# Legislative Fiscal Bureau

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*State of Wisconsin*


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Representative Robin Vos, Assembly Chair
Senator Alberta Darling, Senate Chair
Joint Committee on Finance
State Capitol
Madison, WI 53702

Dear Representative Vos and Senator Darling:

Annually, this office prepares general fund revenue and expenditure projections for the Legislature prior to commencement of legislative deliberations on the state's budget.

In the odd-numbered years, our report includes estimated revenues and expenditures for the current fiscal year and tax collection projections for each year of the next biennium. This report presents the conclusions of our analysis.

**Comparison with the Administration's November 19/December 27, 2010, Reports**

**General Fund Tax Collection Projections**

On November 19, 2010, the Departments of Administration and Revenue submitted a report to the Governor, newly-elected Governor, and Legislature that identified revenue projections for the 2010-11 fiscal year and the 2011-13 biennium. That report, required by statute, identifies the magnitude of state agency biennial budget requests and presents a projection of general fund tax collections.

On December 27, 2010, the administration modified the November 19 report and presented a reestimate of general fund tax collections for 2010-11 and the two years of the 2011-13 biennium.

Our analysis indicates that for the three-year period, aggregate, general fund tax collections will be $202.8 million lower than those reflected in the November/December reports. More than half of the lower estimate ($117.2 million) is due to the impact of Special Session Senate Bill 2 (health savings accounts), Assembly Bill 3 (tax deductions/credits for relocated businesses), and Assembly Bill 7 (tax exclusion for new employees).

Compared with the administration's reports, tax collections are projected to be $12.9 million lower in 2010-11, $139.7 million lower in 2011-12, and $50.2 million lower in 2012-13.

**2010-11 General Fund Condition Statement**

Based upon the November/December reports, the administration's general fund condition statement for 2010-11 reflects a gross ending balance (June 30, 2011) of $67.4 million and a net balance (after consideration of the $65.0 million required statutory balance) of $2.4 million.

Our analysis indicates a general fund gross balance of $121.4 million and a net balance of $56.4 million. This is $54.0 million above that of the administration's reports. The 2010-11 general fund condition statement is shown in Table 1.

**TABLE 1**

**Estimated 2010-11 General Fund Condition Statement**

| | 2010-11 |
|---|---|
| **Revenues** | |
| Opening Balance, July 1 | $25,718,100 |
| Taxes | 12,691,400,000 |
| Departmental Revenues | |
| Tribal Gaming | 22,330,300 |
| Other | 833,733,300 |
| Total Available | $13,573,181,700 |
| **Appropriations** | |
| Gross Appropriations | $14,109,283,800 |
| Compensation Reserves | 95,962,700 |
| Biennial Appropriation Adjustment | -242,677,200 |
| Sum Sufficient Reestimates | -121,637,800 |
| Less Lapses | -389,112,600 |
| Net Appropriations | $13,451,818,900 |
| **Balances** | |
| Gross Balance | $121,362,800 |
| Less Required Statutory Balance | -65,000,000 |
| Net Balance, June 30 | $56,362,800 |

The factors that cause the $54.0 million difference between the administration's reports and our analysis are described below.

First, the 2010-11 opening balance (closing balance for 2009-10) is $25.7 million rather than the $71.0 million reported in the 2009-10 Annual Fiscal Report. This reduction of $45.3 million is based on the Legislative Audit Bureau's report of January 20, 2011, which indicated that certain 2009-10 transfers and expenditures were incorrectly recorded.

Second, the estimated tax collections of our analysis are $12.9 million below those of the November/December reports.

Third, departmental revenues (nontax receipts deposited in the general fund) are projected to be $20.7 million above those included in the administration's reports).

Fourth, sum sufficient appropriations are expected to expend $69.6 million less than is reflected in the November/December reports, primarily due to a reduction in debt service payments. The lower debt service amounts are the result of: (a) the deferral of additional general purpose revenue (GPR) principal amounts that would otherwise have been due in 2010-11; and (b) the application of bond premiums associated with recently issued general obligation bonds toward GPR debt service payments in 2010-11.

Finally, estimated appropriation lapses to the general fund are $21.9 million above those reflected in the administration's reports.

There are two items, not included in Table 1, which would reduce the general fund balance if payment is made in the 2010-11 fiscal year. Those items are discussed below.

*Minnesota/Wisconsin Income Tax Reciprocity Payment.* On September 18, 2009, Minnesota's Governor informed Wisconsin's Governor that Minnesota was terminating the two states' income tax reciprocity agreement as of tax year 2010 (beginning January 1, 2010). Therefore, the agreement last applied to tax year 2009. Because more individuals live in Wisconsin and earn income in Minnesota than live in Minnesota and earn income in Wisconsin, Wisconsin's estimated net payment to Minnesota due on December 1, 2010, for tax year 2009, was $58.7 million. In addition, under the agreement, interest is applied to late payments. The daily interest cost owed to Minnesota is $4,584. To date, these payments have not been made.

