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Vermont Must Address Both Budget Problems

by Jack Hoffman and Paul Cillo

Vermont faces two fiscal problems. One is temporary, brought on by the recession: Tax receipts are down, Vermonters' need for state services is up, and the state doesn't have enough money to provide those services. The other problem—papered over for years—is structural. Parts of the state budget are unsustainable, either because costs are growing faster or revenues are growing slower than the economy overall. The cost of health care, which has doubled in less than nine years, is the primary culprit, but it's not the only one.

Both problems are daunting, and solving either in isolation would be a challenge. But as the current tragedy in Japan demonstrates, crises don't always come one at a time. If Vermont had dealt with its structural problems earlier, it might have been in better shape to handle the temporary difficulties of the recession. Unfortunately, it did not.

To his credit, Gov. Peter Shumlin understands the importance of addressing the rapidly rising cost of health care. He took office determined to reform the way Vermonters pay for doctors and other health services—not just to bring costs under control but to achieve the important goal of providing quality, affordable care to all Vermonters. But health care reform is at least three years away, and between now and then at least three budgets will be written in the face of inadequate revenues. Who will shoulder the burden of bridging the gap? At present Montpelier is asking low- and middle-income Vermonters to take the hit in order to balance the budget, even while they struggle in a down economy. A better approach would be to have every Vermonter, including the wealthiest, go the extra mile to sustain the state—and its values—until reforms are accomplished and the economy is back on its feet.

Structural reform essential, but takes time

Just like businesses and households in Vermont, the state has been covering the rising cost of health care in part by cutting back in other areas. From 1999 to 2009, statewide health care costs increased 8.6 percent a year on average,[1] more than twice the rate of Vermont's economic growth during that period.[2] Many businesses have responded to these increases by pushing more of the cost of health insurance onto their employees. Families, in turn, have cut back on other expenses, switched to cheaper but riskier policies, or dropped their coverage altogether.

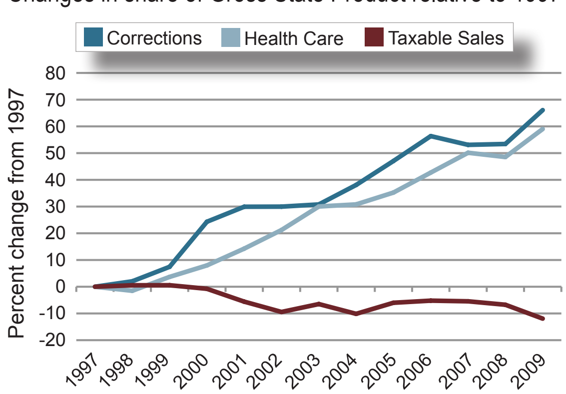
Health care costs also have been rising faster than the state budget. Medicaid and publicly supported health care programs now account for more than 30 percent of state-funded expenditures.[3] For much of the 2000s, Vermont used one-time revenue—extra federal funds or year-end surpluses—to pay for health care cost increases. But over the long run, health care has crowded out funding for other important state services.

Health care isn't the only structural problem. Corrections costs also have been increasing faster than the state's economy, while revenue sources such as the sales tax and motor fuel taxes have been growing more slowly. This above-average growth in expenditures and below-average growth in revenue have exacerbated the budget gaps brought on by the recession (**Figure 1**).

FIGURE 1

Health Care and Corrections Costs Soar, Taxable Sales Lag

Changes in share of Gross State Product relative to 1997



Data sources: Joint Fiscal Office; The Department of Banking, Insurance, Securities and Health Care Administration (BISHCA)

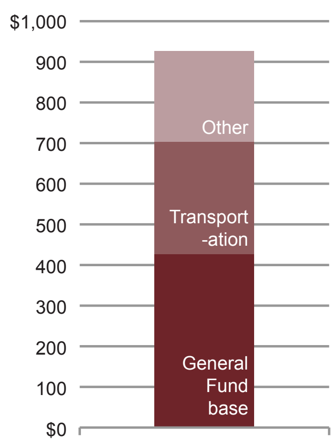
This all adds up to the urgent need for reform to solve these structural problems and put the state on the road to balanced budgets in the future. Without fundamental reform, simply making cuts or raising tax rates, or both, will not put the state on a sustainable budget path. The expenditures and revenue need to grow more in sync with one another, or Vermont will continue to struggle—and tinker—each year to make ends meet.

