

Parsing the Politicians: The Wisconsin Economy and State Finances

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If recurring federal government shutdowns and debt crises teach us anything, it is that the words of career politicians, regardless of party, need to be examined with care: They need to be parsed. Debates among Badger State partisans over Wisconsin job trends and economic health, not to mention state budget and tax policy, have certainly required close examination.

Job Counting: Case Study in Partisan Obfuscation

The partisan clash over Wisconsin employment figures is a case in point. The laser-like focus on job creation over the past three years arose, of course, because Gov. Scott Walker (R) promised to create 250,000 new jobs during his term. Had serious staff work been done on the idea during the 2010 campaign, it is unlikely that it would have been floated. In reviewing the past two decades, WISTAX researchers could find only one four-year period in which the state created that many jobs.

Regardless, the governor, fellow Republicans, and Democratic opponents all have been scouring employment data for figures that confirm the particular partisan story they want to tell. The rhetoric has been self-assured on all sides—and often misleading.

The origin of the confusion is multiple sources of employment data. Preliminary job statistics are released monthly based on a small survey sample and revised annually when data from an all-employer census are generated by the unemployment insurance system. The lag between survey and census reports is about six months.

The difference between the two can be striking, as the following table illustrates. In 2011, when the bipartisan bickering began, the year started strong. Year-over-year, actual monthly employment growth in the first quarter ranged from 1.5% to 1.7%. With Wisconsin adding about 40,000 jobs per month, the 250,000 goal seemed in reach, and the governor embraced the numbers as they came out.

Job-Counting Confusion: How Preliminary (Survey) and Final (Census) Figures can Vary (BLS)

Method	Jan 2011	Feb 2011	Mar 2011	Apr 2011	...	Sep 2011	Oct 2011	Nov 2011	Dec 2011
Prelim. Survey	1.2%	1.3%	1.4%	1.1%		0.1%	-0.3%	-0.9%	-1.2%
Later Census	1.5%	1.5%	1.7%	1.3%		1.5%	0.8%	0.7%	0.8%

Then, with fall, the same preliminary surveys showed a sharp turnaround, with monthly job losses ranging from 0.3% in October to 1.2% in December. It was the Democrats turn to crow, as it appeared that the state had lost over 54,000 jobs in just three months. Months later, the more reliable employer census statistics were released. What had been a 54,000 job loss was actually a 62,000 job gain.

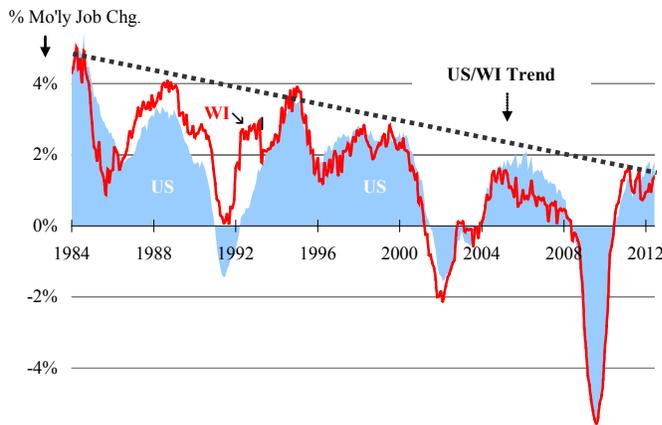
Neither party ended up with truth entirely on its side. Late-fall job expansion was positive—not negative as the Democrats had charged. But, it had slowed to half the first-quarter rate the governor had touted. The back-and-forth over the economy has been non-stop ever since. Every month, each side finds some source of economic news that portends only good, or only bad. The media are often left confused, sometimes reporting self-serving numbers from one side or the other without offering needed qualification or context.

Assessing Job Creation

Historical context is particularly lacking. If journalists or politicians were to study final monthly employment figures from the late 1980s on, a sobering story emerges. Through the early- to mid-90s, Wisconsin

enjoyed 87 consecutive months when percentage job increases here surpassed the US (see graph, immediately below). Then, for the rest of the 1990s, the economy boomed and state job creation more or less kept pace with the country.

