Vermont Legislative Joint Fiscal Office

1 Baldwin Street • Montpelier, VT 05633-5701 • (802) 828-2295 • Fax: (802) 828-2483

Date: January 14, 2017

TO: Members of the Senate Committees on Appropriations and Finance
Members of the House Committees on Appropriations and Ways and Means

FROM: Stephen Klein, Chief Fiscal Officer
Sara Teachout, Senior Fiscal Analyst

RE: 2016 Act No. 134 Sec. 40. EVALUATION OF TAX EXPENDITURES

(c) Full evaluation. On or before January 15, 2017, the Joint Fiscal Office shall develop recommendations for the standards and processes to conduct a full evaluation of tax expenditures, as outlined in the report required by 2015 Acts and Resolves No. 33. The report shall include recommendations on how to structure and fund a program designed to conduct a full evaluation of tax expenditures. The Joint Fiscal Office shall submit its recommendations and report to the Senate Committees on Finance and on Appropriations and the House Committees on Ways and Means and on Appropriations.

Review of Resources Required for Full Tax Expenditure Evaluations

Tax Expenditure Evaluations will generate new responsibilities for any of the three relatively small offices within State government that were identified in the 2016 Tax Expenditure Review Report as potentially capable of conducting full evaluations: the Joint Fiscal Office; the POLA Division within the Department of Taxes; or the Office of the State Auditor. Each office may require the use of consultants, new economic models, mapping software, or potentially hiring of additional staff in order to conduct thorough or "full review" of tax expenditures. An assignment of this magnitude would certainly realign the priorities of any of the offices if attempted without the addition of dedicated staff.

A full review and thorough analysis of any expenditure requires staff with the necessary skills and tools. Often those skills and tools will take some time to develop and will require:

- strong research capabilities
- sorting and matching of existing data in new ways and often combining data sets from difference sources
- utilizing database programs, economic or mapping software that could cost a substantial amount to purchase, develop, or contract out to consultants
- collecting additional data from recipients of tax expenditures
- access to confidential information

Example Resources in Other States:
Iowa, Maryland, Indiana and Washington are a few states which regularly evaluate tax expenditures. A chart compiled by Pew Charitable Trusts, at the end of this report, contains information on all the states' tax expenditure review programs.

- Maryland released its first reports in 2014 and additional reports in 2015. While Maryland does not have a specific budget for these reports they consume a significant amount of staff time in the Legislative Office of Fiscal and Policy Analysis during the off-session. A draft report published in 2015 on the Sustainable Communities Tax Credit required an estimated 188 staff days for analysis and production – between 7 and 9 staff worked on the project with a few dedicated to the evaluations – plus additional time for managerial reviews.

- The Indiana Office of Fiscal and Management Analysis also published a report evaluating 14 tax incentives in 2015 and assigned 6 staff members from an office of 20 to work on the report.

- Washington State utilizes 4.5 staff (FTEs) to complete 20 full evaluations per year.

- Iowa uses just under two full time employees (1.8 FTEs) to conduct 4 tax expenditures evaluations per year.

While every state structures the reports and staffing differently, on average they require between 1.0 and 2.5 FTEs to produce annually.

Full Tax Expenditure Evaluation Options and Estimates

The staff identified options and estimates on how to structure and fund a program designed to conduct a full evaluation of tax expenditures. The Pew Charitable Trusts also recommended different approaches that could be utilized in Vermont that are described in the attached memo.

a) Ad Hoc Approach

Legislative identification of one to three credits annually for a full evaluation. Each session the legislature would identify which tax expenditure(s) to evaluate and the office with the resources best matched to the particular expenditure. The research and evaluation would be conducted during the off session with a report due in the upcoming year. There may be years in which other projects and research are of a higher priority and the ability to conduct full evaluations will be limited.

The Legislature could alternatively hire an expert on a consulting basis to conduct one or more full tax expenditure evaluations. This could provide a template for future evaluations and also help the legislature determine what information and approaches are most useful. An outside entity could provide policy recommendations.

(b) Create Limited Evaluation Capacity

One positon (FTE) could be created in either the Executive and or Legislative Branch to spear head tax expenditure evaluations for the state. This may create the capacity for three to six evaluations annually. The number of evaluations depends on the approach utilized and the data available for analysis. The estimated total cost could be approximately $100,000.

