Measuring Municipal Fiscal Disparities in Connecticut

Bo Zhao and Jennifer Weiner
New England Public Policy Center
Federal Reserve Bank of Boston

Presented to Connecticut General Assembly's
Legislative Program Review and Investigations Committee

May 8, 2015

Disclaimer

The views expressed here are those of the authors and do not necessarily represent the views of the Federal Reserve Bank of Boston or the Federal Reserve System.

Importance of Addressing Fiscal Disparities

- Fiscal disparities exist because of differences across localities in taxable resources and service costs.
- These differences largely fall outside the direct control of local officials.
- Fiscal disparities are therefore widely regarded as inequitable.
- This is an important concern in CT given vast socioeconomic differences across the state's 169 cities and towns.

Impetus for this Report

- The M.O.R.E. Commission was tasked to develop recommendations to address fiscal disparities.
- The Municipal Tax Authority Sub-Committee requested PRI undertake a Municipal Needs Capacity study.
- PRI approached NEPPC to share its expertise in this area.

Preview of Main Findings

- Connecticut municipalities differ significantly in revenue-raising capacity, driven by differences in their property tax bases.
- They also vary in the cost of providing nonschool services.
- As a result, there are large disparities across Connecticut municipalities in their ability to provide nonschool services to their residents, employers, and visitors.

Municipal Budget and Fiscal Disparities

- A municipality's budget is affected by
  - Fiscal choices: tax rates, service levels, management quality, operating efficiencies, etc.
  - Factors that are outside the direct control of local officials: taxable resources, cost pressures from employers and commuters, etc.
- This report measures municipal fiscal disparities caused by differences across municipalities in factors that outside the direct control of local officials.

The “Cost-Capacity Gap” Framework

- We calculate the gap between taxable resources (“capacity”) and the costs of providing public services (“cost”).
- Both capacity and cost are measured using factors that are outside the direct control of local officials.
- A larger gap indicates a worse underlying fiscal condition.

Municipal Capacity

- We do not use actual revenue as “municipal capacity,” because actual revenue reflects the tax rate that local officials choose.
- Municipal capacity is defined as the ability of municipalities to raise revenue from local taxable resources to support nonschool services.
- The property tax is virtually the only own-source revenue available for localities in Connecticut.

Measuring Municipal Capacity

- We measure capacity by computing how much revenue each municipality would be able to raise from the property tax at a “standard” tax rate.
- We set the “standard” tax rate so as to make the statewide municipal capacity equal the statewide local nonschool spending.
- Municipal capacity is directly proportional to each municipality’s taxable property value (excluding exemptions).

Table 1. Illustrations of Municipal Capacity Calculation for One Sample Municipality
(FY 2011, 2012 dollars)

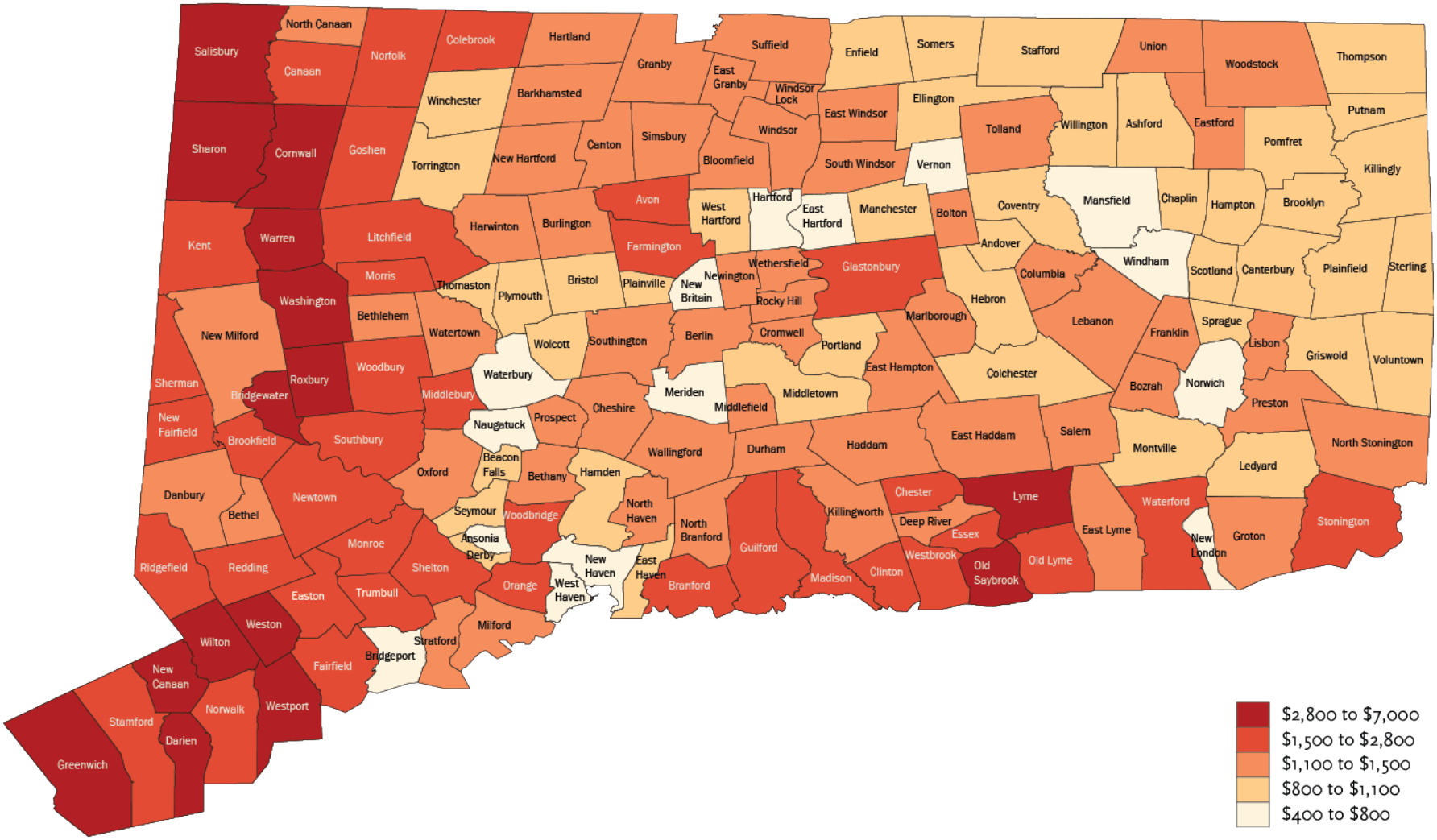
State of Connecticut			New Britain	
State Nonschool Spending ($ per capita)	**State ENGL** ($000s per capita)	**"Standard" Tax Rate** (mills)	**ENGL** ($000s per capita)	**Municipal Capacity** ($ per capita)
(1)	(2)	(3)=(1)/(2)	(4)	(5)=(3)×(4)
1,382	153	9	56	506

