

A vertical, black and white photograph of a classical column with a detailed capital, positioned on the left side of the slide.

Michigan K-12 Finances and the State Budget

**Presented to
Farmington Public Schools**

October 6, 2009



Citizens Research Council

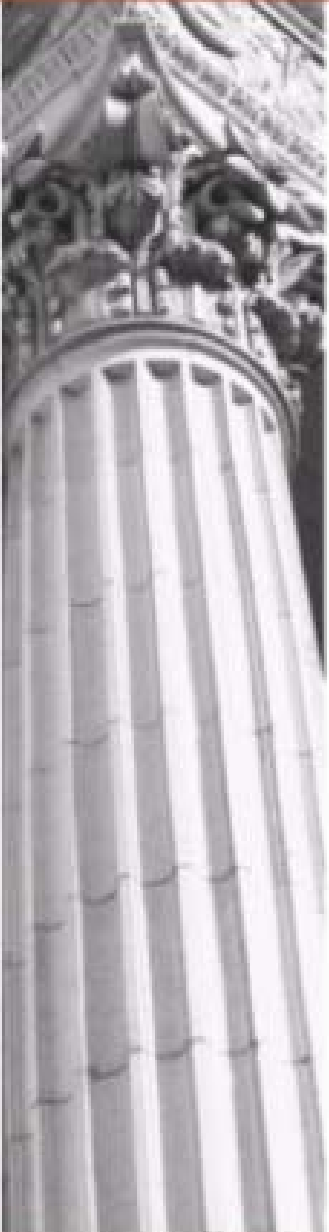
- Founded in 1916
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- Promotes sound policy for state and local governments through factual research – accurate, independent and objective
- Relies on charitable contributions of Michigan foundations, businesses, and individuals
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Michigan's Fiscal 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 to achieving sustainable, long-term structural balance



