

Michigan's On-Going Budget Problems and its Fiscal Future

**Presented to
Marygrove College
Social Justice Program**

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Citizens Research Council

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- Statewide
- Non-partisan
- Private not-for-profit
- 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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What to Cover

- Past
 - look back at Michigan's economy and budget from 2001 to 2008 – major shifts
- Present
 - economic forecast and budget for 2009 and 2010
- Fiscal Future Project
 - outlook for Michigan's budget

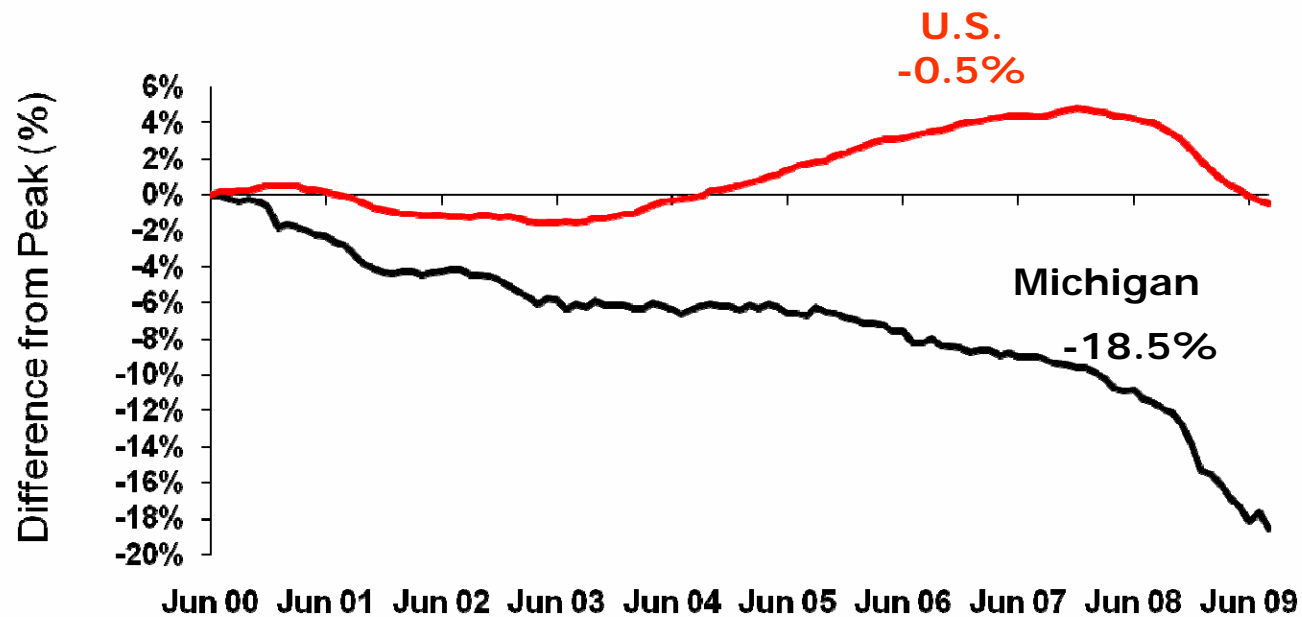


What is Going on in Michigan?

- Michigan economy has shown no improvement since 2001 recession – “single state recession”
- Since employment peak (June 2000), Michigan payroll employment has declined by 812,000 (21%)
 - Concentrated in manufacturing, autos specifically
- 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 Past Expansion

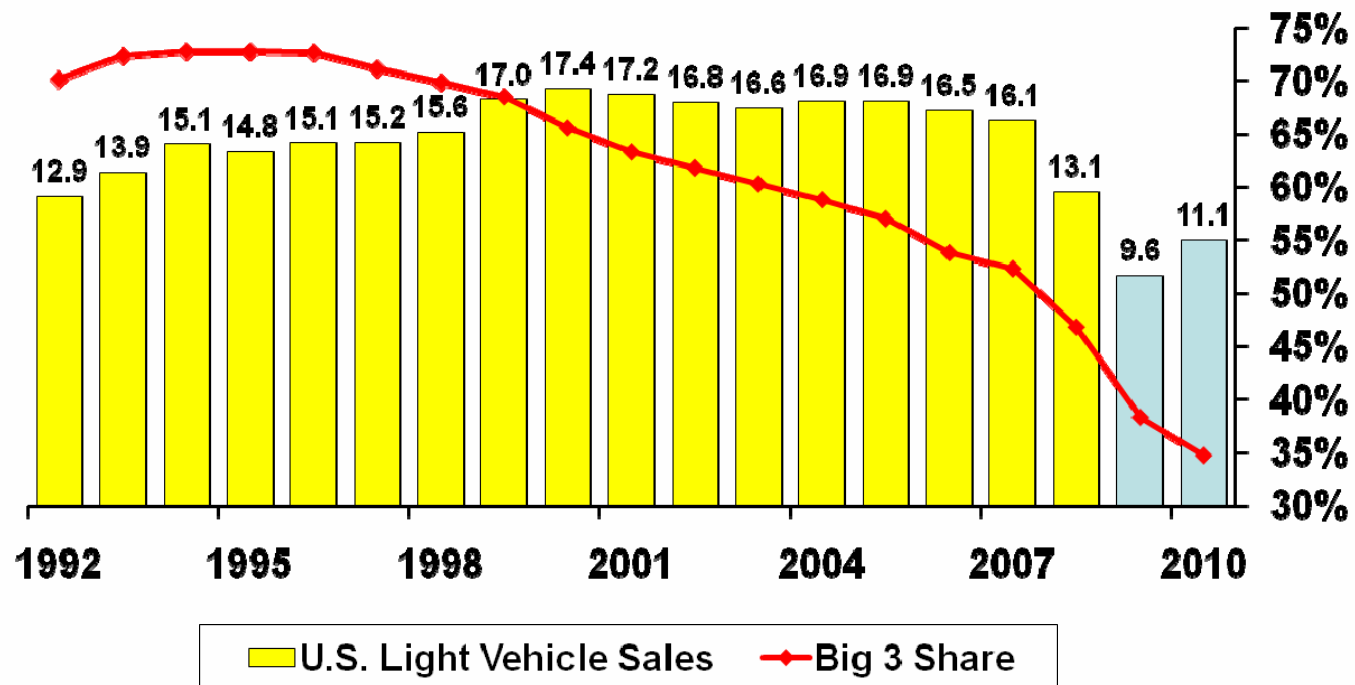


Note: Peak is calculated from Michigan's June 2000 Peak. Data through August 2009.

