

# Legislative Fiscal Bureau

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*State of Wisconsin*

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

Dear Representative Nygren and Senator Darling:

Early each year, this office conducts a review of the status of the state's general fund and presents its findings to the Legislature. In even-numbered years, the analysis includes an examination of economic forecasts and tax collection and expenditure data of the current fiscal year, and projections for each fiscal year of the current biennium. We have now completed that review.

Based upon our analysis, we project the closing, gross general fund balance at the end of this biennium (June 30, 2015) to be \$1,041.6 million. This is \$911.9 million above the \$129.7 million balance that was estimated prior to our review. The estimated \$129.7 million balance includes all bills enacted to date in this legislative session (through 2013 Act 116).

The additional \$911.9 million is the net result of: (1) an \$892.7 million increase in estimated tax collections; (2) an \$18.4 million decrease in departmental revenues; (3) a \$21.6 million decrease in sum sufficient appropriation expenditures; and (4) a \$16.0 million increase in estimated lapses to the general fund.

The following table reflects the general fund condition statement, which incorporates our revenue and expenditure projections.

**TABLE 1****2013-15 General Fund Condition Statement**

	<u>2013-14</u>	<u>2014-15</u>
<b>Revenues</b>		
Opening Balance, July 1	\$759,205,000	\$896,858,900
Taxes	14,399,900,000	15,017,200,000
Departmental Revenues		
Tribal Gaming	23,703,600	23,533,600
Other	<u>576,818,000</u>	<u>535,113,000</u>
Total Available	\$15,759,626,600	\$16,472,705,500
<b>Appropriations, Transfers, and Reserves</b>		
Gross Appropriations	\$15,026,592,200	\$15,513,263,600
Sum Sufficient Reestimates	-5,001,900	-16,615,800
Transfers to:		
Transportation Fund	60,877,000	143,837,100
Veterans Trust Fund	5,300,000	0
Compensation Reserves	78,752,200	133,056,500
Less Lapses	<u>-303,751,800</u>	<u>-342,485,700</u>
Net Appropriations	\$14,862,767,700	\$15,431,055,700
<b>Balance</b>		
Gross Balance	\$896,858,900	\$1,041,649,800
Required Statutory Balance	<u>-65,000,000</u>	<u>-65,000,000</u>
Net Balance, June 30	\$831,858,900	\$976,649,800

The biennial change in departmental revenues is estimated to be -\$18.4 million. Although there are a number of adjustments to departmental revenues, there are two items that contribute to most of the reduction. First, estimated tobacco settlement revenues have been reduced by \$13.3 million in 2013-14, primarily due to litigation that will likely not be resolved in that fiscal year. Second, tribal gaming revenues have been reduced by \$6.0 million to reflect a decline in amounts generated under the gaming compacts.

Net appropriations are projected to decrease by a net of \$37.6 million. Significant factors in this estimate include a reduction in homestead tax credits for the biennium (-\$23.3 million) and earned income tax credits (-\$8.2 million). In addition, it is projected that cigarette and tobacco product tax refunds will increase by \$9.1 million in 2013-14 due to a delayed payment from the prior year. Debt service is projected to be \$19.5 million lower than previously anticipated.

The following additional points should be noted about the condition statement of Table 1. First, it incorporates the fiscal effects of all bills enacted to date in this legislative session

(through 2013 Act 116). Second, it does not reflect the impact of any bills that are pending before the Legislature that have not yet been enacted.

Finally, it does not reflect any appropriation change to the medical assistance (MA) program. The Department of Health Services (DHS) is required to submit quarterly reports to the Joint Committee on Finance on the fiscal status of the medical assistance program. In the December 30, 2013, report, DHS projected that the MA biennial general fund appropriation of \$4.8 billion could potentially face a \$92.6 million shortfall in the 2013-15 biennium. Much of this is due to a reduction in the 2015 federal matching rate from the preliminary estimate of 59.19% to 58.27%. This downward revision would result in a loss of approximately \$52 million in federal MA matching funds in 2014-15. Through the Department's quarterly reports, the Legislature will be able to monitor the fiscal status of the program and react to any modifications, if necessary, prior to the conclusion of the biennium.

### **Budget Stabilization Fund**

Under s. 16.518 of the statutes, half of any excess of actual general fund tax revenues in a fiscal year over the amount included in the biennial budget act must be deposited into the budget stabilization fund after the close of that fiscal year. Currently, the budget stabilization fund has a balance of \$279.3 million.

