

# New England Fiscal Facts

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## Do New England's Public Schools Need Finance Reform? *Part 1*

By Daniel G. Swaine

**R**esiding in the “land of opportunity,” we Americans generally believe in an equal chance for all individuals to succeed, rich or poor. Consequently, we created and have long supported a system of universal public education, which is widely seen as an equalizer. However, we also have another tradition that extends back to colonial times — resistance to centralized authority. Because of this second tradition, the United States has a federalist system of government that spreads authority across three levels: federal, state, and local. Public education developed state by state, and state governments typically delegate control over public education to local districts, with the result that schools have been financed through the local property tax. Since property wealth is unequally distributed across districts, educational spending exhibits wide disparities.

How do we provide equal educational opportunities while maintaining local control over schools? This question has proved to be one of the most controversial policy issues of the last quarter-century. Frustrated by the slow pace of legislative efforts to equalize school spending, advocates of greater equality have challenged existing systems of school finance in state courts across the nation. In New England, four court challenges have been successful: Connecticut in 1977, Massachusetts in 1993, and Vermont and New Hampshire in 1997. A fifth challenge in Rhode Island went as far as the Superior Court before it languished on appeal. A sixth

challenge, filed in Connecticut in early 1998, is still pending. The decisions rendered in these cases have forced school finance reform to the top of the legislative agenda in nearly all New England states.

In a three-part series, *Fiscal Facts* examines the issues posed by educational finance reform:

- In this issue, we present a summary of the legal strategies used to challenge school finances in state courts and discuss how these strategies have been employed in New England. In addition, we discuss the three main fiscal equalization strategies used to narrow spending disparities and the fiscal remedies that have been enacted by the New England states to address court-ordered reforms.

- In our next issue, we will evaluate the extent to which the enacted fiscal remedies have achieved their intended goals in Connecticut, Massachusetts, and Vermont.

- Many critics of school finance reform argue that individuals acquire a poor education because schools are inefficient, not because they lack sufficient funds. These critics note that while per-pupil spending has increased in inflation-adjusted terms over the last quarter-century, student performance as measured by standardized achievement tests has remained constant at best. Although many factors come into play, this result implies that finance reforms may equalize resources, but fail to equalize educational outcomes. Since school finance reform increases the state's contribution to



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**State  
Budget  
Timetables**

*Annual Budgets*

Massachusetts  
Rhode Island  
Vermont  
FY99: July 1, 1998  
to June 30, 1999  
FY00: July 1, 1999  
to June 30, 2000

*Biennial Budgets*

Connecticut  
Maine  
New Hampshire  
FY98-99: July 1, 1997  
to June 30, 1999

education, some critics argue that states should impose performance requirements contemporaneously with all increases in fiscal aid. We will conclude the series by discussing educational performance reform in the context of school finance reform.

**The School Finance Problem: Unequal Access**

During the public school movement of the mid-nineteenth century, states added clauses to their constitutions providing for the education of their residents. These constitutional provisions stipulate education as a state responsibility. However, state legislatures interpreted this mandate in a manner consistent with the tradition of decentralization — most enacted subsequent legislation delegating this responsibility to local school districts, with each having the authority to form a school system and to raise revenues to fund operations. Local property taxes, the primary source of revenues for municipal governments, became the main revenue source used to finance schools.

But property wealth is distributed unequally across communities, and, as a result, students from different communities will likely have unequal access to educational resources.

If all districts levied identical tax rates, then property-rich districts would raise greater property tax revenues (per pupil) than property-poor districts. Since property tax revenues provide most of the funding for school expenditures, rich districts would be able to spend more for education than poor districts. Viewed another way, if all districts were to spend the same amount on a per-pupil basis, property-poor districts would have to levy much higher tax rates than property-rich districts.

Chart 1 illustrates this problem using data on per-pupil property wealth of Texas school districts for the academic year 1986-87.<sup>1</sup> The light green line represents per-pupil revenues that could be raised from property tax assessments, assuming an equal tax rate (at the state average) across districts. As a district's per-pupil property wealth increases, its tax revenue (per-pupil) rises proportionately. The dark green line shows the property tax rate that would need to be charged by each locality to spend at the statewide per-pupil average.

