OCPP OREGON CENTER for PUBLIC POLICY
Because facts matter.

Issue Brief
January 10, 2007

Drawing the Wrong Conclusion, Again:
Tax Foundation Business Climate Index Again Misrepresents the Significance of Oregon's Low Business Taxes

The Tax Foundation's 2007 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 overly simple conclusion is fundamentally flawed. While the Foundation has modified its methodology in response to criticism, the Tax Foundation is making the same fundamental mistakes it has made in previous research.[1]

The Tax Foundation's 2007 State Business Tax Climate Index compares the tax structures of the 50 states as of July 1, 2006.[2] 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 2007 "business tax climate" ranks 10th best in the nation, the same ranking as in the group's 2006 Index, which was based on state tax systems as of July 1, 2005. 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 in the eyes of the Tax Foundation. On the five categories that comprise the overall ranking, Oregon ranked no worse than 34th — for personal income taxes — and as well as fourth best — for sales taxes, including excise taxes (Table 1). Because the Tax Foundation considers low sales taxes 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 that category.

Table 1: Oregon rankings on Tax Foundation's 2007 State Business Tax Climate Index

Category	Oregon rank (1=lowest tax)	Weight given to category*
Overall	10	100%
Corporate tax	20	19%
Individual income tax	34	29%
Sales tax, including excise taxes	4	22%
Unemployment Insurance tax	29	14%
Property tax, including other wealth taxes	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.

A study by the accounting firm Ernst & Young, published by the Council on State Taxation (COST), found that in 2005 the effective state and local tax rate on businesses in Oregon ranked 48th lowest in the nation (i.e, the fourth best among the states and the District of Columbia) as a percent of private sector economic activity.[3] 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 Connecticut 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.[4]

Ignoring Public Structures: The Tax Foundation's Major Flaw

Although the Tax Foundation's findings that Oregon's business taxes are relatively low are 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 — eight-tenths of one percent — of business costs.[5]

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 structures, the impact of lower taxes may be to hinder economic growth rather than strengthen it.

Moreover, both the reality and the perception of a state's ability to provide important public services does have an impact on business climate. Oregon's business community and its economic development officials were not 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."[6]

The Tax Foundation's 2007 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 47th best business tax climate, and that California ranks 45th best. These claims may cause some headshaking for anyone who has visited Cheyenne, Pierre, Manhattan, and the Silicon Valley. Low taxes are not the only – or even the primary – criteria for assessing the business climate of a particular place.

Endnotes:

[1] In response to criticism such as Fisher, Peter, *Grading Places: What Do the Business Climate Rankings Really Tell U*s, Economic Policy Institute, 2005 (available at http://www.epinet.org/content.cfm/books_grading_places). the Tax Foundation changed its methodology somewhat. For instance, the Tax Foundation added a measure that penalizes states with job tax credits, research and development credits, or investment tax credits, to better account for the actual taxes that businesses pay. The Tax Foundation revised state rankings reported in earlier versions of the report to reflect the methodological changes made in the 2007 report. Oregon's overall rank of 10th in the 2006 report did not change as a result of the methodological revisions. The 2007 report, like the 2006 report, is based on state and local tax systems as of the beginning of the standard state fiscal year, July 1. By contrast, in the first two editions of the report in 2003 and 2004 the Tax Foundation based its assessment on state and local tax systems as of January 1.

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

[3] Cline, Robert, Tom Neubig, and Andrew Phillips. *Total State and Local Business Taxes: Nationally 1980-2005, by State 2002-2005, and by Industry 2005.* Council on State Taxation, March 2006. Available at http://www.ocpp.org/2006/COST2006Taxes.pdf.

[4] 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

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

[6] Ibid, p. vii.

This work is made possible in part by the support of the Ford Foundation, the Governance and Public Policy Program of the Open Society Institute, the Oregon School Employees Association, the Gray Family Fund of the Oregon Community Foundation, the Stoneman Family Fund, and by the generous support of organizations and individuals. The Oregon Center for Public Policy is a part of the State Fiscal Analysis Initiative (SFAI) and the Economic Analysis and Research Network (EARN).