Policy Matters Ohio

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Testimony of Zach Schiller on House Bill 1
Senate Finance and Financial Institutions Committee Hearing
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Good morning Chairman Carey, Ranking Member Miller and members of the Senate Finance and Financial Institutions Committee. I am Zach Schiller, research director of Policy Matters Ohio, a nonprofit research institute with offices in Cleveland and Columbus.

Nearly four years ago, the General Assembly approved House Bill 66, including the biggest overhaul of Ohio's tax system in a generation. The tax changes, including the 21 percent cut in the income tax and the elimination of two major businesses taxes in favor of a new tax on gross receipts, were aimed at generating jobs and improving Ohio's economy.

Have they accomplished that goal? There is little evidence to support such a conclusion. Ohio has lost ground to the nation on employment, manufacturing jobs, personal income per person, economic output and other indicators. A Policy Matters study released in January provides additional details.

The March job report provides the most recent illustration that the tax cuts are not working. Since June 2005, according to the seasonally adjusted data on nonfarm payrolls released by the Bureau of Labor Statistics, Ohio has lost 263,500 or almost 4.9 percent of its jobs. Employment in the country as a whole fell by 671,000, or half of one percent. Since the recession officially began in December 2007, Ohio has lost 261,600 jobs or 4.8 percent, while the nation has lost 5.2 million, or 3.8 percent

It's no surprise that the tax cuts did not bring an economic renaissance to Ohio. States with low tax rates do not have superior economic performance. State and local taxes are not the determining factor in how state economies perform. State spending supports investments and services, such as a well-educated workforce, which are a key element in economic success.

A 2005 study commissioned by the Taft administration found that extra economic activity and the taxes it generated would only make up 7 percent of the revenue loss from the tax cuts—and that didn't take into account the spending cuts that would have to take place. Every dollar of tax cuts also means a dollar in reduced spending. Most economists agreed during the discussion of the national stimulus plan earlier this year that spending boosts the economy more than tax cuts. For example, a Jan. 6 article in *The New York Times* on a meeting of the American Economic Association reported that, "Nearly every economist who spoke here agreed that a dollar invested in, say, a new transit system or in bridge repair is spent and respent more efficiently than a dollar that comes to a household in a tax cut. A bigger percentage of the latter is saved, they said."

The Strickland administration has estimated that the major tax changes from 2005 will cost the state General Revenue Fund $2.1 billion next fiscal year. The amount in FY11 will be similar. This is a significant contributor to the state's fiscal problems.

The tax changes also favored Ohio's most affluent taxpayers. Seventy percent of the income-tax cuts went to the 20 percent with the highest earnings. Taxpayers in the top 1 percent by income – whose average income was close to $900,000 in 2007 – on average saw a reduction in their annual state income tax of more than $10,000 a year, or 1.2 percent. Taxpayers in the middle fifth of the income distribution, who made an average of $38,000 a year, saw a cut of $187, or 0.5 percent.

The business tax changes will produce a tax cut for Ohio businesses of $1 billion or more a year. The new Commercial Activity Tax – as designed – will bring in far less revenue than the Tangible Personal Property Tax and the Corporate Franchise Tax. And recent news on the CAT has been disturbing: Not only does it face court challenges, the most recent data show it bringing in less revenue than anticipated. Meanwhile, business's share of state and local taxes in Ohio is considerably lower now than it was in the 1970s.

Supporters of the elimination of the Corporate Franchise Tax and the Tangible Personal Property Tax argued that doing so would reduce tax abatement and incentives. Why, then, is it necessary to create new tax credits and expand existing ones, as HB 1 would do?

The changes in the Job Retention Tax Credit and the Job Creation Tax Credit would ratify a major change in philosophy in Ohio's economic development efforts. Before, we gave tax credits for creating new, full-time jobs, and only gave credits for existing jobs in cases of very large investments by anchor employers with 1,000 or more employees. Under HB 1, we will have a Job Creation Tax Credit that does not require any specific number of new full-time jobs be created. Instead, it will set the requirement in full-time equivalents, allowing hours of part-time employees to qualify. The bill would also establish a payroll measure. Under that requirement, a company that paid a handful of executives large bonuses might qualify. The Job Retention Tax Credit also would be expanded so that an investment of $20 million for corporate administrative offices and 500 full-time-equivalents would qualify. Just two years ago, according to the taxation department, we had one company in the state receiving a Job Retention Tax Credit worth less than half a million dollars a year. Now, that amount is allowed to rise to $13 million new credits each year – with a cap of $195 million in 2024. Even if we have been using this credit at this rate recently, this represents a quantum leap in the use of this incentive over the long term.

The bill also would create a New Markets Tax Credit, piggybacking on an existing federal credit program. The intention apparently is to drive more of the federal credits to Ohio by adding a state credit. This is a misguided effort. Other states will respond with their own, similar credits. In the end, this will simply lead to a reduction in state revenue.

We urge you to remember that HB 66 gave businesses a $1 billion annual tax cut. That was supposed to reduce the need for tax credits and abatements, not produce more of them. And yet despite little evidence that this major tax reduction has helped Ohio's economy generate new jobs, these additions to the tax code will create a new drain on state revenue. If you do approve new or expanded credits, you should create a sunset provision of June 30, 2011, and allow the next General Assembly to decide if these credits should be continued. Other states already have general sunset provisions for tax expenditures.

We hope that the committee will also examine the $7 billion in annual tax expenditures that the taxation department described in its report accompanying the governor's budget proposal. While some are certainly worth keeping, others should have been phased out long ago. Why does Ohio tax payday lenders and mortgage brokers at a lower rate than banks, through our dealers in intangibles tax? Shouldn't lobbying and debt collection be covered by the sales tax? And why do we support property-tax relief for owners of million-dollar homes?

Tax expenditures affect the state budget just as if they were spending on schools or prisons, but they remain unexamined, sometimes for decades. If the committee is unable to review tax expenditures in the time available, we recommend that you create in the bill a study committee to examine all tax expenditures and make recommendations to the General Assembly.

During this national economic decline, it is important that we retain and expand support for human services and make the investments in education that are vital to the long-term future of the state. Needs are growing, not diminishing, as others at this hearing describe much better than I can. While the federal stimulus money is a crucial help, it is not enough. Those who say we should give the tax reform more time should be asked: Why should Ohioans experience real cutbacks in public services to test their theory, incorrect so far, that tax cuts will fuel an economic revival?

Ohio needs more revenue to pay for today's needs and provide a stable source of funding in the future. During hard times in Ohio history – including the Great Depression and the early 1980s – General Assemblies have raised taxes. You should reverse key elements of the 2005 tax changes, and:

- Restore the previous 7.5 percent top rate of the state income tax on income over $200,000 a year. This would affect fewer than 2 percent of Ohio taxpayers.
- Roll back other income-tax rates to 2007 levels, while instituting a state earned income tax credit that would reduce the tax for many low- and moderate-income taxpayers.
- Restore the corporate franchise tax;
- Bolster the commercial activity tax and make sure if the Ohio Supreme Court finds grocers don’t have to pay it that they pay a general business tax, such as the franchise tax.
- Eliminate tax loopholes, as already mentioned.

These changes would add fairness to Ohio’s tax code, while allowing us to invest in needed services. Thank you for allowing me to testify.