Source: Authors' calculations.

Note: For simplicity, some figures displayed are rounded up to the nearest integer.

Figure 1. Municipal Capacity by Municipality

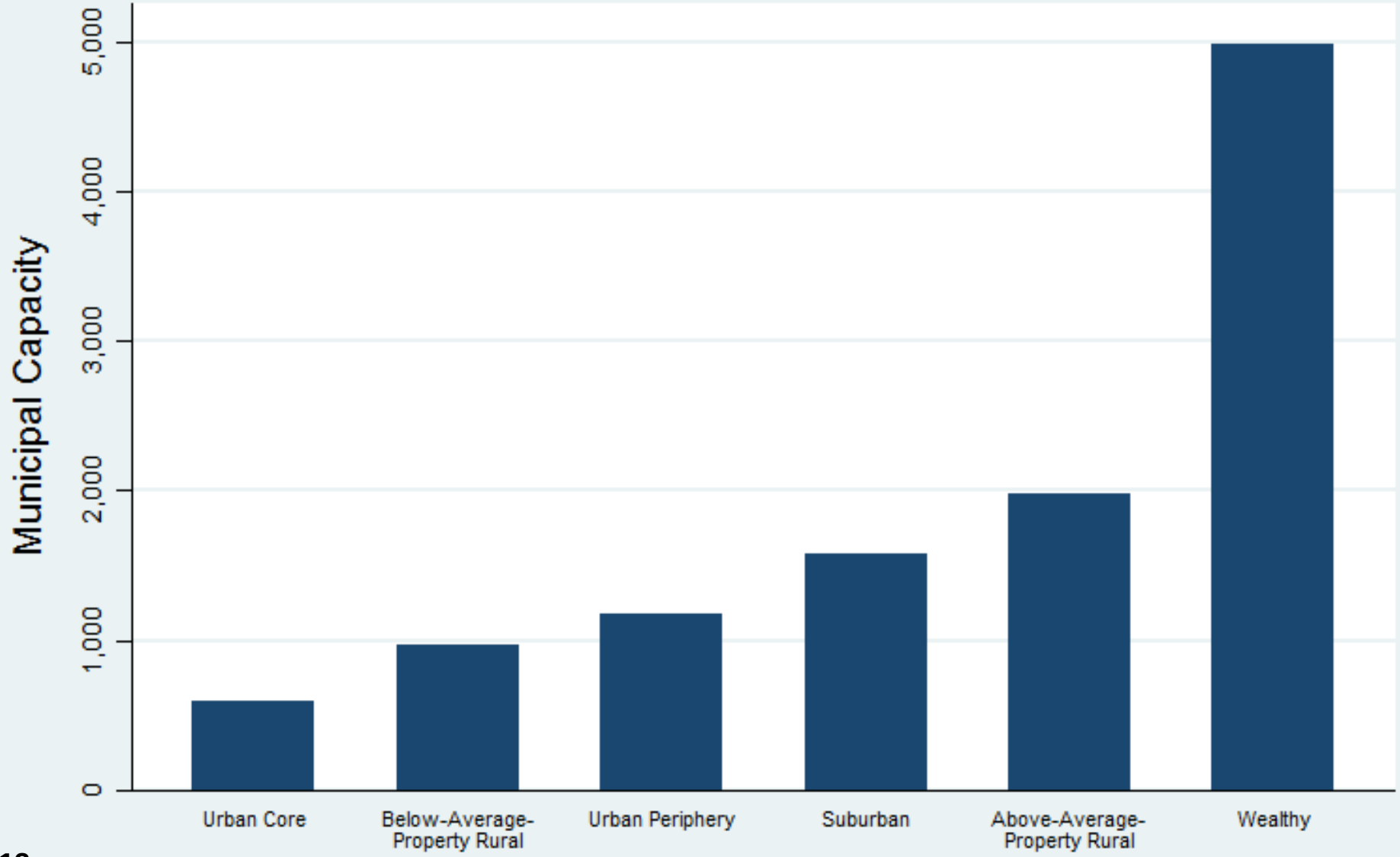
(FY2007–FY2011 average, 2012 dollars per capita)



