State Cashflow Management

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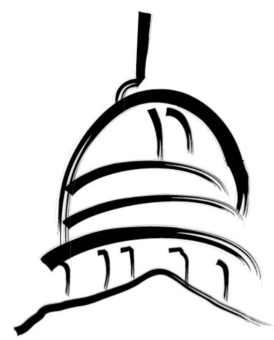

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State Cashflow Management

In response to repeated general fund cashflow problems in the early 1980s, the state developed a number of cashflow management procedures. This paper provides an overview of these procedures, including the statutory provisions that govern cashflow management. In addition, information is presented on recent state cashflow experience and cashflow management alternatives.

State Cashflow Management Procedures

Under current law, there are three tools that are available to the Secretary of the Department of Administration (DOA) in managing the state's cashflow. These tools are: (a) borrowing cash from other state funds on a temporary basis; (b) borrowing cash from investors through the issuance of short-term operating notes; and (c) delaying payments from a fund until enough cash is available to meet its obligations.

Temporary Borrowing from Other State Funds

The state uses the state investment fund as an investment pool for portions of retirement trust assets and cash balances of the state's various funds. In addition, local governments can elect to invest their cash balances in the fund. The state investment fund, which is managed by the State of Wisconsin Investment Board (SWIB), had approximately $5.9 billion in assets during October, 2002.

The Secretary of DOA is authorized to temporarily reallocate to the general fund an amount equal to 5% of total general purpose revenue (GPR) appropriations in order to support the fund's cashflow (approximately $556 million in 2002-03). The Secretary may permit an additional 3% to be used for temporary reallocations to the general fund for a period not to exceed 30 days (approximately $334 million in 2002-03). Reallocations of the additional 3% may not be made for consecutive periods. In total, 8% of GPR appropriations ($890 million in 2002-03) may be allocated to the general fund on a temporary basis. No limit applies to temporary reallocations from the budget stabilization fund to the general fund.

For funds other than the general fund, up to $400 million can be reallocated between the general fund, certain segregated funds, and the local government investment pool.

In no case can borrowing be made from retirement trust assets or from several specific segregated funds. In addition, the fund from which money is borrowed receives interest at the current state investment fund earnings rate. Further, the Secretary cannot temporarily reallocate balances if such borrowing would cause cashflow problems for the fund or account from which it is made. The Department of Administration estimated that the state investment fund had $1.6 billion of monies available for temporary reallocations as of October 31, 2002.

Short-Term Borrowing from Investors--Operating Notes

Operating notes can be issued to fund a cashflow deficit in the general fund. If a general fund cashflow problem is anticipated, the Secretary of DOA, with the Governor's approval, can request the issuance of operating notes. This request is subject to approval by the Joint Committee on Finance under a 14-day passive review process. If the request is approved, the Building Commission issues the notes.

The amount of operating notes that can be outstanding during a fiscal year is limited to 10% of total GPR and program revenue appropriations for that year. In 2002-03, this 10% limit is approximately $1.4 billion. In addition, operating notes must be repaid before the end of the fiscal year of issuance. Table 1 shows the amount of operating notes that have been issued annually since 1983-84.

In deciding on the amount of operating notes to issue, two factors are considered. First, federal arbitrage regulations require that the actual cash deficit equal at least 90% of the issuance amount, or the state must rebate interest earnings above the rate paid on the note. Second, the operating notes should provide sufficient cash to largely avoid temporary reallocations of available state investment fund balances during the fiscal year.

Two notes were issued in 1997-98; one dated July 1 for $300 million and a second dated November 12 for $150 million. The second note was issued to offset the cashflow effects of a $215 million payment made to the special investment performance dividend (SIPD) lawsuit settlement. There were no notes issued during 1999-00 and 2000-01 because it was anticipated that there was sufficient cash available to avoid a deficit. For the 2001-02 fiscal year, however, the state again turned to short-term borrowing from investors to support the general fund's cashflow, with $800 million of operating notes issued in September, 2001. In 2002-03, no operating notes have been issued to date.

