

**NEW ENGLAND: STATE AND LOCAL REVENUE SYSTEMS AND
VULNERABILITY TO RECESSION**

Doug Snow

Suffolk University

New England’s municipal governments are vulnerable to current recessionary pressures on three major fronts. First, municipalities in New England bear the primary financial burden for locally provided services. County governments are either nonexistent or insignificant throughout most of New England, leaving municipalities responsible for assessment and collection of property taxes, including state levied property taxes that are dedicated to the public schools in Vermont and New Hampshire. Municipal governments are also responsible for fiscally dependent school districts, the exceptions being Vermont and some regional districts in Maine. Second, New England’s local governments are heavily dependent on the property tax. Locally imposed property taxes comprise between 42 and 56 percent of local general revenues, except in Vermont, where local property tax reliance is lower than the US total (Table 1). Property tax reliance is even more striking when measured as a percentage of locally raised tax revenue, comprising 94 to 98 percent in the six New England States, compared to a national total of 73 percent.

Table 1. Major Sources of State and Local General Revenue

State	State Government			Local Government		
	Income and General Sales Tax	Federal Aid	Other Taxes and Charges	Property Tax	State Aid	Other Taxes and Charges
Connecticut	45.3%	21%	33%	55.7%	30.1%	14.2%
Maine	31.8%	34%	34%	51.2%	29.9%	19.0%
Massachusetts	39.7%	23%	37%	42.3%	37.1%	20.6%
New Hampshire	1.6%	29%	69%	54.3%	29.7%	16.0%
Rhode Island	30.2%	33%	37%	53.3%	30.4%	16.3%
Vermont	19.5%	29%	52%	16.5%	66.7%	16.8%
United States	34.1%	29%	37%	27.9%	33.9%	38.2%

Note: At the state level, Hew Hampshire relies primarily on selective sales and income taxes, as well as a state levied property tax, all incorporated in the "Other Taxes and Charges" category. Vermont also relies on a state levied property tax as part of the school finance system, which accounts for 18 percent of state general revenue. Source: Author’s calculations from US Census Bureau, Annual Finances of Governments, 2005-06.

With the notable exception of Vermont, which allows a 1 percent local option sales tax, currently adopted by eight communities, local governments have little or no authority to impose additional taxes. Third, with the exception of Vermont and New Hampshire, state aid to local government is financed by elastic tax revenues and directed primarily to the public schools. Municipalities receive little or no state aid for general government services.

ECONOMIC TRENDS AND IMPACT ON REVENUES

All six New England states are experiencing reduced or negative economic growth, higher levels of unemployment, and soft housing markets. Rhode Island has been hit particularly hard. The mortgage crisis struck Rhode Island earlier and with greater severity than in the rest of the US. Rhode Island unemployment by October 2008 was over 9 percent, much higher than the national rate of 6.5 percent.

Table 2. Unemployment Rates for Select Periods

State	January 2004	January 2005	January 2006	January 2007	January 2008	October 2008
Connecticut	5.1	4.9	4.6	4.4	4.8	6.5
Maine	4.7	4.7	4.6	4.5	4.9	5.7
Massachusetts	5.6	5	4.8	4.7	4.5	5.5
New Hampshire	4.2	3.7	3.5	3.7	3.5	4.1
Rhode Island	5.4	5	5.2	4.9	5.7	9.3
Vermont	4.2	3.6	3.7	4	4.2	5.2
United States	5.7	5.2	4.7	4.6	4.9	6.5

Source: US Bureau of Labor Statistics accessed via New England Economic Indicators Data Base, Federal Reserve Bank of Boston.

Table 3. Percent Change in Economic Activity Index

State	% Chg Jan 04 - Jan 05	% Chg Jan 05 - Jan 06	% Chg Jan 06 - Jan 07	% Chg Jan 07 - Jan 08	% Chg Jan 08 - Oct 08
Connecticut	3.6%	3.4%	3.8%	2.1%	-0.2%
Maine	0.5%	0.1%	1.8%	0.2%	-1.3%
Massachusetts	3.0%	2.9%	3.2%	3.8%	0.2%
New Hampshire	4.2%	3.2%	2.8%	3.0%	1.2%
Rhode Island	2.0%	1.1%	4.0%	-1.7%	-3.4%
Vermont	3.1%	1.9%	1.3%	0.8%	-0.5%
United States	3.2%	3.4%	3.0%	2.0%	-0.1%

Source: Federal Reserve Bank of Boston, New England Economic Indicators Data Base. The Economic Activity Index is computed by the Federal Reserve Bank of Philadelphia. 1992 = 100. The Index is comprised of nonfarm payroll employment, average hours worked in manufacturing, the unemployment rate, and wage and salary disbursements, adjusted for inflation.

Foreclosures have been trending steeply upwards since the first quarter of 2005 although, with the exception of Rhode Island, New England foreclosures are below the national rate (Table 4). Following the decline in home sales, housing prices have also declined (Table 5). The Federal Reserve Bank of Boston reports that from the third quarter of 2007 to the third quarter of 2008, home sales dropped 28 percent in Connecticut, 21.5 percent in Maine, 9 percent in Massachusetts, 8 percent in Rhode Island, and 33 percent in Vermont. No data was reported for New Hampshire.

