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# Thinking Outside the Box: The Challenge of Maine's Regional Service Centers

## Introduction

Although the state of Maine is often depicted as a carefree tourist's wonderland of rocky ocean coastline and breathtaking forests, Maine municipal and state governments in real life are in a constant struggle to serve the needs and demands of the state's population. Recently there has been growing attention to the challenges faced by Maine's 69 regional service centers – towns and cities which provide jobs and retail sales to surrounding areas, and are centers for services ranging from education and health to cultural, recreational and social services. A groundbreaking analysis by a 1998 Maine Task Force Report analyzes these challenges, which range from inadequate revenue, high property taxes, and increased demands for services, to shrinking population and declining economic well-being overall.<sup>1</sup> As the Task Force report compellingly points out, assuring the well-being of Maine's regional service centers is in the interest of the entire state, not simply for the residents of those communities, which "account for 75 percent of the State's jobs, 84 percent of its taxable retail sales and a majority of its social services."<sup>2</sup>

More recent evidence confirms that many of Maine's regional service center (RSC) communities, ranging from larger cities such as Portland and Bangor to smaller towns such as Machias, are indeed in trouble, and that trouble may be growing.<sup>3</sup> Unfortunately, while the many issues of regional service centers are complex, much analysis of these problems is based upon some troubling assumptions about municipal revenue. Thus many of the proposed solutions are likely to lead in the long term to further declines in economic well-being and quality of life, both for communities, and for the families and working people who live there.

## Background

One of the most common responses to the problems of inadequate municipal revenue, rising property taxes, and declining service center population has been to construct an easily understood model or picture of how these crucial factors are related. This widely shared model, which we will term the "Closed Loop" model of municipal revenue problems, is increasingly used by municipalities to guide local policy concerning economic development, zoning, and other areas of local planning. However, this model is incomplete and too simplistic in its proposed causal explanations, and leaves out crucial factors contributing to these problems.

The visual diagram of this Closed Loop model (see Figure One) shows how the most important factors are thought to operate in a "vicious cycle" relationship to one another.

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<sup>1</sup> *Reviving Service Centers*, Report of the Task Force on Regional Service Center Communities, Maine State Planning Office, September 1998; and a State of Maine Legislative Task Force working paper, "Proposals for Addressing Sprawl and Promoting Smart Growth Development," for discussion at a 12/13/99 public hearing. (<http://www.state.me.us/legis/opla/ld304wp.htm>)

<sup>2</sup> *Reviving Service Centers*, *ibid.*; p. 1. Similarly, the State Planning Office points out that "the problem of rural and urban areas are not separate, but in fact are one – inner city blight and declining business, suburban sprawl, loss of farmland and other valued natural and economic resources, and loss of our sense of community are all parts to (*sic*) the same problem." (Maine State Planning Office, at National Governors Conference Center for Best Practices, Conference on Smart Growth, July 6-7, 1998. (<http://www.state.me.us/spo/cpip/planning/msgact.htm>))

<sup>3</sup> E.g., "Portland's Financial Distress Won't Leave State Untouched," *Portland Press Herald*, 6/25/2001; "Helping Service Centers," *Bangor Daily News*, 10/2/2001, and "Service Centers Face a Crisis and Need Help," *Maine Sunday Telegram*, 9/2/2001.

1) Starting at the top of the loop, there is the persisting, and highly visible, problem of a high tax burden in regional service center communities, and of high municipal property taxes, compared to suburban or outlying areas.

