



Legislative Fiscal Bureau

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Joint Committee on Finance

Paper #670

County and Municipal Aid in 2004 -- Mechanism for Allocating Reductions (Shared Revenue and Tax Relief -- Direct Aid Payments)

[LFB 2003-05 Budget Summary: Page 380, #1]

CURRENT LAW

Beginning in 2004, payments to municipalities and counties will be made under a new program entitled "county and municipal aid." Each municipality and county will receive a payment in 2004 based on the sum of its payments in 2003 under the shared revenue (except for utility aid), small municipalities shared revenue, and county mandate relief programs. Payments will equal the 2003 amounts, reduced on a per capita basis, so that the sum of all reductions equals \$40 million. Total county and municipal aid payments for 2004 are estimated at \$911.3 million. Additional payments totaling \$89.6 million are estimated under the utility aid (\$31.44 million) and expenditure restraint (\$58.15 million) programs, so combined payments under the three programs are estimated at \$1,000.9 million. These payments are scheduled to be made in July and November, 2004, which is in the second year of the 2003-05 biennium.

GOVERNOR

Require DOR to apply additional per capita reductions totaling \$70,000,000 to the 2004 payments to municipalities under the county and municipal aid program. Provide that this reduction, when combined with the reduction authorized under current law, cannot exceed the payments that would otherwise be made to each municipality. County and municipal aid payments for 2005 and thereafter would equal the amounts distributed in 2004, as decreased by the proposed \$110,000,000 in total reductions.

DISCUSSION POINTS

1. In general, the formulas that have been used to distribute state aid to municipalities and counties are intended to allocate aid according to relative need, which is measured through factors such as tax capacity. Thus, local governments with low tax capacity receive more aid on a per capita basis than local governments with high tax capacity. This policy of distributing aid assumes that local governments with high tax capacity are more able to raise revenues from their own sources and are less in need of assistance from the state.

2. Last session, the Governor's budget adjustment bill recommended reducing payments under shared revenue and three related state aid programs using a per capita reduction mechanism. At that time, the Department of Administration (DOA) indicated that the proposed reduction procedure would be administratively straightforward and was based on several considerations, all of which relate to the policy objective of distributing aid according to need. First, based on the proposed reduction level, payments under the per capita component of the shared revenue program would have been effectively eliminated. The per capita allocation is not a "need-based" distribution. Second, DOA indicated that the proposed reduction would have preserved a greater percentage of aid distributed on the basis of need. Finally, DOA asserted that when the reductions were measured relative to individual governments' overall budgets, the proposed reductions would have had a more uniform percentage impact, relative to other reduction alternatives. Although the Legislature modified the Governor's recommendation in a number of ways, the Legislature retained the per capita reduction mechanism. In SB 44, the Governor proposes using a per capita mechanism to reduce municipal aid payments by an additional \$70.0 million in 2004. In addition to the per capita mechanism, at least three other reduction procedures have been suggested.

3. *Across-the-Board Percentage.* Under an across-the-board percentage alternative, the total reduction amount would be divided by the total amount of 2003 payments subject to reduction. The resulting percentage would be multiplied by each local government's base year payment to determine the reduction amount. This reduction mechanism is based on the policy of uniform treatment of all local governments. However, state aid generally comprises a larger percentage of revenues in low tax capacity municipalities than in high tax capacity municipalities. Consequently, an across-the-board percentage reduction would have a greater impact on the budgets of low tax capacity municipalities.

4. *Tax Rate Equivalent.* Under a tax rate equivalent, the total reduction amount would be divided by the state's total equalized value. This would produce a multiplier that would be similar to a tax rate, and reduction amounts would be calculated by multiplying that rate by each local government's equalized value. The tax rate equivalent would have to be adjusted after its initial calculation to exclude reduction amounts exceeding prior year aid payments. By basing each municipality's reduction on its equalized value, this mechanism reflects the relative tax capacity available to each municipality and imposes relatively larger reductions on municipalities with high tax capacity than on municipalities with low tax capacity.