Table 1: Historical Operating Notes (In Millions)

Fiscal Year	Amount
1983-84	$700
1984-85	350
1985-86	350
1986-87	350
1987-88	350
1988-89	350
1989-90	300
1990-91	200
1991-92	450
1992-93	450
1993-94	350
1994-95	350
1995-96	250
1996-97	150
1997-98*	450
1998-99	350
1999-00	0
2000-01	0
2001-02	800

* Two notes were issued in 1997-98, one for $300 million and a second for $150 million.

Payment Delays

The Secretary of DOA can prorate or delay payments from any fund that is having cashflow problems. This authority can only be used after all other possible procedures, including temporary reallocations of available state investment fund balances, have been used and found to be insufficient. In addition, the Secretary has to notify the Joint Committee on Finance and cannot act without a meeting of the Committee if such a meeting is scheduled within two working days after notification by the Secretary.

The statutes establish a priority schedule for payment in case of cashflow problems. The first priority is debt service payments on state general obligation debt and the second priority is debt service payments on state operating notes. Neither of these debt service payments can be prorated or reduced. State employee payrolls have third priority. The Secretary determines the priority of payments for all other items.

If payments to local units of government are delayed, the Secretary must establish a procedure under which the delay can be appealed for a unit that would be adversely affected. In addition, interest is paid on delayed payments to local units of government at the state investment fund earnings rate for the period of the payment delay.

State Cashflow Experience

The general fund receives revenues and makes expenditures for programs funded with general purpose revenue, federal revenue, and program revenue. Due to the timing of revenue collections and payments of large aid amounts, the state has experienced repeated cashflow problems. The pattern of receipts and outlays is illustrated in Table 2, which summarizes actual general fund revenues and expenditures for fiscal year 2001-02 (excluding the effect of $800 million in operating notes).

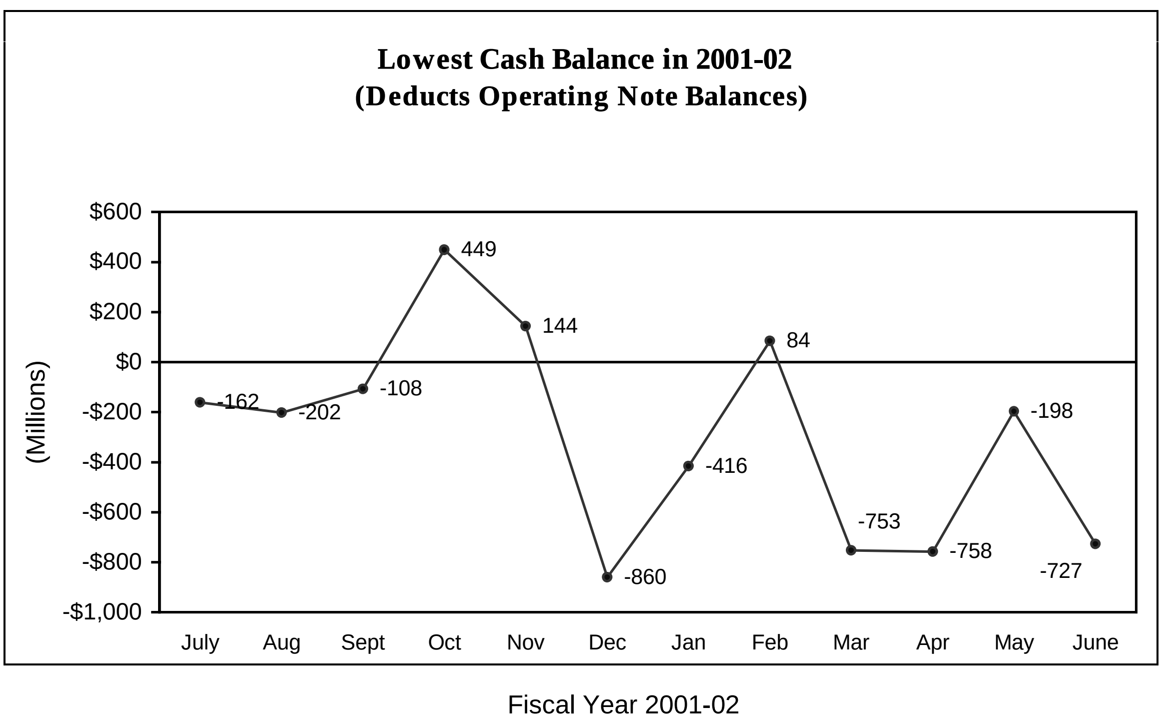
Table 2: Cashflow in 2001-02* (In Millions)

	Revenues	Expenditures	Revenues Less Expenditures
1st Half of Fiscal Year	$9,425.2	$10,123.1	-$697.9
2nd Half of Fiscal Year	11,094.1	11,087.5	6.6
Total	$20,519.3	$21,210.6	-$691.3

*Excludes effects of $800 million in operating notes issued in 2001-02.

