An Economic Analysis of HB18-1125

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HB18-1125 aims to address the shortage of affordable housing in rural Colorado by establishing an income tax credit for anyone who makes a financial contribution to employer-sponsored housing projects. Employer-assisted housing (EAH) is a general term for any housing project for employees that an employer at least partially supports, financially or otherwise.[1] Theoretically, by incentivizing individuals to collaborate with businesses on EAH projects, more low and middle income families will have access to safe, affordable housing close to their workplaces. This paper examines the validity of this goal and potential effectiveness of the bill in achieving it.

Specifically, I seek to determine whether this bill aims to correct an inefficiency or redistribute resources, either of which could justify government intervention. Further, I consider the economic effectiveness of tax credits for charitable donations. Finally, I examine if this bill defines a clear plan for its own evaluation as a pilot program. Ultimately, this paper finds evidence against government intervention of this type and does not support HB18-1125.

The proposed bill initiates a pilot program in which anyone who donates to any sort of EAH program will receive a credit towards their state income tax. The bill allows for a credit equal to 20% of the donation, with a maximum value of $400. The taxpayer must provide certification of their donation and cannot use their donation towards any other tax credit or deduction.

According to the proposal, the shortage of affordable housing in rural Colorado impedes economic development, quality of life, and work force quality, requiring stronger financial incentives for addressing this shortage than the free market on its own provides. This shortage especially affects lower-middle income earners in rural Colorado who do not qualify for government assistance for

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[1] "Fact-Sheet for State and Local Governments." *Employer-Assisted Housing Toolkit.* National Association of Realtors, n.d. Web. Accessed 2/4/18.

housing but cannot find affordable homes in safe places close to their workplaces. As a pilot program, its effects will be analyzed upon its repeal in July 2032.

The government should intervene in imperfect markets, aiming to enhance efficiency. Most market inefficiencies involve wrongly or under-provided public goods or unregulated externalities. If governmental intervention does not correct an inefficiency, it is a redistribution effort. Redistribution interrupts normal market forces and therefore requires a strong and detailed justification.

Housing is not a public good. However, advocates of EAH justify government intervention allude to positive externalities of this type of housing, saying that they justify government intervention. An externality is a consequence of the production or consumption of a good or service that impacts someone other than the user. Examples in existing EAH research include reduced traffic and car pollution due to workers living closer to their workplaces and increased sources of property tax revenue. A Harvard study found that EAH projects promote regional competition by revitalizing and stabilizing neighborhoods and local businesses.[2]

These externalities operate through the free market and do not require regulation. Often called pecuniary externalities, they are triggered by natural consumer and producer behavior, enhancing efficiency instead of preventing it[3]. For example, people will drive less when they live closer to their workplace, not because they know it will help the community and environment as a whole, but out of convenience. The societal benefits of EAH should incentivize employers to promote EAH on their own, without encouragement from the government.

[2] Pill, Madeleine. Employer-assisted housing: Competitiveness through partnership. No. 8. Joint Center for Housing Studies, Graduate School of Design [and] John F. Kennedy School of Government, Harvard University, 2000
[3] Holcombe, Randall G., and Russell S. Sobel. "Public policy toward pecuniary externalities." Public Finance Review 29.4 (2001): 304-325.

Further, this bill incentivizes donations to EAH projects and directs them away from other projects and activities, creating a trade-off. These losses in other activities will offset the pecuniary externalities created by this proposal, which existing research appears not to have considered. The positive externalities associated with EAH, therefore, do not justify this government policy.

The bill identifies a shortage of affordable housing in Colorado, considering it a market failure in need of government involvement. The bill does not define the word "shortage" nor the word "affordable", making it challenging to determine what sort of housing and pricing this bill would find acceptable. Home and rent prices have increased in recent years as hundreds of thousands moved to the state, but this is a natural market mechanism in response to increased demand[4].

