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# DO PROPERTY-TAX CAPS WORK? Lessons for New Jersey from Massachusetts

Josh Barro
*Walter B. Wriston Fellow*
*Manhattan Institute for Policy Research*

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# Executive Summary

New Jersey is considering a tax reform called "Cap 2.5," under which a municipality's tax levy on existing property could not grow more than 2.5 percent in any year, unless its voters pass a referendum allowing a greater increase. This reform is similar to Massachusetts's Proposition 2.5, which that state adopted in 1980.

New Jersey lawmakers may therefore be interested in giving serious consideration to Massachusetts's experience: Did the reform succeed in controlling growth in property taxes? Were property-tax savings merely offset by increases in other taxes? And given that education is by far the largest component of local expenditure, how has the reform affected educational performance in Massachusetts?

Overall, Proposition 2.5 has succeeded in restraining growth of property-tax collections, total tax collections, and per-pupil education spending in Massachusetts. These fiscal successes have not come at the expense of the state's educational outcomes, which are the nation's best, consistently outperforming—or at least tying—New Jersey's results on national school exams. Massachusetts's advantage persists even within certain traditionally disadvantaged demographic groups.

Massachusetts's experience suggests that New Jersey, by adopting a similar reform, could significantly restrain tax growth without hurting educational outcomes. The Bay State has shown that it is not necessary to be the national leader in school spending to be the national leader in school outcomes.

The findings of the report are:

- In Massachusetts, Proposition 2.5 has been effective in controlling growth in property taxes. Real-dollar property-tax growth from 1980 to 2007 was just 22 percent in Massachusetts. It was 68 percent nationwide and 102 percent in New Jersey.

- Tax collections in Massachusetts from other sources rose faster than the national average over the same period, as did state aid to localities. However, these increases did not fully compensate for the slower growth of property-tax revenues. Overall growth in state and local taxes was 58 percent in Massachusetts, while it was 70 percent nationally and 108 percent in New Jersey. As a result, New Jersey went from being the state with the tenth-highest state and local tax burden to being the state with the highest burden. In the same period, Massachusetts fell from second to twenty-third.

- Since 1980, spending per pupil grew significantly more slowly in Massachusetts than in New Jersey or the country as a whole. In 1980, the two states had nearly equal per-pupil spending; but by 2007, New Jersey was outspending Massachusetts by 26 percent. New Jersey's spending of $16,163 per student was the highest in the country that year, according to the U.S. Department of Education.

• Massachusetts's lower spending levels cannot be explained by a lesser need to serve hard-to-teach students. Even school systems in that state with similar percentages of students who were not proficient in English, or who were from low-income families, spent thousands of dollars less than their counterparts in New Jersey.

• Despite their lower spending levels, Massachusetts's public schools are the country's clear top performers, as measured by National Assessment of Educational Progress (NAEP) exams administered by the U.S. Department of Education. In 2009, Massachusetts outperformed New Jersey in both reading and math in grades four and eight (though for grade eight, the gap in reading performance is within the margin of error).

• Massachusetts's stronger NAEP performance is not explained by favorable demographics. Within most demographic groups, students in Massachusetts achieved higher average NAEP scores than their counterparts in New Jersey. Hispanics and Asians/Pacific Islanders were a notable exception. Massachusetts students eligible for subsidized lunch or who were English-language learners also matched or outperformed their counterparts in New Jersey on the NAEP exams, despite lower spending in districts with high concentrations of such students.

# About the Author

JOSH BARRO is the Walter B. Wriston Fellow at the Manhattan Institute focusing on state and local fiscal policy. He is the coauthor of the Empire Center for New York State Policy's "Blueprint for a Better Budget." He writes weekly on fiscal issues for RealClearMarkets.com and has also written for publications including the *New York Post*, *Investor's Business Daily*, the *Washington Examiner*, *City Journal*, and Forbes.com. His commentary has been featured on CNN, Fox News Channel, CNBC, the Fox Business Network, and Bloomberg Television.

Prior to joining the Manhattan Institute, Barro served as a staff economist at the Tax Foundation, where he wrote the 2009 "Tax Freedom Day" report. He also wrote several critical analyses of state tax and budget proposals and gave testimony on tax reform before officials in Arkansas, Louisiana, Maryland, New Jersey, Rhode Island, and South Carolina. Previously, he worked as a commercial real estate finance analyst for Wells Fargo Bank. Barro holds a B.A. from Harvard College.

