

A Property Tax Cap for Maine? Roots of Voter Discontent and Likely Impacts

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In Maine, as in many other states, there is evidence of a growing sentiment to cap the property tax. Josephine LaPlante tackles this issue head on. Following a brief review of property tax limitation efforts in Maine and elsewhere, she provides an analysis of the impacts a property tax cap would have on Maine.

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Introduction

Although we view acquiring funds through taxation as a fundamental power of legislative bodies in representative governments, “power of the purse” is nonetheless a grant of limited authority from the people to their elected delegates (LaPlante, 1995a, 1995b). Beginning in the 1700s with the Boston Tea Party (1773), Shay’s Rebellion (1786-87), and the Whiskey Rebellion (1794), citizens have exerted their right to limit taxation. Since the early 1970s, dozens of states and local governments have faced citizen-initiated tax or spending cap referenda. Although not all were successful, the tax limitation movement lives on. In 1994 alone, tax and expenditure caps made it onto the ballot in eight states, with four of those facing multiple limitation measures (Tolbert, 1994).

Experience with limitation efforts informs us that when voters believe taxes are too high--no matter what purposes for which dollars are used--they act to restrict access to those funds. As Joyce and Mullins (1991) point out: “numerous surveys in states where tax and expenditure limitations have been passed suggest that citizens were satisfied with the level of public services and often desired more but were simply unwilling to pay for them.”

Although many types of taxes have been the targets of cap efforts, the property tax has been the most common (Mikesell, 1986; Hale, 1993). Undoubtedly because of the unpopularity of the property tax, its visibility, and its local “ownership,” it also has been the most successfully targeted for limitation. During the past two years, a grass roots citizen’s group called the Taxpayers Action Network has been urging Maine voters to act to cap property tax collections. Although the secretary of state ruled that the petitions submitted did not include enough valid signatures to place the initiative on the November 1996 ballot, there are many salient factors combining which suggest they will bring the initiative before voters before too much time passes. When that occurs, it is likely that the forces which have heightened dissatisfaction with this nemesis among the tax types also will produce a significant bias toward enactment of a statewide cap.

This article examines the growing anti-property tax sentiment in Maine and projects the effects of a successful limitation referendum. Key conclusions include the following:

- Should a property tax limitation of the type presently being advocated be passed, the consequences for public services will be far more extensive and severe than the total dollar amount (as other states' experiences might lead us to believe).
- Maine has a fairly unique economic and social geography, wherein a small number of hub communities serve a regional population. Without a major injection of carefully targeted state aid and expanded local revenue authority, we can expect the cap to devastate the essential infrastructure of public services these hubs provide, services upon which many of us depend for our livelihoods and quality of life.
- The secretary of state's decision provides a temporary reprieve and a crucial opportunity to change the distribution of financing responsibility between the state and local governments in Maine, and between tax types, to increase the equity, health, and sustainability of the state-local revenue system.

Roots of Discontent

During the 1980s, Maine's economic renaissance produced significant increases in tax bills in communities that serve as regional "hubs" and others where population growth and new economic activity placed pressure on existing infrastructure. Property values that were not increasing uniformly exacerbated these trends by producing a shift in tax burdens within towns and between towns. In particular, properties on waterways or otherwise favorably situated had their tax bills increase, even when the local tax rate did not increase. Differences in the growth of valuations were even more pronounced across municipalities than within them. The wealth equalization mechanism of the state's school funding formula has been the principal catalyst for inter-community shifts in tax burden. As communities' valuations increased, whether due to new properties or increases in the value of existing properties, and despite new costs imposed on growing towns that exceeded new revenues, the state aid formula has taken away assistance. This produced a substantial shift in local education financing responsibility from districts with slow growth or declining tax bases to those with increasing values. Throughout the state, homeowners found increases in their earnings could not cover the brisk growth of their property tax bills.

