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HIDDEN CONSEQUENCES: LESSONS FROM MASSACHUSETTS FOR STATES CONSIDERING A PROPERTY TAX CAP

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Executive Summary

In 1980 Massachusetts voters approved Proposition 2 ½, which mandates that property tax revenues not exceed 2.5 percent of a community's assessed value and that a community's property tax revenue not grow by more than 2.5 percent a year. (See box on p. 4.)

Over the two and a half decades Proposition 2 ½ has been in effect, Massachusetts' level of property taxation has declined. Between 1980 and 1985, property taxes as a percentage of income fell from 76 percent above the national average to 13 percent above the national average, where it stands today.[1] (Massachusetts localities rely more on the property tax than localities in much of the rest of the country because they are not permitted to levy sales or income taxes or various other forms of taxes. (See Figure 1.)

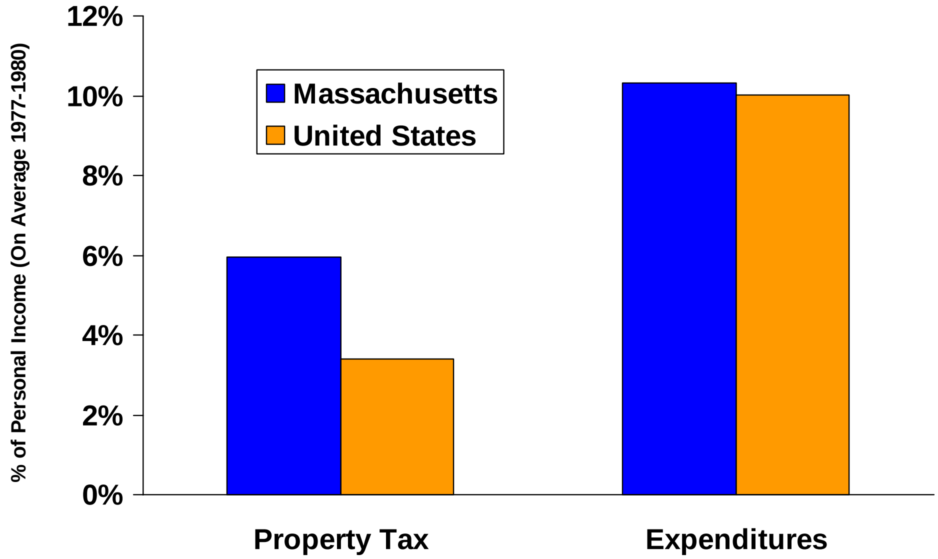
Because Proposition 2 ½ lowered property taxation in Massachusetts, advocates of limited taxation often cite it as a model for reform. But the story is far more complicated than that. State aid has helped fill in some of the gaps in local funding the law created, but not all of them and not reliably over time. Furthermore, the local "overspending" that proponents claimed Proposition 2 ½ could curb did not exist in the imagined quantities, and necessary public services have been jeopardized.

By limiting Massachusetts localities' only major source of revenue, Proposition 2 ½ has exacted a considerable cost — one that highlights the shortcomings of property tax revenue caps as a policy approach. The law has:

- arbitrarily constrained local governments' ability to raise revenues without any consideration of the actual cost of providing services;
- made local governments heavily dependent on state aid, which tends to fluctuate with economic cycles and state policies (a particular problem in an economic downturn when state aid usually declines but the need for local services such as education and fire and police protection does not decline);

FIGURE 1

Prior to Proposition 2 1/2 Massachusetts' Property Taxes Far Exceeded the National Average But Its Local Government Spending Did Not



Source: Census Bureau Data from State & Local Government Finance Data Query System. http://www.taxpolicycenter.org/slf-dqs/pages.cfm. The Urban Institute-Brookings Institution Tax Policy Center.

- exacerbated disparities between wealthier communities and poorer ones in access to quality local services, as many of the former have voted to override Proposition 2 ½'s revenue cap while the latter have generally had to adhere to it; and

- resulted in cuts to valued services rather than simply calling forth greater efficiency from local governments.

Across Massachusetts, a number of communities have been forced to lay off teachers, police officers, firefighters, and other public employees; close fire stations; shut libraries, senior centers, and recreation centers or sharply reduce their hours; and scale back public school programs. One town even turned off its street lights to save money.

The Massachusetts experience can provide lessons about the potential effects of a property tax cap for other states that are considering similar measures. This report looks at the Massachusetts experience and gleans the following lessons.

- **A tax cap won't make government services cost less.** A cap does not prevent employee health insurance costs, special education costs, or other costs beyond localities' control from rising much faster than the cap allows. Nor does it hold down the cost of heating buildings, buying gas for police and fire vehicles, and operating schools buses when the world price of oil is skyrocketing. When these things occur, as they have in Massachusetts, other services have to be cut to fit total expenditures under the cap.

