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The Exploding Use of Debt to Finance Government in Wisconsin

REPORT FROM THE SENIOR FELLOW:

As deliberations on the 2007 state budget stretched from summer into fall, a good deal of discussion centered on taxes. Very little attention was paid to the amount of debt in the budget. Yet, the level of debt authorized today will directly set the level of taxation needed in future years. As Wisconsin's debt load continues to grow, the tax burden for Wisconsin families and businesses will grow right along with it.

There is a very telling chart in this report showing that the growth of debt has far outpaced the growth of tax revenue. State government is spending money faster than it is taking it in. That added spending has been fueled by debt. Anyone who has a mortgage or has taken out a car loan has had a banker ask, "are you good for it, can you repay the loan?" Bankers have been more than willing to approve debt for Wisconsin government because they know that, no matter what, the Wisconsin taxpayers will pay. The taxpayers are good for it.

The Wisconsin Policy Research Institute has documented the growing trend in government to increase spending in the short term without worrying about when the bill will come due. The WPRI has documented that Wisconsin is carrying a $2.2 billion deficit when the budget is measured using the rules that all businesses and most governments follow. However, the public is only beginning to understand the danger of state government's pattern of deferring responsibility for payment to the future.

That is why this report is valuable. As explained by author Christian Schneider, a WPRI Fellow, debt is something everyone can understand. We all know the risk we run when we borrow more than we should. That is why the mounting stack of IOUs in state government is unsettling. Every man, woman and child in Wisconsin now owes $3,500 in debt to pay for unfunded state spending.

In this report, Mr. Schneider traces the growth of debt from the days when debt was constitutionally prohibited to contemporary times when debt is accepted and embraced. Most disturbing in his report is the explosion of debt in recent years. As Schneider details, debt has become an accepted way to prop up spending in the state budget, even when money is tight.

We have watched Wisconsin's debt-per-capita ranking climb from 40th in 1969 to 10th by 2003. Where debt was once restricted to building infrastructure, it is increasingly relied upon to support higher spending across-the-board. As result, Wisconsin's mounting debt has two negative consequences. First, the state's credit rating has fallen, making each state borrowing more expensive. Second, we are assured of higher taxes in the future because, as the bankers understand all too well, Wisconsin taxpayers will pay.

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THE EXPLODING USE OF DEBT TO FINANCE GOVERNMENT IN WISCONSIN

CHRISTIAN SCHNEIDER

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Every new tax is immediately felt more or less by the people. It occasions always some murmur, and meets with some opposition. . . . [D]ebt is not immediately felt by the people, and occasions neither murmur nor complaint.

Adam Smith — *An Inquiry into the Nature And Causes of the Wealth of Nations, 1776*

EXECUTIVE SUMMARY

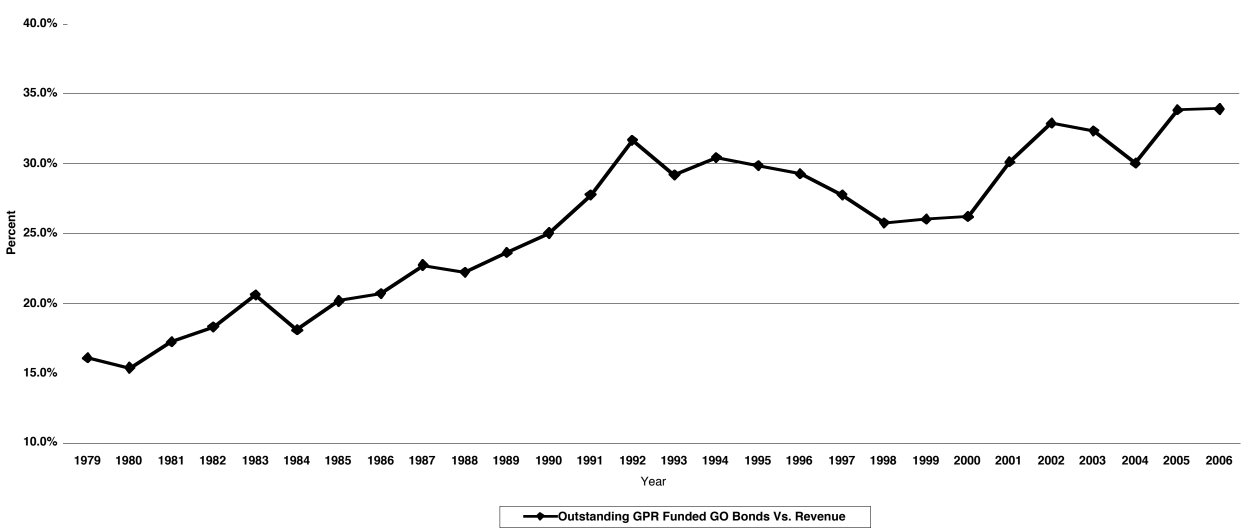
Throughout the early part of Wisconsin history, governmental debt was limited primarily to capital building projects. In 1969, the Wisconsin Constitution was amended to allow the state to issue debt directly. Previously, the state funded capital expenditures by using "dummy corporations," which issued bonds on behalf of the state. Road projects were often funded by local governments, which were then reimbursed by the state. The 1969 constitutional amendment allowed state government to take control of its own debt issuance, rather than leaving it up to independent corporations.

Since Wisconsin began issuing debt directly, the level of debt issuance has expanded dramatically — much of it within the last decade. In addition, the purposes for which the state takes on debt have greatly expanded. Whereas once bonding was used exclusively for state "brick and mortar" projects, debt is now used for programs to provide home loans for veterans and poor individuals, to purchase land for conservation, to clean chemical spills, and sometimes even to boost school aids and fund local governments.

In 1969, when the constitution was amended to allow the state to issue bonds, Wisconsin had $392.8 million in outstanding debt, issued primarily through building corporations. In December 2006, Wisconsin had $19.3 billion in outstanding debt, or $3,476 for every state resident. By comparison, the total amount of general fund taxes the state is expected to collect in 2007-08 is $12.8 billion.[1] Shortly before the 1969 constitutional amendment passed, Wisconsin ranked 40th in the nation in state debt per capita.[2] By 2003, Wisconsin had risen to 10th in per capita debt outstanding[3] — and state debt has increased substantially since then.

Furthermore, the state has issued debt in excess of taxpayers' ability to support that debt. Chart 1 illustrates the growth in General Purpose Revenue (GPR)-supported General Obligation (GO) bonds relative to actual GPR. In 1979, outstanding GPR-supported GO bonding equated to 16.1% of state GPR. By 2006, that number had more than doubled, to 33.9%. This tells us that GPR-funded GO bonding has grown substantially in relation to tax revenue.

CHART 1 OUTSTANDING GPR-FUNDED GO BONDS AS A PERCENTAGE OF GENERAL FUND REVENUE



Source: Wisconsin Department of Administration Bond Issuance Reports, Legislative Fiscal Bureau

As the amount and purpose of debt issuance in Wisconsin continues to expand, two things have become clear. First, state government has utilized debt to purchase things it may not have otherwise been able to afford if it had to use cash financing. Increases in building and land procurement programs indicate the short-term desire to deliver projects to legislative districts, while delaying the cost of these projects for future generations to pay.

Secondly, debt is more often being used as a budgetary tool, rather than a way to buttress the state's infrastructure. Increasingly, debt has been relied upon to bail the state out of difficult budgetary situations brought on by declining revenues and increasing funding pressures.

This report examines the increased use of debt by state government, and how the growing reliance on bonding can be traced to pressures to find short-term answers to the state's fiscal problems.

INTRODUCTION

Recent tight state budgets and citizen distaste for higher taxes have prompted the Wisconsin governor and legislature to greatly expand the purposes for which the state issues debt. In doing so, the state and separate authorities created in state statutes have taken on large amounts of new debt, which could have serious consequences for future taxpayers.

For over a century, debt issuance in Wisconsin was primarily used for capital projects. There are a number of benefits to bonding for construction costs. First, the cost of a project is spread out throughout the life of the project, and spreads the liability to future users. Thus, the benefits for the project will be paid by the people that actually benefit from its construction (drivers, dorm residents, etc.).

Second, citizens receive the near-term benefit of a project being completed more quickly when bonding is used. Since higher short-term taxes are avoided to complete a project, buildings and roads can be built immediately, rather than having to raise taxes all at once or wait years for completion.

Third, when a state uses bonding to construct a building or purchase land, that property increases in value over time. The value may actually increase at a rate faster than the bond repayment rate, which could turn the state a profit in the event the property were ever sold.

Despite the benefits of using debt to finance capital projects, there are also disadvantages. First, debt repayment commits the state to many years of fixed costs. In tough economic times, debt service is the first draw on general fund revenues. Debt service must be paid before any other state government programs are funded — if state revenue goes down, debt service must still be paid at the same levels. It cannot be reduced to aid in repairing budget shortfalls, although it can be refinanced if interest rates are favorable.

Second, as anyone with a mortgage knows, the total cost of projects increases substantially when debt is used, as interest accrues. When thirty years of interest is paid, the state might end up paying double or even triple for a project over its base cost, depending on the rate of the bond's issuance.

Furthermore, by utilizing bonding, some low-priority projects that wouldn't be approved by using cash gain approval. Projects are far easier to approve knowing the costs will be borne by future legislators and governors. Many projects that wouldn't get the green light if cash financing were used are easier to approve if the costs are pushed off.

Finally, excessive bonding without commensurate increases in funding sources can affect state credit ratings, which may increase the cost of borrowing. While the market determines interest rates, a lower bond rating could increase the cost of government borrowing. The credit rating on Wisconsin's bonds has been downgraded twice by credit agencies since 2002, due in large part to various fiscal management techniques employed by the governor and legislature.

Securities that are general obligations of the state, and which are secured by taxing power, are known as "general obligation" (GO) bonds. These bonds are backed by a pledge of the "full faith and credit" of the state, and generally receive lower interest rates as a result.

Securities backed by a dedicated stream of revenue are generally referred to as "revenue bonds." In general, there are two types of revenue bonds in Wisconsin: those that are used for enterprise operations, such as water systems, and those that are used for dedicated revenue sources, such as the transportation and clean water revenue bonds.

In general, when user fees are relied upon to pay for the financing of the facilities, revenue bonds are used. General obligation bonds are generally used when the citizenry as a whole is to pay for the facilities through taxes.

