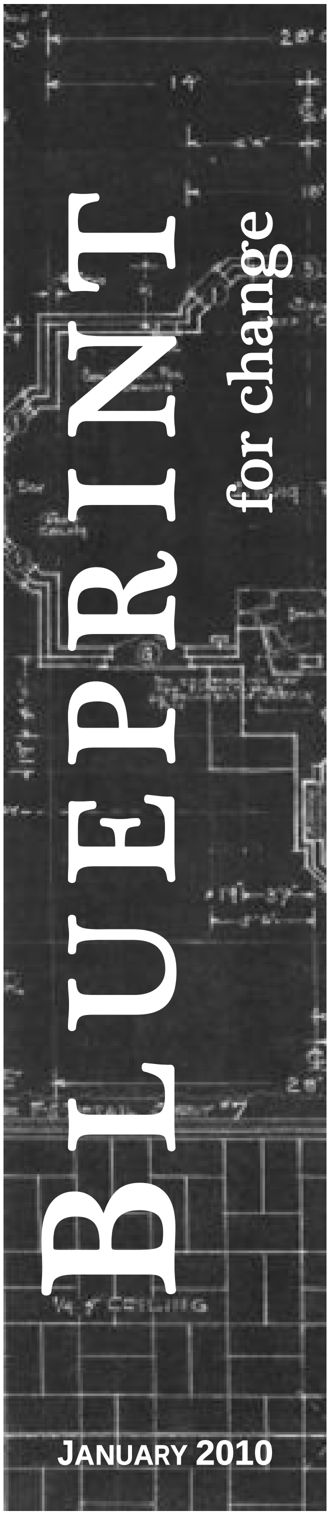
Creating Jobs and Boosting Our Economy

AN ACTION PLAN FOR WASHINGTON'S 2010 LEGISLATURE



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In 2009, Washington's legislature slashed billions from the state budget, adding to the misery of recession by cutting services, jobs, and incomes of public servants. Virtually every area of state government was affected, including K-12 education, higher education, health care, the social safety net, and public safety.

Directly and indirectly, those state budget cuts are costing Washington an estimated 44,000 jobs.

With the economy only tentatively recovering from the deep hole of this long recession, the state now faces an additional budget gap of $2.6 billion. If the legislature were to cut that entire amount from state services, our state would lose another 33,600 private and public sector jobs. Even a $1 billion reduction in state spending would trigger losses of 13,000 more jobs.

In contrast, maintaining state services through a combination of $1.6 billion in new state taxes, plus $1 billion in enhanced federal aid and transfers from other funds would result in a net savings of 18,600 to 29,000 jobs for the working people of Washington.

Instead of compounding job losses, Washington's legislature can act to protect and create jobs during the 2010 session. Priorities to create jobs and build a strong foundation for future prosperity and opportunity include:

- **Maintaining and restoring public services through targeted revenue increases.** The best choice for both short term stimulus and long term stability would be to target tax increases and expand the tax base.

- **Creative bonding to retrofit schools and other public buildings for energy efficiency.** This will immediately create jobs in construction which has lost 40,000 jobs in the past year, while reducing energy consumption and saving taxpayer money in future years. Public spending on infrastructure has a particularly strong multiplier effect. This will stimulate related jobs and allow the state to take advantage of lower prices for materials.

- **Maintaining strong social insurance systems.** Washington's unemployment insurance (UI) and workers' compensation programs are among the strongest and most efficient in the country. While other states are struggling with systems that pay poverty-level benefits and UI trust funds that are going broke, Washington's programs are healthy and providing precisely the counter-cyclical economic stimulus and protection for working families and businesses that they were designed for.[1] Our UI system could be further modernized to ensure that more workers are eligible when unemployed through no fault of their own, but restructuring of either system would be counterproductive.

