

PB 07-16  
December 10, 2007

## SEATTLE'S BUSINESS TAXES ARE A COMPETITIVENESS ISSUE

### BRIEFLY

Taxes matter when businesses decide where to locate. This is particularly true for decisions about where to locate within a metro area, where the competing locations all have access to the same pool of labor.

The increasing suburbanization of employment presents a fiscal challenge to the City of Seattle. At one time the city had a monopoly vis-à-vis businesses that wanted to locate in the metro area. This is no longer the case. Less than half of jobs in King County are in the city itself, and over the last 11 years Seattle has gotten less than one quarter of the County's net new jobs.

The City gets more than one half of its general tax revenue from taxes paid by businesses. Its business tax rates are significantly higher than the rates levied by suburban jurisdictions. These higher tax rates provide a disincentive to locate jobs in the city.

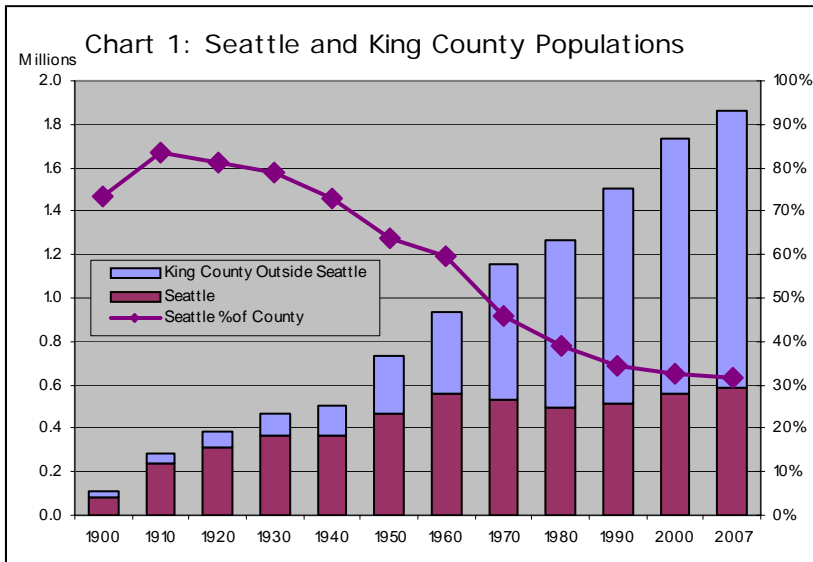
### SUBURBANIZATION OF POPULATION

The 1910 census counted more than 247,000 residents in Seattle; fully five out of six people living in King County were Seattle citizens. From 1910 to 1960, the city added 320,000 residents (some of this growth came through annexation).

King County population outside the city limits grew even more rapidly, and the 557,000 residents of Seattle in 1960 were only 60 percent of King County's population. The growth outside of the city was encouraged by the increasing ownership of automobiles and the construction of roadways (notably the first Lake Washington floating bridge) that made it possible to commute from suburban homes to jobs in the city.

The pace of suburbanization accelerated in the 60s, with the construction of Interstate 5 and the second floating bridge. Seattle actually lost more than 60,000 residents from 1960 to 1980, while the rest of King County gained nearly 400,000. The city was then less than 40 percent of the county's population.

Following 1980, Seattle again began to grow, so that by the 2000 census its population exceeded the 1960 peak. Demographers with the state Office of Financial Management estimate that the city added nearly 23,000 residents from 2000 to 2007. The share of King County residents living in the city has continued to fall, however, and is now below 32 percent.



Following 1980, Seattle again began to grow, so that by the 2000 census its population exceeded the 1960 peak. Demographers with the state Office of Financial Management estimate that the city added nearly 23,000 residents from 2000 to 2007. The share of King County residents living in the city has continued to fall, however, and is now below 32 percent.

### SEATTLE IS BECOMING A CONSUMER CITY

The recent growth in Seattle population has been accompanied by increasing numbers of city residents commuting to jobs in the suburbs. This is a pattern that the economist Edward Glaeser and his colleagues see in a number of U.S. metropolitan areas, and which they ascribe to the increasing importance of central cities as "consumer cities" (Glaeser et al. 2001).

