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For 2023-25 State Budget, Record Surplus Heightens Stakes to Reach Bipartisan Deal

Spending increases to maintain or boost services, tax cuts, retaining reserves can all be in play

With the largest surplus on record, state policymakers have an unprecedented opportunity in the 2023-25 budget to make once-in-a-generation progress on some of Wisconsin's biggest challenges.

Gov. Tony Evers has proposed using the surplus to enact substantial income tax cuts for low and middle-income earners. In addition, he is proposing record spending increases, including a massive boost in aid to schools and local governments that would fundamentally reorient their fiscal relationship with state government.

Some of the governor's proposed changes have a chance to win backing from Republicans in the Legislature, while others appear to lack support. In our state of Wisconsin budget brief, we describe the broad sweep of the governor's proposed budget and its major initiatives, directing most of our focus to the fundamentals of the budget with which lawmakers will have to grapple, regardless of their views on the governor's bill.

By June 30, the state's general fund balance is projected to reach nearly \$7.1 billion, in addition to a rainy day fund balance of \$1.7 billion. This would mark the state's strongest fiscal position in at least four decades, and likely ever. The upshot: state policymakers can make changes in this budget for the two-year cycle starting July 1 that their predecessors could only have dreamed of enacting.

Notably, however, much of the surplus is likely to be one-time in nature. While some of Evers' proposed spending increases are likewise one-time, many would be ongoing and leave the state with a structural imbalance heading into the 2025-27 budget. Republicans have said they will remove or reduce many of the governor's spending increases, which on its own would make the budget more sustainable. However, some lawmakers favor a plan to shift the state's income tax to one flat rate, which would decrease state income tax revenues by such a large amount that it likely would create a structural imbalance that is as great or even larger.

The budget brief identifies five keys that we believe will be critical to the state's future fiscal outlook, its economy, and the quality of life of its citizens:

- **How high to keep state reserves?** Over the past two decades, Wisconsin's budget reserves have gone from being among the lowest of any state to well above average. The state's projected \$8.8 billion in total reserves in June amounts to an unprecedented 44.7% of 2023 general fund spending, the most in at least 40 years. The Evers proposal would spend down reserves to about \$2.9 billion, or roughly 12% of spending. For its part, the Government Finance Officers Association says reserves should cover at least 16.7% of annual spending, which for Wisconsin would be roughly \$4 billion.

- **More aid – and possibly sales taxes – for local governments:** The governor’s proposal would increase the main form of state aid to local governments by the largest percentage since at least 1985. It does so by providing 20% of state sales tax collections to municipalities and counties in the form of shared revenue – a concept in which GOP lawmakers have voiced interest. In addition, Evers would loosen state limits on local property taxes and allow some municipal and county governments to seek voter approval to impose local sales taxes. Following years of stagnant state aid payments and sizable increases in inflation and local government costs, the governor’s proposal would allow local governments and the residents receiving their services to realize some of the benefit of the state surplus.
- **Proposal finds schools at a critical crossroads:** Schools are likewise pressured by the impending expiration of federal pandemic aid, record inflation, and tight labor markets. In response to the extra federal funding, the 2021-23 state budget froze the state limits on district revenues from local property taxes and state general school aids. The governor now proposes more than \$2.6 billion in additional state aid to schools, an amount GOP lawmakers already have vowed to reduce. The budget also would raise revenue limits by \$350 per student in 2024 and an additional \$650 per student in 2025. Another likely sticking point will be GOP efforts to expand voucher and other school choice programs.
- **Major shift coming in state health programs:** In recent years, the biggest debate about state health care for low-income residents has been whether or not to take federal Medicaid dollars to expand it. GOP lawmakers seem likely to again reject the governor’s latest expansion proposal, which means the budget must be balanced without the projected \$1.62 billion in state savings that Medicaid expansion would generate. Meanwhile, a new issue has surfaced: the expiration of a federal mandate approved early in the COVID-19 pandemic that prevents states from dropping Medicaid enrollees even if their incomes rise. During this period, Medicaid enrollment in Wisconsin rose from 1.18 million recipients to 1.65 million, an increase of 39.1%. Though state officials have no estimates on how many recipients will now be dropped from Medicaid, they will number in the tens of thousands at least. State policymakers may wish to consider ways to smooth this transition.
- **Transportation budget relies more on general taxes:** The governor’s proposal continues the recent trend of using substantial sums from the state’s general fund to support transportation spending. Some previous general fund transfers were one-time in nature, but this budget would add to the current ongoing transfer with two new sources of state sales tax revenue from the general fund, totaling about \$190 million. Evers also proposes using nearly \$380 million in general purpose revenue to pay down bonds that would normally be retired using transportation fund revenues.

Though we do not cover every important aspect of the budget in this report, we plan to analyze additional items from the budget in the weeks and months to come, including competing income tax proposals and funding levels for higher education.

The record surplus means the state has sufficient resources to increase spending to maintain or improve service levels, reduce taxes, and ensure it has the reserves to handle any unexpected setbacks. Striking the appropriate balance will depend in no small part on whether the governor and lawmakers can reach a bipartisan deal.

[Click here to read our 2023-25 State of Wisconsin Budget Brief.](#)

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