In some circumstances, bonding unrelated to capital expenditures can save the state money, if interest rates are favorable. For instance, in the 2003-05 biennial budget, Governor Doyle recognized that Wisconsin had a large unfunded liability with regard to the state's pension and sick leave obligations. While the state would have had to pay annual interest of 8% over a 30-year period for state employee benefits, a better interest rate could be had if the state used bonds to fund the obligation. Thus, bonds were issued to fund pension and sick leave obligations, and the total 30-year liability was reduced by $324 million.[4]

While this example illustrates the benefits of bonding for ongoing obligations, there are serious drawbacks, depending on how the bond revenues are utilized. Using one-time bonding revenue for ongoing programs creates a structural deficit that must be filled in the subsequent budget. For instance, the use of one-time bond revenue from securitization of Wisconsin's tobacco settlement created a large hole in funding in the next biennium.

In the case of the pension and sick leave bonds, Governor Doyle utilized an accounting strategy to save the state short-term money in the 2003-05 budget. The Governor structured the thirty-year bonds such that no interest payments were made from the general fund in the first two years. The budget proposal front-loaded about $70 million in savings from the bonds into the first biennium, leaving 28 years of debt service. Not making those debt service payments in the first two years of the biennium allowed Governor Doyle to spend that $70 million on school aids, payments to local governments, and other general purposes. Since that $70 million saved by not making interest payments wasn't available in the 2005-07 budget, the state had to come up with new funding sources for general-purpose programs that had been funded by the savings in the previous biennium.

Furthermore, these pension and sick leave bonds set a potentially troubling precedent — allowing general fund-supported borrowing to support an ongoing operational expense. With the creation of these new appropriation bonds, the state now has expanded authority to issue debt for literally any budgetary purpose it sees fit — a far cry from the intent to use debt to finance capital costs.

This strategy of funding ongoing programs with debt is a new phenomenon for Wisconsin state government, and will be discussed in this report. Furthermore, this report will look at some of the benefits and drawbacks of state reliance on debt, and describe the myriad ways that debt is being utilized in state government.

THE HISTORY OF DEBT IN WISCONSIN

The Prohibition on Debt

In the 1830s, nine states defaulted on the long-term general obligations they had contracted for the construction of roads, canals, banks, and railroads. In order to prevent future government loan defaults, between 18 and 20 new states included constitutional provisions that prohibited their state from incurring debt, or greatly inhibited their ability to do so. Generally, these were states that were new to the Union in the 1840s and 1850s, and Wisconsin, admitted to statehood in 1848, was one of them.

During this period, government debt was becoming increasingly unpopular. Illinois and Michigan, two states adjacent to Wisconsin, had saddled themselves with burdensome debts and were struggling to dig themselves out. The trend among states establishing their constitutions at the time was to adopt the 1844 New Jersey standard of a $100,000 debt limit for states.

At the Wisconsin Constitutional Convention, the committee delegated to write the financial provisions of the new constitution recommended a debt limit of $200,000, with a limit of ten years to retire any debt issued. Instead, through negotiation among delegates, a $100,000 limit was adopted, with a five-year debt retirement period. Exceptions to the limits were made to repel invasion, suppress insurrection, or to defend the state in a time of war.[5]

With the constitutional debt limit enacted, Wisconsin began to incur debts below the prescribed limit. In 1852, $50,000 was borrowed to pay off the debt inherited from the territorial government, to build an asylum for the blind, and to operate a state prison. In 1858, $50,000 was borrowed to enlarge the Capitol and to build a "hospital for the insane."

During the Civil War, Wisconsin borrowed $2,251 million to pay for war expenses under the war exception to the constitutional debt prohibition. These bonds were issued to private investors. It took the state nearly 80 years to pay off the debt on the Civil War borrowing, as debt payments by state government were suspended for decades. In 1903 and 1904, the federal government gave Wisconsin $1.2 million to aid in settling the state's war claims — but these funds were used for "property tax relief" rather than paying down the Civil War debt. Interestingly, many of the Civil War bonds were purchased from private investors by school trust funds. Thus, if the state paid off the bonds, the interest distributed to school districts may have been less, and the state would then just have to increase school aids to make up for the loss in interest revenue for schools. The bonds were finally retired in 1943.[6]

Between the Civil War and the end of World War I, Wisconsin constructed buildings on a cash basis. The state saved money and paid for new capital projects with existing funds, which made it increasingly more difficult to keep up with the state's building needs. By 1910, the introduction of fire-proof construction methods rendered obsolete buildings that had wood as interior support.[7]

Aside from direct appropriations for building projects, the state used other methods to fund capital projects. Profits from state programs such as sales from the binder twine factory at the state prison were used to fund construction projects at the prison. The state borrowed funds from the state insurance fund and the teachers' retirement fund to pay for the State Office Building and the Memorial Union at the University of Wisconsin. Funds raised by the Wisconsin Alumni Research Foundation were also used, among other revenue sources.[8]

Building Corporations

In order to alleviate the pressure to fund new building projects, the state constructed a way to legally circumvent the constitutional restriction on issuing debt. State government began issuing debt on the basis of the "special fund doctrine," which states that there is a difference between debts based on the full faith and credit of the state and debts that are paid for with revenues derived from use of the structure.

In order to issue this debt, the state proceeded to set up extra-governmental corporations, which would receive state government assistance to construct buildings. Under this arrangement, the state would lease state-owned land to a corporation, which would then agree to erect a building on the land for state use. Revenues from the use of the building were then used to pay off debt service. When the building was paid for, it was then transferred to the state.[9]

In 1923, the state set up the first extra-governmental corporation to issue debt. The University Building Corporation was created to acquire land and construct buildings for the benefit of the University of Wisconsin. For 14 years, the University Corporation was the only such "dummy corporation," until a series of authorities were created to erect buildings at the Grand Army at King, at Stout Institute, and at other state colleges. In 1949, a corporation to erect general state office buildings was created and authorized to issue debt for that purpose. By 1957, four principal building corporations had been authorized by the Wisconsin legislature.

The state continued to fund construction through a mix of bonding and existing revenues. In 1949, Wisconsin created the State Building Trust Fund, which set aside 1% of the replacement cost of the state's buildings per year in a separate fund. Also in 1949, the state increased the cigarette tax by one cent and set aside $6.3 million of the revenues from that tax increase for building projects. In 1952, the set-aside amount for the State Building Trust Fund was increased to 2% and made retroactive to 1949. In 1943, the state created the Post-War Construction and Improvement Fund, which set aside 10% of all income taxes collected in a two-year period for building projects.[10] By 1952, Wisconsin had accrued $5 million in debt through its corporations, thereby finding ways to work around the debt restriction.

Despite creation of both the borrowing and cash-based construction funding mechanisms, Wisconsin government facilities weren't adequately prepared for the post-World War II population explosion. The state's population increased from 3.1 million to 3.9 million between 1940 and 1960, which necessitated more schools, colleges, roads, and human service infrastructure. While the Post-War Construction Fund had accumulated $192 million between 1949 and 1965, it wasn't nearly enough to fund Wisconsin's capital needs.

In 1954, the Wisconsin Supreme Court addressed the state law that authorized private corporations to authorize loans to build state buildings. In *State ex rel. Thomson v. Giessel, 267 Wis. 331*, the Court held:

> Where the objective of a lease of an addition to the state office building by the state from the Wisconsin State Public Building Corporation, a private corporation, was to benefit the state, and the arrangement was one highly advantageous to the state, the obligation of the state to pay future rentals to the corporations until the corporation's loan to provide funds with which to construct the new addition should be paid, thereby enabling the corporation to obtain the loan, did not constitute giving or loaning the credit of the state or the benefit of the corporation in violation of the provision in sec. 3, art. VIII, Const., prohibiting the giving or loaning of the state in aid of any individual, association, or corporation.[11]

This decision paved the way for more borrowing by the state for capital projects, assuming the debt was issued through a corporation and not paid directly by the state. Borrowing in the wake of this decision began almost immediately. In the 1955-57 biennium, the state building fund received $17 million in bonding revenue for capital projects. By 1969, the state's biennial bonding authorization had increased to $150 million, and outstanding debt owed by the state was $392.8 million. The following chart demonstrates the growth in corporation borrowing following the *Thomson* decision in 1954.

TABLE 1 WISCONSIN LONG-TERM DEBT OUTSTANDING, 1956-1969 (IN MILLIONS)

Year	Amount	Percent Change
1956	$4.2	N/A
1957	$22.1	426.2%
1958	$32.7	48.0%
1959	$43.2	32.1%
1960	$60.0	38.9%
1961	$72.2	20.3%
1962	$127.5	76.6%
1963	$131.4	3.1%
1964	$133.4	1.5%
1965	$165.1	23.8%
1966	$200.3	21.3%
1967	$269.5	34.5%
1968	$303.4	12.6%
1969	$392.8	29.5%

Source: The Wisconsin Taxpayers Alliance
"The Wisconsin Taxpayer," Vol. 42, No. 7, July 1974

Amending the Constitution

Frequent attempts were made during Wisconsin's history to allow direct borrowing by the state. However, in the late 1960s, the movement to amend the Wisconsin Constitution to allow the state to issue debt began to pick up steam.

In the 1963 session, the legislature created a special panel dubbed the "Committee of 25" to "survey appropriate measures by which the people of Wisconsin can be assured that the expenditures for state and local government will remain within the capacity of the taxpayer and will be used most efficiently." The Committee's final report, issued in March 1965, recommended "the Wisconsin Constitution should be amended to permit the full faith and credit of the State of Wisconsin to be used in borrowing funds for building purposes." The report also recommended limiting the total debt that may be incurred.

Proponents of direct borrowing by the state argued that using the full faith and credit of state government would allow debt to be issued at a much lower interest rate, which would save a great deal of money in the long run. Furthermore, supporters of a constitutional amendment to allow borrowing argued that the state would have more control over the debt it would incur if that debt had to be issued via specific legislative approval.

In 1967, the Wisconsin legislature passed the first consideration of a constitutional amendment to allow direct state borrowing. As required by the Wisconsin Constitution, it would need to be passed by the next legislature and approved by popular vote of the public in order to take effect.

The proposed amendment contained a provision that limited the amount of debt the state can offer to the lesser of:

1. 0.75% of the aggregate value of all taxable property in the state; or
2. 5% of the aggregate value of all taxable property in the state, less the state's net indebtedness as of January 1 of the current year.

During the time the legislature debated the new constitutional amendment, it was unclear what the effect the change would have. In June 1967, Representatives Harold Froelich and Frank Schaeffer, Jr. wrote a letter to Attorney General Bronson La Follette, asking how the amendment might legally be applied. In their questions, the two representatives anticipated the possibility that bonding may someday be issued for "general anticipated requirements."