Downtowns have reemerged as attractive places to live as urban densities offer opportunities for social interaction that are not available in the suburbs. Young single people, in particular, are attracted to central cities.

The low transport costs created by urban density may facilitate enjoyable social contact. . . One area where this appears to be particularly important is the location decisions of young single people, who live disproportionately in the densest urban areas. A natural explanation of this phenomenon is the crowding makes meeting other single people easier and facilitates the operation of the marriage market. . . Alternatively, married people may live disproportionately in suburbs so that they can consume more land. (Glaeser et al., 2001, p. xx)

Seattle is such a city, with a high proportion of residents between the ages of 18 and 35 and the second lowest proportion of residents under age 18 among major U.S. cities (WRC 2001; Population Connection 2004). This high proportion of young adults help make Seattle the U.S.'s most highly educated major city.

The population density of large central cities provides the customer base to support a variety of specialized stores, restaurants and entertainment venues, and this richer mix of consumption opportunities in turn draws residents. Some people find the older buildings in central cities and even the density itself attractive.

The consumption value of some cities may be a product of their possession of a valuable stock of buildings that are considered to be aesthetically pleasant. . . But more generally some people may actually prefer city living itself for aesthetic reasons (of course, many people dislike city living on aesthetic grounds as well). (Glaeser et al., 2001, p. xx)

The City of Seattle has mounted a number of successful initiatives to encourage the expansion of consumption and residential uses in downtown. The public funding of the Pacific Place parking garage was instrumental in convincing Nordstrom to redevelop the old Fredrick and Nelson building. The new art museum and symphony hall were located downtown. Building codes have been modified to encourage the construction of high rise residential towers in the downtown core, while the city has seen the residential conversion of older office buildings. Public money has gone to subsidize two sport stadiums. As a result, downtown Seattle is much more vibrant today than it was 15 years ago.

#### WHILE EMPLOYMENT CONTINUES TO SUBURBANIZE

The “consumerization” of Seattle’s downtown is a positive development. However, even as downtown population grows, the city faces strong competition from the suburbs as locations for office and manufacturing jobs. Over the last 30 years, suburban cities such as Bellevue and Redmond have transformed from bedroom communities to regional employment centers. Increasing numbers of city residents commute to suburban jobs.

Big central cities, with easy access to ports and rail yards, once possessed considerable business-cost advantages, but this is less true for today’s economy. Large-scale manufacturing has fled from central cities to the suburbs and beyond. Cities remain attractive to firms in the finance and business and professional services sectors, which benefit greatly from ac-

Table 1: March Covered Employment

	1995	2000	2001	2002	2003	2004	2005	2006	1995 to 2000	2000 to 2006
Seattle	426,412	510,896	504,266	474,690	467,571	462,137	465,689	470,698	19.8%	-7.9%
King Ex-Seattle	510,799	638,746	651,257	619,722	610,441	615,190	627,396	654,499	25.0%	0.5%
Bellevue	93,539	118,152	120,110	110,697	110,774	109,537	113,306	118,632	26.3%	0.4%
Bothell	15,161	20,389	21,439	20,913	20,068	20,355	22,347	23,695	34.5%	16.2%
Issaquah	9,254	15,035	15,791	15,964	16,275	16,614	17,482	18,668	62.5%	24.2%
Kirkland	28,246	34,092	34,435	31,857	30,866	31,334	31,648	32,050	20.7%	-6.0%
Redmond	47,405	73,024	78,956	77,238	78,286	79,459	82,073	81,814	54.0%	12.0%
Renton	42,804	54,154	55,094	51,443	48,820	46,396	48,304	50,703	26.5%	-6.4%
Suburban Six Total	236,409	314,846	325,826	308,112	305,088	303,695	315,160	325,562	33.2%	3.4%

cess to a deep, diversified labor pool. However, denser suburban locations may be equally attractive to them.

