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Recessions Past: What Worked Then Can Work Again

by Jack Hoffman

Major recessions like the one we're in demand wrenching decisions: how to balance maintaining needed government services, especially for the most vulnerable, against taxpayers' ability to support those services. The country has faced two other big recessions in the last 25 years—in the early 1980s and in the early 1990s—and Vermont's response to those downturns is instructive about what the state can do this time.

Contrary to conventional wisdom, it is possible and even desirable to raise tax rates in a recession. In fact, that's just what political leaders did in 1983 and 1991. They made difficult cuts, but they drew a line on how far they were willing to go in dismantling state services, and general fund budgets still went up from one year to the next. They also matched the cuts with tax increases. When they did as much as they could with cuts and taxes, they resorted to deficit spending—buying time to work their way out of the crisis with the confidence that things would get better. Both times, the strategy worked.

The increases imposed in 1983 and 1991 pushed Vermont's top income tax rate higher than it is today. By 1993, Vermont's highest income-earners were paying a top rate more than 40 percent higher than they do now. Those rates were rolled back after the economy recovered. But the temporary increases allowed Vermont to keep its courts open, continue to educate its children properly, provide health care, food, and shelter to its neediest citizens, and keep state government functioning.

It wasn't just Vermont that defied conventional wisdom. To cope with the recession of the early 1980s, 33 states enacted permanent or temporary revenue increases in 1983 (**Figure 1**). Some raised taxes a second time: the following year 29 approved permanent or temporary revenue increases. In the early 1990s, states again raised new revenues, some for several years in a row, as part of their efforts to maintain services.

Figure 1. Permanent or Temporary Revenue Increases

Recession Year	Number of States[1]
1983	33
1984	29
1990	30
1991	26
1992	31

Data source: National Association of State Budget Officers, Fiscal Survey of the States

Comparable Shortfalls

In many ways, the deep economic declines of the 1980s and 1990s were like the one we're undergoing now: a lot of people were out of work, states struggled to balance their budgets, and there was real fear about the future.

As it happened, the same man was in the Vermont governor's office during both of those periods. Governor Richard Snelling was just starting his fourth consecutive term in 1983 when the state was hit with a large budget deficit at the end of the fiscal

1 Some states are counted more than once because they enacted revenue increases in consecutive years.

year. He called the Legislature back for a special session in July, and he and lawmakers negotiated a package of cuts and new taxes. Snelling retired after that term, but he came out of retirement six years later to run for governor in 1990, specifically to deal with another looming fiscal crisis.

The shortfall of 1983 was on a similar scale to the one confronting Governor Jim Douglas and the Legislature now. The general fund budget in 1983 was $333 million, and when the fiscal year ended on June 30, the general fund was $30 million in the red—a deficit of nearly 10 percent. Now the general fund budget has grown to about $1.2 billion. The gap between projected expenditures and projected revenues for this year—fiscal 2009—is roughly $114 million, or 9.4 percent of the general fund (**Figure 2**).

Figure 2. Recession Deficits

Fiscal Year	General Fund (millions)	Deficit (millions)	Percent of General Fund
1983	$ 333.5	$ 30.2	9.0%
1991	$ 643.3	$ 65.0	10.1%
2009P	$ 1,211.1	$ 114.0[2]	9.4%

P: projected

Data source: Rutland Herald, July 12, 1983, and Joint Fiscal Office memo December 30, 2002

The problems were even bigger in the early 1990s than in the 1980s. When Snelling returned to the governor's office in January 1991, the state was halfway through the fiscal year, and there were clear signs of trouble ahead. When the fiscal year ended in June, the red ink totaled $65 million—again about 10 percent of the general fund. But another, even larger potential shortfall loomed for fiscal 1992, not unlike the projected shortfall forecast for fiscal 2010. During the 1991 session, Governor Snelling and the Legislature again negotiated a deal to slow spending and raise taxes.

Taxes Then and Now

So far during the current budget crisis, the administration and legislative leaders have rejected the idea of increasing revenues. Each time the revenue forecast has been lowered this year—in April, July, and November—the response has been to propose more budget cuts. Montpelier has refused to use any of Vermont's reserve funds, which total more than $100 million. And over and over we hear the mantra that Vermont has no capacity to raise more revenue, especially from the income tax.

But Vermont's top income tax rate is lower than it was in either 1983 or 1991 (**Figure 3**).[3] Today the rate is 9.5 percent and applies to any taxable income in excess of $349,700. This rate is the one critics point to when they argue that Vermont's taxes are too high. Because this is the rate that would be paid by successful entrepreneurs, they say Vermont's rate discourages economic growth.

In 1983, Vermont's top rate was 12.5 percent, and as part of the deficit reduction plan, the Legislature pushed it to 13 percent. That rate applied to taxable income of $109,400, which is equal to about $216,454 in 2007 dollars.[4]

Figure 3. Vermont's Top Income Tax Rate

Year	Tax Rate	Taxable income over. . . (2007 dollars)
1983	13.0%	$ 216,454
1991	10.5%	$ 121,963
1993	13.5%	$ 353,248
2007	9.5%	$ 349,700

