WISCONSIN POLICY FORUM

A HIGH WATER MARK FOR STATE BUDGET?

State Finances Strong But Surplus Likely to Dip

Four years after the arrival of COVID-19, the state of Wisconsin's finances are the strongest on record, thanks to federal relief aid and the actions of state leaders. From ample cash reserves to low debt, the state measures up well on key fiscal metrics. But recent decisions to cut taxes and increase spending will reduce some of these advantages this year, leaving policymakers with important questions to consider in the next state budget.

As unemployment and uncertainty mounted along with COVID cases in the spring of 2020, the impacts on public health and the financial markets posed a double threat to the state budget. A Wisconsin Policy Forum analysis published in March of that year noted the overall strength of the state's finances but questioned whether it would be enough to cope with the looming prospect of falling tax collections and sharp increases in emergency spending if the federal government did not help.

In this review of the state's books, we find the subsequent massive influx of federal aid allowed the state to respond to the crisis while at the same time bolstering its financial health. The fiscal picture has kept improving, with the state lowering its debt levels and payments and strengthening its ability to cover short-term bills and obligations.

There are some exceptions to this bright outlook, however. Although the state's jobless fund has largely replenished its reserves since the significant payments to unemployed workers made in 2020, the fund still lacks the capacity to weather a significant recession. And while total state borrowing has fallen to its lowest levels in more than two decades, debt payments on highway projects remain a point of concern.

Overall, while state government has fared well since the pandemic, it cannot count in the coming years on the same rapid growth in tax collections seen since 2020. Though inflation has been slowing, growth in the national economy is also expected to cool, and the state's key tax revenues have not grown at all so far this year. Here we examine the state's short and long-term financial health and consider how well state finances will hold up over this year and the next – a period in which state elected officials budgeted both tax cuts and spending increases.

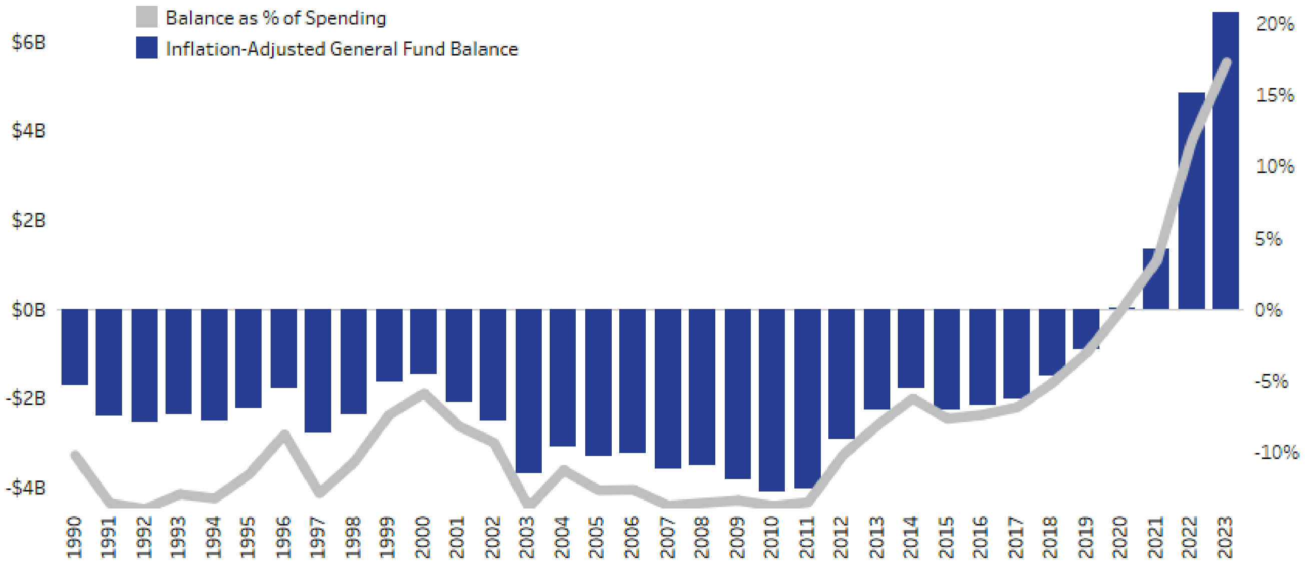
Where Did We Find These Figures?

