Testimony to the House Tax Reform Legislative Study Committee

Zach Schiller

Good morning, Chairman Scherer, Ranking Member Letson and members of the committee. My name is Zach Schiller and I am research director of Policy Matters Ohio, a nonpartisan, nonprofit research institute with the mission of creating a more prosperous, equitable, sustainable and inclusive Ohio. Thank you for the opportunity to testify today regarding tax policy.

For years, North Dakota has had the lowest unemployment rate of any state in the nation. Nevada, by contrast, has had the highest. North Dakota has a personal income tax, while Nevada has no personal income tax. There are, of course, other states that show a different pattern. We cite this to illustrate that taxes, and the personal income tax in particular, are not the factor that determines state economic success.

Economists at the Federal Reserve Bank of Cleveland in a 2006 study reviewed decades of state economic performance to learn what factors had the most influence in per capita income growth. They concluded that average tax rates are not a statistically significant factor. More recently, Peter Fisher of the Iowa Policy Project and Noah Berger of the Massachusetts Budget and Policy Center looked at overall tax levels and median wages, and found no significant correlation. The Center on Budget and Policy Priorities noted in a report earlier this year that, "In the last two decades, a number of states have cut taxes deeply in hopes of spurring economic gains, with unimpressive results. That's not surprising given that the preponderance of the peer-reviewed academic studies indicate that state and local personal income tax levels do not affect economic performance."

Ohio's own experience bears this out. After General Assembly raised the top rate of the income tax to 7.5 percent in 1992, during the administration of Gov. George Voinovich, the state generated more than 100,000 jobs in each of the following three years. On the other hand, our tax cutting has not been followed by the same kind of growth. As you know, the General Assembly approved a phased-in reduction of the income tax by 21 percent beginning in 2005. Whether one begins with the approval date, the beginning or end of the recession, or January 2011, the results were the same: Ohio underperformed the nation. Since June 2005, we have lost a greater share of our jobs than all but three other states, Rhode Island, Nevada and Michigan.

Overall taxes aren't especially high in Ohio. In Fiscal Year 2011 our per capita state and local taxes ranked 26th among states. At $3,910, they were slightly below the U.S. average of $4,296. As a share of personal income, state and local taxes in Ohio ranked 17th, which at 10.6 percent were the same level as the national average. Most states are clustered around the same relative level of taxation.

If you add together the top rates of school, municipal and state income tax that someone may pay in Ohio, the maximum may appear higher than in nearby states. However, this is not the rate that most, or even a substantial share, of Ohioans pay. Because we have a graduated tax, the vast majority of Ohioans pays far less than the top rate—unlike those in flat-tax states. The taxation department found that, as of Tax Year 2011, 2.3 percent of the 5 million Ohio residents reported Federal Adjusted Gross Income of more than $200,000, slightly under where the top bracket kicked in. Thus, 4.9 million Ohioans were not paying the top rate of 5.925 percent. The middle fifth of Ohio taxpayers pay an effective rate of 3.4 percent in state and local income taxes as a share of their income, according to a report by the Institute on Taxation and Economic Policy (ITEP) based on Ohio's tax code as of January and 2010 income levels.

School district income taxes are collected only from those who live in the district. A total of 184 districts had such taxes as of January (of these, 4 charge the top rate of 2 percent, according to taxation department data). Ohioans who prefer to live in a district without such a tax can live in one of more than 400 other districts.

Some of the wealthiest communities in Ohio, such as Indian Hill and Orange, have municipal income taxes. It seems that many affluent Ohioans want the public services such taxes support, and are willing to pay to support them.

When you reduce the state income tax and replace it with the sales tax, you shift who pays for Ohio's public services to lower- and middle-income Ohioans so that affluent Ohioans – those who can afford to pay more – are paying less. This is what the ITEP found when it reviewed the tax changes in this year's budget bill (see www.policymattersohio.org/itep2-jun2013 for a full explanation). Taxpayers in the bottom fifth of the income spectrum, who made less than $18,000 last year, on average will pay $12 more under the tax package, while those in the top 1 percent, who made at least $335,000, on average will get an annual tax cut worth more than $6,000.

As noted, Ohio has not seen relative job gains since enacting the 2005 tax cuts. Budget director Tim Keen cited the economic forecast used to project baseline revenues for the budget in testimony to the conference committee in June. According to that forecast, Ohio's economy will grow less than the nation as a whole does during the two-year budget, our income gains will trail those of the country, and so will the number of jobs. This does not support a policy of tax cuts.

Ohio, unfortunately, is an undereducated state. Despite the infusion of some additional funds in the current budget, our support for preschool – an investment that experts agree is critical – lags behind that of the nation. At the same time, only 26.4 percent of Ohio workers have a college degree, compared to well over 30 percent nationally. Median wages are substantially higher in states with better-educated workers, as noted in the recent study by Fisher and Berger.

In a speech earlier this month, Sandra Pianalto, chair of the Federal Reserve Bank of Cleveland, cited the 2006 study by Cleveland Fed researchers and noted that, "It found that regions with higher levels of education and innovation see higher rates of income growth. That is no less true today than it was when I first said it years ago." She went on to urge her Cleveland audience to "continue investing in human capital. In doing so, we can ensure that our area's workforce is educated and innovative, and we can attract new companies and good jobs to our area. By focusing on building a skilled workforce over the long run, we can make Northeast Ohio a region that is ready and able to meet the opportunities of the twenty-first century."

Education is only one of the public needs that Ohio is neglecting. Our support for public transportation ranks among the lowest in the nation, while some local transit agencies struggle to provide basic service. Public health investments remain inadequate. Efforts to combat tobacco use, for instance, while revived with a modest appropriation in the current budget, remain far below recommended levels. Bonding turnpike revenues will pay for some more road projects, but does not provide for our long-term infrastructure needs.

We need a tax system that provides for these needs, and does so into the future.

We need a tax system that relies on those who can afford to pay, unlike today's tax code.

We need a tax system that bestows special preferences only with careful consideration, regular reviews, and sunsets that ensure they are not entitlements. The committee should review House Bill 24 and House Bill 81, and propose speedy approval of a regular review mechanism – with the addition of sunsets, like the state of Washington recently did.

We agree with Governor Kasich that we need to increase the taxes oil and gas companies pay to that tap Ohio's precious resources, and we need to broaden the base of the sales tax. Raising the sales-tax rate on goods that represent a shrinking share of what Ohioans buy is not forward-thinking tax policy. We need a stronger income tax so that our budget is balanced from those who can afford to pay, along with a refundable Earned Income Tax Credit. Even with the useful step of higher minimums for larger businesses, the Commercial Activity Tax is an inadequate substitute for the taxes it replaced.

Thank you for the opportunity to testify. I am happy to answer any questions you may have.

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