

Focus

31 Oct 2007 • No. 23

In brief

The new 2007-09 state budget is similar to prior budgets in the way it keeps the general fund budget "in the black." Among tools used are: fund transfers, e.g., \$200 million (m) from the patients' compensation fund; uncertain revenues, including \$75m of disputed tribal gaming revenues and \$411m in sure-to-decline tobacco taxes; accounting shifts that spend tax-credit monies in this budget but fund them in the next; "structural deficits" resulting from future fiscal promises; more borrowing; and very slim surpluses that could lead to "red ink" if the economy slows.

Capitol notes

■ *Before signing the 2007-09 state budget, Governor Jim Doyle (D) used his considerable item-veto authority to remove or rewrite several items. Gaining the most attention were vetoes that raised levy limits on municipalities and counties from 2% to almost 4% and that struck a 4% limit on technical colleges.*

■ *The state senate's new majority leader, Russ Decker (D-Weston), has changed his party's representation on the legislature's Joint Committee on Finance. Senator Mark Miller (D-Monona) replaces Decker as committee cochair. Joining Miller are Senators Judy Robson (D-Beloit) and Julie Lassa (D-Stevens Point).*

2007-09 State Budget II

Budget "balancing" tools all too familiar

Increased tobacco taxes, higher vehicle fees, and expanded health care for the poor are a few ways the 2007-09 state budget differs from its predecessors. But when it comes to "balancing the books," new and old budgets have a lot in common: fund transfers, one-time or unsure revenues, accounting shifts, GAAP and structural deficits, borrowing, and slim balances.

Transfers, disputed revenue

In recent years, monies have been moved from other funds to keep the general fund "in the black." The most notable example in the past two budgets involved transferring over \$1.1 billion (b) from the transportation fund to the general fund. Most of the state taxes we pay—income, sales, and excise—are general purpose revenues (GPR) deposited in the general fund.

For 2007-09, the governor proposed and the legislature agreed to shift monies from the patients' compensation fund (PCF) to the general fund. The fund was created three decades ago to protect health care providers who would be financially damaged if forced to pay large settlements from medical malpractice lawsuits. Regardless of politics or philosophy, there is little disagreement that the fund has helped Wisconsin avoid the high malpractice insurance rates or doctor shortages that plague some states.

However, the legality of the \$200 million (m) PCF transfer is being contested by doctors who have sued to block the move. They argue that, constitutionally, the state cannot take their money. Add to that another \$75m in budgeted gaming revenue that is being disputed by the Ho-Chunk tribe, and the state is balancing its budget with \$275m in revenue already tied up in the courts.

Even if the suit were unsuccessful or litigation prolonged, the \$200m transfer is a stop-gap measure—just like previous transportation transfers, because it uses one-time money to pay for permanent and growing programs. Come 2009, the state will have to find \$200m in replacement revenue to pay for existing programs, thus boosting what some call the "structural deficit."

Forecasting challenge

Just as the PCF transfer is a temporary revenue source, increased tobacco taxes could, ironically, also jeopardize future state finances. Tax-hike advocates believe fewer people will smoke if prices rise. Fewer smokers, of course, means declining revenue to support expanding health care programs.

To some degree, projections of future tobacco tax revenues recognize this. However, there are reasons the forecasts could be too high and result in a shortfall. First, cigarette tax revenues last year were overestimated by \$7m, or 1.8%. Second, a tax hike of \$1.00 to \$1.77 per pack could result in committed smokers purchasing cigarettes either in states such as Iowa, Kentucky, and Missouri, where taxes are more than \$1.00 less; via the Internet; or from smugglers of untaxed or low-tax cigarettes.

A September report by California tax officials estimated evasion activity at 15% of consumption in that state and at 22% and 35%, respectively, in Britain and Canada, where taxes are higher. Significant evasion has been confirmed by respected university economists (see *Focus* #2, 2007).

Repeated or unusually large cigarette tax increases make revenue

projection difficult for another reason. In such cases, revenue growth tends to be less robust with each successive tax increase. A cautionary tale comes from New Jersey, where, between 2004 and 2007, cigarette taxes increased 25.6%, from \$2.05 to \$2.575 per pack, yet revenues were flat.

Accounting shifts and deficits

In 2003 and 2005, state leaders used what some call an “accounting trick” to spend school property tax credit money in one biennium but not budget for it until the next. The move takes advantage of a timing difference between state (July-June) and local (Jan.-Dec.) government fiscal years. In lay terms, it is akin to using a credit card to buy an item one year but not paying for it until the next.

The budget signed by the governor uses the “charge-card.” It provides \$79.4m more in school levy tax credits this December but does not fund them until fiscal 2008-09. Likewise, it raises credits by another \$75.0m in 2008 but doesn’t have to fund those until 2009-10, the first year of the next biennium.

Such activity allows the state to spend more than it budgets. However, this does not carry over to Wisconsin’s official financial statements issued by the state controller. Because they must use generally accepted accounting principles (or, GAAP), the statements

Structural Deficits Entering Biennia \$ Millions (Legislative Fiscal Bureau)

Biennium	Yr. 1	Yr. 2	Sum
1997-99	624	908	1,532
1999-01	589	914	1,503
2001-03	693	1,026	1,719
2003-05	1,340	1,527	2,867
2005-07	701	845	1,546
2007-09	653	846	1,499
2009-11	424	468	892

record expenditures when they occur (are charged) and not when they are budgeted (paid off).

The official 2005-06 statements reported a \$2.15b deficit, and a subsequent increase in school levy credits last year means the 2006-07 deficit, when reported, will likely grow. The credit increases for this year and next will only exacerbate the deficit, already the nation’s largest per capita.

Unfunded promises

In addition to boosting the state’s official (GAAP) deficit, the new increases in levy credits add to the “structural deficit” state leaders face in 2009-10. Such structural imbalances between revenues and expenditures result from fiscal commitments made, but not funded, now.

The new state budget contains \$424m in promises that will come due in two years. In addition to school-tax-

credit and PCF commitments that contribute to this figure, several promised tax cuts are on the books that aren’t effective until 2009 or beyond.

The table (left) recaps those promises over seven biennia. The key figures are in the first-year column. If spending is not cut nor revenues increased to close the first-year gap, it becomes larger in the second year. Some observers sum these two years and label it the structural deficit, but that overstates the problem.

More debt, less cushion

Other aspects of the 2007-09 budget continue an old tradition of betting on the future. Although state debt rose from \$4b in fiscal 2002 to \$9b in 2006, new bonding authorizations total \$2.76b. Particularly worth mention is the return of an old “gimmick”: As in 2001, the state plans to sell (“securitize”) future tobacco industry payments in exchange for cash to spend.

Since state tax collections can drop quickly if the economy sours, this budget, like all budgets, is vulnerable to economic slowdown. The general fund has net balances of under \$5m—just over \$60m including a small “rainy day” fund. As a percentage of net spending, these amounts are under 0.1% and 0.5%, respectively. In recent years, other states have carried reserves equalling 4% to 8% of expenditures.

Focus is published by the Wisconsin Taxpayers Alliance, 401 N. Lawn Ave., Madison, Wisconsin, three times monthly during March through June and semimonthly during other months. Subscriptions are \$49 for one year and \$99 for three years. WISTAX contributors of \$75 or more receive a free copy. Media reprinting is encouraged with credit to WISTAX requested.

