VERMONT BUSINESS
ROUNDTABLE

Restructuring Public Education in Vermont: Fundamentals and Funding

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An Analysis of Possible Changes in the Funding of Public Education in Vermont[1]

Executive Summary

The Vermont Senate and House of Representatives are both considering bills that would significantly change the way public education is financed and, in the case of the Senate bill, organized in localities throughout the state. Because education is the single largest expenditure category for Vermont's state government and each town government, both proposals have major impacts on Vermonters' tax bills and education finance.

The House Plan

The House bill would entirely do away with the local property tax on primary residences as a funding mechanism for Vermont schools, replacing the lost revenues with a combination of new taxes and higher existing taxes. These include a local income tax, higher statewide income tax rates, a statewide property tax on nonresidential property, a one percentage point increase in the sales tax, expansion of the sales taxes to various services, an increase in the meals and rooms tax, and a higher corporate tax rate. The local income tax would average 9% of the federal liability but would vary by town.

The House bill also provides for the state to assume the entire cost of teachers' salaries and benefits with salaries and benefits negotiated at the statewide level. This part of the plan is expected to bring all teachers' salaries up to the level of those earned by the highest paid teachers in Chittenden County and would add about $50 million to the cost of public education. The revenue part of the plan only provides for $6 million in additional revenues in the first year to meet this added cost.

If the plan is approved with the $6 million in new spending, Vermont's overall level of taxes would rise slightly from its current level. But our mix of taxes would change dramatically: Property taxes would fall from 46% above the national average to 6% below the national average. Income taxes would rise from 20% above the national average to 63% above the national average.

If the plan to increase all teachers' salaries is fully funded (the revenue sources are not specified) Vermont's overall state and local tax level would rise from 7% above the national average to 14% over the national average. Our ranking would rise from tenth highest in the nation to fifth highest.

[1] A Report to the Vermont Business Roundtable prepared by Arthur Woolf, Ph.D.

This plan, not fully funded, would result in a significant decline in the property tax bill for an average income Vermont family. With the additional new taxes, the net effect on an average income Vermont family earning about $40,000 per year and living in a house worth $100,000 would be a $300 decline in overall taxes. If the full amount of revenues needed to fund the entire package of teacher pay hikes is included, the total decrease in state and local taxes would be about $120 per year.

Higher income Vermonters would pay significantly higher income taxes, with a top state and local marginal income tax rate of between 12% and 16%, depending on income. These would be the highest marginal tax rates in the nation. Middle income Vermont families would face a combined state and local marginal income tax rate of 10%, third highest in the nation.

There are no provisions in the bill for any type of education reform. Its main foci are to eliminate the property tax for schools and provide for centralized teacher negotiations and uniform wages.

The Senate Plan

The Senate Education Committee's plan is to consolidate school districts at the supervisory union level. Supervisory unions would be responsible for curriculum, performance goals, and financing. Union districts would levy a uniform property tax rate and residents would be allowed to replace a portion of the property tax with an optional local income tax rate of three percent of the federal liability.

The Senate plan would increase the state's share of education funding from its current level of under 30% to 50% by the end of the decade. The plan does not identify any funding source for this proposal.

Under this plan, both the regional property tax and the regional income tax proposals would result in a redistribution of tax revenues from taxpayers in richer towns to taxpayers in poorer towns within the supervisory union, but not between unions.

The plan does have several elements of education reform built into it, unlike the House plan.

Current Funding of Public Education in Vermont

Vermont currently funds public K-12 education with locally raised revenues, state assistance to local school districts, and some federal assistance. In FY92 the total revenues raised for the purpose of educating Vermont students was about $673 million.

Local school revenues are raised exclusively by a local property tax. In FY92 the local property tax raised about $411 million — about 61% of the total revenues for schools.

State assistance to local districts is funded out of the general revenues of the state government and consists mainly of general state aid to education distributed through the "foundation plan" and special education aid. The state aid formula attempts to equalize the ability of towns to fund education, whatever their property wealth. While the foundation formula is complicated, it enables poorer towns in the state to increase their per pupil spending and greatly reduces the inequality of spending between the richer and poorer towns.[2]

In FY92, state aid to education amounted to $148 million. The state also paid approximately $29 million to local towns for special education needs. Including other state funding, the total state contribution to education was $205 million — about 30% of the total. Another $33 million of school revenues came from federal sources. This represents about 5% of the total.

State assistance to schools and towns (the two cannot be completely disentangled) is supplemented by two other major programs. One is the property tax rebate program. Under this program, the state rebates any property tax paid on a house and two acres of land in excess of 5% of income for any Vermont resident earning under $35,000. In FY92 the state rebated $22 million to low and moderate income Vermont households. The state also has several programs which are generically referred to as the current use program. Under these programs, the state pays local towns taxes on the difference between the fair market value of agricultural land and the use value in agriculture of that land. In FY92 the cost of these programs was $12 million.

The House Plans

During the 1993 legislative session, the House Education Committee reported out of committee a plan to significantly change the way education is structured in Vermont. The major change was that the state of Vermont would assume all responsibility for paying

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[2]Vermont's equalization formula has been commended as one of the most successful at achieving the goals of equalizing spending among districts of varying degrees of wealth. See Katharine L. Bradbury, "Equity in School Finance: State Aid to Schools in New England," *New England Economic Review*, March/April 1993, pp. 25-45.

salaries and benefits to teachers and staff, removing that responsibility from the taxpayers of the local municipality. Under the plan, all teachers in Vermont would receive identical salaries and benefits for a given level of seniority and education.

