

What's New?

Tax Foundation Releases New Edition

The Tax Foundation released the 2020 State Business Tax Climate Index (SBTCI) October 22nd, 2019. The major features of the SBTCI remain unchanged from earlier editions. The fundamental criticisms of their methodology remain as salient as ever:

1. The State Business Tax Climate Index purports to measure a state's "tax competitiveness" but the index bears very little relationship to what businesses actually pay in taxes in one state versus another. Of the 10 supposedly "worst" states in terms of business taxation, 6 actually ranked among the 21 states with the *lowest* business taxes, including two among the lowest 10. [Read more.](#)
2. Scoring well on the SBTCI does not mean a state will experience more growth; the Tax Foundation provides no evidence that their index actually predicts growth and research has generally found that it does not. [Read more.](#)
3. The index is a combination of 124 components of state tax systems, giving substantial emphasis to some components that cannot plausibly affect tax competitiveness, while ignoring features that have a large impact on business taxes (single-factor apportionment and deduction of federal corporate income taxes). [Read more.](#)

There are a few changes in the 2020 version of the index necessitated by the changes in federal corporate income taxation in the Tax Cuts and Jobs Act (TCJA) of 2017. The Tax Foundation now penalizes states for attempting to rein in corporate tax avoidance in two ways. First, the TF penalizes a state's score on the SBTCI if they conform to the Global Intangible Low Taxed Income (GILTI) provisions of TCJA, which are intended to reduce the incentive to shift corporate assets abroad. State conformity would in fact help states avoid some of the corporate tax avoidance that has been eroding state revenues, due to the ability of corporations to shift profits overseas. But restoring revenues in this way is a bad thing, according to the TF. The second new feature is a penalty for states that conform to the net interest limitation in TCJA. This provision limits the ability of corporations to deduct interest expense, but apparently the TF thinks the deduction should be unlimited.

In the wake of the Wayfair decision allowing states to collect sales tax from remote sellers without a physical presence in the state, the SBTCI now includes a couple of additional measures. Alabama, Alaska, Colorado and Louisiana are penalized because they lack a single administrative point for the collection of state and local sales taxes, and Kansas is penalized for not providing a "safe harbor" for small remote sellers.

As it does every year, the TF has changed the weights applied to the five broad components of the index; sales taxes are a little less important, property taxes a little more important, in the 2020 index compared to the 2019. There were also small changes in the weighting of particular measures within the corporate, sales and property tax components. This means that changes in a state's ranking from 2019 to 2020 could be due to changes in state policy, but could be also due to the addition of measures and changes in weights.

ALEC Releases 12th Edition of Rich States, Poor States

The latest edition of ALEC's *Rich States, Poor States* was released on April 15, 2019. The centerpiece is the Economic Outlook Ranking, which is ALEC's scoring of states on [15 measures](#) reflecting ALEC's preferred policies towards business. The flawed methodology remains unchanged from previous editions. The index purports to predict which state economies will perform the best, but in fact analyses of previous versions have shown there is [no relation between](#) a state's score and how fast the economy grows subsequently.

Since the first edition in 2007, it has remained the case that ALEC's "best" states — the ones with the highest rankings — are actually poorer on several measures than the supposedly "worst" states. In fact, four states noted for their liberal politics who find themselves perennially among the worst 10 states in the ALEC economic outlook rankings — New York, Washington, Oregon, and California — actually were among the top 10 states on two key measures that ALEC uses to measure performance in the latest edition: growth in state gross domestic product and growth in non-farm payroll. [Read more..](#)

