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# The Impact of Post-Recession State Revenue Reductions on Maine's Municipalities

by Emily Shaw

*Maine municipalities have received substantially less revenue from the state over the past several years, due to a combination of financial pressures on state budgets and state administrative policy preferences. The result, says Emily Shaw, is that municipalities have been forced to restructure the provision and funding of local services through a combination of reducing spending in some categories, raising additional money from residents and other users of town services, or taking on additional municipal debt. However, on average, Maine's municipalities have so far been unable to reduce their total spending. Shaw's discussion of municipal responses to reduced state revenue is based on analyzing responses to the 2007–2011 Maine Municipal Association fiscal surveys of municipal revenues and expenditures.*

Maine's recent state budgets have dramatically cut transfers to town programs. As a result, municipalities have received substantially less revenue from the state over the past several years. This change at the state level has been due to a combination of financial exigency and administrative policy preferences and has led to real change in municipal budgets and services. While local service needs have not necessarily declined in the years following the 2007–2009 recession, municipalities have been forced to restructure the provision and funding of those services. In doing so they have chosen among a variety of possible responses: reducing spending on services, raising additional money from residents and other users of town services, or taking on additional municipal debt to continue providing services at the necessary level. By analyzing responses to the 2007–2011 Maine Municipal Association (MMA) fiscal surveys of municipal revenues and expenditures, we can see how municipalities have chosen to follow all three of these strategies as methods of responding to state revenue reductions.

## REDUCED STATE ROLE IN MUNICIPAL REVENUE SOURCES

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The state's own data sources provide a useful starting point for an analysis of the relative roles of state and

municipal sources in funding municipal budgets. Using Maine Revenue Services' Municipal Valuation Return Survey and the state Office of Fiscal and Program Review data on Major State Funding Disbursed to Municipalities and Counties, we can observe a significant shift in state funding patterns (Figure 1).

State and municipal revenues both increased until 2008. Following that year, municipalities continued to collect more property tax each year while the state began contributing less. The national economic recession clearly served as an important inflection point in Maine municipal finance, and we know that part of the reason for reduced state disbursements in 2009 was lower-than-projected state collections of income and sales tax. However, state government policy shifts—including a reduction of top state income tax levels, reductions in state expenditures on education, and a decision to reduce municipal revenue sharing—have led to a perpetuation of the reduced levels of state relative to municipal funding.

We can get a better understanding of how these changes affect municipalities by exploring municipal budget data collected by the MMA. Municipalities responding to the MMA fiscal survey report on the amount of municipal, state, and federal money they have collected during the fiscal year. These revenues are intended to fund that year's municipal expenditures,

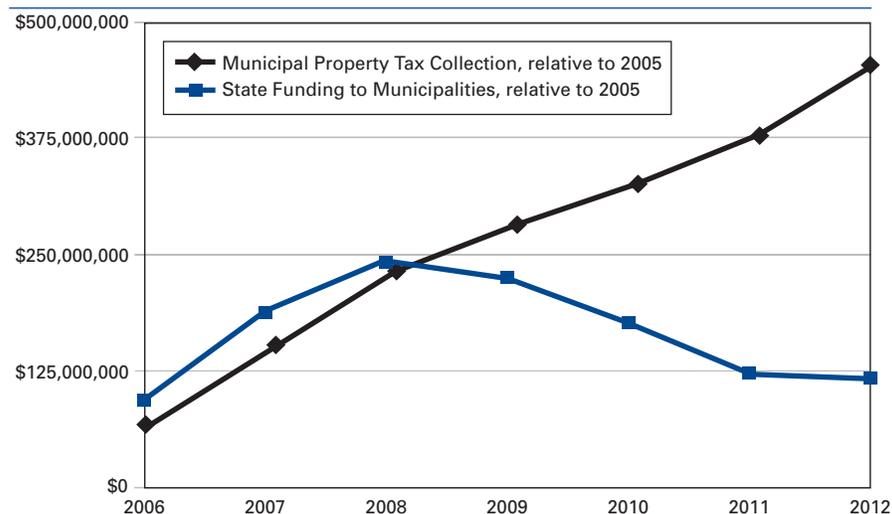
including town services, the town's contribution to its K–12 school district, and payments on short-term and long-term municipal debt. While the specific towns responding to the MMA survey vary from year to year, the MMA is able to draw on their annual sample to estimate state-level aggregates of municipal revenues and expenditures each year.<sup>1</sup> By examining the structure of these revenue sources over time, we can evaluate both how much total municipal revenue has changed over the 2008–2012 period and how the balance of responsibility for this total pool of revenue has changed. By examining year-over-year changes in estimated municipal-level spending across the state, we can see that, collectively, municipalities have increased both the proportion and the absolute amount of their revenue that comes from local residents.

