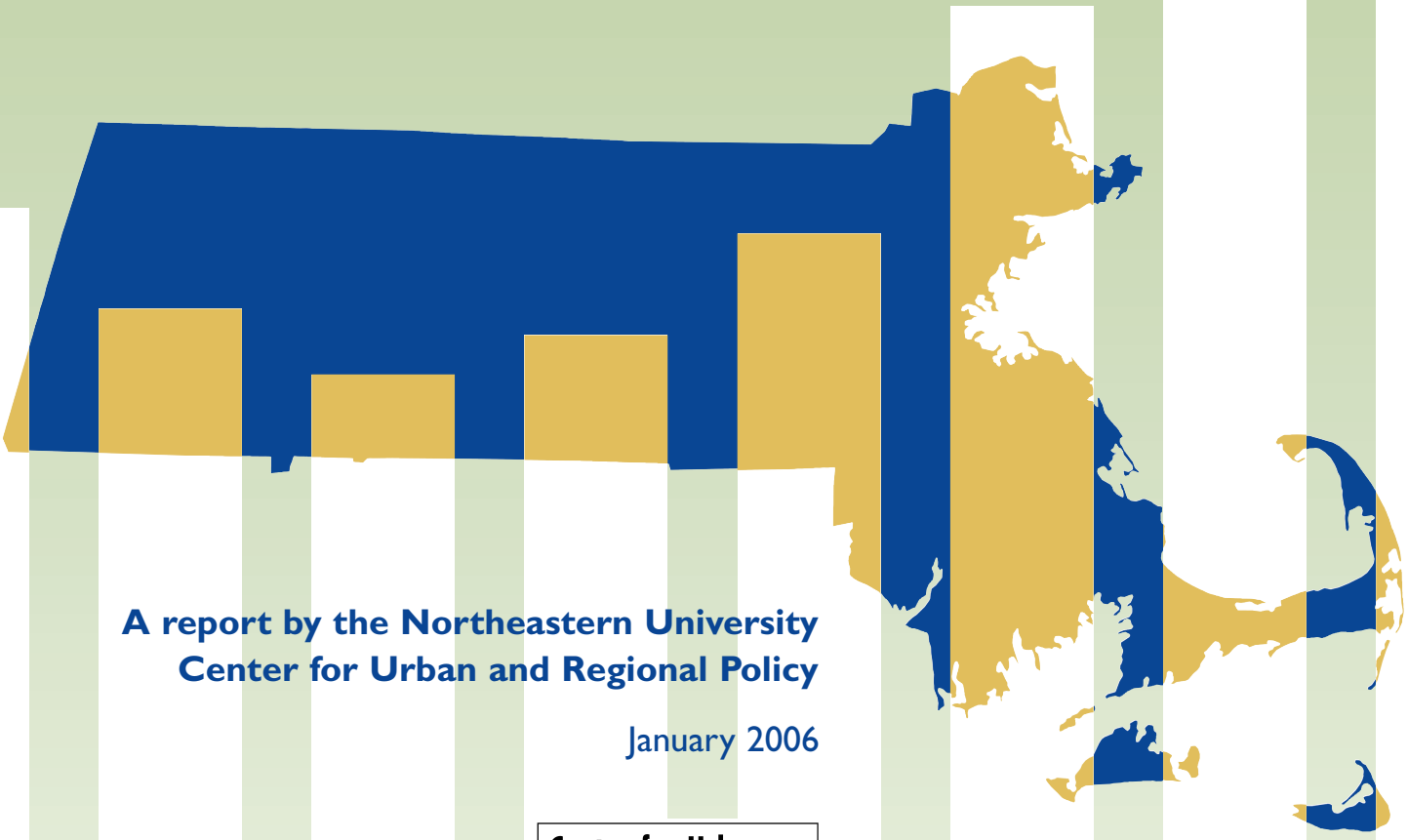
Massachusetts Municipal Association

REVENUE SHARING *and the Future of the* MASSACHUSETTS ECONOMY



A report by the Northeastern University Center for Urban and Regional Policy

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About the Authors

Barry Bluestone is the Russell B. and Andrèe B. Stearns Trustee Professor of Political Economy and the founding director of the Center for Urban and Regional Policy at Northeastern University in Boston, Massachusetts. Before coming to Northeastern in 1999, Bluestone taught political economy for more than twenty-five years at Boston College and the University of Massachusetts Boston. He received his BA, MA, and Ph.D. in Economics from the University of Michigan

As a political economist, Bluestone has written widely in the areas of income distribution, business and industrial policy, labor-management relations, and urban and regional economic development. He contributes regularly to academic, as well as popular journals, and is the co-author of nine books. These include most recently ***Growing Prosperity: The Battle for Growth with Equity in the 21st Century*** (with Bennett Harrison) which explores the post-World War II history of economic growth and income distribution in the U.S, and ***The Boston Renaissance: Race, Space, and Economic Change in an American Metropolis*** (with Mary Huff Stevenson). Currently, he is completing a college textbook tentatively entitled ***The Urban Experience: Economics, Society, and Public Policy.***

As part of his work, Bluestone spends a considerable amount of time consulting with community organizations, trade unions, industry groups, and with various federal, state, and local government agencies. In 1995, he served as Special Policy Adviser to the House Democratic Leader, Richard Gephardt. He is a founding director of the Economic Policy Institute in Washington, D.C. and a member of the scientific committee of the International Center for Social Studies based in Rome, Italy.

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Clayton-Matthews is co-editor of Massachusetts Benchmarks, a joint publication of the University of Massachusetts and the Federal Reserve Bank of Boston that presents timely information and analysis about the performance of the Massachusetts economy. He is also a Director of the New England Economic Project, a group of economists and managers from academia, business, and government who study and forecast the New England economy.

Previously, Clayton-Matthews has worked as an economist and policy analyst for the Massachusetts Department of Revenue, the Social Welfare Research Institute at Boston College, and DRI/McGraw-Hill. He received a Ph.D. in economics from Boston College.

David Soule is Associate Director at the Center for Urban and Regional Policy at Northeastern University. Prior to joining the Center, he stepped down as the Executive Director of the Metropolitan Area Planning Council after 15 + years of service. As the Chief Executive Officer of the Council, he was responsible for a budget which exceeded $8 million and a staff of more than 80 professional and support personnel. During his tenure, he oversaw the development of MetroPlan, a comprehensive plan for the future of the Boston metropolitan area.

The Council develops regional plans and programs and provides technical assistance to the municipalities in the metropolitan area.

In April 2003, Soule completed his Ph.D. in the Law, Policy, and Society program at Northeastern University. Prior to joining the Metropolitan Area Planning Council, Soule served as the Executive Director of the Nashua Regional Planning Commission in Nashua, New Hampshire for 7 years. From 1971 to 1980, he served as Deputy and Planning Director of the Capitol Region Council of Governments in Hartford, Connecticut.

Soule has a bachelor's degree from Trinity College and has done extensive graduate work in urban studies.

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January 14, 2006

Geoffrey Beckwith
Executive Director
Massachusetts Municipal Association
60 Temple Place
Boston, MA 02110

Dear Mr. Beckwith:

On behalf of our Center, I am pleased to enclose the attached report that includes recommendations for a new fiscal and economic development partnership between the Commonwealth of Massachusetts and its 351 municipalities. We assembled a strong group of researchers including Alan Clayton-Matthews and David Soule to work to develop a new way of understanding the critical link between fiscal strength at the municipal level and success in the overall economic health of the Commonwealth.

It is no secret that we are losing ground to other competitor states for both jobs and young workers … in large measure because of the high cost of living and the high cost of doing business in the Commonwealth. This report underscores the essential role that cities and towns can play in encouraging young people to settle in the state, retaining existing businesses and jobs, and encouraging new firms to establish operations here in Massachusetts. We will never be a low cost of living region compared to our competitors, but we can offset at least some of this disadvantage with excellent public services.

We hope this report offers a compelling message that we can meet the economic and demographic challenge facing the Commonwealth by building a new fiscal and economic partnership between State government and local municipalities, making sure that local communities have the resources to compete for young families, investment, and jobs. We believe the Massachusetts Municipal Association and others have an opportunity to build a strong coalition to accomplish this essential task.

We look forward to continuing to work with you to help assure the prosperity of the Commonwealth.

Sincerely yours,

Barry Bluestone
Director

Executive Summary

INTRODUCTION

After two decades of nearly unparalleled economic growth, the Massachusetts economy is sputtering along and young people and families are looking for other places to live and work. Even with our best efforts, the Commonwealth is disadvantaged in the competition for workers and for business investment on the basis of our cost of living and our climate. But we can address this disadvantage by recognizing that economic development turns increasingly on the ability of local communities to compete in the regional, national, and global economy by offering vital public services and high-quality public amenities funded by reasonable property tax levels, increased state aid, and additional forms of local revenue.

When looking where to settle in the United States, the newest research on business location decisions reveals that entrepreneurs and corporate executives seek out a town or city that meets their needs in terms of a combination of workforce, infrastructure, public services, and cultural and recreational amenities. State government can help turn "deal breakers" into "deal makers," but ultimately local communities close the deal. Municipal government is on the front lines of the economic development game. Unless cities and towns have the resources to offer attractive locations for investment, and for where working families can live, virtually everything the state does in the way of economic development incentives will prove inadequate or futile.

Equally important is finding ways to ameliorate the growing gap between those cities and towns whose residents have experienced growing income and wealth and those who are lagging behind. We need economic development and prosperity throughout the state and we need to assure that citizens have reasonably equal access to public goods and services no matter where they live.

Thus, increasing the overall fiscal capacity of cities and towns turns out to be central to the future prosperity of the Commonwealth.

THE ECONOMIC DEVELOPMENT CHALLENGE FACING THE COMMONWEALTH

It may be only a distant memory for many Massachusetts citizens, but as late as the 1970s, the Commonwealth was still suffering from decades of economic distress and decline. Its old manufacturing base was rapidly eroding and the new high tech and financial service industries were still in their infancy.

Increasing the overall fiscal capacity of cities and towns turns out to be central to the future prosperity of the Commonwealth.

In the late 1980's and throughout the 1990's, all of this turned around. Led by Greater Boston's renaissance, the Commonwealth had an enviable economic development record in large parts of the state. With the boom in financial services and in sophisticated high technology industries and with the expansion of the university and health services sectors, thousands of new businesses were created in the Commonwealth and thousands more expanded their operations. Hundreds of thousands of jobs were added to the economy and workers moved here to take advantage of them.

Since the 2000 recession, this record of success has all but evaporated. While the number of jobs nationwide now exceeds the level before the recession, Massachusetts still is 160,000 short. Just between October 2004 and October 2005, nearly 2 million jobs were added to the U.S. total. During the same period, Massachusetts actually lost nearly 10,000 jobs. The state's low unemployment rate remains at 4.8% (October 2005) only because over the past 2½ years, more than 105,000 workers have left the Greater Boston labor market alone.

Added to this weak jobs picture is a longer term challenge—the increasing loss of young workers and families from Massachusetts. Between 2001 and 2004, the number of 20-24 year olds increased by 5.7 percent, but this was much slower than the 9.7 percent increase nationwide. More worrying is that by the time young people begin considering settling down—when they reach age 25-34—they are most likely to leave the state. There was actually a 4.8 percent decline in this segment of the Massachusetts population between 2001 and 2004 despite growth nationwide.

Behind these troublesome employment and demographic trends is the fact that Greater Boston is now the single most expensive place to live among all the metro regions in the nation. At $64,656 for a family of four, the basic family budget in Greater Boston is more than $3,000 higher than in Washington, D.C., $6,000 higher than New York City, and $7,000 higher than in San Francisco. When you combine all the items in the basic family budget, it costs a family of four $20,000 a year more to live in Boston than in our high technology rival Raleigh-Durham-Chapel Hill. If a Boston-based firm moves to North Carolina, it can cut wages by 15 percent and yet still provide its employees with a 15 percent higher standard of living. The same is true for the rest of the state. Lowell, Brockton, Lawrence, Barnstable, Attleboro, Worcester, Fitchburg, Springfield, New Bedford, and Pittsfield all have family of four family budgets of $52,000 or more—within $5,000 of the equivalent family budget in San Francisco and at least $7,000 higher than in Seattle or Raleigh-Durham-Chapel Hill.

Not surprising, we are losing both jobs and people to such locations. That is the nature of the economic development challenge we face, and why we are in trouble.

The one good piece of news is that because of the high productivity of the Massachusetts economy, personal income growth in the Commonwealth is still significantly above the national average and above virtually all of our competitor states. Over the last decade (1994-2004), average per capita personal income grew by 4.74 percent per year compared with the national rate of 4.04 percent. This means that if the Commonwealth wants to invest in keeping jobs and people in the state, it has the resources to do so. We are not a poor state … yet.

THE CENTRAL ROLE OF CITIES AND TOWNS IN ECONOMIC PROSPERITY

PROVIDING COMMUNITIES with the resources to deliver the services and amenities that workers want for their families is critical to the state's future development and prosperity. Equally important is making sure that local municipalities have the ability to provide the economic and social environment that is attractive to industry.

And what do businesses want when they make their location decisions? Additional research undertaken by our Center (CURP) in cooperation with the National Association of Industrial and Office Properties (NAIOP) and CoreNET Global, the association of U.S. corporate real estate officers, suggests that among the top "deal makers" are the availability of an appropriate labor pool in the *region,* the timeliness of approvals and appeals in the *local municipality,* the quality and capacity of the *local municipal* infrastructure, *local access* to roads and airports, minimal *local* traffic congestion, reasonable *local property taxes,* and a *low neighborhood crime rate.*

Factors normally thought to be quite important such as a state or local minimum wage laws and the existence of strong trade unions, according to this research, turn out to be rather *unimportant* in the business siting decision. The predictability and clarity of the local (and state) permitting process is almost as important as state tax and financial incentives. Indeed, businesses place a premium on the physical attractiveness of the local area, the services and amenities offered, a pro-business municipal attitude, and the quality of life in the community.

Municipalities that are strapped for cash are limited in their ability to provide the local environment that businesses demand when they make the decision to put down roots and create jobs. If cities and towns have inadequate revenue to carry out these efforts, economic development for the state suffers.

Providing communities with the resources to deliver services and amenities for workers and families is critical to the state's future.

MUNICIPAL PUBLIC SERVICES

HOW HAS LOCAL SPENDING on key public services changed over the past two decades? If the relationship between income and demand for these public goods and services is like that for private goods and services, then we would expect public spending on such services to rise at about the same rate as private consumption spending. This would mean, of course, that in recent decades public spending should be rising somewhat faster than income.

What the record shows, however, is that over the 1987-2004 period for which municipal general fund expenditures are available for Massachusetts, total real local government expenditures rose at a much lower rate. Over that time, the annual growth rate for real Massachusetts personal income was 2.4 percent. State government spending increased by 2.0 percent. Total local government spending rose by just 1.7 percent. Even worse, local spending on all non-education services was limited to 1.1 percent. Over the last 17 years, the provision of locally-provided public goods and services rose at only about two-thirds of the rate of income growth statewide, and at a lower rate than state government spending as well.

There was a wide variation among the categories of spending. Over the 1987-2004 period, real municipal government spending on education rose at an annual rate of 2.5 percent, just slightly faster than personal income. With the adoption of the Education Reform Act and repeated calls for improvements in education, local and state school spending grew only fractionally faster than income—and slower than private consumption.

A true municipal "budget buster," along with fixed costs, is debt service. It has risen substantially faster than income over this 17-year period, averaging 3.4 percent growth per year, a full point higher than personal income. Debt service has risen quite rapidly in the last several years, much of it due to an increase in the construction of public buildings, especially new and expanded schools.

Lagging behind, local spending on the core public services of police, public works, fire, cultural and recreational amenities, and general government all grew at slower rates than either personal income or state government spending. Public works spending, the bulk of which is reserved for roads, actually declined in real terms during this period.

The fact that municipal spending on key services has generally not kept up with the growth in personal income, let alone personal private consumption, suggests that municipalities are ill-equipped in the battle to offset the negative employment and demographic trends in the Commonwealth. Without spending more in these critical areas, local municipalities simply cannot fulfill their constructive and central role in the fostering of economic development in the Commonwealth.

THE PROPERTY TAX AND STATE LOCAL AID

CITIES AND TOWNS HAVE ATTEMPTED to maintain local services during this time, but they have done so by increasing their reliance on the property tax. Between 1990 and 2004, median household income in the Commonwealth increased by 44.5 percent (in nominal terms). Over the same period, the median single family residential property tax levy increased by 92.2 percent, more than double the rise in household incomes. Moreover, just between FY 2000 and FY 2006, the median property tax levy rose by 42 percent.

The problem is that these increases have been necessary to offset a decline in local aid from the state. Over the past 25 years, state aid has been on a "recession rollercoaster" with sharp cuts coinciding with downturns in the state economy and tax revenues. The cuts beginning with the 2000 recession have been so steep that in real terms, per capita state aid in 2004 was actually lower than in 1989, even though the state economy had grown substantially during that 15-year period. Non-education related state aid has fallen even further to a level not seen in inflation-adjusted terms since the early 1980s. Current local aid levels, when adjusted for inflation, are approximately $700 million below 2002 levels.

Cities and towns have therefore had to increase their property taxes much faster than income simply to keep public services from deteriorating, let alone making them attractive enough to offset the state's high cost of living and doing business.

WIDESPREAD FISCAL STRESS AND THE GROWING GAP BETWEEN COMMUNITIES

INCREASING THE OVERALL LEVEL of local aid to all cities and towns will be necessary to assure success in dealing with the economic development challenges facing the Commonwealth. In addition, if economic development is to occur in any but the more wealthy communities, local aid should also account for the needs of communities with lower income residents and smaller tax bases.

Between 1989 and 1999, 127 Massachusetts communities were in the top half of the state's income distribution and experienced real household income growth over the decade. But at the other end of the spectrum, 70 communities not only began in the lower half of the income distribution but actually experienced a further drop in median household income. The gap in the ability to raise local revenue for municipal services has grown dramatically between these sets of communities.

Municipal leaders must choose to either cut services or ask voters to increase their property taxes.

The result is that even with current state aid, large disparities exist in the provision of public goods and services. With Chapter 70 aid for K-12 schools, the gap has lessened somewhat, but still exists. With the decline in other forms of state aid, the variance in public services such as police and fire protection remains very large. In the long run, this continuing disparity in public spending adds to the difficulty lower income communities face in attracting young families and jobs, and to our ability to ensure equal opportunities for growth and development in every part of Massachusetts.

LOCAL TAX CAPABILITY

ADDED TO THE FISCAL PROBLEMS faced by Massachusetts cities and towns are the severe restrictions placed on municipalities in their capacity to generate revenue from their own sources. This leads to a significant burden on local taxpayers to cover the costs of general municipal services and, in most communities, the bulk of the cost for K-12 education. In 2002, Massachusetts ranked 6th among our key competitor states for per capita revenue ($1,374) generated from the property tax and significantly above the national average ($991). California taxpayers pay 35% less and Arizona property taxes are 40 percent lower. North Carolina, a big competitor state, has a per capita property tax burden that is less than half of the burden in Massachusetts.

Other states are substantially less restrictive than Massachusetts regarding the tax sources available to their municipalities. Competitor states like Michigan, New Jersey, New York and Pennsylvania allow their local governments to collect both income and sales taxes. Arizona, California, Florida, North Carolina, and Washington, also competitors of ours, allow localities to collect sales taxes as well as property taxes.

More and more, municipal leaders must choose to either cut services or ask voters to increase their property taxes. Given no other major source of revenue or options, many officials have done both. The long-term negative impact on economic development cannot be underestimated.

SUMMARY AND RECOMMENDATIONS

WHAT does all of this mean for Massachusetts?

First, the Commonwealth now faces the critical challenge of reversing the loss of young workers and families who are key to our future success, regaining the jobs we have lost since the last recession, and expanding investment for the future prosperity of the state.

Second, local communities play the dominant role in attracting investment and jobs to the state.

Third, local communities compete with the rest of the nation for investment and jobs by providing efficient and effective public services, sufficient infrastructure to reduce traffic congestion and

provide adequate parking, excellent public schools, low crime rates, competitive property taxes, and attractive cultural and recreational amenities.

Fourth, the over-reliance of the state's cities and towns on the local property tax to underwrite public goods and services makes it difficult for the Commonwealth's municipalities to remain competitive in attracting economic development and growth because it forces up property tax levies and forces down municipal services.

