

SYRACUSE UNIVERSITY
Maxwell School of Citizenship and Public Affairs

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State and Local Government Finance
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Case: Revenue Options for Boston⁽¹⁾

The year is 1984 and the City of Boston is in serious financial trouble. Thanks to the passage of Proposition 2 ½, a statewide property tax limitation measure, Boston has been forced to cut its property tax revenues by 15 percent per year for the last three years, despite increasing costs for the public services it provides. Moreover, the State of Massachusetts does not permit Boston, or any other local government, to levy a local income or sales tax, so Boston, unlike big cities in most other states, does not have any other broad-based taxes to which it can turn. The State cushioned the blow from Proposition 2 ½ for a few years through a transition aid program, but this extra aid is scheduled to end this year. As a result, the City will not be able to make ends meet unless the State either passes a new aid program or else empowers the City to levy some form of local income or sales tax.

As a policy analyst for a caucus of state legislators from Boston, you have been asked to determine which new revenue option is most clearly in Boston's interest. Your analysis and recommendation will be presented to the members of the caucus. If they accept your recommendation, they will then try to persuade other state legislators to vote for it. The quality of your analysis will, of course, influence how successful they are. Preliminary discussions in the caucus have eliminated several new revenue sources from consideration, and you must select and defend one of the following proposals:

1. Boston should be allowed to levy some form of local income or payroll tax.
2. Boston should be allowed to levy a local sales tax.
3. The State of Massachusetts should raise its income tax and use the new revenue to finance increased aid to its cities and towns.
4. The State of Massachusetts should raise the state sales tax and use the new revenue to finance increased aid to its cities and towns. The sales tax increase can take the form of either:
 - a. an increase in the sales tax rate, or
 - b. a broadening of the sales tax base to include all the categories listed in Table 5.

The members of the caucus has given you some specific instructions. They must be able to convince a majority of the state's legislators to support their recommendation, so your main job is to build them a very strong case. State (and defend) the criteria you use in selecting a revenue source and explain why your proposal meets these criteria. If you support a new local tax, you must specify and justify the provisions of that tax, such as its geographic coverage, whether it would be available to communities other than Boston, and who would set the tax rate. In addition, any proposal to increase a state tax must explain how that tax should be increased. Moreover, you have been asked to assume that every additional dollar of state taxes collected in Boston would be returned to Boston in the form of new state aid. This assumption may not accurately predict what an aid formula would actually look like, but the caucus does not want you to delve into the complexities of state aid -- at least not at this stage in the process. This assumption about state aid essentially holds every jurisdiction harmless and therefore seems, to the caucus at least, to be a reasonable starting point for any negotiations about a state aid formula. The caucus has said that you may briefly state how uncertainty about a state aid formula affects your recommendation, but it does not want you to dwell on this issue. Finally, the caucus knows that many state legislators will be skeptical about any proposal to help Boston, so it has asked you to rebut the major arguments that could be made against the proposal you recommend.

As a first step in your assignment, you have gathered background material about governmental and tax structure in Massachusetts, including some information that compares Massachusetts to other states. You should draw on this material in making your arguments.

Background Material

I. Governmental Structure in Massachusetts

Massachusetts contains 351 cities and towns, which have responsibility for the provision of a wide range of local public services, including education. Counties and special districts are relatively insignificant and have no taxing power of their own. Instead, the state legislature approves county and special district budgets, which are then billed to the cities and towns within their borders. County functions have shifted to the state over time. The state government took over a large share of welfare expenditure in 1968 and is currently in the process of taking over county courts.

II. Comparison of Massachusetts' Tax Structure with that in Other States

See Tables 1 and 2.

