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### The Budget: Follow the Money



*and watch your wallet*

by **Tom Pelham**

In January, the Governor submitted his FY 2013 budget recommendations to the legislature and now the House has also passed their version. While coverage by the main stream media has been generally acquiescent and superficial, there is reason for taxpayer's to pay full attention. There is much risk baked into the fiscal course upon which the House has embarked which can readily generate pressures for higher taxes, although likely after this fall's elections. Possibly the Senate can address these pit falls before the legislature leaves town.

To understand these risks, referencing the JFO document, "[GF Summary and Outlook](#)", is helpful.

While the entire state budget is much bigger than just the general fund addressed in the "GF Summary and Outlook", the general fund is the main repository of broad based taxes such as the income tax, sale tax, corporate tax, etc. For broader context, it's also helpful to understand that total state spending has grown during this recession from \$4.1 billion in fiscal 2008 to \$4.7 billion in fiscal 2012, for an increase of \$608.3 million. Unfortunately, most of Vermont's reporters somehow find a way to craft this increase as a "cut" or "axe wielding". The House's proposed budget for fiscal 2013 amounts to an additional increase of \$299.2 million, or 6.4%.

As Vermont's Finance Commissioner during the 1990's, my job was a) to help remedy the fiscal mess left from the Kunin years, b) to structure state spending so that it was on a sustainable, stable and affordable track through economic cycles, and c) to provide Governor Dean as much fiscal flexibility as possible to support his spending priorities. All three of these required a perspective of constrained spending growth or in liberal legislative parlance, "black hat" budgeting. "White hats" prefer pushing the budget envelope, which is in vogue today, and if their budget becomes a budget buster, they'll push the tax button.

When I left the Finance Office after nine years, I was pleased to see that Vermont's bond rating had been restored to the best in New England, our "rainy day" reserves were full, the Snelling tax increases had been sunset, that spending was on a track commensurate with long term inflation and economic growth, that Governor Dean got to spend dollars in areas important to him (purchasing the Champion Lands and VHAP for example) and that Vermont, unlike most other states, easily withstood the massive revenue collapse associated with the 2000 "dot-com" bubble bust. Further, I was pleased to see that Governor Dean's fiscal legacy could withstand the full-court scrutiny of the national media in his presidential pursuit.

Given all that, here are some "black hat" concerns Vermonters should embrace about current budget proposals at the state house, while keeping in mind as well the added risks of legislation associated with health care reform and the cost shifting of millions in subsidies for alternative energy onto ratepayers, for example.

#### Revenue Risk:

- **Current Law Revenue:** Current law Revenues profiled in the "GF Summary and Outlook" for fiscal 2013 are projected at \$1,257.9 million or 5.8% more than the \$1,189.4 million for fiscal 2012. In turn, fiscal 2012 revenue is projected at a seemingly reasonable 2.8% increase over the fiscal 2011 amount of \$1,156.69. However, actual revenues for fiscal 2012 through February have, so far, been short of expectations by \$15 million, with more shortages likely to follow. More shortages are likely to follow because fiscal 2012 revenue expectations are built on top of the extraordinary 11.4% percent increase experienced in fiscal 2011 over fiscal 2010. This 11.4% increase in fiscal 2011 was not driven by underlying economic growth in Vermont's economy. It was mostly driven by one-time forces such as a 64% increase in the stock market in the 18 months prior to the end of the fiscal year and tax anomalies at the state and federal level. Given this, the current \$15 million shortfall is likely to be sustained or even grow as returns for March and April are recorded.
- **Direct Applications and Reversions (DA&R's):** DA&R's are revenues into the general fund from non-tax sources. These include, for example, funds from prior years "reverted" back to the general fund and unbudgeted revenues from other funds, such as special funds, that with the approval of the legislature can be redirected to the general fund. Prior to the recession, the normal "run rate" of DA&R's was far less with amounts being \$24.69 million and \$16.64 million for fiscal 2007 and 2008 respectively versus the \$35-\$41 million seen more recently. During recessions, budget managers are tasked with opportunistically scavenging the financial nooks and crannies of state government for available cash, thus the higher levels of DA&R's more recently. One can see their "one-time" nature by those added this session by the House, including the recent one-time mortgage settlement by the nation's attorney generals with banks (Vt's share - \$2.7 million) and a recent \$250,000 fine on United Health Care. DA&R's, at current high levels, are not a reliable revenue source and by the end of recessions, these "cookie jars" are usually striped dry.
- **Reserves and the "real" Rainy Day Fund:** Even though the House budget assumes a 5.8% increase in general fund revenues for fiscal 2013, this still wasn't enough to support their spending appetite, so they dug into the \$23.52 Human Services Case Load Reserve by almost \$21 million while sending the balance of \$2.77 million to a "real" Rainy Day Fund. Some in the

