



## The Ups and Downs of State Fiscal Health

### Wisconsin's Decade-Long Roller Coaster Ride

*Wisconsin's official financial statements are unknown to most residents, but they contain information that can be used to measure state fiscal health over months, a year, or much longer. A review of these reports shows fiscal health eroding during 2002-09 and then improving. Nevertheless, despite recent gains, the Badger State ranked 37th among the states in 2013 in overall fiscal condition, based on an average of fiscal measures covering multiple time frames.*

Over the past two decades, state fiscal health has been much-debated. Often, personal opinions shift depending on political perspective and party leanings.

Regardless of which major party is in power, there are at least three aspects of state finance that make it relatively easy for those in control to mask Wisconsin's overall fiscal health.

First, press and political attention usually focuses on the "general fund," even though it comprises only about half of state revenues and spending. For example, the general fund does not include transportation taxes and fees; hunting, fishing, and other recreation charges; university tuition; or unemployment taxes.

Second, this narrow focus can mask shifting of dollars from separate funds to erase would-be general fund deficits. For example, during 2003-11, lawmakers used \$1.4 billion from the transportation fund to pay for general fund programs. While these transfers made the general fund appear healthier than it was, they also aggravated underlying transportation fund issues.

Third, state budget accounting allows lawmakers to "spend" in one fiscal year, but withhold actual payment until the next. Like fund transfers, these budget maneuvers make the state general fund look superficially healthy.

Is there a source of state financial information that does not have

these deficiencies and can be used to more honestly assess Wisconsin's fiscal health? Yes, it is the Comprehensive Annual Financial Report, or CAFR, which is analogous to tightly regulated financial statements found in annual reports issued by publicly-owned companies to their shareholders.

#### **THE CAFR IN BRIEF**

The CAFR is little known and even less read because it is a 250-page document containing mostly tables of revenues, expenditures, assets, and

#### **Also in this issue:**

Tourism Spending Grows • Wisconsin Adds Businesses • Undergraduate Enrollment Falls

liabilities. That said, the document has information useful in evaluating state financial health.

Using the CAFR has several advantages over other state reports and budget documents. First, all state revenues and spending are reported, allowing a more comprehensive view of state finances than the current general fund focus of lawmakers and the press. Because the CAFR includes all revenues and spending, fund transfers used in budgeting do not mask overall financial condition.

Second, the Government Accounting Standards Board (GASB) requires state accountants to use strict rules, including the use of accrual accounting (see box below), which can reverse timing gimmicks that sometimes have been used to “balance” the state’s general fund budget.

Third, GASB rules mean that figures reported are consistent across states and over time. This permits both tracking of state fiscal health during 2002-15 and fair comparisons of Wisconsin with other states.

### **APPROACH USED HERE**

The approach here follows prior research that measures state financial health using CAFR-derived

ratios—similar to those used to analyze business finances. The primary focus is the state’s ability to meet its financial obligations over three time frames: short term (less than 60 days), the fiscal year, and long term.

Each measure of fiscal health is examined from two perspectives. The first is over time: How did Wisconsin’s fiscal health change during 2002-15? The second is national: How does Wisconsin compare to other states?

The analysis here supports several conclusions:

- State financial health generally worsened during 2002-2010 as lawmakers: used a variety of short-term “gimmicks” to deal with persistent general fund imbalances; issued more debt to offset transportation fund transfers; and failed to fix problems in the state’s unemployment reserve fund.
- Since 2010, nearly every financial measure discussed here has improved.
- Despite recent gains, most measures of state financial health are worse here than elsewhere.

For the casual observer of state finance, accounting and financial ratios can be overwhelming. To aid understanding, household analogues are provided when available.

## **SHORT TERM**

### **Overview**

Like households, states, at a minimum, need to have the resources available to pay their short-term bills. The fiscal measures discussed here relate the state’s ability to meet its obligations over 60 days.

*Fiscal Measures.* State governments have several types of assets that can be used to pay bills coming due within 60 days. Cash or savings are obviously available. Savings, including money market accounts, are often referred to as cash equivalents. Investments in U.S. Treasury bills (short-term debt) are also very liquid, as are certain other investments. Additionally, the state may have receipts that are due within 30 days (“receivables”); e.g., aid payments from the federal government.

