

No End in Sight: Wisconsin's Ongoing Fiscal Challenges

In the wake of all the cuts made in the biennial budget bill, it might be reasonable to anticipate we will soon turn the corner and can expect less difficult budgets ahead. However, the painful fiscal medicine that was administered to the 2003-05 budget did not cure the state's fundamental budget maladies. This paper examines the state's structural deficit in 2005-07 and also looks briefly at the possibility of further budget trimming even before we reach the next biennium.

Balancing the 2003-05 budget

If we were to use a children's story as a metaphor for the state's budget outlook, one possibility is the song "The Bear Went Over the Mountain." We all feel like we have climbed a mountain of pain in the process of balancing the 2003-05 budget. However, upon reaching the summit of that ordeal, we find that there is no end in sight to the state's budget challenges.

A major factor in the state's ongoing budget challenges is the fact that legislators and the Governor steered a course through the fiscal obstacles facing them by side-stepping many of the more painful decisions. They were caught between promises not to take the route of raising taxes and promises not to cut popular programs. Although they made many very substantial cuts in state-funded programs and agency operating budgets, those cuts are just a small fraction of what will be needed in the long run if the budget is to be balanced without raising taxes and/or a dramatic improvement in the state economy.

In other words, rather than scaling the mountain of difficult fiscal decisions, budget writers stuck to the foothills. That is not to diminish the hard and painful work in coming this far; however, lawmakers are far from

reaching a summit that brings us to an easier, downhill path for future budget writers.

In addition to the significant cuts made in the 2003-05 budget, the \$3.2 billion deficit was closed with numerous measures that are very short-term fixes. Some of the more significant of those include the following:

- One-time transfers totaling \$175 million from the Transportation Fund to the General Fund.
- Use of an additional \$400 million from the Transportation Fund in this biennium for Shared Revenue.
- \$333 million of one-time federal fiscal relief.
- \$284 million in increased federal Medicaid funding that, if it materializes, is likely to be one-time funding.
- Transferring about \$46 million from the utility public benefits fund, mostly on a one-time basis.
- Roughly \$145 million in other segregated or program revenue funds that are transferred or lapsed to the General Fund.
- A short-term savings of more than \$140 million by using bonding to finance pension and sick-leave obligations.
- \$28 million saved on a short-term basis by replacing the reserves in the Clean Water Fund with a surety bond.
- Reducing the statutory balance required at the end of the biennium (from \$235 million to \$45 million), which frees up \$190 million that will have to be restored in the 2005-07 budget.

Sizing up the structural deficit

Shortly after the Governor completed his budget vetoes and signed Act 33 into law, the

Legislative Fiscal Bureau (LFB) released a memo calculating the structural deficit the state faces going into the 2005-07 biennium. The LFB concluded that simply maintaining the 2004-05 spending levels in the following biennium, without any adjustments for inflation or increased caseloads, would require spending cuts or general purpose revenue (GPR) growth of \$203 million in 2005-06 and \$508 million in 2006-07. In other words, simply maintaining or freezing GPR spending commitments in the 2005-07 biennium would consume the first \$711 million in revenue growth produced by economic expansion in that biennium.

Obviously, a structural deficit of over \$700 million is a serious concern, but one needs to look more carefully at the budget to put that figure into context. A couple of arguments could be made to suggest that this future budget challenge is not so bad:

- *Revenue growth* – Given the size of the state budget, each one percent increase in state general fund tax collections produced by economic growth generates revenue growth of more than \$110 million per year. A 4 percent annual increase in 2005-07 would raise biennial tax collections by more than \$1.3 billion (roughly \$450 million in the first year and \$900 million the next year).
- *Improvement since 2002* – The LFB memo notes that when the Legislature wrapped up work on the 2001-03 budget, the structural deficit for 2003-05 was estimated at almost \$2.87 billion. Put in that context, the projected structural deficit for 2005-07 appears to be only about a fourth of what it was for this biennium.

Although the structural deficit problem is definitely reduced by Act 33, it is important to note several reasons why the LFB figures understate the extent of the problem:

- *School aids* – In past structural deficit calculations the LFB included the cost of maintaining the state's commitment to pay

two-thirds of public school costs – which added \$525 million to the deficit estimated for 2003-05. Now that the two-thirds commitment has been repealed, no growth in school aids spending is factored into the structural deficit estimate.

