NATIONAL REVIEW

Governors Make Fiscal Progress

Washington is gridlocked, but many states are cutting taxes.

By Chris Edwards & Nicole Kaeding

America's high business taxes are discouraging investment and prompting companies to move their headquarters abroad. Most policymakers say they favor cutting the corporate-tax rate to help fix the problem, but reforms are stuck in Washington gridlock.

Thank goodness for the states. Many governors are championing fiscal reforms, and business tax cuts are one area of progress. We document these reforms in Cato's new "fiscal report card," which assigns grades of "A" to "F" to the governors based on their efforts to restrain government since 2012.

This year we awarded "A" grades to four governors:

Pat McCrory of North Carolina signed a bill replacing individual-income-tax rates of 6.0, 7.0, and 7.75 percent with a single rate of 5.75 percent. He also cut the corporate-tax rate from 6.9 to 5.0 percent and repealed the estate tax.

Sam Brownback of Kansas approved a plan in 2012 replacing three individual-income-tax rates with two and cutting the top rate from 6.45 to 4.9 percent. The reform also increased the standard deduction and reduced taxes on small businesses. Brownback cut income-tax rates further in 2013.

Paul LePage of Maine signed major income-tax cuts in 2011, and he is pushing for further tax reforms. State spending has been roughly flat in recent years, and LePage has trimmed spending on welfare, health care, and other programs.

Mike Pence of Indiana has been frugal on spending and a champion tax cutter. He signed bills to cut individual-income-tax rates 5 percent (the current rate of 3.4 percent will fall to 3.23 percent in 2017) and repeal the inheritance tax. He also approved a corporate-income-tax rate cut and a major reduction in property taxes on businesses.

All of this year's "A" governors were Republicans. Over the years, the data-driven Cato report cards have shown that Republican governors are more fiscally conservative, on average, than

Democrats. This year is no exception, which is illustrated by the fact that all eight governors earning an “F” were Democrats.

Nonetheless, there are some Democratic centrists making reforms, including Andrew Cuomo of New York and Lincoln Chafee of Rhode Island, who both earned a “B.” Cuomo cut corporate-income-tax rates, simplified the corporate tax base, increased the estate-tax exemption, and cut property taxes on manufacturers. Chafee cut the corporate-tax rate by two percentage points, repealed the franchise tax, and reduced the estate tax.

But Republicans were behind nearly all of the major tax cuts of recent years. John Kasich of Ohio and Scott Walker of Wisconsin cut individual-income-tax rates across the board. Jack Dalrymple of North Dakota cut individual and corporate tax rates. Rick Snyder of Michigan and Susana Martinez of New Mexico spearheaded major business tax cuts.

The current focus on business tax cuts is encouraging. According to Ernst & Young, state and local taxes cost businesses $671 billion in 2013, which was more than twice the $274 billion burden of the federal corporate income tax that year. The largest state taxes on businesses are property taxes ($242 billion) and sales taxes on business inputs ($140 billion).

State and local taxes harm America’s competitiveness. One reason why Mexico, for example, is a good place to build a factory is that it has very low property taxes. By contrast, most U.S. states impose property taxes not only on land and buildings, but also on business equipment such as machinery and computers. So kudos to the governors who are making reforms — Pence of Indiana and Snyder of Michigan, for example, approved a repeal of these damaging equipment taxes.

It’s not all good news in the states. Jerry Brown of California and Pat Quinn of Illinois, for example, earned “F” grades for their large tax hikes. But looking across all the states, we are in the midst of the best tax-cutting run since the late 1990s.

As for the federal corporate-income tax, we may have to wait until one of our tax-cutting governors arrives in the White House.

Chris Edwards is the director of tax-policy studies, and Nicole Kaeding is a budget analyst, at the Cato Institute.