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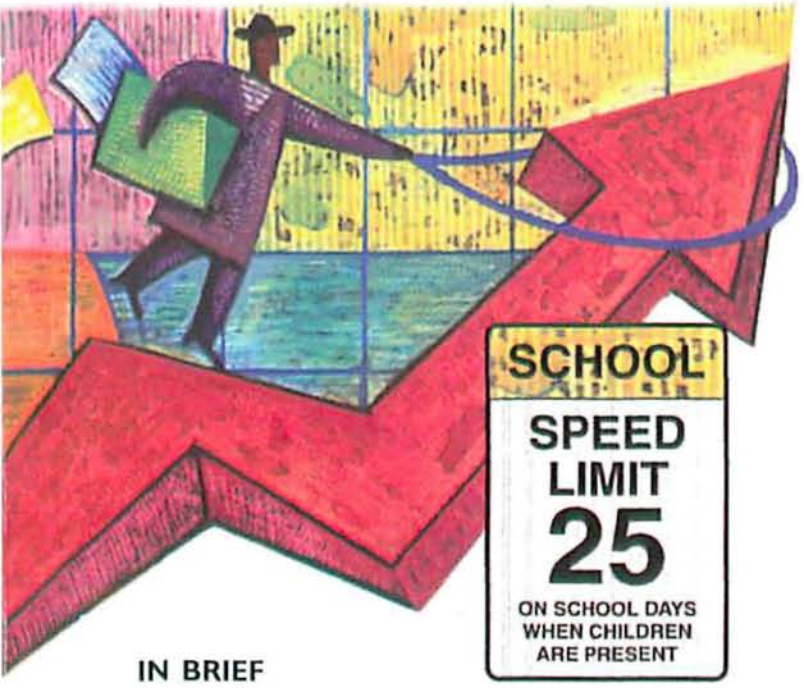
The Wisconsin Taxpayer

A monthly review of Wisconsin government, taxes, and public finance



IN BRIEF

Since 1994, Wisconsin school districts have operated under state-imposed revenue limits and the associated qualified economic offer (QEO) law.

- Revenue limits have helped reduce school property tax increases to less than 5% per year from more than 9% annually prior to the caps.
- The limits have had varied impacts on school districts, with growing districts experiencing the largest revenue gains. Low-spending districts prior to the caps have seen the largest per student gains.
- The QEO law has helped school districts keep compensation costs somewhat in line with revenue limits. However, since benefits are given more weight, teacher salary increases have slowed.

Also in this issue:

wistax
78 Years of Research & Citizen Education

March 2009 Vol. 77 No. 3

A Primer on School Revenue Limits

Since 1994, Wisconsin school districts have operated under state-imposed revenue limits, which are tied to inflation and enrollments. The associated qualified economic offer (QEO) law limits staff compensation increases to about 4% annually. With declining student counts, fluctuations in state school aid, and various concerns over teacher pay, revenue limits and the QEO have attracted increasing debate.

The governor, in his proposed 2009-11 state budget, recommends eliminating the QEO. He has also talked about providing ways for school districts to move away from revenue limits. This report does not address these specific proposals. Rather, it seeks to help inform discussions by examining the history of revenue limits and the QEO, legislative attempts to fix various issues, and the impacts of limits on schools, educators, and taxpayers.

THE REVENUE LIMIT LAW

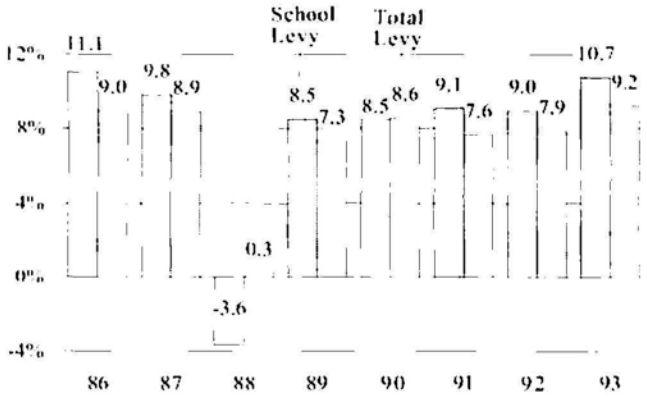
School districts collect revenue from a variety of sources. The two largest sources are the property tax and state general (or equalization) aid. General aid is distributed based on district property wealth and spending. Combined, these two revenue sources account for about 75% of an average district's funding. The remainder is a combination of student fees, federal aid, and state categorical aids, such as those for special education and transportation.