**Legal Strategies**

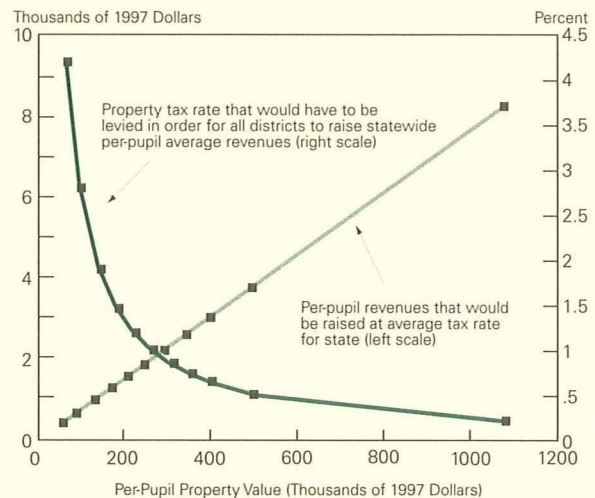
Because pervasive and persistent wealth disparities imply that students will have unequal access to educational resources, advocates of the "equal opportunity" tradition have challenged existing systems of school finance in state courts.

The problem of unequal access suggests a legal strategy based on the equal protection clause of

**Chart 1**

**Variations in Property Wealth Can Cause Sizable Inequities in Educational Funding**

*Data from Texas Illustrate Inequities*



Note: Property values are plotted as deciles, with the first decile broken into two parts. Data are for academic year 1986 - 87. Source: Allan Odden and Lawrence Piccus, *School Finance: A Policy Perspective* (1992), chapter 1.

<sup>1</sup> Texas is used as an example because these data were readily available.



the U.S. Constitution or similar clauses in state constitutions.<sup>2</sup> However, many state laws do treat individuals unequally. Laws that establish certification requirements to operate a motor vehicle or to practice certain professions are examples of laws that discriminate among individuals. The rationale for treating individuals unequally in these circumstances is to protect the public from harm. Therefore, as long as the state has a logical basis for legislating differential treatment, the courts generally uphold the constitutionality of unequal treatment. In school finance cases, the state's rationale for creating unequal access to educational resources is its right to delegate responsibility to local governments. However, if a statute violates a "fundamental right," or creates a discriminatory grouping that has no logical basis, then the courts generally hold that unequal treatment is unconstitutional.

Thus, in school finance cases, the burden of proof rests with the plaintiffs to argue that unequal access to educational resources violates a "fundamental right." If the plaintiffs are successful, then the burden of proof shifts to the state. According to the courts, the state must argue (1) that there is "a compelling state interest" for unequal access, and (2) that there is "no less discriminatory" policy the state could use to satisfy the compelling interest. Therefore, in court challenges to school finances that are based on equal protection, plaintiffs must make two arguments: (1) that education is defined as a "fundamental right," and (2) that there is an alternative financing scheme based on the principle of fiscal neutrality.<sup>3</sup>

The U.S. Supreme Court ruled in 1973 (*Rodriguez v. San Antonio School District*) that education is not a fundamental right guaranteed by the U.S. Constitution, effectively ending all challenges to school finances in the federal courts.<sup>4</sup> But education is specifically mentioned as a state responsibility in every state constitution, so basing challenges on state equal protection clauses has proved to be a more viable legal strategy.

The existence of an education clause in every state constitution has also led to the development of a second legal strategy. In mandating education as a state responsibility, education clauses use such phrases as "a basic education," "a thorough education," or "an adequate education." Legal challenges based on these clauses have interpreted the particular phrases in a meaningful way, arguing (1) that these phrases mandate more than a minimal education for all residents, and (2) that property wealth disparities interfere with the fulfillment of this mandate.

An early successful challenge to school finances that employed both legal strategies (*Robinson v. Cabill*, 1973) occurred in New Jersey, with the result that the second argument

won the case. Since the *Robinson* decision, most subsequent legal challenges have employed this dual strategy — thirty-four states have faced school finance litigation, with slightly more than half of these challenges being successful.

