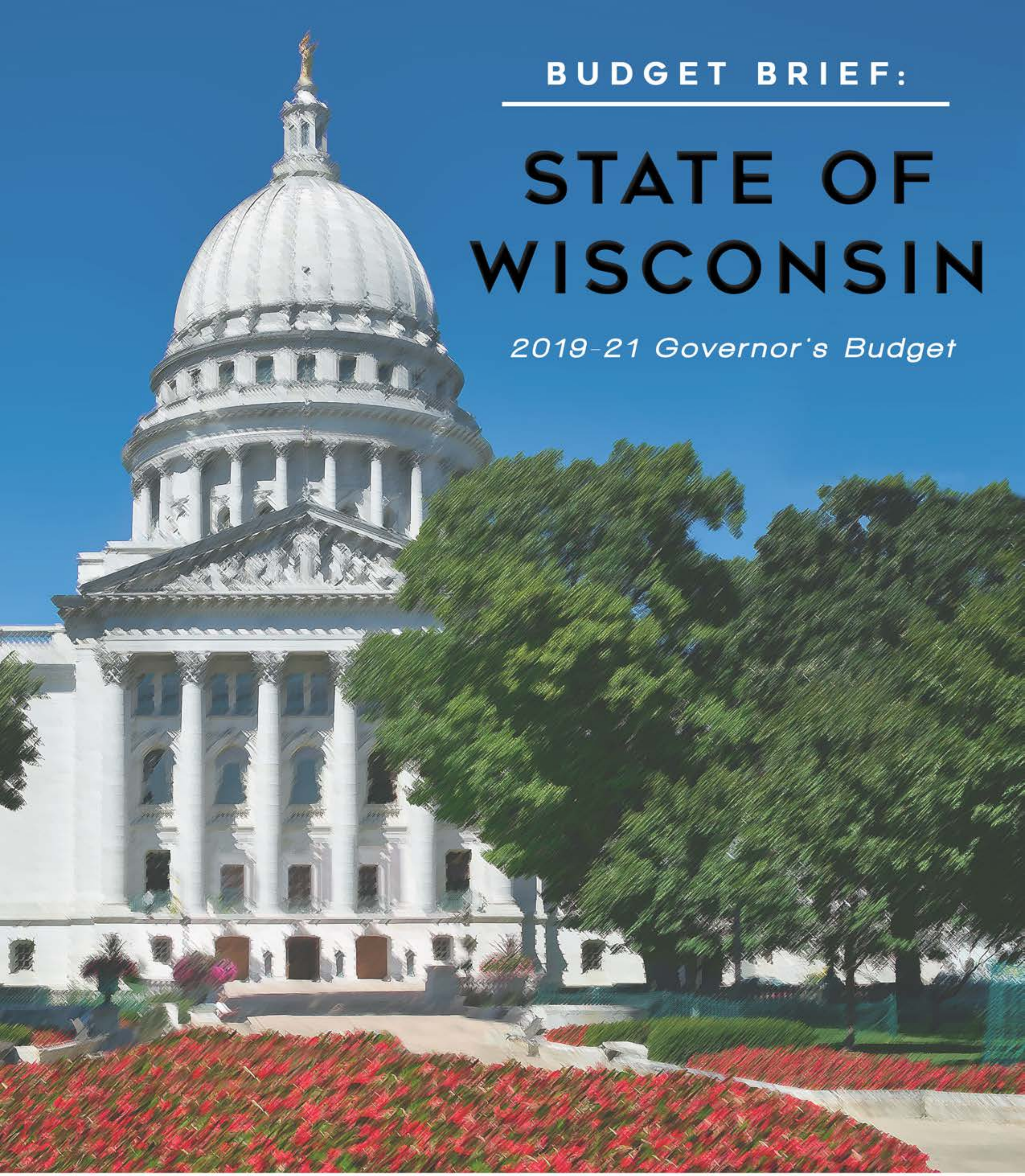
BUDGET BRIEF:

STATE OF WISCONSIN

2019-21 Governor's Budget



WISCONSIN POLICY FORUM

BUDGET BRIEF:

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March 2019

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INTRODUCTION

As a new state budget process begins, Wisconsin finds itself with a seemingly bright fiscal outlook. Unemployment in the state has been at or below 3% since the fall of 2017, general fund tax collections are expected to grow by 3.3% this year, and state reserves are near their highest levels in two decades. With Wisconsin's state and local tax burden at its lowest level in nearly 50 years,[1] there is reason for optimism.

At the same time, questions have mounted about state support for key priorities. Aging infrastructure and lagging gas tax revenues have strained the state transportation fund, leading to project delays and higher debt payments. In calendar year 2018, voters approved local referenda that added a record $2 billion in K-12 school spending across the state. State aid to local governments and the University of Wisconsin System has lagged, prisons are at or above capacity, and stubborn disparities remain in health and other outcomes for low-income and minority residents.

In his first budget, Governor Tony Evers has proposed raising spending to address these concerns, providing some programs with their largest increases in years. To help pay for it, the Democratic governor is calling for a net tax increase and the drawdown of a state surplus. Whether the proposed budget strikes the correct balance between needed re-investment and prudent financing will be an overriding theme of this year's budget deliberations.

To pass the two-year, $83.5 billion budget, Evers will have to work with the GOP-controlled Legislature as Wisconsin faces divided government for the first time since the 2007-08 session. Republican legislative leaders have rejected some of Evers' proposed increases in taxes and spending, signaling their eventual 2019-21 budget will be a markedly different document.

State leaders will have to work together to finalize a new two-year budget before the current one ends on June 30. Without an agreement, the state would continue under current tax and spending levels, a protection against the kind of government shutdowns seen at the federal level. However, the pressure will rise if state leaders do not pass a bill in time for local school boards to determine their own budgets and finalize property tax levies by the November 1 deadline in state law.

Another potential challenge is the economy. The national forecasts used to craft Wisconsin's budget are predicting slower growth in fiscal year 2021. State projections for general fund taxes, such as those on income and sales, predict robust growth in 2020 but a slowdown in 2021 (partly reflecting the effect of a repeal of the sales tax on internet access services). State leaders may want to consider the possibility of slower growth in the future as they make commitments in the present.

In the pages that follow, we analyze the proposed budget's priorities and key features, as well as other elements that are relevant to the state's immediate and long-term financial health. Our aim is to promote informed and thoughtful deliberations as policymakers consider the 2019-21 budget in the months ahead.

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[1] See the December 2018 issue of *The Wisconsin Taxpayer*, "State and Local Tax Burden Falls."

2019-2021 BUDGET SYNOPSIS

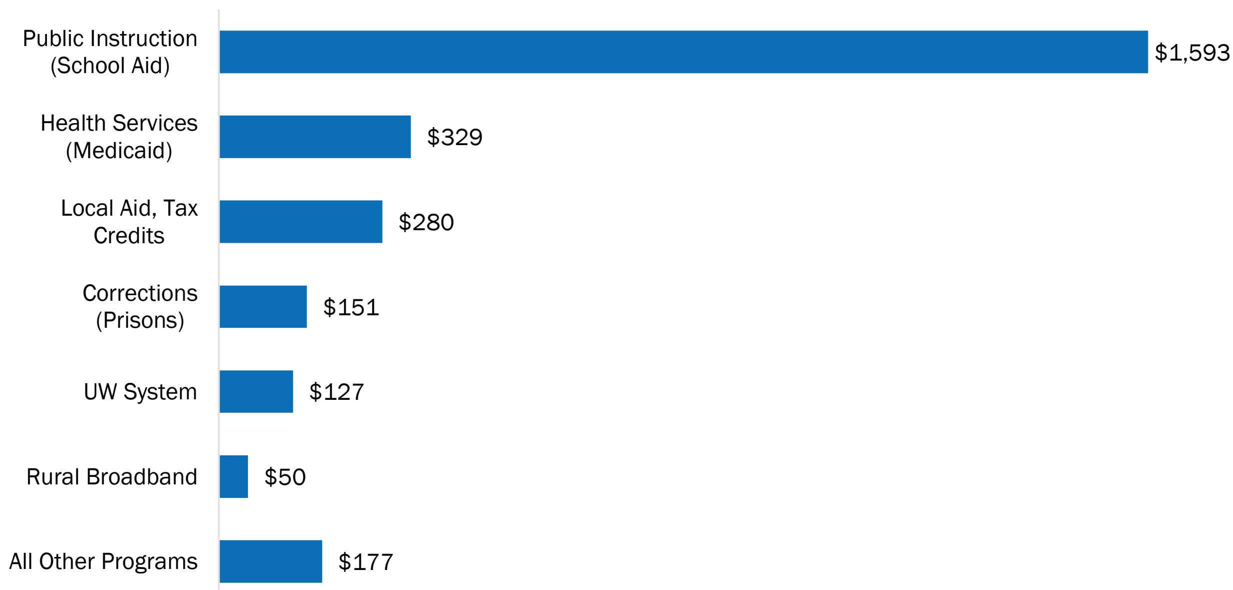
CORE STATE SPENDING

A look at the budget starts with the state's general fund, which under the proposal would see its biggest single-year increase since before the Great Recession.

The general fund supports major programs such as aid to schools and Medicaid health coverage for the needy using income and sales taxes and other general purpose revenues (GPR). The budget proposes GPR spending (gross appropriations) of $18.5 billion in fiscal year 2020 (which runs from July 1, 2019 to June 30, 2020),[2] an increase of 3.8%; and $19.8 billion in 2021, a 7.4% increase and the largest in more than a decade.

Overall, state GPR spending would rise $2.7 billion over the two-year budget, with most of the new money going not to state operations, but instead to K-12 schools, low-income Medicaid recipients, local governments, and tax credit recipients. For example, in 2021, $212 million has been set aside for potential state tax credits to Foxconn Technology Group to support its plans to build a liquid crystal display plant in Racine County. As shown in **Figure 1**, areas of state operations that do receive substantial funding increases include prisons, the University of Wisconsin System, and a Public Service Commission program to expand access to broadband internet.