*Patients Compensation Fund.* On July 20, 2010, the State Supreme Court ruled that the state cannot transfer monies out of the Injured Patients and Families Compensation Fund (Fund). In the 2007-09 state budget, $200 million was transferred from the Fund to advantage the general fund. The Court remanded the case to the circuit court with directions that the $200 million, with lost earnings and interest, be placed in the Fund. To date, the circuit court has not established an amount or date of payment.

A status conference was scheduled to be held on January 24, 2011, regarding progress of the parties in coming to an agreement in calculating earnings and attorney fees pertaining to the Fund transfer. That conference was cancelled and has been rescheduled for March 21, 2011. Pending the outcome of the court directive, the state may be required to return some, or all, of the court-ordered amount to the Fund in 2010-11.

**2010-11 Appropriation Shortfalls**

There are some programs which are facing potential GPR shortfalls in the 2010-11 fiscal year.

*Medical Assistance.* It is estimated that an additional $153.2 million GPR will be required to fund medical assistance (MA) benefit costs through June 30, 2011. The projected shortfall is primarily due to MA enrollment costs and service costs exceeding Act 28 estimates.

The current estimate reflects a number of adjustments that have partially offset the shortfall, including the following: (a) federal legislation that extended, from December 31, 2010, to June 30, 2011, the period during which the state will receive an enhanced federal medical assistance percentage (FMAP); (b) the receipt of $23.1 million in federal "bonus payments" authorized under the Children's Health Insurance Program Reauthorization Act of 2009, for states that have simplified their enrollment and renewal processes; (c) $11.9 million in supplemental funding authorized by the Joint Committee on Finance at its December 14, 2010 meeting; and (d) $25.0 million in savings the state realized by making payments to managed care organizations in December, 2010, for services they will provide in January through April, 2011, in order to take advantage of the higher FMAP rates that applied prior to January 1, 2011.

The current estimate also reflects a reduction of $9.7 million in estimated GPR savings the MA program will generate under the Wisconsin Medicaid cost reporting (WIMCR) program in 2010-11, due to a change in the timing of payments the Department of Health Services will make to counties for certain MA-eligible services counties provide. This change is intended to address an issue raised by the Legislative Audit Bureau in a January 20, 2011, letter regarding certain 2009-10 expenditures that agencies charged to 2010-11 appropriations. Beginning in 2010-11, the costs of these payments will be charged to the fiscal year in which these payments are made.

In addition, the administration indicates that an additional $16.0 million GPR will be required in 2010-11 to support contracted administrative services for MA and other public assistance programs and an additional $5.0 million GPR will be required in 2010-11 to support income maintenance activities, including support for Milwaukee enrollment services.

*Public Defender, Private Bar Shortfall.* In December, 2010, the State Public Defender's shortfall was estimated at $8.9 million. After supplementation by the Joint Committee on Finance at its December 14, 2010, meeting, the remaining shortfall is projected at $3.5 million in 2010-11.

*Department of Corrections.* The Department of Corrections (DOC) is projecting an overall GPR funding shortfall of $21.7 million in 2010-11. According to the Department, the shortfall is associated with insufficient funding to address: (a) the 2% raise provided for represented staff in 2009; (b) fringe benefit expenditures, which are higher than the anticipated supplement amount; (c) non-salary institutional costs, including health care services and inmate supplies; and (d) increased limited-term-employee costs related to providing mental health services.

**General Fund Tax Revenues**

The following sections present information related to general fund tax revenues for 2010-11 and the 2011-13 biennium. The information provided includes a review of the economy in 2010, a summary of the national economic forecast for 2011 through 2013, and detailed general fund tax revenue projections for the current fiscal year and next biennium.

**Review of the National Economy in 2010**

In January, 2010, this office prepared updated revenue estimates for the 2009-11 biennium based on Global Insight, Inc.'s January, 2010, forecast for the U.S. economy. That forecast came in the wake of one of the worst economic downturns of the post-World War II era. Several measures of economic activity in 2009 indicate the recession's magnitude. Real (inflation-adjusted) GDP fell 2.6%, the largest annual decline since 1946. Investment in business equipment and software fell 15.7%. Residential construction spending fell 25.8%. By December, 2009, total nonfarm payrolls were nearly 8.4 million below their pre-recession peak.

At the time Global Insight issued its January, 2010, forecast, however, the economy was receiving a lift from several corners. The first was a turn in the inventory cycle. As final sales fell during the recession, businesses responded by paring inventories. Less call for inventory, in turn, contributed to falling output. That cycle started to reverse itself in late 2009, and in so doing helped stem the economy's slide. The second was the fiscal stimulus supplied through the American Recovery and Reinvestment Act of 2009. Together, they helped real GDP grow at an annual rate of 5.0% in the final quarter of 2009. Heading into 2010, Global Insight expected those two factors (inventory rebuilding and fiscal stimulus) to have a positive but diminishing impact as the year wore on. The question, therefore, was whether other forces could sustain the recovery in 2010 and beyond.

In its January, 2010, forecast, Global Insight identified a number of factors it believed would help support what was likely to be a "subpar" recovery. Those factors included increased investment in business equipment and software, a rebound in manufacturing activity, and modest improvements in consumer spending and the residential housing sector. On balance, Global Insight expected real GDP to grow by 2.6% in 2010.