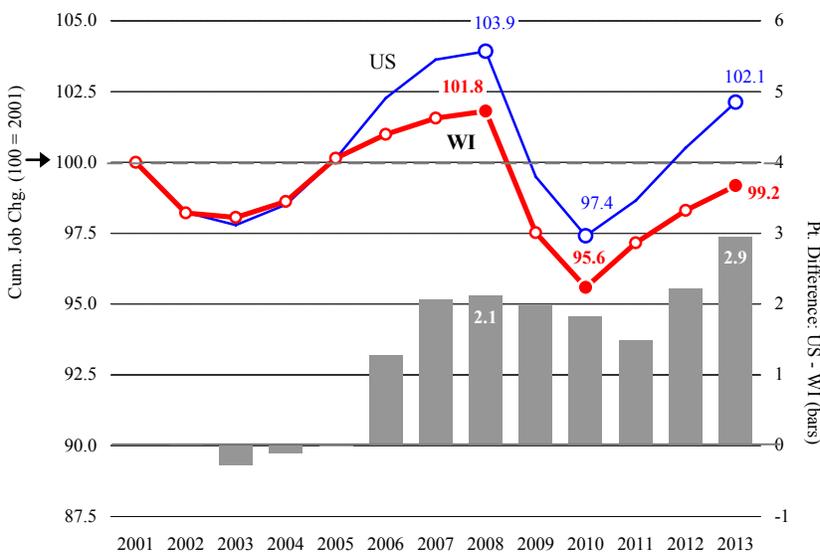
Monthly Employment Chgs. (US and WI), 1984-2013



From 2000 on, however, it has been an entirely different story. In only about one month in four has state employment growth exceeded the US. This is a period during which we have had Republicans in total control of state government, Democrats likewise in charge, and various partisan power-sharing arrangements among the executive branch, the state senate, and the assembly.

The graph (below, left) displays the cumulative increase or decrease in Wisconsin and US employment more recently, since 2001 (2001=100). The state and nation moved together until 2006 when the gap between the two opened and has remained. US job numbers did not surpass the 2001 level (100) until last year (2012). As of March 2013, Wisconsin still was slightly behind 2001 (99.2). However, neither has reached the peaks of 2008 (103.9 and 101.8, respectively), a reminder of general economic weakness.

Cum. Job Growth (2001=100): US vs. Wis. and US-Wis. Difference
 Years are March to March (Source: BLS, with WISTAX calculations)



If politicians are being truthful with voters, they have to acknowledge that increases in monthly employment, both nationally and in the state, have been slowing for years. The graph (top page, left) makes this clear: The largest monthly job gains in each successive economic cycle have been eroding over the past 25 years; in terms of the chart, the peaks have been getting shorter.

This pattern is not likely to change soon. While state policymakers have largely failed to recognize it, demographic change is here. Statewide school populations have been declining for 15 years, a trend that is now rippling across college campuses and is going to spill into a soon-to-stagnate state labor force. It becomes increasingly difficult to court new employers able to create new jobs if the state lacks the workers to fill them.

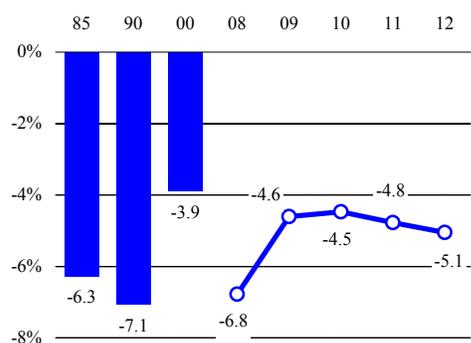
Beyond Job Numbers: Digging Deeper

The “job problem” has other deeper and broader roots than Wisconsin partisans would care to admit. Wisconsin’s economy generally tracks the country more closely than all but a dozen states. Consequently,

no state politician can have much short- or even medium-term impact on the Wisconsin economy, unless it is adverse, the result of ill-advised rhetoric or counter-productive action. No matter who is in charge, the best state politicians can hope for is to create a stable and nurturing environment that fosters long-term growth.

Income and earnings. The “pols” would be wise to include a variety of measures in their thinking and rhetoric. One is the percentage by which Wisconsin leads or lags the US on per capita income (PCPI), of which about 60% is attributable to wages and salaries. Creating new jobs but at lower pay levels limits the economic benefits of employment growth, so income and wages bear watching. Our PCPI has trailed the country for more than 40 years, although we briefly closed to within -2% of the US during the expansion of the late 90s.

Wis. Per Capita Personal Income: Pct. < US
(WISTAX, Benchmarks for a Competitive Wis. 2013)



As the graph (left) shows, average income here lost ground to the nation during the 2007-09 recession. Wisconsin typically begins a recovery somewhat sooner than the country, so it could be expected that we would move back toward income parity as the recession ended. But, we have stagnated at about -5% below the US.