The following chart shows general fund taxes included in the 2013-15 biennial budget (2013 Act 20) and the projections of this analysis.

	<u>2013-14</u>	<u>2014-15</u>
January 16 Estimate	\$14,399,900,000	\$15,017,200,000
2013 Act 20	<u>14,013,498,000</u>	<u>14,517,548,000</u>
Difference	\$386,402,000	\$499,652,000

As the chart indicates, the tax estimates of this analysis exceed those of the biennial budget act by \$386,402,000 in 2013-14 and \$499,652,000 in 2014-15. Thus, if taxes are not modified and actual collections are the same as the estimated amounts, \$193,201,000 ( $\$386,402,000 \times .50$ ) would be transferred to the budget stabilization fund at the end of the 2013-14 fiscal year and \$249,826,000 ( $\$499,652,000 \times .50$ ) would be transferred at the close of 2014-15. The biennial total of the transfer under this scenario would be \$443,027,000.

Section 16.518 further states that if a transfer to the budget stabilization fund would reduce the balance in the general fund below the required statutory reserve, then the transfer must be reduced as needed to maintain the required statutory reserve in the general fund. Currently, the statutory reserve is set at \$65 million, annually. For example, if the gross balance in the general fund at the end of a fiscal year was \$100 million, the most that could be transferred to the budget stabilization fund would be \$35 million.

## **Transportation Fund**

In addition to the previous discussion of the state's general fund and budget stabilization fund, the following information is provided on the condition of the state transportation fund.

Upon passage of the 2013-15 biennial budget act (Act 20), the biennium-ending balance in the transportation fund was estimated at \$1.8 million. The Department of Transportation has recently completed a reestimate of transportation fund revenues. Based on our review of these estimates, the biennium-ending balance is now projected to be \$84.6 million. Although the economic variables used to project future revenues have not changed substantially from earlier estimates, actual revenue collections from the motor fuel tax and vehicle registration fees during the first few months of the biennium are somewhat higher than the Act 20 forecast. The Department's new estimate projects that revenue will continue to build on these early collections, accounting for the higher biennium-ending forecast balance. The new estimated balance is equal to 2.2% of gross transportation fund revenues.

Although the transportation fund is projected to have a higher biennium-ending balance, there are several issues that could affect future decisions with respect to transportation finance. First, the amount of the state's federal highway aid remains uncertain for future fiscal years. Federal highway trust fund collections have been and continue to be below annual program outlays. In several recent years, Congress has supplemented trust fund revenues with federal general fund revenues to maintain a stable highway aid program. It is unclear, however, if additional transfers (or other measures, such as a federal fuel tax increase) will be approved in the future. Congress may decide, instead, to reduce highway aid to the states. In this event, Wisconsin may need to reduce funding for programs that use federal highway aid, or supplement those programs with additional state funds.

Second, while the transportation fund is projected to have a positive, biennium-ending budgetary balance, the fund faces a structural imbalance heading into the 2015-17 biennium. In 2014-15 (the base year), total revenues, net of revenue bond debt service, are \$11.4 million above total transportation fund expenditures. However, of the 2014-15 revenue total, \$123.5 million is provided with one-time transfers from other funds (\$107.5 million from the general fund and \$16.0 million from the petroleum inspection fund). Without the one-time transfer revenues, base expenditures exceed base revenues by \$112.0 million annually. Therefore, over the 2015-17 biennium revenues would have to grow by \$224.0 million to fund expenditures at the 2014-15, base-year level.

In addition, other factors will increase current law expenditure commitments in the 2015-17 biennium. First, Act 20 provided a 4% increase in calendar year 2015 for the mass transit assistance and general transportation aid programs. Since only a portion of the 2015 aid increase, in both programs, is funded in 2014-15, an additional funding increase would be required in subsequent fiscal years to fully fund the increase. For the general transportation aid program, an additional increase of \$9.0 million will be required in 2015-16 (or \$18.0 million over the biennium if the 2015 aid level is continued), while in the mass transit assistance program, an additional increase of \$3.2 million will be required in 2015-16 (or \$6.4 million over

the biennium). Assuming that the 2015 aid level is fully funded and that level is maintained, these commitments add \$24.4 million to the structural imbalance.

