STATE ACHIEVES IMPORTANT FISCAL MILESTONE BUT WILL IT LAST?

Despite financial challenges from COVID-19, the state of Wisconsin in 2020 eliminated its once massive "hidden deficit," addressing a longstanding issue and leaving it better prepared to weather the economic downturn. However, this encouraging news is tempered at least in part by the role played by federal aid in achieving this improvement and the recognition that Wisconsin's deficit may return as it fights the impacts of the pandemic.

For the first time on record, Wisconsin's main fund closed the year with a small positive balance, wiping out the longstanding financial gap that was often referred to as a "deficit." Newly released financial statements report on June 30 of last year the state's general fund had a balance of $1.5 million – essentially the first time year-end assets have outweighed liabilities in reports done since 1990. The milestone reflects the progress Wisconsin made in the years prior to the pandemic and even during its early months.

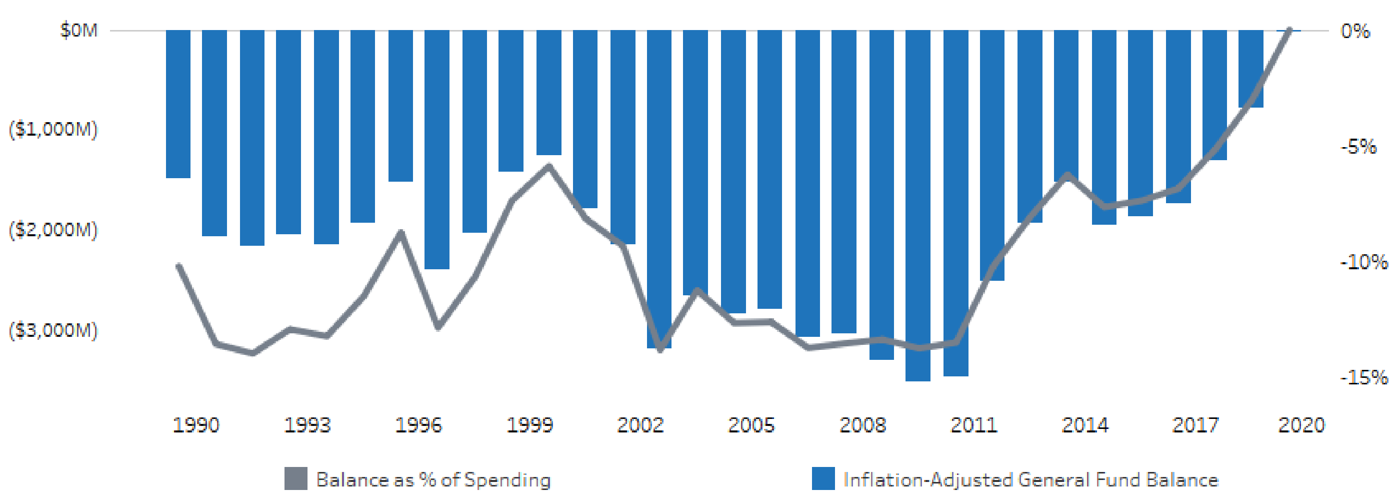
The $764.7 million improvement in 2020 (see Figure 1) was one of the largest on record and can be attributed in part to strong corporate tax collections, an infusion of federal aid to support Medicaid programs, and steps to limit spending growth. At year end, general fund assets and a related part of its balance sheet covered the fund's liabilities and a similar category for the first time since the state began using more a more complex approach to accounting for both. That's welcome news because it leaves the state in a better position to weather the financial challenges from the coronavirus.

As we noted last year, however, nearly every other state had a stronger fund balance prior to the pandemic. In addition, Wisconsin could see its negative balance return over the next two years as its leaders struggle to meet the needs of the state amid a recession.

THE "DEFICIT" DISAPPEARS

This brief uses figures from the Comprehensive Annual Financial Report (CAFR) published by the state last month. The CAFR uses Generally Accepted Accounting Principles (GAAP), which are similar to those of publicly traded companies but which differ from the accounting methods used in state budget documents.

Figure 1: State of Wisconsin Eliminates Hidden Deficit
General fund balance using Generally Accepted Accounting Principles



Sources: State of WI Comprehensive Annual Financial Reports

GAAP or accrual accounting requires the state to record expenditures such as a large payment to local governments when it commits to them even if the payment is not made until later (see this 2019 brief for more.) For budgeting, the state uses cash accounting and only books expenses when it actually pays the money. Under cash accounting, the state general fund and its closely linked rainy day fund had roughly $2 billion in combined balances at the close of the fiscal year on June 30, 2020 and are currently projected to have about the same amount on June 30, 2021.

The CAFR paints a different picture in which the general fund's liabilities and a related category were only slightly less than its assets and a related component of its balance sheet. In 2020, the general fund had revenues of $29.42 billion – including a $1.22 billion increase in the category that includes federal aid. The fund had $26.76 billion in expenditures – including a big increase in the category that includes Medicaid health coverage for the needy and other human services. However, additional federal funds from the Families First Coronavirus Response Act meant that the state actually spent $160.8 million less in general purpose revenue (a category that is mainly state tax dollars) on Medicaid than in 2019. Gov. Tony Evers' administration also sought to curb spending by $70 million in 2020 in response to the pandemic.

