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Testimony of Amy Hanauer on House Bill 400
Based on analysis by Research Director Zach Schiller
House Ways & Means Committee Hearing
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Good morning Chairman Letson, Ranking Member Huffman and members of the House Ways & Means Committee. I am Amy Hanauer, executive director of Policy Matters Ohio, a nonprofit research institute with offices in Cleveland and Columbus.

I am somewhat surprised to find myself testifying before you on this bill. The State of Ohio needs more revenue, not less. Eliminating the income tax would leave us with far less ability to meet the needs of Ohio. House Bill 1 already left major needs of Ohioans unmet. We are not adequately investing in the state's future, and important programs are going unfunded. To further reduce our revenue would be to relegate our state to a downward path.

Mental health services have been slashed. Libraries may have fought off the most draconian cuts, but they are closing branches and reducing hours. Local Job & Family Services offices are laying off workers even as demand for their services increases. Workers have trouble getting to their jobs because we aren't adequately funding public transit. Families are struggling to find affordable childcare, while protective services have been reduced for elderly Ohioans who have been neglected or abused. These cuts weaken Ohio's economy and increase the costs we will face in the future.

Moreover, as you know, the budget in the next biennium is already sure to require even deeper cuts unless we come up with new revenue. The General Assembly has taken note of this by creating a Budget Planning and Management Commission to make recommendations on balancing the next budget. Given this, it is perplexing that anyone is proposing to slash billions of dollars in annual revenue.

This testimony highlights a few of the ways in which a repeal of the income tax would affect the budget and Ohio's people. A quick preview: I'll discuss how this repeal would affect the debt cap; would irreparably slash state revenue and require spending cuts; would likely trigger increases in other, more regressive taxes; and would hurt Ohio's overall economy.

Debt Service
First, there is the effect on debt service. As you know, the Ohio constitution limits debt service to 5 percent of those obligations paid by the General Revenue Fund and net lottery proceeds. Eliminating the state income tax will force a day of reckoning: Will the state be able to issue debt to spend on any new capital projects? The most current calculations by the Office of Budget and Management estimate that in Fiscal 2012, the ratio will be at 4.9 percent. This includes debt service outstanding as of Feb. 1, debt that is authorized but not yet issued, the impact of a state debt restructuring and a projected capital bill for FY11-12 of $1.8 billion. This is not an official OBM estimate – there are not yet official estimates of FY12 revenues – but it is what the state's debt manager is using for internal planning purposes.

Starting with the OBM calculations, Policy Matters estimates that even if it was phased in over ten years, a repeal of the income tax starting next January would mean breaking the five percent cap in Fiscal Year 2012, which begins less than a year and a half from now. The reduction in revenue of more than $1 billion that fiscal year would increase the ratio to more than five percent. This would not be a temporary problem: The ratio would deteriorate further in FY13.

Under the Ohio constitution, the state would be unable to issue new debt supported by the GRF unless the General Assembly authorized it with a three-fifths vote in each house. Such a vote would be required for each state debt issue, or many times each year. Of course, the General Assembly could increase other taxes, stretch out debt repayment or slash new capital spending to delay or avoid hitting the limit. However, eliminating the income tax significantly reduces Ohio's ability to repay its debts and to invest in future capital projects. A proposal that jeopardizes spending for college buildings, cultural facilities, and all of the projects the capital budget supports across the state should be rejected.

Spending Reductions
Eliminating this tax would drastically reduce state revenue and cause a downward economic spiral. Proponents of House Bill 400 may argue that it will pay for itself, by generating new jobs and income. This is a fantasy. When the General Assembly was considering the 21 percent cut in the income tax in 2005, the Taft administration commissioned a study that found that extra economic activity and the taxes it generated would make up **less than six percent** of the revenue loss from the tax cuts – and that did not take into consideration the spending cuts that would have to take place. Every dollar of tax cuts also means a dollar in reduced spending. The U.S. Treasury Department reached a similar conclusion about extending the federal tax cuts in a 2006 study: The cuts would pay for at most 10 percent of their cost under favorable assumptions.[1]

That means that if House Bill 400 is enacted, either there will have to be massive spending cuts or major tax increases.

