



Rebalancing Priorities: The Case for Manufacturing Jobs Part I

The following is the first of a series of special reports on manufacturing and the jobs created in the process. In the series, we focus on conditions and policies that affect this important economic sector including taxation, education and job training, infrastructure, site availability, and regulatory issues. We examine the status of manufacturing statewide and in four distinctly different regions of our state. Finally, at a time of great concern about wage stagnation and the future of the middle class, we explore the unique role manufacturing can play in harmonizing competing and seemingly contradictory policy objectives, while creating good paying jobs that often do not require an advanced degree.

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benefits in many ways
from manufacturing
activity.**

In this installment we consider Governor Jay Inslee's recent line-item veto of a business and occupation (B&O) tax cut for manufacturers, survey manufacturing data for Washington state, and discuss the importance of a reasonable level of taxation. Washington businesses pay more per employee in B&O taxes than the average amount of income taxes paid by firms nationally. Nearly 58 percent of all state and local taxes in Washington state are paid by businesses—the seventh highest percentage of business taxation in the U.S.

1. REBALANCING PRIORITIES: EXAMINING A GOVERNOR'S VETO

The recent gubernatorial veto of a business and occupation (B&O) tax reduction that would have helped some manufacturers in the state brought new attention to that economic sector.

Numerous small businesses in manufacturing operate without a preferential B&O tax rate and want to compete more effectively for sales out of state. Underemployed workers without college degrees would like the opportunity of finding a good paying job. Hard-pressed

rural communities need to attract businesses that pay "living wages," multiply jobs in other businesses, and generate tax revenues. The vetoed tax cut would have been a step toward each of these possibilities.

B&O Tax Rate Reduction in SSB 5977

Washington's B&O tax is collected on gross revenues. The current rate ceiling for manufacturers is 0.484 percent of gross revenues. (This rate has fluctuated over the years from the initial 1934 rate of 0.25 percent.) The Legislature authorizes deductions on items such as bad debts (but not on expenses or profits) that lower reportable income. (DOR 2010)

In the final stage of negotiations between the state Senate and House leadership over the 2017–19 state operating budget, Senate negotiators succeeded in including a lower B&O tax rate ceiling for manufacturing activities. It was passed as part of SSB 5977, which also included several other tax changes.

Under SSB 5977, the B&O tax rate ceiling for manufacturers would have remained 0.484 percent in calendar year (CY) 2018

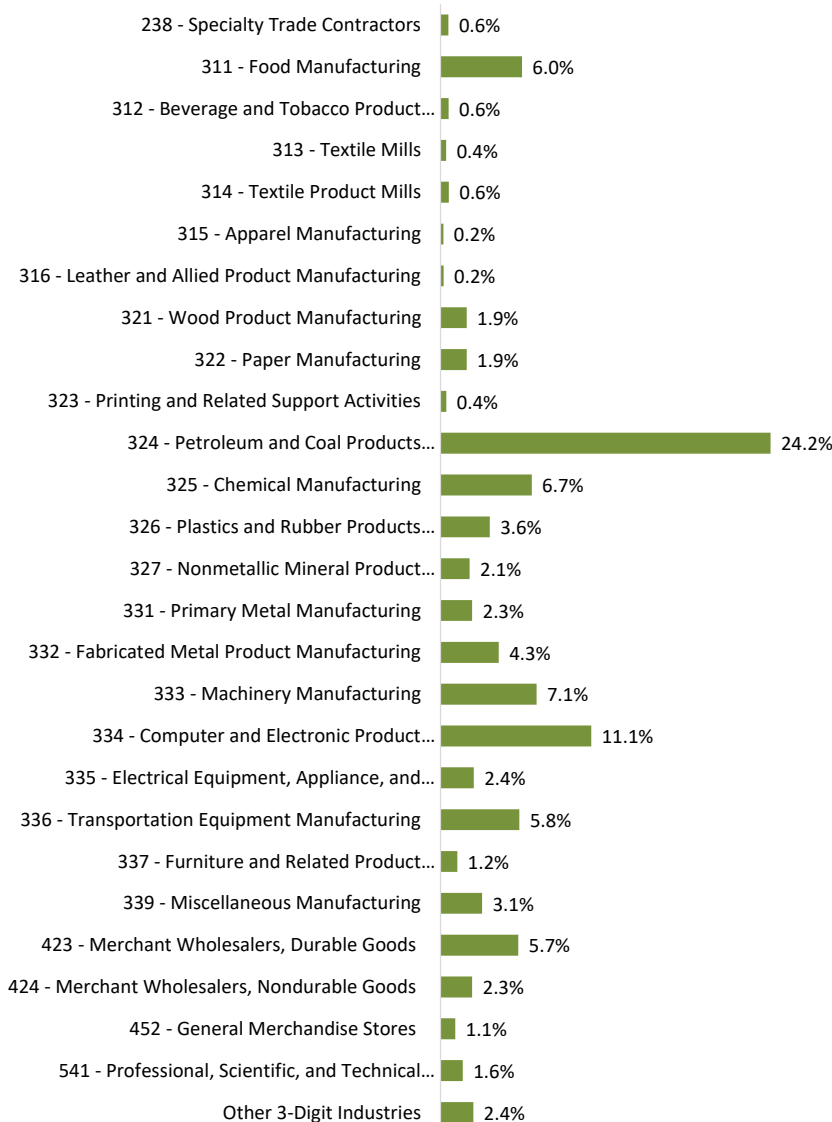
and then dropped to 0.4356 percent in CY 2019, 0.3872 percent in CY 2020, 0.3388 percent in CY 2021, and 0.2904 percent in CY 2022 and thereafter.

