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Brief Summary of Proposed Amendment

A proposal for a constitutional amendment to limit the annual growth of the "revenue" that can be collected by every type of government within the state was recently introduced in the Wisconsin legislature. The formulas limiting revenue growth that would be placed in the Constitution differ by type of governmental body, but all include an inflation factor tied to the Consumer Price Index (CPI). The formula controlling the revenue of the state government, special districts, county governments, and technical college districts includes the annual percentage increase in population of the appropriate level government. The school district formula includes the percentage increase in 5-year old kindergarten through 12th grade enrollment, while the formula for municipal governments includes a factor equal to 60 percent of the growth in property value attributable to net new construction.

Other provisions in the proposed amendment call for referenda to be held by the residents of any governmental unit that wishes to change the revenue limit imposed by the amendment. The amendment also mandates that revenues in excess of the state government limit be placed in an emergency reserve fund. Excess revenues must be returned to taxpayers whenever the fund exceeds 8 percent of the previous year's revenue. "Excess" revenues collected by other governments can not be put in an emergency fund, but must be quickly returned to taxpayers. The amendment is silent on the question of exactly how excess revenue is to be refunded to taxpayers. The amendment also includes a provision that is aimed at prohibiting the state from placing unfunded mandates on local governments.

For purposes of the amendment "revenues" subject to limitation are defined as revenue from taxes, fees, licenses, permits, special assessments, fines, forfeitures, and revenue generated from bonds (excluding "economic development" bonds). Tuition and fees to support the university and the technical colleges are excluded from the revenue limit.

The Revenue Limits Would Result in Reduced Public Services

The core of the amendment is a revenue limitation formula that restricts the growth of government revenue per capita (or per pupil, in the case of public schools) to price inflation as measured by the Consumer Price Index. While this limit may at first glance appear reasonable, it is important to remember that by design the CPI is based on a "market basket" of goods and services purchased by the typical household. Governments however, purchase a very different basket of goods and services. A substantial share of their budgets goes to pay for the services of highly-skilled labor, for example, police officers, teachers, and doctors. A significant portion of the budget of families goes towards the purchase of food, clothing, and various consumer

durables. Over time the price of these items has grown quite modestly compared to the price of goods (especially fuel) and services that are typically purchased by governments.

If the costs of providing public services continue to grow faster than the inflation and population growth rates, the impact of the amendment would be to continuously reduce the level and quality of public services provided to the residents of Wisconsin. Without high-quality services, particularly education, Wisconsin's ability to compete for businesses and residents will suffer.

The Amendment Would Seriously Jeopardize Wisconsin's Future Economic Growth

Supporters of the Taxpayer Protection (TP) Amendment argue that the amendment is necessary as a means of forcing governments in Wisconsin to "live within their means." The best measure of Wisconsin residents' "ability to pay" for both private consumption and state and local government services is the growth rate of the Wisconsin economy, measured by the growth of *personal income* in the state. The TP Amendment, however, is designed to assure that governments in Wisconsin become a continuously smaller part of the state's economy.

As the dotted line in Figure 1 illustrates, if the amendment had been in place since 1985, it would have forced state government revenues (as defined in the amendment) to grow at a rate substantially slower than the growth rate of the state's economy. In 1985, state revenues were 8.8 percent of personal income. By 2005, the formula restricting the growth of state revenue would have limited state government revenue to 6.6 percent of personal income. This trend of reduced state government would continue into the future. While reducing the role of government might sound appealing in the abstract, it would reduce the ability of the state to invest adequately in education, in health care for a population that is growing older, and in highways and other types of public infrastructure that are critical in enhancing the competitive environment of the state and in assuring future growth of the state's economy.

The Amendment Would Substantially Reduce *Local Control* in Wisconsin

By imposing identical revenue limitations on all municipal governments, on all county governments, and on all school districts, the TP amendment greatly diminishes *local control* in Wisconsin. This is a diverse state with varied preferences for public services, great variation in economic conditions and social conditions. If the amendment were enacted, every jurisdiction would face the same revenue limitations, regardless of local conditions. While the ability to hold local referenda would provide some degree of local control, referenda are a very blunt instrument—one can vote either yes or no—for making complex budgetary decisions. There appears to be absolutely no evidence that the current process of budget decision making at the local level—the use of elected representative bodies, for example, school boards and county boards—does not serve the needs of the citizens of Wisconsin very effectively.

The Amendment Would Not Apply to Most Town Governments in Wisconsin

The vast majority of all town governments in Wisconsin would be completely excluded from the revenue limits imposed by the amendment. I estimate that in fiscal year 2009, 1,180 of the state's 1,260 town governments will be exempted from the limits.[1] Twenty-three percent of the state's entire population lives in these towns. It is very hard to imagine an economic or fiscal justification for excluding town governments from the limits. Many municipal governments face fiscal challenges. If anything, research suggests that the range of services that must be provided by local governments and the increase in costs of providing those public services are highest in highly urban, city governments, not in our smallest and most rural communities. Thus, if any type of municipality is to be excluded from the revenue limits, one could argue that it is cities that require more revenue flexibility than rural towns. A similar claim for revenue flexibility could be made for county governments, which must fulfill a wide range of human service and court functions that are mandated by the state.

While excluding town governments from the revenue limit might encourage the residents of those communities to vote for approving the amendment, it is important to note that residents of these towns will not escape the impacts of the amendment. Because both state government and county government would be subject to strict revenue limits, the prospects for additional state or county government fiscal assistance, or new investments by these governments in roads, bridges, or other infrastructure, would be much diminished.[2] As a result, unless rural governments turn to property tax increases, rural services and infrastructure are likely to deteriorate.