Unless otherwise stated, the figures in this report come from Wisconsin's Annual Comprehensive Financial Report (ACFR). These statements detail the state's assets and liabilities and use national accounting standards known as Generally Accepted Accounting Principles (GAAP), which are similar to those of publicly traded companies. These principles factor in delayed payments and other accounting maneuvers, thereby avoiding the more rosy view of the state's fiscal health sometimes presented in budget documents. The most recent financial statement covers the 2023 fiscal year, which ran from July 2022 to June 2023.

GENERAL FUND RESERVES GROW

In a January 2021 brief, we looked at the balance of Wisconsin's general fund - the main state fund that receives income and sales tax dollars and uses them to pay for state priorities like aid to school districts and health care for low-income residents. We found that 2020 had been a milestone year. For the first time on record, the general fund closed the fiscal year with a small positive balance of $1.5 million, wiping out the longstanding financial shortfall that was often referred to as a "deficit."

This positive news was tempered by the knowledge that the state was facing a recession and an ongoing pandemic that might require it to spend down the cash reserves in its general and rainy day funds. But that drawdown never came – the state instead was buoyed



Sources: Comprehensive Annual Financial Reports

by additional federal aid, a resilient economy, and the development of vaccines that helped dampen the spread and effects of COVID-19.

The general fund balance reached a new record high of $6.7 billion by June 2023 (see Figure 1), an increase of nearly $2 billion, or 42%, over the year prior. The current balance equates to $1,133 per Wisconsin resident.

Historically, Wisconsin has not done as well as other states at setting aside reserves to respond to economic downturns or emergencies. Indeed, in 2019 Wisconsin was one of only two states to end the year with a negative general fund balance. The turnaround in this key financial indicator has been as positive for Wisconsin as it has been unexpected. Later in this brief, we will consider whether this incredible run of good fortune can continue in light of recent actions by elected officials to both cut taxes and increase spending.

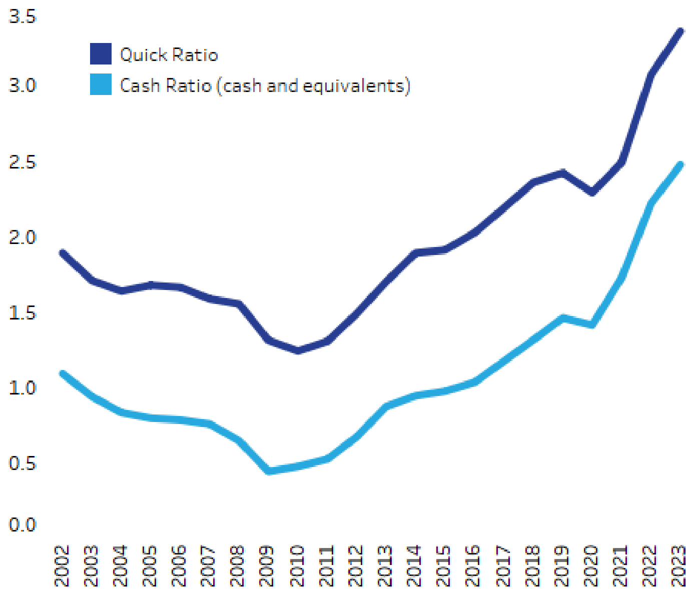
SHORT-TERM HEALTH PROGRESSES

The most basic financial responsibilities for state government are to pay its bills and cover its immediate financial needs. With respect to these near-term obligations, the state of Wisconsin as of last summer was clearly in its best shape in decades.

