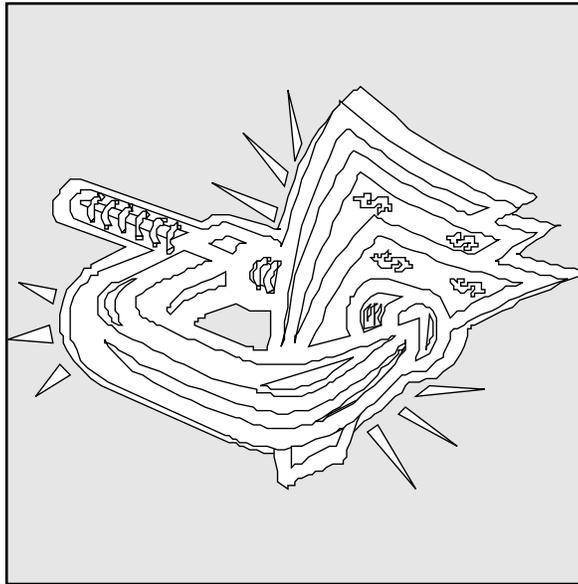


# WISCONSIN'S BUDGET

## THERE'S STILL WORK TO BE DONE

GEORGE LIGHTBOURN

**T**here we sat in a d o w n t o w n Madison conference room: Scott Jensen, Chuck Chvala, Bob Wood (Governor's Chief of Staff), and I. I had been following the stalled budget talks from a distance and suddenly, as the new Secretary of Administration, I was thrust into a front-row seat. My predecessor, Mark Bugher, had the good sense to leave for a UW job, so the budget was now my problem.



grams. While budgets for the past several biennia were dotted with new spending programs, this one was not. Like seamstresses at a fat farm, the Governor and the Legislature never even considered letting the garment out, just taking it in. But where did they trim and how will the final product wear?

### A New Era in Budget Policy?

Perhaps at no time in Wisconsin's history had the divided houses been led by gentlemen who were as partisan as these two and who just plain loved to beat the other guy. It had been several weeks since their last face-to-face meeting. Jensen was holding out for substantial tax cuts, and Chvala had a long list of spending items. I wondered how the budget would ever come together. How would this episode of Kabuki theater conclude? Of course, it ended a few weeks later when both sides claimed victory. A tax cut for Jensen and big new spending programs for Chvala — truly something for everyone.

That was just four short years ago. How things have changed. The budget signed by Governor Doyle on July 24, 2003, had neither the money for tax cuts nor shiny new state pro-

This budget may herald a new era for Wisconsin. While it didn't completely solve the state's long-term fiscal problem, it did stop the bleeding. It made the problem better, not worse. How's that for setting the bar low?

The final budget document shows mixed results. Those hoping that the politicians in Madison would bite the bullet and fix the problem will be only partly satisfied. The cynics who expected the solution to involve only smoke and mirrors will be somewhat disappointed. For those of us who have followed state budgets over the years, the solution is pretty darned interesting. This budget is a blend of real cuts, one-time revenues, and new money from the tribes and the federal govern-

---

*George Lightbourn is the former Secretary of Administration for the State of Wisconsin.*

ment. Oh yes, the biggest part of the solution is the extra revenue that will be coming from state taxpayers.

Grizzled veterans of Wisconsin budgets relate how much the process has declined in recent years: too much pork, too many back-room deals, too much big money involved, and too much rancor among the participants. But let's give credit for some style improvements in this budget. For one thing, it was done on time. For another, it is nearly devoid of non-fiscal policy items. Imagine, done on time and filled only with fiscal items. Isn't that what a budget is supposed to be? Well, yes, but given the recent history of Wisconsin's budgets, these baby steps are tantamount to the Israelis and the Palestinians agreeing on where to hold the annual picnic.

The budget also marks the beginning of a cultural shift in Wisconsin budgeting. Budgets here, and in most states, never start with a blank slate. They are the result of the incremental build-up of programs and dollars added over several years. Lobbyists are judged not on whether the programs they represent will be increased, but on how large an increase they win.

But this budget is different. In this budget increases are hard to find, and cuts are everywhere.

The tough nature of this budget actually surprised many participants. The bureaucracy, for example, submitted requests that would have required \$1.6 billion in new spending, despite daily news accounts of how desperate the state was for cash. However, the culture of past state budgets suggested that every two years, despite dire warnings, there was always enough money to add a little here and there. That changed with this budget.

It was also somewhat surprising that the budget included no significant revenue uppers. Many of us expected that at a minimum the cigarette tax would be boosted, with proceeds used to prop up the Medical Assistance (MA) budget. But not so; Wisconsin's smokers made it through unscathed.

