

Understanding the Urgency for Vermont Tax Reform: A Progress Report

August 9, 2016

Context

In January, Champlain Housing Trust, Preservation Trust of Vermont, and the Vermont Land Trust (the Partners), together with knowledgeable advisors, committed to empirically analyzing Vermont's revenue system and then meeting with emerging state legislative leaders. This commitment was based on two assumptions:

- The Vermont tax code is structurally broken. Because Vermont's economy has evolved over many years, tax revenue from Vermont's current tax structure no longer reflects the breadth and strength of Vermont's economy. The current mix of primary sources -- income tax, property tax, sales tax -- are applied to a narrow tax base, creating higher tax rates and more volatile tax revenue than is desirable. The tax base and tax vehicles do not generate enough revenue to support essential governmental services without creating hardship and unfairness. A continued over-dependence on the current mix of sources and the existing narrow tax base creates unsustainable burdens for Vermont taxpayers.
- These structural problems in our tax base force the Legislature to make impossible choices. We cannot have a meaningful conversation about issues challenging Vermonters -- from health care and poverty, to climate change, to healthy farms and forests, to investing in our local communities -- if our tax structure is unstable, and does not reflect our economy. Absent structural change, the budget process will continue to erode essential services delivered by Vermont's non-profit community to Vermonters.

The Partners' goal is to build a foundation to help create a revenue system designed for the 21st Century. For reform to happen, there must be a carefully considered plan and the political will to move it. While we cannot create political will, we can develop a well-crafted plan that interested policymakers could advance. An important first step to creating such a plan is to articulate a clear case for revenue reform, an explanation that is based on solid research, readily understandable to Vermonters, and able to withstand the scrutiny of skeptics.

Revenue Analysis

The Partners contracted with Public Assets Institute to develop an understanding of and document the need for Vermont revenue system reforms. The work involved research using data from the Joint Fiscal Office, Department of Taxes, Department of Finance and Management, and other available in-state sources. Data and analysis was also secured from out-of-state sources including the Center on Budget and Policy Priorities, Institute on Taxation and Economic Policy, Economic Policy Institute, US Census, and work in other states.

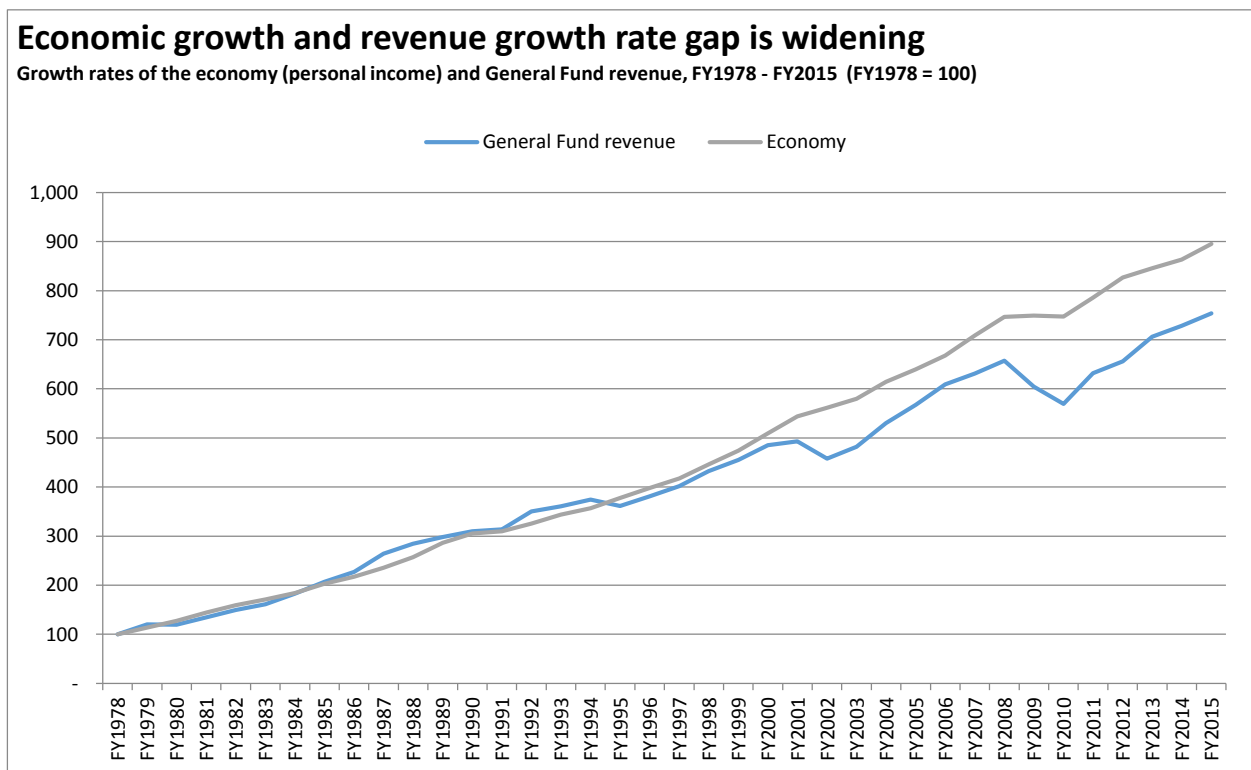
This research attempted to answer the following questions:

1. Why does the state have chronic state budget gaps?
2. What is the relationship between state spending, state revenues, and performance of the state's economy?
3. Have there been changes in Vermont over the last several decades that make the existing revenue system or parts of it archaic?

While this work is preliminary, the data show several trends that suggest answers to these questions. This report highlights four main points.

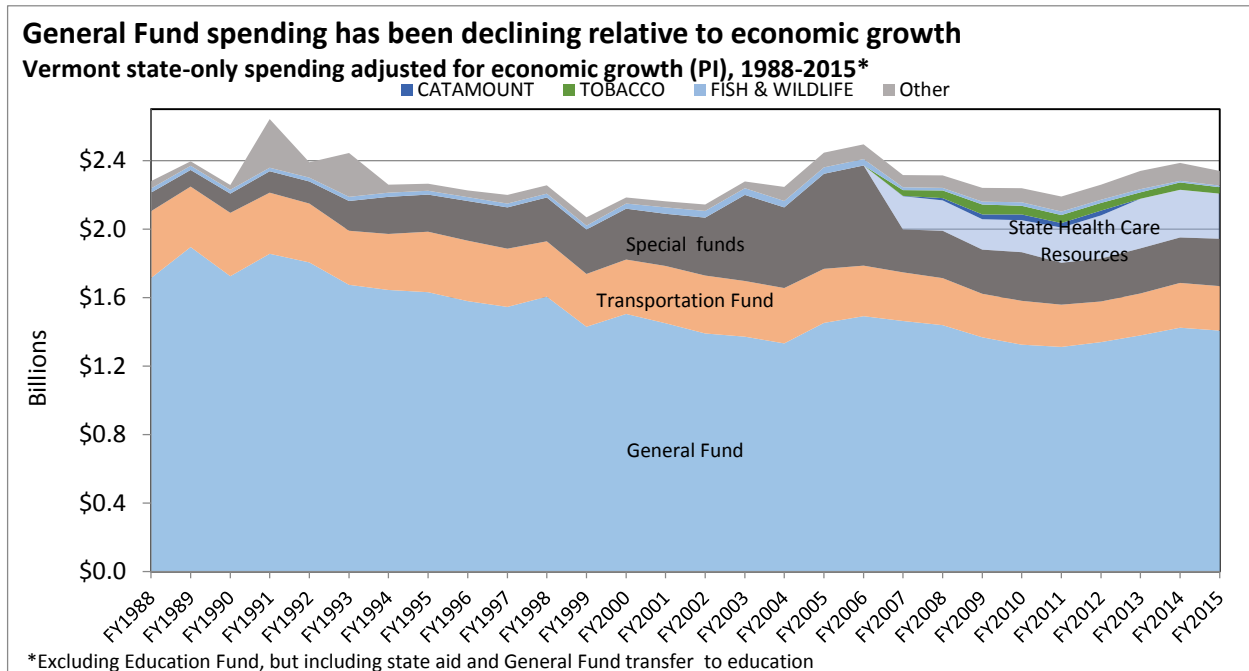
1. **Widening gap between state revenue and the economy**

