

# THE 2005 TAX OVERHAUL AND OHIO'S ECONOMY

A REPORT FROM  
POLICY MATTERS OHIO

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## EXECUTIVE SUMMARY

In 2005, the Ohio General Assembly passed House Bill 66, making dramatic changes to the state tax code with the promise that they would improve economic conditions for ordinary Ohioans. The proponents claimed that lower taxes would yield benefits later. After four years of tight budgets, prosperity is nowhere in sight. Ohio and the nation are now engulfed in what may become one of the worst recessions after the Second World War. The state is cutting its budget dramatically even though more Ohioans are losing their jobs and their homes, and are finding it impossible to meet their basic needs. The budget crisis threatens to undercut the state's ability to maintain a social safety net during the downturn, let alone to make investments in education, transportation, and public safety.

This year marks the end of the phase-in period for the nearly all of the H.B. 66 tax changes. Even though the changes are not complete, it is imperative that we assess their impacts on the economy. This judgment must inform our views about how the state's revenue system can be changed to meet current challenges.

Evaluating H.B. 66 is not a simple matter. An economic consulting firm hired by the state in 2005 to provide economic impact estimates forecasted small positive results but did not model the impact of required state budget cuts and did not provide enough information about its assumptions to permit a follow-up assessment. Most importantly, Ohio's economic performance is strongly influenced by national and international trends and it is difficult to disentangle the effects of state policy from these factors.

What is clear is that the supporters of H.B. 66 recognized Ohio's poor relative economic performance in recent years compared to the rest of the nation, and tried to do something decisive to break this trend. If pre-2005 tax policies were the cause of Ohio's problems, then the changes should have at least prevented the state from falling any further behind national averages on key indicators such as economic output, employment growth, and personal income. This report looks at a number of economic indicators and compares them with national trends, and in some cases with nearby states. The results are very clear. Even before the current economic downturn, Ohio was not keeping pace with the nation. Key economic trends continued to go in the wrong direction after the tax overhaul. The report finds unmistakable evidence that the state's relative economic decline accelerated since H.B. 66 was passed, as evidenced by the following trends:

### Overall employment:

- ◆ If Ohio's total non-farm payroll employment growth since 2005 had matched the nation's, the state would have had 160,000 more jobs in June 2008, three years after tax reform. The U.S. experienced a three percent growth in employment during that time. Ohio's employment level rose slightly after tax reform but then fell slowly so that by June 2008 it was actually below the level of three years earlier.

- ◆ Ohio's failure to add jobs in the past three years means that its employment record underperformed all surrounding states except Michigan.

*Economic Output, Productivity, and Income:*

- ◆ Ohio's real economic output stagnated from 2005 to 2007, just keeping pace with population growth. Only six other states had lower rates of GDP growth per capita. The national economy grew by 3.2 percent on a per capita basis during the same time period. Ohio's level of GDP per capita is now nearly \$4,000 below the national average, having fallen from 27<sup>th</sup> to 32<sup>nd</sup> highest in the nation in just two years.
- ◆ Ohio's output per job, the broadest measure of productivity and now an official state economic benchmark for the Ohio Department of Development, remains below its 2004 level. U.S. output per job grew slowly by 1.3 percent in real terms between 2005 and 2007, climbing from \$62,564 to \$63,377. The size of the gap between the U.S. and Ohio productivity levels increased from \$5,257 to \$6,217 (\$960 per job, or 18.3 percent) over the two year period.
- ◆ Ohio realized a small 2.7 percent gain in inflation-adjusted personal income per capita between 2005 and 2007 but lost relative ground because national personal income grew by 4.8 percent. The gap between Ohio and the nation increased from \$3,186 in 2005 to \$4,055 in 2007. Ohio's ranking among states fell from 29<sup>th</sup> to 32<sup>nd</sup> highest in two years.

*Manufacturing continues to decline:*

- ◆ As measured over three years (3<sup>rd</sup> quarter 2005 to 3<sup>rd</sup> quarter 2008) Ohio's rate of manufacturing job loss was 6.5 percent while the nation's was 5.3 percent. Ohio was in the middle of the pack for nearby and surrounding states. Among nearby states, Ohio fared better than Michigan, New York, and Indiana, but worse than Illinois, Wisconsin, and Pennsylvania.
- ◆ Real, inflation-adjusted manufacturing production levels fell in Ohio between 2005 and 2007, but U.S. manufacturing production rose by 5.3 percent.

As a result of these trends, signs of economic distress continue to mount as more Ohioans become unemployed and seek assistance from social and human services programs. More Ohioans are falling into poverty and are finding it difficult to meet their basic family needs.

- ◆ State population growth has slowed to a crawl. The state grew by less than 5,000 people from 2006 to 2007.
- ◆ Ohio's unemployment rate remained above the national level since the passage of H.B. 66. As of November, 435,000 Ohioans, or 7.3 percent of labor force, were unemployed but seeking work. The national unemployment rate was 6.7 percent.

- ◆ The number of Ohioans seeking assistance from the food stamp program, now called the Supplemental Nutrition Assistance Program (SNAP), continued to increase dramatically through the end of 2008. Eligibility is limited to a household gross monthly income of 130 percent or less of the federal poverty guidelines, currently \$1,907 per month for a family of three. Average monthly participation increased by over 140,000 people between 2005 and 2008, a jump of 14.3 percent. National participation rates increased by 10.5 percent in the same period.
- ◆ In summer 2008, participation in the Ohio Works First program had climbed back to its level of three years earlier, while national participation rates in Temporary Assistance for Needy Families (TANF) had declined by fifteen percent. Ohio participation was rising markedly in the latter half of 2008.

In the current crisis, it is vital that the policymakers and the public engage in a rational debate about taxes. Even before the recession, H.B. 66 led to cuts in government expenditures that most heavily impacted the poor. To this point, H.B. 66's tax changes simply have not shown results, and it cannot be assumed that they will do so in the future. Any expected economic gains likely will be slight and outweighed by the negative effects of disinvestment in education, infrastructure, public safety, and social services. States with low tax rates do not have superior economic performance. Structural changes in our economy, especially the declining market share of domestic car manufacturers and outsourcing of U.S. jobs to low-cost countries, are the primary causes of Ohio's economic problems.

To deal with the revenue crisis Policy Matters Ohio recommends revising our current tax structure. Personal income tax rates should be restored to their 2007 levels for most Ohio families. This would leave three-fifths of the H.B. 66 income tax reduction in place for the vast majority of taxpayers. The top rate, which applies to incomes over \$200,000, should be restored to its original 2004 level. A state Earned Income Tax Credit (EITC) would help low income working families meet their basic needs. Other steps should also be taken on business taxes, including retaining and strengthening the corporate franchise tax. In addition, unneeded tax breaks should be eliminated. These reforms would help to close some of the budget gap for the upcoming biennium.

## INTRODUCTION

On December 1, 2008, Governor Strickland announced that the state is facing one of the most severe budget crises in recent decades.<sup>1</sup> The administration already has made nearly \$2 billion in cuts and budget adjustments in this budget biennium. The consequences of the budget cuts include the closure of two mental hospitals and youth correctional facilities, reductions in adult career center education funding and certain college scholarships, and layoffs at county job and family service departments at a time when more Ohioans are asking for assistance.

Current forecasts call for a budget hole between \$4.7 billion and \$7.3 billion for the next budget biennium (FY 2010-11), even if agency spending is reduced to 90 percent of its previous levels. There is no way for the state to fulfill its responsibility to maintain adequate levels of public services if it cuts spending to close these deficits. The state's financial reserves, at slightly over \$1 billion, do not even come close to filling the gap, which will grow higher as enrollment increases in Medicaid and other human services programs.

While this revenue shortfall is large, it should not be surprising to anyone who has followed state finances in recent years that the state will have a sizable deficit. As pointed out in the OBM budget briefing for the Governor's December 1 press conference, the latest developments come on the heels of three years of small declines in General Revenue Fund (GRF) tax revenue. The tight budgets were the continuation of a strategy set in motion in 2005 by House Bill 66, the final biennial budget bill of the Taft Administration. The intent of the strategy was to reshape Ohio's tax code and deliver tax cuts to both businesses and individuals on the premise that these actions would improve the state's economy.

The tangible personal property tax on new business equipment was removed immediately. Other portions of the tangible personal property tax and the corporate franchise tax on non-financial businesses were phased out and replaced with a new commercial activity tax (CAT) on businesses' gross receipts. Individual income tax rates were cut by 21 percent over a five year period with the final cut taking place in calendar year 2009. Meanwhile, the cigarette tax was increased, and the state sales tax, which had been raised temporarily to 6 percent from 5 percent, was set permanently at 5.5 percent.

It was well-known that the tax changes would constrain the state's budget in the medium-term. An economic consulting firm hired by the state during the debate on H.B. 66 found that the five major components of the tax changes would cause \$2.8 billion in revenue losses at the state and local levels by FY 2010, even after taking into account the

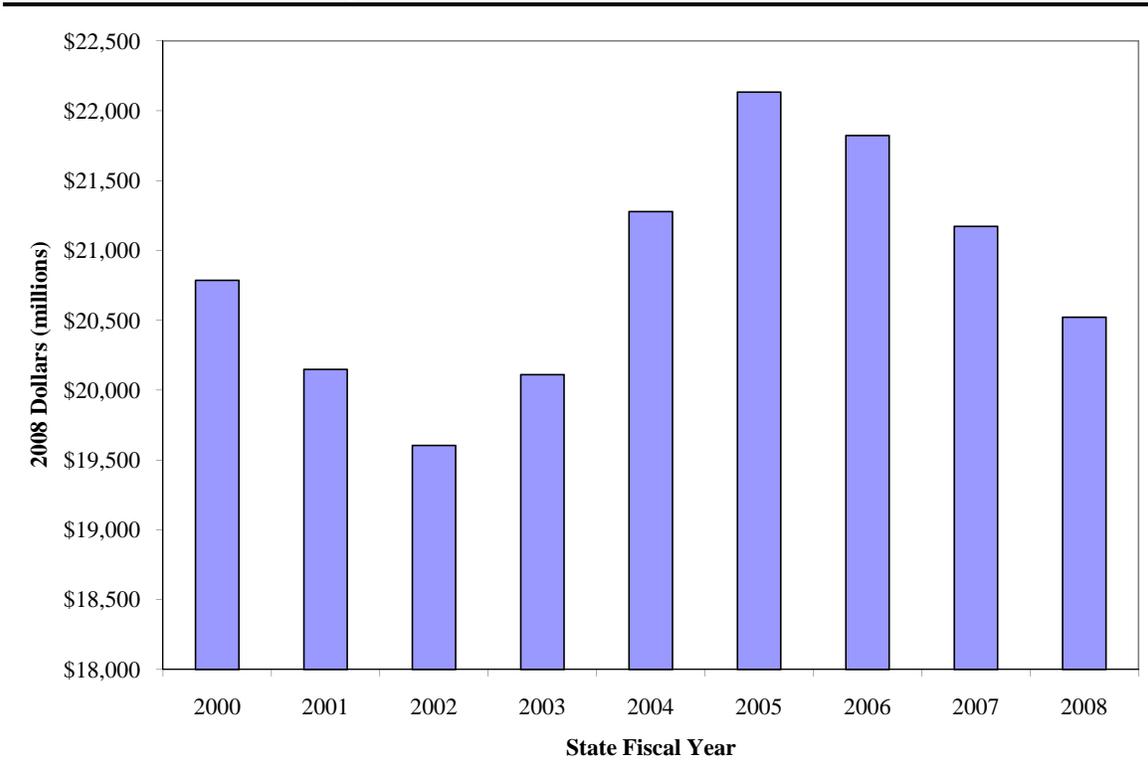
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<sup>1</sup> Gongwer News Service. "Governor, Budget Director Outline State's Financial Conundrum minus Federal Bailout," Volume #77, Report #231. December 1, 2008

“dynamic” effects of the tax cuts.<sup>2</sup> A subsequent OBM forecast from Governor Strickland’s first proposed budget pegged the expected revenue losses to the state GRF at nearly \$1.3 billion in FY 2009, and over \$2.1 billion in FY 2010.<sup>3</sup>

Figure 1 below shows the level of real, inflation-adjusted total state revenue for general programs and local government funds. The chart excludes federal grants to the state. Revenues have been declining in real terms since FY 2006, the first budget to feel the effects of the tax overhaul. FY 2008 revenue, pinched both by the tax changes and the recession, was actually below the level of eight years earlier.

Figure 1  
Inflation-Adjusted Total State Tax Revenue, FY 2000 - 2008



Source: Legislative Service Commission<sup>4</sup>; Policy Matters Ohio.

<sup>2</sup> REMI Consulting, Inc. *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, April 18, 2005, p. 11. The report stated that “...the dynamic revenue feedbacks only offset a small proportion of the direct revenue losses; therefore, these tax changes lead to a net loss of revenues.” (p. 1).

<sup>3</sup> Ohio Office of Budget and Management. *Executive Budget: Fiscal Years 2008 and 2009. Section B: Economic Forecast and Income Estimates*. Table B-1a: Estimated Fiscal Impacts of Major Tax Law Changes in House Bill 66 of the 126<sup>th</sup> General Assembly, p B-8.

