PUTTING THE LID ON
HOW WISCONSIN CAN CAP ITS SPENDING

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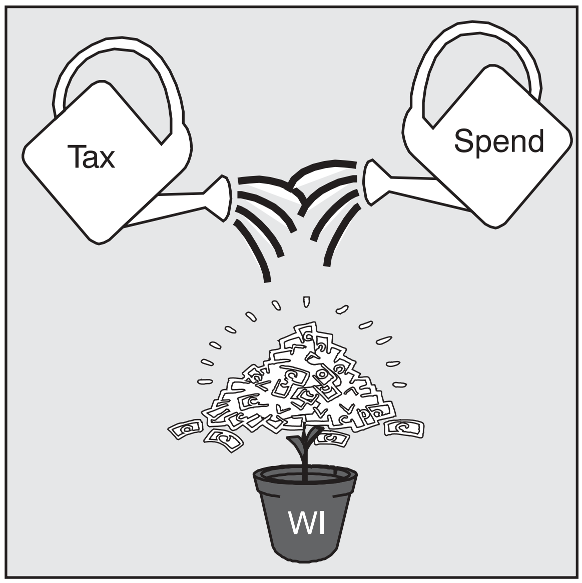

The levels of government spending and taxes have been the subjects of ongoing policy and political debate in Wisconsin for many years and have been the focus of renewed interest in the past several years. The recent economic recession has squeezed incomes and made people more acutely aware of tax burdens. Ongoing discussions about the state's economic future, income levels, and job opportunities have highlighted the negative impact a high tax burden has on our economic growth rates. In addition, state budget difficulties in the past two bienniums have highlighted concerns about state spending levels.

The debate about spending and tax levels is based on the widespread perception that Wisconsin's spending and tax levels are higher than in other states. That perception is confirmed by some basic facts. There is in fact a significant mismatch between the level of state and local spending in Wisconsin and the ability of the state's citizens to pay for government spending. In 2002, total state and local government spending in Wisconsin was 7.7% above the national average, which meant that government spending in Wisconsin was $2.44 billion more than if we had spent at the national average level. At the same time, Wisconsin's income level was 2.8% below the national average.

In light of this mismatch, the Wisconsin Legislature and the public spent considerable time in 2004 debating whether the state should adopt comprehensive spending limits for state and local government. The discussion initially focused on Assembly Joint Resolution 55 (AJR 55), which was introduced in the Legislature in November 2003. AJR 55 contained strict controls which would have limited spending growth to the rate of increase in the consumer price index plus population growth, unless a faster rate of growth was authorized by referendum, and would have imposed other restrictions on state and local spending, taxing, and bonding. Critics of spending limits said that AJR 55 was too restrictive and would damage the quality of government services in Wisconsin, and therefore argued against adopting any comprehensive limits at all.

While some legislators supported AJR 55 and others opposed it, a number of legislators who supported the goal of restraining spending increases had concerns about the specific

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provisions in AJR 55 and wanted to look at other approaches. A number of other alternatives were discussed but no formal legislative action was taken in the first six months of 2004.

In July 2004, the Legislature was called into extraordinary session to debate the issue of spending limits and Senate Joint Resolution 76 (SJR 76) was introduced. It provided that spending for each type of government at the state and local level (state government, K-12 school districts, municipalities, counties, and Wisconsin Technical College System districts) could increase in the aggregate at no more than 90% of the rate of personal income growth, unless a faster rate of growth was authorized by referendum.

A senate committee approved SJR 76, but the Legislature adjourned without taking further action on it. In the end, the Legislature as a whole was not able to come to a consensus about the best approach to this issue and did not vote on any spending limit proposals in 2004.

This issue will be revisited by the Legislature in 2005. As the legislative debate takes place, it is important to view the issue of spending limits in the proper perspective. How high are Wisconsin's spending and taxing levels? What are the effects of our spending and tax levels? What should be the state's goals in developing a policy to address government spending levels? Are spending limits a reasonable way to address this issue? If so, how should they be structured, and how would they work in practice? In short, are there ways to design sensible, reasonable, and workable spending limits that would benefit Wisconsin's taxpayers; help Wisconsin's economy; and improve the state's long-term fiscal health, without jeopardizing vital government services?

There are many critics of proposals to adopt spending limits. Some critics assert that Wisconsin is not a high-spending or high-tax state. Others say that spending limits are a radical and unworkable approach to controlling spending, and would unacceptably reduce the role of elected officials in managing government budgets. Still others say that spending limits would threaten the availability of basic services and drastically reduce the state's quality of life.

The facts clearly indicate that Wisconsin's spending and tax levels are high.

