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February 5, 2002

To the Honorable Common Council  
Finance and Personnel Committee  
City of Milwaukee

Dear Committee Members:

Attached is my report on Common Council file 011395, communication to the Finance and Personnel Committee regarding the impact of the Governor's proposed State budget cuts on the City of the Milwaukee.

The report discusses the State's financial condition, Governor McCallum's budget reform proposal and proposes a solution to the State's fiscal problems that is based on budget priorities identified by State policy makers through the last budget cycle.

If there are any questions, please feel free to contact my office.

Very truly yours,

W. MARTIN MORICS  
Comptroller

WMM:cdk  
Attachment

REF: PD-6021W.DOC

## COMPTROLLER'S REPORT TO THE FINANCE AND PERSONNEL COMMITTEE ON GOVERNOR McCALLUM'S BUDGET REFORM BILL

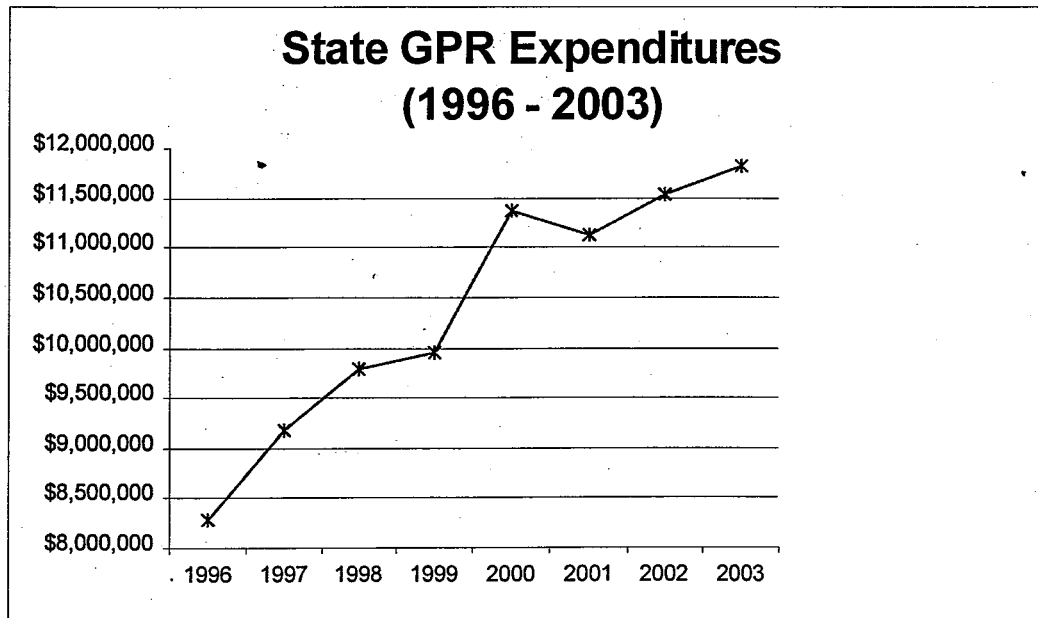
The State of Wisconsin's fiscal problems resulted from \$2.8 billion in general fund (GPR) expenditure growth between 1996 and 2001, overly optimistic revenue estimates and a long standing fund balance deficit of over \$1 billion. The Governor's solution to the State's fiscal problems is to shift the State's fiscal problems to local governments by eliminating shared revenues. The elimination of shared revenues will be catastrophic for the many cities and counties, and also disproportionately harm the poorest communities in Wisconsin. Under the Governor's plan, by 2004 the City of Milwaukee will lose \$248 million in shared revenue or approximately 46% of the City's budget.

This report discusses the State's financial condition, Governor McCallum's budget reform proposal and a solution to the State's fiscal problems that is based on budget priorities identified by State policy makers through the last budget cycle.

