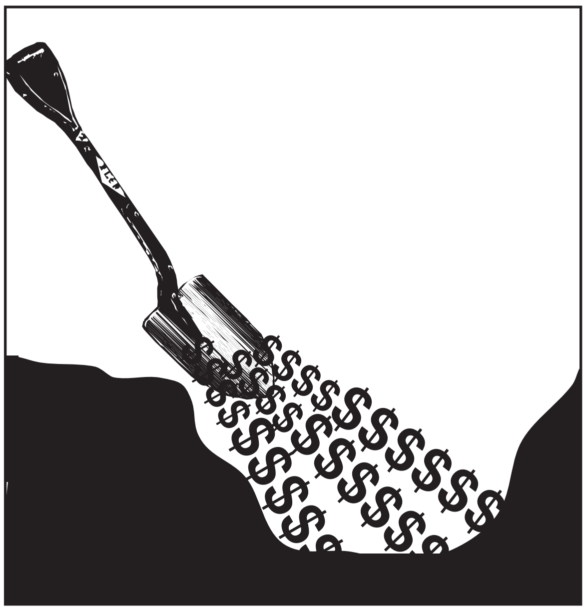
Wisconsin's Next Governor

FISCAL CRISIS — NO POPULAR SOLUTIONS

Jeff Mayers



Think ahead. It's November 6, and the biggest Wisconsin governor's race since 1986 is history. No matter who the winner is, the task ahead is daunting: craft a budget plan that will dig the state out of a potential two-year $2.8 billion deficit.

That's why during campaign 2002 many a politico asked: Who would want to be governor in 2003-07, which figures to be a time of budget sacrifice?

Not Tommy Thompson, Wisconsin's popular ex-governor, who was blessed with good luck and good timing. In 1987, he came into the East Wing after the last real recession had claimed as its victim one-term Democratic Governor Tony Earl. He left Madison for D.C. fourteen years later, when the boom years began to tail off. His successor, his only lieutenant governor, Scott McCallum, inherited a structural deficit (the state for years — by bipartisan agreement — has spent hundreds of millions of dollars more than it was taking in) and a citizenry used to a state government that rarely said no. Then came an economic downturn, a September 11 hit, and a series of local and state government scandals and events that transformed the theoretical structural deficit into immediate red ink and helped turn a happy electorate into a unsettled one. "Wrong track" poll numbers climbed, and so did McCallum's negative ratings.

Three top Democrats vied for the right to challenge McCallum, and one of them — Milwaukee Congressman Tom Barrett — aired a TV ad that showed him in a big earthen hole as he said: "My dad sold ditch diggers for a living. But he never dug a hole as deep as the one the folks in Madison have put us in."

That image provides a perfect metaphor for where the state will be when the newly elected governor takes office. McCallum and a split, and increasingly partisan, Legislature provided a temporary fix in the summer of 2002 to the state's immediate $1.1 billion deficit. But few were happy with the results. A looming election, and the tendency of politicians everywhere to postpone tough decisions left the real heavy lifting to the governor and Legislature elected in November 2002. The early campaigning showed the extent of the problem ahead: none of the main competitors

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provided a detailed plan to fix the $2.8 billion problem, apparently fearful of injuring their campaigns as McCallum did when he used the term “big spenders” and proposed the phase-out of shared revenue. McCallum and Democratic Attorney General Jim Doyle focused on a no-new-taxes plank, reflecting the political atmosphere going into the election and further boxing in the next governor.

For the newly elected government, back-filling that big hole where Barrett stood will be a monumental task given the state's constitutionally mandated balanced budget. While the $2.8 billion two-year figure from the Legislative Fiscal Bureau doesn't take into account potential economic growth, neither does it take into account increased caseloads for things like the health-care programs Medicaid and Badgercare.

The bad news, agree budget-watchers across the political spectrum, is: It's only going to get worse.