Further, growth in transportation fund debt service, on currently-authorized bonds, will further increase 2015-17 expenditures. Typically, the full, annualized debt service on bonds authorized in one biennium is not paid until the following biennium. Based on current bond issuance assumptions, the Department of Transportation estimates that debt service on currently-authorized bonds will grow by \$41.9 million in 2015-16 and by \$45.9 million in 2016-17, above the 2014-15 base, for a biennial total of \$87.8 million.

Finally, the calculations described above do not include the impact of any other costs that the state may incur in the 2015-17 biennium in excess of the 2014-15 appropriation base. Notably, the Department of Transportation estimates that continuing work on the Zoo Interchange and Hoan Bridge projects in Milwaukee County will cost \$957 million in the 2015-17 biennium. By comparison, the 2014-15 base appropriation for the southeast Wisconsin freeway megaprojects program is \$86 million.

## **General Fund Taxes**

The following section presents information regarding general fund taxes for the 2013-15 biennium, including a discussion of the national economic forecast and general fund tax revenue estimates for fiscal years 2013-14 and 2014-15.

**National Economic Review and Forecast.** This office first prepared revenue estimates for the 2013-15 biennium in January, 2013, based on IHS Global Insight, Inc.'s January, 2013, forecast for the U.S. economy. That forecast predicted economic growth in 2013 would slow, primarily due to the expiration of the 2% payroll tax cut and increased taxes on high earners included in the American Taxpayer Relief Act of 2012. Under that forecast, Global Insight had made assumptions regarding federal fiscal policy that sequestration cuts would not occur in 2013 and, instead, those cuts would be replaced with a combination of increases in income taxes on high earners and cuts to Medicare, Medicaid, Social Security, and nondefense discretionary spending. Under these assumptions, real gross domestic product (GDP) growth was expected to increase by 1.7% in 2013, 2.7% in 2014, and 3.4% in 2015. The primary downside risks to the forecast included U.S. policymakers cutting defense and nondefense spending further than was scheduled to take effect under sequestration, an intensification of recession in Europe, and slower than expected growth in China and other emerging markets.

In May, 2013, this office raised its revenue estimates for individual income taxes and corporate income and franchise taxes in 2012-13 and the 2013-15 biennium. The upward revision was primarily based on stronger than expected tax collections through April, 2013. One-time payments of corporate dividends and gains on asset sales that were accelerated into 2012 in anticipation of changes in federal individual income tax rates contributed to increased income tax collections during 2012-13. The revisions also incorporated Global Insight's May, 2013, forecast for the U.S. economy. Real GDP growth had been slightly increased from the January estimates to 1.8% in 2013, 2.8% in 2014, and 3.2% in 2015. The forecast assumed that federal sequestration cuts would stay in place until September 30, 2013, and would be replaced

by a combination of tax increases and cuts to entitlement programs beginning in 2014. The primary downside risk to the forecast remained the same as it had been in the January, 2013, forecast.

According to Global Insight's latest analysis (January, 2014), 2013 real GDP growth was 1.9%, which was slightly higher than the May estimate of 1.8% despite previously unanticipated fiscal austerity constraints. The May forecast had not anticipated that the sequestration cuts would remain in place through the end of 2013, nor had the May forecast anticipated the three-week federal government shutdown, which was estimated to subtract 0.3 percentage points from fourth-quarter U.S. economic growth. Under the current forecast, Global Insight estimates that expiration of the accelerated depreciation allowance at the end of 2013 encouraged some firms to accelerate capital spending into the fourth quarter of 2013 from 2014.

Two strong areas of growth in 2013 were sales of light vehicles and residential housing starts, which grew at rates of 7.7% and 18.9%, respectively. Growth in light vehicle sales was below 2012's rate of 13.4%, but remained historically high. Growth in light vehicle sales is expected to moderate from that pace to 2.9% in 2014 and 2.0% in 2015. While housing starts have shown strong year-over-year growth in 2013 (931,000 units) and strong growth of 28.0% in 2012, it should be noted that the number of housing starts remains more than 55% below the peak level of 2,073,000 units in 2005. Although housing starts are not expected to return to the 2005 level for at least the next 10 years, housing is expected to be a strong, positive contributor to economic growth with double digit growth in starts projected for 2014 and 2015. Among other housing indicators, sales of new and existing homes grew 9.8% in 2013, the average price of an existing home increased 9.1%, and the average price of a new home increased 11.0%.