In the productive sector, it is clear that the advantages the cities once had from reducing transport costs for manufactured goods are no longer important. But the urban advantage in saving transport costs for people and ideas still matters. Indeed, the cost of moving people will probably continue to rise . . . because increases in the cost of time will probably go up more quickly than improvements in people-moving transport technologies. However, it is not obvious that these person-transporting advantages of cities need the denser, older cities to function well. Indeed, a large edge city [Bellevue, for example] appears to provide its residents with a large labor market where they can change employers easily without changing residences. (Glaeser et al., 2001, p. 33)

With automobiles the commute from central city homes to suburban jobs may be no more difficult than the more traditional commute from the suburbs to the city. An in-city location provides no special advantage to employers whose labor pool includes both city and suburban workers.

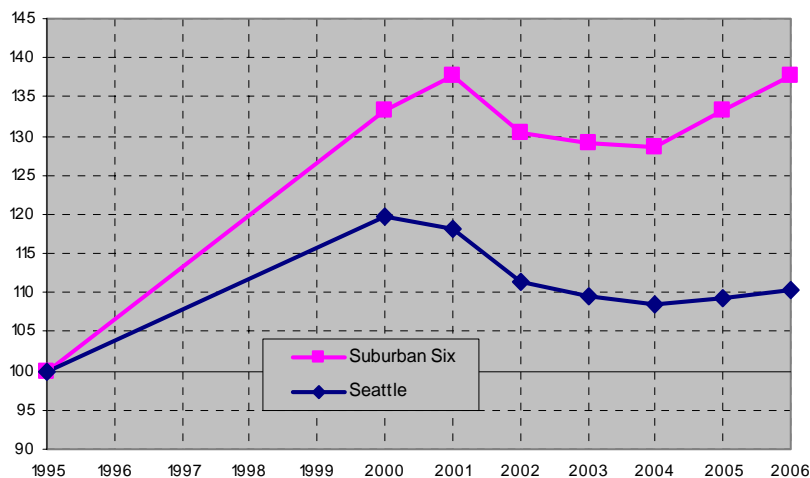
Solid data on the growth of employment in Seattle's suburbs is surprisingly scarce. While the state has for many years collected data on employment by county, information on the location of jobs within counties is sparse. The best available data are from the Puget Sound Regional Council (PSRC), which has estimated *covered employment* (employment in jobs that qualify for unemployment insurance) by city for the four-county PSRC region. The PSRC data include only the years 1995 and 2000–2006.

Table 1 shows the PSRC estimates of covered employment for Seattle and the rest of King County. Between 1995 and 2006 more than three-quarters of the jobs added in King County were outside of Seattle.

Table 1 also shows the PSRC estimates of covered employment for six key suburban cities: Bellevue, Bothell, Issaquah, Kirkland, Redmond and Renton. These six cities, which form a crescent to the east of Lake Washington, are close enough to Seattle to be part of the same labor market. From 1995 to 2006, Seattle added a net 44,300 jobs. Over the period, the net job gain for the suburban-six was nearly twice as great, 86,200.

In percentage term, the relative performance of the suburban cities looks even stronger. Chart 2 graphs indexes of employment in Seattle and the six suburban cities combined, where 1995 employment is indexed as 100.

Chart 2: Employment Growth (1995=100)



Seattle employment grew by nearly 20 percent from 1995 to 2000, its peak year. 2006 employment was 6.7 percent below the 2000 level.

The six suburban cities experienced a greater percentage growth in employment than Seattle from 1995 to 2000 (32.5 percent), although the absolute gain in employment was greater in Seattle than in the suburban cities (84,500 versus 76,900). Employment continued to grow strongly into 2001 for the suburban six, while it turned down in Seattle. Employment growth from 2004 to 2006 was stronger in the suburban six than in Seattle.

And it is not just that employment in these cities is growing faster than employment in Seattle: Jobs in these cities on average pay more than jobs in Seattle.

Table 2 shows average wage rates by sector for 2004 for Seattle and the six suburban cities, as calculated by the PSRC. (The wages for Bothell are the average of the wages calculated by PSRC for the King County and Snohomish County portions of that city.) The average wage for Seattle was \$47,200. This was the lowest among the seven cities. The city with the highest average wage was Redmond, where Microsoft pushed up the average wage (\$89,300). Bellevue ranked second, \$53,400.