Fifth, the decline in state local aid to cities and towns has jeopardized the ability of the Commonwealth's municipalities to offer the type of local public services and overall quality of life that can offset the disincentive of high private sector costs to both families and firms.

Based on these findings and observations, we conclude that Massachusetts must re-craft the fiscal partnership between the state and local governments if municipalities are to play their critical role in economic development. This fiscal partnership should not be seen simply as a budget relationship; it must be seen as an economic partnership that is essential for the state's economic growth, competitiveness and prosperity. The competition is fierce and other states offer significantly more support and many more options to their local jurisdictions to offset the cost of public services.

There are a number of steps that Massachusetts can and should take to make this happen:

A New and Enduring Revenue Sharing Partnership

We join with others, including the Massachusetts Taxpayers Foundation, in recommending that a full 40% of annual revenues from the state's three major tax revenues (personal and corporate income, and sales) be devoted to local aid, which would yield an additional $1 billion to restore and invest in local public services, and provide the necessary stability that municipalities need to plan and invest. This framework should ensure that non-education municipal aid, which has suffered the most, is renewed and is not subject to deeper cuts when state revenues slow down or decline.

A collaborative working relationship between state and local government is central to the Commonwealth's economic competitiveness, growth, and prosperity.

Diversifying the Local Tax and Revenue Structure

Other states offer considerable opportunities for local jurisdictions to access revenue from sources other than the property tax in order to provide the services needed to attract investment and jobs. Massachusetts should follow a similar strategy to diversify local revenues, relieve pressure from the property tax, and export taxes to out-of-state taxpayers who benefit from the state's economy. This should include allowing local option meals and other sales taxes, closing loopholes in the local tax base created by new technologies and businesses such as telecommunications, and pursuing innovative initiatives to leverage a portion of the increased income and sales value from new activity and economic expansion.

Increasing Local Management Authority

Under our Massachusetts constitution, the state has exercised its power to impose restrictions on municipal governments. These go beyond restrictions on revenue and expenditure capacity to include restrictions on the ability of municipal officials to manage their health insurance and other benefit costs, and the imposition of mandated costs such as county government and regional transit services. New approaches are needed to give local communities greater authority and new tools to manage the explosive growth in fixed costs and similar budget busters, at least granting local leaders the same power and flexibility that state officials enjoy.

CONCLUSION

REBUILDING A COLLABORATIVE working relationship between the state government and local authorities is central to the Commonwealth's economic competitiveness, growth, and prosperity, with local government officials understanding the fiscal constraints of state government, but equally important, state officials understanding the critical role that municipalities play in retaining and attracting investment and jobs.

In the end, unless we find a way to regenerate the "collaborative gene" in the Commonwealth's public sector and find a way for the state to better assist local communities in offering the best public services possible, the future prosperity of the state is placed in jeopardy.

Introduction

THE COMMONWEALTH is heading for serious trouble. After two decades of nearly unparalleled economic growth, the economy is sputtering along and young people and families are looking for other places to live and work. Record high living costs make Massachusetts an expensive place to raise a family and a difficult place to recruit a workforce. As a result, in 2004 Massachusetts was the only state in the nation to actually lose population and, unlike the nation at large, employment levels in the state are still well below what they were before the 2000-2001 recession. Where once we could take economic development for granted, there is a growing awareness that much needs to be done to keep young people in the state, attract new ones to settle here, rebuild the state's employment base, and attract new investment and jobs.

Central to keeping families and firms in Massachusetts must be a set of initiatives aimed squarely at offsetting the negative effect of the Commonwealth's high cost of living and the state's high cost of employment. Finding ways to increase the stock of affordable housing for working families, reducing the cost of health care, and improving our schools are all part and parcel of a high-road economic development strategy. Even with our best efforts, however, we are disadvantaged in the competition for young people with Raleigh-Durham-Chapel Hill, North Carolina; Austin, Texas; or any of another hundred locations on the basis of our climate or our cost of living. But we can at least offset some of this disadvantage with vital public services and high quality public amenities funded by a combination of reasonable property tax rates, additional forms of local revenue, and increased state-provided local aid.

Local communities play the dominant role in attracting people and business to the Commonwealth.

While much has been written about the state's role in attracting investment, we are just learning how much economic development is fundamentally a local function. Few businesses decide to move to Massachusetts per se. They seek out a town or city that meets their needs, be it in one of the scores of communities in Greater Boston, along the old Rte. 128, bordering the newer Rte. 495, near the Worcester Medical Complex, or a location in the Western part of the state that offers them the right combination of workforce, infrastructure, and amenities to their liking.

Essentially, local communities play the dominant role in attracting people and business to the Commonwealth. The state government can help, but local communities must close the deal. Cities and towns are on the front lines of the economic development game.

In this context, the loss of local aid over the past five years has eroded the ability of Massachusetts' local communities to supply the services and the amenities that attract families and firms. Without a new fiscal partnership between the state and local government, virtually everything else the state does in the way of incentives to economic growth will prove inadequate or futile. Increasing local aid and finding ways to provide additional locally-generated public funds is not a matter of a "handout" or a "frill." Increasing local fiscal capacity is central to the future prosperity of the entire Commonwealth.

Also important in an era of increasing income disparity across municipalities will be finding ways to ameliorate the growing gap between those cities and towns where residents have experienced growing income and wealth and those who are lagging further and further behind. Economic development is needed throughout the state and we need to assure that citizens have reasonably equal access to public goods and services no matter where they live.

To better understand the role of local government in the new domestic and global economy, this report delves into the present state of the Commonwealth, explores the specific factors that businesses consider when making their location decisions, reviews the level of financial aid supplied to local communities by the state, and finally provides recommendations for action to assure long-term prosperity.

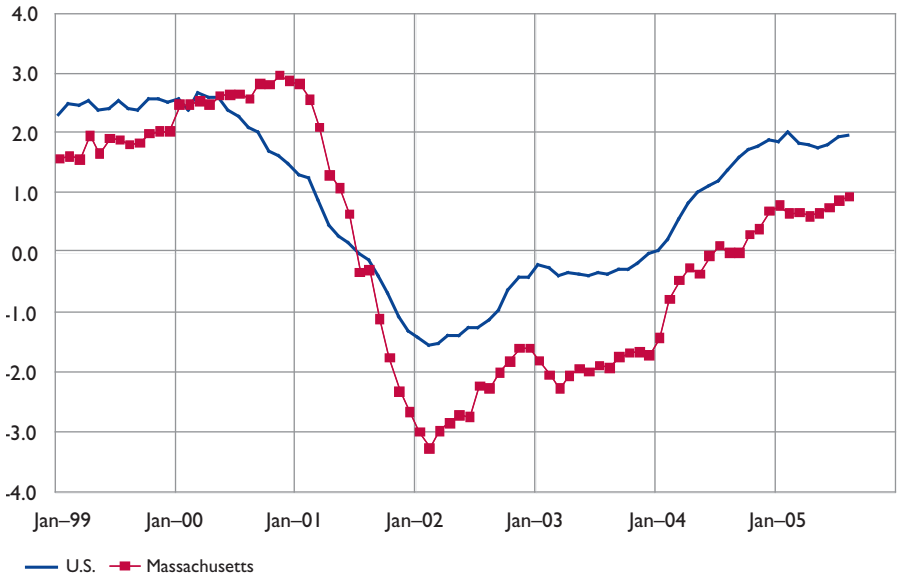
I. The Economic Development Challenge Facing the Commonwealth

IT MAY ONLY BE A DISTANT MEMORY for many Massachusetts citizens, but as late as the 1970s, the Commonwealth was still suffering from decades of economic distress and decline. Its old manufacturing base was rapidly eroding and the new high tech and financial service industries were still in their infancy. In a critically acclaimed study of America's largest urbanized communities, published by the Brookings Institution in 1982, Boston was evaluated alongside the other 153 largest cities in the United States.[1] The authors of the study developed indices of urban distress, decline, and disparity from Census data as well as other government sources. The *distress* index was based on such measures as the unemployment rate, the incidence of violent crime, per capita income, and a city's poverty rate in the mid-1970's. *Decline* was based on changes in these measures during the early 1970's as well as changes in city government indebtedness. *Disparity* measured the gap in these social indicators between the central cities and their surrounding Standard Metropolitan Statistical Areas (SMSA).

Jobs have gone missing even in the state's premier industries.

On a scale running from -4 to +4, the Brookings study rated the City of Boston -4 in terms of city decline. On the urban distress scale from -5 to +5, Boston ranked -5. The entire Boston SMSA hardly did better, ranking -4 on the regional decline index and -5 in terms of region-wide disparity. This put Boston at the very bottom of urban America, in the company of Jersey City, New Jersey; Hartford, Connecticut; Paterson, New Jersey; and Dayton, Ohio. Indeed, Boston ranked *below* Detroit, Gary, Newark, Miami, and Oakland. Across 25 individual indicators of urban life, Boston and its SMSA were in the most disadvantaged third of all metropolitan areas on 22 of them. What was true of Boston was even more true for the other metro areas across the Commonwealth.

Figure I.1: Employment Growth Data Show a Deeper Massachusetts Recession



Source: Bureau of Labor Statistics, Payroll Employment

In the late 1980s and throughout the 1990s, of course, all of this turned around. Led by Greater Boston's renaissance, the Commonwealth had an enviable economic development record in many parts of the state. With the boom in financial services and in sophisticated high technology industries and with the expansion of the university and health services sectors, thousands of new businesses were created in the Commonwealth and thousands more expanded their operations. Statewide employment increased by nearly 400,000 jobs between January 1995 and May 2001, from 2,950,000 to 3,345,000.[2] Even as the U.S. slipped toward recession beginning in mid-2000, the rate at which jobs were being created in the Commonwealth exceeded the national rate. The Massachusetts miracle seemed real enough.

THE EMPLOYMENT TREND

YET WHAT WE HAVE LEARNED in the past five years is that no region can rest long on its laurels. Once the 2000-2001 national recession came to the Commonwealth, employment began to plunge. Within a year, jobs in Massachusetts disappeared at a rate that exceeded the national average. As **Figure I.1** demonstrates, employment growth has lagged behind the U.S. ever since.

The national economic recovery that began in 2002 led to the creation of a sufficient number of jobs so that by August 2005, total national employment exceeded its pre-recession peak. In Massachusetts, however, total employment was still 163,000 shy of its May 2001 record (see **Figures I.2** and **I.3**, next page). Between October 2004 and October 2005, nearly 2 million jobs were added to the U.S. total. During the same period, Massachusetts lost nearly 10,000. The state's low unemployment rate (4.8% in October 2005) masks the fact that over the past 2½ years, more than 105,000 workers have left the Greater Boston labor market alone, keeping the official unemployment rate from rising higher.[3]

In percentage terms, over the last decade (1994-2004), the number of jobs in Massachusetts has increased by an aver-

age of just 0.92 percent per year. That represents only two-thirds the U.S. rate (1.41%) and pales in comparison with such competitor states as California and New Hampshire where employment grew at twice our rate (1.80% and 1.83%, respectively), Washington State (1.59%), North Carolina (1.32%), and New Jersey (1.20%). We can take little comfort from the fact that in the employment game over the last decade, we beat out Pennsylvania, New York, Connecticut, and Michigan. (See **Table I.1**).

What adds a particular note of urgency to the Commonwealth's employment woes is the fact that jobs have gone missing even in the state's premier industries. According to a new report by the Massachusetts Technology Collaborative, seven of the state's nine "innovation clusters" lost jobs in 2004. Among the losses were declines of 1.8 percent in defense manufacturing and instrumentation, 3.9 percent in software and communications services, and 5 percent in computer and networking hardware.[4]

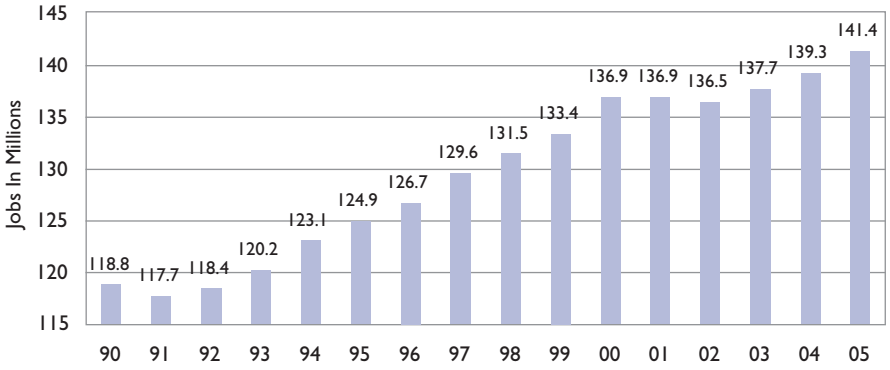
Massachusetts is losing young workers.

THE DEMOGRAPHIC TREND

ADDED TO THIS weak jobs picture is a longer term challenge—the increasing loss of young workers from Massachusetts. This loss in population continues a trend that began as early as 2000. Part of the decline is due to a low birth rate in the state. Massachusetts has a larger share of elderly and baby boomers than the nation as a whole but a smaller share of "echo boomers." A more important factor is net out-migration. According to the U.S. Census, excluding *foreign* net immigration of roughly 31,000 a year, the number of *domestic* net out-migrants increased from 14,000 in 2000-2001 to nearly 59,000 in 2003-2004. Foreign *im*migration more than offset the domestic *em*igration until 2002-2003. The large domestic out-migration in 2004 swamped the level of foreign in-migration leading to the overall loss in population. (See **Figure I.4**, next page)

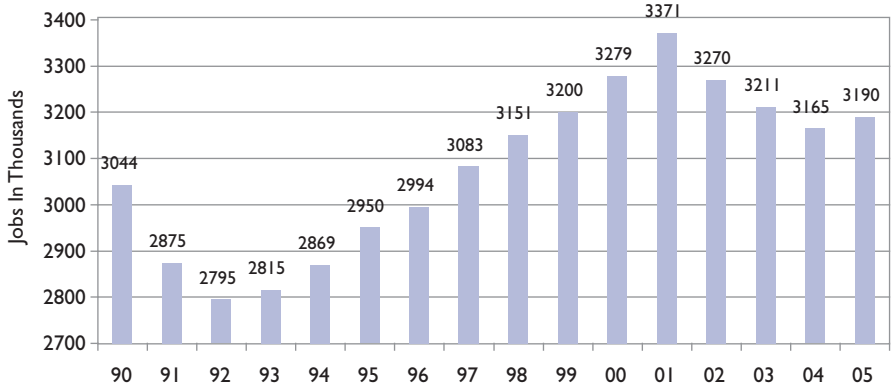
If the net loss was due to seniors moving to warmer climes, that might not portend a serious problem for the Commonwealth. But population data from the American Community Survey (ACS) for the Greater Boston Metropolitan Area suggest that a large proportion of these out-migrants are young people.[5] Between 2001 and 2004, the number of 20-24 year olds in the region increased by 5.7 percent, but this was much slower than the 9.7 percent increase nationally. More

Figure I.2: United States Jobs Recovery



Source: Bureau of Labor Statistics

Figure I.3: Massachusetts Lags Behind



Source: Bureau of Labor Statistics

Table I.1: Percent Employment Growth 1994-2004

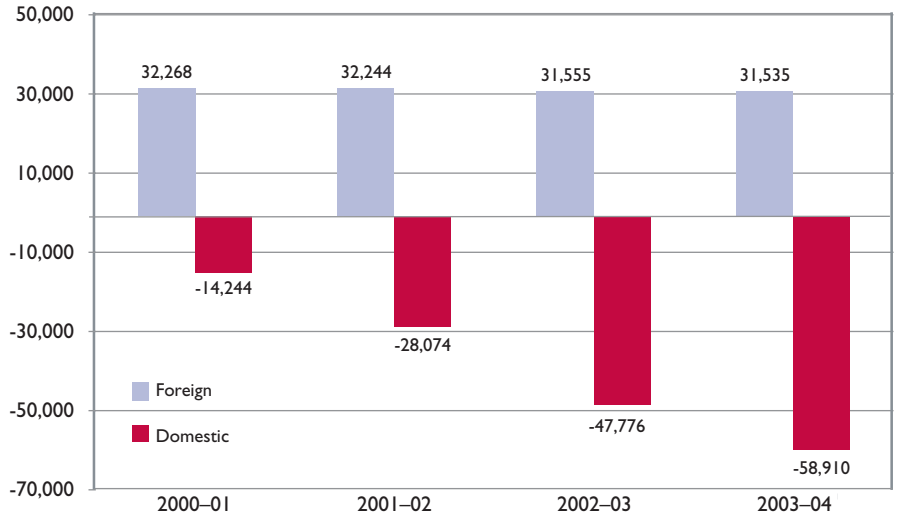
State	Percentage
US	1.41
Arizona	3.45
Florida	2.61
New Hampshire	1.83
California	1.80
Washington	1.59
North Carolina	1.32
New Jersey	1.20
Rhode Island	1.18
Massachusetts	**0.92**
Pennsylvania	0.83
New York	0.76
Connecticut	0.68
Michigan	0.58

Source: Bureau of Labor Statistics

worrying is that by the time young people are considering families—when they reach age 25-34—there was actually a 4.8 percent decline in population. Nationwide, this cohort grew by 0.5 percent. (See **Figure I.5**)

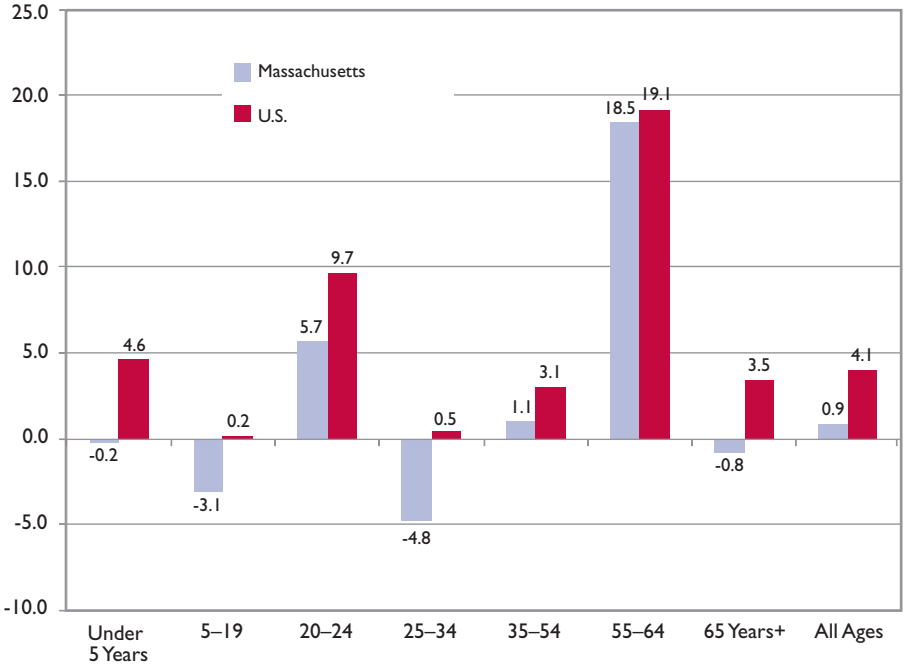
Where did Massachusetts residents go when they left the state? **Table I.2** reveals that between 1990 and 2002, the Commonwealth suffered a net migration loss of 213,000.[6] Nearly 100,000 more went to Florida than came from Florida to Massachusetts, and there was a net loss of 78,000 to New Hampshire, 24,000 to California, 11,000 to Arizona, and 8,000 to North Carolina. These losses could not be made up by the net gains we experienced from such states as New York, Connecticut, and New Jersey. (See **Figure I.6,** next page)

Figure I.4: Massachusetts Net Migration



Source: U.S. Census

Figure I.5: Massachusetts is Losing Young People (2001-2004)



Source: U.S. Census

Table I.2: Where are People Going?