To cover bills coming due within weeks, the state can draw on cash and assets equivalent to cash (including money market accounts and certificates of deposit) as well as certain other liquid investments such as U.S. Treasury bills, a form of short-term debt. Here we compare these liquid assets held by the state as of June 30 of last year with the obligations that were due within the next 60 days.

This "cash ratio" in June stood at 2.48, meaning the state had almost two-and-a-half times more cash and other liquid assets than it had short-term bills and obligations (see Figure 2 on the next page). This level was the highest in our records going back to 2002. It continues an upward trend since 2009, when the cash ratio sank to a worrisome 0.44, suggesting the state had less than half of the liquid assets needed to pay its short-term obligations easily.

Figure 2 on the next page also shows progress has been made in the state's "quick ratio," which adds receivables such as federal aids to the assets in the cash ratio. As of June, these short-term assets were nearly 3.4 times the value of the state's short-term obligations, which was once again their highest level since at least 2002.



A third ratio, known as the "current ratio," factors in assets such as fuel and other inventories that are less liquid but can be converted into cash within one year. The state's current ratio of 3.4 (not shown) has taken an almost identical trajectory to the quick ratio over the years. These ratios indicate the state now has ample resources to cover its immediate financial needs.

UNEMPLOYMENT FUND ON THE RISE

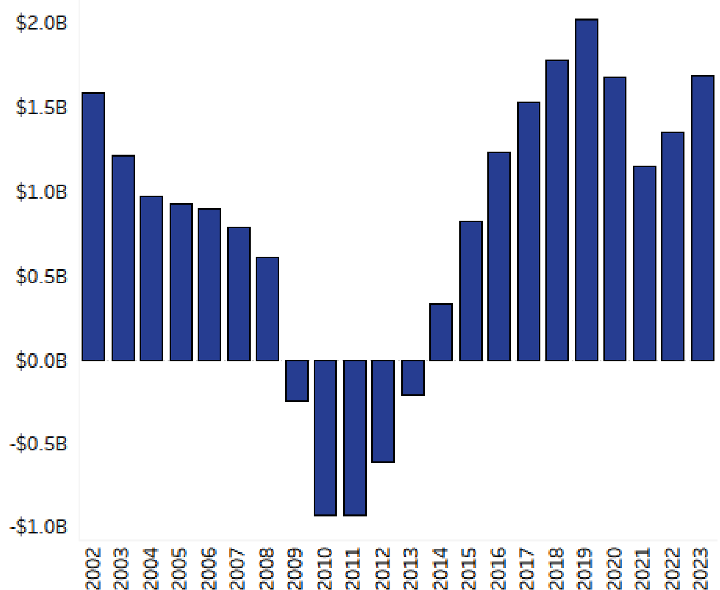
The condition of the state's jobless fund was a key factor in the deterioration in the state's overall cash reserves between 2002 and 2009 and has also played a notable role in its subsequent improvement (see Figure 3). This fund takes in payroll taxes from employers that are then used to make payments to unemployed workers. The fund tends to grow during good times but can be spent down during recessions. As jobless claims and payments rose to historic levels in the early weeks of the pandemic in 2020, the fund's reserves fell.

Massive federal aid to unemployed workers did help to limit those losses. In the years since, the fund also has made significant strides in rebuilding its balance.

On June 30, 2002, after a relatively brief recession, the unemployment fund had a net position of $1.59 billion (including $1.46 billion in cash and equivalents). Even as the economy improved in the following years, state elected officials allowed the fund's net position to shrink, leaving it unprepared for the deep recession that began in late 2007. By the summer of 2009, the fund had run out of cash and in the following years the state was forced to borrow more than $1 billion from the federal government to make payments to workers as well as raise unemployment taxes for a time to pay off the loan.

