Kavet, Rockler & Associates, LLC
Economic and Public Policy Consulting

985 Grandview Road
Williamstown, Vermont 05679-9003 U.S.A.
Telephone: 802-433-1360
Facsimile: 866-433-1360
Cellular: 802-433-1111
E-Mail: tek@kavet.net
Website: www.kavetrockler.com

Selected Charts and Documents for House Ways & Means Committee Discussion

Prepared for the
State of Vermont
Legislative Joint Fiscal Office and
House Ways & Means Committee

September 3, 2020

House Ways & Means Committee Q&A – September 3, 2020

General Questions and Brief Responses:

Q1: Is it preferable to raise [state] taxes or cut spending or some combination of the two during a recession?

A1: Ideally, none of the above, nor a third option - increased borrowing. Sufficient “rainy day” funds should be banked during periods of economic expansion so as to level fund state operations during recessions. If “rainy days” end up being hurricanes, or “rainy day” funds are only sized to cover brief drizzles, usually one or more combination of tax increases, spending cuts and/or borrowing are optimal, depending upon tax base and borrowing capacity, opportunities for efficiencies associated with spending cuts and conditions specific to the recessionary period.

Q2: What are some reasonable ways to raise [state] taxes with minimal damage to the economy?

A2: If state tax increases are necessary, negative impacts may be minimized by making the increases temporary (such as was done in the Snelling administration in 1991-1993, see chart on page 4). They should be levied in areas of greatest tax capacity (generally among higher income and/or higher net worth taxpayers) and be sensitive to equity, efficiency and specific recessionary conditions so as to minimize negative impacts.

Q3: What are some reasonable ways to cut [state] spending with minimal damage to the economy?

A3: State services that can be made more efficient are the optimal areas in which to effect spending cuts. Although these may be difficult to identify, there are almost always such opportunities and sometimes only the necessity of spending cuts brings these to light. Beyond efficiency cuts that result in no reduction of services, the next tier of cuts should be aimed at services that may be either deferred or discontinued with minimal hardship to society and business.

Q4: How is this recession different from previous recessions?

A4: This recession is unique in that was not precipitated by economic imbalances, but by an intentional, temporary shutdown of certain sectors of the U.S. economy in order to avoid probable catastrophic health outcomes. Because of this, it will not be ended by traditional economic forces, but by the epidemiological course of the pandemic, with attendant economic consequences. The other defining characteristic of this recession is the unprecedented federal government fiscal and monetary response – both in terms of speed and magnitude.

Q5: What are the implications of those differences for state budget policy?

A5: The unique causes of this economic contraction and the wide range of potential future federal intervention will create extreme uncertainty with respect to the path of the U.S. and Vermont economies in at least the coming year. This will require extreme flexibility in political decision-making and adaptation to developments as they occur. Because the SARS-CoV-2 virus is novel and many of its critical characteristics are only now being more fully understood, more frequent mid-course corrections will probably be required for some time. While this has been done at times during prior recessions, it may be more long lasting with this event.

Q6: How did Vermont perform in the Great Recession?

A6: The Great Recession was the most severe economic downturn since the 1929 Depression. Although the recession in Vermont was not as deep or prolonged as in some states, the recovery was painfully slow, taking a record 7 years to reach its prior cyclical peak in employment. Paradoxically, Tropic Storm Irene, which hit Vermont in August of 2011, gave rise to enormous federal relief aid and private insurance spending that accelerated the Vermont recovery during the year immediately following the Storm – in addition to federal stimulus measures enacted in 2008 and 2009, but spread over about a five-year period. Following this period of peak stimulus spending, the recovery in Vermont slowed, with longer term impacts affecting (especially) real estate, migratory population flows and related job growth.

Q7: What policies were helpful or harmful in responding to the last recession?

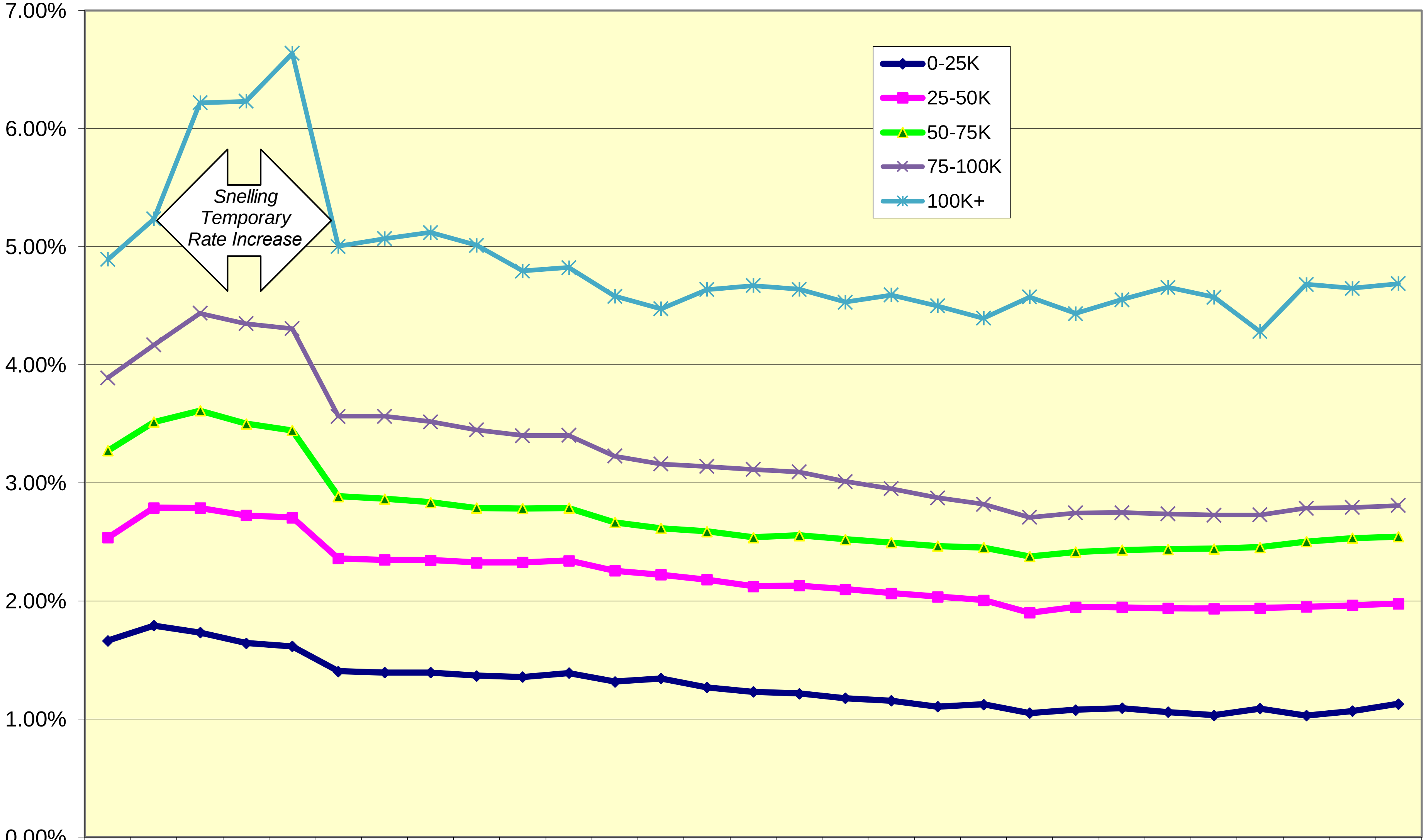
A7: The most important "helpful" policies, then as now, were enormous federal fiscal and monetary measures, without which a prolonged depression would have ensued. State reserves at 5% were completely inadequate to offset the two-year 12% decline in Vermont revenues, and for fear of further declines, were never utilized. The federal policies measures, especially the American Recovery and Reinvestment Act (ARRA), enabled the State to avoid major tax increases, but spending cuts resulted in an 8% reduction in State Government employment between January of 2008 and September of 2009, and at one time included temporary reductions in pay for all State employees – all of which acted as a drag on the economic recovery and were "harmful." The largest tax increase was a "stealth" tax on gasoline and diesel fuel via a transportation infrastructure bonding program to cover shortfalls in T-Fund investments due to the earlier reallocation of T-Fund revenues to the G-Fund.