It is termed a “rate ceiling” due to the existence of tax preferences with even lower rates for certain activities. The 0.2904 percent rate would have been applied to all businesses in the B&O tax manufacturing classification. Producers for hire, who do manufacturing for others, and publishers would also have received the new rate.

The following specific manufacturing activities currently receive preferential rates that are at or below the rate in SSB 5977:

- Commercial aircraft manufacturing (0.2904 percent);
- Manufacturing timber or wood products (0.2904 percent);
- Manufacturing semiconductor materials (0.275 percent);
- Manufacturing solar energy systems and components (0.275 percent);
- Wood biomass fuel manufacturing (0.138 percent);
- Manufacturing wheat into flour, barley into pearl barley, soybeans into soybean oil, or sunflower seeds into sunflower oil (0.138 percent);
- Splitting or processing dried peas (0.138 percent);
- Slaughtering, breaking and/or processing perishable meat products and/or selling the same at wholesale (0.138 percent); and
- Manufacturing seafood products, dairy products, and fresh fruits and vegetables (currently exempt; 0.138 percent beginning in 2025) (WSS 2017).

Chart: Industries Paying 0.484 Percent Manufacturing B&O Rate in 2016 (Taxable Revenues as a Percent of Total Manufacturing Taxable Revenues)



Although there is not an official fiscal note for the bill, the Senate Ways & Means Committee estimated the provision would reduce revenues by \$2.9 million in 2017–19 and by \$61.0 million in 2019–21 (SW&M 2017). For perspective, the state’s spending trajectory is over \$93 billion for this time period (ERFC 2017).

SSB 5977 was passed by the House 83–10 and by the Senate 33–16. After passage, opposition emerged within the governor’s party over the last-minute inclusion of the tax cut. Twenty-three House members wrote to Gov. Inslee urging a line-item veto (Brunner 2017). The governor subsequently removed the provisions for a lower B&O manufacturing rate (sections 201–205 of SSB 5977).

The tax cut would also have brought companies who had not negotiated a tax preference, including many small businesses, to parity with other manufacturers in the state.

Benefit to Manufacturers Selling Out-of-State

The provision vetoed by the governor would have been most beneficial for manufacturers that sell to out-of-state customers. Currently, a B&O tax liability accrues when a good is manufactured in the state and again when it is sold (either wholesale or retail) by the manufacturer within the state. (The basic B&O rate on wholesaling is 0.484 percent; the basic B&O rate on retailing is 0.471 percent.)