Over the next decade, the unemployment rate fell and the state paid back the federal loan and built up just over $2 billion (including $1.87 billion in cash) in the jobless fund as of June 2019. This shift placed one of the state's key programs for responding to a recession in a much better position to address the COVID-19 crisis. As can be seen in Figure 3, the fund balance fell by $871.5 million by June 2021 but regained most of its losses over the next two years. In June 2023, the unemployment fund net position was nearly $1.7 billion.

Despite this progress in rebuilding the fund, a recent Department of Labor report found that as of Jan. 1, 2024, Wisconsin's jobless fund ranked 30th among the 50 states on a key measure of readiness for weathering a recession. The indicator looks at whether the state's reserves meet a federal recommendation of being able to cover one year of benefit payments at a rate equal to



the average of the three highest claims years within the past two decades.

With a score of 0.64, the state would be able to pay unemployment benefits for just over seven-and-a-half months in the event of a significant recession. This score is below the recommended level of 12 months, and as a result Wisconsin would not qualify for interest-free federal loans to support unemployment benefit payments should its unemployment fund become depleted.

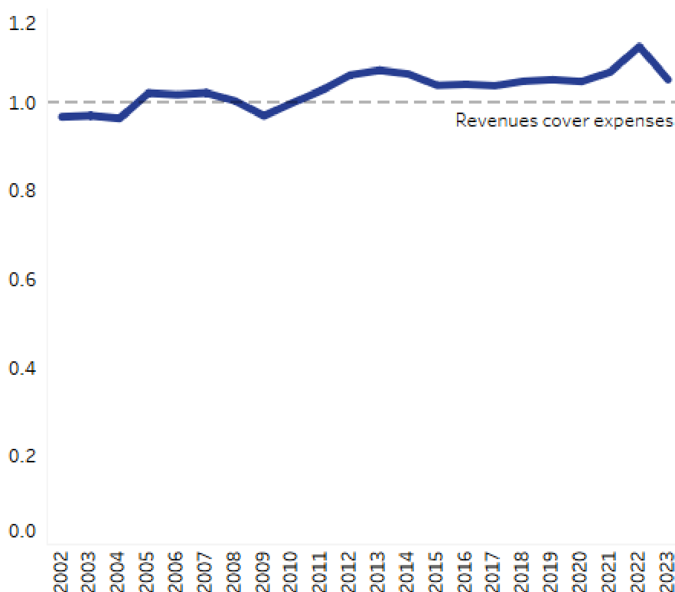
At present, to reach the roughly $2.6 billion needed for a solvency score of 1.0, the fund balance would need to grow by nearly $940 million. For more on the unemployment fund, see our June 2023 research brief.

BUDGET HEALTH MAINTAINED

Since the Great Recession of 2008 to 2009 and even during the height of the pandemic, the state has managed to cover its annual expenses – an important accomplishment that has meant its finances improved every year. Drawing on the state's financial statements, we compared total annual revenues to expenditures from all state funds (not just the general fund), a metric known as the "operating ratio." For 2023, the ratio was 1.05, meaning the state had enough revenues from taxes, federal aids, and other sources to cover its

Figure 4: State Revenues Still Enough to Cover Spending

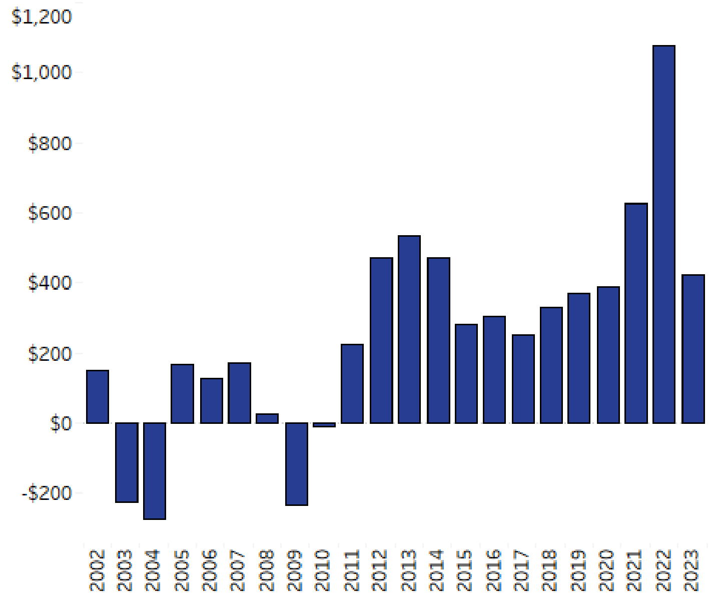
Ratio of total revenues to expenditures, 2002-2023



