State Auditor Doug Hoffer's Remarks to House Commerce re. S.162
25 April 2019

Sec. 6. VEGI Study

"On or before January 15, 2020, [ACCD], in consultation with the State Auditor, shall study and report…concerning [VEGI], specifically addressing the following:
1) the internal controls and methods used to evaluate whether the program is working as intended;
2) the procedures used to select, vet, and approve participants and projects;
3) the controls & due diligence surrounding the application of the "but for" test;
4) the specific outcomes of the Program in each year, including the net revenue gain to the State and the net increase in jobs, payroll & capital investment; and
5) the procedures & controls for measuring and verifying Program outcomes."

I can attend meetings, review draft documents, and offer comments and suggestions, but I cannot approve or endorse the final products as it would create an independence problem.

Sec. 2. New Worker Relocation Incentive Program

General comments:
- ***I question the need to pay non-residents to move here when we have 3,000 residents who are not in the labor force but want to work (or want FT work).***
- ***Some claim that the program will produce new tax revenue. However, most families that move to Vermont will live in existing homes that were formerly occupied by other families that paid income, property, sales and other taxes.***
- ***If a worker retires or takes a different job, the job has to be filled. These are called replacement jobs. Some will now be filled by in-migrants taking jobs from Vermonters.***

(3) "The Agency shall assess applications on a rolling basis and give first priority…to workers in identified **priority sectors**, which may include health care, early child care and learning, **lodging and restaurant industry**, manufacturing, technology, and construction trades."

Has a fiscal note been done for this program? Does it make sense to pay $5,000 - $7,500 for a low-wage worker? For example, the lodging and restaurant industry is listed as a priority sector. The average wage for Leisure & Hospitality is $22,375. On average, Vermont income tax for the group at that range = $287.00. With that in mind, why should low-wage industries be listed as "priority sectors"?

(c)(3) "The Agency shall adopt measurable goals, performance measures, and an audit strategy to assess the utilization and performance of the Program."

I object in principle to creating and funding new programs without measurable goals or performance measures in place.

(d)(2) “As used in this section: Qualifying expenses” mean actual costs that a new worker incurs for:

(A) moving expenses;

(B) repayment of student loan debt;

(C) down payment assistance; and

(D) initial rental deposits.”

We often hear complaints about young people leaving the state. Some leave to earn more in areas where wages are higher. For some, it’s necessary in part because of their student loan debt. So how can we justify helping in-migrants pay down student debt while ignoring similarly situated Vermonters? The same could be said for down payment assistance.

Sec. 1. 3 V.S.A. § 2476 Dept. of Tourism & Marketing

(c) “Economic development marketing. The Department shall be responsible for the promotion of Vermont as great place to live, work, and do business in order to increase the benefits of economic development marketing, including:

1) attracting additional private investment in Vermont businesses;
2) recruiting new businesses;
3) attracting more innovators and entrepreneurs to locate in Vermont;
4) attracting, recruiting, and growing the workforce to fill existing vacancies in growing businesses and to retain workers and their families;”

How will ACCD/T&M measure the effectiveness of its efforts? I am not aware of any methodology to answer the question.

Sec. 5. Enhanced Incentives; Background Growth; Small Business Participation

“On or before Dec. 15, 2020, [VEPC] shall submit…a report addressing:

1) the use of the enhanced incentive for environmental technology businesses in the Vermont Employment Growth Incentive Program and shall specifically address the effectiveness, costs, and benefits of modifying the background growth rate when calculating the value of the enhanced incentives; and
2) specific recommendations for reducing the administrative burdens and other barriers to participation in the Program for small businesses.”

ACCD’s January “White Paper” addressed with these issues.

1. Re. Enhanced Incentives for environmental technology:

The bill asks VEPC to address “the use of enhanced incentives for environmental technology businesses,” but doesn’t say exactly what to address.

Second, the White Paper states that "<u>Many Vermont businesses are anxious to share their ingenuity and apply their entrepreneurial spirit to help accomplish the goals of the Vermont Clean Water Act</u>. Vermont offers an enhanced incentive to businesses that create jobs in environmental technology sectors, but the enhancement does not specifically mention activities that support the Vermont Clean Water Act."

