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July 2006 Economic Review and Revenue Forecast Update

Prepared for the
State of Vermont
Emergency Board and
Legislative Joint Fiscal Committee

July 18, 2006

Economic Review and Revenue Forecast Update

July 2006

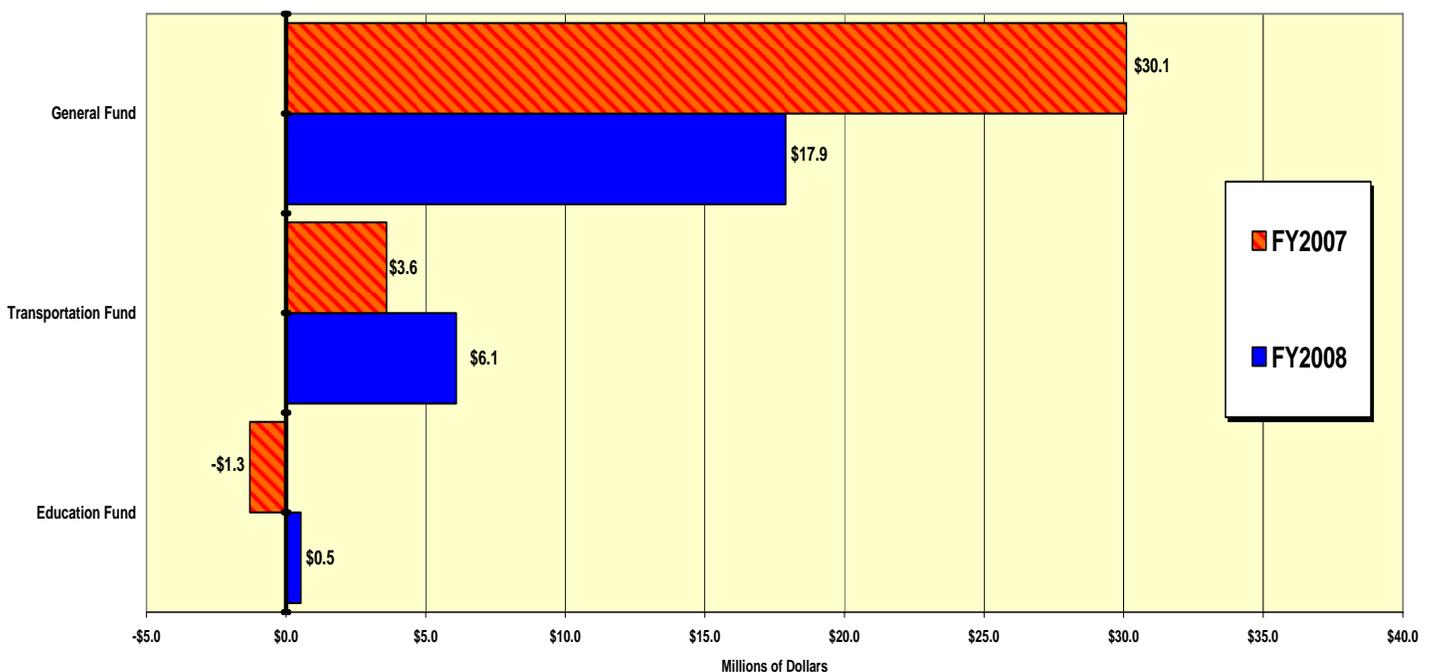
Overview

Vermont General Fund tax revenues in FY06 ended the year with surprising strength, due to a handful of revenue sources linked to high-income taxpayers: namely, personal income, corporate and estate taxes. Despite lackluster job growth, declining real wages and stagnant real household income, these three revenue categories realized huge gains in FY06 due to record corporate profits, soaring real estate-related wealth and associated capital gains. Transportation Fund revenue sources were not so fortunate, as spiraling gasoline prices dampened demand and emptied auto showrooms.

The U.S. Treasury experienced a nearly identical, and similarly unexpected, windfall in corporate and personal income tax receipts – of a magnitude that could even lead to one of the first reductions in the massive federal deficit in the past six years. These revenue sources, however, are extremely volatile and could be vulnerable to sharp declines if and when the economy next falters.

The net changes in the below chart are a combination of economic, tax and technical changes to the prior January forecast, and represent a slight upgrade to prior estimates. Economic effects are the primary source of continued G-Fund gains and T-Fund losses (of \$7-\$8M), with T-Fund fee changes (of \$12-\$13M) offsetting these losses and resulting in modest net gains.

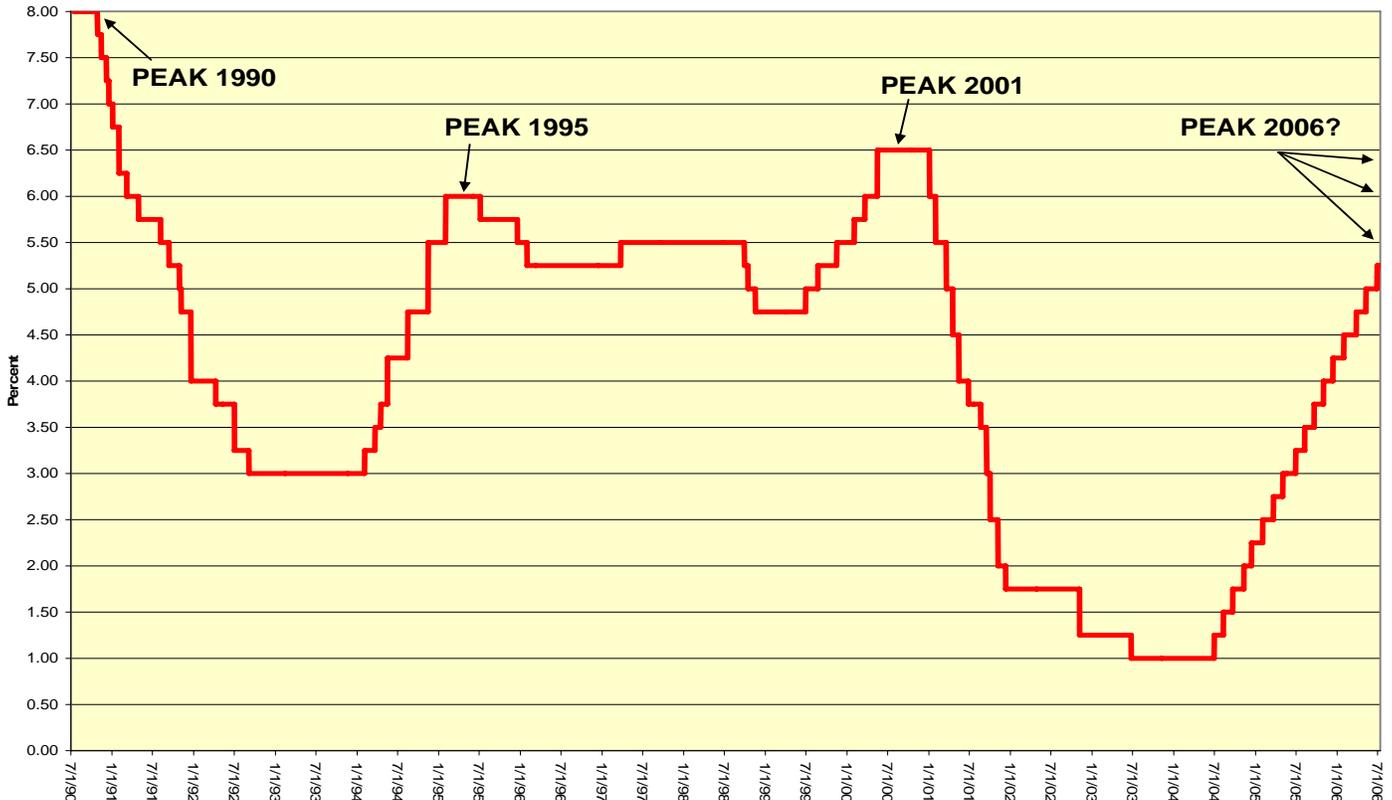
Recommended Net Revenue Changes from January 2006 Forecast - Current Law Basis



The U.S. Economy

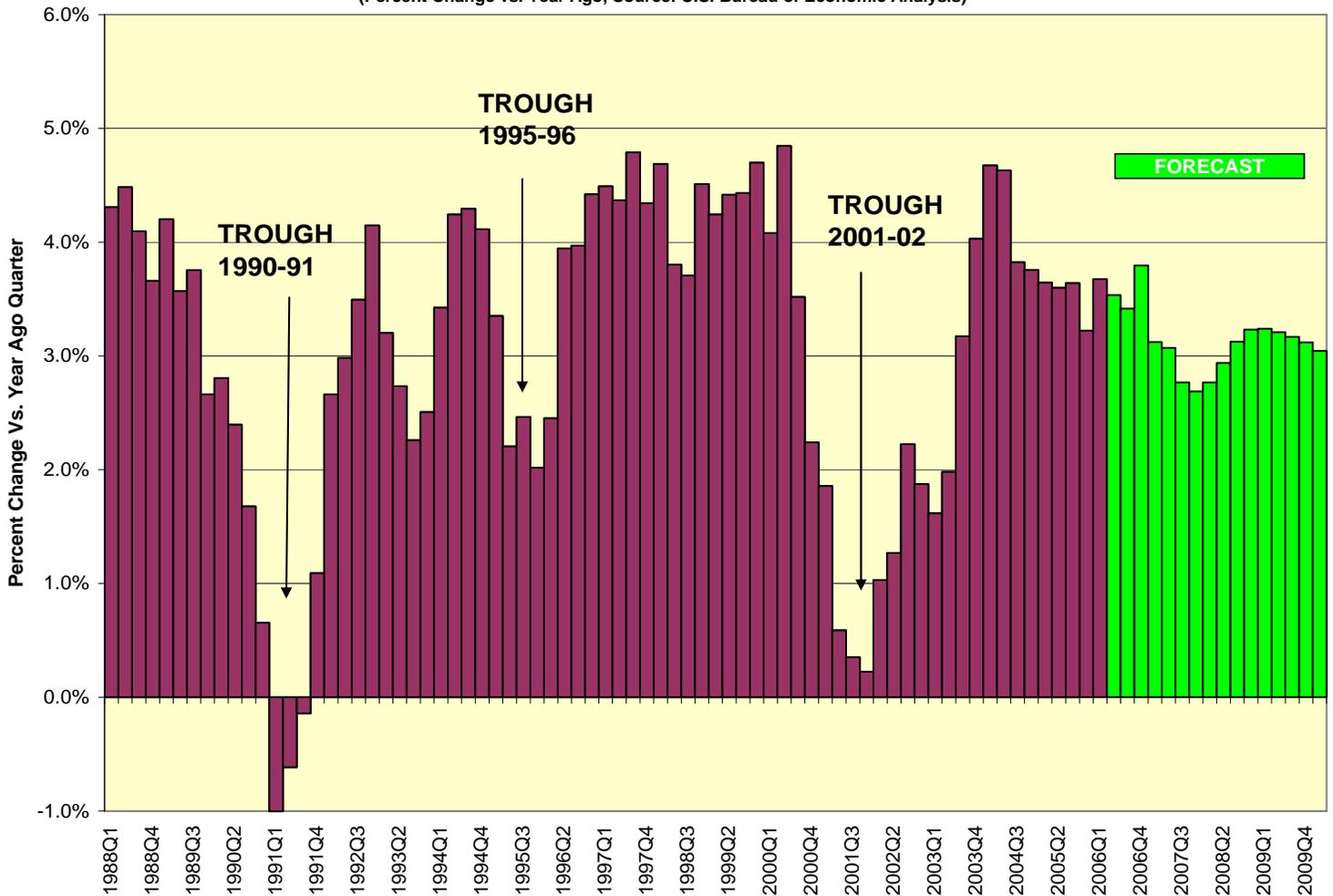
- The U.S. economy in 2006 is still expected to match last year's real growth of about 3.5% (see chart, page 3), despite darkening economic signals in the second quarter of this year. The primary risks to this relatively sanguine outlook are the steady ratcheting up of interest rates and soaring energy prices. After seventeen consecutive interest rate hikes, housing and real estate markets are finally beginning to cool, vehicle sales are hurting and job growth has slowed to a crawl. With oil prices topping \$70 per barrel (see chart on page 4), consumer spending has been shaken and inflationary pressures re-ignited. Both could have serious economic consequences: As two-thirds of the economy, any slowdown in consumer spending could drag the economy down with it. At the same time, accelerating inflation would give the Fed virtually no leeway in responding to any such slowdown by cutting interest rates.