5. *Percentage of Combined Aid and Levy.* Under this alternative, the total reduction would be divided by the sum of municipal purpose tax levies and unrestricted state aids, which would include 2003 payments under the shared revenue, expenditure restraint, and small municipalities shared revenue programs. The resulting percentage would be applied uniformly against each municipality's base year payment to generate the reduction amount for each municipality. The percentage would be adjusted so that reductions would not exceed the base year aid amount for each municipality. This reduction mechanism combines the policy of a uniform percentage reduction with the recognition that state aid comprises a larger share of the revenues of municipalities with low tax capacity. This measure is intended to target aid reductions so that each municipality's aid reduction would have a relatively uniform percentage effect on its spending. A comprehensive database of current general fund municipal budgets is not available on a statewide basis, so the combination of tax levy and unrestricted state aid is intended to represent a proxy of each municipality's discretionary spending.

6. Regardless of the tax capacity available to a municipality, reductions beyond a certain level may appear to be excessive. One feature of the across-the-board percentage alternative is that it limits reductions to less than 100%. Under the other three alternatives, some municipalities could lose all of their aid. In its deliberations on the budget adjustment bill last session, the Committee included a provision that would have limited reductions to a maximum percentage of base aid. A similar feature could be incorporated into the reduction mechanism in SB 44 if an approach other than the across-the-board percentage alternative is adopted.

7. For purposes of the following analysis, a maximum reduction rate of 35% is employed. Also, the analysis assumes that the per capita reductions authorized under current law would become subject to the same reduction procedure, if a procedure other than a per capita reduction is approved. A \$90.0 million municipal aid reduction with a 65% guarantee would result in reduction rates estimated at \$17 per person under the per capita procedure, 11.6% under the across-the-board percentage procedure, \$0.27 per \$1,000 of 2002 equalized value under the tax rate equivalent procedure, and 9.2% under the percent of combined aid and tax levy procedure.

8. The estimated change in funding under the four reduction procedures is displayed by type of municipality in Table 1. The estimated reductions are compared to a 2003 aid base that includes aid amounts not subject to reduction (expenditure restraint and utility aid). This was done to portray the full effect of the reduction relative to unrestricted state aid payments. Generally, the table shows that the per capita and tax rate equivalent reduction procedures would cause towns and villages to lose above-average percentages of their payments, as a group, and cities would lose below-average percentages, as a group. Under the combined aid and levy reduction procedure, each group would be closer to the statewide average, although reductions would still not be uniform. The most uniform percentages would occur under the across-the-board percentage reduction procedure, since that is the policy the procedure is designed to achieve. The percentage reductions under this procedure are not perfectly uniform because the 2003 aid base includes utility aid and expenditure restraint payments, which would not be subject to reduction under either current law or the bill.

TABLE 1

**Estimated State Aid Reductions Under Four Reduction Procedures Relative to
2003 Shared Revenue and Related State Aid by Type of Government
(In Millions)**

| | <u>2003 Current Law Payment</u> | <u>Per Capita</u> | | <u>Uniform Percent</u> | | <u>Tax Rate Equivalent</u> | | <u>Aid and Tax Levy</u> | |
|----------|-------------------------------------|-------------------|-------------|------------------------|--------------|----------------------------|-------------|-------------------------|-------------|
| | | <u>Reduction</u> | <u>%</u> | <u>Reduction</u> | <u>%</u> | <u>Reduction</u> | <u>%</u> | <u>Reduction</u> | <u>%</u> |
| Towns | \$82.4 | -\$22.8 | -27.7% | -\$9.0 | -10.9% | -\$23.4 | -28.4% | -\$14.6 | -17.7% |
| Villages | 84.3 | -11.3 | -13.4 | -8.9 | -10.6 | -11.3 | -13.4 | -9.7 | -11.5 |
| Cities | <u>679.5</u> | <u>-55.9</u> | <u>-8.2</u> | <u>-72.1</u> | <u>-10.6</u> | <u>-55.3</u> | <u>-8.1</u> | <u>-65.7</u> | <u>-9.7</u> |
| Total | \$846.2 | -\$90.0 | -10.6% | -\$90.0 | -10.6% | -\$90.0 | -10.6% | -\$90.0 | -10.6% |

9. For the four alternatives discussed above, Table 2 shows the distribution of municipalities under the four alternatives according to the estimated aid reduction as a percent of 2003 current law aid estimates. On the table, municipalities are divided into three groups based on their 2002 per capita full value. Generally, the table indicates that the tax rate equivalent and per capita reduction procedures result in lower aid reduction procedures among municipalities with low amounts of per capita tax base. The percentage of combined aid and tax levy procedure generally results in larger aid reduction percentages for municipalities with a high per capita tax base. As in Table 1, the across-the-board percentage procedure results in uniform percentage aid reductions without regard to the level of per capita tax base.