The State is obligated to spend hundreds of millions for Lake clean-up so businesses "anxious to share" will have ample opportunity. And since the State is creating the increased demand for services, one wonders how such a VEGI applicant could claim that "but for" the incentives it would not expand to meet the increased demand.

2. ***Re. Background Growth:***

   VEGI "<u>generates economic activity in Vermont that is beyond an applicant's 'organic' or background growth</u>."

   That is false. The methodology uses the industry average background growth rate, not the rate specific to the applicant. In some cases, this has unquestionably cost the state millions in wasted "incentives" for fast-growing companies like Dealer.com and Keurig Green Mountain. Together, they were awarded over $15 million, much of which for growth that – based on the company's organic growth, would have occurred anyway.

   I am troubled that ACCD would make such a misleading statement to policymakers. This issue was first raised almost 20 years ago and VEPC has never sought to address it.

3. ***Re. Barriers to participation in the Program for small businesses:***

   a) "While the VEGI application process is not over-burdensome or complicated, many small businesses lack the capacity to dedicate staff time to State program applications and claim processes, as it can detract staff time from critical business operations. The incentive must be enough to both encourage greater than normal growth and outweigh the opportunity cost to the company."

      This assumes that small businesses will expand more than they would otherwise in response to incentives. There is no evidence to support this.

   b) The White Paper stated that "Very small businesses are not normally adding new jobs at a rate and volume that can overcome the background growth rates utilized in the VEGI incentive calculation. If an incentive can be calculated (because the new jobs do overcome background growth), it is often an amount that is not worth the company's staff time to apply and file annual claims."

      Industry growth rates are typically under 5%. Therefore, for a firm with 20 employees, it need only hire two new workers to make the company eligible,

although the likely award would be de minimus. If the amount of the award is that small, the company should not bother with VEGI (it's not an entitlement after all).

Rep. Kimball asked how we should respond to firms that threaten to leave. A good question, but it is based on assumptions for which there is little supporting evidence. First, the percentage of jobs created and destroyed by interstate moves is very small (2% - 3%) so the magnitude of the risk is modest. Using our limited resources to try and influence decisions by that small group diverts resources from investments intended to benefit all businesses and workers.

More importantly, it has become accepted wisdom that incentives really do influence businesses' location decisions. Recent findings by a highly respected researcher challenge that assumption.

> **Abstract**: "This paper reviews the research literature in the United States on effects of state and local "economic development incentives." Such incentives are tax breaks or grants, provided by state or local governments to individual firms that are intended to affect firms' decisions about business location, expansion, or job retention. Incentives' benefits versus costs depend greatly on what percentage of incented firms would not have made a particular location/expansion/retention decision "but for" the incentive. **Based on a review of 34 estimates of "but for" percentages, from 30 different studies, this paper concludes that typical incentives probably tip somewhere between 2 percent and 25 percent of incented firms toward making a decision favoring the location providing the incentive. In other words, for at least 75 percent of incented firms, the firm would have made a similar location/expansion/retention decision without the incentive**."[1]

We also briefly discussed the amount of resources Vermont devotes to assisting businesses. I noted that five major ACCD programs cost about $15 million per year (VEGI, Tourism & Marketing, TIF, RDCs, and the VTP) and that I can't say with any certainty what we get for those expenditures.

The notion that we don't do much for businesses is a recent perspective that has fueled the enormous growth in subsidies and incentives over the past 30 years. This ignores the huge public sector expenditures for the fundamentals, including education to prepare the next generation of workers, transportation infrastructure to move people and goods, the legal system that protects property rights, and so on.

In the end, there is very little a state can do to affect short-term economic outcomes, although no governor wants to admit that. We are a tiny speck at the tail of the national economy and have no control over the major factors that drive it such as the federal budget, interest rates, trade agreements, currency exchange rates, etc.

With that in mind, it makes sense to devote our scarce resources to long-term investments that improve our human, built, environmental, and intellectual capital.

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[1] Bartik, Timothy, "But For" Percentages for Economic Development Incentives: What percentage estimates are plausible based on the research literature?" Upjohn Institute Working Paper 18-289, July 2018.