The revenue limit law was implemented in 1994 (1993-94 school year) and caps the amount districts can collect from property taxes and general aid combined. It does not restrict student fees, federal aid, or state categorical aid. A district's revenue limit is determined by its prior-year cap, an inflation factor, and enrollments. There is an exception to the limit law for districts defined as "low-revenue." Currently, districts with per student revenues less than $9,000 are allowed to increase their revenues to that level.

Background

While Wisconsin's revenue limit law began in 1994, its roots date back to several teacher strikes in the early 1970s, culminating with the 1974 Hortonville strike during which 86 teachers were fired. That strike gained national attention.

Property Taxes Rise Quickly Prior to 1994
% Increase in Total and School Levies in Yr. of Collection



Mediation-Arbitration. In 1977, partly as a reaction to the Hortonville strike, state lawmakers enacted a mediation-arbitration (Med-Arb) law. Under Med-Arb, if a school board and teachers' union did not agree on a contract, a mediator became involved. If mediation failed, the mediator could impose binding arbitration, in which one of the two final offers—the union's or the school board's—was imposed.

Rising Compensation, Rising Taxes. One of the effects of Med-Arb was gains in teacher pay and benefits. According to the state's largest teachers' union, average salaries climbed more than 10% per year from 1981 through 1983. And figures from the Wisconsin Association of School Boards show that from 1986 through 1993, average salary and benefit increases ranged from 6.9% (1992 and 1993) to 8.4% (1986).

Although state school aids rose significantly during this latter period, they generally did not keep pace with rising compensation costs. As a result, schools relied on property taxes for an increasing share of funding.

As the chart above shows, from 1986 through 1993, school property taxes increased at least 8.5% in seven of eight years and topped 10% in 1993. During this time, the school levy averaged nearly 54% of all property taxes.

Rising school taxes drove annual increases in total property tax levies to more than 7% in seven of the eight years. The average statewide property tax rate climbed from $24.09 per $1,000 of full property value in 1985 to $32.39 per $1,000 in 1993.

Legislative Response. Public concern over rising property taxes peaked in the early 1990s. Since school levies were the primary driver of rising property taxes, state lawmakers focused on school tax relief.

The 1993-95 state budget created Wisconsin's revenue limit law. The limits were originally to end after the 1998 school year, but they became permanent in the 1995-97 state budget. As part of the revenue limit deal, legislators agreed to increase the state share of school funding. In 1997, state school aids and credits were increased more than $1.0 billion to satisfy a new "two-thirds" funding requirement. That requirement was eliminated in the 2003-05 state budget, although it remains a goal for many state politicians.

Limiting Compensation Increases. When lawmakers passed the revenue cap law, they understood that, for it to work, limits also had to be placed on compensation growth. Districts spend about 75% to 85% of their budgets on salaries and benefits. If the state were to limit growth in school budgets, it also would have to limit compensation increases. And, since teachers accounted for nearly 60% of district staff, the primary legislative focus was teacher compensation.

Under the qualified economic offer law, which began in 1994, districts and local teachers' unions would continue to bargain for salary and benefit increases. However, if an agreement was not reached, districts were allowed to avoid binding arbitration by imposing the QEO. Under the QEO, total teacher salaries and benefits must rise 3.8%—the district cannot impose a contract with a larger or smaller increase –though individual teachers could get more or less depending on their circumstances.

Since creation of the QEO, benefit costs, particularly for health insurance, have grown faster than salaries. If the QEO is imposed, the district must leave benefits (including co-pays and employer share of costs) unchanged. Thus, when benefit costs are rising, imposing the QEO leads to smaller salary gains.

Revenue Limit Mechanics

Calculating a district's revenue limit is fairly straightforward. Each district has a revenue base equal to its prior year's per student limit.

To that base, the district adds an inflation factor set by the legislature. For 2009, the inflation factor was $274.68,

The Wisconsin Taxpayer

March 2009 Vol. 77 No. 3

Publication Number USPS 688-800
Periodical postage paid at Madison, Wisconsin

Subscription Price:
One Year, $16; Three Years, $33
Published each month by the Wisconsin Taxpayers Alliance

Postmaster:
Send address changes to *The Wisconsin Taxpayer,* 401 North Lawn Avenue, Madison, Wisconsin 53704-5033
phone: 608.241.9789 fax: 608.241.5807
e-mail: wistax@wistax.org Web site: www.wistax.org

or a per student increase of just under 3% for the average district. The new per student revenue limit is then multiplied by enrollment to get the district's total revenue limit. Enrollment is a three-year rolling average.