In his response to the legislators, Attorney General La Follette stated clearly that "general" programs could not be funded with debt issued by the state. He said,

> The constitutional provisions do not permit borrowing for the payment of ordinary current expenses. The language of the proposed amendment and of other constitutional provisions must be adhered to. Borrowing can be only for those purposes which are specifically stated or necessarily implied. . . . Borrowing could not be for general purposes, or for generally anticipated but uncertain requirements in those areas for which borrowing would be permissible.[12]

In 1969, the legislature passed the second consideration of the constitutional amendment by overwhelming votes (89-to-11 in the Assembly and 23-to-8 in the Senate). On April 1 of that year, Wisconsin voters approved of the measure by a 61% to 39% vote. Shortly thereafter, the legislature created the Building Commission, which was given the responsibility of overseeing all public debt. The Commission was headed by the governor, and included six legislators and one citizen member.

In 1975, the Constitution was again amended, this time to allow the state to borrow money to fund a veterans housing loan program. Under the program, the state would borrow funds to pay for veterans' home loans, and the debt service would be paid back with the interest paid by the veterans. This amendment passed more narrowly, with 56% of the state's voters casting their ballot in favor of the new program.

In the same election voters were asked to expand the state's bonding authority for veterans' mortgage loans, they were also asked to add "transportation facilities" to the list of permissible uses of bonding. Despite initially narrowly passing, a recount of the vote showed the amendment actually failed. Amid controversy, the legislature rescheduled the vote on the amendment for November 2, 1976. The second time around, this constitutional expansion for transportation was resoundingly voted down 56.5% to 43.5%.

While the public rejected the expansion of state indebtedness for transportation purposes, the state legislature wasn't deterred in its quest to use bonding for other purposes. In 1971, the legislature created the Wisconsin Housing Finance Authority, which was intended to act as a funding vehicle for the development of housing for low-and moderate-income families. Funds to cover the bonds would be raised through rents and interest on investments. Much like the building corporations in previous years, the Authority was created as an extra-governmental authority to circumvent constitutional limits on the amount and purpose of bonding. The Authority was allowed to issue notes and bonds which were solely the obligation of the Authority — however, if obligations outpaced revenues, the legislature was required by law to appropriate funds to make the Authority solvent. The initial law passed by the legislature applied a moral obligation to funds issued by the authority for both housing acquisition and rehabilitation. This moral obligation provided bond purchasers with more comfort, since taxpayers would be required to pay the bonds off should the Authority default.

The 1969 constitutional amendment allowing state debt issuance specifically prohibited the use of extra-governmental corporations for the construction of state buildings. Given that the new Housing Finance Authority looked very much like a corporation, its constitutionality was tested in court. In 1973, the Wisconsin Supreme Court ruled that since the Finance Authority was not designed to provide any buildings for state agency occupancy, the constitutional prohibition on public corporations did not apply.

In 1973, the legislature created the Wisconsin Health Facilities Authority, which provided funding for the development of new hospitals, nursing homes, and other health-related facilities. The new law creating the Health Facilities Authority stated specifically that the bonds they issued were payable only by the Authority, and there was no moral obligation provision for the state.

Given the new bonding authority via constitutional amendment, the state quickly began issuing debt. In 1970, Wisconsin issued $126.7 million in general obligation debt. By 1980, the state had $458 million in GPR-funded, GO bonds outstanding.

Wisconsin's Growth in Debt Reliance

Throughout the 1970s and into the new millennium, state government became increasingly reliant on debt. Since Wisconsin began issuing debt in 1970, the state has authorized $18.5 billion in GO debt. Of that $18.5 billion, $15.9 billion has been issued or used by the state. $2.4 billion of the $18.5 billion total in general obligation debt authorization was authorized in the most recent 2005-07 biennial budget. Thus, 13% of the total debt authorized by the state since 1970 occurred in the most recent two-year period.

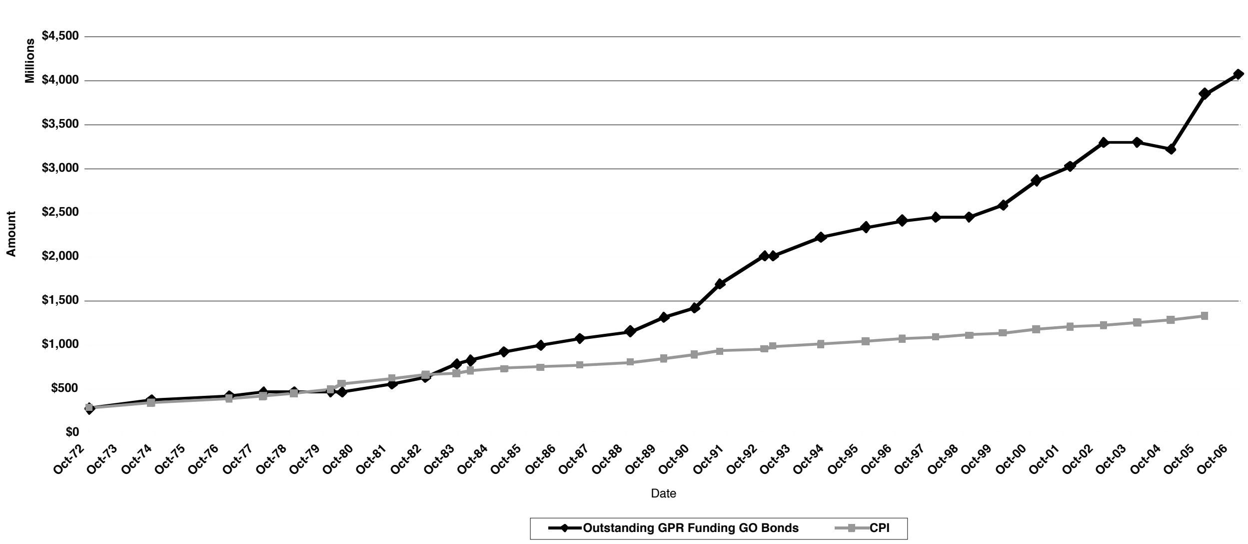
To examine the growth in state reliance on debt, it is instructive to detail the level of general fund-supported, GO bonding the state has issued. As noted, the state issues several types of debt, both directly and through authorities. GO bonding is debt issued by the state directly that is backed by the "full faith and credit" of the state government.

GO bonds can be funded with general fund tax revenue, through program revenue, or be self-amortizing (the veterans home loan program, for instance).

It is instructive to examine the level of GO bonding funded with general fund revenue, and to compare that bonding level with actual general fund revenues. As previously demonstrated in Chart 1, GO bonding relative to tax revenue has grown in the past three decades. A dip can be seen in the years between 1998 and 2000, as the booming economy and legislative tax changes spurred state tax revenue growth (8.1% in 1998, 4.4 % in 1999, and 10% in 2000). Naturally, when revenue increases rapidly, growth in bonding levels will appear to be falling by comparison.

The dramatic increase in taxpayer-supported debt can also be illustrated by comparing the growth in bond issuance versus inflation. Chart 2 compares the annual level of outstanding GPR-funded GO bonds versus the annual change in the Consumer Price Index (CPI), as determined by the United States Bureau of Labor Statistics.

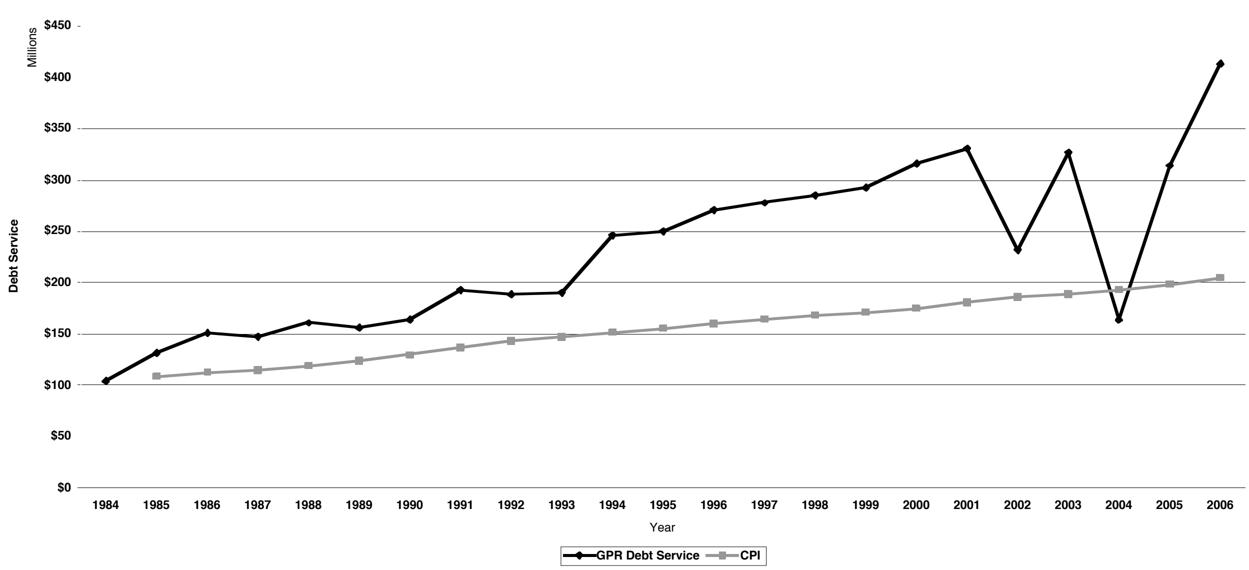
CHART 2 OUTSTANDING GPR-FUNDED GENERAL OBLIGATION BONDS VS. CPI



Source: Wisconsin Department of Administration Bond Issuance Reports, U.S. Bureau of Labor Statistics

As can be expected, a large increase in GO bonding translates into higher annual debt service payments for the state. Chart 3 compares the increasing annual general fund debt load with the growth in inflation.

CHART 3 GENERAL PURPOSE DEBT SERVICE VERSUS INFLATION



Source: Legislative Fiscal Bureau, U.S. Bureau of Labor Statistics

In the years between 2002 and 2004, the state issued $302 million in “refunding bonds,” which allow the state to restructure existing debt to pay debt service in the future. This financing strategy, which often commits the state to paying higher debt service costs in the future in exchange for immediate relief, will be discussed in more detail later.

Traditionally, the Wisconsin Department of Administration has indicated a goal of making sure that annual GPR debt service never exceeds 4% of annual general fund revenues, with a preferred target range of between 3% and 3.5% of annual general fund revenues. DOA policy as set forth in the biennial Budget in Brief document for many years was that debt issuance should be structured so that the 3.5% upper limit of the preferred target range would not be exceeded in the long term. This target was established based on input from bond rating agencies about what a reasonable and prudent level of debt service is. For many years, DOA published a chart in the Budget in Brief that showed debt service costs for existing issued bonds and also projected debt service costs for authorized but unissued bonds as a percent of general fund revenues, looking eight years into the future. Under this policy, the amount of new bond authorizations in each biennium would then be limited to an amount that would result in total debt service of no more than 3.5% of GPR revenues in future years. Despite the total amount of outstanding GPR-supported bonds outpacing state revenues, debt service for the most part has been kept within this range. (See Appendix A.)

