



A Balanced Way to Balance the Budget

By Jack Hoffman

In the end, the Vermont Legislature found a balanced solution to balancing the state budget for fiscal year 2010, which begins July 1. After a gubernatorial veto—the first budget veto in the state’s history—and a dramatic override in a special session on June 2, lawmakers put in place a budget that uses a combination of cuts and taxes to cover part of the drop in revenues. The federal government also provided a big and timely boost, designed to help states weather the recession.

In Vermont, there were more cuts than taxes. While spending reductions totaled about \$76 million, the net effect of tax changes and increased enforcement will bring in about \$28 million more than had been anticipated for fiscal 2010 (**Table 1**). In the wake of cuts to the fiscal 2009 budget, an even split between taxes and additional cuts in the coming year would have been better. But by maximizing the use of federal stimulus money and also raising additional revenues, the Legislature protected services that could have been lost had Montpelier followed its usual practice of managing to the money—that is, balancing the budget by cutting services to make expenditures equal existing revenue—rather than raising adequate revenues to support needed services.

Table 1. Closing the FY2010 Budget Gap

The problem	
Projected need for FY2010 General Fund	\$1,322 million
Projected revenue (before tax changes)	1,044 million
Projected budget gap	\$278 million
The solution	
Federal stimulus funds	\$174 million
Spending reductions	76 million
Net new revenue	28 million
	<u>\$278 million</u>

Source: Legislature’s Joint Fiscal Office

Cuts

The biggest budget reductions were in education and Medicaid. The Legislature cut \$18.4 million, or about 7 percent, of the annual transfer from the General Fund to the Education Fund. It also cut \$15.1 million from a variety of Medicaid programs. Most of those reductions will fall on providers—hospitals, doctors, and nursing homes—although seniors in the VPharm program will have to pay a \$1 higher copay for their prescription drugs.

The state payroll also took a big hit: \$14.7 million. It’s not clear yet what this will mean for programs and services. If all the reductions are made through layoffs, an additional 300 to 400 state employees could lose their jobs, depending on what share of their salaries are paid out of the General Fund. In the last two years, about 400 state jobs have been eliminated, leaving the total number of state employees at about 8,200.

Taxes

The Legislature made several tax changes to produce nearly \$28 million in new revenue for fiscal 2010 (**Table 2**). These include changes to the estate tax, sales tax, and taxes on liquor and tobacco. The largest increase comes from changes to the Vermont income tax, which will also have the overall effect of making it more progressive—that is, taxes will increase more for those in the highest income brackets. The Legislature also lowered tax rates, so many Vermonters will see their income taxes drop. Overall, the income tax changes will generate an estimated \$9.5 million in additional revenue for fiscal 2010¹.

The main income tax changes were:

- **Reducing the deductibility of state income taxes.** In the past, taxpayers who itemized their deductions could count the full amount of their state income taxes among those deductions. Now they will be able to claim no more \$5,000. This change

will affect primarily those with incomes of \$125,000 or more.

- **Limiting the exclusion of capital gains income.**

Previously, 40 percent of capital gains income was not subject to income taxes. Under the new law, which takes effect this July 1, taxpayers will be allowed to exclude a fixed amount of capital gains income rather than a percentage. From July 2009 through 2010, the fixed amount will be \$2,500. However, during that period, taxpayers over 70 years old will be allowed to choose the fixed amount or 40 percent. Starting January 2011, the amount will increase to \$5,000, and the exclusion will be the same for taxpayers of all ages. Taxpayers with capital gains on farm sales and timber sales will continue to be eligible for the 40 percent exclusion.

Table 2. General Fund Tax Changes

Reduction in marginal income tax rates	-\$22.4 million
Change in deduction for state income taxes	16.2 million
Change in capital gains exclusion	15.5 million
Increased tax compliance and elimination of ARRA tax credit for new vehicles	6.3 million
Increase tax on cigarettes and tobacco products	5.9 million
Estate tax increase	3.0 million
Sales tax on liquor	2.4 million
Sales tax on digital downloads	0.7 million
Total	\$27.6 million

Source: Joint Fiscal Office

By stepping up tax compliance and blocking a tax break on the purchase of new vehicles that was included in the federal stimulus bill, the Legislature expects to bring in another \$6.3 million.

Difficult Choices

Vermont's budget struggles are far from over. There will be about \$100 million in stimulus money avail-

able for the state's fiscal 2011 budget, not nearly as much as in fiscal 2010. While forecasters predict the economy will begin to improve in the next 12 to 18 months, tax revenues will still be below pre-recession levels. Even after the stimulus funds are applied, the state is projecting a \$67 million deficit in fiscal 2011.

Health care is a critical problem. Health care costs in Vermont were growing at a much faster rate than the economy even when the economy was doing well. Rising health care costs have pushed General Fund spending for health care up at a rate of 15 percent each year. Since health care accounts for about a quarter of the General Fund budget, reform that slows health care spending is critical. That's why it is imperative that Congress make significant changes in the health care system. A federal solution would be better, but failing that, Vermont will have to find its own solution if it is going to have a sustainable budget.

When the Legislature returns next January, it can expect to confront the same basic choices it faced this year. Policymakers need to keep in mind that the ultimate goal is not simply to balance the budget, but to provide the services Vermonters need. That means ensuring that the state takes in sufficient revenue to pay for those services. Once again, a balanced approach will be the best policy.

ENDNOTE

¹ A summary of all tax changes is available on the Vermont Tax Department website: <http://www.state.vt.us/tax/pdf.word.excel/legal/legislation/Highlights%20of%202009%20Legislation.pdf>

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