

## **SPENDING BOOM: THE ORIGINS OF WISCONSIN'S 2003 FISCAL CRISIS**

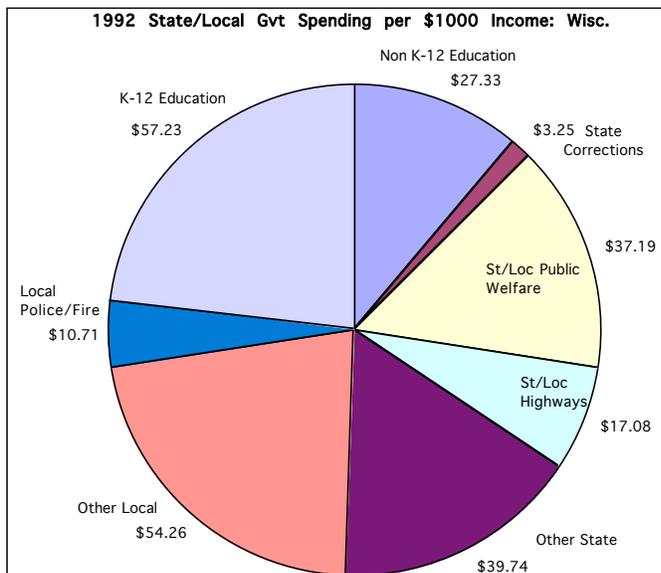
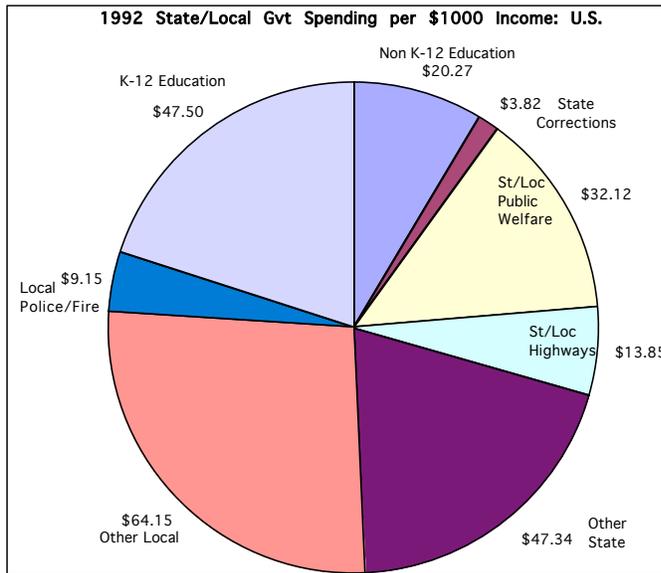
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The State of Wisconsin weathered the 1990-91 recession relatively easily. The unemployment rate peaked at only 5.8% in March 1991, compared to the national peak of 7.8% in June 1992, and although the State government's finances were tight for a year or two, there was no real budget crisis.

It is now 2003, we are in an anemic recovery from the 2001 recession, and the state government has spent the last year and a half arguing over, debating about, and finally resolving a \$3 billion biennial fiscal deficit. The question is, what went wrong? Was the fiscal shock of this last recession that much greater than the one in 1990-91, or was the state's fiscal position entering the recession that much more perilous than a decade before? If the latter, was the fiscal imbalance due to inadequate revenue growth over the decade, or excessive spending growth? And if the problem was the growth in government spending, did that excess growth occur primarily at the local level, in local school, city, county and town budgets, or was it mostly a problem at the state level?

This paper seeks to answer these latter questions by examining the growth in both state and local government budgets over the economic expansion of the 90s. As I will show, the problem was clearly one of government spending growth, and that problem occurred almost exclusively at the state level. Wisconsin state government direct spending, including direct purchases of goods and services, and direct grants to individuals, but excluding state funding of local schools or other local government, grew faster than local school spending, than other local government spending, or than other states' average spending. State spending grew throughout the 90s at an unsustainable rate, all but guaranteeing a massive budget crisis whenever the inevitable recession came along – which, in 2001, it finally did.

