

Michigan s Budget Outlook



**Prospects for FY2002-03
and Beyond**

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**Citizens Research Council of Michigan
www.crcmich.org**

Background



- Michigan's Economy Has Declined for Almost Two Years
- State Revenue Performance is Still Weak
- Tax Cuts Initiated in 1999 Continued

Background



- Spending Reductions Relatively Small
- Onetime Revenues Used to Fill in Gaps
- Threats to Cut Spending Have Not Materialized
- Actions Have Validated Program Policies So Far

The Tax Cuts



- Single Business Tax — 26% of General Fund Revenue
- Individual Income Tax Cut — 8% of General Fund Revenue
- Implication: State Could Afford to Finance Existing Programs With A Third Less Revenue

Effects of the Economy--FY2002

Planned to Current Forecasts--FY2002

Income Tax—Down \$552 M (9%)

Quarterlies/Annals—Down \$406 M
(26%)

Single Business Tax--Down \$189M (9%)

Sales Tax—Down \$234M (3.5%)

Actual Figures Will Be Worse

Current Projections for FY2002

- FY2002 Consensus vs. Actual FY2001
- Income Tax—Down \$509 M (7.6%)
- Single Business Tax—Down \$129 M (6.4%)
- Sales Tax—Up \$142 M (2.2%)

- General Fund—Down \$638 M (7.1%)
- School Aid Fund—Up \$140 M (1.4%)

