Special Report

BOSTON MUNICIPAL RESEARCH BUREAU

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Highlights

- Question 1, if passed, would reduce the state income tax from 5.3% to 2.65% to 0% from January 2009 to January 2010.
- A complete income tax repeal in FY09 could cut $300 million, or 49%, of Boston's General Fund local aid, with additional losses to external state grants for city services.
- No matter how the City responds to Question 1, funding for core city services would be significantly reduced.

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Question 1 Threatens Basic City Services

Boston's operating budget could be reduced by $300 million

Passage of Question 1, a binding initiative petition calling for the elimination of the state income tax, could cause Boston's operating budget to be reduced by $300 million or 12.3% if it were implemented in full in fiscal 2009. Additional cuts in external state grants would only add to a decrease in services. Question 1, which will appear on the November 4th ballot, would reduce the state income tax from 5.3% to 2.65% in January 2009 and eliminate it completely in January 2010. If passed, the state would lose its single largest tax revenue source, which is projected to generate $12.8 billion in fiscal 2009, 60% of the state's total tax revenue and 40% of total state revenue. A share of the loss from this crucial revenue source for the state would be passed on to municipalities through cuts to local aid, which supports the delivery of basic public services in cities and towns. A simulation of a complete income tax repeal in fiscal 2009 performed by the Massachusetts Municipal Association, based on state Department of Revenue estimates, projects that local aid would be cut by 38% statewide.

Applying this methodology, Boston would lose approximately $300 million of its General Fund local aid if the income tax were fully repealed in fiscal 2009. Additional revenues would also be cut from direct funds to state grant programs for services such as highway maintenance and public libraries.

To give a sense of the magnitude of a $300 million cut to Boston's spending, if the four largest departments of School, Police, Fire and Public Works were held harmless and non-discretionary costs such as pensions, health insurance, state assessments and debt service were not cut, all other departments and services would have to be eliminated to maintain a balanced budget.

Question 1 At A Glance

State income tax would be eliminated in 2 phases
Phase 1: January 2009 from 5.3% to 2.65%
Phase 2: January 2010 from 2.65% to 0%

Massachusetts:		**Boston:**		
FY09 State Income Tax Collected	$12.8B	FY09 Spending	$2.4B	
FY09 State Revenue	$31.7B	FY09 Local Aid	$606M	
FY09 State Revenue Reduction	40%			
Projected Statewide Local Aid cut due to Question 1	**38%**	**Projected Local Aid cut due to Question 1**	**$300M**	**49%**

In fiscal years 2003 and 2004 when Boston's local aid was cut by a total of 8.3%, the City was forced to reduce its workforce by 8.7% or 1,522 positions, with 65% of those cuts coming in the areas of education and public safety. By comparison, Question 1 would reduce Boston's local aid by 49%, more than five times the impact of the fiscal 2003-2004 cuts.

Boston already faces a serious fiscal challenge with anticipated local aid cuts next year due to the state's economic downturn. The risk to Boston is too great for voters to support Question 1 just to voice dissatisfaction with the current state budget or spending choices.

Boston's Local Aid

Boston stands to lose $300 million or 49% of its local aid under the full impact of Question 1, with additional losses to state grant programs which support needed city services. The calculation of Boston's local aid cut reflects that certain state accounts, such as Medicaid, Chapter 70 school aid, debt service, pensions, and transitional assistance would receive limited reductions due to statutory mandated funding levels and minimum funding requirements for federal matching funds. After these limited reductions, all other state accounts, including local aid funds, would require a 64.7% cut to close the revenue gap created by Question 1. A loss of $300 million would translate into a 12.3% reduction in Boston's fiscal 2009 budget.

Estimated Local Aid Cuts to Boston

Figures in Millions

Aid Category	FY09 Budget	FY09 Revised	% Change
Chapter 70	$221.4	$97.7	-55.9%
Teacher Pensions	103.0	103.0	0.0%
Charter School Reimb.	17.1	6.0	-64.7%
Lottery Aid	71.6	25.3	-64.7%
Additional Assistance	164.2	57.9	-64.7%
Racing Taxes	0.5	0.5	0.0%
Police Career Incentive	10.4	3.7	-64.7%
State Owned Land	0.3	0.1	-64.7%
Veterans' Benefits	2.9	1.0	-64.7%
Exemptions: Vets, etc.	0.7	0.3	-64.7%
Exemptions: Elderly	0.6	0.2	-64.7%
School Construction	13.2	13.2	0.0%
Total General Fund	**$606.0**	**$308.9**	**-49.0%**

Financial Context

Both the City's revenue limitations and spending requirements are important to understand in order to fully assess the impact of Question 1. Approximately 70% of the City's operating budget supports employee expenses. Thus, with initially only two months to plan if Question 1 passes, the primary short-term option available to the City will be to reduce its employee levels. In response to local aid cuts of 6.6% in fiscal 2003 and 1.7% in fiscal 2004, the City reduced its work force by 1,522 positions or 8.7%. Over the past four years, the City's personnel numbers grew by 1,026, of which 98% occurred in the Departments of School, Police and Fire. The remaining 48 departments increased their employee numbers, in aggregate, by only 24 positions over this time. By necessity, due to their size and recent position growth, education and public safety positions will need to be included in employee reductions.

Another fiscal reality is that eight budget accounts represent 85% of Boston's total operating budget in fiscal 2009. These include the largest four Departments of School, Police, Fire and Public Works. The non-discretionary expenses for health insurance, pensions, debt service and state assessments for the MBTA and Charter schools make up the balance.

