

Governor Whitmer's FY2020 Budget Proposal

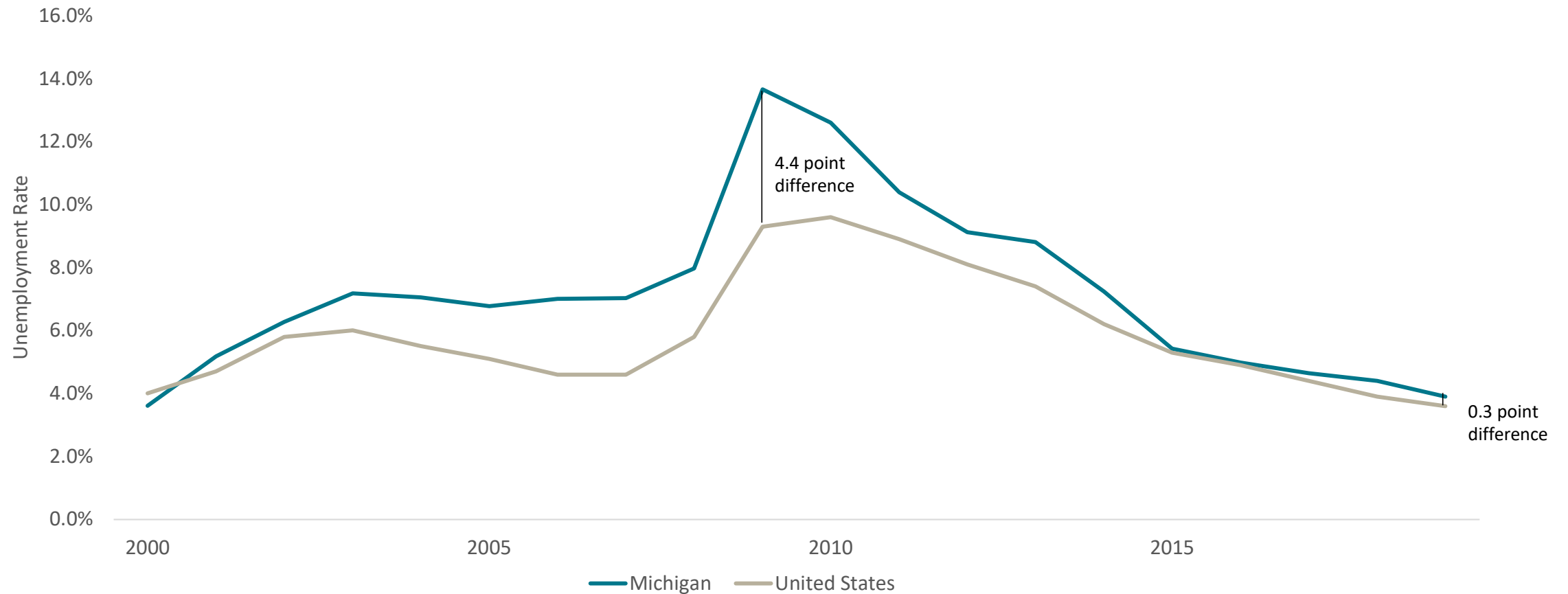
Craig Thiel, Research Director
Jordon Newton, Research Associate
Citizens Research Council of Michigan
March 22, 2019

Citizens Research Council

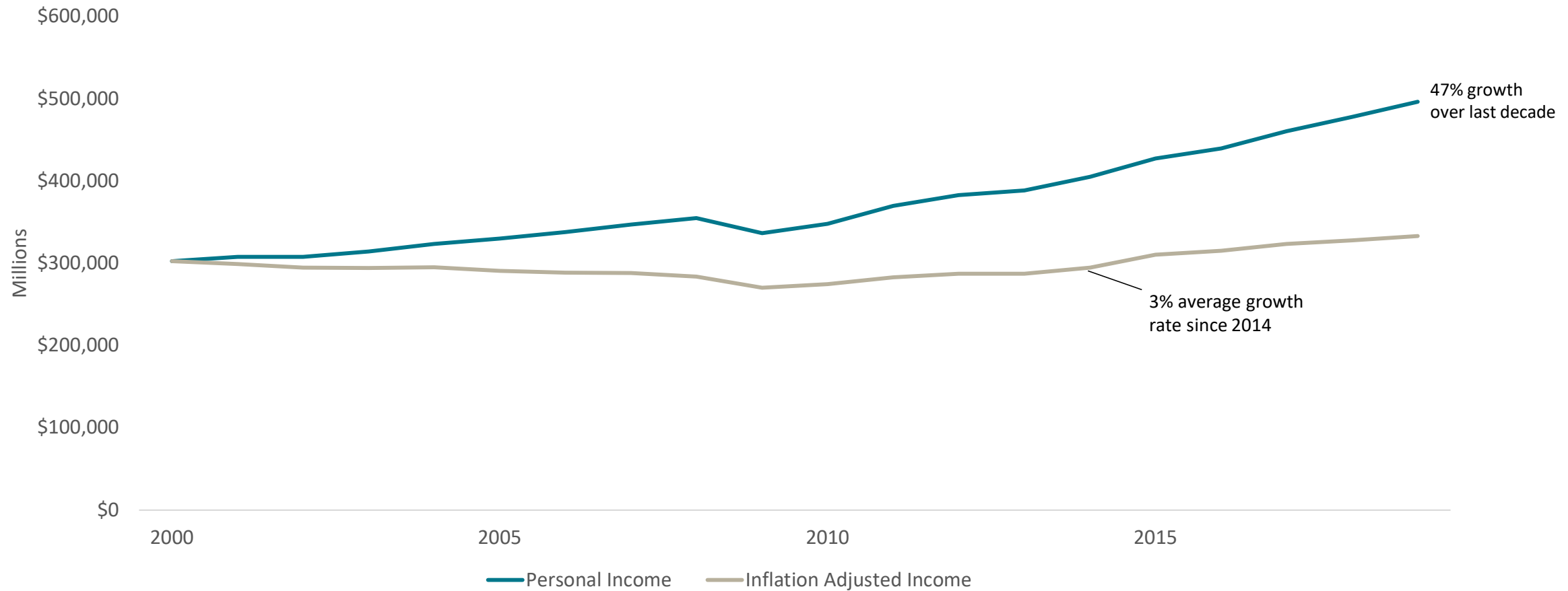
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Economic and Revenue Climate

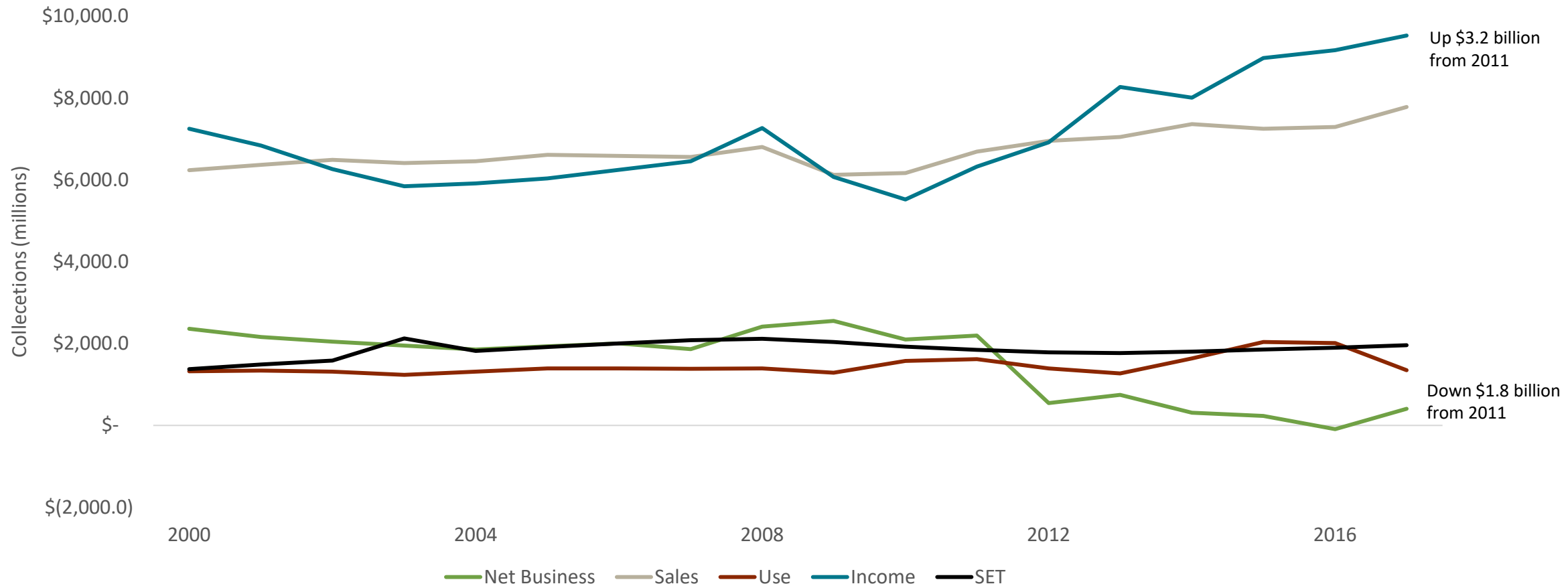
Unemployment Tracking with National Rate



