Tax and budget

Rebalance the income tax to build a better Ohio for everyone

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Ohioans are taking care of each other, wearing masks, donating money and food, and caring for family and friends in need. But none of us, even doing all we can, are able to build the bridge to recovery. The pandemic and recession have shown the importance of public services, from public health monitoring, testing and tracing to foodbanks and unemployment compensation. It's harder in Ohio than elsewhere because policymakers let important public services erode for years even before Governor DeWine cut $776 million out of the 2020 budget in May.

For the past 15 years state lawmakers cut income tax for the wealthiest people and corporations at the expense of things that benefit everyone, like public education and public health programs. Now the wealthiest 1% of Ohioans pay just over $40,000 a year less in state taxes, on average, than they did in 2005; people in the middle pay about the same, and at the lower end, they pay more. Today Ohio's state and local tax system is upside down: The poorest Ohioans pay almost double the share of their income in state and local taxes as the wealthiest. This happens as the latest Census data on income and poverty show that despite overall economic improvements last year, poverty remained unacceptably high, particularly in households headed by Black and Hispanic women. This is the group that is suffering the most, with higher unemployment and the harshest economic setback, in the pandemic recession.

There are many policy initiatives that can help. One is better tax policy. Better tax policy can also help Ohio pay for long-eroded services. Because of the many years of income tax cuts, Ohio has $7 billion less — every year — for schools, public health, social services, financial aid, local government and other important public services. Today, Ohio's ranking on indicators of quality of life are lower than they should be.

We outline in this paper how state lawmakers' tax cutting strategy was sold as the best way to spur the creation of jobs, but it didn't work: Ohio's rate of job growth continues to lag that of the nation. Research by the Institute on Taxation and Economic Policy (ITEP) demonstrates that over the past decade, employment growth in nine states with no income tax was slightly lower than in the nine states with the highest income tax rates. This simply indicates that having low or no income tax is not a formula for job creation.

In this year of pandemic and recession, long-term disinvestment in public services, from outdated public health information technology to inadequate technology and staffing in the unemployment compensation system, has hindered timely response to immediate, pressing needs. State lawmakers need to restore investment to address immediate needs and rebuild eroded services to boost quality of life and opportunity and to create strong and resilient public services that can better protect Ohioans from the next crisis.

At the posting of this paper, the state Office of Budget and Management has not revised the forecast of a $2.4 billion shortfall in the current fiscal year 2021, which ends next June. If Governor DeWine and Ohio lawmakers resort to more spending cuts to handle the shortfall, they will hurt struggling families and eliminate jobs that stabilize many middle-income households. In a recession, public sector job loss ripples through the community and damages local economies. Tax increases on high-income people who aren't living paycheck to paycheck and who have, as a group, rebounded from the recession, are less economically damaging.

A cut to the state's budget that causes layoffs of teachers, for example, hurts their families and the local economy as they reduce purchases of groceries, gasoline, childcare and other basic necessities. A tax increase on wealthy people has less impact because it falls on savings or investments instead of spending into the local economy. This is why New Jersey just raised income tax rates on its wealthiest residents in the pandemic recession, and a number of other states are considering similar proposals: Illinois, Arizona, New York, California and Rhode Island. Still other states have proposals to strengthen the tax structure in various ways.

In this paper, Policy Matters Ohio outlines our second tax proposal this year, to rebalance the state income tax to make it more fair and to raise revenues to build toward an equitable recovery and a brighter future for all Ohioans. The first proposal recommended closing tax breaks to raise hundreds of millions; this plan is focused on the income tax. It would not raise taxes on 97% of Ohioans, and would provide a tax cut to 13% of lower and middle income households:

- Reduce the business income deduction, often known as the LLC loophole, from $250,000 to $100,000 and eliminate the preferential lower top rate on income over the cap.
- Restore the rate on the top income tax bracket to 7.5%, as it was under Republican Governor George Voinovich.
- Create a new tax bracket with a rate of 8.5% on income over $500,000.
- Add a 10% refundable option to the state Earned Income Tax Credit (EITC) to allow the poorest families to benefit.

This tax proposal will raise $1.94 billion for needed public services and to prevent further budget cuts, which could prolong the recession. Most of the revenue — 87% — is raised from the wealthiest 1% of Ohioans, yet it still leaves them with a sizable tax cut, relative to what they would have paid under the tax laws of 2005.

The tax plan proposed here reduces taxes on low-income Ohioans, who pay up to twice the share of their income in state and local taxes as the wealthiest 1%. Ohio's regressive tax structure is especially damaging to Black and brown Ohioans who — because of a history of discrimination — are more likely than whites to be among the poorest fifth of the population. This tax proposal will help address the racial inequity built into Ohio's tax structure.