The "Government is Out of Control" Rationale for the Amendment is not Justified

Supporters of the amendment have argued that it is needed because taxes and spending in Wisconsin are "out of control." The data tell a quite different story. According to data from the Wisconsin Department of Revenue, state and local taxes in Wisconsin relative to state personal income are considerably lower today than they were 10 years ago. Also, if we use the measure of revenue included in the amendment, namely the sum of all taxes and fees, Wisconsin is a quite average state. According to the Census Bureau, in terms of state and local general revenue relative to state personal income, Wisconsin ranks 23rd from the top, only a few tenth of a percentage point above the national average. The solid line in Figure 1 demonstrates that state government revenue is now lower relative to personal income than it was 20 years ago.

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[1] The amendment excludes from any limitation all towns that will have revenues of less than $1 million in FY 2009 with this "floor" growing each year with the percentage increase in the CPI. Given published projections of the CPI, between 2004 and 2009, the $1 million would have been about $910,000 in 2004. My estimate of the number of towns that would be exempt from the revenue limits is based on the towns whose 2004 revenues (as defined in the amendment) were below this amount.

[2] The amendment would effectively prevent the legislature from reducing the nominal value of existing state aid to local governments. However, there is nothing in the amendment that requires that state aid be increased, and over time inflation will erode the value of current levels of state assistance to local governments.

Estimating the Fiscal Impacts of the Amendment

Predicting the exact impact of the Taxpayer Protection Amendment on the future of government revenue and public spending in Wisconsin is very difficult. Absent a crystal ball, one reasonable way to predict the impact of the amendment is to pose the following question. *If the Taxpayer Protection Amendment had become effective in 1985, how would government revenues have differed from the actual revenues that governments raised between then and now?* The results of this exercise are summarized below. In conducting the simulations, I have assumed that the constitutional limits were not overridden through the referendum process.

In defining revenue subject to limitation, the amendment includes, in addition to taxes, fees, assessments, licenses, and fines, "all moneys received from bonds" except for money from municipal economic development bonds.[3] It is important to note however that money from bonds is explicitly not included in the definition of revenue in the "base" year for the limits. The significance of excluding bond proceeds from the base year, but including them in later years is that every dollar spent on capital projects funded by bond revenue must either be offset by revenues that would have funded on-going expenditures, or by holding annual referenda for the approval of all capital funding projects at every level of government.

Because historical data on bond proceeds is difficult to obtain, "actual revenue" in the simulations described in the next sections includes money from bond proceeds only for a limited number of years. For the state government and for municipal and county governments, data on bond issuances were obtained for the years since the late 1990s. For school districts, such data are only available starting in fiscal year 1991. Since bond proceeds are not included in the definition of "revenue" in the "base" year (1985 in the state, county, and municipal simulations and 1990 in the school district simulation), with the exception of school districts, the "allowed revenue" in the figures (indicated by the dotted lines) are unaffected by any missing data on bond proceeds. Because under current law most capital projects initiated by school districts require voter approval through a referendum, the "allowable revenues" for school districts include most bond revenues. The "actual" revenue (indicated by the solid lines), for years for which no data on money from bonds are available, are lower than they should be. This means that the impact of the TP amendment on available revenue is consistently underestimated in those years.

The Impact on State Government Revenues

In Figure 2, the solid line represents the actual "revenue" collected by the Wisconsin state government in the fiscal years from 1985 through 2005. Revenue is defined in approximately the same manner as "revenue" is defined in the proposed amendment, namely, the sum of taxes and fees with the exception of tuition paid to the University. Revenue defined in this way rose in nominal dollars from $5.7 billion in 1985 to $15.6 billion in 2005. After 1996, revenue from annual bond proceeds are added to the definition of revenue (and indicated in the top line in

[3] The text of the proposed amendment provides no definition of what is meant by "municipal economic development bonds."

Figure 2. Between 1997 and 2005, annual bond issuances averaged around $1.3 billion per year. Using the definition of revenue including bond proceeds, state government revenue totaled $17.1 billion in fiscal year 2005.

The dotted line in Figure 2 represents the maximum allowable state revenue under the terms of the Taxpayer Protection Act. The annual increase in allowable revenue is determined by the sum of the inflation and population growth rates. By 2005, allowable revenue would have been $11.9 billion, $5.2 billion and over 30 percent below the actual revenue in that year.[4]

Determining the impact of the amendment on state government spending is complicated by the fact that there is a great deal of uncertainty about how other, primarily federal, sources of state government revenue would be affected by the tax and fee limitation. That being said, it is likely that the amendment would result in a reduction in federal Medicaid funding flowing into the state. In many years, the growth rate in state Medicaid appropriations exceeded the increase in allowable revenues. As Medicaid is financed through a matching grant from the federal government, any reduction in state support for Medicaid services would result in a reduction in federal Medicaid grants.

The Impact on the Funding of the University of Wisconsin System

It is impossible to know with any degree of certainty by how much lower state revenues would reduce state appropriations to the UW System. Perhaps the "best case" scenario would be a reduction in UW System appropriations proportional to the reduction in total state revenues. For example, in the year 2000, the amendment would have reduced state revenues by about 25 percent (from actual state revenues in that year), and in the "best case" would have resulted in "only" a 25 percent decrease in state appropriations to the UW System. Figure 3 compares actual UW System appropriations in the years between 1985 and 2005 with the "best case" appropriations if the amendment had been implemented in 1985. These calculations are based on a definition of state revenue that excluded revenue from bond proceeds. In Figure 4, I indicate the dollar amount by which tuition revenue would have to increase in order to make up for the loss of appropriations due to the amendment. As illustrated by the figure, in 2005 tuition would have to increase by about $200 million to make up for the reduced UW System appropriations, an increase equal to 25 percent of actual tuition revenue in 2005.

The reason I call the assumption of equal proportional reduction in appropriations a "best case" is that the fiscal history of the past couple decades has shown that rising costs elsewhere in the state budget are likely to crowd out additional appropriations for the UW System. Medicaid spending has tended to increase at rates in excess of inflation plus population growth. At the same time, state spending on public elementary and secondary education and on correction has in most years grown at rates in excess of the revenue limit imposed by the amendment. The combination of rising costs and political pressure will make it very difficult to restrict the growth

[4] If we exclude money from bonds from the definition of actual revenue, the gap between actual and allowed revenue would have been equal to $3.6 billion and allowable revenue would have been more than 23 percent below this more restrictive definition of actual revenue

of Medicaid, K-12 education, and corrections spending. As a result, if the amendment is enacted, it is highly likely that the growth of appropriations in these areas will further reduce the amount of state government resources available to fund the UW System.