As the Fed Applies the Brakes, Interest Rates Steadily Ascend...
Federal Funds Target Rate - Source: Federal Reserve Board



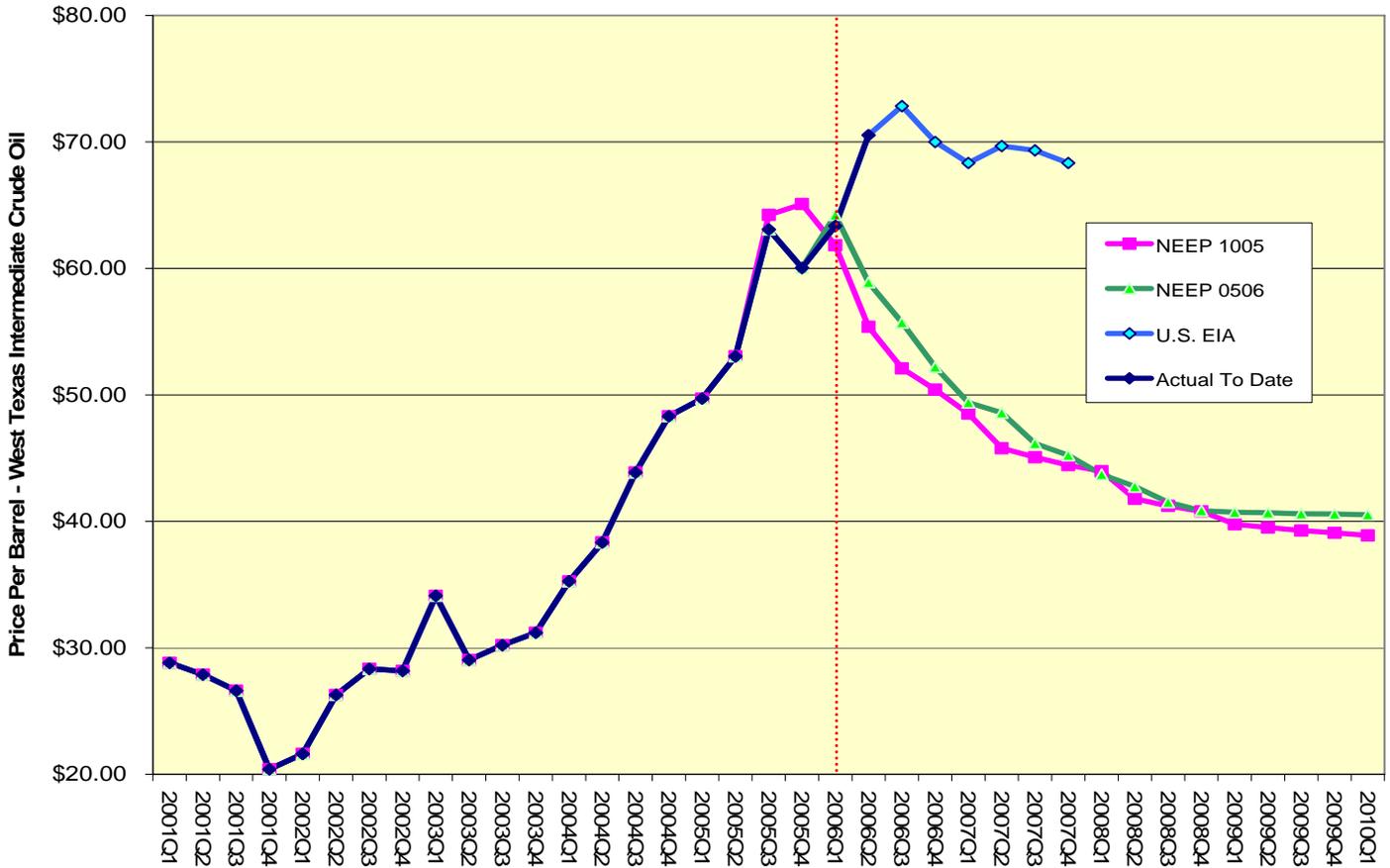
- The Fed is hoping to moderate economic growth and keep inflation at bay with the steady interest rate hikes illustrated in the above chart. Its track record for doing this without pushing the economy into recession, however, is not comforting (see chart on next page). Even a slowdown in growth such as occurred in 1995 - the closest to a "soft landing" that has been achieved in the last two decades - could have substantial negative tax and revenue implications.

...And Slow Projected GDP Growth in FY07 and FY08
 (Percent Change vs. Year Ago, Source: U.S. Bureau of Economic Analysis)



- In addition to rising interest rates, the rapid run-up in oil prices represents one of the most serious threats to the continuance of the current economic expansion. The price of a barrel of West Texas intermediate crude oil has exceeded \$70 per barrel for the past three months and as renewed violence flares in the Middle East, traded at more than \$78 per barrel last week. Higher energy and gasoline prices particularly impact low income families. It is estimated that the poorest 40% of the U.S. population now spends more than 10% of their disposable income on energy purchases.
- As depicted in the chart on the following page, oil price projections in the last two New England Economic Partnership (NEEP) macroeconomic forecasts (and which, by statute, the revenue projections herein are based) assumed prices in the mid-\$50s in the second half of this year and the mid-\$40s next year. It is our opinion that these are unreasonably low. By agreement with the Administration economist, we have opted to use U.S. Energy Information Administration projections with prices in the upper \$60s, where possible. Although we have not run a full macroeconomic model simulation using these altered assumptions, we have attempted to adjust, where possible, relevant models and output to reflect these higher energy price assumptions.

Over A Barrel - Oil Price Forecasts Diverge...



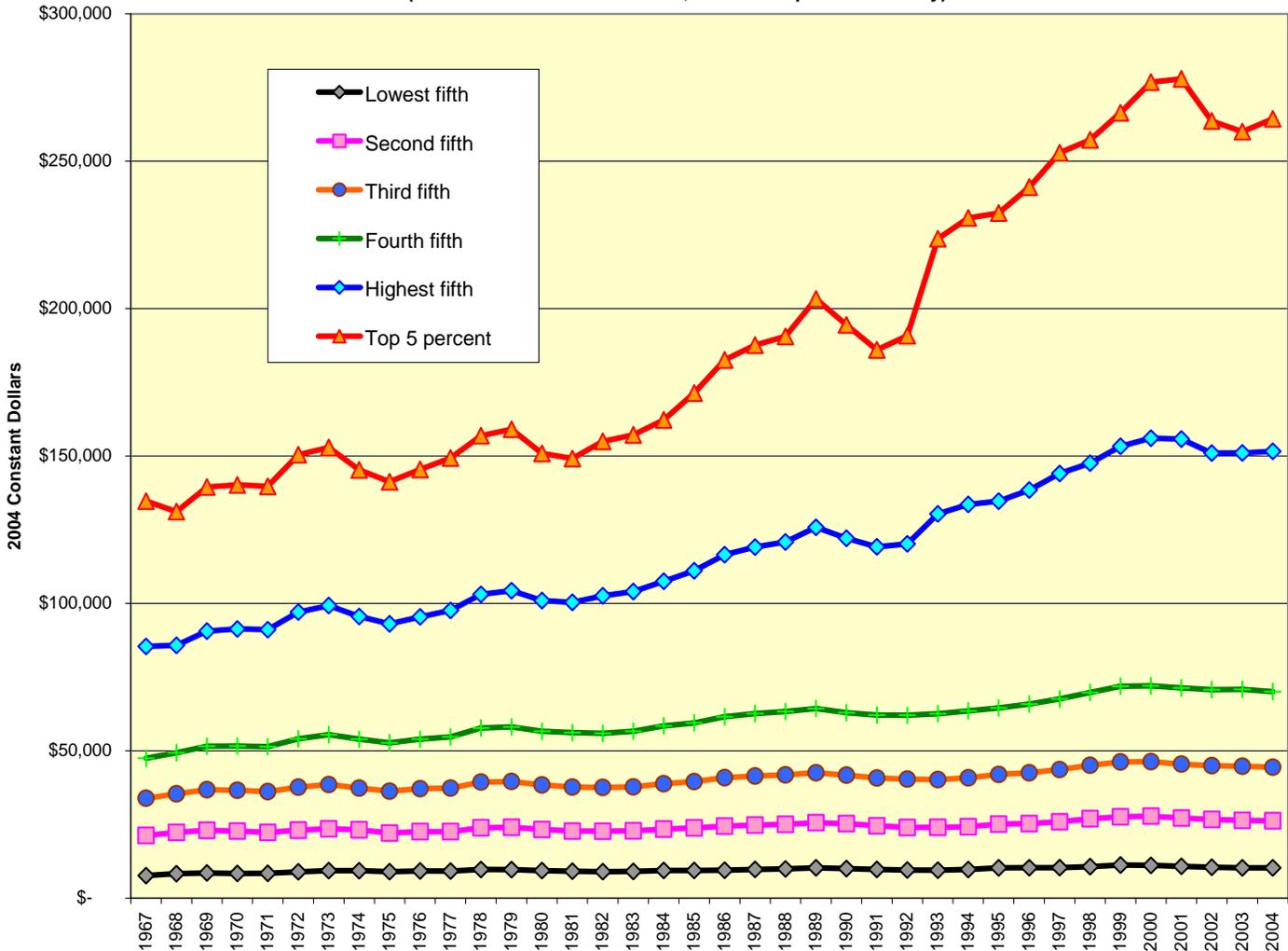
...As Real Oil Prices Approach a 24 Year High
(West Texas Intermediate Crude Oil, PPB in June 2006 Constant Dollars)



Sources: Wall Street Journal, Economy.com

- During this economic expansion, and particularly in the past two tax years, income-related tax revenues at both the state and federal levels have been especially strong due to the changing distribution of income and wealth. As depicted in the below chart, most of the growth in real household income over the past decade has accrued to the top quintile – and within this quintile, to the top 5 percent - of the population. Because marginal tax rates are higher among these income groups, more tax revenue per dollar of income is generated. Currently, about one third of all federal income taxes are paid by households in the top 1% of incomes – those earning about \$300,000 or more per year.

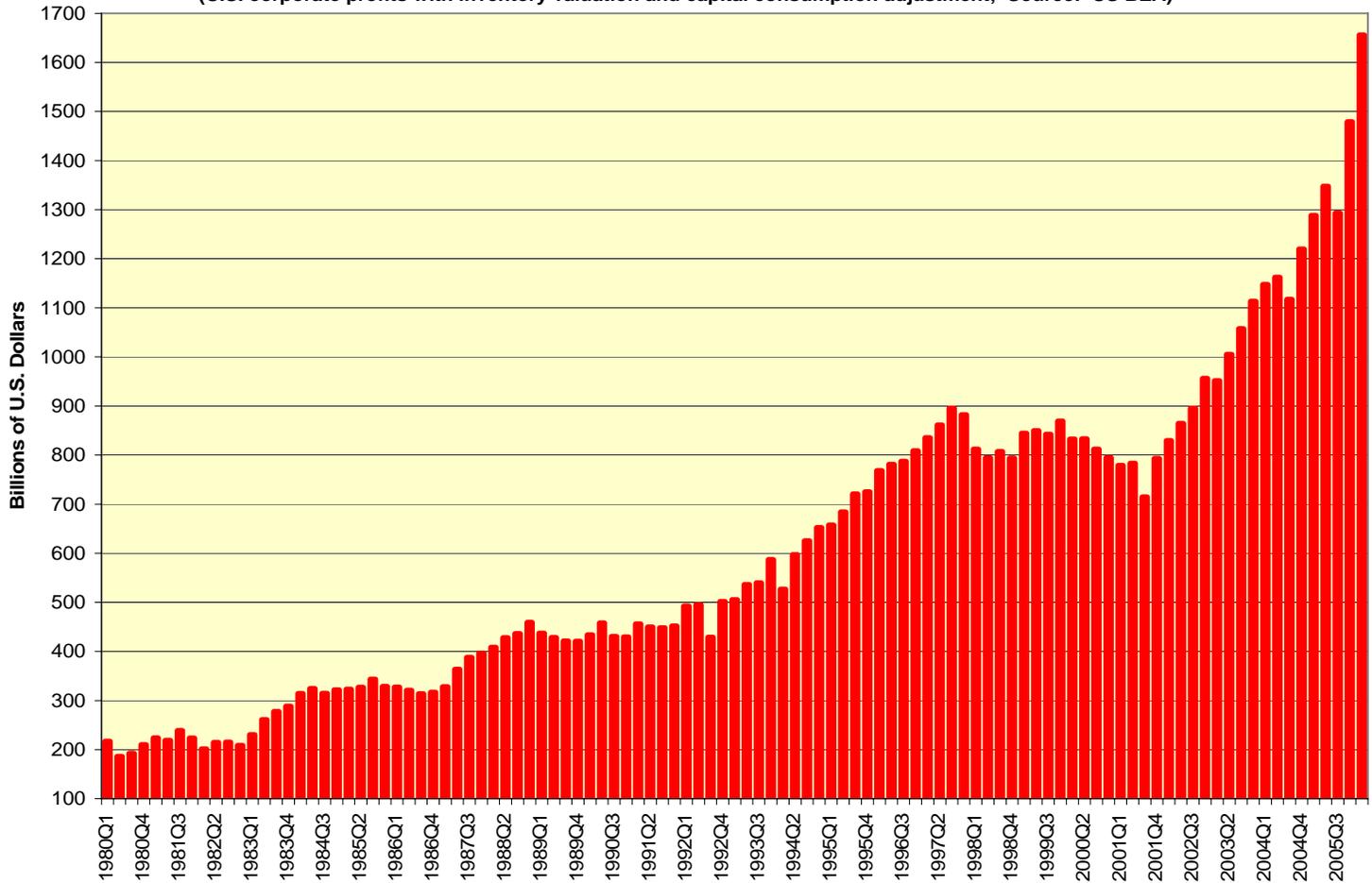
Real U.S. Household Income Growth
 (Source: U.S. Census Bureau, Current Population Survey)



- This shift in income distribution has resulted in added volatility in tax revenues and public budgets, since income swings from business ownership, stock market gains, real estate sales, other taxable investment income and executive bonuses can fluctuate dramatically from year to year.