The House Ways and Means Committee, working with this idea, put forward a plan to pay for this, which also represented a major change in the way education is funded in the state. The most significant change is the complete elimination of residential property taxes to fund local schools (although local property taxes to fund non-school local government services will still remain in place).

To substitute for these lost revenues, the Ways and Means Committee proposed a number of major tax changes. First, local governments will levy a local income tax on its residents which will indirectly be returned to the local school district.

Second, the plan increases numerous existing taxes, including the state personal income tax, corporate profits tax, meals and rooms tax, sales tax, and telephone property tax.

Third, the state will levy a statewide property tax on all non-residential property (including any land in excess of two acres that is occupied by a homestead). This tax would be levied on vacation homes, commercial and industrial land, and other types of property. The plan eliminates the existing tax on personal property, which is a tax on machinery and equipment.

Fourth, the plan levies other additional new taxes, including a sales tax on selected services, a per diem tax on rental automobiles, and a tax on boat moorings.

All of these changes are not planned to change the overall cost of education in Vermont. Rather, they reshuffle the means by which revenues are raised between state and local sources. There is one significant change in the plan that does raise the overall cost of education. That is the state's assumption of all costs of school employee salaries and benefits. All schools will be allowed to hire a number of teachers that gives them a student-teacher ratio of 12 to 1.

Schools will be allowed to have lower ratios (i.e., more teachers), but the local district must pay for any additional teachers (the state will pay for the highest paid teachers that result in the ratio of 12 to 1). The additional cost will be borne mostly by the local district out of local revenue sources, which would be the local income tax. The "guaranteed yield" system means a town can choose to reduce its pupil to teacher ratio (hire more teachers) below 12 to 1 and the state will pay some of those additional costs.

The state will also become the bargaining agent with teachers, removing that responsibility from local school boards. Therefore, all teachers will earn the same salary given a level of experience and seniority.

The House Ways and Means plan envisions a phase-in of the cost of this program, with an additional $6 million in revenues required in the first year. The cost of bringing all teachers' salaries up to the level envisioned in the plan is estimated by the Vermont Department of Education to be approximately $51.2 million in FY94. Had this plan been in effect in FY92, education costs would have been $47.4 million higher than they actually were. This represents a 7% increase from actual expenditures in that year.

Impact on Competitiveness

Measuring economic competitiveness is a difficult task. One crude way of examining the tax-related portion of a state's competitive position is by examining its taxes relative to other states. The standard way of measuring tax burdens is by looking at per capita taxes and taxes per $1,000 of income. This is done below not just for overall taxes but for the major types of taxes in Vermont.

TABLE 1

Vermont Taxes as a Percentage
of U.S. Average

	Taxes per $1000 of Personal Income		Taxes Per Capita	
	Actual Level FY91	VT as Percent of U.S. Avg	Actual Level FY91	VT as Percent of U.S. Avg
Total Taxes	$120.79	106.9%	$2122	101.9%
Property	$52.68	145.8%	$926	139.0%
Sales	$12.62	46.8%	$222	44.6%
Income	$28.62	101.1%	$503	96.4%
Personal	$25.87	121.2%	$455	115.5%
Corporate	$2.74	62.6%	$48	59.7%
Other	$26.88	124.6%	$472	118.7%

The left hand portion of the two sets of data in Table 1 shows the existing tax burdens in Vermont and also how we differ from the national average.[3] As Table 1 shows, Vermont's overall taxes per capita were about 2% above the U.S. average. Because Vermont's average

[3]All analysis is done using FY91 data. This is the most current data that exist for the U.S. as a whole and for all states on a comparative basis.

income is lower than the national average, our overall taxes are about 7% above the national average when measured on an income basis.

Our mix of taxes, however, varies to a greater degree from the national average than the aggregate numbers suggest. Our property taxes measured on a per capita and income basis, are 39% and 46% above the national average, respectively. Our personal income tax was about 15% above the national average on a per capita basis and 21% above average on an income basis.[4]

The property tax is the single largest tax in the state, followed by the personal income tax. Third largest is the sales tax, which is used to a much smaller degree in Vermont than elsewhere. Our per capita sales tax was less than half the national average, whether measured on a per capita or on an income basis.

However, Vermont does levy other types of sales taxes, including the rooms and meals tax, which are included in the "other" category. Vermont relies on these other taxes to a greater extent than do other states, as Table 1 notes.

The other major tax in the state is the corporate income, or profits, tax. Vermont's use of this tax is about 40% below the national average.

In order to evaluate how our tax competitiveness would change with the House Ways and Means Committee proposal, several assumptions need to be made. The first is how much revenue the new taxes and the changes in old taxes would bring in. I use the estimates presented in Table 2, rather than the Ways and Means estimates. The second is by how much the property taxes collected in Vermont would change. This involves estimating the reduction in residential property taxes and increase in non-residential taxes. I base my estimates on the assumption that there is a one-for-one correspondence between the increase in other taxes and decrease in residential property taxes with the caveat that an additional $6 million is raised in non-property taxes to fund that $6 million needed to initiate the teacher pay equity part of the plan.

