

# Commissioner Kleppner's Draft on Demographics – v11-23-2020

*Status: First draft*

## Chapter 8C: Changing Landscape - Demographics

In 2019, this Commission published a report on the effects of demographic changes on Vermont's revenue system (Appendix 1, "POPULATION CHANGES AND VERMONT STATE REVENUE").

That paper reports that while Vermont's total population level is (at least temporarily) stable, the state is undergoing three large demographic trends: the population is aging; it's shifting to the Greater Burlington area and surrounds from everywhere else in the state; and it's dividing into smaller households.

We identify implications for Vermont's revenue system, ASSUMING THOSE TRENDS CONTINUE, AND ASSUMING NO CHANGES TO VERMONT'S TAX SYSTEM:

### Implications of an aging population for Vermont's three major revenue sources

#### **1. Reduction in income taxes**

“• Vermont has benefited in recent years from substantial income tax receipts from the large cohort of baby boomers progressing through their peak earning years.

• Younger baby boomers (age 55-64 in 2018) currently account for more than a fifth of tax returns and more than a quarter of personal income tax dollars. As the state's most populous age cohort progresses through their senior years, their decreasing incomes will no longer contribute as disproportionately high of a share of income tax revenue.” P34

#### **2. Reduction in consumption taxes**

“•Compared to other age groups, seniors tend to spend more on mostly non-taxable services, such as health care, rather than the taxable goods favored by younger cohorts.

• This drop could be partially mitigated due to seniors tending to work and spend later in life, because seniors as a whole are now wealthier than other generations, and because the state benefits from tourism by empty nesters and recent retirees from nearby states.” P35

#### **3. Education property taxes**

As people age, become empty nesters, and retire, they tend to downsize, so an aging population can lead to lower overall property taxes.

### Implications of urbanization for Vermont's three major revenue sources

#### **1. Increase in income taxes**

Statistically, the urban area around Burlington provides higher-paying jobs than the rural areas, so to the extent that the population shifts to the Greater Burlington area, we expect average incomes, and income tax revenue, to increase. “The counties that are losing population are the lowest-income counties.” (P 20)

#### **2. Increase in consumption taxes**

As incomes increase and become more concentrated in the Burlington area where there are more, and more varied, opportunities for consumption, we expect consumption to increase as well.

### 3. Increase in education property taxes

Property values tend to be higher in Greater Burlington, so to the extent that migration leads to an increase in housing units in Chittenden County, we would expect total education property tax revenue to increase.

#### Implications of smaller household size for Vermont's three major revenue sources

Per the paper in Appendix 1,

“Vermont real per capita income has increased five percent while the state’s median household income has fallen four percent. This divergence between per capita income and median household income is driven by two factors. First, smaller households mean fewer earners per household and total income is spread across more households. Second, greater inequality, with greater concentration of income among high-earners, serves to pull up the average more than the median. The first factor can suppress revenue to the extent that tax benefits are given at the household level (as opposed to by filing status or number of dependents), while the second factor produces increased revenue through a higher effective tax rate in a state with a progressive income tax (like Vermont).” PP20-21

All in all, we would expect that the change in household size would not greatly affect **income tax revenue**.

We would expect a very gradual increase in **consumption tax revenue** as household size decreases, since there are that many more households that need to be equipped with kitchenware, furniture, entertainment systems, etc.

As far as **property tax** is concerned, Vermont has a disproportionate number of larger houses (see P17 footnote). This is driven by the prevalence in rural and formerly rural areas of large, rambling farmhouses that grew over many decades to accommodate large farming families; large homes built in towns before the Great Depression designed to accommodate a family and their servants; and “McMansions” built in the 1980s and 1990s during a trend toward larger homes.

However, with smaller households, and the trend toward smaller, more energy-efficient and cost-efficient houses, economists expect demand for the larger houses is likely to fall, so prices will fall, and appraised value will fall, and grand list value will fall. This will be partially offset by new construction of smaller houses, growing the grand list. It is also likely that some of the larger homes will be divided into two-family homes or multi-family homes.

One of the household configurations that is growing is multi-person non-family households, so it is likely that some of these formerly single-family homes will be occupied by unrelated adults.