As Table 2 shows, on a cash basis and in the absence of the operating notes, expenditures exceeded revenues by $697.9 million during the first six months of fiscal year 2001-02. In the second half of the fiscal year, revenues exceeded expenditures by $6.6 million, so that over the full year, expenditures exceeded revenues by $691.3 million. The fiscal year ended with a $421.9 million cash deficit, which was covered through temporary borrowing from other state funds.

The general fund's worst day, which occurred



in December, had a cash balance of -$860 million (deducting the operating note balances). The graph shows the lowest cash balance for each month during 2001-02. As shown in the graph, the lowest cash balance varied considerably from month to month.

Historically, with some exceptions, the general fund would have experienced a cash deficit in December in the absence of operating notes. In 2001-02, cash deficits would have occurred in all but one of the months from December through the end of the fiscal year.

Generally, the state's cashflow pattern is attributable to the uneven distribution of both revenues and expenditures. On the revenue side, approximately 54.1% of all general fund revenues were received during the last half of fiscal year 2001-02. The state's individual and corporate income taxes and federal and program revenue receipts were revenue sources that contributed to this imbalance. It would be difficult for the state to modify the timing of these revenues, because income tax filing deadlines coincide with federal deadlines, and payments under other federal programs are not subject to direct state control.

For expenditures, the current payment schedule for major state aid payments contributes to the general fund cashflow pattern. Table 3 summarizes the approximate payment schedules for three major state aid programs. As shown in the table, the state paid $3.1 billion (56.4%) of the total $5.5 billion in funding for these programs during the first six months of fiscal year 2001-02.

Although over 50% of the state's major expenditures and less than 50% of revenue collections occur in the first half of the fiscal year, a cash deficit had not been experienced in the two years prior to 2001-02 because of unusually large opening cash balances ($736.1 million in 1999-00 and $671.6 million in 2000-01) resulting from higher than expected tax collections. With the

Table 3: Payment Schedule for Three Major State Aid Payment Programs in 2001-02 (In Millions)

Month	General School Aid	Shared Revenue*	School Levy Tax Credit	Totals
July, 2001	$75.0	$201.3	$469.3	$745.6
August	0.0	0.0	0.0	0.0
September	570.0	0.0	0.0	570.0
October	0.0	0.0	0.0	0.0
November	0.0	817.9	0.0	817.9
December	970.0	0.0	0.0	970.0
(Subtotal)	$1,615.0	$1,019.2	$469.3	$3,103.5
January, 2002	$0.0	$0.0	$0.0	$0.0
February	0.0	0.0	0.0	0.0
March	960.0	0.0	0.0	960.0
April	0.0	0.0	0.0	0.0
May	0.0	0.0	0.0	0.0
June	1,435.0	0.0	0.0	1,435.0
(Subtotal)	$2,395.0	$0.0	$0.0	$2,395.0
2001-02 TOTAL	$4,010.0	$1,019.2	$469.3	$5,498.5

* The shared revenue amount includes $930.46 million in shared revenues, $20.76 million in county mandate relief, $57.0 million in expenditure restraint and $11.0 million for small municipalities shared revenue.

carryover cash balance in 2001-02 reduced to a more typical level of $281.6 million, the cashflow problems that occurred in the past reemerged. In spite of the $800 million in operating notes issued in September, 2001, temporary allocations from other state funds were needed to cover cash deficits in five of the remaining nine months in the fiscal year. The 2001-02 general fund closing cash balance was -$421.9 million.

While 2001-02 ended with a negative cash balance, the undesignated balance in the general fund at the year's end was positive ($53.8 million). The undesignated balance is calculated by comparing general fund assets and liabilities as of June 30, of the fiscal year, and deducting required reserve and designated amounts. Since it is an accounting balance, it differs from the cash balance of the general fund, which varies on a daily basis. As was the case in 2001-02, the state's historical cashflow problems have occurred even when the general fund ended with positive undesignated balances.

