A Brief From:

Policy Matters Ohio

REMI report presents just half the Equation

Jon Honeck, Ph.D.
Zach Schiller

May 2005

The Ohio Department of Development in late April released a study showing that some of the elements of the Taft Administration's tax proposal would generate 43,250 new jobs over five years and boost state output by $2.5 billion.[1] "Economic Modeling Report Supports Tax Reform" was how the Development Department headlined the results.[2] However, under closer examination, this claim does not hold up. The study measures the economic effect of Governor Taft's proposed tax cuts, but does not include massive cuts in state spending, or alternative tax increases, that will be required to make up for the revenue shortfall. Such spending cuts or tax increases are a certainty, because of the state's constitutional requirement to balance its budget. Just like the tax changes considered in the study, the tax increases and spending cuts that will be required in the future also will have an impact on jobs and economic output—and could wipe out gains resulting from tax cuts.

Even as the study presents just half the equation, the economic impact it shows is relatively modest, given the existing size of Ohio's economy. Moreover, the study also omits changes in other important taxes that are part of Gov. Taft's plan.

The report was produced by a subsidiary of Regional Economic Models Inc. (REMI) of Amherst, Mass., whose model has been used by researchers for many years. The state of Ohio is paying $154,000 to REMI for its analysis, testimony before legislative committees and additional simulations as the tax proposal is reviewed by the legislature.[3] The REMI analysis covers proposed changes in six types of taxes: the personal income tax, the sales tax, tobacco and alcohol excise taxes, the tangible personal property tax, the corporate franchise tax and a new commercial activity tax.[4]

Altogether, according to the REMI analysis, under the tax plan these six taxes would generate a reduction in tax revenue of $3.06 billion in FY2010, when the plan would be fully implemented. The positive effects of the tax changes would generate economic gains that would allow these taxes to bring in more revenue, REMI calculates, amounting to $216 million that year. This means that the tax changes will not "pay for themselves" over time.[5] The overall result would be a net reduction of more than $2.8 billion in Ohio tax revenue in FY2010.[6]

---

[1] *The Dynamic Economic and Fiscal Impact of the Ohio Administration's Proposed Changes to the Commercial Activity Tax, Corporate Franchise Tax, Personal Income Tax, Tangible Personal Property Tax, and Sales Tax*, Prepared for the Ohio Department of Development and the State of Ohio, REMI Consulting Inc, April 18, 2005.

[2] *Economic Modeling Report Supports Tax Reform*, Ohio Department of Development, April 28, 2005. http://www.odod.state.oh.us/newsroom/releases/1230.asp, accessed May 3, 2005.

[3] State Controlling Board, DEV009-05, approved Feb. 7, 2005. Scope of Work, Personal Service Contract between Regional Economic Models Inc. and Ohio Department of Development.

[4] REMI includes in its analysis the proposed elimination of the furniture and fixtures portion of the tangible personal property tax, which was not in Gov. Taft's plan but was approved by the House of Representatives.

[5] The report does not show the net change in tax revenue beyond FY2010, so we do not know if the shortfall is ever reversed.

[6] Gov. Taft's sales tax proposal would permanently make the state rate 5.5 percent. REMI considers this to be a sales tax cut from the current rate of 6.0 percent. However, the 6.0 percent rate is temporary; the statutory rate is currently set to decline to 5.0 percent on July 1. If the half-penny is considered to be an

REMI is honest and straightforward about its omission in not reviewing the economic effects of plugging this revenue gap. Virtually every chart in the 133-page report contains the advisory that the numbers are shown "without offsetting taxes or government expenditure changes." However, this does not make the REMI estimates meaningful for Ohio's citizens and legislators.

REMI referred questions about the study to the Department of Development. Steven Kelley of the department's Office of Strategic Research said that ODOD and REMI agreed that it was best to do the study as they did, because they wouldn't know what the legislature would cut or choose to raise taxes on. "If the legislature chose to raise taxes versus cuts in spending that has a different implication (for the result)," Kelley said. He added that, "Given the timeframe on trying to be responsive to the legislature, this was deemed to be the most cost-effective, time-effective way of providing some information."[7] However, there is little reason the state couldn't have at least asked for the economic results of an across-the-board spending cut, for example. This would have been feasible to do within the timeframe available. As it is, the spending of $154,000 does not seem cost-effective, when the result is so incomplete and misleading.