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# Do Property-Tax Caps Work? Lessons for New Jersey from Massachusetts

Josh Barro

## Structure of Government Finance in Massachusetts and New Jersey

Since localities in Massachusetts and New Jersey may not impose a sales tax or an income tax, they must raise substantially all their tax revenue from property taxes. Consequently, a cap on property taxes is functionally equivalent to a cap on local taxes.

In 1980, Massachusetts voters approved Proposition 2.5, which places a cap on the growth of local property-tax levies. Under Proposition 2.5, the total tax levy on existing property within a municipality may not rise by more than 2.5 percent per year unless its voters pass an "override" vote by simple majority in a referendum allowing a greater increase. Since 1980, approximately 40 percent of override votes have been approved. (The main structural difference between Proposition 2.5 and New Jersey's proposed Cap 2.5 is that Cap 2.5 will require a 60 percent supermajority to approve an override, likely making overrides more difficult to achieve.)

It is important to note that the Proposition 2.5 limit applies to a municipality's overall tax levy; an individual property may see its tax bill rise by more than 2.5 percent in one year if its value has risen faster than the

rest of the tax base. In addition, the cap applies only to the existing tax base; taxes on newly constructed properties are determined after calculation of the 2.5 percent ratio, allowing for faster revenue growth in towns with growing populations.

New Jersey, as well, has a property-tax cap, enacted in 2007, which limits growth in local tax levies to 4 percent per year. However, unlike Massachusetts's cap, New Jersey's is studded with exceptions that make it an ineffective bar to tax and spending growth. For example, the cap permits exceptions for growth in employee health-care and pension costs, which have been rising rapidly. The proposed Cap 2.5 would not allow these exceptions.

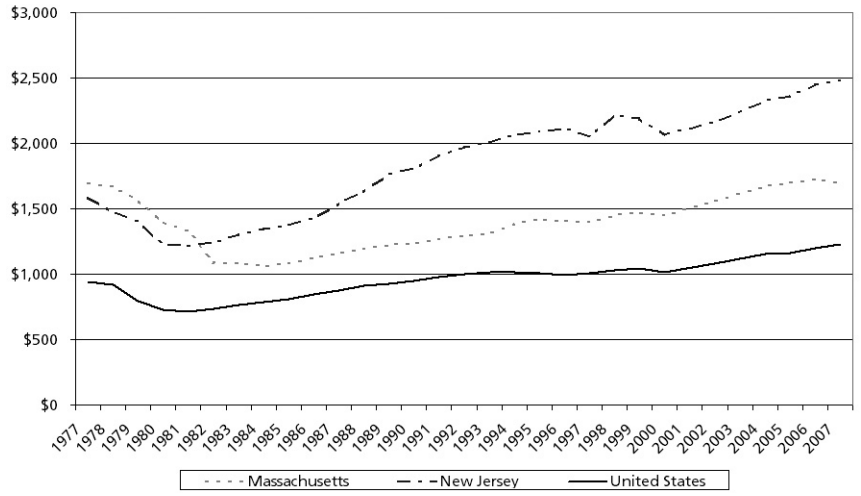
## Proposition 2.5 and Its Effects on Taxes and Spending

Proposition 2.5 has had marked effects on property taxes in Massachusetts. From 1980 to 2007 (the most recent year for which Census of Local Governments data are available), property taxes per capita rose 22 percent in Massachusetts, while they rose 102 percent in New Jersey and 68 percent in the country as a whole (all figures based on constant 2007 dollars). In real dollar terms, per-capita property taxes rose $1,257 in New Jersey, $499 in the country as a whole, and just $303 in Massachusetts.

Through 1981, property-tax collections per capita were higher in Massachusetts than New Jersey. But as of 2007, New Jersey collected 46 percent more per capita in property tax than Massachusetts. New Jersey is now home to seven of the ten counties in the country with the highest median property tax on owner-occupied homes.

