THE ASTOUNDING STATE SURPLUS

The state has run ever larger surpluses in recent years, setting up an unprecedented opportunity for new state spending, reduced taxes, or both in the next budget. However, elected officials still need to factor in the impact of inflation, the risk of recession, mounting needs at the local level, and the fact that recent projections have missed the mark and could do so again.

When Gov. Tony Evers and the Legislature craft the 2023-25 state budget next year, they will draw on an unprecedented state surplus while also facing the looming threat of a recession. Given those two opposing forces, what is the prognosis for the budget?

To answer that question, we sought to present a bare-bones budget, one that showed a starting place for the budget process before most decisions are made and one that could be readily compared with previous years.

To do so, the Wisconsin Policy Forum started with the projected increases in tax collections along with the base spending levels within the state's main fund. After including certain routine adjustments but excluding all *new* spending requests by state agencies, we find general fund revenues are currently projected to exceed budgeted spending by a staggering $6.8 billion over the two-year cycle running from July 2023 to June 2025. The excess revenues amount to just under $3 billion, or 15.3% of spending, in year one of the budget and more than $3.8 billion, or 19.6% of spending, in year two.

These numbers do not factor in the rising cost of present services so they should not be seen as representing the state's actual surplus, which will be less after accounting for those costs.

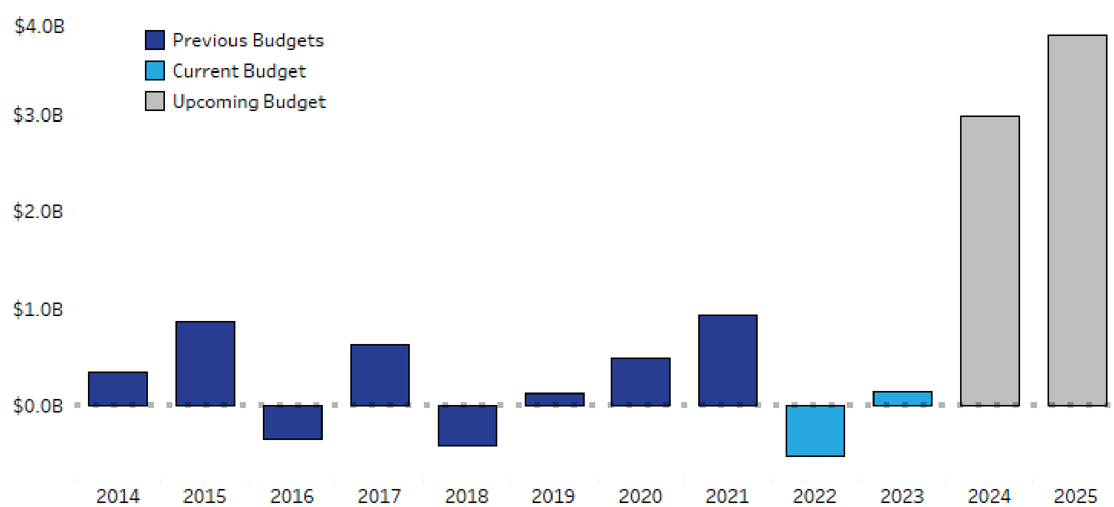
Yet the numbers do show how much stronger the state budget appears now compared to this point in past cycles (see Figure 1). The state is in a much better position this year to shoulder the increasing costs of ongoing state and local services and make new commitments. That's especially true since the above numbers for the upcoming budget do not even include the billions of dollars in the state's general and rainy day fund balances that have built up from past annual surpluses.

UNPACKING THE NUMBERS

The surplus reflects both strong state revenue growth and lower costs than might have been expected in recent years given the high rate of inflation. The growth

Figure 1: Budget Projections Are Best in Years For the State

Projected general fund revenues minus select net appropriations (agency requests excluded) in millions (current $)



Sources: Wisconsin Policy Forum calculations using DOA figures; all figures based on two-year state projections made in the November of even-numbered years. Ongoing revenues do not include general fund balances left over at the end of the prior fiscal year.

in tax collections is due to factors that include federal pandemic relief, previously low interest rates, and the rise in consumer prices, which boosts sales tax revenues in particular. The lower spending is due in part to the federal government shouldering a larger share of Medicaid costs during the pandemic (that assistance is expected to end next year) and lawmakers opting to limit overall state and local funding for schools and local governments while they have been receiving one-time federal COVID-19 aid.