The Impact on County Government Revenues

Under the proposed amendment, county government revenues are restrained by the same formula that would limit state government revenues. Figure 5 allows us to compare the impact of the amendment on county government revenues. The data show that by 2004, allowable revenues under the terms of the amendment would be approximately one-half of actual county government revenues in that year. Such a large reduction in revenues will make it impossible for counties to provide many of the services for which they are responsible.

The Impact on Municipal Government Revenues

The amendment would limit the growth of municipal government revenues by the inflation rate and 60 percent of the growth in property values attributable to net new construction. Figure 6 illustrates the impact of the amendment on municipal governments. Even though many municipal governments have been subject to spending limits in recent years, the amendment would result in substantially lower revenues. By 2004, allowable revenues would have been 57 percent of actual municipal revenues.[5]

It should be emphasized that the impact of the amendment would vary substantially across municipal jurisdictions. Perhaps ironically, municipalities that are particularly efficient in providing services or that are particularly frugal are likely to find it most difficult to maintain existing levels of public services, as they would have no inefficiencies or low-priority public services to eliminate.

The Impact on School District Revenues

The amendment would limit the growth of school district revenue by the inflation rate and the rate of increase in enrollment. In accordance with the language of the proposed amendment, school district revenues include all money raised by local school districts from taxes, fees and charges (including tuition), and proceeds from the issuance of long-term bonds.[6] Figure 7 shows clearly the impact of the decision by the legislature in the mid-1990s to increase state funding of public education by over a billion dollars (the "two-thirds" commitment) and to impose a strict revenue cap on all school districts. These two policies led directly to cuts in locally-raised property taxes. As a result, beginning in 1997 allowable revenue would have been

[5] As the definition of "economic development bonds" has not been specified, no attempt has been made to exclude them from the definition of revenue. If all bond proceeds were excluded from the definition of revenue, allowable revenue would have been about 74 percent of municipal government aggregate revenue in 2004.

[6] School district bond proceeds include money from bonds, state trust fund loans, and long-term notes. Revenue from these three sources is all used for the funding of capital projects and is subject to referendum approval.

greater than actual locally-raised school district revenue.[7] Between 1997 and 2004, however, actual revenue under the existing revenue caps grew at nearly twice the rate of allowable revenue under the amendment. In other words, the amendment would have limited school districts to smaller annual increases in revenue than allowed under the current revenue caps.

The relationship in Figure 7 between actual and allowable revenues only reflects revenues raised by local school districts. The state government also plays a very important role in the funding of public education. Over the past 20 years, state aid to local school districts has increased at annual rates that were substantially higher than the annual rates of increase in total state revenue that would have been allowed under the Taxpayer Protection Amendment. In Figure 8, I make the assumption that if the amendment had been in place starting in 1990, state education aid would have grown each year at the same rate as total allowable state revenue. The result would have been substantially lower levels of state education aid. The solid line in Figure 8 represents the sum of actual state plus local school district revenue, while the dotted line represents the sum of state aid under this assumption plus allowable local revenue. The figure shows that in 2004, 14 years after the implementation of the amendment, allowable state and local revenue for public education would have been $1.6 billion (18 percent) lower than actual state and local education revenue. This amount is equivalent to about $1,850 per student.

After operating with the revenue caps for over a decade, most school districts in the state would find it impossible to absorb further reductions in their revenues without seriously jeopardizing their ability to provide quality public education. Less revenue would translate into larger class sizes, restricted course offerings, and a diminished ability to compete for high-quality teachers.

A Note on Data Sources

The data used in this analysis came from several published sources. Data on state government revenue came from the Department of Administration's *Annual Fiscal Report*. County and municipal revenues were taken from reports provided by the Department of Revenue. Personal income data for Wisconsin came from the U.S. Department of Commerce, Bureau of Economic Analysis and Consumer Price Index data from the U.S. Bureau of Labor Statistics. Annual population figures came from the Wisconsin Department of Administration. Student tuition and fees and University appropriations came from the University of Wisconsin System's *Annual Financial Reports*. Local School District Revenue and Enrollment data came from the U.S. Department of Education's National Center for Education Statistics (NCES), and school district bond revenue from the Wisconsin Department of Public Instruction's *Data*

[7] The allowable revenue numbers in Figure 7 include 95 percent of each year's total bond proceeds. The 95 percent reflects the fact that most, although not all, bond revenues were approved by referendum, and thus would be considered allowable revenue under the terms of the amendment.

Warehouse.

