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Another Brutal Budget Brewing

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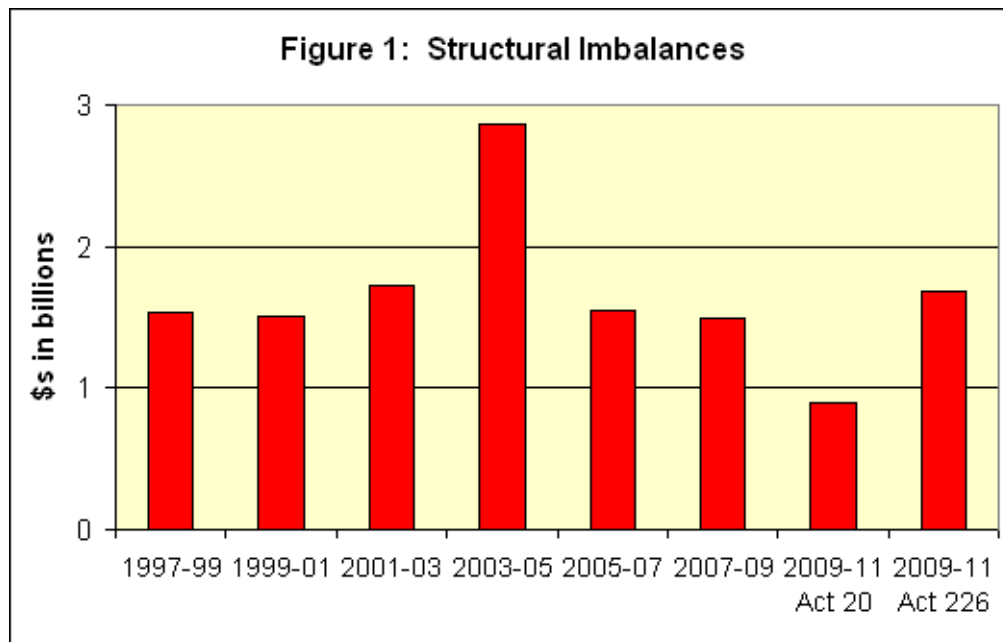
The 2009-11 biennial budget is shaping up to be another extremely difficult one for lawmakers. The last budget was precariously balanced and employed many short-term remedies that create a very large fiscal problem for Governor Doyle and the next legislature to tackle in 2009. Subsequent developments are compounding the problem.

This article looks at the magnitude of the structural deficit, the factors making it worse, and the implications for the next biennium.

The structural “imbalance” – \$2 billion plus

After each budget is passed, the Legislative Fiscal Bureau (LFB) calculates something referred to as the “structural imbalance.” That figure represents the amount of general fund revenue growth needed in the next biennial budget just to maintain spending at current levels. It’s a calculation that takes into account delayed tax cuts and phased-in spending increases, but it does not make any spending adjustments to reflect things like caseload growth or inflation.

As Figure 1 illustrates, Wisconsin has faced very large structural imbalances for more than a decade. Governor Doyle and the legislature were slowly chipping away at the deficit and seemed to be making progress when they passed the 2007-09 budget bill (Act 20). After it was enacted, the LFB estimated that the structural imbalance would be \$896 million for the 2009-11 biennium, compared to \$1.5 billion for the previous biennium.



Unfortunately, the ink on the biennial budget bill had barely dried when the current economic slowdown began to cut into state revenue growth, and by February 2008 the State Budget Office and LFB projected a deficit in the current biennium of about \$650 million. That led to the enactment of a budget adjustment bill in the spring that made some significant cuts, but which also used gimmicks to push much of the deficit into the next biennium. As Table 1 shows, the economic slowdown and the actions taken in the budget adjustment bill increased the structural imbalance to \$1.7 billion.

Table 1: Estimates of the Structural Imbalance in the 2009-11 Biennium

Date	Estimate	Reason for new estimate	Source
Nov. 2007	\$0.9 billion	Enactment of biennial budget	LFB
May 2008	\$1.7 billion	Enactment of budget adjustment bill	LFB
July 2008	\$2.0 billion	Loss of revenue caused by <i>Menasha</i> decision	WCCF

Wisconsin's fiscal problems got even worse in July when the Wisconsin Supreme Court issued a ruling in the *Menasha* case, which created a large new tax break for certain corporations. That ruling adds about \$300 million to the structural imbalance, raising it to approximately \$2 billion.

Generating \$2 billion in the next biennium would require general purpose revenue (GPR) to grow by almost 5 percent in each of the next two fiscal years simply to maintain current spending levels. Although that's certainly an attainable level of revenue growth, a budget with flat spending would have very negative consequences for state and local services. Moreover, the structural imbalance is likely to continue to grow between now and the start of the 2009-11 biennium.

Other potential revenue hits

There are several factors that may add to the state deficit in the coming months. One of those is the possibility that the State Medical Society will win its lawsuit challenging the \$200 million transfer from the patients' compensation fund, which was one of the short-term measures used to help balance the 2007-09 biennial budget.

