

The Rise and Fall of Local Aid in Massachusetts

by Luc Schuster

MAIN FINDINGS

- Total state aid to cities and towns in Massachusetts—including aid for education and general local aid—has declined by about \$1.7 billion over the last 3 decades, adjusted for economic growth.
- Separating education-related funding from other forms of local aid (for fire, police, parks, etc), we find that education funding is essentially flat while non-education aid has declined.
- Non-education aid has declined by about \$1.3 billion over the last 3 decades, and is currently at its lowest point in 30 years.
- State-level tax cuts have combined with effects of the Great Recession to limit dramatically state spending on local aid, especially since the early 2000s.
- Cities and towns reduced their local revenue contributions to school districts as Chapter 70 aid increased, freeing up resources to be spent on other local services.

LOCAL AID OVERVIEW

The term “local aid” refers to money that flows from the state budget to city and town budgets, helping them fund vital local services such as police and fire protection, parks, and public works. While many discussions of local aid separate state revenue support for K-12 school districts from non-school local aid, here we discuss them all together in order to analyze comprehensively how much state revenue goes to fund local government services.

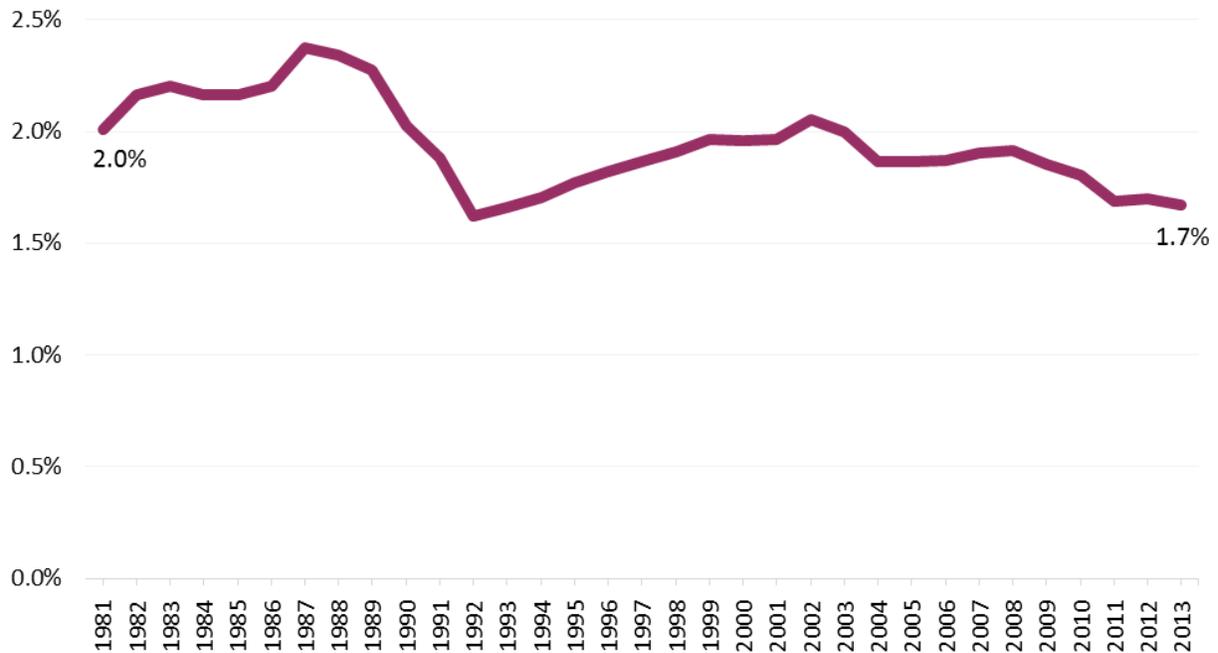
Massachusetts is made up of 351 separate cities and town governments, whose levels of wealth range widely—from low-income gateway cities to high-wealth residential suburbs—and, yet, each of them is charged with providing similar levels of vital public services. The state uses local aid as a mechanism for helping offset inequality of local services that would otherwise exist if these cities and towns primarily funded their budgets with local property tax revenue.