During his campaign, Governor Shumlin talked about the need for structural budget reform, and since his election he has followed through with proposals to begin accomplishing it. He is promoting an ambitious plan to overhaul Vermont's health care system and moving to reduce the state's prison population. So far, his plans have focused on the spending side. He has not addressed the structural problems on the revenue side. In fact, he rejected the Blue Ribbon Tax Structure Commission's proposal to extend the sales tax to services and lower the rate, which would bring tax revenue growth more in line with economic growth.[4]

FIGURE 2

Federal Stimulus of $900 Million Helped Balance the Budget

ARRA, FY2009-12, in millions



Data source: Department of Finance and Management

In the long run, the governor is probably correct that his plan will ease pressure on the state budget. But the needed reforms will take several years to put in place. In the meantime, to ask Vermonters to absorb another round of budget cuts—and Governor Shumlin is proposing to spend even less than his predecessor—is to ignore the cause of the state's current budget problem: a shortage of revenue, not overspending.

Recessionary measures versus permanent downsizing

When the economy collapsed in late 2007, it drove down revenues and pushed up the demand for public services. Vermonters lost their jobs, many more cut back spending, and state tax receipts declined. Meanwhile, more families turned to unemployment insurance, food stamps, Medicaid, and welfare to make ends meet, and the pressure for more public spending rose.

The response at the time from the Douglas administration was to push for permanent downsizing of state government, and in large part the Legislature obliged. The recession was a temporary, downward phase of the economic cycle. But both the administration and the Legislature acted as though there would be no recovery and Vermonters needed to adjust to a new, lower standard of living. The Legislature made $4 in cuts for every $1 in new revenue it raised. Between the fall of 2007 and the fall of 2010, nearly 700 state employees—8 percent of the workforce—were laid off or not replaced when they left.

State funding for education was cut in fiscal 2010 and 2011. Even with the help of federal stimulus funds, Vermont's General Fund spending on human services programs other than Medicaid fell by 5.6 percent from fiscal 2009 to 2011.

A new revenue problem: ARRA ends

The flow of federal funding from the American Recovery and Reinvestment Act (ARRA) is ending. For fiscal 2009 through 2012, Vermont will have received more than $900 million to help pay for health care, human services programs, highway maintenance and construction, job training, economic development, and education.[5] A little less than half of the stimulus money—about $423 million—was used to support core programs in the General Fund budget (**Figure 2**). About $276 million went to transportation projects. The balance of the money funded programs designed to create jobs and help the economy—programs and projects Vermont probably would not have funded on its own.

The fiscal 2012 budget presented by Governor Shumlin in late January is the first in four years that doesn't rely heavily on federal stimulus funds. It uses some ARRA funds, but much of that is stimulus money carried forward from the previous year.

ARRA funds that were used in 2011 for core General Fund services will be gone: $158 million. In addition, Vermont will lose almost $17 million in other federal funds related to Medicaid.

There are also new demands for public services next year. As an indication of how the recession has hit Vermonters, the number of people receiving food stamps through the 3SquaresVT program rose 67 percent from the start of the recession in late 2007 through December 2010. The number of people in the Reach Up program, which replaced Aid to Needy Families and Children (ANFC), increased 30 percent over the same period. According to the administration's projections, General Fund spending for Medicaid and other human services programs needs to increase about $67 million for fiscal 2012—nearly 12 percent over this year—to meet new demand (**Table 1**).

In addition, the administration acknowledged the obligation to restore General Fund support for education, which was cut for the last two years. That added another $22 million to next year's budget. In all, the administration identified almost $110 million in new General Fund spending needed for fiscal 2012—a 10 percent increase.

