

Michigan's Budget: Issues and Options

Presentation for:
New Member Training

November 8, 2010

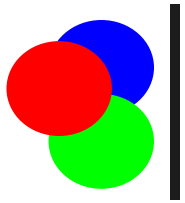


Mitchell E. Bean, Director

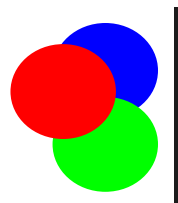


Today's Topics

- **What is the House Fiscal Agency and what can we do for you?**
- **Michigan's budget process**
- **Where we are and how we got there**
- **Budget issues for FY 2010-11 and beyond**

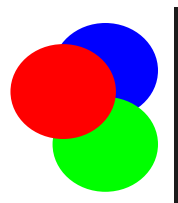


WHO WE ARE AND WHAT WE CAN DO FOR YOU



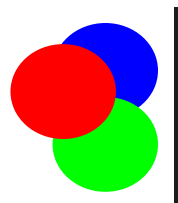
The House Fiscal Agency (HFA)

- A non-partisan agency; neither supports nor opposes policy, legislation, or recommendations made by any House member
- Provides confidential assistance with fiscal questions to
 - House Appropriations Committee
 - All House members
 - Caucus staff
- Prepares reports/publications throughout the budget process; publishes special reports on topics of interest



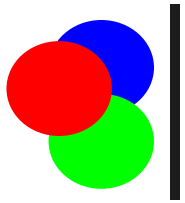
HFA Staff

- Fiscal Analysts
- Economists
- Legislative Analysts
- HFA reports/publications available on the HFA website:
www.house.mi.gov/hfa
- HFA bill summaries/analyses available on the Michigan Legislative Information System website:
www.michiganlegislature.org (as well as the House session website)

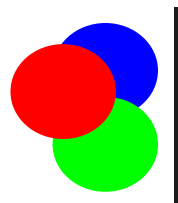


What can the HFA do for Members?

- Analyze/explain proposals and budgets
- Research and analyze fiscal issues
- Respond to breaking news
- Monitor issues/trends that may affect the state budget

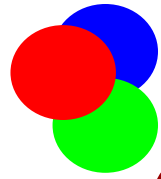


MICHIGAN'S BUDGET PROCESS: HOW IT WORKS

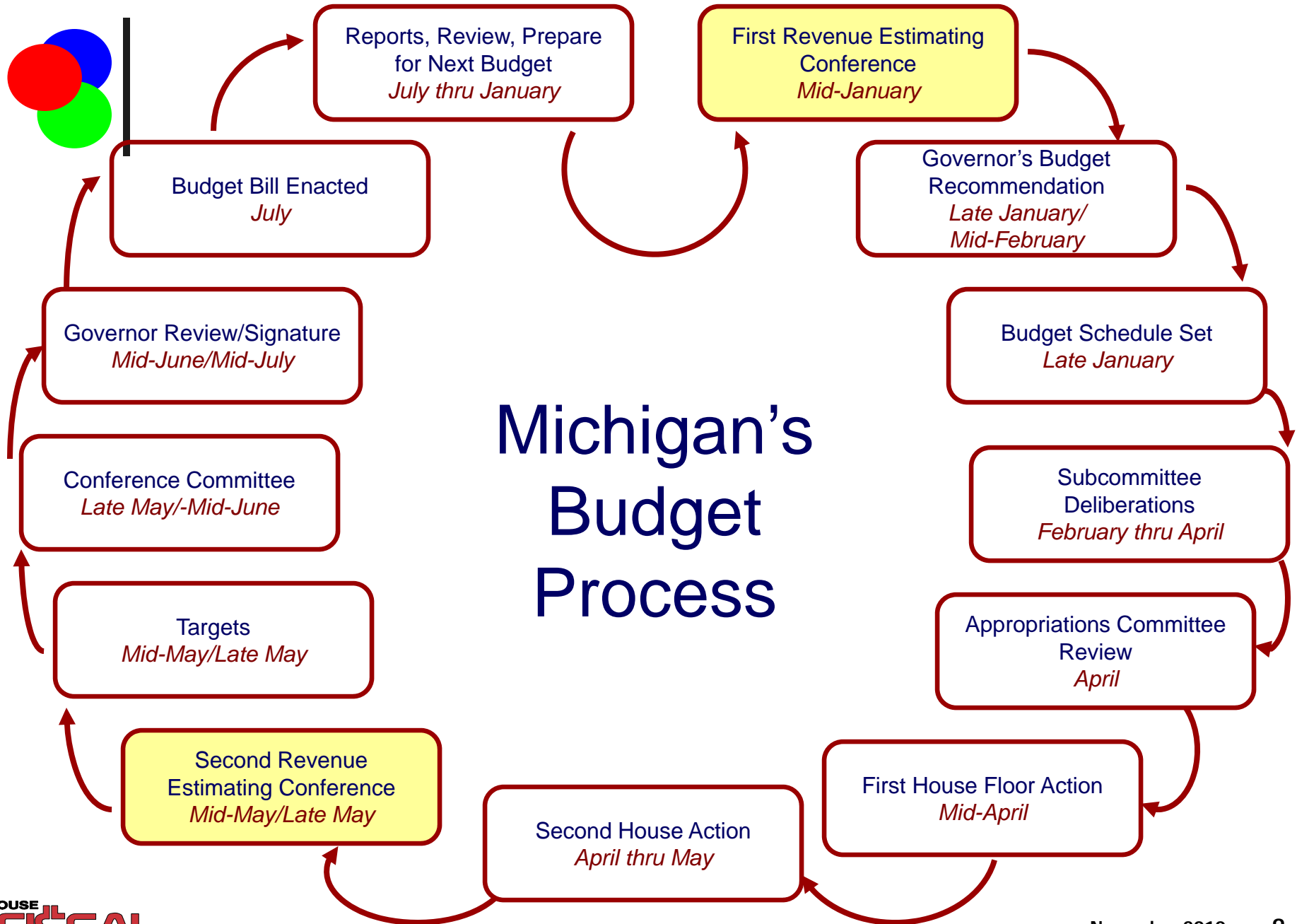


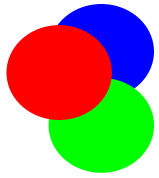
Executive and Legislative Roles

- Michigan Constitution and statute provide that executive and legislative branches share power and responsibility for the state budget process
 - Governor submits a balanced budget
 - Legislature enacts a balanced budget
 - Governor and Legislature maintain a balanced budget
- Legislature has the power to tax and borrow
- Legislature has the power to control spending
- APPROPRIATIONS
 - Are an authority, not a mandate, to spend
 - Are state law while they are in effect

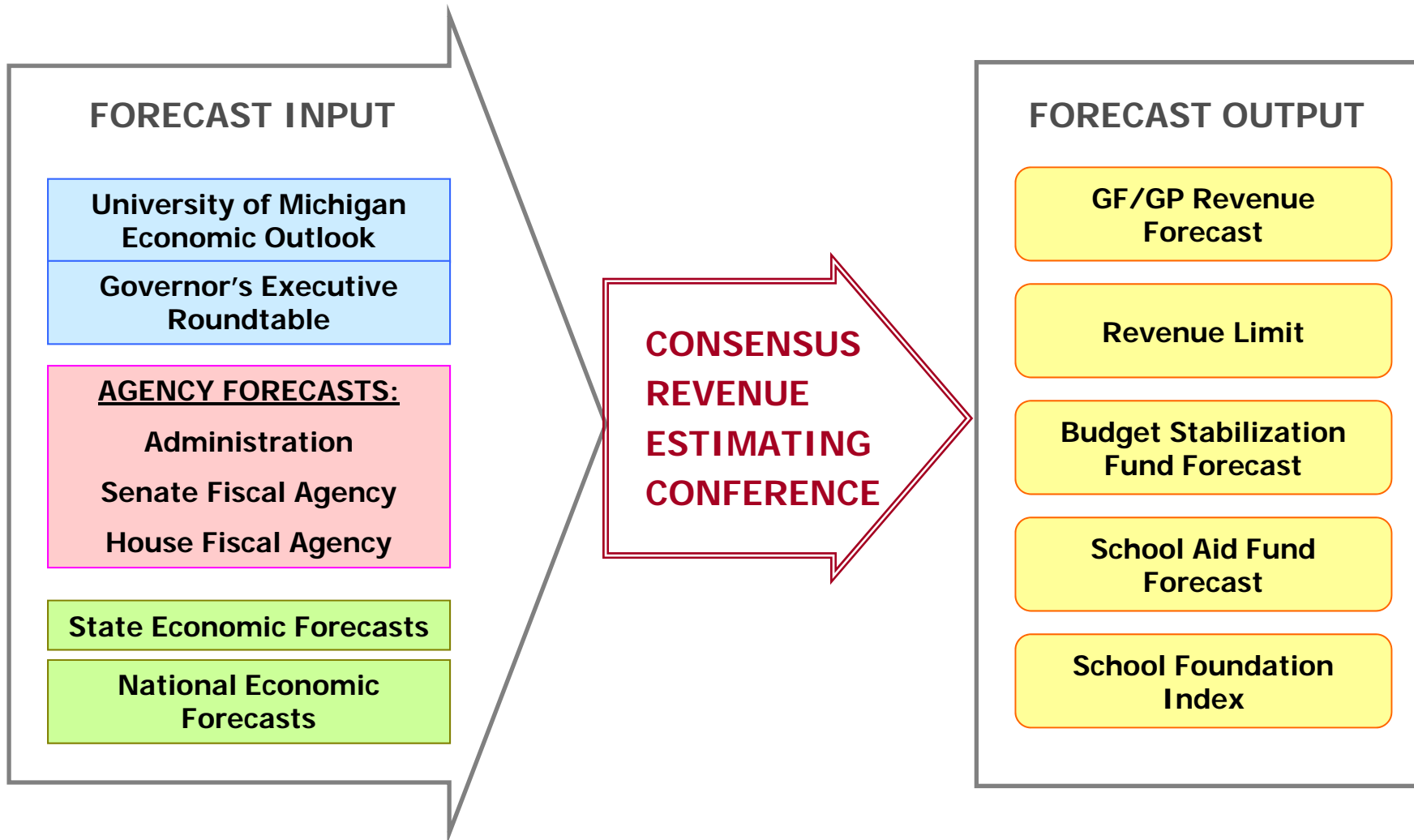


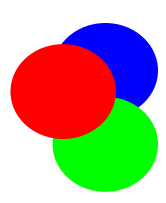
Michigan's Budget Process





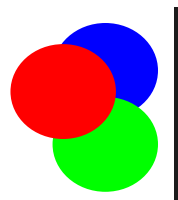
Economic/Revenue Forecasting





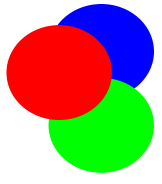
Consensus Revenue Estimating Conference

- Conference held each January and May
 - January forecast used for Executive budget recommendation
 - May forecast used to revise Legislature's proposed budget
- Conference requirements are defined by statute
- Conference principals are HFA and SFA Directors and State Budget Director or Treasurer (or designees)
- Conference is open to the public
- Unanimous consensus among principals is required



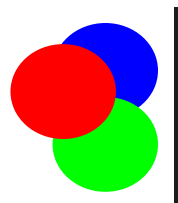
Adjustments to the Budget

- Adjustments to the budget can be made by
 - Transfer (administrative or legislative)
 - Supplemental appropriations bill
 - Executive Order



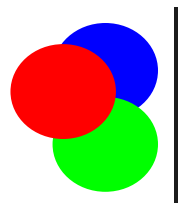
Budget Process Considerations

- It's important to remember that – the Governor proposes, and the Legislature disposes.
- The Legislature is responsible for passing a balanced budget each year – not the executive branch. The Governor has a line-item veto, but he can't change the budget the Legislature sends him – and he doesn't have a vote.
- Balancing the FY 2011-12 budget on a structural basis will require decisions by the Legislature about *which* services are provided/funded by state government, not just *how* services are delivered – the Governor makes recommendations, but the Legislature will make the decisions.



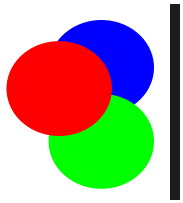
Budget Process Considerations cont.

- If there are changes to the process – the Legislature must retain its constitutional authority to hold the executive branch accountable.
- There has been a great deal of discussion about "outcomes-based budgeting" – remember that the role of the Legislature is to decide which outcome is appropriate.
- It is inherently difficult to evaluate the effectiveness of government functions in a precise, quantitative manner – particularly for those functions with longer-term goals such as health care, education, and public safety – but it's the role of the Legislature to evaluate government functions.



Budget Process Considerations cont.

- There has been a great deal of discussion about multi-year budgets. Multi-year budgeting may improve planning, but would almost certainly result in more frequent and large post-enactment budget adjustments. It would also increase uncertainty about revenue and expenditure estimates.
- Under government accounting standards, an annual comprehensive financial report would still be required.



