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PROPERTY TAX CAP WOULDN'T IMPROVE NEW JERSEY POLICIES

A Response to the Manhattan Institute

By Iris J. Lav

A report released by the Manhattan Institute on May 24 compares taxes, education spending, and standardized tests in Massachusetts and New Jersey, arguing that a property tax cap has reduced property taxes and school spending in Massachusetts without compromising student performance — and implies that a cap would do the same in New Jersey. In reality, however, a property tax cap in New Jersey is likely to end up reducing essential educational programs and services — as well as other public services, as it has in Massachusetts — and by itself would do nothing to create significant efficiencies.

According to its own report, the Manhattan Institute attributes Massachusetts students' high performance to a set of *state-level education policies* Massachusetts has implemented since it enacted an education reform program in 1993 — not to actions that local school districts took to adapt to the state's property tax cap, Proposition 2 ½. Schools suffered in Massachusetts between the adoption of the cap in 1980 and the 1993 education reform. In 1991, the state's Board of Education warned that there was "...a state of emergency created by grossly inadequate financial support of the public schools..." and that "[c]ertain classrooms simply warehouse children at this time, with no effective education being provided."¹

If Massachusetts has policies in education or other areas from which New Jersey can learn to operate more efficiently, it may be appropriate to emulate those policies. But Governor Christie is not proposing state-level education reforms comparable to those adopted in Massachusetts.

Moreover, the Manhattan Institute report looks only at one area of local public services: education. It ignores the host of other problems Proposition 2 ½ has caused in towns across Massachusetts — from deteriorating roads to poorly lit streets to longer police and fire response times.

A state desiring to lower property taxes can figure out the reasons its property taxes are higher than it would like and make specific policy changes to lower costs when it is possible to do so without undermining public services. In addition, it can provide targeted, direct property tax relief to residents, and it can create alternative revenue sources to relieve pressure on the property tax.

¹ MA State Board of Education Committee on Distressed School Systems and School Reform, November 1991.

Is New Jersey Really a High-Tax State?

New Jersey does have one of the nation's highest property taxes as a percent of residents' personal income, ranking 3rd highest in 2006-2007 (the latest Census Bureau data available). This reflects New Jersey's choice to rely almost exclusively on property taxes to support local services. If one considers total revenues local governments collect to support services (excluding state or federal aid), New Jersey ranks 24th among the states.

Local government revenue tells only part of the story. If one looks at total state and local revenue from their own sources as a percent of residents' personal income, New Jersey ranks 31st in the country — i.e., in the lower half of states.

New Jersey's income tax revenue ranks 20th in the country as a share of residents' personal income, while its sales tax revenue ranks 38th and its excise taxes rank 45th. In addition, New Jersey and its localities impose few fees or charges for services, ranking 48th in the country.

Several figures in the Manhattan Institute report comparing tax levels in New Jersey and other states rely on data from the Tax Foundation. Unlike the official Census data, the Tax Foundation figures are speculative projections for current-year taxes, and the Tax Foundation frequently revises these projections radically when actual data become available. (For other issues regarding the Tax Foundation state-level estimates, see Nicholas Johnson, Iris Lav, and Joseph Llobrera, "Tax Foundation Estimates of State and Local Tax Burdens Are Not Reliable," Center on Budget and Policy Priorities, March 27, 2007.)

These approaches do not carry the negative consequences — sometimes unintended — that property tax caps often create and have created in Massachusetts.² Moreover, a rigid property tax cap can stand in the way of reforms that might have short-term costs but long-term cost-reduction benefits.