TABLE 2**Estimated State Aid Reductions Under Four Reduction Procedures Measured as a Percent of 2003 State Aid, Relative to 2002 Equalized Value Per Capita**

| % Reduction | 2002 Equalized Value Per Capita | | | | | | Total | |
|------------------------------------|---------------------------------|------------|----------------------|-------------|---------------|-------------|------------|-------------|
| | Under \$45,000 | | \$45,000 to \$65,000 | | Over \$65,000 | | Number | Percent |
| | Number | Percent | Number | Percent | Number | Percent | | |
| <u>Per Capita</u> | | | | | | | | |
| Under 10% | 346 | 18.7% | 54 | 2.9% | 18 | 1.0% | 418 | 22.6% |
| 10% to 25% | 177 | 9.6 | 272 | 14.7 | 92 | 5.0 | 541 | 29.2 |
| Over 25% | <u>44</u> | <u>2.4</u> | <u>318</u> | <u>17.2</u> | <u>529</u> | <u>28.6</u> | <u>891</u> | <u>48.2</u> |
| Total | 567 | 30.6% | 644 | 34.8% | 639 | 34.5% | 1,850 | 100.0% |
| <u>Across-the-Board Percentage</u> | | | | | | | | |
| Under 10% | 12 | 0.6% | 59 | 3.2% | 70 | 3.8% | 141 | 5.6% |
| 10% to 25% | 555 | 30.0 | 585 | 31.6 | 569 | 30.8 | 1,709 | 92.4 |
| Over 25% | <u>0</u> | <u>0.0</u> | <u>0</u> | <u>0.0</u> | <u>0</u> | <u>0.0</u> | <u>0</u> | <u>0.0</u> |
| Total | 567 | 30.6% | 644 | 34.8% | 639 | 34.5% | 1,850 | 100.0% |
| <u>Tax Rate Equivalent</u> | | | | | | | | |
| Under 10% | 434 | 23.5% | 79 | 4.3% | 9 | 0.5% | 522 | 28.2% |
| 10% to 25% | 128 | 6.9 | 306 | 16.5 | 73 | 3.9 | 507 | 27.4 |
| Over 25% | <u>5</u> | <u>0.3</u> | <u>259</u> | <u>14.0</u> | <u>557</u> | <u>30.1</u> | <u>821</u> | <u>44.4</u> |
| Total | 567 | 30.6% | 644 | 34.8% | 639 | 34.5% | 1,850 | 100.0% |
| <u>Aid and Tax Levy</u> | | | | | | | | |
| Under 10% | 122 | 6.6% | 62 | 3.4% | 14 | 0.8% | 198 | 10.7% |
| 10% to 25% | 445 | 24.1 | 487 | 26.3 | 219 | 11.8 | 1,151 | 62.2 |
| Over 25% | <u>0</u> | <u>0.0</u> | <u>95</u> | <u>5.1</u> | <u>406</u> | <u>21.9</u> | <u>501</u> | <u>27.1</u> |
| Total | 567 | 30.6% | 644 | 34.8% | 639 | 34.5% | 1,850 | 100.0% |

10. Table 3 shows the distribution of municipalities under the four alternatives according to the estimated per capita aid reduction. On the table, municipalities are divided into three groups based on their 2002 per capita full value. Just as Table 2 shows a relatively even distribution under the uniform percentage procedure, Table 3 shows a relatively uniform distribution of municipalities under the per capita reduction procedure. However, the 35% minimum guarantee would allow a per capita reduction of less than \$10 per person among some municipalities. Per capita reductions would be relatively uniform under the tax rate reduction procedure, as well. Under the across-the-board percentage and combined aid and tax levy procedures, larger per capita reductions would tend to occur among municipalities with lower amounts of per capita tax base than among municipalities with a per capita tax base exceeding \$65,000.

