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Financial Delusion

The $1.9 Billion Deficit in a "Balanced" Wisconsin Budget

REPORT FROM THE PRESIDENT:

For the last several years there have been ongoing, painful revelations about the integrity of our elected officials, both in Madison and in local governments around the state. Whether it be the pension scandal in Milwaukee or the indictments of legislative officials in Madison, the credibility of our government officials and institutions is probably at an all-time low throughout Wisconsin. Just when you thought it couldn't get worse, this new report may change your mind.

Written by George Lightbourn, a Senior Fellow of the Institute and former Director of Administration for the State of Wisconsin, this study documents an almost unbelievable governmental ruse used by Wisconsin. The state maintains two separate sets of official books to document whether or not our state's budget is balanced. This study does not simply recount accounting schemes that have been used in the past both by government and the private sector. Rather, it is an indictment of a system that clearly must be reformed.

Wisconsin must have a balanced budget by law. In reality, that has probably not happened since at least 1980. The reasons are very simple. Every two years a cash accounting report is used to document that the state has balanced its budget. This particular accounting system permits an assortment of tricks and accounting schemes, which allows the state to hide the true dimensions of the budget deficit. At the same time, to satisfy bonding houses, the state must present a second accounting report based on Generally Accepted Accounting Principles (GAAP), which paints a more accurate picture of the state's finances. This particular report is more accurate because it eliminates the political and bureaucratic tricks that have been used for over a generation to develop a balanced budget. The most recent GAAP accounting report showed a deficit of almost $2 billion, or 18% of annual revenues. On a percentage basis, that put Wisconsin first among the states that had deficits. This raises the very disturbing issue of whether Wisconsin citizens should grant any credibility to the budget projections and proclamations coming out of Madison from our elected officials.

How does Wisconsin move forward to set its financial house in order when, in fact, the house is built not on concrete but on smoke and mirrors? If there is one lesson that was learned in the private sector after the revelations about Enron and Arthur Andersen, it was that having accounting systems that are accurate and portray a true picture is something that we should expect not only from businesses but also from our government. Politicians, who regularly chastise businesses for accounting discrepancies, have passed legislation to regulate the private sector. If politicians look in the mirror, they will see a system in Wisconsin that make it difficult to have any confidence that the state will have its financial house in order for the twenty-first century. Unless our public officials are willing to show some backbone and make the changes necessary to improve confidence in their financial reports, Wisconsin will continue to struggle every two years with a budget that cannot and will not be balanced.

James H. Miller

WISCONSIN POLICY RESEARCH INSTITUTE, INC.

P.O. Box 487 • Thiensville, WI 53092

(262) 242-6409 • Fax: (262) 242-6459

E-mail: wpri@wpri.org • Internet: www.wpri.org

FINANCIAL DELUSION

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GEORGE LIGHTBOURN

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Executive Summary

Enron, Tyco, WorldCom, Parmalat — each of these businesses conjures an image of fraud — "accounting irregularities" in the staid world of finance. One by one, as the depth of the irregularities became known, investors and the public looked to government to restore their confidence in financial reporting. Sarbanes-Oxley legislation was signed into law; government had imposed belt-and-suspenders fortification to financial reporting.

But what if government itself kept two sets of books? Most taxpayers would be astonished to learn that the State of Wisconsin actually maintains two sets of books — one showing Wisconsin state government with a $1.9 billion deficit for 2004, and another set showing the state's finances to be in balance as required by the state Constitution. The $1.9 billion deficit represents 18% of general fund revenues collected that year (21% in 2003) — the highest percentage of any of the only nine states reporting deficits.

Every year since 1990 the Wisconsin state controller has issued a report, imposingly titled the Comprehensive Annual Fiscal Report (CAFR). It has shown that, year after year, the state was operating in the red. For decades, Wisconsin has made one decision after another to live beyond its means. The most recent CAFR noted that the state's cash report understated its spending obligations and overstated its revenues. The combination of the two yielded the $1.9 billion deficit in 2004. Since the state's general fund consists of $10.7 billion of tax collections, this deficit equates to 18% of state tax revenue.

As a result of the information in the Wisconsin CAFR, in recent years, Wisconsin's bond rating has declined to the point where it is among the lowest in the nation. Thus, while states' finances throughout the nation have been adversely affected by the economic downturn, most states have maintained a bond rating above Wisconsin's.

In the eyes of the bond-rating agencies Wisconsin's fiscal deficit stands out, both because of its durability and its depth. Further, the fact that the deficit has grown over time has caused concern for the rating agencies. The consequence of a lowered bond rating is that more state revenue must be used to pay the higher interest rates that such bonds command.

During the 1990s Wisconsin experienced healthy revenue growth. Beyond that, the notion of using tax revenues for reducing something as esoteric as the deficit did not compete well with other uses of state tax dollars. Thus the 1990s saw substantial increases in spending on school aids, corrections, medical assistance, smaller class sizes, and education technology, as well as many other smaller programs. Reducing the deficit was treated as one of dozens of spending needs, and in that context, competed rather poorly.

Deficit reduction for state government has represented a classic clash between sound fiscal management objectives and more popular policy goals. Over the decades, when revenue collections tightened, the clash yielded a balance sheet with lower reserves, delayed payment dates, an artificially stretched revenue collection period, and a large dose of one-time funding applied to ongoing obligations. Wisconsin budgets have regularly been artificially balanced, a fiscal flaw that is clearly exposed by the CAFR. Wisconsin's budget culture has been to do whatever it takes to balance the budget on a cash basis.

There are two powerful factors that make reducing the state's deficit elusive. First, the state continues to operate with two sets of books. As long as the budget is oriented around cash accounting principles, addressing the deficit will remain an "extra." No elected official is likely to suffer any consequences of a deficit-riddled budget, as long as there is one set of books that shows state finances as being in balance.

Wisconsin taxpayers would be well served by a goal of moving state government toward a budget based on Generally Accepted Accounting Principles (GAAP) and real movement toward reducing the deficit. This process would be aided by the following measures:

- A statutory prohibition against making the current deficit worse.
- A statutory requirement that adds $100 million each year to the state's unobligated reserves (this could include the budget stabilization fund). The greater the budget reserve, the smaller will be the deficit.
- The Legislature should deliver to the Governor a budget developed under the current cash-based process as well as one presented on a GAAP basis. A statutory provision should be enacted requiring a vote in each house on both versions of the budget. The GAAP budget might not balance, but each legislator would know how his or her vote affects the state deficit.
- The measures currently in place, as well as those listed here, should be insulated from the mainstream of the budget process. History has shown that when fiscal solvency measures compete with tax cuts and spending, fiscal solvency always loses. Measures designed to reduce the deficit should be funded before other spending initiatives are approved. Further, a supermajority vote should be required to modify fiscal solvency measures.

INTRODUCTION

In state capitols across the country governors and legislatures have been forced to put all of their energy into solving enormous fiscal shortfalls. Given their dependence on income tax and sales tax revenues, the 2001 recession hit state governments particularly hard. In 2003, no fewer than 39 states, including Wisconsin, experienced budget gaps.[1]

During the 1990s, state treasuries across the country benefited from a robust economy. Every year in the 1990s Wisconsin state government collected more revenues than had been expected when the budget was prepared — in some years, significantly more.[2] The Governor and the Legislature thus had the luxury of debating what to do with the "extra" funds. While the debates resulted in some of the funds being returned to the taxpayers, the bulk of the dollars were devoted to higher spending.[3] A boost in school aids, Medical Assistance increases, and higher spending on a swelling prison population led a long list of spending categories.

The new millennium brought with it a softening of the U.S. economy and a significant fall off in the growth of Wisconsin's tax collections. After the decade of the 1990s, in which annual revenue growth averaged 6.9%, the first four years of the 2000s saw a 7% reduction in revenues.[4] With good economic times in the rearview mirror, policymakers were forced to look at state finances much more critically. January 2003 greeted a new Governor and a new Legislature with a gaping budget hole of $3.2 billion.[5] Another shortfall, now estimated at $1.6 billion,[6] will face the Governor and the incoming Legislature as they construct the 2005-2007 biennial budget.