III. Description of Massachusetts' Major Taxes

A. Individual Income Tax.

The individual income tax accounts for 43.4 percent of state tax revenue and is the mainstay of the state's tax system. The tax is a two-part levy, which taxes earned income (and interest on Massachusetts savings deposits) at 5 percent and unearned income (including other interest,

dividends, and capital gains) at 9 percent. The recent addition of a 7 ½ percent surcharge makes the current effective tax rate 5.375 percent on earned income and approximately 10 percent on unearned income. Taxable income equals gross income less exemptions and deductions. Exemptions equal \$2,000 for the first family member, up to \$2,700 for a working spouse, and \$700 for each dependent. Deductions are permitted for Social Security contributions, medical expenses, and interest paid other than on home mortgages. (Note that the following federal deductions are not permitted for the Massachusetts income tax: home mortgage interest, property taxes, charitable contributions, and one-half of capital gains. On the other hand, Social Security contributions are not deductible in calculating the federal income tax.)

No income tax is imposed on total income below \$5,000 for a husband and wife or \$3,000 for a single individual. A tax credit for state sales taxes paid is allowed for low-income households. This credit equals \$4 each for the taxpayer and his or her spouse and \$8 for each qualified dependent.

See Table 3.

B. General Sales Tax

Retail sales in Massachusetts are taxed at a 5 percent rate. The following items are exempted from the tax base: food, clothing (except for articles costing more than \$175), medicine, and all items subject to a selective sales tax in Massachusetts. In addition, the sales tax does not cover services.

See Tables 4 and 5.

According to the source cited in Table 5, extensions of the sales tax to "personal care and property maintenance services, automobile services, tobacco, long-distance telephone calls, motor fuels, and clothing all appear to be mildly regressive, whereas extensions to entertainment and alcohol appear to be roughly proportional. There is no evidence that the burden associated with any of the potential sales tax base extensions is progressive." However, the burden imposed by most of these extensions appears to be less regressive than the burden of the current sales tax.

Finally, this source also indicates that within the Boston metropolitan area, 41 percent of the services covered by the extensions are provided in the City of Boston.

C. Selective Excise Taxes

Massachusetts taxes gasoline, cigarettes, alcohol, and meals.

IV. City-Metropolitan Comparisons

Boston's relationship to its suburbs is rather unique, largely because Boston makes up only 20 percent of the population of its metropolitan area.

See Table 6.

In addition, Boston's ability to export taxes to nonresidents varies widely from one tax source to another. According to two scholars at Harvard's Kennedy School of Government, the export ratio (defined as dollars of taxes provided by nonresidents for every dollar collected from residents) is 1.11 for its property tax. Despite the success of Quincy Market and other downtown development, however, the export ratio for a general sales tax (with the current base) would be only about 0.13 percent, because most shopping in the area still takes place in suburban malls. In contrast, Boston's export ratio for a tax on all earnings from jobs in Boston would be about 2.10, thanks to the large number of people who commute from the suburbs to work in the city.

TABLE 1
MISCELLANEOUS FEATURES OF STATE-LOCAL REVENUE SYSTEMS,
1983-84

Region and State	State-Local Taxes as a % of State Personal Income	Tax Effort, 1983		Equity Features, 1984	
		Per Capita State-Local Tax Revenue	State Government Percentage of State-Local Tax Revenue 1983	Exemptions and Credits ¹	State Financed Circuit-Breaker Property Tax Relief Programs ²
New England					
Maine	12.10	1082	62.9	E	EHR
New Hampshire	8.93	951	36.1	NST	--
Vermont	12.18	1138	59.9	E,C	AHR
Massachusetts	11.76	1425	62.8	E,C,CL ³	--
Rhode Island	12.03	1295	58.7	E,CL	EHR
Connecticut	10.38	1434	56.4	E	EHR
Mideast					
New York	15.35	1889	48.5	E	LIHR
New Jersey	11.17	1457	56.3	E,CL	--
Pennsylvania	10.70	1169	60.6	E,CL	EHR
Delaware	10.92	1273	82.9	NST	--
Maryland	11.13	1350	59.7	E	AH,ER
D.C.	14.46	2132	N.A.	E	LI,EHR
Great Lakes					
Michigan	12.45	1370	56.5	E	AHR
Ohio	10.26	1106	57.0	E	EH
Indiana	9.05	905	64.4	E	--
Illinois	10.41	1255	51.5	E	EHR
Wisconsin	13.18	1425	63.5	E	AHR
Plains					

