Legislative Fiscal Bureau
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January 29, 2009

Senator Mark Miller, Senate Chair
Representative Mark Pocan, Assembly Chair
Joint Committee on Finance
State Capitol
Madison, WI 53702

Dear Senator Miller and Representative Pocan:

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

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

Comparison With the Administration's November 20, 2008, Report

General Fund Tax Collection Projections

On November 20, 2008, the Departments of Administration and Revenue submitted a report to the Governor and Legislature that identified revenue projections for the 2008-09 fiscal year and the 2009-11 biennium. That report, required by statute, is provided to inform the Governor and Legislature of the magnitude of state agency biennial budget requests and present a projection of general fund tax collections.

Due to the decline in economic indicators since November, our analysis indicates that for the three-year period, aggregate, general fund tax collections will be $342.4 million less than those reflected in the November 20 report.

Compared to the November 20 report, tax collections are projected to be $267.1 million lower in 2008-09, $60.1 million lower in 2009-10, and $15.2 million lower in 2010-11. The primary reason for the $342.4 million reduction is due to lower corporate income tax collections of $322.3 million over the three-year period.

2008-09 General Fund Condition Statement

The administration's November 20 report also includes a general fund balance for the 2008-09 fiscal year. That statement shows a gross ending balance (June 30, 2009) of -$281.2 million and a net balance (after consideration of the $65.0 million required statutory balance) of -$346.2 million.

Our analysis indicates a general fund gross balance of -$528.8 million and a net balance of -$593.8 million. This is $247.6 million below that shown in the November 20 report. The 2008-09 general fund condition statement is shown in Table 1.

TABLE 1

Estimated 2008-09 General Fund Condition Statement

	2008-09
Revenues	
Opening Balance, July 1	$130,696,000
Taxes	12,495,200,000
Departmental Revenues	
Tribal Gaming	93,922,200
Other	532,323,000
Total Available	$13,252,141,200
Appropriations	
Gross Appropriations	$14,117,942,500
Compensation Reserves	132,617,900
Biennial Appropriation Adjustment	-34,777,000
Sum Sufficient Reestimates	-18,340,600
Less Lapses	-416,490,000
Net Appropriations	$13,780,952,800
Balances	
Gross Balance	-$528,811,600
Less Required Statutory Balance	-65,000,000
Net Balance, June 30	-$593,811,600

The factors that cause the $247.6 million difference between the two reports follow.

First, our tax collection estimates for 2008-09 are $267.1 million below those of the November 20 report. Second, the departmental revenues (nontax receipts deposited in the general fund) of this report are $6.3 million less than those of November 20. Third, estimated lapses are

$3.8 million less than those of the administration. Finally, these reductions are partially offset by a decrease in estimated sum sufficient appropriation expenditures of $29.6 million.

2008-09 Appropriation Shortfalls

There are some programs which are facing potential shortfalls in the 2008-09 fiscal year.

Medical Assistance. It is currently estimated that the costs of funding the state's share of medical assistance (MA) and BadgerCare Plus benefits will exceed amounts available for these programs by $133.0 million. This is due to an increase in projected costs of $53.5 million and a decision to require a lapse of $79.5 million from the MA appropriation under the 2007-09 budget and budget adjustment acts. To partially address this shortfall, the Department of Health Services (DHS) indicates that it plans to lapse $15.0 million from the MA trust fund and seek legislative approval to fully expend the rest of the projected uncommitted revenue in the segregated MA trust fund ($31.8 million). In addition, DHS intends to delay $22.0 million of 2008-09 MA payments to 2009-10. After these two actions, the remaining shortfall is projected to be $64.2 million. It should be noted that funding for the MA program in 2008-09 assumes that $309 million from a tobacco securitization transaction will be placed in the MA trust fund. That transaction is anticipated in 2008-09 but has not yet occurred.

Department of Children and Families (DCF). The Department has identified a potential shortfall of $40.1 million in three areas. DCF expects expenditures for direct child care services under the Wisconsin Shares program, including child care subsidies, local administration, on-site child care at job centers and counties, and migrant child care, to exceed the amount of funding budgeted by $20.4 million in 2008-09. The Department has applied for federal temporary assistance for needy families (TANF) contingency funds which, if received, would offset some or all of this shortfall. Second, DCF anticipates expenditures for child welfare services in Milwaukee County will exceed the amount of funding budgeted for that purpose by $5.0 million in 2008-09. Finally, when the federal TANF program replaced the former aid to families with dependent children (AFDC) program in 1996, there was some confusion as to what states should do with the AFDC overpayment recoveries collected. After conflicting guidance, the Administration for Children and Families, in the U.S. Department of Health and Human Services, indicated that states must pay the federal share of AFDC overpayment recoveries. Although the state appealed this decision, it was determined that the state owed $10.7 million, with an additional $4.0 million in interest, for a total of $14.7 million. It is possible that this debt may be repaid over a period of time, such that only a portion of the debt would be repaid in 2008-09.