On the revenue side, receipts are starting to grow again, after declining 8 percent in fiscal 2009 and almost 6 percent in fiscal 2010. General Fund taxes, which include the personal income tax, sales tax, rooms and meals tax, and corporate income taxes, are forecast to increase by $66.4 million. Most of that increase—$60 million—is expected to come from the personal income tax, which is projected to grow by more than 11 percent in fiscal 2012.

Counting growth, transfers, and carry-forward revenue, the administration anticipates about $108 million in new money for next year. But the loss of federal funds, primarily from ARRA, leaves a gap of $176 million—13 percent of the General Fund budget—from what is needed.

Closing the gap

In late January, Governor Shumlin outlined a plan to close next year's budget gap with about $81 million in additional cuts and $95 million in new revenue, including reserve funds and other money carried forward from fiscal 2011 (**Table 2**). The governor has rejected any increases in broad-based taxes, such as the personal income tax or sales tax. However, he proposed additional taxes on health care providers, including hospitals and dentists.[6]

He also proposed a permanent reduction in the annual transfer from the General Fund to the Education Fund. For fiscal 2012, about $19 million in federal funds are going directly to school districts, which will offset most of the reduction in General Fund support for schools. In fiscal 2013, however, the governor's proposed cut in the General Fund transfer would mean school districts either have to cut spending or increase property taxes. In either case, property taxes will

TABLE 1

Additional Funds Needed to Maintain Services in FY2012
In millions

Additional spending	
Human services	$67.10
Education	21.77
Other	20.58
Total	109.45
Reduced federal funds	
ARRA	158.11
Other	16.80
Total	174.91
New money needed	**$284.36**
New money	
General Fund revenue growth	$66.40
Transfers and carry-forward	41.70
Total new money	**108.10**
FY2012 budget gap	**$176.26**

Data source: Department of Finance and Management

TABLE 2

Governor Would Close Gap With Revenues and Cuts
In millions

Projected gap	**$ 176.26**
General Fund cuts	
Human Services	(43.80)
State employee pensions	(2.00)
Labor and contractual savings	(8.00)
State employee health plans	(2.00)
Transfer to Education Fund	(23.18)
Homeowners rebate and current use	(0.92)
Rest areas (to Transportation Fund)	(4.00)
Reserve fund adjustment	3.24
Total General Fund changes	**$ (80.66)**
Revenue	
Health care provider taxes	36.70
Carry-forward	26.20
Federal funds	3.60
Human services caseload reserve	29.10
Total additional revenue	**$ 95.60**

Data source: Department of Finance and Management be higher—approximately $20 for each $100,000 of property value—than they would have been if the General Fund continued to maintain its pre-recession levels of support for education.

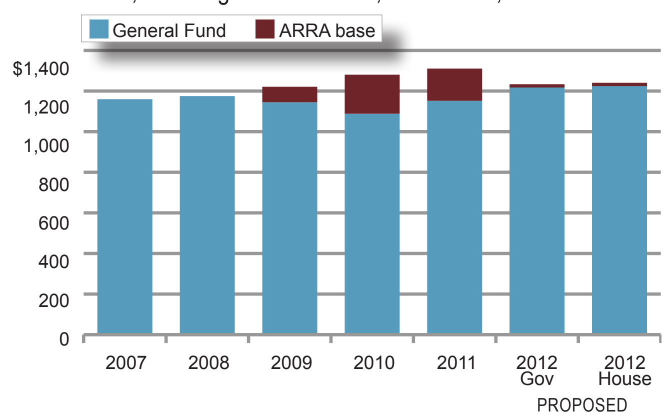
Including federal ARRA funds that were used for base appropriations, Vermont's General Fund spending is projected to be about $1,310 million this year. The General Fund budget the governor has proposed for next year is $1,234 million[7] —a reduction of 5.8 percent (**Figure 3**).