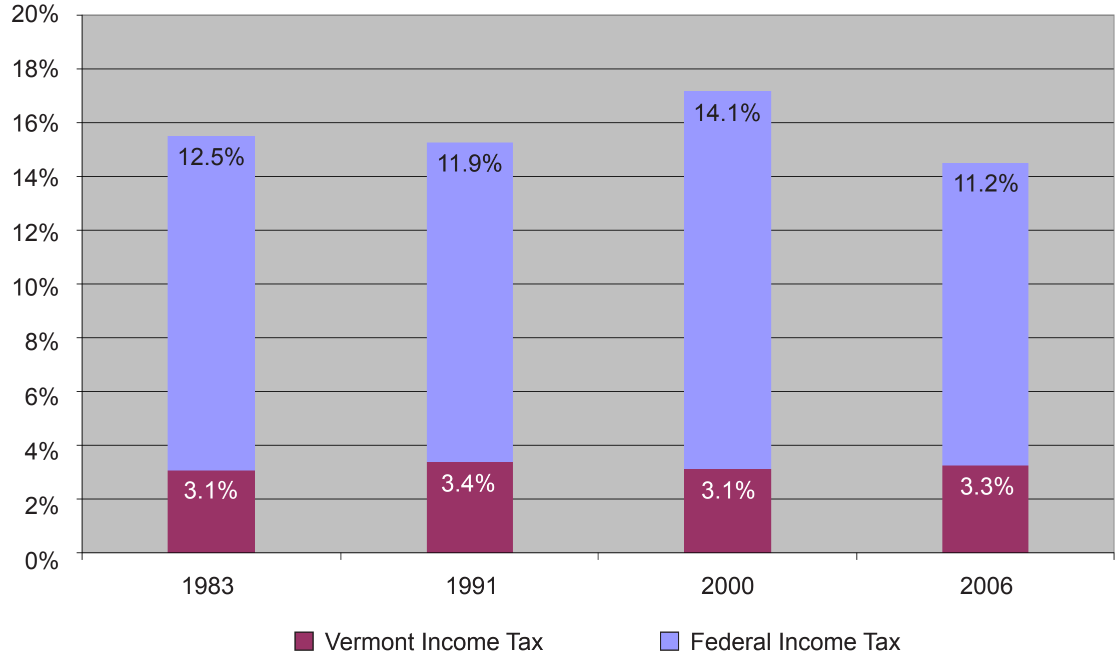
Data source: IRS Form 1040 instructions 1983, 1991, 1993 and Vermont Fiscal Facts

[2] The general fund budget approved for fiscal 2009 was $1211.1 million. Since then, the Legislature's Joint Fiscal Office identified a $23 million shortfall in August (addressed with budget cuts and transfers between funds), a $66 million shortfall in November, and another potential revenue downgrade of as much as $25 million in January.

[3] With a progressive income tax system, which Vermont has, tax rates increase as income increases.

[4] The amount of deductions and other allowances can vary widely from one taxpayer to another. On average, according to IRS statistics for 2006, taxable income is about 70 percent of adjusted gross income (AGI).

Figure 4. State and Federal Income Taxes As Percentage of Total Vermont Income



Data source: IRS State Income and Tax Data and Vermont Tax Department Income Statistics

Even Vermonters with taxable income over $45,800—about $90,600 now—paid a higher rate than they would today.

The tax increases in 1991 came on top of a sizeable hike the previous year. In 1990, as the economy was starting to slow, lawmakers saw a need for additional revenue and approved an across-the-board increase in the personal income tax rate.[5]

With the large deficit looming in 1991 and a shortfall projected for the following year, the governor and legislative leaders negotiated another package of tax increases—on income, sales, and rooms and meals. Because of the hikes the previous year, Democratic leaders insisted that additional income taxes come from those in the upper income brackets. Two new surtaxes were added: one on taxable income between about $23,000 and $63,000, and a higher one on taxable income in excess of $63,000.[6]

The result was that in 1991, Vermonters were paying a top marginal tax rate of 10.5 percent on incomes over $82,150. In 1993, after Congress increased federal income tax rates, Vermont's top tax rate jumped to 13.5 percent on taxable income over $250,000.[7]

President George W. Bush rolled back many of the increases of the 1990s. Today, the portion of Vermonters' income that goes to federal and state income taxes combined is lower than it was during the recessions of 1983 and 1991 (**Figure 4**). Federal and state income taxes as a percentage of income hit a peak in 2000, and now the portion is about 15 percent lower.

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[5] The increase, which affected all income taxpayers, amounted to an extra $12 on every $100 of Vermont income tax.

[6] The effect of the 1990 and 1991 rates changes was that taxpayers paid an extra $24 for every $100 of Vermont income tax on taxable income between approximately $23,000 and $63,000, and an extra $36 for every $100 of Vermont income tax on taxable income of more than about $83,000. These taxable income amounts are in 1991 dollars.

[7] Until 2002, Vermont income taxes were calculated as a percentage of federal tax liability. An increase at the federal level, therefore, increased state income taxes unless the Legislature adjusted the Vermont rate.

Knowing the Options

In both 1983 and 1991, Governor Snelling went on television to explain the problems Vermont faced and what had led to the fiscal crises. In 1983, he told the public that the budget shortfall was a result of declining revenues, not overspending. While he agreed that cuts were required, he also said there was a limit to how deeply the state could cut without hurting people.

Before Vermont can come together to solve the current crisis, the administration, legislators, and the public need to understand what all the options are. They need to understand who would be hurt by proposed cuts and how badly. They need to know who would be asked to pay if taxes were increased. The income tax, for example, reflects people's ability to pay, whereas the sales tax or property tax lands harder on those least able to pay. Vermonters need to know how the reserve funds could be used most effectively. Finally, they need to know the implications of using the last tool Vermont has in its toolkit—carrying a small budget deficit until the economy recovers.

Vermonters also need to separate myth from reality—especially when it comes to conventional wisdom. We hear over and over from pundits and politicians that you don't raise taxes in a recession. In fact, Vermont raised taxes in the two worst recessions of the last 25 years—and so did a lot of other states—with positive results. The rejection of this practical option is purely ideological. It damages the critical state services Vermont has worked for years to build and that Vermonters need more than ever in these hard times.

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