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County Levy Restraint Program (Shared Revenue and Tax Relief -- Direct Aid Payments)

[LFB 2005-07 Budget Summary: Page 446, #6]

CURRENT LAW

Each county is subject to a tax rate limit on the general operations portion of its levy. For purposes of the control, each county's total tax levy and rate are separated into two components. The debt levy and debt levy rate are comprised of amounts for debt service on state trust fund loans, general obligation bonds, and long-term promissory notes, while the operating levy and operating rate are comprised of all other taxes. Each county's operating levy is limited to no more than an amount based on its prior year's allowable levy plus an adjustment equal to the percent change in the county's equalized value. For example, if a county's equalized value increases, or decreases, by 5%, its allowable levy will increase, or decrease, by 5%. Unless a county has claimed an adjustment to its levy, this mechanism has the effect of limiting each county's tax rate to the rate that was in effect in 1992(93), the year before the tax rate limit took effect.

GOVERNOR

Create a county levy restraint program and create two sum sufficient, GPR appropriations to make state aid payments to eligible counties. Set the distribution level for the county levy restraint payment account appropriation at $25,000,000 annually, beginning in 2007. Set the distribution level for the county levy restraint bonus payment account appropriation at $10,000,000 annually, beginning in 2007. Require the payments for each year's distribution to be made on the fourth Monday in July.

Provide payments from the two appropriations to counties if in the December that is two years before the aid payment, the county has a county tax levy that is no greater than the county's maximum allowable levy, as defined under this program. (The proposed language should be clarified to achieve this intent.)

Define county tax levy as the sum for all municipalities in the county of the amounts reported as total county taxes levied on the statement of taxes filed with the Department of Revenue, but excluding any taxes levied for a county children with disabilities education board. Provide that a county's tax levy, for purposes of determining eligibility and computing aid payments, would be adjusted based on the following conditions: (a) if a county transfers to another governmental unit responsibility for providing any service that it provided in the preceding year, the county's tax levy for the preceding year would be decreased to reflect the amount that the county levied to provide the service; and (b) if a county increases the services that it provides by adding responsibility for providing a service transferred to it from another governmental unit in any year, the county's tax levy for the preceding year would be increased to reflect the cost of providing that service. Define county tax rate as the county's tax levy divided by its equalized value, excluding the value of any tax increments.

Define maximum allowable levy as the county's tax levy in the year two years before the aid payment increased by a percentage equal to 85% of the sum of two percentages, based on inflation and valuation growth, rounded to the nearest 0.01%.

Define the inflation factor as a percentage equal to the average annual percentage change in the consumer price index for all urban consumers, U. S. city average, as determined by the U.S. Department of Labor, for the 12 months ending on June 30 of the year that is two years before the year of the aid payment. Define the valuation factor as a percentage equal to 60% of the percentage change in the equalized value due to new construction, less improvements removed, for the county between the year two years before the year of the payment and the previous year, but not less than 0% nor greater than 2%. (The Department of Administration has requested a technical amendment to AB 100 to achieve this intent.)

Specify that the maximum allowable levy does not apply to amounts levied for the payment of any general obligation debt service, including debt service on debt issued or reissued to fund or refund outstanding obligations, interest on outstanding obligations, or the payment of related issuance costs or redemption premiums, secured by the full faith and credit of the county. Provide that if the county and municipal aid payment to a county is less than in the previous year, the county's maximum allowable levy would be increased to reflect the reduction.

Calculate each eligible county's payment from the county levy restraint payment account appropriation by: (a) dividing the county tax levy for the county by the sum of all such amounts for all eligible counties; and (b) multiplying the resulting percentage by $25,000,000.

Calculate each eligible county's payment from the county levy restraint bonus payment account appropriation by: (a) subtracting the county tax levy from the county's maximum allowable levy; (b) dividing that amount by the sum of all such amounts for all eligible counties; and (c) multiplying the resulting percentage by $10,000,000.