State Budget Cuts Have Cost 44,000 Jobs - So Far

Economist Mark Zandi of Moody's Economy.com estimates that every dollar of state spending results in $1.41 in economic activity.[2] Much of that spending – 62% or 88 cents – is in the private sector, through direct purchasing and contracting, transfers to individuals, and spending by public employees from their salaries.[3]

In 2009, Washington faced an $8.9 billion gap between projected revenues and the cost to maintain service levels through fiscal year 2011. Federal stimulus funds and transfers from the rainy day fund and other sources made up part of that amount, but the legislature and Governor chose a no-new-taxes approach and cut $3.4 billion.[4]

A FURTHER REDUCTION IN STATE SPENDING OF $2.6 BILLION WOULD STRIP THE STATE ECONOMY OF 33,600 JOBS.

Using Zandi's multiplier, we can estimate that the $3.4 billion already cut from state spending will lower gross state product (GSP) by $4.8 billion over the three-year period from 2009 through 2011. That loss of GSP translates into 44,000 jobs lost in our state.[5]

At the start of the 2010 session, the legislature faces an additional budget gap of $2.6 billion. A further reduction in state spending of that magnitude would strip the state economy of $3.7 billion in GSP and 33,600 jobs. A $1 billion state budget cut would deprive Washington's workforce of 13,000 jobs.

TABLE 1. FISCAL IMPACT FOR EACH FEDERAL DOLLAR SPENT

Spending Increases	Fiscal Impact Per $1 Spent
Extending unemployment insurance benefits	$1.61
Increase in food stamps	$1.69
Increased infrastructure spending	$1.57
General aid to state governments	$1.41

Tax Cuts	Fiscal Impact Per $1 Spent
Across-the-board tax cut	$1.02
Make Bush income tax cuts permanent	$0.32
Cut in corporate tax rate	$0.32

Source: Moody's Economy.com, October 2009

Raising Taxes to Support State Services Saves Jobs

During the 2001 recession, Peter Orszag, now serving as director of the Office of Management of Budget, and Joseph Stiglitz, economics professor at Columbia University and formerly Senior Vice President and Chief Economist of the World Bank, also concluded that steep reductions in spending and services by state governments would damage local economies. They calculated that maintaining services by increasing taxes – especially on higher income individuals who would otherwise save a portion of the money or spend it out-of-state – was the better option for state governments facing deficits.[6]

More recent estimates by Mark Zandi confirm that public spending gives a much greater boost to the economy than tax cuts. The converse is also true. Reductions in public spending hurt the economy more than tax increases.

Table 1 shows that the greatest fiscal stimulus from public spending comes from increasing unemployment insurance benefits and food stamps. In both cases, recipients immediately spend close to 100% of the benefits in the local economy. In contrast, less than one third the dollar value of tax cuts for corporations or the well-to-do comes back into the economy, while $1.00 spent on general tax cuts results in only $1.02 of economic activity.[7]

RAISING NEW STATE TAXES RATHER THAN CUTTING STATE SPENDING WILL SAVE JOBS.

Increased infrastructure spending is even more stimulating than general state government spending. It provides well-paying jobs, requires purchasing of equipment and materials in related fields, and lays the foundations for greater productivity and widespread opportunity in the future.

Raising new state taxes rather than cutting state spending will save jobs and is a better choice for the people of Washington. The best case scenario for Washington would be to fill the entire $2.6 billion budget gap through new federal grants and fund transfers. That would save an estimated 33,600 jobs. But because state spending decreases reduce total economic activity more than tax increases do, even raising the entire $2.6 billion gap through new taxes would result in a net savings of jobs in the state.

TABLE 2. NET JOBS SAVED BY FILLING GAP AND MAINTAINING SPENDING

State Tax Increases	New Federal Grants and Fund Transfers	Net Jobs Saved
$0	$2.6 billion	33,600
$1 billion	$1.6 billion	24,300 to 30,000
$1.6 billion	$1 billion	18,600 to 29,000
$2.6 billion	$0	9,300 to 26,000

Assumes $1.41 impact on state economy for every $1.00 of state spending; decrease of $0.32 to $1.02 for every dollar of tax increase; and one job on average for every $109,100 of gross state product. Sources: Moody's Economy.com, October 2009; Bureau of Economic Analysis; Washington Employment Security Department

Possible Sources of New Revenue

In considering new revenues, we should give priority to those 1) that focus on profitable multi-state or multinational businesses, thereby keeping money in Washington that otherwise would have been saved or spent elsewhere, and 2) that will strengthen our public structures and our economy in the long run, by:

- Broadening the tax base and stabilizing the tax structure;
- Discouraging behavior that results in higher public costs; and
- Providing revenue to catalyze economic activity in our state.

