VERMONT

In-State Risk Factors and Safeguards

1. Is there a revenue source dedicated to K–12 education? If not, what legal protections exist for education funding?

Vermont has a unique education funding structure that both insulates funds from economic volatility and guarantees a degree of funding fairness across school districts.[1] Education tax rates are set based on the sizes of school districts' voter-approved budgets. All education revenues are pooled at the state level and distributed through the Education Fund, for which Vermont has earmarked multiple tax sources.[2] Property taxes are the largest source of revenue, currently making up 66 percent of the fund.[3] All of the sales and use tax, 33 percent of vehicle purchase and use tax, 25 percent of meals/rooms and alcohol tax, and 100 percent of lottery revenues are also dedicated to the Education Fund.

There are potential challenges down the road: Act 73 of 2025, which contained substantial funding policy changes, is scheduled to go into effect in fall 2028, and there is uncertainty around its implementation.[4] Still, Vermont's education funding is better protected than many other states due to dedicated revenue sources. Vermont also has a strong, court-affirmed constitutional right to an education and equal educational opportunities, which may act as a deterrent to large cuts to education funding.[5]

2. What budget commitments could limit spending flexibility?

Because Vermont's Education Fund is separate from the General Fund, there is less of a crowd-out concern than in other states, where increases in non-education costs might put pressure on education budgets. Instead, there is crowd-out risk within the Education Fund itself, through rapid growth in cost drivers like teacher health insurance and special education services.[6] Absent an increase in property taxes, these costs could crowd out more flexible aspects of education spending. Additionally, an economic downturn or federal spending cuts put economic stress on families, increasing the number of high-need students that receive additional support through the state funding formula. This would put additional pressure on the Education Fund.

3. Are the state's revenue sources vulnerable to an economic downturn?

Vermont dedicates specific tax revenues to the Education Fund. Because of this structure, we focus on the volatility of the state's education revenues—the swings in those revenues from year to year—rather than general revenues, and also note how these are expected to be impacted by Act 73, which goes into effect in 2028.[7]

Property Tax

Roughly two-thirds of the money in the Education Fund comes from a statewide property tax, made up of a non-homestead tax (39 percent of the fund) and a homestead tax (27 percent).[8] Of the homestead portion, about a third is paid by homeowners whose rates are reduced due to an income-sensitive tax credit. Property taxes are generally quite stable. Income-based taxes are closely tied to unemployment rates and wages, making revenues potentially volatile and difficult to forecast during a downturn, though they have the benefit of being more progressive than other taxes.[9]

Act 73 will replace the existing income-sensitive property tax credit with a homestead property tax exemption whose size depends on the payer's household income. Preliminary estimates suggest that this change will reduce revenues by $35 million, so the state would need to set higher property tax rates to compensate.[10]

Sales and Use Tax

The sales and use tax (a flat 6 percent general sales tax)[11] is the second-largest revenue source, making up 26 percent of the Education Fund.[12] General sales taxes tend to be a stable revenue source during economic downturns, but they are regressive in nature.

Selective Sales Tax and Lottery Revenues

The rest of Education Fund revenues (roughly 8 percent) come mostly from selective sales taxes, including 33 percent of the vehicle purchase and use tax, 25 percent of meals/rooms and alcohol tax, and 100 percent of lottery revenues. These tend to be more volatile than general sales taxes, because they come from discretionary purchases (although some research finds alcohol and lottery revenues fairly recession-resilient).[13] These tax sources are regressive, although the level of regressivity varies. For example, vehicle taxes are typically less regressive than alcohol and lottery taxes.[14]

4. Is the state prepared to manage an economic downturn without making cuts to education?

A robust rainy day fund can provide a buffer against budget cuts during a recession.[15] Vermont has multiple rainy day funds that total $328 million–enough to cover 45.6 days of state operations, which is very close to the national median of 47.8 days.[16] The Education Fund has its own dedicated rainy day fund. At the end of 2024, this reserve totaled $47 million.[17] The reserve is capped at 5 percent of the Education Fund's prior-year appropriations and is currently fully funded.

Vermont is preparing to safeguard its finances from federal policy changes. The 2026 state budget reserved $30 million in the General Fund to mitigate federal spending cuts. It included a provision that would allow budget amendments due to federal cuts and authorize the use of up to 10 percent of the state's rainy day fund.[18] A State Treasurer Task Force on the Federal Transition has produced several additional policy recommendations to strengthen Vermont's economy and fiscal stability, although it remains to be seen whether these will be implemented.[19]

Vermont is the only state with no balanced budget requirement, which means it could theoretically deficit-spend if it needed to. However, Vermont has a long-standing tradition of balancing its budget, so this may be unlikely.[20]

Notes

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