Corporate Profits Accelerate to Record Levels

(U.S. corporate profits with inventory valuation and capital consumption adjustment; Source: US BEA)



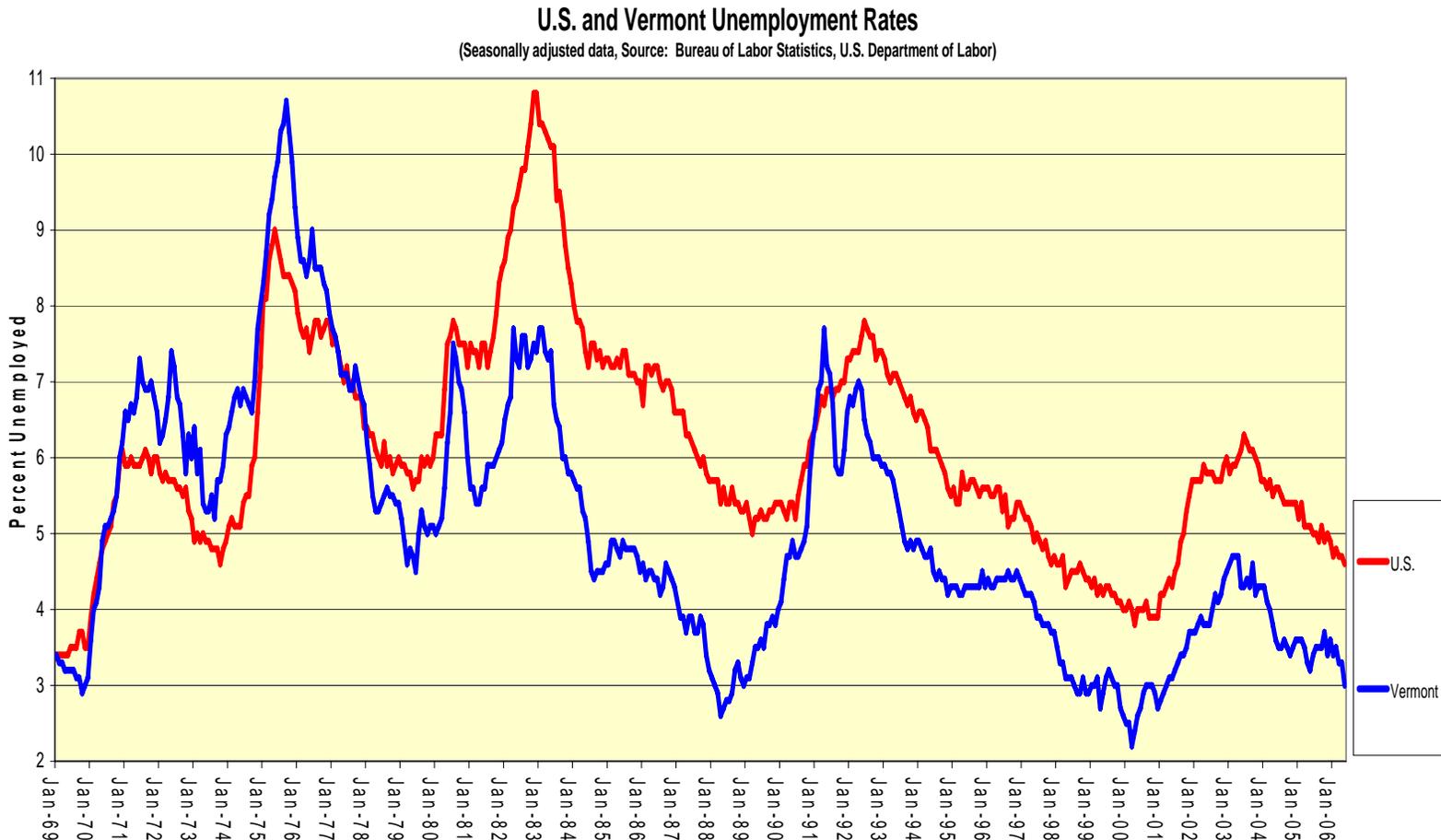
- Unprecedented corporate profitability (see above chart) has also contributed to federal and state tax coffers, as extraordinary productivity gains have virtually all dropped to the bottom line, with very little trickling down to the average worker. In fact, real average weekly earnings for private sector workers have now declined for two consecutive years and dropped again in May of this year by 1.4%, on a year over year basis. Even with flat or declining labor costs, businesses have not hired many additional workers in response to increased demand, due to productivity growth from the application of new technologies. As a result of this, employment growth has continued to be weak – especially at this stage of the economic cycle.
- The macro-economic forecasts upon which the State revenue forecasts are based were prepared by Moody's/Economy.com and are summarized in the below Table A. These forecasts were prepared in March/April of 2006 and released in May of 2006. As noted previously, the use of more current macroeconomic forecasts and alternative model simulations would allow more precise revenue risk quantification and would represent an improvement to the forecasting process now in place. Macroeconomic forecasts prepared and released in June would be a preferred basis for July revenue updates.

TABLE A
Comparison of Recent NEEP/Economy.com U.S. Macroeconomic Forecasts
October 2004 Through May 2006, Selected Variables, Calendar Year Basis

	2002	2003	2004	2005	2006	2007	2008	2009	2010
Real GDP Growth									
Oct-04	1.9	3.0	4.4	3.3	3.3	3.5	3.6		
May-05	1.9	3.0	4.4	3.7	3.3	3.1	3.4	3.1	
Oct-05	1.6	2.7	4.2	3.5	3.8	2.8	3.2	3.3	
May-06	1.6	2.7	4.2	3.5	3.5	3.0	3.1	3.2	3.0
S&P 500 Growth (Annual Avg.)									
Oct-04	-16.5	-3.2	17.1	5.7	15.3	10.9	8.2		
May-05	-16.5	-3.2	17.3	9.2	12.9	10.0	8.5	6.1	
Oct-05	-16.5	-3.2	17.3	6.4	5.9	4.4	6.4	6.7	
May-06	-16.5	-3.2	17.3	6.8	8.4	4.3	5.4	6.6	6.4
Employment Growth (Non-Ag)									
Oct-04	-1.1	-0.3	1.1	1.8	1.5	1.2	1.4		
May-05	-1.1	-0.3	1.1	1.9	1.5	0.9	1.2	1.4	
Oct-05	-1.1	-0.3	1.1	1.7	2.0	0.9	1.0	1.4	
May-06	-1.1	-0.3	1.1	1.5	1.6	1.2	1.0	1.4	1.3
Unemployment Rate									
Oct-04	5.8	6.0	5.6	5.4	5.4	5.2	5.0		
May-05	5.8	6.0	5.5	5.3	5.3	5.2	5.0	5.0	
Oct-05	5.8	6.0	5.5	5.2	5.0	5.1	5.0	4.8	
May-06	5.8	6.0	5.5	5.1	4.7	4.8	4.8	4.6	4.5
Real Disposable Income Growth									
Oct-04	3.1	2.3	3.5	3.3	2.9	3.2	3.3		
May-05	3.1	2.3	3.5	3.1	3.1	3.0	3.1	3.1	
Oct-05	3.1	2.4	3.4	2.3	3.5	2.7	2.8	3.0	
May-06	3.1	2.4	3.4	1.5	3.1	2.9	2.8	3.0	2.8
Prime Rate									
Oct-04	4.68	4.12	4.35	6.04	7.41	7.83	7.50		
May-05	4.68	4.12	4.34	6.16	7.36	7.85	7.50	7.50	
Oct-05	4.68	4.12	4.34	6.17	7.63	7.56	7.50	7.50	
May-06	4.68	4.12	4.34	6.19	7.85	7.56	7.50	7.50	7.50
Consumer Price Index Growth									
Oct-04	1.6	2.3	2.6	2.0	1.9	2.3	2.1		
May-05	1.6	2.3	2.7	2.5	2.4	2.6	2.5	2.4	
Oct-05	1.6	2.3	2.7	3.3	3.1	2.8	2.4	2.3	
May-06	1.6	2.3	2.7	3.4	3.3	2.9	2.5	2.3	2.3
Avg. Home Price Growth									
Oct-04	7.0	7.0	8.6	2.3	2.1	3.7	3.7		
May-05	7.0	7.0	11.2	9.6	3.4	1.5	1.9	3.1	
Oct-05	7.0	6.9	11.0	11.2	4.9	1.7	1.8	3.4	
May-06	6.9	6.8	10.8	13.2	7.3	1.9	1.8	3.4	3.7