Maine's largest program for providing revenue to municipalities is state funding for public education's K–12 Essential Programs and Services (EPS), education funding that is provided to the state's public school districts through municipalities. Maine's second-largest program for providing revenue to municipalities is municipal revenue sharing, a program that aims to "aid in financing all municipal services...[by providing] funds from the broad-based taxes of State Government" since "the principal problem of financing municipal services is the burden on the property tax" (Maine Revised Statutes Title 30-A, §5681). Cuts to both of Maine's largest municipal funding programs have led to the state falling farther short of those programs' pre-recession statutory funding requirements.

### State Aid to Education

The largest program area through which the state funds local services is state aid to education. A dramatic decrease in state spending on education in 2010 has left state education funding substantially below where it was in 2009 although state funding levels have not decreased again since that initial drop. As the state has consistently failed to meet statutory guidelines in this area since before the recession, it is somewhat difficult to characterize the adequacy of funding levels. There is general agreement that the state has not met its statutory target, but there is disagreement regarding the question of by how much the state is missing this target (Rooks 2010).

FIGURE 1: Property Tax and State Funding Since 2005



Source: Maine Revenue Services 2013a; Office of Fiscal and Program Review 2013.

Assessing the level of state compliance has been further complicated by disagreements about what should be included within the calculation of total K–12 EPS. Nonetheless, according to a study commissioned by the state legislature, the state contribution ranged between 50 percent and 53 percent of state EPS during the period between the implementation of the statutory 55 percent funding obligation in 2006 and the 2008–2009 school year. Beginning with the 2009 budget, however, the state provided a lower percentage of EPS each year. According to the state's new preferred method of determining EPS, which excludes teacher pension contributions, the state provided only 45 percent of EPS in 2012–2013. However, using the state's previous method of determining EPS—the one comparable with the measure used by the state until the 2010–2011 school year—the state provided only 42 percent of EPS in the 2012–2013 school year (Picus et al. 2013).

Using the data provided in the MMA fiscal surveys, it is also possible to see the decrease in the proportion of total education spending funded by the state. Though the absolute amount of funding has gone up over previous years in all years but one, in the one year in which education funding decreased (2010), the decrease was substantial (Table 1). Moreover, statewide education expenditures continue to rise at a rate that is faster than the growth in state education funding since the state reformulated its method of determining EPS.

**TABLE 1: Estimated Municipal Education Expenditures vs. Estimated State K-12 Education Funding: 2007–2011**

Year	Municipal Expenditures	State Funding	Percentage Funded by State
2007	\$1,955,637,580	\$856,226,346	44
2008	\$1,937,713,234	\$877,405,328	45
2009	\$2,082,772,296	\$887,484,050	43
2010	\$2,026,104,106	\$831,340,332	41
2011	\$2,116,942,031	\$859,706,760	41

**TABLE 2: Municipal Property Tax Collection vs. Funding from Municipal Revenue Sharing: 2007–2011**

Year	Municipal Property Tax Collection	Municipal Revenue Sharing Disbursements	Percentage of Property Tax Offset by Revenue Sharing
2007	\$1,876,244,644	\$121,378,821	6
2008	\$1,955,410,009	\$133,124,059	7
2009	\$2,004,979,063	\$120,959,079	6
2010	\$2,047,787,605	\$97,473,014	5
2011	\$2,100,857,920	\$93,155,452	4
2012	\$2,175,579,309	\$96,875,178	4

