

Michigan K-12 Finances and the State Budget

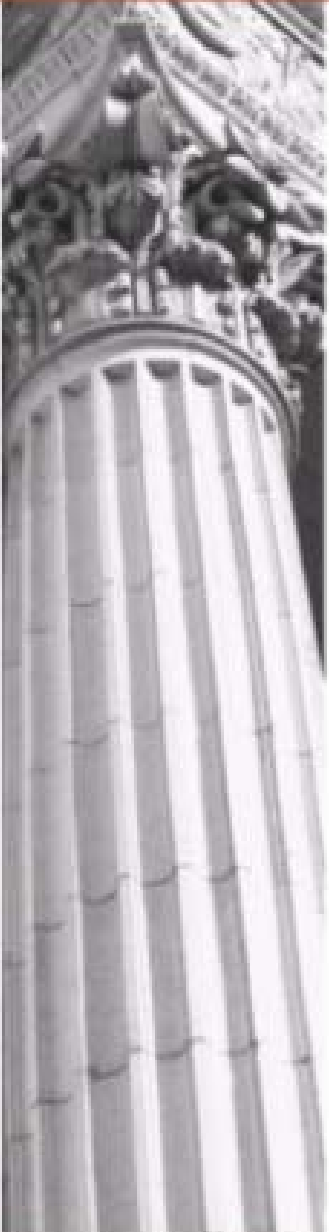
**Presented to
Eaton Rapids Public Schools**

October 28, 2009



Citizens Research Council

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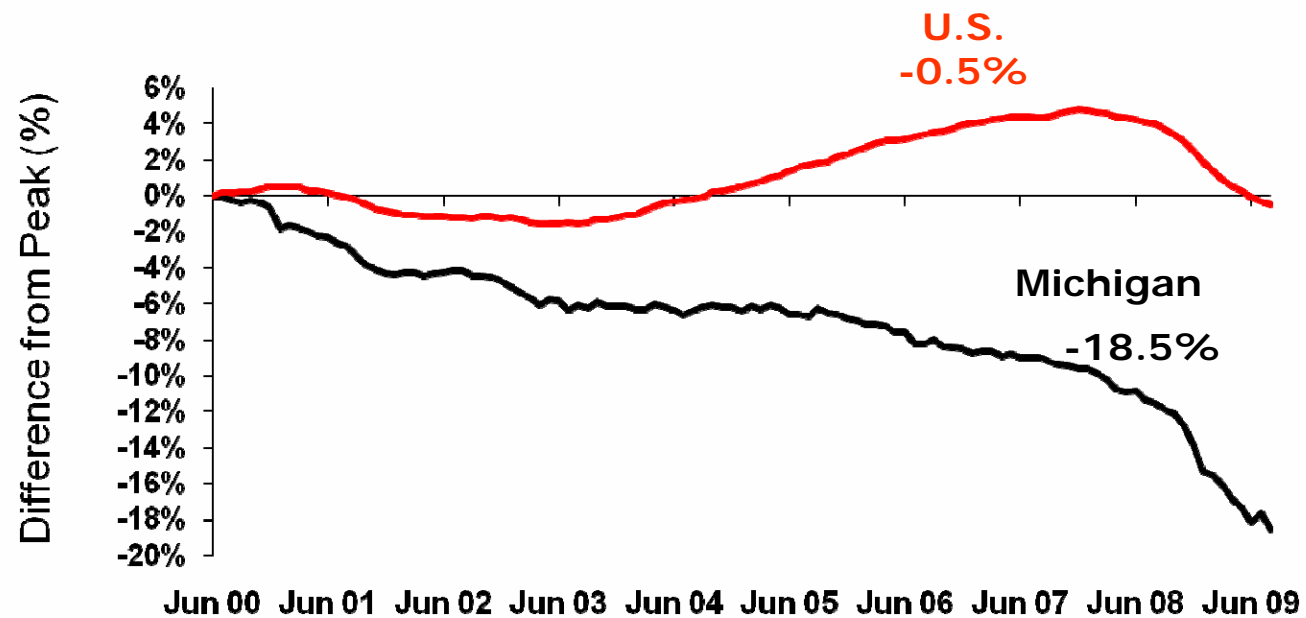


What is Going on in Michigan?

- Michigan economy has shown no improvement since 2001 recession – “single state recession”
- Since employment peak (June 2000)
 - Continued, unabated job losses
 - Concentrated in manufacturing (autos)
- Payrolls for July 2009-281,000 below year ago levels
- Current recession accelerated job losses
- Michigan Personal Income losing ground relative to US – becoming a “poorer” state



Michigan Employment Never Recovered in Last Expansion



Note: Peak is calculated from Michigan's June 2000 Peak. Data through August 2009.

