THE WISCONSIN
TAXPAYER

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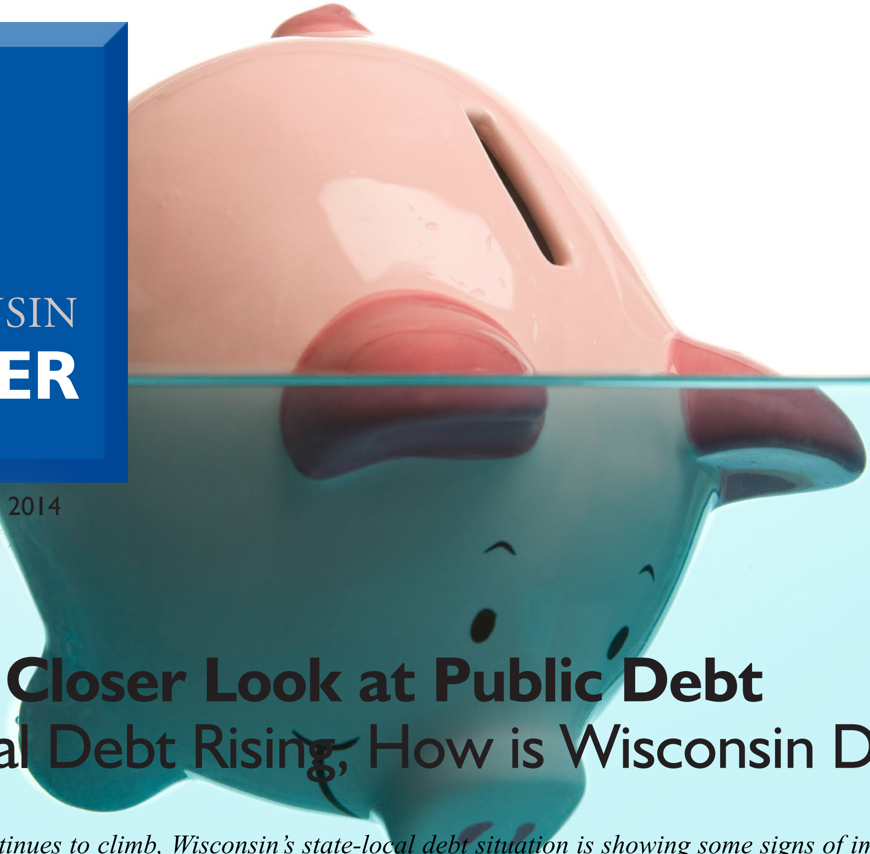

A Closer Look at Public Debt
With Federal Debt Rising, How is Wisconsin Doing?

While federal debt continues to climb, Wisconsin's state-local debt situation is showing some signs of improvement. Combined state-local debt grew 0.3% in 2013, its smallest increase since 2008. State debt here totaled $13.7 billion, up 1.6% from 2012. Local debt fell 1.0% to $13.7 billion, its second consecutive decline. School, county, village, and town debt all declined last year.

During the last recession, debt at the federal, state, and local levels rose. Gross federal debt increased at an average annual rate of 13.7% during 2008-10. Although the increase was less and the timing slightly different, Wisconsin state debt also rose, growing 7.2% in both 2010 and 2011. And, after declining early in the recession, local general obligation debt was up 5.3% here in 2010.

As many Americans learned in recent years, borrowing is not risk-free. Done to excess, it leads to burdensome debt service payments. A slowdown in borrowing is a welcome sign for governments, taxpayers, and those who depend on public services.

In the years since the downturn, as the economy recovered, debt growth slowed and, for some Wisconsin governments, even declined. While cumulative federal debt continues to climb, and economists warn of further increases in the coming years, Wisconsin's state-local debt situation is moderating.

Federal debt held by the public totaled nearly $12 trillion in 2013, equal to 72.1% of gross domestic product (GDP). The Congressional Budget Office projects it will surpass $20 trillion by 2024 and exceed 100% of national output by 2036. U.S. debt increases did slow from 8.7% in 2012 to 4.2% in 2013; however, they are expected to accelerate in years to come.

