Testimony of Dr. Bo Zhao

Senior Economist, New England Public Policy Center, Federal Reserve Bank of Boston

H.1828 - An Act regarding revenue sharing with cities and towns

Massachusetts Joint Committee on Municipalities and Regional Government

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Chairman O'Day, Chairwoman L'Italien, and other members of the committee:

Thank you for the opportunity to provide my testimony. My name is Bo Zhao. I am a senior economist at the New England Public Policy Center at the Federal Reserve Bank of Boston. I have published several research articles that explore reforming municipal aid in Massachusetts. This testimony reflects my own views and does not necessarily represent the views of the Federal Reserve Bank of Boston or the Federal Reserve System.

Based on my research, I believe that the proposed legislation would help improve the distribution of unrestricted municipal aid in Massachusetts. Unrestricted municipal aid in the Commonwealth was mandated to "provide general purpose financial assistance to municipalities on an equalizing basis."[1] However, Additional Assistance, which is an important component of unrestricted municipal aid, has not been distributed in an equitable manner in recent decades. This is largely because the state deeply cut each community's Additional Assistance allocation on an *ad hoc* basis in the early 1990s, and since then level funded or cut it across the board. In FY 2010, the state merged Additional Assistance and Lottery Aid into Unrestricted General Government Aid (UGGA). While Additional Assistance disappeared on paper, it is still an implicit component of UGGA, and therefore continues to affect the distribution of the Commonwealth's unrestricted municipal aid.

In a pair of studies issued by the Federal Reserve Bank of Boston's New England Public Policy Center in 2010, my colleagues and I demonstrated how the state could reform its UGGA program to allocate more new aid to the most disadvantaged communities.[2] The research considered a measure of each community's underlying fiscal health called "municipal gap." This is the difference between a community's uncontrollable costs of providing municipal services and its ability to raise local revenues to pay for those services. The uncontrollable costs depend on each community's socioeconomic characteristics that are outside the direct control of local officials, such as the poverty rate and the unemployment rate. The revenue-raising capacity of each community is largely determined by its property values and income. Communities with larger municipal gaps show a greater need for municipal aid to provide local services to their residents, businesses, commuters, and visitors.

The research suggested a new formula to distribute more new aid to communities with larger municipal gaps while holding existing aid harmless. If distributed through this formula, even modest aid increases could significantly improve the distribution of unrestricted municipal aid in a few years.

The proposed legislation adopts this measure of municipal gap and calls for aid increases to be distributed based on municipal gaps. In my opinion, such aid reform would help target higher shares of any increased aid to cities and towns with relatively large municipal gaps. This would improve the efficiency of state aid in offsetting the fiscal disparities across local communities that are directly attributable to differences in their socioeconomic circumstances.

References

[1] Municipal Data Management and Technical Assistance Bureau. 2003. FY 2003 Cherry Sheet Manual. Boston, MA: Massachusetts Department of Revenue, Division of Local Services.

[2] Zhao, Bo, and David Coyne. 2010. "Reforming Municipal Aid in Massachusetts: The Case for a Gap-Based Formula." Federal Reserve Bank of Boston NEPPC Policy Brief Series no. 10-2.

Zhao, Bo, with Marques Benton, Lynn Browne, Prabal Chakrabarti, DeAnna Green, Yolanda Kodrzycki, Ana Patricia Muñoz, and Richard Walker. "Does Springfield Receive Its Fair Share of Municipal Aid? Implications for Aid Formula Reform in Massachusetts." Federal Reserve Bank of Boston NEPPC Working Paper Series no. 10-4.