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Dear Client:

In today's mobile-capital-and-labor environment, companies will locate where they have the greatest competitive advantage. States with the best tax systems will be the most competitive in attracting new businesses. So, how does Texas stack up against the competition?

It's axiomatic that those states with the best tax systems will be the **most effective at generating economic and employment growth** – especially if it stacks up well in other areas such as educated work force, laws favorable to business, desirable communities in which to live and do business, the quality of its education system, etc.

To assess a state's competitive tax structure, don't listen to the states themselves. **Go to an impartial third party for an accurate analysis – which is what we did.** The Tax Foundation, located in Washington is a non-profit, non-partisan research and public education organization that has monitored tax and fiscal activities at all levels of government since 1937. It has just published its 2007 version of the State Business Tax Climate Index (SBCTI). Now, don't let your eyes glaze over. We're going to only give you the highlights.

The ten best states in the 2007 Index are: #1, Wyoming ... #2, South Dakota ... #3, Alaska ... #4, Nevada ... #5, Florida ... #6, **Texas** ... #7 New Hampshire ... #8, Montana ... #9, Delaware and #10 Oregon. Look carefully. **The states with whom Texas competes for jobs and corporate investment** are only #5 Florida and #10 Oregon. This is significant. Only Florida and Oregon are in our ball park.

Even more significant are the **ten worst states**: #41, Minnesota ... #42, Maine ... #43, Iowa ... #44, Nebraska ... #45, **California** ... #46, Vermont ... #47, **New York** ... #48, New Jersey ... #49, Ohio and #50, Rhode Island. Look at California's rank. Look at New York. Rock bottom in the US in terms of state business tax climate. They are ripe for the picking, in economic development efforts. Those two giants compete in other ways; but taxes, forget it.

What about the other states who vie, along with Texas, for the plum jobs and desirable companies? How do they rank on this Index? Colorado is #14, Georgia is #19, Idaho (a recent high tech player) is #32, Massachusetts is #36, North Carolina is #40 and Washington, #11. What about our adjacent states? Not to worry. Arkansas is #35, Louisiana is #30, New Mexico is #23 and

Taxes matter to business. And states do not enact tax changes in a vacuum – increases *or* cuts. A state always has to keep its competitor states in its crosshairs.

Taxes affect business decisions, job creation and retention, plant location, competitiveness and the long-term health of a state's economy, according to the Tax Foundation.

Most importantly, taxes diminish profits. If taxes take a larger portion of profits, that cost is passed along to either consumers (through higher prices), workers (through lower wages or fewer jobs), or shareholders (through lower dividends or share value).

Every tax law will in some way change a state's competitive position relative to its immediate neighbors, its geographic region and even globally. The Tax Foundation points out that, ultimately, it will affect the state's national standing as a place to live and to do business. For instance, the Foundation notes that entrepreneurial states can take advantage of the tax increases of their neighbors to lure businesses out of high-tax states.

So what makes for a good state tax system? The Tax Foundation's analysis suggests good state tax systems levy **low, flat rates on the broadest bases possible, and they treat all taxpayers the same.** Variation in the tax treatment of different industries, it notes, favors one economic activity or decision over another.

The more riddled a tax system is with politically motivated preferences the less likely it is that business decisions will be made in response to market forces. So the rankings reported in the previous story cover an analysis of five key areas of taxation: individual income taxes, major business taxes, sales taxes, unemployment insurance taxes, and taxes on wealth or assets such as property.

Texas's very high #6 ranking came about as a result of the weighted rankings in those five categories. In the category of **corporate taxes, Texas ranked #17,** and in individual income tax ranking (even though there is no income tax in the Lone Star State), **Texas ranked #7.**

The sales tax ranking for Texas was #31, the unemployment insurance tax rank for Texas was #6 and in the **much-cussed-and-discussed property tax rankings, Texas came in at #36.**

These rankings are important as the Texas Legislature descends upon Austin in just two months. Taxes will again be a serious topic of discussion. It will be interesting to watch the **business-oriented focus of the legislature balanced against the needs to provide services** to one of the fastest growing states in the nation. A healthy business environment, with a gainfully-employed workforce, is important. But the state also has to provide for the safety and welfare of its residents as well. It bears watching to see how the balance ends up.

