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Vermont's 2009 Budget: The State Should Step In, Not Step Back

by Jack Hoffman and Paul Cillo

Montpelier is in the middle of its annual budget battle. In January, Governor Jim Douglas told Vermonters how he would balance the state budget for fiscal 2009. By late March, the House will unveil its version of a balanced budget. In the meantime, the public has been left to sit by and watch the line-item by line-item skirmishes between the administration and the Legislature. Should Medicaid premiums be raised? Should town highway aid be cut? Should Vermont lease the state lottery?

What's missing is a frame that would help Vermonters understand what the squabbling is all about. Montpelier understands that the state is facing a difficult time for the next year — and probably longer. But no one has painted the big picture in a way that the public can see the problem and weigh the options for addressing it.

In this report, we attempt to paint the big picture for 2009; describe and analyze some of the budget-balancing strategies being proposed; and discuss how this process could work better in the future. We recommend the state:

- ***Publish current services budgets to make the state's fiscal situation clear to Vermonters.***
- ***Include the use of reserves, bonding, and targeted tax increases to respond to this economic slowdown.***
- ***Develop a long-term budget strategy instead of reactively adjusting spending to available revenue.***

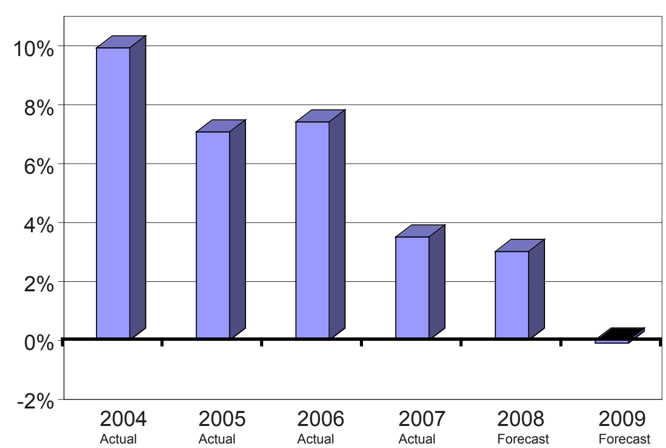
The state budget is more than a list of spending priorities for the ensuing year. It's a critical policy document that shapes where Vermont will be next year, the year after, and five or 10 years from now. The state's political leaders have a responsibility to recast the budget debate so that average Vermonters — and even lawmakers who are not on the Legislature's Appropriations Committees — can join the discussion about where the state is headed, how it should treat its citizens, and what kinds of services it should provide.

The 2009 Basics

The governor didn't mention the word "deficit" when he presented his budget in January, but that's clearly what his administration and the Legislature are trying to avoid. Their problem is that revenues are projected to drop next year, which means there will be no new money to cover the normal spending increases caused by inflation and population growth.

General Fund taxes are forecast to decline next year compared with this year (**Figure 1**). The drop is small — about $1 million out of total projected receipts of

Figure 1. Annual General Fund Revenue Growth



Source: Economic Review and Revenue Forecast Update, Jan. 16, 2008.

$1.18 billion — but rare.[1] In the last 30 years, General Fund tax revenue has declined from one year to the next only a handful of times, in most cases after the Legislature cut the tax rate.[2] Transportation Fund revenues — such as taxes on gasoline and new car purchases — also are projected to be flat. And federal funds, which account for nearly a third of the funds that pay for state services, could be lower next year as well.[3] At the same time, costs are going up on fuel and health care the state will have to purchase next year, and state employees are due for pay increases. Making matters worse is the economic crunch. Demand for government services like low income fuel assistance or health care will increase at the same time the funds to pay for those services are shrinking.

There are no official figures on the gap between how much Vermont will take in and how much it will need to meet all of its obligations and maintain existing services at current levels. Vermont does not require the administration to prepare a current services budget in conjunction with the governor's recommended budget — but it should. A current services budget is a projection of the cost of maintaining the current level of services, with adjustments for inflation, caseload changes, and other factors that are likely to influence costs. When compared with a budget proposed by the governor or the Legislature, a current services budget provides a yardstick to gauge whether the state is meeting its obligations, expanding them, or cutting back.