The economic downturn represents an even bigger threat to state revenue. When the budget adjustment bill was crafted, the legislature was using revenue projections made in February 2008, which estimated state tax growth of 3.1 percent in 2008-09. Those revenue estimates assumed international oil prices between \$70 and \$75 per barrel and economic growth that would boost personal income nationally by a little over 4 percent per year. In light of the continued deterioration of economic conditions since those revenue estimates were made, it wouldn't be surprising if tax collections fall well short of the 3.1 percent estimate.

If tax revenue does not grow at all this year and simply matches the 2007-08 level, that would create a \$400 million hole in the current budget. Since this year's revenue projections create the base for calculating the structural imbalance in the next biennium, a \$400 million increase in the deficit this year would add \$1.2 billion to the structural imbalance for 2009-11, bringing it to about \$3.2 billion. A structural imbalance of that magnitude would require about an 8 percent per year increase in tax revenue to simply maintain current appropriation levels.

Spending pressures

Although the structural imbalance calculations do not include any estimate of the need for higher spending, the fact of the matter is that many areas of spending will have to be increased. Most of the state budget is used for local aid programs. If the state freezes local aid, even as the cost of health care benefits and energy are climbing sharply, it forces local governments to make substantial cuts in public services or large increases in property tax levies.

The recent budgets for 2009-11 submitted by state agencies illustrate some of the challenges on the spending side that lawmakers will struggle with as they craft the next biennial budget. For example:

- The Department of Public Instruction seeks an increase of \$869 million, mostly for the purpose of making inflationary adjustments in aid levels to maintain roughly the current percentage of state support.
- The Department of Health Services (DHS) has requested \$580 million more in state funding for Medicaid and BadgerCare Plus to maintain current and recently-enacted programs, including \$56 million to begin next year to implement the initiative to cover childless adults. The \$580 million also includes \$257 million needed to replace one-time funding transfers used for Medicaid spending in the 2007-09 biennium (which is an action that is already accounted for in calculating the \$2 billion structural imbalance).
- The Department of Corrections requested an increase of \$166 million GPR, or 7.5 percent, to "support current operations and fund commitments that have already been made."
- The UW System is asking for a general fund increase of \$87.8 million for its biennial operating budget, and \$50 million of that simply maintains the status quo.

Previous budget deficits

Wisconsin has faced other large structural deficits over the last decade or two, and has managed to get through those without having to make huge cuts. Perhaps the same will be true in the next biennium; however, the state has already used most of the easier solutions. Many of the remedies used to balance the 2007-09 budget are likely to be impossible or much more difficult in the next biennium. For example:

- The state has virtually eliminated its reserve funds, so they cannot be tapped again in the next session.
- Even assuming the courts do not reverse the transfer from the patients' compensation fund, that tactic probably won't be an option again in the next session.
- The practice of using transfers from the Transportation Fund to finance other areas of the budget (such as school transportation spending) could become much more difficult because the sharp increase in gas prices has suppressed motor fuel consumption, which is also causing shortfalls in the

state and federal transportation funds.

- Cuts have been made in state agency budgets almost every year, and it is getting increasingly difficult to find more areas of savings without causing significant cuts in state services.

Revenue options

To avoid very substantial budget cuts, Wisconsin will need to find ways to increase state revenue. Fortunately, the state does have some options, such as closing corporate income tax loopholes, restoring the estate tax, and approving the hospital assessment proposed last year by the Governor. In the coming months we will examine the revenue options on the Wisconsin Budget Project portion of the WCCF website.

The federal government could also provide some assistance to the states, as it did during the last economic downturn. There has been talk in Congress about including a measure in a new economic stimulus package to temporarily increase the federal share of Medicaid spending (known as the federal Medical Assistance percentage, or FMAP).

A short-term increase in federal spending for state aid would be a quick way to provide an economic stimulus, and it would help states cope with the rising demand for services caused by the recession. Providing an increase in aid through an FMAP increase is an equitable means of boosting state aid because it reflects the level of state spending for Medicaid and it provides larger amounts of aid to states with lower median incomes.

Conclusion

Wisconsin needs at least \$2 billion of revenue growth in the 2009-11 biennium merely to maintain current spending levels. That figure, known as the structural imbalance, could increase sharply if the state loses a pending court case or if the economic downturn further suppresses state tax collections. If revenue is flat this year, instead of growing by 3.1 percent, the structural imbalance could grow to \$3.2 billion.

The state's fiscal problems are compounded by the fact that maintaining current programs will require significantly higher spending. For example, the Department of Health Services projects that the state share of spending for Medicaid and BadgerCare Plus needs to grow by \$323 million in the next biennium (without including additional GPR spending needed to replace one-time transfers used for Medicaid in 2007-09).

To avoid deep cuts in state services and a sharp erosion of state support for property tax relief, Wisconsin policymakers will have to find significant sources of new revenue to balance the next biennial budget.

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