

JAMES H. DOUGLAS
GOVERNOR



State of Vermont
OFFICE OF THE GOVERNOR

April 21, 2010

The Honorable Peter Shumlin
President Pro Tempore
Vermont Senate
State House
Montpelier, VT 05609

Dear Senator Shumlin:

With the House finishing its work on H.792, *An Act Relating to Implementation of Challenges for Change*, all the major money bills are now in the Senate awaiting action. As I mentioned in our meeting this morning, I wanted to share with you and your colleagues some of my concerns regarding the status of the fiscal year 2011 budget, its implications for fiscal 2012 and other unfinished business critical to restoring Vermont's economic health.

I have been encouraged by the improved dialogue between legislative leaders and my Administration. An important tone was set at the outset of this year when we stood together to announce "Challenges for Change." While embarking on a new and altogether different style of budgeting has caused skepticism – and at times cynicism – among some, I appreciate the commitment of you and Speaker Smith, as well as the commitment that legislators of all parties have shown to this process.

That said, as this biennium winds down, I remain concerned that so many critical items remain unaddressed. Important issues like education reform and unemployment insurance (UI) trust fund reform, tax relief and responsible budgeting were not acted on last session and I fear that they may be put off yet again.

The Opportunity Before Us

As our state begins to recover from a long and difficult economic illness, the Legislature's choices this year will determine whether the Vermont economy bounds into full health – stronger than before – or backslides into unhealthy practices that portend a slow and halting recovery. With revenues not expected to rebound to pre-recession levels for several years, the Legislature must not revert to the easy answers of using reserve funds for ongoing expenses, banking on rosy revenue forecasts, or worse: raising taxes even higher when Vermonters have no tax capacity left.

If nothing else, this recession has served as a wake-up call that we must do things differently to make government sustainable and affordable for Vermonters. A robust economy will always provide the strongest safeguard for our exceptional system of health care and human services and remove uncertainty for working families, employers, and others who rely on state programs.

In recent weeks, I have observed a growing complacency among some lawmakers to halt the work of reform, to rest on the hope of rising revenues and simply wait for the storm to pass. This is the clear fork in the road: are lawmakers content to survive the recession only to return to an unsustainable status quo? Or do they resolve – as I do – to complete the unfinished business of necessary reform to make Vermont stronger and healthier than before?

A sustainable budget is a prerequisite to a robust and growing state economy. Because job creation and economic growth are the stated priorities of all this session, we must use this opportunity to institute a forward-looking state budget that makes the difficult, but necessary, reforms this year. I caution legislators to remember that even after we solve our \$154 million general fund gap for fiscal year 2011, there is at least a \$100 million shortfall in fiscal year 2012 – a reality that is ignored at the peril of Vermonters.

While I appreciate the difficult work of House members in crafting a fiscal 2011 budget, the Senate must take a different path than the House in crafting a spending plan for the state, as well as advance serious reforms to education spending and the UI trust fund. To foster an environment of economic growth in Vermont, state government must ensure stable budgets that do not threaten to increase taxes or require deep cuts to programs in the future.

Unfortunately, the House passed budget does not accomplish this, but instead guarantees higher taxes now and in the future, which will stifle our nascent recovery. It does so in three ways: it relies on taxes passed last year; it explicitly raises taxes this year; and it promises tax increases next year.

Fiscal Year 2010 Tax Increases

Last year, the Legislature chose to override my veto of the budget and raise more than \$21 million in new taxes on Vermonters. The taxes raised by capping the deductibility of state taxes, changing how capital gains were taxed, increasing the estate tax, increasing the liquor tax, and imposing a digital download tax, among others, have been a drag on our economic recovery. These new taxes were used to prop up unsustainable spending – as opposed to containing spending growth – last year.

Again this year, the House relied on these taxes to support levels of spending that cannot be supported by taxpayers over time. Further, those taxes are having a detrimental effect on our economy evidenced by the testimony of business leaders at your jobs forum in January. One employer testified that “current business owners are going to shoulder an increased tax burden as more and more Vermonters choose to relocate to tax-friendly climates and more potential business investors bypass Vermont.” The Senate Economic Development, Housing and General Affairs Committee heard similar testimony earlier this year as well.

