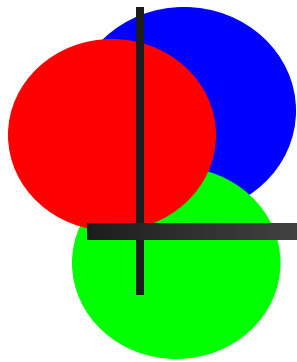


# A Problem 10 Years in the Making

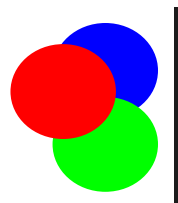


**Prepared for:  
Michigan Political Leadership Program**

**February 26, 2011**

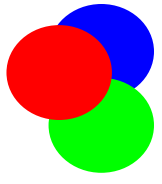


**Mitchell E. Bean, Director**



# State Budget Shortfalls Caused By

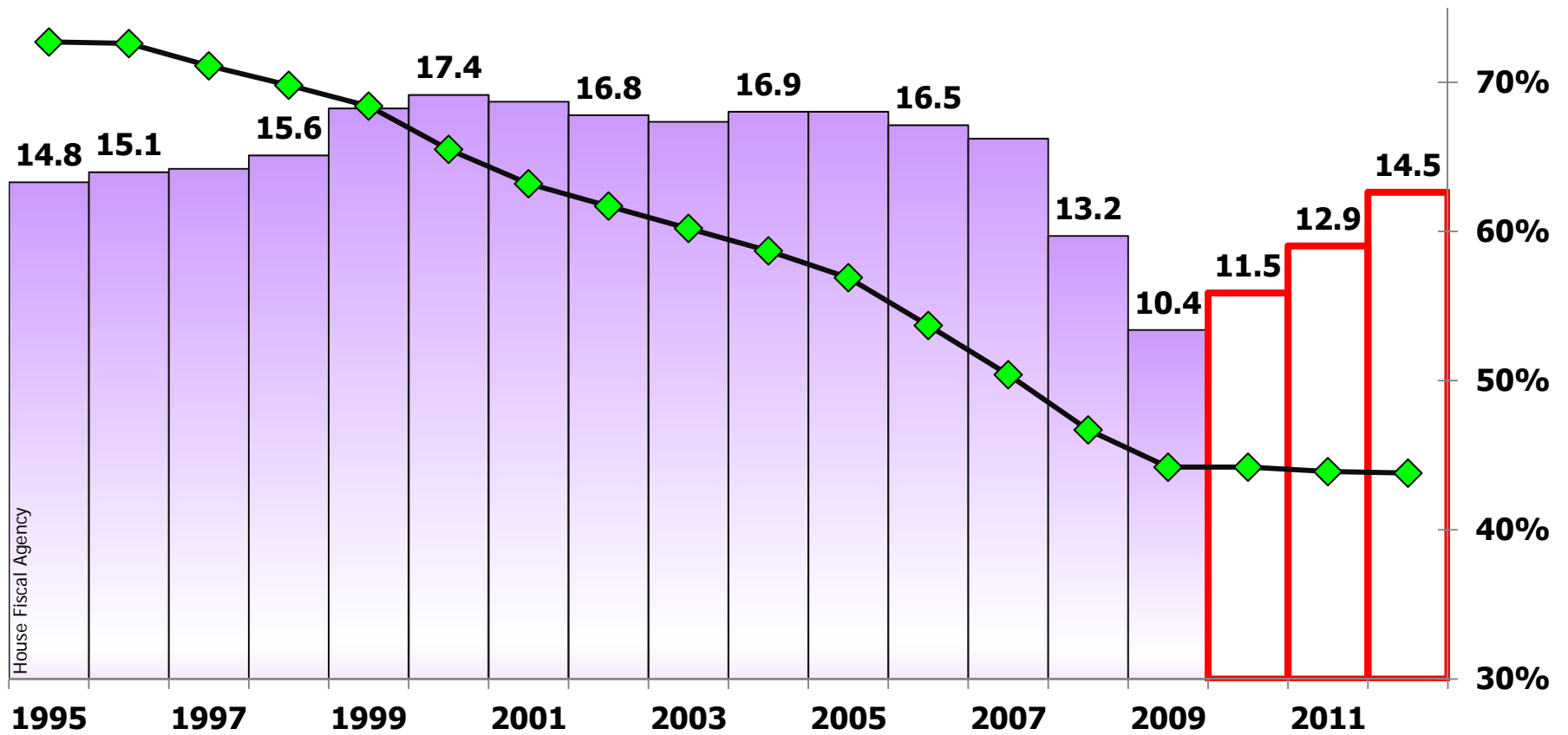
- **Severe economic contraction led by domestic auto industry**
- **State tax policy**
- **Increasing cost of Medicaid and corrections**
- **Chronic use of one-time fixes**

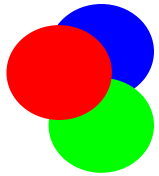


# Big 3 Losing Market Share

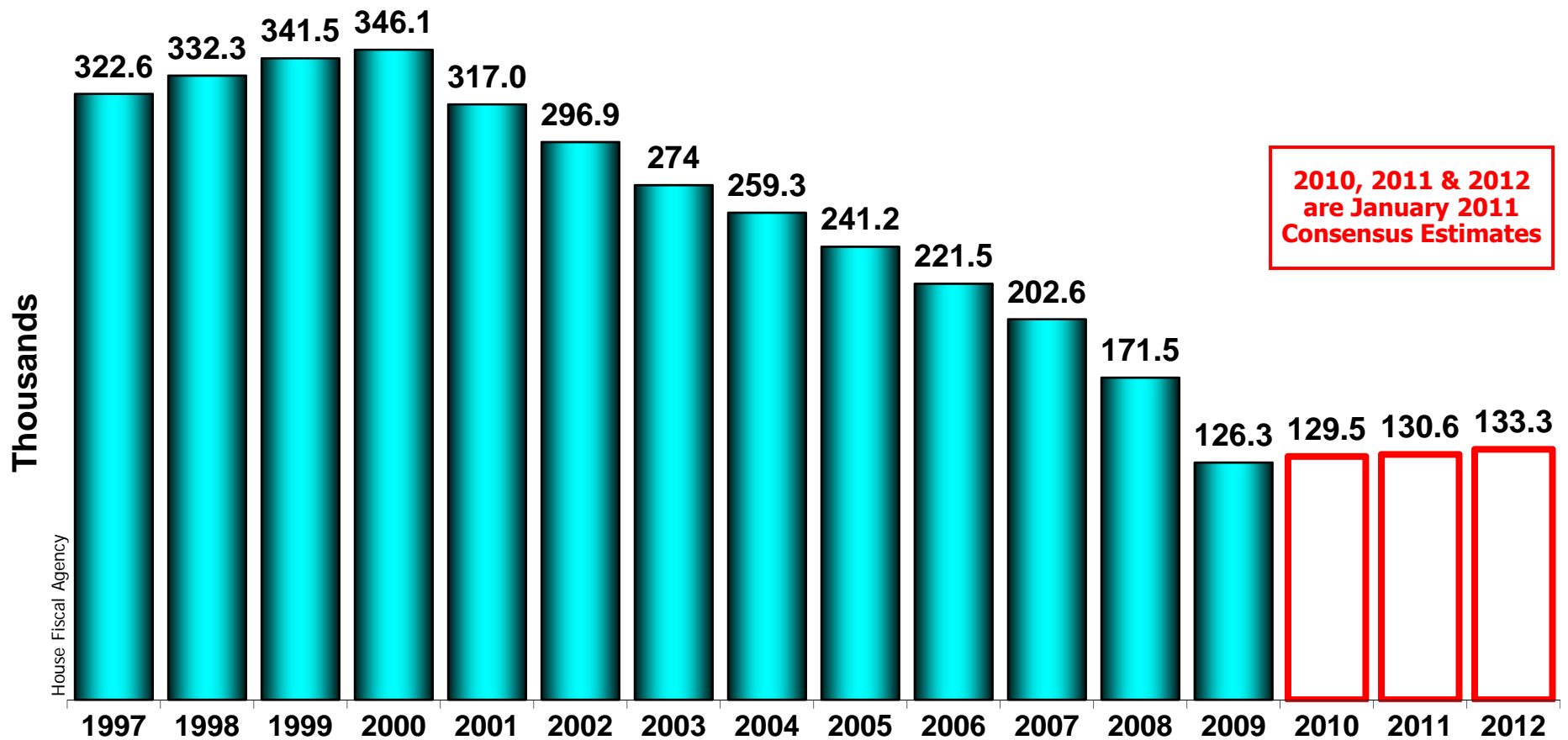
2010, 2011, & 2012  
are January 2011  
Consensus Estimates