The result is shown in Table 3. With the plan in place, but not fully funded, Vermont's overall tax burden would rise only slightly from the current level. Both measures of burden, relative to the national average, would rise by only 0.2 percentage points. But there would be a dramatic change in specific tax burdens. Our property tax burden per capita would drop from being 39% above the national average to 9% below the national average. On an income

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[4]Because the federal statistics treat the $22 million spent on the property tax rebate program as a net out of the income tax rather than a net out of property taxes, our overall property tax burden is actually slightly lower than these figures suggest and our income tax is higher. Correcting for this would give Vermont a per capita property tax burden 33% over the national average and 40% over the national average on an income basis. Our personal income tax, measured correctly, would be 25% over the national average on a per capita basis and would exceed the national average by 32% on an income basis.

TABLE 2

Estimated New Tax Revenues in FY94
From House Plan

Tax Source	Estimated Revenues ($ million)
Raise Sales Tax by 1 Percentage Point	$33.7
Raise Meals and Rooms Tax to 10%	$21.0
Add 2 Percentage Points to Corporate Income Tax	$9.0
Add 1 Percentage Point to Telephone Property Tax	$4.0
New $2 Per Day Tax on Rental Cars	$4.0
Add 2 New Tiers to State Income Tax	$23.7
Add Local Income Tax Averaging 8.9%	$82.6
Eliminate Non Farmer Exemption From Ag Products	$6.0
New 5% Sales Tax on Selected Services	$20.6
Statewide Property Tax	$209.0

basis, the property tax decline would be similar; from a burden 46% above the national average to a burden 6% under.

Our personal income tax would rise significantly under this scheme. The combination of higher income taxes on upper income Vermonters and a large local income tax would raise our personal income tax burden from the current level of 15% (per capita) or 20% (income basis) over the national average to 59% above the national average on a per capita basis or 63% above the national average on an income basis.

Corporate income taxes would also rise, but would still be under the national average by about 20%.

Sales taxes would also rise, but instead of being about 50% under the national average, they would be about 35% under the national average. The other taxes levied, which are types of sales taxes, would bring the "other" taxes category up significantly, rising from 15% to 59% over the national average on a per capita basis and rising from 21% to 63% of the national average on an income basis.

If we assume that the plan to raise all teachers' salaries to the level of Chittenden County teachers is implemented, the total cost of the program rises by an additional $45.2 million. Because it is unclear how this would be funded, this study assumes that the new taxes needed to fund this part of the program are raised in proportional amounts to the new state taxes used to fund the entire restructuring of education finance. Therefore, since 20.4% of the new state taxes are from the sales tax, the study assumes that 20.4% of the new taxes will be sales taxes. The result is shown in Table 4. Using the same methodology as was employed

TABLE 3

Tax Burdens With House Plan Partially Funded

Panel A: Taxes Per $1,000 of Personal Income

	Tax Level		Percent of U.S. Average	
	Hypothetical	Actual	Hypothetical	Actual
Total Taxes	$120.99	$120.79	107.1%	106.9%
Property	$33.84	$52.68	93.7%	145.8%
Sales	$17.74	$12.62	65.7%	46.8%
Income	$38.26	$28.62	135.2%	101.1%
Personal	$34.78	$25.87	162.9%	121.2%
Corporate	$3.48	$2.74	79.6%	62.6%
Other	$28.53	$26.88	132.2%	124.6%

Panel B: Taxes Per Capita

	Tax Level		Percent of U.S. Average	
Total Taxes	$2,126	$2,122	102.1%	101.9%
Property	$608	$926	91.3%	139.0%
Sales	$319	$222	64.0%	44.6%
Income	$687	$503	131.7%	96.4%
Personal	$625	$455	158.6%	115.5%
Corporate	$63	$48	77.5%	59.7%
Other	$512	$472	128.8%	118.7%

earlier, Vermont's total tax bill would rise from 2% over the national average per capita to 9% over. On an income basis, our total tax bill would rise from the current level of 7% over the national average to 14% over. This would give Vermont a ranking of about fifth in the nation, instead of our current level of tenth highest in total state and local taxes.

At a total tax burden of $129 per $1,000 of income, this ranking would put us behind Alaska ($210), New York ($151), Hawaii ($143), and Wyoming ($140).[5] Vermont would have a similar tax level as Arizona ($127), Minnesota ($126), and Wisconsin ($128).

[5]Alaska and Wyoming rely heavily on mineral severance taxes for their revenues.

TABLE 4

Comparative Tax Burdens if Teacher
Pay Equity is Fully Funded

Panel A: Taxes Per $1,000 of Personal Income

	Tax Level		Percent of U.S. Average	
	Hypothetical	Actual	Hypothetical	Actual
Total Taxes	$129.12	$120.79	114.3%	106.9%
Property	$39.65	$52.68	109.8%	145.8%
Sales	$18.97	$12.62	70.3%	46.8%
Income	$39.93	$28.62	141.1%	101.1%
Personal	$36.14	$25.87	169.2%	121.2%
Corporate	$3.79	$2.74	86.6%	62.6%
Other	$30.56	$26.88	141.6%	124.6%

Panel B: Taxes Per Capita

	Tax Level		Percent of U.S. Average	
	Hypothetical	Actual	Hypothetical	Actual
Total Taxes	$2,269	$2,122	108.9%	101.9%
Property	$697	$926	104.6%	139.0%
Sales	$333	$222	67.0%	44.6%
Income	$702	$503	134.5%	96.4%
Personal	$635	$455	161.3%	115.5%
Corporate	$67	$48	82.5%	59.7%
Other	$537	$472	135.0%	118.7%

How Will the House Proposal Affect an Average Family?