New spending initiatives will once again be relegated to the back burner. The Capitol will be filled with talk of program cuts, spending freezes, and other measures to ensure that past fiscal mistakes will not be repeated. The state's fiscal predicament has become so pervasive that serious consideration is being given to amending the state Constitution to guarantee future fiscal restraint at both the state and local level throughout Wisconsin.

Much attention has been given to analyzing the causes of Wisconsin's financial troubles. One analysis showed that the state's budget troubles could be traced to three factors: an elevated level of spending during the 1990s, a tax reduction that went into effect in 2001, and the downturn in the national economy.[7] If any one of these three had not occurred, Wisconsin might have been able to withstand the downturn in revenue collections. However, all three occurred and the state is still reeling from the perfect budget storm.

As with any crisis, the postmortem review uncovered signs of the pending trouble that could have been heeded. Often these signs were obscure and would not have been evident at the time. However, in Wisconsin there had been a forewarning, which clearly predicted eventual fiscal problems.

The state controller, responsible for monitoring state finances, had been waving an unmistakable red flag from the fourth floor window of the Administration Building just two blocks from the Capitol every year since 1990. He didn't just predict the state's fiscal trouble and, as would be expected of a CPA, he put a number on it.

Year after year, the controller issued a report, imposingly titled the Comprehensive Annual Fiscal Report (CAFR). It showed that, year after year, the state was operating in the red; for decades Wisconsin had made one decision after another to live beyond its means. And, each year the head of the Legislative Audit Bureau verified the controller's finding that, indeed, the state was living beyond its means.[8]

But each year the controller's report garnered little reaction from either the public or from state policymakers. The release of the annual CAFR was given scant attention. However, a thousand miles away on Wall Street, analysts were paying attention to the controller's report. Those cool calculating analysts and investment bankers who underwrite Wisconsin's bonds saw the problem in the early 1990s and grew increasingly troubled as they watched Wisconsin's deficit grow to its current level.

As the state's revenue stream slowed to a trickle in 2001,[9] it was no longer possible to ignore the deficit documented by the controller. An ever-growing number of analysts, reporters, and policymakers found themselves scrambling to understand the CAFR. In December 2003 the controller once again waved his annual red flag. His report showed that the state deficit had grown to $2.2 billion, which equated to 21% of total tax collections.[10] Recently, the controller issued the CAFR for 2004 showing the deficit declined slightly to $1.9 billion.

Will policymakers act on the warning from the controller? Only time will tell.

The task will be more difficult because Wisconsin keeps two sets of books: one showing Wisconsin state government with a $1.9 billion deficit and another set showing the state's finances to be in balance. In nearly every instance when a business or government maintains two sets of books, one is clearly intended to portray the operation in a more favorable light. A financial document, produced every year, showing Wisconsin's finances in the black is reassuring to those unaware of the true fiscal picture. However, given current circumstances, with fiscal challenges at every turn, perhaps more elected officials are beginning to heed the warning from the controller's office.

This report will look behind the competing fiscal documents, explain how the $1.9 billion deficit came to be, and what it means to Wisconsin. Further, the report will analyze the impact of this deficit on Wisconsin and will realistically review the options facing policymakers in addressing this deficit.

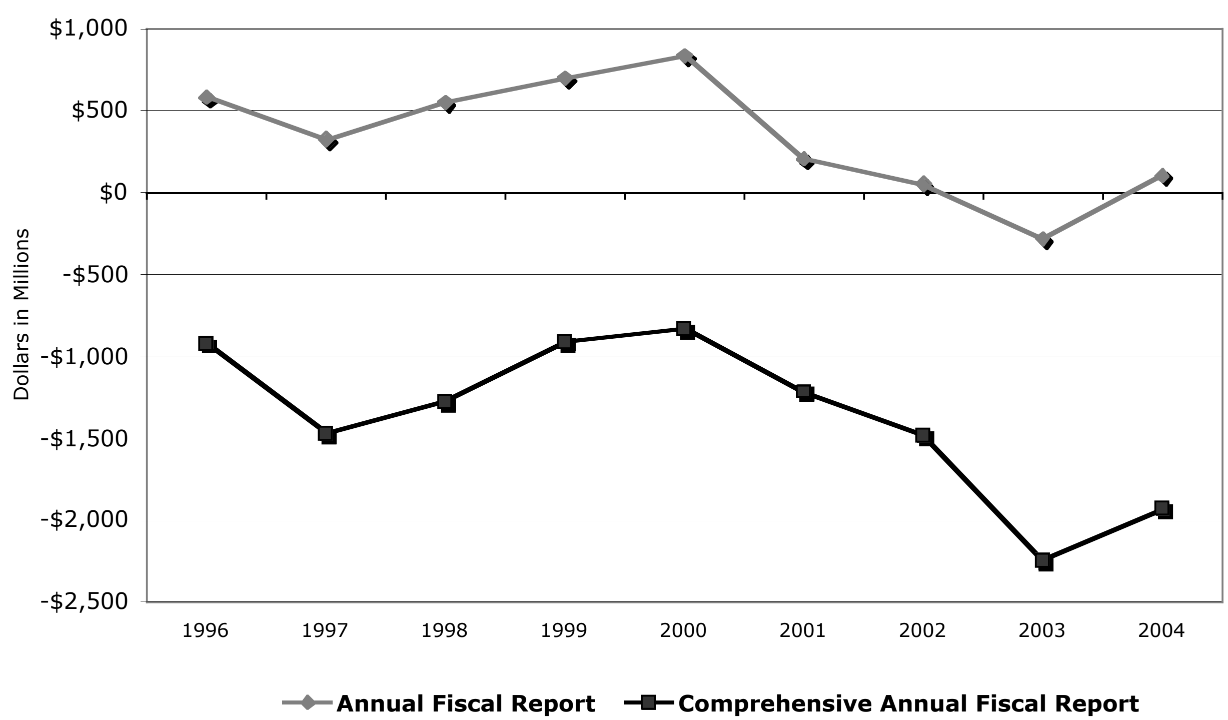
MASKING WISCONSIN'S DEFICIT WITH TWO SETS OF BOOKS

The year-end fiscal report issued by the state controller at the close of 2004 placed the state's deficit at $1.9 billion. This represents 18% of general fund revenues collected that year. How can state government remain viable with such a large deficit? Isn't this at odds with the state Constitution, which requires a balanced budget?

Ironically, the cause of the deficit is actually rooted in Wisconsin's constitutional balanced budget requirement.[11] (Generations of citizens have been comforted by the balanced budget provision. Unlike the federal government, state government cannot engage in deficit spending.) Over the years, Wisconsin state government has found ways to deficit-spend while seeming to balance its books. Balanced budgets do not mean that state finances are balanced. Figure 1 shows the historical comparison between the year-end balances based on the two very different annual financial reports issued by the state. Note that, while the Annual Fiscal Report shows state government having a positive balance at the close of every year except 2003, the Comprehensive Annual Fiscal Report shows state finances are consistently in deficit.

To understand the difference between balancing the state budget in order to technically comply with the Constitution, and truly balancing the state's finances, it is instructive to understand how the state budget is developed. Every two years the Legislature passes a budget, carefully constructed to ensure that spending will stay within

FIGURE 1 WISCONSIN'S TWO FISCAL REPORTS: COMPARISON OF YEAR-END BALANCES



expected revenues. To document that the two-year budget does indeed comply with the Constitution, the Legislative Fiscal Bureau issues a Fund Condition Statement attached to each budget.[12] The Fund Condition Statement is a balance sheet that tallies all of the state's prospective revenues for the coming biennium and matches that against anticipated cash expenditures, as well as any reserves called for in the statutes. The Fund Condition Statement must show a positive balance; state law prohibits the Legislature from passing any bill, including the budget bill, which would bring the Fund Condition Statement into the red.

