Drawing the Wrong Conclusion:

Tax Foundation Business Climate Index Misrepresents the Significance of Oregon's Low Business Taxes

On February 27, 2006, the Tax Foundation released a paper claiming that Oregon's economic future is bright because its business taxes are low compared to the rest of the nation. This overly simple conclusion is fundamentally flawed.

The Tax Foundation's 2006 State Business Tax Climate Index compares the tax structures of the 50 states.[1] The Index defines "business taxes" as a weighted combination of corporate income taxes; sales, excise and gross receipt taxes; unemployment insurance taxes; wealth taxes (including property taxes), and personal income taxes. States with low business taxes fare best on the Index. The Tax Foundation claims that states with low business taxes are better positioned to compete with other states and other countries.

According to the Tax Foundation, Oregon's "business tax climate" ranks 10th best in the nation. Oregon scores well primarily because it does not levy a sales tax. In addition, the fact that Oregon does not levy a tax on corporate stock or certain other forms of wealth significantly helps the State's ranking. On the five categories that comprise the overall ranking, Oregon ranked no worse than 33rd - for personal income taxes - and as best as fourth - for sales and gross receipts taxes (Table 1). Because the Tax Foundation considers low sales and gross receipts taxes to be more important in determining business tax competitiveness than all other categories of taxes except personal income taxes, it gives extra weight to low taxes in this category.

Table 1: Oregon rankings on Tax Foundation's 2006 State Business Tax Climate Index

Category	Oregon rank	Weight given to category*
Overall	10	100%
Business (corporate profits) tax	24	20%
Individual income tax	33	28%
Sales and gross receipts tax	4	22%
Unemployment Insurance tax	30	14%
Wealth (including property tax)	8	16%

* Figures are rounded

Others have noted that Oregon's business taxes are not high

The Tax Foundation's conclusion that Oregon has low business taxes when compared to the rest of the nation jibes with other recent studies.

Last year, a study by the accounting firm Ernst & Young, published by the Council on State Taxation (COST), found that in 2004 the effective state and local tax rate on businesses in Oregon ranked 47th lowest in the nation (fourth best among the states and the District of Columbia) as a percent of private sector economic activity.[2] COST is an association of over 5,000 multistate corporations that works to influence state tax policies. Oregon's business taxes ranked 50th (second best) among the states and the

District of Columbia as a share of all state and local taxes. Only Maryland had lower business taxes using this measure.

It's not just business groups that have concluded that Oregon's business tax burden is low. The Utah State Tax Commission periodically compares Utah's business taxes with those of other western states. Their most recent study found that in 2003 Oregon had the lowest business taxes as a share of Gross State Product of the seven Western states examined.[3]

Ignoring Public Investments: The Tax Foundation's Flaw

Although the Tax Foundation's findings that Oregon's business taxes are relatively low is confirmed by others, its conclusion that low business taxes are the key to attracting and keeping desirable businesses is incorrect. State and local taxes are a small part of business costs, and therefore play a minor role in investment decisions. For businesses throughout the country, state and local taxes account for only about 0.8 percent of business costs.[4]

Businesses are much more concerned about factors such as the proximity of their markets and suppliers, the quality and cost of labor, utilities, education, transportation and communication infrastructures when making investment decisions. Quality public investments in these areas improve the business climate and save companies money in the long run. If lowering corporate income taxes results in significant reductions in the quality or quantity of public investments, the impact of lower taxes may be to hinder economic growth rather than strengthen it.

Moreover, the reality and perception of a state's ability to provide these important public services does have an impact on business climate. Oregon's business community and its economic development officials could not have been happy about the negative publicity that Oregon's crumbling education system received in the Doonesbury comic strip in 2002, for instance.

The Tax Foundation's misguided approach – equating low taxes with a better business tax climate and ignoring the quantity and quality of public services provided by the states – is not supported by research. An analysis of the existing research literature on this topic found "little grounds to support tax cuts and incentives – especially when they occur at the expense of public investment – as the best means to expand employment and spur growth."[5]

The Tax Foundation's 2006 State Business Tax Climate Index asserts that Wyoming has the nation's best business tax climate, and that New York has the worst. These claims may cause some headshaking for anyone who has visited both Cheyenne and Manhattan. Low taxes are not the only – or even the primary – criteria for assessing the business climate of any particular place.

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Endnotes:

[1] The District of Columbia is included in the study for comparison purposes, but is not included in the rankings.

[2] Cline, Robert, et. al. *Total State and Local Business Taxes.* Council on State Taxation, April 12, 2005. Available at http://www.ocpp.org/2005/COST2005Taxes.pdf.

[3] MacDonald, Douglas Aird. *Western States' Tax Burdens, Fiscal Year 2002-2003, Revised.* Utah State Tax Commission, research publication 2003-31, February 3, 2004. Available at http://www.tax.utah.gov/esu/burdens/WTB_2003.pdf

[4] Robert Lynch. *Rethinking Growth Strategies: How State and Local Taxes and Services Affect Economic Development.* 2004. Economic Policy Institute, p. 4 - 6.

[5] Ibid, p. vii.