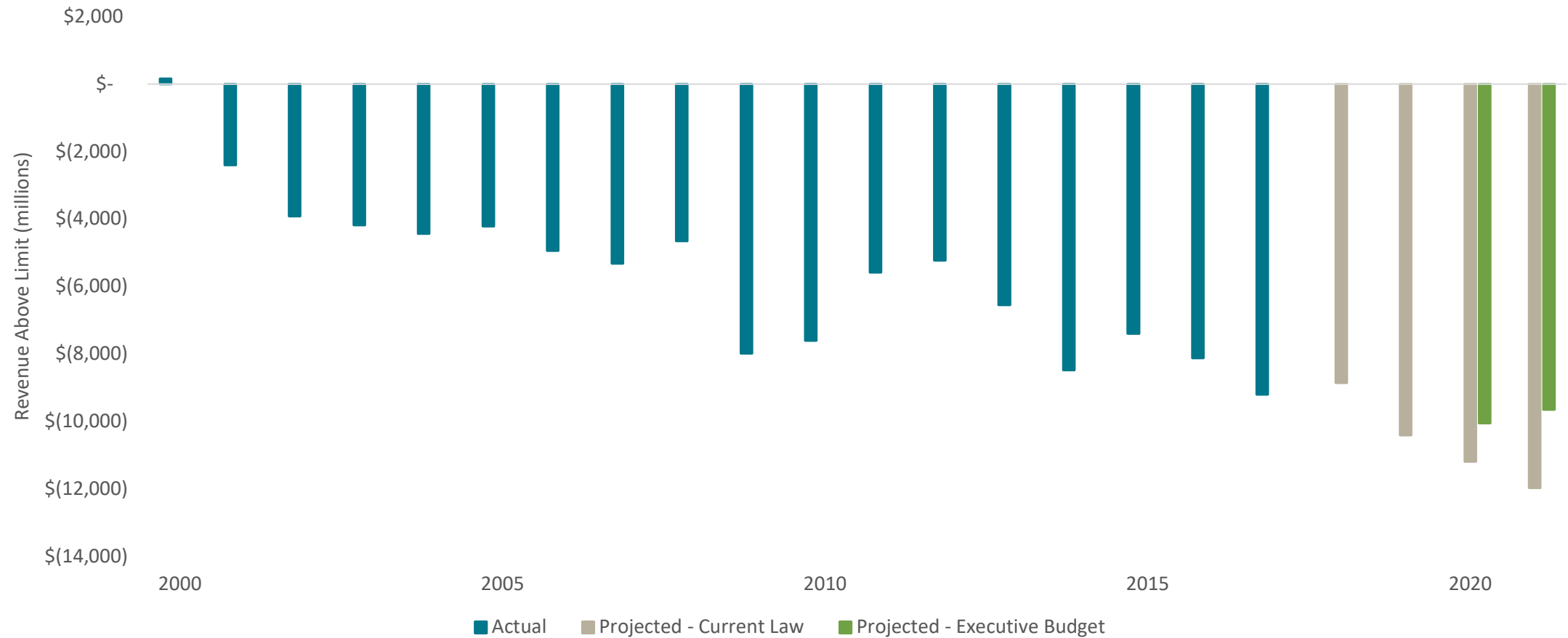
Real Personal Income is Growing



Income and Sales Taxes Drive Revenue Growth



Significantly Below Revenue Limit

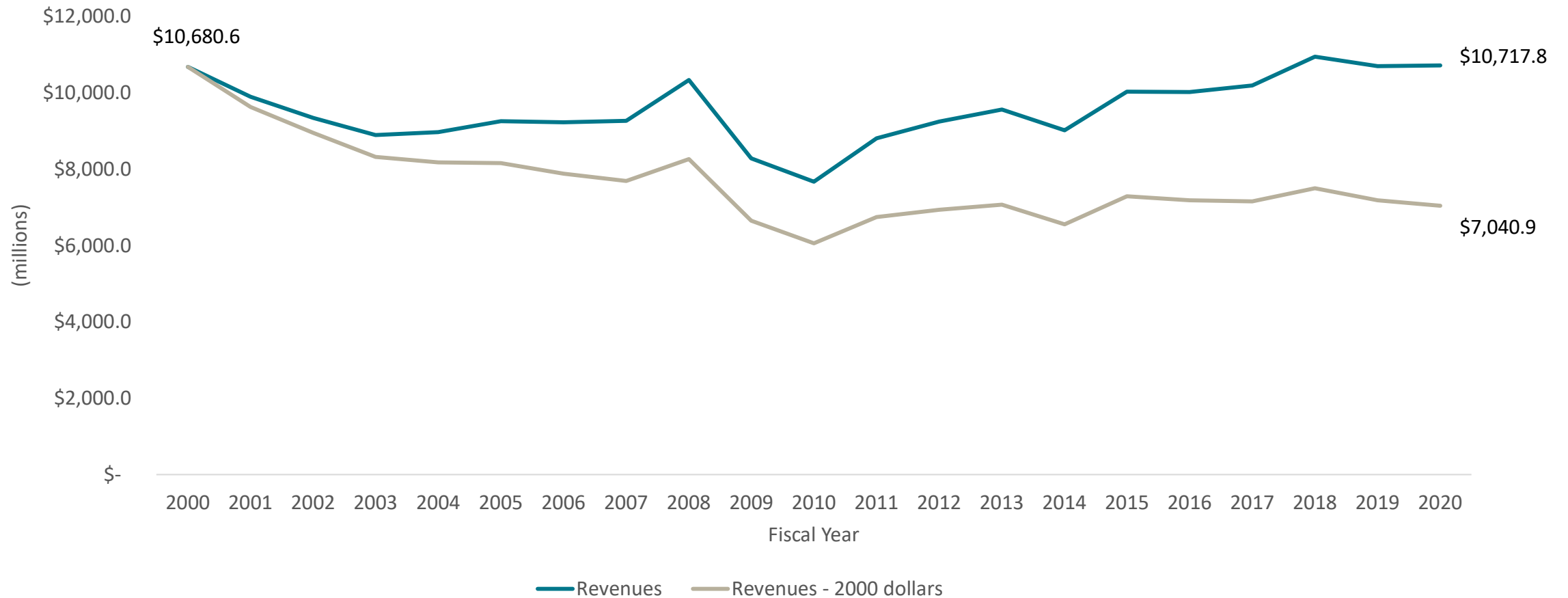


Situation Facing the Governor

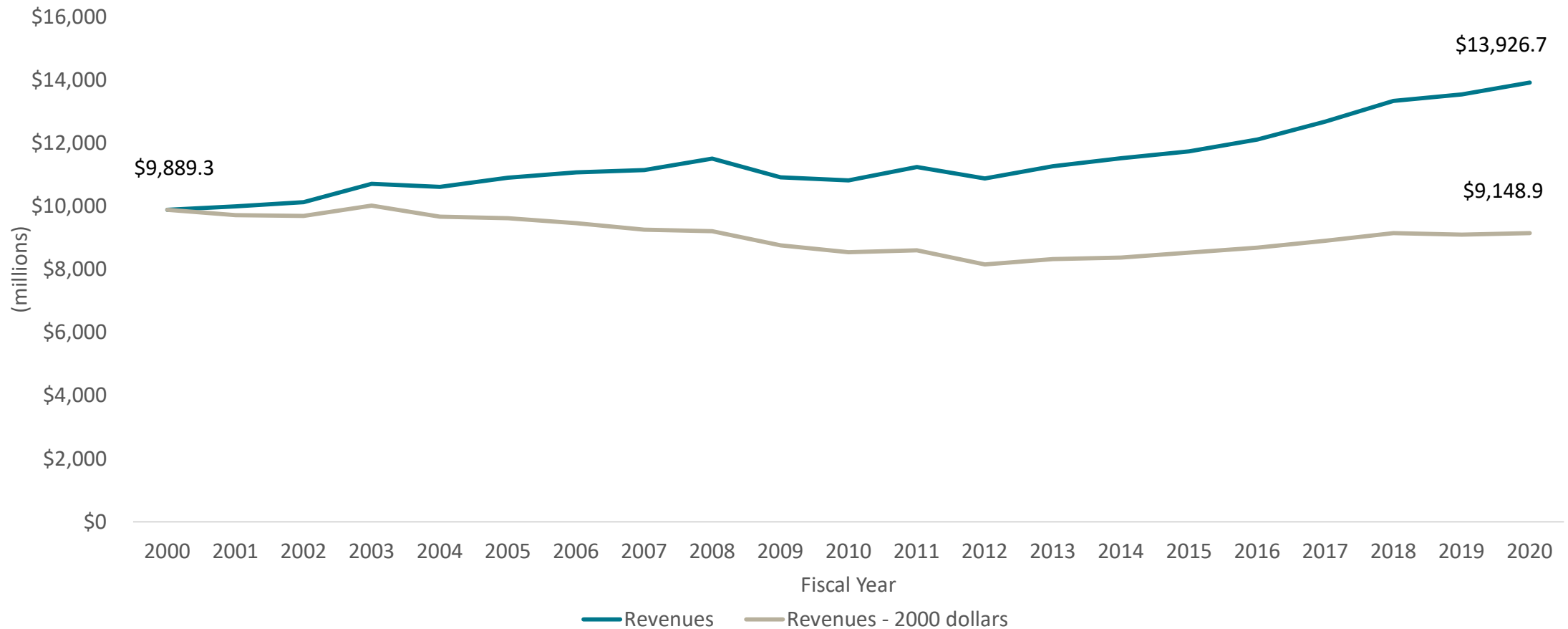
Situation Facing the Governor

- First chance to show priorities and deliver on campaign promises
 - Fix the roads
 - Take universities out of School Aid Fund
 - Repeal 2011 retirement income tax changes
- Few current resources to work with
 - General Fund revenues flat
 - Big price tags on priorities

General Fund Revenues



School Aid Fund Revenues



Appropriation Timeline

- January: January CREC
- **February: Executive Budget (March in years with new governor)**
- February-April: Budget goes through legislative process
- May: May CREC, Budget target agreement, Conference committees meet, budget bills passed and sent to the governor