As anticipated, business investment spurred by the inventory cycle contributed to relatively strong growth in the first quarter of 2010. By late summer, however, Global Insight began scaling back its near-term projections for the U.S. economy as the pace of recovery slowed. Part of that deceleration was expected due to the waning impact of inventory restocking and the fiscal stimulus. Consumer spending was also weaker than projected as households continued to struggle with high unemployment, diminished household wealth, and tight credit conditions. In addition, as individuals worked to improve their personal balance sheets, the household savings rate approached 6.0% (comparable rates from 2005 through 2007 were 1.4%, 2.4%, and 2.1%). While Global Insight believed this so-called "epidemic of thrift" could help foster more sustainable growth in the future, its near-term effect was to limit consumer spending.

Depressed conditions in the housing sector also contributed to the slow recovery, as low mortgage rates and a second homebuyers' tax credit could not overcome the twin drags caused by the large overhang of unsold homes and high foreclosure rates. Adding to the weakness was a very low rate of household formation. From March, 2009, through March, 2010, the number of U.S. households rose by 357,000. That was the smallest increase on record, and only about 25% of the average rate of household formation that occurred from 2002 through 2007. These developments forced Global Insight to repeatedly dial back its expectations for a recovery in the housing sector. For example, Global Insight's January, 2010, forecast expected there to be

792,000 housing starts in 2010 and 1,243,000 housing starts in 2011. By year-end, those estimates had been lowered by 25.5% and 44.9%, respectively.

The U.S. Federal Reserve also noted the economy's mid-year slump. In its September, 2010, summary of current economic conditions, the Fed reported "widespread signs of deceleration compared with preceding periods." It reiterated those concerns in a November press release that identified high unemployment, modest income growth, tight credit, lower housing wealth, and depressed levels of investment in residential and nonresidential structures as factors contributing to the economy's slow recovery.

That same November press release announced the Fed's plans to purchase $600 billion in longer-term U.S. Treasury securities by the end of the second quarter of 2011. This signaled the Fed's second use of a strategy called "quantitative easing." Under quantitative easing, the Fed uses newly created money to purchase assets (in this case, U.S. Treasury securities) in the expectation that by so doing, interest rates on those securities will fall, thereby promoting lower borrowing costs throughout the economy. Central banks use quantitative easing to encourage growth after they have already cut short-term interest rates to very low levels. That situation currently holds in the U.S., where the Fed has kept the federal funds rate near 0% since December, 2008. Critics of quantitative easing argue that by increasing the money supply, the strategy will eventually trigger high inflation. The Fed's November announcement, however, expressed few concerns in that regard ("measures of underlying inflation have trended lower in recent quarters"), emphasizing instead that its immediate focus was to "promote a stronger pace of economic recovery." The policy and views expressed in the November release have been reiterated in more recent announcements by the Fed.

In its most recent update, Global Insight believes the recovery regained its footing in the final months of 2010, with real GDP estimated to have grown at an annual rate of 3.2% in the fourth quarter (the second and third quarter rates were 1.7% and 2.6%, respectively). For the full year, real GDP is thought to have increased by 2.9%. While this marked a dramatic improvement from the preceding 18 months, it was comparatively weak for the first year following a major recession. Furthermore, at year-end 2010, the recovery had made relatively limited headway in replacing the millions of jobs lost during the downturn.

**National Economic Forecast**

Global Insight's January, 2011, forecast reflects an improved near-term outlook for the U.S. economy. That view is based on what it believes were some positive developments in late 2010, including a relatively strong holiday retail sales season. The improved forecast also reflects the anticipated fiscal stimulus provided by the Tax Relief, Unemployment Insurance, and Job Creation Act of 2010 ("Tax Relief Act of 2010"). In broader terms, Global Insight now sees a collection of trends (improved hiring, better consumer confidence, strong investment in business equipment and software, and a bottoming-out in residential and nonresidential construction) as laying the groundwork for a self-sustaining recovery, one that is less dependent on the inventory cycle, and more reliant on final demand.

As indicated, one reason Global Insight upped its latest forecast was passage of the Tax Relief Act of 2010. That legislation contains a number of provisions intended to boost near-term economic activity, including the following: (a) a two-year extension of current income tax rates; (b) a two percentage point reduction in the Social Security payroll tax for employees (from 6.2% to 4.2%) in 2011; (c) 100% depreciation (full expensing) on qualified assets purchased and placed in service between September 8, 2010, and December 31, 2011, and 50% bonus depreciation on qualified assets placed in service in 2012; and (d) a 13-month extension of federal unemployment benefits.

Global Insight's latest forecast is also based on what it terms the following key assumptions. First, federal spending will moderate, with real defense spending growing by 0.6% in 2011, but falling the next two years (-5.0% in 2012 and -4.0% in 2013), and non-defense spending virtually flat throughout that period. Second, the price of oil will average $88 a barrel in 2011, $95 a barrel in 2012, and $99 a barrel in 2013, up from 2010's average price of $79.50 a barrel. Third, the Federal Reserve will complete its $600 billion quantitative easing program, and it will keep the federal funds rate near 0% until March, 2012 (at which time it will begin tightening monetary policy). Fourth, the value of the U.S. dollar will not change significantly against most other currencies in 2011, except for a 4.7% slide relative to the Chinese renminbi. Finally, global economic growth will moderate in 2011, with 1.9% real GDP growth among America's major-currency trading partners, and 4.9% real GDP growth among its important trading partners. These assumptions are incorporated in the following indicators taken from Global Insight's January, 2011, baseline forecast for the U.S. economy.

