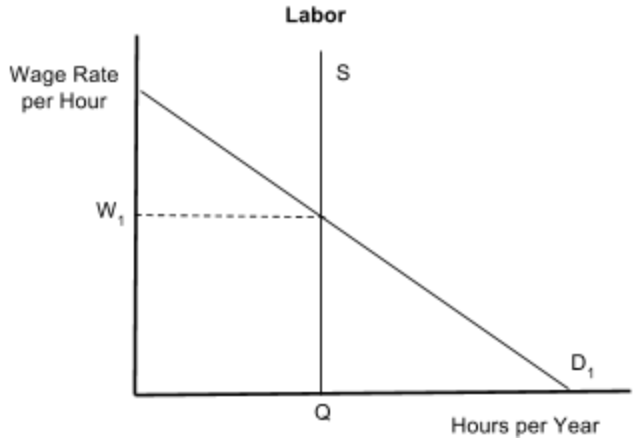
Economic Analysis of HB17-1007

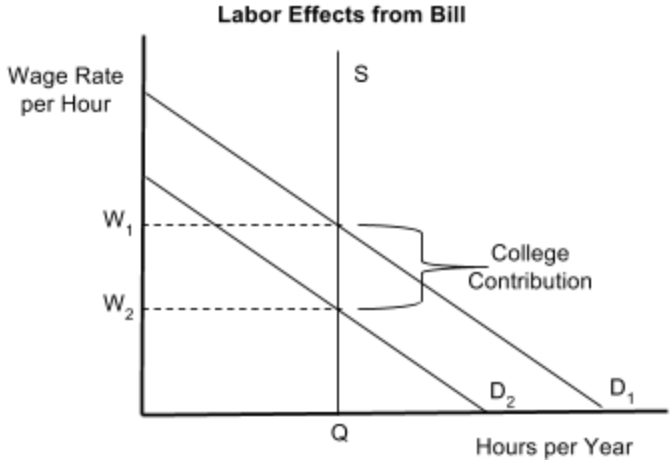
HB17-1007 would allow employers to receive a tax deduction when they contribute to an employee's college saving account or trust account. This bill would allow businesses to receive both a state tax deduction and a federal tax deduction for college contributions.

This bill, at face value, redistributes money to encourage college investment. Higher education is an appropriate discussion in a government setting because there is currently a market failure in higher education from the lack of loans available to potential college students.

Consider a graph of labor supplied and labor demanded, which would compare hours worked per year with the wage rate per hour. In this case, the demand curve of labor should slant downward since firms would demand fewer workers when prices go up. The supply curve of labor is theoretically and empirically thought to be inelastic. This means that the quantity of labor supplied is not sensitive to changes in wages, which results in a vertical sloping curve (Borjas, 2012).



When the amount of labor supplied meets the amount of labor demanded, the market is in equilibrium. This occurs when the



employee is receiving a wage of W_1 and the employer is paying a wage of W_1. The employee works Q hours per year.

The total cost of having an employee determines how much labor a firm will hire. If the cost of having an employee is split between various forms of payment, the quantity of labor demanded remains the same. D_1 represents how much a business pays to have an employee. D_2 represents how much a company pays the employee in wages. The distance between D_1 and D_2 represents how much the firm puts into the employee's college savings accounts.

Further looking at the graph, it is evident that the number of hours worked per year would remain the same with or without the bill, however, employee wage would change. The employee would now receive a total compensation of W_1, which includes a wage of W_2 plus a college contribution. Without a college contribution, the employee was receiving a wage of W_1. Thus college contributions decrease employee wages because part of the employee's wage would now be put into a college contribution. A company's college contribution would come out of an employee's wage, not out of the company's profit. Therefore, the college contribution does not affect employers at all.

The burden of a company sponsored college fund would fall on the employees. However, the bill would be compensating the employers, not the employees. Businesses would receive a deduction despite the fact that they were not affected by the bill. This would redistribute money to businesses.

Furthermore, both firms and individuals can currently only deduct their taxable income on one level. Firms can currently deduct a college contribution from federal taxable income, not from state taxable income. Individuals, on the other hand, can currently deduct a college

contribution from state taxable income (up to a certain amount), and not from federal taxable income. In the event that this bill was passed, firms would be able to deduct any amount of a college contribution from both federal taxable income and state taxable income. However individuals would still only be able to deduct from state taxable income. Employers would get to deduct twice the amount they contributed and would be able to deduct any amount, while employees would only be able to deduct the amount they contributed. This would encourage companies to invest in college savings, which would in turn decrease employee wages.

One may imagine a situation where firms do not reduce wages since they are being compensated by both the state and federal government. However the previous graph showed that firms take additional costs, such as college investments, out of employee wages. Since the goal of most firms is to maximize profit, companies have no reason to give the money from these deductibles to employees. Instead it is more likely that firms would take college investments out of employee wages and spend the money saved by the deductible on something else. Thus this bill would be giving money to firms.

While the intent of the bill was to redistribute money to encourage college savings, money would be actually be unintentionally given to businesses. If the goal is to increase college savings, perhaps this money would be better spent supporting the individuals who would be most affected by company sponsored college contributions. Even more, it would be best if the money was given to individuals who need college contributions, such as people in the lower income brackets.

However, since many employers believe they would be bearing the cost of a college contribution, they are more likely to be giving college contributions to individuals with the most

human capital. However the individuals with the most human capital have higher paying jobs and do not need college savings assistance. Therefore this bill would not only give money to businesses, it would encourage college savings for people who do not need.

This bill should not be passed because it would redistribute money to groups that would not be affected by college contributions (businesses), instead of redistributing money to groups that would be affected by college contributions (employees). Further, the college contributions would be given to the richer individuals in society.

References

Borjas, George. 2012. Labor Economics.

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Rosen, Harvey and Ted Gayer. 2009. Public Finance.