Sources: Comprehensive Annual Financial Reports

Figure 5: State's Net Assets Rise

Annual change in state assets minus debt per capita in 2023$, 2002-23



Sources: Comprehensive Annual Financial Reports

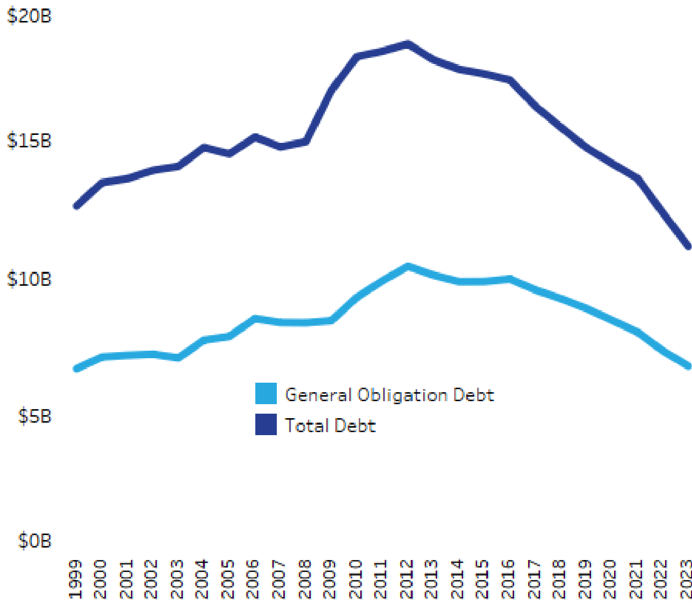
spending that year (see Figure 4). That was down substantially from 1.13 in 2022 but was still relatively strong, beating any year from 2002 to 2011.

Another measure of fiscal health looks at the state's annual change in net assets. This indicator tracks the increase or decrease in the value of all state assets such as cash, investments, receivables, and buildings after subtracting any outstanding debt used to acquire those assets.

The state's total net assets have risen robustly since 2010 as it has steadily improved its financial position (see Figure 5). In 2023, net assets per state resident grew by $425, which was down sharply from an inflation adjusted $1,076 in 2022 but still the sixth-best year in more than two decades.

OVERALL DEBT HITS RECORD LOW

Overall state debt has kept falling from the heights it reached during the Great Recession, dropping to record lows after accounting for inflation (see Figure 6 on the next page). The reduction in debt holds down annual debt payments and also helps provide the state with greater capacity to address current capital needs for infrastructure such as buildings, highways, and bridges. This improvement has also contributed to better bond ratings for the state and lower interest rates when the



state does borrow. As of December 2023, the state had $11.14 billion in total outstanding debt, according to a state Department of Administration report. That is down more than $296.3 million, or 2.6%, from the prior year even before adjusting for inflation. On an inflation-adjusted basis, that represents the lowest debt level for the state in at least a quarter-century.

Another important debt-related metric is general obligation (G.O.) borrowing, since the state pledges its general tax revenues to repay that debt. (Other forms of debt can be supported by special dedicated revenue streams, as we will discuss below in our analysis of transportation borrowing.) The state owed $6.82 billion in G.O. debt in December 2023, a slight reduction from the prior year. After adjusting for inflation, that was the lowest amount of state G.O. debt since 1999.

