

## Michigan Economic and State Budget Update

Michigan Rural Health Conference  
April 23, 2009

Craig Thiel

[www.crcmich.org](http://www.crcmich.org)

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## Citizens Research Council of Michigan

- Founded in 1916
- Statewide
- Nonpartisan
- Private not-for-profit
- Promotes sound policy for state and local governments through factual research
- Relies on charitable contributions from Michigan foundations, businesses, organizations, and individuals

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## Topics to Cover

- 1) Michigan economic update
- 2) Effect of economy on state government revenues/spending
- 3) Managing state budget deficits – yesterday and today
- 4) Tackling Michigan's dual deficits

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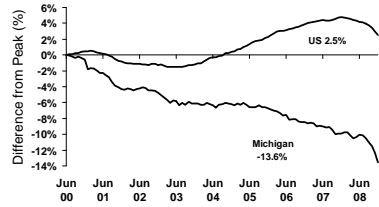
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### Michigan Employment Never Recovered in Last Expansion



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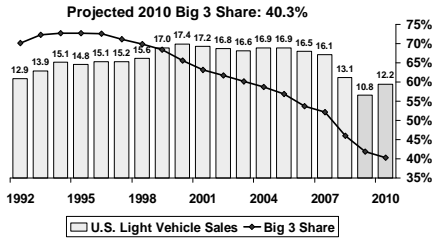
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### Big 3 Auto Companies Losing Market Share



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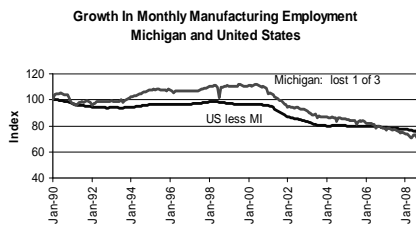
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### Michigan Dependence on Autos Key to Recent Performance



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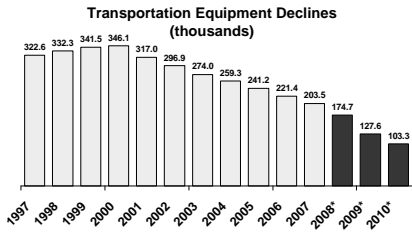
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## Auto Employment



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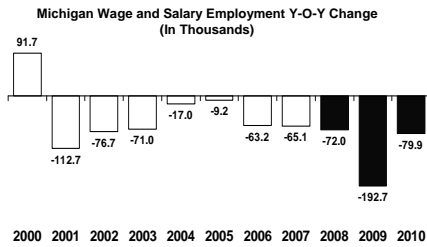
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## Consensus Forecast – More Steep Job Losses



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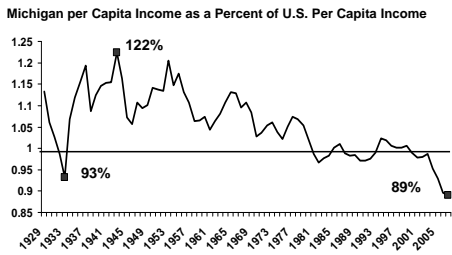
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## Michigan Personal Income Falling Relative to U.S.



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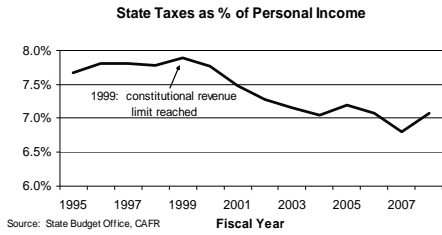
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### State Government's Slice of Economic Activity Declining



\$4.7 billion below revenue limit in '08  
(after '07 tax increases)

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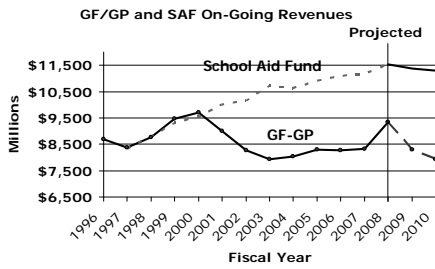
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### Bump from '07 Tax Increases Gone



