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March 4, 2002 Joint Committee on Finance Paper #1236

Shared Revenue Modifications -- Shared Revenue Payments for 2003 and Thereafter (Shared Revenue and Tax Relief)

[LFB Summary of the Governor's Budget Reform Bill: Page 77, #1]

CURRENT LAW

The state provides unrestricted state aid to counties and municipalities under the shared revenue program and under three related programs. The shared revenue program is comprised of two separate distributions and funding levels -- one for counties and one for municipalities. The municipal distribution is calculated under a formula that consists of four components: (1) aidable revenues; (2) per capita; (3) public utility; and (4) minimum guarantee/maximum growth. The distribution for counties does not include a per capita component, although counties receive aid on a per capita basis under the county mandate relief program. Act 16 suspended the shared revenue distribution formula for municipalities for payments in 2002 and 2003. Instead, each municipality's shared revenue payment in 2002 and 2003 will equal 101% of the amount the municipality received in the prior year. This Act 16 provision will not affect county shared revenue payments.

Act 16 increased funding for the shared revenue program by 1% for 2002 (2002-03) and by an additional 1% for 2003 (2003-04, the first year of the next biennium). The 2003 funding level will remain in effect for subsequent years as well, unless revised by the Legislature:

Program	2001 (2001-02)	2002 (2002-03)	2003(2003-04)
Shared Revenue			
Counties	$168,981,800	$170,671,600	$172,378,300
Municipalities	761,478,000	769,092,800	776,783,700
Total	$930,459,800	$939,764,400	$949,162,000

GOVERNOR

The Governor's proposal would make a number of modifications to the funding levels, distribution formulas, payment dates and funding sources for the shared revenue, expenditure restraint, county mandate relief and small municipalities shared revenue programs. The Governor's proposal is described in full in LFB Paper #1235. However, this paper covers only the funding level and distribution of shared revenue payments for 2003 and thereafter. Other Legislative Fiscal Bureau papers address other aspects of the Governor's proposal.

Specify that total payments in 2003 under the shared revenue program and under three related programs (expenditure restraint, county mandate relief and small municipalities shared revenue) for each municipality and county would equal the amount received in 2002, after any aid reductions enacted for 2002. Delete the current law provision establishing each municipality's 2003 shared revenue payment at 101% of the amount received in 2002.

Delete the 1% increase for 2003 in the statutory distribution level for the shared revenue program, remove references to the 2003 level continuing in the future and specify that the statutory distribution levels for shared revenue and the three related programs are subject to the reductions used to save $350,000,000 annually in 2003. Establish a June 30, 2004, sunset for encumbrances and expenditures from the current law appropriation. Establish a sunset after 2003 for distributions under the shared revenue program, including all four of the program's payment components [per capita, aidable revenues, public utility (including payments for spent nuclear fuel storage) and minimum guarantee/maximum growth].

DISCUSSION POINTS

1. State law directs the Department of Revenue (DOR) to provide estimates each September of the aid payments that each local government will receive in the succeeding year. Local governments use these estimates in setting their succeeding year's budgets. This timetable requires the Legislature to authorize changes in funding levels and in distribution formulas well in advance of when the changes take effect. For example, Act 16 suspends the distribution formulas for municipalities in 2003 and, instead, specifies that each municipality's 2003 payment will equal 101% of its 2002 payment. Also, Act 16 sets an annual funding level for the shared revenue program at $949,162,000 for 2003, even though those payments will be made in the first year of the next biennium. As a result, if the Legislature wishes to make changes to the 2003 distribution, it may be advisable to do so during the current session.

2. In the Governor's summary of the bill, the rationale for eliminating the shared revenue program is tied to the need to redesign the state-local relationship. In developing this rationale, the summary cites the findings of the Commission on State-Local Partnerships for the 21st Century. The Commission concluded that the need to redesign the relationship is predicated on a number of concerns, including high state and local tax burdens, a large number of local governments, local governments' low percentage of own-source revenues and confusion over

accountability with regard to service delivery and taxes.