*GDP*. It is estimated that real GDP grew by 2.9% in 2010 as a mid-year lull gave way to improved conditions late in the year. Global Insight expects real GDP to grow by 3.2% in 2011, but for that growth to moderate somewhat in 2012 (+2.9%) as the fiscal stimulus from the Tax Relief Act of 2010 diminishes. In 2013, real GDP is projected to grow by 3.1%. Nominal (current-dollar) GDP is expected to track a similar course, growing by 4.3% in 2011, followed by 4.1% and 4.7% increases in 2012 and 2013.

*Consumer Prices*. Excess productive capacity kept inflation low in 2010, as the consumer price index (CPI) increased by 1.7%. Global Insight expects that trend to continue throughout the term of its latest near-term forecast, with the CPI increasing by 1.6% in 2011, by 1.9% in 2012, and by 2.0% in 2013. Core CPI, which excludes the more volatile food and energy costs, rose by only 1.0% in 2010. That trend is also expected to continue, with projected annual increases in the core CPI of 1.2% in 2011, 1.7% in 2012, and 1.9% in 2013.

*Monetary Policy*. Given the current low-inflation environment, the Federal Reserve has elected to maintain a very accommodative monetary policy, one characterized by extremely low short-term interest rates and multiple installments of quantitative easing. That stance was recently re-affirmed at the Federal Open Market Committee's December 14, 2010, meeting, where the FOMC voted to retain policy language declaring that "low rates of resource utilization, subdued inflation trends, and stable inflation expectations, are likely to warrant exceptionally low levels for the federal funds rate for an extended period."

Global Insight's latest forecast does not expect the Federal Reserve to begin raising short-term interest rates until March, 2012. The forecast also expects other benchmark interest rates to be relatively unchanged in 2011, with the yield on the 10-year U.S. Treasury averaging 3.28% (up from 3.21% in 2010) and rates for a 30-year conventional fixed mortgage averaging 4.73%

(up from 4.69% in 2010). Thereafter, modest increases in 2012 (3.53% on the 10-year Treasury and 4.99% for a 30-year fixed conventional mortgage) give way to bigger increases in 2013, when yields on the 10-year Treasury are expected to average 4.63% and the interest rate for a 30-year conventional fixed mortgage loan is expected to average 6.1%.

*Personal Consumption Expenditures*. Nominal personal consumption expenditures rose by an estimated 3.5% in 2010. Sales of items that are generally subject to the sales tax (durable goods, clothing, restaurant meals and accommodations, and other taxable nondurable goods and services) grew by 4.3%, while sales of nontaxable items (food for home consumption, gasoline and heating fuel, and most services) grew more slowly (+3.1%). Spending on consumer durables was particularly strong, with growth of 6.2%. In 2011, total consumer spending is projected to increase by 4.5%, boosted by the two percentage point reduction in payroll taxes included as part of the Tax Relief Act of 2010. Growth is expected to moderate in 2012 (+4.1%) and 2013 (+3.6%) as the fiscal stimulus wanes. Spending on durable goods should outpace other major categories throughout the period, as pent-up demand helps drive more big-ticket purchases. This is especially true for light vehicle sales, which Global Insight expects to increase by 1.6 million units (+14.0%) in 2011, 1.8 million units (+13.7%) in 2012, and 1.1 million units (+7.2%) in 2013.

*Personal Income*. Personal income grew by an estimated 3.0% in 2010, following a 1.7% decline the previous year. Looking ahead, Global Insight calls for personal income to grow by 4.9% in 2011, with much of that gain attributable to private sector wages and salaries. Government wage and salary disbursements are also expected to show positive growth, but at much lower rates than in the private sector. Similar trends are expected to generate personal income gains of 3.3% in 2012 and 4.6% in 2013.

*Employment*. Full-year results in the employment market were disappointing, as the national unemployment rate averaged 9.7% in 2010, and total nonfarm payrolls closed the year still down more than seven million from their pre-recession peak. While near-term progress is expected to remain slow, some trends offer encouragement. For instance, private sector payrolls in the fourth quarter of 2010 were nearly 1.2 million higher than in the fourth quarter of 2009. Going forward, Global Insight expects private sector payrolls to grow by 2.1 million in 2011, 2.6 million in 2012, and 2.5 million in 2013.

Projected cutbacks in the number of public sector employees, however, are expected to partially offset those private sector gains. In 2010, the number of state and local government employees fell by an estimated 208,000 positions. In 2011, those cutbacks are expected to total an additional 150,000 positions. And while state and local government payrolls are expected to bounce back in 2012 and 2013, the number of federal employees is projected to decline during each year of the near-term forecast.