Districts can exceed the caps, either on a short-term basis (nonrecurring) or permanently (recurring), with voter approval in a referendum.

Several changes have been made to the revenue limit law to ease the burden on school districts. These include:

- allowing "low-revenue" districts to increase their caps by more than the inflation factor (1996);
- permitting districts to add a percentage of their summer school students to student counts (1999);
- allowing declining-enrollment districts to add back some of their student decline (1999);
- eliminating the community service fund from the caps (2002); and
- allowing districts to carry forward any unused portion of the cap (2005).

TAXPAYER IMPACTS

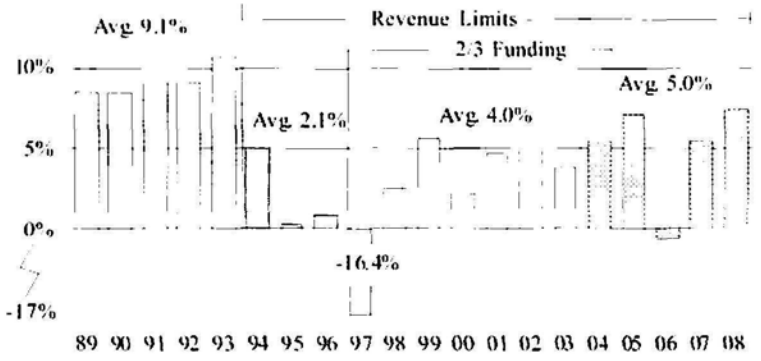
The revenue limit law and associated QEO have affected taxpayers, school districts, and teachers. However, the impacts have varied. The primary goal was to slow property tax growth. As the chart above, right, shows, school levy increases have slowed since 1994.

In the five years prior to revenue limits, school levies rose an average of 9.1% per year. Since then, increases have averaged 2.4% annually, a figure that is affected by the 16.4% drop in 1997 when school aids were increased dramatically. Since 1997, school levies have climbed an average of 4.4% annually, or less than half the rate prior to the limits.

In recent years, levy increases have averaged 5.0% per year, due primarily to state budget difficulties. As previously mentioned, revenue limits are the sum of property taxes and state school aid. In years when general school aid increases slowly, districts can make up the difference with increased property taxes.

With the state struggling to balance its budget for most of the decade, school aid increases have lagged those of prior years. From 1997 through 2003, general aid climbed an average of 4.7% per year. Recent increases have been about half that (2.4% annually). The chart

School Revenue Limits Slow Property Tax Increases
% Increase in School Levies, 1989-2008



below shows the relationship between school aid changes and school levy increases in percentage terms – small aid increases are associated with large changes in school levies, and vice versa. For example, in 2007, general aids increased 2.4% and levies rose 5.6%.

SCHOOL DISTRICT EFFECTS

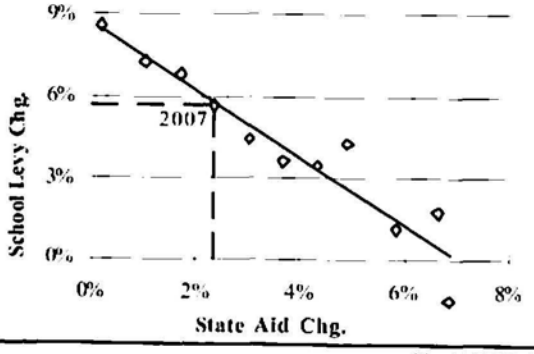
The main impact of revenue limits on school districts has been to slow school spending growth. Prior to 1994, school spending per student from all sources increased 6.3% per year. Spending from state general aid and property taxes rose at a similar rate, 6.2% annually. The revenue limit law slowed annual growth for both to just over 4%.

Generalizing about revenue limits based on statewide averages does not demonstrate the varied impact of the caps on individual districts. The table on page four and the accompanying discussion provide greater insight. Shown in the columns to the left are districts with the largest and smallest average annual revenue cap increases on a per student basis.

The primary goal of the revenue limit law was to slow property tax growth.

A somewhat different view of revenue cap impacts emerges when the average annual increase is examined in terms of total dollars, rather than on a per student basis. This is shown in the columns to the right.

