THE BANKRUPTCY OF GOVERNMENT
THE DECLINE AND FALL OF MILWAUKEE COUNTY

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Within two years Milwaukee County will be insolvent.

Shortsighted, internally-focused decisions have caught up with the county. Over the years Milwaukee County has provided its employees with generous retirement benefits, and over the years the county has failed to set enough money aside to pay for those benefits. In 2007, the county will be forced to start paying the piper.

The 2007 county budget will be swimming in red ink, in spite of the fact that the county will be collecting the maximum amount of sales tax revenue and close to the maximum property taxes allowed under Wisconsin law. The 2007 deficit will be $81 million, and will grow by more than $40 million annually. If left unchecked, the deficit could grow to $250 million by 2011.

The growth of tax receipts simply cannot keep pace with fringe benefits, which are at 61% of salaries this year and will be over 100% by 2010. The price tag on retirement benefits, including pensions and health care, are driving the costs skyward.

This article will examine how the county's budget crisis was born. It will also show how this problem, created within the bowels of the county courthouse, will surpass the county's capacity to solve it.

Milwaukee County's fiscal crisis will pose a dilemma for state government. Should it remain detached and watch Wisconsin's largest county—home to both the state's key economic engine, as well as the largest concentration of low-income people—quickly lapse into insolvency? Or should it take action to stave off bankruptcy?

While state government involvement is probably necessary, a state bailout would be ill-advised. In fact, state financial assistance should only be considered as part of a broader restructuring of the county's finances. Specifically, the state should create a temporary oversight board to rectify the county's fiscal mismanagement. Like boards formed to prevent bankruptcies in other urban centers, the board needs to: restructure staffing, cut

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spending, install financial controls, manage the county's finances until deficits are eliminated, and develop a long-term plan for fiscal solvency. In addition we recommend that it might be time for the Milwaukee County Board to become a part-time body—like the other seventy-one counties in Wisconsin, and that county elected officials be removed from the pension and benefit system they oversee.

Introduction

As the Milwaukee County Board slogged through the hundreds of issues it needed to resolve in preparing the 2006 budget, it was faced with what to do with the County Farm. The farm, located in Franklin, had once been a source of food for the House of Corrections. However, the rising cost of supervising prisoners, and the availability of less expensive food from other sources, had long since rendered the County Farm obsolete. The food it now produces goes not to the jail, but is donated to a local food bank. The fish are raised to stock the ponds at the county parks.

Clearly the $180,000 needed to operate the farm was nearly impossible to justify in light of the county's balance sheet, which is why the county executive deleted it in the budget he sent to the board. But the county board simply could not take a deep breath and let the County Farm go the way of gas lamps and the rotary phones. So, the board ventured into all-too-familiar territory, looking for ways to keep the farm and its four employees going. The board directed Ron Malone, the head of the House of Corrections, not to shut down the operation, but rather to find a way to raise the money needed to keep it going.

The dutiful Malone did what was asked, but was forced to return to the board this past March and admit that, try as he could, there was no other revenue source to keep the farm staffed. An exasperated board, still unwilling to face reality, directed their own staff to simply increase some other revenue line in Malone's budget to cover the cost. In essence, they told the staff to assist in their fiscal slight-of-hand.

This might seem like just another example of the dysfunctional nature of government. However, this decision, made in the shadow of looming deficits, exemplifies the board's inability to deal with the new fiscal reality facing the county. This decision, and hundreds of other similar decisions made over the years, has led Milwaukee County to the brink of bankruptcy. A pervasive interest in taking care of the county employees and preserving the status quo has defined the inner workings of county government.

Not long ago Milwaukee County was the jewel of Wisconsin counties. It had successfully revamped its mission to address the myriad of social issues that confront urban centers everywhere. And every year the county budget balanced. As recently as 2003 the county closed the year with a $14.4 million surplus.[1]

But the Milwaukee County of today is adrift in a rising tide of red ink. It has maxed out the revenue from sales and property taxes, and it is facing an $81 million deficit next January. That deficit will grow to $250 million within four years.

No one can accuse the county executive of trying to sweep the fiscal mess under the carpet. Just the opposite, he seems anxious to describe the fiscal meltdown with the fervor of the radio announcer covering the docking of the Hindenburg. As the county executive lays out the fiscal reality on the breakfast circuit, it quickly becomes apparent to listeners that the county budget is in true crisis. His vision for the county has been reduced to, "keeping the county afloat."

What is at the root of the county budget crisis? Is it escalating caseload counts or a softening of the economy? No, the problem has three root causes:

1. **A fringe benefit budget that will equal 79% of salaries next year.** Contributing to the fringe benefit rate is the well-publicized pension enhancement approved by the previous county executive and Milwaukee County Board. Another substantial factor is that health care costs that are rising at a 15% rate.

2. **Flat aids from state government.** Since 2000, Milwaukee County has seen its shared revenues grow by just $145,000; and decline by $3.5 million since 2003. It is worth noting that state aids have been flat throughout Wisconsin, and yet no other county or municipal government is facing the same fiscal crisis as Milwaukee County.

