



State and Local Government Price Index Questions and Answers

1. What is the “New England Economic Project”?

The New England Economic Project, recently renamed the New England Economic Partnership (NEEP), is a member-supported organization that provides objective economic analyses and forecasts. It is prominently supported by the Boston Federal Reserve Bank, among other private and public sponsors, and includes membership from throughout the six New England states: VT, NH, ME, MA, RI and CT. NEEP forecasts utilize national and state level projections and economic models prepared by Moody’s/Economy.com. These models are managed at the state and region level by designated NEEP “model managers” for each New England state. These model managers are local state economists with considerable expertise and knowledge of their particular state. The NEEP model manager for Vermont is presently Jeffrey Carr, who is also the Administration economist. Mr. Carr consults with other local economists in preparing his Vermont forecast, including Thomas Kavet, Consulting Economist for the Vermont Legislature. Although the Vermont NEEP forecast is not an official consensus forecast, there is considerable JFO input to the NEEP Vermont model forecasting process.

2. How does NEEP arrive at a “cumulative price index for state and local government purchases of goods and services”?

NEEP does not estimate this index. It is calculated by the U.S. Department of Commerce (USDOC), Bureau of Economic Analysis (BEA), as a part of the National Income and Product Accounts (NIPA) series used to estimate U.S. Gross Domestic Product (GDP). It is used to convert current dollar NIPA estimates for State and Local Government expenditures to a constant dollar basis. More detailed technical and methodological source documents are available on the BEA website at: <http://www.bea.gov>

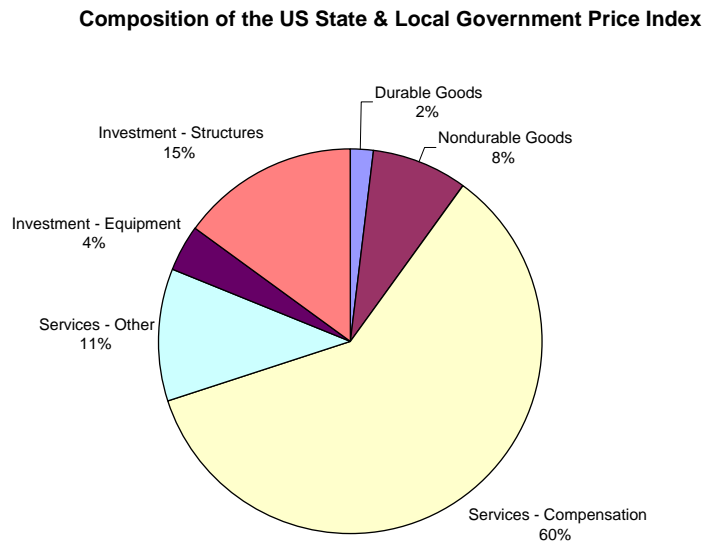
3. Does the index reflect a “market basket” for cost items affecting public education?

The index reflects the cost of purchasing inputs used by state and local governments. The basket of goods measured by this index changes over time as the actual purchasing patterns of government change due to price changes, technological changes, and other factors. This is a

more accurate measure of the costs facing school districts than the Consumer Price Index, which measures the cost of purchasing a fixed basket of *consumer* goods.

Although economists consider this index to be the best overall proxy for inflation in education-related expenditures that is regularly forecast by major econometric consulting firms, it is not a perfect deflator for educational expenditures in the State of Vermont. The index is an aggregation of all state and local expenditures (of which education is the largest but not sole expenditure) and does not account for regional price differences. Although it would be possible to develop an independent Vermont-specific measure of education inflation, the cost of developing and maintaining such an index would be extremely expensive.

The following pie chart shows the overall composition of the BEA State and Local Government deflator. Although this can change over time, generally, more than 60% of the index is driven by service compensation expenditures that are linked to education employee compensation adjusted for education level, experience, and hour worked.



4. Who determines the index's projections?

Economists Tom Kavet (for the JFO and Legislature) and Jeff Carr (for the Administration) prepare a consensus forecast of the state and local government price index twice a year, usually in May and November, as a part of the general Education Fund forecasts. The forecasts for this index are published in Table 3 of this analysis.

5. Who is responsible for approving the index and its projections?

The Joint Fiscal Office and the Department of Finance & Management approve the consensus projections prepared by our economists.

6. What methodology is employed in determining the index's projections?

The consensus forecasting process for this index is similar to all economic variables forecast by the Administration and JFO economists. They start with baseline forecasts from Moody's/Economy.com and also review general inflation projections from a wide range of economic forecasting entities. Each economist prepares projections based on econometric models, statistical models and professional judgment. Both the forecasting results and data inputs are then reviewed by the economists jointly, and consensus forecasts are developed via discussions and further research and analysis, if necessary.

7. How do the projections of the index relate to actuals?

The projections have generally been within 0%-2% of actuals on a prior year basis, however, the NIPA indices are occasionally revised several years after initial "actuals" are reported. On a prior year basis, there has never been an error greater than 2%. During the period from 2003 to 2006, when inflation was generally rising, the projections tended to be slightly below actuals. Since 2007, they have been at or slightly above actuals. If inflation slows dramatically due to the deepening recession, or if deflation occurs, current projections could significantly exceed actuals.

8. Please provide a chart of how the index is used for each of its statutory applications.

See the attached sheet.

9. Where, within Title 16 - Education, is the index applied?

- 16 V.S.A. §559(e)(7) – contract renewal exemption from school boards' public bid requirement
- 16 VSA §563(11)(B)(i)(I) - maximum inflation amount for school budgets
- 16 VSA 1563(b) – technical center transportation assistance
- 16 VSA §2948(c) – essential early education grants

- 16 V.S.A. §2959a(d) – Medicaid reimbursement incentive payment threshold
- 16 VSA §4011(b) – base education payment
- 16 VSA §4016(a) - transportation reimbursement
- 16 VSA §4016(c) – extraordinary transportation reimbursement
- 16 V.S.A. §4025(a)(2) – general fund transfer to education fund

See the attached sheet for statutory language.

10. Where, outside of Title 16 - Education, is the index applied?

A full-text search of the Vermont Statutes Online did not locate any references to the state and local government price index outside of Title 16 - Education.

11. Is the index utilized in any other state or local municipality's financial formulae or calculations?

The state and local government price index is used by many other states for a variety of purposes. For example, the Massachusetts Department of Education uses the index to calculate the inflation rate for cost factors in its foundation budget formula; the State of California uses the index to calculate allowable increases to revenue limits; and the Minnesota Department of Revenue uses the index to determine the amount of state aid to local government.