Q8: What are some characteristics of Vermont that affect budget policy in our state?

A8: Vermont's demographic characteristics (older, relatively highly-educated, small population with very slow growth), economic profile (including relatively large tourism, manufacturing, education and healthcare service sectors), geographic (small and with long borders with other political jurisdictions) and natural resource characteristics (colder climate, scenic, rural, near Canadian border, not centrally located, but with major highway arteries), relatively progressive tax structure amidst increasing economic inequality (which has increased revenue volatility), relatively civil and pragmatic political traditions, and persistent positive economic amenity values related to societal quality of life metrics, all affect budgetary policy in various ways.

Effective VT Income Tax Rates by Current Dollar Income Class

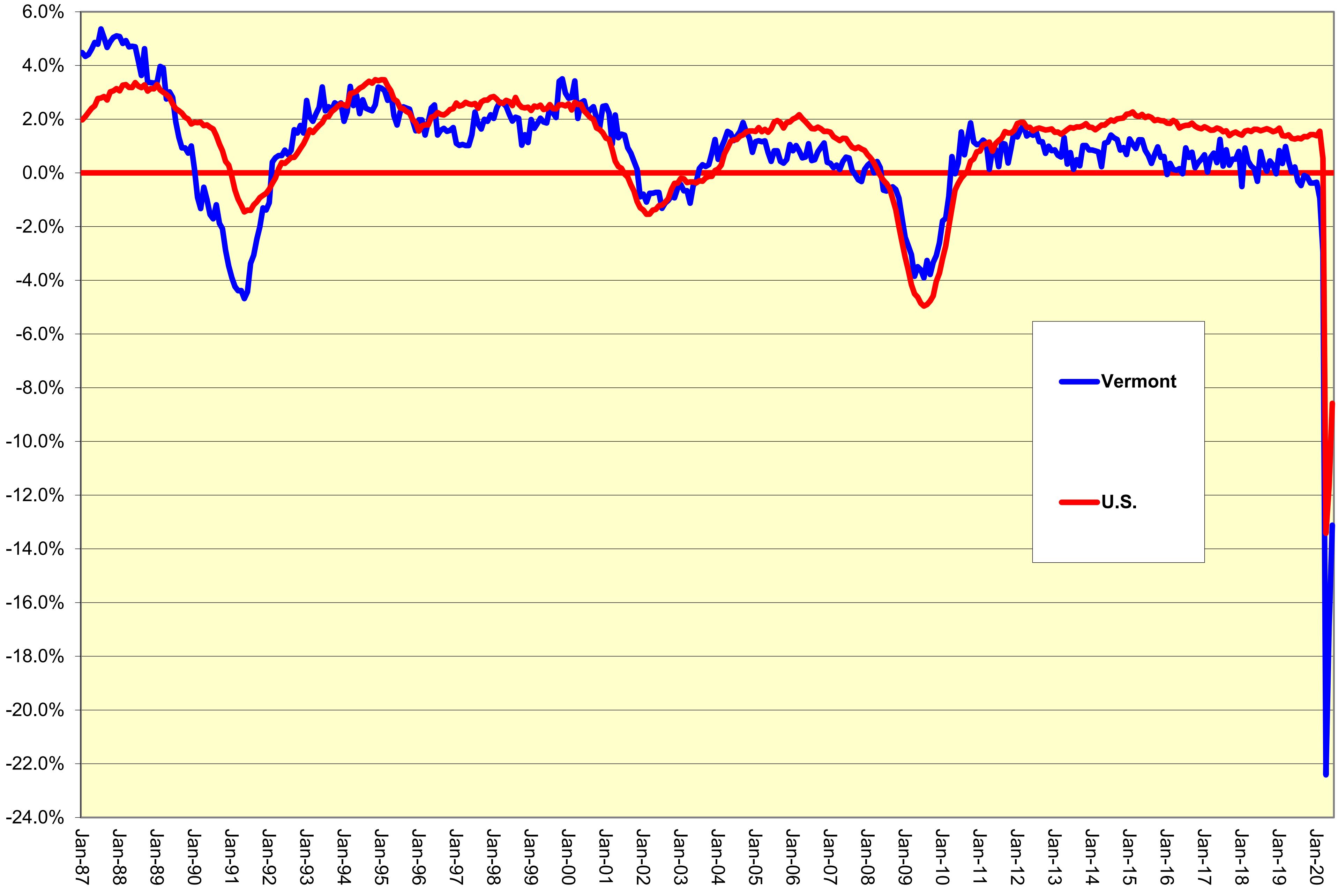