This requirement seemingly brings some discipline to the process of producing a budget. In fact, each of the thousands of spending and taxing decisions made in the course of constructing a budget is made with an eye toward keeping the Fund Condition Statement in the black. Every two years, after much debate and many painful decisions, the Legislature sends a budget that balances to the Governor for signing. So, if the budget balances, how could the state find itself with a $1.9 billion deficit?

The answer rests in a state Constitution that leaves the door slightly ajar for creative bookkeeping. Over the years, in order to show a positive balance on the Fund Condition Statement, and thus comply with the Constitution, budget bills have artificially moved expenses and revenues to make the budget seemingly balance. It has been possible to distort the true picture of Wisconsin's fiscal condition. Wisconsin was not the only state that applied imagination to its financial recordkeeping. Other states have also taken liberties with accounting interpretations over the years, causing an obscure accounting organization in Norwalk, Connecticut, to establish and enforce standard treatment of state bookkeeping.

The Discipline of GASB

The reliability of public financial reports was historically troublesome. Prior to 1984 there existed rather loose standards as to how public bodies were to maintain financial records. In 1984, the Governmental Accounting Standards Board (GASB) was formed to establish standards of financial reporting for state and local governments. GASB understood that, while each unit of government might be able to make a case for its unique method of tracking finances, the external users of the information needed a standard way to compare one government to another.

In calling for government accounting standards the National Council on Governmental Accounting seemed somewhat optimistic in setting the overall goal for state and local financial reporting:

> To provide (1) financial information useful for making economic, political and social decisions, and demonstrating accountability and stewardship, and (2) information useful for evaluating managerial and organizational performance.[13]

To reconcile the differences among states, and among the thousands of local jurisdictions, GASB developed a standard protocol of accounting for public revenues and public spending. The detailed set of standards developed by GASB consumes volumes of manuals for use by those who account for state finances. These manuals describe in great detail the appropriate treatment of financial recordkeeping. Hundreds of hours of training are needed for state accountants in order to ensure that the state's books are maintained according to GASB standards. Further, the standards are continuously updated to accommodate evolving interpretations of accounting transactions. The goal of GASB is to provide a means to ensure an honest and standard treatment of public financial data. This is particularly important information to those outside of government who require accurate and consistent financial information.

Unknown in 1984, when the first GASB standards were issued, a tremor was about to be sent throughout the world of public finance. Not only would the new standards lead to the added expense of training staff, it held the prospect of painting a very different picture of the fiscal condition of state and local governments.

Beginning in the mid-1980s state and local governments began issuing annual financial reports based on the new GASB standards. These standards employed Generally Accepted Accounting Principles (GAAP) to ensure uniform treatment and reporting of public finances.

Wisconsin, slow to adopt a taste for the new standards, was one of the last states to prepare an annual financial report under the GASB rules. The Wisconsin state controller first issued the new report, dubbed the Comprehensive Annual Fiscal Report (CAFR) in 1990. For the first time Wisconsin state government presented its financial status using GAAP accounting.

Wisconsin had not been unique in its use of non-standard methods to prepare its budget and to track it finances. However, once the first CAFR was issued, it was clear that the budget and financial reports traditionally issued by Wisconsin yielded results that were significantly out of step with the standards called for by GASB. While

Wisconsin's traditional financial reports showed the state having a surplus, the CAFR for 1990 showed the state with a $743 million deficit.[14]

Each year since that original CAFR was issued in 1990, Wisconsin has continued to maintain two sets of books. Both require thousands of hours of staff time to prepare, and both testify to the veracity of the state's bookkeepers. But they paint a very different picture of state finances. Why are they so different?

The GASB standards were developed to provide an *external* report done in a uniform way by every state and local government. However, state law was never changed to reflect the new standards. Therefore, it maintains its historical fiscal report, which is an *internal* report prepared principally to track cash. Each year the state controller, in compliance with the statutes, issues the same financial report that has been prepared since the Wisconsin Constitution was written. The annual report was to provide an accounting of the cash collected by the state and the cash expenses incurred. Most importantly, it was intended to satisfy the constitutional requirement that state government spending stay within available revenues.

Regardless of the fact that the report is out of step with GASB standards, it remains the basis for constructing the Wisconsin state budget and tracking finances. While private industry and most of government have long since converted to accrual accounting, Wisconsin remains on an island of cash accounting. Under this system, the tracking of cash receipts and cash expenditures is critical. And, the door remains open to financial loopholes that can distort the picture of the state's finances.

Under a cash system, revenue forecasts are carefully prepared before budget deliberations begin. The Governor and the Legislature take months to carefully assemble a budget that stays within those revenues. At each step in the budget process the major players are cognizant of the fact that the state controller will issue a report each year that will document whether the cash spent remained within available cash receipts. And dutifully each September, the state controller issues a public announcement that state government has once again abided by the balanced budget requirement in the state Constitution.

However, the picture this cash report paints of state finances is far from clear. As the financial affairs of the states have become larger and enormously more complex, there have been significantly different interpretations of the accounting treatment of various transactions. In one jurisdiction an expense might be recorded when it is promised, whereas another jurisdiction might not record it until the cash is actually paid, and the commitment is satisfied. It is easy to see where significant disparities between states might occur. To clarify, each year the state controller notes that, while the cash report fulfills a state statutory obligation, it does not comply with generally accepted accounting practice.

Thus Wisconsin operates using two sets of books — one to satisfy state statute and one that is consistent with accounting standards.

The differences between the two are substantial. The most recent CAFR noted that the state's cash report understated its spending obligations and overstated its revenues. The combination of the two yielded a $1.9 billion deficit in 2004. The state's general fund consists of $10.7 billion of tax collections. The deficit equates to 18% of state tax revenue.

State Government Reaction to the Comprehensive Annual Fiscal Report

When the first CAFR was issued in 1990, the result was startling. How could it yield such a different picture of the state's fiscal condition? That type of fiscal news had the potential of shaking state government to its foundation. Yet the issuance of this new fiscal report was nearly universally ignored.

The fact that the report failed to garner much attention is likely attributable to three factors:

- Technical accounting principals are not generally understood, and the significance of the new standards of governmental accounting was lost on the press and the public.
- State government continued to issue the traditional fiscal report that showed a positive balance.
- The table that revealed that the state finances were in deficit was buried deep within the body of the new report. Only the most dogged analyst would have understood the significance of that table.