## New England Court Challenges

Four successful challenges to school finances have occurred in New England: *Horton v. Meskill* in Connecticut in 1977; *McDuffy v. Secretary of Education* in Massachusetts in 1993; *Claremont v. Governor et al.* in New Hampshire in 1997; *Brigham v. Vermont* in Vermont in 1997. Two of these cases are textbook examples of the legal strategy outlined above. In Connecticut and Vermont, state supreme courts ruled that the education clause contained in the state constitution creates a "fundamental right" to education. They also ruled that disparities in per-pupil spending due to per-pupil property-wealth disparities violate the state equal protection clause, and that the principle of fiscal neutrality creates a less discriminatory alternative. Each court also decided that while exact equality in per-pupil expenditures is not required, overhauled finance systems could not allow district expenditures to vary with district wealth.

In the *McDuffy* case, the Massachusetts Supreme Judicial Court based its decision on the mandate contained in the state constitution's education clause. The court said that the state is constitutionally required to provide an "adequate" education for all citizens without regard to economic status, and that spending disparities due to local property tax funding violate this mandate. While the court did not order the complete overhaul of school finances, it ordered the Commonwealth to design a system that would provide an "adequate education" for all citizens regardless of the fiscal capacity of the district in which they live. The court issued a loose outline of an adequate education for the legislature to use in reforming the system. These guidelines acted as the foundation for the subsequently enacted performance reforms.

New Hampshire's recently decided *Claremont* case differs in a significant way from every other case previously discussed. The plaintiffs, including five school districts, a student from each district, and eight property taxpayers from differ-

<sup>2</sup> The equal protection clause in the U.S. Constitution is contained in the Fourteenth Amendment and states that "no person can be denied equal protection under the laws."

<sup>3</sup> The principle of fiscal neutrality states that per-pupil spending across communities cannot be related to a statistically significant degree to per-pupil property valuations across communities. Assuming that all education expenditures are financed through the local property tax, Chart 1 illustrates a system that is not fiscally neutral.

<sup>4</sup> The *Rodriguez* case was the first and only case to be argued in the federal courts.



ent districts, challenged the system based on unequal treatment of taxpayers. They argued that charging taxpayers in different communities different property tax rates violated their constitutional right to equal protection. This argument also relied on an idiosyncratic provision of the New Hampshire constitution: that all taxes must be proportionate.<sup>5</sup> In its ruling, the court stated that the constitution requires the state to provide an “adequate” education. Therefore, all revenues raised for education are state taxes. Since all education taxes are state taxes, then the proportionate taxation clause mandates that education-specific property tax rates must be equal for all taxpayers within the state.<sup>6</sup> The legislature adjourned at the end of July without enacting a remedy.

### Available Fiscal Remedies

Three basic fiscal remedies are used to address disparities in resources for financing schools: a completely state-funded system, a foundation expenditure system, and a guaranteed tax base system.

**1.** The most obvious solution to fiscal disparities is for the state to completely fund the school system, using broad-based taxes that can be redistributed to school districts for operating expenditures – thereby achieving exact per-pupil resource and expenditure equalization. However, under such a system, states find it difficult to balance the goals of local control and local accountability. If states completely fund education through fiscal assistance with no strings attached, localities can use the state funds for tax relief or for programs other than education. If the states earmark the aid for education, the states control education finance to an unacceptable degree. Consequently, states prefer a system where schools are jointly financed, and states have some say over how their school aid is spent.

**2.** In the foundation expenditure system, a state-determined expenditure level provides a base (or foundation) for a minimally adequate education. The state guarantees this expenditure by funding (with state aid) the difference between the foundation and what the district can raise from its property wealth at some target tax rate. Theoretically, districts that can achieve this expenditure with their own property resources could be required to pay all funds raised above

the foundation back to the state for redistribution to property-poor districts. If foundation systems actually implemented this redistributive payback, then exact per-pupil expenditure equalization would be achieved. In practice, this payback is not required. Property-rich districts are given no state aid, or a relatively small flat grant.

Because property-rich districts are not subject to payback, the degree of expenditure equalization achieved by a foundation system depends upon the level at which the foundation expenditure is set. Equalization is achieved solely through the mechanism of raising school districts at the bottom of the expenditure distribution to the foundation expenditure level. If the foundation is set very low, many districts will spend above the foundation. Per-pupil expenditures will continue to vary with per-pupil property values, so that only a small degree of equalization is achieved. If the expenditure is set at a high level, relatively few districts will spend in excess of the foundation, so that considerable equalization is realized. Furthermore, if the foundation expenditure level is not adjusted for rising costs, then the real (inflation-adjusted) foundation expenditure will shrink over time. Communities will be forced to rely on their own resources to compensate for cost increases, leading to greater spending disparities.

