Tax Structure Study Committee
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Thank you Chairman Adams and members of the Tax Structure Study Committee for allowing the Buckeye Institute for Public Policy Solutions this opportunity to discuss an issue of preeminent importance for the future of Ohio- our tax structure.

The Buckeye Institute is a non-profit, free market think tank. To that end, we believe that the key to prosperity is to maintain a low tax, limited regulation environment that is inviting to those wanting to start businesses.

Indeed, making an environment inviting for new businesses is the only way Ohio will ever be able to shake off its "rust belt", laggard mentality. Of course, this is much tougher now, in the 21st Century than it was in our previous industrial heyday. The communications are faster and the competition much stiffer.

However, one thing that most businesspeople and entrepreneurs will note is that high taxes drain private sector resources and reallocate them based on external considerations that impact economic efficiency. This is not to say that all taxes are bad or that they are not needed to fund essential government services, it is just to make clear that there is always a cost associated with taxes.

Simply put, higher taxes means lower growth. Additionally what and how things are taxed make a big difference as well. As Dr. Arthur Laffer, Stephen Moore and Jonathan Williams state in the 2011 ALEC "Rich States, Poor States" Report, *"An economically efficient tax system has a sensible, broad tax base and a low tax rate."*[1]

Flatter taxes that are levied on broader bases are less distorting to economic activity. This is because the rates are lower and their costs spread out more evenly. The narrower a tax base becomes, typically,

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[1] Dr. Arthur Laffer, Stephen Moore and Jonathan Williams, "Rich States, Poor States," American Legislative Exchange Council, accessed at *http://www.alec.org/AM/pdf/tax/11rsps/RSPS_4thEdition1.pdf* (August 24, 2011)

the higher and more confiscatory the rate for those that are not excluded from the base. In turn, that either forces those wanting to start businesses to reconsider where they want to be or it forces the state and local communities into having to offer additional incentives, thus perpetuating the vicious cycle.

Given that context, it is important to note that entrepreneurial start-ups are a major driver in job creation. Of note is a 2010 study using U.S. Census Bureau data that was conducted by the Kaufmann Foundation.[2] It concluded that between 1977 and 2005 existing firms were found to be net job destroyers, losing 1 million jobs net combined per year while first year businesses added an average of 3 million jobs.

This isn't meant to denigrate large, existing companies. They play a large role in the overall economy. However, it is important to illustrate that new, small businesses are also pivotal to Ohio's future. Today's start-up could be tomorrow's Microsoft, Apple, or Google. Making Ohio's tax system work for them is every bit as important as making it work for larger, established employers.

Again, the narrower the base and the higher the rate, the more it will snuff out the desire of entrepreneurs to take risks, or at least, to take risks in Ohio.

Local Taxes

Of particular concern to the Buckeye Institute is local taxation. While there have been many reforms made at the state level designed to improve our tax climate, such as the lowering of the income tax rate since 2005, the elimination of the corporate franchise tax and the phase out of the tangible personal property tax, there is evidence that local taxes remain deeply problematic.

Ohio has improved in the non-partisan Tax Foundation's state/local tax burden rankings. In 2005, Ohio was 7th highest. By 2009, Ohio was

[2] Tim Kane, "The Importance of Startups in Job Creation and Job Destruction," Ewing Marion Kauffman Foundation, accessed at *http://www.kauffman.org/uploadedFiles/firm_formation_importance_of_startups.pdf* (July, 2010)

18th.[3] According to the Federation of Tax Administrators (FTA), Ohio's state tax burden per capita ranks us at 34 and 31 as a percentage of income.[4]

An analysis done in 2010 by the Ohio Department of Taxation details the tax burden issue. It found that as a percentage of income, Ohio ranks 33rd for state tax burden, similar to the FTA numbers.[5] Ohio's local burden is 6th and the combined burden 16th.[6] This analysis used tax data from 2007-2008, so the FTA ranking at the state level is probably more accurate on the state burden, which means further improvements at the state level. Unfortunately, there is no reason to believe the local burden has improved.

These numbers highlight a significant disconnect between our various levels of government and, what is worse, the problem appears positioned to become worse in the wake of recent cuts to the Local Government Fund (LGF).

It is disingenuous for many local communities to lay the blame on the General Assembly for their woes. Mismanagement, the handcuffs of the current collective bargaining laws, and the changes wrought by globalization have all played major roles in placing smaller governments in tough financial conditions. However, the LGF cuts are exacerbating the problem and giving many communities the justification for going to the ballot for more taxes.

The bottom line here is that it serves the interests of neither local communities nor the state at large to watch the tax burden shift from one level of government to another. Rearranging the deck chairs on the Titanic as it sank proved equally nonsensical.

While the Buckeye Institute does not have all the answers on this issue, it is imperative that the General Assembly look for ways to avoid local

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[3]The Tax Foundation, "Ohio State and Local Tax Burden 1977-2009," accessed at *http://www.taxfoundation.org/taxdata/show/474.html* (August 24, 2011)

[4] The Federation of Tax Administrators, "State Comparisons- Revenue Burdens," accessed at *http://www.taxadmin.org/fta/rate/10taxbur.html* (August 24, 2011)

[5] State of Ohio Department of Taxation, "State and Local Taxation Comparison ," at *http://tax.ohio.gov/divisions/tax_analysis/tax_data_series/state_and_local_tax_comparison/publications_tds_comparison.stm* (accessed on August 24, 2011).

