

2009 State Business Tax Climate Index An Executive Summary

By
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Introduction

The Tax Foundation presents the 2009 version of the State Business Tax Climate Index (SBTCI) as a tool for lawmakers, the media, and individuals alike to gauge how their states tax systems compare. Policymakers can then use the SBTCI to pinpoint changes to their tax systems that will explicitly improve their states' standing in relation to competing states.

How much states collect in taxes is critical, but how they take it is also important. In other words, quite apart from whether a state's total tax burden is higher than in other states, it can enact (and many states do) a set of tax laws that cause great damage to the economy.

The modern market is characterized by mobile capital and labor. Therefore, companies will locate where they have the greatest competitive advantage. States with the best tax systems will have an advantage in attracting new businesses and generating economic and employment growth.

Although the market is now global, the Department of Labor reports that most mass job relocations are from one U.S. state to another rather than to an overseas location.¹ This means that state lawmakers must be aware of how their states' business climates stack up to others in their region and nationwide.

State lawmakers are always tempted to lure business with lucrative tax incentives and

subsidies. This can be a dangerous proposition, as a case in Florida illustrates. In July of 2004 Florida lawmakers cried foul because a major credit card company announced it would close its Tampa call center, lay off 1,110 workers, and outsource those jobs to another company. The reason for the lawmakers' ire was that the company had been lured to Florida with a generous tax incentive package and had enjoyed nearly \$3 million worth of tax breaks during the previous nine years.²

Lawmakers create these deals under the banner of job creation and economic development, but the truth is that if a state needs to offer such packages, it is most likely covering for a woeful business climate plagued by bad tax policy. A far more effective approach is to systematically improve the business tax climate for the long term. When assessing which changes to make, lawmakers need to remember these two rules:

1. Taxes matter to business. Taxes affect business decisions, job creation and retention, plant location, competitiveness, and the long-term health of a state's economy. Most importantly, taxes diminish profits. If taxes take a larger portion of profits, that cost is passed along to either consumers (through higher prices), workers (through lower wages or fewer jobs), or shareholders (through lower dividends or share value). Thus a state with

1 U.S. Department of Labor, "Extended Mass Layoffs in the First Quarter of 2007," August 9, 2007, located at <http://www.bls.gov/news.release/mslo.nr0.htm>.

2 Dave Wasson, "Florida Lawmakers Slam Capital One's Layoff After Years of Tax Breaks," *Tax Analysts*, July 27, 2004.

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lower tax costs will be more attractive to business investment, and more likely to experience economic growth.

- States do not enact tax changes (increases or cuts) in a vacuum. Every tax law will in some way change a state's competitive position relative to its immediate neighbors, its geographic region, and even globally. Ultimately it will affect the state's national standing as a place to live and to do business. Entrepreneurial states can take advantage of the tax increases of their neighbors to lure businesses out of high-tax states.

Clearly, there are many non-tax factors that affect a state's business climate: its proximity to raw materials or transportation centers, its regulatory or legal structures, the quality of its education system and the skill of its workforce, not to mention the intangible perception of a

state's "quality of life."³ Some of these factors are, of course, outside of the control of elected officials. Montana lawmakers cannot change the fact that Montana's businesses have no immediate access to deepwater ports. Lawmakers do, however, have direct control over how friendly their tax systems are to business.