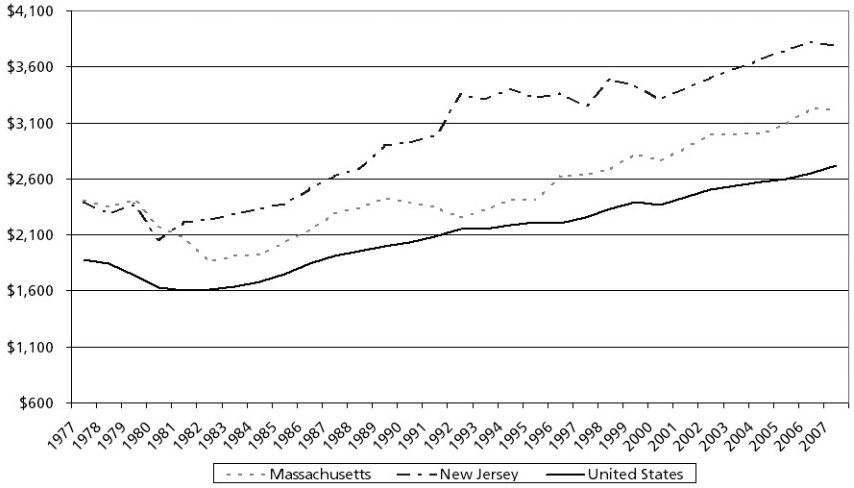
For the typical homeowner, the property-tax gap between Massachusetts and New Jersey is massive. As of 2007, the median owner-occupied home in Massachusetts's most taxed county—Middlesex, a suburban county northwest of Boston—was subject to a property tax of $4,271, which is less than the median tax bill in sixteen of New Jersey's twenty-one counties. Hunterdon, the most taxed county in the Garden State, had a median bill nearly twice as high: $8,347.[1]

### Chart I. Property tax per capita, 1977-2007, in constant 2007 dollars




Source: State and Local Government Finance Data Query System. http://www.taxpolicycenter.org/slf-dqs/pages.cfm. The Urban Institute–Brookings Institution Tax Policy Center. Data from U.S. Census Bureau, Annual Survey of State and Local Government Finances, Government Finances, Volume 4, and Census of Governments (1977–2007).

## Chart 2. State aid plus local property tax, 1977-2007, in constant 2007 dollars




Source: State and Local Government Finance Data Query System. http://www.taxpolicycenter.org/slf-dqs/pages.cfm. The Urban Institute–Brookings Institution Tax Policy Center. Data from U.S. Census Bureau, Annual Survey of State and Local Government Finances, Government Finances, Volume 4, and Census of Governments (1977–2007).

*Interaction with state aid*

Some critics of property-tax caps have noted that they do not restrict the overall level of taxation or spending. States could increase aid to localities to offset slower growth in property-tax collections, or they could begin handling certain traditionally local services themselves.

Either of these alternatives would mean that state-level taxes rise to compensate for slower growth in local taxes. However, neither increases in state aid to localities nor increases in local tax collections have fully offset property-tax restraint in Massachusetts.

Massachusetts did opt for a larger than average increase in state aid to localities from 1980 to 2007 (92 percent vs. 65 percent nationally and 57 percent in New Jersey on a per-capita basis), but it was not enough to compensate for a much smaller increase in property taxes. The sum of state aid and property-tax revenues received by Massachusetts localities went up 48 percent per capita over the study period, while the sum to New Jersey localities went up 84 percent, and 67 percent to localities in every state.

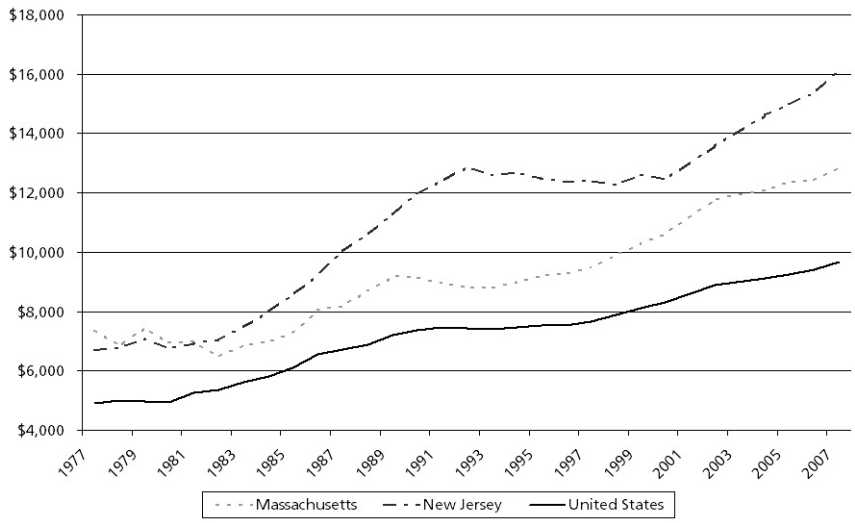
Notably, combined local revenues from property taxes and state aid in New Jersey far exceed those in Massachusetts: as of 2007, Massachusetts municipalities were collecting $3,206 per capita from these streams, while municipalities in New Jersey were collecting $3,789 per capita. New Jersey property taxes could fall substantially before reaching a point where municipalities receive less revenue than those in Massachusetts, even at current aid levels.