Promises made

By 1988, the call for property tax relief was undeviating and loud. In 1989 and 1990 the legislature responded to the cries for tax relief by enacting several important bills, including extension of "circuit breaker" property tax relief to low and moderate income house-holds, an increase in the portion of the state's sales and income tax collections dedicated to the municipal revenue sharing program, implementation of a "floor" for education funding that limited the amount by which state aid to a school district could be reduced in one year, and a homestead exemption which would have reduced property tax bills on homes owned by Maine residents. Despite these important strides toward mitigating some of the more serious negative impacts of the property tax, many local officials and citizens hoped more assistance would be forthcoming from Augusta to address problems such as inter-local tax disparities. Legislators promised to increase the share of local education spending paid by the state, a provision was added to the tax increment financing (TIF) statute to permit districts access to some state revenues generated by

the TIF, and a bill was passed to share some of future excess state revenues with local governments.

Promises broken

In 1991, lawmakers returning to Augusta were greeted with the demand to bring the state budget into line with greatly reduced revenues, an assignment which deftly displaced the 1980s commitment to provide meaningful property tax relief. Not only did promised higher state appropriations aimed at lessening local dependence on the property tax fail to materialize, but cutbacks were enacted. As policy makers have worked to bring state finances under control in the face of lingering economic stagnation, local governments and school districts have seen both real dollar allocations and the portion of state revenue collections shared with them dwindle.

Table 1. Comparison of state's expenditures benefiting Maine local governments and schools, 1990 and 1994

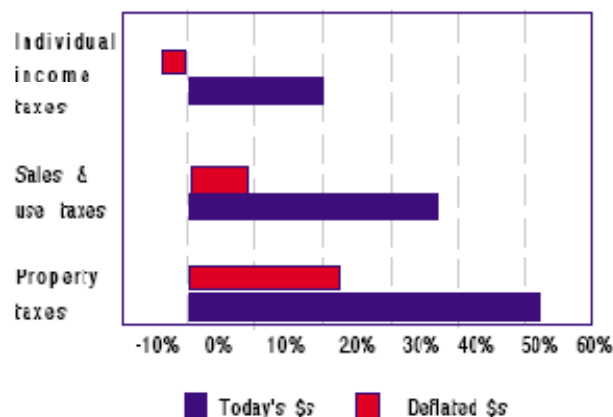
State provided local financial assistance by type	1994 dollars needed to match 1990s purchasing power (in millions)	Actual amount expended by state in 1994 (in millions)
Municipal revenue sharing	\$69.0	\$66.3
Education subsidy	\$539.5	\$504.4
Teachers' retirement contribution	\$132.6	\$101.1
Local road assistance	\$23.0	\$19.3
Property tax circuit breaker	\$22.7	\$5.7
Total	\$786.8	\$696.9

As Table 1 shows, matching the purchasing power of the 1990 state allocation for major local financial assistance programs would have required a 1994 expenditure of \$786.8 million, or nearly \$90 million more than the actual state expenditure. One might respond to this statement by pointing out that state revenues were growing very slowly during this period, when they grew at all. However, as it turns out, the state reduced its commitment to local tax relief even more than the comparison of purchasing power suggests. In 1990, almost 46% of state governmental funds from tax collections were shared with locals through the direct and indirect (teachers' retirement) aid programs shown in Table 1. By 1994, the portion had declined to approximately 40%. If the state had continued sharing its revenues with local governments at the 1990 rate, they would have allocated an additional \$117.8 million for programs benefiting local governments and schools in 1994.

Increasing property tax burdens

As state aid dwindled, pressure on the property tax base mounted steadily. Between 1988 and 1994, property tax collections increased by nearly 9% per year, on average, in nominal terms, or about 4% per year net of inflation. By 1992, property taxes were claiming 4.6% of personal income, 31% above the U.S. average (up from 4.0% of personal income in 1989). During the same period, the “tax bite” of the personal income tax declined notably, from 3.2% of personal income in 1989 (compared to a U.S. average of 2.4%) to only 2.6% (compared to a U.S. average of 2.5%) in 1992. (The significant reduction in the “bite” of the individual income tax on personal income primarily is a consequence of Maine’s progressive tax structure, which works in reverse to reduce revenues faster than

Figure 1. Trends in “Big 3” tax collections
Current & deflated \$s compared, 1988-1994



income falls.) Legislative action taken since then to cap personal income tax collections will reduce the “bite” on income further.