Average nonfarm payroll levels increased 2.195 million in 2013, with private sector payrolls increasing 2.253 million, offsetting the 58,000 decline in government jobs. Last year concluded the third year in a row where private sector payrolls have increased, while government jobs have declined. Employment growth in 2013 was 219,000 higher than Global Insight's May estimated 2.034 million increase in total nonfarm payrolls. The average unemployment rate for 2013 was 7.4%, lower than the May estimate of 7.6%. While higher than expected employment gains helped lower the average annual unemployment rate, increased numbers of workers exiting the workforce since the May forecast has had a greater impact on lowering the unemployment rate.

In the January forecast, Global Insight expects continued moderate growth based on sound economic fundamentals for the U.S. economy, with real GDP increasing 2.7% in 2014 and 3.2% in 2015. The forecast is based on the following key assumptions. First, the discretionary spending levels agreed upon in the recently negotiated federal Bipartisan Budget Act will be kept in place during 2014. Second, emergency unemployment benefits will not be extended in 2014, reducing 2014 real GDP growth by between 0.1 and 0.2 percentage points. Third, the Federal Reserve will continue tapering the amount of long-term securities purchases by an additional \$10 billion per month following each Fed meeting, ending its purchases of long-term securities during the fourth quarter of 2014. Fourth, the inflation-adjusted, trade-weighted value of the U.S. dollar is expected to fall 3.7% over the next ten years against major trading partners and to

fall 23.8% against other trading partners. Fifth, real GDP growth is expected to average 2.0%, annually, among major-currency trading partners and 4.5%, annually, among other important trading partners over the next ten years. Sixth, Brent spot prices for crude oil are expected to average between \$99 and \$108 per barrel over the next five years, overall demand for oil is expected to grow 1.4% in 2014, and annual oil demand growth is expected to average 0.8% over the next ten years as a result of successful energy conservation efforts.

*GDP.* Real (inflation adjusted) GDP is now projected to grow 2.7% in 2014 and 3.2% in 2015. These estimates are similar to Global Insight's May, 2013, forecast, in which real GDP had been expected to increase by 2.8% and 3.2% in 2014 and 2015, respectively. The expectations for nominal (current dollar) GDP growth are slightly lower in 2014 and higher in 2015 compared to the May estimates, changing from 4.7% and 4.8% in 2014 and 2015, respectively, to 4.3% and 5.0%. Overall, Global Insight's January forecast maintains similar expectations for U.S. economic growth in 2014 and 2015 as in its May forecast, but projects slightly slower growth in the first year and stronger growth in the second year.

*Consumer Prices.* The Consumer Price Index (CPI) is expected to rise by 1.4% in 2014 and 1.8% in 2015, with declining energy prices offsetting increases in the cost of other goods and services. These estimates are similar to Global Insight's May, 2013, forecast for CPI, though slightly lower in the first year and higher in the second year. Declining energy prices were somewhat offset by higher prices for other items over the forecast period. Core inflation, which excludes food and energy costs, is expected to increase faster than overall CPI at rates of 1.9% in 2014 and 2.0% in 2015 (which is similar to the May estimates).

*Monetary Policy.* The U.S. Federal Reserve maintained very accommodative monetary policy through 2013. The Fed made outright long-term Treasury purchases of \$45 billion per month and purchased mortgage-backed securities at a rate of \$40 billion per month. The Fed's purchase of \$85 billion per month in long-term securities was an attempt to keep downward pressure on interest rates and support the economic recovery. At the Fed's December 17-18 meeting, the Fed noted that labor market risks had diminished and announced that it would reduce long-term securities purchases by \$10 billion per month, as compared to its current pace of purchases. Global Insight predicts that the Fed will continue reducing long-term securities purchases by an additional \$10 billion per month following each of the upcoming Federal Reserve meetings, and the Fed will end making long-term monthly securities purchases during 2014. This forecast is in line with Global Insight's May, 2013, assumptions.

The Fed maintained historically low short-term interest rates during 2013 by keeping the target range for the federal funds rate between 0.0% and 0.25%. The Fed did not mention at its December 17-18 meeting when the first interest hike might occur. Global Insight expects that the Fed will first increase interest rates in 2015, which is the same assumption as in Global Insight's May, 2013, forecast.