<sup>4</sup> Inflation-adjustment by the author using the CPI-U-RS converted to a fiscal year basis. Source data from the Ohio Legislative Service Commission, Table 1 - GRF, LPEF, and LGF Revenue History, FY 1975-FY 2008, available at

The lost revenue had real consequences for Ohio's citizens. H.B. 66 cut eligibility for Medicaid income eligibility for poor adults to 90 percent of the poverty level, removing 15,000 individuals from the program. It also froze enrollment in Disability Medical Assistance, a program that provides medication for impoverished and disabled individuals who are not eligible for Medicaid. The program remains frozen and will be effectively ended over the next several years as the number of recipients dwindles.<sup>5</sup> Many school districts, including some that experienced enrollment growth, have received little or no increase in state aid for years, forcing them to seek additional local property tax revenue or make cuts.

Lower tax revenue also squeezes the state's revenue sharing with local governments at the same time that many cities and counties are responding to their own revenue crises with layoffs. Hamilton County, for example, laid off approximately 200 employees in 2008, including 87 sheriff deputies, and may need to lay off 150 more employees in 2009.<sup>6</sup>

Despite the squeeze imposed by the tax cuts, the Strickland Administration's first budget managed to accomplish some important goals. The administration used the Medicaid program to expand health insurance for children, disabled adults who work, and pregnant women. The budget also signaled a new bipartisan consensus on freezing college tuition and consolidated adult education programs under the Board of Regents.<sup>7</sup> On the revenue side, however, the budget remained a tightrope walk that continued the practice of using one-time, non-recurring revenue sources. Most notably, the state "securitized" the payments from a national legal settlement against major cigarette companies. Securitization allowed the state to gain a lump sum of \$5.05 billion in return for selling its right to future annual tobacco revenue payments.<sup>8</sup> The administration was then able to use the proceeds to pay for Ohio's K-12 and higher education building programs, rather than issuing general obligation debt. The interest on the lump sum from securitization allows the administration to finance the expansion of the homestead property tax credit to all senior citizens without using the GRF in this budget cycle.<sup>9</sup>

The administration also created needed new initiatives in child care and early childhood education with a TANF surplus. However, these surplus federal funds are now gone, leaving a \$300 million annual budget hole in the next budget that must be filled in order

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<http://www.lbo.state.oh.us/fiscal/budget/RevenueHistory/HistoricalExpendituresRevenue/HistoricalRevenuefromFY1975toFY2008.pdf>

<sup>5</sup> Average monthly DMA enrollment was 4,485 in FY 2007 is expected to drop to 1,688 in FY 2009. Information provided to the author by ODJFS in September, 2008.

<sup>6</sup> Jessica Brown, "87 Deputies get Layoff Notices: Jobs to be gone by Christmas," *Cincinnati Enquirer* (online edition), December 2, 2008. Available at [www.cincinnati.com](http://www.cincinnati.com).

<sup>7</sup> Ohio Office of Budget and Management. *State of Ohio Budget Highlights. Fiscal Years 2008 and 2009*. Available at <http://obm.ohio.gov/sectionpages/Budget/OperatingBudget.aspx>

<sup>8</sup> Buckeye Tobacco Settlement Financing Authority, *Quarterly Report for the Period Ending September 30, 2008*. Prepared by the Office of Budget and Management. (Oct. 2008). Available at <http://obm.ohio.gov/SectionPages/TobaccoSettlement/Default.aspx>

<sup>9</sup> The state uses the interest on the proceeds from securitization to support part of the homestead property tax credit.

to sustain these programs. TANF funds are also used to provide cash assistance to needy families. Due to increased caseloads, the program is projected to run a deficit in FY 2009 of \$48 million (see below).<sup>10</sup> In short, even before the recession, the state had to scramble for revenue to fund a FY 2008-2009 budget that provided for overall cuts in real terms.

## EVALUATING THE IMPACT OF H.B. 66

In June 2005, the Ohio General Assembly enacted House Bill 66, a biennial budget for fiscal years 2006 and 2007 that made sweeping changes to Ohio's tax system to boost economic development. The passage of the bill marked the end of a contentious debate about the future of Ohio's tax system. The debate was marked by sharp partisan divisions in the legislature and a split in the business community over the merits of the new commercial activity tax (CAT). In the end, H.B. 66 passed largely along party lines in a Republican-controlled legislature. Only one Democrat in the House (and none in the Senate) supported the bill.<sup>11</sup> Upon signing the bill, Governor Taft declared that "This historic tax reform plan creates a new business climate that will generate jobs, grow our tax base to support education and all public services and allow Ohio workers to support their family and their community."<sup>12</sup>

The basic outlines of the tax changes were put forth in the Taft Administration's budget proposal released in January, 2005. Just two years before, the General Assembly had enacted a budget that included a temporary one percentage point increase in the sales tax. The administration's budget proposal noted that business groups did not think the tax had been a "significant impediment to Ohio competitiveness."<sup>13</sup> Nonetheless, the Administration moved forward with its tax plan in order to "...reduce the burden on investment, encourage capital formation, increase productivity, and encourage growth in employment and income."<sup>14</sup>

During the debate over tax reform, the Ohio Department of Development contracted with one of the nation's leading economic modeling and forecasting companies, Regional Economic Modeling, Inc. (REMI), to forecast the economic effects of H.B. 66.<sup>15</sup>

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<sup>10</sup> Catherine Candisky, "\$50 Million deficit: Welfare Picture even bleaker," *Columbus Dispatch*, December 10, 2008. Available at [http://www.dispatchpolitics.com:80/live/content/local\\_news/stories/2008/12/10/copy/TANF10.ART\\_ART\\_12-10-08\\_A1\\_31C6GUI.html?adsec=politics&sid=101](http://www.dispatchpolitics.com:80/live/content/local_news/stories/2008/12/10/copy/TANF10.ART_ART_12-10-08_A1_31C6GUI.html?adsec=politics&sid=101)

<sup>11</sup> Gongwer News Service. "Legislature Sends Budget Bill to Governor Mostly on Party Lines." *Ohio Report*. Volume #74, Report #122. June 21, 2005.

<sup>12</sup> Gongwer News Service. *Ohio Report*. "Taft signs \$51.25 billion biennium budget." Volume #74, Report #129. June 30, 2005.

<sup>13</sup> Ohio Office of Budget and Management. *State of Ohio. Executive Budget. Fiscal Years 2004 and 2005*. (Feb. 2003). Tab D, Special Analyses, p. D-12.

<sup>14</sup> *Id.*, p. D-1.

<sup>15</sup> The version of the proposal analyzed by REMI did not differ substantially from the final version passed by the General Assembly. Regional Economic Models, Inc. *The Dynamic Economic and Fiscal Impact of*

REMI's modeling exercise was incomplete in many respects, as noted in a Policy Matters Ohio report at the time.<sup>16</sup> It did not model all of the fiscal changes, only the five major taxes. Most notably, it did not take into account the effects of cutbacks in public services or offsetting tax increases. Budget cutbacks reduce public employment and the state's ability to contract for private sector services. To the extent that residents in certain localities choose not to accept reductions in public services, local tax increases would offset part of any dynamic effects of state tax reductions.

Taking into account public spending reductions would have reduced, or possibly even reversed, the REMI's positive estimates for key economic variables. 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 state gross domestic product if it increased taxes instead of cutting spending by \$925 million.<sup>17</sup> Similarly, a 2003 study 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.<sup>18</sup> A more recent New York study came to similar conclusions.<sup>19</sup>

REMI presented its estimates as changes to the baseline level of key economic indicators: real gross state product (state GDP), disposable personal income, total employment, and population. The report did not make a baseline forecast for Ohio's economy in general and did not provide a methodology that would enable other analysts to disentangle H.B. 66's effects from other economic trends. Two experts at the Ohio Department of Taxation summarized the interpretation problem in this way:

In any given year, going forward, one won't be able to look at the actual data and say conclusively whether the REMI estimates are correct.

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*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 by REMI Consulting, Inc. Using REMI Policy Insight State Model of Ohio. April 18, 2005.

<sup>16</sup> Jon Honeck and Zach Schiller, *REMI Reports presents just Half the Equation*, Policy Matters Ohio (May 2005.) Available at [http://www.policymattersohio.org/REMI\\_Report\\_2005\\_05.htm](http://www.policymattersohio.org/REMI_Report_2005_05.htm).

<sup>17</sup> Timothy Bartik and George Erickcek, *Economic Impact of Various Budgetary Policy Options for the State of Michigan to Resolve its Budget Deficit for FY2004*, 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.

<sup>18</sup> *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>.

<sup>19</sup> *Achieving Adequacy: Tax Options for New York in the Wake of the CFE Case*, Institute on Taxation and Institute on Taxation and Economic Policy, April 2005. <http://www.itepnet.org/newyork.htm>.

However, if Ohio employment growth does not accelerate, the estimates will begin to look implausible.<sup>20</sup>

Table 1 shows REMI's summary impact estimates by calendar year. These estimates should be interpreted as the impact above a baseline in a particular year. For example, REMI predicted an additional 32,795 jobs in the state in 2008 due to H.B. 66. The economic sector with the largest projected gain was retail trade, with 6,141 jobs.<sup>21</sup> The other two sectors with the largest predicted gains were food services and construction.

In reality, Ohio's annual average employment started to decline from 2006 to 2007, as discussed below. The three sectors predicted to have large gains did not show a consistent pattern. The retail sector lost 11,800 jobs between the third quarter of 2005 and 2008, a small decline of 1.9 percent, while food services showed a small gain. Construction employment fell by 17,500 jobs, or 7 percent.<sup>22</sup>

Table 1  
REMI Estimates for H.B. 66 Impacts by Calendar Year

	2005	2006	2007	2008	2009
Total State GDP (Billions 1996 dollars)	.290	.761	1.330	1.758	2.295
Real disposable personal income (Billions 1996 dollars)	.531	1.274	1.978	2.445	3.087
Total Employment	6,319	15,681	25,797	32,795	41,499
Population	3,161	9,887	19,196	29,341	41,167

Source: REMI (2005).<sup>23</sup>

Even using methods that overstate the positive effects of H.B. 66, the scale of the projected impacts in relation to the overall economy would have been extremely small. After adjusting for inflation, the 2007 projected GDP impact amounts to 0.35 percent (.0035) of total GDP.<sup>24</sup> The disposable personal income estimate for 2007 would be 0.75 percent (.0075) of the actual amount. The projected 2008 employment impact would have been 0.61 percent (.0061) of estimated 2008 total non-farm employment. The projected 2007 population impact would be an increase of 1.7 percent over the actual 2007 level.

<sup>20</sup> Frederick Church and Christopher Hall, "Ohio Tax Reform: Cuts and Repeals and That Darn CAT," *State Tax Notes*, January 8, 2007, pp. 23-37 (citation from p. 36). Church and Hall's views do not necessarily represent those of the Ohio Department of Taxation.

<sup>21</sup> Spreadsheet provided by ODOD to Policy Matters Ohio in 2005, after the initial report release. This document revised employment gains downward slightly so that the expected increase in 2008 fell to 29,823. From REMI Policy Insight v6.0 Single Region Model of Ohio.

<sup>22</sup> Author's calculation based on BLS CES series (not seasonally adjusted), 3<sup>rd</sup> quarter 2005 to 3<sup>rd</sup> quarter 2008.

<sup>23</sup> REMI, *op. cit.*, Appendix 1, "Combined Effects of the Five Major Tax Changes in H.B. 1, without offsetting taxes or government expenditure changes. Calendar Year 2005-2020, p. 85.

<sup>24</sup> This result used 2007 Ohio GDP levels for comparison. The result holds whether the comparison is to the BEA's real GDP series or to nominal GDP. The original REMI results were stated in 1996 dollars and converted by the author using the GDP implicit price deflator.

One of the intentions of H.B. 66 was to decrease production costs for Ohio businesses, especially manufacturing. REMI's estimates of the reductions in business costs in relation to total production costs for the whole economy were quite low. The elimination of the tangible personal property tax would lower Ohio's relative costs of production by 0.139 percent (.00139) in 2009. The elimination of the corporate franchise tax would lower costs by 0.121 percent (.00121) by 2010. The new CAT, when fully phased in, would raise production costs by 0.21 percent. The estimated net result of this exchange is that production costs would be lowered by 0.05 percent (.0005), hardly enough to be noticeable.