Meanwhile, in Wisconsin, a consistent decline in debt growth offers hope. State debt rose 1.6% in 2013, and total local debt declined in each of the past two years. Municipal, school, and county debt all fell last year.

PUBLIC DEBT OVERVIEW

Uses of Debt

Traditionally, state and local governments have borrowed to fund construction projects. Buildings, bridges, roads, sewers, and environmental cleanup are all expensive projects that state and local governments often cannot afford to pay for all at once.

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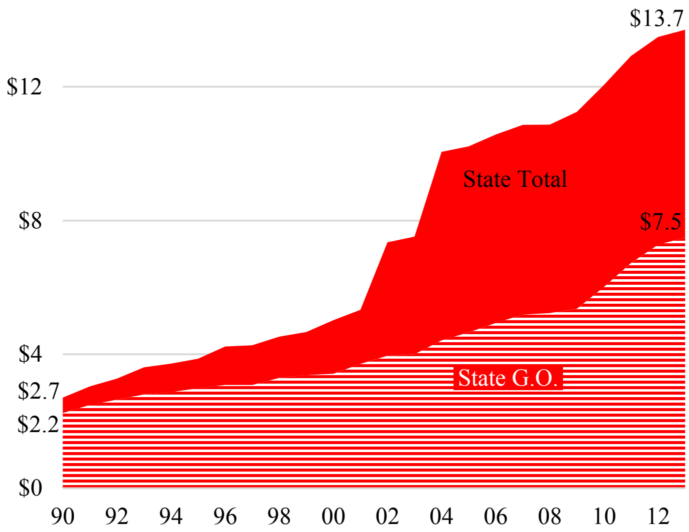
Figure 1:
Total State Debt Outpaces General Obligation Debt
$ Billions, 1990-2013



More recently, however, borrowing has also paid for unfunded pension and health care liabilities of public employees. State government also used it as a "back door" to balancing its budget.

The Evolution of Debt

What is considered legal public borrowing in Wisconsin has evolved over the past 160 years. The original constitution allowed the state to issue debt only "to repel invasion, suppress insurrection, or defend the state in time of war" (Article VIII, Section 6) and for "defraying extraordinary expenditures" (Article VIII, Section 7).

Since 1969, however, the constitution was amended several times to permit other forms of state borrowing. As a result, state government was allowed to issue debt in order to "acquire, construct, develop, extend, enlarge or improve land, waters, property, highways, public buildings, equipment or facilities for public purposes" (1969), to finance veterans' housing loans (1975), and to use for railways (1992).

Types of Debt

Public debt comes in several forms. Until recently, there were two main types of borrowing in Wisconsin: general obligation and revenue bonds. More recently, however, the state has issued a third kind of long-term debt: appropriation bonds. Different kinds of long-term debt have varying implications for the borrowing government and the taxpayer.

General Obligation. General obligation (G.O.) debt is backed by the full faith, credit, and taxing power of the issuing government. That means governments are legally obligated to levy the taxes necessary to pay the debt service payments on these bonds. When a state or local government issues G.O. bonds, taxpayers are on the hook for them.

Revenue Bonds. Unlike G.O. debt, revenue bonds are not backed by the taxing power of government, but by revenues from the project being financed. For example, revenue bonds might be issued to pay for highway construction, with highway tolls pledged to pay debt service. Because they are financed by project proceeds, revenue bonds do not necessarily impact the general taxpayer. However, they may affect those paying the taxes or fees used to finance the project.

Appropriation Bonds. State appropriation bonds are different. The legislature is not legally required to pay annual debt service on these bonds. Payments are made only if the legislature allocates sufficient funds in a state budget. Although the state is not legally obligated to provide funds to repay this debt, failure to do so would negatively impact the government's bond ratings issued by national firms.

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The taxpayer is liable for appropriation bonds only to the extent that the state allocates funds to repay them.

How Much is Too Much?

State and local borrowing is generally capped.

State Limits. Article VIII, Section 7 of the Wisconsin constitution limits state general obligation debt to 5% of total state property value. Furthermore, the state cannot accumulate G.O. debt of more than 0.75% of total property value in a single year. Additional regulations are outlined in Chapter 18 of state statutes.