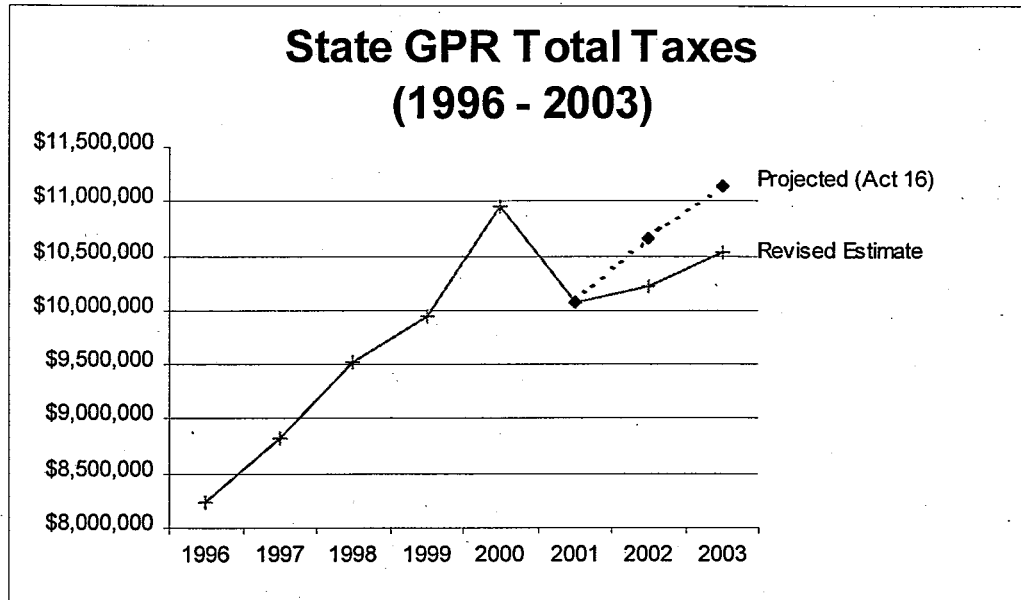
### I. STATE FINANCIAL CONDITION

Throughout the 1990s, the State's financial condition can be characterized by strong revenue and expenditure growth. Most State programs, except shared revenues, grew faster than inflation, with school aids and corrections costs showing the largest growth.

From 1996 to 2001 (the State is on a fiscal year basis that runs from July 1 to June 30), the State's general fund appropriations and revenues grew at an average annual rate of 6.8%, or 34.2% overall, over the five year period. However, not all State expenditures increased at the same rate. Over the same period, school aids increased at an average annual rate of 12.8%, or 64.1% overall, while shared revenue increased at an annual average rate of 0.1%, or 0.7% overall. Figures for other State expenditures, net of school aids and shared revenue, are a 4.8% annual growth and 24.1% five-year growth.



The growth in State expenditures was supported by a growing economy that increased the State's income and sales tax collections. However, State tax cuts and rebates, along with a downturn in the economy, decreased the State's revenue. Despite a slowing economy, the State still estimated a 10.6% increase in their 2002-03 tax revenues. Shortly after the budget was adopted, it became apparent the State would not achieve its optimistic revenue projections. In January 2002, a more reasonable estimated revenue growth of 4.6% was released by the State. Revenues no longer kept up with the State's expenditure growth, and now the State has an annual deficit of over \$500 million for both 2002 and 2003, or about \$1.1 billion in the State current biennial budget.



Despite the State's healthy revenue growth in the 1990's, the State never addressed its sizeable structural deficit in its general fund. This deficit consistently surpassed \$1 billion, or approximately 10% of the State's annual GPR budget. Deferring expenses to the next fiscal year caused the general fund deficit. Responsible fiscal management would have addressed the deficit before expanding programs. This deficit greatly limits the state's financial flexibility in dealing with their current budget problems.

**State Structural Budget Deficit  
(Unreserved Fund Balance)**

Fiscal Year		
1996	\$	(1,211,738)
1997		(1,771,729)
1998		(1,595,010)
1999		(1,229,946)
2000		(1,440,049)
2001		(1,588,872)

This general fund balance deficit was a major factor in the State's bond rating downgrade last year. Also, with no reserve funds, the current budget deficit has resulted in the State being put on credit watch with negative implications by Standard and Poors. The following excerpts from the State's credit reports provide a summary of the State financial conditions.

*"Wisconsin is working to eliminate a structural budget deficit over the 2001-2003 and 2003-2005 bienniums. The deficit accumulated over multiple bienniums due to multiple tax cuts, tax rebates, and the assumption of higher education funding. The tight budget situation is being made worse by the state's slowing economy." - Standard & Poors*

*"The state's current weakened financial condition is due to persistent structural budget imbalance and disappointing revenue growth, a problem made more severe by the state's tradition of maintaining only narrow cash balances and reserves" - Moodys*

## II. GOVERNOR McCALLUM'S BUDGET REFORM BILL

The shared revenue targeted under McCallum's proposal consists of four programs: county shared revenue, municipal shared revenue, the Expenditure Restraint Program, and the Small Municipal Shared Revenue Program. Statewide appropriations for shared revenue are approximately \$1 billion annually. The City receives \$248.1 million under municipal shared revenues and the Expenditure Restraint Program, approximately one-fourth of statewide appropriations for this purpose.