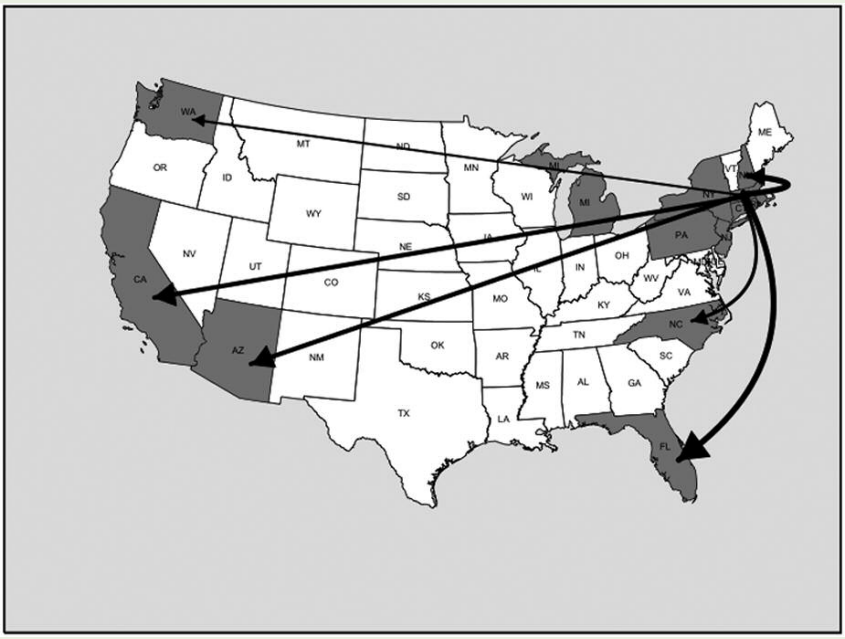
State	Net Migration from/ to Massachusetts (1990-2002)
Massachusetts	**-213, 000**
Florida	-99, 082
New Hampshire	-78,201
California	-23,978
Arizona	-11,033
North Carolina	-8,983
Washington	-4,516
Michigan	809
Pennsylvania	2,433
Rhode Island	2,895
New Jersey	9,672
Connecticut	14,997
New York	28,670

Source: U.S. Census

THE HIGH COST OF LIVING IN THE COMMONWEALTH

WHILE THE LACK OF NEW JOBS is one reason for the exodus of young people from the state, the other factor is the high cost of living in Greater Boston and much of the rest of the Commonwealth. Newly released data from the Economic Policy Institute in Washington, D.C. shows that Greater Boston is now the single most expensive place to live among all the metro regions in the nation.[7] At $64,656 for a family of four, the basic family budget in Greater Boston is more than $3,000 higher than in Washington, D.C., $6,000 higher than New York City, and $7,000 higher than in San Francisco. (See **Figure I.7**, next page). Monthly housing costs are 40 percent higher in Boston than in Austin, Chicago, and Miami and a whopping 63 percent higher than in Raleigh-Durham-Chapel Hill, North Carolina. Moreover, housing costs are only one item in the family's budget that puts us at the top of the cost of living chart. As **Table I.3** (next page) demonstrates, a comparison of Greater Boston's living costs with that of Raleigh-Durham-Chapel Hill puts Boston at a disadvantage when it comes to the cost of housing, child care, health care, and taxes (federal, state, and local combined).

Figure I.6: Net Migration• Between Massachusetts and Competitor States, 1990–2002



State	Net Migration from State
Florida	-99,082
New Hampshire	-78,201
California	-23,978
Arizona	-11,033
North Carolina	-8,983
Washington	-4,516

•Thicker line represents more migration

Source: U.S. Census

It costs a family of four more than $20,000 a year more to live in Boston than in our high technology rival in North Carolina.

Indeed, when all the items in the basic family budget are combined, it costs a family of four more than $20,000 a year more to live in Boston than in our high technology rival in North Carolina.

What is more, Greater Boston is not alone when it comes to the high cost of living in the Commonwealth. Lowell, Brockton, Lawrence, Barnstable, Attleboro, Worcester, Fitchburg, Springfield, New Bedford, and Pittsfield all have family of four family budgets of $52,000 or more—within $5,000 of the equivalent family budget in San Francisco and at least $7,000 *higher* than Seattle and Raleigh-Durham-Chapel Hill. (See **Figure I.8**, page 14)

From a competitive perspective, this poses a daunting challenge. If a Boston-based firm picks up and moves to North Carolina, it can *cut wages* by 15 percent and yet still provide its employees with a 15 percent *higher real standard of living*. Very much the same thing holds for firms in other parts of the state. That means it makes economic sense for Massachusetts-based firms to move to Raleigh and equally sensible for our young families to go there too. Not surprisingly, we are losing both jobs and people to such locations. That is the nature of the economic development challenge we face in the Commonwealth and why we are in trouble.

PERSONAL INCOME GROWTH IN THE COMMONWEALTH

DESPITE THE ECONOMIC and demographic challenge, there is one very good piece of news. Because of the high productivity of the Massachusetts economy, personal income growth in the Commonwealth is still significantly above the national average and above virtually all of our competitor states. As **Table I.4** (next page) demonstrates, over the last decade (1994-2004), average per capita personal income grew by 4.74 percent per year (in nominal terms). This compares with 4.04 percent for the nation as a whole. We are doing better than New Hampshire, Washington State, Connecticut, and Rhode Island; significantly better than California, New Jersey, Pennsylvania, and New York; and much better than Arizona, Florida, and North Carolina.

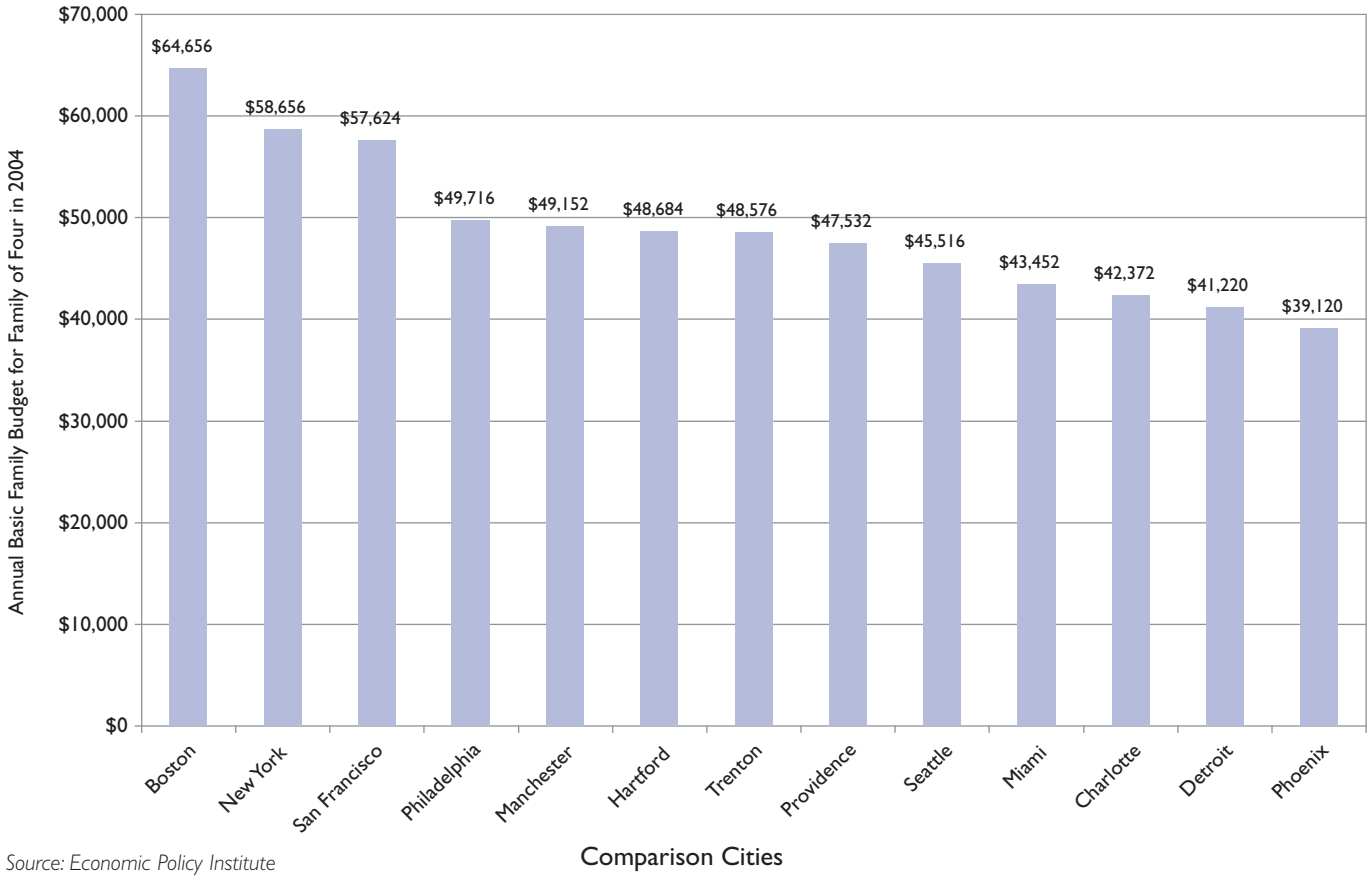
This means if the Commonwealth wants to invest in keeping jobs and people in the state, it has the resources to do so. We are not a poor state … yet. With high and growing personal income, we can choose to raise additional public funds for well-targeted economic development activity. Some of those funds need to go to programs such as the new Chapter 40R and 40S aimed at reducing the cost of housing. Some of those funds need to go toward dealing with health care costs and insuring the uninsured. Reducing some of the high regulatory costs on developers and businesses could help as well.

Table I.3: Basic Budget: two parents, two children

	Boston	Raleigh-Durham-Chapel Hill
Monthly Housing	$ 1,266	$ 779
Monthly Food	$ 587	$ 587
Monthly Child Care	$ 1,298	$ 866
Monthly Transportation	$ 321	$ 358
Monthly Health Care	$ 592	$ 368
Monthly Other Necessity	$ 500	$ 369
Monthly Taxes	$ 824	$ 350
Monthly Total	$ 5,388	$ 3,677
Annual Total	**$ 64,656**	**$ 44,124**

Source: Economic Policy Institute

Figure I.7: Greater Boston is Costliest Region in U.S.



Source: Economic Policy Institute

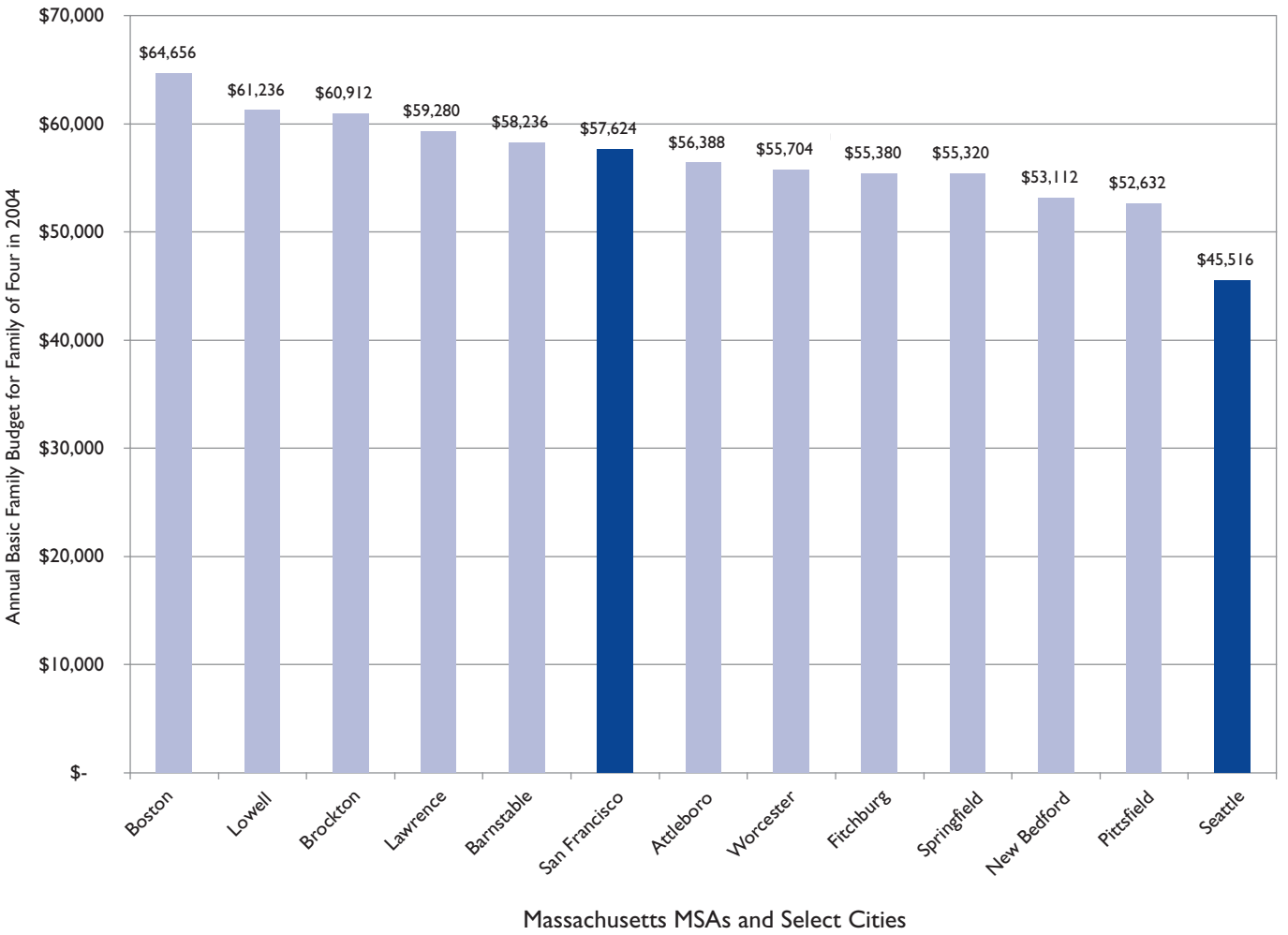
But as the next section of this report will show, much of the economic development effort must be carried out at the local municipal level. Providing communities with all the local amenities that workers want for their families so that they are willing to pay the higher cost of living in the Commonwealth is critical to the state's future development and prosperity. Equally important is making sure that local municipalities have the resources to provide the economic and social environment attractive to industry.

Table I.4: Average Annual Percent Change in Per Capita Personal Income 1994-2004

State	Percentage
US	4.04
Massachusetts	**4.74**
New Hampshire	4.61
Washington	4.40
Connecticut	4.34
Rhode Island	4.32
California	4.20
New Jersey	4.14
Pennsylvania	4.05
New York	4.02
Arizona	4.00
Florida	3.80
North Carolina	3.67
Michigan	3.48

Source: Bureau of Economic Analysis

Figure I.8: Cost of Living Is High Throughout Massachusetts



Source: Economic Policy Institute

II. The Central Role of Cities and Towns in Economic Prosperity

In the new global economy, nations, states, and local communities are in continual competition for investment and jobs. Ongoing research undertaken by our Center (CURP) in cooperation with the National Association of Industrial and Office Properties (NAIOP) and CoreNET Global, the association of U.S. corporate real estate officers, is providing a new and clearer understanding of the nature of business location decisions in highly competitive regional and national markets. In the course of this work, we have held a large number of focus group activities with industrial and commercial developers in the Greater Boston area and then surveyed 230 developers and business siting specialists from across the United States. The results provide detailed information on the "deal breakers" that inhibit investment and the "deal makers" that encourage it.

Local municipal factors play a major role in plant and office location.

TOWARD A NEW UNDERSTANDING OF THE ECONOMIC DEVELOPMENT "GAME"

What is most extraordinary about the survey results is the finding that local municipal factors play such a major role in plant and office location, in many ways trumping the effect of statewide tax and subsidy policies. Essentially, the location decision for companies often turns out to be less a choice between, say, Massachusetts, North Carolina, and Texas and much more a choice between, say, Worcester, Raleigh-Durham-Chapel Hill, and Austin.

From the focus groups with Massachusetts developers, we were able to discern 40 separate factors that can go into the decision of a firm to expand its operations in a given location, move its operations from one location to another, or start up a new operation at an existing or new site. An evaluation of the survey's 230 national responses confirmed a strong consistent pattern. **Table II.1** (next page) provides a cardinal ranking of the 40 factors. The lower the mean number, the more important the factor; the higher the number the less important.

Factors that we thought might be quite important such as a state or local minimum wage law and the existence of strong trade unions turned out to be rather *unimportant* in the business siting decision. The same was true—with the exception of decisions for high technology firms—for proximity to research institutions and universities.

On the other hand, two factors turned out to be almost *sine qua nons.* Essentially, if a location did not have ample onsite parking for employees (or customers), the site is deemed virtually unacceptable. The other key factor, not surprisingly, was the leasing or rental rate. Firms are sensitive to the costs of renting space and often the choice of one location over another turns on favorable office, plant, or warehouse leasing terms.

But the set of factors almost as important as these two—in order of importance—include the availability of an appropriate labor pool *in the region,* the timeliness of approvals and appeals in the *local municipality,* the quality and capacity of the *local municipal* infrastructure, *local access* to roads and airports, and the level of *local traffic congestion.* The predictability and clarity of the local (and state) permitting process is almost as important as state tax and financial incentives. And just behind these factors were two more: the *local property tax* rate and the *crime rate in the area.*

Interestingly, state tax rates came in 18th place, below all those mentioned above. The physical attractiveness of the local area was nearly as important as state tax rates.

When we provided an opportunity for our survey respondents to list on their own the factors they consider "most critical" rather than simply check off each of the 40 factors on a scale from "very important" to "unimportant", the importance of local conditions was, if anything, even more pronounced. Among the top seven were amenities and services nearby, a pro-business/pro-development municipal attitude, and the local area quality of life.

WHAT MUNICIPAL GOVERNMENTS CAN DO

Some of the factors that are important in the siting decisions of business leaders cannot easily be "fixed" by local officials. Providing nearby interstate access and a major international airport is normally beyond the power of a mayor, city council, town manager, or selectman. There is often little they can do, at least in the short run, to assure reasonable rents and leasing arrangements or provide an appropriate labor pool.

Given sufficient local revenue and leadership, municipal officials can create a set of "deal makers" that will encourage businesses to consider locating in their city or town.

But given sufficient local revenue and good local leadership, municipal officials can do a great deal about a number of "deal breakers" that discourage investment in their communities and they can create a set of "deal makers" that will encourage businesses to consider locating in their city or town. Having the revenue to devote to a strong business development plan with increased attention to a timely approvals and appeals process is a key ingredient in attracting business. Providing adequate on-site parking in downtown locations in public parking structures can aid in bringing business back to older industrial areas. Investing in local roads to limit traffic congestion and providing

needed water and sewer facilities is critical, especially for larger facilities. Adding police to restrict crime in the community can limit the impact of a potentially important deal breaker. Adding cultural amenities, improving the quality of parks and recreational areas, and assuring good local schools can be critical for attracting not only business but young families. Aiding local communities to provide zoning for affordable housing can reduce the cost of business by limiting upward pressure on wage rates and the need to pay local bonuses to attract labor.

All of these are increasingly important if municipalities are to play their critical role in the economic development of the Commonwealth. Unfortunately, if cities and towns have inadequate revenue to carry out these efforts, economic development for the state suffers.