Figure 1: Most Proposed Increases Would Go to a Few Programs
State General Fund Spending Increases by Area (In Millions), 2019-2021



Sources: Executive Budget and Budget in Brief

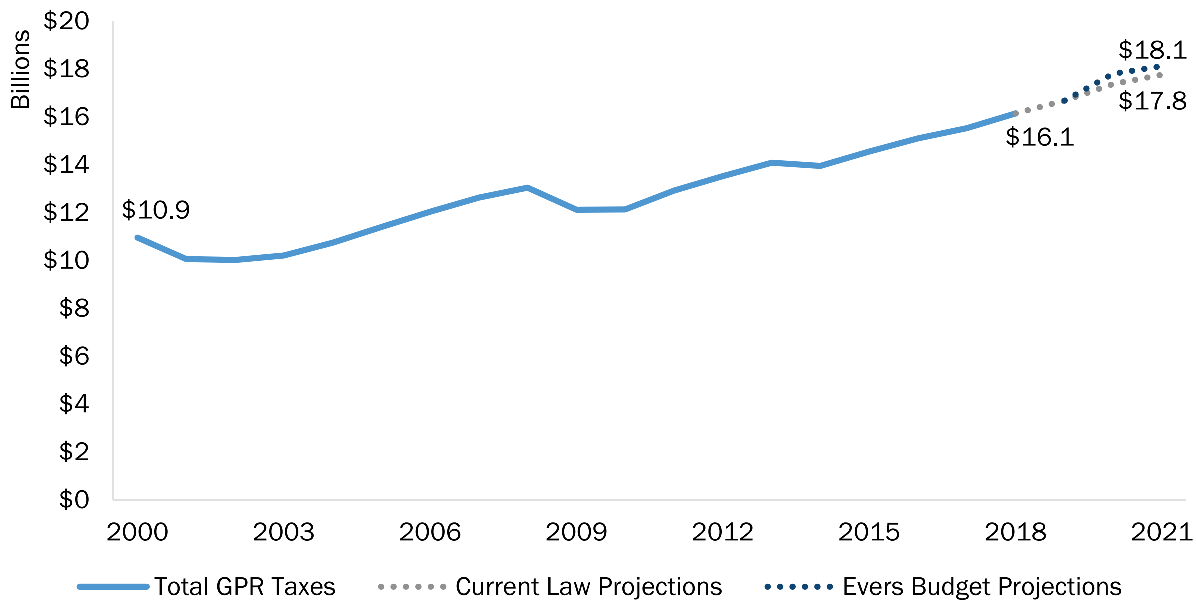
[2] In all future instances throughout this report, the year cited refers to the state fiscal year unless otherwise noted. For definitions of other terms, see WPF's state budget glossary.

CORE STATE TAXES

The governor proposes a 10% income tax cut for low and middle-income earners plus an expansion of the Earned Income Tax Credit and other smaller income tax cuts. However, those are outweighed by several increases primarily affecting upper-income earners. (See Key #1 for further discussion.)

As shown in **Figure 2**, state general fund taxes, such as those on income and sales, currently are projected to grow by $693 million, or 4.2%, in 2020; and by $393 million, or 2.3%, in 2021. Under the governor's proposal, general fund tax collections would grow by an estimated $1.1 billion (6.7%) in 2020 and $321 million (1.8%) in 2021.

Figure 2: Proposal Would Increase Net Tax Collections
State General Fund Taxes (In Billions), 2000-2021



Sources: Wisconsin Annual Fiscal Reports; Budget in Brief

PROPERTY TAXES

The state budget can affect property taxes both by capping increases in school and local government levies and by providing offsetting revenue in the form of state aid. The proposed budget would provide more aid for local governments and schools but would also relax state property tax limits on municipalities and counties and increase per pupil caps that limit school districts' combined revenues from state aid and local property tax levies. (See Keys #2 and #7.)

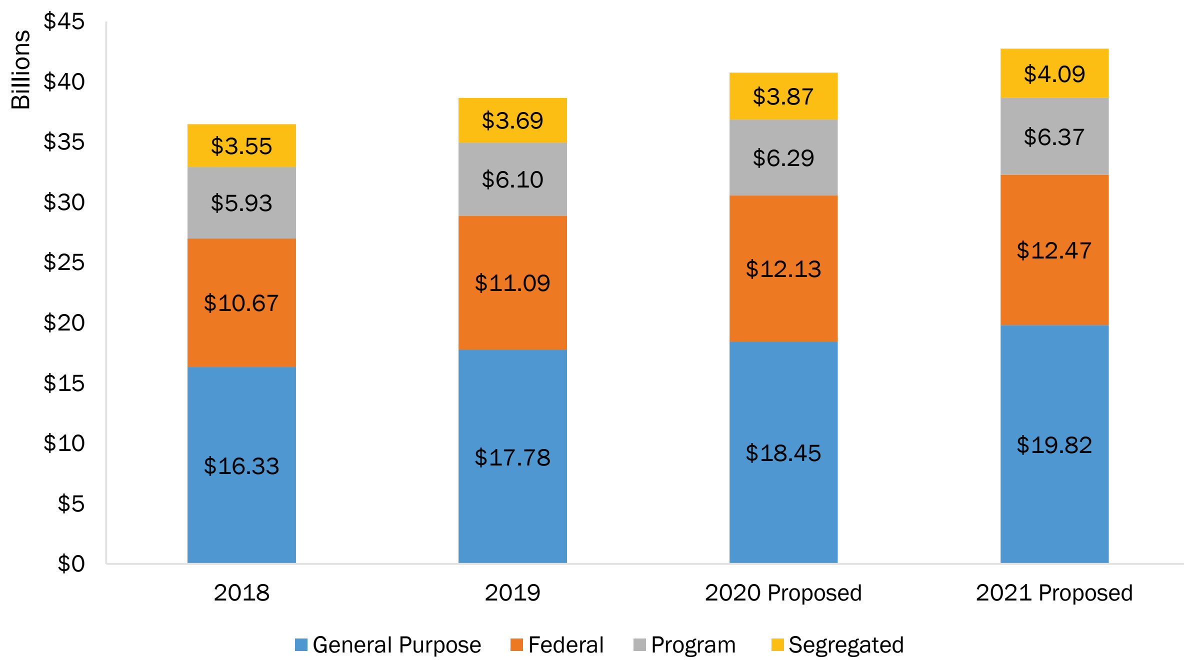
The governor's administration provided projections of the bill's effect on property taxes on the median value home in the state (estimated at $166,967 on 2018/19 taxes levied in December 2018 and collected this year.) Under the first year of the budget, the administration projects taxes on the median home would increase by $50, or 1.7%, to $2,919. In the second year, property taxes on the median home again would rise an estimated $50 (1.7%) to $2,969.

THE "ALL FUNDS" BUDGET

The budget would also significantly increase state spending across all sources of funding.

This "all funds" total includes GPR; federal money; segregated revenues (SEG) such as the gas tax and hunting and fishing licenses that flow into stand-alone accounts such as the transportation fund and the conservation fund; and program revenues (PR) such as university tuition or inspection fees. As **Figure 3** shows, all funds expenditures would rise by a proposed 5.4% in 2020 to $40.7 billion and 4.9% in 2021 to $42.7 billion.

Figure 3: Spending Rises Across Categories
State All Funds Spending (In Billions), 2018-2021



Source: Executive Budget

The governor's proposal would draw down additional federal money by expanding Medicaid health coverage under the provisions of the Affordable Care Act. (See Key #3.) However, federal funds overall would grow at roughly the same rate as the total state budget. In 2021, federal aid would make up 29.2% of all funds appropriations, up slightly from 28.7% in 2019 but almost unchanged from 29.3% in 2018.

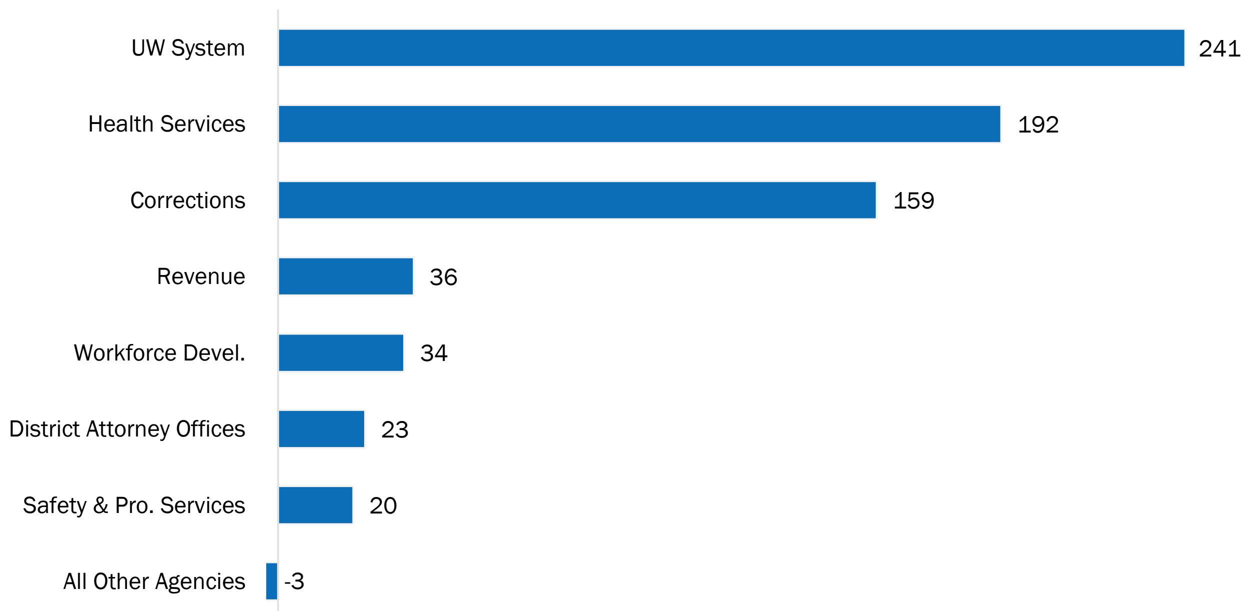
STATE EMPLOYEES

The 2019-21 budget would add 701 full-time equivalent (FTE) positions in state government, bringing the state workforce to just under 72,000. That works out to a 1% total increase over the two years.

Figure 4 shows roughly half of the new jobs are being added at state prisons within the Department of Corrections and secure mental health treatment facilities run by the state Department of Health Services. These institutions must be staffed at all times and can run up significant overtime costs if they lack adequate personnel. The UW System – the largest single employer within state government – would also see an increase of 241 positions to 26,293 FTE under the bill.

In addition, the budget would provide a 2% raise for most state employees in January 2020 and another 2% increase in January 2021 at a cost of $82.1 million in GPR. Overall, the budget would set aside $119.3 million in GPR as compensation reserves for increases in state employee salaries and benefits.