Table 4. Foreclosure Rates for New England (Percentage of Loans with Foreclosure Initiation)

State	1 st Quarter 2005	2 nd Quarter 2008
Connecticut	0.30%	0.70%
Maine	0.30%	0.90%
Massachusetts	0.25%	0.50%
New Hampshire	0.25%	0.70%
Rhode Island	0.25%	1.20%
Vermont	0.20%	0.50%
United States	0.40%	1.10%

Source: Federal Reserve Bank of Boston

Recent press releases and news stories indicate significant revenue shortfalls and budget deficits in all of the New England states. Levels of detail from the states vary, but revenue losses appear to cut across all major state taxes, including those that finance state aid, with the exception of state levied property taxes in New Hampshire and Vermont, which are earmarked for the public schools. General fund “budget gaps” identified by the National Conference of State Legislatures, based on data collected in November and made available in December, are summarized in Table 6. As of this writing, these estimates are far from stable. The Massachusetts budget gap has nearly doubled since the NCSL report was issued.

Table 5. Housing Price Index (Peak Values are Shaded)

State	1 st Qtr 2006	1 st Qtr 2007	1 st Qtr 2008	3 rd Qtr 2008	% Change Peak to 3 rd Qtr 2008
Connecticut	464.56	478.1	475.5	456.2	-4.6%
Maine	491.34	508.19	519.77	513.39	-1.2%
Massachusetts	725.68	715.07	700.7	661.62	-8.8%
New Hampshire	497.88	499.84	495.74	472.47	-5.5%
Rhode Island	592.62	597.83	577.89	532.54	-10.9%
Vermont	439.4	465.64	475.3	468.98	-1.3%
United States	370.53	386.03	385.56	369.42	-4.5%

Source: Office of Federal Housing Enterprise Oversight House Price Index

Dependence on the inelastic property tax will shield New England municipal governments from the worst effects of the fiscal downturn. To the extent that state aid is an equalizing tool, reductions in state aid will hit the least wealthy communities with fiscally dependent school systems the hardest. The New England states appear to be avoiding education aid reductions at present, but, given the size of projected budget gaps, education cutbacks are inevitable. Research indicates that there is a tendency for municipal governments to make up losses in state aid through property tax increases, but this strategy has both political and statutory limits. Citizens of poor communities are unable to afford tax increases. Maine, Rhode Island, and Massachusetts statutes limit the amount by which property tax levies can be increased.

ECONOMIC OUTLOOK

The New England Economic Partnership expects unemployment to peak in 2010 at 10.3 percent in Rhode Island, 8.7 percent in Maine, 8.3 percent in Connecticut and Massachusetts, 6.9 percent in Vermont, and 7.4 percent in New Hampshire. These are rates not seen in New England since 1992. Gains in employment are not expected until after 2011. To date, state governments in New England have been reluctant to draw down rainy day funds and other reserves, although Massachusetts has already tapped its rainy day fund to finance services in both FY 2008 and 2009. Based on the unemployment forecast, it is reasonable to expect state aid to decline or, at the very least, stagnate through Fiscal Year 2012.

While economic conditions in Rhode Island are clearly the worst in New England, the fiscally stressed urban centers of Massachusetts that rely heavily on state aid, and upon whom the public schools are fiscally dependent—such as Worcester, Springfield, Lowell, Lawrence, New Bedford, and Fall River—are arguably the most vulnerable to heavy state revenue losses. Vermont cities that have adopted the local option sales tax—Burlington, Dover, Killington, Manchester, Middlebury, South Burlington, Stratton, and Williston—are also vulnerable. Wealthier cities and towns throughout New England relying almost exclusively on property taxes are the least vulnerable, although citizens in those communities are likely to become more sensitive to their property tax burdens as their property values decline and household members lose jobs.

REFERENCES

Clifford, Robert (2008, June). *Financing Municipalities in New England: Revisiting the State-Local Relationship*, New England Public Policy Center Conference Report 07-1. Federal Reserve Bank of Boston.

Dye, Richard F. and Andrew Reschovsky (2008). Property Tax Responses to State Aid Cuts in the Recent Fiscal Crisis. *Public Budgeting and Finance*, 28 (2): 87-111.

Federal Reserve Bank of Boston, *New England Economic Indicators*. Available: www.bos.frb.org.

Federal Reserve Bank of Boston, *Monthly Economic Update*, December 2008. Available: www.bos.frb.org.

Hoene, Christopher and Michael Pagano (2008). *Cities and State Fiscal Structure*. Washington, DC: National League of Cities Research Report on America's Cities.

Huff, C. (2008, March), *Point of Reckoning: Two Decades of State Budget Trends*, Massachusetts Institute for a New Commonwealth Policy Brief.

New England Economic Partnership, *Significant Recession Anticipated Across New England; Slow, Weak Recovery To Follow*, Press Release, November 20, 2008.

Office of Federal Housing Enterprise Oversight House Price Index. Available: www.ofheo.gov.

Tannenwald, Robert (2001). Are State and Local Revenue Systems Becoming Obsolete? *New England Economic Review* (4): 27-43.

U.S. Census Bureau, Annual Finances of Governments, 2005-06. Available: www.census.gov.

Zhao, Bo and Katharine Bradbury (2007), *Measuring Non-School Fiscal Imbalances Of New England Municipalities*, New England Public Policy Center Policy Brief No. 07-6. Federal Reserve Bank of Boston.