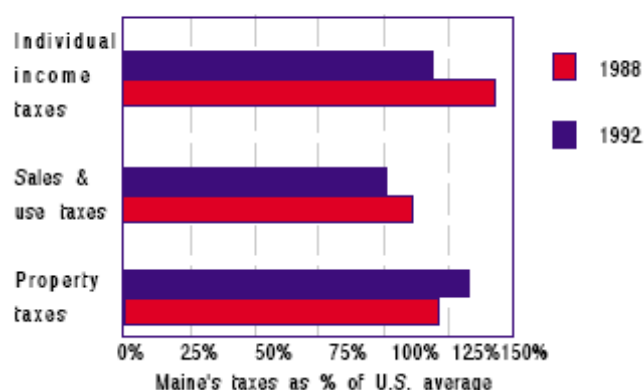
We might assume that other states also would have increased their “tap” on the more stable property tax base during the lingering recession, so that from a comparative perspective Maine’s burden would not have changed. To the contrary, whether measured in terms of per capita taxes, percentage of personal income, or the Advisory Commission on Intergovernmental Relations’ “tax effort” index, not only has the burden of property taxes increased markedly in Maine; we now exceed the burden imposed in 75% of the other states.

Would a limitation measure pass in Maine?

It is always difficult to forecast the results of a ballot measure. Like most New Englanders, Maine voters traditionally have shown a high regard for local governance; they would not be likely to impose a state level tax policy constraint on local autonomy without good cause. However, along with Maine, New Hampshire and Vermont, Massachusetts stood out among the states for many years for a lack of either binding or non-binding limitations on taxes. None the less, Massachusetts property taxes, that were among the heaviest in the U.S., and continuing to grow, produced Proposition 2½. It is interesting that a survey conducted by the Capitol News Service in October 1988, during the last round of tax and expenditure limitation drives in Maine, found broad support throughout the state for tax caps.

Across the United States, we have been seeing voters initiate limits on the use of property taxes for two decades. Affected governments have fought caps largely by predicting dire impacts on

Figure 2. Comparative tax burden, 1988 & 1992
Taxes as % personal income, ME & US



public services, but voters often have enacted limitations anyway. Hale (1993) points out that the public is polarized, with a large minority of voters favoring smaller government, several small minorities supporting increases in different public services, and a “swing vote” that can go either way, depending on circumstances such as their view of the fairness of taxation in their community or state. Interestingly, research in other states shows that even those voters who are satisfied with the current level of public services often believe spending can be reduced through the elimination of waste and by making government more “business-like.” Apparently, few voters believe services will suffer drastic reductions under a limitation (Hale, 1993).

Today, the anti-property tax movement is embedded within--and gaining momentum from--a far larger and national-level effort to reduce government spending. Voter interest in reducing government spending is being supplemented by a “second generation” of tax process reforms (Tolbert, 1994). These new strategies focus on procedural changes to give voters more control over tax policy decisions. By changing the rules of the tax policy game, these innovations make it more difficult for affected governments to increase taxes. Tolbert (1994) points out that “public support for [taxation process] reforms that give the public a more direct role in tax decisions is widespread.”

In 1994, the Americans Talk Issues Foundation interviewed 900 voters and found broad support for reforms that would enable the public to make tax policy decisions. The majority (64%) were in favor of national referenda on major issues, while even more (66%) liked the idea of required ratification of all tax increases approved by Congress at the next general election. The trend toward greater voter involvement in tax policy has already trickled down to the states: Colorado (1992) and Washington (1993) have enacted similar reforms through the initiative process.

Against this backdrop, Maine’s voters have grown increasingly frustrated as they have watched their property tax burdens increase. The erosion of incomes and job losses that have accompanied Maine’s prolonged recession rub salt into the wound. Research on limitation movements has shown that the kinds of mismatches between current income and tax increases based on unrealized capital gains that have undergirded dissatisfaction in Maine have been a focal source of citizen frustration with the property tax in states where caps have passed (Mikesell, 1986; Hale, 1993; LaPlante, 1993).