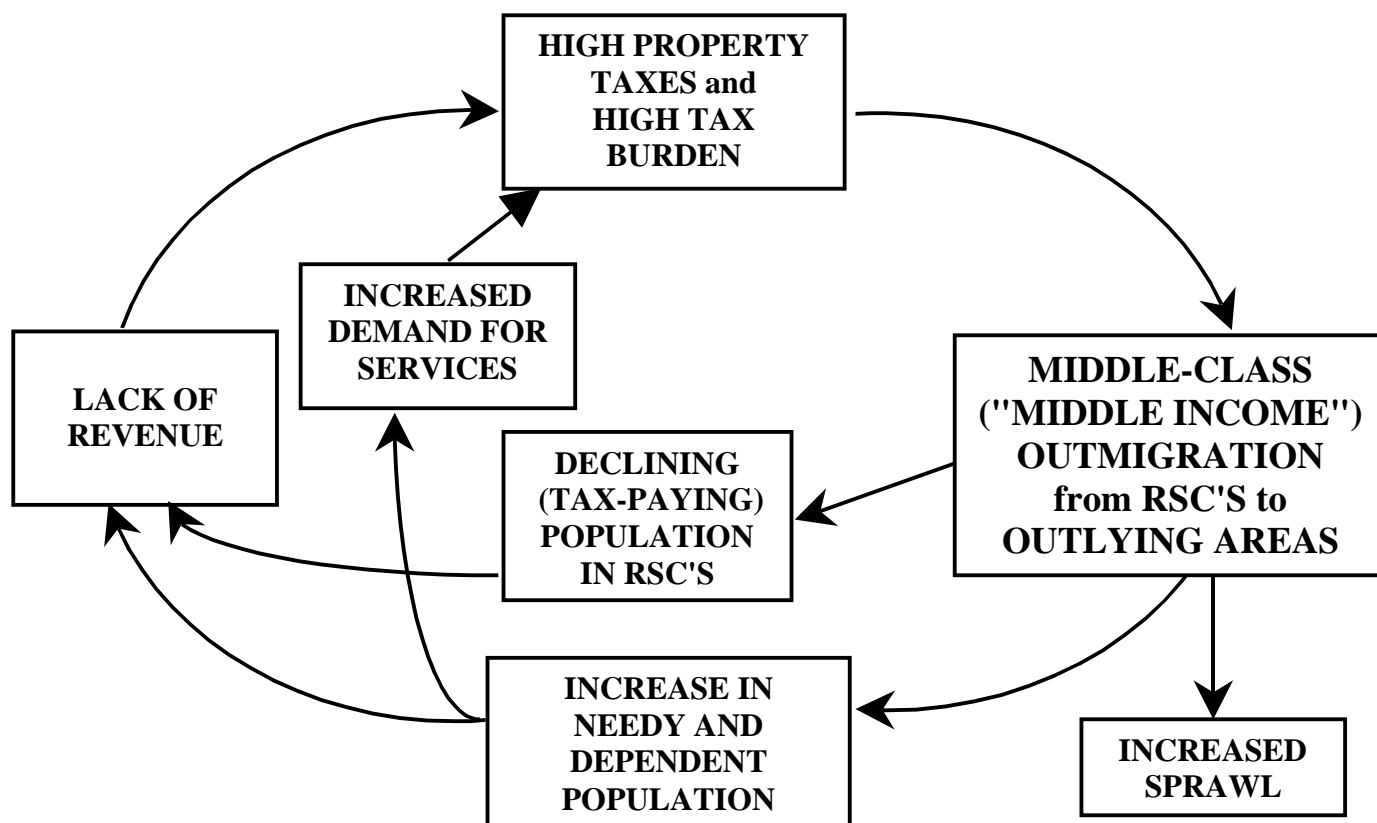
2) In turn, according to this model, the high tax burden leads to middle-class or middle-income outmigration from RSC communities, to outlying suburbs and rural areas with lower taxes. Note that this assumes, implicitly or explicitly, that high property taxes are the primary or most important factor underlying the decision of middle-income families who move out from RSC's.

3) This middle-class outmigration from RSC's leads in turn to further dire consequences: a) a decline in the tax-paying population of these communities, b) an increase in the proportion (and/or numbers) of needy and dependent populations in the RSC communities, and c) increased sprawl, with all of the environmental and social problems arising from it.

4) These problems lead in turn to further decreases in revenue for the RSC community, and to an increased demand for services.

5) The decreased revenue and increased demand for services result in yet higher property taxes and high mill rates for RSC residents and property owners, completing the loop.

**FIGURE ONE: "Closed Loop" Model of the Municipal (Regional Service Center) Revenue Problem**



At first glance the Closed Loop explanatory model seems not only plausible but persuasive. However, closer examination reveals three major weaknesses or shortcomings:

1) The stated reasons for decreased municipal revenue ignore the larger historical, social and economic factors contributing to declining municipal revenue and rising local property taxes;

2) The model ignores other important reasons for the outmigration of families from regional service centers to outlying suburbs and rural areas; and

3) It does not recognize the potential long-term negative impacts of conventional economic development policies which seek to attract large-scale retailers and low-paying service jobs. Although well-intended, such policies can lead to further economic decline and to further deterioration in the community's overall vitality, quality of life, and well-being.

Basing municipal planning on the Closed Loop model may be disastrous for communities in the longer term, since the drive to increase property tax revenue through economic development at any cost is likely to make these problems worse, not better.