Source: Authors' calculations.

Municipal Capacity by Municipality Type

(FY2007–FY2011 population-weighted average, 2012 dollars per capita)



Source: Authors' calculations and Levy, Rodriguez, and Villemz (2004).

Municipal Cost

- We do not use actual spending as “municipal cost,” because actual spending is impacted by management quality, efficiency, and choices about service levels.
- Municipal cost is defined as how much each municipality must spend to provide a given level of nonschool services, given its socioeconomic characteristics that are outside the direct control of local officials.
- We use statistical analysis to identify cost factors and use them to calculate the cost measure.

Cost Factors

- Unemployment rate
- Population density
- Private-sector wage level
- Town maintenance road mileage
- Per capita jobs

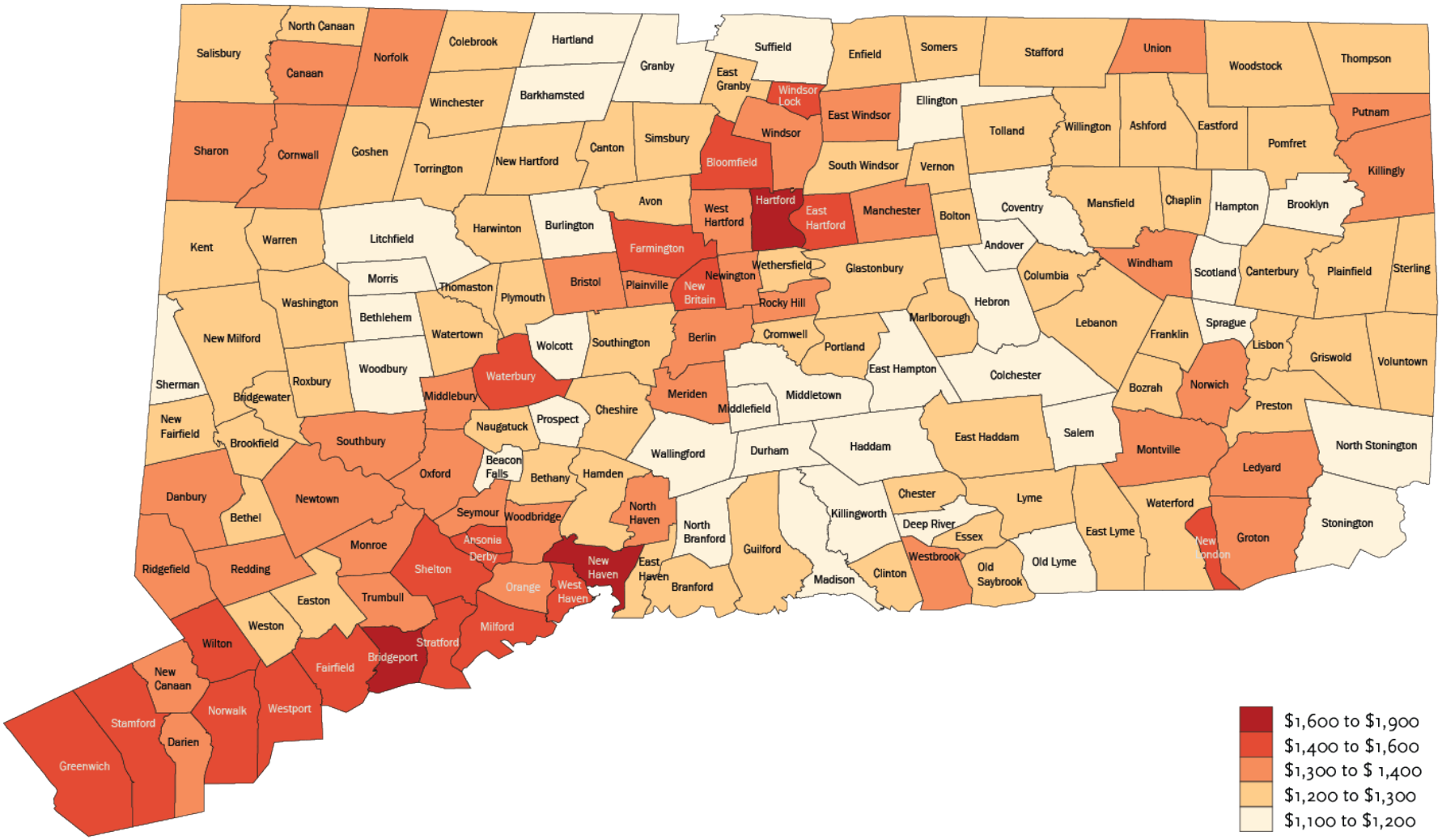
Table 3. Illustrations of Municipal Cost Calculation for One Sample Municipality (FY 2011, 2012 dollars)