- State and local spending in Wisconsin was 7.7% above the national average in 2002. It represented 21.4% of personal income in 2002, up from 19.8% in 1986.
- Wisconsin's tax levels were 12.8% above the national average in 2002. Wisconsin's tax levels were particularly high for the property tax (27.0% above average) and the individual income tax (34.5% above average). The perception that Wisconsin is a high-tax state is exacerbated by the fact that the state is farthest out of line with national averages in the two most visible tax areas, the property tax and the income tax.
- Wisconsin's spending and tax levels have moved closer to the national averages in recent years but remain high today.

High tax levels hurt economic growth and job creation in Wisconsin. The overall tax level and the individual income and property tax levels are important to businesses when they make decisions about where to locate and expand, and are also important to individuals when they make decisions about where to seek career opportunities. Businesses say they have trouble recruiting workers to come to Wisconsin (including researchers, engineers, information technology workers, managers, and professionals), because workers are well aware that their take-home pay will be less here than in other states, due to the state income tax, and know that Wisconsin has higher property taxes than other states. Universities say the same thing about recruiting professors.

These anecdotal impressions are confirmed by in-depth studies done by Professor Jon Udell of the UW-Madison of the weight businesses place on different factors in making location decisions. His studies have concluded that business and personal tax structure and burden are among the most important factors affecting business location decisions. While Wisconsin gets high marks in terms of overall quality of life and workforce quality in Udell's studies, the state gets low marks in the areas of personal and business tax structure and burden.

Why does Wisconsin rank high on taxes? A landmark 2003 study by Todd Berry and Dale Knapp of the Wisconsin Taxpayers Alliance concluded that it was primarily because of higher-than-average spending levels, which accounted for 70% of the difference between Wisconsin and the national average. The study concluded that it was also due in part to a higher-than-average reliance on state taxes rather than fees in our revenue mix and in part to lower-than-average federal revenues, which together accounted for 30% of the difference between Wisconsin and the national average.

We thus have a situation where Wisconsin has government spending levels that are higher than the national average, tax levels that are even farther above the national average (due to the fact that Wisconsin relies more on taxes than on fees and federal revenues compared to the average state), and individual income and property taxes that are substantially and very noticeably higher than the national average. The unfortunate thing about this, from an economic competitiveness point of view, is that Wisconsin ranks farthest above the national average in the two areas that are most noticeable to people and that are most easily comparable to other states—the individual income tax and the property tax.

Clearly there are ample reasons for concern about Wisconsin's tax and spending levels. Are comprehensive spending limits an appropriate response to these concerns? In evaluating spending limits, several questions need to be addressed. What should be our goals in considering spending limits? Are spending limits a reasonable fiscal management tool? What measures make sense from a policy perspective? Would those measures have worked well in practice?

The state's overall goal in this area should be to avoid an excessive tax burden while setting government spending at reasonable levels that will enable the state's citizens to receive good government services. The state's tax levels have to be competitive with other states in order for the state's economy to grow at a healthy rate. Economic growth is essential to create opportunities for our children and grandchildren and to provide the revenues to fund essential services in the future.

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Working toward this goal by adopting spending limits is not a new or radical idea. A review of legislation in other states and of past studies in Wisconsin indicates that spending limits are a commonly used, reasonable way to achieve this goal.

Many states have adopted spending limits. There are 27 states with comprehensive limits. The majority of them link spending growth with personal income growth. Of these, seventeen have limits based on constitutional language, and ten have limits based on statutes passed by their state legislatures. The majority of states with limits, sixteen in all, use personal income growth as the starting point for measuring allowable growth.

Spending limits have been thoroughly studied in Wisconsin. The bipartisan Wisconsin Expenditure Commission appointed by Governor Tony Earl recommended in 1986 that Wisconsin should adopt limits that would bring the state's spending levels to the national average and then allow spending to grow at the rate of personal income growth in the future. The Expenditure Commission's core recommendation was that Wisconsin should develop a long-term government expenditure strategy that would both recognize the ability of the state's citizens to pay for government services and also improve the state's competitive position relative to other states.

Spending limits have been partially implemented in Wisconsin. The state has adopted a number of targeted spending limits over a period of years which apply to specific areas of state and local spending. Revenue limits for K-12 schools which tie allowable spending growth to the rate of inflation plus enrollment changes have been in effect since the 1993-94 school year. For municipalities, the Expenditure Restraint Program limits spending for eligible municipalities that choose to participate to inflation plus an adjustment based on growth in property value due to new construction. Counties and technical colleges have mill rate limits that tie the amount of money that can be raised through the property tax to property value growth. Spending limits for a portion of the state budget, which are tied to the change in state personal income, were adopted in 2001.