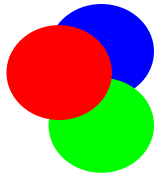
U.S. Light Vehicle Sales    Big 3 Share



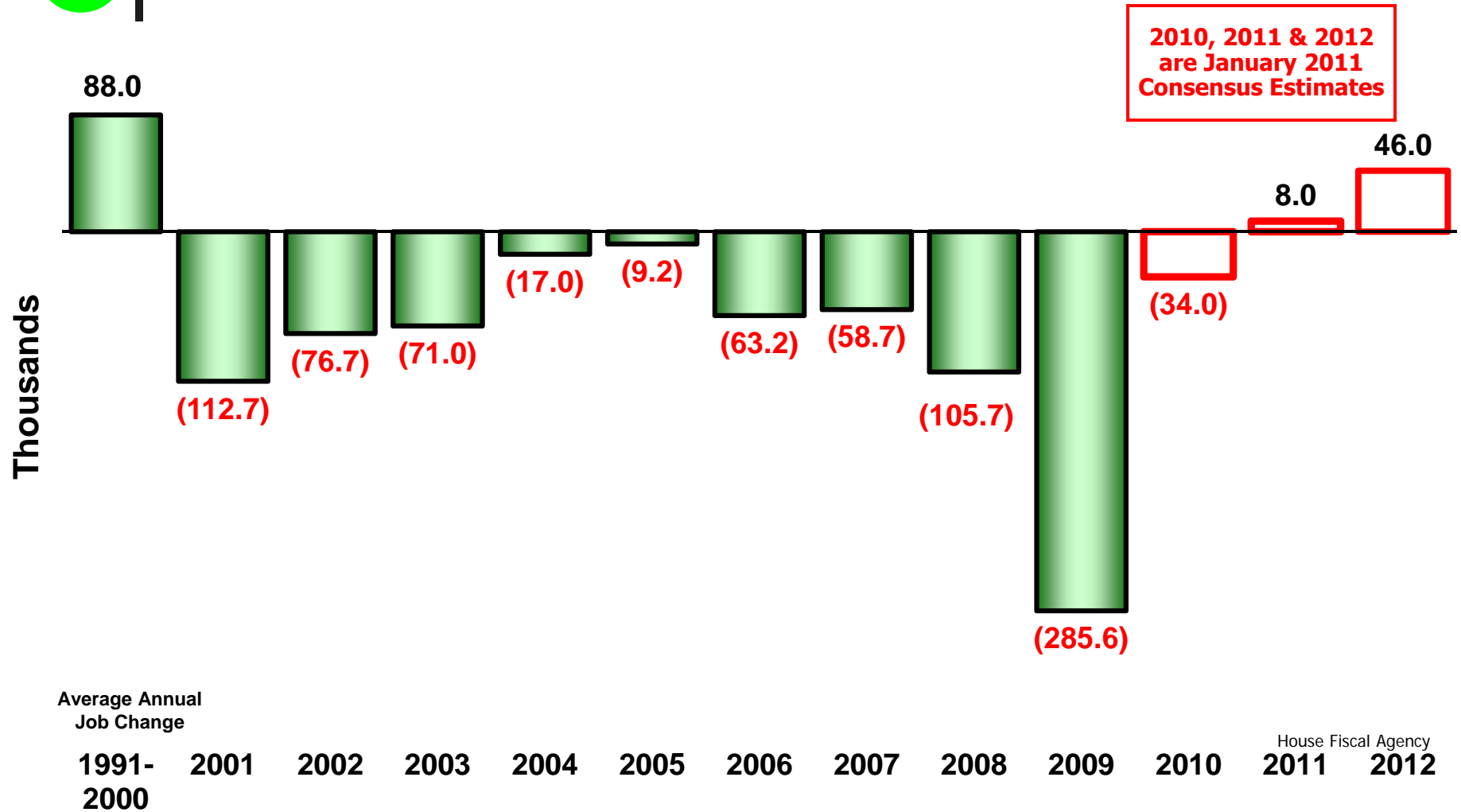


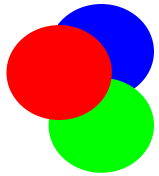
# Michigan Vehicle Employment



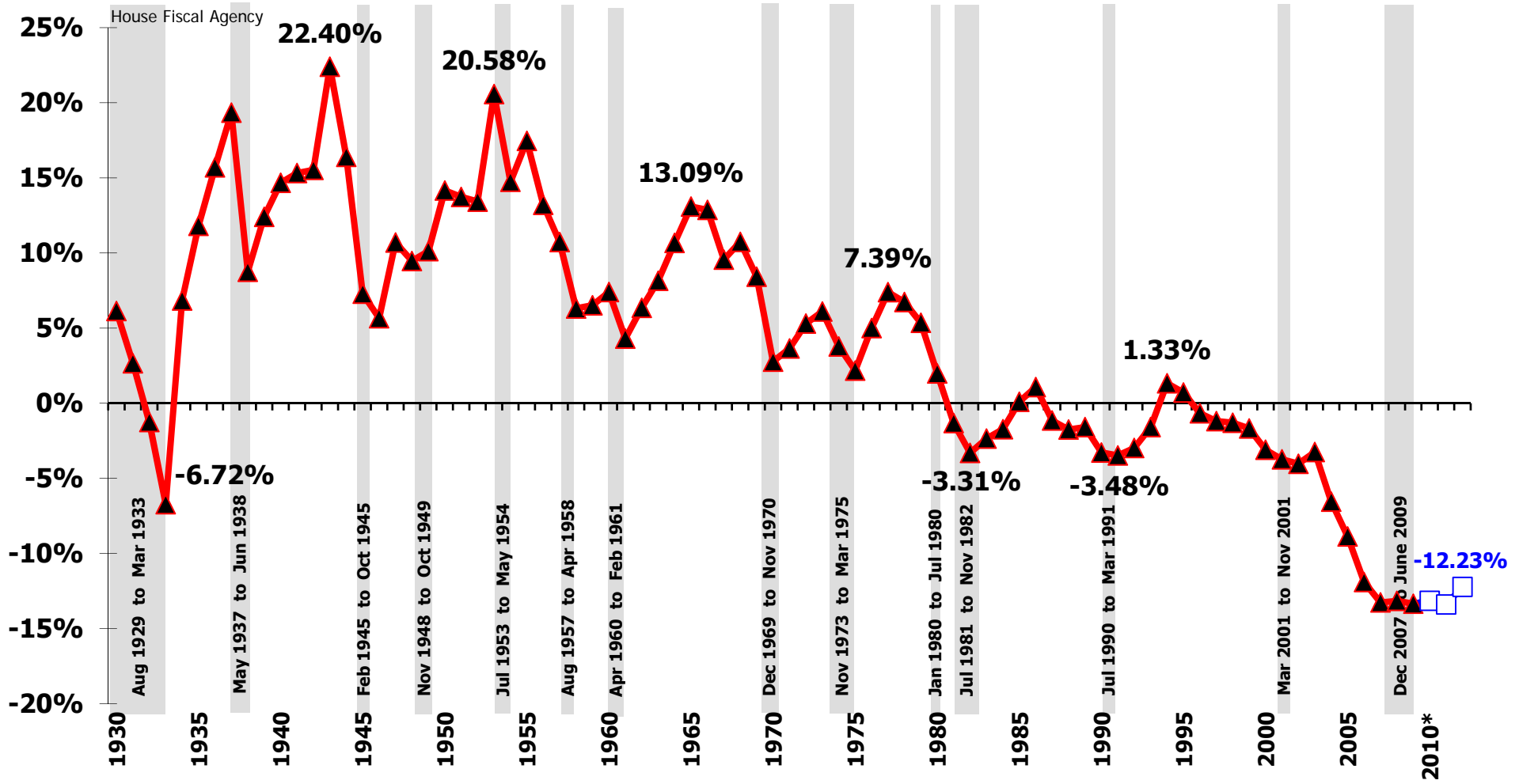


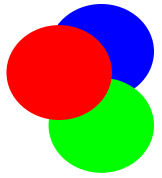
# Job Change in Michigan



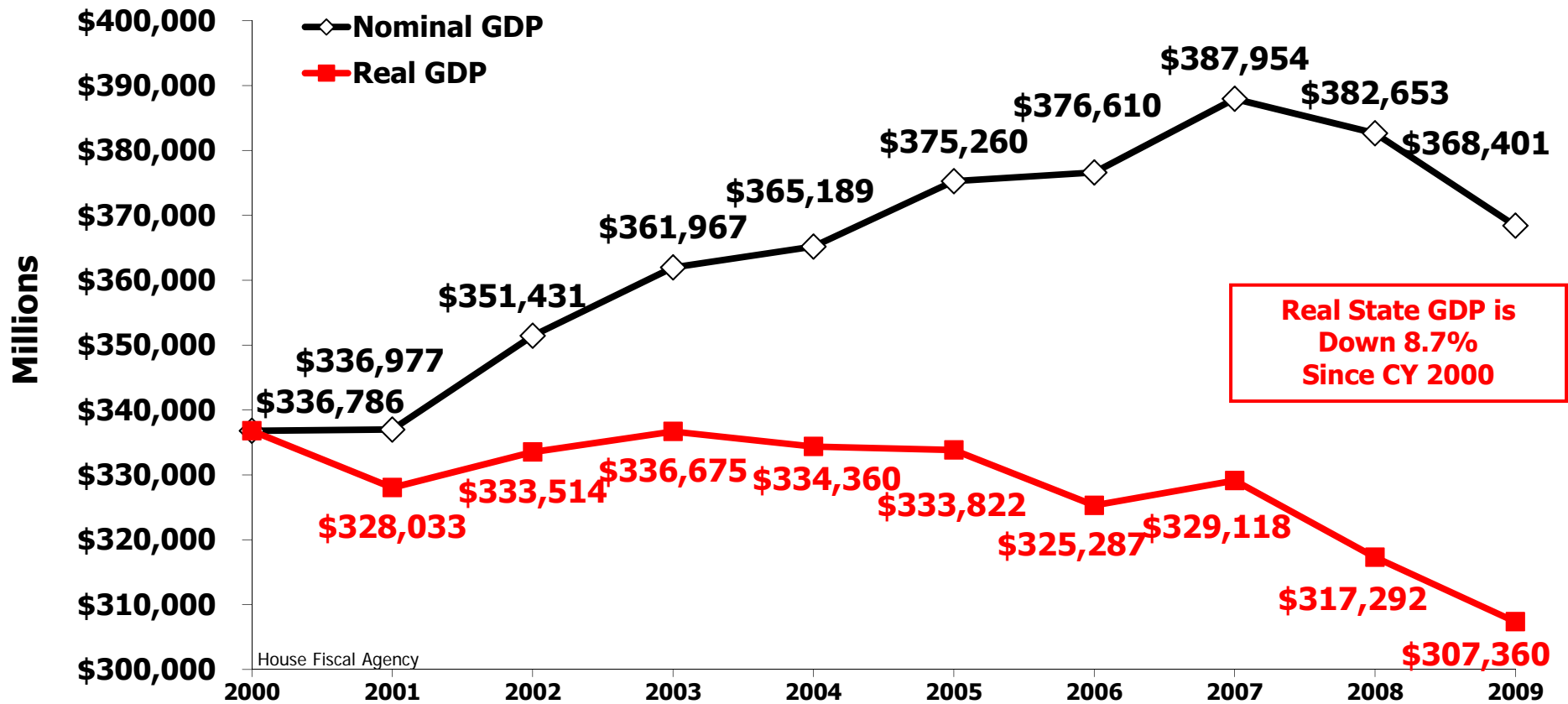


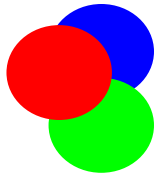
# Michigan Per Capita Income Deviation from National Average



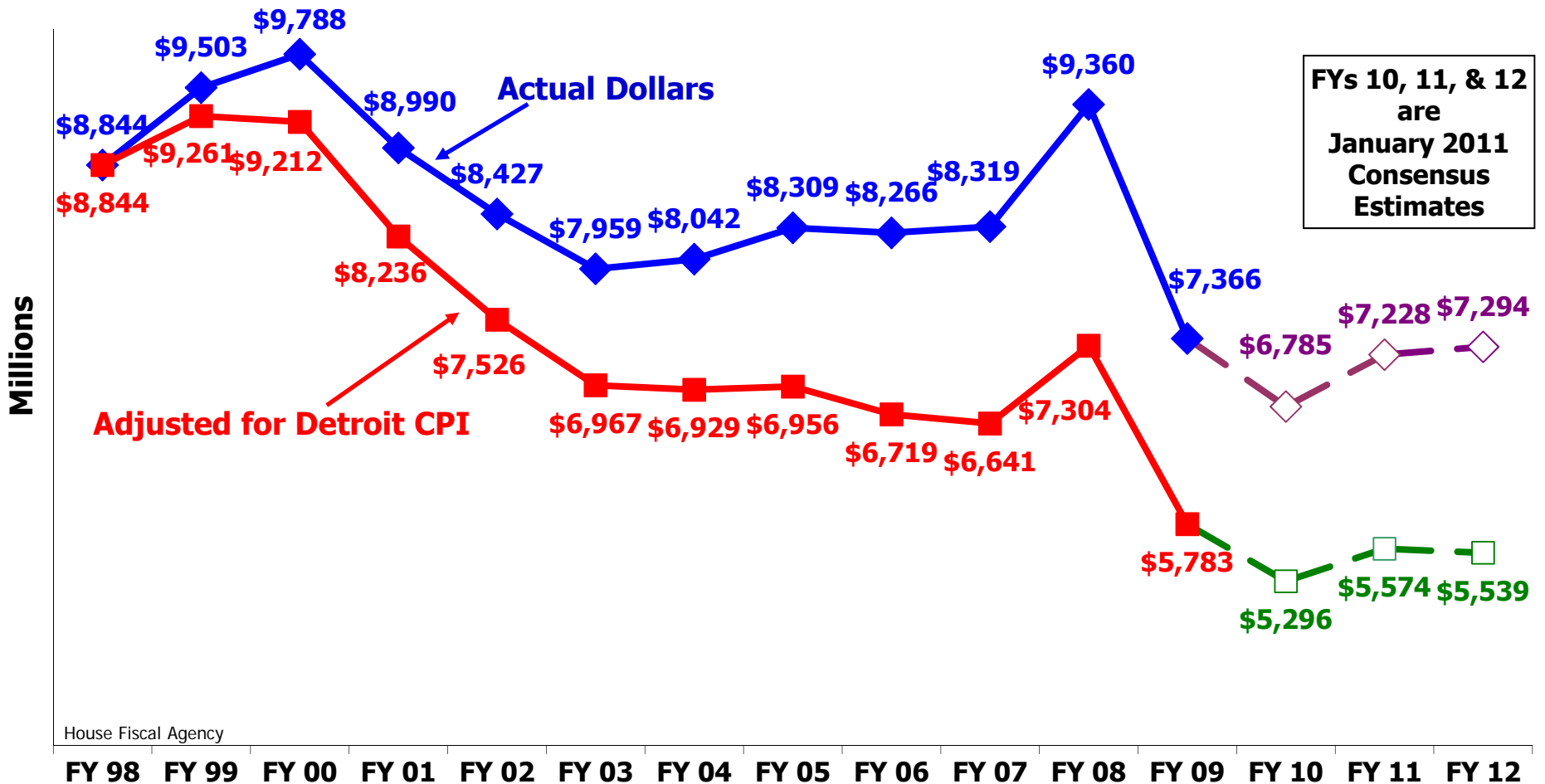


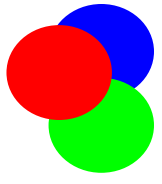
# Real and Nominal State GDP



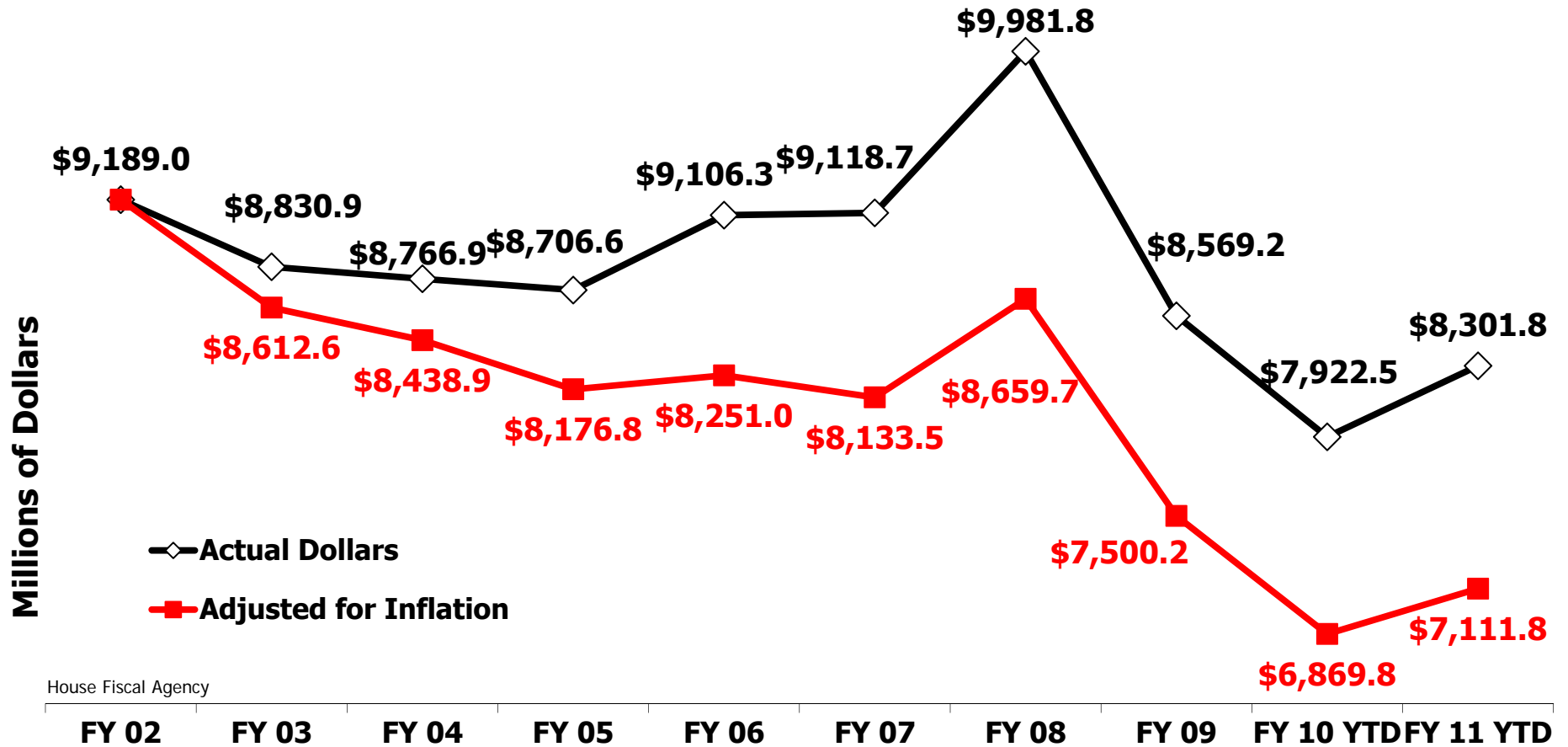


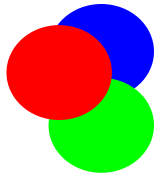
# Inflation Adjusted GF/GP Revenue Down 40% Since FY 2000