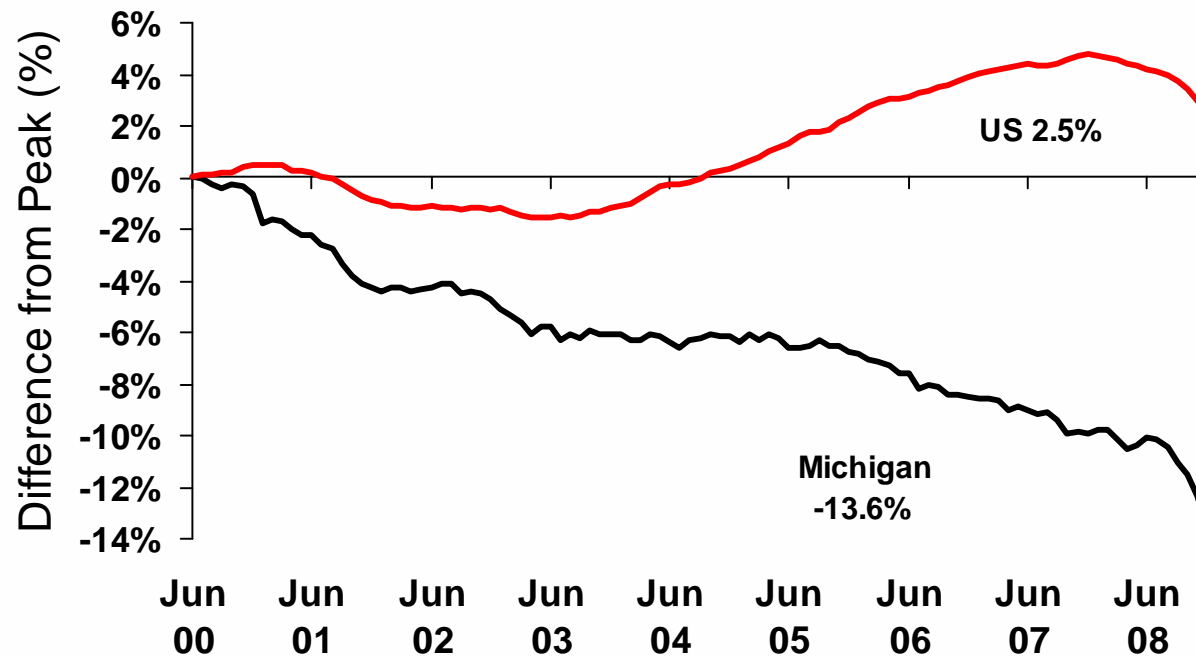


But, There is a New Chapter

- 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



Michigan Employment Never Recovered in Last Expansion

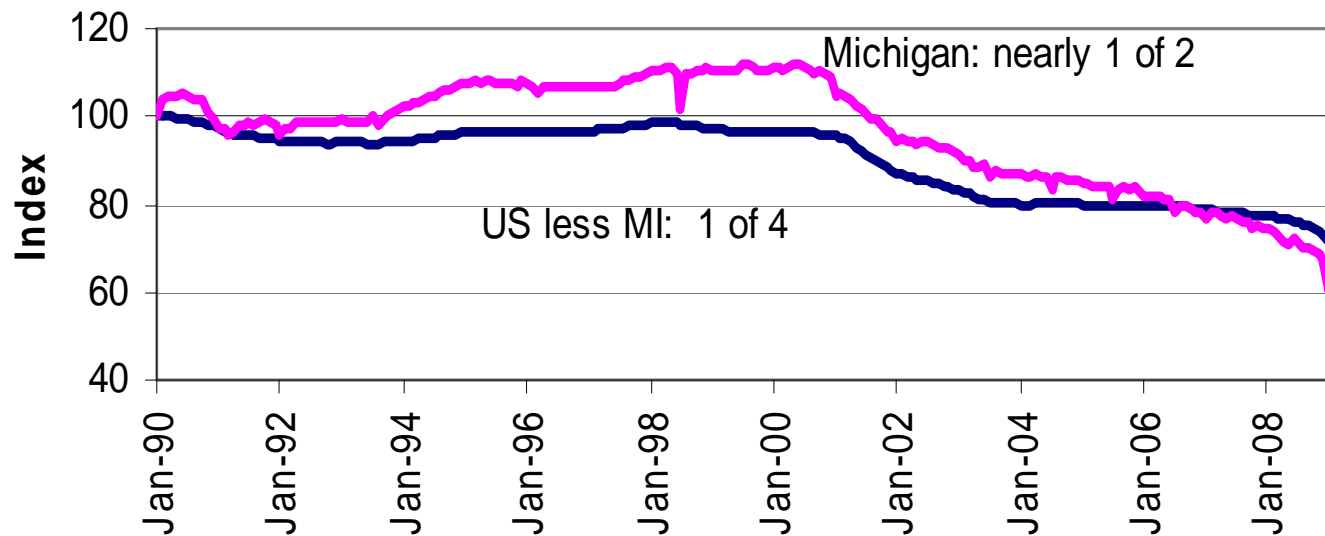


Source: Bureau of Labor Statistics



Michigan Dependence on Manufacturing Key to Decline

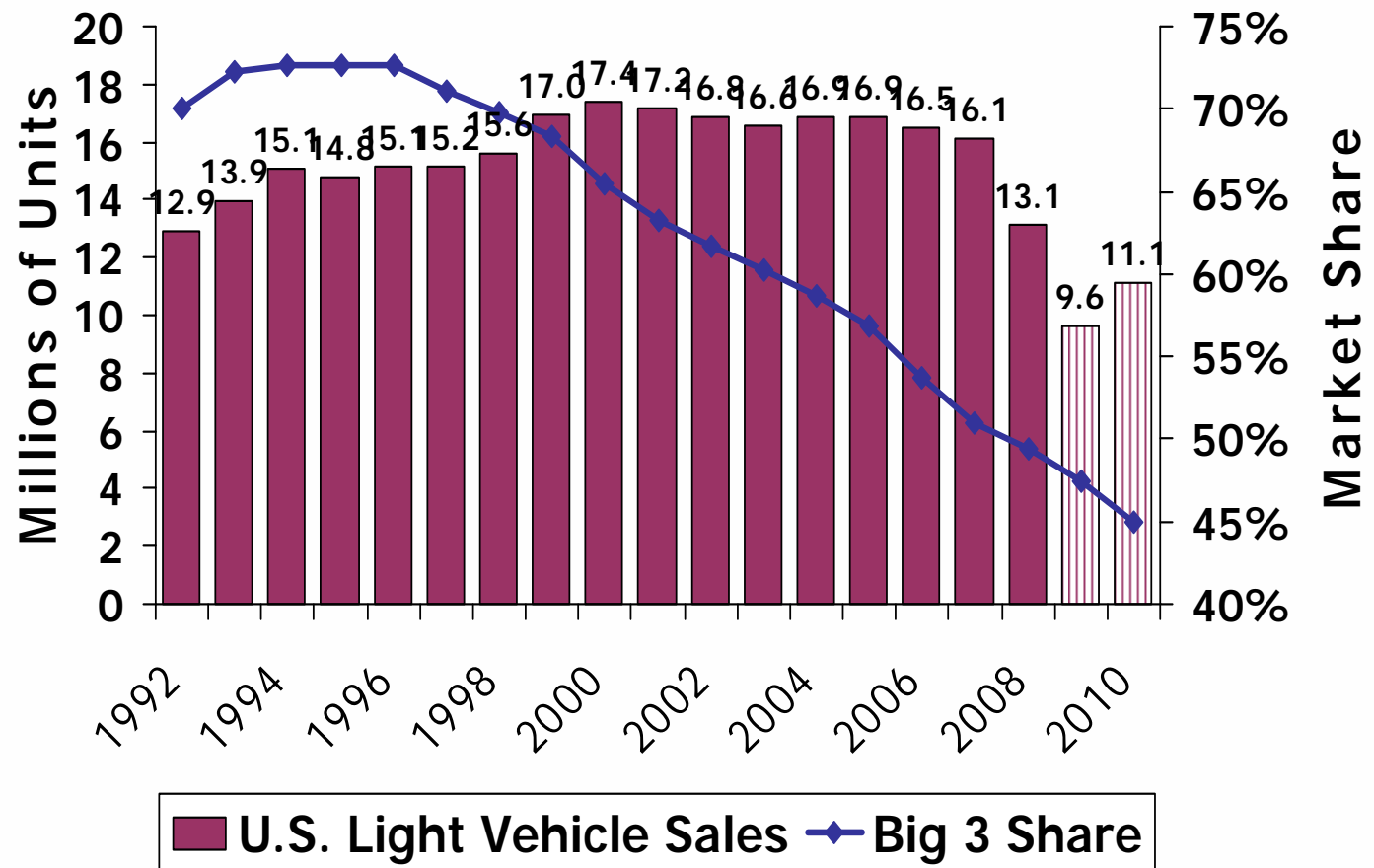
Growth In Monthly Manufacturing Employment Michigan and United States



Source: Bureau of Labor Statistics



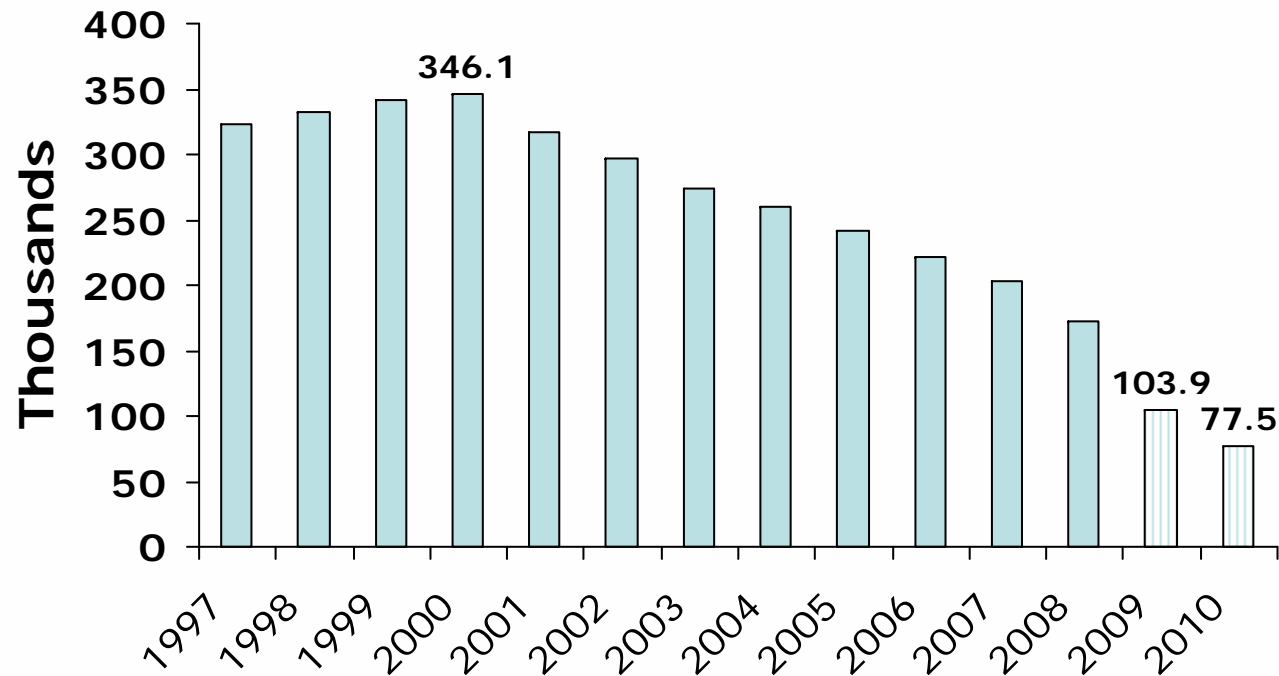
Big 3 Losing Market Share



Source: Automotive News, Consensus Revenue Estimates



Michigan Vehicle Employment

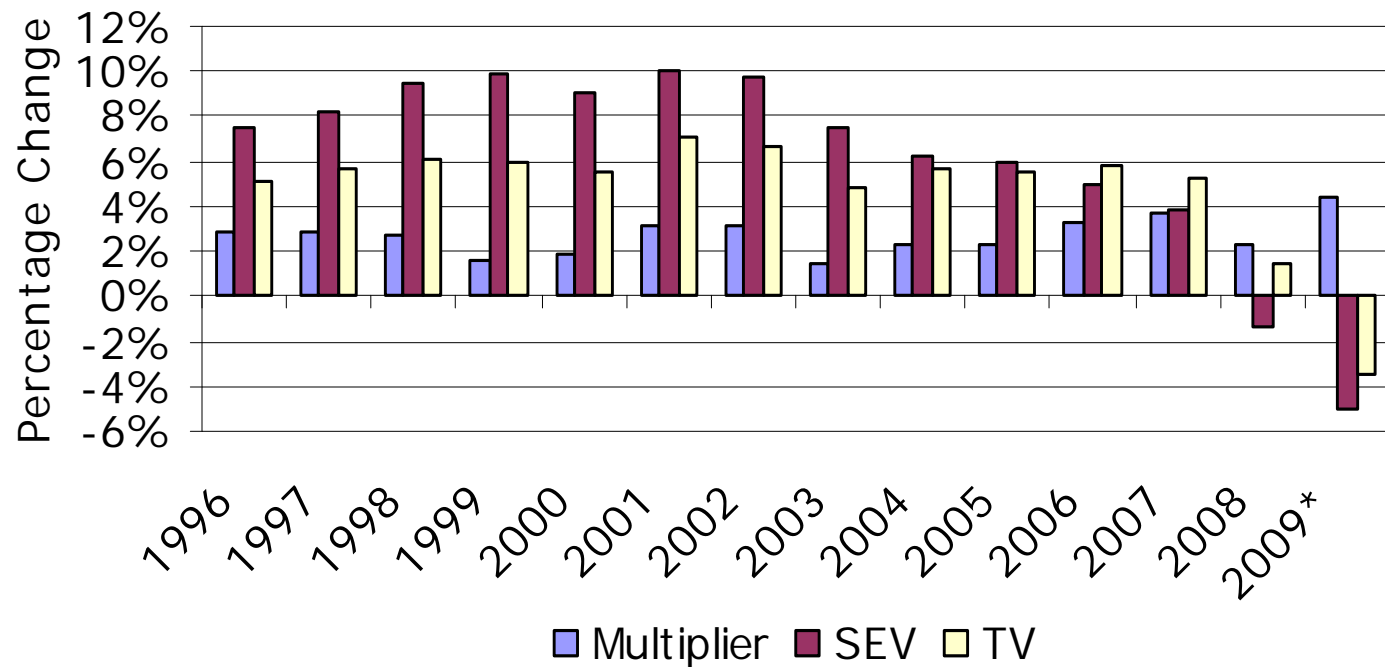


Source: Bureau of Labor Statistics, Consensus Revenue Estimates



Property Values Stagnating

Annual Changes in TV, SEV, and Multiplier



Source: Michigan State Tax Comm.