Our analysis uses figures from the [Nov. 20 budget report] from the Department of Administration (DOA), which presents its own version of the state's fiscal health. According to longstanding custom, the report's 2023-25 budget projections include all the spending requests made by state agencies, even though they will not necessarily all be approved.

That is one reason we subtracted these spending requests – totaling $1.14 billion in year one of the upcoming budget and $2.48 billion in year two – to provide a better comparison of where the state stands. Our analysis does include more routine adjustments such as fund transfers and a placeholder amount for state employee compensation.

ADDING IN POTENTIAL NEW SPENDING AND TAX CUTS

However, the WPF numbers shown in Figure 1 do not factor in the projected expense of maintaining current services within Medicaid health programs – an estimated $754.7 million over the next two years – or include additional funds for K-12 schools or local governments, prisons, the University of Wisconsin System, or pay raises for state workers to reflect rapid inflation. New spending appears particularly likely for Medicaid and aid to schools and local governments, which are facing rising inflation, tight state property tax limits, and the end of federal pandemic aid.

Table 1 provides some context on how hypothetical spending in these areas would impact the next state budget. For example, the Evers administration is bringing back a past proposal to use available federal funds to expand the Medicaid program, which would provide an ongoing savings of $392.1 million in the 2023-25 budget and future ones as well as a one-time federal incentive of $1.16 billion over the next two years. If lawmakers cut the Medicaid expansion, as they have in previous years, then that would mean $1.55 billion less for the state general fund in the next budget.

Table 1: General Purpose Revenue Costs of Budget Proposals

Program	2024	2025
Declining federal funds available to expand Medicaid	$771.4M	$776.9M
Funding cost to continue current Medicaid services	$451.8M	$302.9M
Increasing rainy day fund by one third	$0.0M	$577.2M
Funding UW System and Tech College System requests	$112.4M	$264.4M
Repealing the personal property tax	$0.0M	$202.4M
Reducing state income tax collections by each 1% annually	$96.1M	$96.1M
Accelerating certain aid payments to local governments*	$0.0M	$167.3M
Increasing general school aids by each 1% in each year	$52.2M	$104.9M
Increasing shared revenue aid by each 1% in each year	$8.3M	$16.7M

Sources: WPF calculations using figures drawn from agency budget requests, DOA, and LFB. Some spending includes segregated revenues. *Includes expenditure restraint, exempt computer aid, and video service payments.

As always, the Forum is presenting these figures for context and not advocating for any specific policies. For now, at least, the state's budget projections suggest that the state could take on not just one of these potential commitments but more than one.

