Shared Revenue: An Equitable, Efficient Way to Help Fund Critical Local Services

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Through the shared revenue program, the State of Wisconsin provides tax dollars to cities, villages, towns and counties to help pay for local services like police and fire protection. In 2011, cities and villages will receive $652 million through this program. Counties are projected to receive $183.3 million and towns $59.3 million. When shared revenue is combined with the expenditure restraint program and the computer exemption reimbursement payment, it ranks as the fifth largest state general fund program, behind general elementary and secondary school aids, medical assistance, the University of Wisconsin system, and corrections.

The state shared revenue program is a key component of Wisconsin's state and local relationship. It is also an important part of the state's overall program of property tax relief. During the last ten years, however, funding for the program has been cut on several occasions, the most recent being a 3.5 percent cut that took effect in 2010. In 2002 Governor McCallum even proposed eliminating shared revenue in a bid to fix the state's fiscal difficulties. In 1981-82 shared revenue represented 15 percent of the state's general fund expenditures. It currently makes up 6 percent.

State policy makers need to be informed about the history and rationale for the shared revenue program. It is imperative that the program continue to be maintained and funding levels increased to previous levels.

History

The state created the shared revenue program in 1911 to address the negative effects of a new property tax exemption on local governments. The state, desiring to keep local governments whole, adopted the first tax on income in the country and used the revenue to replace local governments' lost property tax base. In the beginning, shared revenue was referred to as a shared tax system. At the outset, 70 percent of the income tax revenue

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went to municipalities, 20 percent to counties, and 10 percent to the state for administrative costs.

Initially, the state employed a "return to origin" shared tax system where a percentage of certain state taxes was earmarked for return to local governments based on the taxpayer's location. In other words, a percentage of sales or income tax revenue paid by residents and businesses in a community was returned to the community. Consequently, wealthier, economically successful communities received more shared revenue payments than poorer, less economically active communities.

In the early 1970s, the state legislature increased funding for shared revenue and significantly modified how it was distributed. The "return to origin" approach was replaced with a complex tax base "equalizing" distribution formula. Consequently, a major goal of the shared revenue program became to equalize local governments revenue raising capacity by sending proportionately larger amounts of aid to fiscally weaker municipalities. Under this distribution formula, poorer communities generally received proportionally more aid than wealthier communities.

The "equalizing" distribution formula was suspended in 2002. Since 2002 shared revenue payments have been distributed strictly on a historical basis. In the absence of any cuts in funding, each community receives roughly the same amount in shared revenue that it received the year prior.

More detailed information on the history of the shared revenue program is available from the Wisconsin Legislative Fiscal Bureau, *Shared Revenue Program, Informational Paper 18,* which is posted on the Fiscal Bureau's Web page at <http://legis.wisconsin.gov/lfb/>.

Rationale for the Shared Revenue Program

While the policy of the state replacing lost local revenues caused by the creation of property tax exemptions has been a strong justification for the shared revenue program since its inception, several other equally important public policy goals justify its existence and warrant its continuation. These include the following:[1]

- **Substituting State Taxes for Local Taxes.** Using state aid to help finance local government improves the overall equity and efficiency in the state-local tax system. The state income tax, for example, is generally perceived to be more progressive, equitable and better related to a taxpayer's ability to pay than the property tax. Moreover, it is much more efficient for the state to collect income and sales taxes than it is to have such collections made by a hodge-podge of 1,800 local taxing jurisdictions. In many states local sales or income taxes piggyback onto state taxes. Wisconsin's shared revenue program is similar to such a piggyback state-local tax system.

- **Property Tax Relief.** Shared revenue payments help municipalities avoid relying exclusively on the property tax to pay for vital local services like police, fire, streets, libraries, and parks. Under current law, the total amount of shared revenue payments the state plans to distribute to all local governments in 2011 is $894.6 million. Needless to say, if these payments were eliminated or reduced, residential homeowners and business owners would experience higher property tax bills, higher fees, and/or dramatically reduced public services.

