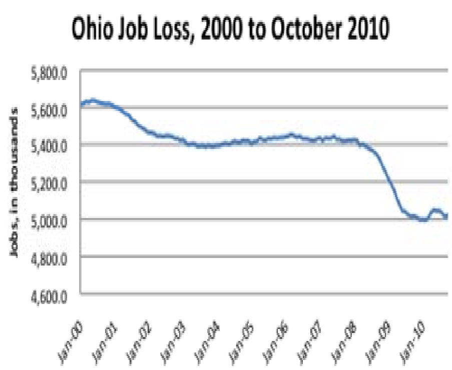
POLICY MATTERS OHIO

Taxes and the business climate

Ohio, like the rest of the nation and much of the world, has lost jobs in the Great Recession.

Figure 1. Job loss in Ohio, 2000-2008



Source: US Bureau of Labor Statistics, Economic Policy Institute

Is it our taxes?

Much is written about the relationship between levels of taxation and job growth or loss in states or cities. At least eight think tanks publish annual rankings that purport to show which states or cities have the best "business climate," or the most "competitive" tax and regulatory environment, or the conditions most conducive to small business growth. They claim that places with lower taxes and fewer government regulations are better. The rankings are used to promote a familiar set of policies: cut taxes, shrink government, and reduce regulations, and your state or city will see more job creation.

Not all the rankings work the same: for instance, 34 of the 50 states can claim that they are in the top 10 in terms of business climate or competitiveness, yet 42 of the 50 states also end up in the bottom 10 in one or more of the indices.

The Economy of the Dakotas

South Dakota, with no income tax and the lowest overall state & local taxes in the country (as a share of personal income), had the 2nd lowest unemployment rate in the country in October 2010. North Dakota, a state with an income tax and the 5th highest overall tax levels, had the lowest unemployment rate. It doesn't take an economist to see that the similar economies of the Dakotas have more to do with a strong economy than tax structure.

Factors of Business Location

- *Location of customers and suppliers has an important impact on some businesses.*
- *Specialized skills of the workforce attracts facilities and helps existing firms grow.*
- *Quality of schools and quality of life are important to firms locating new facilities.*
- *Energy costs may be significant on the corporate balance sheet.*

State and local taxes exist everywhere, and are typically pretty similar (Figure 2).

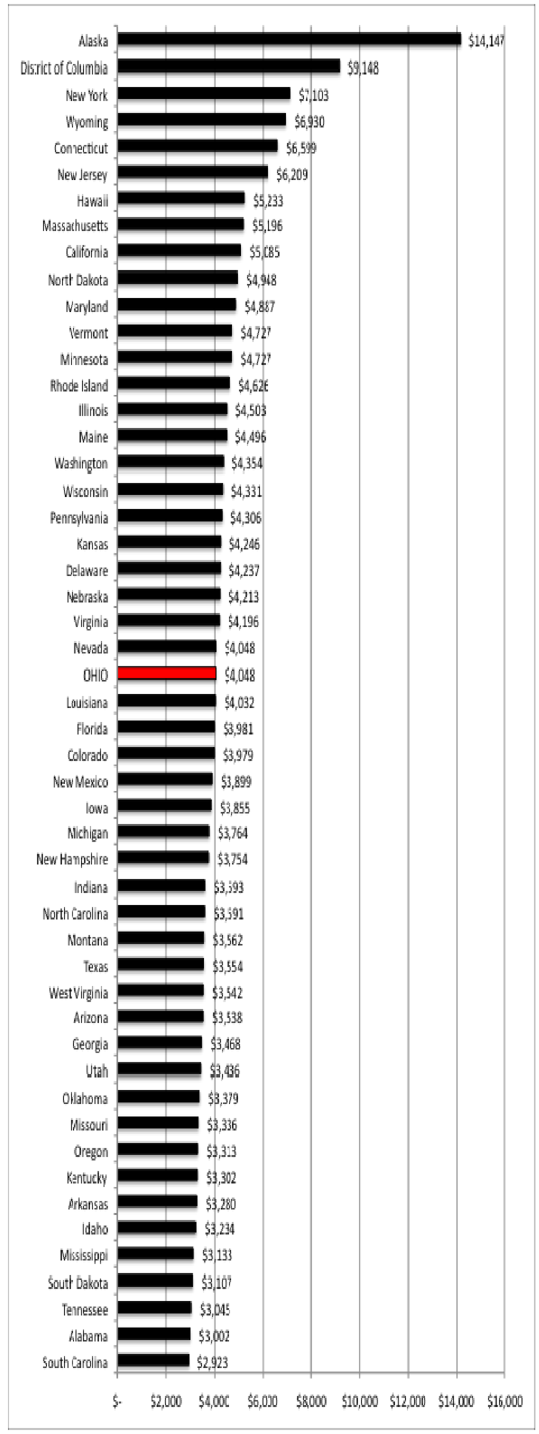
Ohio tries to move in the rankings

In 2005, the Ohio General Assembly eliminated the tax on corporate profits and cut personal income taxes, with special benefits for the wealthy. The tangible personal property tax, a major local business tax, was eliminated. A new gross receipts tax was enacted, but it replaces only part of the business-tax revenue loss. . Together with several other changes, these tax cuts are costing the state $2.1 billion in annual net revenue, according to the Ohio Department of Taxation. The Ohio Business Roundtable noted in a 2008 court filing: "The new business tax system substantially lowered the overall tax burden on business." Since then:

- *Ohio's share of the nation's jobs has shrunk from 4.06% to 3.87%.*
- *Our share of manufacturing jobs has fallen from 5.7% to 5.35%.*
- *Ohio lost 353,100 nonfarm jobs and 182,300 manufacturing jobs.*

The 2005 tax overhaul in Ohio was justified with forecasts of new economic growth, but it didn't work. State and local taxes have little to do with economic strength. A 2006 study by researchers at the Cleveland Federal Reserve Bank found that taxes were not a significant factor in long-term state income growth.

Figure 2. State & local taxes per capita in the 50 states



Source: 2008 data from U.S. Census and U.S. Dept. of Labor, Bureau of Economic Analysis