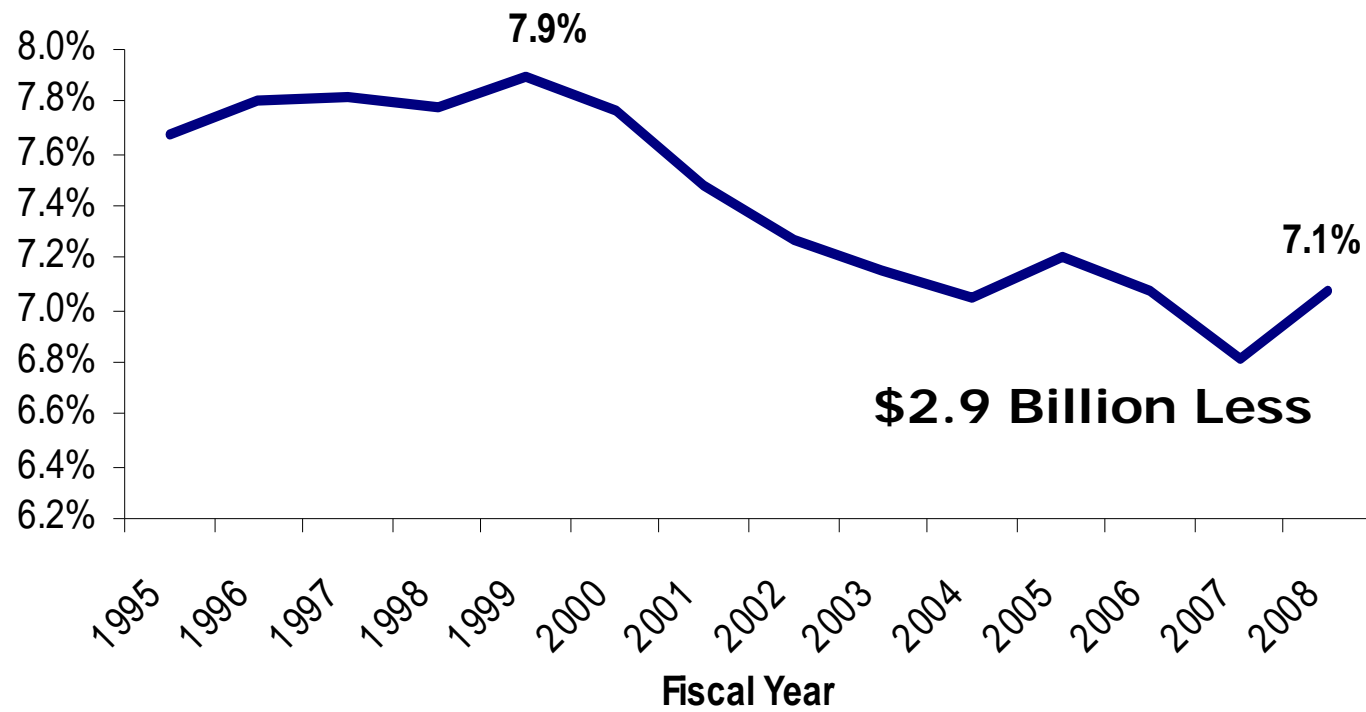


What Does This Mean?

- Taxable Value in 2007 up 5.2%, but home values up only 3.8% statewide
 - Multiplier up slightly less than 3.8%
- 2008 TV continuation of same
 - up only 1.4%
 - shrinking reservoir between TV and SEV
 - Multiplier up 2% = taxpayer discontent
- TV declines 2.8% in 2009 and 3% in 2010
 - Some communities more than others
 - Multiplier up 4% in 2009
- The “bad” side of Proposal A



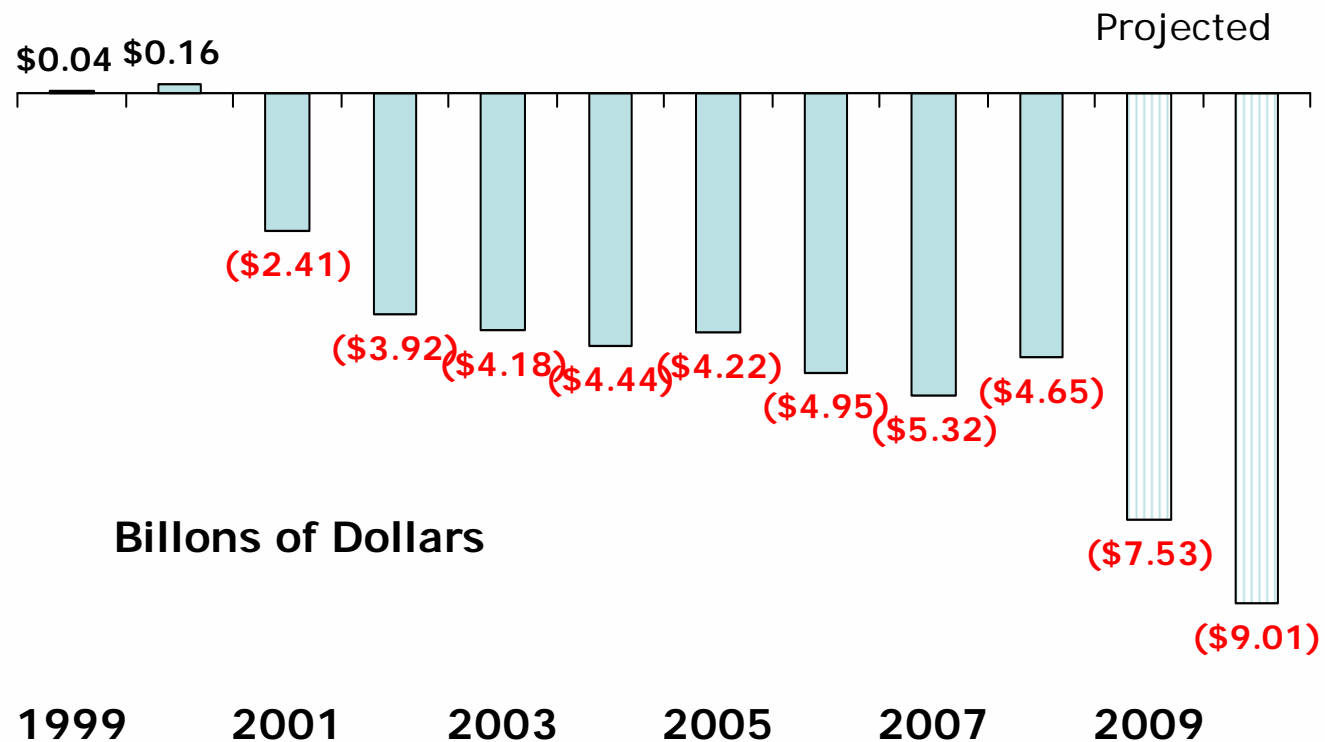
State Taxes as a Percent of Michigan Personal Income



