

Estimating Wisconsin's Budget Problems: Are We Gazing Too Far into the Crystal Ball?

Over the last two weeks, the two major party candidates for Governor have engaged in a heated exchange over whether Governor McCallum is being too optimistic in assuming 5 percent revenue growth in the next biennium. The issue of what assumptions the candidates are making about the revenue available in the next budget is very important.

Yet the debate over the budget assumptions and possible remedies for the next biennium has skipped past a more imminent question: how will we get through the current fiscal year? The candidates have neglected to point out that Wisconsin's fiscal problems are likely to come to a head well before the start of the next biennial budget, on July 1, 2003. It is time to adjust the focus knob on our crystal ball.

The 2002 shortfall – When the Legislature finally wrapped up work on the “budget repair bill” in early July, it assumed the state would take in \$10.21 billion in fiscal year 2002 (which ended on June 30), followed by \$10.52 billion in the current fiscal year. Unfortunately, the state fell well short of the first target, and it could also have trouble reaching the second one.

The clearest indication of Wisconsin's growing fiscal trouble came on August 30 when the Department of Revenue (DOR) released the revenue collections for FY 2002. Unveiled the Friday afternoon before the Labor Day weekend, the report escaped public attention, but what it shows is very troubling. DOR reported that general fund tax collections fell short of previous projections by \$189 million, or 1.9 percent.

The department contends in its report that despite the dip in tax collections, the state would still meet the prior revenue projections for the 2001-03 biennium. However, that will be quite a challenge. Consider these facts:

- The previous projections by the Legislative Fiscal Bureau (LFB) assumed general fund taxes would grow just 3.0 percent this year – from \$10.21 billion in FY 2002 to \$10.52 billion in FY 2003.
- **For total biennial taxes to reach the previous projections, we now need revenue growth**

from \$10.02 billion last year to \$10.70 billion this year – growth of 6.8 percent.

- The economic assumptions contained in the August DOR report do not contain anything to suggest that tax revenue growth will approach 7 percent. However, on the positive side, recent DOR statements indicated that tax collections have been strong in the first two months of FY 2003.
- **If revenue grows 3 percent this year, from the reduced FY 2002 base, the state will finish this biennium about \$380 million short of the amounts assumed in the budget bill, and will also face a base for the next biennium that is \$193 million per year lower than previously expected.**

General Fund Taxes (billions)			
	FY 2002	FY 2003	% Change
LFB estimate of general fund taxes – used for Act 109	\$10.21	\$10.52	3.0%
Actual taxes (DOR – Aug. 2002)	\$10.02	?	?
Growth needed to meet the LFB's initial FY 2003 estimate.	\$10.02	\$10.52	4.9%
Growth needed to offset the 2002 shortfall by the end of the biennium	\$10.02	\$10.70	6.8%

Complications in 2003 – In addition to the shortfall in FY 2002 revenue, a number of other factors could make balancing the next budget far more challenging than the candidates have generally acknowledged. A couple of those factors will complicate the task of getting through the current fiscal year:

- *A Medicaid Shortfall* – The recession has driven Medicaid (MA) caseloads far higher over the last year. Although the budget adjustment bill added MA funding, it provided significantly less than the LFB estimated last spring would be needed for increased caseloads. **The 2003-05 budget request of the Department of Health and Family Services acknowledges the MA budget will be short by \$60 million in the current fiscal year.**
- *Other Spending Pressure* – Some other programs are also likely to run short of funds. The clearest example is the Department of Natural Resources’ request of \$13 million for work relating to chronic wasting disease.

To avoid being alarmist, let’s assume that the state does collect \$10.52 billion in general fund tax revenue this year, as the LFB previously projected. That now requires almost 5 percent growth. **Making that rather optimistic revenue assumption, and factoring in the \$60 million Medicaid shortfall, Wisconsin would be short about \$249 million for the current biennium.** Under that scenario, the state would have to use all of its revenue balance by the end of this fiscal year and probably delay some payments into the next biennium.

If we assume a less optimistic growth rate of 3 percent this year, the FY 2003 shortfall will be even larger, and the structural deficit will be much greater. The gloomy implications of that scenario, coupled with the MA shortfall, are shown in the lower half of the table on the right.

In light of recent pronouncements by the DOR that sales tax collections and income tax withholding have been strong over the first couple months of FY 2003, perhaps Wisconsin can achieve growth of 5 percent or more this year, despite all the bad economic news nationally. Nevertheless, it seems unlikely that revenue will grow enough this year to

offset both the \$189 million revenue shortfall last year and this year’s Medicaid shortfall.

Structural Deficit Scenarios (billions of \$s)				
Scenario:	FY 2003 Rev.	FY 2004 deficit	FY 2005 deficit	2003-2005 deficit
Revenue snaps back in FY 2003 to LFB’s estimate (5% growth)	\$10.52	\$1.65	\$1.59	\$3.24
Revenue grows 3%, as the LFB estimated, but from the reduced base	\$10.32	\$1.84	\$1.78	\$3.62

Conclusion

The figures released in late August by the Department of Revenue indicate that the state is already \$189 million deeper in the hole than we had previously expected. Although the department suggests that we can make up that shortfall in the current fiscal year, a careful review of the figures and assumptions in that DOR report make it appear unlikely that we will achieve the 6.8 percent revenue growth needed this year to make that happen.

The rapidly growing Medicaid caseload will further increase the structural deficit. Without even factoring in the program’s increasing cost in the next biennium – we will need \$60 million more each year to remedy the underfunding of Medicaid in the budget repair bill.

If tax revenues do snap back to the \$10.5 billion target the LFB estimated back in January (which now requires 4.9% growth), Wisconsin would still need more than \$1.6 billion in the first year of the next biennium to maintain its current budget commitments. **That optimistic scenario still leaves a shortfall next year amounting to 16 percent of the general fund budget.**

The state will have to address the structural deficit by some combination of deep cuts in programs or significant increases in taxes and fees. Unfortunately, the political debate has largely sidestepped the extent of the problem and the difficulty of the solutions.