## Wisconsin Budget Situation, Fiscal Year 1991-92



The data presented here is from the U.S. Census Department's Census of State and Local Finances. It's available online at [www.census.gov/govs/www/estimate.html](http://www.census.gov/govs/www/estimate.html). In fiscal year 1991-92, Wisconsin state and local government spending amounted to nearly one fourth of Wisconsin income: \$246.78 out of every \$1,000.00 earned. This exceeded by just a small percentage the national share of income devoted to state and local government spending, \$238.21 per \$1000 income.

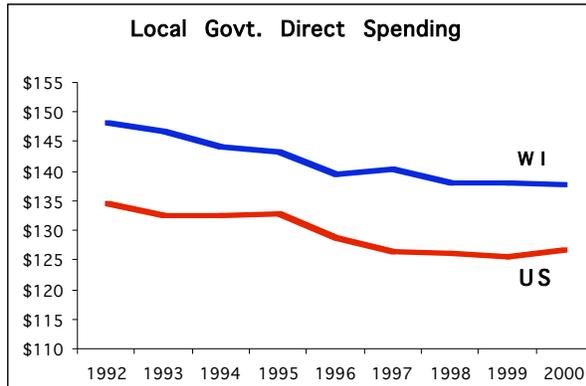
The pie charts compare Wisconsin's government spending to the average state pattern across the U.S. As you can see, Wisconsin residents spend more on education, both in local K-12 school systems and on other (chiefly higher) education, than their counterparts in other states on average. We similarly exceeded national spending levels in 1991-92 in Public Welfare spending and Highway

spending. Since in both of these categories the division in responsibilities between state government and local government are to some extent arbitrary, and differ from state to state, I've combined state and local spending into a single category.<sup>1</sup> Wisconsin residents also spent more on local police and fire services than their out-of-state counterparts. On the other hand, spending at both the state and local level on all the

<sup>1</sup> In both categories, local government direct spending in Wisconsin was substantially higher (by 50% in welfare, more than double in highways) than in other states. Since these are areas where state grants support local spending, the difference may be more illusory than real.

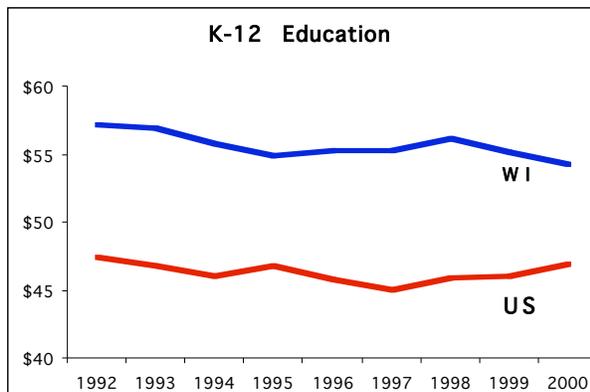
other smaller categories of spending combined, as well as on state corrections spending, were substantially lower in Wisconsin than in other states on average in 1991-92.

### Local Government Spending Growth, 1992-2000



In 1991-92, Wisconsin local governments spent \$148.35 for every \$1000 of state income on schools, roads, police and fire, and various other local public services. This was nearly \$14 higher than the expenditure per \$1000 income of local governments throughout the country. The difference could be attributed to higher spending on local schools (about \$10) and

technical colleges (about \$2.50), police and fire services (about \$1.50), local spending on streets and highways (over \$6), and county welfare services (over \$3), partly offset by almost \$10 less in other forms of local spending (mostly lower utility spending).