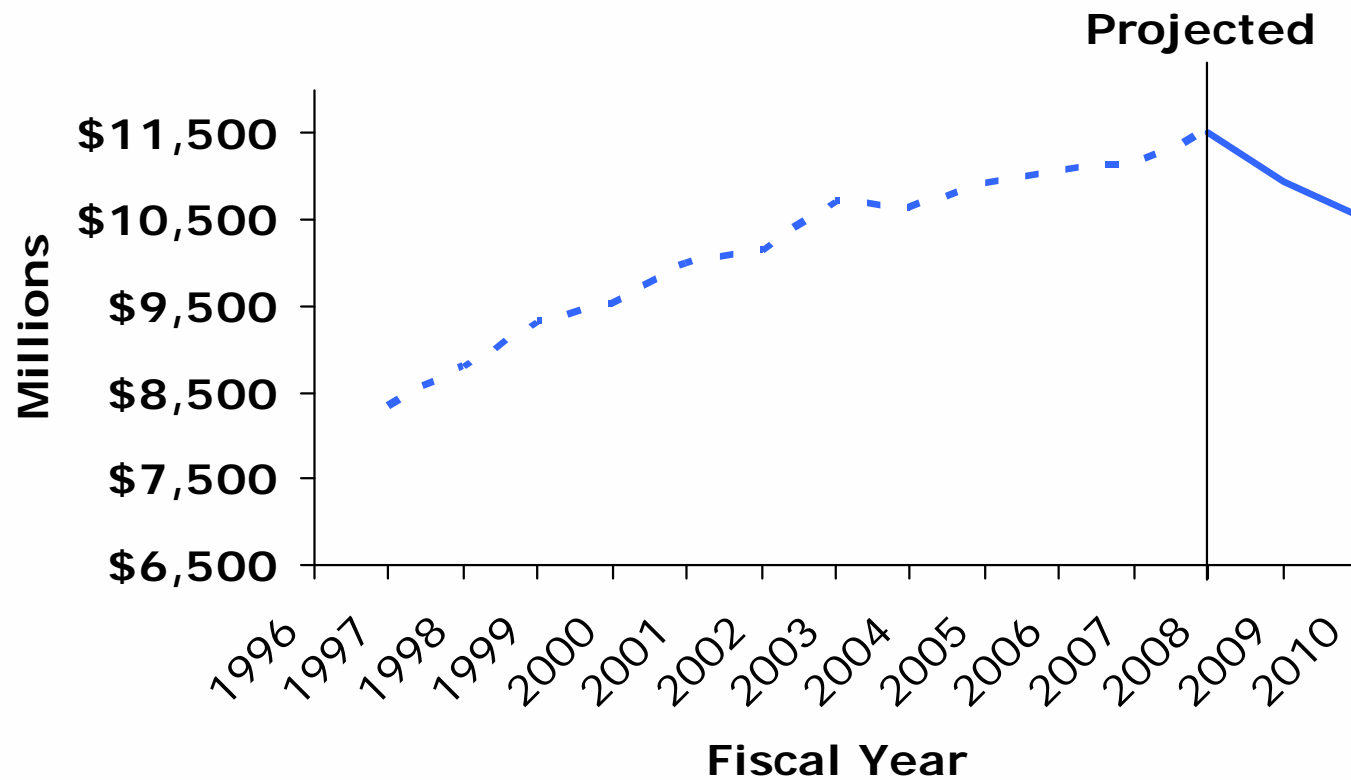
Source: Bureau of Labor Statistics



School Aid Fund

Major Source of K-12 Education Revenue

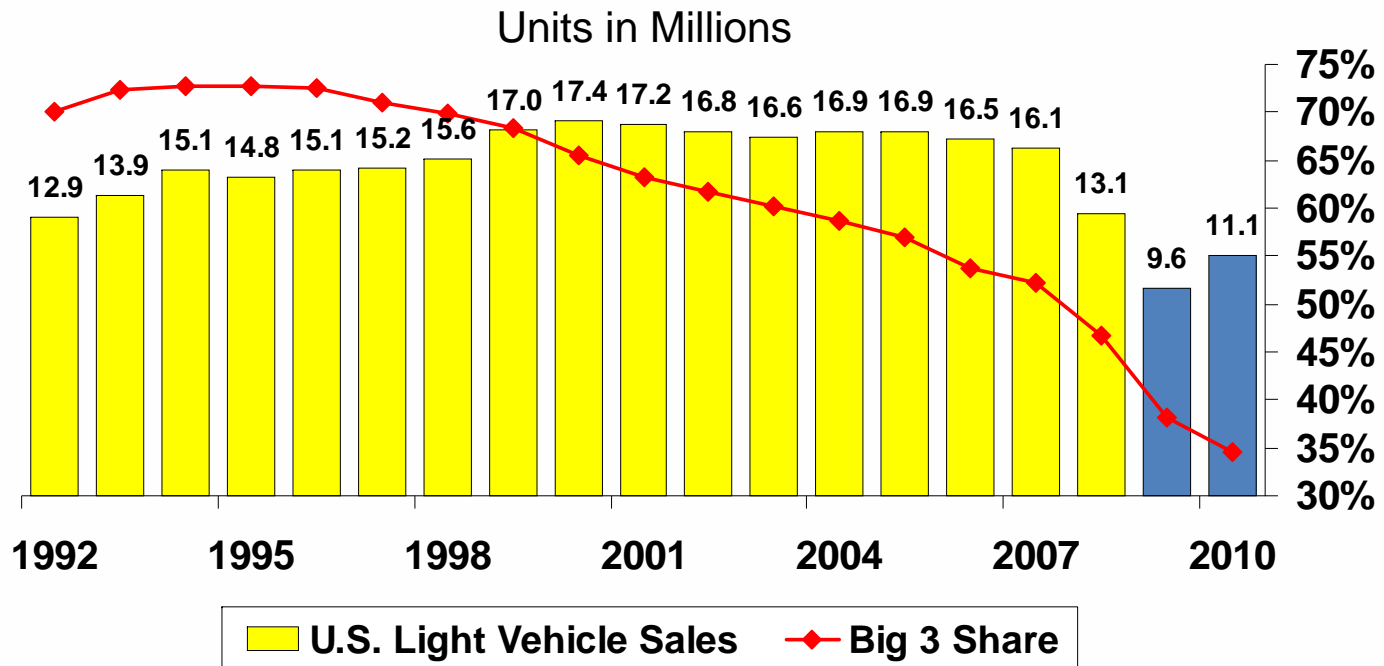
SAF On-Going Revenues



Source: Michigan Department of Treasury



Big 3 Losing Market Share

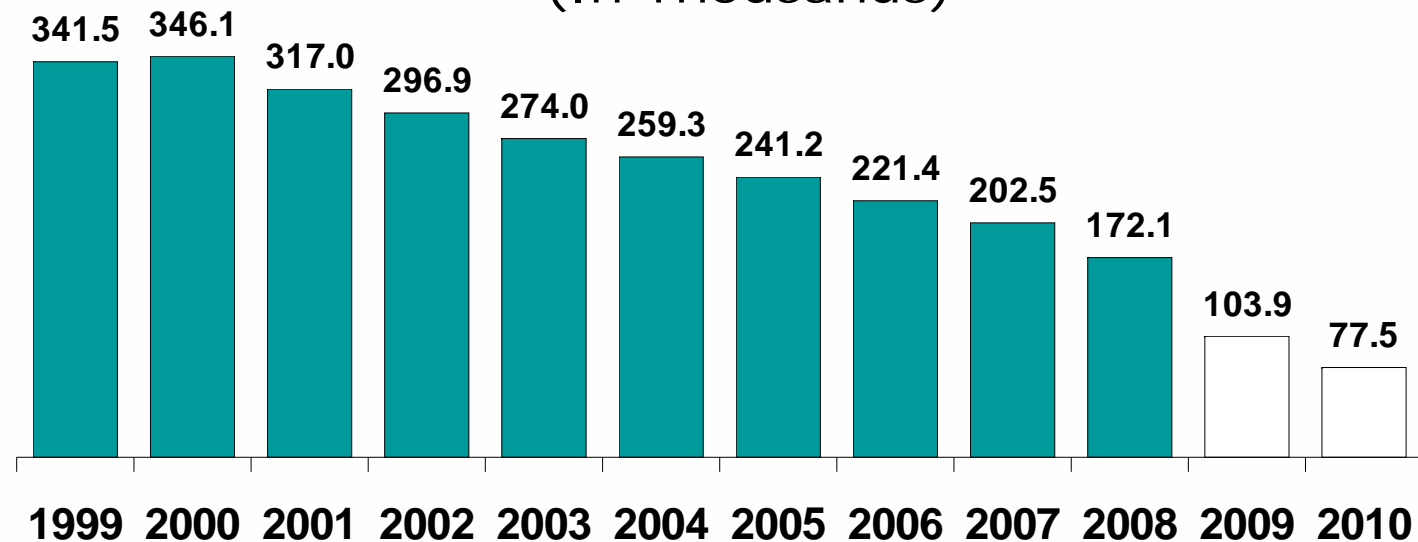


Source: Automotive News, vehicle sales and share; 2009 & 2010 are the May 09 Consensus estimates.



3 in 4 Auto Jobs Lost by 2010

Michigan Transportation Equipment Employment
(In Thousands)

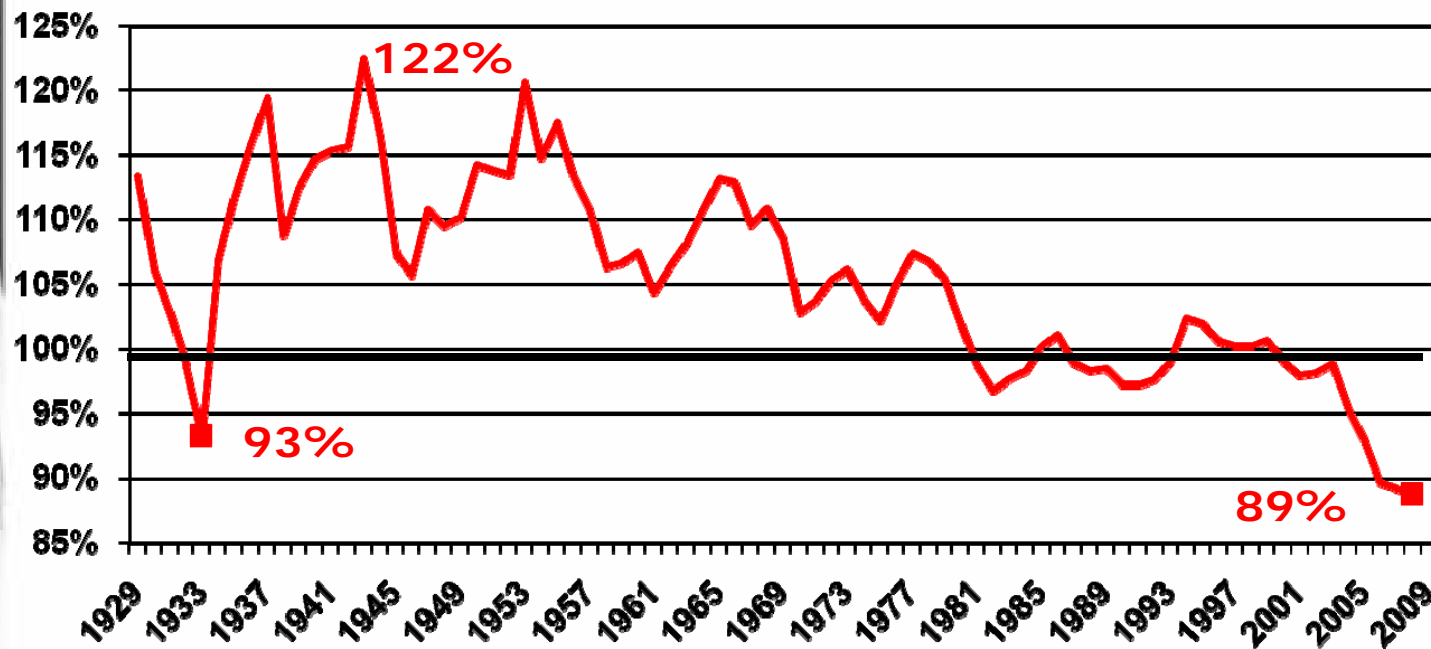


Source: Bureau of Labor Statistics. 2009-2010 estimates are the average of the 3 agency forecasts for the May 2009 Consensus Conference.



Michigan Becoming "Poorer" State

Michigan per Capita Income as a Percent of U.S. Per Capita Income

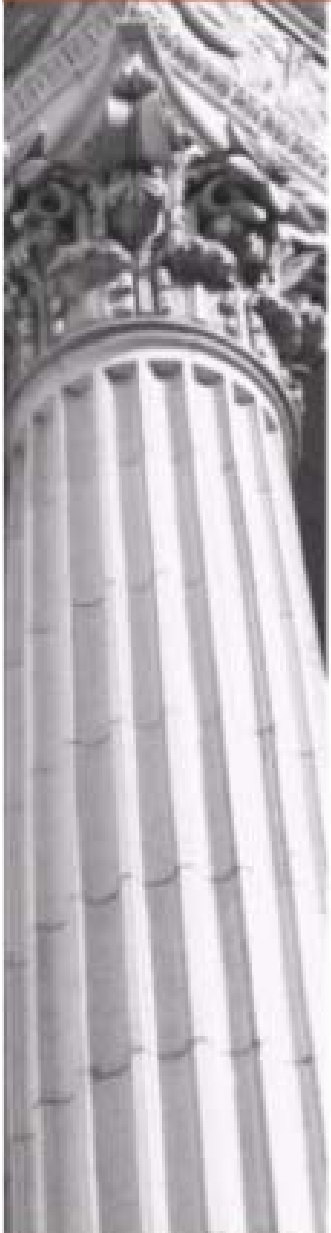


Source: CRC calculations from Bureau of Economic Analysis data. March 24, 2009 personal income release.