**3.** Under the guaranteed tax base (GTB) system, the state determines a level of property wealth that each district is guaranteed as a tax base. Any district with wealth below the guarantee receives state aid that is proportional to the increment in property wealth needed to raise district wealth to the guaranteed base. In its purest form, any district with wealth above the guarantee pays contributions to the state that are proportional to the decrement in property wealth required to lower the district’s wealth to the guaranteed base. In practice, payback provisions are rarely implemented. The amount of state aid (or payback) depends upon the locally determined property tax rate. Districts with wealth below the guaranteed tax base can increase their state aid by taxing themselves at a higher rate.

Since this system equalizes property tax bases across districts, the problem of raising local revenues out of property wealth that varies across districts is eliminated. Nevertheless, a GTB system is not completely wealth neutral. Because each district can choose its own property tax rate, a positive relationship between property wealth and expenditures could still exist if property-rich communities tax themselves more heavily. Furthermore, some districts could set a tax rate that does not provide a minimally adequate expenditure level from the guaranteed tax base. To avoid this problem, many analysts advocate a multi-tier system. The first tier is either a

<sup>5</sup> The courts in New Hampshire have interpreted this provision to mean that all statutory tax rates must be applied equally to all taxpayers within an appropriately defined jurisdiction.

<sup>6</sup> In the *Claremont* case, the defendants claimed that the appropriate jurisdiction was the local school district. Since property tax rates were applied equally to all taxpayers within a district, then the system was constitutional. The court ruled that since education was a state responsibility, the appropriate jurisdiction was the entire state. Since property tax rates were not equally applied across districts, the equal protection clause in the state constitution was being violated.



foundation system or a system of complete state funding for the foundation expenditure to ensure that all districts achieve some minimal level of expenditure. The second tier is a GTB system that allows local districts to supplement the foundation expenditure, subject to tax base equalization.

## Legislative Remedies in New England

To address the *Horton* decision, the Connecticut legislature enacted a modified GTB system that also includes elements of a foundation expenditure system. First, instead of forcing property-rich communities to share revenues with property-poor communities, the state set the GTB at a very high level (the 95th percentile of property valuation), so that most communities receive equalizing state aid. The few communities that are at or above the GTB receive a minimal flat grant. Second, the state set a maximum local property tax rate. This tax rate ceiling caps GTB aid. Third, the state set a minimum expenditure level, similar to a foundation expenditure system. To force compliance, the state withholds equalizing aid for any community that levies a tax rate below this minimum.

However, during its fiscal crisis in 1991, Connecticut changed to a foundation expenditure system. Since districts that spend above the foundation are not subject to payback provisions, many districts have raised non-equalized local property tax revenues to offset the reduction in state aid. Recent figures released by the Connecticut Teachers Association suggest that disparities in spending have increased as a result of the change. A group of communities led by the City of Bridgeport filed suit in early 1998 to challenge the foundation system in court. The case is pending.

The *Sheff v. O'Neil* decision in 1996 also affected Connecticut's school finances. The plaintiffs claimed that the state's school system was highly segregated (racially, ethnically, and economically). The state Supreme Court ruled in favor of the plaintiffs, blaming segregation in the schools on the statutorily drawn school district boundaries. The state is preparing a plan to consolidate school districts (inter-districting) to address the *Sheff* decision (see *Fiscal Facts*, Spring/Summer 1998). Because the new inter-districting plan alters the distribution of property wealth across districts, state-aid formulas will need to be modified.

Vermont enacted a two-tier system. The state supreme court called for "substantial equality" in educational expen-

diture, but did not order complete equality. The legislature enacted a statewide property tax and combined this with additional state revenues to provide each district with a flat grant of \$5,000 per pupil. For the second tier, local communities have the option of raising additional revenues to spend in excess of the state grant. All local school taxes are designed as a GTB system, with property-rich communities subject to a payback provision.