TOTAL LOCAL AID DECLINED SOMEWHAT OVER PAST 30 YEARS

Total local aid to cities, towns, and school districts has declined somewhat over the past 30 years. The graph below looks at total local aid as a percentage of personal income in Massachusetts, a good measure of the size of the state economy. Here we see that today a smaller portion of our economic resources in Massachusetts goes to local aid than it did back in the early 1980s. In fact, if we were dedicating the same share of resources to local aid today as we did back then, cities and towns would be receiving about \$1.7 billion more annually (comparing like periods in the business cycle, FY 1982 funding levels versus FY 2012).

Total Local Aid Spending Declined Somewhat Over Past 30 Years

Total Local Aid as a percent of Massachusetts personal income



When analyzing historical trends, such as over this 30 year horizon, it is most useful to look at spending as a share of our state's total economic resources, as we do throughout most of this paper.¹ Another way to analyze this data, however, could be to adjust spending using a common inflation factor like the Consumer Price Index (CPI).

While CPI-adjusted comparisons can be informative, they don't account for economic growth or population growth. Over the long term, the state economy grows, with population and productivity increasing and total income rising. Historically, many government costs grow at a rate closer to the rate of economic growth. Therefore, when making long term comparisons about the share of our resources that we dedicate to specific goals – such as providing high quality education for all of our children, or local aid to our communities – it is important to adjust for economic growth; that is, to ask

¹ For a more complete explanation of why taxes and/or spending are best measured as a share of State Personal Income (rather than in simple inflation-adjusted dollars or on a per capita basis), please see our factsheet on this topic: http://massbudget.org/report_window.php?loc=Facts_Comparison_Dec_2010.html

Further, it is worth noting that due to issues with the availability of uniform data back to 1981, the measure of personal income used for this paper does not include capital gains income. Ideally, analyses that look at spending as a percentage of personal income include capital gains in order to capture the true level of economic resources available in the Commonwealth. MassBudget analyses generally include capital gains income when feasible.

whether the share of our overall resources being allocated to these goals is increasing or decreasing. That is what we do throughout this paper.²

When we make these comparisons, however, it is important, for technical reasons, to focus on long term trends and to compare comparable points in the business cycles.

Specifically, consumer costs grew by about 3 percent a year over this 30-year period, whereas the overall state economy grew by about 6 percent a year. Looking at the data in CPI-adjusted terms would show total local aid increasing somewhat because it grew more than 3 percent (but less than 6 percent).

THREE PERIODS OF CHANGE OVER LAST 30 YEARS

While spending on local aid as a percent of the economy is down somewhat when compared to 1981 levels, there has been significant variation during the intervening years. The graph below breaks down local aid spending by type, providing a more detailed look at what has transpired.

But, first, here is some detail on each of the spending categories: Chapter 70 Aid and General Local Aid are clearly the largest local aid spending categories. Chapter 70 Aid is the primary source of education support that the state provides to local school districts. General Local Aid is the primary source of general operating support that the state provides to cities and towns. Through FY 2009, the state distributed General Local Aid through two accounts, Lottery Aid and Additional Assistance. Starting in FY 2010 these were combined into Unrestricted General Government Aid.

