



The State of the State Budget

Budget and Economic Trends Point to Continuing Challenges

As Wisconsin prepares to begin deliberations on a new budget, this is an appropriate time to examine the state's current fiscal situation and the challenges and opportunities that will face our state over the next couple of years. Although there are a few positive developments to point to, most signs suggest that state lawmakers will once again be grappling with a substantial gap between projected revenue and the funding needed to adequately cover proposals in areas like education, health care, local aid and infrastructure investments.

New revenue and spending projections will be released by the Legislative Fiscal Bureau in late January and will tell us what state budget writers are going to have to contend with. In the meantime, we can glean a lot from the trends that will have a significant role in shaping budget deliberations.

STATE TAX COLLECTIONS ARE MISSING THE MARK

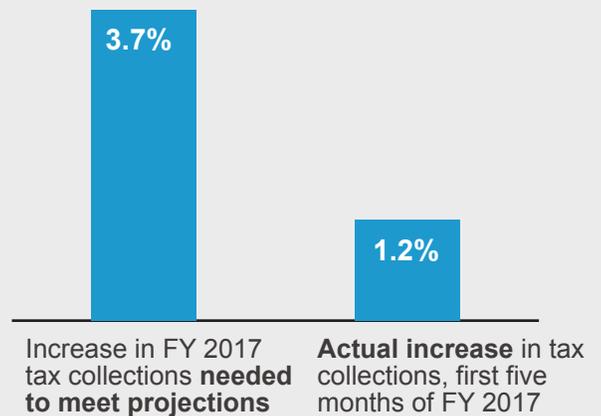
The anticipated gap between spending needs and available revenue results in part from past tax cuts and also because state tax collections have been well below the anticipated amounts. Tax revenue fell \$78 million short of the projected amount in the 2015-16 fiscal year, and that trend seems to be continuing in the second half of the biennium.

The state needs 3.7% tax growth this year to reach the revenue level projected by the Legislative Fiscal Bureau (LFB) last January, but tax collections grew by only 1.2% during the first five months of the fiscal year. That gap creates a risk that corrective actions such as deeper spending cuts or delayed payments will be needed to keep this year's budget in balance. But even if that isn't necessary, the slow revenue growth this year suggests that there is likely to be a downward revision in the revenue projections for the upcoming biennial budget.

If the state cannot meet its revenue projections, many of the proposals from the Governor and legislators will have little chance of approval. There will be inadequate revenue to increase support for things like K-12 education, financial relief for UW students, and local transportation aid, without reducing support for other government services even further.

Tax Collections Miss the Mark

In order to meet projections for 2017, state tax collections need to grow by 3.7% over last year's level. For the first five months of this year, however, collections only grew by 1.2%.



Source: Analysis of figures from Legislative Fiscal Bureau
WISCONSIN BUDGET PROJECT

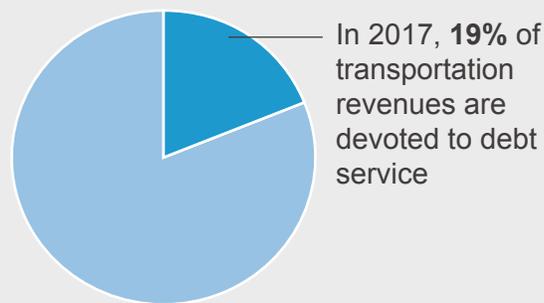
TRANSPORTATION FUND SHORTFALL APPROACHES \$1 BILLION

After years of borrowing to plug holes in the transportation fund, the legislature now faces very tough choices

relating to the state’s transportation system. The recent [Transportation Solvency Study](#) by the Wisconsin Department of Transportation found that even after efficiencies and savings, the state’s transportation funding needs exceed available revenues by an estimated [\\$939 million for the next biennium](#).

Even with modest increases in the budget, road and highway conditions in the state will continue to deteriorate, major highway projects will be delayed, and highway system management, local road and bridge programs, and harbors programs would all face deficits in the short term. Opposition to increasing the gas tax and transportation-related fees may cause policymakers to once again increase bonding – even though debt service is already nearly 20% of the DOT budget – or to siphon more revenue for transportation from the General Fund.

Nearly a Fifth of Transportation Revenues Go To Debt Service Costs



Source: Wisconsin Department of Transportation
WISCONSIN BUDGET PROJECT

MEDICAID BALANCE EXPECTED TO EXCEED \$300 MILLION

One bit of positive news for state budget writers is that Medicaid spending is far below the anticipated level, which reduces the risk that the current state budget will go into the red. [Recently released spending estimates](#) indicate that the Department of Health Services (DHS) now projects that the state share of Medicaid expenditures during the current biennial budget period will be \$312.5 million below the budgeted amount.

A number of factors have contributed to that 5.5% drop in the projected spending, including lower-than-expected participation in Medicaid and BadgerCare, and lower-than-anticipated costs per enrollee. BadgerCare enrollment was expected to grow in 2016, but it fell by 10,000 people over the course of the year. The substantial savings in the Medicaid budget not only mitigate the risk that this year’s budget will go into the red, they also reduce pressure to make Medicaid cuts in the 2017-19 budget.