Source: Michigan Annual Financial Report



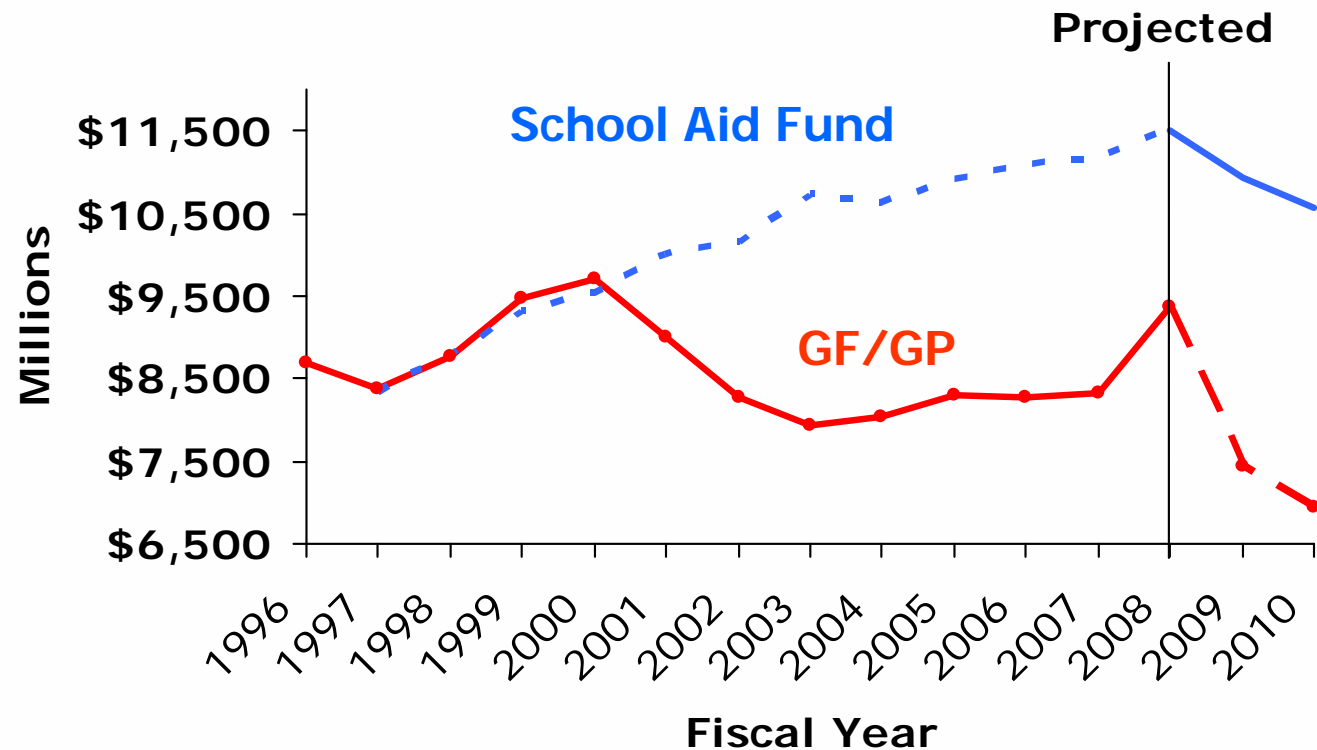
Constitutional Revenue Limit





GF/GP Revenue Below 1996

GF/GP and SAF On-Going Revenues

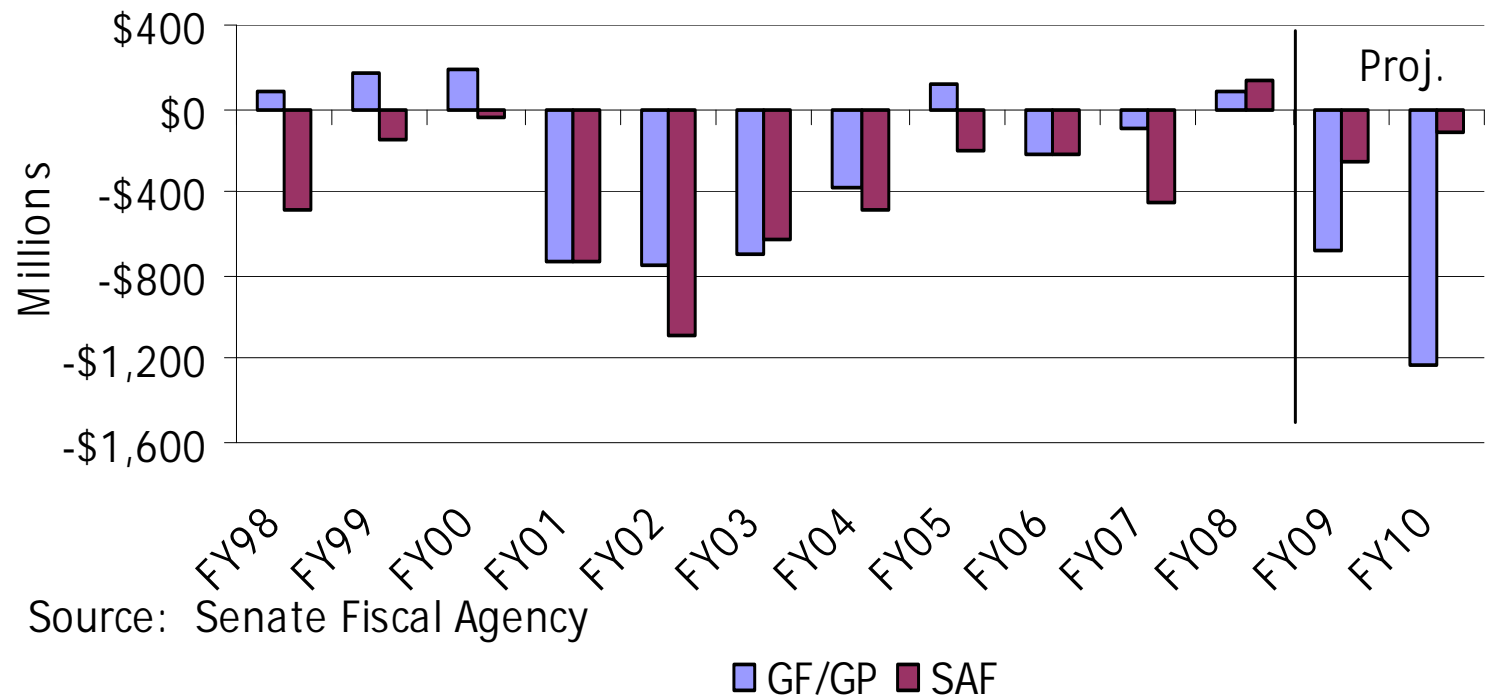


Source: Michigan Department of Treasury



Persistent Structural Deficits

GF/GP and SAF Operating Deficits

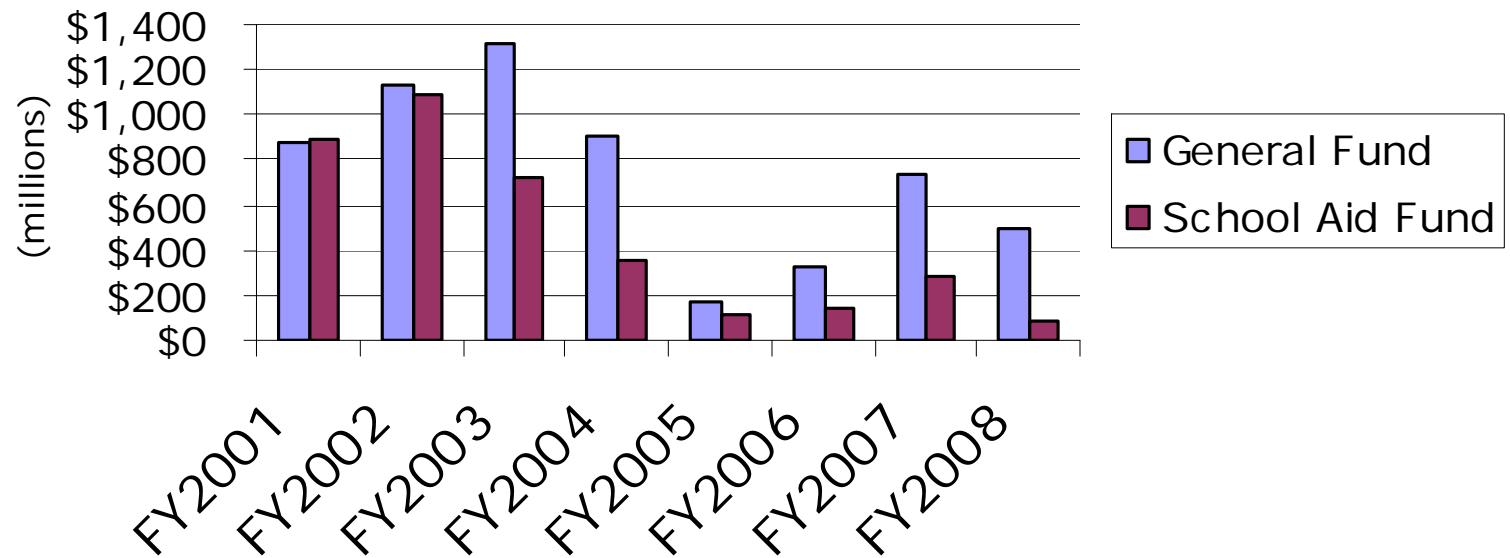


Source: Senate Fiscal Agency



Spending Supported by One-Timers

Non-Recurring Resources Used to Balance Budgets



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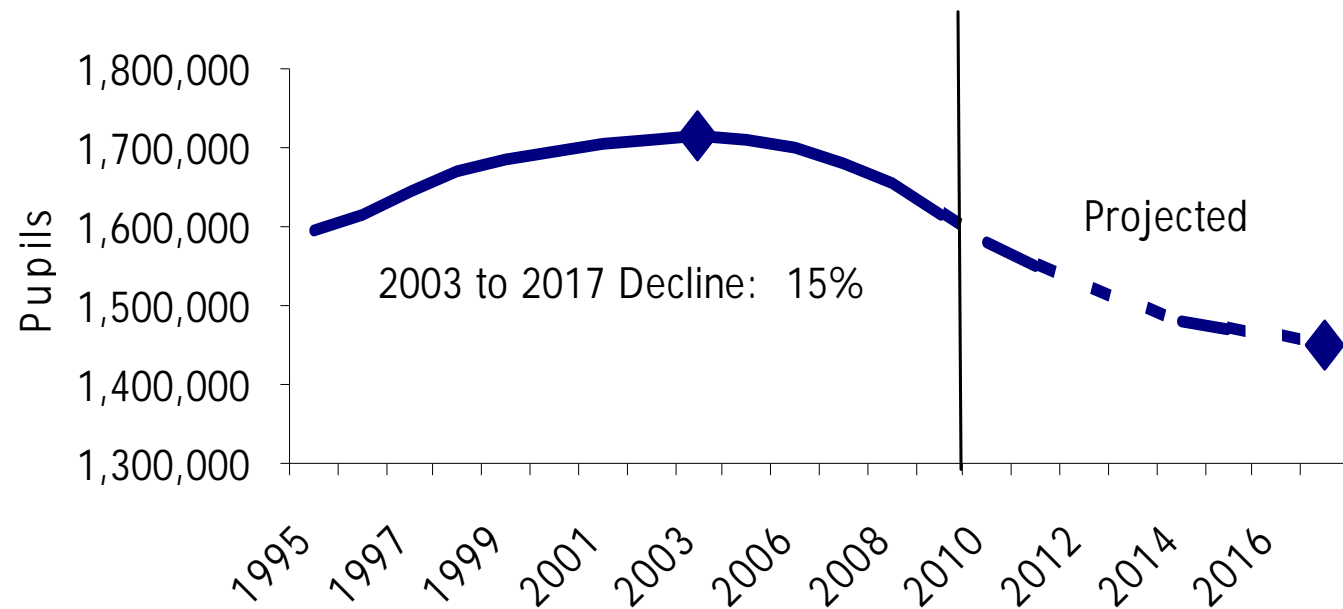
Per Pupil Support for K-12

- 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
- FY2011 Budget, a very early look



Recession Results in Much Lower State Tax Revenues

	2009				2010			
	<u>Jan</u>	<u>May</u>	<u>Diff</u>	<u>Diff</u>	<u>Jan</u>	<u>May</u>	<u>Diff</u>	<u>Diff</u>
Income	\$ 6,501	\$ 6,058	\$ (443)	-7%	\$ 6,027	\$ 5,354	\$ (673)	-11%
Sales	\$ 6,492	\$ 6,212	\$ (280)	-4%	\$ 6,507	\$ 6,067	\$ (440)	-7%
Use	\$ 1,268	\$ 1,153	\$ (115)	-9%	\$ 1,332	\$ 1,194	\$ (138)	-10%
Business	\$ 2,587	\$ 2,318	\$ (269)	-10%	\$ 2,537	\$ 2,234	\$ (303)	-12%
GF/GP net	\$ 8,306	\$ 7,435	\$ (871)	-10%	\$ 7,935	\$ 6,950	\$ (985)	-12%
SAF net	\$ 11,369	\$ 10,944	\$ (425)	-4%	\$ 11,296	\$ 10,563	\$ (733)	-6%



SAF “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



Major Budget 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		\$ 1,234	
Balance	\$ (38)	\$ 812	



FY2009 SAF Solutions

- 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 Cuts Required

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)



2010 State Budget Update

- All full-year General Fund budget work completed by Legislature – awaiting Governor's signature
 - Continuation budget put in place through 10/31
- School Aid Fund budget - HB4447 (conference report) still in House
 - Second conference committee
 - No continuation budget (SB 252)
 - No authority to spend any money



HB4447 – SAF Conference Report

- \$218 per pupil reduction (with some discretion where cut comes from)
 - \$348M in total
 - Amounts to 2.9%
 - Foundation grant held at \$7,316