The Michigan Budget Story Has Not Changed . .

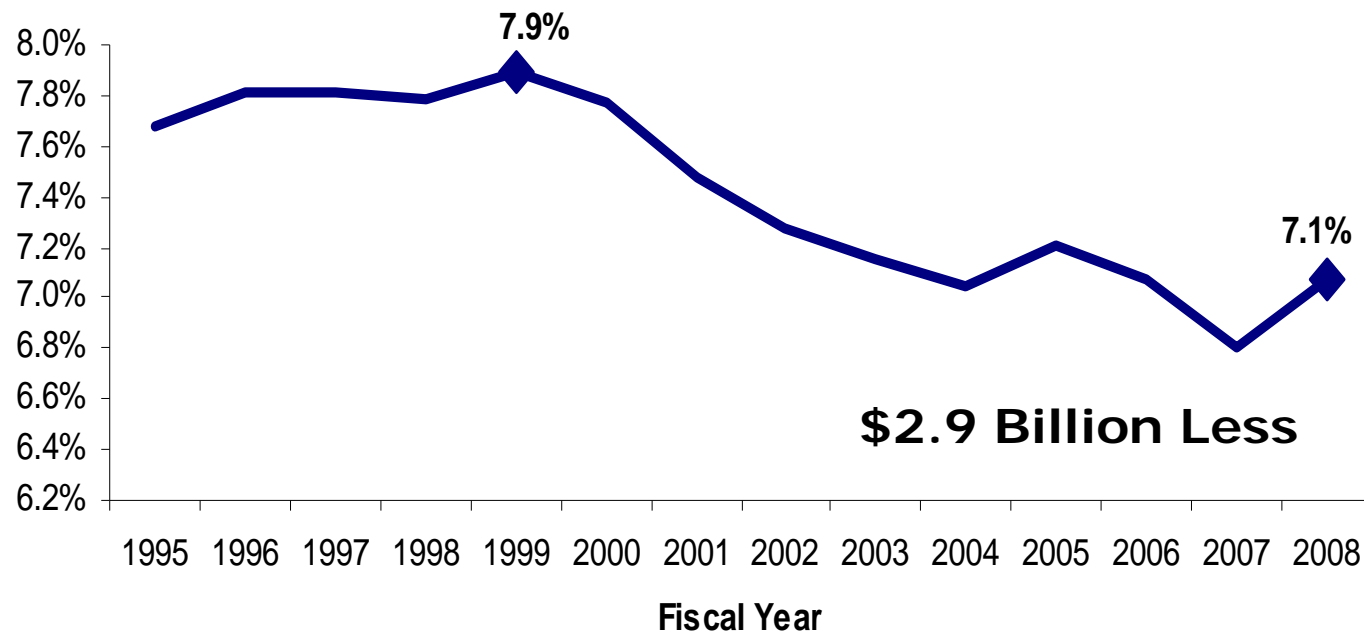
- The State of Michigan continues to face dual structural deficits affecting:
 - Public K-12 education
 - General Fund-financed programs
- Its causes have both spending and revenue components
- We will **not** grow out of it
- Significant spending cuts and/or tax increases will be required





