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# La Follette School of Public Affairs

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at the University of Wisconsin-Madison

## Working Paper Series

La Follette School Working Paper No. 2010-016

<http://www.lafollette.wisc.edu/publications/workingpapers>

## How Large Is Wisconsin's Budget Gap for the 2011-13 Biennium?

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September 2010



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## How Large Is Wisconsin's Budget Gap for the 2011-13 Biennium?

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To balance its 2011-13 biennial budget, the state of Wisconsin will need to close a large fiscal gap. The exact size of the budget shortfall, however, is difficult to predict. Not only is there uncertainty about the performance of the state's economy in upcoming months and years, but there is no single method for measuring budget gaps.

I suggest that a sensible way to gauge the magnitude of the state's fiscal problems is to calculate the state's *structural fiscal gap*, a structural fiscal *deficit* in this case. Such a deficit exists if the minimum amount of money the state government needs to maintain current public services exceeds the amount of money it can raise with its current tax laws and tax rates. In calculating a structural fiscal gap, no judgment is made about the appropriate level of public services or taxes within the state. As the legislature is required to enact a balanced budget, the structural fiscal gap merely provides a measure of the spending reductions and/or revenue increases needed to balance the budget.

The starting point for calculating the state's structural fiscal gap is the Wisconsin Legislative Fiscal Bureau's (LFB) determination of the fiscal condition of the state's General Fund at the end of the current biennium on June 30, 2011. The LFB calculated the fiscal condition by modifying 2010-11 budgeted General Fund revenues and appropriations to reflect provision in the current budget that will affect revenues and expenditures in each year of the 2011-13 biennial budget. The most recent such calculation (dated July 9, 2010) estimates a fiscal imbalance of \$1.232 billion in fiscal year 2012 and of \$1.279 billion in fiscal year 2013.<sup>1</sup>

The LFB makes no attempt to estimate a *current services budget* for the next biennium. In fact, the bureau states explicitly that "no assumptions are made about changes (increases or decreases) in caseload and population estimates or for such items as state employee compensation (salary or fringe benefits) in the 2011-13 biennium." On the revenue side, the LFB takes no account of the likely revenue increases due to expected economic growth during that two-year period.

My approach to estimating a structural fiscal gap is to make a number of adjustments to the LFB fiscal condition determination. The adjustments reflect estimates of the minimum amount of additional money needed to maintain public services at current levels, sometimes referred to as the "costs to continue," and estimates of the likely General Fund revenue increases due to the state's economic growth during the next biennium. The table below summarizes these adjustments.

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<sup>1</sup> The Legislative Fiscal Bureau's fiscal condition calculations are available at [http://www.mbo.wisc.edu/biennial/bienn1113/2010\\_07\\_09\\_WI%20Leg.pdf](http://www.mbo.wisc.edu/biennial/bienn1113/2010_07_09_WI%20Leg.pdf).

**Projected General Fund Structural Deficit  
2011-13 Biennial Budget**

	<b>2011-12</b>	<b>2012-13</b>
	(in millions of dollars)	
<b>Legislative Fiscal Bureau amount needed before revenue growth and program expansion (7/9/10)</b>	\$1,232	\$1,279
<b>Adjustments to reflect spending increase to maintain current services</b>		
End state employee furloughs	\$36	\$36
Increases in state aid for K-12 education	\$219	\$445
Medicaid caseload and utilization adj.	\$65	\$155
"Cost" increases for rest of budget (1.75%)	\$133	\$269
<b>Total spending adjustments</b>	\$453	\$905
<b>Revenue adjustments</b>		
Elimination of estate "pick-up" tax	(\$94)	(\$125)
Growth rate of GPR revenue (3% per year)	\$400	\$812
<b>Total revenue adjustments</b>	\$306	\$687
<b>Structural budget gap</b> (LFB amount needed + total spending adj. – total revenue adj.)	<b>\$1,379</b>	<b>\$1,498</b>
<b>Two-year total</b>	<b>\$2,877</b>	

There are two reasons why the cost of public service grows over time. First, the state's population is growing. Especially important, both the number of school-aged children and the number of older adults are rising, and hence the state must provide education and health-care services to more beneficiaries. Second, the state government has limited control over the prices it must pay to purchase goods and services. As the economy begins to recover, these prices, for example, for employee health insurance, for energy and fuel, and for construction material, are expected to rise. Other cost increases are written into labor contracts and other contractual arrangements.