Overall, total nonfarm payrolls are not expected to return to pre-recession levels until late 2013. Moreover, with new entrants joining the workforce throughout that period, the nation's unemployment rate is projected to average 9.3% in 2011, 8.7% in 2012, and 8.1% in 2013, all of which would be well above pre-recession levels.

*Housing*. Despite record-low mortgage rates much of the year, and a second homebuyers' tax credit that expired at the end of April, the housing market remained depressed in 2010. At 590,000 units, the number of housing starts increased by 6.5% in 2010, but was still 70% lower than the 2005 peak. Prices of existing homes stabilized in 2010, but they too remained well below the previous high (28.7% below, according to the January, 2011, S&P/Case-Shiller home price national index). Sales of existing homes fell 5.6%.

Global Insight expects mixed results for the housing market in 2011. Housing starts are projected to increase by 16.1%, but existing home sales and the median price of an existing house are both expected to register marginal declines. A more robust recovery is expected in 2012, with strong gains projected for housing starts (+59.4%), sales of existing homes (+17.1%), and an uptick in the median price of existing homes (+2.1%).

*Corporate Profits*. Before tax profits (+28.6%) and economic profits (+39.1%) both surged in 2010 as a result of continued corporate cost-cutting, productivity gains, and a strong recovery in the financial sector's earnings. Global Insight expects the rate of increase in corporate profits to moderate during the period of its near-term forecast, with economic profits growing by 1.8% in 2011, 0.8% in 2012, and 2.7% in 2013. Before tax book profits are expected to show a significant decline in 2011, low growth in 2012, and a significant increase in 2013. However, these trends are due primarily to the expensing and depreciation changes in the Tax Relief Act of 2010.

*Business Investment*. The two major categories of business investment took divergent paths in 2010. Investment in business equipment and software (nearly 60% of which relates to information processing) rebounded sharply from the year before, and was in fact one of the principal areas of strength in the U.S. economy. Measured in current dollars, investment in business equipment and software increased 12.6% in 2010, as strong corporate balance sheets and gradually improving business conditions fueled demand for new equipment. Aided by the depreciation incentives in the Tax Relief Act of 2010, this growth is expected to continue in 2011 and 2012, with annual gains of 15.1% and 9.8%, respectively.

Investment in nonresidential structures, on the other hand, fell 15.8% in 2010, and that decline was preceded by a 22.5% decline in 2009. As a result, this relatively small component of the national economy subtracted 0.8% from real GDP growth in 2009 and 0.5% in 2010. Previous overbuilding, tight credit conditions, high vacancy rates, and falling commercial real estate prices have all contributed to the declines. Going forward, Global Insight expects conditions to finally bottom out in late 2011, but no significant improvements to occur until 2013. In current dollars, Global Insight expects investment in nonresidential structures to fall an additional 5.5% in 2011, followed by a 1.4% gain in 2012 and a 15.4% increase in 2013.

*International Trade*. In 2009, sharply lower oil prices were responsible for a big improvement in the U.S. trade deficit. In 2010, the trade deficit grew as oil prices rebounded and U.S. industry imported materials to rebuild inventories. Global Insight's near-term forecast expects the balance of trade to gradually improve in the coming years, as increasing demand from the emerging economies causes U.S. exports to grow more rapidly than U.S. imports. In nominal terms, the dollar value of exported goods and services is projected to increase by 11.4% in 2011, 9.4% in 2012, and 9.5% in 2013. The dollar value of imported goods and services is projected to increase during those same three years by 10.3%, 7.9% and 6.2%, respectively. Looking out a bit further, Global Insight believes these trends will continue, and that an improved balance of trade will add to real GDP growth throughout the upcoming decade.

The figures in Table 2 summarize Global Insight's baseline forecast for the U.S. economy.

**TABLE 2**

**Summary of National Economic Indicators**
**IHS Global Insight, Inc., Baseline Forecast, January, 2011**
**($ in Billions)**

| | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|
| Nominal Gross Domestic Product | $14,661.6 | $15,298.9 | $15,932.3 | $16,679.3 |
| Percent Change | 3.8% | 4.3% | 4.1% | 4.7% |
| Real Gross Domestic Product | $13,253.0 | $13,673.2 | $14,064.9 | $14,499.7 |
| Percent Change | 2.9% | 3.2% | 2.9% | 3.1% |
| Consumer Prices (Percent Change) | 1.7% | 1.6% | 1.9% | 2.0% |
| Personal Income | $12,542.9 | $13,162.0 | $13,598.3 | $14,229.3 |
| Percent Change | 3.0% | 4.9% | 3.3% | 4.6% |
| Personal Consumption Expenditures | $10,351.6 | $10,820.8 | $11,266.9 | $11,671.6 |
| Percent Change | 3.5% | 4.5% | 4.1% | 3.6% |
| Economic Profits | $1,617.4 | $1,646.8 | $1,659.7 | $1,704.2 |
| Percent Change | 28.6% | 1.8% | 0.8% | 2.7% |
| Unemployment Rate | 9.7% | 9.3% | 8.7% | 8.1% |
| Total Nonfarm Payrolls (millions) | 130.25 | 132.05 | 134.72 | 137.48 |
| Percent Change | -0.5% | 1.4% | 2.0% | 2.0% |
| Light Vehicle Sales (millions) | 11.52 | 13.13 | 14.93 | 16.01 |
| Percent Change | 10.8% | 14.0% | 13.7% | 7.2% |
| Housing Starts (millions) | 0.590 | 0.685 | 1.092 | 1.435 |
| Percent Change | 6.5% | 16.1% | 59.4% | 31.4% |