Since the court did not demand a radical overhaul of school finances in Massachusetts, the legislature modified its pre-existing foundation aid formula. The state determines a foundation expenditure level to meet adequate educational standards according to the guidelines set out in the *McDuffy* decision. Provisions ensure that the foundation level is routinely adjusted for changing cost conditions. The state also sets a standard effort tax rate, which determines the property valuation that will achieve the foundation expenditure. State aid is provided to all districts that are below this property valuation level, provided that they spend at least the foundation amount. No foundation aid is provided to districts with property values above this level, although they may be eligible for other aid. The legislation includes a seven-year phase-in period that extends through FY2000.

## Implications and Conclusions

School finance reform is a complicated and lengthy undertaking that generally takes many years to implement. Although most states provide some form of equalizing aid, state governments are generally loath to enact voluntarily additional equalizing measures because of the tradition of local control. Reformers rely on the courts to remedy inequitable financing systems as part of a continuing process. When this litigation is successful, court decisions force state governments to play an even more active role in financing the education of their citizens.

All enacted reforms attempt a difficult balancing act, trying to forge a compromise between two contradictory traditions: equal opportunity and local control. Consequently, enacted reforms do not achieve exact fiscal equalization, but do result in greater equality than the pre-reform system. However, because enacted reforms remain open to future court challenges, educational finance reform is likely to remain an issue for the foreseeable future. In the next issue of *Fiscal Facts*, we continue this series by evaluating the reforms enacted in New England to see how equalizing they have proved to be. **FF**



## Across *the* Region

**R**evenue collections finished fiscal year 1998 with a bang. A hefty budget surplus, ranging from 5 to 10 percent of total revenue collections, was recorded in every New England state. The cornucopia led to supplemental spending increases enacted for FY99, but also provided the wherewithal for major tax reductions in Connecticut, Massachusetts, and Rhode Island. In addition, an obscure tax provision enacted in Maine five years ago kicked in, leading to an unexpected sales tax reduction.

Educational finance reform continues to be newsworthy across the region — Connecticut and Massachusetts are making large investments in state aid to education, while Vermont has begun to implement Act 60. Meanwhile, New Hampshire continues to struggle over how to comply with the *Claremont* decision (see *Fiscal Facts*, Spring/Summer 1998), with efforts to amend the state's constitution to allow for property tax disparities being seriously considered.

### Total State Appropriations for FY98 and Enacted Appropriations for FY99<sup>a</sup>

*Excluding Federal Dollars*

	FY98	FY99	Percent Change
	Millions of Dollars		
Connecticut	8,621.3	8,912.7	3.4
Maine	2,055.4	2,226.1	8.3
Massachusetts	15,232.9	16,110.8	5.8
New Hampshire <sup>b</sup>	1,188.1	1,222.1	2.9
Rhode Island <sup>c</sup>	2,568.5	2,782.4	8.3
Vermont <sup>d</sup>	1,303.5	1,329.7	2.0

<sup>a</sup> Unless otherwise noted, includes general fund and transportation fund appropriations only. Excludes expenditures of federal grants and reimbursements.

<sup>b</sup> Includes budgeted income from sweepstakes earmarked for foundation aid and special education.

<sup>c</sup> Includes general revenue and other unrestricted funds.

<sup>d</sup> Includes Act 60 spending for FY99. FY98 expenditures are appropriately adjusted for comparison.

Source: Official budget documents, state financial statements, and conversations with state budget officials.

## Connecticut

Connecticut collected \$7.5 billion in FY98 tax revenues, up 7.5 percent from FY97. Personal income tax collections were up 16.0 percent, while sales tax revenues were up 6.2 percent. The state realized a revenue surplus of \$794.1 million. Given net supplemental spending of \$27.6 million, the state was left with a budget surplus of \$766.5 million (8.9 percent of expenditures).

At the end of May, Governor John Rowland signed into law an \$8.9 billion own-source revenue budget for FY99 — \$291 million, or 3.4 percent, above final FY98 spending levels. Two major spending initiatives and a tax cut are included in the budget. The state plans to allocate \$2 billion for local aid, up 10.2 percent from FY98 levels. A major portion of the local aid increase is for education, up \$124 million from FY98. The second initiative is \$1.3 billion in spending for

capital projects, primarily in Hartford, Bridgeport, and New Haven. About \$140 million of the expected budget surplus is to be devoted to tax relief, \$100 million in the form of an income tax rebate and \$40 million for property tax abatements. Another \$80 million of the expected surplus is set aside to fix the Y2K problem in the state's computer software systems. An additional \$125 million will be deposited in the state's rainy day fund. The remaining \$422 million is dedicated for expenditures continued to FY99.