This result is in line with national studies of state and local business taxation that find that taxes are only a tiny fraction of the overall costs of doing business. Robert Lynch, a professor of economics at Washington College, estimated that state and local business taxes were 1.2 percent of the total cost of doing business, and even less if the deductibility from federal income taxes are taken into account.<sup>25</sup> Lynch reviewed a number of economic studies of the impact of tax and fiscal policies on economic growth and concluded:

In short, state and local tax cuts and incentives are not effective for stimulating economic activity or creating jobs in a cost-efficient manner. On the contrary, by forcing reductions in public services, tax cuts and incentives may retard economic and employment growth.<sup>26</sup>

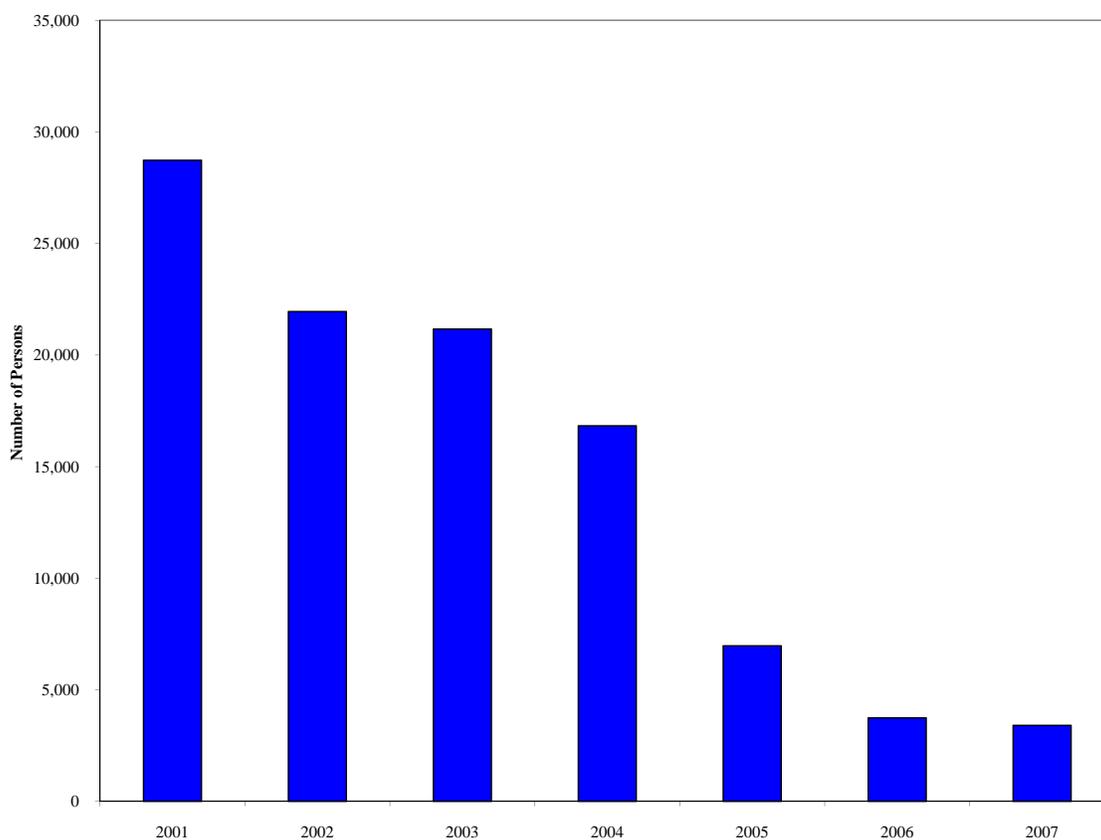
In reality, Ohio's performance has lagged across a wide spectrum of economic variables. For example, the REMI report predicted that H.B. 66 would accelerate Ohio's population growth. As shown in Figure 2 below, Ohio's rate of population growth has been decelerating each year since 2000. In the two years after H.B. 66, Ohio's population grew by a total of 7,141 people. On a base population of over 11.4 million, this represents an increase of 0.06 percent (.0006).

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<sup>25</sup> Robert G. Lynch, *Rethinking Growth Strategies: How State and Local Taxes and Services Affect Economic Development*. Economic Policy Institute (Washington, D.C.), 2004, p. 4.

<sup>26</sup> *Id.*, p. 47.

Figure 2  
Change in Ohio's Population from Previous Year



Source: U.S. Census Bureau; Policy Matters Ohio. Estimates as of July 1 of each year.

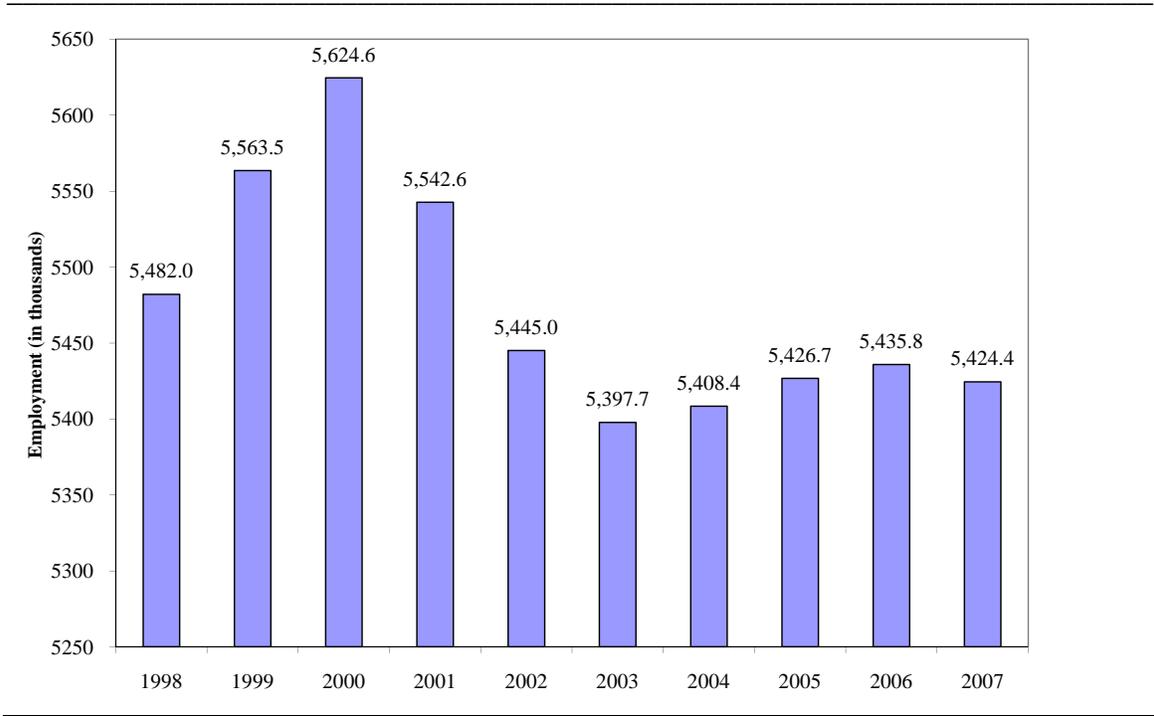
## EMPLOYMENT TRENDS

The most noteworthy trend in Ohio's labor market in the first decade of the 21<sup>st</sup> Century has been the lack of overall employment growth caused in large part by the hemorrhaging of manufacturing jobs. Ohio's non-farm payroll employment never recovered all of the jobs it lost in the recession of 2001.<sup>27</sup> Overall employment losses continued through

<sup>27</sup> This report uses a federal monthly employer survey, Current Employment Statistics (CES), to track Ohio's employment. The survey produces the most up-to-date payroll employment information available and is widely quoted in the press. The survey is benchmarked to administrative records derived from information reported by employers through the unemployment insurance (UI) tax system. UI employment numbers are not released until six months after a calendar quarter is finished. The CES survey estimates for 2008 are officially considered to be preliminary. The benchmarking process is especially important at turning points in the economy, when the survey historically has been less accurate. There is strong evidence that the first quarter of 2008 may have been such a turning point and that employment estimates for 2008 will be revised downward significantly. George Zeller, an Economic Research Analyst (and Policy Matters Ohio Executive Board member) who tracks employment data, estimates that the CES total employment figure for Ohio will be revised downward by roughly 30,000 jobs, or about 0.6 percent. See <http://www.nacs.net/~georgez/ohusajob1208.pdf>

2003. Health care and certain other service sectors have been growing, but manufacturing jobs continue to decline. As the national economy came out of its doldrums in 2004, Ohio’s employment level rose slightly each year through 2006, then slipped again in 2007 (Figure 3).

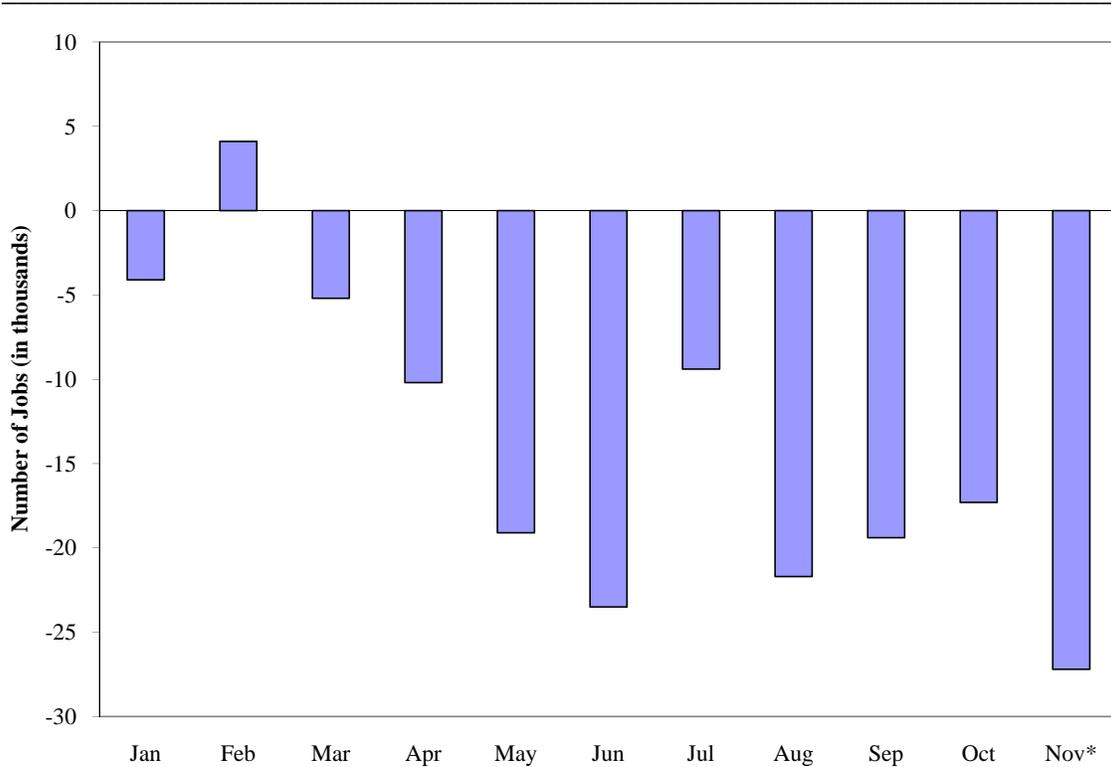
Figure 3  
 Non-farm Payroll Employment in Ohio, 1998 – 2007  
 (Annual Averages)



Source: BLS CES, not seasonally adjusted.

Employment continues to fall in 2008. Monthly job totals through November have been lower than 2007 in all but one month (Figure 4). It is likely that the 2008 average will fall back to the 2004 level or even lower after final revisions.

Figure 4  
 Monthly Ohio Total Non-farm Payroll Employment Levels,  
 Difference with corresponding month 2007 to 2008



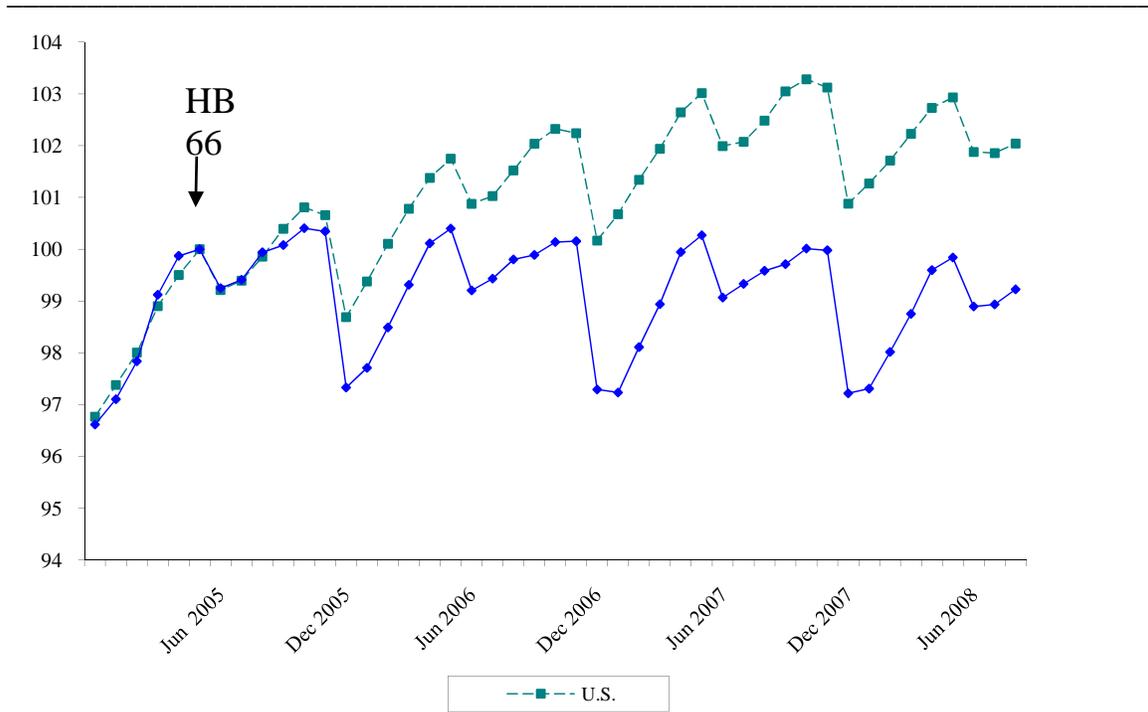
Source: BLS CES, not seasonally adjusted. \* Preliminary

Figure 5 shows an indexed comparison of U.S. and Ohio total employment from the beginning of 2005 through September 2008. The June 2005 level of employment is established as a base period that equals 100. Each whole number increment is equal to a one percent change in the level of employment. For example, a level of 102 indicates that employment is two percent higher than in the base period.