- **Claims that caps will produce large savings through "efficiencies" are overblown.** There are fewer efficiencies to realize from squeezing down revenues than cap proponents generally suggest. One person's "efficiency savings," such as the elimination of a police or fire station, may represent the loss of a critical service for another person. Ultimately, a property tax cap is highly likely to lead to reductions in basic community services and a deterioration in the quality of life in many communities — particularly in communities that cannot routinely override it.

- **Tax caps can be particularly harmful if adopted during a weak economy.** Proposition 2 ½ took effect during a period of extraordinary economic growth — the "Massachusetts Miracle." State revenues were rising, which allowed the state to boost aid to compensate for constrained property taxes, and construction was expanding, which allowed communities to raise their property tax revenue by more than 2.5 percent per year.

  If a state were to adopt a property tax cap during an economic slowdown or a period of weak state revenue growth, a major sustained infusion of state aid would not be possible and property tax revenue growth would be more constrained. As a result, schools and other services dependent on the property tax would have to be cut much more severely than in Massachusetts.

- **State aid can't be relied upon to fill the gap.** Even when state policymakers fully intend to expand state aid to fill local funding gaps created by a cap, a recession or fiscal crisis will usually derail this plan. State aid to localities in Massachusetts has fluctuated greatly with the business cycle and with state policy decisions. In any other state that might implement a cap, local government and school budgets are likely to become more volatile.

- **Changes in school enrollment can have a big impact.** The adoption of Proposition 2 ½ coincided with a decline in Massachusetts' K-12 enrollment, allowing schools to operate with less revenue.

  If another state adopted a property tax cap during a period of steady or rising enrollment, it would be forced to impose much more extensive cutbacks in teachers, classes, and programs than those seen in Massachusetts.

- **Without effectively targeted state aid, low-income communities will fall even further behind.** Massachusetts has a highly targeted system of aiding local governments. The influx of state aid seems to have shielded low-income communities somewhat from Proposition 2 ½'s tendency to exacerbate differences in services between high- and low-income communities. But when state aid has receded as a result of economic downturns or state policy decisions, the poorest communities have had to make the largest budget cuts.

  In states that do not have a system of school aid that is targeted as effectively as Massachusetts', students in low-income communities are likely to fall increasingly behind students in schools that have greater resources.

- **Wealthier communities will override a tax cap more frequently than poorer ones.** This has contributed to a growing spending gap between local governments in high-income communities and all other communities, despite Massachusetts' progressive system of state aid. This is likely to occur in other states that implement a cap.

The Basics of Proposition 2 ½

Proposition 2 ½ sets two kinds of restrictions on the amount of property taxes that a local government can collect: a levy ceiling and a levy limit.

Levy Ceiling: The levy ceiling limits property tax collections to 2.5 percent of the assessed value of a community's property.[1]

Levy Limit: Proposition 2 ½ set a property tax limit for each community in fiscal year 1982 equal to the lesser of a community's actual property taxes or 2.5 percent of the community's assessed value.[2] This "levy limit" grows by 2.5 percent per year.

Proposition 2 ½ allows communities to adjust their levy limit upward to account for "new growth": increases in the tax base that are not the result of revaluation. Such increases can result from the development of new properties, changes in assessed value that result from the renovation or expansion of existing properties, reclassification of properties that were previously exempt from taxation, or the conversion of existing properties into condominiums or new subdivisions.

A community taxing below its levy limit can increase its property tax collections to the limit at any time. The levy limit cannot exceed the levy ceiling.

A community's residents can chose to permanently increase, or override, their levy limit through a majority vote.

Capital Outlay and Debt Exclusions: A community may vote to temporarily exceed its levy limit or levy ceiling for the payment of certain capital expenditures or debt service costs.[3]

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[1] "Levy Limits: A Primer on Proposition 2 ½," Massachusetts Department of Revenue, Division of Local Services, Revised June 2005, p. 4.
[2] David M. Cutler, Douglas W. Elmendorf, and Richard Zeckhauser, "Restraining the Leviathan: Property Tax Limitation in Massachusetts," National Bureau of Economic Research Working Paper, August 1997, pp 4-5.
[3] "Levy Limits: A Primer on Proposition 2 ½."

- **Middle-income communities might end up bearing the brunt of a cap.** In Massachusetts, budgets in middle-income communities grew more slowly than budgets in *either* low-income or high-income communities because they did not receive as much state aid as the former or override Proposition 2 ½ as often as the latter.

Proposition 2 ½ is a structurally flawed policy that has significantly eroded local services in Massachusetts despite a number of factors that have mitigated its impact. Massachusetts had the benefit of an unusually strong economy, declining school enrollment, and a system of effectively targeted school aid. Proposition 2 ½ nevertheless has had negative results for the provision of quality public services in Massachusetts. Other states that attempt to impose a similar tax cap without the benefit of Massachusetts' mitigating factors are likely to face even worse consequences.