		New Britain	
	Factor Weight ($ per capita per cost factor unit)	**Factor Value**	**Contribution to Cost** ($ per capita)
Cost factors:	(1)	(2)	(3)=(1)×(2)
Unemployment rate (%)	24.80	14.50	360
Population density (000s per square mile)	36.48	5.46	199
Private-sector wage index (% of statewide private-sector wage index)	6.66	98.56	656
Town maintenance road mileage (per 000 population)	6.73	2.25	15
Per capita total jobs	217.92	0.35	76
Statewide constant	257	1.00	257
Municipal cost ($ per capita) (total of above)			1,562

Source: Authors' calculations.
Note: The factor weight indicates how much per capita municipal cost would increase with a one-unit increase in each cost factor. For simplicity, some figures displayed are rounded up to the nearest integer.

Figure 2. Municipal Cost by Municipality

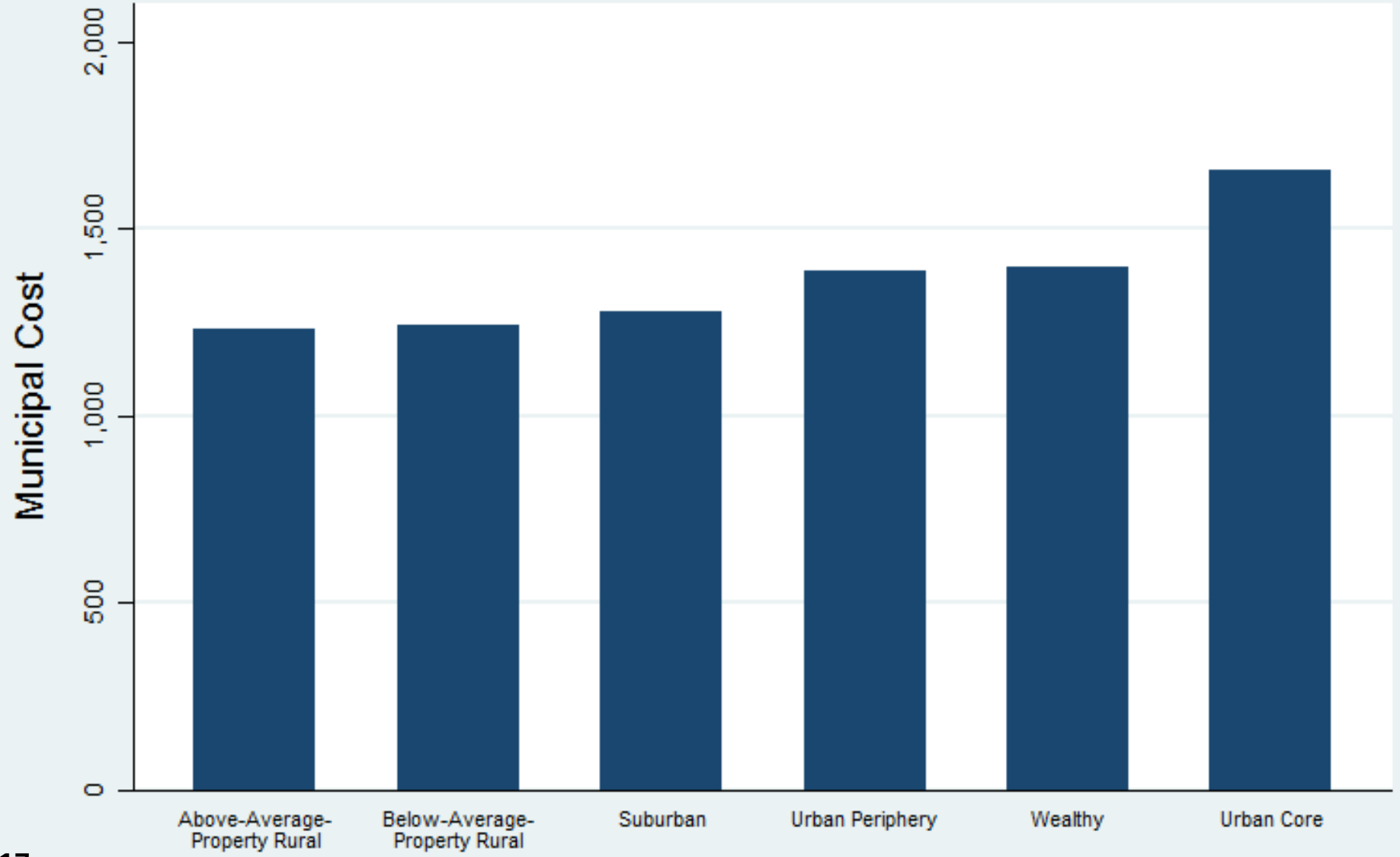
(FY2007–FY2011 average, 2012 dollars per capita)



