MOVING BACK TO BUDGET BASICS

Heading into the 2025-27 state budget, Wisconsin retains impressive reserves that put the state in a strong financial position and allow it to consider limited spending increases or tax cuts. As expected, however, the budget has lost some of its exceptional strength from two years ago, meaning state officials may wish to exercise caution this budget cycle, especially if they are eyeing large permanent tax cuts or spending increases.

After soaring to previously unseen heights two years ago, Wisconsin's budget has predictably returned much closer to earth, our latest analysis shows.

Two years ago, the combined forces of eye-popping inflation and massive federal pandemic aid boosted state tax collections and, when paired with relatively tight limits on spending, produced unprecedented state surpluses. Those surpluses helped to build up state reserves that remain exceptionally large.

Yet today, the situation has reversed: the state's main fund is spending more than it is taking in and the state's balances are falling. The state retains billions in reserves, but state leaders now have more reason to exercise caution in approving permanent spending and tax cuts than they did in November 2022.

To illustrate how the outlook has changed, we strip the budget down to its essentials and compare the starting point for the upcoming state budget with those in previous two-year cycles.

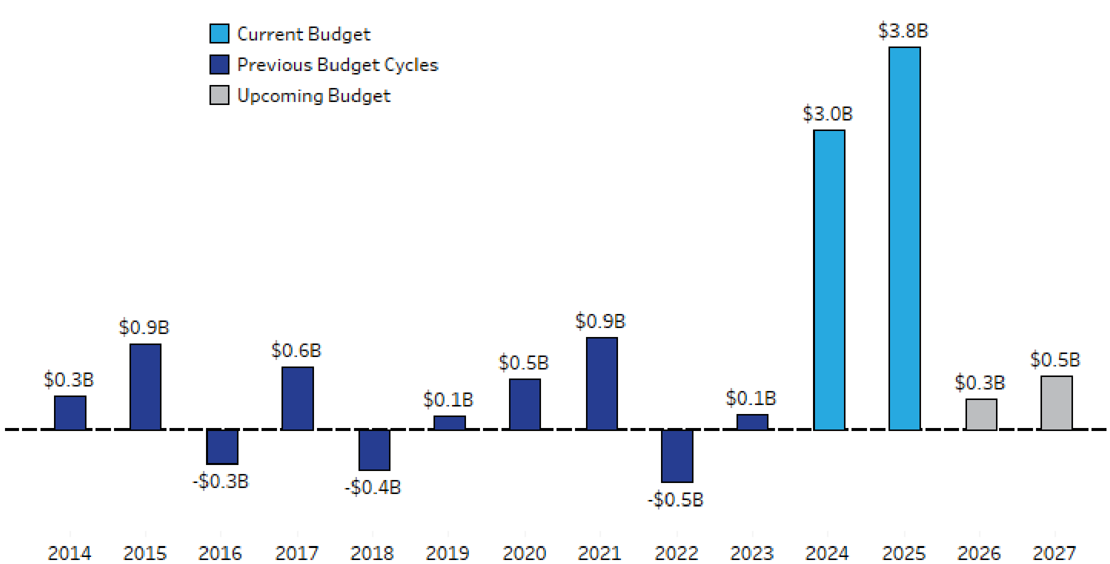
HOW WE DID OUR ANALYSIS

Our analysis relies on projected tax collections and spending amounts in the state's general fund that are estimated by the Department of Administration (DOA) for the budget running from July 2025 to June 2027. We include certain routine adjustments to the budget but exclude all *new* spending requests by state agencies.

As a result, these numbers do not factor in the rising cost of current services and do not represent a true surplus. They should be seen as a starting point for the upcoming budget rather than a complete proposal.

Using this approach, we calculate that state general fund revenues are currently projected to exceed base spending with some adjustments by $838 million over the two-year budget. That's down from the $6.8 billion in excess starting revenues that we calculated two years ago.

Figure 1: Budget Projections Are Positive but Smaller Than Current Budget
Projected general fund revenues minus select net appropriations (agency requests excluded) in millions (current $)



Sources: Wisconsin Policy Forum calculations using DOA figures; all figures based on two-year state projections made in the November of even-numbered years. Ongoing revenues do not include general fund balances left over at the end of the prior fiscal year.

Figure 1 on the previous page puts the amount of excess revenues into historical context. The current budget starts from a reasonably good position. Yet it looks much more like previous cycles than it does the current 2023-25 budget, which had an unusually strong start.

One bright spot not shown in these numbers is the $6 billion in reserves projected for next June in the state's combined general and rainy-day fund balances. Those funds can be used to pay for state priorities but can only be tapped once.