The graph shows that the U.S. and Ohio employment levels started to diverge significantly in 2006. National employment showed a small rise, while Ohio employment stagnated. In June 2008, the most recent seasonal peak, the U.S. level was nearly 103, indicating three percent growth over three years. Although this was not an impressive level of growth by historical standards in an economic expansion, Ohio's level in June 2008 was slightly below 100. Previously, in June 2006 and 2007, Ohio managed to reach 100.4 and 100.3, respectively. If Ohio's employment level growth

since 2005 had matched the nation's, the state would have had 160,000 more jobs in June 2008.

Figure 5  
 Index Comparison of Ohio and U.S. Total Payroll Employment, 2005 – Sep. 2008  
 (June 2005 = 100)



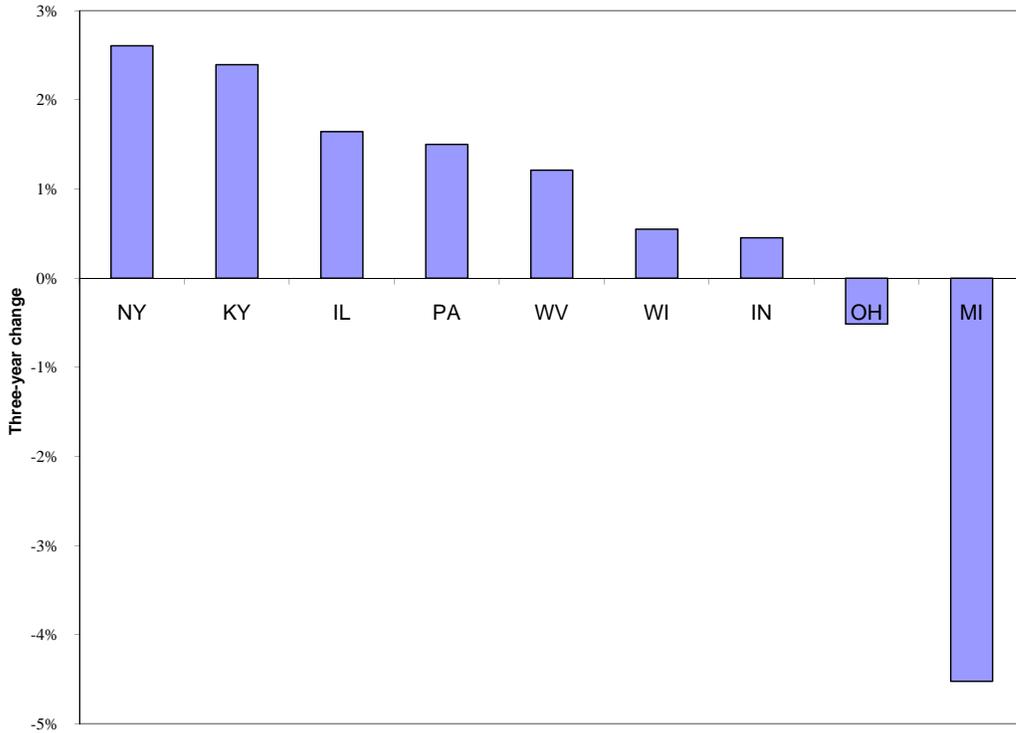
Source: BLS, CES survey (not seasonally adjusted); Policy Matters Ohio.

Another way to look at employment is to take into account both self-employed individuals and payroll employees. Even using this more comprehensive measure, Ohio's employment growth rate did not keep up with the nation. As recently as 1998, Ohio's share of total national employment, including self-employed individuals, was nearly 4.2 percent. Ohio's share continued its slow slide after tax reform, hitting a low of 3.9 percent in the summer of 2008.<sup>28</sup>

Ohio's relative underperformance in employment also holds true in a comparison with nearby states (Figure 6). Looking at third quarter 2008 employment, a full three years after tax reform, all of the nearby or surrounding states gained jobs except Michigan. Ohio and Michigan never truly recovered from the 2001 recession. Structural changes in our economy, especially the declining market share of domestic car manufacturers and outsourcing of manufacturing jobs to low-cost countries, caused both states to hemorrhage manufacturing jobs in recent years .

<sup>28</sup> Author's analysis of BLS Local Area Unemployment Statistics, not seasonally adjusted.

Figure 6.  
Change in Total Non-farm Employment Levels in Ohio and Nearby States,  
3<sup>rd</sup> Quarter, 2005 - 2008



Source: BLS. CES, not seasonally adjusted. Policy Matters Ohio.

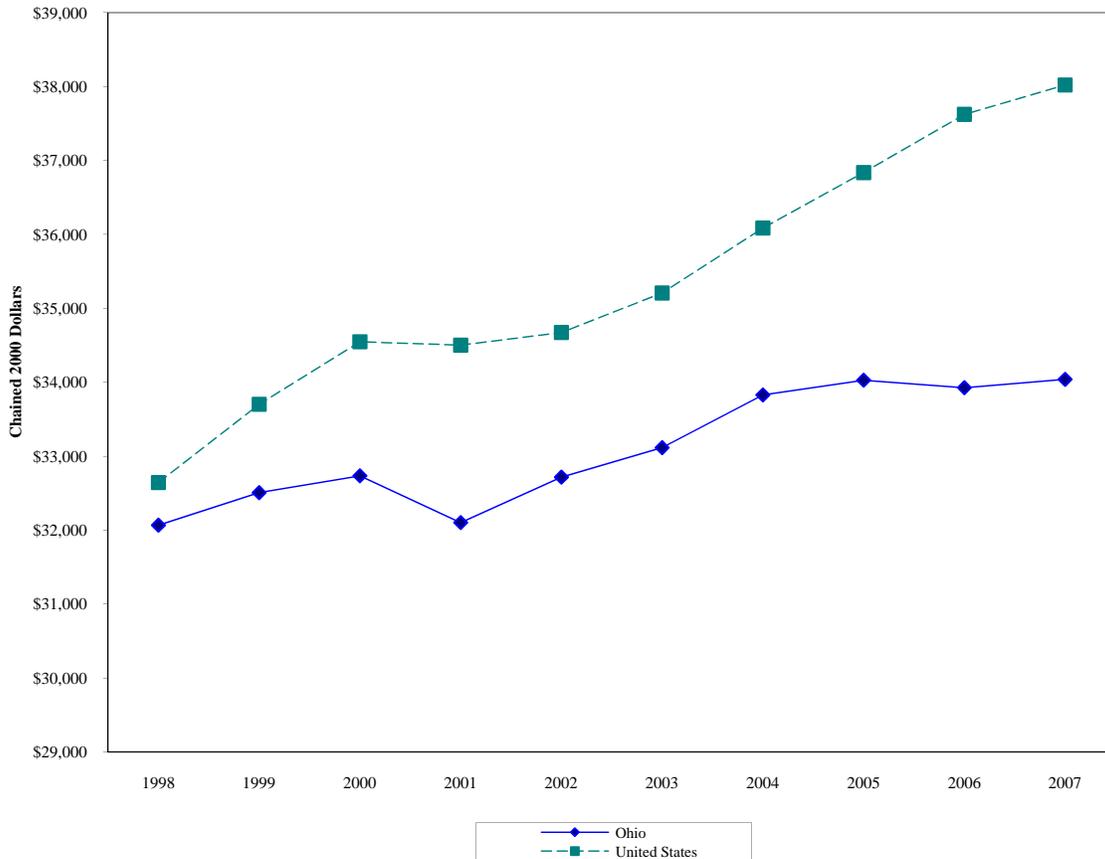
### STATE GDP GROWTH

One of the ways of looking at the health of an economy is to measure its level of production, known more formally as gross domestic product (GDP). An internationally accepted way of comparing economies is to adjust the level of output to account for differences in the population of a geographic unit, i.e., a per capita measurement. From 2005 to 2007, Ohio’s GDP per capita was essentially unchanged (Figure 7). Only six other states had lower growth rates.

National GDP per capita grew by 3.2 percent, further widening the gap between Ohio and US GDP levels by nearly \$1,200 per person.<sup>29</sup> In just two years, Ohio’s GDP per capita ranking among states fell from 27<sup>th</sup> to 32<sup>nd</sup> highest. In 1998, Ohio’s GDP per capita was \$576 per person lower than that of the nation. By 2007, the gap had widened to nearly \$4,000 per person.

<sup>29</sup> The chart shows total national real GDP adjusted for national population growth, not the average of states.

Figure 7  
Ohio and U.S. real levels of GDP per capita, 1998 - 2007



Source: Bureau of Economic Analysis.

Ohio's growth rate was also subpar when compared to the Great Lakes region, which posted a lackluster 0.4 percent per capita growth rate between 2005 and 2007. The Great Lakes states' higher reliance on durable goods manufacturing translated into lower rates of economic growth.

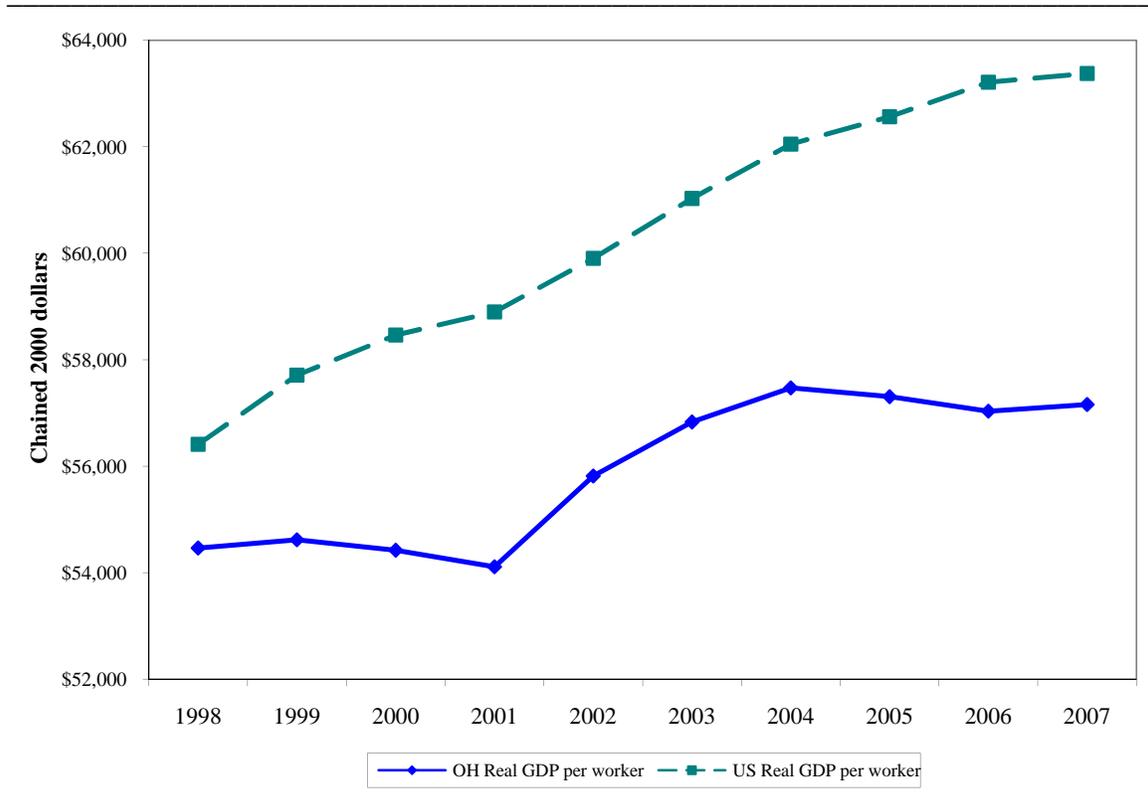
A slightly different way to measure GDP is to adjust for the size of the state's total workforce, including self-employed individuals, and farmers and other proprietors.<sup>30</sup> This is really a broad measure of productivity, and, in theory, could put a slow growth state like Ohio in better light if the economy achieves more output per worker. This is

<sup>30</sup> The BEA estimates both farm proprietors and non-farm proprietors who are not assumed to be limited partners in a business. This estimate is a count of jobs and not of individuals, and includes any sole proprietors who are active during the year. In other words, an individual who is an employee and also runs a business would be counted twice.

one of the “lead measures” of the Ohio Department of Development’s new strategic plan.<sup>31</sup>

As shown in Figure 8, Ohio’s has not become more productive in the last several years, although there was a big jump in productivity in the early 2000s. The overall trend is similar to the previous measurement. U.S. output per job grew slowly by 1.3 percent in real terms between 2005 and 2007, climbing from \$62,564 to \$63,377. Ohio’s output per job declined from 2005 to 2006, rose slightly in 2007, but remains below its 2004 level. The size of the gap between the U.S. and Ohio increased from \$5,257 to \$6,217 (\$960 per job, or 18.3 percent) over the two year period.

Figure 8  
Real Total GDP per Job in the United States and Ohio, including self-employed, 1998-2007



Source: BEA; Policy Matters Ohio.