Source: Bureau of Labor Statistics



Big 3 Losing Market Share

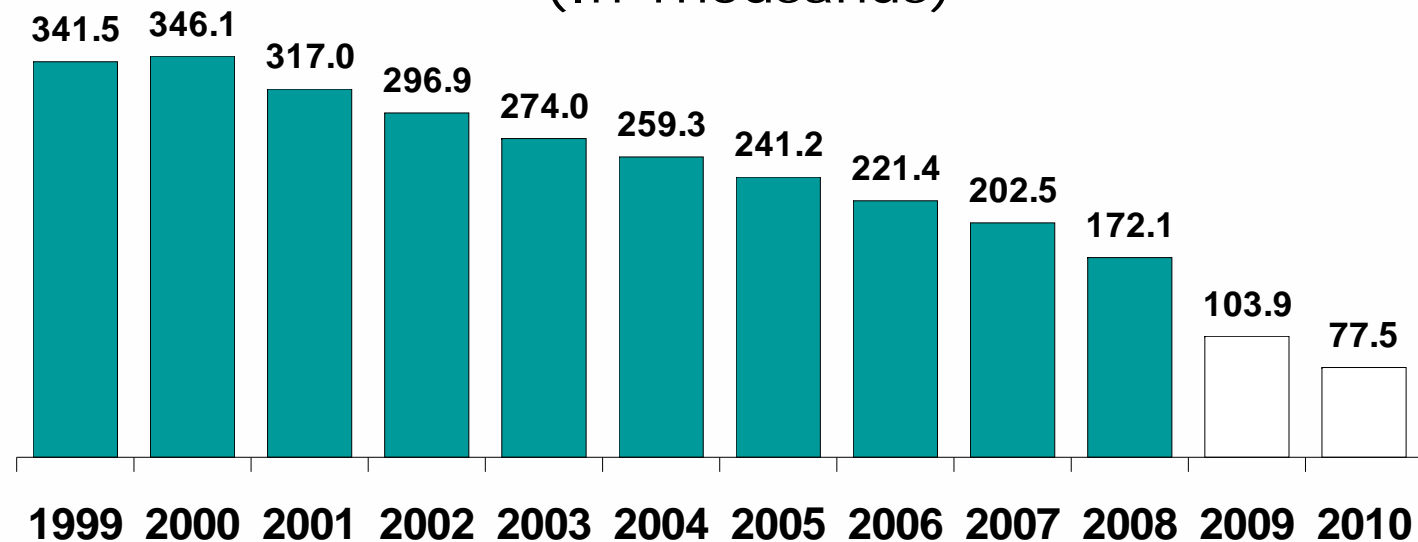


Source: Automotive News, vehicle sales and share; 2009 & 2010 are the May 09 Consensus estimates.



3 in 4 Auto Jobs Lost by 2010

Michigan Transportation Equipment Employment
(In Thousands)

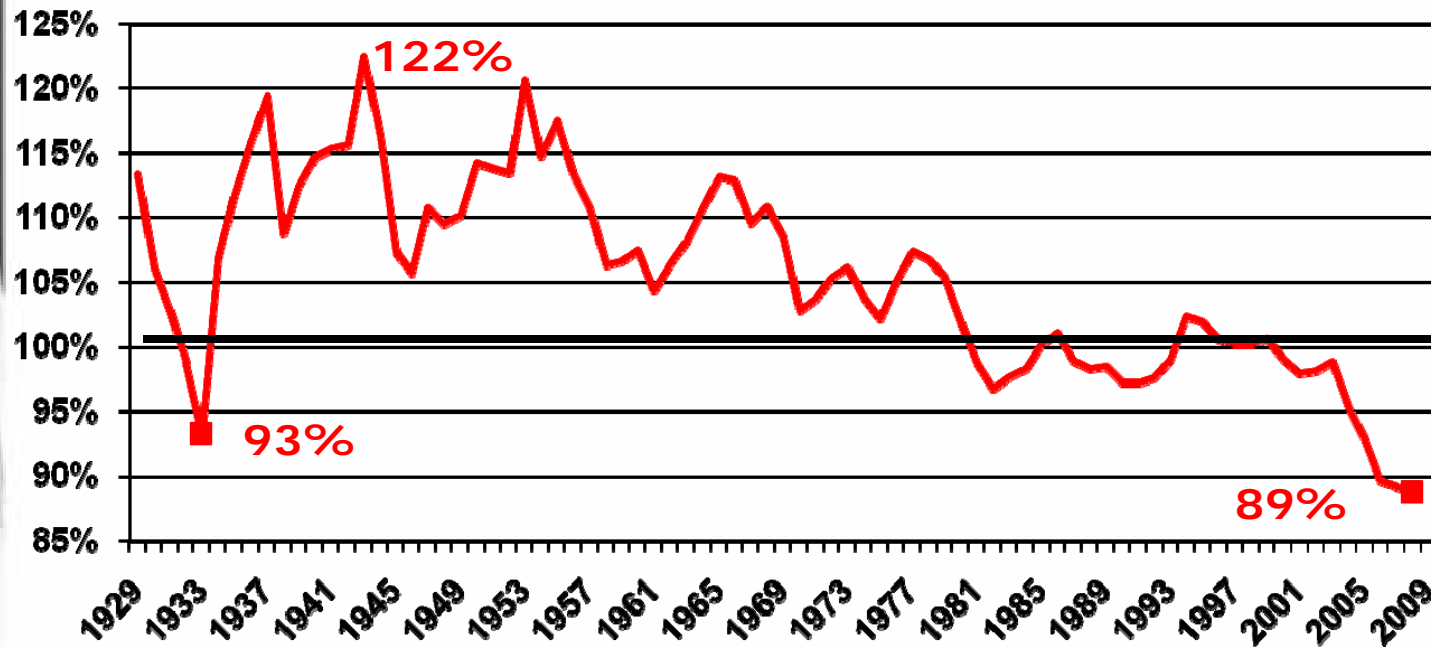


Source: Bureau of Labor Statistics. 2009-2010 estimates are the average of the 3 agency forecasts for the May 2009 Consensus Conference.



Michigan Becoming "Poorer" State

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

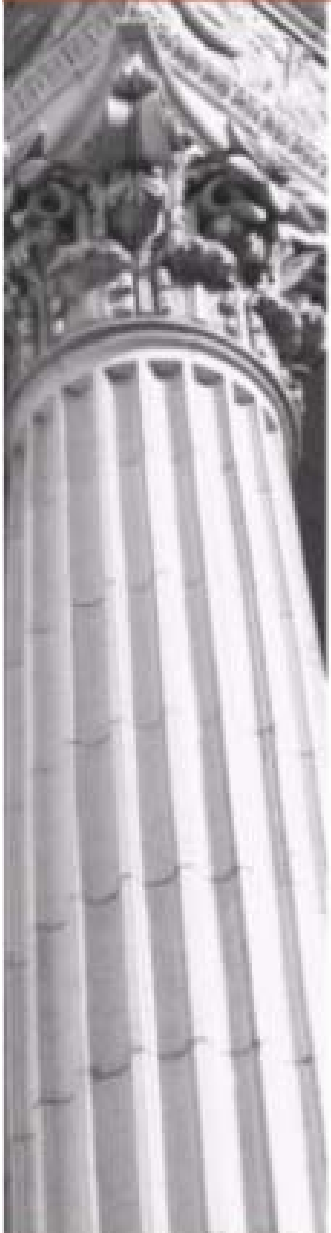


Source: CRC calculations from Bureau of Economic Analysis data. March 24, 2009 personal income release.



The Michigan Budget Story Has Not Changed . .

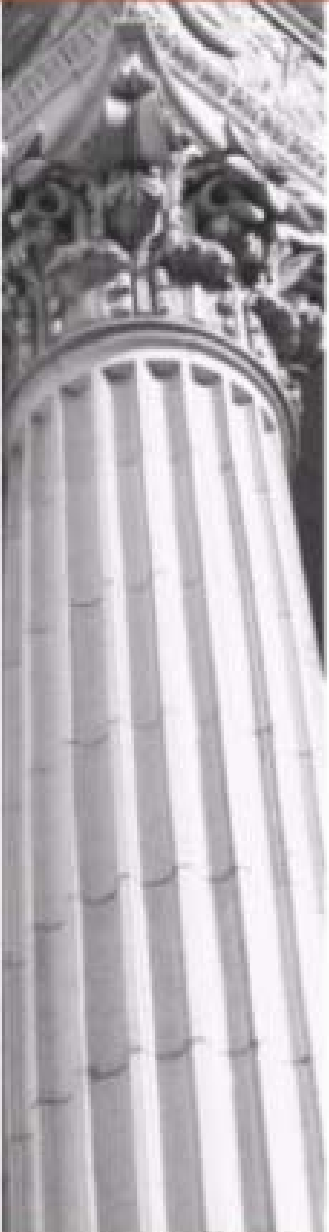
- The State of Michigan continues to face dual structural deficits affecting:
 - Public K-12 education
 - General Fund-financed programs
- Its causes have both spending and revenue components
- We will **not** grow out of it
- Significant spending cuts and/or tax increases will be required