Minnesota	13.22	1473	70.7	E,CL	AHR
Iowa	10.85	1171	59.2	E	EHR
Missouri	9.19	931	57.1	--	EHR
North Dakota	10.27	1100	70.3	E	EHR
South Dakota	9.58	914	50.8	C	EH
Nebraska	10.81	1146	53.9	E	--
Kansas	9.66	1129	57.2	C	EHR
Southeast					
Virginia	9.97	1044	58.5	--	--
West Virginia	11.18	972	77.0	E	EHR
Kentucky	10.07	888	78.9	E	--
Tennessee	9.09	804	59.6	--	--
North Carolina	10.18	911	72.7	--	--
South Carolina	10.53	878	73.7	C	--
Georgia	10.32	973	62.8	--	--
Florida	9.04	968	60.2	E	--
Alabama	9.36	806	73.3	--	--
Mississippi	10.03	769	77.3	--	--
Louisiana	10.45	1051	65.0	E	--
Arkansas	9.23	771	74.6	--	EH
Southwest					
Oklahoma	10.26	1123	70.8	--	ER
Texas	9.30	1032	55.6	E	--
New Mexico	11.66	1041	80.1	C	EHR
Arizona	10.84	1064	65.3	E	EHR
Rocky Mountain					
Montana	12.55	1179	53.3	NST	EHR
Idaho					
Wyoming	20.23	2443	58.6	C	--
Colorado	9.77	1166	47.9	E	EHR
Utah	11.30	963	62.5	--	EHR
Far West					
Washington	11.44	1306	74.6	E	--
Oregon	11.95	1229	54.5	NST	AHR
Nevada	10.25	1214	72.0	E	ERR
California	10.83	1337	66.1	E	EHR
Alaska	33.03	4908	87.0	NST	--
Hawaii	12.87	1457	77.2	C	AR
¹ E means food is exempt from the state sales tax; CL means clothing is exempt; C indicates that an income tax credit is provided. NST indicates no state general sales tax.					

TABLE 2
SOURCE OF STATE-LOCAL GENERAL REVENUE, 1983*

Region and State	Taxes				General Revenue	Charges and Misc. Federal Aid
	Property	General	Income	All Other		
New England						
Maine	22.7	13.0	13.0	11.2	13.2	23.3
New	36.5	0.0	5.8	15.2	17.7	20.0
Vermont	21.9	6.2	12.8	14.	14.8	25.5
Massachusetts	22.9	8.0	23.8	7.7	12.4	21.9
Rhode Island	23.2	9.6	13.7	9.4	15.2	21.4
Connecticut	29.0	16.6	8.1	13.8	11.8	15.5
Mideast						
New York	20.8	12.4	23.2	8.2	12.8	18.0
New Jersey	28.4	10.0	12.6	< 14.2	16.4	15.1
Pennsylvania	16.3	10.3	17.9	16.2	14.5	20.7
Delaware	7.7	0.0	24.1	20.5	22.0	18.3
Maryland	15.6	8.9	23.5	11.6	18.0	18.3
District. of	13.6	10.2	16.3	9.3	7.1	42.2
Great Lakes						
Michigan	24.2	9.2	18.0	6.7	19.0	19.1
Ohio	19.4	11.3	17.3	12.1	19.6	16.9
Indiana	19.2	17.0	11.4	7.9	22.7	18.2
Illinois	23.8	14.5	12.1	12.1	< 13.2	19.2
Wisconsin	23.2	11.0	18.9	8.5	17.0	17.8
Plains						
Minnesota	16.1	9.3	20.9	10.4	19.4	16.6
Iowa	23.8	10.0	14.0	10.6	21.1	16.7
Missouri	15.4	16.9	14.4	12.2	16.7	19.6
North Dakota	13.7	9.3	4.1	20.3	20.2	19.7
South Dakota	20.8	15.3	0.2<	<12.5	15.8	24.7
Nebraska	22.9	12.3	10.1	10.0	21.8	16.2
Kansas	22.3	11.3	13.8	9.0	21.4	16.0
Southeast						
Virginia	18.1	9.8	17.4	15.8	17.2	16.9
West Virginia	10.3	21.7	10.4	13.2	17.1	21.8
Kentucky	10.2	12.0	17.6	16.8	14.1	23.6
Tennessee	13.1	21.0	3.5	13.5	21.0	23.0
North Carolina	13.4	11.0	19.2	13.7	17.9	21.0
South Carolina	13.4	13.2	16.1	11.9	18.7	20.0
Georgia	13.8	13.3	14.3	9.0	23.3	21.9
Florida	19.8	18.6	2.1	17.2	20.3	15.5