To those who are quick to invoke Governor Snelling’s response to the fiscal crisis of the early 1990’s as a justification for increasing taxes again this year, I would remind them of the taxes raised last year. And since we cannot undo the initial imposition of these taxes, we must honor the second phase of the Snelling proposal and sunset the taxes that were raised. That is why I am renewing my call that the capital gains and estate tax increases be rolled back on January 1, 2011 to encourage job creation and economic growth in Vermont.

House Passed Fiscal Year 2011 Tax Increases

Rather than take steps to improve our state’s tax competitiveness, the House passed budget actually moves in the opposite direction by increasing taxes on farmers, manufacturers, contractors – among others – and those who purchase dietary supplements. As a state, we must do all we can to encourage, *not discourage*, those industries – like farming, manufacturing and the building trades – that contribute to the livelihoods of so many in our state. And we should surely not be discouraging healthy lifestyles by levying higher taxes on dietary supplements. There is simply no reason to raise taxes again this year.

On the slight chance that revenues for either fiscal year 2010 or 2011 come in higher than expected, the first order must be to return that money to taxpayers by rolling back other tax increases from last year and investing in another sales tax holiday. The sales tax holiday is a tremendous boon for small businesses and the least we can do to give families a break during these difficult times.

Future Tax Increases Without Education Fund Reforms

One of my greatest concerns is that the Legislature will not address the long term, structural problems in the education fund. There has been no more forceful advocate for limiting the property tax burden on Vermonters than I. Time and again I have proposed education funding changes that would have limited the growth of property taxes only to see them rebuffed by the Legislature. We cannot forget that controlling property taxes

not only provides needed relief for many overly taxed Vermonters; it is an economic imperative as property taxes are among the greatest tax liabilities facing employers.

I commend school districts and local voters who made difficult decisions to nearly level fund school spending at Town Meeting Day. It is now time for Montpelier to respond with reforms that will provide even greater relief to struggling homeowners and small businesses. Local voters and volunteer school boards should not have to make all the hard choices while the Legislature fails to take action to ease the property tax burden.

The consequence of inaction is dire. The House spending plan leaves a large hole in the fiscal year 2012 education fund that must be filled by either large property tax increases, shifting the burden onto other taxes, or squeezing resources from other general fund priorities. In fact, the House relies on money raised from their proposed tax increases to support the education fund and offset property tax rate increases this year. Let me be clear, raising one tax to offset another is not tax relief and it is not a fiscally responsible or sustainable solution to reining in property taxes.

The House passed budget obligates an increase in the general fund costs associated with the education fund in fiscal year 2012 of nearly \$70 million – and that is assuming school districts level fund their budgets again. If this plan stands, the next Governor and the next Legislature will be left with terrible choices. If the Legislature does not honor the commitment to the education fund, property taxes will increase by at least \$70 million. If the commitment is made to the education fund, then there will be no money available to replace ARRA funds now supporting many important programs in human services and other vital areas or funds to support any increases in spending pressures.

The bottom line is that by not addressing the education fund, the House passed budget leaves extraordinary uncertainty about the State's fiscal health. Because it represents such a large portion of our future budget shortfalls, doing nothing in the education fund is not an option. I have presented realistic ideas for containing education costs next year and beyond, such as requiring a prospective 20 percent share of health care premiums for teachers, phasing out "phantom students" and bringing the student to teacher ratio to a reasonable 13 to 1 – still among the very lowest in the nation. Further, the Legislature must act on reforms to find economies-of-scale in our system of education that has over 350 distinct governing bodies in a state with 251 towns.

I have proposed property tax relief measures and education reforms in each of the past five legislative sessions. Each time, every January, the common and united response from education advocates, lobbyists and legislators is that the reforms cannot be implemented without disturbing budgets that school boards have already crafted. This year, my Administration sounded the alarm early as school boards were forming budgets,

and boards and voters responded. But in the State House, the same cadre of advocates, lobbyists and legislators faithfully and successfully argued to the Legislature that there wasn't enough time to act.