- June: Governor signs the budget
- October: Fiscal year begins on October 1

Executive Budget Appropriations

Executive Budget Appropriation (millions)

	FY2019 Year to Date	FY2020 Executive	Difference	Growth Rate
GF/GP	\$10,426.9	\$10,664.7	\$237.8	2.3%
Restricted	\$23,538.0	\$24,876.3	\$1,338.3	5.7%
State Spending	\$33,964.9	\$35,541.0	\$1,576.1	4.6%
Local/Private	\$393.5	\$415.1	\$21.7	5.5%
Federal	\$22,871.6	\$23,125.4	\$253.8	1.1%
Adjusted Gross Appropriations	\$57,230.0	\$59,081.5	\$1,851.5	3.2%

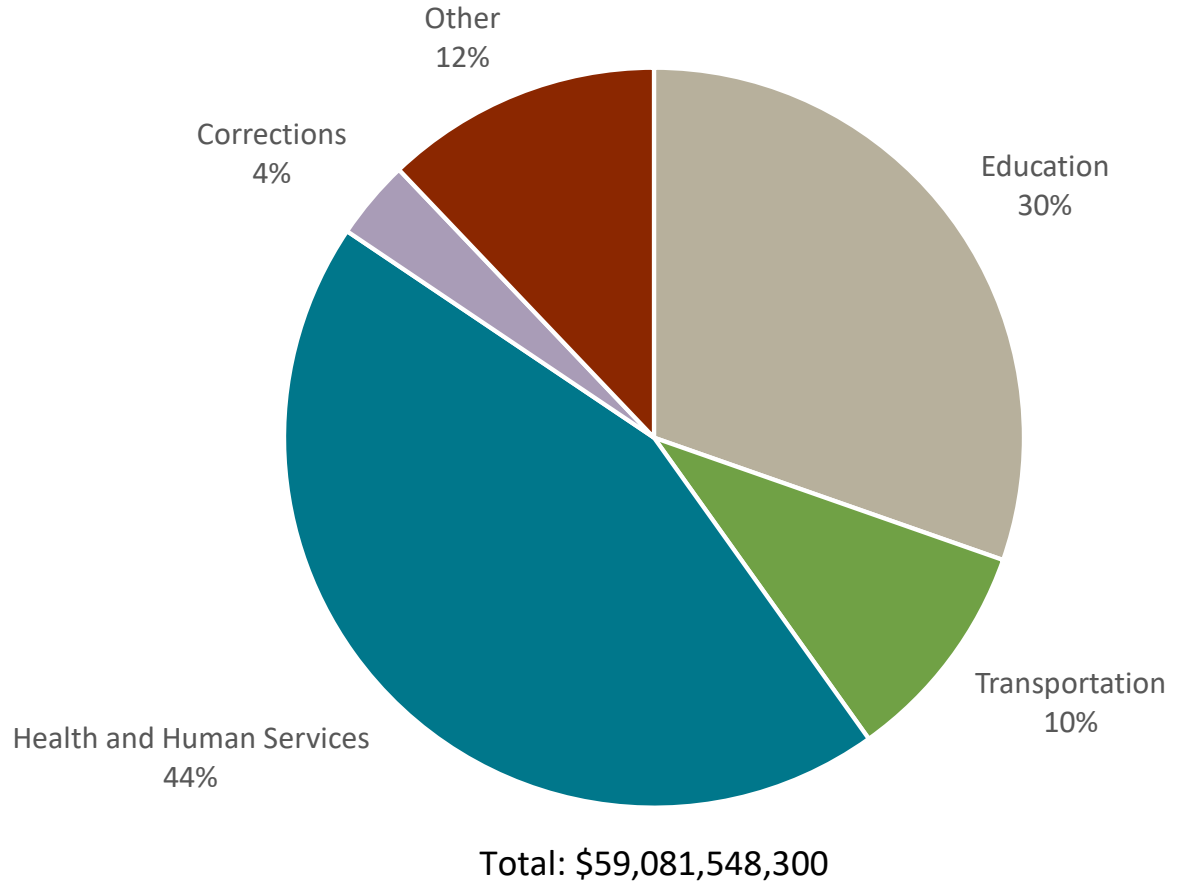
Growth Primarily Transportation

	FY2019 YTD	FY2020 Executive	Difference	Growth Rate
Restricted - Total	\$23,538.0	\$24,876.3	\$1,338.3	5.7%
Restricted - Transportation	\$ 3,283.3	\$ 4,380.7	\$1,097.4	33.4%
Restricted - Excluding Transportation	\$20,254.7	\$20,495.6	\$ 240.9	1.2%

