

FOCUS

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Challenge and Change Ahead for the State Budget

With the campaign over, the next governor faces the challenge of fulfilling campaign promises while balancing the 2019-21 budget. It may not be easy. Over the next two years, the state would need more than \$2 billion in additional revenue to cover projected cost increases in Medicaid, provide the same boost in K-12 school aids as in the current budget, and give 1% increases to other programs.

With the economy growing and unemployment low, the recent gubernatorial campaigns brought promises to expand school funding and other programs and cut taxes in the next state budget. How sustainable are those promises over the next two years? What effect could funding them have on other priorities within the state's general fund, or main account, such as public safety, the University of Wisconsin System, and holding down taxes?

To examine these questions, the Wisconsin Policy Forum considered a potential increase in state funding for schools, the expected cost of new laws taking effect in the next budget, and the projected expense of maintaining current services within Medicaid programs for the needy. Our analysis looks at how much state revenues would have to grow to cover these costs and how that compares to recent growth in state taxes and fees.

Beyond Medicaid, our analysis did not include 2019-21 budget requests from specific state agencies, since governors and lawmakers often modify or deny many of those funding requests. The analysis also did not include any extra money for state or local roads, as that is normally paid for out of the separate transportation fund. Our approach, which draws on one developed by former UW-Madison economist Andrew Reschovsky, did not try to predict the direction of the state or national economy.

Our broad review indicates that, absent strong growth in revenues, the next state budget may have difficulty accommodating campaign promises and rising costs in ongoing programs without a tax increase.

Next State Budget

Our starting point was recent work by the non-partisan Legislative Fiscal Bureau summarizing the tax and spending changes

set to take effect in the 2019-21 budget. This "structural deficit" calculation includes increased state spending and taxes associated with the Foxconn Technology Group plant being built in Racine County, decreased capital gains taxes, and increases in debt service costs.

This calculation, however, does not factor in changes in state taxes and spending due to inflation and economic growth or contraction. Table 1 seeks to account for some of these additional factors to help readers understand how they could impact the 2019-21 budget.

The analysis starts by including the costs to the state of continuing current Medicaid programs providing health care for low-income recipients, long-term care for the elderly and disabled, and prescription drug coverage for seniors. The Department of Health Services estimates this cost at an additional \$496 million in state general purpose revenue (GPR) over the next two years. This projection does not include any potential savings available to the state through taking expanded federal Affordable Care Act funding.

Aid to K-12 schools represents the state's biggest expense. Both candidates for governor called for the state to fund two-thirds of the statewide cost of K-12 education. They did not agree on how to reach that goal, but doing so could easily require hundreds of millions of dollars more in additional state aid. Rather than seek to account for the specifics of such a commitment, our

analysis provides the same dollar increase in each year of the next budget as was given in the current budget at an added GPR cost of \$621 million over two years. State officials could opt to provide more or less.

Our analysis provides specific cost increases for school aids and Medicaid because those are the state's two largest expenses. Together they make up just over half of GPR spending; no other program accounts for more than 7%. In addition, the state's changes to the Medicaid program are restricted by federal law and state officials likewise face political pressure if they do not increase aid to schools.

Our analysis lumps together state spending on other programs such as the UW System, prisons, and local government aid. As a whole since 2012, these programs have averaged about 2% more per year in GPR funding and that is roughly the forecasted national inflation rate. Some spending increases for the 2019-21 budget, however, are already factored into the LFB structural deficit and do not need to be repeated. We are including 1% yearly increases for these programs, for a two-year total of \$256 million more. Meeting this figure may not be easy. For instance, just

Table 1: Cost of Additional Commitments in the 2019-21 budget
(General Purpose Revenue Figures in \$Millions)

Item	Change Over 2018-19 Base		
	2019-2020	2020-2021	2019-21
LFB structural deficit for 2019-21	235.0	630.0	865.0
Adjustments to structural deficit			
Projected Medicaid cost to continue	153.0	343.0	496.0
Providing same \$ increase in GPR school aid as in current budget	177.0	444.0	621.0
1% yearly growth in other GPR spending	85.0	171.0	256.0
Total new commitments & spending	650.0	1,588.0	2,238.0

the UW System and Department of Corrections have together asked for roughly that much in additional spending.

Table 1 shows covering the commitments already approved by lawmakers, providing the same school aid increases as the current budget, funding present Medicaid service levels, and providing 1% increases for all other programs would require an estimated \$2.2 billion more over two years.

Reaching Goals Challenging

How difficult would it be to achieve these goals? Since 2012, state revenue growth has averaged about 2.9% per year. That number would have been somewhat higher if not for a series of tax cuts during

this period. Using the current base, each percentage point of revenue growth would yield a little more than \$170 million a year in new money.

To cover the \$2.2 billion in additional 2019-21 costs shown in Table 1, state revenues would have to increase by a projected 3.8% in the first year and 5.3% in the second—growth that would be challenging to achieve. (See Table 2.)

Budget decisions such as tax cuts or school aid increases can have lasting effects. Take the example of a

family deciding whether to send their three children to college or have one parent go from full-time to part-time work. Either decision may prove beneficial to the family, but both come with financial consequences. Achieving these priorities may mean the family—or their state—has to economize in other areas to balance the budget.

Table 2: Revenues Needed to Balance Table 1 Costs in 2019-21
(GPR Figures in \$Millions)

Item	Increase Over Base Year		
	2018-19 Base	2019-2020	2020-2021
Addtl revenue needed to balance budget		650.0	1,588.0
Total revenue needed	17,109.7	17,759.7	18,697.8
Yearly % revenue growth needed	3.8%	5.3%	

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Policy notes

■ After a one-year respite, state Medicaid spending rose by 10.9% last year; a recent report shows. According to the Annual Fiscal Report (AFR), in the 2018 fiscal year ended on June 30, \$2.92 billion in state tax dollars were spent on Medicaid, making it the state's second largest cost. After decreasing in fiscal 2017 by \$84 million, or 3.1%, the state's costs for the program increased by \$286 million in 2018. That was slightly larger than the average yearly increase since 2011.

Medicaid is jointly funded by the state and federal government to serve low-income state residents by providing health care for families and long-term care for the elderly and disabled. Spending on Medicaid from all state and federal sources in 2018 was up only 3.4%, or \$312 million.

■ Citizens sometimes assume that most of their tax dollars go to funding the state bureaucracy. The AFR shows that most state tax money goes to help local

governments and individuals rather than state agencies. Of the \$16.46 billion in state general fund spending in fiscal 2018, 51.2% went to schools and other local governments and 26.0% went to Medicaid and other programs to help individuals.

The remaining money went to state operations, including \$1.05 billion, or 6.3%, to the University of Wisconsin, and \$2.72 billion, or 16.5%, to all other agencies.