

Washington Research Council

= Public Policy Brief =

November 10, 1988

Understanding Washington's Taxes

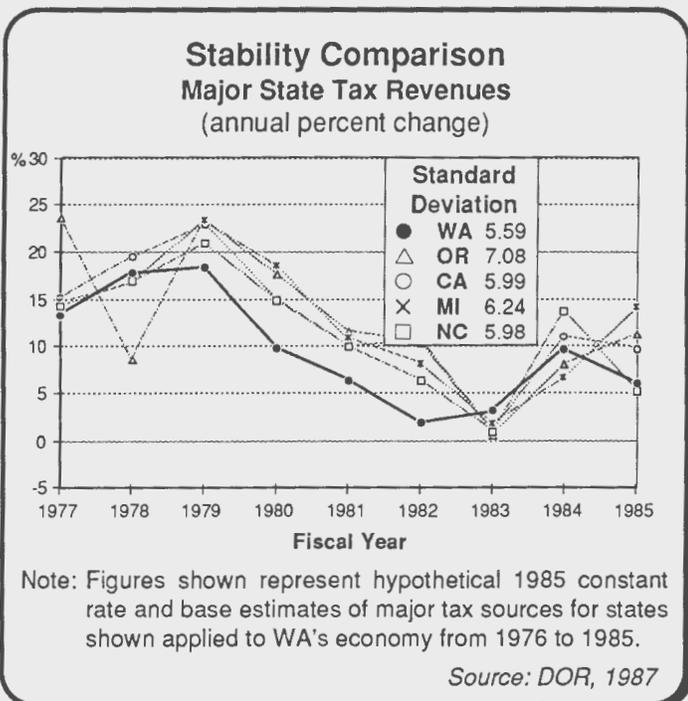
Nearly all the components of the current tax system were in place with the passage of the Revenue Act in 1935. Washington's major general fund state taxes are the sales tax (53 percent of the total), the property tax (12 percent), and the business and occupations (B&O) tax (16 percent). Miscellaneous taxes make up the remaining 19 percent.

The purpose of our "Special Report," *Understanding Washington's Taxes*, was to develop a clear understanding of the state taxes currently in place in Washington — what they are, how they evolved, who pays them, and how well they interact as a system. Three basic indicators are important to a tax system's performance — stability, elasticity and distribution of burden. Each of these is reviewed.

Stability and elasticity are of primary concern to legislators and other public officials as they relate to the ability of the tax structure to fund state government. We, therefore, focus on state-only taxes in our discussion of stability and elasticity. Tax burden, on the other hand, is an issue which is viewed from the perspective of taxpayers. Taxpayers are concerned with their total tax bill and we, therefore, look at state and local taxes in our review of household and business tax burden.

Tax System Stability

Washington's system of state taxes is stable. In fact, the degree of stability inherent in our state's tax system is one of