*Personal Consumption.* Nominal personal consumption expenditures increased by an estimated 3.2% in 2013, slightly higher than the 3.1% increase projected in the May, 2013, forecast. Purchases of consumer durable goods, which are generally subject to the state sales tax,

increased by 5.4%, led by 9.8% growth in expenditures for used motor vehicles. Purchases of services, which are generally not subject to sales tax, increased by 3.1%. Under the latest forecast, personal consumption is expected to grow by 3.9% in 2014 and 4.6% in 2015, with strong, broad-based gains in durable goods and slower growth in purchases of nondurable goods. These projections are slightly lower in 2014 and higher in 2015 than Global Insight's May, 2013, projections of 4.0% and 4.1%, respectively.

*Employment.* In the most recent employment report, it was estimated that the U.S. economy created only 74,000 jobs in December. However, bad weather prevented 273,000 workers from being able to get to their jobs, which was nearly twice as many workers as historically report being unable to get to work due to weather in December. Assuming weather was the primary factor behind this poor jobs report, Global Insight anticipates that U.S. job creation will rebound in the coming months. U.S. job creation averaged 183,000 per month over the course of 2013. Despite the December report, Global Insight expects non-farm payrolls to improve from growth of 2.2 million in 2013 to growth of 2.3 million jobs in 2014 and 2.8 million in 2015. In addition, the forecast calls for small government job gains over the next two years, as compared to the previous four years of government job losses. These estimates are slightly higher than Global Insight's May, 2013, forecast.

The national unemployment rate, which is a function of both the number of jobs and the number of labor market participants, is expected to decline at a faster rate than was anticipated in the May forecast. The average annual unemployment rate for 2013 was 7.4%, as compared to the 7.6% forecast in May. In the December report, the monthly seasonal adjusted unemployment rate dropped from 7.0% in November to 6.7%, as a significant number of workers exited the labor force. The average annual unemployment rate is expected to continue to drop to 6.5% in 2014 and 5.9% in 2015.

*Housing.* Residential construction activity improved in 2013 and is expected to continue strong growth over the next two years. Housing starts finished 2013 up 18.9%; however, this is lower than Global Insight's May forecast of 26.3% growth for the year. In 2014 and 2015, housing starts are expected to grow 24.8% and 26.9%, respectively, which are similar to Global Insight's May estimates.

Sales of existing homes grew at 9.1% in 2013, which is higher than Global Insight's May forecast of 8.5%. Existing home sales are expected to increase by 4.8% in 2014 and 8.5% in 2015, which is lower in the first year and higher in the second year compared to Global Insight's May forecast of 11.9% and 6.9%, respectively. The average price of an existing home is expected to grow more slowly over the forecast period, decelerating from 9.1% growth in 2013 to estimated growth of 4.5% in 2014 and 0.1% in 2015, which are lower than Global Insight's May forecast of 5.0% and 1.9%, respectively.

*Corporate Profits.* Economic profits increased 5.0% in 2013, and are expected to continue relatively strong growth over 2014 and 2015 at rates of 6.3% and 4.3%, respectively. These estimates are higher than the May forecast, which had projected growth of 0.8% in 2013, 4.2% in 2014, and 2.3% in 2015. Similarly, before-tax book profits finished 2013 up 3.7%, and are



expected to increase 14.2% in 2014 and 0.8% in 2015. These estimates are higher than the May estimates of a 1.6% contraction in 2013, 12.9% growth in 2014 and a 1.5% contraction in 2015. The large growth rate in 2014 is due, in part, to the expiration of federal bonus depreciation provisions after 2013.

*Business Investment.* Business investment in equipment grew at a rate of 3.4% in 2013, and is expected to grow 7.0% in 2014, and 9.2% in 2015. These estimates are lower than Global Insight's May forecast in 2013 and 2014, which called for growth of 6.3% and 8.2%, respectively, but is higher than May's estimated growth of 7.7% in 2015.

Intellectual property investment for software, which is another indicator of business investment, is expected to follow a similar pattern, with growth of 4.8% in 2013, and expected growth of 6.2% in 2014 and 7.5% in 2015. Software investment showed a similar deviation from the May forecast as investment in equipment had.

Business investment in nonresidential structures is expected to show year-over-year gains, finishing 2013 up 4.3%, and is expected to increase by 5.4% in 2014 and 6.2% in 2015. These estimates are lower than Global Insight's May forecast, which had called for growth of 4.7% in 2013, 7.6% in 2014, and 9.4% in 2015.