### *Municipal Revenue Sharing*

The second-largest program area through which the state funds local services has been, until recently, municipal revenue sharing. This program represents a smaller share of state-funded municipal revenue than education transfers and has experienced far greater reductions than education funding. Before 2009, the state's municipal revenue sharing program was almost always fully funded at 5 percent of the state's revenue from general income taxes. This began to change in 2009, with municipal revenue sharing initially seeing some reductions. Eventually, Governor Paul LePage's policy effort to eliminate municipal revenue sharing altogether led to the distribution amount being reduced substantially from its 2008 level in 2010–2012. (Table 2), with even more dramatic reductions put into place for the 2014–2015 budget (Long 2013; Maine Office of the State Treasurer 2013; Maine Revenue Services 2013a; Office of Fiscal and Program Review 2013).

### *Cumulative Impact of State Budget Cuts on Municipalities*

Although education and municipal revenue sharing are the largest state municipal revenue programs, they are not the only ones. State programs providing funding to municipalities—including the state homestead exemption, road assistance, general assistance, and the tree growth program—were also the subject of budget cuts and contributed to the overall reduction of state funding to municipal governments. The cumulative impact of the 2008–2011 budget cuts meant that Maine municipalities received about \$80 million less than they would have had 2007 levels of funding remained the same, for all programs except education (Table 3). Cuts to municipal revenue sharing represented more than \$50 million of that reduction in cumulative spending since 2007.

**TABLE 3: Changes in State Funding Levels Since 2007: Differential Effects by Program**

Year	Revenue Sharing	Homestead Exemption	Road Assistance	General Assistance	Tree Growth	Veterans' Reimbursement	State Aid to Education
2008	\$6,024,886	-\$1,603,220	-\$943,707	-\$1,638,639	-\$413,011	\$148,355	\$21,178,983
2009	-\$1,810,443	-\$1,478,058	-\$2,298,644	-\$125,895	\$531,927	\$403,453	\$31,257,704
2010	-\$25,533,355	-\$2,363,945	-\$3,819,080	\$659,436	-\$1,256,449	\$93,397	-\$24,886,014
2011	-\$29,984,580	-\$8,656,652	-\$2,510,038	-\$2,484,408	-\$521,797	\$171,215	\$21,120,525

Maine municipalities received a cumulative \$48.7 million more in K–12 education funding between 2008 and 2011 than they would have under 2007 levels of funding, but again, this represents a smaller increase than the total municipal increase in education expenditures during this period.

### *Impact of Federal Revenue Changes*

The role played by federal revenue during the period under study did have some effect on the impact of state revenue reduction for municipalities (Figure 2). Federal funding, unlike state funding, does not come in regular, standardized amounts; municipalities must apply for federal grants for specific purposes. Nonetheless, while funding from the state has diminished since 2008, overall amounts of money granted through federal sources increased, initially quite dramatically, through the American Recovery and Reinvestment Act of 2009 and other programs. Although this aggregate increase in the amount of revenue provided by the federal government has unquestionably been helpful for municipalities, it has never substituted for a percentage of municipal budgets that would entirely offset the degree of state revenue decrease.

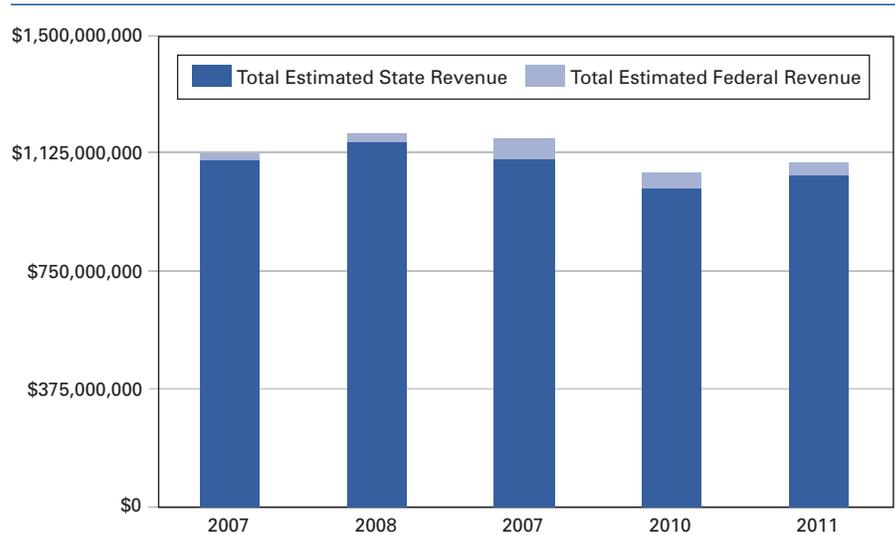
## MUNICIPAL RESPONSE TO REDUCTION IN STATE REVENUE