Corrections. The Department of Corrections has identified a potential 2008-09 shortfall of $21.0 million. During the course of the biennium, the Department has been subject to a $24.7 million lapse requirement and now believes that it may not have sufficient funding for the remainder of the fiscal year.

Public Defender. Under the overall lapse requirements of 2007 Acts 20 and 226, $4.6 million is scheduled to be taken from the appropriations of the Public Defender. Because of that, and increased caseloads, the Office now indicates that it faces an estimated shortfall in 2008-09 of $5.9 million, primarily in the private bar appropriation.

In the November 20, 2008, report, DOA Secretary Morgan indicated that the Governor will be developing legislation to address the fiscal year 2008-09 deficit for introduction in 2009. The shortfalls mentioned above will likely be addressed by that legislation, potential receipt of federal economic stimulus funds, or modifications in lapse requirements.

General Fund Tax Revenues

The following sections present information related to general fund tax revenues for 2008-09 and the 2009-11 biennium. The information provided includes a review of the economy in 2008, a summary of the national economic forecast for 2009 through 2011, and detailed general fund tax revenue projections for the current fiscal year and next biennium.

Review of the National Economy in 2008

The U.S. economy experienced a series of dramatic events in 2008, most stemming from what has been characterized as a global financial crisis. By year-end, the cumulative impact of those events was evident in slower economic activity, rising unemployment, and sharply lower projections for near-term U.S. economic growth.

Last February, this office prepared general fund revenue estimates for the 2007-09 biennium based on the February, 2008, forecast of the U.S. economy prepared by IHS Global Insight, Inc. (Global Insight). At that time, Global Insight stated that the U.S. economy had entered a recessionary phase and that real (inflation-adjusted) gross domestic product (GDP) would contract at annualized rates of 0.4% and 0.5%, respectively, during the first two quarters of 2008. In that forecast, Global Insight identified several factors it believed were negatively impacting U.S. economic growth. Those factors included falling residential construction activity and housing prices, a weak labor market that was constraining consumer spending, and tight credit market conditions exacerbated by the write-offs (and the associated downward pressure on capital reserves) banks and other financial companies were taking in connection with their holdings of mortgage-backed securities. Despite these pressures, positive economic growth was expected to resume in the second half of 2008, fueled by lower interest rates and strong growth in exports. Global Insight also believed the economy would be boosted by the Economic Stimulus Act of 2008, a two-year $168 billion federal stimulus package enacted in February, 2008, that for fiscal year 2008 included $107 billion in personal tax rebates and $45 billion in business tax incentives in the form of enhanced expensing and bonus depreciation. On balance, Global Insight's February, 2008, forecast called for full-year real GDP growth of 1.4% in 2008 and 2.2% in 2009.

Actual U.S. economic growth in the first half of the year exceeded Global Insight's February, 2008, projections, with real GDP increasing at annualized rates of 0.9% in the first quarter and 2.8% in the second quarter. Despite this better-than-expected growth, several concerns led Global Insight at mid-year to lower its economic projections for late 2008 and 2009.

One of those concerns was the rapid increase in world commodity prices that occurred in the first half of 2008. In early July, the price of crude oil, as measured by West Texas Intermediate (WTI) spot prices, exceeded $140 a barrel, more than double its year-earlier level. Global Insight believed the inflationary impact of rising oil, gasoline, food, and other commodity prices would result in a reduction in real disposable income during the second half of 2008, and an associated decline in real consumer spending in late 2008 and early 2009.

Another concern was the continued economic drag caused by the U.S. residential housing market. In February, 2008, Global Insight had estimated that declining investment in the residential sector would subtract from real GDP growth in 2008, but that a gradual recovery would enable that sector to positively contribute to real GDP growth in 2009. As 2008 advanced, an accelerating decline in housing prices, and weak new home sales and housing starts, prompted Global Insight to push the anticipated recovery in the housing sector to late 2009 and beyond.

A third concern was the tightening conditions in world credit markets. Continuing a process that began in 2007, banks and other financial companies in the U.S. and abroad announced large losses on their holdings of mortgage-backed securities as the underlying mortgage loans experienced relatively high rates of delinquency and default. The losses on these and other assets, coupled with increasing loan loss reserves, impaired banks' capital and constrained their capacity and willingness to lend money.

The world financial crisis deepened in the second half of 2008 as several of the nation's largest financial institutions, including Lehman Brothers, Washington Mutual, IndyMac Bancorp, Fannie Mae and Freddie Mac, American International Group (AIG), and Citigroup either filed for bankruptcy, were placed into some form of government receivership or conservatorship, or required substantial assistance from the federal government. These events, combined with the ongoing write-down of asset values, sharply falling stock prices (by mid-November, the S&P 500 had declined by roughly 50% from its year-earlier high), and weakening economic conditions, led to a further contraction in the availability of credit. Describing financial market conditions in its October, 2008, forecast, Global Insight stated that the interbank lending market was not functioning, and that the "seizing up" of credit was working its way into the broader economy as "consumers, businesses, and state and local governments find it harder or impossible to obtain credit - and cut back on spending, investment, and hiring as a result."