Direct DOR to administer the program by calculating payments, by notifying eligible counties of their estimated payment amounts in the year preceding the aid payment, by certifying to the Joint Committee on Finance the appropriate percentage change in the consumer price index that is used to determine the inflation factor on August 1, of each year, and by making adjustments to levies to reflect service transfers.

Because this program's first aid payments would occur in July, 2007, which is in the 2007-09 biennium, the proposal would have no direct fiscal effect in the 2005-07 biennium. However, by limiting county property tax increases in 2005(06) and 2006(07), the 2005-07 funding levels for the computer aid, homestead tax credit, farmland preservation credit, and property tax/rent credit programs would be indirectly affected.

DISCUSSION POINTS

1. Fiscal controls, such as the one proposed under these provisions, are a mechanism to reduce Wisconsin's property tax level, which ranks above-average relative to other states. For 2001-02 (the most recent year compiled by the U.S. Department of Commerce), Wisconsin's level of state and local property taxes per $1,000 of personal income exceeds the national average by 27.3%, and Wisconsin's per capita level of state and local property taxes exceeds the national average by 22.6%. Since 2001-02, the estimated property tax bill for the typical homeowner has increased faster than the rate of inflation, as have gross property tax levies. These observations are discussed more fully in the Legislative Fiscal Bureau issue paper entitled "Levy Limit for Counties and Municipalities" (Paper #685).

2. Local officials cite a number of factors as the cause for property tax increases. They view the state as partially responsible for the increases because the state has imposed mandates on local governments and funding for state aid has not kept pace with inflation. Mandates related to the courts, youth aids, probation and parole, and human services have been cited as particularly significant relative to their impact on county expenditures. In April, 2005, most counties held advisory referenda regarding mandates in the areas of human services and the courts. The Wisconsin Counties Association reports that state funding for these mandates was supported by 85% of the participating voters in 69 of the state's 72 counties. Some county officials view the imposition of fiscal controls as inconsistent with state mandates because local officials are being asked to limit costs that are beyond their control. They often object to state-imposed local fiscal controls as state interference in the local decision-making process and view themselves as better able than the state to evaluate the need for public services in their communities and their taxpayers' ability to pay for those services.

3. AB 100 proposes both a levy limit for counties and a levy restraint program that would provide aid to counties that adhere to a fiscal control similar to, but more restrictive than, the proposed levy limit. By linking local fiscal controls with state aid payments, local governments can decide to forego the state aid. In this way, state policy objectives can be balanced against the goal of

local control. This balancing can be affected by the amount of aid at risk and the other policy objectives associated with the aid payment. Linking a new aid payment to a desired behavior creates a positive incentive to adjust the desired behavior.

4. Because the $35 million in additional funding would be paid in July, 2007, the expenditure would occur in the 2007-09 biennium and represents an advance commitment. When combined with increases in other tax relief appropriations proposed in AB 100 and the proposed delay of the computer aid payment, advance commitments in the "shared revenue and tax relief" portion of the budget total $266 million. This implies that the "first" $266 million in revenue growth in the 2007-09 biennium would be used to fund these increases. As an example, AB 100 anticipates $485.3 million in general purpose revenue growth in the first year of the 2005-07 biennium. Assuming similar revenue growth in the first year of the 2007-09 biennium, the $266 million increase would use 55% of the additional revenues. The $35 million increase for the county levy restraint program would use 7% of the additional revenues.