Ironically, given its failure to consider the overall revenue gap, the REMI analysis projects that there will be increased state and local government spending on the economy as a result of the governor's proposed tax plan. The report outlines a scenario in which the proposed income-tax cuts, for instance, will lead to income and consumption growth, adding to the growth of Ohio-based industries, labor force and population. "Because of the increase in population, Ohio will need additional government services to maintain its existing level of government-service commitments to its citizens," the report states. "State and local governments would need to expand their budgets to satisfy their new citizens."[8] REMI estimates that the increase in government spending would lead to a gain in the Gross State Product of $110 million by 2010, and an increase of 1,834 additional state and local government jobs.[9] Of course, these estimates are speculative, because government may not have the revenue to respond to the additional demands for services

Tax cuts in the REMI study result in government spending increases, while conversely tax increases (such as the proposed Commercial Activity Tax on business receipts) result in lower government spending. This result, though it may be reasonable within the context of the model, is oblivious to the reality that a tax cut will reduce the immediate revenues available and inevitably result in spending reductions, unless there is a rainy day fund the state can use.

---

increase instead of a cut, the net tax revenue decline from all of the taxes REMI analyzes would be $1.3 billion instead of $2.8 billion. For economic modeling purposes, showing the half penny as a tax increase would have a substantial negative effect on the economic outcomes discussed in the report.

[7] Interview with Steven Kelley, May 4, 2005.

[8] REMI report, p. 64.

[9] REMI report, pp. 64-5, 106.

The REMI model can be – and has been – used to review the impact of spending changes as well as tax changes. For example, two researchers at the W.E. Upjohn Institute for Employment Research compared the short-term effect of closing a Michigan state budget deficit by increasing taxes, rather than cutting spending. They found using a REMI model that the state would add 7,000 jobs and add more than $350 million to Gross State Product if it increased taxes instead of cutting spending by $925 million.[10]

Similarly, a 2003 study by issued by the Fiscal Policy Institute using a REMI model found positive economic effects if New York State maintained its K-12 education spending through a $1.84 billion increase in income taxes, compared to cutting that amount of education spending.[11] A more recent New York study came to similar conclusions.[12]

Richard G. Sims, the author of the first New York report, has found broadly using a REMI model that increasing state K-12 education spending by 2 percent and funding that with an equal increase in sales taxes has a beneficial economic effect.[13] State spending on education results in more jobs than tax cuts because education is a labor-intensive activity; much of the additional funding goes to hiring teachers and other staff. Generally, about a third of the added jobs come from the spin-off effects on the overall economy. Based on the latest U.S. Census data covering the school year 2002-2003, Sims estimates that for every $100 million Ohio spends on elementary and secondary education, 1,627 jobs are created, including both classroom and non-classroom personnel.[14] This number does not include any spin-off jobs added outside of the educational sector. Yet it is still more jobs than would be created in FY2006 per $100 million in tax cuts for any of the taxes REMI studied, except for the sales tax, at 1,817. As a result, these data suggest that taxes spent to support K-12 education have a greater impact than the proposed tax cuts.

The amount of jobs that are created through state spending will vary, of course, depending on how the funds are spent; they do not always amount to more than those that a tax cut might produce. However, dollar for dollar, public spending is more likely to create employment in Ohio than private spending because a greater proportion of

[10] *Economic Impact of Various Budgetary Policy Options for the State of Michigan to Resolve its Budget Deficit for FY2004*, Timothy Bartik and George Erickcek, W.E. Upjohn Institute for Employment Research, December, 2003. "Increases in state taxes reduce demand for Michigan's goods and services, but by less than a dollar for each dollar in increased taxes, because Michigan consumers and businesses spend much of their income on goods and services produced at least in part outside Michigan," said a press release on the study. "In contrast, the immediate effect of state spending cuts is to directly reduce, dollar for dollar, the goods and services produced by government employees." See Press Release, W.E. Upjohn Institute for Employment Research, December 2, 2003.
[11] *Schools, Taxes and the New York Economy: An Economic Analysis of a Balanced Budget Alternative to the Governor's School Aid Cuts*, Fiscal Policy Institute, April 24, 2003. http://www.fiscalpolicy.org/April24Report.pdf, accessed May 3, 2005.
[12] *Achieving Adequacy: Tax Options for New York in the Wake of the CFE Case*, Institute on Taxation and Economic Policy, April 2005. http://www.itepnet.org/newyork.htm, accessed May 3, 2005.
[13] *School Funding, Taxes and Economic Growth: An Analysis of the 50 States,* Richard G. Sims, independent consultant. NEA Working Research Paper, National Education Association, April 2004. http://www.nea.org/edstats/images/schoolfunding.pdf, accessed May 2, 2005.
[14] E-mail communication from Richard G. Sims, May 5, 2005.