The Seattle sector with the highest average wage was FIRE (finance, insurance and real estate), where the average was \$66,000. The average

FIRE wage was a bit higher in Bellevue, \$66,400.

Table 2: 2004 Average Annual Wages by Sector by City

	Const/Res	FIRE	Mfg	Retail	Services	WTU	Total
Seattle	\$ 54,300	\$ 66,000	\$ 54,000	\$ 33,800	\$ 42,800	\$ 58,200	\$ 47,200
Bellevue	\$ 55,000	\$ 66,400	\$ 75,800	\$ 32,300	\$ 50,000	\$ 72,300	\$ 53,400
Bothell	\$ 48,800	\$ 50,450	\$ 65,500	\$ 27,850	\$ 48,100	\$ 64,700	\$ 51,500
Issaquah	\$ 46,800	\$ 57,600	\$ 73,200	\$ 28,800	\$ 47,800	\$ 60,200	\$ 47,500
Kirkland	\$ 52,300	\$ 55,200	\$ 50,700	\$ 35,900	\$ 49,400	\$ 76,800	\$ 50,300
Redmond	\$ 47,500	\$ 62,800	\$ 61,100	\$ 25,900	\$ 105,600	\$ 59,700	\$ 89,300
Renton	\$ 44,700	\$ 37,800	\$ 76,800	\$ 35,600	\$ 36,100	\$ 50,900	\$ 51,200

Seattle had the second lowest average wage in manufacturing, \$54,000, ahead of only Kirkland. Renton, with its

Boeing plant, had the highest average manufacturing wage, \$76,800, followed closely by Bellevue.

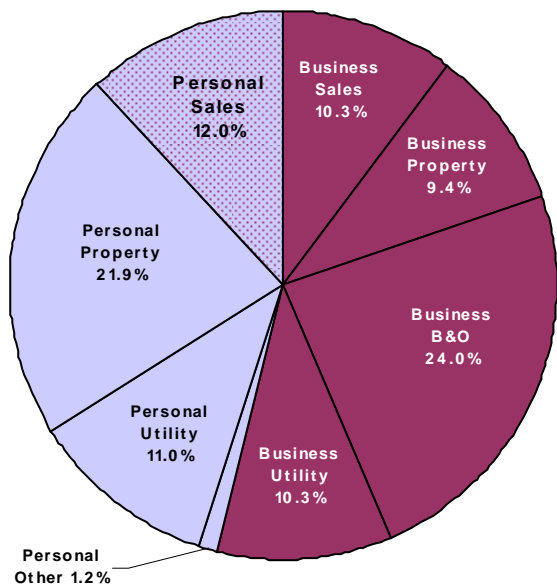
Seattle also had the second lowest average services wage, \$42,800, in this case ahead of only Renton. Redmond had by far the highest average services wage, \$105,600. Again this is the impact of Microsoft. (Many of the best jobs in the 'new economy' are in the service sector.) Bellevue had the second highest average services wage, \$50,000.

TAX SHARES

Historically, the City has been able to exploit its position as the region's primary job center to fund the majority of city services through taxes on

businesses. But as competition from suburban job centers increases, the city's ability to sustain this subsidization will be challenged.

Chart 3: Seattle Taxes, 2006



In 2000, according to the decennial federal census, Seattle's population of 563,376 was 9.6 percent of the state total. The census found that average income of city residents was higher than the statewide average, so that the city had 12.6 percent of statewide income. In March of 2006, the most recent month for which data is available, 16.9 percent of the state's jobs were in Seattle.

Chart 3 shows the distribution of taxes used to fund general city services. In 2006, taxes provided \$683.8 million in General Subfund and Charter revenues. Nearly all of this came from four taxes, the property tax, the business & occupation tax, the sales tax and utility taxes. (We lump the leasehold excise tax with the property tax and the use tax on brokered natural gas with the natural gas utility tax.) Of the total, we calculate that 54 percent is collected from businesses.

In contrast, the state Department of Revenue estimates that businesses pay 45 percent of the corresponding state taxes (B&O, sales, utility and property). The higher business share of city taxes relative to state taxes reflects Seattle's greater reliance on the B&O and the concentration of business in the city.