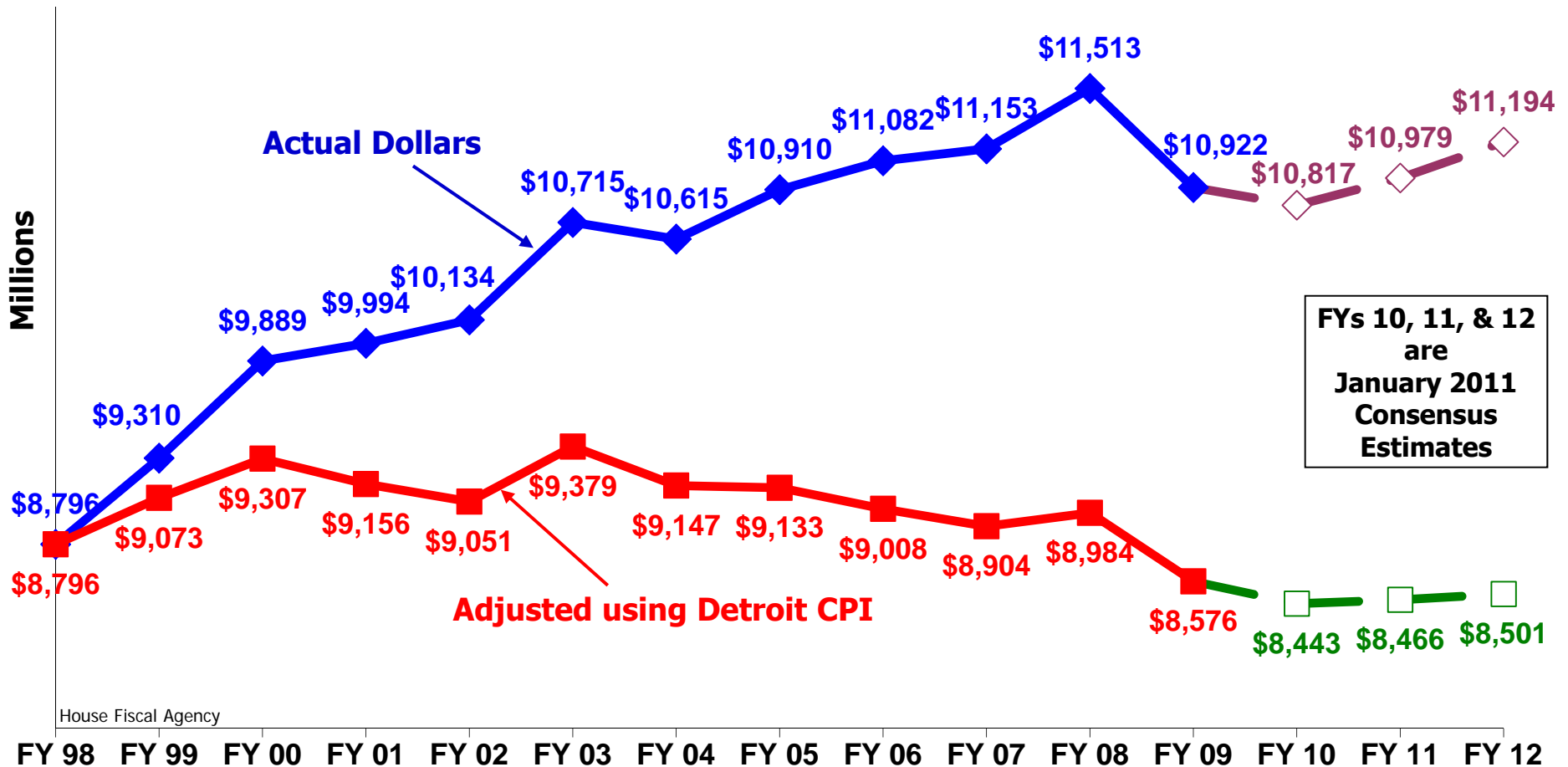


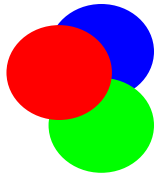
# GF/GP Appropriations



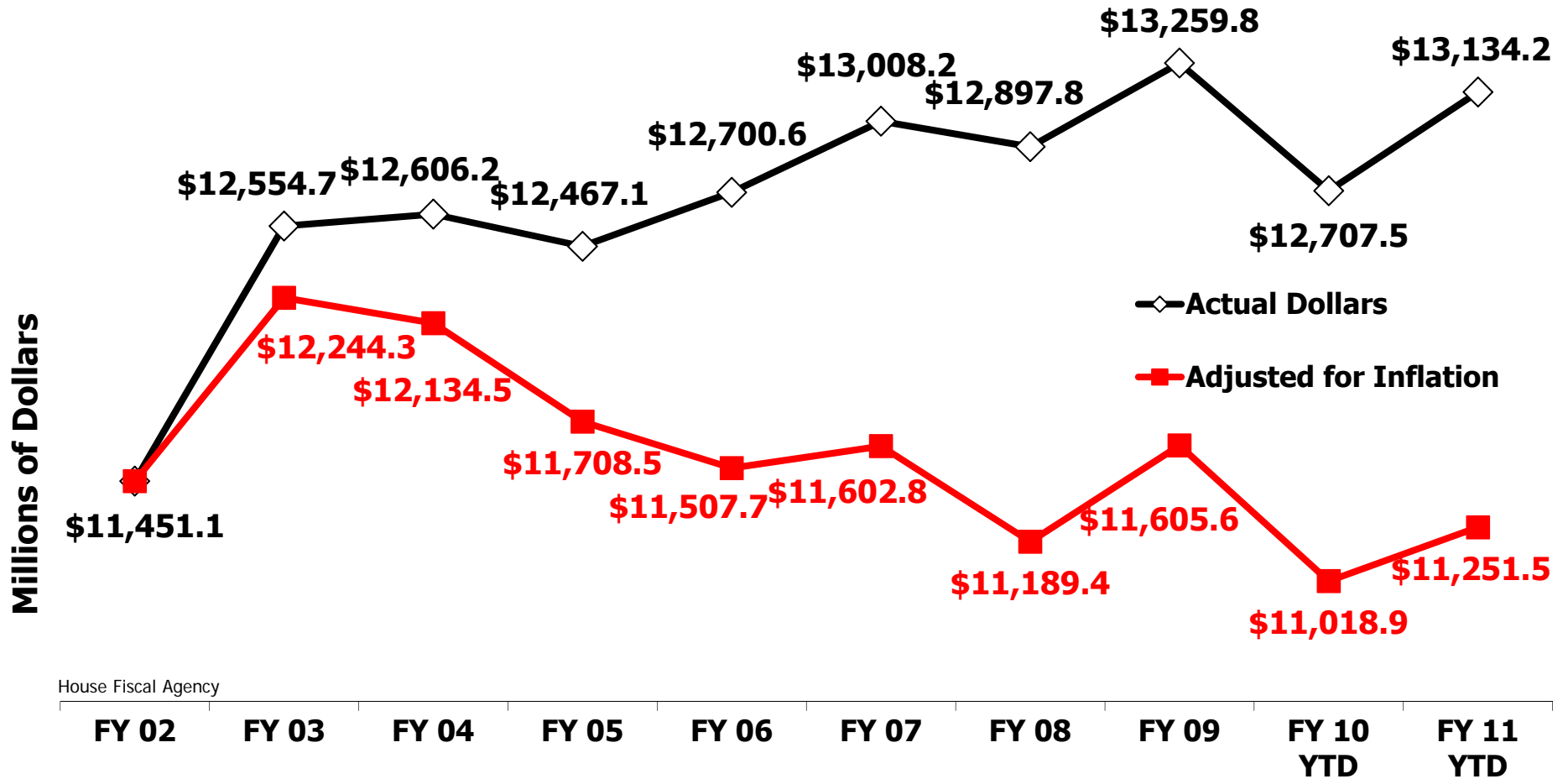


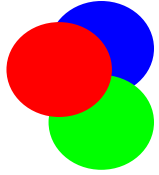
# Inflation Adjusted SAF Net Revenue Down 8.7% Since FY 2000



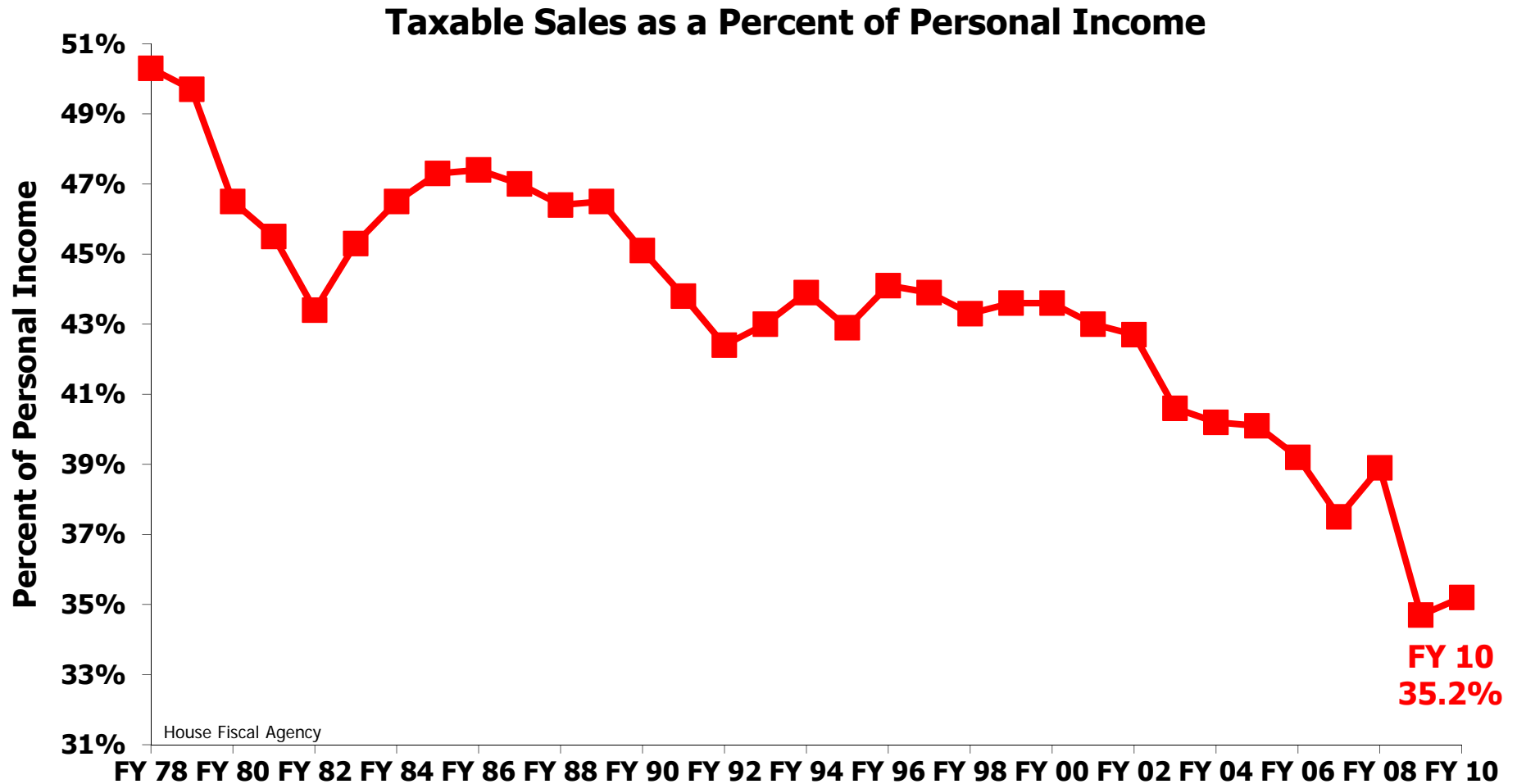


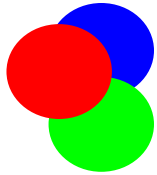
# School Aid Budget Adjusted Gross Appropriations