This part of the analysis looks at the entire Ways and Means tax package and analyzes the total cost and its impact on an average family. The 1990 Census reported an average Vermont family contained 3.06 members. We use this figure in our per family calculations, but obviously a family of four would see higher tax increases than this average.[6] This portion of the analysis deals only with the partial funding of the teacher pay equity. The

[6]Because we rely on different data sources and different measures, some of our analysis is based on family information, some is based on households, and some on consumer units.

following section briefly discusses the tax impact on a median income family if the teacher pay equity portion of the program was fully funded.

The analysis also attempts to model the ultimate incidence of some of the tax increases. There is no generally accepted way to theoretically deal with the incidence of tax increases, especially business taxes. We have used what we consider to be conservative assumptions throughout the analysis; we specifically spell out those assumptions below. But because of the data problems, our bottom line estimate of the total cost per family should be taken as suggestive of the actual incidence of these taxes, not as definitive calculations. And because two of the major tax increases are income taxes, the estimates are very sensitive to the income level assumed. The net change in taxes is also sensitive to the property tax reduction and the level of income of the property owner. There is no Vermont-specific data or evidence on the relationship between income level and value of house or property taxes paid.

All of the results are shown in Table 5.

Our methodology basically shows that for a median income family, the Ways and Means proposal would significantly lower residential property taxes — by about $1,000. But the tax increases would increase direct and indirect taxes on that family by about $700. Therefore, this median income family would see a net decline in taxes of about $300 per year.

The most visible and probably most unpopular tax, the property tax, would decline by a significant amount. The taxes that would be raised would be far less visible, and some invisible to taxpayers. This median income family's income taxes (state and local) would rise by about $410. It would pay about $130 more in increased sales taxes on goods purchased, about $12 more due to new taxes on services, $35 more on meals eaten away from home, and $13 more in phone bills.

Almost all of the other tax increases would be invisible to consumers because they represent increased taxes on business that would be passed on to Vermont consumers. If we ignore these taxes that are levied on business, the net change for the average taxpayer is to reduce taxes by $350.

Background. The median income family in Vermont earned about $35,000 in 1991. The 1990 U.S. Census reported a median family income level of $35,000 in 1990. Our estimate of a median family income of about $40,000 for 1994 is probably a few thousand dollars high, but a reasonable estimate to be used with this analysis.

The Ways and Means package eliminates the residential property tax for schools on a house and two acres of land and substitutes for the lost revenues a local income tax, an increase in the state income tax, and new taxes or increases in existing taxes.

Property Tax. I assume the average family lives in a $100,000 house. The 1990 Census reported a median value of $95,500 for owner occupied houses in Vermont. Vermont property transfer tax data report an average value of $102,500 for R1 housing units (including condominiums but excluding vacation homes) for 1992 in Vermont.

We do not know the actual average school tax rate in Vermont. The ratio of total taxes collected for schools to the total fair market value in Vermont gives us an average school tax rate of $0.955. This means that a $100,000 house would pay $955 for school property tax; under the Ways and Means Proposal, this would be the decrease in property taxes for an average house.

TABLE 5

Net Change in Taxes For an Average Family

Family Income Level	$40,000	
School Tax Rate	.955	
House Value	$100,000	
Property Taxes Paid	$955	
Property Tax Change	($955)	
State Income Tax	$8	
Local Income Tax	$400	
		$408
Sales Tax 1 point	$132	
Meals Tax 3 points	$36	
Auto Rental	$3	
Services to Dwellings	$4	
Legal	$5	
Telephone	$13	
		$193
Corporate Profits	$17	
Management Consulting	$8	
Accounting	$9	
Computer Services	$17	
Misc. Business Services	$10	
		$61
Total Increase in Taxes	$662	
Decrease in Property Tax	($955)	
Net Change	($293)	
Increase in Taxes Ignoring Business Taxes	$601	
Decrease in Property Tax	($955)	
Net Change	($354)	

Note: This assumes the teacher pay equity is only funded at the $6 million level, not the full $51 million needed.

Income Tax. Each locality in the state would levy a local income tax which would range from 2% of the federal tax liability to 21%, with an average tax rate of 8.9% of the federal liability. Assuming a $40,000 family income, the local income tax liability would be $400.

There would also be an increase in the state income tax. There would be no tax hike for married taxpayers earning under approximately $37,000 or single taxpayers earning under about $27,000. A $40,000 family would see an increase of about $8 in its state income tax bill. State income taxes would increase for higher income families.

Sales Tax. The sales tax in Vermont would increase by one percentage point. The current five percent tax is scheduled to be reduced to four percent at the end of FY95; the Ways and Means proposal would keep the rate at five percent. It is not clear at this time whether the rate would go to 6% during FY94 in order to fund the program. Nonetheless, the extra one percentage point would bring in a total of about $33 million and is the largest single tax increase at the state level.

We assume that 10% of the sales tax is paid by non residents of Vermont. Of the balance, 40% is paid by Vermont consumers and 60% by Vermont businesses. We assume that one half of the business share of the taxes is passed on to Vermont consumers. The result is that an average family in Vermont would pay about $132 in additional sales taxes annually.

Meals and Rooms Tax. The meals and rooms tax is currently at 7%. The Ways and Means proposal would increase this to 10% and would bring in $28 million. We assume that 65% of the tax is paid by Vermonters; the balance is paid by out of state visitors. Using this methodology, the average family would pay an additional $36 per year.