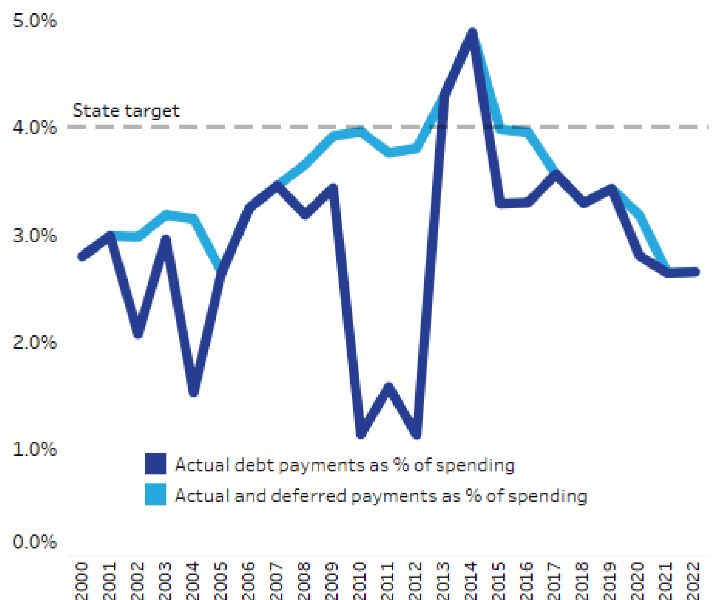
In times of economic stress, however, the state is most immediately affected not by its total outstanding debt but by its annual debt payments, which can reduce the funds available for other spending priorities or put upward pressure on state taxes. The state has long sought to keep annual debt payments made with its main tax revenues, or General Purpose Revenue, to less than 4% of total spending to avoid crowding out other state priorities. (These figures are calculated using reports aligned with the state budget, not with the state's comprehensive financial reports).

The state exceeded this target after it delayed making GPR debt payments during and immediately after the Great Recession from 2008 to 2012 to make it through those hard times (see Figure 7). That meant higher payments in later years. During the decade since, the state has been paying down GPR-funded debt and since 2017, it has largely avoided delaying these debt payments. Even during the chaotic pandemic, the state only delayed a relatively small part of its 2020 payment.

The result has been impressive. The share of GPR spending going to debt payments fell below 2.7% in both 2021 and 2022. With the exception of years in which the state skipped making debt payments because of budget challenges, that is the smallest share since 1984, according to the Legislative Fiscal Bureau (LFB) and Forum records.

TRANSPORTATION DEBT REMAINS A CONCERN

Despite the state's paying down its overall debt, one piece of the state's debt portfolio still merits attention. State borrowing for highways and other transportation projects has represented a greater concern over the past decade, though it also has improved in recent



years. State debt for these projects is typically paid off with transportation revenues such as gas taxes and vehicle registration fees.

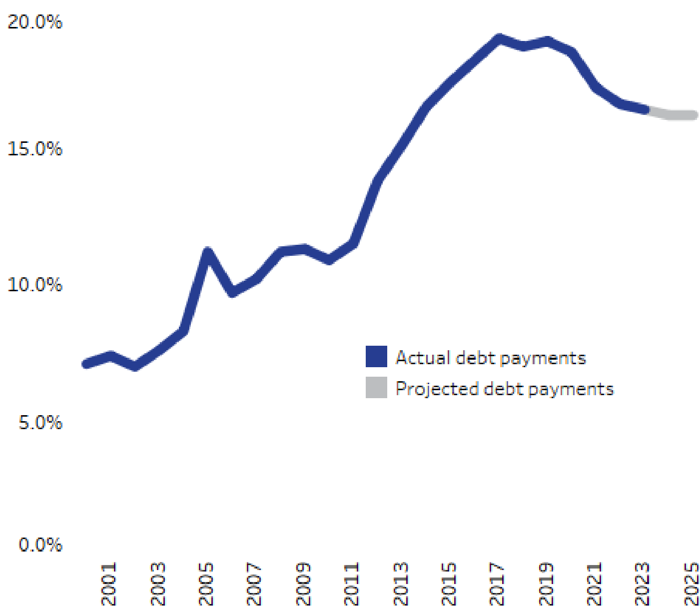
From 2002 to 2019, the share of state transportation fund revenues going to debt payments climbed from 7.0% to 18.9% (see Figure 8), raising questions about whether the fund could support ongoing spending on maintenance and other needs as well as additional debt for new projects. These payments are projected by the state to fall to 16.2% by the end of the 2023-25 budget, allaying some though not all of the worries on this point.