- ISD operations grant cut
 - \$36M in total
 - Amounts to 44%
- Total reductions from FY2009 ~ \$412M
- Federal stimulus ~ \$450M
 - Additional \$250 - \$300 per pupil cut
- Reserves \$ for FY2011 ~ \$223M (mostly stimulus)



Conference Summary

Shortfall	\$	(1,000)
Solutions - Conf Report		
Beginning balance	\$	171
ARRA - FY10	\$	450
Appropriation reductions	\$	412
Balance	\$	33



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CONFERENCE PLAN

Comparing FY 2008-09 Appropriations to
Proposed Conference Reductions

<u>Program</u>	<u>FY 2008-09 Current Appropriation</u>	<u>Conference Proposed Eliminations</u>	<u>Percent Reduction</u>
\$218 Per Pupil Reduction	\$7,316	(347,541,100)	-2.9%
ISD 44.36% Sec. 81 Reduction	81,721,100	(36,252,000)	-44.4%
Non-District School Readiness	15,150,000	(7,575,000)	-50.0%
Small High Schools	8,000,000	(8,000,000)	-100.0%
Dearborn's At-Risk Payment	5,875,100	(1,468,775)	-25.0%
Child/Adolescent Health	4,742,900	(1,185,725)	-25.0%
Math/Science Centers	3,500,000	(875,000)	-25.0%
MEAP and MME Program Changes	28,130,700	(1,500,000)	-5.3%
Michigan Virtual University	2,250,000	(562,500)	-25.0%
Interagency Early Childhood	2,125,000	(531,250)	-25.0%
Grosse Pointe/Harper Woods Pilot Programs	1,500,000	(1,500,000)	-100.0%
School Bus Inspections	1,436,500	(1,436,500)	-100.0%
Youth Challenge	1,295,000	(647,500)	-50.0%
Redford Union, Chippewa Valley, Clintondale	850,000	(850,000)	-100.0%
Early Childhood Investment Corporation	6,750,000	(750,000)	-11.1%
After School Math	725,000	(725,000)	-100.0%
Central Michigan University Lending Library	100,000	(100,000)	-100.0%
Newsline	80,000	(80,000)	-100.0%

Total Conference Proposed Reductions

(\$411,580,350)



FY11 Budget: Very Early Look

A number of issues to resolve:

- How much federal stimulus used in FY2010?
- FY2010 cuts carried into FY2011?
- State revenue growth in FY2011?
- Local revenue growth in FY2011?
- What will legislature do on tax policy front?

Remember: 2010 is an election year



Structural Deficit Estimate

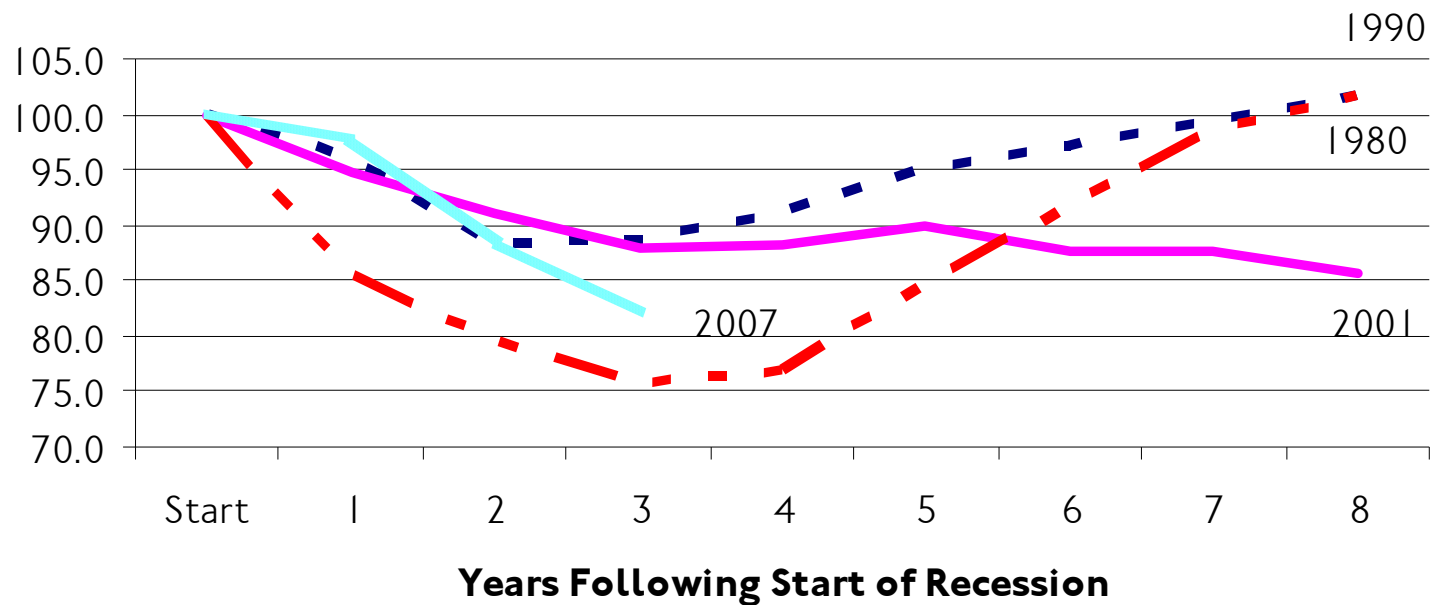
FY2011 SAF Balance Sheet (millions)

