The Vermont Business Roundtable is a non-partisan organization dedicated to helping Vermont achieve long-term public policy objectives worthy of its citizens. Composed of the principal officers of 135 Vermont companies representing geographical diversity and all major sectors of the Vermont economy, the Roundtable is committed to achieving economic prosperity and preserving Vermont's unique quality of life.


INTRODUCTION

The recent slowing of Vermont’s economy has revealed serious imbalances in the fiscal condition of Vermont state government. The recognition of these imbalances has led to increased concern about the management and future direction of Vermont government's finances.

This report is the first part of a study designed to assist policy-makers in Vermont state government in making more informed, forward-looking fiscal decisions. It analyzes key trends in Vermont’s tax, spending, and debt burdens compared to those of the other 49 states, the states which have AA bond ratings\(^1\), and the northeastern states (Box 1).

SUMMARY OF CONCLUSIONS

1) Vermont’s measures of fiscal burden remain universally high despite overall reductions during the 18-year study period.\(^2\) Vermont’s best burden ranking in 1988 for any of its indicators was still above the national average for state taxes per person. Vermont’s worst burden ranking in 1988 placed it among the top ten states in the nation in spending per $1000 of personal income.

2) During the 1980’s, Vermont’s tax and spending burdens have increased in contrast to the significant reductions accomplished during the 1970’s. Although most of Vermont’s fiscal burdens declined over the 1970-88 period, the growth of Vermont’s tax and expenditure burdens during the 1980’s negated some, and in certain cases, all of the improvements in those indicators during the 1970’s.

3) The recent economic downturn and the reversal of many of Vermont’s burden-reducing trends in the 1980’s have produced a significant and growing imbalance between revenue and expenditures. This imbalance raises serious concerns about whether state government can assure Vermont’s continued economic vitality under the pressure of its current spending practices and tax structure.

4) During the study period, Vermont’s debt burden was reduced substantially. This occurred despite the fact that Vermont state government accepts financial responsibility for many of the functions performed by county governments in other areas of the nation.

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Box 1

**IS IT “FAIR” TO COMPARE?**

Broad state-by-state comparisons of various governmental finance indicators inevitably run into controversy. Proponents contend that comparisons are valid because the differences between economic structure and governmental organization go to the very heart of the question of whether a state government has the capability to meet its future obligations. Opponents point out that such ratios and statistics compare “apples with oranges” since a land-locked, resource-poor, rural state like Vermont has little in common with the island of Hawaii, oil-rich Alaska, and urban New Jersey or California.

Who’s right? That question is perhaps best answered by saying that both are partially, but not entirely correct. Such comparisons are routinely made by top government bond rating services, many governmental organizations, and the U.S. Bureau of the Census. However, ratios and comparisons should not be taken strictly at face value. Honest comparisons are impossible without the full disclosure and consideration of the implications of differences which may affect these comparisons.

Comparing a state’s financial ratios and its economic growth record is not unlike comparing the key financial ratios of a bank with its peers. Just as no two states are the same, no two banks are exactly alike even though they may be of a similar size or in the same part of the country. The information obtained from such inter-bank comparisons can be helpful in assessing the relative financial success of a bank, as long as comparisons are made within a valid analytical context.

This study makes comparisons among Vermont, the nation, and two groups of Vermont's peers. The peer groups used in this study share either common geography or similar financial capacity to re-pay outstanding guaranteed debt.

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\(^1\) Indicates those states thought to have a similar financial capacity by Moody’s Investor Services.

\(^2\) All financial concepts are in inflation-adjusted terms.
However, since 1988 the large amount of new debt issued combined with the potential for additional long-term debt commitments suggest that Vermont’s debt burden will increase substantially during the 1990’s. These circumstances cloud an otherwise excellent record of debt burden reduction during the 1970’s and 1980’s.

**VERMONT IN A NEW ERA OF UNPRECEDENTED CHALLENGE**

The Vermont economy today is increasingly being shaped by global events. Meeting the challenges of the world economy will place enormous new demands on the citizens, government, institutions, and businesses of Vermont. Will Vermont state government have the financial wherewithal to provide for the necessary education and training programs to help Vermont compete? Will the state be able to afford the construction of the needed facilities to protect our environment? Will state government have the resources to maintain and improve its transportation systems?