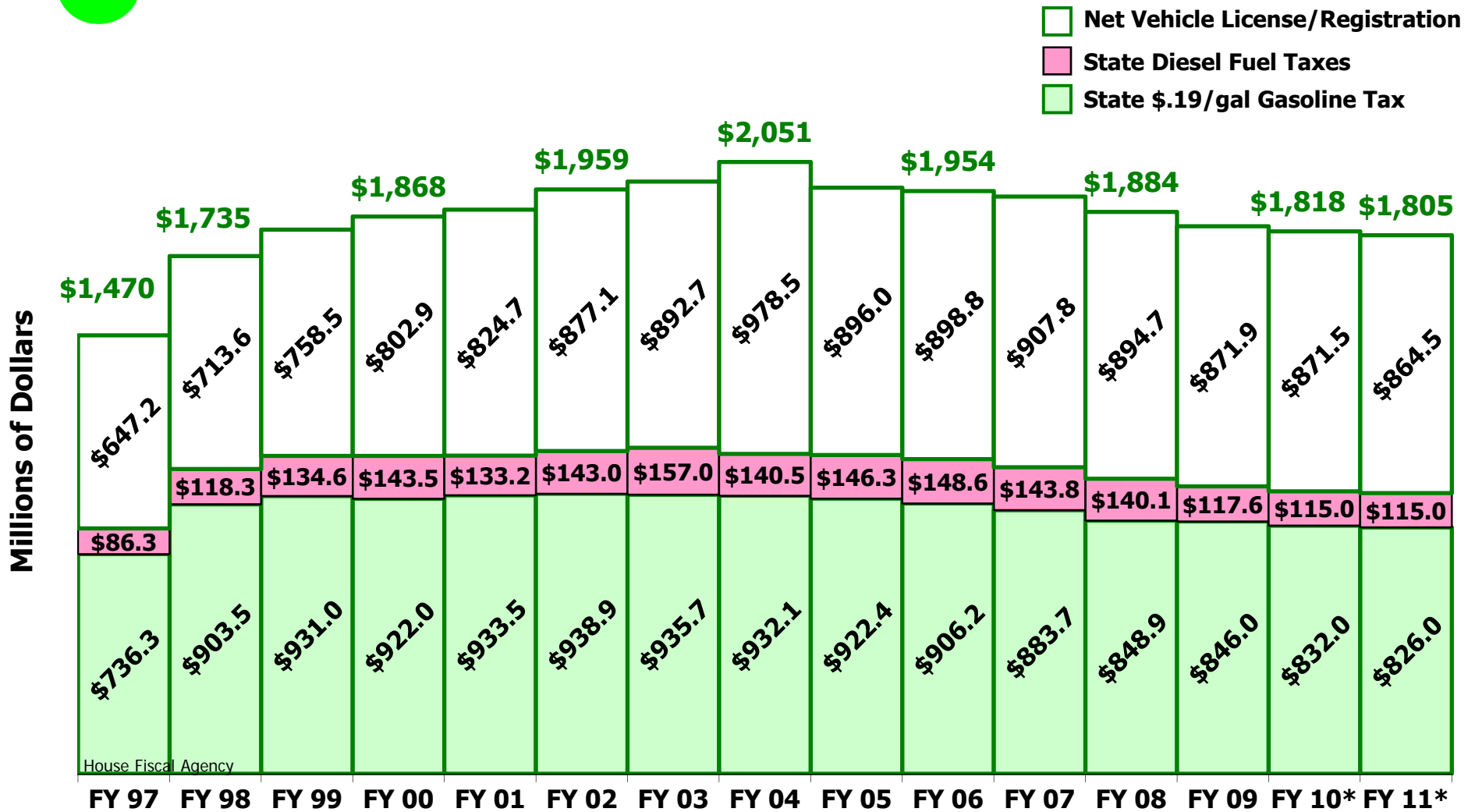


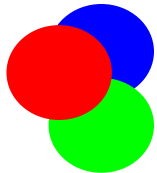
# Sales/Use Tax Share Declining



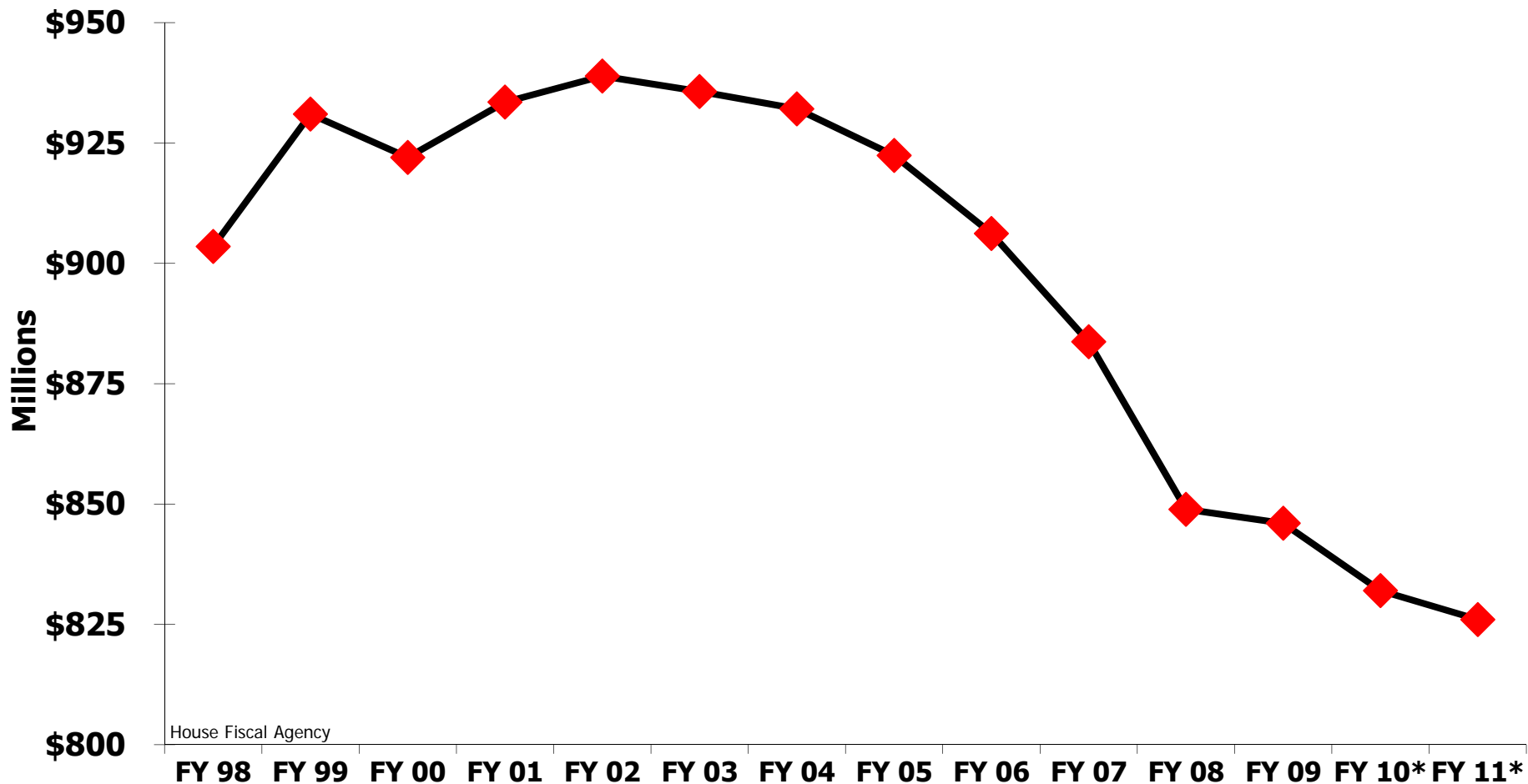


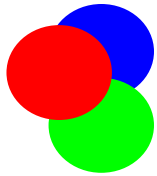
# Transportation Revenue



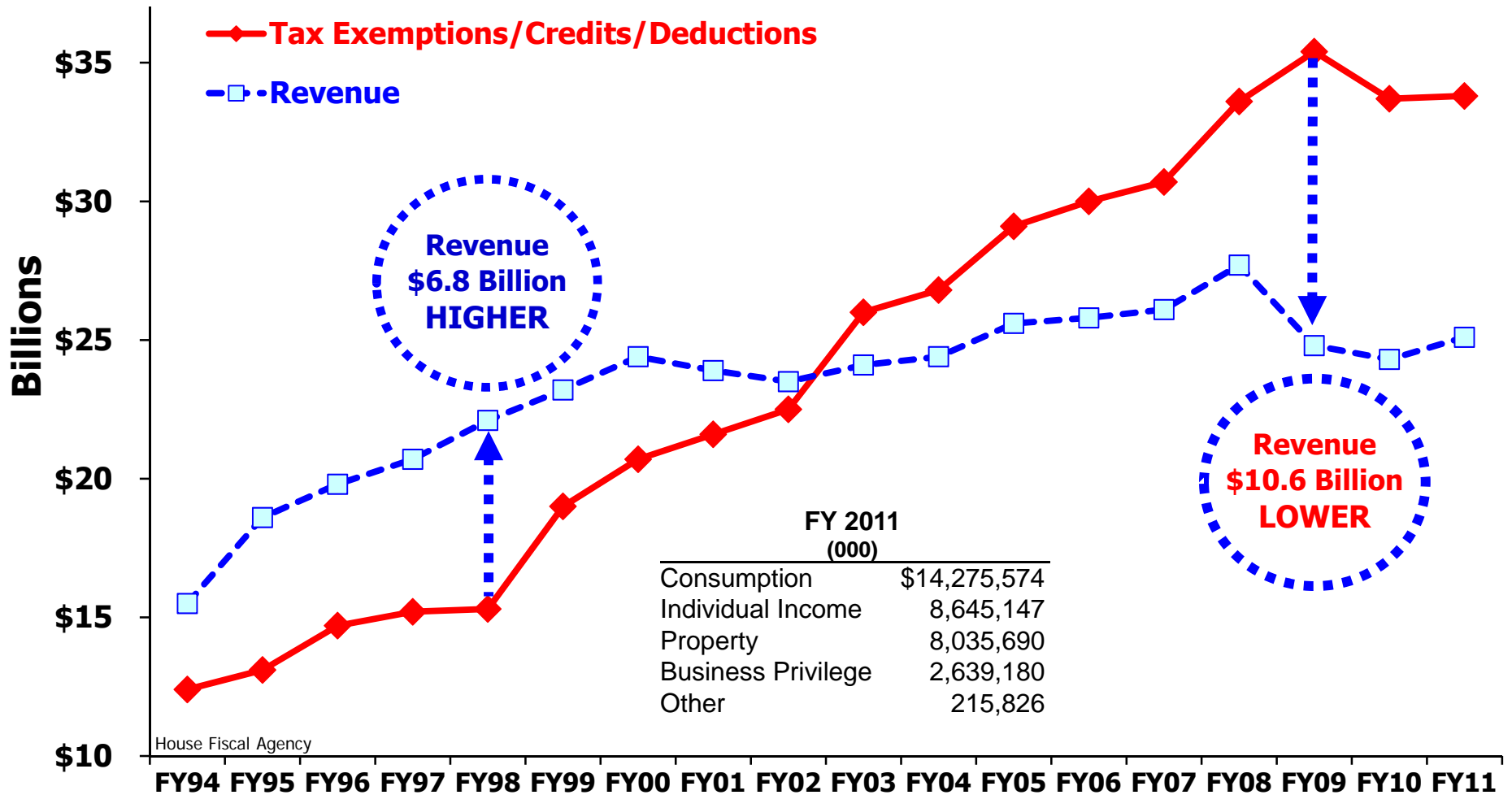


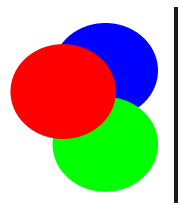
# Michigan Gasoline Tax Revenue





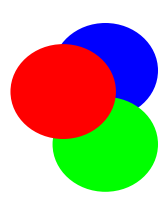
# Impact of Tax Exemptions/Credits/Deductions





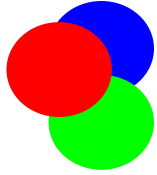
# Why Consider Tax Expenditures?

- 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

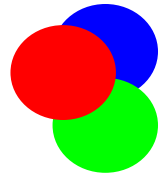
	<u>FY 2009</u>	<u>FY 2010</u>	<u>FY 2011</u>	<u>FY 2012</u>	<u>FY 2013</u>	<u>FY 2014</u>
Reducing Michigan Income Tax Rate	\$0.0	\$0.0	\$0.0	(\$161.8)	(\$342.2)	(\$543.5)
Alternative Energy Credits - Income Tax	(\$16.0)	(\$22.6)	(\$24.2)	(\$18.9)	\$0.0	\$0.0
Michigan EITC	(\$140.0)	(\$341.0)	(\$357.0)	(\$378.0)	(\$400.7)	(\$424.8)
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)	(\$61.9)	(\$105.0)	(\$140.0)	(\$140.0)	(\$140.0)
Photovoltaic Technology - Facility & Manufacturing	\$0.0	\$0.0	(\$1.5)	(\$7.5)	(\$7.5)	(\$10.0)
Polycrystalline Manufacturing Credit	\$0.0	\$0.0	\$0.0	\$0.0	(\$20.0)	(\$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)
Use Tax Bad Debt Deduction Change (Court Case)	(\$2.0)	(\$25.5)	(\$16.6)	(\$17.1)	(\$17.7)	(\$18.4)
Angel Credit	\$0.0	\$0.0	(\$3.4)	(\$9.0)	(\$9.0)	(\$9.0)
Exempt Supplies for Cobo Center	\$0.0	\$0.0	(\$2.5)	(\$2.5)	(\$3.5)	(\$1.5)
<b>Totals in Millions</b>	<b>(\$138.8)</b>	<b>(\$508.1)</b>	<b>(\$589.4)</b>	<b>(\$855.9)</b>	<b>(\$1,295.8)</b>	<b>(\$1,533.5)</b>



# Senior Tax Preferences

## ■ Income Tax

- Fully exempts social security, military, federal, state and local government pension/retirement income
- Exempts private pensions up to \$45,120 single/\$90,240 joint (TY 2009); indexed to inflation
  - Annual cost all pension income exemption = \$725 million
- Deduction for senior investment income \$10,058 single/\$20,115 joint; indexed to inflation
  - Annual cost = \$40 - \$50 million



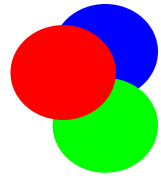
# Senior Tax Preferences

## ■ Income Tax

- Additional Personal Exemption \$2,300 single/\$4,600 joint (TY 2009)
- Annual cost = \$55 million

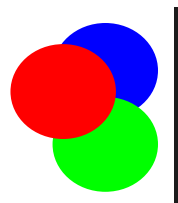
## ■ Property Tax

- Homestead Property Tax Credit
  - Under age 65 – credit is 60% of the amount by which property taxes exceed 3.5% of household income, up to a maximum of \$1,200
  - 65 and older – credit is 100% of the difference  
Annual cost = \$320 million



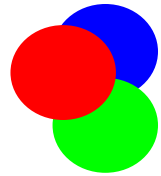
# Demographics

- **Michigan's population is aging**
  - **2000 – 12.3% pop age 65+**
  - **2010 – 12.8% pop age 65+**
  - **2020 – 16.0% pop age 65+**
  - **2030 – 19.5% pop age 65+**
  
- **Senior tax preferences will get more expensive**



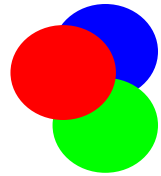
# Fewer People Pay Income Tax

<u>All Filers</u>	<u>2000</u>	<u>2008</u>
Tax Liability < \$0	19.5%	25.6%
Tax Liability = \$0	8.0%	8.0%
<u>Tax Liability Between \$0 and \$100</u>	<u>6.1%</u>	<u>5.0%</u>
Tax Liability < \$100	33.6%	38.6%



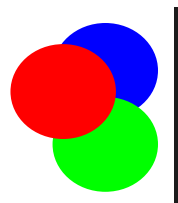
# Refundable Credits on the Michigan Income Tax

- **Homestead Property Tax Credit (\$1,006.6 million in FY 2010-11)**
- **Earned Income tax Credit (\$353.8 million in FY 2010-11)**
- **Alternative Energy/Qualified Home Improvement Credit (\$23.6 million in FY 2010-11)**
- **Adoption Credit (\$1.0 million in FY 2010-11)**
- **Stillbirth Credit (\$41,000 in FY 2010-11)**



# **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**



# Impact of Shrinking Tax Base

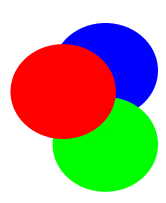
	<u>Income Tax Rate</u>	<u>Collections as Percent of State Personal Income</u>
<b>FY 2000</b>	<b>4.0%</b>	<b>2.6%</b>
<b>FY 2010</b>	<b>4.35%</b>	<b>1.5%</b>
<b>Revenue Impact of Declining Base</b> (In Millions of Dollars)		<b>\$3,653.50</b>

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



# Structural Problems Began in Earnest in 2001

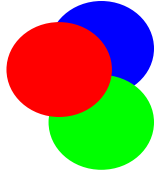
<u>Funding Source</u>	<u>\$ Amount in Millions</u>
■ Withdrawn from the BSA	\$1,264.0
■ SAF surplus	\$870.0
■ One-time revenue from changing SET collection dates	\$454.0
■ Other one-time revenue from various fund shifts and property sales	\$689.0
<b>Total One-Time Revenue June 2001 to December 2002</b>	<b>\$3,277.0</b>



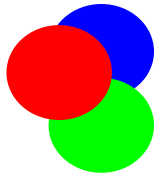
# Structural Problems Continue in FY 2011

<u>Funding Source</u>	<u>\$ Amount in Millions</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
<b>Total One-Time Funding Sources</b>	<b>\$1,419.0</b>

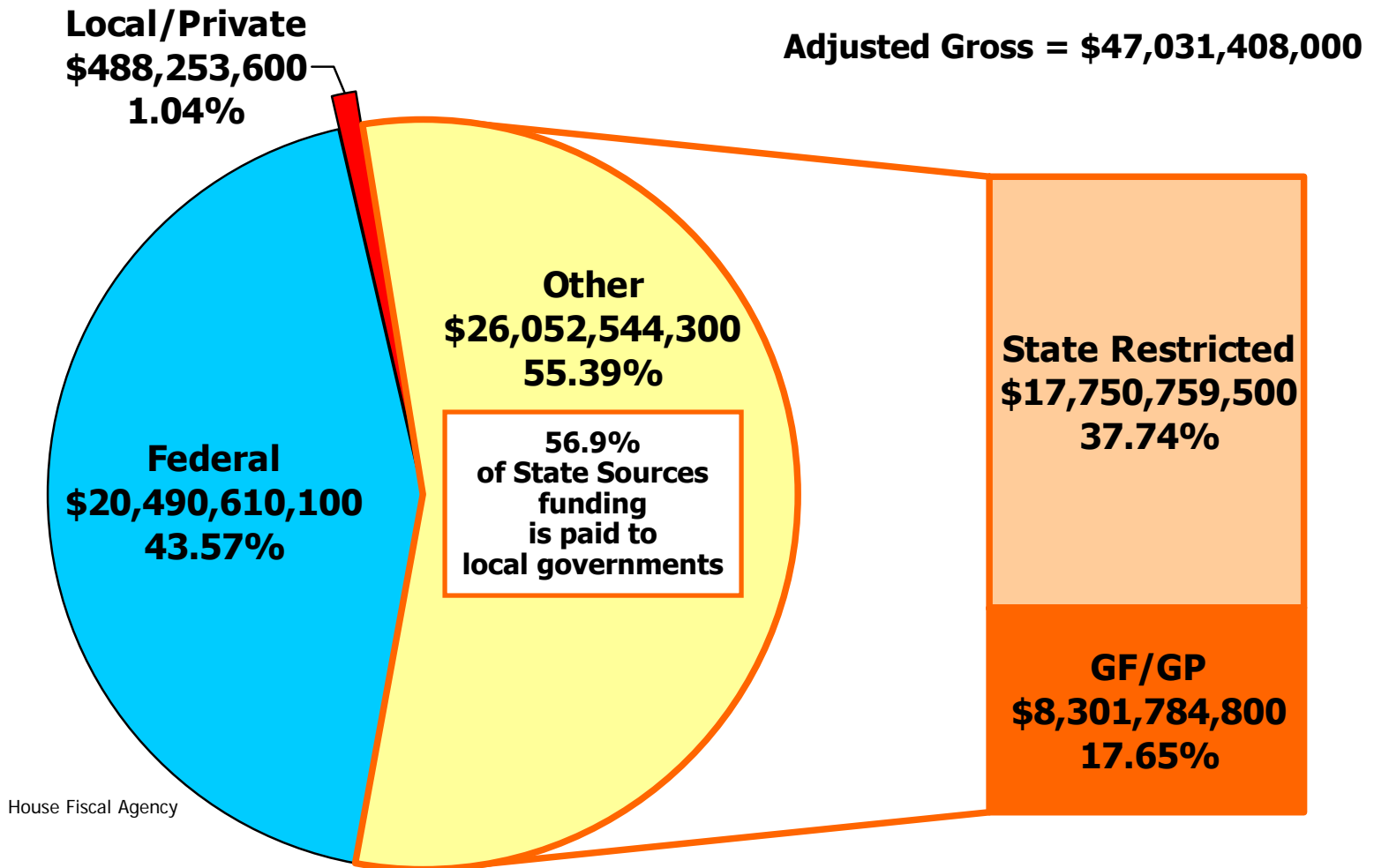
One-time funding sources utilized in FY 2010-11 budget