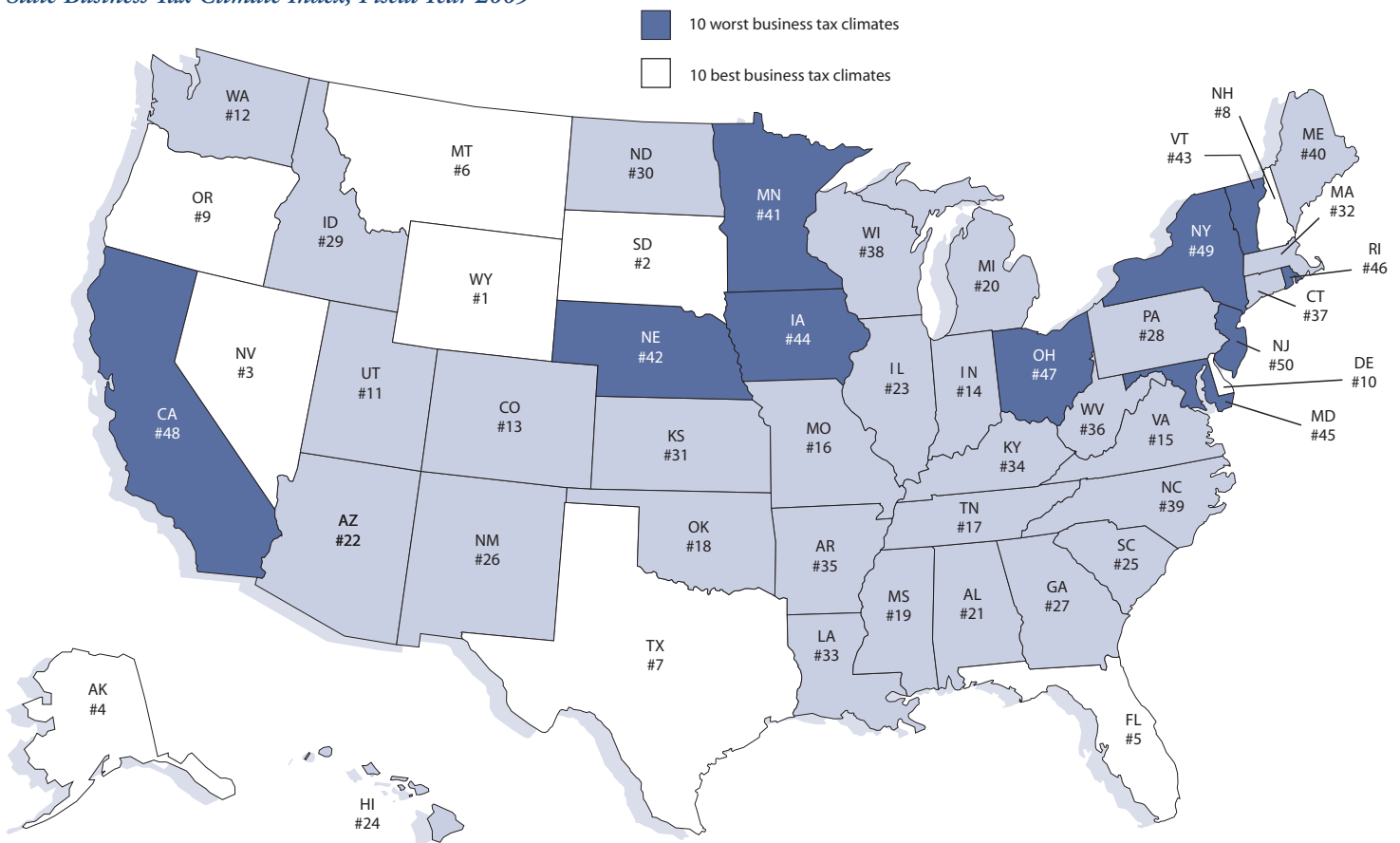
Purpose

The SBTCI is designed to measure the competitiveness of each state's tax system so lawmakers, the media and the public alike can gauge how their state compares to other states. They can also use the SBTCI to pinpoint specific changes that will increase the competitive standing of their state.

Good state tax systems levy low, flat rates on the broadest bases possible, and they treat all

Figure 1

State Business Tax Climate Index, Fiscal Year 2009



Note: The scores for Hawaii, Illinois and Arizona have been corrected since originally published on October 6, 2008.

3 A trend in tax literature throughout the last two decades has been the increasing use of indexes to measure a state's general business climate. Recent examples include the Small Business & Entrepreneurship Council's "Small Business Survival Index 2007" and the Beacon Hill Institute's "State Competitiveness Report 2007." Such indexes even exist on the international level, including the Heritage Foundation's "2008 Index of Economic Freedom." Bittingmayer, Eathington, Hall and Orazem (2005) find in their analysis of several business climate studies that a U.S. state's tax climate does affect its economic growth rate, and that several indexes are able to predict growth. In fact, they found, "The State Business Tax Climate Index explains growth consistently."

taxpayers the same. Variation in the tax treatment of different industries favors one economic activity or decision over another. The more riddled a tax system is with these politically motivated preferences the less likely it is that business decisions will be made in response to market forces. The SBTCI rewards those states that apply these principles in five important areas of taxation: individual income taxes, major business taxes, sales taxes, unemployment insurance taxes, and taxes on wealth or assets such as property.

