

TAX REFORM AND REVENUE SHARING CHANGES: FISCAL IMPACTS ON SMALL, RURAL MASSACHUSETTS TOWNS

Catherine L. Flynn
University of Massachusetts

In 1982, local Massachusetts governments received \$2.9 billion in federal and state aid, which made up 43 percent of local government revenues. State aid was \$2.1 billion and federal aid \$845 million (U.S. Bureau of the Census, p. 188). Since 1982, however, tax reform measures at both the state and federal level have resulted in dramatic changes in local government revenues in Massachusetts.

Proposition 2 1/2

Proposition 2 1/2, a state tax reform measure that took effect in 1981, has cut municipal property tax revenues sharply in recent years. From 1977 to 1986, property taxes declined from 61 percent to 47 percent of municipal revenues, due largely to the mandates of Proposition 2 1/2. During this period, the state stepped in to assist cities and towns and state aid increased from 17 percent to 29 percent of municipal revenues. Despite the rapid increase in state aid during this period, municipalities experienced real losses in revenue. In inflation-adjusted dollars, local spending in 1986 was 3.6 percent below the fiscal 1981 level (Massachusetts Taxpayers Foundation, p. 3).

In 1987, the loss of federal revenue sharing resulted in further losses to municipalities. Federal revenue sharing to Massachusetts municipalities made up an estimated \$143 million, or 2 percent of local government revenues, in 1986 (Massachusetts Bureau of the Budget). Again, the state stepped in and distributed \$60 million to cities and towns to partially offset the loss.

State Aid Distribution Patterns

Both the aid to cities and towns in response to Proposition 2 1/2 (known as "resolution aid") and the later revenue sharing reimbursement were governed by complex state formulas that awarded aid on

the basis of need and on the level of losses sustained by the municipalities. Both need and loss varied greatly among communities, the result of differences in municipal tax bases and the demographic makeup of municipal residents.

Diversity among local governments is not unique to Massachusetts, of course, but is characteristic of local governments nationally (Bender, et al.; Hines, et al.). In Massachusetts the diversity led to significant variation in aid levels across communities. For example, resolution aid in 1986 averaged \$6 per capita for communities under 500 population and \$38 per capita for communities over 50,000 population (Flynn, et al. 1985, p. 2). Similarly, federal revenue sharing losses for the last two quarters of 1986 averaged \$12 per capita for communities under 500 population and state reimbursement \$2; for communities over 50,000 population, revenue sharing losses averaged \$10 per capita and state reimbursement \$12 per capita (Massachusetts Bureau of the Budget).

The disproportionate loss of federal aid to small communities was troublesome, particularly because, according to the Office of Federal Revenue Sharing, "Revenue Sharing is the only major Federal grant program that provides funds to . . . urban and rural areas using the same criteria . . . As a result, the most generous per capita payments go to thousands of poor rural communities as well as to financially troubled major cities" (U.S. Department of the Treasury, p. 10).

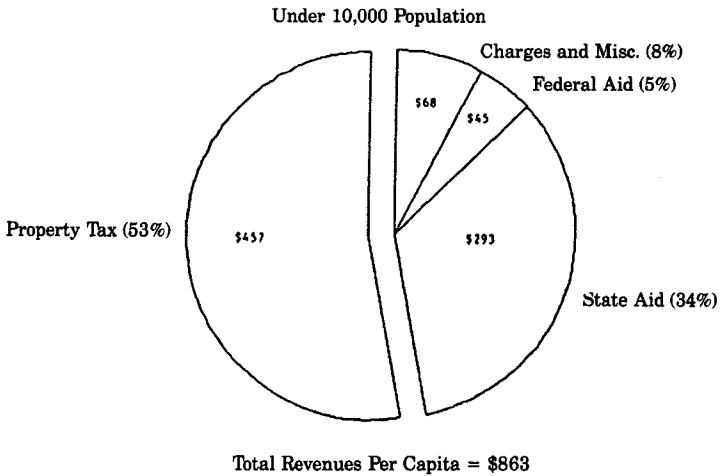
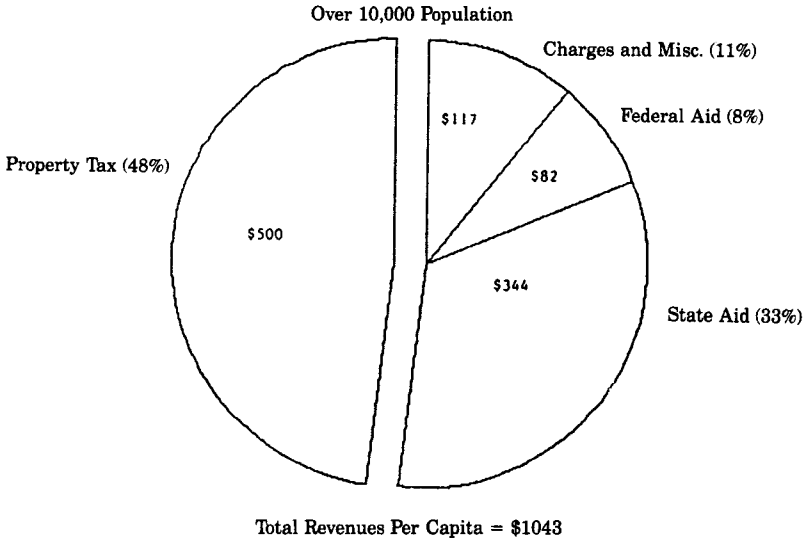
Rural officials were concerned about the impact of state aid programs on small communities. At the request of the Massachusetts Rural Development Committee and the Rural Caucus of the State Legislature, the Extension Local Government Program began to conduct an analysis of rural finances and state aid.