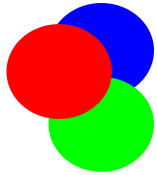


# MICHIGAN'S CURRENT BUDGET



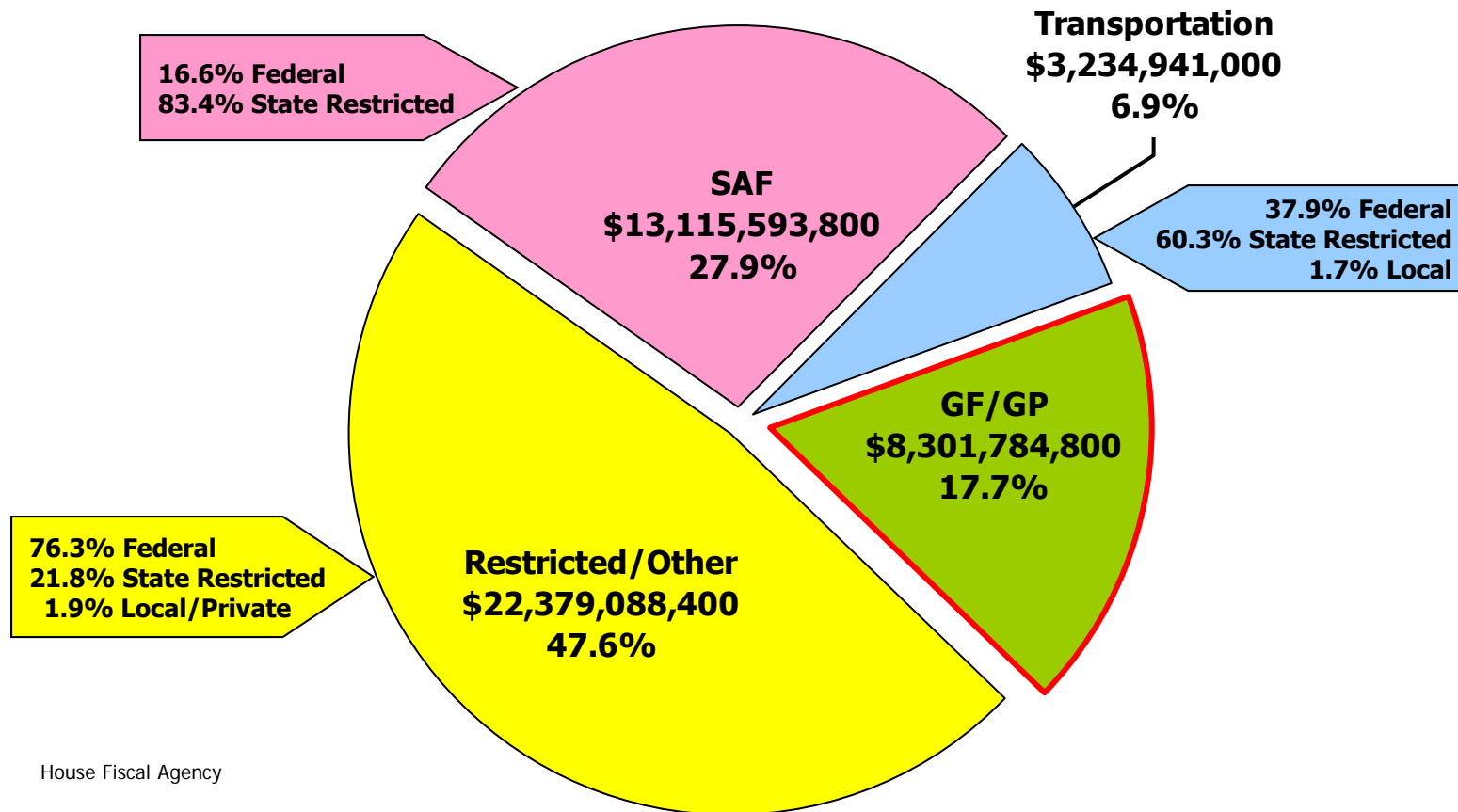
# FY 2010-11 Budget Adjusted Gross Funding Sources