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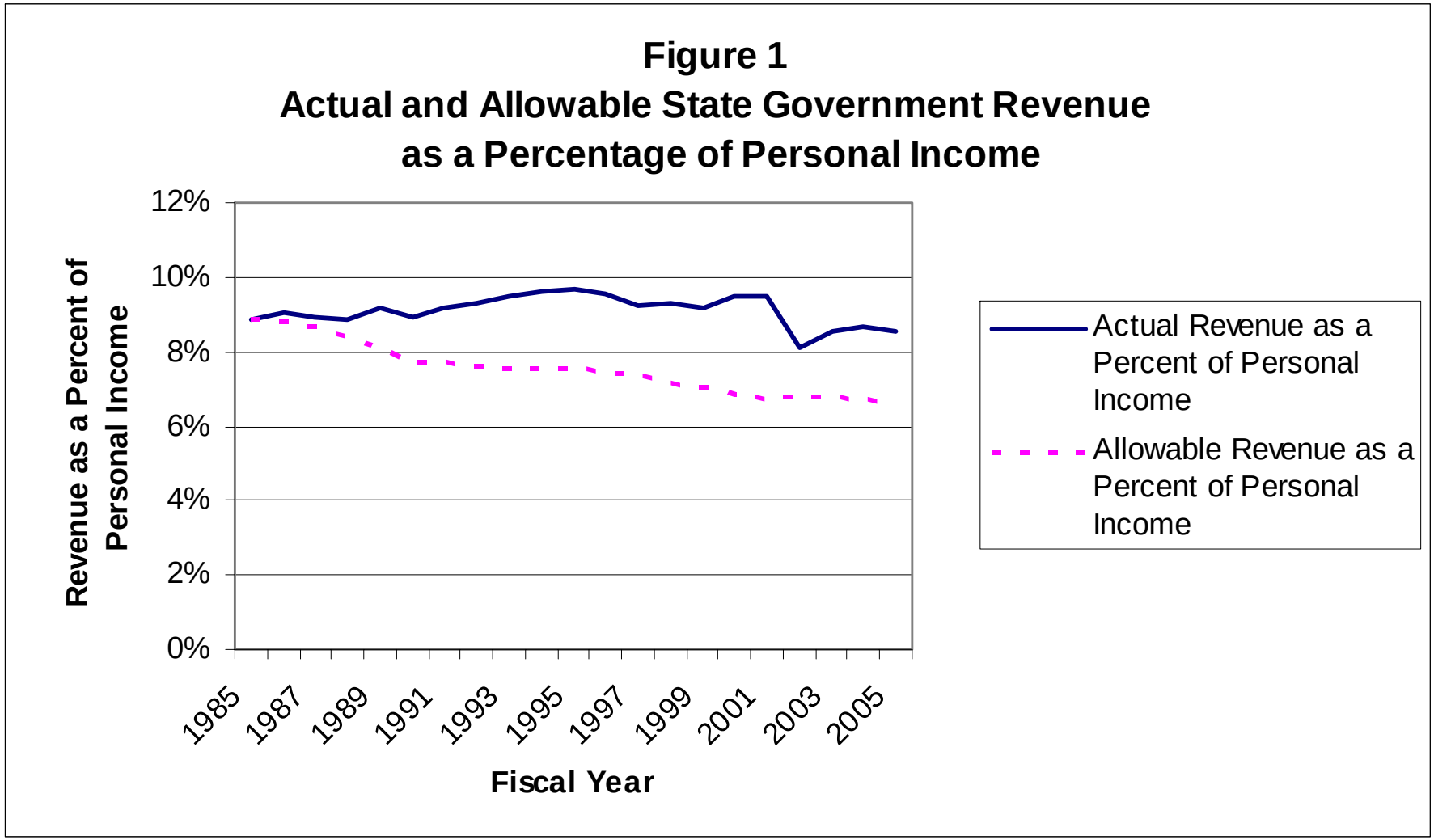


Figure 1
Actual and Allowable State Government Revenue
as a Percentage of Personal Income
Revenue as a Percent of Personal Income
12%
10%
8%
6%
4%
2%
0%
1985
1987
1989
1991
1993
1995
1997
1999
2001
2003
2005
Fiscal Year
Actual Revenue as a Percent of Personal Income
Allowable Revenue as a Percent of Personal Income

