THE BUCKEYE INSTITUTE

Interested Party Testimony Submitted to the Ohio House Ways & Means Committee on Tax Provisions

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Thank you, Chairman Schaffer, Vice Chair Scherer, Ranking Member Rogers and members of the Committee for the opportunity to testify regarding tax provisions in the biennial budget bill. My name is Greg R. Lawson, and I am the Senior Policy Analyst at The Buckeye Institute, a free-market think tank here in Columbus.

Ohio's tax code remains a significant impediment to long-term economic growth and prosperity for our families and businesses. Like other budgets proposed under Governor Kasich's Administration, this budget proposal contains significant tax code changes in line with the Governor's view of the punitive aspects of the personal income tax—and we applaud his efforts. Like the Governor, we believe that Ohio should continue to simplify tax brackets and further reduce the state's personal income tax. Of course, to accomplish these goals, the devil is always in the details.

We need taxes, of course, to pay for legitimate and necessary government activities, but most taxes create disincentives on economic behavior—whether that behavior is producing goods, providing services, saving money, or making investments. Good tax policy must therefore distribute the tax burden so as to limit its impact as much as possible. As The Buckeye Institute has explained before, a sound tax policy must pursue a straightforward, fundamental strategy that is pro-growth, simple, transparent, and fair:[1]

- Pro-growth: A tax system should minimize tax distortions, avoid high rates, and discourage tax avoidance. A good tax plan will reduce tax rates on investment and labor, both of which are key components for economic prosperity and job creation.

- Simple: Tax compliance should be simple and not burdensome. The tax code can be simplified by reducing loopholes, credits, and deductions. A simpler tax code makes government administration and taxpayer

[1] Rea S. Hederman, Jr., Tom Lampman, Greg R. Lawson, and Joe Nichols, "Tax Reform Principles for Ohio," The Buckeye Institute for Public Policy Solutions, February 2, 2015, http://www.buckeyeinstitute.org/uploads/files/Tax_Reform_Principles_for_Ohio(FINAL).pdf

compliance easier, and reduces the risk of carve-outs and favoritism.

- Transparent: The tax code should allow taxpayers to know what specific taxes they must pay. And the debate over taxation should be open and honest, so that all Ohioans can understand the changes in tax policy and how elected officials represent taxpayer interests.

- Fair and Equitable: Sound tax policy promotes equity by creating a level playing field, avoiding double taxation, and ensuring that no industry receives preferential tax treatment. The state should not be picking tax "winners and losers" by assessing punitive tax rates on some industries, so similar earnings should be subject to similar tax rates across all industry sectors. Rates should not force individuals and businesses to change filing status for better tax treatment.

The Buckeye Institute believes that pursuing these strategic principles by transitioning from an income tax to consumption taxes will simplify the state's tax code, reduce taxes on investment and labor, and thus spur economic growth, job creation, and long-term wage increases.

Economic studies have demonstrated that income taxes discourage work and investment, making them the second *worst* form of taxation for encouraging economic growth. Only direct corporate taxes have a more harmful effect. A review by the Tax Foundation showed that an overwhelming majority of empirical studies of taxation's effect on economic growth have found that income and corporate taxes reduce economic investment and growth, whereas none of those studies have shown a *positive* correlation between income and corporate taxes and economic growth.[2] The Organization for Economic Cooperation and Development (OECD) has reported, for example, that "Empirical research on OECD economies and on Switzerland specifically indicates that

[2] William McBride, "What is the Evidence on Taxes and Growth?" Tax Foundation, December 18, 2012, accessed March 5, 2015 at http://taxfoundation.org/article/what-evidence-taxes-and-growth

shifting taxation away from personal income towards the taxation of consumption would strengthen incentives to engage in economic activity."[3]

Taxes on consumption offer a better, less distortive form of taxation by providing a broad and stable tax base. Thus, we would encourage Ohio to expand the sales tax to better reflect the realities of today's more service-oriented economy. We would caution against increasing rates at this time, however, because Ohio has already raised the state sales tax recently, and because county sales taxes continue to "piggyback" on the state sales tax, making goods more expensive.