WE SHOULD GIVE PRIORITY IN RAISING REVENUE TO BROADENING THE TAX BASE AND STABILIZING THE TAX STRUCTURE.

Unlike most states, Washington's tax system does not have a mechanism to target increases solely on high income individuals. Our tax structure, designed for the economy of the 1930s, relies heavily on sales taxes and has no income tax. This combination makes Washington's the most regressive of any state tax system. Low income people in our state pay a higher percentage of their income in state and local taxes, while the highest income pay a lower percentage than in any other state.[8] Small and new businesses also tend to be disadvantaged both by the high sales tax and by the business and occupation (B&O) tax, which is charged on gross receipts rather than on profits.[9]

WASHINGTON SUFFERS FROM A STRUCTURAL DEFICIT, WHICH MEANS THAT BUDGET PROBLEMS WILL REMAIN EVEN WHEN THE ECONOMY RECOVERS.

Washington also suffers from a structural deficit, which means that budget problems will remain even when the economy recovers. Public revenues do not grow at the same rate as the overall economy and demand for services, because the parts of our economy that are growing fastest are taxed at relatively low rates.[10] As a result, from 1992 to 2006, Washington's rank among the states in total per capita K-12 spending fell from 17th to 37th. Measured by our relatively high personal incomes, our rank fell from 24th to 46th.[11] While we rank fifth nationally in the awarding of associate degrees, we are just 37th in bachelor degrees and 39th in professional degrees.[12] Meanwhile, our very elderly population, heavily reliant on state services, is growing at a disproportionate rate.

Extending the sales tax base to additional goods and selected services both slows the erosion of the tax base and provides local governments with badly needed new revenues. From 1990 to 2003 alone, the percentage of sales subject to sales tax in Washington fell from 61% to 45%, according to an Indiana University study of sales taxes across the country.[13] Continuing to raise sales tax rates while the base shrinks is not a viable strategy for long term fiscal health. Most of the sales tax extensions proposed here have been implemented in other states and are simple to do. At least 14 states exempt most food, but not candy, from sales tax and the Streamline Sales Tax Agreement makes the definitions clear.[14] According to surveys by the Federation of Tax Administrators, at least 11 states apply sales tax to custom software and 14 to detective and security services, while virtually every consumer service is taxed in several states.[15]

EXTENDING THE SALES TAX BASE SLOWS THE EROSION OF THE TAX BASE AND PROVIDES LOCAL GOVERNMENTS WITH BADLY NEEDED NEW REVENUES.

Business tax breaks: Since the early 1990s, Washington's legislature has passed new "business incentive" tax breaks at an accelerating rate. Each may seem justified individually, but unlike public services, tax exemptions are not reevaluated every budget cycle against other options for public investment and the state bottom line. From 1994 to 2008, the legislature passed 185 tax breaks that together drain $2.5 billion from the 2009-11 biennial state budget. Tax breaks passed just since 2004 contribute nearly $1 billion to the current shortfall in state revenues.[16]

Beverage and "sin" taxes: Taxing soda pop and cigarettes is regressive, but the public health costs from overconsumption are enormous and justify higher taxes. Further, multi-national corporations will inevitably shoulder a portion of the costs – taxing them will keep more money in the Washington economy. Finally, all bottled beverages, including water, have a high environmental cost, paid for by all of us rather than by the consumer or manufacturer, further justifying a tax.