Source: Vermont Department of Taxes



	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
0-25K	1.66	1.79	1.73	1.64	1.61	1.40	1.39	1.39	1.36	1.36	1.39	1.32	1.34	1.27	1.23	1.21	1.17	1.15	1.10	1.12	1.05	1.08	1.09	1.06	1.03	1.09	1.03	1.07	1.13
25-50K	2.54	2.79	2.79	2.72	2.70	2.36	2.35	2.34	2.32	2.33	2.34	2.25	2.22	2.18	2.12	2.13	2.10	2.06	2.04	2.01	1.90	1.95	1.94	1.94	1.93	1.94	1.95	1.96	1.98
50-75K	3.27	3.51	3.61	3.50	3.44	2.88	2.86	2.83	2.79	2.78	2.79	2.66	2.61	2.59	2.54	2.55	2.52	2.49	2.46	2.45	2.38	2.41	2.43	2.44	2.44	2.45	2.50	2.53	2.54
75-100K	3.89	4.17	4.44	4.35	4.30	3.56	3.56	3.52	3.45	3.40	3.40	3.23	3.16	3.14	3.11	3.09	3.01	2.95	2.87	2.82	2.71	2.74	2.75	2.74	2.73	2.73	2.78	2.79	2.81
100K+	4.89	5.23	6.22	6.23	6.64	5.00	5.07	5.12	5.01	4.79	4.82	4.58	4.47	4.64	4.67	4.64	4.53	4.59	4.50	4.39	4.57	4.43	4.55	4.65	4.57	4.28	4.68	4.65	4.69

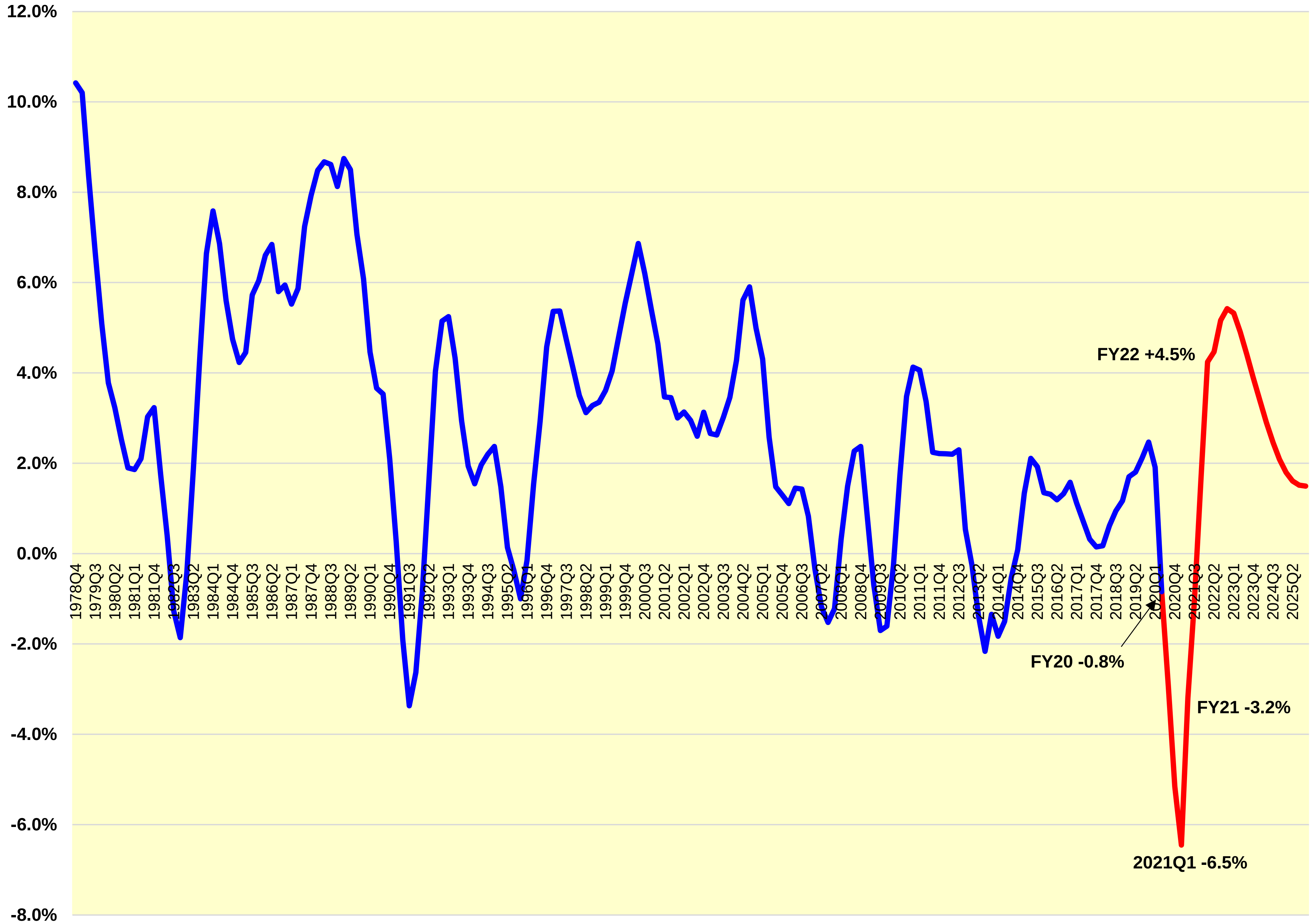
Employment Growth Craters During Shutdown - With Recovery Uncertain