There has been a widening gap between Vermont's economic growth and General Fund revenue growth since 2000. Between 1978 and 2000, the economy and General Fund revenue grew at about the same rates. Beginning in 2000, however, the relationship between economic growth and revenue growth changed and the growth rates began to diverge with revenue lagging behind economic growth.



2. Slowing General Fund spending growth relative to the economy

While there have been short-term ups and downs, the trend over the past 25 years is that General Fund spending has steadily decreased relative to economic growth. In other words, total personal income has grown faster over this period than General Fund spending. The overall state spending trend has been in line with economic growth, but the General Fund portion of that spending has seen slower growth.

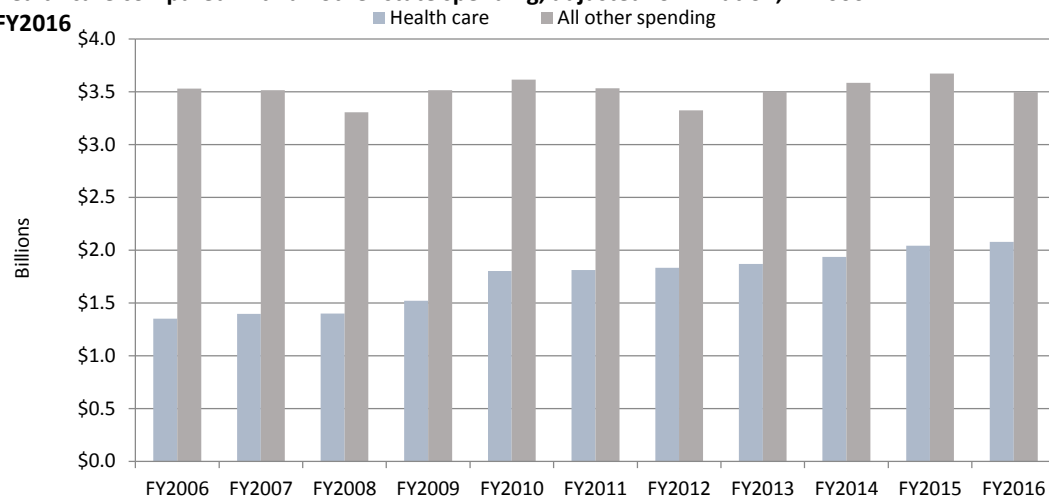


3. The fiscal challenge of health care cost increases

The current revenue structure is not supporting Vermonters' commitment to making health care accessible to all. This important investment in health care is undermining the state's ability to meet the other critical state obligations to Vermonters. To the extent the state has raised revenues, it has tended toward increasing the rates of regressive and/or unsustainable sources of income such as the sales tax and tobacco tax. The political grief from raising taxes doesn't go away with increases in these taxes because these revenue choices are not growing with the economy, which is one reason why budget gaps keep surfacing.

Health care is using up the state's revenue growth

Health care compared with all other state spending, adjusted for inflation, FY2006-FY2016