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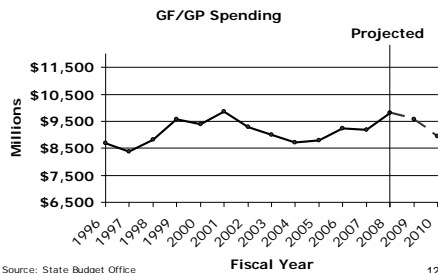
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### Spending Not as Quick to Come Down



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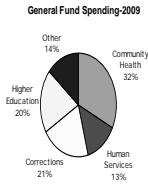
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### State Government as Contract Manager

- Over 80% spent "outside" of state government
- Employee compensation only accts. for \$1 of \$9
- Contract manager for:
  - Local governments
  - Physicians/hospitals
  - Universities
  - Nonprofits
- These entities employ workers, make purchases
- 4 areas take up 86% of GF budget
- When reductions occur - "outside" of government



**Total: \$9.7 B**

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### Deficits Defined

- Cyclical** — Caused by economic downturn
- Revenues worsen
  - Some spending pressures increase
  - Deficit erased when economy recovers
- Structural** — Caused by cost increases to maintain current policies outpacing revenue growth, *Even in Good Economic Times*
- Keep in Mind: Michigan's Constitution requires a balanced budget

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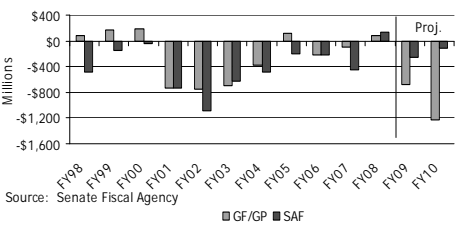
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### Persistent Structural Deficits

GF/GP and SAF Operating Deficits




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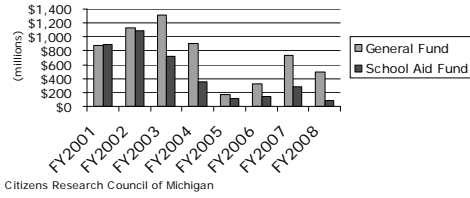
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### Spending Supported by One-Timers

#### Non-Recurring Resources Used to Balance Budgets



Citizens Research Council of Michigan

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### Recession Results in Much Lower Tax Revenues

	FY 2008		FY 2009		FY 2010	
	Final	Change From May	Jan 09	Change From May	Jan 09	Change From 09
GF-GP	\$9,359.7	\$195.6	\$8,306.1	(\$578.5)	\$7,934.5	(\$371.6)
SAF	\$11,513.2	\$138.2	\$11,368.7	(\$338.7)	\$11,295.8	(\$72.9)
<b>Total</b>	<b>\$20,872.9</b>	<b>\$333.8</b>	<b>\$19,674.8</b>	<b>(\$917.2)</b>	<b>\$19,230.3</b>	<b>(\$444.5)</b>
GF-GP Growth	12.5%		-11.3%		-4.5%	
SAF Growth	3.2%		-1.3%		-0.6%	

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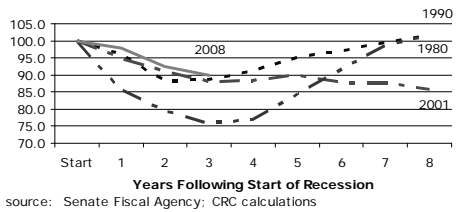
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### Baseline Revenue Performance – Recent Recessions

#### Real Per Capita Baseline Revenue Growth Combined GF/GP and SAF



source: Senate Fiscal Agency; CRC calculations

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### The Dual Deficit Problem

- National recession – cyclical deficit
- Michigan is ill-prepared to deal with
  - State's combined fund equity down \$3.3 billion since FY00
  - Reserves completely exhausted by end of FY03
  - Negative cash balance at beginning of fiscal year, financed by borrowing
  - Increased use of debt-financing, in some cases to support on-going services
- Balancing FY09 and FY10 budgets may come at expense of the state's underlying financial condition
- Policymakers faced with cyclical and structural deficits simultaneously

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### Federal Funding to Rescue?