WHERE WE ARE AND HOW WE GOT THERE



One-Time Funding Sources Utilized in FY 2010-11 Budget

<u>Funding Source</u>	<u>\$ Amount by Affected Fund (Millions)</u>
	<u>GF/GP</u>
■ Federal Funds	\$976.5
■ Tax Amnesty (\$88.8M in FY11 plus assumed \$20.5M loss in FY12)	\$109.3
■ Unclaimed Property (difference between FY11 and FY12)	\$107.0
■ Debt Service Restructuring (difference between FY11 and FY12)	\$162.2
■ Early Retirement (one-time replacement savings minus 3% phase-in)	\$24.0
■ County Revenue Sharing: Projected FY 2011-12 Increase	\$40.0
Total One-Time Funding Sources	\$1,419.0
Impact of Enacted Tax Cuts on FY 2011-12 Revenue	\$210.4
Total Structural Issues for FY 2011-12 Budget	\$1,629.4



One-Time Funding Sources Utilized in FY 2010-11 Budget

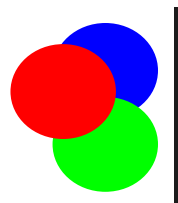
<u>Funding Source</u>	<u>\$ Amount by Affected Fund (Millions)</u>	
	<u>School Aid</u>	<u>Transportation</u>
■ ARRA Funds in School Budget	\$184.3	
■ Ed Jobs Funds for School Aid*	\$318.1	
■ Transportation: Debt Restructuring		\$84.0
Total One-Time Funding Sources	\$502.4	\$84.0
Impact of Enacted Tax Cuts on FY 2011-12 Revenue	\$6.0	\$0.0
Total Structural Issues for FY 2011-12 Budget	\$508.4	\$84.0

* Note: Not built into foundation



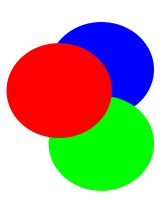
UI Trust Fund

- Interest payments on \$3.8 billion of UI Trust Fund borrowing
 - Approximately \$150 million due September 30, 2011
 - State share approximately \$100 million
 - It will take a decade or more to pay down this debt

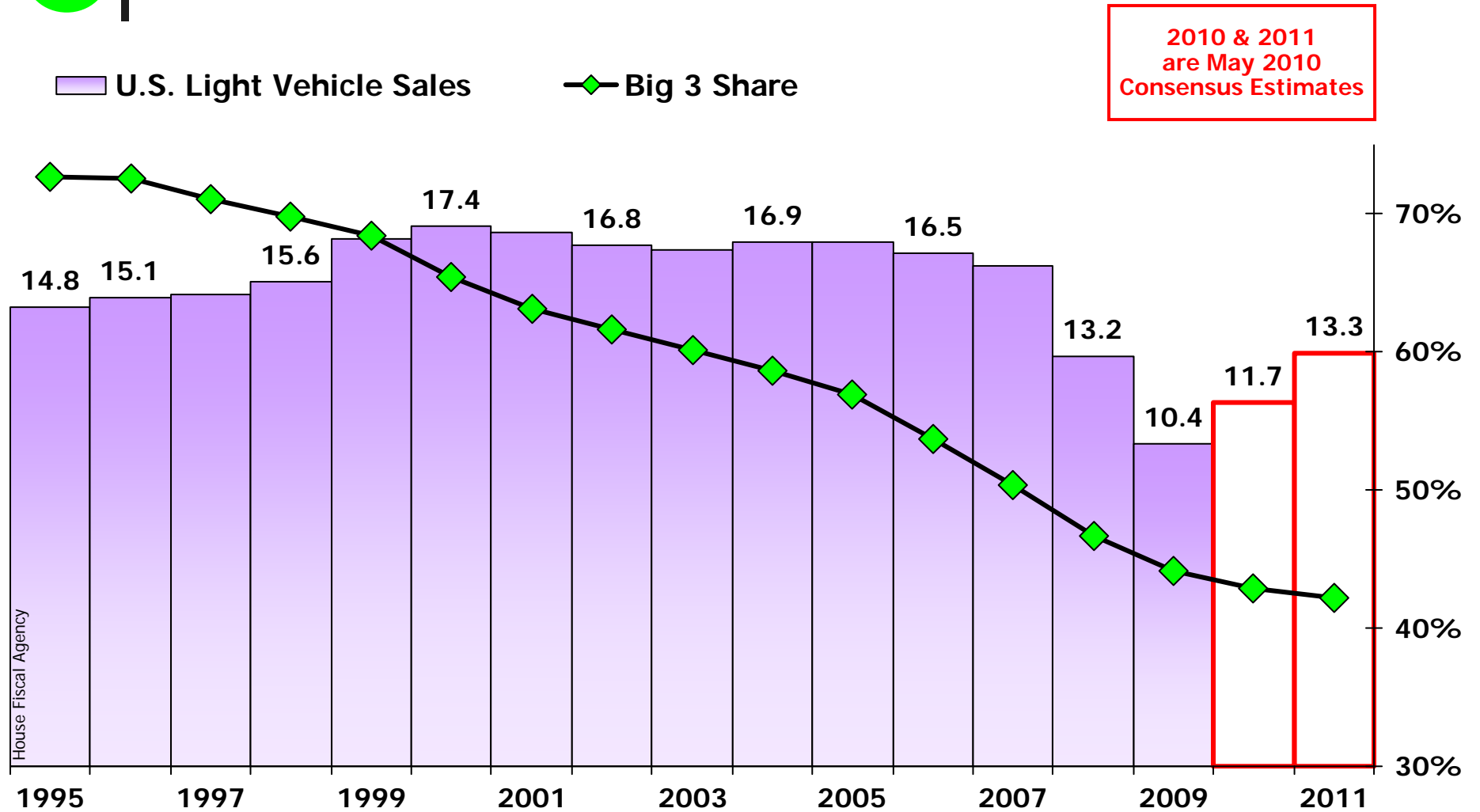


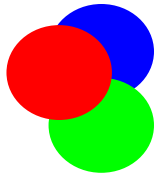
State Budget Shortfalls Caused By

- Severe economic contraction led by domestic auto industry
- State tax policy
- Increasing cost of Medicaid and corrections

