



## 2012: With Federal Protection Gone, Education and Human Services Are in the Crosshairs

by Jack Hoffman

**A** little more than a year ago, the federal government stepped in to help the states weather the recession. When Vermont's next fiscal year ends on June 30, 2011, the state will have received \$874 million through the American Recovery and Reinvestment Act (ARRA). That money has been supporting the delivery of state services. In addition, Vermonters have received hundreds of millions in federal tax cuts, and other stimulus funds have been available to private businesses.

ARRA—commonly known as the stimulus program—has been a boon to Vermont during these hard times. But the temporary funds also have masked weaknesses in the state's fiscal policy. There are structural problems, including the unsustainable rise in health care costs and outmoded tax policies, that have grown over the years. More recently, there has been a concerted effort to reduce the size and cost of government without changing what it is expected to do.

In 2012, when the ARRA funds cease flowing from Washington, a crucial debate over Vermont's budget priorities, especially education and human services, will resume. Its outcome will determine whether we return to having a state government that competently and efficiently delivers the services that individuals can't provide on their own, or we continue to underfund government and make it less effective.

### How to Face a Downturn

Recessions are a difficult time for any government. The economy contracts, workers lose their jobs, and tax collections decline—so the state has fewer resources just when people are turning to it for help.

Some political leaders respond to recessions by using all the tools at hand to maintain important services: rainy day funds, budget cuts, tax increases, temporary

federal funding, borrowing, even deficit spending. Gov. Richard Snelling and the Legislature used all those tools when they attacked the state's last big recession in 1991. They recognized that Vermonters needed more, not less, from their government when the economy was shrinking. The state emerged from that slump on a firm fiscal footing, which allowed it to roll back most of the tax increases and budget cuts.

During his eight years in office, Governor Douglas has been clear about his desire to reduce the size and lower the cost of state government. He has held to that position through this recession, too. He doesn't subscribe to Snelling's counter-cyclical fiscal policy. Instead, he says that when families and businesses cut back, government must cut back, too.<sup>1</sup>

In January 1991, Snelling told Vermonters: "We cannot and will not set lower standards for the education of our children, for the health of the population, for assistance to the troubled, jobless, or homeless, or for protection of the environment."<sup>2</sup> Eighteen years later, this was Douglas's message: "The truth we must all accept is that we can no longer afford the level of services we have come to enjoy."<sup>3</sup>

While the governor has sought to lower expectations, his administration hasn't said what functions and services should be eliminated. He has pressed local school boards to reduce education spending, but hasn't said anything about lowering performance standards. There are fewer state employees working with fewer resources, but except for the judiciary's decision to close the courts on certain days, the basic jobs of state government have not been changed. Despite a promise not to "nickel and dime services . . . [to] a point where our programs are no longer able to serve their purposes,"<sup>4</sup> that has been the result of some recent budget cuts.

The Legislature for the last three years has stood somewhere between Snelling's counter-cyclical approach and Douglas's determination to reduce state spending. Legislative leaders have been willing to use federal stimulus funds to make up for lost state revenue. But they, too, have called for "belt-tightening" and been almost as resistant as the governor to raising taxes.

Even with hundreds of millions in ARRA funds, the recession has left Vermont with gaps between available revenue and the cost of needed services. The Democratic-controlled Legislature passed modest tax increases in 2010, but during fiscal 2009 and 2010 it approved \$4 in cuts for every \$1 in new tax revenue.<sup>5</sup> This year, the Legislature rolled back some of last year's tax increase and closed the fiscal 2011 budget gap almost exclusively through cuts.

The governor also has been willing to use ARRA funds; as chairman of the National Governors' Association, he sought federal help from President Obama and Congress. But back in Vermont, his acceptance of Washington aid seemed almost grudging.