Global Insight's monthly forecasts also include an optimistic scenario and a pessimistic scenario. The January, 2011, forecast assigns a 20% probability to the former. Under that optimistic scenario, economic growth is stronger across the board compared to the baseline forecast, as stimulus from the Tax Relief Act of 2010 combines with growing private sector confidence to generate stronger recoveries in consumer spending and business investment. Under this scenario, real GDP grows by 4.4% in 2011, 3.9% in 2012, and 3.5% in 2013. The unemployment rate improves more quickly than it does in the baseline forecast, while both inflation and interest rates are higher than in the baseline forecast.

Under the pessimistic scenario (assigned a 15% probability), elements of the financial crisis re-intensify, causing the U.S. economy to slip back into recession in the second half of 2011. Tight credit conditions and deteriorating conditions in the housing market undermine consumer spending, as does high unemployment. Internationally, ongoing sovereign debt concerns and fiscal austerity measures suppress Euro-zone growth and trigger a "flight to safety" that pushes the U.S. dollar higher, in turn hurting U.S. exports. Under the pessimistic scenario, real GDP growth (1.5% in 2011, 1.4% in 2012, and 2.6% in 2013) is significantly lower than it is under the baseline scenario, and unemployment is significantly higher. Inflation and interest rates are lower than they are in the baseline forecast.

**General Fund Taxes**

Table 3 shows general fund tax revenue estimates for 2010-11 and each year of the 2011-13 biennium. Over the three years, these estimates are $202.8 million lower than the projections released by the Department of Revenue (DOR) at the end of December (-$12.9 million in 2010-11, -$139.7 million in 2011-12, and -$50.2 million in 2012-13).

Our estimates include the impacts of all law changes enacted in prior years and three of the January 2011 Special Session bills: (a) SS SB 2, which federalizes the treatment of health savings accounts; (b) SS AB 3, which would create an income and franchise tax deduction or credit for businesses that relocate to Wisconsin; and (c) SS AB 7, which would create an income and franchise tax deduction for businesses that increase employment in the state. SS SB 2 has been enacted into law as 2011 Act 1. The other two bills have passed both Houses of the Legislature, and the Governor has indicated that he will sign them. It is estimated that, together, these three bills will reduce general fund tax collections by $55.2 million in 2011-12 and $62.0 million in 2012-13. DOR's numbers were released prior to the introduction of these bills, and do not include their fiscal effects. If the impacts of the Special Session bills are considered, the difference between DOR's December estimates and our projections falls from $202.8 million to $85.6 million, which is a variance of -0.2%. Our estimates are slightly lower than DOR's for most of the tax sources.

In addition to law changes, the estimates reflect several other factors, including the termination of the Minnesota/Wisconsin income tax reciprocity agreement in tax year 2010, a significant reduction in the amount of sales tax refunds paid as a result of the July, 2008, Menasha Corporation decision, and a recent corporate income tax settlement.

**TABLE 3**

**Projected General Fund Tax Collections**
**(Millions)**

| | 2009-11 Biennium | | 2011-13 Biennium | |
|---|---|---|---|---|
| | 2009-10 Actual | 2010-11 Estimated | 2011-12 Estimated | 2012-13 Estimated |
| Individual Income | $6,089.2 | $6,350.0 | $6,650.0 | $7,000.0 |
| Sales and Use | 3,944.2 | 4,150.0 | 4,350.0 | 4,485.0 |
| Corporate Income & Franchise | 834.5 | 935.0 | 900.0 | 925.0 |
| Public Utility | 319.4 | 339.5 | 344.6 | 352.6 |
| Excise | | | | |
| Cigarettes | 644.3 | 620.0 | 615.0 | 610.0 |
| Tobacco Products | 59.9 | 64.0 | 66.5 | 69.0 |
| Liquor and Wine | 44.2 | 45.4 | 46.4 | 47.5 |
| Beer | 9.6 | 9.5 | 9.5 | 9.5 |
| Insurance Company | 130.7 | 132.0 | 133.3 | 134.6 |
| Miscellaneous Taxes | 55.8 | 46.0 | 49.0 | 57.0 |
| Total | $12,131.7 | $12,691.4 | $13,164.3 | $13,690.2 |
| Change from Prior Year | | $559.7 | $472.9 | $525.9 |
| Percent Change | | 4.6% | 3.7% | 4.0% |

**Individual Income Tax.** Individual income tax revenues are estimated to total $6,350.0 million in 2010-11, which represents a 4.3% increase relative to income tax collections in 2009-10 of $6,089.2 million. Individual income tax revenues are estimated at $6,650.0 million in 2011-12 and $7,000.0 million in 2012-13. These amounts represent increases of 4.7% in the first year and 5.3% in the second year. The estimates are based on current collections data, the economic forecast, and assumptions about taxable personal income growth, as well as law changes.