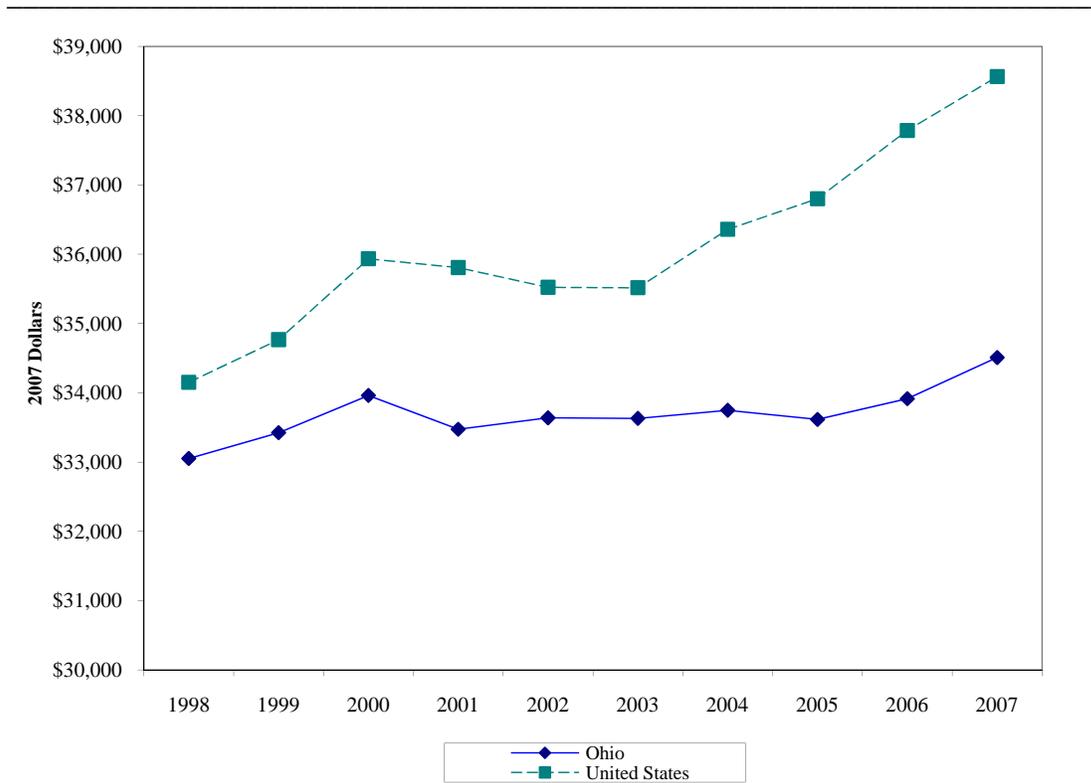
Slow GDP growth constrains the standard of living of Ohio’s population. This can be seen in measures of income and wages. A common way to measure the overall standard of living is to use personal income per capita. Official government personal income statistics include wages and salaries, transfer payments from government programs, proprietors’ (business owners) income, and contributions to social insurance programs.

<sup>31</sup> Ohio Department of Development. *Ohio, Home of Innovation & Opportunity. A Strategic Plan for the Ohio Department of Development.* (October 2008). (see page 5 of Executive Summary). Available at [http://development.ohio.gov/strategicplan/documents/Executive\\_Summary.pdf](http://development.ohio.gov/strategicplan/documents/Executive_Summary.pdf)

This indicator is far from ideal because it does not provide any insights into the distribution of income. In Ohio and U.S., the distribution of income has become more unequal over time, even as personal income per capita grows.<sup>32</sup> Personal income can grow even in periods of slow GDP growth because some individuals who remain employed still receive raises, transfer payments can increase, and capital gains and dividends may rise at a slow pace.

Figure 9 below shows changes in the level of inflation-adjusted personal income per capita in the U.S. and Ohio since 1998. Ohio managed to realize a small 2.7 gain between 2005 and 2007 but lost relative ground because national personal income grew by 4.8 percent. The gap between the US and Ohio increased from \$3,186 in 2005 to \$4,055 in 2007. Ohio’s ranking among states fell from 29<sup>th</sup> to 32<sup>nd</sup> highest in two years.

Figure 9  
Ohio and U.S. Real Personal Income per capita, 1998 – 2007



Source: Bureau of Economic Analysis; Policy Matters Ohio.

Ohio’s personal income per capita growth rate also trailed that of the Great Lakes region, which achieved a 3.3 percent gain from 2005 to 2007. The BEA includes Illinois, Indiana, Michigan, Ohio, and Wisconsin in the region.

<sup>32</sup> Amy Hanauer, *State of Working Ohio 2008*, Policy Matters Ohio (September 2008), Available at <http://www.policymattersohio.org/pdf/SOWO2008.pdf>.

The most recent personal income estimates for the third quarter of 2008 show that Ohio's total personal income had grown by 3.1 percent over the previous year (without adjusting for inflation), slightly below the Great Lakes' growth rate (3.2 percent). U.S. personal income had grown by 3.7 percent over the same period.<sup>33</sup>

## TRENDS IN MANUFACTURING

One of the key claims of proponents of H.B. 66 was that the tax changes would revive the sagging fortunes of the manufacturing sector. Proponents argued that manufacturing made a disproportionate share of local tangible personal property tax payments, and that the tax depressed the level of investment in Ohio.<sup>34</sup> Ohio's overall business tax burden, however, was in the middle of surrounding and nearby states before H.B. 66.<sup>35</sup> Moreover, over the long run the state and local tax system has shifted its burden increasingly onto individuals.<sup>36</sup> Ohio's overall business tax burden as a share of state GDP declined between 1980 and 2000.<sup>37</sup> H.B. 66 further reduced the amount of business taxes because CAT revenue did not come close to replacing the combined revenue from the two taxes it replaced.

H.B. 66 eliminated the tangible personal property tax on new machinery and equipment immediately. Companies continued to pay tax on existing machinery, inventory, and furniture for four years. Policy Matters Ohio testified to the legislature that Ohio's tax structure was not the cause of manufacturing sector's problems, particularly the continuing decline in employment.<sup>38</sup> Manufacturing employment decline is a national problem. The U.S. has lost over four million jobs since the late 1990s. Both Ohio and the nation have lost manufacturing jobs every year since the late 1990s. The long-term rate of decline has been slightly higher in Ohio than nationally. Ohio averaged a 3.1 percent annual decline from 1998 to 2007, while the U.S. average was 2.5 percent (see Figure 10). Ohio lost roughly 260,000 manufacturing jobs, or one fourth of

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<sup>33</sup> Author's calculation based on U.S. Bureau of Economic Analysis press release BEA 08-57, Dec. 18, 2008, available at [www.bea.gov](http://www.bea.gov). Third quarter 2008 estimates are revised. Calculation is in current dollars with no per capita adjustment.

<sup>34</sup> The same general line argument was advanced by the Ohio Manufacturers Association about the corporate franchise tax, although by the spring of 2005 it was widely acknowledged that the tax had numerous loopholes that led to a severe underperformance in revenues. For an analysis of manufacturing and Ohio's tax system before the tax overhaul, see Edward W. Hill, *Ohio's Competitive Advantage: Manufacturing Productivity*, Cleveland State University, Levin College of Public Affairs, 2001.

<sup>35</sup> A 2003 Ohio Department of Taxation study of business taxes found that "Ohio ranks in middle of the seven states, with lower burdens than Illinois, Indiana, and Michigan, but higher than Kentucky, Pennsylvania, and West Virginia." Mike Sobul, Ohio Department of Taxation, "Business Taxes in Ohio and Surrounding States," powerpoint presentation for the Governor's Blue Ribbon Task Force on Financing Student Success, November 13, 2008. Available at <http://www.blueribbontaskforce.ohio.gov/>

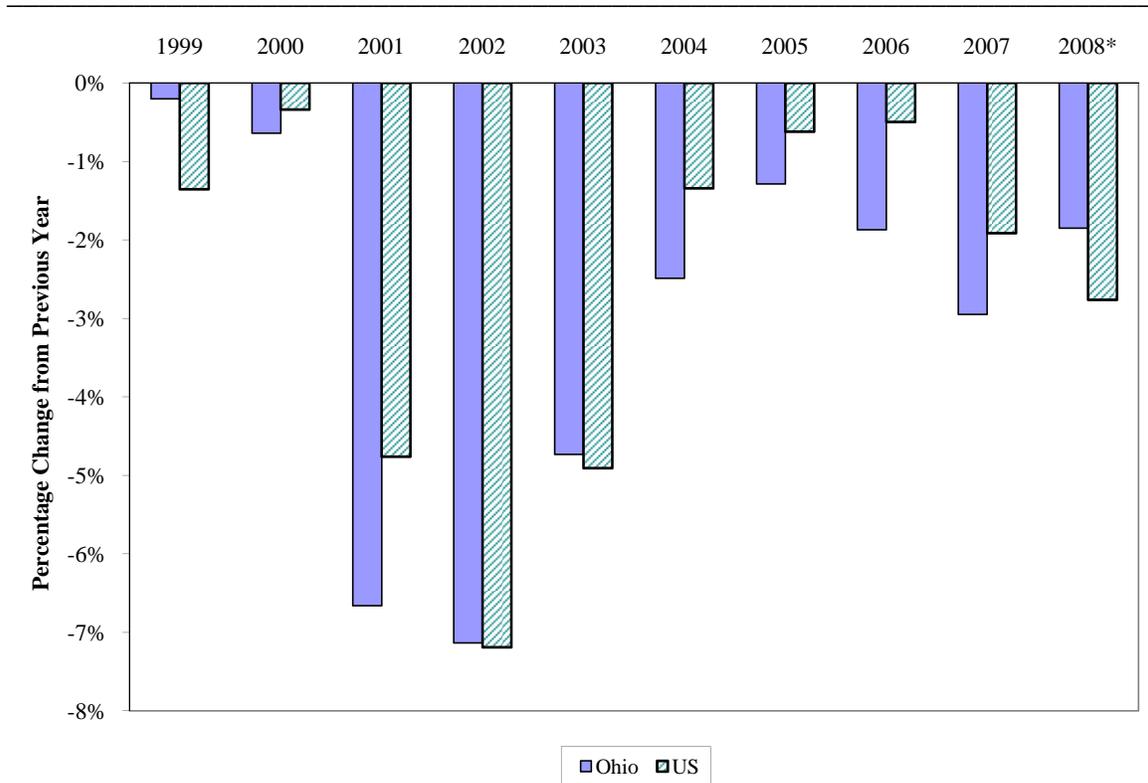
<sup>36</sup> Richard G. Sheridan, David A. Ellis, and Richard Marountas. "Equity and Relative Burden of Ohio's Tax Structure," *Taxing Issues* (Feb. 2003). Cleveland: The Federation for Community Planning (now the Center for Community Solutions), p. 11. See also Zach Schiller, "Ohio's State and Local Taxes: The Dwindling Business Share," Policy Matters Ohio, May 2004, available at <http://www.policymattersohio.org/OhioBizTaxes.htm>

<sup>37</sup> Sheridan, Ellis and Marountas, Op. cit., p. 12.

<sup>38</sup> Testimony of Jon Honeck for the Senate Finance and Financial Institutions committee, May 20, 2005, Available at [http://www.policymattersohio.org/Testimony\\_on\\_Taft\\_Tax\\_Proposal.htm](http://www.policymattersohio.org/Testimony_on_Taft_Tax_Proposal.htm).

its total. Nationally, roughly 3.7 million manufacturing jobs were lost in the same period, or 21 percent of the total. Ohio's rate of decline exceeded national rates in the first two years after tax reform. Based on preliminary figures through November, the U.S. rate of job loss was higher in 2008, a situation that also occurred most recently during 2002-2003.

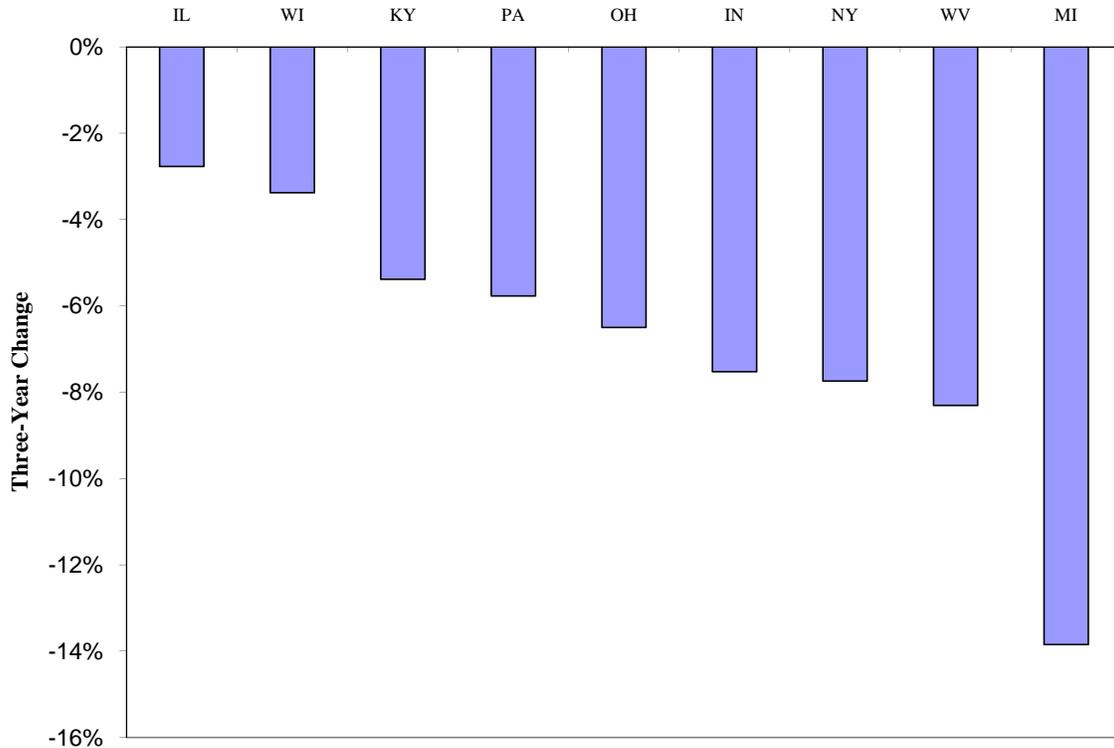
Figure 10  
Change in Average Annual Manufacturing Employment, Ohio and U.S.