Current Situation

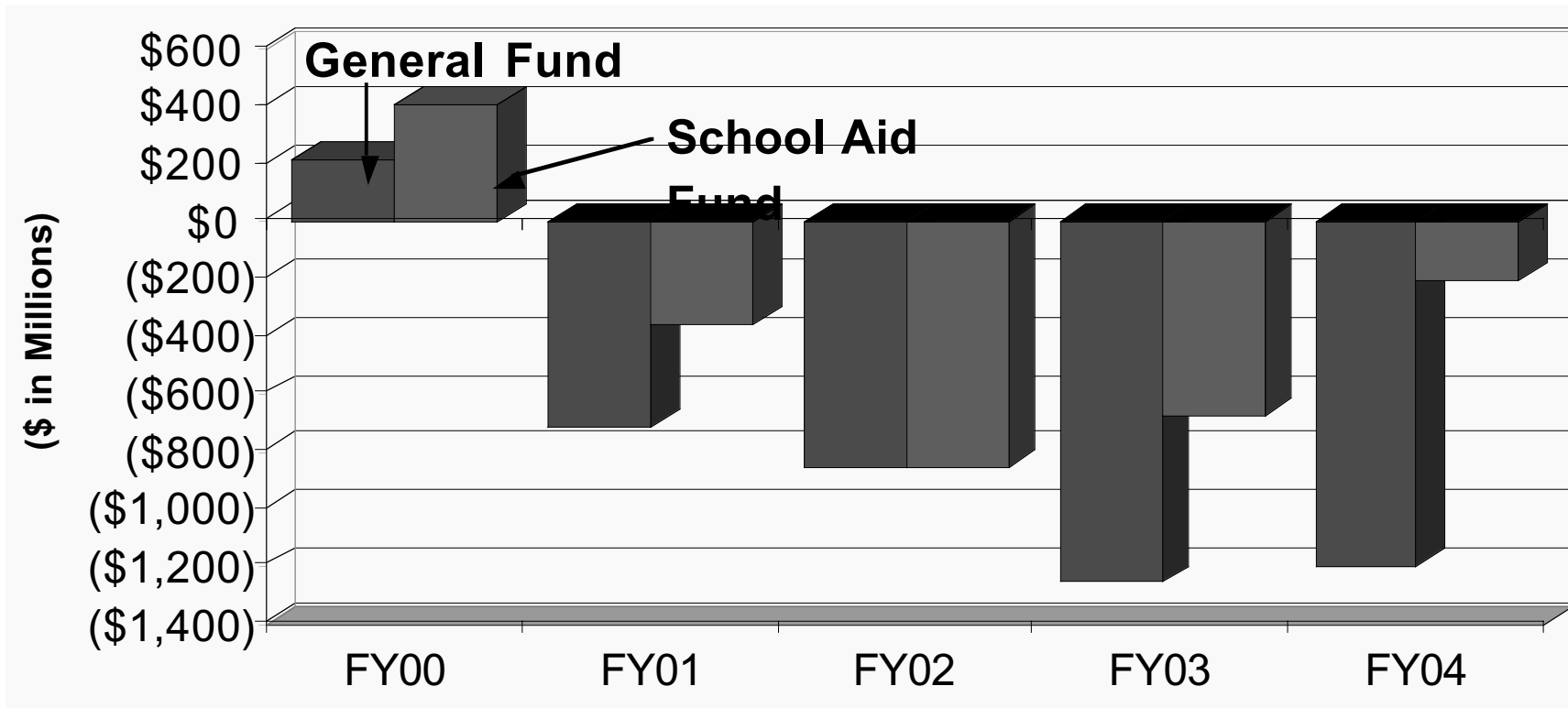


- ❑ Over \$3 Billion in One-time Actions Used Over Three Years
- ❑ Rainy Day Fund and Other Surpluses Exhausted While Tax Cuts Continued
- ❑ General Fund Taxes Have Been Cut By Over \$1 Billion
- ❑ Single Business Tax Cuts Now Paused

Current Situation General Fund

- Budget for FY2003 Passed and “Balanced”
- Revenues Continue to be Weak
- Further Adjustments Needed
- After November 5
- Cookie Jars Are Empty

General Fund & School Aid Fund Operating Gaps



Economic Outlook



- Moderate Growth in Michigan Assumed to Begin in Summer
- Summer is Over—Growth not Evident
- Other Scenarios Less Rosy

Recent Revenue Enhancements



- Cigarette Tax—50 cent Increase
 - 20 cents for School Aid
 - 30 cents for Other Programs
 - General Fund Receives 22 cents
- Total Revenue Increase \$292 Million in FY2003
- SBT Cuts Suspended — \$69 Million in FY2003

FY2003 General Fund

	FY03
Appropriations	\$9,132
One-time Spending Adjustments	236
Adjusted Spending	9,368
Revenues	8,402
Cigarette and SBT Revenues	209
One-time Revenues	442
Structural Gap	(\$757)
Probable Revenue Shortfall	(\$500)

FY2003 School Aid Arithmetic

FY 02 Spending Base	\$11,458
\$6,700 Basic Allowance	337
Other Adjustments	<u>(114)</u>
Total Spending	11,681
Revenues	10,534
Cigarette Tax Increase	103
Tax Date Shift	494
Fund Balance	204
Other	<u>465</u>
Total Resources	\$11,788
Structural Gap	(\$579)
Probable Revenue Shortfall	(\$100)

FY2003 and Beyond



- Both Major State Funds Have Very Large Operating Deficits
- General Fund----\$757 Million
- School Aid Fund----\$579 Million
- Budget Must be Balanced (Michigan Constitution)
- Expenditures Must Eventually Be Balanced with Base Revenues
- FY2003 Begins the Period of Reckoning

FY2003 School Aid



- Foundation Allowance Increased \$200
- Tax Date Shift Used to Finance Increase
- Relatively Small Cuts May be Necessary
- Categorical Programs Likely Target

FY2004 School Aid



- State Appropriations Already Approved
- Continuation of FY2003 Funding—Absorb Inflation
- Revenues Likely to be Short—Cuts May be Necessary
- Schools Will Have Very Difficult Budget Problems
- Most School Spending is Compensation—Health Insurance Looms as Problem
- Absorbing Inflation Means Reducing Employees

General Fund Projections Scenario



- Revenues and Spending Projected to FY2009
- Steady Revenue Growth Assumed (4.5%)
- Income Tax Cuts in State Law Occur on Schedule
- “Normal” Spending Increases for Inflation
- One-time Revenues Factored Out
- Large Increases in Medicaid Factored In

Medicaid Problems Looming



- Temporary Revenues Used to Avoid Cuts -\$236 Million
- Federal Limits on Medicaid Special Financing Adds \$375 Million to State Funding Requirements over Three Years
- Medicaid Reimbursement Rates to Service Providers Under Pressure
- Total Medicaid Problem Exceeds \$400 Million in FY2004