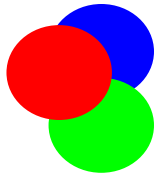


# FY 2010-11 Appropriations Funding

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

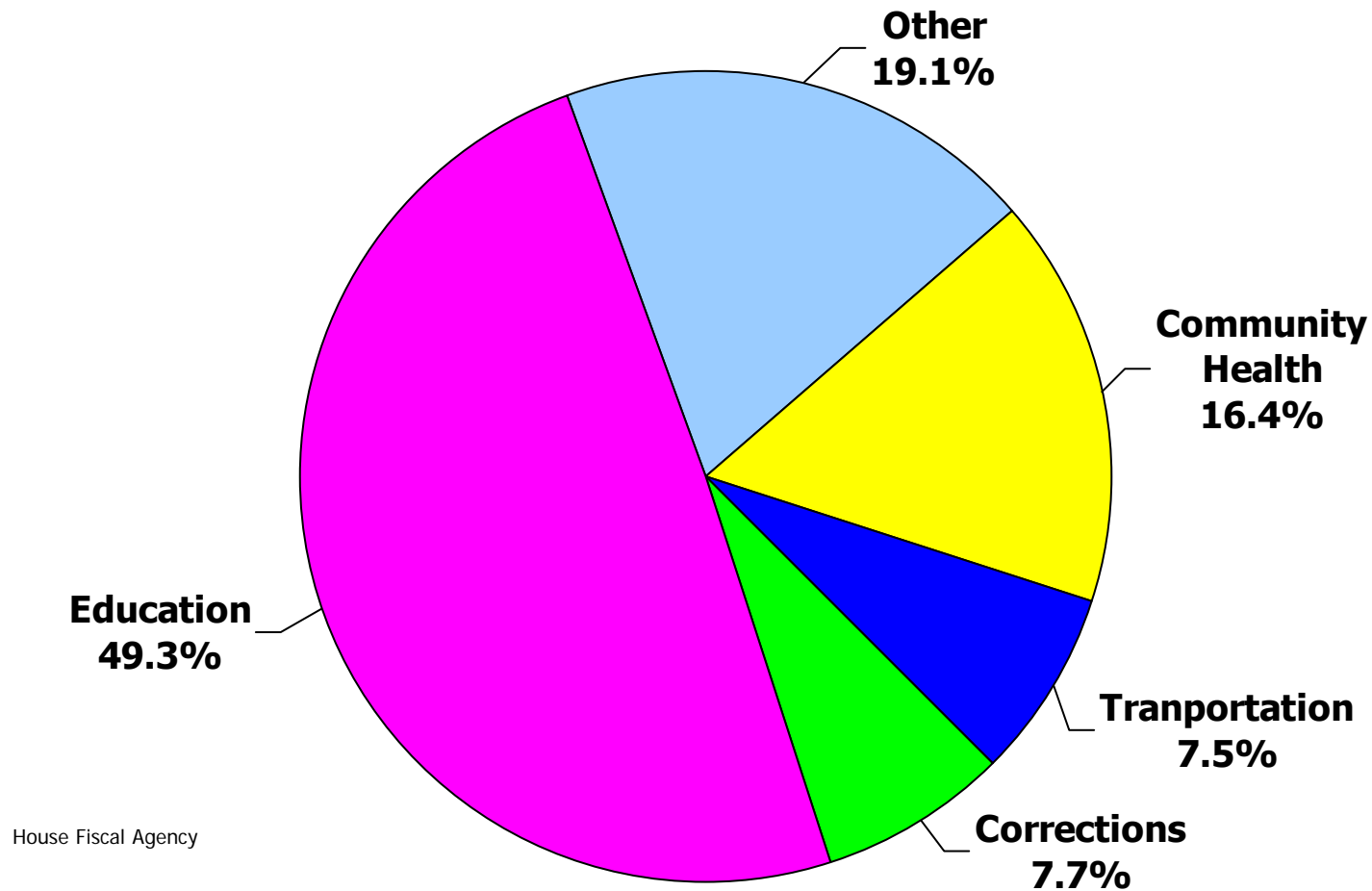


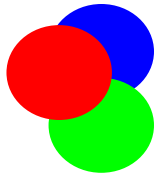
House Fiscal Agency



# State Taxes and Fees FY 2010-11

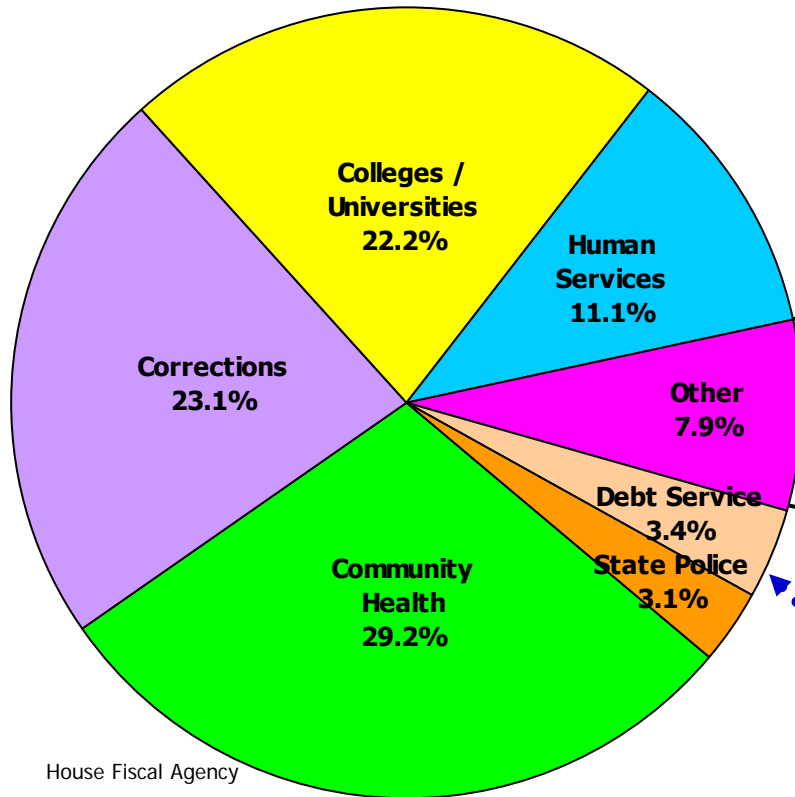
FY 2010-11 Total = \$26,052,544,300



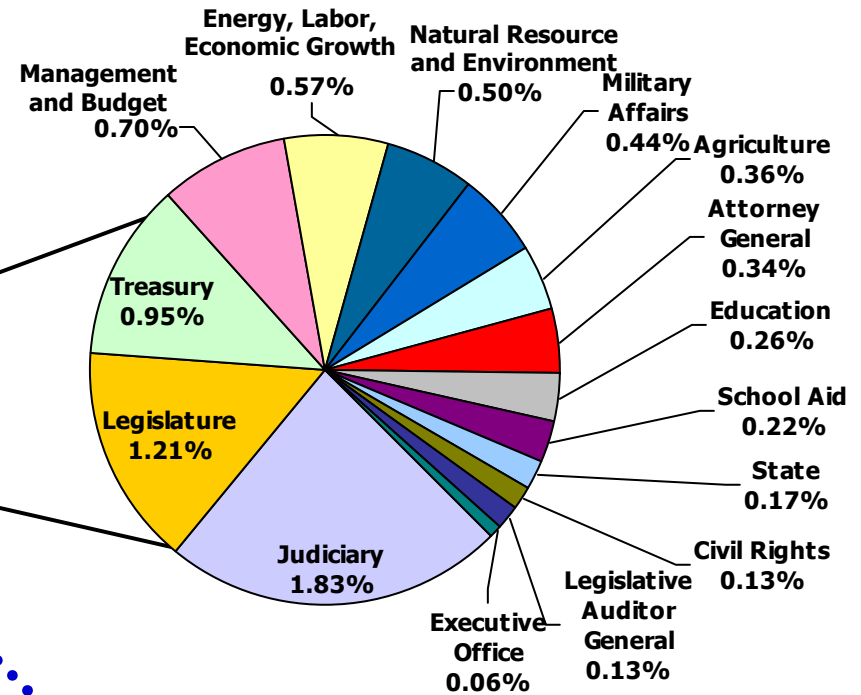


# FY 2010-11 GF/GP

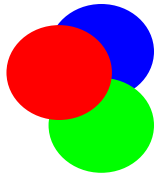
FY 2010-11 Total = \$8,301,784,800



House Fiscal Agency



**3.4%**  
**\$284 million**  
**Debt Service and SBA Rent**

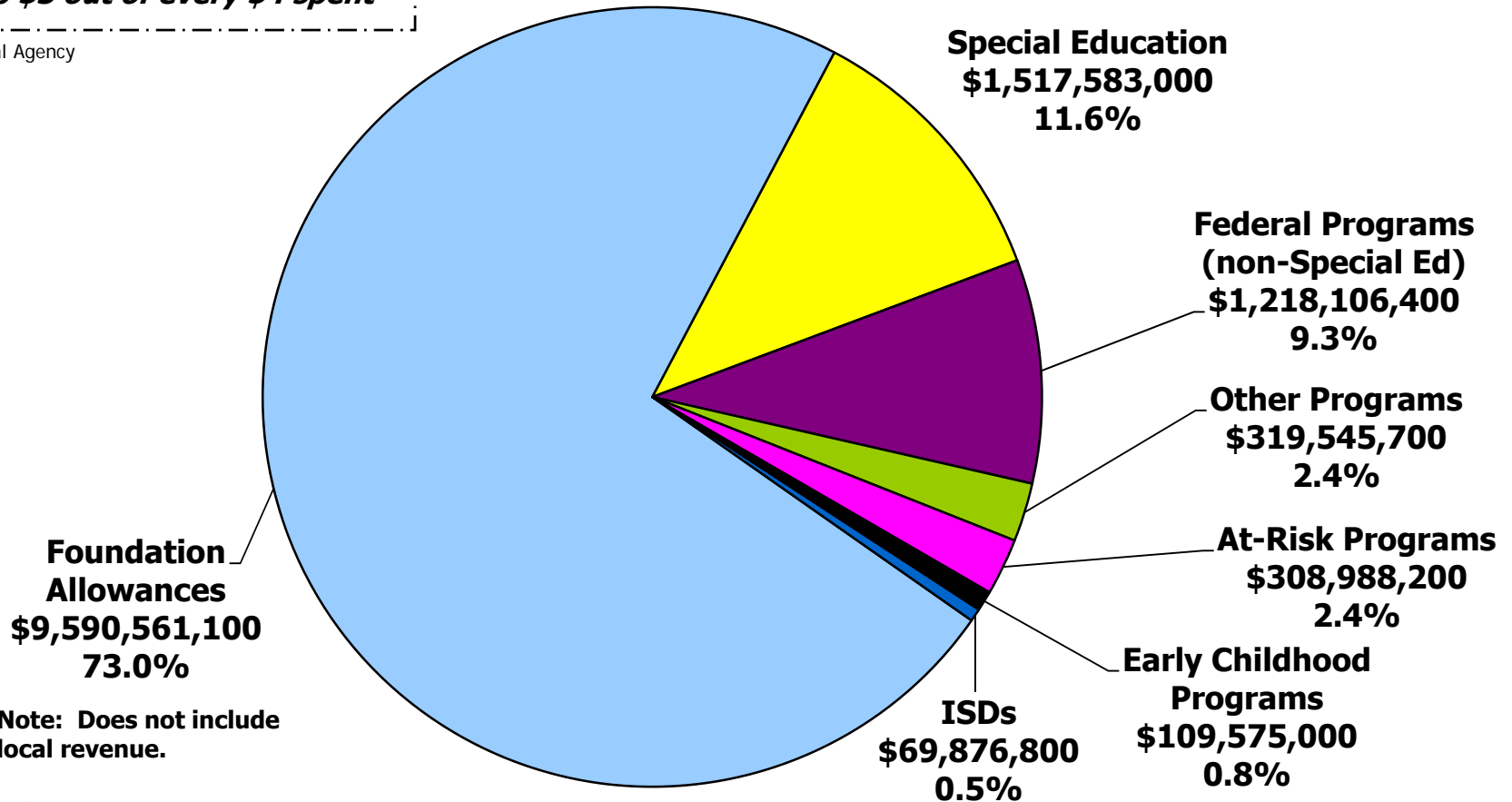


# School Aid Major Spending Categories

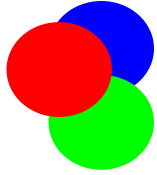
FY 2010-11 Total = \$13,134,236,200

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

House Fiscal Agency

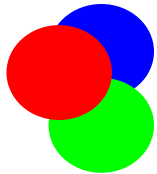


Note: Does not include local revenue.

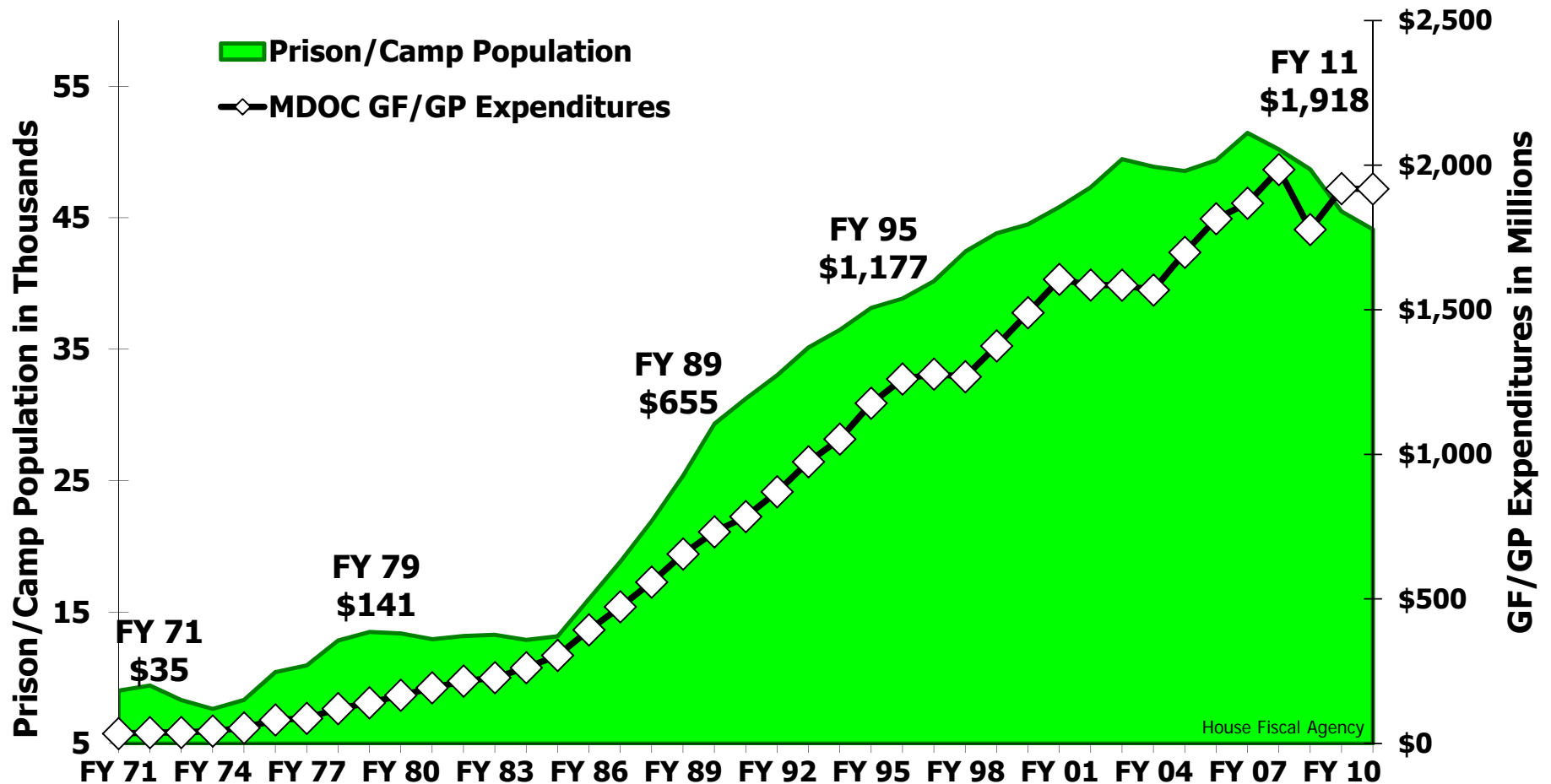


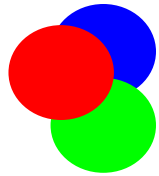
# Medicaid Impact on Michigan Budget

- 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)

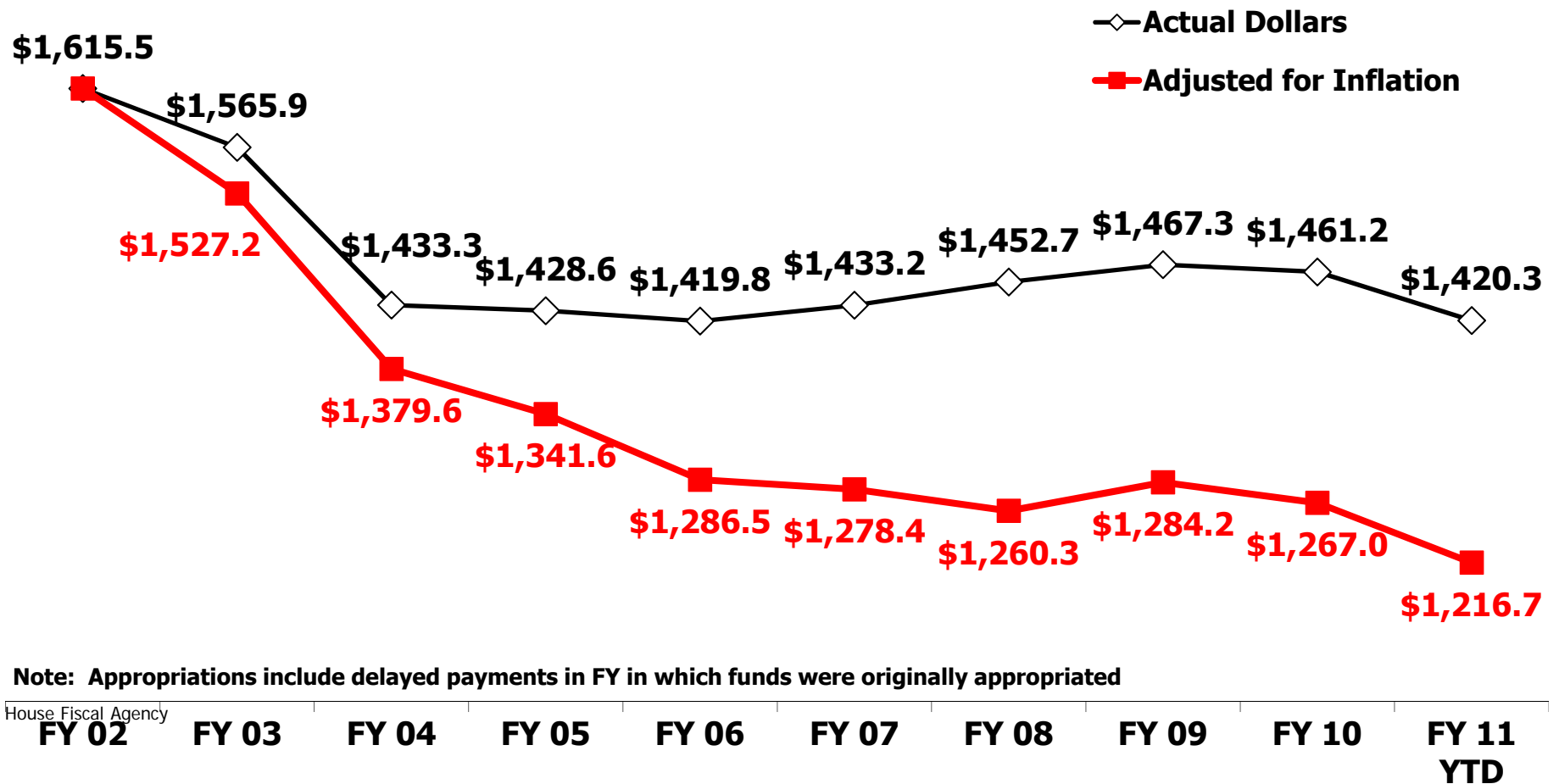


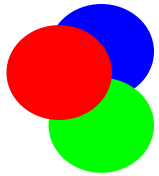
# Corrections Budget Increases



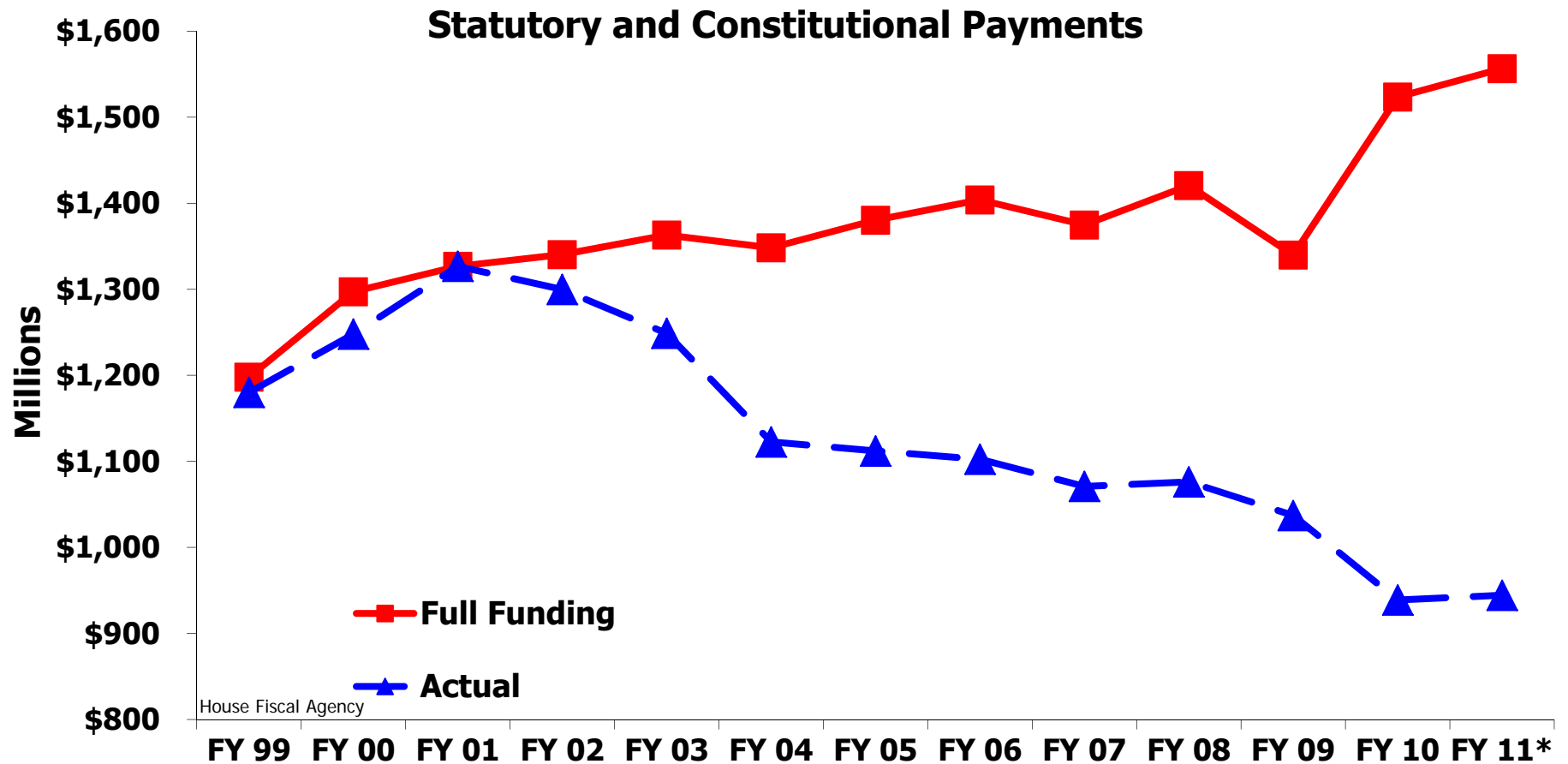


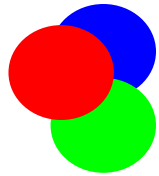
# Total Appropriations for State University Operations