Comparison of Urban and Rural Local Government Finances

Research at the regional and national level indicates that the finances of urban and rural local governments vary significantly. Rural governments are characterized by lower revenue and expenditure levels and higher property tax burdens (Flynn, et al., 1987; Reeder; Stocker, pp. 25-41). Figure 1 shows a similar pattern in Massachusetts (Flynn and Bouffard, pp. 2-3). Smaller communities had lower revenue levels (82 percent of those of larger communities); received less federal and state aid; and relied more heavily on property taxes.

Expenditure levels were also lower in small communities, averaging \$818 per capita, 85 percent of average expenditures in large communities. Small town budgets were dominated by schools and roads, which totaled 73 percent of expenditures, compared to 51 percent of total expenditures in large communities. Education services and highways were also more costly in small towns. School expenditures averaged \$521 per capita in small communities compared to \$446 in large communities, and highway expenditures averaged \$67 per cap-

Figure 1: Revenue Sources of Massachusetts Municipalities Over and Under 10,000 Population: 1982



Source: 1982 Census of Governments, "Finances of Municipal and Township Governments;" Massachusetts Department of Education, "1981-82 Valuation Ratios;" Massachusetts Bay Transportation authority, "Statement of Facts Required by the State Treasurer."

ita in small communities compared to \$42 per capita in large communities (Flynn and Bouffard, p. 3).

Armed with this preliminary understanding of urban and rural municipal finances, the Local Government Program began to analyze

state aid programs to assess their treatment of rural communities.

State Aid Programs in Massachusetts

An analysis of the state aid formula governing distribution of resolution aid showed that it did not recognize many of the differences between urban and rural communities shown in Figure 1 above. For example, tax burden was defined simply as per capita tax levy. Although small communities in Massachusetts relied more heavily on property taxes as a revenue source (53 percent of total revenues compared to 48 percent of total revenues in large communities), they had lower per capita taxes, which were related to the generally lower revenue base shown in Figure 1.

In a series of hearings and meetings during 1986 and 1987, the Joint Commission on Local Aid of the State Legislature and the Executive Office of Administration and Finance solicited the testimony of local officials and the Extension Service in the state aid program. And in the course of these discussions, the state has responded to the needs of both rural and urban communities. The formula for resolution aid, for example, now recognizes the lower revenue levels of small communities and other demographic characteristics such as lower personal incomes.

Figure 2 shows aid levels in 1988 for communities over and under 5,000 population (Flynn 1987, p. 3). Despite the losses in federal revenue sharing experienced by small communities in 1987, by 1988 these communities were receiving a high level of aid.

However, it has become clear that a distinction between communities simply on the basis of population is not adequate. Many small communities are wealthy, for instance; many are suburban communities whose capacities and needs are very different from those of rural communities. We have begun to use a typology of communities that employs a range of economic and demographic variables to describe community types (Massachusetts Department of Education).