However, if the 3% to 3.5% of annual revenue debt service goal is not looked at as a long term goal, but merely as a snapshot of current GPR debt service, it would have little bearing on budgeting decisions being made today. Any increased bonding approved in the current budget wouldn't affect that percentage goal, since almost all of its effect would be in subsequent biennia.[13]

From a short-term perspective, budgeting strategies can be utilized to keep GPR debt service under DOA's goal in the current biennium without actually restraining bonding. As mentioned previously, debt can be restructured to reduce debt service paid in the current fiscal year, as was done between 2002 and 2004.

Additionally, GPR debt service payments can be shifted to other funds to keep the GPR share of debt service artificially low. For instance, in the proposed 2007-09 biennial budget, the administration has proposed converting $26.6 million in 2007-08 and $43.3 million in 2008-09 from GPR debt service to the transportation fund. The debt service still exists, however it will be paid out of gas tax and vehicle registration revenue rather than the general fund. The Legislative Fiscal Bureau estimates that were this debt service shift not to occur, the percentage of GPR debt service compared to GPR revenues would be 4.11% in 2007-08 and 4.2% in 2008-09, which exceeds the administration’s traditional goal.[14]

ALL-FUNDS BONDING

The increase in debt issuance by Wisconsin state government isn’t limited to general fund tax-supported bonds. Wisconsin state government has rapidly increased the use of revenue bonds, self-amortizing bonds, and authority bonds.

Currently, Wisconsin has $19.3 billion in outstanding debt at the state level. Much of the debt issued represents a broad expansion in the purpose of bonding by state government since the state began issuing debt directly.

TABLE 2 WISCONSIN STATE-LEVEL DEBT OUTSTANDING (AS OF DECEMBER 2006)

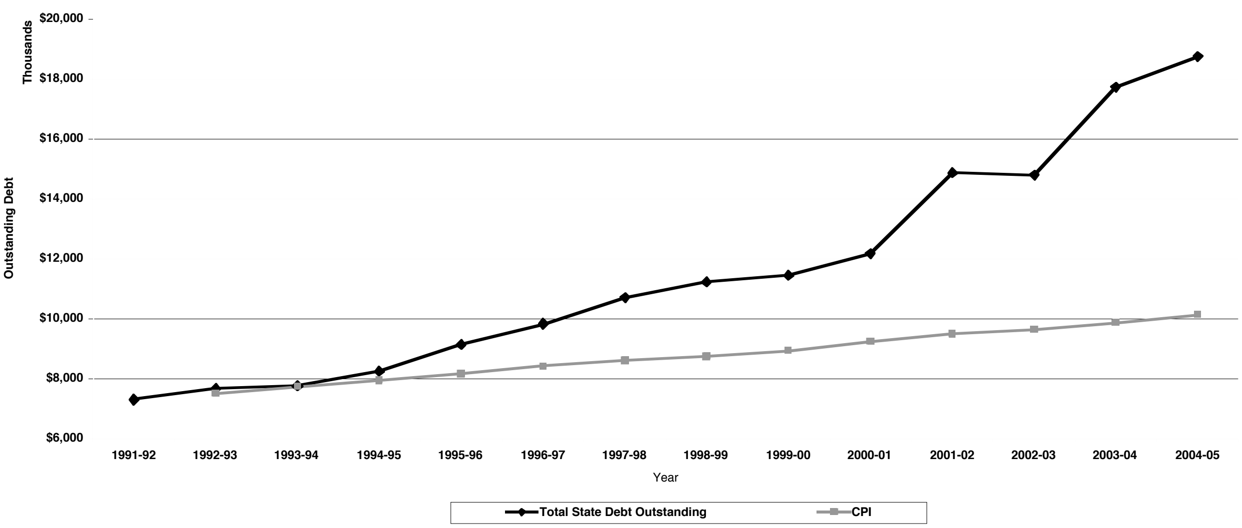
General Obligation Bonds	Amount
Tax-Supported	$4,400,314,275
Self-Amortizing	$1,296,994,413
Total:	$5,697,308,688
Revenue Bonds	
Transportation Revenue Bonds	$1,540,000,000
Clean Water	$776,700,000
PECFA	$272,600,000
Total:	$2,589,300,000
Appropriation Bonds	
Pension and Sick Leave	$1,795,000,000
Authority Bonds	
WHEFA	$6,500,000,000
WHEDA	$2,500,000,000
University Hospitals	$234,000,000
Total:	$9,234,000,000
Total State-Level Bonding	**$19,315,608,688**

Table 2 details the amount and type of state-level debt currently outstanding:

In recent years, Wisconsin's use of debt has accelerated. In the years between 1992 and 2005, total debt outstanding by Wisconsin state government and state-created authorities jumped 157%, with most of the increase coming in the most recent five-year period. In the nine years between 1992 and 2000, total state outstanding debt rose an average of 6.3% per year. In the subsequent five years (2001-05), annual increases in outstanding debt nearly doubled to 10.8% per year.[15]

Chart 4 demonstrates the growth in state outstanding debt between 1992 and 2005, as compared to inflation.

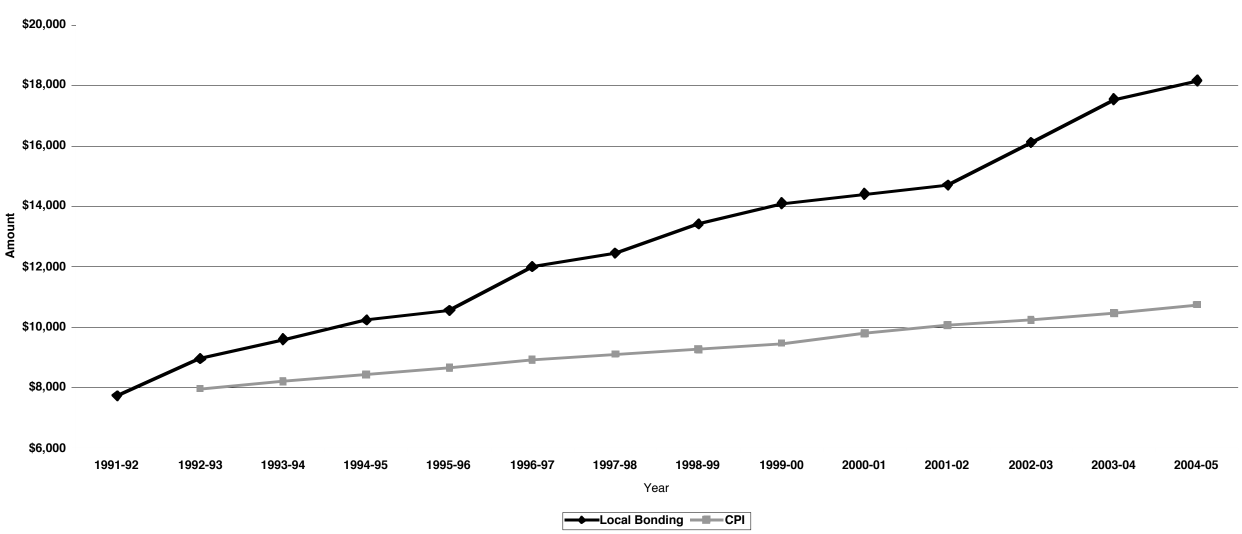
CHART 4 TOTAL WISCONSIN STATE OUTSTANDING DEBT 1992-2005 VS. CPI (IN MILLIONS)



Source: U.S. Census Bureau, State and Local Finance Data, U.S. Bureau of Labor Statistics

The state isn't the only level of government that has seen a recent dramatic increase in bonding. Municipalities, counties, school districts, and technical colleges all utilize bonding for economic development, construction, and infrastructure needs. In the last 15 years, local government bonding in Wisconsin has increased by 137%. Chart 5 compares the total level of local bonding to inflation:

CHART 5 LOCAL DEBT OUTSTANDING IN WISCONSIN VS. CPI (IN MILLIONS)



Source: U.S. Census Bureau, State and Local Finance Data, U.S. Bureau of Labor Statistics

Of course, Wisconsin isn't the only state to see dramatic increases in the use of debt. In 2002, state and local governments nationwide had $1.6 trillion in long-term debt outstanding, up from $954 billion a decade earlier.[16]

However, during the period in which Wisconsin has been able to issue debt directly, its state per capita debt ranking has steadily increased. In 1970, when the state began issuing debt, Wisconsin ranked 40th in state-issued debt per capita.[17] By 1997, Wisconsin had risen to 24th. And by 2002, Wisconsin had risen all the way to number 10 in the nation in total debt outstanding per capita.[18] This demonstrates the rapid growth in utilization of debt by Wisconsin levels of government in relation to that of other states.

Bonding to Pay for Things Government Can't Afford

The previous section detailed government's increased reliance on debt. The question then becomes: Why has the state increased bonding so rapidly? What are taxpayers getting for committing their money to decades of fixed costs?

As noted, the Wisconsin Constitution contains a provision that limits the amount of debt the state can offer to the lesser of:

1. 0.75% of the aggregate value of all taxable property in the state; or
2. 5% of the aggregate value of all taxable property in the state, less the state's net indebtedness as of January 1 of the current year.

Table 3 details the amount of total GO debt issued by the state of Wisconsin in the past ten years, and the debt contracted as a percentage of the constitutional debt limit.

Table 3

Calendar Year	GO Debt Contracted	Debt Limit	Debt Contracted as Percent of Limit
1997	$404,310,000	$1,748,056,751	23.1%
1998	$475,485,000	$1,867,461,864	25.5%
1999	$482,360,000	$1,999,256,351	24.1%
2000	$538,795,000	$2,147,411,189	25.1%
2001	$485,645,000	$2,343,627,800	20.7%
2002	$481,000,000	$2,514,948,590	19.1%
2003	$499,030,000	$2,705,326,585	18.4%
2004	$664,435,000	$2,933,908,610	22.6%
2005	$571,999,000	$3,209,501,715	17.8%
2006	$891,285,000	$3,517,373,999	25.3%

Source: Legislative Fiscal Bureau Informational Paper 74, State Level Debt Issuance

As can be seen by the table, there really is no meaningful limit on state debt issuance. As the state stands now, only one quarter of the limit is currently being utilized. If the state's debt level were to come even close to the limit, the private bond market would make debt issuance prohibitive. Furthermore, since the debt limit is tied to property values, rapidly increasing land values could give the state even more room under the limit.

