capita real taxes from 1972 to 2001 is likely to be in excess of 100 percent.

… states with high population growth have lower tax burdens than states with low population growth.

But it turns out that growth does not require more government – in fact, population growth in low-tax states adds revenues that exceed the cost of serving more people. Analysis of the U.S. Census bears this out. Comparing the 1990 and 2000 Census, there is no positive relationship between population growth and tax burdens. The data show the exact opposite: states with high population growth have lower tax burdens than states with low population growth. New residents who participate in the labor force at high levels tend to raise more revenue at the margin for governments than they cost in incremental spending, allowing a somewhat lower tax burden.

Actually, there is a correlation between higher state tax burdens and low rates of population growth. The tax burden in low-population-growth states was actually $13 higher for each $1,000 in personal income – a tax burden approximately 12 percent larger than in high-growth states.

The conclusion? Low taxes associated with modest-sized government induce greater population growth. Businesses and people want low taxes more than big government, and they vote with their feet by moving to low-tax havens like the Lone Star State. **Over the past nine years, approximately 1,000 people moved to states without an income tax every day excepting Sundays. That's more people than fled from East to West Germany during the Cold War.**

Boom or Bust:

Does A Growing Population Require More Government?

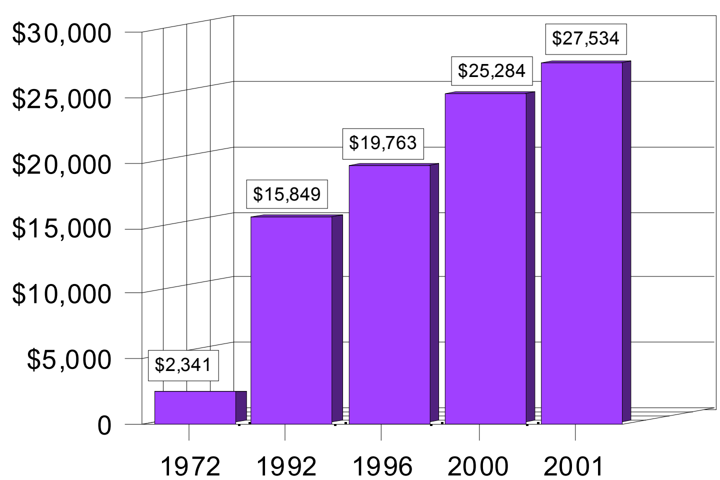
For most people, the following proposition makes sense: growth in population requires higher taxes, because the cost of providing essential government services increases with each new citizen. States with high population growth, like Texas, have greater needs for new school buildings, new highways, improved sewage systems, and hundreds of other infrastructural improvements. These capital outlays alone ought to require higher taxes.

At first glance, the experience of Texas seems to bear out that proposition. Government in Texas – and with it, the taxes that are levied to pay for public services – has grown dramatically over time.

Figure 3-1 shows that state tax collections in fiscal year 2001 (partly estimated) were more **than 11 times** as large as they were in fiscal year 1972. Tax revenues grew at a compounded annual rate of 8.87 percent over the 29-year period.

Figure 3-1

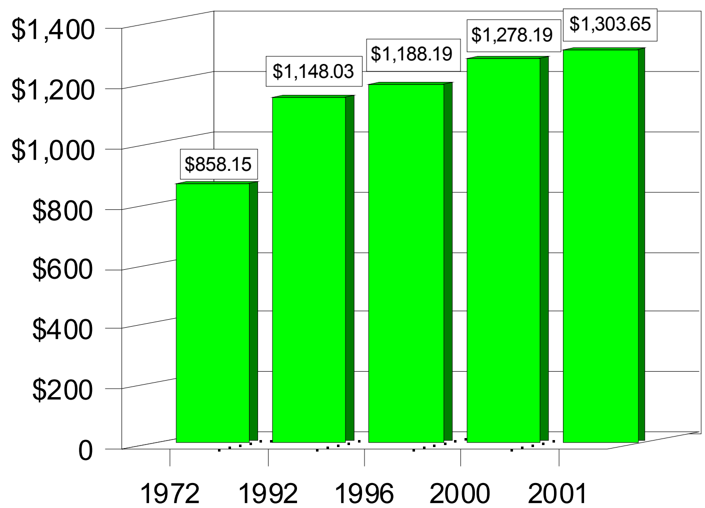
Texas State Tax Collections (In Millions of $)



