Kavet, Rockler & Associates, LLC
985 Grandview Road
Williamstown, Vermont 05679-9003 U.S.A.
Telephone: 802-433-1360
Fax: 866-433-1360
Cellular: 802-433-1111
E-Mail: tek@kavet.net
Website: www.kavetrockler.com

Memorandum

To: Steve Klein, Chief Fiscal Officer, Joint Fiscal Office

From: Tom Kavet

CC: Sara Teachout, JFO

Date: April 7, 2015

Re: Initial Observations: Draft Employee Relocation Tax Credit (dr req 15- – draft 1.1) 4/6/2015 - DPH - 02:44 PM

Background

As requested, I have reviewed the draft Employee Relocation Tax Credit per version (dr req 15- – draft 1.1) 4/6/2015 - DPH - 02:44 PM. The stated purpose of this refundable tax credit is to help businesses "meet employment needs in areas where the workforce is not sufficient."[1]

The legislation as drafted, would provide $5,000 per approved applicant, payable with State personal income tax filings following the end of the tax year. The total State expenditure is capped at $750,000 per year, with no limit on the number of awards granted. If more than 150 awards are granted ($750,000/$5,000) in any year, the recipients would receive a pro-rated share of the award ($750,000/number of awards). Thus, it is possible that award recipients could receive less than the $5,000 face value of the award. The program essentially acts as a hiring bonus for out-of-state employees, paid by State taxpayers.

Potential Issues for Discussion/Resolution

Although further analysis is required to ascertain the likely number of workers who may be affected by this proposal, below are a few initial observations and discussion issues that have arisen based on the research performed to date.

- The primary estimates of annual in-migration to Vermont are derived from IRS data associated with tax filings. They show that about 8,000 to 10,000 filers relocate from other states to Vermont each year.[2] The average number of

---

[1] Per e-mail from Steve Klein of 4-6-2015

[2] About the same number of Vermonters leave the state each year.

exemptions per in-migrant filer is about 1.6, indicating the possibility of multiple jobholders associated with each filer.[3]

- Although it is not clear how many of these in-migrants may be coming to Vermont for employment reasons (vs. retirement , etc.), the share is likely to be substantial. If population shares by age among Vermont in-migrants are the same as for the general population, it would suggest potential in-migrants of working age (excluding dependent children and those over age 65) could exceed 60% of all exemptions and total more than 8,500 potential workers per year.

- Although difficult to estimate without custom data runs by the Vermont Department of Labor, using wage data from State Occupational Employment Surveys, the wage requirement in the proposed legislation[4] would probably exclude at least 70% of all jobs, reducing the potential number of awardees to just over 2,500.

- Even if only half of these potential awardees applied to the program, it could reduce the credit per employee to less than $600. This could be a rude surprise to those expecting a $5,000 payout, with counterproductive program implications.

- Although there are few credible external estimates of future state migration for economic reasons, estimates of *net* economic migrants in the Vermont REMI model during the five year period from 2016 to 2020 exceed 4,000 per year. For this to occur, total in-migration (as measured by IRS exemptions) would likely be substantially higher than the above estimates. This, in turn, would reduce the payout per job even further.

- Limiting the awards to out-of-state employees will provide recipients with additional compensation relative to in-state applicants for the same positions. Since this is part of a total compensation package available only to out-of-state applicants, they will have a greater incentive to apply for available Vermont jobs than in-state residents. It should be noted that relocation costs are not always lower for in-State residents: Consider an unemployed Vermonter in St. Johnsbury applying for a position in Bennington, nearly three hours away, while competing with a Massachusetts resident from North Adams or a New Yorker from Troy. This is probably an unintended outcome of the current draft and yet making the credit available to all employees requiring relocation (in-state and out) would dilute the per employee awards to very low levels under the present cap or, by increasing the program cap to accommodate this expanded universe of potential applicants, would add significantly to the total program cost.

---

[3] The number of exemptions are a proxy for household size, and could be non-working children or elderly persons, but could also be working spouses or other family members. Total non-migrant exemptions per filer in Vermont have been closer to 2.0 in recent years, so in-migrant filing units are smaller, on average, than non-migrants.