## How the \$3.2 Billion Budget Gap was Closed

In January, the size of the budget gap was pegged at \$3.2 billion. This was the "deficit" before any agency requests were considered or any new revenues anticipated. The document signed by Governor Doyle not only balances, it includes a \$205 million cushion. So how did they do it? Further, what still remains to be done? I have listed the key parts of the budget solution. The fiscal estimates are based on an early review of the budget documents. Some refinement of these estimates might be required.

### *Revenue Growth (\$1.7 billion)*

As in every budget, this budget was balanced largely on new revenue growth resulting from an expanding population and an expanding economy. It is money that rolls into Madison without any elected official having to wrestle with a vote to increase taxes.

Some readers might recall that last fall, just before gubernatorial election, candidate Doyle chided Governor McCallum for being too rosy with his projection of future revenue growth. How high was the McCallum forecast? It was just over 5 percent for each year of the biennium. Yet, for all the heat generated by that "rosy" forecast, everyone in the Capitol heaved a sigh of relief when the Legislative Fiscal Bureau issued its formal revenue prediction on January 23. The Bureau pegged growth at 5.1 percent and 5.6 percent for the two years of the biennium.

That revenue forecast plugged \$1.7 billion of the \$3.2 billion gap. It provided a pretty good starting point for further work on a difficult budget. The importance of revenue growth is often lost among all of the verbiage surrounding a budget. And it is rarely revisited once the budget is introduced. As I write this, it has now been six months since that revenue forecast was issued. Much has changed over that time; the ice is off the lakes, the United States began and ended the Iraqi War, Bob Hope died, and many once-optimistic economists are acknowledging the real possibility of deflation.

Much has changed everywhere — except with Wisconsin’s revenue forecast. That forecast has solved half of the state’s budget problem, and it has not been reevaluated. In fact, another forecast is not required until November 20, 2004. Until then, don’t ask, don’t tell is how those in the know approach revenues.

It might seem odd that revenue forecasts are done so seldom in the Wisconsin budget process. We all know how fickle the economy is and how much is riding on that forecast. If the forecast is just one-half of one percent too high in the first year, it will cause a shortfall of \$150 million in the biennium. However, there is no official need for a new forecast for another 15 months.

Many other states do their revenue forecasts on a regular basis and present them publicly. We should consider doing that here. Given the razor-thin margins in the Wisconsin budget, a regular review is in order. After all, the entire budget is resting on the foundation laid by that forecast.

*Spending Cuts (\$480 million)*

Yes, there really are spending cuts in this budget. The Governor’s Press Office has told anyone within earshot that the new budget cut spending on state government by hundreds of millions of dollars and eliminated 2,300 state jobs. That is true. State government will be smaller. State agencies are still reeling from the backlash of Governor McCallum’s “big spender” moniker attached to local government. That incident put a target on the back of every state agency, and this budget did not miss the target.

The biggest target apparently was affixed to the University of Wisconsin. Katharine Lyall was assessed a \$250 million reduction in state

support. Approximately \$150 million of that can be made up through higher tuition paid by students throughout the UW system, and possibly some of the remaining \$100 million will be obtained from other outside sources. But, at the end of the day, the UW will have to cut in order to stay within its budget.

Other agencies also took their share of budget medicine. General, non-specific cuts totaling \$325 million were made to agency budgets. Other more targeted cuts brought the total closer to \$480 million.

*New Money from the Tribes and the Federal Government (\$700 million)*

It is well publicized that Governor Doyle patched part of the budget hole with funding from Wisconsin’s tribes. In exchange for longer compacts and additional games, the tribes will increase their payment to the state by \$157 million in this biennium. This is significantly more than the \$24 million the state now receives from the tribes each year.

It is arguable whether the state cut a good deal with the tribes. The courts

are currently deciding whether the Governor had the authority to negotiate the compacts as he did. Yet all parties were quick to book the new money in piecing together a budget solution. After all, it was \$157 million less that had to be cut.

The federal government also came through with additional funding. After a much-publicized White House event where President Bush told all the governors that the federal government couldn’t help them with their state budget problems, somehow the folks in Washington were able to patch together a tax cut bill that allocated \$10 billion to the states. Wisconsin’s share of the take is \$150 million, which also was quickly booked into the bud-

---

*Governor McCallum’s  
“big spender” moniker  
attached to local  
government. . . put a  
target on the back of  
every state agency, and  
this budget did not miss  
the target.*

---

get. While this special allocation is a one-time windfall, the federal government also provided another \$400 million that helps with the budget.

*Reduced Statutory Balance Requirement  
(\$190 million)*

Buried in the bowels of the state statutes is a requirement that used to require a small unspent balance of 1.6 percent in the first year of this budget and 1.8 percent in the second. This would mean that the budget would have to include a cushion of \$230 million by the second year. However, the budget writers conveniently reduced the balance requirement to a mere \$40 million in the second year, thus saving \$190 million. Note the oddity: A lack of reserves contributed to the current budget dilemma, yet lowering the reserve requirement is now part of the solution.

