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

Presented to
Marygrove College
Social Justice Program

Craig Thiel, Director of State Affairs
October 16, 2009
Citizens Research Council

- Founded in 1916
- 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
- www.crcmich.org
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

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

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

$2.9 Billion Less
Constitutional Revenue Limit

Billions of Dollars

<table>
<thead>
<tr>
<th>Year</th>
<th>1999</th>
<th>2001</th>
<th>2003</th>
<th>2005</th>
<th>2007</th>
<th>2009</th>
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<tbody>
<tr>
<td>Limit</td>
<td>$0.04</td>
<td>$0.16</td>
<td>($2.41)</td>
<td>($3.92)</td>
<td>($4.18)</td>
<td>($4.44)</td>
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<tr>
<td>Projected</td>
<td></td>
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<td>($4.22)</td>
<td>($4.95)</td>
<td>($4.65)</td>
<td>($7.53)</td>
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</tbody>
</table>
Inflation Adjusted GF-GP at 1965 Level

Billions of 2010$

1965 $6.9B

2000 $14.4B

2010 $6.9B

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

source: Senate Fiscal
Spending Supported by One-Timers

Non-Recurring Resources Used to Balance Budgets

Citizens Research Council of Michigan
May Revenue Revisions

<table>
<thead>
<tr>
<th></th>
<th>FY 2009</th>
<th>FY 2010</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Jan Cons.</td>
<td>May Cons.</td>
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<tr>
<td>GF-GP</td>
<td>$8,306.1</td>
<td>$7,435.3</td>
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<tr>
<td>SAF</td>
<td>$11,368.7</td>
<td>$10,943.7</td>
</tr>
<tr>
<td>Total</td>
<td>$19,674.8</td>
<td>$18,379.0</td>
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Growth

<table>
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<tr>
<th></th>
<th>FY 2009</th>
<th>FY 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GF-GP</td>
<td>-11.3%</td>
<td>-4.5%</td>
</tr>
<tr>
<td>SAF</td>
<td>-1.3%</td>
<td>-0.6%</td>
</tr>
<tr>
<td>Total</td>
<td>-5.7%</td>
<td>-2.3%</td>
</tr>
</tbody>
</table>
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

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

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

<table>
<thead>
<tr>
<th>GF/GP</th>
<th>SAF</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ARRA - Medicaid '09</strong></td>
<td><strong>ARRA - Medicaid '10</strong></td>
</tr>
<tr>
<td><strong>ARRA - Education</strong></td>
<td></td>
</tr>
</tbody>
</table>

- **14% of total spending**
- **6% of total spending**
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

<table>
<thead>
<tr>
<th>Economic Projections</th>
<th>Annual Rates</th>
<th>Economic Projections</th>
<th>Annual Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employment</td>
<td>-6.5%</td>
<td>-0.1%</td>
<td></td>
</tr>
<tr>
<td>Personal Income</td>
<td>-3.5%</td>
<td>4.2%</td>
<td></td>
</tr>
<tr>
<td>Salaries and Wages</td>
<td>-5.1%</td>
<td>3.8%</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>State Tax Revenue Projections</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income</td>
<td>-13%</td>
<td>3.25% (1.4% n)</td>
<td></td>
</tr>
<tr>
<td>Business</td>
<td>-3%</td>
<td>3%</td>
<td></td>
</tr>
<tr>
<td>Sales and Use</td>
<td>-5%</td>
<td>3%</td>
<td></td>
</tr>
<tr>
<td>Tobacco</td>
<td>-5%</td>
<td>-2.5%</td>
<td></td>
</tr>
<tr>
<td>State Education</td>
<td>-5.5%</td>
<td>4.25%</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue By Fund</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>General</td>
<td>-13%</td>
<td>1.4%</td>
<td></td>
</tr>
<tr>
<td>School Aid</td>
<td>-4.25%</td>
<td>3.0%</td>
<td></td>
</tr>
</tbody>
</table>
Major Changes in State’s Demographic Composition Ahead

-14.3%  -8.5%  -3.9%  +31.5%
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

- Spending grows 6.8% annually
- Deficit=$6 B in FY17
- Revenues grow 1.4% annually
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

<table>
<thead>
<tr>
<th>Year</th>
<th>Projected</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>1,615,577</td>
<td>(37,831)</td>
</tr>
<tr>
<td>2010</td>
<td>1,580,654</td>
<td>(34,922)</td>
</tr>
<tr>
<td>2011</td>
<td>1,550,007</td>
<td>(30,647)</td>
</tr>
<tr>
<td>2012</td>
<td>1,522,848</td>
<td>(27,160)</td>
</tr>
<tr>
<td>2013</td>
<td>1,499,128</td>
<td>(23,720)</td>
</tr>
<tr>
<td>2014</td>
<td>1,481,494</td>
<td>(17,634)</td>
</tr>
<tr>
<td>2015</td>
<td>1,468,480</td>
<td>(13,013)</td>
</tr>
<tr>
<td>2016</td>
<td>1,458,292</td>
<td>(10,188)</td>
</tr>
<tr>
<td>2017</td>
<td>1,451,616</td>
<td>(6,676)</td>
</tr>
</tbody>
</table>

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

- spending pressures - 6.1%
- revenues - 4.4%

Fiscal Year

$ per pupil
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)

- Services Tax, $151
- Income Tax, $1,559
- Health Spending, $2,203
- Corrections Spending, $1,487
Effects of Alternative Policies to Close $3.7 Billion of $4.0 Billion School Aid FY17 Deficit
($ in Millions)

- Services Tax, $501
- Income Tax, $777
- Health Spending, $2,384
Questions?

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