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The Buckeye Institute Policy Brief

Building a Better Future: An Analysis of Ohio's Tax and Spending Policies

By Orphe Pierre Divounguy, Ph.D. and Bryce Hill

Introduction

Governor John Kasich has pushed hard to lower Ohio's tax rates on income. Lower income taxes, however, only partially offset by higher sales taxes, have reduced the state's tax revenues, and as the state faces revenue shortfalls, some have questioned the true effects of Governor Kasich's preferred tax policies.

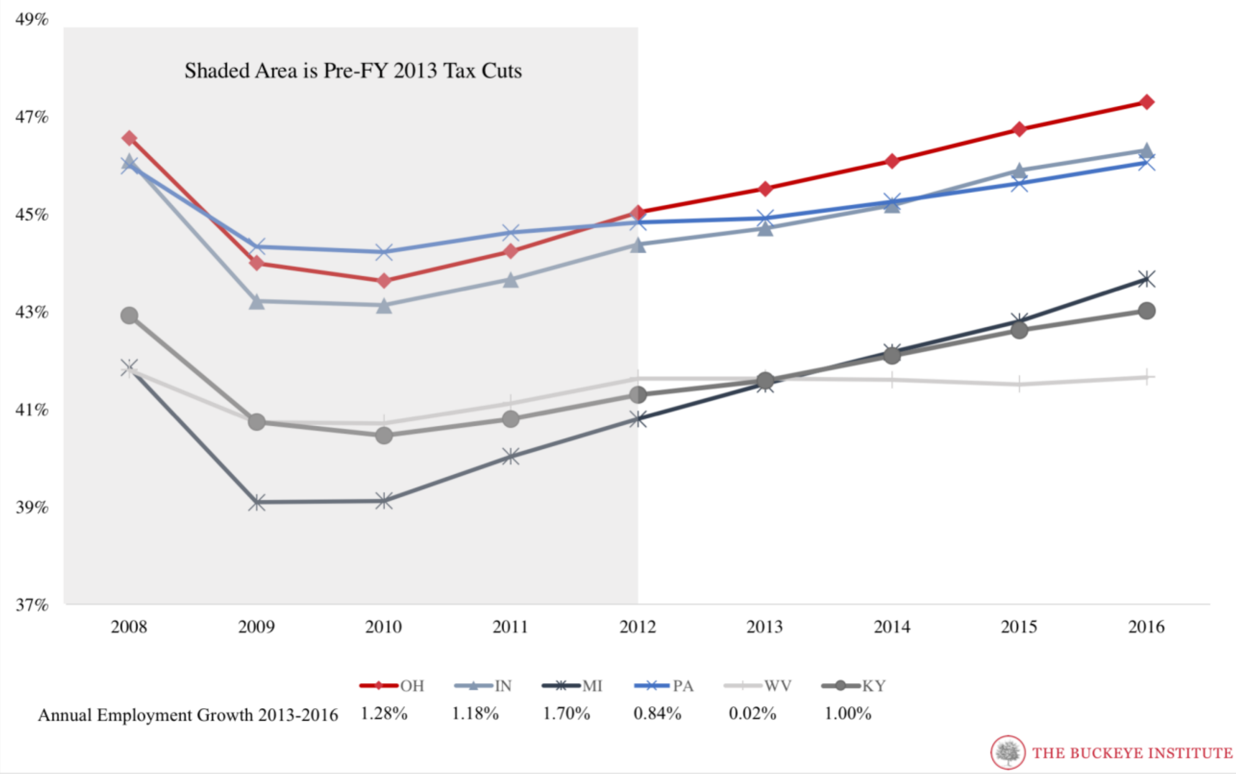
Looking to provide answers, **The Buckeye Institute** analyzed Ohio's recent economic data using its macroeconomic model to find the "dynamic effects"—or behavioral adjustments—caused by shifts in the state's tax policies. The model found that since 2013 the governor's tax policies helped:

- Make Ohio families wealthier;
- Created nearly 7,000 more jobs;
- Raised personal income by $500 million; and
- Saw Ohio's employment rates and economy outperform most of its regional competitors (see Figure 1 and Table 1).

Buckeye's analysis found that by shifting from income taxes to consumption taxes, Ohio's economic conditions and living standards improved, and Ohio is better off now than it was four years ago.

During this year's budget cycle, the Ohio General Assembly voted to reduce state spending to match declining tax revenue, rather than increase taxes. Choosing to reduce spending rather than raise taxes will prove crucial in solidifying Ohio's economic future. If the General Assembly had voted to raise income taxes to cover the revenue shortfall, the positive economic impacts of Governor Kasich's tax policy would have been slashed in half. By choosing wisely today, the General Assembly stayed the course for offering a better tomorrow.

Figure 1: Employment as a Share of Population in Ohio Relative to Neighboring States



Source: Calculated using employment data from the Bureau of Labor Statistics and population data from the Bureau of Economic Analysis.

