HOUSE BILL REPORT
HB 1732

As Reported By House Committee On:
Finance
Transportation

Title: An act relating to review of increases in volume-based taxes.

Brief Description: Requiring study of the effect of increases in volume-based taxes.

Sponsors: Representatives Dyer, Radcliff, Backlund and Goldsmith.

Brief History:
Committee Activity:
Finance: 2/28/95, 3/3/95 [DP];
Transportation: 3/6/95 [DPS].

HOUSE COMMITTEE ON FINANCE

Majority Report: Do pass. Signed by 10 members: Representatives B. Thomas, Chairman; Boldt, Vice Chairman; Carrell, Vice Chairman; Morris, Ranking Minority Member; Hymes; Mulliken; Pennington; Schoesler; Sheldon and Van Luven.

Minority Report: Do not pass. Signed by 2 members: Representatives Dickerson, Assistant Ranking Minority Member; and Mason.

Staff: Rick Peterson (786-7150).

Background: Some excise taxes on commodities are based on the value or price of the commodity. Other excise taxes on commodities are based on a measure of volume. The retail sales tax is an example of an excise tax based on value or price. The following selective excise taxes are based on volume: wine tax (cents per liter), beer tax (dollars per barrel), motor vehicle and aircraft fuel taxes (cents per gallon), carbonated beverage tax (cents per ounce), and carbonated beverage syrup tax, (cents per gallon). A value based tax and a volume based tax apply to spirits (hard liquor).

Elasticity of Demand

Elasticity of demand refers to the responsiveness of amount of a commodity sold in the market to a change in the commodity's price. If the change in quantity sold is less than proportionate to the change in the price, for example a 1 percent increase in price results in less than 1 percent decrease in quantity sold, then elasticity of demand is described as inelastic. If the percent change in quantity sold is greater than the percent change in price, then elasticity of demand is described as elastic.

The size of a commodity's elasticity depends, in part, on the availability of suitable substitutes. It is generally thought that when few suitable substitutes are available for a commodity, then the commodity's elasticity will be small (inelastic demand). If suitable substitutes are available, then the elasticity will be large (elastic demand).

The amount of revenue available from a selective excise tax increase depends on the size of the elasticity of demand. For taxes on inelastic commodities, such as the traditional "sin" taxes on cigarettes and alcoholic beverages, the increased amount of revenue is very nearly as great as the increase in tax.

Economists generally believe that selective excise taxes on commodities that are inelastic are ultimately paid by the consumers of those commodities, while selective excise taxes on commodities that are elastic are passed back to the producers of those commodities. Economists also generally agree that it does not matter whether the tax is imposed at the manufacturer level, the wholesale or distributor level or the retail level, the tax on a commodity with inelastic demand will be passed forward to the final consumer. A selective excise tax on a commodity with elastic demand will be passed back to the suppliers of the commodity even if the tax is applied at the retail level. When a tax is passed back to the suppliers, it results in lower returns to capital and labor employed in the production of these commodities.

1993 Health Care Reform Legislation

The 1993 health care reform legislation increased taxes on cigarettes, tobacco products, spirits (hard liquor), beer, nonprofit hospitals, and health insurance premiums and prepayments. The revenue from these tax increases is deposited in the health services account and used to fund health care reform. Besides the health care taxes, taxes are also imposed on cigarettes, tobacco products, spirits, and beer for general fund and other purposes.

The 1993 health care reform legislation increased some tax rates in steps. Some step increases have not yet taken effect. These tax increases are dedicated to the health services account. The cigarette tax is scheduled to increase by 17.5 cents a pack on July 1, 1995, and by 1 cent on July 1, 1996. After July 1, 1996, the total cigarette tax will be 82.5 cents with 41 cents to the health services account. The beer tax is scheduled to increase by $1.43 a barrel on July 1, 1995, and by $2.39 a barrel on July 1, 1997. After July 1, 1996, the total beer tax will be $9.56 a barrel with $4.78 to the health services account. The per liter tax on spirits will increase by 10 cents on July 1, 1995, and 11 cents on July 1, 1997. The retail sales tax on spirits for the health services account will increase from 1.7 percent to 2.6 percent on July 1, 1995, and increase to 3.4 percent on July 1, 1997. After July 1, 1997, the total tax on spirits will be a sales tax of 20.5 percent of sales price plus a liter tax of $2.44 per liter. The portion for the health services account will be 3.4 percent and $0.41 per liter.