After netting out transfers to other funds, the general fund improved from a negative balance of more than three-quarters of a billion dollars on June 30, 2019 to a slightly positive balance of $1.5 million on June 30, 2020. Even after adjusting for inflation, that was the biggest single year increase in the balance since 2012.

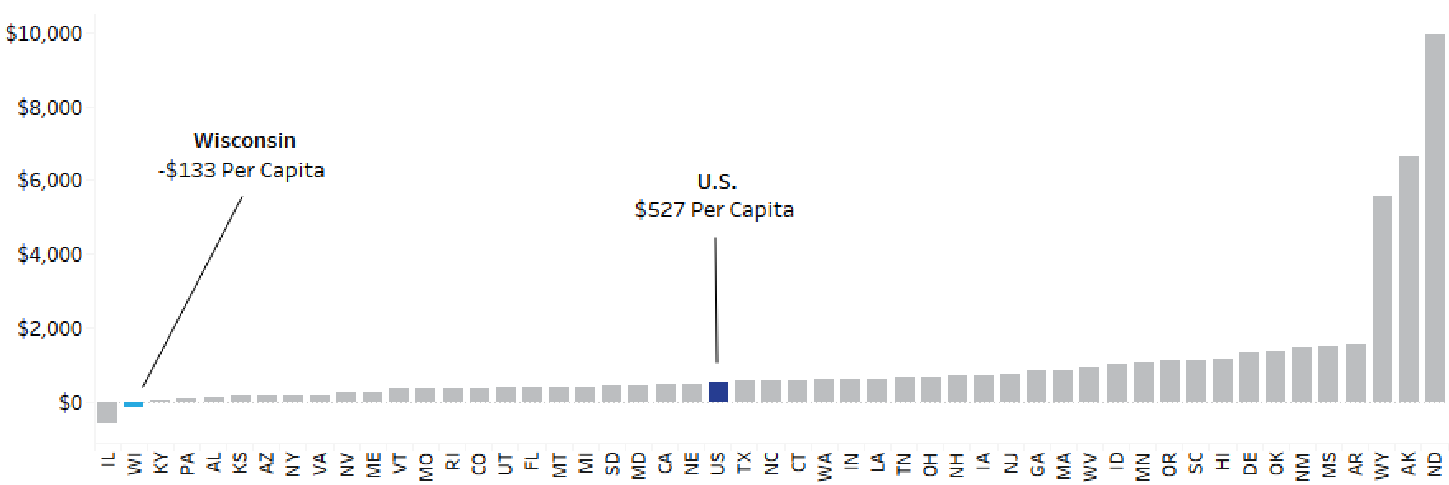
As recently as 2011, the general fund had a negative balance of $2.99 billion (or $3.46 billion after adjusting for inflation). Eliminating it even for one year is a notable achievement. The latest CAFR also shows the state was doing reasonably well on a variety of other financial metrics at the onset of the pandemic.

One question is whether the general fund balance was temporarily propped up by the billions of dollars in federal assistance that were approved in subsequent legislation, the Coronavirus Aid, Relief, and Economic Security (CARES) Act, but that as of last summer had not yet been used. In fact, the report notes that it netted out $1.78 billion in CARES Act funds that had not been spent as of June 30, 2020.

The positive general fund balance matters because it essentially means – as of last summer at least – the fund's assets could cover the spending and commitments it had at the time. That gives the state strength to help shoulder the weighty duties that come with the pandemic.

Despite this progress, state Controller's Office data with a one-year lag show that prior to the pandemic only one other state besides Wisconsin ended 2019 with a negative general fund balance – Illinois (see Figure 2). Given that Illinois has some of the nation's worst budget troubles, the comparison shows Wisconsin still has substantial room for progress.

Figure 2: Despite Gains, Wisconsin Still Had Low Balance Prior to the Pandemic
General Fund GAAP Balance Per Capita by State at Close of Fiscal Year 2019



Source: Wisconsin Department of Administration

WHAT COMES NEXT

Going back to 1990, the state had previously had a negative GAAP balance each year, in part because of the timing of state aid and property tax credits that are paid to local governments. For years, the state has been committing to pay certain amounts for these programs in a given year but not actually paying much of the totals until July, the month after the state's fiscal year ends. That leaves the state's cash balances larger than they otherwise would be at the end of each year. For more, see our look at the issue a year ago.

The state has not stopped using these accounting maneuvers or even decreased the dollar amounts involved – they remain as large as ever. What has changed is that the state has built up greater cash reserves and other assets that as of June 30 were in essence just large enough to cover these and other liabilities.

Though the greater reserves are welcome, the state is continuing to commit each year to make large payments in the following year. That means negative GAAP balances will return if the state spends down the cash reserves in its general and rainy day funds.

Over the next year or two, the state may have little alternative than to allow that to happen. The pandemic poses a grave risk to the health of Wisconsin's citizens and its economy. The state's balances were set aside in part to meet the dire needs of a moment like this one and state leaders should use them as they are needed.

Eventually, however, state officials will have to give thought to replenishing whatever they are forced to draw down. Historically, Wisconsin has not done as well as other states at setting aside reserves to respond to economic downturns or emergencies. The sudden and severe onset of the current challenges underline how critical it is to be prepared for the unexpected.