The projections outlined above and summarized in Table 2 reflect Global Insight's January, 2014, "baseline" forecast for the U.S. economy. Global Insight also prepares "pessimistic" and "optimistic" scenarios. Under the pessimistic scenario, given a 20% chance of occurring, U.S. economic growth stalls following: (a) a significant fiscal tightening in discretionary federal government spending during 2014, which leads to a fall in private-sector confidence and stock prices; (b) additional fiscal tightening in the European Union and slower growth in emerging markets, which reduces international appetite for U.S. imports; and (c) lower employment and wage gains leading to lower housing starts and home sales. Under this scenario, Global Insight expects that the Fed would expand its purchases of long-term securities and keep the federal funds rate at historically low levels until late 2017. Real GDP growth estimates would be reduced to 0.9% in 2014 and 2.0% in 2015, and unemployment rates would remain elevated, at 7.4% in 2014 and 7.2% 2015.

In the optimistic scenario, to which Global Insight also assigns a 20% probability, markets respond favorably to: (a) the U.S. government easily passing a debt-ceiling limit increase; (b) Congress negotiating a long-term deficit reduction program, which includes lower entitlement spending and revenue raising tax reform; (c) global growth accelerating, increasing demand for U.S. imports; and (d) an improving labor market adding 330,000 jobs per month by mid-2014. Under this scenario, the Federal Reserve would respond by increasing interest rates in the third quarter of 2014, five quarters sooner than under the baseline forecast, following stronger than expected improvements in the job market and increased pressure on consumer prices. The optimistic scenario projects higher real GDP growth of 4.3% in 2014 and 4.2% in 2015, with the unemployment rate falling to 5.7% and 4.6%, respectively.

**TABLE 2**

**Summary of National Economic Indicators**  
**IHS Global Insight, Inc., Baseline Forecast, January, 2014**  
**(\$ in Billions)**

	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>
Nominal Gross Domestic Product	\$16,244.6	\$16,792.3	\$17,507.9	\$18,375.4
Percent Change	4.6%	3.4%	4.3%	5.0%
Real Gross Domestic Product	\$15,470.7	\$15,761.3	\$16,182.8	\$16,708.5
Percent Change	2.8%	1.9%	2.7%	3.2%
Consumer Prices (Percent Change)	2.1%	1.5%	1.4%	1.8%
Personal Income	\$13,743.8	\$14,138.2	\$14,785.6	\$15,527.3
Percent Change	4.2%	2.9%	4.6%	5.0%
Personal Consumption Expenditures	\$11,149.6	\$11,501.4	\$11,953.7	\$12,497.9
Percent Change	4.1%	3.2%	3.9%	4.6%
Economic Profits	\$2,009.5	\$2,110.5	\$2,243.6	\$2,340.3
Percent Change	7.0%	5.0%	6.3%	4.3%
Unemployment Rate	8.1%	7.4%	6.5%	5.9%
Total Non-Farm Payrolls (Millions)	133.737	135.932	138.258	141.012
Percent Change	1.7%	1.6%	1.7%	2.0%
Light Vehicle Sales (Millions of Units)	14.44	15.56	16.01	16.42
Percent Change	13.4%	7.7%	2.9%	2.5%
Sales of New and Existing Homes (Millions)	5.029	5.520	5.891	6.508
Percent Change	9.7%	9.8%	6.7%	10.5%
Housing Starts (Millions of Units)	0.783	0.931	1.162	1.475
Percent Change	28.0%	18.9%	24.8%	26.9%

**General Fund Tax Projections.** Table 3 shows revised general fund tax revenue estimates for the 2013-15 biennium. The estimates are based on Global Insight's January, 2014, forecast of the U.S. economy and incorporate the impact of all tax law changes enacted to date.

**TABLE 3**  
**Projected General Fund Tax Collections**  
**(\$ Millions)**

	2012-13 <u>Actual</u>	Previous Estimates		Revised Estimates January, 2014	
		<u>2013-14</u>	<u>2014-15</u>	<u>2013-14</u>	<u>2014-15</u>
Individual Income	\$7,496.9	\$7,294.8	\$7,650.1	\$7,410.0	\$7,800.0
General Sales and Use	4,410.1	4,497.6	4,607.2	4,640.0	4,815.0
Corporate Income and Franchise	925.4	961.0	989.6	1,065.0	1,100.0
Public Utility	341.2	358.3	355.9	353.7	358.3
Excise					
Cigarette	569.2	551.2	541.4	575.0	570.0
Tobacco Products	63.0	64.7	66.7	67.7	69.8
Liquor and Wine	48.3	50.5	51.5	47.7	48.3
Beer	9.0	9.1	9.0	9.0	8.9
Insurance Company	159.3	160.0	167.8	164.0	172.0
Miscellaneous Taxes	<u>63.2</u>	<u>65.0</u>	<u>73.0</u>	<u>67.8</u>	<u>74.9</u>
<b>Total</b>	<b>\$14,085.6</b>	<b>\$14,012.2</b>	<b>\$14,512.2</b>	<b>\$14,399.9</b>	<b>\$15,017.2</b>
Change from Prior Year		-\$73.4	\$500.0	\$314.3	\$617.3
Percent Change		-0.5%	3.6%	2.2%	4.3%