Although we support the Governor's push to continue reducing the state income tax, we do acknowledge that such reductions may lead to "lost" revenues that must then be offset by other funding and tax mechanisms. Allow me to address several of the more significant "mechanisms" currently under consideration.

Raising the Severance Tax

Raising Ohio's severance tax on gas and oil exploration will not only reduce investment in the state, but it also violates the principle of tax equity by penalizing a single industry rather than assessing a broad-based, equitable tax. Ohio's oil and gas firms pay a variety of additional taxes, including the Commercial Activities Tax (CAT), ad valorem taxes, sales and use taxes, and, in some cases, municipal income taxes. Raising the severance tax rate—and basing that rate on a "spot price" that may not reflect true supply—only compounds the disincentive for oil and gas exploration, which means that the policy is not pro-growth.

Raising the Tobacco Tax

Raising the state's tax on tobacco and tobacco-related products also violates the principle of tax equity by imposing a disproportionate tax burden on a single class of consumers. The current proposal would raise the tax by 65 cents per pack, tax cigarettes and other

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[3] Andres Fuentes, "Making the Tax System Less Distortive in Switzerland," Organization for Economic Cooperation and Development, April 16, 2013, accessed March 20, 2017 at http://www.oecd-ilibrary.org/docserver/download/5k480c2rt1d3-en.pdf?expires=1490044971&id=id&accname=guest&checksum=C8AD3C2BD56F1D6ADAED7432B0E82E85

tobacco products equally, and tax electronic vaporized tobacco products as tobacco. A tax increase of this magnitude will drive tobacco users to purchase tobacco out-of-state and reduce smoking—perhaps more severely than currently forecast. Thus, the realized revenue from this particular mechanism may not prove as great as anticipated.

Limiting Tax Expenditures

The Buckeye Institute has long called for eliminating tax expenditures, not creating new ones such as the notorious "NetJets" loophole.[4] According to the Office of Budget and Management, tax expenditures will cost Ohio over $9 billion in revenue in Fiscal Year 2018 and nearly another $9.5 billion in Fiscal Year 2019.[5] Tax expenditures narrow the tax base, which means that higher, more confiscatory rates must be paid by those not exempted from taxes. Too often such loopholes veer close to an insidious "crony capitalism," and almost always effectively allow the state to pick economic "winners and losers." To limit this unfair practice, The Buckeye Institute has called for a more rigorous review of these tax expenditures, and we believe that all revenue gained from eliminating loopholes should pay for an across-the-board income tax cut.

As Ronald Reagan once said, "The problem is not that people are taxed too little, the problem is that government spends too much." So as a final point, allow me a brief comment on Ohio's current spending problem.

The Governor's budget would spend nearly $3 billion more in Fiscal Year 2018 than the projected spending in Fiscal Year 2017[6]— an increase of 4.4 percent. Although Medicaid accounts for much of this spending, the General Assembly must take every opportunity available to reduce state spending in order to avoid major shortfalls during any future recession. Without responsible spending cuts now, Ohio will inevitably face the specter of difficult, draconian spending cuts or tax increases later, reversing the economic strides we have made in recent years. Rather than simply raising taxes to pay for tax cuts, the General Assembly should curb its appetite for government spending,

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[4] See Ohio Revised Code 5739.025 (G)(1).

[5] Office of Budget and Management, "Tax Expenditure Report, Fiscal Years 2018-2019," accessed March 20, 2-17, http://www.obm.ohio.gov/Budget/operating/doc/fy-18-19/FY18-19_Tax_Expenditure_Report.pdf

[6] Office of Budget and Management, "Budget Highlights- Fiscal Years 2018-2019," accessed March 20, 2017, http://www.obm.ohio.gov/Budget/operating/doc/fy-18-19/FY18-19_Budget_Highlights.pdf

tighten its proverbial belt, and use excess revenues to reduce income taxes across the board.

Thank you for your consideration. I welcome any questions that the Committee might have at this time.