Measure 20: The Impact of a 2 Percent Equal Tax on the Oregon Economy

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On November 8, Oregonians will vote on Ballot Measure 20, which proposes a “2 percent equal transactions tax” that would completely overhaul the state and local tax structure.

This publication explains Measure 20 and estimates its impact on tax revenues and household incomes. It also identifies some unresolved issues regarding implementation of the measure.

What is Measure 20?

Measure 20 is a proposed constitutional amendment that would repeal major sections of the Oregon Constitution relating to taxation. Under Measure 20, most current state and local taxes and fees would be eliminated.

In their place would be a single 2 percent (or less) tax on all trade. The tax would apply to sales of goods, services, and property as well as to payrolls and financial transactions.

The measure would require a 60 percent majority vote to increase the tax, to impose a local transaction tax, or to change any of its own provisions.

If passed, it would take effect January 1, 1995.

What would Measure 20 do?

Ban most taxes, fees, assessments, and tolls

Measure 20 bans most taxes, fees, assessments, and tolls in Oregon, including income, and property taxes.

There are certain exceptions; for example, state and local governments could still collect receipts from the following:

- Utility charges for water, electricity, and natural gas
- Bus and train fares
- Tuition
- Dividends and interest
- State accident insurance
- Fines and penalties
- Lottery and other recreational user or admission charges

Impose an equal tax

Measure 20 imposes a tax on all trade within the state and all trade between Oregon individuals, corporations, organizations, or governments and those located outside the state.

It applies to all exchanges of goods, services, labor, capital, and property, whether for cash or barter. Examples include the following:

- Retail and wholesale sales
- Sale of services
- Payments to labor
- Insurance premiums and settlements
- Gifts exceeding $1,000
- Interest payments on loans and deposits
- Payments on interest-bearing loans of more than 30 days
- Sales involving state and local government

The tax is based on the sale price or value of the good, service, or property at the time of transfer.

The equal tax rate would be set at 2 percent or that rate, if less, needed to replace the revenues collected in 1992 from taxes and fees that Measure 20 eliminates. Increases in the rate are allowed only if approved by 60 percent of voters, except that temporary increases (through the end of a fiscal year) require only a majority vote.

Sales of stocks, bonds, certificates of deposit, and other financial instruments would be taxed at a lower rate (one-quarter of 1 percent) and would be exempt from any local tax.

Income, pensions, retirement benefits, and gifts to nonprofit, religious, or charitable organizations would be exempt from both state and local taxes.

Measure 20 requires the Legislature to propose up to a 0.1 percent increase in the tax to be used to reduce college tuition. This proposal would require 60 percent voter approval to be enacted.

The measure would allow counties, cities, and other local governments to impose a local transactions tax of up to 1 percent. If a tax would have to be approved by 60 percent of local voters. Any local tax levy would be limited to 0.1 percent, unless reapproved by 60 percent of the voters.

Repeal debt authority

Measure 20 repeals all existing constitutional authority of state and local government to incur debt. The intent is to prohibit governments from raising money by issuing bonds.

Distribute tax revenues

Measure 20 spells out how the proceeds of the tax would be distributed. State and local governments would receive an amount equal to revenues received in 1992 from banned sources, plus adjustments for inflation and population growth. The Highway Fund would receive 105 percent of 1992 banned revenues, plus adjustments for inflation and population growth.

The measure also allocates 0.1 percent of state equal tax revenues to reduce tuition at all accredited post-secondary schools.

If revenues exceed the amount needed to meet the above obligations, Measure 20 specifies how the excess would be spent. These funds would go first for school equalization, local

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Establish an administrative process
In most cases, the seller would pay the tax. There are five exceptions to the requirement that sellers pay the tax: 
- In the case of services or labor, the purchaser pays 
- The purchaser pays if the state cannot force out-of-state sellers to collect 
- The giver of a taxable gift pays 
- An insurance company collects the tax on premiums and pays the tax on settlements 
- Each party in a barter exchange pays half the tax

The measure requires those liable for the tax to file monthly returns. It allows issuance of tax stamps in lieu of a monthly return. It requires a receipt for all transactions.