Revenues	<u>Projected</u>
Dedicated SAF	\$ 10,880
GF Grant	\$ 32
Federal	\$ 1,562
Total	\$ 12,474
Adj. Baseline Spending @ '09 level	\$ 13,137
Shortfall	\$ (663)



2007 Recession Shaping Up To Look Like 1980 Recession

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

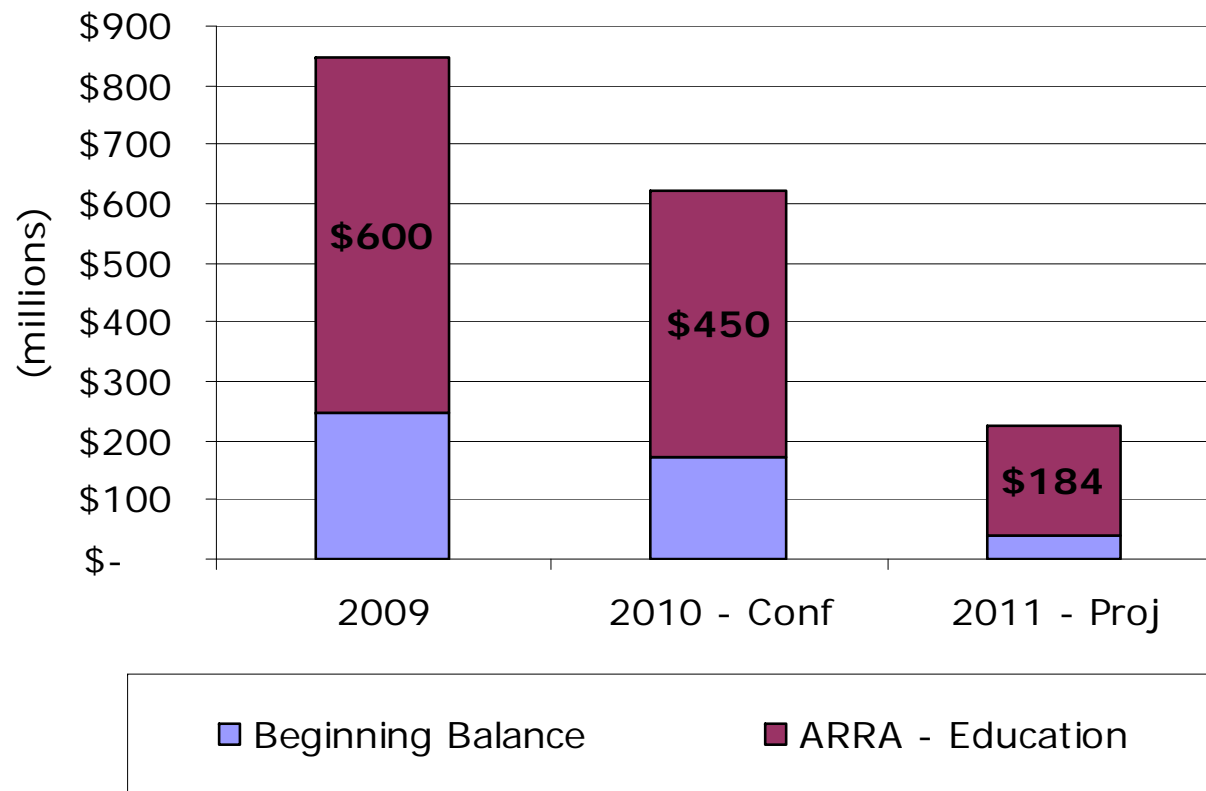


Source: Senate Fiscal Agency; CRC calculations



Heavy Reliance on One-Timers

SAF Budget: Non-Recurring Resources Used





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

Prepared in cooperation with
W.E. Upjohn Institute for Employment Research



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



Summary of Results Major Indicators

Annual rates of change

- Total Employment (-.07%)
- Labor Force (-.25%)
- Real Gross State Product (+1.2%)
- Labor productivity (+1.6%)
- Personal Income (+4.2%)
- Payrolls (+3.8%)
- Population (-.04%)

These statistics better than last 6 years



Employment Projection

Job Losses

- Goods producing—228,000
 - Auto manufacturing -- 117,000
- Retail and wholesale trade—62,000
- Government—19,000

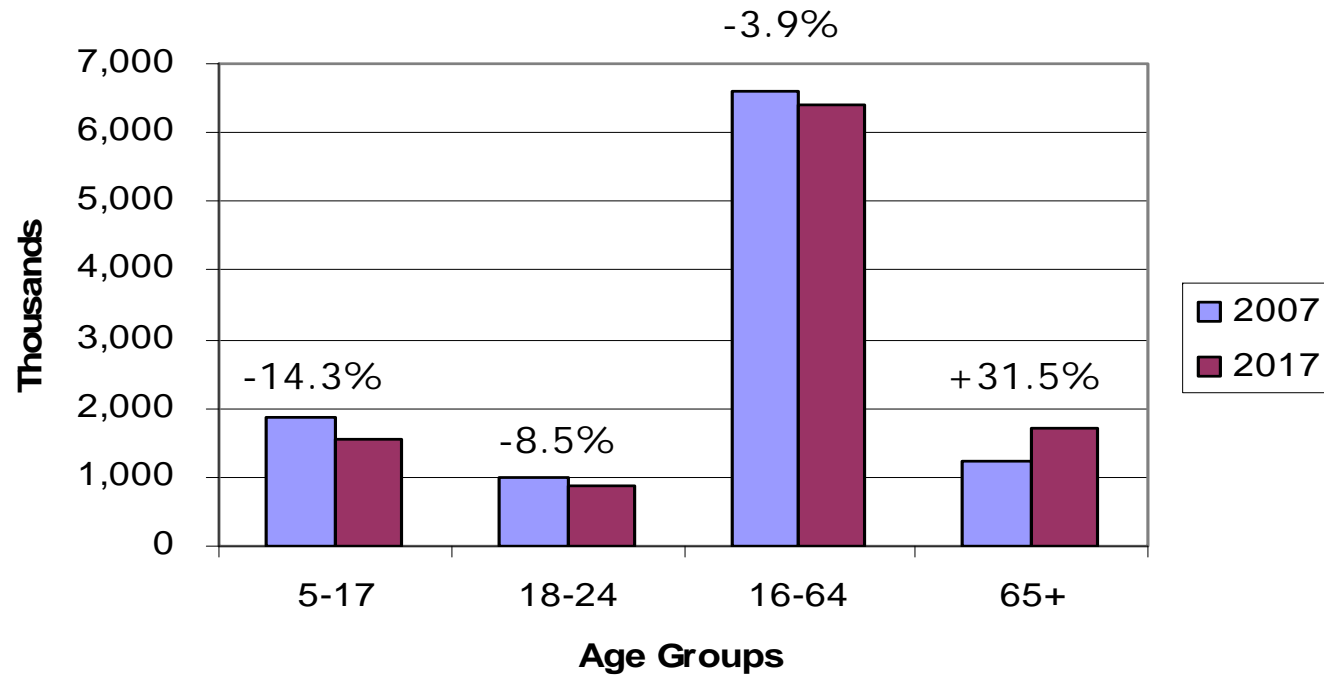
Job Gains

- Health care—134,000
- Business services—52,000
- Social assistance—33,000
- Recreation and amusement—27,000