Continuation Budget

- Most budget areas staying the course
 - Caseload adjustments
 - Healthy Michigan Plan and Medicaid match changes
- General Fund only \$133 million new allocations
 - Primarily drinking water programs

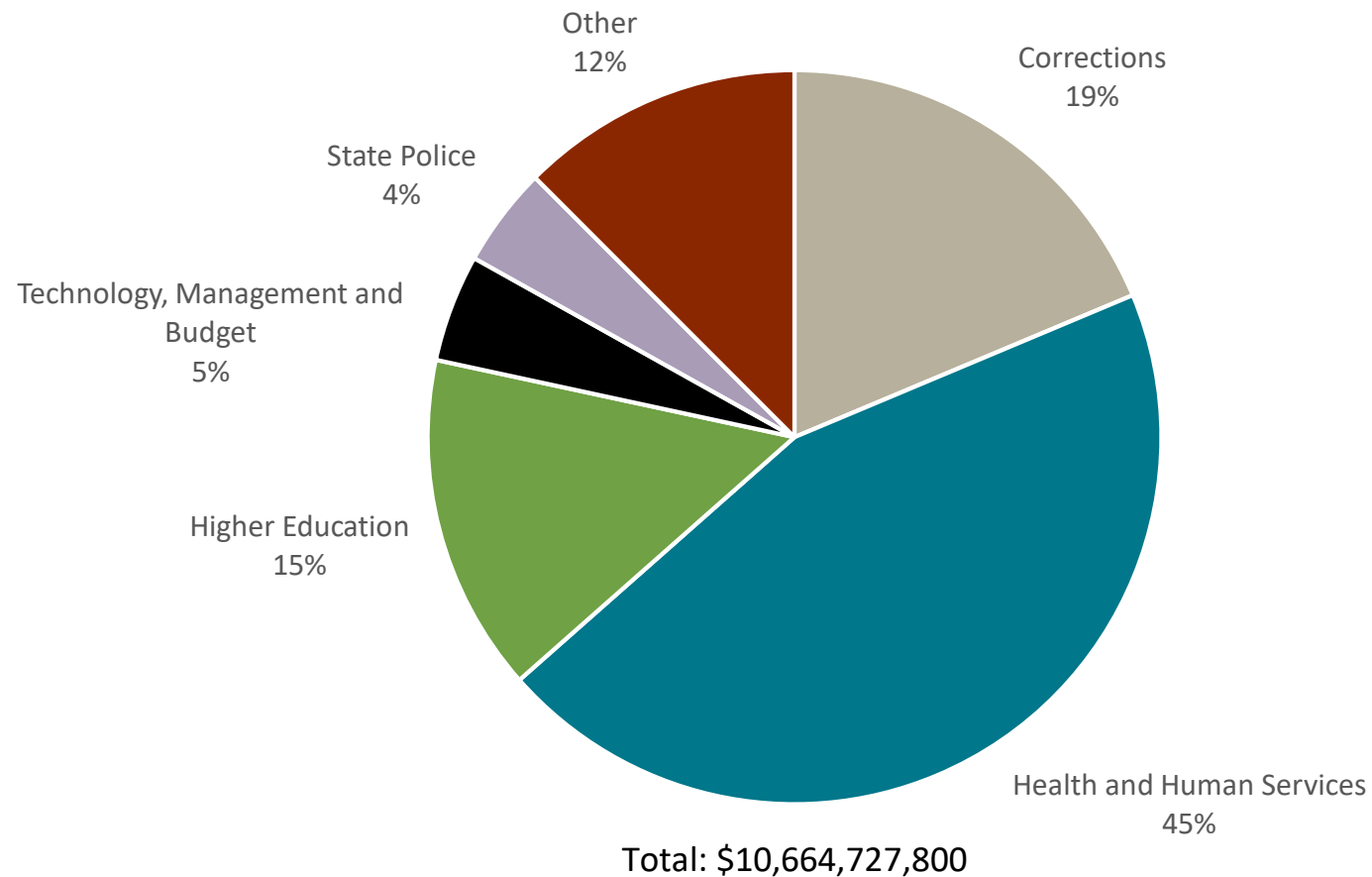
Adjusted Gross Appropriations



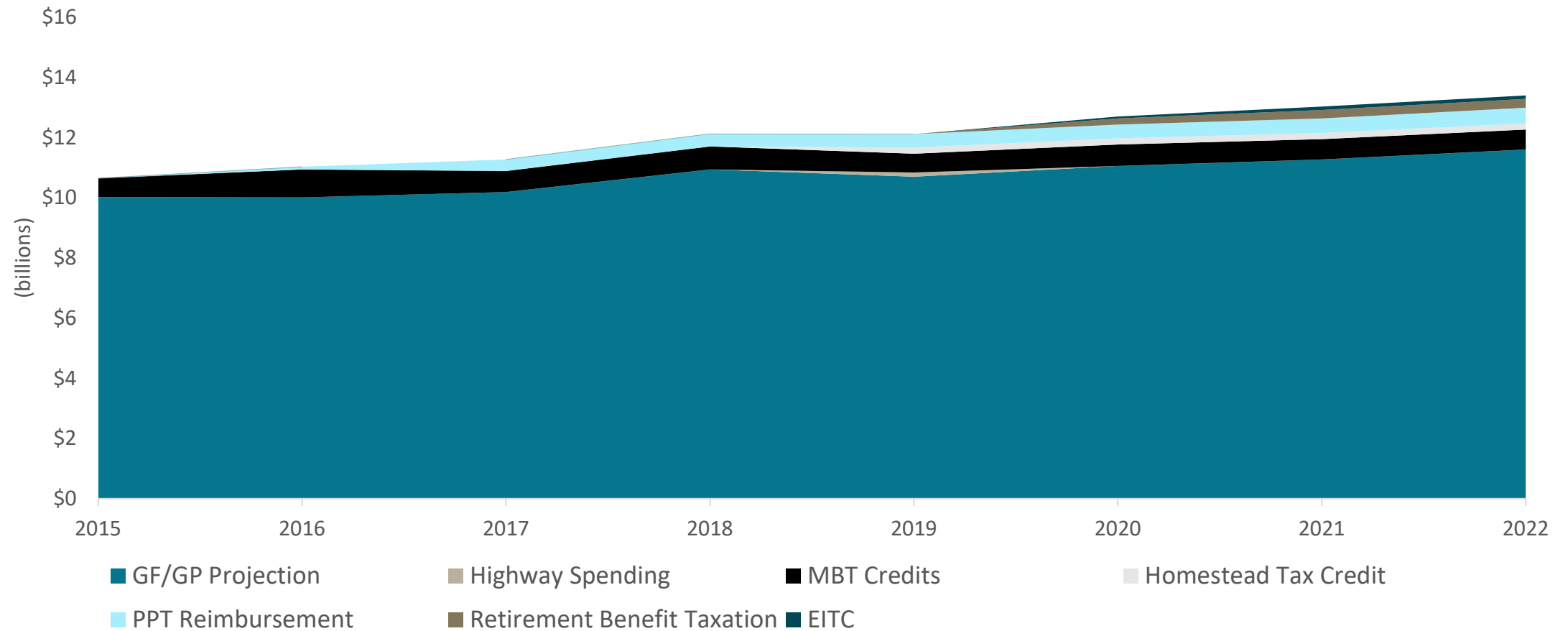
General Fund Balance Sheet

Resources (millions)	FY2019	FY2020
Initial Balance	\$715.2	\$237.5
Consensus Revenue Estimate	\$10,700.2	\$10,717.8
Requested Revisions	\$--	\$348.3
Adjustments	(\$6.3)	\$15.2
Revenue Sharing: Ongoing	(\$466.0)	(\$495.9)
Revenue Sharing: One Time	(\$13.1)	\$--
Total Resources	\$10,930.0	\$10,822.9
Expenditures (millions)		
Budgeted Ongoing	\$9,614.6	\$10,538.7
Budgeted One Time	\$802.8	\$125.9
Rainy Day Fund	\$100.0	\$150.0
Supplemental Requests	\$175.2	\$0.0
Total Expenditures	\$10,692.6	\$10,814.6
Ending Balance	\$237.5	\$8.3