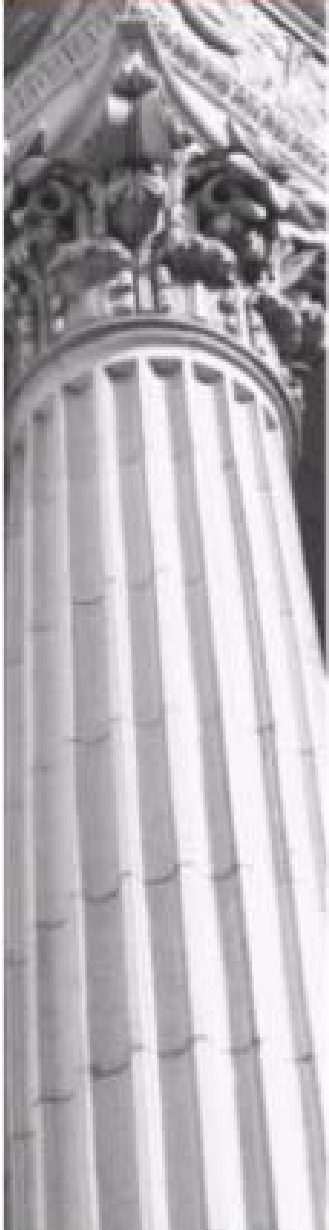
But There is a New Chapter

- National recession – severe
 - Consumption
 - Business spending
 - Homebuilding
- State budget unprepared to deal with current recession
 - Exhausted reserves
 - Tax increases of 2007
- Must correct for two problems simultaneously
 - Structural deficits
 - Cyclical deficits
 - Each problem requires specific set of tools



State Budget Realities

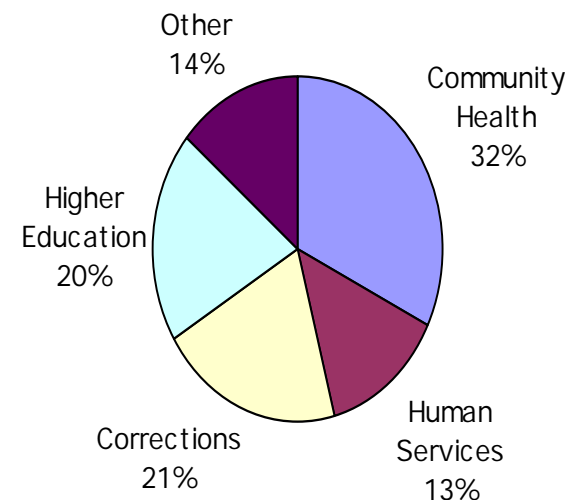
- Budget balance is a constitutional requirement
- Budget totals over \$44 billion, but
 - \$1 of \$4 “no strings”
 - \$3 of \$4 restricted
- Limited options when it comes to balancing the budget
- 80% spent outside of state government
- Only about 11% is spent on state employees
- Corrections is the largest state-run program
- Health care is largest single item – everywhere in the budget



Discretionary Spending

- Annual review and most attention
- \$1 of \$4 spent by state gov't
- 4 areas take up 86% of budget
- Corrections largest state-run program
- School Aid Fund - \$12.6 billion

General Fund Spending-2009



Total: \$9.7 Billion



State Revenues

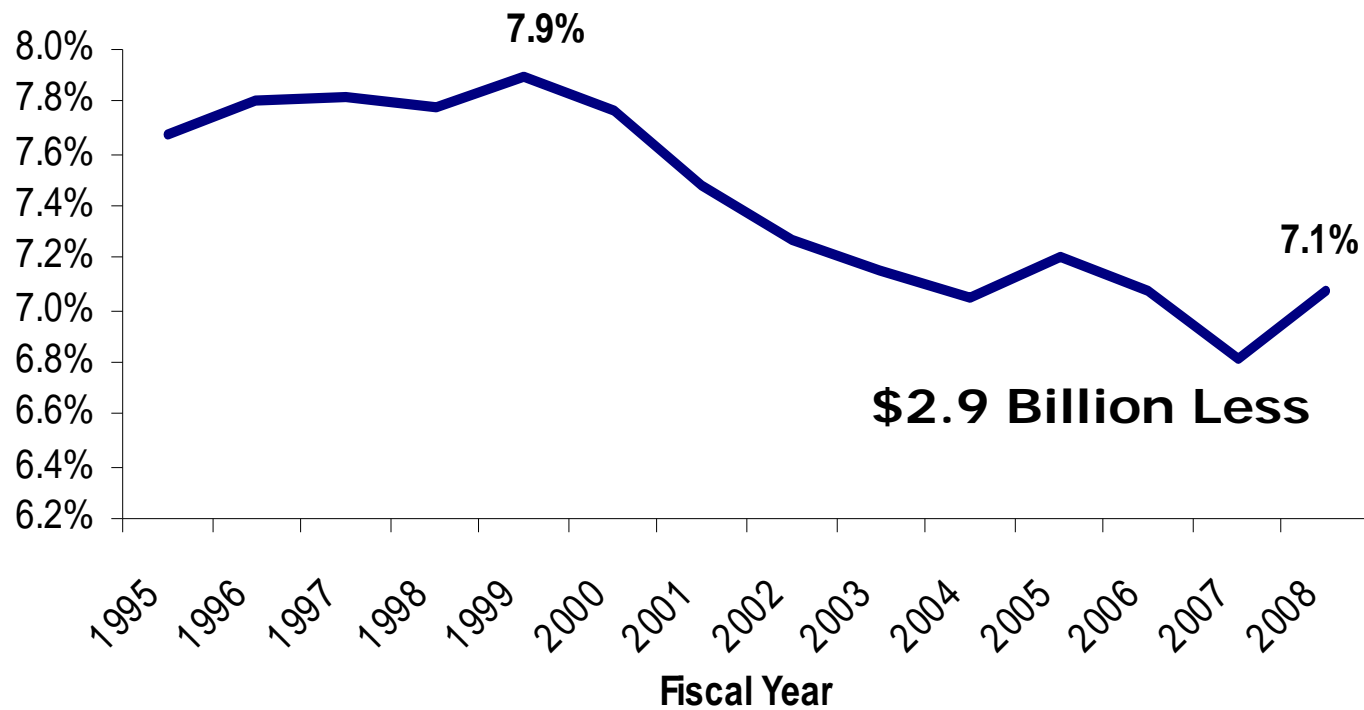
Taxes--59% of Total (\$26 Billion)

- Sales & Use Taxes (31% of Total Taxes)
- Personal Income Tax (28%)
- Michigan Business Tax (10%)
- Transportation (7%)
- Alcohol and Tobacco (5%)
- Property (9%)
- Other Taxes (10%)

