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Both Budgets Backtrack on State Reserves

GOP lawmakers dialed back both the state spending—and tax increases—in Democratic Gov. Tony Evers' budget, but left one aspect of the 2019-21 proposal largely the same: a drawdown of hundreds of millions of dollars in reserves in the state's main fund.

With a new state budget beginning on July 1, the Legislature has sent the governor an $82 billion bill that funds some of his priorities while setting others aside. While falling short of Evers' proposed spending levels, it still provides a roughly 6% spending increase in state funds over two years, boosting K-12 education, prisons, and the University of Wisconsin System. A key test for the governor will be whether he signs the bill with some partial vetoes or issues the state's first-ever complete veto of a two-year budget—a move that would raise the stakes considerably for schools and local governments in Wisconsin.

One point of agreement between lawmakers and the governor has received relatively little notice: mutual plans to spend a surplus in the state's main fund. Each of these proposals would use the money to help deliver on respective goals such as education and tax relief.

Yet both would also leave the state's general fund in a weaker position despite the best economy in nearly two decades. In one bright spot, the state's other main source of reserves, its rainy day fund, is rising to record levels. However, the overall state reserves in the two funds combined would still decline under both budget proposals.

COMPARING BUDGETS

At their core, the two versions of the budget differ on aid to schools, taxes, and their use of federal money. The governor essentially sought a two-year increase of nearly $1.4 billion in state aid to K-12 schools and a net increase of $722 million in general fund tax collections such as those from income and sales taxes. For more, see this interactive chart.

The bill passed by the Legislature would increase state aid to schools by $505 million, but that version of the budget and two other recent pieces of legislation would decrease income, sales and other general fund taxes by $329 million on net. Legislators also opted not to take federal money to expand Medicaid health programs for the needy that would have freed up $324 million in the general fund over the two years.

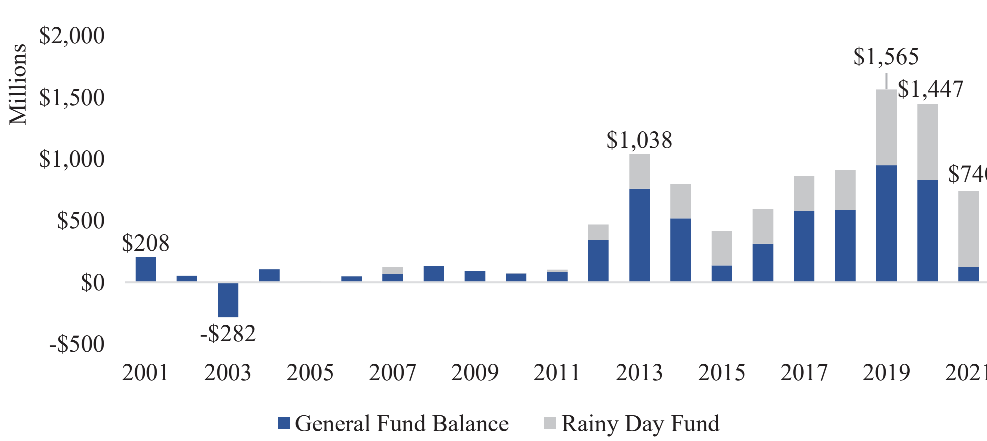
Under the governor's proposal, taxes on the median-value home that was worth $167,000 last year would rise $56, or 2%, to $2,927 on December 2019 bills and then rise $48, or 1.6%, to $2,975 in the following year. The Legislature's budget would have essentially the same effect. In both cases, the overall increases would be somewhat less than those expected if no budget is passed.

Within the overall totals in the two bills, however, are sharp differences in approach to taxes and spending. The Evers proposal would produce a net increase in income taxes, limiting a credit for manufacturers and adding to capital gains taxes in certain cases. At the same time, it would cut taxes by 10% for low and middle-income earners and expand the Earned Income Tax Credit for low-income working parents.

Through the budget and another bill, Republican lawmakers would lower income taxes by $457 million over two years but would also increase taxes on certain internet sales by $115 million. Their proposals would decrease the marginal tax rates in the state's two lowest income brackets, which would lower taxes for any filer with a state income tax liability.

Despite having a similar statewide effect, the two budget plans would have very different effects on property taxes in

State Reserves Would Shrink Under Joint Finance Committee Budget
General Fund and Rainy Day Fund Reserves in Millions, 2001-2021



Source: Wisconsin Legislative Fiscal Bureau individual communities. The Evers plan would tend to deliver more benefits to communities with less property wealth and more students living in poverty.

The differences are also notable when it comes to infrastructure. The governor would provide a large increase in spending and borrowing on state buildings and raise more than $600 million in new gas taxes and vehicle registration and title fees to pay for additional spending on state highways, local roads, and other transportation needs.

Republicans, on the other hand, would accept much of the increase in borrowing and spending on state buildings, but would drop the gas tax increase for roads. Instead, they would raise title and registration fees and take additional money for transportation from the general fund—more than $460 million in total over two years. The difference narrows between the two plans after accounting for the fact that Evers would take $87 million less for roads from the general fund.

BALANCING THE BUDGETS

The governor proposed a budget that, based on the tax projections at the time, would have left the state in two years with just $105 million in its general fund, or enough to fund the state's operations for two days. After the budget proposal was released, however, an improved revenue forecast estimated that the state would take in $753 million more than expected in general fund taxes through June 2021. We do not know whether the governor would have used this revenue to boost reserves or address other priorities.

Despite this additional revenue, an earlier version of the budget approved by the Joint Finance Committee would leave the state's general fund with only $123 million two years from now. (The bill as approved by the full Legislature would yield a similar number.) This gross balance amounts to 0.6% of the state's annual general fund spending. Instead of using the relatively strong economy to build up a state surplus, both the governor's budget and lawmakers' would leave the state with the smallest general fund balance since 2011.

In one respect, the state is still making an important financial gain. Because of the higher than expected tax collections for the 2019 fiscal year ended on June 30, an estimated $291 million is being deposited into the state's rainy day fund. This deposit is expected to boost the rainy day fund total to a record $617 million, as the chart on the previous page shows.

However, even after accounting for that larger amount, both versions of the budget bill would leave the state with smaller combined reserves in the general fund and rainy day fund—less than 4% of general fund spending in each case. That would be down from total reserves of 5.4% in June 2018 and an estimated 9% at the end of this year (including the latest rainy day fund deposit). After making progress in recent years compared to other states, Wisconsin would likely return to its past status as a state with a smaller-than-average financial cushion.

AN EYE TO THE FUTURE

After the lean years that followed the Great Recession, state officials of both parties understandably want to fund priorities such as education, infrastructure, and tax relief. Both sides can point to potential economic growth and other benefits that would justify the cost of these proposals. However, the public and elected officials should also give thought to keeping the budget on a sustainable course.

While essentially making ends meet in the first year, both versions of the budget would spend hundreds of millions of dollars more in the second year than the state is expected to receive in taxes and other revenues. That will make the following 2021-23 budget harder to balance because at least some future growth in taxes would need to cover the previous year's structural gap between revenues and spending.

The nation's economic expansion is one of the longest on record. That fact does not mean a recession is imminent—the economy may grow for some time. Still, decisions made now will have a big impact on the state's ability to manage a slowdown when it does arrive. ☐

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