TABLE 3. REVENUES TO STIMULATE WASHINGTON'S ECONOMY AND STRENGTHEN ITS TAX STRUCTURE

Business Taxes	FY2011 State Revenue (in Millions)	FY 2011 Local Revenue (in millions)
Sales tax on non-organic fertilizer (not approved by the National Organic Program)	*$35.0*	*$10.8*
Sales tax on custom software	*$70.1*	*$21.7*
Sales tax on detective & security services*	*$62.5*	*$19.3*
Sales tax on security brokers	*$45.6*	*$14.1*
Oil spill tax from 5 cents per barrel to 5% of value	*$377.7*	
Repeal pop syrup B&O credit and increase syrup tax from $1 to $2	*$15.4*	
Temporary B&O increase on business and financial services from 1.5% to 2% ($84.3 if no sales tax on custom software, detective & security, and security brokers)	*$68*	
Repeal B&O deduction for interest earned on residential property mortgage loans	*$84.5*	
Public utility tax rate increase 10%	*$50.7*	
SUBTOTAL BUSINESS	**$809.5**	**$65.9**

TAX BREAKS PASSED JUST SINCE 2004 CONTRIBUTE NEARLY $1 BILLION TO THE CURRENT SHORTFALL IN STATE REVENUES.

Individual Taxes	FY2011 State Revenue (in Millions)	FY 2011 Local Revenue (in millions)
Sales tax on candy and gum	*$28*	*$8.6*
Sales tax on bakery products sold on-site	*$15.9*	*$4.9*
Sales tax on cosmetic surgery	*$6.6*	*$2.0*
Sales tax on consumer services	*$99.6*	*$30.8*
Sales tax on trade-ins of boats, motor homes, appliances	*$3.8*	*$1.1*
New 5 cents per 12 oz. can soft drinks (wholesale)	*$93.6*	
New 1 cent per oz. on bottled water (wholesale)	*$134.7*	
Cigarette tax from $2.025 to $3.00**	*$81*	
Real estate excise tax increase 1.28% to 1.6%	*$122.7*	
SUBTOTAL INDIVIDUALS	*$585.90*	*$47.4*

BOTTLED BEVERAGES HAVE A HIGH ENVIRONMENTAL COST, PAID BY ALL OF US RATHER THAN BY THE CONSUMER OR MANUFACTURER.

TOTAL (BUSINESS AND INDIVIDUAL)	**$1,395.4**	**$113.3**

*Sources: Department of Revenue, "Estimated Impact of Revenue Alternatives," November 30, 2009; * based on DOR November 2008 estimate; **Finance Committee staff.*

Conclusion

By raising taxes in 2010 to meet the budget gap, Washington's legislature will save jobs for state residents. This approach to the economic crisis can simultaneously stimulate the economy, bolster economic security for working families, and strengthen our tax structure to meet 21st century needs.

The national and state economies are tentatively starting the long slog out of the Great Recession. But the hole is deep and analysts across the board agree that job recovery will be slow. Following the official end of the much shorter 2001 recession, jobs continued to shrink for several months. Washington did not recover the December 2000 job total until December 2004.[17]

Most states, like Washington, are continuing to face falling tax revenues and growing demand for services. A second round of federal stimulus including major aid to states is desperately needed. However, even if Congress approves a package soon, it is unlikely to be large enough to fully restore vital services in Washington or spur strong job growth.

We can't solve the state's budget problems by further decimating public services. Layoffs resulting from state budget cuts hurt family incomes and local businesses and snowball through the private sector. Shortchanging our youth by slashing early learning and public education and by cutting off access to college and technical schools – at the same time that jobs are unavailable – will reduce lifetime opportunities for tens of thousands of our citizens *and* undermine Washington's ability to compete for jobs and businesses in the emerging economy. Finally, more families than ever are being forced to turn to publicly supported social services.

High quality public services and infrastructure along with a well educated workforce are necessary foundations for building an economy that provides security and opportunity for all Washington residents. We must raise the public revenue to fund these public goods and services.

Endnotes

1 National Employment Law Project, "Unemployment Insurance Financing: State Trust Funds in Recession as of December 2008," February 2009, http://www.nelp.org/page/-/UI/Trust_Fund_Solvency_Update.pdf; Washington State Department of Labor and Industries, How does Washington State Fund Workers' Comp Premiums compare to other states? webpage viewed January 8, 2010, http://performance.wa.gov/EconomicVitality/EV101509/OpenforBusiness/GrowthinWorkersCompe/CostComparisonbyState/Pages/Default.aspx.

2 Mark Zandi, "Fiscal Policy Roadmap," Moody's Economy.com, October 19, 2009, http://www.workforceatm.org/sections/pdf/2009/FiscalPolicyRoadmap.pdf.