The Vermont House of Representatives passed a General Fund budget in late March that is about $7 million higher than the governor's plan, but it is still lower than the amount Vermont spent this year, including stimulus funds used for core expenditures.

FIGURE 3

Governor, House Cut Spending for FY2012

General find, including stimulus funds, FY2007-12, in millions



Data source: Joint Fiscal Office

ARRA provided funding for essential state services over the past three years, so the loss of those funds has created a big hole for the administration to fill in fiscal 2012. Both the governor and the Vermont House have done what they can with all available revenues to minimize the pain for Vermonters least able to weather it. But neither the governor nor the House has been willing to increase any of the broad-based, General Fund taxes, so their proposed budgets reduce General Fund spending by more than 5 percent next year. Included in the cuts are programs that protect Vermonters most in need of support.

Human services hardest hit

Human services, the largest area of the state budget, accounts for $574 million (44 percent) of the $1,310 million in General Fund spending this year.[8] If cutting dollars is the goal, it follows that this area of the budget is being targeted for the biggest reductions.

In budget documents, the administration said this year's General Fund appropriation needed to increase by $67 million just to maintain existing human services programs in fiscal 2012 (**Table 1**). That would have brought the General Fund total for the Agency of Human Services to $641 million. However, the governor proposed $554 million for the agency—$87 million less than the acknowledged need.

Some of that will be made up in other parts of the human services budget. The governor proposed raising about $47 million through health care provider taxes and transfers from other state funds, which would reduce some of the pressure on General Fund spending for human services. Still, the governor's budget leaves General Fund support for human services about $40 million short. And this reduction in state spending will be compounded by a loss of federal matching funds.

The Legislature's Joint Fiscal Office estimates that the governor's human services budget, when all state and federal funds are counted, will be about $80 million less than the amount needed to maintain existing services. The House budget, which restored some of the cuts the governor proposed, is still about $68 million short, according to the JFO estimate.[9] The effect of these cuts will be felt most by low- and middle-income Vermonters.

This squeeze in human services has meant that agency programs have been pitted against one another. For example, Vermont has programs to provide varying levels of services that allow elderly and disabled Vermonters to remain in their homes. These Choices for Care programs offer a better quality of life for people who don't want to go into nursing homes, and they cost much less than institutionalized care.

In the fiscal 2012 budget, the Human Services Agency plans to maintain essential services for people now served by Choices for Care, which include assistance in bathing, using the toilet, meal preparation, and similar routines of daily living at home. However, to reduce overall spending, the governor proposed cutting the next level of services, such snow shoveling, grocery shopping, and banking. His budget would reduce services for these so-called "instrumental activities of daily living" to two hours a week from the current four and a half hours.

The governor's budget included other cuts in programs that serve somewhat less needy Vermonters in order to protect those most in need. He recommended that respite care be reduced for Vermonters who care for sick or disabled family members. In some cases, respite care provides the caregivers with time to earn outside income that allows them to continue to help a bedridden parent, spouse, or sibling. However, the governor's budget would halve the maximum amount of respite care services—to 360 hours a year from the current maximum of 720 hours. The assumption seems to be that these families will make do and find other relatives or community members to provide the help political leaders insist Vermont can no longer afford.

The House version of the budget restored some of the governor's cuts in Choices for Care and respite services. Still, the decision boiled down to how much to cut, rather than weighing the reduction in services against the options for replacing the lost revenue.

Needed: Temporary revenue—and strong Vermont values

Structural reforms show the greatest promise of achieving sustainable fiscal policy over the long term. But even the most optimistic forecasters project we won't start seeing results from health care reform—the reform with the greatest potential to bring the state budget under control—until 2015. For the next few years, times will remain tough, as federal stimulus funds dry up, state tax revenues stay low, and thousands of unemployed Vermonters continue to look for work. Until the economy recovers, the state faces continued budget gaps.

A plan for temporary revenue increases is needed to provide a bridge until the benefits of planned reforms become real. The state can use temporary funds, including untapped reserves[10] and a surcharge on those who are doing well in this economy, to help balance the budget.