Total: 38,000 Decline



Major Changes in State's Demographic Composition Ahead





Implications for State Government Finance

Revenues in General

- Revenues from the current revenue system will grow slowly—even more slowly than the economy
- Revenue (and taxes) declining as share of personal income
- Official FY2009 forecasts (January 2008) used as the beginning point

Taxes

- Account for 87% of General and School Aid Funds revenues
- Aggregate growth rate about 2.4%
- Higher growth rate will be needed to keep up with spending pressure increases
- Remaining sources grow less than 2%



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 %



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

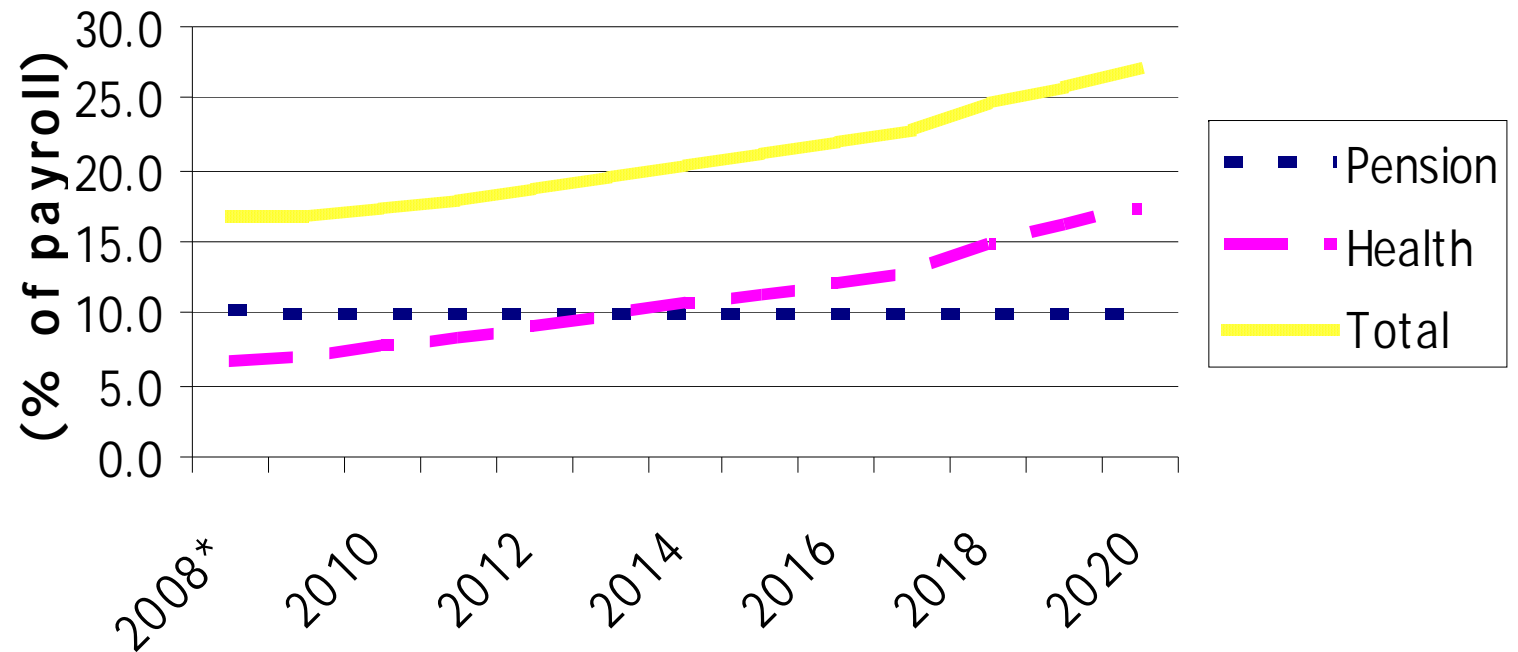


Retirement Funding

- 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



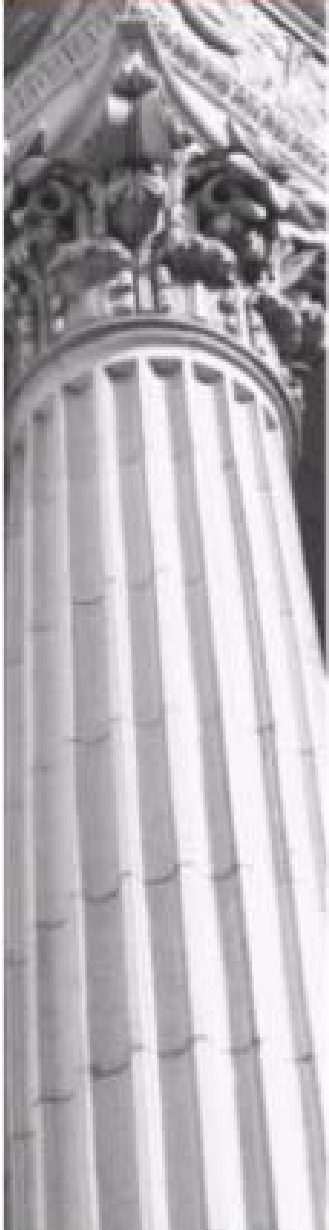
* Actual Rates

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%

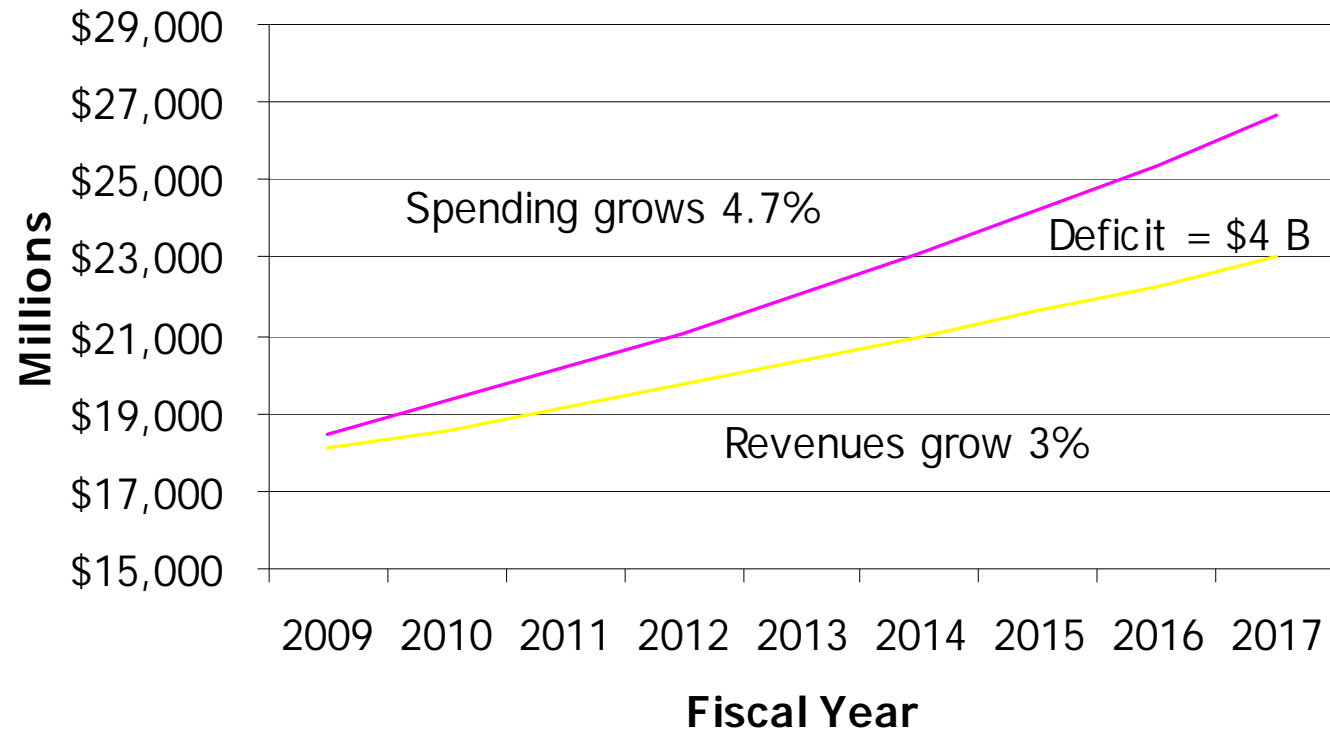


How does this translate at the classroom level?