BORROWING COSTS SHIFTED INTO FUTURE YEARS

Wisconsin’s general obligation debt has grown from \$6.0 billion in December 2006 to almost \$8.1 billion ten years later (according to the [Continuing Disclosure Annual Report](#) issued the Friday before Christmas). That represents an 18.3% increase when measured in inflation adjusted dollars. Debt service payments on the current general obligation debt are expected to be \$864 million in the 2017-18 fiscal year.

Some of the upcoming debt service charges, as well as the total debt amount, result from the Walker administration’s decision to refinance debt in [May 2016](#) and [February 2015](#). In both cases, current obligations were removed from balance sheet to be paid at a later date, which helped to keep the current budget in the black but has added to future debt service.

MEAGER STATE BUDGET RESERVES

During periods between recessions, state and local government bodies should increase their budget reserves, in order to be prepared for the next economic downturn. To the credit of state lawmakers, from 2011 to 2013 they

did add to the state’s extremely small rainy day fund. Boosting it to \$280 million over a three-year period was a long-overdue step toward fiscal responsibility. However, as a recent Wisconsin Taxpayers Alliance report noted, the state hasn’t added anything to that fund in the last three years, even as most other states have continued to expand their contingency funds.

In addition, Wisconsin hasn’t made any progress in building another type of reserve – the unrestricted state budget balance that is carried forward from one fiscal year to the next. In light of recent shortfalls in tax collections, it’s likely that the state will have almost no balance to carry forward into the next biennium. National experts recommend that states have budget reserves of at least five percent of annual spending, and preferably more than 10 percent. Wisconsin’s General Fund reserves at the end of the current fiscal year, including the rainy day fund, could be less than two percent of General Fund spending.

UW SYSTEM BALANCES DECLINE SHARPLY

In contrast to the short-term time horizon that has long been used at the state level, the UW System has historically been careful to set aside substantial reserves in order to guard against fiscal emergencies. However, the last two biennial budget bills have compelled UW System campuses to make large spending cuts, while also spending down their “unrestricted” funds to dangerous levels.

The National Association of College and University Business Officers (NACUBO) recommends reserve amounts of at least 25% of the unrestricted operating budget, enough to sustain operations for 3 months. However, about half the UW System campuses (Madison, LaCrosse, Platteville, River Falls, Oshkosh, Extension, Stevens Point, and Parkside) are now operating with reserves below three percent of their total operating budgets. As a whole, the UW System budget for 2015-16 was over \$5.6 billion, but reserves and discretionary funds totaled only about \$137 million, or 2.4%.

Governor Walker [is now proposing](#) to reduce tuition at UW schools, even after it has been frozen for several years, and has suggested that the state would make the UW schools whole for the loss of tuition. However, if the state is unable to come up with the money for this proposal, tapping reserves would not be a viable option to make up for the loss of tuition. Lower tuition would be another budget cut for campuses without adequate reserves.

Additionally, and notwithstanding the use of reserves, deep cuts in state funding have adversely affected national research rankings. In November 2016, the UW-Madison campus announced that its ranking for research activity has fallen from 4th to 6th nationally, and that its receipt of federal research awards has fallen from 12th to 14th. This is the first time UW-Madison fell out of the top five nationally since 1972.

DEMOGRAPHIC AND WORKFORCE TRENDS IMPEDE BUDGET HEALTH

One of the key factors holding back state revenue growth is that the state economy has been growing much slower than expected. Although Wisconsin enjoys an unemployment rate of just 4.1%, our state’s job growth has lagged well below the national average. The low jobless rate at a time of lackluster job growth stems from a combination of factors, including little population growth, an aging population, and a declining labor force participation rate.

Governor Walker recently announced an initiative to “get everybody in the game” when it comes to the workforce. The state’s ability to increase its labor force is limited to some extent by demographic trends and the

fact that our state is already among the top 10 in labor force participation and well above the national rate (68.4% vs. 62.6%, in November 2016).

Demographic factors have also suppressed growth in Wisconsin's workforce – particularly the fact that our state's population is older than that of much of the nation. In 2015, the median age in Wisconsin increased to 39.4, compared to 38.5 in 2010, and well above the national median of 37.8. Our state's median age in 2015 was tied with Massachusetts for 12th oldest, compared to 15th oldest five years earlier.

For Wisconsin to have a growing workforce with the skills to make us competitive well into the future, we need strong education systems and communities that will attract highly skilled workers, rather than continuing the trend of a state that is aging rapidly and losing well-educated young people to greener pastures. To encourage those who grow up in Wisconsin to remain here during their years of employment, we also need a focus on newer industries (not just manufacturing, agriculture, and extractive industries), a clean environment, and investments that once again leverage the value of having a top flight university system.

LOOKING AHEAD

Later this month, the Legislative Fiscal Bureau will release updated revenue and spending estimates for the current fiscal year, and new tax collection estimates for the 2017-19 budget period. Those figures will have a very important role in setting the parameters for the upcoming budget debate.

Although there have been a few bright spots one can point to, most indicators of economic and fiscal health suggest that the new revenue estimates will be revised downward from the projections released in November. If that's the case, state lawmakers will have to choose between a controversial set of options: making deeper spending cuts, increasing borrowing, raising taxes, or closing tax loopholes.

On the other hand, if the new revenue estimates improve, it won't be quite as difficult to pass a balanced budget that addresses some of the priority areas where more spending is badly needed. An improvement in the revenue outlook should also be used as an opportunity to think longer term and increase the state's inadequate budget reserves.

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