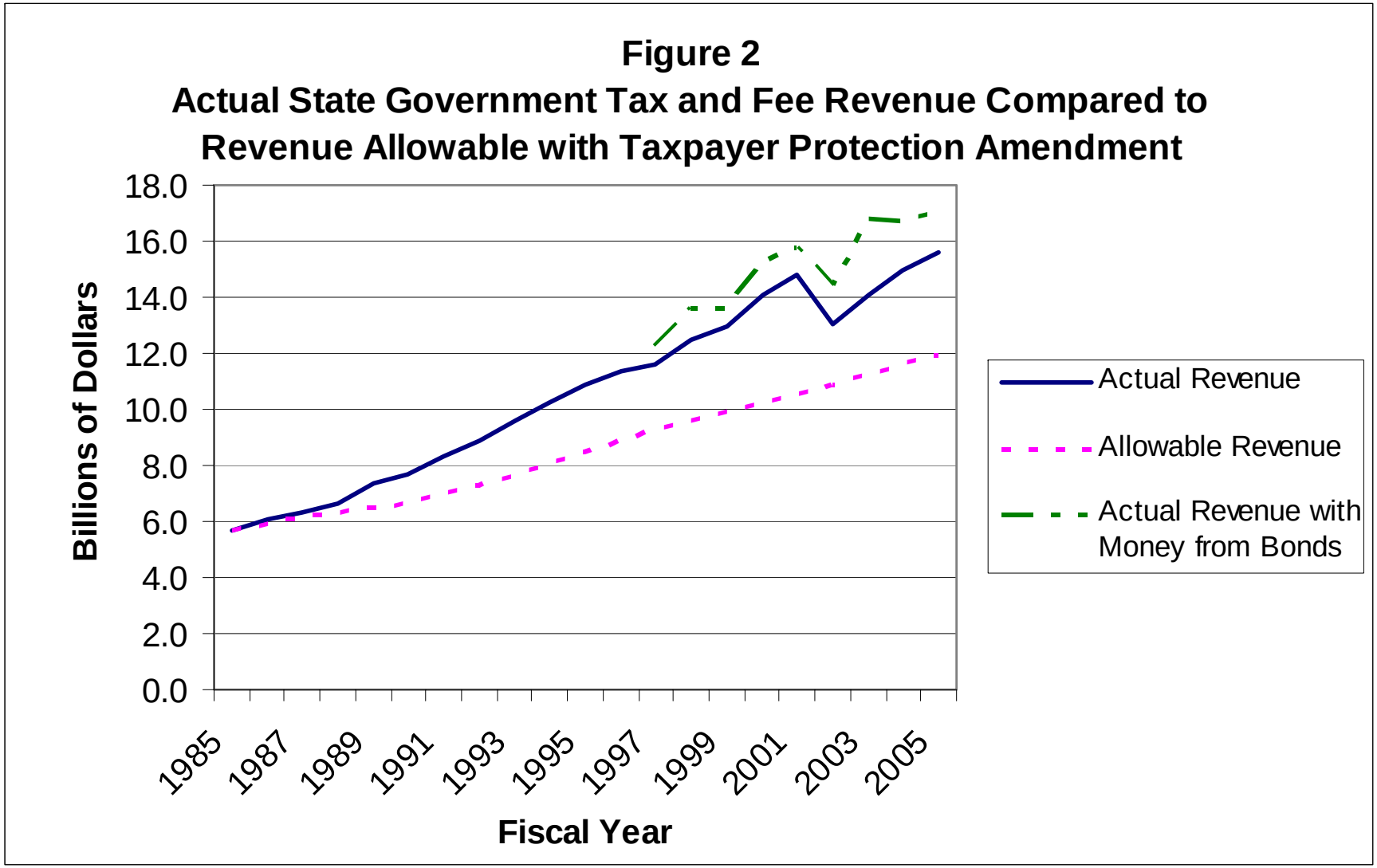


Figure 2
Actual State Government Tax and Fee Revenue Compared to Revenue Allowable with Taxpayer Protection Amendment
Billions of Dollars
18.0
16.0
14.0
12.0
10.0
8.0
6.0
4.0
2.0
0.0
1985
1987
1989
1991
1993
1995
1997
1999
2001
2003
2005
Fiscal Year
Actual Revenue
Allowable Revenue
Actual Revenue with Money from Bonds

Figure 3
Actual UW System State Appropriations Compared to "Best Case" Appropriations with Taxpayer Protection Amendment

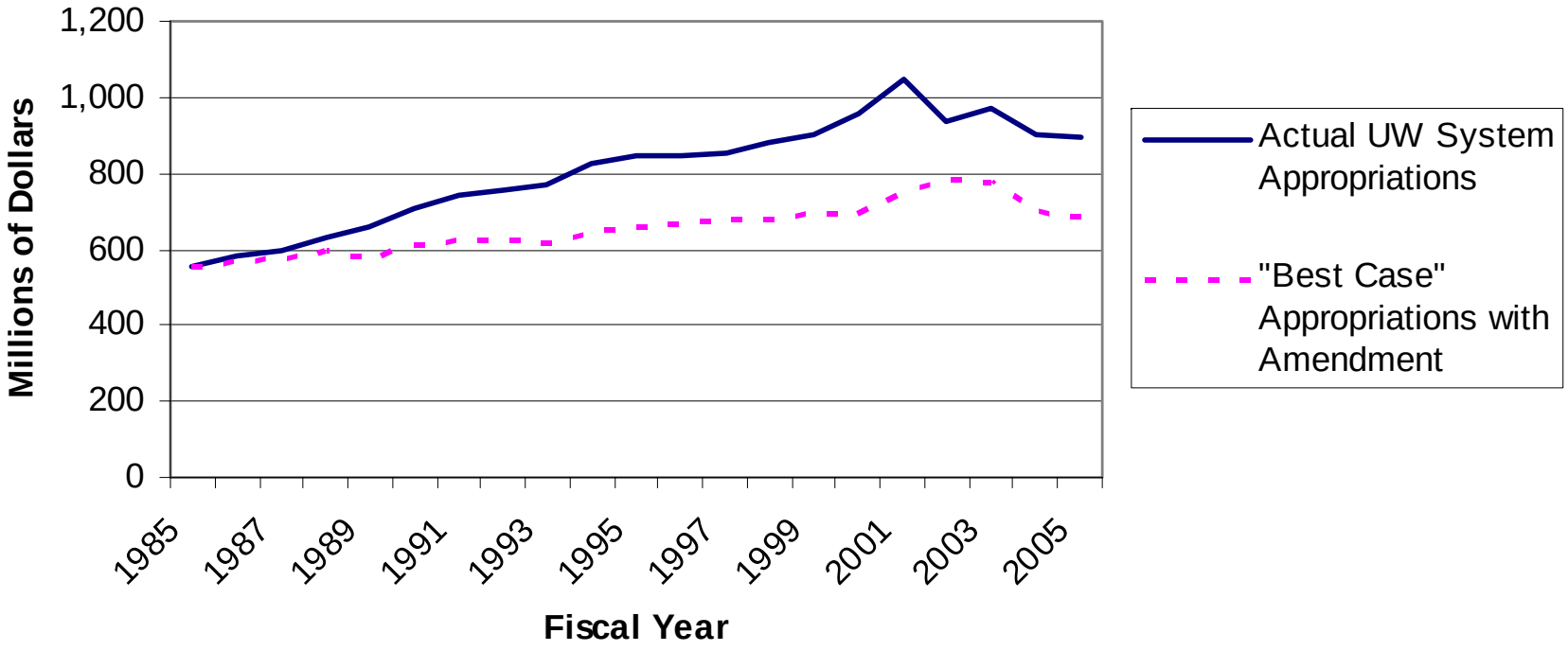


Figure 4
Annual Tuition and Fee Increase Needed to Make Up For Appropriation Cuts due to Taxpayer Protection Amendment