General Fund Outlook



- Revenue Growth Not Enough to Balance With Current Spending
- Increases in FY2004 and FY2005 Constrained By Income Tax Cuts and Federal Tax Reform
- Gap of \$1.2 Billion For FY2004
- Gap is not Eliminated by Sustained Economic Growth

Time to Decide



- Solve the Policy Contradiction
- Spending Policy Has Been Validated By Use of One-time Resources
- Tax Cuts Continued
- Future of Programs Open to Question
- Which Direction Will the State Choose?

Two Budgets Need to be Balanced



- FY2003--Total Shortfall \$600+ Million
- Mostly General Fund
- FY2004—Total Shortfall \$1.4+ Billion
- Mostly General Fund

Approaches to Balancing Budget in FY2003 and Beyond



- **Cut Spending**
- **Raise More Revenue**
- **Combination**
- **Must Eventually Find \$1.2 Billion in Total Revenues or Spending Reductions**
- **Over 10% of General Fund Spending Base**

Cutting Spending



- 80% of General Fund in Four Areas:
- Higher Education (\$2.1B)
- Community Health — Mental Health, Public Health, Medicaid (\$2.7B)
- Corrections (\$1.6B)
- FIA — Family Services, Juvenile Justice, Public Assistance (\$1.2B)

Balancing by Cutting Spending



- Across-the-board Reductions Not An Option
- Fundamental Changes in Priorities Would Be Needed — Such As:
 - Who Pays For Higher Education?
 - Continue Optional Medicaid Services?
 - Prison Sentencing and Prison Populations

Higher Education



- State Pays Half of University Operating Costs (One third of Community Colleges)
- Across-the-board Share Of Reductions Implies Over 20% University Tuition Increases
- Higher Education Could be a Tempting Place to Cut—Larger Reductions Might be Made

Medicaid--State s Options Are Limited--Federal Requirements



- Two Largest Optional Services:
 - Pharmaceuticals
 - Nursing Home Care
- Comprise About 40% of Medical Services Spending
- Reducing Either Program Would Have Serious Consequences

Other Community Health Programs



- Community Mental Health (Nearly \$1 Billion)
- Mental Health Institutions
- Substance Abuse Prevention & Treatment
- Women, Infant, and Children Food and Nutrition Programs
- Programs for the Aging

Corrections



- Most of Budget Spent Housing Prisoners
- Use of Less-costly Options Would Require Reductions in Length of Sentence and/or Length of Stay in Prison
- Current Policies Imply Larger Prison Populations in Next Several Years

Family Independence Agency



- Maximum Grant for Family of Three (\$459 per month) is 38% of Poverty Level
- Food Stamps Raise Support to 60% of Poverty Level
- Caseloads Now One-third of 1994 Level
- Juvenile Justice Programs
- Foster Care, Adoption, Domestic Violence Programs
- Day Care for Working Public Assistance Recipients

Local Government at Risk



- State Revenue Sharing—Statutory Payments Already Cut by 13 Percent
- Cuts are Likely to be Permanent
- More Reductions Could Occur
- \$850 Million Remains of Statutory Allocations

Is Increasing Revenue an Option?

- Cigarette Tax and Pausing SBT Tax Cut Provide Resources That Will Build in Future — The First “Permanent” Revenue Increases Used to Balance Budget
- “Decouple” from Federal Estate Tax
- Delay or Suspend Individual Income Tax Cuts

Delaying/Suspending Income Tax Cuts

■ If Cuts For January 2003 and Beyond are Delayed — Cumulative Effects — For Each Fiscal Year

■ FY2003	\$144 Million
■ FY2004	\$352 Million
■ FY2005	\$421 Million
■ FY2006	\$440 Million
■ FY2007	\$460 Million

■ Not Enough to Close Gap

Who Will Solve the Problem?



- New Governor
- New Legislature — Majority of Legislators May be New
- Most Leadership and Experience With Budget Problem of Current Magnitude Will Be Gone

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