The Vermont Economy

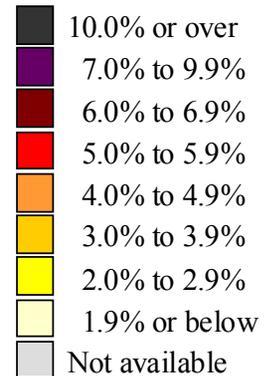
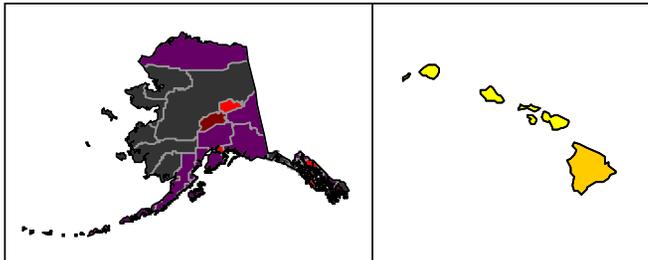
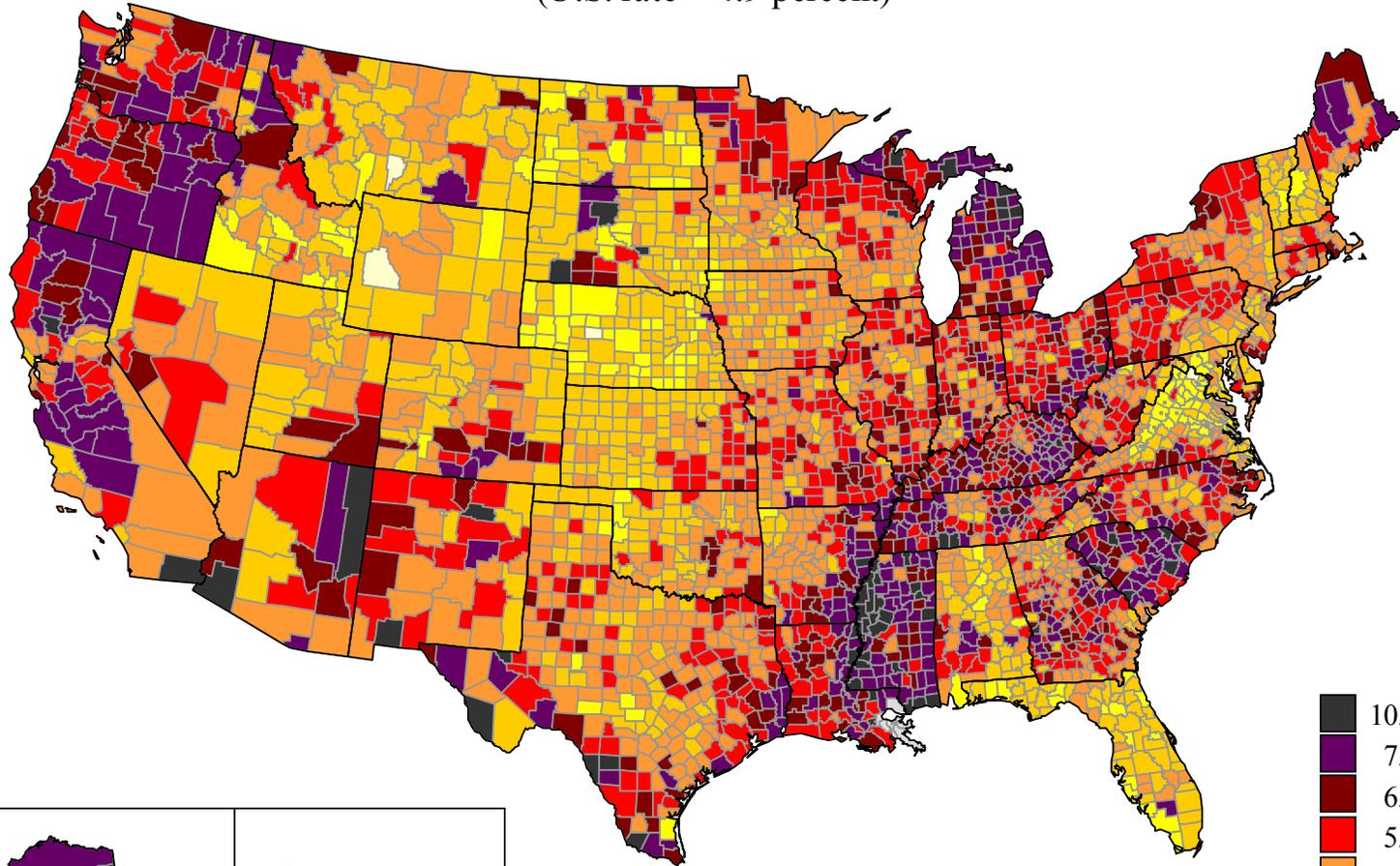
- The Vermont economy has continued to perform well relative to the region and nation. As depicted in the below chart, the Vermont unemployment rate has been consistently below that of the U.S. and, at 3.0% in May of 2006, was the second lowest in the nation and the lowest in New England (with our neighbor to the immediate East in second place, at 3.3%).



- Regional unemployment rates for the twelve month period ending in May of 2006 are illustrated on the maps on the follow two pages. The first is a map of the United States, showing variations in county unemployment rates. The next is a map of New England, illustrating New England Minor Civil Divisions (Towns). It shows that although unemployment rates have come down throughout the State, there are still sub-regions with persistent unemployment rate differentials.
- Despite the low unemployment rate in May, weak job growth may portend rising unemployment rates in the months ahead. Revised employment data for the State, if accurate, show growth rates at or below 1% for the first five months of the year.

Unemployment rates by county, June 2005 - May 2006 averages

(U.S. rate = 4.9 percent)

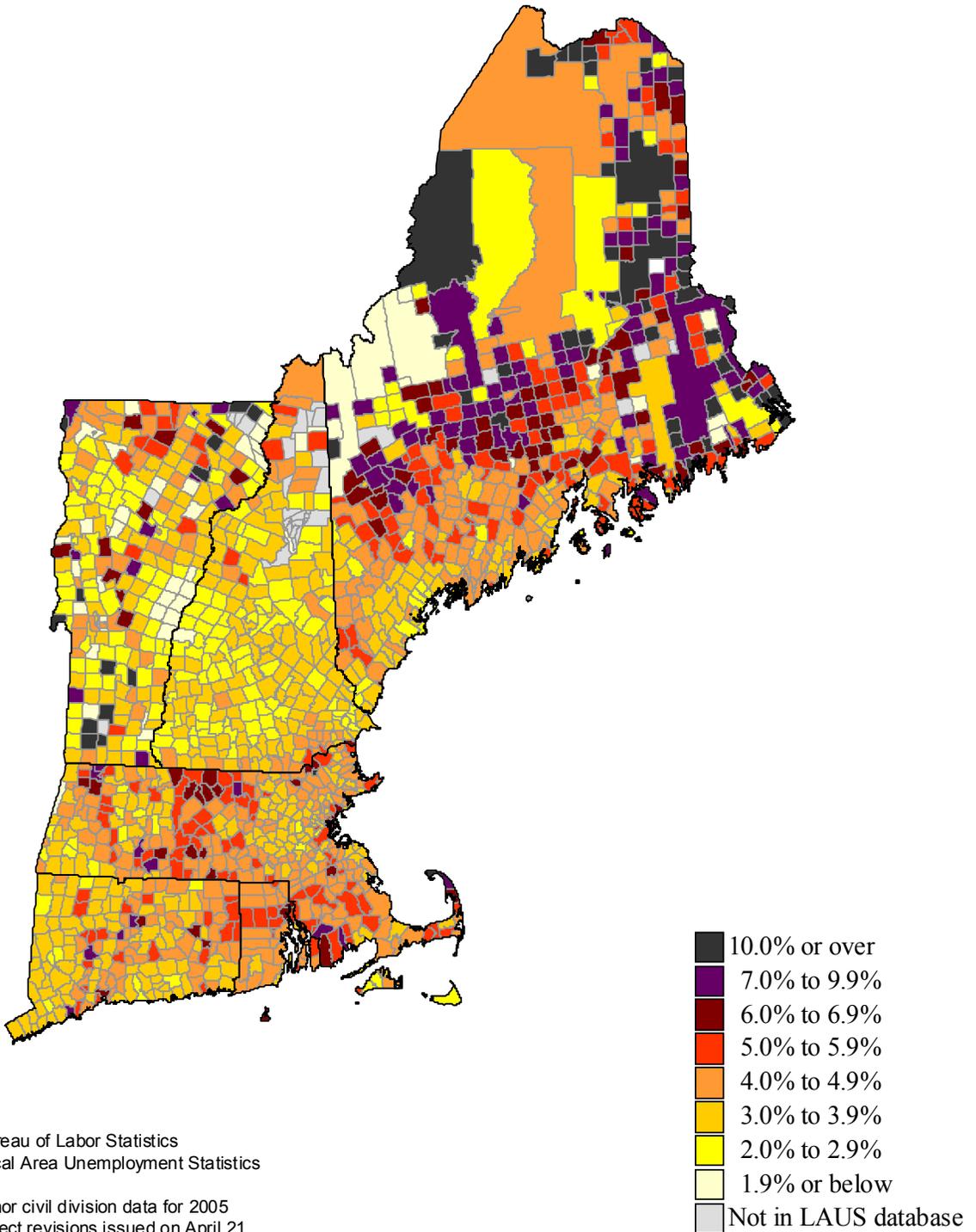


SOURCE: Bureau of Labor Statistics
Local Area Unemployment Statistics

NOTE: County data for 2005 reflect
revisions issued on April 21.

Unemployment rates in New England by Minor Civil Division, June 2005 - May 2006 averages

(U.S. rate = 4.9 percent)



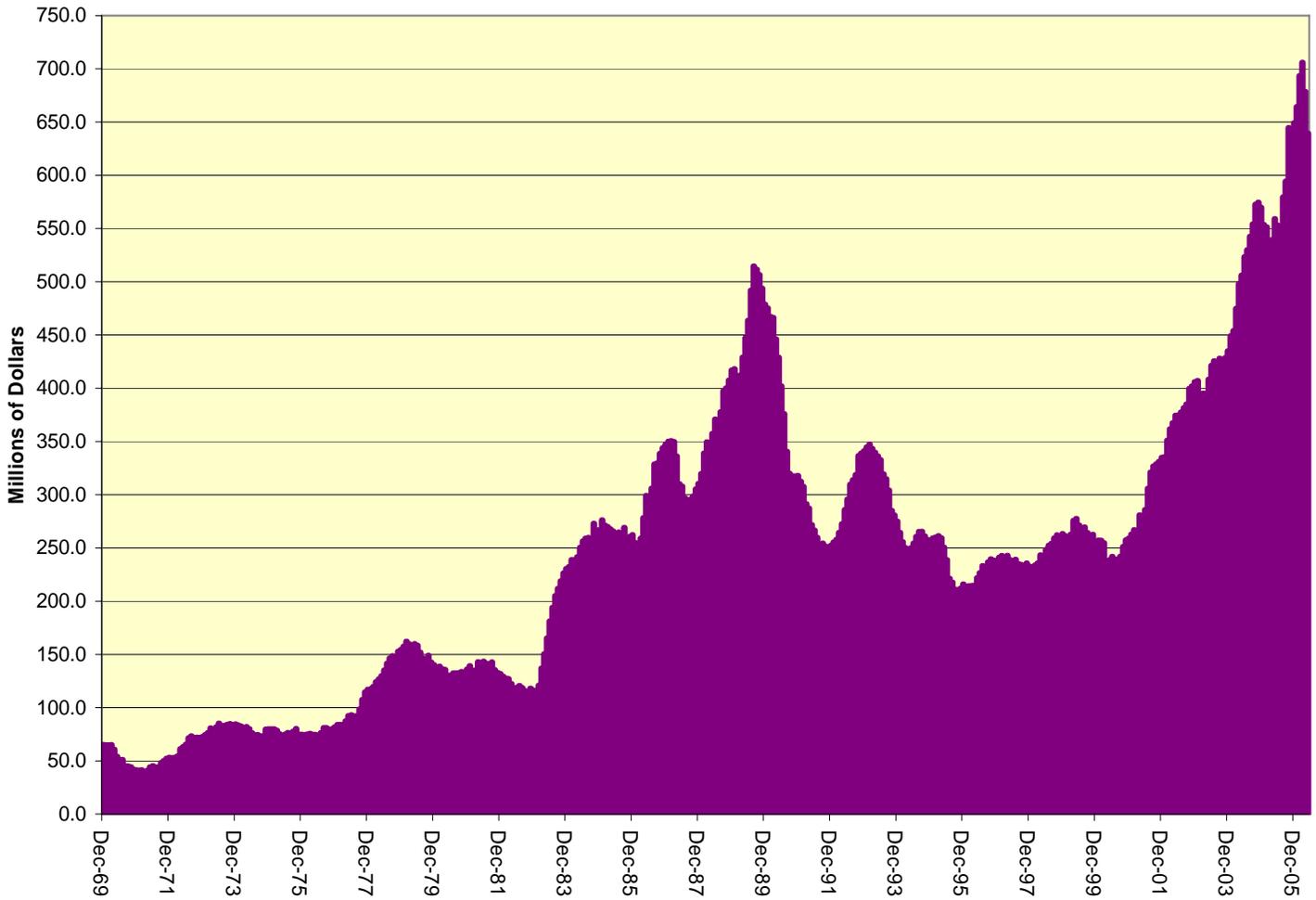
SOURCE: Bureau of Labor Statistics
Local Area Unemployment Statistics

NOTE: Minor civil division data for 2005
reflect revisions issued on April 21.

- The booming construction and real estate market in Vermont probably peaked in the first half of this year and will likely recede further in the face of rising interest rates and continued high fuel prices. As depicted in the below chart, residential construction starts reached an all-time high of \$705 million in March of this year (on a twelve month moving total basis) and have declined for the past two months. Despite this slowing, there will be substantial employment, spending and tax revenues from the economic activity associated with the build-out of these starts during the next six to nine months.

What Goes Up, Must Come Down (and it's started)...