To prevent double taxation, the state then allows the manufacturer to take a “multiple activities” credit against the lesser amount of either the manufacturing tax or the wholesaling or retailing tax due for the manufactured goods sold within the state (RCW 82.04.440). Thus, manufacturers selling at wholesale to in-state customers would have seen no benefit from the reduction in the manufacturing rate from 0.484 percent to 0.2904 percent as they would have continued to pay the 0.484 percent wholesale rate. Manufacturers selling at retail to in-state customers would have seen a small benefit as their tax rate would have fallen from 0.484 percent to 0.471 percent.

But because Washington manufacturers selling out of state are not subject to B&O wholesaling or retailing taxes, the tax cut in SSB 5977 would have been significant and their competitiveness in out-of-state markets would have increased. The B&O tax reduction in SSB 5977 could have helped to level the playing field with the many states that collect corporate income taxes and countries that use the value-added tax system, which have built advantages for their exporting firms into their tax structures. The tax cut would also have brought companies who had not negotiated a tax preference, including many small businesses, to parity with other manufacturers in the state. Most importantly, by making it easier for a seller’s market to expand, the tax reduction could have led to the creation of additional jobs.

Analyzing the Governor’s Veto Message

The governor explained his line-item veto:

But at a time when we are asking homeowners to pay more in property taxes to support our children’s education, Sections 201 to 205 instead give a tax break to business; and 21 percent of the revenue from this tax break goes to out-of-state oil companies. This revenue could be used for education, mental health, public safety, and a host of other important public services. (Inslee 2017)

Let’s examine the reasoning in the governor’s veto statement.

“Homeowners to pay more in property taxes.” Not all homeowners will pay more in property taxes. The new state property tax was passed to comply with a state Supreme Court decision that requires state dollars to replace local school funds for basic K–12 education elements like teacher compensation. Local property tax levies will be capped at a lower level than they are currently, and voters may or may not approve them. The combination of the higher state tax and the lower local taxes means that taxpayers in some school districts may pay more in property taxes and some may pay less.

Businesses pay 35 percent of property taxes in the state; thus, in areas where property taxes for education increase, businesses as well as homeowners will see higher tax bills. (DOR 2014)

“A tax break to business.” Economists regularly argue that business taxes are to a large degree “passed through”; they are ultimately paid by consumers in the form of higher prices or by workers in the form of lower wages. Business taxes also tend to suppress job creation. Business costs, including taxes, are a factor in some businesses moving away from a jurisdiction, or not moving to one. (Oakland 1992)

Cutting taxes for the manufacturing community helps to create new jobs in a growth climate and to protect existing jobs in a downturn.

"Out-of-state oil companies." Tax incentives often go to businesses with out-of-state ownership, by design, to encourage them to locate jobs in the state. And while reducing carbon emissions is a policy goal (and an ongoing process Washington state businesses have undertaken with real success), making petroleum products available at reasonable prices is absolutely critical to our economy (Rosenberg 2016). Having them processed in-state has created several thousand living wage jobs and generated considerable tax revenue for Washington. In fact, oil refining jobs induce jobs in other industries at the highest rate of any industry (OFM 2015).

"This revenue could be used for . . ." The governor also expressed concern over lost revenue that would not be available to fund other needed services. This gets to the heart of the question of governmental priorities. Good tax policy should provide sufficient revenue while fostering economic success and prosperity for its citizens. This balancing act between funding government and creating a climate for job growth is a tricky one, with a plethora of interest groups weighing in on one side or the other.

It's important for us to get this balance right. Cutting taxes for the manufacturing community helps to create new jobs in a growth climate and to protect existing jobs in a downturn. Fostering economic growth creates new tax revenue and contributes to the overall support of government services.

Hope for the Future

Gov. Inslee also objected to the tax reduction being forced into a negotiation, as he put it, "in the middle of the night" (Brunner and O'Sullivan 2017). His veto message stated, ". . . these tax reductions should be considered in a thoughtful, transparent process that incorporates public input and business accountability" (Inslee 2017).

Media accounts report Gov. Inslee's willingness to look at a similar proposal in

the future if it was presented in such a manner. Indeed, it's unfortunate the Senate bill seeking to aid manufacturing did not receive more attention from the executive and legislative branches earlier in the long legislative session. Instead, SSB 5977 surfaced in the fast-moving, deadline-driven endgame of the protracted 2017–19 budget negotiations. We agree with the governor that a deliberative, transparent process is best for changes in tax policy. This potential boost for manufacturing is well worth a thoughtful reconsideration.

