OneVermont

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March 16, 2015

The Honorable Shap Smith, Speaker of the House
The Honorable John Campbell, President Pro Tempore of the Senate
State House
115 State Street
Montpelier, VT 05633

Dear Speaker Smith and President Pro Tempore Campbell,

We're writing with concern about the current budget situation and with a proposal for a possible solution.

As has been stated repeatedly this session, Vermont has a structural budget problem. But, this is not a simple mismatch between revenue and appropriations that can be fixed with budget cuts. In fact, budget cuts do not necessarily eliminate costs and often create other fiscal problems.

The General Fund transfer to the Education Fund is a case in point. When the Legislature cut the transfer, it didn't reduce the cost of education; it merely shifted the cost to the property tax.

Medicaid is another example. Reducing payments to Medicaid providers does not reduce the cost of the services delivered by doctors and hospitals and other providers, but shifts the costs not covered by the state reimbursements to other payers—those with private health insurance or who pay for health care out of pocket. Gov. Peter Shumlin acknowledged this Medicaid cost shift when he proposed a 0.7 percent payroll tax, which would allow Vermont to start paying reimbursements that are closer to the real cost of the services being provided.

One structural budget problem the state faces is that its overall tax system is regressive. While Vermont does have a progressive income tax, which is projected to perform better than the other major General Fund taxes next year as it has in the past, the wealthiest Vermonters still contribute a smaller share of their income overall to pay for schools, roads, prisons, and child protection services than do middle- and lower-income Vermonters. That becomes a greater problem for revenue growth as more and more of the income of the state goes to those at the top, which has been the trend in Vermont, and the rest of the country, for more than 30 years.

The focus this session has been on the projected $113 million gap in the General Fund budget for fiscal 2016. But the $1.4 billion General Fund accounts for only a quarter of the state's annual spending, and it is necessary to look at the entire budget to understand another major structural problem: health care.

The $5.6 billion budget the governor proposed for fiscal 2016 represents an increase of $283 million over fiscal 2010 after adjusting for inflation. Within that total budget, health care-related spending will be up $367 million. That means spending for all of the rest of state government will have declined by $84 million.

Rapidly rising health care costs have been a problem for years, and Vermont took a big step toward addressing the problem when it created the Green Mountain Care Board with authority to regulate health care costs. But we can't continue to cut everything else state government is obligated to do while we wait for the growth in health care costs to come down to a sustainable level.

What the Legislature can do now:

1. Adopt the administration’s 0.7 percent health care payroll tax.
The governor has proposed a 0.7 percent payroll tax to raise the revenue the state needs to increase its payments to hospitals, doctors, and other health care providers. Meanwhile, the Green Mountain Care Board is making progress in slowing the growth of health care costs through regulation and redesign of the system for paying for health services. Both of these steps can begin to take the pressure off the rest of state government.

2. Refrain from making additional cuts to state services.
Cuts over the past decade or more have already undermined the state’s ability to competently deliver the services that Vermonters need and want. The failure to raise sufficient General Fund revenue to support these services has shifted costs onto the property tax and pushed up health insurance premiums. The recession has driven up demand for public services, and much of that demand continues. Nevertheless, for everything but health care-related services, the governor has proposed to spend less in fiscal 2016 than the state spent in inflation-adjusted dollars in fiscal 2010.

3. Eliminate income tax breaks and lower tax rates.
Many Vermonters may be surprised to learn that the state has had the second fastest growing economy in New England since the bottom of the recession in June 2009. Despite the comparatively strong economic growth, state revenues are growing more slowly than they were before the recession.

Vermont is one of six states in the country that still uses federal taxable income rather than adjusted gross income as the base for the state income tax. That means our top marginal rate is higher than necessary to raise the needed revenue. Additionally, tax breaks that primarily benefit upper-income taxpayers are undermining the progressivity and performance of the state’s tax system. The state can lower marginal rates, increase revenue, and improve the progressivity of the tax system by eliminating itemized deductions and replacing personal exemptions with a refundable tax credit.

As the attached Public Assets Institute analysis based on projected fiscal 2016 budget gap data from JFO shows, taking these steps will allow the Legislature to balance the budget while lowering income tax rates and make progress on addressing the structural problems that create budget gaps year after year.

We hope you will consider this approach to balancing the state budget this year and help Vermont to be a state that works for all of its residents into the future.

Sincerely,

One Vermont Steering Committee

Paul A. Cillo, President
Public Assets Institute

Andrea Cohen, Executive Director
Vermont Businesses for Social Responsibility

Joel Cook, Executive Director
VT-NEA

Karen Lafayette, Legislative Advocate
Vermont Low Income Advocacy Council (VLIAC)

Ed Paquin, Executive Director
Disability Rights Vermont

Sheila Reed, Associate Director
Voices for Vermont's Children

Julie Tessler, Executive Director,
Vermont Council of Developmental and Mental Health Services

Cc: The Honorable Peter Shumlin, Governor
The Honorable Phil Scott, Lt. Governor
Members of the General Assembly

Attachment

PUBLIC ASSETS INSTITUTE

Issue Brief
March 2015

How to Close the Budget Gap—Fiscal 2016 and Beyond

Vermont's elected leaders face another projected budget gap as they work to fund state services for fiscal 2016. They blame the gap on structural problems: a mismatch between the growth in revenues and the growth in spending. The prevailing response has been more budget cuts, which is mostly how they've addressed budget gaps for the past decade.