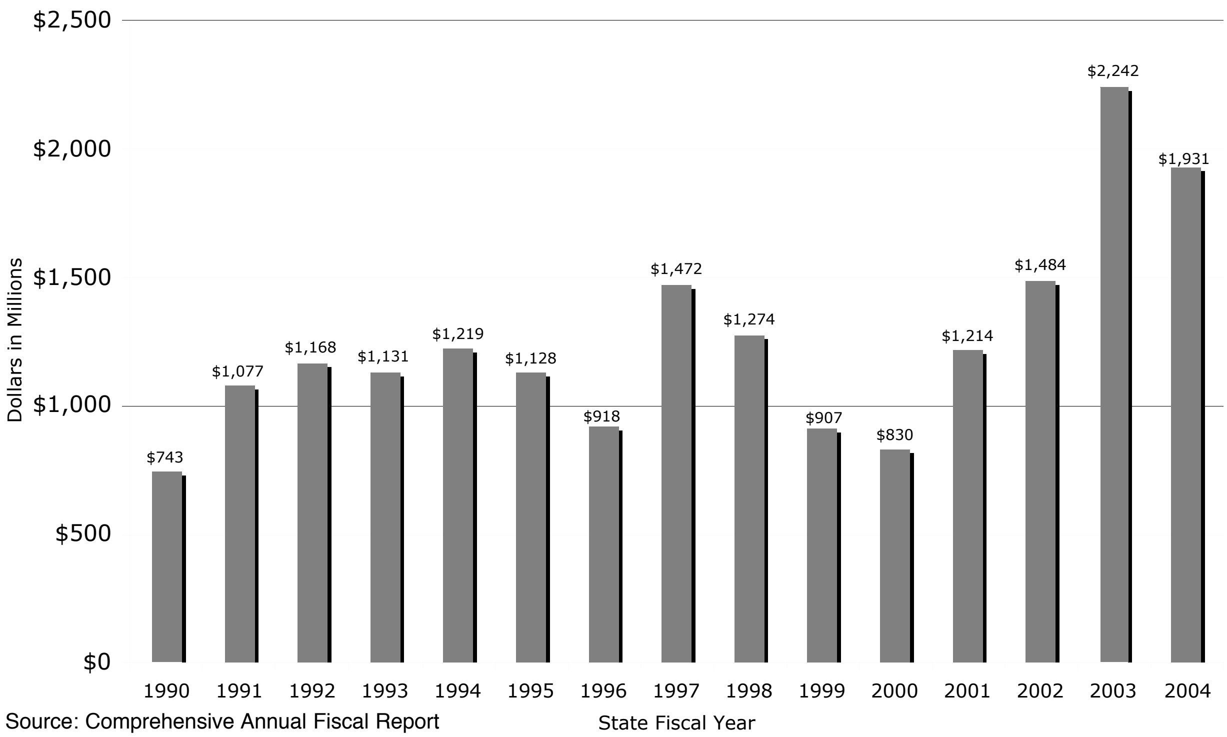
The CAFR is an imposing document, running to more than two hundred pages of tables and technical notes filled with financial data. It is geared toward the fiscally-astute reader, not the more casual observer of state government. Most of the document follows presentation requirements set by GASB. However, one of those requirements is that the CAFR reconcile the difference between the information included in the state's budget report and the information in the CAFR. It is that table, found on page 143 of the 2004 report, which showed the deficit being $1.9 billion.

Only when Wisconsin faced a budget crisis early in this decade was there an interest in the esoteric world of financial reporting. An increasing number of analysts and policymakers found their way to the CAFR and became aware of the information in the CAFR, which served as a road map of sorts for those curious about the depth of the state's fiscal problem. Further, an increasing number of analysts began combing through data in search of the cause of the deficit. What had been arcane data buried in the bowels of the CAFR became required reading.

What the readers found was a significant deficit that had existed since state government began tracking it in 1990. It was almost like an x-ray revealing a tumor that had been growing for a decade.

Figure 2 shows the history of deficits in Wisconsin state government.

FIGURE 2 HISTORY OF WISCONSIN DEFICIT



Source: Comprehensive Annual Fiscal Report

THE COMPONENTS OF THE DEFICIT

Wisconsin state government maintains two profoundly different ways to track revenues and expenses. One approach, which serves as the platform on which the state budget is constructed, utilizes cash accounting. The report of the state's cash accounting is the annually-issued Annual Fiscal Report, a report that essentially records the cash taken in by state government as well as the cash paid out by state government each fiscal year. This report does not account for the future obligations incurred by state government, obligations that can prove substantial.

GAAP-based accounting is a more comprehensive way to ascertain state government's fiscal condition since it also reflects future obligations; commitments made by state government beyond the end of the fiscal year. This more comprehensive accounting is detailed in the CAFR, issued annually by the State Controller and audited by the State Auditor. Among the standard features included in the CAFR each year is a reconciliation between the cash accounting and the GAAP-based accounting. This reconciliation worsens the balance since it reflects substantial commitments that are not included in the cash-based report.

The CAFR includes a *Budgetary - GAAP Reporting Reconciliation note*. The note states:

> The accompanying Budgetary Comparison Schedule compares the legally adopted budget with actual data on a budgetary basis. Because accounting principles applied for purposes of developing data on the budgetary

> basis differ **significantly** from those used to present financial statements in conformity with generally accepted accounting principles (GAAP), a reconciliation of basis and perspective differences . . . is presented. . . . (emphasis added)

Shared Revenue Payment Shift ($453 million)

Shared revenue payments to counties and municipalities are made in July and November each year. While these dates seemingly push the payment beyond the June 30 end of the state's fiscal year (a delay that was made in the mid-1980s), accounting standards recognize that the state has actually obligated the full payment to local governments. Thus, the controller recognizes one-half of the shared revenue payment as obligated but unpaid.

Property Tax Credits ($354 million)

When property tax bills are sent out in December, they include a direct credit, which reduces homeowners' tax liability. This popular program is funded by state payments to local governments. However, while the commitment for the credit is made each December for inclusion on the property tax bill, the payment from the state is not made to local governments and school districts until the following July. The controller recognizes the commitment for payment when it is made (100% for schools and 50% for local government).

School Aids Deferral ($75 million)

In the 1998 budget $75 million of school aid payments were moved from June to July in order to move the spending obligation from one state fiscal year to another. The controller recognizes the full payment in the year in which the obligation is made.

Unpaid Medical Claims ($169 million)

The unpaid claims are related to Medicaid and Medicare claims that have been filed by service providers but remain unpaid at the close of the state fiscal year.

Income Tax Adjustments ($742 million)

This represents two adjustments. The first is to deduct, from the taxes collected by June 30, an estimate of the reduction related to income tax refunds. The second reconciles differences between Wisconsin's treatment of taxes collected after the close of the state's fiscal year. Wisconsin's budget recognizes taxes collected up to 45 days after the closing of the state fiscal year. Accounting standards only allow for a 30-day period of reconciliation.

Utility Tax Collections ($170 million)

The state collects the gross receipts utility tax in advance of the year to which they apply. Since utilities use a calendar year for their fiscal year, the CAFR defers 50% of the revenue collected.

Other Miscellaneous Tax-Related Items ($294 million)

The controller's office makes adjustments to several taxes to reflect timing differences in when the tax revenue is recognized. The largest is the treatment of the tax reciprocity agreements with Illinois and Minnesota.

Payments to Local Governments for Health and Workforce Development Programs ($169 million)

State government makes payments to local governments to administer several health and welfare programs. In relation to these programs state government has incurred several advance obligations to be paid to local government beyond the end of the state fiscal year.

Summary

Each of these items reflects the fact that spending obligations go beyond what is recognized by Wisconsin's budget accounting system. The above listing totals $2,379 million of expenses not recognized in the budgetary-based accounting. These are offset against the $448 million general fund balance to yield the $1.931 billion deficit.

It is notable that the 2004 state deficit is $311 million lower than the deficit in 2003. The difference is almost entirely attributable to an improvement in the fund balance in the general fund. In 2003 the fund balance was minus $163 million; in 2004 the balance was a healthier plus $178 million. The improvement reflects actions by the Governor and the Legislature to limit spending increases in the 2003-2005 biennial budget.

A Case Study — Shifting Payment Dates to "Balance" the Budget

Over the years tight budgets have been brought into balance by delaying a payment rather than reducing it. An example clarifies how this works. In the summer of 2001 the Legislature was in the process of assembling the biennial budget; a budget beset with fiscal challenges. Revenues were in short supply due both to a national economy that was headed toward recession and a previously enacted tax cut that was taking effect. Based on the best economic forecasting information available, significant spending cuts seemed inevitable. However, no one knew for sure how long the economic malaise would last. Few officials in the State Capitol wanted to make deep budget cuts, especially since many held out hope that the economy would make a speedy recovery.

In the Joint Finance Committee's deliberations a provision was added to the budget that took advantage of the constitutional crack in the door. The Committee voted to move $115 million of 2003 school aid payments from June 16 to July 28. Since state government ends its fiscal year on June 30, that 42-day payment delay reduced the money the state would pay to school districts in the biennium by the full $115 being shifted. The "beauty" of this shift was that schools were somewhat indifferent about the payment delay since both the June 16 and the July 28 dates fell within the same fiscal year for schools. School budgets would be unaffected.