[4] Currently set at 200% of the livable wage calculated under 2 V.S.A. Section 505(a), which would be $26 per hour.

Issues Associated With Program Costs and Implementation

As noted above, this program essentially functions as a hiring bonus to out-of-state job applicants. Many employers currently offer such bonuses, to both in-state and out-of-state applicants, and as labor markets begin to tighten, such payments are likely to become more widespread. While most employers would happily accept taxpayer funds to defray their hiring and employment costs, it is not clear why this is an essential public expenditure.

The net cost of a measure such as this critically depends upon the counterfactual: What would occur in the absence of the public expenditure? Would firms offer incentives such as this without taxpayer subsidies? If not, why? If they cannot afford to pay market rates for labor, should taxpayers make up the difference? How much is the State willing to pay to cover expenses a private business cannot afford? If a business cannot be competitive due to its cost structure in a particular state, should the state attempt to make it competitive via public subsidies? If so, how much should it spend to do so?

Public policy intervention in markets is generally considered optimal only in instances of market failure. While a labor shortage in a specific occupation, region or industry can exist even in slack labor markets, such as the present, the market response to this is simple: raise compensation levels until there is a clearing price for the labor needed. At the market clearing price, which may be higher than current compensation levels, as much labor as is needed will be available, in almost any region, at almost any skillset, in almost any occupation. In order to attract workers on the Alaska pipeline, for example, significant wage premiums were required in light of the social deprivation of the workplace, the extreme weather conditions and the relatively high level of skill needed. Even though this work had great benefits to the State of Alaska, the private companies performing this work paid for the exceptional compensation necessary to attract a sufficient number of qualified workers and made a profit in doing so

Very slow wage and income growth have been a notable feature of the current economic recovery and signs that labor markets are beginning to tighten should result in higher wage growth. Aggregate corporate profitability suggests that the capacity of firms to offer higher wages is generally ample. This condition is not a market failure – it is a normal phase of an evolving business cycle. While higher wages often decrease corporate profitability, this is not necessarily a reason for public sector intervention.

Although subsidies for employee relocation will help maintain corporate profitability, since firms would otherwise incur these expenses themselves, this subsidy is unlikely to be the determining factor in whether a job is created or retained. Unlike a VEGI job expenditure, there is no attestation, verifiable or not, that a company would not have filled the job opening without the subsidy. In most cases, it is likely this expense, if necessary, would have been borne by the employer or employee. Thus, this may be

a relatively expensive approach to facilitating labor mobility[5] – especially as the economic recovery progresses.

If such a program is enacted, it would be best if it recognized that relocation expenses may be an issue for both out-of-state and in-state applicants. There is not a good policy reason to favor out-of-state applicants. It would also improve the public return on investment if the payment were to be made over a period of years, such that the award recipient remains both employed and in-state beyond a single year. Variants on the draft proposal that would require an employer match of State relocation funds would leverage benefits somewhat, but most would still probably exceed the $750,000 program allocation and result in lower than advertised recipient payments. Other variations proposed that link the qualifying wage to higher minimums would reduce the number of qualifying applicants, but also probably reduce the need for public intervention, since higher paying jobs are already more likely to have compensatory perks such as relocation reimbursement and hiring bonuses.

[5] Causes of recent declines in U.S. mobility are mostly attributed to the magnitude and breadth of the current recession, in which few regions were spared. Thus, there were few regional opportunities for employment that sometimes exist during downturns. There is also evidence that the steep decline in housing prices in many regions created a condition referred to as "housing lock" that also affected labor mobility among homeowners. Because home equity represents the largest component of personal net worth for many homeowners, realizing an equity loss by selling in a down market affected relocation decisions. See, for example, U.S. Census Bureau research by Dr. Christopher Goetz at: http://www.sole-jole.org/13490.pdf. It should be noted that a $5,000 subsidy would not be large enough to offset the home equity losses experienced in many regions, but could still have beneficial impacts.