Local Limits. Article XI of the constitution limits G.O. debt of municipalities, sewerage districts, and other municipal corporations to 5% of the value of taxable property within their respective jurisdictions. K-12 school districts are limited to 10% of their total property value; union high school districts and the K-8s that feed into them can each borrow up to 5% of value. Technical college debt is limited to 2%.

It is important to note that these debt limits are layered. Every resident lives within a municipality, county, school district, technical college district, as well as the state. Combined, these entities could borrow up to 27% of full-market property value. For someone with a $200,000 home, the combined governments serving them could borrow up to $54,000 for which the taxpayer would be liable. Fortunately, the vast majority of governments in Wisconsin are not near their limits.

STATE DEBT

Long-term Wisconsin state government debt totaled $13.7 billion at the end of fiscal 2013. If the debt of various affiliated organizations, such as the Wisconsin Housing and Economic Development Authority (WHEDA) and the U.W. Hospitals and Clinics Authority, is added, the total rises to $15.9 billion. These governmental units are legally separate from the state but financially accountable to it. Because they are separate, the following discussion ignores these units.

General obligation debt totaled $7.5 billion and accounted for 54.7% of the 2013 total. Revenue bonds, mostly for transportation, totaled $3.0 billion (21.6%). Appropriation bonds ($3.3 billion, 23.8%) accounted for the remainder.

Long-Term Trends

Total state debt has grown significantly since 2000. Between 2000 and 2013, it increased 173%, or

DEBT VS. DEFICIT

The difference between the terms “deficit” and “debt” is easily overlooked. Too often, the terms are used interchangeably in discussing state or local government finances, yet they have different meanings. A deficit occurs when expenditures exceed revenues during a fiscal year. Debt is the amount of money a government body borrows, usually for large capital projects. It is the cumulative total of current and past borrowing yet to be repaid.

To illustrate, consider a household in which a working couple together earns $5,000 per month. Between taxes, house and car payments, insurance, and other expenses, however, they spend $5,200 per month. The couple has a $200 ($5,000 minus $5,200) per month ($2,400 per year) deficit. It can be eliminated in one of four ways: reduce spending, increase income, draw down savings, or borrow. Generally, the last option is not available for government operating purposes in Wisconsin.

As mentioned, the couple is paying off both house and car loans. If they had a $200,000 mortgage and $25,000 in car loans, they would have $225,000 in debt, an amount significantly different from their $2,400 annual deficit.

Laws regarding deficits and debts at the federal level differ from those at the state and local levels. While the U.S. federal government issues debt for major capital expenditures (highways, buildings, etc.), it also borrows to cover operating expenses. In 2013, federal revenues covered only about 75% of expenses; the remainder was borrowed.

State and local governments typically operate under tighter restrictions. The Wisconsin constitution requires that, when a budget is adopted, tax revenues be sufficient to pay for budgeted expenditures. If actual expenditures exceed revenues, Article VIII of the Constitution requires that the legislature levy “a tax for the ensuing year, sufficient…to pay the deficiency as well as the estimated expenses of such ensuing year.”

The implications of this balanced budget requirement are twofold. First, the legislature is required to levy taxes necessary to balance the budget. Second, in the event that tax collections fall short of projections, the legislature cannot issue debt to make up the difference. Instead, sufficient taxes must be levied the following year.

an average of 8.0% per year. Annual growth averaged 6.4% during the 10 years preceding (1990-2000).

General obligation debt more than doubled during 2000-13 (see Figure 2 below). Revenue bonds rose 85%, or an average of 4.8% per year. The state also issued more than $3 billion in new appropriation bonds during these years.

Between 2000 and 2013, total state debt increased 173%, or an average of 8.0% per year. Annual growth averaged 6.4% during the 10 years preceding.