(Residential Construction Starts Peak in Vermont at More Than \$700M in March - 12 month moving total basis)

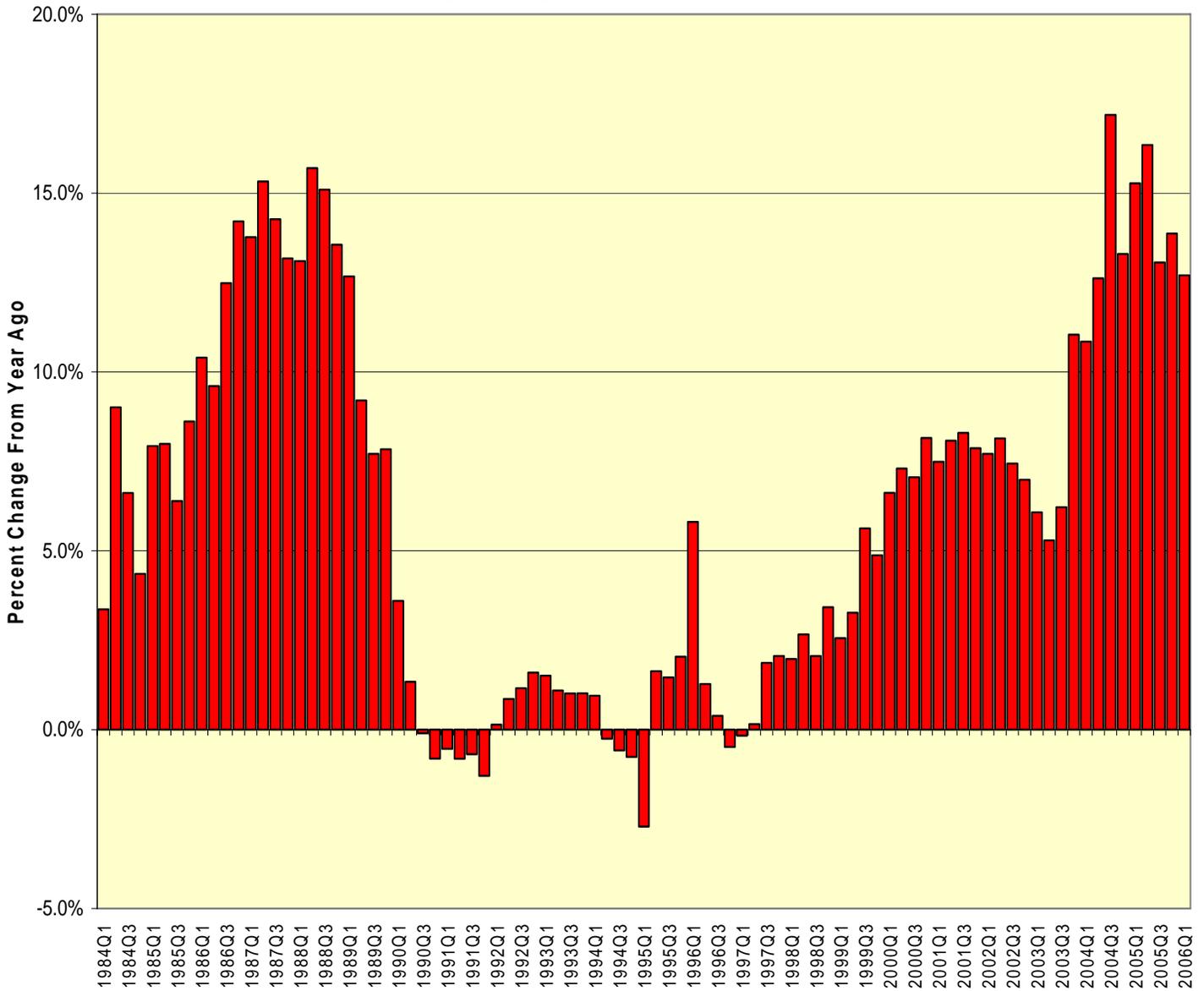


Source: F.W. Dodge/McGraw-Hill

- Real estate market appreciation is also forecast to appreciably slow in the State soon, although the latest available data through the first quarter of 2006 depict continued double digit growth (see chart on following page). Although the current forecast calls for a gradual slowdown in this market over the next two years, it could collapse quickly if interest rates spike or other events trigger a broader recession.

Vermont Housing Price Increases Continue at Double-Digit Rates

(Percent Change vs. Year Ago in Vermont OFHEO House Price Index)



- The Vermont economic forecast, upon which the revenue forecasts in this Update are based, is prepared by the New England Economic Partnership (NEEP), using Moody's/Economy.com state economic models. Although Administration Economist, Jeff Carr, manages the NEEP Vermont model with input and consultation by JFO and other prominent local business economists, unlike the revenue forecasts herein, it is not a consensus JFO/Administration forecast. Because of this, and the fact that the forecast was developed 4-5 months ago, judgmental adjustments were necessary, based on more current Economy.com forecasts and JFO analysis. As with the U.S. macroeconomic forecast, the use of more current consensus State macroeconomic projections would improve the quality of the revenue projections herein.

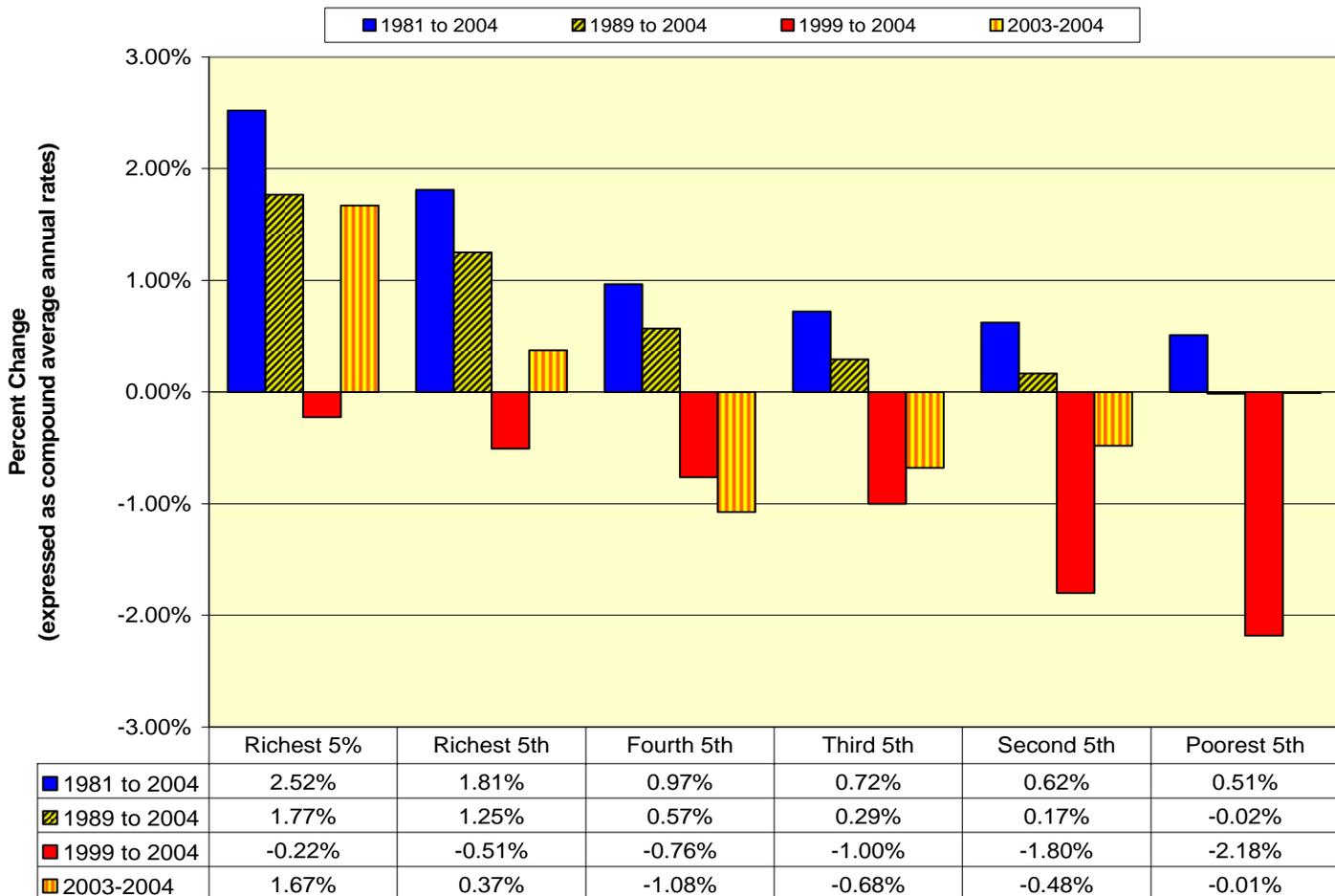
TABLE B
Comparison of NEEP/Economy.com Vermont State Forecasts
October 2003 Through May 2006, Selected Variables, Calendar Year Basis

	2002	2003	2004	2005	2006	2007	2008	2009	2010
Real GSP Growth									
Oct-03	1.5	1.8	2.7	2.1	2.6	2.3			
May-04	1.5	0.4	3.6	2.9	3.1	3.0	2.8		
Oct-04	1.5	0.4	3.3	3.4	2.8	2.8	2.9		
May-05	2.8	3.5	3.7	2.9	2.7	2.4	2.7	2.5	
Oct-05	2.2	4.3	5.3	3.7	3.5	1.8	2.4	2.7	
May-06	2.2	4.3	4.6	3.3	2.8	2.9	3.2	3.5	3.2
Population Growth									
Oct-03	0.6	0.7	0.5	0.3	0.3	0.4			
May-04	0.6	0.4	0.4	0.7	0.4	0.4	0.5		
Oct-04	0.6	0.4	0.3	0.3	0.3	0.5	0.5		
May-05	0.6	0.4	0.3	0.3	0.2	0.5	0.5	0.4	
Oct-05	0.6	0.5	0.3	0.3	0.3	0.5	0.7	0.5	
May-06	0.6	0.5	0.3	0.3	0.3	0.5	0.6	0.5	0.4
Employment Growth									
Oct-03	-0.8	1.4	0.4	1.2	1.1	1.0			
May-04	-0.9	-0.2	1.1	1.7	1.3	1.0	1.0		
Oct-04	-0.9	-0.2	1.1	1.9	1.1	0.9	1.1		
May-05	-0.9	0.0	1.4	1.6	1.2	0.7	0.9	1.1	
Oct-05	-0.9	0.0	1.4	1.5	1.4	0.2	0.7	1.2	
May-06		-0.1	1.3	0.8	1.2	1.2	0.8	1.1	0.9
Unemployment Rate									
Oct-03	3.8	4.2	4.5	4.2	4.0	3.9			
May-04	3.7	4.6	4.6	4.4	4.3	4.2	4.1		
Oct-04	3.7	4.6	3.5	3.4	3.4	3.2	3.1		
May-05	4.0	4.5	3.7	3.4	3.4	3.4	3.3	3.2	
Oct-05	4.0	4.5	3.7	3.3	3.2	3.3	3.3	3.1	
May-06	4.0	4.5	3.7	3.5	3.5	3.6	3.5	3.4	3.3
Personal Income Growth									
Oct-03	3.1	4.4	3.5	3.5	3.8	4.0			
May-04	3.1	3.9	4.0	3.9	3.9	4.3	4.3		
Oct-04	3.3	4.1	5.4	4.1	3.6	4.2	4.3		
May-05	2.6	3.6	6.0	6.2	4.2	4.1	4.2	4.1	
Oct-05	3.7	3.9	6.2	5.8	3.8	2.4	4.2	4.4	
May-06	1.7	3.4	5.8	5.2	4.8	4.4	4.3	4.3	4.1
Avg. Home Sale Price Growth									
Oct-03	7.7	3.7	0.9	0.9	3.0	2.9			
May-04	7.6	7.2	6.8	4.6	3.4	3.5	3.2		
Oct-04	7.6	7.2	8.8	-0.1	4.4	5.0	4.8		
May-05	7.6	7.2	13.4	6.3	2.1	0.3	2.0	3.5	
Oct-05	7.6	7.2	13.5	14.6	8.3	2.7	-0.5	1.0	
May-06	7.6	7.2	13.5	14.5	10.4	3.7	1.9	2.1	3.1

State Revenues

- Aggregate State revenues closed FY06 about 2.2% ahead of prior projections, with the Available General Fund up \$36.8 million (+3.3%), the Transportation Fund down about \$5.8 million (-2.8%) and the Education Fund up \$1.1 million (+0.7%).
- FY06 strength in the **General Fund** was primarily due to exceptional tax revenues from corporate income, personal income and estate tax payments. These three categories logged gains of 26%, 8% and 39%, respectively, over FY05 levels. The **Transportation Fund** suffered from continued high (and under-forecasted per the chart on page 4), gasoline prices, which depressed gasoline sales and new vehicle sales. The **Education Fund** offset losses in MVP&U revenues with steady sales and use revenues and strong lottery receipts that benefited from several rich Powerball jackpots.
- **Personal Income** tax revenue growth is projected to slow in FY07, as real estate appreciation wanes and higher interest rates impact business-related income. Still, disparities in income growth by income class (see below chart) are