The state income tax is crucial to Ohio's budget. The tax brought in a total of $8.3 billion in revenue during the last fiscal year, FY2009. It represented more than 45 percent of tax revenue

[1] Jason Furman, "Treasury Dynamic Scoring Analysis Refutes Claims by Supporters of the Tax Cuts," Center on Budget and Policy Priorities, Aug. 24, 2006, available at http://www.cbpp.org/files/7-27-06tax.pdf.

for the General Revenue Fund during the last two-year budget cycle, or a full 31percent of total GRF resources, even including federal funds. That's more than the state spends on primary and secondary education. We could close down the state prison system, end all aid to higher education and cut off property-tax relief paid by the state, and we still would have to cut more to make up the loss of income-tax revenue.

The Local Government Fund would take a hit of more than 45 percent from the outright elimination of the income tax. The County Commissioners Association of Ohio has estimated the reduction at $263 million a year, not including the effects of House Bill 318 or another $22.9 million for municipal LGF distributions. This ranges from $148,351 for Vinton County to $47.2 million for Cuyahoga County. Even if this were done over 10 years, the effects on counties and units of local government would be substantial. Can Allen County and governments there lose $200,000 next year and $400,000 in 2012? In Ashtabula County, what additional cuts would be needed if it lost $176,000 next year and $350,000 in 2012?

Among those that would be most affected are townships that depend on the LGF for a substantial share of revenue. A 2005 survey of 309 townships across the state found that on average, they relied on the Local Government Fund for 28 percent of their general revenue funds.

Shifting from Progressive to Regressive Taxes

Third, the income tax raises revenue in a way that reflects ability to pay and that also relies on those who benefit most from our state's infrastructure, education system, and economy. State and local tax increases to make up the lost revenue from HB 400 would almost certainly fall more heavily on lower- and middle-income Ohioans.

Ohio's existing state and local tax system is already weighted in favor of upper-income Ohioans, who spend a smaller share of their income paying such taxes than middle-class or struggling Ohioans. The Institute on Taxation and Economic Policy, a Washington, D.C.-based research group that has a model of the tax system, produced a report late last year that outlines this. At the request of Policy Matters Ohio, ITEP reviewed how a repeal of the income tax would affect Ohioans with different incomes. It found that 70 percent of the tax cuts would go to Ohioans in the top fifth of the income spectrum. The top 1 percent, those making more than $309,000 a year, would average an annual tax reduction of $35,490. By comparison, those with income between $31,000 and $48,000 – the middle fifth of Ohioans – would average a reduction of $618. In other words, the highest-income Ohioans on average would save 57 times as much in state taxes as middle-income Ohioans would. For those lower on the income scale, the savings would be smaller still – an average of $28 a year for those in the lowest fifth, who make $17,000 a year or less.

By any measure, income-tax repeal would primarily benefit the most affluent Ohioans. It would also siphon money out of Ohio, since it would reduce the amount that Ohio taxpayers can deduct from their federal tax returns. ITEP estimates this could add up to more than $1 billion a year, or one dollar in every seven of the income-tax cut.