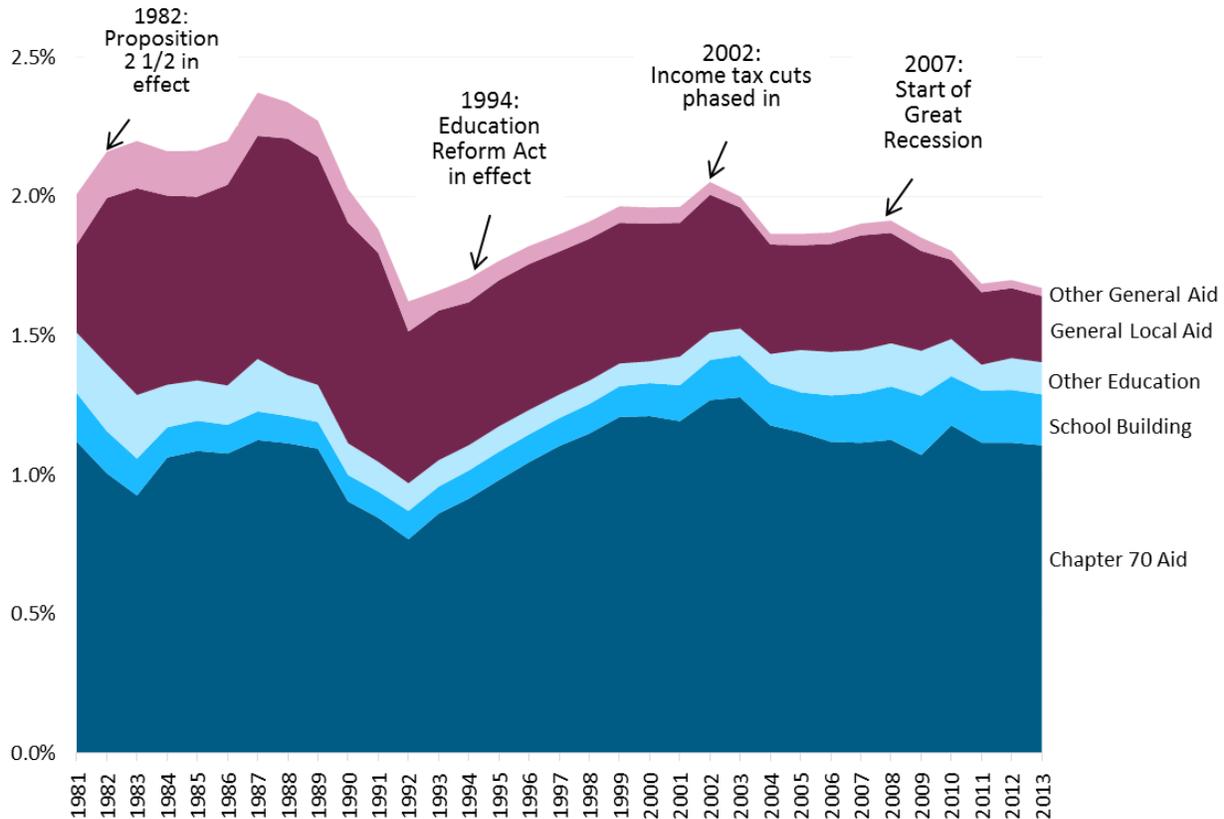
Three other categories of local aid include School Building money, Other Education, and Other General Aid. School Building money helps defray a significant portion of local school district construction and renovation projects. Through FY 2004 this funding was distributed through a few different accounts. Starting in FY 2005 funding for school building was shifted to the School Modernization and Reconstruction Trust Fund (SMART), which is funded through a pre-budget transfer of one out of every 6.25 cents brought in through the state sales tax.

Other Education includes a few smaller programs such as regional special education circuit breaker, school transportation, and school lunch funding. Similarly, Other General Aid is composed of a few smaller programs including library support, a local distribution of racing tax revenue, and revenue offsets for property tax revenue foregone due to exemptions offered to certain types of taxpayers (e.g. veterans and the blind).

² For more information on the effect of rising health insurance and special education costs on school budgets in Massachusetts, see MassBudget's recent report *Cutting Class: Underfunding the Foundation Budget's Core Education Program*, November 2011, available online at: http://www.massbudget.org/report_window.php?loc=Cutting_Class.html

Total Local Aid Has Declined Somewhat Over Past 30 Years

Total Local Aid as a percent of Massachusetts personal income



A few major policy changes have combined with changes in the overall economy to create the shifting local aid trends shown above:

- 1) *Proposition 2 ½*. Passed via voter referendum in 1980, Proposition 2 ½ dramatically constrains the ability of cities and towns to raise revenue through local property taxes.³ In order to help stave off deeper cuts to local services the legislature responded by increasing general local aid significantly during the 1980s. The legislature was able to respond to Proposition 2 ½ through greater local aid spending due in large part to rapid economic growth during the mid-1980s increasing state tax revenues.
- 2) *The Education Reform Act of 1993*. This landmark education law included a major commitment to increase total education aid over 7 years, through the year 2000. This funding increase was coupled with a major redesign of the Chapter 70 formula for distributing education aid to local school districts. The funding increase can be seen clearly in the upward sloping dark blue section of the graph above during the 1990s. Prior to Fiscal Year 1994, the state contributed less money to K-12 education, leaving school districts more heavily dependent on the local property