Source: BLS, CES (not seasonally adjusted). \*Through November 2008 preliminary employment figures.

As measured over three years (3<sup>rd</sup> quarter 2005 to 3<sup>rd</sup> quarter 2008) Ohio's rate of manufacturing job loss was 6.5 percent while the nation's was 5.3 percent. Ohio was in the middle of the pack for nearby and surrounding states (Figure 11). Among large states, Ohio fared better than Michigan, New York, and Indiana, but worse than Illinois, Wisconsin, and Pennsylvania. The immediate problem for Michigan, Indiana, and Ohio is their level of exposure to the domestic auto industry.

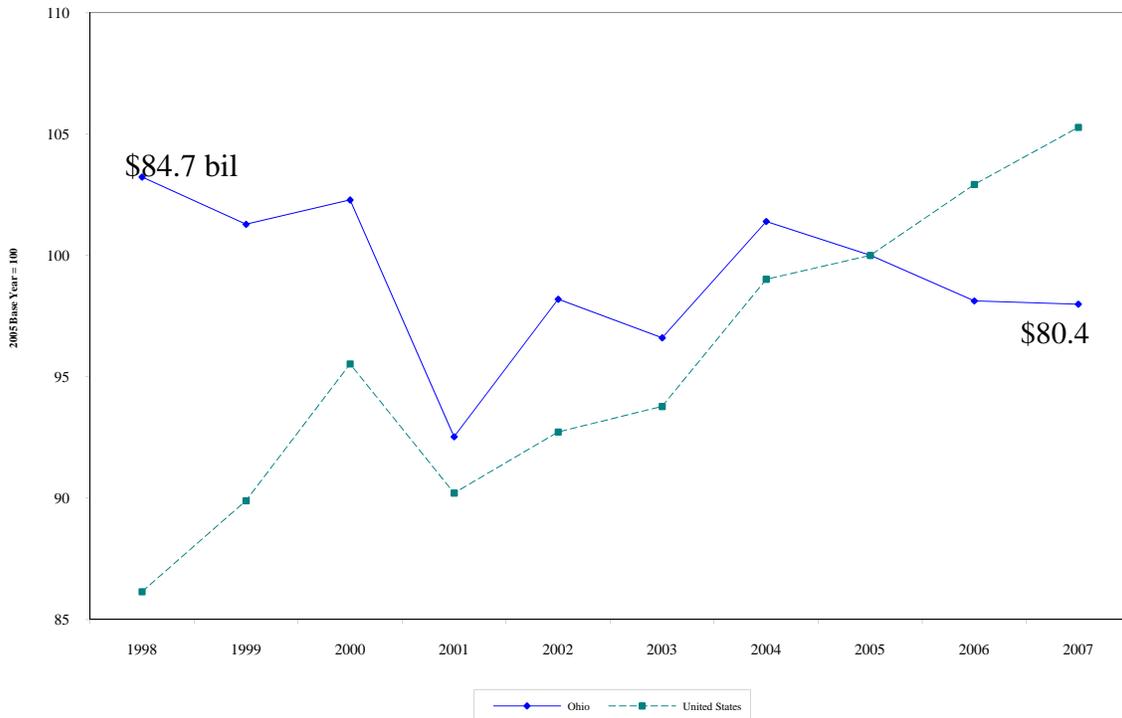
Figure 11  
 Three-year Change in Manufacturing Employment in Ohio and Nearby States,  
 3<sup>rd</sup> Quarter, 2005 – 2008\*



Source: BLS, CES not seasonally adjusted; Policy Matters Ohio. \* Average of three months.

Figure 12 shows changes in real, inflation-adjusted manufacturing production levels in the U.S. and Ohio over the most recent ten year period. By 2004, Ohio’s output recovered from the troughs of the 2001 recession, although it did not attain its pre-recession level. It declined steeply between 2004 and 2006, with a slight decline between 2006 and 2007. In 2007, it stood at roughly 98 percent of its 2005 level. U.S. manufacturing production has risen continuously since 2001, growing by 5.3 percent in the two years after H.B. 66.

Figure 12  
 Index Comparison of Ohio and US Manufacturing Real Production Levels, 1998 – 2007  
 (Chained 2000 dollars)



Source: Bureau of Economic Analysis; Policy Matters Ohio.

The fall in real production has occurred in spite of the growth in Ohio's exports to foreign countries. Ohio was the eighth-leading export state in 2007, and has increased its exports for ten years.<sup>39</sup> The upward trend in exports is nationwide. Ohio's share of total U.S. exports over the last three years peaked in 2003 at slightly over four percent and has declined slightly since then.<sup>40</sup>

Exports, of course, are only half of the equation. As a nation, we import far more than we export. This imbalance results in an enormous trade deficit that amounted to \$473 billion in 2007, excluding petroleum products.<sup>41</sup> Exports have not compensated for the loss of domestic market share in key industrial sectors that are important to Ohio. For example, imported products' share of the domestic automobile market, including parts, climbed from 27 percent to 38 percent from 1998 to 2007.<sup>42</sup> The Economic Policy

<sup>39</sup> Ohio Department of Development. *Ohio Exports 2007: Origins of Movement Series*. (March 2008). Available at <http://www.development.ohio.gov/research/FILES/B000000000.pdf>

<sup>40</sup> *Id.*, p. 5.

<sup>41</sup> Robert E. Scott, *The Burden of Outsourcing: U.S. non-oil trade deficit costs more than 5 million jobs*. Economic Policy Institute Briefing Paper # 222 (October 2008).

<sup>42</sup> Soo jeong Kim, Vincent A. Davis, Anna M. Jacobson, and Amanda S. Lyndaker. "Annual Industry Accounts Revised Statistics for 2005–2007." *Survey of Current Business* (December 2008), Bureau of Economic Analysis, U.S. Department of Commerce, pp. 21-31. See page 22.

Institute estimated that Ohio would have had 300,000 more jobs in 2007 if the trade deficit were eliminated.<sup>43</sup>

## INVESTMENT AND ENTREPRENEURSHIP

Because of a time lag in key economic statistics for Ohio and the nation, it is too early to fully evaluate the investment and new business formation goals of H.B. 66. State-level results from the 2007 U.S. Economic Census, for example, will not be published until later this year. Small Business Administration data on business births and deaths is also not available for 2007.

As evidence that H.B. 66's changes are working, the Ohio Department of Development points to Ohio's first place finish in *Site Selection* magazine's "Governor's Cup" contest for large expansions of private facilities in 2006 and 2007.<sup>44</sup> The relationship of this award to overall investment patterns and economic performance is murky, to say the least. Besides its sole focus on expansions, the award does not capture any information about plant closures or reductions, so we cannot make a judgment about net capital flows. Self-reporting by states may also introduce some bias. Ohio also won the award in 2003 and finished in the top four in 2002, 2004, and 2005. California, the nation's largest state, did not appear among the top ten states in any year since 2002, despite having the highest level of capital investment in manufacturing according to Census Bureau statistics.<sup>45</sup>

Data on the changes in the number of establishments (business locations, not "firms") offer limited insights into entrepreneurship. Figure 13 shows three-year cumulative changes in the number of establishments reporting payroll employees to the state unemployment compensation insurance system.<sup>46</sup> As shown by the bar at the far left of the chart, the total number of establishments grew by about two percent in three years. This figure masked large variations in trends by size of establishment as measured by the number of employees. The number of very small establishments with four or fewer employees increased by nearly four percent. The number of large establishments with 500 to 999 workers declined by over four percent, and those with over 1,000 employees declined by over eight percent. In theory, these large establishments were the most

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<sup>43</sup> Scott, *The Burden of Outsourcing*, p. 1.

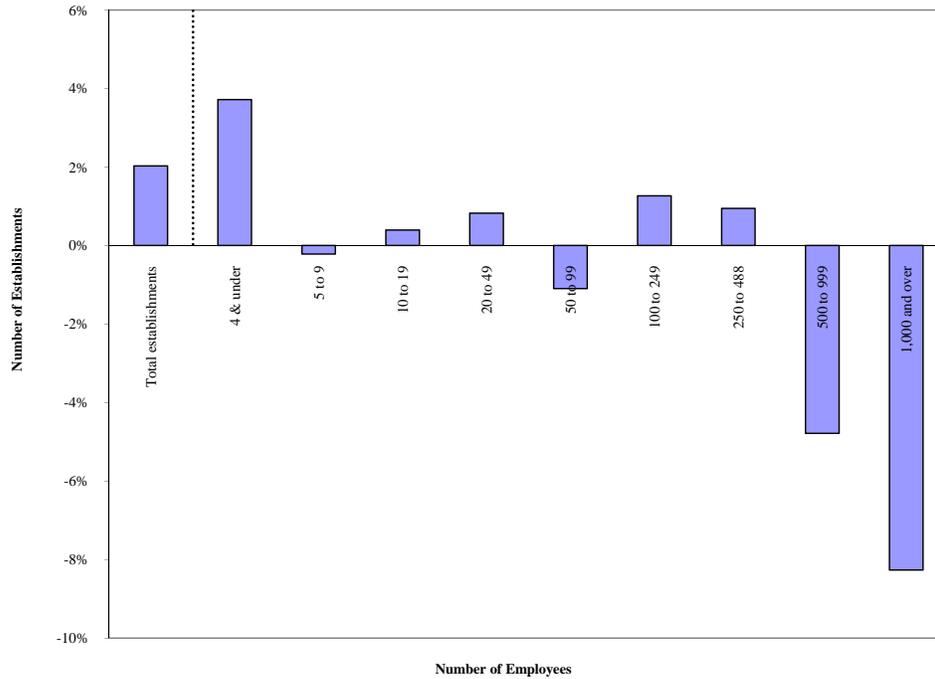
<sup>44</sup> The *Site Selection Magazine* provides the following information: The Governor's Cup is awarded annually to the U.S. state with the most new and expanded corporate facilities (as tracked by Conway Data Inc.'s New Plant Database). The database focuses only on new corporate location projects with significant impact. *Site Selection* does not track retail and government projects, or schools and hospitals. New facilities and expansions included in the analyses must meet at least one of three criteria: (a) involve a capital investment of at least US\$1 million; (b) create at least 50 new jobs; (c) add at least 20,000 sq. ft. (1,858 sq. m.) of new floor area. See [www.siteselection.com](http://www.siteselection.com).

<sup>45</sup> The U.S. Census Bureau's statistics, which include 2006, show that Ohio has ranked third among states in its level of new capital expenditures in the manufacturing sector in recent years. Texas has ranked second. U.S. Census Bureau, *Annual Survey of Manufactures: Geographic Area Statistics* (2003 through 2006) and *2002 Economic Census*. See <http://www.census.gov/mcd/asmhome.html>

<sup>46</sup> The U.S. Bureau of Labor Statistics provides establishment data based on the same administrative source, but the state figures do not match those provided by ODJFS, so we have not made a comparison to trends from other states or the nation.

capital intensive and should have had the most to gain from cuts in the tangible personal property tax.

Figure 13  
Change in the Number of Ohio Private Establishments by size (employees), 2005 - 2008



Source: ODJFS, Bureau of Labor Market Information. (Data are drawn from the first quarter of each year).

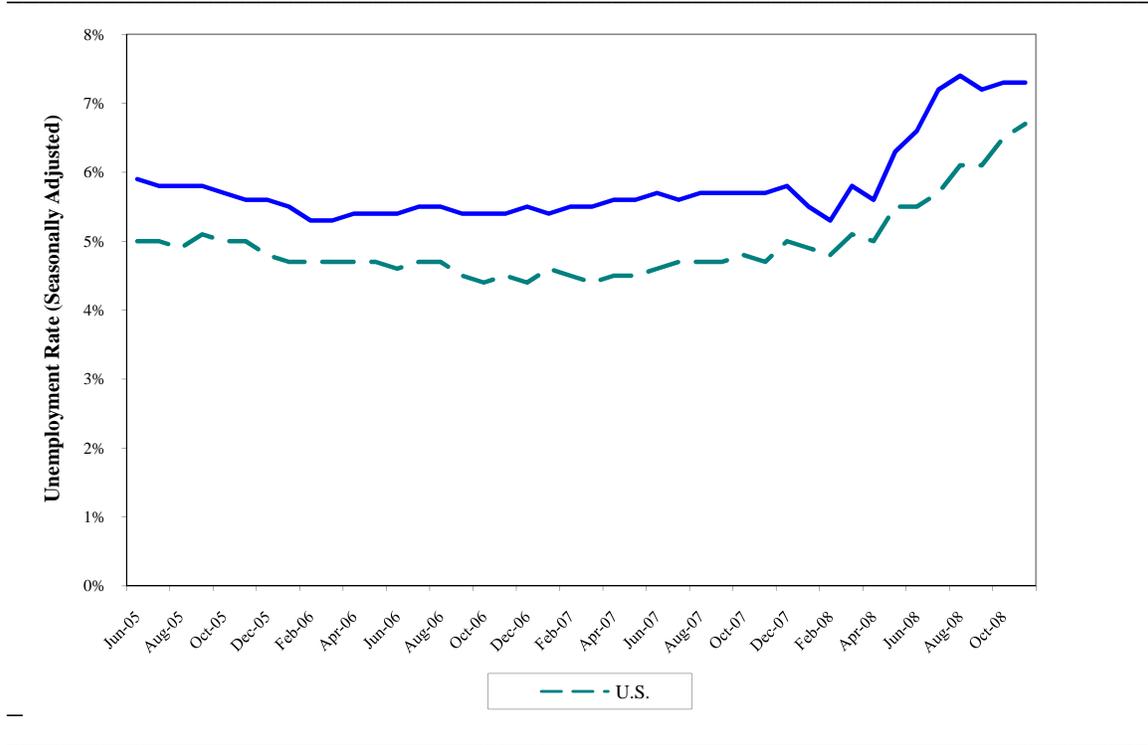
### MORE OHIO FAMILIES CANNOT MEET BASIC NEEDS

Not surprisingly, Ohio's economic struggles are driving more workers into unemployment and forcing them to seek assistance. Ohio's level of unemployment (shown in the solid line) remained above the national rate since the passage of H.B. 66 (Figure 14). Its low point over this period was 5.3 percent in February 2006. Both the national and Ohio rates have climbed steeply since spring 2008. As of November, 435,000 Ohioans were unemployed but seeking work, giving the state an unemployment rate of 7.3 percent.<sup>47</sup> The national rate was 6.7 percent. The recent flood of calls to Ohio's unemployment compensation Internet site and telephone lines, crashing the system, indicated how the problem is worsening.<sup>48</sup>

<sup>47</sup> Ohio Department of Job and Family Services, Labor Market Information Bureau. *Labor Market Review November 2008*. Available at <http://OhioLMI.com/ces/lmr.htm>.