How the State Business Tax Climate Index is Calculated

The SBTCI places 112 variables into five component indexes that each measure a different sector of a state's business tax climate. The five component indexes are the Corporate Tax Index, Individual Income Tax Index, Sales Tax Index, Unemployment Tax Index and Property Tax Index. The total score for each state is calculated based on the scores on each of the five component indexes.

Using the economic literature as our guide, we designed these five component indexes to score each state's business tax climate on a scale of zero (worst) to 10 (best). Each component index is devoted to a major area of state taxation and each has two equally weighted sub-indexes, some of which include several categories and variables under them. The ranking of the states on each of the five major component indexes is presented in Table 2 on page 4.

Results of the 2009 State Business Tax Climate Index

The ten best states in the Tax Foundation's 2009 State Business Tax Climate Index are as follows:

- | | |
|-----------------|------------------|
| 1. Wyoming | 6. Montana |
| 2. South Dakota | 7. Texas |
| 3. Nevada | 8. New Hampshire |
| 4. Alaska | 9. Oregon |
| 5. Florida | 10. Delaware |

The ten worst states are:

- | | |
|---------------|------------------|
| 41. Minnesota | 46. Rhode Island |
| 42. Nebraska | 47. Ohio |
| 43. Vermont | 48. California |
| 44. Iowa | 49. New York |
| 45. Maryland | 50. New Jersey |

Table 1
State Business Tax Climate Index, 2008–2009

State	FY 2009 State Business Tax Climate Index		FY 2008 State Business Tax Climate Index		Change from 2008 to 2009	
	Score	Rank	Score	Rank	Score	Rank
U.S.	5.00	–	5.00	–	5.00	–
Alabama	5.33	21	5.38	20	–0.05	–1
Alaska	7.33	4	7.28	4	0.05	0
Arizona	5.27	22	5.30	21	–0.03	–1
Arkansas	4.90	35	4.90	37	0.00	2
California	4.15	48	3.99	48	0.16	0
Colorado	5.93	13	5.94	12	–0.01	–1
Connecticut	4.84	37	4.95	36	–0.11	–1
Delaware	6.02	10	6.05	10	–0.03	0
Florida	6.93	5	6.93	5	0.00	0
Georgia	5.19	27	5.21	26	–0.02	–1
Hawaii	5.24	24	5.26	22	–0.02	–2
Idaho	5.12	29	5.19	29	–0.07	0
Illinois	5.27	23	5.23	23	0.04	0
Indiana	5.91	14	5.99	11	–0.08	–3
Iowa	4.37	44	4.42	45	–0.05	1
Kansas	5.10	31	5.03	33	0.07	2
Kentucky	4.98	34	4.97	34	0.01	0
Louisiana	5.01	33	4.95	35	0.06	2
Maine	4.71	40	4.68	40	0.03	0
Maryland	4.33	45	5.23	24	–0.90	–21
Massachusetts	5.03	32	5.05	31	–0.02	–1
Michigan	5.34	20	5.22	25	0.12	5
Minnesota	4.64	41	4.68	41	–0.04	0
Mississippi	5.34	19	5.39	19	–0.04	0
Missouri	5.60	16	5.61	15	–0.01	–1
Montana	6.29	6	6.32	6	–0.03	0
Nebraska	4.58	42	4.53	43	0.06	1
Nevada	7.38	3	7.38	3	–0.01	0
New Hampshire	6.17	8	6.27	7	–0.10	–1
New Jersey	3.92	50	3.84	50	0.09	0
New Mexico	5.19	26	5.19	28	0.00	2
New York	4.02	49	4.06	47	–0.03	–2
North Carolina	4.76	39	4.64	42	0.12	3
North Dakota	5.10	30	5.03	32	0.07	2
Ohio	4.16	47	4.11	46	0.05	–1
Oklahoma	5.44	18	5.41	18	0.02	0
Oregon	6.06	9	6.06	9	0.01	0
Pennsylvania	5.17	28	5.18	30	–0.01	2
Rhode Island	4.20	46	3.98	49	0.23	3
South Carolina	5.24	25	5.20	27	0.04	2
South Dakota	7.51	2	7.51	2	0.00	0
Tennessee	5.47	17	5.49	17	–0.02	0
Texas	6.28	7	6.21	8	0.08	1
Utah	5.98	11	5.53	16	0.45	5
Vermont	4.55	43	4.44	44	0.10	1
Virginia	5.73	15	5.78	14	–0.05	–1
Washington	5.94	12	5.91	13	0.03	1
West Virginia	4.88	36	4.84	38	0.04	2
Wisconsin	4.79	38	4.76	39	0.03	1
Wyoming	7.53	1	7.64	1	–0.11	0
D.C.	4.55	–	4.49	–	0.06	–