³ For more information on Proposition 2 ½ see the Property Tax section of MassBudget's *Understanding Our Tax System: A Primer for Active Citizens*, by Kurt Wise and Noah Berger, available online at: http://www.massbudget.org/report_window.php?loc=Tax_Primer_83110.html

tax. The booming economy of the late 1990s aided the legislature in keeping its commitment to increasing this important form of education funding.

- 3) *Income tax cuts.* Over the late 1990s and early 2000s, Massachusetts cut state-level income taxes a few different ways, causing significant revenue declines that resulted in cuts across most state spending categories during the 2000s, including deep cuts to general local aid. The state cut the personal income tax rate from 5.95% to 5.3% (resulting in an annual revenue loss of about \$1.3 billion), cut the dividends & interest tax rate by more than half from 12% to 5.3% (an annual loss of about \$750 million), and expanded the personal exemption (an annual loss of about \$480 million). All told, these large tax cuts along with a few smaller ones, combined with an economic recession in the early 2000s, resulted in an annual loss of about \$3.0 billion in revenue, revenue previously used for funding state and local programs.⁴

Looking at the graph above we see simultaneously the effects of changes in the overall economy and in local aid spending. For this reason, it is important to use like periods in the economic cycle in order to make the most instructive comparisons. Without comparing like periods in the economic cycle, it could appear as though spending changed dramatically when really what change most dramatically was growth or contraction of the overall economy.

GENERAL LOCAL AID⁵

The detailed graph above is useful for seeing the relationship between general local aid and education-related local aid, with one often rising while the other falls, but the graph's fine-grained detail makes it challenging to home in on specific programs. The graph below tracks the same data on local aid spending as a percent of the state economy, but here we focus in on general local aid.⁶ Setting aside education-related aid makes the dramatic changes to general local aid even more clear, showing a sharp increase during the 1980s followed by steady decreases ever since.

⁴ For more information on income tax cuts in Massachusetts, please see Chapter Four: Personal Income Taxes in MassBudget's *Understanding Our Tax System: A Primer for Active Citizens* available online at:

http://massbudget.org/report_window.php?loc=Tax_Primer_83110.html

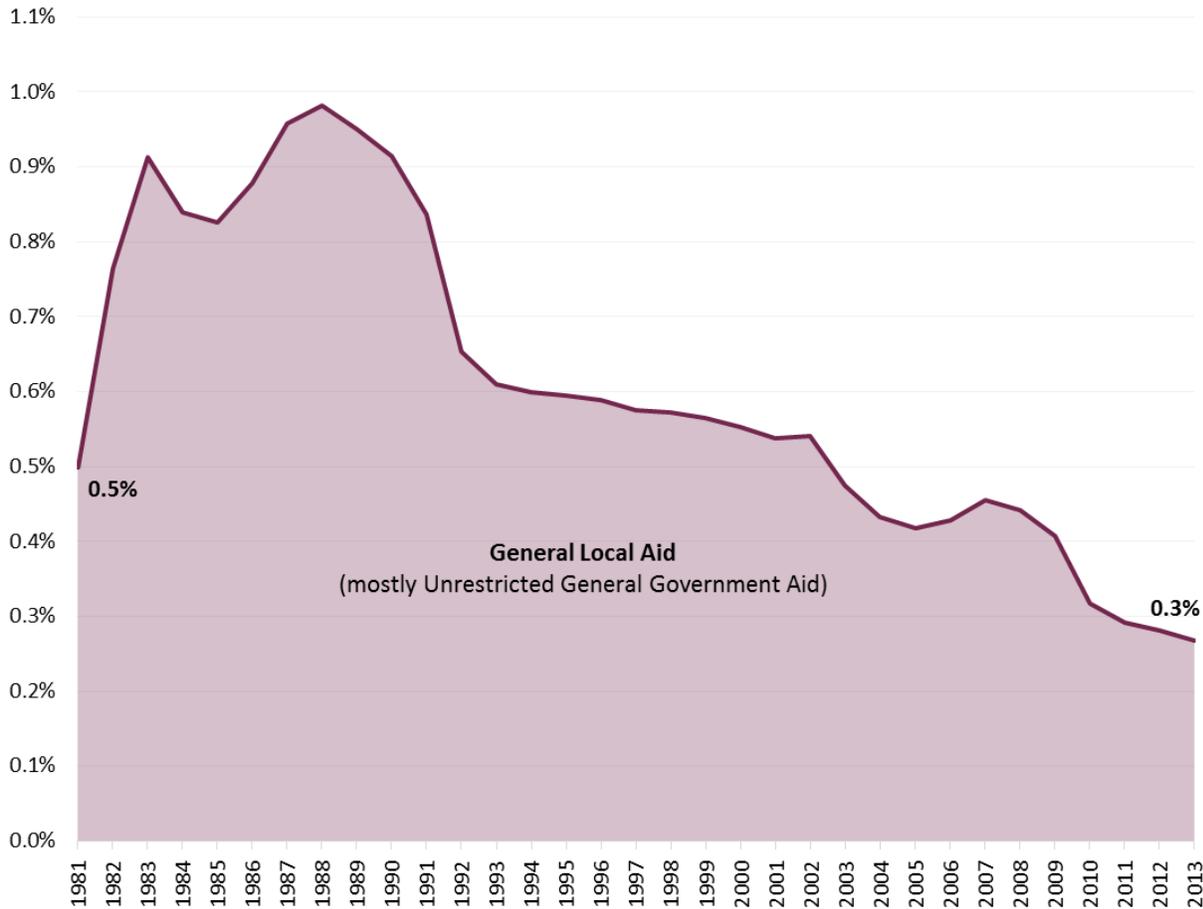
⁵ For this analysis, General Local Aid refers to the sum of Lottery Aid and Additional Assistance from 1981-2009 and the new account that they were consolidated into, Unrestricted General Government Aid (UGGA), starting in 2010.

Other General Aid refers to several much smaller programs that are run by municipal governments with revenue support from the state. These include library funding and revenue support for towns with state owned land that is exempt from the local property tax.

⁶ Prior to FY 2010, the vast majority of general local aid was composed of Lottery Aid and Additional Assistance. Since FY 2010, those two accounts were consolidated into Unrestricted General Government Aid.

General Local Aid Increased During '80s and then Declined Dramatically

General Local Aid as a percent of Massachusetts personal income



If we were dedicating the same level of resources to general local aid today as we did back in the early 1980s, cities and towns would be receiving about \$1.3 billion more annually (comparing like periods in the business cycle, FY 1982-FY 2012).

