

VERMONT'S BUDGET: SHARING THE RESPONSIBILITY

These are extraordinarily challenging economic times. Vermont families, businesses and the state itself are feeling the painful effects of the global recession. The legislature was faced with many difficult choices as it worked to craft a responsible and balanced budget. The scope of the problem is such that legislators had to use all tools at their disposal to write a state budget for the coming year.

None of the choices were easy, but the legislature's budget asks all Vermonters to play a part in the solution. Some Vermonters will share in the responsibility by seeing fewer services. Some Vermonters will pay higher taxes. But we are all in this together.

• *The Context of the Economic Crisis* •

To put the bleak economic climate in perspective, since January 2008, Vermont has experienced the following drops in revenue forecasts:

	Fiscal Year 2009 (7/1/08 – 6/30/09)	Fiscal Year 2010 (7/1/09 – 6/30/10)	Total
General Fund	- \$95 million	- \$196 million	- \$291 million
Transportation Fund	- \$23 million	- \$24 million	- \$47 million
Total	- \$118 million	- \$220 million	- \$338 million

On top of the negative \$338 million downgrade, the Governor pointed out the need to increase General Fund spending by \$141 million to keep pace with increased demand on state services in FY 09 and FY 10, including a Medicaid/Catamount shortfall of \$80 million.

In the General Fund alone, the downgrades, shortfalls and increased demands on the state represent a \$432 million budget challenge over two years.

Even after we put in place a responsible and balanced budget plan, we must be prepared for further drops in revenue and a slow recovery. This budget is the first step in a multi-year process of weathering this economic storm.

• Solving the Fiscal Year 2010 Budget Gap •

The deficit that the Vermont Legislature must tackle in this budget for Fiscal Year 2010 totals \$281.5 million. As the President and lawmakers in Washington intended, we are investing federal stimulus funds to keep Vermonters working and preserve the critical services that our people need now more than ever.

Using the tools at our disposal, the Appropriations and Revenue Conference Committees constructed the following framework for filling that hole:

Cuts	\$59.3 million
Collecting unpaid taxes	\$4.8 million
New revenue	\$21.3 million
Reduction of General Fund transfer to Education Fund	\$18.4 million
Caseload reserves	\$3.2 million
Federal stimulus funds (ARRA)	\$174.5 million
Total	\$281.5 million

None of these are easy choices to make. Some Vermonters will share in the responsibility by seeing fewer services. Some will pay more in taxes. But all of us are in this together.

• ARRA: A partner in Washington •

Under President Barack Obama's leadership, Congress passed the American Reinvestment and Recovery Act earlier this year. This federal stimulus package came at a critical time for struggling American families, businesses and states.

The focus on preserving and creating jobs and making investments to get our economy moving again was the exact medicine our economy needed in difficult times.

In Vermont during FY 2009 and FY 2010, we have the advantage of \$250 million in federal stimulus funds to help fill the General Fund gap. This extra federal support will help Vermonters keep their healthcare and high quality schools, will allow the state to begin fixing our crumbling roads and bridges, make critical investments in our green economy and, most importantly, keep Vermonters working.

However, the relief is temporary and still leaves a substantial hole to be filled on the state level with a combination of the tools we have available – cutting programs and services, finding efficiencies, increasing taxes or fees, collecting unpaid taxes, adjusting transfers between funds and using the state's reserve funds.

• *Cutting state spending* •

Before solving the FY 2010 budget challenge, the state has already made over \$100 million in cuts and adjustments to spending. In August, the Joint Fiscal Committee made almost \$23.5 million in cuts and adjustments, including \$600,000 from environmental conservation, \$3.4 million from the Global Commitment program, almost \$260,000 from Fish and Wildlife and almost \$3 million from the Tobacco Trust Fund. In December, the Joint Fiscal Committee made an additional \$20 million in cuts and adjustments, including over \$240,000 from the Department of Agriculture, over \$810,000 from protection of persons and property, \$1.1 million from public health and \$4.4 million from mental health.