Table II.1: Business Location Decision Survey Results – Mean Scores (1 = Very Important – 4 = Unimportant)

Factor	Mean	Factor	Mean
Onsite parking for employees	1.48	Municipal rep. for economic dev.	2.04
Rental rates	1.52	Zoning by right	2.08
Availability of appropriate labor	1.63	Municipal rep. as good place to live	2.10
Timeliness of approval/appeals	1.67	Proximity to restaurants/shops	2.11
Quality/capacity of infrastructure	1.78	Public transportation	2.16
Access to airports/major highways*	1.79	Complementary business svcs**	2.16
Traffic congestion	1.79	Cost of housing for employees 2	17
State tax/financial incentives**	1.83	Access to airports**	2.21
Land costs	1.84	Critical mass of similar firms	2.22
Competitive labor costs	1.85	Awareness of brownfields	2.24
Access to major highways**	1.85	Quality of local schools	2.26
Predictability/clarity of permitting	1.85	Awareness of strong neighborhood orgs	2.35
Property taxes	1.87	Permitting ombudsman	2.38
Crime rate in the area	1.87	Customized workforce training**	2.49
Local tax/financial incentives	1.90	Proximity to research/universities	2.63
Undesirable abutting land use	1.91	Availability of sports/cultural/recreational opps	2.65
Fast track/concurrent permitting	1.93	Strong trade unions	2.76
State tax rates**	1.96	Informative municipal website	2.82
Physical attractiveness of area	1.99	Access to railroads**	2.84
Municipal rep. as good place to work	2.03	Municipal minimum wage law	3.05

** Question asked in NAIOP survey only.* *** Question asked in CoreNet survey only.*

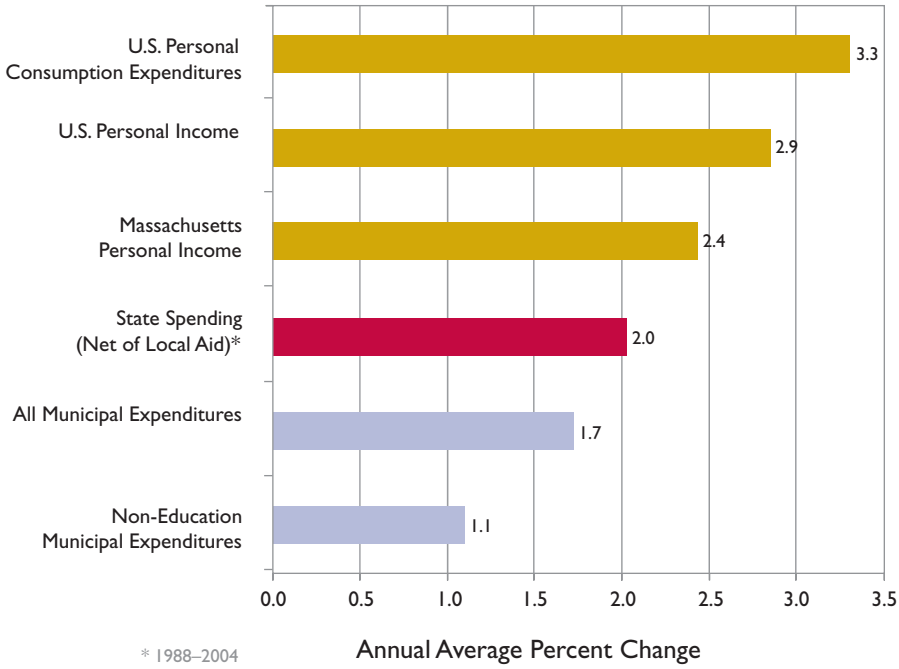
IN LIGHT OF the critical role local municipalities play in economic development, we need to ask whether the cities and towns in Massachusetts have the revenue to play in the development game. How has the growth in local spending on key public services grown over the past two decades?

Local spending on key public services by the 351 municipalities of the Commonwealth has not kept up with income.

Like most goods and services that households consume, most public goods and services are what economists would call "normal". This means that their consumption rises with income, although not necessarily at the same rate as income. In recent decades, private personal consumption expenditures nationwide have been rising somewhat faster than personal income as families use various forms of debt to support their spending. From 1980 through 2004, real U.S. personal consumption expenditures rose at an average annual rate of 3.4 percent versus an annual average growth in personal income of 3.0 percent.[8] Consequently, consumer spending as a percent of income rose during this time, from 76 percent to 84 percent.

What should one expect for the consumption or demand for locally-provided public goods and services like education, public safety, public works, culture and recreation? If the relationship between income and demand for these public goods and services is like that for private goods and services, then we would expect public spending on such services to rise at about the same rate as private consumption spending. This would mean, of course, that in recent decades public spending should be rising somewhat faster than income.

Figure III.1: Real Growth in Local Spending Trails Economy and State Government, 1987–2004



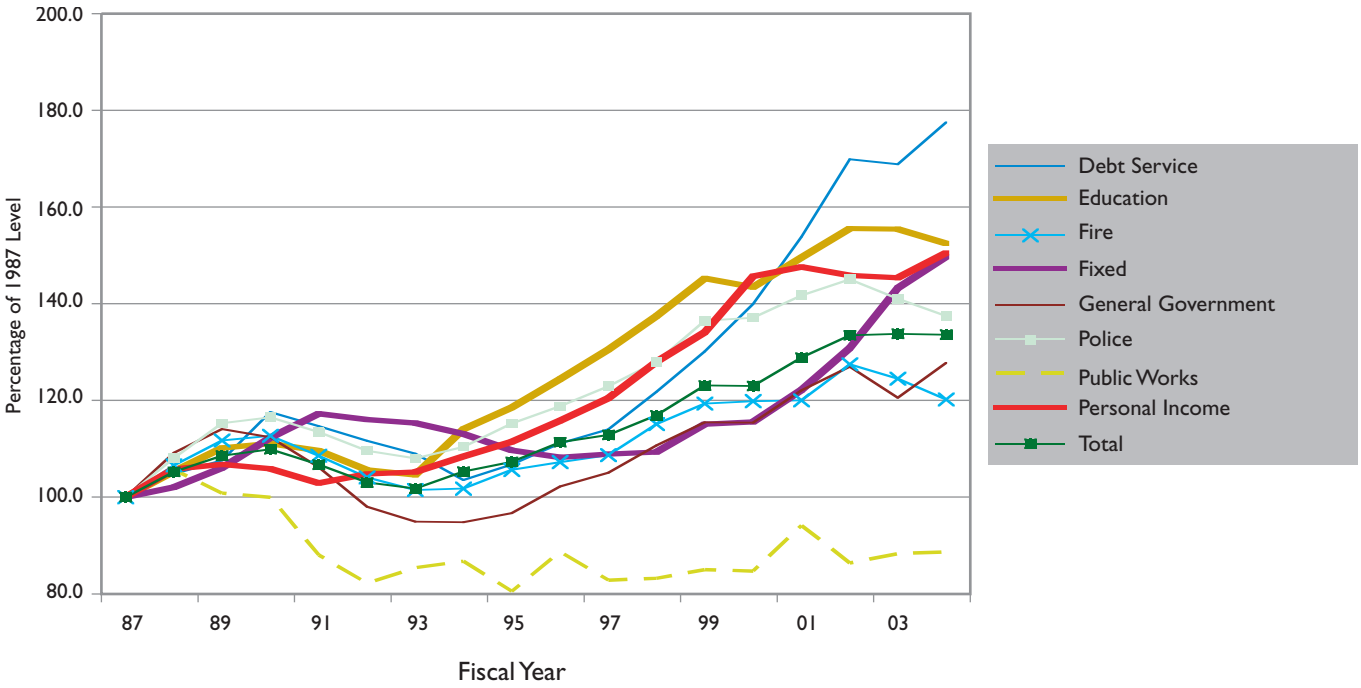
MUNICIPAL SPENDING GROWTH IN THE COMMONWEALTH VERSUS PERSONAL INCOME GROWTH

DESPITE THIS EXPECTATION, local spending on key public services by the 351 municipalities of the Commonwealth has not kept up with income, let alone private consumption. Over the 1987-2004 period for which municipal general fund expenditures are available for Massachusetts, total real expenditures rose at an annual average rate of 1.7 percent, versus a 2.4 percent annual growth rate for real Massachusetts personal income.[9] (See **Figure III.1**) Thus, over the last 17 years, the provision of locally-provided public goods and services rose at only about two-thirds of the rate of income growth statewide.

For purposes of comparison, it is important to note that municipal expenditures for local non-school services rose at an annual rate of just 1.1 percent, about half the 2 percent growth that occurred in the state government's spending during this time. There was a wide variation among the categories of spending as shown in **Figure III.2** (next page). The largest category of spending is education, which accounted for 47 percent of general funds expenditures in 2004. Over the 1987-2004 period, real municipal government spending on education rose at an annual rate of 2.5 percent, just slightly faster than personal income. With the adoption of the Education Reform Act and repeated calls for improvements in education, local and state school spending grew only fractionally faster than income—and slower than private consumption. (See **Figure III.3**, page 19)

Expenditures on fixed costs, which include workers' compensation, unemployment, health insurance, retirement, and other employee benefits for local public employees, form the second largest category of local expenditures, accounting for 13 percent of general fund expenditures in 2004. From 1987 through 2004, fixed

Figure III.2: Spending on Local Service Delivery Has Fallen Behind



Source: Division of Local Services, Mass. Department of Revenue; and the U.S. Bureau of Economic Analysis

costs rose at the same annual average rate as income, although the pattern of growth within this period has been and is quite different than that of income. Real fixed costs actually fell by 8 percent from 1991 to 1998, largely reflecting the containment of health care costs via managed care. In recent years, however, fixed costs have exploded, rising by 35 percent (in real terms) between 2000 and 2004, largely driven by increases in health care premiums.

The real municipal "budget buster," along with fixed costs, is debt service. It has risen substantially faster than income over this 17-year period, averaging 3.4 percent growth per year, a full point higher than personal income. Debt service has risen rapidly over the past several years, in large measure due to an increase in the construction of public buildings, especially new and expanded schools.

The next four most important categories of spending in terms of size—for police, public works, fire, and general government—all grew at slower rates than personal income, with annual average real growth rates of 1.9, -0.7, 1.1, and 1.5 percent, respectively. Public works spending, the bulk of which is reserved for roads, actually declined in real terms during this period. In addition to education, these four categories comprise what are considered the "core" public services offered to the public.

It is important to note that municipal expenditures for local non-school services rose at an annual rate of just 1.1 percent, about half the 2 percent growth that occurred in the state government's spending.

Even culture and recreation spending, which reflect amenities one would expect might rise in step with income, grew at only a 0.9 percent annual rate, well less than half the rate of personal income growth. This category fell nearly 18 percent in real terms in the last two years of the period (2003-2004), a victim of declining state aid and the severe budget crunch experienced by cities and towns as a result of the most recent recession and the growing cost of health insurance and debt service.

Unfortunately, the slow growth of municipal spending on public goods and services does not reflect a shift toward the provision of these services by the state government. Over the 1988-2004 period for which state spending data are available on a consistent basis, real state spending net of direct local aid grew at an annual average rate of 2.0 percent, compared to 2.2 percent for real income.[10] If one were to exclude certain state "budget busters", for example, Medicaid, the growth in real state spending would be even less.

Figure III.3: School Spending Has Just Kept Pace

Real Growth in Spending or Income, 1987–2004

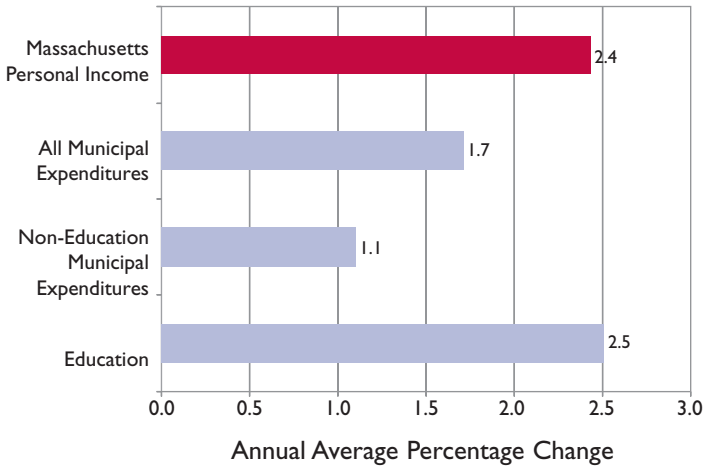


Figure III.4: Fixed Costs Grow at a High Rate

Real Growth in Spending or Income, 1987–2004

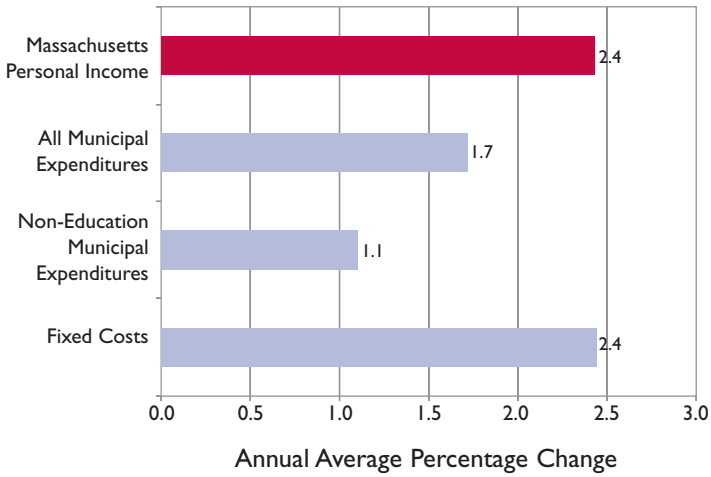


Figure III.5: Debt Service Exceeds All Categories

Real Growth in Spending or Income, 1987–2004

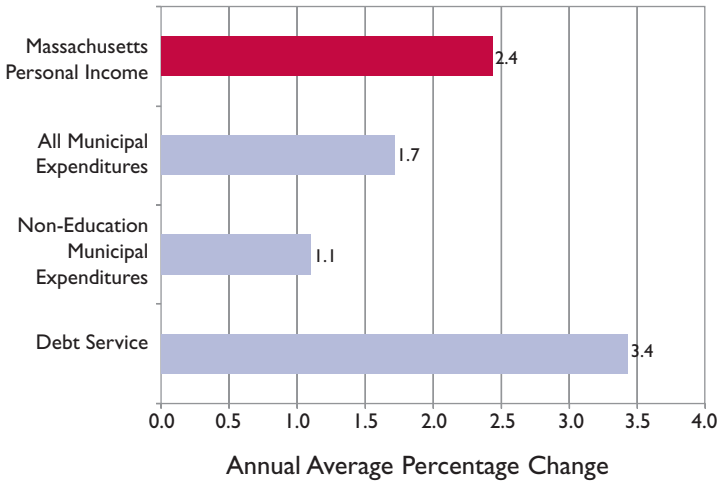


Figure III.6: Spending on Police Lags Income Growth

Real Growth in Spending or Income, 1987–2004

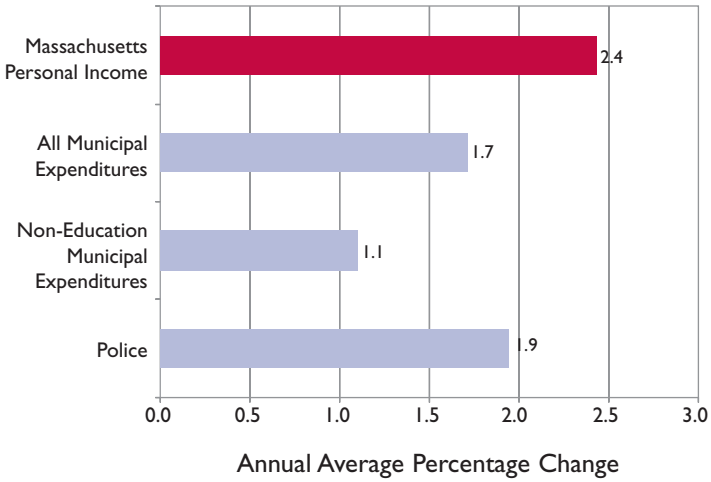


Figure III.7: Spending on Fire Protection Lags Income Growth

Real Growth in Spending or Income, 1987–2004

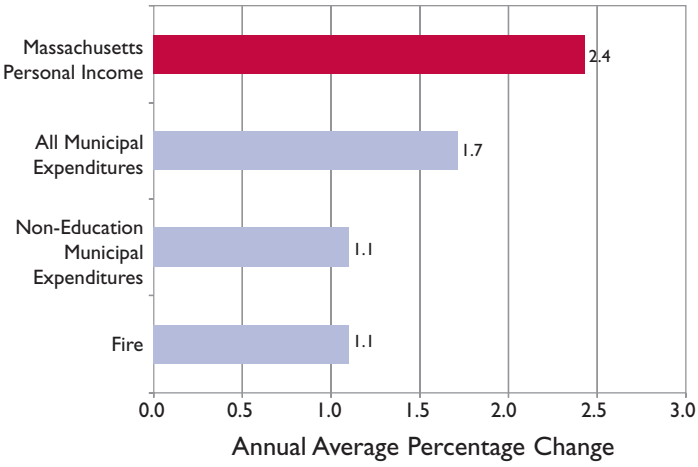


Figure III.8: General Government Functions Lag Income Growth

Real Growth in Spending or Income, 1987–2004

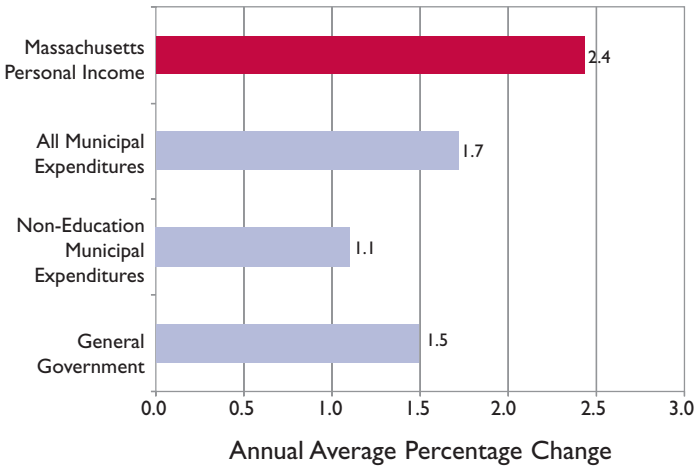


Figure III.9: Municipal Culture & Recreation Spending Lags

Real Growth in Spending or Income, 1987–2004

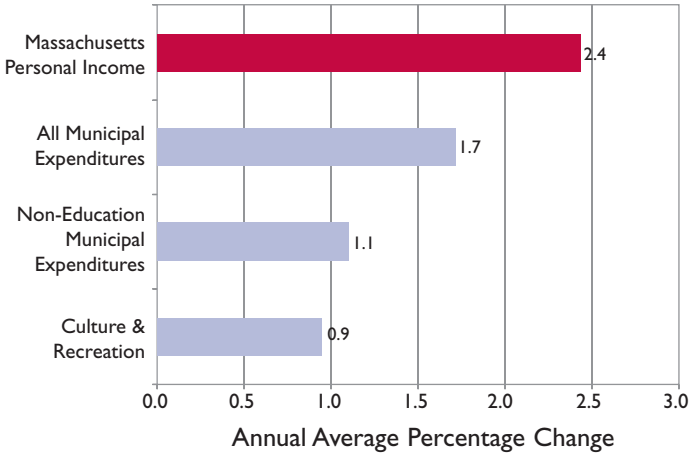
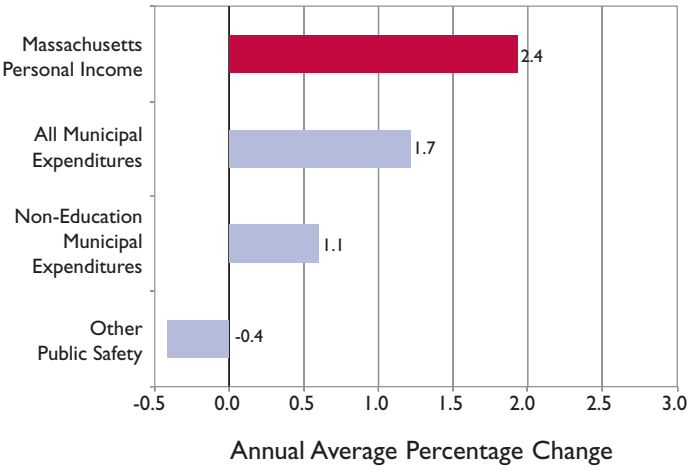


Figure III.10: Other Municipal Public Safety Spending Cut

Real Growth in Spending or Income, 1987–2004



MUNICIPAL SPENDING AND ECONOMIC DEVELOPMENT

THE FACT THAT MUNICIPAL SPENDING on key services has generally not kept up with the growth in personal income, let alone personal private consumption, suggests that municipalities are ill equipped in the battle to offset the negative employment and demographic trends in the Commonwealth.

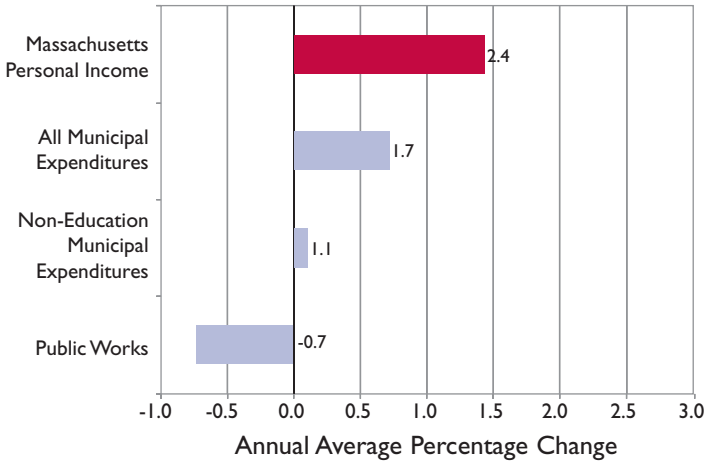
- More than likely, education spending remains inadequate to provide the kinds of K-12 public schools that young families would see as good enough to make them willing to pay higher housing and health care costs in the state so that their kids would have the advantage of a Massachusetts education.
- If the typical municipality could increase its spending on police protection to at least the growth in personal income, it is likely that crime rates could be reduced making more communities good places for people to live and good places for firms to invest.
- If more municipalities could increase their spending on general government functions and on public works, it is likely that towns and cities could reduce the time-consuming processes now in place regarding their planning functions, zoning appeals, and building code enforcement. This would reduce one of the great barriers that many potential investors and developers complain about when they consider firm location in many communities in Massachusetts.
- If cities and towns could spend more on cultural amenities and recreation, they might have an easier time attracting young workers and firms to settle in the Commonwealth.