Proposition 2 ½ Arbitrarily Limits Local Revenues

Proposition 2 ½'s fixed revenue growth limit is wholly arbitrary. It has no relationship to any changes in demographics a locality may be experiencing (aside from growth due to new construction) and no relationship to the growth in cost of specific goods or services local governments must purchase.

Indeed, it would be surprising if a fixed growth figure chosen at single point in time would be appropriate several decades later. Instead, many Massachusetts localities are experiencing cost increases beyond their control that far exceed their annual property tax growth threshold.

Health care costs provide a case in point. Rapid growth in employee health care costs has had a marked impact on public- and private-sector employers across the country in recent years. Health care premiums grew by an average annual rate of 10.2 percent between 2000 and 2007, according to a national survey by the Kaiser Family Foundation and the Health Research and Educational Trust. This was more than *triple* the average annual rate of inflation (2.7 percent) and the average annual growth in workers' earnings (3.1 percent) during that time.[2]

Massachusetts local governments, too, are facing rapid growth in health care costs.

- Municipal health care costs grew by 13 percent annually between fiscal years 2001 and 2006, according to a study by the Massachusetts Taxpayers' Foundation and the Boston Municipal Research Bureau.[3]

- Another study found that between fiscal years 2001 and 2005, the increase in health care costs consumed 80 percent of the entire property tax revenue increase allowed under Proposition 2 ½.[4]

- Between fiscal years 2001 and 2005, health care costs increased from 7.4 percent to 10.6 percent of municipal budgets in Massachusetts. That percentage was projected to grow to 15 percent within four years.[5]

In other words, to accommodate rising employee health care costs under Proposition 2 ½, localities had to cut other costs or services and hold still others to a growth rate of much less than 2.5 percent.

No local government can control health care costs by itself. Efforts are underway in Massachusetts to try to contain municipal health expenditures through pooling and thereby creating larger insurance groups, but even major systemic reforms would be unlikely to contain costs below the threshold stipulated by Proposition 2 ½.

One leading reform approach is to encourage municipalities to join Massachusetts' Group Insurance Commission (GIC), the health insurance system for state employees. The state recently enacted legislation allowing municipalities to participate in the GIC. Proponents argue that the GIC has greater administrative flexibility and bargaining power than individual local governments, which allow it to attain cost savings. Yet while the GIC has had a slower rate of cost growth than local governments, that growth rate was still 8.1 percent annually between 2001 and 2006. Even if municipal governments join the GIC and their annual rate of health care cost growth slows to this 8.1 percent rate, health care costs would still rise to 15 percent of municipal budgets by 2018, according to the Massachusetts Taxpayers' Foundation and the Boston Municipal Research Bureau.[6]

Special education costs have also been rising rapidly in recent years, continuing a longer-term trend. The Individuals with Disabilities Education Act requires states and localities to provide free, appropriate public education to children with disabilities. When the law was enacted, the federal government promised it would fund 40 percent of the additional costs the law requires states to incur. Yet the federal government has never come close to fulfilling this commitment, so localities in all states have had to significantly boost their own expenditures to compensate.

In Massachusetts, special education costs grew 53 percent between 1990 and 1999, an average annual rate of 4.8 percent. As a result, they consumed an increasing percentage of school budgets, rising from 17 percent to almost 20 percent of school district expenditures.[7]

These trends have continued into the new millennium.

- A study by the Massachusetts Department of Education found that special education costs have increased by 28 percent between 2002 and 2006, an average annual rate of 6.4 percent. This can be a particular problem for smaller districts, which can experience large swings in their budgets with the enrollment of additional special education students.

- Out-of-district special education tuition costs have grown especially rapidly, increasing by 39 percent over the same time frame, an average annual rate of 8.6 percent. [8] (Special education students are educated out of district when their home district cannot accommodate their needs. These students typically have especially severe or less common disabilities.)