Impact of Eliminating Individual Income Tax Assuming 2011 Rates							
2009 Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less Than $17,000	$17,000 - $31,000	$31,000 - $48,000	$48,000 - $73,000	$73,000 - $134,000	$134,000 - $309,000	More Than $309,000
Average Income in Group	$10,000	$24,000	$40,000	$60,000	$95,000	$190,000	$820,000
State Tax Change as a % of Income	–0.3%	–1.0%	–1.6%	–1.9%	–2.7%	–3.3%	–4.3%
$ Average State Tax Change	$ –28	$ –238	$ –618	$ –1,146	$ –2,524	$ –6,334	$ –35,490
Total Share of Tax Change	0%	3%	9%	17%	27%	18%	25%

Source: Institute on Taxation and Economic Policy, January 2010

Thus, HB 400 would further skew the state and local tax system in favor of those with high incomes. ITEP's 2009 report covered non-elderly Ohioans and used incomes as of 2007 so it is not directly comparable to the figures I just cited. However, it still provides a reasonable snapshot. Lower-income Ohioans would pay 11.7 percent of their income in state and local taxes after an income-tax repeal, while those in the top 1 percent would pay just 3.4 percent. Those in the middle fifth of the income distribution would pay 9.1 percent.

Affluent Americans have not flocked to live in states without income taxes; such states overall do not have a greater share of wealthy taxpayers. The Center on Budget and Policy Priorities, a Washington, D.C., research organization found that in 2005, 19.2 percent of taxpayers with income of more than $200,000 lived in states without a personal income tax, while 19.6 percent of **all** taxpayers live in those states.

Not helping the economy
States with low overall tax rates also do not have superior economic performance. In a 2006 report, Paul W. Bauer and Mark E. Schweitzer of the Federal Reserve Bank of Cleveland found no statistically significant relationship between average tax rates and state income growth since 1960.[2]

[2] Bauer, Paul W. and Mark E. Schweitzer, "Paths to Prosperity: Knowledge is Key for Fourth District States," Economic Commentary, Federal Reserve Bank of Cleveland, August 15, 2006. Available at http://www.clevelandfed.org/Research/Commentary/2006/0815.pdf See also: http://www.clevelandfed.org/about_us/annual_report/2005/PDF/Essay2005.pdf Federal Reserve Bank of Cleveland, Annual Report 2005, "Altered States: A Perspective on 75 Years of State Income Growth."

Thus, it should be no surprise that Ohio's 2005 tax overhaul has failed to bring a relative improvement in Ohio's economic standing. Ohio has lost ground to the nation on employment, manufacturing output and jobs, economic output per person and other indicators since the tax changes were approved. Of course, there are various reasons for Ohio's economic challenges. However, the notion that the tax changes would turn the state around was clearly misguided.

The most recent state jobs report provides the latest evidence that the tax cuts in House Bill 66 are not fixing Ohio's economy: At 10.9 percent, our unemployment rate is tied with Tennessee for 11th highest in the nation. Incidentally, Tennessee has no income tax, which has not helped that struggling state's economy. While the country has lost 2 percent of its jobs since June 2005, when HB 66 was approved, Ohio has lost 6.2 percent. Relative job loss has exceeded that of the country as a whole, both before and after the recession. Between June 2005 and December 2007, Ohio jobs were essentially flat, down 2,000 or less than half of one percent, while the nation gained 4.5 million jobs or almost 3.4 percent. Since December 2007, when the recession officially began, Ohio has lost 6.1 percent of its jobs, compared to the national average of 5.2 percent.[3]

Past tax cuts have not been a panacea for Ohio's economy. But they have reduced the state's ability to help its neediest residents, to support libraries and basic services provided by local governments or to invest in the future. In light of this failure, Ohio's needs, and the fiscal squeeze we will find ourselves in next year, the 2005 tax overhaul must be reconsidered. Much as the people of Oregon did last month, Ohio should increase the income tax on its wealthiest residents, and restore the overall level of business taxes. We should also examine our extensive tax breaks, which are not regularly scrutinized. What we should not do is further cripple our ability to meet the needs of our people, our educational institutions and our economy by eliminating a progressive tax that raises substantial revenue in a way that effectively targets those able to pay. Thank you for the opportunity to testify.

[3] The U.S. percentages used here do not include recent revisions. Such revisions in the state data will be made soon, but are not yet available. Thus, to allow for comparisons, U.S. data prior to the revisions has been used.