Under Governor McCallum's Budget Reform Bill, statewide appropriations for shared revenue will be reduced to approximately \$680 million in 2002 and 2003, and eliminated in 2004. In 2002 and 2003, shared revenue will be supported by borrowing funds from the State's tobacco settlement, rather than expending General Purpose Revenue; thereby reducing the amount of shared revenue supported by State taxes to \$0 both this year and 2003.

### SHARED REVENUE PROGRAM - BUDGET REFORM BILL

	2002	2003	2004
Total Shared Revenue	\$ 1,029,545,800	\$ 1,039,709,900	\$ 1,039,709,900
Proposed Reduction	(350,000,000)	(360,000,000)	(1,039,709,900)
Percent Reduction	-34.0%	-34.6%	-100.0%
Total Shared Revenue - Reform Bill	\$ 679,545,800	\$ 679,709,900	\$ -

Despite the State's fiscal problems, except for shared revenues the overall State funding for other programs is still increasing. Under Governor McCallum's Budget Reform Bill, shared revenues decline 35.8% annually from fiscal year 2001 through fiscal year 2003, while aids to schools increase by 3.5% annually and other State expenditures (net of aids to schools and municipalities) increase by 2.3% annually over the same period.

**GOVERNOR'S BUDGET REFORM BILL  
IMPACT ON FISCAL YEAR 2002 & 2003**

	2001	2003	Amount of Change 2001 - 2003	Average	Total
				% Change 2001 - 2003	% Change 2001 - 2003
Shared Revenue	\$ 1,019,223,600	\$ 289,223,600	\$ (730,000,000)	-35.8%	-71.6%
Aids to K-12 Schools	4,418,998,100	4,730,457,600	311,459,500	3.5%	7.0%
Other State General Fund Appropriations	5,690,878,300	5,950,918,800	260,040,500	2.3%	4.6%
State's General Fund Appropriations	<u>\$ 11,129,100,000</u>	<u>\$ 10,970,600,000</u>	<u>\$ (158,500,000)</u>	-0.7%	-1.4%

**III. IMPACT ON MILWAUKEE**

Governor McCallum's Budget Reform Bill has a significant impact on the City's revenues. Under the proposal, the City's shared revenue payment will be reduced by \$39 per capita in 2002, remain at the 2002 level in 2003 and be eliminated in 2004. In 2002, the reduction is \$23.3 million, or 9.4% of City shared revenues. Given that the 2003 shared revenue payment was scheduled to increase by 1% over the 2002 payment, the 2003 impact is \$25.6 million, or 10.2%, when compared to current law.

**SHARED REVENUE IMPACT ON MILWAUKEE**

	2002	2003	2004
Milwaukee Shared Revenue	\$ 248,120,000	\$ 250,501,400	\$ 250,501,400
Proposed Reduction	(23,275,000)	(25,656,400)	(250,501,400)
Percent Reduction	-9.4%	-10.2%	-100.0%
Total Shared Revenue - Reform Bill	<u>\$ 224,845,000</u>	<u>\$ 224,845,000</u>	<u>\$ -</u>

Governor McCallum's proposal also will have an impact on the City's credit rating. Standard and Poors has indicated that should the governor's proposal be under serious consideration at the time of issuance, the uncertainty created by the proposal could negatively impact the City's credit rating. S&P also indicated that it would likely establish a negative outlook on the City's current Aa rating or alternatively place the City on "Credit Watch" at the time the rating is issued. Should the Legislature pass the Governor's proposal as currently structured, S&P would likely downgrade the City's new

and existing debt to “junk bond” status. Fitch indicated it would likely place the City’s credit rating under a “Fitch Alert” with negative implications, if at the time of issuance the Governor’s proposal were still being actively considered by the Legislature.

Using the City’s 2002 budget as a basis for estimating the impact of Governor McCallum’s Budget Reform Bill when fully implemented, the amount of shared revenue lost by the City of Milwaukee will total \$248.1 million in 2004. This represents about a 46% reduction in City services. A cut of this magnitude will unquestionably leave the City with insufficient funds to pay its current obligations and provide its most basic services.