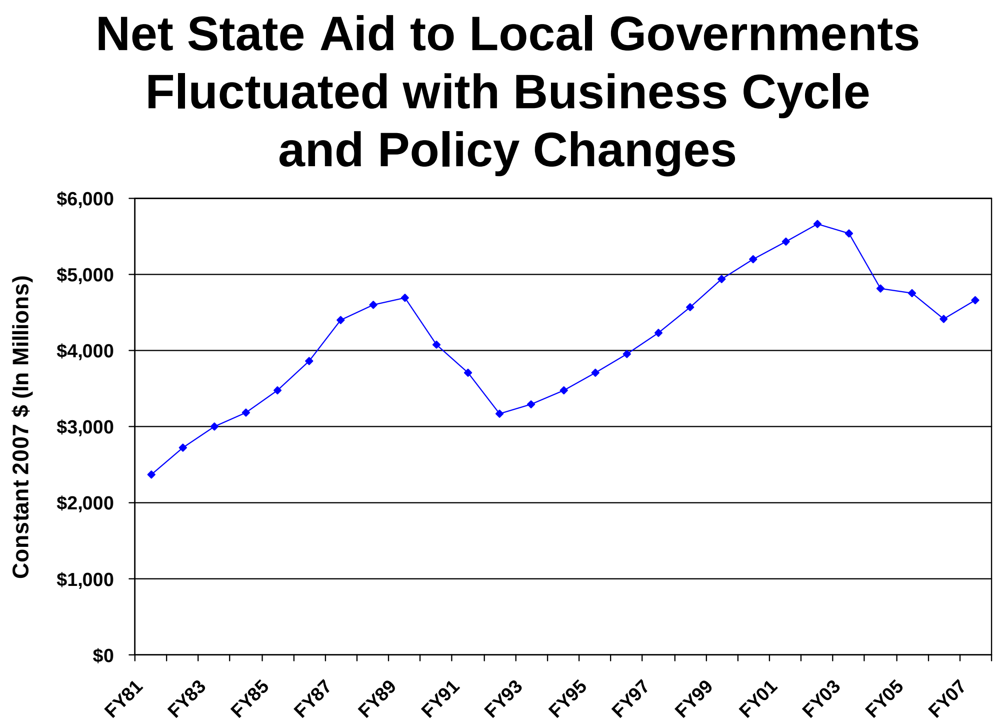
- During this period, payments to out-of-district schools made up an increasing fraction of school district budgets, rising from 6.9 percent to 8.4 percent of total operating expenditures.[9]

- To address this problem, Massachusetts adopted a circuit breaker program in fiscal year 2004 that reimburses school districts for up to 75 percent of their special education costs that exceed a certain threshold ($31,616 in fiscal year 2006). This level of reimbursement, however, depends upon the amount of available funds and is insufficient to fully offset growing special education cost pressures.[10]

The surge in special education costs is arguably largely beyond school districts' control. Since 1980 there has been a marked increase in the survival rates of premature babies, a large percentage of whom manifest lifelong developmental and neurological problems, according to a 2001 Massachusetts study.[11] This may help account for the increased enrollment of students with severe disabilities.

Also raising special education costs, according to the study, are the growing number of students with epilepsy and autism who are able to function in school and the shift in responsibility for educating special education students from state-run institutions to local schools. Finally, the study contends that young children living in poverty or under fiscal stress are more likely to develop special needs; increases in poverty can therefore contribute to mounting special education costs.

FIGURE 2



Note: Massachusetts Department of Revenue Data. Adjusted for inflation using CPI-U.

While the precise impact of each of these factors remains uncertain, they clearly play a significant role in the growth of special education expenses.

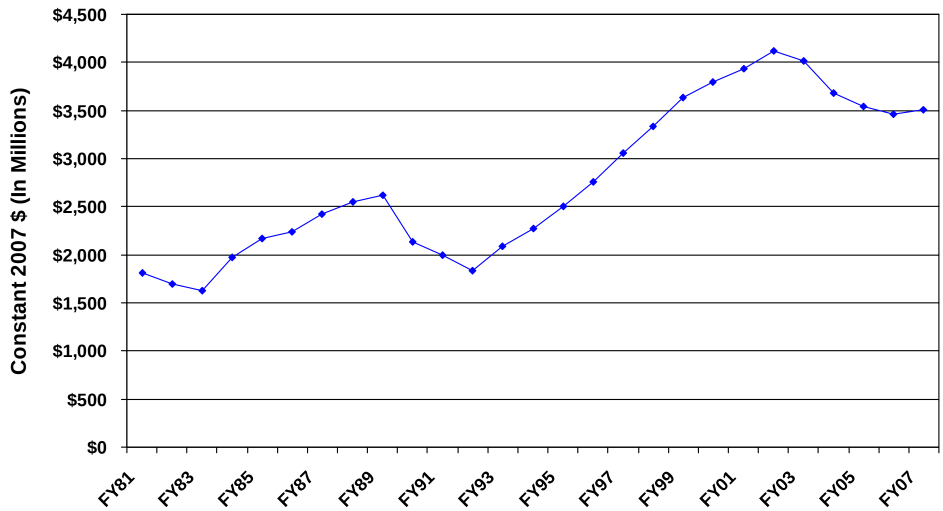
Recently, escalating health insurance and special education costs have started crowding out other municipal priorities. Between 2002 and 2006, for example the percentage of school district operating budgets devoted to teachers' salaries fell from 40.3 percent to 36.8 percent, professional development spending fell from 2.2 percent to 1.6 percent, and instructional materials and equipment fell from 3.7 percent to 3.0 percent.[12] Under Proposition 2 ½, school districts and other local governments facing rising costs have few alternatives unless they can convince voters to approve an override or state assistance increases sufficiently to accommodate the increase in costs.

Proposition 2 ½ Makes Local Governments Overly Reliant Upon State Aid

Since Proposition 2 ½ does not keep pace with many of the cost pressures local governments face, it has forced localities to look to the state for assistance in balancing their budgets. State aid has helped local governments avoid some of the most sweeping service cuts the law might have required. But state aid, unlike the property tax, can be a highly volatile revenue source. It fluctuates considerably with economic cycles, leaving local services at the mercy of changes in the economy and state policy.