The impact of wages and salaries on lagging personal income cannot be overlooked. In 1970, state earnings averaged about 4% less than those of the nation. With the punishing recessions of the early 80s, more ground was lost and never regained. Average earnings in Wisconsin have trailed the nation by 10% to 15% for decades.

Firm creation. A second measure that state leaders should focus on is new business creation. The nation’s leading monitor of entrepreneurial activity, the Kauffman Foundation, finds that, net, most if not all new jobs created since 1980 can be attributed to new or young firms. Data show that, since the early 90s, the Badger State has been among the 10 states with the lowest rates of new-firm creation.

The link between new jobs and new firms is readily apparent for the 1997-2007 period, as the table (below) shows. It arranges states in groups of ten (five quintiles) by their rate of new firm creation (new firms as a percent of all firms), from lowest to highest. For each group of states, firm birth and death rates, as well as average annual job growth during the decade, are shown.

Firm Birth Rates and Job Growth, 1997-07
States Grouped by Birth Rate (Low to High)

Quintile	Avg. Rate - Firms			
	Birth	Death	Net	Jobs
Lowest	2.47	2.34	0.14	0.84
2nd	2.80	2.63	0.17	0.68
3rd	3.06	2.77	0.29	0.99
4th	3.31	3.00	0.31	1.62
Highest	3.91	3.33	0.58	2.25

Note: Firm birth and death rates are percentages of new or expiring firms relative to all establishments. Job growth is on an avg. annual percentage basis.

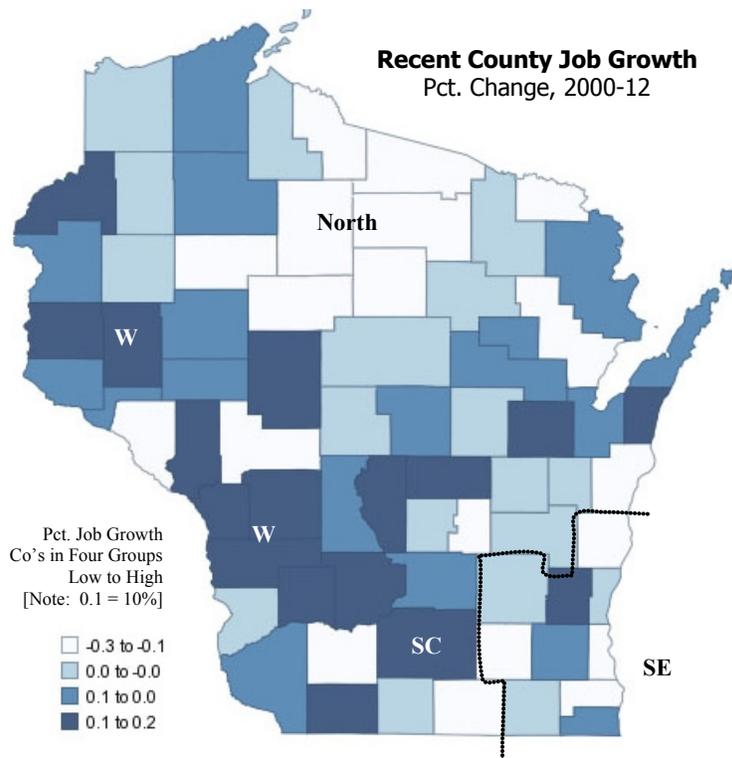
Several conclusions emerge. The most important is that states with high average rates of new firm creation spawned more jobs over the period studied. But, states with higher rates of firm death also tended to have more job growth. Why? Because one is related to the other: When more firms are started, more are going to succeed, and fail. In the vernacular, it helps to “throw more mud at the wall and see what sticks.” The lesson for a state like Wisconsin that, either by reputation or in reality, tends to be more risk averse is this: A successful entrepreneurial culture requires acceptance of failure, as well as success; one goes with the other.

Getting Beyond the “State” Economy

In exchanging partisan barbs, state politicians also err simply by attending only to state economic performance. Yet, it might be argued that there is no state economy but rather a set of regional economies,

each with its own strengths and weaknesses, each with its own patterns of growth and decline that reflect differences in industry mix, major-market proximity, and demography.