With less state revenue, municipalities were put in a position where they needed to decide whether to reduce expenditures, increase revenue from other sources, or do both. In many cases, they appear to have tried to do both. Municipalities faced strong challenges in achieving these changes in budget structure during a period where, on average, they faced substantial additional costs in education—the largest category of municipal expenditure—to continue to meet state and federal education requirements.

### *Increasing Revenues from Other Sources*

The combination of state and federal revenue accounted for an average of 35 percent of total estimated statewide municipal expenditures in 2008.

FIGURE 2: **Estimated Municipal State and Federal Revenues, 2007–2011**



In 2010, at their lowest point during the studied period, state and federal revenue accounted for 29 percent of total estimated statewide municipal expenditures. While MMA estimates suggest that municipalities may have collected an exceptionally high amount of municipal revenue in 2009, these collections reduced quickly following the onset of the recession.<sup>2</sup> Municipal revenue collection figures in 2010 and 2011 suggest that municipalities were functionally replacing state money with municipal sources: increases in locally generated revenues above 2008 levels closely match decreases in state and federal revenues (Table 4).

Despite a national trend in declining property tax collection following the 2009 recession, Maine's municipalities collectively increased their residential property tax collection by an average of 5 percent each year. In addition, recent municipal budget trends demonstrate that municipalities now rely more heavily on user fees as a source of revenue than they did in the past.

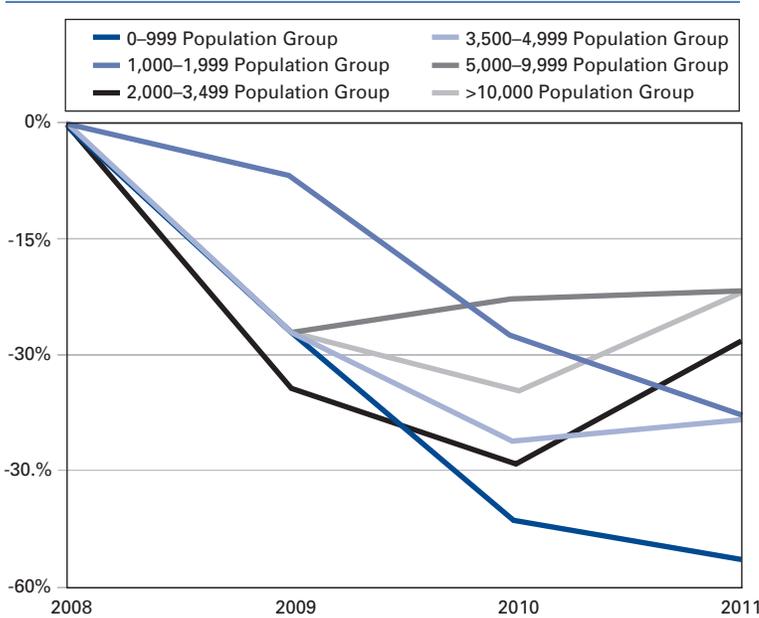
TABLE 4: **Estimated Statewide Municipal Funding Structure: Shifts in Revenue Collection Relative to 2008**

	2009	2010	2011
Change in Municipal Revenue Collection Relative to 2008	\$260,421,262	\$150,367,977	\$119,943,738
Change in State and Federal Revenue Relative to Municipal Expenditures Covered in 2008	-\$46,668,723	-\$144,941,250	-\$122,747,954