All in all, we would expect declining revenue from education property taxes based on the trend toward smaller households.

#### Why these trends might change, and implications for Vermont's tax system

External factors affecting these three trends (aging, urbanizing, shrinking households), combined with the changes we recommend to Vermont's tax system, lead to a different set of implications.

Changes in technology, the economy, and the climate all have the potential to significantly affect Vermont's demographic trends.

First, the age structure of Vermont's population is driven by births, deaths, domestic and international in-migration, and domestic and international out-migration. There is not much reason to expect Vermont's birthrate or deathrates to change, although both are certainly possible. However, there are several factors which could lead to meaningfully increased in-migration from other states:

1. There are many reasons that some people don't want to live in Vermont, the long, cold, dark winters primary among them. Vermont's winters are getting shorter and warmer, which means that:
  - a. More people who live here will be willing to spend all winter here (fewer snowbirds). That means more local consumption from people who otherwise would have spent two to six months somewhere warmer.
  - b. There is likely also to be a new trend of people who live in areas that become uninhabitably hot during the summer, or prone to too many violent storms during hurricane season, who are the opposite of snowbirds, who instead of fleeing south to avoid the cold and snow flee north to avoid the heat and hurricanes.
2. When surveyed, 66% of Americans say they'd like to live in a small town or rural area. "Given six choices of a type of place where they could live, 27% of Americans choose a rural area, more than any other option . . . 39% would choose a town, a small city or a suburb of a small city."<sup>1</sup> The barriers to their actually living in places like that include the lack of employment, the lack of good schools for their children, and the lack of cultural experiences. However, per our paper on demographics, most of Vermont's rural areas are what are called high-amenity rural areas, which is to say, rural areas with access to good schools and recreational and cultural activities.
3. Twenty years ago, we saw in-migration by people fleeing terrorist attacks on urban areas, and recently, we have seen in-migration driven by people fleeing pandemic hot-spots. These people are either moving year-round to what had been a vacation home, or simply moving to Vermont. School enrollment in Windham County is up for the first time in a very long time. "The Covid-19 pandemic is bringing a new crop of students to the state, as newly remote workers decamp from urban areas to Vermont, which has made [national headlines](#) for its low rates of infection."<sup>2</sup>

Advances in communication technology now mean that many people no longer need to live near their employer. This removes another one of the big barriers to moving to Vermont, which was lack of good jobs. For many people, a Vermont with mild winters and plentiful employment opportunities is a much more attractive place to live, and this is particularly true of the rural areas. People moving to Vermont tend to be younger and have (or soon give birth to) children, and to the extent that they are pursuing a

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<sup>1</sup> <https://news.gallup.com/poll/245249/americans-big-idea-living-country.aspx>, 2018.

<sup>2</sup> <https://vtdigger.org/2020/08/04/the-pandemic-is-bringing-students-to-vermont-mostly-in-towns-without-schools-%EF%BB%BF/>

rural or small-town environment, they are likely to settle outside of Greater Burlington. This may temper or reverse all three of the big trends of aging, urbanizing, and shrinking household size.

The implications for our tax system are generally positive. More people earning good incomes means more income tax revenue. More people living in Vermont means more consumption tax revenue.

Further, even if the population does continue to age, our recommendation that Vermont continue to expand the consumption tax base to include all consumer-level purchases of goods and services means that the shift in consumption caused by an aging population (purchases of fewer goods and more services, like health care services) will not erode the consumption tax base.

Our recommendation that we complete the many-decades-long process of transitioning the source of education finance from property tax to income tax means that the affect of any future trends on homestead property tax revenue will affect only local revenue, not state revenue. To the extent that people move year-round to what had been their vacation homes, the state will go from collecting non-homestead property tax to collecting income tax.

All in all, we believe that our recommendations mitigate or even neutralize the threats to Vermont's revenue system posed by the long-term changes that may arise from Vermont's changing demographics.

Underlying all our recommendations is a belief that our economy and our climate and our population are all becoming less stable, and Vermont will need to be ever-vigilant and ever-agile to be successful in continuous adaptation to a changing world.