Municipalities are ill equipped in the battle to offset the negative employment and demographic trends in the Commonwealth.

Without spending more in these critical areas, local municipalities simply cannot fulfill their constructive role to foster economic development in the Commonwealth.

Figure III.11: Local Public Works Spending Declines

Real Growth in Spending or Income, 1987–2004



THE REVENUE CONSTRAINTS ON LOCAL GOVERNMENTS

WHILE THE STATE'S MUNICIPALITIES may have wanted to play a greater role in supplying the public services needed to foster economic development, many faced severe financial constraints beginning in the early 1980's as a result of the implementation of Proposition 2½ and the prohibition of implementing other forms of revenue generation. They were then constrained in the 1990's by the need to pay ballooning fixed costs for public employee benefits and the need to service debt. Unable to increase revenue to keep pace with personal income, spending on key public services increased much slower than personal income. Between 1981 and 2004, real personal income rose at an annual average rate of 3.1 percent, while real municipal revenues, *including state aid,* rose at only a 1.2 percent annual rate.

This is not to say that local governments did not raise property taxes on residential property as much as they might have in an attempt to provide adequate municipal services. Between 1990 and 2004, median household income rose by 44.5 percent (in nominal terms). Over the same period, the median single family residential property tax levy increased by 92.2 percent—more than double the rise in household incomes. The higher tax levy reflects the meteoric increase in assessed housing values and a shift toward more residential taxes and away from commercial and industrial taxes as the latter's appreciation lagged behind the former. This is not news to Massachusetts homeowners. A recent analysis published by *The Boston Globe,* shows the single family median property tax levy has increased by 42 percent between Fiscal Year 2000 and FY 2006—clearly well beyond the rise in median family income.[11] In each of the last three years, the average increase in single family property taxes across the state has exceeded six percent.

IV. The State-Aid Rollercoaster

In large measure, municipalities have been forced to increase residential property levies in order to offset the loss in commercial and industrial property revenue and because of sharp cuts in local aid. State aid comprises the second largest component of municipal revenue, after property taxes, accounting for approximately one-quarter of total local revenue in recent years.

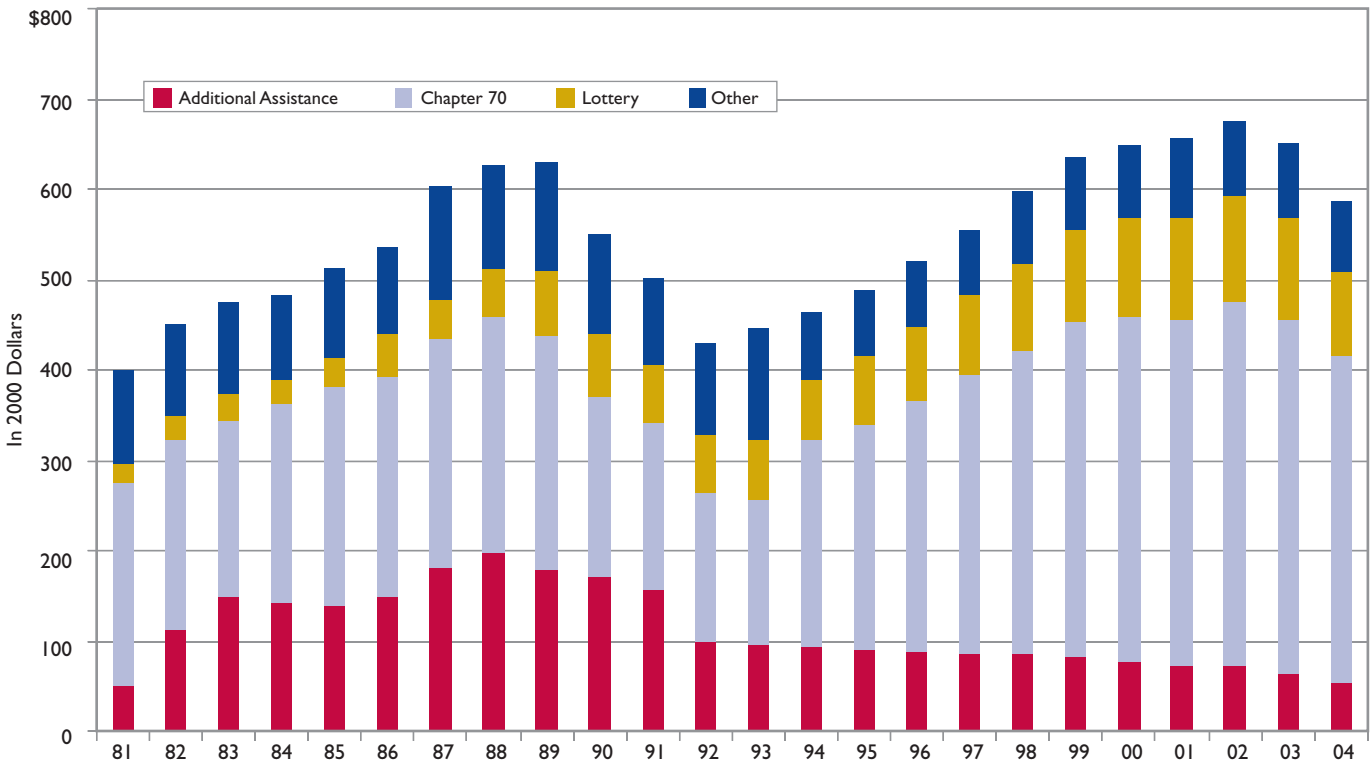
Over the past quarter century, from 1981 through 2005, two waves of state fiscal assistance have been initiated in response to local needs. The first was the establishment of the Additional Assistance program, a state aid allocation designed to help municipalities deal with the implementation of Proposition 2½ and the subsequent decline in property tax revenues that spread budgetary pain unevenly across the state's cities and towns. The second wave took the form of Chapter 70 Aid to schools under the Education Reform Act of 1993. While the introduction of both programs was a welcome relief to municipalities coping with the revenue restructuring of Proposition 2½ and the spending mandates of education reform, these local aid programs did not fully solve the fiscal problems of municipalities and ended up creating two new problems with regard to the predictability and reliability of state-aid revenue streams.

Municipalities have been forced to increase property taxes to offset the sharp cuts in local aid.

The first was that what the state gave in aid during good economic times, it took back during economic recessions. The second was that particular aid programs like Chapter 70 were funded in part by raiding other state-aid programs. Over the past 25 years, this has created a "state-aid recession rollercoaster". Like a rollercoaster, state aid exhibited marked cycles of ups and downs coinciding with the state's own revenue cycles. Also like a rollercoaster, which generally begins and ends at the same elevation, state aid today, in real terms, is roughly where it was in the early 1980's. This is especially true for non-education aid.

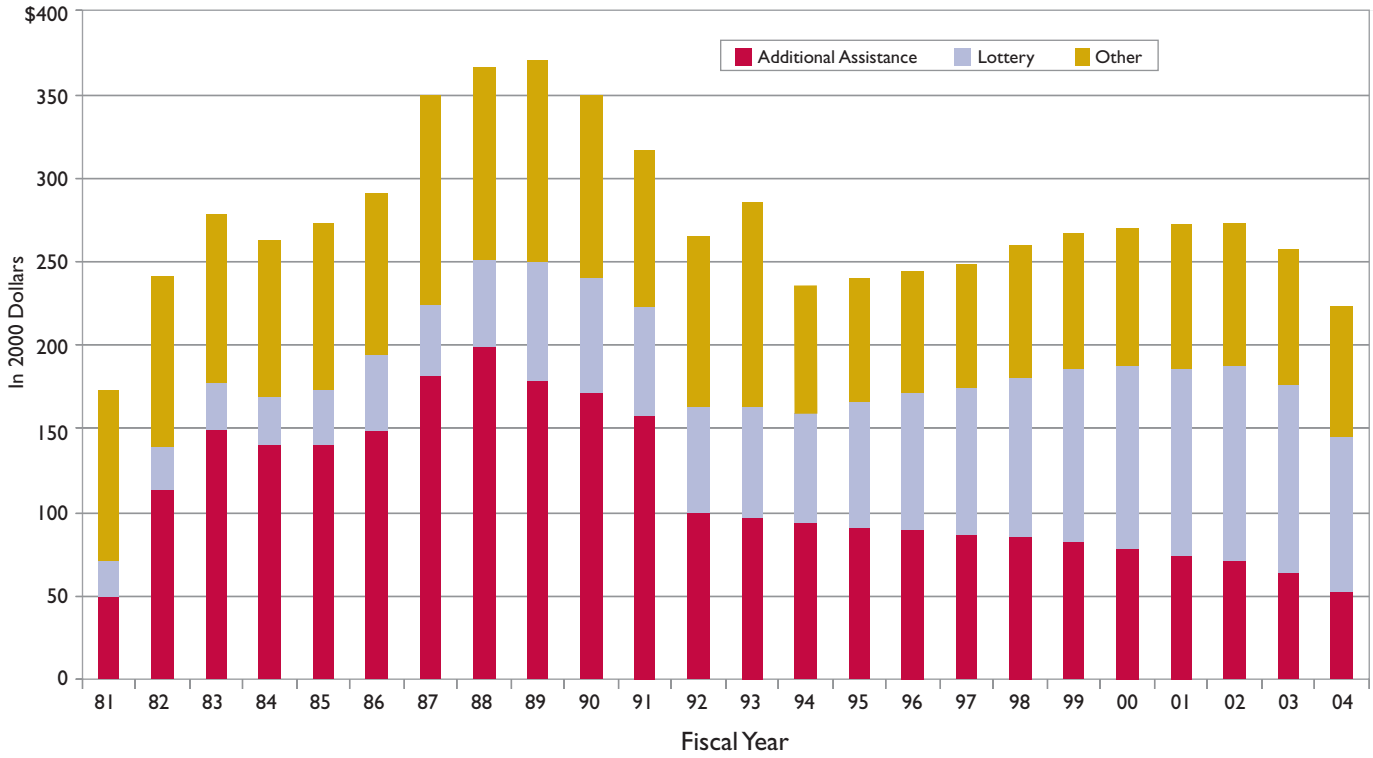
The most widely used source for counting how much aid a municipality receives is the so called "Cherry Sheet". In this report we make a distinction between the three largest aid programs: Additional Assistance, Chapter 70 education aid, and Lottery aid, plus other Cherry Sheet aid, which we simply label as "other aid". For simplicity, we do not account for municipal charges or assessments made by the state on local communities. These should be subtracted to arrive at the most accurate tally of state aid for each

Figure IV.1: Real State Aid Per Capita to Municipalities, by Type



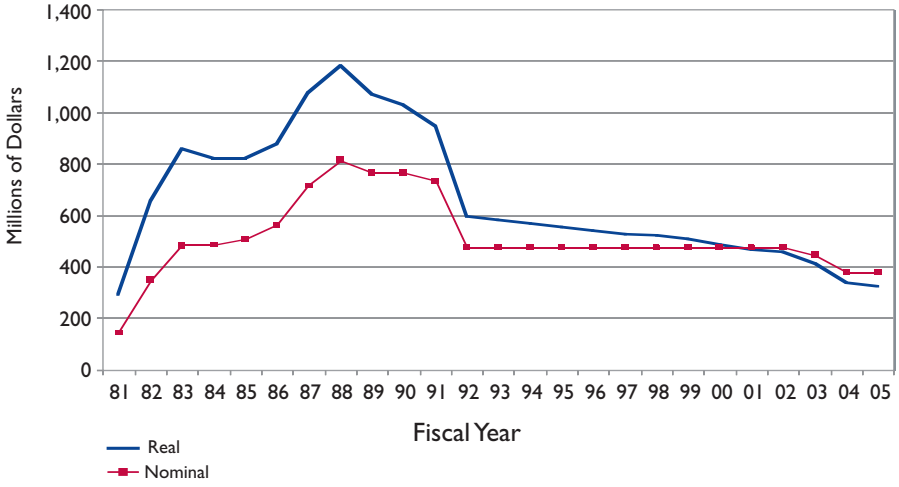
Source: Division of Local Services

Figure IV.2: Non-Chapter 70 Real State Aid Per Capita to Municipalities, by Type



Source: Division of Local Services

Figure IV.3: Additional Assistance Cut Deeply, in Real and Nominal 2000 Dollars



Source: Division of Local Services

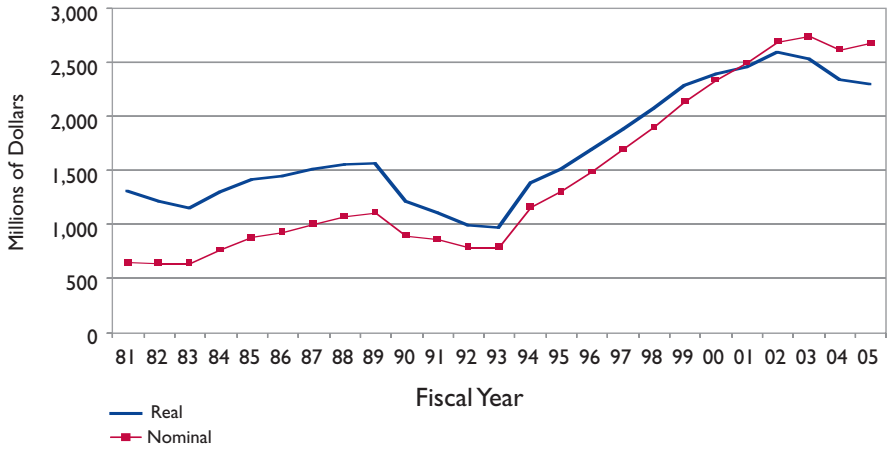
municipality, but their absence does not change the analysis either qualitatively or substantially.

Figure IV.1 graphically illustrates the "state-aid rollercoaster". Here, all aid components are added together for each fiscal year, adjusted for inflation, and expressed on a per capita basis, so the vertical height in any given year is the total state aid per Massachusetts resident, expressed in dollars that have the same real value as in fiscal year 2000. Adjusting for inflation is performed with the national price index for state and local government consumption expenditures. Expressing dollars on a per capita basis controls for the size of the population being served.

Most striking is the cyclical nature of overall state aid. It rose during the economic expansions of the 1980's and 1990's, and fell just after the recessions that began in 1989 and 2001. The decline in local aid since 2001 has been so steep that, in real terms, per capita state aid in 2004 was actually lower than in 1989, even though the economy had grown substantially during that 15 year period.

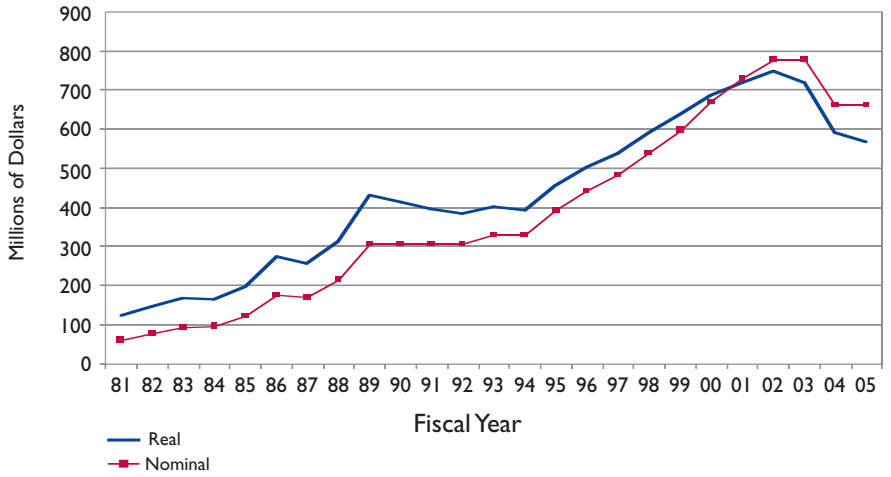
The composition of state aid has also changed over time. Additional Assistance grew rapidly during the first years of Proposition 2½ and then became the step child of state aid when it was cut and subsequently capped during the 1989 economic downturn. Chapter 70 aid to

Figure IV.4: Chapter 70 Aid to Municipalities, in Real and Nominal 2000 Dollars



Source: Division of Local Services

Figure IV.5: Lottery Aid Cut, Capped or Both in Recessions



Source: Division of Local Services

public K-12 education grew substantially during the 1980s until the post-1989 recession. With the 1993 Education Reform Act, Chapter 70 aid was expanded again, this time dramatically. Lottery aid has grown throughout the period as the sales of Lottery tickets increased, but in recent years even Lottery aid has not been immune to the budget cycle and the state aid rollercoaster.

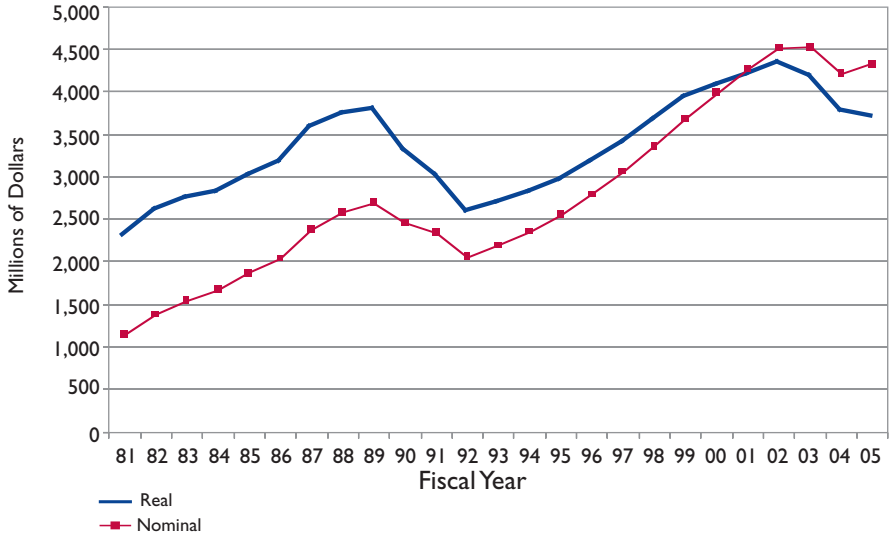
In recent years, state aid has been dominated by mandates imposed in the Education Reform Act. **Figure IV.2** reveals that expansion in education aid now seems to come at the expense of other state aid components, especially Additional Assistance. In real per-capita terms, non-Chapter 70 state aid as a whole has never really recovered from the 1989 recession. From 1994 to the present, non-education local aid has been no more than, and usually substantially less than, the level of aid in 1983.

Total state aid is back to its 1989 level, despite an increase in population and household income.

Real non-education state aid in 2005 was as low as the early 1980s, a quarter century ago.