Figure 4: UW, Secure Institutions Would Add Staff
Proposed Change in All State FTE Positions, 2019-2021



Source: Executive Budget

DEBT AND STATE BUILDINGS

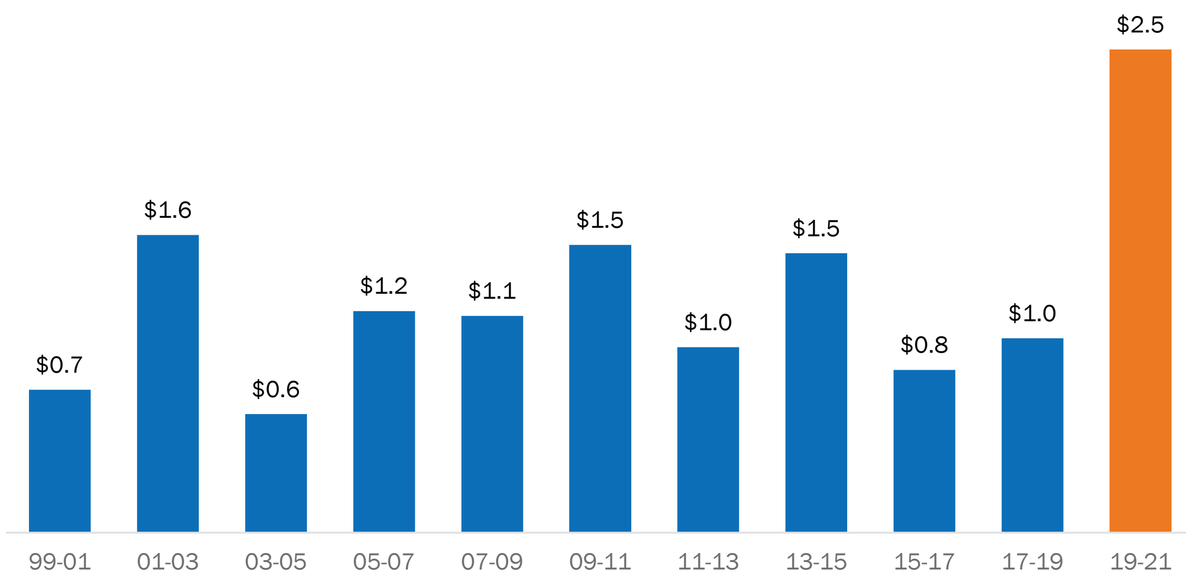
In a sharp reversal of recent trends, the governor's proposal would more than double the budget to construct and renovate state buildings and triple the borrowing used to support these capital costs. If approved, the capital budget would provide the highest level of spending on state buildings in two decades, as shown in **Figure 5**.

The 2019-21 capital budget would authorize $2.5 billion in spending, a 148.4% increase over the previous budget. To help cover the proposed projects, the budget would authorize just under $2 billion in new borrowing, up from $656 million in the 2017-19 capital budget. The proposed budget would also draw on $94.8 million in already approved borrowing and $429.7 million from other sources such as federal funds, gifts and grants, and borrowing supported by segregated revenues.

Nearly half of the capital budget, or $1.1 billion, would go to the UW System, including major projects on the Madison, Milwaukee, La Crosse, Eau Claire, and Stout campuses. Other major spending areas include $259 million for projects in state prisons and other correctional institutions and $128.9 million for Department of Health Services institutions.

With Republican lawmakers in opposition, the state Building Commission deadlocked on March 20 and failed to recommend any of the projects put forward by the governor. GOP legislators have said they oppose the total borrowing and spending levels in the budget but could still approve some of the projects in the overall plan later in the legislative process.

Figure 5: Capital Budget Would Hit Highest Level in Decades
Previous and Proposed Capital Budgets (In Billions), 1999-2021



Sources: Capital Budget, Wisconsin Legislative Fiscal Bureau Comparative Budget Summaries

HOW THE BUDGET IS BALANCED

In recent years, the state has built up its reserves from the minimal levels seen in the years before and after the Great Recession. The general fund is projected to close the 2019 fiscal year on June 30 with a gross balance of $691.5 million. In addition, the state is expected to end the year with $320.1 million in its separate rainy day fund (also known as the budget stabilization fund.)

These projected 2019 reserves amount to roughly 6% of general fund spending and represent some of the strongest numbers the state has achieved over the past two decades. However, they are still well below the 10.1% in median reserves among the 50 states nationally, according to the National Association of State Budget Officers (NASBO).[3]

In the first year, the governor's proposed budget would take in substantially more than it spends and the state's general fund balance would grow to $937.9 million at the end of 2020, as shown in **Table 1**. In the second year, however, proposed spending would exceed projected revenues by $832.6 million. (**See Figure 6**.) Consequently, the state would close the two-year budget cycle in June 2021 with just $105.3 million in its main account, or the lowest balance since 2011. The balance would amount to 0.5% of annual spending, or enough to fund the state's operations for two days.

Table 1: General Fund to Build, Then Spend Surplus
General Fund Condition Statement (In Millions), 2019-2021

	Estimated 2019	Proposed 2020	Proposed 2021
Opening Balance	$588.5	$691.5	$937.9
New Revenues	$17,173.7	$18,319.3	$18,665.3
Total Resources	$17,762.2	$19,010.8	$19,603.2
Total Net Expenditures	$17,070.7	$18,072.9	$19,497.9
Gross Ending Balance	**$691.5**	**$937.9**	**$105.3**
Revenues Minus Spending	$103.0	$246.5	-$832.6

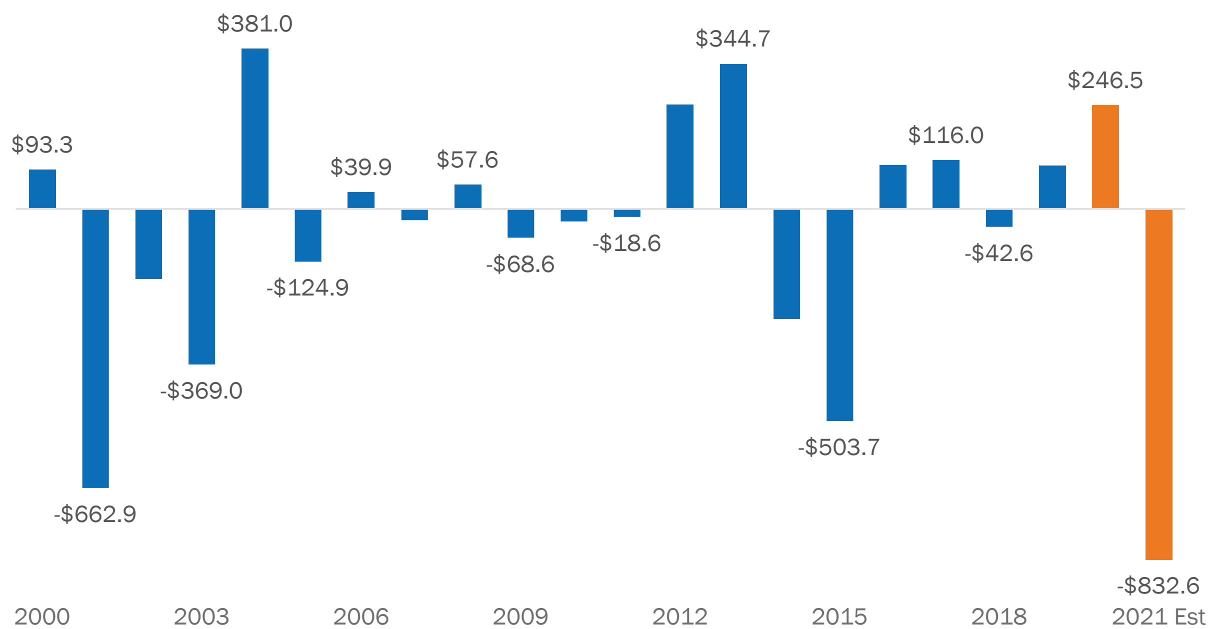
Source: Budget in Brief

Adding the rainy day fund to the total would raise total state reserves to a projected $425.4 million at the end of 2021. This figure still would amount to just 2.2% of general fund spending for the year, or enough to run the state for eight days.[4]

The mismatch of revenues and spending would be carried forward and lead to a potential shortfall of more than $800 million in each of the following two budget years, according to the Budget in Brief. This so-called "structural deficit" calculation for 2022 and 2023 is not exact, however, since it does not account for potential changes in state taxes or costs due to inflation and other economic forces.

[3] See the Fall 2018 *Fiscal Survey of States* from NASBO.
[4] For more, see *Focus* #5-2019, "Gov. Evers' Budget: A First Look."

Figure 6: State Costs to Outstrip Revenues
General Fund Revenues Minus Net Appropriations (In Millions), 2000-2021



Sources: Wisconsin Annual Fiscal Reports, Budget in Brief

Proposed Budget Contains New Policy Initiatives

With proposals ranging from raising the state's minimum wage to altering legislative redistricting practices, the governor's proposal is a reminder the budget bill is not only a fiscal plan, but also a policy document reflecting his priorities and political objectives. For decades, the insertion of such non-fiscal policy items into the budget has been a common practice for governors and lawmakers of both parties.

The Joint Committee on Finance typically asks the nonpartisan Legislative Fiscal Bureau to identify the non-fiscal policy items in the governor's budget. The panel then votes whether to keep or remove these items from the bill. **Table 2** shows a general recent decline in these items but a major uptick in the 2017-19 budget bill.

Table 2: Non-Fiscal Policy Items in Budget

Budget	Governor	Items
97-99	Thompson	114
99-01	Thompson	112
01-03	McCallum	150
03-05	Doyle	21
05-07	Doyle	21
07-09	Doyle	48
09-11	Doyle	45
11-13	Walker	21
13-15	Walker	12
15-17	Walker	14
17-19	Walker	83