## **The Municipal Revenue and Property Tax Problem**

Local or municipal government is "the closest government to the people it serves," and "is the government which most often has the direct responsibility of providing those services which meet the people's needs."<sup>4</sup> While local governments are expected to provide an array of services, ranging from schools and sewers to highway maintenance, snowplowing and public safety, they also have the unhappy task of needing to raise revenue to pay for these services.

In Maine, property taxes are still the major source of revenue for local governments.<sup>5</sup> The task of paying for needed services has been immensely complicated, however, by broad structural changes and external societal forces which have had enormous impacts on municipalities and states nationwide. This suggests a revenue problem which is far more complex than the one depicted in the Closed Loop model. Here are some examples:

1. There have been profound transformations in the American economy over the past few decades, and these have had tremendous impacts on the traditional sources of revenue for states and cities. Perhaps most notable is the shift from an economy based on "manufacturing and property-based wealth to one based on services and knowledge-based wealth."<sup>6</sup> As the National League of Cities has pointed out, this historical change has created "unprecedented challenges for municipal finance structures."<sup>7</sup>

In addition, the shift towards lower-paying service jobs in the economy means that workers and their families are more vulnerable. Workers are less likely to have health benefits as unionized industries continue to decline, and households must often work longer hours just to stay afloat.

2. A complex combination of technological, social, economic and political changes have created a transformed global economy in which capital, production, goods and jobs flow more freely across national borders, contributing to the decline of manufacturing jobs in Maine and elsewhere in the U.S.

3. The technological and social revolutions in information, computers, and telecommunications have also led to the explosion of the Internet and "e-commerce" (Internet-based remote sales), which further threatens traditional sources of revenue for states and localities.

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<sup>4</sup> Chapter 5: "What Local Governments Do " (p. 1), in Kenneth L. Roberts, *Local Government in Maine*; Maine Municipal Association, 1979. (<http://www.memun.org/resources/Public/HTML/Publications/localgovtbk/ch5.htm>)

<sup>5</sup> *Ibid.*

<sup>6</sup> "Toward A System of Public Finance for the 21<sup>st</sup> Century: A Framework for Public Discussion"; Fiscal Transitions Panel, National League of Cities; July, 2000, p. 1. (<http://www.nlc.org/pubfin.pdf>)

<sup>7</sup> *Ibid.*

4. A number of other important political and economic shifts have also impacted on local fiscal problems. For example, skyrocketing increases in the costs of health care,<sup>8</sup> decreased federal responsibility for the provision of health and other services, increased unfunded federal and state mandates, and deregulation of key industries in the past three decades have vastly increased the needs and responsibilities facing city governments, while often lessening the resources with which to meet them. Many of these issues are rooted in greater political decentralization over the past two decades, and "the devolution of federal and state responsibilities to cities."<sup>9</sup>

In other words, the lack of municipal revenue, the increased demand for services, and high property taxes are problems which are considerably more complex than suggested by the Closed Loop model. One cannot explain the municipal revenue problem simply in terms of middle-income outmigration to suburbs and rural areas.

## **Outmigration from Regional Service Centers to Outlying Areas**

The Closed Loop model of the municipal revenue problem suggests that the critical issue facing regional service center communities is that of the outmigration of "middle income" families and households to outlying suburbs and rural areas. This problem is real, and is supported by many statistics, such as data from the Maine State Planning Office. However, proponents of this model focus primarily on one causal factor driving these households out from urban areas: high property tax burdens in service center communities, compared to the lower tax rates in outlying areas. While this again seems to be intuitively obvious and compelling, one cannot stop there. Fortunately, there is an extraordinarily important and useful source of recent data relevant to this question: a study conducted by the Maine State Planning Office, entitled "Why Households Move."<sup>10</sup> And the findings are startling.

In the study, people who had moved to new homes were asked which of 20 reasons were important in their decision to move. People who moved from relatively urban areas to outlying suburbs and rural areas<sup>11</sup> emphasized issues such as "houses too close together," "lack of privacy," noise, too many people, traffic congestion, unattractive neighborhoods, and a number of other factors. However, property taxes were NOT high on their lists. As the report states, "High or increasing taxes and school issues appear at the bottom of the list of factors pushing sprawlers and suburbanizers-from-the-city to more rural places."<sup>12</sup> (emphasis added). This is of utmost importance, since many of the proposed solutions in conventional economic development have potentially negative consequences for quality of life in urban or service center areas.