Total Nonagricultural Employment, Percent Change vs. Year Ago, Seasonally Adjusted Data



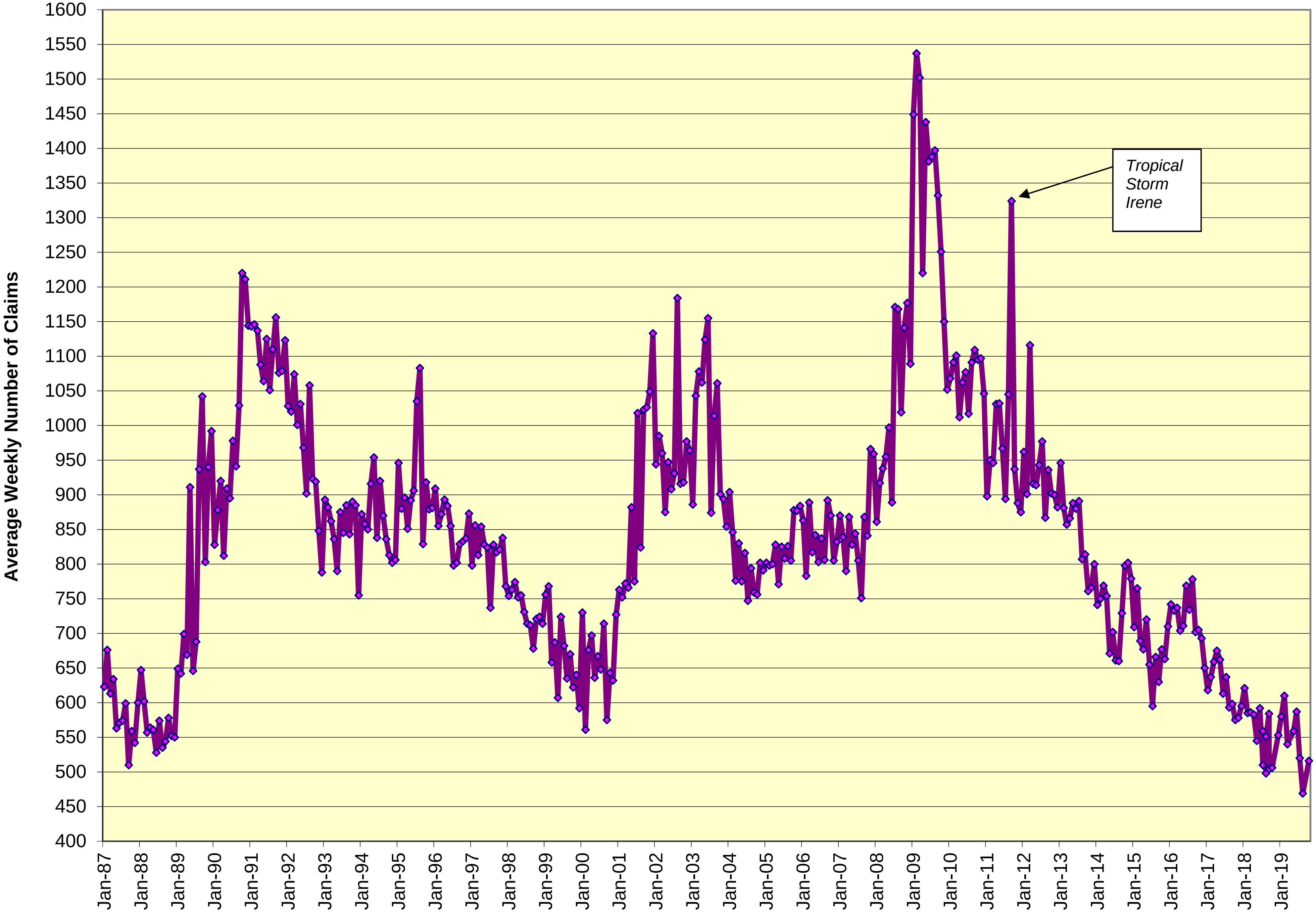
Source: Bureau of Labor Statistics, U.S. Department of Labor

