

GOVERNOR JAMES H. DOUGLAS

**ALTERNATIVE APPROACH TO
FY 2010 BUDGET**

BALANCED – RESPONSIBLE - SUSTAINABLE
MAY 19, 2009

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BUDGET SUMMARY: BALANCED, RESPONSIBLE AND SUSTAINABLE

The Governor's budget approach outlined here addresses three critical areas that must be part of any comprehensive budget plan we pass. The Douglas plan addresses key budget areas with bold and thoughtful solutions to our toughest challenges.

- **This proposal is a balanced, responsible and sustainable budget approach** that addresses immediate fiscal pressures with long-term fiscal prudence. It meets legislative leadership in the middle on new revenue and advances reforms necessary to address deficits in years to come. In fact, this budget approach deals with the Legislature's FY 2011 projected deficit of \$67 million.
- **This proposal invests in job creation.** It removes legislative tax increases counter to economic development such as the \$5.5 million income tax hike on small businesses and farms. It makes reforms needed for the future such as instituting an R&D tax credit and addressing the challenge in the UI trust fund. It also invests in a workforce for the 21st century by restoring funding for workforce training and scholarships for 600 Vermonters.
- **This proposal gives Vermont families a needed break** as they face higher gas taxes, electric rates and other costs. It provides a middle-class tax cut by returning every cent from capital gains tax changes to Vermonters in the form of lower income tax rates. It also restores the Sales Tax Holiday, which proved so successful last year and gives a needed break to Vermont consumers.

Long-term economic security in Vermont depends on crafting budgets that are sustainable and affordable for the coming years and assisting private enterprise to create new job opportunities for Vermonters. The Governor's revised fiscal 2010 budget balances state government growth while managing to the realities of this recession.

Sustainable budgets to protect Vermont in the coming years:

Long-Term Sustainability

- The Legislature's budget contains deficits of \$67 million for fiscal 2011 and \$141 million for fiscal 2012 - when federal stimulus funds are no longer available. If left unaddressed, this will undoubtedly lead to over \$200 million in higher taxes, deeper cuts or a combination of both.
- ✓ The Governor's budget has no structural deficit for fiscal 2011. For fiscal 2012, the projected deficit in the Governor's budget (\$44 million) is nearly \$100 million below the Legislature's plan and can be effectively managed by taking action on necessary, cost-saving reforms outlined in his budget.

Taxing and Spending

- The Legislature's budget uses a combination of one-time ARRA funds and \$26 million in tax increases - including \$9.3 million in the income tax - to allow spending to grow to artificially high levels - 3.5% above fiscal 2009 - when state revenues are in fact below fiscal 2006 levels. While Vermont has the most generous human services programs in the nation, the Legislature's budget increases funding for human services by 5.5%.
- ✓ The Governor's plan uses one-time ARRA funds for their intended purpose; to avoid drastic spending reductions and costly tax increases at the state level. And while he does not believe new taxes are needed in light of federal stimulus money and the fact that Vermont is already the highest taxed state in the nation, the Governor is prepared to meet Democratic leadership on common ground with \$13 million in non-broad-based splinter taxes.
- ✓ The Governor's plan addresses the rate disparity for unearned income (capital gains) while protecting farmers, loggers and Vermonters over 65 who rely on investments for retirement income. By making this change, the Governor's plan offers \$13.3 million in income tax relief to low-to-middle income Vermont families.
- ✓ Further, the Governor's budget holds fiscal 2010 spending to near fiscal 2009 levels, thus avoiding building unreasonable spending expectations in the coming years. Rather than using one-time money to build-up base spending, the Governor uses these funds to invest in job creation and economic growth – the surest way to grow revenues and protect state services in future years. And contrary to the rhetoric of some, Vermont would still remain at the top in terms of the quantity and quality of social services it provides – even with the Governor's modest proposed reductions in some areas.

Reforms to Control Education Spending & Property Taxes

- The Legislature's budget does not make essential reforms in the Education Fund that are necessary for a sustainable and affordable state budget. The Legislature's budget plan has no strategy for containing costs – in this coming year and in the future – that are required to hold down soaring property taxes.
- ✓ Governor Douglas has made Act 60/68 reform and property tax relief one of his key initiatives this year. The effect of skyrocketing education spending over the past decade has fueled property tax increases that place significant pressure on the General Fund, which is struggling under the

weight of the national recession. Without reform, nearly \$340 million of the General Fund budget is either transferred to the Education Fund or spent for education purposes. That constitutes over 25% of all available general funds. It is a matter of equity and transparency that education costs be placed in the Education Fund. Failure to address the growth in education costs risks the State's ability to provide for other General Fund expenses, especially human services.

- ✓ Coupled with the transfer of teachers' retirement from the General Fund to the Education Fund must be necessary cost-containment measures to prevent property tax increases. The two proposals cannot be taken alone. In fact, the Governor's plan reduces the statewide rate by 2 cents in the coming year instead of the 1 cent reduction in the Legislature's plan.