Portions of Central Texas are changing dramatically, some say “remarkably,” and very few people are aware of the scope of this change – or even *where* it is occurring.

Anyone who drives the 5-county Austin-Round Rock metro area sees growth happening all around us. You can see construction and building cranes hovering over sites with traffic tie-ups almost anywhere – sure signs that **significant growth is impacting Central Texas**. But all areas are not equal.

Texas state demographer **Steve Murdock** points out the fastest-growing small community in the state from 2000 to 2005 was, hold on, Hutto. **Can you believe Hutto grew by 492% during this period! Murdock calls this population surge “phenomenal.”** Hutto, in the northeastern portion of our metro area, has incurred this growth while most of us were unaware this was happening.

Hutto is not alone, though it leads the pack, in this remarkable population surge. There are four small communities in the Austin-Round Rock metro area that rank in the Top Ten in Texas for this period. Look at these numbers: **Kyle, at #5, grew by 233% ... Bee Cave, at #8, grew by 135% ... and Leander, at #10, grew by 129%.** Let this sink in. Very few are aware of this phenomenon.

This unbelievable population surge is practically surrounding the Capitol City – Hutto to the northeast, Kyle to the south, Bee Cave to the southwest and Leander to the northwest. Obviously this has important implications for anyone living and doing business in the five-county metro area.

First of all, these four communities are all incorporated entities and their governing bodies have a tremendous responsibility **managing this overwhelming tide of people** moving into their area. Secondly, just think about the traffic patterns that are being impacted by this increase in **people inside vehicles driving to-and-from goodness-knows-where**, because these communities do not yet have a big enough commercial presence to provide jobs or services to handle these numbers. We could go on-and-on, but you get the picture.

While these are looking-back numbers, **it is even more important to realize that, without exception, this growth is continuing in these four communities** with no immediate sign of a let-up.

Also, while other smaller communities in Central Texas did not make Murdock’s Top Ten, this **growth on a *slightly* smaller scale is occurring in places such as Manor and Cedar Park** – not to mention the bigger cities such as Austin, Round Rock, San Marcos and Georgetown, where it is more obvious because they started out this decade as bigger population centers.

Keep your eye on Hutto, Kyle, Bee Cave and Leander. Most tend to focus on Austin, Round Rock, etc. But these smaller communities are indeed experiencing phenomenal growth.

Speaking of Central Texas cities, Round Rock was recently ranked as one of the least dangerous in the US. Austin did not fare so well.

Round Rock was named at the 13th safest city in the US, based on FBI figures released in June and compiled by Morgan Qutno Press. **Austin, however, came in way down the list at #158.** Could it be the “tough on crime” reputation of Williamson County (compared to the more “live and let live” reputation of Austin) is at work here? On the flip side of that question is that the nation’s big cities tend to all be ranked in the “more dangerous” category.

The trend is continuing. Delta Air Lines and Northwest Airlines are losing Austin passengers right and left.

It is so marked that, in September, **Delta’s and Northwest’s passenger traffic drop were in the double-digit percentages** compared to a year ago, while overall the market grew by 8% and strong competitors Southwest (up 10%), American (up 2%) and Continental (up 15.5%) continued gaining market share.

Through the first three quarters of 2006, here are the actual number of passengers who put their butts in the seats of the Austin carriers: Southwest, 2,174,574 ... American, 1,716,280 ... Continental, 744, 832 ... Delta, 422,406 and Northwest, 182,770. Newbie JetBlue, that only started serving the Austin market this year, is creeping up on Northwest, with 163,697 passengers carried through September.

The Delta-Northwest development **doesn’t appear to be harming service** at Austin-Bergstrom International Airport. And, in the worst case, if either/both of the airlines stop service here, their gate positions will probably be scarfed up quickly by more aggressive competitors, who would likely look at such potentially-lucrative routes as Austin-Atlanta, now served by Delta.

Dr. Louis Overholster observes that nothing is foolproof to a sufficiently talented fool!

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