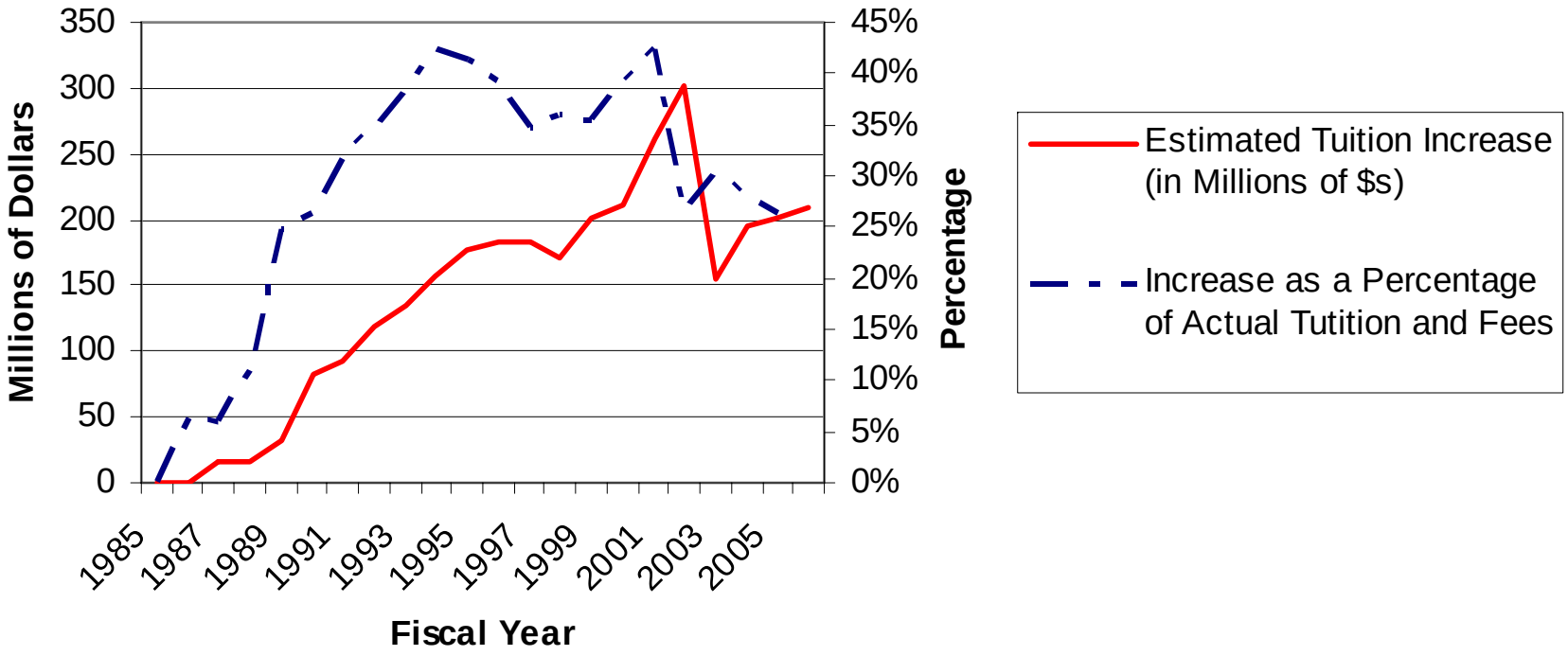


Figure 5
Actual County Tax and Fee Revenue Compared to Revenue Allowable with Taxpayer Protection Amendment