Table 1: Annual Real GDP Growth

State	2004-2006	2013-2016
WV	3.90% (1)	-0.79% (6)
KY	2.67% (2)	1.43% (4)
IN	1.77% (3)	0.52% (5)
PA	1.09% (4)	1.77% (3)
OH	0.01% (5)	2.06% (2)
MI	-1.43% (6)	2.85% (1)

Source: Bureau of Economic Analysis.

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Economic Impacts of Ohio's Tax Changes[1]

U.S. Census Bureau tax data shows that from 2012 to 2016 Ohio's personal income tax revenues fell 17.02 percent while the state's sales tax revenues rose 40.9 percent. A deeper analysis[2] reveals that although Ohio's tax burden on labor income decreased by 25.9 percent, and fell by 47.4 percent for investment and corporate income, the tax burden increased 22.2 percent on consumer goods and 28.6 percent on investment goods.

Not surprisingly, state income tax revenues dropped immediately after the income tax cuts (see Table 2). However, shifting away from the income tax toward a sales tax had positive effects on personal income and employment (see Table 3) because income tax cuts lift households' disposable incomes, which frees resources for more investment.

More investment, in turn, raises the marginal product of labor, and when real wages increase relative to leisure, individuals will choose work over leisure and thus supply more labor to the market—once again confirming the elementary economic principle that when people get to keep more of their earnings, they take advantage of the incentive to earn more.

Table 2: Initial Economic Impacts of Tax Policy Changes

State Individual Income Tax Revenues 2012-2016	Change in Personal Income	Change in Employment
-16.76%	+$500 Million	+7,000 Jobs

Source: Buckeye's Macroeconomic Model. According to the Office of Budget and Management actual change in income tax revenue was -17.0%.

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[1] **HB 59/2013:** To reduce income tax rates by 10 percent; create 50 percent small business deduction on first $250,000; create state earned-income tax credit (EITC) equal to five percent of the federal EITC.
HB 483/2014: Accelerate income tax reduction from HB59; increase personal income tax exemption for low- and middle-income earners; increase state EITC to 10 percent of federal EITC; temporarily increase small business deduction to 75 percent on the first $250,000.
HB 64/2015: Reduce income tax rates by 6.3 percent; increase small business deduction from 75 percent to 100 percent of first $250k in FY2017; create three percent flat tax rate above $250,000.
SB 208/2015: Marginal rates not to exceed three percent apply to 25 percent of business income subject to tax in tax year 2015; income taxpayers receive full deductions and credits even if all income is a business income.
[2] See **McDaniel (2007)** for the methodology for calculating the tax burden.

Table 3: Initial Impact of Income Tax Cuts

Policy	Personal Income	Employment
Income Tax Cuts & Sales Tax Increases*	+$500 Million	+7,000 Jobs
Income Tax Cuts Only	+$2,600 Million	+36,000 Jobs

Source: Buckeye's Macroeconomic Model.
*This was the policy adopted and signed into law.

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Some of the gains produced by lower income tax rates were offset by the 28.6 percent increase in the sales tax burden on investment goods such as production materials and inventories (see Table 3). Taxing production materials, for example, negatively affects the value of additional business activity. As a result, investment falls and the marginal product of labor declines, which lead to lower real wages.

Higher Income Taxes Would Have Hurt Ohio

The most recent budget process presented legislators with essentially two options for dealing with the state's $321 million personal income tax shortfall over the course of calendar year 2016: Raise income tax rates or reduce spending. If the General Assembly had chosen raising income tax rates, Ohio families would have suffered lower income and lower employment (see Table 4).

Fortunately, the legislature chose to reduce spending instead, and thus preserved the positive effects of lower income taxes for the foreseeable future. Maintaining this course, while avoiding new tax hikes on consumption and investment, will help Ohio's economy to continue outperforming regional competitors.

Table 4: Impact if the General Assembly had Enacted an Income Tax Increase in 2016

Personal Income	Employment
-$250 Million	-2,700

Source: Buckeye's Macroeconomic Model.

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References

McDaniel, Cara. 2007. "**Average Tax Rates on Consumption, Investment, Labor and Capital in the OECD 1950-2003**."

About the Authors

Orphe Pierre Divounguy, Ph.D. was the lead economist with The Buckeye Institute's Economic Research Center. In this role, Divounguy analyzed the impact of federal and state government policy on economic outcomes in Ohio.

Divounguy joined The Buckeye Institute after earning his Ph.D. from England's University of Southampton, where he also obtained his master's degree.

After receiving his Ph.D., Divounguy served as a teaching and research fellow. He also worked as an international economic consultant. His research focused on labor policy, migration policy, and economic development.

Before his time in higher education, Divounguy interned at the United Nations Department of Economic and Social Affairs in New York, and the Cato Institute in Washington, D.C.

Bryce Hill was an economic research assistant with The Buckeye Institute's Economic Research Center.

In his role, Hill supported the Economic Research Center in analyzing the impact of federal and state government policy on economic outcomes in Ohio and other states.

THE BUCKEYE INSTITUTE
88 East Broad Street, Suite 1120
Columbus, Ohio 43215
(614) 224-4422
BuckeyeInstitute.org

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