60% of Total is Earmarked



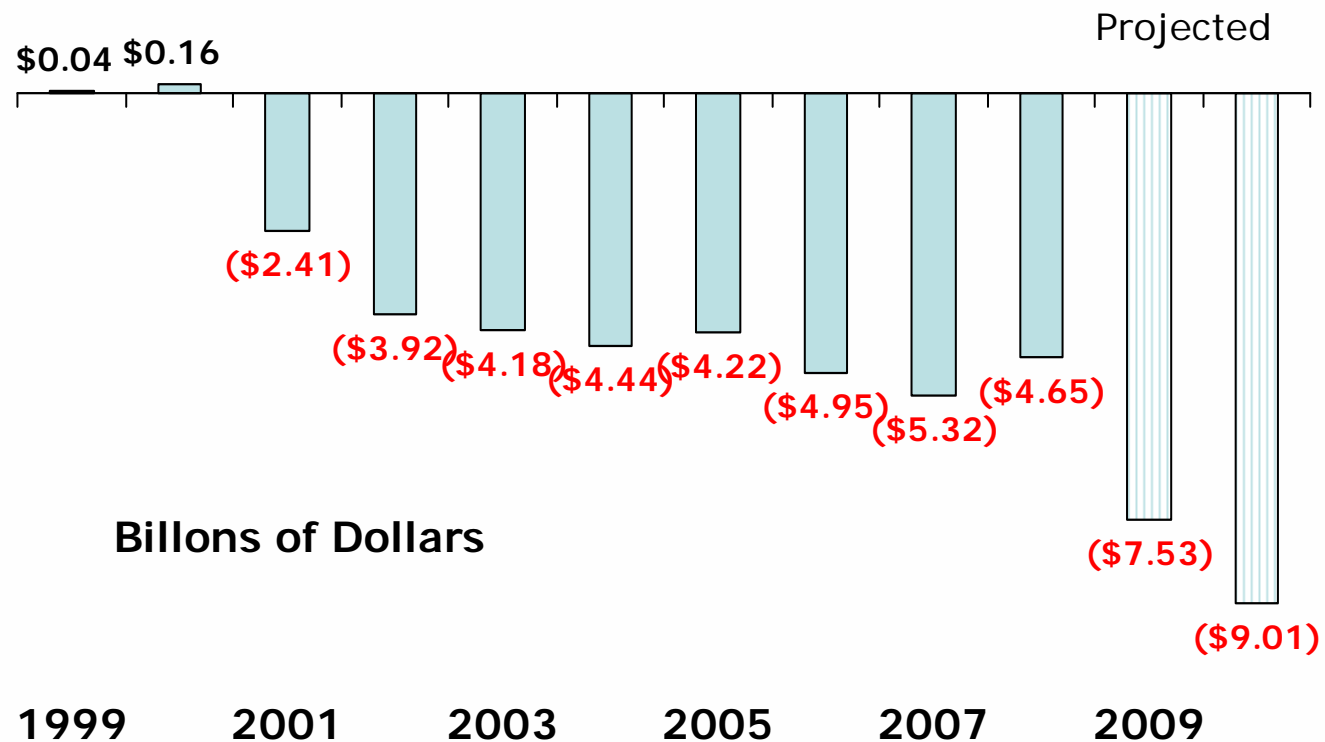
State Taxes as a Percent of Michigan Personal Income



Source: Michigan Comprehensive Annual Financial Report

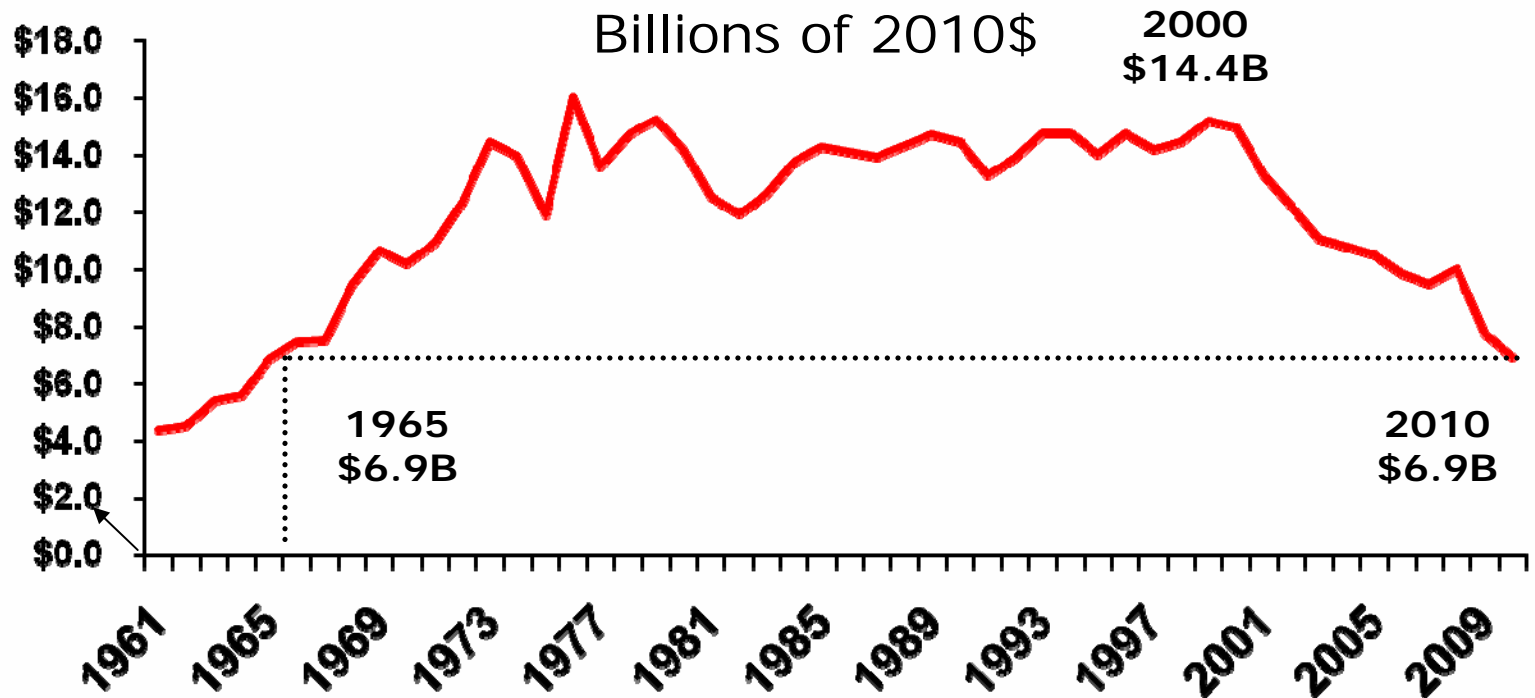


Constitutional Revenue Limit





Inflation Adjusted GF-GP at 1965 Level



Note: GF-GP figures are presented on a Consensus basis and adjusted for inflation to 2010 dollars using the state and local government price deflator. 2009 and 2010 are estimates.



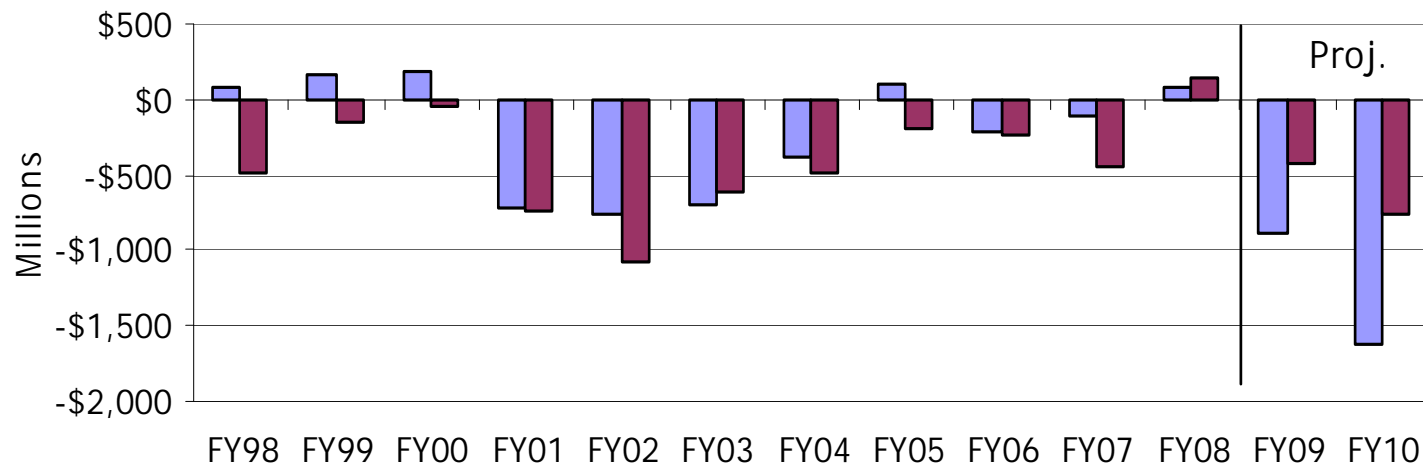
Michigan's Budget Problems FY2001 to FY2008