4. The need for a 21st Century revenue system

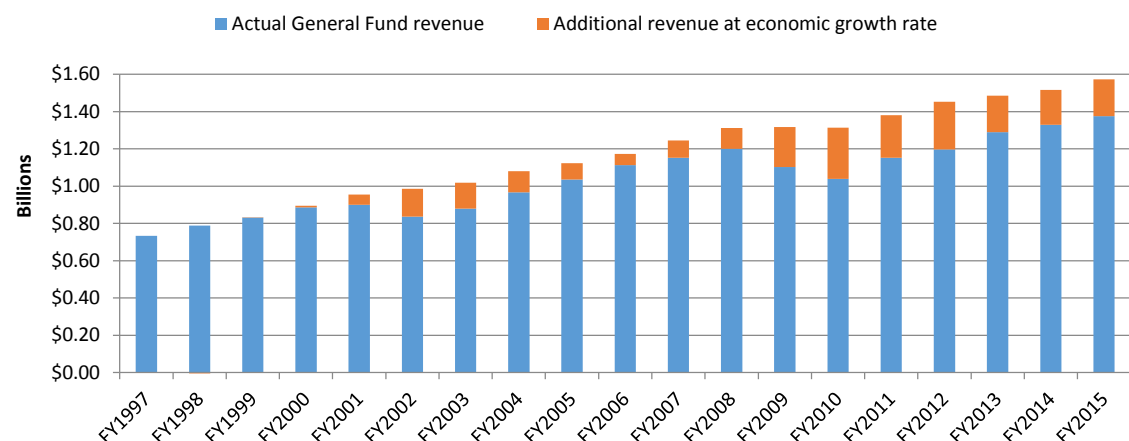
We need to modernize Vermont's revenue infrastructure. The economy has changed, and the current revenue structure has failed to keep up with those changes.

Conventional thinking is that we need to raise taxes or cut spending to address annual shortfalls. In fact, the problem is that our state's economy has gradually changed over the past several decades, but our revenue system has not kept pace.

The structure and mix of revenue sources needs modernizing so that the benefits of economic growth result in increased state revenues. For example, Vermont has lost sales tax revenue to online sales and the state doesn't tax many services—both are economic growth areas that are not taxed. Quick fixes would be counter-productive. Solutions need to be based on a thorough analysis of changes to Vermont's economy and of durable, fair alternative revenue choices.

Revenue system failure has left the General Fund short each year

Actual General Fund revenue and additional revenue if growth had matched the economy, FY1997-FY2015



Summary of Legislative Meetings on Tax Reform

We met individually with a selected group of legislative leaders, including up and coming legislators, to see where they stood on the issue of tax reform. The legislators chosen are in current leadership positions, sit on either House and Senate money committees, or are recognized as smart, capable legislators with the likelihood of advancement. These House and Senate members were also picked because we knew they either were familiar with tax reform because of their professional or committee history or understood the budget and tax pressures due to their committee assignments already.

Over the course of April and May of 2016, with our preliminary research provided by Public Assets, we held meetings at the Statehouse to discuss modernizing Vermont's tax code.

During our conversations with legislators, there was little to no push back on the problems that our data showed nor on the need for some type of tax reform in the future. They were intellectually in agreement with the need for taxing changes. However, there was little clarity on what reform would look like, but all agreed the conversation needs to continue. We had no push back on moving the conversation forward in some way. All the legislators we talked to were familiar with or had read the Blue Ribbon Tax Commission report that was published six years ago.

Strategically, what we heard from all legislators was they know they cannot achieve tax reform alone. They understand it is a big and complicated political lift regardless of what the reform looks like. They know they need pressure inside and outside of the building to provide both an impetus to move tax reform from a series of ideas and principles to actual words on a page. Many leaders expressed appreciation for the Partners' initiative and indicated that a coalition led by NGOs could provide the impetus for statehouse action on tax reform. Finally, it is clear that any tax reform effort is a multi-year proposition.

If the Partners and other organizations are intent on achieving tax reform, several steps are in order over the next two years:

1. Organize an external framework, like a coalition, with diverse groups and individuals to create and fund a multi-year commitment to promoting tax reform.
2. Conduct fiscal analysis and develop alternatives to the current tax structure.
3. Build a structure or campaign for grassroots action to help create the climate for legislative action.
4. Engage in statehouse lobbying, likely focused on the 2019 legislative session.
5. Coordinate these efforts, perhaps informally, with key legislative leaders.

In summary, we heard we need to build a coalition and campaign to create pressure for tax reform. They cannot do it alone.