## **The Search for Solutions: Economic Development, Well-Being and Quality of Life**

While state and municipal planners continue to explore ways to increase local revenue, a major focus in recent years has been to encourage conventional economic development through attracting businesses which promise to pay handsome amounts of property taxes to RSC communities. In practice, this has often resulted in a "bidding war" of sorts to attract service jobs to local communities. In some cases, service industries, such as retail "big boxes," telemarketing and financial services are enticed to locate in

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<sup>8</sup> For example, a 2001 survey of municipalities by the National League of Cities reports: "On the services and spending side of the ledger, the cost of employee health benefits was the factor most often cited (89%) by cities as having a negative impact on their budgets... 53 % of cities reported that the cost of health benefits was 'among the most negative impacts' on their budgets, surpassing 'infrastructure needs' (47 %), and reaching its highest point since 1993." (Michael A. Pagano, "City Fiscal Conditions in 2001," National League of Cities, July 2001, p. vi.)

<sup>9</sup> "Toward A System of Public Finance," NLC, *ibid.*, p. 1. The report also points out the importance of "federal and state preemption of local revenue authority." (p. 3)

<sup>10</sup> Maine State Planning Office, *Why Households Move*, August, 1999.

<sup>11</sup> "Sprawlers" (those moving from more developed areas to outlying rural areas) and "suburbanizers from the city" (those moving from more developed areas to outlying suburbs) were the two relevant categories in the study. (*Ibid.*)

<sup>12</sup> *Ibid.*, p. 28.

communities with the help of various tax incentives, which can exacerbate the problem and place yet greater burdens on local property taxes.

There are a number of unintended consequences associated with conventional economic development strategies to increase revenue.

1) Corporate tax incentives can further reduce municipal revenue.<sup>13</sup> Many corporate tax incentives are offered in the hope that the benefits of economic development will outweigh the drain on state and municipal coffers. However, the returns on such incentives are highly problematic, and may be just as likely to decrease tax revenue in the long term, particularly when there are few mechanisms of accountability to ensure that businesses create quality long-term jobs with adequate pay and benefits. "Double dipping" in the state of Maine (receiving tax breaks twice for the same purpose, through different programs) remains a serious problem for tax revenues as well, and it "privileges" large corporations, while leaving out small businesses which supply most of the state's jobs.<sup>14</sup>

2) Low-wage jobs and inadequate benefits increase demand for services, and put more economic strains on families. Having more low-wage service sector jobs, often with inadequate or no benefits, results in greater demand for state and municipal services, and greater burdens placed on local health facilities when people must turn to the emergency room, where medical care is the most costly. When workers and their families lack health insurance, health problems that could have been prevented or treated inexpensively in early stages can burgeon into expensive medical crises.

In addition, the shift to low-wage service jobs contributes to a decreased standard of living for families, and/or can result in families needing to work more hours in order not to lose ground. This in turn can create a cycle of problems regarding child care, lack of parental supervision, and so on.

3) Attracting more large scale retail "big box" stores harms small locally-owned businesses and the social fabric of communities. A growing body of evidence describes the long-term harmful impacts of big box retail centers on communities and small businesses, which are forced out of business due to extremely predatory competitive practices. Some "big box" corporations deliberately target smaller retailers for extinction, and make life more difficult by eliminating existing wholesalers as well. As the Edward Shils nationwide study of big box retailing and other studies have documented, when small retail businesses are shut down through predatory competition, there is an expanding chain of negative impacts on the social and economic well-being of communities.<sup>15</sup>

4) The negative impacts of inappropriate commercial development on "quality of life" in service center communities are likely to exacerbate middle-income AND working class outmigration. The promise of more property tax revenue in the short term often becomes a primary driver

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<sup>13</sup> In their appendix on "Trends and Challenges/Opportunities," the National League of Cities notes this fiscal challenge: "Cities sacrificing existing/future tax revenues by providing tax breaks/incentives to businesses to (re)locate/remain in the jurisdiction." ("Toward a System of Public Finance," NLC, *ibid.*, p. 7).

<sup>14</sup> Orlando E. Delogu, "BETR Is a Windfall to a Handful of Corporations and Unfair to Everyone Else." Augusta, ME: Maine Center for Economic Policy; February 7, 2000; Arn H. Pearson and Lisa Prosienski, "Anatomy of a Tax Loophole: How Corporate "Double Dipping" Costs Maine Taxpayers Millions." Portland: Maine Citizen Leadership Fund. (2000); and Peter Mills, "Reforming Business Tax Incentives"; Augusta, ME: Maine Center for Economic Policy; *Choices*: Vol. VI: No. 9; December 13, 2000.