Responding to these forces, economic activity slowed in the second half of 2008, with real GDP contracting at an annualized rate of 0.5% in the year's third quarter. Global Insight's most recent forecast (January, 2009), discussed in more detail below, estimates that real GDP fell at an

annualized rate of 5.6% in the final quarter of 2008, which would be the largest quarterly contraction in real GDP since the first quarter of 1982.

Employment also fell at an accelerating pace through 2008, with job losses averaging 483,500 a month in the year's last four months according to the U.S. Bureau of Labor Statistics' December, 2008, jobs report. For 2008 as a whole, total non-farm payroll employment in the U.S. declined by 2.6 million, and the unemployment rate increased from 5.0% at the beginning of the year to 7.2% in December. Other measures of U.S. economic activity such as industrial production and business investment also fell during the second half of 2008.

In the U.S., the federal legislative response to the world financial crisis included the aforementioned Economic Stimulus Act of 2008, the Housing and Economic Recovery Act of 2008, and perhaps most notably, the troubled asset relief program (TARP). Enacted into law on October 3, 2008, as part of the Emergency Economic Stabilization Act of 2008, the initial stated intent of the $700 billion TARP was to purchase troubled assets (such as mortgage-backed securities) from financial institutions in order to restore liquidity and stability to the financial system. The legislation created an Office of Financial Stability in the Department of the Treasury authorized to immediately expend $250 billion, with an additional $100 billion available with presidential approval. With respect to the remaining $350 billion, the President was required to submit a written request to Congress seeking the release of those funds. Under the legislation, that release would be authorized unless, within 15 days of receiving the President's request, both houses of Congress passed a joint resolution of disapproval.

Shortly after TARP was enacted, the U.S. Treasury shifted the program's focus away from purchasing troubled assets and toward making direct capital infusions into financial institutions (in exchange for preferred shares and warrants from those institutions) through a "Capital Purchase Program." By year-end 2008, it appeared that through this Capital Purchase Program, other bank capitalization efforts, large commitments to AIG and Citigroup, and assistance to the domestic automotive industry in the form of bridge loans to General Motors and Chrysler and a $5 billion equity investment in GMAC, all or virtually all of the initial $350 billion in TARP financing had been allocated. On January 15, 2009, the Senate effectively authorized the release of the remaining $350 billion by voting down a proposed joint resolution disapproving the President's request for the funds.

The U.S. Federal Reserve responded to the crisis by initiating a series of "facilities" such as the Term Auction Facility, the Term Securities Lending Facility, the Term Asset-Backed Securities Loan Facility, the Commercial Paper Facility, the Money Market Investor Funding Facility, and the Primary Dealer Credit Facility, all of which are intended to promote liquidity and increase access to credit. Similarly, under a mortgage-backed securities purchase program designed to reduce the cost and increase the availability of credit for the purchase of homes, the Federal Reserve plans to purchase up to $500 billion of securities guaranteed by Fannie Mae, Freddie Mac, and Ginnie Mae by the end of the second quarter of 2009.

The Federal Reserve also cut several key interest rates. In September, 2007, the Federal Open Market Committee (FOMC) lowered its target range for the federal funds rate (the rate at which banks lend balances at the federal reserve to other banks overnight) by 50 basis points to 4.75%. Through the rest of 2007 and through 2008, the FOMC continued to lower the federal funds rate, culminating in a 75 to 100 basis point reduction in December, 2008, that took the rate's target range to an all-time low of 0.0% to 0.25%. During that same period, the Federal Reserve also lowered its discount rate (the rate at which banks can borrow money from their regional federal reserve bank's discount window) by a comparable amount, to 0.5%.

Other U.S. policy responses to the crisis have included case-by-case interventions, such as the Federal Reserve's actions to facilitate JP Morgan Chase's acquisition of Bear Stearns in March, 2008, and the Federal Deposit Insurance Corporation's (FDIC) increase of the basic limit on federal deposit insurance coverage from $100,000 to $250,000.

Like the U.S. Federal Reserve, the Bank of England, the European Central Bank, and central banks in China, Japan, and Canada, among others, lowered interest rates in the second half of 2008. Further mirroring the U.S. response, foreign governments also sought to restore liquidity and improve the flow of credit in their economies. Those efforts included increased deposit insurance limits, fiscal stimulus programs, and direct government investment/intervention in domestic banking sectors. Additional monetary and fiscal-stimulus initiatives are expected in 2009 as economies in Japan, Canada, and the Eurozone contract and as growth in many of the world's other economies slows relative to the experience of recent years.

