POLICY brief
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Seattle Initiative 77: The Espresso Tax is a Shot in the Dark

Frequently, to secure funding for a favored program, advocates earmark a tax – typically a tax on a nonessential good or service – and dedicate the money to the program. That's essentially the strategy underlying Seattle Initiative 77.

It calls for a ten-cent tax on espresso drinks in Seattle, with the money to be used to fund early childhood programs. Proponents call the dime-a-drink tax a "luxury tax," that will bring in substantial money to support important programs.

Initially, campaign organizers said the tax would bring in about $6.5 million annually. More likely, the proceeds will be closer to $1.5 million, the less than a quarter of initial estimate. To generate the revenue, the tax creates substantial administrative burdens for espresso shop employees and city officials.

Overview

I-77, like most earmarked tax proposals, appears simple. The sponsors, the Early Learning and Care Committee, match a revenue source to a dedicated account.

In this case, the Early Childhood and Care Account (ECCA) would be established in the City of Seattle Treasury and receive the money generated by the espresso tax plus any interest or other earnings generated by the account. The initiative makes clear that the money spent from the ECCA would supplement, but not supplant, money currently being spent by the City, noting that Seattle currently funds a number of early learning and care programs.

Oversight Committee. The initiative also provides for creation of an oversight committee to "review and advise upon the expenditure" of money from the account.

The fifteen-member committee would include the director of city's human services department (or a designee), two directors of early learning or child care centers, two teachers employed by such centers, a family child day care home provider, a parent of a child under age six, an administrator of a Head Start or similar program, a representative of a college or university offering a degree in early childhood education, a representative of a nonprofit childcare advocacy organization, a representative of the Seattle business community, a representative from the Seattle public schools, a policy specialist in child

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development, a health care professional, and a representative of a community-based advocacy or service delivery organization.

The mayor, with city council consent, would make all appointments, with the exception of the department director or designee. The committee would serve without compensation, other than expense reimbursement.

Spending the Money. Among the committee's responsibilities: setting the standards that determine which programs qualify for funding. No more than 5 percent of annual revenues would be available to be spent on management of the fund. The remainder of funds would be spent as follows:

- 55 percent per year for qualifying pre-kindergarten programs and related services for three to five year-olds,
- 20 percent per year for grants to low-income families to subsidize the cost of purchasing early learning and care services,
- 20 percent per year for career and wage ladder program contracts with qualifying center-based providers, and
- 5 percent per year for professional education program contracts with qualifying family child day care home providers.

Some of the terms may be a bit unclear.

According to the initiative, "early learning and child care services" are "services designed to support families and children to ensure that each child in Seattle has the opportunity for developing into a healthy, contributing member of our community, including but not limited to such services as childcare, early childhood education, out-of-school-time services and related quality assurance programs."

A career and wage ladder program is "any program approved or adopted by the Oversight Committee to fund education-linked wage increments for early learning and care workers who are employees of qualifying center-based providers."

The Espresso Tax. According to the initiative, "espresso beverages, as distinguished from other forms of coffee, are luxury item." Therefore, the initiative goes on to say, it is appropriate for the city to tax businesses for "the privilege of engaging in the sale of a luxury item in order to allocate tax responsibility among persons who prefer a luxury item and can thus better afford to pay the tax."

Everyone selling espresso drinks in Seattle would pay the tax, and the tax would be ten cents on each espresso sale. Only business with gross revenues below $50,000 a year would be exempt. An espresso beverage is defined as "any beverage prepared for immediate consumption containing half an ounce or more of espresso regardless of caffeine content, whether served hot or cold.

The definitions are important. In estimating a yield of $6 million or more annually, proponents based their estimate on estimates by the Economic Opportunity Institute (EOI), a Seattle-based think tank supporting the initiative. The EOI calculations were drawn from the consumption estimates produced by the National Coffee Association (NCA) for 1999.

EOI looked at estimated per capita consumption of gourmet coffee in the western United States, about 0.38 cups per adult per day. Multiplying by Seattle's population over age 18 (about 475,000 people), and allowing for some falloff because of the higher price (i.e., elasticity of consumption), EOI came up with an estimate of nearly $6.5 million.

NCA finds two flaws in the analysis. First, the definition of gourmet coffee includes a number of non-espresso drinks, such as cold coffee beverages and whole gourmet coffee beans. Second, the EOI calculation failed to factor into the equation whether or not the beverage was to be purchased for immediate consumption, as the initiative specifies. The per capita consumption figures take into account all gourmet coffee consumption, including, for example, coffee consumed at home.