The January, 2011, Global Insight forecast projects national personal income growth of 3.0% in 2010, 4.9% in 2011, and 3.3% in 2012. However, personal income includes both taxable components, such as wage and salary disbursements, and nontaxable components, such as employer contributions for employee fringe benefits and government transfer payments to individuals. The taxable components of personal income are estimated to increase by 2.0% in 2010, 4.4% in 2011, and 4.7% in 2012. Personal income, as measured by the U.S. Bureau of Economic Analysis, does not include income from capital gains realizations. The tax revenue estimates include a significant upward adjustment in the amount of income tax paid on capital gains to reflect recent increases in asset markets.

A number of law changes are scheduled to take effect in 2011, and they are reflected in the revenue estimates. These include continuing the phase-in of the deductions for health insurance premiums paid by employees whose employer pays some portion of their health insurance costs, medical insurance premiums paid by an individual who has neither an employer nor self-employment income, and child and dependent care expenses. These deductions were enacted prior to the 2009-10 legislative session, but 2009 Wisconsin Act 28 suspended their phase-in until 2011. Act 28 also created a capital gains deferral for investments in qualified new business ventures, beginning in 2011, and expanded the contributions that can be made to college savings (Section 529) plans. Also, Wisconsin's tax treatment of contributions to individual retirement accounts and pension and retirement plans was federalized in 2009 Wisconsin Act 161. Finally, the estimates reflect the estimated effects of the passage of 2011 Special Session bills SB 2, relating to health savings accounts, and AB 7, relating to tax credits for small businesses. These and other law changes are estimated to reduce individual income tax collections by more than $100 million per year during the biennium.

In September 2009, Minnesota Governor Tim Pawlenty informed Governor Doyle that the Minnesota Commissioner of Revenue was exercising his authority to discontinue the two states' income tax reciprocity agreement as of tax year 2010. This has affected the Wisconsin budget in two ways. First, beginning in 2010, Minnesota employers discontinued making withholding payments to Wisconsin on behalf of their employees who are Wisconsin residents, and Wisconsin employers began making withholding payments to Wisconsin on behalf of their employees who are Minnesota residents. Beginning with the 2010 tax filing season, Wisconsin will receive tax returns from Minnesota residents who work in Wisconsin, and Wisconsin residents who work in Minnesota will receive an income tax credit on their Wisconsin returns for income taxes paid to Minnesota. Because there are more Wisconsin residents working in Minnesota than vice versa, withholding and income tax payments to Wisconsin will experience a net reduction. These withholding and tax return changes will cause Wisconsin income tax collections to be lower by about $60 million annually. The second effect due to the cancellation of reciprocity is the elimination of Wisconsin's reciprocity payment to Minnesota, also estimated at about $60 million. The net effect of cancellation on Wisconsin's general fund is that revenue decreases will be offset by spending reductions. However, as previously noted, Wisconsin has not yet made its final reciprocity payment to Minnesota for tax year 2009, even though the payment became due on December 1, 2010.

In addition to recent law changes, anticipated growth in individual income tax revenues is influenced by the effect of the annual indexing adjustments made to the sliding scale standard deduction and the tax brackets. The indexing adjustments for a given tax year are based on the annual percentage change in the Consumer Price Index as of the month of August of the year prior to the tax year. The CPI amount for August of 2009 was below the amount for August of 2008, triggering negative adjustments for the standard deduction and the tax brackets in tax year 2010. A provision in Act 28 prohibits negative adjustments in future years, beginning with tax year 2012. The indexing adjustment for 2011 is 1.1%, and annual adjustments of about 2.0% are estimated for tax years 2012 and 2013.

**General Sales and Use Tax.** State sales and use tax revenues totaled $3,944.2 million in 2009-10 and are estimated at $4,150.0 million for 2010-11. The estimate represents an increase of 5.2% over the prior year. Sales tax revenues in the next biennium are estimated at $4,350.0 million in 2011-12 and $4,485.0 million in 2012-13, reflecting growth of 4.8% and 3.1%, respectively.

Sales tax collections through December, 2010, are 5.1% higher than the same period in 2009. If the impact of refunds paid in accordance with the Menasha Corporation decision, law changes, and accounting adjustments are accounted for, the adjusted year-to-date growth rate is 3.3%. The projections reflect year-to-date collections, forecasts for growth in taxable personal consumption expenditures, modifications to account for law changes that expanded the tax base, law changes that enhanced collection of the tax, and certain new sales tax exemptions. As noted, these estimates also account for the refunds paid pursuant to the July, 2008, State Supreme Court decision in Wisconsin Department of Revenue v. Menasha Corporation, which expanded the types of computer software that were exempt from the sales tax (the types of computer software that were determined to be exempt in this decision became taxable under 2009 Wisconsin Act 2). Actual refunds paid were $10.2 million in 2008-09 and $26.8 million in 2009-10, and are estimated at $6 million for 2010-11, $2 million for 2011-12, and $1 million for 2012-13.