The recent improvement is attributed to several factors, including an increase in the state's vehicle registration fees in 2019, additional revenues from a petroleum tank inspection fee, and a decrease in new transportation borrowing and overall transportation debt. One major factor in limiting borrowing in recent state budgets has been the increase in one-time transfers of general fund revenues such as income and sales tax dollars into the transportation fund to help finance projects. For more on this trend, see our July 2023 brief on the state budget.

Going forward, transportation debt will likely remain an ongoing concern for Wisconsin unless lawmakers and Gov. Tony Evers identify additional revenues for the transportation fund, make the general fund transfers permanent, or sharply scale back road projects. None of these options are politically appealing, making this an issue to watch in the next state budget.

Fig. 8: Transportation Debt Payments Still Relatively High

Transportation fund debt payments as % of revenues, 2000-25



Sources: Legislative Fiscal Bureau

LONG-TERM OUTLOOK IMPROVES

The state's fiscal condition has also improved with respect to overall long-term liabilities, a category that extends beyond debt to include benefits owed to employees and retirees. In general, Wisconsin performs well in this area because of its fully funded pension fund and its manageable retiree health care obligations.

In one favorable trend, the state's long-term liabilities are falling as a share of the assets it can draw on to meet those obligations. The state's long-term liabilities grew as a share of assets during the 2000s, peaking at 41.2% of assets in 2011. Since then, they have fallen as a share of assets to 30.2% in 2023. Though that was up slightly from the prior year's record low of 28.4%, it was still one of the lowest percentages in our two decades of data (see Figure 9 on the next page).

Long-term liabilities per Wisconsin resident have also been falling after adjusting for inflation. The state's long-term liabilities per resident rose from $2,582 in 2011 to $3,393 by 2023, but actually fell modestly over that period after adjusting for inflation. For example, the inflated-adjusted debt per capita at the end of 2012 was $3,501, or somewhat higher than it is today.

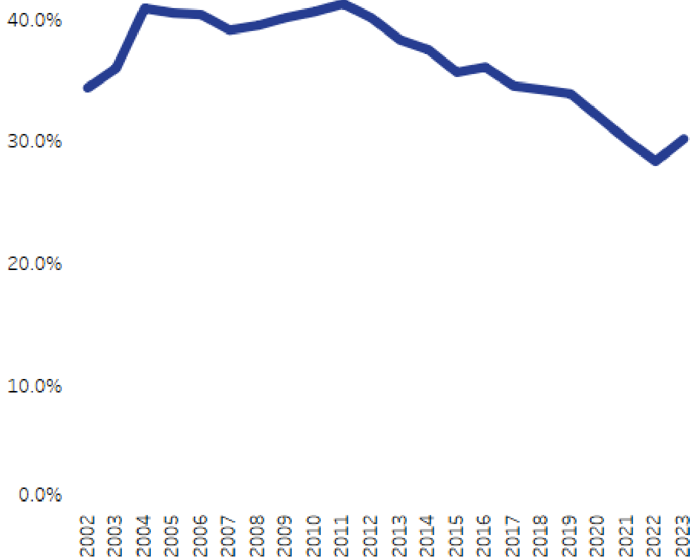
One final metric to examine is the state's net asset ratio, which is a way to show and think about how much the state would have in assets after paying off its debts. To calculate this figure, one takes the state's net assets (its assets minus any debts) and divides by the state's total assets. A higher ratio indicates greater health. After falling as low as -18% in 2010, it climbed to 20.3% by June 2023, the highest level in our data going back to 2002.

