TAX FOUNDATION’S

State Business Tax Climate Index

Compete to Win: Using Rankings to Drive Reform
INTRODUCTION

The Tax Foundation is a nonprofit think tank in Washington, D.C. It was founded in 1937 in response to fundamental changes in U.S. tax laws including an expansion of the federal income tax and the introduction of state-level income taxes. From its website, the Tax Foundation describes itself as “devoted to educating taxpayers, the media, and policymakers. Our federal research and outreach highlight our tax code’s strengths and weaknesses and show how tax policy impacts taxpayers, the government, and the economy at large. At the state level, we use our research to foster competition between the states and advise policymakers on how to improve their tax systems.”

The organization today has a staff of 23 full-time and 10 part-time employees and an annual budget of about $3 million. It is led by Scott Hodge, the foundation’s president, with an executive team that includes a vice president of operations, a vice president of development, a director of federal projects, a director of state projects and an accountant who is also responsible for human resources.

According to the Tax Foundation website, Hodge helped found the Heartland Institute in 1984 and has since served in several tax and budget roles including director of tax and budget policy at Citizens for a Sound Economy which later split to become FreedomWorks and Americans for Prosperity Foundation), and ten years as a budget and tax policy fellow at Heritage Foundation. He has a degree in political science from the University of Illinois at Chicago.

Joe Henchman is vice president of operations and he also carries the title vice president of legal and state projects. He joined Tax Foundation in 2005. He has a law degree from George Washington University.

Since 2005, the Tax Foundation has produced an annual State Business Tax Climate Index, a ranking of the competitiveness of the 50 states’ tax systems, using 118 variables related to every major tax affecting investment. The report has evolved over time and is now a much-anticipated reference for governors, state legislators and the media. It has proved influential in shaping reforms at the state level, triggering invitations for Tax Foundation staff to provide in-depth assistance towards crafting and achieving reform.
The State Business Tax Climate Index was created in response to a problem. For decades, the Tax Foundation had been computing how much taxpayers in each state pay in taxes. Those figures, combined with federal and local obligations, formed the basis of identifying Tax Freedom Day, the date on the calendar that represents symbolically the proportional end to working “for” the government each year. It is a popular and effective rhetorical tool for communicating the size of the tax burden. In response to its efforts to raise awareness about Tax Freedom Day, the foundation heard from policymakers asking for guidance on how to do a better job. For all of Tax Freedom Day’s virtues as a think tank product, it didn’t provide specific guidance for policymakers. “We would just say ‘Raise less money,’” said Henchman. “It wasn’t that helpful of a response. We needed a better way to express our principles and to motivate policy makers to move in the right direction.”

That’s when Hodge conceived of the State Business Tax Climate Index. The index doesn’t just show how much money states are collecting in taxes, it uses 118 variables to reveal how well-structured states’ tax systems are, how onerous tax regulations are, and provides a roadmap for improvement. It favors states with low tax burdens that are collected fairly. Top ranking states tend to be those that do without one of the more common major taxes such as the corporate income tax, the individual income tax, or the sales tax. Among those with major taxes, some still manage to perform well on the index because they maintain low rates and broad bases.
Henchman explained what makes the index successful: “We don’t make it personal. We sell it as a broad view of the state’s tax system as a whole and how friendly it is to business. The ranking then plays on the inherent competitiveness people feel. You don’t want your state to be worse than the one next door.”

That competitiveness drives state leaders to pay attention to their rankings each year and many reach out to Tax Foundation for advice on how to do well. “It’s the ranking that gets us in the public mind. That pressures politicians to do something about it,” Henchman added. Top performers want to find out how to stay at the top or even how to improve a little more. Poor performers want to know how they can get out of the bottom. It can be a source of great embarrassment. Some react by dismissing the index or by attacking Tax Foundation. Even then, positive outcomes are still possible.

For example, in 2013, Gov. Andrew Cuomo of New York learned his state was dead last, 50 out of 50. Cuomo had earlier referenced the index during his campaign for governor promising to improve New York’s ranking. When the new rankings were released, Cuomo’s chief of staff spoke negatively about the index and the Tax Foundation on the radio attempting to dismiss the index as biased and inconsequential, but both the New York Times and the New York Post reacted by defending Tax Foundation’s
credibility. Gov. Cuomo then invited the Tax Foundation to team to Albany, New York’s capital city.

Henchman said he was prepared for a tense meeting. After discussing New York’s policy landscape, Henchman said he told the governor the best way to improve on the index is to improve New York’s tax system. Gov. Cuomo reportedly then said, “Try me. What are some of your ideas?”

This conversation led to a reform package that passed the legislature and was signed into law by the governor. The new measure, once fully phased in, broadens the tax bases, increases the estate tax threshold, reduces the corporate tax rate from 7.1 percent to 6.5 percent, and reduces the complexity of New York’s flawed corporate tax code by eliminating the duplicative individual minimum tax and business bank tax, among other simplifying improvements. In the latest index, while New York is still 49th in the nation, its corporate tax system subranking moved up nine places.