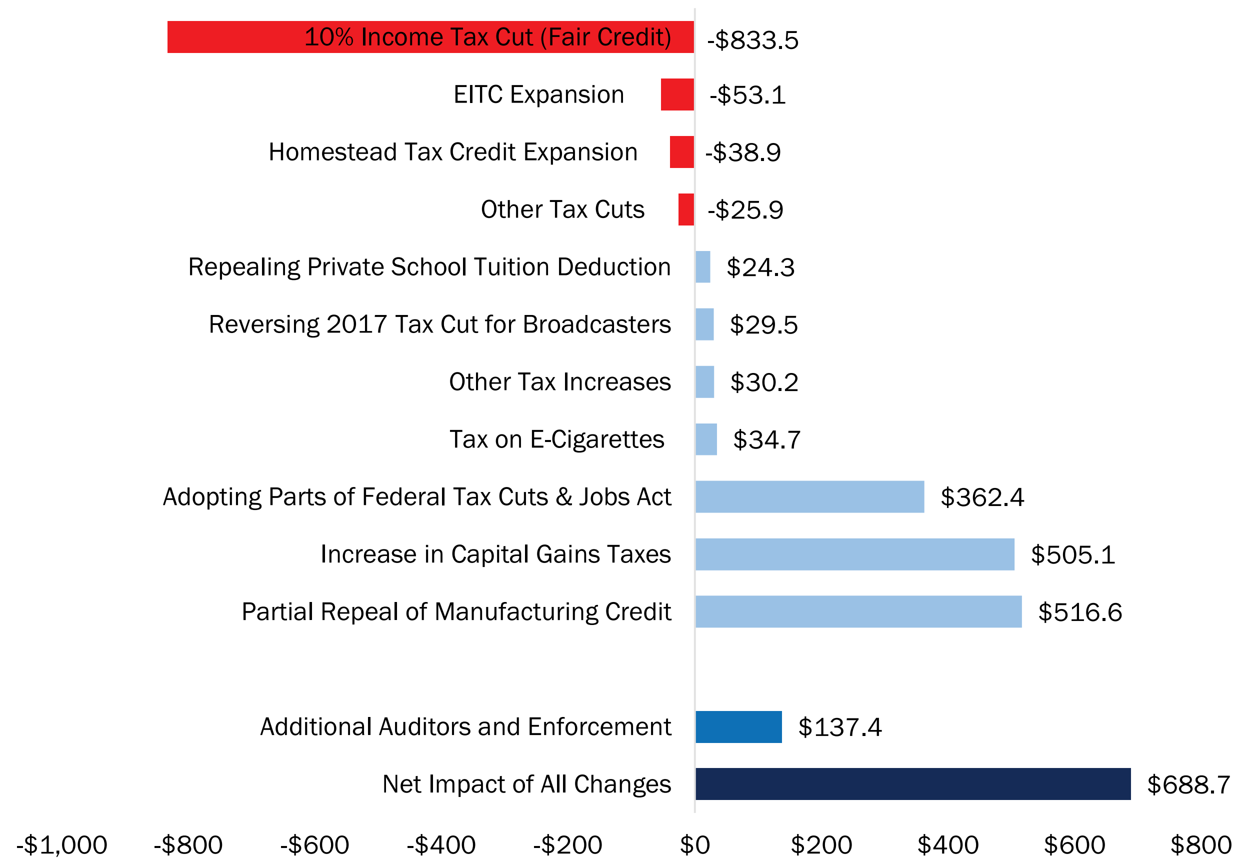
Given our focus on the budget bill's fiscal impacts and the likely removal of many non-fiscal items, this budget brief generally does not touch on policy proposals. However, we hope to analyze some of the most far-reaching ones in future reports.

KEYS TO UNDERSTANDING THE STATE BUDGET

KEY #1: MANY TAXES GO DOWN, MORE GO UP

As compared to current law, the budget proposal would produce a two-year, $688.7 million net increase in collections of GPR income, sales, and excise taxes. (For gas tax increases see Key #6.) **Figure 7** shows the GPR total is produced by a number of proposed decreases and increases to state tax law and enforcement.

Figure 7: Breaking Down State Tax Changes
Two-Year Impact (2020 and 2021) of Proposed GPR Tax Changes (In Millions)



Source: Budget in Brief

Tax Cuts

The biggest proposed cut is the "Family and Individual Reinvestment Credit (FAIR)." This income tax credit would equal 10% of a qualifying taxpayer's liability or $100, whichever is greater. The credit's full value would go to individual tax filers with adjusted gross incomes of less than $80,000 and married joint filers with incomes below $125,000. The credit's value would phase out for individuals making between $80,000 and $100,000 and joint filers making between $125,000 and $150,000.

The "non-refundable" credit can only be used to reduce tax liability. The administration estimates it would cut taxes for roughly 1.9 million tax filers by $833.5 million, with the savings almost equally distributed between each of the budget's two years.

In addition to creating the FAIR credit, the bill would increase two existing credits. First, the budget would expand the state's Earned Income Tax Credit (EITC), which is calculated as a percentage of the separate federal EITC. The EITC is meant to supplement the incomes of workers with lower wages and is refundable, meaning tax filers receive the credits in cash after satisfying any tax liability.

Starting in the 2019 tax year (spring 2020 tax returns), the proposal would increase the state EITC from 4% of the federal credit to 11% for families with one qualifying child and raise it from 11% of the federal credit to 14% for families with two children. The administration estimates nearly 200,000 filers with children would receive a two-year benefit of $53.1 million.

Second, the budget would increase the state's Homestead Tax Credit, a refundable income tax credit providing property tax relief for lower-income homeowners and renters. The bill would expand eligibility for the credit, raise its value, and index those factors to inflation, providing an estimated $38.9 million in benefits to 277,000 taxpayers.

Tax Increases and Added Enforcement

A number of provisions in the budget also would increase tax collections, with the main impact coming in four areas:

- **Limiting a state credit that eliminates all or most individual and corporate income taxes on manufacturing profits.** The bill would restrict the value of the credit to the first $300,000 of profit for each qualifying manufacturing firm, which would increase taxes by an estimated $516.6 million over the two years.
- **Restricting who can exclude a portion of their capital gains from state income taxes.** Currently, Wisconsin taxpayers can exclude 30% of the capital gains from the sale of non-farm assets owned for more than a year. Under the bill, this "exclusion" would be limited to individuals with adjusted gross income below $100,000 and married joint filers who make less than $150,000. Taxes would rise by an estimated $505.1 million over the two years.
- **Adopting in state law various federal tax provisions such as the 2017 Tax Cuts and Jobs Act.** These changes would increase state income taxes by $362.4 million over the two years. Notably, the budget bill would not adopt TCJA provisions allowing businesses to claim tax deductions more quickly based on the depreciation of assets such as equipment.
- **Increasing enforcement of existing state laws.** The proposal would add 36 auditors and compliance staff at the Department of Revenue and require online marketplaces to collect sales taxes when they facilitate retail transactions between consumers and other businesses. The budget assumes an additional $137.4 million in revenues over the two years from these moves.

In addition, the bill would include a number of smaller sales or excise tax increases on products such as clay pigeons; small, filtered cigars; and e-cigarettes and vaping products.

KEY #2: BOOST IN K-12 SPENDING ACCOMPANIED BY SHIFT IN STATE AID DISTRIBUTION

The past decade has proved challenging for school district budgets. In 2011-12, the Legislature and governor made large cuts to K-12 education, reducing state aid to school districts and the state-imposed revenue caps that effectively control how much districts can raise in local property taxes. (The state also gave districts more tools to control labor costs through 2011 Act 10.) Since then, state aid has risen moderately but revenue caps have remained tight, limiting increases in school property taxes. This approach has helped lower the state and local tax burden in Wisconsin, but the impact on district budgets also may have contributed to an increase in voter referenda to raise property taxes for schools, with 2018 marking a record $2 billion in successful ballot questions.

Asserting that "the challenges facing our schools demand investment and reform," the proposed budget channels significant new dollars to schools and relaxes revenue limits. Just as important, the budget proposes changes in the approach to allocating school aids, with greater attention to districts that face difficulties under the current funding formula and revenue limit restrictions and those serving the highest percentages of low-income students, English Learners, and students with disabilities.

> The 2019-21 budget proposes a $600 million increase for special education. More on the financial challenges posed by these programs can be found in our February 2019 report, *Special Education Funding in Wisconsin*.

The budget would increase GPR spending for the Department of Public Instruction (DPI) by $1.59 billion over two years. In the first year of the budget, DPI would spend $6.76 billion in GPR, a 7.5% increase over 2019. In the second year, spending would go up by 9.7% to $7.41 billion. The increase includes $618.8 million more over the two years for general school aids, a large share of which is equalization aid (a formula directs greater shares of this form of aid to poorer districts).

This boost in general school aids anchors a broader overhaul of school finance that would make three major changes:

1. Restoring a previous state commitment to funding two-thirds of K-12 education costs.
2. Indexing annual adjustments to districts' per pupil revenue limits to the rate of inflation, and lifting the limits of the lowest-spending districts. The revenue limits cap the combined amount that districts can raise per student from state general school aids and local property taxes.
3. Embedding a poverty factor into the equalization aid formula to direct more state aid and property tax relief to districts serving large populations of low-income families.

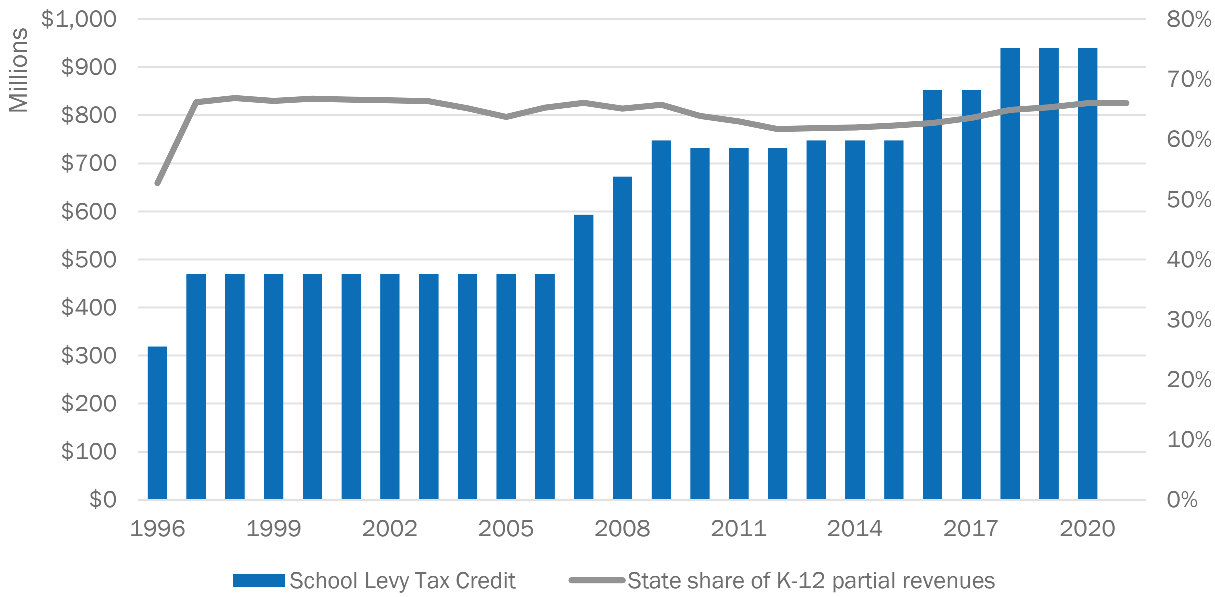
Return to two-thirds funding

Starting in 2021, the governor's budget would restore the state's commitment to funding two-thirds of K-12 education costs. The state implemented the commitment in 1997 but repealed it in the

2003-05 budget. Prior to 1997, the state's share of school costs was about 50%. As shown in **Figure 8**, the state share has ranged between 61.7% and 65.4% over the past decade. However, the recent upward trend in the state share of K-12 costs does not necessarily indicate more resources for schools. It also corresponds to several years of flat or minimal growth in revenue limits (implemented in 1994) along with increases in the School Levy Tax Credit. While that credit counts as state support for schools, the state dollars are used to lower property taxes and do not go to schools.

