

INTRODUCTION

There is considerable interest by taxpayers and government officials in Washington's relative tax position among the states. In order to properly compare tax burdens, uniform and reliable data must be utilized. The best source of comparative tax information for all state and local governments is "Government Finances," compiled annually by the Census Bureau of the U.S. Department of Commerce. The figures for 1997-98 were released in late July, 2001.

For fiscal year 1998, tax collections in Washington amounted to \$17.3 billion. This figure includes all state and local tax collections, according to the definitions used by the U.S. Census Bureau. Taxes include compulsory payments which are not related to particular governmental services; that is, tax liability is independent from the benefit taxpayers receive from government operations. Instead, taxes are determined by other measures such as income, purchases and property values. Furthermore, taxes are the source of funding for general programs over which legislatures typically have the most discretion in terms of spending levels, since nontax revenue sources are usually dedicated to specific programs.

Examples of revenues excluded from the tax category are sales of commodities and services directly benefiting individuals (e.g., utility charges, tuitions and fees). Also, enterprise revenues from liquor sales and utility operations are omitted. Required payments for unemployment and workmen's compensation programs are other significant exclusions. These are not considered general tax revenues because they are earmarked to provide assistance to employees who are laid off from work or injured while on the job.

There are several ways in which tax burdens may be measured. Each approach has its own merits and is suited to a particular purpose. The two primary methods used in this report are the amount of taxes in relation to population and personal income.

PER CAPITA TAXES

A first step often taken in measuring relative tax burdens is to divide total state and local tax collections for each state by its population. This computation results in a state and local tax amount of \$3,038 for each Washington resident and gives Washington a ranking among the 50 states of 13th for FY 1998 (Table 6). Washington per capita taxes are \$175 above the national average of \$2,863. Chart 3 portrays the change in per capita state and local taxes since 1960 for Washington and the average for all states.

A per capita tax comparison is far from complete, however, because differences in the level of income among the states greatly influence their capability to finance the cost of government services. Furthermore, the per capita approach assumes that all citizens are identical for purposes of computing the "average" tax burden. In addition to income, many other factors including age, family size, and consumption preferences for housing and other taxable items are significant in determining the tax burden for any particular individual or family. Also, tax collections include

taxes initially paid by businesses, so the per capita amount does not correspond to what the "average" individual would pay in direct state and local taxes.

TAXES PER \$1,000 PERSONAL INCOME

To obtain a better measure of the relative ability of states to finance the cost of government, the total state and local taxes may be divided by total state personal income--a statistic representing the "wealth" of all residents living in each state. This computation produces a 1998 Washington state and local tax burden of \$115.00 for each \$1,000 of personal income (Table 1). Stated another way, Washington state and local taxes equaled 11.5 percent of personal income in fiscal year 1998. By this measure Washington ranks 17th in the nation and 6th among the 13 western states.

Washington's average tax burden is \$3.30 higher than the national average. Chart 2 illustrates the change in state and local taxes per \$1,000 of personal income since 1960. According to the latest available data, the average share of personal income in Washington, \$30,392, ranks 12th among all states (Table 5).

STATE TAXES VS. LOCAL TAXES

Both of the above tax comparison methods include state and local government taxes, since most taxpayers are concerned with their total tax burden. (Federal taxes are assumed to apply uniformly throughout the country and, therefore, are not significant in explaining differences in tax burden among the states.) Another comparison that is sometimes made is to look at only state or local taxes. Washington has traditionally ranked high in state taxes but low in local taxes. For fiscal 1998 Washington state taxes per \$1,000 income are ranked 16th, while local taxes are ranked 34th (Table 3). On the per capita basis, Washington state taxes are ranked 8th and local taxes are in 25th place (Table 8).

The explanation for these differences is provided in Table 11 which indicates that 68.3 percent of Washington's state and local tax dollar is collected at the state level while only 31.7 percent is attributable to local taxes. This is in contrast to most other states in which the relative share of state and local taxes is more evenly balanced. On the average, 61 percent of the total is collected at the state level and 39 percent is collected locally. Washington collects a greater share of total state and local taxes at the state level for several reasons: limitations have been placed upon the revenue producing ability of the local property tax; Washington funds public education and certain other programs to a larger degree by state tax sources than many states; and local taxing authority is controlled by state law and new local tax sources must be authorized by the Legislature.

ANALYSIS OF TAX BURDEN

Both the per capita and the personal income approach are based on total state and local tax collections obtained by survey of governmental jurisdictions by the Census Bureau. Taxes include amounts paid by individuals as well as business, but there is no accurate way of classifying tax burdens by type of taxpayer for most tax sources. For example, in Washington it

is estimated that households pay about 58 percent of total sales tax collections, with the remainder paid by businesses (supplies, nonmanufacturing machinery, construction, etc.), government and tourists. But the exact amounts are not known because vendors do not record the type of purchaser who pays the tax. Similarly, the actual burden of the property tax and other major taxes by taxpayer type is not precisely known in this or other states.

