BY MARILYN P. WATKINS, PH.D.

We can’t afford to provide the young people of Washington state with the best education because our outdated tax system is so out of sync with the modern economy. It’s up to us, the voters and decision-makers, to come up with the revenue plan that will amply fund education.

The Inadequacy Problem

Providing for the education of our children is one of the most fundamental responsibilities of citizens in a democratic society. Washington is failing, however, in funding an educational system that will fully equip our children for opportunity and success.

Washington’s state constitution declares it is “the paramount duty of the state to make ample provision for the education of all children residing within its borders.”¹ In January 2012, the Washington State Supreme Court ruled in the McCleary decision that the state was failing in this constitutional duty and must achieve complete funding by 2018.²

Washington has established goals aimed at increasing student achievement, including funding full-day kindergarten, reducing class size in the lower grades, and increasing hours and requirements in grades 7-12.³ The legislature allocated $1 billion towards those reforms in the 2013-15 two-year budget, but that was after four years of recession-driven cuts, when school funding was slashed along with everything else. The Supreme Court deemed that down payment insufficient progress toward ample funding. Fully implementing K-12 improvements will require at least $5 billion in additional funding for the 2017-18 budget – an increase of one-third over the state’s current spending on public schools.⁴

Washington began ratcheting down the level of spending on public education well before the Great Recession. In the 1991-92 school year, Washington ranked 17th among the states in per pupil allocation. By 2010-11, that ranking had slipped to 30th. Relative to the income of state residents, Washington ranked 24th in 1991-92 and 44th in the most recent tally.⁵ Washington’s average student to teacher ratio is the fourth highest in the nation.⁶

![Figure 1. Washington’s Rank Among the States in K-12 Public School Revenue](source: U.S. Census Bureau)
In addition to beefing up the K-12 system, providing educational opportunity to every child in Washington requires strong early learning programs and more investment in higher education. Many of our children now enter kindergarten unprepared for school success.\(^7\)

Restoring accessibility and affordability to higher education also is important. An increasing share of future jobs will require an associate or college degree.\(^8\) Since the 1970’s when the state covered 90% of the cost of instruction for higher education, Washington has been shifting the cost of college to students and their families. By 2008, the state only covered 65% of instructional cost. Budget cuts and tuition hikes since then have reduced the state’s share to just 35%.\(^9\) Washington ranks 47\(^{th}\) among the states in the percentage of young adults enrolled in college and 33\(^{rd}\) in funding higher education.\(^10\)

The Tax Structure Problem

Even when the economy is booming again, Washington simply will not be able to wring enough revenue from the current tax structure to build the education system our children and workforce need. Washington’s tax structure was designed in the 1930s when agriculture, extractive industries, and manufacturing were the drivers of economic growth. In those days, mastering the fundamentals of the “three Rs” was sufficient preparation for most jobs. In today’s world of computers, fast moving technology, globalization, and climate change, our kids need a lot more to be prepared for the challenges of a continually changing economy and the decision-making of citizenship.

Most states modernized their tax systems last century with an income tax, but Washington remains one of only seven states that has not adopted this flexible tool. Even as the U.S. economy shifted from manufacturing to a service base, revenues from state income taxes grew along with the overall economy, allowing other states to increase their investments in education and other services.

Washington instead continues to rely on the sales tax for half of public funds. The sales tax is limited to a narrow segment of the economy which has continually shrunk in importance since the mid-20\(^{th}\) century. Washington’s population and economy are growing more quickly than the national average, but with each passing year the gap grows wider between the revenues our state tax system generates and the services state residents and businesses need to prosper. (See Figure 2.)

The Inequity Problem

The heavy reliance on sales tax and lack of a state income tax make Washington’s the most regressive tax system in the country. That means low- and moderate-earners in Washington pay more of their income in state and local taxes than in other states, while the wealthiest contribute far less. We tax most heavily the people who must spend all their income – those who can least afford it. Rich people buy more expensive stuff, but they don’t spend most of their money.\(^11\) (See Figure 3.)
3.3%  
**Percent of Income Paid in State and Local Taxes by the Top 1% of Income Earners in Washington**

16.9%  
**Percent of Income Paid in State and Local Taxes by the Lowest 20% of Income Earners in Washington**

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**Figure 2. Growth in Personal Income vs. Growth in Sales Subject to Sales Tax, Washington, 1979-2013**

[Graph showing growth in personal income and taxable retail sales from 1979 to 2013.]


**Figure 3. Percent of Income Paid in State and Local Taxes, Washington State and U.S. Average, 2010**

[Bar chart showing the percentage of income paid in state and local taxes for different income brackets.]