In addition to the 54 percent of city taxes that are paid by businesses, an additional 12 percent of city tax revenues come from personal sales taxes that are collected through retail businesses located in the city.

#### TAX RATES

Taxes on business are lower in the suburbs. Table 3 compares tax rates in Seattle with the rates in six nearby cities: Bellevue, Bothell, Issaquah, Kirkland, Redmond and Renton.

*Major business taxes.* Three distinct types of business tax are used across the seven cities: the gross receipts tax, the square-footage tax and the head tax. Seattle is the only city with all three.

Seattle, Bellevue and Issaquah impose gross receipts (business and occupation) taxes. In Seattle, the tax applies at the rate of 0.215 percent of gross receipts in the retail, wholesale, manufacturing, extracting, printing and publishing sectors and 0.415 percent of gross receipts in the services and other sectors. In Bellevue, the rate is 0.1496 percent. In Issaquah, the rates are 0.10 percent on services and real estate, and 0.08 percent on other businesses.

Bellevue imposes a square-footage tax at the rate of 82 cents per square foot, per year. This tax targets activities that are not taxed under Bellevue's B&O tax. The Seattle City Council recently approved square-footage tax, which will be collected for the first time in 2008. This new tax targets business activities that escape taxation as the result of state-

Table 3: Tax Rate Comparison

	Seattle	Bellevue	Bothell	Issaquah	Kirkland	Redmond	Renton
<b>Business Taxes</b>							
Business and Occupation Tax (Percent of Gross Revenue)	0.215, 0.415	0.1496	-	0.08, 0.10	-	-	-
Square Footage Tax (Annual per Taxable Square Foot)	\$156, \$0.52	\$0.82	-	-	-	-	-
Head Tax (Annual per Employee)	\$25	-	-	-	-	\$90	\$55
<b>Utility Taxes</b>							
Electricity (Percent of Gross Revenue)	6	5	6	6	6	6	6
Telephone (Percent of Gross Revenue)	6	6	6	6	6	6	6
Natural Gas (Percent of Gross Revenue)	6	5	6	6	6	6	6
Other Utilities (Percent of Gross Revenue)	12-15.5	5	6	-	7.5	-	6
<b>Property Tax</b>							
City Property Tax (Per \$1,000 Assessed Value)	\$2.13	\$1.09	\$1.50	\$1.55	\$1.40	\$1.18	\$2.88
Total Property Tax (Per \$1,000 Assessed Value)	\$9.28	\$7.74	\$10.47	\$9.98	\$8.99	\$8.81	\$10.94

mandated reforms to Seattle's B&O tax (WRC 2008). The rates are \$1.56 per square foot, per year for office, retail or production space and 52 cents per square foot, per year for space with other usages.

Redmond imposes an employee head tax at the rate of \$90 for a full time, full year employee. Renton imposes such a tax at the rate of \$55 for a full-time, full-year employee. These are the major business taxes for the two cities. In 2008, Seattle will begin to collect a head tax of \$25 per full-year, full-time employee, as part of the "Bridging the Gap" transportation-funding program.

*Utility Taxes.* State law caps utility tax rates on electricity, gas and telephones at 6 percent, unless local voters have explicitly approved a higher rate. With the exception of Bellevue, all seven cities are at the 6 percent cap for these utility services. Bellevue taxes telephones at 6 percent, and electricity and gas at 5 percent. For other utilities, Seattle's rates range from 10 percent (cable TV) to 15.54 percent (water). Other cities charge lower rates, typically 6 percent.

*Property Taxes.* The City of Seattle's property tax ranked second highest among the seven cities in 2007 (only Renton was higher). In terms of the overall property tax rate, however, the city ranked somewhat lower, fourth. The reason for this difference in ranking is the low property tax rate for schools in Seattle, due to the city's relative dearth of families with school-aged children. (The unattractiveness of the city to families with children largely outweighs whatever business-location advantage the city gains from low school property taxes.)

