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Expenditure Restraint Program Budget Test
(Shared Revenue and Tax Relief -- Direct Aid Payments)

CURRENT LAW

The expenditure restraint program provides targeted, general aid to towns, villages, and cities. The aid is targeted in that municipalities must qualify for a payment by meeting two eligibility requirements. Under the first requirement, a municipality must have a full value property tax rate for operation of town, village, or city government that exceeds five mills. Under the second requirement, a municipality must restrict the rate of year-to-year growth in its budget to a percentage determined by statutory formula.

GOVERNOR

No provision.

DISCUSSION POINTS

1. Since 2003, the expenditure restraint program's annual distribution has been set at $58,145,700. Each year during that period, about 300 municipalities have received a payment. While the 317 municipalities that received payments in 2008 represent only 17% of all municipalities in the state, their levies comprised 71% of statewide municipal purpose levies in 2007(08), and 58% of the state's population resides in these municipalities.

2. Under the program's budget test, each municipality's allowable rate of budget growth is calculated as the sum of two percentages. The first percentage is unique for each municipality and is based on growth in the municipality's tax base. The second percentage is based on the inflation rate and is identical for each municipality. The allowable rate of growth is calculated in the fall of one year, so that a municipality can limit its spending in the following year in order to qualify for an aid payment in the third year.

3. The tax base percentage equals 60% of the percentage change in the municipality's equalized value due to new construction, net of any property removed or demolished. The resulting percentage cannot be less than 0%, nor more than 2%. This measure is intended to allow municipalities to extend services to new properties that did not previously receive municipal services. The percentage is limited to 60% of total growth to differentiate between a municipality's fixed and variable costs.

4. On a statewide basis, the value added by new construction to the state's tax base has declined in each of the last three years. For 2008, new construction added only 2.0% to the state's equalized value, providing an average adjustment under the expenditure restraint budget test of 1.2%. A smaller average adjustment is estimated for 2009.

5. The inflation measure is intended to allow municipalities to deliver the same package of services in the succeeding year as in the current year. The inflation rate equals the average change in the consumer price index for all urban consumers (CPI-U) for the one-year period ending in September two years prior to the payment year. Relative to the year in which a municipality's budget is limited, the index for September of the previous year is averaged with the indices from the previous 11 months and compared to the average of the indices for the preceding 12-month period. For example, the inflation rate used for 2009 budgets compared the average of the indices for the period from October, 2007, through September, 2008, to the average of the indices for the period from October, 2006, through September, 2007.

6. Between 1992 and 2007, the CPI-U component of the expenditure restraint budget test ranged from a low of 1.5% in 2002 to a high of 3.7% in 2006 and was between 1.5% and 3.0% in 12 of the 16 years. That period of low to moderate inflation ended in September, 2007, when the index became more volatile due to fluctuations in oil prices. The index increased in each of the next 11 months, by a total of 5.8%, before declining in each of the following five months, by a total of 4.4%. The use of a 12-month average reduces some volatility in the index, and the expenditure restraint program's 2008 inflation rate, which applied to 2009 municipal budgets, was set at +4.4%. The table on the following page displays recent changes in the CPI-U arranged according to the expenditure restraint program's calculation procedures.

7. Thus far in 2009, the index increased 0.4% in January, 0.5% in February, and 0.2% in March, but the index remains below its level of July, 2008, which preceded the five monthly decreases. The index for March, 2009, was set at 212.709, a reduction of 2.8% relative to the September, 2008, index of 218.783 (the final month used in last year's budget test). Some local officials have expressed concern that the decreases in the index between August and December, 2008, could result in a negative inflation adjustment in 2009 for 2010 municipal budgets. Based on the index amounts for October, 2008, through March, 2009, the index would have to post month-to-month increases of 0.5% in each of the next six months in order for the 2008-09 index average to equal the 2007-2008 index average under the 2009 budget test calculation. This is equal to an annual rate of increase of 6.2% measured on a month-to-month basis. In its April, 2009, summary of the U.S. economy, IHS Global Insight, Inc., forecasts annualized inflation rates for 2009 of -0.7% for the second quarter and 0.3% for the third quarter.

Consumer Price Index and Inflation Factor Calculations
Under the Expenditure Restraint Program

Month	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09
October	185.0	190.9	199.2	201.8	208.9	216.6
November	184.5	191.0	197.6	201.5	210.2	212.4
December	184.3	190.3	196.8	201.8	210.0	210.2
January	185.2	190.7	198.3	202.4	211.1	211.1
February	186.2	191.8	198.7	203.5	211.7	212.2
March	187.4	193.3	199.8	205.4	213.5	212.7
April	188.0	194.6	201.5	206.7	214.8	
May	189.1	194.4	202.5	207.9	216.6	
June	189.7	194.5	202.9	208.4	218.8	
July	189.4	195.4	203.5	208.3	220.0	
August	189.5	196.4	203.9	207.9	219.1	
September	189.9	198.8	202.9	208.5	218.8	
Sum	2,248.2	2,322.1	2,407.6	2,464.1	2,573.5	
Average	187.4	193.5	200.6	205.3	214.5	
Percentage Change		3.3%	3.7%	2.3%	4.4%	
Applies to Municipal Budgets in:		2006	2007	2008	2009	2010

8. In addition to the CPI-U, the Bureau of Labor Statistics, U.S. Department of Labor, maintains a "core" CPI, which excludes energy and food prices. During the five-month period in 2008 when the CPI-U decreased 4.4%, the core CPI remained stable, increasing by less than 0.1%. It could be argued that a negative inflation adjustment in 2009 would offset an inflation adjustment in 2008 (+4.4%) that was unusually large due to short-term fluctuations in the CPI and that, over time, ignoring negative changes in the CPI would allow above inflationary growth in expenditures. However, if there is a desire to ensure that municipalities participating in the expenditure restraint program can continue to provide a similar level of services in 2010 and in subsequent years as they are in 2009, the program's inflation adjustment could be limited to no less than 0% (Alternative #1).

ALTERNATIVES

1. Modify the definition of "inflation factor" under the expenditure restraint program to limit it to no less than 0%.

2. Maintain current law.

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