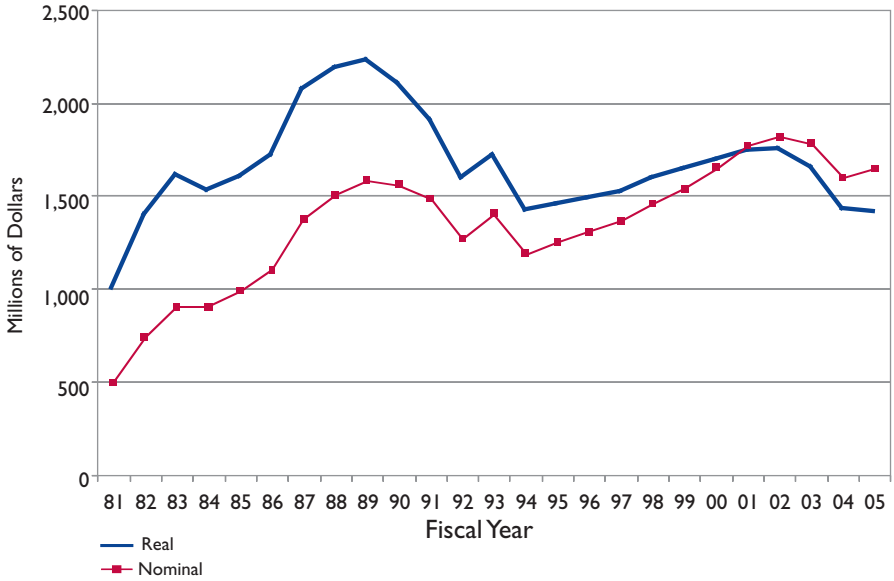
It is also instructive to look at the history of each of these aid programs in current and real dollars, unadjusted for changes in population. **Figure IV.3** shows the rapid growth in Additional Assistance in the early years of the program, the subsequent cuts in the program beginning during the 1989 downturn, level funding during the 1990s, and finally the steep cuts following the last recession, in fiscal years 2003 and 2004. After the original cuts were made in the program, the formula was "frozen" so that ever since 1992 the distribution of aid has been unchanged, even though the cost structure and revenue generating capacity of cities and towns has changed. Today, nominal Additional Assistance Aid is lower than in 1983, and real aid is almost as low as in 1981.

Figure IV.6: Total State Aid to Municipalities is Below 1989, in Real 2000 Dollars



Source: Division of Local Services

Figure IV.7: Non-School State Aid Trails Early 1980s Level, in Real 2000 Dollars



Source: Division of Local Services

As **Figure IV.4** demonstrates, when the 2000 recession hit, not even education aid was recession proof, despite the 1993 Education Reform Act. In real dollar terms, it has been cut for three successive fiscal years, 2003-2005.

In face of the state aid roller-coaster, local communities have had to rely increasingly on the property tax to buffer the vicissitudes of the Commonwealth's local assistance.

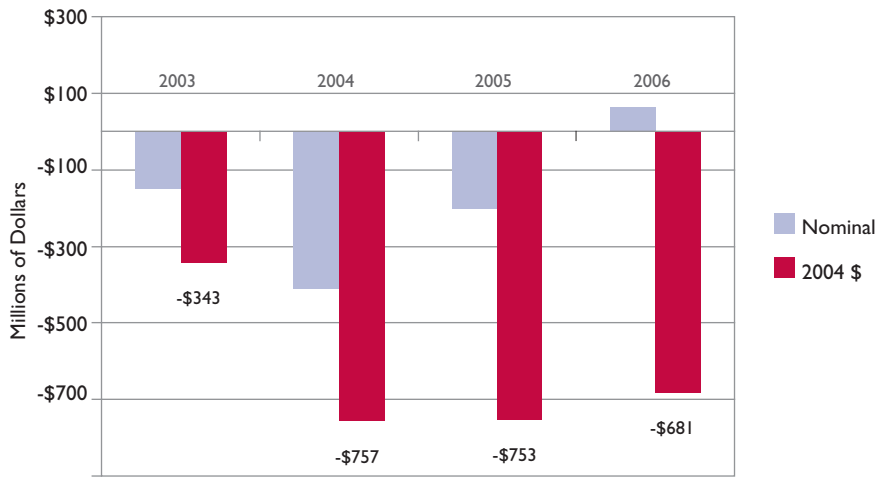
Lottery Aid to local communities began after the State Lottery was created in the early 1970's. The expressed purpose of the State Lottery was to provide financial support for municipalities, with aid distributed by a formula based inversely on property values and proportional to population. This program has generally been seen as a success, with aid rising along with growth in ticket sales. Nevertheless, as **Figure IV.5** shows, once again, when faced with a state budget crisis, a portion of this revenue stream was diverted away from municipalities back toward the state. Aid distributions were capped between fiscal years 1989-1992, and again between fiscal years 2002 and 2003, and were then reduced in fiscal year 2003.

When adding up all state aid, as shown in **Figure IV.6**, one might get the initial impression that the state is adequately supporting municipal budgets. In current dollars, even though state aid fell in fiscal year 2004, it is back on track to set a new peak in fiscal year 2006. However, if one takes into account the real value of state aid, it is apparent that it has never fully recovered from the recession beginning in 1990. Controlling for inflation, total state aid is back to its 1989 level, despite an increase in population and household income. Furthermore, if one focuses on aid directed at non-education municipal services, the picture is even bleaker. Real aggregate non-education state aid in 2005 was as low as the early 1980's, a quarter century ago. (See **Figure IV.7**)

Local aid levels are approximately $700 million below fiscal 2002 levels.

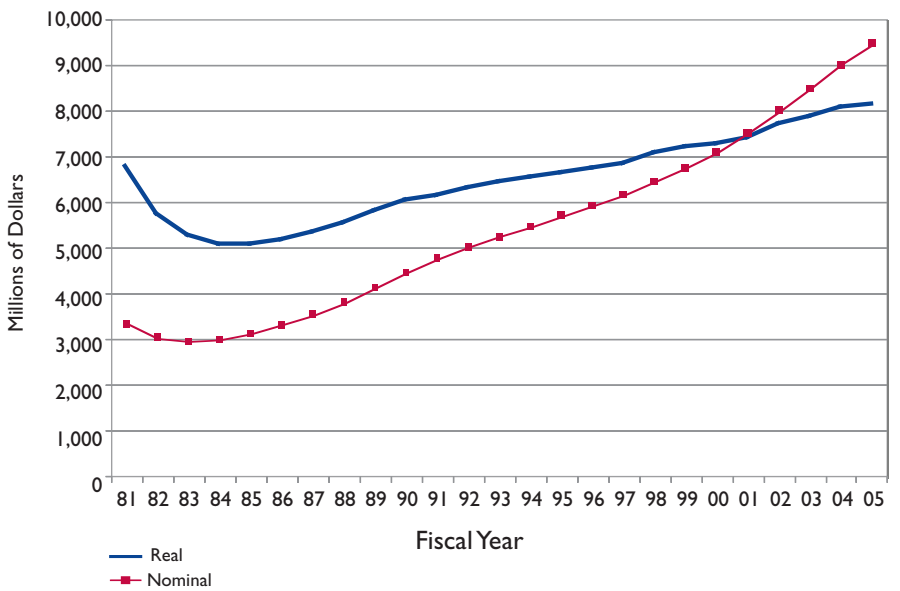
If we look at the impact of the most recent round of local aid reductions, we see that current, inflation-adjusted, local aid levels are approximately $700 million below fiscal 2002 levels as reported by the Massachusetts Taxpayers Foundation. (See **Figure IV.8**). In face of the state aid rollercoaster, local communities have had to rely increasingly on the municipal property tax and other local own-source revenue to buffer the vicissitudes of the Commonwealth's local assistance. As **Figure IV.9** illustrates, real property taxes are higher than even before the implementation of Proposition 2½—and nominal property taxes have grown three fold. Only by continuing to increase the residential property tax have cities and towns been able to limit the fluctuations in total municipal revenue and spending.

Figure IV.8: Total Reduction in Local Aid vs. Fiscal 2002 Level



Source: Massachusetts Taxpayers Foundation

Figure IV.9: Property Tax Levy is Higher Than Before Proposition 2½



Source: Division of Local Services

V. Where Does Massachusetts Stand in the Provision of Local Municipal Services

SPENDING ON LOCAL MUNICIPAL SERVICES has not kept up with the growth in personal income in Massachusetts. Yet, from this alone, one cannot conclude that too few services are being provided. We need to explore other indicators.

There is no direct way to tell whether the absolute level of services is appropriate in a state. But given the competition between states for investment and jobs, we can at least test whether Massachusetts is holding its own in terms of the public services it is offering. Here we do this by comparing the number of state and local government workers per capita in each state as a proxy for the amount of public sector goods and services being offered. Presumably the technology of public goods and service delivery is similar across states so the level of such goods and services varies more or less directly with the number of workers providing them. Because state versus local responsibility for providing the same good varies so much among states, a fair interstate comparison requires that we count state and local employment together.

Massachusetts—despite its reputation—has one of the smallest state and local public sectors of any state in the nation.

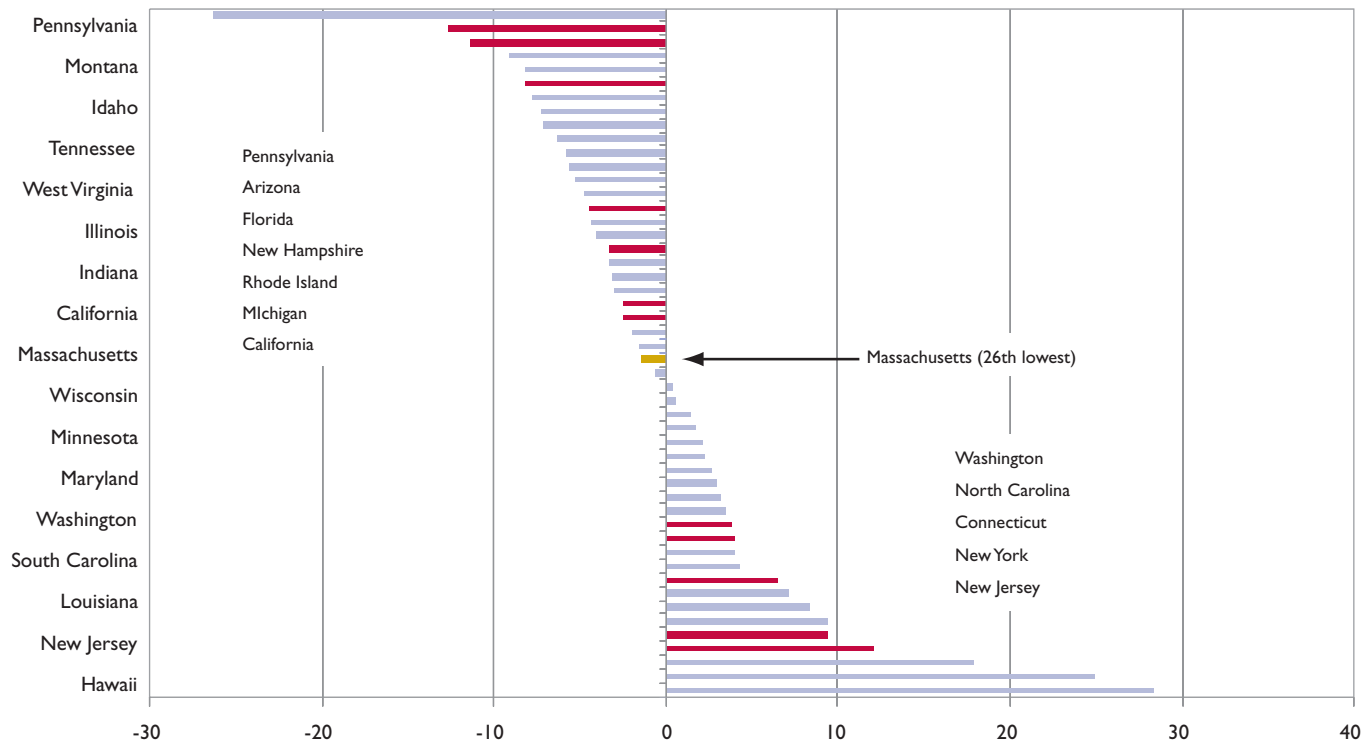
Using this measure of public sector employment as an index of the relative amount of public services offered, how should we expect Massachusetts to compare with other states? If the Commonwealth were just an average state, with an average level of public goods and services, it should rank about in the middle on the employment measure. However, Massachusetts is not an "average" state. It varies from other states in terms of the mix of public services provided and because of its population density. These two factors require that adjustments be made in order to get fair state rankings in the provision of public sector goods and services.

To clarify the first point, think about the technology of providing individual public goods and services, all of which may require different labor intensities to produce. We can see this best in terms of public education. The number of children per household or per capita varies significantly from state to state, and public education is perhaps the most labor intensive service the state or municipality offers. Massachusetts ranks second among the 50 states in having the lowest public enrollment per capita[12], and so should have fewer public teachers per capita than most other states, unless, of course, it decides to have smaller average class sizes. Adjusting for the number of school children per capita is therefore is warranted.

The other adjustment is for population density. Many goods and services can be

Figure V.1: Massachusetts Public Employment is Below National Average

Number of State and Local Government Workers vs. Average, per 1,000 population



Comparison states are in red

provided more efficiently, that is, with fewer persons, where the population is denser. This can result from lower transportation costs because people are closer to the good or service being provided, or because of economies of scale, meaning that fixed costs can be spread over a larger client population, lowering per unit costs. Massachusetts ranks third highest among the 50 states in population density[13], so in theory it should be able to use fewer workers to provide some kinds of goods and services than other states, unless of course, it decides to provide a higher level of services than other states.

We have used linear regression analysis to control for these two factors: public school enrollment per capita and population density.[14] This technique allows one to compare states to one another because it estimates the expected, or average, number of state and local workers per capita a state would have—controlling for its public school enrollment and its population density. The difference between the number of workers per capita a state *actually* has and this expected number can be called the state's "residual" from the regression. A state that employs more public workers than expected has a positive residual and presumably provides a higher level of public services than the average state. A state that employs fewer public workers than expected has a negative residual, and thus presumably provides a lower level of public services than the average state. The states' residuals can therefore be used to rank states.

Before controlling for enrollment and population density, in 2004 Massachusetts ranked *5th lowest* among the 50 states in the number of state and local government workers per capita, behind Pennsylvania, Rhode Island, Nevada, and Florida.[15] Thus, before controlling for the mix of public services or population density, Massachusetts—despite its reputation—has one of the smallest state and local public sectors of any state in the nation.

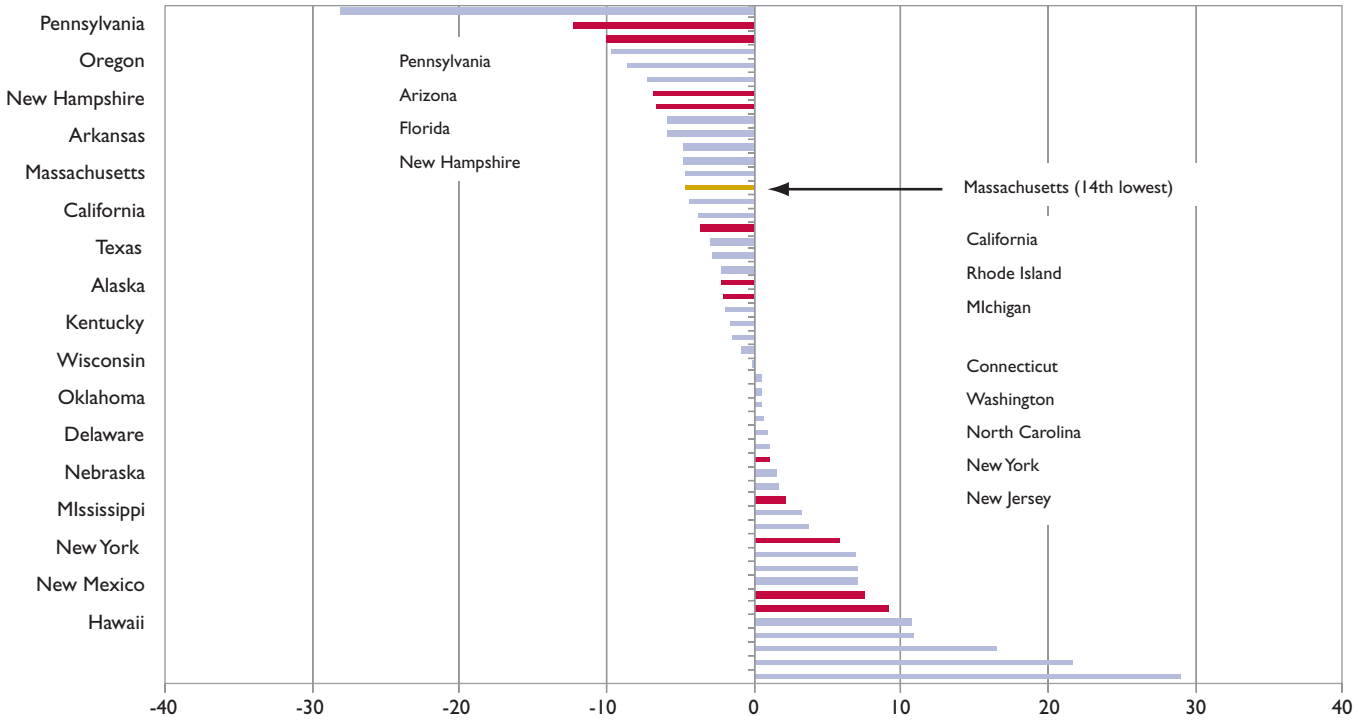
After using regression to control for enrollment, Massachusetts ranking is now 13th lowest. Its ranking changed because it has fewer publicly-enrolled students than most other states. After using regression to control for both enrollment and population density, Massachusetts rank moves to 26th lowest, about in the middle of states. (See **Figure V.1**) It employed 1.4 *fewer* local and state government workers per 1,000 population than the "average" state with the same enrollment intensity and population density, or about 2.4 percent fewer workers than the 57.0 per 1,000 estimated by the regression.

So even when we control for these factors, Massachusetts does not appear to be top heavy in terms of public sector employment or the provision of public sector goods and services. It is simply average… despite the fact that the Commonwealth has the second highest per capita income of all 50 states, after Connecticut. Moreover, between February 2002 and August 2004, the local municipal workforce in Massachusetts has dropped by 5.2 percent, the steepest reduction of any state in the nation.[16] This implies that the Commonwealth is providing about the same level of public goods and services as states with much lower per capita incomes. If states compete for highly educated and skilled workers on the basis of the level and quality of public services they provide, then Massachusetts has effectively opted out of this competition.

What happens if we also control for per capita income on the assumption that richer states can afford more public services. How does Massachusetts rank then? According to our regression analysis, Massachusetts falls back to 14th lowest in the country, well below such states as Washington, Connecticut, North Carolina, New York, and New Jersey.[17] (See **Figure V.2,** next page) This 14th place ranking suggests that Massachusetts could afford to compete for investment and jobs by augmenting its public goods and services, but it has chosen not to. Thirty-six other states are trying harder. To the extent that local public services do matter when it comes to attracting young workers and firms, this is not a record of achievement that bodes well for our economic development goals.

Figure V.2: Massachuestts Public Employment is Far Below Average When Adjusted For Income

Number of State and Local Government Workers vs. Average, per 1,000 population



Comparison states are in red

VI. Fiscal Stress and "Fairness" Across the Commonwealth

INCREASING THE OVERALL LEVEL of local aid to all cities and towns will be necessary to assure success in dealing with the economic development challenges facing the Commonwealth. In addition, if economic development is to occur in any but the more wealthy communities, local aid should also account for the needs of communities that have lower income residents and smaller tax bases.

Virtually all of the municipalities in Massachusetts underwent at least some fiscal stress during the 1990s.

At the present time, we find a wide variance in per-household property tax revenue across communities and a correspondingly wide range in municipal expenditures. Although there are many factors that account for this variation, one factor—household income—stands out above all else. Households in cities and towns with higher incomes tend to pay more in property taxes and get more in the way of public goods and services. Simply by being home to wealthier citizens, these communities have an advantage over the poorest communities—many of whom are home to recent immigrants—being left with too little local revenue to invest in the public services needed to attract business investment and jobs.

THE GROWING GAP BETWEEN COMMUNITIES

TO ASSESS THE DIFFERENCE in property tax revenue and local municipal spending across the Commonwealth, we have used census data for 1989 and 1999 and a simple two-step method to divide the 351 municipalities in the state into four categories. First, we separated the municipalities into those with 1989 median household incomes above the all-state median and those below the all-state median. Then we divided both halves into those where median household income increased between 1989 and 1999 and those where income declined. Thus we have a four way classification system that looks like **Figure VI.1.** In the top left cell, are cities and towns that were in the top half of the state income distribution in 1989 and experienced an increase in median household income during the 1990s. These communities include such affluent towns as Weston, Dover, Carlisle, and Brookline—bedroom suburbs of Boston. (See **Figure VI.2**) At the opposite end of the income spectrum are communities in the bottom right cell. These are towns and cities where median household income was in the bottom half of the state distribution in 1989 and where income actually declined during the booming 1990s. Typical of these municipalities are Worcester, Springfield, Lowell, Brockton, and Lawrence—all older industrial cities. In between are cities that started out in the top half of the income distribution, but saw their incomes decline (e.g. Framingham, Randolph, and Saugus) and those that started out in the bottom half but enjoyed an increase in median household income (e.g. Boston, Cambridge, Somerville, and Attleboro).