Education Spending

The Manhattan Institute cites spending per pupil of \$12,857 in Massachusetts and \$16,163 in New Jersey in 2007 — a gap of approximately \$3,300 per pupil.³ Special education appears to account for a major portion of the difference,⁴ as New Jersey has both a greater proportion of its students classified as needing special education and a higher per-pupil cost for special education services. The Manhattan Institute attributes these differences to disparities in the two states' policies for

² See Phil Oliff and Iris J. Lav, *Hidden Consequences: Lessons From Massachusetts for States Considering a Property Tax Cap*, Center on Budget and Policy Priorities, Revised May 25, 2010. <http://www.cbpp.org/cms/index.cfm?fa=view&id=301> and guest column "Massachusetts is not a Model for New Jersey," *Star-Ledger*, May 23, 2010. http://blog.nj.com/njv_guest_blog/2010/05/massachusetts_is_not_a_model_f.html

³ Both Massachusetts and New Jersey are high-spending states compared to national average per-pupil expenditures, both ranking among the top 10 states in education expenditures per pupil.

⁴ There is no current data that compares total special education costs across states. A 2004 study found that New Jersey spent \$1,272 more than Massachusetts for each special education student in the 1998-1999 school year. Special education costs in both states have increased substantially since that time, but the differential is likely to be at least as great today. Given the higher percentage of special education students in New Jersey (27% of NJ students compared to 15% of MA students) it is likely that anywhere from a third to a half of the current difference in total per-pupil spending is attributable to special education costs.

funding local school districts for special education. But a property tax cap would not change New Jersey's policies in this area.

For example, one factor affecting a state's special education expenditures is the proportion of its special education students that are educated out-of-district and in costly private schools. These students not only require high tuition payments but also create large transportation costs. A recent report found that in New Jersey, students in out-of-district placements account for about 10 percent of the special education population but almost 40 percent of the expenditures.⁵ In part, New Jersey school districts may find it difficult to provide a full range of service to special needs children because they are small; New Jersey has 591 operating school districts serving about 1.4 million children. Methods of state reimbursement to local schools may also affect the incentives to classify children as needing special education or requiring a particular level of special education.

A key characteristic of all of these classification and cost differential issues is that state, rather than local, policies make the major difference. States, along with the federal government, set both the policies under which local schools determine their special education classifications and expenditures and the incentives that make those policies work. A number of policy experts and advocates in New Jersey are recommending changes in the state's special education policies to improve efficiency and reduce expenditures. But such changes have nothing to do with a property tax cap.

Other factors besides special education policies may also help account for New Jersey's higher per-pupil spending.

- Class sizes are smaller in New Jersey. In 2007-2008, Massachusetts had 13.6 students per teacher, while New Jersey had only 12.4 students per teacher. There is evidence to suggest that smaller class sizes improve achievement, particularly in the lower grades and for low-income students and minority students in urban schools.⁶
- New Jersey spends over \$1,000 more per student than Massachusetts in two areas combined: school administration (the office of the principal, full-time department chairpersons, and graduation expenses) and operations and maintenance (the operation of buildings, upkeep of grounds and equipment, vehicle maintenance and operations other than student transportation, and security). New Jersey could examine why its costs in these areas are relatively high and require school districts, as a condition of receiving state aid, to make changes in areas found to be out of line.

⁵ Mari Molenaar and Michael Luciano, Financing Special Education in New Jersey, New Jersey Association of School Boards, September 2007. According to this report: "The U.S. Office of Special Education and Rehabilitative Programs cited New Jersey for having the highest proportion of students with disabilities in separate settings (both public and private). New Jersey also has the fourth highest classification rate in the nation. In response to the federal agency's concern about New Jersey's progress toward educating special education students in the least restrictive environment, the state changed its funding formula in 1996 to one designed to provide the same aid regardless of the setting in which the services were delivered. In spite of this alteration in funding, there has been no change in the proportion of students in separate settings nor has there been any appreciable change in the classification rate. The design of future funding formulae should ensure that school districts are not inadvertently encouraged to place children in more restrictive settings." <http://www.njsba.org/specialeducation/index.html>

⁶ See Education Commission of the States, State Notes, "State Policies Focusing on Class Size Reduction," updated by Kyle Zinth, September 2009. There are a variety of opinions on this topic, including on how small is small enough and whether class size reduction is cost effective.

