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LEGISLATIVE MEMO

Keeping the promise – the long-term tax incentive policy is working for Washington

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Key Findings

1. *Washington state has been at the forefront of aerospace technology from the earliest days of aviation.*
2. *The purpose of the aerospace tax incentive program is to preserve the knowledge and skill base of this key sector of the state economy.*
3. *Governor Inslee recognized the success of aerospace tax incentives by extending them to 2040.*
4. *Aerospace tax policy has not reduced revenues to the state. General Fund revenue has risen 46 percent since Governor Locke launched the program in 2003.*
5. *Aerospace tax incentives are not a "spending" program. A policy of tax reduction – allowing citizens to keep more of their income – is not the same as public spending.*
6. *The new aircraft production in the state shows the tax incentive program has worked, and continues to serve the public interest of the people of Washington.*
7. *Altering the long-term incentive program would demonstrate that Washington is not a reliable place to do business. Maintaining the commitment would confirm that Washington leaders can be trusted to keep their promises.*

Introduction

Washington state has been at the forefront of aerospace technology from the earliest days of aviation, and every advance in aircraft design since then has been incorporated into the knowledge and skill base of this key sector of the state economy. Washington has been able to secure this favorable position primarily because of The Boeing Company and the hundreds of manufacturers, engineering firms and contractors that make up the state's aerospace industry.

For that reason elected officials of both major parties determined that continued growth, innovation and job creation in the aerospace sector, which employs tens of thousands of workers, serves the public interest of the people of our state. The resulting bipartisan consensus led to wide political support for specific state policies related to aerospace.

In 2003, state legislators and Governor Gary Locke enacted an economic incentive package to help the aerospace sector of Washington's high-tech economy. The policy goal was to encourage The Boeing Company and hundreds of smaller companies and contractors to continue doing business in Washington state, rather than re-locating business activity to other states or to other countries.

The purpose of a policy of long-term tax incentives is to build on this historic base of technical knowledge and the billions of dollars in private investment Washington-based aerospace companies have made over the decades.

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The policy initiative made sense in light of growing globalization and the rapid development of the internet and other technologies. As leaders in other U.S. regions have learned, public officials can no longer assume that traditional industries that developed in their states will always be located in the geographic areas where they began.

The tax-incentive policy was viewed as a success, with the result that final assembly work for the Boeing 787 program is based in Washington. In 2013, recently-elected Governor Jay Inslee signed legislation to extend the program to fiscal 2040. Under the renewed policy Boeing's production of the 777X airplane and its advance carbon fiber wing technology will be based in Washington state. As a system of economic incentives the policy worked, and continues to meet its goals today.

The economic benefits of the aerospace tax incentive program

The $1 billion in tax incentives of the 2003 policy has generated a reported $4 billion in fiscal benefits for the state, according to a study commissioned by the Washington Aerospace Partnership.[1]

Aerospace industry sources report the tax incentive program has performed as intended, bringing extensive economic benefit to the people of Washington. For example, the industry reports:

- The 777X program supports 56,000 direct and indirect jobs;
- Resulting in $3.2 billion in total wages and employee benefits;
- And generated $20.1 billion in economic activity.

The Department of Revenue estimates the extension of the incentive program will result in the following economic benefits from fiscal 2025 through fiscal 2040:

- $21.3 billion total in direct and indirect fiscal benefits;
- $11.0 billion in additional state Business and Occupation tax revenue;
- $6.1 billion in additional state sales tax revenue;
- $3.3 billion in other state tax revenue.

The Boeing Company employs about 81,000 people in Washington and is in effect an extension of the state's larger high-tech sector. Yet, in terms of jobs, Boeing alone employs more people in Washington than several other successful Washington-based global companies, like Microsoft, Costco, Nordstrom and Starbucks, combined.

Because of the advanced technology needed in aircraft manufacture, the aerospace sector in general involves high-paid, high-skilled work. The industry promotes an ethic of hard work and high quality in manufacturing some of the most complex machines ever designed. For example, the average yearly wage of Boeing in-state employees is $88,000, plus benefits and bonuses, well above the state average annual wage of $55,000. High wages and good family benefits are common throughout the aerospace industry.

Foregone tax collections from the aerospace sector are estimated at $8.7 billion between FY 2025 and FY 2040, which is much less in "lost" tax revenue than the anticipated economic and tax revenue benefit the state will receive from the tax incentive program.

1 "The Impact of the Aerospace Industry in Washington State, Washington Aerospace Partnership, November 2013, at http://www.wstc.wa.gov/meetings/agendasminutes/agendas/2013/November/documents/2013_1119_BP4_PSRCAeroImpactsL.pdf.

A further consideration is that altering or repealing the tax incentive program would not necessarily lead to the state collecting $8.7 billion more in taxes from the aerospace sector. The policy change would likely result in a smaller tax base in this sector, as business leaders are forced to consider the consequences of a state breaking its legislative promises.

Strategic business decisions are based on long-term planning. Should Washington officials roll back the incentives or add new reporting conditions, businesses may have to conclude it is safer and more responsible to move manufacturing operations to a more reliable political jurisdiction. Changing incentives sends a message that Washington is not a dependable place to do business. The outcome for Washington would be fewer jobs and less investment, both in aerospace and in other business sectors, and consequently lower-than-expected revenues to the state.