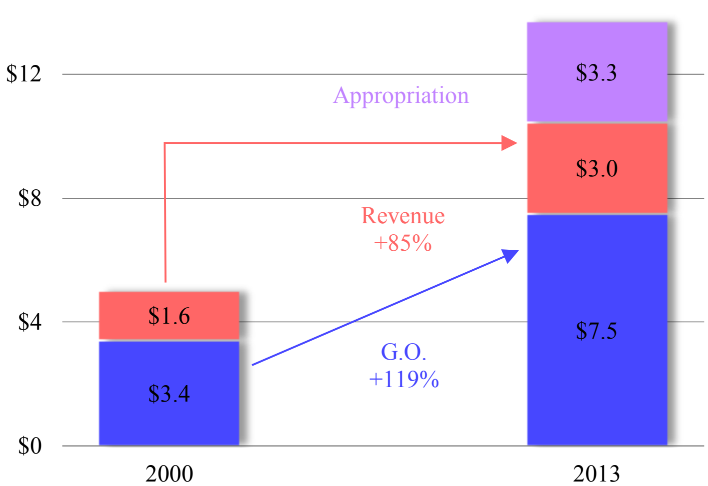
Three factors contributed to the relatively rapid growth in total debt during 2000-13:

- the "securitization" of tobacco revenues in 2002;
- the financing of unfunded retirement liabilities; and
- state budget problems that led to shifting of transportation monies to the general fund and replacing them with increased borrowing.

Tobacco Bonds. In 1998, Wisconsin and 45 other states settled a lawsuit with tobacco product manufacturers. As a result of the settlement, Wisconsin was to receive annual payments in perpetuity from these companies. Payments through 2032 were expected to total nearly $6 billion, with money going to tobacco cessation programs.

However, the 2001 recession left holes in the 1999-2001 and 2001-03 state budgets. Like some other states, Wisconsin "securitized" the stream of payments; i.e., it sold $1.6 billion of bonds backed by the actual tobacco payments. After some fees and set-asides, securitization provided the state with $1.3 billion.

Figure 2: State Debt Rising; Appropriation Bonds New
By Type, $ Billions, 2000 and 2013



Governor Scott McCallum (R) initially planned to use $450 million to balance the 2001-03 state budget and set aside the remainder in a permanent endowment fund. However, the legislature and governor ultimately used the entire amount to fund the budget.

In 2009, the state refinanced these bonds, replacing them with appropriation bonds. It refinanced at a lower interest rate, but borrowed more than the amount of the outstanding tobacco bonds. This generated about $450 million that the state spent in its 2007-09 and 2009-11 budgets and extended the payoff date from 2018 to 2029. As of 2013, Wisconsin had $1.5 billion of these outstanding appropriation bonds, which represented 17.3% of the $8.7 billion in debt added during 2000-13.

Unfunded Liabilities. The state's initial use of appropriation bonds occurred in 2004 when it issued them to pay for unfunded retirement liabilities. Retroactive liberalization of state pension benefits in 1999 left state government with a $730 million liability.

Additionally, the state allowed its employees to apply unused sick leave credits to the payment of health insurance premiums after retirement. Rather than continue to use a pay-as-you-go system, lawmakers decided to borrow money to set aside for future payments.

In December 2003 (fiscal 2004), the state issued $1.8 billion in appropriation bonds to fund these two liabilities. No principal was due on them until 2009. Then, the state refinanced them along with the tobacco bonds. Wisconsin currently owes nearly the same amount on this borrowing as it did in 2004. These appropriation bonds accounted for 20% of added state debt during 2000-13.

Budget Maneuvers. While the amount of general obligation and revenue bonding typically rises with a growing economy and incomes, state budget problems during the 2000s resulted in more borrowing than usual. Most of it was additional G.O. debt for transportation.

During 2001-11, lawmakers confronted state budgets that had first-year structural imbalances ranging from $650 million to $1.4 billion. State law does not allow for borrowing to balance its budget, so the governor and legislature turned to the transportation fund, shifting revenues from gas taxes, driver licensing fees, and vehicle registration fees to the general fund. During 2003 through 2011, the state shifted $1.4 billion from the transportation fund to the general fund.

Without further action, this would have had major consequences for transportation finance. However, to compensate for the funding shift, the state authorized $1.1 billion in G.O. bonds for transportation. All are supported by general fund revenues, and represent an unprecedented shift in Wisconsin transportation finance. While the 2011-13 state budget did not shift transportation funds to the general fund, it authorized $115 million of general-fund-supported G.O. bonds to pay for transportation. Combined, the state added $1.2 billion of general fund G.O. debt for transportation during 2003-13.

