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To: William Shubart, Chair  
Blue Ribbon Tax Structure Commission  
Kathy Hoyt, Vice Chair  
William Sayre  
Date: 28 September 2009  
Re: Comments on LCRCC / GBIC testimony

I see that the Lake Champlain Regional Chamber of Commerce and GBIC have submitted “Recommendations for Government Sustainability and Effectiveness”. This document presents statements of fact as if they are self-evident rather than the result of analysis. In addition, the LCRCC / GBIC also offered “The Facts on Vermont’s Business and Tax Climate”. This document contains references to various rankings that are demonstrably misleading.

I offer the following comments.

First, according to the LCRCC / GBIC, the “Facts on Vermont’s Business and Tax Climate” was “based upon an internet search of various studies and reports”. Unfortunately, it appears the LCRCC / GBIC search was limited to what they wanted to find. The supposed “facts” presented are a litany of misrepresentations from (mostly) biased organizations and are derived from flawed methodologies. Business climate rankings have become a small industry. But advocacy is not necessarily scholarship.

Indeed, there is an excellent report that examines several of the most frequently cited rankings: *GRADING PLACES: What Do the Business Climate Rankings Really Tell Us?* [Peter Fisher, EPI at [http://epi.3cdn.net/b2020f5ab6cb867d72\\_rcm6b3fo3.pdf](http://epi.3cdn.net/b2020f5ab6cb867d72_rcm6b3fo3.pdf)] After reviewing the Tax Foundation’s Small Business Tax Climate Index, the author states

“There is no point, really, in trying to assess whether the SBTICI successfully predicts which states will do better in attracting business investment, creating jobs, or the like. If it does, it is purely by accident, for the index does not even measure the effect of a state’s tax system on a firm’s cost of doing business. Even if the index appeared to be correlated with growth, one could not conclude, as the Tax Foundation would like us to, that lower taxes cause growth. The index does not measure tax rates to begin with, or even correlate with relative business tax levels. **As a tool for assessing public policy, it is fatally flawed, notwithstanding its carefully groomed appearance of plausibility and academic credentials (however spurious).** [Grading Places, p.27 – 28; emphasis added]

I sincerely hope you will review *Grading Places* because (to my knowledge) it is the only serious effort to get below the surface of the rankings reports. The frequency of the rankings’ appearance in popular media is not a measure of their value to policy makers. Important issues must not be decided based on anecdotes or unexamined assumptions. We can do better.

Second, as noted, the LCRCC / GBIC Recommendations include a number of items that are assertions masquerading as received wisdom. For example

*“We believe we have gone beyond our taxing capacity....” [Recommendations, p.3]*

How is our “tax capacity” defined? For the personal income tax, the effective tax rate for those who earn more than \$500,000 was 5.4% in 2007, down from 5.9% in 2003. The number of filers reporting more than \$500,000 in income doubled from 2003 to 2007 and their income tripled. This trend reflects a continuing concentration of income at the top. As reported by the CBPP (using IRS data), “Two-thirds of the nation’s total income gains from 2002 to 2007 flowed to the top 1 percent of U.S. households, and that top 1 percent held a larger share of income in 2007 than at any time since 1928”.

<http://www.cbpp.org/cms/index.cfm?fa=view&id=2908>

A little historical perspective is needed. During the Post-War decades, the effective rates for the top earners were double what they are today yet the economy grew enormously. And unlike today’s extreme income inequality, all income quintiles benefitted (a “rising tide lifts all boats” actually meant something). So exactly what is out tax capacity?

*“One standard or benchmark for government compensation (pay and benefits) going forward should be to put the public sector on par with, but not better than, the private sector. A recent study of average compensation costs of state employees versus private sector employees by David Coates found that the average base salary and benefit package is \$66,000 for state employees and \$44,000 for private employees.” [Recommendations, p.3]*

This recommendation is disingenuous at best. How does the make-up of the private sector workforce compare to state employees? Mr. Coates’ average is for the state’s entire workforce, which is not an appropriate comparison for state employees. For example, the Dept. of Labor reports that there were 40,000 Vermonters working in retail in 2008 (avg. wage \$25,260); 18,000 working in Food Services (avg. wage \$14,917); and 11,000 working in accommodations (avg. wage \$22,044). And most do not receive health care benefits. It is absurd to suggest state workers’ compensation should be compared to workers in these industries.

If this recommendation were adopted, thousands of state workers could see their compensation reduced by a third. How much state tax revenue would be lost as a result? How many workers (and their families) would become eligible for Medicaid, Dr. Dynasaur, and other public assistance programs? At what cost?