Investing in the economic future of Vermont

Investing in Job Creation

- The Legislature's budget uses only \$4.1 million in the discretionary State Fiscal Stabilization Funds (SFSF) from ARRA for job creation investments. Their plan will leverage \$52 million in FY 2010 with no job creation plan or investment in FY 2011. The remainder – \$4.4 million – of these one-time funds goes to on-going, business as usual, base spending.
- ✓ The Governor's *SmartVermont* proposal invests \$11 million in SFSF money for fiscal 2010 in job creation initiatives. In fact, the Governor's plan draws down an additional \$2.5 million in SFSF money above what the Legislature has proposed. Additional investments in fiscal 2011 could leverage another \$83 million for a staggering economic development and job creation package of nearly \$185 million over the next two years.

Protecting Small Businesses and Farms

- The Legislature's budget raises \$9.3 million in new income taxes that will cost small businesses thousands of dollars in new taxes. The Legislature's proposed changes to our income tax system will only add to the struggles of these employers as they also face higher gas taxes, increased electric rates, and other rising expenses.
- ✓ Rather than adding to challenges facing small businesses and farms, the Governor's budget does not increase their income tax burden. Instead, the Governor's plan includes initiatives to help employers weather this

difficult economic time by reducing income tax rates. It includes the Sales Tax Holiday, which proved so beneficial to retailers and consumers last year, and a Research and Development tax credit to help emerging, cutting-edge businesses grow and expand here. Further, it eliminates the Estate Tax from the legislative proposal. Finally, the Governor proposes to address challenges in the Unemployment Insurance Trust Fund, because if this problem goes unaddressed businesses and the state will be on the hook for a \$160 million deficit by the end of next year as well as the nearly 6 percent interest we'll have to pay on that deficit.

Investing in the Next Generation

- The Legislature's budget reduces funding for workforce training - jeopardizing \$7.2 million in federal stimulus money - and eliminates Next Generation scholarships for over 600 Vermont students.
- ✓ Governor Douglas recognizes that in an economic downturn, it is critical that we continue to make investments in our workforce and the next generation. The long-term economic well-being of Vermont depends on a highly skilled and educated workforce. That is why the Governor's budget restores \$750,000 for the Vermont Training Program and \$2.6 million for scholarships.

FY 2010 TAX FAIRNESS AND INCOME TAX REDUCTION PROPOSAL

Eliminating the capital gains income tax exclusion and lowering income tax rates for all Vermonters will give businesses, families and those who are most vulnerable during tough economic times much needed relief from the burden of high taxes. By lowering marginal income tax rates, some of which are the highest in the country, we are better positioned to compete with other states for business. The Governor's proposal will protect farmers, loggers and the elderly with exemptions and allocate all income tax dollars into much needed income tax relief.

In 2004 and 2008, Governor Douglas submitted to the Legislature a plan to reform the treatment of capital gains under Vermont's income tax system. The Governor's approach called for taxing capital gains at the same rates as wages and other earned income.

In the 2009 session, the Legislature also proposed to make this tax change, but their plan did not provide protection for those over 65 or for farmers and woodlot owners. The Legislature also eliminated the deduction for paid state income taxes, thus raising the taxable income for over 26,000 Vermonters. Finally, the Legislature siphoned off or took \$9.3 million in new taxes from the above changes before lowering income tax rates.

In contrast, the Governor's plan creates important exemptions for those Vermonters over 65 and for farmers and woodlot owners to protect these important investments. His plan also eliminates taxes on the first \$2,500 of capital gains. These changes raise \$13.3 million, which the Governor would use to lower income tax rates for all Vermonters as follows:

Current Law Rates	Tax Bracket - Married	Proposed Rates	% Change in Rate
3.6%	\$0 - \$54,400	3.60%	0.0%
7.2%	\$54,400 - \$131,450	6.80%	-5.6%
8.5%	\$131,450 - \$200,300	8.25%	-2.9%
9.0%	\$200,300 - \$357,700	9.00%	0.0%
9.5%	Over \$357,700	9.00%	-5.3%

Under the Governor's plan, the taxes for 72,900 Vermonters, including over 27,000 Vermont filers with capital gains income, would be lower, while the taxes of 5,200 primarily capital gains filers would rise because the tax on their income would be at the same rate as wage and salaried workers. This plan has the positive effect of providing tax relief to over 44,500 Vermont seniors over 65, who will not see a change in the tax treatment of their capital gains income, but will benefit from the overall lower tax rates in the Governor's proposal.

ECONOMIC DEVELOPMENT PLAN, PART I

SMARTVERMONT: JOBS SUPPLEMENT

Connections – Jobs – Progress

Even as Vermonters face the most challenging economic times in decades, we must seize the opportunity to build a foundation for a prosperous future. Preserving Vermont values and improving our state's economic environment in the competitive global marketplace requires building a *SmartVermont*.

Now is the time to make bold investments in both new and traditional businesses to ensure that Vermont's economy is one of the first to recover from the national recession. Relatively low cost power, great connectivity, a well-educated and trained workforce, and an e-government that is open and welcoming will create a favorable environment for employers, employees and all residents to succeed.