media ballyhooed the creation of this new “real” Rainy Day Fund as “salting away money for a rainy day” while missing the larger fact entirely that almost the full corpus of the Human Service Caseload Reserve was being depleted. A successful misdirection play on the part of House Speaker Smith? Bottom line is the House budget for 2013 relies significantly on spending one-time reserves.

This is one-time money for which a replacement must be found going forward through either cuts or efficiencies, or higher taxes. Further, if fiscal 2012 revenues do not meet expected targets, as currently is the situation, these reserve funds might be depleted before 2013 even arrives.

Overall, a prudent course under current circumstances would be to assume a Current Revenue shortfall of at least \$15 - \$20 million for 2012 which would be duplicated for 2013; a 2013 shortfall of \$10 million in DA&R’s for 2013, and a \$20 million depletion of the Human Service Caseload Reserve in fiscal 2012. These revenue risks total \$50 million for fiscal 2013.

#### Appropriations (Spending) Risk:

- The Agency of Human Services: One can see from the “General Fund Summary and Outlook” that the House budget calls for an overall 6.3% spending increase for 2013 over 2012. However, this spending growth is not distributed equally across state government. The House proposal recommends an 8.5% increase for the Agency of Human Services (AHS), leaving at best only meager increases in other areas of government. For example, the House gave the Agency of Natural Resources a 2.6% increase (which is still a decrease of \$2.2 million since fiscal 2008), gave no increases to Vermont’s higher education institutions like UVM and the Vermont State Colleges, and cut the General Government functions by 3.4%, in part by cost shifting some expenditures in the Treasurer’s Office onto retirement funds.

The above movement of general funds to the Agency of Human Services is a long term trend that squeezes resources from other areas of state government. In 2008, AHS consumed 38.2% of current law general fund revenues, at \$458.1 million. The House proposed budget assigns 46%, or \$578.9 million, of these revenues to AHS for fiscal 2013. Since as far back as fiscal 2000, state support for the AHS budget has grown at almost 7.6% annually even though Vermont’s population is growing at less than 1% annually. This growth is often fueled by federal funds which, when they recede, as they did with recent ARRA funding, the legislature diverts general funds from non-AHS programs to fill the gap rather than adjust AHS spending.

Should general fund revenue targets not be achieved or federal reductions pending in Washington become realized, given the above expansions of AHS programs at the expense of the remainder of state government, it’s either budget cuts for AHS or tax hikes on the rest of us.

- Education Spending: While not directly a general fund item, the House increased spending from the Education Fund by \$14.7 million. That’s the difference between the Governor’s call for level funding and the 3% increase approved by voters on town meeting day. This spending increase will show up on property tax bills unless the legislature agrees to restore the \$23.2 million raided from the education fund last year.

Details supporting the above and profiling state spending over the past 5 years by agency and department can be found here:

[http://www.leg.state.vt.us/jfo/appropriations/fy\\_2013/FY09-FY13\\_Funding\\_Summary\\_House.pdf](http://www.leg.state.vt.us/jfo/appropriations/fy_2013/FY09-FY13_Funding_Summary_House.pdf)

[http://www.leg.state.vt.us/jfo/appropriations/fy\\_2013/FY09-FY13\\_Funding\\_Summary\\_House.pdf](http://www.leg.state.vt.us/jfo/appropriations/fy_2013/FY09-FY13_Funding_Summary_House.pdf)

[http://www.leg.state.vt.us/jfo/appropriations/fy\\_2013/Direct%20Apps\\_Reversions\\_Transfers\\_FY12\\_FY13.pdf](http://www.leg.state.vt.us/jfo/appropriations/fy_2013/Direct%20Apps_Reversions_Transfers_FY12_FY13.pdf)

[http://www.leg.state.vt.us/jfo/appropriations/fy\\_2013/FY13%20HAC%20General%20Fund%20Outlook.pdf](http://www.leg.state.vt.us/jfo/appropriations/fy_2013/FY13%20HAC%20General%20Fund%20Outlook.pdf)

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