School Levy Chg. Tied to State Aids
2000-2008



By District: Per Student

Every school district is limited each year to raising a certain dollar amount of revenue as defined by the state (property taxes plus state aid). A per student limit can be obtained by dividing the total limit by enrollment.

Of 422 districts studied, nearly 60% had per student revenue limits grow between 3% and 4%.

Of 422 districts studied (excluding districts that merged or were created since 1994), 252, or nearly 60%, had per student revenue limits grow between 3% and 4% per year. Another 103 had growth between 4% and 5%, and 15 saw annual growth top 5%. The remaining 52 districts had their limits grow less than 3% per year.

A closer look at per student revenue cap changes shows that three K-8 districts– Raymond #14, Waterford Graded, and Washington-Caldwell—had the fastest per student increases at more than 6% per year (see table below). Meanwhile, per student limits grew less than 2.5% per year in eight districts. Northwood's per student revenue limit rose only 1.8% per year over the 15 years studied because the district has levied fewer property taxes than allowed in every year since revenue limits began.

The main difference between districts with high growth in per student limits and those with low growth—the difference between the districts shown top left and bottom left of the table—goes back to the creation of limits in 1993. Districts with relatively low beginning limits on a per student basis have tended to increase at a faster rate than those that initially had high limits. Put another way, a $200 per student increase for a district with a limit of $5,000 per student is a 4.0% gain. However, it is a 2.0% bump for a $10,000 per student district.

Another factor that helps explain differences in how fast or slow per student revenue caps grow relates to the exception in state law for "low-revenue" districts described at the outset. These districts received additional increases as the low-revenue floor was raised. In 1996, districts with per student revenues less than $5,300 were bumped up to that amount. The low revenue amounts were increased each year by $200 to $500, providing these districts with additional resources. For 2009, the low-revenue floor is $9,000.

In 1996, only 29 districts were considered low revenue. However, with the relatively large increases in the floor in recent years, the number of low-revenue districts topped 90 in 2007, before declining slightly in 2008.

As a result of the exemption from limits for the low-revenue districts and other factors already cited, the state caps have tended to "equal-

The main difference between high- and low-growth districts, in per student terms, is spending prior to creation of the caps.

Revenue Limit Increases Vary by District

Average Annual Changes in Per Student and Total Revenue Limits, Top and Bottom 10 Districts, 1993-2008

Ranked by Average Per Student Increase

	Per Student	Rk.	Total	Rk.
Raymond #14	6.5%	1	8.2%	8
Waterford Graded	6.5	2	9.2	2
Washington-Caldwell	6.4	3	8.7	6
Campbellsport	5.9	4	6.2	42
Royall	5.8	5	2.1	390
Union Grove J1	5.7	6	7.2	21
Phelps	5.6	7	4.1	190
Lac Du Flambeau #1	5.5	8	6.9	27
Wonewoc-Union Ctr.	5.5	9	5.0	94
Florence	5.4	10	2.9	337
State Avg.	3.6		4.2	
Menomonee Falls	2.5	413	4.3	169
Franklin Public	2.5	414	4.8	106
Whitefish Bay	2.4	415	3.6	265
Glendale-River Hills	2.4	416	1.1	417
Nicolet UHS	2.4	417	3.1	322
Rubicon J6	2.3	418	3.6	256
Drummond	2.2	419	1.9	404
Fox Point J2	2.2	420	2.9	338
Maple Dale-Ind. Hill	2.0	421	0.8	420
Northwood	1.8	422	2.9	335

Ranked by Average Total Increase

	Per Student	Rk.	Total	Rk.
North Cape	5.3%	12	9.8%	1
Waterford Graded	6.5	2	9.2	2
Kimberly Area	3.4	293	9.1	3
Hortonville	4.1	113	9.1	4
De Pere	4.0	123	8.8	5
Washington-Caldwell	6.4	3	8.7	6
Somerset	4.0	118	8.3	7
Raymond #14	6.5	1	8.2	8
Waunakee Comm.	3.4	271	7.7	9
Linn J4	4.3	65	7.7	10
State Avg.	3.6		4.2	
Goodman-Armstrong	3.0	372	1.5	413
Ladysmith-Hawkins	3.3	319	1.5	414
Niagara	3.4	282	1.5	415
Belmont Community	3.5	248	1.4	416
Glendale-River Hills	2.4	416	1.1	417
Butternut	4.8	26	0.9	418
Herman #22	3.2	345	0.8	419
Maple Dale-Ind. Hill	2.0	421	0.8	420
Mellen	3.1	364	0.5	421
South Shore	3.5	260	0.2	422

ize" per student revenues. That is, districts are becoming more similar over time. In 1993, less than 60% of districts had per student caps within 10% of the state average. By 2008, more than 83% were in that range.