For purposes of the Fund Condition Statement, the 42-day delay would have shown up as a $115 million spending reduction, just as if the committee had actually cut spending by $115 million. Such a maneuver is perfectly allowable under the crack in the door allowed by state statutes.

This particular payment delay was never enacted into law because when the budget was delivered to the Governor for consideration, he vetoed it. However, many other such shifts remain on the state's books and contribute to the $1.9 billion deficit.

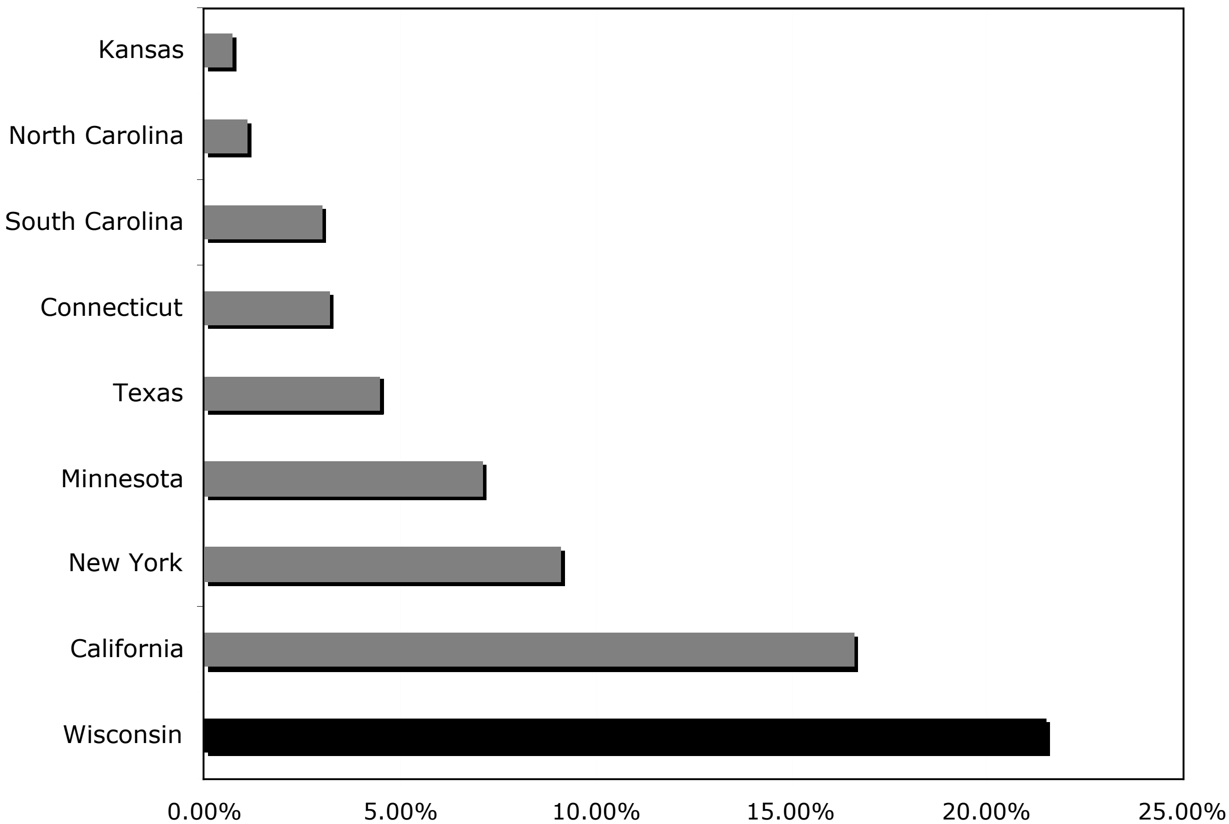
The payment delay, while solving part of a budget problem, would have been completely transparent to the state controller. He would have been obligated to report the $115 million as an obligation, just as though the delay had never occurred.

Other States

Is Wisconsin unique in carrying an operating deficit? The answer is yes, but not as much as in previous years. In 1995, Wisconsin was one of only nine states showing a deficit on their books. The size of the deficit ranged from a low of $34 million in Kansas to $13.4 billion in California. In order to assess the severity of the deficits in the context of state budgets, Figure 3 shows the deficit as a percent of the state's general funds. Thus, while California has a much larger GAAP deficit than Wisconsin, it is not as significant of a percentage of the general fund in California as it is in Wisconsin.

The increase in the number of states showing a budget deficit is consistent with the findings in the Fiscal Survey of the States that notes a decline in the year-end balance reported by states from a high of 10.4% of expenditures in

Figure 3 Deficit as Percent of General Funds: Fiscal Year 2003



Data provided by the State Controller's Office

2000 down to 3.1% of expenditures in 2003.[15] Clearly the downturn had caused many states to draw down reserves and implement other techniques to accommodate the fiscal downturn.

Effect on State Bond Costs

As previously noted, when GASB issued its initial accounting standards, it noted that they were intended for use primarily by those external to government. One of the key audiences is purchasers of state bonds. As with any investment, individuals and institutions that purchase public bonds are interested in the financial viability of the entity that issues the bonds.

This question is not only important in setting the initial price (interest rate) of the bonds, but in determining the marketability of the bonds at any point in the life of the bond. If the marketability of the bond declines, to the holder of the bond the liquidity of the bond is adversely affected. The financial condition of Wisconsin will affect both pricing and liquidity. In making decisions about which bonds to purchase, investors have a greater attraction to public bonds that are likely to maintain their value and their liquidity. In the bond market, particularly the secondary market, Wisconsin is in competition with every other issuer of municipal debt. This is where the financial condition of the state is critical.

The question of the fiscal viability of governments might seem extraneous since the bondholder has a high degree of assurance that the state will make debt service payments on its outstanding bonds. Behind every bond issued by the state is pledged the full faith and credit of the State of Wisconsin. Further, the state Constitution and state law require that the state's debt obligations be satisfied before any other obligations are paid. The Official Statement prepared for each bond issue reiterates:

> The Bonds are direct and general obligations of the State. The full faith, credit, and taxing power of the State are irrevocably pledged to make principal and interest payments on the Bonds. There has been irrevocably appropriated, as a first charge upon all revenues of the State, a sum sufficient to make principal and interest payments on the Bonds as the payments become due.

Bondholders have a high degree of assurance that they will be paid, especially in light of the fact that Wisconsin has never defaulted on a debt obligation. In fact, defaults on municipal bonds are rare. However, the handful of defaults, such as the default by Orange County, California, sent shock waves through the municipal finance community. Such events have long-lasting impact on the market, causing purchasers of bonds to seek ironclad assurances of bond security.

In order to garner assurance of security, bond purchasers look to the rating agencies to provide independent, rigorous, and objective analysis of public entities that issue bonds. The three principle agencies rating public bonds are Fitch, Standard and Poor's, and Moody's Investment Services. While each performs independent reviews, they tend to reach similar conclusions about the financial soundness of governments.

Each rating agency reviews four factors when evaluating state and local governments. Two of the factors, the amount of outstanding debt and the quality of debt management show Wisconsin compares favorably with other entities. The third factor, the strength of the economy shows Wisconsin comparing favorably with other states, although the soft outlook for job growth in the state's manufacturing sector has begun to draw some attention from the rating agencies.

In recent years Wisconsin has drawn criticism from the three rating agencies in its financial management. Specifically, they note the state's budget deficit; the growth in the deficit; the lack of budget reserves; and the state's inability to meet revenue projections. Drawing particular mention is the proclivity of Wisconsin to use one-time revenue to finance ongoing expenses.

In the eyes of the rating agencies Wisconsin's fiscal deficit stands out, both because of its durability and its depth. Further, the fact that the deficit has grown over time has caused concern for the rating agencies.

Table 1 shows a history of the State's bond rating.