3. **Beginning in 2007 accounting rules will require the county to reflect the full cost of benefits provided to retired employees**. This will add a minimum of $29 million per year to its budget, an amount that will rise to $40-$60 million when the actuarial analysis is finished. In the past, the true cost of employee benefits has been hidden in the pay-as-you-go approach to budgeting, which significantly understated costs.

The county cannot delay fixing the problem until the point where it cannot pay its bills.

Understandably, the public has been desensitized to reports of government budget problems. However, the magnitude of Milwaukee County's problem puts it into a different category. The size of the problem transcends traditional budget solutions such as trimming departmental budgets or delaying expenditures.

Like a failing business, it will not be long before the county is unable to meet its obligations. When corporate America is confronted with a balance sheet as daunting as the county's, business is forced to take extreme measures. The ultimate solution is bankruptcy court.

And, like any failing business hoping to survive, Milwaukee County needs to accomplish two goals. First, it needs to restore sound financial footing. Second, it must shed the systems and the processes that have led to insolvency. For the county this will require a fresh approach to fiscal management, one that diminishes the impact of politics on financial decisions.

The lone ray of sunshine is that, as of today, Milwaukee County is still able to meet its commitments. The full force of the fiscal fiasco will be felt in 2007. But the county cannot delay fixing the problem until the point where it cannot pay its bills. The programs operated by the county are simply too vital to too many people, and Milwaukee County is home to Wisconsin's most powerful economic engine. A healthy Milwaukee County is important to the citizens of the county and the citizens of the entire state.

The problem

The common perception is that Milwaukee County's fiscal problem stems from the 2001 pension enhancements. While that is largely true, the seeds of the problem were sown much earlier—actually before 1994. Remarkably, prior to 1994 the benefit package included free health insurance for life for retired employees and their dependents. Although rescinded in 1994, that health-care-for-life benefit began a ticking time bomb in the county budget. It would explode when those pre-1994 hires began retiring.

Approving a benefit package that included health-care-for-life proved to be relatively painless at the time, since the cost wouldn't show up in the county's budget until the employees retired. The big costs of the benefit wouldn't be realized until well into the future because accounting was handled on a pay-as-you-go basis. So even though it was understood that a day of reckoning would eventually come, the county's financial statements have never included an accounting of the true cost of the benefit.

That is about to change for Milwaukee County and every other local government with budgets of at least $100 million. Because of a new national standard by the Government Accounting Standards Board (GASB) to be implemented in 2007, Milwaukee County will have to reveal the estimated value of post-retirement benefits (which includes health-care-for-life). The disclosure requirement is meant to recognize the value of promises of post-retirement health care for county employees. This is the same standard that the private sector has been operating under since the early 1990s.[2] For Milwaukee County the disclosure of the cost of these benefits will add $40-$60 million per year[3] to the county budget.

Similarly, in 2007 the county will have to disclose the full value of the funded and unfunded pension liability. Milwaukee County's unfunded pension liability was set at $356 million in a 2005 analysis. This amount is amortized over thirty years using an 8% growth rate. The annual cost of working off the total pension liability is $50 million, which will grow by $3 million per year. In 2006, to help balance the budget, the county knowingly underfunded pension liability by approximately $19 million. This effectively funded part of the operating budget with money borrowed at an 8% interest rate.

Because of multiple years of underfunding, Milwaukee County's pension funding now covers only 79% of total liabilities. This looks anemic compared to the Wisconsin Retirement System (99% funded) and the City of Milwaukee Pension System (funded at 116%). It is notable how quickly the Milwaukee County funding ratio dropped. In 2000 it stood at 121% and gradually eroded to 79% in 2005.[4] The decline is attributable to declining investment returns, payments to retirees, and underfunded contributions from the county.

Throughout the country, as budgets have been stressed, governments have cut back on pension contributions. This has caused Milwaukee County's funding ratio to drop to 79%. Other local governments with lower funding ratios than Milwaukee County include Atlanta, Chicago, Minneapolis, and Boston. A national survey in 2002 pegged the average ratio for those funds that are underfunded to be 88%.[5]

It might be tempting for the county to try to avoid the full impact of the new GASB standard. And in fact GASB has stated that governments are not required to fund the liability. However, there is a specific Wisconsin statute that applies only to Milwaukee County. It states that "Every accounting and budgeting procedure that is applied under this section shall comply with generally accepted accounting principles for government as promulgated by the governmental accounting standards board. . . "[6] Whatever wiggle room the county formerly had is gone.

Governments across the country are learning that underfunding pensions and other post-retirement benefits is even more expensive in the long run. Actuaries set the growth of pension liabilities at 8% annually and other retirement benefits at 6% annually. So whatever amount is underfunded in any year, that amount will increase by the relevant percentage in subsequent years. Compounding will drive the cost of those unfunded liabilities up quickly. Therefore if the county chooses to underfund these obligations, the "savings" from underfunding will simply push additional costs into future years with these growth rates applied to them. In effect, this represents a very expensive borrowing option for the county.