3. Over time, the shared revenue program has embodied a number of policy objectives. Initially, the program was intended to compensate local governments for tax base lost due to state enacted property tax exemptions. The program was used in this manner as late as 1981 when funding for the aid programs compensating counties and municipalities for the manufacturers' machinery and equipment exemption and the exemption for business inventories and farmers' livestock was folded into the shared revenue appropriation. Currently, the primary policy of the program is to equalize tax base between communities. This has the effect of reducing the disparities in tax rates between local governments, thereby allowing governments with limited amounts of tax base to provide basic levels of service.

4. If there is a desire to continue the shared revenue program, the following table shows several options for funding reductions, based on eliminating the three related programs (expenditure restraint, small municipalities shared revenue and county mandate relief) and making any additional reductions to the shared revenue program. The amount of the combined reductions are identical to those presented in LFB Paper #1235, "Shared Revenue Modifications -- Distribution of 2002 Payments." Since the shared revenue appropriation is divided into separate distributions for counties and municipalities, those amounts should be specified, as well. Further, that division could be made consistently with the reductions applied against payments to counties and municipalities in 2002. Table 1 displays those options based on the alternatives in the previous paper.

TABLE 1

Alternate 2003 Distribution Levels
(No Funding for Three Related Programs)

Reduction Amount and Procedure:	Counties	Municipalities	Total
-$350 Million			
Per Capita	$42,090,500	$637,325,300	$679,415,800
Aid + Levy	71,576,900	607,838,900	679,415,800
Uniform Percent	126,484,600	552,931,200	679,415,800
-$200 Million			
Per Capita	$98,993,300	$730,422,500	$829,415,800
Aid + Levy	119,224,600	710,191,200	829,415,800
Uniform Percent	154,409,600	675,006,200	829,415,800
-$100 Million			
Per Capita	$142,480,600	$786,935,200	$929,415,800
Aid + Levy	154,119,900	775,295,900	929,415,800
Uniform Percent	173,026,300	756,389,500	929,415,800

5. If there is a desire to preserve the three programs related to the shared revenue program, yet still hit an overall reduction level, the preceding amounts would have to be further reduced, with the savings appropriated to the related programs. If the current percentage division between shared revenue and the related programs is preserved, the following amounts would be available for the shared revenue program.

TABLE 2

Alternate 2003 Distribution Levels
(Preserves Proportionate Funding for Three Related Programs)

Reduction Amount and Procedure:	Counties	Municipalities	Total
-$350 Million			
Per Capita	$37,484,600	$585,077,800	$622,562,400
Aid + Levy	63,744,300	558,008,700	621,753,000
Uniform Percent	112,643,500	507,602,300	620,245,800
-$200 Million			
Per Capita	$88,160,500	$670,543,000	$758,703,500
Aid + Levy	106,177,900	651,970,200	758,148,100
Uniform Percent	137,512,600	619,669,700	757,182,300
-$100 Million			
Per Capita	$126,889,000	$722,422,800	$849,311,800
Aid + Levy	137,254,600	711,737,700	848,992,300
Uniform Percent	154,092,100	694,381,200	848,473,300

6. Prior to Act 16, funding for shared revenue was last increased in 1995. If the funding level had grown at the rate of inflation since that time, 2002 funding would be $1,101.6 million. This is $161.8 million greater than the 2002 funding level under current law. Proponents of retaining shared revenue use this rationale to argue that shared revenue funding has already been reduced in real terms and that additional reductions are unwarranted.

7. Another way of examining the history of shared revenue since 1995 is to evaluate how the two major components (aidable revenues and per capita) have changed since that time in regards to meeting formula objectives. The aidable revenues component guarantees each local government a certain tax base per capita. In 1995, this was $41,914 for municipalities and $39,675 for counties. By 2002, this would grow to $57,019 for municipalities and $56,104 for counties. However, the guarantee in 2002 would only have to be $52,896 for municipalities and $50,070 for counties to guarantee the same real, per capita tax base as was guaranteed in 1995. At the lower guarantees, aidable revenues funding would be $185.4 million less than the 2002 amount (if the formula ran in that year).