Building off both the original *SmartVermont* proposal – offered by Governor Douglas in March – as well as work by the Legislature in H.313, this supplemental proposal makes full use of the one-time American Recovery and Reinvestment Act (ARRA) funds to support existing and emerging businesses. If the state places this money carefully, the state will continue to realize the benefits of this investment long after the stimulus funds stop flowing.

‡ SMART INVESTMENTS IN JOB CREATION

Getting Vermont's economy moving again is our most important priority, and using Vermont's flexible funding from ARRA for job creation is vital to position Vermont for recovery. Of the \$94 million in State Fiscal Stabilization Funds (SFSF) within ARRA, 18.2%, or \$17.1 million, is available to Vermont over two years for essential state services.

The Governor's *SmartVermont* proposal seeks to allocate the \$11 million available to the state in fiscal 2010 to essential job creation and economic development activities. In total, the \$11 million invested this year will leverage as much as \$101,000,000 in low interest loans, working capital and equity investment for existing employers, growing businesses and start-up companies. Additional investments in fiscal 2011 could leverage another \$83,000,000, for a total of nearly \$185,000,000 for job creation activities over the next two years.

A large portion of the *SmartVermont* proposal relies on the good work, long history and strong lending expertise of the Vermont Economic Development Authority (VEDA). Since VEDA uses state moral obligation as the basis for raising private capital or a reserve for loan guarantees, and as VEDA loans become an incentive for banks to co-invest, each dollar put into VEDA can result in a substantial return on investment.

Further, the state's partnership with VEDA is fully supported by the Legislature, who through the budget bill (H.441) and the economic development bill (H.313) already appropriated over \$3 million in SFSF money to VEDA for a new seed capital fund and the Vermont Jobs Fund. The Administration seeks to augment those funds with additional investments designed to jumpstart the Vermont economy.

ARRA SFSF "Discretionary" Funds In FY2010 Budget		
<i>Proposal</i>	<i>Legislature H.441</i>	<i>Governor Proposed</i>
VEDA - Vermont Jobs Fund - Low Interest Capital for Growing Businesses	\$1,000,000	\$1,350,000
VEDA - Seed Capital Fund - Start-Up Funds for Starting Business	\$2,150,000	\$2,150,000
Tourism & Marketing Promotion - Summer/Fall/Winter	\$500,000	\$1,350,000
Vermont Training Program ¹	\$200,000	\$750,000
Vermont Sustainable Jobs Fund and Farm-to-Plate Investment	\$250,000	\$250,000
VEDA - Strategic Retention Fund - Working Capital & Flex Funding for Existing Business	\$0	\$1,500,000
VEDA - Small Business Lending Program	\$0	\$1,000,000
VEDA - Technology Loan Program for Emerging Companies	\$0	\$1,000,000
Opportunity Zone Pilot (Springfield Redevelopment per H.313)	\$0	\$500,000
Regional Economic Development thru Revolving Loan Funds	\$0	\$1,000,000
Early Stage Business Support (VCET)	\$0	\$150,000
<i>Subtotal for Job Creation Investments</i>	\$4,100,000	\$11,000,000
Department of Public Safety	\$4,400,000	\$0 ²
<i>Total SFSF Spending</i>	\$8,500,000	\$11,000,000³
¹ Administration will swap with GF funds to preserve \$7.2M in ARRA Workforce Training Funds.		
² Administration uses \$4.4M GF for Public Safety.		
³ Administration draws down additional \$2.5M for FY2010.		

Stimulus & Interest Rate Subsidies (VEDA)

Goal: New Business Investment

	State Funding	VEDA Financing	Private Capital	Total Projects
2009-2010	\$1,350,000	\$24,000,000	\$36,000,000	\$60,000,000
2010-2011	\$1,350,000	\$24,000,000	\$36,000,000	\$60,000,000
			Total	\$120,000,000

In 2008, as part of Governor Douglas' Economic Stimulus Package, the General Assembly authorized VEDA's Economic Recovery and Opportunity Program (EROP) to offer low-interest loans to stimulate immediate investments in eligible economic development projects. VEDA participates with other financial institutions to bring a lower blended rate to borrowers.

Through the EROP, \$18 million in loan funds were made available starting in July 2008 to be used by June 30, 2010. Since then, more than \$6.2 million has already been loaned out and another \$6 million committed through this successful program.

The Legislature proposed spending \$1 million to build upon this success. Governor Douglas proposes investing an additional \$0.35 million in this budget, plus \$1.35 million next year in the Vermont Jobs Fund. Each \$1.35 million can leverage \$24 million in VEDA financing, as well as an additional \$36 million in private capital, for a total of \$60 million in each of the next two years to fund important economic development projects.