The table summarizes several of the specific increases in the costs of maintaining current services during the next biennium. During the current biennium, state government employees have been required to take up to eight furlough days each year. As employee absence from work reduces the delivery of public services, adding back the cost of the furlough reflects the additional resources needed to return to the normal level of public services.

More than one-third of state General Fund spending consists of state aid to school districts. These funds not only support elementary and secondary public education, they provide Wisconsin property owners with a substantial amount of local property tax relief through the revenue limits imposed on school districts. To estimate the funding needed to maintain the current level of support for public education and property tax relief, I assume that state appropriations need to grow at an annual rate equal to the average rate of growth of state education support from 1999 to 2009.

Medical Assistance is the second largest category of state spending. I use information from the Department of Health Services to estimate the cost of expected caseload and

utilization of services growth over the next biennium. This growth reflects increases in the number of elderly state residents who are becoming eligible for Medical Assistance, increases in medical costs, and rising caseloads among the nonelderly due to high unemployment and falling incomes associated with the economic recession.

State government spending on elementary and secondary education and on Medical Assistance accounts for nearly half of General Fund expenditures. Estimating cost increases of the hundreds of programs that make up the rest of the General Fund budget is extremely difficult. Thus, I make the assumption that spending will need to grow by 1.75 percent per year in order to maintain the current level of these services. This estimate is probably conservative, in light of the fact that the average annual growth rate of expenditures since 2000 has been about 2.5 percent.

Together, these assumptions suggest that to maintain current services, spending will need to increase by \$453 million during fiscal year 2012 and by \$905 million (relative to 2011, the current fiscal year) in fiscal year 2013.

While the cost of services rises over time, the revenues available to the state also increase. Based on the most recent economic forecast released by the Wisconsin Department of Revenue, I estimate that General Fund revenue growth will average 3 percent per year over the next biennium. This assumption implies that General Fund revenues will increase from current levels by more than \$1.2 billion.

Federal law mandates that as of January 1, 2011, the federal estate tax provisions that were in place in 2001, including state pick-up taxes, be reinstated. For this reason, the LFB estimates that Wisconsin will collect approximately \$220 million during the next biennium in state estate tax revenues. However, I have subtracted this amount from projected state revenue for the next biennium because there appears to be widespread bipartisan support in Congress for enacting legislation this fall to reinstate provisions that eliminated state pick-up taxes.

The adjustments to the LFB fiscal imbalance estimates outlined in this report result in a structural fiscal deficit of nearly \$1.4 billion in fiscal year 2012 and of \$1.5 billion in fiscal year 2013. This cumulative gap for the biennium of nearly \$2.9 billion is equivalent to 10.4 percent of the state's \$27.7 billion General Fund budget for the 2009-11 biennium. To put this deficit in perspective, in dollar terms it is equivalent to 70 percent of the total amount of money the state is spending this biennium on the University of Wisconsin System and on shared revenues with municipal and county governments.

I emphasize that any estimate of a structural budget gap is based on a set of assumptions. I have attempted to utilize reasonable assumptions. However, alternative assumptions are likely to result in only a modest change in the size of the fiscal gap. For example, if cost increases for the "rest of the budget" grew at an annual rate of 1.25 percent instead of the assumed 1.75 percent, the structural fiscal deficit for the next biennium would decrease by \$115 million. Alternatively, if revenue were to grow at an annual rate of 3.25 percent instead of 3 percent, the gap would shrink by \$102 million. On the other hand, more rapid cost increases or slow tax growth rates would increase the size of the structural fiscal gap by corresponding amounts.

In July, the state Supreme Court ruled that the state must return \$200 million to the state's Injured Patients and Families Compensation Fund that it had transferred to the General Fund in October 2007. The courts have not yet determined a schedule for the transfer. If part or all of the required transfer is scheduled during the next biennium, the state's structural fiscal deficit could be as large as \$3.1 billion.

Given the requirement that the legislature enact a balanced budget, policymakers will need to close the fiscal deficit by cutting spending, increasing state revenues, or a combination of the two approaches. A portion of the structural fiscal deficit could be addressed if the state can find ways to increase the efficiency with which it provides public services. In that way, spending could be cut without reducing public services; however, tight state budgets for most of the past decade mean that the easiest efficiency gains have been implemented. If the provision of services is as efficient as possible, most spending cuts made to close the budget deficit will result in reductions in public services Wisconsin's residents now enjoy.