Two measures of short-term fiscal health compare these liquid assets to what is owed over the next 60 days. The “*cash ratio*” compares the sum of cash, cash equivalents, and investments to short-term obligations, while the “*quick ratio*” adds receivables to the mix.

### **The Basics of GAAP Accounting**

The difference between cash accounting, which elected officials use to prepare state budgets, and the accounting which follows generally accepted accounting principles (GAAP), used in the CAFR, rests largely on when revenues and expenditures are recognized.

A simple example illustrates the difference. Suppose Betty goes to a furniture store and purchases living room furniture with a credit card. The furniture is delivered and placed in Betty’s living room, where it is immediately used by her three children, her many friends, and the family dog. There is little question for most people, and definitely for accountants, that Betty owns and is actively using the furniture purchased. Thus, under GAAP accounting, Betty has spent money and owns a living room set.

However, that is not the way Wisconsin state government budgets. Thinking in cash terms, state officials would argue that Betty did not make a purchase since no cash transaction occurred. When a credit card bill arrives a month later and Betty pays off her balance, that is when she spends money.

The use of cash accounting has allowed Wisconsin lawmakers to balance budgets using various accounting maneuvers. For example, to balance the 2000 budget, lawmakers pushed \$75 million of school aid payments into the 2001 fiscal year. GAAP accounting undoes these kinds of gimmicks and accounts for spending in a way consistent with the rules from the Government Accounting Standards Board.

“Liquid” assets greater than or equal to 100% of liabilities is a sign of short-term fiscal health. A figure below 100% indicates short-term fiscal stress.

**Household Analogy.** John and Jill Badger have \$200 in their checking account and \$1,000 in savings. Over the next month, bills totaling \$6,000 come due. The Badgers appear to be in a financially precarious position; cash on hand covers only 20% (\$200 + \$1,000 vs. \$6,000) of their short-term obligations. However, each spouse is expecting a \$3,000 paycheck next month. Adding that \$6,000 to the checking and savings balances gives them sufficient funds to cover what is owed (120%, or \$7,200 vs. \$6,000), though the couple is clearly living paycheck to paycheck.

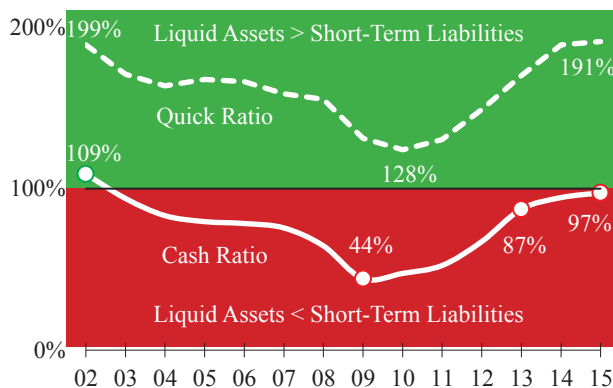
Comparing the Badgers to their neighbors highlights their uncertain finances. The Smiths also have \$6,000 in bills coming due next month, but have a total of \$6,000 in checking and savings combined, enough to fully cover these obligations. Their combined paychecks total \$7,000, so they have \$13,000 available to cover \$6,000 in bills, a ratio of 216%.

**Cash Ratio**

At the end of fiscal 2015 (June 30, 2015), Wisconsin state government had \$4.36 billion in cash and cash equivalents, and \$2.50 billion in investments, for a total of \$6.86 billion in the most-liquid assets. At \$7.04 billion, short-term liabilities were slightly more, yielding a cash ratio of 97% ( $\$6.86 \div \$7.04$ ). In other words, like the Badgers, the state had insufficient liquid assets to cover short-term bills.

This was not an unusual position for the state. In only one year during 2002-15 (2002, see Figure 1), did the state have enough cash on hand to cover short-term bills, and that was due to a one-time cash

**Figure 1: Short-Term Fin. Health Worsens, Improves**  
Liquid Assets % of Short-Term Liabilities, 2002-15



**Terms to Know**

- Assets.** Items with economic value, including cash, investments, buildings, vehicles, roads, and amounts due from others.
- Cash Equivalents.** Very liquid investments that can be readily converted to cash or within three months of maturity.
- Liabilities.** Amounts owed to others. Short-term liabilities include amounts that must be paid within 60 days. Long-term liabilities include, among others, long-term bonds and post-retirement benefits.
- Net Assets.** The value of assets after subtracting outstanding debt used to acquire them.
- Receivables.** Amounts due from others.

infusion from selling bonds backed by annual payments from tobacco companies.