This is a topic that can be studied at length (see, for example, the September 2013 issue of WISTAX's monthly *Wisconsin Taxpayer* magazine). But, in brief, western Wisconsin—bordering Iowa, Minnesota, and the Mississippi River—has been outperforming the state as a whole on a number of economic and demographic measures. So has the south central region centered around Madison. By contrast, the south and east, with almost half the state's population and a disproportionate amount of its manufacturing base, is lagging.



Regional differences are evident when employment increases (2000-12) are examined by county. The map (left) displays the 72 counties and groups them into quartiles (four groups of 18) by their rate of job creation. Growth is highest in dark-shaded counties and lowest in white or lightly shaded counties. Clearly, the growth counties are concentrated in the west and south central areas, while the populous southeast and sparsely populated north tend to lag.

Given these intrastate differences, one has to wonder how useful it is for partisan politicians to use—and misuse—economic statistics that are state totals. If successful long-term strategies for Wisconsin are to be developed, the assets of each region have to be recognized.

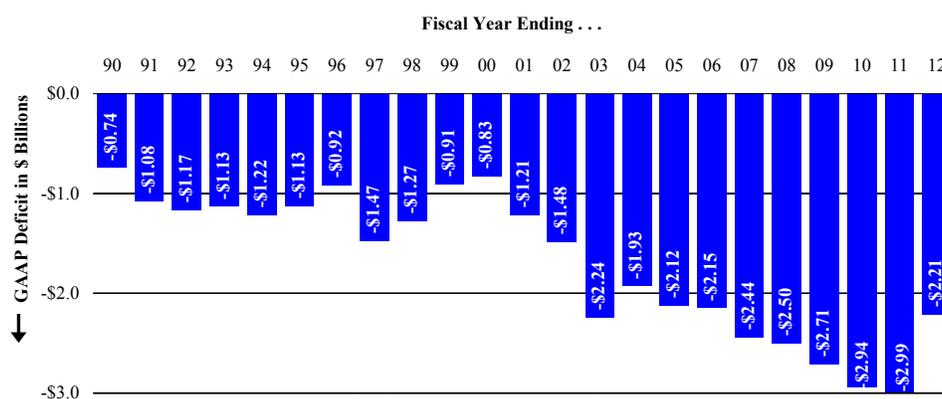
State Finances: Fact, Not Fiction

Even more than jobs and the economy, the bread and butter of partisan political exchange is taxes and spending. Most state financial decisions—both revenues and expenditures—are made in Wisconsin's biennial budget. To understand current state finances, it is important to have a grasp of the recent past.

Modern Budget History. From the late-1990s until mid-2011, state budgets were characterized by boom-bust, patchwork decision making. When the economy and state tax collections were growing robustly in the late-1990s, the governor and lawmakers of both parties found themselves in a political “sweet spot”: Revenue was sufficient to cut taxes, e.g., a billion-dollar “buydown” of school taxes, restoration of income tax indexing, and major income tax reform and reduction in 2000-01. There was also revenue to boost spending on education, tax rebates, welfare reform, and Medicaid.

As long as the tax collections were strong, the consequences of fiscal “over commitment” in the late 90s were avoided. However, with the 2001 recession, state tax growth withered, and a billion-dollar general fund deficit opened up. Over the next ten years, the budget was ostensibly balanced using a number of short-term maneuvers, including sale and later refinance of “tobacco bonds”; fund “raids,” including \$1.4 billion in transfers between the transportation general funds; rapid growth of highway bonding that indirectly facilitated general fund budget balancing; and accounting tricks that spent money but delayed its appropriation

State General Fund Balances (\$ Billions) Using GAAP, 1990–2012 (Source: Wis. Financial Statements)



until the following year. In the depths of the recession, large amounts of temporary federal stimulus money were also used to replace general-fund school aid and Medicaid costs.

Getting a fix on the state's true fiscal condition during this period was difficult. This is, in part, because as accountants view finances, Wisconsin budgets are prepared on a modified "cash" basis. Relying on this approach and the gimmicks just mentioned enabled state officials to declare budgets balanced. However, from a CPA's perspective (using generally accepted accounting principles, or GAAP), state general fund deficits grew for much of the past decade, reaching about \$3 billion in 2010-11 (see graph above).

To the casual observer, what might be surprising about the past two decades is, in some ways, how little party label mattered. The "outs" always blamed the "ins" for hidden deficits, spending growth, subpar bond ratings, and increased borrowing. When election results led them to switch places, all they had to do was trade scripts.