Impact of Measure 20
How would Measure 20 affect the level of transactions in the Oregon economy?

A foundation of modern economics is the "law of demand," which states that as the price of a good or service increases, purchases of that item will decrease if all other things remain equal.

The equal tax would apply to wages, increasing the cost of labor. Other costs would increase firms to reduce hiring and output. With less output, there would be fewer sales to tax.

Reduced wage payments also would directly reduce household income. In turn, this would reduce consumption, thereby further limiting taxable sales.

The cost of goods and services used in production also would increase in response to the equal tax. These increased costs generally would be larger than the relief firms receive from the elimination of property and excise taxes.

Firms usually cannot pass on taxes on import purchases and export sales to sellers and buyers outside the state.

Import suppliers are unlikely to charge less than the world market price for their products. Consequently, import buyers would have to pay the tax on top of the purchase price, thereby increasing their costs and reducing their purchases.

Likewise, export buyers would have to pay the tax on exports out of their own sales revenues.

Using an economic model that incorporates the responses of businesses and consumers, we estimated the impact of instituting a 2 percent equal tax in place of all current Oregon taxes. We estimate that the volume of transactions in goods, services, labor, and capital in Oregon in 1994 would have been reduced about 5 percent under a 2 percent equal tax, compared with the volume of transactions under the current system. Figure 1 shows how the replacement of current taxes with a 2 percent equal tax would have affected the levels of various transactions.

A transactions tax provides an incentive for firms to reduce the volume of taxable transactions in production and between producer and final consumer. There is a strong incentive to include production, wholesaling, and retailing functions within a single firm. As a result, we would expect to see mergers and a change from an economy with many small firms to one with fewer, larger ones and fewer transactions.

Some transactions that are easily moved, such as business services and financial instruments and securities, would leave the state. Imposing a tax on financial transactions, for example, likely would cause financial institutions to shift such transfers to states where they are less subject to taxation.

How would Measure 20 affect state and local government tax revenue?

No one knows. It is difficult to estimate how much revenue Measure 20 would generate because:
- There are no data on transactions in Oregon. It is possible to make reasonable estimates of some transactions (goods, services, real property, loans and deposits, wage and salary employment). However, there are no credible estimates of transactions in securities and financial instruments, gifts, or barter.
- Even if there were data, it is not clear what transactions would be legally taxable. The measure itself is not clear
about which financial transactions would be taxed. And, although the measure proposes to tax out-of-state transactions involving Oregon firms and individuals, states do not have this power under the U.S. Constitution.

States with sales taxes have developed measures to circumvent this problem, particularly with respect to purchases from out-of-state firms. But it is unclear whether Measure 20's ban on all taxes other than the equal tax would allow a similar mechanism in this case.

Furthermore, even if the state could tax out-of-state transactions, it is unclear how to tax transactions of companies with operations in Oregon and other states. For example, suppose a company produces products in Oregon and two other states. If it purchases advertising services from a company in New York, is this purchase subject to the equal tax? Is it only part of the transaction taxable? If so, how is the proportion of taxable to nontaxable transactions determined?

- Assuming the legal issues could be resolved, the tax on some transactions would be difficult to collect. Barter, out-of-state purchases by individuals, gifts, and financial transactions would pose enforcement challenges.
- Assuming legal and enforcement issues could be resolved, businesses and consumers would respond to the new tax by producing and consuming less and by moving transactions out of state. This would shrink the transaction base. Since no state has imposed a transaction tax, no one knows for sure how businesses and consumers would respond.
- It is not clear how much revenue the measure allows to be raised. The measure limits collection in fiscal year 1995-96 to about $59 billion, about $490 million less than the current system would raise. Yet the measure promises to attribute about $5.3 billion to state and local governments and so may have been intended to raise revenues of that amount.

While the measure specifies a process for distributing revenues if the tax raises more than needed to fund state and local services at prescribed levels, there is no process for raising more revenue if the tax raises less than the distribution formula requires.