Source: Authors' calculations.

Municipal Cost by Municipality Type

(FY2007–FY2011 population-weighted average, 2012 dollars per capita)



Source: Authors' calculations and Levy, Rodriguez, and Villemz (2004).

Municipal Gap

- Municipal gap = municipal cost – municipal capacity
- Statewide municipal gap is zero.
- A positive gap represents a municipality lacking sufficient revenue-raising capacity to provide common nonschool services. The larger the gap, the worse the fiscal condition.
- A negative gap represents a municipality having more revenue-raising capacity than needed for providing common nonschool services.

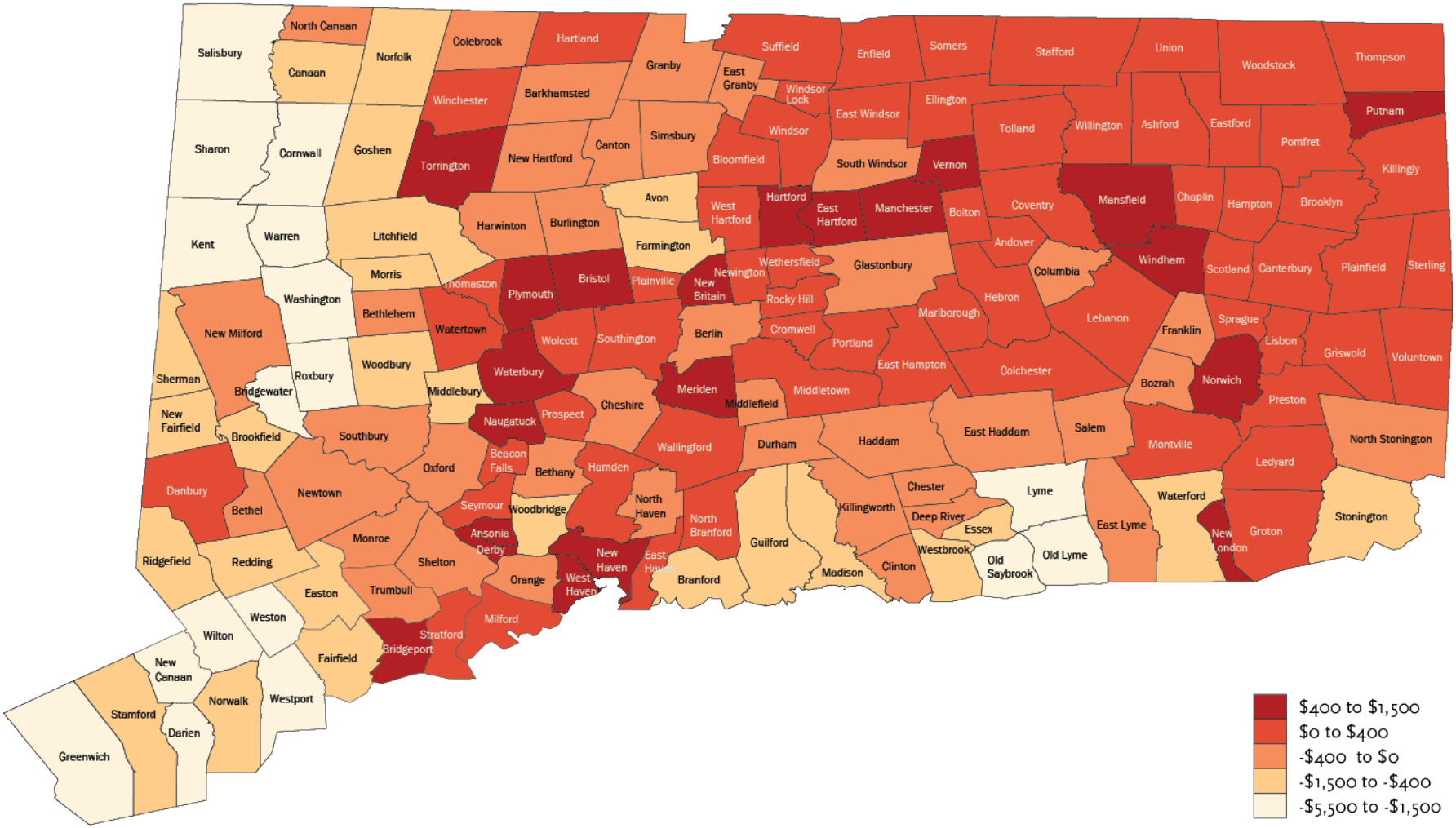
Table 4. Illustrations of Municipal Gap Calculation for One Sample Municipality and the State (FY 2011, 2012 dollars per capita)