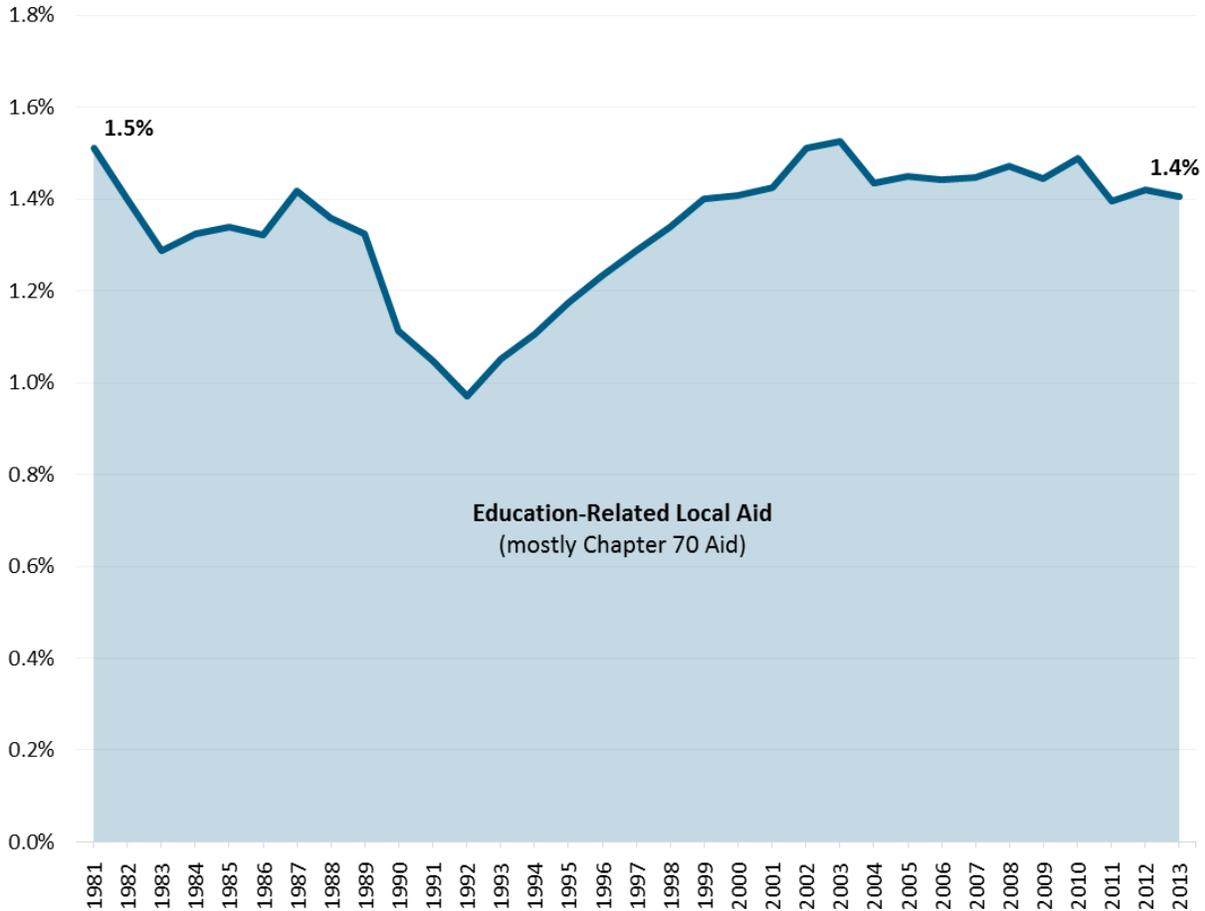
EDUCATION-RELATED LOCAL AID⁷

Finally, the graph below homes in on education-related local aid as a percent of the Massachusetts economy.

⁷"Education-Related Local Aid" refers to those education programs that send state revenue support to local school districts. Chapter 70 aid has historically been by far the largest account in this category, composing 79% of education-related local aid in FY 2013. In addition to Chapter 70 aid, education-related local aid includes School Modernization and Reconstruction Trust Fund money and other education-related local aid programs such as: Special Education Circuit Breaker, School Lunch, and Charter School Tuition Assessment Reimbursement.

After Decrease During '80s, Education Local Aid is Roughly Level with 30 Years Ago

Education-Related Local Aid as a percent of Massachusetts personal income



While General Local Aid saw a reduction from the early 1980's to today (going from 0.6% of the economy in 1982 to 0.3% in 2012), Education Local Aid today is basically equal to 1982 levels (around 1.4% of the economy). Interestingly, however, General Local Aid spending was higher for much of the 1980s and early 1990s, whereas Education Local Aid spending spent much of the 1980s and early 1990s below the 1.5% level. It wasn't until the Education Reform Act of 1993 that education aid, namely Chapter 70 aid, increased dramatically, offsetting cuts of the 1980s. While Chapter 70 aid has remained above its early 1990s level, it has more recently experienced another period of decline starting around 2003.