<sup>48</sup> Candisky, Catherine, "Jobless System Fried," *The Columbus Dispatch*, Jan. 7, 2009

Figure 14  
Ohio and U.S. Monthly Unemployment Rates, June 2005 – Nov. 2008



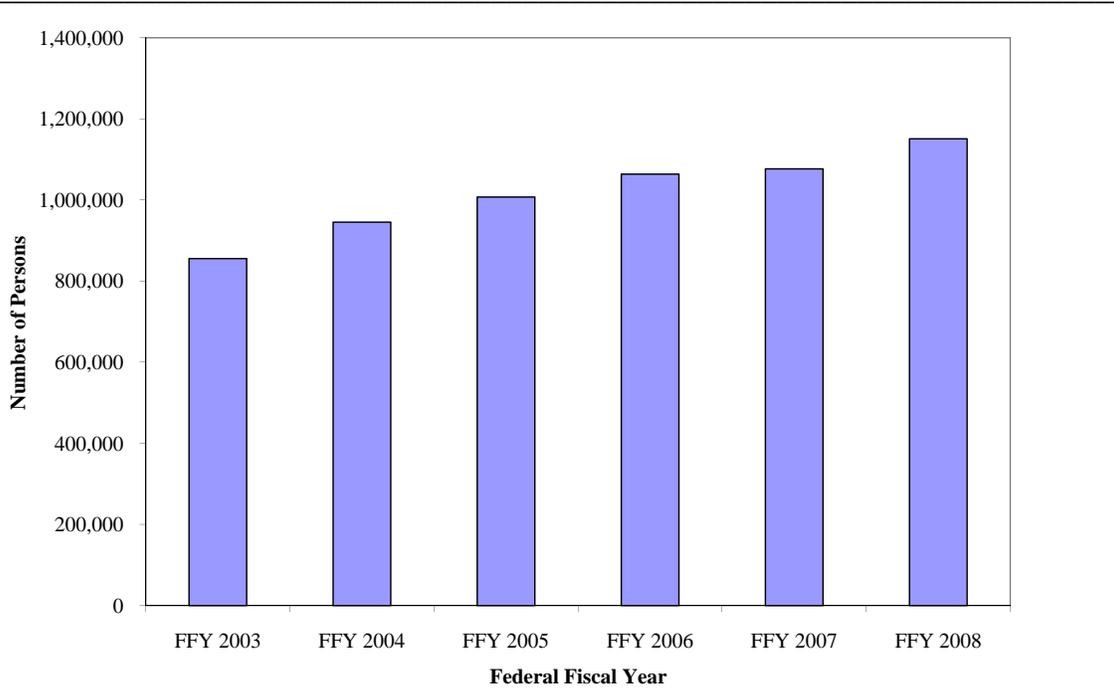
Source: BLS. November estimates are preliminary.

One of clearest indicators of the increased difficulties that Ohio families have in meeting basic needs is growing levels of participation in key social programs. A 2008 survey of individuals seeking assistance from county Job and Family Services departments found that 35 percent of the applicants had not applied in the last five years.<sup>49</sup> The federally-funded Supplemental Nutritional Assistance Program (SNAP), formerly known as “food stamps,” has seen increasing participation since the previous recession. SNAP is a means-tested program, administered by county Job and Family Services departments with state guidance. Households must have an income limit below 130 percent of the federal poverty level. Increased participation can result from more Ohioans falling under the income limits and more financial distress on families who were already eligible. In 2008, roughly one in ten people in Ohio, or about 1.1 million, received assistance from SNAP.

Figure 15 shows average monthly participation in SNAP by federal fiscal year, which runs from October 1<sup>st</sup> to September 30<sup>th</sup>. Federal fiscal year 2008 ended on September 30, 2008. After an increase from FFY 2005 to 2006, the program grew only slightly the next year, consistent with the slight improvement in Ohio’s labor market in 2006. Participation increased by over 74,000 individuals, or 6.9 percent, from FFY 2007 to 2008.

<sup>49</sup> Gongwer News Service, “Budget Warning Especially Dire for Aid to the Poor, but Medicaid Spending Remains Under Estimates,” Vol. 77, Report 240, Art. 1, December 12, 2008. Quoting Joel Potts, senior policy analyst for the Ohio Job and Family Services Director’s Association.

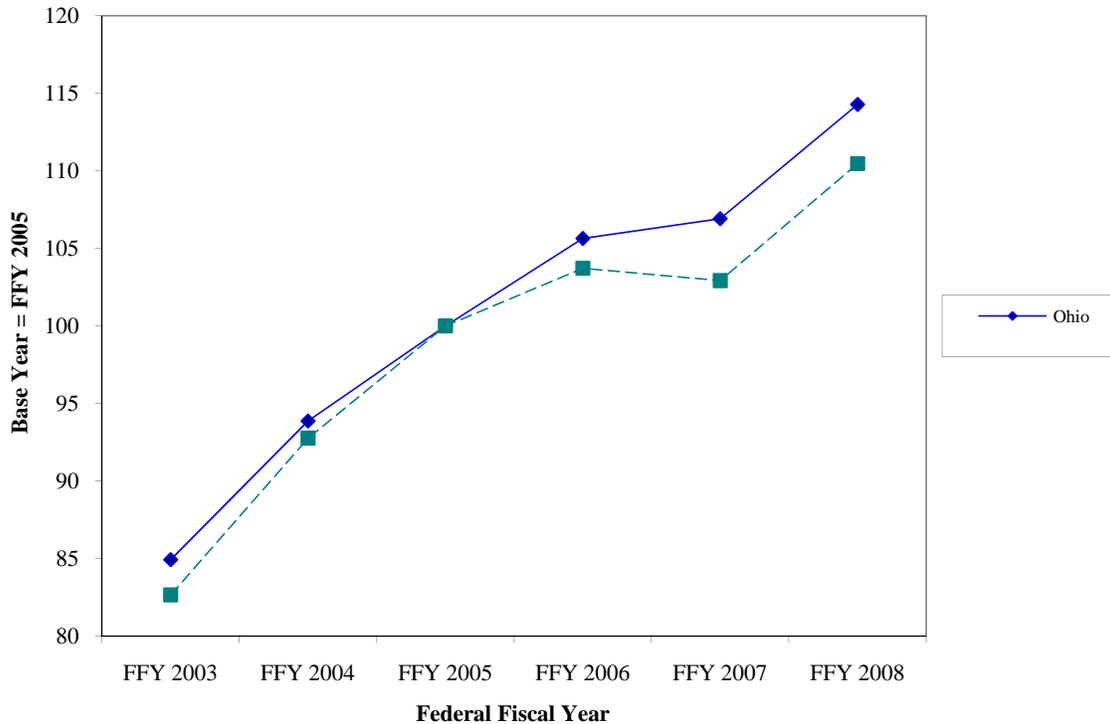
Figure 15  
Average Monthly Participation in Ohio SNAP, by federal fiscal year



Source: US Department of Agriculture.

Figure 16 compares the annual levels of food stamp participation in the U.S. and Ohio. By FFY 2008, three years after H.B. 66, the national participation level was 10.5 percent higher, but enrollment in Ohio's program had grown by 14.3 percent. On average, 144,000 more Ohioans participated in the program each month in 2008.

Figure 16  
Index Comparison of Ohio and U.S. Average Monthly Participation in SNAP



Source: US Department of Agriculture; Policy Matters Ohio.

The Ohio Works First (OWF) program provides cash assistance to the poorest families in Ohio through a mix of state and federal funds from the Temporary Assistance to Needy Families (TANF) grant. Gross monthly income limits are 50 percent of federal poverty guidelines.<sup>50</sup> States have significant flexibility in designing their programs, so national comparisons of caseloads are a reflection of policy choices and not just need. In Ohio, adults cannot receive benefits for more than three years.<sup>51</sup> There is no time limit for children. Most of the individuals receiving OWF are children with no OWF-eligible adult in the household.<sup>52</sup>

<sup>50</sup> Ohio Department of Job and Family Services, *Temporary Assistance to Needy Family (TANF) State Title IV-A Plan*, January 31, 2008. Available at [http://jfs.ohio.gov/owf/tanf/070107tanfplanamendment\\_011708final%20draft.pdf](http://jfs.ohio.gov/owf/tanf/070107tanfplanamendment_011708final%20draft.pdf)

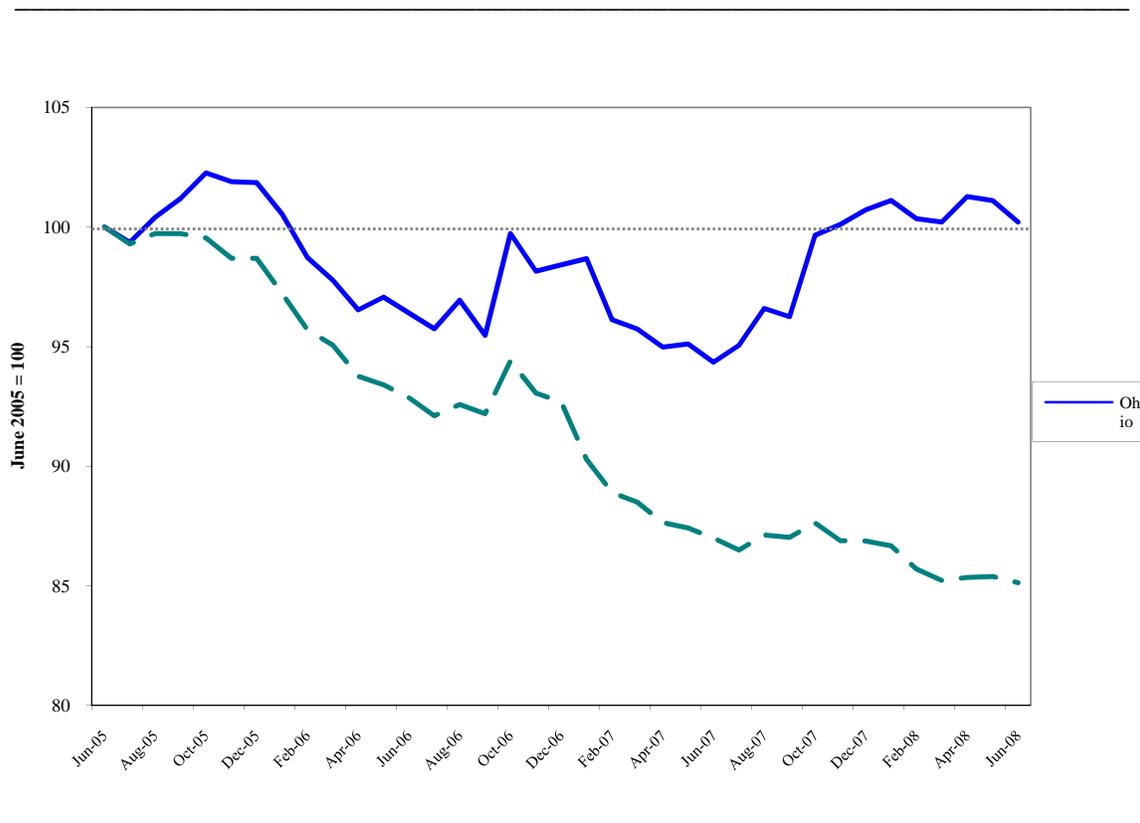
<sup>51</sup> After 24 months away from the program, individuals may reapply for an additional 24 months of benefits upon showing good cause for reapplying. “Table IV.C.1: State Lifetime Time Limit Policies,” p. 142-4. *Welfare Rules Databook: State TANF Policies as of July 2007*. The Urban Institute. August 2008. Available at

[http://www.acf.hhs.gov/programs/opre/welfare\\_employ/state\\_tanf/reports/wel\\_rules07/wel\\_rules07.pdf](http://www.acf.hhs.gov/programs/opre/welfare_employ/state_tanf/reports/wel_rules07/wel_rules07.pdf)

<sup>52</sup> Most commonly they are children cared for by an adult relative or guardian who has an income level above the eligibility threshold.