General Fund Appropriations



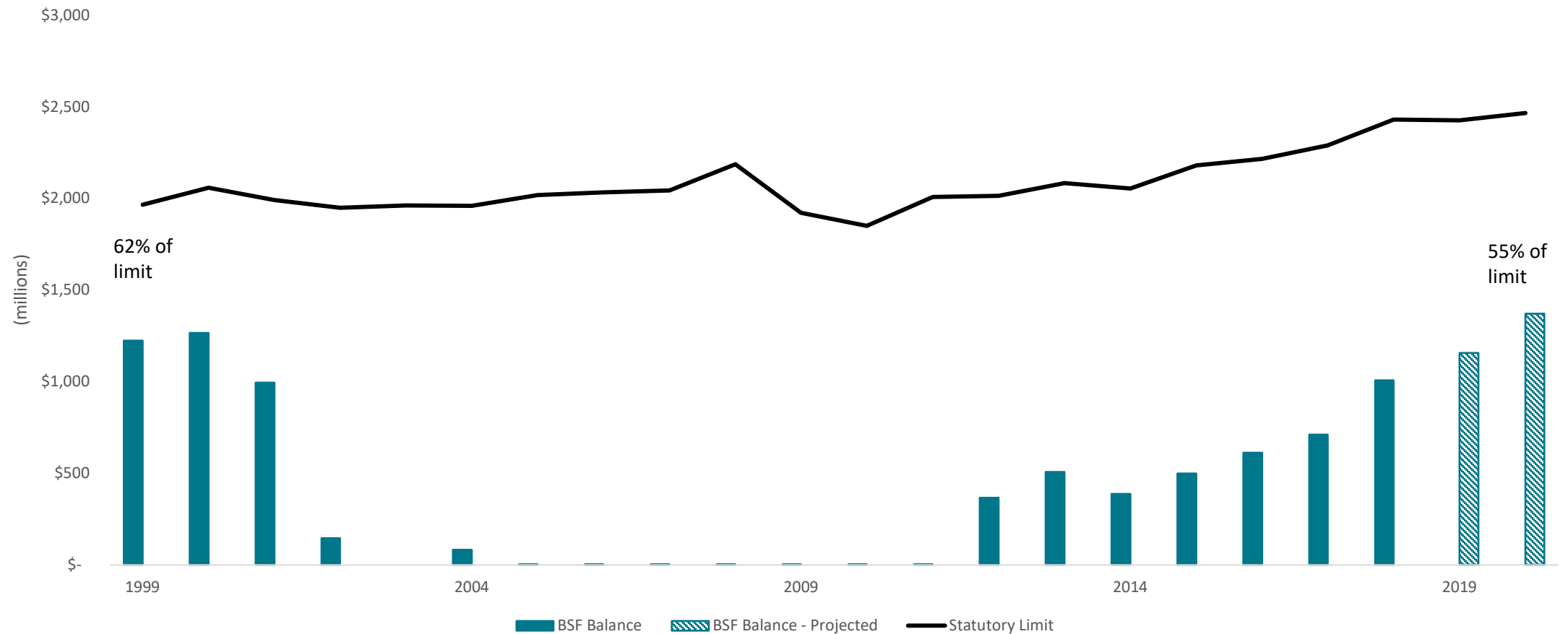
General Fund Revenue Projections



School Aid Fund Balance Sheet

Resources (millions)	FY2019	FY2020
Initial Balance	\$316.7	\$39.4
Consensus Revenue Estimate	\$13,550.5	\$13,926.7
General Fund Grant	\$87.9	\$45.0
Federal Aid	\$1,745.9	\$1,749.6
Other	\$102.0	\$61.1
Total Resources	\$15,803.0	\$15,821.8
Expenditures (millions)		
School Aid	\$14,855.3	\$15,371.2
Deposit into MPSERS Reserve	\$0.0	\$40.0
Community College	\$408.2	\$408.2
Higher Education	\$500.1	\$0.0
Total Expenditures	\$15,763.6	\$15,819.4
Ending Balance	\$39.4	\$2.4

Budget Stabilization Fund Continues to Grow



Revenue Sharing

- Constitutional revenue sharing increased \$51.2 million
 - \$27.2 million over January CREC estimates
- Statutory revenue sharing up 3%
 - \$7.7 million for cities, villages and townships
 - \$6.6 million for counties
- Overall 5.2% increase
 - \$240 million below FY2001

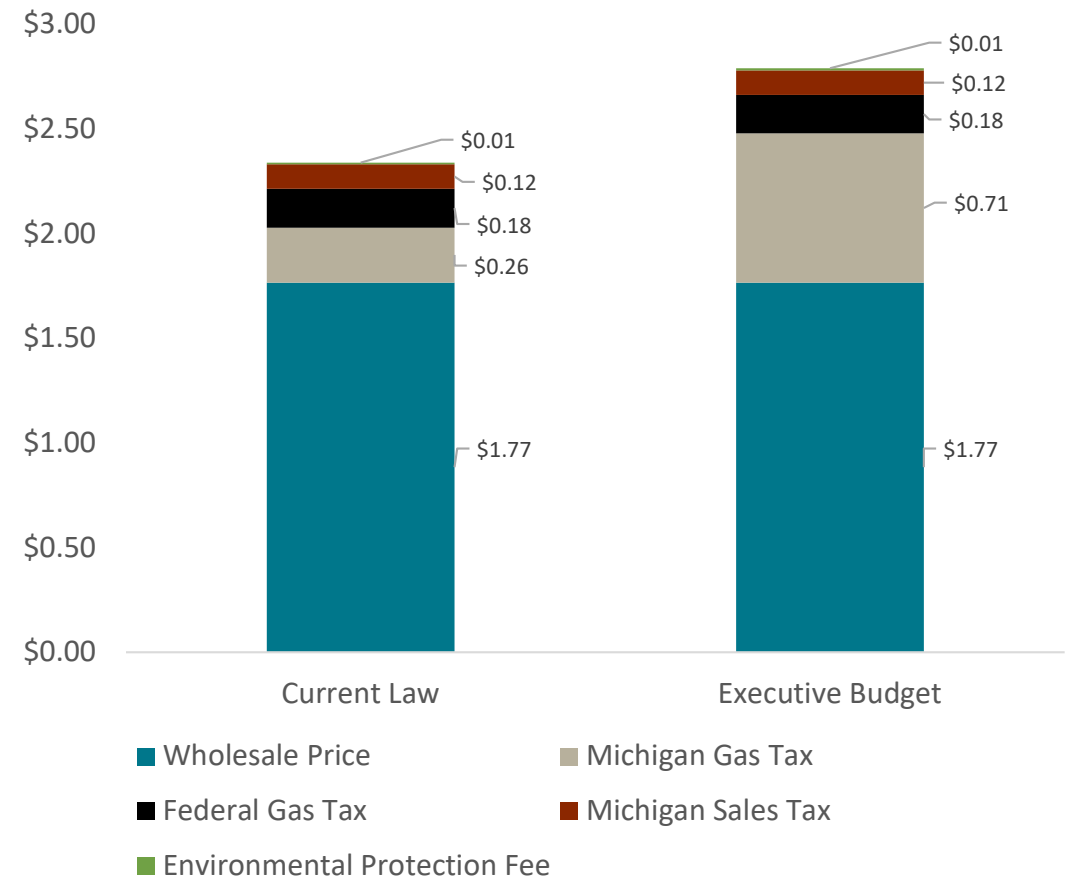
The Fixing Michigan Roads Plan

Fuel Tax Increase

- Proposes a 45 cent increase in fuel taxes
 - 15 cents every six months beginning October 1, 2019
- Changes funding distribution for new revenues
 - Creates “Fixing Michigan Roads Fund”
- Eliminates General Fund support for roads
 - Backfills some revenues to the MTF
- Projected to raise \$2.5 billion once in full effect
 - \$2.1 billion in Gas Tax
 - \$400 million in Diesel Tax