To date, bond ratings have not reflected the underfunding of public pensions. However, with the advent of the new GASB rules for post-retirement health care, that will likely change. One rating agency said, "An absence of action taken to fund OPEB (other post employment benefits) liabilities or otherwise manage them will be viewed as a negative rating factor.[7]

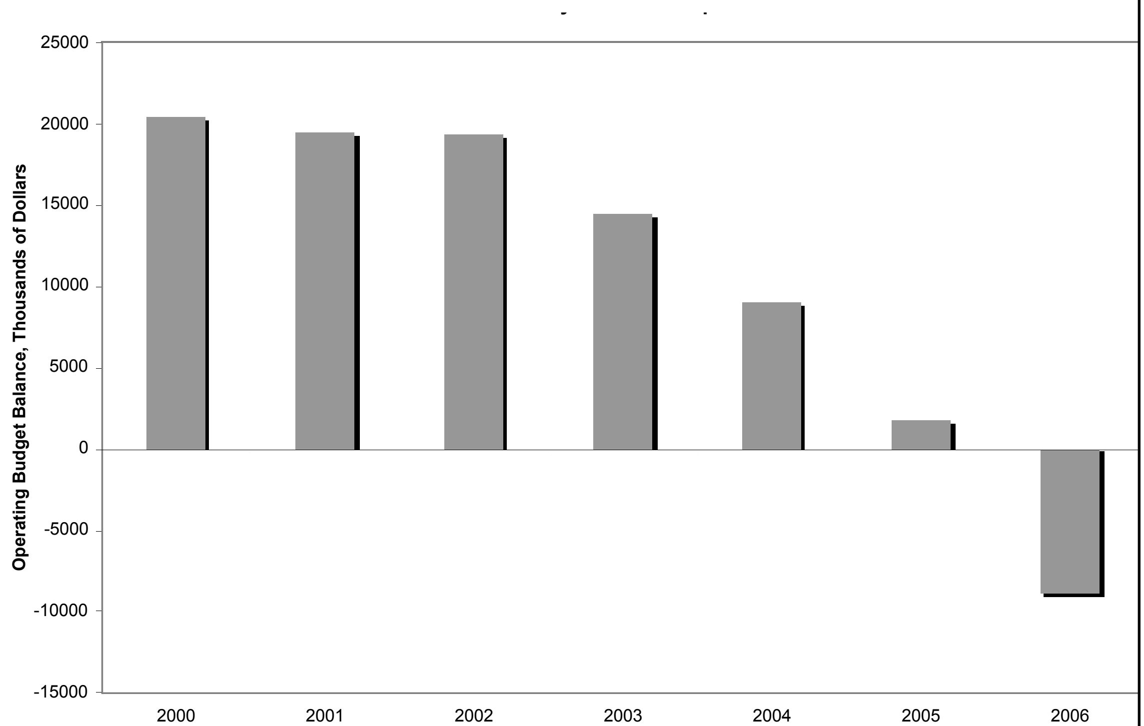
The final major cost driver in the county budget is employee health care. Like all Milwaukee-area employers, Milwaukee County has experienced rapidly rising health care costs. In response the county has introduced several changes including co-payments, reduced employer contributions, and a tiered prescription drug plan. County staff estimate 15% annual cost increases for the foreseeable future. This might be higher than will actually be realized, but historically few employers have overestimated health care costs. The 15% growth rate is thought to be prudent.

When the cost of the unfunded liability of pensions and retiree health care are added to the fringe benefit costs for current employees, the county's fringe benefit rate will grow from 61% in 2006 to 79% in 2007. Based on the County's estimate, *the fringe benefit rate is projected to exceed 100% by 2010.* This means that the county will be paying more than a dollar in benefit payments for every dollar of salary paid.

Let's stand back and put this rampaging fringe benefit obligation in the context of the overall county budget. Figure 1 shows that from 2000 to 2002 the county budget had a healthy budget reserve. However, beginning in 2003, expenses outstripped revenues and the reserve began to disappear. The county was able to produce balanced budgets in 2003-2005 only by eating into the reserve. At the close of 2005 the reserve had been eliminated.

The county has taken several measures to improve the bottom line. The county workforce was reduced from 7,726 in 2000 to 6,026 in 2006. With the reduced workforce and limited salary increases, the county's salary expenditures are actually less in 2006 ($254 million) than they were in 2000 ($263 million). The county also moved to eliminate the 2001 pension enhancements. Further, the county has implemented several changes in health insurance—introducing co-payments, reduced employer contributions, and a tiered prescription drug plan.

