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Think tanks rate states' tax and spend records

David M. Kall | Thursday, October 13, 2016

Both the Tax Foundation and the Cato Institute have recently released reports grading the states on their tax policies. What is interesting about these two sets of rankings is how different they are; though the underlying metric for both is low taxes, the groups take into account markedly different data, and reach dissimilar conclusions.

The Tax Foundation's 2017 State Business Tax Climate Index is designed to show how well states structure their tax systems, and provides a roadmap for improvement. Indeed, the absence of a major tax is a common factor among many of the top 10 states, but also important are structural complexity, and the neutrality and comparative rate of a tax. It is therefore feasible for a state to be highly ranked while still levying all the major taxes, as Indiana and Utah, ranked at numbers eight and 10, respectively, are. The five major taxes are the corporate tax; individual income tax; sales tax; unemployment insurance tax; and property tax.

On the other hand, the Cato's Fiscal Policy Report Card on America's Governors 2016 considers, simply quantitatively, how much states cut their taxes and spending. Thus, governors who have been the most aggressive at reducing taxes and spending rank the highest, and those that have increased taxes and spending the most received the lowest grades. The Report Card excludes the governors of Kentucky and Louisiana because of their short time in office, and it excludes Alaska's governor because of peculiarities in that state's budget.

The top line rankings of the 10 best and 10 worst states in each study underscore just how unique they are:

10 BEST STATES	**TAX FOUNDATION**	**CATO**
1	Wyoming	Main
2	South Dakota	North Carolina
3	Alaska	Florida
4	Florida	Arizona
5	Nevada	Indiana
6	Montana	Oklahoma
7	New Hampshire	Indiana
8	Indiana	Ohio
9	Utah	Illinois
10	Oregon	New Mexico

10 WORST STATES	TAX FOUNDATION	CATO
41	Louisiana	Alabama
42	Maryland	Vermont
43	Connecticut	California
44	Rhode Island	Hawaii
45	Ohio	Connecticut
46	Minnesota	South Dakota
47	Vermont	Nevada
48	California	Oregon
49	New York	Washington
50	New Jersey	Pennsylvania

A look at each provides a glimpse into these two very different systems of evaluating state tax arrangements.

Tax Foundation

Among the states that had notable changes are New York (though its rank remains the same at number 49); North Carolina (also unchanged in rank at number 11); Pennsylvania (from number 28 to 24); and Texas (from number 13 to 14). Although the small or non-existent changes in rank suggest that nothing is worthy of note, the Tax Foundation explains why these states are prominently ranked.

New York, for instance, is still phasing in a major corporate tax reform package that lawmakers passed two years ago; this year the rate will drop from 7.1 to 6.5. This improved the Empire State's position on the corporate income tax component from number 11 to 7. In addition, the property tax component is likely to improve due to the reduction of the capital stock tax rate from 0.15 to 0.125 percent.

North Carolina, one of the states that imposes all of the major taxes but has a high rank, recently had the most dramatic improvement in one year, when it went from number 41 to 11 between 2014 and 2015. It continues to improve its overall tax structure, and now has the lowest-rate corporate income tax in the country at 4 percent. North Carolina also scheduled for 2017 is an individual income tax reduction, from 5.75 to 5.499 percent.

Pennsylvania's capital stock tax was fully phased out in 2016, which improved its ranking by six slots on the property tax component, from 38th to 32nd. When combined with improvements its previously worst-in-the-nation unemployment insurance tax structure, Pennsylvania took four steps up, improving its overall rank from number 28 to 24.

In Texas, the gross receipts tax, also known as the Margin Tax, fell from 0.95 to 0.75 percent in 2016, but the reason for its small drop, from number 13 to 14, was its decline on the property tax score.

Cato

As noted above, Cato takes a simpler approach when ranking the states. The grading mechanism is based on seven variables, including two spending variables, one revenue variable, and four tax-rate variables.

Even so, Cato recognizes that governors face significant challenges, including rising Medicaid costs, the likelihood that federal aid for Medicaid will be reduced in the future, and high levels of unfunded liabilities in pension and retiree health plans. All of this creates pressure for states to raise taxes, while global competition pushes lawmakers to lower taxes.

The performance of Governors Pat McCrory of North Carolina, Rick Scott of Florida, John Kasich of Ohio, Bruce Rauner of Illinois, and Greg Abbott of Texas, put them at number two, three, eight, nine, and 13, respectively, because they supported the most spending restraint and tax cuts.

For instance, Pat McCrory promised, and then delivered, major tax reforms, signing legislation that has reduced the individual income tax rates from 6.0, 7.0, and 7.75 percent to a single rate of 5.8 percent, which dropped again to 5.75 percent. Gov. McCrory also increased standard deductions, repealed the estate tax, and cut the corporate tax rate from 6.9 to 4.0 percent, which is scheduled to drop again, to 3 percent, next year. And finally, the general fund budget will be just 8 percent higher in 2017 than it was when the governor took office in 2013.

In the Sunshine State, as we noted last week, Gov. Rick Scott remains intensely focused on implementing more tax cuts to benefit corporations that are designed to bring more jobs to the Sunshine State. Cato approves of this strategy, praising the Governor's 2012 increase of the corporate income tax exemption; 2014 $400 million cut to vehicle fees; 2015 reductions in the communications, sales and business taxes; and 2016 elimination of the sales tax on manufacturing equipment. Gov. Scott also scored well on spending, having trimmed state government employment by 4 percent.

As for Ohio, Cato applauds Gov. Kasich as being one of the best tax-cutting governors of recent years. In 2013, he approved of a plan to reduce individual income taxes by 10 percent, and accelerated that plan in 2014. In 2015, he signed more income tax reductions into law, and expanded the small business exemption. In 2016, he promised additional tax reforms in the future. However, substantial spending and state government employment increases hurt his overall score.

It is no secret that Illinois is under severe financial stress. In August, we addressed its pension problem, and in July we wrote about the bridge plan to keep the lights on. Nevertheless, Cato's praise for Gov. Rauner stems from the facts that he is better than his predecessor, supports tax reform and vowed not to increase taxes without it.

Texas, ranked number 13, is another favorite of Cato because Gov. Abbott opposed the franchise tax, also known as the Texas Margin Tax, and signed a permanent 25 percent tax cut into law that is expected to save businesses $1.3 billion. He also opposed legislation that would have harmed doctors and other professionals by subjecting them to annual licensing fees, saving them $125 million a year.

Conclusions

Ultimately, the Tax Foundation holds the position that states with the best tax systems will be the most competitive at attracting new businesses and most effective at generating economic and employment growth. Other factors, like access to raw materials, infrastructure, and a skilled labor pool, also attract businesses, but a simple, sensible tax system can positively impact business operations.

Cato concedes that its Report Card takes into account only short term tax and spending actions, and that it does not contemplate longer-term or structural changes including reforms to state pension plans. Thus, its results provide but one measure of how fiscally conservative each governor is, without reflecting all the fiscal actions that governors make.

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