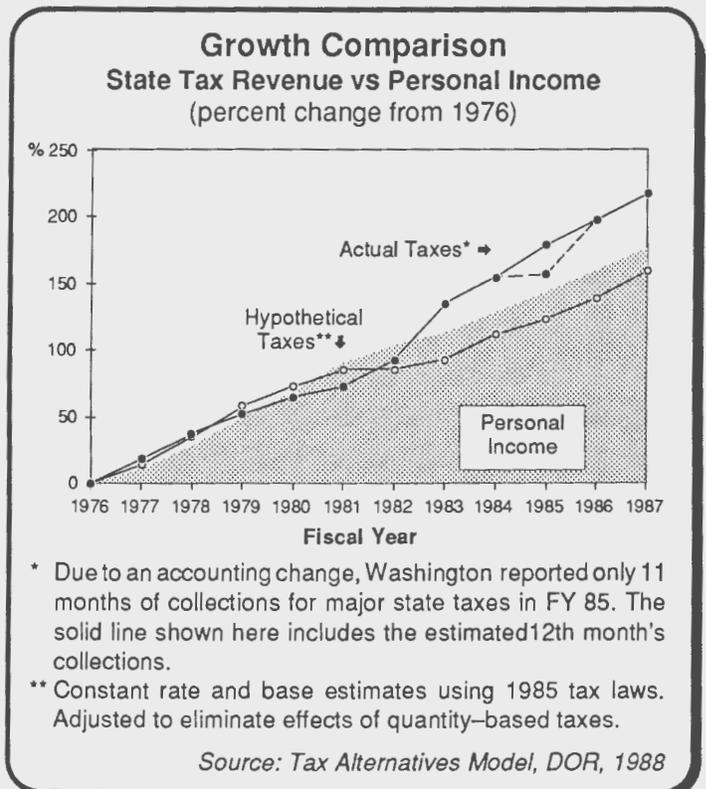


its major strengths. Our system of state taxes is probably more stable than most of our alternatives, due primarily to the presence of the B&O tax and the absence of income-based taxes in Washington — especially the corporate income tax.

The graph on the left compares Washington's tax system with the tax systems of Oregon, California, Michigan and North Carolina. Under our state's 1985 tax structure, Washington's tax revenue would have grown in each year of the 1976–85 period (i.e. all points are greater than zero). The rate of growth for Washington's system of major taxes, however, would have begun to slow down sooner going into the 1980–83 recession than the other states to which it was compared. Over the period hypothetical tax revenues with Washington's tax structure would have produced revenues more slowly, slowed down earlier, and begun recovering sooner than the other systems.

Tax Growth and the Economy

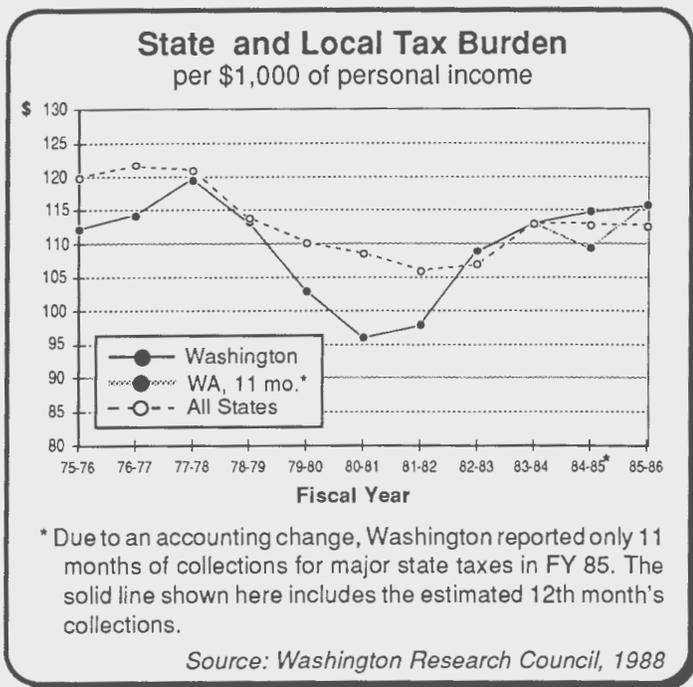
State tax systems should grow at a rate similar to the rate of growth in the state economy, where elasticities approximate 1.00. Faster growth in taxes would effectively constitute a tax increase, while slower growth would constitute a decrease.



In most years over the last decade Washington's taxes were elastic, growing slightly in excess of growth in the economy (elasticity ≥ 1.00). During the 1980-83 recession, however, our system, similar to other systems which might have been used, experienced considerably slower revenue growth than is typical of non-recession periods. That recession was the sharpest since the Depression, and forced state lawmakers and administrators to cut budgets, reduce and eliminate programs, and raise taxes in order to balance the state budget. It was an unusual time (with tax elasticities falling below 0.50) which required unusual actions. Over the 11-year period reviewed, state taxes grew at about 90 percent of the growth in the state's economy (elasticity = 0.90). This is shown in the graph on the previous page. The key to reading the graph is to compare the relative slopes of the tax lines with personal income. When the slopes of the lines are parallel, elasticities are equal to 1.00.