According to this classification, the gaps in income across municipalities have widened considerably. According to **Figure VI.3** (next page), on average, the most affluent communities experienced an *increase* in median household income from $71,362 to $77,765 between 1989 and 1999. The poorest communities experienced a *decline* in income from $45,038 to $41,954 over the same period. Put another way, in 1989, the average median income of the wealthiest communities was 58 percent higher than the average for the poorest. By 1999, the income gap had mushroomed to 85 percent.

According to this analysis, there are 127 communities in Massachusetts that are in the top half of the income distribution and experienced an increase in median household income. Another 105 communities were in the bottom half of the income distribution in 1989, but enjoyed an increase in household income during the 1990s. In general, these cities and towns are doing better than the

Figure VI.1: Massachusetts Municipal Classification by Median Household Income

Top Half of Median HH Income and Income **Grew** 1989-1999	**Bottom Half** of Median HH Income and Income **Grew** 1989-1999
Top Half of Median HH Income and Income **Declined** 1989-1999	**Bottom Half** of Median HH Income and Income **Declined** 1989-1999

Figure VI.2: Selected Communities In Upper or Lower Half of 1989 Median Household Income, by Income Growth or Decline, 1989-99

Income Grew 1989-99		Income Declined 1989-99	
Upper Half	**Lower Half**	**Upper Half**	**Lower Half**
Weston	Boston	Framingham	Worcester
Dover	Cambridge	Weymouth	Springfield
Carlisle	Somerville	Woburn	Lowell
Sudbury	Waltham	Chelmsford	Brockton
Wellesley	Haverhill	Randolph	New Bedford
Newton	Medford	Tewksbury	Fall River
Natick	Plymouth	Dracut	Lynn
Billerica	Peabody	Saugus	Quincy
Brookline	Barnstable	Danvers	Lawrence
Arlington	Attleboro	Stoneham	Malden

119 municipalities where income actually declined after 1989. And of these 119, seventy (70) not only began in the lower half of the income distribution in 1989 but ended up with even lower household income in 1999. (See **Figure VI.4**) Nearly 30 percent of Massachusetts residents live in these 70 communities, with another 10 percent residing in communities which have seen incomes drop despite being in the top half of the income distribution in 1989. (See **Figure VI.5**)

Virtually all communities in Massachusetts taxed themselves more during the 1990s in order to supply needed public goods and services. It is no wonder that so many residents in the state complain about the rising burden of residential property taxes.

WIDESPREAD MUNICIPAL FISCAL STRESS

IT MIGHT APPEAR AT FIRST that the Commonwealth might only have to worry about the 119 communities that experienced declining incomes during the 1990s. But, in fact, virtually all of the municipalities in Massachusetts underwent at least some fiscal stress during the 1990s. Municipal fiscal stress occurs at the local level when the average single family property tax levy—the typical property tax paid on a single family home—increases faster than median household income. In Massachusetts, despite Proposition 2½, property tax levies increased dramatically faster than income between 1989 and 1999 as **Figure VI.6** (next page) demonstrates. For the median town in the top half of the income distribution and growing household income, households experienced a 6.5 percent increase in income but paid a whopping 67 percent increase in local property taxes. Things were even worse for the 70 municipalities

Figure VI.3: Average Median Household Income, by Income Classification and Year

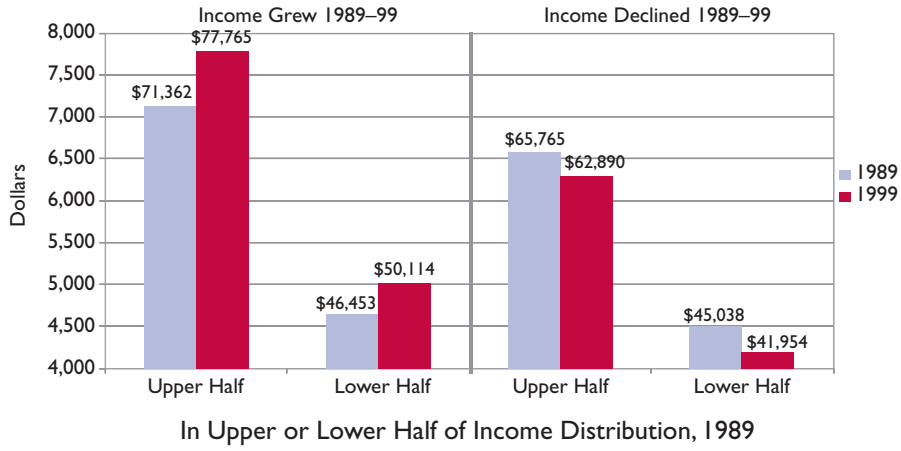


Figure VI.4: Number of Municipalities, by Income Classification

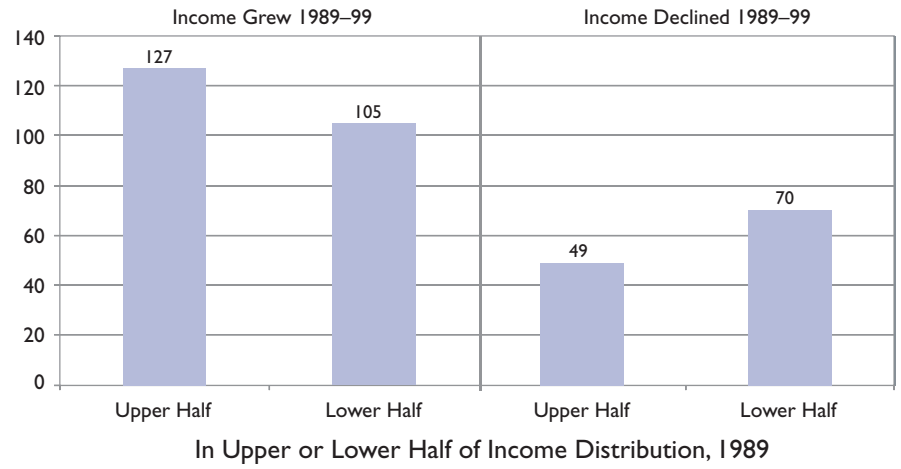
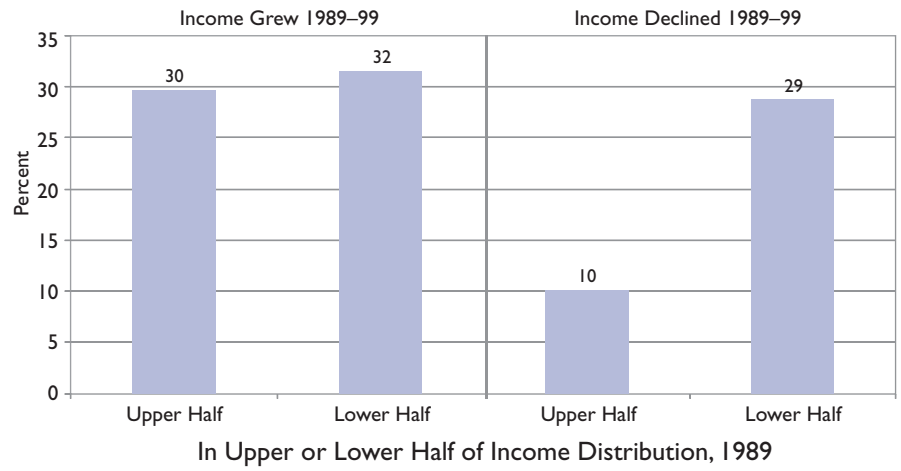


Figure VI.5: Percent of 2000 State Population, by Income Classification



where incomes were low to begin with and declined during the 1990s. Here households in the median town in the bottom half of the income distribution and declining median income experienced a *loss* of 5.3 percent in household income but nevertheless ended up paying 59 percent more in property taxes.

Thus, virtually all 351 communities in Massachusetts taxed themselves more during the 1990s in order to supply needed public goods and services—taking a larger share of household income to pay for these. It is no wonder that so many residents nearly everywhere in the state complain about the rising burden of residential property taxes.

Figure VI.6: Change in Property Tax and Household Income, 1989-1999

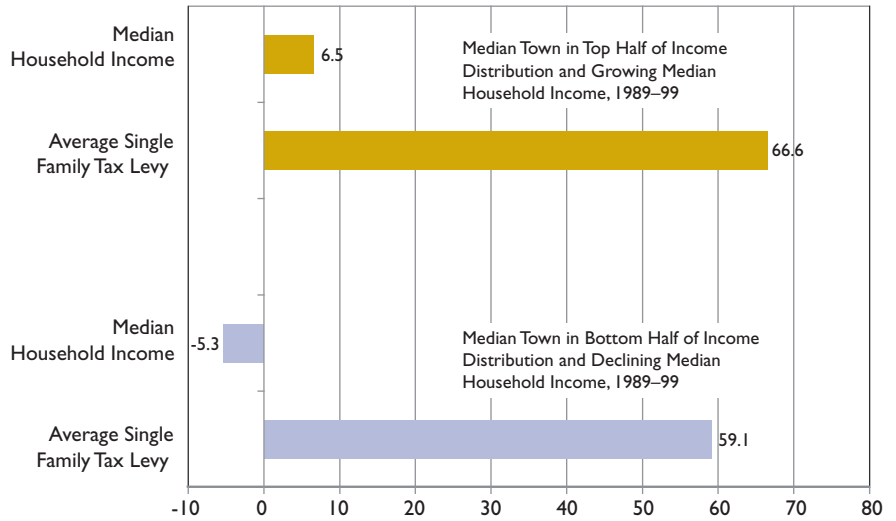
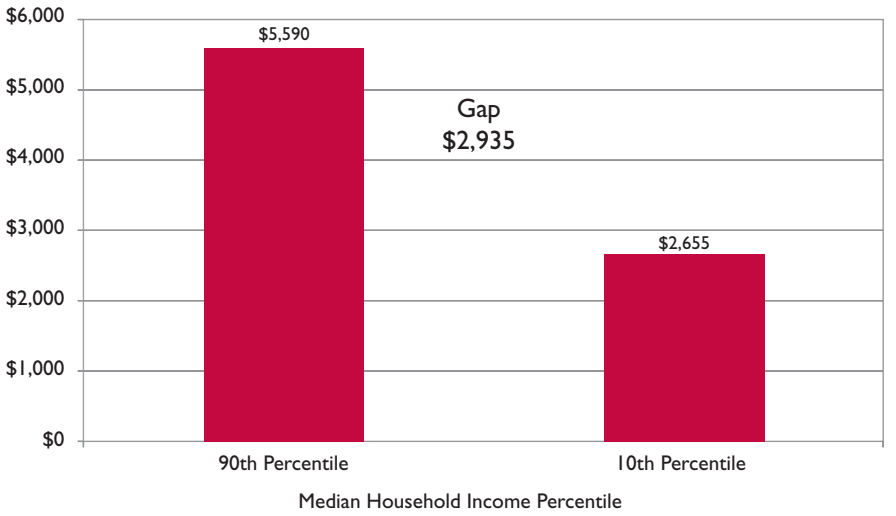


Figure VI.7: Average Per Household Property Tax, by Income of Community, FY2000



INEQUALITY IN TAX REVENUE

While the local tax burden has increased for households in more affluent and poor communities alike, the large gaps in household income (and therefore residential property tax assessments) across communities produce an immense difference in the amount of property tax raised per household each municipality. **Figure VI.7** compares the average per household property tax between a typical community in the 90th (highest) percentile of the income distribution with the average property tax for a typical community in the 10th (lowest) percentile. These figures are for FY2000. The differences in revenue and spending between these two communities are typical of the gaps between relatively affluent and poor municipalities in the Commonwealth.[18] The $5,590 per household in the wealthier community was more than double the amount generated in the poorer ($2,655). Hence, the more wealthy cities and towns in the Commonwealth could afford to offer more than double the public services of the poorer communities, if property taxes were the only source of revenue.

When other local revenue sources besides the property tax are included in these calculations (e.g. excise taxes, local fees), the per household dollar gap grows even larger as shown in **Figure VI.8.** Now the wealthier community, with average own-source revenue of $7,090 exceeded that of the poorer community by more than $3,350.

THE ROLE OF STATE AID IN REDUCING INTER-MUNICIPAL FISCAL INEQUALITY

ONE IMPORTANT ROLE of state government is to extend local aid so as to offset some of the fiscal inequality across communities. The Commonwealth's application of its various aid formulas has resulted in some redistribution of state tax dollars. As **Figure VI.9** indicates, in FY2000 the community in the 90th percentile in the income distribution received $915 in state aid per household. Meanwhile, the poorer community benefited to the tune of $1,360.

This closed the gap in total revenue slightly as **Figure VI.10** (next page) demonstrates, but still left a large disparity between the municipalities. Before state aid, the typical wealthy community had nearly 90 percent more revenue per household than the typical poor community. After the inclusion of state aid, the gap closed to 57 percent.

Such large differences in revenues translate into large differences in municipal spending on some key public services. The disparity in education spending between communities is strikingly less than for non-education services, because of the explicit goal of Chapter 70 that all municipalities provide a minimum level of spending on schools as set forth in communities' foundation budgets. Even so, some disparities remain, although they are significantly less now than before the Education Reform Act of 1993. The wealthier community spent $7,270 per pupil while the poorer community spent $6,087. (See **Figure VI.11,** next page) Thus, even with state aid, the higher-income community spends more than 19 percent more per pupil than the poorer community.

The gap in other services is larger, and sometimes much larger. The top-tier community spent $481 per household on police while the poor community spent only $397—even though there may have been more crime to fight in the poorer community. This represents a 21 percent gap. (see **Figure VI.12**, page 35). As **Figure VI.13** (page 35) demonstrates, the gap in funding for fire protection is even larger. In the long run, this continuing disparity in public spending adds to the difficulty lower income communities face in attracting young families and jobs, and to our ability to ensure equal opportunities for growth and development in every part of Massachusetts.

Figure VI.8: Average Per Household Own Source Revenue, by Income of Community FY2000

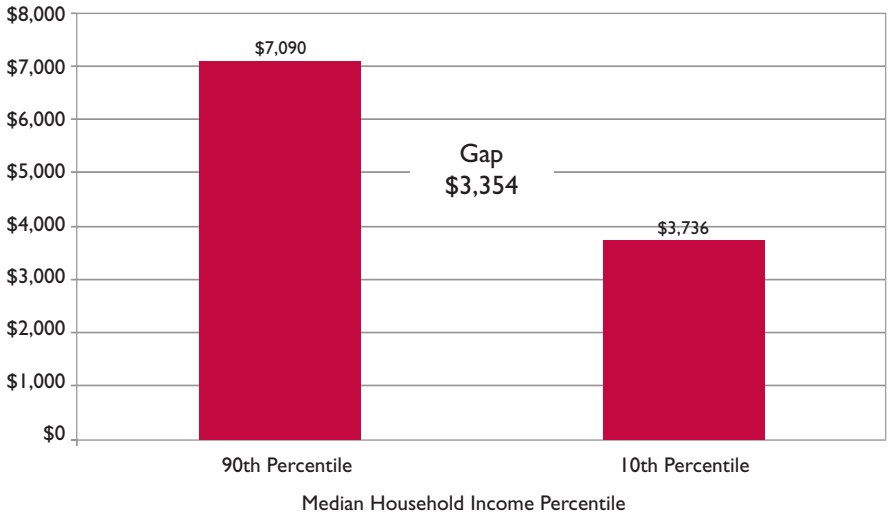


Figure VI.9: Average Per Household State Aid, by Income of Community, FY2000

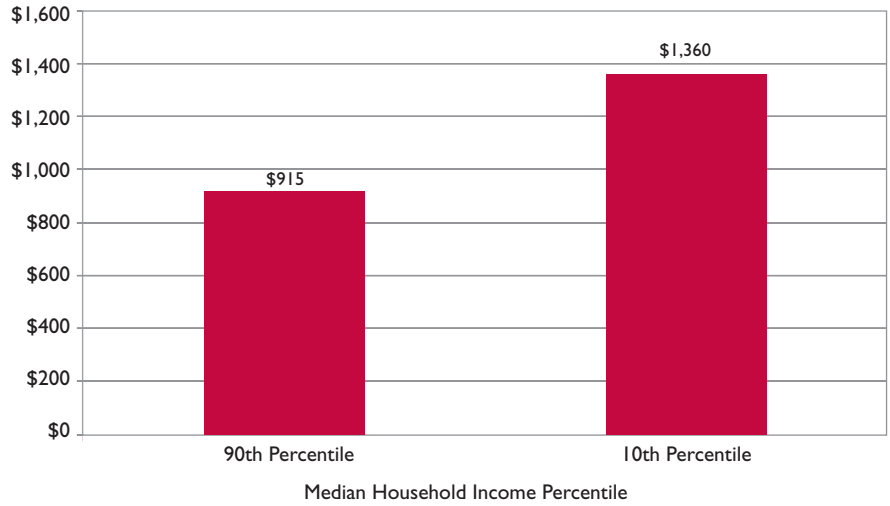


Figure VI.10: Average Per Household Total Revenue: Own Source Revenue + State Aid, FY2000

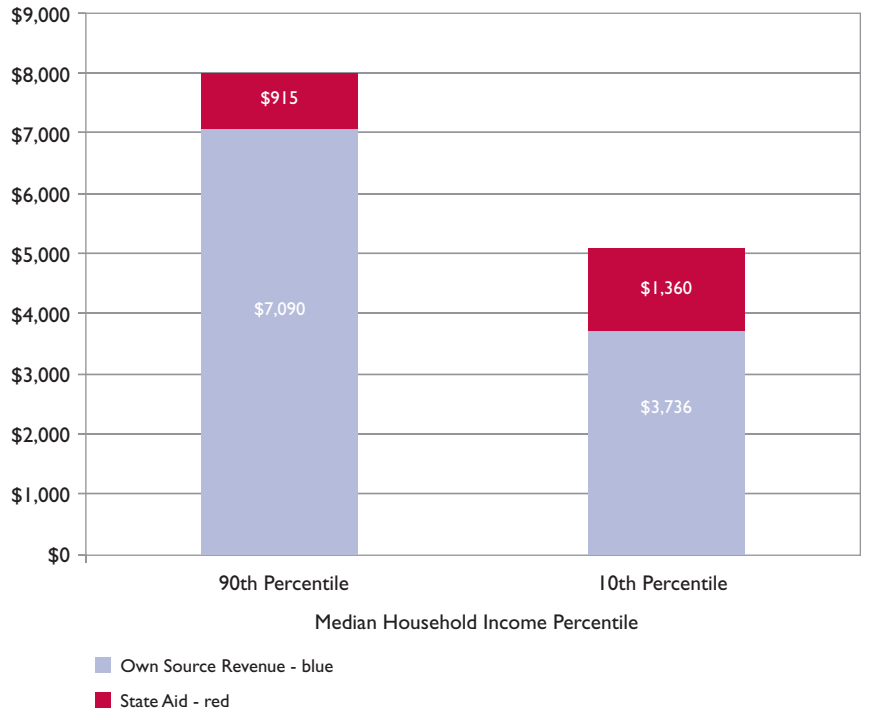


Figure VI.11: Average Per Pupil Education Spending, by Income of Community, FY2000

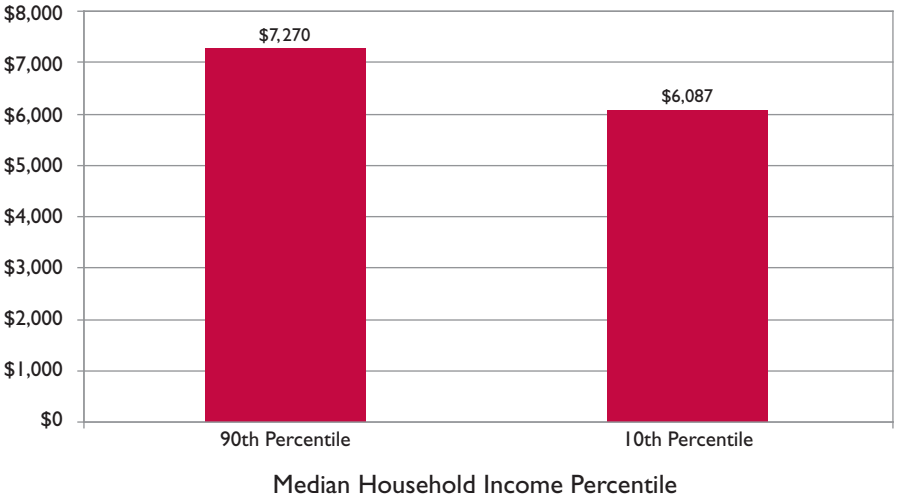


Figure VI.12: Average Per Household Spending on Police, by Income of Community, FY2000