Strategic Retention Fund: Working Capital & Flexible Funding for Existing Businesses (VEDA):

Goal: Provide Working Capital for Existing Businesses

	State Funding	VEDA Financing	Private Capital	Total Projects
2009-2010	\$1,500,000	\$7,500,000	\$7,500,000	\$15,000,000
2010-2011	\$1,000,000	\$5,000,000	\$5,000,000	\$10,000,000
			Total	\$25,000,000

Working capital is higher risk lending as loans are generally collateralized with inventory and receivables, which can deteriorate quickly in value if a company finds itself in difficulty. This program fills an important need during difficult economic times. It will be available for all companies, but is intended to assist some of Vermont's larger employers who may be struggling and finding it difficult to obtain all of their working capital from their banks. That is why Governor Douglas believes that expanding opportunities for businesses to secure working capital is a necessary step to retain and create jobs.

The \$2.5 million in funding from the SFSF for the next two years would go to cover loss reserves and could leverage up to \$25 million in VEDA financing and private capital. Only banks that already have the infrastructure to effectively monitor and administer working capital lines of credit will be permitted to participate in this program. The loans

are expected to be a 50%-50% split between VEDA and the banks, with VEDA absorbing the first losses.

Technology Loan Program (VEDA):

Goal: Loans for Emerging Technology Companies

	State Funding	VEDA Financing	Private Capital	Total Projects
2009-2010	\$1,000,000	\$6,000,000	\$4,000,000	\$10,000,000
			Total	\$10,000,000

In Vermont, the growing technology sector of our economy has demonstrated real promise in providing high-paying, quality jobs for Vermonters. Technology companies, however, often do not have traditional “bankable” assets making them more risky for lenders than traditional asset-based lending.

Governor Douglas proposes using \$1 million of the SFSF for loss reserves to secure technology loans made by VEDA. This \$1 million investment can secure up to \$6 million in VEDA loans, as well as an additional \$4 million in private capital for a total of \$10 million in capital for technology companies in Vermont.

Investments in our technology sector today will allow Vermont to continue to diversify its economy and be a leader in these emerging industries. Examples might include wireless internet service providers, software development firms or businesses wishing to implement health information technology.

Small Business Lending (VEDA):

Goal: Increase Small Business Growth

	State Funding	VEDA Financing	Private Capital	Total Projects
2009-2010	\$1,000,000	\$4,000,000	\$2,500,000	\$6,500,000
2010-2011	\$1,000,000	\$4,000,000	\$2,500,000	\$6,500,000
			Total	\$13,000,000

Small businesses make up the greatest portion of Vermont’s employment base, with roughly 4 out of 5 Vermonters working for a small business. Critical to creating and preserving jobs is ensuring that new and existing small businesses have an opportunity to succeed, even in these difficult economic times. The goal of this program is to increase the growth of small business in Vermont.

This program combines an interest rate subsidy model with a working capital loan program for small business. The program is intended to assist existing small businesses to expand working assets and to help others maintain operations. The small business lending program includes \$2 million of SFSF funds for two years, of which \$1.1 million will go towards interest rate subsidies and the remaining \$900,000 will go to a loss reserve for higher risk small businesses and start-ups.

Entrepreneurs' Seed Capital Fund (VEDA):

Goal: Assist Early Stage Entrepreneurs

	State Funding	VEDA Financing	Private Capital	Total Projects
2009-2010	\$2,150,000	\$2,150,000	\$4,000,000	\$6,150,000
2010-2011	\$2,150,000	\$2,150,000	\$4,000,000	\$6,150,000
			Total	\$12,300,000

Even in a recession, Vermont must find creative ways to encourage innovators and entrepreneurs. Seed capital will support those organizations whose projects carry above-average risk but have the potential for substantial growth and job creation.

Access to capital is generally the biggest obstacle facing new and innovative businesses whose plans are not supported with a great deal of historical data. In H.313, Sec. 25, the Legislature established the Entrepreneurs' Seed Capital Program within VEDA for this expressed purpose. A state investment in this program will be used for direct equity investments in these dynamic businesses, which will provide growth and jobs that may prove less susceptible to future economic downturns.

The Governor proposes to fund this important program at the Legislature-recommended level of \$2.15 million in the fiscal 2010 budget and an additional \$2.15 million in fiscal 2011. This \$4 million in state money has the potential to leverage an additional \$4 million in VEDA financing and \$8 million in private capital for a total of \$12 million in new investment in early stage companies.

Vermont Training Program

Goal: Upgrade Skills for 21st Century Jobs

2009-2010: \$750,000

2010-2011: \$450,000

For businesses to remain competitive in the global economy, they must have access to a talented and well-trained workforce. Stimulus funds entering the state through the American Recovery and Reinvestment Act will be used to support and expand the highly successful Vermont Training Program (VTP). The customized training of workers provided by VTP in previous years has been a critical element in the success and growth of businesses both large and small.

In the 2008 fiscal year, the VTP completed 81 contracts with Vermont companies, providing support to nearly 5,000 Vermonters with on-the-job training, classroom learning and lean-manufacturing programs. Workers trained through these programs earned an average hourly wage of \$15.95. Each dollar invested in the VTP yields an estimated \$2.67 in revenues to Vermont's economy.