TABLE 1 RECENT HISTORY OF BOND RATINGS FOR THE STATE OF WISCONSIN

Moody's	Fitch	Standard and Poor's
1973 - AAA	1995 - AA+	1973 - AAA
1981 - AA+	2001 - AA	1981 - AA+
1982 - AA	2004 - AA-	1983 - AA
1991 - AA (negative outlook)		1997 - AA (positive outlook)
		2000 - AA (stable outlook)
		2001 - AA (negative outlook)
		2002 - AA-

While the state's deficit is considered serious by all three rating agencies, the operating deficit by itself would probably not cause the state's bond rating to decline. If the balance of the state's financial management were in order, it is doubtful that the state bond rating would have undergone a downgrade. One analyst with Fitch noted that the state's budget deficit, while troubling, is "probably not a lynchpin rating factor." However, the budget deficit is seen as an indicator of other structural weaknesses in the management of state government's finances.

Wisconsin's bond rating has declined to the point where it is among the lowest in the nation. Table 2 shows that, in the summer of 2004, only six states had a bond rating as low as or lower than Wisconsin. Thus, while states' finances throughout the nation have been adversely affected by the economic downturn, most states have maintained a bond rating above Wisconsin's. The state's low bond rating is consistent with its position as one of a handful of states in deficit.

It is also instructive to review the ratings for other Midwestern states. Table 3 shows that, while the Midwest has been affected by similar economic conditions, all other states have been able to maintain a higher bond rating than Wisconsin. Each of these states is likely to see their bonds priced more advantageously than Wisconsin.

Regardless, it is often maintained that a lower credit rating will result in the state paying higher interest rates when it enters the capital markets. In 2002, Wisconsin's Capital Finance Officer attempted to quantify what the impact might be.[16] He noted that Wisconsin's lower rating could add $210,000 annually to the state's cost of debt service ($210,000 this year, $420,000 next year, etc.) The net present value of the higher interest rates would be approximately $2.8 million for bonds issued in each year. (Net present value is a method of discounting future dollars to current dollars.)

Table 2 States Having Bond Ratings as Low as or Lower than Wisconsin

State	Standard and Poor's Rating
Wisconsin	**AA-**
California	BBB
Hawaii	AA-
Kentucky	AA-
Massachusetts	AA-
Oregon	AA-
West Virginia	AA-

Table based on June 21, 2004, summary compiled by UBS Financial Services Inc.

However, the impact is only theoretical since there is no accurate before and after picture of state debt costs. The interest rate placed on state bonds is affected by a number of factors, only one of which is the credit rating. Theoretical or not, it is certain that a lower credit rating is not advantageous in pricing of State of Wisconsin bonds.

Table 3 Bond Rating of Midwestern States

State	Standard and Poor's Rating
Minnesota	AAA
Missouri	AAA
Iowa	AA+
Michigan	AA+
Ohio	AA+
Indiana	AA
Illinois	AA
Wisconsin	**AA-**

Table based on June 21, 2004, data compiled by UBS Financial Services Inc.

The following is a listing of the negative factors the rating agencies have noted regarding Wisconsin state government's fiscal management:

- $1.9 billion deficit,
- Use of one-time revenue to support continuing spending,
- Uncertainty of Indian gaming revenues based on Supreme Court ruling, and
- Inadequate budget reserves and no rainy day fund.

In order for Wisconsin to improve its credit rating, it will have to improve its financial performance as well as its fiscal management. Rating agencies look favorably on any movement a state makes to improve its financial position. It is clearly in Wisconsin's best interest to make changes that will yield a higher credit rating. However, a relevant issue is whether the effort required to improve the state's credit rating is one that policymakers feel is worth the effort. To date they have implicitly decided that it is not worth the effort.

Wisconsin's Response to the Nation's Largest Deficit

Opportunity Lost—The 1990s

Wisconsin's fiscal deficit was initially documented when the first CAFR was issued in 1990. It was almost serendipitous that the deficit first came to light early in a decade that would feature unprecedented revenue growth. The decade of the 1990s saw fortune smile on state treasuries throughout the nation. Wisconsin was no exception. During the decade, state general fund revenues nearly doubled, growing by 94%. In 1990 state tax collections totaled $5.6 billion and grew to $10.9 billion by the close of the decade.[17] It appears that revenue growth provided the capacity for state government to begin to address the deficit.

More significant than the pure revenue growth was the amount of revenue flowing into the state treasury beyond what had been anticipated. Forecasting state revenue collections is difficult during times of relative stability; during a period of substantial growth the challenge is particularly vexing. As a result, revenue forecasting in the 1990s tended to underestimate actual collections (a phenomena which seems like a distant memory). By one estimate, actual revenues grew a collective $1.4 billion beyond what had been anticipated in constructing the state budget.[18]

It is clear that Wisconsin state government had the capacity during the 1990s to address the state's fiscal deficit. However, the state closed the decade with a deficit slightly larger than the deficit documented at the decade's opening. It is instructive to understand why at least some of the state's significant revenue growth was not applied to reducing the deficit because, if the deficit is to be eliminated or reduced, future revenue growth will likely be the source for deficit reduction.

Any number of reasons could be pointed to as to why revenue growth was not applied to deficit reduction in the 1990s. In the author's estimation, the principal reason was that there was no sense of fiscal danger. Revenues were flowing into the state treasury, and each year the state reported a budget that balanced on a cash basis. There was simply no clear understanding of the significance of the deficit. It remained a theoretical accounting phenomenon rather than a clear sign of fiscal vulnerability. It wasn't until the revenues ceased to flow freely during the recession of 2001 that the diagnostic significance of the state's deficit moved from the theoretical to the practical.

However, there was a more significant reason why the revenue growth of the 1990s was not applied to reducing the deficit. Simply stated, reducing the deficit required the use of state revenue and, in a sense, was viewed like any other demand for state spending. The notion of using tax revenues to reduce something as esoteric as the GAAP deficit quite frankly did not compete well with other uses of state tax dollars. Thus the 1990s saw substantial increases in spending on school aids, corrections, medical assistance, smaller class sizes, and education technology, as well as many other smaller programs. Reducing the deficit was treated as one of dozens of spending needs, and in that context, competed rather poorly. If deficit reduction continues to compete with other spending priorities, it is unlikely that strides will be made to reduce the deficit. A different approach will be needed, likely one that does not require explicit action from elected officials.

Wisconsin's Deficit Comes Out of the Closet

In retrospect it seems odd that Wisconsin's billion-dollar deficit was acknowledged but not addressed during the 1990s. However, understanding the context of the 1990s helps explain the dichotomy. The 1990s was a decade in which the nation's economy hit full stride, and expanding wealth was evident everywhere. Individual stock portfolios were creating temporary wealth for millions of Americans, nearly everyone seeking a job found one, and state treasuries' major stress was simply counting the revenues that resulted from the boiling economy.

It was a heady time in state government; nearly everything seemed possible. This attitude was not only manifest in significant new spending initiatives,[19] but also in tax cuts.[20] There was something for everyone. As the decade closed, any thought that state government might be living beyond its means was blunted by revenue growth of a whopping 10% in 2000 alone.

All that came to an abrupt end with the recession of 2001.[21] While the 2001 recession was rather temperate by historical standards, its juxtaposition with an era of substantial economic growth, made it seem inordinately harsh. State government finances were profoundly affected. The 10% *growth* in 2000 was replaced by an 8% *decline* in 2001. Further, the upward spending demands, still a hangover of the 1990s continued, almost unabated. It was almost as though state government had a delayed reaction to the recession.

But reality did sink in as the depth of the state's fiscal condition became widely apparent. Dictated by requirements built into the state's Constitution, the Governor called a special session of the Legislature to ensure that state government would be able to meet its cash commitments. Distressing fiscal news was to be found at every turn and was a major theme in the 2002 gubernatorial and legislative elections. In short, since 2001 the state's fiscal condition has dominated public policy issues in Wisconsin.