*Effect on overall tax levels*

From 1980 to 2007, state and local tax collections per capita grew 58 percent in Massachusetts in real dollars, while growing 70 percent nationally and 108 percent in New Jersey. This means that Massachusetts's faster than normal growth in revenues from other taxes only partly compensated for the slower growth of its property-tax revenues.

The difference in overall tax growth allowed New Jersey to leapfrog Massachusetts in tax collections per capita. In 1980, New Jersey's tax collections per capita were 9 percent lower than Massachusetts's. By 2007, they were 21 percent higher. Between 1980 and

Chart 3. Education spending per pupil, 1977-2007, in constant 2007 dollars




Source: U.S. Department of Education, National Center for Education Statistics Common Core of Data; and U.S. Census Bureau. Data are actual from 1987 to present, reflecting the length of the Department of Education data set. Figures for 1977–86 are estimated, based on Census Bureau population and school expenditure data. State and Local Government Finance Data Query System. http://www.taxpolicycenter.org/slf-dqs/pages.cfm. The Urban Institute–Brookings Institution Tax Policy Center. Data from U.S. Census Bureau, Annual Survey of State and Local Government Finances, Government Finances, Volume 4, and Census of Governments (1977–2007).

2007, New Jersey rose from tenth to first in the Tax Foundation's ranking of state and local tax burdens as a share of income, while Massachusetts fell from second to twenty-third.[2]

## Effects on Education Spending

Given that Massachusetts has seen relatively slow growth in tax revenues since 1980, it is unsurprising that education spending per pupil has also grown more slowly than the national average. In 2007, Massachusetts public schools spent $12,857 per K–12 student, much less than the $16,163 spent by New Jersey but more than the $9,669 all states spent on average. Those figures represent an 85 percent increase for Massachusetts since 1980, a 139 percent increase in New Jersey, and a 95 percent increase nationally.

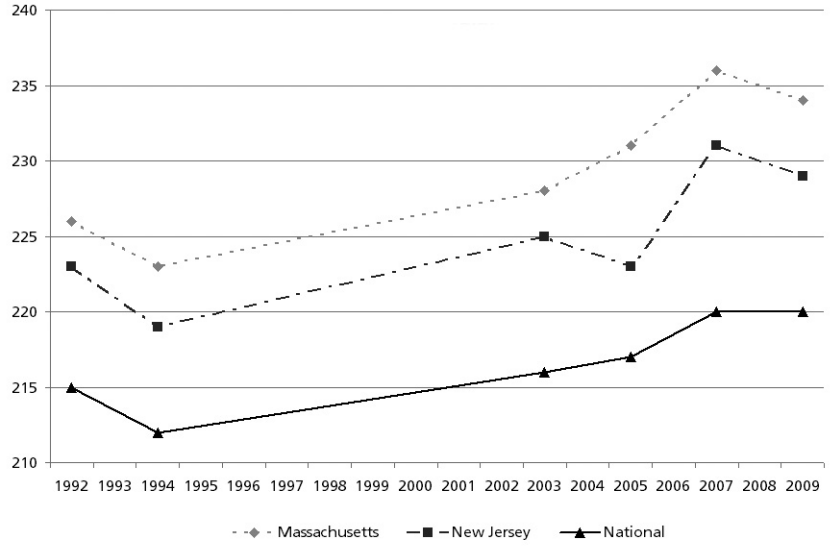
As I will discuss in the next section, most student demographic groups in Massachusetts are outperforming their peers in New Jersey on the National Assessment of Educational Progress exams. Remarkably, they are achieving this outcome though the state is spending less than New Jersey not just overall, but also within school districts with high levels of need.

*Relationship between spending and student family income*

Even if we examine districts with a comparable share of students who are eligible for subsidized lunch, New Jersey significantly outspends Massachusetts. (Low family income qualifies students for subsidized school lunches.)