Historically, the state used G.O. bonds—paid for with transportation fund revenues—to pay for freight rail and harbor improvement projects. In 2003-05, these totaled $7.5 million. Since then, G.O. bonds have also been used for highway improvement projects traditionally funded with revenue bonds. During 2005-13, the state authorized $1.2 billion in transportation-fund-supported G.O. bonds to pay for state highway projects and the Stillwater bridge. When combined with the general fund debt discussed above, atypical transportation debt totaled $2.4 billion during 2003-13.

State fiscal problems led to another change in 2007-09. To compensate for funds transferred to the general fund, the state issued $412 million in revenue bonds during 2007-09. That was nearly 40% more than the average amount issued in the prior two biennia, and 30% more than the average of the subsequent two biennia.

Short-Term Trends: Debt Slowing

Although state debt has more than doubled since 2000, its growth has slowed recently. It increased at an average annual rate of 13.2% between 2000 and 2006, compared to 3.8% annually between 2006 and 2013. Total state debt rose just 1.6% in 2012-13, compared to 7.2% in 2009-10. This is good news for Wisconsin. While federal debt continues to rise, Wisconsin state government is showing some signs of declining reliance on borrowing.

Debt Service

When the state issues debt, it agrees to pay back the principal as well as interest. Debt service is the sum of the principal and any interest on the loan, which the state pays in a series of annual payments. The more debt the state has, the more it will spend each year on debt service. When borrowing is excessive, debt service payments can become onerous.

During 2003-13, lawmakers issued $1.2 billion of general fund G.O. debt to pay for transportation. Historically, transportation revenues were used to pay transportation debt.

State debt service represents a much larger percentage of total spending today than previously. It totaled $1.1 billion in 2013, or 4.1% of total state expenditures (see Figure 3). By comparison, debt service hovered around 2.0% of total state spending during the 1990s.

Between 2002 and 2009, debt service's share of expenditures rose steadily, reaching 4.5% in 2009. It then dropped to 2.4% in 2010 due mostly to a reduction of nearly $300 million in principal payments. Much of the short-term decline was likely due to refinancing of old debt.

Perhaps of greater concern is debt service in the transportation fund. During 1998-2003, debt service averaged about 7.2% of the fund's revenues. However, increased borrowing and slow-growing revenues since raised debt service costs to 15.5% of fund revenues in 2013. That percentage could reach 25% in 10 years.

Figure 3: State Debt Service Share of Spending Rises
% of Total Spending, 1990-2013

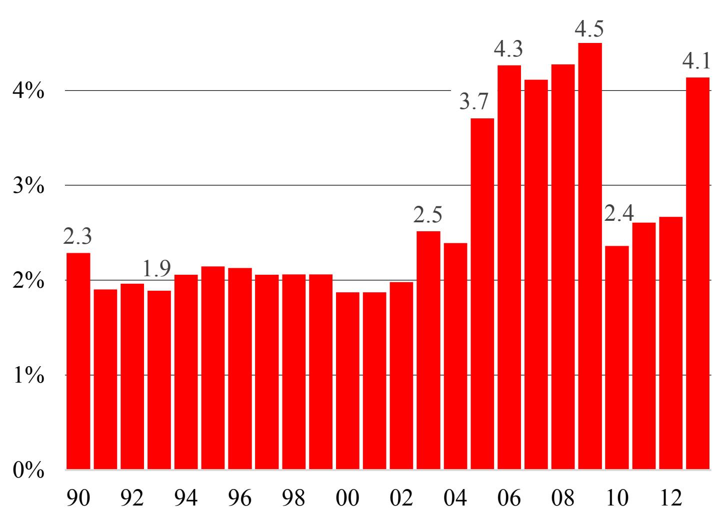
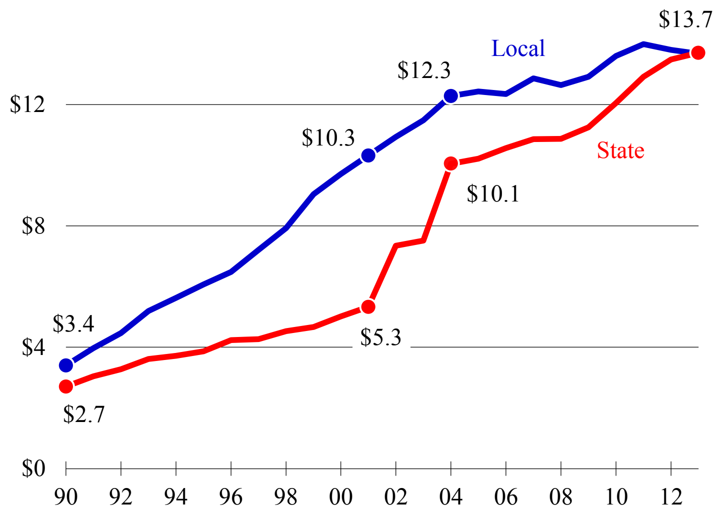