# Revenue Sharing Payments to Cities, Villages, and Townships

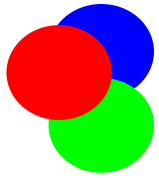




# Property Value Growth Slowing

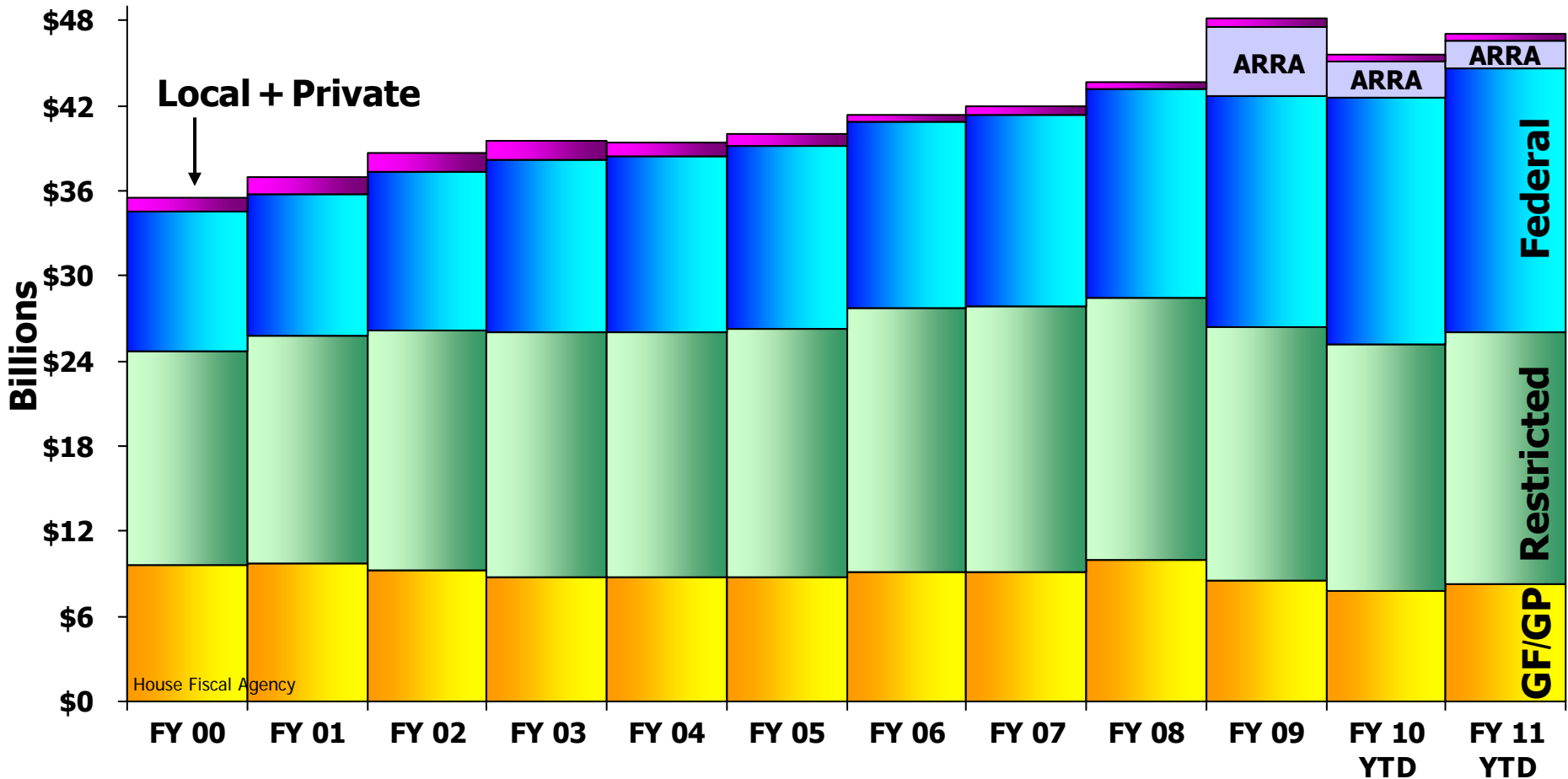
Yearly Change

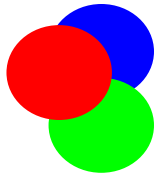
	<u>Inflation Rate Multiplier for Property</u>	<u>Total SEV Growth</u>	<u>Total Taxable Value Growth</u>
<b>1997</b>	<b>2.8 %</b>	<b>8.2 %</b>	<b>5.7 %</b>
<b>1998</b>	<b>2.7 %</b>	<b>9.5 %</b>	<b>6.1 %</b>
<b>1999</b>	<b>1.6 %</b>	<b>9.9 %</b>	<b>6.0 %</b>
<b>2000</b>	<b>1.9 %</b>	<b>9.0 %</b>	<b>5.5 %</b>
<b>2001</b>	<b>3.2 %</b>	<b>10.0 %</b>	<b>7.1 %</b>
<b>2002</b>	<b>3.2 %</b>	<b>9.8 %</b>	<b>6.7 %</b>
<b>2003</b>	<b>1.5 %</b>	<b>7.5 %</b>	<b>4.8 %</b>
<b>2004</b>	<b>2.3 %</b>	<b>6.3 %</b>	<b>5.7 %</b>
<b>2005</b>	<b>2.3 %</b>	<b>5.9 %</b>	<b>5.6 %</b>
<b>2006</b>	<b>3.3 %</b>	<b>5.0 %</b>	<b>5.8 %</b>
<b>2007</b>	<b>3.7 %</b>	<b>3.8 %</b>	<b>5.2 %</b>
<b>2008</b>	<b>2.3 %</b>	<b>-1.1 %</b>	<b>1.4 %</b>
<b>2009</b>	<b>4.4 %</b>	<b>-5.4 %</b>	<b>-0.8 %</b>
<b>2010</b>	<b>-0.3 %</b>	<b>-5.4 %</b>	<b>-8.0 %</b>
<b>2011</b>	<b>2.5 %</b>	<b>N/A</b>	<b>-4.3 %</b>



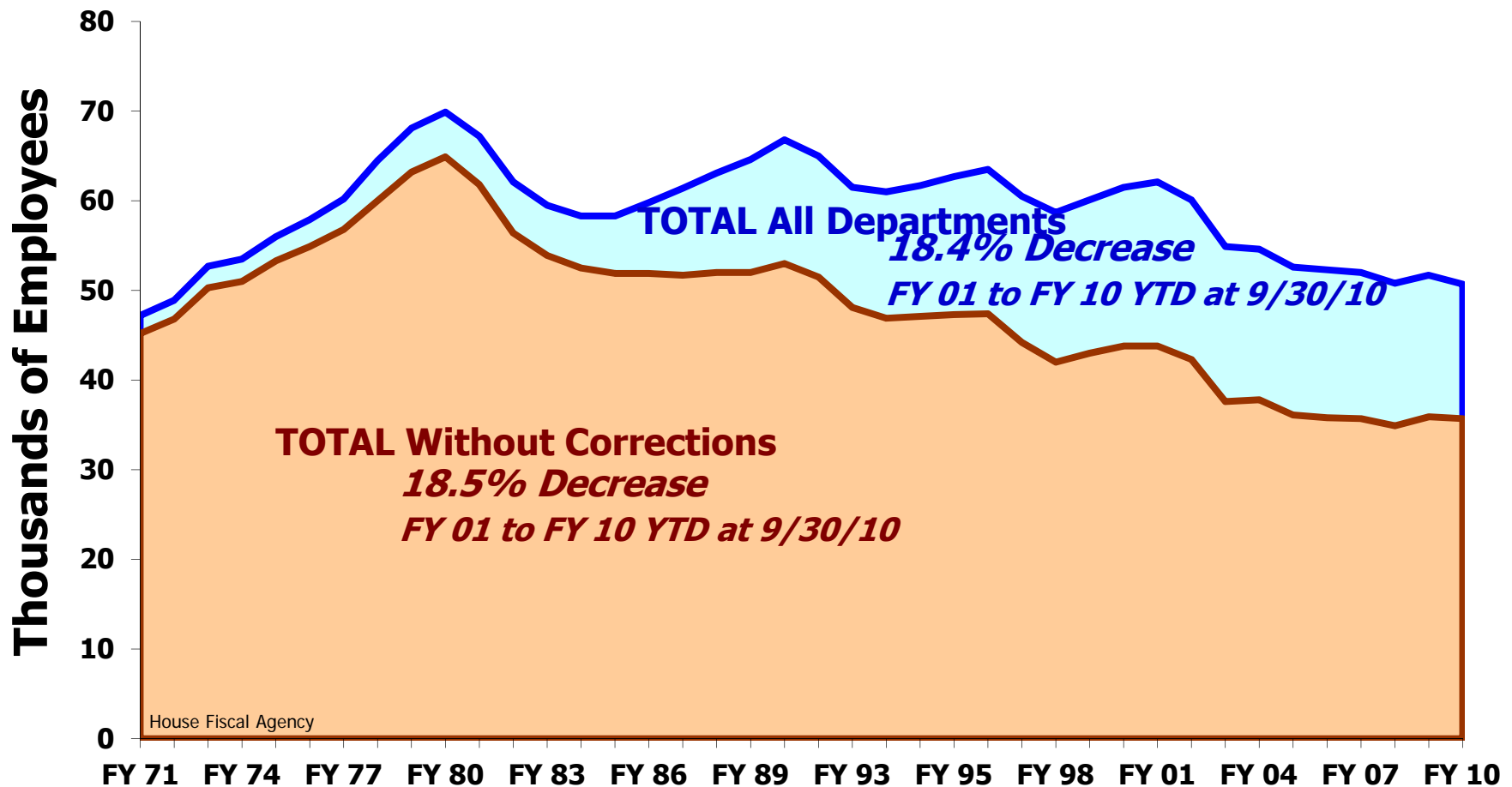
# Adjusted Gross Appropriations by Fund Source

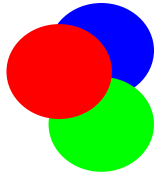
Excluding federal funds, FY 00 = FY 10 adjusted gross appropriations





# Average Number of Classified State Employees

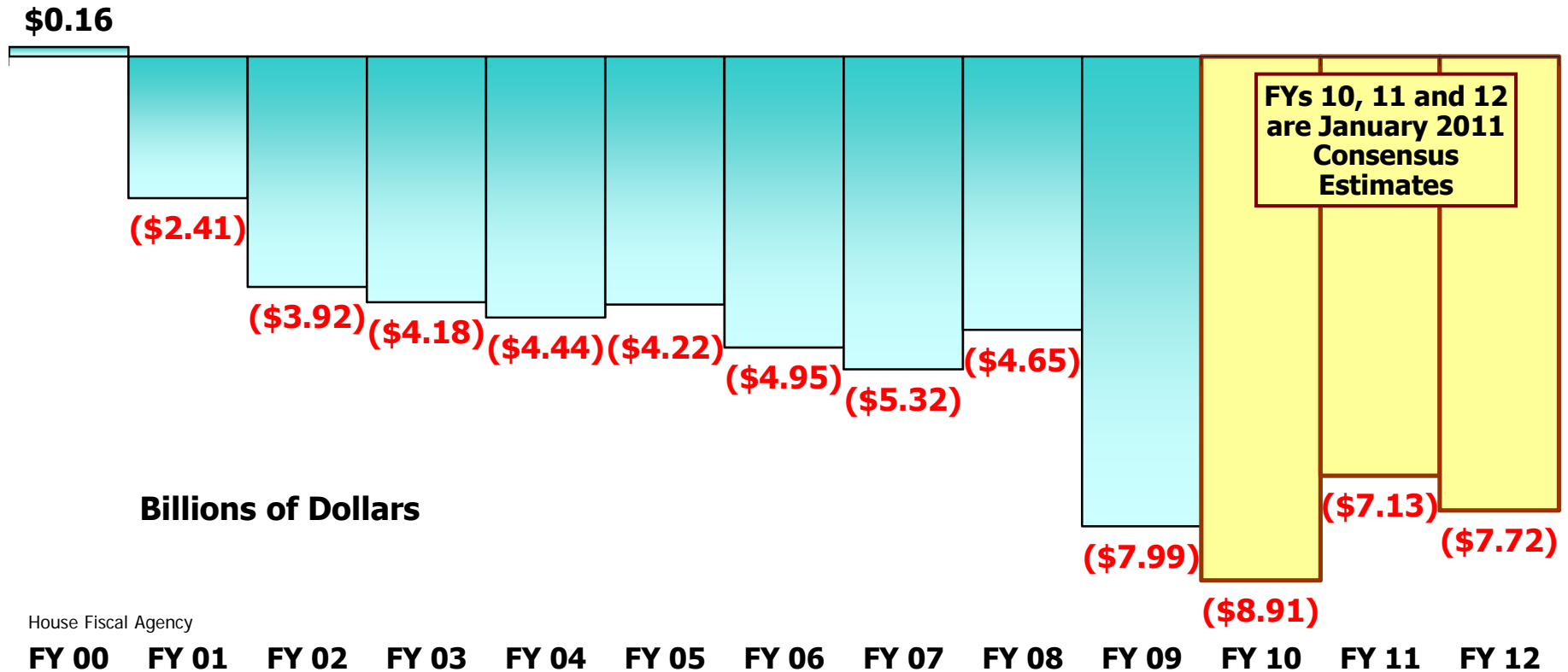




# Constitutional Revenue Limit

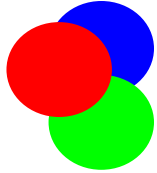
Average growth of Michigan personal income = 2.0% per year from 2000 through 2012

Average increase of Michigan revenue = 0.4% per year from 2000 through 2012



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 FY 12

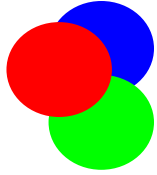


## **PROBLEM: The State tax base is not stable and will not support any level of service for long.**

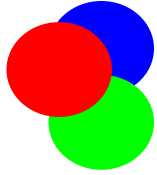
**SOLUTION: Stabilize the tax base at some level – higher, lower, or revenue neutral by doing the following.**