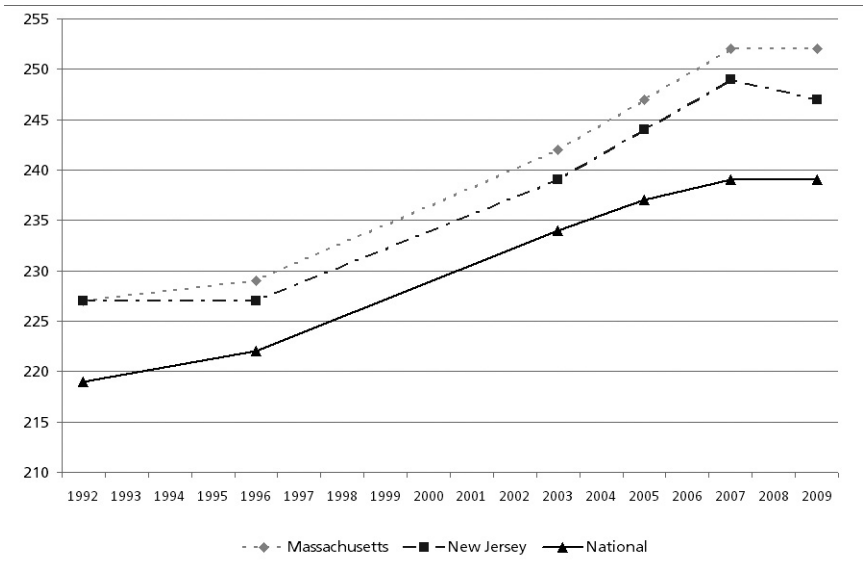
In both Massachusetts and New Jersey, subsidized-lunch eligibility is positively correlated with spending per pupil: that is, poorer districts spend more per student. New Jersey's Abbott school-funding formula, which directs aid to a small number of districts with particularly low family incomes, causes this relationship to be nonlinear: not only does New Jersey spend more in lower-income districts, but spending rises faster as the share of students from low-income families rises. In Massachusetts, the relationship between subsidized-lunch eligibility and spending per pupil is close to linear.

## Chart 4. Average Grade 4 Reading Composite Score




Source: U.S. Department of Education, National Center for Education Statistics Common Core of Data.

## Chart 5. Average Grade 4 Math Composite Score




Source: U.S. Department of Education, National Center for Education Statistics Common Core of Data.

As a result of the Abbott formula, the most impoverished school districts in New Jersey are vastly outspending their counterparts in Massachusetts. A New Jersey district where 70 percent of students, for example, are eligible for subsidized lunch would be expected to spend $17,690 per pupil, $4,191 more than a comparable Massachusetts district would.

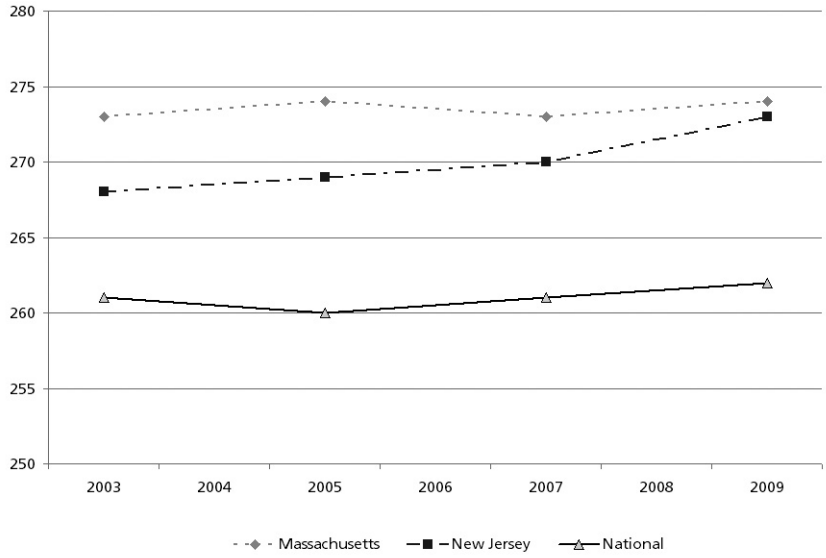
As far as individual school systems are concerned, there are six in Massachusetts and thirteen in New Jersey where at least 70 percent of students were eligible for subsidized lunch in 2006. In Massachusetts, these districts spent between $12,181 and $17,421 per pupil; in New Jersey, the range was $15,659 (Perth Amboy) to $25,984 (Hoboken).