National Economic Forecast

As 2009 begins, Global Insight believes the current U.S. recession (which according to the National Bureau of Economic Research began in December, 2007) is likely to prove among the longest and deepest of the postwar era. In its January, 2009, forecast, however, Global Insight expects economic conditions to begin stabilizing in the second half of 2009 and to move toward recovery in 2010. Several key assumptions underlie that forecast. First, there will be a new federal fiscal stimulus package, comprised of a mix of infrastructure spending, support for state and local governments, increased transfer payments, and tax cuts. Second, the remaining $350 billion in TARP funds will be used primarily to purchase troubled assets and to fund a foreclosure prevention program. Third, oil prices will average $34 a barrel in 2009 before resuming a multi-year climb back to $77 a barrel in 2011. Fourth, the Federal Reserve will keep the target federal funds rate at or near 0.0% for all of 2009, and will only begin to tighten in the first quarter of 2010. Fifth, after appreciating in the second half of 2008 in a "flight from risk", the U.S. dollar will remain relatively constant against other major currencies in 2009, and depreciate modestly during the ensuing several years. Sixth, foreign economic growth is weakening rapidly and will remain weak through 2009, with full-year real GDP falling in Canada, Japan, the Eurozone, and Mexico. Finally, real defense expenditures will continue to grow in 2009 (+4.0%), but at a slower rate than in 2008 (+7.1%). These assumptions are reflected in the following economic indicators taken from Global Insight's January, 2009, forecast.

Real GDP. After growing by 2.0% in 2007, real GDP growth is believed to have slowed to 1.2% in 2008, marked by a pronounced slowdown in the second half of the year. Negative economic growth is expected to continue in the first two quarters of 2009, with real GDP contracting at annualized rates of 5.4% and 1.8%, respectively, before stabilization and recovery begins in late 2009 and 2010. For full-year 2009, real GDP is expected to fall by 2.5%. In 2010 and 2011, Global Insight believes real GDP will grow by 2.2% and 3.2%, respectively.

Consumer Prices. Consumer prices increased 3.8% in 2008. That full-year rate, however, masks a dramatic mid-year reversal coinciding with the collapse in world energy and other commodity prices. After rising above $140 a barrel in early July, WTI spot prices fell approximately 70% to close the year near $40 a barrel. The national average retail price of gasoline (including taxes) followed a similar track, ending the year near $1.60 a gallon, compared to more than $4.00 a gallon in the summer of 2008. These trends are expected to continue in the near term, with oil prices averaging approximately $34 a barrel in 2009. For full-year 2009, overall consumer prices are expected to fall 2.2%, with the less volatile "core" prices (consumer prices excluding food and energy) rising 1.0%. A return of moderate consumer price inflation is anticipated in 2010 (overall consumer prices up 2.4%, core inflation of 1.4%), and 2011 (overall consumer prices up 3.4%, core inflation of 2.0%).

Personal Consumption Expenditures. In 2008, nominal (current-dollar) consumer spending increased by an estimated 3.7%. However, purchases of several items not subject to the state sales tax, such as food for home consumption (+6.7%), gasoline and oil (+12.1%), heating fuel (+13.6%), and services (+4.7%) increased at a faster rate than did personal consumption expenditures as a whole. Conversely, purchases of consumer durable goods, which are generally subject to the state sales tax, fell by 5.5% in 2008, including a 14.0% decline in the sale of motor vehicles and parts.

Looking forward, consumer spending is expected to get some support from the anticipated federal stimulus package and lower energy prices. More than offsetting those positives, however, at least in the near term, will be increased levels of unemployment and more conservative spending patterns as consumers adjust to the negative wealth effects of lower housing values and lower stock prices (the real net worth of U.S. households declined by an estimated 17.4% in 2008). Light vehicle sales are expected to be particularly weak in 2009, totaling 10.3 million vehicles. That projected sales total would represent a 21.2% decline from the 2008 figure and would be about 40% less than the number of light vehicles sold in 2000. For full-year 2009, total personal consumption expenditures are expected to fall 2.1%. According to Global Insight, this would be the first year-over-year decline in nominal consumption since 1938. A rebound, reflecting the anticipated improvement in general economic conditions, is forecast for 2010 (+4.2%) and 2011 (+5.0%). Sales of items that are generally subject to the sales tax are expected to decrease by 5.2% in 2009 and then increase by 3.9% in 2010 and 5.2% in 2011.

Employment. Total U.S. employment, as measured by non-farm payrolls, fell by 2.6 million in 2008. The great majority of those losses (1.9 million) occurred in the last four months of the year. The nation's unemployment rate also increased in 2008, from 5.0% in January to 7.2% in

December. Particular areas of employment weakness in 2008 were the construction (-8.5%) and manufacturing (-5.7%) sectors. Weakness in those two sectors is expected to continue in 2009, with employment in the construction industry falling 9.3%, and manufacturing employment falling 9.0%. The few areas of relative strength in 2009 are expected to include educational services (+4.3%) and health care (+3.4%).