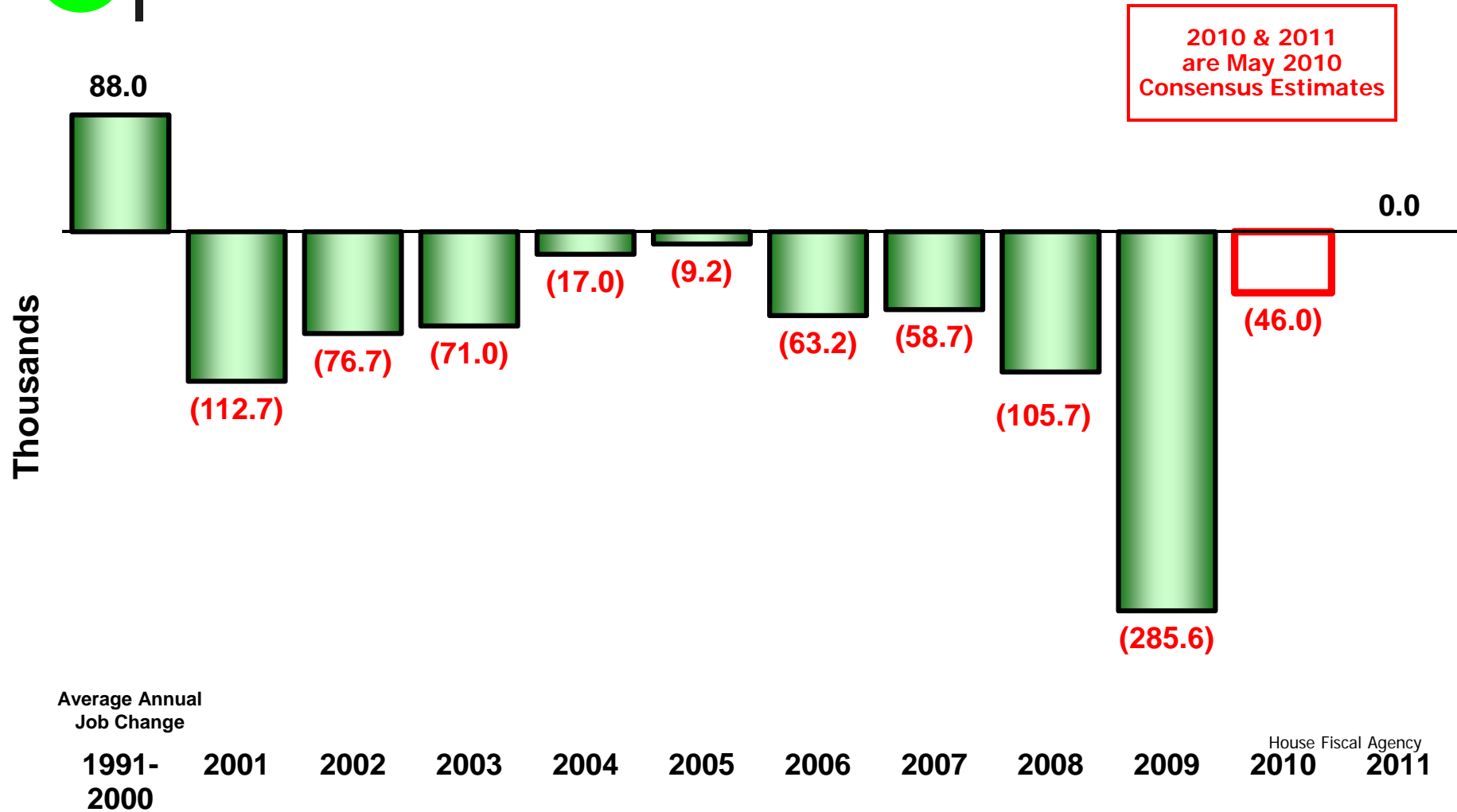


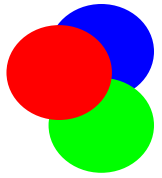
Big 3 Losing Market Share



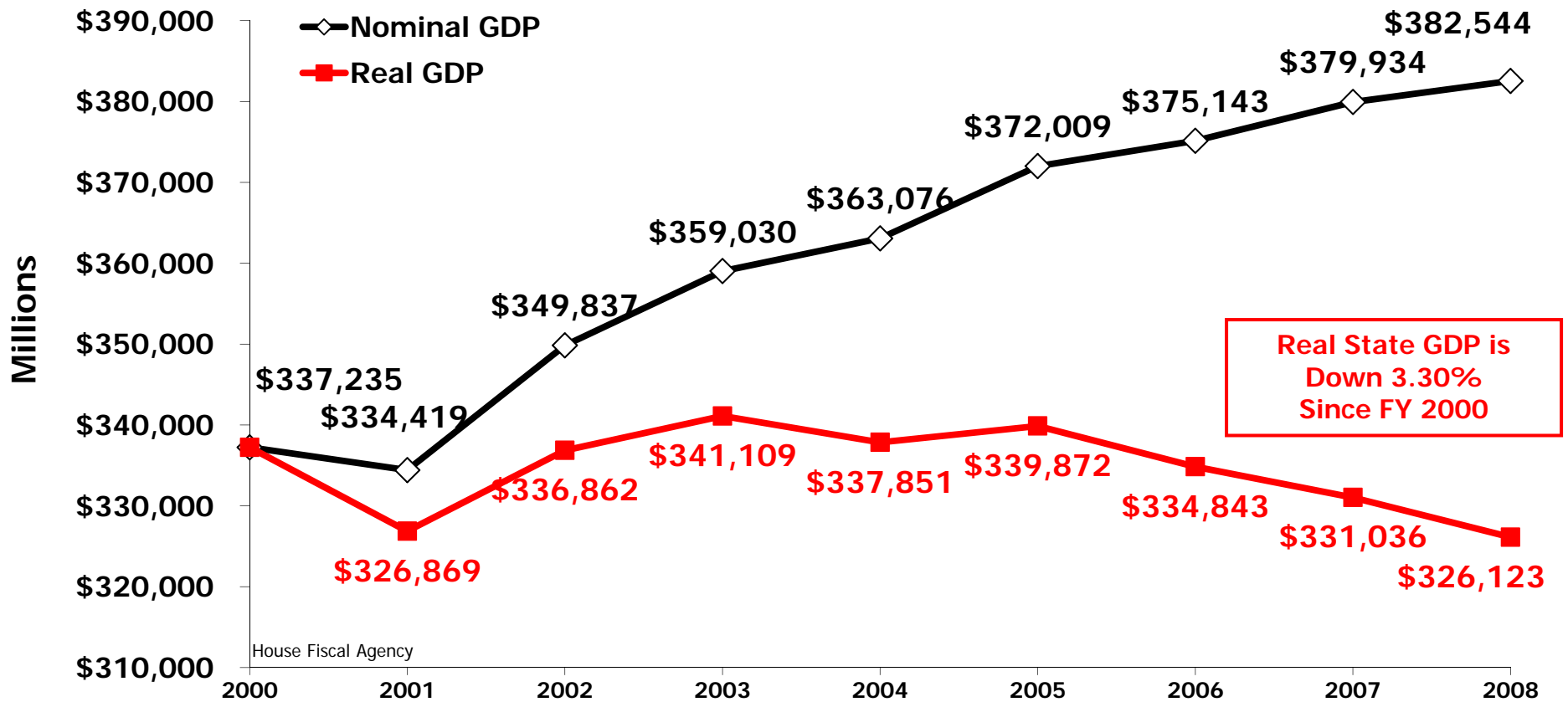


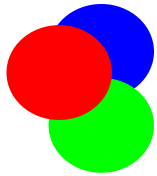
Job Change in Michigan



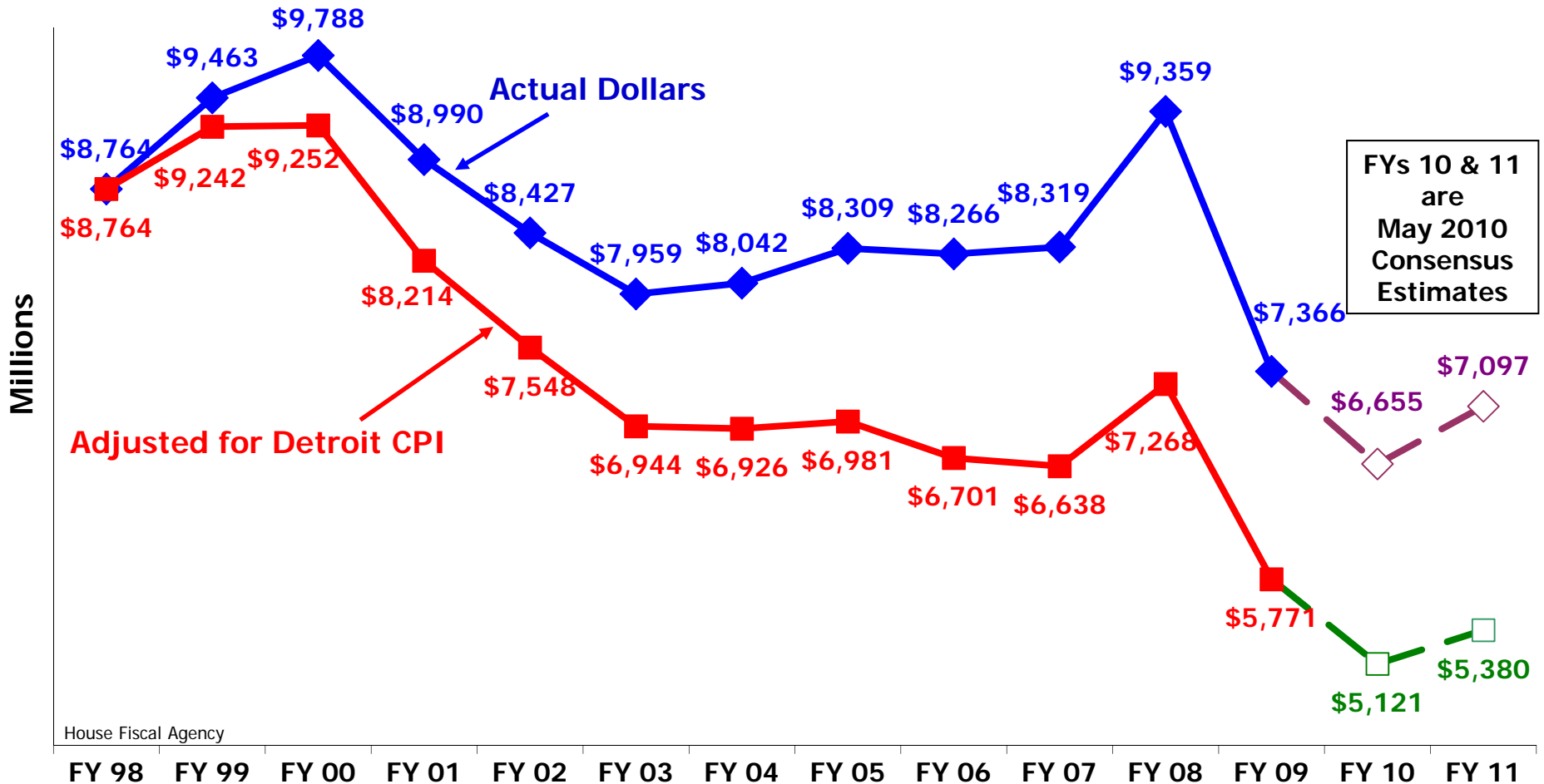


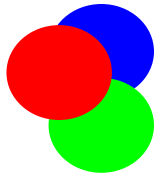
Real and Nominal State GDP



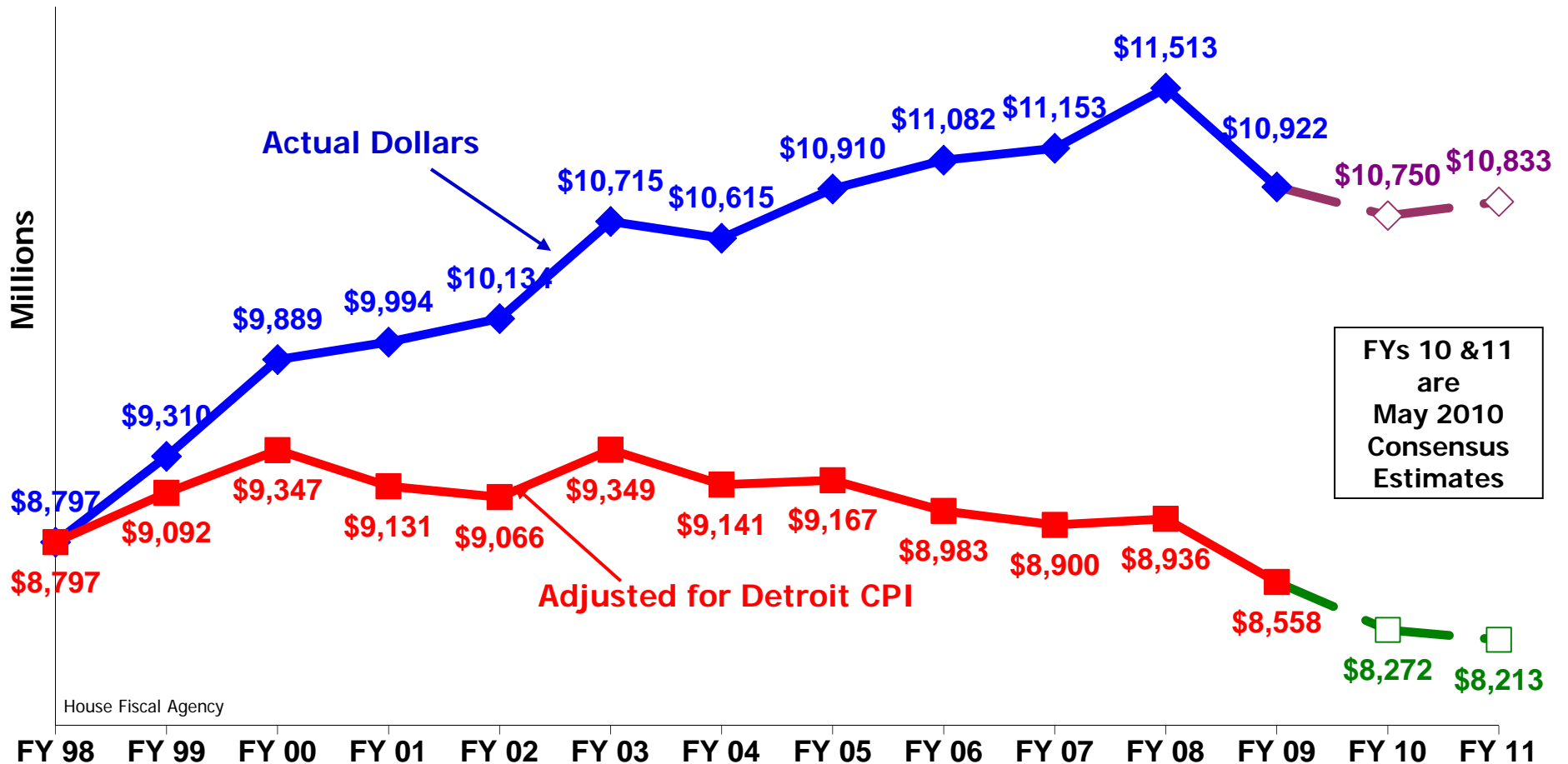


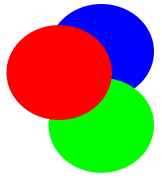
Inflation Adjusted GF/GP Revenue Down 42% Since FY 2000





Inflation Adjusted SAF Net Revenue Down 12% Since FY 2000

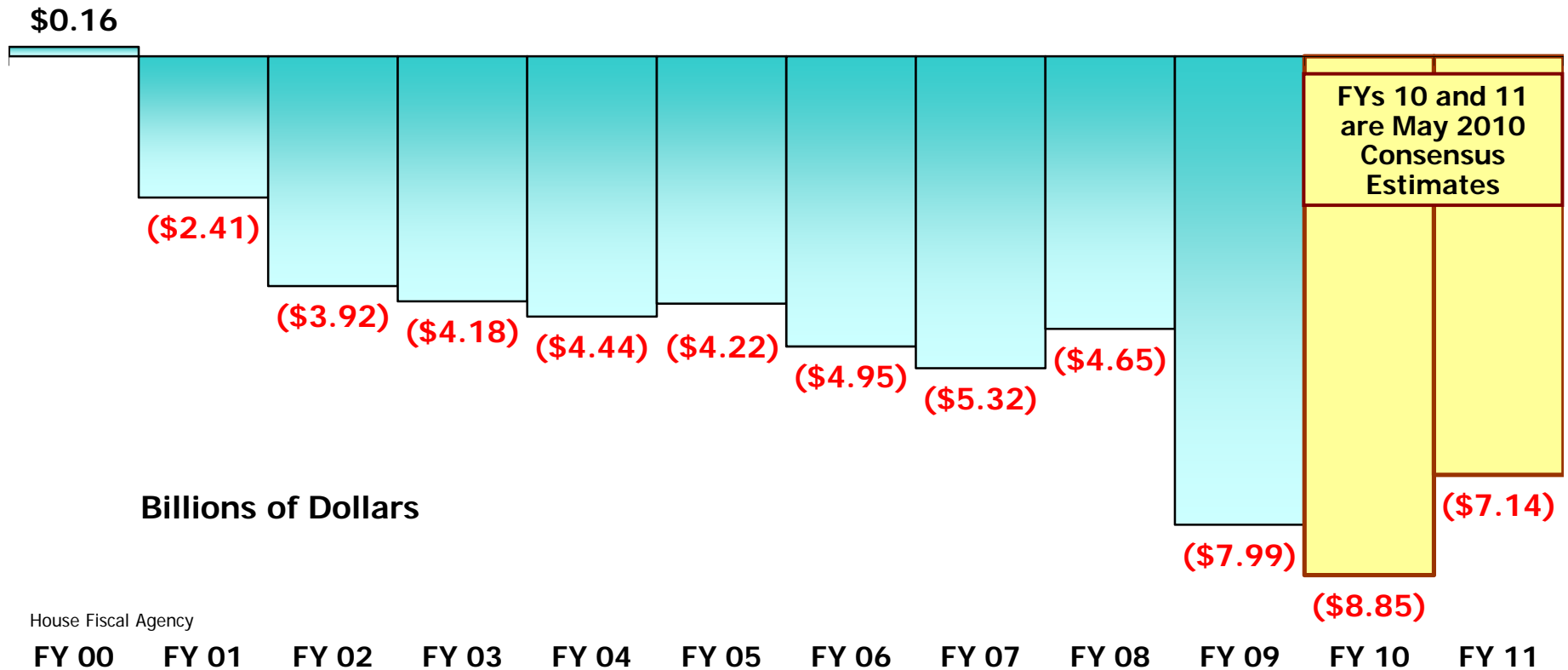




Constitutional Revenue Limit

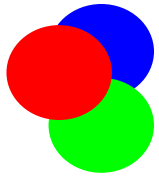
Average growth of Michigan personal income = 1.7% per year from 2000 through 2011