Figure 8: Not All of Two-Thirds Commitment Goes to School Districts

State Share of K-12 Funding (Gray Line) and School Levy Tax Credit (Blue Bars), 1996-2021



Sources: Department of Public Instruction, Legislative Fiscal Bureau, 2019 Assembly Bill 56

The budget would eliminate the School Levy Tax Credit as well as the First Dollar property tax credit in 2021 and fold those appropriations – a total of $1.1 billion – into general equalization aids, thereby channeling those resources into school budgets. According to the Legislative Fiscal Bureau (LFB), because of the way the School Levy Tax Credit and equalization aids are allocated, the credit's elimination likely would have a larger impact on wealthier and higher-spending districts.

Governor Evers is not alone in advocating for a return to some form of two-thirds funding. Both former Governor Scott Walker and legislators on the bipartisan Blue Ribbon Commission on School Funding made similar recent calls. Consequently, unlike many of the K-12 education provisions in Evers' proposal that signal reversals of Walker-era budget policies, this recommendation could gain traction in some form in the Legislature. However, the state's two-thirds commitment does not necessarily determine how much school districts can actually spend.

Revenue limit increases

Without a revenue limit increase, the two-thirds funding provision would not result in more spending authority for school districts. Rather, it would raise state aid and reduce the property taxes levied for schools in equal measure. With a few exceptions such as for low-spending districts, revenue limits have been held constant in recent years, which helps explain why many districts have turned to referenda to exceed them.

The governor's budget would increase revenue limits for all school districts by $200 per pupil in 2020 and $204 in 2021. Future increases would be indexed to the Consumer Price Index, a return to the inflationary adjustments in place between 1994 and 2011 (and recommended by the Blue Ribbon Commission on School Funding). The 2011-13 budget cut revenue limits by 5.5% ($529 per pupil); after that, they were increased by $50 or $75 per pupil for three years and then largely frozen at 2016 levels.

In 2013, the state created a new "per pupil" categorical aid to help school districts cope with cost pressures. This aid – which is provided irrespective of a district's property wealth and does not count against revenue limits – has grown from its original $50 per pupil in 2013 to $654 per pupil in 2019. A notable change in the budget is its proposal to keep this aid flat and instead use general school aid and revenue limit increases to help school districts keep pace with increasing costs. This approach would help poorer districts because it is tied to the equalization aids formula, as opposed to providing an across-the-board increase that does not take district characteristics into account.

Finally, the budget would increase the per pupil revenue ceiling for certain low-spending districts from the current $9,400 to $9,700 in 2020 and $10,000 in 2021 (the average in 2018 was $10,555). According to the budget, this step would allow 125 school districts with the lowest revenue limits to increase them without a referendum.

Poverty factor introduced into school aids formula

In addition to adding substantial sums for school aids and channeling the bulk of the increases into the equalization aids formula, the budget would make substantial changes to the formula itself. The bill specifies that economically disadvantaged students receive 20% more weight in the equalization formula, thus benefiting districts with higher percentages of such students. If adopted, Wisconsin would join 41 other states that factor poverty into the state's funding formula.[5]

Because of revenue limits, however, an increase in state aid to districts with more low-income families would not allow them to raise spending but instead would provide property tax relief. Notably, the budget does not follow the Blue Ribbon Commission on School Funding's recommendation to also allow school districts to weight low-income pupils by 1.2 for revenue limit purposes. By doing so, the budget would limit potential property tax increases.

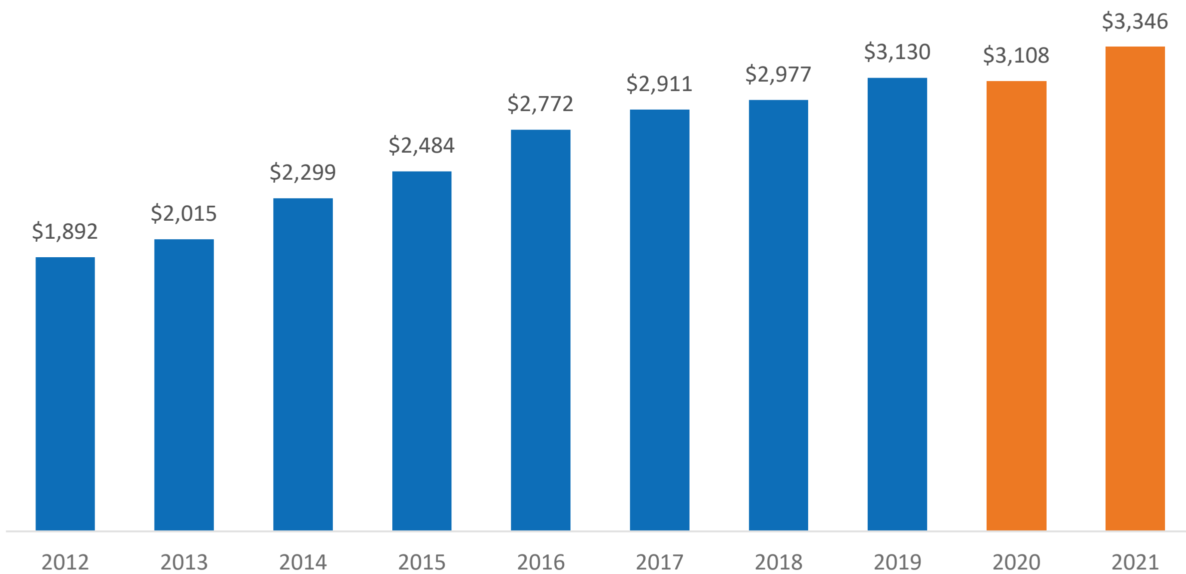
What is the likelihood that these provisions will remain in the budget the Legislature ultimately approves? Past Republican-controlled Legislatures have rejected four similar proposals the governor made as state schools superintendent. However, legislative leaders have signaled support for more resources for K-12 education. The question is in what form and what amounts.

[5] See this June 2018 Education Commission of the States presentation to the Blue Ribbon Commission on School Funding.

KEY #3: MEDICAID EXPANSION DOLLARS USED TO ADDRESS LONGSTANDING HEALTH CARE CONCERNS

The Department of Health Services (DHS) would receive the second largest GPR increase in the proposed budget after DPI, with $329 million of increased expenditures over two years. This increase is not surprising; Medicaid-related programs, which comprise one of the largest segments of the DHS budget, have represented one of the state's fastest growing expenses in recent years. As shown in **Figure 9**, budgeted GPR spending for Medicaid programs grew from $1.9 billion in 2012 to $3.1 billion in 2019 (65.4%). Under the proposal, that amount would grow 7.5% to $3.3 billion in 2021 (though it would shrink slightly in the first year of the budget).

Figure 9: Medicaid Spending Rises Rapidly
GPR Medicaid Appropriations (In Millions), 2012-2021



Source: Wisconsin Department of Health Services

A twist in the proposed budget is the controversial recommendation to finance increased spending by expanding Medicaid coverage to individuals with incomes up to 138% of the federal poverty level (up from the current 100%). This would allow the state to save $320 million in GPR over the two years by taking advantage of a provision in the Affordable Care Act that would draw down more federal reimbursement for services provided to certain existing Medicaid recipients. The infusion of federal funds is a major contributor to the even bigger growth in All Funds spending for Medicaid programs in the proposed budget, from $10.3 billion in 2019 to $11.6 billion in 2021 (13.5%).

Republican lawmakers have opposed Medicaid expansion, contending that GPR savings in the state budget would be more than offset by increased charges to privately insured individuals. Ostensibly, private insurers would face higher costs from health care providers seeking to make up for inadequate state reimbursements for services provided to Medicaid patients and would pass those costs to policyholders. Opponents also have argued the increased federal payments could be short-lived.

Supporters argue Medicaid expansion would provide health care coverage to more low-income citizens and generate additional resources to reinvest in badly needed health care initiatives. The proposed budget estimates the expansion would extend Medicaid coverage to an additional 82,000 individuals and would reinvest the net GPR savings plus the additional federal dollars in a series of initiatives designed to enhance Medicaid-based services and provider reimbursements.

Republican opposition to the expansion proposal makes it highly unlikely that it will survive the budget process. That, in turn, casts serious doubt about the prospects for survival of several of the bill's new or enhanced Medicaid-related investments. It could be argued, however, that **several of these investments merit careful consideration outside of the context of whether Medicaid expansion should pay for them**. While it is difficult to imagine how the largest of these initiatives could be afforded without the Medicaid expansion dollars, each addresses longstanding policy concerns, and failure to consider them also could prove costly. For example:

- **Hospital reimbursement** – the budget would provide a $365 million overall expenditure increase in Medicaid reimbursements to hospitals (of which about $47 million is GPR), including an additional $143 million for hospitals that serve a disproportionate share of Medicaid recipients; an additional $200 million for supplemental payments to all hospitals that serve Medicaid recipients; and $20 million targeted to hospitals that serve large numbers of child enrollees. According to the Wisconsin Hospital Association, in 2016, hospitals across the U.S. were reimbursed for an average of 89% of the costs associated with providing care to Medicaid patients; in Wisconsin, hospitals receive an average of only 65% reimbursement.[6] While we cannot independently verify that statistic, insufficient Medicaid reimbursement rates have been cited by hospitals and other providers for years as a factor that is driving up health care costs for patients outside the program and reducing access to care for Medicaid recipients.

- **Dental care** – the administration states that Wisconsin ranks 45th among states in providing access to dental services for Medicaid enrollees. To address this concern, the budget would devote an additional $43 million to several initiatives. The foremost is an increase in dental reimbursement rates to encourage more dentists to serve Medicaid patients (at a cost of $39 million, including $22 million in GPR). The budget document argues that poor access to preventive dental services can drive up Medicaid costs in the long run because of the absence of early detection and treatment.

- **Crisis services** – the budget would initiate state cost sharing for the non-federal share of behavioral health crisis intervention services provided or funded by counties. Those services – including mobile crisis, call center, walk-in, and others designed to reduce costly inpatient hospitalization – draw down some federal reimbursement, but counties have paid the remaining share. The budget would change that by providing $40 million over the two years (including $28 million in GPR) to initiate state cost sharing, particularly for expanded crisis intervention services.[7]

[6] See the Wisconsin Hospital Association website for the figures.
[7] WPF discussed the health-related and fiscal benefits of effective crisis intervention in a recent report related to the crisis service continuum in Milwaukee County, which can be found at: https://wispolicyforum.org/research/psychiatric-crisis-redesign-in-milwaukee-county-phase-i-report/.