In an age of shrinking public resources, the answers to these questions will to a great extent depend on understanding the state’s current fiscal position and where the state government’s current financial trends and known obligations may be taking it in the future.

**ASSUMPTIONS RELATING TO SOUND FISCAL MANAGEMENT**

This study is based on the premise that the key to effective fiscal policy at any level of government is how government maintains its capacity to efficiently and compassionately meet the needs of its people. Although “meeting needs” is subjective, the government can help itself in that effort by taking steps to promote a supportive economic environment with increasing tax revenues to do the job. Such steps may include (1) maximizing the purchasing power of public resources, (2) limiting government’s claim on the income and assets of the governed, and (3) making consistent decisions to retain the confidence of the people.

**INTERPRETATION OF THIS STUDY**

Vermont state government today is a complex, billion dollar enterprise whose fortunes are increasingly being impacted by economic forces from outside the state.

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**Box 2**

**HOW STATES EXPORT THEIR TAX BURDEN**

Understanding a state’s ability to export its tax burden is important in assessing the relative tax burden of state tax collections on a state’s population. Two of the most common vehicles used by states to export tax burden are: (1) severance taxes imposed on the out-of-state sale of a state’s natural resource commodities and (2) general and selective sales and use taxes on goods and services which are often borne by out-of-state tourists.

Nine states (Alaska, Kentucky, Louisiana, Montana, New Mexico, Oklahoma, Texas, West Virginia, Wyoming) currently each collect over $100,000,000 in severance taxes. In fiscal 1988, these states accounted for over 85 percent of total severance tax collections in the U.S. These tax receipts averaged 12.3 percent of the total taxes collected in each of these states. By contrast, 16 states, including Vermont, are not able to collect severance taxes on natural resource exports and therefore must look to income, sales, and other more conventional sources of revenues to meet their obligations.

Similarly, highly tourist-based economies in states such as Florida, Hawaii, and Nevada receive substantial tax receipts from non-residents who visit their states. These three high-tourist states together collect almost three of every four of their total tax dollars (70.9 percent) from broad consumption-based or selective sales and use taxes. By contrast, Vermont collects 49.2 percent of its total tax revenues from consumption and use taxes, close to the national average.

That means a substantial portion of the tax base of these high-tourism states, like those states which levy severance taxes, is supported by non-residents. Not surprisingly, these “severance tax” and “high tourist” states rely somewhat less on income taxes for the resources they need to carry out their functions. In fact, five of the seven states which did not levy a tax on the income of individuals in 1988 are members of either the “severance tax” or “high-tourist” state categories.
With many factors beyond our control shaping Vermont's future, one of the most important factors over which its citizens can exert influence is the effective financial management of the state government.

It often is difficult to understand what may be "good" or "bad" in terms of trends for a particular fiscal burden indicator. For the most part, a reduction in a particular fiscal burden indicator is a positive development.

Similarly, an increase in a burden indicator is generally not desirable, although not under all circumstances. The key to assessing the implications of an increase or reduction in burdens is whether or not a state's relative ranking rises or falls among some relevant group of its peers.

**Tax Burden Indicators**

Any investigation of fiscal status and trends should include an analysis of key tax burden indicators. Taxes represent those monies assessed and collected by state governments to raise the necessary resources to meet public goals and obligations.

The level and growth of tax burden indicators for a particular state are affected by several factors, including changing economic conditions, population growth, sources of wealth, changes in federal aid, and changes in the price of natural resources. Moreover, there also can be dramatic differences in economic structure between the states. Each state may pursue different tax policies depending upon the operative social objectives and a state's capability to export its tax burden to those living beyond its borders (Box 2). All of these factors can and do have a dramatic impact on tax burden comparisons.

This information suggests two significant conclusions. First, although Vermont has demonstrated a favorable tax burden reduction over the 18 year study period, all of this reduction in tax burden occurred during the 1970's. The data show that Vermont's tax burden growth indicators reversed their declining trend during the 1980's and showed substantial increase during the period, despite strong economic and population growth (Table 1).