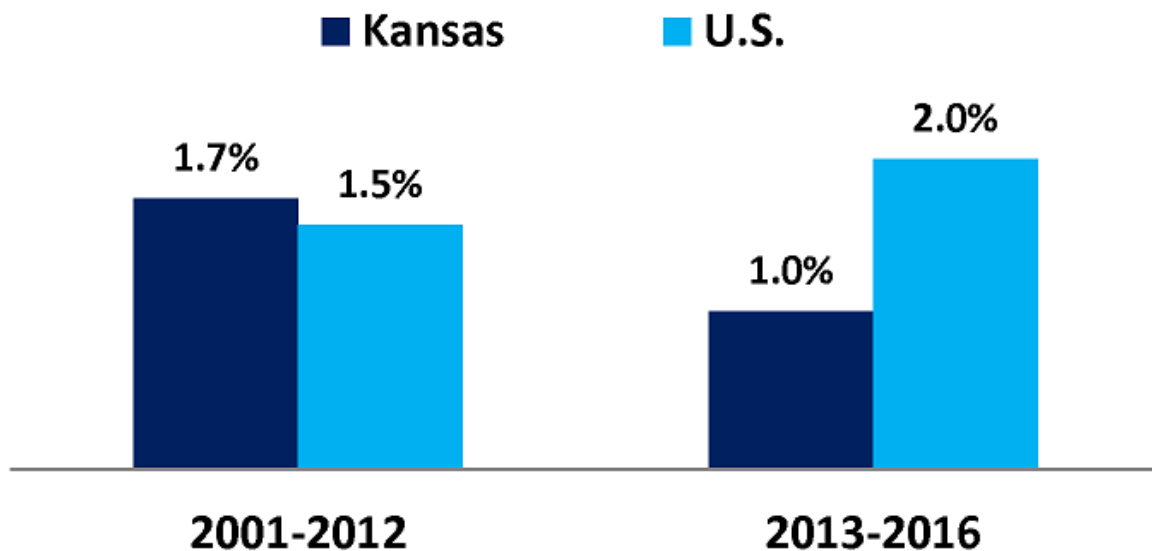
The Failure of the Kansas Experiment

For ALEC and other advocates of income tax cutting, Kansas was to be the poster child. Governor Sam Brownback signed legislation in 2012 slashing income taxes, a move that was supposed to provide an "immediate and lasting boost" to the economy. In June of 2017, this drastic social experiment came to an end. The Kansas legislature overrode the Governor's veto and enacted a bill to roll back most of the tax cuts.

The experiment failed in part because the tax cuts did not produce the promised boost to the state's economy. The state of Kansas had not been a laggard before the cuts. From 2001 through 2012, the state had actually grown faster than the U.S. as a whole. But for the four years since the tax cuts took effect, the Kansas economy has grown at just half the rate of the U.S. economy.

Kansas GDP Growth Lags Behind U.S. after Tax Cuts

Average annual percent change in real GDP



Source: Bureau of Economic Analysis , Real GDP by State (chained 2009 dollars), 2000-2016

For an updated and detailed discussion, see [The Lessons of Kansas](#).

New Evidence on Tax Incentives and State Growth

A remarkable database on state business taxes and incentives over the past 26 years was recently made available by the Upjohn Institute for Employment Research. Timothy Bartik, a leading national expert on business incentives, is the author of a report describing the results of his analysis of the data: *A New Panel Database on Business Incentives for Economic Development Offered by State and Local Governments in the United States*. His analysis drives another nail in the coffin of the claim, often argued but never supported, that incentives will pay for themselves.

The data measures the value of state and local incentives, as well as the cost of state and local taxes, through a representative firm model. For each of 45 industries, a firm representative of that industry is created, and the model determines how much that firm would pay in taxes and gain from incentives if the firm located a new establishment in a particular city. The model includes state corporate income and sales taxes, and local property taxes, in 47 cities in 33 states. The 33 states account for 92 percent of national GDP. Incentives include job and investment tax credits, R&D credits, customized job training, and property tax abatements. It covers tax laws and incentive programs each year in each location from 1990 through 2015.

Among the key findings in the report:

- The total spent on business incentives by state and local governments across the U.S. is estimated at \$45 billion in 2015.
- The average incentive package amounts to about 30 percent of state and local business taxes.
- Incentives more than tripled from 1990 through 2015, though a large part of that growth occurred in the 1990s, with incentive growth slowing since then.
- Incentives persist through good times and bad, and don't seem to be higher in states with weaker economies.
- Incentives generally are not well targeted at the types of businesses that create the most jobs, or the highest paying jobs.
- There is considerable room for reform of incentives that would reduce costs substantially.

The database is particularly valuable for research purposes, because the effects of incentives on growth can be measured both as differences across places at a point in time, and as differences within a state or city over a long time period. Do cities with higher incentives or lower taxes, compared to other cities, and compared to their own history, experience more growth?