Fuel Tax Increase

- Increases the per gallon fuel tax to 71.3 cents per gallon
 - By far the largest nationally
- Total taxes (federal and state) would be more than \$1.00 per gallon at current prices
 - Today's taxes: \$2.34 pump price and \$0.57 in taxes
 - Proposal rate: \$2.79 pump price and \$1.02 in taxes



Reduced General Fund Burden

- New transportation dollars would end scheduled General Fund allocations
 - \$468 million FY2020 (2015 package + *Wayfair* dollars)
 - \$600 million FY2021 and beyond (2015 package)
- Those revenues will primarily be used to bring Higher Education back to the General Fund
 - Frees up money for School Aid Fund changes

Road Funding Changes

	2019	2020	2021
MTF-Current Law	\$ 3,103.0	\$ 3,374.2	\$ 3,563.1
MTF-Executive Budget	\$ 3,103.0	\$ 3,231.2	\$ 3,288.1
MTF-Net	\$ -	\$ (143.0)	\$ (275.0)
Fixing Michigan's Roads Fund	\$ -	\$ 938.7	\$ 2,179.1
Net Road Funding	\$ -	\$ 795.7	\$ 1,904.1

Road Funding Changes

- Existing Revenues will still follow Act 51
- \$325 million additional dollars will go to MTF
 - Backfill General Fund dollars
- MTF revenue reductions lead to small losses
 - Counties and MDOT lose about \$108 million each in MTF revenue
 - Cities lose \$60 million
- \$42 million to DNR
 - Constitutional requirement
- Fixing Michigan Roads Fund creates new distribution

Road Funding Changes

- Act 51 funding does not line up with current needs
 - Does not factor road usage
 - Ignores road condition
- Funding favors rural counties
 - Road miles a large factor
 - 69% of road miles are rural
 - Account for 29.8% of usage

Road Funding Changes

- Fixing Michigan Roads Fund targets high-use roads
 - 47% to Interstates and Freeways
 - 30% to Principal Arterials
 - 7% each to Minor Arterials and Major Collectors
 - 4% to Local Bridges
 - 3% to Multi-Modal Transportation Projects
 - 2% to Local Rural Economic Corridors
- \$1.5 billion (70%) would go to MDOT

Lessons From Our Research

- Principles for increasing road funding
 - Disentangle sales tax
 - Don't create new problems elsewhere
 - Bonds are not a solution without revenues
 - Re-examine revenue distribution
 - Needs more than lip service
- Long-term sustainability question
 - Increased fuel efficiency
 - Electric vehicles

Other Major Tax Changes

Exemption of Retirement Income

- Tax overhaul in 2011 included retirement income reform
 - Aging population affected Income Tax base
 - Tax fairness questions
 - Private vs Public benefits
 - Young vs old taxpayers
- Changed taxation of retirement income
 - 3 categories
 - Those already retired
 - Those nearing retirement age
 - Those well below retirement age

Exemption of Retirement Income

- Reverts to previously existing Income Tax exemption for retirement Income:
 - Public pensions and social security completely exempt
 - Private pensions receive nominal exemptions
 - \$52,808 (single filing) or \$105,615 (joint filing)
- Allows taxpayers over 67 to keep the \$20,000/\$40,000 deduction and forego exempting pension income specifically

Exemption of Retirement Income

- Projected to affect more than 400,000 households
 - Households would save \$800 a year on average
 - 600,000 senior households would pay no state income tax
- Reduces revenues
 - \$259 million FY2020
 - \$200.7 million General Fund
 - \$355 million FY2021
 - \$275.6 million General Fund

Exemption of Retirement Income

- Favors public income
 - Private pensions would have sizable exemption, but not completely exempt
- Targeted break for those on fixed income in response to fuel tax increase
 - Higher income public pensions benefit the most
 - No changes for those previously unaffected by 2011 law
- Reduces long-term revenue growth
 - Those most affected have not retired yet
 - Baby boomer generation close to retirement

Pass-Through Entity Tax Parity

- Creates new 6% tax on pass-through entities
 - Currently taxed at 4.25%; C-corporations at 6%
 - Provides Individual credit against taxes paid
 - \$50,000 deduction on new tax
- Raises \$280 million annually once fully implemented
 - \$217 million General Fund
 - Provides federal tax benefits; only increases tax burden \$100 million
- Larger burden on smaller to mid-size entities

Increase Earned Income Tax Credit

- Federal program that incentivizes work
 - Michigan piggy-backs the federal credit
- Michigan credit started in 2008
 - 10% initially
 - Increased to 20% in 2009
 - Dropped to 6% in 2011
- Increase the credit from 6% to 10% in 2020, 12% in 2021
 - \$76 million in FY2020, \$114 million in FY2021 and thereafter

Expanded EITC Breakdown

	Current Max Credit	Proposed Max Credit	Monthly Increase	Single Filing		Joint Filing	
				Income Range for Max Credit	Complete Phase-Out	Income Range for Max Credit	Complete Phase-Out
No Children	\$ 31.40	\$ 62.80	\$ 2.62	\$ 6,784 - 8,486	\$15,270	\$ 6,784 - 14,166	\$20,950
1 Child	\$207.66	\$415.32	\$17.31	\$10,179 - 18,662	\$40,320	\$10,179 - 24,352	\$46,010
2 Children	\$342.96	\$685.92	\$28.58	\$14,290 - 18,660	\$45,802	\$14,290 - 24,350	\$51,492
3+ Children	\$385.83	\$771.66	\$32.15	\$14,291 - 18,657	\$49,194	\$14,291 - 24,347	\$54,884