TABLE 3

**Estimated State Aid Reductions Under Four Reduction Procedures Measured
On a Per Capita Basis, Relative to 2002 Equalized Value Per Capita**

| Per Capita Reduction | 2002 Equalized Value Per Capita | | | | | | Total | |
|------------------------------------|---------------------------------|-------------|----------------------|------------|---------------|------------|------------|-------------|
| | Under \$45,000 | | \$45,000 to \$65,000 | | Over \$65,000 | | Number | Percent |
| | Number | Percent | Number | Percent | Number | Percent | | |
| <u>Per Capita</u> | | | | | | | | |
| Under \$10 | 2 | 0.1% | 42 | 2.3% | 302 | 16.3% | 346 | 18.7% |
| \$10 to \$25 | 565 | 30.5 | 602 | 32.5 | 337 | 18.2 | 1,504 | 81.3 |
| Over \$25 | <u>0</u> | <u>0.0</u> | <u>0</u> | <u>0.0</u> | <u>0</u> | <u>0.0</u> | <u>0</u> | <u>0.0</u> |
| Total | 567 | 30.6% | 644 | 34.8% | 639 | 34.5% | 1,850 | 100.0% |
| <u>Across-the-Board Percentage</u> | | | | | | | | |
| Under \$10 | 91 | 4.9% | 438 | 23.7% | 600 | 32.4% | 1,129 | 61.0% |
| \$10% to \$25 | 221 | 11.9 | 188 | 10.2 | 33 | 1.8 | 442 | 23.9 |
| Over \$25 | <u>255</u> | <u>13.8</u> | <u>18</u> | <u>1.0</u> | <u>6</u> | <u>0.3</u> | <u>279</u> | <u>15.1</u> |
| Total | 567 | 30.6% | 644 | 34.8% | 639 | 34.5% | 1,850 | 100.0% |
| <u>Tax Rate Equivalent</u> | | | | | | | | |
| Under \$10 | 301 | 16.3% | 42 | 2.3% | 302 | 16.3% | 645 | 34.9% |
| \$10 to \$25 | 266 | 14.4 | 602 | 32.5 | 325 | 17.6 | 1,193 | 64.5 |
| Over \$25 | <u>0</u> | <u>0.0</u> | <u>0</u> | <u>0.0</u> | <u>12</u> | <u>0.6</u> | <u>12</u> | <u>0.6</u> |
| Total | 567 | 30.6% | 644 | 34.8% | 639 | 34.5% | 1,850 | 100.0% |
| <u>Aid and Tax Levy</u> | | | | | | | | |
| Under \$10 | 43 | 2.3% | 255 | 13.8% | 382 | 20.6% | 680 | 36.8% |
| \$10 to \$25 | 271 | 14.6 | 344 | 18.6 | 215 | 11.6 | 830 | 44.9 |
| Over \$25 | <u>253</u> | <u>13.7</u> | <u>45</u> | <u>2.4</u> | <u>42</u> | <u>2.3</u> | <u>340</u> | <u>18.4</u> |
| Total | 567 | 30.6% | 644 | 34.8% | 639 | 34.5% | 1,850 | 100.0% |

11. Table 4 is arranged similarly to Tables 2 and 3, except aid reduction amounts are displayed as a tax rate equivalent. The tax rate equivalents are reported per \$1,000 of equalized value. The tax rate equivalent reduction procedure results in the most uniform reduction pattern, although the 35% minimum guarantee would produce a tax rate equivalent impact of less than \$0.20 per \$1,000 of value for some municipalities. Each of the other reduction procedures would result in higher tax rate equivalent impacts among low-value municipalities than among high-value municipalities.