FIGURE 1 MILWAUKEE COUNTY RESERVES DEPLETED



Source: Preliminary Official Statement

But in spite of these efforts, in 2007 the county will be challenged to accommodate the added budgetary requirements of the new GASB requirements. Table 1 shows the projected county budget for 2006-2011.[8] The table shows the deficit growing from $81 million in 2007 to $250 million in 2011. The projections in the table are based on projections of neither growth or contraction of the county workforce or county programs. Also, it assumes no county-wide salary increases. Revenue projections include some growth in sales tax receipts and increasing the property tax levy to maximum allowed by law.

Table 1 shows the steady upward trend of spending, particularly for Social Security, Health Insurance, Medicare Reimbursements, Pension, and OPEB (mostly health care for retired employees). Overall spending is up 21% during the 2007-2011 period. Spending for non-fringe costs shows modest growth. Clearly, the fringe benefit category is what fuels expenditure growth.

Overall revenue growth is projected to be much slower—2% during the same five years. While property tax collections are projected to increase by 22% during the 2007-2011 period, they represent only 18% of total revenues. Of particular note is the fact that the county is forecasting a decline in state and federal aids and flat collections from departmental revenue. These two sources account for 69% of county revenues.

TABLE 1 MILWAUKEE COUNTY PROJECTION OF BUDGET GAP: 2006-2011

Milwaukee County Operating Results Projection, 2006 to 2011, Millions of Dollars

EXPENDITURES	*Estimated* ***2006***	*Projected* ***2007***	*Projected* ***2008***	*Projected* ***2009***	*Projected* ***2010***	*Projected* ***2011***
Salaries	263.7	268.0	272.0	276.1	280.2	284.4
Social Security	18.8	20.5	20.8	21.1	21.4	21.8
Employee Health Insurance	125.2	135.8	162.0	193.4	231.1	276.3
Medicare Reimbursement to Retirees	5.3	6.1	7.0	8.1	9.3	10.7
Other Fringe Benefits	4.0	4.1	4.2	4.3	4.4	4.5
Pension Contributions	27.4	50.0	53.0	56.0	59.0	62.0
OPEB	0.0	29.1	29.1	29.1	29.1	29.1
Total Personnel Related Costs	444.7	513.7	548.2	588.2	634.6	688.8
Debt Service Payments	46.8	47.7	54.6	59.5	55.1	56.5
Internal Abatements	(33.9)	(34.6)	(35.3)	(36.0)	(36.7)	(37.5)
Capital Expenditures	86.7	62.4	92.0	66.0	62.7	64.6
Remaining Operating Expenditure Budget	720.1	727.3	734.6	741.9	749.3	756.8
TOTAL EXPENDITURES	1,264.4	1,316.4	1,394.1	1,419.6	1,465.0	1,529.3
REVENUES						
Operating Levy	185.8	191.8	195.6	199.5	223.0	229.1
Debt Levy: Projected Based on Debt Service	46.8	47.7	54.6	59.5	55.1	56.5
Total Property Tax Levy (Cap Amount)	232.6	239.5	250.2	258.9	278.0	285.5
Sales Taxes	64.7	60.5	56.1	61.1	60.6	62.3
Investment Earnings	4.4	4.4	4.4	4.4	4.4	4.4
*State and Federal Aids**	417.3	417.3	417.3	415.0	405.7	406.9
Departmental Income	448.1	448.7	448.7	448.7	448.7	448.7
State Shared Revenues	37.1	37.1	37.1	37.1	37.1	37.1
Bond Proceeds	64.8	27.5	42.5	26.0	27.2	30.3
Capital Improvement Revenue	21.3	35.0	49.4	40.1	35.2	40.8
Internal Abatements	(33.9)	(34.6)	(35.3)	(36.0)	(36.7)	(37.5)
2 Yr. Prior Surplus/(Deficit)	(1.6)	(0.5)	0.0	0.0	0.0	0.0
TOTAL REVENUES	1,254.7	1,234.8	1,270.4	1,255.2	1,260.2	1,278.7
Change in Total Expenditures	5.5	52.1	77.6	25.5	45.4	64.2
Change in Total Revenues	(4.2)	(19.9)	35.7	(15.2)	4.9	18.5
Annual Gap	*(9.7)*	*(81.7)*	*(123.6)*	*(164.4)*	*(204.9)*	*(250.6)*

The annual gap shown on the bottom line of Table 1 assumes a carryover of the gap from year to year. The $123 million gap in 2008 would be realized if nothing were done to address the gap in 2007. Stated differently, if the county were to close the $81 million gap in 2007, it would face another $41 million gap in 2008. If it does not eliminate the gap in 2007, it will face a $123 million gap in 2008.

The fact that the gap is ever-increasing is particularly nettlesome. That is why simply addressing the county budget gap on a short-term basis is futile. Without a long-term solution, balancing the budget in one year will provide exactly twelve months of breathing room. When the next year rolls around the county will face another $40 million deficit.

The alternatives

Raise taxes

Could the county raise taxes to cover the projected deficits? In a word, no, since the required tax increases would be massive, and they would require the approval of the county electorate and the legislature.