Education Highlights

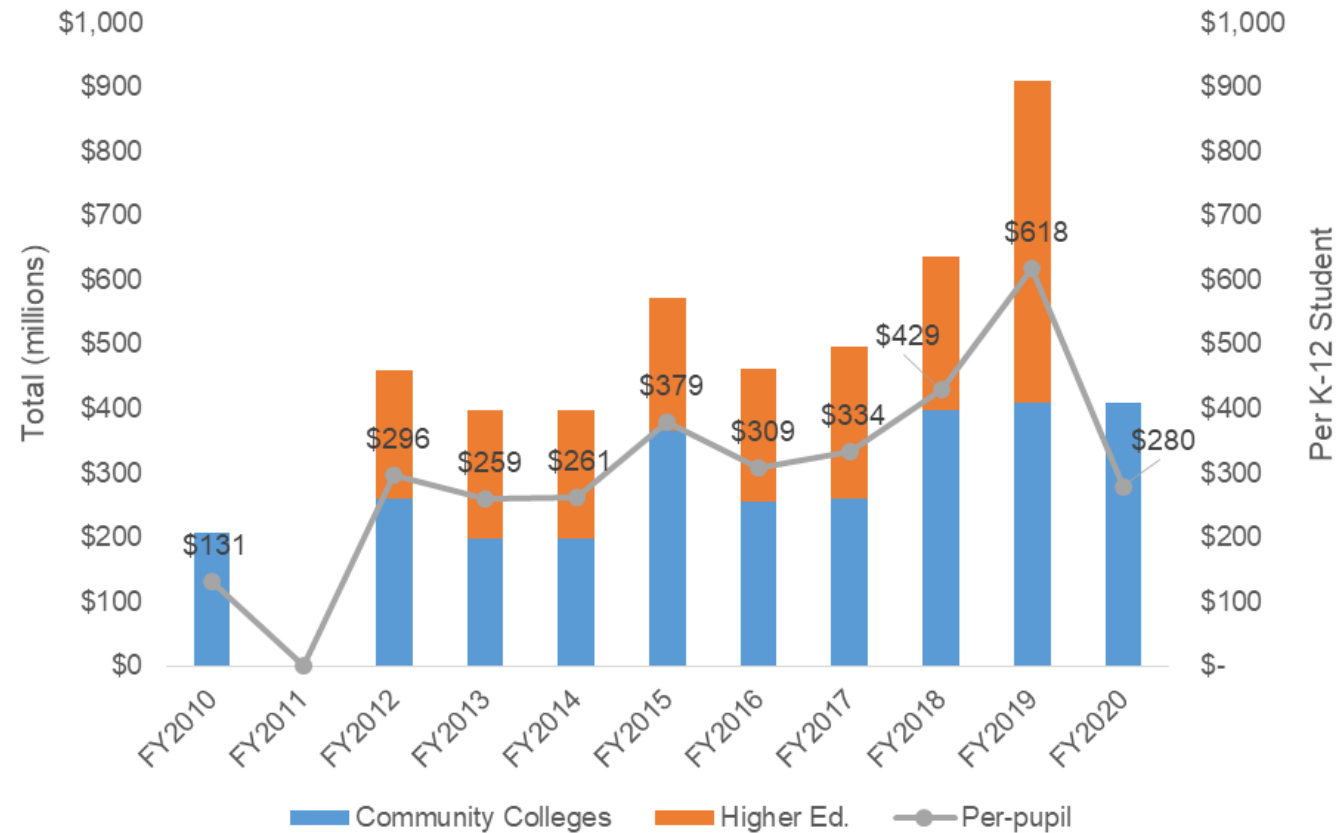
School Aid Overview

- Total state funding \$13.6B - up 4% from FY2019
 - School Aid Fund (SAF) used for community colleges, but NOT university appropriations
 - The \$500M funding shift is THE key component of the proposal
- **Highlights**
 - Sizeable increases in operational funding (~\$500M) – foundation allowance, special ed., career/tech. (CTE), and at risk students
 - Pre-school expansion – eligibility and reimbursement
 - Retirement system reforms continue to draw SAF resources
 - Continued decline in student enrollment (-0.5%)

Higher Education Funding Shift

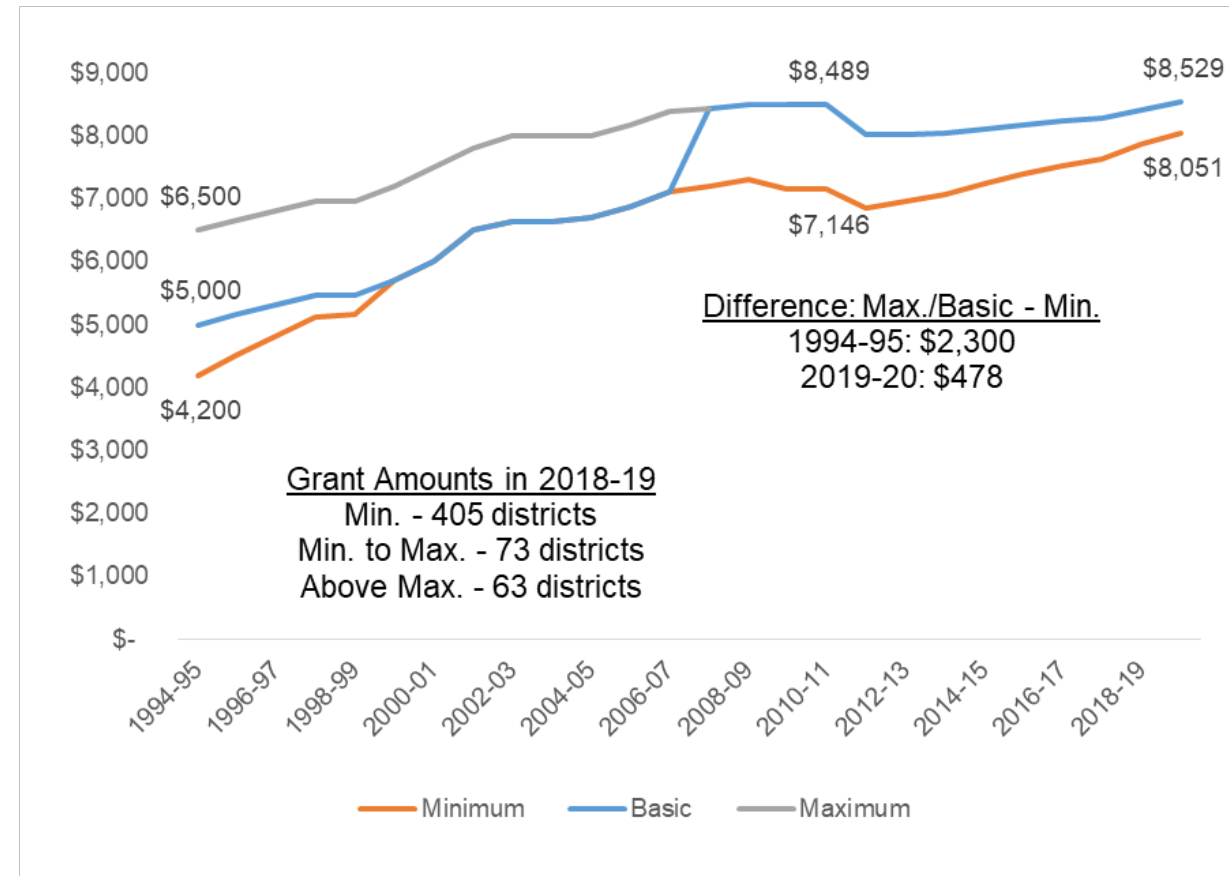
Frees up \$500M School Aid Fund for K-12

SAF for Higher Education Appropriations



Base Funding - Foundation Allowance

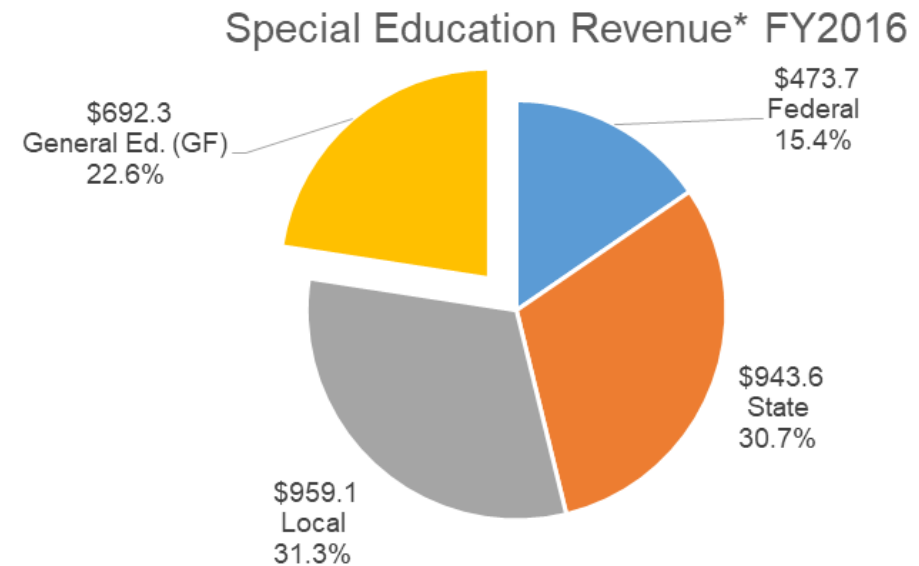
- \$235M for foundation grants
- Per-pupil increases
 - Using 1.5x formula
 - Ranging from \$120 to \$180/pupil
- Narrows per pupil gap to \$478
 - 3/4 of districts at min. grant
 - 2/3 of pupils receive min. grant
- Cyber schools – 80% of per-pupil grant (\$6,441)



Special Education

Offset current general fund contributions

- Increase of \$120M
- Keeps **current reimbursement model** (Durant)
 - Increases state reimbursement from 28% to 32% of costs
- Reduce **General Fund subsidy**
 - In 2016, \$692M in unfunded costs covered by districts (\$460/pupil)
 - Additional funds allow districts to reduce general fund contributions
 - Funding will have little impact on the amount of spec. ed. services provided in state



* amounts in millions
source: Special Education Funding Subcommittee Report, 2017