By District: Total Revenues

A different perspective on the 16-year-old revenue limit legislation is gained when the total dollar value of each district's revenue limits is considered. While changes in per student amounts depend to a large degree on whether a district was a high- or low-revenue district to begin with, changes in total revenue limits depend mostly on whether the district's student population is growing or shrinking.

The Florence School District illustrates how revenue limits have different effects depending on whether they are examined in terms of per student or total revenues. On a per student basis, the district's limit rose 5.4% per year, from $5,096 to $11,189. However, in this small northern Wisconsin district, student counts have been generally declining since 1997—its three-year average student count has fallen from 920 to 616. Dropping enrollments have tightened the total dollar value of the district's revenue limit. Since 1993, its total limit rose only 2.9% per year, from $4.5 million to $6.9 million. Thus, while it collects significantly more per student, its total revenue lags due to fewer students.

Districts with the largest and smallest increases in total dollar revenue limits are shown to the right in the table on page four. Among districts with the slowest revenue limit growth, average enrollments declined between 17% and 44% from 1993 to 2008. Among those with the largest increases, enrollments rose between 27% and 125%.

Declining enrollment has become more widespread since 2000. The impact shows in district revenue limit totals. Eleven districts had 2008 revenue limits below their 2000 levels. Another 11 were below their 2004 limits.

While these districts have more to spend per student, their total budget is shrinking. And fewer students does not translate proportionally to fewer staff or lower transportation costs. Other district costs, like utilities and maintenance, are not related to student counts. Thus, these districts have to find areas to reduce expenditures as their revenues slow, or they must ask taxpayers for more money via referendum.

Successful Referenda and Revenue Limits
No. and Amount ($ mill.) of Referenda Included in Rev. Limit Totals

	Recurring		Nonrecurring		Total as
	No.	Amt.	No.	Amt.	% of R.L.
94	2	$0.21	0	$0.00	0.0%
95	6	1.41	0	0.00	0.0
96	8	1.52	5	0.60	0.0
97	23	6.40	7	0.61	0.1
98	34	10.17	15	2.73	0.2
99	52	18.61	14	2.59	0.4
00	63	22.28	19	9.76	0.5
01	81	28.38	34	18.03	0.7
02	104	39.56	39	26.33	1.0
03	116	50.86	36	27.37	1.1
04	121	53.88	36	39.91	1.3
05	131	57.19	36	31.92	1.2
06	146	66.09	46	35.32	1.3
07	157	70.96	61	46.66	1.5
08	173	78.27	78	57.27	1.7

In 2008, successful referenda added $135.5 million to district limits, or 1.7% of the total.

Referenda

Districts that face a combination of rising costs and slow-growing revenue limits can ask voters for approval to exceed the caps. The table above shows the number and dollar amount of successful revenue cap referenda included in the cap figures for each year. These are not necessarily the number of referenda passed.

For example, in 2000, Greendale voted to exceed the caps on a nonrecurring basis by $550,000 for 2001 through 2004. Citizens voted again in 2004 to exceed the caps by the same amount for 2005 through 2010. Thus, despite only two referenda, the $550,000 is counted for each year from 2001 through 2008.

Growth in a district's total revenue limit is affected largely by changes in enrollment.

Since 1994, more than 170 recurring referenda, totalling $78.3 million, have been approved. Districts have also passed nonrecurring, or temporary, referenda. The number of referenda in effect in any one year has ranged from zero in the first two years to 78 totalling $57.3 million in 2008. Total referenda dollars accounted for 1.7% of the statewide revenue limit total in 2008.

NATIONAL COMPARISONS

Revenue or spending caps on schools are not unique to Wisconsin. According to the Education Commission of the States, Wisconsin is one of 41 states that limits school spending or revenues.

As has been shown, Wisconsin's revenue limit law slowed the growth in school spending here. Since 1993, per student spending in-

creases here have lagged the nation, yet Wisconsin remains a relatively high-spending state.