It's possible to estimate part of the gap, though, by looking at the governor's budget proposal. To make expenditures equal projected revenue, the budget calls for cutting and underfunding services, shifting costs onto other payers, deferring expenditures, and raising additional revenue.

It's evident that the administration saw a gap of at least $59 million that needs to be filled for fiscal 2009 (**Figure 2**). But that's not what the public has been hearing. Instead, they have heard about fights over individual budget items. Finding a comprehensive solution to the bigger problem — a potential shortfall of $59 million or more — would be a better approach than tackling each of the small problems in isolation.

Figure 2. Some of the steps the administration proposed to close the 2009 budget gap: [4]

Deferred contribution to teacher's retirement fund	$3,300,000
Deferred General Fund appropriation for employee pay raises	$7,000,000
Deferred appropriation for 2008 elections	$450,000
Cut low-income fuel assistance	$6,500,000
Cut smoking cessation funds	$8,200,000
Cut Vermont Housing and Conservation Board funding	$5,200,000 [5]
Cut payments to hospitals to offset provider tax	$8,000,000
Cut highway aid to towns	$8,000,000 [6]
Underfunded payments for childcare	$6,000,000 [7]
Underfunded assistance to needy families	$2,100,000 [8]
Raised revenue by increasing premiums for Medicaid recipients	$2,100,000
Shifted cost to Medicaid recipients by increasing copayments	$2,300,000
TOTAL	$59,150,000

Options for Managing the Projected Deficit

The administration and to a lesser extent the Legislature are looking to make do with available revenue — that is, they are "managing to the money." This approach means that government estimates state revenues first, then cuts back spending when projected revenues are insufficient to cover the projected costs of current services.

But that's not what people expect from government. When the state is hit by a crisis — a flood or earthquake, for example — citizens rightly expect their government to act. Economic recession, which is the primary driver behind Vermont's lagging revenues, is an economic crisis that requires government action. In relying heavily on spending cuts in response to a recessionary deficit, both the administration and the Legislature are stepping back at a time when the state should step in.

Here are additional options for dealing with this economic crisis:

Use Rainy Day Funds. Since the mid-1990s, Vermont has maintained rainy day funds for all its major accounts. The official name for these funds is "budget stabilization reserve," which aptly describes what the money is for. Currently, the state has about $58 million in the General Fund reserve and another $17 million in the human services caseload reserve. The reserves for the Transportation Fund are about $11 million, and for the Education Fund, about $27 million.

This is a good time for the state to use reserves to fill some of the holes in the budget. Any decision to use these funds would require a specific plan to replenish them. But they provide a way to maintain budget stability — that is, continuity of services for Vermonters — when money is short.

Increase Revenues. Despite the instinct states often have to cut spending to balance their budgets, cuts are more harmful to the economy than tax increases, particularly increases on those in higher income brackets.[9] A temporary tax increase on upper-income Vermonters was a major part of the recovery plan the governor and the Legislature crafted when the state had recessionary budget deficits in the early 1990s. Vermont shouldn't be afraid to use the same approach in this recession.

There has been some discussion this year about raising revenue, but not on those in the upper income brackets. The governor proposed the partial elimination of a tax break on capital gains, which he estimates would bring in $21 million in new revenue. Legislative alternatives boost this amount by as much as $10 million. But the governor proposed using these funds to pay for tax cuts for those in middle- and upper-income brackets. While eliminating the tax break is good policy, a recession is not the time to lower tax rates on those in upper-income brackets because it reduces the money that could be available to provide state services as demand for them is rising.

The governor called for leasing the state lottery to a private business, which he said could give Vermont a one-time infusion of $50 million. While the influx of money at the outset of the recession might be helpful, in the long run this plan, which has gotten a chilly reception in the Legislature, would depend on increased lottery sales that would come primarily from lower-income Vermonters.