For non-elderly taxpayers. Source: Institute for Taxation and Economic Policy
The inequity of Washington’s tax system extends to businesses, too. Most states have an income tax on corporations as well as individuals. Washington, however, taxes total business expenses rather than profits. In addition, over the years the legislature has adopted hundreds of special tax breaks for certain types of businesses – from airplane manufacturers, to high tech companies, to honey bee farmers. Most of these stay on the books for decades, even after the original purpose has been served or is long forgotten. The result is that small, low profit companies pay far higher tax rates than do big, highly profitable ones.

Funding Education for an Opportunity Economy

Washington needs a new tax structure that reflects today’s economy and has the built-in flexibility to keep up with newer standards in education, health, transportation, and other core public functions, even as economic change continues. Reforms that add a personal income tax, lower the sales tax, and revamp business taxes would make Washington’s system more sustainable and fair. Without these reforms, we will not have the tools to ensure that all state residents have the opportunity for a healthy and prosperous life.

3 Easy Steps to Funding Education in Washington

Step 1 – Close Tax Breaks

Is every one of the hundreds of tax breaks on the books more important than a full day of school for 5-year-olds and teens, or quality preschool for at-risk 3- and 4-year olds? Closing tax breaks would be an interim step to finance additional education improvements. But tax breaks alone will not come anywhere close to providing the $6 billion additional funds we need – and each one has strong political support from its beneficiaries. (See p. 6.)

Step 2 – Enact a Capital Gains Excise Tax

In 2015, Washington’s legislature will again face adopting a two-year budget which must significantly increase funding for public schools. A new source of funds that would add flexibility to Washington’s tax structure and begin reducing regressivity is the capital gains tax. A 5% tax rate with exemptions to exclude middle- and lower-income state residents (as proposed in 2012 in HB 2563), would raise $1.4 billion per biennium – enough for significant progress toward education reform goals.

Step 3 - Tax System Overhaul 2017

The 2002 Tax Structure Study Committee (Gates Commission) and earlier bipartisan commissions have recommended the key elements for a sustainable revenue system. To fully meet the challenge of amply funding education in the 21st century, Washington needs a tax system makeover that includes:
Going where the money is – 43 states include a personal income tax in their revenue mix, which helps to assure natural growth of revenue in the face of ongoing economic change, and to make the tax system more fair across income levels. Some of the wealthiest people in the world live in Washington, and they pay far less in taxes than the well-to-do in most other states. Without a state income tax, it’s impossible to ask people to contribute according to their means.

Reducing reliance on a regressive and shrinking source – Reducing the state portion of the sales tax will offset the impact of a new income tax for lower- and moderate-income households, and promote tax equity for small and expanding businesses.

Making business taxes more equitable – Washington’s business taxes could be made much more manageable for small, new, and expanding firms, for instance by allowing deductions for key expenses.

Conclusion

Today’s children will be the leaders, innovators, caregivers, and voters of future decades. No one can predict the next invention or trend that will transform our state and national economy – but we know change will happen. We know we are not providing the young people of Washington state with the best education now. We can’t afford to because our tax system is so out of sync with the economy.

Americans enjoy access to education, transportation, public health and safety, clean air and water, and a functioning economy because of publicly provided services. Taxes paid by previous and present generations, built, maintain, and staff the schools, roads, fire stations, courts, regulatory agencies, and other public facilities that keep society ticking and provide the foundation for individual opportunity.

It’s up to us, the voters and decision-makers of today, to amply fund education with a new tax system. Without it, Washington’s education system will continue to crumble, failing future generations and dragging down our economy.
### Sampling of tax breaks that could be repealed to fund education

<table>
<thead>
<tr>
<th>Tax Breaks</th>
<th>Estimated Annual New Revenue (millions)</th>
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<tbody>
<tr>
<td>Custom software and computer-related services (sales tax)</td>
<td>$71</td>
</tr>
<tr>
<td>High tech R&amp;D (B&amp;O and sales tax)</td>
<td>$66</td>
</tr>
<tr>
<td>Vehicle trade-ins valued over $10,000 (sales tax)</td>
<td>$45</td>
</tr>
<tr>
<td>Financial planning and investment management services (sales tax)</td>
<td>$38</td>
</tr>
<tr>
<td>In-state portion of interstate transportation (Public utility tax)</td>
<td>$35</td>
</tr>
<tr>
<td>Farmers whose annual gross income exceeds $200,000 (B&amp;O tax)</td>
<td>$34</td>
</tr>
<tr>
<td>Oil company exemption for extracted fuel</td>
<td>$30</td>
</tr>
<tr>
<td>Change sales tax exemption for nonresidents to refund</td>
<td>$30</td>
</tr>
<tr>
<td>Bottled water (sales tax)</td>
<td>$24</td>
</tr>
<tr>
<td>Resellers of prescription drugs (preferential B&amp;O rate)</td>
<td>$16</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$389</strong></td>
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Sources: Department of Revenue and Office of Financial Management.
Notes

1 Washington State Constitution, Article IX, Section 1.