Given the lack of transactions data and unresolved legal and enforcement questions, it is difficult to be confident about estimates of revenues under the measure.

Our analysis of tax revenue under Measure 20 assumes that most of the legal and implementation issues identified above are resolved. This analysis is based on a model of the state's economy consisting of a series of equations that capture the behavior of firms and households as they respond to a tax change. All current taxes and charges are eliminated in this analysis, and a 2 percent equal tax is imposed.

On transactions for which transactions information is available (goods and services, labor and capital, real property, bank loans and deposits), our analysis indicates that a 2 percent tax would have generated $5.36 billion in 1994:

- $5.0 billion in taxes on transactions in goods, services, labor and capital (but not on property, loans and deposits, financial instruments, gifts, or barter)
- $231 million in taxes on real property transactions
- $124 million in taxes on outstanding bank loans and deposits

This $5.36 billion is about 79 percent of the $6.76 billion in tax revenues that would be raised under the current system (see Figure 2).

There are no data on financial instrument transactions in Oregon. If total transactions in Oregon are $506 billion, as Measure 20 proponents claim, and if our transactions estimates used in the above analysis are correct, then financial instrument transactions in Oregon would be $228 billion. If the $570 million in taxes could be collected on $228 billion in financial instrument transactions, total revenue from a 2 percent equal tax would be $5.93 billion. This is 88 percent of tax revenue under the current system.

What would be the impact of Measure 20 on Oregon households?

Measure 20 would change the direct tax payments by households. Most of the increased taxes imposed on businesses would be passed on to households in the form of higher prices or lower incomes.

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<th>Oregon Tax Revenues Impact of Measure 20</th>
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Note: The tax revenues in this figure do not include unemployment taxes, which currently are paid to state government and would be paid in nearly equal amount to the federal government if the 2 percent equal tax passes.

Figure 2.—Estimated effect of Measure 20 on state tax revenues, compared with revenues under the current tax system.
Measure 20 would not tax income, but would tax employers' purchases of labor services. This is effectively a payroll tax. Under Measure 20, labor would experience reduced net wages, a reduction in hours worked, or both. Net payments for capital services (such as payments for use of industrial buildings and machinery) would be similarly affected.

These effects combine to reduce economic activity in the state by reducing the available transactions base, consumption, and total household income.

The impact of Measure 20 on low-, medium-, and high-income households is shown in Figure 3. Total household income decreases by 4.8 percent, 5.9 percent, and 6.6 percent, respectively.

After-tax income would decrease for low- and medium-income households by 3.5 percent and 4.5 percent, respectively, but would increase by 3.8 percent for high-income households.

Even though direct taxes on low- and middle-income households would be lower under Measure 20 than under the current system, incomes would decrease more than taxes for these groups, resulting in lower after-tax incomes.

For high-income households, on the other hand, tax cuts under Measure 20 would be greater than the decreases in income, leading to higher after-tax incomes for these households. This is an expected result of substituting a transaction tax (which falls more heavily on low-income households) for an income tax, which falls more heavily on high-income households.

What would be the impact of Measure 20 on local control?

Measure 20 would centralize power over local government spending in state government. Under the current system, local officials and citizens determine taxes and budgets of cities, counties, and nonschool local governments subject to certain constitutional limits. Under Measure 20, the state Legislature would determine local budget revenues by making adjustments to a local government's 1992 budget.

Summary and conclusions

Ballot Measure 20 is a proposal to replace the existing state and local tax system with a 2 percent equal tax on all transactions involving Oregon individuals, firms, organizations, and governments.

There are questions regarding the constitutionality and feasibility of implementing some provisions of Measure 20. Assuming these questions could be resolved, and accounting for some responses by businesses and individuals to the tax change, our analysis indicates that:

- A 2 percent tax would generate less revenue than the current tax system
- It would reduce labor and capital income and output
- It would reduce the after-tax income of low- and medium-income households
- It would increase the after-tax income of high-income households

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