Cashflow Management Alternatives

As noted, the state's large opening cash balances of $736.1 million in 1999-00 and $671.6 million in 2000-01 were sufficient to support the general fund's cash needs in those fiscal years. Based on this experience, it is reasonable to expect that approximately $700 million would be sufficient each year to avoid large cash deficits in the general fund associated with the timing of revenues and expenditures.

Historically, the state has managed its need for additional cash at certain times of the year by issuing operating notes. Under current law, the state is able to borrow money at tax-exempt interest rates to support the general fund's cashflow, rather than at the higher rate paid on the taxable securities held in the state investment fund. Under this authority, the state issued operating notes each fiscal year from 1983-84 to 1998-99. Each of these note issues was repaid by the end of the fiscal year of issue and supplied sufficient cash for the state to make payments in a timely manner, without having to make significant temporary reallocations from available balances of the state investment fund after the note issue. In fiscal year 1998-99, it was estimated that the state saved approximately $3.8 million through the issuance of operating notes, compared to utilizing temporary reallocations from the state investment fund.

While issuing operating notes is typically less costly than temporary borrowing through the investment fund, this is not always the case. In 2001-02, the interest rate paid to investors for the operating notes exceeded the rate earned in the SIF fund for some months. Therefore, the interest paid on the notes was higher than the interest that would have been paid for temporarily using other state funds in those months. However, in the absence of the operating notes, there would have been a greater risk of cash deficits exceeding the amounts available under the temporary borrowing authority.

One alternative to relying on operating notes would be to increase the statutory balance requirements under current law. Wisconsin statutes provide that no bill may be enacted by the Legislature if it would cause the estimated general fund balance on June 30 of any fiscal year to fall below a specified percentage of budgeted GPR expenditures for the fiscal year. The current requirements, provided under 1999 Act 9 (the 1999-01 budget), established a 1.2% reserve requirement in 2000-01 and specified phased-in increases that will reach 2.0% for 2005-06 and thereafter. Based on GPR expenditures budgeted under 2001 Act 109 (the 2001-03 budget adjustment act), the required rate would have to be increased to 6.2% to achieve a statutory reserve of $700 million.

A second alternative to issuing operating notes would be to add to the current budget stabilization fund. Under 2001 Act 16 (the 2001-03 budget), the Secretary of DOA is required to transfer into the budget stabilization fund 50% of the amount by which actual tax collections exceed those that had been forecast for the fiscal year (up to a maximum of 5% of estimated GPR expenditures for that fiscal year). In the absence of an excess of actual revenues over those forecast, no amounts are transferred to the budget stabilization fund under this mechanism. In order to guarantee increases in the budget stabilization fund, the Legislature could require that sums be transferred to the fund whether or not actual revenues exceed tax collections that had been projected for the fiscal year.

An additional option would be to shift a portion of the shared revenue and school levy credit payments to later in the fiscal year. The lowest cash balance after deducting the operating notes has historically occurred in December. Under current law, all of the shared revenue payments ($1.0 billion in 2001-02) are made in the first half of the fiscal year. In addition, all of the school levy credit ($469.3 million in 2001-02) is paid in the first month of the fiscal year. If $300 to $400 million of these payments were shifted to May or June, the state's cashflow in the fiscal year would be improved.

A major disadvantage of this alternative is the effect this type of shift would have on municipal budgets. Since municipalities budget on a calendar year basis, the shift of $300 to $400 million in shared revenue or school levy credit payments to May or June would result in a significant one-time loss of revenues for municipalities. Alternatively, the state could advance $300 to $400 million of payments from July and November to the preceding May or June to establish the proposed payment schedule. However, this approach would represent a one-time cost of the same amount to the state's general fund.

A final alternative would be to channel any future increases in these state aid programs to payment dates in the later part of the state's fiscal year. This would more slowly balance the state's cashflow pattern. This alternative does not relate to the policy decision of which state aid programs should receive additional funding, but rather to the timing of the payment of any increased funding for each of these state aid programs. If additional payment amounts for these programs could be scheduled late in the state's fiscal year, the general fund's cashflow situation would be improved.