8. Per capita aid provides a broad-based distribution, assuring some aid to each municipality and county. In 1995, the aid amounts were $142.7 million for municipalities and $20.2 million for counties (paid as county mandate relief). For 2002, the municipal amount was unchanged and the county amount had increased to $21.0 million. In order to provide the same real aid per capita, these distributions would need to be set at $180.1 million for municipalities and $25.5 million for counties. This is a total increase of $41.9 million compared to current law.

9. The previous points show that the ability of the shared revenue program to accomplish various objectives changes over time based on overall funding decisions and the allocation of funding among program components.

10. If the current law funding level for the shared revenue program is significantly reduced, modifications to the current law distribution formulas would be necessary. Modifications could include: (a) changing how the distribution is divided between the aidable revenues, per capita and public utility components; (b) changing the aidable revenues formula to allow more local governments to compete for funding; and (c) changing the minimum guarantee/maximum growth component to reflect the impact of lower overall funding.

11. The division of shared revenue funding between the various components under current law is determined by the sequence in which entitlements are calculated. Entitlements under the per capita and utility aid components are calculated first, so amounts generated under those formulas comprise the "first draw" against the total funding levels. Any remaining amounts are distributed under the aidable revenues component. If the per capita and utility aid formulas are not revised, any reduction in shared revenue funding would be targeted entirely against the aidable revenues distribution. Table 3 reports the 2001 shared revenue distribution by component. Amounts under the minimum guarantee/maximum growth component are not shown because that component redistributes amounts allocated under the per capita and aidable revenues components. Once a funding level has been determined, these percentages could be used to allocate the funding among the components and set the new distribution amounts for the per capita and utility aid components. If that approach is taken, utility aid amounts would have to be allocated on a pro rata basis. A separate issue paper has been prepared on utility aid (LFB Paper #1237), which includes an alternative to separate the utility aid funding into a new appropriation.

TABLE 3

Shared Revenue Distribution by Component, 2001

	Public Utility	Per Capita	Aidable Revenues	Total Shared Revenue
Counties	8.5%	0.0%	91.5%	100.0%
Municipalities	1.8	18.8	79.4	100.0
Total	3.1%	15.3%	81.6%	100.0%

12. Accounting for over 80% of the total distribution, aidable revenues is the dominant shared revenue component. It is based on the policy of tax base equalization, where relatively greater amounts of aid are distributed to local governments with lower tax capacities, as measured by each government's adjusted property value per capita. In periods with limited fiscal resources, it could be argued that the available resources should be targeted to those with the greatest need. Focusing aid reductions first on the per capita distribution has been suggested as a way of accomplishing this goal. However, except for any utility aid payment, this could effectively end participation in the shared revenue program for many local governments, depending on changes to the minimum guarantee.

13. A local government is eligible for an aidable revenues entitlement if its per capita adjusted full value is below the standard value. Separate standard values are calculated for the county and municipal distributions, and the standard values change from year to year so as to distribute all of the available funding. For 2001, the standard values were set at $52,566 for counties and $53,256 for municipalities. At those levels, 45 of the state's 72 counties and 1,088 of the state's 1,850 municipalities were eligible for funding. If funding reductions are not accompanied by formula changes, the number of local governments eligible for aidable revenues entitlements will decline. Table 4 shows the estimated effect of aid reductions of $350 million, $200 million and $100 million relative to the 2001 distribution and assumes those reductions were applied entirely to aidable revenues funding in proportion to the current, overall county and municipal funding amounts.

TABLE 4

Effect of Funding Reductions on 2001 Aidable Revenues Distribution

	Actual 2001 Distribution	$350 Million Reduction	$200 Million Reduction	$100 Million Reduction
Counties				
Distribution	$154,549,205	$90,985,330	$118,226,991	$136,388,098
Standard Value	$52,566	$47,927	$49,920	$51,265
Number Eligible	45	36	41	42
Number Ineligible	27	36	31	30
Percent Ineligible	37%	50%	43%	42%
Municipalities				
Distribution	$604,859,946	$318,423,821	$441,182,160	$523,021,053
Standard Value	$53,256	$42,410	$46,841	$49,996
Number Eligible	1,088	681	865	979
Number Ineligible	762	1,169	985	871
Percent Ineligible	41%	63%	53%	47%