After accounting for all of these factors, our analysis finds the state is in a reasonably strong position to address the ongoing costs of present state and local services and make some new commitments, particularly if they are one-time in nature. However, elected officials may wish to exercise caution as they consider some of the large potential proposals for permanent new spending or tax cuts that have been discussed.

WHY THE SURPLUS ROSE AND FELL

The excess revenues that we found in the run-up to the current 2023-25 budget reflected several exceptional factors that have since changed. First, the federal government delivered more than $60 billion in pandemic aid to state and local governments, individuals, and businesses in Wisconsin. These payments juiced the economy and state tax collections and also helped to offset state and local government costs. High inflation added to state sales tax revenues, and yet despite these rising costs, lawmakers limited state and local spending fairly tightly in the 2021-23 budget.

All of these factors have now shifted. Federal COVID-19 aid has run out, inflation has largely subsided, and elected officials have felt pressure to allow both state and local spending to rise to make up for the impact of previous inflation. One example is the passage last year of Wisconsin Act 12, which increased state aid to local governments and provided for automatic increases in future aid payments that the state must fund going forward.

Some of this shift is reflected in the state's latest revenue projections, which show more modest growth in tax collections over the next two years. The figures come from the Nov. 20 budget report, which is published every two years by DOA as a starting point for state budget deliberations. According to longstanding custom, the report's 2025-27 budget figures incorporate every spending request made by state agencies. These requests total $2.11 billion in year one of the upcoming budget and $3.47 billion in year two.

Yet because the governor and Legislature never approve these requests in their entirety, we remove them to provide a better comparison of where the state stands. Our analysis does include more routine adjustments such as fund transfers and a placeholder reserve amount for potential increases to state employee compensation.

WHAT'S NOT INCLUDED

The numbers shown in Figure 1 allow for helpful comparisons across budget cycles. However, they do not include additional funds to help pay for the rising cost of services such as Medicaid health care for the poor, K-12 schools, local governments, prisons, technical colleges, and the Universities of Wisconsin. Table 1 shows estimates for those additional costs.

For example, maintaining existing Medicaid services is expected to cost an additional $1.1 billion over the next two years, which on its own is more than the excess revenues we identified. The state could save an estimated $1.7 billion over the next two years by using federal funds to expand Medicaid coverage in Wisconsin, but Republican legislative leaders have indicated that they do not support doing so.

Some of these changes in Table 1 would have permanent impacts on the state budget, including

Table 1: General Purpose Revenue Costs of Budget Options in Millions

Program or Budget Item	2026	2027
Increasing general school aids by 1% in each year	$55.8M	$112.2M
Funding Gov. Evers' Child Care Counts proposal	$81.3M	$221.7M
Funding Department of Corrections request	$209.5M	$230.5M
Funding UW System request	$398.7M	$458.1M
Funding cost to continue current Medicaid services	$381.0M	$723.3M
Restoring vetoed income tax cuts	$1,402.5M	$1,333.6M
Increasing rainy-day fund to 10% of general revenue	$0.0M	$430.6M
Repeating current budget transfer to Transportation Fund	$555.5M	$0.0M
Restoring vetoed reduction in income tax witholding	$603.4M	$0.0M
Half of current budget transfer to building program	$617.0M	$0.0M

One-Time Costs or Revenue Losses   Ongoing Costs or Revenue Losses

Sources: WPF calculations using figures drawn from agency budget requests, DOA, and LFB.

income tax cuts previously approved by lawmakers and then vetoed by Gov. Tony Evers and the governor's own past childcare proposal. Approving several of these ideas could require countervailing tax increases or spending cuts at some point in the future to keep the state budget balanced.

There could also be many local effects of increasing spending permanently or opting not to do so. For example, current state law ensures a $325 per student increase each year in the total revenues that school districts can receive from state general aid and local property taxes. Over the two-year budget, that increase will allow up to nearly $790 million in new revenues for school districts. Absent any change to the limits, the state would need to provide additional general aid or else school boards could decide whether to raise property taxes by the remaining amount.

Other proposals would have only one-time impacts to the budget that could be absorbed using the state's reserves. For example, the state could choose to invest $617 million of its reserves into capital projects, about half of the general tax revenue transferred to the building program for this purpose in the current 2023-25 budget. Using cash for these projects instead of borrowing for them would match one-time spending with one-time revenue while also limiting state debt. Elected officials could even consider helping to fund pressing local capital needs such as replacing the Milwaukee County Justice Center.

The Forum is not advocating for or against any of these proposals from across the political spectrum. However, the size and ongoing nature of some of these commitments show how unlikely it is that the state could fund all of them without encountering budget challenges in future years.