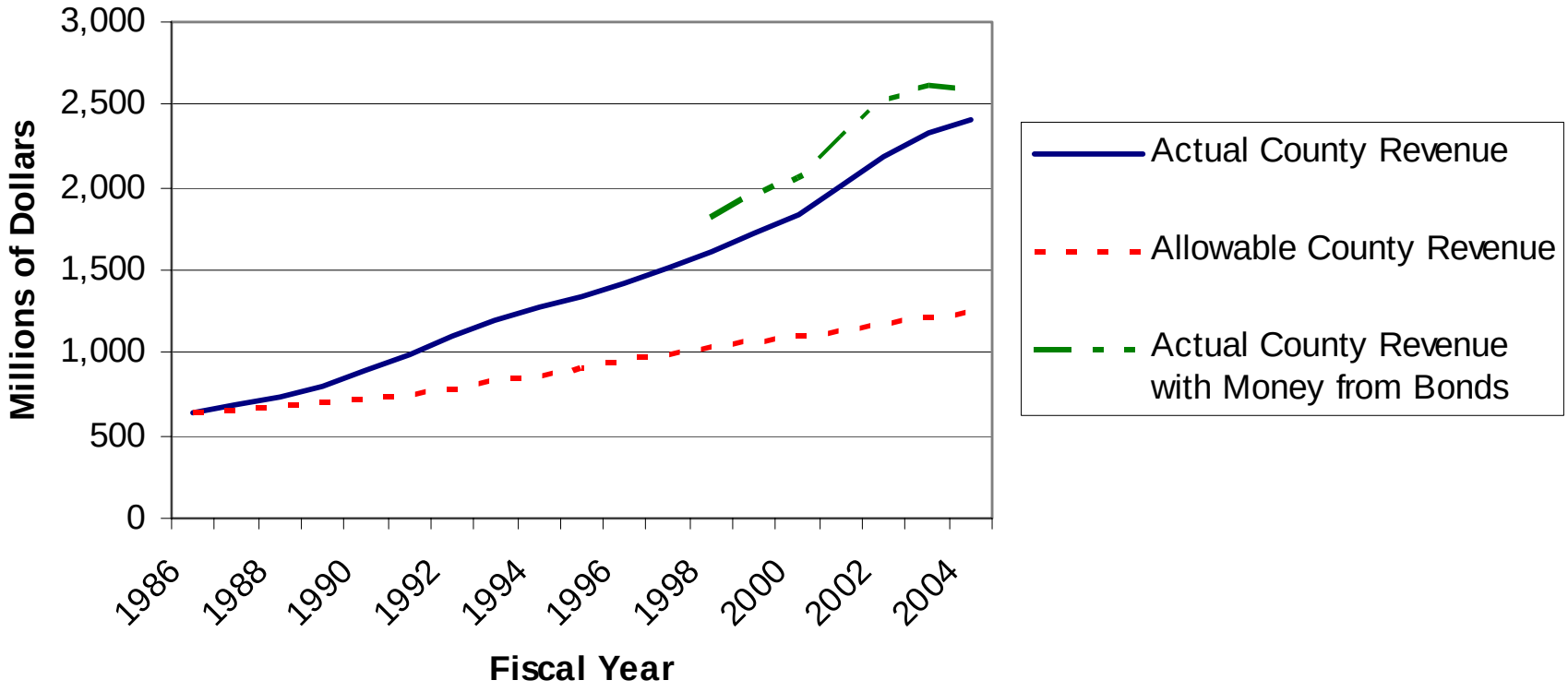
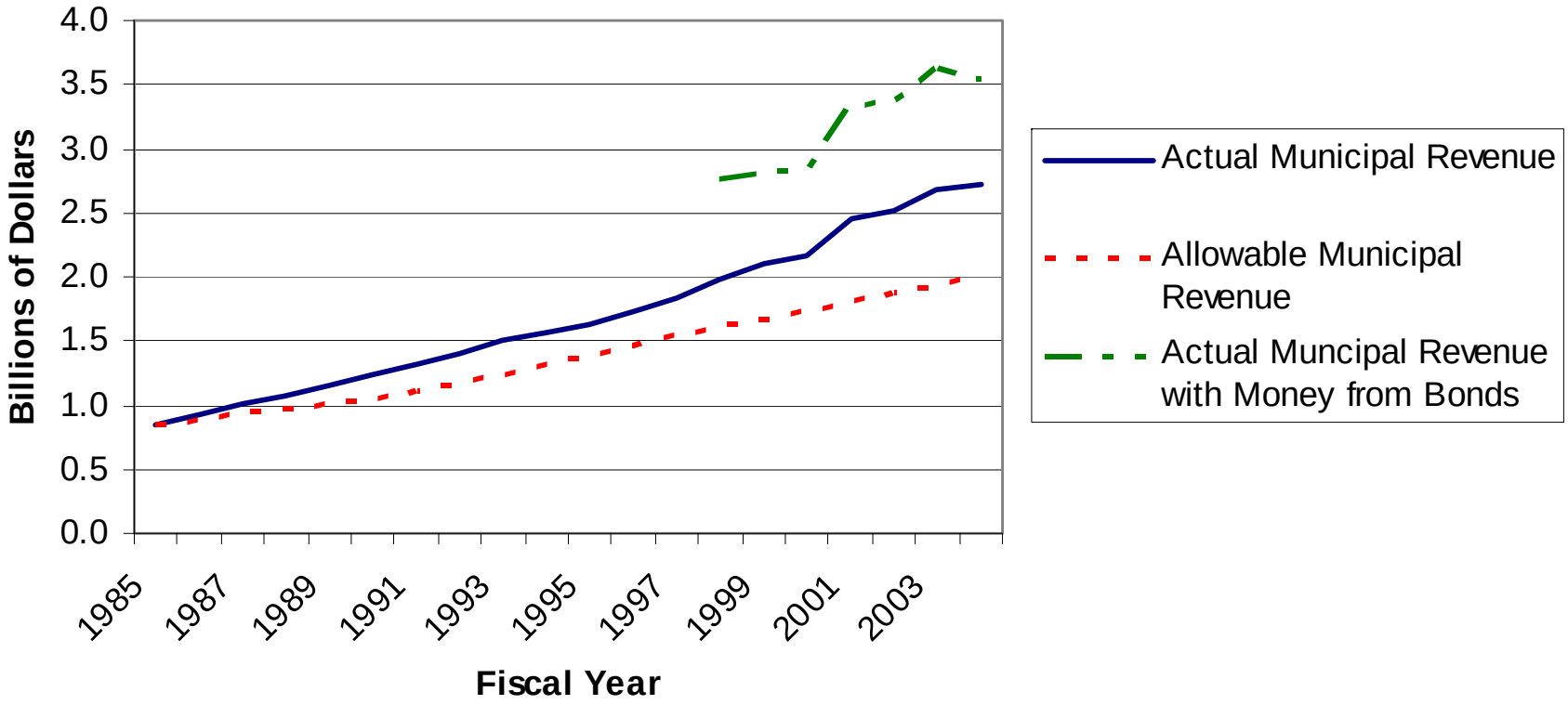


Figure 6
Actual Municipal Tax and Fee Revenue Compared to Revenue Allowable with Taxpayer Protection Amendment