A review of news articles covering the wave of local tax and spending limitation campaigns that swept the state in 1988, and a comparison of tax and socio-economic data for those towns to other communities where no caps were proposed is revealing. A number of factors can be identified that distinguished the municipalities where limitations were proposed--and particularly those where the cap passed--from the “typical” community in the state. First, property tax bills were large in all of the municipalities where petition drives to place a cap measure before voters succeeded. If we consider tax burdens from the perspective of the claim the tax bill on the median valued home would place against the median voter’s income, we find that all of the towns had heavier than average burdens. Second, taxpayers in nearly every one of these towns had seen sudden, sharp increases in taxes one year followed by another significant increase within two years. Rapid, repeated increases exacerbated an initial heavy tax burden.

Not surprisingly, many news articles covering the cap efforts reported that citizens were saying they did not think their elected representatives were listening to them and they believed local

spending was “out of control.” Communities where limitations failed tended to have above average income and education levels and a higher percentage of citizens “from away.” Since then, taxes have continued to climb, and in many people’s eyes, the state government has left municipalities and school districts without the proverbial paddle.

The climate surrounding tax increases has been exacerbated by a perception among some citizens in Maine’s more urbanized municipalities that, relative to businesses, they are bearing property tax increases disproportionately. Throughout the U.S., the tax productivity of individual parcels of non-residential property has been declining slowly for two decades, due to our economy’s transition from manufacturing and agrarian bases towards services. In Maine, where the property tax on business machinery and equipment is an important local tax source, this trend is especially problematic. During the late 1980s, a more rapid increase in residential home values relative to business and commercial properties further shifted the financing responsibility onto residential property. However, because many large municipalities were not fully up-to-date on residential assessments, the brunt of the change in the proportion of taxes borne by residential and business properties was not felt until the time of revaluation. Unfortunately, in a number of towns revaluation and recession arrived close together, fueling residents’ resentment of property taxes.

Taxes in Maine’s hub communities are among the heaviest in the state. These local governments provide services to a large, non-resident group of users, without any means under Maine law to ask them to pay a fair share of the cost. It is important to recognize that with the residents of these hubs, all of the numbers that spell successful revolt are in place. Residents of hub communities comprise 35% of Maine’s population, they tend to have lower than average incomes, and as a consequence of lower than average educational levels, many do not foresee the kind of bright future and movement along a steep “earnings curve” that many of their suburban neighbors take for granted. To further tilt the balance toward a “yes” vote on a statewide cap, as Table 2 reveals, voters in these communities also stand to benefit dramatically under a cap on property taxes. The magnanimous gestures that saved Portland and other hubs from limits in the 1980s are not likely to recur in today’s economy particularly given recent property tax history.

Another factor favoring passage of a statewide limit where a local ballot measure might fail is that the link between a statewide cap and the impact on local public services is less clear than when local tax dollars are at issue. Voters prone to rationalizing service impacts will find it easier to say “yes;” afterall, everyone will be in it together, so the state will have to step in . . . right? Experiences of local governments in Massachusetts and California, which saw significant increases in state aid after statewide limitations were approved by voters, could serve to reduce any anxiety about cuts in important services. However, since the beginning of the recession, voters in those states have learned the hard way that the fountain can dry up.

Projecting the fiscal effects of enactment

The property tax cap proposal has a variety of features, but the one-percent limit that would be placed on property tax collections is of utmost concern. Based on 1993 tax collections, the 1% ceiling would reduce the number of mills raised statewide from 15.5 to 10. Had the cap been enacted that year, property tax revenues would have been reduced by almost \$400 million.

Nearly 80% of Maine's municipalities on average would be required to reduce property taxes by \$1.5 million or \$527 per capita.