### Changing Expenditures

The achievement of rough parity between new municipal revenue and loss of old state revenue hid a number of shifts within municipal expenditures that

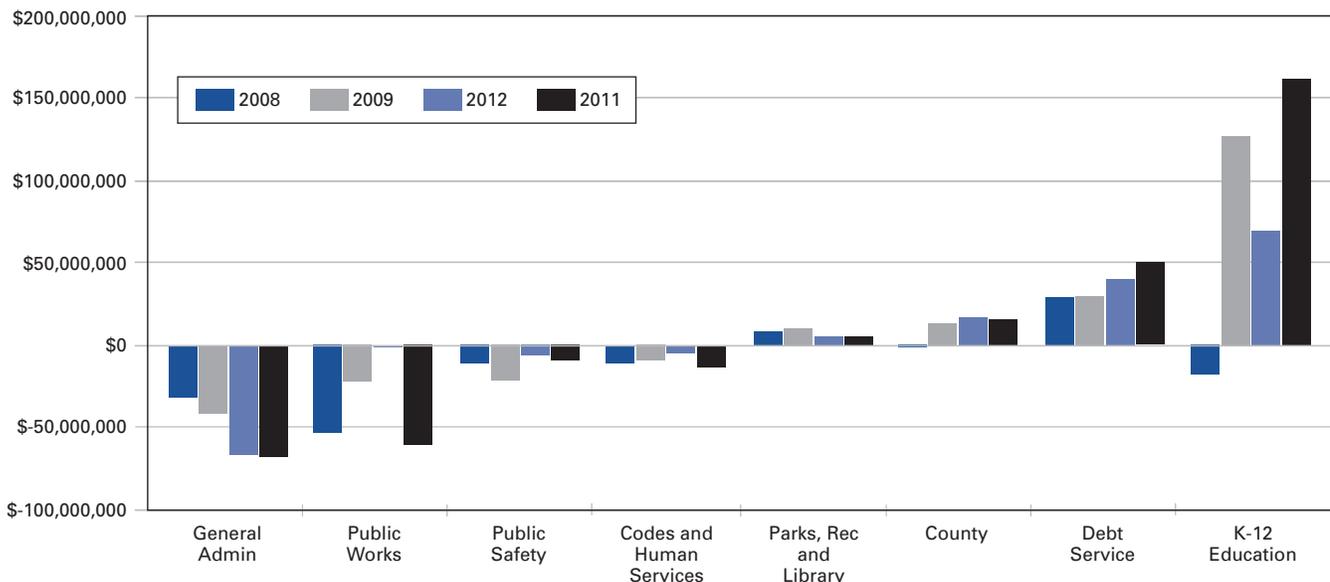
**FIGURE 3: Percentage Municipal-Level Reduction in Employee Benefits since 2008, by Town Size**



occurred during this time. Statewide, municipal spending on general administration decreased each year after 2007; the largest estimated decrease in this expenditure category, \$15 million, occurred in 2010. Cumulatively, reduced spending on general municipal administration has resulted in more than \$203 million less in municipal expenditures than if municipalities had maintained 2007 levels of spending in this category. Looking at reductions in general administration in closer detail, we can see that 2010 was also the year of largest reductions in one major dimension of general administration expenditures: employee benefits (Figure 3).

Figure 4 shows municipal expenditures across various categories. This figure demonstrates that public works also demonstrated substantially reduced spending relative to 2007 in most years during this period, as did public safety and codes and human services. Meanwhile, most years during this period witnessed slightly increased statewide estimated spending on parks, recreation and library relative to 2007 (although this is chiefly due to increases in 2008 and 2009, with 2010 and 2011 demonstrating reduced spending relative to those two years). Spending on county assessments rose sharply in 2009 and increased in 2010 also. Increased statewide municipal expenditures on debt service increased most in 2010 and 2011. Finally, although statewide municipal

**FIGURE 4: Changes in Categories of Municipal Expenditure Since 2007**



spending on K–12 education dipped in 2010 relative to 2009, the increased spending on K–12 education relative to 2007 drives the largest piece of the overall increase in municipal spending, despite the numerous cuts that have taken place during the same period.