Henchman said incrementalism is important. “It’s not a repeal of the income tax, but it’s a real improvement that affects people today.”

The middle of the pack states can be motivated to improve, too. In Indiana, Governor Mike Pence’s team worked closely with Tax Foundation staff in 2014 to craft a successful bill that reduced the state’s corporate tax rate. In addition to this, the foundation team has helped to repeal Indiana’s estate tax and cut its already second-lowest-in-the-nation individual income tax, moving Indiana up to a top ten ranking.

The index can be a major reference point for election campaigns as well. For example, in North Carolina, the state’s need to improve its 44th place ranking was a widely shared talking point in 2012. The foundation issued a special state report laying out options for change and worked alongside state allies to promote the recommendations. The subsequent reform package included, among other favorable measures, a drop

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in the corporate tax rate and the repeal of the estate tax.

Henchman said those results did not come quickly. The index, now in its 11th edition, was not always influential. He explained that while there have been minor improvements in methodology and data over the years, the real change has been the cumulative effect of producing the index every year and creating a reliable and anticipated benchmark for success or failure. “The amount of attention we get for it now versus when it started is like night and day,” he said. “People know it’s coming and that it won’t go away.”

The outreach strategy is centered around carefully tailored pitches to key audiences. For example, the outreach team keeps an updated directory of reporters covering state capital issues, as well as reporters that cover tax issues. Those reporters don’t all get the same message when the report is released. Instead, the team monitors what is happening in each state and creates tailored messages. The report is also sent to about 8,000 legislators. This heavy investment in staff time and effort has helped to grow the media presence of the report each year. The foundation does not maintain a large marketing budget and spends little to no money on paid promotion.
KEY INSIGHTS

ON RANKINGS
The ranking aspect of the index appears to compel both allies and non-allies alike to pay attention to the Tax Foundation’s recommendations. Not only do low performers want to avoid negative attention, but the rankings give all state leaders a way to measure their impact on their state.

ON INCREMENTALISM
The Tax Foundation sees its objective as achieving good policy and that is why they tie research analysis to policy outcomes. Not all of their successes are major changes, and sometimes they play an influential role in preventing worse outcomes. Henchman said they don’t celebrate those victories loudly, but they do think they are important. Simplifying or improving the structure of a tax system is important to the foundation’s mission, just as reducing or eliminating bad taxes are.

ON MARKETING
The Index achieves media presence through individualized pitches to carefully researched media contacts. There is little to no paid promotion. Spending a lot of money on marketing can be valuable and highly effective, but it is not the only way to achieve publicity. Honing a meaningful message and putting in the time to deliver it can also yield impressive results. The online version of the Index is read well over 100,000 times with thousands of media stories each year. The Index is discussed and highlighted in the largest newspapers in the U.S. and has been referenced many, many times in governor’s state of the state speeches, annual addresses that serve, in part, to define a state leader’s vision for the future.

One word of caution; Henchman wonders if they ought to have thought harder about the name of the index that first year. “State Business Tax Climate Index is not easy to remember and it doesn’t have a useful acronym,” he said. His advice is to think carefully about what your project name communicates, and how easily it will be remembered and repeated accurately, particularly by reporters or other target audiences.

The foundation tends to employ policy staff for outreach rather than create intermediaries. They want their representatives in the field to be fully conversant in the organization’s policy priorities and recommendations.

ON NONTRADITIONAL ALLIES
Tax Foundation enjoys a fairly positive reputation as a nonpartisan and independent organization. This is due, in part, because is interested in achieving any favorable policy that is in line with
its mission and looks for opportunities to partner with organizations that may not align with all of the foundation’s goals. For example, the foundation is working alongside others on the left to oppose corporate tax incentives, which distort and complicate the tax system.

ON MEASUREMENT

In addition to staking out policy reform goals and tracking progress, the foundation measures its media presence compared to other organizations, controlling for budget size. They also track the nature of the media mentions they receive: are they positive or negative? The state team creates a legislative plan each year for their state-level efforts knowing that the nature of policy battles in the states will have them ending up with different victories and losses than they expected. However, they feel it is important to start with a plan so you know what your priorities are.
DISCUSSION QUESTIONS

- Think about the research and policy reports your organization produces. Are there cost-effective ways to increase the likelihood the content will get people's attention?

- How does your organization weigh the tradeoffs between incremental change and major reform? How do you relate this perspective to how you identify priorities and allocate your time and resources?

- Does your organization work to build relationships with organizations that some might think are your enemies? Why or why not? How do you weigh those tradeoffs? Can you identify five policy objectives where you might share common ground with nontraditional allies? Who are those potential allies and how could you build a relationship?

- What is a new report you would like to create that you think could be produced on an annual basis? What is your plan to increase its influence year after year?

- Programs like Tax Freedom Day can help to raise awareness about the size of government, begging the question: What is to be done? How does your organization approach the relationship between raising public awareness of a problem and advocating specific reform solutions to that problem? Is it important to always do both? Why or why not?