14. Aidable revenues entitlements are calculated by multiplying sharing percentages by average local revenues. Sharing percentages are calculated by comparing each local government's per capita adjusted full value to the standard value. Average local revenues are the revenues raised by each local government over three prior years, divided by three. County revenues are reduced to 85% of their three-year average. Local revenues are comprised of property tax collections and other revenues considered to be substitutable for the property tax. These other revenues include: other local taxes; special assessments; various permit fees; various user charges and fees; proxies for private sewer service costs, solid waste and recycling costs and retail charges for fire protection purposes; and certain state aids (aidable revenues entitlements and computer reimbursement aid).

15. The number of local governments that a funding reduction would cause to become ineligible for aidable revenues entitlements could be decreased by reducing the amount of local revenues that are aided. For example, if the definition of local revenues had been limited to general local taxes and the currently enumerated state aids, an additional 199 local governments would have generated aidable revenues entitlements in 2001. Table 5 shows the effects of changing the local revenue definition to include only taxes and aids relative to the amounts displayed in Table 4 under the $350 million, $200 million and $100 million funding reductions. Although the number of counties eligible for entitlements would increase by two or less, the number of municipalities eligible for entitlements would increase by more than 100 under each funding amount. However, in aggregate, entitlements for municipalities with lower per capita values would decrease to allow this broader participation.

TABLE 5

Combined Effects of Funding Reductions and Change in Local Revenues Definition on 2001 Aidable Revenues Distribution

	$350 Million Reduction	$200 Million Reduction	$100 Million Reduction
Counties			
Distribution	$90,985,330	$118,226,991	$136,388,098
Standard Value	$48,466	$50,594	$52,024
Number Eligible	37	41	44
Number Ineligible	35	31	28
Percent Ineligible	49%	43%	39%
Municipalities			
Distribution	$318,423,821	$441,182,160	$523,021,053
Standard Value	$45,373	$51,583	$55,977
Number Eligible	800	1,039	1,174
Number Ineligible	1,050	811	676
Percent Ineligible	57%	44%	37%

16. The minimum guarantee/maximum growth component of the shared revenue program prevents large, year-to-year decreases or increases in payments. If a local government's entitlements under the aidable revenues and per capita components are less than 95% of its prior year actual payment, the entitlements are supplemented through the minimum guarantee so that the decrease equals only 5%. Minimum payments are funded by limiting the increase in payments to other local governments to a maximum percentage increase. Any increases in entitlements in excess of the percentage are "skimmed-off." The maximum percentage changes each year so that the total amount skimmed through the maximum provision equals the total amount supplemented under the minimum provision.

17. If the current shared revenue formulas are retained and funding for 2003 is reduced relative to funding for 2002, the minimum/maximum component may be unable to offset minimum payment supplements with maximum payment reductions in the transition year. There could be few or no governments experiencing payment increases, which would be needed to fund the minimum supplements. Also, minimum/maximum provisions reduce the impact associated with other formula changes that may be enacted to address the effects of the funding reduction. In response, the minimum/maximum component could either be suspended for the transition year, modified to provide a lower minimum guarantee or repealed.

18. The minimum guarantee was cited as one factor that hampers the shared revenue program's "ability to reduce disparities between the state's richer and poorer communities" in the January, 2001, report by the Commission on State/Local Partnerships for the Twenty-First Century. Also, the Commission found that the program "contains incentives for municipalities to increase their spending." In response to these concerns, the Commission recommended transforming shared revenue "into a program that equalizes municipalities' ability to purchase a basic package of services." If a radical change to the current distribution formula is desired, an expenditure-based distribution formula could be developed to replace the current program. The formula could be designed to encourage cost-effective service delivery, and also could incorporate other policies advanced by the Commission. Because some lead time would be needed to develop and authorize a new distribution formula, shared revenue payments could be frozen in 2003 at their 2002 amounts. As an incentive to develop and enact a new distribution formula, the current distribution formula could be repealed.