5. The levy limit proposed under the county levy restraint program differs from the levy limit that AB 100 proposes for all counties in several ways. First, the valuation factor under the levy limit program would be "capped" at no more than 2% under the county levy restraint program. Second, the allowable percentage increase in levies would be reduced to 85% of the percentage allowed under the levy limit program, which the administration indicates is intended to produce levies lower than those allowed under the bill's levy limit. Third, the county levy restraint program would not authorize the adjustment to the allowable levy for referenda, as authorized under the levy limit program. This configuration may violate the principle of administrative simplicity, which suggests that individuals are most likely to modify their behavior if there are understandable rules and predictable consequences. Therefore, imposing multiple fiscal controls and distribution formulas may not have the desired effect on local decisions. The Committee could use whatever levy limit it adopts as the eligibility test for the levy restraint aid payment to avoid having two tests. Another option that would not require additional funding in 2007-09 would be to link AB 100's levy limit proposal to the county and municipal aid program. Currently, that program provides $174.7 million annually in unrestricted state aid payments to counties. This action would reduce the bill's advance commitment of expenditures for 2005-06 by $35 million.

6. Between 2003(04) and 2004(05), county levies for operations increased by $66.5 million (5.1%) on a statewide basis. If the county levy restraint program had been in effect, statewide increases of only $40.8 million (3.1%) would have been allowed, assuming all 72 counties would have set their levies at the maximum allowable amounts to qualify for a payment. Reductions of 10% or more would have been required for four counties, and reductions of 5% to 10% would have been required for an additional eight counties. Therefore, it appears unlikely that all 72 counties would be able to continuously qualify for aid payments. If all 72 counties had lowered their levies to just below the maximum allowed, a levy reduction of $25.7 million would have been rewarded with aid payments totaling $35 million.

7. Rather than employing a fiscal control based on tax levies, a control could be designed that would limit increases in spending. An expenditure control tied to a state aid payment

has been authorized for municipalities since 1991. Under the expenditure restraint program, municipalities with municipal purpose tax rates above five mills receive an aid payment if they restrict the rate of year-to-year growth in their budgets to a percentage determined by statutory formula. The statutes define "municipal budget" as the municipality's budget for its general fund exclusive of principal and interest payments on long-term debt. Adjustments to the budgeted amounts are allowed for service transfers, state recycling tipping fees, and revenue sharing agreements. For the year prior to the aid payment, the rate of budget growth cannot exceed the inflation rate plus an adjustment based on growth in municipal property values.

8. A fiscal control based on spending, such as under the expenditure restraint program, will have different impacts than a control based on taxes. A control with a focus on spending implies a policy objective of limiting the size or scope of government. A control with a focus on taxes implies a policy objective of reducing local governments' reliance on the property tax. A fiscal control will achieve a greater level of effectiveness if it is designed on the basis of a clearly articulated public policy objective.

9. Intergovernmental revenue, such as state aid, is one reason that different types of fiscal controls have different impacts on individual local governments. The most recent year for which the Department of Revenue has tabulated local revenue and expenditure data is 2003. Using that data, Table 1 shows the distribution of counties based on the percentage of their general expenditures within the governmental funds category funded with intergovernmental revenue. On average, intergovernmental revenue funded 37.6% of county expenditures. However, intergovernmental revenue funded less than 30% of expenditures for 14% of all counties, and more than 40% of expenditures for 35% of all counties.

TABLE 1

Intergovernmental Revenue as a Percent of General Expenditures Within the Governmental Funds Category, 2003

	Number	Percent
Under 20%	1	1.4%
20% to 30%	9	12.5
30% to 40%	37	51.4
40% to 50%	19	26.4
50% to 60%	6	8.3
Total	72	100.0%

10. Based on the 2003 financial information, Tables 2 and 3 relate the variation in intergovernmental revenue reliance to the impact resulting from the two types of fiscal controls. Table 2 illustrates the potential impact of a 3% across-the-board increase in tax levies on county spending, assuming no other increases in the counties' revenue sources. A 3% levy control would

have limited spending increases (unless fees or other non-levy and non-aid revenues were raised) to less than 1% for 50% of all counties. No county would have been able to increase spending by more than 1.75%, and only two counties (3%) would have been able to increase spending by 1.50% to 1.75%.