**Corporate Income/Franchise Tax.** Corporate/franchise taxes are estimated to increase from $834.5 million in 2009-10 to $935.0 million in 2010-11. Collections are forecast to decrease to $900.0 million in 2011-12, and then increase to $925 million in 2012-13. Although the estimates show a somewhat erratic pattern, with a 12% increase in 2010-11, a 3.7% decrease in 2011-12, and then a 2.8% increase in 2012-13, the underlying base estimates (minus a one-time settlement and adjustments for tax law changes) have an average annual growth rate of about 3.5%.

The estimate for 2010-11 reflects year-to-date corporate income/franchise tax collections. Through December 2010, collections were over 10% higher than for the same period in 2009. However, monthly collections were lower in October and December, potentially indicating a slowing of the annual growth rate for fiscal year 2010-11. The 2010-11 estimate includes a large one-time tax settlement amount. The estimates also have been adjusted to reflect the impact of corporate income/franchise tax law changes enacted during the 2009-11 biennium, including combined reporting, use of 100% of throwback sales in the apportionment formula, repeal of the domestic production activities income deduction, and enactment of a number of tax credits, such as the economic development and super research and development tax credits. Further, the estimates reflect tax law changes enacted in the January 2011 Special Session, including the relocated business tax credit and income exclusion for increased employment.

Corporate income/franchise tax collections for 2011-12 and 2012-13 reflect projected increases in consumer demand, export growth, and business purchases of capital goods, which lead to increased corporate output and business income. After a large increase in 2010, corporate economic profits are projected to increase moderately in each year between 2011 and 2013 under the forecast.

**Public Utility Taxes.** Public utility taxes are estimated to be $339.5 million in 2010-11, $344.6 million in 2011-12, and $352.6 million in 2012-13. These estimates represent year-to-year increases of 6.3% in 2010-11, 1.5% in 2011-12, and 2.3% in 2012-13. The gross revenues tax group comprises about 70% of estimated collections over the three-year period, and private light, heat, and power companies are the largest taxpayer group among the gross revenues taxpayers. Utility tax collections from private light, heat, and power companies declined between 2008-09 and 2009-10, largely due to the effect of the economic downturn. As the economy recovers, tax collections from these companies are estimated to increase, and this taxpayer group accounts for 58% of the estimated increase in total public utility tax collections. Collections from gross revenues taxpayers are estimated to increase by 7.0% in 2010-11, decrease by 0.7% in

2011-12, and increase by 2.0% in 2012-13, while increases of 4.8% in 2010-11, 6.8% in 2011-12, and 3.0% in 2012-13 are estimated for the ad valorem taxpayer group. Increases in the statewide average property tax rate are responsible for much of the increase in ad valorem taxes.

**Excise Tax Revenues.** General fund excise taxes are imposed on cigarettes, liquor (including wine and hard cider), tobacco products, and beer. In 2009-10, excise tax collections totaled $758.0 million. Of this amount, $644.3 million (approximately 85%) was from the excise tax on cigarettes. Excise tax revenues are estimated at $738.9 million in 2010-11, which represents reduced revenue of 2.5%. The estimated reduction in excise tax revenues in 2010-11 compared to the prior year is primarily due to the one-time revenue increase of $15.4 million in 2009-10 from the floor tax on cigarettes, as well as reduced cigarette tax revenue resulting from the statewide indoor smoking ban, which became effective July 5, 2010, pursuant to 2009 Act 12. Excise tax revenues over the next biennium are estimated at $737.4 million in 2011-12 and $736.0 million in 2012-13, which reflects reduced revenue of 0.2% in 2011-12 and 2012-13.

**Insurance Premiums Taxes.** Insurance premiums taxes are projected to increase slightly from $130.7 million in 2009-10, to $132.0 million in 2010-11, $133.3 million in 2011-12, and $134.6 million in 2012-13. The estimate for 2010-11 is based on year-to-date premiums tax collections, which show minimal growth. Collections through December, 2010, were slightly over 1% higher than for the same period in 2009-10. Estimates for 2011-12 and 2012-13 reflect a similar increase over the forecast period. The demand for insurance products is projected to increase moderately as the economy improves. Increasing automobile sales are expected to be reflected in auto insurance sales, while health insurance premiums are projected to rebound from relatively low 2009 levels. However, sales are expected to be constrained by high unemployment, and shrinking of some market segments, such as life insurance consumers aged 35 to 50 years old.

**Miscellaneous Taxes.** Miscellaneous taxes include the real estate transfer fee, municipal and circuit court-related fees, and a small amount from the occupational tax on coal. Miscellaneous tax revenues were $55.8 million in 2009-10, of which 79% was generated through the real estate transfer fee. Based on the economic forecast for the housing sector, as well as collections through December, 2010, miscellaneous taxes are projected to decrease to $46.0 million in 2010-11 (which represents a 17.6% decrease from 2009-10 collections). As the housing sector recovers, miscellaneous taxes are estimated to increase to $49.0 million in 2011-12 and to $57.0 million in 2012-13.

We will continue to monitor economic forecasts, tax collections, other revenues, and expenditures and keep you informed of any modifications that may be necessary.

Sincerely,

Bob

Robert Wm. Lang
Director

RWL/sas
cc: Members, Wisconsin Legislature