Along with a growing awareness of Wisconsin's fiscal dilemma was an interest in diagnosing its cause. Increasingly policymakers were looking for answers as to how state government's fortunes reversed so quickly. Were there signs that foreshadowed the downfall? The state's deficit, which had been reported in relative obscurity, became a focus of policy discussions. Once relegated to accounting publications, the CAFR was now front-and-center. The CAFR's day had arrived. The existence of an official state report that documented fiscal insolvency jibed with the general perception of the state's fiscal condition.

Of particular note was the formation of a Joint Legislative Special Committee on Improving Wisconsin's Fiscal Management.[22] The committee met several times in the fall of 2002 and heard testimony from both state and national fiscal experts. The committee performed a postmortem of sorts on the state's gloomy fiscal condition. A number of factors were sighted, but special attention was reserved for the well-documented state deficit. The committee was especially captivated by the notion of the CAFR in that it was based on GAAP accounting:

> GAAP-based financial statements more accurately depict the state's financial condition . . . As a result, GAAP-based financial statements can expose a budget deficit otherwise obscured by the budgetary basis of accounting required by state law, which is focused on the two-year biennial budget.[23]

The committee came to understand the link between the deficit documented in the CAFR and the fiscal reality facing state government in 2002. The CAFR was no longer seen as an isolated esoteric fiscal report. In writing for the Special Committee on Improving Wisconsin's Fiscal Management, Staff Attorney Mary Offerdahl noted:

> The committee recognizes that the GAAP-reported deficit was a central problem facing the committee, and the legislative action on the budget is impaired to the extent that the Legislature does not take into account the longer-term fiscal management concerns reflected by GAAP.

Further, the committee demanded action. Its members seemed dissatisfied with simply having uncovered the importance of the CAFR, they pushed for change in the way Wisconsin went about its fiscal business. For example, they pushed the Legislative Audit Committee to hold a special hearing each year after the CAFR is issued. The committee also drafted legislation encompassing tangible steps to reduce the deficit. In response to the charge from the special committee, the Legislature's Joint Audit Committee has held hearings on the CAFR in both years since the report was issued. But the legislative response to the special committee ended there. It is revealing that none of the other changes called for by the committee have been enacted. What should be read into the lack of action?

Prospects for the Future

Wisconsin state government owns a deficit of $1.9 billion, which represents nearly 18% of revenues. This is not an obscure academic calculation. It is a stark, straightforward fiscal accounting determined by applying widely recognized accounting standards to state government's financial transactions. Any private business hoping to remain solvent with a balance sheet in this condition would undoubtedly implement drastic measures in order to return to a positive balance. But is such the case for state government? The answer to date is no, and will likely remain no unless specific measures are put in place to reduce the deficit.

The current deficit is not a new phenomenon for Wisconsin government. Yet, not one action has been taken to reduce the deficit since it was first reported in 1990. During that time state revenue collections have experienced both highs and lows, from a one-year increase of 10% in 2000 followed by an 8% decline in 2001. Regardless of whether revenue growth was robust or depressed, the state's deficit has continued to mount. The deficit, once passed off as an arcane accounting measure, has come to be understood as a sign of significant fiscal weakness. Further, the deficit is adding to Wisconsin's cost of borrowing.

Clearly, it is in the interest of Wisconsin taxpayers to at least reduce, if not eliminate, the deficit. However, as the past fifteen years have demonstrated, there has been scant movement made to reduce the deficit. Reducing the deficit has simply not risen high on decision-makers' list of priorities. Deficit reduction has represented a classic clash between sound fiscal management objectives and more popular policy goals.

When revenue collections have tightened, the clash has yielded a balance sheet with lower reserves, delayed payment dates, an artificially stretched revenue collection period, and a large dose of one-time funding applied to ongoing obligations. Wisconsin budgets have regularly been artificially balanced, a fiscal flaw that is clearly exposed by the CAFR. Wisconsin's budget culture has been to do whatever it takes to balance the budget on a cash basis. Spending cuts and revenue increases are seen as a last resort. Yet even when dollars have been more plentiful, the clash between fiscal management and popular policy goals has pushed deficit reduction to the end of the line. When forced to compete with new spending initiatives or tax cuts, reducing the deficit has fared poorly. This is particularly noticeable through the 1990s, a decade that saw large revenue increases but no reduction of the deficit.

Small Steps in Deficit Reduction

Out of Wisconsin's recent fiscal crisis there has emerged a growing appreciation for understanding the root cause of the state's deficit. In recent years a number of small measures have been taken to at least raise the awareness of the deficit. While the Special Study Committee on Improving Wisconsin's Fiscal Management drafted legislation aimed at reducing the deficit, none of the measures was enacted. However, the committee did succeed in raising the awareness of the deficit.

In response to a recommendation from the Special Committee, the Legislature's Joint Audit Committee has become proactive in highlighting the results of the CAFR. In each of the past two years the committee has held a hearing regarding the state CAFR. The sessions have raised the awareness of legislators about state government's deficit.

Also in a public awareness vein, the statutes call for the Governor, in presenting his budget, to show the impact the budget will have on the deficit, according to GAAP standards. This provision was put in state statutes in 2001 when the depth of the state fiscal crisis was beginning to emerge. On page thirty of the Governor's budget was the table required by law, showing a deficit in excess of two billion dollars. However, the impact was negligible.

In the presentation of the Governor's 2003-2005 biennial budget, most of the emphasis was placed on how the Governor had closed the large budget gap without raising taxes. The 2003-2005 biennial budget was prepared in the comfortable, traditional manner with a focus on the cash available in the next two years.

The two initiatives listed above represent small steps toward highlighting the deficit. Yet the impact seems slight.

Other measures have been enacted into law in an attempt to improve Wisconsin's fiscal management. For example, Wisconsin statutes provide for a rainy day fund, formally called the budget stabilization fund. Many states have established rainy day funds to receive some excess tax collections when revenue growth is robust. The budget stabilization fund has been in place since 1986, but no money has been appropriated to the fund. A budget stabilization fund without money is an empty promise.

Therefore, in the 2001–2003 budget a new provision was inserted into the statutes that would automatically put money into the budget stabilization fund during times of significant revenue growth. Specifically, statutes provide that, when state revenue collections exceed projections, 50% of the surplus is to be deposited into the budget stabilization fund. The maximum amount to be transferred to the fund is 5% of General Purpose Revenue (GPR), which would be approximately $585 million. While the intent of the rainy day fund is to accommodate difficult budget times, nothing would prevent the Governor and the Legislature from using the funding for something other than a fiscal emergency. Thus, the current structure of the budget stabilization fund is only as reliable as the commitment of policymakers to leave untouched any money appropriated for the fund.

Another provision intended to improve the state's balance sheet is a limitation on state spending enacted as part of the 2001-2003 budget. (In the discussion of tax freezes and a Taxpayers Bill of Rights this spending control is often overlooked.) The provision limits GPR spending to the percentage growth in personal income. Much of the state budget is exempt from this provision, including all spending on education and debt service payments. Since this provision was enacted it has not been tested because modest revenue growth has effectively held spending in check. It will be interesting to see how effective this provision will be in restraining spending over the long run.

Finally, it should be noted that the statutes call for the state to include in the budget a small, undesignated balance to accommodate slight swings in revenue collections and spending estimates. Prior to the enactment of the 2003-2005 biennial budget, the statutes called for the balance to be at least 1.8% of GPR appropriations. However, the budget bill changed the law to lower the requirement to just 0.3% of total spending. Ironically, this provision, intended to bolster fiscal management, was used as a source of funding in a difficult budget. This is an example of how a seemingly strong provision can be altered to suit the times. Any moves to reduce the deficit must recognize that statutory provisions are only as strong as the commitment to abide by them.

Therefore, in spite of the many attempts to improve the fiscal condition of the state, they have yet to yield any tangible improvements in the state's deficit. To an extent this is due to the fact that state revenue collections have been weak since the package of fiscal improvements were enacted in 2001. The true test will be seen in future budgets when the effects of the 2001 recession have subsided and annual increases in revenue collections return to normal levels. Will the existing tools be used to reduce the deficit?