One factor that is widely believed to account for New Jersey's higher costs — teacher salaries — is *not* a significant factor. The average annual salary of teachers in public elementary and secondary schools in 2008-2009 was \$62,769 in Massachusetts and \$63,018 in New Jersey, a difference of less than one-half of 1 percent.⁷ Despite this, the governor's proposed "tool kit" focuses on salary issues.

What might the impact of a property tax cap be on all these issues? A cap would more likely lead a local school district to cut expenditures for *non*-special education students than to revise its special education policies because special education is a federal mandate that must be accomplished. Absent major changes in state policies, for example, local schools are likely to continue using private or out-of-district placements for special education students rather than provide services in their own schools.

Similarly, a cap would do nothing to improve the efficiency of school districts' administration or maintenance. Instead, class sizes may increase and course offerings and activities such as music, art, foreign languages, and athletics are likely to decline in many areas — as happened in Massachusetts.

Test Scores

Another part of the Manhattan Institute's claim that New Jersey would benefit from a Massachusetts-style property tax cap is that Massachusetts students have higher scores on the National Assessment of Educational Progress tests than New Jersey students. In fact, however, students in the two states have very similar scores; average student scores place both Massachusetts and New Jersey among the highest-scoring five states in 4th and 8th grade reading and math tests.

The effect a cap might have on test scores is unclear. Certainly there is nothing about a property tax cap itself that would improve New Jersey test scores. Depending on what local school districts choose to cut to keep costs under a cap, scores could deteriorate.

In addition, the sweeping state education reform Massachusetts enacted in 1993, which includes highly targeted state funding and curriculum standards, apparently helped to improve test scores, and New Jersey's cap proposal is *not* accompanied by any comparable reform proposal. Some schools in Massachusetts, particularly ones in less affluent towns, struggled between the 1980 enactment of the property tax cap and the 1993 enactment of the education reform. As the Massachusetts Business Alliance for Education wrote in a 1991 report, "The public education system is failing to provide its students with the knowledge and skills necessary for them to be productive, informed citizens in coming decades. The prospect of an under-educated citizenry, unable to understand or cope with issues arising in the management of the country and Commonwealth, should alarm everyone." Another 1991 report, by the Committee on Distressed Schools Systems and School Reform of the Massachusetts Board of Education, found that there was "...a state of emergency created by grossly inadequate financial support of the public schools..." and that "[c]ertain classrooms simply warehouse children at this time, with no effective education being provided."

⁷ Digest of Education Statistics, 2009. Table 79.

These funding problems occurred despite the fact that Massachusetts student enrollment dropped about 20 percent in the decade after adoption of Proposition 2 ½. New Jersey would not have the advantage of much lower enrollment to finance if it adopted a cap.⁸

Moreover, there is more to education than test scores. It is possible to have bare-bones schools that focus primarily on students' performance on the reading and math standardized tests. But without other types of courses that foster students' creativity and talents in areas such as art or athletics, and their broader reasoning and problem-solving ability beyond reading and arithmetic, education may be lacking. This is a clear danger under property tax caps.

What Can Be Done?

There are three possible approaches to lowering New Jersey's property taxes that do not depend on enacting a property tax cap.

Identify and Fix Problems Causing High Property Taxes

The state could make a concerted effort to identify and fix the actual problems that are causing property taxes to be high. This brief report mentions two examples — in the areas of special education and school administration and maintenance — where opportunities exist to carefully identify problems and change state policies in ways that improve efficiency.

New Jersey can also address the fragmentation and duplication of services caused by the state's extremely high number of school districts and municipalities, each with its own administrative structure and weak bargaining power against health insurance providers. Some claim that consolidation would not produce much savings. While this could be true in the very short run, in the longer run significant savings should materialize.

In addition, fixing such problems often entails up-front costs, such as the construction of facilities to teach special education students within a local school or to consolidate public services.⁹ A tax cap can prevent localities from making these up-front investments.

Provide Substantial and Reliable Individual Property Tax Relief

Property tax caps do not guarantee property tax relief to any individual home owner or renter. A cap restrains the growth in the total property tax a jurisdiction collects; within the jurisdiction, some residents' taxes may go up more than 2 ½ percent.