It is true that inflation reduced the purchasing power of the dollar over time, and the Texas population nearly doubled. To deal with these problems, I calculated tax collections in per capita dollars, using the Consumer Price Index (CPI) of the U.S. Department of Labor and Bureau of Labor Statistics to "deflate" numbers to dollars of current (2001) purchasing power. The findings are represented in Figure 3-2 and, at 1.45 percent, show a steady per capita growth in tax collections.

Figure 3-2

Real Texas State Taxes Per Capita, 1972-2001



Tax revenues have been rising faster than inflation plus population growth. Moreover, the 1.45 percent rate is almost certainly understated. First of all, there is virtual universal consensus in the economics profession that over time the CPI overstates the true amount of inflation. Correcting for that, the growth in per capita real taxes from 1972 to 2001 is likely to be in excess of 100 percent – more than doubling, implying an annual growth in real per capita tax revenues of at least 2.4 percent.

Population Growth and Taxation

... population growth in low-tax states adds revenues that exceed the cost of serving more people.

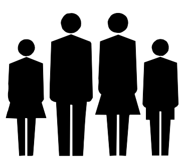
Tax collections have been growing *too* fast – faster than the rate of inflation plus population growth. And this brings us to an important point that at first seems counterintuitive but makes sense when fully explained: *the marginal costs of serving more people (reflected in government spending) does not exceed the marginal revenue associated with having those added residents add to the tax coffers by their labor and spending.* In other words, population growth in low-tax states adds revenues that exceed the cost of serving more people.

To see why, you have to start by looking at the varied rate of population growth across the country. Comparing the 1990 and 2000 Census, population growth varied from less than one percent (in North Dakota and West Virginia) to over 66 percent (in Nevada). Twelve states gained more than 20 percent in population (Arizona, Colorado, Florida, Georgia, Idaho, Nevada, New Mexico, North Carolina, Oregon, Texas, Utah, and Washington), while seven gained less than five percent

(Connecticut, Maine, North Dakota, Ohio, Pennsylvania, Rhode Island, and West Virginia).

If the notion that "population growth increases revenue needs" is correct, you would expect a positive relationship between population growth and tax burdens. But the data show that the exact opposite occurred: **on average, states with high population growth have lower tax burdens than states with low population growth.**

Using regression techniques, I examined the relationship between decennial population growth from 1990 to 2000 and the tax burden in 1998, as measured as a percent of personal income. The observed relationship was *negative and statistically significant at the five percent level.* One interpretation of this is that new residents who participate in the labor force at high levels tend to raise more revenue at the margin for governments than they cost in incremental spending, allowing a somewhat lower tax burden.