Spending by Department

Figures in Millions

Name	FY09	% of Total Spending
School	$754.2	31.2%
Police	281.9	11.7%
Health Insurance	264.3	10.9%
Pensions	213.2	8.8%
Fire	161.6	6.7%
State Assessments	142.0	5.9%
Debt Service	127.6	5.3%
Public Works/Snow Removal	100.7	4.2%
Subtotal	**$2,045.6**	**84.6%**
All other	$373.3	15.4%
Total	**$2,419.0**	**100.0%**

Boston's heavy reliance on the property tax and state aid for 81% of its total operating revenue in fiscal 2008 means that the City does not have a broad base of other revenue sources to generate significant new increases. The City does periodically update its own fees, permits and charges and should ensure that these fees do pay for the full cost of providing the service.

However, whatever increases are generated in the next few years may not even offset potential losses in revenue sources more directly influenced by the economy such as the motor vehicle, jet fuel and hotel/motel excises, interest on investments and building permits. The City does have the ability to seek a Proposition 2½ override but that option has not been considered politically viable in the past and an override would place even more of a burden on the property tax.

Finally, addressing anticipated local aid cuts in fiscal 2010 will already be more difficult, never mind absorbing a $300 million revenue loss, because tools utilized by the City in 2002-2004 are less available now. For example:

- An early retirement incentive in 2002 was utilized by 476 employees but created a pension liability increase of $62 million and should not be repeated.
- The current economic situation will likely reduce attrition savings with fewer employees leaving for private sector jobs.
- Reducing the property tax overlay to generate greater tax revenue cannot be replicated again.
- The Administration recently negotiated contracts in which employees will increase their share of health insurance premiums by 5% over a two-year period, delaying future premium savings for a few years.

What A $300M Cut Would Mean For Boston

There are many possibilities for assessing the impact of Question 1 on Boston. Given the magnitude of the estimated loss of state aid, the Research Bureau developed several expenditure scenarios as to how the City could respond. The main finding of this exercise is that no matter how the reduction is allocated, funding for basic city services will be significantly reduced.

It is important to note that a large amount of city expenses are non-discretionary and cannot be cut, or at least not immediately, due to requirements set by law or contract. These non-discretionary expenses include employee health insurance, pensions, debt service and state assessments and other accounts that total $786.8 million in fiscal 2009 or 32.5% of the total operating budget. These costs are factored into the scenarios below.

Non-discretionary Spending

Figures in Millions

Account	FY09
Health Insurance	$264.3
Pensions	213.2
State Assessments	142.0
Debt Service	127.6
Other	39.6
Total	**$786.8**

Scenario 1 — As stated earlier in the report, to achieve a $300 million reduction in spending, without impacting the four largest departments or the non-discretionary costs, all other departments and services such as Library, Park, Transportation and Law would have to be completely eliminated to reach the $300 million target. This scenario cannot be pursued but does illustrate the depth of cuts that a $300 million spending reduction requires.

Scenario 2 — A more balanced scenario to achieve a $300 million reduction would be a 5% cut in the non-discretionary accounts and a 15.5% decrease in the largest four departments which would then require a 21.7% reduction in all other departments and budget accounts.

Even this scenario would have a detrimental impact on service delivery and would paralyze some of the smaller departments. For example, a 15.5% cut of the Boston School Department's budget would reduce spending by $116.9 million, which is inconceivable in terms of its impact on academic achievement. It is difficult to comprehend this level of spending cuts given that the school reprogramming plan Superintendent Johnson released recently, which involves the closing and consolidation of schools, projected savings of only $13.8 million over five years. A 15.5% decrease of the Police

Department budget translates into a cut of $43.7 million which is insupportable in an urban environment. That amount represents 20% of the total police budget for permanent employees.

A 21.7% reduction in the budgets of the next tier of city departments and below would be felt more deeply than the largest four since they have experienced relatively no growth in employee levels and thus any loss of positions would affect more directly the core services of the department. For example, a 21.7% reduction of the Transportation Department's fiscal 2009 budget of $31.9 million would require a cut of $6.9 million. The Inspectional Services budget of $15.9 million would be cut by $3.5 million which would slow down important public safety inspections and reduce inspectional revenues collected by the department. Undoubtedly, the City's relationship with its citizens through the services it provides would change if Question 1 were to pass.

A table showing the budget reductions by each department and service associated with this scenario is available by clicking **here** or going to the *Research Bureau's* website **www.bmrb.org**.

Capital Spending

Continued maintenance of the City's capital infrastructure of roads, sidewalks, facilities and equipment would be put in jeopardy with Question 1. The City's five-year capital budget anticipates the City issuing General Obligation bonds totaling $600 million over the fiscal 2009-2013 period. To reduce its debt service costs for payment of the bond's principle and interest, the City would decrease its annual capital borrowing over five years, making less resources available for what is now a $1.5 billion five-year plan. That was the strategy employed by the City in fiscal years 2003 through 2005 during the last economic downturn. Reduced resources will delay capital projects as well as ongoing maintenance which could cause greater expenses in future years.

Conclusion

Question 1 would fundamentally compromise the City's ability to provide essential and quality of life services to the residents and businesses it serves. City officials will be challenged enough in responding to expected local aid cuts in fiscal 2010 without having to deal with a 49% cut in the City's state aid. As indicated in this report, there is no practical way for Boston to respond to a decrease of $300 million without jeopardizing the delivery of critical city services. Too much of the City's budget is allocated to too few accounts for education, public safety, public works, transportation and other core services to not be affected by such a deep loss of revenue. The fact that state grants that have supported important city services will also be reduced just compounds the problem. Clearly, the City will need to develop a spending reduction plan and a revenue strategy.

This vote comes at a time of unprecedented economic turmoil for our country that is affecting our state economy and which will directly impact state support for local services, especially next year. Voters should carefully assess these issues and consider the impact Question 1 would have on municipal services when voting on this issue on November 4th.