



## A Cost Shift to the Education Fund: Smaller is Better

By Paul Cillo

Vermont property taxpayers dodged a bullet this year. The Legislature blocked the governor from transferring the cost of teachers’ retirement to the Education Fund. Had the governor succeeded, in two or three years local voters would have faced big property tax increases or deep cuts to their education programs.

The Education Fund, set up with the passage of Act 60 in 1997, pays for kindergarten-to-12th-grade education in Vermont. Total expenses paid by the Education Fund are projected at \$1.3 billion for fiscal 2010 – about the same as the state’s General Fund, which provides revenue for most of the rest of state government. But the two funds have been caught in a tug-a-war this year.

When the Education Fund was first established, some education-related General Fund obligations—including state aid to education and special education—were moved to the Education Fund, along with money that used to pay for them. The idea was that when an obligation went to the Education Fund, the funds to cover it went there too.

Over the past several years, however, this basic principle eroded, especially as General Fund expenditures, primarily from rising health care costs, exceeded revenue from existing General Fund taxes. This year, Governor Douglas proposed to transfer the state’s obligation for the teachers’ retirement system, currently a General Fund obligation, to the Education Fund as a way to relieve pressure on the General Fund. But the governor’s plan did not include a funding stream to cover this obligation.

Increasing the obligations on the Education Fund without increasing the state funds to cover them results in higher property taxes, the main source of Education Fund revenue. The governor’s proposal started with a transfer of the retirement obligation, which will

be about \$40 million in the coming year. But there is another, potentially larger obligation, to pay for health care benefits for retirees. Lawmakers feared the governor’s plan was just the first step in what would become more than a \$100 million cost shift to the Education Fund (**Table 1**). At current rates, that’s the equivalent of a 10-cent increase in the property tax rate. Fortunately, that didn’t happen. The Legislature passed

**Table 1: Projected State Liability for Retired Teachers<sup>1</sup>**

	FY2010	FY2011
Retirement benefits	\$41.5 million	\$59.9 million
Health care benefits	\$34-\$63 million	\$36.3-\$66.8 million
Total Obligation	\$75.5-\$104.5 million	\$96.2-\$126.7 million

Source: JFO

a budget without moving the retirement obligation. The governor vetoed the budget in large part because the property tax revenue he needed for his budget was not in the bill. And the Legislature overrode the governor’s veto preventing this massive cost shift to the property tax.

The governor also proposed other ways to make more room in the General Fund budget by shifting costs onto property taxpayers – and he was forthright about his intentions. “Like the Legislature, I proposed changes in the Education Fund to free up general funds to support important human services programs,” he wrote in a May 15 letter to Senate President Peter Shumlin and House Speaker Shap Smith. He wanted to limit the number of Vermonters who pay school taxes based on income, which would have meant higher property

taxes for them. The governor also proposed a cap on school spending, arguing that it would protect property taxpayers. In reality, what caps do is take away taxpayers' control over how to spend school tax revenue.

While both the governor and the Legislature proposed changes in the Education Fund, there are some important differences: The governor's cost shifts would ultimately have been much larger, but, more important, they would have been permanent. The Legislature enacted temporary transfers.

The Legislature relies heavily on federal stimulus funds to balance the fiscal 2010 budget. The net contribution of the Education Fund to the General Fund in fiscal 2010 is about \$18 million, with another \$18 million slated for transfer in fiscal 2011. While zero would be a better number for both years, these amounts are preferable to the much larger \$100 million annual cost shift.

Through all the rhetoric about not raising taxes, the bottom line is this: Shifting obligations to the Education Fund, without finding revenue besides the property tax to pay for them, will increase property taxes. Apparently this year the General Fund problem was so grave that some cost shift was unavoidable. But given the choice in the future between a large and permanent cost shift and one that's small and temporary, Vermont property taxpayers would be wise to choose the latter.

#### ENDNOTE

1 The health care liability will vary depending on whether the benefits are "pre-funded"—that is, paid in advance on a regular basis so that payments can earn interest. With pre-funding, the liability will be at the low end of the range; without pre-funding, it will be at the upper end.

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