Fortunately, a source of revenue for that surcharge is available. With the extension of the Bush tax cuts, Congress has given the top 5 percent of Vermont income tax filers a big federal tax break, amounting to $190 million each year for 2011 and 2012. This windfall to the wealthiest Vermonters stands in stark contrast to the plight of families now forced to decide whether to spend time bathing an elderly parent or shoveling her snow—or the myriad untenable tradeoffs being asked of the elderly, children, people with developmental disabilities, and all low-income and middle-class Vermonters.

The state budget—a plan for how money is both raised and spent—is an expression of a state's values. Vermont's progressive income tax reflects a belief that those who prosper the most from our economy should contribute the most to the support of the courts, police, schools, public works, and public welfare programs that make civilized society possible. We have a property tax rebate program because we believe Vermonters should not be forced to sell their homes to pay their taxes, especially after they retire and their incomes decline. Our higher-than-average spending on schools reflects the importance we attach to educating our children.

We now have a choice: Abandon the values that have shaped and sustained our state, or require that everyone, including the wealthiest, make an extra effort so that the burdens of this recession and Vermont's recovery are not borne primarily by poor and middle-class Vermonters.

States across the country are wrestling with this same two-part budget problem: lagging state revenues and greater human need in the aftermath of the Great Recession on top of soaring health care costs and other structural deficiencies that have been building for decades. Some states are showing just how bad things can get as governors and legislators slash services—education, care for the elderly, safe roads and bridges, and other essentials—in order to protect those with the highest incomes from additional taxes.

Vermont could well become a model for addressing both parts of the state's budget problem in a sane and civilized manner: Raise temporary revenue to help Vermonters climb out of this recession, and address the biggest budget buster, health care.

ENDNOTES

1. Vermont resident health care expenditures, Department of Banking, Insurance, Securities, and Health Care Administration, Vermont Health Care Expenditure Reports, 1999-2009.

2. According to U.S. Bureau of Economic Analysis data, the compound average annual growth rate of Vermont's gross domestic product was 4.2 percent 1999-2009.

3. The cost of Medicaid and health programs (not including state employee health care benefits) are projected to rise at an average annual rate of 4.4 percent FY2008-2012. Overall, state-funded expenditures, excluding the Education Fund, are projected to rise at an average annual rate of 2.9 percent for the same period.

4. The Vermont Blue Ribbon Tax Structure Commission recommended that Vermont extend the sales tax to most retail services, (Final Report, Recommendation 2, page 49). Governor Shumlin rejected that recommendation (vtdigger.org, Tax reform: Part 1, Feb. 3, 2011).

5. This is only the money received by the state and does not include approximately $340 million in tax cuts to individual Vermonters in 2009 and 2010 or federal grants and loans to private businesses.

6. The so-called "provider taxes" have typically been paid by health care providers, matched by federal Medicaid dollars, and then re-paid to providers. This would be the case for the dentists, but other health care providers would no longer receive the repayment.

7. Including $4.9 million in ARRA money carried forward from fiscal 2011.

8. Including $116 million in ARRA funds used to cover what the administration and Legislature characterize as base appropriations.

9. "Total Appropriations FY09 (actual) - FY12 HAC Proposed March 2011," Joint Fiscal Office, http://www.leg.state.vt.us/jfo/appropriations/fy_2012/FY08_-_FY12_Total_Appropriations_Comparison.pdf#page=19.

10. Vermont is projected to have nearly $58 million in the General Fund Stabilization Reserve at the start of FY2012. According to a new report from the Center on Budget and Policy Priorities, of the 44 states that had reserves in 2006—either "rainy day funds" or General Fund reserves—28 used at least half of those funds during the recession to avoid budget cuts. Vermont is one of 15 states that increased their rainy day funds during the recession.

Elizabeth McNichol and Kwame Boadi , "Why and How States Should Strengthen Their Rainy Day Funds," Center on Budget and Policy Priorities, September 2011: Table 5, p. 22.

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