Figures from the U.S. Census Bureau show that, nationally, school spending climbed 4.4% per year from 1993 through 2006. Wisconsin spending rose 4.1% per year, or 37th highest.

Despite the below-average growth, the Badger State's national rank changed little. In 1993, Wisconsin was 13th in per student spending; in 2006, 15th. At $9,970 per student, Wisconsin's 2006 spending was 9.1% above the U.S. average.

The QEO, like the revenue limit law, was a reaction to rapidly rising compensation and property taxes.

THE QEO

The QEO law, like the revenue limit law, was part of the 1993-95 state budget and was a reaction to rapidly rising compensation and property taxes. The chart below shows, leading up to 1994, average teacher compensation packages increased an average of 7.5% per year. With total revenue limits slated to rise between 3% and 4%, increases of this magnitude would have been unsustainable for school districts.

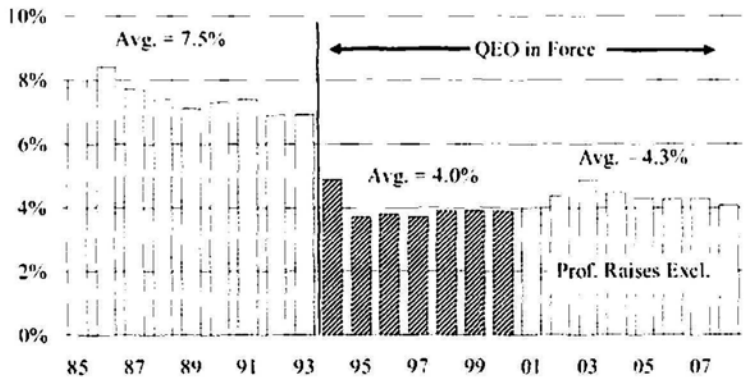
The QEO formula, like other parts of Wisconsin school finance law, is somewhat complex. At its most basic, it means that, if a district and its teachers cannot agree on a contract, total teacher compensation (salaries and benefits) must increase 3.8%. The district cannot impose a contract with a larger or smaller increase.

While average teacher salaries are below the U.S. average, total compensation remains above.

Under the QEO, benefits are given a higher priority than salaries. The QEO must leave benefits (including co-pays and employer share of costs) unchanged. Thus, when benefit costs are rising rapidly, imposing the QEO will lead to small salary increases.

Originally, all teacher salaries were counted under the QEO. However, a 1999 change to state law removed salary increases due to promotion or additional professional qualifications (e.g., master's degree). This meant that, even when the QEO was imposed, compensation costs would rise more than the statutory 3.8%.

QEO Law Limits Teacher Compensation Increases
% Change in Teacher Settlements, 1984-85 Through 2007-08



Effects

Slowing the Increases. The QEO law has had several effects. First, it slowed the growth in compensation costs, as it was designed to do (see chart below). During its first seven years, the law limited compensation increases to an average of 4.0% per year. In the most recent eight years, increases have averaged 4.3%, due partly to the 1999 law change already discussed.

Second, when the QEO law is combined with recent double-digit increases in health insurance costs, there is little new money for teacher salaries, and their growth has slowed. According to national figures, average Wisconsin teacher salaries increased 5.1% per year from 1985 through 1993. Since then, they have grown 2.0% per year.

Part of this slowdown is due to the QEO. But part is also due to the retirement of more experienced teachers and their replacement with younger staff at lower salaries. In 1994, about two-thirds of Wisconsin teachers had 10 or more years of experience, and only 9.1% had less than three. By 2004, 57.2% had been teaching for 10 or more years, and 13.1% had less than three years of experience.

Average teacher salaries here have fallen from about 4% above the national average prior to the QEO to 6.2% below in 2008. Total compensation (salaries plus benefits) remains above the U.S. average due to the high level and rapid increase in benefit costs.

Squeezing Budgets? The final impact has been the recent effect on district budgets. From their inception through 2000-01, statewide revenue limit totals rose an average of 4.8% per year, while teacher settlements climbed 4.0% annually (see chart on page seven). With compensation growing less than allowable revenues, school budgets were generally not under pressure.

However, during the most recent seven years, with enrollments declining and compensation cost growing faster, school budgets began to be squeezed. From 2001 through 2008, revenue limit totals rose an average of 3.6% per year. At the same time, teacher settlement costs were up 4.4% annually. Part of the increase in compensation costs was due to the relaxing of the QEO, as previously mentioned. A second factor was that some districts voluntarily agreed

to increases in compensation that exceeded the QEO.