But cutting the budget year after year does not address the underlying causes. It simply shifts costs—onto property taxes or health insurance premiums, for example—and leaves more and more Vermonters without needed state services. But there are two things the Legislature can do this year both to close the projected budget gap and begin to address the underlying structural problems.

1. Adopt the governor's payroll tax
The governor's proposed 0.7 percent payroll tax would begin to create a rational way to pay for health care for the increasing number of Vermonters who rely on the state rather than private insurance coverage. This will reduce the upward pressure on the property tax and private health insurance premiums and stem the continuing cuts to state services.

2. Reform income taxes
Vermont is one of six states in the country that uses federal taxable income rather than adjusted gross income as the base for the state income tax. Because this base is lower, the state must set its top marginal rate higher than necessary to raise the needed revenues. Additionally, tax breaks that primarily benefit upper-income taxpayers unfairly burden lower-income taxpayers, while also reducing the amount the entire tax system raises. The state can lower marginal rates, increase revenue, and improve the progressivity of the tax system by eliminating itemized deductions and replacing personal exemptions with a refundable tax credit.

Income tax: Eliminate itemized deductions and lower tax rates

Additional revenue: $80 million

This reform uses federal adjusted gross income to calculate Vermont taxable income, replacing itemized deductions with a higher standard deduction and converting personal exemptions to a refundable credit. Both the standard deduction and the personal exemption credit phase out at higher incomes. All income for filers of $400,000 or more is taxed at the top rate.

Effect of change by income group

	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	< $24k	$24k –$43k	$43k –$65k	$65k –$105k	$105k -$195k	$195k –$435k	$435k+
Average Income	$14,000	$33,000	$53,000	$81,000	$134,000	$269,000	$1,081,000
Change: average tax	–$191	–$159	–$29	+$122	+$710	+$2,922	+$9,575
Change: % of income	-1.3%	-0.5%	-0.1%	+0.2%	+0.5%	+1.1%	+0.9%

Vermont Income Tax Brackets by Filer Type

CURRENT

Married Filing Jointly	Single	Married Filing Separately	Head of Household	Tax Rate
-	-	-	-	3.55%
$61,600	$36,900	$30,800	$49,400	6.80%
$148,850	$89,350	$74,425	$127,550	7.80%
$226,850	$186,350	$113,425	$206,600	8.80%
$405,100	$405,100	$202,550	$405,100	8.95%

PROPOSED

Married Filing Jointly	Single	Married Filing Separately	Head of Household	Tax Rate
-	-	-	-	3.50%
$50,000	$25,000	$25,000	$40,000	4.75%
$100,000	$50,000	$50,000	$80,000	7.25%
$250,000	$125,000	$125,000	$200,000	8.75%

The Institute on Taxation and Economic Policy (www.itep.org) in Washington, D.C., prepared the analysis and revenue estimate of the tax reform plan for Public Assets Institute. The revenue projection and estimated tax effects for taxpayers in various income brackets are for calendar year 2015.

Vermont Can Balance the Budget without More Cuts to State Services

FY2016 General Fund Budget Gap Analysis (in millions)[1]

	Governor's Proposal	One Vermont Proposal[2]
Initial FY2015 gap projection	($94.61)	($94.61)
Revenue downgrade (January 2015 Revenue Forecast)	($18.60)	($18.60)
TOTAL GAP	**($113.21)**	**($113.21)**
Anticipated FY2015 surplus	$2.00	$2.00
Proposed new revenue (details below)	$49.86	$114.36
Proposed budget cuts (details below)	$44.75	$0.00
(Gap)/Surplus after new revenue and budget cuts	**($16.60)**[3]	**$3.15**

PROPOSED NEW REVENUE DETAILS

	GOV	ONE VT
Eliminate state income tax deduction for state income taxes	$15.50	incl. below
Portion of 0.7% payroll tax (to cover Medicaid caseload increase)	$15.87	$15.87
Miscellaneous fees and revenue	$3.79	$3.79
One-time transfers		
Property transfer tax	$2.80	$2.80
Rainy Day Fund	$5.00	$5.00
Other one-time transfers and reversions	$6.90	$6.90
Income tax reform: Lower rates/eliminate itemized deductions	$0.00	$80.00
Total new revenue	**$49.86**	**$114.36**

PROPOSED BUDGET CUTS DETAILS

	GOV	ONE VT
Education Fund cuts used to reduce General Fund		
Current Use	$1.20	$0.00
Community High School of Vermont	$1.74	$0.00
Lottery revenue used to fund Veterans' Home	$1.00	$0.00
Cuts other than human services		
Current Use	$0.40	$0.00
Libraries, Judiciary, Natural Resources Board, etc.	$2.90	$0.00
Miscellaneous	$2.84	$0.00
Labor reductions		
Across-the-board savings (to be determined)	$10.79	$0.00
Human Services		
LIHEAP, Reach Up, general assistance, Legal Aid, etc.)	$21.15	$0.00
Offset reductions in federal funds	$2.73	$0.00
Total budget cuts	**$44.75**	**$0.00**

1 Data source for governor's budget gap proposal is a Joint Fiscal Office document dated February 11, 2015: http://www.leg.state.vt.us/jfo/appropriations/fy_2016/Major%20Components%20of%20Gov's%20$94M%20Gap%20Close.pdf

2 Public Assets Institute is a member of the One Vermont coalition and prepared this analysis for the coalition (onevt.org).

3 Revenue projections for fiscal 2016 were lowered a week after the governor presented his budget recommendations in January. The administration and legislative committees are working to close the remaining gap.

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