Growth in Real U.S. Household Income, by Income Class

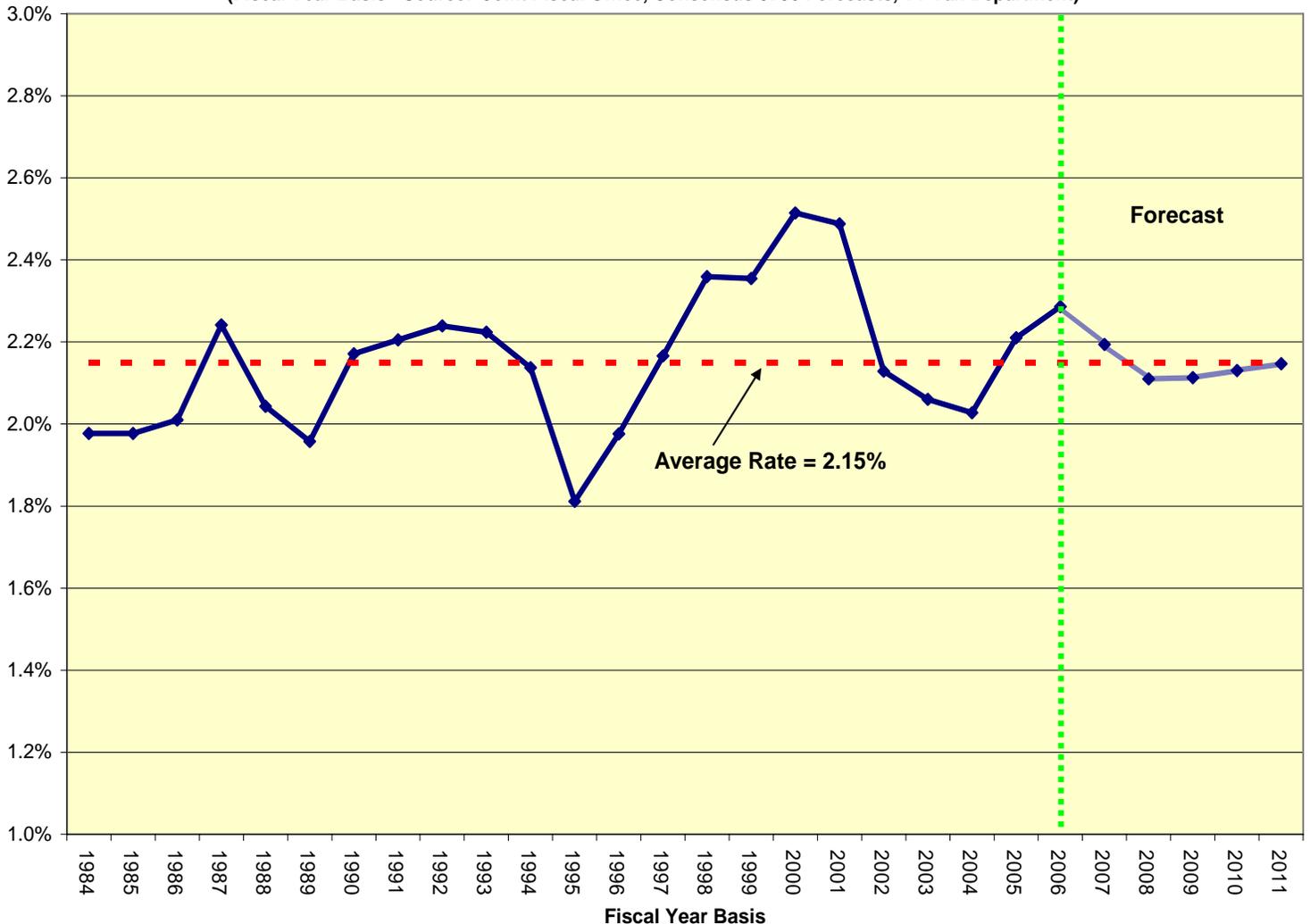


Source: U.S. Census Bureau

projected to continue, supporting relatively strong growth in this tax revenue source in the long run. Calendar 2006 projections for both stock market and real estate appreciation growth exceed 8% and should support continued personal income growth of at least 2-3% in FY07. Although the control forecast assumes continued growth through FY08, the downside risks to personal income revenues in both FY07 and FY08 are significant.

- The vulnerability of this sector to decline, especially in FY08, requires a note of budgetary caution. Like the stock market-related capital gains in the late 1990s, the revenue windfalls directly associated with this sector should not be considered “permanent.” As occurred in the late 1980s, conditions could develop that would lead to a rapid real estate market correction with far-reaching tax and other implications. Because of this, a close monitoring of this sector is recommended, with immediate budget review if unfavorable conditions begin to emerge.

Vermont Personal Income Tax Revenues as a Percent of Gross State Product
 (Fiscal Year Basis - Source: Joint Fiscal Office, Consensus 0706 Forecasts, VT Tax Department)



- As depicted in the chart on page 13, revenue growth from personal income receipts are expected to be close to their long term trend as a percent of Gross State Product (GSP) over the next five years. This is one of the few revenue sources that is expected to grow at rates comparable to the general economy.



- **FY06 Corporate Income** tax revenues reached an all time high of nearly \$76 million – exceeding estimated by more than \$12 million. This extraordinary growth mirrored national trends, as corporate profits soared (see page 6) along with tax liabilities. With refunds likely to accelerate as economic growth slows in FY07 and FY08 and both State and Federal tax changes likely to lower corporate revenues, FY07 is projected to decline to about \$65 million with a further decline to about \$54 million in FY08. Any more pronounced economic slowdown could accentuate both the speed and depth of this decline – as has been demonstrated during numerous business cycles over the past 30 years.
- **Estate Tax** revenues in FY06 benefited from rapid recent real estate appreciation and continued sporadic, very large estate tax payments. While such events are exceedingly difficult to forecast, they have become frequent enough to include as “likely” in future estate tax revenue projections. Accordingly, even with the calendar 2006 change in the unified credit exclusion amount (from \$1.5 million to \$2.0 million), which will affect FY07 receipts, estate tax revenues are projected to total nearly \$18 million. With the strong appreciation in assets such as real estate, stocks and bonds that has occurred over the past 10 years, estate tax revenues could be substantial in FY08 and beyond.

- **Sales and use** tax revenues performed slightly above expectations in FY06, ending the year less than 1% above target projections. With the implementation of the Streamlined Sales Tax (detailed below) finally occurring in January of 2007, sales and use tax revenues are expected to reach nearly \$340M in FY07 and more than \$356M in FY08

The Streamlined Sales Tax: Coming to Vermont Soon...

The Streamlined Sales Tax Agreement (SSTA) is a multi-state endeavor to simplify and streamline state sales and use taxes in order to facilitate the collection of such taxes from out-of-state vendors – notably mail order and internet retailers.

Vermont's Streamlined Sales Tax statutes were last expected to be "current law" effective October 1, 2006, however, technical implementation issues have again delayed the start-up date – which is now assumed to be January 1, 2007 – and resulted in a reduction in expected FY07 revenues of about \$2.8 million from prior January estimates.

Of critical importance, out-of-state vendor payments are still voluntary until and unless Congress acts to allow states to require such tax collection. Accordingly, all current estimates are based on voluntary vendor participation and assume minimal impacts as a result of this.

Current estimates, based on a conservative assumption of a 10% voluntary vendor participation rate and the new effective start date, should total just under \$1 million in FY07 and about \$2.3 million from SST vendors for the full 2008 fiscal year. Changes in the taxation of beer, telecommunications and the current clothing exemption necessary to be in compliance with the new system are expected to add about \$3.8 million in FY07 and about \$9.4 million in FY08.

It should be noted that current SSTA revenue estimates are highly uncertain. Revenue estimates from the initial program participants (who launched the program on October 1, 2005) vary by a factor of about 9(!), based on assorted assumptions. While we have no data on the revenue yields from these states to date, the Joint Fiscal Office and Tax Department will be in close contact with analysts from these states in the coming months in order to refine our estimates based on actual program experience.

- FY06 **Lottery** revenues benefited from a number of large Powerball jackpots and closed the year up 7.3% - more than \$1.5 million above expectations. Although last year's concentration of large jackpots is unlikely to be duplicated in FY07, the steady improvement in the management and operation of the State lottery will lead to slight revenue gains in FY08 and beyond. While long term prospects for Lottery revenue growth are limited by existing game fatigue, marketing restrictions and limited business development options, annual receipts in any given year could vary widely based on random Powerball jackpot sizes, other new games and associated promotional activities.

- Hobbled by above-average temperatures during much of the critical winter ski season, and gasoline prices that kept people close to home, **Meals and Rooms** tax revenues suffered in the second half of FY06 and closed the year \$2.5 million below expectations. With natural snowfall unevenly distributed throughout the season both by region and month, many ski areas experienced an abbreviated ski season in which rain was as prevalent as snow. Those areas without substantial snow-making capacity were especially impacted, with virtually every area reporting below average snowfall. Waterville Valley, NH reported its lowest snowfall on record, with only 78 inches – about half its normal level. Although weather conditions are always uncertain, higher gasoline prices seem likely, and will reduce meals and rooms revenues over the forecast period, relative to prior projections.

Global Warming:

Measuring Possible Economic Impacts in Vermont, as the Debate Heats Up...

While this winter's warmer than average temperatures may or may not be a part of a longer term trend, eight of the ten warmest years in the Northern Hemisphere since 1860 have been in the last decade. Average Vermont temperatures in January of 2006 reached a full 10 degrees warmer than normal, limiting even artificial snow-making.

As a result of growing scientific data on the likelihood of continued global warming and the recognition of specific possible consequences, longer term economic analyses have recently begun to quantify potential economic impacts associated with these consequences. In response to both private and public sector contingency planning, Global Insight (GI), the nation's largest economic forecasting and consulting firm, recently launched an economic service focusing solely on the issues of measuring economic costs associated with various alternative policy options and business strategies for contending with global warming.

While there has been no analysis to date that specifically looks at Vermont's economy and the possible impacts of rising average temperatures on it (and there are no state economic forecasts that extend beyond a five year planning horizon, except in the energy sector), this may be an issue that deserves attention in the coming years. The GI analysis suggests that the sooner action is taken to plan for and address this issue, the lower the social and economic costs may be.

Possible State impacts could include reduced winter tourism and associated real estate investment, agricultural and forestry changes, the introduction of new insects and warmer-climate crop diseases, and increased flooding, to name a few. Meteorologist Roger Hill believes "maple sugaring will be the canary in the coal mine" in Vermont. He notes that maple tress in Ohio are already beginning to bud in February and that the sugaring industry could be one of the first casualties in Vermont.

- The Largest Transportation Fund** revenue sources were severely impacted by soaring energy and gasoline prices during FY06. Forecasts of declining oil prices were frustrated by strong international demand and continued Middle East turmoil, keeping prices well above \$2.50 per gallon for most of the year. These prices shifted the demand curve for **Gasoline** down, resulting in tax revenue yields that were nearly \$2.5 million lower than projected and contributed to a decline of nearly 4% in **Motor Vehicle Purchase and Use** revenues. Both gas and diesel tax revenues are expected to experience subdued growth over the forecast period, as oil prices remain relatively high and volatile. Motor vehicle purchase and use taxes will also be negatively affected by higher interest rates in FY07 and FY08 - offsetting tax rate changes in H.869 that will add approximately \$1.5 million in MVP&U revenues in FY07 and \$1.6 million in FY08.