THE ROAD AHEAD

While the state's strong financial performance as of the end of 2023 is notable and encouraging, several factors suggest that it may turn out to represent a high point that will not be repeated in the near future.

Figure 9: State Liabilities Fall Compared to State Assets

Long-term liabilities as % of assets, 2002-23



Sources: Comprehensive Annual Financial Reports

First, the federal pandemic relief funds that have helped to boost both state and local governments in Wisconsin run out in 2024, leaving elected officials with fewer resources moving forward. Another factor is the condition of the state economy and labor market. While these remain relatively strong, economic growth has slowed. Through February of this fiscal year, tax collections within the state's general fund have not grown at all, according to the state Department of Revenue.

Finally, Evers and lawmakers drew on the massive state surplus to pass a 2023-25 state budget that cuts property and income taxes, increases funding for schools, local governments, and transportation, and raises state worker pay.

During the current 2024 fiscal year that closes on June 30, the state's general fund is projected to spend nearly $3.3 billion more than it takes in from taxes and fees, according to LFB. As a result, the general fund balance (according to the cash-based accounting used for state budgeting) will fall from nearly $7.1 billion on June 30, 2023 to a projected $3.8 billion at the end of June 2024.

To some degree, spending down at least part of this sizable surplus can be seen as appropriate. Despite the drop in the general fund balance, the state's rainy day fund will still retain an additional $1.8 billion to bolster state reserves. In addition, much of this new spending in 2024 is temporary or one-time in nature rather than permanent (such as expenditures for constructing and repairing state buildings). Also, the projected drop in the fund balance for 2025 is smaller at $551 million.

Still, while most observers agree that the state's surplus grew too large during the pandemic and needed to be reduced, the effect of these decisions will be to weaken the state's overall fiscal strength. As a result, in future years it is unlikely to match its performance on several of the fiscal metrics used in this report, particularly those that measure its short-term financial health.

CONCLUSION

Overall, the state's finances ended 2023 in outstanding fashion. Wisconsin has improved its fiscal condition substantially since the Great Recession years, a period marked by severe budget challenges in which the state raised taxes, cut aid to schools and local governments, delayed debt payments, and decreased benefits and take-home pay for state and local workers.

Today, we find that state finances have improved across the board since our last analysis in 2020, showing greater strength last year than at any point in decades on important indicators including general fund balance, short-term cash reserves, and overall debt and debt payments. We also find strong ratios of state revenues in relation to spending and liabilities in relation to assets.

On the cautionary side, we find that while overall state debt levels are trending downward, transportation fund borrowing remains a concern. This is particularly the case given decisions to move income and sales tax revenues from the general fund into the transportation fund in recent years, a maneuver that state leaders may not be able to repeat after the current state budget ends.

Also, despite some progress since 2020, the reserve levels in Wisconsin's unemployment fund lag behind a majority of states nationally. The state's jobless fund has the ability to pay just over seven and a half months of unemployment benefits at a historically high rate

instead of the twelve months recommended by the federal government.

Moving forward, the spending and tax cuts in the current state budget are likely to leave the state with a lower score on some of the financial metrics in this report. That said, over the next year the state's finances should remain relatively strong overall, particularly with respect to debt levels and other long-term metrics.

The progress the state has made over the past decade is the result of a strong economy and federal pandemic assistance as well as many decisions by state elected officials of both parties, including some that were painful. This newfound strength better positions the state to take advantage of future opportunities and weather potential storms. Holding onto these hard-won gains, however, will require both vigilance and prudence from state leaders as well as some measure of good fortune.