In H.441, the Legislature cut the General Fund portion (\$712,000) of the Vermont Training Program funds and replaced it with \$200,000 in ARRA SFSF. The Vermont Department of Labor is concerned this might run afoul of ARRA provisions for

supplanting funds and maintenance of effort requirements and might disallow the state from \$7.2 million in ARRA workforce training grants. Governor Douglas proposes investing \$750,000 in General Funds to restore VTP funding and would replace equal funds for eligible programs with SFSF monies. The Governor believes the state must ensure that Vermont employees have the tools they need to remain competitive in the 21st century workforce and help their companies compete.

Regional Revolving Loan Fund Coordination (RDCs):

Goal: Support RDC Job Creation with Supplemental Capital

2009-2010: \$1,000,000

The State will make funds available to regional development corporations that establish a substantial revolving loan fund with the purpose of extending working capital to businesses within their region to sustain these businesses through this economic cycle. Job retention and creation will be given priority funding as will businesses who provide value added product and capital importation.

Once the RLF is established, RDCs will be further encouraged to coordinate RLF's in their region with additional funding available for the RLF. RDCs will be encouraged to work with a banking partner to conduct the financial accounting while retaining the decision making at the RDC level. There are many inactive RLFs throughout Vermont, and by coordinating lending capability within a region, more lending activity will help local businesses spread the risk among lenders with a goal of keeping Vermonters employed.

Early Stage Business Support (VCET):

Goal: Assist Early Stage Entrepreneurs

2009-2010: \$150,000

2010-2011: \$150,000

A recent study of their economic impacts has found that business incubators can be prolific job creators – in some cases, providing up to 20 times the number of jobs as compared to infrastructure projects for similar public investments. The Vermont Center for Emerging Technologies (VCET) is a leading-edge technology business incubator in our state. VCET offers early-stage businesses access to necessary services such as furnished office and laboratory space, business consultation, shared office equipment, administrative support, business education and workshops. To further support early stage companies and encourage their growth and development, the Governor proposes a \$500,000 investment in VCET for the next two years.

Tourism and Marketing Promotion:

Goal: Spur Tourism through 2009-2010

2009-2010: \$1,350,000

Travel is America's fifth largest industry and one of the largest service-sector exports. Travel for business, leisure, meetings and events – both domestic and from abroad – is a major driver in the nation's economy, producing \$740 billion in direct travel expenditures, \$115 billion in tax revenue for local, state and federal governments and directly employing nearly 8 million American workers.

According to an analysis conducted by Economic and Policy Resources, Inc. for the Department of Tourism and Marketing, estimated visitor spending in Vermont was \$1.57 billion in 2005. That resulted in an estimated \$3.1 billion impact on Vermont's \$22.7 billion Gross State Product, about 13.7 percent of the state's total, and 36,250 direct and indirect jobs, about 12 percent of the state's total employment of 300,941 for that year.

Investments in this sector benefit virtually every corner of Vermont in some form or fashion. In these tough economic times, promoting our state as an economical travel destination can help the thousands of Vermonters whose livelihood depends on this sector.

Opportunity Zone Pilot – Springfield Project (per H.313):

Goal: Reinvest in Abandoned Industrial Sites using SmartVermont Principles

2009-2010: \$500,000

The Department of Economic Development (DED) will make technical assistance available to the Springfield regional development corporation for re-developing the Jones & Lamson building as a pilot Opportunity Zone project. This project was established in H.313.

Bringing near derelict property back into service is time consuming and expensive. DED would grant money to diminish the costs involved in project preparation – the costs of project development and design, estimating, pre-selling and environmental design. This fund will also be available to other regional economic development corporations with like projects to bring them to readiness for a developer to complete.

ECONOMIC DEVELOPMENT PLAN, PART II

PROGRAM ADDITIONS: R&D TAX CREDIT & SALES TAX HOLIDAY

Research & Development Tax Credit

The R&D tax credit provides businesses with a tax credit for certain related expenditures. The credit spurs innovation and economic growth by promoting investment in R&D jobs and the development of new and innovative products and services.

The Vermont R & D credit would piggy back on the federal credit at 30% providing an incentive for incremental R&D expenditures made in Vermont. The tax credit – in all cases – helps offset a tax liability, such as corporate or income tax.

It is a common misperception that the R&D tax will only benefit high-tech enterprises, when in fact there are many industry sectors that are eligible. A company that engages in research and development through activities like new product development, prototype testing and application for patents are all eligible activities.

The technology and innovation sectors are key components of Vermont's overall economic development plan. The knowledge-based sector of the global economy creates high-paying, low-environmental impact jobs. We have seen this sector mature with emerging associations like the BioScience Alliance and the Vermont Software Developers Alliance. The Vermont Center for Emerging Technologies is an established incubator facility for these growing companies. And in the past few years, Vermont has recognized this by expanding our training funds to support jobs in the technology sector and providing an additional incentive for green technology jobs.

Sales Tax Holiday

Last year's sales tax holiday was huge success with shoppers enjoying a needed break from the sales tax and local merchants benefiting from very brisk business. For some employers, it was the boost they needed to get through the early stages of this economic downturn.