TABLE 2

Distribution of General Expenditure Increases Permitted Under a 3% Across-the-Board Levy Limit Based on 2003 Financial Information

	Number	Percent
0.50% to 0.75%	7	9.7%
0.75% to 1.00%	29	40.3
1.00% to 1.25%	21	29.2
1.25% to 1.50%	13	18.1
1.50% to 1.75%	2	2.8
Total	72	100.0%

11. Table 3 illustrates the potential impact of a 3% across-the-board increase in expenditures on county property tax levies, assuming no other increases in counties' revenue sources. To achieve the allowable expenditure level, levy increases of more than 7.5% would have been allowed in 72.2% of all counties.

TABLE 3

Distribution of County Tax Levy Increases Permitted Under a 3% Across-the-Board Expenditure Limit Based on 2003 Financial Information

	Number	Percent
5.0% to 7.5%	20	27.8%
7.5% to 10.0%	35	48.6
10.0% to 12.5%	10	13.9
12.5% to 15.0%	5	6.9
15.0% to 17.5%	2	2.8
Total	72	100.0%

12. The preceding analysis indicates that due to variation in the percentage of expenditures funded by intergovernmental revenue, a levy limit may offer more restrictive expenditure increases than anticipated and an expenditure control may allow larger increases in levies than anticipated. Nonetheless, it should be acknowledged that taxing and spending levels are related and controlling one will also control the other, to some degree. In addition, the two controls

will have other secondary impacts. For example, a property tax control would likely cause some counties to make use of other revenue sources, such as fees. Likewise, a spending control could lead to some counties reclassifying certain operating expenditures as capital assets to be funded with debt.

13. Because fiscal controls will likely trigger behavioral responses by local officials, the design of a control should balance effectiveness against flexibility. Exclusions and adjustments to a control may make it more flexible, but the control will also be less likely to meet its intended policy objectives. If the control offers few exclusions or adjustments, it may be viewed as inflexible, and local officials may be able to persuade taxpayers to override the control or legislators to amend the control. In AB 100, the proposed county levy restraint program's fiscal control would offer adjustments for service transfers and state aid reductions and exclusions for amounts levied for county children with disabilities education boards and general obligation debt service (DOA has indicated that this exclusion should extend only to amounts resulting from new debt). The levy limit proposal included in AB 100 would offer the same adjustments and exclusions. In addition, AB 100's levy limit could be overridden through referendum. A number of other adjustments could be provided for other occurrences, such as an unusually low base year levy, service consolidations, an unused portion of the prior year's allowable levy or spending, natural disasters, emergencies, or court orders.

14. Each of the preceding adjustments and exclusions may appear to be reasonable when evaluated alone, but in combination, they could undermine the effectiveness of the fiscal control. Unlike AB 100's levy limit proposal, which would be sunset after two years, the county levy restraint program is intended to be ongoing. This heightens the importance of balancing the program's flexibility with its effectiveness.

15. Depending on the number of adjustments or exclusions that are authorized, the program's allowable rate of increase could be adjusted in a way that achieves the desired level of effectiveness. Fiscal controls utilize an allowable rate of increase, typically expressed in percentage terms, to be applied against a local government's tax levy or expenditures. For example, if a large number of exclusions or adjustments are authorized, it may be advantageous to specify a more restrictive allowable rate of increase.

16. The allowable rate of increase could be measured in several ways. The expenditure restraint program limits spending increases to a percentage equal to the sum of the inflation rate and an adjustment based on growth in property values. The inflation rate is measured as the change that occurred in the consumer price index. The property value adjustment is unique for each municipality and equals 60% of the percentage change in the municipality's equalized value due to new construction, net of any property removed or demolished, but not less than 0% nor more than 2%. AB 100 proposes a similar measure for the county levy restraint program, but the combined percentage would be reduced to 85% of its initial value. In Enrolled AB 58, the Legislature voted to limit each county's tax levy increase to the percentage change in the county's equalized value due to new construction, net of any property removed or demolished, but not less than 0%, with no

inflationary adjustment. Table 4 compares the statewide average increases that would have been allowed under the levy limit proposals in Enrolled AB 58 and AB 100 with the allowable statewide rates of increase under the county levy restraint proposal.