Bigger Steps for the Future

Those who tout fiscal responsibility are quick to suggest that the state move to reduce, and eventually eliminate, the deficit. However, there are two powerful factors that will make reducing the state's deficit elusive. First, the state continues to operate with two sets of books. As long as the budget is oriented around cash accounting principles, addressing the deficit will remain an "extra." No elected official is likely to suffer any consequences of a deficit-riddled budget, as long as there is one set of books that shows state finances as being in balance.

Second, there is no constitutional or statutory requirement to reduce the deficit. It remains at the discretion of decision-makers to allocate the resources needed to reduce the deficit. Reducing the deficit will continue to compete with other demands for state funding. For deficit reduction to become a reality it will have to be considered at least on a par with the growing demand for Medicaid funding, or popular education initiatives, or shared revenue, or tax reductions. In short, deficit reduction must compete well in the political process known as the state budget.

Over the decades, Wisconsin budgeting has been marked by a culture that has allowed a number of fiscal maneuvers to forestall an unbalanced budget. This has resulted in the current fiscal crisis facing state government. If Wisconsin had prepared its budgets using GAAP principles, the state would be in much sounder fiscal straights than it is. However, in practice GAAP standards have had little impact on either the management of state government or the preparation of the budget.

Sixteen states do prepare their budgets according to GAAP principles.[24] Wisconsin has a long way to go before it can join these states. It remains devoted to the largely cash-based budget system that has yielded the worst deficit in the country. A number of factors are working against Wisconsin changing its budget culture:

- The size of the deficit, representing 18% of revenues, is imposing. Even the most determined policymakers find eliminating the deficit to be almost overwhelming.
- Reducing and eventually eliminating the deficit will require the acquiescence and the active support from policymakers in Madison. Yet the track record since the deficit was first documented in 1990 suggests little interest in reducing the deficit.
- Elected officials are being asked to solve a problem that is not of their making. The current $1.9 billion deficit is the result of budget decisions made over several decades.

Recognizing these realities, Wisconsin taxpayers would be well-served by a goal of moving state government toward a GAAP-based budget and real movement toward reducing the deficit. This process would be aided by the following measures:

- A statutory prohibition against making the current deficit worse.
- A statutory requirement that adds $100 million each year to the state's unobligated reserves (this could include the budget stabilization fund). The greater the budget reserve, the smaller will be the deficit.
- The Legislature should deliver to the Governor a budget developed under the current cash-based process as well as one presented on a GAAP basis. A statutory provision should be enacted requiring a vote in each house on both versions of the budget. The GAAP budget might not balance but each legislator would know how his or her vote affects the state deficit.
- The measures currently in place, as well as those listed here, should be insulated from the mainstream of the budget process. History has shown that when fiscal solvency measures compete with tax cuts and spending, fiscal solvency always loses. Measures designed to reduce the deficit should be funded before other spending initiatives are approved. Further, a supermajority vote should be required to modify fiscal solvency measures.

The goal for Wisconsin state government should be to eventually produce budgets that balance using GAAP principles, just like local governments and businesses throughout Wisconsin. State government should take the steps necessary to begin to reduce its long-standing deficit.

NOTES

1. The budget gaps of the states were documented in *Budgeting Amid Fiscal Uncertainty* prepared by the National Association of State Budget Officers in 2004.

2. The comparison between the actual and the forecasted revenue collections is detailed in *State Revenue Forecasting in Wisconsin*, a May 2004 report authored by Scott Niederjohn for the Wisconsin Policy Research Institute.

3. A Wisconsin Policy Research Institute report, *Reforming Wisconsin's Budget for the Twenty-First Century, (*April 2003) noted that in the decade of the 1990s state government spending increased by an average of 6.9% annually, which contrasts with inflation increases of only 2.9% and population growth of .9%.

4. Fiscal Year 2000 General Fund collections were $10,946 million. Fiscal Year 2003 collections were $10,200 million yielding a reduction of 7%. The reduction was in part due to a tax law change.

5. Documents issued in support of the Governor's 2003-05 budget identified a gap of $3.235 billion between base revenues and known spending needs.

6. From November 19, 2004, press release issued by the Wisconsin Department of Administration.

7. George Lightbourn, *Reforming Wisconsin's Budget for the Twenty-First Century*, Wisconsin Policy Research Institute, April 2003.

8. The Legislative Audit Bureau issues an *Independent Auditor's Report* annually attesting to the accuracy of the Comprehensive Annual Fiscal Report.

9. A slowing of the U.S. economy in 2001 adversely affected the revenue collection in nearly every state. In Wisconsin, 1999-2000 revenue collections totaled $10.9 billion. In 2000-01 collections dropped to $10.1 billion.

10. Based on FY 2003. General Fund Tax Revenues of $10.2 billion as reported in an August 29, 2003, letter from the Legislative Fiscal Bureau.

11. Article VIII, Section 5 of the Constitution requires the Legislature to levy sufficient taxes to defray the expenses of the state. If the state overspends in one year, the Legislature must raise revenues in the following year to cover outstanding expenses.

12. The biennial budget passed by the Legislature in July 2003 showed a positive balance of $146.4 million. Since then the size of the balance has been estimated downward due to uncertainties both in revenue collections and spending.

13. Vol. 1, page 107, *National Council on Governmental Accounting*, 1981.

14. Based on *Budgetary – GAAP Reporting Reconciliation* from the 1990 CAFR.

15. National Association of State Budget Officers, *Fiscal Survey of the States: December 2003*.

16. Testimony of Frank Hoadley, State Capital Finance Officer, before the Special Committee on Improving Wisconsin's Fiscal Management.

17. The growth of state revenues was primarily due to the significant increase in income tax collections as documented by the Wisconsin Policy Research Institute Report, *Reforming Wisconsin's Budget for the Twenty-First Centur*y.

18. *State Revenue Forecasting in Wisconsin* compared actual revenue collections to the state's official forecast prepared biennially by the Department of Revenue. Actual collections compared to more frequent revenue projections prepared by the Legislative Fiscal Bureau would yield a lower amount of unanticipated revenue.

19. In Wisconsin, school aids, corrections, and medical assistance were three of the more significant new spending drivers.

20. Late in the decade of the 1990s legislation was approved that reduced the number of tax brackets and lowered the marginal rate. In addition, the state was able to return over $700 million to taxpayers in the form of sales tax rebates.

21. The National Bureau of Economic Research pegged the recession as lasting from the first quarter of 2001 to the third quarter of that year.

22. The committee was appointed by the Legislative Council in May 2002. The Committee was co-chaired by Senator Jauch and Representative Friske.

23. From the final report of the Special Committee on Improving Wisconsin's Fiscal Management.

24. National Association of State Budget Officers, *Budget Processes in the States, January 2002*.

About the Institute

The **Wisconsin Policy Research Institute** is a not-for-profit institute established to study public-policy issues affecting the state of Wisconsin.

Under the new federalism, government policy increasingly is made at the state and local levels. These public-policy decisions affect the life of every citizen in the state. Our goal is to provide nonpartisan research on key issues affecting Wisconsinites, so that their elected representatives can make informed decisions to improve the quality of life and future of the state.

Our major priority is to increase the accountability of Wisconsin's government. State and local governments must be responsive to the citizenry, both in terms of the programs they devise and the tax money they spend. Accountability should apply in every area to which the state devotes the public's funds.

The Institute's agenda encompasses the following issues: education, welfare and social services, criminal justice, taxes and spending, and economic development.

We believe that the views of the citizens of Wisconsin should guide the decisions of government officials. To help accomplish this, we also conduct regular public-opinion polls that are designed to inform public officials about how the citizenry views major statewide issues. These polls are disseminated through the media and are made available to the general public and the legislative and executive branches of state government. It is essential that elected officials remember that all of the programs they create and all of the money they spend comes from the citizens of Wisconsin and is made available through their taxes. Public policy should reflect the real needs and concerns of all of the citizens of the state and not those of specific special-interest groups.