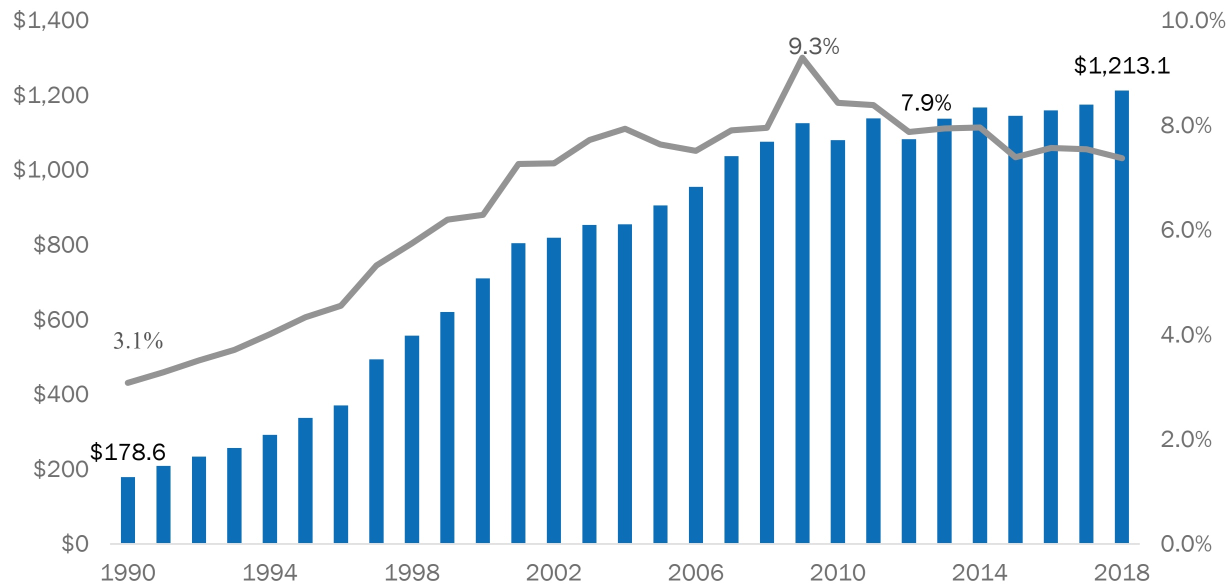
Other budget initiatives intended to improve health care quality and access for Medicaid recipients include rate increases for the state's nursing homes and direct care workers and a new benefit for nonmedical services like housing and transportation. Taken together, these proposals come with a significant cost. Yet, while the proposed use of Medicaid expansion dollars to help pay for them is likely to get most of the attention, the potential programmatic and fiscal benefits of these initiatives should not be overlooked.

KEY #4: INCREASING CORRECTIONS POPULATION REQUIRES MORE RESOURCES

As discussed in our October report, *Wisconsin's Prison Population on the Rise*, the state's prison population has begun to grow again after a brief period of decline in the early 2000s. In fact, by the start of 2021, the population is projected to reach a record 25,055, which is an increase of 13.3 % from the 2018 population of 22,117. This increase has been driven largely by inmate admissions outpacing releases; the largest share of admissions in recent years (roughly 37% in 2017) are offenders on probation, parole, or extended supervision who were revoked by DOC.

The growth in the prison population leaves state officials little choice but to also increase the DOC budget, at least in the short term. Unlike many other state agencies, DOC is funded almost entirely with GPR; the proposed budget would increase GPR spending for DOC over the two years by a total of $151.5 million. GPR spending would rise $63.1 million, or 5.4%, in 2020 (to $1.22 billion), and by $25.3 million, or 2.1%, in 2021 (to $1.25 billion). As shown in **Figure 10**, this increased GPR spending for DOC is nothing new; it rose 70.8% between 2000 and 2018, the latest year for which actual spending figures are available, and increased more than six-fold between 1990 and 2018. DOC's share of total state GPR spending has trended downward in recent years, however, and that overall trend would continue in the proposed budget.

Figure 10: Corrections Spending Up Overall, Down as Share of Budget
Actual Corrections Spending (Bars) (In Millions) and as % of GPR Budget (Line), 1990-2018



Source: Wisconsin Annual Fiscal Reports

Meanwhile, the governor's capital budget calls for nearly $259 million in new corrections buildings and other improvements, including $15 million to build two barracks units at the Jackson Correctional Institution and one at the Taycheedah Correctional Institution to house more inmates. The governor would add 72 FTE positions in 2021 for these units.

While the growing corrections population is a driver of DOC expenditures and will likely preclude any notion of diverting corrections spending to other priorities in the 2019-21 budget, it is important to note that there are several other factors contributing to growing DOC costs. For example:

- As WPF noted in a 2017 report, the state's inmate population is aging, which often requires additional health services. The governor would increase staffing in the health care units at the Columbia and Racine correctional institutions by a total of 38.7 positions, while the capital budget would add $10.6 million for a new health services unit at the Stanley Correctional Institution (but without any new staff).

- The governor has prioritized prisoner reentry programming, which he contends is a worthwhile investment for both corrections and workforce development purposes. The budget includes $7.8 million to expand the Opening Avenues to Reentry Success program for offenders with mental health issues from the current 44 counties to all 72 counties; $500,000 to expand the Windows to Work job training program to every medium security prison in the state; $150,000 to expand institution-based job centers to help inmates find jobs before they are released; and $880,000 to pay instructors to teach welding at Taycheedah and industrial maintenance at Jackson. The governor would also provide 11.25 positions for a new building for inmate programming at the Wisconsin Secure Program Facility at Boscobel.

- In response to challenges associated with recruitment and retention of corrections staff as well as excessive levels of overtime spending, the budget includes $23.8 million in GPR over the biennium to institute a revised pay system for corrections officers, correctional sergeants, and related positions in both DOC and the Department of Health Services. According to the budget, the new system will increase starting hourly wages for corrections officers and reduce overtime hours. The budget also includes $14.2 million in each year to support additional overtime costs.

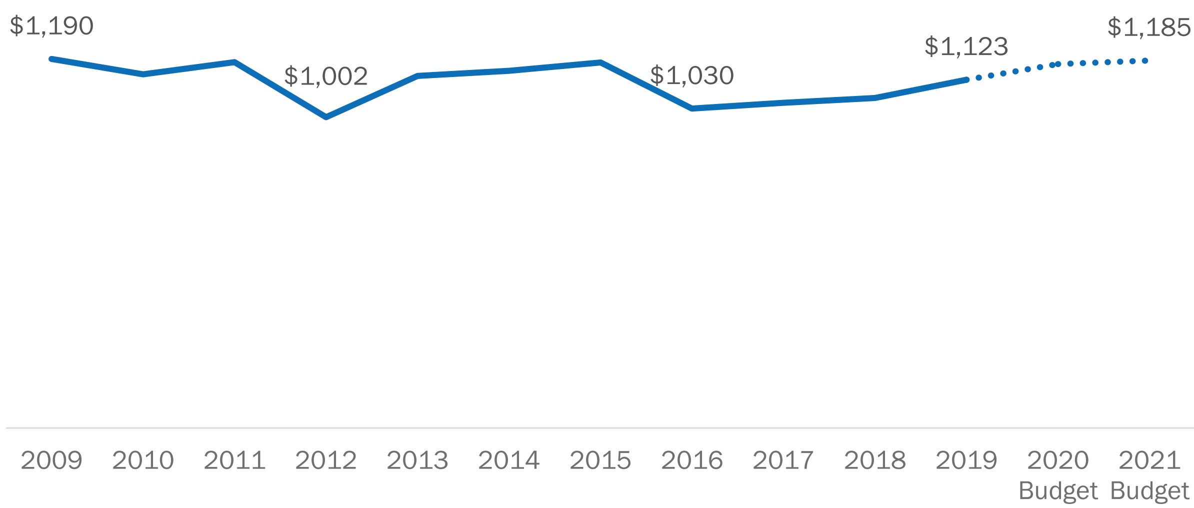
The proposed budget also makes a number of changes related to juvenile corrections, including substantial increases in capital funds for counties to build residential care centers for children and youth, and for the state to build three regional corrections facilities to replace Lincoln Hills and Copper Lake. We plan to provide further analysis of proposed changes to juvenile corrections programming and costs in future reports.

Justice system reforms that may hold promise for reducing corrections costs (among other benefits) have been widely seen as one of the few issues on which lawmakers of both parties and the governor might be able to find common ground. However, as indicated by the proposed increase in DOC spending, while such efforts may bear financial fruit in the future, near-term reductions in corrections spending would appear to be out of reach.

KEY #5: UW FUNDING DECLINE REVERSED WHILE TUITION FREEZE IS MAINTAINED

The governor's budget includes a GPR increase of $127 million for the University of Wisconsin (UW) System over the next two years, which is the fourth largest increase among state agencies. This proposal would continue a recent trend of slowly rising GPR for the UW System that began in 2017, following several years of flat or declining funding. As shown in **Figure 11**, the budget allocates about $1.2 billion of GPR for the UW System in 2021. That is slightly below 2009 levels in nominal value and substantially lower after adjusting for inflation – the state's funding level from a decade ago would now be worth about $1.4 billion in today's dollars.

Figure 11: State Support for UW Would Rise
GPR Funding Budgeted for UW System (In Millions), 2009-2021



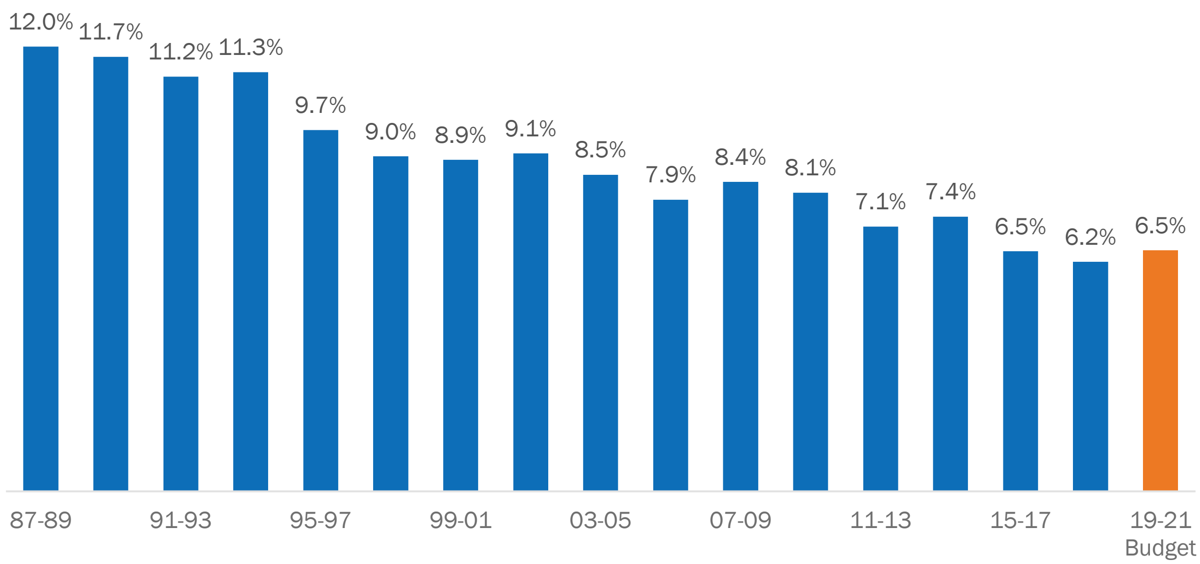
Sources: Legislative Fiscal Bureau, Executive Budget

The share of the state's total GPR spending going to the UW System has been declining since at least the late 1980s, as shown in **Figure 12**. The budget would reverse this trend slightly, but at 6.5%, the percentage of overall spending would remain at just over half the rate in the late 1980s.