The model allowed Bartik to analyze separately the effects of a state's gross taxes (before incentives), the effects of the incentive package, and the effect of net taxes (gross taxes less incentives) for a particular industry, on state economic growth. He analyzed both the state average rates, and the rates specific to each export industry. His statistical analysis found that these tax and incentive variables always were statistically insignificant. In other words, the strength of the relationship between the tax variables and growth was so weak that he could not rule out that it was caused by chance. Moreover, the maximum effect of taxes in reducing growth, or incentives in increasing growth, was toward the lower end of the range of possible effectiveness that had emerged as a consensus through previous research.

It should be noted that most of the previous research did not have the quality of data that is contained in this database: effective tax rates on new investment for particular industries over a substantial time period, covering most export sectors (the ones most "footloose"). It is such effective tax rates, not the average taxes on established businesses that have been used in most studies, that should affect business location and investment decisions, and hence state growth.

No doubt additional research, taking into account additional factors such as variability across states in the level of public services or wage rates, will be conducted by Bartik and other researchers using this public database. But Bartik's preliminary analysis confirms our conclusion: state and local business taxes are too small a share of business costs to

affect most location and investment decisions. The vast majority of jobs created in firms that receive incentives would have been created at that location anyway, because of other considerations more important to the firm's decision. If only one firm out of every 20 granted incentives was actually influenced by the incentive, as appears likely given Bartik's statistical analysis and the average incentive package, then incentive strategies are very costly indeed.

New Evidence that High Taxes Don't Drive out Millionaires

A new report sheds light on the debate about whether high state taxes cause millionaires to flee to low-tax states.¹ The conclusion: With the possible exception of Florida, taxes seem to have no effect on the migration decisions of the rich. In the words of the authors: "[O]utside of Florida, differences in tax rates between states have no effect on elite migration. Other low-tax states, such as Texas, Tennessee, and New Hampshire, do not draw away millionaires from high-tax states." As for Florida, "It is difficult to know whether the Florida effect is driven by tax avoidance, unique geography, or some especially appealing combination of the two." The authors conclude that taxes on the rich could be raised substantially and the result would be a substantial increase in revenue, not a loss. The Urban Institute's Howard Gleckman has provided a [summary of the research](#).

¹ "Millionaire Migration and Taxation of the Elite." Young, Cristobal; Varner, Charles; Lurie, Ithai Z.; Prisinzano, Richard. *American Sociological Review*. June 2016, Vol. 81 Issue 3, pp. 421-446.

ALEC Lauds Tax Cutting States

Once again ALEC is pushing their discredited notion that tax cuts are a potent tool to promote state economic growth. While the preponderance of serious research indicates that cuts to a state's [income tax](#) or its [business taxes](#) have little positive effect on a state's economy, and may well prove harmful to the long term [prospects for growth](#) and for increased prosperity, ALEC continues to push their anti-tax anti-government agenda. The latest effort is their *State Tax Cut Roundup* for the 2015 legislative session.

ALEC lays out in this report their principles of good tax policy, based for the most part on standard economic principles of taxation (transparency, simplicity, neutrality, fairness, reliability, and revenue adequacy), plus the need for balance between state and local governments, and their favorite: pro-growth policies, or economic competitiveness. As in other ALEC reports on tax policy, however, the discussion here is exclusively on their notion of pro-growth tax policy – tax cuts of pretty much any variety. It is, after all, the *Tax Cut Roundup*, but there are no corresponding ALEC reports called the "State Tax Fairness Roundup" or the "State Tax Revenue Adequacy Roundup."

The recent experience of Kansas should be caution enough against tax cutting as economic policy. For advocates of income tax cutting, Kansas was to be the poster child.