Staff (1 FTE)	$ 65,000
Benefits	$ 26,000
Equipment/set up Training	$ 9,000

Legislative authorization of the positon and requirement of access to data and cooperation and participation of Tax Department, any other relevant agency of jurisdiction, and the Legislative Joint Fiscal Office depending on which entity had the assignment would be required. A schedule for tax expenditure reviews could be established. This could be a permanent or a temporary project.

(c) Establish a Tax Expenditure Evaluation Office

Statutorily assign responsibility to one entity or stand-alone office. This assumes six to eight or more evaluations annually, and ongoing monitoring and year round analytical capacity. An appropriation of approximately $240,000 could fund 2.5 FTEs using the estimates in (b) above this could be higher depending on the level of the positions created. In many states, this type of analysis is combined with compatible functions such as government accountability, audit or program evaluation.

THE PEW CHARITABLE TRUSTS

2005 Market Street, Suite 2800
Philadelphia, PA 19103-7077
P 215.575.9050
F 215.575.4939

901 E Street NW, 10th Floor
Washington, DC 20004
P 202.552.2000
F 202.552.2299
pewtrusts.org

Memo

To: Representative Janel Ancel, Senator Tim Ashe, Senator Jane Kitchel, and Stephen Klein and Sara Teachout, Legislative Joint Fiscal Office

From: Robert Zahradnik and Josh Goodman, The Pew Charitable Trusts

Date: November 14, 2016

Subject: Tax Incentive Evaluation Options for Vermont

As you know, H.873 directed the Legislative Joint Fiscal Office (JFO) to provide "recommendations on how to structure and fund a program designed to conduct a full evaluation of tax expenditures." One option to do so would simply be to provide funding to one of the three potential evaluation offices that the JFO's January 2016 report identified: The Office of the State Auditor, the Department of Taxes' Policy Outreach and Legislative Affairs Division, or the JFO itself. However, given that the JFO's report noted possible drawbacks to assigning any one of these offices to conduct full evaluations, this memo offers other alternatives.

Outside experts

A number of states have partnered with academic institutions or private consultants to evaluate incentives. When there is not a good fit within state government to evaluate incentives, working with these types of outside experts has proven to be an effective alternative. For example, under a 2014 law, Mississippi assigned evaluation responsibility to a research center that is part of the state's public university system. The center already had a role in state fiscal analysis, assisting in the state's revenue forecasts. Likewise, Oklahoma has hired a private consulting firm with former state budget directors on its staff to evaluate incentives. Analogously, Vermont has contracted with a private firm for many years to perform fiscal and economic analyses such as revenue forecasts.

The state could also consider a hybrid option, where outside experts perform economic modeling for select programs as necessary, but a state office retains primary responsibility for evaluation. This approach might reduce the cost of hiring contractors, while obviating the need for a state office to develop expertise at measuring economic impact.

A technical working group

As you know, Vermont's 2016 omnibus economic development legislation, H.868, created a technical working group to review aspects of the Vermont Employment Growth Incentive (VEGI) program. By law, the membership of the working group includes:

- The legislative economist or another designee from the Joint Fiscal Office
- A policy analyst from the Agency of Commerce and Community Development
- An economic and labor market information chief from the Department of Labor
- A fiscal analyst from the Department of Taxes or the state economist

One option is for Vermont to create a similar working group to evaluate incentives on an ongoing basis. This type of group would represent a range of perspectives, potentially leading to better evaluations. This approach would also ensure that no single office or agency has to staff evaluations on its own. Vermont has had success with the working group approach before. A decade ago, a similar working group identified reforms to the Economic Advancement Tax Incentives (EATI) program that helped lawmakers design VEGI as EATI's successor.

Other states have found value in seeking input from a variety of state offices. In Iowa, for example, economists in the Department of Revenue evaluate incentives with the assistance of advisory panels that Revenue convenes for each evaluation. The panels include officials from agencies that administer incentives, as well as relevant academics and industry representatives. These panels have helped Revenue's economists determine how incentives function, the programs' goals, and what data is available to measure their results.

Focus on economic development programs

The alternatives listed above are each options for who could conduct evaluations. Another option is to shift which programs are subject to evaluation (regardless of who policymakers determine should conduct them).