As shown in the table, total general fund taxes are estimated at \$14,399.9 million in 2013-14 and \$15,017.2 million in 2014-15. These amounts are higher than the previous estimates by \$387.7 million in the first year and \$505.0 million in the second year. The biennial increase is \$892.7 million, or 3.1%. The estimates for each of the three major taxes, and the cigarette tax, have been increased significantly, primarily based on strong year-to-date collections data. Smaller adjustments have been made to the estimates for the other taxes.

**Individual Income Tax.** State individual income tax revenues were \$7,496.9 million in 2012-13 and are currently estimated at \$7,410.0 million in 2013-14 and \$7,800.0 million in 2014-15. Relative to the previous figures, the current estimates are higher by \$115.2 million in the first year and \$149.9 million in the second year. On a year-to-year basis, the current estimates reflect a decrease of 1.2% for 2013-14 and an increase of 5.3% for 2014-15. The revised estimates incorporate a number of law changes estimated to reduce revenues by approximately \$350 million in 2013-14 and \$385 million in 2014-15. The most significant law change is the income tax rate reductions and bracket reconfiguration enacted as part of 2013 Wisconsin Act 20. Those changes are estimated to reduce collections by \$328 million in 2013-14 and \$320 million in 2014-15. Act 20 contained a number of other provisions intended to simplify the state's income tax system, but they have a less significant fiscal impact.

Based on preliminary collection information through December, 2013, individual income tax revenues for the current fiscal year are 4.7% higher than such revenues through the same period in 2012-13. However, taxpayers have not adjusted their withholding payments to reflect the law changes noted above, and this will result in higher refunds and lower tax payments in the coming months.

**General Sales and Use Tax.** In 2012-13, state sales and use tax collections were \$4,410.1 million, which was 2.8% higher than the prior year. Sales tax collections through December, 2013, are 7.9% higher than the same period in 2012-13. Accounting for law changes and a one-time tax refund paid in August of 2012, adjusted year-to-date sales tax collections are 6.8% above the same period in 2012-13. State sales and use tax revenues are currently estimated at \$4,640.0 million in 2013-14 and \$4,815.0 million in 2014-15, which represents increased revenue of 5.2% in the first year and 3.8% in the second year. These estimates are \$142.4 million higher in the first year and \$207.8 million higher in the second year than the previous estimates. The increased estimates are based on: (a) higher than anticipated year-to-date growth in tax collections; (b) increased growth projected for 2014-15 for taxable personal consumption expenditures in Global Insight's forecast; and (c) enhanced sales and use tax collections from Amazon.com agreeing to collect Wisconsin sales and use taxes beginning November, 2013 (the Department of Revenue estimates state tax revenue increases of \$28 million annually resulting from this agreement).

**Corporate Income and Franchise Tax.** Corporate income and franchise taxes were \$925.4 million in 2012-13. Corporate income/franchise tax revenues are projected to be \$1,065.0 million in 2013-14, and \$1,100.0 million in 2014-15. These amounts represent an annual increase of 15.1% in 2013-14, and 3.3% in 2014-15. The new estimates are higher than prior estimates by \$104.0 million in 2013-14, and \$110.4 million in 2014-15.

The new estimates reflect year-to-date corporate income and franchise tax collections, which are approximately 25% higher than a year ago. In addition, the outlook for corporate earnings is positive. Corporate profits are forecast to increase in 2014 and 2015, with economic profits projected to increase 6.3% in 2013-14, and 4.3% in 2014-15. Consumer confidence has improved with both the Conference Board Consumer Confidence and University of Michigan Consumer Sentiment indexes increasing. Real disposable income is forecast to increase 3.3% in 2014, and 3.5% in 2015, and consumer purchases of durable goods are projected to increase 5.1% in 2014, and 5.2% in 2015. The improving economy is also expected to signal to businesses that it is time to expand. Companies have substantial amounts of cash on hand, profits are strong, and interest rates are low. Investment in equipment is projected to increase 7.0% in 2014 and 9.2% in 2015. Also, industrial production is forecast to grow at a faster rate than 2013, in both 2014 and 2015, and manufacturing output is projected to improve in both years as well.

