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2005 State Tax Overhaul Fails to Produce Economic Returns

Report finds that Ohio fell further behind the nation even before recession

A new report from Policy Matters Ohio, ***The 2005 Tax Overhaul and Ohio's Economy***, analyzes trends in Ohio's economy since 2005 when House Bill 66 overhauled the state tax system. House Bill 66 made dramatic changes to the state tax code on the premise that they would improve economic conditions for ordinary Ohioans. These changes removed over $2 billion a year from the state budget at a time when the state must cut basic services to solve massive budget deficits. Many factors besides taxation affect the state economy, so the report looks at Ohio's *relative performance* with respect to the nation and nearby states. If the tax changes were fulfilling their promise, Ohio's economy would start to close the gap on key indicators, and at least keep pace on others. Instead, even before the recession Ohio's economy lost ground relative to the nation, as evidenced by the following:

<u>Total payroll employment:</u>

◆ If Ohio's non-farm 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.

◆ 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. The size of the gap between the U.S. and Ohio productivity levels increased from $5,257 to $6,217.

◆ 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 per capita in 2007.

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 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.

◆ 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 in November.

◆ 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. Average monthly participation in Ohio 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 levels of three years earlier, while national participation rates in TANF had declined by fifteen percent. Ohio participation rose markedly in the latter half of 2008.

"The 2005 tax overhaul shows few signs of reversing Ohio's economic decline," said report author Jon Honeck. "Continuing to starve the state of revenue will not solve Ohio's economic problems," he added, "but it will add to human distress and prohibit Ohio from making the public investments it badly needs."

Policy Matters Ohio recommends revising our current tax structure. Personal income tax rates should be restored to their 2007 levels, with one exception: The top income tax rate, which applies to incomes over $200,000, should be restored to its original 2004 level. Together, these changes would leave three-fifths of the H.B. 66 income tax reduction in place for the vast majority of taxpayers. A state Earned Income Tax Credit (EITC) would help low income working families meet their basic needs. Business taxes also need to be strengthened, included retaining and reforming 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.

Policy Matters Ohio is a non-profit, non-partisan research institute with offices in Cleveland and Columbus.