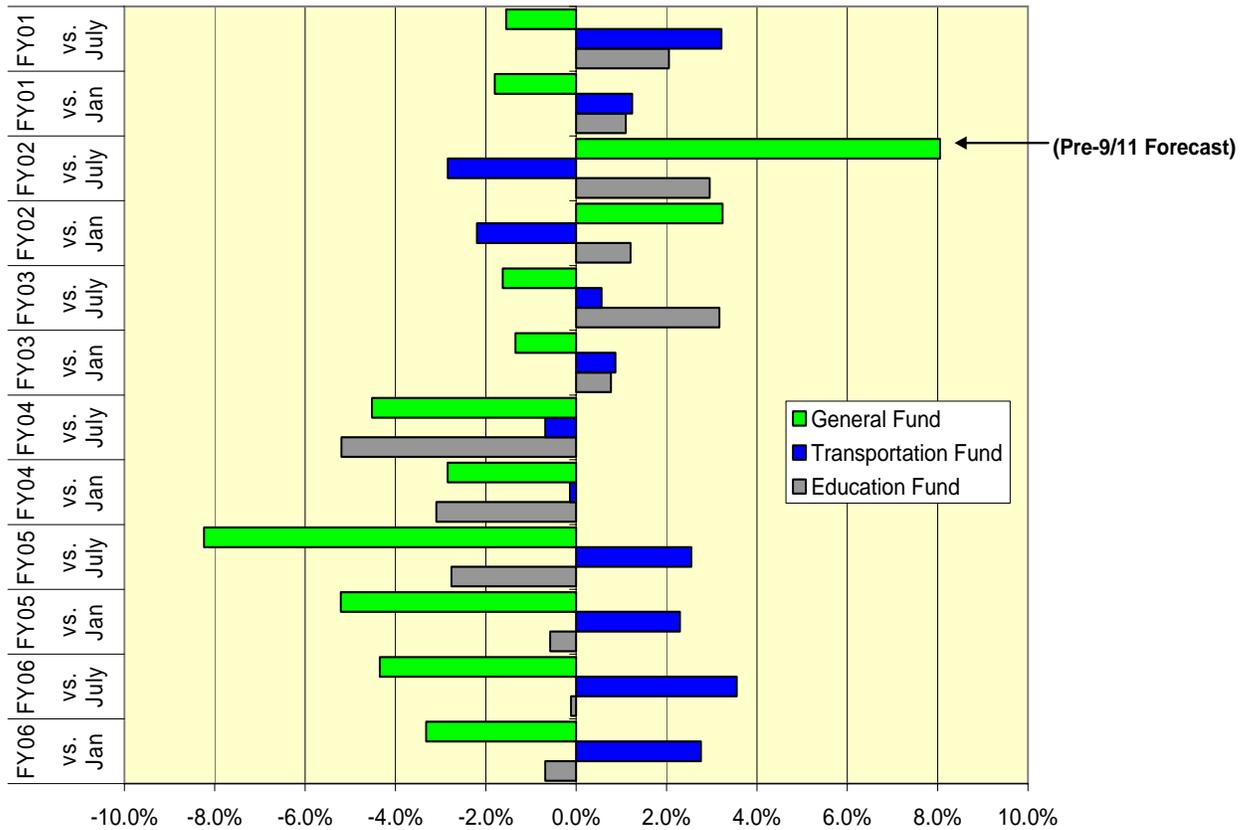
- Even **Motor Vehicle Fee** revenues were impacted by higher gas prices in FY06, as both new vehicle registrations and renewals lagged expectations. Fee revenues will increase substantially in FY07 due to fee schedule changes associated with H.869, adding approximately \$8.1 million in FY07 and \$10.3 million in FY08. In addition to these changes, the two year vehicle registration cycle will continue to cause alternating annual revenue fluctuations in this category. Fee changes in H.869 will also add about \$2.3 million to **Other T-Fund Revenue** in FY07 and FY08 in addition to prior changes that add approximately \$0.3M in additional revenue transfers from the G-Fund associated with interest on the T-Fund Stabilization Reserve beginning in FY07.

Methodological Notes and Other Comments

- This analysis has benefited significantly from the input and support of Tax Department and Joint Fiscal Office personnel. In the Joint Fiscal Office, Sara Teachout and Mark Perrault have contributed to numerous policy and revenue impact analyses and coordinated JFO forecast production and related legislative committee support functions. Sandy Noyes has organized and maintains large tax and other databases in support of JFO revenue forecasting activities. Neil Schickner has provided Transportation Fund data and analyses. In the Tax Department, Susan Mesner, Tax Department Economist, has made important analytic contributions to many tax and revenue forecasts, including tax law change analyses. George Phillips, Tax Department Policy Analyst, has provided critical information on a wide range of tax and revenue issues, and Bill Smith Tax Department Statistician and Policy Analyst has provided a wealth of statistical and related background information from the detailed tax databases he has developed and maintained. Our thanks to all of the above for their many contributions to this analysis.
- The analysis in support of JFO economic and revenue projections are based on statistical and econometric models, and professional analytic judgment. All models are based on 29 years of data for each of the 25 General Fund categories (three aggregates), 26 years of data for each of the Transportation Fund categories (one aggregate), and 8 to 29 years for each of the Education Fund categories. The analyses employed includes seasonal adjustment using the X-11 and X-12 Census methods, various moving average techniques (such as Henderson Curves, etc.), Box-Jenkins ARIMA type models, pressure curve analysis, comparable-pattern analysis of monthly, quarterly and half year trends for current year estimation, and behavioral econometric forecasting models.
- Because the State does not currently fund an internal State or U.S. macro-economic model, this analysis relies primarily on macro-economic models from Moody's/Economy.com and the New England Economic Partnership (NEEP). The NEEP forecast for Vermont is managed by Jeff Carr, of Economic & Policy Resources, Inc., who is also the current Administration economist. Since October of 2001, input and review of initial Vermont NEEP model design and output prior to its release has been provided by the JFO Consulting Economist and other prominent Vermont economists. Dynamic and other input/output-based models for the State of Vermont from Regional Economic Models, Inc. (REMI), Regional Dynamics, Inc. (REDYN), and IMPLAN are also maintained and managed by the JFO for use in selected economic impact and simulation analyses used herein.
- The Consensus JFO and Administration forecasts are developed following discussion, analysis and synthesis of independent revenue projections produced by Administration and Joint Fiscal Office economists.

- Consensus forecasting accuracy is summarized in the below chart. Although independent forecasts are generated for hundreds of revenue categories and associated independent variables, error percentages for the three broad revenue funds are presented for both prior July and January forecasting periods. As depicted in the chart, the T-Fund error term is positive (over-forecast) in eight out of the last 12 forecasts, the G-Fund error term is negative (under-forecast) in 10 of the last 12 forecasts, and the E-Fund is evenly split, with 6 positive and 6 negative error terms over the past 12 forecasts. Thus, over-forecasts (high relative to actuals) represent about 44% of the major fund forecasts over the past six years, while under-forecasts (low relative to actuals) occur about 56% of the time. The average absolute value of the January miss for total revenues is about 2%, with the comparable July miss at just over 3%.

Vermont Consensus Revenue Forecasting Accuracy
FY2001 to FY2006 - Source: Joint Fiscal Office



	FY06	FY06	FY05	FY05	FY04	FY04	FY03	FY03	FY02	FY02	FY01	FY01
	vs. Jan	vs. July										
■ General Fund	-3.3%	-4.3%	-5.2%	-8.2%	-2.8%	-4.5%	-1.3%	-1.6%	3.2%	8.1%	-1.8%	-1.5%
■ Transportation Fund	2.8%	3.6%	2.3%	2.6%	-0.1%	-0.7%	0.9%	0.6%	-2.2%	-2.8%	1.2%	3.2%
■ Education Fund	-0.7%	-0.1%	-0.6%	-2.8%	-3.1%	-5.2%	0.8%	3.2%	1.2%	3.0%	1.1%	2.1%

**TABLE 1A - STATE OF VERMONT
LEGISLATIVE JOINT FISCAL OFFICE
SOURCE* GENERAL FUND REVENUE FORECAST UPDATE
Consensus JFO and Administration Forecast - July 2006**

* **SOURCE G-FUND** revenues

are prior to all E-Fund allocations and
and other out-transfers. Used for
analytic and comparative purposes only.

	FY 2003	%	FY 2004	%	FY 2005	%	FY 2006	%	FY 2007	%	FY 2008	%
	<i>(Actual)</i>	<i>Change</i>	<i>(Actual)</i>	<i>Change</i>	<i>(Actual)</i>	<i>Change</i>	<i>(Preliminary)</i>	<i>Change</i>	<i>(Forecast)</i>	<i>Change</i>	<i>(Forecast)</i>	<i>Change</i>
REVENUE SOURCE												
Personal Income	\$411.3	0.9%	\$429.8	4.5%	\$500.5	16.4%	\$542.0	8.3%	\$554.6	2.3%	\$561.2	1.2%
Sales & Use**	\$232.4	1.1%	\$272.2	17.1%	\$310.8	14.2%	\$325.4	4.7%	\$339.4	4.3%	\$356.2	4.9%
Corporate	\$35.3	10.5%	\$55.7	57.7%	\$60.4	8.3%	\$75.9	25.8%	\$64.9	-14.5%	\$53.7	-17.3%
Meals and Rooms	\$102.0	2.6%	\$108.5	6.4%	\$113.0	4.1%	\$111.8	-1.1%	\$116.1	3.9%	\$119.0	2.5%
Cigarette	\$43.4	77.0%	\$49.8	14.9%	\$46.1	-7.5%	\$46.2	0.3%	\$57.6	24.7%	\$56.3	-2.3%
Liquor	\$11.2	5.7%	\$11.7	4.5%	\$12.5	7.1%	\$13.2	5.1%	\$13.5	2.5%	\$13.9	3.0%
Insurance	\$42.5	21.7%	\$47.0	10.7%	\$50.3	7.0%	\$52.5	4.2%	\$54.0	3.0%	\$55.5	2.8%
Telephone	\$10.1	-2.6%	\$10.4	2.5%	\$10.5	1.6%	\$10.4	-1.4%	\$10.5	1.2%	\$10.6	1.0%
Beverage	\$5.1	1.3%	\$5.2	2.9%	\$5.3	2.0%	\$5.4	2.8%	\$5.6	2.8%	\$5.7	1.8%
Electric	\$2.6	-8.3%	\$2.8	7.4%	\$2.6	-6.0%	\$2.6	0.0%	\$2.6	-0.2%	\$2.7	3.5%
Estate	\$15.6	12.4%	\$14.7	-5.7%	\$18.9	28.2%	\$26.2	39.0%	\$17.9	-31.7%	\$19.0	6.1%
Property	\$27.5	10.1%	\$34.0	23.3%	\$45.2	33.2%	\$43.7	-3.4%	\$39.6	-9.3%	\$36.1	-8.8%
Bank	\$6.3	18.4%	\$6.5	3.2%	\$8.6	32.0%	\$10.2	18.3%	\$10.8	6.4%	\$11.0	1.9%
Other Tax	\$2.7	36.3%	\$4.4	59.8%	\$6.6	52.1%	\$7.2	9.1%	\$6.4	-11.3%	\$5.9	-7.8%
<i>Total Tax Revenue</i>	\$948.0	4.9%	\$1052.7	11.0%	\$1191.2	13.2%	\$1272.6	6.8%	\$1293.5	1.6%	\$1306.8	1.0%
Business Licenses	\$2.7	5.9%	\$2.7	0.6%	\$2.8	2.9%	\$2.8	-0.5%	\$2.8	0.3%	\$2.9	3.6%
Fees	\$10.7	-4.3%	\$11.3	6.1%	\$12.5	9.9%	\$13.2	6.1%	\$14.0	5.8%	\$14.8	5.7%
Services	\$2.0	60.1%	\$1.6	-18.8%	\$2.0	22.9%	\$1.3	-35.3%	\$1.6	25.0%	\$1.7	6.3%
Fines	\$3.5	36.2%	\$7.4	114.1%	\$4.4	-40.2%	\$3.3	-25.5%	\$3.5	6.1%	\$3.6	2.9%
Interest	\$1.2	-63.6%	\$0.2	-86.2%	\$1.6	894.1%	\$3.0	86.0%	\$3.5	17.1%	\$3.5	0.0%
Special Assessments	\$0.1	180.5%	\$0.0	-73.0%	\$0.0	-74.7%	\$0.0	NM	\$0.0	NM	\$0.0	NM
Lottery	\$15.5	-8.0%	\$20.3	30.7%	\$20.4	0.4%	\$21.9	7.3%	\$21.5	-1.7%	\$21.8	1.4%
All Other	\$1.6	141.4%	\$0.5	-71.4%	\$0.4	-9.9%	\$0.3	-18.2%	\$0.4	20.4%	\$0.5	25.0%
<i>Total Other Revenue</i>	\$37.3	-2.8%	\$44.0	18.1%	\$44.1	0.1%	\$45.8	3.9%	\$47.3	3.3%	\$48.8	3.2%
TOTAL GENERAL FUND	\$985.3	4.6%	\$1096.7	11.3%	\$1235.3	12.6%	\$1318.4	6.7%	\$1340.8	1.7%	\$1355.6	1.1%