Further, the initial tax burdens may be shifted to other entities. Business taxes are particularly susceptible to shifting, either forward to consumers (increased prices) or backward to owners (reduced earnings) and workers (lower wages). Tax burdens may also be shifted to persons in other states. For example, Alaska typically has a very high tax burden due to its petroleum tax revenues. However, consumers in many other states pay a portion of this tax, which is included in the price of oil delivered via Alaska's pipeline. Unfortunately, there is no adequate way of estimating such shifts of tax burden. Some studies attempt to do so, but they require significant resources to model tax impacts, and the results are no better than the underlying assumptions.

Many state and local taxes in Washington are based on consumption expenditures. Thus, revenues are dependent upon price changes, and inflation can have a direct influence upon collections. Population growth is also a major factor, but the rate of increase in tax collections typically exceeds the rate of population growth. Therefore, per capita taxes usually increase from year to year. Fiscal 1998 was no exception, and Washington's per capita tax burden increased by 4.2 percent.

Two factors influence the tax burden calculation in relation to income: the amount of state/local tax collections and the rate of growth in state personal income. Often the income statistic, which is the denominator of the calculation, is a more significant variable than the tax figure which tends to fluctuate less dramatically. The state's tax burden ranking is dependent upon not only changes in Washington, but also in the other states.

In the 1960s, state and local tax burdens of about \$115 per \$1,000 of personal income were typical for Washington, and the state usually ranked about 18th among all states. (This is virtually identical to the FY 1998 figures.) The economic downturn, which occurred around 1970, caused some reduction in the growth rate of tax collections. However, the fall-off in personal income was even greater. The relatively smaller income caused the tax burden calculation to rise to as high as \$128 in 1972 and 1973. Rankings ranged from as high as 17th to as low as 25th during this period.

Later in the 1970s, growth in consumer expenditures exceeded the rate of income growth, due to strong demand for housing and durable goods. Such purchases are often financed from savings or by borrowing rather than current income; thus short-term tax elasticity was very high. The result was a very high tax burden, reaching \$127 in 1978.

A dramatic change in the national economy occurred in 1979-80 due to soaring interest rates, credit controls and reduced demand for autos and housing. The resulting recession in Washington caused the state economy to bottom out in 1981-82. The percentage of personal income devoted to taxable retail purchases (a major driver of Washington tax revenues) dropped from over 70 percent to less than 60 percent in only two years. Also contributing to the reduction

in Washington tax revenues was the exemption of food from sales tax, limitation of local special school levies, extension of the 106 percent limit on property taxes to the state levy, and repeal of the state's inheritance tax. Somewhat ironically, personal income remained rather high during most of this period, and Washington ranked from 8th - 10th in per capita personal income throughout the recession years. The high level of income, coupled with the reduced tax collections, produced a precipitous drop in the tax burden for this state to \$100 in 1981, along with the lowest-ever ranking of 39th.

Later in the 1980s Washington's tax burden returned to the level of about \$115 and rankings of about 16th were common. Since 1990 the tax burden has risen, and for several years the tax burden ranged between \$121 and \$123. Rankings have been as high as 9th-11th. A major factor was the package of state tax increases enacted in 1993 which amounted to a biennial increase in state revenues of \$650 million. Also influencing high tax collections during the 1990s has been a very high rate of population growth for the state. From FY 1989 to FY 1992, only the states of Alaska and Nevada experienced a more rapid rate of population growth. New residents typically purchase appliances and other durable goods to furnish new homes. This causes an increase in tax elasticity and a short-term increase in revenues which can exceed the growth rate in income.

In recent years Washington's tax burden by the income measure was dropped significantly (\$8.00 in the past three years). The FY 1998 tax burden of \$115.00 is the lowest level in the past eleven years. This is largely due to the rollback of state B&O tax rates, the sales tax exemption of manufacturing machinery, reductions in the state property tax rate, and a myriad of new tax exemptions enacted in recent legislative sessions.

Although recent tax burdens for Washington have ranked at relatively high levels, it should be noted that the amount is not out of line with some comparable states. Five of the 13 western states now have higher tax burdens in relation to income. Two Midwestern states with economies similar to Washington and with comparable levels of personal income have significantly higher tax burdens than Washington's \$115.00: Wisconsin and Minnesota, both with 1998 tax burdens more than \$12.50 above Washington's.

A major tax policy change has taken place in Washington since the fiscal year 1998 data reflected in these tax burden comparisons. This is the elimination of the motor vehicle excise tax, effective January 1, 2000. The impact of this will first be reflected in the tax burden data during the second half of FY 2000. To give an idea of the relative impact this change would have had in FY 1998, the tax burden figures have been recalculated after excluding the \$775 million motor vehicle excise tax collections in FY 1998. This would have reduced the state/local tax figure from \$115.00 to \$109.84 per \$1,000 of personal income. Washington's ranking would have been reduced from 17th to 26th among all states. (Of course, major tax changes may have also taken place in other states, affecting their rankings.)