Despite the widespread impact of a tax limitation and the picture painted by aggregate figures, approximately 150 of Maine's 500 plus local governments would experience the brunt of the impact. As Table 2 shows, some low wealth, rural communities would see their revenues decimated. Since the largest portion of local expenditure in these places is for education, it is unlikely that schools would escape unscathed. Maine's urban centers would suffer severe revenue cuts, whether considered from the perspective of total dollars, per capita dollars, or percentage of 1993 collections. The smaller economic centers that serve as regional hubs for tourism and retail trade also would be faced with large revenue losses.

Although many people have become familiar with the hub community problem, the inadequacy of meager tax bases to support needed services in small, rural communities has received little attention. As a result of significant diseconomies of small scale and low population density, a unit of public service often costs more to produce in rural regions of the state. In the face of low wealth, these municipalities and school districts often make extraordinary tax efforts to support a minimal level of services. These are towns that would suffer disproportionately large revenue losses under a cap, further exacerbating the line between Maine's "have" and "have not" communities.

Expected short term adaptations to a tax limitation

The experiences of other states and local governments in Maine and elsewhere suggest that municipalities will adopt a number of strategies in the short run. Upon the imposition of a statewide cap, they will impose hiring and purchasing freezes and use any available surplus to balance their budget, to buy time to seek out alternative revenues before beginning to dismantle programs. Municipalities will also step up the collection of delinquent property taxes and impose higher penalties for late payment. Given the dramatic disparities in the financial impacts of a cap, and the varying current fiscal conditions of local governments and school districts, there can be little doubt that there will be significant financial emergencies in the more vulnerable communities.

After enactment of a cap, local governments generally have turned to their state legislature for relief. Municipalities in Massachusetts and California received substantial, additional financial assistance until the onset of recession, when they were left with their hands out. The lingering recession and Maine's current cap on personal income tax collections, however, suggest that the state may be unable or unwilling to bail out municipalities. Joyce and Mullins (1991) report: "where limitations were imposed on both state and local governments, the state was found to be more reluctant to assume increasing burdens."

Bond ratings are likely to suffer, as they did when caps were enacted in South Portland and Bath, because the rating agencies view a cap as a constraint on the flexibility of elected officials to act promptly in the face of a financial emergency, thus increasing the risk of default. Even when overrides are possible, the added time involved in getting voter approval reduces management control. Maine's bond rating suffered as the result of indecisiveness (among other, economic

factors) at time of onset of the recession. Lowered bond ratings tend to increase the cost of borrowing, which places additional stress on local budgets and crowds out other expenses.

The long term effects of a tax limitation depend upon the stringency of the limitation and whether exceptions to the cap are permitted. As noted earlier, the cap being proposed for Maine is highly restrictive, rivaling Propositions 2½ and 13 in the extent to which revenue growth is constrained. A one-percent cap is severe: Proposition 2½ limited annual tax collections to 2.5% of the tax base. The strength of the economy and the growth of the property tax base will be critical determinants of survival under such a stringent cap. There has been some economic expansion over the past four years, but local government employment growth has been one of the more important contributors of new jobs (LaChance, 1996).

Table 2: Examples of municipalities with large projected annual revenue losses (as measured by per capita dollars and percentage of 1993 tax revenues)

Municipality	Projected loss of property tax revenues	Projected loss as a % of 1993 tax collections	Projected per capita loss	Projected savings to owner of the median valued home
Old Orchard Beach	\$6,713,272	56%	\$875	\$1,249
Millinocket	\$5,278,727	61%	\$765	\$908
Baileyville	\$1,540,850	34%	\$757	\$305
Portland	\$46,365,709	59%	\$732	\$1,704
Jay	\$3,428,811	35%	\$660	\$375
Eastbrook	\$187,531	44%	\$656	\$495
Frenchboro	\$26,167	34%	\$623	\$518
Yarmouth	\$5,060,816	42%	\$623	\$1,238
Rumford	\$4,331,981	39%	\$618	\$363
Eustis	\$384,349	31%	\$603	\$304
Bath	\$5,746,787	3%	\$598	\$1,047
South Portland	\$13,637,705	48%	\$596	\$1,033
Freeport	\$4,005,265	41%	\$576	\$955
Scarborough	\$7,102,099	41%	\$560	\$1,001
Auburn	\$13,187,190	57%	\$553	\$1,221