TABLE 4**Estimated State Aid Reductions Under Four Reduction Procedures Measured as a Tax Rate Equivalent, Relative to 2002 Equalized Value Per Capita**

| Reduction Rate Per \$1,000 | 2002 Equalized Value Per Capita | | | | | | Total | |
|------------------------------------|---------------------------------|-------------|----------------------|------------|---------------|------------|------------|-------------|
| | Under \$45,000 | | \$45,000 to \$65,000 | | Over \$65,000 | | Number | Percent |
| | Number | Percent | Number | Percent | Number | Percent | | |
| <u>Per Capita</u> | | | | | | | | |
| Under \$0.20 | 0 | 0.0% | 75 | 4.1% | 533 | 28.8% | 608 | 32.9% |
| \$0.20 to \$0.40 | 100 | 5.4 | 569 | 30.8 | 106 | 5.7 | 775 | 41.9 |
| Over \$0.40 | <u>467</u> | <u>25.2</u> | <u>0</u> | <u>0.0</u> | <u>0</u> | <u>0.0</u> | <u>467</u> | <u>25.2</u> |
| Total | 567 | 30.6% | 644 | 34.8% | 639 | 34.5% | 1,850 | 100.0% |
| <u>Across-the-Board Percentage</u> | | | | | | | | |
| Under \$0.20 | 48 | 2.6% | 455 | 24.6% | 624 | 33.7% | 1,127 | 60.9% |
| \$0.20 to \$0.40 | 147 | 7.9 | 147 | 7.9 | 12 | 0.6 | 306 | 16.5 |
| Over \$0.40 | <u>372</u> | <u>20.1</u> | <u>42</u> | <u>2.3</u> | <u>3</u> | <u>0.2</u> | <u>417</u> | <u>22.5</u> |
| Total | 567 | 30.6% | 644 | 34.8% | 639 | 34.5% | 1,850 | 100.0% |
| <u>Tax Rate Equivalent</u> | | | | | | | | |
| Under \$0.20 | 0 | 0.0% | 75 | 4.1% | 504 | 27.2% | 579 | 31.3% |
| \$0.20 to \$0.40 | 567 | 30.6 | 569 | 30.8 | 135 | 7.3 | 1,271 | 68.7 |
| Over \$0.40 | <u>0</u> | <u>0.0</u> | <u>0</u> | <u>0.0</u> | <u>0</u> | <u>0.0</u> | <u>0</u> | <u>0.0</u> |
| Total | 567 | 30.6% | 644 | 34.8% | 639 | 34.5% | 1,850 | 100.0% |
| <u>Aid and Tax Levy</u> | | | | | | | | |
| Under \$0.20 | 22 | 1.2% | 280 | 15.1% | 538 | 29.1% | 840 | 45.4% |
| \$0.20 to \$0.40 | 124 | 6.7 | 276 | 14.9 | 75 | 4.1 | 475 | 25.7 |
| Over \$0.40 | <u>421</u> | <u>22.8</u> | <u>88</u> | <u>4.8</u> | <u>26</u> | <u>1.4</u> | <u>535</u> | <u>28.9</u> |
| Total | 567 | 30.6% | 644 | 34.8% | 639 | 34.5% | 1,850 | 100.0% |

12. Table 5 is arranged similarly to Tables 2, 3, and 4, except aid reduction amounts are displayed as a percent of combined aid and tax levy. The table is intended to display the impact of the reductions on municipal spending, and the reductions could be considered as an indication of budget reductions that municipalities would be required to make, absent tax levy increases. The most uniform impact would occur under the combined aid and tax levy approach. The tax rate equivalent reduction procedure would appear to have the least impact on the budgets of municipalities with a low per capita tax base, and the across-the-board percentage reduction procedure would appear to have the least impact on the budgets of municipalities with a high per capita tax base.

TABLE 5

Estimated State Aid Reductions Under Four Reduction Procedures Measured as a Percent of Combined Aid and Levy, Relative to 2002 Equalized Value Per Capita