19. Milwaukee County is currently required to make an annual contribution of $58,893,500 to the Department of Health and Family Services (DHFS) for the provision of child welfare services in Milwaukee County. This contribution is made as follows: (a) through a reduction of $37,209,200 from the amount DHFS distributes as the basic county allocation under community aids; (b) through a reduction of $1,583,000 from the federal substance abuse prevention and treatment (SAPT) block grant that DHFS distributes as a categorical allocation under community aids; and (c) through a deduction of $20,101,300 from shared revenue payments. Under the bill, Milwaukee County's annual contribution for child welfare services would be reduced from $58,893,500 to $38,792,200, beginning July 1, 2004, to reflect the proposed elimination of shared revenue. If Milwaukee County's shared revenue payment is eliminated or significantly reduced, the Bureau of Milwaukee Child Welfare would face a funding shortfall. If there is a desire to continue

the Bureau's services at the current level, its funding should be supplemented from other sources.

20. Any formula changes that are adopted will change the distribution of shared revenue. Depending on the choices that are made, new formulas could have distributions that vary significantly from current law and from one another. As an example, Table 6 compares the distribution of aid under current law with two alternate distributions at a $350 million lower funding level. The first alternative retains the current per capita distribution, reduces aidable revenues funding by $350 million, limits local purpose revenues to local taxes and aids and retains a minimum guarantee. The second alternative deletes the per capita distribution, reduces aidable revenues funding by $207.3 million, retains the current law aidable revenues distribution formula and eliminates the minimum guarantee. As shown, the first alternative would distribute aid in a pattern somewhat comparable to the pattern under current law. The second alternative would distribute a higher percentage of aid to local governments with lower per capita values.

TABLE 6

Comparison of Shared Revenue Distribution by Value Per Capita Categories
Current Law Versus Two Alternatives With Lower Funding and Formula Modifications
(Amounts in Millions)

	Current Law		First Alternative		Second Alternative	
Value/Capita	Amount	% of Total	Amount	% of Total	Amount	% of Total
Counties						
Under $20,000	$0.0	0.0%	$0.0	0.0%	$0.0	0.0%
$20,000 to $30,000	0.0	0.0	0.0	0.0	0.0	0.0
$30,000 to $40,000	72.4	42.8	46.5	44.1	67.9	64.4
$40,000 to $50,000	70.2	41.6	42.3	40.2	31.8	30.2
Over $50,000	26.4	15.6	16.6	15.7	5.7	5.4
Total	$169.0	100.0%	$105.4	100.0%	$105.4	100.0%
Municipalities						
Under $20,000	$4.7	0.6%	$3.2	0.7%	$5.1	1.1%
$20,000 to $30,000	342.4	45.0	234.2	49.3	287.6	60.5
$30,000 to $40,000	168.4	22.1	96.8	20.4	116.3	24.5
$40,000 to $50,000	151.3	19.9	78.3	16.5	58.5	12.3
Over $50,000	94.7	12.4	62.5	13.1	7.5	1.6
Total	$761.5	100.0%	$475.0	100.0%	$475.0	100.0%

21. Short-term suspension of aid formulas often occurs to postpone shifts in aid that would otherwise occur. The longer a formula is suspended, the less relevant it becomes in determining an aid policy. Over time, aid resources are used more to stabilize local budgets and less to accomplish any of the objectives that were desired when the aid program was created.

22. If shared revenue is reduced, but not eliminated, the future aid policy chosen to allocate the lower aid amounts can be shaped to meet the goals of the Legislature. The 2002 aid reductions discussed in LFB Paper #1235 deal with a short-term response given that local governments have already set their budgets for this year. The formula alternatives discussed in this paper represent possible choices to establish an aid policy for the future, when local governments will have more time to respond. A revised formula could be used beginning in 2003. Alternately, if the Legislature wants to build in an opportunity to revisit the issue before the revised formula affects local budgets, the revisions could be delayed to 2004 and 2003 payments could be set at a specified percentage of 2002 payments.