- *Assumed state operation cuts* – Late in the budget process, a couple of Republican Senators, Michael Ellis and Robert Cowles, announced that they would vote against the budget because of the size of the structural deficit. In an unsuccessful bid to mollify their concerns, GOP leaders came up with a strategy to reduce the structural deficit. They offered an amendment that simply mandates that the 2005-07 budget cut another \$100 million GPR in each year, on top of deep cuts already made in state operations in the last several budgets. On paper, that move reduces the structural deficit by \$200 million in the next biennium, but it does not reduce the amount of cutting that will be needed – it only tells the Governor and next Legislature where some of that cutting should be done. Although that amendment did not secure the votes of Senators Ellis and Cowles, it does obfuscate the size of the structural deficit.
- *Optimistic revenue assumptions* – The 2003-05 budget is based on rather optimistic tax growth projections that were made back in January 2003. It assumes general fund revenue growth of 5.1 percent in 2003-04 and 5.6 percent the next year. If tax collections in 2004-05 fall short of the projected level, and if other offsetting adjustments are not made in the budget for that year, the structural deficit for 2005-07 could grow considerably larger.

Another important consideration is that the LFB's structural deficit calculations are based just on the general fund budget. They

do not include similar fiscal problems, such as the structural deficit in the TANF budget. Act 33 spends almost \$50 million more from TANF in 2004-05 than the annual allocation.

Barring an increase in federal TANF funding levels, or a decrease in the need for TANF programs, the state will have at least a \$50 million per year hole in its TANF budget in 2005-07. That problem could be exacerbated if Congress requires states to use TANF funding for marriage promotion programs and does not provide any additional federal funds.

Shorter-term challenges?

One problem with looking ahead to the next biennium is that we are not out of the woods with respect to the current biennial budget. As noted above, Act 33 was balanced with the help of rather optimistic revenue growth projections that were made early in 2003, when it appeared that an economic recovery was closer at hand. The budget assumes that 5.1 and 5.6 percent tax growth over the next two years will generate a total of more than \$1.6 billion in increased general fund revenue in this biennium. Obviously, there is a possibility that the economic recovery will not produce such a robust increase in revenue and the state could face serious fiscal problems before the end of this fiscal year.

We have already seen some evidence of a slower recovery in state revenue. In late August the Department of Revenue released preliminary revenue collection figures for 2002-03. Those revenues fell \$24 million short of what the LFB had projected back in January. On the positive side, that amounts to only a 0.2% shortfall, which is considerably better than some of us feared. In addition, it represents a 1.8% increase over the depressed revenue collections in 2001-02. However, it also means that the state was starting this biennium with an even lower revenue base than had been anticipated in Act 33.

Another potential fiscal problem in the current biennium is that Act 33 assumes the state will receive about \$284 million in additional

federal Medicaid funds, as a result of a federal waiver or new inter-governmental transfer (IGT) funds. That appears at this point to be rather wishful thinking, which is why the Governor used his veto power to increase the budget's slim balance by about \$145 million. However, that amount falls well short of what might be needed for Medicaid, and there could be competing demands for the very modest amount of reserves.

Conclusion

Wisconsin has not completely turned the corner on its budget problems, though it has made some progress. Because the Legislature and Governor relied on many one-time revenue sources to balance the budget, the state once again has a significant structural deficit to contend with in the following biennial budget.

The Legislative Fiscal Bureau estimated that simply maintaining programs in the 2005-07 biennium at the budgeted level for 2004-05 would require \$711 million in increased revenue. That is a substantially smaller figure than the estimated structural deficit following completion of the previous budget, but a couple of changes made by the Legislature mask the magnitude of the challenges ahead.

A more imminent problem facing the state is making it through this biennium. Act 33 contains rather optimistic assumptions about general fund revenue growth and especially regarding increased federal funding for Medicaid. If either or both of those assumptions prove to be faulty, the Governor and Legislature may once again be confronted with difficult choices between cutting important and politically popular programs, such as Medicaid, or finding some way of raising state revenue.

Jon Peacock
Wisconsin Budget Project Director
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