### Impact of State Budget Reform Bill on City of Milwaukee

		<u>Percentage of 2002 Budget</u>
Total Budget for 2002 (Excludes Special Revenue Funds)	\$ 769,568,873	
Borrowing	<u>(83,226,494)</u>	
Budget Supported by General City Revenues, State Aids & Property Taxes	686,342,379	
Less: Non-Discretionary Expenditures		
Debt Service	(113,987,651)	
Other	<u>(33,667,752)</u>	
Total Non-Discretionary 2002 Adjusted Budget	<u>(147,655,403)</u>	
Supported by General City Revenues, State Aids & Property Taxes	538,686,976	100%
Less: State Aids Loss by 2004	<u>(248,120,000)</u>	46% McCallum Cut
Total Adjusted Budget Available in 2004 Funded by General City Revenues, State Aids & Property Taxes	<u>\$ 290,566,976</u>	54% Revenue Remaining

- \* Excludes inflationary and other contractual obligations.
- \* Excludes impact of revenues decreases due to expenditure cuts.
- \* Excludes new fees, or increases to current fees .

#### IV. STATE - "THE BIG SPENDER"

Governor McCallum's dialogue often includes the reference to local governments as "big spenders." The table below clearly illustrates that this reference is intended to mislead rather than inform the public that he serves. From 1996 to 2001, the City's growth in expenditures has grown at an average annual rate of 2.4%, or 11.9% overall. These growth rates are approximately half of the growth rates for State operations (excluding school aid and shared revenue).

#### COMPARISON OF STATE AND CITY APPROPRIATIONS

	1996*	2000*	Average Annual % Change 1996 - 2001	Total % Change 1996 - 2001
State General Fund Appropriations				
Less School Aids and Shared Revenue	\$ 4,585,140,300	\$ 5,690,878,300	4.8%	24.1%
City General Fund Appropriations	\$ 403,029,600	\$ 450,924,000	2.4%	11.9%

\* State fiscal year July 1, 1996 to June 30, 1997 is compared to the City's January 1, 1996 to December 31, 1996 Budget

\* State fiscal year July 1, 2000 to June 30 2000 is compared to the City's January 1, 2000 to December 31, 2000 Budget

The Governor continuously says local governments only need to cut their budget by 4%. Applying this 4% approach to State government using the same methodology that the Governor used in estimating the 4% municipal budget reduction would reduce State expenditures by \$1.8 billion. This 4% budget cut would generate over \$700 million more than the amount needed to close the projected State budget shortfall. The State would have to cut only 2.3% to generate the required \$1.1 billion under the Governor's methodology.

#### V. ALTERNATIVE TO GOVERNOR McCALLUM'S BUDGET REFORM BILL

In attempting to find a starting point for resolving this issue, it would perhaps be constructive to review the various iterations, which the current state budget underwent. These iterations include: the Governor's Proposed Budget, the Joint Finance Committee Budget, the Senate Budget version; the Assembly Budget version, and Act 16 (Current Law). In addition, the cuts to state agencies identified under the Governor's Budget Reform Bill are also included in this alternative.

The one essential commonality which these various proposals share is that each was, at some point, approved by at least a committee of State policymakers as part of the budget deliberation process. Therefore, reviewing these various iterations, which were under

serious consideration and passed some level of scrutiny, and selecting the **LOWEST APPROPRIATION FOR EACH OPTION**, results in a \$923 million reduction to the State budget. The effects of this option are outlined below.

**GOVERNOR'S BUDGET REFORM BILL  
IMPACT ON FISCAL YEAR 2002 & 2003**

	Year 2001	Year 2003	Amount of Change 2001 - 2003	Average Annual % Change 2001 -2003	Total % Change 2001 - 2003
Shared Revenue	\$ 1,019,223,600	\$ 289,223,600	\$ (730,000,000)	-35.8%	-71.6%
Aids to K-12 Schools	4,418,998,100	4,730,457,600	311,459,500	3.5%	7.0%
Other State General Fund Appropriations	5,690,878,300	5,950,918,800	260,040,500	2.3%	4.6%
State's General Fund Appropriations	<u>\$ 11,129,100,000</u>	<u>\$ 10,970,600,000</u>	<u>\$ (158,500,000)</u>	-0.7%	-1.4%

**LOW APPROPRIATION OPTION  
IMPACT ON FISCAL YEAR 2002 & 2003**

	Year 2001	Year 2003	Amount of Change 2001 - 2003	Average Annual % Change 2001 -2003	Total % Change 2001 - 2003
Shared Revenue	\$ 1,019,223,600	\$ 1,015,520,000	\$ (3,703,600)	-0.2%	-0.4%
Aids to K-12 Schools	4,418,998,100	4,628,642,543	209,644,443	2.4%	4.7%
Other State General Fund Appropriations	5,690,878,300	5,326,437,457	(364,440,843)	-3.2%	-6.4%
State's General Fund Appropriations	<u>\$ 11,129,100,000</u>	<u>\$ 10,970,600,000</u>	<u>\$ (158,500,000)</u>	-0.7%	-1.4%

This starting point utilizes only those proposals which had been under serious consideration already, and while still decreases shared revenue somewhat, at least presents a rational and reasonable starting point for a constructive dialogue on how to equitably and fairly deal with the State's budgetary shortfall. I strongly feel that such a proposal should be considered.





