CITIZENS RESEARCH COUNCIL OF MICHIGAN

Michigan's Path to a Prosperous Future: Public Sector Challenges and Opportunities

Altarum and the Citizens Research Council of Michigan joined forces to develop "Michigan's Path to a Prosperous Future: Challenges and Opportunities," **a five-part series of papers that presents a realistic, data-informed vision of Michigan's future based on current trends and trajectories across multiple dimensions — population and demographics, economy, workforce, talent, health, infrastructure, environment, climate, and state and local government.**

This brief provides a top-level summary of major areas of focus in the fifth and final paper: Public Sector Challenges and Opportunities. The full paper is available at https://crcmich.org/publications/prosperous-future.

A Thriving Future Needs a Healthy and Functioning Public Sector

The series of papers examines where Michigan is now, including its strengths, weaknesses and major challenges. The series found that Michigan is suffering from stagnant population growth, brain drain, a shrinking workforce, a population in declining health, and poorly maintained infrastructure, and ranks in the bottom third of states on a number of key indicators.

Not all of these ills fall on state and local governments to solve. Many of these problems worsened between 2000-2010, when economic hardships and scarce public resources constrained government funding, regulation, and investments to make the Mitten State a destination for people and businesses.

A healthy, functioning government sector is the common thread to addressing many of these challenges by structuring its revenue and spending to invest in Michigan's people, drive the economy and create places where people want to live.

Recession of Yesteryear Still Impacts Michigan Today

The State of Michigan relies on two major funds to support much of its state-financed public programs: the School Aid Fund (SAF) supports public K-12 education and preschool programs, as well as a portion of the operating cost of public post-secondary institutions; and the discretionary General Fund/General Purpose (GF/GP) budget supports much of the remaining state budget.

Between Fiscal Year (FY)2000 and FY2010, GF/GP revenue declined by $3 billion, a 27 percent reduction. This substantial decline forced difficult decisions within the state budget. Large budget reductions were implemented across all of state government and the state workforce declined by 23 percent between FY2001 and FY2011. Few areas of the budget were spared, resulting in the sufficiency and quality of many state services declining.

While GF/GP revenue has since grown, it has not yet recovered on an inflation-adjusted basis to FY2000 levels. Further, additional income tax reductions implemented in March 2023 — including changes restoring more favorable treatment of retirement income and an expanded Earned Income Tax Credit — will eat into what had been a COVID-related boost to GF/GP revenue. Under current projections, FY2025 inflation-adjusted GF/GP revenue will be 25 percent below the FY2000 level.

Implications of Being a Low Tax State

The Tax Foundation ranked Michigan's state and local tax burden in 2022 as 46th among all states with a state-local effective tax rate of 8.6 percent, lower than all but two of our neighboring states and significantly below the 11.2 percent national average.

Being a low-tax state can be a benefit, but only if the state is also attracting residents and providing desired services at the state and local government level. Low taxes have reduced funding for key services, while the menu of public services offered has increased over the last three decades. Local governments, which are often only funded by property taxes, would benefit from state revenue-sharing and could use that funding to enhance public services that improve quality of life. Underfunded local governments result in a poor quality of life, which makes it difficult to retain and attract residents.

As the nation began to climb out of the Great Recession in FY2010, so did Michigan, and the state has experienced consistent growth in revenues since then. However, state revenues and funding in 2020 were still below 2000 levels on an inflation-adjusted basis, climbing only when federal stimulus funds distributed during the COVID-19 pandemic and the subsequently recovering economy brought Michigan a bit of a surplus. Major tax reforms in 2023 will partially offset this new boost to state revenue. Between FY2022 and FY2024, Michigan committed an additional $380 million to the Budget Stabilization Fund — the state's "Rainy Day Fund" — and this balance is expected to approach $2 billion by the end of FY2024. However, major tax reforms in 2023 will partially offset this new boost to state revenue.

