Progressive Tax Reform in Washington State

No matter your political persuasion, tax reform is a contentious topic in Washington state. On the one hand, the Washington Policy Center argues that our state's budgetary problems stem from disconnected officials who refuse to seriously consider the anti-tax perspectives of voters (Mercier, 2015). This perspective contends that since voters emphatically do not want more taxes, current budget shortfalls are resultant from either a case of overreach in state government aspirations, or a case of bloated government institutions misusing resources and inefficiently pursuing their missions. In either case, more money raised via tax increases will only compound the problem of waste, in direct contradiction to the people's will. This is one story. From progressive opposition on the left, we hear a much different story.

Articulated most clearly by Treasurer Jim McIntire and John Burbank of the Economic Opportunity Institute, the progressive perspective holds that the tax structure in Washington is unfair, vital services are underprovided to citizens, and that an overhaul of the tax system is necessary to remedy these problems (McIntire, 2016) (Burbank, 2015). Progressive suggestions for change include a reduction of sales tax and the establishment of income taxes, carbon taxes, and others. Proponents for reform argue that the state government does not currently have the resources required to provide the levels of service demanded by citizens but that this overhaul could provide the much-needed resources while also relieving working class families of their significant tax burdens.

This paper aims to examine the arguments in Washington state regarding tax reform and to advocate for comprehensive, progressive reform. The paper will begin with a summation of Washington state's financial status and the background for arguments made for or against tax reform. Next, the argument against sales-tax reliance will be specifically examined. Finally, the paper will close with a discussion on the political feasibility of broad-scale tax reform in Washington state.

Background

To determine whether the state should simply tighten its belt or try to enact sweeping tax reform, it is prudent to consider financial figures. By the raw figures, Washington has the 14th largest GDP of states in the USA. On a per capita consideration, Washington is 9th in GDP, 21st in tax collections, and 35th in spending (US Census Bureau, 2015). In terms of ongoing economic health and growth, *Business Insider* ranks Washington as having the best economic health of all states, based upon 2015 performance in several metrics, including GDP growth, unemployment, and wages. (Kiersz, 2016). Accordingly, the personal finance site *WalletHub* ranks the Washington state economy as number two (behind Utah) based on similar metrics (Bernardo, 2016). The GDP of the state has continued to grow throughout 2016: after an especially strong first quarter performance, Washington's growth rate in the second quarter is 2.3%, placing it at the fifth spot nationally for the quarter (Bureau of Economic Analysis, 2016). By all accounts, Washington state is a growing hub of economic activity.

However, despite the sustained and significant growth in the business sectors in the state, the financials for the state government lag behind. What was to be a $357 million surplus for the 2015-17 budgeting cycle is now predicted to be, at best, a wash (Halter, 2016). The lackluster budgetary performance in this budgeting cycle will likely compound the shortfall of $474 million that was already predicted for the next budgeting cycle ending in 2019 (Corte, 2015). These deficits come in addition to the court-mandated increases in education funding from the *McCleary* decision: an estimated $3.5 billion (or roughly 10% of the state's general fund) in additional funding is required to fund K-12 education to the state Supreme Court's satisfaction (McIntire, 2016). Given the overall economic health of the state, the dire financials of the state government are both troubling and perplexing.

Since there is a context of local economic prosperity, it is a reasonable question to ask whether the state's financial woes are resultant from mismanagement or from a broken system. Arguably, there is evidence for both cases. For the mismanagement case: much of the budgetary shortfall for the 2015-17 cycle is due to increased Medicaid spending costs. While the costs themselves (mostly increased medication costs) were outside of the Health Care Authority's (HCA) direct influence, Senator Andy Hill argues that actuarial projections by the agency could have taken medication price inflation and other cost increases into account had they performed better actuarial work (Halter, 2016). Hill argues that better actuarial modeling would have allowed state legislators to better prepare for the costs and still balance the budget, noting further that this type of mis-projection has come from the HCA before but Governor Inslee vetoed measures that would require more stringent actuarial review for the HCA.

However, while state agencies such as the HCA, Dept. of Transportation, and Dept. of Corrections may have made costly mistakes over the last several years, this does not mean that budget shortfalls can be attributed solely to governmental mismanagement. In a time of prosperity, vital services are still substantially underfunded. Aside from severe education underfunding, case managers for foster kids have workloads 30% greater than the national average, college tuition has doubled over the last ten years, and the state parks system is now, according to Governor Inslee, "held together by bailing wire and duct tape" (Burbank, 2015) (Floberg, 2015). Since the state is failing to fully fund a variety of services despite careful balancing acts, it is necessary to examine the structure of our revenue sources to determine why there is such a disparity between our state's economic health and our budget's health. This examination can be completed in two stages.