Tax Cuts and Economic Performance Affect State Tax Collections

State Taxes as a Percent of Michigan Personal Income

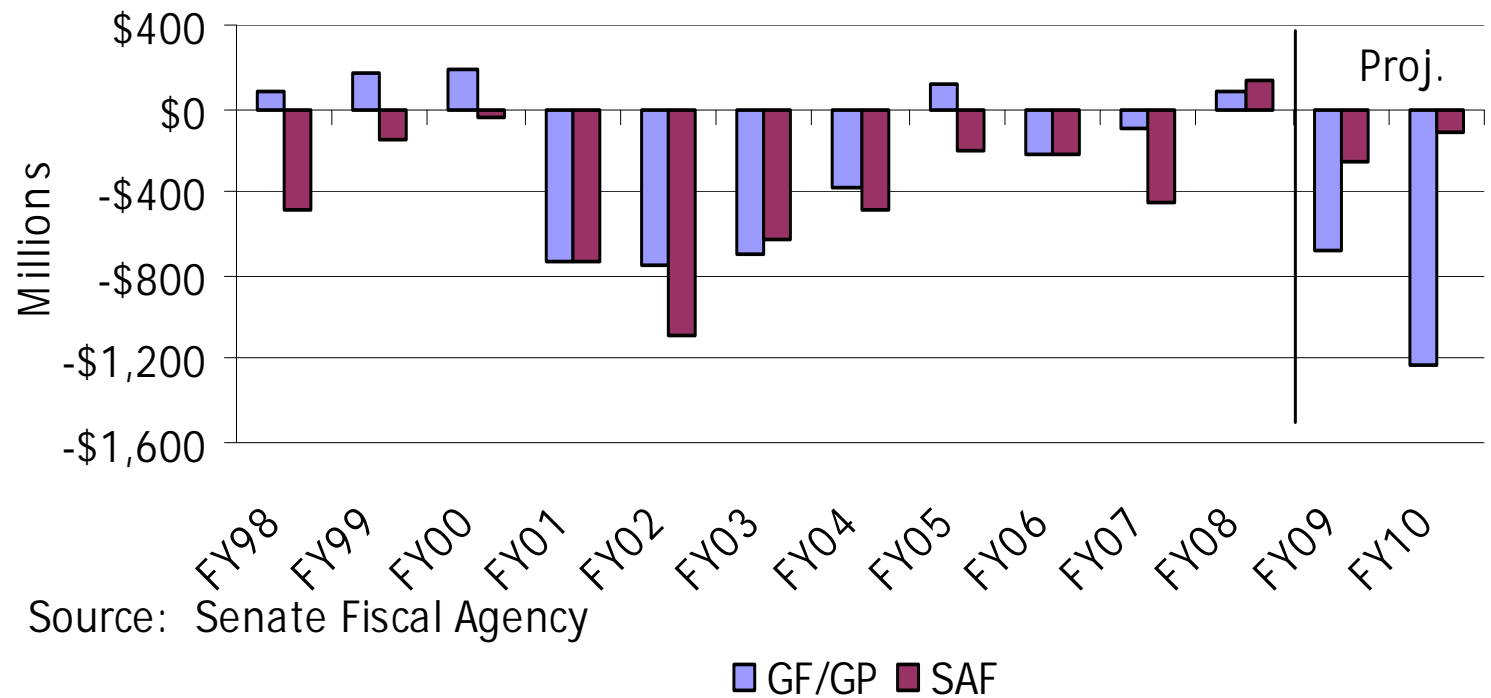


Source: Michigan Annual Financial Report



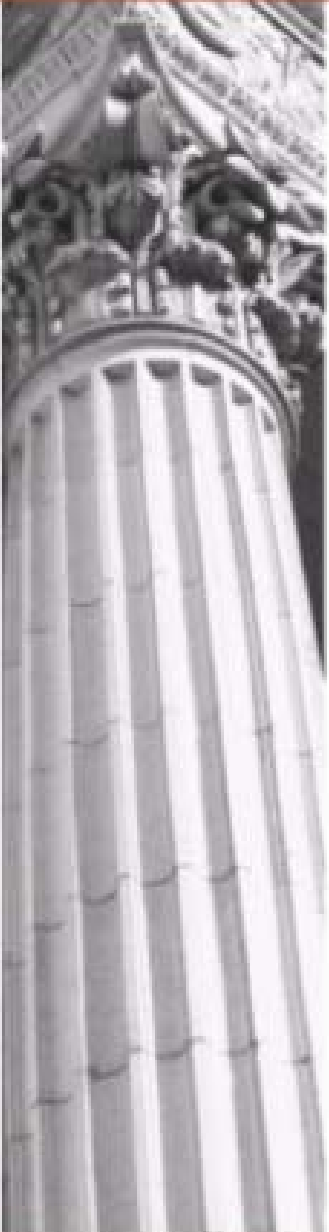
Persistent Structural Deficits

GF/GP and SAF Operating Deficits



Source: Senate Fiscal Agency

■ GF/GP ■ SAF



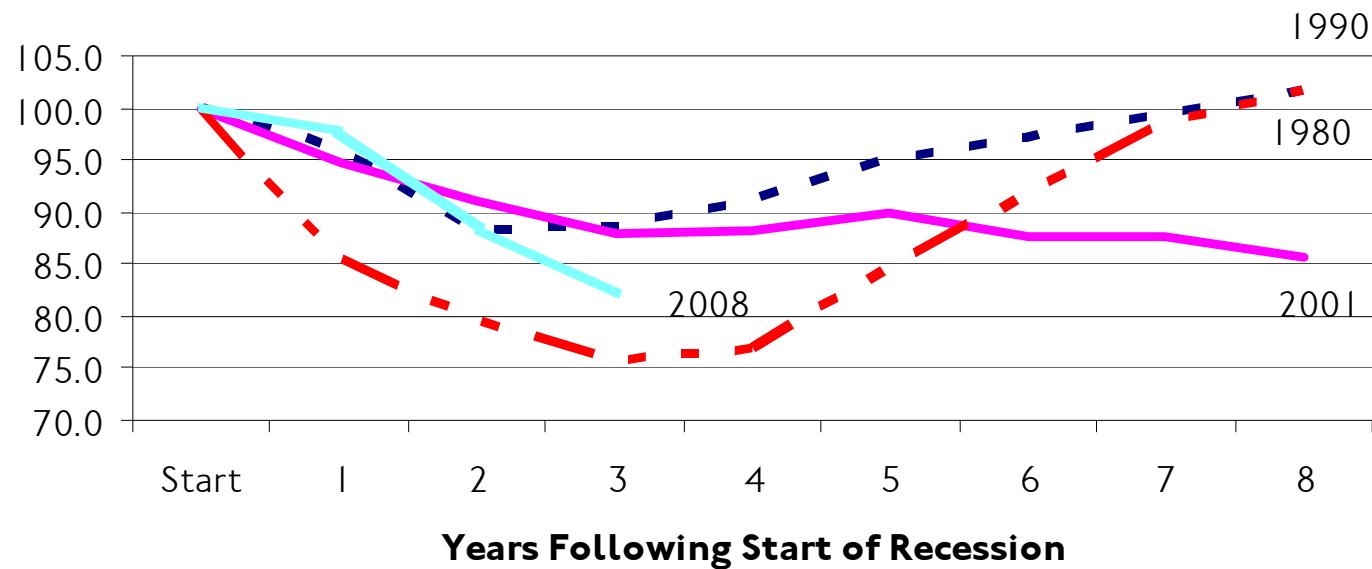
But, There is a New Chapter

- National recession – severe
 - Consumption
 - Business spending
 - Homebuilding
- Impacts on state finances – revenue **and** spending
- State budget unprepared to deal with short-term impacts:
 - Exhausted reserves
 - Extensive use of non-recurring resources
 - General tax increase of 2007
- Must correct for two problems simultaneously
 - Structural deficit
 - Cyclical deficit
 - Each problem requires specific set of tools



2008 Recession Impact on Revenue

Real Per Capita Baseline Revenue Growth
Combined GF/GP and SAF



Source: Senate Fiscal Agency; CRC calculations



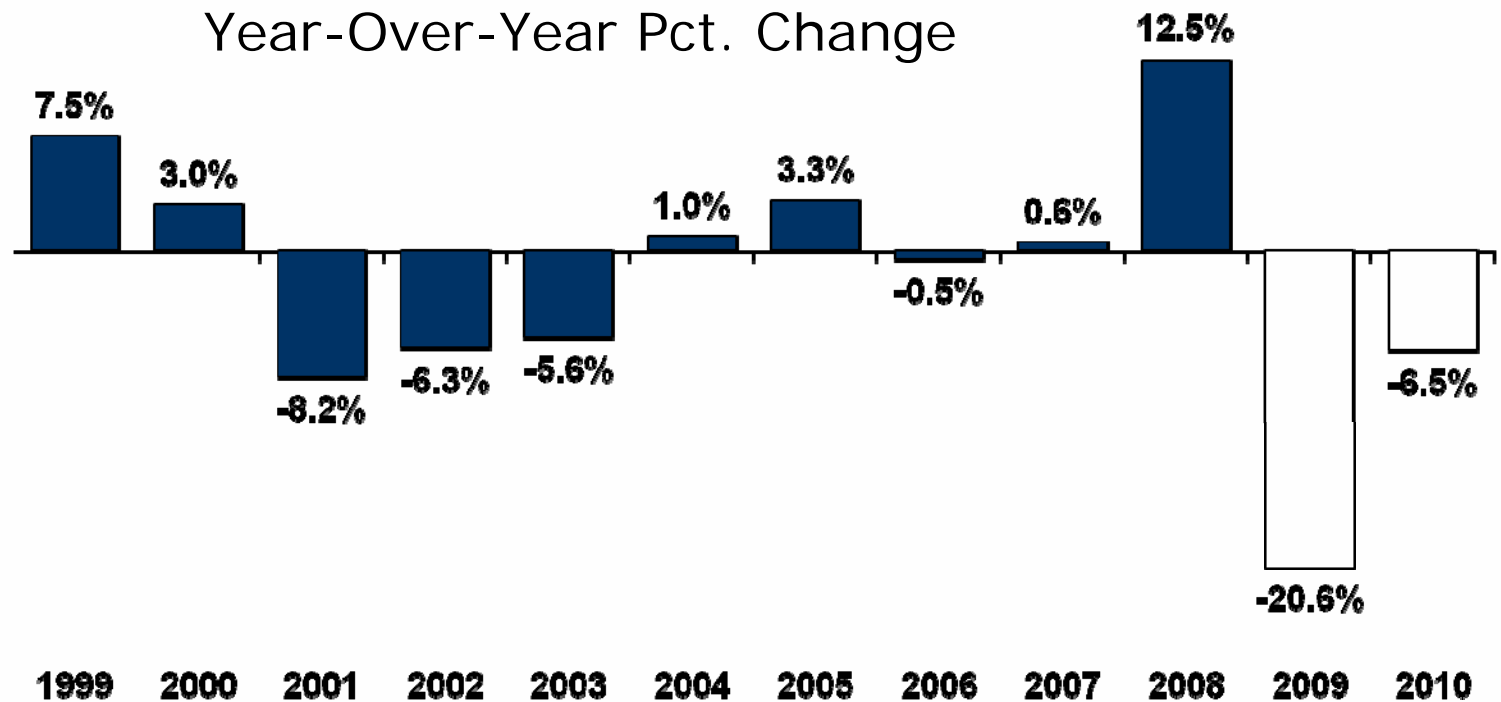
May Revenue Revisions

	FY 2009			FY 2010		
	Jan Cons.	May Cons	Change	Jan Cons.	May Cons	Change
GF-GP	\$8,306.1	\$7,435.3	(\$870.8)	\$7,934.5	\$6,949.7	(\$984.8)
SAF	\$11,368.7	\$10,943.7	(\$425.0)	\$11,295.8	\$10,563.0	(\$732.8)
Total	\$19,674.8	\$18,379.0	(\$1,295.8)	\$19,230.3	\$17,512.7	(\$1,717.6)
Growth						
GF-GP	-11.3%	-20.6%		-4.5%	-6.5%	
SAF	-1.3%	-4.9%		-0.6%	-3.5%	
Total	-5.7%	-11.9%		-2.3%	-2.8%	



GF-GP Revenues Fall Off Table

GF-GP Revenues
Year-Over-Year Pct. Change





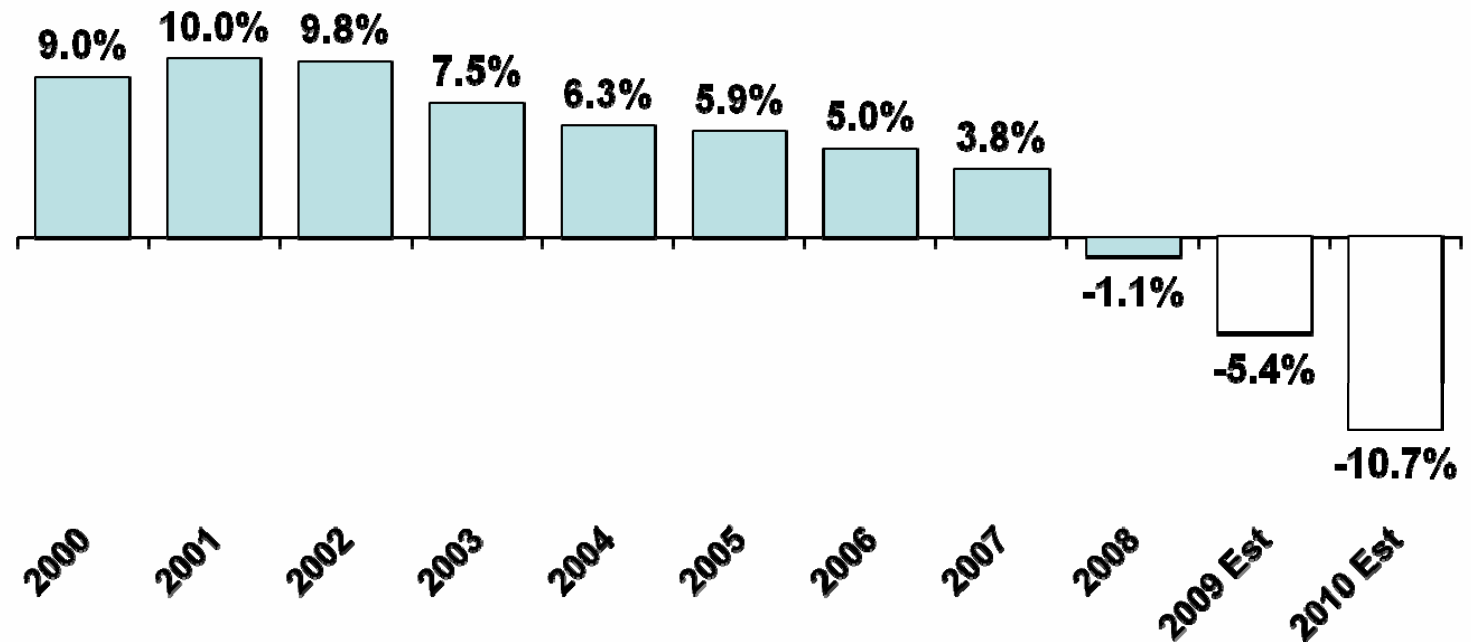
School Aid Fund “Firewall”

