



# Competition and property tax limit overrides: Revisiting Massachusetts' Proposition 2½<sup>☆</sup>



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## ABSTRACT

This paper looks at the role of spatial proximity of other towns' decisions to hold an override vote on the decision of a Massachusetts town to hold an initial override vote under Proposition 2½. We find that if a neighboring town has already held a vote at some point in the past, a town's likelihood of holding an initial vote increases by 10–15%. A prior vote being successful has a strong impact, whereas losing votes are relatively ignored. The presence of spatial dependence remains when we look at the specific purpose of override vote, or at the annual number of votes that have occurred between 1982 and 2010. This result is consistent across weighting schemes.

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## 1. Introduction

2011 represented the 30 year anniversary of Proposition 2½, Massachusetts' voter initiated property tax limitation program. That year 40 towns held 51 override votes, in which voters were asked to increase property taxes beyond the threshold set by Proposition 2½ by nearly 30 million dollars. 20 such votes were successful, resulting in an average \$745,000 increase in tax receipts for the winning towns. While the override process is now quite engrained in local governance, 2011 was not a particularly active year; in fact only five years had seen fewer votes.

In this paper, we look back to the beginning of Proposition 2½ and ask what caused Massachusetts municipalities to hold their first override vote. In particular, we are interested in the role of spatial proximity

in voting patterns; does the fact that a neighboring town held a vote increase the likelihood that you hold a vote in subsequent years? We think that spatial proximity can affect voting via two simple mechanisms: competition and technology transfer.

Competition can manifest itself in a variety of ways. In a traditional tax competition framework, a vote in town 1 causes town 2 to hold a vote in order to encourage capital to relocate through the lowering tax rates. On the other hand, towns could also use a vote to indicate a willingness to increase taxes (and hence increased spending on public goods). By engaging in so-called fiscal competition, towns are hoping to encourage Tiebout sorting through these increased expenditures and to attract a higher tax base. Finally, in yardstick competition, a vote in town 1 is used by voters in town 2 to proxy for financial conditions in their own town. Thus if town 2 was to hold a vote in the future, voters would be less likely to blame their elected politicians for their town's financial condition because they saw that town 1 also had a similar need. Under such a scenario, voters blame larger macroeconomic issues rather than political mishaps, making it easier for politicians to authorize a vote as they recognize that voters will not hold the vote against them in future elections.

Under a scenario of technology transfer (or policy diffusion in the political science literature), the override vote is the actual technology in question. By watching a vote in town 1, elected officials in town 2 can learn how to use the override vote and assess its suitability for future use. Seeing votes raise money in neighboring towns may make politicians more likely to use the technology in the future. Thus, we

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can think of this as a specific type of governmental learning, as proposed by Becker and Davies (2013).

In both scenarios, what happens beyond the town border influences the decisions made at home; econometric results alone cannot distinguish between the two. But whereas any neighboring vote should have an impact in a tax/yardstick competition framework, only the first vote should happen under technology transfer; once a town has learned the technology, there's no need to rely on your neighbors going forward. We can get at this subtle difference by using the presence of any neighboring vote to test for competition, but we can use the total number of votes to argue for or against technology transfer. Because override votes can be for multiple uses, we repeat this exercise for specific categories of votes (education, safety, etc.) to see if results are similar.

In the end, we find evidence of competition in Massachusetts, but when we look specifically at wins and losses, we find wins have more clout. When we examine the total number of votes, we still find a pattern of spatial dependence. This becomes particularly acute when we look at spending categories, as K-12 education spending is steadily the one category where voters are consistently comparing votes, and not outcomes of those votes, across the border.

## 2. The nitty-gritty of an override vote in Proposition 2½

Proposition 2½ was implemented in 1980 in response to voters' anger over the high level of taxation in Massachusetts. It imposed constraints on the amount of property tax revenue raised by municipal governments and on how much governments can increase that revenue from year to year. In particular, a city/town<sup>2</sup> cannot raise more than 2.5% of the total value of all taxable property in the community (called a levy ceiling). Moreover, a town is further limited in that its maximum levy automatically increases by 2.5% a year (this is called a levy limit), provided that the increase does not take it over the levy ceiling. The levy limits were initially set beneath the levy ceiling, hence in most cases towns will levy less than the ceiling.<sup>3</sup>

As an example, if a town has a taxable base of 1 million dollars, the levy ceiling would be 2.5% of the base, or \$25,000. This represents the maximum amount the town could ever collect. If in the previous year, the town had a levy limit of \$14,000, the new levy limit would automatically increase 2.5% to \$14,350. Proposition 2½ limits the growth of the levy limit and not the levy itself. The town is free to raise as much of the \$14,350 as it desires. This means that the levy itself is not tied to the 2.5% limit; if a town is under its levy limit one year and chooses to use the full limit the next, the levy will increase by greater than 2.5%. The difference between the levy limit and the amount a town actually chooses to levy is called the town's excess capacity.