ALTERNATIVES TO BILL

1. Approve the following provisions in the Governor's recommendation related to the shared revenue distribution for 2003 and thereafter. Specify that total payments in 2003 under the shared revenue program and under three related programs (expenditure restraint, county mandate relief and small municipalities shared revenue) for each municipality and county would equal the amount received in 2002, after any aid reductions enacted for 2002. Delete the current law provision establishing each municipality's 2003 shared revenue payment at 101% of the amount received in 2002. Delete the 1% increase for 2003 in the statutory distribution level for the shared revenue program, remove references to the 2003 level continuing in the future and specify that the statutory distribution levels for shared revenue and the three related programs are subject to the reductions used to save $350,000,000 annually in 2003. Establish a June 30, 2004, sunset for encumbrances and expenditures from the current law appropriation. Establish a sunset after 2003 for distributions under the shared revenue program, including all four of the program's payment components [per capita, aidable revenues, public utility (including payments for spent nuclear fuel storage) and minimum guarantee/maximum growth].

2. Retain the shared revenue program subject to the following modifications:

a. *Funding*. Set the total shared revenue distribution, the county distribution and the municipal distribution as follows, effective with payments for 2003 and thereafter.

(1) Establish shared revenue funding levels consistent with the policy of repealing the expenditure restraint, county mandate relief and small municipalities shared revenue programs and making proportionate reductions to the county and municipal shared revenue distributions and that are consistent with the policy adopted to make aid reductions in 2002 and one of the following overall aid reductions (see Table 1 for specific details):

(a) $350 million;
(b) $200 million; or
(c) $100 million.

(2) Establish shared revenue funding levels consistent with the policy of making

proportionate reductions to the expenditure restraint, county mandate relief and small municipalities shared revenue programs and making proportionate reductions to the county and municipal shared revenue distributions and that are consistent with the policy adopted to make aid reductions in 2002 and one of the following overall aid reductions (see Table 2 for specific details):

(a) $350 million;
(b) $200 million; or
(c) $100 million.

b. *Funding by Component -- Counties*. Set each component of the county distribution at the following percentages:

(1) 8.5% for public utility aid and 91.5% for aidable revenues; or

(2) 100.0% for aidable revenues.

c. *Funding by Component -- Municipalities*. Set each component of the municipal distribution at the following percentages:

(1) 1.8% for public utility aid, 18.8% for per capita aid and 79.4% for aidable revenues; or

(2) 19.1% for per capita aid and 81.9% for aidable revenues; or

(3) 100.0% for aidable revenues.

d. *Aidable Revenues*. Modify the definition of local purpose revenues to include only the general local taxes and state aid amounts included under the current law definition.

e. *Minimum Guarantee/Maximum Growth Component*. Modify the minimum guarantee/maximum growth payment provisions as follows:

(1) Suspend the provisions for the 2003 shared revenue distribution;

(2) Establish a minimum guarantee for 2003 and thereafter that allows a 10% spread between the minimum guarantee and maximum growth percentages;

(3) Establish a minimum guarantee for 2003 and thereafter that allows a 20% spread between the minimum guarantee and maximum growth percentages; or

(4) Repeal the provisions, effective with the 2003 shared revenue distribution.

f. *Temporary Formula Suspension.* Set the 2003 payment amount for each local government at a fixed percentage of the 2002 payment amount, based on the funding level approved for payments in the two years. Make any approved formula modifications effective with 2004 payments.

g. *Cost-Based Aid Distribution Formula*. Repeal the existing distribution formula after the distribution for 2003 and specify that the 2004 distribution be based on a formula that measures tax capacity and expenditure levels. (The specifics of the distribution formula would be specified in subsequent legislation.)

3. Create a sum sufficient, GPR annual appropriation to provide funding for the Bureau of Milwaukee Child Welfare in the Department of Health and Family Services. Set the appropriation at an amount equal to $20,101,300 minus any amounts deducted from the shared revenue payment for Milwaukee County that are used to fund the same services. Modify the Governor's proposal to lower the contribution from Milwaukee County by specifying that the County's annual contribution would equal $38,792,200 plus an amount equal to the lesser of the County's shared revenue payment for the year or $20,101,300.

4. Delete the Governor's recommendation to reduce in 2003 and eliminate in 2004 state aid payments under the shared revenue program.

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