TABLE 2

	Levy Allowed Under State Law	Levy Increase Needed To Close Gap	% Increase
2006	$232.6 million	$9.7 million	
2007	$239.5 million	$81.7 million	34.1%
2008	$250.2 million	$123.6 million	49.4%
2009	$258.9 million	$164.4 million	63.5%
2010	$278.0 million	$204.9 million	73.7%
2011	$285.5 million	$250.6 million	87.8%

Yet the county board has already broached the notion of increasing taxes. The County Board Finance Committee has raised the prospect of presenting an advisory referendum next fall to increase the county option sales tax from one half percent to three quarters of a percent. If their goal is to solve the county deficit with additional tax revenue, the 1⁄4% increase would be the first of several increases needed.

Let's examine the additional revenue required to meet the projected deficit. Table 2 shows the levy increase that would be required each year. Remember, this is an increase above the current levy which is nearly the maximum allowed under current law. By 2011 the levy rate would be 87% above the statutory cap. At that point property taxes would be 61% above where they stand in 2006 pushing the tax on a $150,000 house from $636 to $1,020.

Alternatively, if the county wanted to close the gap with sales taxes, the Legislature would have to to remove the statutory 1⁄2% limitation on the local option sales tax (the 1⁄2% currently yields $64 million per year for the county). Filling the county budget shortfall would require increasing the 1⁄2% rate to 1.5 % in 2007, to 2.0% in 2008 and 2.5% in 2011. This would potentially drive business away from Milwaukee County and could significantly dampen economic development.

However it is highly doubtful that the electorate or the legislature would approve the requisite increases. Further, the county executive has publicly rejected solving the budget deficit through tax increases. But however unlikely it is that tax increases will be used to fill the budget gap, it is instructive to itemize the breathtaking magnitude of additional tax money that would be required to balance the budget.

Program cuts

The expectation of the public is that if government sees a looming fiscal imbalance, steps should be taken to reduce spending. In fact, in 2005 an early $6.9 million deficit was erased through budget cuts. The 2006 budget is again facing a deficit, this time it is $8.9 million. County officials are working to erase the deficit through spending cuts.

However, the magnitude of the deficit in 2007 and beyond dwarfs previous deficits. Exacerbating the challenge for the county is the fact that the fastest growing expenses—those for retiree benefits and health care—are beyond the reach of spending reductions. The county is obligated to pay these costs regardless of fiscal circumstances. Similarly, debt service payments cannot be reduced. In 2007 the part of the budget that cannot be cut will stand at $204 million and will grow to $405 million by 2011.

TABLE 3 DISCRETIONARY VERSUS NON-DISCRETIONARY SPENDING (MILLIONS $)

	2007	2008	2009	2010	2011
Total Expenditures	$1,316.4	$1,394.1	$1,419.6	$1,465.0	$1,529.3
Increase over Prior Yr.	$52.1	$77.6	$25.5	$45.4	$64.2
% Change	4.1%	5.9%	1.8%	3.2%	4.4%
Total Non-discretionary *	$268.7	$305.8	$346.2	$383.6	$434.7
% of Total	20.4%	21.9%	24.4%	26.2%	28.4%
Increase in Non-discretionary	64.1	37.1	40.3	37.5	51.0

*Non-discretionary includes health insurance, retiree health insurance, Medicare contributions, pensions, and debt service.

Therefore, only a fraction of the budget is subject to cuts. In 2007, if the deficit were eliminated entirely through program cuts, departmental budgets would have to shrink by 8% (if applied across the board). This would grow to 22% by 2011. If, rather than cutting across the board, specific cuts were made, they would eliminate funding for General Assistance Medical Aid, parks, arts and cultural programs, as well as discretionary funding for the Sheriff's Department. In short, the county's fiscal problem would significantly impact services in a way that all citizens would notice. And the cuts would stand in sharp contrast to the employee retirement benefits that would remain intact.

Delay

Delay seems always to be an option in government. Short-term decisions are the hallmark of public sector financial management. In Milwaukee County's case, making decisions that allow the county to eek through each fiscal year is the norm. Predictably, as the full extent of the county's pending deficits becomes known, many county leaders will no doubt seek budgetary safe harbor in delay.

And GASB opened the door a crack for those inclined toward delay when it advised that the new accounting rules do not require government to budget for post-retirement benefits. Yet once disclosed, the price of those benefits will become part of the county's fiscal reality, and the degree to which the county chooses to under fund those costs will be explicitly known. Also known will be the cost of not fully funding the obligations. An accounts payable will be there, and as the oil filter pitch man said, "you can pay me now, or pay me later." Delay in funding the county's post-retirement obligations is the most expensive option available.

Create an oversight board

Extreme solutions have been contemplated for Milwaukee County's dilemma including the dissolution of the county. A dissolution scenario implies that responsibility for county services would revert to state government, not unlike the transfer of child welfare services back to the state that occurred in 1998. However, it is unclear that the county could be dissolved without amending the Constitution, which is a long, laborious process. Also, Milwaukee County's financial problem probably does not rise to such an extreme approach.