In fact, there are only two meaningful limits on the amount of debt that the Wisconsin state government can issue, yet the actual effect of each on holding down debt is questionable.

1. The Political Process

One way to limit reliance on debt is for the public to hold their legislators and elected officials responsible for the increased future costs they incur. If the public became dissatisfied with the increasing debt load they and their children were being burdened with, they could vote their legislator out.

In fact, it appears that the political system is much more accommodating to legislators who are willing to advocate *for* bonding. To many legislators, debt means projects — land acquisition, road improvements, and new buildings. In fact, many constituents actually believe the role of their legislator is to bring projects back to their district. It is likely that a legislator that brings one of those projects home is likely to get more political credit than they are blame.

Thus, the irony of the political process as a watchdog of excessive debt: What is supposed to be a check on irresponsible budgeting could actually become an incentive to incur debt. Elected officials aren't ensured of a new term — the idea that their constituents should benefit now and pay later seems perfectly reasonable to legislators.

Furthermore, for the total debt level in Wisconsin to be a campaign issue, it would require both media scrutiny and candidate attention. Realistically, debt issuance is rarely written about, and is, at best, a minor campaign issue.

2. The Bond Market

The other check on excessive bonding could be the bond market, where municipal bonds are bought and sold. If the market is unfavorable, higher interest rates could make it more expensive for the state to borrow money. Increased debt service costs, when added to the cost of a project, could slow down the approval process. Additionally, the market considers the amount of debt when evaluating state credit.

When the state decides to issue debt, it contracts with an underwriter, who purchases the entire bond issue with the intent of selling the issue on the open market for profit. For especially large issuances, several underwriters may band together to get involved, thus spreading the risk. When underwriters sell the bonds to investors on the open market, they must price them high enough to make a profit, but low enough to entice prospective purchasers to buy them. Naturally, the less expensive the bonds are, the greater yield to the investor there will be. However, pricing them too low means the underwriter may need to sell them at a loss.

The interest rates at which bonds are issued are influenced by a variety of market factors. Of course, it is in the interest of the state to sell its bonds at the lowest interest rate possible, as low rates mean less money to pay off in the future. Interest rates are affected most by the supply of money in the economy. When the nation's economy has a higher supply of money, interest rates tend to be lower. Conversely, when money supply is low and there is more competition for capital, interest rates tend to rise.

The quantity and quality of the bonds issued also influence the rates they carry. The "quality" of an issue deals with the amount of risk an investor is taking on by purchasing the bonds. The higher the chance a bond issuer will default on paying back the bonds, the higher the interest rate on the bonds will be.

However, when one examines the increase in general obligation bonding in the past thirty years, it is difficult to pinpoint projects to which legislators have actually said "no." Bond market interest rates certainly have fluctuated over time, yet state level bonding has consistently increased over that period of time. It is possible that state bonding could have been higher during some periods had interest rates been lower, but it doesn't appear to have been that substantial of a barrier.

The Building Commission

The discussion of state government utilizing bonding to purchase property and construct facilities has to start with the Building Commission, a board which oversees state capital projects.

The Wisconsin Building Commission was created in 1949, with the purpose of creating a long-term building program for the state. The Commission is responsible not only for authorizing bonding for the construction of state facilities, but also renovation and maintenance of existing state properties. The Commission is comprised of the governor, who serves as chair, one governor-appointed citizen member, and three legislators from each house of the legislature, with both majority and minority members being represented. The Commission meets monthly to review projects before them, including pending bond issuances.

The Building Commission is responsible for approving the Capital Budget, which is then attached to the State Biennial Budget for consideration by the legislature. Projects greater that $500,000 are required to be enumerated by the Building Commission, then approved by the full legislature.

Table 4 details the amount of GPR-supported GO bonding approved by the Building Commission in the past ten biennial budgets.

While the Building Commission process is well established, certain recent practices relating to bonding for state projects have drawn scrutiny from board members. Certain actions by the Building Commission have called into question whether the board has full control of debt issuance.

Table 4 GPR-Supported General Obligation Bonding Approved by the Wisconsin Building Commission (in Millions)

Biennium	Amount
1989-91	$278.9
1991-93	$468.1
1993-95	$225.6
1995-97	$246.7
1997-99	$366.2
1999-01	$424.4
2001-03	$712.2
2003-05	$247.2
2005-07	$667.9
2007-09	$448.4*

*-Proposed

Source: Legislative Fiscal Bureau, GPR-Supported Bonding Authorizations and 2007-09 Building Program Projects (Building Program), May 24, 2007

1. Non-State Project Bonding

Traditionally, state-approved bonding has been used for state purposes. However, in recent years, several non-state projects have been approved. These are generally non-state level enterprises for which the state provides bonding, with the debt service being paid by state taxpayers.

For instance, the proposed 2007-09 capital budget provided $10 million for Translational Research Equipment at the Medical College of Wisconsin, $2.5 million for a Hmong Cultural Center, and $500,000 for a Kenosha Civil War Museum. Other recent budgets have approved projects such as: $1 million for the Nash Auto Museum, $2 million for a Swiss Cultural Center, $1 million for a Milwaukee Police Youth Activities Center, $1 million for the Racine Discovery Museum, and $1.5 million for a Holy Redeemer Academy Youth and Family Center.

Projects with no state purpose that are funded with state tax dollars should theoretically sound an alarm. The appropriateness of asking state taxpayers to pay the principal and interest for non-state ventures is questionable. In the case of the proposed $10 million for the Medical College of Wisconsin, those funds are being used to purchase equipment for non-state buildings — which is a departure from the traditional use of bonding for brick-and-mortar purposes for non-state projects.

However, as discussed previously, certain legislators often fight vigorously to retain these "pork" projects, for which they can then take credit around election time.

2. "Advance" Enumerations

Traditionally, the majority of bonding issued for state buildings has been for the University of Wisconsin System (in the 2005-07 capital budget, the UW accounted for 81.7% of project-specific funding).

A recent trend for the UW System is to try to obtain "advance" enumerations for building projects. These are essentially placeholders for bonding in future budgets that, if approved during a past budget, is not revisited in the future. Some have argued advance enumerations are a way the UW has been able to expand their bonding allotments.

For instance, the 2007-09 budget proposed $115.9 million in advance committed borrowing: the BioStar project ($31 million), State Historical Society/Department of Veterans' Affairs Storage ($15 million), University Health Services ($39.9 million), Sterling Hall in Madison, ($20 million), and the Platteville Tri-State Initiative ($10 million). Initially, the budget contained another advance commitment for UW-Milwaukee totaling $28.3 million.[19] However, at the recommendation of the Department of State Facilities (DSF), that bonding was delayed for two more years. The department stated to the Building Commission that too many advance commitments were pending, and the project was eliminated.

Advance commitments change the dynamic in subsequent biennial budgets. New legislative sessions often bring new legislators to the Building Commission, who will be expected to honor authorized, but unused, bonding approved in the past.

3. The Lure of Private Dollars

One strategy begun in the 1990s has been to push the Building Commission to approve projects with the promise of private matching dollars. The UW might request a private donor pledge a large contribution to partially fund a project. If the state denies the request, it appears that the state is forgoing the donation — but in approving the project, it is pledging taxpayer-supported bonds for what is often the vision of an individual donor.

In 2006, UW Alumni John and Tashia Morgridge made a commitment of $50 million to fund the third portion of the state's BioStar project, the Wisconsin Institute for Discovery. BioStar is a UW construction project developed in the early 1990s that is designed to foster research in biochemistry, nanotechnology, computer engineering and bioinformatics.

The project's financing also called for a $50 million donation from the Wisconsin Alumni Research Foundation (WARF) and $50 million in GO bonding from the State of Wisconsin. As originally proposed, once state funding was approved the entire design and construction of the project would be turned over to WARF, to spend the state's money. For the first time a non-state entity, WARF, would be the contractor on a state building project. Essentially, the state gifted the land to WARF, who contracted for the work, and will then gift it back to the state when construction is complete. This process allowed WARF to circumvent certain state contracting policies.

It is certainly possible that the private donors used their leverage to take control of the project from the state. Had the state demanded certain provisions, the donors could have threatened to withhold their contributions. Regardless of the merits of these projects, the Building Commission often loses a degree of control when gift funds are used.

Having successfully attracted state dollars for the Institute for Discovery, the UW System is currently seeking funds for the UW-Madison Human Ecology Addition and Renovation project. In fact, the UW has taken the process a step further in seeking advance enumeration for the Human Ecology project, arguing that approval of funding for the project will help attract private dollars. Instead of the preferred method of private dollars being pledged before state approval of a project, these new arrangements require a pledge of the state into new bonding before any commitment is made.

The Knowles-Nelson Stewardship Program

In the last decade, bonding has been expanded to include environmental programs, which have grown quickly in both size and scope. This new bonding has been used primarily to purchase state land for conservation. It could be argued that this use of bonding allows the state to purchase land it couldn't otherwise afford, while pushing the costs off into the future.

In 1961, Wisconsin Governor Gaylord Nelson began the Outdoor Recreation Act Program (ORAP), which purchased land for conservation purposes. The program was funded by a one cent tax on cigarettes, and purchased land with cash on hand. In the first five years of the program, 197,000 acres of recreational land was purchased.[20] A 1967 task force report to Governor Warren Knowles recommended issuing bonds "selectively and prudently" in order to increase revenue for land purchase.[21] The program was expanded in later years by Governor Knowles.

In 1989, the ORAP program was replaced by the Stewardship program (later named after Knowles and Nelson), which used bonding revenue to purchase state land for conservation and to expand recreational opportunities. The original program allowed for $250 million in general obligation bonding over a ten-year period.

In 1999, the program was reauthorized at a level of $460 million in GO bonding for the next decade, or $46 million per year. Just two years later, the 2001 biennial budget increased that amount to $60 million in bonding per year beginning in 2002-03 and ending in 2009-10. This increased the total 20-year GO bonding authority to $803 million for the Stewardship program.[22]

As of June 30, 2006, the Department of Natural Resources (DNR) had purchased 1.4 million acres of land, which represented approximately 4% of the state's land area (34.76 million acres). Stewardship land is found in 71 of the state's 72 counties, and the DNR has set an acquisition goal of 2.5 million acres for the program.[23]

The 2007-09 budget recently signed in October by Governor Doyle increased annual bonding for the Stewardship program to $86 million per year for an additional ten years. Of this $86 million in general fund-supported borrowing, $62 million annually is devoted to land acquisition and $21.5 million would be used to aid local government property development and recreation programs. $2.5 million is dedicated to a new recreational boating aids subprogram. The budget as signed increased total bonding authority for the Stewardship program to $1.66 billion, up from its current level of $803 million.