- 7 years of spending cuts
- Major tax cuts since late 1990s
- FY2008 General Fund revenues lower than in FY1996
- 1.4 % growth in School Aid Fund since 2000
- \$8 billion in one-time resources used including reserves
- Cash position improved with 2007 tax increases, but still very tenuous
- Weakened connection between revenue structure and the economy
- Spending pressures growing faster than revenues – structural ***not*** cyclical



On-Going Deficits

GF/GP and SAF Operating Deficits



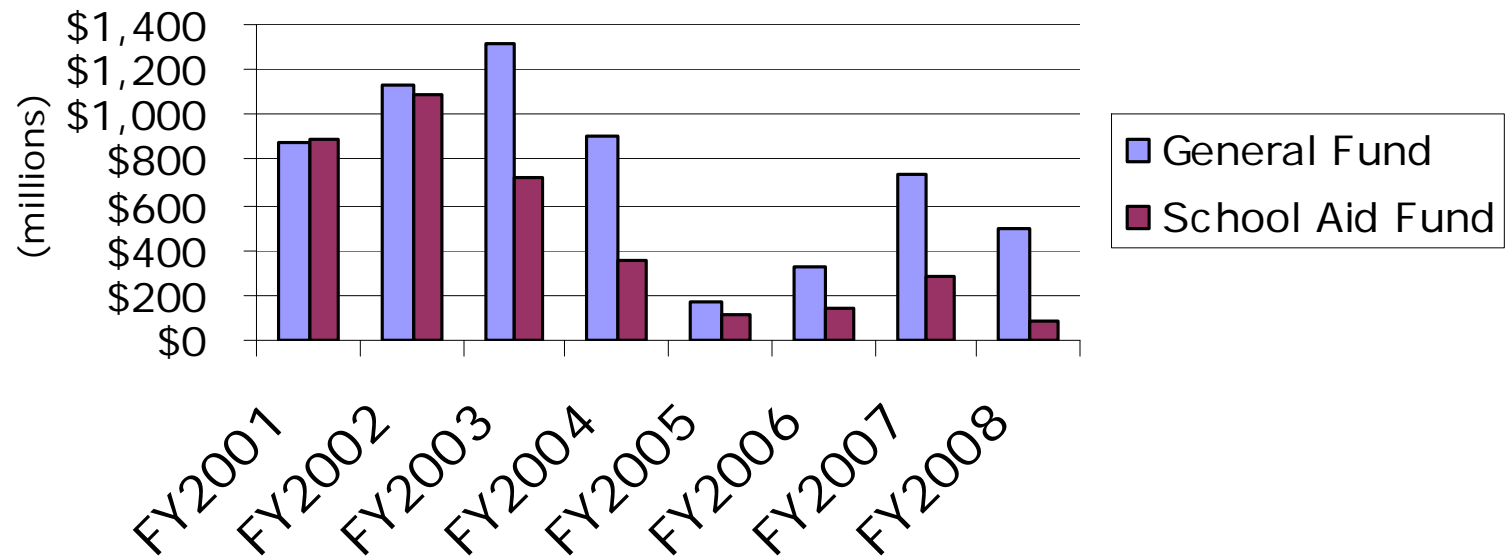
source: Senate Fiscal

■ GF/GP ■ SAF



Spending Supported by One-Timers

Non-Recurring Resources Used to Balance Budgets



Citizens Research Council of Michigan



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%	



General Fund FY09 Solutions

- Budget shortfall ~ \$1.2B
- One-quarter (~\$300 M): spending reductions
 - Employee layoffs and furloughs
 - Medicaid reimbursement rate reduction/eliminate optional services
 - Revenue sharing
 - Some areas protected per ARRA
 - Some address structural problems, others?
- Three-quarters (~\$900 M): federal recovery funding (ARRA)
 - \$300M completely discretionary
 - Remainder from Medicaid match rate increase - states have a significant amount of flexibility



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 (2nd conference report) awaits Gov signature
 - Full-year budget, but
 - No authority to spend any money



Status of GF Budget on 9/30

	<u>FY 2010</u>	<u>FY 2011</u>
Revenue	\$7,700.1	\$8,032.4
Adjusted Exec. Rec.	\$9,522.6	\$10,070.5
Projected Shortfall	(\$1,822.5)	(\$2,038.1)
<u>Target Proposal (9/30)</u>		
Appropriation Reductions	\$842.8	\$842.8
Revenue Changes	\$0.0	\$0.0
ARRA (Fed. Stimulus)	\$973.0	\$209.6
ARRA Carryforward	\$209.4	\$202.7
Projected Ending Balance	\$202.7	(\$783.0)

Source: Senate Fiscal Agency



HB4447 – 2nd Conference Report

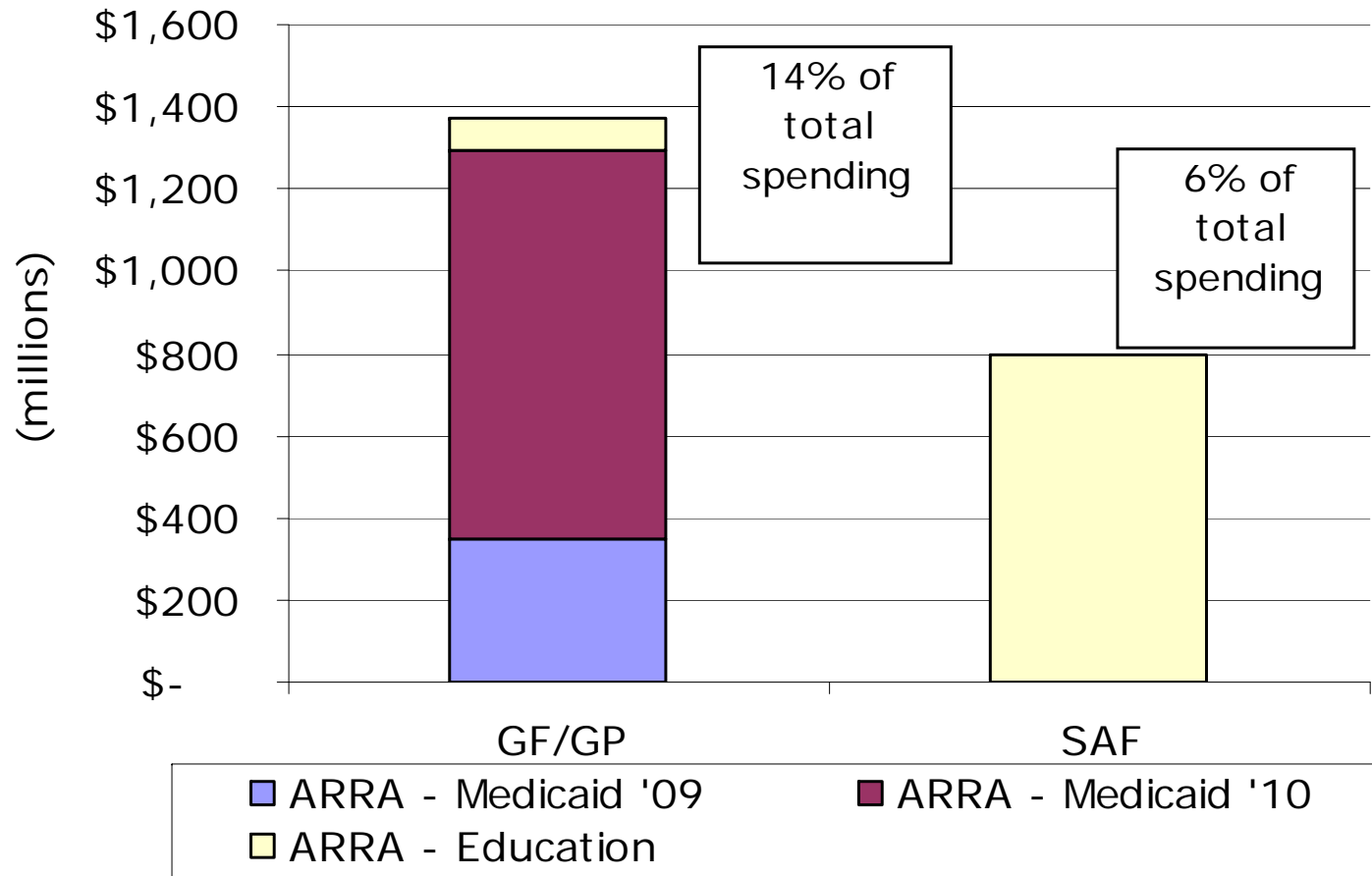
- \$165 per pupil reduction (with some discretion where cut comes from)
 - \$263M in total
 - Amounts to 2.3%
 - Foundation grant held at \$7,316
- ISD operations grant cut
 - \$16M in total
 - Amounts to 20%