Categorical Funding Enhancements

Additional funds to address student needs

- \$102M for **at-risk students**
 - Targets economically disadvantaged students
 - 771K students in current year
 - 11% of foundation grant - \$886/pupil
 - Districts above basic grant- 50% of per-pupil allocation (from 30%)
 - Purpose remains same
- Total at risk funding - \$619M
 - Up from \$300M in FY2015
- \$50M for **career/tech. students**
 - 6% of foundation grant for high school students (\$487/pupil)
 - Current payment is \$50/pupil
- \$25M for **literacy coaches**
 - 3rd grade reading law
 - Triple the number of coaches to 279 statewide
 - Coaches allocated to intermediate districts based on students eligible for free lunch

Great Start Readiness Program

Expanded eligibility, slots and reimbursement

	FY2019 Funding	FY2020 Funding	\$ Change	% Change
Great Start Readiness Program	\$244.9M	\$328.9M	\$84.0M	34%
Allotment per Full Day Placement	\$7,250	\$8,500	\$1,250	17%
Estimated Slots (full and half day)	37,000	42,100		

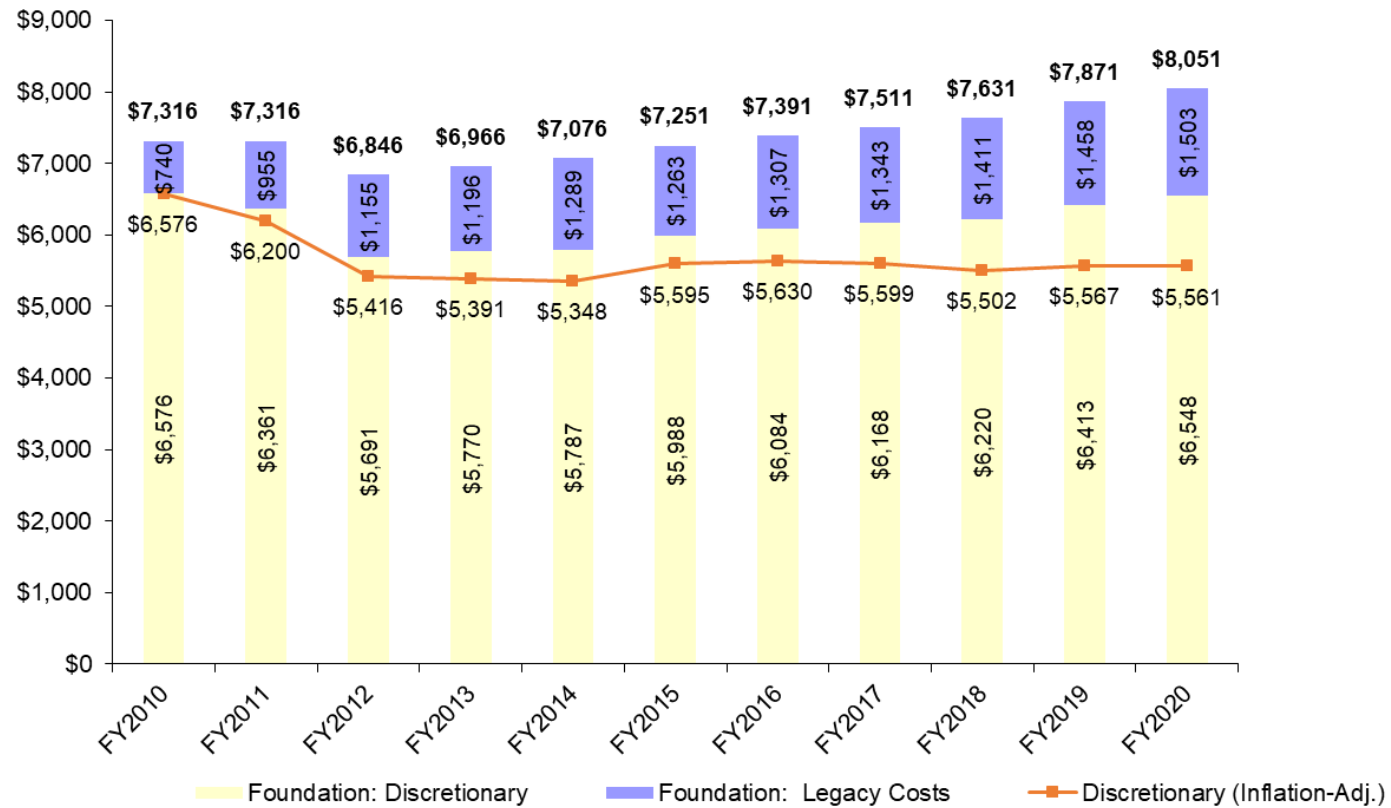
- State-funded preschool program for **low-income children** (4 yr. olds in families at 250% of federal poverty level or less)
- Flat funding (\$245M) since FY2015 and reimbursement rate since FY2014
- \$84M increase to allow **program expansion**
 - Increases eligibility to 300% of federal poverty level (\$77k for family of four)
 - Estimated to add 5,000 slots
 - Increases half-day allotment from \$3,625 to \$4,250; up from \$3,400 in FY2013

Teacher Retirement System

- Maintains current policy to **pay down pension debt** and shield districts from added costs associated with state policies
 - Lower assumed rate of return (7.05% pension) – add'l \$84M
 - Increased employer normal costs from 2017 reforms – add'l \$5M
- **Retirement cost offset** payment maintained
 - \$100M (ave. \$67/pupil) to districts based on statewide share of payroll
- Total “off the top” SAF contributions to system - \$1.34B
 - Equivalent to average of \$900/pupil statewide
 - State reforms provide predictability for districts
- Districts remain responsible for **fixed percentage of payroll** for legacy costs from their foundation (ave. \$1,500/pupil)

Effect of Legacy Costs on Foundation Grant

Impact on minimum grant



Notes: Includes retiree health payments funded on a cash basis in FY2011 and FY2012.

Source: Senate Fiscal Agency and House Fiscal Agency Reports; Office of Retirement Services

Weighted-Student Funding

Some attributes, but largely relies upon existing structures

- Proposal includes components of a weighted-student system
 - Recommended by School Finance Research Collaborative report (2018)
 - Base funding – per-pupil foundation allowance grant
 - Weights – additional funds, above base, for higher cost students
- Foundation grant contains cost items that should not be included (retirement, transportation, spec. ed.)
 - Result: moving further away from a true “base” cost per student
- Weighted funding for specific student populations
 - Relies on existing structures to allocate funding, some of which include weights today (at risk) but others that do not (spec. ed.)
 - Result: continue to fund similar students at different weights

Postsecondary Education

Operating increases and new scholarships

- \$46M for **university operations**,
 - Provides 3% across-the-board increase for each school
 - Abandons the performance funding model used in past
 - Caps tuition growth at 3.2%
- Gov. Whitmer's goal – 60% of adults with high-quality certificate, 2- or 4-year degree by 2030
 - **Michigan Reconnect Program** (\$110M in FY2019 supplemental)
 - Up-skill adult workforce (age 25 and older)
 - Tuition-free grant ("last dollar" basis) for 2 years of college or tech. program
 - Re-purpose \$60M from Gov. Snyder's 2018 Marshall Plan
 - **Michigan Opportunity Initiative** not included in current budget (FY2021)

Assessment

Governor's Proposal from 30K Feet

- Reverses SAF support of university operations, but maintains current-year funding for community college
- Re-purposes SAF from higher education budget to K-12; primarily focus on foundation grant, but also categorical grants
- Additional funding to meet teacher retirement system reforms
 - School districts held harmless, BUT costs financed by School Aid Fund
- Inflationary increases for universities and community colleges
 - Additional scholarship money to re-engage adults and getting them certificates/degrees

Governor's Proposal from 30K Feet

- Big proposals to help deliver on campaign promises; everything else is emblematic of a continuation budget
- Proposed changes maintain structural balance, but minimal long-term growth will put pressure on future budgets
- Changes in the budget hinge on the road plan

Questions?

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