Over the past decade, GPR has also made up a declining share of the overall funding for the UW System. GPR dropped from 25.1% of the UW System's budget in 2009 to 17.7% in 2019.[8] Under the proposed budget, that rate would increase to 18.6% in 2021 but remain well below 2009 levels.

[8] See the Wisconsin Legislative Fiscal Bureau's January 2019 "Informational Paper 32: University of Wisconsin System Overview."

Figure 12: Share of Budget Going to UW Has Shrunk
% of Total GPR Going to UW System by Budget Cycle, 1987-2021



Sources: Annual Fiscal Report, Legislative Fiscal Bureau, Executive Budget

The budget would continue a tuition freeze for resident undergraduate students that began in 2013. The proposal comes at a time when student loan default rates are increasing nationally and student loans are second only to mortgages among the top sources of total household debt.[9] In Wisconsin, nearly two-thirds (64%) of college graduates from the class of 2017 have student loan debt, which ranks sixth nationally.[10]

Since Governor Evers' proposal aligns with a campaign pledge by then-Governor Walker to continue the undergraduate tuition freeze, it may well find support in the Republican-controlled Legislature. The new governor's budget, however, would support the tuition freeze with a $50 million GPR increase for the UW System over the next two years, which may be a point of contention. In the past, the tuition freeze has not been tied to increased state funding.

Notably, the UW System could still raise tuition for graduate students and nonresident undergraduates, as it has done in previous years. The system would see a $93.5 million increase in each fiscal year based on recent trends in tuition revenues. The 2017-19 budget included a similar annual increase of $84 million, with $52.5 million of that (62.6%) coming from increases in nonresident and graduate tuition and $9.7 million (11.5%) from increased enrollment.[11]

[9] Brookings Institution: "The looming student loan default crisis is worse than we thought." (January 11. 2018.) https://www.brookings.edu/research/the-looming-student-loan-default-crisis-is-worse-than-we-thought/
[10] The Project on Student Debt of the Institute for College Access & Success can be found at: https://ticas.org/posd/map-state-data#.
[11] Wisconsin Legislative Fiscal Bureau's November 2017 "Comparative Summary of Provisions – 2017 Act 59."

The budget diverges from previous policy adopted by the Republican Legislature on another major proposal to eliminate a performance-based funding system introduced in the 2018-2019 academic year. Currently, $26 million is allocated to UW System institutions each year based on their performance on a range of indicators designed to measure student access and progress, workforce contributions, and operating efficiency.

According to the governor, eliminating performance-based funding would allow the UW System to use the $26 million each year to supplement faculty pay throughout the state. The governor and UW System leaders have said this is critical to address what they see as the system's declining ability to compete for faculty nationally. The budget also would add $45 million over the two years for capacity-building initiatives aimed at improving student success.

Performance-based funding was supported by legislative Republicans and opposed by minority Democrats when it was created, and GOP lawmakers see it as an important strategy for ensuring UW institutions are providing a quality service for students, families, and the state's economy. Therefore, this proposal could hit roadblocks.

KEY #6: NEW TRANSPORTATION TAXES AND FEES BOOST SPENDING AND REDUCE BORROWING

For years, the state's transportation fund has struggled to provide sufficient resources to replace the state's aging infrastructure and complete all the authorized projects at a time of lagging revenues from sources such as the gas tax. State leaders have largely avoided raising taxes and fees in recent years and instead have increased borrowing or deferred projects. The result has been rising debt levels within the fund and some declines in road conditions.

To respond, the governor's 2019-21 budget would provide the Department of Transportation with $6.63 billion over the two years – a $537.7 million increase in all funds spending. In addition, the budget would hold transportation borrowing to the lowest levels in two decades. The trade-off, however, would be the first increase in state gas taxes in 13 years and additional increases in fees. In principle, some leaders in the GOP-controlled Legislature have expressed openness to additional transportation revenues, but it is unclear if the governor's gas tax proposal can pass.

Tax and Fee Increases

The governor is seeking an 8-cent-per-gallon gas tax increase, from 30.9 cents to 38.9 cents.[12] The administration estimates the increase would generate an additional $485 million over two years.

In addition, the gas tax could automatically rise even higher each year under a proposal to resume indexing of the tax. Wisconsin had linked its gas tax to inflation beginning in 1985. Initially, the adjustment was pegged to changes in the consumer price index (CPI) and fuel consumption (the Legislature eliminated the latter factor in 1997). Most years, indexing led to an increase in the tax.

[12] The petroleum tank clean-up fee adds another two cents for a total of 40.9 cents per gallon in state taxes.

However, in 2005, Democratic Governor Jim Doyle and the GOP-controlled Legislature repealed gas tax indexing, with the change taking effect in 2006.[13] By June 30, 2019, the state will have foregone an estimated $1.9 billion in revenue because of the repeal, according to the LFB. Now another Democratic governor is attempting to convince a different GOP Legislature to undo the earlier action.

Restoring indexing would raise an additional $41.6 million over the budget cycle beginning on April 1, 2020. The governor's proposed 8-cent increase approximates where the gas tax would be today if indexing had not been repealed. In addition to the gas tax increases, the governor's proposal would bring in an additional $81.8 million in transportation revenue by:

- Raising title fees for all vehicles by $10, from $62 to $72 ($35.7 million). The change does not affect the supplemental $7.50 title fee.
- Increasing heavy truck registration fees by 27% ($36.4 million).
- Revising the definition of hybrid vehicles, enabling the state to receive $9.7 million from a surcharge on them that was passed in the last state budget but not collected because of difficulties in applying the current fee language.

Last, the governor's proposal would end the yearly transfer of 0.25% of general fund tax collections into the transportation fund. The transfer should amount to an estimated $41.7 million in 2019.

Minimum Markup Repeal

The Evers administration maintains the gas tax increases would be more than offset by 14 cents per gallon in savings generated by the proposed repeal of the Unfair Sales Act, also known as the minimum markup law. The statute, which dates back to the Depression era, mandates a markup of at least 9.18% above wholesale for retail gasoline prices.

Estimating the impact of minimum markup repeal is no easy task. One reason is an exception in the Unfair Sales Act that allows a retailer to sell gasoline under the required markup by filing a notice with the state to demonstrate it is meeting the price of a competitor. We hope to conduct additional research on this matter later this year, particularly if the repeal proposal gains traction. Two years ago, Assembly Republicans put forward their own plan raising overall taxes on gasoline while scaling back the minimum markup. Repeal of the Unfair Sales Act, however, remains controversial.

Projects and Borrowing

The 2017-19 state budget avoided gas tax increases, reduced borrowing, and increased state aid for local roads. However, it did so largely through delays of several major state highway projects. The governor proposes using the additional revenues in the transportation fund to move up some projects and again increase state support for local roads, as well as for local transit. (See Key #7.) The accelerated state projects would include completing the Zoo interchange in Milwaukee County;

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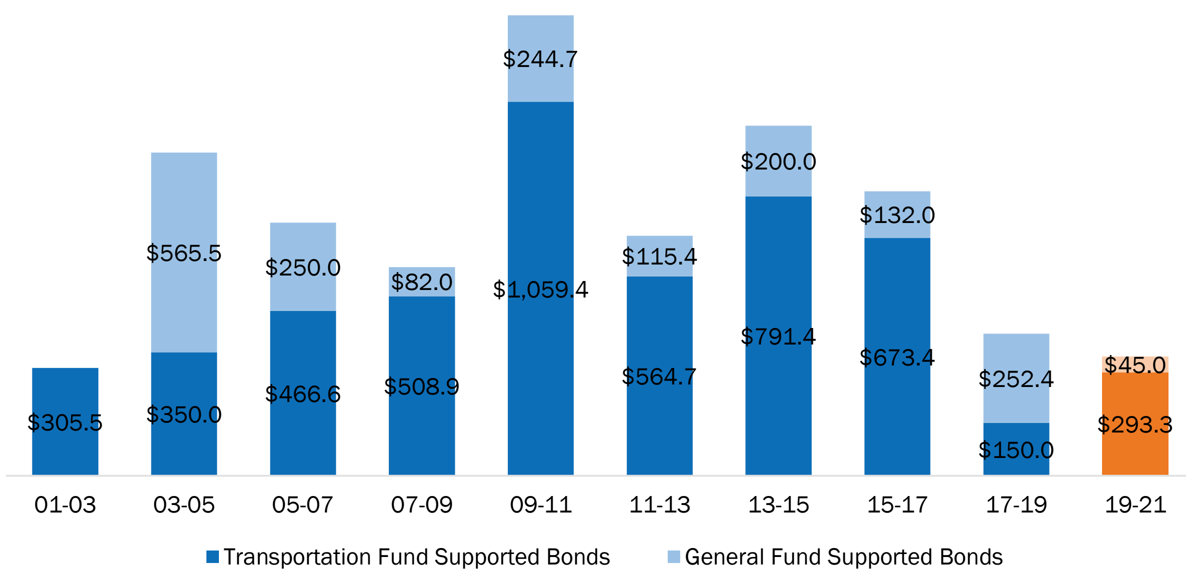
[13] See the Department of Transportation website: https://wisconsindot.gov/Documents/about-wisdot/who-we-are/dept-overview/history.pdf. The last gas tax increase passed by the Legislature through a statute as opposed to indexing was one cent in 1997.

starting the Interstate 43 north-south expansion project in Milwaukee and Ozaukee counties; and funding the remaining costs of the St. Croix Crossing bridge project.

The increased revenues also would help reduce borrowing in the proposed budget. As **Figure 13** shows, the budget proposal includes $338.3 million in transportation borrowing ($293.3 million of which would be paid off with transportation fund revenues and $45 million with money from the general fund). Even before adjusting for inflation, that would represent the smallest amount of new transportation bonding in a state budget in nearly two decades.