Solutions

- Total reductions from FY2009 ~ \$312M
- Federal stimulus ~ \$450M
 - Additional \$250 - \$300 per pupil cut
 - Reserves \$ for FY2011 ~ \$223M (mostly stimulus)
- \$100M in new revenue



FY10 Budget: Non-Recurring Resources Used



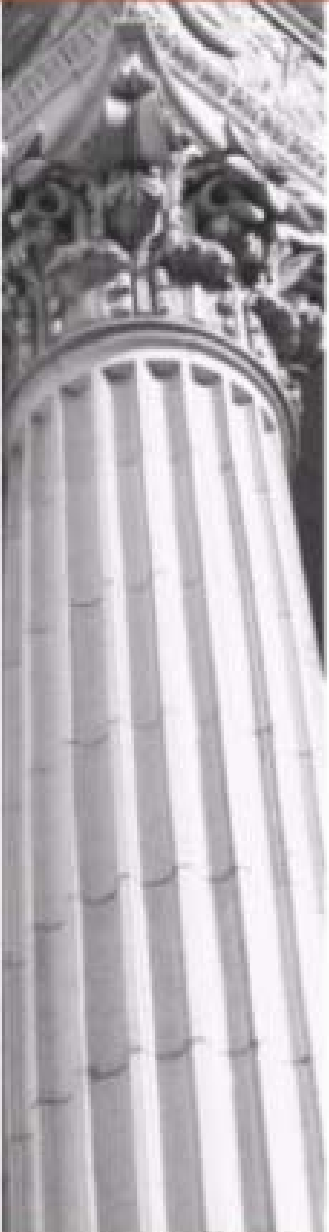


FY11 Budget: Very Early Look

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



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



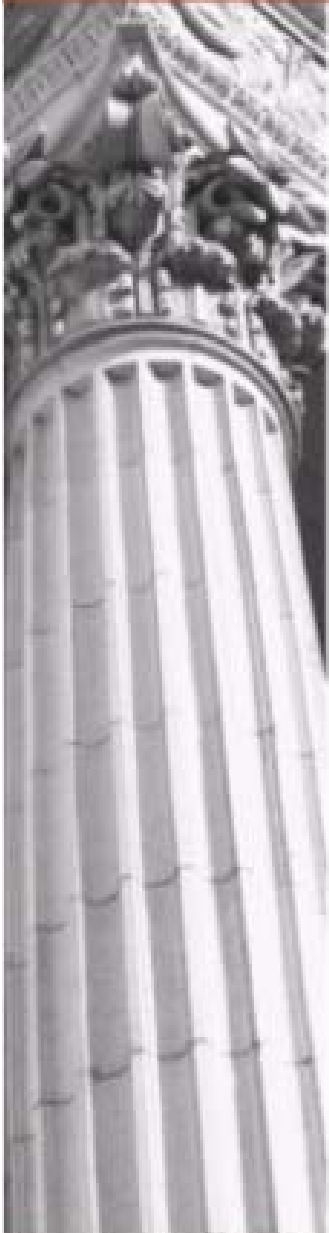
Scope of the Analysis

- 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 prepare economic projections
- Economic projections translated to revenue projections and projections of spending pressures
- Not predictions but projections

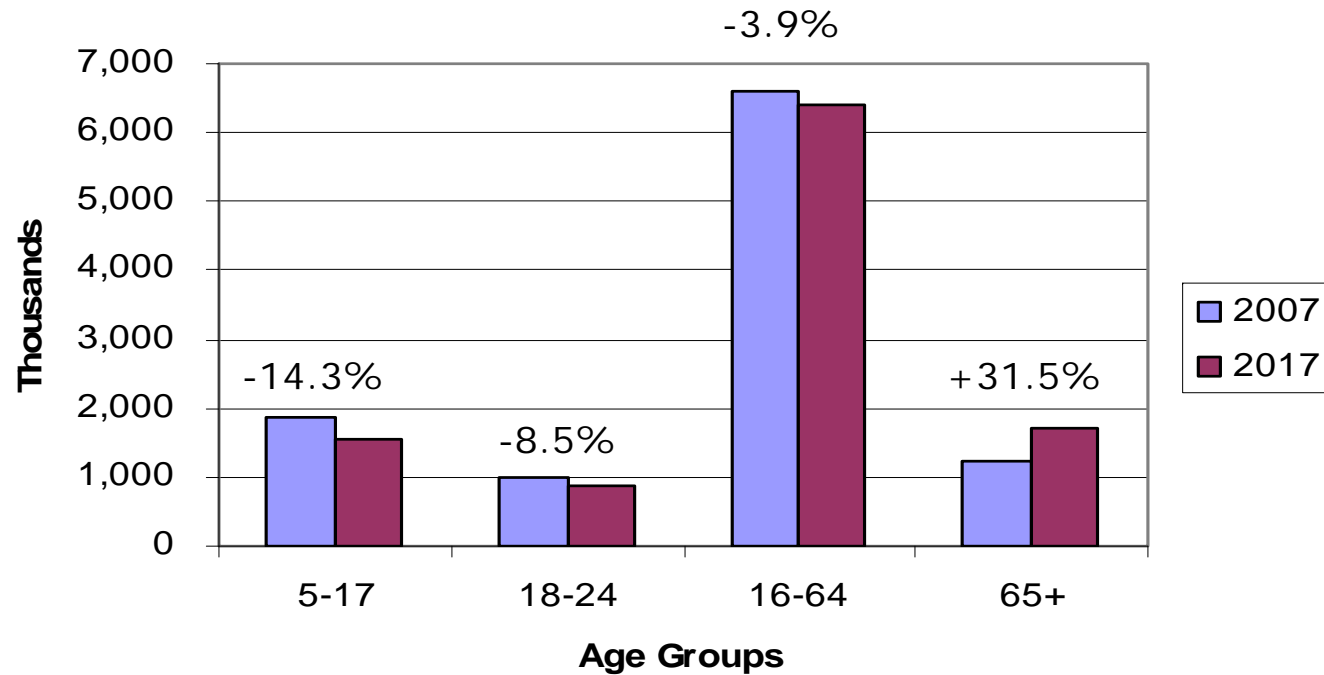


Projections Made Against a Much Different Backdrop

	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%



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
- FY2009 forecasts (Jan. '08) used as the beginning point

Taxes

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



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
- Tax Policy –
 - Earned Income Tax Credit
 - Phase-out of Income Tax increase



Structural Deficit

Spending Pressures Outpace Revenue Growth

- Over 85% of GF/GP budget concentrated in four areas:
 - Community Health (\$3.1B)
 - Corrections (\$2 B)
 - Higher Education (\$2 B)
 - Human Services (\$1.3 B)
- Most significant spending pressures:
 - Health care
 - Corrections – personnel costs
 - Employee compensation – pay and fringes