Indeed, there have been other recent proposals to lower the B&O ceiling rate for manufacturers, from across the political spectrum. A B&O tax rate reduction for manufacturers was introduced earlier in the year in a bipartisan effort from Republican Senators Mike Baumgartner and Mike Padden and Democratic Senators Dean Takko, Steve Hobbs, and Mike Sheldon. It was the basis of the language the governor vetoed in July. The bill, SB 5888, lowered the ceiling rate directly to 0.2904 percent rather than phasing in the reduction. (It received a public hearing in April but was never voted on.)

Additionally, economist James McIntire, a Democrat and state Treasurer from 2009 to 2017, crafted a tax plan that would have cut all B&O ceiling rates except for services to 0.2904 percent (Herald 2015). Yoram Bauman, a University of Washington economist and author of 2016's unsuccessful carbon tax initiative, included a provision to lower the manufacturing B&O tax rate to 0.001 percent, with the goal of "keeping living-wage jobs in the state" (Carbon Washington 2016).

2. SNAPSHOT: MANUFACTURING IN WASHINGTON STATE

In Washington state, manufacturing output was \$58.7 billion in 2015. Direct manufacturing employment was 291,904. The average wage for a manufacturing job in Washington state was

\$74,884, while total compensation per employee was \$93,244. Of non-farm jobs in the state in 2015, 9.19 percent were in manufacturing (compared to 8.69 percent nationally). (BEA n.d.) In 2017, durable goods manufacturing produces 10 percent of state GDP—the third highest percentage (tied with the information sector), behind the real estate industry and government (Cao and Yoon 2017).

The average annual wage for manufacturing workers is higher than the average

wage for all employees in 32 of 37 Washington counties. This is a particularly important statistic when we consider the policy priority the state has established for rural economic development and it shows that manufacturing jobs are of critical importance to smaller, rural communities.

Nationally, the manufacturing sector has been invigorated by a growth in overseas exports, which were worth over \$1.3 trillion in 2015. U.S. manufactured goods exports rose 19.6 percent during the 2010–2015 period—they rose 79.7 percent in Washington state in the same period. In 2013, 90.0 percent of Washington exporters were small businesses. Over 400,000 Washington jobs were supported by international exports in 2014—only California had more. In 2011, the export share of state manufacturing jobs was 38.8 percent, the highest in the country. In 2015, overseas exports from Washington were worth over \$73 billion, topped only by the much more populous states of Texas and California. (NAM 2016)

Table 1: Manufacturing Jobs by County, 2016

	Establishments	Annual Average Employment	Annual Wages per Employee
U.S.	343,978	12,295,670	\$64,860
Washington	7,599	286,235	\$74,609
Adams	18	1,072	\$50,891
Asotin	30	432	\$40,443
Benton	182	3,997	\$55,656
Chelan	125	2,007	\$43,580
Clallam	78	1,175	\$46,374
Clark	482	13,216	\$56,360
Columbia	8	41	\$35,760
Cowlitz	129	6,290	\$66,948
Douglas	24	480	\$44,203
Franklin	62	3,736	\$40,829
Grant	85	4,867	\$52,023
Grays Harbor	92	2,408	\$51,640
Island	63	784	\$52,953
Jefferson	54	603	\$55,637
King	2,469	104,268	\$86,257
Kitsap	180	2,409	\$46,525
Kittitas	43	557	\$37,242
Klickitat	41	1,310	\$80,258
Lewis	113	3,063	\$51,811
Lincoln	8	46	\$19,416
Mason	50	1,072	\$44,963
Okanogan	37	558	\$35,302
Pacific	30	796	\$35,950
Pend Oreille	8	210	\$75,784
Pierce	611	16,867	\$61,642
San Juan	35	176	\$39,654
Skagit	178	5,687	\$63,939
Skamania	19	289	\$44,093
Snohomish	776	63,051	\$92,336
Spokane	520	15,231	\$52,269
Stevens	53	1,228	\$46,855
Thurston	183	3,326	\$52,516
Wahkiakum	6	46	\$28,591
Walla Walla	137	3,699	\$50,575
Whatcom	349	9,770	\$60,059
Whitman	32	2,760	\$63,392
Yakima	253	8,367	\$44,761

Note: Ferry and Garfield counties are excluded.