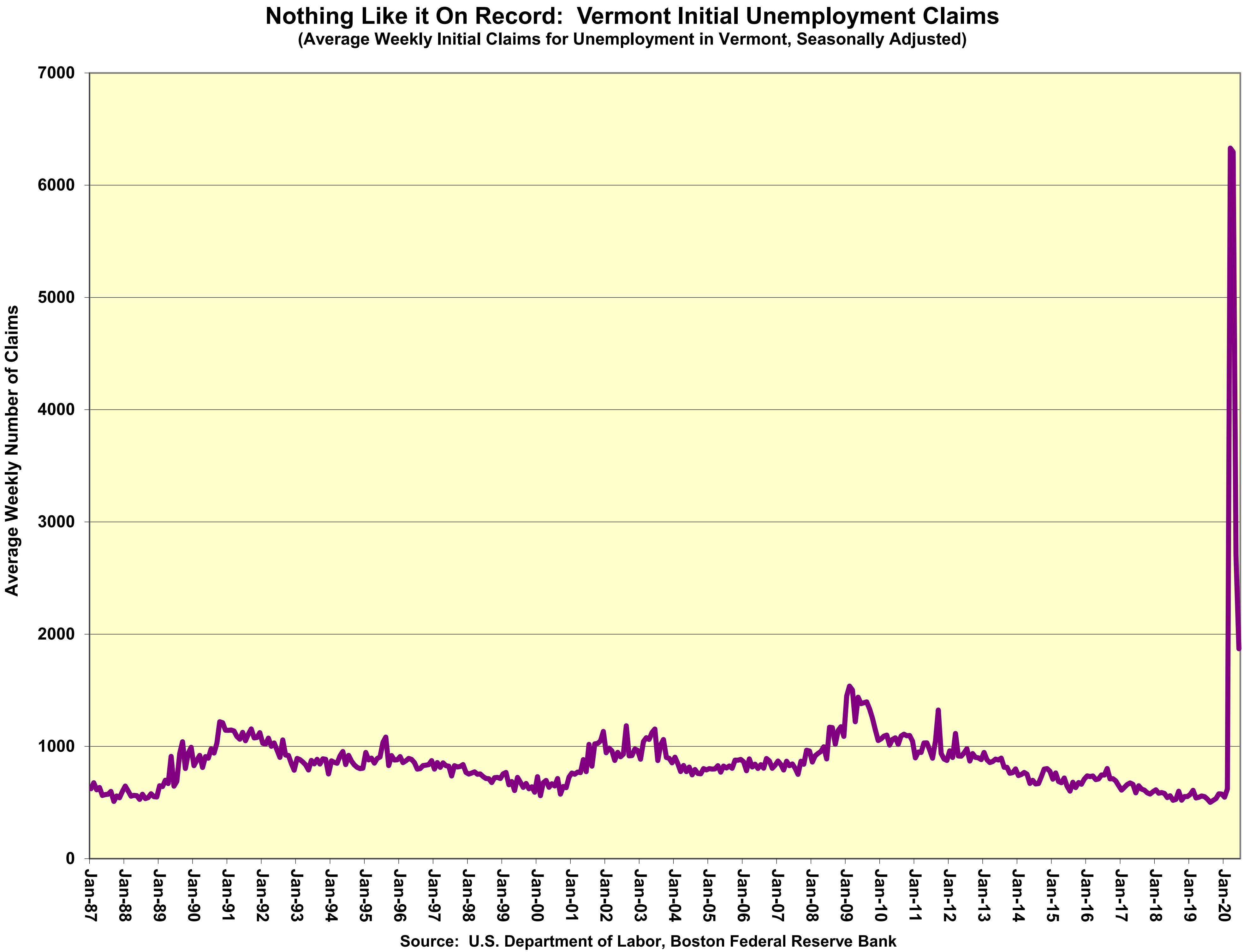
The Pandemic Storm Path: More to Come
Annualized Real Vermont GDP Percent Change vs. Prior Year Period



Vermont Unemployment Insurance Claims Drop to Record Lows

(Average Weekly Initial Claims for Unemployment in Vermont, Seasonally Adjusted, Source: BLS and Boston Fed)




Nothing Like it On Record: Vermont Initial Unemployment Claims
(Average Weekly Initial Claims for Unemployment in Vermont, Seasonally Adjusted)
Average Weekly Number of Claims
7000
6000
5000
4000
3000
2000
1000
0
Jan-87
Jan-88
Jan-89
Jan-90
Jan-91
Jan-92
Jan-93
Jan-94
Jan-95
Jan-96
Jan-97
Jan-98
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Jan-00
Jan-01
Jan-02
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Jan-09
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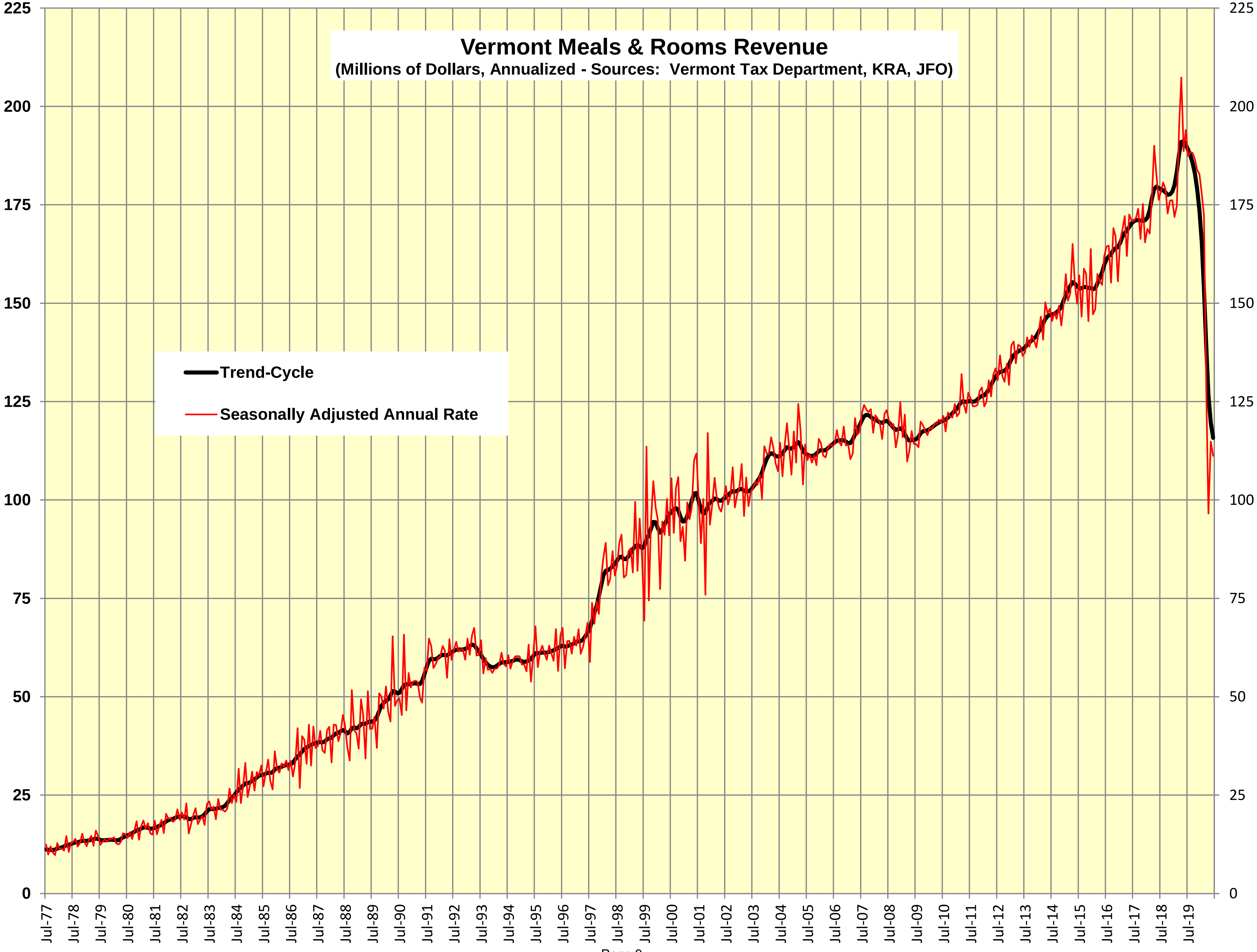
Jan-20
Source: U.S. Department of Labor, Boston Federal Reserve Bank