Summary of Bill: The scheduled increases in the cigarette, beer and liquor taxes for the health services account are delayed until a review of the potential adverse effects of the tax increases is completed and the tax increases are reenacted by the Legislature.

Before enacting a tax increase on a volume based tax, a study of the following must be completed: (1) whether the elasticity of demand for the commodity indicates that the increase in revenue will be proportionate to the increase in tax; (2) the potential for increased tax noncompliance; and (3) the potential for adverse impact on employment in industries manufacturing, distributing, or selling the commodity.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill contains an emergency clause and takes effect immediately, except section 7 of the bill which takes effect July 1, 1995. (Section 6 of the bill expires by July 1, 1995).

Testimony For: There comes a time of diminishing returns on taxing items like cigarettes, beer and hard liquor. These taxes are relied on to fund the basic health plan and could become unstable and not provide enough monies for that program in the future. The federal government also continues to heavily tax these products. Due to the high costs of cigarettes, people are willing to travel farther to get a cheaper price either in another state or on an Indian Reservation. In July, this state will have the highest tax in the country on cigarettes. Smuggling has increased significantly. Beer prices have not reflected the increased taxes. Merchants have instead had to lower their prices in order to compete. Many businesses have closed recently.

Testimony Against: The average age of children starting to smoke cigarettes is 13 years old. Removing or not implementing tax increases allows children to continue to afford cigarettes. As taxes have increased, consumption has declined. It is appropriate for these taxes to fund the basic health plan because they cause health problems.

Testified: Representative Phil Dyer, prime sponsor (pro); Jim Scroggs, Coalition for Smoking or Health (con); Bill Fritz, Tobacco Institute (pro); Trevor Sandison, Phillip Morris (pro); Brian Harris and Tamara Warnke, Distilled Spirits Council (pro); Celia Fritz, Anheiser-Busch (pro); Lisa Smith, citizen and volunteer American Cancer

Society (con); David Harrelson, American Cancer Society (con); and Dick Ducharme, Washington Beer and Wine Wholesalers Association (pro).

HOUSE COMMITTEE ON TRANSPORTATION

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 24 members: Representatives K. Schmidt, Chairman; Benton, Vice Chairman; Mitchell, Vice Chairman; Skinner, Vice Chairman; R. Fisher, Ranking Minority Member; Hatfield, Assistant Ranking Minority Member; Backlund; Blanton; Brown; Buck; Cairnes; Chandler; Elliot; Hankins; Horn; Johnson; Koster; McMahan; Ogden; Robertson; Romero; D. Schmidt; Scott and Tokuda.

Minority Report: Do not pass. Signed by 2 members: Representatives Chopp and Quall.

Staff: Roger Horn (786-7839).

Summary of Recommendation of Committee on Transportation Compared to Recommendation of Committee on Finance: The substitute bill excludes fuel taxes from the definition of "volume-based commodity tax." With these taxes excluded from the definition, the bill no longer requires that a study of the effect of fuel tax increases be completed prior to enacting a fuel tax increase.

Appropriation: None.

Fiscal Note: Available.

Effective Date of Substitute Bill: The bill contains an emergency clause and takes effect immediately, except section 7 of the bill which takes effect July 1, 1995. (Section 6 of the bill expires by July 1, 1995.)

Testimony For: The Interagency Revenue Task Force provides a collaborative, rigorous and regular process for the determination of fuel tax elasticities and impacts. It is not necessary to mandate a special study to determine the impacts of fuel tax increases.

Testimony Against: None.

Testified: Representative Phil Dyer, prime sponsor (pro); and Amy Arnis, Department of Transportation (pro, with amendment).