Alabama	6.0	14.1	11.0	17.2	25.1	21.5
Mississippi	10.3	18.4	6.6	12.8	25.3	23.9
Louisiana	7.2	18.7	6.0	19.3	23.2	18.4
Arkansas	10.9	13.6	13.7	13.6	19.0	21.5
Southwest						
Oklahoma	10.2	13.1	12.4	25.0	16.8	17.6
Texas	14.5	0.0	22.2	20.8	14.7	
New Mexico	5.4	14.5	2.1	17.2	23.8	23.4
Arizona	18.5	11.3	9.5	24.2	13.3	
Rocky Mountain						
Oklahoma	10.2	13.1	12.4	25.0	16.8	17.6
Texas	14.5	0.0	22.2	20.8	14.7	
New Mexico	5.4	14.5	2.1	17.2	23.8	23.4
Arizona	18.5	11.3	9.5	24.2	13.3	
Far West						
Washington	16.9	27.6	0.0	13.6	17.8	17.9
Oregon	22.0	0.0	21.3	10.0	16.8	19.0
Nevada	10.6	18.7	0.0	25.6	22.5	14.9
California	15.3	16.9	17.9	8.9	16.6	18.9
Alaska	7.1	0.7	4.7	28.8	28.2	8.0
Hawaii	11.1	24.4	15.0	9.9	13.8	19.7

Source: Advisory Commission on Intergovernmental Relations, Significant Features of Fiscal Federalism, 1984.

* Entries are percentages of total revenue from each source. They sum to slightly less than 100 percent for each state because interest earnings are omitted from the table.

**TABLE 3
EFFECTIVE TAX RATES FOR THE MASSACHUSETTS INDIVIDUAL INCOME
TAX BY TOTAL MONEY INCOME, 1982***

Income Class (money income)	Number of Returns	% of Total Returns	Without Federal Offset		With Federal Offset	
			Tax as a % of AGI I	Tax as a % of Money Income	Tax as a % of AGI	Tax as a % of Money Income
Less than \$5,000	276,852	10.4%	0.67%	0.26%	0.67%	0.26%
\$5,000-9,999	480,257	18.1	1.26	1.13	1.26	1.13
\$10,000-14,999	403,477	15.2	2.58	2.30	2.58	2.30
\$15,060-19,999	332,684	12.5	3.35	3.11	3.26	3.02
\$20,000-24,999	272,354	10.2	3.71	3.43	3.49	3.21
\$25,000-29,999	195,394	7.4	3.81	3.50	3.41	3.11
\$30,000-34,999	177,791	6.7	3.99	3.65	3.45	3.14
\$35,000-39,999	150,241	5.7	4.06	3.77	3.25	3.00
\$40,000-44,999	106,277	4.0	4.19	3.96	3.11	2.93
\$45,000-49,999	73,050	2.8	4.36	4.17	3.12	2.99
\$50,000-69,999	78,913	3.0	4.93	4.45	3.20	2.90
\$70,000 and over	107,326	4.0	5.40	4.55	2.99	2.52
Total or average	2,654,612	100.0%	2.89%	2.64%	2.50%	2.29%

Source: Massachusetts Income Tax Simulation Model.