[6] *Ibid.*

tax hikes. Failure to do so could unwind much of the hard earned progress Ohio has made at the state level.

Recently, the Buckeye Institute joined forces with two other think tanks that come from different perspectives, The Center for Community Solutions (CCS) and the Greater Ohio Policy Center (GO) to propose the creation of a bipartisan State and Local Tax Study Commission (excluding politicians, but including Independents as well as Democrats and Republicans) to review the framework of state and local taxation in Ohio. The idea is to better align state and local taxation with the roles of both state and local governments in the 21st Century. This includes allowing flexibility to assure stable funding for public services while meeting the goal of a broad, fairly distributed tax burden.

One example shows how our tax system makes little sense. The City of Dublin charges a 2% tax on income. This income tax generates enough revenue for the City of Dublin that it currently sits on a rainy day fund big enough to cover the city's expenses for 3/4ths of the year. At the same time, Dublin City Schools charges a tax on properties in the district. This property tax does not generate enough revenue for Dublin City Schools to cover its yearly expenses.[7]

Why do these two government entities operate independently when the combined cost of each likely could be covered with a lower combined tax burden? Does not the presence of excellent schools make the city a more attractive place for businesses and their employees to reside? Does not a city offering a higher quality of life attract families with high-performing children? Both the city and the school district are intertwined, yet one is flush and the other is broke.

Tax Expenditures

As part of alleviating these pressures, a critical area that we have been focusing on lately concerns the rampant use of tax expenditures, or "TEs" in Ohio. In this effort, we have to highlight the need to more thoroughly examine these items.

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[7] This example is meant to highlight the quirks in our tax system and does not pass judgment on whether either the City of Dublin or Dublin City Schools management their funds wisely.

Commonly referred to as "tax loopholes," TEs are constantly attacked in abstract political discourse as being simple giveaways to corporations or to the wealthy. This is not an accurate way to view TEs. While there are some that seem to fit this bill, it is important to define exactly what these TEs are so that we can move beyond rhetoric and zero in on substance.

In Ohio, the Department of Taxation basically defines TEs according to four basic criteria:

- The item reduces, or has the potential to reduce, one of the state's General Revenue Fund taxes.
- The item would have been part of the defined tax base.
- The item is not subject to an alternative tax.
- The item is subject to change by state legislative action.

With that background, the use of tax expenditures has proliferated at the state and federal levels for decades. The real problem here is that once they are ensconced in statute, they seem to become immune to real scrutiny. While they may be reviewed briefly during the drafting of the initial budget blue print every biennium, there are few, if any performance measures that allow the TEs to be reviewed for efficacy and, quite frankly, fairness. Some of these TEs literally go back to the horse and buggy days.

Every time a TE is implemented, it makes an exception to the tax code and that means the tax base narrows. While under appropriate circumstances that can be a good thing, we have already discussed the consequences of too much narrowing of the tax base.

Policies that incentivize jurisdictions to compete with each other in ways that fail to grow the economic and jobs pie and simply slice it differently are not going to be helpful to Ohio in the long run. Obtaining jobs by offering incentives to a business across the street in a different political jurisdiction is not economic development; it is "poaching." Its not creating new value, its redistributing existing value.

This same process also plays itself out at the state level. There is constant discussion of "winning" the battle with Indiana or Kentucky (or rarer a state in the South or West) for securing the location of a particular company's new expansion. While there is no doubt this is the way the game is played currently, wouldn't it make more sense to stop these one off "battles" and simply focus on making Ohio a low-cost place to operate? By making the entire environment more business-friendly, there would be no need for politics and "deals with the devil."

CCS, GO, and the Buckeye Institute proposed terminating a group of these TEs as part of the biennial budget. You can see the list of agreed items that would yield over $300 million in each fiscal year on the attachment to my testimony.

The three groups also proposed a "sunset" provision that would force all TEs currently in the Ohio Revised Code to be voted on at statutorily defined intervals. This would force the issue of review through what amounts to a cost-benefit analysis or performance review. Those TEs that are working and attain economic benefits would be voted on in the affirmative while those that cannot be shown to have benefit would be voted down. The bottom line here is to avoid TEs remaining on the books in perpetuity with minimal scrutiny.

It should be pointed out at this point that CCS, GO, and the Buckeye Institute have differing perspectives on what should be done with any revenue that is generated through the elimination of certain TEs. As one could gather from previous parts of this testimony, the Buckeye Institute will argue that lowering and flattening our tax rates at all levels of government is essential to making the state more inviting.

The Buckeye Institute respectfully asks the General Assembly to make every effort to stem local government tax hikes and that it rigorously review the myriad of TEs on the books at a regular interval to assure that a flatter, fairer and more efficient tax code can stay that way.

We welcome the opportunity to discuss these or other proposals with you and your staff.

Thank you.