- Fiscal effects of economic pressures moderated to some extent
 - Insulated from tax policy credits (film, battery, alternative energy)
 - EITC impacts GF only
 - Replacement of local personal property tax with fixed amount of MBT revenue (FY09), then grows with US CPI (FY10)
 - Mix of taxes dedicated to SAF



Total State SEV Declines for 2nd Year in a Row

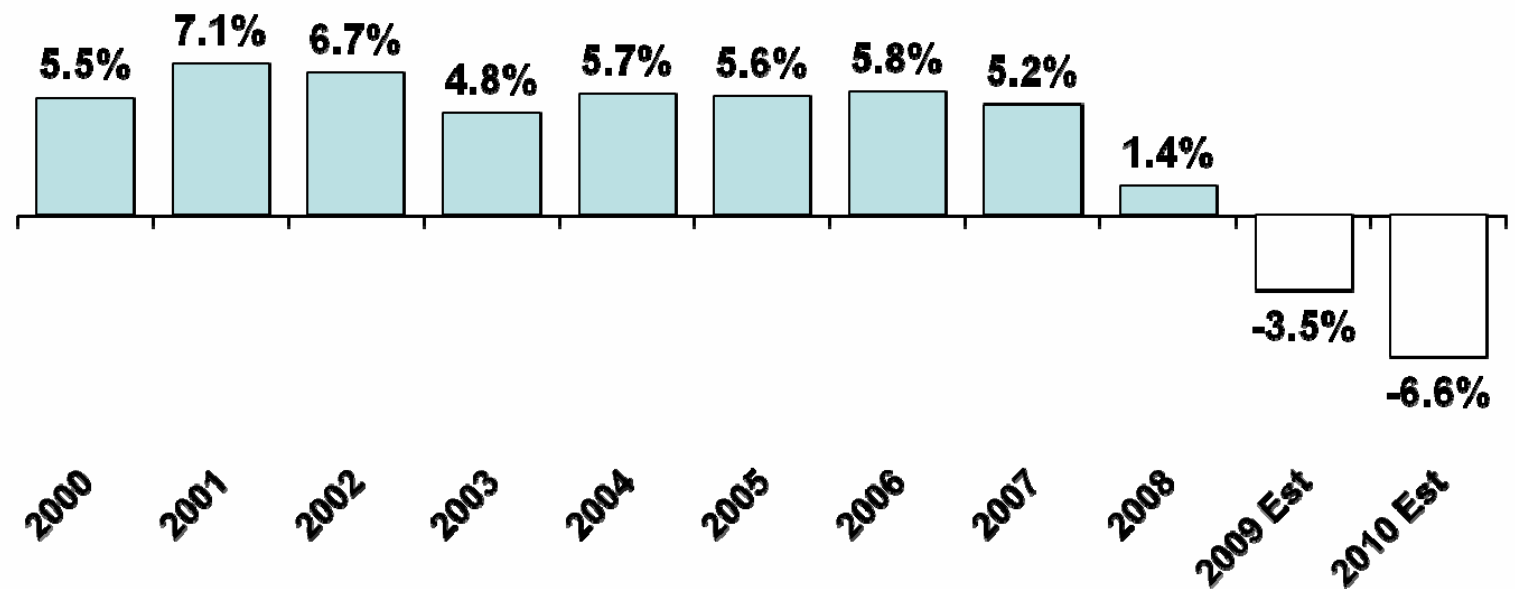
% Change in Total Real and Personal SEV





TV More Stable Due to Cap But Starting to Decline

% Change in Total Taxable Value





What Does This Mean?

- Taxable Value in 2007 up 5.2%, but home values up only 3.8% statewide
- 2008 TV continuation of same
 - up only 1.4%
 - shrinking reservoir between TV and SEV
 - Multiplier up 2% = taxpayer discontent
- TV declines 3.5% in 2009 and 6.6% in 2010
 - Some communities more than others
 - Multiplier up 4% in 2009
- Local governments facing revenue challenges
- For schools : the “bad” side of Proposal A



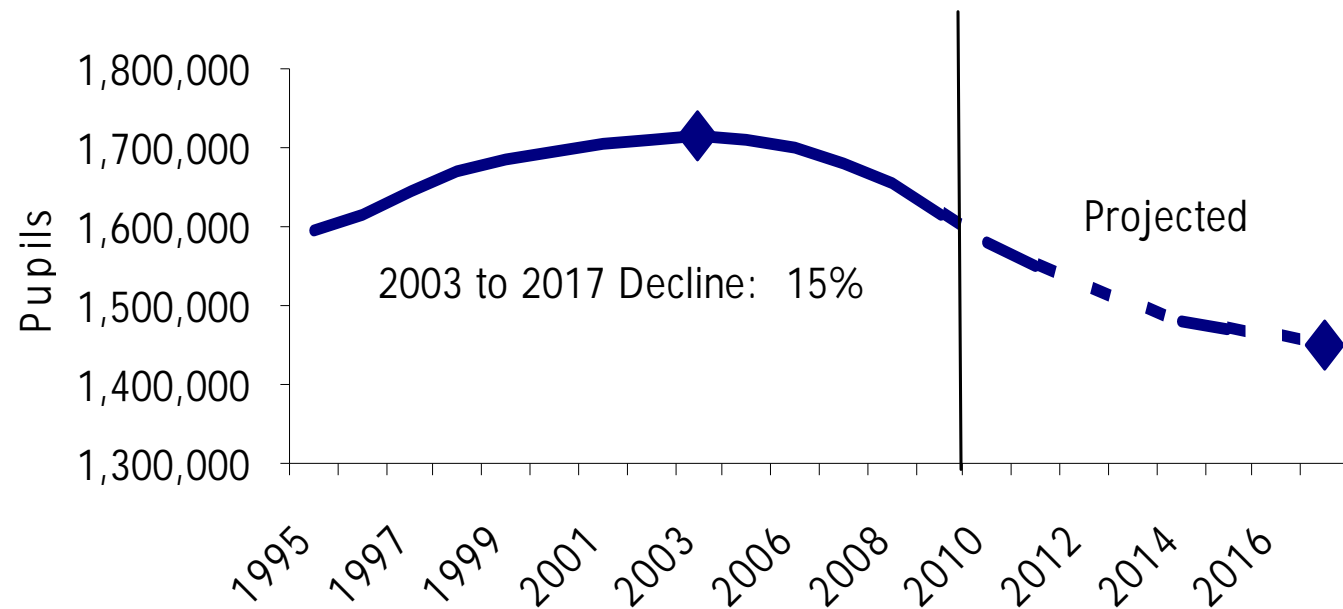
Per Pupil Support for K-12

- Min grant: up \$616 (9%) from '03 to '09
- Max grant: up \$489 (4%) from '03 to '09
- State support basically flat – less than 1% increase
- Declining enrollment responsible
 - 98,000 fewer students (-5.7%) - '03 to '09
 - 36,000 students - '08 to '09
 - Translates into about \$717 million
- Another 2.2% reduction from '09 to '10
- No new state money added to grant



Declining Enrollments Continue

Pupil Count

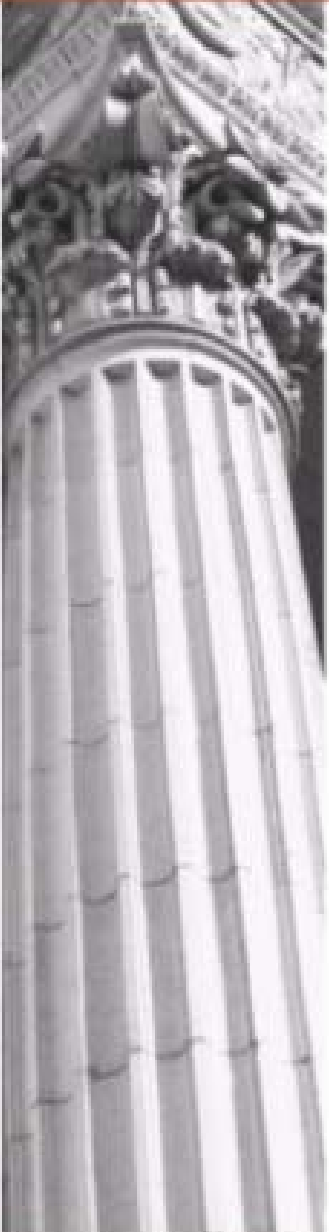


Projections: Michigan Fiscal Future



Where Do Things Stand Today?