FIGURE 3

Education Aid Increased with Reform, then Declined



Source: Massachusetts Department of Revenue Data. Adjusted for inflation using Implicit Price Deflator for State and Local Governments.

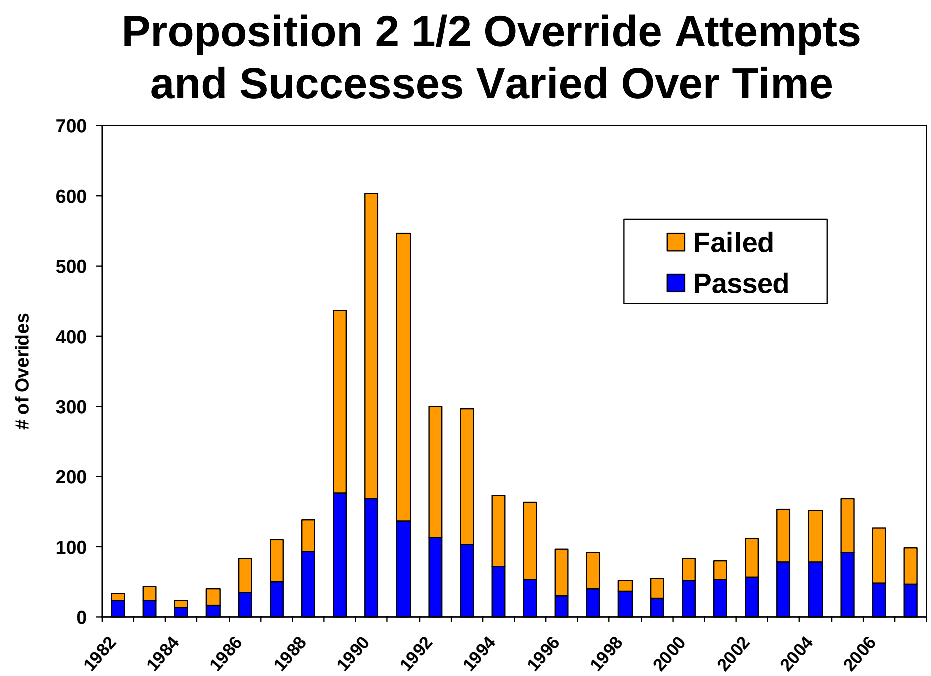
State aid levels under Proposition 2 ½ have largely reflected Massachusetts' economic condition. An infusion of state aid followed the imposition of Proposition 2 ½ in the early 1980s, and aid continued to grow through most of the 1980s as the state's economy flourished. But when the economy began to sour at the end of the 1980s, aid levels suddenly declined. Real net aid dropped at a rate of 12.3 percent per year between 1989 and 1992.[13] (See Figure 2.)

In 1993, Massachusetts revamped its system of education finance and provided additional state aid for education. As a result of the new reform law and the strong economic growth of the 1990s, real net state aid grew at an annual rate of 6 percent between 1992 and 2002. Much of this growth was earmarked for education. The reform law, however, could not insulate education aid from the impact of subsequent economic downturns. When the economy slowed again in 2002, aid again fell sharply.[14] It rebounded somewhat in the last recovery but remains only at 1999 levels (after adjusting for inflation). And the state now faces the prospect of another recession.[15]

The stagnation of state education aid comes at a time when Massachusetts school districts are facing increasing challenges. The percentage of low-income students and English-language learners in Massachusetts schools has increased over the past several years. These students are more likely to require additional educational services than other students.[16] Moreover, state and federal requirements demand that schools bring increasing numbers of students to academic proficiency.

These pressures, along with the cost of health insurance and special education discussed above, have forced up the cost of educating a student today relative to a decade ago. Yet state education aid is barely higher than it was a decade ago, after adjusting for inflation,[17] and has not reflected the increase in the cost of educating students. (See Figure 3.)

FIGURE 4



Source: Massachusetts Department of Revenue Data.

When local governments in Massachusetts face declines in state aid, they have few options for maintaining service levels. Moreover, those options are of limited effectiveness. During the recession of the late 1980s and early 1990s, localities generally raised property taxes to the legal limit.[18] They then attempted an unprecedented number of overrides. But the success rate of these overrides was modest and quickly declined from 40 percent in 1989 to 25 percent in 1991. When the economy is in a slump and people are worried about their jobs and incomes, they are not likely to vote to increase their taxes, even though those are the times when strong public services are most needed.