Of course, utilizing bonding to purchase property also means paying interest costs over the life of the bonds. As noted, $803 million in bonding has been authorized for the Stewardship program as of 2007. The Wisconsin Legislative Fiscal Bureau estimates the interest paid on these bonds to be $1.3 billion over a 40-year period. Debt service on Stewardship purchases in the upcoming budget is estimated to be $55.5 million in 2007-08 and $61 million in 2008-09, 77% of which will be paid from general purpose revenue. The remainder is paid from the segregated forestry account of the state conservation fund.

As initially introduced, Governor Doyle's budget expanded bonding to $105 million per year for the next decade. If the provision had passed, total bonding authorized over the life of the program would have increased to $1.85 billion and interest costs would have jumped to $2.9 billion, according to the Legislative Fiscal Bureau.[24]

Aside from the interest costs for bonding, there are other ancillary expenditures the state must make for the Stewardship program. When the state purchases land, it makes a payment in lieu of property taxes to the local government. These payments are split between the state's general fund and the state conservation fund, and totaled $7.2 million in 2005-06.

In the year 2000, the Legislative Audit Bureau conducted a study to investigate whether the state was overpaying for land purchased through the Stewardship program. The audit found that the DNR was paying an average of 120% more per acre for properties than their assessed value reflected.[25] When compared on a per property basis, the difference between assessed and purchase price was 304.9%, according to the audit.[26] In fact, on many purchases, the DNR would accept the price of a property based on an appraisal done by the property's seller.

For instance, the Department purchased a 1.4 acre property in Newport State Park in Brown County for $360,000, while the assessed value was $70,000 — meaning the state paid 414.3% more than the assessed value. Even on large grant purchases, the DNR wasn't even doing their own appraisal, instead counting on the word of the seller to set the price.[27]

In the 2002 budget adjustment bill, the legislature changed the law to require two appraisals, although Wisconsin taxpayers continue to pay the debt service on previous purchases questioned by the Audit Bureau.

THE WISCONSIN HOUSING AND ECONOMIC DEVELOPMENT AUTHORITY

Numerous new government programs have been created through the Wisconsin Housing and Economic Development Authority (WHEDA), and financed with bonding. While WHEDA bonding is different than GO debt in that it employs revenue bonds paid for by users of the programs, WHEDA is a good example of how bonding can lead to an expansion in a program's size and scope.

As noted, the Wisconsin Housing Finance Authority was created by the legislature in 1971 with the mission of providing affordable housing loans to low- and middle-income Wisconsin citizens. The Authority was created as a public corporation with the authority to issue bonds, in order to lessen the total amount of debt issued directly by the state. In 1973, the Wisconsin Supreme Court ruled that the Authority was not a state department and the state was not obligated to pay off the Authority's bonds. Consequently, the Court concluded that the constitutional limitations on government debt issuance did not apply to the Finance Authority.

In 1983, the mission of the Authority was greatly expanded to allow debt issuance for a number of new purposes. Pursuant to this legislative change, the Authority was able to issue bonds to finance economic development projects and export sales of Wisconsin products. In order to reflect the new duties of the Authority, it was renamed the Wisconsin Housing and Economic Development Authority.

In subsequent years, the mission of WHEDA expanded to even more purposes. In 1985, the legislature authorized creation of the credit relief outreach program (CROP), which provided farmers with low interest agricultural production loans and interest rate subsidies on the loans. The Authority was provided $11 million in general-purpose revenue in 1984-85 to finance the loans. Furthermore, WHEDA was granted $7.5 million in 1988-89 to guarantee and subsidize drought assistance loans.

In the years following the creation of the aforementioned agricultural loan programs, the scope of WHEDA's bonding programs grew rapidly. Between 1989 and 1997, eleven new programs were created for WHEDA to administer. This expansion included programs for small business loans, tourism development, nonpoint source pollution, agricultural chemical cleanup, clean air, ozone protection, farm asset reinvestment, and safe drinking water (many of these programs were repealed from WHEDA and consolidated under the Small Business Development Program in 1997). Additionally, several programs were authorized by the legislature but then quickly revoked due to funding problems.[28]

Through July 1, 2006, WHEDA had issued $8.1 billion in bonds and notes, of which $2.5 billion were outstanding. In January 2006, Governor Doyle signed a bill that expanded WHEDA's bonding authority for low- and moderate-income housing programs from $325 million to $600 million, among other changes. Included in these changes was a controversial proposal that required a social security number for an individual to receive a WHEDA loan — a law change that angered some in Wisconsin's immigrant communities.

While WHEDA is funded with revenue bonds, it provides a lesson as to how the use of bonding can be expanded once a program is created. Once a debt-funded program is established, splitting its purposes to meet whatever needs emerge at the time is a tempting proposition for lawmakers.

Bonding Used to Balance the Operating Budget

One of the newer uses of debt at the state level is to utilize bonding as a budgetary tool, to be used to patch up revenue shortages to the state's general fund. Not only does this increase the state's bonding level and push tough decisions into the future, it also creates structural problems, as bond revenues are one-time in nature.

Numerous strategies have been utilized in recent budgets to incur long-term debt to solve short-term programs. Each of them worsens the state's structural deficit and forces the government into a difficult position in the future.

Transportation Bonding To Benefit The General Fund

Bonding has traditionally been used for building and infrastructure. By issuing debt for capital projects, the state obtains the use of a tangible asset.

However, in recent years, the state has greatly expanded the purposes for which it accumulates debt. This has led to debt being used for ongoing general government operations, as opposed to capital projects. This not only increases the total cost of paying for ongoing appropriations, it also causes significant budget problems in the future. These phenomena are demonstrated by the recent use of transportation bonding to shift funds to general-purpose appropriations.

As Table 5 below shows, between 2003 and 2007, the governor and legislature transferred a total of $1.1 billion out of the transportation fund to pay for general-purpose programs, and backfilled those transfers with $815.5 million in new bonding.

Table 5

	2003-05	2005-07	4-Year Total
Transfers and Appropriations	$675.0	$427.0	$1,102.0
Less General Obligation Bonds	-$565.5	-$250.0	-$815.5

Source: Legislative Fiscal Bureau, 2007 Informational Paper 40, "Transportation Finance,"p. 6.

In the 2003-05 budget, the governor proposed shifting funds out of the transportation fund and into the general fund. Since transportation projects traditionally have been an appropriate use for debt issuance, Governor Doyle backfilled the hole that transfer created in the transportation fund with more bonding. As a result, bonding was extended to highway rehabilitation, which has traditionally been considered a day-to-day operation and financed with gas tax and vehicle registration revenues.

The shift of funds out of the transportation fund in the 2003-05 budget consisted of $400 million to pay for the state's shared revenue program, which aids local government expenditures, and $100 million to school districts. When the budget moved through the legislative process, the legislature agreed to these funds transfers. When the final budget became law, $675 million had been transferred out of the transportation fund and replaced by $565.5 million in bonding.

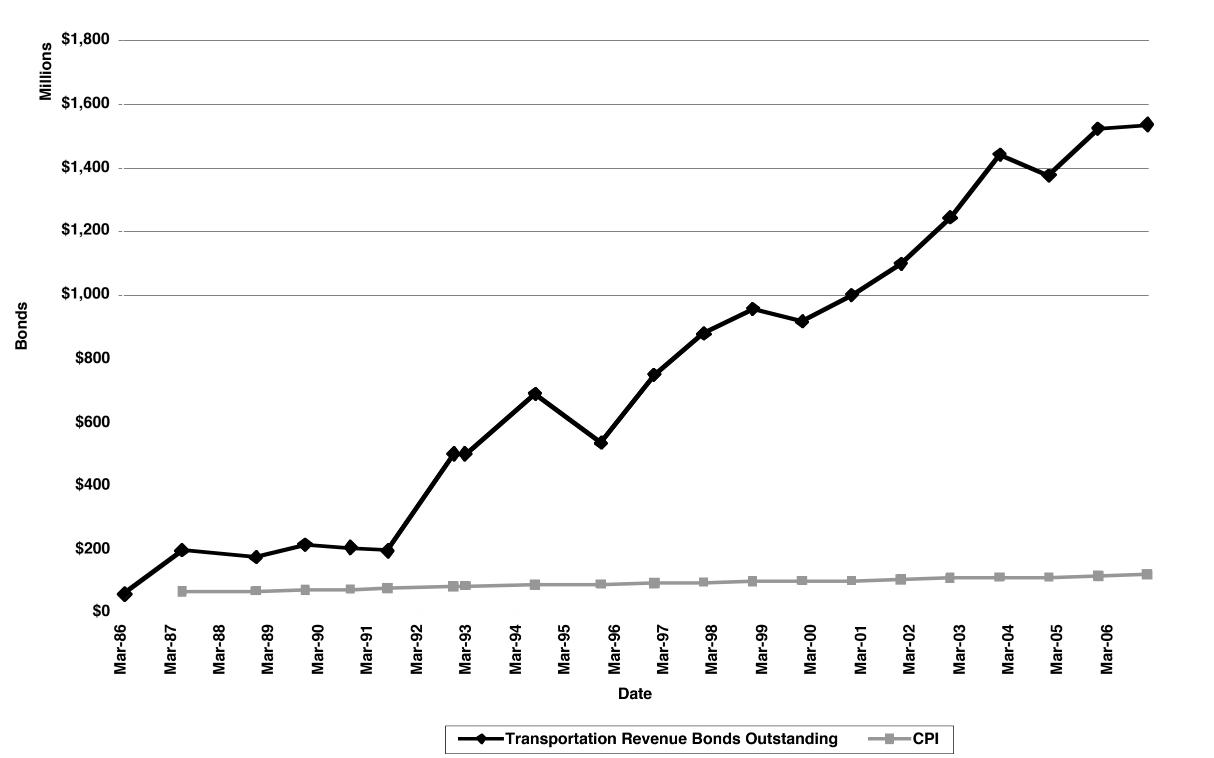
Of this $565.5 million in new transportation revenue bonding, $483.9 million was authorized for state highway rehabilitation, which had never before used bonding.[29] Whereas rehabilitation had always been funding on a cash basis, it would now be funded by bonding for the 2003-05 biennium — to allow the cash that it had normally used to be shifted to the general fund.