While the limits which have already been put in place have helped moderate spending growth in some areas, the state still lacks comprehensive limits which apply to all areas of state and local spending. In light of the experiences in other states, the recommendations of the Wisconsin Expenditure Commission, and the endorsement of targeted spending limits in Wisconsin, a logical next step would be to adopt comprehensive spending limits in Wisconsin.

Comprehensive spending limits based on personal income growth or a percentage of personal income growth would balance the need for reasonable spending and tax levels with the desire to have good government services.

- Limits based on personal income growth or a percentage of personal income growth would relate government spending increases to the ability of Wisconsin's citizens to pay.

- If comprehensive spending limits tied to personal income growth had been adopted in the state in 1986, by 2002 Wisconsin's state and local government spending level would have been roughly at the national and regional averages. Wisconsin would have spent 19.8% of personal income in 2002, rather than the actual level of 21.4%. This compares with a national average of 19.9% and a regional average of 19.6% in 2002.

- If comprehensive spending limits based on personal income growth were in place, government services would still be adequately funded based on comparisons with national and regional averages, and the state's tax burden could be reduced by a noticeable amount, all other factors being equal.

- If comprehensive spending limits tied to personal income growth had been adopted in the state in 1986, by 2002 Wisconsin's state and local spending would have been roughly $2.58 billion less than it actually was. If this amount would have been used to reduce property and individual income taxes in 2002, the 2002 tax collections from these tax sources could have been reduced by approximately 19% for property taxes and 25% for income taxes.

- Spending limits tied to personal income growth would moderate the rate of spending increases so the state would establish a more desirable level of spending over time. They would result in a slightly slower rate of annual growth in government spending (by about one-half of one percent per year) but would not result in massive dislocations of government services.

How should limits be established? A few states, such as Colorado, have very detailed constitutional language, which is essentially self-executing, meaning that little in the way of additional statutory language is needed. Other states have broad constitutional language to establish the guidelines in concept, accompanied by specific language adopted by the Legislature to implement the guidelines. A number of states have statutory language only. It is also possible to establish guidelines through less formal measures, such as by passing a budget resolution in each session of the Legislature. Any of these approaches would advance Wisconsin toward the goal of having an explicit goal of setting state spending and taxes at competitive levels.

Proposals to adopt spending limits have been criticized on a number of grounds. Some critics seem to feel that there should be no spending guidelines at all. But without guidelines, all spending decisions will be made on an ad hoc basis. It seems reasonable to take the position, as the Expenditure Commission did, that the people of the state should make a conscious decision about how much of the state's resources should be devoted to government services.

Some critics say that limits are inconsistent with representative government. Philosophically, limits are not a repudiation of representative democracy, but simply a collective decision made by the people and their representatives about overall parameters to guide spending decisions, similar to the constitution's balanced budget requirement.

In fact, adopting reasonable spending limits could actually help the state avoid the periodic severe budget cutbacks which now occur.

Some critics raise the specter of sudden, draconian spending cuts if limits are adopted. However, limits will simply moderate the rate of spending increases each year. They would result in spending coming into line with national and regional averages over time.

In fact, adopting reasonable spending limits could actually help the state avoid the periodic severe budget cutbacks which now occur. Cutting spending by large amounts in a short time period is agonizing. Reasonable spending limits, combined with the buildup of a reserve fund, would help the state avoid the pattern of big spending increases during good economic times followed by wrenching cuts during economic slowdowns.

A common criticism is that spending limits would drag the state's spending services down to the level of states such as Alabama and Mississippi. However, spending limits tied to personal income growth would bring our spending levels over time in line with those in the other Midwest states, which provide a very adequate level of government services.

In terms of comparisons with other states, most Wisconsinites would not want to see the state rank in the bottom ten states in such areas as education, transportation, parks, or general quality of life. By the same token, it is not desirable to have the state's tax burden rank in the top ten states, as it does now. It is problematic for a state to be an outlier as a high-tax state or a low-service state. People want to receive good government services, but they also want those services to be affordable.

Another common criticism is that limits would not be workable. Clearly, any constitutional or statutory language adopting limits should be carefully drafted so that it does not cause problems in practice by impeding the ability of the state or local governments to issue bonds, discouraging new development needed for economic growth, or creating other unintended consequences. The experience in the vast majority of other states that have adopted limits indicates that it is certainly possible to develop and implement workable limits.

Spending limits are not the only tool that should be used to improve the state's fiscal situation. A comprehensive fiscal management strategy would include spending limits, an adequately funded reserve fund, and measures designed to discourage unfunded future spending commitments and deferrals of payment obligations to future years.

Overall, reasonable, sensible, and workable spending limits tied to personal income growth would ease the tax burden on Wisconsin's citizens, help the state become more competitive economically, allow us to maintain good government services, and help avoid boom-and-bust budget cycles.