Average decline of Michigan revenue = 0.5% per year from 2000 through 2011

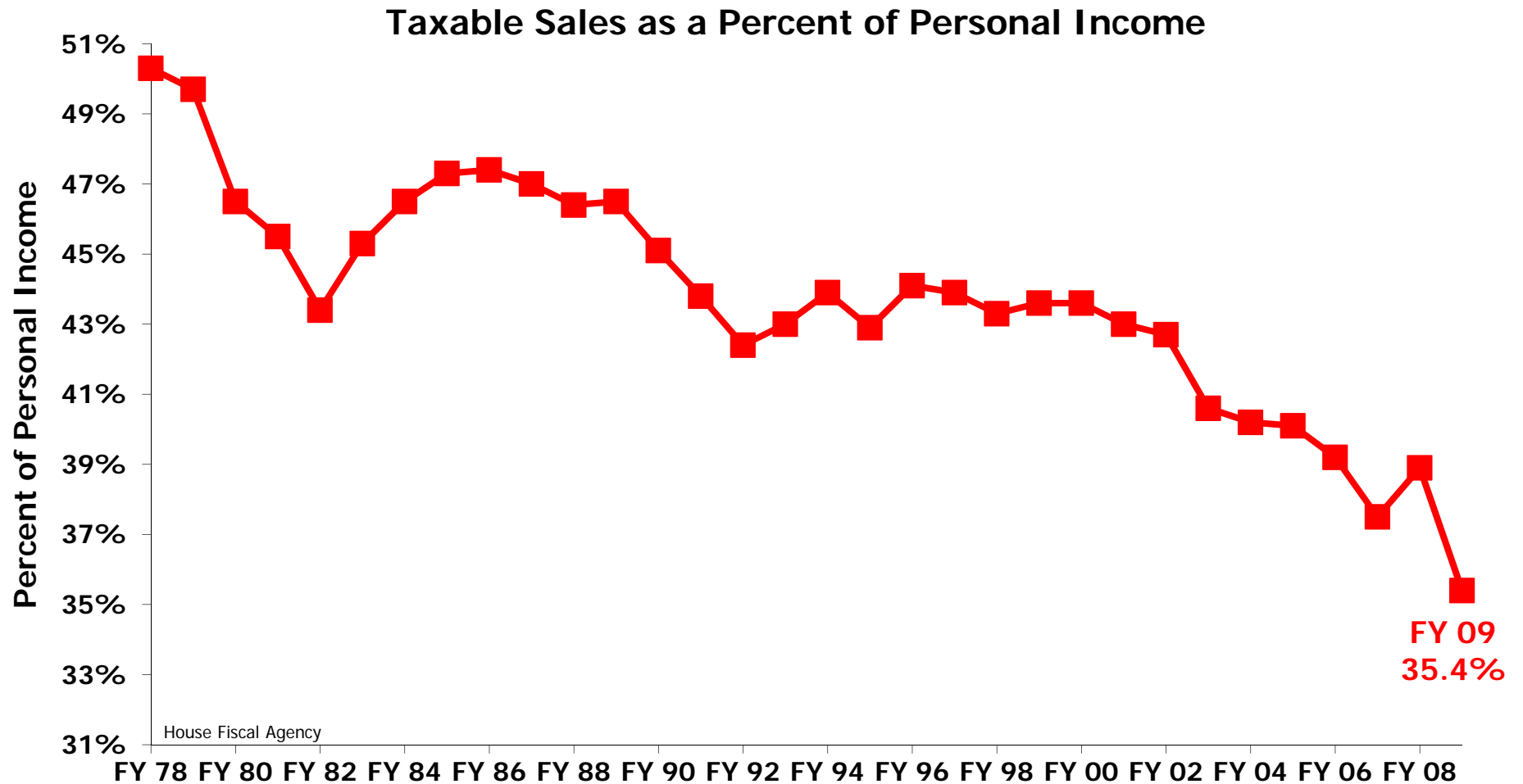


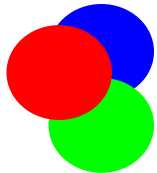
House Fiscal Agency

FY 00 FY 01 FY 02 FY 03 FY 04 FY 05 FY 06 FY 07 FY 08 FY 09 FY 10 FY 11

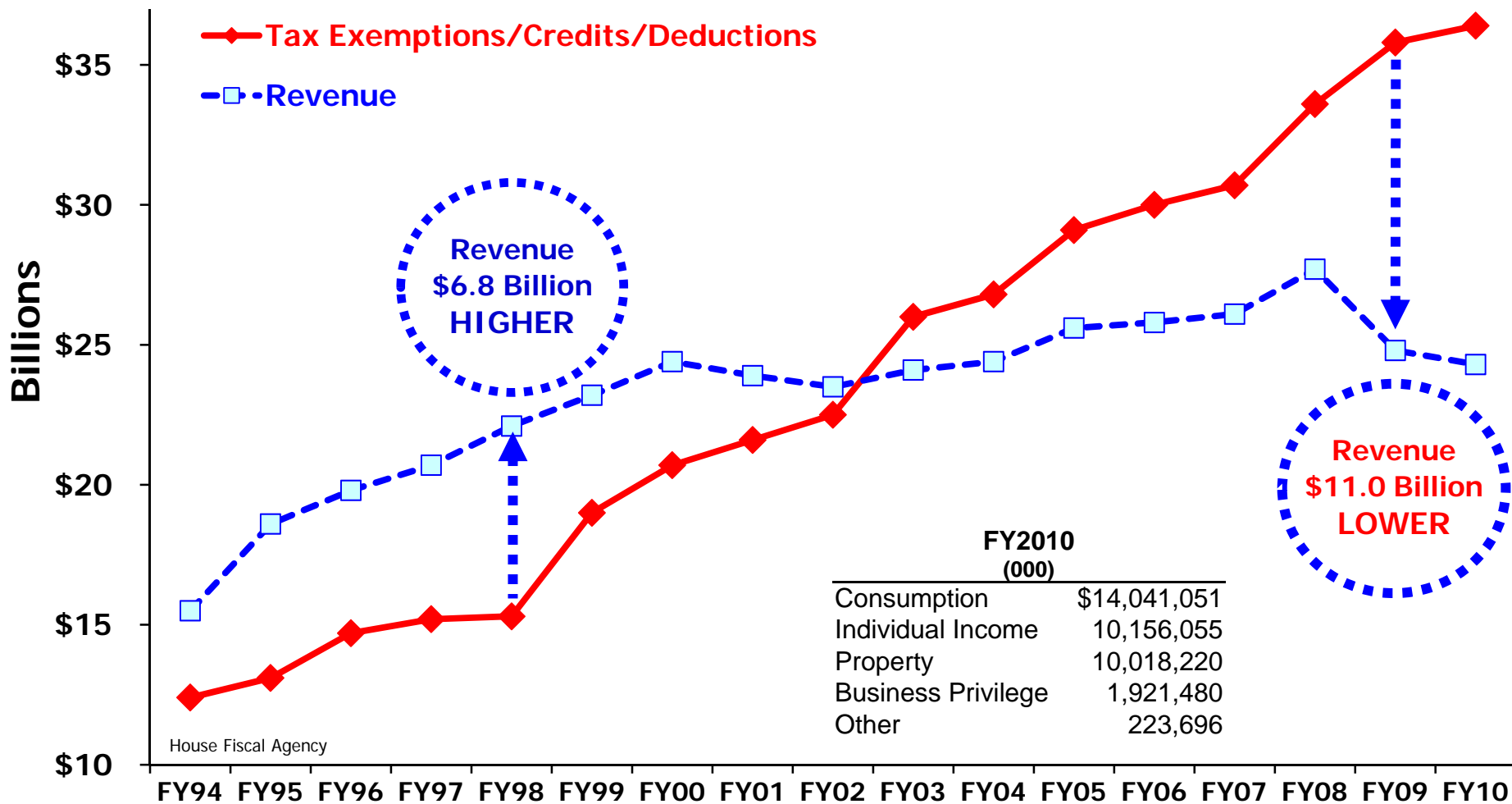


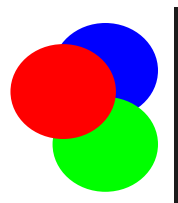
Sales/Use Tax Share Declining





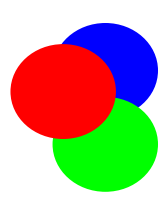
Impact of Tax Exemptions/Credits/Deductions





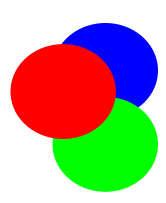
Why Consider Tax Expenditures?

- Tax expenditures are an alternative to direct spending.
- They can be used to effectively continue to spend tax dollars on policy initiatives while the budget is being reduced.
- They're "off-budget" for all practical purposes.
- Transparency and government accountability demand they be reported and evaluated.



Impact of Recent Tax Cuts on Future Revenues

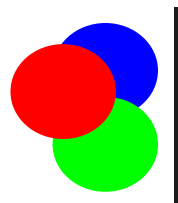
	<u>FY 2009</u>	<u>FY 2010</u>	<u>FY 2011</u>	<u>FY 2012</u>	<u>FY 2013</u>	<u>FY 2014</u>
Reducing Michigan Income Tax Rate	\$0.0	\$0.0	\$0.0	(\$150.0)	(\$329.0)	(\$522.5)
Alternative Energy Credits - Income Tax	(\$16.0)	(\$46.0)	(\$47.0)	(\$42.0)	\$0.0	\$0.0
Michigan EITC	(\$140.0)	(\$325.0)	(\$338.0)	(\$358.3)	(\$379.8)	(\$402.6)
Eliminating MBT Surcharge			Eliminated in Tax Year 2017			
MBT Battery Credits (Assumes Maximum Used)	\$0.0	\$0.0	\$0.0	(\$40.0)	(\$268.0)	(\$278.0)
MBT Film Production Credit	(\$37.5)	(\$100.0)	(\$125.0)	(\$125.0)	(\$125.0)	(\$125.0)
Photovoltaic Technology - Facility & Manufacturing	\$0.0	(\$0.8)	(\$9.8)	(\$12.5)	(\$12.5)	(\$15.0)
Polycrystalline Manufacturing Credit	\$0.0	\$0.0	\$0.0	\$0.0	(\$25.0)	(\$25.0)
MBT Gross Receipt Changes	(\$115.8)	(\$80.5)	(\$93.4)	(\$117.8)	(\$129.9)	(\$132.7)
Decouple Bonus Depreciation/Production Activities	\$172.5	\$23.4	\$19.2	\$45.3	\$52.3	\$60.0
Historic Preservation Credits	\$0.0	\$0.0	(\$5.0)	(\$8.6)	(\$9.6)	(\$10.6)
Promise Zones - SET	\$0.0	(\$1.0)	(\$4.0)	(\$10.0)	(\$15.0)	(\$20.0)
IFT Exemption for Commercial Real Land	\$0.0	(\$2.0)	(\$2.0)	(\$2.0)	(\$2.0)	(\$2.0)
Use Tax Bad Debt Deduction Change (Court Case)	(\$2.0)	(\$25.5)	(\$16.6)	(\$17.1)	(\$17.7)	(\$18.4)
Exempt Supplies for Cobo Center	\$0.0	\$0.0	(\$2.5)	(\$2.5)	(\$3.5)	(\$1.5)
Totals in Millions	(\$138.8)	(\$557.4)	(\$624.1)	(\$840.5)	(\$1,264.7)	(\$1,493.3)



Potential GF/GP Base Revenue (millions)

	Consensus <u>FY 2011</u>	<u>FY 2012</u>	<u>FY 2013</u>	<u>FY 2014</u>
Baseline Revenue				
* Assume 3% Growth	\$6,968.4	\$7,177.5	\$7,392.8	\$7,614.6
Adjust for Tax Change Not Built Into FY 2011	N/A	(\$194.4)	(\$591.5)	(\$789.1)
Net GF/GP Revenue	N/A	\$6,983.1	\$6,801.3	\$6,825.5
Percent Change from Prior Year	N/A	0.2%	(2.6%)	0.4%

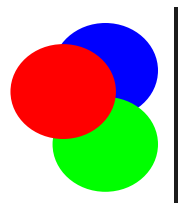
* Note: 3% baseline growth has not been achieved since 2000.



Impact of Shrinking Tax Base

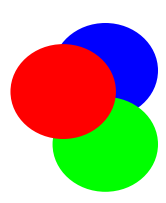
	<u>Income Tax Rate</u>	<u>Collections as Percent of State Personal Income</u>
FY 2000	4.0%	2.6%
FY 2010	4.35%	1.5%
Revenue Impact of Declining Base (In Millions of Dollars)		\$3,653.50

	<u>Sales and Use Tax Rate</u>	<u>Collections as Percent of State Personal Income</u>
FY 2000	6.0%	2.8%
FY 2010	6.0%	2.1%
Revenue Impact of Declining Base (In Millions of Dollars)		\$2,511.60



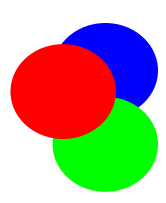
Fewer People Pay Income Tax

<u>All Filers</u>	<u>2000</u>	<u>2008</u>
Tax Liability < \$0	19.5%	25.6%
Tax Liability = \$0	8.0%	8.0%
Tax Liability < \$100	33.6%	38.6%



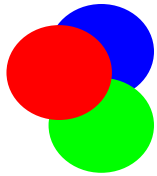
Refundable Credits on the Michigan Income Tax

- Homestead Property Tax Credit (\$987.5 million in FY2009-10)
- Earned Income tax Credit (\$333.0 million in FY2009-10)
- Alternative Energy/Qualified Home Improvement Credit (\$46.0 million in FY2009-10)
- Adoption Credit (\$1.0 million in FY2009-10)
- Stillbirth Credit (\$41,000 in FY2009-10)



Indexed Provisions of the Michigan Income Tax

- Personal Exemption
- Special Exemptions for Seniors and/or Disabled Individuals
- Special Exemption for Qualified Disabled Veterans
- Income Threshold for Pension Income Deduction
- Income Threshold for Deduction of Interest and Capital Gains Earned by Seniors
- Home Heating Credit
- Stillbirth Credit

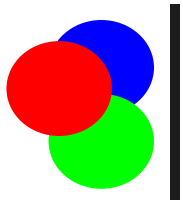


PROBLEM: The State tax base is not stable and will not support any level of service for long.

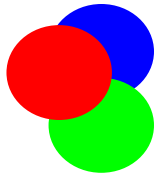
SOLUTION: Stabilize the tax base at some level – higher, lower, or revenue neutral by doing the following.

- **Reduce or eliminate as many tax expenditures as possible and lower marginal rates as much as possible.**
- **Institute a Sunset Commission that officially reviews economic development incentives on a regular basis.**
- **Institute a Peer Review process using M.S.U., U of M, and the Upjohn Institute to verify the expected impact of economic development incentives.**
- **Institute a Pay-As-You-Go system to identify spending cuts or revenue increases to fund program expansions and new tax expenditures.**

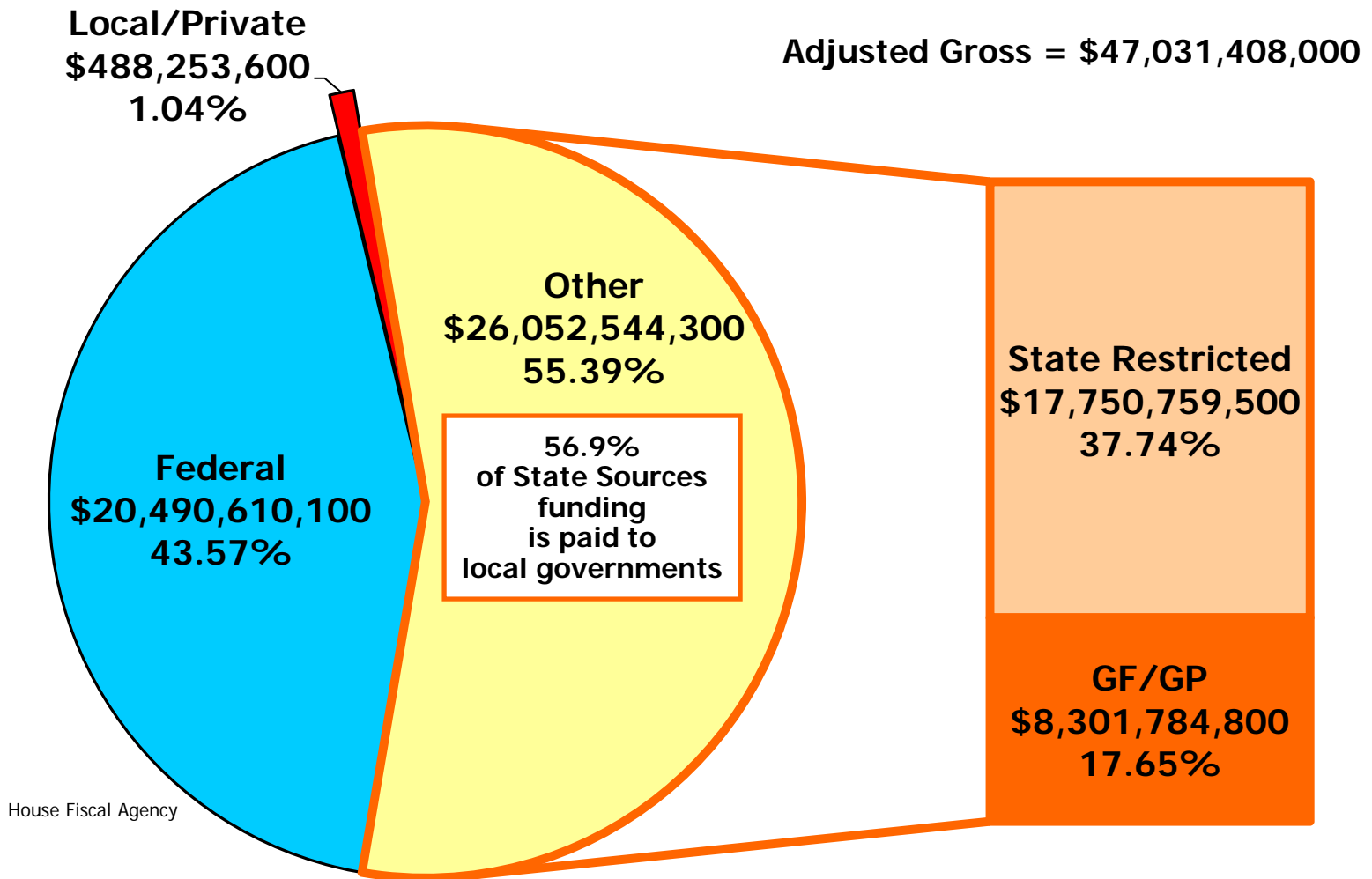
The same principles apply to a flat tax and a graduated tax. The "Best" tax system is a diverse set of taxes that are stable, simple to understand, and easy to comply with. The tax base would be as broad as possible, and marginal rates as low as possible.