| Reduction as a % of Aid & Levy | 2002 Equalized Value Per Capita | | | | | | Total | |
|------------------------------------|---------------------------------|------------|----------------------|-------------|---------------|-------------|------------|-------------|
| | Under \$45,000 | | \$45,000 to \$65,000 | | Over \$65,000 | | Number | Percent |
| | Number | Percent | Number | Percent | Number | Percent | | |
| <u>Per Capita</u> | | | | | | | | |
| Under 6% | 235 | 12.7% | 49 | 2.6% | 218 | 11.8% | 502 | 27.1% |
| 6% to 12% | 229 | 12.4 | 265 | 14.3 | 224 | 12.1 | 718 | 38.8 |
| Over 12% | <u>103</u> | <u>5.6</u> | <u>330</u> | <u>17.8</u> | <u>197</u> | <u>10.6</u> | <u>630</u> | <u>34.1</u> |
| Total | 567 | 30.6% | 644 | 34.8% | 639 | 34.5% | 1,850 | 100.0% |
| <u>Across-the-Board Percentage</u> | | | | | | | | |
| Under 6% | 38 | 2.1% | 313 | 16.9% | 543 | 29.4% | 894 | 48.3% |
| 6% to 12% | 529 | 28.6 | 331 | 17.9 | 96 | 5.2 | 956 | 51.7 |
| Over 12% | <u>0</u> | <u>0.0</u> | <u>0</u> | <u>0.0</u> | <u>0</u> | <u>0.0</u> | <u>0</u> | <u>0.0</u> |
| Total | 567 | 30.6% | 644 | 34.8% | 639 | 34.5% | 1,850 | 100.0% |
| <u>Tax Rate Equivalent</u> | | | | | | | | |
| Under 6% | 398 | 21.5% | 79 | 4.3% | 204 | 11.0% | 681 | 36.8% |
| 6% to 12% | 145 | 7.8 | 301 | 16.3 | 225 | 12.2 | 671 | 36.3 |
| Over 12% | <u>24</u> | <u>1.3</u> | <u>264</u> | <u>14.3</u> | <u>210</u> | <u>11.4</u> | <u>498</u> | <u>26.9</u> |
| Total | 567 | 30.6% | 644 | 34.8% | 639 | 34.5% | 1,850 | 100.0% |
| <u>Aid and Tax Levy</u> | | | | | | | | |
| Under 6% | 0 | 0.0% | 7 | 0.4% | 182 | 9.8% | 189 | 10.2% |
| 6% to 12% | 567 | 30.6 | 637 | 34.4 | 457 | 24.7 | 1,661 | 89.8 |
| Over 12% | <u>0</u> | <u>0.0</u> | <u>0</u> | <u>0.0</u> | <u>0</u> | <u>0.0</u> | <u>0</u> | <u>0.0</u> |
| Total | 567 | 30.6% | 644 | 34.8% | 639 | 34.5% | 1,850 | 100.0% |

13. The four preceding tables are intended to illustrate how different reduction procedures can be fashioned to address different concerns. Some of the reduction procedures appear to address more than the single concern that was the basis for their design. If the Committee has more than one concern, the Committee could adopt more than one reduction procedure and specify that each municipality's reduction amount be calculated by averaging the reduction amounts under each of the adopted procedures.

14. Under current law, state aid payments to counties will be reduced by \$20.0 million in 2004, and those reductions will be applied on a per capita basis. If the Committee elects to change the reduction procedure for municipalities, each of the three reduction alternatives presented above could be applied to counties, as well.

ALTERNATIVES

1. Approve the Governor's recommendation to apply any additional reductions on a per capita basis.
2. Replace the per capita reduction procedure recommended by the Governor with a procedure whereby reductions would be calculated as one of the following:
 - a. a uniform percent of 2003 aid payments under the shared revenue and small municipalities shared revenue programs, excluding any amounts that would have been paid as utility aid if 2003 aid had been distributed under the utility aid formula;
 - b. a uniform percent of each municipality's 2003 equalized value, exclusive of any value increment in a tax increment district;
 - c. a percent of each municipality's 2002(03) municipal purpose tax levy and the municipality's 2003 state aid payments under the shared revenue, expenditure restraint, and small municipalities shared revenue programs; or
 - d. the combined reductions under two or more of the preceding reduction procedures divided by the number of reduction procedures employed.
3. In addition to Alternative 2, modify the Governor's recommendation by doing one or more of the following:
 - a. establishing a maximum payment reduction for municipal payments of 35% (this percentage may have to be increased if payments are reduced by more than an additional \$70.0 million);
 - b. replacing the per capita reduction procedure for the \$20.0 million municipal reduction authorized under current law with the reduction procedure adopted under Alternative 2; or
 - c. replacing the per capita reduction procedure for counties authorized under current law with the reduction procedure adopted under Alternative 2.

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