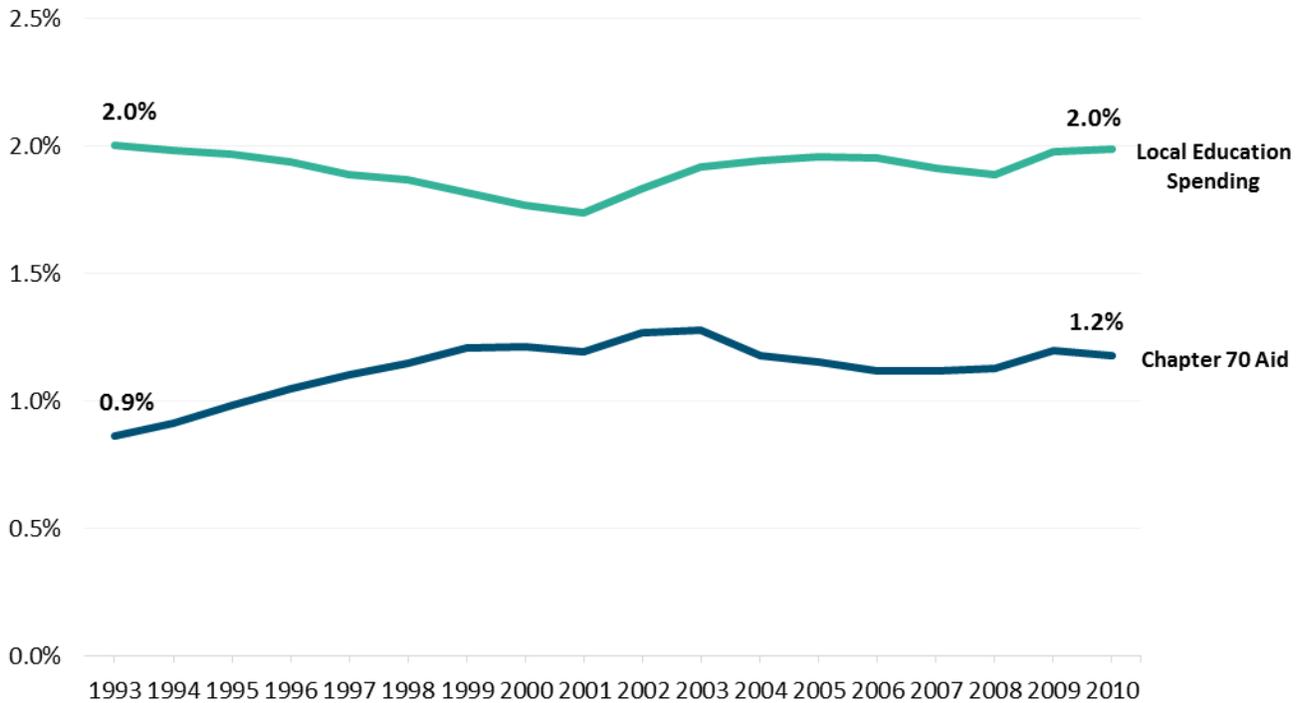
It is important to note that while state education spending composes a significant portion of total local school district revenues, especially in lower-income districts, school districts also receive a significant portion of their revenue from local sources, namely the local property tax. In FY 2009, for instance, 53 percent of school district revenues in Massachusetts came from city or town revenue.⁸ Increasing state aid during the mid to late 1990s allowed many communities to scale back local revenue contributions to their school districts, as demonstrated in the graph below.

⁸ For more information see MassBudget's factsheet *Public School Funding in Massachusetts: Where We Are, What Has Changed, and How We Compare to Other States*, September 1, 2011, available online at:

http://www.massbudget.org/report_window.php?loc=Annual_Census_Education_paper_FY09_data_Sept_2011_release_v04.html

During 1990's Local Education Spending Declined as State Chapter 70 Aid Increased

Local education spending and Chapter 70 aid as a percent of state personal income



The trend of local education spending decreasing as Chapter 70 aid increased is most clear and steady from 1993 through 1999. Since 1999, local education spending has rebounded back to its 1993 level.

Ultimately, cities and towns must use a given amount of revenue, regardless of source, to fund all of their municipal services combined – schools, police and fire protection, road construction and maintenance, etc. Dollars not spent on one program are freed up for spending on another. In the case of the 1990s, cities and towns cut their local education spending as new state revenue became available, allowing total education spending to remain relatively level while also freeing up funds for other local non-school services. This flexibility of revenue sources is part of why it is useful to look at all local aid spending together.