Vermont Meals & Rooms Revenue
(Millions of Dollars, Annualized - Sources: Vermont Tax Department, KRA, JFO)
Trend-Cycle
Seasonally Adjusted Annual Rate
225
200
175
150
125
100
75
50
25
0
Jul-77
Jul-78
Jul-79
Jul-80
Jul-81
Jul-82
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Fax: 866-433-1360
Cellular: 802-433-1111
E-Mail: tek@kavet.net
Website: www.kavetrockler.com

Memorandum

To: Steve Klein, Chief Fiscal Officer, Legislative Joint Fiscal Office

From: Tom Kavet

CC: House Committee on Commerce and Economic Development

Date: August 26, 2020

Re: Economic Priorities: CARES Act Allocation Inquiry

Per your request, I am writing in response to two inquiries from the House Committee on Commerce and Economic Development regarding the optimal use of remaining CARES Act funding. Although the time allotted for analytic work on this issue is nowhere close to adequate given the complexity and magnitude of the expenditures involved, I will offer a few general observations and if further inquiry is desired, am available to perform a more rigorous review with specific program recommendations and costs, if legislative timing permits.

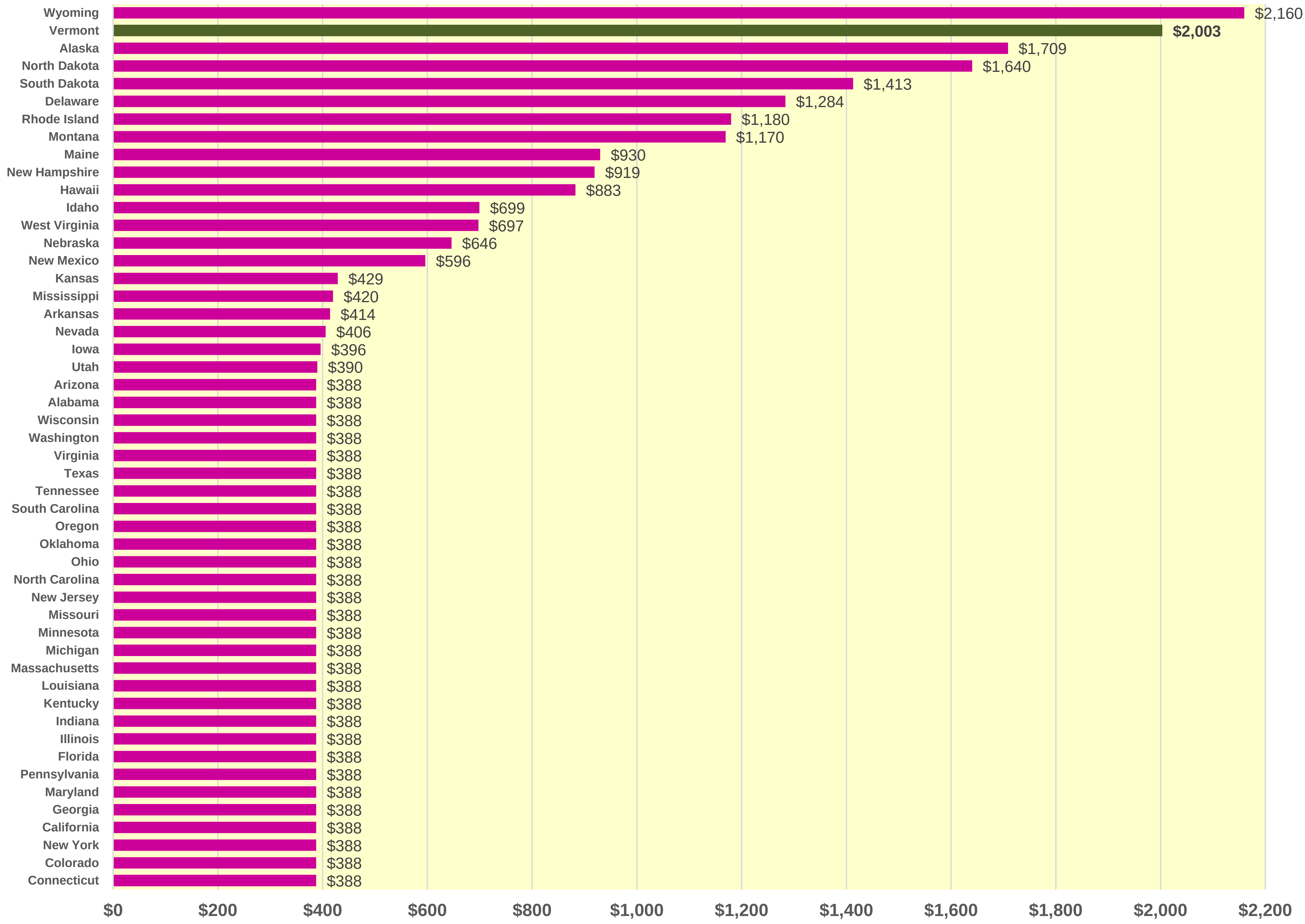
The CARES Act comes with a stringent and ever-changing set of limitations, including a year-end cutoff date, for use of the vast federal funding provided to Vermont. As noted previously, and in the graphs on the following two pages, Vermont has received more per capita federal COVID-related funding than most other states. CARES Act restrictions impinge upon the use of the funds for maximum beneficial State economic impact, however, almost all contemplated uses will have significant positive economic effects.