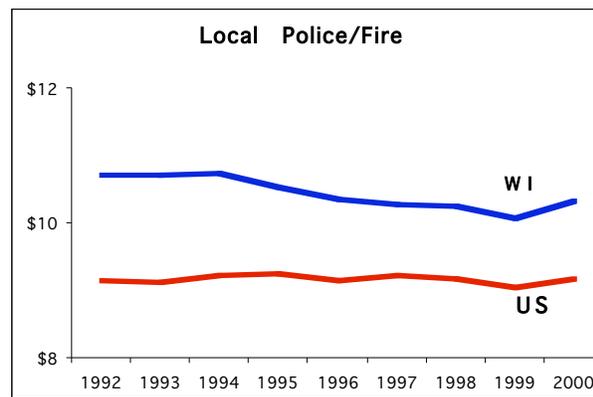
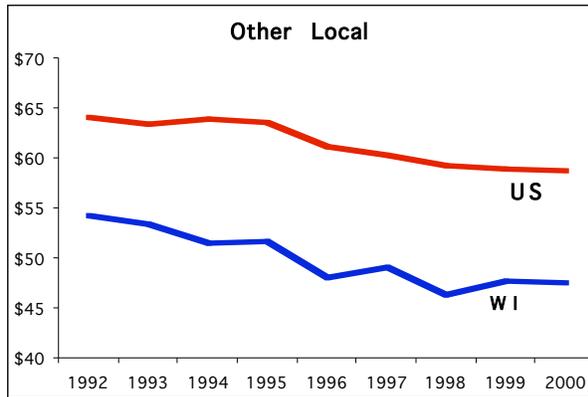


By 1999-00, Wisconsin local government spending had fallen to \$137.86 per \$1000 income, a 7% drop. This slightly exceeded the 6% drop nationwide, and narrowed the difference in spending per thousand to just over \$11. The relative spending decline was spread across most spending categories: only in health spending (48¢), utility costs (41¢), technical school

spending (37¢), local government administration (31¢), employee retirement (28¢) and other uncategorized spending (30¢) did spending rise more than a few cents per \$1000 income. The biggest drop, over \$4 per \$1000 was in sewerage spending, followed by a nearly \$3 decline in spending on local public education. These drops were primarily a function of the strong growth in personal income than outpaced the real per capita increases in spending.<sup>2</sup>

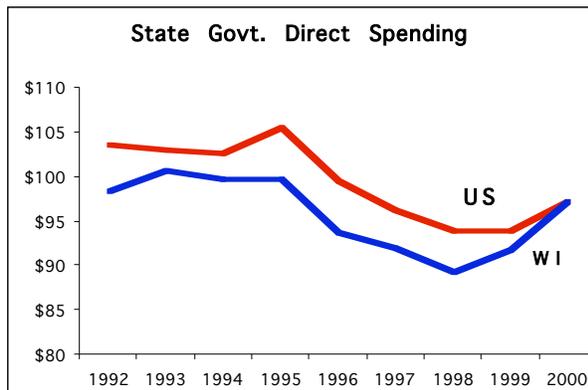
<sup>2</sup> Nominal personal income grew 62% during this time span, while Wisconsin local government nominal spending rose 50%. Since state population increased 7.4% and the price level rose 23%, to keep real local government spending per capita unchanged, nominal spending would have had to rise 32%.

Overall, in both our local school systems and our other forms of local government, local government spending as a share of income fell continuously through the 1990s. If Wisconsin's recent fiscal problems were due to out of control spending, they did not occur because of local governments.



State Government Spending Growth, 1992-2000

In 1991-92, Wisconsin state government spent \$98.44 for every \$1000 of state income,