EOI Calculation

.38 (West per capita daily gourmet coffee consumption) * 475,574 (Seattle population 18 and over) * 365 days – 1.7% elasticity of consumption * 0.10 (tax) = $6,484,406

NCA calculation

0.15 (West per capita daily espresso consumption) *.6 (purchased for immediate consumption) =.09 taxable per capita consumption
Using .09 as the correct rate of espresso consumption that will be taxed under this initiative:
.09 * 475,574 * 365 – 1.7% *0.10 = $1,535,702

New funding provided by the initiative, using the more accurate $1.5 million tax yield*:

Pre-kindergarten programs and related services (55%)	$825,000
Grants to low-income families (20%)	300,000
For career and wage ladder programs (20%)	300,000
For professional education programs (5%)	75,000
	$1,500,000

*Disregarding the five percent for administration.

Citing more current data, NCA finds that the correct per capita daily consumption figure for the West is 0.15 cups of espresso per adult (rather than the 0.38 cups of gourmet coffee used by EOI). Further, NCA says only about 60 percent of espresso drinks are sold for immediate consumption, and therefore subject to the tax.

It turns out to make a big difference. Making the adjustments, and updating the data for 2002, a more accurate estimate of the estimated revenue to be derived from the espresso tax would be about $1.5, or 25 percent of the $6.5 million claimed by proponents.

NCA does not endorse the EOI calculation, but says that if you're going to use that equation, you should use the proper data (see table).

Comments

Impact on small business. The $50,000 gross revenue exclusion will exempt very few espresso vendors. And the accounting and regulatory burdens imposed on the rest are substantial, particularly in comparison to the relatively small revenue generated for early childhood education and support services. Most shops do not account separately for espresso drinks. Those that have computer systems will have to reconfigure those systems. Vendors with multiple locations will have to account for their Seattle operations differently. And the smaller shops without computerized systems will face a new, possibly daunting, requirement for manual record-keeping – an unpleasant prospect when faced with a line of impatient coffee customers. Increasing the price may not be an option for many vendors, who instead face a shrinking profit margin in a recession.

Regulatory impact. The tax impacts virtually every business selling espresso drinks. Enforcing the tax presents city government with a new auditing challenge, as the tax applies to restaurants, espresso carts, coffee shops, company cafeterias, hospitals, schools, concession stands, and so on. Even state ferries would be affected. Is an espresso sale in Colman Dock subject to the tax? How far into Elliott Bay does the ferry have to travel before the sale is untaxed?

Funding adequacy. Without question, the revenues generated by the tax will fall far short of initial expectations. Creating a new oversight committee, requiring city staff members to administer a new account and manage fund distributions, determining eligible recipients and verifying that the money is spent as intended would impose new costs on at a time when the city is facing significant funding shortfalls. The administrative costs are likely to exceed the five percent provided by the initiative. Further, the arbitrary allocation of funding prescribed by the initiative provides little assurance that the new revenues will achieve the goals of initiative backers.

Earmarking as public policy. Initiative 77 carries with it all of the basic problems of any earmarked tax. As we've noted before, the nonpartisan National Conference of State Legislatures has done significant work in this area, closely evaluating the common justifications for earmarking. Three of them pertain to I-77.

1) *The benefit principal: those who benefit should pay.* Gas taxes, for example, conform to the benefit principal, which essentially looks at the earmarked tax as a user fee. No such claim is being made, nor can it reasonably be made, for taxing espresso to pay for early child services.

2) *Assured funding.* Advocates of earmarked taxes generally say that the only way they can be assured adequate funding for their programs is by snagging a revenue stream that cannot be used for other purposes. The basic problem with this approach is that there is often no correspondence between funding needs and revenues generated by the earmarked tax.

3) *To secure public support for new or higher taxes.* Earmarking remains popular. Voters, it seems, are more willing to support a tax increase if they know how the money will be spent.

Long-term consequences. Funding for human service programs has been seriously and negatively affected by the deficits looming in city, county and state budgets. Managing the shortfall while preserving the most vital programs is a challenge facing all public officials, including the mayor and city council in Seattle. Few would question the importance of early learning and care programs, but the approach taken by I-77 fails to provide a long-term solution.

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