With compensation costs rising faster than overall revenues in recent years, districts have faced several choices. First, the gap could be offset by slower growth in spending on items other than compensation (books, computers, equipment, maintenance, etc). Second, districts could turn to sources other than the property tax and state general aid (fees, federal dollars, or state categorical aids). Third, districts could ask voters to increase their limits by referendum. Finally, they could reduce staff.

LONG-TERM VIABILITY?

Revenue limits have been effective at limiting school property tax increases. But what do they mean for the long-term viability of school districts, particularly those with declining enrollments?

In general, districts with growing enrollments struggle less with the caps than those with declining student numbers. Districts with more students each year enjoy increases in their limits that are above average.

Declining-Enrollment Districts

Declining-enrollment districts face difficult decisions as their revenues grow slowly or even fall. Unless districts reduce staff at the same rate as the decline in students, personnel costs will account for an increasing share of district spending.

Districts also have fixed costs over which they do not have full control. For example, even with declining enrollment, the number of miles district buses must travel is essentially unchanged. School buildings are still heated. And rising fuel costs can mean these expenditures take an increasing share of the budget.

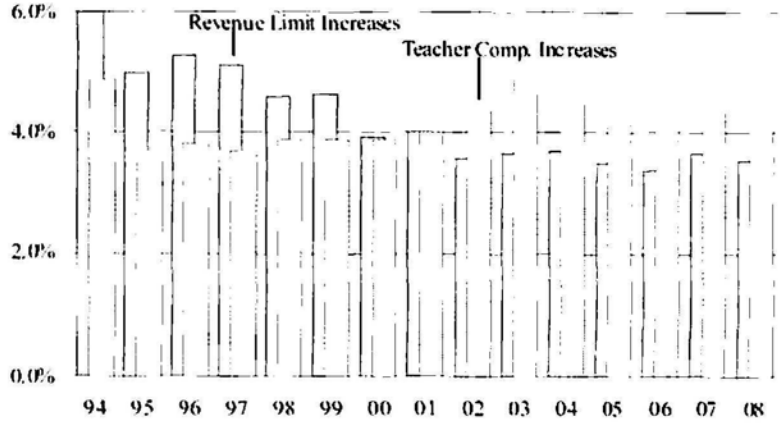
Many districts, through the bargaining process, have promised to continue paying health or other benefits for teachers or other staff after they retire. As health costs have risen and increasing numbers of staff have retired, these so-called legacy costs have grown.

For a district with fewer students and slow-growing revenues, legacy costs can consume an ever-larger share of the budget, leaving fewer dollars for the classroom. The revenue limit law forces these districts to make difficult spending decisions, or to seek additional revenues via referendum.

State or Local Control?

The focus of this article has been on state revenue and compensation limits. As such, it might leave the impression that districts with shrinking student populations would have no budget problems if there were no state-imposed limits. However, even without revenue limits, many declining enrollment districts would be forced to make difficult budget decisions. With fewer students, districts would face trade-offs between the levels of staff and programs, and rising property taxes. Eventually, with higher property taxes and falling student numbers, public demand for spending reductions that reflect lower student numbers would likely increase.

Compensation Changes Below, Then Above Revenue Limits
% Change in Teacher Settlements and Revenue Limits, 1993-94 Through 2007-08



In the end, the debate over state-imposed limits on school districts is one of control and timing. In a state where the school-aged population will virtually stagnate over the next 20 years, some districts are going to lose students and will eventually face fiscal problems requiring "right-sizing." Should the state be involved in accelerating that day, effectively forcing districts to deal incrementally with falling student counts as they occur? Or should that decision be left to citizens in each school district to decide without state law—on their own schedule and in their own way? □

The debate over state-imposed limits on school districts is really one of control and timing.

Other Government Revenue Limits

School districts are not the only Wisconsin local governments with a limit on revenues or expenditures. Technical colleges and counties have tax rate limits. Wisconsin technical colleges cannot levy an operating (excluding debt service) tax rate of more than $1.50 per $1,000 of equalized property value. County operating tax rates cannot exceed their 1992-93 levels.

Municipalities and counties have also faced levy limits since 2005. With certain exceptions, they cannot increase their levy more than the percentage change in new construction. For 2007-08, if that percentage was less than 3.86%, counties and municipalities could raise the levy by 3.86%. For 2008-09, that percentage is reduced to 2%.