Source: Employment Security Department

Table 2: Manufacturing Jobs by Industry in Washington, 2016

	Average Annual Employment
Manufacturing	286,148
Food manufacturing	37,142
Beverage: soft drink, water, ice	2,407
Beverage: beer, wine, liquor	5,817
Textile, textile products, apparel, leather, leather products	4,200
Wood product manufacturing	12,894
Paper manufacturing	7,740
Printing and related support activities	5,777
Petroleum and coal products manufacturing	2,873
Chemical manufacturing	6,793
Plastic and rubber product manufacturing	8,641
Nonmetallic mineral product manufacturing	9,460
Primary metal manufacturing	4,899
Fabricated metal product manufacturing	19,506
Machinery manufacturing	15,165
Computer and electronic product manufacturing	19,904
Electrical equipment and appliance manufacturing	5,035
Aircraft, aircraft engines, parts, equipment	89,787
Other transportation equipment	10,951
Furniture and related product manufacturing	6,293
All other manufacturing	10,864

Source: Employment Security Department

We estimate the average statewide multiplier for all manufacturing jobs is 2.93, which means that for every 100 manufacturing jobs, 293 other jobs are created. Manufacturing has a relatively high multiplier for two reasons: (1) the large number of suppliers critical to manufacturing processes and (2) spending by well-compensated manufacturing workers.

As of 2016, there were 7,599 manufacturing establishments in Washington state (ESD 2017). Over 15,000 businesses have open tax accounts with the Department of Revenue that have paid the B&O tax for some type of manufacturing activity.

3. MANUFACTURING JOBS: THE SUCCESS ELEMENTS

As we have previously written, tax rates are one economic factor governments can affect relatively quickly (WRC 2017). The type and amount of state and local taxation are considered in key business decisions such as where to locate and when to create or eliminate jobs. This pits states against each other in a nationwide competition to obtain or keep job creators. Individual firms compete too. Washington companies have to compete with businesses in most other states that do not have to pay a state tax before they make their first dollar of profit and receive some type of tax benefit when exporting goods out of state (whether to other states or overseas.)

Balanced Taxation: A Key Economic Factor

Across all sectors, Washington businesses pay more per employee in B&O taxes than the average amount of income taxes paid by firms nationally (WRC 2017). Business pays nearly 58 percent of all state and local taxes in Washington state—the seventh highest percentage of business taxation in the U.S. (Phillips et al. 2017). These taxes include the B&O tax on gross receipts, sales taxes, employment taxes, and property taxes. Businesses pay the same rates for sales and property taxes as individuals and account for approximately 42 percent of sales tax revenue and 35 percent of property tax revenue in 2015. Sales taxes paid by Washington businesses per employee are the third highest in the nation (WRC 2017). Washington has a broad sales tax base for businesses and is one of the few states that collect sales tax for contract construction labor (Phillips et al. 2017).

Manufacturing accounted for 9.6 percent of all B&O taxes in calendar year 2015. Of the more than 15,000 companies that declared manufacturing activities, 9,752 were small businesses with taxable annual revenues under \$250,000. Another 2,423 had revenues between \$250,000 and \$1 million. But 75.9 percent of manufacturing B&O taxes came from the 444 firms in the state that had taxable receipts over \$25 million in 2015. (DOR 2016) About 40 percent of manufacturing revenues were taxed at the full rate

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Table 3: Manufacturing B&O Taxes, 2015

Taxable Revenues	Taxpayers	B&O Tax Paid	Share of Manufacturing B&O Tax Paid	Share of Statewide B&O Taxable
\$0 to \$250,000	9,752	1,523,382	0.5%	0.0%
\$250,001 to \$1,000,000	2,423	6,337,725	2.0%	0.2%
\$1,000,001 to \$25,000,000	2,845	69,683,269	21.7%	2.1%
\$25,000,001 and above	444	244,266,343	75.9%	7.3%
Total	15,464	321,810,719	100.0%	9.6%