<sup>15</sup> Edward B. Shils, *The Shils Report: Measuring the Economic and Sociological Impact of the Mega-Retail Discount Chains on Small Enterprise in Urban, Suburban, and Rural Communities*; Wharton Entrepreneurial Center, The Wharton School, University of Pennsylvania, 1997. (<http://www.lawmall.com/rpa/cover.html>); Kenneth E. Stone, "Impact of the Wal-Mart Phenomenon on Rural Communities," in *Proceedings: Increased Understanding of Public Problems and Policies – 1997*, Farm Foundation, Chicago, IL; and Center for Applied Economic Research, "The Impact of Big Box Retail Chains on Small Businesses," Montana State University (<http://www.msubillings.edu/caer/bix%20box%20report.htm>)

of potentially destructive commercial development, particularly for service center communities. Inappropriate development can also cause the destruction of valuable natural resource areas and open spaces, as well as greater problems with traffic congestion, increased traffic in residential areas, and noise. Such "quality of life" issues are at the top of the list of concerns that drive people out of urban areas, according to the State Planning Office research cited earlier. Such development, then, can increase the problems of inadequate municipal revenue.

In recent months, there has been growing discussion about another way to address the revenue problems of regional service centers which takes some pressure off property taxes: allowing a local option sales tax.<sup>16</sup> Maine is currently one of roughly 15 states without local sales taxes.<sup>17</sup> Some analyses of Maine's tax structure point out that while it is fairly progressive compared to that of many other states, it is also highly volatile (rather than providing a stable stream of revenue), and results in a disproportionate dependence on property taxes, particularly during times of recession.<sup>18</sup>

The implementation of a local option sales tax is politically appealing for many municipal governments, as an alternative to raising already-high property tax rates in service center communities. However, this strategy may also pose some risks to the economic well-being of working class and poor families. It is well known that sales taxes are inherently regressive, in that low-income people pay a larger proportion of their total income in sales taxes.<sup>19</sup> In addition, while sales taxes apply to retail goods, they do not generally apply to retail services. Since low-income people spend more of their income on goods and less on services than higher-income families, sales taxes place a larger burden on working families in this way as well.<sup>20</sup> Property taxes can also be regressive, according to some analyses, although the "homestead exemption" for property tax, which took effect in 1998, helps to "soften the regressivity" of the property tax.<sup>21</sup>

If a local option sales tax were adopted, low-income families may need additional protection from its regressive effects, possibly through further targeted tax breaks such as increasing Maine's Earned Income Tax Credit, and making it refundable.<sup>22</sup> One version being considered by the Maine legislature would allow a limited local option sales tax which would be in place only for a specific period of time, to fund specific regional development and infrastructure projects. This legislation would give municipalities the option of broadening their tax base through a local sales tax of up to 1% on the first \$5,000 of a purchase, and the tax would have to be approved by each municipality through a referendum.<sup>23</sup> According to some advocates, the advantage of such a tax is that people from other communities who depend on service centers for shopping and services, etc., would be helping to support infrastructure from which they also benefit.

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<sup>16</sup> *Reviving Service Centers, ibid.*, p. 25, and Revised Draft of "Debt Avoidance Act," Maine State Planning Office, August, 2001.

<sup>17</sup> This number does not count Alaska or the District of Columbia. See State of Washington data, "Table 16: Rates of Selected Major State Taxes, October 2001." ([http://dor.wa.gov/reports/compare99/Table\\_16.pdf?noframes](http://dor.wa.gov/reports/compare99/Table_16.pdf?noframes))

<sup>18</sup> "Identifying the Problem: The Principles of Tax Reform" (DRAFT), Maine Service Centers Coalition document; and Maine Municipal Association, "Local Government in Maine" (MMA "local government resources" webpage) (<http://www.memun.org/resources/Public/default.htm>)

<sup>19</sup> A recent study in North Carolina showed that an increase in local sales taxes "would hit the least-affluent 20 percent of North Carolinians about three times as hard as the most-affluent 20 percent when viewed as a share of household income." Kimberly Cartron, North Carolina Budget and Tax Center, "Is this the time for local sales tax increases?" *BTC Reports* Vol. 5: No. 5; March, 1999.