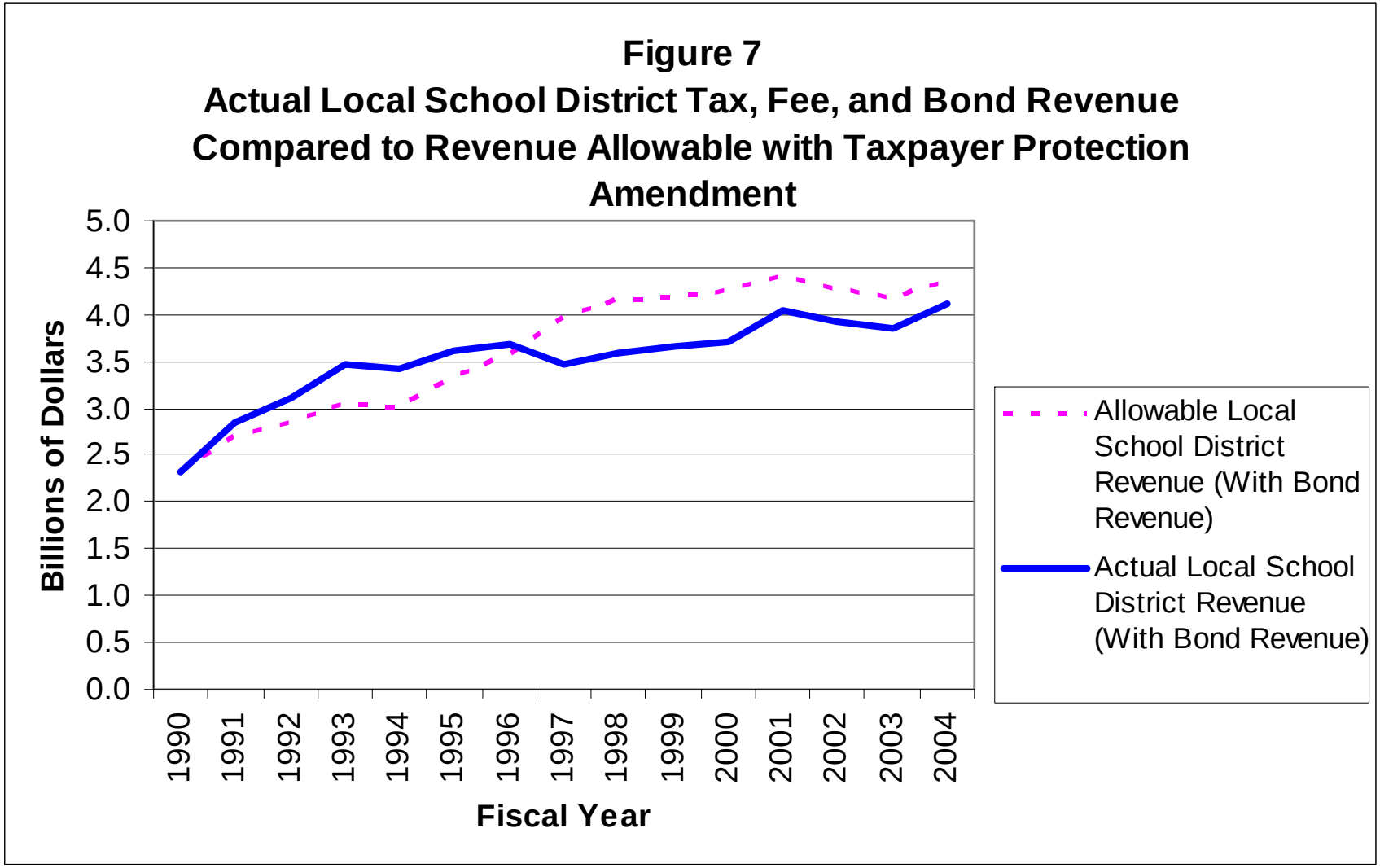


Figure 7
Actual Local School District Tax, Fee, and Bond Revenue Compared to Revenue Allowable with Taxpayer Protection Amendment
Billions of Dollars
5.0
4.5
4.0
3.5
3.0
2.5
2.0
1.5
1.0
0.5
0.0
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
Fiscal Year
Allowable Local School District Revenue (With Bond Revenue)
Actual Local School District Revenue (With Bond Revenue)

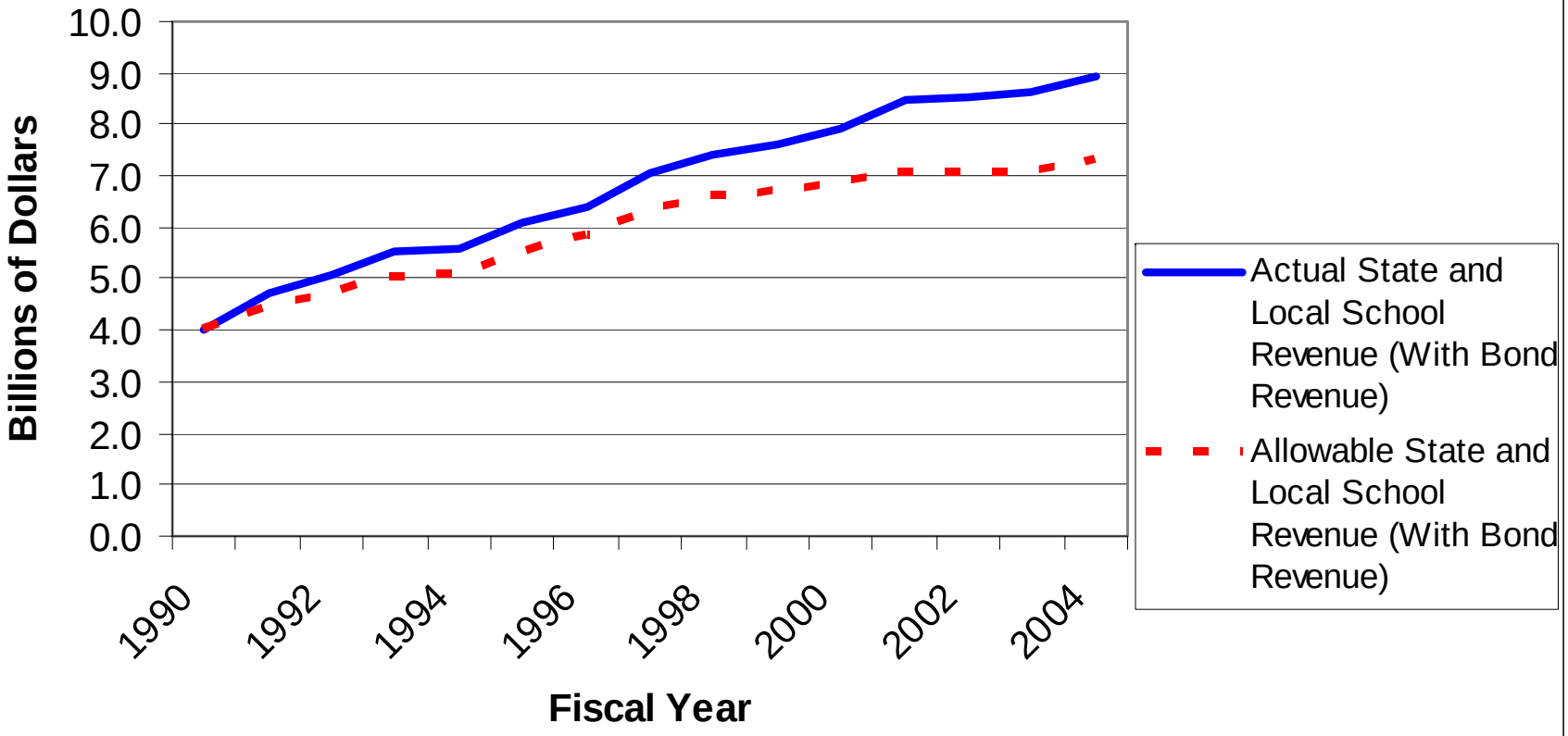



Figure 8
Actual State and Local Public School Revenue Compared to Revenue Allowable with Taxpayer Protection Amendment