

Business Rankings Once Again Declare “All is Well with Washington.” Not so.

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January 2009

Washington state is facing a projected \$6 billion budget deficit, because the rise in state revenues is not keeping up with the legislature’s planned spending increases. The unemployment rate at the end of 2008 jumped to 7.1%, from 4.6% a year before. The U.S. economy is on shaky ground, and the state economy is also teetering.

So policymakers should resist the urge to feel safe that a recent ranking of the best states to open a business put Washington state at the top, and that everything in the business community – especially the small business community – is fine and dandy.

In early January, *U.S. News and World Report* ranked Washington state as the “best state to start a business.”¹ The article states “The problem is that there’s no one measure for evaluating a state’s business environment. Do you look at the education of the workforce? The amount of regulations? The current level of economic growth?”²

The *U.S. News and World Report* team pulled data from two sources. One is the Kauffman Foundation³, the other the Small Business & Entrepreneurship Council (SBEC).⁴

Both are respectable organizations that have the well-being of small businesses in mind. Neither study ranked Washington the best state to open a business. That means the *U.S. News* report cherry picked data, therefore vaulting Washington state ahead of others. Interesting enough, last year Washington ranked the 4th best state for business according to the SBEC, but in 2008 we ranked 5th. Not a newsmaker necessarily, but a poorer finish compared to last year. Kauffman ranked Washington 2nd overall for states in the New Economy Index. The high Kauffman ranking is a good indicator that Washington’s high-tech, trade-heavy and knowledge-based sectors are ahead of the curve.

While Washington does have a highly-trained and productive workforce, it should be noted that our tax system actually punishes efficiency. The more value that is added between business inputs and outputs, the more taxes you have to pay via the B&O tax. This means that firms with

¹ “The 7 Best States to Start a Business – Ranking the states based on how friendly they are to entrepreneurs,” by Matthew Bandyk, *U.S. News and World Report*, January 9, 2009.

² Ibid.

³ http://www.kauffman.org/uploadedfiles/2008_state_new_economy_index_120908.pdf

⁴ <http://www.sbecouncil.org/uploads/sbsi%202008%5B1%5D1.pdf>

high profit margins and low volume (e.g. airplanes) benefit from this system, whereas businesses with low profit margins and high volume take the brunt of the tax hit (e.g. retail).

This is made self-evident by the sheer number of tax exemptions that apply only to specific industries. Industries that have tremendous costs of business inputs need relief (e.g. Boeing) and have to receive it via tax exemptions, deductions or credits. A recent Department of Revenue Report pegged the number of B&O tax exemptions at 161, retail sales and use tax exemptions at 158 and other business tax exemptions at 41.⁵

Interestingly, the SBEC ranks Washington state last in “State Rankings of State and Local Sales, Gross Receipts and Excise Taxes.” But then the *U.S. News* study goes on to claim that Washington has low taxes when, in fact, the B&O tax, when measured as a corporate income tax, actually results in the second highest tax rate in America.⁶

Some other statistics that the *U.S. News and World Report* study skipped over in the SBEC report:

- Washington ranked 44th in “State Rankings of Adjusted Unemployment Taxes”
- We ranked 45th in “State Rankings of Number of Health Insurance Mandates”
- Washington ranked 49th in “State Rankings of Workers’ Compensation Benefits Per \$100 of Covered Wages”
- 45th in “State Rankings of State Gas Taxes”
- 40th in “State Rankings of Per Capita State and Local Government Expenditures 2005-2006”
- 39th in “State Rankings of Highway Cost Effectiveness, 2006”

Some of these statistics have a direct effect on Washington’s competitiveness – particularly the portion on unemployment taxes and workers’ compensation. Nowhere in the *U.S. News and World Report* study are these high costs mentioned.

Regarding the Kauffman Foundation ranking, Washington ranks first in “Manufacturing Value-Added” largely because of our substantial high tech industry. This is good news.

However, the *U.S. News and World Report* paper cites the Kauffman report ranking our state among leaders in energy efficiency and alternative energy usage as a reason for being a good state to start a business. This seems disingenuous.

The fact that Washington state uses alternative energy (as mandated by I-937, passed in 2006) and invests in energy efficiency would be fine if the study were just ranking states on energy efficiency and usage of alternative energy sources. The reality is that this ranking has little bearing on a state’s capacity to be business friendly. The one exception is that low energy costs can play a part in lowering the cost of business. But that is not what this study says. So, this is a case of coincidence, not causality.

Washington state entrepreneurs are recognized for their proclivity to open lots of new businesses in the state. However, Washington is also notorious for having a high “business closure”

⁵ “Table 1 - Summary of Tax Exemptions by Tax Source,” *Tax Exemptions – 2008*, Washington State Department of Revenue, pg. I-2.

http://www.dor.wa.gov/Content/AboutUs/StatisticsAndReports/2008/Tax_Exemptions_2008/Default.aspx

⁶ “Business and Occupation Tax Reform, Part II,” Carl Gipson, Washington Policy Center Policy Note, August, 2008, <http://www.washingtonpolicy.org/Centers/smallbusiness/policynote/B&OPart2.pdf>

rank as well – ranking 1st in business terminations in both 2004 and 2005, while improving to 2nd worst in 2006 (latest data available).⁷

All debate on Washington’s business climate aside, if legislative leaders wish to protect our high ranking, which seems to be largely predicated upon the falsehood that Washington is a low-tax state, they should *immediately* table any discussion about raising taxes or increasing the cost to operating a business in Washington state. To do otherwise would jeopardize our supposed high ranking.

There is a time and place for these rankings and they can be useful in identifying where Washington has its strengths and weaknesses. But to say Washington’s business climate is fine because a poorly written report from *U.S. News and World Report* says so misses the entire point.

Washington’s businesses are struggling and in this economic recession we must ensure that business owners and employees have every opportunity to succeed. A business should rise and fall on its own merits and its ability to weather the economic storm. It should not be put in a position of having to survive in the face of unnecessary and artificial costs imposed by policymakers.

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⁷ “2008-2009 Regional Competitiveness Indicators,” Puget Sound Regional Council, pgs, 43-44. <http://www.prosperitypartnership.org/indicators/indicators2008-2009.pdf>