Consider:

- Predictions of tepid economic growth mean no more bigger-than-expected rolling surpluses to bail out state finances. The good news is that the state's real estate boom has propped up the economy in the short term.
- The state and politicians' commitment to funding two-thirds of the cost of kindergarten-through-12th grade education has become the promise that ate the budget.
- The anti-crime push of the 1990s has kept the pressure on prison spending. New prisons still are coming on line, and they must be staffed. The push is on to bring home the prisoners who are out of state. And few observers think the public will accept mass releases of prisoners — even if they're non-violent offenders monitored via bracelets.
- McCallum's failed attempt to phase out shared revenue aid for local governments has made that program harder to slash — especially in the face of rising property taxes. Local leaders will blame property tax increases on shared revenue cuts.
- The burden on state taxpayers has risen, and it's considered political suicide to advocate for a boost in sales, income, or corporate tax rates. Wisconsin's state-local taxes in 1998-99 were 12.7 percent of personal income, third highest in the nation, according to the Wisconsin Taxpayers Alliance, a non-partisan budget watchdog group in Madison.
- In 1998-99, Wisconsin's state-local government general expenditures were 20.5 percent of personal income — 8 percent higher than the national average, the Taxpayers Alliance said.
- The state's tobacco fund has been extinguished, sold off to fill the majority of the short-term deficits with one-time monies.
- The state's rainy day fund, never funded during the boom years, has but a few coins clinking around the vault.
- An aging population will demand more of the social services state government provides and — when combined with a declining birth rate — likely will spur a labor shortage.
- Future indicators suggest Wisconsin's economy is in for tough sledding in the first quarter of the new century. The state lags the nation in average wages, wealth and per capita personal income, the Alliance says, noting that the state Department of Revenue's long-term forecast show state per capita personal income falling to 8.6 percent below the U.S. average by 2025.
- And a “brain drain” of the state's college-educated workers to other states and a lack of venture capital make it harder to expand the Wisconsin economy — despite the promise of home-grown high-tech and bio-tech industries.

“The state's fiscal condition remains in question in the years ahead,” the Alliance said in a June report.

> Income forecasts for the next 20 years show inflation-adjusted income growth in Wisconsin slowing. In calendar 2001, real personal income increased only 0.6 percent, the smallest rise since 1991.

"Forecasters expect Wisconsin's real personal income to grow 3.1 percent per year for the next five years, and eventually slow to 2.1 percent annual growth between 2016 and 2021," the report said, noting that changes in state general fund tax revenues are closely tied to changes in personal income.

> The expected slowdown in income growth will affect state taxes. It will also raise questions about what state residents can afford.

A report by Andrew Reschovsky of UW-Madison's La Follette Institute confirms the bad news.

It is hard to imagine, however, any source of revenue suddenly materializing to bail out the state once again.

> Over the past few biennial budgets, the Legislature has been able to put off making the difficult choices that are required to eliminate the structural deficit. First the extraordinary economic growth during the late 1990s and then the ability to use up the tobacco settlement have allowed the state to balance the past few biennial budgets. It is hard to imagine, however, any source of revenue suddenly materializing to bail out the state once again. Come 2003, the Legislature and the governor will have no choice but to address the state's structural deficit. The existence of a structural deficit means that as a state we must choose whether we want to reduce the existing level of public services or whether we are willing to collectively pay more money in taxes and fees in order to continue receiving the public services to which we have become accustomed.

It's a simple equation in a way. Reduce some $22 billion in general spending by $2.8 billion in 2003-05, raise revenues by that amount, or do some combination of the two. The projected $2.8 billion deficit estimate assumes no growth, but Reschovsky and the Alliance say it's unlikely the state can grow its way out of the problem.

Reschovsky put it this way in the weeks before the much-maligned budget compromise:

> During the three-year period, 1997 through 1999, personal income grew at an average annual rate of 3.6 percent. Although economists think it is highly unlikely that the Wisconsin economy will be able to grow at anywhere near that rate, what if such a rate of growth was in fact sustainable in both 2003 and 2004?
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> If the economy grew at an annual rate of 3.6 percent (in real terms), would this rapid economic growth solve our structural deficit problems? The answer is decidedly no. The structural deficit would decline by about $150 million in 2003-04 and by about $275 million in 2004-05, but the total structural deficit over the course of the biennium would still add up to $1.3 billion.