# Summary of Total All Funds Appropriations by Agency

Agency	2001 - 03 Governor	2001 - 03 Jt. Finance	2001 - 03 Senate	2001 - 03 Assembly	2001 - 03 Act 16	Governor's Reform Bill	Low Appropriation Option
Military Affairs	110,682,200	109,327,000	110,095,200	109,137,100	108,858,200	107,577,800	107,577,800
Miscellaneous Appropriations	871,279,300	972,813,200	994,913,200	972,822,300	995,013,200	988,703,400	871,279,300
MN-WI Boundary Area Commission	393,000	393,000	393,000	-	892,596,500	888,285,300	888,285,300
Natural Resources	936,529,800	959,432,300	1,011,341,600	958,570,400	892,596,500	888,285,300	888,285,300
Personnel Commission	1,727,600	1,727,600	1,727,600	1,727,600	1,727,600	1,654,400	1,654,400
Program Supplements	91,309,000	100,638,400	103,594,000	103,969,100	102,969,100	102,023,500	91,309,000
Public Defender	126,642,100	131,010,000	131,010,000	131,010,000	127,742,100	127,539,600	126,642,100
Public Instruction	10,522,030,500	10,434,978,600	10,339,133,700	10,471,274,300	10,461,008,300	10,437,778,600	10,339,133,700
Public Service Commission	44,982,400	44,691,400	44,691,400	39,845,400	44,651,400	44,651,400	39,845,400
Regulation and Licensing	24,418,300	23,044,300	23,044,300	23,044,300	23,044,300	23,044,300	23,044,300
Revenue	311,974,300	310,045,800	310,045,800	-310,045,800	309,991,800	302,972,500	302,972,500
Secretary of State	1,408,200	1,408,200	1,408,200	1,408,200	1,408,200	1,408,200	1,408,200
Shared Revenue and Tax Relief	3,782,682,800	3,773,113,100	3,786,337,000	3,770,713,100	3,786,454,500	3,770,713,100	3,770,713,100
State Fair Park	35,816,700	35,566,800	35,566,800	35,566,800	35,566,800	35,566,800	35,566,800
State Treasurer	4,588,900	4,223,700	4,223,700	4,223,700	4,223,700	4,220,400	4,220,400
Supreme Court	47,989,900	47,451,800	48,865,100	47,650,400	47,658,600	47,062,400	47,062,400
TEACH Board	124,376,800	131,328,000	131,222,600	131,088,300	131,300,300	131,245,100	124,376,800
Tobacco Control Board	33,175,600	21,527,400	21,527,400	21,527,400	21,527,400	21,527,400	21,527,400
Tourism	32,205,500	31,918,700	31,918,700	32,013,200	31,908,200	31,908,200	31,908,200
Transportation	4,361,067,100	4,371,925,200	4,376,675,100	4,368,437,800	4,372,982,000	4,372,982,000	4,361,067,100
University of Wisconsin System	6,472,457,500	6,487,788,000	6,542,789,500	6,488,329,200	6,505,364,800	6,454,831,400	6,454,831,400
UW Hospitals and Clinics Board	162,247,000	162,247,000	162,247,000	162,247,000	162,247,000	162,247,000	162,247,000
Veterans Affairs	335,276,100	325,691,700	328,004,800	325,711,700	328,224,800	328,162,600	325,691,700
Technical College System	372,192,000	372,808,000	372,508,000	365,008,000	367,008,000	360,628,100	360,628,100
Workforce Development	2,288,937,100	2,452,425,200	2,460,166,200	2,451,917,700	2,453,629,700	2,451,639,500	2,288,937,100
DOA Adjustment of E-Government Transfer							100,646,500
<b>TOTAL</b>	<b>\$46,641,013,400</b>	<b>\$46,795,705,400</b>	<b>\$46,980,116,000</b>	<b>\$46,878,166,800</b>	<b>\$46,850,505,400</b>	<b>\$45,927,630,700</b>	<b>\$ (922,874,700)</b>

Change from Act 16 \$ (922,874,700)

Percent Change -2.0%