TABLE 4

Estimated Allowable Rates of Increase in Tax Levies Calculated on a Statewide Basis Under Three Controls, 2001-04

	Enrolled AB 58	-------- AB 100 Levy Limit --------			AB 100
	Levy Limit, New Construction	Growth (60%)	Consumer Price Index	Combined Factors	County Levy Restraint
2001	2.7%	1.6%	3.4%	5.0%	4.3%
2002	2.5	1.5	1.8	3.3	2.8
2003	2.5	1.5	2.2	3.7	3.1
2004	2.6	1.6	2.2	3.8	3.2

17. If the county levy restraint program had been in effect in 2004(05), allowable rates of levy increase would have ranged from a low of 2.5% in four counties (Green Lake, Menominee, Price, and Taylor) to a maximum of 3.6% in seven counties (Brown, Calumet, Dane, Outagamie, Saint Croix, Sauk, and Washington). For the 72 counties, Table 5 reports the range in allowable rates of increase.

TABLE 5

Allowable Rates of Levy Increase Under the County Levy Restraint Program If the Proposal Had Been in Effect for 2004(05)

2004(05) Allowable Rates of Increase	Number of Counties	Percent
Under 2.8%	20	27.8%
2.8% to 3.0%	15	20.8
3.0% to 3.2%	10	13.9
3.2% to 3.2%	17	23.6
3.4% to 3.6%	10	13.9
Total	72	100.0%

18. A fiscal control requires some enforcement mechanism. Under AB 100's levy limit proposal, the limit would not be enforced by the state, but taxpayers could bring actions to require local governments to comply. Under AB 100's proposed county levy restraint program, counties that fail to meet the program's eligibility criteria would not receive an aid payment in the succeeding year. A similar response could be utilized by extending a fiscal control under the county and municipal aid program. Withholding the entire aid payment may be viewed as too punitive because

county and municipal aid payments fund a larger percentage of county expenditures, on average, than the county levy restraint program would fund. Instead, counties could forfeit an aid amount equal to all, or part, of the levy or spending in excess of the allowable limitation. If an amount equal to all of the excess is withheld, there would be no advantage in exceeding the limitation. Withheld amounts could be redistributed to other counties or lapse to the state's general fund.

ALTERNATIVES

1. With three exceptions, approve the Governor's recommendation to do the following: (a) create a county levy restraint program to make payments beginning in 2007 to each county that has a tax levy that is no greater than its allowable levy as determined through a formula based on the inflation rate and the rate of tax base growth due to new construction in the county; and (b) create two sum sufficient appropriations with annual funding levels of $25,000,000 GPR and $10,000,000 GPR, respectively, to make payments to eligible counties based on each county's tax levy as a percent of the sum of the tax levies for all eligible counties and the amount by which each county's tax levy is below its allowable amount. To achieve the proposal's original intent, modify the Governor's original recommendation regarding calculation of the allowable levy to clarify that: (a) the calculation pertains to the levy that is adopted in the year that is two years prior to the year of the aid payment; (b) the calculation of the valuation factor is based on construction that occurs between the year that is two years prior to the aid payment and the previous year; and (c) the calculation excludes debt service only for debt authorized on or after July 1, 2005, rather than excluding all debt service.

2. Delete the Governor's recommendation to create a county levy restraint program and, instead, do one or both of the following:

a. Modify the county and municipal aid program to provide that the amount of any county's levy exceeding the allowable levy as determined under the levy limit program proposed in AB 100, including any modifications adopted by the Committee, would be deducted from the county's next succeeding county and municipal aid payment; and/or

b. Modify the county and municipal aid program to provide that the amount of any county's expenditures exceeding the allowable expenditures as determined using the same formula as for the expenditure restraint budget test would be deducted from the county's next succeeding county and municipal aid payment.

3. Delete provision.

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