



STATE BUDGET NOTES



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THE FY2011 SCHOOL AID FUND BUDGET: A DAY LATE AND A FEW HUNDRED MILLION DOLLARS SHORT

In Brief

Before embarking on its traditional 4th of July two-week recess, the Michigan Legislature passed the Fiscal Year 2011 (FY2011) budget for the School Aid Fund (SAF), which provides operating funding for Michigan's local and intermediate school districts. July action on the SAF budget this year breaks with recent history, during which the state budget (SAF and General Fund) has not been enacted until late September or even after October 1, the start of the new state fiscal year. The legislature's "early" adoption of the budget provides schools with a greater degree of certainty as they begin their fiscal years on July 1. Observers should be cautious about placing too much importance on the recent legislative action, however, as a number of major budgetary issues, both for this year and next, remain to be resolved.

Given the fiscal struggles of FY2009 and FY2010, coupled with the loss of \$1.3 billion in temporary federal stimulus funding from the budget, crafting a balanced budget that did not further reduce per-pupil spending is a significant accomplishment. However, the adoption of this "early" budget was aided greatly by the significant positive change in the official SAF revenue estimates and the fact that major General Fund budget shortfalls were not addressed at the same time.

The Michigan Legislature should be lauded for its work to complete next year's School Aid Fund (SAF) budget more than three months earlier than it did last year. In 2009, the FY2010 SAF budget was passed by the Legislature on October 13 and signed by the Governor, with vetoes, on October 20, 2009 – the day that the first state aid payment of the new fiscal year was scheduled to be released to K-12 and intermediate school districts and well after the beginning of the state's fiscal year on October 1. Late SAF budget passage over the last few fiscal years has posed significant problems to public schools because their fiscal years begin on July 1 and state dollars provide over two-thirds of their school operating budgets.¹

While final passage of the FY2011 SAF budget *on* July 1 provides some direction to local school administrators and elected officials at the start of their fiscal year, it was, literally, a day late and, figuratively, a few hundred million dollars short. Local school budgets were enacted before July 1st and took effect *on* this date. Although the FY2011 budget restores some funding, it is "short" in that it retains a sizeable per-pupil reduction, originally enacted as part of the FY2010 budget. Furthermore, the budget deal is "short" in that the legislature left unresolved major decisions concerning projected General Fund budget shortfalls for the current and next years, which may or may not affect the School Aid Fund. While the Michigan Legislature completed its work *on* July 1st, the budget does not become law until signed by the governor, which did not occur on that date.

¹ See CRC's August 2009 Memorandum (No. 1092), "Late Budgets in Michigan: Causes, Effects, and Implications".



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CRC'S STATE BUDGET NOTES

The “Hows” and “Whys” of a Budget Deal

Leading up to the passage of the SAF budget, few capitol observers were willing to wager that the legislature would complete its work by July 1. Given recent precedent, final legislative agreement comes as somewhat of a surprise. “Early” passage of the School Aid Fund budget can be explained by the factors (i.e., “hows” and “whys”) contributing to the recent legislative action. Asking the interrelated questions “How was a deal struck early?” and “Why was a deal struck early?” elicits two very different, and unrelated, responses.

Addressing the first question requires one to look no further than the dramatic change in the projected fiscal picture facing the School Aid Fund for both the current year and next year. At the January 2010 consensus revenue conference, updated SAF revenue estimates for FY2010 and initial estimates for FY2011 were adopted. At that time, the economic forecast for the state was lowered in response to lingering effects of the Great Recession and the estimate for FY2010 SAF tax receipts was reduced by \$280 million from the FY2010 SAF budget. The conference’s initial FY2011 SAF revenue estimate

was \$10,481 million, which resulted in an estimated \$400 million, or \$250 per pupil, shortfall in the SAF budget compared to FY2010 expenditure levels, once the expected decline in federal stimulus funds was included.

Between the January and May revenue estimating conferences, current-year SAF revenues performed much stronger than previously expected. Revenue estimates were revised substantially in May over the January figures for both FY2010 (\$292 million increase) and FY2011 (\$352 million increase). Following the May conference, the improved rev-

Table 1
Projected School Aid Fund Balance Sheet as of May 2010 Revenue Estimating Conference
(in millions)

	<u>FY2010</u>	<u>FY2011</u>
Beg. Balance	\$238	\$397
Consensus Revenue Estimates	\$10,750	\$10,833
General Fund Grant	\$30	\$30
Federal ARRA Resources	\$450	\$184
On-Going Federal Aid and Other	\$1,632	\$1,690
Total Revenue	\$13,100	\$13,109
Baseline Appropriations	\$12,824	\$12,703
Adjustments	(121)	0
Total Expenditures	\$12,703	\$12,703
Projected Year-End Balance	\$397	\$402

Source: Senate and House Fiscal Agencies, various; CRC calculations.

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enue picture, along with some adjustments in spending requirements, produced significant estimated year-end balances in the SAF for both fiscal years (See **Table 1**).

The improved May 2010 state revenue estimate eliminated the need to develop a FY2011 budget that would require additional per-pupil expenditure cuts or tax increases to achieve budget balance. In the end, the improvement allowed for a very small (\$11) per-pupil increase for both FY2010 and FY2011. Ultimately, it was the financial picture that provided the impetus for the Michigan Legislature to enact the SAF budget in July. Also of note on the fiscal front, the recently-enacted early retirement/pension reform legislation, which is projected to reduce current and future school spending pressures, improved the financial picture facing schools in FY2011 and contributed to early budget adoption.