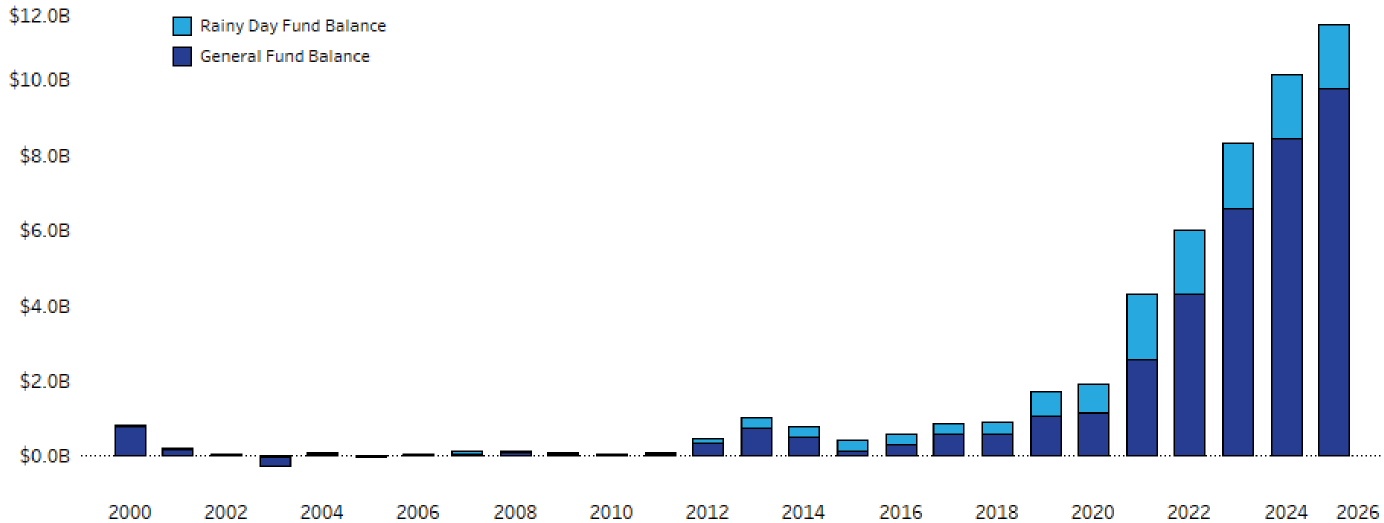
PROJECTIONS FAR FROM PERFECT

All budget projections, however, are freighted with uncertainty. Every state budget is based on predictions about tax collections and economy more than two-and-a-half years into the future. Those will be heavily affected by unpredictable factors such as the future trend of inflation and interest rates set by the Federal Reserve, as well as the course of the war in Ukraine and global energy prices. The DOA budget projections are currently built on the assumption that the economy will go into a mild recession next year, but the nation ultimately might fare worse or better than that.

In November 2020, for example, the revenue projections for the state budget [appeared relatively poor], but they turned out to be much too pessimistic. In fact, two massive pandemic measures (the Consolidated Appropriations Act and the American Rescue Plan Act) juiced the national economy with federal stimulus and boosted state tax collections over the next two and a half years to levels that vastly exceeded initial estimates. Under current Department of Revenue projections, the state expects to take in $5.43 billion more in general fund revenues during the current 2021-23 budget than in November 2020.

Figure 2: Projected State Reserves Keep Climbing

State general and rainy day fund balances by year (current $)



Sources: Department of Administration; Legislative Fiscal Bureau; projections for 2024 and 2025 are from DOA Nov. 20 report and assume all agency requests are approved.

In short, these projections for the next two years are useful but far from certain. The currently fuzzy picture will come into better focus next year as the Legislative Fiscal Bureau (LFB) issues its own revenue forecast in January – and possibly again in May – that will draw on more data on the state's taxes and economy.

One thing that is somewhat more solid, however, is that the state expects to have a $6.58 billion general fund budget balance at the end of the current fiscal year on June 30 and an additional $1.73 billion rainy day fund balance – or more than $8 billion in total reserves (see Figure 2). That would amount to more than 42% of 2023 net appropriations – an unprecedented amount. To give some context, the National Association of State Budget Officers reported last spring that states nationally averaged total reserves of 25.4% of general fund spending in 2021 (Wisconsin was just below that level at 22.1%) with the national average expected at the time to dip somewhat to 19.6% in 2023.

OPTIONS GOING FORWARD

So for now, state officials can expect a strong budget and an opportunity to increase state spending, cut taxes, or both. Previous WPF reports have noted that the state's options include providing additional aid for schools and local governments or even overhauling the state systems for funding these local services; reshaping the income tax or eliminating the personal property tax; increasing support for higher education; strengthening infrastructure such as roads and rural broadband; and improving state finances by retiring debt and maintaining ample reserves to prepare for the potential recession that lies ahead.

One additional option state leaders might explore would be to accelerate certain payments to municipalities and counties, essentially making them in or before the final month of the upcoming budget in June 2025 rather than in the following budget starting in July 2025. Such accelerated payments might help some local governments save a modest amount on short-term borrowing costs.

According to LFB, there are nearly $2.1 billion in state aid and property tax credit payments being made to local governments this July and November. Though the state could not accelerate all of them, moving up some by a few months in 2025 would allow the state to meet these commitments more promptly and also continue a trend. In recent years, the state has already taken advantage of its strong finances to accelerate certain aid payments made to school districts and Medicaid payments made to heath care providers.

When writing budgets, lawmakers typically face agonizing choices between meeting the needs of the present and preparing for future challenges that are hard to predict, like a potential recession. This time, state officials may have the financial wherewithal to accomplish both.