<sup>20</sup> *Ibid.* While a working family would pay sales tax on purchasing a vacuum cleaner, for example, more affluent families do not pay a sales tax on purchasing house-cleaning services.

<sup>21</sup> "Identifying the Problem," *ibid.*

<sup>22</sup> See the BTC report, "Is this the time for local sales tax increases?," *ibid.*

<sup>23</sup> *Reviving Service Centers, ibid.*, p. 25, and Revised Draft of "Debt Avoidance Act," *ibid.* Such a targeted tax, of limited duration, may not have the long-term regressive effects of a permanent sales tax, and it could only be implemented with the consent of the local community.

## Alternative Strategies for Service Center Communities

State, regional and municipal policy makers need to consider a wide range of alternative strategies to deal with the challenges facing regional service centers, while protecting quality of life in communities, meeting the needs of local educational systems for adequate funding, and shielding households which are economically vulnerable. Since many of these problems are rooted in the regional and statewide responsibilities that these communities are addressing, it becomes essential to explore intergovernmental, regional and state solutions. In fact, a recent analysis by the National League of Cities argues forcefully that local and state governments must work together to develop a new system of municipal public finance which reflects the unprecedented challenges facing municipal governments. The report stresses that these problems cannot be understood or addressed "within the confines of existing financial structures of individual municipalities."<sup>24</sup>

Maine's Task Force on Regional Service Center Communities also makes 20 specific recommendations to "reinvigorate" service center communities, through changes in legislation, investment, or public policy, and many of these recommendations reflect the critical need for a central role for state government as well as horizontal (e.g., intermunicipal, and town/county) solutions.<sup>25</sup> Some recommendations focus on changes in state funding formulas and revenue sharing, which would provide greater resources to service center communities, such as a "second tier formula" for revenue sharing.<sup>26</sup> Other recommendations are framed as investments in service center communities, such as investing in urban parks and trails,<sup>27</sup> and funding a Municipal Infrastructure Trust Fund, which was created by the legislature in 1994, but never funded.<sup>28</sup> The report also suggests a number of revisions in tax policy, and encourages greater cooperation among municipalities, such as shared regional economic development.<sup>29</sup> Also widely discussed is the need to reconsider existing laws regarding tax-exempt properties, which in some service center communities can constitute a high proportion of property.<sup>30</sup> Other related recommendations under consideration include changing the formula used to distribute state aid for education, increased support for special education,<sup>31</sup> and compensating service-center communities for hosting tax-exempt, non-profit services such as hospitals and universities through a broader state sales tax.

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<sup>24</sup> "Toward a System of Public Finance," NLC, *ibid.*, p. 1. The research report urges the National League of Cities to take a leadership role in promoting discussion and public policy debate over these issues, stressing the importance of understanding problems and solutions for cities and towns "in the contexts of the entirety of intergovernmental fiscal arrangements." (p. 1).

<sup>25</sup> *Reviving Service Centers, ibid.*, p. 2 and pp. 19-28.

<sup>26</sup> A "second tier formula" could be based in part on a community's share of state jobs, or on the amount of tax revenues that communities have lost because of "tax exempt state buildings and properties located in them." *Ibid.*, p. 19.

<sup>27</sup> Such investment in urban parks and trails, and strategies to increase the amount of accessible open spaces through such mechanisms as conservation easements and land trusts, are visible and effective strategies for protecting quality of life in service center communities, and stemming the flow of outmigration.

<sup>28</sup> *Ibid.*, p. 21.

<sup>29</sup> *Ibid.*, p. 28.

<sup>30</sup> In addition, some property which is currently tax-exempt is actually income-producing.

<sup>31</sup> *Ibid.*, p. 20, and *Maine Sunday Telegram*, "Service Centers Face a Crisis and Need Help," 9/2/2001.



## Conclusions

The challenges facing regional service center communities in Maine need to be addressed by creative problem solving which goes beyond the simplistic and flawed assumptions of the "Closed Loop" model of service center revenue. Many existing strategies to increase municipal revenue through tax incentives and inappropriate economic development are often counterproductive to the long-term well-being of service center communities and their quality of life. The health of RSC's is critically important for the well-being of the state as a whole, and the taxpayers in these communities should not be expected to assume the entire financial burden of providing needed services and infrastructure for surrounding areas. Policymakers, citizens, and workers should become informed about the need for comprehensive state and regional solutions that will be equitable and effective, in order to prevent a continuing downward spiral of economic and social decline in service center communities, and in the rest of the state.



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