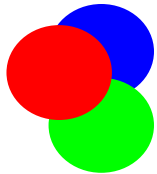


MICHIGAN'S BUDGET



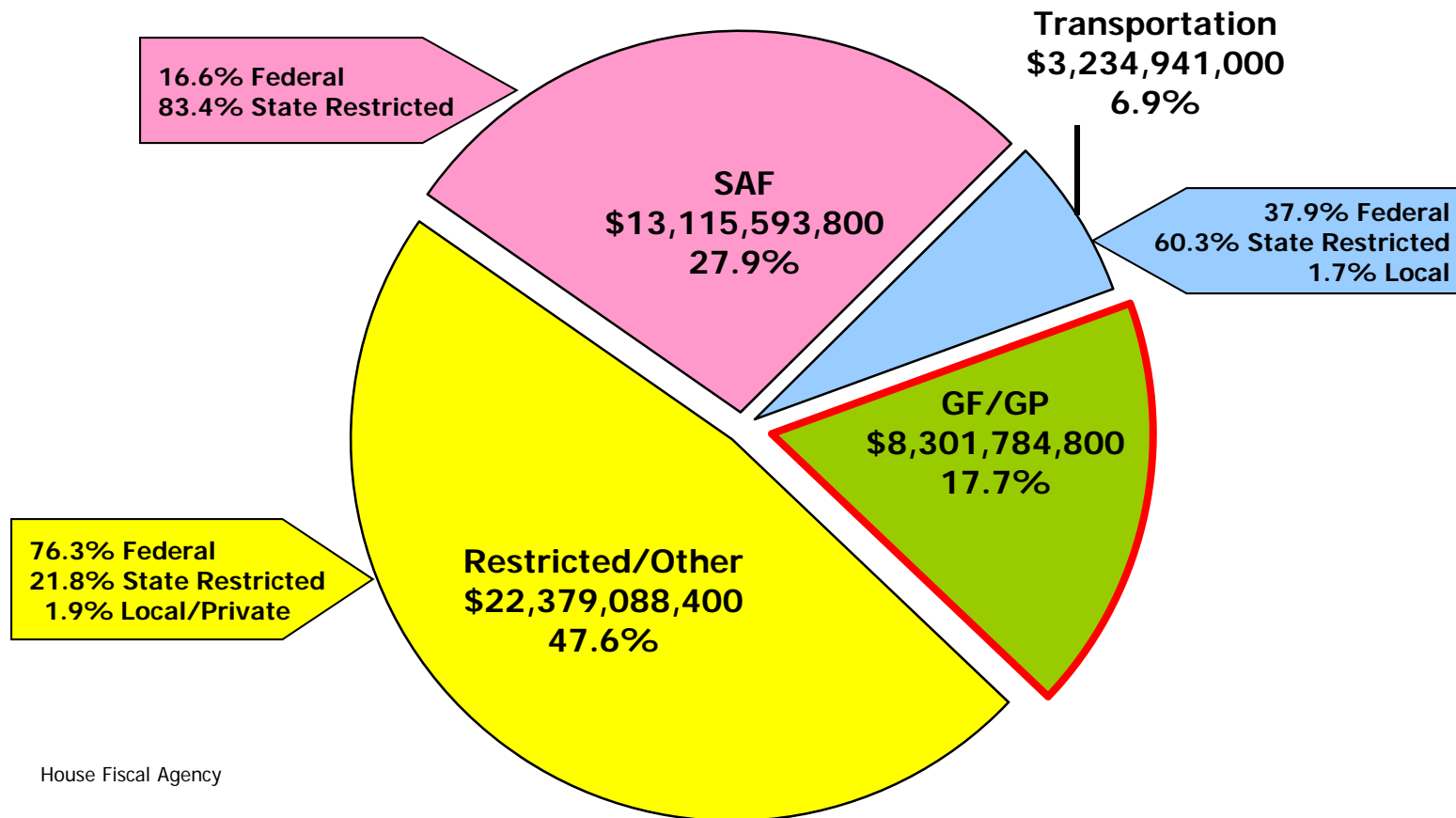
FY 2010-11 Budget Adjusted Gross Funding Sources



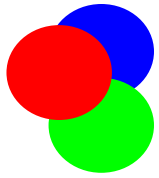


FY 2010-11 Appropriations Funding

Adjusted Gross = \$ 47,031,408,000

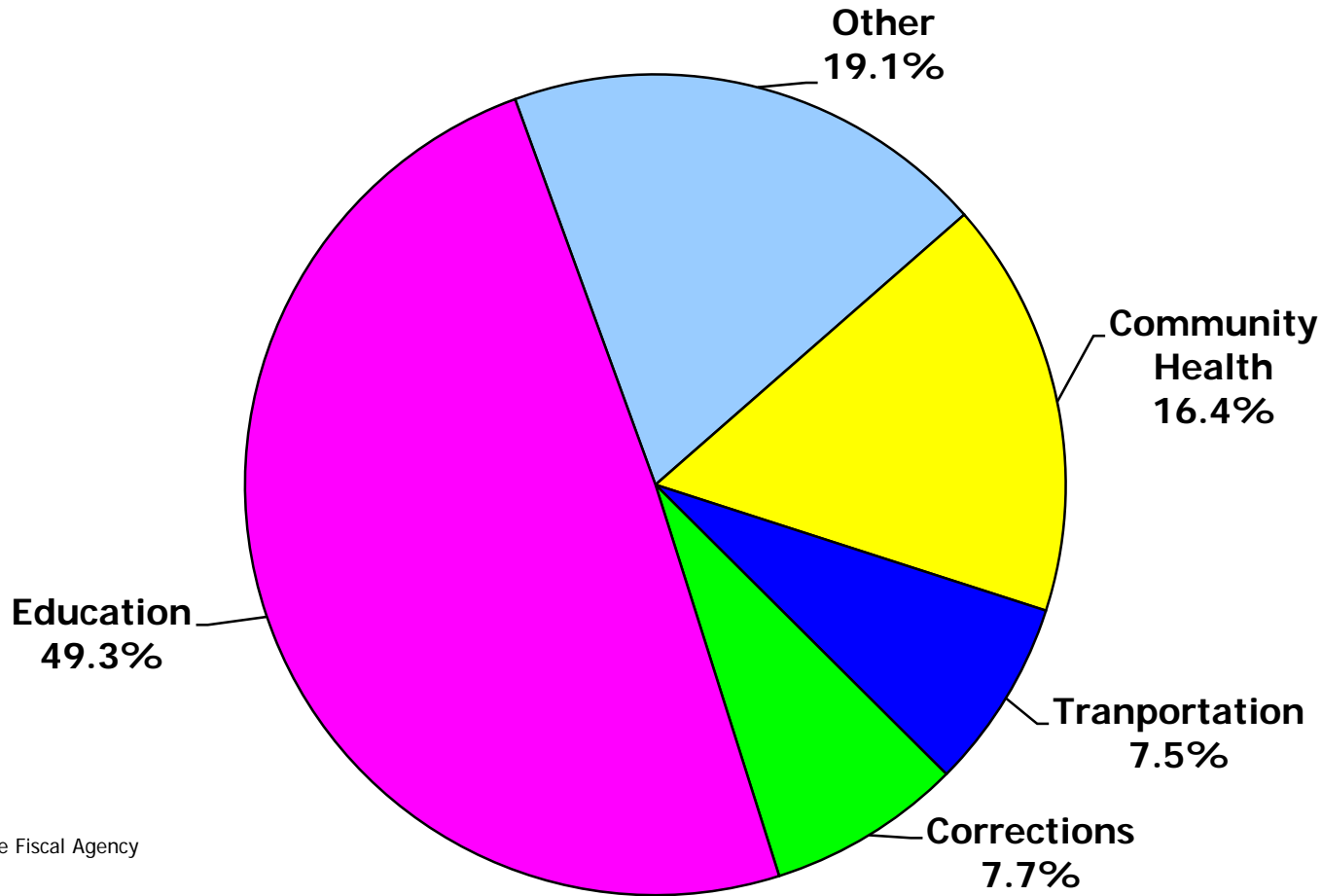


House Fiscal Agency

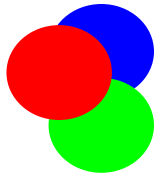


State Taxes and Fees FY 2010-11

FY 2010-11 Total = \$26,052,544,300

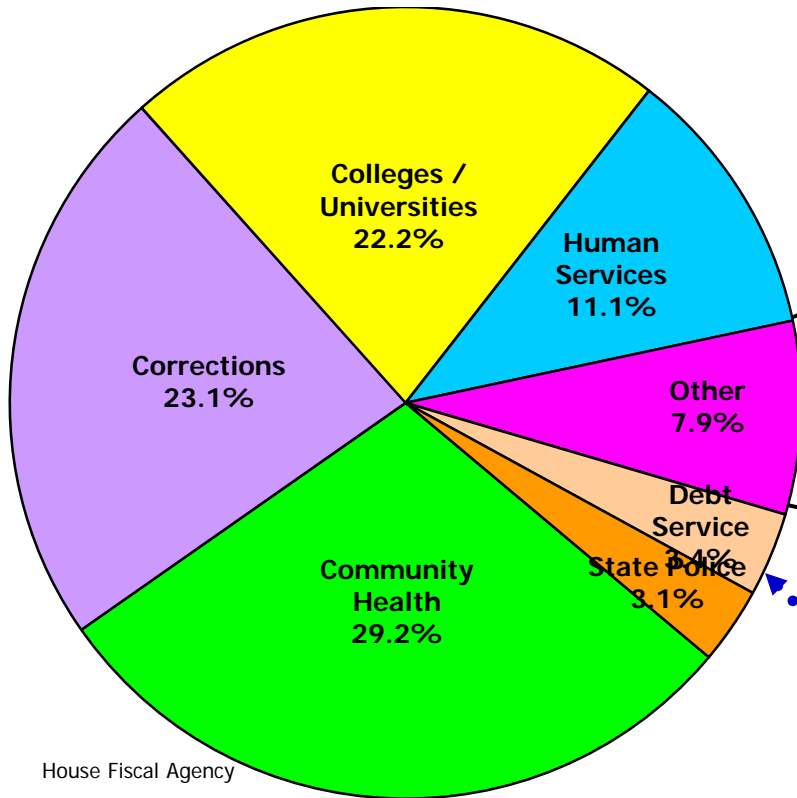


House Fiscal Agency

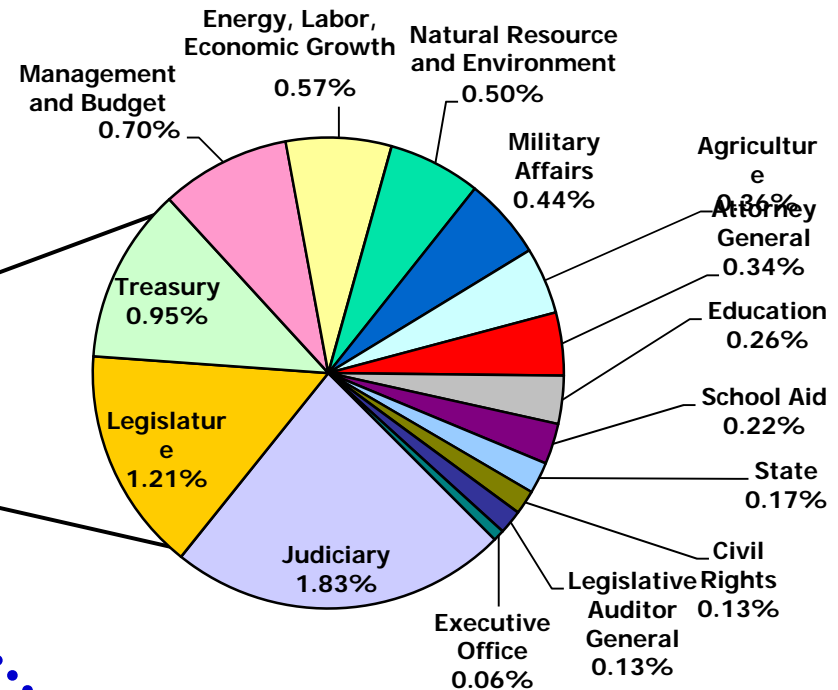


FY 2010-11 GF/GP

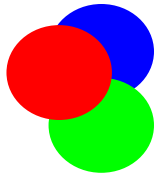
FY 2010-11 Total = \$8,301,784,800



House Fiscal Agency



3.4%
\$284 million
Debt Service and SBA Rent

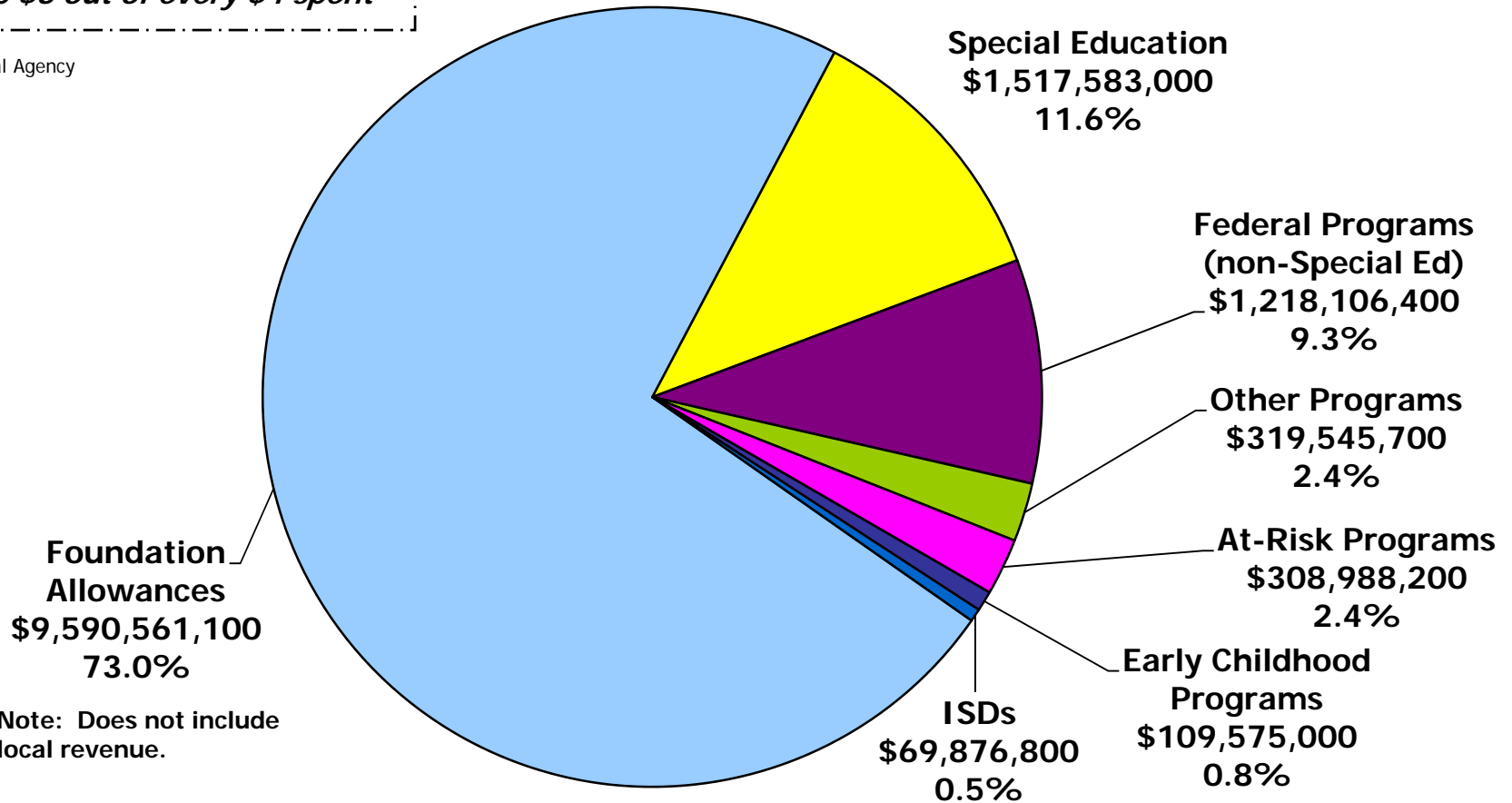


School Aid Major Spending Categories

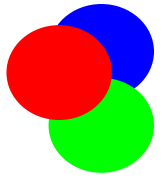
*Foundation allowances
(used for school operations)
absorb \$3 out of every \$4 spent*