Note: The scores for Hawaii, Illinois and Arizona have been corrected since originally published on October 6, 2008.

Source: Tax Foundation

Tax competition is an unpleasant reality for state revenue and budget officials, but it is probably the most effective restraint on state and local taxes. When a state imposes higher taxes than a neighboring state, business will cross the border to some extent. Therefore states with more competitive tax systems score well in the SBTCI because they are best suited to generate economic growth.

Starting with the 2006 edition, the SBTCI has measured each state's business tax climate as it

stands at the beginning of the standard state fiscal year, July 1. Therefore, this edition is the 2009 SBTCI and represents the tax climate in each state as of July 1, 2008, the first day of fiscal year 2009 for most states. Please view the full study on our website at www.taxfoundation.org/files/bp58.pdf, or, alternatively, call or write us for a free copy.

Table 2
Major Components of the State Business Tax Climate Index, FY 2009

State	Overall Rank	Corporate Tax Index Rank	Individual Income Tax Index Rank	Sales Tax Index Rank	Unemployment Insurance Tax Index Rank	Property Tax Index Rank
Alabama	21	21	17	33	14	13
Alaska	4	27	1	4	47	27
Arizona	22	24	23	45	2	4
Arkansas	35	34	31	35	23	18
California	48	45	49	43	16	15
Colorado	13	15	14	12	19	6
Connecticut	37	18	25	25	21	49
Delaware	10	49	28	2	7	8
Florida	5	13	1	21	3	19
Georgia	27	8	30	16	20	36
Hawaii	24	11	38	29	11	9
Idaho	29	17	32	32	45	3
Illinois	23	28	10	39	43	41
Indiana	14	23	11	19	13	7
Iowa	44	46	46	26	35	33
Kansas	31	37	21	17	8	32
Kentucky	34	38	36	7	48	20
Louisiana	33	19	24	46	10	22
Maine	40	43	40	8	40	40
Maryland	45	14	50	10	31	34
Massachusetts	32	47	16	9	49	44
Michigan	20	48	15	11	46	25
Minnesota	41	44	39	40	38	17
Mississippi	19	10	18	34	5	29
Missouri	16	5	27	22	4	11
Montana	6	16	22	3	18	10
Nebraska	42	32	33	42	12	48
Nevada	3	1	1	44	42	16
New Hampshire	8	50	9	1	39	39
New Jersey	50	39	48	41	24	50
New Mexico	26	35	19	47	17	1
New York	49	22	43	49	44	45
North Carolina	39	26	37	38	6	37
North Dakota	30	30	35	27	34	5
Ohio	47	33	47	36	15	46
Oklahoma	18	7	26	31	1	23
Oregon	9	20	34	5	30	14
Pennsylvania	28	41	12	24	26	47
Rhode Island	46	40	42	30	50	43
South Carolina	25	9	29	13	41	26
South Dakota	2	1	1	37	37	12
Tennessee	17	12	8	48	32	38
Texas	7	42	7	28	9	30
Utah	11	6	13	23	27	2
Vermont	43	31	45	15	22	42
Virginia	15	4	20	6	29	28
Washington	12	36	1	50	36	21
West Virginia	36	25	41	20	33	24
Wisconsin	38	29	44	18	25	31
Wyoming	1	1	1	14	28	35

Note: Rankings do not average across to total. States without a given tax rank equally as number 1. The rankings for a handful of states have been corrected since originally published on October 6, 2008.

Source: Tax Foundation



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