Figure 4: State Debt Slows, Local Debt Declines
$ Billions, 1990-2013

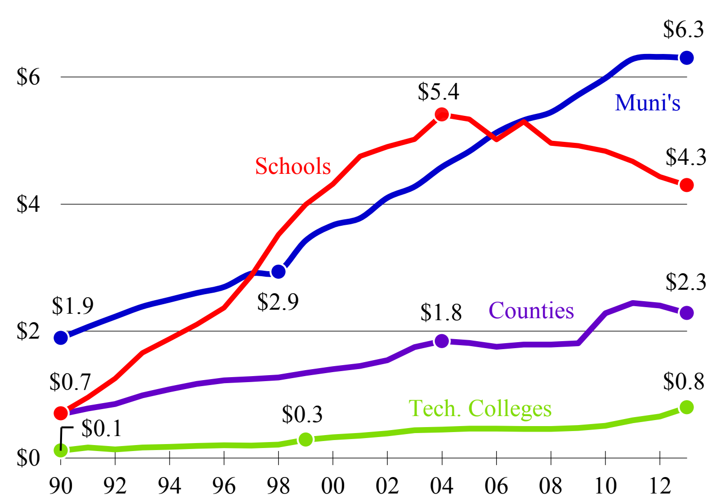


LOCAL DEBT

Local government debt in Wisconsin has flattened and even declined in the past few years. Total local debt has long outstripped state debt in size (see Figure 4). But as local debt stabilized and state debt rose with use of appropriation bonds, state borrowing has overtaken its local counterpart. Local general obligation debt totaled $13.7 billion in 2013, roughly $10 million less than state debt.

Local debt climbed rapidly during the 1990s, an average of 10.0% annually. In the following decade, however, annual growth averaged only 3.1%. Local debt declined in both fiscal 2012 and 2013.

Figure 5: Local Debt Slows, Declines
$ Billions, 1990-2013



* Fiscal years for schools and technical colleges are July-June; for municipalities and counties, calendar year. For reporting, fiscal years are lined up as follows: 2012 calendar year with July 2012-June 2013 fiscal year.

School Debt Declining

K-12 schools had roughly $4.3 billion of debt in 2013, down from $4.4 billion in 2012. This continues a general pattern of decline that has been occurring since 2004 (see Figure 5). School debt peaked at $5.4 billion in that year, after climbing steadily during the 1990s and early 2000s. Schools currently carry less debt now than they did in 2000.

Most school debt is for construction of new buildings or renovation of existing ones. During the 1990s, school districts replaced aging buildings and built new ones to accommodate increased student populations. The 1997 shift to state "two-thirds" funding of schools helped districts pass many of the borrowing referenda. Between 1990 and 2001, voters approved $4.8 billion in new school borrowing, and school debt climbed almost 600%.

Statewide enrollments peaked in the late 1990s and began falling after 2003. Following the building boom of the 1990s, school districts passed fewer building referenda in the 2000s. Moreover, the state eliminated the two-thirds requirement in the 2003-05 budget. The result has been falling school debt. Between 2006 and 2013, it declined by an average of 2.2% per year. By comparison, school debt increased by an average of 2.5% during the six years prior.