State intervention would be recognition that Milwaukee County's fiscal problem surpasses the ability of the county to solve it.

On the other hand, a bailout from state government is unlikely. State government has its own problems, as evidenced by a recent announcement of a $1.5 billion structural deficit in the next budget cycle. Also, a straight bailout would be a tough political sell in Madison. Worst of all, a bailout would do nothing to address the underlying factors causing the county's structural imbalance.

It might seem prudent for the county to pursue bankruptcy. While bankruptcy proceedings are common for private businesses, they are less common for governments. Municipal bankruptcies (counties would fall under this definition) are covered by Chapter 9 of the United States Code. The most significant public bankruptcy in recent years is Orange County California, which declared bankruptcy in 1994.

While the federal statutes provide for local government bankruptcy, there is a delicate interplay between federal law and the sovereignty of the states. In order for local governments to proceed under a Chapter 9 bankruptcy state statutes must provide for local bankruptcy. Wisconsin statutes do not. In order for a local government in Wisconsin to go through bankruptcy, state statutes would have to be changed to accommodate the federal process.

However, whether or not state statutes provide for local governments to declare bankruptcy, there is an important role for state government to play. Since local governments are instrumentalities of the state, several states have taken the initiative to intervene when local governments have faced bankruptcy circumstances. This was the case during the fiscal crises in New York, Philadelphia, and Miami. In Washington D.C. the intervention came from the federal government due to the unique nature of that city. Milwaukee County's projected fiscal condition shows similarities to those cities.

State intervention would be recognition that Milwaukee County's fiscal problem surpasses the ability of the county to solve it. It would also be recognition that it is in the interest of the state to preclude a fiscal emergency in the state's largest and most visible county. Further, intervention would be recognition that the problems that have led to fiscal insolvency are the result, not just of bad decisions, but of systemic financial management shortcomings. Intervention is a way to ensure that the county can meet its short-term obligations, as well as restoring long-term solvency.

State government intervention would require state legislation to create an oversight board. The board would be responsible for managing county finances until a balanced budget is delivered.

A path to recovery

Milwaukee County is on a course toward bankruptcy whether state law allows it or not. It is also evident that, if left to its own devices, the county cannot avoid bankruptcy. County fiscal projections evidence classic signs of structural imbalance: the budget cannot support a minimal level of services from a reasonable level of taxes.

Clearly the magnitude of the problem supersedes the county's ability to manage the problem. But equally clear is the county's track record of fiscal decision making and its deficient financial management systems. Time after time the Milwaukee County Board has rejected steps presented by the county executive and the Legislative Audit Bureau[9] to improve its balance sheet and its fiscal management systems.

The undoing of the county balance sheet lies in a series of irrevocable commitments made to county employees. While most of the 2001 pension enhancements have been rescinded for new county employees, they remain a binding right for county retirees. There is a perception that the decisions to enhance the benefits might have been self-serving on the part of county decision makers. The public perceives, and the financial statements reflect, an unmistakable pattern of inwardly-focused, short-term decision making that is ill-suited to solving a structural budget crisis. The tale of the County Farm exemplifies the fiscal decision process. It is doubtful that the county's elected officials will be able to unify around the tough decisions that will be required.

State intervention will be needed if the problem is to be solved—the same type of intervention that restored healthy financial statements to New York, Philadelphia, and Washington D.C. However, state intervention should not take the form of a bailout. Simply moving money from the state treasury to the county treasury will not solve the county's problem.

Milwaukee County's problem is particularly insidious in that it will continue to grow each year, and there are few options to slow the primary cost drivers—pension and health care benefits committed to current and former county employees. Solving the imbalance in one year will only forestall the problem, because there will be another $40-$45 million problem in the following year.