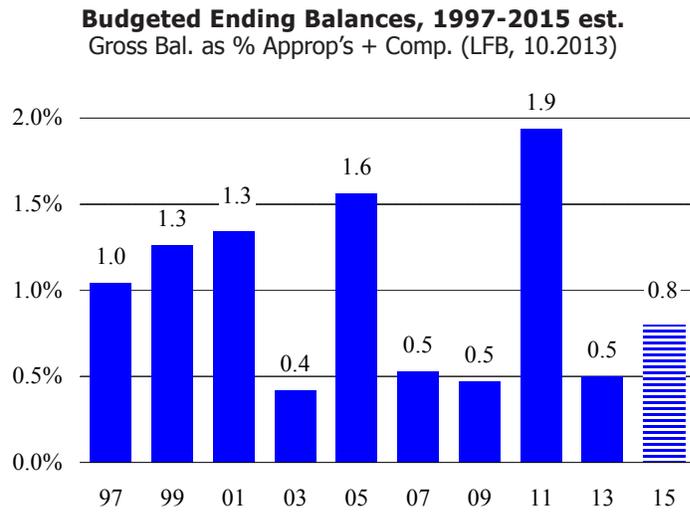
A decade of delay-and-defer budgets came to a head in 2011-13. With federal stimulus monies drying up, state budgeters projected a general fund "cash" deficit in excess of \$3 billion. Many difficult decisions accompanied the 2011 budget, but they can be summed up simply: Backfill lost stimulus funding with over \$1 billion in new state monies for Medicaid, and freeze or cut other major programs, e.g., shared revenues for local governments, the UW System, and corrections. The resulting budget pain and controversy were considerable, but with a little economic luck, the dividend was real—a surplus of \$759 million (about 5% of annual spending) when the biennium ended in mid-2013. The amount may seem large, but a 5% surplus is what most budget experts recommend for states.

The New 2013-15 Budget. The difficult 2011-13 budget paved the way for an easier 2013-15 version that was passed in June and "tweaked" in October. The gist of the partisan debate might be distilled to one side hailing it as fiscally responsible and taxpayer responsive and the other criticizing it for lack of adequate funding for health and education. As usual, neither point of view is entirely correct.

In numerical terms, the general fund budget (with the October trailer) spends, net, \$14.88 billion the first year and \$15.46 billion the second—increases of 3.5% and 3.7%, respectively. Although the opening 2013-15 balance of \$759 million (over 5% of annual expenditures, without the "rainy day" fund) is healthy, the gross ending balance is \$125 million, or just 0.8% of spending in 2015. The latter amount approaches the 0.5% balances Wisconsin had in 2007-09 (see graph, next page, top) that were smaller than any state's, save Arkansas. Going into the recession that year, the 50 states averaged reserves equaling 8.5% of expenditures.

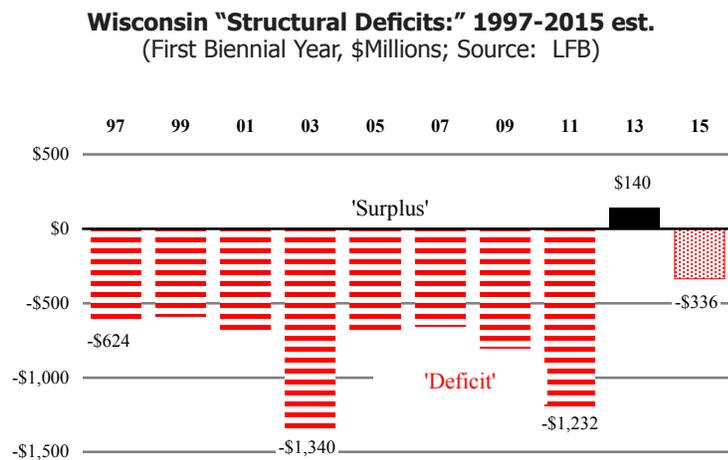
Reasons for the surplus drawdown are straightforward: Net expenditures exceed annual revenues by \$254 million in the budget's first year and by \$380 million in its second. Surplus is consumed to fund spending

increases, as well as to enable two-year cuts in income taxes (about \$650 million) and property taxes (\$100 million, as proposed in October). A history of those surpluses is shown in the bar graph below.



Another way state biennial budgets have been evaluated in the past two decades is in terms of structural balances or “deficits.” This notion is different from the usual meaning of “deficit.” The structural imbalance results from tax or spending decisions in one budget that have implications, positive or negative, for the next. In part because of many one-time, budget-balancing gimmicks used during 1997-2011, Wisconsin had eight consecutive biennial budgets with structural imbalances. The Legislative Fiscal Bureau estimated their size in the first year as ranging from \$589 million in 1999 to \$1.3 billion in 2003 and \$1.2 billion in 2011.