In the longer term, in the absence of a significant amount of new state aid targeted to communities on the basis of their public service needs, we can expect fundamental change in the nature, extent, and delivery mechanisms of public service. If state aid were to be increased, the balance of revenues between the regressive property tax and the broader state tax types would likely improve. However, increased centrality would reduce the autonomy of local governments and the accountability to those paying the bills fostered by voter scrutiny of annual property tax levies. Based upon experiences of local governments trying to live under caps in other states, our municipalities and school districts would become more financially vulnerable as they increased dependency on the state.

Diversification of local revenues (beyond an increase in state aid) typically accompanies the implementation of a cap. Some municipalities will be able to “grow” revenues locally by imposing new and increased fees and charges on residents and other service users. However, despite much conventional wisdom to the contrary, the fiscal capacities of communities that will be most affected by a cap, like Portland, Lewiston, Augusta, and Presque Isle, do not suggest large, untapped revenue sources.

Evidence from California and other states where property tax caps have been enacted shows that the composition of public services and who benefits from public funds tends to change markedly under a fee-based system of finance, because services that can “pay their own way” begin to dominate. A related phenomenon called the “fiscalization” of land use has also been documented: local governments are much more likely to permit zoning variances and to disregard environmental regulations when a business or industry will bring needed new revenues to the city coffers.

Evidence from other states also points to the probability that the state will approve some expansion of local tax authority, should a property tax cap be passed. Proposals to permit municipalities access to the sales tax with proceeds divided between the “point of origin” (or community where the sale occurred) and other towns (and school districts) in the region may be met with less resistance if the only alternative is a large outlay of state funds.

Without targeted state aid or a significant expansion of tax authority, Maine’s hub communities would face structural budget gaps and increased fiscal stress. There are already significant disparities in incomes, educational levels, and home values between suburban and urban areas in Maine. Reductions in the level or quality of services that offset and exceed the benefit of reduced property taxes will lower home values. This will force those residents who have the financial capacity to “vote with their feet” to move to other towns where the balance between services and the price paid is more in line. Service deterioration and new fees and charges that reduce any property tax savings from the cap are likely to encourage businesses to abandon the cities and perhaps the state. If the educational system suffers--and evidence from other states tells us it will--businesses will need to look elsewhere for qualified employees.

Table 3. Comparison of major fiscal capacity factors for municipalities with projected large revenue losses (Projected tax loss as % of 1993 collections shown in parentheses)

Cross tabulation of wealth variables	Per capita property valuation below the 1995 state average	Per capita property valuation above the 1995 state average
Median household income below the 1993 state average	Portland (59%) Lewiston (57%) Presque Isle (57%) Vanceboro (56%) Easton (55%) Eastport (55%) Augusta (54%) Bangor (54%) Masardis (50%) Charlotte (50%) Bancroft (48%) Rockland (45%) Searsport (44%)	Pleasant Ridge Plt. (70%) Rumford (39%) Jay (35%) Bridgton (35%) Frenchboro (34%) Eustis (31%)
Median household income above the 1993 state average	Millinocket (61%) Old Orchard Beach (56%) Auburn (57%) Bath (53%) Brewer (49%) South Portland (48%) Saco (47%) Westbrook (45%) Biddeford (44%) Kittery (44%) Madawaska (43%)	Wiscasset (59%) Baileyville (34%) Eastbrook (44%) Yarmouth (42%) Freeport (41%) Scarborough (41%) Cumberland (39%) Falmouth (38%) Kennebunk (32%)

Conclusions

Maine is in dire need of lower property taxes and a reduction of the great disparity in tax rates across municipalities. However, a limitation on tax authority of the stringency being proposed is not the way to bring relief, because it will require sudden, severe reductions in tax collections and leave little local flexibility to meet pressing public service needs. The temporary reprieve we have been granted is a crucial opportunity to rethink Maine's state-local tax policy from the perspectives of long term revenue sustainability, equity, and the health of Maine's fiscal system.

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