"I am not counting on additional federal [Medicaid] assistance in my budget," Douglas said. "But even if new aid does eventually come our way, we must recognize that federal recovery funds will not flow forever, nor should they. We must take responsibility for our own programs and begin to step down our funding levels gradually and responsibly. By starting now the difficult process of realigning human services spending within currently available resources, we will spare programs from devastating cuts when the federal spigot is inevitably turned off."<sup>6</sup>

At a time when thousands of Vermonters were losing jobs, the administration resisted participating in a program to provide hot meals to poor schoolchildren that was fully funded by the federal government.<sup>7</sup> (It eventually gave in.) Among the more than 700 state positions eliminated in recent years, some were funded entirely with federal money. Cutting the federally funded jobs saved no state money, took the money out of the state economy, and put workers on Vermont's unemployment rolls.

Similarly, the administration has pushed for Medicaid cuts that end up costing Vermonters more money. For every \$1 in Medicaid cuts, the state saves 30 cents and the federal government saves 70 cents. Meanwhile,

the full cost of those services is shifted to low-income families—or those people go without. Where Medicaid is concerned, it costs Vermonters \$1 to reduce the state budget by 30 cents.<sup>8</sup>

## More with Less

Challenges for Change was the Legislature's attempt to reduce spending without undercutting important public services. The government reform plan, developed by a group of Minnesota consultants, recommended ways to "do more with less"—to increase efficiency so that agencies and departments could cut their budgets and still improve or at least maintain the quality of services. Challenges for Change has provided one of the rare instances in recent years of a discussion about delivering better government services.

The plan was unveiled at the start of the 2010 session and garnered broad support. The Legislature quickly endorsed the goals laid out by the consultants and

FIGURE 1

## Challenges for Change: FY2011 Spending Reduction Plan

	Gross Savings	General Fund Savings
<b>Charter Units</b>	<b>\$ 2,000,000</b>	<b>\$ 2,000,000</b>
<b>Performance Contracts</b>	<b>2,600,000</b>	<b>2,600,000</b>
<b>Regulatory Efficiencies</b>	<b>125,000</b>	<b>125,000</b>
<b>Economic Development</b>	<b>965,600</b>	<b>965,600</b>
<b>Human Services</b>		
Office of Vermont Health Access	10,652,000	3,799,568
Department of Children and Families	6,026,100	3,401,100
Department of Mental Health-forensic evaluation	200,000	200,000
Designated agency Challenge ideas	6,730,669	3,162,963
Community Driven Initiatives	2,000,000	2,000,000
Department of Corrections	6,028,548	6,028,548
<b>Total Agency of Human Services</b>	<b>31,637,317</b>	<b>18,592,179</b>
<b>K-12 Education</b>	<b>17,330,000</b>	<b>6,070,000</b>
<b>TOTAL</b>	<b>\$ 54,657,917</b>	<b>\$ 30,352,779</b>

Remainder needed to reach General Fund goal savings of \$37.8 million \$7,500,000

Data source: Joint Fiscal Office

committed to the plan's savings before knowing how they would be achieved. When legislators later saw the administration's implementation plans, many had second thoughts.

The fiscal 2011 budget assumes \$38 million of Challenges for Change savings in the General Fund, of which about \$30 million have been identified so far. Of those, more than half—\$18.6 million—are expected to come from human services (**Figure 1**).

One of the main criticisms of Challenges for Change is the absence of adequate measures to determine whether the reforms will, in fact, improve services.

The problem is compounded by the fact that some of the state employees laid off in recent years were those who collected and analyzed information needed to assess the government's performance. The Agency of Human Services, for instance, last produced its annual assessment of the state's social programs, "Vermont Well Being," in 2006.

Critics of Challenges for Change, including those who support its general goals, believe the administration has seized on the plan as another way to reduce the size and cost of government, regardless of the effect on Vermonters. "Efficiency savings" has begun to look like another way to cut the budget and reduce services—to do *less* with less.