**A Seven-Year Decline.** Wisconsin’s short-term fiscal position, as measured by its cash ratio, worsened during 2002-09. In 2002, cash and investments combined were 9% greater than short-term bills. By 2009, they were less than half (44%).

Nearly one-third of the erosion in cash and investments was from state government spending down various reserves to pay for general fund programs. For example, lawmakers used \$826 million from the tobacco reserve fund and \$200 million from the injured patients and families compensation fund to pay for general fund programs.

Another 40% of cash-and-investment decline was from the gradual depletion—both prior to and during the 2007-09 recession—of the unemployment reserve fund, from \$1.5 billion in 2002 to zero in 2009.

**Recent Improvement.** Since 2009, some cash balances have grown significantly, improving the state’s short-term fiscal health. U.W. System balances tripled during 2009-15 from \$636 million to just under \$2.0 billion. Repayment of the \$200 million taken from the injured patients fund and rising unemployment insurance reserves (\$512 million in 2015) also added to the state’s overall cash position.

**Quick Ratio**

Just as the Badger family’s short-term outlook improved when accounting for future paychecks, Wisconsin state government appears financially healthier after accounting for receivables—amounts due from others and expected to be paid within three months.

In most years during 2002-15, receivables were at least as large as the sum of cash, cash equivalents,

and investments. Thus, Wisconsin’s quick ratio (see dashed line in Figure 1, page 3) is much larger than its narrower cash counterpart; in 2015, it was 191% compared to a cash ratio of 97% .

**Wisconsin’s short-term fiscal position worsened during 2002-09 as state officials spent down various reserves to pay for general fund programs. Since then, short-term fiscal health has improved.**

While the quick ratio remained above 100% during the entire 2002-15 period, it also declined after 2002, indicating a worsening fiscal position. It reached its nadir in 2010. Like the cash ratio, the quick ratio rebounded in recent years.

**FISCAL-YEAR HEALTH**

**Overview**

Extending the time frame a little farther, one might ask: How healthy are state finances over an entire fiscal year?

*Fiscal Measures.* Just as the short-term ratios measure the state’s ability to pay its upcoming bills, two fiscal-year measures look at revenues and spending over an entire year. The “operating ratio” compares total revenues to total expenditures. A result greater than 100% is desired; that is, revenues are sufficient to fund annual expenditures.

A second statistics looks at changes in net assets over the year. Net assets are the value of all assets, such as cash, IOUs, and buildings, minus any outstanding debt used to acquire them. When revenues exceed spending in a year, the resulting surplus adds

to net assets. Similarly, if the state pays off some of its outstanding debt, net assets rise. Conversely, if the state draws down balances or sells assets to pay for spending, net assets decline.

*Household Analogy.* A return to the finances of John and Jill Badger is helpful in understanding these measures. In January, the two reviewed their income and spending over the prior year and noted income of \$60,000 and spending of \$55,000; the couple saved \$5,000. Their income was 109% of spending (operating ratio). In addition to the the \$5,000 they saved, monthly mortgage payments reduced the debt on their house by \$3,000. Their change in net assets was positive, increasing by \$8,000, or \$4,000 per person.

**Operating Ratio**

In 2015, total state revenues of \$35.7 billion funded spending of \$34.4 billion. Thus, Wisconsin’s operating ratio was 104% ( $\$35.7 \div \$34.4$ ).

However, during much of 2002-10, state expenditures exceeded revenues; in five of the nine years, Wisconsin’s operating ratio was less than 100% (see line in Figure 2).

Among many factors, one that stands out was a continuing imbalance between revenues and spending in Wisconsin’s unemployment reserve fund. In each year during 2002-10, the state paid out more in benefits than it collected in unemployment taxes. In the five years in which total state expenditures exceeded revenues, unemployment deficits accounted for two-thirds of the difference between the two.