Overall, Global Insight expects the U.S. unemployment rate to rise to 8.5% in 2009 and to 9.1% in 2010, before receding to 8.5% in 2011. Total employment is projected to decline by nearly five million jobs, peak to trough (fourth quarter 2007 to fourth quarter 2009), before job growth resumes in early 2010. Total U.S. nonfarm payrolls are not expected to return to their fourth quarter 2007 level, however, until 2012.

Housing Starts and Housing Prices. U.S. housing starts are estimated to have totaled 906,000 units in 2008, down over 30% from 2007. In the near-term, residential housing construction activity is expected to contract further, with total housing starts of 604,000 units in 2009. That total would represent a decline of more than 70% from the total number of housing starts that occurred in 2005. Global Insight believes residential housing construction activity will rebound in 2010, driven by an improving economy and reduced inventories of new houses. Total housing starts are expected to be 976,000 units in 2010 and 1,339,000 units in 2011.

According to the Federal Housing Finance Agency (FHFA), average U.S. housing prices fell 7.5% during the 12-month period ending in October, 2008, and are down 8.8% from their peak in April, 2007. Other housing price indices indicate much larger price declines. For instance, as of October, 2008, the S&P Case-Shiller 20-city composite index is down 23.4% from what it views as the mid-2006 price peak. Due to high inventory levels of unsold homes and rising foreclosure rates, Global Insight expects the median price of an existing home to continue falling in 2009 (-11.7%) and 2010 (-4.4%), before recovering modestly in 2011 (+3.8%).

Personal Income. After rising by annual rates of between 5.6% and 7.1% in the preceding four years, personal income is estimated to have grown by 3.8% in 2008, as rising unemployment and deteriorating economic conditions constrained income growth. For 2009, personal income is expected to increase by only 0.8%, with real disposable income increasing by a healthier 3.3% due largely to falling consumer prices. In 2010 and 2011, personal income is projected to increase by 2.5% and 4.5%, respectively. Inflation's return in 2010, however, will limit the growth in real disposable income during those years to 0.5% and 1.1%, respectively.

Exports. Exports contributed to U.S. economic growth in 2008, increasing by an estimated 12.8% in nominal terms. Export growth was particularly strong in the first half of the year, aided by a weaker U.S. dollar and economic growth overseas. In its most recent forecast, Global Insight expects U.S. exports to decline in 2009 (-11.7%) as foreign demand falls in the face of a worldwide recession. The U.S. trade deficit, however, is expected to improve in 2009, from $666 billion to $280 billion, as the dollar value of oil imports declines by more than $300 billion due to lower crude oil prices. After remaining flat in 2010, exports are expected to increase by 9.8% in 2011.

The trade deficit is projected to increase to $462 billion in 2010 and to $621 billion in 2011, as oil prices rise and the demand for imports by U.S. consumers increases in response to gradually improving economic conditions.

Corporate Profits. In 2008, pre-tax book profits are estimated to have fallen by 15.5%. Consistent with Global Insight's macroeconomic forecast, that measure of corporate profitability is expected to decline again in 2009 (-4.1%) before recovering in 2010 (+11.9%) and 2011 (+1.0%). Economic profits, which are not affected by federal tax law changes, are believed to have fallen 8.0% in 2008, and are expected to fall in 2009 (-9.8%). In subsequent years, economic profits are projected to increase in 2010 (+7.9%) and 2011 (+2.9%).

Business Investment. Global Insight estimates that business investment spending increased 3.1% in 2008. Continuing a trend of recent years, spending on nonresidential structures was strong in 2008, increasing by an estimated 14.8%. That trend is expected to reverse itself, as investment in nonresidential structures is projected to decline by 18.2% in 2009 and 16.2% in 2010. A slight recovery (+8.7%) is anticipated in 2011. Business spending on equipment and software (E&S) fell 2.3% in 2008, and will fall an additional 15.5% in 2009. This anticipated decrease in overall E&S spending in 2009 includes decreases of over 20% in spending on computers, industrial equipment, and transportation equipment. E&S spending is expected to recover in 2010 (+6.7%) and 2011 (+15.5%).

The economic indicators described above, and summarized in Table 2, reflect Global Insight's "baseline" forecast. Under a more pessimistic scenario, which Global Insight characterizes as a "very deep recession" and to which it assigns a 20% probability, the U.S. economy experiences a more severe economic downturn triggered by a deepening financial crisis, higher rates of unemployment, and greater rates of decline in housing starts and capital spending. In addition, the combined impact of falling asset values and negative economic growth causes consumers to retrench even further than is assumed under the baseline forecast. Real GDP under Global Insight's pessimistic scenario falls by 3.5% in 2009 before recovering slightly in 2010 (+0.8%) and 2011 (+2.7%). Under this scenario, the unemployment rate averages 8.8% in 2009, and 9.9% in 2010, and does not return to below 8.0% until late in 2015.