- **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.**



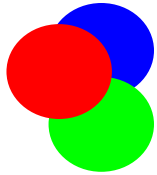
# EXECUTIVE BUDGET RECOMMENDATION



# Overview

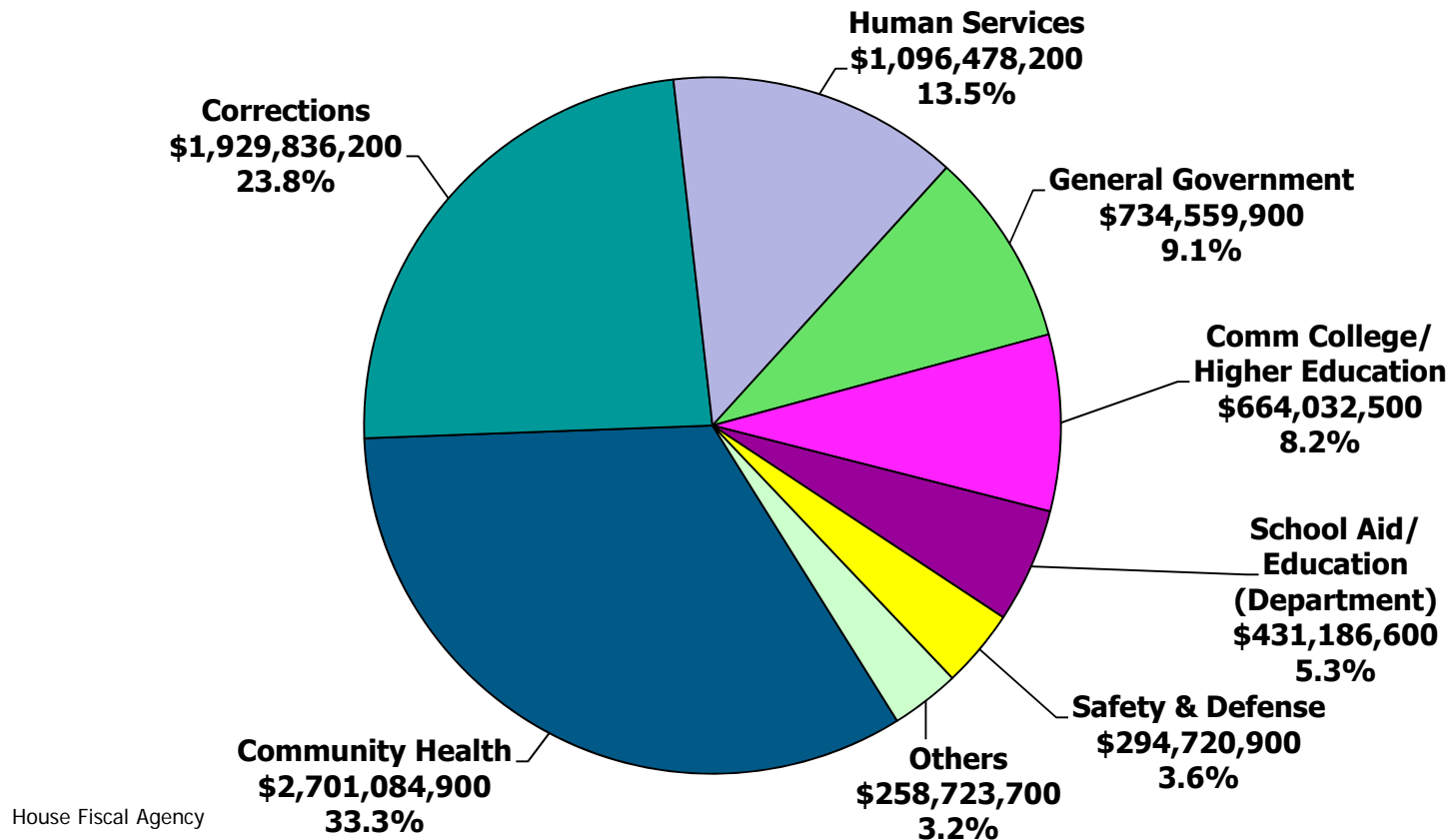
**Incorporates GF/GP and SAF budget adjustments and tax reform, to address the estimated \$1.4 billion FY 2011-12 budget shortfall**

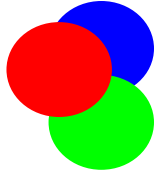
- **GF/GP budget reductions (\$982.8 million)**
  - **Corrections (\$51.2 million)**
  - **Community Health (\$212.6 million)**
  - **Human Services (\$109.5 million)**
  - **Higher Education (\$222.4 million)**
  - **Statutory Revenue Sharing (\$143.9 million)**
  - **State employee concessions (\$180.0 million)**
  - **Other (\$63.2 million)**
  
- **School Aid reductions (\$538.1 million)**



# FY 2011-12 Executive Recommendation

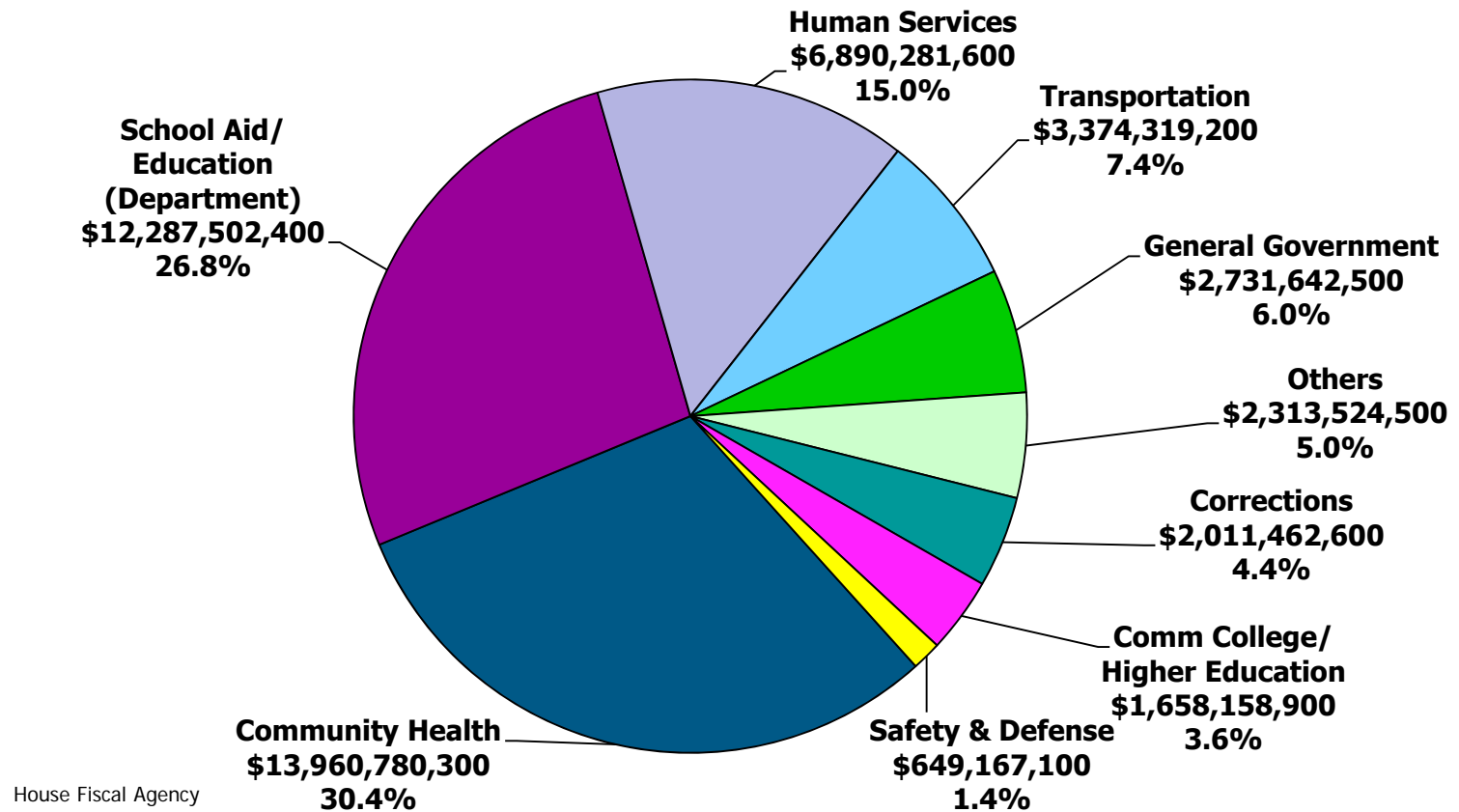
General Fund/General Purpose = \$8,110,622,900

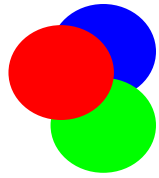




# FY 2011-12 Executive Recommendation

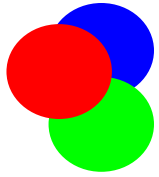
Adjusted Gross = \$45,876,839,100





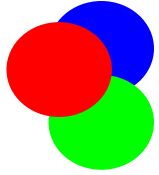
# Executive Budget Appropriation Changes

- **GF/GP appropriations decreased by \$191.2 million (2.3%)**
- **State restricted appropriations increased by \$473.7 million (2.7%)**
- **Federal appropriations decreased by \$1,449.8 million (7.1%)**
- **Local and private appropriations increased by \$9.3 million (1.9%)**
- **Total state spending from state sources in FY 2011-12 increased by \$282.5 (1.1%)**
- **Total adjusted gross decreased by \$1,158.0 (2.5%)**



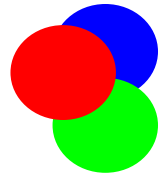
# Executive Budget Appropriation Changes (FY 2012-13 Planning)

- **GF/GP appropriations increased by \$347.2 million (4.3%)**
- **State restricted appropriations increased by \$137.0 million (0.8%)**
- **Federal appropriations increased by \$178.2 million (0.9%)**
- **Local and private appropriations decreased by \$48,000 thousand (0.01%)**
- **Total state spending from state sources in FY 2012-13 increased by \$484.2 (1.8%)**
- **Total adjusted gross increased by \$662.4 (1.4%)**



# Community Colleges

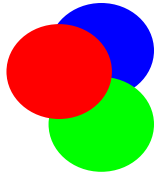
- **Operations Funding**
  - **Funding for operations remains unchanged**
  
- **Fund Shift**
  - **Funding would now include GF/GP revenue (\$100.0 million) as well as the SAF (\$195.9 million)**
  
- **Budget Act Structure**
  - **Budget will be incorporated into a single education budget (renamed State Education Funding Act) that includes funding for K-12 and universities**



# Department of Education

## ■ Library Funding

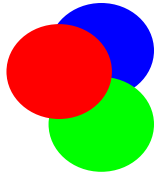
- Reduces state aid to libraries by \$2.3 million
  - Additionally, the School Aid budget eliminates \$1.5 million in state aid to libraries
  
- Redirects \$950,000 of the \$3.4 million remaining funding to support the statewide Michigan eLibrary (MeL)
  - This additional funding is meant to offset potential reductions in Federal Library Services and Technology funds due to fewer federal match dollars



# Higher Education

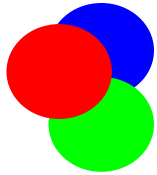
## ■ University Operations

- Each university's appropriation is reduced by 15% (\$222.4 million GF/GP)
- Tuition restraint incentive funding available
  - Funds would be paid only if a university held its FY 2011-12 resident undergraduate tuition/fee increases below the prior-five-year state average
  - Individual incentive amounts for universities (based on average annual tuition/fee rate increase over the last five years) ranging from 5.1% to 9.8% of proposed FY 2012 appropriation amounts
- \$699.7 million of GF/GP funds are replaced with SAF revenue
- Higher Education budget is merged into the School Aid Act



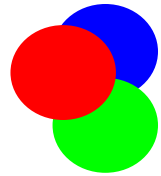
# School Aid

- **Reduces Foundation Allowances by \$470 Per Pupil**
  - **Makes the FY 2011 \$170 per pupil reductions permanent by rolling the cut into the foundation allowance**
  - **Reduce all foundations by \$300 per pupil, for a total foundation allowance reduction of \$470 per pupil**
  - **Additional \$300 per pupil cut equals a savings of \$452.5 million**
- **Certain Categorical Funding programs eliminated - totaling \$82.8 million**
- **Intermediate School District (ISD) General Operations**
  - **Reduces payments by 5% or \$3.3 million**
- **School Aid Fund (SAF) Revenue Shifts Totaling \$1.1 Billion**
  - **Tax proposal reduces SAF revenue (\$593.9)**
  - **Budget proposal increases GF/GP transfer to SAF (\$393.9)**
  - **SAF revenue shifted into Community College budget (\$195.9) and Higher Education budget (\$699.7 million)**



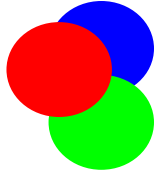
# Treasury

- **Statutory Revenue Sharing line item for cities, villages, and townships (CVT's) eliminated and replaced by Local Government Incentives Program**
  - **Revenue distributed to units that use "Best Practices" (details not yet released)**
  - **Net reduction in funding (\$107.1 million)**
  
- **County Revenue Sharing**
  - **Distributed on a pro-rata basis for those who qualify, and is reduced \$14.7 million from FY 2011**
  - **Total reduction from current law is \$51.7 million**



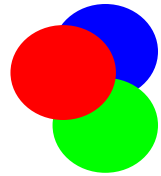
# Corrections

- **Prison Closure**
  - **Anticipates closure of one state prison (\$18.9 million GF/GP)**
  
- **Operational Savings**
  - **Various programs (\$31.7 million)**
    - **Supply chain transformation (\$10.0 million GF/GP)**
    - **Competitive bidding on prison food service (\$13.3 million gross and \$9.5 million GF/GP)**
    - **Reduction of 81 lieutenant positions (\$8.5 million GF/GP)**
  - **Additional food service and prisoner store savings (\$3.8 million gross and \$2.3 million GF/GP)**



# Human Services

- **Public Assistance Benefit Reductions**
  - **Retroactive 48 month lifetime limit for cash assistance recipients (FIP)**
    - **Will close 12,600 FIP cases generating \$77.4 million gross, \$65.0 million GF/GP, in savings**
  - **Reduce child development care (CDC) subsidy rate for enrolled providers (\$13.9 million)**



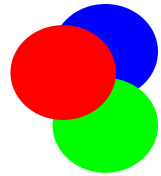
# State Police

- **Field Services Restructuring**

- **Field Services are restructured (potential post closings) and GF/GP is reduced \$3.2 million**

- **Fingerprint Fee Increase**

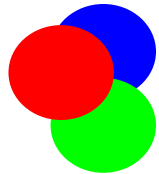
- **Fee increase replaces \$3.0 million of GF/GP with restricted funds**



# Transportation

## ■ Matching Federal Funds

- Department estimates it would be \$147 million short of state funds needed to match an estimated \$884 million in available federal funds for FY 2012
- Department's proposed plan:
  - Carry-forward of \$49 million in FY 2011 estimated State Trunkline Funds (STF)
  - Administrative reductions (\$16 million)
  - State trunkline maintenance reductions (\$5 million)
  - Charging to federal funds \$15 million in right-of way costs previously charged to the STF
  - Permanent redirection of \$12 million in driver's license fee revenue to the STF
  - Use of \$50 million in Canadian funds offered regarding the construction of a new bridge



# Other Departments

## Community Health

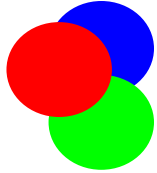
- Graduate Medical Education (GME)
  - 40% reduction in the payments resulting in savings of \$67.3 million Gross (\$22.8 million GF/GP)

## Energy, Labor and Economic Growth

- Fire Protection Grants
  - Reduces grant payments to local units with state property (\$1.6 million)

## Environmental Quality

- Solid Waste Surcharge Fee Proposal
  - Funding anticipates an increase in surcharge fee to support the program



# Other Departments

## Natural Resources

- **Captive Cervid Fee Proposal**
  - **Increase in fees on captive cervid facilities to support the program**

## Military and Veterans Affairs

- **Grand Rapids Veteran's Home Resident Care Aides**
  - **Moving to competitive bidding for Resident Care Aide positions (reduces \$4.2 million of GF/GP)**

**HOUSE**  
**FISCAL**  
**AGENCY**

[www.house.mi.gov/hfa](http://www.house.mi.gov/hfa)