Taking funds from the injured patients and tobacco funds rather than using ongoing revenues to pay for spending also played a role.

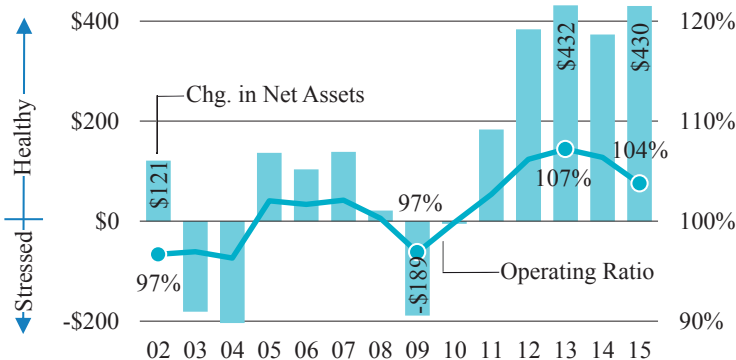
To “fix” the unemployment insurance fund, the state gradually increased the amount of wages subject to the unemployment tax, from \$10,500 in 2009 to \$14,000 in 2013 and thereafter. That action, along with benefit changes and declining unemployment, helped reverse annual deficits in the fund.

Since 2010, total state revenues have exceeded spending in every year. As the chart (left) shows, in 2013, Wisconsin’s operating ratio peaked at 107%, but has since declined slightly.

**Change in Net Assets**

In 2015, state revenues were \$1.3 billion more than expenditures. Due partly to that surplus, the state

**Figure 2: Fiscal-Year Health Improving**  
Operating Ratio (Line) & Chg. in Per Capita Net Assets\* (Bar), 2002-15



\*Inflation-adjusted

was able to increase its net assets by \$2.4 billion, or \$430 per state resident (see bars in Figure 2, page 4).

The 2002-15 change in Wisconsin’s net assets during 2002-15 is similar to the change in the operating ratio. Generally, net assets decline when the operating ratio is less than 100%.

## LONG-TERM HEALTH

### Overview

A final time frame examined is the long run, technically anything greater than one year but typically 10 to 20 years. The primary focus here is long-term debt and other liabilities.

*Fiscal Measures.* State governments borrow to construct roads and buildings, and repay those loans over 20 years or more. They also may have less-visible long-term obligations, such as paid employee absences (e.g., accumulated sick leave). The size of these obligations is measured by two ratios. The first simply sums long-term liabilities and converts them to per capita amounts (“*long term liabilities per capita*”). The second compares them to total state assets (“*liabilities relative to assets*”).

A third measure looks at long-term health from a different perspective. The “*net asset ratio*” compares net assets to total assets. A higher ratio indicates greater long-term fiscal health.

*Household Analogy.* Home ownership and the accompanying mortgage illustrate these measures as they would apply to a household. The Badgers own a home valued at \$200,000—it is their only asset. They owe \$150,000 on the mortgage (long-term debt or liabilities). Liabilities are \$75,000 per person and 75% ( $\$150 \div \$200$ ) of total assets. Their net assets are \$50,000 (the equity in their home), resulting in a net asset ratio of 25% ( $\$50 \div \$200$ ).

Now, suppose the Badgers inherit \$50,000 and use it to pay down their mortgage, reducing it to \$100,000. The decline in liabilities to \$50,000 per person and 50% of the home’s value indicate greater long-term financial health for the two. An increase in the net asset ratio to 50% is also a positive.

### Long-Term Liabilities Per Capita

In 2015, Wisconsin had \$15.5 billion in long-term liabilities. Thus, with a population of 5.8 million, it owed \$2,700 per capita (see Figure 3).

During 2002-11, Wisconsin’s long-term obligations rose \$5.3 billion, or 55%, from \$9.5 billion to

\$14.7 billion. Two state actions explain more than half the increase.