House Fiscal Agency

FY 2010-11 Total = \$13,134,236,200

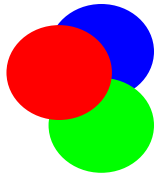


Note: Does not include local revenue.

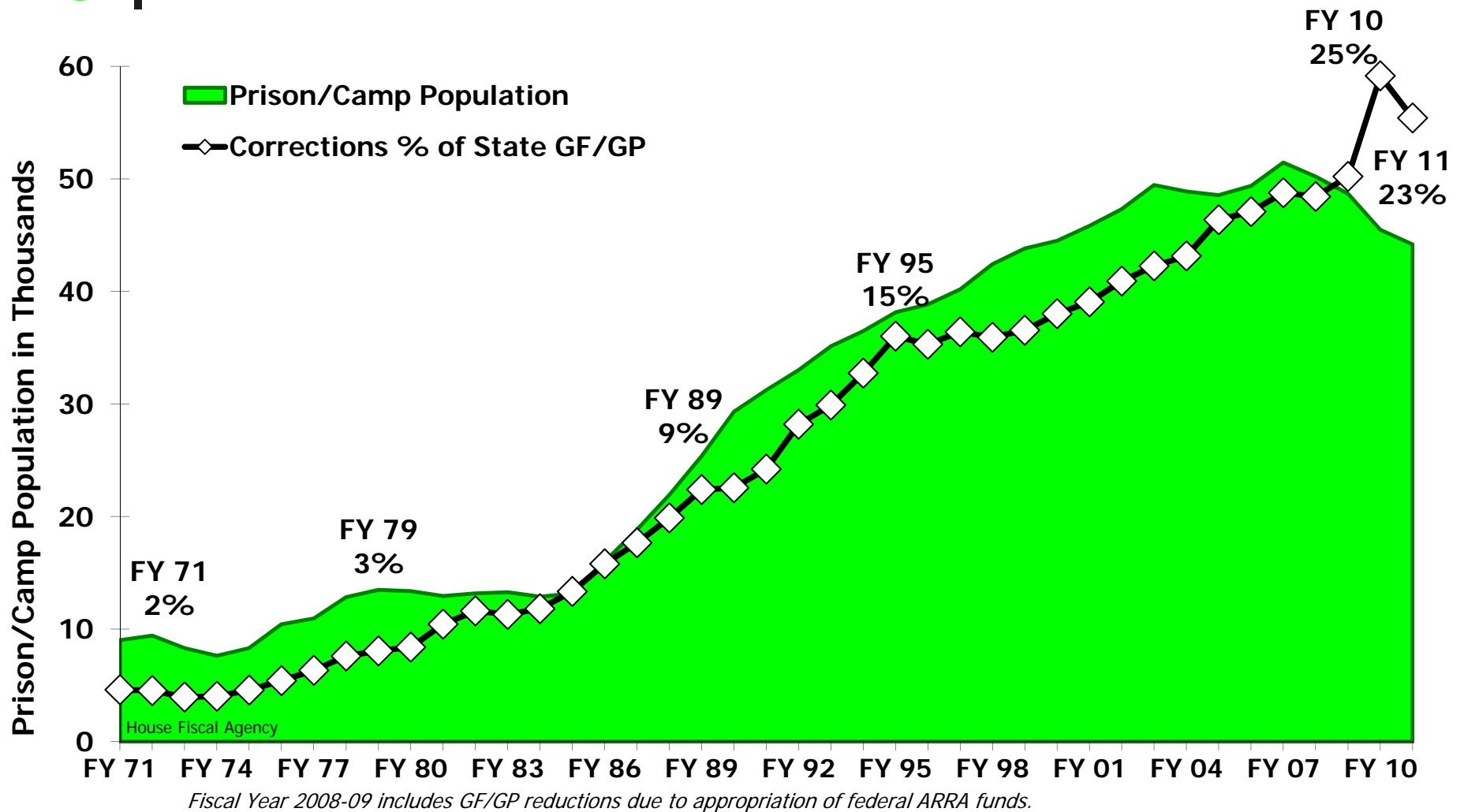


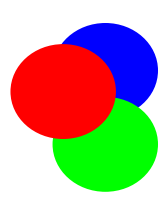
Medicaid Impact on Michigan Budget

- For FY 11, approximately 19.1% of Michigan GF/GP revenue is appropriated for Medicaid
- 1 of 6 Michigan residents were eligible for Medicaid in April 2009
- 42% of births and 70% of nursing home expenditures in Michigan are financed through Medicaid
- Total state and federal Medicaid appropriation is over \$11.5 billion in FY 11
- Since FY 1999-2000
 - 126.5% increase in Medicaid funding
 - 71.5% growth in Medicaid caseload (759,800 cases)



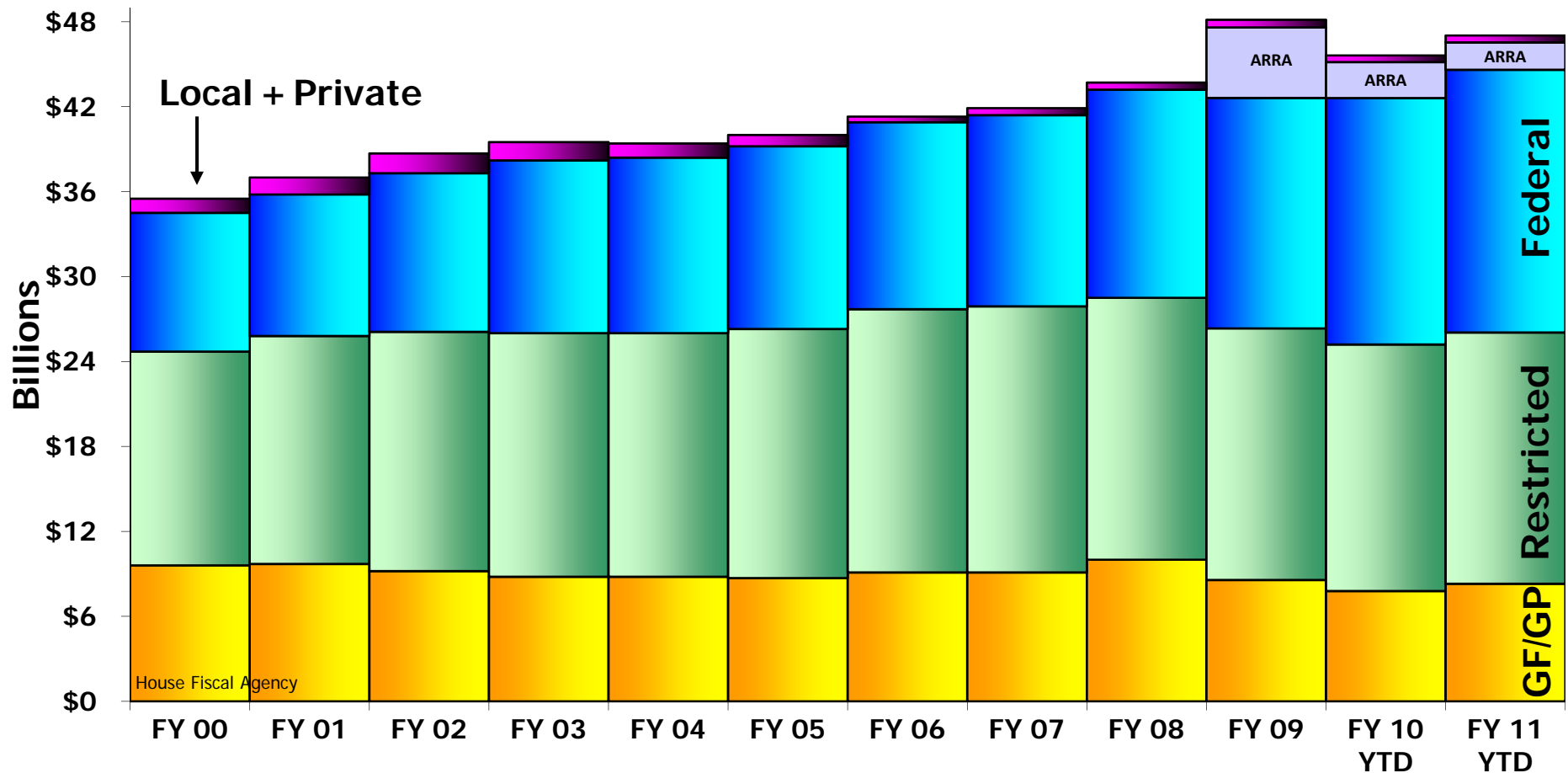
Corrections Budget Increases

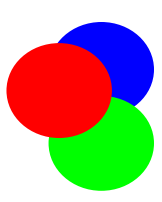




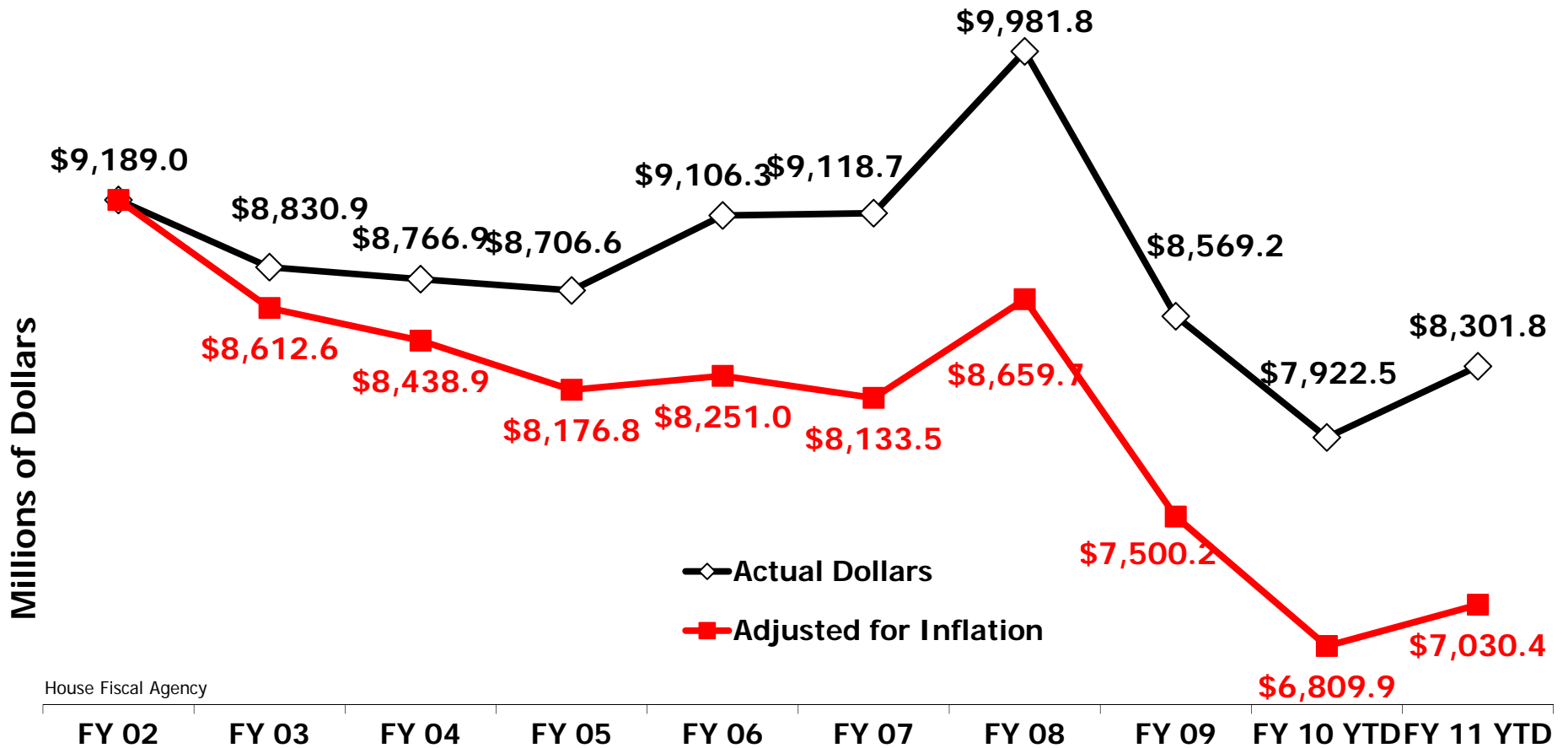
Adjusted Gross Appropriations by Fund Source