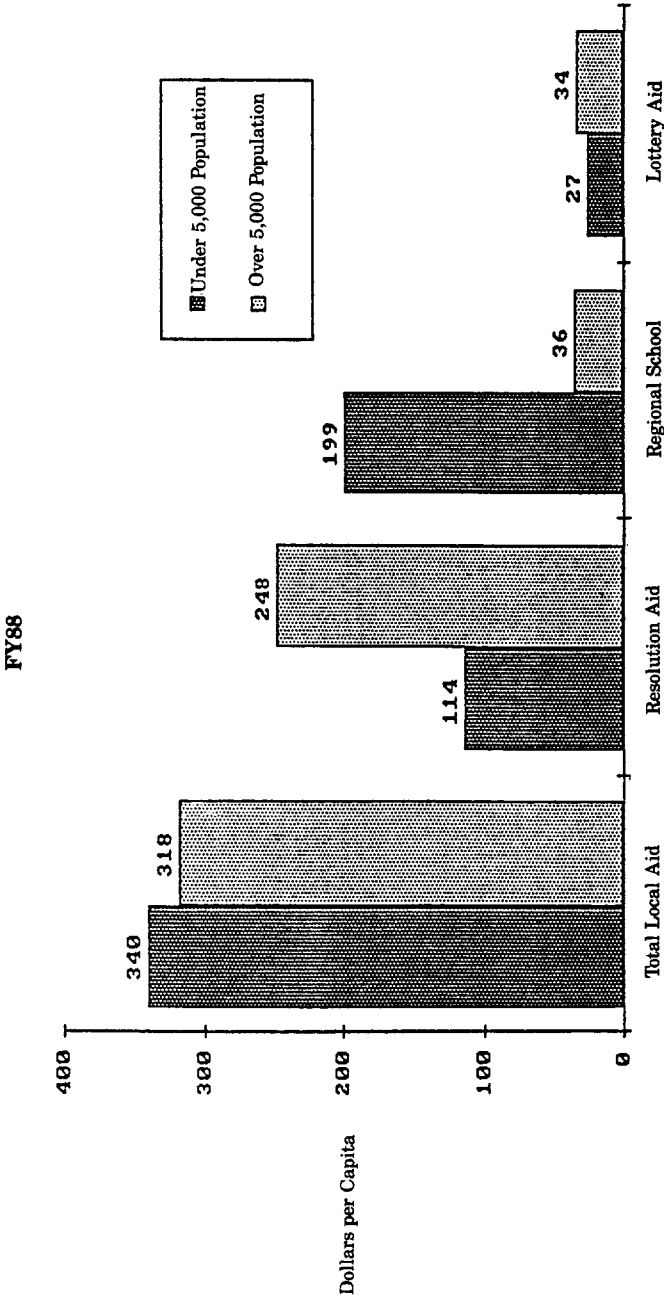
Figure 3 uses this typology to analyze 1988 state aid (Flynn 1987, p. 5). Clearly, such a typology will be very useful in future analysis of Massachusetts communities. In particular, we plan to look at state aid programs in transportation, housing and water and sewer facilities—all areas of critical need in rural communities.

Conclusion

In the course of this work with state and local officials, we have learned several things about policy analysis, among them:

- (1) Small and rural communities in Massachusetts are served by part-time and volunteer officials who often lack the time and sometimes the training to make the needs of their communities known to

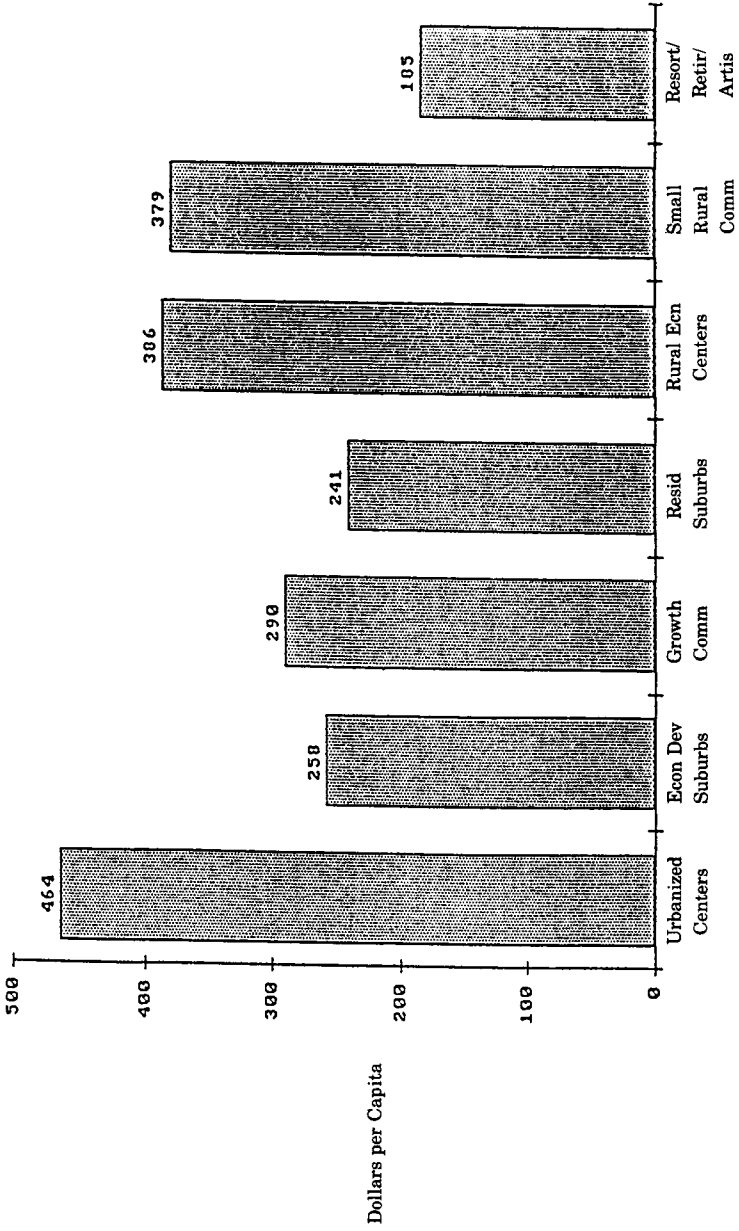
**Figure 2: Total Local Aid per Capita to Municipalities
Over/Under 5,000 Population**