School debt varies by district, of course. Wilmot Union High School reported the most in 2013 at $30,401 per student. New Richmond ($29,218), Maple ($26,275), Spooner ($24,532), and Sun Prairie Area ($21,518) completed the top five. Five school districts have no debt: Baraboo, Bristol #1, North Crawford, Randall J1, and Friess Lake.

Technical College Debt Rises

Technical college debt is limited to 2% of aggregate technical college district property value. In 2012-13, technical colleges reported $797.6 million in long-term debt, just 7% of all local debt in Wisconsin.

That said, while K-12 school debt has been declining in recent years, technical college debt has been increasing. Annual growth averaged 5.8% during 2000-06. Between 2006 and 2013, it averaged 8.1% and debt increased 21.7% between 2012 and 2013. In recent years, voters in several technical college districts have approved referenda authorizing borrowing for new buildings.

County Debt Down

County debt is also showing signs of decline. In calendar 2012, counties had $2.3 billion in debt, less than in the previous year. After increasing 25.9% in 2009 and 7.3% in 2010, county debt fell 1.7% in calendar 2011 and another 5.1% in 2012.

Counties with the most debt were home to the state's largest cities. Milwaukee County topped the list at $680.2 million with Dane County, home to the state capitol, next at $237.7 million. Florence, Jefferson, and Oconto counties have no long-term debt.

While county debt has fallen over the past several years, annual debt service payments have increased; they rose 16.2% in calendar 2012. However, historically, these payments have fluctuated between large drops and increases over the past decade. The 2012 increase followed a 16.9% decrease in 2011 and a 39.7% increase in 2010.

Municipalities

The most surprising change in local debt has been the recent decline at the municipal level. Over the past 25 years, municipal debt grew faster than most other forms of local debt. While total local debt increases averaged 2.7% per year between calendar 1999 and 2012, municipal debt averaged 4.2%. Yet municipal debt totaled $6.3 billion in 2013, 0.3% less than in 2012 and the first decline since at least 1989.

Not surprisingly, municipalities with the largest, densest populations had the most debt. Milwaukee ($829.2 million) and Madison ($342.3 million) led, followed by Green Bay ($135.1 million), Kenosha ($138.7 million), and Racine ($108.3 million).

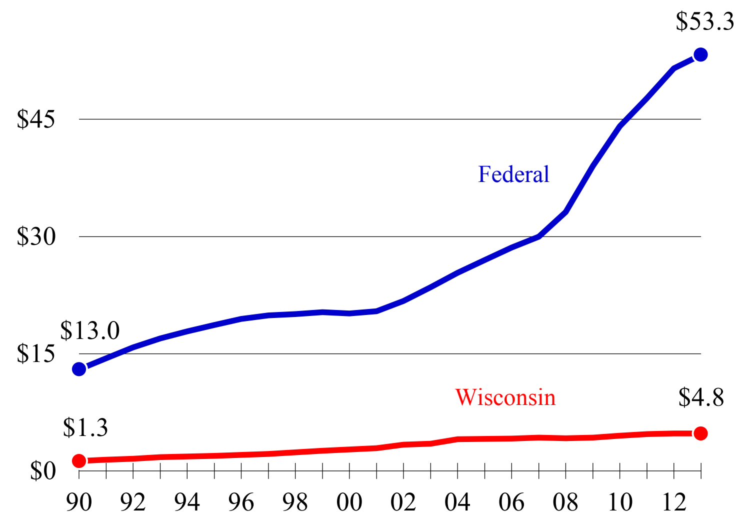
Taking population into account, a different picture emerges. Although Milwaukee has the most total debt of any city, its per capita debt places it 26th among Wisconsin's 50 largest municipalities. The village of Pleasant Prairie had the most per capita debt at $4,865, over three times Milwaukee's ($1,393). The city of Middleton ($3,573) and the town of Menomonee Falls ($2,846) were next highest.

NATIONAL COMPARISONS

Wisconsin vs. the Nation

When state and local obligations are combined, Wisconsin has $27.4 billion of debt, roughly $4,782 for each of its 5.7 million residents. If local revenue bonds are added, the total rises to nearly $32 billion. This debt is not trivial; however, compared to the U.S. ($53,261 per capita in 2013), Badger state debt is modest (see Figure 6).