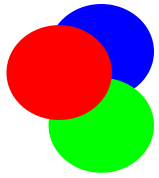
Excluding federal funds, FY 00 = FY 10 adjusted gross appropriations



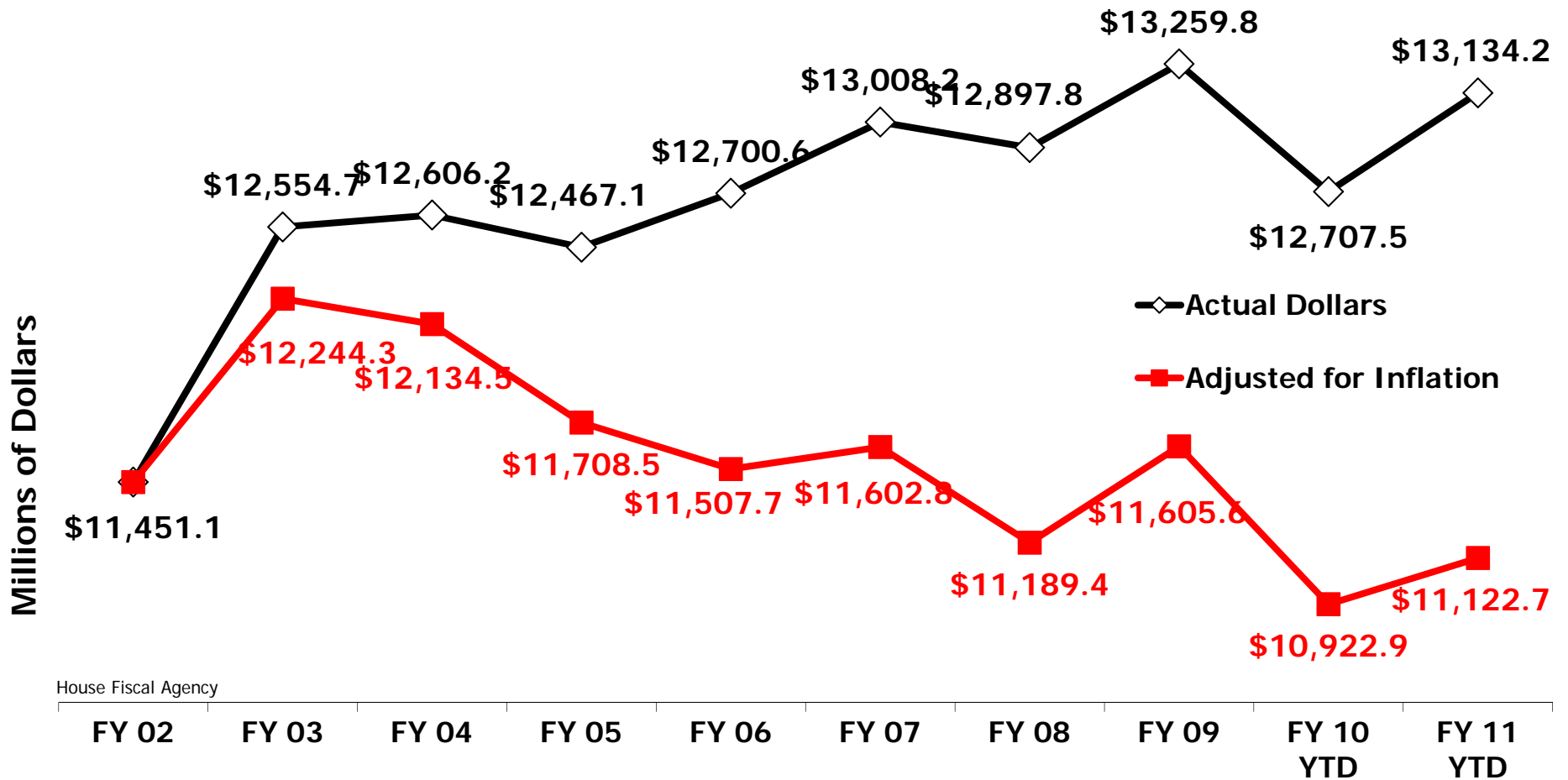


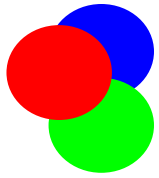
GF/GP Appropriations



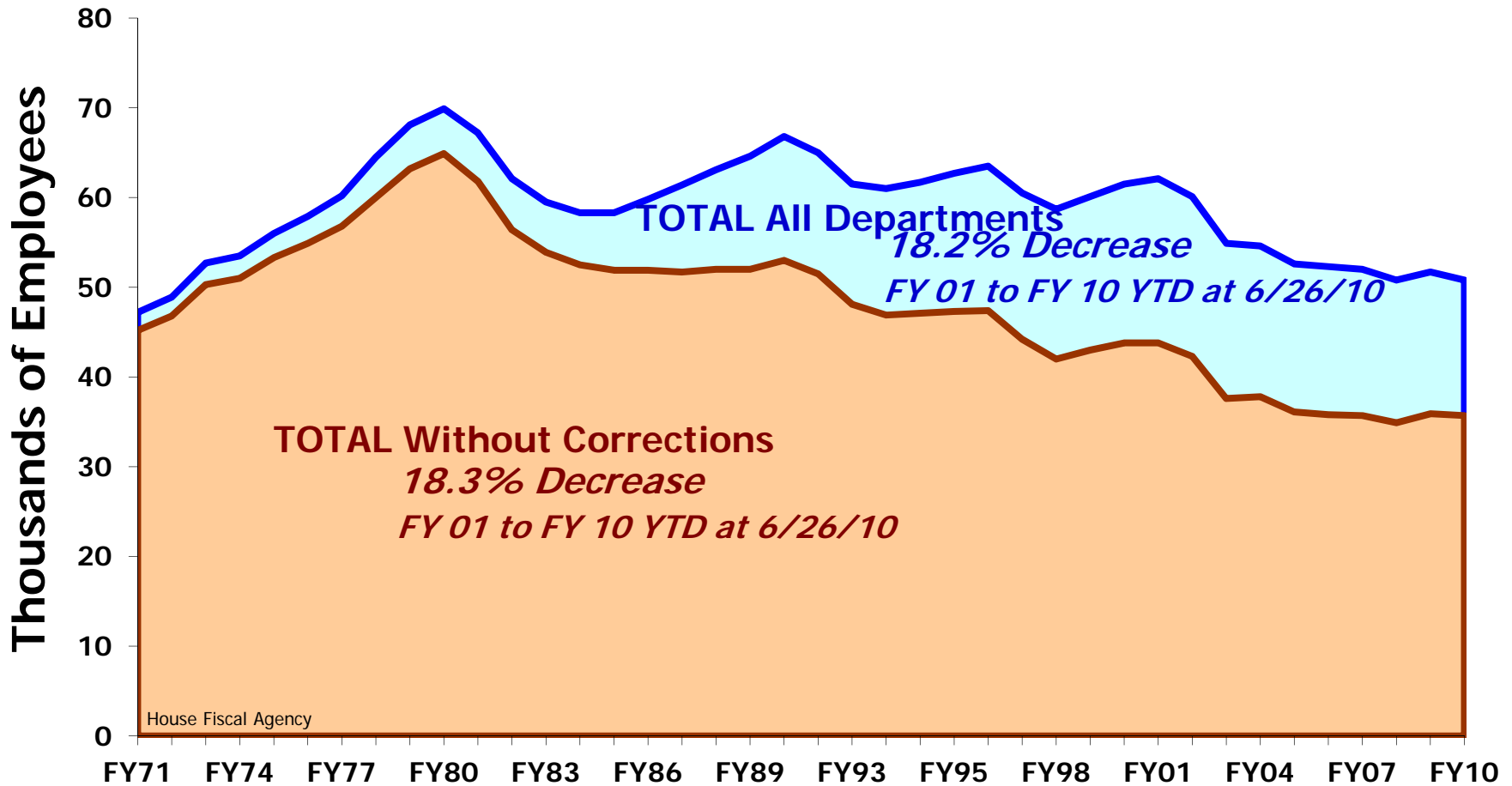


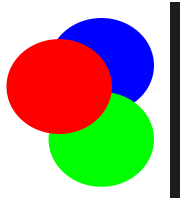
School Aid Budget Adjusted Gross Appropriations



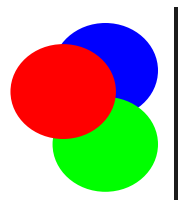


Average Number of Classified State Employees



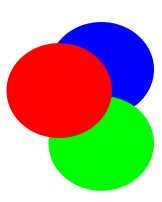


CURRENT ISSUES

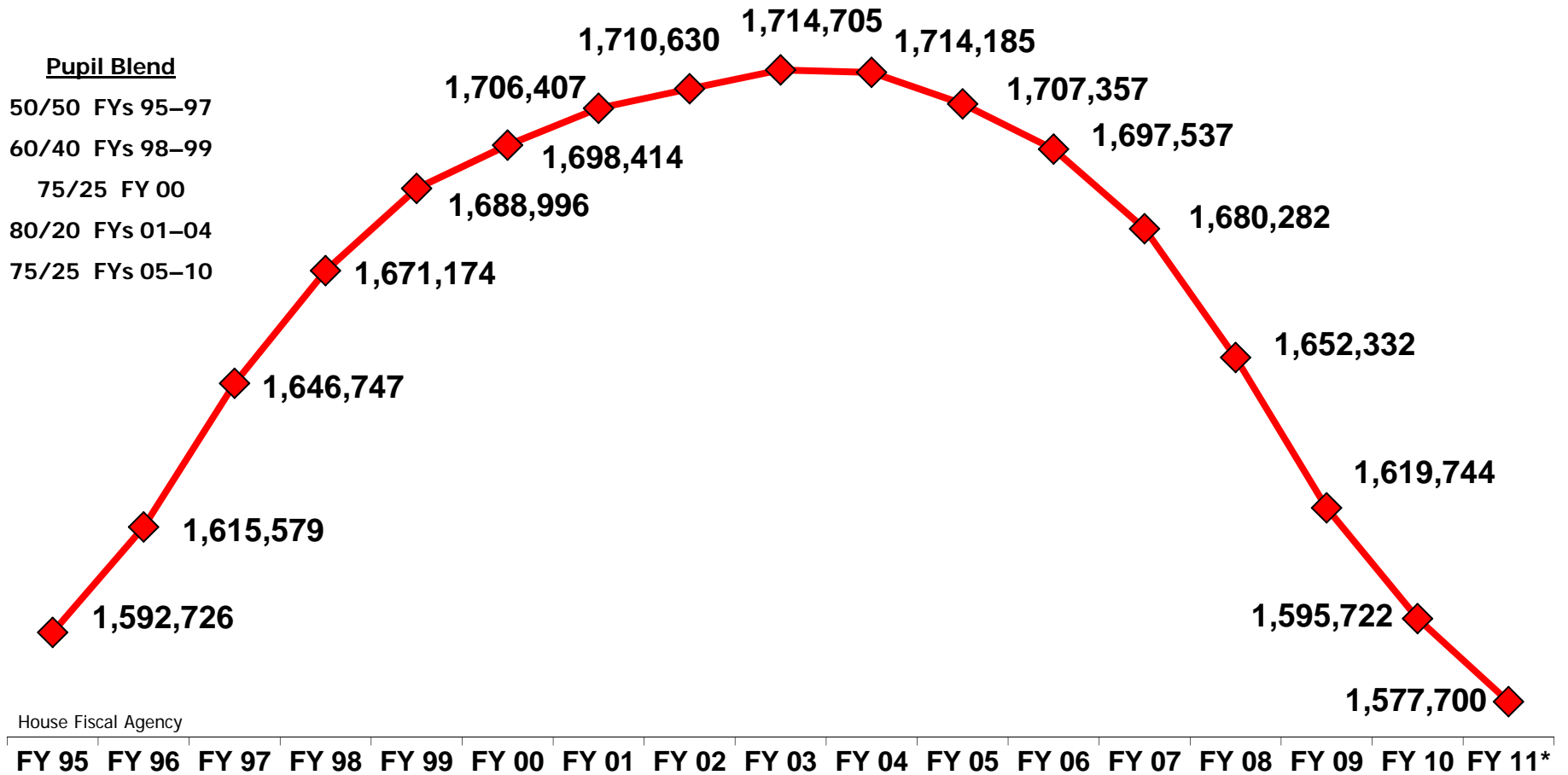


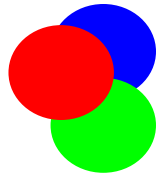
Major School Aid Issues

- Funding levels
- Declining enrollment
- Deficit districts
- Retirement costs
- Infrastructure financing
- Local property taxes