Auto Rental Tax. The auto rental tax would be a flat $2 per vehicle per day and would bring in an estimated $4 million. Using CES data, we estimate that an average family would pay $3 per year.

Telephone Property Tax. The telephone property tax is an existing tax levied on the personal property (machinery and other capital items) of telephone companies. This tax would be raised from the current 2.37% of book value to 3.37% of book value and would bring in an estimated $3.9 million. Most of this tax would fall on New England Telephone (NET) and the incidence of the tax would depend on regulatory decisions. We estimate a per family cost of $13 per year as follows:

Three quarters of NET's plant and equipment is apportioned to intrastate calls. Seventy percent of NET's phone lines are residential. We assume that 70% to 75% of the costs would therefore be allocated to residential customers. We assume that none of the business costs are passed along to residential customers in this analysis. This gives us $13 per family per year.

Sales Taxes on Selected Services. The Ways and Means proposal raises about $20 million in new taxes by taxing selected services. Some of these are services directly purchased by households and families, others are purchased by businesses. It is difficult to determine the ultimate incidence of these business taxes. Part of the problem is that we do not know how the law will be structured. If it is structured like the sales tax, taxes will not be levied on sales to out of state customers but a use tax will be levied on these services purchased from out of state firms. Ultimately, we believe that all these taxes will be passed along to consumers, except for those that are passed on to consumers in other states. Our estimate, presented in Table 4, is that these new taxes will cost the average family $68 per year.

The analysis presented above assumes that only $6 million of the teacher pay equity costs are funded. If the entire $51 million cost of teacher equity, that is, bringing all teacher salaries up to the level of Chittenden County teachers, is funded, the per family cost will clearly be higher. Without knowing how the extra funds would be raised, it is difficult to analyze its impact on an average income family. However, by making some plausible assumption about how much of the extra cost would be exported out of state, to tourists and others, and allocating the balance equally to all Vermonters, a reasonable estimate can be made.

If we assume that of the $45 million needed, one-quarter would be exported out of state or absorbed by businesses, $34 million would be needed to be collected from Vermonters. On a per capita basis, this is $60 per person. For the average sized Vermont family of 3.06 persons, the cost is $184.

Therefore, if the program is fully funded, the total tax savings to a median income Vermont family earning about $40,000 would be approximately $120 per year. This includes the reduction in property taxes and the additional new taxes needed to fund the program with full teacher pay equity included.

Other Considerations

A massive change in funding education, such as that proposed by the Ways and Means Committee, has many other impacts in addition to the direct fiscal impacts discussed above. In this section, we touch on some of these. Many of these issues are not easily quantifiable, but will have impacts that will be felt by Vermonters individually and will affect different towns and regions of the state.

- It should be noted that all of the estimates presented above are only estimates. With such a massive change in taxes, our ability to forecast new revenues from these sources is limited. It is well known that forecasts of income and sales taxes are subject to uncertainty, especially due to unanticipated changes in the economy. But enacting new taxes, such as taxes on services, auto rentals, and the like, entail an additional risk. Without any historical track record on which to base revenue forecasts, a significant degree of error — either overestimating revenues or underestimating them — is likely. This will be a significant problem for the first several years of the new taxes.

- The range of error in forecasting existing taxes also means that towns could experience a significant shortfall in revenues if the economy does not perform as expected. If the Ways and Means plan was in effect in FY91, the shortfall in revenues would have been $3 million from the state income taxes, $0.3 million from corporate income taxes, $2 million from the sales taxes, and $10.7 million from the local income tax. Therefore, local governments would have come up $16 million short on their revenues.

Where would this money have come from? Either local governments would have to raise their local income taxes or the state would have to make up the difference or local districts would have had to cut their budgets. The most likely option is the latter.[7]

- Under the House plan, Vermonters would not have to pay any school taxes on their homestead property, which is defined as a house plus 2 acres of land. This essentially discriminates against rural Vermonters. In cities, house lots are typically less than one acre. But in most rural areas of the state, zoning laws restrict lot sizes to more than 2 acres. Thus, many rural Vermonters will find themselves paying school taxes on that portion of their land that exceeds two acres. Large landowners will be able to enroll their land in whatever variant of the current use program that emerges from the new plan, but those with small parcels of over two acres but less than 20 (or whatever the minimum size will be for enrollment in the new current use program) will pay school property taxes.

In addition, there will be an incentive for town listers to value land in excess of two acres at a low value. If someone owns a house on twenty acres, listers currently have no incentive to arbitrarily change the value of the house on two acres or the eighteen acres.

But under the new plan, valuing the land in excess of two acres at a high value would give no benefit to the town. Listers will probably tend to value houses at a relatively high dollar value and land at a relatively low dollar value. This will tend to reduce the property tax revenues accruing to the state that goes into the new education trust fund and the general fund. As the example in Table 6 shows, a small change in the relative values of the house and the land changes the amount of money going to the state by a large amount but result in no change in total town tax revenues. This could affect the revenues the state has available to fund its share of the program.

- It is unclear from the proposal exactly how the current use program would be structured and how taxes would be levied on farmers. Especially unclear is the fiscal impact of this on tax revenues.