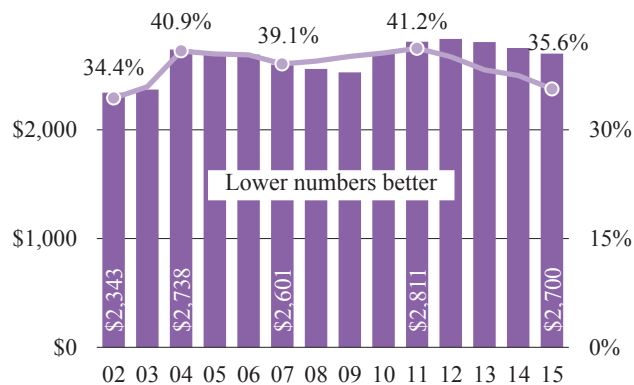
The first was borrowing \$1.8 billion in 2004 to fund post-retirement benefits for state employees. Previously, these benefits were paid to retirees annually from ongoing revenues.

### During 2004-11, lawmakers approved \$1.1 billion in additional transportation borrowing to limit the impact of their use of gas taxes and vehicle registration fees to fill potential general fund deficits.

The second action related to several transportation fund “raids” during 2004-11. To fill potential general fund deficits, lawmakers shifted gas taxes and vehicle registration fees from the transportation fund to the general fund. To limit the impact on road and highway spending, they also approved additional borrowing totaling \$1.1 billion. Combined, these two actions added \$2.9 billion to long-term liabilities.

Long-term liabilities per capita increased 20.0% from \$2,343 to \$2,811 (again, see bars in Figure 3). In recent years, long-term liabilities have stabilized; per capita, they declined to \$2,700 in 2015.

**Figure 3: Long-Term Liability Ratios Improving**  
Liabilities Per Cap. (bars) and % of Total Assets (line), 2002-15



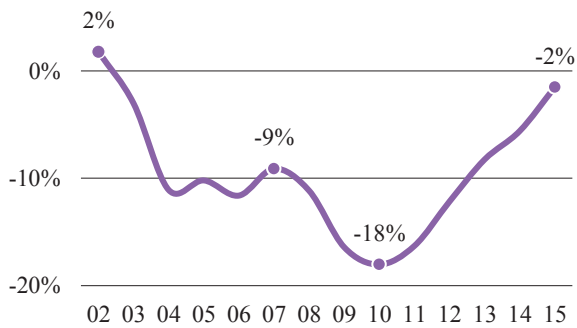
### Liabilities Relative to Assets

In 2015, the state had \$43.6 billion in total assets. Thus, the state’s long-term liability ratio was 35.6% ( $\$15.5 \div \$43.6$ ). Since 2002, this ratio followed a pattern similar to per capita liabilities (see line in Figure 3). The ratio climbed with debt during 2002-11, but then fell.

### Net Asset Ratio

In 2015, Wisconsin’s net assets were negative. So the ratio of its net assets to total assets was -2%. A

**Figure 4: Net Asset Ratio Negative, But Improving**  
Net Assets % of Total Assets, 2002-15



negative net asset ratio is unusual; in 2013, Wisconsin was one of 13 states with a negative ratio. In fact, Wisconsin’s ratio was negative in every year during 2003-15 period (see Figure 4).

Like most other measures of fiscal health, the Badger State’s net asset ratio declined from 2% in 2002 to -18% in 2010. Since then, it has trended higher.

**OVERALL HEALTH**

The previous sections evaluated Wisconsin’s fiscal health separately over three time frames—short term, the fiscal year, and long term. However, it is instructive to combine them into a single measure of overall fiscal health that can be compared from year to year. That is a challenge since some are percentages and some dollars.

Fortunately, statistical techniques allow a re-scaling of each measure (for the mathematically inclined, creating a “z-score”). The re-scaled figures can then be averaged to yield annual composite figures. These composites relate each year’s overall fiscal health to the average over the entire 2002-15 period.

**Figure 5: State Overall Health Improving**  
State Total Financial Health Relative to 2002-15 Average

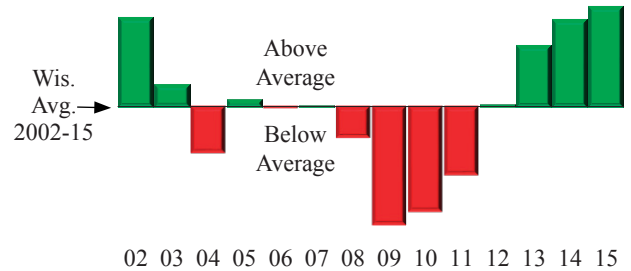


Figure 5 displays these annual composites. Financial health was at its worst during 2009-11, when the recession exacerbated questionable state fiscal decisions made during 2002-09. Based on these measures, three of the best four years were during 2013-15.

