The 2005 Tax Overhaul and Ohio's Economy

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:

<u>Overall employment:</u>

• 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.

<u>*Economic Output, Productivity, and Income:*</u>

• 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 27th to 32nd 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.

Read the full report and learn more about an economy that works for all:
www.policymattersohio.org

Policy Matters Ohio
3631 Perkins Avenue Suite 4C–East, Cleveland, OH 44114 • 216/361-9801 • Fax: 216/361-9810
1372 Grandview Avenue Suite 242, Columbus, OH 43212 • 614/486-4601 • Fax: 614/486-4603

POLICY MATTERS OHIO
3631 PERKINS AVENUE SUITE 4C–EAST, CLEVELAND, OH 44114 • 216/361-9801 • FAX: 216/361-9810
1372 GRANDVIEW AVENUE SUITE 242, COLUMBUS, OH 43212 • 614/486-4601 • FAX: 614/486-4603

• 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 29th to 32nd highest in two years.

Manufacturing continues to decline:

• As measured over three years (3rd quarter 2005 to 3rd 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.