And with no tobacco settlement or rainy day fund or politically palatable tax rate boost to fill the hole.

This has not been lost on the McCallum administration, which issued tough budget instructions shortly after McCallum signed the short-term budget fix on July 26. He put the focus on the general purpose revenue (GPR) budget funded primarily by general taxes but didn't leave out budgets funded by segregated, or specifically targeted, taxes, fees and revenue sources.

"In this budget, we must address the state's long-term structural deficit," McCallum wrote his agency heads on August 2, 2002, formally beginning planning for the next budget cycle.

> The major budget policies and budget Instructions call for most agencies to hold overall fiscal year 2003-04 and fiscal year 2004-05 GPR budgets to fiscal year 2002-03 levels. The same targets will apply to the SEG funded administrative operations of the Department of Transportation, Department of Natural Resources and Lottery. The targets will be difficult to meet, but we are no different than hard-working Wisconsin families — we must live within our means. We are also asking agencies to prepare plans to reduce their 2003-05 state operations budgets by 5 percent per year below fiscal year 2002-03 base funding. A scenario where cuts of this magnitude are required is very possible.

The cut plans are due to the state Budget Office on November 15, 2002. Whether McCallum, a Democrat, or Libertarian Ed Thompson wins will not keep the agencies from this grim task.

So, Wisconsin politicians have dug themselves into a hole, as the Barrett TV ad showed us. How will they dig themselves out? Here are some scenarios that were being kicked around in political circles before and after the budget signing.

- *End the two-thirds school funding promise, lift revenue caps on schools and end the qualified economic offer (QEO) — the so-called three-legged stool that was to bring property tax relief.*

Lifting revenue caps and ending the QEO would take the state out of local decision-making, putting pressure on school boards to rein in costs. While it might be recipe for a property tax spiral, state policy-makers could say: Blame your local school board.

At about $5 billion a year, school aid is the biggest single budget category of spending, and it keeps going up each year because of the two-thirds promise. Education was such a powerful issue that McCallum and the biggest state teachers' union, WEAC, combined to preserve two-thirds education funding in 2002; the Democratic candidates fell in line. McCallum, WEAC and other interest groups have talked about alternatives, however. One idea is to keep the current pot of money and revise the school aid formula — perhaps devising a "foundation plan" that would give get rid of "rich" and "poor" districts and set a dollar amount per student. Various foundation plans have circulated, including one from Senator Michael Ellis, R-Neenah, that would have given every student a basic grant of $7,600. Additional funds would be provided to children with special educational needs, children with limited English proficiency, and children eligible for free or reduced-price lunches. Under the Ellis plan, two-thirds of the total funding for these grants would be provided through state income and sales taxes revenue. The other one-third would come from a state-levied property tax with a uniform mill rate so that every homeowner throughout the state would pay the same rate. A local district would be free to raise and spend additional money but such additional spending would have to be authorized by referendum.

Doyle, during an August 21, 2002, debate co-sponsored by WisPolitics.com, appeared to back the foundation concept.

> We really need to go to a formula that is based on how much money does it take to give a child of this state a sound basic education, which is that child's constitutional right. We've got to get back to basics. Not formulas that punish every district in the state, except rich growing suburban districts. And formulas that are exceptions piled on exceptions. We've got to get back to basics. How much does it cost to educate a kid in this state? . . . If you keep the dollar level commitment right now [it] goes a long way. Right now, we are punishing any district that has a student body that is staying relatively the same or decreasing.

- *Expand the sales tax base.*

Barrett raised this issue the most during the primary campaign, saying it was only fair to review sales and property tax exemptions and ask those interests getting the benefit to justify the tax breaks. But Barrett got rapped by critics who said this was code for raising taxes.

Earlier in 2002, the Wisconsin Counties Association proposed a $1.1 billion deficit fix that would have saved $745 million a year by eliminating sales tax exemptions while lowering the sales tax rate. The plan would have removed tax exemptions for all items currently tax exempt *except* for food, water sold through mains, prescription drugs, medical equipment, fuel and electricity for residential use, farm machinery and repair, electricity used in farming, fuel used in farming, motor fuel, milkhouse supplies, newspapers, periodicals, and shoppers guides, sales to state and local governments and schools. The plan also would have cut the sales tax rate for all sales taxable items from the current 5 percent to an estimated 3.5 percent and then to an estimated 3 percent. That same WCA "fiscal fairness plan" would designate a percentage of state sales tax to help fund the state court system, community aids, youth aids, and shared revenue programs.