Figure 6: Federal Debt Outpaces Wisconsin
Per Capita, $ Thousands, 1990-2013



The difference in per capita debt between Wisconsin and the U.S. has widened substantially since 1990. While it averaged annual growth of 4.3% here between 2000 and 2013, federal debt averaged 7.8%. The difference has been larger in recent years. Wisconsin's average annual debt growth fell to 2.1% between 2006 and 2013 but national growth rose to 9.3% per year.

Wisconsin vs. Other States

The U.S. Census Bureau publishes state and local debt statistics for all 50 states. These figures are the broadest measure of public debt available because they include debt for public improvements and public debt issued for private benefit. These data vary somewhat from those previously mentioned.

According to the Census Bureau, Wisconsin state-local long-term debt totaled $43.2 billion in 2011. Of that, $11.8 billion was "public debt for private purposes," which includes credit obligations of state or local governments or of one of their independent agencies. When that amount is excluded, Wisconsin's total debt drops to $31.3 billion, or $5,488 per capita. That places Wisconsin 28th among the states. ☐

DATA SOURCES:

Congressional Budget Office; U.S. Census Bureau; Wisconsin Department of Revenue; Wisconsin Legislative Fiscal Bureau.

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WISTAX NOTES

■ **Cigarette Smuggling Rises.** Wisconsin ranked fifth among the states for cigarette smuggling in 2012 vs. 18th in 2006. Smuggled cigarettes accounted for 34.6% of cigarette consumption here, up from 13.1% in 2006. Wisconsin's cigarette tax increased from $0.77 to $2.52 per pack during 2006-12.

Wisconsin is one of twelve states in which smuggling accounts for greater than one quarter of cigarette consumption. New York (56.9%) had the highest rate, followed by Arizona (51.5%), New Mexico (48.1%), and Washington (48.0%).

States with the most smuggling tend to tax cigarettes more heavily than their neighbors. New York charges $4.35 per pack, while neighboring Pennsylvania's tax is $1.60. The cigarette tax in Wisconsin is $2.52 per pack, more than twice Illinois' ($0.98). *(Source: Tax Foundation)*

■ **Bikes in Wisconsin**. According to the U.S. Census Bureau, 5.1% of workers in Madison bike to work, more than any other large (200,000+ residents) U.S. city, save Portland, Oregon (6.1%). Another 9.1% of Madison workers walk to work, the sixth highest rate for large cities. Madison is one of many areas, such as Portland, Minneapolis, Denver, and Washington, D.C., that have devoted funds to maintaining bicycle friendly landscapes.

Biking has become a much more popular form of commuting in the last decade. Nationwide, 0.6% of workers commuted by bike in 2012, up from 0.4% in 2000. The number of bike commuters increased 61.1% nationwide between 2000 and 2012, a greater increase than any other form of commuting.

FROM WISTAX PRESIDENT TODD BERRY

Civic education is our mission. Being true to that means keeping WISTAX publications *accessible and affordable.*

In addition to annual contributions from individuals, firms, and foundations, we rely on special gifts to accomplish that.

This year, thanks to **Walmart** and to **Ehlers and Associates**, we can again publish our upcoming *MunicipalFacts14* reference book, a one-of-a-kind resource that provides financial and demographic information about every Wisconsin city and village over 2,000 population.

We are also grateful to the **American Transmission Company** and the **Wisconsin Counties Association** for special donations that helped the American Legion and its Auxiliary provide copies of our civics text, *The Framework of Your Wisconsin Government*, to 1,670 high schoolers attending Badger Boys and Girls State this summer.

The Framework is also used in high schools across Wisconsin because it complies with state law for civics education. Unfortunately, some schools do not have funding for the book. If you would like to help put our *Framework* text into more high schools, or want to help underwrite our *SchoolFacts14* book this fall, contact us at wistax@wistax.org or call (608) 241-9789.

This important work requires the generosity of many. All are truly blessed by sponsors who support our civics programs. Thank you! □