The proposed Fiscal Year 2010 budget includes an additional **\$59.3 million in cuts** to state programs and services. These were extremely hard choices. Examples of these cuts include:

Housing and Conservation Trust Fund	- \$3 million
Next Generation Program	- \$4 million
Tobacco Program	- \$1.6 million
Human Resources IT system	- \$4.5 million
Hospital Reimbursements	- \$7.1 million
Rest Areas (reducing hours to 12 hour average)	- \$500,000
June Grads – Department of Aging and Disabilities	- \$290,882
Human Services providers, grants and contracts	- \$2.7 million
Fish & Wildlife and Forests, Parks & Recreation	- \$801,399
Legislature	- \$240,000
Nursing Homes	- \$545,760

A complete list of cuts is attached.

• *Generating new revenue to protect vital services* •

The Conference Committee put together a revenue package that will collect money owed to the state, close two loopholes to make our tax system fairer and modestly raise several consumption taxes. With the revenue raised, the conference committee was able to provide an income tax break for middle and lower income Vermonters and protect vital state programs from \$26.1 million in additional cuts.

To put the revenue package in context, only \$21.3 million in new taxes are raised to solve a \$281.5 million budget problem – that’s just 7.5 percent.

This tax package accomplishes several critical goals:

- 1) Provides a middle and lower income tax cut to help Vermonters who are struggling most
- 2) Lowers the top marginal rate, which some have been quite concerned about because of its potential impact on competitiveness
- 3) Closes loopholes to create a fairer and more progressive tax code
- 4) Allows the state to protect critical services from deeper cuts for the Vermonters who need them most

The components of the revenue package include:

Collecting unpaid taxes -- \$4.8 million	
Tax compliance	\$1 million
Labor compliance – Addressing worker misclassification	\$1.2 million
Tax amnesty	\$2.5 million
Delinquent taxes	\$0.1 million
Net new revenue -- \$21.3 million <i>(includes the reduction in marginal rates)</i>	
State yard sale	\$0.03 million
Estate tax	\$3 million
Digital downloads	\$0.8 million
Closing capital gains loophole (with \$5,000 exclusion)	\$16.2 million
Closing income tax deduction loophole (with \$5,000 cap)	\$15.5 million
Sales tax on liquor	\$2.4 million
Increasing cigarette tax from \$1.99 to \$2.24 <i>(accrued to Health Care funds)</i>	\$4.1 million
Increasing tax on other tobacco products from 41 to 92 percent <i>(accrued to Health Care funds)</i>	\$1.8 million
Lowering marginal income tax rates*	- \$22.4 million
Total	\$26.1 million

* The Conference Committee used \$22.5 million of the revenue package to offer a middle class tax cut and the remaining \$26.1 million to protect vital state services.

• *Cutting taxes for middle and lower income Vermonters* •

Working Vermonters are struggling. In recognition of their struggle, this package lowers taxes for the middle and lower income Vermonters who need it most. This package works in concert with President Obama’s middle class tax cut to ensure that our families survive and thrive to kick start our economy.

This middle class tax cut will help Vermonters buy groceries in our stores, pay for gas at our local stations, make their mortgage or rent payments and pay their other household bills.

When taken as a package, the result of the three major components of the revenue plan – closing the capital gains loophole, as previously proposed by Governor Douglas, closing the income tax deduction loophole and lowering the marginal income tax rates – Vermonters making under \$200,000 a year will, on average, pay less in state taxes while Vermonters making more than \$200,000 will pay more. The following chart explains the net effect of the tax changes as a whole on average in-state filers:

Adjusted Gross Income	Average change in state taxes	Effective Rate Comparisons		
		Current Effective Rate	Proposed Effective Rate	Change in Effective Rate
Under \$25,000	- \$2	1.1 percent	1.1 percent	- 0.02 percent
\$25,000 - \$49,999	- \$14	2.1 percent	2.0 percent	- 0.04 percent
\$50,000 - \$74,999	- \$36	2.5 percent	2.4 percent	- 0.06 percent
\$75,000 - \$99,999	- \$73	2.9 percent	2.8 percent	- 0.08 percent
\$100,000 - \$124,999	- \$119	3.4 percent	3.2 percent	- 0.11 percent
\$125,000 - \$149,999	- \$119	3.7 percent	3.6 percent	- 0.09 percent
\$150,000 - \$199,999	- \$39	3.9 percent	3.9 percent	- 0.02 percent
\$200,000 - \$299,999	+ \$218	4.4 percent	4.5 percent	+ 0.09 percent
\$300,000 - \$499,999	+ \$1,267	4.8 percent	5.2 percent	+ 0.34 percent
\$500,000 - \$999,999	+ \$3,393	5.1 percent	5.6 percent	+ 0.50 percent
Over \$1,000,000	+ \$20,272	4.4 percent	5.1 percent	+ 0.69 percent

The net result of the revenue package is **that middle and lower income Vermonters will, on average, see modest decreases in the taxes they pay to the state.** The Vermonters who will see their taxes go down are the ones most affected by cuts in important services, like programs for the blind and disabled, nursing homes and tobacco cessation programs. Higher income Vermonters, who are less impacted by cuts in state services, will on average pay more to ensure that all Vermonters weather the economic storm.

• *Reducing the General Fund transfer to the Education Fund* •

Perhaps the most difficult choice made in the proposed budget is agreeing to a portion of the Governor’s proposal to reduce support to the Education Fund. The proposed budget does not agree to the scale of the Governor’s proposal – \$63 million – or the scope – to *permanently* move teacher’s retirement obligations into the Education Fund and on to property taxpayers.

The budget does, however, temporarily reduce the transfer from the General Fund to the Education Fund by \$18.4 million – over 70 percent less than the Governor proposal to reduce the transfer and shift teacher’s retirement into the Education Fund.

However, because of the hard work of school boards this year and by using some reserve funds, **the homestead tax rate and the base per pupil grant will remain exactly the same** as school boards anticipated when they passed their budgets at the beginning of the year. The homestead rate will drop a penny to 86 cents and the base education payment will remain the \$8,544 per pupil that the schools had anticipated when they crafted and passed their budgets.

<i>Homestead property tax rate anticipated when school budgets passed:</i>	\$0.86
<i>Homestead property tax rates under legislative budget:</i>	\$0.86
<i>Base education payment anticipated when school budgets passed:</i>	\$8,544
<i>Base education payment under legislative budget:</i>	\$8,544

School boards worked diligently in crafting their school budgets in these difficult times and the result this year was that *statewide education spending was \$24 million lower than anticipated*. Of that \$24 million, \$12 million automatically returns to Vermonters through lower homestead education taxes.

At the beginning of the year, the legislature had hoped to drop the homestead rate by an additional penny for a total reduction of 2¢. By keeping the reduction at the original 1¢, \$10.1 million can be used to make up for part of the lower General Fund Transfer. The remainder of the transfer is covered through a combination of reserve funds, and increasing the share of some revenue sources that goes to the Education Fund.

This package maintains the legislature’s commitment to lowering property tax rates this year.

Covering the \$18.4 million reduction in the General fund Transfer to the Education Fund:

Reduce education tax rates by 1¢ instead of 2¢ <i>(As proposed when school boards crafted their budgets)</i>	\$10.1 million
Use Education reserve funds	\$5.9 million
Increase sales tax revenue to the Education Fund	\$1.5 million
Increase Purchase and Use tax to the Education Fund	\$0.2 million
Use undesignated Education Fund balance	\$0.7 million
Total	\$18.4 million

Under the legislature's budget, the base education payment for Fiscal Year 2011 will be frozen at \$8,544 per pupil. School boards worked hard this year to craft responsible budgets in difficult times. While crafting school budgets with the base education payment frozen will be a challenge, we are confident school boards will continue their hard work to hold down spending. By giving school boards advance notice of the rate, they can begin working with their communities now with a greater degree of predictability to craft responsible budgets next year.

This budget approach strikes a responsible balance between cost containment and local control.