## Maine

Total general fund revenues collected in FY98 were \$2.2 billion, up 15.1 percent from FY97. Forecasters had budgeted for revenue growth of 3.5 percent for the year. Sales and use tax collections grew 12 percent from one year ago, while individual income tax collections grew 17.5 percent,



and corporate taxes grew by 10 percent. Maine finished FY98 with a revenue surplus of \$125 million (6.1 percent of expenditures), of which \$78 million was allocated to two tax relief funds and \$23.5 million was deposited in the state's rainy day fund. As of June 30, the rainy day fund balance was \$91.5 million (4.4 percent of expenditures). The remaining \$23.5 million (1.1 percent of expenditures) was carried into FY99 as undedicated balances.

Whenever total revenue growth exceeds 8 percent for any fiscal year, a Maine statute triggers a reduction in the state sales tax rate of 0.5 percentage points in the following year. Since the state controller has determined that revenue growth exceeded 8 percent for FY98, this statutory tax reduction took effect in October 1998. It is expected to cost \$60 million annually in forgone sales tax revenues.

## Massachusetts

For FY98, the Commonwealth collected \$14.0 billion in tax revenues, up 8.9 percent from FY97 levels. Both personal income tax collections and corporate tax collections grew faster than projections — up 11.8 percent and 10.7 percent, respectively. Sales tax collections, which exhibited sluggish growth for most of the year, were up 3.0 percent. Since the enacted FY98 budget projected negative revenue growth of 0.2 percent, the state realized both a revenue surplus and an operating budget surplus. The operating budget surplus totaled \$1.2 billion (7.9 percent of expenditures).

The Governor enacted into law a \$16.1 billion own-source revenue budget for FY99, 5.8 percent above final FY98 expenditures. The FY99 spending increases are dedicated to education and human services. Total educational expenditures will increase by \$310 million, of which \$253 million will be used to fully fund the state's contribution required by the 1993 Education Reform Act.

Two tax cuts were also enacted into law: an income tax cut of \$970 million and an insurance industry tax cut of \$240 million. The income tax legislation includes both a \$770 million permanent tax cut and a one-year \$200 million tax break. The permanent income tax reduction doubles the personal exemption for all taxpayers (retroactively to January 1) and reduces the tax rate on unearned income from 12 percent to the earned income tax rate of 5.95 percent.

Both the one-year temporary income tax cut and the phase-in of the insurance industry tax reduction will be funded from this year's \$1.2 billion budget surplus. In total, over half of the surplus (\$607 million) is allocated to tax breaks. The remaining surplus is allocated for \$190 million in one-time capital spending and a \$378 million deposit into the rainy day fund.

## New Hampshire

General fund revenue collections totaled \$968 million for FY98, up 8.3 percent from FY97 and exceeding the 2.7 percent growth rate projected at the start of the fiscal year. The resulting revenue surplus was \$50 million. The strongest revenue gains came from business taxes and meals and rooms taxes, which were up 14.5 percent and 7.6 percent, respectively. In addition to a tax amnesty program, state officials attribute the boost in revenues to positive economic conditions. The economic climate, the mild winter, and tourism activity all helped meals and rooms tax revenues to exceed projections.

The state is still trying to respond to the Supreme Court's decision in *Claremont School District v. Governor*. Because the state constitution mandates that education is a state responsibility, the court ruled that property taxes levied by local school districts are state taxes. Therefore, the court decided that a system in which local property tax rates vary widely violates the state constitution's equal protection clause (see the article in this issue).

The ABC plan, proposed by state leaders, would have replaced local property taxes with a statewide property tax levied at a uniform rate (see *Fiscal Facts*, Spring/Summer 1998). However, for property-rich districts that can raise sufficient revenues to fund schools at tax rates below the statewide rate, the ABC plan would have required sending "excess" revenues back to these districts — in effect maintaining local tax rate disparities. The supreme court decided that, like the status quo, the ABC plan did not pass constitutional muster.