It is important to note that higher spending levels also persist in New Jersey districts with moderate or low poverty rates. The gap between the two states is narrowest in districts where approximately 40 percent of students are eligible for subsidized lunch; but such a district would still be expected to spend $1,898 more per pupil if it is in New Jersey rather than Massachusetts.

*Relationship between spending and incidence of limited English proficiency/English-language learner status (LEP/ELL)*

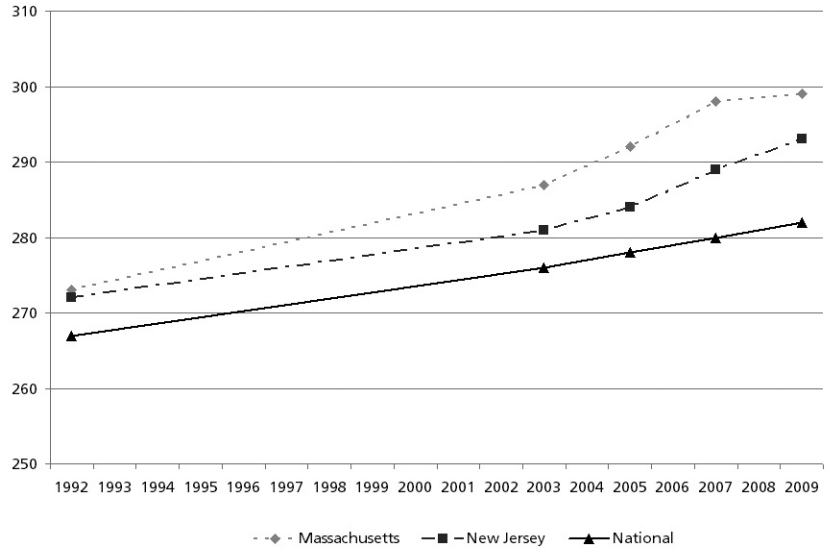
New Jersey districts with varying shares of LEP/ELL students are outspending their closest counterparts in Massachusetts. In districts where at least 10 percent of students are not English-proficient, New Jersey can

## Chart 6. Average Grade 8 Reading Composite Score




Source: U.S. Department of Education, National Center for Education Statistics Common Core of Data.

## Chart 7. Average Grade 8 Math Composite Score




Source: U.S. Department of Education, National Center for Education Statistics Common Core of Data.

be expected to outspend Massachusetts, typically by approximately $3,000 per student.

The trend is even more marked in those districts with the highest share of students not proficient in English. There are three districts in New Jersey and six in Massachusetts where at least 20 percent of students qualify as LEP/ELL. All three of the New Jersey districts outspend all six of the Massachusetts districts on a per-pupil basis.

*Relationship between per-pupil spending and share of nonwhite students*

Most New Jersey districts significantly outspend most Massachusetts districts, regardless of racial composition. Massachusetts spends significantly less than New Jersey in the most-white as well as the least-white districts. In districts with enrollments that are approximately 50 percent white, spending is roughly equal in the two states.

*Effect of a given percentage of special-education students on per-pupil spending*

Overall, New Jersey has a far higher rate of special-education enrollment than Massachusetts: in 2005–06, 27 percent of New Jersey pupils were Individualized Education Program (IEP) participants, while in Massachusetts, 15 percent were. Because these rates are so different, it is difficult to find school districts in the two states that are comparable. In districts with 1,500 or more students, no Massachusetts district had an IEP participation rate above New Jersey's average of 27 percent. Conversely, only three of all 263 New Jersey districts with at least 1,500 pupils had a participation rate below or equaling Massachusetts's 15 percent average. However, it appears that the Massachusetts districts with the highest IEP rates do outspend New Jersey districts with similar (and therefore relatively low for New Jersey) IEP participation.

New Jersey's high rate of IEP participation likely stems in significant part from the state's special-education funding formula, which directs more funding to districts that place more students in special education. Massachusetts used to have a similar system but adopted a "lump sum" reform in 1993 that ended the basing of aid to school districts on special-education enrollment. As education scholar Jay Greene found in 2002, states with funding systems like New Jersey's tend to have higher rates of enrollment in special education.