The 2005-07 budget initiated a similar fund shift. While the legislature agreed to much of the governor's proposal, Governor Doyle utilized a creative line-item veto that transferred $427 million out of the transportation fund for general fund use. This fund shift was accompanied by a $250 million bonding increase for the transportation fund to backfill the transfer out of the fund.

As demonstrated in Table 5 above, the replacement of transportation with bonding revenue has left the transportation fund with a $330.4 million loss over the previous four years (once $43.9 million in debt service is accounted for). This loss to the account has prompted Governor Doyle to propose gas tax and vehicle registration fee increases in his 2007-09 budget to make up for the lost revenue.[30]

Wisconsin began issuing bonding for highway projects in 1969, when the Constitution was amended to allow the state to issue debt. Before the amendment, municipalities and counties were able to issue debt for road construction, and the state oftentimes would pay the debt service on those bonds. Prior to 1984, Wisconsin issued transportation bonds as GO debt, with revenues from gas taxes and vehicle registration fees pledged for repayment. In 1984, state government began issuing transportation bonds as non-GO revenue bonds, instead supported by specific transportation-related revenues. As a result, these new bonds didn't carry the state's moral obligation pledge. Following the initial transportation revenue bond issue in 1984, the amount of these bonds outstanding quickly escalated. Chart 6 details the growth in transportation revenue bonds outstanding, as compared to inflation.

CHART 6 TRANSPORTATION BONDS OUTSTANDING VS. CPI (IN MILLIONS)



The state's experience with transportation bonds mirrors the increased use of GO bonds. The following table shows that the use of bonding has grown faster than revenues to the transportation fund. Most notably, debt service has increased significantly in the past six years. In 2002-03, debt service increased from 7% of gross revenues to 11.8% in 2006-07, due in most part to bonds issued to fill a hole left by transfers from the transportation fund to the general fund. The number dipped in 2005-06 due to debt service on transportation bonds being paid from the general fund, rather than the transportation fund.

TABLE 6 (IN MILLIONS)

Fiscal Year	Total Debt Service	Gross Revenues	Debt Service as % of Revenues
1995-96	$67.3	$1039.8	6.5%
1996-97	$76.4	$1047.4	7.3%
1997-98	$78.7	$1141.7	6.9%
1998-99	$87.4	$1235.1	7.1%
1999-00	$90.3	$1271.1	7.1%
2000-01	$94.5	$1283.4	7.4%
2001-02	$93.3	$1337.7	7.0%
2002-03	$105.8	$1386.6	7.6%
2003-04	$119.7	$1440.4	8.3%
2004-05	$166.2	$1482.9	11.2%
2005-06	$148.2	$1523.3	9.7%
2006-07*	$184.9	$1566.0	11.8%

*Estimate

Source: Legislative Fiscal Bureau 2007 Informational Paper #40, "Transportation Finance"

The debt service on the replacement bonds continues to grow. In the proposed 2007-09 budget, it is estimated that debt service on these bonds will cost the state $175.9 million. By the time the $815.5 million in replacement bonds are repaid, Wisconsin taxpayers will have paid an additional $1.1 billion in debt service on the bonds.[31]

The one-time nature of these fund transfers have exacerbated the state's structural deficit, which is the disparity between future anticipated revenues and funds needed to satisfy future obligations. Since revenue transferred from the transportation fund is not an ongoing funding source, the governor and legislature have several options in the next budget to make up the loss in available funds for ongoing appropriations (such as school aids and shared revenue). They may cut spending to these programs, which is politically unpopular and therefore difficult to do. They may raise taxes or fees to fill the hole. Or they may continue to use budgeting maneuvers to cover over the hole, such as using the transportation fund to pay for general purpose programs (as has been proposed in the 2007-09 budget).

Refunding Bonds

Recently, bonding has been used to refinance the state's debt service on previously issued bonds. Through "refunding bonds," the state can replace an old stream of debt service payments with a new stream in order to take advantage of lower interest rates ("economic refunding"), or the state can issue new bonds to stretch debt service payments out into the future, with savings realized in earlier years ("structural refunding").

In January 2004, the Wisconsin Legislative Fiscal Bureau indicated that the state's Medical Assistance (MA) Fund would be short $310 million, due to federal revenues the state budgeted for, but wouldn't receive. As a result, the governor and legislature had to act quickly to make sure MA had enough funds to operate.

Their answer to fund a large portion of this deficit was to issue $175 million in new structural refunding bonds, which allowed the state to retire debt service on previously issued bonds. The remaining funding — the $175 million in general purpose revenue saved by not having to pay debt service on the old bonds — was shifted to the MA fund. Thus, the new bonding, along with other fiscal maneuvering, allowed the governor and legislature to fully fund MA benefits.

Despite the success in funding MA, there are downsides to the use of refunding bonds as a budgetary band-aid. As estimated by the Fiscal Bureau at the time of the restructuring, interest on the new bonds would be $46.1 million higher than if the original bonds had been paid off on schedule. Furthermore, the Fiscal Bureau estimated that general fund principal and interest payments were $52.3 million higher in 2005-06 and $30.2 million in 2006-07 with the new bonds.[32]

Thus, the use of refunding bonds had a negative effect on future budgets. First, the new bonds will cost the state more money in the future. The short-term relief the state received from not having to pay $175 million in general fund debt service payments cost the state $82.5 million in the next biennium. Since the relief from the refunding bonds was one-time in nature, more revenue was needed in the next budget to fill the hole left by the refunding mechanism. As a result, the state's structural deficit grew.

Appropriation Bonds

Not all bonding is necessarily detrimental to the state's economic condition. Facing large budget deficits and declining state revenues, Governor Jim Doyle in 2003 proposed what he called "appropriation bonds" for the purpose of refinancing the state's unfunded pension liability and accumulated sick leave conversion programs.

Under the Wisconsin Retirement System (WRS), employers are obligated to pay to fund the future retirement obligations being generated by current employees. At the time, the state's actuarial analysis forecast an 8% yearly interest rate required to fund the growing unfunded pension liability. The projections showed that the state would need to pay over $2 billion into the system over a 28-year period, $1.3 billion of which was interest.

In 2003, interest rates for borrowing were less than the projected 8% interest necessary to fund the state's unfunded pension and health care liability. In the 2003-05 biennial budget, Governor Doyle requested $750 million in what he called "appropriation bonds" to pay off the unfunded pension liability. In theory, this would allow the state to fully fund pensions and pay a lower interest rate than the 8% required if the funds were to be paid over the full term. Such an arrangement could have saved the state money over a 30-year period, as it would be paying a lower interest rate on the bonds it issued.

However, the state structured the bonds in such a way that no debt service payments would be made in the 2003-05 biennium. This allowed the state to keep the $70 million it *would have* had to pay to the pension fund in the state's general fund.

While issuing the bonds allowed Governor Doyle to spend that $70 million in the two year 2003-05 budget cycle to fill the budget deficit, it causes some fiscal problems for the state. The $70 million retained in the state's general fund represented a one-time funding fix for the state operating budget. When continuing programs are funded with one-time money, it creates a structural deficit for the next biennium. In subsequent biennia, the government either has to raise taxes, cut spending, or hope tax revenues grow enough to make up for that $70 million hole. A state's structural deficit is one of the primary benchmarks used by credit rating agencies to determine the value of a state's bonds. The higher a state's structural deficit, the more likely they will earn a lower credit rating.

Aside from the structural operating budget problem, the creation of appropriation bonds set a potentially troublesome precedent for the use of debt for budget relief. These bonds are nearly identical to GO bonds, but have been issued in such a way as to allow them to be used for a general government operation.

These new bonds were technically considered revenue bonds, yet are structured to be repaid by an annual appropriation from the general fund. This was done to dodge the constitutional requirement that debt be issued essentially for capital projects. Since revenue bonds are not considered public debt of the state, they may be issued for any purpose. Because repayment of the appropriation bonds was structured to require an annual general fund appropriation by the legislature, these new bonds were considered revenue bonds, and therefore weren't considered public debt of the state.

However, the state applied its moral obligation to these bonds, which is generally reserved for GO bonds. The moral obligation pledge has been applied to revenue bonds in the past, but only in specific and targeted instances. Essentially, the administration tried to set up a new type of bonding that had all the characteristics of general fund-supported GO bonding, without the limit on the uses for them.

At the time the plan went to the legislature for examination, the Legislative Fiscal Bureau questioned the appropriateness of this broad expansion of bonding authority. In a memo to the Joint Committee on Finance, they noted that "using general fund revenues to pay off revenue obligation bonds or GPR funding to pay the appropriation bonds authorized under the bill could establish a precedent for the state's debt programs." They further warned that "such borrowing programs that use state general fund revenues to support debt that is not constitutionally limited in its use or amount, could be statutorily expanded to support bonds that could be issued for any state government operating function or expense."[33] However, the legislature chose not to heed the warning and proceeded to approve the governor's proposal.

In essence, the state has now devised a way to use general fund-supported debt for general government programs, a practice that has been specifically forbidden by the constitution. When a new funding crisis exists, it would be entirely possible for the state to issue general fund-supported borrowing to plug the hole — leaving future generations to pick up the tab.

Thus, while appropriation bonds will serve the purpose of saving the state money in the long term, they were used in a manner that exacerbated the state's structural deficit. In this case, greater long-term savings were sacrificed for a short-term budgetary band-aid — a theme common when debt is used as a budgetary tool.

Tobacco Securitization

In the 2001-03 biennial budget, Governor Scott McCallum faced a significant shortfall in state revenues. In order to fill the hole caused by lagging state revenue, the governor proposed "securitizing" the stream of revenue state government was set to receive from the multi-state tobacco master settlement agreement. In essence, the state would take a large, one-time lump sum payment rather than payments that were scheduled to be paid by the tobacco companies over a 30-year time period.

Aside from merely filling a budget hole, supporters of securitization argued that it would be wise to maximize revenue from the tobacco settlement while it was still available. They argued there would be no guarantee the tobacco funds would be available, given possible litigation and other circumstances. Furthermore, the McCallum administration had to make the choice between securitizing the tobacco funds or raising taxes.

At the time of Wisconsin's proposal, several other local and state governments had utilized securitization for various needs. Some used it to get around the constitutional limits on debt issuance they were up against, while others used the proceeds for capital projects. Still others used securitization bond revenues to set up health care endowments or rainy day funds.[34]

The one-time lump sum payment was achieved by setting up a nonstock corporation to issue revenue bonds on behalf of the state. In April 2002, the Badger Tobacco Asset Securitization Corporation issued $1.59 billion worth of revenue bonds, $1.275 billion of which were available to the State of Wisconsin to balance the budget. The debt service on the bonds is paid with the yearly revenue from the tobacco company payments. It is anticipated that the bonds may actually be paid off sooner than expected, which would then allow the state to reclaim the settlement payments as early as 2018.[35] As of December 2006, the Corporation still had $1.46 billion in bonds outstanding.