Figure 13: Transportation Borrowing at Lowest Levels in Two Decades
Transportation Bonds and Payment Source by Budget in $Millions, 2001-2021



Sources: Legislative Fiscal Bureau, Executive Budget

KEY #7: MODEST INCREASES IN LOCAL AIDS

A combination of flat state aids and state caps on property tax increases has limited revenue growth for municipal and county governments in recent years. The consequences have manifested themselves in various ways that may be of concern to policymakers, including a rise in wheel taxes, increased use of referenda to exceed levy limits, and growing levels of municipal debt.[14]

The governor's budget would change course by modestly increasing shared revenues, relaxing levy limits, and boosting local transportation aids. Yet, while allowing for greater local revenue growth, the proposed increases are far less than those proposed for K-12 schools. Moreover, they likely would

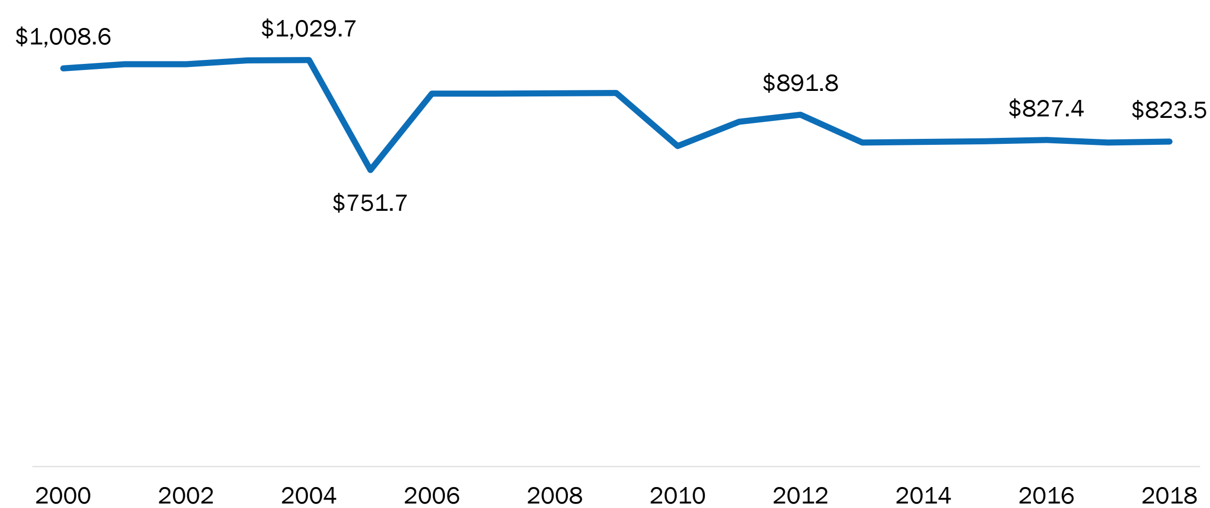
[14] WPF has discussed these consequences in *A Growing Divide*, *Municipal Voters Approve Levy Hikes*, *Local Governments Turn to Wheel Taxes as Other Revenues Lag*, and *Is Municipal Debt Rising Too Fast?*

provide only modest relief to those local governments facing sizable infrastructure backlogs and pressing operational needs.

The following briefly describes some of the key increases in local aid programs:

- **Shared revenue.** The proposed budget's 2% increase in County and Municipal Aid Program payments marks the first bump in shared revenue since 2012. As shown in **Figure 14**, the $824 million appropriation for municipalities and counties in 2018 was $185 million lower than the $1 billion provided in 2000. When adjusted for inflation, that amounts to a $647 million (44%) decline in shared revenue since 2000. For context, if adopted, the proposed 2% increase would translate into roughly $4.35 million more for the City of Milwaukee, $95,000 for Madison, and $312,000 for Green Bay; and $620,000 more for Milwaukee County, $32,000 for Dane County, and $13,000 for Waukesha County.[15]

Figure 14: Major Form of State Aid to Local Governments Not Keeping Up
Actual State Shared Revenue Payments (In Millions), 2000-2018

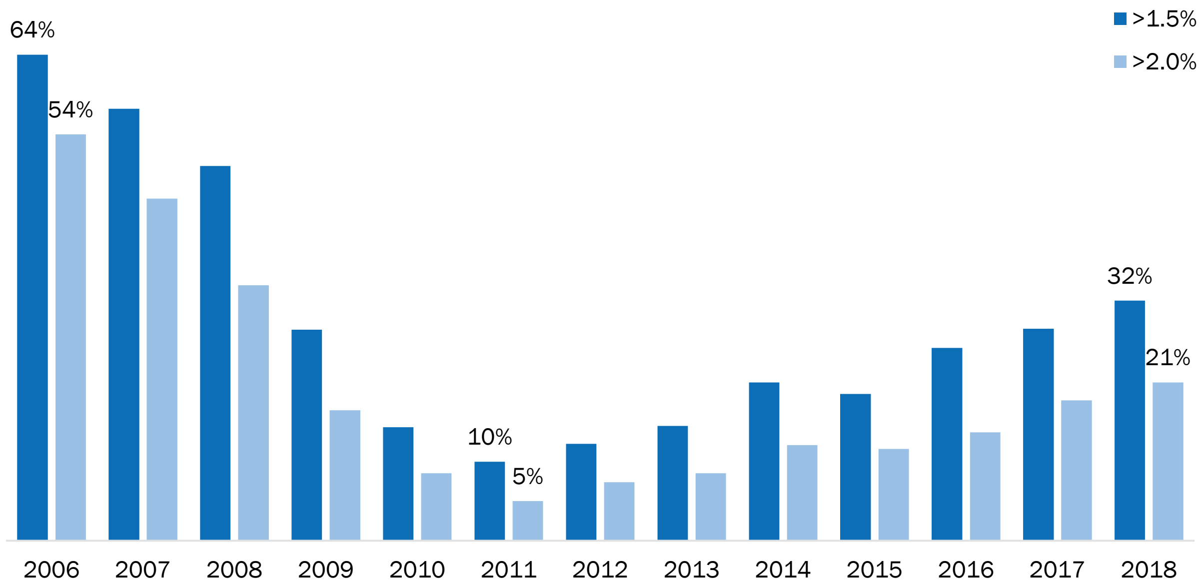


Source: Wisconsin Annual Fiscal Reports

- **Property tax levy limits.** The budget would change property tax limits to no longer tie annual increases in the operating levy for counties and municipalities exclusively to the percent change in equalized value due to new construction. Instead, levies could increase by the greater of the new construction rate or 2%. This matters because the statewide new construction rate averaged 1.6% in 2018. In fact, as shown in **Figure 15**, only 21% of the state's municipalities exceeded a 2% growth rate last year. In contrast, in 2006, the year levy limits were established, a majority of cities and villages exceeded 2% growth in new construction.[16] A "floor" for levy limit increases is not a new idea, as floors ranging from 2% to 3.86% existed from 2006 through 2011.

[15] Figures are based on a 2% increase of the applicable portion of 2019 shared revenue payments as estimated by the Department of Revenue. Milwaukee County estimates come from county budget office.
[16] See our March 2018 *Wisconsin Taxpayer*, "Changing Patterns of New Construction."

Figure 15: Growth in New Construction Has Slowed
Percent of Cities and Villages with New Construction Greater than 1.5% or 2%, 2006-18



Source: Wisconsin Department of Revenue

- **Local transportation aids.** The proposed budget provides 10% increases in both General Transportation Aids and General Transit Aids, at a combined cost of $23 million in GPR in the first year of the budget and $57 million in the second. It also establishes a program for transit capital assistance that is funded with $10 million of GPR in 2021. The 2017-19 state budget also included a sizable increase in General Transportation Aids at $27 million over the prior budget, although General Transit Aids have been largely flat. For context, a 10% increase in General Transportation Aids would mean approximately $2.5 million in new revenue for the city of Milwaukee and $1 million for Madison. In addition, Madison would receive a roughly $1.7 million increase in General Transit Aid. Milwaukee County would receive about $271,000 in additional General Transportation Aid, as well as $5.5 million more in General Transit Aid.[17]

The proposed budget seeks to boost state aids and relax levy limits, but it does not provide additional revenue options that would allow Wisconsin municipalities and counties to diversify their financing frameworks. Our recent report, *Dollars and Sense*, found that cities and villages in Wisconsin rely more heavily on property taxes than any other state in the Midwest and most states nationally. While the proposed budget would provide some relief to municipal and county governments that have seen minimal recent revenue growth, it would do little to alter their reliance on property taxes. That continued reliance – as well as the relaxation of levy limits for both local governments and school districts – could erode recent progress in lowering the property tax burden for Wisconsin residents.[18]

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[17] These estimates are based on a 10% increase of the estimated 2019 GTA amounts as reported by the Department of Revenue and the state share of 2018 mass transit expenditures as reported by LFB. Milwaukee County estimates come from county budget office.
[18] See the December 2018 issue of *The Wisconsin Taxpayer*, "State and Local Tax Burden Falls."

CONCLUSION

Perhaps the most striking element of the proposed 2019-21 budget is the breadth of new and expanded spending to address priorities ranging from greater access to health care, enhanced salaries and staffing in prisons, and increased state funding for schools, local governments, transportation, and the UW System. The proposed budget also redirects resources toward needy and disadvantaged groups through the Medicaid expansion, revisions to the school aids formula, and expansion of tax credits for low-income families.

In making these proposals, Governor Evers maintains he is both taking advantage of a favorable economy and addressing years of under-investment by the state. He argues that spending the money now will bring future benefits, whether through training the workers of tomorrow or avoiding maintenance costs in aging state buildings or local roads.

In deciding the budget, the state must weigh these benefits and priorities against their cost. To help pay for them – as well as tax cuts for both low and middle-income earners – the governor is seeking a range of new taxes on businesses and individuals that, like the additional spending, amount to the largest increases in more than a decade. The administration has argued the impact would be limited for those least able to pay. Still, the rise in gas taxes and greater allowance for local property tax increases would affect state residents broadly, as would some smaller changes in state taxes and fees.

The proper balance between public investment and appropriate levels of taxation is an old argument in politics. With Wisconsin entering a new era of divided government, the tension between the two sides is expected and not necessarily a cause for alarm – so long as both parties reach an agreement in time for schools and local governments to set their budgets.

More concerning, perhaps, is the apparent willingness of both the Democratic governor and Republican legislators to spend down a state surplus to help pay for proposed tax cuts or spending. On the one hand, the existence of a healthier surplus – made possible by a decade of economic growth – affords the state an opportunity to address some of its outstanding needs. On the other, no economic expansion will last indefinitely. If the state cannot sustain the tax and spending levels it sets now, then doing so will prove even more difficult when growth slows or recession occurs. State officials may want to consider building reserves now so they are available to draw on when a downturn occurs.

Wisconsin citizens can expect spirited debate in the weeks ahead as the Republican-led Legislature crafts its own budget. The key is priorities: should the state spend more or tax more, and where should new investments be made versus taxes reduced. While impartial fiscal analysis cannot settle those questions, we will continue to analyze important budget proposals and considerations as they arise. As with this report, our goal is to objectively frame the issues for citizens and policymakers and inform them of long-term fiscal implications.