The effective tax rate is the tax burden expressed as a percentage of income.

TABLE 4
EFFECTIVE SALES TAX RATES FOR MASSACHUSETTS AND THE U.S.
AVERAGE

Effective tax rate¹		
Income class Massachusetts		U.S. Average²
Less than \$5,250	1.09	5.02
\$5,250-7,000	1.11	3.49
\$7,000-8,750	0.99	3.12
\$8,750-10,500	0.95	2.87
\$10,500-12,250	0.95	2.75
\$12,250-14,000	0.94	2.64
\$14,000-17,500	0.93	2.47
\$17,500-21,000	0.94	2.34
\$21,000-26,250	0.86	2.20
\$26,250-35,000	0.86	2.06
\$35,000-43,750	0.84	1.97
\$43,750-52,500	0.88	1.91
\$52,500-61,250	0.87	1.83
\$61,230 and over	0.73	1.63

Source: Donald Phares, *Who Pays State and Local Taxes?* (Oelgeschlager, Gunn and Hain, 1980). The income classes are Phares' 1976 incomes inflated to 1982 levels using estimates from Data Resources, Inc. on personal income growth in Massachusetts between 1976 and 1982.

¹ The effective tax rate is defined as average tax payment divided by average income for each income class.

² Average for the 45 states that have a general sales tax.

TABLE 5
MASSACHUSETTS SALES TAX REVENUES
Actual and projected (Millions of dollars)

1985 sales tax revenue - current base, 5% Projected revenues from base expansion	\$1,300
Personal services (e.g. shoe repair, beauty shops)	70
Automobile services (e.g. auto repair and rentals)	44
Entertainment services (e.g. movies, bowling)	49
Miscellaneous (e.g. alcohol, cigarettes, hotels)	237
Total	400
Total projected revenues with expanded	\$1,700

TABLE 6
CITY-METROPOLITAN FISCAL COMPETITION, 1980

City	City/Suburban Income ^a	City Tax/ Income	% Tax Property ^c	City Empl. Per Capita	City/SMSA Employment	City/SMSA Population
Boston	.83	.134	99	.45	.18	.20
New York	.72	.144	45	.41	.79	.78
Philadelphia	.74	.082	24	.37	.38	.36
Baltimore	.68	.075	64	.39	.45	.36
San Francisco ^d	.87	.058	48	.50	.37	.31
Boston	.83	.134	99	.45	.18	.20
New York	.72	.144	45	.41	.79	.78
Denver	.94	.047	34	.43	.37	.35
St. Louis	.72	.074	16	.38	.19	.19
Houston	.98	.029	55	.52	.67	.55
Atlanta	.79	.044	54	.41	.22	.21
Chicago	.71	.038	44	.41	.41	.42
Cleveland	.63	.047	29	.37	.26	.30

Sources: U.S. Department of Commerce, *Local Government Finances in Selected SMSA's and Large County Areas, 1979-1980*

U.S. Department of Commerce, *Census of Population and Housing, 1980*

U.S. Department of Commerce, *City Government Finances, 1980*.

^a City per capita income divided by suburban per capita income.

^b City tax revenues per capita divided by city income per capita.

^c Percentage of locally raised tax revenue from the property tax, including auto excise revenue.

^d The San Francisco SMSA has two central cities: San Francisco and Oakland.

¹. This case was written by John Yinger solely for the purposes of class discussion. It is based on an earlier version co-authored with Howard Bloom and Helen Ladd.