Second, Vermont's tax burden reduction should be interpreted within the context of decline from a very high original tax burden position in 1970 (Table 2). Therefore, the implications of the large reduction in Vermont's tax burden during the study period can be misleading and should be judged accordingly. As of 1988, Vermont remains above average in its state tax burden level.

### Table 1

<table>
<thead>
<tr>
<th>Variable</th>
<th>1970's</th>
<th>1980's</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxes Per $1,000 of Income</td>
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<td>+1.12</td>
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<tr>
<td>Taxes Per Capita</td>
<td>-16.23</td>
<td>+29.25</td>
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</table>

*Reflects an eight year average

Basic Data Source: U.S. Department of Commerce

### Table 2

<table>
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<tbody>
<tr>
<td>Taxes Per $1,000 of Income</td>
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<tr>
<td>Rank in U.S.</td>
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<td>30</td>
<td>19</td>
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<tr>
<td>Rank in AA States** (of 20)</td>
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<td>15</td>
<td>12</td>
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<tr>
<td>Rank in Northeast States (of 9)</td>
<td>1</td>
<td>6</td>
<td>3</td>
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</tbody>
</table>

| Taxes Per Capita          |     |      |      |
| Rank in U.S.              | 5   | 34   | 19   |
| Rank in AA States** (of 20)| 4  | 15   | 10   |
| Rank in Northeast States (of 9)| 2 | 8    | 7    |

*Ranking is 1st (highest burden) to 50th (lowest burden).
**Denotes the 20 states with a AA bond rating from Moody's Investor Services.

Basic Data Source: U.S. Department of Commerce
Expenditure Burden Indicators

A second important measure of a state government's relative fiscal standing and financial management is expenditure burden. How much a state government spends relative to its peers is an important indicator of a state's policy goals. Such data can also yield important information about a state's current fiscal condition, and the likelihood that a state can continue to meet its future financial obligations.

This analysis examines the trends in the level of selected indicators of state government expenditure burden utilizing the concept of "Own-Source Expenditures" (Box 3). "Own-Source Expenditures" measure the amount of state spending that is made directly from revenues received through a state's own tax and revenue sources (i.e. from its residents or taxpayers).

Like the tax burden performance, this analysis shows a similar pattern of "burden" reduction during the 1970's and "burden" increase during the 1980's (Table 3). Compared to declines in the 1970's, Vermont's "Own-Source Expenditures" burden increased even more dramatically during the 1980's than did the tax burden indicators.

The reversal in Vermont's expenditure burden decline was mainly the result of two factors. First, the early 1980's saw the development of "fend-for-yourself" fiscal federalism, where the federal government off-loaded much of the responsibility for many federally mandated programs to the state and local governments.

Second, the strong economic growth of the mid- to late-1980's made it possible for Vermont state govern-

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**Box 3**

"Own-Source Expenditures"

First published by the Council of State Governments in August 1978, "Own-Source Expenditures" is not a creation of the Vermont Business Roundtable. It recognizes that all state governments receive revenues from the two other levels of government (federal and local) which can be used to finance its expenditures. These intergovernmental revenues need to be subtracted from the total general state government expenditure amount in order account for the effect that differing levels of intergovernmental support may have on the implied expenditure burden level of state governments. The result is a superior expenditure concept which portrays spending financed solely by a state's own tax, fee, and other revenue collections structure.

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<table>
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<tr>
<th>Variable</th>
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<th>1980's</th>
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<tr>
<td>Expenditures Per $1,000 of Income</td>
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<tr>
<td>Expenditures Per Capita</td>
<td>-23.65</td>
<td>+42.42</td>
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*Reflects an eight year average

Basic Data Source: U.S. Department of Commerce

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<td>8</td>
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<td>Rank in U.S.</td>
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<td>Rank in AA States** (of 20)</td>
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<td>Rank in Northeast States (of 9)</td>
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<td>11</td>
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*Ranking is 1st (highest burden) to 50th (lowest burden).
**Denotes the 20 states with a AA bond rating from Moody's Investor Services.

Basic Data Source: U.S. Department of Commerce
ment to “catch-up” on what many considered neglected spending priorities. Financial support for these programs may have been delayed during the economic slumps that occurred in Vermont during the mid-1970's and early 1980's.