*One-Time Revenue (\$1.1 billion)*

There is little doubt that the use of one-time money has contributed to the budget problem (especially the \$1.3 billion of tobacco money). However, the use of one-time money means that fewer cuts are needed. This is very helpful to those building budgets. So, how much one-time funding is included in the current budget? The answer is, a lot. As of this writing analysts are still totaling the one-time funding, but it will probably amount to \$1.1 billion.

The largest source of one-time funding is the \$500 million transfer from the transportation fund to forestall cuts in school aids and shared revenues. Even though a Governor's veto technically allows part of the transfer to be made in the future, the Legislature is far from agreeing with this position. To count this as anything other than a one-time transfer would seem to be wishful thinking.

Other one-time funding items include these:

- \$150 million from the federal government as part of the one-shot bailout of state budgets

- \$140 million of one-time savings from refinancing state employee pension and sick-leave benefits
- \$28 million transferred from the segregated clean water fund
- \$15 million transferred from the segregated Petroleum Inspection fund
- \$40 million of hoped-for efficiencies in state government technology
- \$47 million transferred from the energy conservation program funded by utility customers
- \$21 million from the UW's auxiliary account balances
- \$11 million lapse of budget funding from the Legislature (rather than a permanent cut)
- \$20 million shift of debt service in DNR from the general fund to the segregated forestry fund
- \$14 million of revenue transferred from the segregated recycling fund to the general fund
- \$4 million transfer of funds from the universal services fund to offset a cut to libraries
- \$1.5 million the Supreme Court is directed to find in its budget to reduce state funding in this biennium

Many others lapses of funds and one-time transfers are sprinkled throughout the budget. While most observers thought that one-time funding would be a thing of the past once the tobacco money was spent, they were wrong. In fact, the Governor suggested using \$200 million from the patients' compensation fund to balance the budget. Although the Legislature didn't use that funding, look for it to reappear not too far down the road.

In addition to the cuts and funding noted above, the budget also tightened the belt of the two largest spending items in the budget, school aids and medical assistance increases.

### *Reduce State Funding of Schools*

Since the budget was signed into law, most attention has focused on whether property taxes should be frozen or not. This is a hot topic mainly because the budget short-sheeted school aids. The state had a deal with local schools; state taxpayer funds would cover two-thirds of local school costs, and spending caps would be used to hold down teacher pay and overall school costs. For property taxpayers, this deal provided a real limit to their tax liability. The deal was encoded in state statutes. What could be more solid than that?

Well, the Governor and the Legislature changed the deal. While it looked doable in the roaring 1990s, the deal had finally become a burden. Going into the budget, the Department of Public Instruction estimated that \$447 million would be needed to feed the two-thirds funding requirement. In the end, after numerous twists and turns, the Governor signed a bill that included only \$189 million of additional school aids (\$100 million of which is transportation money). This saved the budgeters in Madison a nice sum of \$258 million — a move that is keeping local superintendents awake nights.

### *Limit Medical Assistance Increases*

While attention shifted sharply to school aids after the state committed to funding two-thirds of the cost, the real pacman in the budget is MA. The Department of Health and Family Services estimated that \$650 million of additional state funds would be needed to deal with rising caseloads and higher medical costs. That simply wasn't in the cards, given the state's fiscal condition. While the administration and the Legislature batted the MA budget back and forth, in the end the budget passed

with less spending than the agency wanted, some one-time financing, program cuts, and a place-holder in case additional federal funding materializes.

All told, the MA budget increase (including BadgerCare and SeniorCare) was limited to \$572 million of which only \$55 million is new state money. In addition, for the first time in memory, the rules for some of the MA programs were tightened. Eligibility screening for BadgerCare was tightened, and many families will see their premiums increased. Similarly, the relatively new SeniorCare prescription drug benefit program will require higher enrollment fees and deductibles. Many other changes also were made to bring overall cost increases down.

The jury is still out as to whether any substantial increase in federal funding will materialize. However, analysts tracking MA trends worry that before the end of the biennium the state could fall as much as \$200 million short. All involved are hoping the economy will pick up; an upturn would reduce the rolls of those using MA programs. They are also hoping that

the cost of drugs and medical services can be controlled. Good luck.

### **Problems for the Future**

At the last possible moment — i.e., in the veto process — Governor Doyle created a \$205 million budget reserve. He did this in spite of the fact that he and the Legislature had earlier *reduced* the required statutory balance requirement. The reserve is largely a product of shifting transportation cash to the general fund and using more debt to finance road projects. But why would Doyle take this action? Why not just keep the current statutory balance requirement?

