

---

# *Tax Reform Considerations in Vermont*

*Presentation to the Vermont Blue Ribbon  
Tax Structure Commission*

September 29, 2009  
Montpelier, VT

Don Boyd  
Senior Fellow, Rockefeller Institute of Government  
(Affiliation for identification purposes only)  
[boydd@hughes.net](mailto:boydd@hughes.net)

---

## Introduction and outline

- My background
- State and local governments in the overall fiscal system
- Financing challenges for state and local governments
- Principles of taxation and tax reform
- Vermont in the national system
- General advice as you approach tax reform
- Specific advice as you think about AGI and taxable income
- Concluding remarks

---

## State and local governments in the federal-state-local fiscal system

- For nation as a whole, S&L Gov't is larger than the manufacturing sector; accounts for 1 out of 6 workers. Large in VT, too.
- SLG direct spending on domestic programs - education, health, public protection, transportation, income support – larger than federal gov't direct spending. (Feds play major role in financing)
- Responsible for over 90% of all prisoners, approximately 95% of the public road system; spend more than 90% of all public capital infrastructure money
- Financing systems are not up to the task.

---

# Financing challenges for state and local governments

## Short and medium term

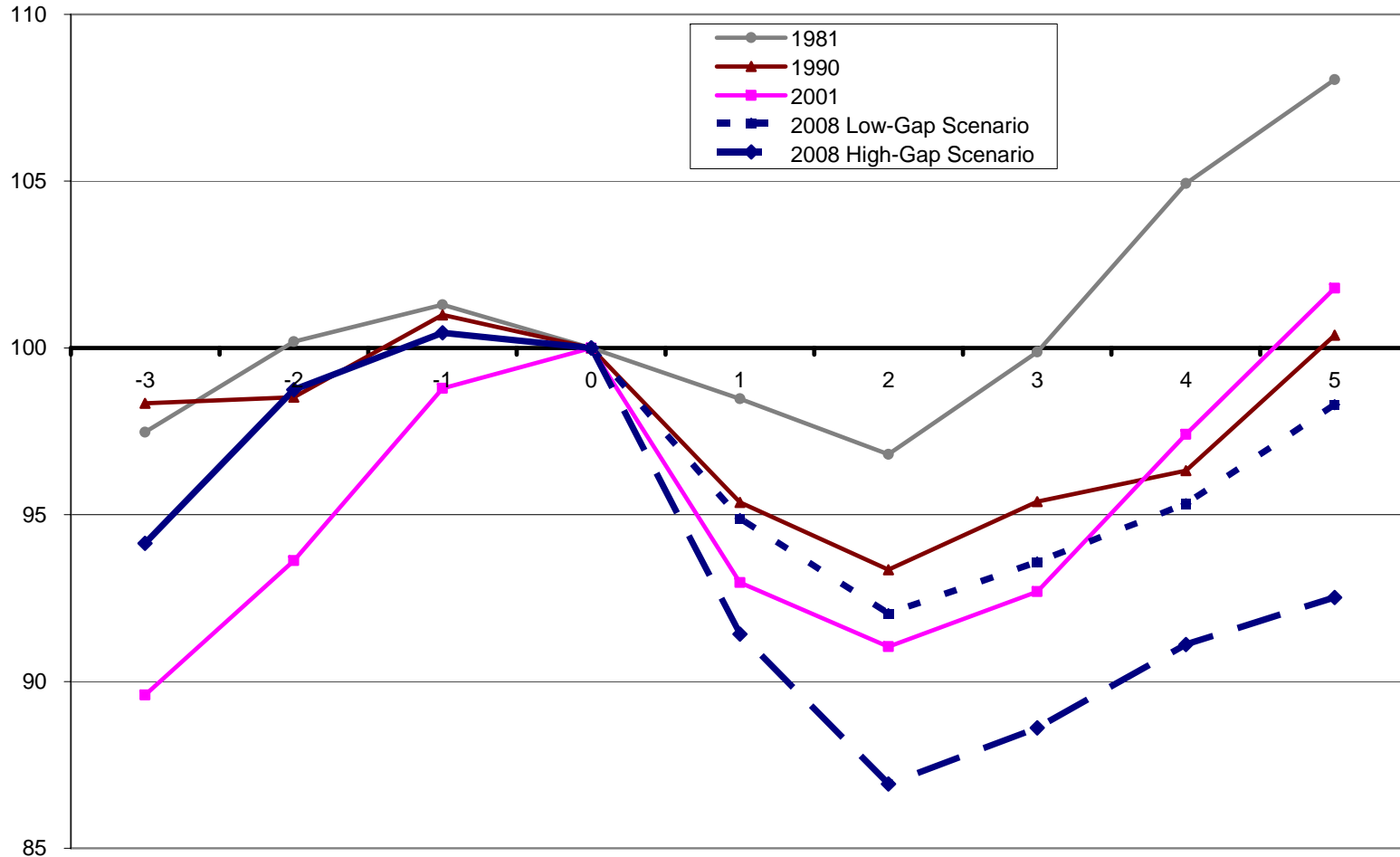
- Volatile revenue, stable and rising spending demands
- Huge budget gaps in recessions, annual budget balance requirement → fiscal and policy roller coaster
- The “cliff” after federal stimulus \$ goes away