What Figure 5 does not reveal is how Wisconsin’s fiscal health compares to other states. That is explored next.

**NATIONAL COMPARISONS**

A 2015 George Mason University study used this same statistical approach to compare the fiscal health of states. Figures from that study are reproduced here for three time periods.

**Short Term**

Earlier discussion (page 3) showed Wisconsin’s short-term fiscal health improving after 2009. By 2013, Wisconsin’s cash ratio was 87% and its quick ratio was 170% (see Table 1). These were among the highest levels reached during 2002-15.

Nevertheless, Wisconsin lagged most states on these measures. The 50-state median (half the states higher, half lower) in 2013 was 159% for the cash ratio and 228% for the quick ratio, yielding ranks

**Table 1: Wisconsin Not As Fiscally “Healthy” as Most States**  
Measures of State Fiscal Health, 2013

Ratio	Definition	Wisconsin		50-State	
		Ratio	Rk.	Average	Median
<i>Short-Term</i>					
Cash Ratio	Cash+cash equiv.+investments ÷ short term liabilities	87%	39	223%	159%
Quick Ratio	Cash+cash equiv.+invest.+s.t. receivables ÷ s.t. liabilities	170%	39	302%	228%
<i>Fiscal Year</i>					
Operating Ratio	Fiscal year revenues ÷ fiscal year expenditures	107%	15	107%	104%
Change in Net Assets	One-year change in net assets	\$419	9	\$473	\$210
<i>Long-Term (L.T.)</i>					
L.T. Liab. Per Capita	Long-term liabilities per state resident	\$2,726	33	\$2,768	\$1,929
Liab. Relative to Assets	Long-term liabilities ÷ total assets	38%	33	40%	28%
Net Asset Ratio	Net assets ÷ total assets	-8%	40	3%	6%

\*From 2015 George Mason University Study

of 39th on both. In other words, despite significant improvement, Wisconsin still lagged most states in short-term financial health.

The George Mason study combined these two measures (along with a third not discussed here) to create a single number used to rank states on overall short-term fiscal health. Wisconsin placed 41st, with North Carolina, New York, Arizona, Pennsylvania, California, Massachusetts, Connecticut, Illinois, and Maine placing lower.

Among neighboring states, Iowa was “healthiest” (16th) in 2013. Like Wisconsin and Illinois, Minnesota (31st) and Michigan (34th) ranked in the bottom half of states.

### Fiscal Year

In 2013, the fiscal year was the one time frame in which Wisconsin fared better than most states. At 107% (revenues 7% greater than expenditures), the state’s operating ratio was 15th highest nationally. Net assets per capita rose \$419 (not inflation adjusted), the ninth largest increase among the states and nearly double the national median. When the two measures are combined, Wisconsin ranked 11th among the states on fiscal-year health.

### Long Term

Like short-term fiscal health, Wisconsin’s long-term health has improved in recent years (see page 5). Yet, despite those gains, our long-term health lagged most states in 2013. The state ranked 33rd on the two long-term liability measures. Both were similar to 50-state averages, but worse than medians. Wisconsin’s net asset ratio ranked 40th nationally—one of 13 states with a negative ratio.

Combining these three long-term measures, Wisconsin placed 38th in long-term financial health (see Table 2). Among neighbors, Iowa (13th), Minnesota (23rd), and Michigan (25th) were in the top half of states, while Illinois ranked 49th.

### Overall Health

Compared to other states in 2013, Wisconsin was below average on short term and long term health, but ranked 11th in fiscal year health. When all measures from the three time periods are combined for 2013, Wisconsin placed 37th nationally (see Table 2).