- **Funding Local Mandates.** Local governments provide a wide variety of services that are required by state law. State aid helps to offset the cost of providing such services.

- **Spreading Costs.** Some local services are provided to residents of other communities. Examples include:

  ◆ Commuters from outside a city who use city streets, city buses, and parking garages when working in the city.

  ◆ County residents who use municipal libraries, parks, and museums.

Shared revenue helps to ensure that local residents do not bear the entire burden of providing these services for non-residents.

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1. This list of reasons for the shared revenue program is taken from the Legislative Fiscal Bureau's *Informational Paper 16, Municipal and County Finance,* by Rick Olin.

- **Tax Base Equalization.** While the equalization formula for distributing shared revenue has not been applied since 2002, the echo of that formula continues to impact how shared revenue is distributed among municipalities to this day. For example, a community with high property values like Brookfield continues to receive less shared revenue than communities like Beloit or Ashland, which have lower equalized values. Consequently, the shared revenue program continues to equalize local governments' revenue raising capacity by sending proportionately larger amounts of aid to fiscally weaker municipalities.

Criticism of Shared Revenue

Over the years, critics of shared revenue, like Governor Scott McCallum, have made two main arguments in support of discontinuing the program:

1. The shared revenue system is not a good way to fund local services because the ultimate spenders are not required to levy the taxes they expend and, therefore, are less accountable to the citizenry for their spending decisions.

2. Unrestricted shared revenue payments spur local spending.

Neither of these arguments hold up under close examination.

1. Issue of Accountability

Most of the money spent by local officials to provide local services is raised locally in the form of property taxes, special assessments and fees. In 2007, about 18.1 percent of city revenues came from state aids consisting primarily of shared revenue and transportation aids. Only about 11.5 percent of village resources came from state aids. Locally imposed taxes represented the largest revenue source for villages (34.7 percent) and cities (28.5 percent). Naturally, citizens and local taxpayer groups closely scrutinize municipal budgets every year to ensure that their tax bills are not unnecessarily increased because of superfluous spending.

Neither the electorate nor local officials distinguish between shared revenue, property taxes or other revenue sources when considering whether a particular expenditure might be excessive or non-essential. As long as property tax revenues, fees, and other locally raised funds support most of a municipality's budget, municipal spending decisions will be subject to the same level of scrutiny by the electors as if the entire budget was funded by the local property tax.

Municipal leaders are part-time officials living in the same neighborhoods of the people who elect them. Local officials receive comments and complaints on a daily basis about the quality and cost of services that they provide. Residents have continuing direct input into municipal spending decisions. Local elected officials are held accountable for their spending decisions at the ballot box every two years.

2. Shared Revenue Does Not Spur Spending

The claim that shared revenues leads to excessive spending by municipalities can be refuted by looking at the numbers. Wisconsin's shared revenue program is fairly unique among the states. Most states simply authorize local governments to raise revenue at the local level through income, sales and property taxes. If shared revenue leads to unnecessary spending by local governments, then Wisconsin local governments should compare unfavorably to local governments in other states when it comes to spending. This is not the case, however. Wisconsin local governments are not high spenders compared to local governments in other states. Based on the most recent national data (from 2008), Wisconsin ranked 27th in total state and local spending (measured as a percentage of income). The national average for "direct general spending" by state and local government in 2008 was $7,886 per capita. In Wisconsin, it was $7,541 per capita – or $345 below the national average. In addition, Wisconsin ranked 41st (10th lowest) in total state and local government employees relative to population. Source: The Wisconsin Budget Project.

Conclusion

For over 90 years the shared revenue program has been a key component of Wisconsin's system of state and local finance. It is an important part of the state's effort to provide property tax relief. Moreover, it is an equitable, efficient way to help fund police, fire, street maintenance, and other critical local services. It is crucial that shared revenue be maintained and program funding be restored to its previous levels.