Since 2002, the number of override attempts has again increased, though it is nowhere near the levels of the early 1990s, and the success rate has declined in the past two years. (See Figure 4.) The pattern of decline in override success rates suggests that voters may tire of repeated override attempts — or may simply reflect a weakening economy. Overall, between 1982 and 2007, only about 40 percent of all override attempts passed.[19]

Local governments now face an extremely difficult budgetary challenge: mounting cost pressures at a time when state aid is depressed and is unlikely to soon recover. Under these circumstances, local governments have little recourse aside from cutting needed services.

TABLE 1: BUDGET GROWTH LOWEST IN MIDDLE-INCOME COMMUNITIES, BUT LOW-INCOME COMMUNITIES' BUDGETS DECLINED MOST IN RECESSIONS Average Annual Change In Local Budgets (Constant Dollar, Per Capita, By Income Quintile)			
Per Capital Income	**1981-2004**	**1989-1992**	**2002-2004**
Lowest 5th	1.4%	-2.9%	-1.9%
Second 5th	1.0%	-2.3%	-1.1%
Third 5th	1.0%	-1.9%	-0.7%
Fourth 5th	1.2%	-0.6%	0.6%
Highest 5th	1.5%	-0.5%	1.8%

Note: Table Excludes Boston
Source: "Local Communities at Risk," Municipal Finance Task Force, 2005

Proposition 2 ½ Exacerbates Disparities in Access to Quality Local Services

Proposition 2 ½ does not constrain all local governments equally. The wealthiest communities have had more success in passing overrides and avoiding service cuts than communities of more modest means.

The Municipal Finance Task Force of the Boston Metropolitan Mayors Commission found that between 1981 and 2004, the highest rate of budget growth was in the quintile of Massachusetts communities with the highest per-capita incomes. Surprisingly, governments in the *lowest*-income quintile had the second-highest rate of budget growth, while budget growth was slowest among communities in the middle of the income spectrum.[20] (See Table 1.)

There are several factors behind this seemingly anomalous pattern:

- The lowest quintile of communities had the fastest growth in state aid over the 1981-2004 period.[21] Massachusetts' aid to local governments is strongly targeted toward the lowest-income communities. (It is worth noting, however, that these communities' high dependence on state aid results in major swings in their ability to provide services. During the 1989-1992 and 2002-2004 periods, the lowest-income communities were forced to cut their budgets by a larger amount than any other quintile in major part because of reductions in state aid.)

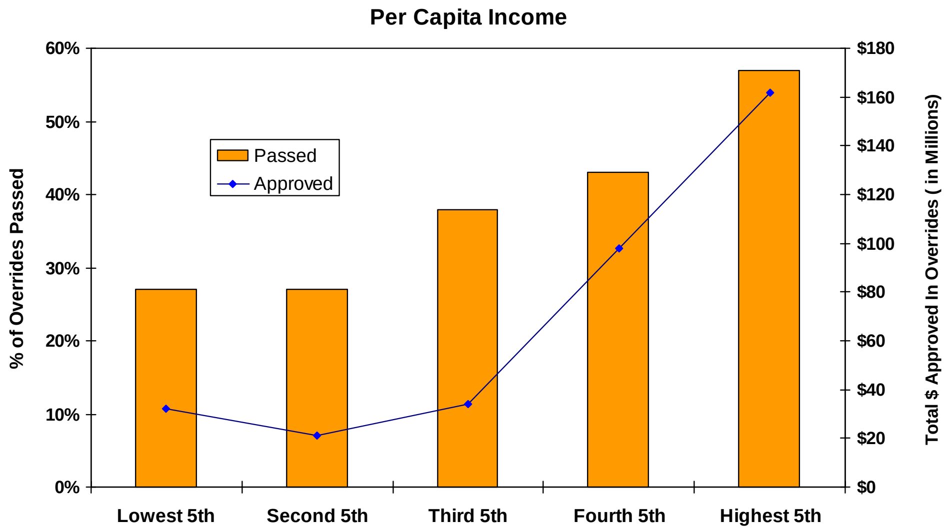
- Communities in the highest quintile were able to maintain the highest rate of budget growth because they overrode Proposition 2 ½ at rates far higher than other communities.[22] (See Figure 5.)

- Communities in the middle quintile benefited neither from high levels of state aid nor from relatively high success rates in override attempts. As a result, their budget growth lagged behind that of wealthier and poorer communities.[23]

  Although data on services is far more elusive than data on budgets, services may have suffered the most in middle-income communities as well. A recent article in the magazine *CommonWealth*

FIGURE 5

Higher Income Communities Had a Higher Override Success Rate, Approved a Much Larger Amount of $ (Fiscal Year 1983-Fiscal Year 2004)



Note: Table Excludes Boston Which Has Never Attempted an Override
Source: "Local Communities at Risk," Municipal Finance Task Force, 2005

noted that fiscal problems "are not just hitting struggling older cities, but are increasingly finding their way to middle-class suburbs. Today's communities on the edge are … places where libraries and pools were never regarded as perks, but as time-honored touchstones of community life."[24]

Proposition 2 ½ worsens disparities in local government resources along other demographic lines as well. Some researchers have observed that smaller communities are more likely to pass overrides than larger communities, possibly because they are more homogenous[25], or because smaller communities have a greater sense of common purpose. Communities with more school-age children are more likely to pass overrides than those with fewer families.[26]

Moreover, economic research has found that families with school-age children tend to move to communities that are less constrained by Proposition 2 ½'s revenue cap.[27] Thus, Proposition 2 ½ may sort voters in a way that increases the concentration of override supporters in particular communities, producing even greater disparities in local services. This could be a major problem for families living in communities that are unwilling to support a decent quality of education if the families lack the resources to move.

