# Tax Competition Among States Works – Here's Why

David R. Henderson

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In my February 23, 2022, TaxBytes, "Tax Competition Between States: How Low Will Tax Rates Go?," I pointed out some good news at the state level: State governments are competing for residents from high-tax states by cutting tax rates.

New evidence shows that cutting tax rates or keeping them low attracts residents, especially high-income earners, from high-tax states.

Economist Chris Edwards, an expert on taxes and budgets at the Cato Institute, has garnered the evidence. In a September 25 article in the Washington Examiner, Edwards writes:

**"The IRS data confirm the news stories about top earners moving to low-tax states. For households with incomes above $200,000, California is losing two households for each one it gains, and New York is losing three households for each one it gains.**

**"On the flip side, Florida is gaining more than two top-earning households for each it loses.**

**"Eight of the nine states that do not have income taxes enjoy net in-migration of top earners."**

Edwards also points out that although top-earning households — those with $200,000 or more of income — were only 7 percent of interstate movers, they "accounted for 41% of all movers' income."

Why should state governments care about losing high-income people? One main reason is they pay way more than their pro-rata share of state income taxes.

In 2012, shortly after California's electorate voted to raise the top marginal state income tax rate from the already-high 9.3 percent to a whopping 13.3 percent, I did a back-of-the-envelope calculation for someone making $1 million annually in California. I wrote:

*"He now pays approximately $88,000 in state income taxes. With the new higher tax rates, the*

*California State government is planning to collect approximately an extra $19,500 from him, for a total of about $107,500 in tax revenue. But if he moves to another state, it collects a big fat zero. Revenue falls by $88,000.*

*"What if one out of every ten people making one million dollars a year leaves California and the rest don't change their behavior in response to the higher rates? Then the tax rates, which were estimated to extract an extra $195,000 from these people, instead extract $175,500 from the nine who stay ($19,500 x 9) but lose $88,000 from the guy who leaves. Net revenue increase: not the planned $195,000 but, instead, $107,000, or only 55% of the amount the government planned on."*

Why should the rest of us care? Two reasons.

First, simple fairness: People who pay high state taxes don't get much more from government services than people who pay low taxes. So why is it fair to tax high-income earners so heavily?

Second, high-income people tend to bring some dynamism to a state economy: starting businesses, hiring employees, and adding to economic well-being.