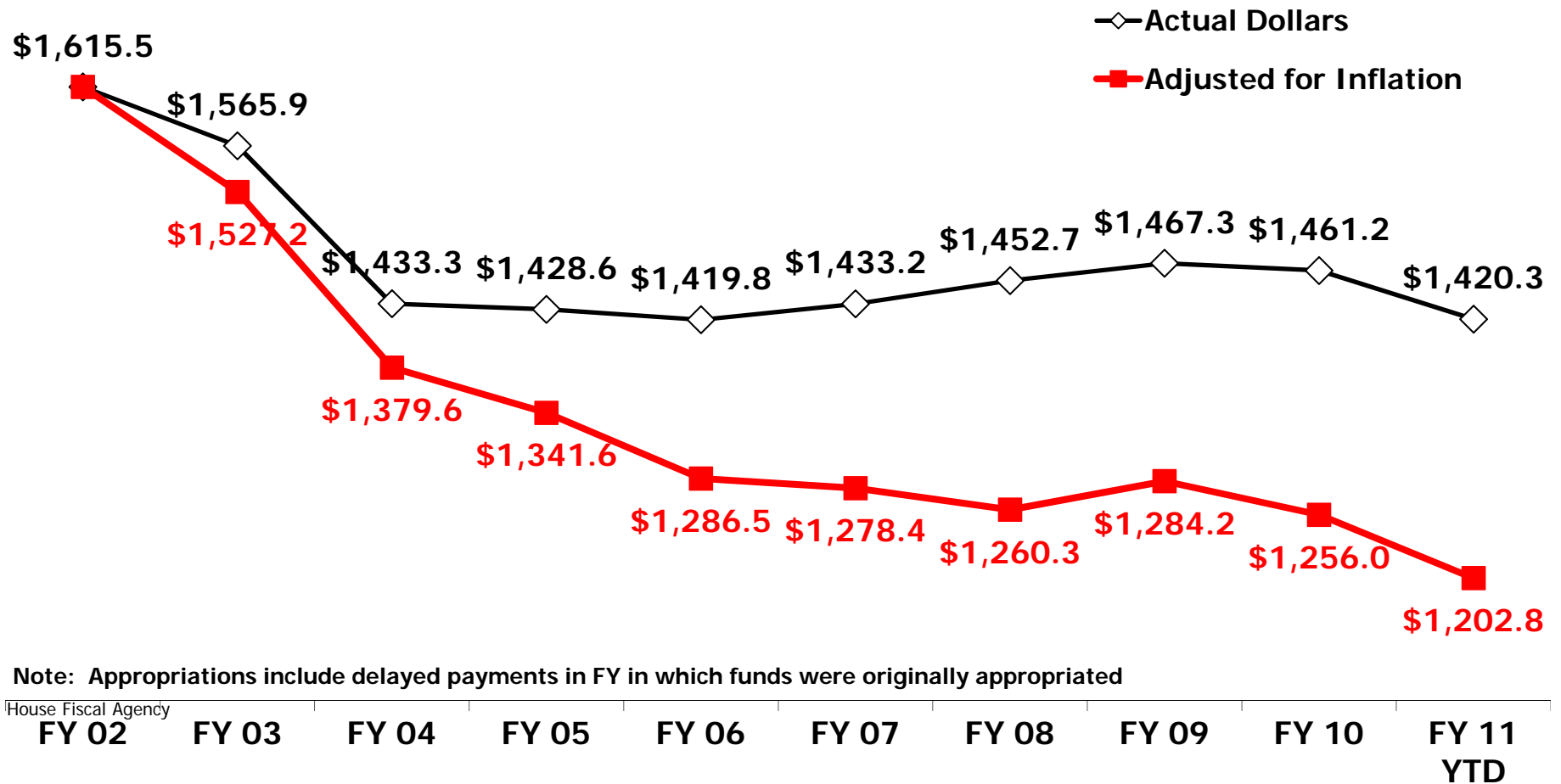


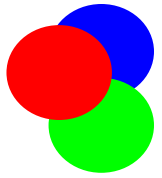
Total Membership Pupil Counts



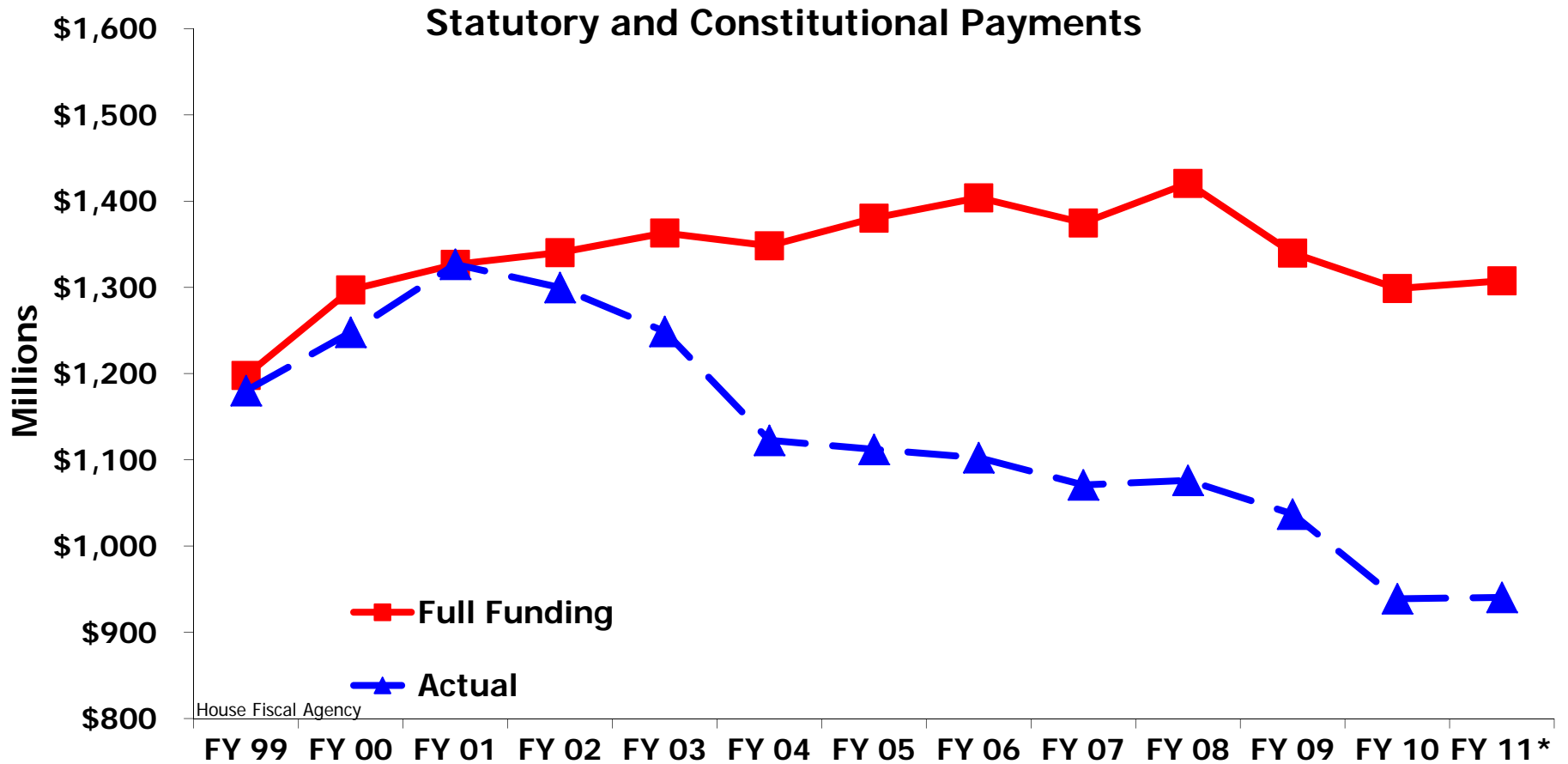


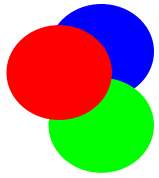
Total Appropriations for State University Operations



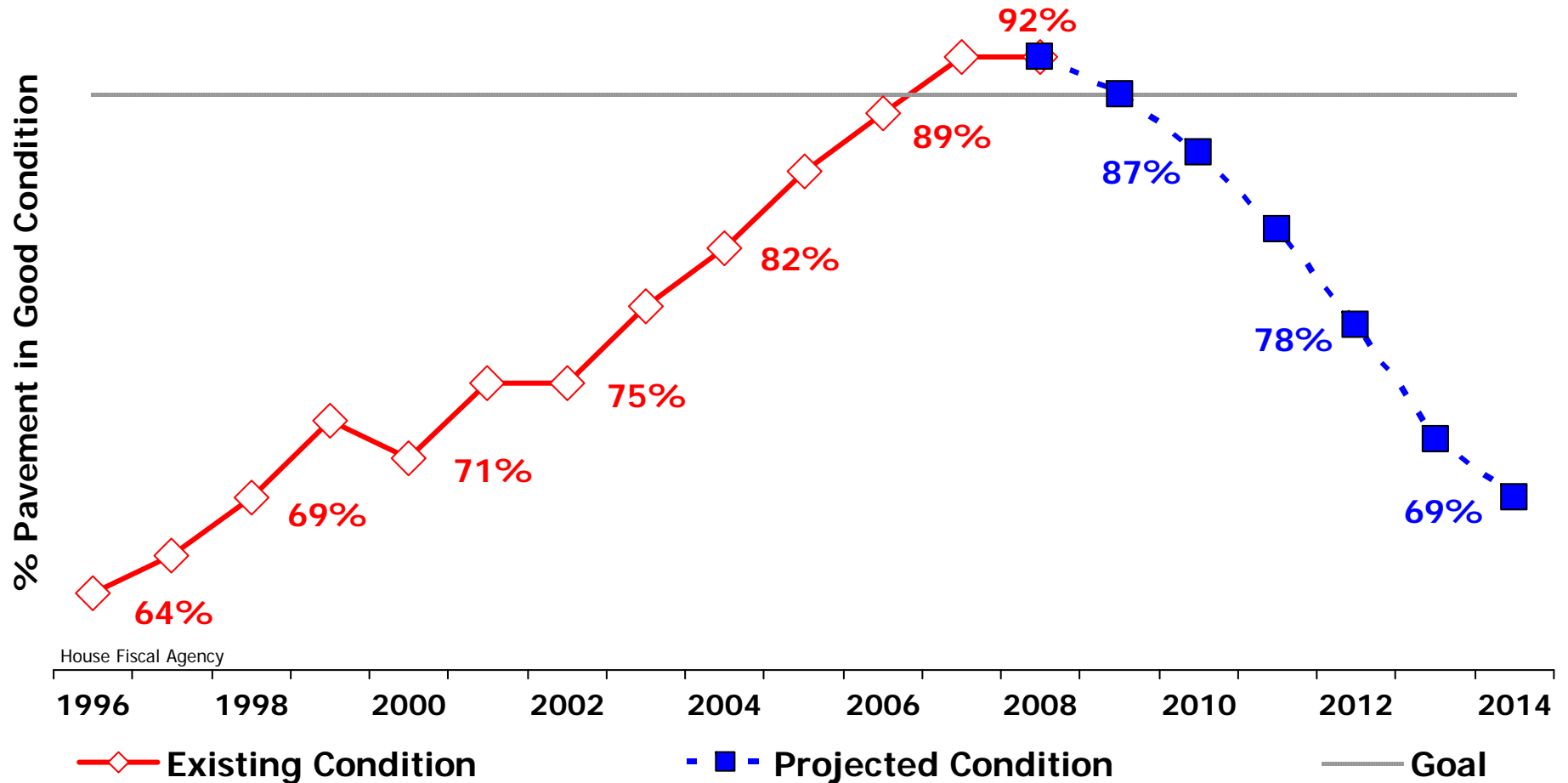


Revenue Sharing Payments to Cities, Villages, and Townships

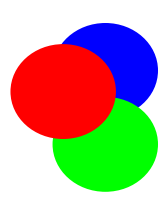




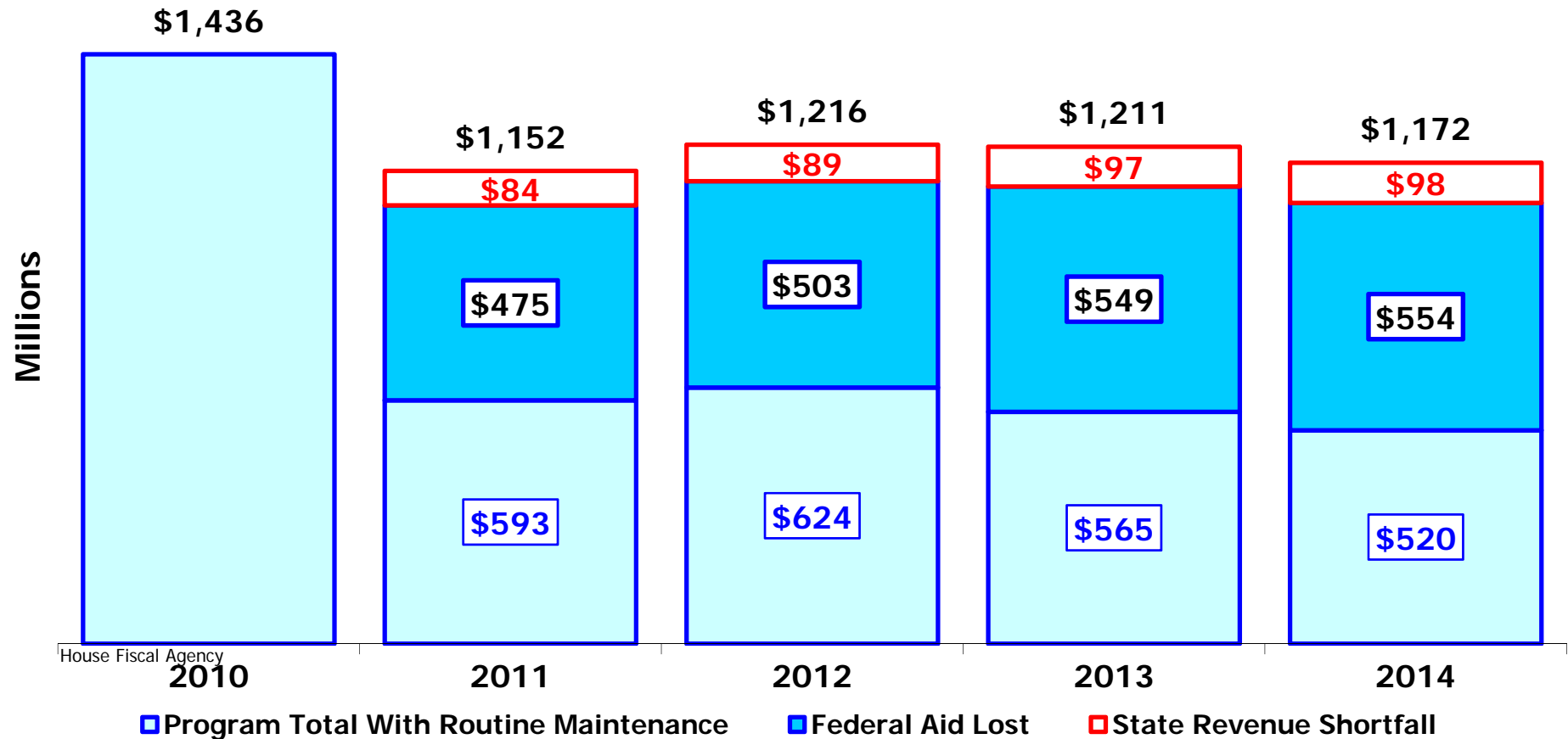
Statewide Pavement Condition Combined Freeway and Non-Freeway



House Fiscal Agency



Reduced State Revenue May Lead to Loss of Federal Aid



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