### Gaps in the General Fund

Vermont's fiscal 2011 budget relies on \$320 million in ARRA funds, including \$54 million for transportation projects and a \$46.7 million increase for federally funded education programs (**Figure 2**). The remaining stimulus money has gone into General Fund programs, most of which would have been funded with state revenue if the federal money had been unavailable. The administration and the Legislature's Joint Fiscal Office have concluded that \$181.4 million of ARRA funds were used in the fiscal 2011 budget to

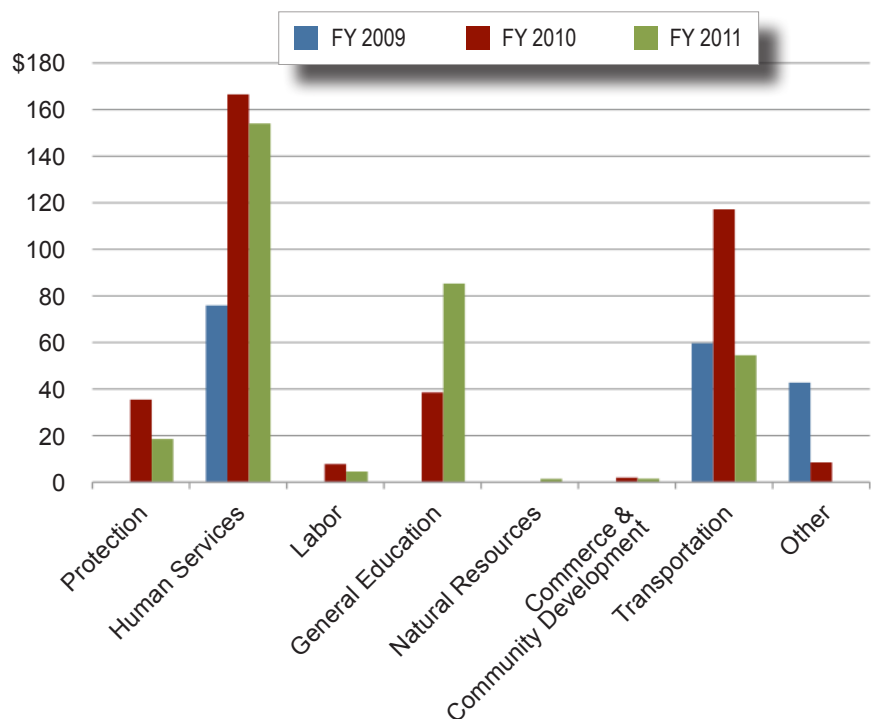
cover appropriations considered part of the General Fund base budget—that is, expenditures for continuing programs that the state expects to make year in and year out.

Fiscal 2011 is the last year for federal recovery money. For fiscal 2012—just a year away—Vermont will have to go back to relying on its own revenues to pay for General Fund obligations. While the state does not expect to replace all the federal funds, it is likely to cover those base budget expenditures. Looking ahead to some revenue growth and other changes, the Joint Fiscal Office is forecasting a \$120 million hole in the General Fund base budget in fiscal 2012.

FIGURE 2

### Where Vermont's Stimulus Funds Were Spent

ARRA Fund appropriations, FY2009-2011, in millions



Data source: Joint Fiscal Office

The budget projections for fiscal 2012, including the potential deficit of \$120 million, assume that the savings from Challenges for Change will be expanded in fiscal 2012, and there will be \$72 million in efficiency savings that year. If the efficiencies are not realized, the gap will be bigger.

## ARRA: A Bridge to What?

It was always understood that the recovery funds were temporary. The question is how to incorporate these temporary federal funds into a budget plan that sets the state on a sustainable path.

The problem policymakers face is a compound one. The recession has reduced revenue to operate state government at time when Vermonters need government to do more. Furthermore, the downturn has come on top of long-term economic changes that have made it more difficult for the state to meet Vermonters' needs and balance its budgets. For decades, health care costs have grown at nearly twice the rate of the overall Vermont economy. Taxable sales have diminished as a percentage of the overall economy; motor fuel taxes, levied on a per-gallon basis, have been lagging as higher fuel prices move Vermonters to use less. These and other structural issues require reform before Vermont can expect both to sustain existing services and balance its budgets. The solution will require something more creative than budget cuts.