## Longer term

- Rising demographic & cost pressures on Medicaid
- Pensions and OPEB
- Continued movement toward service-based economy
- Erosion of the sales tax

# Financing challenge: Taxes could take 4-5 or more years to re-attain prior peak (Data are for nation)

Taxes adjusted for population growth, inflation, and legislative changes  
By fiscal year, indexed to approximate start of each fiscal crisis (Year 0)



Sources: Tax revenue (Census Bureau and Rockefeller Institute estimates), Inflation (BEA GDP price index), Legislative changes (NGA/NASBO Fiscal Survey of States Fall 2008)

---

## Principles of taxation and tax reform – comments on selected NCSL principles

- Adequacy – stability, certainty, sufficiency
- Equity – horizontal, vertical
- Minimize economic distortion, responsive to economic competition – Repeat: “broad base, low rates,” BBLR, BBLR, ...
- Easy to comply with and administer
- Must look at whole *system* – state-local, all major sources

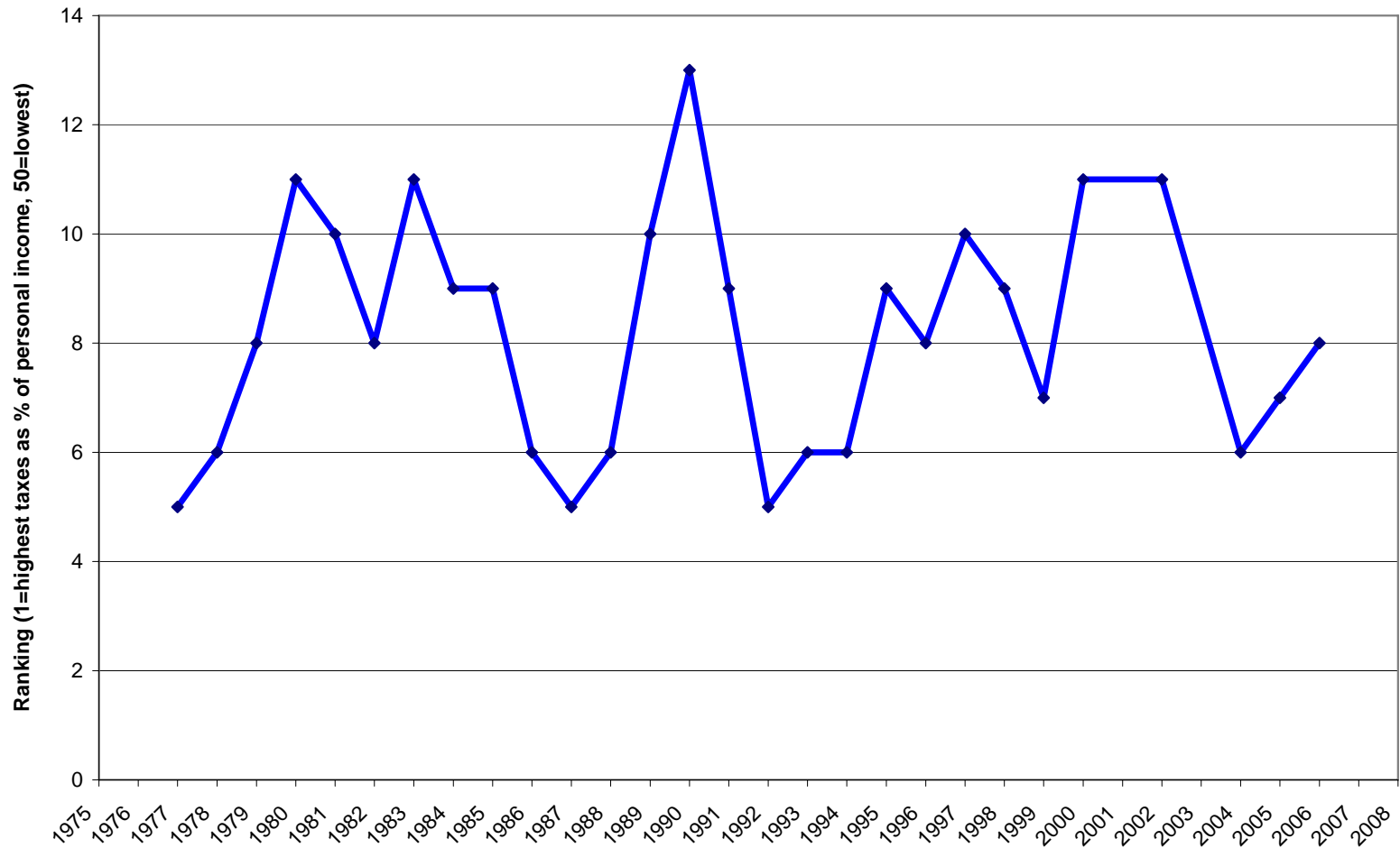
---

## Unfortunately, principles often conflict with each other!

- Steeply progressive income tax may meet some policymakers' equity goals, but it is volatile and high marginal rates are distortionary
- Sales tax on food and services may be stable and less-distortionary, but will violate some policymakers' equity goals
- Crucial to think about *system* as a whole. Some otherwise-problematic individual options can be attractive as part of a larger package

# Vermont has ranked about 6<sup>th</sup> to 10<sup>th</sup>-highest for most of 30 years

Vermont's ranking for state and local taxes as % of personal income



# Vermont's higher taxes driven by property tax and selective sales (esp. meals & rooms)

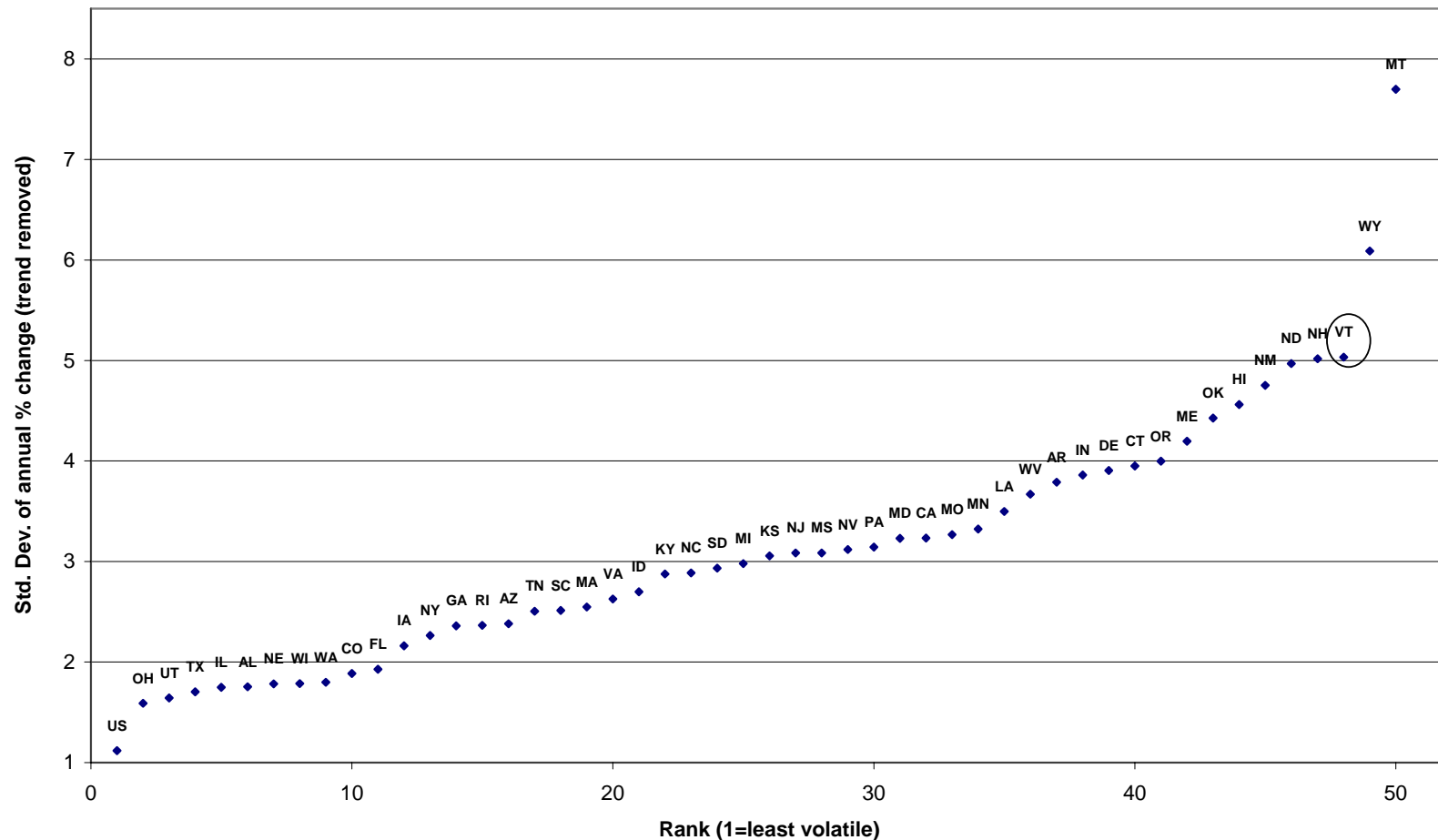
State and local government taxes as a percentage of personal income, 2006