A more optimistic scenario, to which Global Insight also assigns a 20% probability, envisions a relatively less severe recession and a quicker recovery as the combination of fiscal and monetary stimulus succeeds in restoring the flow of credit in the economy. Under this scenario, real GDP contracts in 2009 by less than under the baseline forecast (-1.5% versus -2.5%) and the full-year unemployment rate in 2009 is 8.1% rather than 8.5%. Under this optimistic scenario, the U.S. economy also experiences a stronger recovery beginning in 2010, as measured by higher rates of real GDP growth (+3.4% in 2010 and +3.3% in 2011), and a gradually retreating unemployment rate (8.0% in 2010 and 7.3% in 2011).

Table 2 shows several national economic indicators drawn from Global Insight's January, 2009, U.S. Economic Outlook.

TABLE 2

Summary of National Economic Indicators
IHS Global Insight, Inc., Baseline Forecast, January, 2009
($ in Billions)

	2008	2009	2010	2011
Nominal Gross Domestic Product	$14,276.7	$14,081.2	$14,573.2	$15,278.5
Percent Change	3.4%	-1.4%	3.5%	4.8%
Real Gross Domestic Product	$11,657.7	$11,364.4	$11,616.8	$11,985.6
Percent Change	1.2%	-2.5%	2.2%	3.2%
Consumer Prices (Percent change)	3.8%	-2.2%	2.4%	3.4%
Personal Income	$12,108.9	$12,204.3	$12,513.8	$13,079.9
Percent Change	3.8%	0.8%	2.5%	4.5%
Personal Consumption Expenditures	$10,064.8	$9,857.4	$10,273.0	$10,782.0
Percent Change	3.7%	-2.1%	4.2%	5.0%
Economic Profits	$1,511.1	$1,362.4	$1,469.7	$1,512.6
Percent Change	-8.0%	-9.8%	7.9%	2.9%
Unemployment Rate	5.8%	8.5%	9.1%	8.5%
Light Vehicle Sales (millions)	13.1	10.3	12.5	14.5
Percent Change	-18.8%	-21.2%	21.5%	15.8%
Housing Starts (millions)	0.91	0.60	0.98	1.34
Percent Change	-32.4%	-33.3%	61.6%	37.2%
Exports	$1,875.0	$1,656.3	$1,655.0	$1,817.4
Percent Change	12.8%	-11.7%	- 0.1%	9.8%

General Fund Tax Collections

Table 3 shows revenue estimates for all general fund tax sources for the 2008-09 fiscal year and each year of the 2009-11 biennium. Over the three-year period, these estimates are $342.4 million lower than the Department of Revenue's November 20 projections (-$267.1 million in 2008-09, -$60.1 million in 2009-10, and -$15.2 million in 2010-11). The $342.4 million variance is a difference of 0.9%. The reduced estimates reflect more recent revenue collections data and a national economic forecast that is more pessimistic than the November forecast. Most of the decrease ($322.3 million over the three-year period) is in the corporate income tax. Smaller

decreases are projected for the sales tax, real estate transfer fee, insurance company taxes, and the estate tax. Projected revenues from the individual income tax, public utility taxes, and excise taxes on alcohol and tobacco are slightly higher than DOR's November estimates. The estimates include the effects of all tax law changes enacted to date and the estimated impact of sales tax refunds associated with the Menasha Corporation lawsuit, which is discussed in more detail below.

TABLE 3

Projected General Fund Tax Collections
(Millions)

	2007-09 Biennium		2009-11 Biennium	
	2007-08 Actual	2008-09 Estimated	2009-10 Estimated	2010-11 Estimated
Individual Income	$6,713.7	$6,585.0	$6,335.0	$6,600.0
Sales and Use	4,268.0	4,025.0	3,955.0	4,205.0
Corporate Income & Franchise	837.8	650.0	700.0	725.0
Public Utility	297.5	327.0	331.0	340.0
Excise				
Cigarettes	455.7	565.0	559.4	553.8
Liquor and Wine	45.2	44.0	45.8	47.6
Tobacco Products	29.8	41.5	42.0	42.5
Beer	9.6	10.0	10.0	10.0
Insurance Company	156.6	170.0	178.5	180.0
Estate	158.8	22.0	0.0	0.0
Miscellaneous Taxes	70.3	55.7	51.5	53.2
Total	$13,043.0	$12,495.2	$12,208.2	$12,757.1
Change from Prior Year		-$547.8	-$287.0	$548.9
Percent Change		-4.2%	-2.3%	4.5%

Individual Income Tax. Individual income tax revenues are estimated to total $6,585.0 million in 2008-09, which represents a 1.9% decrease relative to income tax collections in 2007-08 of $6,713.7 million. Individual income tax revenues are estimated at $6,335.0 million in 2009-10 and $6,600.0 million in 2010-11. These figures represent a decrease of 3.8% in the first year and an increase of 4.2% in the second year. The estimates are based on current collections data, the economic forecast, and assumptions about taxable personal income growth, as well as the effect of law changes.