	Municipal Cost	**Municipal Capacity**	**Municipal Gap**
	(1)	(2)	(3)=(1)-(2)
New Britain	1,562	506	1,056
State of Connecticut	1,382	1,382	0

Source: Authors' calculations.

Figure 3. Municipal Gap by Municipality

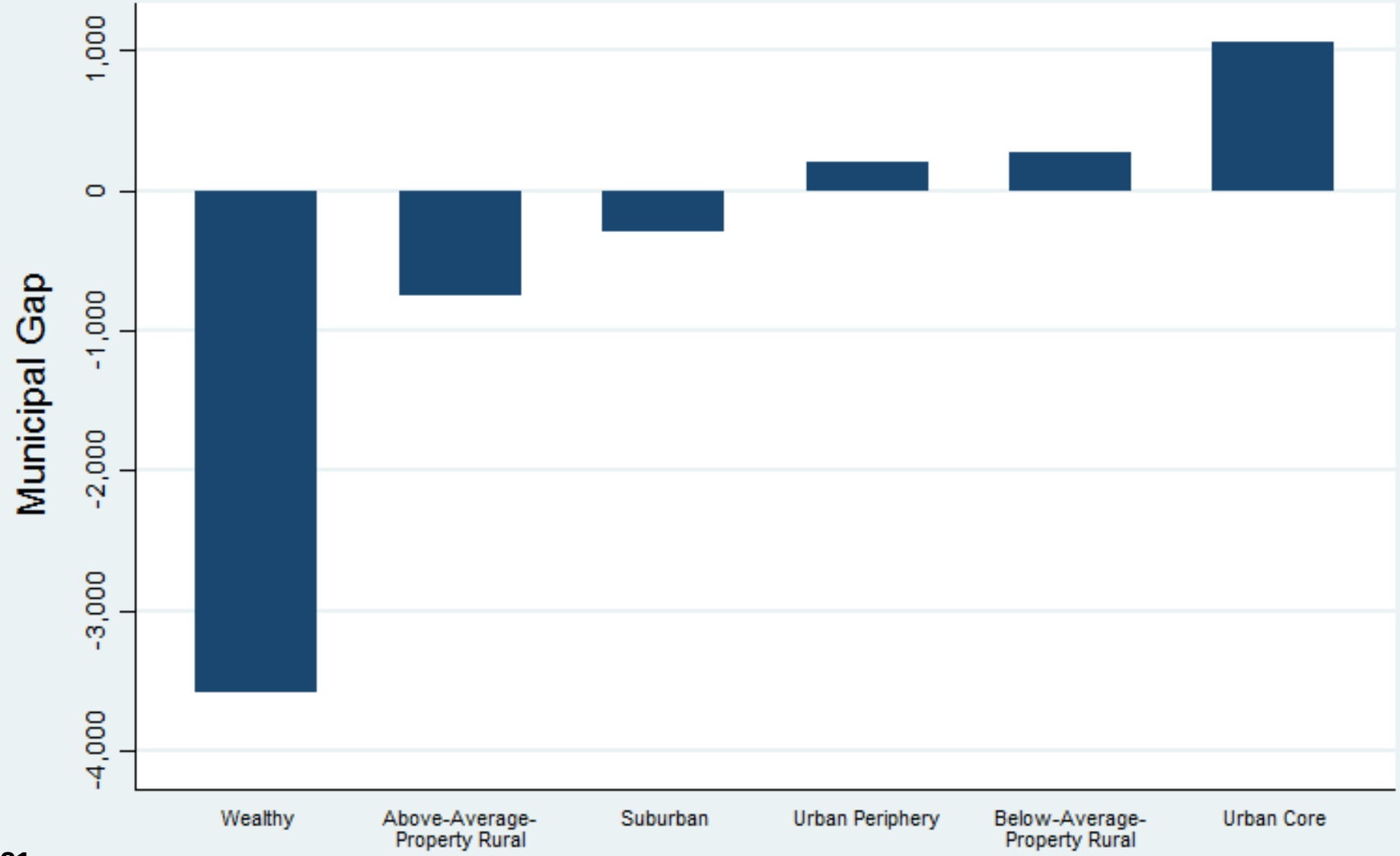
(FY2007–FY2011 average, 2012 dollars per capita)



Source: Authors' calculations.