FUTURE UNCERTAINTY

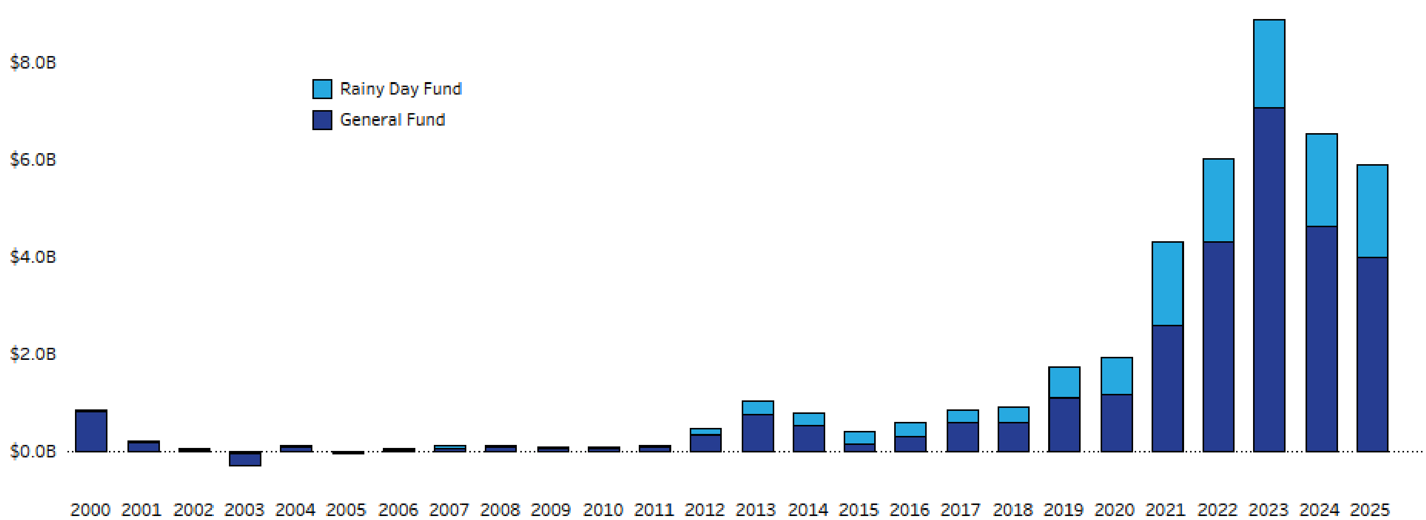
As with any projection for conditions more than two years from now, there is considerable uncertainty about future state revenues and spending. The economy and state costs and tax collections could be affected by global events and federal policies on taxes, tariffs, and immigration. Those factors in turn could have big impacts on the state's fiscal position.

The picture will clear somewhat once the Legislative Fiscal Bureau (LFB) issues its own revenue forecast in January – and possibly again in May – that will draw on more data on the state's taxes and economy. Yet even then, much could change over the following two years.

We can say with more certainty that the state expects to have substantial reserves on June 30, 2025. At present, the state is projected to have a $4.0 billion general fund budget balance at that time and an additional $2 billion rainy-day fund balance. That adds up to $6.0 billion in total reserves (see Figure 2).

While this figure is $3 billion less than the unprecedented balances for the state at the close of

Figure 2: Projected State Reserves Now Falling, Still Historically High
State general and rainy day fund balances by year in billions (current $)



Sources: Wisconsin Department of Administration and Legislative Fiscal Bureau

2023, it is still much greater than the state's reserves at almost any other point in recent history. To put the state's balances into context, the National Association of State Budget Officers reported last spring that states averaged total reserves of 23.3% of general fund spending in 2024 compared to 26.9% for Wisconsin.

These balances provide a substantial opportunity for state leaders to make investments in their chosen priorities. However, they would only cover large permanent spending increases or tax cuts – such as those shown in Table 1 – for a limited time.

OPTIONS GOING FORWARD

Decisions by state and federal leaders of both parties in recent years have left the Wisconsin budget in a solid position. Given the state's many needs and sizable reserves, it is appropriate for elected officials to consider a range of investments in the next budget to improve the lives of Wisconsin residents.

However, state leaders may wish to consider how much budget conditions have changed in just two years. No longer can they make massive spending increases and tax cuts without impacting future funding for existing programs and services. In particular, they may wish to consider how much of their current reserves they should spend and how much they should save to protect against unforeseen shocks.

The influx of federal aid and a relatively strong economy helped protect the state's finances in recent years despite the incredible turmoil of the pandemic. Yet there is no guarantee that the state's good fortune will last. In future years, the state may have to rely less on outside assistance and more on the prudence of its own elected officials.