Tax Burden by State

State	Effective Tax Rate	National Rank
Illinois	12.9%	7
Wisconsin	10.9%	20
Indiana	9.3%	38
Michigan	**8.6%**	**46**

Opportunity to Reverse Cuts and Invest in Michiganders

Michigan's state and local governments are smaller and less capable of providing services than they were 20 years ago, after the state implemented large budget reductions between FY2000 and FY2011. On the heels of the COVID bump in revenue, future revenue growth is expected to look more "normal" allowing for inflationary type adjustments. This research series has identified a number of key areas where additional public investment may be necessary to address Michigan's challenges related to an aging population, talent attraction and retention, public infrastructure, and the state's education system. Major investments in any of these areas will likely require either new revenue or the redirection of current revenue from existing programs or functions.

Key priority areas for investment should include:

Higher Education: Adjusted for inflation, state funding for Michigan's public universities is 34 percent below the level of two decades ago.

Safety Net: The number of low-income families receiving state cash assistance fell by 94 percent between FY2000 and FY2020 — the fourth-highest decline in the nation.

Road Funding: With some of the worst roads in the nation, Michigan faces challenges funding the infrastructure to keep drivers and passengers safe as they travel through the state.

Revenue Sharing: Reductions in state revenue sharing to municipalities and counties have created significant financial strain on local governments. Today, inflation-adjusted local aid funding remains 35 percent below its FY2001 peak.

Ensuring a Sustainable Future for Local Government

Local governments are dependent on the economic and financial health of the state, presenting challenges for them as the state is operating without a comprehensive, long-term economic plan or strategic direction. Limits on local taxation have hindered provision of services, while an outdated hyper-local governance model discourages regional cooperation among cities, townships, and counties on issues that can make the state a more attractive place to live. Local government organization has changed little since Michigan statehood in the 1800s, with 83 counties, 533 cities and villages, and 1,240 townships that provide a broad, and somewhat overlapping, range of services.

Incentivize Investments in Michigan's Communities.

The property tax is used by all forms of local government in Michigan to fund a variety of services; for many local units, the property tax is their only own-source revenue. Property tax limitations constrain local governments' ability to keep up with the needs of residents.

The property tax is constrained because it is inadequate to serve as the sole source of local government revenue in Michigan's modern economy. For almost a century, the state used revenue sharing to supplement the property tax. Revenue sharing provides local governments with diverse revenue streams but centralizes the revenue-raising function at the state level. But drastic cuts to state revenue sharing over the past two decades have meant balancing the state budget on the backs of these local entities, which do not have the own-source resources to provide quality of life services that will retain residents and attract new ones.

Advance New Models of Regional Governance.

Michigan needs a more regional focus that will create more effective collection and utilization of tax revenue, service provision, and governance if the state is to overcome the many challenges it faces and provide the quality of life services needed to attract new residents. Advances in communication, technology, and transportation can enable a new model of regional governance that would be more efficient and effective than thousands of small local governments doing things alone. Greater regionalism will allow for a broader and more diverse tax base to fund public services across all communities.

Services That Regional Governments Should Provide:

Public transportation

Public safety

Public works and sanitation

Information technology

Taxation

Elections

Property assessment

Road maintenance

A Rising Tide Lifts All Boats

In the absence of greater regional public service provision and financing, communities with low property values have few options to fund critical public services other than to levy prohibitively high tax rates. This further segregates communities as those with means continue to leave for lower-tax communities.

It also creates a system where Michigan's poorest people living in its most struggling communities are paying taxes at rates much higher than their more wealthy neighboring communities, while sometimes receiving fewer services for those taxes paid. This raises issues of equity, opportunity, and fairness — people who are paying high tax rates in low-property value communities deserve better than sub-standard local services.

As well, Michigan is only as strong as its weakest local government. The state cannot thrive if it leaves some of its communities behind.

Looking Toward the Future

Michigan's economic struggles throughout much of the 2000s brought home the need to create a different model for state and local governments. To grow the population, Michigan needs to fund state and local governments so they can provide what potential new residents will seek — desired services, modern infrastructure, good school systems, and an environment conducive to providing job opportunities.

With workers more mobile than ever, Michigan can market its abundant natural resources, moderate climate, and lakeshore and rural areas to attract residents who can work remotely – but will only succeed if people find the services and quality of life they seek. This means using state revenue to invest in Michigan's education, infrastructure, and public health, while creating sustainable models of funding local and regional governments that enable them to provide desired services and a standard of living across regions.

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