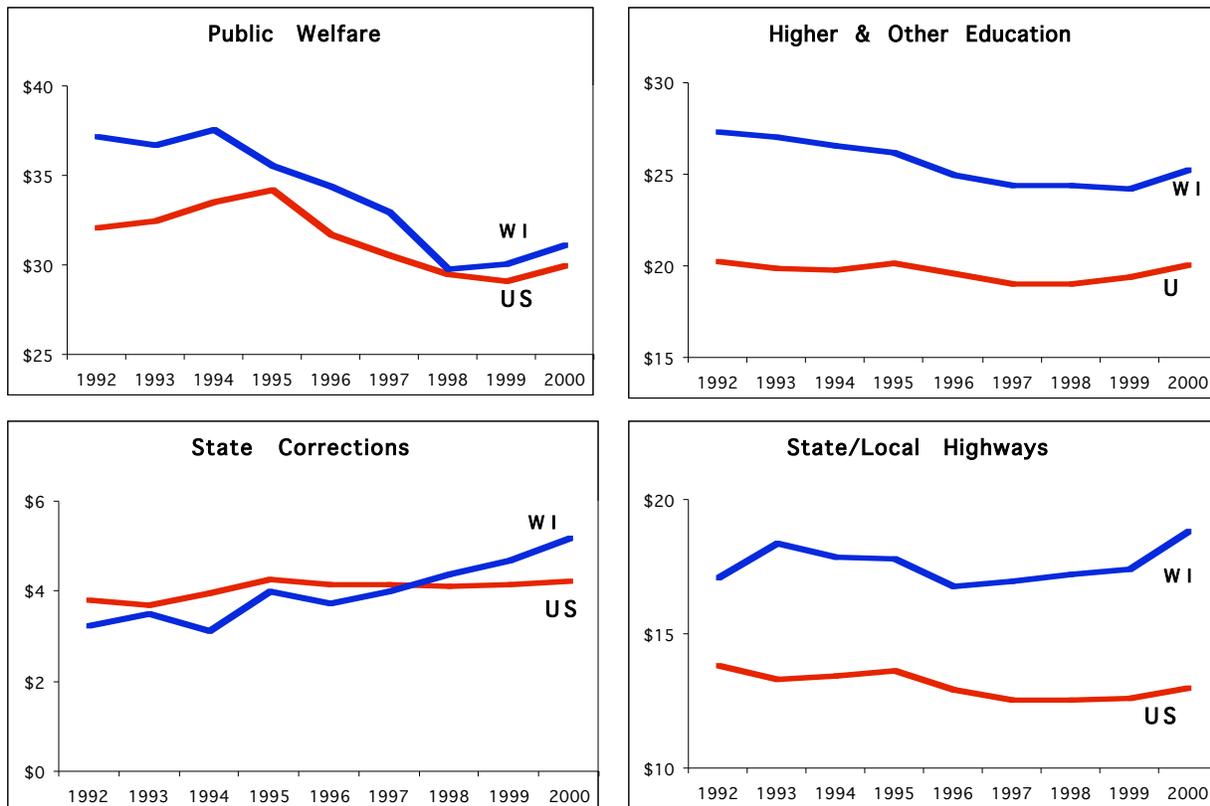


about \$5.50 below average state spending per \$1000 nationwide. While we exceeded the national average in state support of higher education and technical training (about \$4.50) and state welfare spending (about \$1.75), they were more than offset by lower state direct spending on highways (by nearly \$3) and a variety of other categories. Again, we should be careful in interpreting the figures for welfare and highway spending, since both involve a

division of responsibilities between local and state government that is at least partially arbitrary, a significant fraction of local spending is financed in part with state grants, and Wisconsin's local governments outspend other local governments on average in both categories. Overall spending on welfare programs in Wisconsin exceeded overall average state/local spending per \$1000 by about \$5 in 1991-92; overall highway spending was over \$3 higher per \$1000 here than elsewhere.

By 1999-2000, Wisconsin state government spending had edged down slightly, to \$97.24 per

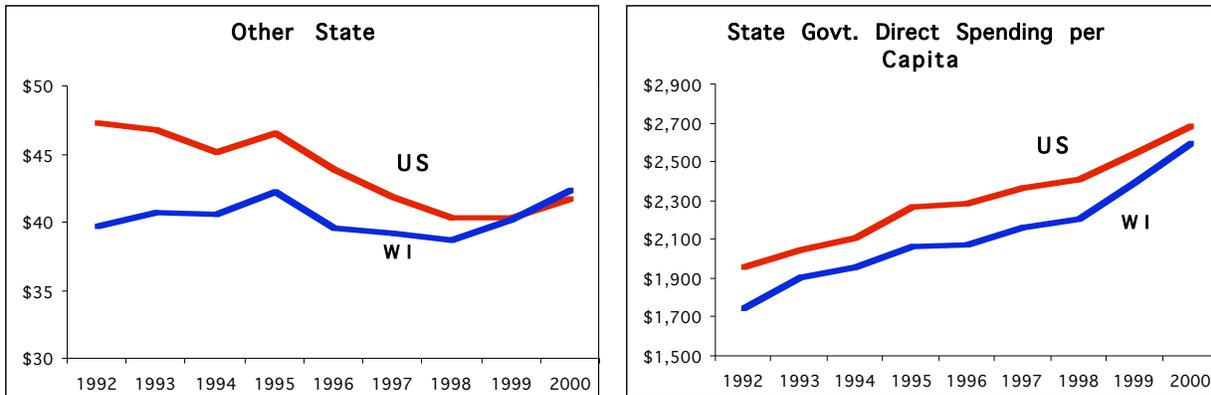
\$1000.<sup>3</sup> While this may sound acceptable, during the same time period state government spending nationwide had dropped over \$6 per 1000, almost totally eliminating the spending advantage Wisconsin had held 8 years before. Or stated another way, over a period of time when Wisconsin's local governments, local governments nationwide, and state governments nationwide were all increasing spending between 50% to 52%, Wisconsin's state government spending rose almost 60%, just a bit below the 62% income growth of those 8 years of economic boom.