Massachusetts municipalities have the ability to implement an increase above the levy limit (but not the levy ceiling) of 2.5% by passing an override in an election.<sup>4</sup> This can only occur if the community is currently below its levy limit and a majority of the town's selectmen or town/city council votes to have the override be put in front of voters. Override questions offered for a vote must specify a dollar amount and a specific purpose,<sup>5</sup> which can range from the most general (general operating expenses) to the mundane (snow plowing, funding education) to the very specific (allowing residents to participate in Super Tuesday primaries, buying a sander for the Department of Public Works). A

successful override requires a majority vote from the electorate and permanently increases the levy limit.

In our previous example, an override vote would be limited to \$10,650, as the levy limit for the current fiscal year plus the override amount cannot be greater than the levy ceiling. If an override for \$5,000 was passed, the levy limit for the following year would be 102.5% of \$19,350, or \$19,834, as the override amount is added to the prior year's levy limit before calculating the 2.5%.

## 3. Prior work

A lot of early work on interjurisdictional competition focused on property taxation (Brueckner and Saavedra, 2001; Heyndels and Vuchelen, 1998; Revelli, 2001) and tended to find a good degree of competition between jurisdictions in setting the millage rate.<sup>6</sup> The challenge in understanding such a finding, however, is knowing whether or not this interaction is due to tax (competition for mobile capital) or yardstick (competition for voters) competition. This ambiguity stems from the fact that the empirical specification used to determine the presence of interjurisdictional competition is the same regardless of the source (see Besley and Case (1995), Brueckner (2003) and Rork (2009) as examples of the discussion, and Eugster and Parchet (2013) for a newly proposed identification strategy to end such ambiguity). In fact, recent work by Costa-Font et al. (2011) has undertaken a meta-analysis of over 50 papers on interjurisdictional competition to try to determine which motivation is at the forefront. While the authors suggest tax competition as a main motivator, the use of national level variables to tease this effect out is questionable given the large number of subnational studies.

Brueckner and Saavedra (2001) found evidence of property tax competition in Massachusetts prior to Proposition 2½. While they found evidence of competition continuing post Proposition 2½, they attribute that competition to the taxation of business and not residential property, where the limitation had more bite. Rather than focus on the property tax rate, our project focuses on the choice to have an override vote, which is a different mechanism by which a town can change its tax.

While there has also been a vast literature on Proposition 2½, early work here tended to focus on questions of why it came into existence (Bradbury, 1991; Cutler et al., 1999; Ladd and Wilson, 1982; Vigdor, 2004). More recent efforts have focused on discovering the impact the act has on property values and fiscal outcomes (Bradbury and Zhao, 2009; Bradbury et al., 2001; Lang and Jian, 2004).

Our interest is in the determination of specific override votes, and in that regard a recent paper by Wallin and Zabel (2011) is closest to ours. The authors are focused on the relationship between override votes and local fiscal condition, which they define as the gap between revenue capacity and costs. As a side finding, the authors discovered that if a town has successful votes, it was more likely to have additional successful votes.

Our work advances the Wallin and Zabel (2011) piece in three significant ways. First, our focus is specifically on understanding the determinants of *initial* override votes, whereas Wallin and Zabel (2011) make no distinction about the timing of the vote. Second, unlike Wallin and Zabel (2011), we specifically incorporate voting behavior in neighboring districts. Finally, we will focus on the specific purpose of the override votes, seeing if the distinction leads to different outcomes. We can also look at the interrelations between override purposes in the voting process. When our results are combined with those of Wallin and Zabel

<sup>2</sup> Although towns and cities have differing governing structures in Massachusetts, going forward we use the terms interchangeably to refer to any of Massachusetts' 351 municipalities.

<sup>3</sup> The discussion that follows is based on *Levy Limits: A Primer on Proposition 2½*, published by the Massachusetts Department of Revenue.

<sup>4</sup> Municipalities can also add the value of new growth to the levy limit, but that is beyond the scope of our paper.

<sup>5</sup> For our purposes, votes for debt exclusions and capital overlays are not considered overrides. These are often temporary in nature, do not become part of the tax base from which future levy limits are calculated and require a 2/3 majority vote.

<sup>6</sup> The literature has moved beyond property taxes to look at taxes on corporate income (Brett and Pinkse, 2000), sales and excise taxes (Egger et al., 2005), and estate and inheritance taxes (Conway and Rork, 2004). In fact, interjurisdictional competition has been shown in arenas beyond taxes, such as tax progressivity (Chernick, 2005), sales tax bases (Fletcher and Murray, 2006), and state lotteries (Brown and Rork, 2005).

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