First, when compared to other states, there is an over-reliance on sales tax and gross receipts in Washington. Of all states, Washington has the highest proportional reliance on sales tax and gross receipts, with roughly 60% of their total revenue collected from those sources (Malm & Kant, 2013). An additional 31.5% of revenue comes from property taxes (for which Washington is ranked 23rd in the nation in per capita collections), with the remainder of revenue coming from various licensing fees. Notably, Washington is one of seven states to lack an income tax. (Tax Foundation, 2015). On the whole, Washington's overall approach to taxation differs significantly from that of many other similarly-sized states.

For the second part of analysis, the over-reliance on sales tax leads directly to the disconnect between the health of our governmental finances and the health of our local economy. Treasurer Jim McIntire says it clearly in a *Seattle Times* op-ed piece: “Expansion of the service and information economy means an increasingly smaller share of consumer income is spent on items subject to the sales tax, which funds half the state budget. This means tax revenue doesn’t grow as fast as our economy and the demand for public services” (McIntire, 2016). Part of the problem comes from widening inequality: an influx of technology and highly-paid service workers has arrived to Washington state. These workers spend less money on goods that are subject to sales tax but demand high quality services to match their lifestyles. Economic gains in the state, similarly to trends nationally, now tend to accrue largely to those at the top of the income ladder, meaning that great growth in the state’s economy does not translate directly to great growth in government coffers. This pattern is confirmed by Standard & Poor’s, who released a report in 2014 stating directly that widening inequality across the United States has led to diminished revenue growth for all states (Boak, 2014). Their report confirms that this trend is particularly significant for states that over-rely on sales tax, like Washington state.

The ultimate impact of widening inequality and an overreliance on sales tax is a tax system that places a disproportionate burden on working class families, to the detriment of all state services. The Institute on Taxation and Economic Policy ranks Washington state’s tax system as the most unfair on the basis of progressivity (ITEP, 2015). Their analysis finds that those in the lowest income quintile (making under $21,000) pay 16.8% of their income in state and local taxes, compared to 8.5% for those in the fourth quintile ($65,000-103,000) and 2.4% for those in the top 1% ($507,000 and over). Worse still, there are no features of the tax system which negate the inherent regressivity of sales tax reliance. Our tax system actually worsens the nation-wide problem of widening income inequality, rather than neutralizing its impact.

Proposal and Discussion

Given the bleak outlook for our prospective tax revenue growth in both the short and long term, this author advocates for the immediate consideration of broad tax reform in Washington state. There are various ways in which these changes could be arranged, but most progressive efforts will include: A) a reduction in sales tax, b) the implementation of an income tax, c) increased capital gains taxes, and/or d) harmonization and reduction of business tax rates, to be offset by increased revenue from b) and c). In a 2016 op-ed in the *Seattle Times*, Treasurer McIntire advocated for a plan much along these lines, except with additional stipulations on property tax and a tentative proposal that future changes to sales, income, or B&O tax require a 60% legislative majority (McIntire, 2016). This author is in complete agreement with McIntire's plan, with the sole reservation that legislative restrictions should not be necessary to pass necessary fiscal reforms.

However, despite what should or should not be necessary, McIntire's proposed concessions are aimed at specific constituencies in Washington state. Represented most frequently by the Washington Policy Center, there is a large base of anti-tax voters in Washington who consistently vote against tax increases or even the legislature's ability to conduct tax reform (Mercier, 2015). According to Mercier, this has happened six times in the past two decades. There can be much speculation as to the specific motivations of these voters: Are they motivated by fear of growing government glut? Are they fixated on their current tax rates vis-à-vis sales tax and unwilling to pay more, *ceteris paribus*? Or are they simply tired of the band-aid solutions offered out of Olympia, where legislators attempt to solve revenue-flow problems imposed by a broken tax system by increasing fees wherever possible? If that were the case, could broad-based reform be the answer we are searching for? It is hard to say. One thing is certain: in comparison to resolving this political dispute, sorting out the policy-side of tax reform is an easy affair.

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