Municipal Gap by Municipality Type

(FY2007–FY2011 population-weighted average, 2012 dollars per capita)

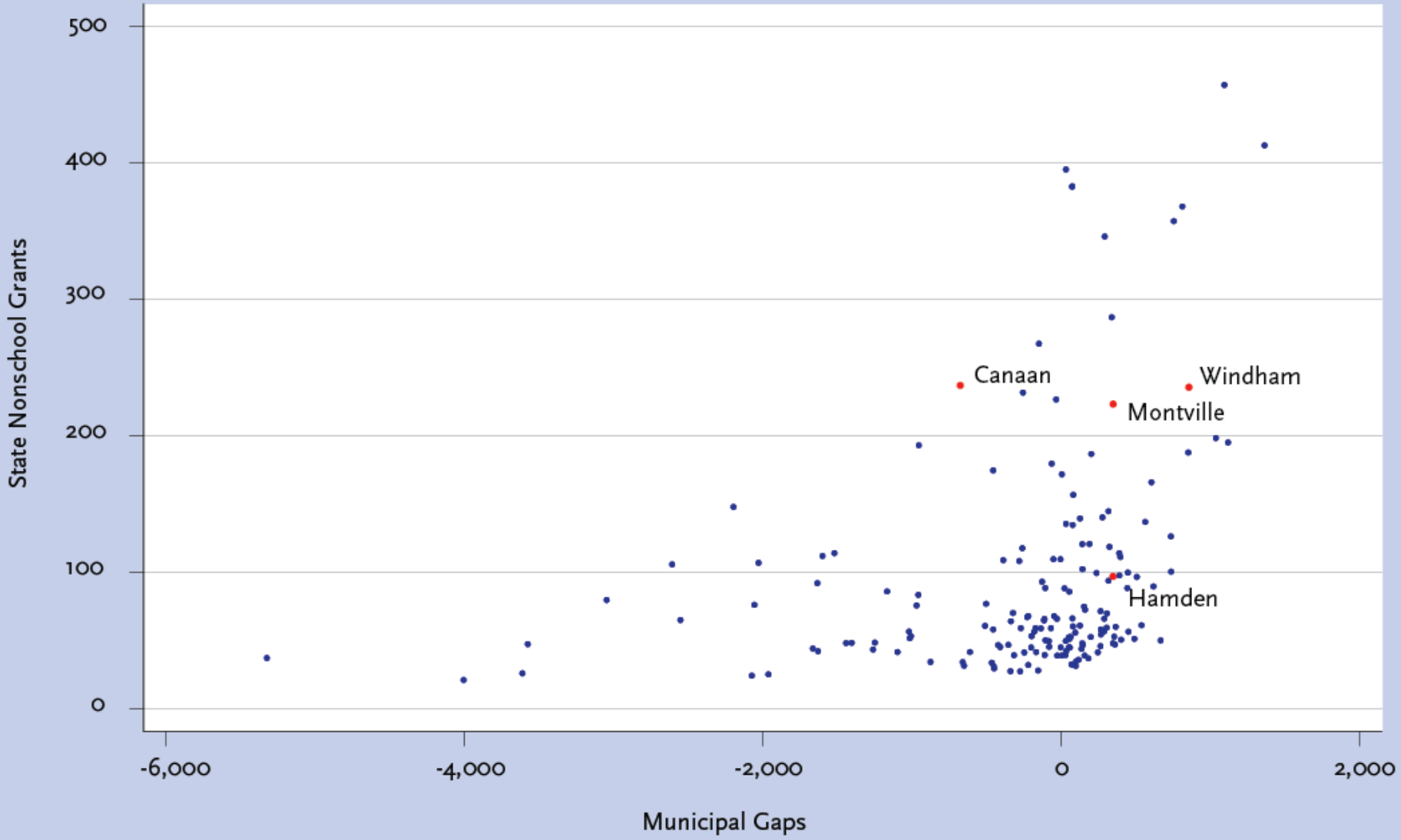


Source: Authors' calculations and Levy, Rodriguez, and Villemz (2004).

State Nonschool Grants

- The state provides municipalities with some nonschool grants, which are relatively small compared with the ECS grant.
- They include Colleges & Hospitals PILOT, State Property PILOT, Pequot Grants, Town Aid Road, LoCIP, etc.
- These nonschool grants do not have an explicit equalization goal, although some formulas consider some socioeconomic factors.