- FY2009 Budget
- FY2010 Budget
- Federal Recovery Funding Impacts





FY2009 Budget Major Cuts Avoided

2009 SAF Budget
(millions)

	<u>Jan</u>	<u>May</u>	<u>Diff</u>
Beginning Balance	\$ 247	\$ 247	
Revenues			
Dedicated SAF	\$ 11,369	\$ 10,944	\$ (425)
GF Grant	\$ 41	\$ 78	\$ 37
Federal	\$ 1,562	\$ 1,562	
Total	\$ 13,219	\$ 12,831	\$ (388)
Proj. Spending	\$ 13,257	\$ 13,260	\$ 3
Shortfall	\$ (38)	\$ (429)	
Solutions			
Exec Order Cuts		\$ (7)	
ARRA - Education		\$ 600	
Balance	\$ (38)	\$ 178	



FY2009 SAF Solutions

- \$429M problem not nearly as large as General Fund shortfall (\$1.2B)
- Much less time to effect spending cuts, schools end fiscal year on June 30
 - GF cuts nearly \$300 million
- Foundation grant can NOT be cut, per ARRA
 - Without Fed \$, cuts ~ \$250 per pupil
- Almost entirely reliant on federal recovery funding (education portion) to maintain balance
 - Non-recurring resources (\$683M) total 5% of total spending
- Remainder of stimulus (\$800M) available for FY10 and beyond



FY2010 Baseline Shortfall

FY2010 SAF Balance Sheet (millions)

Revenues		<u>May</u>
Dedicated SAF	\$	10,563
GF Grant	\$	32
Federal	\$	1,562
Total	\$	12,157
Baseline Spending	\$	13,157
Shortfall	\$	(1,000)
ARRA - FY09 and FY10	\$	805
Balance	\$	(195)



FY2010 Budget: HB4447

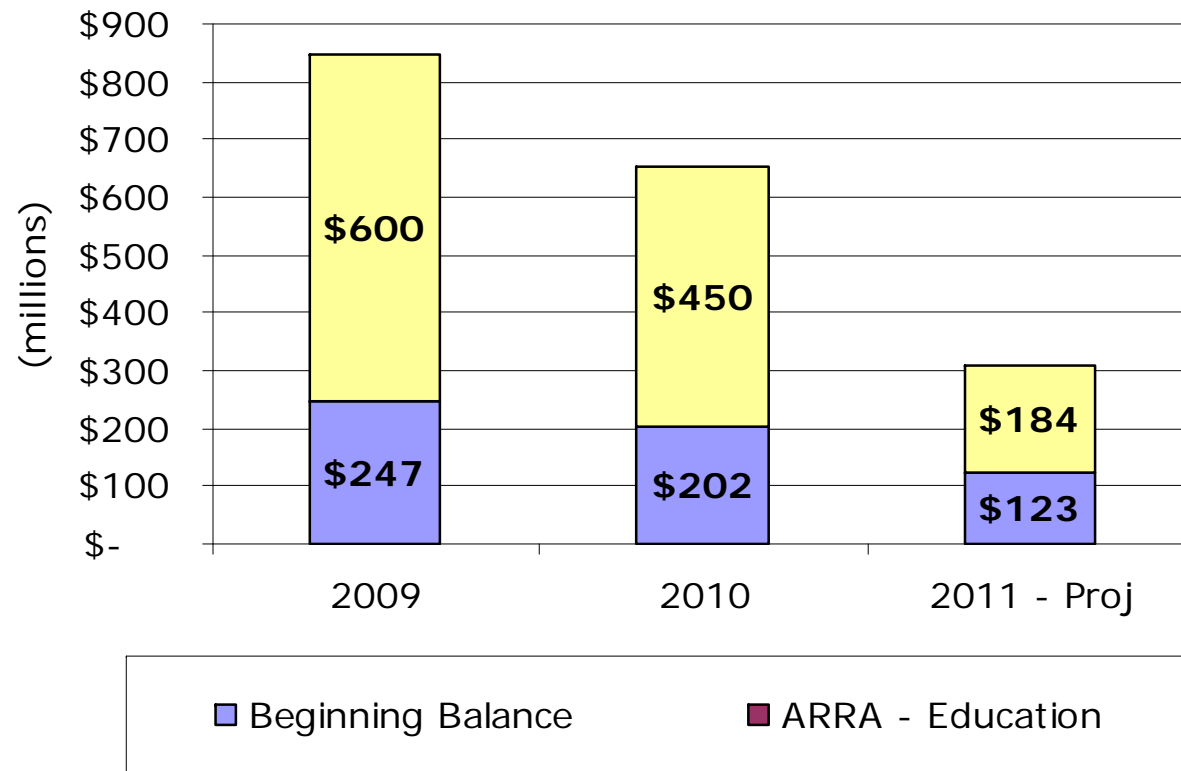
Legislative Response (millions)

Appropriation Reductions (before vetoes)		
\$165 per pupil cut	\$	263
ISD grant cut	\$	16
Other cuts	\$	30
Federal Stimulus	\$	450
New Revenues	\$	100
Beginning Balance	\$	202
 Total	 \$	 1,061



Heavy Reliance on One-Timers But Declining

SAF Budget: Non-Recurring Resources Used





Governor's Response

- Revenues deteriorating and budget out of balance
- 10/19: Vetoes – cut \$56M
 - Section 20j payments to “hold harmless” districts (\$52M)
 - Per pupil cut - \$119 to \$324
- 10/22: Proration letter – cut \$212M
 - Per pupil cut - \$127
 - 30-day clock

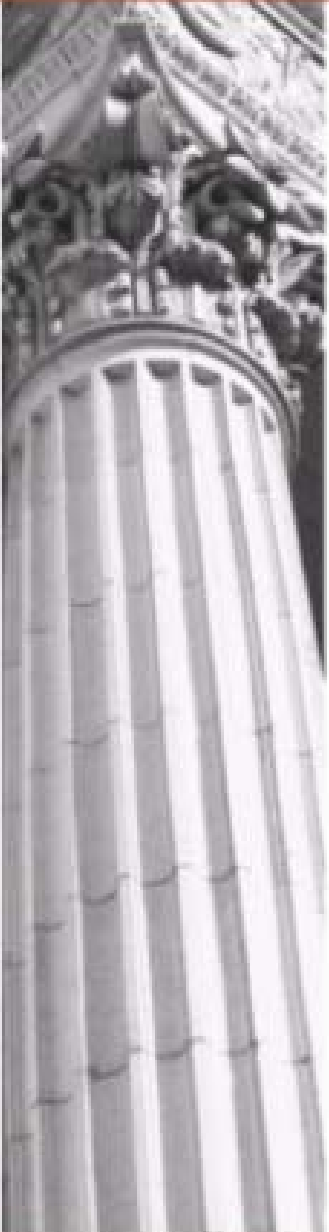


FY11 Budget: Very Early Look

A number of issues to resolve:

- FY2010 cuts carried into FY2011?
- State revenue growth in FY2011?
- Local revenue growth in FY2011?
- What will legislature do on tax policy front?
- Federal stimulus funding nearly exhausted, replacement revenue?

Remember: 2010 is an election year



Michigan's Fiscal Future: A Long-Term Analysis of Michigan's Economy and Budget

Report by CRC of Michigan, May 2008



Scope of the Analysis

- Ten-year scenarios of the Michigan economy with varying assumptions about:
 - Auto industry
 - Office furniture
 - Chemicals
 - R & D
- W.E. Upjohn staff used Regional Economic Models, Inc. (REMI) to prepared economic projections
- Economic projections translated to revenue projections and projections of spending pressures
- Not predictions but projections



Annual Growth Rates—General and School Aid Revenues (FY09-FY17)

- Income—3.25% (1.4% after tax changes)
- Business—3.1%
- Sales—3%
- Use—3%
- Tobacco—Minus 2.5%
- State Education (Property)—4.25%
- Other Sources—1.9%

Overall

General Fund: 1.4%

School Aid Fund: 3 %



Projections Made Against a Much Different Backdrop

	Annual Rates	
	Current Estimates <u>2009 - 2010</u>	Fiscal Future Projections <u>2009 - 2017</u>
Economic Projections		
Employment	-6.5%	-0.1%
Personal Income	-3.5%	4.2%
Salaries and Wages	-5.1%	3.8%
State Tax Revenue Projections		
Income	-13%	3.25% (1.4% net)
Business	-3%	3%
Sales and Use	-5%	3%
Tobacco	-5%	-2.5%
State Education	-5.5%	4.25%
Revenue By Fund		
General	-13%	1.4%
School Aid	-4.25%	3.0%



Reasons for Sluggish Revenue Growth

- Increasing senior citizen population—retirement income not taxed and spend less on goods
- Consumption taxes goods oriented—economic growth is in service sector
- Slow or no growth revenues drag down overall growth (e.g. tobacco, gambling, alcohol)
- Flat rate income tax
- Earned Income Tax Credit (GF impact only)
- Phase-out of Income Tax increase (GF impact only)



School Aid Structural Deficit

Spending Pressures Outpace Revenue Growth

- Retirement Contributions—rapid growth
- Employee Health Insurance—rapid growth
- General Pay Raises
- Other—Fuel, Utilities, Supplies
- Revenues Growing Slowly