As the figures above and below demonstrate, this state spending boom occurred primarily in the last two fiscal years of the decade. With the exception of a spending bump in 1995, state spending both in Wisconsin and across the country rose roughly linearly from 1991-92 to 1997-98 at a pace slower than economic growth, thereby dropping as a percent of

<sup>3</sup> The U.S. Census data shows the figure rising to \$102.12 per \$100,000, up sharply over the \$91.77 of the previous fiscal year. An inspection of the spending details showed an unusually high not-elsewhere-categorized expenditure of \$1.4 billion in 1999-2000, more than double the value of the previous fiscal year (or any other data year). Since the difference of \$700 million is approximately the amount of that year's tax rebate, I have reduced the state spending measure by \$700 million to wash out the impact of this one-time-only outlay.

income over the 6 year span. In the last 2 years of the decade, however, spending accelerated both in Wisconsin and across the country, perhaps due to an influx of tax revenue from realized stock market capital gains. This spending surge was far more pronounced in Wisconsin, however, causing the state to close the gap between our state's spending per capita and the national average, and appears to be across the board: evident in every chart involving some degree of state spending. To put it succinctly, Wisconsin's state government went on a spending spree.

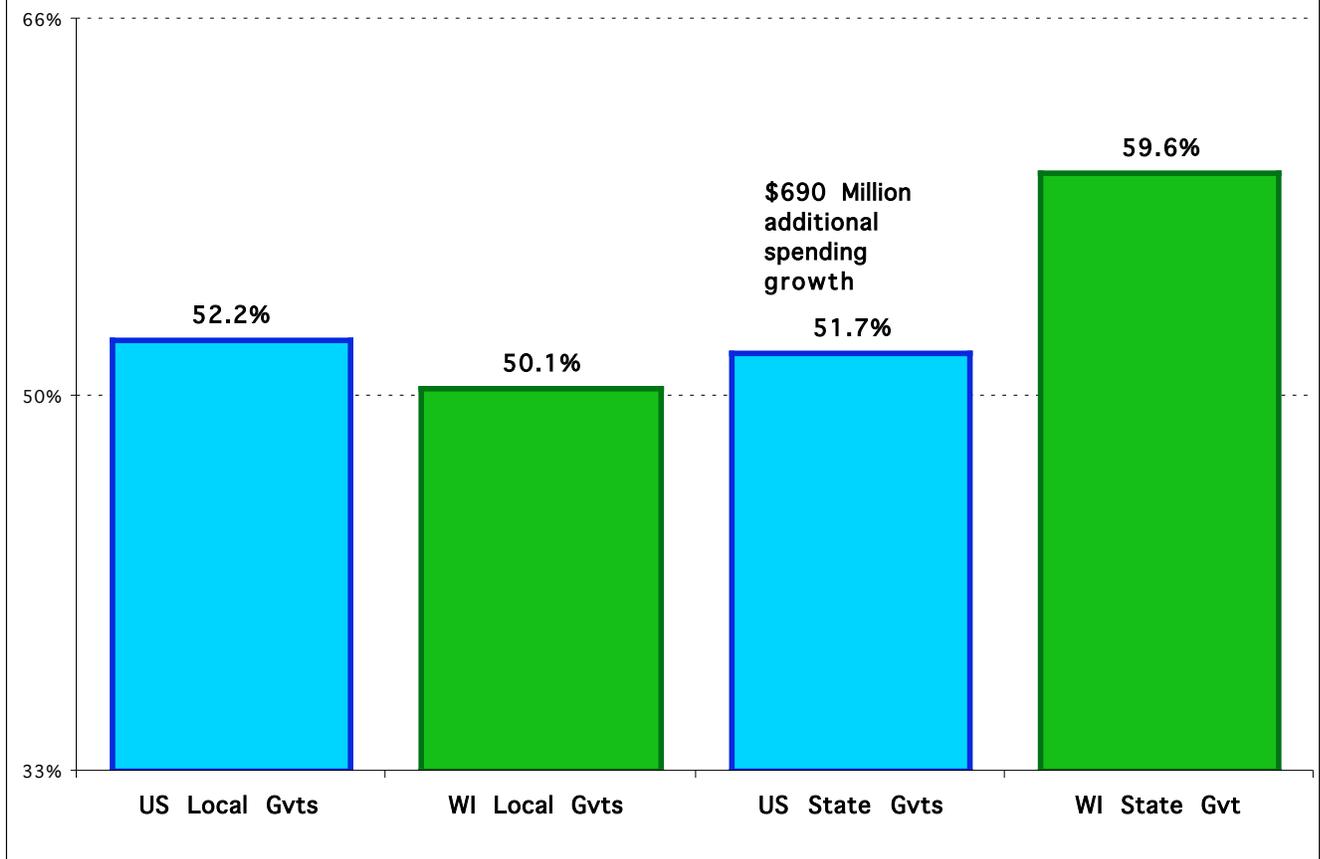


To gauge the size of the spree, notice that from 1991-92 through 1997-98, Wisconsin's per capita state direct spending was a relatively constant fraction, about 91%, of the national average. If Wisconsin had stayed at 91.2%, in fiscal year 1999-00, state spending would have been \$150 per capita, or \$5.60 per \$1000, lower than it actually was – which translates to over \$800 million in excess spending in fiscal year 1999-00. A similar but somewhat smaller figure is reached by looking at spending growth over the entire 8 year time span: if Wisconsin state spending had grown at exactly the average rate, fiscal year 1999-00 would have been \$690 million smaller.