To further encourage immediate economic activity, Governor Douglas is again proposing to suspend the state sales tax for one weekend. Working with Vermont's retailers, the state will select dates that provide the most substantial economic value. These sales tax holidays will provide Vermonters an opportunity to save on purchases large and small and encourage visitors to shop in our state. The Sales Tax Holiday is a great way to encourage economic activity and help local businesses as they feel the pinch of this recession.

ENTERPRISE-LEVEL STRUCTURAL REFORM

In order for us to build a sustainable budget for the long run, we must act now to restructure areas of government where significant savings can be achieved through efficiencies. These reforms will not only save the state millions of dollars, they will also help us better deliver the services Vermonters need.

On a \$1.2 billion General Fund budget, finding \$20 million in operating efficiencies is realistic and responsible. In fact, we laid the ground work for this intensive effort in September 2003 when Governor Douglas appointed seven private citizens to undertake an independent review of how well we operate Vermont State Government. In September 2005, the Vermont Institute on Government Effectiveness, Inc. (VIGE) issued its findings and recommendations. It concluded that the growth of State government was unsustainable and that there is a “once-in-a-generation opportunity to flatten the managerial, processing and bureaucratic layers of the state government organization using smarter technology deployments, workforce attrition and departmental reorganizations.”

The VIGE report became the overarching framework for a proactive self-assessment undertaken by every department in state government called the Strategic Enterprise Initiative (SEI). This self-assessment continues today with consolidations and reorganizations throughout State government - as well as emerging IT projects which achieve savings and improve the level of services we deliver to our citizens. We laid the groundwork for change six years ago and we have made a lot of progress, but time is of the essence and we need to focus all our creative energy on reforms so that we leave a sustainable government for our children and grandchildren.

Our goal is to make necessary reforms to find \$20 million in annualized General Fund savings beginning in FY 2010. Below is a partial list of structural reforms to be analyzed.

Reorganization/restructuring of state government and governmental entities along functional lines:

- Agency of Economic & Workforce Development
- Agency of Regulations & Permitting
- Agency of Public Safety
- Agency of Health Care Reform
- Department of Revenue
- UVM / Vermont State Colleges

Re- thinking Service Delivery Models:

- Contracts with private vendors to deliver some services (similar to F&W licenses and lottery sales at private enterprises)

- Greater investment in online services; reduced office hours open to public
- Contract out all information/rest areas with local chambers of commerce

Re-focusing on Core Mission of State Government:

- Reevaluate mission of non-core services:
 - Liquor
 - Lottery
- Reevaluate State pension system and teachers' retirement system to make sustainable

Consolidation opportunities:

- Court system
- State economic development organizations
- State housing authorities
- State lending authorities
- State energy and efficiency programs
- Social service providers
- Overlapping boards and commissions

EDUCATION FUNDING REFORM: THE TIME HAS COME

In the Governor’s Inaugural Address to lawmakers, he stated that Act 60/68 is fundamentally broken and beyond repair. In this current economic crisis, property taxpayers can no longer afford property tax bills that rise annually at 5% or more. The State’s General Fund and the human services programs it supports, can no longer bankroll Vermont’s burgeoning cost of K-12 education. Our current system is complex and difficult to understand. Our focus should be on building a system that is transparent, where Vermonters can see clearly the impact that the school budget and education spending has on their property tax bills and one that reflects the true costs of education.

Reforms to our education system must be made in order for our state to continue to deliver the high level primary and secondary education we all want for our children in the years ahead. Act 60/68 is a complicated, elaborate system that few can understand and even fewer can explain.

Vermont’s ratio of students to teachers is the lowest in the nation, at 10:1. And, despite a drop of more than 10,000 in Vermont’s student population over the past decade, the staffing levels in our schools have increased by 22%. Our K-12 education costs are among the highest in the nation, at over \$14,300 per student per year versus a national average of \$9,963. Spending at this rate is not practical as soaring education costs crowd out human services and other important programs in the General Fund. We must institute short term cost containment strategies that will serve as a bridge to more comprehensive reforms in the year to come. Even with these modest reforms, Vermont will still rank among the top in per pupil spending and we will still deliver a quality education we can all be proud of.

Here’s a detailed comparison of the Governor’s comprehensive education reform plan versus the Legislature’s education proposals.

<u>DOUGLAS EDUCATION REFORM PLAN</u>	<u>THE LEGISLATIVE EDUCATION PROPOSALS</u>
<i>Education Cost Containment</i>	
For FY 2011, the Douglas proposal provides school districts an Adjusted Education Payment equal to their FY 2010 per pupil expenditures updated for their FY 2011 pupil count. This will give districts 14 months to plan and build responsible FY 2011 budgets. This is a one-year proposal to curb soaring education costs. The Governor’s proposal also level funds	The Legislature has no proposal to contain rising education spending.