Health Care Costs

Single largest component in state budget

- Medicaid
- Mental health services
- Health insurance for school and state employees
- Health insurance for school and state retirees
- Health care provided to prisoners



Medicaid

- Medical care for 1 in 7 Michigan citizens
- Future spending growth pressures nearly 8% annually
- Some state revenues dedicated to Medicaid do not grow—Tobacco Settlement revenues, Cigarette Tax
- Others lag behind the overall growth in program
- General Fund requirements grow nearly 11% annually
- General Fund spending pressures outpace revenue growth eight-fold



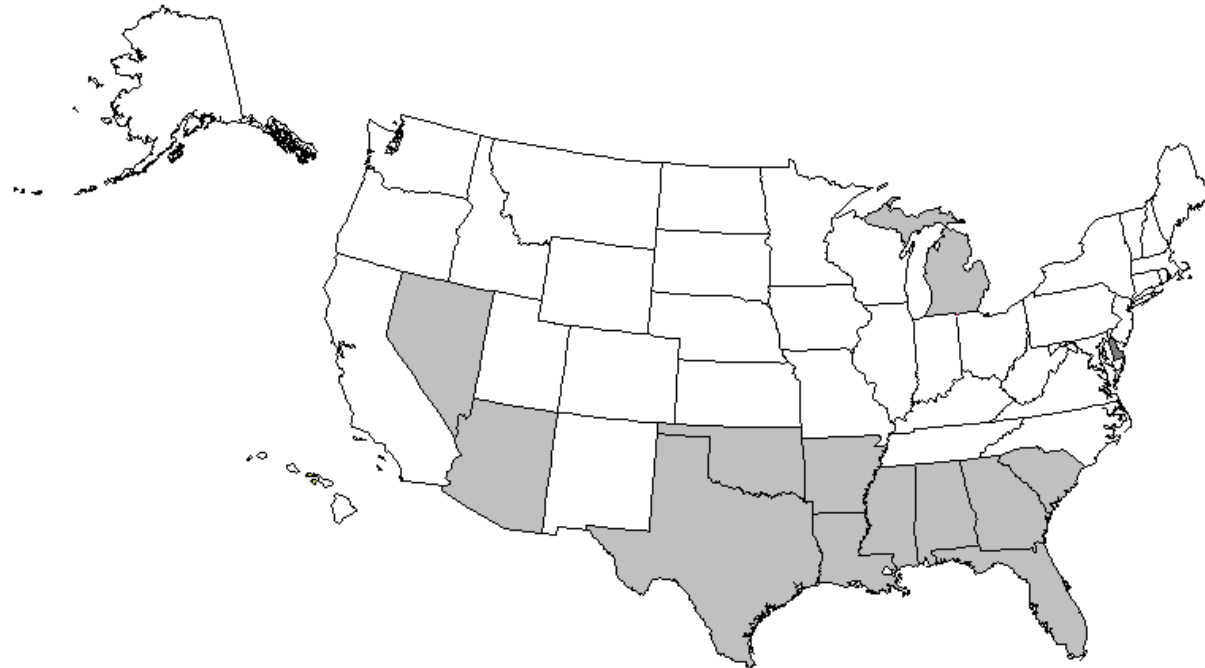
Corrections

- Largest state-operated program
- 30% of state employees
- More than 50,000 prisoners and growth of 1,200 annually
- 45 prisons and camps
- \$30,000 per prisoner cost per year
- Incarceration rate 47% higher than Great Lakes neighbors-the result: \$500 million higher costs
- Spending pressures will increase 7%, five times as fast as GF growth



Michigan's Incarceration Rate

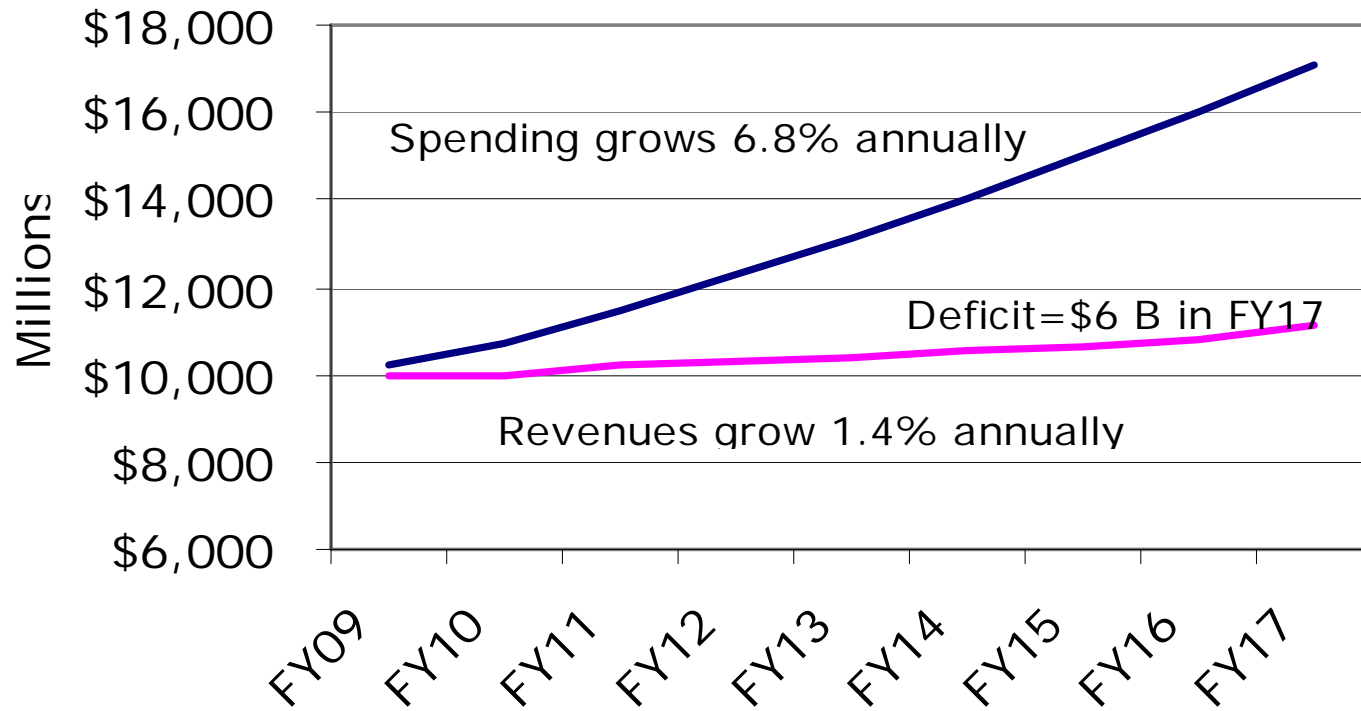
States with at least 500 Prisoners per 100,000 Residents



Source: U.S. Department of Justice, Bureau of Justice Statistics, 2006



General Fund Structural Deficit Projections FY09 to FY17





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
- School districts also pay for health care for retirees
- 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