In the aftermath of H.B. 66, Ohio diverged substantially from national caseload trends despite the state's relatively stringent eligibility guidelines (Figure 17). Between June 2005 and June 2007, national caseloads dropped by thirteen percent, while Ohio's had fallen by less than six percent. In the latter half of 2007 and the first half of 2008, national caseloads continued to decline, while the number of OWF recipients in Ohio returned to 2005 levels and is expected to climb higher as the economy worsens.<sup>53</sup> The chart does not reflect caseload growth in the second half of 2008. In just one month in 2008 (September to October), the number of OWF recipients increased by over 4,000.<sup>54</sup> Of course, Ohio could reduce its caseloads by further restricting eligibility, something we would consider undesirable. The point is simply that need is increasing in Ohio and increasing relative to the rest of the nation.

Figure 17  
Monthly Ohio and U.S. TANF Recipients,  
June 2005 – June 2008



Source: U.S. Department of Health and Human Services; Policy Matters Ohio.

<sup>53</sup> Gongwer News Service, Budget Warning Especially Dire for Aid to the Poor...” *op. cit.*

<sup>54</sup> Ohio Office of Budget and Management, Monthly Financial Report, Dec. 12, 2008, p. 15.

## TAXES AND ECONOMIC PERFORMANCE

In the eyes of its supporters, H.B. 66 served a dual purpose: to redesign the tax code and to restrict the rate of growth of state spending. The latter agenda flowed from a supply side argument that lower tax rates would induce more savings by firms and households. Increasing savings would then lead to more investment in Ohio. Even at the federal level, empirical support for supply side policies raising the long-term level of national economic growth is weak. The U.S. economy performed better across a range of economic outcomes -- investment, GDP, median household income, hourly earnings, and employment -- after the 1993 tax increase than after the 1981 or 2001 tax cuts.<sup>55</sup>

The arguments for supply side economics are even more implausible at the state level because states must balance their budgets. When revenue declines, states and local governments must reduce spending. Spending cuts impact jobs in public agencies and in private sector organizations that contract with the state. These cuts not only have an impact on economic activity, they affect the ability of the public sector to provide services -- education, health, law enforcement, infrastructure -- that are necessary for an acceptable quality of life.

In a 2006 report, Policy Matters Ohio examined the empirical relationship between state budget growth and private sector economic performance.<sup>56</sup> The results produced no support whatsoever for arguments that state budget restraint boosted economic growth. The first set of analyses tested the proposition that the size of the public sector, as measured by the state and local government share of total GDP, is related to private sector growth. In the 1990 to 1997 period, states with larger public sectors performed better economically. In the 1997 to 2004 time period, the size of the public sector was not related to economic performance.

The second set of analyses examined the relationship between changes in state and local government GDP and private sector GDP per capita. There was wide variation in changes in state and local government GDP per capita. Some states even experienced a decline. In both the 1990-1997 and 1997-2004 time periods, increases in public sector GDP were associated with increases in private sector GDP.<sup>57</sup> As a group, states that experienced a decline in public sector GDP did not perform as well as states with growing public sectors. These results should not be interpreted to imply causality. On the whole, they reflect the negligible influence that states and local governments have over short-to-medium term economic performance.

Snapshots of the relationship between tax collections, as measured by state and local tax revenue per capita show a strong positive association with GDP and personal income. In

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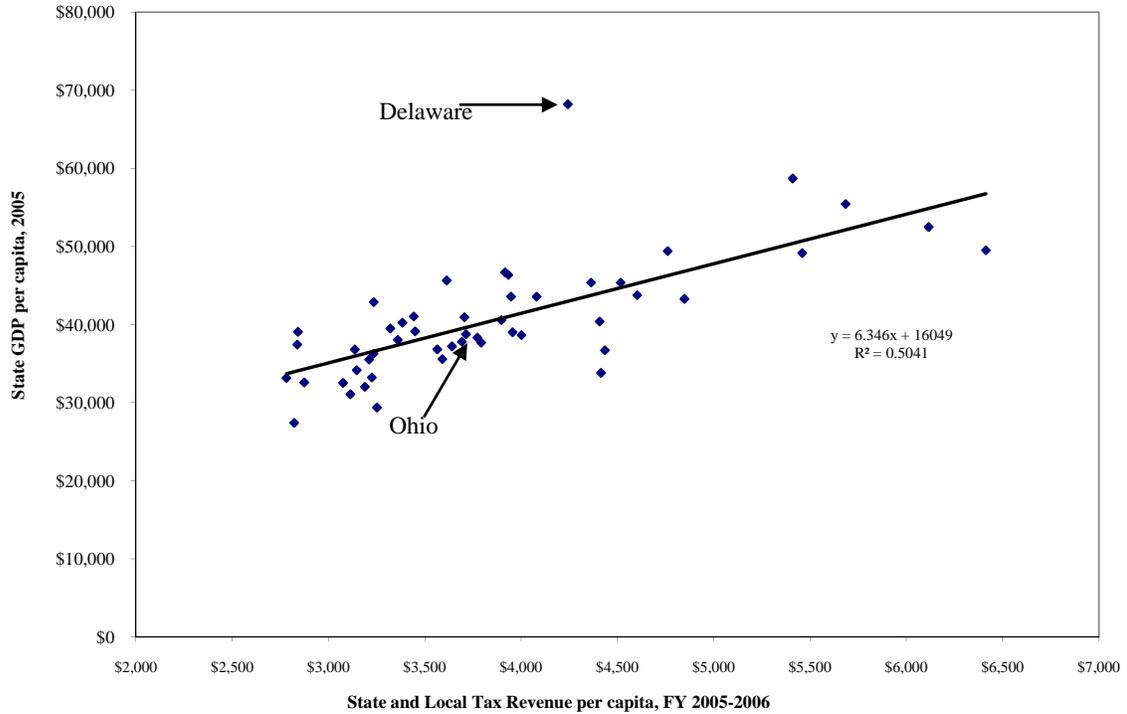
<sup>55</sup> Michael Ettlinger and John Irons, *Take a Walk on the Supply Side: Tax Cuts on Profits, Savings, and the Wealthy Fail to Spur Economic Growth*. September 2008. Economic Policy Institute and the Center for American Progress.

<sup>56</sup> Honeck, Jon. *Economic Growth and the Public Sector*. Policy Matters Ohio. September 2006, available at [http://www.policymattersohio.org/state\\_economic\\_growth\\_2006.htm](http://www.policymattersohio.org/state_economic_growth_2006.htm).

<sup>57</sup> These time periods are the result of a change in government classification systems for economic activity.

other words, states with higher incomes and higher levels of output choose to tax themselves more. The relationship shown in Figure 18 implies that an additional \$100 in per capita tax revenue is associated with a \$635 increase in per capita state GDP.

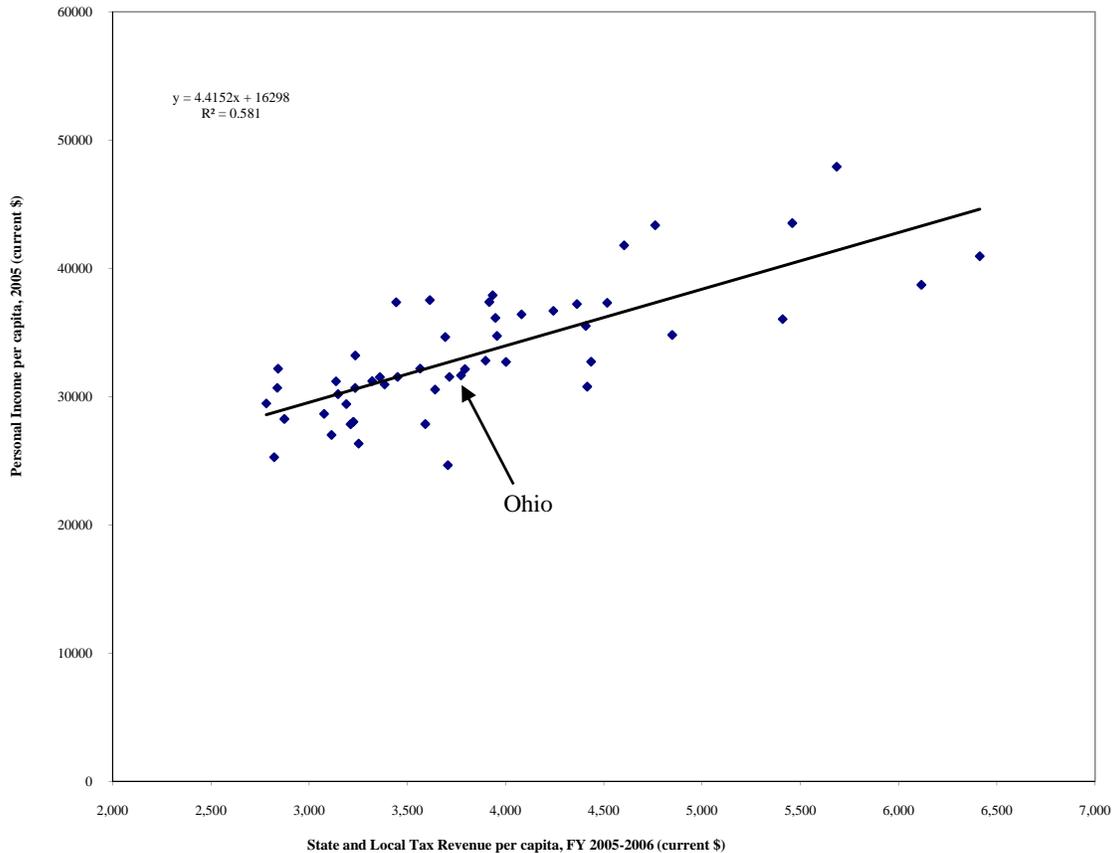
Figure 18  
Regression of State and Local Tax Revenue per capita and State GDP per capita



Source: U.S. Census Bureau; BEA; Policy Matters Ohio. Each diamond represents a state.

The relationship shown in Figure 19 below implies that an additional \$100 in tax revenue per capita is associated with an increase of \$442 of personal income per capita.

Figure 19  
Regression of State and Local Tax Revenue per capita and Personal Income per capita



Source: Census Bureau; BEA; Policy Matters Ohio. Each diamond represents a state.

These data should not be used to suggest higher taxes result in higher personal income. However, as with the data on public sector output, they provide no support for the idea that lower state and local taxes boost economic growth.

## CONCLUSION AND RECOMMENDATIONS

House Bill 66 marked the most significant overhaul of Ohio's tax system in a generation. Each element of the plan had a specific rationale, but the unifying principle was to provide a supply side stimulus to Ohio's economy with the expectation that it would increase private investment. It was designed to remove over two billion dollars in tax revenue from state coffers upon full implementation and to severely restrict the growth of the state budget. The package created clear winners and losers among households and businesses. Cuts to the income tax and increases in the sales tax and the tobacco tax

made the state tax system more regressive. The elimination of the tangible personal property tax in favor of a gross receipts tax was intended to help manufacturing while shifting the tax burden to the service sector.

Evaluating the economic effects of H.B. 66 is a challenging task. There were no official benchmarks included in the legislation and the overall direction of Ohio's economy is determined by national and international economic forces. One cannot expect any state to sail against the headwinds created by a global credit crunch and collapse in consumer confidence. Instead, our approach has been to look at Ohio's *relative performance* with respect to the nation and nearby states. If the H.B. 66 changes were fulfilling their promise, it would be reasonable to expect that Ohio's economy would start to close the gap on key indicators, and would at least keep pace on others.

Since the passage of H.B. 66, Ohio's economy has failed to keep pace with the nation and nearby states in overall employment, productivity, or GDP growth. In the manufacturing sector, Ohio's real output fell while the nation's rose, and the number of jobs declined slightly more than the national average. These negative economic trends had real social costs. The state unemployment rate remained above the national average, and more Ohioans sought assistance from food security and cash assistance programs.

Thus, the evidence does not show that H.B. 66 has helped Ohio's economy even while continuing its framework impedes the state's ability to respond to the crisis. We need to ask some forthright questions of those who would take a "wait and see" approach and maintain the H.B. 66 tax framework: When will we see positive results? How will those results improve the lives of ordinary Ohioans? And, most immediately, how are we to measure the impact of cutbacks in public services on the quality of life and the business climate?

To deal with the revenue crisis Policy Matters Ohio recommends revising our current tax structure. Personal income tax rates should be restored to their 2007 levels for most Ohio families. This would leave three-fifths of the H.B. 66 income tax reduction in place for the vast majority of taxpayers. The top rate, which applies to incomes over \$200,000, should be restored to its original 2004 level. A state earned income tax credit would help to relieve the crunch facing lower income working families, although it would not help the state meet other needs. Other steps should also be taken on business taxes, including retaining and strengthening the corporate franchise tax.<sup>58</sup> In addition, unneeded tax breaks should be eliminated.<sup>59</sup> These reforms would help to close some of the budget gap for the upcoming biennium. Federal aid to the states will also play a critical role.

Structural changes in our economy, especially the declining market share of domestic car manufacturers and the outsourcing of U.S. jobs to low-cost countries, are the primary

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<sup>58</sup> A forthcoming report from Policy Matters Ohio will provide more detail on the 2005 business-tax overhaul and recommendations for business taxes.

<sup>59</sup> A 2008 Policy Matters Ohio report, *Limiting Loopholes: A Dozen Tax Break Ohio Can Do Without*, identified up to \$270 million a year that could be saved by closing tax loopholes. Available at <http://www.policymattersohio.org/LimitingLoopholes2008.htm>

causes of Ohio's economic problems. Starving the state of revenue will not address these problems, but it will add to human distress and prohibit Ohio from making the public investments it badly needs.

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