In my view, it is never too late in the session to give property tax relief to Vermont families; taxpayers do not have the luxury of time and elected leaders should not squander such a rare gift. With over seven months until school boards begin the budget process and over 14 months before the fiscal year 2012 budget starts, the Legislature has a unique opportunity to make fundamental reform that will take effect the year after next – giving boards, voters and communities plenty of time to plan and prepare. If next January, a new Governor and new General Assembly are met with the same song from the same chorus of narrow interests, and nothing is done yet again, the only losers will be Vermont taxpayers.

UI Reforms and Future Concerns

In addition to the taxes raised last year, the taxes raised in the House budget this year and the potential tax increases next year if you do not take action now, there is other unfinished business that affects the economic well-being of Vermonters that must be addressed. The UI trust fund cannot go another year without a fix. Maintaining the status quo could mean as much as a \$172 million tax increase on employers over the next decade due to the loss of the FUTA tax credit. It could also mean \$112 million in interest payments from the general fund over the next decade – money that would not be spent on programs and services for needy Vermonters.

Not only will inaction increase taxes on employers and divert funds from important state priorities; it will ultimately require steeper increases to the taxable wage base and a deeper reduction in benefits to bring the fund to solvency. I appreciate the constructive conversations we are having on this issue and I remain hopeful that we can find a solution.

Although the Legislature made some progress this year on reforming the teachers' retirement system, significant challenges in our teachers and state employee pension systems remain. Despite the retirement commission's clear recommendations, no movement was made on modifying the state employees' retirement system and I fear that increasing retirement costs will continue to crowd out other important government priorities. Also, the Legislature must take meaningful steps to address how teachers' retirement is funded. Continuing to pay for the teachers' system through the general fund will likewise push out other important priorities and exacerbate the challenges in both the education and general funds.

Challenges for Change

While “Challenges for Change” has garnered much attention and is an important component to closing our budget gaps for years to come, we must keep in mind that the \$38 million saved in making state government more efficient is a mere quarter of our general fund deficit for fiscal year 2011. And even with the full \$72 million in Challenges savings for fiscal year 2012, we still have an estimated \$100 million or more budget gap.

With \$17 million in outcome-based efficiencies identified in the House, I recognize the difficult task ahead in the Senate to achieve the targeted \$38 million in savings. My Administration will continue to work closely and collaboratively with both chambers to resolve the remaining proposals. But if legislators do not choose Administration proposals, it is their responsibility to offer their own alternatives that meet the mandated outcomes and are fiscally sustainable - meaning without tax increases or the use of reserve funds.

Conclusion

The economic outlook for Vermont remains uncertain. Like the rest of the nation, and most of the world, we have experienced the deepest and longest recession in generations. Although unemployment in Vermont is well below the national average and the severity of our budget shortfalls may not be as acute as some other states, we must not take comfort in our relative position.

In my State of the State address I said that “the trajectory of the Vermont economy for the next decade will be shaped by the decisions we make this year.” This is indeed a watershed year for our state. If we rely on high taxes, put off tough decisions in the education fund and in “Challenges for Change,” and if we do not act on the UI trust fund crisis, uncertainty will remain for families, businesses and working Vermonters. But if we act affirmatively to make our tax climate more competitive, put education and general government spending back on a sustainable path and shore-up the UI trust fund, then Vermonters can move into the next decade of the 21st century with the certainty required for a strong and robust economy.

Too often in the State House, the perceived lack of time becomes an excuse for a lack of progress. I understand that some lawmakers are eager to adjourn. During my time in public service, I have always believed that a citizen legislature should dispense its duties in a timely manner. But I also know that the job must be completed and the hard work cannot be pushed off for another year. The challenges are not new, in fact many of them are issues we have faced for years, decades, even longer and with the fiscal health


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of our state hanging in the balance, there can be no excuse for inaction. We must resolve these fiscal and economic challenges today.

In the coming weeks, we must work quickly and smartly, and, if needed, nights and weekends to get the job done. My Administration is ready to labor side-by-side with you and your colleagues to put Vermont on a sustainable course for the next Governor and the next General Assembly.

I look forward to working with you to set Vermont on a course for success in the short time we have left in this legislative session.

Sincerely,



James H. Douglas
Governor

JHD/pdc

c: Speaker Shap Smith
Senator Bill Doyle
Representative Patti Komline