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%



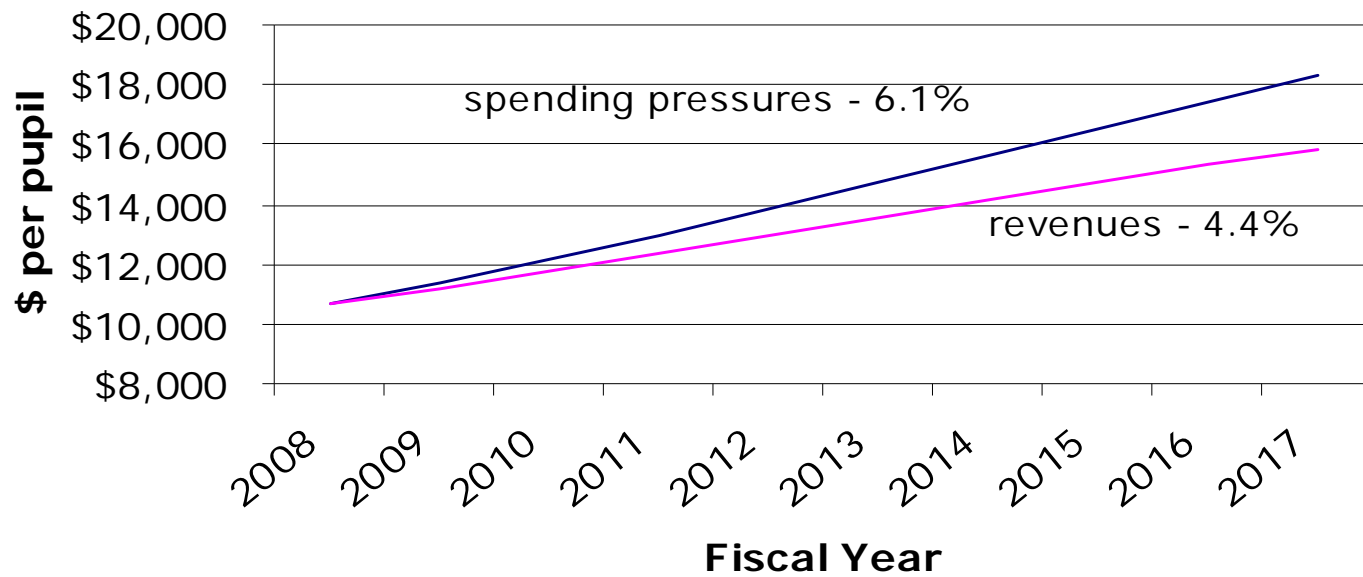
How does this translate at the classroom level?

- 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



Per Pupil 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 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

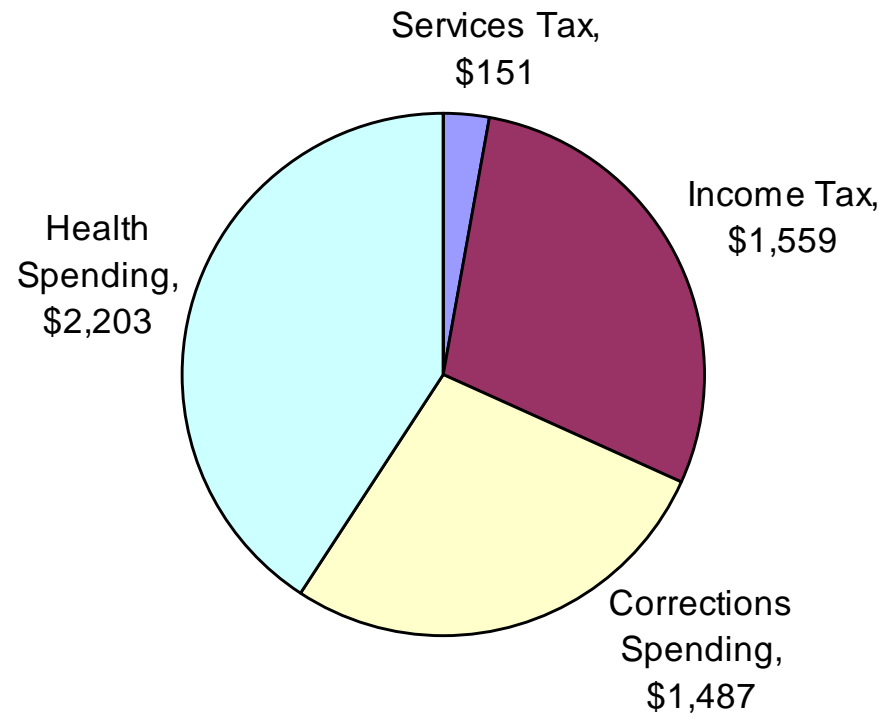


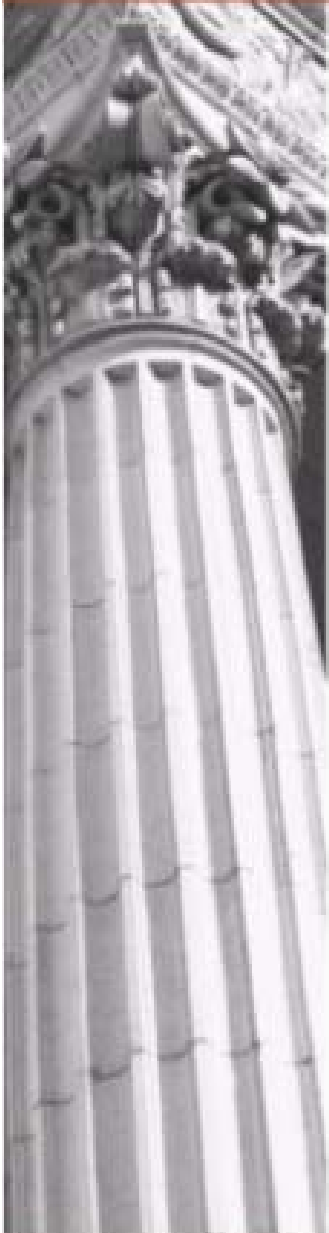
Spending Scenario

- Corrections
 - Reducing prison incarceration rate to the average of our neighbors (1,200/yr)
 - Ten-year phase-in
 - Eliminates growth pressure in Corrections (from plus 7% to negative 1%)
 - Reduces overall General Fund spending pressure growth by 1.1%
- Health care
 - 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%

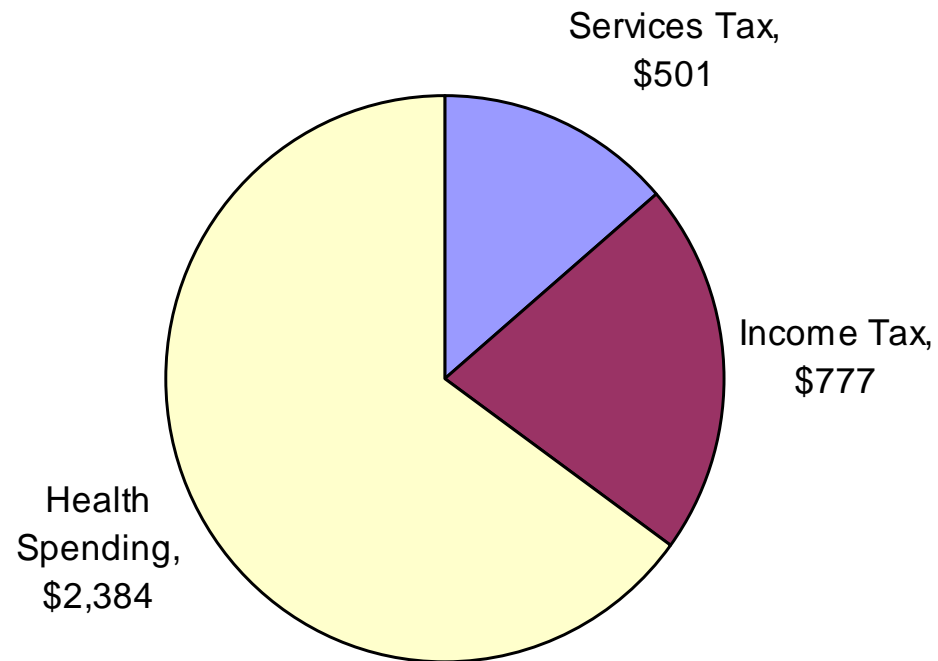


Effects of Alternative Policies to Close \$5.4 Billion of \$6 Billion General Fund FY17 Deficit (\$ in Millions)





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





Questions?

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