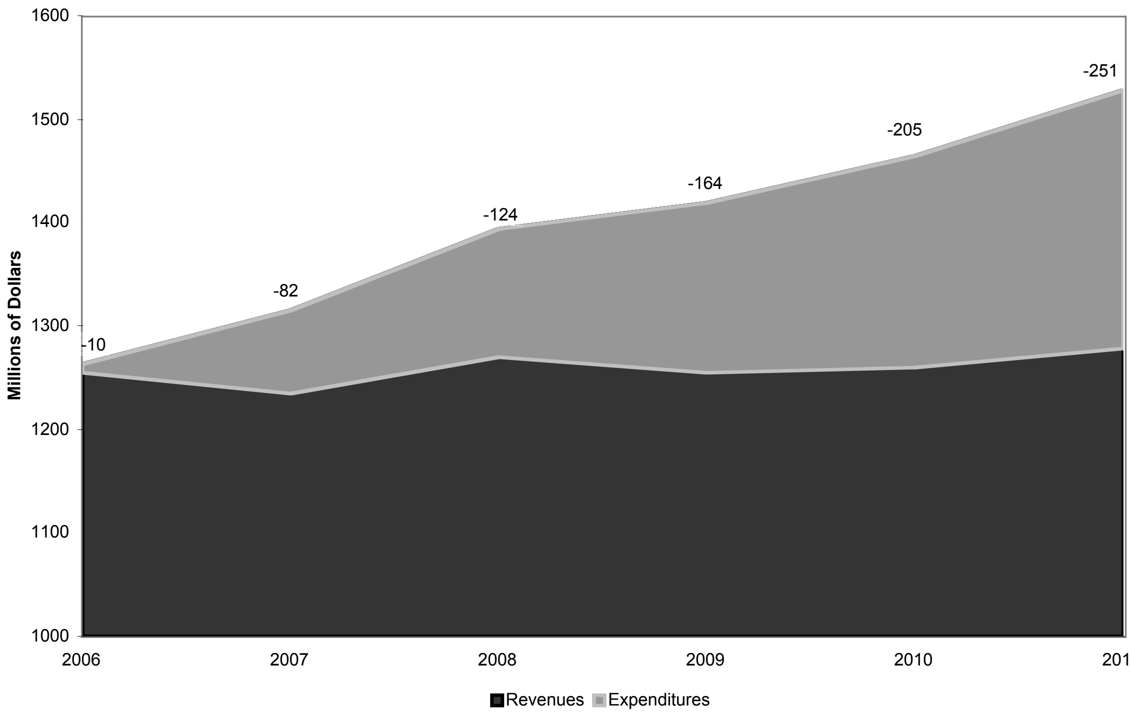
Time is of the essence. Any delay in addressing the problem will only worsen the situation. The deficit for 2006 is expected to be $9.7 million, a tough but manageable gap. However, the 2007 gap explodes to $81 million.

It will undoubtedly be argued by some that part of the county's budget solution should include budgeting something other than the full amount required to fund pension and post-retirement health care liabilities. This "solution" does nothing to reduce the ultimate liability and therefore simply pushes the fiscal morass off to the future. Frankly this type of short-term thinking that has predominated Milwaukee County's budgeting in the past and is part of why the deficit forecasts are so grim.

The 2006 county budget was balanced only because the pension obligation was underfunded by $19.6 million. This most recent underfunding pushed the unfunded liability to $356 million and has squeezed the funding ratio down to 79%. This contrasts with the Wisconsin Retirement System that is currently funded at 99%. State government and the local governments that participate in the system have been willing to budget for their pension liability. Milwaukee County has not.

We should also be wary of budget solutions that are built on improved revenue forecasts since revenue forecasting is inherently speculative. But beyond that, the viability of Milwaukee County government should not rest on the health of the economy. County government must be on sound enough financial footing to weather an economic downturn, since the county is the first responder the public looks to during troubled economic times.

FIGURE 2 WIDENING GAP BETWEEN EXPENDITURES AND REVENUES



When the economy slumps it will do little good for the county to face the citizens and turn its pockets inside out.

The logical way to approach a solution is to follow the path that other major urban centers have taken to avoid pending bankruptcies. This will entail active participation by both county and state government. The first step of this process is for the county to petition the state for intervention. Without this step it would be foolish for state government to consider any financial assistance.

The second step would entail state government enacting legislation to create an oversight board with the authority to right the county's finances. This step alone will not solve the problem, but it will stanch the flow of red ink and assure that the county's bills will be paid.

Where oversight boards have been formed, they have been charged with three primary functions:

1. They must assure that the local government can pay its bills.
2. They assume control of all fiscal activity.
3. They prepare the workout plan to restore the long-term fiscal health of the local government. While it is up to state and county government (and perhaps the federal government) to enact legislation making the necessary structural changes and revenue changes, the leverage of the oversight board has proven substantial enough to cause the needed changes to be enacted.

The specter of an oversight board highlights the tug-of-war between the rights of democratic government and the need for sound fiscal management, since an oversight board would temporarily relieve local elected officials of the ultimate authority over financial decisions. However, the goal of this radical move is to preserve the long-term health of democratic institutions.

Based on the experience of other cities, the following are suggested elements of an oversight board for Milwaukee County:

- The members should be individuals with financial management credentials who are appointed by elected officials. The board should be small—five to seven members. In other settings it has been required that the board members reside within the jurisdiction.
- The board would have a limited life, disbanding the year after solvency has been restored.
- The board should hire its own staff drawing from state government and private sector financial professionals. Further, the board should appoint a Chief Financial Officer (CFO) for Milwaukee County to oversee board staff and be responsible for day-to-day financial management of the County. Following the lead of Washington D.C. the CFO would be nominated by the county executive and appointed by the board. The CFO would remain as the county's CFO after the board disbands.

During the life of the oversight board any financial transaction of the county would be subject to board approval. This would include the annual budget, any proposed legislation, and all county contracts and borrowing. The county would be precluded from approving a contract or passing a law that did not fit into the fiscal plan approved by the oversight board.