Because there is such strong variation across municipal expenditure categories in terms of total dollar amounts, it is also valuable to look at percentages of expenditures reduced in particular categories to get a sense of how existing services might be affected by reductions. Although the absolute value of changes in general administration and education are the largest, on a percentage basis the expenditure categories of codes and human services and debt service have experienced the greatest degree of change since 2007, and in the case of debt service, since 2008 (Table 5).

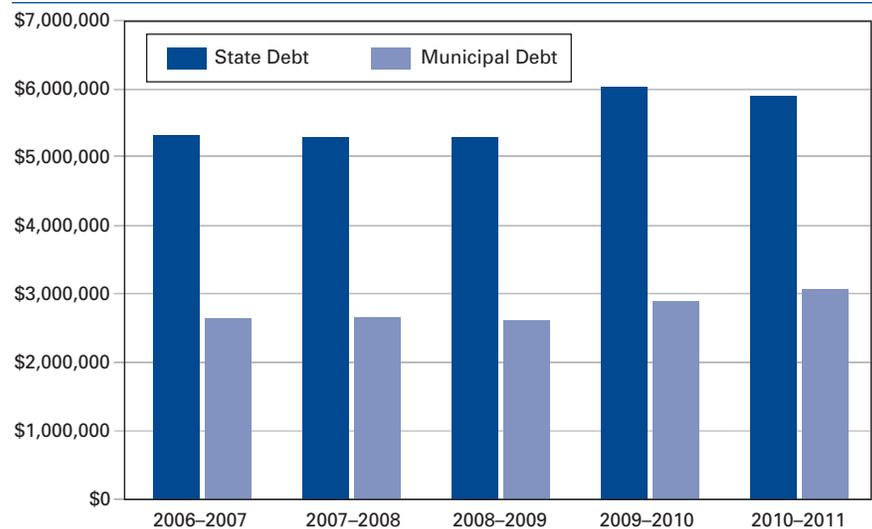
### Taking on More Debt

The increase in debt service reveals that one of the strategies used by municipalities facing a decline in state support appears to be an increased willingness to take on debt. The U.S. Census Bureau surveys of state and local government spending demonstrate that municipal borrowing is on the rise in Maine. In comparing the change in the amount of state debt with the change in the amount of municipal debt statewide, we see that though state debt reduced in 2010–2011, municipal debt continued to climb 6 percent over the previous year's amount (Figure 5) ([www.census.gov/govs/local/index.html](http://www.census.gov/govs/local/index.html)).

### Education Expenditures and Funding

Under these trying conditions, it is important to note that education spending is generally continuing to increase. That many towns have raised local revenue

FIGURE 5: **State and Municipal Debt, 2006–2007 to 2010–2011**



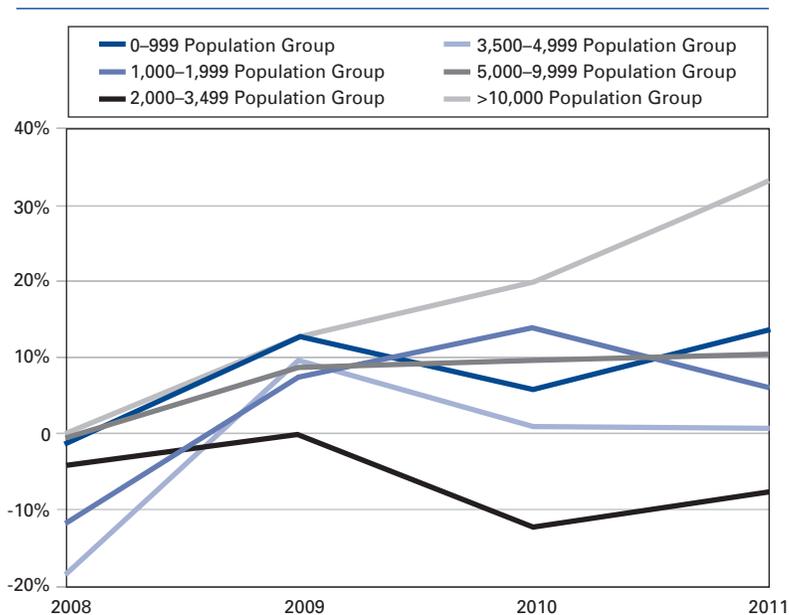
rather than cut K–12 education expenditures reveals the relatively inelastic nature of education spending. Though investigating the increase in education spending in budgetary hard times is not within the scope of this paper, we could assume that the increase reflects both structural elements (substantial ongoing capital investments, salaries and benefits levels guaranteed under union contract) and widely shared municipal preferences (maintaining high-quality schools). Looking more closely at education spending, we can also see that there is substantial variation in education spending by town size (Figure 6). Though the belt-tightening of 2010 caused most towns to cut back, at least temporarily, Maine's largest towns continued to increase spending on education, so that by 2011 they were on average spending more than 33 percent more than they were in 2007.

