Looking Back, Looking Forward: Budget Lessons from Midwest States

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Evidence-Based Budgeting: Making Decisions to Move Wisconsin Forward
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Outline

- Relationship between economic and fiscal health
- What happened during the last decade?
- What can we expect over the next decade?
- Long run strategies for effective fiscal management
- Budgeting in periods of fiscal stress
- Special considerations for Midwestern states
Recessions and fiscal health

- State revenue falls when unemployment rises
  - Severe drop in both 2001 and 2007 recessions (policy change also played a part).
  - After 2001 recession revenues rose very slowly.
  - Too early to tell in 2007-09 recession but slow increase in revenues.

- Demand for state spending rises in recessions
  - Medicaid enrollments typically rise with a lag after the recession ends.
  - In three past recession (1980-82, 1990-91 and 2001) state education expenditures also rose rapidly.
  - Too early to tell in 2007-09 recession but large increase in Medicaid rolls.

Long-term economic growth and fiscal health

- A high standard of living and fiscal balance can be maintained without rapid population growth.
What happened during the last decade (through 2008)?

- Nationally state revenues and expenditures have risen faster than inflation.

- Wisconsin revenues, taxes and expenditures have risen slower than the national average.

- Wisconsin has lagged behind other states in getting federal revenues.

- Wisconsin had less increase in Medicaid costs than other states.
Figure 1: State Total General Revenue
Real 2005 dollars per capita
Figure 2: State Total Tax Revenue
Real 2005 dollars per capita

United States
Wisconsin
Figure 3: Intergovernmental Revenue from Federal Sources
Real 2005 dollars per capita
Figure 4: Total General Expenditure
Real 2005 dollars per capita

- United States
- Wisconsin
Figure 5: Medicaid Expenditure
Real 2005 dollars per capita
What can we expect over the next decade?

- Short-term
  - Unemployment rates will remain high for several years and state revenue growth will be sluggish.
  - Financial markets may be less willing to loan to states and may require higher interest rates.

- Longer-term (US Government Accountability Office projects major imbalances in state & local sectors)
  - Demographic transition (especially health care) will strain state budgets.
  - Sales tax revenue growth will lag behind economic growth.
  - Medicaid and other health care costs will rise rapidly.
  - Inflation-adjusted federal aid will not rise and may fall.
2012 Could Be Worst Year Yet for States

Budget shortfalls in billions

- Blue: Budget gaps offset by Recovery Act and extension
- Dark blue: Remaining budget gaps after Recovery Act and extension

FY2009: $31  
FY2010: $123  
FY2011: $101  
FY2012: $134

Long run strategies for effective fiscal management

- Things to avoid
  - One time fixes (asset sales, tax amnesties).
  - Stagnant/antiquated revenue sources (e.g. narrow sales tax).
  - Uncontrollable spending commitments (e.g. health care spending for retirees).
  - Concealed cost or burden shifting to local government.
  - Borrowing to pay recurring expenses.
Long run strategies for effective fiscal management

- Things to consider
  - Budget transparency
    - Report budget categories on consistent basis over time.
    - Identify one-time and recurring revenues and expenses.
    - Publish multi-year spending and revenue forecasts.
    - Independent analyses of revenue, spending, and long-term obligations.
  - Enforceable and transparent budget rules.
  - Regular reports on structural deficits and cyclical deficit
  - Build rainy-day funds during boom periods.
Budgeting in periods of fiscal stress

- Use data to anticipate future fiscal stress and begin early discussion of options.
- Understand that fiscal stress may persist long after an economic downturn ends.
- Use a comprehensive budgeting process (budget rules) that encourages explicit trade-offs.
- Use evidence-based studies to prioritize competing categories.
When spending cuts are necessary consider:

- Categorizing by policy rather than political criteria (e.g. families vs single adults rather than North vs South).
- Better targeting of existing spending (e.g. reductions in school aid to high property wealth districts).
- Small targeted increases in spending (e.g. subsidies for child care for low income families) that offset spending cuts.
- Targeted reductions in relatively ineffective tax expenditures (e.g. sales tax exemption for food).
Midwestern states

- Continue to lose population relative to the rest of the nation.

- Are aging rapidly—this has important implications for both the kind of public services needed and sales, property and income tax bases.

- Are highly interdependent. About 1/3 of Wisconsin’s out-of-state trade is with IL, IN, MI and Ohio. By comparison, only 10% involves foreign countries.
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