The governor clearly has seen the ARRA money as a bridge to smaller, leaner state government. His philosophy is simple: "Manage to the money." In this case, that means when the stimulus funds run out, cut state services to adjust.

Others have seen the recovery funds differently: as a way to maintain the state's most critical services until the economy picks up and necessary structural reforms can be enacted. The expectation is that a stronger economy reinforced by structural reforms will provide sustainable revenue to support the services and other public structures in which Vermont has invested over the years.

Despite its over-reliance on cuts to deal with the current crisis, the Legislature also has made progress on health care and tax reforms. It established the Blue Ribbon Tax Structure Commission in 2009, which is looking at ways to modernize Vermont tax system. It also appropriated funds to design three options for a new health care system for Vermont, which will be ready for review early next year.

State revenues are beginning to grow again, but the projected budget gap for fiscal 2012 means they're not yet growing fast enough.

## Education and Human Services At Risk

Temporary federal money can be a double-edged sword. On one hand, it can be a lifesaver for maintaining critical services. But when the money is gone, those same services can suddenly become the most vulnerable. Among these are education and human services, which together account for three-quarters of state spending. Although the Legislature has resisted some of the administration's efforts, Governor Douglas has targeted these two areas for reductions, especially as he prepares to leave office. It remains to be seen whether the next governor and Legislature will maintain Vermont's commitments to high-quality education and the services and public structures that make the state a good place to live for all its citizens.

Much of the recovery money given to Vermont and the other states came with requirements for how it could be spent. That was true for most of the human services funding. With some of the ARRA money, states had more flexibility. Vermont chose to use these so-called Fiscal Stabilization Funds, given to the governors, to cover some of the state's share of education funding. The administration and the Legislature could have used the stabilization funds to replace state dollars for other programs and left all of the state funds for education intact. Instead, they put the money into education, which makes it vulnerable when the federal money dries up.

Between the loss of ARRA money and other cuts to education, the Legislature needs to come up with \$60 million to restore the General Fund commitment to education to its pre-recession levels. Already, this shortfall of education funding is being portrayed as a big culprit in the projected \$120 million budget gap for fiscal 2012—so pressure is building to get local school districts to cut their budgets rather than make up the lost revenue at the state level. If school districts choose not to make cuts that they believe will undermine their children's education, and the Legislature doesn't restore education funding, local residents will face another round of property tax increases.

In human services, the loss of recovery money will leave another big hole. The General Fund appropriation for the Agency of Human Services in fiscal 2011 is expected to be about \$437 million if the Challenges for Change savings are realized. That would be about \$65 million less than the General Fund appropriation

for the agency in fiscal 2008, before any ARRA money was available.

Assuming even the modest budget growth rate of 3.5 percent that the Joint Fiscal Office typically uses and continued savings from Challenges for Change, the Human Services Agency will need an increase of about \$65 million in fiscal 2012 just to maintain existing services.<sup>9</sup>

### Needed: New Revenue

Since the recession began, Vermont's elected leaders have looked to budget cuts and federal help to address the revenue shortfall. Over the governor's objections, the Legislature did raise some taxes in 2010, but these were outweighed by cuts. In fiscal 2011, new tax cuts cancelled out whatever small tax increases the Legislature approved. Meanwhile, the Legislature cut another \$110 million from General Fund programs to balance the budget.