As difficult a budget as it was, the 2011-13 edition accomplished something that had not been done since 1995. Wisconsin began budgeting for 2013-14 with a \$140 million structural “surplus” in 2013. One of the unfortunate aspects of the latest budget is that it brings back a structural problem. Although smaller than at any time between 1997 and 2011, this means that when Wisconsin begins planning for 2015, it will first have to use new revenue to cover \$336 million from the prior budget before it can devote this to future needs (see bar graph, below).



Drawdown of surplus and a future structural imbalance are probably the two leading issues associated with the 2013-15 budget. Both become even more problematic if what has been an unpredictable and uneven economic recovery loses steam. The governor and legislature are relying on tax projections revised in May 2013 that gave them extra revenues to complete budget preparations and to enact larger-than-planned income and property tax cuts. Should these estimated revenues not materialize, the state’s fiscal vulnerability would quickly become apparent.

Other Issues . . . Transportation. Major finance issues aside, the 2013-15 budget leaves several programmatic questions unanswered as well, chief among them roads. For years, Wisconsin has had difficulty funding transportation. Inelastic gas tax revenues are being eroded by inflation and increasing vehicle fuel-efficiency. An aging population is putting pressure on tax and fee revenue.

Other indicators of transportation’s long-term fiscal problems are: (1) general fund subsidies in recent years, which total about \$450 million in 2013-15; (2) about \$1 billion in bonding for transportation, about half of all state borrowing in the new biennium; and (3) federal highway data for 2011 that show a noticeable drop in high-quality road miles since 2009. In short, the hand-to-mouth nature of transportation finance in

recent years will force a difficult choice in the near future: Increase fees and taxes, or scale back the public's appetite for highways.

Borrowing. Transportation bonding raises a related issue, total state borrowing. The new budget authorizes \$2.05 billion in additional debt, \$1.64 billion of which requires repayment with general fund taxes. State debt serviced by the general fund more than tripled between 1999 and 2012. Nascent legislative concern for the issue this year will probably return stronger in 2015.

State-Local Finance. Historically averaging about 58% of general fund spending, state aid to local governments and schools has been losing budget share, as shared revenues and schools aids were cut, frozen, or increased only minimally. That percentage share has now dipped under 50%. At the same time, state government imposed and tightened revenue and levy limits on local units of government. A number responded by creating or increasing fees, or borrowing more. Although this combination of policies could be defended during a state budget crisis, it is not sustainable long-term, especially when state spending is rising close to 4% annually. If fixed costs rise, even minimally, but all local revenues are restricted, "something has to give," as the saying goes.

Biggest Issue of All? In the drama that is state budgeting, Medical Assistance (MA), or Medicaid, has moved from bit part to center stage over the past 20 years. MA participation, due mostly to eligibility expansions, has grown from one in 13 residents 15 years ago to one in five today. While it generally claimed 10% or less of general fund expenditures during the two decades ending in 2003, it grabs more than 15% during the current biennium.

Final Thoughts. Medicaid spending is currently averaging growth of almost 9% per year and shows no sign of relinquishing the budget spotlight. As MA consumed increasing shares of the state general fund budget, it has also diminished the likelihood of new funding for schools, local governments, or the UW System, which has been modest to nil. How long can it last?

Other decisions made as part of the new budget raise similar questions. How sustainable are the "spending down" of a hard-won surplus, the return to structural imbalances, temporary approaches to transportation funding, and increased borrowing?

The difficult budget decisions of 2011-13 righted the state's fiscal ship and returned it to stability. The new biennium began with commendable reserves. But, in spending more than is collected in revenues this year and next, in avoiding difficult decisions now that leave unresolved issues for later, the 2013-15 budget raises the same question yet again, only in different words: Although the new budget seems to "work" for this biennium, what about the next? Can recent budget choices and decisions be sustained beyond 2015?

If not, and particularly if the uneven recovery slows again or ends, Wisconsin may add yet another chapter to its long saga of boom-bust budgeting characterized by short-term, politically motivated financial decisions that eventually come back to haunt. If that happens, the 2015-17 budget might begin to resemble its recessionary counterparts of 2007-11 when, ironically, taxes were increased *and* spending was cut.