- There is no incentive in the plan for districts to look for inexperienced, and hence lower cost, teachers to hire. One of the problems of the current system is that richer districts can attract more experienced teachers from other districts because the richer districts pay more. If the state pays all teacher salaries, districts have no incentive to look for less experienced teachers that cost them less. This therefore could add to the overall cost of the entire plan to the state. If there is a correlation between experience and quality of teaching, it could improve the quality of instruction as well.

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[7] To put that amount in perspective, a shortfall of this magnitude would be equivalent in the current system of education finance to the state of Vermont cutting its state aid to education by more than 10%. In the current round of budget cuts, Governor Dean has held state aid to education harmless from his 2% across the board cuts.

TABLE 6

Statewide Property Tax Implications
Of Changes in Values of House and Land
By Town Listers

	Original Town Appraisal	Listers Appraise House High, Land Low
Value of House and Land	$150,000	$150,000
House Plus 2 Acres	$130,000	$140,000
18 Acres of Land	$20,000	$10,000
Local Tax Rate for		
Schools	$1.50	$1.50
Town	$0.40	$0.40
Statewide Property Tax	$1.13	$1.13
Tax Revenues to Town		
From House Plus 2 Acres	$520	$560
From 18 Acres	$80	$40
Total to Town	$600	$600
Property Tax Revenues to State	$226	$113

This plan, by implementing a uniform salary, does not completely eliminate the advantage rich districts have over poorer ones. Certainly salary and fringe benefits such as health insurance and retirement will be equalized. But richer districts will be able to afford to spend more on perks for their teachers. They will have more travel funds, professional training, equipment, smaller class sizes, and the like that they will use to "buy" the better teachers that they seek and hence will spend more per pupil than other districts.

- The House plan mandates a 12:1 student to teacher ratio. As discussed above, some districts will want to spend more than the average district. Will this new, higher level of spending by some districts at some point in the future be a new floor that will be seen as the minimum that all districts should spend per pupil? This is not merely idle speculation. The foundation plan when it was implemented in the mid 1980s was also supposed to insure roughly equal spending among districts, and indeed it has significantly leveled the playing field. But the higher spending districts are now seen as the floor up to which all districts should spend.

- This proposal is purely a fiscal change in the sources of education funding. There is no reform of education built into the program and there is no focus on education costs. Indeed this plan raises the total costs of education by raising teachers' salaries for most teachers in the state. Education reform is currently done by both the state and by local districts. Local districts frequently tie changes in working conditions or other types of reform to changes in pay structures. Districts will no longer be able to attempt to make any links between pay and performance or between pay and reform. This will be able to be accomplished at the state level; the essential question is whether reform is more easily accomplished by local districts tying reform to salary or whether it is more easily accomplished in a more centralized framework at the state level.

- On bargaining issues, the state may very well be a more effective counter to the bargaining power of the Vermont Education Association than numerous small districts negotiating individually with their local school unions. In the long term, this will probably help contain labor costs, although the potential of a statewide teachers' strike could wreak havoc on the state.

- Although the plan does a great deal to equalize per pupil spending, it does not equalize taxes or tax rates. Currently property tax rates vary among towns, but under the House plan local income tax will also exhibit a large amount of variation. And these local income tax changes are large enough to give people an incentive to move. For example, as shown in Table 7 the towns of Colchester and Shelburne in Chittenden County currently have similar school effective tax rates of $1.17 in Colchester and $1.28 in Shelburne. The owner of a $100,000 house in Shelburne currently pays $110 more in school taxes than the owner of a similarly valued house in Colchester.[8] For a house appraised at $200,000 the difference would be $220.

Under the House plan, these school property taxes would be replaced by a local income tax. Colchester would have a 6% local income tax and Shelburne would have a local income tax rate of 11%. The differences in local income taxes in the two towns are shown in Table 7.

For a median income family earning about $40,000, the difference in local income taxes between the two towns is somewhat more than the difference in school property taxes. But for high middle income and upper income families, the difference widens and would presumably be one factor that would determine a family's choice of location.

This problem is compounded by the fact that local income tax rates are town-specific. One basic goal of the plan is to increase the progressivity of the tax structure in Vermont. But the plan, because it relies on significant differences in town income tax rates, does not accomplish the goal of horizontal equity -- treating people equally if they have equal incomes. A rich person in a town with a low local income tax rate will pay lower income taxes than a rich person in a town with a high income tax rate. And that person may pay less than a middle income person in a town with a high income tax rate.

[8] The owner of a $100,000 house in Colchester pays $1,170 in school taxes compared to $1,280 for the $100,000 house in Shelburne.

TABLE 7

Local Income Tax Comparison: Shelburne and Colchester

Income Level	Colchester Local Income Tax	Shelburne Local Income Tax	Difference
$40,000 - $44,999	$269	$493	$224
$50,000 - $74,999	$417	$765	$348
$75,000 - $99,999	$790	$1,448	$648
$100,000 - $199,999	$1,475	$2,703	$1,228

- It is extremely difficult to explain how the local income taxes are distributed back to the town. The simple answer is that the state guarantees a set amount, say $250 per student, that will be paid to each town for each percentage point of the local income tax. But the exact method by which this works, and indeed whether that amount can be guaranteed by the state, is not at all transparent. One goal of taxes should be that people understand where taxes come from and where they are distributed. This latter goal is not met by the redistribution portion of the local income tax mechanism.