*“Any increases to the State budget going forward must be based on a financial model of sustainable spending. Increases should not exceed the annual percentage rate increase in the gross state product or the Consumer Price Index, whichever is less.” [Recommendations, p.3]*

This too is disingenuous. In the last five years, the CPI-U has increased by 13.9% (Aug. to Aug.). During that same period, the BEA implicit price deflator for state government was 24.7% (3rdQ to 3rdQ; BEA). The CPI market basket includes many goods and services not purchased by state government. This is not apples-to-apples and using the CPI is not an appropriate standard for state government purchases or operations.

State GSP grew by 19.7% from 2003 to 2007 (before the recession). During that same period, total instate AGI grew by 35.6%. Moreover, AGI for those earning over \$500,000 increased by almost 200% during the same period. So why should state government be limited to growth in CPI or GSP?

*“We must collect more tax revenue for the State by lowering tax rates and encouraging more people to become income tax paying residents of our State and by encouraging more businesses to stay and new ones to relocate.” [Recommendations, p.5]*

No evidence was provided to support the view that lowering tax rates has a significant effect on residential migration or has an appreciable effect on business location. Indeed, there is considerable evidence to the contrary (see Phase 9 of the Job Gap Study, p.11 at <http://www.vtlivablewage.org/Phase%209.pdf>; citing the New England Economic Review).

Note: I encourage the Commission to review a recent report from the Woodrow Wilson School at Princeton on “Trends in New Jersey Migration: *Housing, Employment, and Taxation*”. See [http://www.princeton.edu/prior/PRIOReconomy-Final-\(2\).pdf](http://www.princeton.edu/prior/PRIOReconomy-Final-(2).pdf).

*“Our tax policy must encourage entrepreneurial activity, create good jobs, and change the reality and perception of Vermont as a high tax state. (Set a goal of getting to a ranking of 25<sup>th</sup> nationally in the next 10 years.)” [Recommendations, p.5]*

Volume 2 of the JFO Tax Study demonstrated clearly that Vermont is already in the middle of the pack. References to per capita rankings are misleading and a disservice to this process. Furthermore, it is ironic that any perception “of Vermont as a high tax state” has been fostered by groups like the LCRCC/GBIC, who now complain that their efforts may have succeeded.

*“We must work to broaden our tax base and create more equity as to who pays income taxes. We cannot continue to have a tax structure that reduces the state’s economic activity and penalizes wealthier Vermonters. The target should be tax rates for each income cohort which matches the average of other states with income taxes.” [Recommendations, p.5]*

This recommendation seeks to eliminate Vermont’s progressive tax structure. To suggest that wealthy Vermonters are “penalized” by a system that results in an avg. effective rate of 5.4% is absurd. Moreover, there is no supporting evidence for the assertion that our tax structure “reduces the state’s economic activity”. This is a shibboleth. Finally, rather than penalizing the wealthy, there is evidence that moderate-income Vermonters pay a higher percentage of their income in total state taxes than high-income Vermonters. See ITEP’s report “*Who Pays? A Distributional Analysis of the Tax Systems in All 50 States*” at <http://www.itepnet.org/wp2000/vt%20pr.pdf>.

*“The recent changes by the Legislature in capital gains exemptions, depreciation, the estate tax and deductibility of state taxes enacted during the last few years should be repealed. These changes do not raise a lot of money, but they do make Vermont stand out as a less competitive place to live or conduct business.” [Recommendations, p.5]*

The 40% capital gains exclusion cost the state at least \$160 million in foregone revenue (State Tax Expenditure Reports at <http://www.state.vt.us/tax/expenditurereports.shtml>). It is outrageous for the LCRCC / GBIC to state that this is not a lot of money. And the suggestion that the exclusion has made Vermont “less competitive” is without supporting evidence.

*“Vermont must create and implement a long term strategic plan for economic development, within the next 18 months. Stewardship of the strategic plan must be the non partisan responsibility of the Agency of Commerce and Community Development, acting in the role of convener for the various arms of*

*economic development in the private, public and educational sectors. The plan must be focused on clear, measurable objectives with indicators of progress.” [Recommendations, p.5]*

This is a shocking admission that the state does not currently have a coherent economic development plan. Moreover, it is especially curious because the LCRCC / GBIC have been major participants in previous long-range planning efforts undertaken by VEPC (which had statutory authority for this work before it was removed). And while I do not agree that the ACCD is a “non-partisan” actor, non-partisan is not necessarily the same as objective.

As for the need for “clear, measurable objectives with indicators of progress”, see Phase 9 of the Job Gap Study, which exposed the failure of the state in this regard. Furthermore, see the Unified Economic Development Budget which, for the third year in a row, noted “*a lack of clear and measurable goals for each initiative / program.*” [2009 UEDB, p.2 at [http://finance.vermont.gov/sites/finance/files/pdf/uedb/2009\\_UEDB.pdf](http://finance.vermont.gov/sites/finance/files/pdf/uedb/2009_UEDB.pdf)]. To my knowledge, the LRCC / GBIC never offered testimony in the legislature on the UEDB.