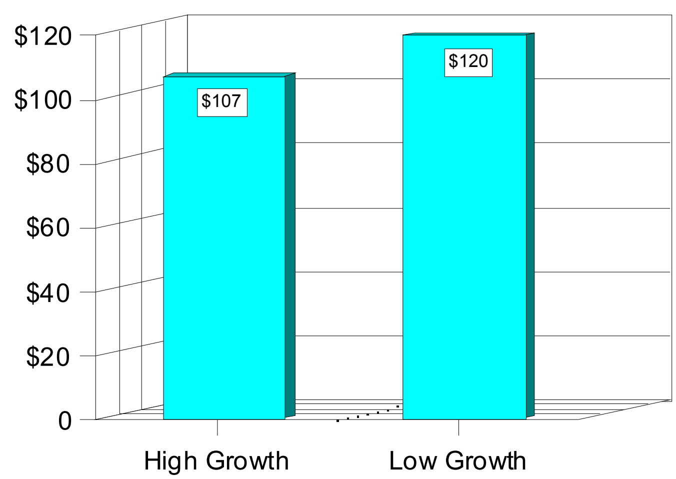


Indeed, one could calculate a population-adjusted ranking of the states in terms of tax burdens, taking into account the fact that lower taxation is expected, on average, in high-population-growth states. What would be Texas' tax burden ranking if its population growth, and that of all other states, was at the national average growth rate of 13.1 percent during the 1990s? The state's ranking would actually rise from 46th to 44th, passing Virginia and Missouri in terms of tax burden. This further supports the view that Texas' tax burden, while generally relatively low, is actually roughly equal or above that of many rather populous states, including Florida, Virginia, and Tennessee.

A simple graphical presentation makes this point even stronger. Take the seven states that from 1990 to 2000 grew faster than Texas – Arizona, Colorado, Florida, Georgia, Idaho, Nevada, and Utah. All had population growth of at least 23 percent. Now, compare their tax burden (which is closely correlated with spending) to the seven states with the slowest population growth, in each case under five percent – Connecticut, Maine, North Dakota, Ohio, Pennsylvania, Rhode Island, and West Virginia.

Figure 3-3

Taxes Per $1,000 Income, High vs. Low Population Growth States



The results (Figure 3-3) are startling. The tax burden in the low-population-growth states was actually $13 higher for each $1,000 in personal income – a tax burden approximately 12 percent larger than in high-growth states.

Voting With Their Feet

So the causation between population growth and government size has actually been reversed. Rather than population growth dictating larger government (which has clearly been shown incorrect), or even that population growth allows smaller government, it seems clear that low taxes associated with modest-sized government induce greater population growth. Businesses and people want low taxes more than big government, and they vote with their feet by moving to low-tax havens like the Lone Star State.

In fact, this tax-driven population shift is one of the most underreported stories of the century. Compare the nine states that have essentially no personal income tax (Alaska, Florida, Nevada, New Hampshire, South Dakota, Tennessee, Texas, Washington, and Wyoming) to the other 41 states and the District of Columbia. Some 2,849,310 persons moved into the no-income-tax states from the states that levied taxes on the productive activity of their citizens over the past decade. Excepting Sundays, around 1,000 people moved to states without an income tax *every day for nine years.* That's more people than fled from East to West Germany during the Cold War. And all of those people added to the extraordinary economic growth of these low-tax states, growth that exceeded the increased costs of government.

People who move to low-tax states know what's best for them and their families. It turns out, what's best for them is also best for Texas – no matter what the advocates of big government and high taxes say.

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About the Author

Richard Vedder is Distinguished Professor of Economics at Ohio University. Educated at Northwestern University and the University of Illinois, Dr. Vedder has served as an economist with the Joint Economic Committee of Congress and has taught at several other universities, most recently as John M. Olin Visiting Professor of Labor Economics and Public Policy at the Center for the Study of American Business at Washington University in St. Louis.

The author of more than 200 scholarly papers and articles and six books or monographs, Professor Vedder writes and speaks frequently on tax and other public policy issues. His commentary has appeared in such leading newspapers as the *Wall Street Journal*, *Christian Science Monitor*, *Washington Post*, *Investor's Business Daily*, *USA Today*, the *Chicago Tribune*, and the *Dallas Morning News*. He has also advised political leaders in more than 20 states and several nations on fiscal policy issues. His most recent books include: *Can Teachers Own Their Own Schools* (Oakland, CA: Independent Institute, 2000), and, with Lowell Gallaway, *Out of Work: Unemployment and Government in Twentieth-Century America* (New York: New York University Press, 1997).

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