In sum, Proposition 2 ½ increases the likelihood that an individual's access to local government resources, such as an adequately funded education, would be determined by her household wealth and the kind of community she inhabits.

Proposition 2 ½ Leads to Cuts in Valued Services, Not Just Greater Efficiencies

Voters who supported Proposition 2 ½ believed it would make government more efficient and would not entail major service cuts.[28] Even today, proponents argue that it provides incentives for local governments to prioritize and restrain spending.[29] Evidence suggests, however, that Proposition 2 ½ has achieved "savings" primarily through a decline in key local services, not through sweeping new efficiencies.

Prior to Proposition 2 ½, Massachusetts property taxes relative to income were high — 75 percent above the national average for the 1977-1980 period — but as mentioned earlier, this was because local governments did not have the option of imposing sales or income taxes.[30] *Expenditures* prior to Proposition 2 ½ were *not* high. In the 1977-1980 period, local government expenditures as a percentage of income were only 3 percent above the national average.[31]

Property tax revenue dropped sharply in Massachusetts' first few years under Proposition 2 ½, but several factors mitigated the need for severe service cuts during this period.

- **Infusion of state aid.** For fiscal year 1982, the state provided a 22 percent increase in additional net local assistance.[32] Massachusetts was able to maintain high levels of aid through most of the decade because its economy was growing (the "Massachusetts Miracle") and state fiscal conditions were strong.

- **New construction.** The surge in economic growth in the 1980s also precipitated new construction, which added value to property tax rolls and provided communities with additional leeway under their property tax caps.

- **Decline in student enrollment.** Between school years 1980 and 1989 the number of K-12 students in Massachusetts fell by 21 percent, reducing school costs.[33] And because the enrollment decline was a continuation of an earlier trend,[34] schools were likely better positioned to consolidate services when Proposition 2 ½ took effect than they otherwise would have been.

- **Property revaluations.** When Proposition 2 ½ was passed, communities that had not recently updated the assessed value of the properties within their boundaries to reflect their actual market values could revalue them. This allowed these communities to raise more revenue with lower tax rates.

- **Cuts in public workforce.** Many communities imposed a hiring freeze, attempting to thin their workforce through attrition; others laid off employees.[35]

Unfortunately, these factors were only temporary, and they did not eliminate the need for cuts in critical services to conform to Proposition 2 ½'s revenue cap.

A 1997 study by economists at the Federal Reserve Bank of Boston, Columbia Business School, and Wellesley College concluded that Proposition 2 ½ has led local governments to *underfund* local services. If the law merely prevents local governments from overspending, the economists reasoned, towns that conform to their revenue cap should see their home values increase faster than towns that do not conform to the cap. In fact, however, the opposite has occurred: *home prices have* *risen fastest in communities that increased their spending beyond the cap.*[36] This suggests that the additional spending provides services that make a community a more valuable place to live — and that the value of those services exceeds the cost of the taxes needed to pay for them.

Considerable anecdotal evidence also indicates that Proposition 2 ½ has led to a significant decline in valued services. Most of the following examples took place during a period of economic prosperity; if the current economic slowdown continues, there are likely to be many more.

- After an override failed in Chelmsford in April 2008 the town was expected to close an elementary school and fire station and lay off four firefighters, two police officers, and 14 teachers.[37]
- Bridgewater severely cut its library budget after an override failed in the fall of 2007, reducing its hours of operation from 52 to 15 hours per week.[38]
- After a series of overrides failed in Tyngsborough in fiscal years 2006 and 2007, town employees received a 10 percent pay cut and a 10 percent reduction in their working hours. The town also eliminated two police officer positions, cut the highway department budget, and depleted its reserve funds.[39]
- After an override failed in 2007, Newburyport eliminated middle school foreign language programs and roughly a dozen teaching positions.[40]
- Saugus closed its library after an override failed in 2007.[41]
- After an override failed in 2007, Ashland's school board approved a plan to fill teaching vacancies with inexperienced teachers in order to save money.[42]
- When an override failed in Lexington in 2006, the town eliminated 31 teaching positions and the elementary school Spanish program[43] and instituted fees for the elementary school instrumental music program.[44]
- A failed 2007 override in Northbridge forced the town to lay off six of its nine library employees and scale back the library's hours of operation to 12 hours a week.[45]
- When an override failed in Hampden in 2005, the town closed its library, senior center, and recreation department — and even shut off all of its street lights.[46]
- Gloucester shut down operations at two full-time fire stations almost entirely following a failed override in 2004. Two years later, a woman who lived just one mile from one of the understaffed stations died in a fire; it took firefighters 11 minutes to reach her because the nearby station was closed at the time of the fire.[47]
- After a marked decline in state aid and a series of failed overrides, Randolph eliminated two elementary schools, nearly all busing, over 60 classroom teachers, and almost all freshman and junior varsity sports. During this period the academic performance of the district's students declined markedly. Only when the state threatened to take control of the district did local voters approve an override.[48]