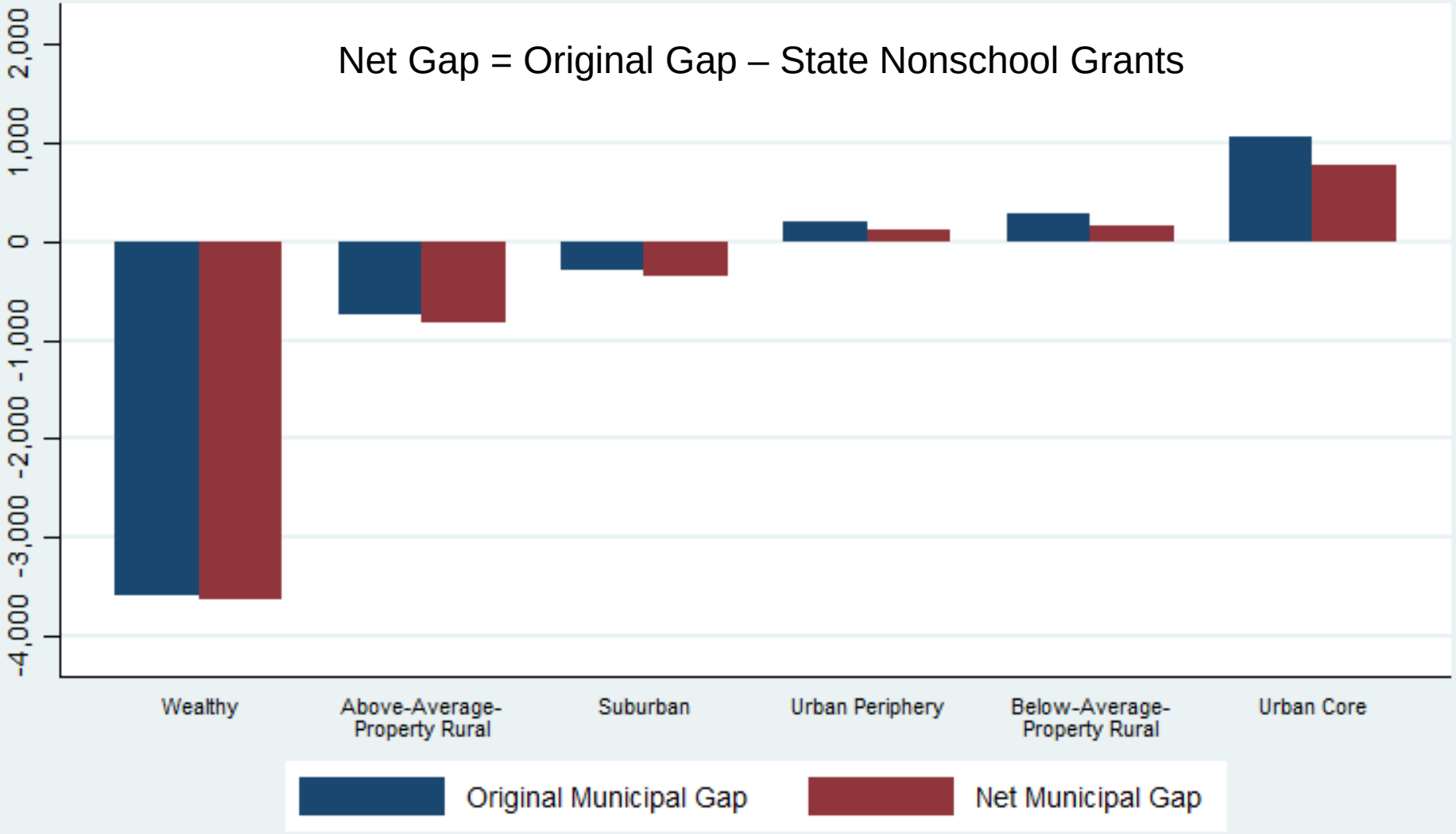
Figure 4. State Nonschool Grants Versus Municipal Gaps
(FY2007– FY2011 average, 2012 dollars per capita)



Source: Authors' calculations.

Original Municipal Gap versus Net Gap by Municipality Type

(FY2007–FY2011 population-weighted average, 2012 dollars per capita)



Source: Authors' calculations and Levy, Rodriguez, and Villemz (2004).
Note: State nonschool grants include Veterans' Exemption, Elderly Circuit Breaker, Elderly Freeze, Disability Exemption, State Property PILOT, Colleges & Hospitals PILOT, LoCIP, Pequot Grants, Town Aid Road, DECD PILOT Grant, and DECD Tax Abatement.

Conclusion

- There are significant nonschool fiscal disparities among Connecticut municipalities.
- These disparities are mostly driven by the uneven distribution of the property tax base across the state, while cost differences also play a role.
- State grant programs play a limited role in reducing nonschool fiscal disparities in Connecticut.

Contact Information of the Corresponding Author

Bo Zhao

Senior Economist

Federal Reserve Bank of Boston

600 Atlantic Avenue T-8

Boston, MA 02210

(617) 973-3061

Bo.zhao@bos.frb.org