Although the spending spree was to some extent across the board, the lion's share occurred into just two spending categories: state corrections and state highway spending. From 1991-92 through 1995-96, state spending in both categories roughly maintained its position relative to the national average. In the next 3 fiscal years, however, spending in both categories exploded, growing faster than income while the national average as an income share was essentially flat. Had these two categories of spending only grown at the national average growth rates of 80% and 53% respectively, Wisconsin state corrections spending and highway spending would have been \$227 million and \$352 million less in 1999-00 than what they actually were – accounting together for 84% of the earlier estimate of \$690 million of excess spending growth.

## State and Local Direct Spending Growth, 1992-2000

Source: <http://www.census.gov/govs/www/estimate.html>



### Summary

The state's recent fiscal problems appear to have been brought on at least in part by spending growth, entirely at the state level. Although both local school districts and other forms of local government increased spending by over 50% during the economic expansion, this was well in line with spending growth at both the state and local level nationally. In contrast, Wisconsin state government spending grew nearly 60% during this time frame, almost exactly matching personal income growth, and certainly exhausting all revenue growth; when the economy slowed and income growth fell sharply, the state had no revenue buffer to fall back upon.

Had state government spending in Wisconsin grown at only the 51.7% rate that state

government spending across the country grew, the Wisconsin state budget would have been nearly \$700 million leaner in 1999-2000, which suggests that the fiscal crisis encountered two years later would have been about \$1.4 billion smaller. In other words, about half the fiscal crisis was self imposed through spending increases.

These results also suggest that the attempts at the state level to solve its fiscal problems by cutting revenue sharing with local government were unjustified. It was state spending, overwhelmingly in highway and corrections spending, that created the problem. Unless a radical change in public goods priorities is warranted, it should therefore be state spending, again perhaps especially in those two categories, that needs to be cut.