These examples vividly demonstrate that Proposition 2 ½ did not simply streamline bloated local governments. Rather, it forced cuts in valued local services.

Conclusion: Lessons for Other States

Other states considering property tax limitations like Proposition 2 ½ can draw the following lessons from the Massachusetts experience:

1. **A tax cap won't make government services cost less.** A cap does not prevent employee health insurance costs, special education costs, or other costs beyond localities' control from rising much faster than the cap allows. Nor does it hold down the cost of heating buildings, buying gas for police and fire vehicles, and operating schools buses when the world price of oil is skyrocketing. When these things occur, as they have in Massachusetts, other services have to be cut to fit total expenditures under the cap.

2. **Claims that caps will produce large savings through "efficiencies" are overblown.** There are fewer efficiencies to realize from squeezing down revenues than cap proponents generally suggest. One person's "efficiency savings," such as the elimination of a police or fire station, may represent the loss of a critical service for another person. Ultimately, a property tax cap is highly likely to lead to reductions in basic community services and a deterioration in the quality of life in many communities — particularly in communities that cannot routinely override it.

3. **Tax caps can be particularly harmful if adopted during a weak economy.** Proposition 2 ½ took effect during a period of extraordinary economic growth — the "Massachusetts Miracle." State revenues were rising, which allowed the state to boost aid to compensate for constrained property taxes, and construction was expanding, which allowed communities to raise their property tax revenue by more than 2.5 percent per year.

   If a state were to adopt a property tax cap during an economic slowdown or a period of weak state revenue growth, a major sustained infusion of state aid would not be possible and property tax revenue growth would be more constrained. As a result, schools and other services dependent on the property tax would have to be cut much more severely than in Massachusetts.

4. **State aid can't be relied upon to fill the gap.** Even when state policymakers fully intend to expand state aid to fill local funding gaps created by a cap, a recession or fiscal crisis will usually derail this plan. State aid to localities in Massachusetts has fluctuated greatly with the business cycle and with state policy decisions. In any other state that might implement a cap, local government and school budgets are likely to become more volatile.

5. **Changes in school enrollment can have a big impact.** The adoption of Proposition 2 ½ coincided with a decline in Massachusetts' K-12 enrollment, allowing schools to operate with less revenue.

If another state adopted a property tax cap during a period of steady or rising enrollment, it would be forced to impose much more extensive cutbacks in teachers, classes, and programs than those seen in Massachusetts.

6. **Without targeted state aid, low-income communities will fall even further behind.** Massachusetts has a very targeted system of aiding local governments. The influx of state aid seems to have shielded low-income communities somewhat from Proposition 2 ½'s tendency to exacerbate differences in services between high- and low-income communities. But when state aid has receded as a result of economic downturns or state policy decisions, the poorest communities have had to make the largest budget cuts.

   In states that do not have a system of school aid that is targeted as effectively as Massachusetts', students in low-income communities are likely to fall increasingly behind students in schools that have greater resources.

7. **Wealthier communities will override a tax cap more frequently than poorer ones.** This has contributed to a growing spending gap between local governments in high-income communities and all other communities, despite Massachusetts' progressive system of state aid. This is likely to occur in other states that implement a cap.

8. **Middle-income communities might end up bearing the brunt of a cap.** In Massachusetts, budgets in middle-income communities grew more slowly than budgets in *either* low-income or high-income communities because they did not receive as much state aid as the former or override Proposition 2 ½ as often as the latter.

Proposition 2 ½ is a structurally flawed policy that has significantly eroded local services in Massachusetts despite a number of factors that have mitigated its impact. Massachusetts had the benefit of an unusually strong economy, declining school enrollment, and a system of effectively targeted school aid. Proposition 2 ½ nevertheless has had negative results for the provision of quality public services in Massachusetts. Other states that attempt to impose a similar tax cap without the benefit of Massachusetts' mitigating factors are likely to face even worse consequences.

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[1] State & Local Government Finance Data Query System, Urban Institute-Brookings Institution Tax Policy Center; data from U.S. Census Bureau, *Annual Survey of State and Local Government Finances, Government Finances* (Volume 4) and *Census of Governments (1977-2005)*, http://www.taxpolicycenter.org/slf-dqs/pages.cfm, accessed 23-Apr-08 02:38 PM.
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