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Living Costs and Taxes in Wisconsin

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The cost of living and the cost of doing business are both important to the competitiveness of an economic region. Taxes are an important part of those costs.

In Wisconsin, taxes levied directly on businesses are low. The biggest contributor to this low ranking is the property tax. Because of the uniformity provision in the Wisconsin Constitution, business property in Wisconsin is assessed at the same rate as household property. In surrounding states, business property is assessed at much higher rates than household property, and, hence, the property tax levy is much higher on businesses in surrounding states than it is in Wisconsin despite our higher mill rates. Some other business taxes are also lower in Wisconsin than in surrounding states. On an overall basis, a Chicago Federal Reserve report concluded, Wisconsin had the lowest business taxes in the Midwest.

Personal taxes, on the other hand, are high in Wisconsin. Personal taxes are part of a household's cost of living and therefore affect the ability of Wisconsin to attract employees.

The total of all taxes and fees Wisconsin businesses and residents pay to all of Wisconsin's state and local taxing entities is about 16.5 percent of personal income. This is about 10 percent higher than the national average of 15 percent. (These numbers fluctuate from year to year.) Placed in perspective, the difference is about one-and-a-half cents on the dollar.

The biggest component of a household's cost of living is not taxes but housing. Housing costs vary greatly by location, even within a single metropolitan area. A rough perspective on how taxes and housing affect regional cost differentials is to think that taxes vary by at most a few pennies on the dollar, while housing costs vary by a few dimes.

The best measure of how overall living costs vary from city to city is published by the American Chamber of Commerce Researchers Association, which does not publish statewide averages. Using 100 as the average cost of living of all cities, Manhattan (the highest cost city) has a cost of 218.5, and San Francisco has a cost of 183. Paris, Texas, (the lowest) has a cost of 83.7. In the Midwest, Milwaukee-Waukesha has a cost of living of 101.5, Minneapolis-St. Paul-Bloomington has a cost of living of 110.7, and Chicago has a cost of living of 130.4. (Note that these costs do not include taxes. All cities do not report in all years. The most recently available number is used for each city. The New York City and San Francisco numbers are for

2004; the rest are for 2002.) Of relevance to Wisconsin readers, a reduction in Milwaukee's tax burden by a penny and a half on the dollar would improve its cost of living advantage over its near neighbors, but not by much. Milwaukee's cost of living advantage is already quite high.

The differentials among cities are so large that one is forced to conclude that factors other than living costs dominate location decisions, especially those made by young college graduates who seem to be migrating from low-cost areas to high-cost areas. Migration patterns drawn from Census data are reported in the Competitive Wisconsin paper "Migration to and from Wisconsin" by Yeri Lopez and John Karl Scholz and in the report on the Wisconsin Alumni Association survey of graduates of the University of Wisconsin-Madison. These studies indicate that many of Wisconsin's young college graduates are choosing to live in Chicago and Minneapolis rather than in Milwaukee despite the higher cost of living. A change in the local tax burden of a penny or two on the dollar is unlikely to change these decisions and would not change the relative rankings of Milwaukee and its regional competitors.

Cities with large and growing groups of affluent residents have high housing costs. Indeed housing costs are probably high because of the in-migration of highly educated high-income people.

Wisconsin has traditionally been more attractive to the married-with-children group than to the young singles. The Lopez-Scholz paper shows that Wisconsin has out-migration of young (22-29) college educated workers and in-migration of somewhat older (30-49) college educated workers. It is well known that singles aged 20-29 look for different amenities than married 40-year-olds. In the 1995-2000 period, Wisconsin had a net outmigration of 7,000 people with college degrees.

When young college graduates choose where to live, job choice is paramount, but many also find the feeling of Denver, San Francisco or New York to be attractive. When the Wisconsin Alumni Association asked them which factor dominated their choice of where to live, they responded employment opportunity was the main influence. Less than one-tenth of a percent said that they had moved because of taxes. Somewhat surprising is that these young graduates chose to move to cities with high costs of living.

Marrieds with family may care a lot about living costs, especially housing, but they also care about taxes, commuting time, crime rates and the quality of schools. In many states, the schools are so bad that affluent professionals choose to send their children to private schools. This is much less common in Wisconsin, and if private school costs are included as part of the cost of living, Wisconsin's cost advantage becomes even greater than reported above.