---

*\$650 million of additional state funds would be needed to deal with rising caseloads and higher medical costs.*

---

The stated reason is to protect against a shortfall in the MA budget. Another potential reason lies in a statutory provision that snagged the McCallum administration. Whenever the budget is out of balance by one-half of one percent, the Governor must do something to bring it back into balance. Higher-than-expected spending could cause such a problem, but the most likely cause would be that revenues aren't materializing. Either way, the Governor would have to call the Legislature back to balance the budget. No one in Madison relishes that prospect.

The next budget, which the Governor will begin working on in about 13 months, seems likely to be somewhat less harrowing than this one, but still no easy matter. We already know that, conservatively, the budget is out of balance by \$711 million going into the process. This estimate is conservative since we know that it doesn't fully capture all of the likely spending pressures, some of which are outlined below.

#### *Growth in Medical Assistance*

The heaviest spending pressure will probably come from the MA budget, which funds programs for the disabled, low income, and elderly. Pressure has built up in this budget to fund these programs driven by increasing enrollments (which grow faster in a down economy) and the higher cost of medical services and drugs. Neither factor is likely to abate in the near future, setting up a real problem for future budgets. When the aging of the baby boom population is factored in, the future looks worrisome to budget analysts.

Of particular interest is the nursing home budget. A couple of years ago we convinced Washington to give Wisconsin \$1 billion to take care of our nursing home cost increases for about six years. That fund was raided in this budget to solve the overall shortfall in MA funding. So, entering the next budget there will be \$0 reserved for future nursing home cost increases. Given the nature of our aging population, this could present a real problem. How will Wisconsin provide long-term care to its

elderly? Put this high on a list of policy hangovers caused by the state's fiscal problems.

#### *School Aids*

School funding is likely to be front and center in the next budget once again. It will probably take something in the neighborhood of \$400 million to maintain the current state share of local school costs. Will there be money to pay that share, or will state government once again short the school aid budget? Quite frankly, it would be naïve for local school budgeters to count on the state maintaining its current share. But how far will the state share fall? That won't be known until the depth of the next budget deficit is known.

#### *Other Sources of Budget Pressure*

While these two behemoths should be enough to keep the Governor up nights, consider some other sources of pressure that lie ahead:

- Prisons. Little has been done to stem the rising cost of housing Wisconsin's criminals. With no progress in truth-in-sentencing, we should expect to see longer sentences and fewer releases. This means that the Department of Correction's budget is likely to demand much more funding for the foreseeable future.
- Pensions. Only a few of the hardiest followers of the Byzantine Wisconsin pension system understand the impact of the pension sweetener of 2000 and the fall-off in earnings by the Investment Board. Either one of these variables by itself would have put pressure on the pension budget, but the fact that they occurred simultaneously yielded a toxic result. We will see both state and local governments needing to increase their budgets to maintain funding of their pension obligations. And, since there is a robust body of law ensuring that pensions are a property right, there is little in the way of a law change that will help the situation.
- Employee Salaries. Public employees, especially state employees, have fallen out

of favor with the public recently. This budget includes funding for very limited pay increases. While employees will probably begrudgingly accept a year or two of no pay increases, that is unlikely to last for another biennium. It is likely that in the next biennium public employees will push for pay increases similar to those of the late 1990s and early 2000s. This is just one more source of budget pressure.

#### *School Aid Formula Rewrite*

One other piece of business coming out of this budget will bear watching. The Governor and the Legislature have widely proclaimed that this fall they will take on the school finance issue. To the academic, this means looking at how Wisconsin finances schools. To all others it means redoing the formula that sends \$4.8 billion to local schools.

We had a sneak preview of how the Governor and Legislature work together in rewriting state aid formulas. The Republican Legislature rewrote the shared revenue formula and placed the new formula in the budget. Suffice it to say that Governor Doyle did-

n't concur with the rewrite. In vetoing the new formula the Governor said, "Their budget tried to stick it to our children. . . . They manipulated formulas. . . . They forced school districts to choose between small class sizes and special education."

So, there doesn't seem to be a lot of love left over for use in revising the school aid formula. Few would be surprised if no changes result from either the Governor's or the Legislature's study of the problem. Seasoned observers have held low expectations for a formula rewrite all along. Traditionally, formula changes occur when there is cash available to soften the blow to any losers. That's the grease that's essential to any formula revamp. Since there is no grease now, there probably will be no change. But it will make for interesting rhetoric in an off-budget year.

The new budget clearly represents progress in bringing state spending in line with revenues. However, the job is far from done. The Governor will be forced to introduce another tough budget in January of 2005, and that is the budget he will run on for reelection. Stay tuned.