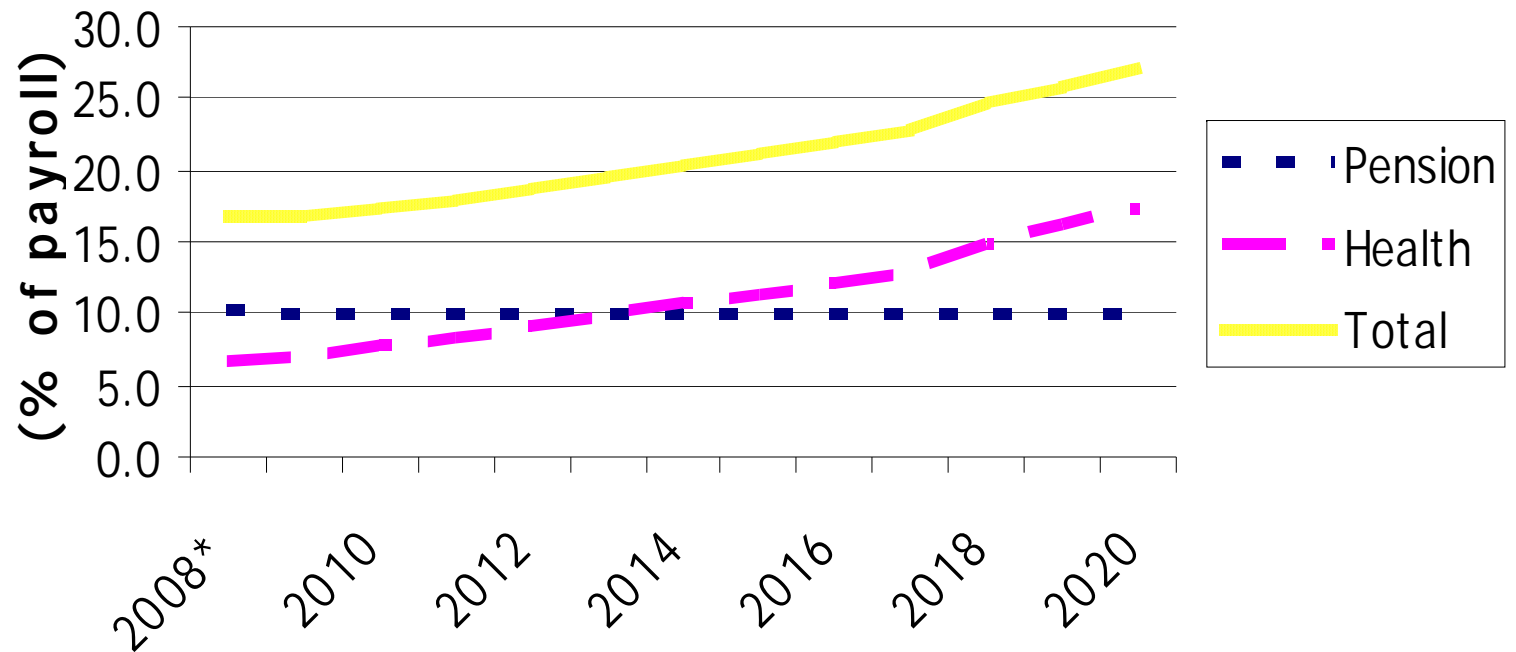


Retirement Funding

- School districts make contributions for employees – advance funded
- School districts also pay for retiree health care – cash funded
- Rate for FY2009 is 16.54% of payrolls
- Contribution rate composed of two parts
 - Regular pension benefit (9.73%)
 - Health care benefits (6.81%)
- Both parts will continue to increase in the future
 - Pension because of market in 2008
 - Health because of increase in retirees and cost of health care



MPSERS Projected Rates



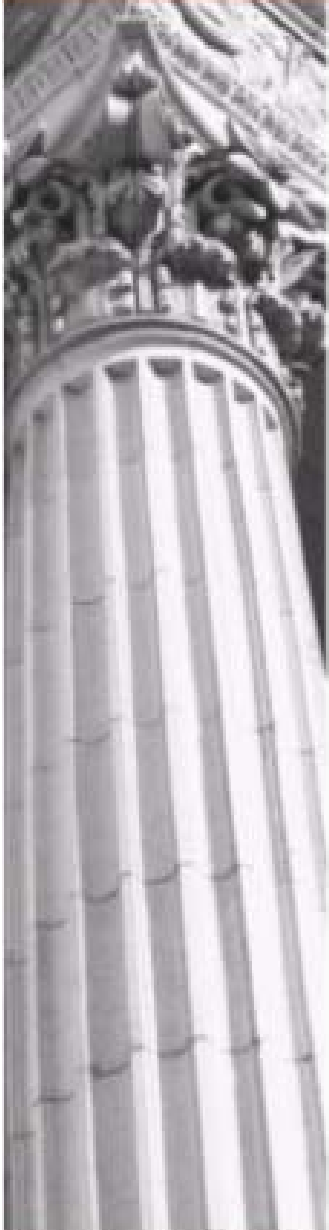
* Actual Rates

Fiscal year



School Aid Revenues & Spending Pressures

- Spending pressures grow 4.7% per year
- Revenues (state and local) grow 3% per year
- Shortfall of 1.7 percentage points each and every year without spending and revenue policy changes
- By FY17, revenues will cover only 86% of spending



Declining Enrollments

Year	Projected	Change
2009	1,615,577	(37,831)
2010	1,580,654	(34,922)
2011	1,550,007	(30,647)
2012	1,522,848	(27,160)
2013	1,499,128	(23,720)
2014	1,481,494	(17,634)
2015	1,468,480	(13,013)
2016	1,458,292	(10,188)
2017	1,451,616	(6,676)
Average Rate		- 1.4%

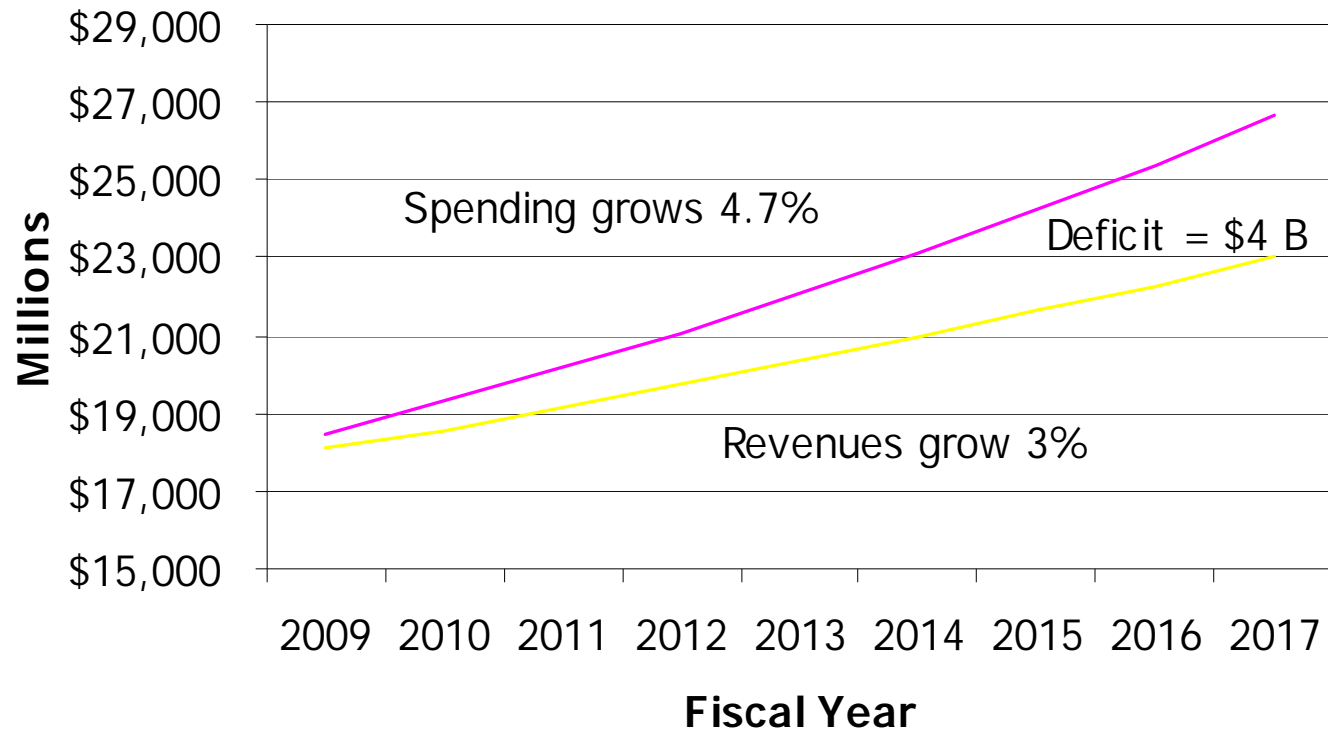


How does this translate at the classroom level?