3 Ethan Pollack, "Dire States: State and Local Budget Relief Needed to prevent Job Losses and Ensure a Robust Recovery," Economic Policy Institute, November 19, 2009, www.epi.org.

4 Office of Program Research, Summary Proposed 2009-11 Biennial Operating Budget & 2009 2nd Supplemental, April 24, 2009.

5 This number was calculated by dividing lost GSP by $109,100: Washington's GSP in 2008 was $322.8 billion according to the Bureau of Economic Analysis (http://www.bea.gov/regional/gsp/) and average monthly employment was 2,958,600, or $109,100 of GSP on average for every job.

6 Orszag and Stiglitz wrote: "Since higher-income families tend to have lower propensities to consume than lower-income families, the least damaging approach in the short run involves tax increases concentrated on higher-income families…. The conclusion is that, if anything, tax increases on higher-income families are the least damaging mechanism for closing state fiscal deficits in the short run. Reductions in government spending on goods and services, or reductions in transfer payments to lower-income families, are likely to be more damaging to the economy in the short run than tax increases focused on higher-income families." Peter Orszag and Joseph Stiglitz, "Budget Cuts vs. Tax Increases at the State Level: Is One More Counter-Productive than the Other During a Recession?" Center on Budget and Policy Priorities, revised November 2001, http://www.fiscalpolicy.org/10-30-01sfp.pdf.

7 Mark Zandi, "Fiscal Policy Roadmap," Moody's Economy.com, October 19, 2009, http://www.workforceatm.org/sections/pdf/2009/FiscalPolicyRoadmap.pdf.

8 Institute for Tax and Economic Policy, *Who Pays: A Distributional Analysis of the Tax Systems in All 50 States*, Institute on Taxation and Economic Policy, January 2003, http://www.itepnet.org.

9 Washington Department of Revenue, "Incidence of Washington Taxes," presentation to the House Finance Committee, February 15, 2005.

10 Over the past decade, Washington's near General Fund spending has held steady at about 6% of state personal income, compared to between 6.5% and 6.7% in the late 1980 through mid 1990s. For state personal income see http://www.bea.gov/regional/spi/drill.cfm; and for state budget see http://www.ofm.wa.gov/budget/budgets.asp .

11 U.S. Census Bureau, Survey of Local Government Finances – School Systems, www.census.gov.

12 Washington Higher Education Coordinating Board, "Increasing the Future Capacity of Higher Education in Washington," Presentation to the House Higher Education Committee, January 2009, http://www.hecb.wa.gov/.

13 John L. Mikesell, "State Retail Sales Tax Burdens, Reliance, and Breadth," *State Tax Notes*, July 12, 2004, as cited in Iris Lav, et al, "Faulty Foundations: State Structural Budget Problems and how to Fix Them," 2005, Center on Budget and Policy Priorities, www.cbpp.org.

14 National Confectioners Association, "State Sales Tax List & Treatment of Confectionery," August 2003, http://www.ntconcepts.com/ecandyfiles/SALES%20TAX%202003%20REPORT%201.doc. See for example, Iowa Grocers Association, "Streamlined Sales Tax Update: Several Baking Items Taxable Beginning January 1st", www.iowagrocers.com/index.cfm?page=60. Tennessee Department of Revenue, Sales and Use Tax on Candy, http://www.state.tn.us/revenue/notices/sales/2002candy.pdf.

15 Federation of Tax Administrators, Sales Taxation of Services Survey, 2007, www.taxadmin.org. For a fuller discussion, see "Expanding Washington's Sales Tax Base, Economic Opportunity Institute, July 2008, http://www.eoionline.org/tax_reform/fact_sheets/ExpandingWashingtonsSalesTaxBase.pdf.

16 See Marilyn P. Watkins, "Everybody Else Gets One: An analysis of tax breaks in Washington," April 2008, Economic Opportunity Institute, www.eoionline.org; and Department of Revenue, *Tax Exemptions 2008*, January 2008, www.dor.wa.gov.

17 See Watkins, et al, "State of Working Washington 2009," Economic Opportunity Institute, November 2009, www.eoionline.org.