Although Vermont showed a trend of overall reduction in expenditure burden during the 1970-88 period, it should, like the tax burden analysis, be viewed with the understanding that Vermont’s expenditure burden remains above average for both the nation and Vermont’s peers (Table 4). Even though the differences between the Vermont level and these averages have narrowed significantly, it must be noted that in 1970 Vermont had one of the highest levels of expenditure burden in the entire nation.

**DEBT BURDEN INDICATORS**

The trends in the relative debt burden position of state governments are the final burden indicators examined in this analysis. The management of state indebtedness is perhaps the most commonly watched indicator of a state’s financial management.

State governments issue debt primarily in support of their capital construction budgets. While capital budgets may vary from state to state, such capital expenditures are most often made for the construction of government facilities, roads, higher education facilities, environmental infrastructure, and corrections and recreational facilities.

For the most part, this debt carries a maturity period (or time to full retirement) of 10 to 20 years. In theory, the facilities built with the proceeds of this debt exist and are used for many years, and therefore they should be paid for by those who use them over their entire useful life and not just when they are built. This debt is often issued by the governmental jurisdiction with the backing of its capacity to impose taxes on its citizens to service the debt. This is the “full-faith-and-credit” (FF&C) pledge.

This analysis shows that Vermont has made significant reductions in its FF&C debt burden over the entire 18-year study period. Unlike the experience with its tax and expenditure burden indicators, Vermont posted declines in its debt burden levels during both the 1970's and 1980's (Table 5). In fact, Vermont ranked no higher than second lowest in the nation for both debt burden indicators studied during the period of 1970-1988.

However, similar to its tax and expenditure indicators, Vermont’s FF&C long-term debt burden remains high relative to the national average and the average of its relevant peer states. In fact, Vermont began the study period in 1970 with a FF&C debt burden level that ranked among the top five states in the nation — five times greater than the national average (Table 6).
From such a high original debt burden position in 1970, large declines in the Vermont’s debt burden would be expected, considering the state’s strong economic and population growth during the period. In fact, despite the large reductions in debt burden levels, Vermont’s debt burden never achieved a ranking below the highest 14 in the nation.

However, Vermont state government appears to have good cause for its relatively high debt burden level. Vermont’s debt burden is high because Vermont state government (like other state governments in New England) assumes many of the debt-related functions that are routinely undertaken by local governments (i.e. county governments) in most states in other regions of the country. Therefore, it would appear that Vermont state government would naturally have a FF&C debt burden level that ranks high among other states in all regions of the nation except for New England.

An examination of combined state and local government FF&C debt levels for Vermont compared with the other 49 states shows this is indeed the case (Table 7). Although Vermont’s state-only FF&C debt burden ranks near the top in comparison with other states around the nation, it falls to well below average when combined state and local FF&C debt burden levels are examined.

This situation provides a glaring contrast to the tax and expenditure burden indicators studied. Differences in intergovernmental organization and responsibility appear to account for little of the difference between Vermont’s relatively high tax and expenditure burden levels and the average burden levels for both the nation and peer groups studied.

Nevertheless, despite Vermont’s record of significant debt burden reduction over the 1970-88 period, developments since 1988 suggest that a reversal of this debt burden improvement trend is now underway. This is indicated by the recent repeal of Vermont’s debt limitation statute in 1989, the issuance of $184.6 million in FF&C general obligation long-term debt over the past three fiscal years, and the strong possibility of the authorization of approximately $100 million more debt “FF&C” during the current fiscal year. If these debt proposals are implemented, much of the state’s accumulated unused debt burden capacity will already have been spoken for as we move into the mid-1990’s.

| Table 7 |
|-----------------|--------|--------|
| Relative State & Local FF&C Debt Burden Level in 1988 | Constant 1982 Dollars |
|                | $ Per Capita | $ Per $1,000 Income |
| U.S. Average   | 669.37    | 50.06  |
| Vermont Average| 552.84    | 44.48  |
| Rank in U.S.*  | 25        | 28     |
| Rank in AA States** (of 20)  | 12   | 13     |
| Rank in Northeast States (of 9) | 9    | 9      |

*Ranking is 1st (highest burden) to 50th (lowest burden).
**Denotes the 20 states with a AA bond rating from Moody’s Investor Services.

Basic Data Source: U.S. Department of Commerce
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