That the tax incentive policy is in the public interest is confirmed by the state's highest elected leaders. In signing the 2003 legislation Governor Locke said, "This package reflects extraordinary bipartisan commitment and effort. We will not stand by and watch our state start to lose this industry [aerospace] and these jobs.[2]

In praising the legislation he signed to continue the incentive policy, Governor Inslee said, "This is a great day for everyone in Washington." He said the policy extension would "...bolster our state's legacy as the aerospace capital of the world," adding, "We should all be thankful for that.[3]" He said it was in the public interest to continue a great Washington tradition and that the purpose of the tax incentive policy was to "lead the country in aerospace.[4]"

Aerospace tax policy has not reduced revenues to the state

Some critics say the legislation would cut public revenues, but the data shows the decision by Governor Locke and state leaders to establish a long-term tax policy for aerospace has not reduced tax revenue to the state. On the contrary, due to broader economic growth, including expansion in the aerospace sector, state revenues have increased nearly every year since the policy was adopted. The single exception was 2009-11, when the national economy was in deep recession and job losses and business closures were widespread.

Revenues to the state General Fund increased from $25.4 billion in 2003-04 to $37.2 billion in 2015-17, a rise of 46 percent.[5] In fact, state officials soon reaped what may be the largest single revenue windfall in state history, plus 17.3 percent, in the biennium immediately following the 2003 creation of the aerospace tax incentive program.

Lawmakers expect revenues to increase further to $40.5 billion in 2017-19, reflecting continued annual increases in state tax collections well after the aerospace

2 "Gov. Gary Locke signs aerospace tax incentives package into law, expresses confidence in state's bid for Boeing 7E7," press release, Office of the Governor, Olympia, Washington, June 18, 2003, at http://www.digitalarchives.wa.gov/GovernorLocke/press/press-view.asp?pressRelease=1375&newsType=1.

3 "Legislature approves key elements of 777X incentive package," press release, Office of the Governor, Olympia, Washington, November 10, 2013, at http://www.governor.wa.gov/news-media/legislature-approves-key-elements-777x-incentive-package.

4 "Inslee signs Boeing tax break bill," by John Stang, Crosscut, November 11, 2013, at http://crosscut.com/2013/11/inslee-signs-boeing-rax-break-bill/.

5 "Economic Review and Budget Outlook," Table: "General Fund-State, History and Forecast by Fiscal Year, FY 1995 – 2019," Economic and Revenue Forecast Council, Olympia, Washington, November 4, 2015, page 29, at http://www.erfc.wa.gov/forecasts/documents/rev20151118_color_corrected.pdf.

incentive program was renewed and extended in 2013.[6]

Steady windfall increases in state tax revenue underscore that the budget line-item cost of Governor Locke's 2003 aerospace tax incentive policy is zero. The same is true of Governor Inslee's 2013 extension of that policy; current and future line-item state spending under the aerospace tax incentive program through 2040 is zero.

A policy of tax reduction is not the same as public spending

Critics of the tax incentive policy treat a policy decision by lawmakers not to collect money from private citizens as the equivalent of spending public money, because they believe reducing tax rates constitutes a "cost" to the government.

However, the decision by state leaders to adopt a policy of not taking money from citizens is not the same as spending tax money through the normal budget process. An example from property tax policy will illustrate this point.

For over 15 years, Washington state and local jurisdictions have followed a policy of increasing regular property tax collections by no more than 1 percent per year. Previously, elected officials had routinely increased the regular property tax burden by up to 6 percent a year. The policy change in 2001 does not mean that for 15 years state and local officials have "spent" 5 percent of their public revenue each year by letting homeowners and other property owners keep more of their money.

Instead, the 1 percent policy limits the yearly rise in the regular property tax burden (other kinds of property tax still increase at faster rates), achieving the goal of allowing families and businesses to keep more of their own income. Meanwhile, state and local public officials have adjusted their level of (rising) public spending accordingly.

The more broadly policymakers apply a policy of tax-relief the fairer and more economically beneficial the result. The 1 percent property tax limitation policy benefits nearly every resident of the state, since the cost of all housing and all business rents are affected by the property tax burden. The state's aerospace tax-incentive program, while not as broad, benefits communities and working families far beyond the employees of a single company.

Conclusion

The best and fairest tax policy is one of simple low rates and few exceptions. In general, policymakers should not attempt to manage the economic lives of citizens by trying to predict which businesses should thrive and which ones should be neglected. Instead, the purpose of a state tax system should be to raise needed revenue to fund public services, not to engage in central planning.

Similarly, low business tax rates applied to a major economic sector such as aerospace benefits the state as a whole, without elected officials continually picking winners and losers among people working in the private economy.

Another principle of fair governing is the consistency and reliability of state tax policy. In 2003 Governor Gary Locke and lawmakers of both parties established a public policy of long-term tax incentives for preserving and promoting business activities in the state's aerospace sector.

More than a decade of experience shows the aerospace tax incentive policy is working. The decision just three years ago by Governor Inslee and state lawmakers to extend the policy through 2040 demonstrates their confidence that the

6 Ibid.

policy will continue to serve the public interest well into the future.

Efforts to add new requirements presented as "accountability" or "transparency" raise questions about legislative commitment and threaten the stability of a tax incentive program that is working as intended. Legislative proposals to repeal or otherwise restrict this successful policy would undermine confidence in the long-term decisions of state leaders.

Maintaining the state's commitment to tax incentives for this key economic sector will secure ongoing benefits for businesses and working families, while confirming that public leaders in Washington can be trusted to keep their promises.

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