As to the question "Why was a deal struck?" a number of factors merit attention. First, the SAF budget was separated, at least temporarily, from legislative discussions regarding the General Fund budget. In contrast to the SAF budget, the General Fund budget is currently projected to be in deficit by \$220 million in FY2010 and by in excess of \$500 million in FY2011. Traditionally, the two budgets have been dealt with jointly and the entirety of the state budget considered when solutions have been crafted to address a shortfall in one or both budgets. For the time being, it does not appear that the SAF surplus will

be used to help balance the FY2010 General Fund budget, but it is possible that SAF funds may ultimately be used to help balance the General Fund. It is highly likely that if the SAF and General Fund budgets were dealt with at the same time and a plan to use SAF revenues to address the General Fund problem had been proposed, passage of the SAF budget would have been delayed beyond July 1 because of the political resistance that would have accompanied such a plan.

Public perception also contributed to the earlier adoption of the SAF budget. Last year's budget was not enacted until three weeks after the start of the state fiscal year, which generated considerable public attention as it extended legislative action further into the new fiscal year than was the case in previous years. School districts were nearly four months into their fiscal year by the time the Governor signed the education budget. Negative public attention and displeasure with past delays prompted earlier legislative action this year. Some in the legislative ranks called for a July 1st budget deadline and supported a constitutional amendment that would mandate such a deadline or face financial penalties. This sentiment was echoed by the Governor in her January State of the State address when she asked for the budget (both General and School Aid Funds) to be returned to her by July 1. Finally, electoral politics and the upcoming August primary likely served as a motivating factor for earlier legislative action on the budget this year, especially for

those members seeking re-election or aspiring to serve in another state office.

Practical Effects of the "Early" SAF Budget

In theory, adoption of the SAF budget on July 1 should be welcomed news for local schools, especially in light of the fact that two-thirds of school budgets are supported by state aid. Early legislative adoption of the budget is an improvement over the last four years. Any entity that has a budget that takes effect on July 1 is severely disadvantaged when a significant portion of its revenue base is unknown until October 1. However, the benefit of earlier adoption is reduced by the fact that most locally-elected school boards approved their budgets well before July 1st.

Local school boards are required by The Uniform Budgeting and Accounting Act (Public Act 2 of 1968) to hold a public hearing and approve a budget prior to the commencement of their fiscal year on July 1. Most of the budget preparation work for the upcoming year is done in May, prior to board approval in June, and well before passage of the state SAF budget on July 1. Even in a year where the state revenue picture does not change dramatically from January to May, the July 1 deadline is still tight from a practical and legal standpoint.

This year, the July 1 completion date was rendered even less helpful from a practical perspective because of the significant changes in the state revenue estimates

from January to May. During their budget deliberations in May and June, school district officials did not have an accurate basis for projecting the level of state aid. State-aid budget estimates varied considerably, from a \$250 per pupil state aid cut to flat funding.

Consider, for example, the differing SAF budget proposals adopted by the two legislative chambers during the period that districts were working on their local budgets for the coming year. The Michigan Senate, which initiated debate on the FY2011 SAF

budget using the January revenue estimates, included a \$118 per-pupil reduction (on top of the \$165 per-pupil cut of FY2010) when it passed its version of the budget in late March. In contrast, the House of Representatives, working with the higher May revenue estimate, adopted a FY2011 spending plan in late May that reduced the existing \$165 per-pupil cut to a \$110 per-pupil cut for FY2011. The spread between the two chambers' proposals was \$183 per student (\$287 million in total). For a school district of average size (3,000 students),

this amounted to \$550,000. Under both proposals, the respective per-pupil reductions were to be partially, if not entirely, offset by the early retirement/pension reform legislation being considered at the same time that would result in reduced spending obligations at the local district level.

An on-going factor (e.g., enrollment), which varies from district to district, further complicated the estimates of state-aid levels that locals had to contend with while putting together their budgets for FY2011.

Conclusion

The Michigan Legislature made major progress by adopting an annual SAF budget three months earlier than it did last year. Given the FY2009 and FY2010 state revenue declines associated with the Great Recession and the loss of \$1.3 billion in temporary federal stimulus funding from the budget, crafting a balanced budget that did not further reduce per-pupil spending is a significant accomplishment. However, the adoption of this "early" budget was greatly aided by the significant positive change in the official SAF revenue estimates.

"Early" budget adoption was also facilitated by the fact that discussions surrounding the General Fund budget shortfall were extricated from discussions about school funding, at least for now.

The pressure to resolve some, or all, of the General Fund budget problems in FY2010 or FY2011 with SAF resources may grow stronger as the October 1 beginning of the state's fiscal year nears and if previous budgetary assumptions are not sustainable. At the present time, the federal government does not appear willing to authorize an extension of certain enhanced federal Medicaid funding, which will exacerbate the General Fund problem in FY2011. Under the recently-passed budget, current projections have the SAF enjoying a year-end balance of \$372 million in FY2010 and \$236 million in FY2011. Interestingly, these amounts would permit full restoration of the FY2010 per-pupil cut in FY2011; however, the exhaustion of this fund balance along

with the end of the temporary federal stimulus funding would result in tremendous fiscal pressures in FY2012 to maintain previous year spending levels. At this point in time, the Michigan Legislature has decided against spending the estimated fund balance and to reserve these funds for FY2012, although the possibility of using them to address the General Fund shortfalls still exists.

Also, the practical effects of the "early" adoption were limited, because local districts completed work on their budgets well in advance of the July 1 date. However, the enactment of the budget does aid local school districts by providing them with some certainty as they start their new fiscal year.