Testimony of Steve Robinson, Decision Metrics, for House Revenue, March 8, 2013

Mr. Chairman and members of the committee:

Several bills related to tax expenditures are before you this morning. Please accept these written comments in lieu of my personal testimony. At the end, I offer two specific suggestions.

My research into tax expenditures suggests a concept that would make these bills more effective, with special attention to HB 2002. That concept is **windfall benefits**. You may know that I have testified to several committees on this topic, urging them to be wary of programs that *purport* to create numerous jobs or other public benefits for Oregon, but which may instead be mostly windfalls for taxpayers.

My research has convinced me that it's typical for "job-creating" incentive programs to involve a large majority of windfall benefits, wherein employers are awarded tax credits just for engaging in activities that they would do anyway, just in the normal course of business. When this happens, not only do we fail to create new jobs, but we must cut the services those lost tax dollars would otherwise support. Cutting services means lost jobs for public employees, contractors, providers, and the community businesses they patronize.

I would offer three clear examples of programs with substantial windfall benefits:

1. The **Qualified Research tax credit** adds a small Oregon credit on top of an existing federal credit with the same structure. The federal credit has been criticized as ineffective by the Government Accountability Office on the grounds that over 50 percent of the credited R&D activity would have been done anyway. To think that Oregon's tiny additional incentive would motivate these mostly large national companies to augment their R&D programs, and to do so in Oregon, is overly optimistic in my view.
2. **Hiring tax credit programs** for employers who hire a particular class (e.g. long-term, displaced, veteran, local) of unemployed people have an extremely high component of windfall benefits. According to a California study, the size of the credits in such programs is typically such a small percentage of the employee's salary that it fails to tip the balance in favor of making an additional hire. In somewhere around *95 percent* of all such cases, the employers in question would have hired *someone* for those jobs anyway, just because their business conditions called for those hires. So it should be an assumption that any hiring tax credits will be 90-95 percent windfalls, i.e. wasted public resources. Only rarely will the advantages of the remaining 5 percent of new hires be worth the high windfall losses.
3. While not a purported "economic development" program, the **Additional Medical Deduction** is another type of windfall benefit. It simply gives tax benefits to certain people who have had medical expenses during the past year, *without regard to their needs or means*. There is no evidence that it changes behavior or creates jobs; in fact, in this era of exploding medical costs, it would even be *perverse* to provide any incentive to consume more medical services. Thus this deduction is purely windfall to the recipients, *three fifths of whom are in the top income quintile*. If the rationale for this deduction is to help needy senior citizens defray crippling medical costs, it should be limited to those under the median income (about $30,000), saving $163 million for the General Fund. These funds could then be used to augment programs that actually help seniors gain access to the care they need, and that generate federal matching funds.

Many other tax expenditures, too numerous to examine here, also follow this pattern. I hope HB 2001, 2002 and 2003 can be tools for raising our standards to ensure that future decisions regarding tax breaks give due consideration to actual public benefits, rather than vague promises or the popularity of "free" money.

Here are my suggestions.

1. Descriptions of the presumed benefits of various tax expenditures typically ignore the windfall effect altogether. Therefore, consider adding another subparagraph under Section 2(2) of HB 2002 that requires the LRO to comment on the windfall effect specifically. Something like the following may work, inserted near subparagraph (c):

   "(x) The extent to which the benefits of the credit result from changes in behavior motivated by the credit, rather than mainly creating a windfall for the taxpayers."

2. This legislation uses the term "tax credit," but many important tax expenditures are not credits at all. They are characterized in the *Tax Expenditure Report* as deductions, subtractions, exclusions and the like. Also, tax breaks contained in the federal tax code are far more impactful on Oregon's revenues than are the state measures. I would like to see the legislation amended and broadened:
   a. to emphasize that it *covers federal tax breaks* as well as state ones, and
   b. to include *all types of tax expenditures*, not just credits.

   These bills will improve accountability and the quality of analysis of tax expenditures. Such improvement should not be confined merely to Oregon credits, a small subset of tax expenditures.

Thank you for your consideration.