** Includes Telecommunications Tax, which is no longer reported separately

**TABLE 1 - STATE OF VERMONT
LEGISLATIVE JOINT FISCAL OFFICE
AVAILABLE GENERAL FUND REVENUE FORECAST UPDATE
Consensus JFO and Administration Forecast - July 2006**

CURRENT LAW BASIS

including all Education Fund

allocations and other out-transfers

	FY 2003	%	FY 2004	%	FY 2005	%	FY 2006	%	FY 2007	%	FY 2008	%
	<i>(Actual)</i>	<i>Change</i>	<i>(Actual)</i>	<i>Change</i>	<i>(Actual)</i>	<i>Change</i>	<i>(Preliminary)</i>	<i>Change</i>	<i>(Forecast)</i>	<i>Change</i>	<i>(Forecast)</i>	<i>Change</i>
REVENUE SOURCE												
Personal Income	\$411.3	0.9%	\$429.8	4.5%	\$500.5	16.4%	\$542.0	8.3%	\$554.6	2.3%	\$561.2	1.2%
Sales and Use*	\$232.4	1.1%	\$272.2	17.1%	\$207.2	-23.9%	\$216.9	4.7%	\$226.3	4.3%	\$237.5	4.9%
Corporate	\$28.6	10.5%	\$45.2	57.8%	\$60.4	33.6%	\$75.9	25.8%	\$64.9	-14.5%	\$53.7	-17.3%
Meals and Rooms	\$83.1	2.6%	\$88.4	6.3%	\$113.0	27.8%	\$111.8	-1.1%	\$116.1	3.9%	\$119.0	2.5%
Cigarette	\$0.0	NM	\$0.0	NM	\$0.0	NM	\$0.0	NM	\$0.0	NM	\$0.0	NM
Liquor	\$11.2	5.7%	\$11.7	4.5%	\$12.5	7.1%	\$13.2	5.1%	\$13.5	2.5%	\$13.9	3.0%
Insurance	\$42.5	21.7%	\$47.0	10.7%	\$50.3	7.0%	\$52.5	4.2%	\$54.0	3.0%	\$55.5	2.8%
Telephone	\$10.1	-2.6%	\$10.4	2.5%	\$10.5	1.6%	\$10.4	-1.4%	\$10.5	1.2%	\$10.6	1.0%
Beverage	\$5.1	1.3%	\$5.2	2.9%	\$5.3	2.0%	\$5.4	2.8%	\$5.6	2.8%	\$5.7	1.8%
Electric	\$2.6	-8.3%	\$2.8	7.4%	\$2.6	-6.0%	\$2.6	0.0%	\$2.6	-0.2%	\$2.7	3.5%
Estate**	\$15.6	17.8%	\$14.7	-5.7%	\$18.9	28.2%	\$21.0	11.3%	\$17.9	-14.8%	\$19.0	6.1%
Property	\$12.5	25.4%	\$11.1	-11.0%	\$14.8	33.1%	\$13.5	-8.9%	\$12.9	-3.8%	\$11.8	-8.8%
Bank	\$2.6	18.4%	\$2.7	3.2%	\$8.6	216.6%	\$10.2	18.3%	\$10.8	6.4%	\$11.0	1.9%
Other Tax	\$2.7	36.3%	\$4.4	59.8%	\$6.6	52.1%	\$7.2	9.1%	\$6.4	-11.3%	\$5.9	-7.8%
Total Tax Revenue	\$860.3	2.9%	\$945.5	9.9%	\$1011.1	6.9%	\$1082.5	7.1%	\$1096.1	1.3%	\$1107.4	1.0%
Business Licenses	\$2.7	5.9%	\$2.7	0.6%	\$2.8	2.9%	\$2.8	-0.5%	\$2.8	0.3%	\$2.9	3.6%
Fees	\$8.2	-5.5%	\$8.9	8.8%	\$12.5	40.4%	\$13.2	6.1%	\$14.0	5.8%	\$14.8	5.7%
Services	\$2.0	60.1%	\$1.6	-18.8%	\$2.0	22.9%	\$1.3	-35.3%	\$1.6	25.0%	\$1.7	6.3%
Fines	\$3.5	36.2%	\$7.4	114.1%	\$4.4	-40.2%	\$3.3	-25.5%	\$3.5	6.1%	\$3.6	2.9%
Interest	\$1.5	-51.5%	\$0.4	-73.4%	\$2.1	438.3%	\$3.7	75.1%	\$4.3	15.9%	\$4.4	2.3%
Special Assessments	\$0.1	180.5%	\$0.0	-73.0%	\$0.0	-74.7%	\$0.0	NM	\$0.0	NM	\$0.0	NM
All Other	\$1.6	141.4%	\$0.5	-71.4%	\$0.4	-9.9%	\$0.3	-18.2%	\$0.4	20.4%	\$0.5	25.0%
Total Other Revenue	\$19.5	4.2%	\$21.5	10.2%	\$24.2	12.6%	\$24.6	1.8%	\$26.6	7.9%	\$27.9	4.9%
TOTAL GENERAL FUND	\$879.8	3.0%	\$967.0	9.9%	\$1035.3	7.1%	\$1107.1	6.9%	\$1122.7	1.4%	\$1135.3	1.1%

*Includes Telecommunications Tax, which is no longer reported separately; ** Excludes transfers to the Higher Education Trust Fund of \$2.4M in FY05 and \$0.7M in FY02, but includes transfer of \$5.2M in FY06.

**TABLE 2A - STATE OF VERMONT
LEGISLATIVE JOINT FISCAL OFFICE
SOURCE* TRANSPORTATION FUND REVENUE FORECAST UPDATE
Consensus JFO and Administration Forecasts - July 2006**

* **SOURCE T-FUND** revenues are prior to all E-Fund allocations and other out-transfers. Used for analytic and comparative purposes only.

	FY 2003		FY 2004		FY 2005		FY 2006		FY 2007		FY 2008	
	(Actual)	% Change	(Actual)	% Change	(Actual)	% Change	(Preliminary)	% Change	(Forecast)	% Change	(Forecast)	% Change
REVENUE SOURCE												
Gasoline	\$64.8	2.6%	\$65.1	0.5%	\$65.5	0.7%	\$63.8	-2.7%	\$65.0	1.9%	\$65.9	1.4%
Diesel	\$16.4	-1.3%	\$18.0	9.7%	\$15.5	-13.8%	\$17.7	14.0%	\$18.2	2.8%	\$18.6	2.2%
Purchase and Use*	\$82.1	1.5%	\$86.2	5.0%	\$84.1	-2.5%	\$80.9	-3.8%	\$81.1	0.3%	\$84.0	3.6%
Motor Vehicle Fees	\$51.6	8.3%	\$55.2	7.0%	\$56.1	1.6%	\$57.3	2.2%	\$66.7	16.4%	\$71.9	7.8%
Other Revenue**	\$14.6	-33.3%	\$15.2	4.3%	\$15.9	4.9%	\$17.1	7.4%	\$19.4	13.4%	\$20.0	3.1%
TOTAL TRANS. FUND	\$229.5	-0.3%	\$239.7	4.5%	\$237.1	-1.1%	\$236.8	-0.2%	\$250.4	5.8%	\$260.4	4.0%

**TABLE 2 - STATE OF VERMONT
LEGISLATIVE JOINT FISCAL OFFICE
AVAILABLE TRANSPORTATION FUND REVENUE FORECAST UPDATE
Consensus JFO and Administration Forecast - July 2006**

CURRENT LAW BASIS

including all Education Fund allocations and other out-transfers

	FY 2003		FY 2004		FY 2005		FY 2006		FY 2007		FY 2008	
	(Actual)	% Change	(Actual)	% Change	(Actual)	% Change	(Preliminary)	% Change	(Forecast)	% Change	(Forecast)	% Change
REVENUE SOURCE												
Gasoline	\$54.0	2.6%	\$54.3	0.5%	\$65.5	20.8%	\$63.8	-2.7%	\$65.0	1.9%	\$65.9	1.4%
Diesel	\$16.4	-1.3%	\$18.0	9.7%	\$15.5	-13.8%	\$17.7	14.0%	\$18.2	2.8%	\$18.6	2.2%
Purchase and Use*	\$68.7	1.5%	\$71.9	4.7%	\$56.0	-22.1%	\$53.9	-3.8%	\$54.1	0.3%	\$56.0	3.6%
Motor Vehicle Fees	\$51.6	8.3%	\$55.2	7.0%	\$56.1	1.6%	\$57.3	2.2%	\$66.7	16.4%	\$71.9	7.8%
Other Revenue**	\$14.6	-33.3%	\$15.2	4.3%	\$15.9	4.9%	\$17.1	7.4%	\$19.4	13.4%	\$20.0	3.1%
TOTAL TRANS. FUND	\$205.2	-0.5%	\$214.6	4.5%	\$209.1	-2.5%	\$209.8	0.3%	\$223.4	6.5%	\$232.4	4.0%

*As of FY04, Motor Vehicle Purchase and Use includes Motor Vehicle Rental Tax revenues, restated with estimated values for historical data; **Beginning in FY07, Other Revenue includes interest from the T-Fund Stabilization Reserve

**TABLE 3 - STATE OF VERMONT
LEGISLATIVE JOINT FISCAL OFFICE
AVAILABLE EDUCATION FUND* REVENUE FORECAST UPDATE**
(Partial Education Fund Total - Includes Source General and Transportation Fund Allocations Only)
Consensus JFO and Administration Forecasts - July 2006

CURRENT LAW BASIS

* Source General and Transportation

Fund taxes allocated to or associated
with the Education Fund only.

	FY 2002	%	FY 2003	%	FY 2004	%	FY 2005	%	FY 2006	%	FY 2007	%	FY 2008	%
	<i>(Actual)</i>	<i>Change</i>	<i>(Actual)</i>	<i>Change</i>	<i>(Actual)</i>	<i>Change</i>	<i>(Actual)</i>	<i>Change</i>	<i>(Preliminary)</i>	<i>Change</i>	<i>(Forecast)</i>	<i>Change</i>	<i>(Forecast)</i>	<i>Change</i>
GENERAL FUND														
Meals and Rooms**	\$18.3	2.3%	\$18.8	3.0%	\$20.1	6.8%	\$0.0	NM	\$0.0	NM	\$0.0	NM	\$0.0	NM
Sales & Use***	\$14.9	8.6%	\$13.7	-8.0%	\$16.4	19.2%	\$103.6	533.1%	\$108.5	4.7%	\$113.1	4.3%	\$118.7	4.9%
Bank	\$3.1	-39.6%	\$3.7	18.4%	\$3.8	3.2%	\$0.0	NM	\$0.0	NM	\$0.0	NM	\$0.0	NM
Corporate	\$6.1	-36.7%	\$6.7	10.5%	\$10.5	57.1%	\$0.0	NM	\$0.0	NM	\$0.0	NM	\$0.0	NM
Security Registration Fees	\$2.5	-1.0%	\$2.5	-0.4%	\$2.5	-2.5%	\$0.0	NM	\$0.0	NM	\$0.0	NM	\$0.0	NM
Interest	\$0.2	-21.4%	(\$0.3)	NM	(\$0.2)	NM	(\$0.5)	NM	(\$0.7)	NM	(\$0.8)	NM	(\$0.9)	12.5%
Lottery	\$16.9	-3.1%	\$15.5	-8.0%	\$20.3	30.7%	\$20.4	0.4%	\$21.9	7.3%	\$21.5	-1.7%	\$21.8	1.4%
TRANSPORTATION FUND														
Gasoline	\$10.5	0.2%	\$10.8	2.6%	\$10.8	0.5%	\$0.0	NM	\$0.0	NM	\$0.0	NM	\$0.0	NM
Purchase and Use****	\$13.2	6.9%	\$13.4	1.5%	\$14.3	6.2%	\$28.0	96.2%	\$27.0	-3.8%	\$27.0	0.3%	\$28.0	3.6%
TOTAL	\$85.8	-4.2%	\$84.9	-1.0%	\$98.5	15.9%	\$151.5	53.8%	\$156.6	3.4%	\$160.9	2.7%	\$167.6	4.2%

** Note: After Travel Tourism out-transfer of \$1.56 million ***Includes Telecommunications Tax, which is no longer reported separately ****Includes Motor Vehicle Rental revenues, restated.