A review of the county budget for 2005 and 2006 shows why this level of intervention is needed. According to the most recent *Official Statement* issued by the county, in the first quarter of 2005 the county forecasted a deficit of $2 million, which jumped to $6.9 million in May of that year. In reaction to the May estimate, controls were put in place to cut spending. In December, as the county neared the end of the year it was estimated that the year would close with a $1.8 million surplus. But one month later new numbers showed that the surplus might have disappeared and the county would close the books with no surplus. As this report was going to press, it now appears that the surplus might have reappeared.

That was last year. For 2006, current estimates place the county's 2006 budget deficit at $8.9 million. Yet when it was passed last October the budget had no deficit. Such fluctuation in essential budget numbers clearly points to the need for better controls.

The following is a list of other actions the oversight board should undertake.

1. Implement fiscal management systems and processes that will ensure the county has up-to-date accurate information and that the fiscal decisions are sound.
2. Restructure the county workforce. This has been a key responsibility of oversight boards in other settings. They have recommended downsizing many operations and contracting with private sector providers to do some of the functions previously performed by public employees. In addition, some of the county's functions could revert back to state government as was the case with the Milwaukee Child Welfare program. The goal of restructured workforce is to improve the cost-effective delivery of public service. Restructuring can free up significant operating costs that can be used to help balance the budget.
3. Review the degree to which Wisconsin's mediation/arbitration law has contributed to Milwaukee County's fiscal stress and, if appropriate, draft changes for consideration by the legislature.
4. Recommend changes to be made to the county board and to the administration of county government. The need for a full-time county board might have passed (Milwaukee County is the only county in Wisconsin with full-time board members with annual salaries of $52,000/year plus benefits).
5. Review the county pension system and recommend changes. Serious considera-

tion should be given to merging the Milwaukee County pension system into the Wisconsin Retirement Fund. If the pension system is not merged into the state system, consideration should be given to having employees contribute to their pensions. Also, changes should be made to ensure that elected county officials are not in the same pension or benefit system that they approve. This would eliminate even the appearance of conflict.

6. Recommend the use of debt, tax increases and other revenue enhancements needed to erase the deficit. Oversight boards in other settings have had to recommend revenue increases to ensure long-term fiscal stability. However, the revenue increases are the last piece of the fiscal recovery and are not formulated until other restructuring changes have been made.

7. Recommend whether to spin off county enterprises or other county operations, e.g. the airport, the zoo, etc. into separate, self-supporting operations.

8. Develop a system to signal when intervention might be required in the future. For example, if the county misses an important payment or underfunds its pension liability, state government would be ceded control of county finances.

This list represents most of the measures needed to return solvency to Milwaukee County's budget. An oversight board is an extremely invasive mechanism that intentionally errs on the side of fiscal prudence. It adds definition to the radical change required for fiscal recovery.

Milwaukee County has the opportunity to rebuild a well run, citizen-centered government.

Summary

The next few years promise to be stressful for Milwaukee County. County leaders will choose whether to address the issues that have led to insolvency or to try to push the problem off into the future, with fingers crossed hoping that a palatable solution presents itself.

Dealing honestly with the county's financial realities presents an opportunity to fix the problems that led the county to the fiscal brink—not just to fix the balance sheet, but to fix government. It is a rare opportunity for government to be able to wipe the slate clean and rebuild itself from the ground up. Milwaukee County has the opportunity to rebuild a well run, citizen-centered government.

Notes

1. From *Five Year Summary of Revenues, Expenditures and Changes in Fund Balance*, included in the Official Statement, April 1, 2006.

2. Financial Accounting Standards Board Rule 106.

3. The data in Table reflect an annual liability of $29 million. This is based on an actuarial analysis of the County's proprietary fund operation, primarily the transit operation. The actuarial analysis of the general fund operations has not been completed. Early estimates are that the final analysis will push the total liability for the County to between $40 and $60 million.

4. From the *Schedule of Funding Progress and Employer Contributions, Employee's Retirement System,* included in the Official Statement, April 1, 2006.

5. In the near term Milwaukee's bond rating will probably be unaffected by its OPEB liability based on a presentation given by Paul Nolan, Assistant Vice President of Moody's Investor Services. Longer term the manner in which a government addresses its OPEB liability will be factored into its credit rating.

6. *Wisconsin Statutes* Section 59.60(3m).

7. FitchRatings – *The Not So Golden Years – Credit Implications of GASB 45*. June, 2005.

8. The data in Table 1 was supplied by Milwaukee County. They are consistent with the data used by the county executive to describe the county budget. While some of escalators used in the data could be adjusted, such an adjustment would only alter the magnitude of the county's budget dilemma. It would not erases the deficit.

9. In 2002 the Legislative Audit Bureau (LAB) issued a report calling for efficiencies in Milwaukee County Board procedures and governance, including improved budgeting processes and budget management, more effective use of board professional staff. Most of the specific LAB recommendations have not been implemented.