- 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

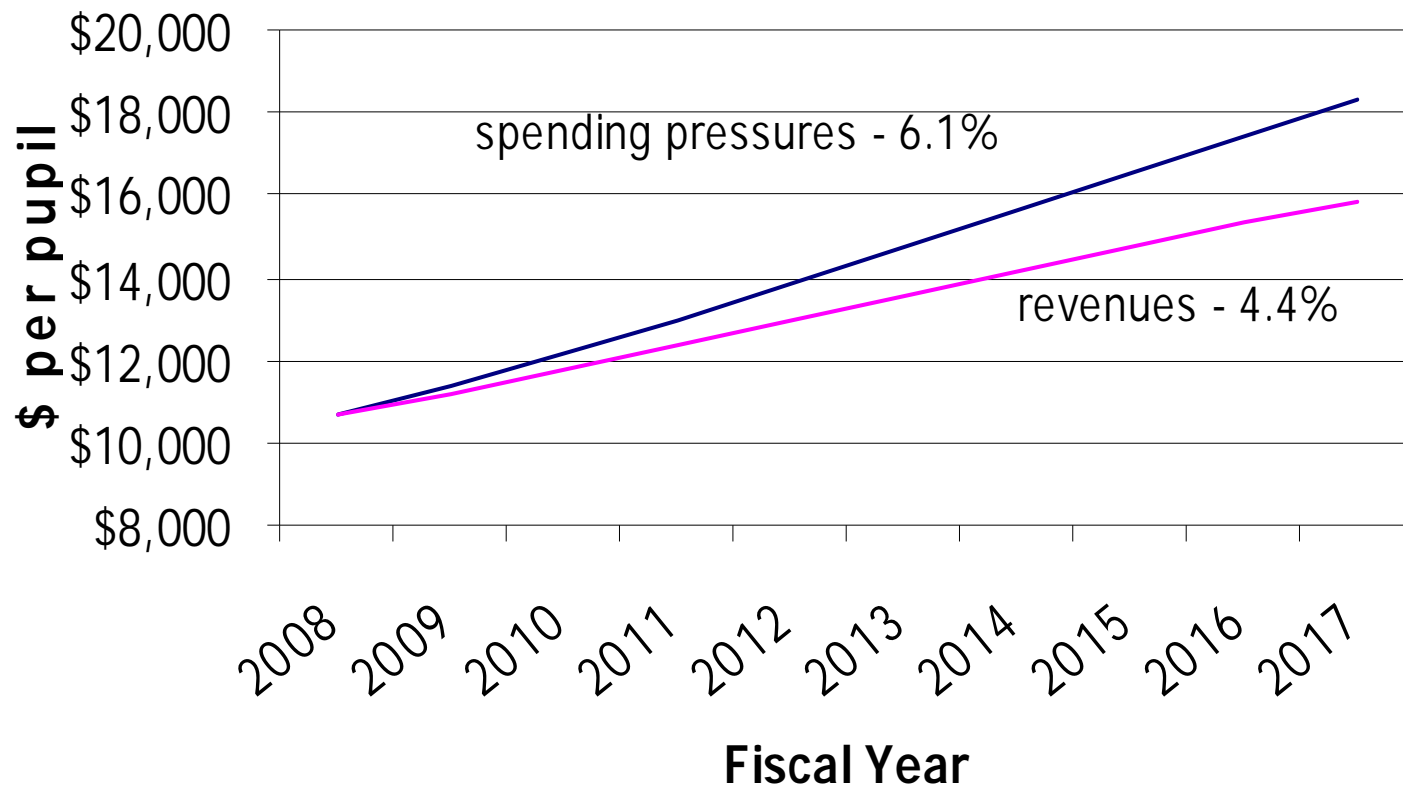


School Aid Structural Deficit Projections FY2009 – FY2017





Per Pupil Structural Deficit Projections

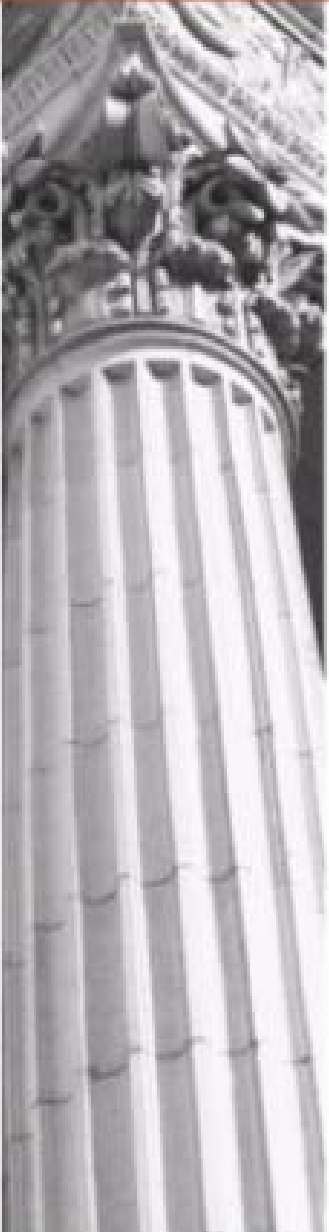




Policy Options

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)



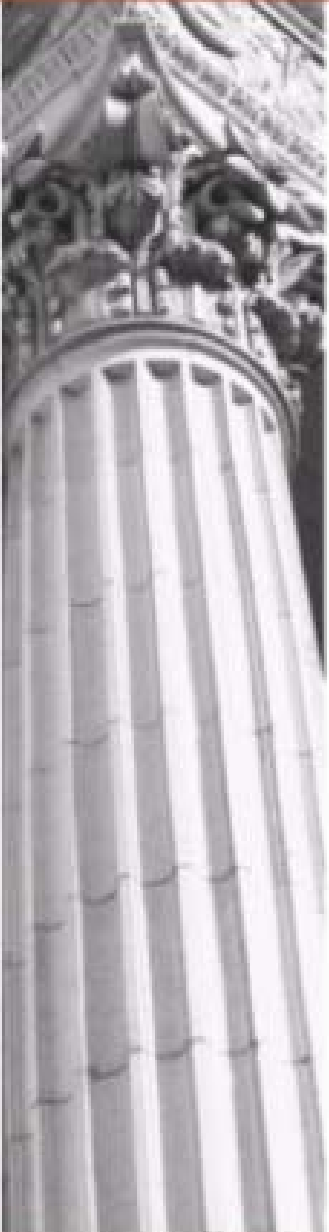
Tax Scenario

- 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

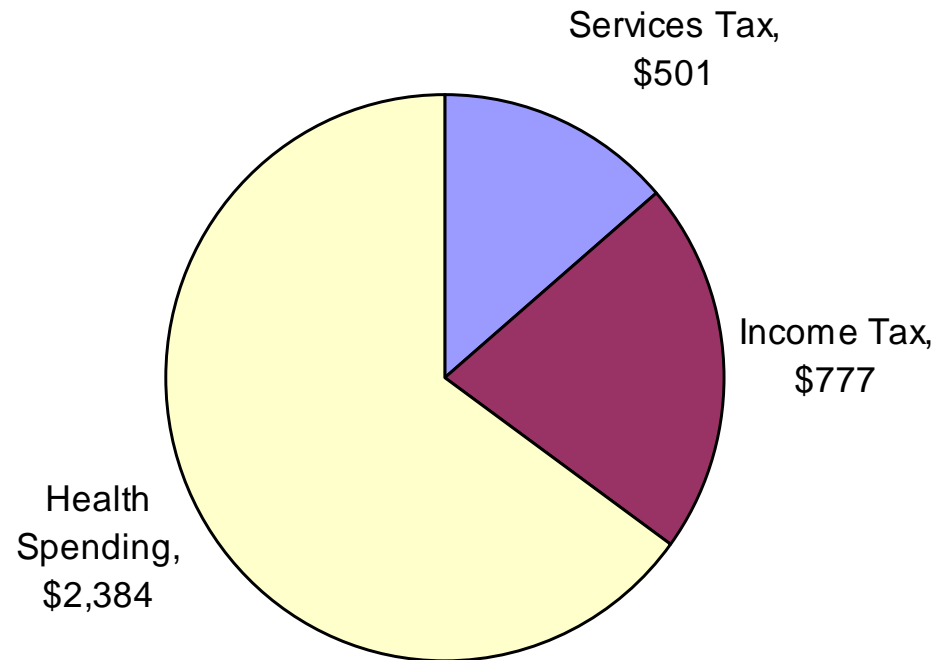


Spending Scenario

- 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)





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