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Predictably Wrong

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

The Tax Foundation's 2008 State Business Tax Climate Index claims that Oregon's economic future is bright because its business taxes are low compared to the rest of the nation. This simplistic conclusion — rehashed every year by the foundation — is fundamentally flawed.

State and local taxes are a small part of business costs and therefore play a minor role in investment decisions. A good business climate depends much more on the strength of public structures. To the extent that low corporate income taxes weaken public structures, they may hinder economic growth.

The Tax Foundation's myopic analysis

The Tax Foundation's 2008 Index compares the tax structures of the 50 states as of July 1, 2007.[1] The Index defines "business taxes" as a weighted combination of corporate taxes, sales taxes, unemployment insurance taxes, 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 2008 "business tax climate" ranks 10th best in the nation, the same as in the group's 2006 and 2007 rankings. Oregon scores well primarily because it does not levy a sales tax. In addition, the fact that Oregon does not tax corporate stock or certain other forms of wealth significantly helps the state's ranking in the eyes of the Tax Foundation.

On the five categories that comprise the overall ranking, Oregon ranked no worse than 35th — for personal income taxes — and as well as fourth best — for sales taxes, including excise taxes. The Tax Foundation gives extra weight to low sales taxes, second in importance only to personal income taxes in assessing business climate.

Oregon rankings on Tax Foundation's 2008 State Business Tax Climate Index

Category	Oregon rank (1=lowest tax)	Weight given to category*
Overall	10	100%
Corporate tax	20	20%
Individual income tax	35	30%
Sales tax, including excise taxes	4	22%
Unemployment Insurance tax	32	13%
Property tax, including other wealth taxes	14	15%

* Figures are rounded

Oregon's business taxes are indeed low

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

A study by the accounting firm Ernst & Young, published by the Council on State Taxation (COST), found that in 2006 the effective state and local tax rate on businesses in Oregon and four other states tied for the second lowest in the nation (after the District of Columbia) as a percentage 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 tied with those of Maryland for second lowest among the states and the District of Columbia as a share of all state and local taxes. Only Connecticut had lower business taxes using the COST 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 structures: The Tax Foundation's major flaw

The Tax Foundation's claim that Oregon's low business taxes engender a good business climate is incorrect. Vastly more important is the strength of public structures. If low corporate income taxes result in weakened public structures, economic growth may suffer.

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 — eight-tenths of 1 percent — of business costs.[4]

When making investment decisions, businesses focus more on factors such as the proximity of markets and suppliers, the quality and cost of labor, utilities, education, transportation and communication infrastructure than on taxes. Quality public investments in these areas improve the business climate and save companies money in the long run.

Moreover, both the reality and the perception of a state's ability to provide important public services impact the business climate. Oregon's business community and the state's economic development officials, for instance, were not pleased to see the state's education system lampooned in the Doonesbury comic strip in 2002.

The Tax Foundation's misguided approach — equating low taxes with a better business tax climate and ignoring public investments — is not supported by research. The existing literature reveals "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]

Conclusion

The Tax Foundation's 2008 State Business Tax Climate Index asserts that Wyoming has the nation's best business tax climate and that South Dakota is second best. The index also claims that New York has the nation's 48th best business tax climate and that California ranks 47th best. Perhaps the foundation thinks that Wall Street is located in Cheyenne and Silicon Valley in Pierre.

The Tax Foundation's myopic focus on taxes in assessing the business climate is clearly misguided. Much more important are quality and quantity of public structures, and those areas are where Oregon should concentrate its efforts when attempting to maintain and improve its business climate.

Endnotes:

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

[2] Cline, Robert, Tom Neubig, and Andrew Phillips, *Total State and Local Business Taxes: 50-State Estimates for Fiscal Year 2006,* Council on State Taxation, February 2007. Available at www.statetax.org/Template.cfm?Section=Studies,_Articles_and_Special_Reports&template=/ContentManagement/ContentDisplay.cfm&ContentID=7978.

[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 tax.utah.gov/esu/.

[4] Lynch, Robert, Rethinking Growth Strategies: How State and Local Taxes and Services Affect Economic Development (Washington, D.C.: Economic Policy Institute, 2004) pp. 4-6.

[5] Ibid., p. vii.

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