The “fiscally healthiest” states were those whose economies relied on natural resources: Alaska, North Dakota, and Wyoming. The least healthy were gen-

**Table 2: Overall Fiscal Health Ranks 2013**

Rk.	State	Rk.	State	Rk.	State
<i>Top 5</i>		<i>Midwest</i>		<i>Bottom 5</i>	
1	Alaska	17	Iowa	46	New York
2	North Dakota	24	Minnesota	47	Connecticut
3	Wyoming	27	Michigan	48	Massachusetts
4	Nebraska	37	Wisconsin	49	Illinois
5	South Dakota	49	Illinois	50	New Jersey

erally in the northeast—New Jersey, Massachusetts, Connecticut, and New York—with Illinois ranking second to last.

### SUMMARY

Looking at its 2002-15 history (Figure 5, page 6), 2013 was Wisconsin’s fourth best year in terms of its own fiscal health. Yet, it still ranked 37th of the 50 states. Fiscal health has improved slightly since then, but room for improvement remains. Budgeting sufficient ending balances in the general fund would protect against economic volatility and improve both short-term and fiscal-year health. Keeping debt levels manageable will improve long-term outlook. □

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**WISTAX NOTES**

■ **Tourism Spending Grows.** In 2015, tourism spending in Wisconsin rose 4.4% from \$11.4 billion to \$11.9 billion. While strong, annual spending growth was down from an average 5.5% gain during 2010-14, according to a new report from the Wisconsin Department of Tourism.

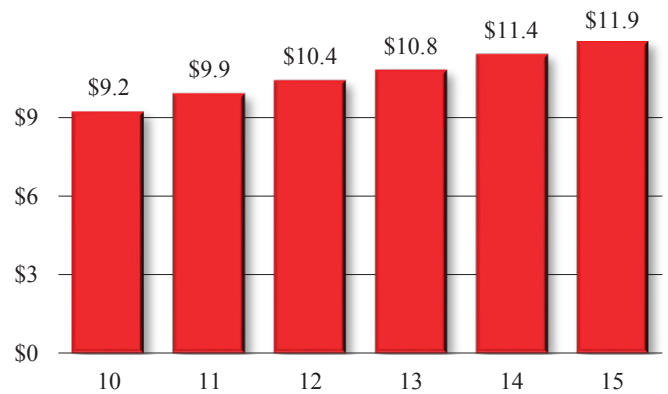
Counties where visitors (tourists) spent the most were generally the state’s most populous: Milwaukee, Dane, Waukesha, and Brown counties all ranked among the top five, joined by Sauk County (Wisconsin Dells area). However, the impact of tourism in a county is better measured by comparing visitor spending to resident population. Statewide, tourism spending was \$2,072 per capita. Visitors spent more than \$10,000 per resident in three counties: Sauk (\$16,161), Door (\$11,813), and Adams (\$10,143). Tourists spent the least per capita in Calumet (\$589), Menominee (\$596), Pierce (\$603), and LaFayette (\$701) counties.

■ **Wisconsin Adds Businesses.** In the third quarter of 2015, Wisconsin added 3,833 new private business establishments, the highest number since at least 1992. The new firms represented 2.8% of all private sector establishments, the third-highest firm creation rate since 1992; it reached 3.0% in the fourth quarter of 1997 and 2.9% in the third quarter of 1994.

However, Wisconsin continues to trail the nation in firm creation. Nationally, new firms were created at a 3.1% rate in that same quarter, according to the Bureau of Labor Statistics.

■ **Undergraduate Enrollment Falls.** In 2015-16, Wisconsin’s 13 four-year public universities enrolled 124,497 full-time equivalent (FTE) undergraduate stu-

**Wisconsin Tourism Spending Nears \$12.0 Billion**  
Visitor Spending in \$ Billions, 2010-15



dents. That figure was 3,046 (2.4%) below its 2010-11 peak (127,543).

Campuses in La Crosse (+7.2%), Madison (3.1%), Platteville (9.7%), and Whitewater (7.1%) bucked the trend. FTE enrollments declined more than 10% in River Falls (-15.1%), Superior (-11.5%), Milwaukee (-11.3%), Parkside (-10.7%), and Green Bay (-10.4%).

Despite declining enrollment, the number of bachelor’s degrees conferred has been rising. In 2014-15, U.W. System schools awarded 27,425 such degrees, 2,025 (8.0%) more than in 2010-11 (25,400). □

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- State income tax story: Lessons about rates, wants, and inflation (#5-16)
- Could national politics affect state balance of power and 2017-19 state budget? (#6-16)

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