- The House plan's major tax reform is to completely eliminate the property tax on residences as a source of revenue for schools. It does this based on a concern over the perceived inequity of the property tax but does not consider other goals of tax policy such as efficiency, stability of revenues, predictability, or ease of understanding, among others. The House proposal does not consider any of the positive aspects of the property tax, nor does it consider whether eliminating the property tax and making the changes outlined above will, on balance, be a net improvement in Vermont's overall tax policy.

Overall Impact

The major goal of the House plan is to reduce property taxes and it succeeds in that. But there is a cost to doing this. Vermont's tax system is currently a lopsided one, with an overemphasis on property taxes, an underemphasis on the sales tax, and a higher emphasis on the personal income tax than most states. But this plan replaces the currently unbalanced system with another unbalanced system, one that is far lighter than most states on the property tax and relies much more heavily on the income tax. It should be noted that the income tax is the most progressive tax that the state levies, but it should also be noted that the property tax is not as regressive as most people assume.

In weighing the relative advantages and disadvantages of different types of taxes from an economic competitiveness standpoint, one must look at the incentives and disincentives inherent in any type of tax. The property tax gives a disincentive for individuals to build large and expensive houses; it also unfairly burdens property-intensive industries, such as agriculture. But the property tax is stable and is usually not a significant factor in business location or expansion decisions.

The income tax is a disincentive to earning income, especially a progressive income tax such as Vermont's. It takes a larger share out of income of those earning larger incomes, and the Ways and Means proposal superimposes a progressive state income tax on top of an already progressive federal income tax. The marginal combined state and local income tax rate of Vermonters earning an adjusted gross income between $80,000 and $180,000 would be 12.4%.[9] For those earning between $180,000 and $300,000, the combined state and local marginal tax rate would be 14.4%. The marginal rate of those families earning over $300,000 would be 15.8%.[10]

Even for middle income Vermonters earning $40,000, the marginal state and local tax would be 10.3%, third highest in the nation.

These rates are based on the newly-passed federal tax increase and would give Vermont the highest marginal tax rate in the nation. With these high marginal tax rates, there would be a strong incentive for many Vermonters to shelter their income from income taxes. There are various methods they can use, the most important being the purchase of tax-free municipal bonds. This would obviously affect the forecasted revenues that the state would receive from the higher income tax rates at the state and local levels. Higher marginal tax rates can also lead to changes in residence, either to towns with lower local income tax rates or to other, lower-tax states.

The Senate Plan

The Vermont Senate Education Committee is also considering a bill to reform education in Vermont. That bill (S255) has not been studied in nearly as much depth by any Vermont government agency, so the analysis here is limited as well.

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[9] As of January 1993, Vermont's top marginal income tax rate was 10.54%, second in the nation. The highest was California, with a top rate of 11%. But California's top rate affected taxpayers at a taxable income level of $414,000 while Vermont's took effect at a taxable income level of $55,000 (which corresponds to an adjusted gross income of about $89,000).

[10] This analysis assumes that the local income tax rate is 8.9%, the statewide average local income tax rate. But those upper income Vermonters living in towns where the local income tax rate is greater than 8.9% would face higher marginal tax rates. The extreme case, for a Vermonter with income over $300,000 is in those towns where the local income tax rate is 20%. In that case, the marginal state and local tax rate would be 20% of adjusted gross income.

The Senate bill attempts to do three things: regionalize the delivery of education, increase the state share of education funding to 50% of the total, and institute reforms to improve performance of the schools. Each of these will be taken in turn.

Regionalize Delivery of Education

The Senate bill regionalizes the delivery of education and the local funding of education. Local education finance and structure would be based on the supervisory union. Towns in each of the supervisory unions would have the same local property tax rate and foundation aid would be distributed to each town in the union district by the share of students in each union. All teacher negotiations will be done on a supervisory union basis rather than the current local district basis.

If the state board of education determines that existing school districts are not operating efficiently or economically, the state board can create new supervisory unions. Towns are encouraged to do this by having the state pay a higher percentage share of school construction costs if towns consolidate their programs or if school programs within a town are consolidated.

Supervisory districts will have the option of levying a 3% local income tax. These revenues will be distributed back to the individual districts based on the number of students in each local district. In turn, each local town district would reduce its property taxes. But the total amount of income taxes distributed to each town would be divided by the number of residential properties in each town and each property owner would see his or her tax reduced by an equal dollar amount. This would benefit lower valued houses proportionally more than higher valued houses.

Increasing State Share of Education Costs

The bill mandates the state to increase its share of the total foundation cost of education (essentially the minimum per pupil cost deemed necessary to meet minimum state requirements) to 30% in FY95, 35% in FY96, 40% in FY97, 45% in FY98, and 50% in FY99. No mechanism or source of funds is identified to meet these goals.

Performance Plans

In this plan, each supervisory union would have to adopt an education performance plan, which includes education goals, curriculum content, methods for measuring the achievement of the goals, and methods to report on these to the community. If the plan is not acceptable to the state board of education, a two-tiered response is specified. First, the state department of education is to work with the school district to make the plan acceptable. If the plan is not acceptable, state aid to the district will be withheld until an acceptable solution is worked out.

Conclusion

The Senate plan is a less radical restructuring of education finance than is the House plan. On the financing side, it basically regionalizes the property tax and also gives supervisory unions the option of replacing a portion of their property tax revenues with a regional income tax. The net result of both of those policies would be to redistribute both property tax revenues and income tax revenues within the supervisory union district.