- ARRA: Approx. \$7 billion for state/local government
- All of it temporary: FY09, FY10, and FY11
- About \$2.1 billion available for budget balancing – the remainder is restricted
- FMAP rate increase yields potential "savings" in budget totaling \$1.8 billion
- No effect on underlying structural problems
- Challenge: using the "right tool for the job"

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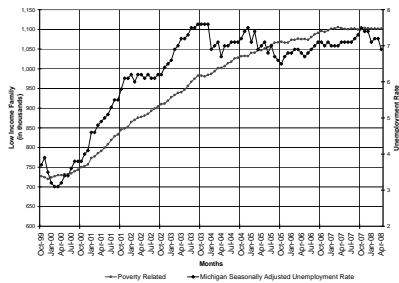
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### Medicaid and Unemployment



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### Michigan's Fiscal Future

Collaborative Research Effort with W.E. Upjohn Institute

- Economic scenarios translated into long-term projections of state revenues and spending
- Even in improving economic climate, structural deficits continue
  - Incapable of growing out of problem
- Causes on both sides of budget ledger
- Conclusion: Structural changes required, otherwise problem must be dealt with each year
- Full report: [www.crcmich.org](http://www.crcmich.org)

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### Sluggish Revenue Growth

- Increasing senior citizen population—retirement income not taxed and spend less on goods
- Consumption taxes goods oriented—economic growth is in service sector
- Slow or no growth revenues drag down overall growth (e.g. tobacco, gambling, alcohol)
- Flat rate income tax
- Tax policy changes already “baked in”
  - Earned Income Tax Credit
  - Phase-out of Income Tax increase

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### Structural Deficit

*Spending Pressures Outpace Revenue Growth*

- **Health care: single largest component in state budget**
  - Medicaid
  - Mental health services
  - Health insurance for school and state employees
  - Health insurance for school and state retirees
  - Health care provided to prisoners
- **Employee Compensation**

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## Structural Deficit

### Spending Pressures Outpace Revenue Growth

- **Corrections policies: we spend a lot and the amount is growing**
  - Incarceration rate 40% higher than GL states
  - Function of both new admits and length of stay
  - "Crowds out" spending in other areas

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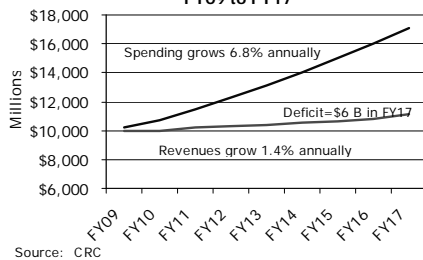
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General Fund Structural Deficit Projections  
FY09 to FY17



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## Policy Options

### Achieving Long-Term Structural Balance

- Increase revenue growth
- Reduce rate of spending pressure growth
- Bend the two curves so they meet

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### On Revenue Side of Budget

- Change system so revenues grow in line with economy and personal income
- Consider taxing services broadly
- Modify personal income tax by changing rate and exemptions—or—implement graduated income tax (Constitutional amendment required)
- Reduce reliance on “sin” taxes
- Consider taxing pensions and other retirement income (area of income growth in future)

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### Spending Scenario

- Corrections
  - Reducing prison incarceration rate to the average of our neighbors (1,200/yr)
  - Ten-year phase-in – **not** immediate savings
  - Eliminates growth pressure in Corrections (from plus 7% to negative 1%)
  - Reduces overall General Fund spending pressure growth by 1.1%
- Health care
  - Limited role for state policymakers
  - Holding health care cost increases to 5% per year
  - Reduces General Fund annual spending pressure growth by 1.6%
  - Reduces K-12 annual spending pressure growth by 1.1%

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### Conclusions

- Michigan economy faces recession and major restructuring of primary industry
- State finances face challenges in near- and long-term
- Policy makers must ensure that solutions do not make problems worse
- Federal recovery designed to be short-term, Michigan's problems more structural in nature

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**CRC Publications are available at:**

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