⁸ New Jersey enrollment is projected to drop 2.4 percent over roughly the next decade (2006 – 2018). U.S. Department of Education, NCES, Common Core of Data surveys and State Public Elementary and Secondary Enrollment Model.

⁹ For example, eliminating opposition to consolidation of two or more municipal or school district administrative structures may require generous compensation to people whose jobs are eliminated in the short run, in order to garner salary savings from consolidation in the long run. Or the consolidation of municipalities and the streamlining of services may require the building of one fire station, library, or other facility near the current border of the areas, in order to close two other facilities that have been serving each community. A cap can prevent these types of facilitating changes.

Cap Would Affect Public Services Beyond Education

A property tax cap affects more than just educational programs and services. In Massachusetts, all local services, including education, are under the single cap for a town or city. The proposed cap in New Jersey would apply separately to school districts, municipalities, and counties, which arguably allows even less flexibility to provide services. In either case, a wide variety of public services are at risk.

Towns in Massachusetts have eliminated police and firefighter positions and closed stations, increasing the time to respond to emergencies. In one well-known case, a person died because it took firefighters too long to reach a fire after nearby fire houses had closed for lack of funding.^a

Senior citizen centers and recreation facilities in Massachusetts also have closed or reduced their hours substantially. Public libraries have limited their hours of operation or closed, with some remaining open only because of volunteer fundraising.

Massachusetts localities have also been forced to postpone road maintenance. Poor roads can cause accidents and cost motorists money. New Jersey roads and bridges already are in poorer condition than those in Massachusetts by some measures and could get much worse under a cap.^b

^a Kay Lazar and Raja Mishra, "A Gloucester Death from Blaze Brings Home Budget Cut Realities: Loss of Fire Station Slowed Response," *The Boston Globe*, October 3, 2006.

^b According to the American Association of State Highway and Transportation Officials, New Jersey has the highest proportion of roads (arterial routes, including Interstates, freeways, and major urban routes) that have "poor" pavement conditions. Massachusetts ranks 9th worst. *Rough Roads Ahead*, 2009.

A state can guarantee individual property tax relief through a well-designed "circuit breaker," or tax credit that prevents homeowners' and renters' property taxes from exceeding a specified percentage of their income. When using a circuit breaker, it is important for the state to provide sufficient public education and publicity around the credit so that residents understand the amount of property tax relief they are receiving and perceive that the credit is property tax relief rather than a reduction in their income tax. It is also important for residents to be able to rely on the property tax relief each year.¹⁰

In New Jersey, there have been several different schemes for direct property tax relief, some quite complex. Moreover, Governor Christie has proposed eliminating the property tax rebate this year, which would undermine residents' ability to rely on the relief. There is room for significant improvement in the way New Jersey provides property tax relief and explains that relief to residents.

Shift from Property Tax to Other Sources of Revenue

In virtually all states, the property tax is residents' *least* favorite revenue source. This suggests that states should not over-rely on property taxes to fund local services, but rather should spread the cost of providing local services over a variety of revenue sources.

¹⁰ For information on circuit breakers see Karen Lyons, Sarah Farkas, and Nicholas Johnson, "The Property Tax Circuit Breaker," Center on Budget and Policy Priorities, May 21, 2007 <http://www.cbpp.org/cms/?fa=view&id=51>

Allowing localities to levy income taxes or sales taxes is one way to accomplish this. Several states have local income taxes, including Maryland, Pennsylvania, and Ohio, as well as New York City. Localities levy sales taxes in the vast majority of states. A variety of other types of taxes also are levied at the local level or shared by states and localities in different states. New Jersey does not allow localities to levy income taxes or sales taxes; localities are nearly entirely dependent on property tax revenues to fund programs and services.

Another way a state can reduce dependence on property taxes is to reallocate the responsibilities between itself and its localities, with the state directly assuming some responsibilities and supporting them with state revenue sources. A broad, strong circuit breaker, as noted above, is yet another way for the state to use state dollars to relieve residents' property taxes.