



What's Passed Is Prologue: Looking ahead to 2013-15 Lawmakers Shouldn't Count on a Significant Balance in the Next Budget

The Legislative Fiscal Bureau (LFB) calculated in early July that the deep cuts in the 2011-13 budget put Wisconsin in a position to go into the next biennium in the black – with an estimated structural balance of about \$300 million in the 2013-15 budget. That good news is tempered by a careful examination of the assumptions and caveats in the [July 5th LFB memo](#) and a sober assessment of the economic and political realities that will affect the state budget.

This paper examines how the recently enacted budget bill managed to create a structural balance in the 2013-15 biennium, and it outlines some of the economic and political developments that could push Wisconsin's long-term budget outlook back into the red.

The Fiscal Bureau's Calculations

After a budget bill is enacted, the LFB generally performs a set of calculations that compute the underlying fiscal health of the state's General Fund in the next biennium. This exercise assumes that the 2nd year spending and revenue figures will remain the same in the next biennium (or will grow by the same amount). The only changes in revenue or spending that it accounts for are those that have already been enacted.

For well over a decade, this exercise has shown that there will be a large "structural imbalance" in the next biennium, which means that policy-makers will begin the next budget in a deep hole. Fortunately, that is not currently the prognosis for the next biennium. According to the July 5th LFB memo, the budget bill puts the state in a position to have a balance of \$292 million in the 2013-15 biennium, assuming current revenue and spending projections hold up. (That figure also accounts for other budget-related bills adopted this year.)

The LFB memo has been misconstrued by some to mean that Wisconsin will have a healthy budget balance at the end of the current biennium, which is not the case. The estimated closing balance at

the end of June 2013 is just \$9 million above the minimum required reserve of \$65 million.

Factors that result in a positive structural balance

Balancing the budget was achieved by making deep cuts relative to the spending needed to maintain current programs. Those cuts, coupled with a modest increase in projected tax collections when the LFB revised its revenue estimates in late May, brought General Fund revenue and spending into line in fiscal year 2012-13.

Getting those figures in line and making only modest use of short term remedies to balance the budget are the keys to eliminating the state's long-running structural imbalance. However, there are also a number of other factors that help explain the projected balance in 2013-15:

1. *Assuming the state estate tax resumes* – Much of the projected \$292 million structural balance can be attributed to the assumption that Wisconsin's estate tax will be restored in 2013 and will generate \$219 million in the next biennium. That assumption is based on current federal law, but it's a law that is virtually certain to be changed, and there is almost no chance the state will see that \$219 million.

2. *Sunsetting two spending measures* – Another significant factor in the LFB calculation is that a couple of spending measures are slated to end in the 2013-15 biennium. The budget says that a \$102 million per year General Fund transfer to the Department of Transportation won't be continued, and a \$42 million boost in school aid in 2012-13 won't be renewed. Those assumptions improve the projected balance by \$288 million in 2013-15.

3. *Cutting the Earned Income Tax Credit* – The Recovery Act made changes to the federal Earned Income Tax Credit, and those enhancements are set to expire in 2013. As a result, spending for the state EITC, which is linked to the federal credit, is expected to drop by \$32 million in 2013-15.

4. Delayed Increase in the Reserve Funds – In addition to those factors, another key reason why the state budget is projected to have a surplus in 2013-15 is that the budget bill delays until fiscal year 2015-16 the plan to increase the minimum statutory reserve to 2 percent of gross state appropriations. That change, which had previously been slated to go into effect in 2013-14, would increase the state's very slim reserve requirement (now just \$65 million) by roughly \$250 million, and would have subtracted that amount from the state's structural balance in the 2013-15 biennium.

5. Delayed Tax Cuts – Another significant factor in holding down the state's structural deficit is that some of the new tax cuts are phased in fairly slowly. The tax cuts enacted this year cost about \$210 million in the current biennium, and their growth in the 2013-15 lowers the structural balance by \$132 million. Continued growth brings the ten-year cost to more than \$2.3 billion.

A factor that helped balance the current budget, while adding to the state's fiscal challenges, is that the budget repair and budget bills authorize a record level of restructured debt. The bond restructuring applies a credit card approach to government financing – sharply reducing spending in 2011-12, but raising costs over the longer haul. Principal and interest costs jump dramatically in the second year of the biennium and then grow by another \$46 million in 2013-15 (measured relative to the 2012-13 appropriation times two). The increased cost will remain at about that level through 2017-18, before gradually declining.

Threats to the projected balance

The good news of a projected structural balance in 2013-15 could be fleeting. A number of factors will cut into the anticipated black ink and could put the projections back into the red. Some of those factors are apparent through a close reading of the caveats in the LFB memo; whereas others relate to subsequent political developments and economic trends.

1. The estate tax – Congress will have to reach a compromise to continue the federal estate tax. None of the compromises that have any chance of passing would bring back state estate taxes structured like Wisconsin's, which are subtracted from the amount owed for the federal estate tax. If/when federal law is changed to keep that type of state estate tax from returning, Wisconsin's projected balance will fall by \$219 million.

2. Reduced federal spending – Cuts being made in the federal budget will almost certainly result in reductions in aid to states and local governments.

The state isn't obligated to fill the holes that are likely to result, but federal cuts would create significant fiscal challenges for Wisconsin, such as making it more difficult not to continue state spending for transportation and education that is currently slated to sunset in 2013-15.

3. The economic slowdown – The revenue and spending estimates in the budget bill were based on assumptions of economic growth that are starting to look overly optimistic. For instance, the tax revenue projections assumed Wisconsin personal income and GDP growth averaging 4.5% per year in 2011, 2012 and 2013. The Fiscal Bureau has a great record of estimating tax revenue, and it's much too soon to revisit the LFB's May projections, but economic trends now look quite a bit weaker than they did back in May. Preliminary tax collection figures for 2010-11 recently released by the Department of Revenue indicate a \$13 million shortfall over the last two months of fiscal year 2010-11, which cuts into the slim budget balance and hints at the possibility of deeper revenue shortfalls in the current biennium.

Conclusion

The Fiscal Bureau's calculation that Wisconsin will have a structural balance in the 2013-15 budget was good news because getting revenue and spending in balance creates a firmer foundation for the next budget, and that development provides some consolation for the deep cuts in the budget bill. However, the picture for the next biennium is less rosy than some lawmakers have suggested.

Although the LFB must base its calculation of the structural balance on laws now in place, including one that would restore the state estate tax in 2013, there's virtually no chance that law will take effect and will generate the assumed \$219 million in estate taxes in 2013-15. The bill also assumes spending cuts in the next biennium that aren't necessarily a given. In addition, the projected balance in the next biennium would be about \$250 million less if the budget bill hadn't postponed a long-overdue increase in the reserve requirement.

Legislators who are anxious to use the projected balance for new tax breaks or restoration of some of the spending cuts are counting chickens a couple of years before the eggs have hatched. In light of the bad economic news of the last couple of months, plus the factors noted above about how the projected balance was achieved, it's premature to count on having a budget that is well in the black in 2013-15.

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