- Ave. per pupil revenue growth of 4.4% or \$570
- Spending pressures and “requirements” of 6.1%:
 - Salaries - \$350
 - Retirement - \$110
 - Group insurances (health) - \$250
 - Other (fuel, utilities, etc.) - \$130
- Structural deficit of \$270 per pupil

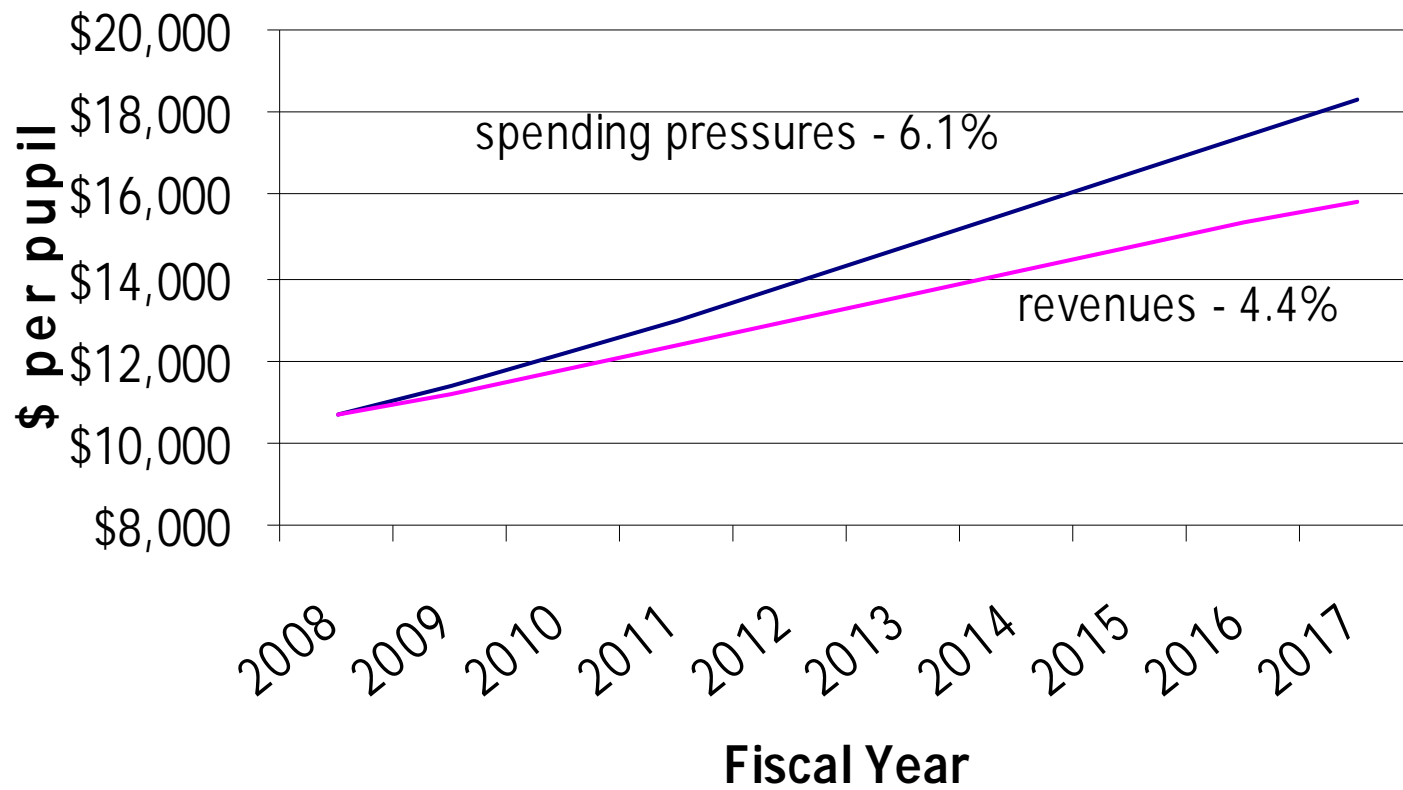


School Aid Structural Deficit Projections FY2009 – FY2017





Per Pupil Structural Deficit Projections

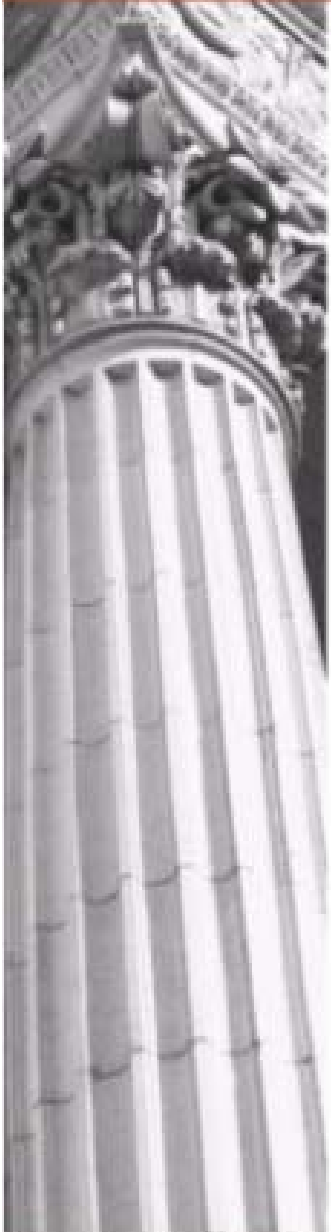




Policy Options

Achieving Long-Term Structural Balance

- Increase revenue growth
- Reduce rate of spending pressure growth
- Bend the two curves so they meet





Revenues

- Change system so revenues grow in line with economy and personal income
- Consider taxing services broadly
- Modify personal income tax by changing rate and exemptions—or—implement graduated income tax (Constitutional amendment required)
- Reduce reliance on “sin” taxes
- Consider taxing pensions and other retirement income (area of greatest income growth in future)



Tax Scenario

- Expanding Sales and Use Taxes
 - Exempt business-to-business
 - Reducing rate to 3.6% (neutral)
 - Adds about 0.8% to growth rate
- Graduated Income Tax
 - Revenue-neutral starting point
 - Nearly doubles growth rate
- Combined effects
 - Adds 0.8% to School Aid Fund growth
 - Adds 1.5% to General Fund growth
 - Still work to do – spending solutions

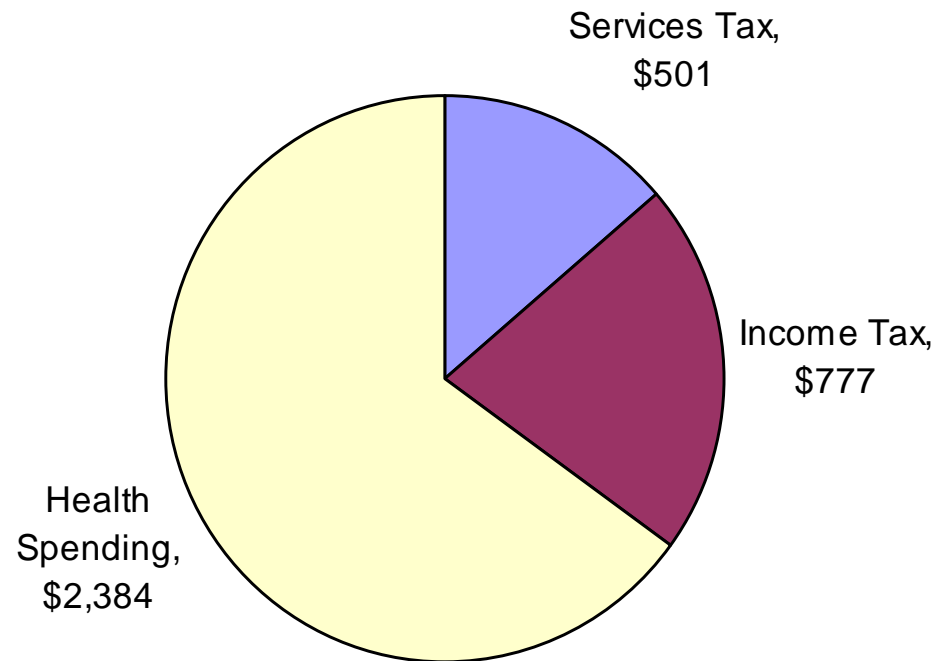


Spending Scenario

- Health care – employees and retiree
 - Holding health care cost increases to 5% per year
 - Reduces General Fund annual spending pressure growth by 1.6%
 - Reduces School Aid annual spending pressure growth by 1.1%

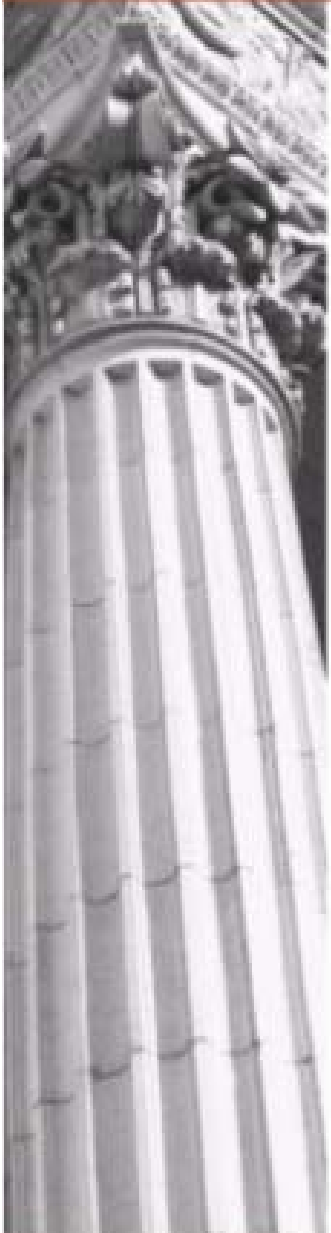


Effects of Alternative Policies to Close \$3.7 Billion of \$4.0 Billion School Aid FY17 Deficit (\$ in Millions)





Questions?





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