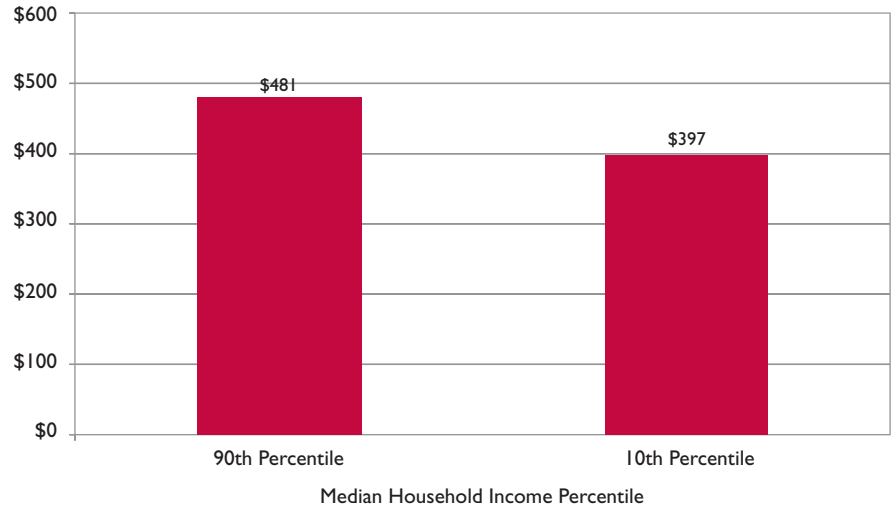
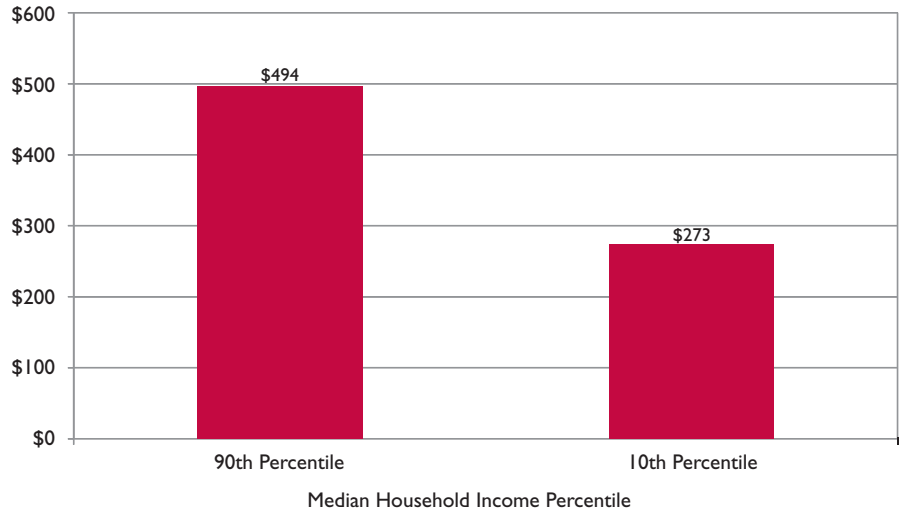


Figure VI.13: Average Per Household Spending on Fire, by Income of Community, FY2000



VII. Local Tax Capability

WHAT MAKES MATTERS WORSE in Massachusetts is that municipalities in the Commonwealth are severely restricted in their capacity to generate revenue from their own sources. States control the revenue raising capabilities of their local governments and the Commonwealth has chosen to limit the tax options to the property tax, a small excise tax on motor vehicles, and a few small revenue generators including taxes on hotel and motel stays and jet fuels. Some revenue is generated by fees for various services, but still communities are reliant on the property tax to generate most of their local revenue. This leads to a significant burden on local taxpayers to cover the costs of general municipal services and, in most communities, the majority of the cost for K-12 education. In 2002, Massachusetts ranked 6th among key competitor states for per capita revenue ($1,374) generated from the property tax and significantly above the national average ($991). While we rank below our neighboring states of Connecticut, New Hampshire, and Rhode Island and well below New Jersey and New York, the states outside the Northeast region that are attracting our workers and our firms are all less reliant on this tax, providing their local governments with a significant competitive edge. California taxpayers pay 35 percent less in property taxes and Arizona residents 40 percent less. North Carolina, a major competitor state, has a per capita property tax burden that is less than half of the burden in Massachusetts. (See **Figure VII.1**)

Other states are substantially less restrictive than Massachusetts when it comes to permitting local authorities latitude in using a broader array of revenue sources.

Of even greater importance is the fact that other states are substantially less restrictive than Massachusetts when it comes to permitting local authorities latitude in using a broader array of revenue sources. Four competitor states—Michigan, New Jersey, New York and Pennsylvania—allow their local governments to collect both income and sales taxes. Arizona, California, Florida, North Carolina, and Washington, also competitors of ours, allow localities to collect sales taxes as well as property taxes. (See **Figure VII.2**)

This excessive burden on local property taxpayers led to the tax revolt of the early 1980's that further restrained local governments through the imposition of the restrictions in Proposition 2½. While many of our competitor states have tax and/or expenditure limitations, the use of local option sales and income taxes has provided relief. The Commonwealth's

Figure VII.1: Per Capita Revenue from Property Tax 2002

State	Tax
New Jersey	$ 1,907
Connecticut	$ 1,760
New Hampshire	$ 1,755
New York	$ 1,414
Rhode Island	$ 1,395
Massachusetts	**$ 1,374**
US	*$ 991*
Florida	$ 986
Michigan	$ 985
Washington	$ 982
California	$ 893
Pennsylvania	$ 888
Arizona	$ 829
North Carolina	$ 674

Source: Author's Calculations of U.S. Census Bureau 2002 Census of Governments

Figure VII.2: Revenue Sources Available to Local Governments

State	Property	Income	Sales
US	X	X	X
Michigan	X	X	X
New Jersey	X	X	X
New York	X	X	X
Pennsylvania	X	X	X
Arizona	X		X
California	X		X
Florida	X		X
North Carolina	X		X
Washington	X		X
Connecticut	X		
Massachusetts	**X**		
New Hampshire	X		
Rhode Island	X		

Source: Author's Calculations of U.S. Census Bureau 2002 Census of Governments

communities struggle under the double bind of high property tax rates and a significant restraint on their ability to expand their tax base using other revenue sources to meet the increasing costs of municipal government. Faced with a choice of cutting services or chancing voter rejection of a request to override Proposition 2½, many officials have cut services. Many have done both.

Massachusetts law does allow municipalities to charge different tax rates on commercial and industrial properties from that applied to residential property. Originally designed to provide residents relief as tax bills crept up, the recent decline in the assessed value of non-residential property in many communities as a result of rising vacancy rates has led to another sharp increase in the property tax burden on homeowners—as we noted in an earlier section. This is one factor that helped make Greater Boston the single highest family cost of living metro area in the nation—leading to the loss of young workers from the Commonwealth.

The Commonwealth's communities struggle under the double bind of high property tax rates and a significant restraint on their ability to expand their tax base using other revenue sources.

Reliance, on the other hand, on the commercial and industrial property tax generates fierce inter-local competition for development. Our national survey of developer/site specialists revealed that local property tax rates are more important to firms in their location decisions than state tax rates, leaving cities and towns with the difficult dilemma of balancing low property tax rates to attract investment and high public spending to provide the public services, infrastructure, and important amenities that businesses increasingly demand in making their location decisions. Over-reliance on the local property tax therefore has become a major "deal breaker" in the economic development game by fostering either non-competitive taxes or worse yet, non-competitive public services.

The key point is that we simply cannot expect to reverse the loss in population and jobs if we do not address the local aid issue. It is just too important to ignore, and we must act now if we want to compete and prosper.

We simply cannot expect to reverse the loss in population and jobs if we do not address the local aid issue.

VIII. Conclusions and Recommendations

IN THE END, what does all of this mean?

CONCLUSIONS

FIRST, THE COMMONWEALTH now faces the critical challenge of reversing of the loss of young workers and families who are key to our future success, regaining the jobs we have lost since the last recovery, and expanding investment for the future prosperity of the state.

SECOND, local communities play the dominant role in attracting investment and jobs to the state.

THIRD, local communities compete with the rest of the nation for investment and jobs by providing efficient and effective public services, sufficient infrastructure to reduce traffic congestion and provide adequate parking, excellent public schools, low crime rates, competitive property taxes, and attractive cultural and recreational amenities.

FOURTH, the over-reliance of the state's cities and towns on the local property tax to underwrite public goods and services makes it difficult for the Commonwealth's municipalities to remain competitive in attracting economic development and growth because it forces up property tax levies and forces down municipal services.

FIFTH, the decline in state local aid to cities and towns has jeopardized the ability of the Commonwealth's municipalities to offer the type of local public services and overall quality of life that can offset the disincentive of high private sector costs to both families and firms.

We are convinced that the fiscal partnership between state and local governments needs to be significantly re-crafted if municipalities are going to attract and retain firms and workers in the 21st century.

Recommendations

1. A New and Enduring Revenue Sharing Partnership.
2. Diversifying the Local Tax and Revenue Structure.
3. Increasing Local Management Authority and Revisiting State Mandated Costs.

Based on these findings and observations, we make the following recommendations:

RECOMMENDATIONS

WE ARE CONVINCED that the fiscal partnership between state and local governments needs to be significantly re-crafted if municipalities are going to attract and retain firms and workers in the 21st century. The Commonwealth is important to the successful attraction and retention of firms, but principally by creating a strong supportive environment for the cities and towns where actual development takes root. The competition is fierce and other states offer significantly more support and many more options to their local jurisdictions to offset the cost of public services.

We have found that in attempting to hold on to younger workers and their families and attract business investment, the Commonwealth's cities and towns are in a triple bind. They do not have the power to create new revenue sources without the state's permission; they must continue to pay for the bulk of municipal costs including K-12 education through the property tax; and they are constrained in their ability to increase local revenues to support those services by the rules of Proposition 2½.

In the past, the Commonwealth has stepped in to underpin essential municipal services with various forms of local aid. However, this historic relationship is at an all time low. Declining local aid over the past five years has put municipal finances in serious jeopardy with economic consequences for generations to come.

We therefore believe that the following areas are worthy of significant discussion as we pursue the goal of a new fiscal and economic partnership between the Commonwealth and its cities and towns.

1. A New and Enduring Revenue Sharing Partnership

The Massachusetts Taxpayers Foundation released the 35th edition of their *Municipal Financial Data* in November 2005. Their analysis suggests that as the state's economy improves, providing increased income and sales tax collections, a unique opportunity now exists to increase local aid to the Commonwealth's 351 communities. Their recommendation is to dedicate a full 40 percent of the annual revenues from the state's three major tax sources (personal income, corporate income, and sales taxes) which would have yielded an additional $1 billion in local aid in 2005. This recommendation must be considered as a valuable starting point for this discussion.

In the future, in order to maintain greater stability in the level of local aid—making it possible for municipal leaders to better plan for and invest in local public services—the state should assure cities and towns that the municipal share of the state budget will remain the same and local aid will rise and fall at the same rate as state revenues. In crafting this new revenue sharing compact, state leaders should guarantee that cuts in local aid necessitated by any downturn in the economy are not concentrated in non-school public services as they have been in recent years.

During the 1990's a broad coalition of business leaders, educators, and public officials significantly restructured the state's financing of K-12 education leading to additional resources for schools and

a formula to reduce the spending disparity across school districts. That same energy developed through a broad coalition now needs to focus on supporting additional state aid for essential local public services in order to underpin the capacity of cities and towns to deliver these services on a predictable and sustained basis. While this new revenue sharing compact may be phased in over several years, the Governor and the Legislature should immediately protect current sources of local revenue including the Lottery and make sure these are no longer diverted to other purposes.

2. Diversifying the Local Tax and Revenue Structure

Other states offer considerable opportunities for local jurisdictions to access revenue from sources other than the property tax in order to provide the services needed to attract investment and jobs. Massachusetts should consider a similar strategy. It should remove loopholes in the tax base created by new technologies and businesses such as telecommunications. Local option meals and other sales taxes should be allowed as is the case in most competitor states. Innovative tools such as income and sales tax increment financing should be considered, particularly where a strong case can be made that a local public investment will yield sizable economic development opportunities for the Commonwealth. These policies would diversify local revenue sources, relieve pressure on the property tax, and export some of the tax burden to out-of-state taxpayers who benefit from the Massachusetts economy.

3. Increasing Local Management Authority and Revisiting State Mandated Costs

Under the Massachusetts constitution, municipalities are "creatures of the state." Not only does this restrict their revenue and expenditure capacity, but the state is free to impose restrictions on municipal governments. These include restrictions on the ability of municipal officials to manage their health insurance and other benefit costs. While reform in this area will be challenging, cities and towns clearly need increased authority and management tools to address the explosive growth in fixed costs and similar budget busters. Further, local aid, distributed through the "Cherry Sheet" is discounted in order to pay for such state mandated functions as county government and regional transit services. The state should consider ways of assuming some of this burden so that the full value of local aid can be distributed to the state's local communities. Many municipal services lend themselves to cooperation and collaboration among and between cities and towns on a regional basis. Significant cost savings are possible through developing economies of scale and every available mechanism and incentive should be explored to facilitate this capacity with the state encouraging such activity through fiscal incentives in the form of additional local aid.

A NEW RELATIONSHIP BETWEEN STATE AND LOCAL GOVERNMENT

Central to the Commonwealth's competitiveness, economic development, and prosperity is the rebuilding of a collaborative working relationship between the state government and local authorities with local government officials understanding the fiscal constraints of state government, but equally important, state officials understanding the critical role that municipalities play in retaining and attracting investment and jobs.

Such a new collaboration must begin to find new ways for the state to underwrite the costs of local government both to assure economic development and to improve fiscal "fairness" across the Commonwealth.

A new fiscal partnership is not simply a budget partnership. Indeed, it is much richer. In the end, unless we find a way to regenerate the "collaborative gene" in the Commonwealth's public sector and find a way for the state to better assist local communities in offering the best public services possible, the future proserity of the state is placed in jeopardy.

Endnotes

[1] Katherine Bradbury, Anthony Downs, and Kenneth Small, *Urban Decline and the Future of American Cities* (Washington, D.C.: The Brookings Institution, 1982).

[2] See U.S. Department of Labor, Bureau of Labor Statistics, http://data.bls.gov/PDQ/servlet/ SurveyOutputServlet, September 2005.

[3] Bonnie Heudorfer and Barry Bluestone, "The Greater Boston Housing Report Card 2004", Center for Urban and Regional Policy; The Boston Foundation; and Citizens' Housing and Planning Assocation, September 2005, p. 4.

[4] See Robert Weisman, "Job Growth Stalled in 7 of State's Key Sectors," *The Boston Globe,* December 19, 2005, p. E6.

[5] These figures from the U.S. Census *American Community Survey* are for the Boston PMSA only, an area representing about 80% of the Greater Boston region as we have defined it. The latest data available are for the period between July 1,2002 and June 30, 2003.

[6] See Robert Nakosteen, Michael Goodman, and Dana Ansel, "Mass.migration," A Joint Project of MassINC., the University of Massachusetts Donahue Institute, and MassHousing, December 2003.

[7] See Economic Policy Institute, "Basic Family Budget Calculator" (Washington, D.C. 2005). According to the EPI, "the basic family budget is indeed 'basic.' It comprises only the amounts a family needs to spend to feed, shelter, and clothe itself, get to work and school, and subsist in 21st Century America. Hence, it includes no savings, no restaurant meals, no funds for emergencies—not even renters' insurance to protect against fire, flood, or theft."

[8] Personal income and consumer expenditures for the U.S. are from the U.S. Bureau of Economic Analysis. The personal consumption deflator from the same source was used to adjust for inflation.

[9] General Fund Expenditures for fiscal years 1987-2004 are from the Department of Revenue, Division of Local Services. They include municipal assessments for regional school districts, and reflect spending supported by all revenue sources including state aid. Personal income growth from 1987-2004 is calculated on a calendar year basis. To adjust for inflation, we use the state and local government consumption expenditures price index for local and state revenues and expenditures, and the personal consumption price index for personal income. Both deflators are for the U.S., and are from the U.S. Bureau of Economic Analysis.

[10] State aid to municipalities and regional school districts is omitted here because they are included in the municipal general fund expenditures.

[11] See Matt Viser, "Property Taxes Still on the Rise in Mass." *The Boston Globe,* December 18, 2005, pl A1.

[12] In 2004, 18.4 percent of the population was enrolled in public schools. Among states, only Pennsylvania had a lower percent of its population enrolled in public schools. On this measure, the District of Columbia was lower than all 50 states.

[13] In 2004, Massachusetts' population density was 818.4 persons per square mile of land area. Among states, New Jersey and Rhode Island had a higher population density. The District of Columbia had a higher population density than all 50 states.

[14] State and local government payroll employment per 1,000 population is regressed on public school enrollment as a percent of the population, and the logarithm of population density. The observations are the 50 states, and the data are for 2004. See the appendix for a more complete description and the regression estimates.

[15] The Massachusetts Budget and Policy Center, in "Measuring Up, Taxes and Spending in Masschusetts, FY 2002", also found that Massachusetts ranked 4th. In FY 2002, they reported that Massachusetts employed 57.8 state and local employees per 1,000 population, while we calculate a 55.6 in 2004. Both studies used Bureau of Labor Statistics payroll employment and Census population.

[16] See Massachusetts Taxpayers Foundation, "Municipal Financial Data 34th Edition," October 2004.

[17] This analysis is confirmed by a recent Federal Reserve Bank of Boston study that found that New England employs relatively fewer public employees per capita than the nation and Massachusetts employs much fewer than the New England region as a whole. Nationally, in 2003, there were 542 state and local employees on average per 10,000 population. In New England, the ratio rate was 518 and in Massachusetts 498. See Nick Turner and E. Matthew Quigley, "Do New England State and Local Governments Have Too Many Employees, and Are They Overpaid?" *New England Fiscal Facts,* Summer 2005, Issue No. 34.

[18] This section compares revenue and spending components for two actual municipalities, one with median household income near the 90th percentile of income of the 351 municipalities, and another with median household income near the 10th percentile. As an alternative methodology for assessing the role of income inequality on municipal budgets, we also estimated the relationship between per-household revenue and spending components and median household income across the 351 municipalities using regression analysis. The conclusions from this statistical analysis, available from the authors on request, are in accord with those presented in this report for these two "typical" relatively rich and poor communities.

The Center for Urban and Regional Policy at Northeastern University

THE CENTER FOR URBAN AND REGIONAL POLICY (CURP) was launched in 1999 at Northeastern University as a "think and do tank"—a center where faculty, staff, and students from the university pool their expertise, resources, and commitment to address a wide range of issues facing cities, towns, and suburbs with particular emphasis on the Greater Boston region. It has produced an array of reports on housing, small business development, and workforce training; created new computer-based information tools for researchers, students, and government agencies; and sponsored major "action" projects, including the World Class Housing Collaborative, which is devoted to assisting community groups develop housing in their neighborhoods. CURP has also focused its attention on inner city development in older industrial cities in Massachusetts. A new collaborative is also underway aimed at helping small minority enterprises improve and expand their operations. In 2000, CURP produced the *New Paradigm for Housing in Greater Boston* report, a comprehensive document detailing the nature of the housing crisis in the region. Its subsequent annual Housing Reports Cards have kept track of the Commonwealth's progress toward meeting its housing needs. Working with the Commonwealth Housing Task Force, CURP staff and consultants were instrumental in developing the Chapter 40R and Chapter 40S housing legislation enacted in 2004 and 2005 in Massachusetts. CURP's Web site, www.curp.neu.edu, is a leading source of information for community leaders, public officials, urban researchers, and students.

The Massachusetts Municipal Association

ESTABLISHED IN 1979, THE MASSACHUSETTS MUNICIPAL ASSOCIATION is the statewide nonprofit, nonpartisan association of cities and towns formed to promote and build strong and effective local government across the Commonwealth. The Association serves as the local voice of cities and towns before the state and federal government, and provides a wide range of services to municipalities, including advocacy, policy research and development, membership training and education, substantive print and electronic publications, and nonprofit insurance and energy programs that have provided millions of dollars in savings to local governments in Massachusetts.

Massachusetts Municipal Association

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