The governor has also proposed raising state revenue by increasing premiums on Medicaid recipients. This wouldn't increase overall consumer spending that might help stimulate the economy; it just means low income families would pay more for health care instead of paying for some other essential.

Increase Bonded Indebtedness. During the 1990s, when the economy was strong, Vermont used surpluses to pay off some of its debt. That was a good idea. But now that the economy is slipping into recession, increasing state bonding for school improvements, state buildings, or highways would help pay for needed capital improvements and stimulate the economy through job creation.

A Better Process for Rational Budgets

The state budget process should not be an annual squabble over line items or a raid on piggy banks to get through another year. The budget is a concrete expression of the state's priorities — so a better dialogue with Vermonters is needed to make sure the budget reflects their priorities. Here are two concrete steps that would help make the annual budget process more rational:

Publish a current services budget. The federal government has been using current services budgets for more than 30 years, and about a dozen states have adopted the practice. It's a way for the public and all lawmakers to see whether government has the means to meet its existing commitments. It also can improve government efficiency by helping to identify services that are either underfunded or overfunded. It is an important document that the public should have.

Manage to a plan, not to the money. The short-term problem with trying to make do with the money available is that it forces government to reduce services just when demand is increasing.

It hasn't always been this way in Vermont. In the early 1980s and again in the early 1990s, the state ran up big budget deficits instead of making the deep cuts in services that would have been required to bring spending in line with the available revenue. The governor at the time took a counter-cyclical approach to state budgeting. He believed in maintaining slow but steady growth in state spending and wasn't afraid to raise taxes temporarily when the economy slowed. He also cut spending, but he recognized that the demand for government services increases when times are tough and tax revenues are soft.

There is also a long-term problem with trying to manage to the money and letting the state be at the mercy of the economy: the state cannot plan for the future or determine its own way forward. The poor condition of Vermont's roads and bridges is a stark example of the pitfalls of managing to the money.

The state can play a vital role in helping the economy, especially by planning, building, and maintaining public structures over the long term. But Vermont can't play that role if it has to wait each year to see how much money is available.

A better approach — and this is where the public plays its role — would be to envision where Vermont wants to be in the next two, five, and 10 years and lay out a roadmap for getting there. Once the plan is in place, the administration and the Legislature can manage to the plan and adjust revenues and spending to accomplish the goals the state has set for itself.

ENDNOTES

1 *Economic Review and Revenue Forecast Update*, Jan. 16, 2008, p. 24.

2 Joint Fiscal Office, revenue spreadsheet.

3 President Bush's proposed 2009 budget would cut funds to Vermont, but Congress won't act until next fall or perhaps even later.

4 *Fiscal Year 2009 Budget Recommendations, Fiscal Year 2009 Executive Budget Recommendations Summary*, Joint Fiscal Office documents, interviews with legislative and administrative staff.

5 Includes $4.6 million reduction in state funding for fiscal 2009 and $600,000 cut for fiscal 2008.

6 Includes $5.3 million cut in federal and state funds for town bridge projects plus an estimate of the effect of inflation on the cost of highway paving materials.

7 In Vermont statute (33 VSA § 3512) childcare reimbursement rates are based on federal poverty guidelines. The administration is using 10-year-old guidelines. Joint Fiscal Office estimates program costs would increase $6 million if current guidelines were used.

8 Caseload projection for Temporary Assistance for Needy Families (TANF) program for fiscal 2009 is lower than the caseload projection for fiscal 2008 as updated in January 2008.

9 Nicholas Johnson, *Budget Cuts or Tax Increases at the State Level: Which is Preferable During an Economic Downturn?*, Center on Budget and Policy Priorities, Jan. 8, 2008, available at www.cbpp.org/1-8-08sfp.htm

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Public Assets Institute

PO Box 942, Montpelier, Vermont 05601
802-223-6677
www.publicassets.org

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