The Senate plan also focuses on performance issues. This also involves a regionalization of public education at the supervisory union level. The performance standards, curriculum content, and other measures of performance are not spelled out, but they are integral parts of the Senate proposal and they are enforced through the threat of losing state aid to education.

Vermont Business Roundtable Comments on Dr. Woolf's Analysis

Education is a critical component of any prosperous economy. It is therefore essential that Vermont builds a superior education system now, if we want to ensure our economic vitality and unique quality of life into the next century.

Current Situation

Vermont has initiated a number of significant reform and restructuring initiatives including developing portfolio benchmarks in mathematics and writing in the 4th and 8th grades. In 1992, Vermont won a New American Schools Grant that will allow some Vermont "test" schools to attempt to "break the mold" in education. Vermont also recently opened the Vermont Institute for Science, Math and Technology with a $10 million grant from National Science Foundation.

However, many of the problems that have traditionally plagued Vermont education continue to do so. Of the 24,000 students in grades 9 through 12 in Vermont in 1990, over 1,200 eventually dropped out of school. Moreover, 17.5 percent of the 19-year-olds living in Vermont in 1990 had dropped out of school. In the class of 1990, only 62.5 percent of seniors continued their education within 6 months of completing high school, and that was fewer than from the class of 1988.

Vermont students demonstrate average performance on their Scholastic Aptitude Tests (SATs); in 1993, they scored 2 points above the national average in the Verbal portion of the test, and 11 points below the national average in Math.

The cost of education is another concern. Local spending devoted to education has increased 148 percent since 1983, from $163 million to $405 million in 1991. State education expenditures have increased by 102 percent, rising from $98 million to $197 million. During this same period, the consumer price index, or CPI, increased by only 40 percent while total public school enrollment in Vermont increased by less than five percent! These figures indicate that in the last ten years our spending increases have greatly outpaced enrollment without producing commensurate results.

These conclusions have been further validated by the recently released report card on U.S. education. Compiled by the National Center for Education Information, it reports that Vermont has the sixth highest spending per student and is the state with the most staff per student. Yet Vermont's SAT scores ranked only 36th of the 50 states.

The Current Legislative Proposals

Vermont needs comprehensive education reform legislation because the present education system is not producing the results we want. We have an outmoded structure that no longer works. Rather than reacting to the cost of the present system and changing how we pay for it, we need to confront a system that is not working for us.

The legislative proposals analyzed in the accompanying paper do not meet the fundamental challenge -- assuring an education system that is structured to deliver quality education for every Vermont child in a manner that maximizes results with available resources and provides the assurance of a stable, equitable, and economically sound financing system.[11] In their current draft status, the House and Senate proposals do not provide comprehensive reform and restructuring of the Vermont K - 12 education system.

The House proposal is primarily a plan to alter the Vermont tax structure by placing less of the burden on the ownership of property and more on other taxes. It proposes a different way to pay for education rather than a plan to restructure or improve education. The House proposal also includes establishing a statewide teachers' contract that separates the compensation and performance of teachers from the quality of the educational outcomes.

The Senate proposal makes an effort to deal with governance and organization and includes some elements of education reform as part of the design; however, it does not detail the specifics. In addition, this plan does not identify the sources for the proposed increase in the state's share of funding the new financing plan.

Roundtable Recommendation

The Vermont Business Roundtable is committed to achieving a high quality education for every Vermont child. If we want to guarantee all our children a first-class economic future, we must offer not occasional excellence but sustained excellence <u>for all</u> of our students, those who are college bound, those pursuing other post-secondary training, and those preparing to enter the workplace.

Because of the changing Vermont economy, the public education system must teach appropriate skills to Vermont children. The existing K - 12 educational system is failing to

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[11]Financing system should:

- Be understood by Vermont taxpayers.
- Provide an equitable distribution of funds across the state.
- Establish stability of revenue sources.
- Hold local schools accountable for educational performance and outcomes.
- Allow Vermont to remain economically competitive.

graduate Vermonters who will meet the emerging and more demanding skill requirements of the 21st century. For Vermonters to succeed in the workplace tomorrow, they must succeed in the classroom today.

We need to determine how the system should be changed and *then* we need to deal with an uneven funding system and alternative means of funding public education. It is essential that any restructuring of the education system be focused on the educational achievement of the students (not only on education inputs) if we wish to develop significant and lasting improvements in the education of Vermonters.

Therefore, the criteria for restructuring initiatives should assure a maximum return on investment combined with accountability. High standards tied to effective assessment, teacher compensation linked to performance, and a system responsive to the needs of the students being served (eg. school choice) are some of the means of achieving those results.

Restructuring the public education system should be a continuous and creative process that creates institutions that are capable of responding to a changing environment and adapting to increasingly diverse student needs. A process for accomplishing this kind of restructuring should:

1. Define the desired educational outcomes.
2. Design the best structure and organization for achieving those outcomes within the constraints of the fiscal capacity of state and local governments.
3. Determine the most cost effective budget for the system required to deliver the results.
4. Identify the appropriate sources of revenue to pay the cost.

The reform of K - 12 education in Vermont should be viewed as a package with results that have a direct relationship to quality, governance, cost, and financing. This reform effort should also assure a relationship between responsibility and authority. If this is effectively done, we can have high quality affordable education for all Vermont children.

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Established in 1987, 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 125 Vermont companies representing geographic diversity and all major sectors of the economy, the Roundtable is committed to achieving a healthy economy and preserving Vermont's unique quality of life.

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