government spending is for locally supplied goods and services. "Given the nature of state and local expenditures (such as education, infrastructure, and health care) it is likely that the "export quotient" of public spending is lower than that of private spending," notes Robert G. Lynch, chair of the economics department at Washington College.[15]

Besides the jobs that state spending cuts would eliminate, the long-term effects of such reductions also must be included in a realistic analysis of the tax plan. If Ohio's workforce is not adequately educated and trained, the economy is unlikely to grow at an acceptable rate. The long-term damage from underinvestment in schools, public health and infrastructure will make the state unattractive for business, not to mention its impact on citizens.[16] The reduction in state spending that would result from the tax cuts, absent other new revenues, also could trigger additional negative spending effects. Spending reductions in Medicaid, for example, the state's largest program expenditure, likely would result in a reduction in federal aid, multiplying the negative effect on the Ohio economy.

Even aside from the major omission in the REMI study, the results show relatively small effects on the Ohio economy, even when the tax plan is fully phased in five years from now. The Ohio Department of Development has estimated the 2004 Ohio Gross State Product at $406.9 billion.[17] State nonagricultural employment in March 2005 was 5.4 million.[18] The increase REMI estimates by FY2010 of 43,250 jobs amounts to 0.8 percent of the number of jobs in Ohio, or under a fifth of the 221,000 jobs the state has lost in the past five years. The GSP increase amounts to somewhat more than 0.7 percent of the Ohio Gross State Product, adjusted for inflation.

The REMI analysis also does not include significant elements of the governor's tax plan or the version passed by the House in April. Four elements of the governor's plan that are omitted would produce a $567 million net fiscal gain for the state in FY2010: the increase in the kilowatt hour tax ($170 million), the elimination of the 10 percent commercial and industrial property tax rollback (a $365 million spending reduction for the state but a local property tax increase for business), the imposition of a state-level real estate transfer tax ($40 million) and the elimination of the sponge portion of the estate tax

[15] *Rethinking Growth Strategies, How State and Local Taxes and Services Affect Economic Development*, Robert G. Lynch, Economic Policy Institute, 2004.

[16] See for example a recent national survey by Louisiana State University, which found that that workforce issues were the top consideration in business location decisions. Other leading factors included proximity to major markets, public safety and access to transportation (via highways, railroads and airports). *Louisiana Business Image Survey,* Sponsored by The Committee of 100 for Economic Development in partnership with the Louisiana Governor's Office, Public Policy Research Lab, Louisiana State University, Jan. 24, 2005. http://www.survey.lsu.edu/LouisianaBusinessImageReport2004.pdf, accessed May 4, 2005.

[17] *Ohio's Gross State Product, March 2005,* Don Larrick, principal analyst, Office of Strategic Research, Ohio Department of Development. James Kell, Steven Kelley, editors. p. 4. This is a preliminary estimate. The department pegged the 2003 GSP at $403 billion. http://www.odod.state.oh.us/research/files/E100.pdf, accessed May 3, 2005. Adjusted into 1996 dollars, as REMI uses for its GSP statistics, this would be $343.65 billion.

[18] Ohio and U.S. Employment Situation (Seasonally Adjusted), News Release, Ohio Department of Job & Family Services, April 15, 2005. http://jfs.ohio.gov/releases/unemp/UnempPressRelease.htm, accessed May 3, 2005.

(a revenue loss of $8 million).[19] In combination, these changes undoubtedly would reduce economic activity and lower REMI's estimates for employment growth, GSP, and investment if they were included in the study.

In conclusion, the REMI report is an incomplete analysis of the economic effects of the Taft tax plan. It does not live up to its billing, and fails to establish that the plan will significantly boost Ohio's economy.

[19] Proposed Administration Tax Reform and Budget Review Plan FY 2006-2010, Ohio Department of Taxation.