Unlike all the other demographic factors considered in this paper, such as poverty or race, IEP participation is not an inherent characteristic of students before they enter the school system, but rather an artifact of school districts' own decisions to place students in special education or not to do so. Despite the modest demographic differences between the two states, there is no reason to believe that New Jersey needs to place nearly twice as large a share of its students in special education.[3]

## Educational Performance in Massachusetts and New Jersey

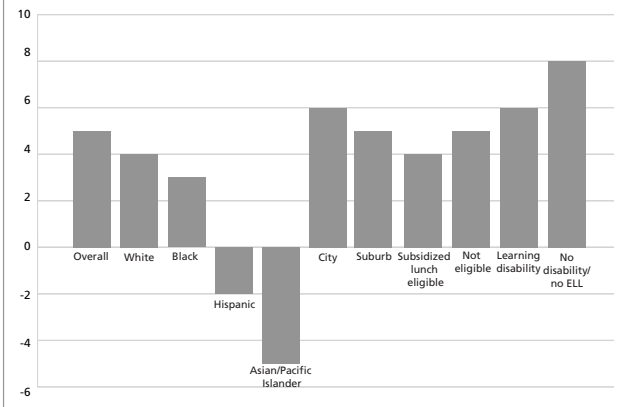
Per-pupil education spending in Massachusetts exceeds the national average but is significantly lower than it is in New Jersey and other states at the top of the spending ladder. However, Massachusetts is managing to be the clear top performer on the National Assessment of Educational Progress (NAEP)—at only a moderately high cost.

Since the inception of the NAEP exams in 1992, Massachusetts has consistently tied or outscored New Jersey, and the gap between the two has grown over time. On the 2009 exam, Massachusetts soundly beat New Jersey in grade four reading and math and grade eight math; Massachusetts also outperformed New Jersey in grade eight reading, though by a statistically insignificant margin. (See charts 4-7)

*Do demographics explain Massachusetts's better performance?*

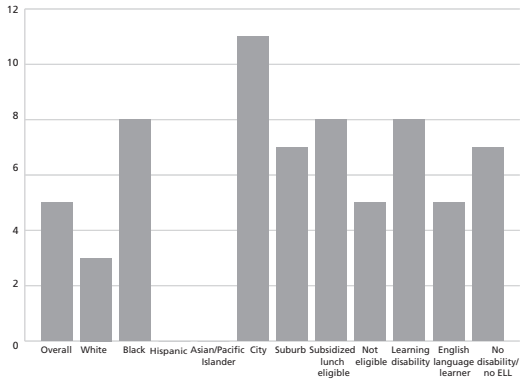
Massachusetts and New Jersey are demographically similar states, with heavily suburban populations and two of the highest median family incomes in the

Chart 8. Grade 4 reading 2009, Massachusetts v. New Jersey score advantage by demographic



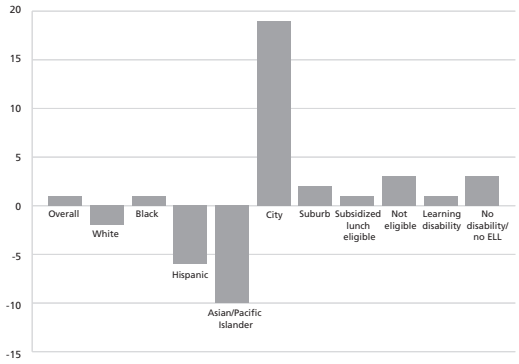

Source: U.S. Department of Education, National Assessment of Educational Progress

Chart 9. Grade 4 math 2009, Massachusetts v. New Jersey score advantage by demographic



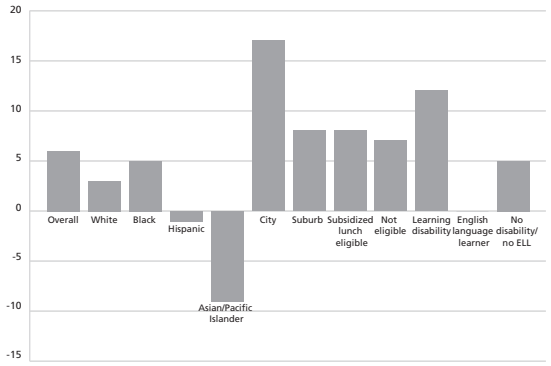

Source: U.S. Department of Education, National Assessment of Educational Progress

Chart 10. Grade 8 reading 2009, Massachusetts v. New Jersey score advantage by demographic




Source: U.S. Department of Education, National Assessment of Educational Progress

Chart 11. Grade 8 math 2009, Massachusetts v. New Jersey score advantage by demographic




Source: U.S. Department of Education, National Assessment of Educational Progress

country. But there are key demographic differences that could give Massachusetts students an advantage on the NAEP exams.