<p>categorical grant at 2010 levels and returns funding for State Placed Students to the statutory calculation allowed by state law prior to 2007. The Governor’s plan also encourages school consolidation by phasing out – over two years beginning in FY2011 – the Small Schools Grant, which subsidizes the operations of high cost school districts with small school populations.</p>	
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Education Funding Reform

<p>In January, Governor Douglas established an Education Funding Reform Task force comprised of citizens, legislators and members of the Administration. The task force has met a number of times and has explored a number of ideas for reforming our education funding system. Based on the work of this task force and after further discussions with the Commissioner of Education, the Administration will release specific proposals by December 1st to reform Vermont’s education funding system for fiscal 2012 and beyond. These reforms will target over \$60 million in education cost containment.</p>	<p>The Legislature has not identified specific proposals to reform our education funding system nor have they created a timeline to do so.</p> <p>They have authorized a study committee to report to leadership in December and make recommendations to the Legislature in January. However, no savings targets have been announced for the study committee to achieve and no implementation deadline has been established.</p>
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Property Tax Rates

<p>The Governor’s Plan lowers property tax rates by \$.02 in both fiscal 2010 and 2011.</p>	<p>The Legislature’s proposal reduces rates by only \$.01 in FY 2010 and 2011 – opting instead to back out \$19 million in general funds to support higher levels of general fund spending.</p>
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Property Tax Burdens

<p>The Governor’s Plan significantly reduces the trend of rising property taxes. Based on the Governor’s responsible approach to education cost containment, property taxes increase by 1% (after income sensitivity</p>	<p>The Legislature’s proposals do not contain important cost containment provisions. Consequently, property taxes will rise, as they have in the recent past, with increases in school spending. The most recent JFO</p>
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<p>payments) in FY 2011 over FY 2010 from \$906 million to \$915.4 million.</p>	<p>Education Fund Outlook for the Legislature’s approach indicates net property tax increase will be \$6.4 million in FY 2011 compared to the Governor’s Plan.</p> <p>The JFO Outlook indicates 0% growth in education spending in FY 2011 but the Legislature makes no provisions for level funding school spending, resulting in further increases in property taxes.</p>
<p><i>Transfers from the General Fund and ARRA Funds</i></p>	
<p>The Douglas proposal transfers \$274.8 million to the Education Fund in both FY 2010 and 2011. Further, the Governor applies \$43.8 million in ARRA funds in 2010 and \$33.4 million in 2011 to support education spending.</p>	<p>The Legislature’s plan transfers \$240.8 million to the Education Fund in FY 2010 and 2011, or \$34 million less than the Governor. The Legislature applies the same amount of ARRA funds over the two-year period, but with equal allotments of \$38.6 million in each year.</p>
<p><i>Base Education Grant and School Spending</i></p>	
<p>Governor Douglas’s plan provides for a base grant of \$8,544 in FY 2010 with a modest but responsible increase to \$8,640 in FY 2011.</p> <p>Most importantly, the Governor’s plan supports school budgets as voted in FY 2010 and level funds per pupil spending in fiscal 2011.</p>	<p>The Legislature’s grant proposal allows for a base grant of \$8,544 in FY 2010 with no increase in the base education grant in FY 2011.</p> <p>The Legislature’s approach also supports school budgets as voted in 2010 but adds no cost containment measures for fiscal 2011 which as stated above, will result in additional property tax increases.</p>
<p><i>Transfers to the Education Fund</i></p>	
<p>The Governor’s Plan calls for the Education Fund to pay the annual contribution costs for teachers’ retirement, which is roughly \$40 million. This is an appropriate and necessary use of education funds as local school boards, through their contracts with the NEA, determine teachers’ salaries and therefore their retirement benefits. The Governor</p>	<p>The Legislature continues to pay for the annual cost of teachers’ retirement from the general fund, where it competes with and crowds out human service programs for funding.</p>

<p>recommends this transfer only when partnered with his plan to level fund education for the next fiscal year. These proposals cannot and should not be taken apart from each other.</p>	
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BUDGET LANGUAGE ADJUSTMENTS

As the Legislature rushed to pass a FY 2010 budget, language was added that Governor Douglas cannot support. Provisions added without legislative vetting and committee hearings, proposals that have not been analyzed for their fiscal impacts as well as initiatives that violate separation of powers should be revised or removed until further consideration can be given by lawmakers and administration officials.

Below is a partial list of budget language that will need to be addressed:

Sec. E.135.2 and Sec. 135.3 State Employee Retirement Incentive

We are not opposed to an incentive plan, but we need to see the data on how such a plan would work. There was no analysis on the effectiveness of this plan, nor did the Legislature provide any appropriation to pay for what may be increased costs to carry out this plan. The budgetary language provides for more post-retirement insurance coverage than employees or retirees currently receive. Employees are permitted to return to state government after a year (before they even receive their second installment of incentive money) and this also may result in increased costs to the state.

Sec. E.813 Vt. Housing and Conservation Board

This section changes the composition of the Vt. Housing and Conservation Board (VHCB), raising the number to 11 and eliminating ACCD as a member (replaces ACCD with AHS). It changes the public members from 5 selected by Governor (ratified by Legislature) to 3 selected by Governor; 1 selected by Speaker of the House; 1 selected by Senate Committee on Committees, and 2 selected jointly by Speaker and the Senate President Pro Tem. These changes significantly change the mix on the Board. The elimination of ACCD from the Board with its front-line relationship to housing issues is especially problematic.