Source: Department of Revenue

National experts of varying ideological persuasions agree that restoring American manufacturing should be a priority.

of 0.484 percent, with about half of those receipts taxed technically under the currently identical wholesaling rate. Just under 50 percent were taxed at what is now a preferential rate of 0.2904 percent. The remaining revenues were taxed at the lower preferential rates listed earlier in this report. (DOR 2017)

As a result of the recent veto, manufacturers and processors for hire without a tax preference will continue to be subject to the rate ceiling of 0.484 percent. As noted above, the Legislature does authorize some deductions. These lower the figure calculated as taxable revenue, reducing the percentage of actual gross receipts paid as B&O tax. In 2015, firms with under \$250,000 in taxable revenue deducted an amount equal to 79 percent of their gross receipts, while the largest firms (with above \$25 million in revenue) deducted just under 25 percent. (DOR 2016)

The state can also grant a tax preference in the form of reduced rates or exemptions, for the purpose of attracting or keeping jobs in the state, or maintaining a social policy, such as preventing the collection of B&O tax on employee wages or exempting food products from sales tax. These tax adjustments can also address systemic inequities, such as “pyramiding,” where a producer can be required to pay B&O or sales tax once or multiple times, depending on the business’s structure, as a product goes through the supply chain. Tax preferences are granted to categories of business activity, not to individual companies, and are subject to periodic public review. They can be granted for property, sales, or the B&O tax. Tax credits, taken after the tax liability is calculated, are extended to certain groups, such as small businesses operating in rural areas. (WRC 2017)

The Tremendous Value of Manufacturing

Manufacturing is a particularly beneficial economic activity. Wages are generally substantial. Most positions do not require an advanced degree, which is un-

sual for a “living wage” job in our fast-evolving, tech-based economy. National experts of varying ideological persuasions agree that restoring American manufacturing should be a priority.

In 2015, economists brought together by the Brookings Institution and the American Enterprise Institute (AEI) agreed that the creation of manufacturing jobs is key to securing a middle-class life for workers without advanced degrees and should be among our highest priorities. Applying that idea to Washington, lowering taxes on manufacturers would pave the way for jobs that offer workers good pay and the promise of a more secure, family-wage income. (AEI/Brookings 2015)

The whole community benefits in many ways from manufacturing activity. Each manufacturing position creates from two to eight additional jobs, and sometimes as many as 13 (OFM 2015, WRC 2016). And manufacturing is returning to America’s shores for a variety of reasons (though in these workplaces, productivity has often risen with fewer workers). According to MIT professor David Autor, the concern expressed over the stagnation or decline of middle class wages is a reaction to “wage polarization” (Autor 2010). Middle class wages are rising, but these increases vary widely and are often dependent upon the skill level required for a job.

The manufacturing jobs of the future will require a higher skill level than ever before. The ability of the education and job training system to produce qualified candidates for potentially thousands of future manufacturing jobs in the state will be tested. Such an opportunity demands placing a priority on preparing the needed workforce and maintaining an economic climate with balanced taxation that will ensure job creators want to stay or come here.

Comment

The state’s manufacturing base has provided hundreds of thousands of its resi-

dents without advanced degrees the chance to make a living wage and enjoy a middle class life. This year the state missed an opportunity to help manufacturing firms that sell out of state and don't have a preferred B&O tax rate. Lowering business costs for these companies would help level the playing field with their rivals in other states. Economic growth, new jobs, and increased tax revenues are benefits that can flow directly from changes in state tax policy. Washington state manufacturing jobs in 2015 averaged \$93,000 a year in compensation. Each one led to the creation of more jobs. We need to rebalance our priorities

with a focus on the creation, retention, and importation of manufacturing jobs.

Next

In Part II, we will look at some of the other success elements needed to create manufacturing jobs, including: education and job training that produces a skilled work force; a transportation and port system that provides access and moves goods and people efficiently; a genuinely protective environmental framework that allows for the productive use of land, water, and power; and competitive, job-friendly workplace regulations.

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