In particular, a higher percentage of New Jersey's school-age population is black or Hispanic. In both states, black and Hispanic students taking the NAEP exams have tended to score lower than the statewide mean. Massachusetts students were slightly more likely to be eligible for free or reduced-price lunch (an indicator of family income) or to be English-language learners. Both of these demographic groups also tend to score lower than the statewide mean. New Jersey students were nearly twice as likely to be enrolled in an IEP.

There are two ways that demographic differences could explain New Jersey's underperformance, though it outspends Massachusetts. One is that Massachusetts's outperformance stems only from its more favorable student demographics; the other is that Massachusetts saves money because it has fewer students who are more expensive to educate.

As discussed in the previous section, Massachusetts school districts spend less than New Jersey school

## Why does Massachusetts perform so well?

Readers may be interested to know: If high spending does not explain Massachusetts's unparalleled educational success, what does? A full answer is beyond the scope of this paper. But policy experts have pointed to a series of curriculum and testing reforms in the 1990s that appear to have significantly improved performance.

The reforms required the adoption of certain pedagogical techniques, such as the teaching of phonics in early grades, and imposed strict state-level curriculum standards, a testing regime linked to these standards, and a requirement that high school students pass an exit exam to graduate. Notably, none of these is high-cost.

As Sandra Stotsky, a former assistant commissioner of education in Massachusetts and now a professor of education at the University of Arkansas, maintains: "The lesson from Massachusetts is that a strong content-based curriculum, together with upgraded certification regulations and teacher licensure tests that require teacher preparation programs to address that content, can be the best recipe for improving students' academic achievement."

## Table I. Student Demographics

| Category | Massachusetts | New Jersey |
|---|---|---|
| White non-Hispanic | 72% | 56% |
| Black non-Hispanic | 8% | 18% |
| Hispanic | 13% | 18% |
| Asian/Pacific Islander | 5% | 8% |
| Subsidized-lunch eligible | 28% | 27% |
| English-language learner/limited proficiency | 5% | 4% |
| Individualized education plan | 15% | 27% |

Source: U.S. Department of Education, National Center for Education Statistics Common Core of Data

districts with similar demographics. Nevertheless, Massachusetts students outperform New Jersey students overall. They even do better, for the most part, demographic group by demographic group.

*NAEP performance by demographic group*

I reviewed Massachusetts's and New Jersey's NAEP performance broken down by demographic group: race/ethnicity; urban or suburban school location; status as English-language learner or learning-disabled; and eligibility for free school lunch (a proxy for family income).

On this basis, the Massachusetts advantage persists. Massachusetts outperforms New Jersey among students eligible for free lunch and those not eligible; among English-language learners and students with

learning disabilities, as well as English speakers without learning disabilities; and among both urban and suburban students. Massachusetts's black students also do better on all four exams; its white students do better on all exams except grade eight reading.

The key exceptions are Hispanic students, who are 18 percent of New Jersey's student population, and Asian/Pacific Islander students. In New Jersey, they outperform on three of four exams.

## Conclusion

Proposition 2.5 appears to have held down property taxes as well as overall taxation in Massachusetts, despite above-normal increases in state aid to localities since the enactment of the property-tax cap. As a result, per-pupil education spending is significantly lower in Massachusetts than in New Jersey.

However, Massachusetts's students consistently outperform New Jersey's on the NAEP exams. Massachusetts's advantage persists within most demographic groups. All kinds of school districts in Massachusetts have a lower cost model, even those with high percentages of students who are learning English or who come from low-income families, and these students still outperform their New Jersey counterparts on the NAEP.

## Endnotes

1. See http://www.taxfoundation.org/taxdata/show/25429.html.

2. See http://www.taxfoundation.org/publications/show/22320.html.

3. Greene, Jay P. and Greg Forster. 2002. "Effects of Funding Incentives on Special Education Enrollment." Manhattan Institute for Policy Research Civic Report No. 32. http://www.manhattan-institute.org/html/cr_32.htm.

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