Private donations to EAH will not solve the bill's stated problem of unaffordability. Naturally, higher housing prices yield higher profits and in a competitive market, developers and landlords can charge these high prices for quality houses. Employer sponsored housing will face the exact same market pressures.

To address the stated "affordable housing shortage," housing supplying in general must increase. However, only lower quality housing options will produce the desired lower prices because it is cheaper in production. Unfortunately, zoning regulations often prohibit the development of tall apartment buildings, a low cost, high density housing option. For example, in Windsor, a rural city in northern Colorado, the city code limits buildings to maximum heights between 35 and 55 feet, only permitting short apartments of just a few stories[5]. In pursuing more affordable housing options for the Colorado working class, legislators must evaluate the limitations that existing regulations impose on EAH instead of depending on taxpayer donations to facilitate what the market cannot.

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[4] DePillis, Lydia. How Colorado Became One of the Least Affordable Places to Live in the U.S. CNN Money. Cable News Network, 2017.

[5] "Sec. 16-10-50. - Building height regulations." *Charter and Municipal Code.* The Town of Windsor, Colorado, 2017.

Beyond the lack of economic justification for this form of government involvement in EAH provision, the proposed tax credit policy itself raises concerns. In theory, this policy incentivizes taxpayers for certain behavior, in this case, encouraging people to donate to a particular public cause. This incentive targets people who have enough disposable income to donate and who typically choose to make donations. Studies in the United States found elastic rates of donating in relation to tax credit, indicating responsiveness to tax credits as incentives[6]. This suggests the policy's potential effectiveness in changing taxpayer behavior and re-directing donations.

However, a study in France found that while charitable giving increases in response to tax credits, often the increase in donations paled in comparison to lost government revenue due to the tax credits[7]. This means that while people may respond to incentives, the net increase in economic activity does not offset the costs of implementing them. For each tax credit given for charitable donations to EAH projects, revenue will decrease, reducing funding for public projects. The bill does not specify which section of the state budget these credits will impact, making it challenging and risky to find a justification for such a vague and unclear policy proposal.

Given that this bill does not enhance efficiency by reducing barriers to EAH by employers themselves, the only remaining consideration for its validity is redistribution. The tax credit will incentivize taxpayers out of their normal donation patterns, redirecting charitable funds from their natural destination. It is impossible to determine exactly how taxpayers would use their funds without this incentive nor can we measure the economic impact of a loss in another sector, which may outweigh any positive effects of the bill.

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[6] Fack, Gabrielle, and Camille Landais. "Are tax incentives for charitable giving efficient? Evidence from France." American Economic Journal: Economic Policy 2.2 (2010): 117-41.

Finally, the bill text fails to adequately address methods for measuring the outcome of this pilot program. Only three other states have similar policies in place, so the bill will serve as one of the pioneers of its kind. This means it is essential to closely measure its effects. Research from the Pew Charitable Trust suggests clearly delegating evaluation tasks to a particular agency or governmental office upon the creation of new legislation.[7] Establishing, training and regulating this agency or task force will extend the timeline and present a new set of costs. The bill does not mention any sort of task force, account for any of these costs or even indicate how results will be measured. Given the inconclusive research on the effectiveness of tax credit incentives and the risks associated with enacting economically unnecessary policy, this analysis finds no justification for dedicating government resources to this project.

In conclusion, this paper finds that HB18-1125 does not fill an economic need in Colorado. The market naturally facilitates all positive externalities associated with affordable housing, so government intervention will actually impede their spread. Further, given the lack of specification about this bill's impact on state revenue, it does not validate redistribution, especially since *employer-assisted* housing is designed to be driven by employers, not the government. This proposal removes responsibility from employers themselves to address their employees' needs. Future policy should examine why employers do not invest in EAH given its positive economic effects and consider policies that reduce barriers to making naturally low cost housing accessible to rural Coloradans.

[7] Chapman, Jeff. "Evaluating the Effectiveness of State Tax Incentives." The Pew Charitable Trusts. Pew Trusts.org, 2014.