The January, 2009, Global Insight forecast projects national personal income growth of 3.8% in 2008, 0.8% in 2009, and 2.5% in 2010. Wisconsin personal income has typically grown at a slower rate than national personal income in recent years, and it is anticipated that this trend will continue over the forecast period. Personal income, as measured by the U.S. Bureau of Economic

Analysis, does not include income from capital gains realizations. The tax revenue estimates include a significant downward adjustment in the amount of income tax paid on capital gains to reflect recent losses in asset markets.

The most significant law changes affecting the estimates are the 100% exemption from taxation for social security benefits and the deduction for medical insurance premiums paid by individuals whose employers provide partial health insurance coverage. These provisions were enacted in 2005 Wisconsin Act 25 (the 2005-07 biennial budget) and 2007 Wisconsin Act 20 (the 2007-09 biennial budget), respectively, and each first applied in tax year 2008. The full effect of the social security exemption will occur in 2008-09, but due to a four-year phase-in, the full effect of the medical insurance premium deduction will not occur until 2011-12. Other deductions and credits enacted in recent years will also have a downward impact on revenues.

In addition to the recent law changes, anticipated changes in individual income tax revenues are influenced by the effect of the annual indexing adjustments made to the sliding scale standard deduction and tax brackets. The indexing adjustments for a given year are based on the annual percentage change in the Consumer Price Index as of the month of August of the prior year. While the change in the index as of August, 2008, was considerably higher than in recent years, the change in the index as of August, 2009, is expected to be a reduction from the prior year. These changes will lower income tax collections for tax year 2009 (fiscal year 2009-10) but increase collections for tax year 2010 (fiscal year 2010-11). The indexing adjustment for tax year 2009 will be 5.3%, while the adjustment for tax year 2010 is projected to be -3.8%. The negative indexing adjustment in 2010 will reduce the standard deduction and narrow the tax brackets compared to 2009.

Sales and Use Tax. State sales and use tax revenues totaled $4,268.0 million in 2007-08 and are estimated at $4,025.0 million for 2008-09. The estimate for 2008-09 is a 5.7% decrease from the prior year. Sales tax revenues in the next biennium are estimated at $3,955.0 million in 2009-10 and $4,205.0 million in 2010-11. These estimates reflect a 1.7% reduction in 2009-10 and growth of 6.3% in 2010-11.

Sales tax collections through December, 2008, are 0.47% lower than the same period in 2007 (after adjusting for law changes and modifications to the year-end accrual process in 2007-08), which is higher than the annualized growth rate of -5.7% for the entire fiscal year. The projections reflect forecasts for growth in taxable personal consumption expenditures, modified to account for law changes that provided new sales tax exemptions. These estimates also account for the revenue loss due to the July, 2008, State Supreme Court decision in Wisconsin Department of Revenue v. Menasha Corporation, which expanded the types of computer software that are exempt from the sales tax. The fiscal effects of this decision reduce ongoing sales tax revenues by an estimated $28.3 million per year beginning in 2008-09. The Department of Revenue estimates additional revenue losses from anticipated sales tax refunds resulting from the decision of $21 million, $73 million, and $29 million in 2008-09, 2009-10, and 2010-11, respectively. These amounts are lower than previous estimates because the Department has received fewer claims for refunds than anticipated.

Corporate Income and Franchise Tax. Corporate income and franchise taxes are projected to decrease from $837.8 million in 2007-08 to $650.0 million in 2008-09. Collections are forecast to rebound somewhat to $700.0 million in 2009-10 and $725.0 million in 2010-11. The estimate for 2008-09 is a 22.4% decrease from the previous year. Growth rates of 7.7% and 3.6% are estimated for 2009-10 and 2010-11, respectively.

The estimate for 2008-09 reflects a substantial decline in year-to-date corporate income and franchise tax collections. After adjusting for accrual modifications at the end of 2007-08, through December, 2008, corporate income and franchise tax collections are almost 18% below 2007-08 amounts, and corporate earnings are not projected to improve during the remainder of the fiscal year.

During the forecast period, corporate collections will be affected by declining and then depressed consumer spending, higher inventory to sales ratios, and substantial cuts in capital investment. Under the forecast, real personal consumption expenditures decrease 0.9% in 2009, then increase 2.3% in 2010. In contrast, real personal consumption expenditures grew at least 2.8% each year from 2003 through 2007. Real nonresidential fixed investment is forecast to decrease 15.1% in 2009 and 0.3% in 2010. Exports, which were a prominent source of corporate earnings in recent years, are projected to drop sharply in 2009 before flattening out, due to the global nature of the recession. The forecast projects real exports to decline 7.0% in 2009 and 0.9% in 2010. Business costs are not expected to be able to be cut enough to offset the decline in demand. In addition, the substantial decline in demand reduces the pricing power of firms. As a result, corporate economic profits are forecast to decline 9.8% in 2009 and then to increase 7.9% in 2010, and 2.9% in 2011. Aggregate economic profits in 2011 will be at essentially the same level as in 2008.