Table 4: 2006 Revenue from Business Taxes, Licenses and Permits

	Seattle	Bellevue	Bothell	Issaquah	Kirkland	Redmond	Renton
Population	578,700	117,000	31,690	19,570	47,180	49,890	58,360
Private Employment	391,305	111,070	21,220	17,322	27,519	79,636	43,671
Private Employment ÷ Population	0.68	0.95	0.67	0.89	0.58	1.60	0.75
Business Taxes (\$ millions)	160.20	27.06	-	2.20	0.98	3.80	-
Business Licenses & Permits (\$ millions)	15.38	0.13	0.24	0.34	1.38	2.81	2.98
Taxes ÷ Private Employment (\$)	409.40	243.61	-	127.12	35.54	47.71	-
Licenses & Permits ÷ Private Employment (\$)	39.31	1.19	11.50	19.74	49.98	35.34	68.16
Taxes, Licenses & Permits ÷ Private Employment (\$)	448.71	244.80	11.50	146.86	85.52	83.06	68.16
Taxes, Licenses & Permits ÷ Population (\$)	303.41	232.40	7.70	129.98	49.88	132.58	51.01

#### BUSINESS TAX, LICENSE AND PERMIT REVENUE

Table 4 provides a comparison of revenue from business taxes across the cities.

The first line of the table shows the estimated April 1, 2006 population for each of the cities, and the second line shows March 2006 covered employment in private sector jobs. With 0.68 private jobs per resident, Seattle ranked fifth among the cities, barely ahead of sixth-place Bothell and well behind Redmond, which hosted 1.6 private sector jobs per resident.

The State Auditor's Office makes financial information from local governments available on the web through the Local Government Financial Reporting System (LGFRS, at <http://www.sao.wa.gov/applications/lgfrs/>). The fourth and fifth rows of Table 4 show the amount that LGFRS reports for the seven cities under two categories of revenue: Business Taxes and Business Licenses and Permits. Seattle is the leading city, by far, in both cases, as would be expected given its large employment base.

To put these revenues in scale, we divide business tax revenue by the number of private sector employees in the sixth row and divide business license and permit revenue by private sector employees in the seventh row. The difference between a tax and a license or permit fee is at times purely semantic, and so it makes sense to combine business taxes with business license and permit fees. We have done so and divided the sum by the number of private sector employees. The result is shown in the eighth row.

Seattle collected \$449 in business taxes and fees per private sector employee in 2006 (and this figure does not include property or sales taxes paid by the employers or the taxes on utility services purchased by these employers). This is nearly twice the \$245 in business license and permit fees that Bellevue, the second highest tax and fee city, collected.

#### DISCUSSION

Taxes matter when businesses decide where to locate. This is particularly true for decisions about where to locate within a metro area, where the competing locations all have access to the same pool of labor (Mark, McGuire and Papke 2000; Wasylenko 1997).

Seattle faces strong competition from nearby suburban cities for jobs. In recent years, the majority of jobs created in King County have landed out-

side of the city. Recent success in redeveloping the city as a place to live and consume should not blind policy makers to the fundamental importance of enhancing the city's attractiveness as a place to work.

Business taxes are higher in Seattle than in the suburban cities east of Lake Washington. These cities are growing jobs faster than Seattle. As we've said: Taxes matter.

#### REFERENCES

- Glaeser, Edward L., Jed Kolko, and Albert Saiz. 2001. "Consumer City." *Journal of Economic Geography* 1. 27–50.
- Mark, Stephen T., Therese J. McGuire, and Leslie E. Papke. 2000. "The Influence of Taxes on Employment and Population Growth: Evidence from the Washington, D.C. Metropolitan Area." *National Tax Journal* LIII (1).
- Population Connection. 2004. Kids Friendly Cities: Report Card 2004. <http://www.kidfriendlycities.org/2004/>
- Washington Research Council (WRC). 2002. "Front Lawns or Balconies? Trends in WA Housing." PB 02-12. September.
- . 2007. "Recent Fiscal Trends for the City of Seattle." PB 07-13. October.
- Wasylenko, Michael. 1997. "Taxation and Economic Development: The State of the Economic Literature," *New England Economic Review*, March/April.