	Vermont % of personal income	Vermont percent of personal income minus percent elsewhere:					VT indexed to:			
		Individual New England States					CT, MA, ME, NH, RI as a group	United States average	CT, MA, ME, NH, RI as a group	United States average
		Conn- ecticut	Maine	Massa- chusetts	New Hamp- shire	Rhode Island				
Total taxes	13.5%	1.5%	-0.8%	2.6%	4.4%	1.2%	2.1%	1.8%	118	116
Individual income tax	2.7%	-0.8%	-0.7%	-1.1%	2.5%	0.0%	-0.6%	0.0%	82	101
General sales tax	1.6%	-0.2%	-0.9%	0.2%	1.6%	-0.6%	0.1%	-1.1%	104	59
Property tax	5.6%	1.1%	0.2%	1.8%	0.0%	0.7%	1.2%	2.1%	128	161
Corporate net income tax	0.4%	0.0%	0.0%	-0.2%	-0.7%	0.0%	-0.2%	-0.1%	71	82
Selective sales taxes	2.4%	1.2%	0.8%	1.6%	0.9%	0.9%	1.3%	1.1%	230	186
All other taxes	0.8%	0.3%	-0.1%	0.3%	0.0%	0.3%	0.2%	-0.2%	143	81

Source: U.S. Bureau of the Census (taxes); Bureau of Economic Analysis (personal income)

# Historically, Vermont's tax structure has been volatile

State-local total tax volatility -- 1986-2005  
(AK excluded as extreme outlier: value=19.6)



Source: Boyd, Tax Volatility Memorandum to the Pew Center on the States, 2007.

---

## General comments as you approach your study

- Adequacy – esp. stability - is a crucial consideration. Must consider the state *system*. Consider financial management tools as well as volatility.
- Equity/incidence analysis – can models analyze the complexity of important parts of VT's system, esp. property tax? How will they deal with rooms & meals tax?
- Economic considerations – the BBLR goal more likely to be achieved by a package than a single option. But that raises equity and planning issues – can you get there from here?

---

## Specific comments as you think about AGI versus taxable income

- Broad base, low rates is a *possible* outcome
- Will be great pressure to deviate from this
  - Retirement income, other income
  - Itemized deductions
  - “Incentives”
  - Credits
- Distributional consequences potentially severe, credits or other low-income offsets may be desirable
- Will not eliminate whipsawing from federal tax changes; will not eliminate complexity

---

## Concluding comments

- This is certainly the right work at the right time
  - Short-term volatility
  - Medium-term adequacy issues as economy recovers
  - Longer-term issues as economy continues to shift toward services