To date, the conversation around evaluation in Vermont has focused on all tax expenditures, including both tax expenditures that are intended to support economic development and those that serve other purposes. Not all states focus this broadly. Some, such as Connecticut, Nebraska, and Rhode Island, only study economic development tax incentives. Others, including Florida, Oklahoma, and Virginia, study a wider variety of economic development programs including both tax incentives and cash incentives (such as grants and loans), but do not include other tax expenditures.

The scope of a state's evaluation process should be driven by the needs and interests of policymakers—if lawmakers think they need better information on all tax expenditures, then studying all of them is reasonable. That said, there are several reasons Vermont may want to consider developing a process to evaluate economic development programs:

- The narrower focus would reduce the number of evaluations that would need to be completed, easing the workload of the evaluation office.

- This scope would allow for evaluation of some of Vermont's largest and/or most-discussed incentives, such as the loans offered by the Vermont Economic Development Authority and the EB-5 program. Since they are not tax incentives, evaluation of these programs has not been part of the conversation to date. An evaluation process that focused on a handful of the state's largest economic development programs could help lawmakers identify the most effective strategies to strengthen Vermont's economy.
- With a narrower focus, the choice of evaluation office might be easier. Lawmakers could task economic development experts with conducting evaluations, without worrying whether the evaluators have the broader tax policy expertise to evaluate all tax expenditures. For example, the new VEGI working group includes representatives from the Agency of Commerce and Community Development and the Department of Labor—agencies with knowledge of economic development policy, rather than general tax policy expertise.
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H.873 initiated a process for expedited reviews of certain tax expenditures. If Vermont were to begin an evaluation process for economic development programs, lawmakers could also require that additional tax expenditures receive expedited reviews. In this way, a wide variety of tax expenditures would be subject to greater scrutiny without the st

State	Evaluator branch	Offices involved	Includes cash incentives	Includes other tax expenditures	Cycle length (years)
Alabama	Executive	Administering agencies	No	No	4 years
Alaska	Legislative	Legislative Finance Division	No	Yes	6 years
Arizona	Legislative	Joint Legislative Budget Committee	No	Yes	5 years
Colorado	Legislative	State Auditor	No	Yes	5 years
Connecticut	Executive	Department of Economic and Community Development	No	No	3 years
Delaware	Executive	Department of Revenue	No	Yes	2 years
Hawaii	Legislative	State Auditor	No	Yes	5 years for some, 10 for others
Florida	Legislative	Office of Program Policy Analysis and Government Accountability and Office of Economic and Demographic Research	Yes	No	3 years
Indiana	Legislative	Legislative Services Agency	No	Yes	5 years
Iowa	Executive	Department of Revenue	No	Yes	5 years
Louisiana	Executive	Administering agencies (primarily Department of Revenue and Louisiana Economic Development)	No	Yes	1 year
Maine	Legislative	Office of Program Evaluation and Government Accountability	No	Yes	6 years (not specified in law)
Maryland	Legislative	Department of Legislative Services	No	Yes	7 years
Minnesota	Legislative	Legislative Auditor	Yes	No	None (at least one evaluation a year)
Mississippi	Outside	University Research Center	Yes	No	4 years (5 for newly created ones)
Missouri	Independent agency	State Auditor	Yes	Yes	4 years
Nebraska	Legislative	Legislative Auditor	No	No	3 years
New Hampshire	Legislative	Joint Committee on Tax Expenditure Review	No	Yes	5 years
North Dakota	Legislative	A legislative management interim committee	No	No	6 years
Oklahoma	Outside	Private consulting firm	Yes	No	4 years
Oregon	Legislative	Legislative Revenue Office	No	Yes	6 years
Rhode Island	Executive	Department of Revenue	No	No	3 years (5 for newly created ones)
Tennessee	Outside	Private consulting firm	No	No	4 years
Texas	Outside	Economic Development Oversight Board	Yes	No	No schedule adopted yet
Utah	Executive & Legislative	Governor's Office of Economic Development and Legislative Fiscal Analyst	No	Yes	3 years
Virginia	Legislative	Joint Legislative Audit and Review Commission	Yes	No	No schedule adopted yet
Washington	Legislative	Joint Legislative Audit & Review Committee	No	Yes	10 years
District of Columbia	Independent agency	Chief Financial Officer	No	Yes	5 years
Wisconsin	Legislative	Legislative Audit Bureau	Yes	No	2 years

Source: Pew Charitable Trusts