This difference in spending on education demonstrates another potential consequence of the reduction in state support for municipal services. As Figure 6 demonstrates, many smaller towns cut education spending in 2010, presumably in response to that year's

TABLE 5: **Percentage Change in Categories of Municipal Expenditure Since 2007**

	Codes and Human Services	General Admin	Public Works	Public Safety	K–12 Education	Parks, Rec and Library	County	Debt Service (change from 2008)
% change between 2007 and 2011	-37	-16	-14	-3	8	9	15	17

FIGURE 6: **Changes in Categories of Municipal Expenditure Since 2007**



dramatic reduction in state funding for education. Since larger towns appear to be continuing to increase their education expenditures despite those cuts, there is a possibility of a larger than usual gulf between the educational services provided in smaller and larger towns across the state. Variation within the state in municipal education funding has continued to increase over the entire 2007–2011 period, increasing the distance between the level of education expenditures made in smaller as opposed to larger towns.

## CONCLUSION

The variety of shifts in municipal revenue collection and expenditure reveal that municipalities are seriously affected by reductions in state revenue. The outcome is a mixture of heightened municipal revenue collection, decreased spending on general town services, increased spending on education—and where necessary, increased indebtedness. Because of the availability of data, this study considers primarily budgetary changes that occurred between 2007 or 2008 and 2011. We know that the trends exemplified in the post-recession period have largely continued—and in some situations, like the reduction in municipal revenue sharing and education spending relative to municipal K–12 assessments, have greatly accelerated. However, it is

impossible to discern the magnitude of the most recent changes without additional data. Nonetheless, the impact of the existing trends is highly likely to continue given the state’s continued failure to meet its previous statutory requirements for municipal funding.

On the expenditure side, municipalities spend substantially less than they had earlier on town administration, including code enforcement and human services. Municipal-level fiscal surveys also reveal that spending on county services has increased in recent years, suggesting that municipalities in the aggregate may be seeking to provide services in less expensive ways through service consolidation. Unfortunately, since these elements of the town budget account for relatively little of the overall spending—especially in comparison to education—dramatic cuts in these areas may substantially alter the nature of the services available in towns. Despite the cuts to many municipal services, education spending continues to rise in many towns to a degree that collectively outstrips the other cuts that municipalities may make.

Looking at spending patterns in the aggregate, we can see that municipal spending statewide is fairly inelastic. On average, Maine’s municipalities have so far been unable to reduce their total spending in response to substantial reductions in state funding. Instead, despite obvious efforts to cut where they can, municipalities are largely making up for the lack of state spending through increasing the tax and fee burden on their local populations. 🐟

## ENDNOTES

1. The MMA provides the methodology for their state-level estimates at the beginning of each fiscal survey report. (Maine Municipal Association 2013).
2. Although we lack data on this phenomenon, it is likely that towns were able to provide lowered assessments of property values over the course of 2009–2010 as a result of the impact of the recession on home values, allowing property owners to pay lower total taxes even if mil rates increased. As of 2010, state valuations reported to the state began to decline sharply (Maine Revenue Services 2013b).

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