In general, the criteria for optimal disbursements of the remaining CARES Act funds include both economic and equity considerations. Ideally, resources should be targeted to those most in need and, first and foremost, insure provision of essential needs such as food, housing and medical care for all. In the interest of getting funding out quickly, and with inadequate extant institutional mechanisms to do so, prior federal COVID disbursements were not well-targeted. This resulted in not only waste, but shortfalls in areas of real need and windfalls elsewhere that have fueled a boom in new car and truck sales, housing and stock prices. Reflecting this, personal saving rates did not rise for those most in need, but the aggregate national rate soared from 12.6% in March to 32.2% in April and to 23.2% in May.

Targeted essential needs funding includes things such as: Food banks, emergency shelters, rental assistance, mortgage assistance, property tax assistance, and transfer payments to the 30,000 Vermonters who have lost their jobs and are still unemployed, including supplemental and extended unemployment insurance benefits. Although some of these have been funded in whole or part previously, these needs should come first and have sufficient capacity to withstand a second wave of the pandemic if possible, when CARES Act funding or a successor program may not be available. For example, food banks can expand

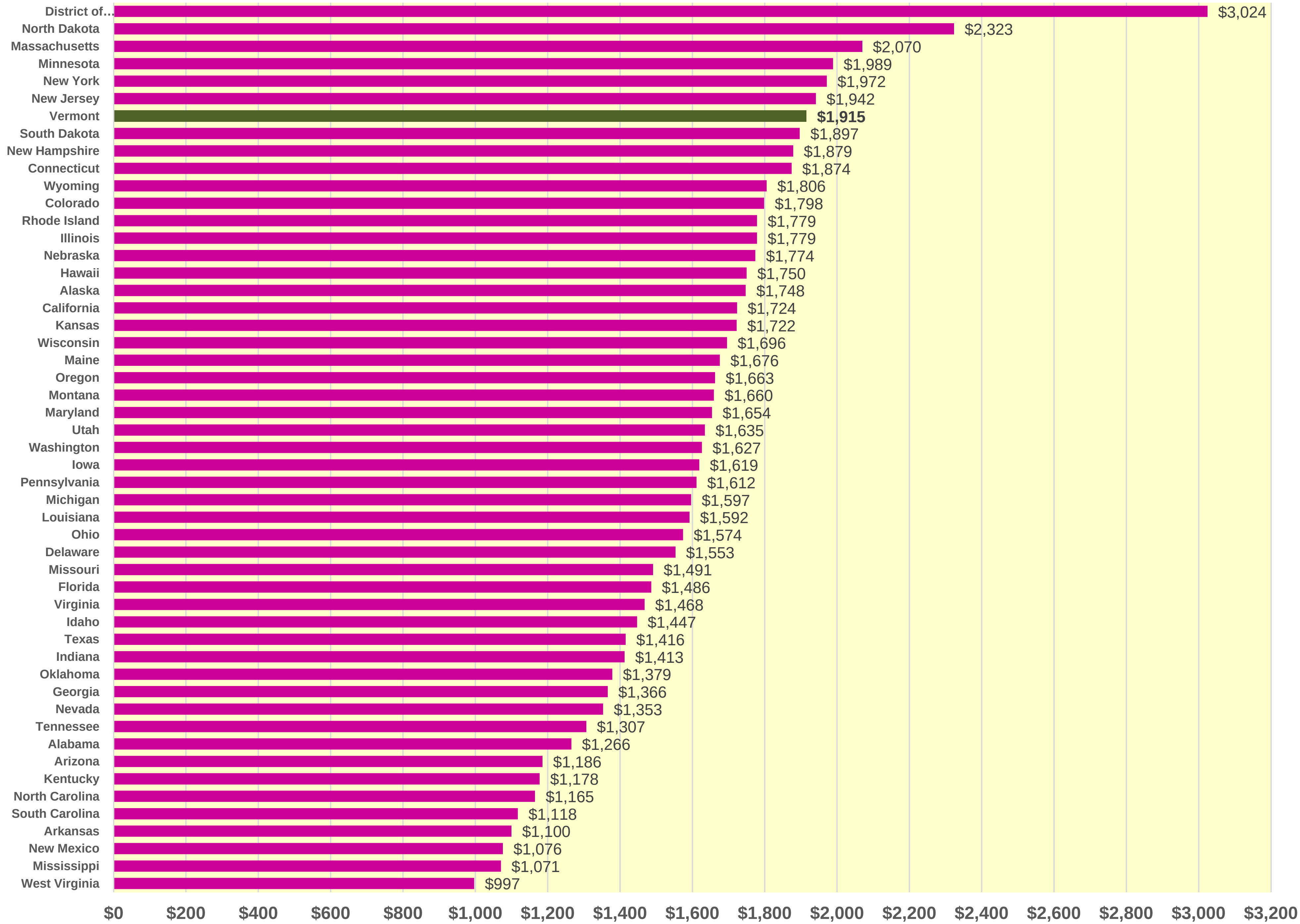
New York x 5 = Vermont: Per Capita CARES Act Funding

Source: U.S. Department of the Treasury



West Virgnia x 2 = Vermont: Per Capita PPP Funding

Source: U.S. Department of the Treasury



stocks and delivery systems with current funding increases, thereby providing surge capacity to handle future potential needs.

The second highest areas of beneficial potential economic impact are investments that encourage and support both current economic activity and future economic development. This includes maximum upgrading and extension of broadband services and funding for safe childcare and K-12 reopening measures. If was not clear before the pandemic, the importance of reliable high speed broadband access is obvious now. It has enabled economic activity during the pandemic where present and stunted it where not. It has enabled a wave of second home owners to work from (and pay taxes in) Vermont and attracted a growing number of permanent residents far in excess of anything the paltry incentive to move programs could possibly achieve. Although there have been prior allocations of money for this purpose, no stone should be unturned between now and the end of the year in extending and improving this critical infrastructure throughout the State.