The non-economic factors that affect location decisions are often grouped under the heading “Quality of Life.” Regional economists call these factors “Amenities.” Quality of life is an important attractor for a labor force. Most components of the quality of life are difficult to measure, and most are not measured. Moreover, the importance of these factors varies from person to person regardless of age. To some, quality of life is climate, the Packers and golf, while to others it is the urban environment with its restaurants, shops, arts and interest groups.

Conclusions

The cost of living including taxes probably has a substantial effect on migration decisions, though we find many of the youngest highly educated, high-income people choosing to move to the highest cost locations. The cost of housing as a percent of income varies enormously from place to place, especially when compared to the small variations in taxes as a percent of income.

Within Wisconsin, young educated people migrate from low-cost rural areas to high-cost urban areas. Within the northern United States, the migration is from rural states to states with large urban centers.

The Lopez-Scholz paper reports that Wisconsin has fared better than many other Midwest states in attracting college educated migrants. Illinois and Minnesota were the big gainers in the migration of college-educated individuals in the 1995 to 2000 period, while Indiana, Iowa and Ohio were the big losers. Michigan and Wisconsin roughly broke even. Taxes do not seem to be correlated with migration decisions.

A Technical Note on Comparing Income and Living Costs Across States

The most widely used measure of income at the state level is average personal income, also known as personal income per capita. Wisconsin’s average personal income, unadjusted for living cost differentials, has been about 3 percent below the national average in recent years.

This measure could be improved for cross-state comparisons by adjusting it for differences in the cost of living. The adjustment would lead to a measure that economists call “real personal income.” Real personal income would be a measure of the volume of goods and services that could be bought with the reported levels of personal income. There are no statewide measures of living costs that can be used to generate comparisons of real personal income across states, which is unfortunate because these costs of living vary widely.

While Wisconsin's income shortfall has been widely cited, differences in living costs could easily undo the result and might lead to the conclusion that the standard of living in Wisconsin is higher than the national average.

The Bureau of Labor Statistics, which produces the Consumer Price Index (CPI), has always argued that it would be impossible to create statewide measures of the CPI that would be suitable for cross-state comparisons. The CPI is a weighted average of the prices of a given basket of goods and services where the weight assigned to each item in the basket equals the percent of income that consumers spent on it in a base period. As the prices of the various items change, the change in the average of all the prices is claimed to be the change in the cost of living. In this way, the CPI provides a good measure of year-to-year changes in the national cost of living for a fixed basket of goods and services.

Despite its aversion to the publication of regional indexes, the Bureau of Labor Statistics does provide regional estimates of inflation. These are sometimes confused with regional estimates of the cost of living. The Bureau of Labor Statistics publishes estimates of changes in the CPI for many large cities. To do this, it publishes a price index for each city. But these indexes do not report differences in costs among cities. This is because each metropolitan index has an identical value of 100 in the same base year, and the practice of giving these indexes the same starting point ignores any differences in cost that might have existed in that year. This practice negates the possibility of using the indexes to compare living costs across cities.

The main reason the Bureau of Labor Statistics resists requests to publish regional cost-of-living indexes is that different baskets of goods are consumed in different parts of the country. Heating costs are higher in the North, for example. Regional spending patterns differ in other ways as well, so it would be inappropriate to price the same basket in different states. But if different baskets were to be used in different states, then what would cross-state comparisons mean?

While the Bureau of Labor Statistics has sound technical reasons for not publishing regional costs of living, there is a huge demand for such information on the part of the public. The American Chambers of Commerce Researchers Association (ACCRA) has stepped into this void. It computes and publishes a local cost of living for any metropolitan Chamber of Commerce that chooses to participate in its program. These local chapters are required to submit to the national association the local prices of a long list of goods and services, and the national association computes a price for each city of its fixed basket of goods and services.

The final product is a set of estimates of local costs of living that are very useful for rough comparisons but that do not avoid the problems the Bureau of Labor Statistics cites and hence cannot be viewed as precise. These are called the ACCRA indexes because the American Chambers of Commerce Researchers Association is the

publisher. The ACCRA indexes are proprietary and available for a fee, and so the ACCRA data are not reproduced here.

Because the ACCRA indexes report the cost of living in metropolitan areas only, there are no statewide indexes for cross-state comparisons. Moreover, there are no ACCRA indexes for rural areas, nor is there an accurate way to add up the local ACCRA indexes to create a statewide average.

My view is that because real estate prices are so much lower in Wisconsin than on the far richer coasts, the 3 percent gap between Wisconsin's average personal income and income in the nation as a whole is an overestimate of the difference in real personal income. Unfortunately, we do not know by how much.