Sec. E.813.1 Powers and Duties of the Vt. Housing and Conservation Board

This section allows the VHCB to be the administrator of and designated entity to seek national Housing Trust Funds. The Federal Budget as recommended by the President includes \$1 billion to fund this Trust Fund in FFY10. The language in Sec. E.813.1 would have the VHCB be the only entity that could apply for these Federal funds, and it would also administer these funds. It is more appropriate that a state department such as Housing and Community Affairs perform this larger role in applying for and administering these funds. This would not preclude the VHCB from applying for subgrants from these funds.

Sec. E.1103 Cost Reduction Authorization

In subsections (a) – (g), the Legislature has inserted itself into negotiations between the Administration and the VSEA - and if negotiations are unsuccessful, the bill requires that we go through the Joint Fiscal Committee before we exercise our managerial rights under the four negotiated collective bargaining agreements to RIF employees. This

micromanagement by the Legislature impedes our Constitutionally-assigned function and disrupts the separation of powers.

Sec. E.1103 Cost Reduction Authorization

Subsection (h) requires approval of the Joint Committee on Corrections Oversight and the JFC before closure or significant reductions in operations at any correctional facility. AHS will not be able to meet the position savings that were in the Governor's proposed, House passed or Senate passed budget without the closure of a correctional facility.

House Bill H.313 Sec. 107

This proposal would expand the Privatization Act to include contracts that cover any functions that were previously performed by a state employee, regardless of whether the employee lost his or her job by RIF, or if there simply was a vacant position that could have arisen from resignation, retirement, or just been on the books as a never-filled position. The Privatization Act was passed to protect state employees from losing their jobs, not to protect vacant positions. In addition, this provision would be a breach of Executive authority – the Legislature authorizes positions, the Executive branch manages positions; and the VSEA represents classified employees covered by a collective bargaining agreement. We will want this Section nullified in the Budget Bill.

*** Please note: full list of changes will be forthcoming following final analysis of H.441 and other related legislation.*

UNEMPLOYMENT INSURANCE INTERIM STRATEGY

We must act now to tackle our projected deficit in the Unemployment Insurance Trust Fund. If we do not take action, we will be forced to borrow from the federal government to pay benefits. That money will have to be returned with interest of nearly 6% paid out of the general fund. Today the Governor presents an interim plan to help curb the sharp deficits we are facing. This plan will serve as a first step until lawmakers can come together over the summer and during the next session to craft a comprehensive solution which addresses both our taxable wage base and our generous benefits structure.

Balanced Interim Plan:

Employer Contribution: Increase taxable wage base to \$10,000 in 2010 and to \$12,000 in 2011. This will generate approximately \$20 million in new revenues each year.

Benefit Reductions:

- Freeze maximum weekly benefit in 2009 at \$425. The maximum weekly benefit will go up on July 1, 2009 without action. This will only exacerbate the trust fund problem. This will save approximately \$5 million dollars in 2009. Federal stimulus has resulted in all claimants receiving an additional \$25 per week through calendar 2009.
- Disqualify those fired for misconduct from receiving benefits. This modest change will prohibit benefits for those who lose their job by demonstrating willful neglect of the employer's interests. This will save approximately \$2.9 million dollars per year.

Summer work group:

Charge a group of lawmakers, administration officials and other interested parties to examine the trust fund and develop recommendations for additional action in January 2010.

Additional benefit adjustment options:

To avoid even greater borrowing and interest expense, which must be paid from the general fund, we need to add at least one of the following additional benefits adjustments to take effect in 2010.

Variable duration - Remove a fixed duration of benefits for 26 weeks and move to variable duration tied to the worker's attachment to the labor force. Vermont is one of only 9 states that provide a full 26 weeks of unemployment benefits. Most states have a variable duration the same or similar to this proposal, which is based on their employment history (base period) being used to compute their eligibility. A worst case scenario is that someone could earn 26 weeks of benefits after working as little as 4 months. This would save \$5.9 million dollars per year.

Return the maximum weekly benefit from the current \$425 to \$409 - The maximum weekly benefit was \$409 in July 2008. This would affect approximately 22% of UI claimants and save the fund another \$5 million per year.

Modify the weekly benefit amount to be 50% of the average wage replacement - Presently, the weekly benefit amount is calculated at 57% wage replacement of the amount of wages an employee was paid during the previous 5 quarters. Vermont has the 17th highest wage replacement of all states. We can reduce this slightly and then be in line with other states.

Add back a one-week waiting period before someone can apply for benefits - This is supported by many business organizations and was of interest to some members of the House Commerce Committee. Vermont had a one-week waiting period until 2000. Only 13 states have no waiting period. Annual savings would vary but would be approximately \$5 million in 2010.

Next Steps:

Draft language for the interim agreement and options is available at the Department of Labor and should be acted on at the Legislature's next opportunity. However, additional action beyond the interim strategy outlined here is required to return the Unemployment Insurance Trust Fund to solvency before another recession.