Similarly, safe childcare and K-12 public schools allow parents to return to work and have also been an attraction to new residents. Vermont's exemplary performance in limiting COVID community transmission through widespread social compliance allows the possibility of safe public school attendance in a way not possible in states and regions with higher transmission rates. Funding to enable this will produce immediate economic returns as well as educational benefits to students.

The third area of optimal disbursements would target companies and institutions in critical State economic sectors not previously served or substantially underserved that are not at high risk of permanent loss. The sectors that should be considered for substantial additional support include private higher education institutions, non-profits, and arts, entertainment and community service sector firms, including sole proprietors. The State could also help these sectors to transition to digital platforms via on-line marketplaces for Vermont products and services, including galleries for artists and craftsmen, store-fronts for local food products, and musical performances projected to all through the internet - bringing a kind of "virtual tourism" to products and services normally sold to visitors to the State.

Industry sectors experiencing the greatest employment losses are included in Table 1 on page 5. Not every business that has been hurt by the pandemic, however, will survive – with or without public assistance. Some sectors and stressed businesses confronting a protracted period of diminished business activity will disappear or need to be reconstituted at some future time. Spending on such entities will not accomplish the desired objective and deprive others of funds needed for their survival. This presents difficult funding decisions, but pouring massive additional funding into more permanently stressed sectors is unlikely generate desired outcomes.

For workers in sectors beset by longer term losses and firms that do not survive, job training in fields with higher demand will be essential. Funding for free or heavily discounted vocational and college courses in Vermont would benefit displaced and underemployed workers, the Vermont educational institutions they attend and future economic growth. This should be immediately available, with second semester charges paid in December (as is the norm), and large enough to enable many thousands of unemployed and underemployed workers to participate.

In general, programs that indiscriminately disburse funds or do so with little targeting of need are the least effective. The federal payments of $1,200 per person, regardless of negative COVID impact and, for the most part, income, are an example of this. While providing stimulus, they usually have lower local economic multipliers and reduce funds available for businesses and individuals in greatest need. The current $50M ACCD proposal to provide "gift cards" to all Vermonters falls in this category. If there are funds available after funding all of the above more targeted needs and/or unspent funds in December requiring quick use, a better program option would be to provide supplemental retroactive hazard pay to low income essential workers or gift cards to low income residents for limited use in purchasing non-taxable food, medicine and clothing. Either, or both of these, could easily consume $20M-$50M in unused funds on short notice if necessary.

Lastly one of the inquiries requested comment on "austerity budgeting vs. deficit spending." While deficit spending at the federal level is prescriptive in a recession, it is not at the state level. Once rainy day funds and other surpluses are consumed, any revenue shortfall will need to be offset with lower spending, higher taxes, greater borrowing, or some mix of these – all of which have negative economic effects (unless there are spending cuts that represent efficiencies that should have been effected in any event, vast unused borrowing capacity, or comparable unused tax capacity).

Please let me know if you would like further analysis or greater detail regarding any of the above comments and perspectives.

TABLE 1

Vermont Payroll Employment	**Percent Change vs. Year Ago (Not Seasonally Adjusted)**						
Industry Sector	**Jan 2020**	**Feb 2020**	**Mar 2020**	**Apr 2020**	**May 2020**	**Jun 2020**	**Jul 2020**
Total Nonfarm	-0.4	-0.4	-2.6	-22.5	-17.4	-13.5	-11.8
Mining and Logging	0.0	0.0	-12.5	-25.0	0.0	0.0	-11.1
Construction	-7.3	-6.7	-8.1	-56.6	-34.4	-27.0	-25.9
Manufacturing	-1.4	-1.0	-2.0	-26.4	-10.1	-12.2	-12.1
Trade, Transportation, and Utilities	-1.7	-0.9	-2.8	-20.9	-13.1	-8.1	-5.9
Information	0.0	0.0	0.0	-4.8	-7.0	-7.0	-4.7
Financial Activities	-5.7	-2.5	-3.3	-8.3	-8.9	-8.9	-8.7
Professional and Business Services	1.4	1.1	-0.7	-14.7	-9.6	-9.0	-7.2
Education and Health Services	-0.2	-1.0	-4.0	-14.0	-12.5	-6.2	-5.2
Leisure and Hospitality	1.3	0.5	-6.4	-66.5	-59.5	-49.1	-43.7
Other Services	-1.0	-1.0	-2.0	-19.6	-19.4	-11.4	-11.4
Government	2.0	1.9	2.1	-5.5	-7.6	-4.5	-1.2

Source: U.S. Bureau of Labor Statistics, July data are preliminary

U.S. PPP Disbursements by NAICS Sector

NAICS Sector Description	Loan Count	Net Dollars	% of Amount
Health Care and Social Assistance	522,900	$67,308,168,304	12.91%
Professional, Scientific, and Technical Services	664,941	$66,431,416,001	12.74%
Construction	484,806	$64,697,933,772	12.41%
Manufacturing	234,948	$53,922,171,696	10.34%
Accommodation and Food Services	377,460	$42,226,563,861	8.10%
Retail Trade	463,764	$40,378,607,813	7.74%
Other Services (except Public Administration)	563,154	$31,286,196,747	6.00%
Wholesale Trade	171,553	$27,508,783,153	5.28%
Administrative and Support and Waste Management and Remediation Services	251,285	$26,381,319,807	5.06%
Transportation and Warehousing	215,982	$17,241,704,592	3.31%
Real Estate and Rental and Leasing	256,412	$15,605,067,970	2.99%
Finance and Insurance	175,760	$12,088,513,425	2.32%
Educational Services	85,426	$11,982,020,521	2.30%
Unclassified Establishments	219,582	$9,655,072,807	1.85%
Information	72,057	$9,279,228,782	1.78%
Arts, Entertainment, and Recreation	125,777	$8,089,594,232	1.55%
Agriculture, Forestry, Fishing and Hunting	144,334	$7,994,868,458	1.53%
Mining	22,156	$4,521,098,771	0.87%
Public Administration	13,956	$1,748,125,718	0.34%
Management of Companies and Enterprises	9,137	$1,548,812,402	0.30%
Utilities	8,195	$1,490,681,774	0.29%

Approvals through 07/31/2020