Governor Sam Brownback signed legislation in 2012 slashing income taxes and cutting the state budget by over 13 percent. The tax cuts had been pushed by Stephen Moore and by Arthur Laffer, author of ALEC's *Rich States, Poor States*, who argued they would provide an "immediate and lasting boost" to the economy. But instead of boosting the economy, Kansas GDP actually declined by 1.1 percent in 2013, the first year of the tax cuts, while nationally GDP grew at 1.3 percent. In 2014, Kansas growth once again lagged the nation, 1.4 percent versus 2.2 percent. Estimates for 2015 show the trend continuing, with state GDP growth expected to be just half of the national rate. [Read more.](#)

That **the underlying ALEC agenda is to shift taxes from upper to lower income groups** becomes clear when one contrasts their statement of tax fairness in the *State Tax Cut Roundup* with the tax policies they actually favor. The principle stated by ALEC is: "The government should not use the tax system to pick winners and losers in society, or unfairly shift the tax burden onto one class of citizens. The tax system should not be used to punish success or to "soak the rich," engage in discriminatory or multiple taxation, nor should it be used to bestow special favors on any particular group of taxpayers."

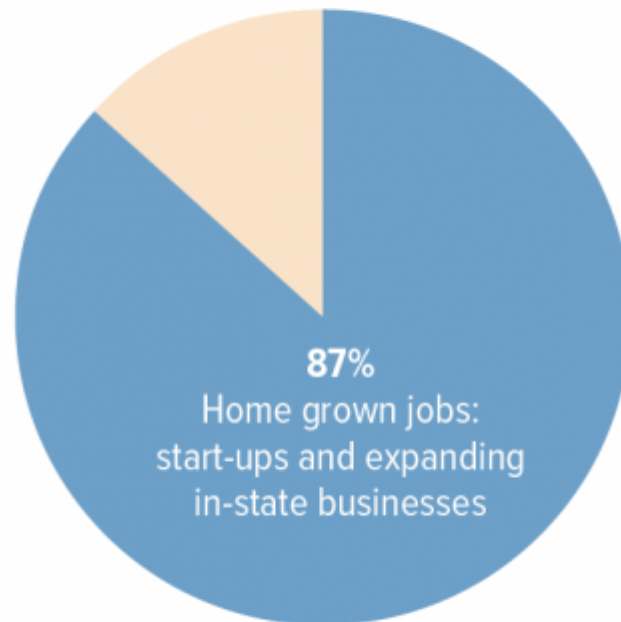
So how do ALEC's policy prescriptions stack up against the concept of fairness? A state tax system that did not alter the distribution of income, as they supposedly favor, would be a proportional system: it would take the same percentage of income from every income group. However, most state tax systems are regressive: they take a larger percentage of income from lower income groups, because they are dominated by sales, excise and property taxes, and an income tax generally of only modest progressivity. Yet ALEC invariably applauds income tax cuts, which would make a state's system more regressive, moving the state further from the goal of neutrality with respect to income distribution. Apparently shifting taxes from upper to lower income groups is the fair thing to do according to ALEC.

State Policies Should Focus on Homegrown Jobs

A new report by Michael Mazerov and Michael Leachman finds that the vast majority of new jobs in a state are homegrown: They are created by start-ups and by firms already in the state who are expanding. Only 13 percent of new jobs come from new branch plants of out-of-state companies, or actual plant relocations to a state. They argue that public policies need rethinking as a result:

Vast Majority of New Jobs Come From Businesses Already in a State

Shares of gross private sector job gains for the median state, 1995-2013



Note: Remaining 13 percent of jobs are created through branching into the state by firms not headquartered in the state and those that relocated into the state from another state.

Source: National Establishment Time Series (NETS) database (Walls & Associates) provided under contract by the Business Dynamics Research Consortium: a project of the University of Wisconsin-Extension Division for Business and Entrepreneurship.

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“State economic development policies that ignore these fundamental realities about job creation are bound to fail. A good example is the deep income tax cuts many states have enacted or are proposing. Such tax cuts are largely irrelevant to owners of young, fast-growing firms because they generally have little taxable income. And, tax cuts take money away from schools, universities, and other public investments essential to producing the talented workforce that entrepreneurs require. Many policymakers also continue to focus their efforts heavily on tax breaks aimed at luring companies from other states — even though startups and young, fast-growing firms already in the state are much more important sources of job creation.”

Michael Mazerov and Michael Leachman. *State Job Creation Strategies Often Off Base*. Center on Budget and Policy Priorities, February 3, 2016.

http://www.cbpp.org/research/state-budget-and-tax/state-job-creation-strategies-often-off-base#_ftn