The corporate income and franchise tax estimates have been adjusted to reflect the effect of certain law changes, including allowing combined group members to share pre-2009 net business losses, increasing the total credit limit for the economic development tax credit, and the phase-in the manufacturing and agriculture tax credit, that are effective for fiscal years 2013-14 and 2014-15. In addition, the estimates have been adjusted to reflect certain law changes related to tax

enforcement activities by the Department of Revenue, including the reduction in the interest rate on tax refunds.

**Public Utility Taxes.** Public utility tax revenues were \$341.2 million in 2012-13, and are currently projected at \$353.7 million in 2013-14 and \$358.3 million in 2014-15. Compared to the previous estimates, these figures are \$4.6 million lower in 2013-14 and \$2.4 million higher in 2014-15. Utility tax collections are currently expected to increase by 3.7% in 2013-14 and 1.3% in 2014-15. Private light, heat, and power companies are the largest taxpayer group, comprising 65% of estimated public utility taxes for the 2013-15 biennium. Collections from these companies totaled \$226.1 million in 2012-13, and are estimated to increase to \$226.8 million (0.3%) in 2013-14 and \$234.8 million (3.5%) in 2014-15.

**Excise Taxes.** General fund excise taxes are imposed on cigarettes, other tobacco products, liquor (including wine and hard cider), and beer. Total excise tax revenues were \$689.5 million in 2012-13. Excise tax revenues are currently estimated at \$699.4 million in 2013-14 and \$697.0 million in 2014-15, which represents increased revenue of \$23.9 million in the first year and \$28.4 million in the second year compared to the prior estimates. Excise tax revenues have been increased largely due to higher year-to-date cigarette tax collections, which represent 82% of total estimated excise tax revenues.

Cigarette tax revenues were \$569.2 million in 2012-13, which was 3.2% lower than the previous year. Cigarette tax collections are currently estimated at \$575.0 million in 2013-14 and \$570.0 million in 2014-15, which represents increased revenue of 1.0% in the first year and reduced revenue of 0.9% in the second year. Compared to the previous estimates, these amounts are \$23.8 million higher in the first year and \$28.6 million higher in the second year, primarily due to higher than expected year-to-date collections. Minnesota enacted a significant cigarette tax rate increase on July 1, 2013, resulting in its current rate of \$3.432 per pack (which is higher than Wisconsin's tax rate of \$2.52 per pack). It is believed that higher year-to-date tax collections are, in part, due to consumers living along the state border purchasing cigarettes in Wisconsin, rather than in Minnesota, in response to that state's tax increase.

**Insurance Premiums Taxes.** Insurance premiums taxes were \$159.3 million in 2012-13. Premiums tax collections are projected to be \$164.0 million in 2013-14, and \$172.0 million in 2014-15. The estimates are higher than prior estimates by \$4.0 million in 2013-14, and \$4.3 million in 2014-15. The estimate for 2013-14 is based on year-to-date premiums tax collections, which are 3.7% higher than 2012-13 collections. The estimate for 2014-15 reflects industry forecasts of moderate growth in sales, premiums, and profits.

**Miscellaneous Taxes.** Miscellaneous taxes include the real estate transfer fee (RETF), municipal and circuit court-related fees, a small amount from the occupational tax on coal, and some estate tax revenue from ongoing lawsuit settlements. Miscellaneous tax revenues were \$63.2 million in 2012-13, and are estimated at \$67.8 million in 2013-14 and \$74.9 million in 2014-15. These estimates are higher than the previous estimates by \$2.8 million in 2013-14 and \$1.9 million in 2014-15. The increase in estimated revenue is due primarily to higher than expected year-to-date RETF collections.

This office will continue to monitor state revenues and expenditures and new economic forecasts, and notify you and your colleagues of any further adjustments that may be necessary.

Sincerely,

A handwritten signature in black ink that reads "Bob". The letters are cursive and stylized, with the 'B' being particularly large and the 'o' and 'b' following in a fluid, connected script.

Robert Wm. Lang  
Director

RWL/sas

cc: Members, Wisconsin Legislature