- *Phase out shared revenue and give more local tax options to local governments.*

Some number-crunchers say the $1 billion shared revenue pot could be phased down over a five-year period while preserving a much smaller pot that would make sure property-poor districts continue to get help. Local communities could augment their resources by other sources of revenue such as a local sales tax, a wheel tax, or an income tax. One motivation behind this idea is to clean up state accounting; roughly 60 percent of general fund spending is for aid programs to schools, counties and municipalities, and many believe local governments would spend less if they had to raise all their own revenues.

In the end, all the fee increases don't get you very far.

- *Raise tuition, cigarette taxes and other fees.*

A variety of fees and sin tax rates almost assuredly would be considered prime candidates for an increase. Kathleen Falk, the Democratic Dane County executive, made an 85-cent-a-pack cigarette tax boost a centerpiece of her campaign, saying it could be used to replenish the tobacco fund and help solve the budget crunch. But the increase — to $1.62 per pack — would bring in only an additional $250 million a year more in state revenue. Tuition increases are very sensitive politically; politicians aren't likely to easily go along with double-digit boosts. In the end, all the fee increases don't get you very far.

- *Bring in more gambling money.*

A common suggestion is to get more money from tribal gambling revenues, estimated at $1.1 billion a year. Gaming compacts between the state and tribes are up for renegotiation beginning next year, and some suggest a trade: Tribes will get longer compacts in return for sharing more revenue with the state. One report, done for the Wisconsin Policy Research Institute, recommended that tribal "revenue sharing" be upped from $25 million a year to $90 million a year.

Another source of gambling money is untapped. Lawmakers perennially propose legalizing and taxing video poker machines. One failed proposal this session from Senator Roger Breske, D-Eland, would have licensed about 30,000 machines and generated $418 million in state revenue and $4 million in local government revenue. But opponents say this is expanding gambling.

• *Cut state bureaucracy.*

McCallum signed a budget that cut state bureaucracy by tens of millions of dollars. And all the gubernatorial candidates talked about cutting bureaucracy. Doyle, in fact, said he'd cut the number of employees to pre-Thompson levels, mostly through attrition. McCallum's Department of Electronic Government also was targeted by Democrats as wasteful spending. But cuts to bureaucracy alone can't fill the $2.7 billion hole.

• *Get more federal aid.*

Federal dollars received by the state went from 12.5 percent above the national average in the 1987 fiscal year to 13.5 percent below average in 1997-98, according to the Wisconsin Taxpayers Alliance. But with Wisconsin losing congressional clout, turning that around fast is unlikely.

• *Freeze spending and taxing levels.*

One proposal advanced earlier this year would have frozen local taxes and spending at their current levels, reduced state spending by $600 million and then frozen it. Any revenue growth would have gone towards reducing the deficit and cutting taxes. New taxes would have been barred for two years, and there would have been a two-year moratorium on all tax referendums and state and local bonding. Plus, tuition would have been frozen at UW System and Technical College schools.

Proponents said the two-year freeze would give state policymakers two years to, in the words of GOP Senator Mike Ellis, "redesign our house."

Come November, all eyes will be on the newly elected governor and the general fund budget, now running about $11 billion a year. There will be many plans to raise a little money here and cut programs there — all with a political twist. Various combinations of the scenarios will be tested by legislative fiscal analysts and by politicians, and everyone will hope for a robust economic recovery as the promises of the 2002 campaign are brought back into play.

But the current economic and political climate suggest the real answers will lie in big revenue increases and / or cutting the biggest chunks of state appropriation dollars: K-12 public education, Medicaid, the UW System, shared revenue and corrections — which make up the lion's share of that yearly $11 billion total.

Political pain, not gain, will be the order of the day and the newly elected governor may have second thoughts about gubernatorial ambition.