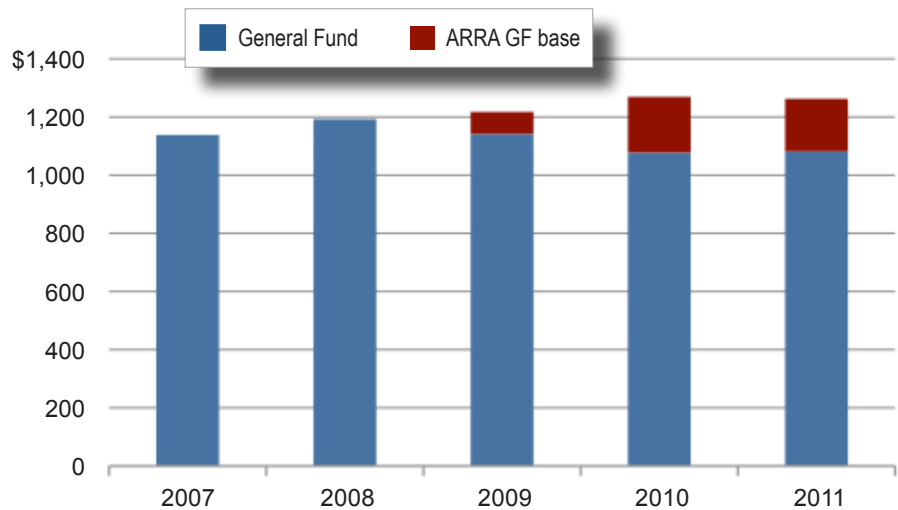
Vermont could have taken a balanced approach through the recession and used an equal measure of spending cuts and new state revenues, including reserves, to make up for the shortfalls. The result would have been a more stable budget situation going into fiscal 2012 when the temporary federal ARRA funds run out.

With the help of the ARRA funds, Vermont's General Fund base budget grew at an average annual rate of 2.6 percent for fiscal 2007-2011.<sup>10</sup> That is not enough to cover the normal growth in General Fund spending, let alone the increased demand for state services during a recession (**Figure 3**). The state workforce has been reduced, and the deterioration in the delivery of services is beginning to show. The courts have reduced their operating hours,<sup>11</sup> the state has closed bridges because it can't afford to repair them,<sup>12</sup> and Vermonters with developmental disabilities have fewer support services.<sup>13</sup> But if Vermont fails to find new revenue after the stimulus money is gone, the deterioration of services will accelerate.

FIGURE 3

## ARRA Funds Provided Modest Spending Growth

Base General Fund expenditures FY2007-2011, in millions



Data source: Joint Fiscal Office

### Conclusion

So far in this recession, Vermont's elected leaders have not asked Vermonters to step up to help maintain the essential public services that are important to their quality of life. Voters in many local communities did that on their own when they rejected calls from Montpelier to cut their school budgets. In the face of decreased state funding for education, they accepted higher property taxes rather than undermine their children's education.

If the Legislature does not restore the lost federal funding for education in fiscal 2012, that will mean a further shift onto the property tax. And without increased revenue to restore the human services budget, poor and vulnerable Vermonters will continue to bear the heaviest burden of this recession.

## ENDNOTES

1. “It is unfair and unacceptable for us to expect the people of Vermont—who are making difficult budget choices everyday in their homes and businesses—to pay for an unwillingness to make tough budget decisions.” Gov. Jim Douglas, Inaugural Address, Jan. 8, 2009.
2. Gov. Richard Snelling, Inaugural Address, Jan. 10, 1991.
3. Gov. Jim Douglas, Budget Address, Jan. 22, 2009.
4. Gov. Jim Douglas, Inaugural Address, Jan. 8, 2009.
5. Public Assets Institute, *Reducing State Services: The Wrong Fix*, December 2009.
6. Gov. Jim Douglas, Budget Address, Jan. 19, 2010.
7. Public Assets Institute, *No Supper for Schoolchildren*, December 2009.
8. Public Assets Institute, *Medicaid Math*, February 2009. Under ARRA, the Medicaid match rate for Vermont was increased to 70 percent federal and 30 percent state.
9. Public Assets Institute analysis of appropriations data from the Joint Fiscal Office.
10. Ibid.
11. Public Assets Institute, *Vermont Judiciary*, October 2009.
12. Public Assets Institute, *Vermont’s Bridges are Going Nowhere Good*, February 2010.
13. Public Assets Institute, *A Step Backward for Developmentally Disabled Vermonters*, April 2010.

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## Public Assets Institute



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