• *Fighting for Vermonters* •

While the budget picture is bleak, the Committees of Conference fought hard to protect Vermonters, include language to prevent unilateral layoffs of state employees, restore at least partial funding to many programs and make important investments.

State employees: Vermont’s state employees make sure our government works for Vermonters. The legislature’s budget ensures that our state workers get the respect they deserve while still asking them to contribute to our fiscal solutions.

While the budget does rely on \$14.7 million in payroll savings (compared to the Governor’s proposed \$17 million), it also includes language to protect state employees from unilateral layoffs and stipulating that some of the savings must come from reductions in contracts and exempt positions:

Reductions in contracts	\$1.3 million
Cuts from non-union positions	\$2.4 million
Cuts from union employees	\$11 million

If the administration is unable to negotiate a compromise with union employees that does not include layoffs, it must present a plan for the cuts to the Legislative Joint Fiscal Committee by June 10. The budget language stipulates that the Joint Fiscal Committee must approve the reduction plan before employees can be terminated.

The budget language provides additional protections for employees at the St. Johnsbury prison by requiring the administration to receive approval from both the Joint Fiscal Committee and the Legislative Joint Corrections Oversight Committee before closing or significantly reducing operations at a correctional facility.

Finally, the budget includes a limited retirement incentive to save state dollars and reduce the need for layoffs. State employees who are eligible for retirement on July 1 can apply for the retirement incentive between June and August of this year.

Current Use: Though the Conference Committee originally considered a \$3 million cut to the Current Use program, conferees ultimately found additional federal stimulus dollars and updated revenue numbers to fully fund the program for this year. The budget language tasks the Current Use Advisory Task Force with making a recommendation on how best to save \$3 million from the program next year.

NOTE: The attached list of cuts includes a \$1.6 million cut to Current Use. That funding was restored through a companion bill, H.12, passed alongside the budget

Protecting vital programs and services: Even as the legislature made difficult choices about cuts, new revenues and tax shifts, the legislature’s budget sheltered important programs and services from further draconian cuts. The programs and services protected by the legislature’s budget and investments made include:

- VPharm – helps senior citizens pay for prescription medication. The Governor proposed eliminating the program; the legislature’s budget ensures that Vermont seniors continue to have access to the prescriptions they need.

- June Grads program – helps developmentally disabled students transition out of high school. The Governor’s budget proposal provides no funding for these Vermont students; the legislature’s budget provides nearly \$1 million to ensure June grads transition successfully from high school.
- The legislature’s budget increases PILOT payments to towns to ease the pressure on local property taxpayers.
- The Governor proposed slashing \$1.3 million from Aid to Aged, Blind and Disabled Vermonters. The legislature protected these Vermonters and restored half of this cut.
- Agency of Human Services grant programs, including grants for homeless shelters and Residential programs – the Governor proposed a 4 percent cut; the legislature’s budget halved that to 2 percent and provided flexibility for how those cuts are applied.
- Reach Up and Reach Ahead help unemployed Vermonters get back to work. The Governor proposed significant cuts in spite of the current job environment. The legislature ensured that Vermonters continued to have access to these important services.
- The legislature’s budget invests \$4.1 million in economic development to support Vermont businesses and entrepreneurs.
- The FY 2010 budget makes significant new investments in child care to ensure working parents can hold down jobs.
- The budget also invests \$1 million for Home Access to help Vermonters with disabilities renovate their homes to make them more accessible. The program will also create jobs for Vermonters in construction and renovation.

Building for the future: The legislature’s budget takes a number of important steps to build a more efficient and effective government for the future. Though these are difficult times, this budget takes the important steps we need to emerge stronger from this economic crisis. Examples include:

- Funding for reinvestment to bend the spending curve in the Department of Corrections, such as transitional housing and substance abuse services
- Providing for the Agency of Human Services to pursue an expanded Catamount health waiver
- Initiating a series of actions to increase the use of generic drugs to reduce pharmacy expenses
- Maintaining caseload reserves so they can be used to offset higher Medicaid premiums in a time of greater federal match