While the revenue bonds issued to finance securitization may have been self-funding, the decision to take the lump sum amount to balance the state budget had other ramifications. The use of one-time money to support ongoing government operations created a hole in the next budget that required new revenue to fill.

CONSEQUENCES

Increased utilization of bonding allows the state to defer many short-term budgetary decisions, but carries some significant consequences for the future.

Increased Debt Service Costs

Increased bonding necessitates increased debt service payments. In the case of most general obligation and transportation bonding those debt service payments are paid with tax and fee revenue collected from citizens of the state. As noted, when the state issues bonds, it commits taxpayers to paying debt service on those bonds for between ten and thirty years into the future.

In good economic times increasing debt service is not as big as a problem, since the growth in state tax collections allows for more flexibility in spending decisions. More money in the state's treasury makes it easier to pay for increased debt service.

However, when the economy slows down and tax collections begin to recede, debt service becomes a real problem. Even though the state has less money to spend, debt service payments are non-negotiable and must be paid.

In fact, because debt service puts such a squeeze on the general fund in a slowing economy, it provides incentives to lawmakers to use even more bonding to fill the remaining hole. In this sense, the process becomes cyclical — too much bonding shrinks the general fund, which forces more bonding to fund programs that can't be paid for with existing revenues.

This is, in essence, what happened with the state's transportation fund in the previous two budgets. Transportation funds were transferred to bolster the sagging general fund, and replaced with more transportation bonding. As a result, taxpayers will be picking up the tab for the $1.1 billion in debt service costs for the transportation bonds issued to backfill the road-building fund.

Structural Deficits

Another consequence of increased bonding is the substantial budgetary problems caused by the one-time nature of bond revenues. The use of one-time bonding revenue to plug ongoing holes in the budget further exacerbates the structural deficit, which forces higher taxes, program cuts, or even more bonding in the subsequent budget.

Table 7 details the structural deficits in recent state budgets:

Table 7 Recent Structural Deficits by Biennium (In Millions)

Biennial Budget	1st Year	2nd Year	Total
2005-07 for the 2007-09 Biennium	$653	$846	$1,499
2003-05 for the 2005-07 Biennium	$701	$845	$1,546
2001-03 for the 2003-05 Biennium	$1,340	$1,527	$2,867
1999-01 for the 2001-03 Biennium	$693	$1,026	$1,719

Source: Legislative Fiscal Bureau

Given the size of the structural deficit in Wisconsin, it is clear state government has continued to utilize strategies to push obligations off into the future. In 2006, according to the Wisconsin Taxpayers Alliance, Wisconsin was one of only three states with a Generally Accepted Accounting Principles (GAAP) deficit and, relative to population, it had the largest deficit in the nation.[36]

Credit Ratings

State and local governments issue bonds through the municipal bond market. It is in the government's interest to get the best rating for their bonds, as highly-rated bonds receive lower interest rates, and reduce the amount the government will have to repay in interest.

The three major bond rating firms (Moody's Investor Service, Standard and Poor's, and Fitch) use a number of measures when determining what rating a specific group of bonds will receive. The overriding principle in rating bonds is risk — the more probable it is that the bond issuer will repay the bonds, the better rating they are likely to get. Much of the probability of repayment is determined by the soundness of the borrower's financial practices.

For governments, one factor used by bond agencies to measure financial practices is how the debtor manages current debt, including the per capita level of debt issued. Bond ratings consider the amount of debt outstanding and compare that amount to the revenue the government is estimated to receive. How the debt is used is also considered, as is the growth pattern in debt issued.

When Wisconsin first issued bonds directly in 1970, it received the highest possible rating by Moody's and Standard and Poor's for its general obligation bonds. The state's general obligation bond rating was reduced by Standard and Poor's in 1981 (from AAA to AA+) and by Moody's (From Aaa to Aa) in 1982.

In recent years, Wisconsin's general obligation bond ratings have continued to fall. In 2002, general obligation bonds received an AA- rating from Standard & Poor's, Aa3 from Moody's, and AA by Fitch. In March 2004, Fitch downgraded a general obligation bond issue to an AA- rating. Currently, Moody's and Fitch rank 31 states higher than Wisconsin, and Standard & Poor's puts 37 states ahead of Wisconsin.[37]

In their explanations for downgrading state bond ratings, rating agencies pointed to a number of questionable budgeting practices by Wisconsin state government. Among these practices was the use of one-time revenue to plug budget holes, as was done with tobacco securitization and transportation funds (as well as numerous other lapses from various state accounts).[38]

Naturally, when the state receives a lower rating on its bonds, it must pay a higher rate of interest to repay those bonds. Thus, the increased level of bonding relative to tax receipts, coupled with the one-time use of those bond revenues will cost the state more for new bonds issued in the future.

SUMMARY

The recent tendency of Wisconsin state government to defer responsibility for fiscal decisions will likely have detrimental effects in the future. Wisconsin state government has found itself on a treadmill of fiscal procrastination, unable to slow down the growth in structural deficits. On the contrary, increased reliance on debt has worsened the state's financial situation, the costs of which will be borne by future generations.

Increased reliance on debt has exacerbated the state's fiscal problems in two major ways, as demonstrated in this report. First, increased debt means increased long-term costs to taxpayers. Short-term decisions made by elected officials can cost taxpayers millions in interest costs for decades. The startling increase in general fund-supported, general obligation bonding issued by Wisconsin relative to tax revenues indicate that this is taking place.

The second fiscal problem related to state debt is in some ways caused by the first. High fixed debt payments force the state to use even more debt to patch budgetary holes in tight times. As a result, even more interest costs are pushed off into the future. It is easy to see that in Wisconsin, debt begets more debt.

In good economic times, revenue growth may be able to handle the increased debt load the state has taken on. However, when the economy slows down, high state debt squeezes the state budget, as debt service must be paid before any other general fund appropriations are made. High debt service payments often serve as an excuse for elected officials to push other obligations off into the future — the other options, cutting programs or raising taxes, are often politically untenable.

The legislature can do little to affect the debt currently on the books. Yet in the future, it can employ real budgetary strategies that can slowly bring Wisconsin's borrowing back in line with its citizens' ability to pay.

Appendix A

General Purpose Debt Service as a Percentage of General Fund Revenues

Year	Revenue	Debt Service	Percentage
1985	$4,447,227,069	$131,400,000	3.0%
1986	$4,775,530,427	$150,800,000	3.2%
1987	$4,954,946,296	$147,300,000	3.0%
1988	$5,173,664,638	$160,900,000	3.1%
1989	$5,536,440,000	$156,000,000	2.8%
1990	$5,649,480,000	$164,100,000	2.9%
1991	$6,072,950,000	$193,200,000	3.2%
1992	$6,339,600,000	$188,400,000	3.0%
1993	$6,871,020,000	$190,300,000	2.8%
1994	$7,287,600,000	$246,500,000	3.4%
1995	$7,806,870,000	$250,300,000	3.2%
1996	$8,235,640,000	$271,200,000	3.3%
1997	$8,817,540,000	$278,100,000	3.2%
1998	$9,528,430,000	$285,200,000	3.0%
1999	$9,948,410,000	$292,800,000	2.9%
2000	$10,945,900,000	$315,700,000	2.9%
2001	$10,063,440,000	$330,900,000	3.3%
2002	$10,020,180,000	$232,200,000	2.3%
2003	$10,199,740,000	$326,800,000	3.2%
2004	$10,739,320,000	$164,200,000	1.5%
2005	$11,396,650,000	$314,200,000	2.8%
2006	$12,030,090,000	$413,600,000	3.4%

Notes

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5. "The Wisconsin State Building Program," *1952 State of Wisconsin Blue Book*, p. 171.

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7. "The Wisconsin State Building Program," *1952 State of Wisconsin Blue Book*, p. 171.

8. Ibid, p. 175.

9. "Financing Wisconsin State Government," *1954 Wisconsin Blue Book*, p. 173.

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14. Ibid, p. 7.

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19. Department of Administration, 2007-09 Capital Budget Recommendations.

20. *Government Report to the Governor by the Task Force on the Outdoor Recreation Act Program*, October 9, 1967, p. 5.

21. Ibid, p. 14.

22. Wisconsin Legislative Fiscal Bureau, 2007 Informational Paper #60, *Warren Knowles-Gaylord Nelson Stewardship Program*, January 2007

23. Ibid.

24. Wisconsin Legislative Fiscal Bureau, 2007 Budget Paper #555, "Stewardship Reauthorization (DNR – Stewardship Program).

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26. Several properties had large acreages that didn't differ significantly from the assessed value, which the Audit Bureau may have felt skewed the sample. Thus, they provided a number on a per property basis to provide a fairer look.

27. Audit Bureau Stewardship Evaluation.

28. Wisconsin Legislative Fiscal Bureau, *2007 Informational Paper #88*, "Wisconsin Housing and Economic Development Authority," p. 3.

29. Wisconsin Legislative Fiscal Bureau *Comparative Summary of Budget Provisions 2003-05, Transportation.*

30. Wisconsin Policy Research Institute, "The Truth Behind Wisconsin's Oil Company Tax: Why You'll Pay More at the Pump," by George Lightbourn, Christian Schneider, and Benjamin Artz, March 2007.

31. Legislative Fiscal Bureau analyst Jon Dyck provided this number via phone interview.

32. Wisconsin Legislative Fiscal Bureau, *Assembly Bill 909: Refunding Bonds, Medical Assistance, Public Defender, District Attorneys and Bonding Reductions*, February 25, 2004.

33. Wisconsin Legislative Fiscal Bureau, "Unfunded Pension Liability – Revenue Obligations and Appropriation Obligations (Building Commission)," Budget Paper #191, May 16, 2003.

34. Wisconsin Legislative Fiscal Bureau, *2001 Budget Paper #885*, “Discussion of Tobacco Securitization,” April 26, 2001.

35. Wisconsin Legislative Fiscal Bureau, *2007 Informational Paper #74*, “State Level Debt Issuance,” p. 18.

36. Berry, Todd, “State Finances: What Would Our Forebears Say?” *Wisconsin Taxpayers Alliance*, June 12, 2007.

37. Wisconsin Taxpayers Alliance, *Focus*, July 19, 2006, No. 15.

38. LFB, State Level Debt Issuance, p. 22. Also contributing to the state’s lower debt rating were its lack of a sufficient rainy day fund, the lack of general fund surpluses, and its large generally accepted accounting principles (GAAP) deficit.

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.