The corporate income and franchise tax estimates have been adjusted to reflect a number of tax law changes that will take effect during the forecast period, such as the medical records tax credit and the treatment of related entity rent and interest expenses.

Public Utility Taxes. Public utility taxes are estimated to be $327.0 million in 2008-09, $331.0 million in 2009-10, and $340.0 million in 2010-11. These estimates represent year-to-year increases of 9.9% in 2008-09, 1.2% in 2009-10, and 2.7% in 2010-11. The gross revenues tax group comprises over 70% of estimated collections over the three-year period and accounts for just over half of the estimated increase over 2007-08 actual tax collections. The largest increase is forecast for the private light, heat, and power companies and is due to higher revenues resulting from the construction of new electric generating facilities and the cost of fuel used to generate electricity. Although the ad valorem tax group represents only 27% of total public utility tax revenues over the three-year period, the ad valorem group is forecast to provide 47% of the growth in tax revenues. This is attributable to estimated increases in ad valorem tax rates and higher assessed values due to investment in plant and equipment.

Excise Taxes. General fund excise taxes are imposed on cigarettes, liquor (including wine and hard cider), tobacco products, and beer. In 2007-08, excise tax collections totaled $540.3 million. Of this amount, $455.7 million (approximately 84%) was from the excise tax on cigarettes. Excise tax revenues are estimated at $660.5 million in 2008-09, $657.2 million in 2009-10, and $653.9 in 2010-11. These estimates represent growth of 22.3% in 2008-09, -0.5% in 2009-10, and -0.5% in 2010-11.

The anticipated 22.3% growth in 2008-09 is largely caused by the effects of the increased tax rates on cigarettes and tobacco products. The cigarette tax was increased from $0.77 to $1.77 per pack effective January 1, 2008. Tobacco products were taxed at a rate of 25% of the manufacturer's sales price prior to January 1, 2008. Under current law, tobacco products are taxed at a rate of $1.31 per ounce for moist snuff and 50% of the manufacturer's sales price for all other tobacco products. The increased rates in these excise taxes were in effect for only six months of 2007-08, whereas 2008-09 collections will have a full year of collections at the higher tax rates.

Insurance Premiums Taxes. Insurance premiums taxes are projected to increase from $156.6 million in 2007-08 to $170.0 million in 2008-09, $178.5 million in 2009-10, and $180.0 million in 2010-11. The estimate for 2008-09 is based on year-to-date premiums tax collections, which are about 9.0% higher than for the same period of 2007-08. Estimates for 2009-10 and 2010-11 reflect anticipated increased premiums charged by insurers. Investment income is generally a significant source of income for insurers. In response to the substantial decline in investment income from the downturn in financial markets, insurance companies are expected to increase premium rates to attempt to maintain some level of profitability. Collections are projected to moderate in 2010-11 to reflect the forecast of a stabilizing economy.

Estate Tax. Revenues from the estate tax totaled $158.8 million in 2007-08 and are currently estimated at $22.0 million for 2008-09 and $0 in 2009-10 and in 2010-11. The significant reduction in estimated revenues in 2008-09 and absence of revenue in the next biennium are the result of provisions under current federal and state laws that eliminate the state estate tax for deaths on or after January 1, 2008. As of January 1, 2008, the state statutes impose an estate tax equal to the credit for state death taxes allowed under the federal estate tax in effect on the date of the decedent's death. However, federal law no longer includes a credit for state death taxes (which was phased out between 2002 and 2005, and eliminated as of January 1, 2005). Therefore, the Wisconsin estate tax is no longer imposed for deaths occurring on or after January 1, 2008.

The current federal estate tax provisions are scheduled to sunset for deaths occurring after December 31, 2010, which would restore the credit for state death taxes. In the absence of a federal law change to repeal the sunset provision or otherwise modify the federal estate tax, Wisconsin would resume collecting an estate tax for deaths occurring in 2011. Because estate taxes are generally payable nine months after the date of death, Wisconsin would begin receiving revenues in the fall of 2011 (the 2011-12 fiscal year).

Miscellaneous Taxes. Miscellaneous taxes include the real estate transfer fee, municipal and circuit court-related fees, and a small amount from the occupational tax on coal. Miscellaneous tax revenues were $70.3 million in 2007-08, of which 85% was generated through the real estate transfer fee. Based on a decrease in average home prices, a slowdown in the housing sector as described under the "U.S. Economic Outlook," and a 25.8% decrease in the real estate transfer fee collections through December, 2008, miscellaneous taxes are projected to decrease to $55.7 million in 2008-09 (which represents a 20.8% decrease from 2007-08 collections). Miscellaneous taxes are estimated to decrease to $51.5 million in 2009-10 and increase to $53.2 million in 2010-11, which represents a 7.5% decrease and a 3.3% increase in revenues, respectively.

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

Sincerely,

Robert Wm. Lang
Director

RWL/sas
cc: Members, Wisconsin Legislature