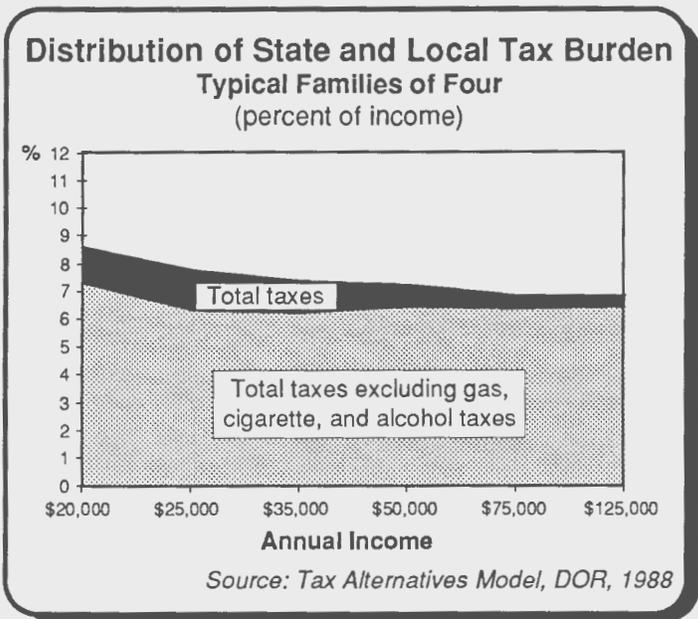
Distribution of Tax Burden

At \$116 per \$1,000 of personal income, Washington ranked 18th in the country in fiscal year 1986 (FY 86) in state and local tax burden. Washington's state and local tax burden peaked in FY 78 at \$120 per \$1,000 of personal income, very similar to the average burden for all states that year of \$121. From this high point, tax burden fell to \$96 per \$1,000 of personal income in FY 81. Since FY 81, Washington's tax burden increased steadily each year, surpassing the national average for the first time in FY 83. As shown in the figure below, we continued to exceed the national average through FY 86.



Household Tax Burden

The initial burden of our state and local taxing structure among households appears to be slightly regressive (see graph, top right). Despite the popularity of tax burden studies, however, reliable supporting data are hard to find. For the broad range of taxpayers, the system is probably propor-



tional, particularly when cigarette, gas and alcohol taxes are removed.

Business Tax Burden

The tax burden on business is high in this state — 44 percent of total taxes, compared with about one-third nationally. The state B&O tax is visible and controversial, but it accounts for only 28 percent of total state and local business taxes paid in Washington. The other 72 percent of business taxes is collected through retail sales and use (33 percent), property (28 percent) and miscellaneous taxes (11 percent). The retail sales tax on capital is an acknowledged disincentive to investment. But our examination of the available data found that sufficient information does not exist with which to support conclusions regarding the distribution of total business tax burden across industries, either on the basis of gross receipts or on the basis of profitability.

As the country and Washington state prepare for the challenges of the 21st century, the discussion of taxes is timely and crucial. Only by understanding the characteristics of our current system can we understand the extent to which there is a problem.

We have reviewed the fundamental characteristics of the present tax system — stability, elasticity and burden. And our review indicates that the system performs adequately under most conditions, most of the time.

This isn't to say that it is trouble-free, or beyond improvement. However, based on the measures we reviewed and with the exception of business tax burden, for which there is insufficient data on which to base definitive conclusions, we found Washington's tax system to be fundamentally sound.

The Washington Research Council is an independent public policy research organization which promotes efficient and effective government in Washington. To order a copy of the full report on Washington's taxes or to request a presentation on the topic, contact the Research Council office at (206) 357-6643.