¹Resolution aid includes general revenue sharing loss, lottery, equal education opportunity grants and additional assistance.

Source: Massachusetts Bureau of the Budget

Figure 3: Total Local Aid¹ by Kinds of Communities: FY00



¹Includes regional school aid, offset to general revenue sharing loss, additional assistance, equal education opportunity grants, and lottery.
 Source: Massachusetts Bureau of the Budget

state policy makers in an effective and timely fashion. As a result, state policy may exhibit a benign neglect of rural needs. Particularly with respect to rural finances, there was no state agency or organization with responsibility or interest, aside from the Extension Service.

(2) The participation of university-based extension specialists in such grass roots organizations as the Massachusetts Rural Development Committee, has provided an invaluable exposure to the real world problems of rural local governments and enabled us to focus research on timely and critical rural policy issues.

(3) We have learned that involvement in ongoing public policy work requires a rapid and focused response that often resulted in research that was not always as sophisticated or comprehensive as we would have wished. A computerized municipal data base proved invaluable in analyzing and presenting research results.

REFERENCES

- Bender, Lloyd D., et al. *The Diverse Social and Economic Structure of Nonmetropolitan America*. Washington DC: USDA ERS Res. Rep. 49, Sept. 1985.
- Flynn, Catherine L. *Analysis of Local Aid to Cities and Towns of Massachusetts: 1988*. University of Massachusetts Cooperative Extension report prepared for Legislative Rural Caucus, Amherst MA, Sept. 1987.
- Flynn, Catherine L., and Betty Jean Bouffard. "Rural and Urban Communities: The Public Finance Difference." *Resources and Environment*, ed. J. Foster. Amherst MA: Dept. of Agr. and Res. Econ., University of Massachusetts, July 1986.
- Flynn, Catherine L., et al. *Financial and Demographic Characteristics of Urban and Rural Local Governments in Four Northeast States*. Amherst MA: University of Massachusetts Coop. Ext. Rep. prepared for the Northeast Regional Center for Rural Development, Jan. 1987.
- _____. *Getting and Spending: A Comparison of Rural and Urban Finances in Massachusetts Municipalities*. Amherst MA: University of Massachusetts Coop. Ext. presentation at a hearing of the Massachusetts Legislature's Joint Commission on Local Aid, Oct. 1985.
- Hines, Fred K., et al. *Social and Economic Characteristics of the Population in Metro and Nonmetro Counties*. Washington DC: USDA, ERS AER-272, Mar. 1975.
- Massachusetts Bureau of the Budget. *General Revenue Sharing*. Boston MA: Executive Office of Administration and Finance, Jan. 1986.
- Massachusetts Department of Education. *Technical Manual for Clustering Massachusetts Cities and Towns*. Quincy MA: Kinds of Communities Working Group, Jan. 1986.
- Massachusetts Taxpayers Foundation. *Municipal Financial Data*. Boston MA, 1986.
- Reeder, Richard J. *Rural Governments: Raising Revenues and Feeling the Pressure*. Washington DC: USDA ERS Rural Dev. Res. Rep. 51, July 1985.
- Stocker, Frederick D. *Fiscal Needs and Resources of Nonmetropolitan Communities*. Washington DC: U.S. Senate Committee on Agriculture, Nutrition and Forestry, 12 July 1977.
- U.S. Bureau of the Census. "Finances of Municipal and Township Governments." *Census of Governments*. Washington DC, 1982.
- U.S. Department of the Treasury. *Revenue Sharing 1972-86*. Washington DC: Office of Revenue Sharing, Apr. 1985.