## Rhode Island

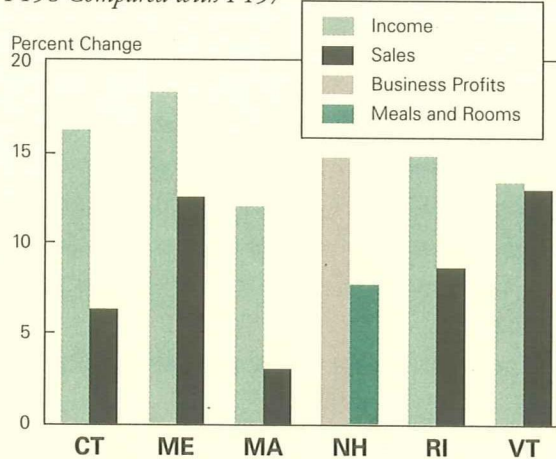
Based upon preliminary year-end FY98 figures, Rhode Island collected a total of \$1.6 billion in taxes, up 14.6 percent from FY97 collections. Personal income tax collections, sales tax collections, and corporate tax collections all exhibited strong growth, up 14.6 percent, 8.5 percent, and 5.2 percent, respectively. These preliminary figures suggest that the state realized a revenue surplus of \$149 million. The budget office projects additional net expenditures of \$21 million, leaving an operating general fund surplus of \$128 million.

In June, Rhode Island enacted a \$2.8 billion own-source revenue budget for FY99, up \$214 million (8.3 percent) over the projected FY98 figure. The budget includes one major spending initiative, a \$43 million increase in aid to local schools. Most of this increase (\$31 million) will be allocated to six urban school districts. The remaining \$12 million will be spread among other districts across the state. The budget also includes a shift of \$33 million in capital maintenance



## Revenues from the Two Largest Taxes in Each New England State

FY98 Compared with FY97



Source: Official budget documents, state financial statements, conversations with state budget officials.

outlays from the capital budget to the operating budget. The budget stipulates that the entire DEPCO (Depositors Insurance Corporation) tax (0.6 percentage points of the sales tax rate) is to be used to retire DEPCO debt ahead of schedule.

A tax reduction package was also enacted. This will gradually eliminate some local motor vehicle excises and business inventory taxes. The state will increase local aid to compensate communities for the resulting revenue losses. This additional state expense is expected to total \$245 million per year when fully phased in. The motor vehicle excise tax reduction will begin next summer and will exempt the first \$1,500 of each vehicle's value from taxation. This exemption will increase every year until the tax is eliminated in FY05. The inventory tax will be phased out over ten years. Once DEPCO debt is eliminated in the year 2001, sales tax revenues dedicated to DEPCO will be used to finance the local aid reimbursements.

## Vermont

Tax revenues exhibited strong growth in FY98, ending 12.8 percent above FY97 levels as compared with projected growth of 4.3 percent. Personal income tax collections were up 13.1 percent, sales and use taxes grew 12.8 percent, and corporate taxes grew 20.6 percent. However, Act 60, the educational finance reform bill, resulted in statutory changes to both sales and corporate taxes. After adjustment for these changes, sales and use taxes grew 8 percent, and corporate taxes grew 1.2 percent. Vermont closed FY98 with a \$61 million revenue surplus and, given some expenditure cuts, ended the year with a \$76.8 million operating budget surplus.

Vermont enacted into law an own-source revenue budget of \$1.33 billion for FY99 – a 2.0 percent increase over FY98 levels and \$4.4 million (0.3 percent) above the Governor's recommendations. A large portion of the budget surplus, \$60 million, is earmarked for the new education fund. Another \$13 million will be used to fund some one-time capital projects, including state buildings, school construction, sewers, and water systems. The remaining \$3.8 million will go into the budget stabilization fund.

Act 60 includes a property tax relief provision. Taxpayers whose total household income is less than \$75,000 are not required to pay more than 2 percent of their income in property tax. If a household with a maximum of 2 acres of land is assessed a property tax bill that exceeds 2 percent of household income, the state must return the excess in the form of a rebate. Since property taxes have yet to be paid this year, the rebate will come as an advance refund (termed a "pre-bate") from the full payment of taxes that will be received later in the year. Pre-bate checks totaling \$46.8 million were mailed out in July. In the future, property tax rebates will take the form of an income tax refund system. **FF**

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